NATIONWIDE BUILDING SOCIETY'S RESPONSE TO THE CORPORATE GOVERNANCE GREEN PAPER A MUTUAL APPROACH TO CORPORATE GOVERNANCE

Overview

Nationwide aims to be an exemplar organisation in all aspects of its business. The Board is committed to the highest standards of governance, and this approach has served us well throughout our history. For a number of years we have underpinned this principle by seeking to adopt the FRC Corporate Governance Code on all matters of governance, reporting and disclosure, notwithstanding our "private" ownership and mutual status. However, we recognise that the demands of governance change and evolve, and we keep our arrangements under review to ensure they remain fit for purpose. In the last year, for example, we updated and codified the Society's governance approach and controls in the Nationwide Governance Manual, which has been communicated right across the Society.

Good governance is not a "nice to have" or a "tick boxing" exercise. Rather it is an essential pre-requisite to the legitimacy of business to operate in any society. If business is to regain the trust of society, it needs to act and be seen to act to the highest standards of probity and to deliver for all stakeholders in the economy. Good governance standards are an essential part of making this happen. Furthermore, in a post Brexit world, the United Kingdom needs to be an attractive place for overseas businesses to operate and invest. An effective and proportionate governance regime is one component of creating such an environment. It is for these reasons Nationwide supports the Government's review. Furthermore, Nationwide believes all large businesses, whether public, private, or indeed with different ownership models such as ours, should be subject to the highest standards of governance. As part of the advancement of this work the Government could consider ways of implementing the equivalent of the FRC Code for alternative business models. We would be pleased to provide input to such a review, should the Government believe this to be of benefit.

At the heart of Nationwide's approach to governance is our mutual status, which sets us apart from other types of business. As the world's largest building society, Nationwide is owned by, and run for, its members. That means putting members first and doing the right thing are the central tenets of how we run our business.

Like any other business, we do have a range of stakeholder interests to consider and balance – customers, owners, colleagues, regulators and wider society. We believe that if the interests of any one group is allowed to dominate, other stakeholders, and society more generally, suffer.

We believe that the key to safeguarding our members' interests actually lies in balancing the interests of our varied stakeholders. If our staff are treated with care and sensibly rewarded, they will serve our customers better. If our customers are well looked after with good products and service they will give us more of their business. In short, it is our belief that good governance can produce a virtuous circle of success.

As a mutual, where our members are our owners, rather than shareholders[1], we recognise it is easier to align these interests, and that this alignment is conducive to genuine long term value creation. One of the vitally important ways we align these interests is by ensuring that there are direct lines of communication between members and colleagues on the one hand and Nationwide's senior decision makers.

We therefore welcome the Government's initiatives in this area and hope we can help to progess actions that will rebuild public trust in business. What follows aims to capture Nationwide's philosophy and our thoughts on some of the challenges posed in the Green Paper.

[1] Other than a small amount of Core Capital Deferred Shares owned by institutions

Thinking long-term
As a building society, Nationwide's roots can be traced back to 19th century communities coming together to pool money to fund the purchase of homes for each other. This is still at the heart of our model, where funds from savers support mortgages for home buyers. Although some building societies have increased in size, our members are still the people who save money and those who use it to buy a home. As a result, we do not have outside shareholders[2], and this allows us to prioritise long term member benefit rather than being pressurised into generating quick shareholder returns.

In practice this long term approach means:

- We can keep lending responsibly even against an uncertain economic backdrop. Between March 2011 and March 2015 Nationwide lent £26bn of £56bn net mortgage lending in that period – 46% of the UK total.
- After the Brexit vote, we pledged to make at least £10bn available for first time buyers.
- We look at more than economics when we consider our branch network. Banks are closing branches in record numbers, and we are investing £500mn over 5 years in our branches.

Mutuality helps to hardwire the interests of consumers and other stakeholders into our model but we accept that it's no guarantee of good governance by itself. In our view mutuality needs to be buttressed through close adherence to guidance, rules and best practice. This provides the 'dual lock' for good corporate governance.

Voluntary approach to avoid unintended consequences
Consequently, we ensure our governance standards are in line with industry best practice. For example, we voluntarily adhere to the UK Corporate Governance Code in line with Building Societies Association (BSA) guidance. We will continue to strive to ensure our standards of governance meet or exceed best practice – which we believe should be a rising bar.

In our view, a single approach to improving governance across diverse businesses is unlikely to lead to good outcomes. We believe it is right to retain flexibility and proportionality in the eventual policy solutions the Government proposes, recognising the varied anatomy and character of businesses.

