Response from the UK Policy Governance Association (UKPGA) to:

A review of corporate governance in UK banks and other financial industry entities by David Walker

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To: Sir David Walker, Review of Corporate Governance of the UK Banking Industry
c/o Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS

Introduction

The UK Policy Governance Association is a non-profit organisation committed to owner-accountable ethical and effective governance through the use of the Policy Governance[1] approach which has been hailed by Sir Adrian Cadbury as:

> *"a unifying vision, a logical and coherent base – an integrated theory of governance."* [2]

And

> *"a fully integrated and coherent system of governance… as near a universal theory of governance as we at present have"*[3]

Others have made similar observations:

> *"a clear, convincing and comprehensive framework for corporate governance"* – Robert A.G. Monks[4]

> *"probably the single best manual for directorial functioning in an Anglo-American context is the work of John Carver"* – Robert A.G. Monks[5]

> *"an unparalleled contribution to this essential subject"* - Judith Hanratty[6]

> *"John Carver's book Boards That Make a Difference "offer[s] the most relevant and sensible advice"* – Council for Healthcare Regulatory Excellence[7]

The model is available free to all with no royalties or licence fees for its use. However, to ensure its accurate description and thereby the protection of its integrity and efficacy. "Policy Governance®" has been registered as an international service mark by its creator, John Carver

Response to the Report's Conclusions

a) We welcome the clear recognition that *"governance failures contributed materially"* to excessive risk taking in the lead up to the financial crisis. However we believe this falls well short of holding the boards properly to account. Boards are the ultimately accountable bodies not merely *"contributors"*. We would go as far as to say that this is further evidence of the way in which we constantly let boards off the hook for the fulfillment of their legal role and therefore undermine their importance.

b) We agree that it is important to acknowledge that "*Better governance will not guarantee that there will be no repetition of the recent highly negative experience".* We would also say that, with a better model of governance it should be possible to be more precise in the future about exactly how and when boards fell down.

c) We welcome the fact that there are no proposals for new primary legislation in the report. We believe that the problems are not about the law they are about boards' ability to fulfill the intent of the law.

d) Saying that the principal deficiencies in BOFI boards are related much more to patterns of behaviour than to organisation does not seem very meaningful given that the way we organise ourselves has such a profound influence on the way we behave. We believe that it would be extremely helpful if the report were to highlight the Policy Governance® system which has been hailed by Sir Adrian Cadbury and many others as a good example of a organising tool for ensuring appropriate behaviour.

e) We see several problems with saying:

> *"The right sequence in board discussion on major issues should be presentation by the executive, a disciplined process of challenge, decision on the policy or strategy to be adopted and then full empowerment of the executive to implement.."*

Firstly it assumes that executive directors have a different role than non-executive directors when in fact they are all full board members with equal responsibility for governance. We agree that formal independence is not so important as independence of mind but we would assert that what matters most of all is the alignment of ALL directors with a well-informed interpretation of the best interests of the company's ownership.

Secondly, we are nervous that the emphasis on the particular skills and experience of individual non-executives and the role of the chairman in *"confidently and competently"* getting *"to grips with major strategic issues"* and therefore the need for a *"commitment that will leave little time for other business activity"* feeds the impression that non-executives are there to act as a higher-level executive team rather than a lower-level ownership team.

From the ownership perspective, starting the strategic planning process with *"presentation by the executive"* is to start with those who are most likely to be vested in what is currently so rather than what may be in the long-term best interests of the ownership.

f) We are also extremely concerned about the idea that there should be full independence in the group risk management function which presumably means that it would be accountable to the proposed *"dedicated NED focus on risk issues in addition to and* *separately from the executive risk committee process"* either directly or through the "CRO" who *"should have clear enterprise-wide authority and independence, with tenure and remuneration determined by the board"*.

All these proposals appear to undermine the role of the board as a whole and interfere with the board's ability to frame the role of the Chief Executive as the single point of delegation. Remembering that "a slave with many masters is a free man" we would urge that Executive Directors' inescapable conflicts of interest be managed through a board Conflict of Interest policy rather than by interfering with the clarity of the chain of accountability from executive to board to ownership.

g) We agree that there is a *"need for fund managers and other major shareholders to engage more productively with their investee companies with the aim of supporting long-term improvement in performance"* and that *"boards, in turn, should be more receptive to such initiative".* However, we would caution boards to be careful that such engagement does not distract them from the need to act in the best interests of all owners, not just the most active or well-represented ones.

h) Having the remit and responsibility of board remuneration committees extended "beyond board members to cover the remuneration framework for the whole entity" carries with it the risk of interference in the chain of accountability referred to under f) above. We believe it is important to clarify that the remit and responsibility is to research possible policy for the board and monitor its application rather than to substitute its authority for that of the board or the Chief Executive.

