NAPF
Securing the future of pensions

Corporate Governance Policy

Policy and Voting Guidelines for AIM Companies

March 2007

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Introduction

The substantial growth in the number of companies admitted to AIM in recent years, their increasingly international character and the appearance of larger companies alongside the more traditional smaller capitalisation stocks means that this market is attracting greater interest among institutional investors, including pension funds. Most of these investors take their voting responsibilities seriously and therefore look to organisations such as the NAPF to provide voting guidelines. We also believe that, by encouraging higher standards of corporate governance, AIM companies will be better able to manage their growth and attract a greater institutional investor following, thereby enabling them to raise fresh capital more easily and on potentially more advantageous terms.

The starting point for these Guidelines has, perhaps inevitably and despite the exemption from compliance, been the Combined Code and the NAPF Policy and Guidelines which are based on it.

The boards of AIM companies should be familiar with the Main Principles of the Combined Code and should seek to apply them as appropriate to each company's circumstances.

The Guidelines do not cover every provision of the Combined Code. They are intended to provide guidance to companies and shareholders on those issues which we believe are of key importance and where practice may reasonably differ from the Code.

Part of the success of AIM derives from its appropriate approach to regulation and any corporate governance guidelines need to be drafted with this in mind. However it is also appropriate that a company's governance structure reflects its size and the complexity of its business and we therefore expect companies at the top end of the AIM market capitalisation range to comply with the provisions of the Combined Code (or to explain non-compliance). Likewise, at the other end of the scale, very small companies can best serve their shareholders by concentrating on growing their business and providing good levels of disclosure in their annual report and accounts, without the burden of compliance with inappropriate guidelines. Between these two extremes, we expect companies to apply the highest standards of corporate governance consistent with the size and complexity of their business. As far as practicable, we expect that shareholders will apply these guidelines with a degree of flexibility suitable to each company's individual circumstances.

We have also consulted with the Quoted Companies Alliance, with the object of making our Guidelines consistent with their "Corporate Governance Guidelines for AIM Companies", which is generally accepted as setting appropriate standards for smaller companies. In addition the London Stock Exchange and the Financial Reporting

Council have had sight of drafts of these Guidelines and any comments have been taken into account when preparing this publication.

It is intended that these Guidelines should be reviewed periodically and updated to reflect developing best practice among AIM companies and their investors.

NAPF Investment Council - March 2007

Disclosure Standards

Directors are appointed by shareholders who are the owners of companies and it is therefore important that they report to the owners regularly on the company's performance and the development of its business, and that governance structures are in place to ensure that the company is led by an effective board.

However, it has not been unusual for smaller companies to publish annual reports that provide little, or no, explanation of their governance structure, or remuneration policy and practice. Consequently, it can be very difficult for shareholders to make an informed evaluation of a company's governance.

Companies should seek to apply the disclosure standards set by the Combined Code. However, this may be inappropriate for some smaller companies and therefore as a minimum we expect companies to disclose:

Directors' names, other directorships and brief biographical details (including executive or non-executive status);

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 nomination, audit and remuneration committees (where these committees exist); and

The names of the non-executive directors whom the board determines to be independent, with reasons where necessary.

These requirements are broadly similar to those of the latest AIM Rules. We encourage companies to include them in their annual report, but as a minimum they should refer shareholders to the company website.

NAPF AIM Policy

The **NAPF AIM Policy** expects a company to disclose its corporate governance policies, including biographical details of its directors and details of board committees.

Combined roles of Chairman and Chief Executive

The Combined Code states that companies must provide a clear explanation of the respective roles and responsibilities of the Chairman and Chief Executive. The Main Principle emphasises that no one individual should have unfettered powers of decision, hence the roles of Chairman and CEO should be separated.

The QCA Guidelines state the roles of chairman and chief executive should not be exercised by the same individual or there should be a clear explanation of how other board procedures provide protection from the risks of concentration of power within the company.

The NAPF policy considers that the functions of Chairman and CEO are different. They should be clearly distinguished and not confused or compromised by being combined. However, where this is not the case the Company should provide details of the exceptional circumstances which caused the roles to become combined as well as a forward looking statement explaining its intentions to separate the roles.

NAPF AIM Policy

The **NAPF AIM Policy** does not deviate from the NAPF Policy. However a pragmatic approach is justified if a vote against the director combining these roles might be considered detrimental to the company.

CEO becoming Chairman

The Combined Code states that a CEO should not go on to be Chairman of the same company.

The QCA Guidelines do not address this point.

The NAPF policy supports the Combined Code principle that the CEO should not become Chairman. However should this happen, the Company must disclose in the annual report its reasons for the appointment and describe the selection process.

NAPF AIM Policy

The **NAPF AIM Policy** does not deviate from the NAPF Policy.

Appointment of a Senior Independent Director

The Combined Code states that companies should appoint a recognised senior independent non-executive director, other than the board Chairman.

The QCA Guidelines do not address this point.

The NAPF policy supports the Combined Code principle.

NAPF AIM Policy

The **NAPF AIM Policy** requires the appointment of a Senior Independent Director where a company has a combined Chairman and CEO, to ensure an independent voice on the board who can provide a communication channel for the Company's shareholders if needed. In other circumstances a Senior Independent Director is to be encouraged but is not required.

