

# Guidelines on Corporate Governance

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# 1 Preamble

During the past decades freedom in all aspects of business activities has increased markedly creating more leeway for entrepreneurs. International development has been marked by a multitude of companies establishing themselves abroad. Cross borders business relationships have increased dramatically. This development has also taken place in Iceland and Icelandic enterprises have shown that they have the necessary knowledge and strength to take part in new ventures abroad, as well as within Iceland, and have thus helped increase the affluence in Iceland.

Increased freedom means increased responsibility; enterprises must show respect for their shareholders as well as for other stakeholders and indeed society as a whole. The Icelandic business community wants to show that their enterprises are ready to shoulder this increased responsibility. Enterprises realize that by building better relations with shareholders, employees, customers, suppliers and the general public, many new avenues of business opportunities will open. Mutual trust between the public and the business community is a key to improved competitiveness and thus to higher living standards.

An important step to ensure that the business community is trustworthy is to improve practices in relations between shareholders, boards of directors and managing directors. During the summer of 2003 Iceland Chamber of Commerce started work on a set of recommendations regarding good corporate governance, the purpose of which was to clarify the role and work of the board of directors and managers of Icelandic enterprises and thus make it easier for them to fulfill their duties. The goal was to assemble guidelines for corporate governance working methods, hereafter named guidelines for good corporate governance. In the autumn of 2003 the Iceland Stock Exchange joined the work of the Chamber as did The Confederation of Icelandic Employers at year's end. The reason for this co-operation was to create a broad front on good corporate governance.

The aim of the guidelines that follow is to assist enterprises in conducting relations between shareholders, boards of directors and managers. Similar work on corporate governance is being done internationally in a changed and globalized economy. During the past few years more than 30 countries, international organizations and business associations have brought forward recommendations for good or appropriate corporate governance so the debate on these matters has been quite extensive. It is essential that the business community accepts its responsibility and adopts good practice working methods and procedures, which will strengthen the infrastructure of enterprises and increase mutual trust between the general public and enterprises.

The reason why so many feel it necessary to study corporate governance in their respective country is no doubt that traditions, practices, circumstances, laws and regulations differ so much from one country to the next that it is impossible to put forward international standardized proposals that would be appropriate in all situations. It is clear however that the increase of cross borders activity means that each country has to follow developments in this field closely and use practices, rules and regulations in other countries as a reference for their own work. In this instance no country is an island.

British, Danish and Finnish reports on corporate governance were studied and taken into consideration when work on these guidelines was being conducted, as was OECD's Principles of Corporate Governance from 1999 and the work done by The International Chamber of Commerce.

The Icelandic business community firmly believes that in order to obtain satisfactory results internal control and supervision within the companies themselves should be increased. There is a lot at stake and important that the initiative comes from the business community itself and that it point out methods to increase the confidence of shareholders and the general public have the right to demand from enterprises.

These guidelines suit all limited liability companies whether they are listed on the Iceland Stock Exchange or not, as well as private limited liability companies and state and municipality owned companies as the case may be.

The purpose of this review is to :

- Advance best practice in corporate governance in Iceland.
- Make it easier for directors and managers to fulfill their duties and assist them in advancing the growth and development of the companies they are entrusted with directing.
- Ensure public confidence in enterprises and business activities in general.
- Strengthen trust between investors, directors and managers.
- Increase the competitiveness of Icelandic enterprises by adapting similar corporate governance methods as recommended in neighbouring countries.
- Make it easier for prospective foreign investors to evaluate what fundamentals of corporate governance are the norm in Iceland when they are evaluating investment in Iceland.
- Facilitate the access of domestic enterprises to finance, both here and abroad.
- Define appropriate working practices of boards and managers within existing legislation on Public Limited Companies (# 2/1995), on Private Limited Companies (# 138/1994), as well as other legislation on activities of commercial enterprises.

