Written evidence to the Treasury Committee inquiry into the banking crisis

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Introduction

Pensions & Investment Research Consultants Ltd (PIRC) has been an independent adviser to pension funds and other institutional investors for over 20 years. PIRC's clients have combined assets in excess of £1.5 trillion and include some of the largest pension funds, investment management companies and insurance companies in the UK and overseas. Together, they comprise a diverse group of institutional investors with long-term liabilities and broad fiduciary duties.

PIRC undertakes company research on corporate governance and corporate social responsibility issues at public companies, and provides advice to clients on proxy voting strategies and other active shareholder initiatives. Our comments are based on two decades of practical experience, which inform our views on the strengths and weaknesses of disclosures, governance structures, and the interaction of statute, regulation and codes of practice.

We have only commented on those areas of the consultation where we have particular views and expertise.

The role and responsibility of bank boards

Before responding to the questions that the committee has set, we would urge that consideration is given to the role and responsibility of the boards of banks. Too much commentary on the banking crisis has overlooked or underplayed the primary responsibility that the boards of banks have for their own failures. Whilst it is of course right to consider the role of regulators and central banks, the board members of the banks that have run into difficulties must take their full responsibility too. They approved the business strategies and products that have caused such damage after all. Therefore we urge the committee to consider the role of boards.

PIRC will also be looking at the role of the directors of the banks that have run into serious difficulties. We believe that they have failed in their role as stewards of major financial institutions, and as such this will influence our analysis of their directorships of other companies. This analysis will be made available to the committee in due course.

1.1 The role of auditors in the banking crisis, and whether any reform to that role is desirable.

For PIRC, the key principle is that the audit should be perceived to be a wholly independent process. This depends on independence being beyond reasonable and informed challenge, as opposed to being simply an arguable case. The independence of the auditor is of paramount importance to shareholders, both in respect of individual companies and in terms of audit's public policy function of ensuring investor confidence in financial reporting. Although the auditing profession has long had ethical guidance on objectivity, this has not been sufficient to prevent

significant public and regulatory concerns.
During the financial crisis, there has been some speculation about the independence of the auditors at the banks. The argument has been made, for example, that independence might be compromised by the involvement of auditors in securitisation and other non-audit work. Certainly this is an issue that deserves exploration, and PIRC has carried out some initial analysis of disclosures made by UK-listed banks in respect of auditor fees in relation to securitisation and other non-audit work. This is included as an appendix.

It is unfortunate, though not untypical, that banks' disclosures do not provide a great deal of detail on non-audit work. However, the reports of two banks – Northern Rock and RBS – specifically highlight work on securitisation. In addition it is notable that in the majority of cases UK-listed banks have paid considerable fees to their auditor for non-audit work. We share the view expressed in the committee's report on the failure of Northern Rock published last year that this creates a conflict of interest.[1]

In fact the level of non-audit work carried out for banks by their auditors would often fall foul of our view of best practice in this area. Our more detailed views on the audit process, including the appropriate level of non-audit work, are set out below.

Non-audit work
We disagree with the view that audit firms can be employed to provide consultancy services to the management at the same time as undertaking an independent audit on behalf of the shareholders. We firmly believe that other commercial interests can compromise auditors in their ability to confront directors on difficult issues.

As a general principle, we consider that other professionals should undertake all non-audit work and would wish to see a prohibition on non-audit services being provided. The regulations regarding the disclosure of non-audit work were updated in 2005. These remove the loophole whereby UK companies only need to disclose non-audit fees incurred by the UK incorporated members of the group. Most companies disclose global non-audit fees, and PIRC believes that any company not doing so in 2009 should explain its reasons. In the absence of a good justification, we will normally look to hold a member of the audit committee accountable for the omission.

The new regulations require disclosure under ten headings.
1. Statutory audit
2. Other services supplied pursuant to legislation.
3. Other services relating to taxation.
4. Services relating to information technology.
5. Internal audit services.
6. Valuation and actuarial services.
7. Services relating to litigation.
8. Services relating to recruitment and remuneration.
9. Services relating to corporate finance transactions.

1 http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf

10. All other services.

Given current practices, PIRC considers that fees paid to the auditor for work covered in headings other than 1 or 2 should be no more than 25% of the audit fee. Given the broad nature of the headings, specific details of the nature of the work undertaken are required in order for shareholders to make a judgement. Taxation is potentially one of the most controversial areas given the scope for reputation risk. In normal circumstance PIRC does not consider tax advice to be acceptable work.

