

Sir David Walker
Review Secretariat Office
c/o Financial Services Authority
25 The North Colonnade
Canary Wharf
LONDON E14 5SH

feedback@walkerreview.org

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Dear Sir David

A Review of Corporate Governance in UK Banks and Other Financial Industry Entities

- Comments by the British Bankers' Association -

The British Bankers' Association welcomes the opportunity to comment on the review of corporate governance in UK banks and other financial industry entities. Our response has been prepared in full consultation with member banks, both UK and non UK, and in the context of our expectation that the review's will impact non UK member banks too as it is likely to influence both the international debate on corporate governance as well as UK standards such as the Combined Code.

The Review's five key themes

We are broadly in agreement with the principles behind the five key themes of the report, but believe that there may in some instances be a case for reviewing the specific approach proposed within the interim report issued for comment:

- We agree that the Combined Code, under the aegis of the Financial Reporting Council, remains a better conduit for corporate governance practice than primary legislation. The 'comply or explain' regime is a cornerstone of the UK's approach to corporate governance and has broadly been adopted across other European member states. It reflects the fact that many of the Code provisions are qualitative in nature and also that major companies have differing business models. The means of delivering enhanced standards of corporate governance in banks and other financial institutions (BOFIs) therefore is amplified guidance and provisions and better observance based on a 'comply or explain' approach which recognises the importance of flexibility and does not presume compliance is the 'better' approach.
- We agree that experience shows that principal deficiencies in the boards of BOFIs related to patterns of behaviour and that the objective should be to foster the right environment for a board to provide an effective challenge of the executive in a way that engenders useful discussion and debate. This involves ensuring that boards have the right mix of skills and experience, operate in a way that allows different views to be expressed and require a time commitment from non-executive directors (NEDs) commensurate with their making a meaningful impact on the

British Bankers' Association

Pinnars Hall
105-108 Old Broad Street
London
EC2N 1EX

T +44 (0)20 7216 8800
F +44 (0)20 7216 8811
E info@bba.org.uk
www.bba.org.uk

management of the company. The exact extent of this commitment will ebb and flow according to the needs of the board and its developing agenda.

- We agree that board-level engagement in risk process should be materially increased, with more deliberate attention on the monitoring of risk and discussion leading to decisions on risk appetite and tolerance. We agree that this should involve NED focus on risk issues, full independence in the group risk management function and the appointment of a CRO with enterprise-wide authority and independence, with tenure and remuneration determined by the board. We envisage that the CRO will have a direct reporting line to a senior executive director – perhaps the finance director or the chief executive - and a parallel reporting line to the non-executive director chairing the risk committee.
- We agree that fund managers and other major shareholders should engage more productively with their investee companies and that the Institutional Shareholders Committee, the FRC and the FSA have a role in promoting enhanced engagement by owners on the basis of principles of stewardship and a comply or explain disclosure; we particularly support the proposal that fund managers in pitching for business should advise clients whether their business model includes engagement with a view to long-term performance improvement.
- We agree that enhancement is needed in board level oversight of remuneration policies but believe that the detailed provisions are better set out elsewhere. In respect of variable pay and its disclosure we agree that the remit and responsibility of board remuneration committees should be extended beyond board members to cover the remuneration framework of the entire entity. We also agree that the alignment of interests, performance conditions and deferral in respect of variable pay for executive board members and other relevant senior executives should be subject to specific board scrutiny that is materially more demanding than previous industry norms. We are concerned, however, about the level of detailed provision within the recommendations and are of the opinion that the proposals detailed in the FSA Code of Practice and the second package of the EU's Capital Requirements Directive (CRD) revisions (published in July 2009) provide the means of addressing political and regulatory expectations on remuneration, including the agreement since reached at the G20 summit in Pittsburgh last week. The FSA code and EU legislation provide the means for addressing the detail of these matters and would ask that this be borne in mind when looking at the revisions to the Combined Code that should flow from the Review. It will be necessary for any planned legislative provisions to align as appropriate with the detailed measures already agreed in the form of the FSA Code.

The Review concludes that it is highly unlikely that a form of stronger statutory provision in relation to governance could have prevented that part of failure that was attributable to general market failure to recognise 'fat-tail' events such as the relatively sudden effective closure of the wholesale markets – on the part of regulators, central banks and rating agencies as well as boards. The Review makes the point that 'errors of commission', often associated with specific events or decisions, are generally more readily identifiable for purposes of legislation, regulation and enforcement than 'errors of omission' which tend to stem from some behavioural process or deficiency which is more difficult to pin down. Moreover, greater engagement on the part of institutional investors is unlikely to be achieved through statute or regulation. Adherence to the FSA Handbook and Combined Code is rightly seen as exercising powerful influence unlikely to be matched by box-ticking conformity with new, inflexible statutory provision.