The working group on corporate governance consisted of :

Svanbjorn Thoroddsen, Man. dir. Medcare Flaga Ltd., (chairman),  
Ari Edwald, Man. dir. SA- Conferderation of Icelandic Employers,  
Erlendur Magnusson, Executive of Íslandsbanki Ltd.,  
Gudfinna S. Bjarnadottir, Dean of Reykjavík University,  
Olafur Nilsson, State authorized chartered accountant, KPMG,  
Thorgeir Eyjolfsson, Man. dir. Pension fund of Commerce,  
Thor Sigfusson, Man. dir. Iceland Chamber of Commerce and  
Thordur Fridjonsson, Man. dir. Iceland Stock Exchange.

David Sch. Thorsteinsson was the Project leader and Sigridur Á. Andersen, Legal Counsel at the Chamber of Commerce, worked closely with the working group as an advisor.

## 2 Board of Directors

The responsibility of the board of directors is great as it is the highest authority of any company between shareholders' meetings. The main role of the board according to law and the nature of its mission can be summed up in the following way :

- The board is responsible for promoting the success of the company by directing and supervising the company's affairs and manager(s).
- The board and the manager(s) are responsible for setting the company's values and standards, as well as short and long term objectives.
- The board is responsible for ensuring that the company's obligations to all its shareholders are understood and met. The members of the board may not look specifically after the interests of the shareholders that voted for them as directors.

The role of the board of directors is specified in Company Law - Act No. 2/1995 respecting Public Limited Companies, where the following is i.a. stated:

- The Company's Board of Directors undertake Company affairs and shall see to it that the Company's organization activities be at all times in correct and good order and that the book-keeping and the handling of the Company's funds be sufficiently supervised. ( Art. 68).
- A Board of Directors shall engage one to three Managers, unless a larger number be stipulated in a Company's Articles of Association. (Art. 65).
- The Company's Board and Manager undertake the administration of the company. (Art. 68).
- The Manager undertakes the daily operations of the Company and shall in that respect follow the policy and instructions laid down by the Company's Board of Directors. (Art. 68, Para. 2).
- Daily operations do not extend to unusual or major arrangements. (Art. 68, Para. 2).
- The Manager of a Company may not be elected Chairman of the Company. (Art. 70).
- The Manager attends meetings of a Company's Board of Directors although he be not a Board member and he has the right to debate and submit proposals there, unless the Company's Board of Directors decide otherwise in individual instances. (Art. 70, Para. 2).
- A Company's Board of Directors, Manager and those others being authorized to represent the Company may not make any such arrangements as are obviously suited to acquire improper interests for specific shareholders or others at the expense of other shareholders or the Company. (Art. 76).
- Upon assuming office Directors and Managers shall render a report to the Board of Directors relating to their holdings in the Company and in Companies within the selfsame group of Companies. They shall also subsequently report on purchase and sale of such shares. (Art. 67).
- A Company's Board of Directors shall lay down their working rules wherein there are further stipulations concerning the execution of the Boards function. (Art. 70, Para. 4).

The implementation of the following guidelines should help ensure best practice in the boardroom and assist boardmembers in performing their duties.

## **2.1 Duties**

**In order to be able to fulfill the duties of a director any individual chosen to sit on a board should have the relevant and necessary knowledge and experience in relation to the requirements of the company and have the possibility of devoting sufficient time to the work. It is important that every director is fully aware of all the duties and responsibilities his membership on the board entails.**

Successful board work requires knowledge of the operations of the company. The prime requisite for a board's effective work is that its members complement each others knowledge, experience, qualifications and skills. Every director must have the time required to attend to his duties for the company.

Each director should :

- Be familiar with the relevant laws and regulations pertaining to the company's operations.
- Be familiar with the company's goals, basic values and strategies, as well as understanding how best to conduct his/her work to help reach these goals.
- Fully understand the function of the board and have good judgement and intuition.
- Make independent decisions in each instance.
- Ensure that internal control is functioning satisfactorily and that the board receives reliable, timely and accurate information necessary for the performing of its supervisory work, and that all decisions by the board are adhered to.
- Make certain that all Acts of law, rules and regulations are followed to the letter at all times.
- Endeavour to inspire good and positive morale amongst the staff.

