

# **Corporate Governance Policy and Voting Guidelines**

**November 2012**

[www.napf.co.uk](http://www.napf.co.uk)

## Contents

Introduction.....	3
Global Corporate Governance Principles.....	5
UK Corporate Governance Principles .....	6
Responsible Investment.....	7
UK Voting Guidelines .....	8
<b>PART 1: Companies .....</b>	<b>9</b>
<b>SECTION A: Leadership .....</b>	<b>9</b>
<b>SECTION B: Effectiveness .....</b>	<b>10</b>
<b>SECTION C: Accountability .....</b>	<b>12</b>
<b>SECTION D: Remuneration.....</b>	<b>13</b>
<b>SECTION E: Relations with shareholders.....</b>	<b>15</b>
<b>Appendix 1: Detailed Voting Guidelines .....</b>	<b>16</b>
<b>SECTION A: Leadership .....</b>	<b>17</b>
A.1: The role of the Board .....	17
A.2: Division of responsibilities .....	17
A.3: The Chairman.....	18
A.4: Non-executive Directors .....	19
<b>SECTION B: Effectiveness .....</b>	<b>20</b>
B.1: The composition of the Board .....	20
B.2: Appointments to the Board .....	22
B.3: Commitment .....	23
B.4: Development .....	23
B.5: Information and support .....	24
B.6: Evaluation .....	24
B.7 Re-election .....	24
<b>SECTION C: Accountability .....</b>	<b>26</b>
C.1: Financial and business reporting .....	26
C.2: Risk management and internal control.....	26
C.3: Audit committee and auditors.....	26
<b>SECTION D: Remuneration.....</b>	<b>29</b>
D.1: The level and components of remuneration .....	29
D.2: Procedure .....	30
<b>SECTION E: Relations with shareholders.....</b>	<b>32</b>
E.1: Dialogue with shareholders .....	32
E.2: Constructive use of the AGM .....	32
<b>SECTION F: Other voting issues.....</b>	<b>34</b>
F.1: Continued material non-compliance with the code without adequate explanation .....	34
F.2: Share issues and purchases.....	34
F.3: Vote withheld (abstain) option / voting disclosure.....	35
F.4: Committee Composition .....	35
F.5: Memorandum and articles.....	36
F.7: Dividends.....	37
F.8: Political donations.....	37
<b>APPENDIX 2: List of relevant websites .....</b>	<b>38</b>

## Introduction

Members of the National Association of Pension Funds (NAPF) have a clear interest in promoting the success of the companies in which they invest. As a consequence of this, the NAPF has long considered that one of its prime functions is to represent these interests on behalf of pension funds and the investment management firms who manage their assets. At the heart of all the NAPF does in representing the interests of its members as shareholders are four key themes:

- The NAPF should assist its members in promoting the success of the companies in which they invest.
- The NAPF should help to ensure that the board and management of these companies are held accountable to shareholders.
- The NAPF's efforts should be directed towards maximising the long-term return of its member assets, irrespective of the potential for short-term discomfort.
- The NAPF's policy and guidelines should reflect current market best practice as determined through consultation with its members and other interested parties.

In the Preface to the revised UK Corporate Governance Code (the Code) published in September 2012, the Financial Reporting Council (FRC) noted that its two principle conclusions remained: "First, that much more attention needed to be paid to following the spirit of the Code as well as its letter. Secondly, that the impact of shareholders in monitoring the Code could and should be enhanced by better interaction between the boards of listed companies and their shareholders."

These conclusions present shareholders with a challenge in two respects: firstly, it is harder for them to assess compliance with "the spirit of the Code" than it is to apply its Principles in a voting policy; and, secondly, "better interaction" requires a greater understanding of both a company's strategy and shareholders' objectives than has often been the case in the past. The NAPF sees the Stewardship Code as an important step along the road to improving dialogue and oversight and expects institutional investors, including pension funds to disclose the extent to which they comply with its Principles. Pension funds and other asset owners can help raise standards of compliance by committing to the Code and incorporating a review of compliance into their periodic manager monitoring.

Our Corporate Governance Policy remains firmly rooted in the provisions of the UK Corporate Governance Code. Where the views of boards and their shareholders differ on matters of corporate governance, it is to be hoped that constructive discussion will follow, albeit that ultimately shareholders will exercise their rights as owners to do what they see as necessary to protect their interests.

There are significant reforms being introduced in the areas of company reporting and executive remuneration. This next 12 months therefore reflect an important period of evolving understanding of what these changes will mean for both companies and investors. The NAPF therefore encourages dialogue between both issuers and their shareholders as they develop their responses to the new requirements.

## **Corporate Governance Policy and Voting Guidelines**

The main purpose of the NAPF Corporate Governance Policy and Voting Guidelines is to assist investors and their proxy voting agents in their interpretation of the provisions of the UK Corporate Governance Code when assessing a company's compliance with it. While it is particularly focussed on what voting sanctions may be applied at a company meeting, a decision to vote against management can only be taken after proper consideration of the company's explanation for non-compliance and in the light of the particular circumstances at that company.

We hope that in addition the Policy will assist companies and their advisers when they set or review governance practices, by providing guidance as to how shareholders may react to policies which may not comply with the letter of the Code but, in the company's view, are consistent with its spirit.

The NAPF Corporate Governance Policy and Voting Guidelines can be found on the NAPF website ([www.napf.co.uk](http://www.napf.co.uk)).

**Martin Mannion**  
**Chairman, NAPF Investment Council**

November 2012

## **Global Corporate Governance Principles**

The NAPF believes the informed use of votes, while not a legal duty, is a responsibility of owners and an implicit fiduciary duty of pension fund trustees and asset managers to whom they may delegate this function. Trustees should periodically review their asset managers' execution of their corporate governance policy and in such a review should consider among other things, engagement activity, the application of voting policy and conflicts of interest. Engagement with companies is seen as a necessary part of responsible ownership. These principles are set out in the Stewardship Code, which was updated by the Financial Reporting Council in September 2012.

The NAPF supports the OECD Corporate Governance Principles ([www.oecd.org](http://www.oecd.org)) and the ICGN Statement on Global Corporate Governance Principles ([www.icgn.org](http://www.icgn.org)), which provide widely accepted standards for corporate governance in many countries. It is recognised that local law and practices do vary and as a result it is not practical to set detailed guidelines covering all markets, however, investors can use these principles as benchmarks by which to judge the companies in which they invest and should use their votes in support of better compliance with them.

The NAPF considers these overarching principles to be a sound foundation for the development of market-specific codes of best practice for investors to adopt and implement as part of their corporate governance programmes.

