

Mr. Paul Myners
H. M. Treasury
1 Horse Guards Road
London
SW1A 2HQ

15 September 2004

Dear Mr. Myners,

REVIEW OF CORPORATE GOVERNANCE OF LIFE MUTUALS

We enclose herewith our answers to the 16 “Main Questions” contained in your Consultation Document.

However the thought occurs that in so doing, our views are inevitably communicated to you in a somewhat fragmented form. Therefore we thought it may be helpful to summarise them in one document – hence this letter. We would emphasise that this is a concise summary – all the issues raised in this letter are expanded on in the individual answers.

Our overall position is that we wholeheartedly support a thorough modernising of the way Life mutuals are governed and run. We see tremendous opportunities for *well run* Life mutuals – to the benefit of individuals and society as a whole. Moreover we see this more modern approach being relevant to other types of mutual financial organisations.

In this letter we explain our views under four headings:

1. Corporate governance standards.
2. The Board.
3. Market accountability.
4. The future for Life mutuals.

1. CORPORATE GOVERNANCE STANDARDS

We believe there should be a Combined Code of Corporate Governance specifically for Life mutuals – adapted from the existing code. Moreover we believe:

- a. There should be a “ **Comply or Explain**” principle established in relation to this code.
- b. All incidences of non compliance to be explained – **in the annual report.**

- c. **Obligatory communication** of a summary of the annual report, (including all non compliance explanations), to all policyholders annually. This mailing to include;

Continued...

Continuation.../1

- * A summary of the company results.
- * A summary directors' report
- * A summary remuneration report
- * Details of forthcoming AGM.
- * Proxy voting facilities.

- d. **Oversight** of adherence to Code by an appropriate independent body – possibly this could be included in the annual audit.

We have included with our submission our suggestions on how the existing Combined Code for listed companies might be adapted for mutuals.

We believe the above measures, in themselves, would represent a major step forward in corporate governance terms for mutual Life offices.

2. **THE BOARD**

We group our thoughts here under two sub headings – the overall composition of the Board and realistic expectations regarding individual non executive directors.

a. **Board Composition**

We believe the key here is to achieve the right balance in several areas. These are between:

- * The number of executive and non executive directors.
- * **If** the mutual has a strong affinity group connection - the number of non executives with relevant experience of the affinity group.
- * Amongst non executives – the achievement of a range of key skills/knowledge.

The key areas of specialist knowledge which we believe should be present amongst non executive directors of a mutual Life office are actuarial , accountancy and regulatory. It is, of course, the case that it is unlikely that individuals who have actuarial/accountancy backgrounds are still practising technicians when they achieve the level of maturity

and business experience which qualifies them for directorships of financial organisations. Nevertheless such previous experience can be harnessed to enable the Board to exercise effective oversight of the business – provided the company's procedures are structured in an appropriate way. *Our thoughts in this area are expanded on in our answer to question 4.*

b. Realistic expectations re. non executive directors

A key question posed by Penrose is can non technical, non executive directors ever be expected to be able to exert effective oversight of a complex, technical business?

Continued...

Continuation.../2

We firmly believe that they **can**, provided:

- a. The right individuals are selected – in terms of their individual calibre, skills and experience.
- b. They are inducted and trained in the business of the company. Thereafter there is a process for the updating of such training coupled with an assessment of how they perform as directors.
- c. The information provided to directors, on which decisions are required, is presented in an appropriate manner with ample opportunity for questioning of the executive management team.

There should be structured processes in place regarding a and b above, with external professional help obtained where appropriate.

Regarding c above, the information provided should clearly demonstrate the business implications of the issue under discussion – and facilitate questioning by the directors.

We believe this system can work very well –given an executive management team which is open and honest with its board. However as regards safeguards, the newly required actuarial audit of Life company accounts will give some comfort to directors in assessing the information provided by management. Beyond that, we believe directors should have right of access to any form of independent technical advice they might feel they need – at the company's expense.

This last safeguard should be a measure which is never required, in practice, in a well run mutual – but its existence could give comfort to both non executive directors and policyholders.

3. **MUTUALS' ACCOUNTABILITY TO THEIR POLICYHOLDERS**

All our policyholders have the dual status of customers and owners. However we have carried out some research amongst our policyholders specifically to inform our response to this review – and we have examined previous relevant research.

The vast majority of policyholders see themselves as customers rather than owners – and are mainly interested in the performance of their products. Their interest in company performance would be largely met by a regular reassurance that the company was financially sound and able to meet its' future commitments.

Accordingly we summarise our recommendations on accountability under two headings;

Continued....

Continuation.../3

a. Accountability to policyholders as customers

Here we advocate the mandatory publication of key product performance data via a trusted third party – we suggest the website of the FSA. We would supplement this information with a few key company results (specifically expense ratio and balance sheet strength). This step alone would represent a major advance in market accountability. *NB For this measure to be effective - it would need to apply to listed life companies as well.*

b. Accountability to policyholders as owners

As has already been mentioned under section 1 above, we would advocate an annual communication to all policyholders which included summaries of the results, directors' report, remuneration report, company strategy—together with details on the upcoming AGM and proxy voting facilities.

We believe the above twin “accountability strategies” would result in a much more informed public (when it came to buying the products of Life companies) and offer the opportunity to engage with the management in the way the company is run .

5. THE FUTURE OF MUTUALS

Clearly the world in which we live today is vastly different from that which existed when many mutuals were created – some 100/200 years ago.

Nevertheless we see dominant societal trends emerging which could signal a renaissance of the need for mutuals. In summary these are:

- * Significantly longer life spans with a consequent need to plan for living expenses and health expenses for longer retirements/semi retirements.
- * The virtual certainty that much of this provision will have to be made by individuals themselves.
- * The consequent need for life long relationships with financial institutions in which issues of value and trust will be right to the fore.

Accordingly we see a place for *well run, accountable* mutuals – which customers know are acting in their interests and which offer better value.

As we have said, all the above is amplified in the answers to your specific questions.

If you would like us to expand further on any of these points, or require any further information from us, then, of course, don't hesitate to ask.

Yours sincerely ,

I. S. GEDEN
Managing Director

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?

Q2. What is the best way of securing mutual Life office's compliance with corporate governance best practice?

These questions naturally go together and therefore we give a combined response here.

Regarding our current practices the NFU Mutual, whilst, of course, not required to comply with the Combined Code – nevertheless seeks to do so where practical and appropriate. *(We extend this principle to as many aspects of the Code as possible. For example, for some years we have arranged an annual meeting of our largest members (by premium income) with the Board. This mirrors the Combined Code principle that the Board should maintain sufficient contact with major shareholders.)*

Where it is impractical or inappropriate to comply with the Combined Code – we explain our reasons for non compliance in our annual report. *To facilitate this whole approach we have carried a detailed “gap analysis” of the Combined Code requirements and our own corporate governance procedures – a copy of which has already been provided to the Myners Review Team.*

Looking ahead, we would strongly support the introduction of an appropriate Combined Code for all mutual Life offices. We would make the following points on this:

1. The existing Combined Code is the appropriate starting point – and we believe it can be adapted for Life mutuals. Separately enclosed with this submission is our suggestion for such an adaptation.
2. In drawing up a Combined Code for mutuals, care must be taken to allow for the differences between mutuals - particularly regarding membership rights and voting strength. For instance, within the NFUM all policyholders are members (as opposed to, say, solely with-profits policyholders). Their voting strength is determined by the amount of premium paid to us. These factors will differ in other life mutuals. Therefore the Code provisions will probably need to be expressed in general terms on these issues – and require specific commentary by individual mutuals as to how compliance is achieved.
3. Compliance with the Code should be on a “comply or explain” basis for all Life mutuals – with the requirement to explain any deviations in the annual report.
4. For number 3 above to be effective in changing the behaviour of mutual management teams – there would need to be a requirement for annual communication to all policyholders. We would advocate a communication covering;

* A summary of the results.

