

## Corporate Governance

In accordance with the Listing Rules of the Financial Services Authority, GKN is required to state whether it has complied with the relevant provisions set out in Section 1 of the 2006 Combined Code on Corporate Governance (the Code) and, where the provisions have not been complied with, to provide an explanation. GKN is also required to explain how it has applied the principles set out in the Code.

The following paragraphs, together with the Audit Committee report on page 56 and the Directors' remuneration report on pages 57 to 68, provide a description of how the main and supporting principles of the Code have been applied within GKN during 2007. The Directors' statement of compliance with the Code is given on page 55.

### The Board of Directors

The Board is collectively responsible for the success of the Company. Its role is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets the Company's strategic aims, ensures that the necessary financial and human resources are in place for the Company to meet its objectives, and reviews management performance. It also sets the Company's values and standards and ensures that its obligations to its shareholders (including reporting to shareholders on the Board's stewardship) and others are understood and met. Specific responsibilities reserved to the Board include:

- › setting Group strategy and approving an annual budget and medium term projections;
- › reviewing operational and financial performance;
- › approving major acquisitions, divestments and capital expenditure;
- › reviewing the Group's systems of financial control and risk management;
- › ensuring that appropriate management development and succession plans are in place;
- › reviewing the activities of the three sub-committees of the Executive Committee;
- › reviewing matters relating to corporate social responsibility, including the environmental, health and safety performance of the Group;
- › approving appointments to the Board, to the Executive Committee and to the position of Company Secretary, and approving policies relating to Directors' remuneration and the severance of Directors' contracts; and
- › ensuring that a satisfactory dialogue takes place with shareholders.

The Directors' responsibility for the preparation of accounts is explained on page 51 (their confirmation that they consider it appropriate to prepare the accounts for 2007 on a going concern basis is given on page 37).

A description of the role of the Board, together with that of the Chairman, Chief Executive, Senior Independent Director and Company Secretary, is available on GKN's website and further details of the Board's role in relation to the Group's systems of internal control and risk management are given on pages 54 and 55. Descriptions of the specific responsibilities which have been delegated to the principal Board Committees are given on page 54.

The Board currently comprises five executive and five non-executive Directors including the Chairman. Biographical details of the Directors are given on pages 48 and 49. With the exception of the Chairman, who is presumed under the Code not to be independent, all the non-executive Directors are regarded by the Board as independent and the Board does not consider that there exist any relationships or circumstances likely to affect the judgement of any Director. The terms and conditions of appointment of the non-executive Directors are available for inspection at the Company's registered office and at the AGM.

As referred to in the Directors' report, Richard Parry-Jones has been appointed as an additional non-executive Director with effect from 1 March 2008. His biographical details are given in the AGM circular. From 1 March 2008, Richard Parry-Jones will be a member of the Chairman's Committee, Audit Committee, Remuneration Committee and Nominations Committee.

The Board normally meets 11 times a year, including at least one meeting at a Group operating company. A 12 month rolling programme of items for discussion by the Board is prepared to ensure that all matters reserved to the Board and other key issues are considered at appropriate times. During the year there are sufficient opportunities for the Chairman to meet with the non-executive Directors without the executive Directors being present should this be deemed appropriate.

The Company maintains appropriate insurance cover in respect of legal proceedings and other claims against its Directors. Details of indemnities in place between the Company and the Directors can be found in the Directors' report on page 51.

### Chairman and Chief Executive

The roles of Chairman and Chief Executive have been split since 1997. Whilst collectively they are responsible for the leadership of the Company, the Chairman's primary responsibility is for leading the Board and ensuring its effectiveness and the Chief Executive is responsible for running the Company's business.

The other significant current commitments of the Chairman, Roy Brown, are listed in his biography on page 48. The Board is satisfied that his commitments do not unduly restrict his availability to GKN and, in particular, would not do so in the event of GKN being involved in a major corporate transaction or other action.

### Information and professional development

The Chairman is responsible for ensuring that Directors receive accurate, timely and clear information. The supply of information provided to the Board was reviewed during the year as part of the performance evaluation exercise referred to below.

Comprehensive briefing papers are prepared and circulated to all Directors one week prior to scheduled Board meetings. Directors are continually updated on the Group's businesses, the markets in which it operates and changes to the competitive and regulatory environment through briefings to the Board and meetings with senior executives. The Chairman arranges for the Board to visit at least one of the Group's business locations each year to enable the Directors to meet with local management and employees and to update and maintain their knowledge and familiarity with the Group's operations.