## UK Corporate Governance Principles

- **The NAPF supports the UK Corporate Governance Code** in its entirety and wishes to add minimal requirements to that body of work.
- **The Code emphasises the importance of applying the spirit of the Code** and of effective engagement with shareholders. Effective engagement begins with good-quality reporting and a willingness to listen to shareholder concerns on the one hand and an appreciation of the company's approach to governance on the other. For shareholders and their agents the challenge lies in interpreting companies' application of the Code and developing the skills and resources required for effective engagement. The common aim should be to raise standards of corporate governance and thus reinforce companies' ability to deliver sustainable performance for their owners.
- **The NAPF and its members will engage with companies** individually and collectively on routine and more serious matters. In addition, the NAPF will facilitate confidential Case Committees for members who have concerns about particular issues and/or about the strategic direction of companies. Equally, companies should take care to ensure their messages are clearly understood by shareholders and the concerns of the shareholders are clearly understood by the board. The roles of the chairman and the senior independent director in these regards are of the greatest importance.
- **The NAPF expects Boards to support the Code** by observing its provisions wherever appropriate. Non-compliance should be accompanied by a clear explanation. Shareholders should not accept "boiler-plate" explanations which provide no insights into the reasons for a board choosing to over-ride the provisions of the Code. Equally, investors should listen to boards that believe it is appropriate not to comply. For that reason the NAPF is a strong supporter of the reforms to company reporting being proposed by the Government. Good corporate governance and its reporting is a matter of principle and nuance, not dogma.
- **Prompt and effective communication of changes** in board structures and responsibilities, and remuneration policies, greatly assists in developing good relations between companies and their shareholders and a better understanding of how their governance policies are applied.
- **Shareholder resolutions** can be good means of drawing attention to shareholder concerns which have not been addressed adequately through engagement or conventional voting activity. A consequence of increasingly engaged shareholders is likely to be greater use of this device.
- **The Nomination Committee** should anticipate change by ensuring the proper planning of succession. This is part of the process of refreshing the board to which reference is made in the Code.
- **The Remuneration Committee** has a particular responsibility to ensure that executive directors and senior management are appropriately rewarded. This can best be achieved by establishing incentives which are harmonised with the stated long-term objectives of the company. There is increasing concern among shareholders about the asymmetry between remuneration and shareholder returns.
- **The Audit Committee** has arguably the most complex and demanding brief of any of the board committees. It is important therefore that it is staffed solely by independent directors and that there is sufficient relevant experience on it to carry out its responsibilities to a high standard. The

NAPF is supportive of the work being done by the FRC to improve reporting standards from and transparency of audit committees.

- **The NAPF supports the principle underlying pre-emption rights** except where a clear case is made for these not being applied in the context of the best interests of all of the owners of the company concerned. For the same reason, protecting the rights of existing shareholders and reinforcing the accountability of management to the company's owners, the NAPF will generally oppose the creation of any "poison pill" provisions.
- **The NAPF strongly supports the Stewardship Code** which sets out important principles for the role of institutional investors in monitoring and improving standards of corporate governance in the UK. Pension funds as well as asset managers are encouraged publicly to state their support for the Stewardship Code.

## Responsible Investment

### Pensions Disclosure

The SRI Pensions Disclosure Regulation 2000 requires "that trustees of occupational pension funds disclose in the Statement of Investment Principles the extent (if at all) to which social, environmental and ethical considerations are taken into account in their investment strategies". Where responsibility has been delegated, pension funds are responsible for monitoring compliance with this Regulation as part of the oversight of their investment managers.

In 2009 the NAPF published guidance on Responsible Investing, which includes social, environmental and ethical issues (SEE). We see a close link between the more established principles of corporate governance and SEE (by both companies and investors) and expect that best practice will develop further in this area especially as pension funds and their investment managers take steps to implement the Principles of the Stewardship Code. The NAPF's recently published Principles for Stewardship Best Practice suggest that pension fund trustees should develop an investment policy which encourages the incorporation of material non-financial risks, including corporate governance factors, within investment decisions.

## UK Voting Guidelines

(Note: for ease of reference, the Guidelines mirror the format of the Code as much as possible)

The general structure of these Guidelines is based around a quotation from the Code, followed by a discussion of the relevant Principle and general voting guidance. Detailed voting guidance in support of the Code's Provisions is set out in Appendix 1.

The voting recommendations assume that investors have evaluated explanations for non-compliance, taken account of a company's individual circumstances and engaged as appropriate. They should in no way be interpreted as being prescriptive.

"Comply or explain" confers a dual responsibility: it is the company's duty to avoid "boiler-plate" explanations, providing instead a thoughtful explanation for areas of non-compliance. Conversely, investors should evaluate explanations, taking care not to adopt a mechanistic approach and should make companies aware of the reasoning behind their votes on contentious issues. An effective "comply or explain" regime must be based on regular and open dialogue between companies and shareholders, which should extend beyond the voting season.

While recognising the importance of engagement, the NAPF also notes that this may not always be practical where an investor's holding is small and time constraints mean that other governance issues may take priority.

Voting decisions should be made in the context of a company's overall governance arrangements and any trends towards (or away from) improved standards.

Certain governance issues would not generally have voting consequences; an accumulation of minor issues, however, may be indicative of poor governance. A holistic approach should be adopted when assessing governance arrangements.

The use of an abstention, only when combined with a clear explanation to the company, may allow an investor to convey a strong signal of concern or dissent with a company's policies.

Shareholders are encouraged to make use of all of the powers at their disposal in order to support the highest standards of governance at the companies in which they invest. These include the re-election of directors, adoption of the annual report and accounts, adoption of the remuneration report and appointment of the auditors, which at present are only rarely challenged. We note the increase in shareholder resolutions in recent years and encourage their use where engagement has failed to bring the changes sought by the shareholders concerned.

Finally, shareholders should balance the "signalling" effect of a voting sanction against the potential for it to exacerbate the situation which they seek to remedy.



## **PART 1: Companies**

### **SECTION A: Leadership**

- A.1. Every company should be headed by an effective board, which is collectively responsible for the long term success of the company.**
- A.2. There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.**
- A.3. The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.**
- A.4. As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.**

#### **Guidance**

The Code sets out the responsibilities of the directors for overseeing the company. The challenge for a board and its chairman is to demonstrate to shareholders the effective application of the Principles. Shareholders will naturally look at financial results as one measure, but will also look for evidence that the chairman and the board as a whole are applying the Code's Principles. There is rightly emphasis given to these Principles and companies and shareholders are encouraged to engage on investment and governance issues alike in order better to understand their application.

Shareholders place particular importance on the separation of the roles of chairman and CEO and on the appointment of a senior independent director (SID).

#### **Voting**

Shareholders are asked to make a voting judgement on the independence of the chairman (on appointment) and the separation of the roles of chairman and chief executive. This includes the appointment of a former executive to the role of chairman. Absent a compelling argument with clear plans for appropriate succession, it is unlikely that they will support a breach of these Principles and can be expected to register their opposition by abstaining on or voting against the re-election of the chairman and/or the SID.

Section A also includes detailed guidance on behaviours and disclosures. Shareholders should expect sufficient disclosure to enable them to judge the extent of compliance with the Code's Provisions. Where disclosure is inadequate, and engagement on the issue is unsuccessful, they may choose to vote against the report and accounts. Evidence of consistently poor performance or governance weaknesses may prompt the tabling of a shareholder resolution.

