

## MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS

Personal response from Alastair Ross Goobey, CBE.

1. I am currently Chairman of the International Corporate Governance Network, but am responding on a personal basis, arising from my experience in this field.
2. Between 1978 and 1986 I was a non-executive director of the Scottish Life Assurance Company, then an independent mutual (having mutualised at the end of the 1960s). I have also been a director of a mutual building society (the Cheltenham & Gloucester) in the late 1980s and early 1990s when it de-mutualised and was sold to Lloyds Bank. In addition I have been on the Council of Lloyd's and am currently a Governor of the Wellcome Trust, both institutions that have similar characteristics to those of mutual life offices for their non-executive board members.
3. Professionally, I was Chief Executive of Hermes Pensions Management Ltd., for the nine years between 1993 and 2001 inclusive.
4. I will attempt to respond to the 11 questions in Chapter 4 seriatim, but will have more to say on some than on others.
5. Q1: The revised Combined Code is a good basis on which the governance of mutual life offices should be founded.
6. Q2: A 'comply or explain' regime still seems the best option, although, as the consultation document points out, there is no real sanction if neither is done as there are no external shareholders to challenge short-comings. The FSA should require a 'comply or explain' regime.
7. Q3: In my experience of sitting on mutual company boards, the question of in whose interests is the Board acting is a very difficult one. In a mutual life office, there is no coincidence of interest between a member whose policy is about to mature and one who has just taken out a new contract. There is also an inherent potential conflict between the possible ambitions of the management and the short-term interests of the policyholders. It would be impossible to have a board that represented all the possible constituencies of the membership. Consequently it seems desirable to have a Board that is experienced in more general terms and whose members are not 'delegates' of one interested party or another. It may be desirable for it to be made easier for policyholders to nominate and vote on board members, but it would not be in anyone's interests for the Board to be dominated by 'single-issue' directors.
8. Q4: This is the nub of the inherent problem. A particular emphasis on director training and self-assessment is a new feature of the new Combined Code. There is often some reluctance on behalf of senior executives of other companies who serve as non-executives on boards to believe themselves in need of training and better understanding of the business to which they have been asked to act as stewards. Some euphemism is often helpful in encouraging such senior people to accept the need for continuing education: 'Masterclasses' have been used in this context. Actuarial science is often, like so many specialisations, couched in very abstruse language and jargon. It is certainly no reflection on the ability of directors from other backgrounds if they admit to being in need of extensive education in the finer points of the actuarial assumptions and their effect on bonuses, the overall solvency of the office and cash-flows. **One suggestion is that the annual report of the office would contain a statement of the number of days on which non-executive directors received such training from external sources.** Directors of other, highly specialised, businesses have similar challenges, but only in the case of a mutual company do you have the combination of the need for technical knowledge and lack

of immediate accountability to the people in whose interests the non-executives are acting.

9. Q5: A non-executive director cannot hide behind the complexity or technicality of a business as an excuse for failing to understand the crucial impact such matters might have on its viability. Although it is often difficult to challenge the executives about these technical elements, it is still true that, unless the executive can explain them in a way that intelligent non-specialists can understand, then a director should not be satisfied.
10. Q6: It would probably not be in the interests of policyholders for the non-executives of a mutual life office all to have an actuarial background. There is a great danger of the received wisdom of a profession becoming the norm, and external challenge to those views would be more difficult to generate. The owners of such businesses (and the definition of ownership in this context is by no means straightforward) rely either on the skill and prudence of an 'ordinary man of business', or, as recommended in the Myners Review of Institutional Investment in the UK (March 2001), on the skill and prudence of someone 'familiar with the issues concerned' (paras 76,77). **This higher level test does seem appropriate for mutual life offices**, if it is thought appropriate for Trustees of pension schemes, who act in a very similar context. Familiarity with the issues does not mean thoroughgoing expertise. There already seems to be acceptance that an executive director has a higher duty of care in such a business than a non-executive director on the purely technical aspects, although this has not been tested in the UK courts to any extent.
11. Q7: The only time that members of mutual companies usually take the opportunity of expressing a view on the governance of their company is when there is a proposal for demutualisation. Because, as the consultation document observes, there is no obvious coincidence of interest between different kinds of policyholder it is preferable that a disinterested group of non-executives plays the role of arbiter. It is difficult to see how the involvement of another organisation or group would add to that process. The non-executives of a mutual life company act very much in the same way as the trustees of a pension fund do – they should act in what they perceive to be the best long-term interests of the office as a whole, not favouring one group over another.
12. Q8: Although Lord Penrose is obviously right that policyholders provide their capital at risk, over time a life office builds up capital whose ownership is far less precise (as we have seen in the case of 'orphan assets'). There is no reason to believe that a mutual or a proprietary company would take a different attitude to risk as a consequence simply of the ownership structure. Although a proprietary company might appear to have easier access to additional capital, there have been cases where mutual companies have demutualised in order to gain equivalent access to external capital. For policyholders where the benefits are expressed in absolute amounts (whole life), the ability of the office to meet those obligations are paramount, and Boards should not be taking risks of failure to meet them.
13. Q9/10: The FSA has introduced substantial new rules about the governance of life offices, including important constraints on the ability of a small group of executives to dominate the discussion. There has, however, been very little direct contact between the non-executive directors of life offices (whether proprietary or mutual) and their regulator. I would recommend considering whether there should be **a formal annual meeting of the non-executive directors of a mutual life office and the FSA regulatory staff** where areas of concern or current interest could be discussed, without the presence of the executive. This should not be seen as a matter of no confidence in the executive, rather as a safeguard for both the regulator and the non-executives that all relevant issues are being addressed.

