

Financial Reporting Council Consultation UK Corporate Governance Code and Guidance on Board Effectiveness Questions

Introduction

This response is submitted by Nationwide Building Society. Nationwide is the world's largest building society – and as a mutual we are owned by and run for the benefit of our members.

Nationwide aims to be an exemplar organisation in all aspects of its business. The Board is committed to the highest standards of governance, and this approach has served us well throughout our history. For a number of years we have underpinned this principle by seeking to adopt the Financial Reporting Council's (FRC's) Corporate Governance Code on all matters of governance, reporting and disclosure, notwithstanding our “private” ownership and mutual status. However, we recognise that the demands of governance change and evolve, and we keep our arrangements under review to ensure they remain fit for purpose. As such we are grateful for the opportunity to provide input to the FRC's consultation on the UK Corporate Governance Code (the Code) and Revised Guidance on Board Effectiveness.

Responses to FRC consultation paper

Turning to the specific questions raised in the consultation paper, and following the same numbering:

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

Assuming that the final version of the Code does not differ to a great extent from the proposals set out for consultation - and is published in *early* summer 2018 - we do not currently foresee any issues with implementation for accounting periods beginning on or after 1 January 2019. However, should publication be delayed, or there be substantial changes we would suggest an implementation date for accounting periods beginning on or after 1 June 2019 but with an eye to encouraging early adoption. As currently envisaged, the revised Code would be applicable to Nationwide with effect from 5 April 2019.

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

No.

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

Provision 3 provides for three methods of gathering views from the workforce: a director appointed from the workforce, a formal workforce advisory panel or a designated non-executive director.

We appreciate that the FRC has included all three options proposed by the Government to give flexibility and we would suggest that it be made clearer that these are options, and that meaningful two-way dialogue with the workforce can be achieved through other means, depending on the particular circumstances of the organisation.

In order to ensure that the Code retains flexibility for the diversity of organisations it covers, it should be emphasised that the suggested methods of engagement are not the only ones available to promote positive and constructive engagement between Board and workforce. We note that the para 35 of the revised Guidance brings this out more clearly and it would be useful to see this given greater emphasis.

At Nationwide, we have a range of engagement methods including attendance by front line employees at Executive and Management Committees, an Employee Involvement Committee structure with our recognised trade union – the Nationwide Group Staff Union (NGSU) and a variety of employee feedback mechanisms including an annual all-employee survey, employee panels and a variety of local initiatives.

The Board is also reviewing other means of bringing the employee voice into the boardroom, including:

- Inviting selected People’s Choice¹ individuals as employee representatives to attend and participate in an opening session of a Board meeting or a Board Committee meeting on a regular basis;
- Fostering greater engagement by the Board with the Society’s recognised trade union by means of an annual presentation from the union’s General Secretary to the Board; and
- Developing an employee annual general meeting.

We recognise that many organisations would be likely to favour the method of a designated non-executive director to achieve greater engagement but it should be recognised that any non-executive director taking on such a role would need support from their organisation in order to fully discharge their responsibilities. It may also increase the required time commitment from the non-executive director concerned and, as an unintended consequence, associated fees. However, Nationwide would like to explore this possibility further and will review in addition to the above plans.

We would sound a note of caution regarding appointing a director from the workforce. Whilst this may be the right option for some organisations it should be recognised that once appointed the individual is statutorily responsible, collectively with other directors, for acting in the manner that would be most likely to promote the success of the company for the benefit of its members (in most instances shareholders) as a whole, and would be held to the same legal and regulatory standards as other directors, with the same degree of accountability as other board members. It should therefore be recognised that an “employee director” would need appropriate skills and experience to act as a director, with an extensive and supportive induction and ongoing training to ensure they were suitably prepared for the responsibilities of directorship and not inadvertently set up to fail. Moreover, in the case of a financial services business, the employee would need to be capable of meeting the Financial Conduct Authority’s fitness and propriety requirements.

We understand the use of the term “workforce” in provision 3 is designed to capture more individuals than would naturally fall within “employees” as this reflects the more flexible make up of many organisations. However, as it is important to retain an appropriate differential between employees and other contingent workers, at Nationwide, we would prefer to facilitate alternative measures to ensure the voice of our contingent workers and suppliers is heard.