On joining the Board, a Director receives a comprehensive induction pack which includes background information about GKN and its Directors, and details of Board meeting procedures, Directors' duties and responsibilities, procedures for dealing in GKN shares and a number of other governance-related issues. This is supplemented by a briefing with the Company Secretary who is charged with facilitating the induction of new Directors both into the Group and as to their roles and responsibilities as Directors. The Director meets with the Chief Executive and with relevant senior executives to be briefed on the general Group strategy and each individual business portfolio. Plant visits are organised as necessary for new Directors. External training, particularly on matters relating to the role of a Director and the role and responsibilities of Board Committees, is arranged as appropriate.

Ongoing training is provided as and when necessary and may be identified in annual individual performance reviews or on an ad hoc basis. The suitability of external courses is kept under review by the Company Secretary. Training and development of Directors in 2007 took various forms and included visits to GKN plants (both with the Board as a whole and on an individual basis).

All Directors have direct access to the advice and services of the Company Secretary who is tasked with ensuring that the Board is fully briefed on all legislative, regulatory and corporate governance developments. In addition, Directors may, in the furtherance of their duties, take independent professional advice at the Company's expense.

#### Performance evaluation

During the year, the Board carried out a formal evaluation of its own performance and that of its Committees. The process involved each Director, as well as other attendees of Board Committee meetings, completing a detailed questionnaire covering issues such as Board remit and objectives; composition, training and resources; corporate governance; stakeholder engagement; Board meetings, visits, procedures and administration; Committee terms of reference and other specific Committee-related questions. The results of the evaluation and recommendations for improvements were reported to the relevant Committees before the Board as a whole agreed appropriate changes. These were minor and included changes in the scheduling of certain items to be considered by the Board and the nature of information to be circulated prior to Board meetings. It was also agreed to review the quanta of delegated authorities.

The individual performance of the Directors was also evaluated at one-to-one interviews with the Chairman. To assist this process, a number of assessment areas were identified in advance and used as a framework for conducting the appraisal interviews. In the case of John Sheldrick and Sir Peter Williams, who completed their initial and second three year terms respectively as non-executive Directors during the year, their evaluations provide the basis for the recommendation to shareholders set out in the notice of meeting circular that they be re-elected at the forthcoming AGM. Sir Ian Gibson, as Senior Independent Director, led the review by the non-executive Directors of the Chairman's performance, which took into account the views of the executive Directors. Similarly, the views of the other Directors were taken into account by the Chairman in his review of the Chief Executive's performance. No actions were considered necessary as a result of any of these evaluations.

#### Re-election of Directors

The Company's articles of association require Directors to seek re-election by shareholders at least once every three years. In addition, all Directors are subject to re-election by shareholders at the first AGM following their appointment by the Board. Any non-executive Directors who have served for more than nine years are subject to annual re-election. Details of the Directors retiring and seeking re-election at the 2008 AGM are given in the notice of meeting circular.

#### Relations with shareholders

GKN is committed to ongoing engagement with shareholders and has a well established communication programme based on the Group's financial reporting calendar. This programme enables the Directors to gain an understanding of the views and opinions of its shareholders. In its communications with shareholders, GKN aims to present a balanced and understandable assessment of the Group.

Communication with major institutional shareholders is undertaken as part of GKN's investor relations programme, in which non-executive Directors are encouraged to participate. This includes presentations of the full year and interim results, and meetings between institutional investors (both in the UK and overseas) and the Chief Executive, Finance Director, Head of Investor Relations and other executive Directors. Periodic meetings with representatives of major institutional shareholders, other fund managers and the financial press are also held. Feedback is sought by the Company's brokers after meetings and presentations to ensure that the Group's strategy and performance is being communicated effectively and to develop further an understanding of shareholder views. This feedback is included in twice-yearly reports to the Board on meetings with existing and potential investors which, during 2007, included the results of an investor audit of GKN conducted by an external investor relations firm. In addition, external brokers' reports on GKN are circulated to all Directors.

The Chairman offers major shareholders the opportunity to meet with him to discuss matters relating to governance and strategy. Feedback to the Board is provided by the Chairman on any issues raised with him. The Senior Independent Director is also available to discuss issues with shareholders where concerns cannot be addressed through normal channels of communication.

Shareholders who attend the AGM are invited to ask questions during the meeting and to meet with Directors after the formal proceedings have ended. Details of the level of proxy votes received are advised to shareholders at the meeting and are published on GKN's website.

Written responses are given to letters or email received from shareholders and all shareholders receive, or can access electronically, copies of the annual and interim reports. The investor relations section of GKN's website provides further detail about the Group, including share price information, webcasts and presentations of annual and interim results, other presentations made to the investment community, and copies of financial reports.

## Corporate Governance

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### Board Committees

The full terms of reference of the following Board Committees are available upon request and on GKN's website.

