



Unite response to HMT Review of corporate governance in UK banks and other financial industry entities

This response is submitted by Unite the Union. Unite is the UK's largest trade union with 2 million members across the private and public sectors. The union's members work in a range of industries including financial services, manufacturing, print, media, construction, transport, local government, education, health and not for profit sectors.

Unite is the largest trade union in the finance sector representing some 150,000 workers in all grades and all occupations, not only in the major English and Scottish banks, but also in investment banks, the Bank of England, insurance companies, building societies, finance houses and business services companies.

Executive Summary

- Training and competence of NEDs and executive directors must be improved significantly;**
- NEDs have in the past been deferential rather than probing and this can create situations where conflicts of interests can ensue which may influence appropriate judgements or decisions;**
- Alignment of interests of consumers and financial companies is needed to focus behaviour and deliver on TCF principles;**
- Remuneration policies should reward fairly and equitably paying workers decent basic salaries with less reliance on commission driven sales and be developed in partnership with trade unions or other employee representative body;**
- A serious democratic deficit exists in the UK financial system with few public interest representatives at the heart of the decision-making structures providing independent scrutiny.**

Introduction

1. Unite welcomes the opportunity to respond to this consultation and supports many of the recommendations put forward. However Unite is disappointed that recommendations on corporate governance put forward some time ago by trade unions have been ignored.
2. Unite predecessor union Unifi wrote in response to the consultation from the then Department for Trade and Industry on the White Paper: Modernising Company Law that:

“Another area that may be developed is that of non-executive directors. We see an increased role for NEDs. We propose an expansion of the role of non-executive directors, including representation of employees in a two-tier structure, distinct from the Board of Directors. This may take the form of a stakeholder council, where all stakeholders would have the ability to be involved including trade unions. This would provide the opportunity to challenge decisions and ask probing questions to ensure effective and independent monitoring. Basically performing a checks and balances function.

NEDs should be nominated and reflect a more diverse mix of society than presently represented by existing NEDs and be provided with the proper training and skills required to enable them to perform the role competently.

At present the Combined Code on Corporate Governance is generally accepted as best practice guidelines in this area. This should be the foundation upon which to build and which should be enhanced by other initiatives from within company law.”

3. This response by Unifi was provided to the DTI in November 2002. It is therefore disappointing for Unite that our forewarning on improving training for NEDs and also for the expansion of the function of NEDs by involving other stakeholders including trade unions in order to provide an opportunity to challenge decisions and ask probing questions was not taken on board by the Government at that time.

Qualifications

4. Training and competence of NEDs and executive directors must be improved significantly. It was evident from oral evidence to the Treasury Select Committee Banking Inquiry that certain banking executives were appointed without the proper checks under FSA rules on appointment nor apparently a knowledge or understanding of the role they were appointed to do.

5. Recommendation 1 proposes that NEDs should have the knowledge and understanding of the business, with thematic business awareness sessions provided on a regular basis. Recommendation 2 provides for additional support on which NEDs may require separate advice on a specific matter if necessary. Unite accept that improved financial knowledge, skills and training should be utilised and this is welcome.
6. However ensuring public interest involvement will further allow for independent scrutiny and provide legitimacy and objectivity to the policymaking and decision-making process. A report commissioned by Unite and carried out by the Financial Inclusion Centre identified:

“Too few independent, well-resourced public interest representatives at the heart of the regulatory system whether at international, European Union or UK national level.”¹
7. Recommendation 3 suggests raising expectations of greater time commitment by NEDs than in the past. If NEDs are expected to provide adequate oversight and grasp the complexities of certain financial decisions, then an increased time commitment to perform the role adequately is a prerequisite. Unite would also support the notion that commitment to the role of a NED within an organisation would limit the ability to commit time to any other business.

Functioning of the board and evaluation of performance

8. Recommendation 6 states that NEDs should be ready, able and encouraged to challenge and test proposals on strategy put forward by the executive. NEDs have a duty to scrutinise on behalf of the wider public and shareholders however they are often provided, through the remuneration system, with access to share option schemes in the company. This may therefore compromise their independence, as any criticism of decisions made by the board, could impact on their pay package.
9. Experience from Northern Rock has shown that there is a risk that NEDs would be reluctant to divulge any information which could negatively impact on the business and create a conflict of interest. The business model which supported high risk 125%+ mortgages adopted by Northern Rock appears to have gone unchallenged by NEDs within Northern Rock as the share price continued to rise.

¹ Financial Inclusion Centre Report: Reforming Financial Systems 2009 (page 10)

10. This is supported in a Report by the House of Commons Treasury Committee which stated that “The high-risk, reckless business strategy of Northern Rock, with its reliance on short- and medium-term wholesale funding and an absence of sufficient insurance and a failure to arrange standby facility or cover that risk, meant that it was unable to cope with the liquidity pressures placed upon it by the freezing of international capital markets in August 2007.”²
11. The Report goes on to state that “Given that the formulation of that strategy was a fundamental role of the Board of Northern Rock, overseen by some directors who had been there since its demutualisation, the failure of that strategy must also be attributed to the Board. The non-executive members of the Board, and in particular the Chairman of the Risk Committee and the senior non-executive director, failed in the case of Northern Rock to act as an effective restraining force on the strategy of the executive members.”³
12. It would appear that NEDs have in the past been deferential rather than probing and this can create situations where conflicts of interests can ensue which may influence appropriate judgements or decisions.
13. Alignment of interests of consumers and financial companies is needed to focus behaviour and deliver on FSA Treating Customers Fairly principles. TCF is part of the FSA regulatory function and is a set of principles which aim to provide customers with a fair deal in financial services and to ensure that the products and services sold to consumers meet their needs.
14. Unite would welcome additional powers for the FSA to call to account those NEDs who act inappropriately or who fail to act and whose actions may result in severe financial or reputational damage to the business.
15. It is imperative under any new proposals that executives and NEDs tasked with scrutinising the performance and approach of senior management decisions, and who fail to act appropriately, must be disciplined up to and including criminal or civil proceedings where appropriate. Fines or removal from office can be suitable levels of penalty in some circumstances, however where significant damage to the company’s financial position or reputation is concerned Unite would see fines or removal from office as an inadequate outcome.

