



THE UK CORPORATE GOVERNANCE CODE

An Annotated Version for Mutual Insurers

October 2010

©Copyright 2010

Published with permission of the Financial Reporting Council.

The text and the annotations in this document may be reproduced free of charge in any format or medium providing that it is reproduced accurately and is not used in a misleading context. The material must be acknowledged in the correct way.

Association of Financial Mutuals (AFM)

PO Box 21, Altrincham, Cheshire, WA14 4PD, United Kingdom

tel: 0844 879 7863

www.financialmutuals.org

Introduction

1. This document is a copy of the June 2010 version of the UK Corporate Governance Code, ('the Code') to which annotations have been added. The annotations, as with this Introduction, are given in boxes. The text of the Code itself has not been amended.
2. The guidance in this document, which comprises this Introduction and the annotations, is intended to assist mutual insurers in having 'regard' to the Code. The annotations follow a 'by exception' approach, in that they are given only for those elements of the Code that either raise particular issues for mutual insurers or are not considered to be relevant to mutual insurers. All parts of the Code are regarded as being appropriate in their present form unless this Introduction and/or annotations indicate otherwise, with direct references to 'listed companies' being read as mutual insurers. The annotations are not intended to alter the principles of the Code but rather to promote interpretations that should best uphold these principles. Code provisions that are not annotated should not be regarded as any less important than those that are.
3. The Code follows a 'comply or explain' approach. An important element for listed proprietary companies adhering to the Code is the disclosure statement required by paragraph 9.8.6 of the Listing Rules (which is detailed in Schedule B to the Code). Mutual insurers should also produce a disclosure statement observing the 'comply or explain' principle in accordance with this approach. Schedule B to the Code also contains FSA Disclosure and Transparency Rules ('DTR's) sub-chapters 7.1 and 7.2 ('Sub-chapters') from the FSA Handbook. There is substantial overlap between the content of the Code and these Sub-chapters, which is summarised in the Appendix to Schedule B. Hence compliance with the Code will mean that mutual insurers will comply with most of the DTR's in Schedule B. However DTR 7.2.5 R and DTR 7.2.6 R are not covered within the Code and consequently mutual insurers should also consider these in relation to disclosure of their own corporate governance arrangements.
4. Although the 'comply or explain' disclosure statement plays an important part in ensuring that a firm is accountable to its members on governance matters, it may not alone be sufficient. It may be appropriate, for example, to discuss governance arrangements directly with member representatives as part of the dialogue discussed in the annotations to section E.1 of the Code.
5. The Code makes several references to 'shareholders' (A.1, A.3, A.3.1, A.4.1, B.7.1, B.7.2, C.2.1, C.3.2, C.3.7, D.1.3, D.2.3, D.2.4, E.1, E.1.1, E.1.2, E.2.1, E.2.4). Although mutual insurers do not have shareholders, the principles underpinning these provisions of the Code are relevant and should be considered in relation to members.
6. The Code also makes several references to 'major', 'principal' and 'significant' etc. shareholders (A.3.1, B.1.1, B.4.1, D.2, E.1, E.1.1, E.1.2).

Again although mutual insurers do not have shareholders, the principles underpinning these provisions of the Code are relevant and should be considered in relation to appropriate methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/or delegate systems) and/or any members with significant membership rights.

7. Mutual insurers' policies on facilitating member dialogue and involvement should be clearly articulated to members in the Annual Report and on the firm's web site.
8. Schedule C of the Code contains main and supporting principles relating to mutual insurers acting as institutional shareholders in their own right, whether directly or via agents such as investment managers, or voting services. These principles should be considered as part of a mutual insurer's overall approach to socially responsible investing.
9. Certain provisions within the Code may use terminology that is not used by some, or all, mutual insurers. Where there is a difference in terminology, mutual insurers should consider the provisions of the Code in relation to the most appropriate equivalent. For example, where the Code refers to the 'Board', this should be taken to mean the governing body of the undertaking, whatsoever this might be called. Similarly 'directors' should be read as the members of the governing body of the undertaking. 'Articles of Association' should be read as the relevant constitutional document, which may be Articles or Rules. 'Company' should be read as society as appropriate.
10. The FSA was consulted about the development of the annotated version of the July 2003 UK Combined Code – the precursor to this UK Corporate Governance Code - and has welcomed this initiative. The FSA expects that such guidance will be helpful in identifying the issues to be considered by mutual insurers' boards when seeking to apply the latest version of the Code to the different circumstances of a mutual insurer and to their particular firm. The FSA shares the objective of the AFM that, by following the guidance in the annotations firms should be able to demonstrate that they have had regard to the FSA's own high-level guidance relating to corporate governance.
11. Mutual insurers should anticipate that the FSA will wish to discuss compliance and their explanations for departures from the provisions of the annotated Code in the context of a risk assessment or other supervisory work.
12. It is intended that the annotated Code should apply to all the forms of mutual undertaking engaged in insurance business in the UK, including small mutual insurers (where a 'small mutual insurer' is defined as a firm with an average gross premium income over the preceding three financial years of less than £20 million per annum and average assets at the end of the last three years of less than £100 million). While small firms will tend to operate under greater cost constraints than larger firms,

the governance principles of the Code, such as independence, transparency, and the separation of function are applicable to all. The flexibility inherent in the principle 'comply or explain' should enable any small firm to achieve a manner of adherence appropriate to its circumstances, taking into account its size, legal form, and any relevant constitutional documents such as the Rules of the society or the Articles of Association of the company.