Although there may be no legal or regulatory requirement for overseas companies listed on the London Stock Exchange to disclose details of fees paid to auditors, PIRC will apply the same standards to such non-UK companies.

Audit partner

The Companies Act requires the lead audit engagement partner to sign in his /her own name on behalf of the firm. PIRC believes that companies should in their 2008 accounts identify the individual together with his /her date of appointment and the length of tenure of the audit firm.

Where company directors have been senior employees or partners in an audit firm in recent years, there remains the risk of the loss of an outsider's independent perspective, notwithstanding the requirement for a two-year cooling-off period. If a new director is appointed after the requisite cooling off period, then PIRC will look for the company's audit committee to explain the actions the company and the audit firm have taken to minimise any threats to independence and objectivity.

Auditor rotation

PIRC continues to see a risk that over time the auditor's familiarity with the audit client's affairs results in excessive trust.

If the same firm continues to hold the position of auditor for many years, then previous judgements are not subject to outside scrutiny. We do not consider that rotation of the audit partner, within the same firm, is sufficient. We maintain that firm rotation after a period of five years is best practice.

We list below the leading UK-listed banks and when they have appointed auditors. Notably most do not disclose the date of appointment, despite our repeated request that they do so.

Bank	Auditor	Date of appointment
Barclays	PricewaterhouseCoopers	Not disclosed
Lloyds TSB	PricewaterhouseCoopers	Not disclosed
HBOS	KPMG	2001
RBS	Deloitte & Touche	2000
HSBC	KPMG	Not disclosed
Standard Chartered	KPMG	Not disclosed
Alliance & Leicester	Deloitte & Touche	Not disclosed

Authorising audit fees

By law, shareholders have to approve the auditors' fees. It is usual for a resolution to be put which seeks authority for the directors to determine the auditors' fees. PIRC accepts that it is appropriate for the directors to do this. It is also common for the authority to determine the fees to be included with the resolution to appoint or re-appoint the auditors. While this is technically a bundled resolution, PIRC does not regard it as a material voting issue so long as there are no concerns over the appointment of auditors or the disclosure of fees for non-audit work.

Auditor liability and indemnification

In our view it is inappropriate for auditors to be indemnified by the company, or for the company to purchase liability insurance for them, as such relationships may affect independent judgement. Any such provisions in company articles should be removed. Under sections 532 to 538 of the Companies Act 2006 auditors will be able to limit their liability by contract provided that shareholder approval is obtained. PIRC is not in favour of such agreements.

Internal audit

We consider that, in almost all cases, internal audit functions are appropriate for listed companies. Boards that have determined such a function is not required should justify their position. A company's auditors should not undertake internal audit functions for that company.

Whistleblowing

The 2003 Combined Code introduced a responsibility on the audit committee to review 'whistleblowing' arrangements. PIRC believes that this is an important element in bolstering public confidence in business legitimacy, ensuring good employee relations, and protecting the company from serious risks. PIRC would welcome meaningful high-level disclosure in the annual report of the company's procedures. In particular it would be beneficial to shareholders if companies disclosed information such as how the whistleblowing mechanism was reviewed, whether the mechanism had been used during the year, how far it is 'independent', what had been the outcome, and if a report is disclosed to all employees, or publicly.

Audit Committee Report

In addition the Code requires that the committee should be provided with sufficient resources, that its activities should be reported in a separate section of the directors' report (within the annual report) and that the chairman of the committee should be present to answer questions at the AGM. PIRC believes that the audit committee's report is a cornerstone of good governance and that its approval by shareholders should become a regular agenda item at the AGM of companies. When constructing the report, the board should be aware of the guidance provided in the Smith Report. In particular, PIRC believes such a report should cover the issues dealt with by the committee in the year under review rather than merely describing the duties of the committee, or attendance.

1.6 Possible reforms to the remuneration structures prevalent in financial services.

Public policy issues

PIRC believes that the initial guidance formulated by the Financial Services Authority provides a useful framework for financial institutions to use to configure their bonus policy, even if it is rather a restatement of good practice.2 Clearly there must be a shift towards remuneration policy that rewards long-term value creation, rather than short-term risk-taking. In addition there is emerging new practice that deserves proper consideration. PIRC believes that the bonus-malus system adopted by UBS contains features that could be applied more widely.

Clearly remuneration policy at financial institutions poses challenges to shareholders since often the effects below board level are very important. The nature of company reporting on remuneration further increases the focus on board members with, for example, typically very little or no discussion of pay across the company. Therefore there is a compelling argument that further consideration should be given to the rules covering disclosure of information in companies' remuneration report.

We also believe that a review should be undertaken into the use of shareholder voting rights by institutional investors in respect of remuneration. The UK now has six years' experience of a shareholder advisory vote on remuneration policy. This is enough time to conduct a comprehensive review of both the impact of the vote on executive remuneration (structure, absolute level and in comparison to pay and benefits within the same company) and how shareholders have used the rights in practice. PIRC does not believe that all fund managers have exercised these rights effectively on behalf of their clients (see further discussion under point 4.2).

We list below votes for on remuneration-related resolutions at UK-listed banks in recent years to illustrate the lack of shareholder pressure.

Bank	AGM year	Resolution	Vote for
Alliance & Leicester	2008	'Approve the Remuneration Report'	97.2%
	2006	'Approve Alliance & Leicester 2006 Restricted Share Plan'	98.5%
	2006	'Amend rules of the Share Incentive Plan'	98.7%
	2006	'Approve the remuneration report'	97.0%
	2006	'Approve Alliance & Leicester 2006 Deferred Bonus Plan'	98.4%
	2006	'Approve Alliance & Leicester 2006 Share Option Scheme'	95.4%
Barclays	2008	'Approve the Remuneration Report'	90.5%
	2007	'Remuneration Report'	94.2%
	2006	'Approve the remuneration report'	94.1%

2 http://www.fsa.gov.uk/pubs/ceo/ceo_letter_13oct08.pdf

Bradford & Bingley	2008	'To approve the Directors' Remuneration report'	95.9%
	2008	'To approve the increase to the EIP maximum amount to be applied in the acquisition of deferred shares '	85.4%
	2006	'Approve the remuneration report'	86.6%
HBOS	2008	'Approve the Remuneration Report'	82.9%
	2007	'Remuneration Report'	96.9%
	2006	'Approve the remuneration report'	98.5%
	2006	'Approve the Extended Short Term Incentive Plan'	95.6%
HSBC	2008	'Approve the Remuneration Report'	81.8%
	2008	'Amend the rules of the HSBC Share Plan'	84.2%
	2006	'Approve the remuneration report'	95.2%
Lloyds TSB	2008	'Approve the Remuneration Report'	89.6%
	2006	'Approve the directors' remuneration report'	93.9%
	2006	'Approve the new long-term incentive plan'	95.2%
Northern Rock	2006	'Approve the remuneration report'	89.2%
RBS	2008	'Approve the Remuneration Report'	88.8%
	2006	'Approve the remuneration report'	92.4%
Standard Chartered	2008	'Approve the Remuneration Report'	89.4%
	2006	'Approve the remuneration report'	93.8%
	2006	'Approve amendments to 2001 Performance Share Plan'	94.4%
	2006	'Approve the 2006 Restricted Share Scheme'	96.5%

Finally, we should be clear that standard approaches to remuneration have incentivised inappropriate behaviour. For example, in a special audit demanded by its shareholders, UBS acknowledged that its internal remuneration policy made little adjustment for risk, so staff benefited in the short-term despite the fact that positions made could cause problems at a later stage, and as such did not protect the bank's long-term interests.3

Such serious failings have emerged despite the fact that remuneration policy has presumably been designed to encourage effort in the interests of shareholders. Therefore one might question whether a more fundamental review of how incentive pay affects behaviour is required. As a starting point shareholders could, for example, finance research into the impact of incentive pay on behaviour.

We have included a more detailed outline of PIRC's approach to remuneration, and what we consider to be best practice, below.

3 http://www.ubs.com/1/e/investors/releases.html?newsId=140339

PIRC's approach to remuneration analysis

Remuneration is not just an issue of the cost to the company. Remuneration policies and practices:

- Send public signals about the company and its values;
- Are an indicator of the overall integrity, accountability and governance standards applied by the board;
- Are an important lever in whether company strategy is fulfilled;
- Can be positively damaging if the wrong incentives are provided; and
- Badly handled, can contribute to a perception of unethical business undermining wider legitimacy; and
- Should also be integrated into the company's risk procedures.