## **SECTION B: Effectiveness**

- B.1. The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.**
- B.2. There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.**
- B.3. All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.**
- B.4. All directors should receive an induction on joining the board and should regularly update and refresh their skills and knowledge.**
- B.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.**
- B.6. The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.**
- B.7. All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.**

### **Guidance**

Shareholders have a reasonable expectation that boards should be effective in delivering results, over time, which are consistent with the company's stated strategy. Where results are below expectations they should assess the extent to which any shortfall can be attributed to poor management judgements, weaknesses in corporate governance or external factors over which the board has limited control. The annual report should be used to set out the ways in which the board has sought to ensure its effectiveness. The NAPF welcomes the increasing use of the Chairman's statement to set out governance policies.

Of particular concern to shareholders will be the following: independence of non-executive directors; succession and refreshment policies; evaluation; and re-election.

The NAPF sees the nine-year "rule" as a milestone rather than a cut-off. Thereafter directors will be subject to increasing scrutiny as to their effectiveness and independence. Boards are encouraged to set out their succession and refreshment policies in detail when they propose the re-election of a long-serving non-executive director.

Shareholders will look for evidence of implementation of a succession policy. Any statement on succession should also cover its policy on diversity, including gender. The disclosure should set out

clearly the board's approach to succession planning, any changes anticipated in the next year and its diversity objectives and progress towards achieving them, bearing in mind the need to develop the right skills and experience on the board. The NAPF is opposed to diversity quotas but it does expect companies to set targets for gender diversity and to demonstrate progress towards achieving them.

The NAPF views board evaluation as an important tool for all boards. Companies are encouraged to disclose details of the process and as far as possible the outcomes from the evaluation.

Given the recognition of the importance of board effectiveness and the widespread acceptance of annual re-election, the NAPF encourages companies to state more fully the skills and experience which a director brings to his/her role. Such a statement should also include other current appointments which might affect his/her ability to make a full contribution to the work of the board (e.g. an executive role or a potential conflict of interest). In this way shareholders can make a better informed voting decision.

### **Voting**

Where a director fails the independence test, and therefore upsets the balance of the board or its committees, shareholders may vote against the re-election of that director.

Absence of a disclosed succession policy, a policy on diversity or an evaluation process may lead to shareholders abstaining on or opposing the re-election of the chairman of the nominations committee and/or, where appropriate, the chairman of the board.

Shareholders will scrutinise carefully the company's policy on director appointments and may choose to abstain on or vote against the re-election of the chairman of the nominations committee in the absence of a full explanation for non-compliance with the Code, and where engagement on these matters has failed.

## **SECTION C: Accountability**

- C.1. The board should present a balanced and understandable assessment of the company's position and prospects.**
- C.2. The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.**
- C.3. The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.**

### **Guidance**

The disclosures covered in this section provide important support to the Principles set out in the previous sections and should, where relevant, be linked into them.

Shareholders expect the assessment of the company's position and prospects to be balanced, succinct and at the same time cover the key elements of the business, by size and by risk exposures. The report should set out the board's view of the key strategic and operating risks facing the business and how it seeks to manage those risks.

The NAPF supports the appropriate application of the FRC guidance on risk management and internal controls and the role of the audit committee. Shortcomings by companies and their boards in these areas are likely to attract criticism from shareholders and potentially adverse voting decisions.

The NAPF strongly supports the recent revisions to the Corporate Governance Code which encourage enhancing the audit committee report to include an assessment of the effectiveness of the external audit process, the approach taken to the appointment or reappointment of the external auditor, the length of tenure of the current audit firm, when a tender was last conducted and an explanation of how auditor objectivity and independence is safeguarded. In addition the Code provision states that "FTSE 350 companies should put the external audit contract out to tender at least every ten years". This should enable the audit committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms. Shareholders should be informed in advance of the intention to tender the audit contract.

### **Voting**

Poor disclosure of the strategy and risk exposures may lead to a vote against the report and accounts, or the submission of a shareholder resolution.

Where issues relating to audit quality, auditor independence and/or non-audit fees are not resolved to their satisfaction, shareholders may choose to vote 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.

## **SECTION D: Remuneration**

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

**D.2. There should be 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.**

### **Guidance**

The Principles set out above are clear and yet remuneration remains one of the key points of dispute between boards and shareholders. This is often due to the absence of demonstrable links between strategy, performance and pay, coupled to the multi-year trend of executive remuneration rising at a faster rate than pay more generally and, in recent times at least, poor returns to shareholders, as measured by share prices and dividends. Many investors are also concerned that remuneration has become too complex and question its effectiveness in motivating management. NAPF in its engagement with companies is pressing for simpler plans and for executives to be required to hold greater numbers of shares for long periods.

It is incumbent on remuneration committees to demonstrate when both setting and reviewing policy that there is a strong link between pay and performance and that risk is taken into account when establishing performance targets. Committees should acknowledge that from time to time the link may have weakened and should take steps in that event to strengthen it.

The NAPF supports the reforms to remuneration policy being introduced by the Government. Companies which choose to adopt some or all of the new regulations ahead of their formal introduction in October 2013 can expect shareholders to review compliance rigorously but to acknowledge that best practice is still evolving.

In light of the above, the NAPF will continue to press for prudence in executive pay and to oppose the use of peer benchmarking, unless it is applied infrequently (we suggest 3 – 5 yearly intervals) and then only as one part of the committee's assessment of remuneration policy.

## **Corporate Governance Policy and Voting Guidelines**

### **Voting**

Remuneration policy is seen by many investors as a litmus test for wider corporate governance practices. It encompasses board effectiveness, oversight, strategy and risk management for example. Shareholders will therefore continue to examine remuneration policies critically, with a view to ensuring that they are closely aligned with their interests. They are likely to oppose excessive individual pay awards, discretionary bonuses, share plans with weak or inappropriate performance conditions, and policies which fail to take into account the risks arising from the pursuit of aggressive performance targets. Companies should be encouraged to ensure that their remuneration policy is tailored to their specific circumstances.

Voting sanctions will normally focus on the remuneration report and new share scheme proposals, but may from time to time extend to the chairman and members of the remuneration committee. The NAPF Policy will be updated in due course to take account of the new regulations.

## **SECTION E: Relations with shareholders**

- E.1. There should be a dialogue with shareholders based on a mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.**
- E.2. The board should use the AGM to communicate with investors and to encourage their participation.**

### **Guidance**

The NAPF has consistently advocated dialogue between companies and their shareholders and facilitates such dialogue through “Case Committees”. Investor engagement is a cornerstone of effective and responsible ownership.

Shareholders should be clear about their investment objectives when discussing governance and strategy with a company, so the chairman and directors are able better to understand what is expected of them. They should also make it clear to a company where decisions on both investment and voting rest.

The AGM is an important part of the dialogue between a company and its shareholders, regardless of size, as well as being the occasion at which the board is held accountable for its actions during the preceding year. Shareholders should therefore make every effort to register their votes after careful consideration of the resolutions on the agenda.