## **2.2 Working rules**

**The board of directors shall adopt written working rules where the role, procedures and working methods of the board are defined.**

These working rules need to deal with how the work of the board is divided between directors and how responsibilities are divided between the directors, the chairman and the managing director. The information contained in the board's working rules will enable shareholders to evaluate operations of the board.

The working rules of the board should include the following factors :

- Division of responsibilities between the members of the board.
- Division of responsibilities between the board and its chairman.
- Division of responsibilities between the chairman and the managing director.
- Sub-committees of the board.
- The calling of meetings, their frequency, attendees and form.
- Information submitted to the board.
- Minutes of meetings.

- Decisions and voting.
- Non-disclosure and confidentiality.
- Disqualification.
- Connections to other rules of the company.
- Connections to other rules and regulations as appropriate, such as from The Financial Supervisory Authority of Iceland and the Iceland Stock Exchange.

### ***2.3 Information submitted to the board***

**In order for the directors to be able to discharge their supervisory duties it is important that they receive relevant information on a regular basis from the managing director. It is necessary to specify how and in which form this information is to be submitted.**

In order to discharge their duties the directors need information on financial matters and development and operations of the company on a regular basis. Furthermore a newly elected director needs to be comprehensively and formally introduced to the structure of the company and its operations.

Information submitted to the board by the managing director needs to be submitted in time, in a form, of a relevance and of a quality that helps the board discharge its duties in a satisfactory way.

### ***2.4 Evaluation of performance***

**It is desirable that the board evaluates regularly its performance, practices, procedures and working methods, as well as the development of the company, with the assistance of outside specialists, if deemed desirable by the board.**

Such evaluation entails amongst other that the board takes a realistic look at its strengths and weaknesses in discharging its duties and identifies how its working procedures might be bettered.

### ***2.5 Independent directors***

**It is desirable that the majority of directors be independent of the company, as specified under 2.6. In addition it is also desirable that at least two directors be independent of significant shareholders of the company.**

One of the duties of the directors is to supervise those who take care of the day-to-day running of the company. It is therefore to be desired that the majority of directors be independent and that within that majority at least two directors be independent of significant shareholders of the company.

A significant shareholder is anyone that controls at least 10 % of total outstanding shares of the company, on his own, or in collaboration with closely related parties or entities.

## ***2.6 Evaluation of the independence of directors***

**The board shall evaluate the independence of directors and state its conclusions in the annual report of the company.**

It is important that it be reported in the annual report if the majority of the board is not independent.

A director is not independent of the company :

- If he is or has been an employee of the company, or the conglomerate, during the past three years.
- If he receives compensation from the company, or from a member of the operative management, besides the compensation due him as a director, for example as a consultant or contractor.
- If he has close family ties with any of the consultants, directors or members of the operative management of the company.
- If he is a member of the operative management of a company that does significant business with the company.
- If he is a member of the operative management of a company in which a member of the operative management of the company is a director,
- If he does considerable business with, or has significant business interests in the company.
- If he participates in a performance-based or a share purchase compensation scheme of the company.
- If the board is aware of any other instances wherein the interests of the director and the company might be in conflict.

In order to make it easier for the board to carry out the above specified evaluation each director should provide the board with sufficient information about themselves and shall notify the board of any changes in their position which may have a bearing on the evaluation of the board of their independence.

It is desirable that the following information on directors is reported in the annual report:

- Name, date and year of birth.
- Education.
- Main occupation.
- Primary working experience.
- First elected to the board.
- Other key positions of trust.
- Shareholdings in the company.
- Rights based on the share-related compensation system of the company.

### **3 Sub-committees of the board**

Well organized working methods of the board are a prerequisite for efficient functioning of management and operations of the company. Establishing sub-committees composed of some of the directors can enhance the effectiveness in some of the spheres within the domain of the board. Directors entrusted with a seat on such specialized sub-committees can concentrate more efficiently on the tasks delegated to them than when the full board is convened. It is important that sub-committees report regularly to the board on their work.