Remuneration policy is all about recognising the circumstances and values of the individual company and its strategic goals and performance drivers and then designing an approach that will reflect and contribute to these. A good remuneration structure will use stretching but achievable targets that are in line with the objectives of the business and the long-term interests of shareholders.

Justification of policy will become increasingly testing with enhanced narrative reporting including key performance indicators, as recognised by the Companies Act. In particular, in light of the current economic crisis, companies will need to further justify in their 2008 remuneration reports how their current policy is aligned to the long-term interest of shareholders if it remains unchanged.

Media coverage of remuneration controversies often focuses on the size of pay packages in absolute terms or relative to average salaries. The most important issue for investors is whether executive remuneration policy is commensurate with actual performance that is of benefit to investors. In order to achieve this, the policy needs to be well thought out and properly operated.

Recognising excess

Executive remuneration has the potential to be excessive in terms of:

- Absolute levels;
- The amount required to attract, retain and motivate directors of the necessary quality;
- That justified by business performance;
- Relative to the workforce in general for their contribution to business success; and
- Relative trends within society as a whole.

None of these are objectively measurable, but given current public concern remuneration committees will need to demonstrate sensitivity and be prepared to justify the company's approach. Absolute amounts paid in some companies that appear excessive in a UK context may be justified by companies using international comparisons. However, in our experience, these arguments are sometimes used

inappropriately. Also, when using US comparators, companies need to be aware of the growing US domestic concern at executives' judgement in this area.

The remuneration committee should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.
Expanding differentials between the boardroom and the rest of a company's employees have significant implications for employment relations and shareholder returns.
Boilerplate statements simply asserting that the committee 'is sensitive ...' are commonplace and insufficient. Quantitative and qualitative evidence is required to demonstrate that directors' remuneration forms part of a coherent policy framework throughout the organisation consistent with the company's goals and culture, so that all levels are fairly rewarded for their contribution. Indeed, as of 6 April 2008, large and medium-sized companies have been legally required to make a statement "of how pay and employment conditions of employees of the company and of other undertakings within the same group as the company were taken into account when determining directors' remuneration".

A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.
PIRC's approach assumes that a director's salary requires an acceptable level of performance. Incentives should be for demonstrable out-performance. In general, annual and long-term awards with an expected value of more than 200% of salary per year will trigger PIRC's matrix for assessing excessiveness. However, excessiveness may be in part offset by exceptionally challenging performance targets or low base salaries.

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance.
Market levels of remuneration are an important element but should not be the sole determining factor. The company's own circumstances and culture, the scope and complexity of the job and the experience of the incumbent will be just some of the other factors to consider.
Often, remuneration consultants are asked to undertake a benchmarking exercise across 'similar' companies to come up with a median (or higher) figure.
A better use for consultants is for the remuneration committee to set out the objectives of the company's remuneration policy and then ask them to come up with structural remuneration options to contribute towards it.

SPECIFIC ASPECTS OF REMUNERATION POLICY

Base salary

In deciding on the balance between fixed and variable pay remuneration committees should take into account the benefits of fixed pay, namely, simplicity and

transparency. Where salaries are significantly higher or lower than the sector average the reasons should be clearly explained. Base salaries should be clearly highlighted and companies should clearly state, and explain, the level of salary increases implemented during the year.

Bonuses

Bonuses should be designed to encourage and reward executive success, objectively measured rather than viewed as an entitlement.

Potential bonuses should:

- Be offered only as part of a considered package;
- Reward short term performance but this focus should not be to the detriment of longer-term strategy;
- Be subject to pre-determined performance targets that relate to the company's objectives, such as its KPIs
- Be capped at a reasonable level; and
- Not be increased without a requirement for better performance.

Amounts paid should:

- Broadly 'fit' with the view of performance in a particular year described in the company's business review;
- Be justified with details of performance achieved during the year against targets;
- Over time, reflect variations in business performance; and
- Require prior shareholder approval, if the bonus was not subject to predetermined performance criteria

Significant shareholding requirement

Executive directors should retain a meaningful commitment in the company by way of shares. PIRC considers that a holding equal to one year's salary is generally an appropriate level, and that this holding should be built up within a specified time frame, ideally no more than three years.

