

Corporate governance report

Statement of compliance

The Board supports the principles of corporate governance and this report sets out the Company's compliance with the Combined Code on Corporate Governance, which is appended to the Listing Rules of the Financial Services Authority.

The Company complied with the provisions set out in Section 1 of the Combined Code throughout 2006.

The Board

The Board comprises the Chairman, four Executive Directors and four Non Executive Directors. The roles of the Chairman and Chief Executive are separated and there is a clear division of responsibilities.

The Board has a schedule of regular meetings together with ad hoc meetings when required and a strategy review. The Board focuses on strategic issues and financial performance. The matters reserved for the Board's approval include major capital expenditure, acquisitions and disposals, treasury and dividend policy and Group budgets and business plans. Other responsibilities are delegated to the Committees of the Board within a framework of delegated authorities.

An evaluation of the Board's effectiveness was carried out twice during the year in the form of a questionnaire covering Board processes and behaviours and the Committees of the Board. Responses were openly discussed and debated at a Board meeting and were constructive in identifying areas for improvement. The evaluation process will also be repeated during the year.

All of the Non Executive Directors are considered to be independent. The terms and conditions of appointment of Non Executive Directors are available for inspection at the Company's registered office and at the Annual General Meeting ('AGM'). Non Executive Directors are not appointed for specified terms, but on a rolling basis determinable on either side at any time by giving three months' written notice. Contracts also provide for the termination of appointment in accordance with the provisions of the Company's articles of association. There are clear channels of communication between the Chairman and the Non Executive Directors providing opportunities for discussion outside Board meetings.

Keith Peraux, who is due to retire at the AGM, has decided not to seek re-election in order for him to focus on his other business activities. The Board are grateful for his contribution since his appointment in 2002. The Board are actively seeking a new Non Executive Director to ensure a balance of Non Executive Directors and Executive Directors.

All Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that Board procedures and applicable rules and regulations are observed. There is an agreed procedure whereby Directors can obtain independent professional advice, paid for by the Group. External training is also provided as necessary.

Committees of the Board

The Board's Committees meet regularly to enable them to discharge their responsibilities. Each committee has written terms of reference, which are reviewed annually by the Board and are available to view in the Corporate Governance section of the Group's website: www.erinaceous.com.

Audit Committee

The Audit Committee comprises Nicholas Fry, Lord Poole and Lord Razzall, all independent Non Executive Directors. Nicholas Fry, a Chartered Accountant with recent and relevant financial expertise, chairs the Committee and all three members of the Committee hold recognised professional qualifications.

The Committee meets at least three times a year. The Chairman, Non Executive Directors, Chief Executive, Finance Director, head of Group risk management and internal audit and the external auditors are invited to attend meetings. There is an opportunity at Committee meetings for private discussion to take place between the Non Executive Directors and the external auditors.

The Audit Committee is responsible for reviewing the external audit process, including the effectiveness of the audit, and considering any major accounting issues.

Following a review during the second half of 2006, Deloitte & Touche LLP were appointed as external auditors in place of Grant Thornton UK LLP. It had been recognised that the Group would benefit from the global presence and technical expertise of a larger audit service provider and a formal tendering process took place with three of the big four audit firms. Two of the firms later presented to a committee of the Board including the Chairman of the Audit Committee, resulting in the selection and appointment of Deloitte & Touche LLP on 20 December 2006.

Details of non-audit work provided by Grant Thornton UK LLP during the year are provided in note 3 and it is envisaged that Deloitte & Touche LLP will undertake similar types of work going forward.

The Board and Audit Committee monitor the cost effectiveness of audit and non-audit work performed by the auditors and also consider the potential impact, if any, on the corporate relationship and independence of the auditors before awarding any non-audit work. The auditors also operate procedures to safeguard their objectivity and will report annually to the Audit Committee with an assessment including a summary of non-audit services provided and fees receivable.

The Committee also oversees the work of the Group's risk management and internal audit function, paying particular attention to the effectiveness of the Group's internal control procedures.

Corporate governance report

Nomination Committee

The Nomination Committee comprises Nigel Turnbull, Lord Razzall and Lord Poole and is chaired by Nigel Turnbull. The Chief Executive is also invited to attend meetings.

The Committee is responsible for recommending candidates for appointment to the Board, reviewing the structure of the Board and appraising succession planning processes to ensure that an appropriate balance of skills is maintained within the Group and on the Board. The Committee also ensures that relevant training and induction requirements of any new Board appointments are addressed.

Remuneration Committee

The Remuneration Committee comprises Lord Razzall, Nicholas Fry and Keith Peraux and is chaired by Lord Razzall. The Committee met six times during the year and is responsible for determining the remuneration packages of the Executive Directors and certain key senior executives. The Directors' remuneration report on page 34 includes details of the Remuneration Committee and its work.

Executive Committee

The Executive Committee is chaired by Nigel Turnbull and currently comprises the Executive Directors together with Ken Hackney (a former Board member), Andy Halstead (Managing Director of insurance and residential lettings) and Melanie Gurney (Group HR Director). The Executive Committee has concentrated on operational performance, decision-making and the formulation of strategic proposals to the Board.

Following a review, and having taken into account the successful progress being made by the Operations Board it has been agreed that operational issues can be delegated to that Board. The future emphasis of the Executive Committee will be to challenge the financial results and future costs of the Group and the members of the Committee will in future be Nigel Turnbull, the Executive Directors and Andy Halstead.

