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The Myners Review
Room 4/16, HM Treasury
1 Horse Guards Road
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8 September, 2004

Dear Paul,

To follow up the submission made by the Association to your Review in my letter of 25 August, I would like to pick up some further issues which we feel the Review should also consider.

At the end of that previous letter, I alluded to the level of inconsistencies that exist between mutuals as regards current governance practice in their relationships with, and representation by, their members/owners. Because of this level of inconsistency and in many cases lack of representation, we feel strongly that the Review needs to look at the practices of **every** single mutual and that it should then be for **them** to argue (if they wish) as to why a "one size fits all" (i.e. one member, one vote) system of member/owner representation, at the very least, should not be imposed rather than vice versa. In terms of your initial Consultation paper, our views here touch on several of the Questions you list, but principally Q2, Q7, Q14, and Q15.

To illustrate the problems, and how much needs to be changed over hopefully a short space of time, we would like to use this letter just to highlight three specific examples, which might highlight the wider issues.

1. **The Royal London Mutual Insurance Society – AGM Voting**. With the recent decision by the management of Standard Life to attempt to abandon mutual status, Royal London is arguably left as one of the principal flag bearers of mutuality in the Life sector. In our view, it also appears to have a capable, vigorous and approachable senior management team. However, the Rules of this major Society do not match the needs of a "modern" mutual, in that there is no provision for Postal or Proxy AGM voting at all – qualifying members/owners can only do so by attending the AGM in person. Having done so myself this year and having seen the numbers present, it is no exaggeration to say that if a group of malcontent policyholders had decided to subvert the meeting, it would have taken no more than a large coach party of them to do so and prevent the re-election of the two incumbent Directors who were standing (including the Chairman!) However the potentially serious consequences of Rules which do not fit modern mutuality do not appear to have spurred the Royal London Board to rapid action.

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We would add, that in the whole of this leading Life Office's extensive website we only found the word "mutual" (or mutuality) mentioned a total of 10 times (and we happily stand to be corrected if others can be found!) - this included 4 times in a standard phrase for the bottom of Press Releases, and twice in reference to a question about ELAS and Standard Life at the AGM. Most of the others form part of a stock phrase such as "Wesleyan is a mutual assurance society, which was founded in 1841." The only, and general, reference to what mutuality means is a definition of barely two lines in the Glossary section. **Nowhere** on an extensive and well-developed website for the business does it say what being a current or prospective policyholder/member of the Society implies in terms of governance and ownership.

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However they illustrate the widespread problems of inconsistency and the fact that change to a more inclusive and substantive member/owner participation in the running of financial mutuals often does not come speedily or voluntarily. We would therefore urge you to look at the practices current at **each and every** financial mutual and ensure that it is compulsory for them all to be brought rapidly into line with what should be best practice – examples of which we gave in our last submission. In this conclusion, there is also some further relevance to your Q15. We believe that size or affinity has no part to play in whether these improvements should be implemented or not – mutuals evolve over time, as does their market. Some of the problems we have identified in this submission appear to have arisen because the development of best mutual governance practice has not in any way matched the growth of the business itself over many years. It is therefore vital that the governance model implemented for mutuals of any size today must be robust enough to stand the test of time.

Once again, please note that if it is more convenient for your team we can email this submission as well, and would be happy to do so upon request. There are a few more pertinent points to your Review that we will wish to make in a further letter and submission to follow closely on from this one.

Yours sincerely,

Steve Huxham
for The Investors' Association

Strengths and Weaknesses in Building Society Corporate Governance

Steve Huxham, Founder Member and Spokesman, Investors Association

Building Societies Association Conference – 5th May 2004

Good morning ladies and gentlemen, and thanks to our conference Chairman, and to the BSA for inviting me here this morning to address you all. Now if it's good enough for our Prime Minister to start a meeting with an apology it's plenty good enough for me (although I hope that is where any remote similarity ends!) so, since I was asked to broadly reprise the speech I delivered to the BSA/Mutuo Conference last November I will apologise in advance to those of you who were there and have therefore heard much of this content previously.

I was conscious at that meeting that some of the audience might not have been best pleased to see me on that platform, and that might also be true for some of you today. If so, that is a shame, but as I joked last time around, in November I didn't need the Kevlar armoured vest as part of my preparation, and I trust I won't today either!

