

THE FINANCIAL REPORTING COUNCIL'S CONSULTATION ON THE REVISED UK CORPORATE GOVERNANCE CODE

A response by The Building Societies Association

Introduction

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 52 UK building societies. Mutual lenders and deposit takers have total assets of over £390 billion and, together with their subsidiaries, hold residential mortgages of almost £260 billion, 21% of the total outstanding in the UK. They hold over £250 billion of retail deposits, accounting for just under 23% of all such deposits in the UK. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

2. The BSA welcomes the opportunity to respond to the consultation. Whilst the Combined Code is addressed to listed companies, building societies follow the Combined Code. They are encouraged in this by the FSA¹ and assisted in doing so by BSA guidance in the form of an annotated version of the Combined Code². So, building societies are closely interested in the changes now being proposed by the FRC as they will be applied by societies on an equivalent basis.

Annual re-election of directors

3. Having reviewed all of the proposals that the FRC has set out in its consultation paper, we find the vast majority of the changes to be sensible and we do not hesitate in lending our support to these. In particular, we welcome the tacit acknowledgement that considerations of a non-executive director's independence need to be viewed in the context of the board's overall balance of skills, experience and knowledge of the firm. As the Walker Review pointed out, in financial services firms, expertise and experience are at least as valuable to a board as independence.

4. There is just one change that we would like to comment upon in any detail. This relates to the re-election of directors. The consultation paper sets out two possible options:

- that all directors should be subject to annual election by shareholders; or
- that the chairman – and any non-executive directors who have served more than nine years, should be subject to annual re-election by shareholders. (All other directors being subject to election at the first AGM following their appointment.)

5. We acknowledge - and support - the rationale for regular re-election of directors. Clearly, the discipline of regular re-election promotes the accountability of the board to its shareholders. In the case of a building society, the shareholders are the members of the society who are also its customers. Under current arrangements, the chairman of a building society is already subject to annual re-appointment. For the purposes of election by the members, the chairman is subject to the same regime as other directors, ie re-

¹ <http://fsahandbook.info/fsa/html/handbook/bsog>

² http://www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf

election every three years, and his election is as a director, not as chairman. The appointment of a building society chairman is conducted annually at the board meeting that follows the society's AGM. To require members to elect the chairman on an annual basis would require an amendment to the Building Societies Act 1986. However, we could envisage a less formal arrangement, which would not require legislation whereby, annually at the AGM, the members would be asked to endorse the board's nomination for chairman, although such an arrangement may not be supported by all building societies.

6. There has been a debate - which is reflected in Sir David Walker's final report³ - about the extent to which the chairman should be held accountable for the performance of the board as a whole, and this has prompted the suggestion, embodied in one of the options contained in the FRC's proposal, that the whole board should be subject to annual re-election. This, it is argued, is in tune with the collective responsibility of a unitary board. Against this, it should be borne in mind that in any given year there will always be a proportion of directors up for re-election. Accordingly, there will always be a means by which shareholders may express their dissatisfaction with board members other than the chairman. Arguably, therefore, the collective responsibility of the board is already reflected in current arrangements. And the proposal for annual re-election of the chairman reflects the fact that - as Walker concluded - the chairman is in a pivotal position and should have enhanced responsibility to shareholders, even in a unitary board.

7. One of the criticisms of the annual re-election of the chairman is that it presents shareholders with a 'nuclear option' of the removal of the chairman. This is fair comment, although we would observe that the prospect, however remote, of the entire board being voted out is very much more of a nuclear option. Exposing the whole board to annual re-election does not seem to be in line with the promotion of financial stability, which is a key objective of the tripartite authorities.

Conclusion

8. Of the two options put forward by the FRC concerning re-election of directors, the BSA favours the proposal for annual re-election to be confined to the chairman and any NEDs who have served more than nine years.

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³http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf