



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
Canary Wharf
London
E14 5HS

By email to: feedback@walkerreview.org

Dear Sir David

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

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to provide comments to the Walker Review announced by HM Treasury in February 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. 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 750,000 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. The Institute's 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.

OUR PROCESS

Following the HM Treasury announcement in February the Institute concluded that the Walker 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.

The Institute welcomes on-going dialogue on the matters raised in the Walker Review.

KEY OBSERVATIONS

We have highlighted some key observations together with some additional specific comments below.

Increased regulation is no substitute for good governance

There is a case for large banks (and any similar credit creating organisation capable of creating a systemic risk (referred to throughout the rest of this submission as 'banks')) having enhanced systems of governance simply because of their inherent complexity and the systemic risk that they pose. Historically, this additional complexity has been addressed by FSA and/or Bank of England regulation to take into account the systemic effect and externalities that each individual firm cannot take into account. Increasing regulation and disclosure of governance is not a substitute for good corporate governance or effective supervision. Current bank disclosure is already extensive. Future regulatory focus should be on what is relevant and of use.

Banks only

While we believe that there is a case for improving and strengthening the corporate governance mechanisms for systemic risk in some banks (and organisations undertaking bank-like activities) we are less convinced that there is a need for major change in the rest of the financial services sector. We believe that the differentiator should be whether an organisation can contribute materially to systemic risk irrespective of whether it is a bank or a listed entity.

International context

While we note that the remit for the Walker Review is UK-specific, most banks operate in an international context. Potential problems of regulatory arbitrage will therefore need to be considered. In the international context it may be appropriate to suggest that the Basel Committee should review the principles published in 2006 entitled 'Enhancing corporate governance for banking organisations'.

Leadership role

The Bank of England and the FSA are in a position to take a leadership role in convening annual briefing meetings of non-executive directors of banking institutions to discuss forward looking macro-economic issues and regulatory risk outlooks. Both authorities produce valuable information that could be used in this way.

Considered change

We believe that good governance practice is constantly evolving over time in response to changing circumstance and behaviours. Too rapid, or too much, prescriptive change, when not based on objective evidence, may not be helpful and may have unintended consequences. We accept the need for change but believe that it should be thoughtful and evidence based, and its implications carefully considered before implementation.

DETAILED COMMENTS

Risk management

- Risk management, the effectiveness of risk management systems and the methods that boards employ to ensure that their organisations have robust risk management are central to good governance in all organisations. There should be a clear distinction between the setting of risk appetite and the management of risk within an organisation. The setting of risk appetite and the management of risk are separate issues but completely linked in that risk appetite will determine how the risk needs to be managed. Boards should determine risk appetite and should take responsibility for oversight of risk and determination of risk profile. Oversight of risk management can be delegated to a committee of the board but setting the risk appetite must be a matter reserved to the board.
- There should be clear disclosure in annual reports of a firm's risk appetite (thought would need to be given on how best to describe this). There should be mechanisms to allow shareholders to have a clear understanding of when a firm significantly deviates from its traditional business model.
- Greater clarity about how risk management information flows up to the board and how this information is aggregated, collated and reported would be useful to investors and regulators. As with financial information, it is important that reliable and meaningful risk management information forms an integral part of a company's annual disclosures. The inclusion of a risk discussion in the annual report which not only discloses risk appetite but also the major risks and how these have been managed should be considered.
- The primary responsibility for information flows to the board must be a shared responsibility of the Chief Executive Officer and Chairman. Executive directors should have a responsibility to make all relevant information available to the board.