Last time around I also joked that perhaps the Association being present might be akin to putting Daniel into the lions' den. I must confess that this same thought came to me a few weeks back as I sat in the audience as the Treasury Select Committee quizzed Lord Penrose (very mildly by their usual standards!) and I realised that this would be perhaps the first large gathering of mutuals' Directors following his report. Given the impact of his findings generally though, perhaps this time we need to perhaps wonder who is playing Daniel and who is taking the role of the lions this time?

Joking aside, and perhaps for those of you that don't realise it, I trust that one of the reasons I do get invited to speak is that the Association does try very hard to take a balanced approach and hand out plaudits as well as brickbats. This has been seen in both our commentary and in the product surveys we have done. Fortunately the number of journalists who still don't recognise this and attempt the occasional "mutual basher" jibe is thankfully very small indeed. Just as well bearing in mind that the principal targets of the IA's ire at any one time are often not mutuals – at present it is for example almost anyone who sends out unsolicited blank credit card cheques, which hopefully rules most of you out, I'm pleased to say.

The BSA and several of you, I know, already recognises that we do indeed try to take an even-handed approach, and even more so, we believe in **dialogue and engagement**, wherever possible and wherever you are willing. Our presence here at another conference is one more step down that constructive path.

And so to the subject – the wide-ranging remit of "Strengths and Weaknesses in Building Society Corporate Governance." This is indeed a vast topic, and in the time allotted I can do no more than scratch the surface with what I believe are a few key topics, and then to set you all some challenges too. Firstly though, let me pick up on a key positive - you are all still here!

This is no facile comment. Rather, it is a factor that you should all be very proud of as you carry out your duties. Here today we have collectively organisations which between them represent many hundreds of years of mutual tradition. The fact that you are here and thriving is proof enough that the mutual model still works and has relevance in the 21st Century. Of course I do also recognise that some of you are under pressure, perhaps as never before, due to the pace of market changes, increased competition, and dare I say it, the ever-increasing burden of regulation, as well as many other factors. Dare I say it too, but you in the Building Societies sector are often, we find, well ahead of your mutual brethren in the Life and Friendly Societies

areas – apologies to some of the BSA Associates present for saying that, but you know who you are!

All that considered, our view is that the mutual model has some distance to travel to consistently match the best practice set by some members of your community, let alone the demands of the market. I am afraid too, that I must also remind the audience once again that public confidence in the mutual model has also been undermined in recent times, not only by the demutualisation fad of the late 90's, but more recently and pertinently by the Equitable Life fiasco and the findings of Penrose. Recent events at Standard Life, where a senior management team who fought so passionately for the mutual cause only four years ago now also stands to make great gain from “the mother of all U-turns”, hardly help matters...

This brings me to the three areas of challenge that I have set out before and want to set to and for you today. They come under the broad headings of - **enfranchisement, representation, and governance.**

Enfranchisement, representation, and governance.

Let us start with **enfranchisement**. Like so many of the issues surrounding the mutual movement, what I find most strange here is the inconsistency of standards between one organisation and another.

What is almost uniform of course is the annual Directors report notes that arrive at AGM time with the inevitable line that runs something like “...we are owned by our members and therefore we do not have to pay dividends to shareholders, nor do seek to maximise profits.”

Fine words indeed, and ones, as I say, that can be found on the AGM report for most mutuals, but what do they mean? Do they come from the heart (of the Board members who penned them) or are they a convenient get-out for poor performance? Or are they seen as a useful Marketing tool of differentiation as opposed to the lifeblood of the organisation? Some of my audience may well be shocked to hear such questions, but I suspect others will not, even if they do not admit it openly. It is to that latter group that I pose those questions...

So where does enfranchisement come into this? Put simply, and if you will all pardon my language for a moment:

If this mutuality thing is so damn good, why isn't it good enough for all the customers who do business with you?

Of course, we have extremes even represented here at the conference today. We have some Societies which broadly operate in the same core areas of saving and lending that they always have done, but we have others (and some mutual Associates too) who now operate diversified businesses and have acquired or set up myriad subsidiaries, whose customers are often not members/owners. Why? Last time I spoke on I particularly gave the example of non-BSA member - the Co-operative Group, or as they style themselves as “one of the worlds largest consumer co-ops.” They have an increasing record of shareholder activism in other businesses in which they invest, so why is it that a customer of Smile, their bank, is not automatically a member? Why if I buy an insurance policy from CIS am I not again automatically a member? I have to say that I have seen nothing yet in the recent announcements by Martin Beaumont there that give me optimism that this will change soon.

