Financial Conduct Authority

Review of Board Effectiveness

In June 2015, the Board of the FCA commissioned Boardroom Review Limited to undertake a review of its effectiveness. The review was conducted between June and October 2015 and the outcome considered by the Board at its meetings in October and December 2015.

In its response[1] to the report of the Treasury Committee into the Press Briefing of the FCA's Business Plan for 2014/15, the FCA undertook to publish the results of this effectiveness review (the 2015 Review) and the report produced by Boardroom Review is published today in accordance with this undertaking.

The 2015 Review highlighted many strengths of the Board and contained a number of recommendations to enhance its effectiveness. The Board accepts all the recommendations and where necessary is taking steps to implement them. Of the recommendations, six will require new arrangements to be established, 24 will entail a refinement to existing arrangements, 11 are already in progress and one will be considered further once the new Board members currently being recruited have taken up their positions.

In 2014, the Board commissioned Independent Audit Limited to undertake a review of its effectiveness (the 2014 Review). The Board has now decided, in the interest of completeness and transparency, also to publish the 2014 Review today.

The Board intends to commission further external reviews of its effectiveness on a biennial (every two years) basis.

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[1] "Press Briefing of the FCA's Business Plan for 2014/15: FCA Response to the Committee's Thirteenth Report of Session 2014-15" Published 12 October 2015

FINANCIAL CONDUCT AUTHORITY

REVIEW OF BOARD EFFECTIVENESS

18 June 2014

INDEPENDENT
AUDIT LIMITED

Contents

EXECUTIVE SUMMARY

1. The Board of the Financial Conduct Authority is substantially different from that of its predecessor, the Financial Services Authority. The change is widely seen as being for the better, and the Board continues to develop.

2. The relationship between Executive and Non-executive Directors is a healthy one, with high levels of trust and mutual respect leading to a willingness to share information and be open. NEDs have extensive contact with management outside the boardroom which, together with more formal assurance, provides a solid grounding for trust.

3. The Board composition brings less inherent conflict of interest than was previously the case, along with less industry experience but more expertise in regulation, competition and consumer protection. There are well-established procedures for managing conflicts of interest when they do arise.

4. Boardroom time is always under pressure but is used well. Discussion is well-managed to focus on the more important topics and involve all members of the Board, including the Executives.

5. Executives welcome constructive challenge from NEDs and, within certain constraints, get it. One constraint is that the NEDs, although able, committed, unafraid to question and expert in a number of fields, are not expert in all the topics that can arise from the FCA's wide remit. Steps are in hand to address this to some extent but a degree of constraint remains inevitable, as in every board. Another constraint is that the organisation is itself developing and this limits its ability to support the Board.

6. Amongst the items of work in progress that constrain the Board, perhaps the most significant are performance and risk information. In addition, the Board's ability to step back from detail and contribute on strategy will be increased with the completion of a strategic review and development of a strategic framework, although progress on these is itself dependent on the Executive Committee's own capacity to give time and attention to big picture issues.

7. The distinction between the Audit and Risk Committees is less clear in practice than it seems in theory. The Committee roles could be clarified or redefined without requiring substantial reorganisation. There is work in progress to develop the risk and control functions and define the three lines of defence within the organisation; this would be facilitated by increased clarity over the Committee structure.

8. Many of the areas for improvement that we have identified, and particularly the more important ones, are already in progress. As improvements are put in place the Board's work will become easier.

9. The Board has performed well in its first year and can be expected to continue to improve as the constraints upon it are eased. Taking into account its own particular context, we think it compares well with many corporate boards.

Introduction

The nature and purpose of this report

10. This report sets out the conclusions arising from our review of the Board of the FCA. It is a contribution to the Board's continuous improvement, rather than an attempt to pass judgement against some yardstick of "board effectiveness". For reasons explained in paragraph 13 below, there is no such yardstick and we do not consider that any attempt to pass judgement would be either practicable or helpful. Rather, the purpose of this report is to help the Board take stock of where it stands and consider whether there is anything that might help it work better in future.

11. The work on which this report is based was performed during April and May 2014. We reviewed Board and certain Committee papers, held confidential discussions with all Board members and a number of others as set out in Appendix 2, and observed a meeting of the Board and two of its Committees. We were given unimpeded access to all relevant information except that relating to the subject of the Davis Inquiry, which was in progress during our review. The Oversight Committee and the Regulatory Decisions Committee were excluded from our scope.

12. While the Board's duties and aspects of its organisation are defined by statute, it seeks so far as is appropriate to adopt good governance practice as described in the UK Corporate Governance Code. Consequently, we have had regard, where relevant, to practice as we have observed it in corporate boards, and on occasion we have considered how the Board's practice compares to the common expectations of FCA supervisors regarding board practice in authorised firms.

13. In our experience, effective governance rests above all else on the behaviour of those involved, and the formal structures and supporting processes will help or hinder, but rarely determine, the effectiveness of governance behaviour. Moreover, there are multifaceted relationships between the skills, character and style of the people involved, the information they receive, the varying expectations of the different roles, the way the executives are organised to support the Board, the differing ways in which the Board's work is shared and responsibility delegated, the practical and logistical arrangements and many other matters. These multiple and complex interdependencies mean that it is possible – although of course not inevitable – that weaknesses in some respects can be compensated by strengths in others and that no two boards ever work in exactly the same way.

14. Commenting on a board's effectiveness is therefore a matter of considerable judgement, and in the end what matters is that the Board should be stimulated to seek further improvement in the way it works.

Context

15. To understand the FCA Board, it is important to acknowledge its context.

16. Despite its origins within the FSA, the FCA's Board is to a considerable extent a new one and it is evident that considerable thought has been given to its structure and operation. In terms of its composition, structure and, we understand, *modus operandi*, the differences from its predecessor are more marked than the similarities. In many respects the same can

be said of the FCA as a whole, which despite its origins from within a long-standing organisation has many of the growing pains of a young one.

