

17 September 2004

Myners Review
Room 4/16
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Dear Sirs

Myners Review of the Governance of Life Mutuals

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (for example, pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorized investment funds (collective investment schemes).

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Our interest in the governance of mutual life companies is from two standpoints:

- as institutional investors in that a mutual may demutualise and seek a listing in the future; and
- as fund managers who may manage funds on behalf of a mutual.

As such it is helpful if there is a history of good governance.

We welcome the report and believe that the questions raised are timely and focused in seeking to improve the corporate governance of mutual life companies. We consider that existing Company Law, in conjunction with the Combined Code, has provided a satisfactory framework for the governance of publicly listed companies and would welcome the extension of this framework, modified as appropriate, to mutual life companies.

That said, mutual life companies, in contrast to listed companies, have no share capital or shareholders and are owned by their policy holders. A mutual operates by investing policy holders' premiums in a range of assets which are held in a pooled fund. The mutual has discretion to operate the fund particularly over investment strategy and bonus policies, and will "smooth" payments in order to cushion policy holders from fluctuations in asset prices. To enable this to work, in contrast to a company where shareholders have the option of selling their shares, in the interests

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of protecting the pool, the costs of entry and exit to the fund tend to be high and policy holders' contracts tend to be long term. Furthermore, the fund's operation is not particularly transparent and policy holders have few powers.

Thus, as recognised in the CP, whereas ordinarily a company's board is held to account by its shareholders the same is not true of a mutual whose policy holders are relatively powerless. We consider that this places even greater importance on the role of the board and that the board's independent, non-executive directors need to exercise even greater oversight of the executive than they do in a company where there are shareholders. In this respect, we believe that the recent declaration by the US's Securities and Exchange Commission requiring mutual fund companies to, and the Financial Services Authority's ruling that listed investment trusts must, have an independent chairman should also apply to mutual life companies. In addition, given there is limited effective outside engagement, mutual life companies should, at least have a majority of independent non-executive directors on the board and consideration given to them having a completely separate supervisory board. Whatever the structure, there needs to be a framework to hold the executive to account and to align management's and policy holders' interests.

We set out in the attached annex some detailed comments on the questions in the CP. Please do call me on 020 7 269 4668 if you would like to discuss any of the points in this letter or the attached or if you would like to discuss any issues further.

Yours faithfully

Liz Murrall
Senior Adviser – Corporate Governance

IMA RESPONSE TO THE CONSULTATION PAPER (CP) ON MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS

The IMA's detailed comments on the questions in the CP are set out below.

Q1. 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?

Existing Company Law, in conjunction with the Combined Code, has provided a satisfactory framework for the governance of publicly listed companies and we would welcome the extension of this framework, modified as appropriate, to mutual life companies. The governance of mutuals is of interest to a wide range of parties and, as they may well seek a listing in the future, we consider that it would be helpful if there is a history of good governance.

That said, a mutual life company differs from a publicly listed company in that there are no shares or shareholders and the "persons with whom business is done are the persons for whom business is done" (paragraph 1.3). Any revised code for mutuals needs to recognise their structure and the limited powers of policy holders, and as the CP acknowledges, would need to be tailored to the specific circumstances of mutuals. In particular, the following sections would need to be amended:

- Section 1, sub-section D, Relations with Shareholders, which covers the dialogue with institutional shareholders (D.1) and constructive use of the AGM (D.2); and
- Section 2, sub-section E, Institutional Shareholders, which covers their dialogue with companies (E.1), evaluation of governance disclosures (E.2) and shareholder voting (E.3).

Q2. What is the best way of securing mutual life offices' compliance with corporate governance best practice?

As noted in the CP, listed companies are required by the listing rules, made and enforced by the Financial Services Authority (FSA), to make a statement on their compliance with the Combined Code.