The general approach of the Review, therefore, in examining the case for strengthening the corporate governance of BOFIs is through better implementation of provisions that are already in place and for incorporation of new provisions that seem necessary and appropriate within the Combined Code. The Review leaves for future, separate consideration the question of how far the Combined Code changes recommended for BOFIs should be extended to non-financial institutions and whether, in respect of the amended provisions for BOFIs, an explicit and dedicated Combined Code review and monitoring process should be put in place beyond that currently undertaken by the FRC.

Key industry concerns

While our comments on the specific recommendations made within the Review are set out overleaf, we would highlight the following key issues.

Scope and promulgation

Our first concern relates to scope, in that paragraph 1.21 explains that the principal focus of the Review was the governance of entities listed on the London Stock Exchange within the FTSE 100 and clarifies 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 the holding company. This is entirely appropriate given that boards of unlisted group-operated subsidiaries will not have separate risk policies, systems and controls, remuneration policies, or business strategies in isolation from the group.

Paragraph 1.21 then adds that in the case of other BOFIs, it is envisaged that they will be encouraged by the FSA to take account of such best practice “to the extent that it is appropriate to their circumstances” within the understanding between regulators on regulation and supervision of international corporate structures. It is also explained that the proposals are also relevant for governance in other smaller listed and non-listed UK-resident BOFI entities such as private banks and asset management groups and that “the need to promote conformity with the proposed best practice standards should be influenced in particular by their potential significance in terms of the customer and wider market impact of possible failure”.

We can therefore see that the recommendations are aimed principally at the main boards of major listed entities. Paragraph 1.21 on the scope of the Review makes clear that there is an expectation that the FSA should look for the enhanced best practices to be followed by UK-resident subsidiaries of foreign-owned BOFI entities – on a basis described in the penultimate paragraph of the Preface as being “at least broadly applicable”. The preface adds that “the applicability of others will depend in part on progress toward international convergence in corporate governance standards” and presses the Treasury and FSA to press for agreement on the enhanced best practices identified within the Review in international discussion as an urgent and high priority.

This raises significant issues about the jurisdiction of the recommendations in the Review in advance of any such international agreement and we believe that further thought should be given to the question of whether it is appropriate to place foreign-owned subsidiaries in a position of having to apply the enhanced best practices in advance of their being agreed internationally and, more specifically, to the question of what is meant by the statement that the practices should be applied on a broadly applicable basis. It also needs to be borne in mind that many of the considerations that apply in terms of the non-listed subsidiaries of UK groups will also apply to the non-listed subsidiaries of foreign-owned groups, ie they will not have discretion over risk policies, systems and controls, remuneration policies, or business strategies in isolation from the group. This must also have a relevance to the applicability of the proposed measures to these entities.

We are therefore of the view that the governance of overseas groups is principally a matter for home state regulators and that the obligation on the FSA should be for it to establish that arrangements of an equivalent standing are in place in keeping with Basel principles on governance.

A similar issue arises with the expectation that smaller and non-listed entities also follow the enhanced best practices outlined in the Review. So, for example, while it may be appropriate that they follow the guidance in respect of the Board responsibility, the establishment of a Risk Committee and the status of the Chief Risk Officer, we would find it hard to believe that the intention would be for the time commitment on the part of the Chairman or NEDs to apply equally.

We therefore see a need for a more definitive statement about the extent to which the proposals are seen as relevant to smaller and non-listed entities – where for example guidance on Chairman or NED time commitments may not be proportionate - as they may otherwise find themselves under pressure to take disproportionate account of such best practice.

A related issue is the question of whether the Combined Code, a section of the Combined Code for FTSE 100 listed BOFIs or the FSA Handbook provides the best medium for the promulgating the Review's recommendations. Our preference would be for the recommendations to be reflected as far as possible in the Combined Code since this is the primary reference document for corporate governance in the UK and has a higher profile in Europe and internationally. There is a concern amongst smaller institutions, however, that by incorporating the Review recommendations into the Combined Code there is a danger that they will be wrongly judged by the market if they do not comply in full with the requirements. It may be therefore that they should be included as a specific appendix to the Combined Code for BOFIs.

We need therefore to think very carefully about the extent to which the recommendations apply to the broader financial community and the need to avoid placing foreign-owned and smaller and non-listed entities in a position of having to account for their non-adoption of recommendations framed with UK FTSE 100 listed entities in mind.

Non Executive Directors

We are broadly supportive of the recommendations concerning the operation of the board, the expectations to be placed on NEDs and the support to be provided to them. But we have reservations about the increased expectations to be placed on NEDs and believe that in seeking to enhance their effectiveness we must also take care not to put in place demands that cannot be met or which may confuse the role of non-executives with the role of executive members of the board. As the Review explains, there is a balance to be found between the role of executives and non-executives on a well functioning board. This is a point that we believe merits emphasising in the final report.

We are also inclined to the view that the inclusion of a minimum expected time commitment of 30-36 days for NEDS in a major bank board may be unnecessarily crude. In many cases NEDs may be able to make a significant and worthwhile contribution on the basis of a lesser time commitment, particularly in the case of individuals who do not participate in a board's principal committees. We are also concerned about how this time commitment may translate in terms of its scaling down for the subsidiaries of foreign banks and smaller and non-listed entities.

Notwithstanding the fact that there will continue to be a role for NEDs who can bring expertise and experience from outside the financial sector, we would concur with the view, expressed in paragraph 3.5 that the need for industry experience on BOFI boards is greater than in non-financial businesses. We also agree with the sentiment, expressed in the following paragraph, that independence relates to "the quality of independence of mind and spirit, of character and judgement" and that a NED who brings both independence of approach in this sense together with relevant industry experience is most likely to be able to bring effective and constructive challenge to the board's decision-taking process. We therefore believe that there are grounds for reviewing the relevant provisions on independence in the Combined Code and will be writing to the Financial Reporting Council separately on this.

Remuneration

We need to be clear about the scope of the remuneration measures under discussion with the FSA and the Review ie "high end" executives as opposed to middle and lower ranking staff, including those in branches, who may be eligible to receive a modest bonus as part of their annual performance appraisal.

As mentioned above, we are supportive of the Review ensuring that the right governance is placed around remuneration policies and agree with the proposed extension in the scope of the board's responsibility as proposed. We are concerned however about whether the level of detail within the recommendations is compatible with there being a separate, more detailed Code of Practice and believe that the detail should be left to the Code and an appropriate means found to ensure that the Review recommendations and the Code interrelate appropriately. There will also be a need to ensure that any planned legislative provisions suitably align with the Review's final recommendations and the FSA Code.

In broad terms we believe that by virtue of the Walker Review and the FSA Code the UK authorities and BOFIs are at an advanced stage in reforming compensation practices as sought by G20 leaders at the Pittsburgh Summit. It is imperative, however, that all who have signed up to these measures act upon this political lead and that other national supervisors adopt as proactive a stance as the one that the FSA has signalled it intends to take. The need therefore will not necessarily be that the Financial Stability Board propose additional measures by 2010 but that they bring to account any authorities perceived not to have implemented the clear instruction given in the G20 Leaders Statement at the conclusion of the summit.

The need to avoid 'tick box' reviews

We agree with the analysis within the Review of the importance of 'comply or explain' but believe that there remains a pejorative element to the 'explain' part and that demands on the part of institutional investors to be more proactive may intensify pressures on them to adopt tick box reviews.

Concluding remarks

The closing paragraph of Chapter 1 explains that a challenge throughout the review process has been to identify enhancements in governance that are both proportionate and capable of being implemented without putting financial institutions operating in the UK at a competitive disadvantage viz-a-viz their non-UK domiciled competitors. While we believe that there are adjustments to be made to the recommendations in advance of their being incorporated into the final version of the report, we see no reason why the review team cannot meet this objective in completing its work.

We would be pleased to meet with the Review Team to discuss the issues raised in this submission if that would be helpful.

Yours sincerely



Paul Chisnall
Executive Director

T +44(0)20 7216 8865
E paul.chisnall@bba.org.uk

Comments on the 39 recommendations within the consultative document

Board size, composition and qualification

Recommendation 1

To ensure that NEDs have the knowledge and understanding of the business to enable them to contribute effectively, a BOFI board should provide thematic business awareness sessions on a regular basis and each NED should be provided with a substantive personalised approach to induction, training and development to be reviewed annually with the chairman.

We agree that there should be a more organized approach to supporting NEDs in their induction, training and development needs and that this should be reviewed annually with the chairman.

Recommendation 2

A BOFI board should provide for dedicated support for NEDs on any matter relevant to the business on which they require advice separate from or additional to that available in the normal board process.

We agree. Care should be taken however to ensure that the support available is consistent with the role of the NED to challenge constructively the decisions of the executive and to assist with mapping out strategy.

Recommendation 3

NEDs on BOFI boards should be expected to give greater time commitment than has been normal in the past. A minimum expected time commitment of 30 to 36 days in a major bank board should be clearly indicated in letters of appointment and will in some cases limit the capacity of the NED to retain or assume board responsibilities elsewhere.

We agree that there should be an increased time commitment for members of major UK bank boards, but do not think that a minimum time requirement need be prescribed. For instance, we are advised by a larger bank that in normal circumstances they would envisage a 24 day commitment on the part of NEDs as being sufficient for them to make a full and effective contribution, while a second points to some of their NEDs having devoted 72 days or more to their bank responsibilities. It is further arguable that the time commitment will be less in the event that the individual in question is not a member of any of the board's principal committees. What matters is attracting a range of well qualified candidates for NED roles and in this respect we believe Section A4 of the Combined Code already provides adequate guidance on the commitment envisaged.

Recommendation 4

The FSA's ongoing supervisory process should give closer attention to both the overall balance of the board in relation to the risk strategy of the business and take into account not only the relevant experience and other qualities of individual directors but also their access to an induction and development programme to provide an appropriate level of knowledge and understanding as required to equip them to engage proactively in board deliberation, above all on risk strategy.

We agree. It needs to be borne in mind, however, that there is a limited gene pool for NEDs, particularly of major institutions. We would not wish to see NEDs with the right qualities declined because of shortcomings in experience that can be filled by an induction and development programme. Whilst we recognise this is an area of supervisory interest we do not think the regulator should be the final arbiter on the balance of the board's skills. This should remain the domain of the shareholders of the firm.

Recommendation 5

The FSA's interview process for NEDs proposed for major BOFI boards should involve questioning and assessment by one or more senior advisers with relevant industry experience at or close to board level of a similarly large and complex entity who might be engaged by the FSA for the purpose, possibly on a part-time panel basis.

Our understanding is that the FSA is already approaching with greater deliberation the interview process for NEDs and that more senior staff are engaged in this than previously may have been the case in recent years. We support this as we think this capability should be a core competency of the supervisor, but believe that if insufficient internal resource is available then the engagement of outside advisors should be considered. In any event, the interview should be complementary to that conducted by the board's nomination committee and any concerns held by the FSA communicated in clear and specific terms.

Functioning of the board and evaluation of performance

Recommendation 6

As part of their role as members of the unitary board of a BOFI, NEDs should be ready, able and encouraged to challenge and test proposals on strategy put forward by the executive. They should satisfy themselves that board discussion and decision-taking on risk matters is based on accurate and appropriately comprehensive information and draws, as far as they believe it to be relevant or necessary, on external analysis and input.

We agree that NEDs should be clear in their role being to challenge and test the strategic proposals made by the executive and to satisfy themselves that key decisions on risk matters are based on accurate and comprehensive information including external analysis and input. This will include ensuring that sufficient weight is placed upon the macro-prudential analysis envisaged from the UK authorities, the European Systemic Risk Council and the Financial Stability Board established under the aegis of the G20, depending on the global reach of the BOFI.

Recommendation 7

The chairman should be expected to commit a substantial proportion of his or her time, probably not less than two-thirds, to the business of the entity, with clear understanding from the outset that, in the event of need, the BOFI chairmanship role would have priority over any other business time commitment.

We agree, though as the consultative document observes, this does not mean that the chairman will have an executive role and despite allocating a substantial portion of their time on the business of the entity care should be taken to ensure that the chairman does not compromise or interfere with the ability of the CEO and executive team to implement the agreed strategy. This is also one of the recommendations for which the conclusion may be different when considering an entity other than the main board of a major UK bank.

Recommendation 8

The chairman of a BOFI board should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position. Where this desirable combination is only incompletely achievable, the board should give particular weight to convincing leadership experience since financial industry experience without established leadership skills is unlikely to suffice.

We agree that the two “desirable conditions” for a successful chairman of a major bank are the ability to lead the board and to draw on substantial financial industry experience. While it is preferable for this to be from an earlier senior role in banking, the consultative draft does not rule out a candidate without substantial relevant financial industry experience being able to demonstrate “wholly exceptional experience of leadership” in another major board situation or situations sufficient to compensate for the deficiency in financial industry experience. This is important given that the list of potential candidates is likely to be limited. As the consultative document observes, a new chairman of plainly considerable ability but with less than the desired financial industry experience can be assisted through a rigorous tailored induction and training programme to move up the industry learning curve relatively quickly; the same cannot be said of the vital chairman leadership skills.

Recommendation 9

The chairman is responsible for leadership of the board, ensuring its effectiveness in all aspects of its role and setting its agenda so that fully adequate time is available for substantive discussion on strategic issues. The chairman should facilitate, encourage and expect the informed and critical contribution of the directors in particular in discussion and decision-taking on matters of risk and strategy and should promote effective communication between executive and non-executive directors. The chairman is responsible for ensuring that the directors receive all information that is relevant to discharge of their obligations in accurate, timely and clear form.

We agree that the chairman’s leadership role entails ensuring board effectiveness in all aspects of this role and setting its agenda so that full and adequate time is available for substantive discussion on strategic issues. We would further underline the need for the chairman to create a climate around the board table that allows for different views to be expressed and decisions to be challenged in a way that is constructive and engenders open and useful debate.

Recommendation 10

The chairman of a BOFI board should be proposed for election on an annual basis.

We cannot see any reasons for objecting to this.

