STANDARD LIFE

STANDARD LIFE INVESTMENTS

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Sir David Walker
The Walker Review Secretariat
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By email: feedback@walkerreview.org

Dear Sir David

A REVIEW OF CORPORATE GOVERNANCE IN UK BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES

We write on behalf of Standard Life plc, as a major UK listed company and an "other financial institution", and its wholly-owned subsidiary Standard Life Investments Limited, as a major institutional investor. We have implemented a joint approach to preparing this submission, and our comments have been subject to a rigorous review process which has sought to ensure that the views of, and benefits to, shareholders are upheld, whilst taking into account the practical aspects of implementing the recommendations. Both companies support the review which you have undertaken in terms of considering the current corporate governance arrangements in UK banks and other financial institutions and are keen to offer their views on your recommendations. Subject to the comments below, we support your recommendations. We recognise that a number of them may be quite onerous on issuers, but we believe it is important that corporate governance, in general, and accountability to shareholders, in particular, should be strengthened, and this view has influenced the development of our comments.

1. Board size, composition and qualification

Recommendation 3

We support the principle that a non-executive director ('NED') should be required to make a sufficient time commitment to carry out the role properly, but we question whether it is practical and useful to specify a "minimum expected time commitment of 30 to 36 days". We believe that the accepted principles-based approach to standard-

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setting should be followed and that a NED should commit to being able to give the proper and necessary amount of time required to fulfil the requirements of the role, without the need to commit to a specified minimum number of days. We do support the NED appointment letter giving an indication of the likely number of days required, based on assumptions derived from the number of likely board and committee meetings and preparation for these meetings, but we think that this will vary significantly depending on the organisation, and its needs at any particular time.

2. Functioning of the board and evaluation of performance

Recommendation 7

As above, we support the principle that the chairman should commit to giving sufficient time to fulfilling the requirements of his role, and we question whether specifying a minimum proportion of his available time ("two-thirds"), and requiring that the BOFI role should take priority over any other commitments, would add any strength to the quality of the chairman's performance or the effectiveness of how he fulfils his role. In our view, the chairman should be appointed on merit, following an appropriate due process which recognises the necessary time commitment. Also, we believe that the "priority" recommendation is not a practical suggestion since it would give rise to a conflict with the legal duties of a director. Therefore, we suggest that this aspect of the recommendation is deleted in favour of emphasising the need for the chairman of a BOFI and its board to ensure that the chairman has sufficient and appropriate time capacity to fulfil his BOFI responsibilities.

Recommendation 10

We believe that a well-run company recognises the importance of having appropriate board and chairman succession plans in place which aim to reach a balance of both stability and renewal. In addition, we believe that the succession to the chair, in particular, is a significant exercise requiring much planning and consideration to ensure appropriate accountability and maintain board continuity. In our view, a company does not consider lightly the succession of the chairman, and will always aim to appoint the best available candidate. Therefore, we are not supportive of the recommendation that the director appointed by the board as chairman should be subject to annual re-election.

We recognise the context which led to this recommendation but we are concerned that it could result in a reactive requirement to remove the chairman (depending on the result of the re-election vote), rather than a considered shareholder decision which is in the best interests of the company. In addition, this recommendation might require

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Companies to implement changes to their Articles (which would require shareholder approval). During our discussions, we have identified that there are alternatives proposals on this issue. We note the position proposed by the Institutional Shareholders' Committee ('ISC'), suggesting that the chairmen of all of the main board committees should be proposed for re-election each year, and if the result of this votes were less than 75%, then the chairman would stand for re-election the subsequent year. However, in practical terms, at Standard Life plc, we currently have five board committees (and would have six if a risk committee were established). If the chairman of each board committee were proposed for re-election every year, this would result in almost all of the non-executive directors being proposed for re-election. Equally, as the chairman is the chairman of the nomination and governance committee, he would also stand for re-election by default.

