

ANNEX A – SUGGESTED REVISED CODE (INCORPORATING REVIEW RECOMMENDATIONS)

Part 1 Principles of Good Governance

SECTION 1 COMPANIES

A DIRECTORS

The Board

1. Every listed company should be headed by an effective board. The board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs.

Chairman and Chief Executive

2. There are two key tasks at the top of every public company – the running of the board and the executive responsibility for the running of the company's business. There should be a clear division of responsibilities at the head of the company which will ensure a balance of power and authority such that no one individual has unfettered powers of decision.

Board balance and independence

3. The 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.

Appointments to the Board

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

Information and professional development

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

Performance evaluation

6. Boards should evaluate their performance.

Re-election

7. All directors should be required to submit themselves for re-election at regular intervals and at least every three years subject to continued satisfactory performance.

B. REMUNERATION¹

The Level and Make-up of Remuneration

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

Procedure

2. Companies should establish 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.

Disclosure

3. The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director.

C. RELATIONS WITH SHAREHOLDERS

Dialogue with Shareholders

1. Companies should enter into a dialogue with shareholders based on the mutual understanding of objectives.

Constructive Use of the AGM

2. Boards should use the AGM to communicate with investors and encourage their participation.

D. ACCOUNTABILITY AND AUDIT

Financial Reporting

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

Internal Control

2. The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

¹ Some of the provisions on directors' remuneration have been superseded by the Directors' Remuneration Report Regulations 2002 S.I 2002/1986 and a revision of the Code will need to reflect this.

Audit Committee and Auditors

3. The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

SECTION 2 INSTITUTIONAL SHAREHOLDERS

E. INSTITUTIONAL INVESTORS

Shareholder Voting

1. Institutional shareholders have a responsibility to make considered use of their votes.

Dialogue with Companies

2. Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

Evaluation of Governance Disclosures

3. When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention.

Part 2 Code of Best Practice

SECTION 1 COMPANIES

A. DIRECTORS

A.1 *The Board*

Principle

Every listed company should be headed by an effective board. The board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs.

Code Provisions

- A.1.1 The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enable 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 fully understood and met.

- A.1.2 The board should meet regularly and there should be a formal schedule of matters specifically reserved for its decision. The number of meetings of the board and of its main committees and individual attendance should be identified in the annual report.
- A.1.3 The board should publish a high level statement of which decisions are to be taken by the board and which are to be delegated to management.
- A.1.4 Non-executive directors should constructively challenge and contribute to the development of strategy. 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 that financial information is accurate and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of executive remuneration and have a prime role in appointing, and where necessary removing, senior management and in succession planning.
- A.1.5 The non-executive directors should meet regularly as a group without the executives present and at least once a year without the chairman present. The meetings should be led by the senior independent director. There should be a statement in the annual report on whether the non-executive directors have met without the chairman or executives present.
- A.1.6 Where they have concerns about the way in which a company is being run or about a course of action being proposed by the board, directors should ensure that their concerns are recorded in the board minutes if they cannot be resolved. A written statement should be provided to the chairman, for circulation to the board, setting out the reasons where a non-executive director resigns.
- A.1.7 Companies should arrange appropriate insurance cover in respect of legal action against its directors.

A.2 *Chairman and chief executive*

Principle

There are two key tasks at the top of every public company – the running of the board and the executive responsibility for the running of the company’s business. There should be a clear division of responsibilities at the head of the company which will ensure a balance of power and authority such that no one individual has 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. It should be set out in writing and agreed by the board.

- A.2.2 The chairman and the chief executive should be identified in the annual report.
- A.2.3 A chief executive should not go on to become chairman of the same company.
- A.2.4 On appointment, the chairman should meet the independence criteria set out in A.3.4 below.
- A.2.5 The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. The chairman should also facilitate the effective contribution of non-executive directors and ensure constructive relations between executive and non-executive directors.

A.3 *Board balance and independence*

Principle

The 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.

Code Provisions

- A.3.1 Boards should not be so large as to become unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption.
- A.3.2 To ensure that power and information are not concentrated in one or two individuals, there should also be a strong executive representation on the board.
- A.3.3 All directors must take decisions objectively in the interests of the company.
- A.3.4 A non-executive director is considered independent when the board determines that the director is independent in character and judgement, and there are no relationships or circumstances which could affect, or appear to affect, the director's judgement.

Such relationships or circumstances would include where the director:

- is a former employee of the company or group until five years after employment, or any other material connection, has ended;
- 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 ten years.