Recommendation 11

The role of the senior independent director (SID) should be to provide a sounding board for the chairman, for the evaluation of the chairman and to serve as a trusted intermediary for the NEDs as and when necessary. The SID should be accessible to shareholders in the event that communication with the chairman becomes difficult or inappropriate.

We agree with the assessment of the role of the SID, but would add that some of these responsibilities may also be fulfilled by a deputy chairman additional to the SID.

Recommendation 12

The board should undertake a formal and rigorous evaluation of its performance with external facilitation of the process every second or third year. The statement on this evaluation should be a separate section of the annual report describing the work of the board, the nomination or corporate governance committee as appropriate. Where an external facilitator is used, this should be indicated in the statement, together with an indication whether there is any other business relationship with the company.

We agree with the proposal for a formal and rigorous evaluation of board performance every second or third year and that a statement on this evaluation should be provided in a separate section of the annual report describing the work of the board and the nomination or corporate governance committee as appropriate. We also agree that the statement should give an indication of the outcomes of the evaluation process and that the statement should include confirmation that individual directors were given the opportunity to raise questions and concerns and that action has been taken or is being taken to remedy any material weaknesses identified in the evaluation process. We further agree that an indication should be given of any other business relationships with the company in question. The implication here is not that other relationships are inappropriate but that some may be; involvement in the selection process, in particular, should clearly deem a company ineligible for board performance evaluation.

Recommendation 13

The evaluation statement should include such meaningful, high-level information as the board considers necessary to assist shareholders understanding of the main features of the evaluation process. The board should disclose that there is an ongoing process for identifying the skills and experience required to address and challenge adequately the key risks and decisions that confront the board, and for evaluating the contributions and commitment of individual directors. The statement should also provide an indication of the nature and extent of communication by the chairman with major shareholders.

We agree. We also agree with the proposal that external attestation of the board evaluation statement and possible provision for an advisory resolution on the evaluation statement be left to the discretion of individual boards for now. As recommended, the statement should include an indication of the nature and extent of communication by the chairman with major shareholders but stop short of stipulating the form that this should take.

The role of institutional shareholders: communication and engagement

Recommendation 14

Boards should ensure that they are made aware of any material changes in the share register, understand as far as possible the reasons for changes to the register and satisfy themselves that they have taken steps, if any are required, to respond.

We agree.

Recommendation 15

In the event of substantial change over a short period in a BOFI share register, the FSA should be ready to contact major selling shareholders to understand their motivation and to seek from the BOFI board an indication of whether and how it proposes to respond.

We are inclined to agree but can see a need for the process to be carefully thought through in order to avoid inadvertently creating a potential source of market instability and abuse, although the recent FSA guidance on this has provided some reassuring clarity.

Recommendation 16

The remit of the FRC should be explicitly extended to cover the development and encouragement of adherence to principles of best practice in stewardship by institutional investors and fund managers. This new role should be clarified by separating the content of the present Combined Code, which might be described as the Corporate Governance Code, from what might most appropriately be described as Principles for Stewardship.

We agree with remit of the FRC being extended as recommended but would note that its remit necessarily would be restricted to fund managers located in the UK. This brings with it the need to ensure that any new charter envisaged for institutional investors and fund managers be both practical in nature and promoted internationally.

Recommendation 17

The present best practice “Statement of Principles – the Responsibilities of Institutional Shareholders and Agents” should be ratified by the FRC and become the core of the Principles for Stewardship. By virtue of the independence and authority of the FRC, this transition to sponsorship by the FRC should give materially greater weight to the Principles.

We agree statement of principles on the responsibilities of institutional investors and agents being ratified by the FRC and forming the core of a statement on principles for stewardship.

Recommendation 18

The ISC, in close consultation with the FRC as sponsor of the Principles, should review on an annual basis their continuing aptness in the light of experience and make proposals for any appropriate adaptation.

We agree but can see a need for further considerable thought on the mechanics.

Recommendation 19

Fund managers and other institutions authorised by the FSA to undertake investment business should signify on their websites their commitment to the Principles of Stewardship. Such reporting should confirm that their mandates from life assurance, pension fund and other major clients normally include provisions in support of engagement activity and should describe their policies on engagement and how they seek to discharge the responsibilities that commitment to the Principles entails. Where a fund manager or institutional investor is not ready to commit and to report in this sense, it should provide, similarly on the website, a clear explanation of the reasons for the position it is taking.

We agree but can see a need for a dialogue on how the scope of the Principles of Stewardship could be extended to include market participants who are not long only holders of investments in a company – other types of investors can have material impact in influencing the management of a company.

We must recognise, however, that the degree to which an investment firm actively engages with the companies in which it invests will be both a function of its investment style and the degree to which they have sufficient market power to make such engagement effective. It may be unrealistic to expect all firms to aspire to the Principles of Stewardship best practice guidelines and in particular to make this a condition of authorisation.