14. Q11: Although the external monitoring of mutual life offices seems rather limited, in my experience it was not as poor as that available to the member of a building society. In the latter case, a Board did not have to put any offer to its members, or explain its actions. I am not aware of whether the same freedom of action is given to the board of a mutual life office. In the same way that a public company is obliged to put any bona fide formal offer to its shareholders, a mutual life company board might be given the same obligation.
15. Q12/13/14: During the 1970s, it was widely thought that the mutual life offices would have an unbeatable advantage over the proprietary companies, in that they did not have to meet the needs of shareholders' capital. Too many companies used this potential advantage poorly, preferring to develop products without much real thought about the costs involved in distribution. The lack of accountability to shareholders turned out to be a disadvantage. In board meetings of Scottish Life that I attended during this time, I would often point out that, for our existing policyholders, selling no new policies would probably be more beneficial to their own outturns. Only by being convinced that the benefits of new business (and the use of Zillmer Adjustments) would reduce overall costs to the majority of existing policyholders (all except those with policies maturing imminently) did the board approve a growth strategy. This was, I suspect, typical of the conversations around board tables of the medium-sized mutual life companies during the early 1980s. As a result, with little pressure at the time for merger, there were simply too many medium-sized offices with relatively similar products and high distribution costs.

Similar discussions were held around the board table at Cheltenham & Gloucester Building Society (C&G) in the 1980s. The C&G was run very much as though it was already a proprietary company, and had a very successful business model. However the Board came to the conclusion that its relatively modest access to distribution was a long-term disadvantage to its members, in keeping average costs down, yet building such distribution internally was too expensive to contemplate. The decision to de-mutualise, and sell the business to Lloyds Bank followed, to the general advantage of customers of all sorts.

Most mutual companies are only driven to de-mutualise when they see the need for extra capital that cannot be generated through retained profit. The alternative model, exemplified by Nationwide Building Society, is to use the capital cost advantage wholly in the members' interests, in the form of lower borrowing rates or higher deposit rates. For a life office, that should show through in better bonus rates against a proprietary company of similar size and investment performance.

A final trigger for de-mutualisation may also be the realisation, for the current generation of members, of the retained profits of the business. For managements too the financial rewards of working in a proprietary company will tend to be higher than in a mutual.

There is no inherent reason why a mutual model should not work in the life assurance industry, provided that the boards analyse the position thoroughly. The transition of both mutual life office and building society boards in the past twenty years, from being dominated by local worthies to having more experienced business people engaged, has been striking. It is ironic that this Review has to take place despite that. The reason is that many of the decisions that led to the problems of recent years were taken when the boards really were not concentrating on the

longer-term viability of their strategies, and were indeed 'self-perpetuating oligarchies'.

What the Review must be careful to avoid is to make being a board member of a mutual life office so unattractive in personal risk terms that it proves impossible to recruit suitable candidates. The current case against the ex-board of Equitable Life has changed the perception of people who might otherwise be good candidates for mutual life office boards. Raising the standard of care (see para 10 above) would be an appropriate response, but going further might create an unintended consequence.

16. Q15/16 I have no in-depth experience to offer on either of these questions. I would only observe that there are plenty of rather odd hybrid governance and ownership companies around the world where these issues are relevant. For instance, in the governance of the Popular banks in Italy, where, although they are theoretically public companies, managements are protected through voting arrangements, present difficulties for investors and may not necessary provide the best protection for depositors.