Operations Board

The Operations Board is chaired by Neil Bellis, and comprises the Executive Directors, managing directors of core business units and heads of corporate functions. The Operations Board mainly focuses on operational matters.

Board and Committee Attendance

The following table details the number of Board and Committee meetings held during 2006 and the attendance record of each Director.

	Board Meetings	Audit	Committee Meetings Remuneration	Nomination
Number of meetings in year	9 ⁽ⁱ⁾	3	6	1
* Nigel Turnbull	9	3	6 ⁽ⁱⁱ⁾	1
Neil Bellis	9	–	4 ⁽ⁱⁱ⁾	–
Lucy Cummings	9	–	–	–
Nigel Davis	8	–	–	–
Michael Pearson	9	2 ⁽ⁱⁱ⁾	–	–
* Nicholas Fry	9	3	6	–
* Keith Peraux	6	2 ⁽ⁱⁱ⁾	5	–
* Lord Poole	9	3	5 ⁽ⁱⁱ⁾	1
* Lord Razzall	8	3	6	1

*Non Executive Director

(i) One Board meeting was called at short notice

(ii) Attendance by invitation

Risk management and internal control

The Board has accountability for reviewing and approving the adequacy and effectiveness of internal controls operated by the Group, including financial, operational and compliance controls and risk management. It is the role of management to implement the agreed policies on risk, compliance and control. This is effected both by the Executive Committee and the Operations Board.

The system of internal financial and operational control is designed to meet the Group's particular needs and aims to facilitate effective and efficient operation, to safeguard the Group's assets, ensure proper accounting records are maintained and that the financial information used within the business, and for publication, is reliable.

Such systems of internal control can only be designed to manage rather than eliminate risk of failure to achieve business objectives and can provide reasonable, but not absolute, assurance against material misstatement and loss. In March 2006 the Group became aware that an employee at its valuation office in Bow Lane in the City of London was the subject of a criminal investigation. The office was



Corporate governance report

closed and the employee suspended. The Board has considered that the design of this aspect of the Group's system of internal control was satisfactory and that this was not a failing or weakness in internal control. However, further procedures have been adopted in light of the Board's review.

The Board confirms that there is a continuing process for identifying, evaluating and managing the risks faced by the Group which complies with the Revised Guidance of Code Principle C2 and that this process covers all of the Group's subsidiaries. The Audit Committee has reviewed risk registers detailing associated controls for mitigating risks and has also received reports on the operation and effectiveness of the Group's internal controls that operated during the period covered by the financial statements, up to and including the date of approval by the Board.

Key features on the system of the Group's internal control are as follows:

Control environment

The Group's management systems include financial and business policies and procedures, quality assurance manuals and corporate health and safety procedures. These procedures are subject to ongoing review and improvement.

Financial reporting

The Board approves annual budgets for each division in the Group and the monthly financial performance of each division is reported and compared to budget. The Group reports to shareholders on a half-yearly basis. Forecasts for the Group are updated and reviewed by the Board on a regular basis.

Individual business controls

Individual businesses and central corporate functions complete an annual self-certification statement. The managers responsible personally confirm the review of their systems of internal control to manage significant risks identified within their divisional risk register and also confirm their compliance with regulations. The statement also requires the reporting of any significant control issues that have emerged so that areas of group concern may be identified, addressed and experience shared.

Businesses who undertake activities regulated by the FSA have compliance officers within the division who undertake a programme of compliance reviews to ensure that the highest standards are maintained. Where agents have been appointed, the compliance teams undertake site visits to ensure appointed representatives adhere to FSA requirements. During the year the Group continued to improve the corporate governance arrangements within the insurance division and two Non Executive Directors have been appointed to the Board of Erinaceous Insurance Services Limited.

Functional speciality reporting

The Board assesses the risks facing the business on an ongoing basis and has identified a number of other key areas that are subject to regular reporting to the Board, such as financial performance, acquisition reports, human resources, and compliance.

Risk management review

The Board is committed to improving risk management and internal control across the Group and has established a Risk Review Forum that meets on a quarterly basis. The Group risk management framework requires divisions to formally record all significant risks facing their businesses and detail the steps being taken to avoid or mitigate those risks. A summary of the key risks facing the Group is recorded in the risk registers, which are reviewed regularly by the Board.

The Group maintains insurance policies to provide protection from losses and the adequacy of the insurance cover is reviewed by the Executive Committee on an annual basis.

Acquisitions

The Group operates a system of internal controls over business acquisitions. This is achieved through due diligence of the target company and business cases presented to the Board. Following acquisitions, the Board is presented with an integration plan and financial and non-financial targets are set for the newly acquired business. Performance is monitored and reported to the Board as normal.

Internal audit

The Group risk management and internal audit function undertakes a programme to assess internal control, compliance and risk management processes with particular reference to the Turnbull report. The conclusions of these reviews are communicated to the relevant level of management and the function has a direct reporting responsibility to the Audit Committee.

Investor relations

The Board encourages communication with its institutional and private investors. All Board members attend the Company's AGM and the Chairman and the Senior Independent Non Executive Director are available to meet with major shareholders when reasonably requested. Throughout the year the Chief Executive and relevant Executive Directors hold regular meetings with investors, analysts and brokers. Non Executive Directors are informed of the views of shareholders by the Executive Directors and via the analysts' reports that are circulated to the Board.

A range of information is available from the Group's website including copies of presentations, press releases and the latest annual and interim financial reports.