

Dear Sir Walker

I have a number of comments on your report particularly in respect of Board effectiveness and governance of risk as detailed below. My expertise and basis for comment is that I built and led Ernst & Young's global risk management and governance business. Prior to launching the practice, I studied the practices of large and small organisations throughout the world, led research studies, sought comment from colleagues, experts and institutions and subsequently launched the practice throughout the world and advised many businesses. I have also for the last 5 years worked in a privately backed business as joint CEO and FD so I also know the reality from the coal face of SMEs.

Board Culture

One matter that needs to be considered and addressed is a recognition that many of the fundamental risks were already well known to the boards, regulators and industry experts. These recent problems were not a surprise to many of the experts and board members; this group of people know their businesses well and are well aware that profits are the upside of risk and that should something go wrong there is a downside, but were prepared to take the risk given the scale of upside.

The issue therefore wasn't failing to identify and accurately quantify the risks but failure to acknowledge certain risks and be transparent about the level of risk being accepted. One comment made to me when I challenged an executive on a specific risk was that "there is no way that it is being quantified on these board papers. The potential is catastrophic; we don't want to know its potential and neither does the regulator want us to work it out and note it down".

The issue is cultural. The deep industry experts on the boards at times keep information away from those broader industry minds who would have questioned more if they had fully understood or been given the information to enable challenge. Until we see a change in the quality and commitment of those on some of the boards things are unlikely to change. In this context an improvement in quality means starting to see some fresh faces and a broader range of experience. A set of industry measures such as the average number of directorships, number of brand new NEDs being appointed, max number of FTSE100/250 and private company directorships etc needs to be agreed and tracked to see if change is really starting to happen and if not, there needs to be a mechanism to force change in. The reputation of the London markets depends on it.

Board effectiveness and governance

The assessment of board performance and its effectiveness needs to be undertaken in the context of the business and market performance. In my experience, many of the organisations who are offering their services in this area do not have the financial capability or understanding of the markets to do this effectively and more often they are conflicted by existing relationships with the board or its members to provide an effective challenge on board effectiveness. This means that the issues mentioned above are not brought out into the open to allow them to be addressed or for example, board effectiveness is just assessed based on the ability of the board to work together not on their achievement of outcomes.

In respect of the governance of risk, many organisations have still failed to fully understand risk management, internal control and governance and how they link together. In my experience the regular management information is rarely good enough to make it visible where the potential risks are, what upsides and downsides there are and how well they are being controlled. Without this

information how can management know the spread of potential outcomes and boards take effective decisions? You only have to look at the delivery and related management information of major programmes in some of our largest organisations or their regular financial information to see that many aspects of risk management are still a bolt on and not fully embedded in everyday thinking. Until senior execs and shareholders realise they need to improve and have a desire to improve ("they don't know what they don't know" is a telling term for many in our boards) things will not change.

Finally, I consider that the guidance on risk management, internal control and governance whilst improving, still fails to clarify the distinctions and connections between "*Board matters and activities*" and "*Business (ie the rest of organisation excl the Board) matters and activities*". Many still consider governance as just a board matter and don't consider it fully across the whole organisation; or consider risk management as a business activity rather than a business and board activity and as such whilst they may challenge and review risk information from the business, don't consider the fundamental market and company wide risks.

I would be happy to meet up to share my thoughts further if this would be useful.

Yours faithfully

Nick Mottershead