Learning from alternative business models
To achieve the policy ambitions in the Green Paper, Nationwide would be delighted to help lead a group of businesses with alternative ownership models to look at how the proposals can be transferred. Such a coalition could also explore what aspects of governance could be replicated from mutual and non plc models across businesses more generally.

Nationwide's approach to some of the core questions in the corporate governance debate with views on some of the specific options in the Green Paper are set out below.

Nationwide key facts

Board and member interaction
- Most months Nationwide's 'Member Talkbacks' put Board Directors in front of members around the country to account for the Society's performance and decision making.
- Our annual AGM mailing is one of the Royal Mail's largest single exercises.
- Our AGM voting is done by individual members casting their vote. One person, one vote.
- 93% of members supported our 2016 Remuneration Report; we aim to at least maintain this level.
- All Board directors are also members of the Society.

[2] Other than a small amount of Core Capital Deferred Shares owned by institutions

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Worker and management interaction

- Last year, our 18,000 all-employee 'Big Conversation' was the keystone of our strategy refresh.
- Last month, over the course of a week around 3,000 colleagues per day joined our ExCo at the Birmingham NEC for full briefings on our plans.
- Every week, frontline personnel join our weekly 'Heartbeat' meeting with our CEO and ExCo. This is a key locus of decision making.
- Nationwide has one of the UK's highest levels of employee engagement. 80% compared to 63% in FS sector and 73% for "high performing companies".
- We consult Nationwide's Group Staff Union on our pay principles.

Executive pay

- Were it listed, Nationwide would be a top-40 FTSE firm – our CEO pay barely makes the top-100 (97th).
- Nationwide bonuses are more focused on customer satisfaction and member growth than on profits.
- At the height of the financial crisis (2009) executives received no bonuses under annual performance plans, but staff did.

Nationwide's approach to pay

In line with our mutual status, Nationwide takes a different view on pay to other organisations in the financial services sector. We aim to achieve fair, but not excessive, pay throughout our organisation. We have, for example, championed the Living Wage for our employees and in our supply chain. We have also voluntarily increased our employee pension contributions.

Meanwhile, at the highest level, our CEO package is lower than all our major peers and most FTSE 100 companies. Indeed, Nationwide is the equivalent size of a FTSE-40 firm, but our CEO pay would only be 97th on the FTSE 100.

Nationwide is also bound by FCA and PRA regulations so there is more scrutiny of remuneration than in some other sectors. This means that pay for a number of executives can be subject to "clawback" for up to ten years.

Remuneration principles

The bedrock for Nationwide's pay policies are a strong set of basic principles. These include;

- Rewarding our executives at a level which is fair but not excessive.
- Assessing performance of executive directors against a balanced scorecard of measures which focus on delivering benefits for our members and reflect our mutual interests.
- Award levels as a percentage of base salary under our performance pay plans are at the lower end when compared with our main competitors. This means that the maximum potential total remuneration levels for our executive directors are substantially below the market median.

The "gateways" to Group Performance Awards across Nationwide set out minimum capital and profit requirements before employees become eligible to participate. The profit and capital levels are not set to maximize returns, rather to ensure the Society remains safe and secure, and generates sufficient profit to finance future investment. As a result, poor financial performance would mean little or no bonus. This happened in 2009 at the height of the financial crisis when the executive team did not receive bonuses, but staff did.

Once these gateways have been passed, bonus levels are based on three metrics covering customer satisfaction, member growth and efficiency; pre-requisites for long term value creation. The highest bonus levels are only available with maximum performance against each of these targets. Full retrospective disclosure of the targets set for these three measures is reported in our Annual Report and Accounts. In essence, all colleagues are incentivised on supporting the long-term health and success of the Society, as opposed to driving short-term financial value.

Nationwide does not disclose significant information in advance on targets due to commercial sensitivity.

We are confident that Government will work with businesses to understand how to balance the twin needs of increased disclosure and commercial confidentiality. Nationwide would be willing to consider greater disclosure of bonus targets if commercial confidentiality issues can be addressed.

Remuneration committee oversight
The executive pay process and principles are overseen by an experienced remuneration committee.

We believe that further steps can be taken to improve the oversight provided by remuneration committees. Nationwide's current remuneration committee chair, was a member of the committee for 12 months before becoming chair and we support this as standard industry practice. To achieve this, we support option (ii) within the role of the remuneration committee sections.

Ideally, this experience should be on the same remuneration committee the person is chairing. As this is not always possible there must be safeguards for extraordinary situations. In these cases, businesses should be able to appoint someone with experience on another remuneration committee or, in exceptional circumstances, no experience at all.