The board should identify in its annual report the non-executive directors it determines to be independent. The board should state its reasons if a director is considered independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination.

- A.3.5 At least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.
- A.3.6 A senior independent director should be identified in the annual report. He or she should be available to shareholders if they have reason for concern on which contact through the normal channels of chairman or chief executive is inappropriate or has failed to resolve.
- A.3.7 Unless the company is small, no individual should sit on all three principal board committees at the same time.

A.4 *Appointments to the Board*

Principle

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

Code Provision

- A.4.1 All listed companies should have a nomination committee which should lead the process for board appointments and make recommendations to the board. The nomination committee should consist of a majority of independent non-executive directors. It may include the chairman of the board, but should be chaired by an independent non-executive director. The chairman and members of the nomination committee should be identified in the annual report.
- A.4.2 The nomination committee should make publicly available terms of reference explaining its role and the authority delegated to it by the board.
- A.4.3 Before making an appointment, the nomination committee should evaluate the balance of skills, knowledge and experience on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

- A.4.4 The nomination committee should set out in the letter of appointment the time and responsibility (including in relation to chairmanship or membership of board committees or as the senior independent director) envisaged in the appointment of a non-executive director.
- A.4.5 The board should set out to shareholders why they believe an individual should be appointed to a non-executive role and how they meet the requirements of the role.
- A.4.6 The non-executive director should undertake that they will have sufficient time to meet what is expected of them, taking into account their other commitments. These commitments should be disclosed to the company before appointment, with an indication of the time involved.
- A.4.7 The nomination committee should review annually the time required from a non-executive director and performance evaluation should be used to assess whether the non-executive director is spending enough time to fulfil their duties. If the non-executive director is offered appointments elsewhere, the chairman should be informed before any new appointments are accepted and the board should subsequently be informed.
- A.4.8 A full time executive director should not take on more than one non-executive directorship, nor become chairman, of a major (FTSE 100) company. No individual should chair the board of more than one such company.
- A.4.9 The nomination committee should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management to maintain an appropriate balance of skills on the board.
- A.4.10 The nomination committee should make a statement in the annual report detailing its activities and the process it has used to make appointments. An explanation should be given if external advice or open advertising has not been used.
- A.4.11 Terms and conditions of appointment of non-executive directors should be published.

A.5 *Information and professional development*

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

Code Provision

- A.5.1 Information volunteered by management may not be enough in all circumstances and directors should make further enquiries where necessary.

- A.5.2 The company secretary should be accountable to the board through the chairman on all governance matters.
- A.5.3 There should be a procedure agreed by the board for directors in the furtherance of their duties to take independent professional advice at the company's expense.
- A.5.4 All directors should have access to the impartial advice and services of the company secretary who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. Under the direction of the chairman the company secretary's responsibilities include facilitating induction and professional development, ensuring good information flows within the board, its committees and between non-executive directors and senior management.
- A.5.5 Both the appointment and the removal of the company secretary should be a matter for the board as a whole.
- A.5.6 It is the responsibility of the chairman to ensure that new directors receive comprehensive, formal and tailored induction on joining the board. This should include, amongst other things, meeting major investors.
- A.5.7 The chairman should ensure that the directors continually update the skills and knowledge required to fulfil their role both on the board and on board committees. The company should acknowledge that as part of the cost of running an effective board they need to provide money and time for developing and updating their directors.

A.6 *Performance evaluation*

Principle

Boards should evaluate their performance.

Code Provision

- A.6.1 Performance evaluation of the board, its committees and its individual directors should be undertaken at least once a year. 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, appointing new members to the board or seeking the resignation of directors.
- A.6.2 The board should state in the annual report whether such performance evaluation is taking place and how it is conducted.

A.7 *Re-election*

Principle

All directors should be required to submit themselves for re-election at regular intervals and at least every three years subject to continued satisfactory performance.

Code Provision

- A.7.1 Non-executive directors should be appointed for specified terms subject to re-election and to Companies Act provisions relating to the removal of a director, and reappointment should not be automatic.
- A.7.2 All directors should be subject to election by shareholders at the first opportunity after their appointment, and to re-election thereafter at intervals of no more than three years.
- A.7.3 Non-executive directors would normally be expected to serve two terms of three years subject to continued satisfactory performance, but may exceptionally serve longer where this would be in the interests of the company and the reasons are explained to shareholders. Non-executive directors serving nine years or more should be subject to annual re-election.
- A.7.4 Before proposing re-election, the chairman should confirm as a result of performance evaluation that they are satisfied that the non-executive director continues to contribute effectively and demonstrate commitment to the role.