Balance of the Board

The Combined Code states that a smaller company should have at least two independent non-executive directors on its board.

The Combined Code provisions for board balance, along with committee composition, are the areas where smaller companies have most problems in complying. The make-up of smaller company boards varies considerably. AIM comprises a broad spectrum of companies, some of which are more mature and have an advanced corporate governance framework that includes larger boards and established board committees, whilst other less mature companies may have as few as three directors, typically, a Chairman, CEO and a non-executive director.

In addition to the size of a board, the Combined Code definition of independence presents a further hindrance towards compliance, since some of the criteria may be unachievable for smaller companies.

The QCA Guidelines state that a company should have at least two independent non-executive directors and not be dominated by one person or group of people.

The NAPF policy supports the Combined Code principle and encourages companies to provide a detailed explanation in the event of non-compliance.

NAPF AIM Policy

For larger boards the **NAPF AIM Policy** does not deviate from the NAPF Policy, which requires at least two independent directors, excluding the Chairman.
For smaller boards the **NAPF AIM Policy** requires that boards have at least two independent non-executive directors to comprise not less than one third of the board, one of whom may be the Chairman.

This less stringent requirement is appropriate for AIM companies who have boards comprising of no more than four directors. Such boards might consist of the Chairman, the CEO and, at most, two non-executive directors, of which one should be independent. These provisions safeguard independent representation on the board whilst providing sufficient flexibility for those companies with smaller boards.

Composition of the Audit, Remuneration and Nomination Committees

The Combined Code requires that the Nomination Committee should be made up of a majority of independent non-executive directors.

The QCA Guidelines state that there should be a Nomination Committee which should lead the process for board appointments and make recommendations to the board. The Committee could comprise the whole board.

A majority of members of the 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 Combined Code requires that:

Audit and Remuneration Committees comprise at least two non-executive directors, all of whom are considered independent.

At least one member of the Audit Committee should have 'recent and relevant' financial experience.

The QCA Guidelines are aligned with the Combined Code provision with regard to the composition of the Audit and Remuneration Committees.

NAPF AIM Policy

The **NAPF AIM policy** supports the Combined Code principle. However, it recognises that the lack of independent membership, compounded with the insufficient number of non-executive directors on a board, could make compliance unachievable.

The Audit, Remuneration and Nomination Committees ideally should comprise solely independent non-executive directors. At the least there should be a majority of independent directors on all committees

The Chairman may be a member of the Audit, Remuneration or Nomination Committees (not as Chairman) provided that, other than his chairmanship, he/she fulfils the test of independence, in which case he/she will be viewed as an independent director.

Remuneration Arrangements

NAPF AIM Policy

The **NAPF AIM Policy** does not deviate from the NAPF Policy. Companies should also generally adhere to current best practice guidelines (ABI & NAPF Remuneration Guidelines). A significant component of senior management's remuneration should be linked to performance and there should be disclosure of the performance conditions attaching to any bonuses or long-term incentive plans. Companies are strongly encouraged to put their Remuneration Reports to a vote at the AGM.

Director Independence

The NAPF Policy and the QCA Guidelines encourage all companies to be rigorous in the assessment of independence using the criteria of independence defined in the Combined Code.

However, when applied to AIM companies some of the stated criteria require more flexibility due to the particular circumstances faced by such companies. A significant shareholding, option grants and tenure are among the most common problems faced by AIM companies.

For FTSE All-Share companies, NAPF considers personal shareholdings in excess of one percent of a company's issued share capital to be material and consequently considers that such a shareholding may affect independence.

However, we believe that the threshold should be increased for AIM companies, because they have a smaller share capital and they may pay non-executive directors' fees in shares rather than cash, due to cash flow pressures.

NAPF AIM Policy

The **NAPF AIM Policy** is that independence may be compromised if a director has a beneficial or non-beneficial shareholding of more than three percent of the Company's issued share capital.

NAPF believes that remuneration other than fees paid in cash or shares may compromise independence. This includes participation in the company's share option scheme or a performance-related pay scheme, or membership of a company's pension scheme.

It is most common for smaller AIM companies to have issued options to non-executive directors, either historically upon Initial Public Offering (IPO) or as a one-off grant (due to cash flow constraints).

The **NAPF AIM Policy** excludes historical one-off grants, if the quantum is not considered to be material, from the assessment of independence. However, should this practice become routine or a director actively participates in an option scheme then the director's independence may be judged to have been compromised. Companies can use fully-paid shares as part of the remuneration for non-executive directors.

The **NAPF AIM Policy** is flexible in cases where tenure is between nine and twelve years and tenure is the only factor affecting a director's independence. The board evaluation process and succession planning policy are important when reviewing independence and should be disclosed in the Annual Report.

Pre-emption Rights

NAPF AIM Policy

The **NAPF AIM Policy** is to support the Pre-emption Principles published in 2006 by the Pre-emption Group. Companies should seek annual approval from shareholders for issuance on a non-pre-emptive basis.

However, it is recognised that there will more often be good reasons for waiving pre-emption rights among smaller companies; for example, for reasons of cost, shareholder structure or speed. Companies should, in keeping with the spirit of the principles, consult with leading shareholders in advance, provide them with a full justification for a decision to seek authority to issue stock above the 5% annual limit and should account for its usage in the subsequent Annual Report.

Securing the future of pensions

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