We also recognise the importance of whistleblowing provisions and note that, at Nationwide, the responsibility for reviewing arrangements relating to, and the effectiveness of, this sits with the Board, given its importance.

Q4. Do you consider that we should include more specific reference to the UN Sustainable Development Goals or other NGO principles, either in the Code or in the Guidance?

We understand that the UN Sustainable Development Goals are seen as the most pervasively referenced and widely adopted standard. We would, however, suggest that legislation already in place (s172 Companies Act 2006), should be more fully utilised and more transparent reporting against it encouraged.

¹ The ‘People’s Choice’ are individuals (including award winners) who have been elected by colleagues from across the Society to be included within the Society’s leadership programme – Leading for Mutual Good.

Q5. Do you agree that 20 per cent (of votes being cast against a resolution) is 'significant' and that an update should be published no later than six months after the vote?

Yes. We agree that such an approach encourages transparency and clear communication with members / stakeholders. The matching of the significant threshold to that which would also trigger inclusion on the Investment Association's public register of shareholder dissent is useful and welcomed.

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.

We believe that applying the principles of the Code can benefit organisations, irrespective of size. Nationwide undertakes regular and rigorous board evaluations, and believes that these exercises could also be of benefit to smaller quoted and unquoted companies. We do however recognise that the cost of the evaluation should be proportionate to the size and complexity of the organisation concerned, and that allowing flexibility in how the evaluation is undertaken – rather than mandating - is essential.

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

We agree that nine years is appropriate and in line with accepted practice. However, it should be recognised that length of service is only one factor in determining independence and that many non-executive directors retain an independence of mind irrespective of time served. Members should not be discouraged from expressing their concerns (and rationale) if they feel that a non-executive director or chair has ceased to be independent before the nine year point.

We do recognise that this could have an unintended consequence regarding Chairmen as often, in financial services, and other sectors, individuals may serve on the Board for a period before being appointed as Chairman. The proposed provision as it stands would therefore limit the tenure of any Chairman appointed from within the ranks of existing non-executive directors of a Board. Were this proposal to be incorporated into the revised Code we would suggest that an approach that takes account of the unique position of the Chairman be considered (e.g. an additional three year term).

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

We agree this is not necessary. Accepted practice, and peer or shareholder pressure is already, in effect, imposing a de facto limit on tenure. To impose a maximum period of tenure could be unduly restrictive if, for example, the search for a suitable replacement director took longer than anticipated, or where an organisation in exceptional circumstances such as a takeover bid found it helpful to retain the services of an experienced director for a finite period beyond nine years' service.

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?

Yes, but only as an additional and supportive measure. Not in and of themselves. Organisations will need to equally ensure that appropriate initiatives are in place to drive and encourage diversity at all levels of the organisation. At Nationwide we have supporting initiatives such as flexible working policies, reverse mentoring programmes and inclusive family friendly policies as well as an approved and monitored Equality, Diversity & Inclusion (ED&I) strategy and plan with challenging Diversity measures and targets.

Q10. Do you agree with extending the Hampton-Alexander recommendation (FTSE 350 companies should aim for a minimum of 33% women's representation on their Boards by 2020) beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

We agree. Good practice should be developed where possible although this needs to be balanced against any burdens that may be placed on smaller organisations that are disproportionate. We would also encourage greater development of the marzipan layer across organisations of various sizes – for example executives and senior managers could hone their experience, and develop diversity in others, through non-executive roles. We do however recognise that this may be more challenging for smaller Boards where one individual carries a greater percentage terms of overall composition so a proportionate response by the FRC would be welcomed.

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.

We would agree that encouraging companies to report on levels of ethnicity in executive pipelines may provide a stimulus to increasing diversity at senior levels within the workforce, but this would certainly have a cost in terms of management time and data capture. It should also be noted that much of this data would be drawn from voluntary disclosure which would need to be captured in any external reporting for the sake of clarity. Much would depend on the specifics of the proposed requirements. If such a proposal were introduced, it would be logical for it to apply as widely as possible.

