



## Governance in brief

### Your summary of the latest corporate governance developments

#### Headlines

- FRC consults on Stewardship Code for Institutional Investors
- FSA issues a consultation paper on effective governance standards

#### FRC consults on Stewardship Code for Institutional Investors

**In Brief:** The FRC is consulting on the content, operation and oversight of a stewardship code that will set out good practice for institutional investors when engaging with the UK listed companies in which they invest.

The FRC agreed to take on responsibility of oversight of the proposed code at the request of the Government, following Sir David Walker's report on the corporate governance of banks and other financial institutions in November 2009.

The FRC is seeking views on:

- whether the code published by the **Institutional Shareholders' Committee (ISC) in November 2009** provides a suitable basis for the Stewardship Code, in either its existing or an amended form;
- what the responsibilities for engagement of institutional shareholders and their agents are to the beneficial owners whose money they manage;
- how adoption of the standards in the code by UK and foreign investors can be encouraged;
- what information investors should disclose on their engagement policy and practice; and
- what arrangements should be put in place to monitor how the code is applied.

The Code issued by the ISC includes seven principles together with guidance on implementation of those principles. The principles are that institutional investors should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities;
- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed;
- monitor their investee companies;

- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value;
- be willing to act collectively with other investors where appropriate;
- have a clear policy on voting and disclosure of voting activity;
- report periodically on their stewardship and voting activities.

Announcing the consultation Sir Christopher Hogg, Chairman of the FRC, said:

“The benefits of a code which can help to bring about more effective engagement between companies and shareholders are potentially significant. They should lead to sustainable and enduring improvements in the governance and performance of UK listed companies and greater clarity in the respective responsibilities of asset managers and asset owners, which will assist the ultimate owners to hold to account those acting on their behalf.”

These proposals are expected to create some controversy amongst the investor community. A significant issue will be the requirements for disclosure and auditor verification of those disclosures. The largest impact will be on fund managers who attempt to be active.

**Date:** 19 January 2010

**Deadline for comment:** 16 April 2010

**Source:** Financial Reporting Council

**Further info:**

<http://www.frc.org.uk/press/pub2216.html>

### **FSA issues a consultation paper on effective governance standards**

**In Brief:** The FSA has outlined its latest steps to address corporate governance in regulated firms. The consultation paper (CP 10/3) includes proposals to adopt the FSA-related recommendations made in Sir David Walker’s review, guidance on expectations in relation to non-executive directors and a new framework of classification of controlled functions.

### **The Walker Review**

The FSA proposes a renewed emphasis on the standards and quality of governance in firms and hopes that this will help to introduce the more effective practices needed to deliver a step-change in the way financial services firms are governed. In evaluating the quality of governance, the FSA will look closely at:

- the practical effectiveness of board, management and organisational structures including shareholder relationships, particularly looking for evidence of depth of understanding and effective discussion, challenge and risk-based decision-making in practice;
- the formulation of strategy and determination of risk appetite and the subsequent monitoring of performance against strategy/appetite, including the role of the key functions;
- the quality of the reporting and analysis of management information and reporting to the board and evidence that it is understood and gives rise to feedback and actions; and
- the key factors, such as incentives and culture, which support and enable robust governance, building on the work already taking place to verify compliance with our new code of remuneration practice.

This more intensive work on governance will be complemented by an in-depth review of the group-wide risk management function. The consultation paper states that some aspects of this approach to governance and risk management for major banks will be more generally applicable to other firms, including insurance companies, although the level of intensity will vary according to the impact of the firm.

There is a proposal to include guidance in the Senior Management Systems and Controls Sourcebook (SYSC) on the need for firms – in particular FTSE 100-listed banks and insurers – to consider the value of establishing a committee charged with advising the board on high-level issues about current risk exposures and future risk strategy. In addition there will be guidance on the need for some firms to appoint a chief risk officer. This senior executive will play a pivotal role in ensuring that the board receives balanced and accessible information and advice on high-level risk issues. As before, the FSA has not sought to limit the scope of the guidance to specific firms. It will be up to individual firms to decide whether it is appropriate and necessary to appoint a CRO depending on their nature, size and complexity.

## Non-executive directors

Sir David Walker recommended that for several non-executive directors (NEDs), a minimum expected time commitment of 30 to 36 days in a major bank board should be clearly indicated in letters of appointment. Rather than introducing this definitive requirement in to the FSA guidance materials, the FSA is proposing to make clear in the guidance on the 'fit and proper' test for approved persons that in assessing an individual's capability, the FSA may have regard to the extent to which the individual is capable of meeting the level of time commitment that the firm has specified in its contractual terms of appointment for the role. It will be for the firm and individual, as part of the application for approval, to demonstrate they have given due consideration to the amount of time required for the role, and that the individual has the capacity to deliver it.

In another significant step, and to emphasise the importance of a NED's role in the active governance of firms, the FSA proposes to delete current guidance in the Handbook that discusses the limits of NED liability. The FSA is concerned that the existing guidance could be misinterpreted and taken to mean that it would not hold NEDs responsible for, for example, failing to intervene and challenge the executive.

## Significant influence controlled functions

The FSA created the significant influence controlled functions to capture those individuals who, in the FSA's opinion, exercised a significant influence on a firm.

In order to improve the support the current regime provides to our regulatory objectives, the FSA has reviewed the structure of the significant influence controlled functions and concluded that they are not currently sufficiently detailed to allow segregation and capture of specific key roles within governance structures. There are proposals to introduce a number of new, more specific, controlled functions capturing key roles in organisations, e.g. chairman, chairman of risk committee, chairman of audit committee, chairman of remuneration committee and senior independent director. Transitional arrangements are discussed further in the consultation paper. In addition, the FSA is proposing to extend the scope and application of the parent entity significant influence function (function CF00). This is likely to capture a number of new people into the regime formally for the first time.

The consultation period closes on 28 April 2010 and the FSA hopes to have final rules in place during the third quarter of 2010.

**Date:** 28 January 2010

**Deadline for comment:** 28 April 2010

**Source:** Financial Services Authority

## Further info:

[http://www.fsa.gov.uk/pubs/cp/cp10\\_03.pdf](http://www.fsa.gov.uk/pubs/cp/cp10_03.pdf)

## Time to take action

- Directors should consider the FRC's proposals in light of their current engagement with institutional shareholders.
- Where appropriate, boards need to be confident that their risk governance arrangements will stand up to increased scrutiny from the FSA in light of the proposals described above.

## On the horizon

- FRC revised UK Corporate Governance Code.

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