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**GUERNSEY
FINANCIAL
SERVICES
COMMISSION**

**CODE OF CORPORATE GOVERNANCE
CONSULTATION PAPER**

19 January 2010

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A PERSONAL NOTE

In drafting this Code of Corporate Governance ("the Code"), I have drawn information from many and varied sources, including the vast body of recent documentation and research on this topic. I have also relied on local finance industry knowledge and consulted with several industry experts.

The predominant sources of input, somewhat unsurprisingly, have been The Combined Code and the recent Sir David Walker Review. I have also considered the key feedback and inputs utilised from these for the development of the new UK Corporate Governance Code, which should come into effect on or after 29 June 2010. Other important sources of input have been various international Codes and wording from existing GFSC Codes and Guidance where appropriate.

I have tried to choose the best and most appropriate corporate governance Guidance available, have injected my own thoughts and beliefs and then adapted it to our own particular finance industry needs in Guernsey.

The development of this Code has been driven by practitioners rather than regulators, on the basis that it is the behaviour of practitioners it seeks to influence. It is also my strong belief that, if we have the right people, heading businesses in the right way and providing robust governance and oversight - then there should be less need for rigid and voluminous new regulation.

I have benefited greatly from the invaluable assistance provided by the Corporate Governance Working Party:

Sponsor: GFSC

Supporter Group: The Institute of Directors, Guernsey Branch

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I owe a huge debt of gratitude to this group of people for all their support and assistance and to other individuals in the finance industry who have provided input to this document. I would like to express my very sincere appreciation to all those who have contributed so unselfishly to the development of this important piece of work.

Carol P Goodwin

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INTRODUCTION

What is the GFSC Code of Corporate Governance?

The GFSC's Code of Corporate Governance has been distilled from recent research, local knowledge and consultation, and has also been drawn from international experience of good company governance and oversight. It outlines the basic requirements for a sound corporate governance regime for the regulated finance sector in the Bailiwick of Guernsey and sets out details of what is expected of directors and senior managers in the sector.

The Code provides a set of "Outcomes" but is not intended to be fully prescriptive (see the "comply or explain" approach described below). Rather, it is a formal expression of the components of good corporate practice, and provides direction and Guidance. Each business's approach to corporate governance should reflect its legal and operating structure, as well as the nature, scale and complexity of the business. Compliance with the Code must be owned by the Board and senior management and cannot be delegated.

The Code is not a final word as corporate governance continues to evolve; the Code will be reviewed and updated from time to time. Nor should it be the only word; as it recognises that in certain circumstances good corporate governance may be achieved by other means. What is crucial though, is disclosure of these alternative arrangements and explaining the governance practices considered appropriate to an individual business's circumstances.

Who is covered by the Code?

The Code provides a framework which applies to all companies as defined below.

A company means any person who holds or is deemed to hold a licence, registration or authorisation from the GFSC under the regulatory Laws. The regulatory Laws are:

- (a) the Protection of Investors (Bailiwick of Guernsey) Law, 1987;
- (b) the Banking Supervision (Bailiwick of Guernsey) Law, 1994;
- (c) the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000;
- (d) the Insurance Business (Bailiwick of Guernsey) Law, 2002;
- (e) the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002;

For the purposes of this Code the definition of "company" above covers not only companies but every other form of structure or person (except unit trusts and limited partnerships which are authorised or registered as collective investment schemes under the Protection of Investors Law and individuals who are personal fiduciary licensees) which is licensed,

registered or authorised. Hence, for example, branches and partnership structures are covered by the Code unless they fall within the exceptions.

References in this Code to “the Board”, “Boards” or “Boards of directors” must be read as also meaning the senior management or partners, where the entity covered by the Code is not a company – for example, senior branch committees or partners. Where the entity subject to this Code is not incorporated as a company and there are no directors appointed to oversee the business, partners or senior management have the same responsibility for any actions required by Boards and directors under the Code. Additionally, an individual partner or senior manager should be nominated to carry the day to day responsibility for compliance with the Code as if they were an appointed director.

Where a Board does not appoint a standing Chairman or where no Chairman is in office, Boards and directors have joint and several responsibility for the actions required under the Code by the Chairman.

