

CODE OF GOOD PRACTICE

INSTITUTIONAL INVESTORS AND
CORPORATE GOVERNANCE

Association of Unit Trusts
and Investment Funds

Foreword

AUTIF believes that investment fund managers, as stewards of the money of others, need to have regard to their role as shareholders. We recommend, therefore, that fund managers should have a policy relating to the corporate governance arrangements and behaviour of the companies in which they invest; consider the processes required to implement this policy; and review the information that should be presented to their own investors, that is the holders of units and/or oec shares.

In order to assist member firms, AUTIF has developed a voluntary Code of Good Practice for investment fund managers, in their capacity as shareholders. This is intended to complement codes and guidance already developed by other bodies such as the ABI, NAPF and the Institutional Shareholders Committee.

AUTIF recommends that fund managers should, wherever possible, maintain a dialogue with companies, vote actively and inform their own investors about their policy on voting and other corporate governance matters. This last element distinguishes the AUTIF Code from other, long-established codes, and builds on the reputation of investment funds for transparency and fair disclosure.

In the first instance, voluntary adoption of the Code is likely to be practicable only for the relationships between investment fund managers and UK listed companies. In the longer term, it may be desirable to consider the practicalities of extending the Code to relationships with overseas companies.



Alan Ainsworth
Chairman, Executive Committee



Keith Niven
Chairman, Investment Committee

Statement of Key Principles

1. POLICY ON CORPORATE GOVERNANCE

AUTIF encourages all member firms to adopt a clear and considered policy towards their responsibilities as shareholders. As part of this policy, AUTIF recommends that member firms should take steps to satisfy themselves about the extent to which the firms in which they invest comply with the recommendations of the Combined Code issued by the Committee on Corporate Governance.

AUTIF also encourages member firms to identify an individual who may be contacted regarding corporate governance matters.

2. RESPONSIBLE VOTING

AUTIF welcomes Principle E.1 of the Combined Code which states that shareholders have a responsibility to make considered use of their votes.

AUTIF therefore encourages member firms to exercise actively the voting rights represented by the shares they manage on behalf of their investors.

(See also detailed guidance notes).

3. VOTING PROCEDURES

AUTIF recommends that member firms agree, in writing, and keep under regular review with trustees, depositaries and custodians the practical arrangements for circulating company resolutions and notices of meetings and for exercising votes in accordance with standing or special instructions.

4. INTERNAL AUDIT OF VOTING ACTIVITY

AUTIF encourages member firms to establish appropriate systems of internal audit of voting activity. Firms may wish to include in the annual report a statement that such an internal audit system is in place.

5. DIALOGUE WITH COMPANIES

AUTIF welcomes Principle E.2 of the Combined Code which states that shareholders should be ready, where practicable, to enter into a dialogue with companies based on the mutual understanding of objectives.

AUTIF therefore encourages member firms to develop and maintain a dialogue with the companies in which they invest. This dialogue is likely to be most effective if it includes, where practicable, regular meetings with company representatives.

Regular dialogue will provide opportunities for member firms to explore with companies any concerns they may have about companies' compliance with the Combined Code. The guidance notes include suggestions about particular items which firms may wish to cover in their discussions with companies and when evaluating company reports.

6. EVALUATION OF COMPANIES' CORPORATE GOVERNANCE ARRANGEMENTS

AUTIF welcomes Principle E.3 of the Combined Code which states that, when evaluating companies' governance arrangements, particularly those relating to board structure and composition, shareholders should give due weight to all relevant factors drawn to their attention.

The guidance notes set out factors which member firms may wish to keep under regular review, whether or not they are drawn to their attention by the companies themselves.

7. DISCLOSURE

AUTIF recommends that member firms should include in their annual reports to investors, as a minimum, a statement as to whether the firm is following the AUTIF code of good practice or another similar code. The detailed content of such a statement would of course be a matter for the discretion of individual members. However, the guidance notes set out suggested items which the statement might cover.

Member firms may also wish to take additional opportunities to inform investors about their approach on corporate governance matters. The guidance notes recommend other possible methods of regular communication with investors.

8. OTHER CODES

Where member firms already subscribe to the recommended practice of another representative body (for example ABI or NAPF), including the possible use of a voting advisory service, AUTIF encourages member firms to communicate this to investors.

9. WIDER ISSUES

Where member firms have a policy on wider issues affecting the companies in which they invest, such as attitudes towards environmental or social issues, or on donations to political parties, AUTIF encourages firms to disclose this to investors.

10. TRAINING

AUTIF encourages all member firms to provide training for relevant staff on corporate governance issues and on communicating the firm's policy on corporate governance to its investors.

Guidance Notes

KEY PRINCIPLES 2 AND 3: VOTING PROCEDURES

Practical Issues

- Responsible shareholders should ensure as far as possible that votes are always actively exercised.
- Member firms should review regularly any standing or special instructions on voting. Responsible shareholders should, where possible, discuss with company representatives any issues on which they are unlikely to be able to support the board. See also guidance notes below on Key Principle 6.
- Member firms should agree, preferably in writing, and review regularly with trustees or depositaries the voting process, that is the practical arrangements for transmission of company resolutions, meeting notices, proxy votes etc.
- Member firms will be aware of the implications of stocklending arrangements, that is, when stock is lent to the extent permitted by FSA regulations, the voting rights attaching to that stock pass to the borrower.