Board and committee effectiveness

- We do not believe that board and committee effectiveness is simply a matter of individual competence or organisational size. We are not convinced that further regulation on the composition, qualification and size of listed company boards would necessarily change behaviours for the better. Different structures of equal effectiveness will develop within different institutions, and therefore we would encourage you to avoid undue prescription as to the committee or organisational structure required, to avoid diluting or damaging structures that are working well.
- Board and individual director evaluations play a critical role in board effectiveness. Some banks already provide greater transparency and we would like to see all banks attaining the disclosure levels of the best. We are supportive of all boards looking at the time they devote to directors' continuing professional development and the degree of formality and structure involved.
- Annual board evaluations should periodically be undertaken by external firms (possibly every third year). The policy on board evaluation should be disclosed together with the detail of which firm has facilitated the external evaluation.
- We support the unitary board concept and believe that the best outcomes are achieved when a board acts as a cohesive unit. Corporate governance guidelines provide tools and processes but we question whether it was board lack of understanding or inability to exercise controls that provided such limited control in some firms. In some boards the continual strengthening of the 'control' role of non-executive directors may come to infect board

relationships by creating a climate of apparent mistrust and suspicion between executives and non-executives.

- There may be arguments for independent board secretariats within banks. However, there are dangers that this may divide executive and non-executive directors. What matters is the quality of the relationships between the secretariat, the Chairman and Chief Executive Officer and the businesses. A dual reporting line for the secretariat to both Chairman and Chief Executive Officer/Chief Financial Officer would be preferable to the formation of independent secretariats serving only non-executive directors.

Balance of skills, experience and independence

- The current crisis appears to have exposed certain bank boards as lacking banking and risk knowledge and not having voluntarily sought to add such knowledge. While the Combined Code sets out the expectations on non-executive directors, the role and contribution of all directors should be considered.
- There should be strong emphasis given to capabilities and experience of non-executive directors serving on bank boards as well as their independence and objectivity. Independence should not be the dominant criterion.
- There is a case for increasing the numbers of executive directors on bank boards beyond the Chief Executive Officer and Finance Director, subject to the non-executive directors remaining in the majority. To a certain extent too much has been expected of non-executive directors given available time commitments and the limited pool of individuals who can serve on bank boards due to existing independence criteria.
- Serious attention needs to be focussed on why bank boards have not looked for risk and banking expertise in their non-executive directors. There are many experienced risk professionals. Such risk professionals are unlikely to have been prior board members as risk functions have rarely been managed at board level. We believe that this imbalance could be addressed by increasing the number of executive directors on boards rather than further increasing expectations on non-executive directors.
- The role of executive committees has, so far, not featured in any consideration of bank governance. We believe that the role of executive committees is important and may be worthy of further guidance.

Remuneration policy

- We are supportive of the position set out in the FSA's CP 09/10: Reforming remuneration practices in financial services. We believe that no further regulation is currently needed in this area.
- It should be for individual businesses to decide, within the context of the regulatory framework, the most appropriate levels and mix of remuneration.
- How remuneration is structured is a fundamental driver of any business. There may therefore be scope for overall remuneration policy, and how it is linked to the firm's risk appetite, to be a matter which is reserved to the board rather than delegated to a committee of the board. The remuneration policy and how it links to risk appetite should be transparent and disclosed in annual reports. We believe it is worth exploring the existing role of the remuneration committee to determine if a better structure would produce better outcomes in some banks.

Institutional shareholders

- The dialogue between banking organisations and institutional shareholders needs to be broader and stronger and new thinking on this is required. It is for directors to run the company having regard to the views of the owners who have the ability to vote them out of office. The weight of external expectations on banking organisations is primarily from investors in relation to delivering value and good governance. The role assigned to institutional investors is based on an agency theory view that agents can influence the conduct of both boards and companies. We know that shareholder interests are not homogenous: different investors will have different interests which will produce different demands. The conventional view of the role of institutional investors is by its very nature limited and is in need of review particularly with regard to owners who hold shares for short-term considerations.
- Actual board effectiveness depends upon the skills of individual directors and a positive dynamic in board relationships. This is not, and arguably can never be, visible to institutional investors from a distance. It is unrealistic to expect institutional investors to try to assess this with any precision although we do believe that institutions could meet with independent directors more frequently.

We hope that our comments are useful and we welcome on-going dialogue with the Walker Review team especially in view of the relatively short time-scale in which to consider the issues.

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 or if you would like to meet with our advisory group.

Yours sincerely

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