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# House of Commons Treasury Committee Review

May 2009

The House of Commons Treasury Committee report (May 2009) entitled "*Banking Crisis – Reforming Corporate Governance and Pay in the City*" focuses on remuneration in the City of London and scrutinises the roles of those who oversee the senior managers including: non-executive directors, institutional shareholders, credit rating agencies, auditors and the media.

The report makes a number of useful comments; some of the key points are summarised below. This report is required reading for those interested in finding out not only how senior executives in both commercial and investment banks have been remunerated, but also how effectively senior managers and the executive boards of banks have done their jobs.

Some key points from the report:

## **Remuneration in the City of London**

The Committee concluded that the banking crisis exposed serious flaws and shortcomings in remuneration practices particularly within the investment banking sector. The Committee stated that bonus-driven remuneration structures, especially in investment banking led to reckless and excessive risk taking. It expressed concern that the recently published Turner Review downplayed the role of remuneration in causing the banking crisis, and questioned whether the FSA had attached sufficient priority to tackling remuneration in the City.

## **Non-Executive Directors**

The financial crisis has exposed serious flaws and shortcomings in the system of non-executive directors' oversight of banking executives. They pinpointed several problems:

- the lack of time many non-executives commit to the role - many combine a senior full time position with multiple non-executive directorships;
- the lack of both experience and diversity of those undertaking the role; and
- non-executive directors failing to act as an effective check and challenge to executive managers.

The Committee suggested that the risk management function should report directly to the non-executives.

## **Institutional Shareholders**

The Committee examined the failure of institutional investors to scrutinise and monitor the decision of boards and executive management in the banking sector effectively. It concluded this may reflect the low priority some institutional investors placed on governance issues and that in some cases they encouraged the risk taking that has proved the downfall of several banks.

It was also particularly concerned that fragmented and dispersed ownership, combined with the costs of detailed engagement with firms by shareholders, has resulted in the phenomenon

of “ownerless corporations”.

## Auditors

The Committee noted that the audit process failed to highlight developing problems in the banking sector, leading them to question the current value of audit. It remained concerned about the issue of auditor independence and argued that investor confidence and trust in audit would be enhanced by a prohibition on audit firms conducting non-audit work for the same company.

## Media

The Committee reviewed the role of the media in the banking crisis. It concluded there was no need for further regulation of the media and argued that the press had generally acted responsibly when asked to show restraint in particular areas. It also concluded that on a number of occasions those responsible for creating the current crisis sought refuge in blaming the media for their conduct.

Sir David Walker, a director of and advisor to various City institutions, is currently reviewing corporate governance in the banking sector. The Committee raised a number of questions it believes should be covered in his report including:

1. How institutional investors with holdings in the financial services sector have exercised their rights.
2. Whether remuneration committees would benefit from having a wider range of input from interested stake holders such as employees.
3. The need to broaden the talent pool from which the banks draw from to appoint non-executive directors.
4. Proposals that would help reduce the barriers to effective shareholder activism in financial services companies.

As part of Ince & Co’s continuing monitoring of new legislation relating to directors’ duties and other issues a detailed commentary of the House of Commons Treasury Committee Report and, when published, the Walker Report will be prepared.

If you would like a copy please contact **Nick Gould** ([nick.gould@incelaw.com](mailto:nick.gould@incelaw.com)).

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