The FSA's requirements are wider ranging for mutual life companies in that, in order to be able to conduct their business, they have to be authorised and supervised by the FSA and comply with the FSA's rules. As regards their governance, they must meet the threshold conditions for authorisation, have a board that conducts itself according to the standards expected, and comply with the "fit and proper" test which gives the FSA the power to assess the fitness and propriety of board members and other senior management positions (paragraph 3.23). They may choose to make a statement on their compliance with the Combined Code but it is entirely voluntary.

We consider that it would be helpful if it was an FSA requirement for mutual life companies to comply with corporate governance best practice and make a statement on their compliance with the Combined Code, modified as appropriate. This would help to improve their governance and make it more transparent - as a mutual may demutualise and seek a listing in the future; it is helpful if there is a history of good

governance. Furthermore, compliance with the Code would ensure that they had a chairman who is independent of the executive (Code Provision A.2.2) and that at least half the board include independent non-executive directors (Code Provision A.3.2).

Q3. In your opinion, should the ownership structure or the nature of the business conducted by a life mutual affect the composition or structure of its board? If so, how?

As noted, a mutual life company has a distinct structure in that it does not have shares or shareholders and those with whom business is done are the persons for whom business is done. This is different to the position of proprietary companies where a tension exists between the owners and managers (paragraph 3.16) such that the former are able to hold the latter to account. As noted in paragraph 3.36 of the CP, this means that in promulgating a mandatory corporate governance code for mutuals, the degree of supervision of the executive by the board may need to be increased to address this.

As noted in the covering letter, we believe that the recent declaration by the US's Securities and Exchange Commission requiring mutual fund companies to, and the Financial Services Authority's ruling that listed investment trusts must, have an independent chairman should also apply to mutual life companies. In addition, the balance of non-executive representation on the board or its powers should be increased. Indeed, given the special structure of mutual life companies, consideration may need to be given to establishing a separate supervisory board. It may also be helpful if policy holders were to increase their involvement in the running of the mutual which could be facilitated, for example, by making it easier for them to vote at general meetings (paragraph 3.42).

Q4. In your experience, is the information and advice (including actuarial advice) used by the non-executive directors of life mutuals sufficient – in terms of quality and relevance – to enable them to exercise effective oversight of the executive? In what ways might it be improved? If more information and advice is needed, what are the resource implications? Do similar issues arise for the non-executives of other complex businesses, such as wholesale banking or science-based businesses?

We are not in a position to assess whether the information and advice currently used by mutual life companies' non-executive directors is sufficient, although it would appear that in the Equitable Life situation it was not. Whatever the existing position, it is important that non-executives are adequately informed to enable them to exercise their oversight function. In this respect, we believe that the supporting principles to Principle A.5 of the Combined Code on Information and Professional Development, should apply in that:

"The chairman is responsible for ensuring that the directors receive accurate, timely and clear information.....

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfill their role both on the board and on board committees."

Furthermore, Code Provision A.5.2 requires the board to "ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors".

This question has wider implications than just for mutual life companies in that similar issues arise for the non-executives of other complex businesses.

The question refers to the role of the “non-executive directors”. In this respect, we believe it is important that sufficient non-executive directors are also independent of mind and can challenge and question. Independence of management should be a key qualification for the role and this should be clear and the word “*independent*” should be added so that it is the role of the “independent non executive directors” that is considered as opposed to simply the “non-executive directors”.

Q5. What is the role of the non-executive director in a complex or technical business? In particular what is their capacity to understand and to challenge the executive over technical aspects of the business?

As in any business, be it complex or technical, or otherwise, non-executive directors are not involved in the day-to-day running of the company which can enable them to bring a fresh perspective and an objective approach to a variety of matters. Thus they can scrutinise, constructively challenge and monitor the management team. They can also help in developing the company's overall strategy.

However, non-executive directors can only be effective in this if they have the capacity to understand, and to challenge the executive over, technical aspects of the business. Thus particularly in the instance of complex or technical businesses, they need to have the necessary skills, knowledge and experience required. To help ensure this, we believe it is important for the experience and capabilities required, and the responsibilities of the independent non-executive directors to be set out clearly in writing. This would help those taking on the role understand better what is required and expected of them. In this respect, Code Provision A.4.2 states, “the nomination committee should evaluate the balance of skills, knowledge and experience on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment”.

