

Nigel Fray
Operational and Reporting Policy Team
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email to: cp10_03@fsa.gov.uk

28 April 2010

Dear Mr Fray

FairPensions welcomes the opportunity to respond to the FSA's Consultation on Effective Corporate Governance. FairPensions is a project of The Fairshare Educational Foundation, a registered charity (no 1117244) established to promote Responsible Investment by UK pension schemes and fund managers, and to ensure that the ultimate beneficiaries are well served by institutional investors and other professional agents in the investment world.

FairPensions is a member organisation. Our members include organisations representing the beneficial owners of pension schemes, such as the Occupational Pensioners Alliance, UNITE and Unison, as well as thousands of individual pension fund members.

We believe that effective corporate governance is essential to the protection of beneficiaries' assets and the long-term health of the wider economy. We have a history of engagement with the post-financial-crisis reviews of this issue, including the Walker Review and the FRC's consultations on the Corporate Governance Code and the Stewardship Code. We reproduce some relevant passages of our Walker Review submission below where they are relevant. All of our previous submissions can be found on our website at <http://www.fairpensions.org.uk>.

Introductory remarks

In this submission we respond only to the consultation questions that are relevant to our remit. Q1-3 and Q14-15 are taken together. We also make some comments about the Walker recommendations on training for NEDs which, although relevant to the questions in Chapter 5, do not fall under any of the specific questions for consultation (see 'Chapter 4' below).

However, we would like first to make some brief remarks on the consultation process. We are concerned that responses to consultations such as this one tend to be dominated by industry voices, with the result that excellent initial proposals by the FSA are watered down or abandoned altogether (see our response to Q12 below).

Consultation Paper 10/3 explicitly notes that this consultation "will be of interest to consumers and consumer bodies". We would therefore hope that the voice of consumers and end-beneficiaries, whose long-term financial well-being depends on effective governance, will be appropriately represented in the responses received. If this proves not to be the case, we would urge the FSA to consider how it can more pro-actively reach out beyond directly self-interested parties.

Chief Executive: Catherine Howarth | **Chair of Trustees:** Jeremy Nicholls
Trustees: Stuart Bell | Sam Clarke | David Davies | Stephen Hine | Jenine Langrish | Jennifer Morgan | Tim Valentine
| Paul Watchman

Fairshare Educational Foundation is a company limited by guarantee registered in England and Wales number 05013662 and a registered charity number 1117244. *Printed on recycled paper.*

Chapter 2: A new framework of classification of significant influence controlled functions

Q1: Do you agree with our proposal to separately identify certain key roles that are performed within the CF1 (director) CF2 (NED) or CF 28 (systems and controls) controlled functions?

Q2: Are there any other key roles we should be identifying?

Q3: Do you agree that we should separately approve all candidates for a systems and controls function, even if they have, or are seeking, approval to perform a governing function?

We strongly agree with these proposals. It is crucial that key positions dealing with risk, remuneration and internal auditing are subject to full and proper oversight, and we welcome the FSA's decision to extend its activities in this regard.

We also agree that separate approval should be required for systems and controls functions and for governing functions, even where the candidate is the same individual. Indeed, one could argue that where a single individual holds multiple significant influence controlled functions, full scrutiny by the FSA becomes even more crucial, due to the huge amount that rests on that individual's competence and the potential for conflicts of interest to arise.

This connects to our anxiety that, despite its renewed focus on the technical competence of approved persons, the FSA should not lose sight of the centrality of conflicts of interest to the failures of governance and risk management exposed by the financial crisis. Although it is clearly vital that people in key positions are experienced and capable enough to recognise problems as they arise, it is equally vital that they have sufficient independence to voice their concerns and ensure that problems are confronted. Competence alone will not deliver the improvements to governance which everyone agrees are needed. Indeed, the Walker Review highlighted the 'tension between independence and experience', and managing this tension is clearly a key role for the FSA. As such, we hope that the FSA will share our view that improving its capacity to deal with conflicts of interest must remain a core part of its response to the financial crisis.

We would also note the importance of enhancing the accountability of these approved persons, not only to the FSA, but also to shareholders. In our Walker submission, we suggested that all directors should be subject to annual re-election by shareholders. If institutional investors are to be encouraged to exercise more effective stewardship over the governance of their investee companies, then their rights and engagement opportunities in relation to governance functions must be enhanced.

Q4: Do you agree that we should automatically grant the new controlled functions to individuals already performing the relevant role within their existing approvals?

