

MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS

Response to Consultation Document

Q1. I do not unfortunately have sufficient time to review the current level of compliance by life mutuals with the Combined Code, but I suspect that it is patchy at best, and in particular my impression is that Nomination Committees are rare and where they exist inadequately constituted: as a result, there must be some doubt about the level of true independence amongst NEDs.

In my view the right approach would be for the Code to be applied in full (except of course for the provisions concerning institutional investors), with additional requirements appropriate to mutuals' circumstances, structure and business. This was the approach followed by the AITC, of whose Working Party on Corporate Governance I was a member: though the results are not perfect, they do provide a useful additional framework which was previously absent.

The essential additions relate to improved disclosure, dialogue and voting arrangements for policyholders, which can best be achieved via the formation of an adequately representative body (see response to Q7 below).

I believe that the principle of 'comply or explain' is equally relevant to mutuals, partly because it is feasible for at least some pressure to be exerted through dialogue with a representative body of policyholders, and also because of the potential for shame and embarrassment associated with public exposure of non-compliance: mutuals often like to present themselves (not wholly justifiably, in my view) as in some sense morally superior to shareholder-owned companies, and they are thus arguably more susceptible to this sanction.

Q2. The FSA should require the same statement on compliance as for listed companies, with similar oversight and updating of Code provisions by the FRC.

Q3. At least half of the board should, as for listed companies, consist of independent NEDs; I see no harm in the presence of one or two non-independent NEDs also, e.g. retired executive directors (EDs), as this could provide some useful understanding of the business and the organization (as Americans say, "of where the bodies are buried"). In a life mutual it is clearly very desirable for at least one of the independent NEDs to be a retired actuary - just as in listed companies "at least one member [of the Audit Committee should] have significant, recent and relevant financial experience" (Higgs, 2001); he/she should be a member of the Audit Committee, and also of a new committee which I would propose - Risk Management (for obvious reasons).

Q4. I am not qualified to pronounce on the quality and relevance of actuarial advice received by NEDs, but it is my experience that in other fields they are over-reliant on

information and advice provided by EDs: it seems to me clear that they should have, and be expected to use, access to independent expert advice when they require it, in exactly the same way as provided for listed companies under the Code.

Q5 & 6. I feel strongly that it would be wrong to limit in any way the role and accountability of an NED in any business, however complex and technical, and that NEDs should have exactly the same legal duties to the company as EDs. My reasons are both practical and philosophical: practical, in that it would be almost impossible to define satisfactorily which types of business were too difficult for an NED to exercise appropriate supervision over them; and philosophical, in that any NED should be required, as an outsider, to do the necessary homework to understand the key issues, and ask questions and demand comprehensible answers if appropriate. I have as a consultant in my career had to grapple with the complexities of various complex businesses, including insurance, pharmaceuticals and oil, and it is my experience that given sufficient intelligence and application it can be done - and we should require no less of NEDs. Having said that, I accept that it would be highly desirable for boards to include some individuals with the necessary knowledge and experience of the sector, and I should expect an effective Nomination Committee to ensure that. Some types of business are harder to understand than others, but it is always an issue - even relatively simple businesses such as retail have considerable complexities of their own - e.g. supply-chain management.

Q7. Policyholders are currently very little engaged, except when there is a proposal or vote on demutualization. There is certainly much scope for better information, e.g. quarterly or half-yearly updates in comprehensible terms on performance (especially that of the investment portfolio), on prospective bonus levels and the basis for determining these, and the level of risk to future payouts (all of which could properly be covered in something like the OFR envisaged for listed companies), but the key issue is empowerment: I would propose a requirement for mutuals to fund a small elected committee of policyholders, with paid staff, for collective representation through regular dialogue of their interests, which could perhaps seek board representation. It should also be given proxies by members, in order to enable it to vote them as a block, subject to suitable safeguards, to ensure that members' views commanded attention by the board.