B. REMUNERATION

B.1 *The Level and Make-up of Remuneration*

Principle

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

Code Provisions

Remuneration policy

- B.1.1 The remuneration committee should provide the packages needed to attract, retain and motivate executive directors of the quality required but should avoid paying more than is necessary for this purpose.
- B.1.2 Remuneration committees should judge where to position their company relative to other companies. They should be aware what comparable companies are paying and should take account of relative performance. But they should use such comparisons with caution, in view of the risk that they can result in an upward ratchet of remuneration levels with no corresponding improvement in performance.
- B.1.3 Remuneration committees should be sensitive to broader issues, including pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

- B.1.4 The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels.
- B.1.5 Executive share options should not be offered at a discount save as permitted by paragraphs 13.30 and 13.31 of the Listing Rules.
- B.1.6 In designing schemes of performance-related remuneration, remuneration committees should follow the provisions in Schedule A to this Code.
- B.1.7 Levels of remuneration for non-executive directors should reflect the time and responsibilities of the role. Remuneration for non-executive directors in share options should be avoided.

Service Contracts and Compensation

- B.1.8 Notice or contract periods should be set at one year or less.
- B.1.9 If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce after the initial period.
- B.1.10 Remuneration committees should consider what compensation commitments (including pension contributions) their directors' contracts of service, if any, would entail in the event of early termination. They should, in particular, consider the advantages of providing explicitly in the initial contract for such compensation commitments except in the case of removal for misconduct. In doing so, they should bear in mind the need to ensure that such provisions do not have the effect of rewarding poor performance which would not amount to misconduct or otherwise entitle the company to terminate the contract.
- B.1.11 Where the initial contract does not explicitly provide for compensation commitments, remuneration committees should, within legal constraints, tailor their approach in individual early termination cases to the wide variety of circumstances. The broad aim should be to avoid rewarding poor performance while dealing fairly with cases where departure is not due to poor performance and to take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.

B.2 *Procedure*

Principle

Companies should establish 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.

Code Provisions

- B.2.1 The remuneration committee should consist exclusively of independent non-executive directors and should have at least three members.
- B.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 set the level and structure of remuneration for senior executives. The remuneration committee should make publicly available its terms of reference, explaining its role and the authority delegated to it by the board.
- B.2.3 The members of the remuneration committee should be listed each year in the board's remuneration report to shareholders (B.3.1 below).
- B.2.4 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors, including members of the remuneration committee, within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a small sub-committee, which might include the chief executive.
- B.2.5 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 consultants in respect of executive director remuneration. If executive directors or senior management are involved in advising or supporting the remuneration committee, this role should be clearly separated from their role within the business.
- B.2.6 The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters.

B.3 *Disclosure*

Principle

The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director.

Code Provisions

- B.3.1 The board should report to the shareholders each year on remuneration. The report should form part of, or be annexed to, the company's annual report and accounts. It should be the main vehicle through which the company reports to shareholders on directors' remuneration.
- B.3.2 The report should set out the company's policy on executive directors' remuneration. It should draw attention to factors specific to the company. It should also set out the company policy on non-executive directors remuneration.

- B.3.3 In preparing the remuneration report, the board should follow the provisions in Schedule B to this Code.
- B.3.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) save in the circumstances permitted by paragraph 13.13A of the Listing Rules.
- B.3.5 The board's annual remuneration report to shareholders need not be a standard item of agenda for AGMs. But the board should consider each year whether the circumstances are such that the AGM should be invited to approve the policy set out in the report and should minute their conclusions.

C. RELATIONS WITH SHAREHOLDERS

C.1 Dialogue with Institutional Shareholders

Principle

Companies should enter into a dialogue with major shareholders based on the mutual understanding of objectives.

- C.1.1 Boards 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 investors.
- C.1.2 The senior independent director should attend sufficient regular meetings of management with a range of major shareholders to develop a balanced understanding of the themes, issues and concerns of shareholders. The senior independent director should communicate these views to the non-executive directors and, as appropriate, to the board as a whole. Non-executive directors should be able to attend regular meetings with major investors and should expect to attend them if requested by major shareholders.
- C.1.3 On appointment, non-executive directors should meet major investors, as part of the induction process.

C.2 Constructive Use of the AGM

Principle

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

Code Provisions

- C.2.1 Companies should count all proxy votes and, except where a poll is called, should indicate the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands.
- C.2.2 Companies should propose a separate resolution at the AGM on each substantially separate issue and should in particular propose a resolution at the AGM relating to the report and accounts.

