

NATIONAL ASSOCIATION of PENSION FUNDS

Corporate Governance Policy and Voting Guidelines

2008/9 Updates

Ahead of the 2009 AGM season, the revisions to the NAPF Corporate Governance Policy and Voting Guidelines are set out below.

It is recognised that the current crisis has raised questions about the Combined Code (on which the Policy is based) and its application. It is likely that investors will as a result take a less tolerant view of non-compliance with the Code where the explanation is deemed unsatisfactory. The NAPF will, in coming months, consult with its members and with companies on ways in which the NAPF Policy might be amended in order to protect better the interests of long term investors.

Updates

1. Section A - Directors

A.2.4 Combined Chairman/CEO - Investors remain convinced that separation of these roles is important. While they may be willing to accept non-compliance for a short time it will only be where there is an explicit statement setting out the reasons for combining the roles and a clear timetable for their separation.

Voting (new): Investors may consider an actively withheld vote or a vote against the Board Chairman in the event of the role being combined for more than one year.

A.2.6 (new) Continued material non-compliance with the Combined Code, without adequate explanation – Investors consider that the Chairman is ultimately responsible for the maintenance and oversight of a strong governance policy. In the event of continued material non-compliance with the Principles of the Combined Code, he/she should be held accountable by investors.

Voting (new): Investors may consider an actively withheld vote or a vote against the re-election of the Board Chairman

A.3 Non-executive Directors and Independence – Recognising that a strict application of the nine year test is not widely accepted by investors, increased emphasis is to be placed on a concurrency test (under which a NED who has served more than nine years concurrently with an executive director is deemed no longer to be independent) for both **FTSE** and **AIM** companies.

A.3.5 (new) Where a director has served for over nine years concurrently with an executive director, that director should no longer be deemed to be independent. He/she should therefore no longer serve on those committees which should consist solely of independent directors.

Voting – no change.

2. Section B – Remuneration

No changes are proposed to the remuneration policy for 2009. However, following consultation with NAPF members and in the light of the current economic crisis investors can be expected to focus on companies' application of a few principles:

Executive pay policy should be clearly aligned with pay policies in the company as a whole (as recommended by the Combined Code, yet often ignored).

For executive directors:

- Base pay: increases capped at inflation, unless there are sound and compelling reasons for a different approach;
- Bonuses: aligned with profits – thus if profits fall then bonuses also fall; as a corollary, the bonus opportunity should not normally be greater than in 2007/8;
- Share Plans: we expect EPS (but not TSR) performance targets will be reduced, reflecting recessionary conditions, but at the same time it is reasonable to expect the scale of awards to be reduced. Many awards were increased in recent years in exchange for more stretching/higher targets.

3. Section C - Accountability and Audit

C.4 Non-Audit Fees – Investors are concerned about the tendency of companies to use their auditors for non-audit work. While this can on occasion be justified on grounds of cost and relevant expertise, more use should be made of third parties. We therefore propose a non-audit fee cap of 100% of audit, absent an explanation of the exceptional circumstances which apply. A company's clearly defined policy on non-audit work should form part of the Audit Committee's report to shareholders.

Voting (no change): If shareholders have major concerns on auditor and/or non-audit fee issues which are not resolved by the Board or Company to their satisfaction, voting against the re-election of the Chairman of the Audit Committee, or another member of the Audit Committee or, in exceptional circumstances, the reappointment of the Auditor may be appropriate.

4. Section d – Other Resolutions

D.1.3 Borrowing Limits – Current policy states: *Where a company seeks to increase its borrowing powers, a limit should be stated.*

There has been a trend recently towards increasing borrowing limits and on occasion removing them altogether. The latter is unacceptable to most

institutional shareholders in all but the most exceptional circumstances. Where a company seeks a material increase (eg 30%) in borrowing powers this should be accompanied by a detailed explanation setting out the rationale for it and their policy on managing their debt.

Voting (new): Where a material increase in borrowing powers or no limit is proposed, it may be appropriate for investors to vote against the proposed change(s) to the Memorandum & Articles.

D.3.1 - Section 95 Authorities – The NAPF remains a supporter of the pre-emption principle and is concerned about the increasing use of "cash boxes" to circumvent the 5% cap on issuance by way of placing.

However it is proposed to increase threshold to 10% of issued share capital for **AIM** companies only. Most AIM companies seek up to 10% under section 95 of the Companies Act. Due to their small issued share capitals, the normal 5% limit is not a sizeable amount and in most cases not sufficient to be used effectively. While the same arguments may apply to Small Cap Index constituents, exemptions should be sought on a case by case basis.

Voting: Amend **AIM Policy** only

D.5 (new) Rule 9 Waiver – Investors are not for the most part supportive of Rule 9 waivers. Waivers are usually sought where a company proposes to institute a share buy back programme in which a large investor or concert party intends not to participate and institutional investors are naturally concerned about the risk of creeping control. Where a company proposes such a resolution, it is best practice for the large shareholder to refrain from voting in order to avoid a possible conflict of interest.

Voting (new): Normally vote against the resolution proposing a waiver of Rule 9 of the Takeover Code.

Articles of Association – Policy is amended for section 80, 95, share buybacks and political donation to be consistent with the Companies Act 2006, which allows authorities for up to 18 months or next AGM (previously 15 months or next AGM).