* A summary directors' report

- * A summary remuneration report
- * A clear exposition of areas where the Combined Code has not been complied with -- with reasons.
- * Details of the company's Annual General Meeting.
- * A facility for proxy voting on key resolutions.

Additionally policyholders could be invited to request the full annual report and accounts if they wished. However research we have very recently carried out amongst our policyholders , specifically to inform our response to this consultation, suggests few would wish to do so.

5. Finally there remains the issue of policing - to ensure companies are actually complying when they say they are. Here we would advocate that the whole issue of compliance with the code, (including the reasons given for areas of non-compliance) be covered as part of the annual external audit.

In summary we believe the combination of “comply or explain , plus communication, plus independent oversight” would represent a major step forward in corporate governance standards and accountability for the mutual life sector.

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 the Board? If so how?

Regarding the “ownership vs nature of business” issue – the nature of the business must be a significant factor in determining the composition of the Board.

However if a Life mutual does have a strong affinity connection, there is a case for some representation of the affinity interests on the Board (always with the caveat that the individuals involved must be of sufficient calibre to perform the role of Director).

It is, of course, a truism that no one individual can encompass all the skills needed to run a company. Therefore the Board of any company needs to be made up of a range of individuals - some with relevant specialist skills and, where appropriate, some with relative affinity experience. Collectively, they must have all the skills and experience needed to supervise the running of the company.

Therefore in deciding the composition of the unitary Board for a mutual Life office with a strong affinity connection – several balances need to be achieved:

- a. between executive and non executive directors (with a majority of the latter).
- b. amongst non executive directors – between “affinity directors” and “non-affinity directors”.
- c. also among non executives directors– a range of specialist skills. (*Some of the required specialist skills may be found amongst the “affinity directors”.*)

The NFU Mutual’s split of Directors is shown below – both the current position and our view of the optimum for the foreseeable future in the light of the development of our business. (The NFUM is a composite insurer, having both General Insurance and Life Insurance businesses. This affects the composition of our Board.)

<i>Executive</i>	Current
<i>Directors</i>	3
<i>“Affinity</i>	
<i>Non</i>	5
<i>Executive”</i>	
<i>Directors</i>	
<i>“Non</i>	4
<i>Affinity</i>	
<i>Non</i>	
<i>Executive”</i>	
<i>Directors</i>	

In our case the “Affinity Directors” relate to our strong farming connection.

Regarding the specialist knowledge which the non executive directors of a mutual Life office require – we believe the key areas are actuarial, accountancy and regulatory.

It must be recognised that in the vast majority of cases the individuals appointed to Board positions will be of mature years and long business experience – but are highly unlikely to be practising technicians in their original technical discipline. Hence, for instance, it would be unrealistic to expect a director of a mutual life office, who happened to be a qualified actuary – to double check the calculations of the appointed actuary of the company. Nevertheless

such individuals with actuarial/accountancy/ regulatory backgrounds could certainly be expected to understand the actuarial/accountancy/regulatory issues.

Therefore given appropriate information they could reasonably be expected to ask relevant questions and to understand the business implications of the answers. Hence they could make Board judgements. (*This whole area regarding the information provided to the Board, and the ability of non executives to act on it, is discussed more fully in our responses to questions 4, 5 and 6.*)

In the case of the NFU Mutual our Non Executive Directors include:

- * *A former Chief Executive of another Life company who is a qualified Actuary.*
- * *A current Chief Executive of a Building Society who is a qualified Accountant.*
- * *A current Euro MP who is a qualified Lawyer and formerly worked on insurance regulation.*
- * *A former Director of a Bank (and a FTSE listed utility company).*

Regarding the issue of how “life mutuals establish the relevance of candidate’s knowledge and see that it is kept up to date?” – this raises the question of the processes for selection, recruitment, induction, training, ongoing learning and performance review of non executive directors. Clearly the objective is to attract people of the right calibre; with the right background knowledge; ensure that they are fully briefed on the company’s affairs – and thereafter make a meaningful contribution to the running of the company. To achieve these objectives we would advocate an approach which has three key elements:

- * *a structured process to achieve each of the above objectives.*
- * *appropriate outside professional help where necessary.*
- * *FSA oversight of the process – both in terms of the standards it sets and its application.*

The whole of the NFUM process is described in documentation already supplied to the Myners Review team.

Regarding the Board Committee structure – we believe our own to be highly effective. (A complete list of Committees with Terms of Reference for each has already been supplied to the Myners Review team). We are about to split our Audit and Risk Committee into two separate Committees – reflecting the growing workload under each heading.

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 size based businesses?

Whilst the question asks “Is the information and advice ... sufficient?”, the implied question is “Can it ever be?”. Penrose raised the question of whether non-technical non executive directors could ever be expected to understand complex technical issues. We firmly believe that they **can** – certainly sufficiently well to make competent Board decisions.

In line with this, we firmly believe that the information the NFUM management supplies to its non executive directors is sufficient for them to exert effective oversight of the business.

To achieve such effective oversight requires separate consideration of the directors and the information they receive.

Regarding non-executive directors, they need:

- * a good overall knowledge of the market in which the company operates.
- * a good overall knowledge of the company itself.
- * a high-level training in the key technical and financial issues the company faces.
- * a more in depth knowledge of the key drivers of the business and the key risk areas - both short term and long term.
- * personal qualities of confidence and independence of thought.

How these objectives are achieved are covered in the answer to question 3.

Thereafter, the detailed Board briefings on specific issues should be characterised by a clear exposition in “layman’s terms” of:

- * the technical/financial issues involved.
- * the recommendations of the management with reasons.
- * the business implications of these recommendations.
- * a quantification of the financial and other consequences of the recommendations – as appropriate.

Such information should be sent in advance of Board meetings – with the opportunity for discussion/questioning at the Board.

This is the NFUM’s standard procedure. We have on a number of occasions supplemented this by:

- * *Having extra Board meetings (often day long) on specific matters of importance which required in-depth briefing or the in-depth review of a range of options.*
- * *Supplementing the above with the involvement of appropriate external consultants/experts who to provide advice on the issue in question.*

In addition, once a year, the Board reviews all its major decisions in the light of experience – to judge the quality of those decisions with a view to improving future decision making.

More specifically ref our Life business, the appointed actuary attends all board discussions which may impinge on his area of responsibility. The With-Profits committee allows non executive directors the opportunity to explore technical issues in greater depth, and the Audit Committee has a regular formal private session between the non executive directors and the external auditors.