#### Executive Committee

The Executive Committee is tasked with leading, overseeing and directing the activities of the Group. It is responsible for reviewing divisional and Group strategy plans, approving and leading the consistent implementation of business and operational processes, and identifying, evaluating and monitoring the risks facing the Group and deciding how they are to be managed. The Committee normally meets monthly.

The Committee consists of the executive Directors and the Group's senior executive team under the chairmanship of the Chief Executive. The current membership of the Executive Committee is given on page 48.

The Executive Committee has three sub-committees consisting of members of senior management:

- › the Lean Enterprise Sub-Committee, under the chairmanship of Sir Kevin Smith, Chief Executive, is responsible for driving operational best practice globally through the application of 'Lean' business processes;
- › the Technology Sub-Committee, under the chairmanship of Martyn Vaughan, Group Director Enterprise Excellence, is responsible for setting policy and providing guidance and direction in relation to technologies employed across all business areas, and provides input to the Executive Committee to contribute to the formulation of the Group's business strategy; and
- › the Governance and Risk Sub-Committee, under the chairmanship of Grey Denham, Company Secretary, has responsibility for developing strategy for and providing oversight and direction on all matters relating to governance and compliance, risk management and corporate social responsibility.

#### Chairman's Committee

The Chairman's Committee is a forum for the Chairman and Chief Executive to brief and obtain the views of the non-executive Directors on particular issues. The Committee meets before each Board meeting and consists of the non-executive Directors together with the Chief Executive under the chairmanship of the Chairman.

#### Audit Committee

The Audit Committee ensures the integrity of financial reporting and audit processes and the maintenance of a sound internal control and risk management system. The Committee meets at least four times a year and consists of all the independent non-executive Directors under the chairmanship of John Sheldrick. A report by the Committee on its activities in 2007 is given on page 56.

#### Remuneration Committee

The Remuneration Committee is responsible for approving the terms of service and setting the remuneration of the executive Directors and the Company Secretary in accordance with a remuneration policy which is approved annually by the Board. It is also responsible for determining the fees of the Chairman and the terms upon which the service of executive Directors is terminated having regard to a severance policy adopted by the Board, and for monitoring the remuneration of senior managers just below Board level. It also prepares for approval by the Board the annual report on Directors' remuneration (set out on pages 57 to 68).

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. It is responsible for appointing any consultants in respect of executive Directors' remuneration.

The Committee meets periodically when required and consists of the independent non-executive Directors under the chairmanship of Sir Peter Williams.

#### Nominations Committee

The Nominations Committee leads the process for identifying, and makes recommendations to the Board on, candidates for appointment as Directors of the Company and as Company Secretary, giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Chairman's and Nominations Committees and the composition and chairmanship of the Audit and Remuneration Committees. It keeps under review the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive Directors, and makes recommendations to the Board with regard to any changes.

The Board has agreed procedures that are followed by the Nominations Committee in making appointments to the various positions on the Board and as Company Secretary. These procedures, under which the Committee agrees a description of the role, experience and capabilities for a Director, are available on GKN's website. The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external executive search consultants, where appropriate.

The Committee meets periodically when required and consists of the non-executive Directors and the Chief Executive under the chairmanship of the Chairman of the Board (except when the Committee is dealing with the appointment of a successor as Chairman of the Board when the Senior Independent Director chairs the Committee).

#### Directors' attendance record

The attendance of Directors at relevant meetings of the Board and of the Audit, Remuneration and Nominations Committees held during 2007 was as follows:

Director	Board (11 meetings)	Audit Committee (4 meetings)	Remuneration Committee (9 meetings)	Nominations Committee (7 meetings)
Roy Brown	11	—	—	6 <sup>†</sup>
Sir Kevin Smith	11	—	—	7
Marcus Bryson	5/6*	—	—	—
Sir Ian Gibson	7	3	5	5
Helmut Mamsch	11	4	9	7
Sir Christopher Meyer	9	3	7	6
Andrew Reynolds Smith	6/6*	—	—	—
Bill Seeger	4/4*	—	—	—
John Sheldrick	10	4	8	7
Nigel Stein	11	—	—	—
Sir Peter Williams	10	4	8	7

\* Actual attendance/maximum number of meetings Director could attend based on date of appointment.

<sup>†</sup> Roy Brown did not attend the meeting of the Nominations Committee at which his reappointment was considered.

#### Internal control

The Board attaches considerable importance to, and acknowledges its responsibility for, the Group's systems of internal control and risk management and receives regular reports on such matters.

The Board's policy is to have systems in place which optimise the Group's ability to manage risk in an effective and appropriate manner. The Board has delegated to the Executive Committee responsibility for identifying, evaluating and monitoring the risks facing the Group and for deciding how these are to be managed. In addition to a formal quarterly review of risk management by the Executive Committee, members are expected to report to the Committee as necessary the occurrence of any material control issues, serious accidents or events that have had a major commercial impact, or any significant new risks which have been identified. Such matters are reported to the next Board meeting and/or Audit Committee meeting as appropriate. As part of its remit, the Governance and Risk Sub-Committee develops strategy for and provides oversight and direction on all matters relating to risk management. It reports formally on an annual basis to the Executive Committee and to the Board.