Recommendation 20

The FSA should encourage commitment to the Principles of Stewardship as a matter of best practice on the part of all institutions that are authorised to manage assets for others and, as part of the authorisation process, and in the context of feasibility of effective monitoring to require clear disclosure of such commitment on a “comply or explain” basis.

We would agree with the Principles of Stewardship operating on a “comply or explain” basis.

Recommendation 21

To facilitate effective collective engagement, a Memorandum of Understanding should be prepared, initially among major long-only investors, to establish a flexible and informal but agreed approach to issues such as arrangements for leadership of a specific initiative, confidentiality and any conflicts of interest that might arise. Initiative should be taken by the FRC and major UK fund managers and institutional investors to invite potentially interested major foreign institutional investors, such as sovereign wealth funds and public sector pension funds, to commit to the Principles of Stewardship and, as appropriate to the Memorandum of Understanding on collective engagement.

We agree subject to more detailed discussion about how this would work in practice and consideration of whether this gives rise to legal issues arising from potential constraints on collective shareholder engagement with the boards of BOFIs as a result of changes to FSMA to accommodate the EU Acquisitions Directive.

Recommendation 22

Voting powers should be exercised, fund managers and other institutional investors should disclose their voting record, and their policies in respect of voting should be described in statements on their websites or in other publicly accessible form.

We support the recommendation that voting powers be exercised and suitable disclosure made of voting records and policies on voting.

Governance of risk

Recommendation 23

The board of a BOFI should establish a board risk committee separately from the audit committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy. In preparing advice to the board on its overall risk appetite and tolerance, the board risk committee should take account of the current and prospective macro-economic and financial environment drawing on financial stability assessments such as those published by the Bank of England and other authoritative sources that may be relevant for the risk policies of the firm.

We agree with the establishment of a board risk committee separate from the audit committee responsible for oversight and advice to the board on current risk exposures and future risk strategy. This is desirable in any financial service institution other than the very small. We also agree that this should take into account the current and prospective macro-economic and financial environment drawing on financial stability assessments published by the Bank of England and other authoritative sources that may be relevant. This is an area on which further thought needs to be given about the degree of prescription for organizations other than major BOFIs.

We would caution that the recommendation needs to be sensibly interpreted. It would not be reasonable, for instance, to expect that members of a board risk committee for a large, complex BOFI analyse personally all reports. They have need for recourse to internal and external analysis and this should remain acceptable.

Recommendation 24

In support of board-level risk governance, a BOFI board should be served by a CRO who should participate in the risk management and oversight process at the highest level on an enterprise-wide basis and have a status of total independence from individual business units. Alongside an internal reporting line to the CEO or FD, the CRO should report to the board risk committee, with direct access to the chairman of the committee in the event of need. The tenure and independence of the CRO should be underpinned by a provision that removal from office would require the prior agreement of the board. The remuneration of the CRO should be subject to approval by the chairman or chairman of the board remuneration committee.

We agree with the recommendation on the role and status of the Chief Risk Officer. We are concerned however with the level of prescription in recommending that the CRO should report to either the CEO or Finance Director and believe that this should be broadened to include other Executive Directors. This would meet the objective in terms of status while at the same time enabling the reporting line to fit within the internal structure and circumstances of the BOFI in question.

In addition, the practical working arrangements for oversight of the CRO should not be unduly conflicted and the recommendation should acknowledge that day-to-day oversight and management rests with the relevant executive. Although we acknowledge that there must be reasonable consultation which ensures consistency with the board risk committee's expectations.

Recommendation 25

The board risk committee should have access to and, in the normal course, expect to draw on external input to its work as a means of taking full account of relevant experience elsewhere and in challenging its analysis and assessment.

There is a discussion to be had about the nature and extent of the external input that the board risk committee is expected to draw on in the normal course of its work. We are concerned that the recommendation may be interpreted as assuming a higher status accords to externally prepared advice and believe that were this to be the case then this would undermine the internal risk function. This is most evident where the advice requires intimate knowledge of the BOFI's operations which can only be met by the internal function.

Recommendation 26

In respect of a proposed strategic transaction involving acquisition or disposal, it should as a matter of good practice be for the board risk committee to oversee a due diligence appraisal of the proposition, drawing on external advice where appropriate and available, before the board takes a decision whether to proceed.

We believe it is right for the review to draw attention to the momentum keynote transactions can attain and the importance of questioning their strategic merit at an early stage. But we would see merit in ensuring that clarity remains between board responsibility for approving the strategic transaction and satisfying itself as to the level of due diligence carried out and the execution of the due diligence that should remain the responsibility of the executive. It is also important to ensure that the involvement of the board risk committee be seen as an additional step in the process as opposed to any dilution of responsibility on the part of the board itself in respect of strategic transactions.