Electronic voting

- Member firms should be aware of the continuing debate about the introduction of electronic voting. AUTIF will inform member firms of any policy proposals to change company law to allow electronic transmission of votes and any other proposed changes to the arrangements for AGMs and other company meetings.
- AUTIF is aware that the introduction of electronic voting will have systems implications for member firms. It will also greatly simplify both the voting process and the subsequent audit arrangements. AUTIF therefore encourages member firms to play an active role in consultations aimed at developing systems for electronic transmission of votes.

KEY PRINCIPLE 5: DIALOGUE WITH COMPANIES

AUTIF encourages member firms, as part of their dialogue with the companies in which they invest and when scrutinising the annual reports and accounts, to pay particular attention to the companies' compliance with the Combined Code in the areas summarised below, and discussed in more detail in the guidance on Key Principle 6:

- nomination and audit committees
- remuneration committee and directors' remuneration
- role of chairman and chief executive
- board balance
- financial reporting principles
- internal control system and annual review of its effectiveness

KEY PRINCIPLE 6: EVALUATION OF COMPANIES' CORPORATE GOVERNANCE ARRANGEMENTS

Companies listed on the London Stock Exchange are required, as a continuing obligation of listing, to make two disclosure statements. Firstly, they must report on how they apply the principles in the Combined Code on Corporate Governance. The form and content of this report are not prescribed – it is for shareholders to make their own evaluation. Secondly, listed companies are also required to confirm that they comply with the Code provisions or – where they do not – to provide an explanation. Again, it is for shareholders to evaluate such explanations. Copies of the Combined Code may be obtained from the London Stock Exchange.

Factors which member firms may wish to keep under regular review as part of their dialogue with companies, and when evaluating company reports, or companies' explanations where these are required to justify a departure from the Combined Code, include the following:

Composition of board

- Principle A.2 of the Combined Code recommends that there should be a clear division of responsibilities at the head of a company. Code Provision A.2.1 states that a decision to combine the roles of chairman and chief executive should be publicly justified. The chairman, chief executive and senior independent director should be identified in the annual report.
- Principle A.3 of the Combined Code recommends that a company board should include a balance of executive and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision taking.
- Principle A.5 of the Combined Code recommends that there should be a formal and transparent procedure for the appointment of new directors to the board. Code Provision A.5.1 recommends the establishment of a nomination committee, chaired by the chairman of the board or a non-executive director, and with the chairman and members identified in the annual report. The company should provide an explanation if there is no nomination committee.
- Principle A.6 recommends that all directors should be required to submit themselves for re-election at regular intervals and at least every three years.

Guidance Notes *continued*

Remuneration

- Principle B.1 of the Combined Code recommends that levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but that companies should avoid paying more than is necessary for this purpose. Code Provision B.1.7 recommends that directors' contracts should, for the most part, be for one year.
- Principle B.2 of the Combined Code recommends that companies should establish a formal and transparent procedure for developing policy on executive remuneration. In practice, this normally results in the appointment of a remuneration committee. There have been suggestions, as part of the DTI's review of company law, that a company's remuneration policy (and possibly also the report of the remuneration committee) should be ratified at the AGM.
- Member firms should consider the remuneration policy of companies in which they invest. They may wish to pay particular attention to those elements of remuneration packages, for directors and senior executives, which are performance related, including share options, and to compensation arrangements.

Accountability and Audit

- Principle D.1 states that the board should present a balanced and understandable assessment of the company's position and prospects.
- Principle D.2 states that the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets. Code Provision D.2.1 recommends an annual review by the directors of the company's effectiveness of internal controls, with a report to shareholders. This review should cover financial, operational and compliance controls and risk management.

Guidance for directors on the implementation of these recommendations was set out in the report of the Internal Control Working Party of the Institute of Chartered Accountants in England and Wales (the Turnbull Committee). The Stock Exchange considers that compliance with the Turnbull guidance will constitute compliance with the relevant provisions of the Combined Code.

- Principle D.3 recommends the establishment of an audit committee.

Corporate activities

- AUTIF supports pre-emption rights for existing shareholders in the event of an issue of new share capital. Member firms should discuss with the company any proposal to depart from this policy.
- Member firms may wish to take into account the policy of the companies in which they invest towards environmental and social issues and on political donations.

KEY PRINCIPLE 7: DISCLOSURE

Statement in annual reports to investors

Member firms may wish to consider including some or all of the following items in their annual reports to their investors:

- general policy statement on corporate governance
- general statement as to voting practice
- indication of issues which could cause concern

Other methods of communicating with investors on the subject of voting policy which member firms may wish to consider include:

- pre-sale communications such as scheme particulars, key features documents or other marketing material;
- half yearly reports or other reports at regular intervals;
- as frequently as is appropriate on the firm's website;
- and of course at the request of investors.

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