Following this sort of approach, we see no reason why non-technical, non executive directors cannot be given information which both *accurately describes* the issues on which they must decide – and is *comprehensible* to them. Certainly directors have a duty to satisfy themselves that they do understand the information they are given. (In the case of the NFUM this is written into their letter of appointment.)

All that is required is an executive management team which is prepared to provide it.

This raises the issue of trust between the non executive directors and the executives. We recognise that there must be an open and honest relationship between the two parties for the system to work. (The same applies in Plc companies.)

This should very much be the norm in a well run mutual. However in terms of further safeguards it must be remembered that recent legislation requires life company accounts to include an actuarial audit. This will cater for many of the concerns raised by the case of the Equitable.

Therefore, one additional safeguard we would suggest is that Directors be given the right to seek independent actuarial (or any other form of technical) advice on an ad hoc basis at the company's expense - if they feel dissatisfied with the quality of information they are receiving from the management. In practice this should never be needed in a well run life office. However the existence of such a right could give comfort to non executive directors, and policyholders, and perhaps encourage some management teams to be more open.

Regarding other complex/technical businesses – we can only assume the same issues arise. We do have non executive directors (past and present) who have had experience on the Boards of such companies. They report that the challenges of being a Non Executive Director of a mutual Life office are not significantly different in either principle or degree – and the same approach to information provision does indeed allow for effective supervision of the management.

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 Executives over technical aspects of the business?

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?

These questions were linked in the Consultation Documents as clearly they cover related areas. Hence we have combined our answers as per the following.

We can only respond to the first part of question 5 by observing that the role of the non executive director (whether the business is complex and technical or not) is as prescribed in law – and is the same as that of an executive director. There are a range of duties – some sourced in statute law, others (e.g. fiduciary

duty and overall duty of care) found in English common law. In summary non executive directors should both challenge and support the executive management team – ultimately helping them to make better decisions.

Clearly the main focus of these questions is on the capacity, in practice, of non executive directors to fulfil this role in complex/technical businesses. We firmly believe that such Directors can understand the issues and challenges in such businesses provided:

- a. *they are recruited and inducted as per our answer to question 3 and trained across the range of subjects listed in our answer to question 4 (this training being updated as appropriate) .*
- b. *they are briefed on particular issues as per our answer to question 4.*

In assessing the competence and effectiveness of a Board we believe it is essential to both take a holistic view of the Board – and to examine Board processes. Any unitary Board is made up of a range of individuals who have different skills and experiences – but who collectively should exhibit the skills and experience required to exercise effective supervision of the company. Structured Board processes (including Committee structures etc.) are essential to ensure that issues are examined and decided upon in a appropriately rigorous way.

As to the expectations of the owners of a mutual life office – we believe they can reasonably expect non executive directors to oversee the actions of the executive management so that the business is run prudently and in their interests. More specifically the non executive directors have authority over the selection and remuneration of senior management and, if necessary, their removal. They would also set the values of the organisation – which in turn would guide the strategy.

Non executive directors also bring independence and objectivity to the Board. Given the right calibre of individual then (with the training and briefing mentioned above) we firmly believe they can play a key role in corporate governance.

Regarding possible codification of requirements for non executives generally we would suggest:

- a. *the requirement to adopt defined codes of practices for recruiting/inducting/training/appraising of non executive directors. (We would offer our own practices in these areas as a starting point for consideration. A summary of our procedures has already been provided to the Myners review team.).*
- b. *a formal qualification for non executive directors (e.g. the Institute of Directors Certificate in Company Direction covering, amongst other things, their general duties as a director) – or at least attendance at an appropriate course at a recognised business school. .*

However we would make the point that such codification should logically apply to Non Executive Directors of all types of financial services companies – not just mutual Life offices.

Finally, we firmly believe that the legal duties of non executive and executive directors should remain the same. We do not see the Board functioning properly if all the directors did not carry both the same authority and responsibilities.

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 ?

The notion of policyholders “running” a Life company is open to a wide range of interpretations - so it is necessary to define terms closely.

Day-to-day involvement with running a Life company could raise issues such as the FSA “Fit & Proper Persons” rules, the criminal records of policyholders and their level of experience and skills. We believe it is not practical, desirable or necessary to consider policyholder involvement on this basis.

Life Mutual policyholders should, however, be able to express their approval/disapproval of management actions - and our proposals in response to questions 1 / 2 would facilitate this.

However with regard to this question it is also relevant to recognise the duality of the relationship the policyholders of a Life Mutual have with their company:

- a) As customers - our research shows that most policyholders see this as the most relevant relationship. They are primarily interested in product performance and the advice/service associated with it. (Significantly enhanced accountability in this area is proposed in our answer to Question 11).
- b) As owners - our research shows that reporting of corporate performance along the lines of our answer to Questions 1 and 2 will meet the requirements of the vast majority of policyholders in this regard.

NB; Since throughout this review comparisons have been made with listed companies - it is relevant to note here that policyholders of listed Life companies have no say whatsoever in the running of those companies.

Regarding the NFU Mutual's own mechanisms for engaging policyholders and the running of the business - these are described in the attachment to this question.

However, we would strongly make the point that this structure was developed specifically for the farming community - and our research shows that farmers see the NFU Mutual as more than simply a provider of General and Life insurances. The company is seen as part of the fabric of the farming community - playing a major role in supporting its trade association and local network of trade association representatives. Therefore many farmers believe that the considerable personal time commitment required of them by our local corporate governance structure is worthwhile. They wish to see the NFU Mutual perpetuated for future generations of farmers.

We have researched this issue with our non-farmer customers - and the same level of interest in corporate governance simply does not exist . We find very few non-farmer policyholders are willing to give their time in the way that our current local corporate governance structure would require. Therefore we are currently researching other ways of engaging such policyholders, on a meaningful basis, and this work was well in hand prior to the announcement of the Myners' Review. Hence whilst this work proceeds - it will await the outcome of the Myners' Review before a recommendation is made to our Board.

As regard the differing interests of different policyholder groups - such differences do indeed exist. The challenge to ensure equity between such groups can be technically complex (e.g. balancing the needs of policyholders for different classes of business or different generations of policyholders). We firmly believe that such judgements can only be made by an impartial , well informed board.

We do not see a need for outside organisations to act on policyholders' behalves. This should not be necessary if the board of the Life Mutual is performing its function properly and accounting to its policyholders in the ways described elsewhere in this response.

APPENDIX – QUESTION 7

Main Board/ Local Boards/ County Committee structure

Since the 1930's we have operated a formal structure to maximise membership engagement with the management.

County Insurance Committees exist in England and Wales. Each county has between 12 –15 members (549 members in total) who are predominately farming policyholders. The local Regional/Branch NFUM manager makes appointments. The chairman of the committee is called a Local Director (appointed by the main board). Meetings are held once a year and act as a consumer council for the society. During the year informal contact takes place between members and local NFUM management – which maintains a continuity of dialogue.

