

Proposed Revisions to the UK Corporate Governance Code

A response by the BSA to the
Financial Reporting Council's
consultation of December 2017

Introduction

The Building Societies Association (BSA) represents all 44 UK building societies. Building societies have total assets of £387 billion and, together with their subsidiaries, hold residential mortgages of £298 billion, 22% of the total outstanding in the UK. They hold £268 billion of retail deposits, accounting for 18% of all such deposits in the UK. They employ approximately 40,000 full and part-time staff and operate through approximately 1,550 branches.

Building societies take matters of corporate governance very seriously. The building society governance model of one member/one vote has proved resilient and engenders a long-term perspective not driven by the vicissitudes of stock markets or the needs of external shareholders. Building societies have readily embraced higher standards of governance over recent decades. The demutualisation of several building societies in the 1990s caused the rest of the sector to reinvent their engagement with their members and this has further evolved in line with market best practice over time. The BSA welcomes the opportunity to engage in the consultation about improvements to the UK Corporate Governance Code. The Code review is concerned with themes relevant to those, such as our members, who have a keen interest in high standards of corporate governance. We welcome the direction of travel and most of the detail of the FRC's latest proposals.

Although the Code is not addressed to building societies, they are required by the Prudential Regulation Authority to have regard to the Code and, to assist societies in this, the BSA issues [guidance to societies](#) in the form of an annotated version of the Code. Most of the Code can readily be applied to building societies, so the BSA guidance concentrates on the relatively small number of matters, such as listed companies' relations with major shareholders, which do not readily translate to building societies, whose individual customers are also their members/shareholders.

Our responses to the specific questions posed in the FRC's consultation paper are as follows:

Q1. Do you have any concerns in relation to the proposed Code application date?

Subject to addressing the concerns we have about the implications of the chair being designated independent (per our response to Q7 below), we consider the proposed application date to be achievable.

Q2. Do you have any comments on the revised Guidance?

The *Revised Guidance on Board Effectiveness* provides some really useful pointers for all board members and we envisage it will be particularly helpful to non-executive directors.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

We welcome the proposed approach to enhancing employee engagement and agree that there should be flexibility for firms to decide which of the 3 options either singly or in combination work best for them. The revised guidance on board effectiveness includes examples that we feel our members will find helpful.

Meaningful engagement can be achieved only if there is a real willingness on the part of boards to listen and to actively take account of the interests of staff in their running of the business. Building societies place a lot of importance on their employees understanding and embracing the culture of the business and, in particular, understanding the benefits of the ownership structure for their customers who, as members of the society, own the business. This is evident in the findings of a 2017 survey, the highlights of which were set out in a BSA report, [Ownership Matters](#). This showed a high level of knowledge and understanding by building society employees about what working in a customer-owned organisation means. The differences it makes to their working environment, behaviour and approach to customers and the broader range of stakeholders who benefit from the business are highlighted in the report, as are the differences compared with other sectors.

Draft Principle C also envisages enhanced relations with other stakeholders. For building societies, the main stakeholders are the members of the society, who are also the customers. Societies already use a range of mechanisms to facilitate engagement and consultation with their members, including member consultative forums and panels. A BSA paper, [Engaging conversations](#), surveys various initiatives by societies to promote effective engagement with their members.

We also have a comment on board engagement: in Principle E, we suggest the last few words be amended to read “*the chair should ensure the effective contribution of all directors*” (ie not just NEDs). In practice, a bigger challenge for the chair is not in encouraging NEDs to speak up, but in ensuring a full contribution from non-CEO executive directors on matters outside their direct line of responsibility – a good chair will draw these out.

4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

The FRC’s proposed approach to reflecting the United Nations Social Development Goals seems to us to be appropriate. Some of the goals appear more relevant to some firms than others and to include more specific references to these or other NGO principles would seem inappropriate.

Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

Yes, we agree that in the event of a 20 per cent vote against a resolution it is reasonable to require firms to explain to their shareholders (in the case of building societies, their members) the actions they intend to take to better understand the reasons for shareholder discontent and take steps to address these. Six months would seem an appropriate timescale for an update to be provided.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

While comparisons between different corporate forms are not straightforward, the BSA estimates that only the five largest building societies are large enough to be considered equivalent to companies in the FTSE 350. The other 39 societies would fall below and could therefore be affected by the FRC’s proposed removal of the four current exemptions. We

certainly agree with the FRC's view that all firms should aspire to the highest standards of corporate governance, irrespective of their size. However, there is a need for proportionality and as FRC suggests, the cost of undertaking an external board effectiveness review may be disproportionately high for some smaller firms. Building societies are regulated and supervised by the Prudential Regulatory Authority and, as part of this, PRA monitors board effectiveness. Some societies are likely to consider board effectiveness reviews conducted by the PRA a more searching and valuable mechanism than additional paid-for reviews by commercial third parties.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

The nine year threshold has become widely accepted as a proxy measure of independence of non-executive directors and the building society sector has adopted this. There is inevitably an element of arbitrariness about any time limit and, no doubt, a case could be made for some movement either way. However, in the absence of a compelling case for change, our members would be content to continue to apply the nine year period. All building society boards have a majority of independent NEDs and this has been the case for several years.

FRC's proposal to designate the Chair of the board as an independent director appointment is much less convincing.

The rationale for the change is not clear as the consultation paper does not explain FRC's thinking. Presumably, though, the main motivation is the desirability, as a matter of principle, of the Chair being independent, whereas the current provision in the Code seems to us to be both realistic and pragmatic in determining the Chair to be independent only at the time of his or her appointment. Our observations are as follows:

The Chair is inevitably far closer to the business than the other non-executive directors. Their time commitment is greater and, while they act as a counterpoint to the chief executive and have a role distinct from those of the executive, their proximity to the business means that it is inevitably more difficult for a chair to have - or be seen to have - the same degree of independence as other NEDs, even if in practice they retain independence of mind. At a time when the FRC is tightening the Code provisions on independence of NEDs, it seems odd to be extending their scope in this respect.

We think there is a difference between the listed and building society sectors, which may not have been considered by the FRC in framing its current proposals. New non-executive appointees to the board of a listed company, including new Chairs, are likely to have had experience of other such boards prior to their appointment. In the building society sector, new non-executive appointees typically will not have served on a building society board before, so may be unfamiliar with the unique challenges of governing a mutual business. Accordingly, most societies tend to appoint their chairs from within the ranks of their NEDs. The combination of the planned move to independent Chairs, and the proposed hardening of the emphasis on the independence criteria, so that any director serving more than nine years will not be considered independent, is likely to prove problematic for some building societies. It could lead to Chairs exiting building society boards, having served only a very short time in the post, when they still have a lot to offer, or being appointed as Chair having served perhaps only one three year term on the board and, as such, relatively inexperienced. Alternatively, it

may encourage societies to appoint as Chair ex executive directors of other societies, in order that they may 'hit the ground running'. While this may have some advantages, it could mean that some valuable cross fertilisation of ideas and experience from outside of the sector will be lost to building societies.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

Yes, for the reasons set out in the consultation paper and, given that companies (and building societies) are able to explain if they choose to have a NED or Chair on their board for more than nine years.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

The BSA is supportive of initiatives to improve diversity in boards and senior management, to more closely reflect the changing demographics of wider society. It is not straightforward to achieve much greater diversity in the short-term, however, particularly for smaller firms, so momentum will need to be maintained over the medium term to ensure necessary progress.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Duplication is not unhelpful if it helps to ensure requirements of the Listing Rules etc are not overlooked.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

We are supportive of the FRC's aims of aligning remuneration policies with the long-term interests of the business and promoting greater stakeholder engagement in executive pay. We

think the building society practice of subjecting their remuneration reports to annual votes of their members, ie the societies' customers, provides a discipline to which listed companies are not subject. Members' approval ratings have been consistently high, with between 89% and 94% voting in favour of societies' annual remuneration reports over the past 10 years. Had the personal customers of banks had a similar say in their executive pay policies, it might conceivably have applied a brake to some of the excesses evident in that sector, which contributed to the financial crisis. We recently commissioned PwC to survey remuneration practices in the building society sector. Their report [Remuneration at Building Societies – the remuneration committee perspective](#), published in December 2017, provides some helpful insights to remuneration policies and practices across the sector.

13 February 2018

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £345 billion, and account for approximately 20% of both the UK mortgage and savings markets