Guidance consultation

Governance in retail firms –

Feedback from Winter 2010 seminars

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Financial Services Authority

Governance in retail firms – feedback from Winter 2010 seminars

Chairman of the Board/Chief Executive

[address]

Dear [name]

This letter summarises the key points we discussed during a series of seminars on governance, hosted by our Retail Firms Division (RFD) during October/November 2010. Please share this letter with your Board and consider the issues raised in it.

The seminars were well attended by senior executive and non-executive Board members from firms supervised by the RFD. Our Panel was made up of senior managers from the RFD and our senior advisers. The three key areas of discussion were:

- Board effectiveness;
- non-executive directors; and
- risk appetite.

There was broad agreement at the seminars that it would be helpful for us to summarise the key points of discussion.

The purpose of these meetings was to:

- consider common issues relating to governance that we have identified through the supervision of RFD firms;

- seek feedback from firms about topics they find challenging; and
- share good practice.

The intention was not to suggest a single approach that is applicable to all firms, but to provide examples of arrangements that have been judged effective, which firms may find helpful when thinking of such matters from their own perspective.

Board effectiveness

Participants noted that Board effectiveness arises from various factors, including:

- the knowledge and skills of the board members, both individually and collectively;
- their personal dynamics and teamwork;
- a culture of open and constructive challenge;
- a strong chairman who ensures all members' engagement; and
- the integrity and quality of the Board's financial information.

Participants recognised the importance of regularly reviewing the effectiveness of the functioning of a Board. Reviews can cover individual's skills/knowledge, interpersonal dynamics, structures, processes and Management Information (MI). Participants observed that an effectiveness review gives the Board an opportunity to step back and consider how the business and the Board have changed and whether the structure, membership and reports are still fit-for-purpose. The Panel agreed and noted that this is particularly important where a firm is growing rapidly, as problems can emerge where the governance and controls do not keep pace with the business.

There was some discussion of the merits of internal and external reviews, with the Panel stating that the FSA considers either approach to be equally valuable. Participants that favour external reviews noted that they give Board members the opportunity to express frank and unattributable opinions about colleagues, strategy, etc and allow the firm to benchmark against others. One disadvantage can be that the consultants may not have enough understanding of the firm.

There was extensive discussion about the difficulties firms face in showing the FSA how they provide effective challenge of decisions at Board level. Participants noted that challenge often occurs outside formal Board discussions. They said Board minutes were only one indicator of challenge, but the FSA focused too much on minutes. The Panel acknowledged the concern and said that we do not require word for word minutes, but suggested that a firm (as well as the regulator) needed minutes that show why a decision has been made. The Panel noted that supervisors seek evidence of robust decision-making and they agreed that supervisors should look at a range of elements to build up a picture, including sub-board committee meetings, informal discussions between executives and non-executives, the quality of Board papers and other information, and its processes and controls.

Non-executive directors (NEDs)

There was extensive discussion about the challenges of finding NEDs who have the skills and knowledge necessary to meet what were widely perceived as regulatory expectations. The Panel noted that it is not the FSA's intention to require all NEDs to be industry specialists. In fact, we welcome diversity on a Board, as it provides different perspectives and can discourage 'group-think' where the Board only considers a single or a few solutions to an issue due to similar perspectives or experiences.

The Panel noted that a firm should not expect one individual to have all the skills and knowledge that the Board needs. A firm should instead look at the balance of skills and knowledge across the whole of the Board. This could allow NEDs from different sectors or representative organisations – who were not financial services specialists, but who nevertheless have other relevant skills – to contribute to the overall balance of the Board. The Panel suggested that firms explain to the FSA what particular skills and experiences they envisage a new NED bringing to the Board so that the individual can be assessed in that context. It was also noted that succession planning was key to ensuring a Board maintains continuity of skills and experience over time.

There was broad agreement that a structured induction and training plan for new NEDs, which takes account of their skills, experiences and gaps, can be key to them quickly understanding the nature and risks of the business and becoming effective contributors to the Board. Nevertheless, firms varied in the degree of formality of their induction process. The most effective plans include NEDs spending time in the business and meeting people at sub-board level. Having a structured plan can give a firm the confidence to appoint non-financial specialists.

Risk appetite

The Panel said that the most effective risk appetite statements are those that are clear and easy to understand, and emphasised that firms should consider how their risk appetites might inform their strategic decisions. The Panel noted that risk appetite statements may need to contain a mixture of qualitative and quantitative elements, although several participants suggested that it can be easier to embed and monitor against quantitative measures. If a firm sets granular risk appetites at business unit level, these should be clearly linked to the firm's overall risk appetite statement.

Participants also provided feedback on supervisory relationships, in particular their experience of the ARROW process, frequency of interaction with NEDs and use of s166. There was a general desire expressed from NEDs for there to be more frequent contact between the supervisors and the NEDs that sit on Boards. These points are being considered and fed back to supervisory departments.

Yours sincerely

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