There are 8 *Local Boards* covering specific geographical areas. Meetings are chaired by a non-executive Main Board director and are attended by Local Directors (65 in total). Local Boards meet twice a year. One meeting is at our Head Office in Stratford upon Avon. Presentations on company results , strategy and other topical issues are given by the company's top management. There is also ample opportunity for questions and discussion. There is also a local meeting attended by our regional management. The role of Local Directors is to monitor performance locally, provide feedback on local issues, help resolve problems and to perform a public relations/ambassadorial role.

The *Main Board* composes 5 non-executive farming directors, 4 non-executive non farming directors and 3 executive directors. The Board acts , inter alia, as the representative of policyholders to ensure company strategy and financial decisions reflect policyholder interests. As the non-executive farming directors chair the Local Boards they are well acquainted with the issues affecting our policyholders.

NFU Mutual Field Force

Through our distribution networks, which we own and control, we have high levels of direct contact with policyholders. A number of elements make up the field force,

- Tied agents & Staff (1,951)
 - Sales Manager / Inspectors (61)
 - Financial Consultants (113)
 - Claims inspectors (50)
 - Staff engineers (30)
 - Local Assessors (330)
- 2,535

Our focus on local service offers policyholder's regular direct contact with NFUM employees and agents and provides a channel for communication on either specific policyholder issues or broader concerns. Through our distribution network we have estimated that on average we have at least 25,000 personal customer contacts per week.

We strive to provide policyholders with the highest level of service but there is a formal complaints procedure to ensure any complaints are recorded in one central place and actioned. The complaints are analysed for trends and feedback is provided to specific business areas.

Other Engagement

Twice a year a newsletter, *Mutual news*, is produced and is made available to our policyholders by the following methods,

- Inserting in to NFU farming publications, which are sent to all NFU members, the great majority of whom we insure (circulation 93,000).
- Inserting into "NFU Countryside" magazine, which is sent to all NFU countryside members; again we insure the majority of members (circulation 75,000).
- Copies supplied to all tied agents offices for display and handout (distribution 38,000)
- *AGM*. Notice is published in Daily Telegraph, two weekly farming magazines and inserts placed in Mutual News.

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?

For this question , in particular , we would also mention the supplementary questions --- around which we have framed our response below. Some of these are;

What information is supplied to policyholders on the business strategies of their offices? In what ways are policyholders made aware of the risks attached to the strategic decisions of their boards? What account is taken of policyholders' attitudes to risk?

First, we would suggest a common sense perspective on the notion that "policyholders are the source of risk capital". It is true that the policyholders of a life mutual have the dual status of customers and owners. However their primary interest is as customers – and certainly the only money they pay into the organisation is their premiums. It is through many years of trading that surpluses are built up. It is these surpluses which provide the capital for the business.

The Board, in effect, acts as trustees of these surpluses – ensuring they are used for the benefit of (particularly) current policyholders and also future generations of policyholders. Therefore policyholders don't *subscribe* capital in the way shareholders do.

Nevertheless we wholeheartedly agree that the organisation should be run for the benefit of policyholders. The concept of "the benefit of policyholders" is a technically complex issue in itself – with different types of policyholder and different generations of policy terms. Nevertheless this complexity should not deflect focus from the principle when deciding on company strategy.

Purely by way of example this might mean:

- a. not embarking on a rapid growth strategy (whether organic or by acquisition) – unless very clearly for the benefit of existing policyholders. *For instance if such a growth strategy was driven mainly by the corporate ambition of the senior management team, but was not really in the policyholders' interests – then it would be wrong. If policyholders were best served by a strategy of steady growth then this would be the right course – unexciting though it might be.*
- b. in contrast if a mutual found itself outpaced by market developments so that it could no longer compete (i.e. it became "structurally uncompetitive") and faced the prospect of delivering steadily worsening returns – then in this case the best course might be to opt for a merger or seek an acquirer.

The above are simply examples. There may be circumstances when it is right for a mutual to grow organically, or by acquisition, or to diversify into other lines of business etc. The overriding test is whether such a strategy is in the interests of its policyholders.

We take the supplementary question of being risk averse as applying to business strategies (as opposed to the normal investment strategy of the office).

Again the primary question regarding any proposed business strategy is “is it in the policyholders’ interests?”. Assuming the answer is “yes” – then obviously the risk/reward balance needs to be examined. In broad terms one would expect mutuals to be more risk averse because they have limited options for accessing capital should things go wrong. The extent of “risk averseness” will clearly depend on the level of risk associated with the new venture and the balance sheet strength of the mutual in question.

Regarding the question of consultation with policyholders on business strategies, risks attaching and associated policyholders views - we have carried out some research on this specific issue to inform our response. A copy of the results of this are available if required.

Our policyholders overwhelmingly see themselves as customers rather than owners. They are primarily interested in product performance rather than company performance. They would like regular reassurance that the company is sound , and able to meet its’ future commitments - but beyond that interest in company strategy is very limited.

Therefore, in broad terms as regards accountability to policyholders , we believe there should be considerably more accountability on product performance (as per our answer to Q11) - but that our answer to Qs 1&2 provides sufficient improved accountability on company performance.

With regard to the specific supplementary questions quoted above we believe , with respect, that the notion of a mutual life office seeking to ascertain the views of its policyholders on corporate strategic risk , in order to gain their endorsement of corporate strategy , is;

**inappropriate - because, as stated , corporate strategy is not policyholders’ primary interest*

** impractical – because many policyholders would not have the experience necessary to make such judgements. Neither would it be a simple matter to research their attitude to corporate risk.*

** unnecessary - as the role of the board is to perform this duty on policyholders’ behalf.*

In conclusion we strongly support a greater degree of accountability from Life Mutuals to their policyholders - but along the lines of our answers to questions 1,2 & 11.

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 enquiry 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?

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

We would first say that the FSA has indeed made progress in relation to many of the key issues raised by the Penrose enquiry. We have the development of the realistic reporting regime and the external actuarial audit - which should afford a better view of the financial health of firms. The system of Arrow assessments has brought a focus on how well run firms are.

Beyond these, the Treating Customers Fairly initiative is clearly aimed at achieving higher standards of “corporate good behaviour” by firms towards their customers. Whilst it is still early days for this initiative, the fact that it will be principles based rather than rules based suggests the industry should see genuine cultural change in this whole area (in the customers’ favour).

Nevertheless it is true that these initiatives by the FSA are focused on the more immediate financial concerns of policyholders. The broader issues covered by the Combined Code of Corporate Governance are not, to date, obligatory for mutual life offices. We have already advocated, in our answers to questions 1 and 2, that this should change. However we believe the policing role in relation to such a code would be more appropriately carried out by including code-observance in the annual audit.

We would advocate the FSA:

- * develop their role as “trusted third party information provider” by requiring all life companies to post on the FSA website details on past product performance, expense ratio, balance sheet strength and complaints record with the Financial Ombudsman Service. These ideas are expanded on in our answer to Q11.
- * develop mechanisms to ensure that well governed companies enjoy lighter touch regulations. *(The FSA must resist any temptation to automatically “raise the bar” on corporate governance standards – no matter what standards it finds within a company. This approach would provide no incentive for companies to improve their standards. Rather, the reward for companies which consistently demonstrate good standards should be a less onerous inspection regime.)*
- * drop the idea of an FSA Board appointee. We believe this would present the FSA with a conflict of interest impossible to resolve - and could also constrain the entrepreneurial instincts on the board to the company’s detriment.