Furthermore, the board of a listed company is required to satisfy itself that “at least one member of the audit committee has recent and relevant financial experience” (Code Provision C3.1). Given the specialist nature of a mutual life company's business, we consider that in the interests of ensuring that the non-executives have the right skills, at least one should have direct experience of mutual life companies.

Q6. What can the owners of a complex or technical business reasonably expect of its non-executive directors? How would you characterise the practical limitations of a non-executive director? What steps might be taken to codify what is reasonable and realistic in this context? Should executives and non-executives have the same legal duties to the company?

Again, this question has wider implications than just for mutual life companies in that similar issues arise for the non-executives of other complex businesses. In the interests of ensuring the proper functioning of a company's board or boards, the executives and non-executives should have the same legal duties to the company.

That said, within that board structure, different individuals have different roles. The IMA believes that there is a clear, distinct and important role for directors who do not form part of the executive management team running the company day-to-day. By bringing a fresh mind to a problem, unhindered by the detailed debate that will have

gone on in the run-up to a proposal, they can provide an important leavening of the decision process. With an independent but informed perspective on key decisions, non-executives can bring fresh ideas and thinking to bear. They can also ensure that proposals from executive management are thoroughly and rigorously tested before being finalised and acted upon. Their ability to achieve this is dependent on them having the necessary skills, knowledge and experience required. As noted under question 5, we consider that it is important that the role and capabilities required are defined in writing.

Specifically, a mutual life company's policy holders have relatively few powers as compared to shareholders. Thus, as noted under question 3, in promulgating a mandatory corporate governance code for mutuals, the degree of supervision of the executive by the board may need to be increased to address this.

Q7. What role should policyholders play in the running of mutual life companies? Are there practical barriers to policyholder participation in UK life mutuals? What action would be needed to allow more effective engagement?

This question is outside the IMA's remit.

Q8. Lord Penrose says that in a life mutual "...it is the policyholders who are the source of the risk capital for the enterprise." (Chapter 20, paragraph 51). What does this mean for the relationship between a mutual life office and its policyholders?

This question is outside the IMA's remit.

Q9. Lord Penrose acknowledges that the FSA's work since 1997 "...has sought to anticipate many of the lessons that might be drawn by this inquiry, and it should come as no surprise that it has largely succeeded in that." (Chapter 30, paragraph 3). In so far as corporate governance is concerned, do you agree?

This question is outside the IMA's remit.

Q10. Is there a further role for the FSA to play in improving firms' corporate governance?

Our views on the FSA's role in improving life mutual companies' governance are set out above under question 2.

Q11. Listed companies are subject to the influence of their shareholders, particularly large shareholders, and the risk of takeover. What market forces are most relevant for mutual life offices? How effective are they in promoting good performance and how might they be enhanced?

This question is outside the IMA's remit.

Q12. Do specific barriers exist to the success of mutual businesses in the UK? If so, how might they be addressed?

This question is outside the IMA's remit.

Q13. What are the forces that drive de-mutualisation? What are the implications of demutualization for members and customers?

This question is outside the IMA's remit.

Q14. What specific governance arrangements currently apply to other financial mutuals? In what ways do their governance arrangements differ from those that apply to life mutuals? Which, if any, of the options for life mutuals could be applied more widely in the financial mutual sector? What would the consequences be?

Although this question is outside the IMA's remit, we believe consideration should be given to applying the generic options in paragraphs 3.34 to 3.47 to other types of financial mutual.

Q15. Do small, affinity group-based, mutual life firms face different governance issues from the largest firms in the sector?

This question is outside the IMA's remit.

Q16. Are you aware of effective governance regimes for life (or other) mutuals in other countries? Is this the result of a formal (regulatory or government) requirement or is it voluntary, driven by the industry? Are there aspects of the arrangements in other countries that it would be desirable and practical to adopt in the UK?

This question is outside the IMA's remit.