17. The Board's statutory duties include a considerable list of specific items, such as the making of regulations, as well as the overall responsibility for ensuring that the FCA achieves its strategic objective, summarised as "to ensure that the relevant markets function well". This is a remarkably wide-ranging objective, on two counts. Firstly, "functioning well" includes consumer protection, financial system integrity and effective competition – three quite different things. Secondly, the "relevant markets" are very large (and growing, as new responsibilities such as consumer credit are added), very diverse and often very complex.

18. A final piece of relevant context is that, along with establishing itself as a new organisation for new responsibilities, the FCA at the same time has to deal with a multitude of legacy issues from the time of the FSA which are making constant demands on the time and attention of senior management.

19. Taken together, along with the fact that the FCA has to operate in a very public but rather delicate environment while carrying out a task that is bound to leave many people dissatisfied, all this causes us to think the Board has a more difficult job than that of many corporate boards.

Overview

20. Our overall view is that the Board has got off to a good start, and particularly so given the scale of the task that confronted it. It has developed well since its formation and although still relatively new it is far from being immature. While allowing for the fact that it still has some settling down to do, it compares well to many other boards, and it should be able to look back on its first year with some satisfaction, notwithstanding recent difficulties.

21. In this report we make a number of suggestions for change. These are generally the easy ones. There are other challenges facing the Board which are not easy to address, certainly not very rapidly. These are identified as matters to which the Board should give consideration; they should not be seen as suggestions for new actions or as implicit criticism.

22. This report is structured under a number of thematic headings, under which we summarise our observations and where relevant make suggestions for the Board to consider. Because of the interdependencies referred to in paragraph 13 above, some of the matters discussed may be relevant to more than one theme, but in the interests of brevity are, so far as possible, considered under only one thematic heading, even if the allocation to headings is somewhat arbitrary.

Board composition and dynamics

Composition

23. The Board has 12 members, a number largely driven by statutory requirements, the desire to have several executive directors and the need to balance these with independent directors. This is large by most corporate board standards, and around the upper end of the range which is commonly considered desirable for effective debate and decision-making. However, there is no hard and fast rule about this and the Board meeting that we observed

gave us no reason to think that the Board was too large for effective discussion. No-one dominated and each member of the Board participated, although economically, asking questions and making contributions only when they were relevant. The size of the Board also means there is greater capacity for NEDs to share the Committee responsibilities and workload.

24. While the quality of discussion reflects well on all participants, credit also falls to the Chairman, who has an inclusive style and encourages others to contribute. He allows discussion of particular items to continue beyond their allotted time when it is valuable so to do, while still managing to bring the meeting to a timely close.

25. Unlike its predecessor, the Board includes not only the CEO but also executive directors – three of the Divisional Directors who report to him. The latter participate in Board meetings not just as functional heads but as full Board members. This is something that all boards aspire to but the FCA Board does better than most. This reflects well not only on the executives themselves but also on the CEO, who combines clear leadership with a willingness to allow others to take the floor.

26. The executive directors' inclusion in the Board, and their contribution, are much appreciated by the NEDs. The only significant questioning of the present arrangement is that some would like another executive to be included to bring an additional and potentially valuable perspective; we can see the merit of this but it is a fine call, as increasing the size of the Board yet further might impair the quality of discussion, and is best left to the Chairman's judgement.

27. The present balance of the Board is eight NEDs and four executives. The former category includes the Chairman and the Prudential Regulation Authority's statutory nominee, leaving six who are wholly independent. Of these, three were formerly members of the FSA Board and three are new to the FCA Board. This balance seems to work well, although we do not think that any marginal change in it would have a detrimental effect. The Board's ability to oversee and challenge the executives would not be impaired just by virtue of the NED majority reducing.

28. The Board has good gender diversity but not ethnic or social diversity. We do not think this affects the effectiveness of the Board, which already benefits from a valuable diversity of experience, interests, perspectives and styles. However, future recruitment could consider increased diversity as a secondary criterion after all-round ability to contribute to the Board.

Dynamics

29. The Board has benefitted from a high level of trust, with executives and NEDs demonstrating mutual respect and a willingness to be open and, when appropriate, supportive. Recent events and the establishing of the Davis Inquiry have cast something of a shadow over this and threaten to create a barrier between the two groups. It will be very important for the Board to work at avoiding this risk.

30. Informal meetings, such as those held over dinner the night before Board meetings, play an important part in the creation and maintenance of trust. These often have guest speakers, which is useful; but in present circumstances it might be desirable to shift the balance somewhat and for a while have a higher proportion of dinners at which only Board members are present.

31. It is also good practice to have the occasional dinner at which only NEDs are present, as this gives them an opportunity for open discussion with the Chairman regarding any concerns they might have about management. Short private sessions of NEDs before or after Board meetings have their place but they do not make up for less formal sessions when discussion can range more freely. We understand that quarterly NED-only meetings are planned, and one of these each year will be held without the Chairman in attendance. We think this is a good idea.

32. The NEDs all demonstrate great commitment to the Board, working well in excess of their contracted time. Their participation extends beyond the formal meetings, with management valuing their contributions both as subject matter experts and as wise counsellors. There is a good induction process in which new members have invested substantial additional time, and they seem to have got up to speed quickly. All NEDs clearly maintain a considerable amount of informal contact with different parts of the organisation and different levels of management. This is welcomed by management, and it is also an important input to the NEDs' own assessment of the extent to which they are entitled to rely on management.

33. It is also notable that Board members, while contributing from their own individual perspectives, do not seek to represent particular constituencies, but rather to work together in pursuit of the FCA's objectives.

34. There appeared to be some uncertainty over the extent to which NEDs should be active in representing the FCA in the wider world. We infer that the answer – and the position generally taken at present – is that they should not, except perhaps in certain special circumstances and with specific safeguards, but this is a matter that the Board should address in order to establish an explicit policy that removes any ground for uncertainty.