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

We would first observe that the listed company model is far from flawless in terms of ensuring good corporate behaviour -- nevertheless we believe mutual life offices should be more accountable to their policyholders. The question is, in what way?

We would first observe that virtually all policyholders enter into a relationship with a life mutual as customers. They are primarily interested in the performance of the products they have purchased (and also the service they receive). For the vast majority of customers the only aspect of company performance which is of interest to them is balance sheet strength – as this has implications for the company’s continued ability to offer good investment returns etc.

There are independent surveys of product performance and they have existed for many years. However they are not comprehensive (because participation is voluntarily and some companies refuse to take part) – and they appear in specialist financial magazines which tend to be read by the financially literate minority.

However mandatory communication of product performance by individual Life companies to their own policyholders would be of limited value because:

- * on the company’s product performance generally there would be concern about lack of objectivity on any comparisons with the market as a whole.

- * information on performance of customers' individual products is invariably limited as, for instance, it is impossible to predict maturity values years ahead.

Nevertheless we believe it would be possible to publish information which could make life companies more accountable. There are three aspects of life company performance, in particular, which if published by a trusted third party would raise the level of awareness and debate amongst the investing public. These are:

1. past performance of investment products – whilst such figures are no guarantee to future performance they are nevertheless the most up to date factual comparison that exist between alternative investing institutions.
2. expense ratio and balance sheet strength – the best guide to the current efficiency and financial strength and hence sustainability of investment performance. (*The new “realistic reporting” basis introduced by the FSA helps here, although further guidance on its application will be needed to ensure fair comparability between firms*).
3. Financial Ombudsman Service - complaints analysis. Essentially data on the number of complaints found in the policyholders' favour.

Obviously strict parameters would have to be defined for each of the above to ensure comparability of information between companies. (*Under the Financial Ombudsman's complaints analysis, for instance, it will be necessary to relate the number of complaints to the company's overall number of policyholders to get a valid, proportionate perspective.*)

We would suggest the FSA itself is the most obvious “trusted third party” which should publish this information. Its website already contains information on product charges for all life companies. We suggest this could be extended with the information above.

The consequence of doing this would be that the information would be readily available, first hand, to anyone who cares to access it via the internet – and would also be readily available to a wide range of financial journalists in both the specialist and popular press.

We would finally observe that this approach would, of course, need to be made mandatory for all life companies – both mutuals and Plc's.

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

Q13. What are the forces that drive demutualisation? What are the implications of demutualisation for members and customers?

The key underlying question here is whether or not there is a role for mutual financial institutions (particularly life offices) in the modern world? If so – what is that role and what type of mutual organisation is required to fulfil it?

We firmly believe that not only does there continue to be a role for well run mutuals – but that the role is growing. To demonstrate this, and to answer some of the supplementary questions raised in the Consultation Document, it is instructive to take a brief look at the origins of the mutual movement.

Originally mutuals were all about two key things – value and trust.

The original terminating building societies majored on availability of funds and value – they offered the only viable means for many ordinary people to buy a house.

The original life mutuals majored on trust. Early in the 19th century growing numbers of people were recognising the need for long term savings and investment contracts. Yet actuarial science was in its' infancy and there was great suspicion of the new, mainly privately owned, insurance companies which were beginning to offer them. Essentially the fear was that either:

- a. *the owners would extract excessive profits from the funds leaving little to pay out over the long term, or*
- b. *the owners would over charge to ensure they covered their liabilities – thereby offering poor value for money for the policyholders.*

It was only with the advent of mutual Life offices that the industry really took off. For instance in the US the longest term contract from proprietary companies was only for 7 years by the mid 19th century. It was the mutual sector which successfully introduced whole of life contracts.

When the “dividend advantage” is also taken into account, the combination of trustworthiness and superior value offered a powerful combination.

After some 150 plus years we now have many types of mutuals across the world. The relative lack of accountability of mutual company management has meant that in some cases inefficiencies have crept in – to the extent that in some companies they more than outweigh the “dividend advantage”. Nevertheless, credible international studies (certainly within Europe) have shown that, in aggregate, life mutuals have continued to offer better value than their Plc competitors – and overall have continued to demonstrate lower expense ratios.

However the 1980's and 1990's have seen significant market changes. The combination of deregulation and advances in technology have created new options for virtually all financial institutions. Consequently we have seen both growth by acquisition and significant diversification. This has altered both the scale-economics of financial institutions, and the choice of products and services they can offer their customers. There have been huge implications for the capital required to continue to compete in the market.

Like all other financial services companies, mutuals have been forced to re-examine fundamental issues such as the market sectors in which they compete and the business model they employ.

Some mutuals were well run companies, but took the view that the nature of their business model meant that they would need to follow their Plc counterparts down a high growth/diversification route – which was simply not possible because of lack of capital. Therefore they were forced to demutualise and either list or be acquired by larger companies. Some mutuals had relatively weak balance sheets and could not finance even the organic growth required to maintain their scale economics. Therefore they had to follow the same route. Some mutuals, sadly, seemed to lose touch with their policyholders – failing to distinguish themselves in terms of either service or policyholder value. Such mutuals were particularly vulnerable to demutualisation initiatives. Some mutuals were well run companies – but had uninvited offers made to their policyholders by larger companies who were seeking to enter the Life Assurance market. The Boards of these companies were obliged to put such offers to their policyholders – and in some cases the policyholders accepted.

In all cases the implications for the policyholders, long term, were that the company was no longer being run in their interests only. The primary interest, henceforth, would be the interests of the shareholders. The interest of the policyholders was simply a means to satisfying that end.

Looking ahead, society is entering virgin territory in many respects. People are living considerably longer. Increasing resources will be needed for both their ordinary living expenses and their healthcare needs. Inevitably we are moving into an age of much greater self provision for these needs. This will mean that lifelong relationships with financial institutions will become much more widespread and very important. Individuals will be hugely dependent on such relationships for their whole standard of life during the last, perhaps, 25% of their lifespan. Consequently the issues of trust and value will be, once again, at the forefront of peoples' minds.

Therefore we believe consumers would like to see a renaissance of the mutual model. True we don't have the 19th century dominant societal characteristics of widespread personal poverty and industry actuarial ignorance. Instead we have widespread consumer scepticism of both financial institutions and government; a much higher level of consumer awareness regarding their rights – yet a continuing low level of consumer knowledge of financial matters.

Therefore we believe the circumstances are ripe, in principle, for mutuals to make a very positive contribution to the emerging financial services market.

There are barriers to the future success of mutuals. The two principal ones are:

a. *Size*

These days there are certain fixed costs associated with running a financial services business – such as technology and compliance. Therefore a certain scale is necessary in order to keep these costs proportionate.

b. *Access to Capital*

Whilst mutuals do have ways of accessing capital they do not have the options available to listed companies. Therefore a business strategy which requires regular access to large amounts of capital is unlikely to be viable for a mutual.

In terms of future overall market significance, this will vary by sector and will be influenced by the number and size of the existing mutual firms. Mutuals are still significant in the mortgage market, less so in the life market (ignoring the Equitable and also Standard Life in view of its' pronouncements about its' future).

