

Myners Review of the Governance of Life Mutuals

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In the answers below, the use of non-executives should be taken to mean independent non-executives. It is important that shareholders or policyholders interests' are represented by directors who are independent of the management of the company or society. Non-executives serving on the board of a mutual life company who are not independent of management would find it difficult to exercise the oversight required to safeguard policyholders' interests.

Q4.

It is not possible to be certain about the quality of information supplied to directors of mutual life companies, and we have no direct evidence of its sufficiency.

Non-executives play an important role as guardians of the interests of policyholders in a mutual life company. The nature of life mutuals is such that this role is not primarily about any financial conflict of interest or the "agency problem", but rather about the risk management and distribution philosophy. In order to fulfil this function, non-executives need to be party to important strategic policy decisions, and to exercise oversight over the process by which other tactical decisions are made, and the basic assumptions which underpin these decisions. The fact that the business might appear complex or highly technical should not be an obstacle to effective independent oversight and if anything should provide an even greater motivation because of the inevitable opacity of certain decisions.

Proper training of all directors is an essential pre-condition to understanding the information and advice presented. In this area there is every reason for a mutual to adopt provisions of the combined code which deal with this point, which envision an independent chairman taking responsibility for the quality of information and an adequate level of skills. In other businesses with large risks, there is also a clear need to understand enough about the business to exercise oversight. There has been improvement in this area in the UK, especially after the Turnbull and Smith reports but it is quite likely that shareholders are still too dependent upon a small subset of independent directors with adequate knowledge. It should not be regarded as an impossible task to find directors with sufficient willingness and ability to acquire the necessary skills.

In the case of actuarial advice, one would have to conclude that the current schism in the profession between those proponents of financial economics, and those of the traditional school is very likely to give rise to confusing or inconsistent advice. A key role for independent non-executives in a life mutual should be the evaluation of risk management processes and decisions made based upon them. Advice in this area is likely to be the distillation of more complex and detailed technical work carried out by a combination of external and internal staff. It is important that the information supplied includes the theoretical basis on which the work is built in order that constructive evaluation can take place. Significant changes to the investment strategy and capital reserves of life companies brought about recently by the introduction of realistic (i.e. consistent with financial economics) measurements of assets, liabilities

and risks in mainstream life businesses would suggest that the quality of advice given to these companies has been poor, or ignored.

There are no significant resource implications in providing independent directors with adequate information since this must already exist within the society in order that the management can run the business. There are two reasons why additional resources may be required : - if the existing information is inadequate to fulfil the purpose of oversight (a somewhat alarming conclusion if it is the independent directors who make this discovery), or there is a need for completely independent advice. There is a good case for independent advice, but the cost of such advice would not be prohibitive provided that it was confined to major issues of principle or theory, and not detailed analysis of individual actions. It would then be up to independent directors to form an opinion about the validity of assumptions made (for example in calculation of bonus rates), set against the context of an analysis of the actuarial framework and theoretical basis.

Q5.

There are very few businesses that do not fall into the “complex or technical” category. This is partly because of the growth of litigation and the greater liability of boards to identify and control risks but also as a result of increasing competition and the use of technology in the production process. The role of the non-executive, amongst others, is to exercise oversight in relation to the executive and in particular to ensure that risks to shareholders have been identified properly and managed. The incidence of “rogue traders”, and the subsequent appearance of black holes in balance sheets is testimony to the failure of non-executives in these companies as much as the management. Although the cause of the losses can appear technical, the heart of the issue is very often dishonesty undiscovered because of poor information systems or controls. A knowledge of the industry without detailed technical skills can provide the non-executive with enough background to understand and challenge the executive. The non-executives willingness to do so would be influenced greatly by his or her character as much as technical knowledge and it is an important matter for the chairman and the nominations committee to ensure an adequate balance.

Q6.

It would be reasonable to expect the non-executives to have identified (with the assistance of advisors and management) the major risks within the organisation and how these had been addressed by management. In addition, how management were addressing the major strategic issues would also be an obvious part of their scope. In a technical business, it is still reasonable to expect this to take place, and a non-executive's role in preventing some of the larger shocks seen in recent years in the quoted sector in “technical” industries (Shell springs to mind), did not require deep technical knowledge. In cases where non-executives feel they need to participate in judgements involving complex issues, there may be a case for external advice if there is a possibility that management information is either too inward looking or in other ways not adequate.

The practical limitations to a non-executives duties in a very large business are considerable, as it is unlikely that the hours available would be sufficient to carry out

the role in the same way as within a smaller less complex entity. However it is for the non-executives to define what they require in terms of information in order to gain a proper understanding of the way in which the company is being run and participate at a suitable level of decision-making. Larger companies have more resources, and these should be deployed to allow the agents of the owners, in the form of non-executives to perform their oversight role.

It would be hard to codify very tightly the limits to what is reasonable as each company is different and requires a different level of oversight. Performance of all directors should be subject to review, and it would be reasonable for such a review to set out what may be achieved in the particular set of circumstances of the company in question. Such an approach would be preferable to one in which there were more widespread, and by implication general rules available. Naturally, in the event of a serious failing, the matter is likely to arrive in the courts; in such a case it is probably better to have a flexible and widely defined set of duties as the starting point, refined by the specific roles a capabilities required for each position.