The following responses are related to the conclusion numbers in the report.

<u>Board size, composition and qualification</u>

Recommendation 1
It is important to note that ALL board members (ED and NED's) need to be acquainted with their distinct role as board members, how board policies relate and how the board goes about monitoring them.

Recommendation 2
The requirement to provide "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" should not be open-ended. The CEO must be given the right to check if the amount of company time necessitated by the requirements of a minority is OK with the whole board.

Recommendation 3
Assuming a board meets on average once a month for a day at a time plus two days to prepare for each meeting, the suggested minimum expected time commitment of 30-36 days in a major bank board seems reasonable. However it does of course limit the potential pool of board members mainly to the retired and self-employed.

It is important to recognise that with a more systematic approach to governing, such as that offered by Policy Governance, boards can become a lot more efficient - they are not there to be another management tier.

Recommendation 4
We believe it would be more sensible for the FSA to focus on the robustness of the board's standing policy controls and the monitoring thereof. The balance of the board in relation to the risk strategy of the business, the relevant experience and other qualities of individual directors (including the chairman) and the availability of an induction and development programme should all be seen as means to these ends.

Recommendation 5
We would question whether or not this recommendation could detract from the board's accountability for itself.

Recommendation 6
Please see our comments under e) and 1) above.

Recommendation 7
To have the chairman spending *"probably not less than two-thirds"* of his or her time *"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"* is to suggest that the chairman's role is to be super-chief executive rather than governance process leader. The board should have a robust and frequently monitored policy place upon the Chief Executive that ensures appropriate emergency succession plans are in place without necessitating the chairman to be on permanent stand-by.

Recommendation 8
See e), 4) and 7) above.

Recommendation 9
We agree with this description of the role of the chairman subject to the cautions above.

Recommendation 10
We agree that the chairman of a BOFI board should be proposed for election on an annual basis and assume that this would not prevent boards re-electing the current chairman in order to preserve continuity when they felt appropriate.

Recommendation 11
The role of the senior independent director (SID) is only necessitated by ineffective handling of the inevitable conflicts of interest involved in having executives on the board. No other comment.

Recommendation 12
This is a reasonable good practice recommendation.

Recommendation 13
This is a reasonable good practice recommendation. We see no need to specify that communication with major shareholders should be by the chairman – could be by the whole board or other board appointed representative.

The role of institutional shareholders: communication and engagement

Recommendation 14
We believe that this could most effectively be done through the creation and monitoring of a board policy governing the register.

Recommendation 15
No comment.

Recommendation 16
This recommendation could be helpful in offering greater clarity to the issue of ownership. Such Principles for Stewardship should be the subject of further consultation and we would appreciate the opportunity to comment.

Recommendation 17
No comment.

Recommendation 18
No comment.

Recommendation 19
This seems like a reasonable good practice recommendation but we claim no particular knowledge in this area.

Recommendation 20
See 16 above.

Recommendation 21
See 16 above.

Recommendation 22
Welcomed.

<u>Governance of risk</u>

Recommendation 23
Having a board risk committee separately from the audit committee runs the risks referred to under f) above.

Recommendation 24
Having a CRO who reports both to the CEO or FD, and board risk committee, with direct access to the chairman of the committee in the event of need, seems unnecessarily complicated and highly likely to cause role confusion and duplication.

Recommendation 25
We see no reason why this could not be a whole board job.

Recommendation 26
This could be a whole board job. The board could develop comprehensive policy criteria to be used for delegation and monitoring purposes.

Recommendation 27
Alternatively, the whole board (with any expert independent advice it might feel necessary) could:

i) set down a comprehensive range of permanent standing, but often reviewed, governing policies

ii) regularly monitor each policy to ensure that current CEO interpretations of each policy are (a) made explicit with operational compliance standards and compliance data against same and (b) discussed and accepted by the board as reasonable, or not.

iii) ensure that any anticipated or actual non-compliance with any policy is reported and dealt with in a timely manner.

<u>Remuneration</u>

Recommendation 28

A remuneration committee makes sense as a body for helping the whole board with research in relation to determining remuneration for the board's direct employees – the CEO, and NEDs. However we believe that the board should govern rather than directly manage the compensation of those employees whose accountability for performance is through the CEO. In this latter respect the remuneration committee could play a role in researching and monitoring of whole board created policy. See h) and 27 above.