For the purpose of this Code references to “stakeholders” mean individuals, groups or businesses with a vested interest in the success of the company.

How does the Code work?

The Code is structured around a set of Outcomes, Best Practice Provisions, Guidance and a “comply or explain” methodology. The levels are:

- Level one – this represents the Outcomes of good corporate governance and sets out the required standard for compliance by Boards. The outcomes are included in bold type in blue boxes and the term “must” is used in the text.
- Level two – this comprises Best Practice Provisions on how to comply with the required outcomes in level one. The Best Practice text is expressed as statements and, more frequently, the word “should” is used so as to allow the possibility of alternative approaches.
- Level three – this comprises Guidance on how to comply with the Outcomes and Best Practice. The Guidance is included in boxes with a white background; it is expressed as statements and, more frequently, the word “should” is used so as to allow the possibility of alternative approaches. Please note that the GFSC is not currently consulting on the level three text contained in this document. This text has been prepared by the Corporate Governance Working Party to provide a preliminary indication at this stage of the potential direction of the Guidance. This text will be further developed and made as sector-specific as possible by the GFSC’s regulatory Divisions, which will work with industry sector associations and consult separately with industry.

The main reasons for adopting this structure are:

- A Code can be more flexible than formal legislation

- This Code should also complement existing legislation and regulation
- The structure provides standards and benchmarks against which corporate behaviour can be judged and enforced
- Adoption is likely to create more transparency, which should stimulate a greater understanding of Best Practice behaviour.

What does “comply or explain” mean?

The Code will be operated on the basis of a “comply or explain” regime and it is intended that each company as defined above will report annually to shareholders and relevant stakeholders, including the GFSC, on this basis. To be fully effective “comply or explain” requires companies to provide shareholders and relevant stakeholders with the information they need on the adequacy of the company’s governance arrangements.

The GFSC requires to be provided with an explanation for each level one Outcome, each level two element of Best Practice and each level three item of Guidance which is not met by the company. Although each provision of the Code, other than factual statements, is subject to the “comply or explain” regime, it is self-evident that some aspects of the Code lend themselves more readily to an explanation of non-compliance or compliance by alternative means than others.

It must also be clearly understood by licensees that the Code is separate from all other corporate governance standards or other requirements administered or issued by the GFSC; a failure to comply with any element of the Code – whether or not it is explained – will not excuse or mitigate any failure to meet any other standard or other requirements of any kind administered or issued by the GFSC regarding corporate governance.

Failure to meet the Code either by non-compliance with the Outcomes, Best Practice and Guidance or by inadequate explanation of non-compliance is taken into consideration by the GFSC in its licence, registration and authorisation granting and monitoring.

There are a number of reasons why a “comply or explain” approach is believed to be appropriate for the sort of issues the Code addresses. These are:

- It recognises the differing nature and requirements of the individual financial services industry sectors operating in the Bailiwick;
- It encourages companies to follow Best Practice, while recognising that in certain circumstances it may be appropriate for them to achieve good governance by other means;
- By allowing a degree of flexibility it enables the Code to be more easily adapted to account for developments in Best Practice;
- It leaves responsibility about a company’s governance arrangements in the hands of the Board and its shareholders; and

- It should assist in developing greater understanding and more constructive relationships between regulators and the Boards of companies.

Ultimately, corporate governance is about the behaviour of Boards and their senior management. Responsibility for a “comply or explain” framework rests solely with them.

When does the Code become effective?

It is proposed that levels one and two of the Code will be issued on 1 March 2010 and be fully implemented by the end of 2010. It is also proposed to work with industry associations and consult with industry on the level three Guidance and to issue that as soon as possible during 2010, also for implementation by the end of this year. Companies subject to the Code will therefore be required to comply with it before 1 January 2011.

Companies will be required by the close of business on 30 April each year to confirm to the GFSC they have complied with the Code during the previous calendar year and, where there has been compliance by alternative means or where there has not been compliance, to explain this. The first “comply or explain” reports from companies will therefore be required by the close of business on 30 April 2012 for the 2011 calendar year.