35. Many of those we interviewed remarked on the NEDs' willingness to make constructive challenge, particularly commenting on the tenacity sometimes shown in pursuing a line of enquiry to a satisfactory conclusion. We too observed this during the meeting we attended. The executives receive challenge well and defensive reactions are rare. A number of executives said that they found the Board's questioning a valuable exercise in giving them confidence that their arguments held up, and also that preparing for presentation to the Board was in itself a valuable discipline.

36. The principal limitation to the effectiveness of challenge lies in the fact that the NEDs, while all possessing sharp minds and expert knowledge in certain areas, do not collectively possess expertise in all the diverse topics that are brought to them, and so are sometimes unable to probe certain topics as rigorously as might be wished. This is felt more by the executives, who, while valuing the Board's challenge, nonetheless feel that they could sometimes be tested harder, than by the NEDs themselves. (This is not an uncommon state of affairs in good boards, where it reflects well on the executives' willingness to receive challenge.)

37. Given the diversity of matters that the FCA has to deal with and the necessary limitation on the number of NEDs, some constraint on the ability to challenge is inevitable from time to time. The Board is able to address this by ensuring that it receives assurance about the extent and nature of internal challenge to which proposals were subject before they reached the Board agenda.

38. The area where lack of expertise has been felt most keenly is markets, and this is in the process of being addressed by the recruitment of a well-qualified NED. Until the planned retirement of a long-standing NED next year this will increase the Board's size by one, which

will be an opportunity to see how much the discussion is affected by having one more person at the Board table.

39. The NEDs bring a diverse range of skills and experience, with consumer champions and experience of other regulators and competition being particularly prominent. However, the Board does not have the concentration of "industry heavyweights" possessed by its predecessor. The limitations of that model became apparent a few years ago and there is no desire at all for the FCA to return to it, but some do question whether the pendulum has swung too far in the other direction, and if the Board would benefit from having at least one "captain of industry" from a major financial services company (presumably recently retired, to avoid conflict). There are arguments for and against; if the right person could be found it would probably increase the Board's understanding, but perhaps at the cost of reducing the public perception of its independence from those it regulates. If the status quo is to be maintained, it might be possible to compensate by trying to get more out of the Practitioner Panel. In any event, this is something which should be reconsidered periodically.

40. Some extent of conflict will always be present if Board members are to have any relevant experience (not to mention being consumers of financial services themselves), and on occasion this will present a more significant issue, either in reality or in perception. The Board and Secretariat are very well aware of this and take good measures to manage the risk. Potential conflicts are identified early and the members concerned recuse themselves from relevant discussion, with wholly independent sub-committees being formed in particularly sensitive cases.

Chairman

41. The Chairman has a highly collegiate style, chairing Board meetings by facilitating an inclusive discussion and bringing it to a satisfactory consensus, rather than by leading the discussion. This is greatly welcomed by almost all members of the Board, who see it as a significant contributor to the Board's effectiveness. He uses humour to good effect and is ready to praise good work, a valuable gesture which boards often overlook.

42. Although the Chairman spends a substantial amount of time working for the FCA, there is a clear distinction, both in theory and, we understand, in practice, between his role and that of the CEO. The relationship between the two has been a good one, both on their own account and as observed by others. The way the Davis Inquiry has been structured has the potential to threaten this and it will be important that this risk is managed, as the constructive relationship is seen by everyone else as a real asset to both the Board and the organisation.

43. The Chairman has a major role in dealing with external stakeholders. This work is important, but it is not always visible to other Board members, and they would find it useful if he could give a short report of his work to each Board meeting, including a calendar of recent and planned external meetings

44. The only significant reservation regarding the Chairman is over the extent of his past experience in dealing with Government and Parliament, and there is no other NED with significantly greater relevant experience to contribute advice. The Chairman is rapidly increasing his experience but it might nonetheless be worth considering this as a possible criterion when planning future NED appointments.

The Board's role and focus

Introduction

45. Because the FCA's remit is so wide, the Board necessarily has to prioritise the topics to which it gives attention. This is something that all boards must do, but the need is even more marked here. It does this by separating its work into several major categories, including oversight of operations, rule-making and strategic/policy matters, as well as through delegation to its Committees.

Oversight of operations

46. Over the last year, a substantial effort has gone into developing the "Quarterly Performance Report", containing performance measures – many of them new – to enable the Board to assess the FCA's progress in meeting its objectives. This is difficult, as it is hard to measure regulatory outcomes, and it remains a work in progress; but it has already made a significant improvement to the Board's ability to understand the organisation's activity, and further improvement can be expected. Taking this together with the recent introduction of a regular, and quite full, report from the CEO, and the individual NEDs' "extra-curricular" time with management, the Board can be reasonably confident – not that it knows everything, as this is impossible and disagreeable surprises will always pop up from unexpected quarters – that the risk of this happening has reduced and, with continued management attention and Board encouragement, should continue to reduce. We do not think that any board of a still-young organisation should reasonably be expected to achieve more than this.

47. Oversight of management control over operations is substantially delegated to the Audit Committee, which is considered later in this report. At this stage it is sufficient to note that management generally acknowledges, and welcomes, that the Board (including its Committees) is more attentive to the FCA's internal workings than its predecessor had been.

48. Feedback from the various panels and from the periodic surveys of regulated firms also contribute to the Board's understanding. There is some suggestion that the Board would benefit from additional channels to give it better visibility of how things are working for consumers.

49. The principal area of uncertainty in relation to operational oversight relates to the Board's level of involvement in regulatory activity. NEDs are informed of significant regulatory decisions before they become public, which is helpful, but have no direct involvement. A number of those we interviewed contrasted it with the role played by the PRA's Board, which we understand to be more closely involved in significant regulatory matters.

50. However, as was widely acknowledged, the PRA Board operates to a different model, with more frequent meetings, and the PRA has far fewer firms to regulate. It is generally accepted that the PRA model is not transferable to the FCA's Board, a view with which we concur, and the comparison, while interesting, is of little practical relevance.

