THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Sir David Walker
Walker Review Team
The Financial Services Authority
25 The North Colonnade
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London
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By email to: feedback@walkerreview.org

Dear Sir David

WALKER REVIEW OF CORPORATE GOVERNANCE IN THE UK BANKING INDUSTRY (REVIEW)

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the consultation paper 'A review of corporate governance in UK banks and other financial industry entities' published on 16 July 2009.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council (FRC). As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

The Institute has participated in consultations regarding corporate governance and plays an active role in the development of corporate governance in the UK and internationally. Our Financial Services Faculty was established in 2007 to become a world class centre for thought leadership and guidance on issues and challenges facing the financial services industry. It draws together professionals from across the financial services industry and from the 25,000 Institute members specialising in the sector.

The Institute welcomes on-going dialogue on the matters raised in the Review and supports the incremental changes that the majority of the recommendations encourage. We also support the introduction of the recommendations in a thought out way using the existing framework.

Our process

Following the HM Treasury announcement in February 2009, the Institute concluded that the Review was of such significance that a separate advisory group was formed to formulate a response. This advisory group is drawn from investors and institutions; executive and non-executive directors; auditors and company secretaries. The group reports jointly to the Institute's Corporate Governance Committee and the Financial Services Faculty's Risk and Regulation Committee.

We highlight below some key observations and make additional specific comments in the attached appendix.

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Key observations

Leadership role
We suggested in our response to the Review team on 29 May 2009 that the Bank of England and the FSA are in a unique position to take a leadership role in convening annual briefing meetings of non-executive directors of banking institutions to discuss forward looking macro-economic and macro-prudential risk and regulatory risk outlooks. Both organisations produce valuable information that could be used in this way and is of enormous benefit to non-executive directors on boards of banks and other financial institutions (BOFIs).

Scope
We do not believe that it would be in the best interests of the market as a whole to see all recommendations mandated as best practice for all listed companies.

We remain of the view that these recommendations should apply only to organisations that can contribute to systemic risk. We support the principal focus of the recommendations on the governance practices of BOFIs. However, we note that not all BOFIs may materially contribute to systemic risk and that other organisations, not included in the list of BOFIs, may contribute to systemic risk. There is a need to define the sub-set of listed companies to which the recommendations should apply and which firms will be in scope. It is important to avoid creating an uneven playing field in respect of BOFIs themselves.

Whilst we note that the principal focus of the Review relates to the governance of entities that are listed on the London Stock Exchange, we support the proposal that where an FSA-authorised, but unlisted, BOFI entity is a subsidiary of a UK-listed holding company, the best practice proposals of the Review should be taken to apply to that holding company.

It may be the case that not all of the recommendations should apply to unlisted BOFIs whether overseas owned or privately held. Perhaps recommendations 1-9, 23-30, 32 and 35 only would suffice.

Prescription
Too much prescription in the recommendations particularly in respect of remuneration may be counter-productive and lead to box-ticking and bland boiler-plate disclosures. A principles-based approach rather than one that is too prescriptive has many advantages. Pure compliance with strict requirements can suppress additional and more in-depth disclosures.

Risk
Risk remains a key concern for boards. How risk reporting is escalated to the board is of paramount importance as is how risk tolerance is communicated from the boardroom. Risk oversight and risk tolerance are key concerns for a board and any confusion of responsibilities for risk between boards and committees must be avoided. There may not be sufficient emphasis on the need for the board to set out their risk tolerances. Too much reliance on board committees can be as dangerous as too much reliance on risk assessments made by regulators and could encourage boards to delegate discussion of risk more than is appropriate.

International context
Most banks operate in an international context as do most institutional shareholders and non-executive directors. There are issues raised in the recommendations that have international implications. It is important to ensure that the international nature of institutional shareholders and non-executive responsibility are reflected in the recommendations and any final changes made to the Combined Code on Corporate Governance.