#### ***3.1 Establishing sub-committees***

**In order to make the work of the board more effective it may be advisable to establish special sub-committees of the board. The board elects the directors and the chairman of each sub-committee. Names of the directors of each sub-committee shall be reported in the annual report.**

It may be necessary to give sub-committees the task of concentrating on specific areas, in particular financial control, compensation of the managing director and compensation systems of the members of the operative management. The board must evaluate the necessity of such sub-committees based on the size and scope of the company as well as the composition of the board.

#### **A Audit committee**

##### ***A 1 Establishment of the audit committee.***

**It is desirable to establish an audit committee, if the size and scope of the company is such, that it may be deemed advisable that reports on control and financial matters be subject to further scrutiny and analysis by a small group of directors rather than by the whole board.**

The role of the audit committee is to monitor the integrity of financial reports to the board and the financial reporting system of management and thus make certain that the information given to the board on the running of the company, its economy and future prospects give a clear picture of the situation of the company at all times.

Those companies that have not yet established an audit committee should evaluate yearly whether such a committee should be established.



## *A 2 Appointment of members*

**The audit committee shall consist of at least three members and the majority of the members should be independent of the company. Members must have the relevant skills and experience to discharge the duties of the committee.**

As the role of the audit committee is to monitor financial matters, financial statements and internal control all members of the committee should have significant, recent and relevant knowledge of accounting practices and the preparation of annual financial statements.

## *A 3 Tasks*

**The board shall define the duties of the audit committee tailored to the needs of the company.**

Amongst other the duties of the committee should include:

- Supervision of the financial position of the company.
- Evaluation of the internal financial control system of the company and risk management.
- Evaluation of the financial reporting of management.
- Evaluation of the compliance with all laws, rules and regulations.
- Preparation of the decision concerning appointment of the external auditor of the company.
- Direct contact with the external chartered accountant, the external auditor.
- Evaluation of the reports submitted by the external auditor, a chartered accountant.
- Evaluation of other services supplied by the external auditor, a chartered accountant.

## **B Remuneration committee**

### *B. 1 Establishment of a remuneration committee*

**The board can establish a special remuneration committee to set the level and structure of compensation for the managing director and other employees if they sit on the board of directors. Furthermore this committee can structure the company's policy on performance related wages and/or share purchase options.**

A remuneration committee should always be established if the managing director sits on the board, or if the chairman or other directors are employees of the company.

### *B. 2 Members*

**The remuneration committee shall consist of three members of which the majority shall be independent of the company.**

Because of the tasks given to the remuneration committee neither the managing director nor any other employee may be a member of the committee.

### ***B. 3 Tasks***

**The board shall define the role of the remuneration committee.**

The board shall define the duties and working methods of the remuneration committee in the charter of the committee which frame of reference shall be the needs of the company.

The tasks of the committee should amongst other be to :

- Negotiate wages and other compensation terms of the managing director.
- Negotiate wages and other compensation terms of other employees that are directors of the company.
- Structure the company's policy on performance related wages and/or share purchase options.

### ***B 4 Share purchase options***

**It is desirable that the main provisions of a share purchase option plan be submitted to the general meeting of shareholders for acceptance.**

If the board has taken the decision to enter into a share purchase option plan for employees, or if shares are sold to them with re-selling rights, it is desirable that the main provisions of such agreements and/or plan be submitted to the general meeting of shareholders for acceptance.

In this connection main provisions means, amongst other, the total number of shares in the plan, the maximum length of re-purchase rights, the maximum length of time of purchasing rights, the time frame in which employees can exercise their purchasing rights, the frame of reference as regards decision on price, and conditions if the company finances the purchasing, but not agreements with individual employees or the amounts of such agreements.

If the share option plan also extends to directors it is proposed that their part of the share purchase option plan be dealt with separately at the general meeting of stockholders when the compensation to directors is decided upon.

## **4 Review of these guidelines**

**It is recommended that these guidelines be reviewed in view of experience.**

It should be stated once more that no international definition of good corporate governance practices exists and it is therefore to be expected that discussions and work on good corporate governance will continue in the future. It is therefore necessary to monitor closely how matters in this field evolve, both here and internationally, and to review and update these recommendations at year's end 2005.