13. This Introduction and the annotations to the Code will be updated in step with the periodic reviews of the Code itself that are to be undertaken by the FRC and following periodic review by the AFM.
14. The UK Corporate Governance Code is reproduced by kind permission of the FRC.

GOVERNANCE AND THE CODE

1. The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company.

Mutual insurers are expected to maintain high standards of governance in the best interests of their members. This annotated version of the Code has been published by the Association of Financial Mutuals to support mutual insurers in meeting these high standards of governance and to promote confidence in governance and reporting within the mutual sector.

2. The first version of the UK Code on Corporate Governance (the Code) was produced in 1992 by the Cadbury Committee. Its paragraph 2.5 is still the classic definition of the context of the Code:

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.

In regard to 'shareholders' role in governance' the above is relevant both in the manner that boards of mutual insurers facilitate the engagement with members in order for members to be able to 'satisfy themselves that an appropriate governance structure is in place', and in the manner that mutual insurers act in their role as institutional investors in their own right.

3. Corporate governance is therefore about what the board of a company does and how it sets the values of the company, and is to be distinguished from the day to day operational management of the company by full-time executives.
4. The Code is a guide to a number of key components of effective board practice. It is based on the underlying principles of all good governance: accountability, transparency, probity and focus on the sustainable success of an entity over the longer term.
5. The Code has been enduring, but it is not immutable. Its fitness for purpose in a permanently changing economic and social business environment requires its evaluation at appropriate intervals. The reviews preceding this one were in 2005 and 2007. The Preface, which should be

regarded as an integral part of the Code, introduces the changes made in the current review.

6. The new Code applies to accounting periods beginning on or after 29 June 2010 and, as a result of the new Listing Regime introduced in April 2010, applies to all companies with a Premium Listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

For mutual insurers, this annotated code will apply for reporting years beginning on or after 1 November 2010.

PREFACE

1. The financial crisis which came to a head in 2008-09 triggered widespread reappraisal, locally and internationally, of the governance systems which might have alleviated it. In the UK, Sir David Walker was asked to review the governance of banks and other financial institutions, and the FRC decided to bring forward the Code review scheduled for 2010 so that corporate governance in other listed companies could be assessed at the same time.
2. Two principal conclusions were drawn by the FRC from its review. First, that much more attention needed to be paid to following the spirit of the Code as well as its letter. Secondly, that the impact of shareholders in monitoring the Code could and should be enhanced by better interaction between the boards of listed companies and their shareholders. To this end, the FRC has assumed responsibility for a stewardship code that will provide guidance on good practice for investors.
3. Nearly two decades of constructive usage have enhanced the prestige of the Code. Indeed, it seems that there is almost a belief that complying with the Code in itself constitutes good governance. The Code, however, is of necessity limited to being a guide only in general terms to principles, structure and processes. It cannot guarantee effective board behaviour because the range of situations in which it is applicable is much too great for it to attempt to mandate behaviour more specifically than it does. Boards therefore have a lot of room within the framework of the Code to decide for themselves how they should act.
4. To follow the spirit of the Code to good effect, boards must think deeply, thoroughly and on a continuing basis, about their overall tasks and the implications of these for the roles of their individual members. Absolutely key in this endeavour are the leadership of the chairman of a board, the support given to and by the CEO, and the frankness and openness of mind with which issues are discussed and tackled by all directors.
5. The challenge should not be underrated. To run a corporate board successfully is extremely demanding. Constraints on time and knowledge combine with the need to maintain mutual respect and openness between a cast of strong, able and busy directors dealing with each other across the different demands of executive and non-executive roles. To achieve good governance requires continuing and high quality effort.
6. The Code's function should be to help boards discharge their duties in the best interests of their companies. The FRC in this review has focused on changing the "tone" of the Code by making limited but significant changes to signal the importance of the general principles which should guide board behaviours. It is to be hoped that these changes will promote greater clarity and understanding with regard to the tasks of a

board and that communication with shareholders will be more effective as a result.

7. Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board (in Sections A and B of the new Code) have been applied. Not only will this give investors a clearer picture of the steps taken by boards to operate effectively but also, by providing fuller context, it may make investors more willing to accept explanations when a company chooses to explain rather than to comply with one or more provisions. Above all, the personal reporting on governance by chairmen as the leaders of boards might be a turning point in attacking the fungus of “boiler-plate” which is so often the preferred and easy option in sensitive areas but which is dead communication.
8. The new Code recommends that, in the interests of greater accountability, all directors of FTSE 350 companies should be subject to annual reelection. As with all other provisions of the Code, companies are free to explain rather than comply if they believe that their existing arrangements ensure proper accountability and underpin board effectiveness, or that a transitional period is needed before they introduce annual re-election. The boards of smaller companies are also encouraged to consider their policy on director re-election.