Such a body, as well as policyholders individually, should of course be given access to a register of membership, in order to hold elections and inform and consult members directly, since the boards are clearly either unable or unwilling to do this. Voting by individual policyholders, who did not wish to surrender proxies to the representative body, could be facilitated in either or both of two ways - by ensuring that the location of General Meetings was easy of access, and by permitting electronic voting, perhaps even remotely.

Whether or not all policyholders should be members, and the means of achieving a balance between the interests of different types of policyholders, should be left to this body to resolve in a democratic way, and the board should play no part in this process. There are some categories, e.g. investors in unit-linked funds, for whom membership may be less necessary, since unlike most other policyholders they have the option of relatively easy exit.

Q8. Not much information is currently supplied to policyholders on business strategies or risks, and little account is taken of their views - how could it be, since there are no channels for consultation (apart from the AGM, which hardly counts), and it is thus largely non-existent?

Q9. No.

Q10. The FSA should require (see response to Q1 above) adherence to the Code, as supplemented by specific provisions appropriate to the sector, on a 'comply or explain' basis.

Q11. External discipline could be enhanced by the creation of a representative body for policyholders, as outlined in my response to Q7 above. This body would have access to the improved information proposed for individual policyholders, and its representatives should be able to supplement this as required through regular dialogue with the board.

Q12 & 13. The main problem facing mutuals is of course ready access to additional capital, and this is clearly one of the major forces driving demutualization, plus of course, it is not unduly cynical to say, the financial interests of the EDs, especially the CEO, in gaining access to share-based remuneration. The mutual ownership structure is appropriate to quite small businesses with a local or affinity-based identity (which is after all how it began); in these the level of identification of, and accountability to, members is high, but with larger multi-site or disparate organizations these inevitably break down, and the board becomes a self-perpetuating and unaccountable oligarchy - unless of course countervailing forces are created (see above).

Q14. It seems to me that the governance arrangements of other mutuals are open to the same objections as those outlined above, and I would therefore advocate that the remedies I have proposed should be applied, mutatis mutandis, to all other mutuals above a certain size - most obviously to building societies.

Q15. I have dealt with the issues of size and policyholder base above: it is not easy to define the criteria or cutoff points, but it seems clear that the smaller and more localized the business, and the greater the similarity between its members/policyholders (e.g. if there is an affinity basis) the less likely it is that the governance problems identified in larger mutuals will arise.

Q16. No.

Supplementary Comment: One aspect of life mutuals' governance not raised in the Document, which I believe merits attention, is that of executive remuneration. It is true that many if not most of the larger ones do have Remuneration Committees, but I believe that there is reason to doubt whether they are as effective as those in the listed sector. As a former consultant in the field, I recall an illustrative and troubling incident.

While working a few years ago with one of the largest life mutuals, I was asked by the HR Director to advise on proposed changes to the existing LTIP (which at the

time seemed unlikely to pay out); these fairly detailed proposals had been worked out by the Finance Director - one of the beneficiaries of the plan. They seemed to me unjustified, for various reasons, including the probability that they would deliver substantial rewards for little in the way of improved performance, and the fact that the existing plan had not run its full course. I spelt out my reservations in writing, and suggested a meeting with the Chairman of the Remuneration Committee to discuss them. Considerable difficulties were placed in the way of arranging such a meeting, and since I was unsure whether he had ever seen my memorandum on the proposals, I was obliged eventually to telephone him at home to explain my concerns. I later learned that the Finance Director had subsequently spoken to my firm's lead consultant (on the actuarial and insurance side) to complain that I was being "unco-operative"; he further added, I was told, that this was hard to understand "in view of the large amount of other business which they gave to the firm". I am pleased to record that no internal pressure was put on me to change my stance, but not long afterwards the firm was formally asked to make a competitive bid to the Remuneration Committee to renew its existing role as adviser to the Committee: the bid did not succeed, and the work was given to another firm. Needless to say, there was no evidence that the two events were causally connected, but I do not believe that the pressure involved in the first one would have been applied nowadays in a listed company.

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