

18 November 1992

CAD-02495



Our Ref: Lby\Or\SAC.CG



Sir Adrian Cadbury
Chairman
Committee on the Financial Aspects of
Corporate Governance
P O Box 433
Moorgate Place
London EC2P 2BJ

Dear Sir Adrian.

In my absence on holiday, my colleague Hugh Priestley wrote to Nigel Peace on 31 July in response to your Committee's request for comments on its draft report. In his letter, Hugh pointed out, inter alia, that investment trust companies have boards of which the great majority of directors (if not all) are non-executive; he stressed that the dominance of non-executive directors should ensure that investment trusts already meet the need for proper supervisory governance and that, as a result, investment trusts should have no problem in complying with the major recommendations and requirements of your proposed Code.

We believe, however, that the letter of the proposed Code is unlikely to be applicable to investment trusts; as a consequence, and in order to show that investment trusts support the spirit of your Code, we have prepared draft guidelines which we believe address their special needs. A copy of our draft is attached. We intend to send copies of these guidelines to each of our Members but, before doing so, would welcome your confirmation that there is nothing in them which might cut across anything your Committee is contemplating for its final report.

We understand that publication of your final report is imminent. We would like to issue our guidelines to our Members at the same time as your report is published or, if possible, even earlier. It would therefore be a great help if you are able to let us have your views on, and hopefully approval of, the enclosed draft by close of business on Tuesday 24 November. I thank you in anticipation.

Yours
Paul Manduca

P V S Manduca
Chairman



Investment Trusts

ASSOCIATION OF INVESTMENT TRUST COMPANIES

DRAFT STATEMENT OF POLICY ON CORPORATE GOVERNANCE FOR INVESTMENT TRUSTS

The Cadbury Committee has recently published a draft report on "The Financial Aspects of Corporate Governance". As at present drafted the Report does not recognise the existence of a listed company such as an investment trust company, which does not have an executive role. A note on investment trusts and the Financial Services Act 1986 is attached as an Appendix.

An investment trust is a publicly quoted company, with a supervisory board of directors. The trust usually has no employees of its own. Instead it makes a contractual arrangement with a fund management house to manage its affairs and its funds. A small number of investment trusts have their own staff and are described as "independent" or "self-managed".

The AITC has submitted its comments on the draft report to the Cadbury Committee. In the course of its discussions, the Association has identified a number of issues which particularly affect investment trust boards. The results of the Association's deliberations are now reflected in this Statement of Best Practice.

It is not the role of the AITC to compel its membership to comply with this Statement. However, it believes that it is helpful to all members, and to investors and potential investors, to publish the results of its work. It is confident that an investment trust board which applies these standards will have no difficulty in complying with regulatory requirements and, more importantly, will be acting in the best interest of all its shareholders.

THE INDEPENDENCE OF THE BOARD IS PARAMOUNT

The board members of an investment trust must be able to act independently, so that the board is always be able to discharge its responsibilities to shareholders. To achieve this a majority of board members should be independent of management and of other interested parties.

The condition of independence cannot be fully satisfied where a director is an employee or former employee of the manager, a professional adviser to the manager, or is in any way remunerated by the manager.

In practice there will always be a close relationship between an investment trust company and its management. The majority of independent directors on the board will ensure that this relationship does not impair the company's freedom, if necessary, to recommend the termination of a management agreement.

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Code
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ROLE OF THE AUDIT COMMITTEE

The directors of an investment trust should ensure that the highest standards of conduct are maintained on behalf of the company and should seek full assurances of the managers' stewardship and independent confirmation, where appropriate, from the auditors.

An investment trust board has an on-going responsibility to review the company's investments regularly to ensure that the company's investment policy is followed and that best practice is observed. In addition to this general responsibility the board should undertake a regular audit review through an appointed audit committee drawn from the independent directors. This group:

1. Receives a report from the management each year confirming that the investment trust company has been run in compliance with the regulations applying to it. The management should report to the audit committee any untoward events or formal complaints recorded in connection with any Savings Schemes or similar products in which the company participates. The board should have direct access to the management company's compliance officer.
2. Receives an annual report from the company's auditors and has the opportunity to question the auditors without management present.
3. Reviews the company's investments. Particular attention should be paid to the values attributed to unquoted investments to ensure that valuation is conservative and to the rationale, where relevant, for the ownership of shares in the managers.