Other practices

A good remuneration policy may be still be undermined by poor practices. These may be indications of how the policy will be implemented in future.

DIVERGENCES FROM AN EXISTING REMUNERATION POLICY

These may include significant discretionary, non-contractual, or ex-gratia payments; failure to apply mitigation; or agreement of new contract terms.
In PIRC's view, any such changes should be subject to prior shareholder approval. Requiring the board to justify itself to shareholders is a useful discipline. Often, the changes appear to shield management from the risks inherent in variable pay - skewing the risk /reward balance.
Controversy can be caused by the committee acting significantly outside a previously stated policy.

RECRUITMENT INCENTIVES

In the short term, compensating a proposed director for the loss of potential rewards from their previous employer or providing upfront cash or share awards as an enticement to join may appear to be in the interest of the company, if it believes it cannot otherwise attract the executive. However, the practice is not in the company's or investors' long-term interests as it contributes to a general tendency to grant such replacement awards, which in turn devalues the retentive effect of share schemes.
Any such awards, when used, should have challenging performance conditions attached to ensure that the company pays only on the basis of the recruit's delivery rather than apparent potential. Under no circumstances will PIRC support the use of a cash payment as part of the recruitment award.

SIGNIFICANT SALARY INCREASES

Salary increases should be explained as a matter of course, in particular when they reach double-digits. PIRC does not consider it appropriate that significant increases be given to simply align with the market, rather it should only be for additional responsibilities.

LARGE ONE OFF SHARE BASED AWARDS

Share based rewards can produce distorted or unsustainable gains for the individual, unrelated to the company's underlying performance, due to market volatility and other factors. Conversely, in bear markets, participants learn that traditional options are not without risk with potentially de-motivating effects. Best practice is to make smaller awards of options or shares each year, so that rewards are less dependent on market timing. If the company believes that it has a case for making a large award, then this will need to be fully explained and justified. PIRC generally does not look favourably on front-loading of incentive awards.

OPTION RE-PRICING AND REPLACEMENT

This practice undermines any incentive effect of issuing options in the first place and is not acceptable as a matter of principle. The perceived need to re-price only arises if excessively large awards were made in the first place and are followed by a decline in share price.
Replacement of underwater options with new awards at a lower market price can have the same effective result as re-pricing and will be viewed with scepticism.

AWARD RE-BASING

In response to a sudden decline in performance, a company may consider it appropriate to alter the performance conditions of awards that are part way through their performance period. Even if changes are not retrospectively applied, we still consider the re-basing of unvested awards to be inappropriate as it undermines long-term performance targets.

TRANSACTION BONUSES

Bonuses for completion of a merger, acquisition, or other transaction assume that the completion of the deal is in itself a measure of success, whereas the value will be in its impact on long-term performance. Transaction bonuses are strongly

discouraged.

BELOW-BOARD REMUENRATION

Although executive directors are the overall stewards of the company, often important decisions and responsibility is also allocated to senior managers below Board level. Senior managers may have similar incentives to those at executive level, but this is not always the case. Given the importance of aligning employee incentives with those of shareholders, PIRC considers that companies should disclose the remuneration structures of senior managers, in order to enable shareholders to assess their appropriateness.

1.8 Possible improvements to the architecture of international financial regulation and maintenance of global financial stability.

PIRC believes that there is a compelling argument for reforms in the governance of regulatory bodies. In the UK we believe that, given our role in much shareholder voting, corporate governance advisory services such as ours ought to have some representation within the corporate governance policy structure of the Financial Reporting Council.

1.14 The impact of short-selling in the banking crisis and its regulation.

PIRC's principal experience of the impact of short-selling is in relation to stock-lending. A number of our clients loan their stock out to other market participants and earn not insignificant fees from doing so.

We recognise that the facilitation of short-selling through stock-lending creates potential conflicts with investors' long-term interests. For one, it is possible that stock-lending is counter-productive if the stock is shorted and returned at a lower value, or having undermined confidence in the investee company. In addition there may be a conflict with shareholder voting. Although many clients stipulate that stock should be returned for the purposes of voting, there is anecdotal evidence that this leads to them being less attractive to those seeking to arrange a loan. As such there may be a financial disincentive for taking ownership responsibilities seriously. Finally, some have made the point, for example, that by making so much stock available to lend, long-term investors like pension funds have made borrowing it very cheap, and the income they can derive from it is therefore limited.