But having said the above, we are firmly of the belief that there are many business models which could be viably followed by a mutual. If an individual mutual can identify a market sector and devise a business model which allows:

- * ongoing efficient operating expenses.*
- * the provision of competitive products and trustworthy advice.*
- * the maintenance of balance sheet strength.*

then it has the ingredients for future success. Especially in the light of emerging market trends mentioned above. We are sure this is possible in our own case – and indeed we are sure it is possible for some other mutuals.

Tomorrow's successful mutual will certainly be different to many of the mutuals of the past. They will be tightly managed organisations, efficiently run, financially strong – and fully accountable to their members. Such "lean and mean, muscular but responsive mutuals" we see as being the model for the future.

In fact an umbrella organisation for such mutuals has been formed in recent years. Mutuo (lead patron Gordon Brown, the Chancellor of the Exchequer) has been formed to research and promote the contribution "modern mutuals" can make to the modern world.

Finally, it should be remembered that the presence of successful mutuals in a market has a moderating effect on the overall level of the market pricing. A 1998 report by the American Strategy Consultants, Conning & Company, said: "Because the mission of a mutual is to provide low cost insurance, mutual profit margins and returns on capital generally are lower than those of their stock counterparts. As a result, there is greater price competition as mutuals exert downward price pressure on the entire industry. This is a positive outcome for all policyholders – not just those of mutuals – and a negative one for the shareholders of stock insurance companies, whose returns are lower than they would be if they had no mutual competitors."

Admittedly this comment was made of the US market - which has a much larger mutual presence in its' General and Life Insurance markets. Nevertheless there will be a similar effect in the UK - dependent on the size of the mutual presence in the sector in question.

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?

In response to these questions we would first observe that we have been developing our own corporate governance procedures over the last 15 years or so. In so doing we have looked mainly to the listed public company sector – as clearly this now has the strictest standards of corporate governance and most of the corporate governance reviews have focused on it.

Accordingly, as mentioned elsewhere, we have analysed closely the Combined Code of Corporate Governance and adopted it wherever practical for our own organisation – even though this was not compulsory. We have also adopted the “comply or explain” principle – explaining deviations from the Code in our annual report.

Regarding the corporate governance practices in other types of mutuals - we don't feel able to comment with authority on these. However there is one well known practice which we do feel should be applied to life mutuals – and that is the current requirement on Building Societies to mail their members annually with information on the company's results, the Annual General Meeting and offering proxy voting facilities. We would also support the recommendations of the Building Societies Association that these proxy votes cover the summary directors report and remuneration report.

Notwithstanding our belief that the primary interest of a life mutual's policyholders is in product performance – we believe life mutuals should also engage with their policyholders on company performance. An annual communication of this nature would be an essential part of the process for ensuring that mutuals did “comply or explain”. It would also make it much easier for policyholders to make their views known on the running of the organisation as a whole, should they wish to do so.

(As a matter of practicality it would need to be recognised that the computer systems of some life mutuals have not been developed to carry out such an exercise. For instance, this type of mailing would require a perfectly de-duplicated list of members – whereas some Life companies' computer systems are policy based rather than customer based. Therefore a time period would have to be allowed for the development of appropriate computer systems.)

Regarding ideas contained in this submission which may be applicable to other mutuals – we would suggest three areas for consideration:

- 1. an appropriate version of the Combined Code of Corporate Governance be developed for other mutuals – and coupled with a “comply or explain” principle.*
- 2. structured processes to select, recruit, induct, train, and appraise Board Directors.*
- 3. relevant product (and possibly company) performance data to be published by a trusted independent third party.*

We would suggest the external auditors could have a role in policing numbers 1 and 2 above and the FSA could play the role of trusted third party regarding number 3.

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

This is a question on which we could only speculate as it is outside our experience. In consequence we do not think it would be helpful, or indeed right, for us to speculate – so we feel unable to answer this question.

Q16. Are you are 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 companies that it would be desirable and practical to adopt in the UK?

We are a UK company and have no experience of the regulatory regimes which obtain in other countries for mutuals. Therefore we do not feel we can answer this question with any authority.

<p>Preamble</p>	<p>It is intended that this Code will apply for reporting years beginning on or after 1 November 2005.</p> <p>The Code contains main and supporting principles and provisions. The company will report on how it applies the main and supporting principles. The company has either to confirm that it complies with the Code’s provisions or – where it does not – provide an explanation.</p>
<p>Main Principle</p>	<p>Every company should be headed by an effective Board, which is collectively responsible for the success of the company.</p>
<p>Supporting Principles</p>	<p>The Board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board should set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The Board should set the company’s values and standards and ensure that its obligations to its members and others are understood and met.</p>
	<p>All directors must take decisions objectively in the interests of the company</p>
	<p>As part of their role as members of a unitary Board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning.</p>
<p>Code Provisions A1.1</p>	<p>The Board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the Board operates, including a high level statement of which types of decisions are to be taken by the Board and which are to be delegated to management.</p>
<p>A1.2</p>	<ul style="list-style-type: none"> • The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees. It should also set out the number of meetings of the Board and those committees and individual attendance by directors. The company should make clear where different titles are used for individuals fulfilling the above roles.
<p>A1.3</p>	<ul style="list-style-type: none"> • The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman’s performance (as described in A.6.1) and on such other occasions as are deemed appropriate.
<p>A1.4</p>	<ul style="list-style-type: none"> • Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the Board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the Board, if they have any such concerns.

A1.5	<ul style="list-style-type: none"> The company should arrange appropriate insurance cover in respect of legal action against its directors.
A2	Chairman and Chief Executive
Main Principle	There should be a clear division of responsibilities at the head of the company between the running of the Board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.
Supporting Principle	The chairman is responsible for leadership of the Board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with members is taking place. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive Directors.
Code Provisions A2.1	The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the Board.
A2.2	The chairman should on appointment meet the independence criteria set out in A.3.1 below. A chief executive should not go on to be chairman of the same company.
A3	Board balance and independence
Main Principle	The Board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the Board's decision taking.
Supporting Principles	The Board should not be so large as to be unwieldy. The Board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the Board's composition can be managed without undue disruption..
	To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the Board of both executive and non-executive directors .
	The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.
	No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee

<p>Code Provisions A3.1</p>	<p>The Board should identify in the annual report each non-executive director it considers to be independent*. The Board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgement. The Board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:</p> <ul style="list-style-type: none"> • has been an employee of the company or group within the last five years; • has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company; • has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme; • has close family ties with any of the company’s advisers, directors or senior employees; • holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; • has a significant interest in the company either through membership rights or through being a significant policyholder; or • has served on the Board for more than nine years from the date of their first election. <p>* A2.2 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman.</p>
<p>A3.2</p>	<p>Except for smaller companies*, at least half the Board, excluding the chairman, should comprise non-executive directors determined by the Board to be independent. A smaller company should have at least two independent non-executive directors.</p> <p>* A smaller company is one that has less than £25m turnover throughout the year immediately prior to the reporting year.</p>
<p>A3.3</p>	<ul style="list-style-type: none"> • The Board should appoint one of the independent non-executive directors to be the senior independent director (“SID”). The senior independent director should be available to fairly assess and appropriately respond to policyholders concerns, relating to the operation of the company*, which contact through the normal channels of chairman, chief executive or finance director has failed to resolve or for which such contact is inappropriate. <p>* Concerns and complaints specifically relating to a member’s policies with the company should continue to be dealt with according to existing regulation.</p>
<p>A4</p>	<p>Appointments to the Board</p>
<p>Main Principle</p>	<p>There should be a formal, rigorous and transparent procedure for the appointment of new directors to the Board.</p>
<p>Supporting Principles</p>	<p>Appointments to the Board should be made on merit and against objective criteria. Care should be taken to ensure that appointees have enough time available to devote to the job. This is particularly important in the case of chairmanships</p>
	<p>The Board should satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the Board.</p>