Companies should publish the results of the meeting as soon as practicable after the meeting. Where a significant number of votes against a resolution has been registered the board should seek to understand the reasons for dissent and to address them as appropriate, and disclose the outcome by way of an RNS announcement.

This section links closely to the Stewardship Code. The Stewardship Code and guidance on its implementation is covered in greater detail both in the NAPF’s publication, *The UK Stewardship Code: Guidance for Investors*, published in November 2010, and the NAPF’s Stewardship Policy, published in November 2012.

### **Voting**

While the absence of effective dialogue is in itself unlikely to result in a voting sanction, it may be symptomatic of other problems. Failure to address the concerns raised by shareholders is likely to lead to their votes being applied to remedy the situation.

## Appendix 1: Detailed Voting Guidelines

### Introduction

In this section we have not repeated the detailed provisions of the Corporate Governance Code, but have sought, under the same headings as the Code, to identify those issues which will be of particular relevance to shareholders when assessing a company's compliance with the Code and deciding what voting sanction, if any, to apply.

A significant number of the Code's provisions relate to disclosure of information about the board or its governance practices, without which it can be very difficult to arrive at an informed opinion about the quality of its compliance. Poor levels of disclosure are likely to lead investors to take a less sympathetic view of explanations of non-compliance.



## **SECTION A: Leadership**

### **A.1: The role of the Board**

#### **Provisions: Decision-making / membership / committees / meetings / insurance**

##### **Discussion**

- A.1.1. The disclosures covered by these provisions are fundamental to understanding a company's governance model. Shareholders will look to the corporate governance statement for evidence of effective application of them. In setting out details of the board members, a company should state the relevant skills and experience which each director brings to the board.
- A.1.2. Where a director has been unable to attend a number of board or committee meetings, both scheduled and ad hoc, an explanation should be provided in the annual report. Low attendance rates, unaccompanied by a suitable explanation, may be a factor when shareholders consider the re-election of directors.
- A.1.3. Directors' contracts should be made available for shareholder inspection online.

##### **Voting**

- A.1.4. In the absence of suitably detailed disclosures, and only after engagement, shareholders may choose to vote against the adoption of the report and accounts. A vote against a member of the board because of poor disclosure is unlikely, and a shareholder resolution would be submitted in only the most extreme circumstances.
- A.1.5. Where a trend of low attendance at meetings has been identified, in the absence of a sufficient explanation and perhaps over the space of more than one year, voting against the re-election of the non-executive concerned may be an appropriate sanction.

### **A.2: Division of responsibilities**

#### **Provision: Joint chairman / chief executive**

##### **Discussion**

- A.2.1. Separation of these roles is a cornerstone of good governance in the UK, enshrined in the Code and propounded for many years by the NAPF. The contravention of this tenet, by (a) the combination of the roles; or (b) the designation of an executive chairman would cause significant concern.
- A.2.2. The temporary combination of the roles may be justified, notably when a chairman "bridges the gap" between the departure of a CEO and the appointment of his/her successor.

## Corporate Governance Policy and Voting Guidelines

### Voting

- A.2.3. Investors may consider actively abstaining or voting against the board chairman in the event of the role being combined for more than one year or where there is evidence of poor succession planning.

### A.3: The Chairman

#### Provision: Independence

#### Discussion

- A.3.1. If a new chairman has been appointed or a successor to the current chairman has been announced/proposed, the board should provide shareholders with confirmation in the annual report that the past/retiring chairman was not involved in the selection or appointment of his/her successor.
- A.3.2. If the chairman is not independent on appointment, the company should consult its investors and provide a detailed explanation as to why it considers the appointment desirable. Investors will wish to approach each case on its individual merits.
- A.3.3. The calibre of the individual, the balance of the board, and the nature of the impediment to the proposed chairman's independence may all be factors in investors' deliberations.
- A.3.4. The succession of the CEO to chairman is a significant issue, acceptable only on rare occasions. The company should enter into early dialogue with its investors and provide an explanation for the proposed succession. Investors would expect confirmation that external search consultants had been engaged and that external candidates of at least equivalent stature had been considered.
- A.3.5. The complexity of the business is an insufficiently persuasive argument *ipso facto* to justify this type of succession. Given the issues posed by a former CEO assuming chairmanship of the board, it is important for shareholder approval to be sought at the AGM coinciding with or following his/her appointment.
- A.3.6. The NAPF appreciates that voting against the election of a chairman is a decision with broader implications. However, this must be balanced against the requirement for a chairman to have sufficient time to fulfil his/her responsibilities and to be independent on appointment. These are issues which call for extensive dialogue between companies and their owners.

### Voting

- A.3.7. In the above cases, investors may consider an active abstention or a vote against the re-election of the chairman of the nomination committee or, in exceptional circumstances, a vote against the proposed board chairman.

#### **A.4: Non-executive Directors**

**Provisions: Senior independent director / meetings without executives / assessment of chairman / recording concerns**

##### **Discussion**

A.4.1. The Code provides important clarification to the role of the non-executive directors (NEDs), particularly the SID. Shareholders will look for evidence of compliance with its spirit as well as its letter, while recognising that many of the issues covered are of a confidential nature and therefore difficult to disclose in detail.

##### **Voting**

A.4.2. Where no SID has been identified, an appropriate voting sanction, taking account of the company's circumstances, may be to vote against the re-election of the chairman of the nomination committee. Where the chairman or the individual designated as the SID is not deemed independent, voting against his/her re-election may be appropriate.

## SECTION B: Effectiveness

### B.1: The composition of the Board

#### Provision: Director Independence

##### Discussion

- B.1.1. The issue of director independence calls for a particularly thoughtful application of the “comply or explain” principle. The onus is on the company to provide a detailed and considered explanation as to why it considers a director to remain independent despite the existence of one (or more) of the seven factors listed in the Code.
- B.1.2. Some of the more complex impediments to independence are discussed below.
- B.1.3. **Length of tenure** is an aspect of the Code that has triggered much discussion. The NAPF appreciates that nine years is a milestone, rather than a fixed date after which independence is entirely lost, and before which it is entirely present. A pragmatic approach from companies and investors is therefore required.
- B.1.4. As an over-riding principle, the NAPF does not dismiss the possibility that a long serving non-executive director can remain independent. However, independence is likely to diminish with time and the company has a responsibility for explaining why a long-serving non-executive director remains independent.
- B.1.5. Just as the company has a responsibility to consider independence carefully in these circumstances, equally shareholders will wish to assess the company’s explanation and may take account of some or all of the following factors:
- General board refreshment and succession planning. This is perhaps the most important consideration.
  - Overall corporate governance standards and history and wider independence on the board.
  - Evidence of independence in the director’s conduct.
  - Confirmation that independence (as distinct from performance) was evaluated.
  - The length of service of the executives is also a factor. In general, concurrent tenure of an NED with an executive director for over nine years should lead shareholders to question the NED’s independence.
- B.1.6. **Cross-directorships** may create links between directors which are of potential concern to shareholders. They occur when two or more directors of the company are also directors of another company or a company in the same group (which includes holding, subsidiary companies and joint venture companies).

