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**Response from RiskMetrics Group to Walker Review Consultation Document:  
“A review of corporate governance in UK banks and other financial industry entities”**

**Introduction**

RiskMetrics Group specialises in financial services and is recognised as the standard in financial risk management. We work to make risk transparent and leverage our expertise in corporate governance, compliance, accounting, legal, transactional, and sustainability risks. Our clients include most major asset managers, pension funds, banks and hedge funds.

RiskMetrics Group welcomes the opportunity to respond to the Consultation Document *A review of corporate governance in UK banks and other financial industry entities* issued by the Walker Review on 16 July 2009.

Yours sincerely

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## **Responses to questions from the consultation:**

### **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.

*RMG generally supports the preamble to this recommendation. RMG considers that the appointment of high-calibre directors with appropriate and relevant industry experience is crucial on company boards, especially on BOFI boards due to the complexity of the business and the direct impact that BOFIs have on the economy and society. RMG believes that one way in which this can be achieved is by the appointment of former BOFI executive directors, who either originates from within the company or from other financial companies. RMG does not believe that the interpretation of the Code as stated in Chapter 3, section 7 (3.7) is correct. The recruitment of a former executive, or any candidate who does not fulfill the criteria of independence, as a NED is not prohibited by the Combined Code so long as adequate board independence is achieved. Within the 'comply and explain' framework companies are able to explain why they believe it to be appropriate to appoint a director who is perceived to be non-independent and whose appointment may compromise the balance of the board. In fact companies should, as a matter of course, explain in more detail than is current practice their reasons for appointing specific individuals and the knowledge and experience that they bring to a board and how the board will benefit from such an appointment. This has been the case in the past, where shareholders at HSBC and Barclays have accepted the rationale for the appointment of the outgoing CEO to the post of chairman even though the Code recommends against this practice.*

*The Combined Code currently does provide some guidance on training of NEDs but it is felt that this could be more specific and, for the BOFI companies, more prescriptively required as is recommended in the following 'Walker' recommendations. We support the principles prescribed in Recommendation 1 and would suggest that the proposed session include presentations by the executive management team and below-board business managers or other internal experts. As part of the training and development RMG would encourage that this extends to attendance at industry conferences or participation of accredited courses.*

*We also consider that time spent with experts within the organisation in order to better understand the complexities faced by various parts of the business at root-level can be extremely beneficial.*

*Any or all of the training and development received by an NED should be disclosed to shareholders with accounts of the activities run by the board and their individual attendance records.*

#### **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.

*RMG supports this recommendation and believes that the 'installation of a dedicated resource under the group secretary' is appropriate and that NEDs should also 'make regular use of advice from sources outside the company'. We believe that the latter should be under the unfettered discretion of the chairman and the committee chairs. All such external consultancy engagements should be disclosed to shareholders.*

#### **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.

*As stated in recommendation 1, RMG supports the idea that NEDs should 'spend time with the executives within the business as a means of gathering insight and understanding of how the organisation works', and accepts the 'need to increase the expectation of time commitment' due to the need for more intense work.*

*Board fees need to better reflect that the NED position is a 'real' job that requires specific time dedicated to fulfilling such responsibilities. BOFI boards will likely need to pay for such greater commitment and to attract top talent. RMG accepts that this may lead to initial widespread NED remuneration increases but these must be balanced so that such amounts are not considered material enough to compromise independence.*

*Whilst RMG agrees that the time commitment required going forward may limit the capacity of the NED to retain or assume board responsibilities elsewhere and the issue of over-boarding may need to be scrutinised more closely, BOFIs may also find it problematic in appointing NEDs who hold CEO or executive positions at other companies as they may not be able to dedicate the appropriate time needed to effectively fulfil the NED role on financial boards. This could severely impact upon the pool of talent available.*

#### **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.

*RMG supports this recommendation. RMG would not object to further expanding this recommendation by clarifying that the FSA may also be best placed to run accredited BOFI NED education programs as highlighted in our response to Recommendation 1.*

*Whilst RMG fully supports the principle that an effective board is one that contains a balance of both 'relevant financial experience and a wider perspective from other business experience', RMG considers it crucial for NEDs to be very familiar with 'risk strategy' issues within the financial industry. The initial absence of such knowledge may be considered a disqualifier.*

*RMG also believes that the FSA supervisory process should not be limited to the appointments and training process but also include ongoing verification that NEDs continue to have appreciation and understanding of both the company's risk strategy and the issues as they relate to the wider financial services industry. This could be achieved through annual continued professional development (CPD) requirements for NEDs, similar to those applied in the legal and accountancy professions.*

#### **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.

*While RMG broadly supports this recommendation, RMG believes that the FSA involvement in the appointment process should not be over-bearing. A board should feel that it continues to hold sufficient weight in such processes and is not subservient to the FSA on individual appointments at the interview stage. Recent anecdotal evidence suggests that FSA screening has already deterred a significant number of applicants for BOFI positions taking their candidacy any further. Although the*

*need for competence and suitability is significant, there is a real danger of drastically limiting the talent pool by the invasive involvement of the FSA at the individual hiring level. Therefore it may be more appropriate for an initial FSA accreditation/clearing house for prospective BOFI NEDs, which could be awarded on the basis of the individual's job history in the majority of cases, with personal interviews only being necessary for a minority.*

## **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.

*RMG supports this recommendation. However, it remains ambiguous how this recommendation will be monitored and reported to shareholders, avoiding standardised process-focused boilerplate explanations. RMG agrees fully with the observation that experience and knowledge alone is insufficient where there are failures in communication channels and the flow of information. Access to information and the appropriate level of expertise is key to the ability of a NED to fulfil this mandate. Therefore, in addition to the 'Risk' recommendations made in Chapter 6, other supporting structures need to be put in place with a requirement that the board should spend sufficient and appropriate time on matters such as the consideration of exposure and risk.*

### **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.

*RMG supports this recommendation. However, contrary to the statement regarding a potential increase in NEDs fees, it is considered that the current level of remuneration for the post of chairman at the largest companies remains appropriate and should not be increased significantly unless appropriate justification is provided. Any significant increase may confuse the position with that of an executive.*

*Accepting that a chairman has a prominent and important function on the board which may require him/her to devote substantial time to board and business matters, the issue of over-boarding may need to be reconsidered by re-introducing limitations on outside board appointments through the Combined Code.*

### **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.

*RMG supports this recommendation though we refer to our concerns on the same topic with respect to NEDs in recommendation 4. There is no doubt that both direct experience of the financial industry and leadership skills is the optimal combination which leaves a relatively small pool of qualified talent (particularly in light of increased time commitment).*

**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.

*RMG supports this recommendation.*

**Recommendation 10**

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

*RMG supports the principle of increased accountability but cautions over automatic/routine annual re-elections as this may promote short termism when in fact alignment with long-term shareholder interests is what is being sought.*

*Accepting that the chairman is viewed as ultimately responsible for adherence to governance best practice guidance and overall board performance, possible alternatives to annual re-election include: (1) The requirement for a higher threshold of support (e.g.75%); (2) Consistent with the concept used for recommendation 36, automatic re-election in the year following significant shareholder dissent (approval does not exceed at least 75%) of any resolution proposed by the board at the previous AGM. This latter can be used as reconfirmation of support of the chairman's leadership notwithstanding opposition to particular resolution; and (3) The adoption of a Corporate Governance Statement presented at the general meeting, either as a point on the agenda for discussion only (as it is the case in the Netherlands), or perhaps as a formal voting agenda item used as an advisory vote or even as a mandatory vote. This would enable shareholders to voice their opinion of a company's corporate governance practices without the need to direct their disapproval at other agenda items which may, or may not be, directly related to the issue in question.*

*When looking at levels of 'support' in the foregoing options, it should be noted that as an abstain/withhold vote is a valid vote option on a UK proxy card and is used by shareholders as a way of demonstrating 'disapproval without consequence', the 75% approval threshold should be assessed against the total number of vote cast (including abstain/withhold votes).*

**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.

*RMG does not consider this to be significantly different from the current Combined Code. We would propose that this recommendation be expanded such that it provides for a more proactive obligation on the SID to meet with shareholders, rather than in response to dissatisfaction with the chairman, since the lines of communication with the SID may hamper the expression of such dissatisfaction unless there is positive outreach from the SID to shareholders.*

**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.

### **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.

### **Combined response for Recommendation 12 and 13.**

*RMG supports the Combined Code principle of board evaluations and the recommendation regarding meaningful information. However, at present, disclosure on board evaluation is little more than boilerplate in nature. There is a tendency for disclosure on this subject to centre on recounting the evaluation process with little meaningful information on the evaluation itself.*

*Boards should be open-minded as to the purpose of disclosure and not see this as a self-criticism of any failings. Boards should provide meaningful disclosure of the areas evaluated, the conclusions of such evaluations and the actions taken in response to such conclusions. It is the latter that is the only proof of effectiveness. Such meaningful disclosure is not a self-criticism of individual board function but recognises that at times the functions and dynamics of a board changes and new issues arise. Disclosure should therefore be focused on the identity of such changes and the steps taken to address these without being seen as a criticism of failure.*

### **The role of institutional shareholders: communication and engagement**

*RMG is broadly supportive of the narrative that introduces these recommendations. RMG supports the principle of open engagement between companies and shareholders (shareholder bodies). In all cases engagement works best when both parties are transparent and open and are willing to receive explanations and provide feedback.*

*RMG believes that the 'explain' part of 'comply or explain' should not only be limited to companies, when the explanation is centred around non-compliance with governance best practice provisions, but should also be applicable to shareholders in explaining their final position. It is not unreasonable to suggest that at times companies receive opposition from shareholders at general meetings without fully understanding the reasons why.*

*One way of overcoming this problem is for companies to use shareholders first as a sounding board for intended changes it wishes to pursue before subsequently submitting proposals to shareholders for formal approval at general meetings. This will ensure that companies have the option to take into consideration shareholder feedback in a timely manner without 'last minute' surprises and embarrassment as a result of shareholder opposition displayed at a general meeting.*

*This works best when shareholders are forthcoming with clear opinions and companies are willing to embrace and act on such feedback. At times companies need to be more open to shareholder feedback and if necessary 'go back to the drawing board' instead of pursuing proposals known not to be supported by its shareholders. When shareholders approach companies to engage on any concerns that they may have, companies should not see such engagement or accompanying adverse feedback to be intrusive or 'shareholders being difficult'.*

*It is also important that when companies do undertake company-led engagement initiatives, they present the 'whole picture' and not just specific areas they require shareholders to support. Many*

*companies undertake a consultation process with shareholders regarding proposed changes to their remuneration arrangements. However, on many occasions where shareholders have devoted much time to the proposals presented to them, they then find that upon publication of the annual report the company failed to transparently explain other aspects of their remuneration policy and subsequent practices (the unwarranted use of discretion) which may not be acceptable to shareholders.*

*RMG concludes that effective pro-active engagement is centred upon open and transparent discussion by both parties and a willingness to listen and address any concerns exchanged.*

#### **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.

*RMG supports this recommendation.*

#### **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.

*RMG understands this recommendation to propose a type of 'exit interview' for departing shareholders. RMG has reservations around this 'big government' approach and questions (1) whether the FSA should be undertaking a function best placed with companies; (2) the appropriateness of forcing shareholders to justify their reasons for selling their holdings; and (3) the practicality of implementing such a proposal as a routine function of the FSA. A better alternative may be to provide a conduit via the FSA for shareholders to use if they believe it to be necessary to report any concerns that they have with a company or its management which go to issues such as transparency and prudence that consequently resulted in them disposing of their shareholding.*

#### **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.

#### **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.

#### **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.

#### **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.

#### **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.

#### **Combined response for Recommendations 16 to 20.**

*RMG is supportive of a governance and engagement policy statement appearing with the same prominence as traditional investment policy statements on institutional investor websites, in literature etc. This would reinforce good governance as an integral part of investment policy. Whether statements should be made relative to a single code of best practice as a benchmark is more open to debate. However, it is noted that the ISC Statement of Principles as a framework has already received considerable industry support. Whether this will help address the ‘free-rider’ issue is debatable but being required to report will provide a greater degree of transparency for beneficial owners regarding the governance and engagement policies of asset managers (or lack thereof) which can, in turn, be more effectively monitored. As also previously stated, the ‘explain’ approach required of companies could be an appropriate model for shareholder reporting.*

*Regarding the appropriate custodian of a governance code for investors, we note the respective cases to be made for the FRC, as the independent regulator responsible for promoting confidence in corporate governance; for the ISC, as author of the Statement of Principles (though obviously not independent and, not a regulator); and the FSA, as the regulator of the investment industry. Perhaps the situation can be reviewed as analogous to the requirement for companies to report against Combined Code provisions, imposed by the FSA via listing requirements, with the principles and their monitoring under the guardianship of the FRC.*

#### **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.

*RMG does not consider it is necessary to be prescriptive regarding the mode of collective engagement considering that the FSA has cleared the way for collective engagement by its recent announcement that it would not fall foul of its market abuse and holdings disclosure provisions. There already exists a number of investor representative bodies and networks able to facilitate and administer collective engagement.*

*RMG supports the principle of shareholders working together but this should not be seen as shareholders acting in concert.*

#### **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.

*RMG supports this recommendation as a complement to recommendation 19, which requires institutional investors to disclose a governance and engagement policy statement. RMG is supportive*

*of institutional investors being required to report regularly on the implementation of both voting and engagement activity. As background, some European market commentators criticise the US N-PX filings format for providing a large volume of undifferentiated data whilst not providing sufficient context about why certain voting decisions were taken, which were the most important and the extent to which engagement was undertaken to address issues of concern.*

*RMG therefore suggests that ISC members could develop models of good practice rather than a regulator being overly prescriptive about specific formats. RMG believes that areas which could be included are on broadly two levels. At a basic level there should be a formal overview report reflecting the voting universe and the percentage of votes opposing management proposals. At a more detailed level, for underlying clients only, a report should be produced which includes individual voting and engagement records.*