For mutual insurers ‘FTSE 350 companies’ should be read as mutual insurers with gross premium income of more than £20 million per annum on average over the preceding three financial years or assets of more than £100 million on average at the end of the last three financial years.

COMPLY OR EXPLAIN

1. The “comply or explain” approach is the trademark of corporate governance in the UK. It has been in operation since the Code’s beginnings and is the foundation of the Code’s flexibility. It is strongly supported by both companies and shareholders and has been widely admired and imitated internationally.

Mutual insurers should also be minded as to how they use the flexibility of the ‘comply or explain’ principle of the Code, adhering to each provision of the annotated Code unless their individual circumstances mean that they cannot do so, or that it is demonstrably in the best interests of their members for them not to do so.

2. The Code is not a rigid set of rules. It consists of principles (main and supporting) and provisions. The Listing Rules require companies to apply the Main Principles and report to shareholders on how they have done so. The principles are the core of the Code and the way in which they are applied should be the central question for a board as it determines how it is to operate according to the Code.

Although the ‘comply or explain’ disclosure statement plays an important part in ensuring that a firm is accountable to its members on governance matters, it may not alone be sufficient. It may be appropriate, for example, to discuss governance arrangements directly with member representatives as part of the dialogue discussed in the annotations to section E.1 of the Code.

3. In their responses to explanations, shareholders should pay due regard to companies’ individual circumstances and bear in mind, in particular, the size and complexity of the company and the nature of the risks and challenges it faces. Whilst shareholders have every right to challenge companies’ explanations if they are unconvincing, they should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches. Shareholders should be careful to respond to the statements from companies in a manner that supports the “comply or explain” process and bearing in mind the purpose of good corporate governance. They should put their views to the company and both parties should be prepared to discuss the position.

Mutual insurers may have governance and voting structures different to those used by listed companies. Mutual insurers should regularly review the appropriateness of such structures in regard to the Code principles and provisions as, in themselves, the existence of such structures should not be used as a reason for failing to comply with any Code provision or principle.

¹ References to shareholders also apply to intermediaries and agents employed to assist shareholders in scrutinising governance arrangements.

4. Smaller listed companies, in particular those new to listing, may judge that some of the provisions are disproportionate or less relevant in their case. Some of the provisions do not apply to companies below the FTSE 350. Such companies may nonetheless consider that it would be appropriate to adopt the approach in the Code and they are encouraged to do so. Externally managed investment companies typically have a different board structure which may affect the relevance of particular provisions; the Association of Investment Companies' Corporate Governance Code and Guide can assist them in meeting their obligations under the Code.

For mutual insurers 'companies below the FTSE 350' should be read as mutual insurers with gross premium income of less than £20 million per annum on average over the preceding three financial years and assets of less than £100 million on average at the end of the last three financial years. These small mutual insurers should consider current best practice guidelines produced by the AFM on corporate governance in their interpretation and application of the annotated Code.

5. Satisfactory engagement between company boards and investors is crucial to the health of the UK's corporate governance regime. Companies and shareholders both have responsibility for ensuring that "comply or explain" remains an effective alternative to a rules-based system. There are practical and administrative obstacles to improved interaction between boards and shareholders. But certainly there is also scope for an increase in trust which could generate a virtuous upward spiral in attitudes to the Code and in its constructive use.

Mutual insurers have the responsibility for engaging effectively with their members to ensure that a mutual's "comply or explain" approach remains an effective alternative to a rules-based system.

THE MAIN PRINCIPLES OF THE CODE

Section A: Leadership

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Section B: Effectiveness

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Section C: Accountability

The board should present a balanced and understandable assessment of the company's position and prospects.

The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.

Section D: Remuneration

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Section E: Relations with Shareholders

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

The board as a whole for mutual insurers have the responsibility for ensuring that a satisfactory dialogue with members takes place.

The board should use the AGM to communicate with investors and to encourage their participation.

SECTION A: LEADERSHIP

A.1 The Role of the Board

Main Principle

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

Supporting Principles

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

All directors must act in what they consider to be the best interests of the company, consistent with their statutory duties².

Code Provisions

A.1.1

The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.

A.1.2

The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees³. It should also set out the number of meetings of the board and its committees and individual attendance by directors.

A.1.3

The company should arrange appropriate insurance cover in respect of legal action against its directors.

² For directors of UK incorporated companies, these duties are set out in the Sections 170 to 177 of the Companies Act 2006.

³ Provisions A.1.1 and A.1.2 overlap with FSA Rule DTR 7.2.7 R; Provision A.1.2 also overlaps with DTR7.1.5 R (see Schedule B).

A.2 Division of Responsibilities

Main Principle

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

Code Provision

A.2.1

The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.

A.3 The Chairman

Main Principle

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

Supporting Principle

The chairman is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors.

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders.

