

Sue Smith
Walker Review Secretariat
Financial Services Authority
25 The North Colonnade
Canary Wharf
London EC14 5HS

31 May 2009

Dear Ms Smith,

Walker Review of Corporate Governance of UK Banking Industry

I write in response to the invitation to contribute views about the future of corporate governance in the UK banking sector. My submission focuses on the fundamental importance of effective Board Strategy Audit.

Corporate Value Associates (CVA) is a firm of strategy consultants which I founded in 1987, initially in Paris and London. Today, CVA has offices in 16 countries employing 300 consultants and has developed long term relationships with many major national and international companies, including major UK and international banks.

CVA's differentiation in the marketplace is based on its total value perspective, enabling chief executives and boards to optimise long term value for shareholders and other stakeholders by managing the value flow, the source of which is always the customers.

Definitions of value

It is useful to refer to three broad definitions of the value of the shareholders' investment in an enterprise – accounting or financial value (AV), market value (MV) and strategic or intrinsic value (SV). AV is basically given from a perusal of the financial accounts and the assessment therein of the business risks. It reflects compliance with the accounting standards used and is a measure of soundness and control, management's view being validated by the work of their external accountants and their audit committee. MV is basically given by the current stock market quotation. It is dependent on information supplied by the company, on the quality of dialogue with the market and on a host of other factors. SV is basically given by an informed view of the real present value of the enterprise. It has regard to its business strategy and capacity, its industrial and market context, its relative strengths and weaknesses, and the expected future context.

To deliver shareholder value over the longer term, in addition to clarity on accounting value – which is largely historic - and attention to market value – often a volatile indicator - it is critical for boards to keep a focus on strategic value.

There is no necessary equivalence between the three definitions of shareholder value but, assuming good information is exchanged with the market, MV and SV should, over time, track each other reasonably closely.

The Combined Code focuses on the accuracy of AV and on information to inform MV. The regulatory regime of the Financial Services Authority focuses on risk. Except implicitly, neither the Code nor the FSA identify or deal with SV or require that boards are well versed in SV. The

assumption is either boards do this naturally and well, or SV is not as important a view of a bank's value as MV or AV or as reflected in regulatory returns or inspections. Neither is, in my view, correct. A major lesson from the bubble and the ensuing banking crisis is the need to raise the focus on strategy and strategic valuation as an integral part of the governance of UK banks.

We have yet again learned in recent months that shareholders, bondholders, depositors and deposit insurance organisations are not the only principals with money at risk to banks. Taxpayers, in effect, underwrite the residual risk of banks too big to be allowed to fail without excessive damage to the economy. SV is therefore of as much interest to taxpayers, government and regulators as to bank creditors and shareholders.

Board Strategy Audit

Board Strategy Audit is a tool to enable bank boards to ascertain and take steps to enhance and protect the fundamental, strategic or intrinsic value of their business over the medium to long term, considering the likely scenarios and the strategic options that may be created.

Strategy is the purpose of the bank, its relative position, its capability, its vision and future journey and its strengths and weaknesses. Strategic valuation is the translation of strategy into a range of underlying valuations.

Strategy and strategic valuation are usually brought to a board by the chief executive. An effective audit of strategy would enable the board to challenge, understand and own the strategy and the related strategic valuation. Strategic planning as practised in many banks tends to change a vital concept into a bureaucratic task where the wood can be missed for the trees.

In the current climate, strategy and vision are more needed than ever. It is critical to get the "periscope" above the clouds, see what is really going on and subject the strategy and its valuation to challenge. Strategy audit is as important to the good governance of the UK banking industry as financial and risk audit. It should be made an explicit requirement.

How to make effective Strategy Audit a reality

Bank boards should audit strategy rigorously and regularly. They should be equipped to do so in order to arrive at a fully informed and considered view. Many boards have strategy committees, but they can be not much more than useful talking shops without the capability, analytical power or status necessary to challenge the strategy and the strategic valuation put to them by the executive so as to arrive at a well informed view owned by the board as a whole. The checks and balances needed for good governance are often missing in this critical respect.

I recommend provision be made for a regular board audit of the strategy and the strategic valuation of banks, carried out by a board which is competent to the task, if necessary with the support of external experts. The board should signify in its annual report and accounts that it has the capability to conduct such an audit and has done so.

Follow up

CVA has well tested methodologies for describing and analysing strategy and arriving at strategic valuations. Peter Bateau CBE, senior adviser to CVA and known to Sir David Walker, would be glad to accompany me in any discussion of this submission.

If of interest to Sir David, in preparation for such a meeting we would be happy to do two things. Firstly, draft brief terms of reference for what we would consider an effective board strategy audit process. Secondly, prepare evidence to demonstrate how and why effective board strategy audit would have helped mitigate part of the shareholder and taxpayer value destruction caused by the current banking crisis.

Yours sincerely,



Paul-Andre Rabate
Founder and Managing Partner
Corporate Value Associates