We consider that some assessment of the capability of current incumbents of newly designated roles is essential if the intent behind the proposals is to be achieved. After all, many of these incumbents are the very people who were responsible for governance in the run-up to the financial crisis. To exclude them from the new, more rigorous regime seems inconsistent with the overarching aim of protecting the financial system from future shocks, and with the FSA's objectives of maintaining market confidence and protecting consumers.

However, we respect the FSA's conclusion that going through the approval process for all relevant individuals would be "excessively burdensome and unlikely to be cost-effective" (para 2.18). We would therefore suggest that the FSA consider establishing a rolling programme of approvals for individuals already performing the relevant roles within their existing approvals (if necessary following the provisional granting of such functions under the new rules). Alternatively, it could devise some method of generating a sample of such individuals to assess according to the new criteria, with the aim of providing a 'snapshot' of existing capabilities. If this survey revealed problems, the FSA would then be in a position to consider what further action might be needed - whether in terms of training or enhanced oversight - to address these.

As a minimum, the FSA should retain the discretion to require existing incumbents to undergo the new approval process in cases where they have specific concerns about a firm's governance.

Q5: Do you agree that a phased approach of between 3 and 12 months is sufficient for the notification process, and that the Remuneration Code provides an appropriate basis for this phasing?

Please see our comments on Q4 above.

Chapter 3: Significant influence controlled functions - other proposals

Q6: Do you agree that we should extend the proposed CF00 (parent entity SIF) to apply irrespective of the corporate status of the UK subsidiary?

No comment

Q7: Do you agree that we should extend the proposed CF00 (parent entity SIF) regime to apply to regulated firms whose parent entity is also FSA-authorized?

No comment

Q8: Do you agree that these transitional periods are sufficient?

No comment

Q9: Do you agree that it is appropriate for us to extend CF29 to UK branches of incoming EEA banks accepting retail deposits?

No comment

Q10: Do you agree that our proposed guidance on compromise agreements is useful in clarifying the current position?

No comment

Chapter 4: Approving & supervising SIFs - our more intrusive approach

We appreciate that this chapter does not contain specific consultation proposals or questions. However, we wish to comment briefly on the FSA's response to Recommendations 1 & 2 of the Walker Review, regarding the need for dedicated training and support for NEDs. We welcome the "expectation that SIF applications, including those for NEDs, will address the need for induction and ongoing training" (Annex 4 of consultation paper). We also welcome the FSA's intention to "develop a standing programme of briefings on regulatory matters aimed particularly at NEDs" (para 4.45 of consultation paper).

In our submission to the Walker Review, we suggested that there would be value in some collective provision by BOFIs of training for new and potential NEDs, and that the FSA might be the most appropriate body to oversee this. We continue to feel that this would be useful and reproduce below our response to the draft Recommendation 1 of the Walker Review.

This recommendation is particularly relevant to the tension between independence and experience which the Review identifies: one of the reasons for increasing diversity on boards is to bring in fresh perspectives and combat "groupthink", yet an NED who lacks knowledge of the enterprise will be unable to contribute usefully to discussions or to challenge the executive effectively, even if he or she has the requisite qualities of character and independence.

The most thorough and rigorous induction programme, followed by further training and development, is so important a part of the solution to this problem that we would suggest that consideration be given to the banking industry (and other BOFIs) making more of a collective effort to organise formal training sessions for potential and recent recruits to the ranks of NEDs.

This would have the further advantage of giving tangible proof of the industry's real commitment to diversity and should encourage more candidates to apply. In other words, it could be a component in an "outreach" programme for NEDs.

An industry-wide training scheme could also help counteract any tendency for individual in-house induction and development programmes to be "captured" by the executive, which could undermine the objective of fostering constructive challenge on the part of the NEDs.

Naturally, we are not suggesting that such external programmes would be in any way a substitute for enterprise-specific induction and development, merely that they could be a useful supplement.

[...] If any industry-wide programmes of [this] kind were established, it would be appropriate for the FSA to have an oversight role over these, in view of its general supervisory function in this regard.

Chapter 5: Non-executive directors (NEDs)

Q11: Do you agree with our proposed guidance on the time commitment required for chairmen and NEDs?

We welcome the increased recognition of the time commitment involved for chairmen and NEDs. However, in our Walker Review submission we expressed concerns that even the increased minimum days suggested by Walker may still be too little.

