



## **A review of corporate governance in UK banks and other financial industry entities**

Sir David Walker,  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

30 September 2009

Dear Sir David,

The Co-operative Asset Management (TCAM) welcomes the opportunity to respond to the initial proposals set out in the Walker Review. As investors in banks we have an interest in corporate governance and are keen to contribute to the debate on the lessons that should be learned from the recent crisis.

### **About TCAM**

TCAM considers that sound corporate governance in the companies in which it invests is of central importance to create and sustain long-term shareholder value. TCAM considers that it is the responsibility of institutional investors to act as owners of the companies in which they invest and will seek to maximise value from its investments by using its influence as a shareholder, through engagement and the use of its voting rights, to further good corporate governance in investee companies.

### **Introductory Comments**

We note positively that you are liaising with the Financial Reporting Council (FRC) in respect of their Combined Code review. We believe a number of the recommendations are broadly transferable as best practice for non-financial companies.

Overall, we believe the recommendations contained within the report are sensible and address areas in which current practice has been deficient, for instance, poorly designed incentive plans.

## **Specific responses**

### **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 concur. TCAM co-authored a letter to the Chairman of the FTSE Allshare, with Railpen and Universities Superannuation Scheme, in February 2008 to reiterate the importance we attached to best boardroom practice and to being able to see evidence of continuing professional development for all boards and senior management teams. We highlighted the value we felt the Institute of Directors Chartered Director qualification offered.*

*Furthermore, we would like to accentuate the role of the Company Secretary in ensuring a high quality formal induction covering specifics such as audit, risk, remuneration and sustainability.*

#### **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 with this recommendation and again highlight the value a company secretariat can offer to non-executives.*

#### **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 welcome the acknowledgement that the NED role is time consuming. However, we would ultimately like to leave the minimum number of days to the discretion of the board, although we would welcome disclosure in the Report and Accounts of the number of days NEDs spend on the job. As part of our voting policy we vote against serial NEDs where we feel their multiple board positions may leave them overstretched.*

#### **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 with this recommendation in respect of BOFIs Achieving breadth of experience will require boards to think more laterally about board experience.*

#### **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.

*We agree with the spirit of this recommendation. However, we would welcome clarity around the interview criteria.*

### **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 fully agree with this in respect of both BOFIs and non-financial companies. This would be included by boards from a broader representation of society.*

#### **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 fully agree with this in respect of both BOFIs and non-financial companies. As per recommendation 3 we do not believe a prescriptive 2/3rd's is preferable, the ultimate discretion should be left in the hands of the board, but fully disclosed in the Report and Accounts. A welcome additional disclosure would be actual time worked compared to expected time commitments.*

#### **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 cite the case of Royal Bank of Scotland as a caution to this recommendation's weighting towards leadership experience. Sir Tom McKillop's background would have satisfied the weighting above given his experience as AstraZeneca. However, this experience appeared to be insufficient to challenge the AMN AMRO acquisition (which we voted against) or Sir Fred Goodwin's pension agreement.*

#### **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.

*Agreed. Furthermore, we strongly believe the role of Chief Executive and Chairman should be separate.*

### **Recommendation 10**

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

*We strongly agree, both in respect of BOFIs and other non-financial companies. Additionally, the chairman of the board committees should stand for annual re-election to increase accountability. We support the principle of annual re-election of all directors.*

### **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.

*Agreed.*

### **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 that it is of paramount importance to ensure the external facilitator is independent in addition to disclosing who the external facilitator is. Whilst we are happy with the evaluation being every other year we would welcome drafting that supports companies who wish to carry out annual evaluations. Anecdotal evidence from non-financial investee companies of TCAM indicated a full evaluation one year and a cut down version the next provides a rigorous framework. We believe the key is external, independent facilitation with some disclosure of methodology.*

### **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.

*Agreed*

## **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.

*Agreed*

### **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 agree with the spirit of this recommendation however, the FSAs approach would need to take into account what level of obligation shareholders would be under to provide timely, accurate information.*

### **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 the FRC is an appropriate facilitator of this development. Further, we believe sovereign wealth funds and overseas investors should also subscribe to this code.*

### **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 in principle.*

### **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.

*Given institutional investors' position as key stakeholders in the process we would welcome an avenue for input, without wishing for institutional investors to define the*

*code of conduct.*

**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 think this is a reasonable ask of fund managers and other institutions.*

**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.

*Agreed.*

**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.

*Agreed.*

**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 were one of the first institutions to publish our voting records, in 2002, and believe voting disclosure should be mandatory.*

**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 believe this to be a positive step so long as the committee was viewed with the same credibility and importance as the other established committees e.g. the audit committee. However, a number of BOFIs already appear to have this committee in place for instance Northern Rock. We hesitate in strongly backing this recommendation as we believe risk management should be a feature that runs throughout the entire board and not delegated to a committee.*

#### **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.

*As per recommendation 23 we do not wish accountability for risk to be delegated away and prefer that risk oversight remain the responsibility of the entire board.*

#### **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.

*Agreed.*

#### **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.

*Agreed.*

#### **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 would prefer any additional disclosure to sit within the risk disclosure section in the business review. Presently the range of reporting on risk management varies widely within the BOFI sector.*

## **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.

*Agreed. We believe this recommendation is a logical step building on the Combined Code guidance in respect of the need to be sensitive to pay and conditions across the company when determining remuneration. Furthermore, we would welcome closer links between the remuneration committee and the risk committee (should there be one) to strengthen appropriate remuneration.*

### **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 this recommendation.*

### **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 with this recommendation. However, we have concerns that in this instance, a committee, comprised of independent non-executives, would be taking on more of an executive function by providing oversight to sub-board remuneration.*

### **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 with this recommendation and the increased disclosure it would bring. The main thrust should be to assist shareholders to gain a picture of how risk, remuneration and strategy are aligned. One area which may benefit from greater transparency is pension contributions of board minus one executives.*

### **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.

*Agreed, although a case by case approach may need to be adopted to take into account disclosure from non-resident companies.*

### **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.

*We strongly support the use of claw backs. Furthermore, we believe 5 year performance periods should be encouraged. Our corporate governance voting and engagement policy is strongly weighted to encourage a tangible link between executive remuneration and long term performance.*

*Frequently, non-financial performance metrics can capture long term value add for instance the carbon intensity of assets in the loan portfolio.*

### **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.

*Agreed.*

### **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 a strong link between the two committees would be of benefit to the companies and its shareholders. This is particularly the case for changes in risk profile from sustainability factors for instance, adaptation to climate change.*

### **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 spirit of this recommendation but would welcome clarity as to*

*whether votes cast to abstain would be counted. We believe votes cast to abstain as still a strong signal and should be counted. Furthermore, we would welcome the chairman of all board committees to stand for annual re-election for greater accountability.*

**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 believe increased transparency in this area would be of benefit to shareholders.*

**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 strongly support this recommendation and consider it long overdue. We would caution against remuneration consultants self governing given the ingrained conflict of interest and the failure of remuneration consultants to address these conflict of interests comprehensively. We believe the FRC is the appropriate vehicle to govern the code. Furthermore, we believe the remuneration consultants used as well as fees paid should be disclosed in the remuneration report. In addition, we believe the introduction of an annual vote for the re-election of remuneration consultants should be considered.*

**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.

*Agreed.*

Thank you once again for inviting The Co-operative Asset Management to participate in this consultation. Please do not hesitate to contact me should you wish to discuss further.

Yours sincerely,

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