On 1 January 2011 the GFSC will repeal its existing document “Guidance on Corporate Governance in the Finance Sector”, which was issued in December 2004.

What happens after the Code is issued?

The GFSC will work with industry sector associations to devise appropriate language for the level three Guidance and issue it for consultation as soon as possible.

Consultation

Interested parties who wish to make comments on levels one and two of the Code should respond in writing to this consultation paper by writing to the Policy and International Affairs Division of the GFSC by the close of business on 11 February. Please note that, unless respondents advise otherwise, all responses will be copied to the Corporate Governance Working Party (which includes representatives from industry); where respondents do so advise, the response will be anonymised before circulation to the industry practitioners.

Code of Corporate Governance

OUTCOMES, BEST PRACTICE PROVISIONS AND GUIDANCE

OUTCOME 1. THE BOARD

Companies must be headed by a robust and effective Board of directors (“the Board”) which is responsible for governance and oversight of the company and compliance with this GFSC Code of Corporate Governance.

1.1 *Governance structure*

The Board should have a clear governance structure which reflects the demands and complexities of the company’s business environment, strategy, company values, standards, risk appetite, internal controls and key policies.

1.2 *Central role of the Chairman*

The role of the Chairman is central to the effective corporate governance of the company.

1.2.1 The Chairman is responsible for the leadership of the Board, ensuring effectiveness in all aspects of its role and for setting its agenda so that adequate time is available for substantive discussion on strategy and key issues.

1.2.2 The Chairman should facilitate, encourage and expect the informed and constructive contribution of all Board members and should promote open communication between senior management and the Board.

1.2.3 The Chairman should lead engagement with shareholders and relevant stakeholders.

1.3 *Balance and composition of the Board*

The Board should comprise an appropriate balance of executive and non-executive directors (including independent non-executive directors) and take into account its members’ relevant experience, such that no individual or small group of individuals can or does dominate the Board’s decision making.

- 1.3.1 Boards should ensure that their members have an appropriate balance of skills, experience and knowledge and that all directors devote adequate time to the role.
- 1.3.2 The Chairman should ensure that all directors contribute constructively and openly to Board discussions and demonstrate independence of mind.

1.4 *Committees of the Board*

The Board may establish specialised committees to review and analyse specific issues or functions and provide advice and recommendations to the Board on them. While the Board may delegate powers and authority to committees, they retain the responsibility for their actions, with such committees being under an obligation to report to the Board.

1.5 *Delegation to management*

The Board should ensure that a clear senior management structure is in place and should determine the powers and duties entrusted to management to enable them to effectively perform their duties. Such delegation does not absolve the Board from overall responsibility for the sound governance of the company.

- 1.5.1 The Board should ensure that the company's organisation structure and resource capabilities are at all times appropriate and sufficient for the efficient operation of the business.

1.6 *Board meetings*

The Board should meet sufficiently regularly to ensure that it fully discharges its duties in an effective manner.

- 1.6.1 Detailed minutes should be maintained of the contents of Board and Committee discussions.
- 1.6.2 A record should be maintained of the number of Board and committee meetings and the attendance of each director, whether in person or by telephone/video-conference.

OUTCOME 2. DIRECTORS

Boards of directors must take collective responsibility for maximising the long-term success of the company in directing and supervising the affairs of the business on behalf of all shareholders and relevant stakeholders.

2.1 *Directors' duties*

Directors have a duty to operate in accordance with the Companies (Guernsey) Law, 2008 and any other relevant company and other legislation, and should also operate within a clear framework of specified directors duties and reserved powers of the Board.

2.2 *Legislation and regulation*

Directors have a duty to be conversant with applicable legislation, regulation, policy, rules, Instructions, Guidance and codes of practice to enable them to discharge their responsibilities.

2.3 *Strategic oversight*

Directors should robustly and constructively challenge management and assist with and test the development of proposals on company strategy and key policies.

2.4 *Appointment, induction and re-appointment of directors*

The Board should undertake a rigorous process for the appointment of its members and provide a suitable induction programme to new appointees. It should also satisfy itself that plans are in place for the orderly succession of appointments to the Board.