Code Provision

A.3.1

The chairman should on appointment meet the independence criteria set out in B.1.1 below. A chief executive should not go on to be chairman of the same company. If, exceptionally, a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report⁴.

⁴ Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

In regard to “major shareholders” mutual insurers should consider this provision in relation to appropriate methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/or delegate systems) and/or any members with significant membership rights.

A.4 Non-executive Directors

Main Principle

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Supporting Principle

Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.

Code Provisions

A.4.1

The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.

Mutual insurers that do not appoint a senior independent director should consider whether it is necessary to offer members an alternative mechanism for the handling of their concerns (i.e. to replicate the arrangements envisaged in Section A.4.1) that acknowledge that members may not always wish to contact the chairman or an executive director.

A.4.2

The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman’s performance and on such other occasions as are deemed appropriate.

A.4.3

Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.

SECTION B: EFFECTIVENESS

B.1 The Composition of the Board

Main Principle

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

Where mutual insurers have significant numbers of members with common interests, through geographic location, occupation or otherwise, this might also be considered in determining the appropriate balance for the board and its committees.

Supporting Principles

The board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy.

The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.

No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.

Code Provisions

B.1.1

The board should identify in the annual report each non-executive director it considers to be independent⁵. The board should determine whether the director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director

⁵ A.3.1 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman.

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

B.1.2

Except for smaller companies⁶, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

B.2 Appointments to the Board

Main Principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Supporting Principles

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.

⁶ A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

Code Provisions

B.2.1

There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board⁷.

B.2.2

The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

B.2.3

Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.

B.2.4

A separate section of the annual report should describe the work of the nomination committee⁸, including the process it has used in relation to board appointments. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.

In mutual insurers, the recruitment process should involve appropriate sources of objective external opinion. When seeking to appoint independent directors, as well as considering the use of external recruitment consultants to lead the process, the nomination committee may wish to seek other outside views, for example by utilising methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/or delegate systems). The advertising of posts should also be considered as a way of reducing the reliance on the personal connections of existing board members.

⁷ The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.

⁸ This provision overlaps with FSA Rule DTR 7.2.7 R (see Schedule B).

B.3 Commitment

Main Principle

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

Code Provisions

B.3.1

For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report.

B.3.2

The terms and conditions of appointment of non-executive directors should be made available for inspection⁹. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.

B.3.3

The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.

For mutual insurers, which are of equivalent size to a FTSE 100 company, no full-time executive director should be appointed to more than one non-executive directorship, or the chairmanship, of either a FTSE 100 company or another company of equivalent size to a FTSE 100 company.

B.4 Development

Main Principle

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

⁹ The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM (for 15 minutes prior to the meeting and during the meeting).

Supporting Principles

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

To function effectively, all directors need appropriate knowledge of the company and access to its operations and staff.

Code Provisions

B.4.1

The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders.

In regard to "major shareholders" mutual insurers should consider this provision in relation to how directors can use any appropriate methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/or delegate systems) and/ or meet with any members with significant membership rights.

B.4.2 The chairman should regularly review and agree with each director their training and development needs.

B.5 Information and Support

Main Principle

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

Supporting Principles

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required.

The company secretary should be responsible for advising the board through the chairman on all governance matters.

The secretary of a mutual insurer should endeavour to fulfil an equivalent role. The roles of secretary and chief executive should ideally be split. If the same person holds both positions, the responsibility of ensuring good information flows to the board and its committees and between senior management and non-executive directors should be delegated to a different individual reporting to the chairman.

Code Provisions

B.5.1

The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.

Boards should establish clear procedures through which non-executives can obtain advice from independent external advisers at the firm's expense when required. The availability of independent sources of advice should be made clear at the time of appointment. The Higgs best-practice guidance contains a draft non-executive's letter of appointment, in which a commitment to allow access to external advice is made. Non-executives need not seek to appoint a relevant adviser for each and every subject area that comes before the board. When difficult issues arise, the first course of action should always be to encourage further and deeper analysis to be carried out within the firm. But it is important that any non-executive can access advice at the firm's expense from a source that is independent of the executive when there is an important issue on which he or she does not feel comfortable despite having sought clarification and amplification from within the firm.

B.5.2

All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.

B.6 Evaluation

Main Principle

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Supporting Principles

The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

Code Provisions

B.6.1

The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.

B.6.2

Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. A statement should be made available of whether an external facilitator has any other connection with the company¹⁰.

For mutual insurers 'FTSE 350 companies' should be read as mutual insurers with gross premium income of more than £20 million per annum on average over the preceding three financial years or assets of more than £100 million on average at the end of the last three financial years.

B.6.3

The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

The appraisal of the chairman should be led by an independent director if a senior independent director has not been appointed.

B.7 Re-election

Main Principle

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

¹⁰ See footnote 7

Code Provisions

B.7.1

All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Non-executive directors who have served longer than nine years should be subject to annual re-election. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.

For mutual insurers 'FTSE 350 companies' should be read as mutual insurers with gross premium income of more than £20 million per annum on average over the preceding three financial years or assets of more than £100 million on average at the end of the last three financial years.

B.7.2

The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.