<p>Code Provisions A4.1</p>	<p>There should be a nomination committee which should lead the process for Board appointments and make recommendations to the Board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available* its terms of reference, explaining its role and the authority delegated to it by the Board.</p> <p>* The requirement to make the information available would be met by making it available on request and by including the information on the company's website.</p>
<p>A4.2</p>	<p>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.</p>
<p>A4.3</p>	<p>For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the Board before appointment and included in the annual report. Changes to such commitments should be reported to the Board as they arise, and included in the next annual report. No individual should be appointed to a second chairmanship of a FTSE 100 company, or non-quoted company of a similar size.*</p> <p>* Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.</p>
<p>A4.4</p>	<p>The terms and conditions of appointment of non-executive directors should be made available for inspection*. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the Board before appointment, with a broad indication of the time involved and the Board should be informed of subsequent changes.</p> <p>* The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the AGM (for 15 minutes prior to the meeting and during the meeting).</p>
<p>A4.5</p>	<p>The Board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company, or non-quoted company of a similar size, nor the chairmanship of such a company.</p>
<p>A4.6</p>	<p>A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to Board appointments. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.</p>
<p>A5 Information and professional development</p>	
<p>Main Principle</p>	<p>The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the Board and should regularly update and refresh their skills and knowledge.</p>
<p>Supporting Principles</p>	<p>The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.</p>

	The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the Board and on Board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.
	Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the Board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required.
	The company secretary should be responsible for advising the Board through the chairman on all governance matters.
Code Provisions A5.1	The chairman should ensure that new directors receive a full, formal and tailored induction on joining the Board.
A5.2	The Board should 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. Committees should be provided with sufficient resources to undertake their duties.
A5.3	All directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that Board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the Board as a whole.
A6	Performance evaluation
Main Principle	The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.
Supporting Principle	Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for Board and committee meetings and any other duties). The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the Board and, where appropriate, proposing new members be appointed to the Board or seeking the resignation of directors.
Code Provision A6.1	The Board should state in the annual report how performance evaluation of the Board, its committees and its individual directors has been conducted. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.
A7	Re-election
Main Principle	All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The Board should ensure planned and progressive refreshing of the Board.

Code Provisions A7.1	All directors should be subject to election by qualifying members at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable qualifying members to take an informed decision on their election.
A7.2	Non-executive directors should be appointed for specified terms subject to re-election and to Companies Acts provisions relating to the removal of a director. The Board should set out to qualifying members in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to qualifying members when proposing re-election that, following formal performance evaluation , the individual's performance continues to be effective and to demonstrate commitment to the role. Any term beyond six years (e.g. two three-year terms) for a non-executive director should be subject to particularly rigorous review , and should take into account the need for progressive refreshing of the Board. Non-executive directors may serve longer than nine years (e.g. three three-year terms), subject to annual re-election. Serving more than nine years could be relevant to the determination of a non-executive director's independence (as set out in provision A.3.1).
B1	The Level and Make-up of Remuneration*
Main Principles	Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.
Supporting Principle	<p>The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance. They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.</p> <p>* Views have been sought by the Department of Trade and Industry by 30 September 2003 on whether, and if so how, further measures are required to enable shareholders to ensure that compensation reflects performance when directors' contracts are terminated: See "Rewards for Failure": Directors' Remuneration – Contracts, performance and severance, June 2003.</p>

Code Provisions B1.1	<i>Remuneration policy</i> The performance-related elements of remuneration should form an appropriately significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of policyholders and to give these directors keen incentives to perform at the highest levels. The performance-related elements should be designed in such a manner that executive directors are incentivised to take an appropriately long-term view and consideration should be given to such issues as financial prudence, service to policyholders and expense efficiency as well as policyholder returns. In designing schemes of performance-related remuneration, the remuneration committee should follow the provisions in Schedule A to this Code.
B1.2	Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role.
B1.3	Where a company releases an executive director to serve as a non-executive director elsewhere , the remuneration report* should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is. * As required under the Directors' Remuneration Report Regulations.
B1.4	Service Contracts and Compensation The remuneration committee should carefully consider what Compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.
B1.5	Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.
B2	Procedure
Main Principle	There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.
Supporting Principles	<ul style="list-style-type: none"> The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration. Where executive directors or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.

Code Provisions B2.1	<p>The Board should establish a remuneration committee of at least three, or in the case of smaller companies* two, members, who should all be independent non-executive directors. The remuneration committee should make available** its terms of reference, explaining its role and the authority delegated to it by the Board. Where remuneration consultants are appointed, a statement should be made available** of whether they have any other connection with the company.</p> <p>* A smaller company is one that has less than £25m turnover throughout the year immediately prior to the reporting year.</p> <p>** The requirement to make the information available would be met by making it available on request and by including the information on the company's website</p>
B2.2	<p>The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the Board but should normally include the first layer of management below Board level.</p>
B2.3	<p>The Board itself or, where required by the Articles of Association, the qualifying members should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the Board may however delegate this responsibility to a committee, which might include the chief executive.</p>
B2.4	
C1	Financial Reporting
Main Principle	<p>The Board should present a balanced and understandable assessment of the company's position and prospects.</p>
Supporting Principle	<p>The Board's responsibility to present a balanced and understandable assessment extends to information sent to members prior to an AGM as detailed in schedule D2.4 below, and reports to regulators as well as to information required to be presented by statutory requirements</p>
C1.1	<ul style="list-style-type: none"> • Code Provisions <p>The directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.</p>
C1.2	<p>The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.</p>
C2	Internal Control*
	<p>Main Principle</p> <p>The Board should maintain a sound system of internal control to safeguard policyholders' interests.</p> <p>* The Turnbull guidance suggests means of applying this part of the Code.</p>

C2.1	The Board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report in the annual report that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.
C3	Audit Committee and Auditors
Main Principle	<p>The Board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.</p> <p>* The Smith guidance suggests means of applying this part of the Code.</p>
C3.1	<p>The Board should establish an audit committee of at least three, or in the case of smaller companies* two, members, who should all be independent non-executive directors. The Board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.</p> <p>* A smaller company is one that has less than £25m turnover throughout the year immediately prior to the reporting year.</p>
C3.2	<p>The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:</p> <ul style="list-style-type: none"> • to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them; • to review the company's internal financial controls and, unless expressly addressed by a separate Board risk committee composed of independent directors, or by the Board itself, to review the company's internal control and risk management systems; • to monitor and review the effectiveness of the company's internal audit function; • to make recommendations to the Board, for it to put to the members for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor; • to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements; • to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.
C3.3	<p>The terms of reference of the audit committee, including its role and the authority delegated to it by the Board, should be made available*. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.</p> <p>* The requirement to make the information available would be met by making it available on request and by including the information on the company's website.</p>