Clearly views diverge on the legitimacy or otherwise of shorting. Some have argued that it allows valuable negative sentiment to be expressed, which can prevent shares from becoming overvalued. Others make the point that shorting has failed to prevent asset price bubbles, and instead may only exacerbate downward spirals in prices and a loss of confidence in the companies whose shares are being shorted. What is certainly true is the growth of shorting represents increased trading, and with it increased trading costs.

These questions do deserve further discussion. PIRC believes that it would be valuable to undertake detailed research into what impact shorting has on prices, both in terms of volatility and price formation. The increased trading costs resulting from shorting should be taken into account in any such analysis. In tandem it would be helpful to review the costs and benefits attached to stock-lending by long-term investors such as pension funds, and in particular its tax exempt status for pension funds. PIRC believes that, as presently constituted, stock-lending is an activity that should be more properly described as 'trading' and therefore should be appropriately taxed.

2.5 The role of UKFI and its relationship with the part-nationalised banks.

PIRC concurs with the view that has been articulated by Sir Philip Hampton and John Kingman that UKFI must act as an "engaged investor". Given the size of the stakes in the banks that UKFI holds this phrase must be given real meaning. It has been said that UKFI will operate at 'arm's length'. A document setting out clearly how this policy will be operated in practice should be produced and made publicly available.

PIRC believes that as an asset manager UKFI must adhere to the best practice that the Government advocates for the market as a whole. In addition to setting out its 'arm's length' policy, UKFI should also have a publicly available corporate governance policy. This should describe, for example, how UKFI will address issues such as remuneration policy and election of board directors. Finally, UKFI should also disclose how it votes its shares and the rationale behind its decisions.

We would also urge that UKFI also considers the role of the asset management businesses that form part of the banks in which it has taken an ownership stake. These investors also have an influence over remuneration at investee businesses, including financial services companies, so the voting records of these asset managers should be reviewed. In addition it should be noted that Scottish Widows Investment Partnership does not disclose its voting record, despite this being industry best practice. As SWIP is a subsidiary of RBS it is hoped that this omission will be remedied. The taxpayer now has an interest in ensuring that asset managers whose parent companies are part-nationalised use their influence as shareholders to push for the high governance standards.

4.2 The responsibilities of shareholders in ensuring financial institutions are managed in their own interests.

PIRC believes that there has been a failure of shareholder engagement in the run-up to the current crisis. For example, it is now widely accepted that remuneration policy at banks may have contributed to excessive risk-taking, and delivered short-term rewards at the expense of long-term success. This ought to have been an area

where shareholders used their ownership rights to rein in inappropriate policy. In fact PIRC's analysis of shareholder voting provided earlier has revealed that no UK-listed bank has ever lost the vote on its remuneration report, or come close to doing so.

Unfortunately, beneficial owners such as pension funds typically delegate responsibility for analysing corporate governance issues and the exercise of shareholder voting to their existing fund managers. But PIRC does not believe that many fund managers have the capacity, and perhaps the desire, to undertake this role effectively. PIRC has a staff of over 30 in place in order to deliver a global corporate governance service based on thorough company research. It is hard to see how fund management houses with a handful of corporate governance staff can play this role effectively.

In fact more detailed analysis of fund manager voting and engagement has revealed that there is a wide spread of activity and competence. PIRC's own analysis of the (limited) disclosures made by fund managers in respect of shareholder voting has, for example, revealed one manager that has not voted against a single resolution at a UK-listed bank in six years. A number of others appear to only rarely oppose management. We also expect the situation to deteriorate further. A number of large financial institutions have already cut back the resource they dedicate to corporate governance analysis. This is despite the clearly increased relevance of corporate governance failure in the financial crisis.

Therefore PIRC believes that if shareholders are to provide proper oversight of the governance of financial institutions then there must be a step-change in behaviour. Large investors such as pension funds should either take more responsibility for corporate governance themselves (our preferred option), or keep a much closer watch on how their fund managers deal with such issues. At present not enough shareholders are playing the ownership effectively.

Given the scale of the financial crisis, an evaluation of the role played by shareholders in the governance of financial institutions is surely warranted. In addition, given the obvious public interest in this area (now that the taxpayer part-owns much of the banking sector) PIRC believes that the case for the mandatory disclosure of shareholder voting records is overwhelming and this should be implemented as soon as is practical.