SECTION C: ACCOUNTABILITY

C.1 Financial And Business Reporting

Main Principle

The board should present a balanced and understandable assessment of the company's position and prospects.

Supporting Principle

The board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

Whilst the issue regarding price-sensitive public reports will not typically be relevant to mutual insurers the board should still have responsibility for presenting a balanced and understandable assessment of the mutual's position and prospects to members, regulators and in information required to be presented by statutory requirements.

Code Provisions

C.1.1

The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and there should be a statement by the auditor about their reporting responsibilities¹¹.

C.1.2

The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company¹².

Directors of mutual Insurers should Include In the annual report an explanation of the basis on which the mutual generates or preserves value for Its members over the longer term.

¹¹ The requirement may be met by the disclosures about the audit scope and the responsibilities of the auditor included, or referred to, in the auditor's report pursuant to the requirements in paragraph 16 of ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements". Copies are available at: <http://www.frc.org.uk/apb/publications/pub2102.html>.

¹² It would be desirable if the explanation were located in the same part of the annual report as the Business Review required by Section 417 of the Companies Act 2006. Guidance as to the matters that should be considered in an explanation of a business model is provided in paragraphs 30 to 32 of the Accounting Standard Board's Reporting Statement: Operating And Financial Review. Copies are available at: <http://www.frc.org.uk/asb/publications/documents.cfm?cat=7>.

C.1.3

The directors should report in annual and half-yearly financial statements that the business is a going concern, with supporting assumptions or qualifications as necessary¹³.

Mutual Insurers should consider the benefits of producing half-yearly financial statements if they do not already do so.

C.2 Risk Management and Internal Control¹⁴

Main Principle

The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

Code Provision

C.2.1

The board should, at least annually, conduct a review of the effectiveness of the company's risk management and internal control systems and should report to shareholders that they have done so¹⁵. The review should cover all material controls, including financial, operational and compliance controls.

C.3 Audit Committee and Auditors¹⁶

Main Principle

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.

¹³ 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' suggests means of applying this part of the Code. Copies are available at: www.frc.org.uk/corporate/goingconcern.cfm.

¹⁴ The Turnbull guidance suggests means of applying this part of the Code. Copies are available at www.frc.org.uk/corporate/internalcontrol.cfm.

¹⁵ In addition FSA Rule DTR 7.2.5 R requires companies to describe the main features of the internal control and risk management systems in relation to the financial reporting process.

¹⁶ The FRC Guidance on Audit Committees suggests means of applying this part of the Code. Copies are available at: <http://www.frc.org.uk/corporate/auditcommittees.cfm>.

Code Provisions

C.3.1

The board should establish an audit committee of at least three, or in the case of smaller companies¹⁷ two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience¹⁸.

C.3.2

The main role and responsibilities of the audit committee should be set out in written terms of reference¹⁹ and should include:

- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgments contained in them;
- to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
- to monitor and review the effectiveness of the company's internal audit function;
- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm, and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

¹⁷ See footnote 6.

¹⁸ This provision overlaps with FSA Rule DTR 7.1.1 R (see Schedule B).

¹⁹ This provision overlaps with FSA Rules DTR 7.1.3 R (see Schedule C).

C.3.3

The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available²⁰. A separate section of the annual report should describe the work of the committee in discharging those responsibilities²¹.

C.3.4

The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

C.3.5

The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.

C.3.6

The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditor. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.

C.3.7

The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

²⁰ See footnote 7.

²¹ This provision overlaps with FSA Rules DTR 7.1.5 R and 7.2.7 R (see Schedule B)

SECTION D: REMUNERATION

D.1 The Level and Components of Remuneration

Main Principle

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

Although the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 apply only to quoted firms, mutual insurers should produce a remuneration report equivalent to that described in Schedule 8 of the regulations and hold an advisory vote on the report at the AGM †. Mutual insurers should draw on current best practice guidelines produced by the AFM on the remuneration report.

Supporting Principle

The performance-related elements of executive directors' remuneration should be stretching and designed to promote the long-term success of the company.

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance.

They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

Code Provisions

D.1.1

In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code.

†Those sections of Schedule 8 relating to share options will not be relevant to mutual insurers (unless directors of mutual insurers are involved in ownership schemes involving subsidiaries). These are Section 3 sub-paragraph (2)(a)(i), all of Section 5 (relating to the Performance Graph), Sections 8, 9 and 10 (the treatment of Share Options in the information subject to audit) and Section 12 sub paragraphs (2) and (3).
(http://www.opsi.gov.uk/si/si2008/draft/ukdsi_9780110806303_en_1)

D.1.2

Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report²² should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.

D.1.3

Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision B.1.1).

Although the Listing Rules apply only to quoted firms, mutual insurers should consider following the appropriate provisions of the Listing Rules in relation to the above. Note, share options may be relevant to mutual insurers, in the above provision, if executive directors of mutual insurers are involved in ownership schemes involving subsidiaries.

D.1.4

The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.

D.1.5

Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

D.2 Procedure

Main Principle

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

²² As required for UK incorporated companies under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008.