Q12. Do you agree with retaining the requirements included in the current Code (Section 4 – Audit, risk and internal control), even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Yes. A key strength of the Code is its simplicity and accessibility – by having all the key elements of best practice in one place. This supports that approach.

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.

We have no strong view regarding the removal of C.3.3 (The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available). This is now accepted best practice and implemented as such as a matter of routine.

However, we would caution against removing too many elements to the Guidance. As noted above a key strength of the Code is its simplicity and accessibility – by having all the key elements of best practice in one place. Whilst we recognise the driver is keeping the Code short and clear, the removal of certain provisions could lead to fragmentation and confusion with individuals needing to check a range of data sources to ensure compliance.

Q14. Do you agree with the wider remit for the remuneration committee (to engage with employees and oversee pay and incentives across the wider workforce should encourage greater focus on the strategic rationale for executive pay levels in a broader context) and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

We agree with the proposed extension of the remit of the Remuneration Committee to include setting remuneration for senior management (as defined as the Executive committee or the first layer of management below the Board). This is already the case at Nationwide with the Committee having responsibility for all material risk taker roles (which includes the senior management team). The decisions made at this level of management can have a material impact on the business, and these individuals may eventually move to board roles, and we therefore agree that the Committee should have approval powers for these individuals.

In terms of the wider remit of the Remuneration Committee, we agree that it would be beneficial for the Remuneration Committee to oversee pay and incentives across the wider workforce in order to ensure that remuneration arrangements for senior managers are considered within the context of the organisation as a whole. We think that this is correctly currently positioned as an “oversight” role rather than the Committee being involved in the approvals process for wider workforce remuneration policies. In particular we would caution against non-executives being asked to take on a management function.

In terms of how the Committee engages with the wider workforce, we agree with the principle of what the Code is seeking to achieve and will give consideration to how this is achieved in practice, for example increased reporting from Executive / Management Committees and those forums which engage with staff union. We do already provide oversight to the Remuneration Committee on pay and benefits across all levels at Nationwide including pay, variable pay and performance management arrangements.

We also note the Government’s previous proposal that chairs of remuneration committees be required normally to have served for at least 12 months on a remuneration committee before taking up the role is one of which we remain supportive.

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

We think that the requirement for longer time horizons under incentive plans (i.e. a vesting and holding period of at least 5 years) will align the broader market with financial services norms and may support long-term sustainable performance. At Nationwide, our executive director incentive plans are currently delivered over 7 years in line with regulatory requirements.

The performance measures used under incentive plans are key in driving long-term sustainable performance. In the financial services sector, regulations require firms to consider performance against a balance of measures (both financial and non-financial) to try and guard against short-term decisions that come at the expense of longer-term sustainable performance. To this effect, at Nationwide we currently use a number of measures - linked to delivery of core elements of business strategy - in our variable pay plan (including customer satisfaction and financial efficiency) to ensure that reward supports the long-term sustainable performance of the Society and take full account of conduct requirements.

We also note that there have recently been great efforts in the market to simplify executive remuneration over the past few years and we support the proposed drafting of the Code on this point within the context of driving long-term sustainable performance. At Nationwide we operate one variable pay plan, Sharing in Success, across the organisation which offers eligible employees the opportunity to receive an award that recognises everyone’s collective contribution to achieving the gateways and measures aligned to the cornerstones of our strategy. We continue to apply the current regulatory requirements for our most senior employees.

Q16. Do you think the changes (Section 5 – Remuneration) proposed will give meaningful impetus to boards in exercising discretion?

We agree that the specific identification serves as a useful reminder to Boards of their role in exercising independent judgement and challenging remuneration outcomes (such as formulaic incentive outturns) where considered appropriate to do so.

At Nationwide, the Remuneration Committee has wide ranging discretionary powers, in part as a result of the financial services regulations that apply, which means that the Committee takes into account a suite of information in determining remuneration outcomes, including underlying Society performance, individual performance, risk and conduct, considering and receiving input from the Board Audit and Risk Committees, in order to ensure that variable pay awards are appropriate in the round.