2.4.1 Appointments to the Board should be made and accepted in writing and include the expected time commitment and all other main terms and conditions of such appointments.

2.4.2 Before accepting an appointment, potential directors should undertake to secure sufficient understanding and have time to meet what is expected of them, taking into account the number and importance of their other commitments.

2.4.3 The induction process should be structured to enable directors to understand the fundamentals of the company's business, including its strategy, values, business challenges, key policies, risk management and internal control and governance systems and procedures.

2.4.4 The Chairman should ensure that the Board's composition is periodically reviewed and its membership refreshed on a periodic basis to maintain alignment with the current and future needs of the business.

2.5 *Provision of information and support for the Board*

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, facilitate decision making and allow for effective monitoring and control of company performance.

2.5.1 The Chairman is responsible for ensuring that directors receive all information necessary and relevant to the discharge of their fiduciary duties.

2.5.2 All directors should have access to the advice and services of the company secretary, administrative and research support and independent professional advice, where they judge it to be necessary or desirable.

2.5.3 The company secretary or an executive of the company should be designated by the Board as being responsible for ensuring good information flows to the Board and its committees and between executive management and all Board directors.

2.6 *Performance evaluation*

The Board should periodically undertake a documented and rigorous process of evaluating the performance of its members and of the effectiveness of the actions of the Board and its committees.

2.6.1 Performance evaluations should provide a means of ensuring that directors exercise independent judgement, care and diligence and commit an appropriate amount of time to their directorial duties and responsibilities.

2.6.2 The format, frequency and content of performance evaluations should be proportionate to the size, nature and complexity of the business.

2.6.3 The Chairman should present the results of performance evaluations to the Board for discussion and implementation of any necessary action.

2.7 *Training and continued professional development*

All directors should regularly update and refresh their skills and knowledge and undertake ongoing professional development.

2.7.1 The Chairman should ensure that all directors continually update their skills and knowledge to enable them to fulfil their role as a member of the Board and its committees.

2.7.2 Necessary resources should be made available for developing and updating directors' training and continued professional development.

OUTCOME 3. BUSINESS CONDUCT AND ETHICS

All directors must maintain high standards of business conduct, integrity and ethical behaviour and must operate with due care and diligence and at all times act honestly and openly.

3.1 *Policy and standards*

Boards should establish, implement and maintain an effective conflicts of interest policy which sets out standards of expected behaviour and which is appropriate to the nature, scale and complexity of the business.

3.2 *Conflicts of interest*

Directors have a duty to avoid conflicts of interest and should arrange their personal and business affairs so as to avoid direct and indirect conflicts of interest with the company, its shareholders and relevant stakeholders.

- 3.2.1 Where the company is a member of a group the policy should take account of any circumstances that could give rise to a conflict of interest within or otherwise relevant to the group.
- 3.2.2 Directors have an obligation not to accept any benefit from a third party where acceptance of such benefit could reasonably be regarded as likely to give rise to a conflict of interest.
- 3.2.3 Directors have an obligation to handle confidential company and other information received in their capacity as directors with caution and should not use it for purposes other than in the exercise of their duties.

3.3 *Self dealing/preferential treatment*

Any transactions between the company and its Board members should take place at arms' length.

- 3.3.1 The Board should establish a policy for transactions or other contractual relationships between the company, including related companies, shareholders and relevant stakeholders, and its Board members.
- 3.3.2 Should a director be in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, they should declare the nature and extent of that interest to the Board and stand aside from any discussion related to it.

3.4 *Subsidiaries*

Directors have a duty to act in the best interests of the company to fulfil their fiduciary duties.

- 3.4.1 Where a company is part of a group of companies, while its directors may have regard to the interests of the group, this is subservient to the principle set out above.

- 3.4.2 Directors should ensure that they act and manage any group conflicts of interest and/or duties in such a way that they do not breach the principle set out above.

OUTCOME 4. ACCOUNTABILITY

The Board must have formal and transparent arrangements in place for presenting a balanced and understandable assessment of the company's position and prospects and must provide clear disclosure on how they apply financial reporting and internal control principles.

4.1 *Strategic business management*

The Board is responsible for the development of the company's business strategy and for defining its strategic objectives and key policies.

- 4.1.1 Directors should ensure they have a full understanding of the company's strategy and are aware of its competitive positioning and any potential impact that external forces may have on its strategy.
- 4.1.2 The Board should review and approve any new or prospective material business endeavours before their adoption.
- 4.1.3 Boards should, at least annually, undertake a strategic review of the company's business model and its strategic objectives.

4.2 *Financial reporting*

The Board is responsible for the integrity of the company's financial statements and any other formal information relating to its financial performance, as well as financial reports to regulators and any other statutory information required.

4.3 *Performance monitoring*

The Board should determine and ensure that monitoring criteria of the company's performance are in place and should regularly evaluate their effectiveness on an ongoing basis.

- 4.3.1 Directors should ensure that procedures for monitoring and evaluating progress against plans, objectives and budgets are in place and that sufficient information is provided to them to enable the Board to accurately track and monitor company results against all key performance indicators.

4.4 *Internal control systems*

The Board should maintain a sound system of internal control to safeguard shareholder and stakeholder investments and the company's assets and to manage risk.

- 4.4.1 The Board should ensure that internal control procedures are in place that are robust and sufficient for the purposes of managing operational business risk.
- 4.4.2 The Board should ensure that effective systems are in place for managing and monitoring internal control and risk management.
- 4.4.3 The Board should, at least annually, conduct a review of the system of internal controls. The review should cover all material controls, including but not limited to financial, operational and compliance controls.

4.5 *Outsourcing controls*

The Board should establish clear accountability for all outsourced functions whatsoever, as if these functions were performed internally and subject to the company's normal standards of internal control.

- 4.5.1 Where outsourcing arrangements are entered into the Board remains at all times responsible and

accountable for compliance by these functions.

- 4.5.2 Boards should put in place a legally binding contract with each third party service provider containing appropriate details of outsourced activities and responsibilities and other material terms and conditions.

4.6 *Audit*

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

- 4.6.1 The Board should ensure that the company maintains the highest standards of integrity in financial reporting.

- 4.6.2 The Board has a duty to maintain an effective relationship with the company's auditors and approve auditor appointments, audit scope, terms of engagement and remuneration and also require that auditor independence is maintained.

- 4.6.3 The main role and responsibilities of any audit committees should be set out in written terms of reference and should include an explanation of the authority delegated to the committee by the Board.

- 4.6.4 Internal and external audit arrangements and the establishment of any committees should be proportionate to the company's needs and will vary according to the size, nature, complexity and risk profile of the company.

- 4.6.5 The Board should review all internal and external audit reports produced and monitor the resolution of any issues raised by them.

4.7 *Annual business reviews*

At least annually the Board should undertake a comprehensive review of the company's business activities and future prospects.

4.7.1 Annual business reviews should include, but not be limited to, regulatory compliance, business objectives and plans, financial reporting, internal controls and risk management.

4.7.2 Periodic performance reviews should also be undertaken on all major service suppliers, advisers and outsourcing agents.

OUTCOME 5. RISK MANAGEMENT

The Board must provide suitable oversight of risk management, establish a clear risk management strategy and maintain a sound system of risk measurement and control over all key risks.

5.1 *Risk strategy and policy*

Considerable attention should be paid by the Board in determining the company's risk appetite and tolerance and to establishing a clear risk management strategy and comprehensive supporting policies, procedures and controls for identifying, evaluating and managing all significant risks faced by the company.

5.1.1 Risk management systems should provide for relevant, accurate and timely analysis and reporting to the Board.

5.1.2 Risk management policies should include determination by the Board of the adequacy of the company's capital, liquidity and insurance arrangements for the nature and level of risk.

5.2 *Responsibility for risk*

The Board should maintain overall responsibility for the risk management of the company and should support and be supported by an appropriate senior executive of the company whose primary responsibility it is to assess and manage risk.

5.2.1 The company's senior risk officer should have a direct reporting relationship to an executive member of the Board and should also have direct access to the Chairman and all other Board members.

5.2.2 The senior risk officer should regularly attend Board meetings to present findings on risk measurement results and testing against controls.