51. The FCA Board's decision to remain apart from individual regulatory matters is a reasonable one which avoids any risk of undermining management and/or the RDC. However, if the FCA were a corporate, its board would be involved in decisions that had the potential to have significant impact on reputation or strategy. Major enforcement actions such as large

fines are equivalent here. Where proceedings are settled, rather than contested, the RDC plays no part, but we are told that there are internal governance processes within Enforcement to oversee the agreements to settle and that the Board is informed of major settlements via the quarterly reports from the Director of Enforcement and Financial Crime. The Board might wish to review its current policy in relation to large and high-profile enforcement decisions, taking into account the need to respect the RDC's role while keeping itself satisfied about the robustness of the underlying internal governance processes.

52. That still leaves the question of how the FCA Board should oversee the exercise of its wider regulatory functions. Given the scale of the FCA's responsibilities, it has to rely largely on organisational processes. The work of the Supervisory Oversight Function should be able to make a valuable contribution to this, although it appears that there is work to do on both its capability and its acceptability to the organisation before its potential contribution can be fully realised. It will be important for the Board, through the Audit Committee, to maintain close oversight of its further development. There is no equivalent function for either Authorisations or Enforcement, and the Audit Committee should consider whether it receives sufficient assurance over the work of these divisions. The fact that the scope of Internal Audit reaches across all activities, and not merely those conventionally thought of as subject to audit, is helpful.

53. The only suggestion we might add is that, because the pattern of regulatory activity, even when unpublished, shapes policy as it is perceived by firms, the Board might usefully give time to a periodic assessment of the past pattern of supervisory activity, to ensure that the signal being given is in accordance with its own intentions. The immediate practicability of this suggestion is dependent on the reporting systems that are in place.

Rule-making

54. The Board is legally responsible for rule-making, something which is complicated by the fact that individual rules and changes to rules are often extremely detailed and technical, and it is far from obvious how the Board could contribute in this area even if it were to spend a lot of time on it. In fact, the Board places a high degree of reliance on the organisational processes and consultations that have led to rules coming up for approval and consequently this statutory obligation takes relatively little Board time. The situation is not ideal but we can see no better way to deal with it.

Strategy

55. The most challenging area is that of strategy and policy, which in this context are sufficiently linked to be treated as one. Policy-setting is a main part of the strategic function, with the other being how the FCA should act and be organised to ensure that its policies are effective at meeting its objectives, and so we will use the two terms interchangeably.

56. Like every other board, the FCA Board feels that it should be spending more time on strategy. This is partly an inevitable consequence of the high-level role that any board of a large organisation must play: NEDs are unable to contribute much to operations, even if they wanted to, and it is at the strategic level where they are most able to make a valuable contribution to the organisation's success (for example, in shaping the approaches to the senior persons regime and to competition). But equally inevitably, the urgent can take priority over the important. We have never known a board where there was not a desire for

more time and attention to be given to strategy, but the universal difficulty is exacerbated at the FCA by a number of factors.

57. There is not yet an overarching vision of what the financial services industry should look like in the future, in terms relevant to the FCA's objectives, nor of how the FCA should be organised to work towards this. One legacy from the FSA that has not yet been superseded is the regulatory model (authorisation, supervision, enforcement) and although changes have been made there is no overall framework to guide the allocation of resources.

58. It is understandable that the FCA has not wanted to rush into a change of strategic course, but the continuing situation does have consequences for the Board. We understand that the Executive has initiated a strategic review which is aimed at bringing a new proposal to the awayday in the Autumn. This will be an important milestone which should enable the Board to play a more influential role in guiding the future direction of the organisation and shaping it to be effective.

59. The Board cannot, of course, shape strategy on its own. It needs the Executive to undertake the necessary work to determine and evaluate the strategic options. So a further constraint lies in the fact that the "urgent vs important" conflict is even greater for the Executive, which not only has the very substantial management task of adapting the legacy organisation and systems but is constantly distracted by fire-fighting – often very large fires. The Board's ability to take a long-term, strategic view is dependent on the Executive being able to step back and do likewise.

60. The workings of the Executive Committee and how it in turn is supported by management are outside the scope of our review, but we did pick up some suggestions that changes aimed at increasing its ability to deal with the big picture might be both possible and desirable. We understand that an Internal Audit review of executive governance is planned for later this year, which might provide an opportunity for this matter to be considered.

61. Responsibility for considering market behaviours and changes that might pose a threat to the FCA's objectives lies in the first instance with the Risk Committee, along with consideration of the appropriate response. However, the formulation of regulatory responses and the consequent allocation of resources is a main part of strategy for this organisation. If the FCA were a regulated firm, its supervisor would probably be telling it that strategy-setting should not be delegated to a committee but should be a matter for the whole board.

62. The analogy is not perfect, but it does provide another reason to emphasise the importance of the Board getting to the situation where it can approve the overall strategic direction and set a framework for resource allocation, so that the Risk Committee's role is more clearly that of monitoring changes to assess their strategic impact and bringing them to the Board for consideration, as well as guiding resource allocation within the overall framework. This is considered further in the section on Committees below.

63. A further factor complicating the development of long-term strategy is that public and political expectations of the FCA can change relatively rapidly. There is not much that the FCA can do about this, which means that the strategy needs to be formulated to contain some flexibility, rather than waiting until conditions are stable – it could be a long wait – and that the implementation of strategy needs to leave room for some degree of change as it goes along.

Agenda management

64. A practical aspect of how the Board achieves its focus is the question of how things get onto the agenda. The main source of agenda items is the CEO/Executive Committee, where the flow through the Secretariats and Chairman to the Board agenda seems to work reasonably well. Some of those we interviewed commented that the forward agenda could be planned more fully; it is certainly more thinly populated than we would expect in most boards, but to at least some extent this is because little of the Board's work follows an annual cycle. Nonetheless, Secretariat might wish to review the forward planning process to see whether more could be made of it.

65. The efficiency and effectiveness of the agenda planning is very dependent on the communication between Executive Committee and Board. This is rather more difficult here than in most organisations because the two have separate Secretariats. Given the nature of the organisation, which includes multiple committees and panels requiring support, the secretarial apparatus is much larger than in most other organisations and the separation of the Executive Committee Secretariat can be defended on practical grounds, but it does mean that effective co-ordination is very important. We understand that this has improved substantially over the last year, but its importance means that the two functions must make a very conscious effort to seek continued improvement.

66. A valuable element of the agenda preparation process is that the Company Secretary holds planning meetings with the Chairman both before and shortly after Board meetings. This helps to ensure that topics which surface in one meeting are when necessary developed in a later one.

67. Another element of agenda formation is that "novel and contentious" items are to be brought to the Board. These, understandably, are not defined and in practice it is left to the judgement of the CEO and Chairman to determine whether something qualifies. While no-one questions their judgement, some are curious as to the sort of issues that fail the test, and the suggestion was made that it would be interesting occasionally to hear from the CEO about significant issues that were considered but judged insufficiently novel or contentious to make the Board agenda. We do not think this would be the best use of the Board's time, particularly as NEDs receive the Executive Committee minutes which, if sufficiently informative, should answer the question.

Board information

68. Board information is very influential on both the focus and the quality of Board discussion. In general, the information received by the Board is good quality and makes an increasingly helpful contribution to the Board's effectiveness.

69. Papers are distributed to the Board in good time for reading before the relevant meeting, with short notice papers being rare and for good reason. NEDs devote sufficient time to reading them beforehand, as evidenced by their behaviour during meetings (executives are always quick to notice if someone is ill-prepared).

70. A standing item on the agenda is a report from the PRA's appointee. This is not preceded by a paper and can have a rather impromptu feel to it. We understand that the PRA is reluctant to accede to a request for a written paper, but if it were possible the FCA Board

members would find it useful to be given (at the Board meeting if necessary) a bullet-point list of headings to give some structure to the report and make it easier to follow the flow.

71. The Board packs can be large, but the Board cannot (and does not seem to) expect more sympathy than is given to the boards of regulated firms on the same matter. Compared to many boards, the FCA's Board papers are more than usually NED-friendly: well-written and with brief introductions that are effective at identifying the key issues. A useful feature is a summary of "the story so far" for matters which have come to the Board at earlier stages. A helpful addition would be a glossary of acronyms and jargon.

72. Papers are distributed electronically through Brainloop as well as in hard copy. Electronic distribution of board papers is increasingly common and generally achieves a good degree of satisfaction amongst users. Here there is a higher than usual level of dissatisfaction, and the Board's take-up of Brainloop is low. This could be either because Brainloop does not deliver what Board members require or because Board members have not had sufficient support in learning how to make good use of it. We suggest that this be investigated and resolved without delay, as there is no point in having a system that is not sufficiently used and does not deliver efficiency gains to Secretariat and to Board members.

73. Management presentations of Board papers are efficient in that they do not repeat content that Board members are presumed to have read beforehand, but instead summarise key points as a basis for discussion. This is a very good discipline which should not be taken for granted – it is surprisingly rare, particularly in relatively new boards.

Meetings

74. The "pre-Board briefings", in which NEDs are briefed on the background to topics coming to the Board meeting on the next day, have been welcomed and are perceived as making a significant contribution to the Board's ability to challenge. There have been concerns that the discussion sometimes strays into the Board discussion proper, but without all the executive members being present. The Chairman is alert to this risk and we understand that, whenever possible, pre-briefings are now being scheduled for a month, rather than a day, in advance of the relevant Board meeting. The separation should be helpful in keeping the pre-briefings restricted to the provision of background information.

75. There are 10 scheduled Board meetings a year, each of about a day-and-a-half in duration when the pre-Board briefings and dinners are taken into account, plus Committee meetings. This is quite a lot by corporate standards but there is wide agreement that it represents the minimum possible for dealing adequately with the workload. It would be easy to spend even more time but this is unrealistic, not only in terms of the demands on NEDs but perhaps even more importantly in the additional encroachment on the time executives have for their other responsibilities. Continued attention to agenda management and other efficiency-gaining steps are thus particularly important.

76. The only increase in Board meeting time that might be realistic would be to insert another awayday into the calendar. Board members find these valuable occasions and the pace of change in the external environment and within the organisation would justify holding them more than once a year.

Other points

77. The FCA has a broad range of stakeholders arising from its wide ranging objectives. These range from the firms which it supervises (whose views it gets from the Director of Supervision's regular contact with firms' boards and through Panels and firm surveys) to consumers and the public (whose views it gets through the Consumer Panel and the work undertaken by Policy, Risk and Research) to HM Treasury and the Treasury Select Committee. As a relatively new organisation, the FCA's relationships with these multiple stakeholders are still forming, and it is not entirely clear what the reporting relationships are, nor how legal accountability to the Treasury and Treasury Select Committee is in practice to be reconciled with the FCA's statutory independence. The Board would benefit from greater clarity around these matters.

78. Competition is a responsibility for which there is no legacy experience, and although the organisation is equipping itself to deal with it there is some suggestion that it is not yet sufficiently at the forefront of Board members' minds during Board discussion. One way to address this could be to include a competition heading on the standard "front sheet" already in use for Board papers, so as to require management to set out its assessment of the competition implications of every proposal. It would require regular NED challenge to prevent this from natural degeneration into boilerplate, but there is every reason to expect that this challenge would be forthcoming.

79. The FCA places great emphasis on the importance of culture within regulated firms, and the Board sets a good example by attaching considerable importance to the FCA's own culture. There might be some scope for improving the formal mechanisms for assessing this and reporting to the Board, so as to reduce the dependence on the Executive as a channel of communication, but the NEDs' regular individual contact with lower levels of management is a valuable source of insight for the Board.