- B.1.7. Independence is compromised where a directly reciprocal cross-directorship is involved or created. This happens when a non-executive director of 'company A' is also an executive director of 'company B' where an executive director of 'company A' sits on the board as non-executive director.
- B.1.8. In these circumstances it is unlikely that investors will regard the non-executive director of 'company A' as independent. The chairman of the board should look to resolve these concerns through discussion with the directors involved in the cross-directorship and appropriate action being taken. The fact of such cross directorships should also be disclosed and explained.
- B.1.9. Cross-directorships which are not directly reciprocal are less likely to raise concerns of independence but should be reviewed by investors in the light of each specific set of circumstances.
- B.1.10. **Links to a significant shareholder** present particular issues. Under UK company law, directors and the board are responsible to shareholders as a body and not to any specific shareholder.
- B.1.11. In the situation where an individual director has been appointed to the board as the representative of or through the contractual board rights of a significant shareholder, other shareholders may have concerns in the following areas:
- Whether a director who consistently faces conflicts of interest or represents the interests of one shareholder should remain on the board – irrespective of whether or not designated by the board as an independent non-executive director. This is an issue for the chairman and other directors to address.
  - Whether the director was appointed through 'a formal, rigorous and transparent procedure' as required by the Code. Board appointments which are effectively controlled by, or in the gift of, or subject to the approval of a third party are unlikely to meet the requirements of a rigorous and transparent process.
  - How conflicts of interest are dealt with by the board. The NAPF considers that a non-executive director 'represents' a significant shareholder if he/she is:
    - An employee of a shareholder or remunerated by a shareholder (e.g. directly or indirectly, for example through receiving consultancy income from the shareholder).
    - Appointed to the board as a contractual right of the shareholder – for example at the time of a financing or as a result of a partial merger, acquisition or joint venture.
- B.1.12. If such individuals are appointed to the board, it is preferable that the nomination committee, board and shareholders are consistent in the treatment of the director as being non-independent.
- B.1.13. In addition a director may be nominated for election by a significant dissident shareholder, which presents different independence issues. In such a case, the onus is on the nominee to demonstrate his/her independence which should be based on the independence criteria

## **Corporate Governance Policy and Voting Guidelines**

applying in the UK, as set out above with particular attention to the assessment of the links between the nominee and the dissident.

- B.1.14. Where the presence of one (or more) non-independent non-executive directors impairs board balance, the role of such non-executive directors should be clarified. The company should justify why it believes the independent element is sufficiently strong to counter the imbalance and why the continued presence of the non-independent non-executive director is in the interests of the company and its shareholders.
- B.1.15. It may be advisable for the company to appoint additional independent non-executive directors, although this should be evaluated by investors on a case-by-case basis.
- B.1.16. Where there is insufficient independent representation, investors will require a detailed explanation as to why the company's exceptional circumstances justify the situation. Ideally a timetable for compliance should be provided.

### **Voting**

- B.1.17. There can be no objection in principle to non-independent directors sitting on the board. Voting sanctions against a non-independent non-executive director would normally be warranted only where the composition of the key committees or the balance of the board was compromised.
- B.1.18. If a dissident nominee is deemed non-independent and his/her election would result in the balance of the board or its committees being inconsistent with the provisions of the Code, shareholders will normally vote against his/her election.
- B.1.19. 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.
- B.1.20. Investors may consider voting against the chairman (or a member) of the nomination committee, whose role it is to ensure that the board is properly constituted.

## **B.2: Appointments to the Board**

### **Provisions: Nomination Committee role / balance of skills / re-election / reporting**

#### **Discussion**

- B.2.1. Shareholders will expect the nomination committee to demonstrate that it has applied the provisions of the Code particularly in respect of developing a succession and appointment policy, ensuring the right balance of skills and experience on the board and supporting the re-election of directors. This last point is especially important in the case of those directors who have served more than nine years on the board and shareholders will expect appropriate levels of disclosure.

B.2.2. Shareholders will expect companies to explain what steps they are taking to bring diversity to their boardroom, particularly gender diversity. This section should include a description of the board's policy on diversity – including professional, international and especially gender diversity - any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.

B.2.3. Shareholders recognise the confidential or sensitive nature of some succession planning issues which may make disclosure more difficult.

#### **Voting**

B.2.4. If disclosure is poor or there is an evident lack of succession planning, including due consideration of diversity and the balance of skills on the board, investors may wish to consider abstaining, or voting against the re-election of the chairman of the nomination committee, whose responsibility it is or in extreme cases the chairman of the board.

B.2.5. Where there is no statement on a company's diversity policy and its application, shareholders may choose to vote against the election of a director or in an extreme case the chairman.

### **B.3: Commitment**

#### **Provisions: chairman and directors' job specifications / time commitment required**

#### **Discussion**

B.3.1. It is important that shareholders have access online to the terms and conditions on which directors are appointed and that due consideration has been given by the board and each director to the time commitment required, particularly in the event of a crisis developing.

#### **Voting**

B.3.2. In the event of poor disclosure, shareholders may wish to vote against the adoption of the report and accounts or, in extreme circumstances, vote against the re-election of the chairman, or submit a shareholder resolution.

### **B.4: Development**

#### **Provisions: induction / training**

#### **Discussion**

B.4.1. Shareholders will expect disclosure of how a company has chosen to comply with these provisions, including meetings with major shareholders.

#### **Voting**

B.4.2. Where engagement has failed to result in better disclosure, shareholders may wish to vote against the adoption of the report and accounts.

## **Corporate Governance Policy and Voting Guidelines**

### **B.5: Information and support**

#### **Provisions: directors' access to advice / committee resources / role of the company secretary**

##### **Discussion**

B.5.1. Shareholders will expect disclosure of how a company has chosen to comply with these provisions.

##### **Voting**

B.5.2. Where engagement has failed to result in better disclosure, shareholders may wish to vote against the adoption of the report and accounts.

### **B.6: Evaluation**

#### **Provisions: board and committee evaluation / external facilitation / evaluation of the chairman**

##### **Discussion**

B.6.1. An effective evaluation process, utilising as appropriate an external facilitator, is seen by shareholders as an important part of a company's governance processes. Companies are expected to provide details of the approach adopted and broad conclusions reached from the evaluation in their annual report.

B.6.2. At a minimum, the board should seek to provide the following details:

- What was specifically reviewed (including rationale behind this decision);
- Who conducted the evaluation, and whether they were internal or external appointments (including rationale behind their selection);
- The nature of the process;
- The key findings and lessons learned; and
- Any follow up required, and by whom.

##### **Voting**

B.6.3. Where engagement has failed to result in better disclosure, shareholders may wish to vote against the adoption of the report and accounts.

### **B.7 Re-election**

#### **Provisions: annual elections of directors / biographical details / board's rationale for election**

##### **Discussion**

B.7.1. The NAPF accepts that annual elections for all directors leads to better accountability and supports this provision of the Code. In the instance where a company chooses not to comply with the Code, the policy on director elections should be clearly explained in the context of shareholders' interests.