5.3 *Business risk reviews*

Boards should undertake, at least annually, to review and approve their risk management strategy, and all related policies, procedures and controls.

5.3.1 Risk reviews should be documented and should identify all key business risks and exposures, the information to monitor such risks and the controls identified and agreed by the Board.

5.4 *Contingency planning and testing*

Companies should have in place properly constructed business continuity and contingency plans to safeguard against disruption of their operations and services and to protect against risk of loss; the Board should review and approve these plans at least annually.

5.4.1 Risk management policies, procedures, and controls, including but not limited to business continuity and contingency plans, should be subject to regular stress testing to ensure their continued applicability and robustness.

OUTCOME 6. DISCLOSURE AND REPORTING

The Board must ensure the timely and balanced disclosure of all material matters concerning the company.

- 6.1 *Statutory disclosure and regulatory reporting*
The Board has a duty to ensure that comprehensive information is made available as required by applicable rules, regulations and codes and that all statutory and regulatory reporting deadlines are met.
- 6.2 *Corporate governance reporting*
Boards have a duty to comply with annual reporting requirements to disclose their corporate governance arrangements and compliance with this GFSC Code of Corporate Governance.
- 6.3 *Annual general meetings*
The Board should use the annual general meeting to communicate openly with shareholders about such matters as the corporate governance and financial affairs of the company and encourage their participation in the governance and oversight of the company.
- 6.4 *Relations with the GFSC*
Companies have a duty to deal with the GFSC in an open and co-operative manner and keep it promptly informed of anything concerning the company which might reasonably be expected to be disclosed to it.

OUTCOME 7. REMUNERATION

The Board must ensure that all directors and senior managers are remunerated fairly and responsibly and that remuneration policies are consistent with effective risk management.

- 7.1 *Remuneration policy*
The Board should review and approve all remuneration policies for executive directors and senior management and policies should have regard for company and individual performance, and avoid creating incentives that encourage uncontrolled risk taking.

7.1.1 Remuneration policies should promote the longer-term sustainability and success of the company.

7.1.2 No individual should be solely responsible for deciding their own remuneration.

7.2 *Function of remuneration*

Levels of remuneration should be sufficient to attract, retain and motivate individuals of the quality required to manage and direct the company successfully.

7.2.1 Any performance related elements of remuneration should be designed to align individual interests with those of shareholders and relevant stakeholders and should not include incentives that would encourage imprudent behaviour.

7.2.2 Levels of remuneration for non-executive directors should reflect the responsibilities of the role and the time commitment required.

OUTCOME 8. SHAREHOLDER AND STAKEHOLDER RELATIONS

The Board must ensure that engagement and communications with shareholders and relevant stakeholders is encouraged and is based on a mutual understanding of needs, objectives and concerns.

8.1 *Shareholder/stakeholder engagement*

The company should have in place an appropriate communications policy which promotes transparency and effective engagement with shareholders, potential shareholders and relevant stakeholders.

8.1.1 The Chairman should ensure that the Board has in place a contact procedure to enable shareholders and relevant stakeholders to communicate with the Board, should they so wish.

8.2 *Rights of shareholders and stakeholders*

The Board should respect the rights of shareholders and relevant stakeholders, is responsible for ensuring that an ongoing dialogue with shareholders and stakeholders takes place and that all necessary facilities are made available for them to exercise their rights.

8.3 *Information provided to shareholders and stakeholders*

The Board should ensure that shareholders and relevant stakeholders are provided with sufficient information for them to understand the risks and rewards they are exposed to through their dealings with the company.

8.3.1 The Board should take responsibility for the content of communications with shareholders and relevant stakeholders on major factors affecting the company.

8.4 *Shareholder/stakeholder profiles*

The Board should regularly consider the shareholder and relevant stakeholder profiles of the company and have in place methods for obtaining and understanding their views.

8.4.1 The Board should make itself aware of the corporate governance attitudes of shareholders and relevant stakeholders and give such attitudes due consideration.

8.5 *Shareholder and stakeholder responsibilities*

The Board should encourage shareholders and relevant stakeholders to make considered use of their votes and views and to engage with the Board on a collaborative basis.