Recommendation 27

The board risk committee (or board) risk report should be included as a separate report within the annual report and accounts. The report should describe the strategy of the entity in a risk management context, including information on the key exposures inherent in the strategy and the associated risk tolerance of the entity and should provide at least high level information on the scope and outcome of the stress-testing programme. An indication should be given of the membership of the committee, of the frequency of its meetings, whether external advice was taken and, if so, its source.

We agree that the risk report should be included as a separate report within the annual report and accounts; we also agree with most of the recommendations on its contents. But we are concerned about the potential interpretation of the committee's reference to external advisors. Too many referrals may be interpreted as a lack of ability on the part of, or a lack of confidence in, the CRO and risk community of the firm, while too few referrals may be interpreted as a failure on the part of the risk committee to do its job. The provision of contextual information around seeking external advice may be difficult, particularly when the issue on which advice was sought has not crystallised and/or the information may be commercially or market sensitive. This would include decisions not to proceed with an acquisition because due diligence on the target firm facilitated by external advisors revealed concerns with capital provision.

We are further concerned about the proposed reporting of the scope and outcome of stress-testing. Even with a knowledgeable audience and plenty of time to explain key assumptions within the model it can be very hard to get across precisely what the stress test outcome is actually saying and what it is not saying. There is therefore a real danger that sharing even high level outcomes could cause misunderstanding with external stakeholders with potential risk to financial stability. Reporting of stress testing therefore will necessarily be high level, limited strictly to the reporting of a positive outcome and/or the confirmation of corrective action having been taken. We need to ensure that this is understood and that banks reporting on this basis will not in some way be accused of reverting to "boilerplate".

Remuneration

Recommendation 28

The remit of the remuneration committee should be extended where necessary to cover all aspects of remuneration policy on a firm-wide basis with particular emphasis on the risk dimension.

We agree. In the case of a bank, the committee should be responsible, in particular, for reviewing remuneration policy in light of the FSA's Code of Practice.

Recommendation 29

The terms of reference of the remuneration committee should be extended to oversight of remuneration policy and remuneration packages in respect of all executives for whom total remuneration in the previous year or, given the incentive structure proposed, for the current year exceeds or might be expected to exceed the median compensation of executive board members on the same basis.

We agree with the terms of reference for the remuneration committee being extended to cover highly remunerated executives who are not board members but would suggest that further thought be given to the formulaic approach set out in the interim report. Apart from anything else, the approach set out would result in a greater number of remuneration packages being disclosed where executive board remuneration is the lowest. We would further view the disclosure of remuneration packages as an initiative that would be of most value if coordinated internationally.

Recommendation 30

In relation to executives whose total remuneration is expected to exceed that of the median of executive board members, the remuneration committee report should confirm that the committee is satisfied with the way in which performance objectives are linked to the related compensation structures for this group and explain the principles underlying the performance objectives and the related compensation structure if not in line with those for executive board members.

We agree in principle with this recommendation covering highly remunerated executives who are not board members. In taking this forward, it will remain important to maintain the distinction between remuneration for "high end" earners and middle and lower ranking staff, including those in branches, who may be eligible for a modest bonus as part of their annual appraisal performance. In companies with large branch networks even these modest payments can in aggregate attract "tens of millions" headlines in the press and they should be distinguished from the changes in practice sought within the Review.

Recommendation 31

The remuneration committee report should disclose for "high end" executives whose total remuneration exceeds the executive board median total remuneration, in bands, indicating numbers of executives in each band and, within each band, the main elements of salary, bonus, long-term award and pension contribution.

We agree in principle with the recommendation for some disclosures for unnamed "high end" executives being provided in the form of bands of remuneration above the board median level with an indication of the numbers in each band and, within each band, of the main elements of salary, bonus, long-term award and pension contribution. We will, however, need to ensure that the disclosure requirements to apply in the UK are consistent with the approach that we are seeking to promote internationally.

Recommendation 32

Major FSA-authorized BOFIs that are UK-domiciled subsidiaries of non-resident entities should include in their reporting arrangements with the FSA disclosure of the remuneration of "high end" executives broadly as recommended for UK-listed entities

but with detail appropriate to their governance structure and circumstances agreed on a case by case basis with the FSA. Disclosure of “high end” remuneration on the agreed basis should be included in the annual report of the entity that is required to be filed at Companies House.

We agree with the recommendation for UK-listed BOFIs and note the observation in the consultative document that it would seem appropriate and necessary for broadly comparable disclosure to be provided by FSA authorised BOFIs that are UK-domiciled subsidiaries of non-

resident entities. While the consultative document recognizes that some definitional adjustment will be necessary to reflect the fact that the UK board structure of such entities will not be directly comparable to that of a UK-listed entity, the proposal is that determination of an appropriate disclosure formula for total remuneration be settled on a case-by-case basis in discussion between the FSA and individual major BOFIs – to be determined by the FSA – and that reporting to the FSA should include disclosure on the agreed basis, and that the annual report of the entity required to be filed at Companies House should include such disclosure.