- B.7.2. Sufficient biographical details should comprise a statement of a director's other directorships and responsibilities (including any relevant previous positions held) and the contribution that the director can make to the board.
- B.7.3. In all cases, the board should explain to shareholders why it believes that the director should be re-elected and confirm that the director has recently been subject to formal performance evaluation and continues to be an effective member of the board.
- B.7.4. When the director is an independent non-executive proposed for re-election beyond nine years, a particularly rigorous review and evaluation process is to be expected.
- B.7.5. Boards and shareholders should consider the history of a director when contemplating support for his/her re-election. Particular care is required where a director has had significant involvement, whether as an executive director or non-executive director, in material failures of governance, stewardship or fiduciary responsibilities at a company. Shareholders rely heavily on the board's recommendation and directors should ensure that re-election proposals take into account not just the individual's performance on the board in question but also any external factors which may be relevant to that judgement.

#### **Voting**

- B.7.6. Shareholders may choose to vote against the re-election of a director in the absence of a supporting statement from the board or where there is clear evidence of poor performance by the individual or the company.
- B.7.7. There is no recommended voting sanction for companies who do not subscribe to annual re-elections of directors. Where a company does not undertake annual re-elections, investors should expect a thorough explanation as to the rationale behind this decision.
- B.7.8. Over time, a failure to move to annual director elections, especially where unsupported by an acceptable explanation, may lead to an abstention on the vote to re-elect the chairman and/or chairman of the nomination committee, particularly where there are concerns that the absence of annual elections may not, in the company's specific circumstances, be in the interest of shareholders.

## **SECTION C: Accountability**

### **C.1: Financial and business reporting**

**Provisions: annual report / business model / going concern**

#### **Discussion**

C.1.1. Shareholders will expect disclosure of how a company has chosen to comply with these provisions and the relevant Guidance from the FRC.

#### **Voting**

C.1.2. Where engagement has failed to result in better disclosure, shareholders may wish to vote against the adoption of the report and accounts.

### **C.2: Risk management and internal control**

**Provision: annual review of risk management and internal controls**

#### **Discussion**

C.2.1. The provision has been modified to give increased prominence to risk management, which should lead to a fuller report to shareholders and in particular greater focus on risk in the context of the business strategy. Companies are encouraged to consider the broader strategic risks facing the business and to comment on those in the annual report.

#### **Voting**

C.2.2. Where engagement has failed to result in better disclosure, shareholders may wish to vote against the adoption of the report and accounts.

### **C.3: Audit committee and auditors**

**Provisions: audit committee / role and responsibilities / reporting to shareholders / whistleblowing / internal audit review / appointment of auditors / non-audit services**

#### **Discussion**

C.3.1. As can be seen from the provisions above the audit committee has a key role to play in oversight of the company and its executives, it is therefore important that its structure is consistent with the Code in every respect. Its report to shareholders should explain how it has complied with the provisions of the Code and the accompanying Guidance as appropriate including the significant issues the committee considered in relation to the financial statements, and how these issues were addressed and an assessment of the effectiveness and independence of the external auditor.

C.3.2. The appointment of external auditors is a separate issue to the setting of the auditor's remuneration. This is principally because shareholders may have concerns about the balance

between audit and non-audit fees which need to be considered separately, or substantially so, to the appointment of the auditor alone. Therefore separate resolutions should cover the appointment of auditors and the setting of (or the authorising of the board to set) auditors' fees.

- C.3.3. Investors believe that auditor independence is crucial to audit quality. The NAPF supports the Code provision requiring FTSE 350 companies to submit the audit function to tender at least every ten years and clearly disclose their policy on this matter, including when the audit was last subject to tender. The NAPF encourages improved disclosure on the auditor re-selection decision and the disclosure of any contractual obligations to appoint audit firms, in the interests of making the criteria used for auditor selection and evaluation as explicit as possible.
- C.3.4. Any change of auditors should be explained to shareholders.
- C.3.5. Where the auditors have resigned, the resignation letter should be posted on the company's website.
- C.3.6. Where the auditors also supply a substantial volume of non-audit services to the company, the audit committee should keep the nature and extent of such services under regular and close review, seeking to balance the maintenance of objectivity and independence with value for money. In addition, in the annual report there should be full disclosure of the value of any non-audit fees. There should be a clear break-down between the types of services received, with tax compliance services differentiated from tax advisory services and non-statutory acquisition-related services separated from statutory services.
- C.3.7. 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 any exceptional circumstances which may apply. A company's clearly defined policy on non-audit work should form part of the audit committee's report to shareholders.
- C.3.8. If non-audit fees comprise more than 20% of the audit fees disclosed in the annual report, investors expect to see an analysis of the principal areas of non-audit fees.

#### **Voting**

- C.3.9. Voting sanctions may be required when a breakdown of non-audit fees is not provided (where they comprise more than 20% of the audit fee) or where there is not an adequate explanation in the annual report of how auditor objectivity and independence is safeguarded.
- C.3.10. If shareholders have major concerns regarding the auditor and/or non-audit fee issues which are not resolved by the board or company to their satisfaction, voting against the re-election

## Corporate Governance Policy and Voting Guidelines

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.

### **Auditor Liability**

C.3.11. The Companies Act 2006 permits, subject to the approval of shareholders, agreements to limit the liability of statutory auditors - though the liability can never be reduced below what a court deems as fair and reasonable in all the circumstances. The NAPF welcomes the guidance issued by the FRC on such auditor liability limitation agreements. In response to this, in June 2008 the Institutional Shareholders Committee issued a statement on these agreements and how companies are most likely to win the support of their shareholders.

C.3.12. The NAPF and most institutional shareholders support proportional liability, whereby each party is liable for a portion of the loss commensurate with their responsibility for it, in the expectation that this will lead to improved audit quality. There is a generally shared view that agreements which include an element of a fixed cap - however calculated - are not appropriate. There is no compulsion to agree any limitation of liability and company directors will need to be conscious of their fiduciary duties when entering into any such agreement; in order to agree any proposal, shareholders will require evidence of how the liability limitation is associated with improvements in audit quality.

### **Voting**

C.3.13. Investors should consider voting against any resolution which proposes a form of auditor liability limitation which includes a form of fixed cap or which leads in any other way to liability which is not proportional. In order to give their support, they will need disclosure of how any liability limitation is in the interests of the company and will lead to improved audit quality; certainly any form of proposed limitation which is not proportionate will need some company-specific justification and an explanation of why the directors feel that the agreement would survive the court's judgement of what is fair and reasonable.

## SECTION D: Remuneration

### D.1: The level and components of remuneration

#### Provisions: performance-related pay / NED pay / early termination / notice periods

#### Discussion

D.1.1. The NAPF policy is that in general, for executive directors:

- **Base pay** increases should be capped at inflation and should be in line with the rest of the workforce, unless there are sound and compelling reasons for a different approach;
- **Bonuses** should be aligned with profits available for distribution;
- **Share awards**, should be reduced when lower performance targets are set which make the target easier to reach;
- **Remuneration structures** should be simplified to offer improved line of sight to both executives and shareholders;
- Executives should be required to hold significant numbers of **shares for the longer term**;
- Remuneration Committees should be prepared to use **discretion** when finalising bonus payments and share award vesting to ensure that rewards are aligned with the success of the business over time.