Further information

PIRC would be happy to discuss the points we have made in our submission in more detail. Please contact:

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Securitisation in the UK Banking Sector

Summary

From the examination of the reporting of eight banks, two explicitly disclose the fees that were paid to auditors relating to securitisation services, namely RBS and Northern Rock. With the remaining banks these fees could potentially be listed under 'other services relating to corporate finance transactions' or 'other services'. The latter is used by HSBC and Standard Chartered to cover 'reviews of financial models', which could also potentially contain securitisation related fees.

Alliance & Leicester

The remuneration of the auditors, Deloitte & Touche LLP, is set out below:

	Group & Company	
	2006 £m	2005 £m
Fees payable to the Company's auditors for the audit of the Company's annual accounts	0.4	0.5
Fees payable to the Company's auditors and their associates for other services to the Group:		
Audit of the Company's subsidiaries pursuant to legislation	0.3	0.3
	0.7	0.8
Tax services	2.3	0.2
Recruitment and remuneration	0.1	0.1
Other services	0.4	0.3
Total	3.5	1.4

The above figures exclude VAT. The audit fee for subsidiary companies is included in 'Audit of the Company's subsidiaries pursuant to legislation'.

Tax services include a fee in 2006 for taxation advice regarding the sale of the credit card business.

Fees payable to Deloitte & Touche LLP and their associates for non-audit services to the Company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

Other services (£0.4m)

HBOS

6. Auditors' Remuneration

The aggregate remuneration of KPMG Audit Plc and its associates for audit and other services (excluding value added taxes) is analysed below.

	Audit and audit-related services £m	Non-audit services £m	2006 Total £m	Audit and audit-related services £m	Non-audit services £m	2005 Total £m
Statutory audit of the Company and HBOS consolidation	0.3		0.3	0.3		0.3
Fees payable for other services:						
Audit of the Company's subsidiaries and associates	6.5		6.5	5.9		5.9
Audit of the Company's pension schemes	0.1		0.1	0.1		0.1
Other services pursuant to legislation	1.4		1.4	2.4		2.4
Tax services (compliance and advisory)		0.9	0.9		0.9	0.9
Services relating to information technology		0.3	0.3		0.3	0.3
Services relating to corporate finance transactions		0.7	0.7		1.0	1.0
Other services		1.1	1.1		1.5	1.5
Total other services	8.0	3.0	11.0	8.4	3.7	12.1
Total	8.3	3.0	11.3	8.7	3.7	12.4

The analysis of 2005 auditors' remuneration has been restated to reflect the new guidance issued by the Institute of Chartered Accountants in England and Wales on the disclosure of auditors' remuneration.

6. Auditors' Remuneration continued

Other services pursuant to legislation includes work in support of regulatory reporting and listing rules and includes the review of the half yearly results ('audit-related services'). Other services relating to corporate finance transactions includes fees for reviews in relation to capital and debt issues, securitisations and covered bond issues.

Services relating to corporate finance transactions (£0.7m)

HSBC

8 Auditors' remuneration

Auditors' remuneration in relation to statutory audit amounted to US$44.7 million (2005: US$47.0 million; 2004: US$41.7 million).

The following fees were payable by HSBC to the Group's principal auditor, KPMG Audit Plc and its associates (together 'KPMG'):

	2006 US$m	2005 US$m	2004 US$m
Audit fees for HSBC Holdings' statutory audit:			
– fees relating to current year	2.7	2.8	2.3
– fees relating to prior year	–	0.2	0.7
	2.7	3.0	3.0
Fees payable to KPMG for other services provided to HSBC:			
– audit of HSBC's subsidiaries, pursuant to legislation	40.4	42.5	36.6
– other services pursuant to legislation[1]	15.4	29.2	13.4
– tax services	2.0	2.6	6.2
– services relating to information technology	0.6	–	–
– services related to corporate finance transactions	1.6	0.3	1.6
– all other services	4.1	5.0	4.7
	64.1	79.6	62.5
Total fees payable	66.8	82.6	65.5

Other services

- 'Services relating to information technology' include advice on IT security and business continuity and performing agreed upon IT testing procedures.
- 'Services related to corporate finance transactions' include fees payable to KPMG for transaction-related work, including US debt issuances.
- 'All other services' include other assurance and advisory services such as translation services, ad-hoc accounting advice and review of financial models.