We have in mind in particular the case of recently appointed NEDs who have been recruited more on the grounds of their personal qualities than for extensive previous experience. Inevitably, to some extent such recruits will initially have to “learn on the job” before they can make their full contribution but it is clearly in everyone's interests that their learning curve be as steep as possible. We therefore suggested that in such cases consideration be given to requiring a greater time commitment for a suitable period after their first appointment.

In this light, it is disappointing that the FSA's proposed guidance does not explicitly refer even to the suggested minimum days stipulated in Sir David Walker's recommendation. We are concerned that the proposed wording - that the FSA will ‘have regard’ to “whether the person has adequate time to perform the controlled function and meet the responsibilities associated with that function” - is too vague and may not be sufficient to ensure that the intention of the Walker recommendations is realised. We are also concerned that the emphasis on “tak[ing] into account the process a firm has undertaken to determine the time commitment required” implies that deciding what constitutes ‘adequate time’ will be left to the discretion of firms.

In the wake of the financial crisis, we would question whether such discretion remains appropriate. We would prefer explicit guidance to the effect that, in the case of non-executive directorships on a FTSE 100-listed bank or life assurance company board, the starting point in determining the time commitment required should be 30-36 days.

Q12: Do you agree that we should delete the guidance in SYSC 2 and 4 on NEDs' responsibilities?

We welcome the FSA's proposal to delete guidance that might suggest that NEDs are not responsible for failing to intervene and challenge the executive. We agree with the FSA that NEDs' responsibilities are broad (para 5.3 of consultation paper).

However, we consider it unfortunate that this paragraph has not been replaced with anything, and as such there continues to be an unacceptable lacuna in defining the role, responsibilities and expectations of NEDs. It is disappointing that the proposed guidance in CP08/25 has been abandoned, apparently in response to industry pressure.

In particular, we note industry concerns that “[the FSA's] expectation that NEDs should challenge the executive and intervene where necessary was insufficiently clear - for example, about how this challenge and intervention should take place” (para 5.6 of the consultation paper). It seems odd that, rather than seeking to provide clarification, the FSA has abandoned any attempt to assert this expectation - which we regard as crucial to good governance.

We note that the FSA feels that the proposals regarding new controlled functions deal with the need to reinforce standards for NEDs. However, we would note that enhanced oversight of “the different roles performed by NEDs” does not necessarily fill the gap regarding expectations of the core role of NED in and of itself. We hope that the FSA will keep under review the question of whether further guidance may be needed in this area.

In this regard we would also refer back to our comments on Chapter 4 regarding the provision of training for NEDs. We would note that the benefits of such a collective training programme in terms of ‘outreach’ to potential NEDs might help to address one of the objections to the FSA's proposed guidance, namely that such guidance would be “too burdensome and prescriptive and... might deter individuals from taking on NED roles” (para 5.5 of consultation paper).

Q13: Do you agree that we should amend our rules to reflect the introduction of the new Corporate Governance Code?

Yes.

Q14: Do you agree with the content of our proposed guidance on board risk committees?

Q15: Do you agree with the content of our proposed guidance on CROs?

We strongly support Recommendations 23 and 24 of the Walker Review, and as such we welcome this new guidance.

However, we are concerned that the proposed wording may be too permissive and may not fully reflect the intent of the Walker Recommendations.

Specifically, whereas Recommendation 23 states that “the board of a FTSE 100-listed bank or life insurance company *should establish* a board risk committee”, and Recommendation 24 states that “a BOFI board *should be served by* a CRO”, the proposed FSA wording appears to weaken this requirement, saying only that “firms should, taking account of their size, nature and complexity, *consider whether*” to appoint a CRO or establish a risk committee. (emphasis added)

As with the question of NEDs’ time commitments, in the wake of the financial crisis we do not believe this discretion remains appropriate.

We note that the guidance does go on to state that

“The FSA considers that banks and insurers that are included in the FTSE 100 Index are examples of the types of firm that should structure their risk control arrangements in this way. However, this guidance will also be relevant to some similar sized firms (whether or not listed) and some smaller firms, by virtue of their risk profile or complexity.”

This stipulation is vital and we would urge the FSA, as a minimum, to retain this wording. However, we would also encourage the FSA to consider whether this guidance could be strengthened.

We remain at your disposal and would welcome the opportunity to meet with you to discuss any or all of the above.

Yours sincerely,

Catherine Howarth
Chief Executive, FairPensions