D.1.2. The NAPF expects companies to tailor remuneration policies to their specific circumstances and not to rely solely on advice from consultants or the application of the ABI Principles or other guides to best practice. While these can be helpful the Committee must own the policy and be able and willing to justify it to executives and shareholders alike. Shareholders should judge the suitability of the policy based on a clear understanding of how it is linked to the long-term success of the enterprise.

D.1.3. Just as the remuneration committee should adopt a holistic approach when designing and assessing packages, so investors should evaluate remuneration arrangements in their entirety. As noted earlier in this Policy (Page 14) shareholders will seek reassurance that there is a clear link between strategy, performance and reward. Total remuneration should be structured to reflect the ambitions and risks inherent in the business. Performance pay should motivate management to deliver results which are both stretching and sustainable.

D.1.4. Remuneration practices which would most likely cause concern and may trigger a voting sanction in the absence of sufficient explanation include:

- Increases in base salary in excess of inflation;
- Over frequent re-benchmarking (we suggest 3 – 5 year intervals);
- Insufficiently demanding performance targets;
- Guaranteed, pensionable or discretionary annual bonuses;

## Corporate Governance Policy and Voting Guidelines

- Insufficient disclosure on the scope of annual bonuses and performance conditions (retrospective disclosure can be acceptable);
- Any provision for re-testing of performance conditions;
- Ex-gratia and other non-contractual payments;
- Change in control provisions triggering earlier and/or larger payments and rewards;
- The absence of service contracts for executive directors;
- Unwarranted use of discretion.

D.1.5. The NAPF, jointly with the ABI, has published guidance on termination payments which is designed to eliminate 'payments for failure'.

D.1.6. The NAPF, jointly with the LAPFF, has published a paper highlighting the importance of the disclosure of pension arrangements for executives.

D.1.7. The checklist in D.1.4 and the issues in D.1.5 and D.1.6 are not exhaustive, particularly as good practice in this area continues to evolve.

D.1.8. Executive pay policy should be clearly aligned with pay policies in the company as a whole.

### Voting

D.1.9. Most individual elements of remuneration policy are likely to be insufficient to trigger a voting sanction in isolation, but might warrant such a measure when coupled with other deviations from good practice. It is also important for investors to be aware of recurring trends in remuneration (for example, a basic salary increase in excess of inflation in a particular year may not cause excessive concern whereas a trend of such increases might well).

D.1.10. The resolution on the remuneration report is generally an appropriate channel for registering concern at a company's remuneration practices.

D.1.11. However, where severe or persistent infringements of good practice have been identified, or there is evidence from the remuneration arrangements of a policy generally unaligned with shareholders' interests, a vote against the re-election of the chairman (or members) of the remuneration committee may also be appropriate.

## D.2: Procedure

### Provisions: Composition of committee / role and responsibilities / role of the board / shareholder approval of long-term incentive schemes

#### Discussion

D.2.1. The remuneration committee is responsible for the formulation and implementation of executive remuneration packages. While remuneration consultants may act as advisers, they

should not involve themselves in the decision-making process, which is the responsibility of the committee members and/or the board.

D.2.2. The remuneration Report should describe:

- The key parameters and structure of the remuneration policy set by the committee;
- How this has been applied to the remuneration and incentive arrangements for the executive directors and other senior executives falling within the committee's responsibilities, including: (a) the cost to the company and (b) the potential end-value to each participant of the company's remuneration schemes (assuming minimum and maximum vesting levels).

D.2.3. **Consultants to the Remuneration Committee** should be appointed by the committee and be independent of the company's management. Potential conflicts of interest should be scrupulously and demonstrably addressed.

D.2.4. The remuneration committee is exclusively responsible for the selection and appointment of its advisors.

D.2.5. The remuneration committee is encouraged to disclose whether the Remuneration Consultants Group's 'Code of Conduct' has been taken into consideration when selecting its consultants.

D.2.6. Companies are encouraged to consider submitting the remuneration consultant function to periodic tender and disclose their policy on this matter, including when the consultant was last subject to tender.

D.2.7. If any services are provided by the same remuneration consultants to the company:

- They should be fully disclosed to the remuneration committee and to shareholders.
- The chairman of the remuneration committee should explain to shareholders why it is appropriate for the committee to appoint the same consultants as the company, notwithstanding this conflict of interest.

#### **Voting**

D.2.8. Consistently poor disclosure of the procedures set out in the Code may result in a vote against the re-election of the committee chairman and/or against the remuneration report.

D.2.9. Companies are encouraged to tailor their long-term incentive schemes to their particular circumstances and to explain those circumstances when seeking approval for a new or amended scheme. While shareholders should be supportive of innovative schemes they will seek assurance that the incentives are aligned with their own interests and may vote against schemes where alignment is seen as poor.

## SECTION E: Relations with shareholders

### E.1: Dialogue with shareholders

#### Provisions: communications with shareholders / informing the board

##### Discussion

E.1.1. Given the growing diversity of the shareholder base at many companies, communications with shareholders are both more difficult and more complex. The NAPF believes that boards could usefully spend more time understanding the objectives of their larger shareholders. Evidence of an effective approach to communicating with key shareholders is a demonstration of good governance practices at the company.

##### Voting

E.1.2. While poor communications are of themselves unlikely to result in a voting sanction, they may be seen as evidence of weak governance and when taken with other factors may result in a vote against the re-election of the chairman or members of the board.

### E.2: Constructive use of the AGM

#### Provisions: agenda / proxies / director attendance / notice

##### Discussion

E.2.1. The ability of companies to hold meetings at short notice is important and commercially desirable in certain circumstances. Without wishing to advocate that companies should exceed 21 days notice, we do expect that companies will give as much notice as is practicable when calling a general meeting.

E.2.2. Therefore, the flexibility afforded by the Shareholder Rights Directive to call a meeting at 14 days' notice should only be used in limited circumstances. The shorter notice period should not be used as a matter of routine for such meetings, but only where the flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole.

E.2.3. If the proposals at a given meeting are not time-sensitive, they should not normally use the shorter notice period.

E.2.4. Companies are encouraged to outline the circumstances in which a short-notice meeting may be called when tabling the enabling resolution.

##### Voting

E.2.5. In normal circumstances, these are not issues which will merit a voting sanction, as these issues are more likely to be taken up during direct engagement with the board of directors.



E.2.6. However, shareholders may wish to vote against resolutions tabled at a short-notice meeting where the use of the shorter notice period has not been adequately justified by the company or the proposals are of such complexity that shareholders require more time to consider their voting decision.

## SECTION F: Other voting issues

Several voting issues are not covered by the above Guidelines and merit separate mention. As stated earlier the NAPF does not seek to embellish the Code in any way but to ensure there is clarity around how shareholders may exercise their responsibilities as owners.

### F.1: Continued material non-compliance with the code without adequate explanation

#### Discussion

F.1.1. 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 Code, he/she should be held accountable by investors.

