



### Key Contact

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*“... effective challenge at board level is essential before decisions on major risk and strategic issues are made...”*

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## THE WALKER REVIEW

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### Overview

**The Walker Review was published in July in the form of a consultative document. If adopted in its current form, which seems likely, it will lead to significant changes to corporate governance arrangements in banks and other financial institutions (“BOFIs”).**

### Key themes

The review has five key themes:

- the Combined Code remains fit for purpose, but relevant guidance and provisions require amplification and better observance;
- principal deficiencies in BOFI boards related much more to patterns of behaviour than to organisation. Effective challenge at board level is essential before decisions on major risk and strategic issues are made;
- the level of involvement of the board on monitoring risk and making decisions on the risk appetite and tolerance of entities should be materially increased;
- fund managers and major shareholders should engage more productively with their investee companies;
- a significant improvement is needed in the level of board oversight of remuneration policies.

The report makes 39 recommendations.

### Board size, composition and qualification

The first five recommendations outline requirements relating to the board size, composition and qualification. Much of the focus of these recommendations is on non-executive directors (“NEDs”) and the need for them to have sufficient knowledge and support to enable them to understand the business. The report recommends that during the process for appointing an NED of a major bank or other financial institution, the FSA use senior advisors with relevant industry experience to interview the prospective NEDs. Following appointment, support should be given to the NED by the firm, including an induction and development programme. NEDs will also be expected to give a greater time commitment than has been normal in the past.

### How the board functions and evaluation of performance

The next eight recommendations address the way the board functions and the evaluation of performance of the board. Much of the focus of these recommendations is on the chairman and the need for him to be proposed for election on an annual basis; to have a combination of industry experience and proven leadership skills; and for him to commit the majority of his time to the business of the entity. These recommendations highlight the need for the chairman to ensure that the board has all the information it needs to

enable it to discharge its obligations as well as facilitating communication between board members. The report also includes recommendations for a senior independent director to act as a sounding board for the chairman and to intermediate between the NEDs and chairman if necessary. An external facilitator should be involved in evaluating performance of the board, publishing an evaluation statement as part of the firm's annual report.

### **The role of institutional shareholders**

The report makes nine recommendations on the role of institutional shareholders, focusing on how the firm communicates and engages with them. The recommendations include the need for the board to be aware of changes to the share register. In the event of a major change to the share register over a short period, the FSA should consider contacting major selling shareholders to understand their motivation and seek an indication from the board of how they intend to respond. The recommendations also address the need for a Memorandum of Understanding among major long-only investors to establish a flexible and informal but agreed approach to issues such as arrangements for leadership of a specific initiative, confidentiality and any conflicts of interest that may arise. The report makes a number of recommendations in relation to the development and adherence to a set of Principles of Best Practice for Stewardship, to be overseen by the Financial Reporting Council. The FSA should encourage commitment to the Principles for Stewardship as a matter of best practice for all institutions that are authorised to manage assets for others.

### **Governance of risk**

The report makes five recommendations relating to the governance of risk. These recommendations include the need to establish a board risk committee separately from the audit committee with responsibility for advising on current risk exposures and future risk strategy. The risk committee should produce a risk report to be included within the annual report and accounts. The risk committee should take advantage of experience available externally as well as utilising external challenge to its risk analysis and assessment. It should be responsible for overseeing any proposed strategic transaction involving an acquisition or disposal. Firms should also employ a Chief Risk Officer to participate in oversight of risk strategy and management at the highest level.

### **Remuneration**

The final twelve recommendations relate to remuneration and the need for firms to have a remuneration committee to oversee all aspects of remuneration policy on a firm-wide basis. Part of their role will be to oversee the remuneration policy and packages of all executives for whom total remuneration in the previous year exceeds the median compensation for executive board members on the same basis. For any executives who meet these criteria, the remuneration committee should report to confirm that it is satisfied with the way in which performance objectives are linked to compensation structures and ensure that at least half of the variable remuneration should be in the form of a long term incentive scheme. The report should also state whether any executive has the right to receive enhanced pension benefits and whether the committee has enhanced any pension benefits during the year. These executives will also be expected to maintain a shareholding or portion of vested awards, at least equal to their total compensation on a historic or expected basis.

A final version of the report is expected to be issued in November.

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