80. A particular concern at present is whether the Davis Inquiry will have a detrimental effect by making the FCA's people excessively risk-averse and inclined to take refuge behind procedure rather than making judgements, which would pose a considerable threat to the organisation's ability to meet its objectives in the long run. It will be very important that the Board continues to monitor this and to consider what mitigating actions are available, and it is helpful that Risk Management is proposing to undertake a review.

Committees

Remuneration Committee

81. This is the most straightforward to understand of the Board's three main Committees, and it seems to work well. It is chaired "crisply" but effectively and there is good engagement by all Committee members.

82. The HR Director provides good support to the Remuneration Committee. She has regular pre-meetings with the Committee Chairman and attends throughout most of each Committee meeting, both of which are good practice.

83. The Committee's job is less technical than that of most corporates, as there are no share-based reward schemes, but on the other hand its public status and profile presents a

different set of challenges. It is too early to infer from the absence of criticism from within and without the organisation that these are navigated successfully, but there seems little reason to suppose otherwise.

84. A major concern at present is the increasing rate at which the FCA is losing experienced staff to commercial firms. There are multiple reasons for this but pay levels have to play their part. The risk is firmly on the Board's agenda and it may become desirable for the Remuneration Committee to play a more active role in supporting the employee value proposition.

85. In the absence of a Nominations Committee, the Remuneration Committee also maintains oversight of executive succession planning. Dealing with this in the Remuneration Committee has the advantage that it is already the Committee's responsibility to consider executive performance. We understand that the Committee's work is facilitated by a very open relationship with the CEO and other executives, which enables a more open and constructive discussion than is often the case.

86. The remaining work which might be done by a Nominations Committee is done elsewhere. There has in fact been little to do as the Board has been stable since its formation. The first new appointment is currently in progress and is being dealt with by a small panel formed of the Chairman, a NED, an independent advisor and a representative of the Treasury, which actually makes all appointments. This arrangement seems to work satisfactorily and it is evident that other Board members are sufficiently informed.

87. The continuing work of considering NED succession plans and the desired balance of skills in relation to the expected strategic development of the organisation is largely in the hands of the Chairman. This is the main area where a more conventional Nominations Committee might be useful. For the time being it is sufficient that, as we understand to be the case, he maintains regular dialogue with the Senior Independent Director on the matter; but the continuing suitability of this arrangement should be reviewed periodically.

Audit Committee

88. The Audit Committee is different from typical audit committees, in that the financial reporting part of its job is straightforward. The nature of the organisation means that its accounts are not complex and there are few matters requiring significant judgement.

89. Committee meetings are well-chaired and those who attend find them to be valuable occasions. The information coming to the Committee is of good quality, although it is still evolving in form and content.

90. It is unusual for a finance director not to attend entire audit committee meetings – indeed, not even to be a board member – but in the FCA's circumstances this is reasonable. Instead, and very appropriately, the COO attends. In other organisations it is usual for the finance director to meet the audit committee chairman in preparation for the committee meeting. The parallel here would be for there to be a regular pre-meeting between the Audit Committee Chairman and the COO, and this is something which should be considered.

91. The Audit Committee also has a duty to oversee the effectiveness of external audit. This is something that many audit committees find difficult and here it is made more complicated by the fact that the National Audit Office is the statutorily-appointed auditor and cannot be

threatened with replacement. However, the simplicity of the accounting makes the financial audit straightforward so little oversight is needed. The scope of audit is wider than it would be in a corporate, as it includes value for money, and there is little room for the Audit Committee to assess this other than by reviewing the NAO's report, discussing it with the audit team and benchmarking it against the members' own knowledge of the organisation and its work. We do not think the Audit Committee could usefully do much more in relation to external audit, unless it were to be called upon to help resolve any service issues.

92. The main part of the Audit Committee's brief, and where most of its time and attention goes, concerns internal controls and the internal risk management framework. A substantial element of this involves oversight of Internal Audit, to which the Audit Committee devotes considerable time. The Committee plays an important role in reinforcing Internal Audit's effectiveness and supporting the recently-appointed Head of Internal Audit as she develops the function.

Risk and Audit Committee structure

93. Where matters get more complicated is in relation to "the internal risk management framework" part of the Audit Committee's brief. The distinction between this and the responsibility of the Risk Committee is not defined and the Committee Terms of Reference merely say that it should be sorted out between the two Committee Chairmen. In discussion, the distinction is usually expressed as the Audit Committee being inward-facing (looking at risks affecting the organisation operationally) and the Risk Committee being outward-facing (looking at risks affecting the markets which the FCA regulates). This seems to be clear to the two Committee Chairmen, who evidently have good co-ordination, and to the Board Chairman, but we found that it was not so clear to many others. Uncertainty over these arrangements was widely raised in our interviews and a significant number of those we interviewed questioned whether the Audit and Risk Committees would be better combined.

94. Because of the timing of meetings in relation to our own work, we were unable to observe a meeting of the Risk Committee and consequently must be a little more tentative than we would wish. However, we can understand why there is uncertainty: although the theoretical distinction between two Committees as summarised above seems clear enough, when we tried to bring this down to practicalities, it became less evident. In the following paragraphs we try to understand the reasons for the difficulty and suggest how the structure might be made clearer.

95. The difficulty arises partly because of certain practicalities. Risk reports in very similar form and covering the whole range of risks, internal and external, are provided to both the Risk Committee and the Audit Committee, and the CRO attends both meetings. External risks have internal consequences, and vice versa, and there is no consistently obvious point at which they move from one category to the other. Nor is it wholly clear where decisions about the nature and extent of mitigation should fall.

96. To some extent this is due to the internal risk management framework being a work in progress. The Risk Management function is relatively new and the "three lines of defence" concept is still being worked out in practice. It is possible that, as things bed down and practice becomes established, the distinction will become more apparent.