#### Voting

F.1.2. Investors may consider an actively withheld vote or a vote against the re-election of the board chairman.

### F.2: Share issues and purchases

#### Shareholder approval required for issue of new shares

#### Discussion

F.2.1. In accordance with company law, companies must secure shareholder approval to be able to issue new shares. Resolutions allowing the company to issue new shares are normally of two types known as 'Section 551' and 'Section 570' Authorities.

F.2.2. **Sections 551 and 561 Authorities** allow companies to issue new shares. The accepted limit to this authority is normally one-third of the company's issued share capital at the time the authority is approved. If issued to this maximum, the new shares would be equivalent to 25% of the enlarged issued share capital. Under the Principles of the Pre-Emption Group and frequently also under companies' own Articles, these shares would normally have to be first offered to existing shareholders.

F.2.3. **Section 570 Authorities** allow companies to issue shares for cash without the application of pre-emption rights. The maximum allowed under the Pre-Emption Principles is equivalent to 5% of the issued share capital at the time of the Authority. A multi-year limit also applies, typically a maximum of 7.5% of shares to be issued over three years without the application of pre-emption rights. The Principles do support flexibility in their application and, while the onus is on companies to make the case, investors "should review that case on its merits and decide on each individually, using the usual investment criteria".

F.2.4. When presenting such resolutions:

1. Section 551 and Section 570 Authorities should be separated into two resolutions; and
2. Section 551 and Section 570 Authorities should be renewed annually.

### **Voting**

F.2.5. Where Section 551 and 570 Resolutions which (a) are bundled together, or with any other voting issue (b) are not consistent with Pre-Emption Principles without a satisfactory explanation and (c) grant Authorities for more than one year, an adverse vote would usually be appropriate.

### **Application of Pre-emption Group guidelines**

F.2.6. The NAPF supports the issue of shares provided, where there is a proposed disapplication of pre-emption rights, the issuer has applied the Pre-emption Group's Principles.

F.2.7. (The Pre-Emption Group comprises listed companies, investors and intermediaries. It monitors the development of practice in this area, agrees to any revisions to the Principles, and examines whether the relevant processes could operate more efficiently. The Statement of Principles can be found on the Group's website: <http://www.pre-emptiongroup.org.uk>.)

### **Voting**

F.2.8. If the proposed issue exceeds guidelines, investors may consider voting against the issue.

## **F.3: Vote withheld (abstain) option / voting disclosure**

### **Discussion**

F.3.1. Investors may wish to register reservations on an issue without having to vote against a resolution. Companies should facilitate this by including an abstain option on proxy cards.

F.3.2. Companies should disclose on the website the voting outcome on each resolution, including the breakdown of votes in favour, against, and withheld.

## **F.4: Committee Composition**

### **Discussion**

F.4.1. The Code stipulates rules around the composition of the audit, remuneration and nomination committees. This includes the size of committees; the extent to which non-independent directors should be involved in committees; the failure to establish committees; the role of the board chairman; committee refreshment; and the terms of reference of the committees. The NAPF Guidelines reflect those of the Code.

### **Voting**

F.4.2. Where committee composition is not in accordance with the Code's Provisions, shareholders may choose to vote in such a way as to improve the company's compliance with the Code.

### F.5: Memorandum and articles

#### Discussion

F.5.1. Any changes proposed to the company's Memorandum & Articles should be explained. In addition, boards should regularly review the company's Memorandum and Articles, consult with major shareholders on material amendments and make the Memorandum and Articles readily available.

#### Voting

F.5.2. Investors will normally wish to support changes to the company's Memorandum and Articles, provided that it is clearly demonstrated by the board that any changes will not detract from shareholder value or materially reduce shareholder rights.

#### Non-routine changes to Memorandum & Articles not to be bundled

F.5.3. Changes to the company's Memorandum and Articles should not be 'bundled' into a single resolution when they cover non-routine matters.

#### Voting

F.5.4. Shareholders may consider voting against changes to the Memorandum and Articles if non-routine changes are included in the same resolution.

#### Borrowing limits

F.5.5. Where a company seeks to increase its borrowing powers, a limit should be stated.

#### Voting

F.5.6. 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 and Articles.

### F.6: Conflicts of Interest

#### Discussion

F.6.1. The Companies Act 2006 includes four separate sections relating to conflicts of interest and their disclosure. These differentiate between interests in transactions and arrangements with the company, which must be disclosed but need not be approved and all other conflicts, which will require approval.

F.6.2. In the second instance, the Act creates a duty to avoid a situation where a director has an interest which may conflict with the company's interests, which would apply to the exploitation of any property, information and opportunity.

F.6.3. These provisions have implications for directors with multiple board appointments. Consideration of this issue will be required where a new director is appointed or an existing director wishes to assume a new directorship.

### **Indemnification**

F.6.4. Where a company seeks to provide for director indemnification in the Memorandum and Articles, auditor indemnification should be explicitly excluded.

### **Dispute Resolution**

F.6.5. The introduction or maintenance of a provision in the company's Articles of Association which prescribes arbitration as the sole mode for settlement of all or a significant class of disputes between shareholders (whether acting in their own right or on in the name of the company, as applicable) and any one or more of the company, its directors, executive management, or its professional advisors, should be viewed in the first instance as a material reduction in shareholder rights.

## **F.7: Dividends**

### **Shareholder approval for final dividend**

F.7.1. If shareholder approval is not sought for the approval of the final dividend, investors may wish to consider submitting a shareholder resolution or voting against the company's report and accounts, except where companies can demonstrate that changing their practice to seek shareholder approval of the dividend would significantly delay payment, to the material disadvantage of shareholders.

### **Cash alternative when scrip dividend proposed**

F.7.2. There should always be a cash dividend available as an option to a scrip dividend or other equivalent paper. If such an option is not available, shareholders may wish to vote against approval of the dividend.

## **F.8: Political donations**

### **Discussion**

F.8.1. The NAPF opposes the payment of bona fide political donations. Under EU legislation, the term could potentially encompass donations to charities or educational causes. It is therefore common for authorities to be sought on a precautionary basis.

F.8.2. Where authority is sought, it should be specified that:

- Bona fide political donations are precluded
- A cap is set on the level of donations

F.8.3. It is acceptable to seek authority for a four-year period where the company has no history of making bona fide political donations. However, where the authority sought exceeds one year, the company should clarify that separate authorisation will be sought at the following AGM should the authorisation be utilised.

## APPENDIX 2: List of relevant websites

**The UK Corporate Governance Code:**

[www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx](http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx)

**The UK Stewardship Code:**

[www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx](http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx)

**OECD Principles:**

[www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm](http://www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm)

**ICGN Principles:**

[www.icgn.org/best-practice](http://www.icgn.org/best-practice)

**ABI Remuneration Principles:**

[www.ivis.co.uk/Guidelines.aspx](http://www.ivis.co.uk/Guidelines.aspx)

**United Nations Principles for Responsible Investment:**

[www.unpri.org](http://www.unpri.org)