I could give examples “closer to home” for this audience, but it might be rude to name the names, as once again you know who you are. If it is a trend for some Building Societies to acquire non-mutual banks, or other assets, or establish non-mutual subsidiaries, all reporting to

the mutual parent Board, but whose customers are not “members/owners” then is this actually demutualisation by stealth? Does it serve as a vehicle to grow the business without increasing the accountability of the Board? Is the mutual model not good enough for those customers?

I can't answer those questions – only you can. But I have to say to you all, it is simply not good enough and it is not acceptable. If you don't really believe in mutuality, then please come clean about it on this subject, but if you do, then the fact is that the numbers of members/owners of mutuals in the UK could be significantly increased at a stroke. There are no excuses – Rules and other blocks could be amended, if you had the will to do so.

We say; enfranchise all your customers now, and shame members of your community who refuse to do so.

I move on to **representation**. Once again I am afraid to say that the old maxim “the curate's egg” comes to mind when we consider the mutual sector – it can be “good in parts.” It's the parts that are not so good that give cause for concern. I should say though that we do appreciate that being a mutual can give rise to some unusual and demanding situations – that relationship between the management and the members/owners remains one that is charged with issues as to how it should operate most effectively and efficiently, particularly when some of those owners decide to challenge the Board, as we have seen on occasion in the past. Perhaps a political analogy can be drawn here. Just as politicians are elected to serve all members of a constituency, including those who did not vote for them, then so should mutual Directors be elected year on year to serve and represent **all** of their members/owners, including those who might disagree with the Board's agenda.

But who or what acts as a genuine guarantor of an “ordinary” member's interest on a mutual Board? How do mutual Boards ensure they are genuinely representative of what members at “grass roots” level want of their mutuals? As I say, it's rather a mixed bag I am afraid to report. If there was a “silver lining” at all that the sector gained from the pain of the demutualisations of the late 90's, it probably was that the name, the history, the brand (and the products?) were not good enough in themselves to guarantee a continuation of the mutual model.

That did indeed prompt a reaction. Mutuals (or at least some of them) recognised that they had to communicate with, and generally engage with their grass roots more, and we do indeed see more evidence of that around us today. We note positively for example the measures some Societies have employed to dramatically increase the numbers voting in annual elections. The added inducement of donating a set number of pence to charity for each postal ballot received which some of you have taken up is a great – more of you should, and by the way the idea still seems largely confined to Building Society mutuals at present, so please do spread the word to your colleagues elsewhere!

In addition there has been a growth in the number of so-called Members Panels set up to get members engaged directly with Boards. Before the last conference I also heard of the example, where a local regional Building Society sets up a Charity panel each year from members with no input from the Board on selection, and makes their decisions on where the donations should go – again with no influence from the Board.

These are all great ideas –so far as they go...

The problem is that these “best practice” examples are not always the norm, and **neither do they go far enough.**

If we just consider AGM voting for a moment (oh, and the one or two of you who still don't put a Freepost envelope in with the notice and/or “bury” the voting paper at the back of the SFS –

please make this the last year that happens!) then numbers voting at AGM time as a percentage of total membership would still generally be classed as a “low turnout” by most politicians.

So we have to ask ourselves, do all of these initiatives, worthy (if patchy) though they are, amount to little more than a bit of tinkering or tokenism? Only you know the answer to that one in your hearts. But I would say that they circumvent the main issue here – **why is there not owner involvement/representation at the very heart of your business?**

Yes, I do mean the Board, and yes, I’ve heard all the arguments against too – they mostly run along the lines of “this is a complex financial services business and we need to have appropriately qualified individuals on the Board.”

Of course you do, and when you are recruiting Executive Directors and NEDs I can usually see that you aim for someone who is, let’s say, a Regulatory, or an IT, or an HR, or a Finance expert - I am a Search & Selection Consultant when doing my “day job” after all, so I know a little about these things! That’s all fine – **but what has it got to do with being a Mutual?**

So, in terms of representation, we believe that you all need to have a Board member (whether Executive or NED) who is independent, who speaks for the members on the Board because he/she is an “ordinary” member, and who has been elected without nomination, any influence or any interference whatsoever from the rest of the Board.