ROLE OF THE MANAGEMENT ENGAGEMENT COMMITTEE

The Board of an investment trust company should (formally or informally) appoint a Management Engagement Committee or, in the case of self-managed investment trust companies, a Remuneration Committee, of independent directors. In many cases the same group handles audit and management engagement issues; in others, formal committees are constituted.

This group is responsible for reviewing the terms of the management contract from time to time to ensure they are competitive and sensible for shareholders. In the case of self-managed investment trust companies the Remuneration Committee is responsible for agreeing remuneration policy in relation to the company's staff.

APPENDIX A

INVESTMENT TRUSTS AND THE FINANCIAL SERVICES ACT 1986.

Although investment trust shares are increasingly becoming regarded as "retail investments" they do not themselves fall within the framework for investor protection laid down by the Financial Services Act (FSA).

The fund manager is regulated under the FSA so that incompetence or dishonesty within the manager's business will be dealt with under the familiar framework for investor protection. This will include compensatable losses arising within an Investment Trust Savings Scheme. However, the conduct of the investment trust company itself (ie the board of directors) is governed in quite a different way: by company law, by Stock Exchange regulations and by financial reporting regulations.

There are a number of practical consequences of this difference in regulation. While shareholders of listed companies have recourse to the Stock Exchange or the Courts in the event of a dispute there is no impartial Ombudsman service to resolve disputes between investment trust shareholders and their board of directors. Nor does the Investors Compensation Scheme apply to losses as a result of incompetence or misconduct by the board. Where shares are bought through an Investment Trust Savings Scheme compensation would, however, be available if it is established that claimable losses occurred during the period when the ITSS monies were passing through the hands of the relevant management.

APPENDIX B

ADDITIONAL POINTS

The chairman of an investment trust company should always be independent.

While it may be preferable that the chairman should be independent, where there is a clear majority of independent directors it is far from essential. Where the chair holds a casting vote the chairman's independence is particularly important.

Investment Trust companies should not be "branded" with their manager's name.

This is not a corporate governance issue. It is for the board to decide whether it will include the manager's name in the title of the trust. "Branding" can be a powerful marketing tool in the retail market and the independent board of a "branded" trust has a very powerful weapon to exact an improvement in service and commitment from unsatisfactory managers.

(Ref: MFM\AITC\Misc\CorpGov2)

31 July 1992

Our Ref: Cms\AP\Let\Peace

Nigel Peace
Secretary
Committee on the Financial Aspects
of Corporate Governance
PO Box 433
Moorgate Place
LONDON EC2P 2BJ



Dear Mr Peace

COMMITTEE'S DRAFT REPORT

The Association supports the objective of establishing best practice in the areas of financial reporting and accountability. As the representative of a significant group of institutional investors in plcs, the Association therefore welcomes the Draft Report's recommendation for a Code of Practice which it regards as an important contribution and benchmark towards proper supervisory corporate governance in the case of those plcs which have boards without a majority of non-executive directors. The Association believes, however, that it may be unrealistic to expect small companies to be able to meet all the requirements of such a Code and that the Committee may have to recognise the problems for such companies, possibly by laying down the minimum which it considers necessary to meet the spirit of the Code's objectives.

The Members of this Association are some 220 quoted investment trust companies, a few of which are independently managed but the great majority of which do not employ any staff but enter into a management contract with an external firm for the provision of fund management, secretarial, accounting and administrative services. Under either structure, investment trust companies have boards of which the great majority of the directors (if not all) are non-executive and their dominance should ensure that investment trust companies already meet the need for proper supervisory governance. Thus, even where currently investment trust companies do not already have formally constituted Audit and Remuneration Committees, the obligations which the Code proposes for such Committees should already be met by the non-executive directors. As a result, investment trust companies should have no problem in complying with the major recommendations and requirements of the Code; and the Association has no objection to the proposal for a requirement, under the London Stock Exchange's continuing listing obligations, for a statement in the report and accounts of all listed companies as to whether they are complying with the Code, and identifying and giving reasons for any areas of non-compliance.

Yours sincerely

A handwritten signature in black ink, appearing to read 'H M Priestley', with a long horizontal flourish underneath.

H M Priestley
Deputy Chairman



Investment Trusts
ASSOCIATION OF INVESTMENT TRUST COMPANIES