It should be noted that remuneration of highly skilled executives is as core to the competitiveness of a UK-owned or UK-located financial institution as other contributing factors to the business environment. It is critical therefore that all G20 governments and their regulatory authorities act upon the course of action set out in the Pittsburgh Summit communiqué and are brought to account if they do not.

Recommendation 33

Deferral of incentive payments should provide the primary risk adjustment mechanism to align rewards with sustainable performance for executive board members and executives whose remuneration exceeds the median for executive board members. Incentives should be balanced so that at least one-half of variable remuneration offered in respect of a financial year is in the form of a long-term incentive scheme with vesting subject to a performance condition with half of the award vesting after not less than three years and of the remainder after five years. Short-term bonus awards should be paid over a three year period with not more than one-third in the first year. Clawback should be used as the means to reclaim amounts in limited circumstances of misstatement and misconduct.

The BBA supports the objective of aligning remuneration policy with risk management, as well as the linking of remuneration practice to capital planning in order that risk management is holistic. Assessments on longer term performance will align the objectives of employee, employer and shareholder, especially as an employee can be assessed over the first few years of the life of a transaction (three years being the maximum before the deferral is usually discounted and the most appropriate time span for review).

We would, however, question the level of detail and the quite narrow prescription given in the recommendation and whether this cuts across the approach set out in the FSA’s Code of Practice on Remuneration Policies operational from January 2010. We would therefore suggest that further thought be given to the interrelationship between the corporate governance elements of the Walker recommendations and the FSA Code of Practice, with the former limiting itself to embedding broader remuneration policy and disclosure expectations within the corporate governance structure for BOFIs. There is also a need to ensure that the planned legislation aligns appropriately with the detailed measures already agreed in the FSA Code.

Recommendation 34

Executive board members and executives whose total remuneration exceeds that of the median of executive board members should be expected to maintain a shareholding or retain a portion of vested awards in an amount at least equal to their total compensation on a historic or expected basis, to be built up over a period at the discretion of the remuneration committee. Vesting of stock for this group should not normally be accelerated on cessation of employment other than on compassionate grounds.

We would question level of detail and the quite narrow prescription given in the recommendation and whether this cuts across the less prescriptive and more principled approach set out in the FSA's Code of Practice. For example, to the extent that recommendation 33 is moderated to

allow for BOFIs to exercise judgement and to permit justifiable differentiation, prescribed levels of shareholdings may depend on decisions relating to the nature and term of deferral mechanisms.

Additionally, the application of prescribed shareholdings is quite complex (eg is the appropriate valuation measure acquisition cost or balance sheet date fair market value and to what extent should unvested shares in performance related deferrals be taken into account?) and the recommended approach is perhaps overly simplistic. We see this as a further reason for the recommendation being drafted more in terms of principle.

Recommendation 35

The remuneration committee should seek advice from the board risk committee on an arm's-length basis on specific risk adjustments to be applied to performance objectives set in the context of incentive packages; in the event of any difference of view, appropriate risk adjustments should be decided by the chairman and NEDs on the board.

We agree that the remuneration committee should consult the board risk committee as proposed and that the chairman and NEDs should determine the outcome of any difference of view.

Recommendation 36

If the non-binding resolution on a remuneration committee report attracts less than 75 per cent of the total votes cast, the chairman of the committee should stand for re-election in the following year irrespective of his or her normal appointment term.

We agree with the recommendation that the chair of the remuneration committee stand for re-election in the following year in the event of the non-binding resolution on the remuneration committee report attracting less than 75% support of the total votes cast.

Recommendation 37

The remuneration committee report should state whether any executive board member or senior executive has the right or opportunity to receive enhanced pension benefits beyond those already disclosed and whether the committee has exercised its discretion during the year to enhance pension benefits either generally or for any member of this group.

We agree with the additional disclosures proposed on enhanced pension benefits for executive board members and senior executives.

Recommendation 38

The remuneration consultants involved in preparation of the draft code of conduct should form a professional body which would assume ownership of the definitive version of the code when consultation on the present draft is complete. The proposed professional body should provide access to the code through a website with an indication of the consulting firms committed to it; and provide for review and adaptation of the code as required in the light of experience.

We agree with the proposals relating to remuneration consultants.

Recommendation 39

The code and an indication of those committed to it should also be lodged on the FRC website. In making an advisory appointment, remuneration committees should employ a consultant who has committed to the code.

We agree with the proposed use of the FRC website and the recommendation that remuneration committees employ only consultants committed to the code of conduct.

**British Bankers' Association
29th September 2009**