Votes on pay
In a building society, individual voting members make pay decisions, rather than institutional investors. This means our approach to pay is endorsed by our 7.7 million voting members at our AGM. All voting members have the opportunity to vote on a 'one member one vote' basis. In 2016, our vote on remuneration was supported by 93% of those who voted. To illustrate the scale of this democratic exercise, the posting of the voting forms is one of Royal Mail's biggest annual mailing exercises.

Although member votes on pay are advisory, we would take immediate action should we lose a vote. As a result, we would support the introduction of binding votes on pay and for these votes to be held on a regular basis. Within the Green Paper we would support a combination of options (i) and (iv) within the shareholder voting and other rights section. As a building society, if Nationwide were to adopt a binding vote on its remuneration policy it would not enjoy the same legal protections afforded to quoted companies. Similar issues could arise if a binding vote on certain elements of executive pay was required by the Government, or we chose to implement one to meet best practice. In such a case appropriate changes to the Building Societies Act would be needed to ensure the same legal protections were available as with other business types.

Nationwide would be pleased to lead a piece of work with the Government and the wider mutual sector to explore how to resolve this issue.

Supporting employees to save for their pensions
During 2015 Nationwide took the decision to increase support for employees saving for their retirement by making significant changes to pension provision. Nationwide, following discussions with employees and the Nationwide Group Staff Union, increased its standard pension contribution from 9% to 13% of salary and also matches employees' additional contributions up to 3%. The minimum employee contribution is 4% of salary, but if employees choose to save an additional 3%, then with the matched contributions the total employer contribution is 16% and the total combined contribution rate is 23%.

To encourage employees to save more, Nationwide automatically sets employee contributions at 7% of salary enabling them to receive full matching from Nationwide. Employees must take specific action if they want to adjust this optional 3% down to the minimum contribution of 4% or opt out completely.

Nationwide undertook these changes in consultation with the NGSU as we wanted to encourage employees to save more and receive more from Nationwide to be on track for a better pension outcome on retirement.

Tackling low pay
It is our view that addressing widening pay differentials also demands measures to lift pay at the bottom. Nationwide has taken a leading role in the campaign for fairer pay, since April 2014 we have been a principal partner of the Living Wage Foundation, paying the full Living Wage of £8.45 per hour (£9.75 in London).

Nationwide has pledged to ensure that everyone regularly working for Nationwide is paid the Living Wage, even if they are not our direct employees. More than 1,500 people have benefitted from this decision, many of whom are employed by companies within our supply chain.

As well as measures to increase transparency and oversight of executive pay we see a role for businesses in going beyond their legal requirements to tackle low pay, whilst accepting that this can be a significant decision.

The limitations of pay ratios
We believe these concrete steps to address pay at both ends of the spectrum are more effective than reporting pay ratios. We do not support the introduction of a pay ratio reporting requirement because, as the Green Paper notes, pay ratios can be very misleading. Our concerns centre around the so called "Goldman-Waitrose effect" where a retailer's pay would look less fair than the bank's, because the latter's staff are all very highly paid.

As a business focused around a branch network, Nationwide will have a greater number of lower paid colleagues than some other businesses. We remain committed to ensuring Nationwide rewards its lowest paid colleagues effectively by paying the full Living Wage. In addition, Nationwide has low levels of outsourcing and has been working to onshore more activity within the UK. We are concerned that these changes, while having clear consumer benefits, would potentially have the effect of creating a misleading pay ratio when compared to others.

<u>Strengthening consumer, employee and other stakeholder connections to senior level decision making</u>

In our view a common factor in poor corporate behaviour and excessive short term profit maximisation at the expense of other outcomes is poor linkage between the boardroom, senior management and the interests of customers, staff and other outside interests.

To illustrate how those connections can be strengthened, we have set out some of the practical ways in which we seek to connect senior management with our employee and customer stakeholders.

1. **The AGM voting process: One member, one vote**

As a mutual, Nationwide has short lines of responsibility between the members of the Building Society and the Board. This keeps members close to the decision making process.

Each voting member, of which there are 7.7 million, has a single equal vote at the AGM which can be cast online or via a form. It does not matter if someone is saving £100 or £100,000 or if they have a mortgage of £20,000 or £200,000 – their vote counts equally. As a result, the path from members to decision makers is both short and direct and not elongated or diluted through pension funds, fund managers and proxy votes.

The logistics behind this exercise demonstrate the level of public involvement – the annual 7.7m member AGM mailing is one of the Royal Mail's largest single exercises.