We have provided more detailed comments on the individual recommendations in the attached appendix.

We hope that our comments are useful and we would welcome on-going dialogue with the Review team. Please do not hesitate to contact me or my colleague Vanessa Jones, vanessa.jones@icaew.com, should you wish to discuss any of the points raised in this response.

Yours sincerely

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APPENDIX

Recommendation 1: The knowledge and skills of BOFI non-executive directors should, on a board by board basis, be considered collectively as well as individually.

For international BOFIs this consideration needs to include an assessment of skills and knowledge at an international level. It would be helpful to include this dimension in the recommendation particularly for BOFIs that have an international aspect.

The Bank of England and FSA could provide a leadership role by hosting yearly or twice yearly sessions on macro-economic trends with emphasis on macro-prudential risk. This leadership role need not be provided on a BOFI by BOFI basis. There could be real benefit in this type of awareness briefing taking place across different companies within the financial services sector.

Recommendation 2: It should be for boards to decide how any dedicated support for non-executive directors is provided. It would be better if this recommendation were a statement of principle rather than a prescribed requirement.

We absolutely support the principle that boards should provide non-executive directors with mechanisms to get separate advice as and when needed but believe that it should be for boards to decide how this is delivered. For the majority of boards, especially those outside the FTSE 100, a dedicated support function may not be appropriate.

Recommendation 3: We concur with the basic aim of this recommendation but it would be helpful if it was clarified whether the 30 to 36 day time commitment includes all committee work. We note that the expected time commitments will vary according to the complexity of the organisation and its business activity.

There must be recognition that certain directors (depending on their role) will spend considerably more time than 30-36 days but that BOFIs can still gain great benefit from non-executive directors who are serving Chairmen/Chief Executive Officers at other organisations whose time commitment may be less than 30-36 days. It is essential to avoid any restriction on the talent pool of potential non-executive directors so there should be a comply or explain opt-out subject to FSA veto.

Recommendations 4 and 5: We agree with these recommendations to the FSA as drafted.

Recommendation 6: We agree with this recommendation and note that many BOFI boards already draw on external analysis and input on risk matters.

Recommendation 7: The size and complexity of the BOFI should always be taken into account when looking at external appointments. This recommendation should be restricted to BOFIs as it is unlikely to be appropriate for the majority of listed companies.

Recommendation 8: This recommendation would be strengthened if the combination of relevant financial industry experience and evidence of successful leadership capability in a significant board position were also applied to the senior independent director.

Recommendations 9 and 11: We agree with these recommendations on the roles of the Chairman and senior independent director as drafted.

Recommendation 10: We recognise investor pressure towards the annual re-election of the Chairman as a means of enhancing the quality of board communication with shareholders and improving director accountability. However, we are concerned that implementation of this recommendation could lead to greater uncertainty and reinforce short-term behaviours.

Recommendations 12 and 13: These recommendations may lead to more annual report disclosures, but they are sensible and reflect current good practice in BOFI boards. Greater disclosure of the board and committee evaluation is positive and a separate section of the annual report focussed on this and the activities of the nomination committee is a welcome development. However it is, once again, important to approach this driven by principles and to avoid any undue or unnecessary prescription which may dilute the quality of the reporting.

Recommendations 14 and 15: These recommendations would in theory encourage greater dialogue with shareholders and introduce FSA involvement in the engagement with selling shareholders. However, it is not immediately clear what the FSA will do with the information or how it will progress any follow-up actions with such sellers.

In relation to recommendation 15 it would be helpful if the recommendation clarified whether the FSA should be involved as supervisor of the BOFI concerned or as UK Listing Authority/Market Supervisor.

From a shareholder register perspective it is one thing to monitor changes, as a matter of good practice, but there are limited actions that a company can take to respond to major movements. The limited options available to companies should be noted in recommendation 14.