97. However, we think that a large part of the uncertainty rests also upon the description of the two Committees. The names "Audit Committee" and "Risk Committee" bring presumptions

of role which are not appropriate to the actual work that the two bodies need to carry out. In fact, the very way in which the word "risk" is used seems to us to be unhelpful.

98. The FCA is charged with a very wide range of responsibilities, and it has limited resources with which to do the work necessary to fulfil them. It necessarily has to decide where to deploy its resources, and this involves making judgements about where its regulatory intervention has the greatest capacity to make change for the better. While it is possible to describe these as "risk decisions" it seems to us to be much clearer if they are thought of as strategic decisions, prioritising the allocation of resources and determining the nature of their deployment in ways that are expected to make the greatest contribution towards achievement of the FCA's objectives.

99. Even though this involves consideration of adverse impacts in conditions of uncertainty, we are not convinced that describing the FCA as "being in the risk business" is a wholly useful shorthand expression, as the phrase carries connotations of choosing to take risk in the pursuit of gain that are not relevant to the FCA.

100. Seen in this light, the work of looking at "external risks" is actually the job of examining developments in the markets, in firms, in consumer preferences and habits, in government in the UK, EU and abroad and so on, in order to see whether changes are taking place that require adjustment to the strategic priorities, as turned into practical reality by the allocation and deployment of resources. "Risk Committee" is not a helpful name for the body charged with overseeing this work and it would be better to choose a more descriptive name (for example, Strategic Monitoring Committee).

101. Major decisions concerning the prioritisation of resources, and indeed whether changing threats to achievement of the FCA's objectives justify changes in the level of resources available to the organisation, require substantial judgement. Because of their significance, especially when there are longer-term implications for the organisation, it is right and proper that these decisions should be approved by the Board. As a practical matter, it is suitable for the work involved to be delegated to a Committee of the Board, although the most significant decisions should then be put to the whole Board for approval.

102. It then follows that the role of this Committee, whatever it is to be called, should be to bring to the Board its recommendations for changes in strategy (the big changes) and to oversee the Executive's tactical adjustments to resource allocation (the small changes). With its role defined in this way, it does not seem either necessary or appropriate for the Committee to consist wholly of independent members: the work of reviewing changes in the environment and considering responses would be better done with executive participation.

103. The present form of risk reporting should be split, so that the "external" content comes to this Committee. As the Risk Management function exists within Policy, Risk and Research, which has the responsibility for horizon scanning, no reorganisation should be necessary.

104. Alongside this, the Audit Committee could usefully be renamed the Audit and Operations Committee, with clearly undivided responsibility for oversight of how the organisation is executing the strategic priorities. Both the Risk Management function and the remaining risk reporting, after splitting off the "external" content, would then fulfil a more recognisably conventional role, and the use of risk management techniques and terminology could support the work of this Committee without generating confusion.

105. It would then become a more straightforward matter to review the "three lines of defence" to put operational management, Risk Management and Internal Audit into a fully coherent relationship.

106. A consequential matter is that executive attendance at the two renamed Committees should be reviewed. For example, the work of Supervision is a major source of external intelligence of developments in the financial services sector; it also is the most substantial actor in fulfilling the FCA's responsibilities (and hence firmly within the remit of the Audit [and Operations] Committee). Accordingly, regular attendance of the Director of Supervision or another appropriate executive (for example, the head of the relevant sector team) may be helpful to the Committees in their understanding of the risks involved.

107. An alternative approach would be to combine the two Committee and it would be sensible to consider this when the present Risk Committee Chairman retires next year. Until then, it would be very desirable for the two Committees to produce a more clearly-defined statement of their respective responsibilities, perhaps illustrated by practical examples, of what lies within the scope of each and at what point something is to be handed over from Risk to Audit. (A similar statement would be of practical value even if the above suggestions are adopted.)

Risk Committee

108. This section includes observations regarding the Risk Committee as it is currently in operation. If the suggestions made above were to be adopted, some of these observations would become inconsequential.

109. For all the structural uncertainty surrounding it, we found general agreement that the Risk Committee is well-chaired and does valuable work. It was, however, suggested that it would benefit from giving more time and attention to European and other international developments that have implications for the regulatory strategy and the deployment of the FCA's resources.

110. The Risk Committee receives a report, the Risk Radar, which is explicitly outward-facing. However, it now also receives another report, known as the Risk Report, whose scope runs across both external and internal and which is also used by the Audit Committee. This very new report, like the risk management framework itself, is still evolving, and while some recipients find it informative, it does seem that it has some way to go. There also seem to be inconsistent views about how the risk reporting should develop and over the practical constraints that should be tolerated.

111. One feature of the risk reporting which is helpful is that it sets out the executives' view of risk and then gives the CRO's separate view. This increases the overall level of assurance given by the report. However, to maximise this, there should be greater executive presence at the Risk Committee. At present it is somewhat limited, which means that the CRO might have to represent the management view in discussion as well as his own. It would be better if executives were there to speak directly to the Committee. (Paragraph 106 above suggests another benefit of the presence of executives at Risk Committee meetings.) The burden on individual executives could be reduced by their participating on a cyclical basis. We understand that this is already under consideration by Risk Management.

112. Our discussions with management suggest that the Risk Report is prepared mainly for the Committees and is not used to any great extent by management for its own purposes. This

is not surprising since the reporting is so new, but as it evolves one of the criteria against which it should be measured is whether it would meet the "use test" of being embedded in the way the organisation is run.

113. We picked up some concern that Risk Management is too expansive in its ambitions and that a narrower, but sharper, focus might be preferable. It is outside our scope to comment on this but we do think the matter would repay further consideration. In particular, the role and organisation of Risk Management as a function, and the nature of its work and its reporting, should be firmly placed in the context of an overall vision of how the risk and control framework should be shaped to meet the present and emerging needs of the organisation and the Board. Any such review should cover all three lines of defence so as to bring in the risk and control responsibilities of management as the core around which Risk Management and Internal Audit should fit. The realignment of responsibilities suggested in the preceding section would make this easier to resolve.