Shortening the distance between decision makers in big businesses from owners, customers and employees is one solution to help restore trust in business.

2. **Increasing member involvement in AGM voting**

Nationwide is looking to further strengthen member involvement by increasing turnout at the AGM and the number of members who vote. We have increased the number of members receiving electronic communications and improved the quality and customer focus in our Annual Report and Accounts. We would be pleased to share the lessons of these exercises with policymakers.

We identified three main reasons why members do not vote in the AGM, which we are seeking to address:

- Members were generally happy with the performance of the Society
- Members intended to but never got round to it
- Members did not think it would make any difference

We believe Government action in this area might focus on supporting businesses to address this last point in particular. As well as ensuring the effectiveness of our own governance we would hope that voting in the Nationwide AGM could help demystify some of the processes around corporate governance for our members who may also be individual retail shareholders in other businesses.

In relation to the Green Paper options on increasing shareholder involvement in pay, we support option (iii) which seeks to facilitate or encourage individual retail shareholders to exercise their rights to vote on pay and other corporate decisions. We are willing to work with the Government to share our work and current lessons around this issue to help understand how a large financial services provider can engage effectively with individuals on these issues.

3. Giving members a voice at Member Talkbacks

Almost every month Nationwide holds a member talkback in a different UK location. A Board Director attends, along with the CEO or a member of his top team, and members are invited to quiz the team on any aspect of the operations of the Society. Any of Nationwide's 14 million members can attend these BBC Question Time-like occasions; which can be every bit as spontaneous and harrowing for the Board members taking part. As there is no control over the questions, Talkbacks are intentionally challenging for the Directors and executives taking part. Indeed, we strongly believe that this unfiltered member feedback drives real accountability.

Feedback shows that Member Talkbacks remain highly valued by our members. These events could be easily replicated by other firms, but we believe they are still a rarity among other businesses.

4. Employee attendance at weekly "Heartbeat" meetings

Nationwide's weekly Heartbeat meeting brings together the CEO, his Executive Committee and senior managers to review the performance of our product and service and take decisions to meet the organisation's strategic objectives.

Each week customer-facing teams in branches or contact centres attend these meetings to give feedback on decisions and pass on concerns. This gives them direct access to high level decision making and allows them to give unfiltered feedback to senior managers. Colleagues are encouraged to raise issues on any issue, whether customer service, overall policy, product, risk appetite or operational process.

These meetings result in real change. In a recent meeting a branch manager in Milton Keynes raised questions over the difficulty customers were finding in proving their identity when opening accounts online. This was leading to wasted journeys and duplicated effort for employees and members alike. Following the feedback, the Executive Committee set about addressing this issue for the benefit of staff and customers alike. There are literally dozens of other examples of improving how we operate as a direct result of employees having access to our senior people.

5. The 'Big Conversation' and Colleague Panel

Attendance at the weekly "Heartbeat" meetings provides an opportunity for colleagues to influence the Society's operations. However, this meeting is predominantly focused on day-to-day issues. It is our belief it is also important our colleagues have a real opportunity to influence the Society's strategy and priorities. During June and July 2016 Nationwide involved all 18,000 employees in our 'Big Conversation' as the kick-off for the CEO's strategy refresh. We have committed to respond to all 22,000 pieces of feedback.

We spent five weeks talking with colleagues about products and services, what Society membership means, who we trust and why, how we make decisions and how our service compares to others. One of the main outcomes of this process was the creation of a Colleague Panel. 70 people put themselves forward to be on the panel and around 3,600 votes were cast to elect the 15 panel members. The panel is involved with:

- The Big Conversation feedback actions – helping the newly formed taskforce to prioritise the actions that are being implemented.
- Nationwide's refreshed strategy – having sight of the new strategy overview before it is issued to all colleagues.
- Internal brand – as we more closely align our internal brand with our external brand, the Panel sees the new guidelines and templates for feedback before launch across the business.

The Colleague Panel therefore has real influence over the Society's plans and priorities by ensuring the feedback from all staff is acted upon where appropriate. Follow-up to the Big Conversation also led to the establishment of a special taskforce led by Nationwide's Executive Director of Transformation. This taskforce has already successfully implemented a number of changes on the back of employee recommendations.