Continuing processes under the oversight of the Executive Committee and its Governance and Risk Sub-Committee are in place for all parts of the Group to assess the major risks to which their operations are exposed and the way in which such risks are monitored, managed and controlled. The risks covered by these processes include those relating to strategy, operational performance, finance (including risk financing and fraud), product engineering, business reputation, human resources, health and safety, and the environment. These processes are summarised in a 'risk map' which is reviewed annually by the Audit Committee. A summary of those risks which could have a material impact on the future performance of the Group is given on pages 37 to 39.

Each year all Group businesses are required formally to review their business risks and to report on whether there has been any material breakdown in their internal controls. This formal review is supplemented by an interim review conducted at the half year. Companies also have to confirm annually whether they have complied with statutory and regulatory obligations as well as with the policies which support the GKN Code. Risk profiling is undertaken across all subsidiaries to identify accidental risks and highlight action required to mitigate such risks.

As part of GKN's enterprise risk management programme, a risk profiling software tool has been developed and deployed across the Group. The tool provides a consistent set of risk definitions, a common approach to probability and impact, and strengthens the ability to consolidate measurement of risk. The objective of the Group's risk management processes is to ensure the sustainable development of GKN through the conduct of its business in a way which:

- › satisfies its customers;
- › develops environmentally friendly products and processes;
- › provides a safe and healthy workplace;
- › protects against losses from unforeseen causes;
- › minimises the cost and consumption of increasingly scarce resources;
- › prevents pollution and waste;
- › maintains proper relationships with our suppliers and contractors; and
- › maintains a positive relationship with the communities in which it does business.

The Group's systems and procedures are designed to identify, manage and, where practicable, reduce and mitigate the effects of the risk of failure to achieve business objectives. They are not designed to eliminate such risk, recognising that any system can only provide reasonable and not absolute assurance against material misstatement or loss.

### The review process

The Board reviews the Group's systems of internal control and risk management on an ongoing basis by:

- › setting the strategy of the business at both Group and divisional level and, within the framework of this, approving an annual budget and medium term projections. Central to this exercise is a review of the risks and opportunities facing each business and the steps being taken to manage these;
- › reviewing on a regular basis operational performance and updated forecasts for the current year. Comparisons are made with budget and the prior year and appropriate action plans put in place to optimise operational and financial performance;
- › retaining primary responsibility for acquisition and divestment policy, and the approval of major capital expenditure, major contracts and financing arrangements. Below Board level there are clearly defined management authorities for the approval of capital expenditure, major contracts, acquisitions, investments and divestments, together with an established framework for their appraisal, which includes a risk analysis and post-implementation plan, and where appropriate, a post-acquisition review;
- › receiving regular reports on the Group's treasury activities, having approved the operating policies and controls for this function;
- › performing at least annually a review of the Group's pension fund arrangements and insurance and risk management programmes;
- › receiving an annual report, following its review by the Executive Committee, on corporate social responsibility matters, which includes the environmental, health and safety performance of the Group's operations; and
- › reviewing an annual management development and succession plan. The Executive Committee also reviews management development issues at least annually.

The Board receives an annual report from the Audit Committee concerning the operation of the systems of internal control and risk management. This report, together with the reviews by the Board during the year of the matters described above, enables the Board to form its own view on the effectiveness of the systems.

The Audit Committee is responsible for reviewing the ongoing control processes, and the actions undertaken by the Committee during 2007 to discharge this responsibility are described in the Audit Committee's report on page 56. To assist it in this role the Committee liaises closely with the internal audit department which, using a risk-based audit programme, reviews and tests the systems, controls, processes, procedures and practices across the Group. The Head of Internal Audit, who reports directly to the Finance Director, meets regularly with the Chairman of the Audit Committee, the Group Chairman and the Chief Executive. The department's reports are seen by the relevant members of the Executive Committee. The resolution of any control issues raised by Board members or in reports reviewed by the Audit Committee are discussed in Committee with management.

The Board has reviewed the effectiveness of the Group's systems of internal control and risk management during the period covered by this annual report. It confirms that the processes described above, which accord with the guidance on internal control appended to the Code (the revised Turnbull Guidance), have been in place throughout that period and up to the date of approval of the annual report. The Board also confirms that no significant failings or weaknesses were identified in relation to the review.

### Compliance with the Code

It is the Board's view that, throughout 2007, GKN was in compliance with the relevant provisions set out in Section 1 of the Code.