Supporting Principles

The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration. Where executive directors or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.

The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration.

In regard to 'principal shareholders' mutual insurers should consider this supporting principle in relation to appropriate methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/or delegate systems) and/or any members with significant membership rights.

Code Provisions

D.2.1

The board should establish a remuneration committee of at least three, or in the case of smaller companies²³ two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board²⁴. Where remuneration consultants are appointed, a statement should be made available²⁵ of whether they have any other connection with the company.

D.2.2

The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.

²³ See footnote 6.

²⁴ This provision overlaps with FSA Rule DTR 7.2.7 R (see Schedule B).

²⁵ See footnote 7.

D.2.3

The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.

'Articles of Association' should be read as the relevant constitutional document, which may be Articles or Rules.

D.2.4

Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules²⁶) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.

The Listing Rules only apply to quoted companies. Mutual insurers should consider the above in relation to share option schemes if executive directors of mutual insurers are involved in ownership schemes involving subsidiaries. Other significant long-term incentive schemes should be detailed as part of the directors' remuneration report, which is subject to an advisory vote at the AGM.

²⁶ Listing Rules LR 9.4; available at <http://fsahandbook.info/FSA/html/handbook/LR/9/4>.

SECTION E: RELATIONS WITH SHAREHOLDERS

E.1 Dialogue with Shareholders

Main Principle

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place²⁷.

Supporting Principles

Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders' issues and concerns.

In regard to "major shareholders" mutual insurers should consider this principle in relation to feedback from any appropriate methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/ or delegate systems) and/or any members with significant membership rights.

The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

Code Provisions

E.1.1

The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.

In regard to "major shareholders" mutual insurers should consider this provision in relation to views resulting from appropriate methods for facilitating direct member dialogue and involvement that may be in place (such as member forums or panels and/ or delegate systems) and/ or any members with significant membership rights.

²⁷ Nothing in these principles or provisions should be taken to override the general requirements of law to treat shareholders equally in access to information.

E.1.2

The board should state in the annual report the steps they have taken to ensure that the members of the board, and, in particular, the non-executive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.

E.2 Constructive Use of the AGM

Main Principle

The board should use the AGM to communicate with investors and to encourage their participation.

Code Provisions

E.2.1

At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should, in particular, propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a 'vote withheld' is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.

E.2.2

The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. For each resolution, where a vote has been taken on a show of hands, the company should ensure that the following information is given at the meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company:

- the number of shares in respect of which proxy appointments have been validly made;
- the number of votes for the resolution;
- the number of votes against the resolution; and
- the number of shares in respect of which the vote was directed to be withheld.

E.2.3

The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

E.2.4

The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

SCHEDULE A

THE DESIGN OF PERFORMANCE-RELATED REMUNERATION FOR EXECUTIVE DIRECTORS

For mutual Insurers the remuneration committee should ensure that performance conditions are designed to promote the long-term Interests of members.

The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to promote the long-term success of the company. Upper limits should be set and disclosed. There may be a case for part payment in shares to be held for a significant period.

The remuneration committee should consider whether the directors should be eligible for benefits under long-term incentive schemes. Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liabilities.

Any new long-term incentive schemes which are proposed should be approved by shareholders and should preferably replace any existing schemes or, at least, form part of a well considered overall plan incorporating existing schemes. The total potentially available rewards should not be excessive.

Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives, including non-financial performance metrics where appropriate. Remuneration incentives should be compatible with risk policies and systems.

Share options may be relevant to mutual insurers, in the above paragraph, if executive directors of mutual insurers are involved in ownership schemes involving subsidiaries.

Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.

Consideration should be given to the use of provisions that permit the company to reclaim variable components in exceptional circumstances of misstatement or misconduct.

In general, only basic salary should be pensionable. The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.

SCHEDULE B

DISCLOSURE OF CORPORATE GOVERNANCE ARRANGEMENTS

Corporate governance disclosure requirements are set out in three places:

- FSA Disclosure and Transparency Rules sub-chapters 7.1 and 7.2 (which set out certain mandatory disclosures);
- FSA Listing Rules 9.8.6 R, 9.8.7 R, and 9.8.7A R (which includes the 'comply or explain' requirement); and
- The UK Corporate Governance Code (in addition to providing an explanation where they choose not to comply with a provision, companies must disclose specified information in order to comply with certain provisions).

These requirements are summarised below. The full text of Disclosure and Transparency Rules 7.1 and 7.2 and Listing Rules 9.8.6 R, 9.8.7 R and 9.8.7A R are contained in the relevant chapters of the FSA Handbook, which can be found at <http://fsahandbook.info/FSA/html/handbook/>.

The Disclosure and Transparency Rules sub-chapters 7.1 and 7.2 apply to issuers whose securities are admitted to trading on a regulated market (this includes all issuers with a Premium or Standard listing). The Listing Rules 9.8.6 R, 9.8.7 R and 9.8.7A R and UK Corporate Governance Code apply to issuers of Premium listed equity shares only.

