

## **MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS**

### **RESPONSE OF THE FINANCIAL REPORTING COUNCIL**

#### **Summary**

1. The Financial Reporting Council (FRC) is responsible for the Combined Code on Corporate Governance. In considering the appropriateness of the Combined Code to life mutual companies the FRC believes it is important to distinguish between its content and the way it is enforced.
2. The FRC believes that the principles underlying good corporate governance in life mutuals are essentially the same as for listed companies. It does not consider that a separate corporate governance code for the life mutuals sector is required, but guidance on how to apply the Combined Code would be appropriate. The guidance produced for building societies by the Building Societies Association provides a possible model.
3. “Comply or explain” enforcement of corporate governance codes can only work where those to whom the explanation is addressed are able to hold the board to account. Shareholders in proprietary companies are able to do so; arguably, policyholders in mutual companies are not. The FRC suggests that the FSA should either require or incentivise life mutuals to ensure there are appropriate arrangements in place. One option might be a policyholders’ committee, such as the delegation system used by Royal Liver Assurance Ltd.

#### **Detailed response**

4. The FRC is the independent regulator responsible for promoting high standards of corporate reporting and governance in the UK. In particular, the FRC is responsible for maintaining the Combined Code for Corporate Governance.
5. The FRC’s comments primarily concern the first two questions in the consultation document:
  - To what extent does the current guidance on corporate governance particularly the Combined Code provide an appropriate framework for mutual life offices? Would another approach be more effective?
  - What is the best way of securing mutual life offices’ compliance with corporate governance best practice?

**Question 1: To what extent does the current guidance on corporate governance particularly the Combined Code provide an appropriate framework for mutual life offices? Would another approach be more effective?**

6. The Combined Code provides guidance on various aspects of corporate governance including board composition, professional development and internal control. With the exception of the sections of the Code concerning relations with shareholders, the guidance is as relevant to life mutuals as to proprietary companies. Our understanding is that, in general, large mutuals already follow the existing Code where relevant and explain departures.

7. The consultation document raised questions about board composition (question 3) and the role of, and support given to, non-executive directors (questions 4 to 6), and asked whether the circumstances of the life mutuals sector required a separate code to deal with these issues.

8. On the question of board composition, the FRC does not believe that the nature of mutuals has any implications for the balance between executive and non-executive directors on the board. It seems appropriate to have a model similar to listed companies, so that there is a strong executive presence and an equally strong challenge from the NEDs.

9. Moreover, even if the review were to conclude differently, the FRC does not consider that a separate code would be required. The Combined Code is already capable of being applied flexibly (for example, it recognises that the requirement that at least half of the board comprise independent NEDs may not be appropriate for smaller listed companies).

10. Similarly the FRC considers the issues about the role and professional development of NEDs in life mutuals to be specific examples of more general issues. The need for information and advice for NEDs within life mutuals should be no different to that in any other complex or proprietary business, and this is not the only sector to present NEDs with complex business problems. While the particular skills and experience needed on the board of a life mutual may differ from other sectors, the principles remain the same.

11. The FRC does not therefore consider that a separate corporate governance code is necessary. The preferred approach would be for an appropriate body to produce sector specific guidance on how mutual life companies should apply the principles in the Combined Code. This is already common practice, especially where the Code is not directly applicable. For example, the Quoted Companies Alliance has recently published guidance on the Code for smaller quoted companies and is in the process of producing guidance for companies listed on AIM.

12. The FRC commends the approach taken by the Building Societies Association. The guidance they have produced for their members, which we understand is due to be published in September, reproduces the full text of the Combined Code and provides commentary on how its provisions should

be applied. For example, the guidance offers advice on how the parts of the Code concerning the provision of information to shareholders could be applied to the building society's borrowing members.

**Question 2: What is the best way of securing mutual life offices' compliance with corporate governance best practice?**

13. The FRC accepts that the "comply or explain" approach to enforcement can only work for life mutual companies if the policyholders are able to exert the same degree of influence as shareholders are in proprietary companies.

14. The FRC believes that it may be possible to put in place arrangements that may have this effect. For example, we understand that Royal Liver Assurance Ltd operates a "delegation" system. Under this system, the policyholders elect a "Delegation" that represents their interests at the AGM. There are about 230 delegates who elect a chairman at the start of the meeting. They challenge management and vote on management remuneration and on the strategic plans. One NED on the board is an elected Delegation member.

15. There may also be other models and, as suggested by question 15, other arrangements may be appropriate in smaller mutuals or those operating in niche markets where policyholders have a common background

16. The FRC believes that the review should look at different options under which the FSA would either require or incentivise life mutuals to put in place appropriate arrangements to ensure policyholders have the ability to enforce a "comply or explain" regime. This might be done, for example, by making the existence of such arrangements a condition of authorisation under the Financial Services and Markets Act, or by making it clear that the FSA would take direct action (perhaps along the lines suggested by Lord Penrose) if the company did not put suitable arrangements in place voluntarily.

17. If the review were to conclude that it was not possible to replicate the role of major shareholders, then the FRC considers that direct enforcement by the FSA through its existing or extended powers might be a more appropriate solution than inviting the FSA to act as a surrogate for policyholders in a "comply or explain" system. There are clear difficulties in asking a regulator to operate a regulatory regime under which non-compliance is acceptable in some circumstances. There might also be concerns among listed companies that judgements made by the FSA on compliance by life mutuals under such an arrangement might indirectly have the effect of limiting their flexibility under the Combined Code.