Services relating to corporate finance transactions (£1.6m)
All other services (£4.1m)

Lloyds TSB

During the year the auditors earned the following fees:	2006 £m	2005 £m
Fees payable for the audit of the Company's current year annual report	6.0	6.3
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	2.3	1.7
Additional fees in respect of the previous year's audit of subsidiaries	0.6	-
Other services supplied pursuant to legislation	4.7	0.8
Total audit fees	13.6	8.8
Other services – audit related fees	1.4	1.6
Total audit and audit related fees	15.0	10.4
Services relating to taxation	0.6	0.6
Other non-audit fees:		
Services relating to corporate finance transactions	1.0	0.3
Other services	0.4	0.5
Total other non-audit fees	1.4	0.8
Total fees payable to the Company's auditors by the Group	17.0	11.8

During the year, the auditors also earned fees payable by entities outside the consolidated Lloyds TSB Group in respect of the following:

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital, transactions and other assurance and advisory services.

Services relating to corporate finance transactions (£1.0m)

Northern Rock

Services provided by the Group's auditor and network firms

During the year the Group obtained the following services from the Group's auditor, as detailed below:

	2006 £m	2005 £m
Audit services:		
Fees payable to Company auditor for the audit of parent Company and consolidated accounts	0.5	1.0
Non audit services:		
Fees payable to Company auditor and its associates for other services		
– The audit of Company's subsidiaries pursuant to legislation	0.3	0.4
– Other services pursuant to legislation	0.3	0.3
– Other assurance services	0.7	0.8
	1.8	2.5

Other assurance services comprise services provided in respect of securitisation transactions and the raising of wholesale funding. No other non-audit services were provided.

Other assurance services (£0.7m)

RBS

4 Auditors' remuneration

Amounts paid to the auditors for statutory audit and other services were as follows:

	Group	
	2006 £m	2005 £m
Fees payable to the Group's auditors for the audit of the Group's annual accounts	0.8	0.6
Fees payable to the Group's auditors and their associates for other services to the Group:		
– The audit of the company's subsidiaries pursuant to legislation	10.8	9.3
Total audit fees	11.6	9.9
– Other services pursuant to legislation (1)	5.9	3.3
– Other services relating to taxation	0.2	0.2
– Services relating to corporate finance transactions, including securitisations, entered into by the Group	2.4	4.9
– All other services (2)	2.6	6.0
Total non-audit fees	11.1	14.4
Fees payable to the Group's auditors and their associates in respect of pension schemes:		
– Audit	0.3	0.3
Total	23.0	24.6

Notes:

(1) Includes fees for work relating to Section 404 of the US Sarbanes-Oxley Act.

(2) Includes fees relating to the transition to IFRS in 2005.

Services relating to corporate finance transactions, including securitisations (£2.4m)

Standard Chartered

Auditor's remuneration

Auditor's remuneration in relation to the Group statutory audit amounts to $3.3 million (2005: $3.1 million). The following fees were payable by the Group to their principal auditor, KPMG Audit Plc and its associates (together "KPMG"):

	2006 $million	2005 $million
Audit fees for the Group statutory audit:		
Fees relating to the current year	3.3	3.1
Fees payable to KPMG for other services provided to the Group:		
Audit of Standard Chartered PLC subsidiaries, pursuant to legislation	7.6	7.7
Other services pursuant to legislation	1.6	3.1
Tax services	1.0	0.8
Services relating to information technology	0.1	0.1
Services relating to corporate finance transactions	1.4	0.4
All other services	0.2	0.3
Total fees payable	15.2	15.5

- Services related to corporate finance transactions include fees payable to KPMG for transaction related work irrespective of whether the Group is vendor or purchaser, such as acquisition due diligence and long-form reports.
- All other services include other assurance and advisory services such as translation services, ad-hoc accounting advice and review of financial models.

Services relating to corporate finance (£1.4m)
All other services (£0.2m)

Bradford & Bingley

Remuneration of auditor and associates		
Statutory audit of the Company in accordance with legislation	0.5	0.5
Auditing of accounts of associates pursuant to legislation	0.2	0.2
Other services pursuant to such legislation	0.2	0.5
Other services relating to taxation	0.2	0.1
Regulatory services	0.6	0.5