There is some overlap between the mandatory disclosures required under the Disclosure and Transparency Rules and those expected under the UK Corporate Governance Code. Areas of overlap are summarised in the Appendix to this Schedule. In respect of disclosures relating to the audit committee and the composition and operation of the board and its committees, compliance with the relevant provisions of the Code will result in compliance with the relevant Rules.

Disclosure and Transparency Rules

Sub-chapter 7.1 of the Disclosure and Transparency Rules concerns audit committees or bodies carrying out equivalent functions.

DTR 7.1.1 R to 7.1.3 R set out requirements relating to the composition and functions of the committee or equivalent body:

- DTR 7.1.1 R states that an issuer must have a body which is responsible for performing the functions set out in DTR 7.1.3 R, and that at least one member of that body must be independent and at least one member must have competence in accounting and/or auditing.
- DTR 7.1.2 G states that the requirements for independence and competence in accounting and/or auditing may be satisfied by the same member or by different members of the relevant body.

- DTR 7.1.3 R states that an issuer must ensure that, as a minimum, the relevant body must:
 - (1) monitor the financial reporting process;
 - (2) monitor the effectiveness of the issuer's internal control, internal audit where applicable, and risk management systems;
 - (3) monitor the statutory audit of the annual and consolidated accounts;
 - (4) review and monitor the independence of the statutory auditor, and in particular the provision of additional services to the issuer.

DTR 7.1.5 R to DTR 7.1.7 G set out what disclosure is required. Specifically:

- DTR 7.1.5 R states that the issuer must make a statement available to the public disclosing which body carries out the functions required by DTR 7.1.3 R and how it is composed.
- DTR 7.1.6 G states that this can be included in the corporate governance statement required under sub-chapter DTR 7.2 (see below).
- DTR 7.1.7 G states that compliance with the relevant provisions of the UK Corporate Governance Code (as set out in the Appendix to this Schedule) will result in compliance with DTR 7.1.1 R to 7.1.5 R.

Sub-chapter 7.2 concerns corporate governance statements. Issuers are required to produce a corporate governance statement that must be either included in the directors' report (DTR 7.2.1 R); or in a separate report published together with the annual report; or on the issuer's website, in which case there must be a cross-reference in the directors' report (DTR 7.2.9 R).

DTR 7.2.2 R requires that the corporate governance statements must contain a reference to the corporate governance code to which the company is subject (for companies with a Premium listing this is the UK Corporate Governance Code). DTR 7.2.3 R requires that, to the extent that it departs from that code, the company must explain which parts of the code it departs from and the reasons for doing so. DTR 7.2.4 G states that compliance with LR 9.8.6 R (6) (the 'comply or explain' rule in relation to the UK Corporate Governance Code) will also satisfy these requirements.

DTR 7.2.5 R to DTR 7.2.10 R set out certain information that must be disclosed in the corporate governance statement:

- DTR 7.2.5 R states that the corporate governance statement must contain a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process. DTR 7.2.10 R states that an issuer which is required to prepare a group directors' report within the meaning of Section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts.
- DTR 7.2.6 R states that the corporate governance statement must contain the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups

(Accounts and Reports) Regulations 2008 where the issuer is subject to the requirements of that paragraph.

- DTR 7.2.7 R states that the corporate governance statement must contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees. DTR 7.2.8 G states that compliance with the relevant provisions of the UK Corporate Governance Code (as set out in the Appendix to this Schedule) will satisfy these requirements.

Listing Rules

Listing Rules 9.8.6 R (for UK incorporated companies) and 9.8.7 R (for overseas incorporated companies) state that in the case of a company that has a Premium listing of equity shares, the following items must be included in its annual report and accounts:

- a statement of how the listed company has applied the Main Principles set out in the UK Corporate Governance Code, in a manner that would enable shareholders to evaluate how the principles have been applied;
- a statement as to whether the listed company has:
 - complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code; or
 - not complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code, and if so, setting out:
 - (i) those provisions, if any, it has not complied with;
 - (ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
 - (iii) the company's reasons for non-compliance.

The UK Corporate Governance Code

In addition to the 'comply or explain' requirement in the Listing Rules, the Code includes specific requirements for disclosure which must be provided in order to comply. These are summarised below.

The annual report should include:

- a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management (A.1.1);
- the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees (A.1.2);
- the number of meetings of the board and those committees and individual attendance by directors (A.1.2);
- where a chief executive is appointed chairman, the reasons for their appointment (this only needs to be done in the annual report following the appointment) (A.3.1);

- the names of the non-executive directors whom the board determines to be independent, with reasons where necessary (B.1.1);
- a separate section describing the work of the nomination committee, including the process it has used in relation to board appointments and an explanation if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director (B.2.4);
- any changes to the other significant commitments of the chairman during the year (B.3.1);
- a statement of how performance evaluation of the board, its committees and its directors has been conducted (B.6.1);
- an explanation from the directors of their responsibility for preparing the accounts and a statement by the auditors about their reporting responsibilities (C.1.1);
- an explanation from the directors of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company (C.1.2);
- a statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary (C.1.3);
- a report that the board has conducted a review of the effectiveness of the company's risk management and internal controls systems (C.2.1);
- a separate section describing the work of the audit committee in discharging its responsibilities (C.3.3);
- where there is no internal audit function, the reasons for the absence of such a function (C.3.5);
- where the board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position (C.3.6);
- an explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded (C.3.7);
- a description of the work of the remuneration committee as required under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 including, where an executive director serves as a non-executive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (D.1.2);
- the steps the board has taken to ensure that members of the board, in particular the non-executive directors, develop an understanding of the views of major shareholders about their company (E.1.2).