## **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.

### **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.

### **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.

### **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.

### **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.

## **Combined response for Recommendations 23 to 27.**

*RMG is strongly supportive of these recommendations, in particular the establishment of a CRO role with reporting lines to the risk committee and the board. This would clearly enable the board's fundamental role in setting of a risk strategy and oversight, with the CRO taking the day-to-day responsibility for the execution and monitoring thereof. There is also merit in the CRO being invited to attend board meetings so that he can acquire a better understanding and appreciation of all factors affecting risk strategy.*

*RMG believes that there should perhaps be some flexibility regarding the separate risk committee for smaller financial institutions. However, this flexibility should not provide exceptions to the appropriate management of risk and accompanying disclosures.*

*RMG considers that transparency is the key to effective risk management and that disclosure of risk strategy/profile is positive; however, this should not lead to the demonization of a high risk profile if that is consistent with the stated strategy of the institution.*

*In order to promote accountability, RMG believes that consideration should be given to requiring a statement in the 'Risk Report' from the CRO and Risk Committee confirming that the company has managed its business in accordance with its stated risk profile and strategy throughout the reporting year.*

*The challenge will be in establishing a basis for meaningful comparative analysis of the risk profiles of different institutions in the absence of common standards for the benchmarking of risk.*

## **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.

*RMG supports this recommendation. However it is felt that the recommendation itself is too vague to offer any tangible guidance and with the exception of its reference to risk it may be considered entirely superfluous when set against recommendation 29 onwards.*

### **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.

### **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.

### **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.

### **Recommendation 32**

Major FSA-authorised 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.

### **Combined response for Recommendations 29 to 32.**

*RMG supports these recommendations. There is clearly a need to address the below-board risk taking associated with the revenue-based bonus culture highlighted by the global financial crisis, such as by reference to heads of business units, most highly cash-compensated individuals etc. The chosen formulation using median executive board remuneration certainly goes some way to capturing this information, though only at the level of bands rather than precise roles or individuals. This will lead to an expanded Remuneration Report and a broader set of criteria on which shareholders may assess their advisory vote.*

### **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.

*RMG supports this recommendation and favours the principle of deferral. Deferral already seems to be the mechanism adopted in response to the call for sustainability of performance, not only among BOFIs but adopted by many other non-BOFI companies. RMG would encourage that deferral be made into company shares in order to promote better alignment with a company’s longer-term performance and its shareholders.*

*RMG supports the clawback principle. RMG would encourage clawback provisions to be specifically referenced to the underlying continued performance of a company and beyond cases of fraud or similar misconduct. Unless clawback provisions are clearly defined within the terms of contractual arrangements, obtaining repayment would likely involve expensive litigation with limited chance of success. Current experience is that good leavers normally receive their deferred bonuses in full, as they are classified as ‘already earned’. Any Walker style deferral with clawback will require new contractual provisions if such automatic payments are not to continue in the future.*

### **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.

*RMG supports this recommendation which expands current requirements expected of board executives to below board level and the increase in the size of the holding from that which is commonly equal to one year’s salary to total compensation which may be seen to be a more meaningful level of alignment with shareholders. Nevertheless, it has to be acknowledged that this is not a wholly effective in achieving alignment with shareholders at Leman Brothers.*

**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.

*RMG supports this recommendation. RMG believes that there is a need for collaboration between remuneration and risk committees in this area but it should not be allowed to become an abdication of responsibility by the remuneration committee for the design of a plan which promotes responsible, sustainable long term performance in the first instance.*

*Greater clarity is required in reference to the definition and concept behind 'arms-length'. If the proposal is for both the Risk and Remuneration Committees to be truly independent of one another, then this should be clarified. However, RMG believes that it may be not be appropriate to provide restrictions on cross-committee membership as there is clear merit in cross-committee membership of one remuneration committee member in order to provide understanding of risk and guidance/ direct input to the remuneration committee.*

**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.

*RMG fully supports this recommendation as it believes it ensures greater accountability of the leadership and decision-making of the remuneration committee.*

*RMG questions whether the threshold is viewed as too low given that anything much below 95% support indicated material shareholder opposition. Perhaps a threshold of 85% may be considered.*

**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.

*RMG believes that such disclosure was present in the 2007/8 RBS annual report, however it did not attract shareholder censure. This single item on pensions does seem something of an afterthought and misses many other aspects such as excessive accruals, matches etc. A more thorough consideration of the issues is merited. Perhaps it would be more effective for remuneration disclosure to provide a list of exceptions to normal arrangements and any discretion applied by the remuneration committee.*

**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.

**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.

***Combined response for Recommendation 38 and 39.***

*RMG supports the premise of a code of conduct and professional standards for remuneration consultants designed to safeguard the integrity and ethical provision of service. RMG would also encourage that disclosure be enhanced surrounding the advice received by remuneration committees from their consultants and increased clarity of 'other services' provided to a company by the remuneration consultants.*