An alternative approach would be for the final recommendations to take account of and give due prominence to the opportunities offered by the introduction of the Shareholder Rights Directive ('SRD'). If shareholders have issues regarding the performance of the chairman of the company or the chairmen of the various board committees, the SRD has provided shareholders with increased means to express these concerns by giving them the right to raise questions for proper discussion at the AGM as well as easier means of raising resolutions to be put to a vote at the AGM.

Recommendation 12

Standard Life plc is fully committed to undertaking a formal annual board evaluation process, and to reporting the results of the review in the Annual Report, but we do not believe that the review process would be significantly strengthened by introducing the prescriptive requirement that it is externally facilitated every two or three years. We acknowledge that there are likely to be benefits in having the review independently facilitated, as it may lead to an increased openness in contributions, and bring additional external benchmarking not available in house, but we do not believe that there are sufficient benefits from the exercise to justify the proposed external-use timescale. In addition, the company incurs significant cost in having this review externally facilitated.

As a balanced solution, we recommend that a company should have a defined and standard policy regarding its approach to board evaluation, which is disclosed in the corporate governance report and applied on a "comply or explain" basis in order to provide a basis for effective accountability.

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3. The role of institutional shareholders: communication and engagement

We support effective communication and engagement between companies and their institutional shareholders but, recognising the increasing globalisation of BOFI share registers, we are concerned that the current recommendations may result in the introduction of an uneven playing field and disadvantage UK BOFIs and their UK institutional investors. In particular, recognising the UK jurisdiction of the FSA and the Walker Review, we believe that it may not be possible to enforce the final recommendations effectively with non-UK domiciled institutional investors. Therefore, we recommend that there is further consideration given to this so that any requirements which are introduced do not disadvantage UK BOFIs and UK institutional shareholders.

We welcome the introduction of the "Principles of Stewardship" on the responsibilities of institutional shareholders and agents and we hope that the final recommendations are clear with regard to status, ownership and maintenance of the Principles. We support the principle that the ISC would be the owner of the content and would be responsible for the periodic updating of the content, after proper consultation with the Financial Reporting Council ('FRC') which should be responsible for including the Principles in the revised Combined Code. The current drafting and terminology of the relevant recommendations should be clarified so that there is no confusion on this matter.

We also believe that a further challenge to the effectiveness of the relationship between institutional investors and issuers is the concentration of year-ends and the resulting short length of the period available to review Annual Reports and Accounts, engage with issuers and prepare and attend AGMs. This impacts the overall quality of engagement and should be addressed with due resolve, which may require more than reliance on market forces.

In addition, we urge you to consider the role of voting agencies, which can have a very significant influence on the outcome of voting at shareholder meetings. Currently these entities are unregulated. It would seem appropriate that a review is undertaken of their role and responsibilities to ensure that there is a clear and objective understanding of their processes and relationships with their clients. It may be appropriate that a "Code of Practice for Voting Agencies" is developed, similar to the Code of Practice of Remuneration Consultants. Voting agencies would be required to sign up and demonstrate adherence to the code and there may be a role for the FRC to oversee the implementation of any code. We believe that this would provide increased assurance to issuers and the agencies' clients as to the quality of the analysis process and dialogue which had gone on to support the voting recommendation.

Recommendation 14

We are supportive of the principle that the board should understand the composition of, and major movements within, its share register, but we do not believe that the merits and benefits of FSA engagement in this area are convincing. Guidelines would have to be agreed to establish what constitutes a "material change over a short period" in a BOFI share register, and depending on the retail/institutional investor composition of the register, it may be difficult to establish a meaningful level. It is also unclear as to how the FSA would then respond and whether it has the authority to contact investors with the purpose of questioning the strategy behind their investment decisions. Equally, it is not clear what the FSA would then do with the responses it receives to such enquiries. Finally it is not clear that real value would be added to the board's processes and decision-making by requiring Directors to then consider whether or not, and how, they might respond to any movements highlighted to them by the FSA. We believe that this recommendation should be removed on the basis that the FSA's existing processes should be sufficient in this area.