The following information should be made available (which may be met by placing the information on a website that is maintained by or on behalf of the company):

- the terms of reference of the nomination, audit and remuneration committees, explaining their role and the authority delegated to them by the board (B.2.1, C.3.3 and D.2.1);
- the terms and conditions of appointment of non-executive directors (B.3.2) (see footnote 9);

- where performance evaluation has been externally facilitated, a statement of whether the facilitator has any other connection with the company (B.6.2); and
- where remuneration consultants are appointed, a statement of whether they have any other connection with the company (D.2.1).

The board should set out to shareholders in the papers accompanying a resolution to elect or re-elect directors:

- sufficient biographical details to enable shareholders to take an informed decision on their election or re-election (B.7.1);
- why they believe an individual should be elected to a non-executive role (B.7.2); and
- on re-election of a non-executive director, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role (B.7.2).

The board should set out to shareholders in the papers recommending appointment or reappointment of an external auditor:

- if the board does not accept the audit committee's recommendation, a statement from the audit committee explaining the recommendation and from the board setting out reasons why they have taken a different position (C.3.6).

Additional guidance

The Turnbull Guidance and FRC Guidance on Audit Committees contain further suggestions as to information that might usefully be disclosed in the internal control statement and the report of the audit committee respectively. Both sets of guidance are available on the FRC website at:

<http://www.frc.org.uk/corporate/ukcgcode.cfm>

APPENDIX

OVERLAP BETWEEN THE DISCLOSURE AND TRANSPARENCY RULES AND THE COMBINED CODE

DISCLOSURE AND TRANSPARENCY RULES	COMBINED CODE
<p>D.T.R 7.1.1 R</p> <p>Sets out minimum requirements on composition of the audit committee or equivalent body.</p>	<p>Provision C.3.1</p> <p>Sets out recommended composition of the audit committee.</p>
<p>D.T.R 7.1.3 R</p> <p>Sets out minimum functions of the audit committee or equivalent body.</p>	<p>Provision C.3.2</p> <p>Sets out the recommended minimum terms of reference for the committee.</p>
<p>D.T.R 7.1.5 R</p> <p>The composition and function of the audit committee or equivalent body must be disclosed in the annual report</p> <p><i>DTR 7.1.7 R states that compliance with Code provisions A.1.2, C.3.1, C.3.2 and C.3.3 will result in compliance with DTR 7.1.1 R to DTR 7.1.5 R.</i></p>	<p>Provision A.1.2:</p> <p>The annual report should identify members of the board committees.</p> <p>Provision C.3.3</p> <p>The annual report should describe the work of the audit committee. Further recommendations on the content of the audit committee report are set out in the Smith Guidance</p>
<p>D.T.R 7.2.5 R</p> <p>The corporate governance statement must include a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process.</p> <p><i>While this requirement differs from the requirement in the Combined Code, it is envisaged that both could be met by a single internal control statement.</i></p>	<p>Provision C.2.1</p> <p>The Board must report that a review of the effectiveness of the internal control system has been carried out. Further recommendations on the content of the internal control statement are set out in the Turnbull Guidance.</p>

<p>DTR 7.2.7 R</p> <p>The corporate governance statement must include a description of the composition and operation of the administrative, management and supervisory bodies and their committees.</p> <p><i>DTR 7.2.8 R states that compliance with Code provisions A.1.1, A.1.2, A.4.6, B.2.1 and C.3.3 with result in compliance with DTR 7.2.7 R.</i></p>	<p>This requirement overlaps with a number of different provisions of the Code:</p> <p>A.1.1: the annual report should include a statement of how the board operates.</p> <p>A.1.2: the annual report should identify members of the board and board committees.</p> <p>A.4.6: the annual report should describe the work of the nomination committee.</p> <p>B.2.1: a description of the work of the remuneration committee should be made available. [Note: in order to comply with DTR 7.2.7 R this information will need to be included in the corporate governance statement].</p> <p>C.3.3: the annual report should describe the work of the audit committee.</p>
---	---

SCHEDULE C

ENGAGEMENT PRINCIPLES FOR INSTITUTIONAL SHAREHOLDERS

The FRC issued its Stewardship Code for Institutional Investors in July 2010.
<http://www.frc.org.uk/corporate/investorgovernance.cfm>

The FRC would strongly encourage all institutional investors to publish by the end of September 2010 a statement on their website of the extent to which they have complied with the Code and to notify the FRC when they have done so.

The FRC encourages all institutional investors to report if and how they have applied the Code, on the same basis as asset managers.