Before anyone misunderstands me, I am not speaking here of those individuals who stand perennially at some mutuals as “rebels” against existing Board members who are up for re-election. This idea is radically different – it is about creating the new and additional category of “Member Director” who is within the inner sanctum of the Board, and is there to act as the voice of the owners, and to ensure the mutual acts with transparency for the benefit of the owners. I’ll leave the practical mechanics of this to another debate (i.e. how many nominations should a candidate need to stand, should he/she stand for one or more terms of office, etc) but the fact is it could be done, **if the will was there.**

Does this prospect scare any of you? Well, let me be blunt – if it does I suggest you start asking yourself why you are a Mutual, and do you want to stay that way? Because I can assure you of one thing – this idea will certainly not go away from here on in. I for one would always prefer to see such a cultural shift come about as a self-generated move that you all embrace, but willingly or unwillingly, one way or another it will come.

You say Mutuality is different – well then show us!

Finally, I move to **governance** itself. We take the view that, whatever his or her previous career background, anyone taking up a senior appointment at a mutual must recognise the unique status of such an institution, and the need for correspondingly greater, rather than lesser, standards of accountability and governance, compared to other corporate models. I am always reminded of the conversation I had some time ago with a mutual CEO who made the observation that if he wanted to work for a plc he and his Board colleagues would earn rather more than their present, admittedly generous, salaries. However he stated that he preferred the status quo, and felt that all his colleagues were genuinely in accord over the topic. I tell you that I have never had cause to doubt his word whatsoever.

I think the point is here that we have no problems with the earnings of mutual Boards, as long as they represent rewards for success, not mediocrity, stagnation or failure, and irrespective of what headlines those packages may attract. The key issue is that they are transparent, measurable, and that we do not see above inflation rewards simply for average performance year on year, or

indeed for cost cutting measures that impact on ordinary members such as branch closure programmes.

We also believe that these Board packages should be subject to transparency and member approval, and have been pleased to see that some of you have taken a firm lead on this. Others have been more reticent thus far. Well the good or the bad news I have for you all, depending on your perspective, is that in this area at least “size really **doesn’t** matter!” We will be looking for improvements next year!

Moving on I have to say that we are also broadly in accord with Higgs as far as governance is concerned, but it is an ongoing source of disappointment to us that some mutuals appear to have to be dragged kicking and screaming into 21st Century governance best practice, rather than being the beacons of innovation that you truly should be. Why is it that we still have mutuals where Director contracts run longer than a 12 month period and we see no particular inclination to change? Why do we still have mutuals where Non-Executive appointments are permitted to serve for longer than what are now commonly accepted maximum periods? Why do we have mutuals where NED appointments are not made in an open and transparent way, so that applications can be welcomed from all comers? And lastly, why do we have annual voting papers where the “preferred answers” the Board wants are heavily highlighted, voting instructions given, and the negatives boxes shaded out – all in a way that would quite blow the mind of a Returning Officer if such practices were attempted in a political election.

The message from me is quite simple – **all such practices and similar ruses are quite unacceptable**, and damage the reputation not just of the perpetrators but of the mutual movement as a whole. Some of you have, I accept, made considerable progress in righting the wrongs of the past. Others have not. I would contend therefore that it is the duty of **you all** to put not only your own house in order, if need be, but also that of your mutual neighbour.

So there we have it – the challenges of enfranchisement, representation, and governance, which I set before you. Will you rise to them, and “encourage” your mutual colleagues to do the same? If you don’t I would contend that they will be visited on you anyway – it’s simply a question of time –but in that time the reputation of the whole sector will erode, if you do not act now.

Just to conclude, I was grateful to the Financial Times the other week, which reminded us that corporate governance is by no means a new subject – Adam Smith wrote in the late 18th century that Directors, as managers of money that is not their own, could not be expected to watch over it “with the same anxious vigilance” as if it were their own. Perhaps in that context, looking back to the historical origins of your own Societies holds the key to future success, and maybe even survival, along the lines that I have suggested.

Genuinely “getting back to the roots” means going far further than any of you have already ventured, but if you are willing to take up rather than flunk that challenge, it might mean that you can grasp the opportunity to be seen as both ahead of the rest of the non-mutual market and readily differentiated from it. I hate to end on a negative note but I do really wonder if for some of you it might even be that taking up the challenge really is the difference between life and a slow lingering death for your own Society? If that is potentially so, then do you actually have a choice?

Thank you.

Please visit The Investors' Association at:
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