There are currently no obligations on selling entities to respond to requests for dialogue and information and we think that this is a weakness in the recommendations. Furthermore, there is a danger that responses from selling shareholders, even if provided, might become boilerplate statements, rather than genuinely useful information.

Recommendation 16: This is a recommendation that could apply to the whole of the listed sector. We would welcome additional clarity as to how the investor Principles of Stewardship will operate in practice especially in relation to overseas institutional investors over which the FRC has no jurisdiction.

Recommendations 17 and 18: These are sensible recommendations as drafted provided that the FRC has the resources to perform the proposed additional functions.

Recommendations 19 and 20: We welcome these recommendations: public disclosure by fund managers on their websites is helpful as is the requirement to comply or explain against the Principles of Stewardship.

Recommendation 21: In principle the recommendation is helpful, but we urge that the practicalities are carefully worked through with the institutional investor community. The key element of this recommendation is the importance of engagement with overseas investors and we urge that further thought be given to how to encourage greater engagement with this sector. We are concerned that, as drafted, the recommendation may promote a formal centralised mechanism to guide collective engagement which could result in an inefficient, inflexible bureaucratic process which could duplicate existing initiatives in the market-place (such as those of the ABI).

Recommendation 22: There is an important distinction between how an institutional investor has voted and the fact that they have voted at all. While it is right that there should be disclosure that an investor has voted, there could be detrimental effects on companies and investors alike if voting directions were always made public.

Recommendations 23 and 24: For some organisations these recommendations may be too prescriptive. Provided that the board is primarily responsible for risk it should be for a board to decide and communicate what structure it wants to adopt and operate. In particular we have concerns about how these two recommendations would operate in smaller and less complex BOFIs.

We note that risk committees evolved out of audit committees as a result of the increasing workload being placed upon the audit committee of larger and more complex organisations, rather than due to inherent conflicts between the objectives of audit and risk. There may be considerable overlap between the objectives of audit and risk committees, and close interaction will be necessary. For smaller and less complex organisations, mandating the creation of separate risk committees might be disproportionately bureaucratic.

It is essential that the board should not get a diluted message on risk. For the purposes of these two recommendations it would be useful to have an explanation of risk tolerance and some guidance as to what the board's role in setting risk tolerance should be.

It is important to avoid over-prescription when looking at the Chief Risk Officer role because not all BOFIs are the same. There must be room for each BOFI board to adopt practices that are most fitting to its business.

Recommendation 25: In principle it is right that a board risk committee should be able to draw on external input but this should be on an occasional basis and not as a matter of routine. This is an area where prescription is not beneficial. What is essential is that a board committee should not feel constrained in taking advice where necessary.

Recommendation 26: In relation to any proposed strategic transactions involving acquisition or disposal it should be a matter for the whole board to decide what structure it wants to adopt and operate providing that the whole board is responsible for due diligence.

Recommendation 27: We support the principle that the board risk committee should publish a separate report in the annual report. It would be extremely helpful if any final recommendation set out guidance on what good practice risk disclosures should aim to achieve. In particular, the final sentence could be expanded to include an obligation for the BOFI to explain in detail what the risk committee spends its time on.

Recommendations 28 to 39 (Remuneration): We do not have anything to add on remuneration to the points we made in our earlier response of 29 May 2009. We believe that several of these recommendations are too prescriptive with too much emphasis on the amount of remuneration rather than consideration of structure and remuneration policy/strategy. We believe this is a weakness and a missed opportunity given the importance of the subject.

Too much focus on detail, rather than substance, should be avoided. A principles-based approach would be preferable. In particular, recommendations 33 and 36 are overly prescriptive and may lead to unintended consequences. Greater clarity of remuneration committee oversight and responsibility for senior executives who are not board directors would be more helpful.

However, we welcome recommendation 38 to develop a remuneration consultants' code of conduct and think that this is a useful mechanism to address the conflicts of interest that are inherent in the provision of remuneration consultancy services.