C.2.3 The chairman of the board should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all non-executive directors to attend.

C.2.4 Companies should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

D. ACCOUNTABILITY AND AUDIT

D.1 Financial Reporting

Principle

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

Code Provisions

D.1.1 The directors should explain their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.

D.1.2 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.

D.1.3 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

D.2 Internal Control

Principle

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Code Provisions

D.2.1 The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management.

D.2.2 Companies which do not have an internal audit function should every year review the need for one.

D.3 Audit Committee and Auditors

Principle

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

- D.3.1 The board should establish an audit committee of at least three members, who should all be independent non-executive directors. At least one member of the audit committee should have significant, recent and relevant financial experience.
- D.3.2 The main role and responsibilities should be set out in written terms of reference and should include:
- to monitor the integrity of the financial statements of the company, reviewing significant financial reporting judgements contained in them;
 - to review the company's internal financial control system and, unless expressly addressed by a separate risk committee or by the board itself, risk management systems;
 - to monitor and review the effectiveness of the company's internal audit function;
 - to make recommendations to the board in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
 - to monitor and review the external auditor's independence, objectivity and effectiveness, 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.
- D.3.3 The audit committee should be provided with sufficient resources to undertake its duties.
- D.3.4 The annual report should contain a separate section that describes the role and responsibilities of the committee and the actions taken by the committee to discharge those responsibilities.
- D.3.5 The chairman of the audit committee should be present at the AGM to answer questions, through the chairman of the board.

These provisions are amplified in the 'Guidance on Audit Committees' to be attached to the Code. As the introduction to the guidance explains, compliance with the parts of the guidance printed in bold type should be regarded as essential for compliance with the Code.

SECTION 2 INSTITUTIONAL SHAREHOLDERS

E. INSTITUTIONAL INVESTORS

E.1 *Shareholder Voting*

Principle

Institutional shareholders have a responsibility to make considered use of their votes.

Code Provisions

- E.1.1 Institutional shareholders should endeavour to eliminate unnecessary variations in criteria which each applies to the corporate governance arrangements and performance of the companies in which they invest.
- E.1.2 Institutional shareholders should, on request, make available to their clients information on the proportion of resolutions on which votes were cast and non-discretionary proxies lodged.
- E.1.3 Institutional shareholders should take steps to ensure their voting intentions are being translated into practice.
- E.1.4 Institutional investors should be expected to attend AGMs where practicable.

E.2 *Dialogue with companies*

Principle

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

- E.2.1 Institutional shareholders should apply the principles set out in the Institutional Shareholder's Committee's Code of activism which should be included in fund manager contracts.

E.3 *Evaluation of Governance Disclosures*

Principle

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention.

NEW SCHEDULE TO BE ANNEXED TO CODE

Guidance on liability of non-executive directors: care, skill and diligence

Although non-executive directors and executive directors have the same legal duties and objectives as board members, the time devoted to the company's affairs is likely to be significantly less for a non-executive director than for an executive director and the detailed knowledge and experience of a company's affairs that could reasonably be expected of a non-executive director will generally be less than for an executive director. These matters may be relevant in assessing the knowledge, skill and experience which may reasonably be expected of a non-executive director and therefore the care, skill and diligence that they may be expected to exercise.

In this context, the following elements of the Code may also be particularly relevant.

In order to enable directors to fulfil their duties, the Code states that:

- the contract or letter of appointment of the director should set out what is expected of them including the level of responsibility and time commitment (suggested Code provision A.4.4); and
- the chairman should provide sufficient, accurate, timely and clear information to board members to give them a fair and balanced understanding of relevant issues (suggested Code provision A.2.5).

Non-executive directors should themselves:

- undertake appropriate induction and, as needed, professional development (suggested Code principle A.5);
- make appropriate enquiries, and where necessary, take and follow appropriate professional advice (suggested Code provision A.5.3);
- where they have concerns, ensure that these are addressed by the board and to the extent that they are not resolved, ensure that they are recorded (suggested Code provision A.1.6); and
- give a statement of reasons to the board if they resign (suggested Code provision A.1.6).

It is up to each non-executive director to reach a view as to what is necessary in particular circumstances to comply with the duty of care, skill and diligence they owe as a director to the company.

In considering whether or not a person is in breach of that duty, a court would take into account all relevant circumstances. These may include having regard to the above where relevant to the issue of liability of a non-executive director.