114. A specific responsibility of the Risk Committee is oversight of the RDC. A number of people described this reporting line as an anomaly, although none thought it such a serious matter that it demanded immediate change. In principle, because of the RDC's importance in making the FCA's regulatory policy explicit to the markets, we think it would be better coming direct to the whole Board, but as a practical matter the Board agenda is already full and the decision to leave this to the Risk Committee is a reasonable one for the time being. (If the suggestions made in the preceding section were to be adopted, the most logical reporting line would be to the Audit [and Operations] Committee.) It does make it very important that the Risk Committee gives the Board a full report of its work in overseeing the RDC.

115. Reporting from the Risk Committee, as from the Audit and Remuneration Committees too, is indeed full, but Committee minutes can sometimes come to the Board rather after the event. We understand that the process has now been accelerated so that the Board can read the relevant Committee minutes, at least in draft, in preparation for receiving the Committee Chairman's report.

116. Mistakes and accidents will always occur in any organisation. While good risk management and board oversight can help to reduce their likelihood and impact, they will not prevent them. So an important responsibility of any board is to ensure that the organisation learns from the things that do go wrong, so that it is quickly and suitably strengthened for the future. In general, the Board acknowledges this and acts upon it, although where control of investigation is wholly removed from the Board it is difficult for it to fulfil that responsibility in a timely fashion.

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We should like to thank the Board members and other executives of the Financial Conduct Authority for the time they have given us, and in particular to thank Secretariat for the practical help. The organisational support could not have been better.

APPENDIX 1:

SUGGESTIONS FOR THE BOARD TO CONSIDER

	Principal points	Paragraph
1	Ensure that all possible steps are taken to maintain trust between executives and NEDs in general, and between the CEO and Chairman in particular	29-30, 42
2	Ensure that challenge is consistently rigorous, taking into account challenge at executive level and below	36-37
3	Provide each Board meeting with a report of the Chairman's activity	43
4	Consider the extent of Board oversight of major regulatory decisions	51
5	Maintain close oversight of the development of the Supervisory Oversight Function and review the extent of assurance over divisions other than Supervision	52
6	Ensure that the proposed strategic review leads towards a strategic framework for the allocation of resources and that the strategy is sufficiently flexible	56-58, 63
7	Review the Executive Committee's capacity to spend time on strategy	59-60
8	Clarify the strategic responsibilities as between the Board and the Risk Committee	61-62
9	Investigate Brainloop and its implementation and take remedial action	72
10	Consider holding more frequent awaydays	76
11	Consider how stakeholder accountability should best work in practice	77
12	Continue to monitor the organisational culture and how it is responding to pressure	79
13	Clarify the roles of the Risk and Audit Committees and consider renaming them accordingly, along with other supporting and consequential adjustments	98-106, 114
14	Alternatively, take short-term measures to clarify the distinction between the two Committees and in due course consider combining them into a single Audit and Risk Committee	107
15	Achieve consensus over what is an achievable target state for risk reporting, and monitor its evolution to ensure that in due course it passes the "use test"	110, 112
16	Review the executive attendance at Risk Committee meetings	105, 111
17	Develop an overall vision of how the risk and control framework should be shaped	113

APPENDIX 1 (continued):

SUGGESTIONS FOR THE BOARD TO CONSIDER

	Other points	Paragraph
18	Consider ethnic/social diversity as secondary criteria when recruiting future NEDs	28
19	Allow time for NED-only meetings (some without the presence of the Chairman)	31
20	Establish a clearly-defined policy on NEDs' external representation of the FCA	34
21	Seek to strengthen the understanding of large firms' perspectives, through NED recruitment and/or making more of the Practitioner Panel	39
22	Consider the desirability of government-related experience when planning future NED recruitment	44
23	Consider whether the Board would benefit from additional channels to understand consumer needs and experiences	48
24	Receive a periodic assessment of the past pattern of supervisory activity	53
25	Consider whether forward agenda planning can be more extensive	64
26	Continue to seek improvement in liaison between the Board and Executive Committee Secretariats	65
27	Ensure that Executive Committee minutes are sufficient to show NEDs how agenda judgements over "novel and contentious" items are made	67
28	Consider whether the report from the PRA could be accompanied by a bullet-point list of headings	70
29	Include a glossary of acronyms and jargon in the Board and Committee packs	71
30	Include "competition" as a standard heading on Board paper front sheets	78
31	Consider whether the Remuneration Committee should play a more active role in the employee value proposition	84
32	Periodically review whether it would be helpful to have a Nominations Committee with terms of reference wider than current appointments	87
33	Hold pre-meetings between the Audit Committee Chairman and the COO	90
34	Consider increasing the Risk Committee's time on EU and international developments	109

APPENDIX 2: INTERVIEWEES

Board members

Clive Adamson	–	Director of Supervision
Andrew Bailey	–	Non-Executive Director
Amanda Davidson	–	Non-Executive Director
Amelia Fletcher	–	Non-Executive Director
John Griffith-Jones	–	Chairman
David Harker	–	Non-Executive Director
Mick McAteer	–	Non-Executive Director
Tracey McDermott	–	Director of Enforcement and Financial Crime
Jane Platt	–	Non-Executive Director
Sir Brian Pomeroy	–	Non-Executive Director
Lesley Titcomb	–	Chief Operating Officer
Martin Wheatley	–	Chief Executive

Others

Vito Capobianco	–	Manager, Risk Department
Lalitha Henry	–	Director of Internal Audit
David Lawton	–	Director of Markets
Sean Martin	–	General Counsel
Stuart Mead	–	Assistant Company Secretary
Simon Pearce	–	Company Secretary
Gavin Stewart	–	Chief Risk Officer
Claire Strong	–	Deputy Company Secretary
Christopher Woolard	–	Director of Policy, Risk and Research