Recommendation 29

See h) and 27 above.

Recommendation 30

See 27 above.

Recommendation 31

This seems like a reasonable good practice recommendation but we claim no particular knowledge in this area.

Recommendation 32

This seems like a reasonable good practice recommendation but we claim no particular knowledge in this area.

Recommendation 33

This seems like a reasonable good practice recommendation for large publicly-owned companies but we claim no particular knowledge in this area. Could not be applied in small privately owned companies where the owners might wish to demand a higher risk short-term strategy. Could be implemented through whole-board standing policy controls as in 27 above.

Recommendation 34

The acceleration of vesting of stock on compassionate grounds could become open to widespread abuse. The whole board could create and monitor policy regarding this matter for all executives other than the CEO who is rightfully the board's direct employee.

Recommendation 35

Could be governed, rather than directly managed, as under 27 above.

Recommendation 36

Why should a non-binding resolution on a remuneration committee report reflect only on the committee chairman? The chairman is responsible for process but how can he or she be responsible for the outcome of the process when proper decisions are held to be group decisions?

Recommendation 37
This seems like a reasonable good practice recommendation but we claim no particular knowledge in this area.

Recommendation 38
This sounds like good practice.

Recommendation 39
This sounds like good practice.

For further information on this submission please contact:

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References

[1] Policy Governance® is an internationally registered service mark of John Carver. Registration is only to ensure accurate description of the model rather than for financial gain. The model is available free to all with no royalties or licence fees for its use. The authoritative website for Policy Governance is www.carvergovernance.com. There are many books and articles on the theory and practice of Policy Governance. The basic text is: Carver, John, *Boards That Make a Difference: A New Design for Leadership in Nonprofit and Public Organizations*, Jossey-Bass, An Imprint of Wiley, San Francisco 1990; 2nd edition, 1997; 3rd edition, 2006)..

[2] Sir Adrian Cadbury in a review of: *John Carver on Board Leadership: Selected Writings From the Creator of the World's Most Provocative and Systematic Governance Model* (Jossey-Bass, 2001). Sir Adrian Cadbury is director of the Bank of England (1970-1994), retired chairman of Cadbury-Schweppes, Chancellor of Aston University, Chairman of the Committee on Financial Aspects of Corporate Governance in the UK (*The "Cadbury Report"*), and author of *The Company Chairman.*

[3] Sir Adrian Cadbury in the Foreword to: *Corporate Boards That Create Value: Governing Company Performance from the Boardroom,* John Carver with Caroline Oliver (Jossey-Bass, July, 2002).

[4] Robert AG Monks in a review of: *Corporate Boards That Create Value: Governing Company Performance from the Boardroom,* John Carver with Caroline Oliver (Jossey-Bass, July, 2002). Robert AG Monks is founder of Institutional Investor Services and the investment fund LENS**.** He is also the board chairman of Governance for Owners the London and U.S. based share-ownership services venture. He is the author of *Corporacy and The New Global Investors,* and with Nell Minow, *Watching the Watchers, Corporate Governance and Power & Accountability.* He was the recipient of the Award for Outstanding Financial Executive from the Financial Management Association in 2007.

[5] Robert A.G. Monks in a review of: *From Conformance to Performance, Best Corporate Practices for Asian Companies,* Editor Mak Yuen Teen, Singapore. (McGraw Hill, July 2005).

[6] Judith Hanratty in a review of: *Corporate Boards That Create Value: Governing Company Performance from the Boardroom,* John Carver with Caroline Oliver (Jossey-Bass, July, 2002). Judith Hanratty was Company Secretary of BP plc until her retirement in 2004. She was also a Member of the Competition Commission and of the Takeover Panel; and has been a Director of London Electricity, the British Standards Group, and of Partnerships UK. She was a Bank of England Nominated Member of the Council of Lloyd's of London, and Chairman of the Market Supervision Committee for 9 years ending in August 2007. She is currently a Director of Partner Re Limited, Charles Taylor Consulting plc, Chairman of the Commonwealth Education Trust, an Honorary Fellow of Lucy Cavendish College, Cambridge University, a Fellow of the Royal Society for the Arts, Manufactures and Commerce and a non-executive member of the Gas and Electricity Markets Authority.

[7] From Appendix 3 of*: Implementing the White Paper Trust, Assurance and Safety: Enhancing confidence in healthcare professional regulators. Final Report of the Working Group chaired by Niall Dickson.* Department of Health, July 2008.