4. Governance of Risk

We support in principle the recommendations in this area. However, it would be necessary for the risk committee to establish the correct level and balance of oversight and involvement. In particular, we do not believe that it should be the intended role of the committee to micro-manage specialist risks or operational risks. Rather we believe that it should focus its activities on reviewing the processes to identify and manage strategic risks in particular. Therefore, we support increased guidance being developed in terms of the role and responsibilities of the risk committee, but we believe that any recommendations must take into account the current requirements of the Combined Code and the Turnbull Guidance to ensure there is clarity of roles and responsibilities and that expectations are managed and not unreasonable.

5. Remuneration

Overall, we support non-prescriptive remuneration principles which link behaviour to risk and which encourage appropriate behaviour and stewardship. For clarity and accountability, it is important that the final recommendations proposed should be consistent with the FSA Code on Remuneration.

Recommendation 31

We believe that it is appropriate that there is no recommendation for disclosure by name

of the remuneration of those senior employees who are not executive directors as we do not believe that such disclosure is in the legitimate shareholder and wider public interest. We consider that the nature of the employment arrangements with such employees is confidential. We acknowledge that individuals appointed as executive directors are bound by statutory and regulatory requirements which bring disclosure responsibilities and accountability to shareholders and stakeholders. However, we do not agree that non-director employees have equivalent statutory and regulatory responsibilities. Also such employees are generally employed based on their particular expertise, and, given the nature of the competitive market, and the desire of the employer to derive maximum benefit from such expertise, we believe that it is reasonable that the associated contractual arrangements are a private matter.

However, we do support disclosure of this level of total remuneration by banding. We believe that it provides evidence of the level of payments to those who contribute to the risks the company is running. Disclosure could indicate risk inconsistent with the stewardship responsibilities of these individuals. We believe that this is an appropriate moral and balanced stance based which provides a basis for accountability. We believe that it may also be appropriate for the Remuneration Committee to develop and disclose an explanatory commentary on its approach in respect of banded disclosures, with particular emphasis on risk evaluation.

Recommendation 34

We support the recommendation that there should be shareholding requirements for "executives whose total remuneration exceeds that of the median of executive board members" as long as they are meaningful in context, objective and balanced, and do not give rise to unintended consequences. We recognise that this recommendation is intended to represent an alignment of the interests of employees with the company and its shareholders but if an employee's personal wealth is unduly dependent on his or her employer's stock price, there is a potential risk that the individual could manipulate risk information or financial results to affect the share price at key times during the financial year. Control procedures in the design of any STIP and/or LTIP arrangements should be in place to mitigate this risk.

We believe that the level proposed ("at least equal to their total compensation on a historic or expected basis") is unnecessarily high, does not recognise sufficiently the individual nature of the remuneration structures for some executive directors and would bring challenges in defining the term "total compensation". We support the current

market practice of expressing share ownership guidelines as a percentage of base salary as we believe this demonstrates the necessary balance of transparency and accountability. Equally, we believe that executive directors should be given a reasonable period of years to reach the level of the guideline amount, and recommend that further consideration is given to including guidance on this.

Conclusions

As stated, we support your aim of strengthening current corporate governance processes in BOFIs. However, we are keen to reinforce that the recommendations should not be finalised without proper consideration of their practical application and likely efficiency, effectiveness, added value and increased accountability. Equally, we hope that prudential cost considerations and the risk of unnecessary bureaucracy are also taken into account. In addition, we would like to raise an overall note of caution that some points seem to indicate a move towards introducing a supervisory board structure in the UK rather than the current unitary board structure and we would be seeking re-assurance that such a move was not broached without significant further consultation and debate.

We hope that the above comments contribute to the consultation process. Please contact either of us if you wish to discuss any our comments further.

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