A selection of these are listed below:

We said	**We did**
We should allow customers to transfer money between accounts over the phone.	We've run a pilot with more than 50 of our contact centre colleagues to assess the take up of this service.
Reduce the number of internal referrals – give clear information so customers are directed to the right channel.	We've introduced Quantum Lite (an online system for sharing customer documents) into 74 of our branches (with a further 250 planned in January 2017). QL allows branch and contact centre colleagues to see the same information.
We should be clearer on the use and explanation of call handling target times.	We don't measure average handling time directly as part of our performance agreements, we use calls per hour as a better measure to enable our people some scope in handling longer and shorter calls.
Members sometimes have to state personal information when at the desk in a branch for certain transactions.	We're introducing a new Customer Authentication Tool which will reduce the number of occasions this is required.
Look at the high volume of paperwork to open adult current accounts.	We've completed a review of all of our marketing literature and streamlined the paperwork needed for customers.

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Increasing stakeholder engagement
These examples show some of the steps we are taking to engage with members and employees but we are always aware that more action can be taken.

Of the options contained in the Green Paper, Nationwide would support increased reporting around stakeholder engagement. We already undertake some of this reporting within our Annual Report and Accounts and would be willing to look at how it can be enhanced. One option would be to mandate, under the Code, the Chairman to report on how the Board gained insight into the views of various stakeholders, but perhaps most importantly employees, and to detail how these views were taken into account in decision making during the year under review.

If the Government determined substantive action was required, we believe the best option would be option (ii): Designate existing non-executive directors to ensure that the voices of key interested groups, especially that of employees, is being heard at board level. We believe that this non-executive director would be able to perform an effective role in representing stakeholders. Our main concern if this change was made would be around the undermining of collective responsibility and the requirement for all boards members to consider stakeholder needs. One option might be to nominate the Chairman as the focal point for ensuring the voices of key stakeholders are heard and to widen the role of the Senior Independent Director (SID) to be the escalation point for employees if they believed their voices were not being heard, or taken into account. This would mirror the current arrangements for the SID in relation to shareholders.

Nationwide is concerned that the appointment of individual stakeholder representatives to company boards, as set out in option (iii) would, as recognised in the Green Paper, provide a number of challenges around selection and election of board representatives. This process would be further complicated in the financial services sector where any board member would need regulatory approval. The differences between business types also need to be taken into account. Four of Nationwide's board are employees and all are members of the Society. As a result, they will also be able to approach decisions from these points of view.

Whilst there are many examples of employee nominated Directors working effectively, particularly but not exclusively in Europe, we do not believe this should be mandated within the UK. The UK business community is very diverse and includes substantial numbers of global, multi business line, multi product businesses. Further work is required in articulating how employees from one area could effectively represent all employees. However, if the Government were to decide to mandate employee nominated Directors, we would suggest the following requirements need to be put in place:

- Any employee nominated Director carries the same duties as all Directors for the success of the business and to consider the needs of all stakeholders. As such the individual is nominated and voted for by all employees (and not just those in a Trade Union), and is not placed on the Board to represent the employees. This distinction is vital for the effective operation of a unitary Board.
- Any employee nominated Director serves a minimum term of three years. This is necessary to allow the individual to contribute to the development of strategy and policy over time and for there to be continuity of input.
- An onus of responsibility is placed on the Chairman of the Board to ensure appropriate training, induction and support is put in place to ensure the individual is able to make a significant contribution to the Board's discussions and decisions.
- As with all Directors, any employee nominated Director accepts an onus of confidentiality in relation to all aspects of the Board's discussions and has no reporting duty to the wider employee community.

How can reform be put in place
Nationwide believes that any changes should be introduced on a voluntary basis in the first instance and that the Government should only consider stronger measures, such as codes and legislation, if take up of voluntary schemes is low.

In our opinion a voluntary approach could help different companies apply good corporate governance standards in a way that is the most effective for their business structure. A one-size-fits-all legislative structure would fail to take into account the differences between plcs, mutuals, cooperatives, employee owned businesses and other business types. A legislative approach also runs the risk of firms simply carrying out a tick box exercise where they fulfil their minimum legal requirements.

The take up of the findings on the Ghadia Review into the representation of women in financial services and the subsequent HM Treasury Women in Finance Charter demonstrates the effectiveness of a voluntary scheme. 72 organisations have signed the Charter so far, including Nationwide along with major banks, insurance providers and other groups operating in the financial services sector. This commits them to implementing measures to support the progression of women into senior roles and requires firms to publicly report on progress to deliver against internal targets. Most importantly this voluntary approach takes into account the diversity of the financial services sector and that firms will have different starting points. This gives greater flexibility than a legislative or code based approach allowing each firm to set its own targets and implement the right strategy for their organisation. A similar approach regarding corporate governance may increase overall take up.

Further information

If you would like any additional information about the points raised in this document or more generally about Nationwide please contact