² House of Commons Treasury Committee Fifth Report of session 2007-08: The run on the rock (amended page 167)

³ Ibid.

16. This should ensure that only those individuals seeking to act in the best interest of the firm and the public interest and who would be bound to act with complete probity, would take on the role.
17. NEDs must play a more active role in managing risk and to be in a position to provide objective oversight of operations, practices and procedures. If faced with harsher penalties for failing to perform the duty of a NED adequately perhaps more robust investigations and questioning may ensue.

Remuneration

18. The issue of remuneration has been placed under severe scrutiny due to the excessive pay awards and bonuses of senior executives within the finance sector. It is therefore right that this issue should be addressed with remuneration packages transparent, accountable and be open to independent scrutiny. This should also involve explicit caps on salaries and bonuses. Indeed Unite Finance Sector National Committee has recently passed a motion calling for the introduction of a National Maximum Wage based on ten times the average salary. While this is not policy throughout Unite it shows the strength of feeling among Unite members within the finance sector.
19. Other initiatives could include deferred bonuses paid based on medium term corporate performance with contractual clawback and share options structures linked to agreed, independently audited, long term performance metrics. Unite would also propose independent representatives and trade unions on the board of remuneration committees.
20. The proposals put forward in recommendation 30 states that remuneration committees should review packages which may exceed the median compensation of other executive board members. While Unite welcomes a curb on excessive remuneration it remains the case that executive level remuneration packages significantly exceed the compensation levels for most employees.
21. Unite sees a case for linking remuneration at executive board level to that of other employees in the organisation with rewards for success being distributed equitably throughout the company.
22. It is important that lessons should be learned across the whole sector from the apparently lax procedures and practices which were in place prior to the current financial crisis. Remuneration policies should therefore be developed in partnership with trade unions or other employee representative body with public interest representation on remuneration committees.

23. Directors have an explicit duty to deliver shareholder value which may or may not result in behaviours which treat customers fairly. A thorough review of pay and reward systems within the sector should also be carried out. The sector should not base its pay and reward systems on selling inappropriate products to consumers.⁴ In the UK this type of behaviour goes against the Treating Customers Fairly policy which forms part of the FSA regulatory principles.⁵

24. This is further supported by the Financial Inclusion Centre report which found that:

“Aggressive remuneration policies have focused sales staff to chose unsustainable targets – one of the causes of the consumer detriment and misselling scandals witnessed in the UK retail financial services industry over the past two decades.”⁶

25. It is vital that remuneration policies reward fairly and equitably and that paying workers decent basic salaries with less reliance on commission driven sales will serve to create a more transparent pay system.

26. The FSA adopted a laissez faire approach to remuneration in the past however reports that the Government intends to bring forward plans to give the FSA new powers to obtain copies of a companies remuneration policy through the introduction of a Remuneration Code⁷ is supported by Unite. The FSA has a duty to ensure fair remuneration which is risk-focused and this proposal is welcome.

Public interest representation

27. Unite sees a fundamental failing in the proposals outlined in that there remains an over-representation of shareholder interests over public, employee or wider social interests on the board and committees and therefore in the decision-making process. Maintaining the composition of such groups is unlikely to deliver independent oversight or provide checks and balances to improve corporate governance structures.

28. There is a serious democratic deficit in the UK’s financial system with few public interest representatives at the heart of the decision making structures which represent the interests of wider society.

⁴ A survey carried out by Irish trade union IBOA found that employees were placed under pressure to reach target rather than addressing the concerns of consumers. Access the results at: <http://www.uniglobalunion.org/Apps/iportal.nsf/pages/homeEn>

⁵ <http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/who/index.shtml>

⁶ Financial Inclusion Centre, *ibid* (page 16)

⁷ <http://www.fsa.gov.uk/pubs/other/remuneration.pdf>

29. In his recent Mansion House speech Lord Adair Turner, Chairman of the FSA said that “parts of the financial services industries need to reflect deeply on their role in the economy, and to recommit to a focus on their essential social and economic functions, if they are to regain public trust.”⁸
30. He went on to suggest that the banking industry needed to restore trust in the vital role that it performs. Banks should be focusing on their core functions for the economy and society.
31. Unite believes that to promote good governance which takes account of the role financial companies play in the wider economy, a number of seats should be reserved for public interest representation on boards and committees. Recruiting from a narrow group of individuals can create a situation where albeit informed individuals may be driven to support self interest and this can dictate the decision making process away from the greater good.
32. The Unifi response to the DTI of 2002 previously mentioned went on to state that:

“It is evident that something radical is required to calm the crisis in confidence present in corporate Britain and to reassure the public that the debate surrounding issues of corporate excesses is being addressed.”

33. Perhaps this time the Government will listen.

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⁸ http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0922_at.shtml