C3.4	The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.
C3.5	All companies, other than those defined as smaller companies*, should have an internal audit function. The audit committee should monitor and review the effectiveness of the internal audit activities . Where, for a smaller company*, there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the Board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report. * A smaller company is one that has less than £25m turnover throughout the year immediately prior to the reporting year.
C3.6	The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors . If the Board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the Board has taken a different position.
C3.7	The annual report should explain how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded .
D1	Dialogue with members and other policyholders
Main Principle	There should be a dialogue with members and other policyholders based on the mutual understanding of objectives. The Board as a whole has responsibility for ensuring that a satisfactory dialogue with members and other policyholders takes place.
Supporting Principles	The Board should keep in touch with member and other policyholder opinion in whatever ways are most practical and efficient.
Code Provisions	
D1.1	The Board should state in the annual report the steps they have taken to ensure that the members of the Board, and in particular the non-executive directors, develop an understanding of the views of members and other policyholders about their company, for example through direct face-to-face contact, outputs of member and other policyholder forums, and surveys of member and other policyholder opinion.
D2	Constructive Use of the AGM
Main Principle	The Board should use the AGM to communicate with members and to encourage their participation
Code Provisions D2.1	The company should count all proxy votes and, except where a poll is called, should indicate the level of proxies lodged on each resolution, and the balance for and against the resolution and the number of abstentions, after it has been dealt with on a show of hands. The company should ensure that votes cast are properly received and recorded.

D2.2	<ul style="list-style-type: none"> The company should propose a separate resolution at the AGM on each substantially separate issue and should in particular propose a resolution at the AGM relating to the report and accounts and, on an advisory basis, the remuneration of directors.
D2.3	The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.
D2.4	<p>The company should arrange for the Notice of the AGM and related papers as well as a summary document providing company information to be sent to all qualifying members at least 20 working days before the meeting.</p> <p>The summary document should include information on:</p> <ul style="list-style-type: none"> compliance with this Combined Code; financial performance; remuneration of directors; social, ethical and environmental issues; and the approach taken to maintain a dialogue with members and other policyholders, including the role of the senior independent director. <p>The summary document should include the directors' remuneration report and should make reference to the availability of the latest company report and accounts on request and on the company's web-site (unless report and accounts are sent to all members).</p>
E1	
E2	
E3	
Schedule A1	<ul style="list-style-type: none"> Provisions on the design of performance related remuneration <p>The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to be aligned with the interests of policyholders. Upper limits should be set and disclosed.</p>
Schedule A2	The remuneration committee should consider whether the directors should be eligible for benefits under long-term incentive schemes.
	(Note: this clause has been excluded as we believe it is designed to relate to long-term share option schemes that have the potential to adversely impact shareholder value in quoted companies.)
Schedule A3	Payouts under all incentive schemes should be subject to challenging performance criteria reflecting the company's objectives. Consideration should be given to criteria which reflect the company's performance relative to a group of comparator companies in some key variables.
Schedule A4	Payouts under long-term incentive schemes should normally be phased rather than awarded in one large block.
Schedule A5	In general, only basic salary should be pensionable.
Schedule A6	The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.

Schedule B1	<ul style="list-style-type: none"> • Guidance on liability of non-executive directors: care, skill and diligence Although non-executive directors and executive directors have as Board members the same legal duties and objectives, the time devoted to the company’s affairs is likely to be significantly less for a non-executive director than for an executive director and the detailed knowledge and experience of a company’s affairs that could reasonably be expected of a non-executive director will generally be less than for an executive director. These matters may be relevant in assessing the knowledge, skill and experience which may reasonably be expected of a non-executive director and therefore the care, skill and diligence that a non-executive director may be expected to exercise.
Schedule B2	<p>In this context, the following elements of the Code may also be particularly relevant.</p> <p>(i) In order to enable directors to fulfil their duties, the Code states that:</p> <ul style="list-style-type: none"> • The letter of appointment of the director should set out the expected time commitment (Code provision A.4.4); and • The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. The chairman is responsible for ensuring that the directors are provided by management with accurate, timely and clear information. (Code principles A.5). <p>(ii) Non-executive directors should themselves:</p> <ul style="list-style-type: none"> • Undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company (Code principle A.5 and provision A.5.1) • Seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice. (Code principle A.5 and provision A.5.2) • Where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, ensure that they are recorded in the Board minutes (Code provision A.1.4). • Give a statement to the Board if they have such unresolved concerns on resignation (Code provision A.1.4)
Schedule B3	<p>It is up to each non-executive director to reach a view as to what is necessary in particular circumstances to comply with the duty of care, skill and diligence they owe as a director to the company. In considering whether or not a person is in breach of that duty, a court would take into account all relevant circumstances. These may include having regard to the above where relevant to the issue of liability of a non-executive director.</p>
Schedule C1	<ul style="list-style-type: none"> • Schedule C: Disclosure of corporate governance arrangements The Listing Rules require a statement to be included in the annual report relating to compliance with the Code, as described in the preamble. For ease of reference, the specific requirements in the Code for disclosure are set out below: The annual report should record:
	<ul style="list-style-type: none"> • a statement of how the Board operates, including a high level statement of which types of decisions are to be taken by the Board and which are to be delegated to management (A.1.1);
	<ul style="list-style-type: none"> • the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees (A.1.2);

	<ul style="list-style-type: none"> the number of meetings of the Board and those committees and individual attendance by directors (A.1.2);
	<ul style="list-style-type: none"> the names of the non-executive directors whom the Board determines to be independent, with reasons where necessary (A.3.1);
	<ul style="list-style-type: none"> the other significant commitments of the chairman and any changes to them during the year (A.4.3);
	<ul style="list-style-type: none"> how performance evaluation of the Board, its committees and its directors has been conducted (A.6.1);
	<ul style="list-style-type: none"> the steps the Board has taken to ensure that members of the Board, and in particular the non-executive directors, develop an understanding of the views of members and other policyholders about their company (D.1.1).
	<p>The report should also include:</p> <ul style="list-style-type: none"> a separate section describing the work of the nomination committee, including the process it has used in relation to Board appointments and an explanation if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director (A.4.6);
	<ul style="list-style-type: none"> a description of the work of the remuneration committee as required under the Directors' Remuneration Reporting Regulations 2002, and including, where an executive director serves as a non-executive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (B.1.3);
	<ul style="list-style-type: none"> an explanation from the directors of their responsibility for preparing the accounts and a statement by the auditors about their reporting responsibilities (C.1.1);
	<ul style="list-style-type: none"> a statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary (C.1.2);
	<ul style="list-style-type: none"> a report that the Board has conducted a review of the effectiveness of the group's system of internal controls (C.2.1);
	<ul style="list-style-type: none"> a separate section describing the work of the audit committee in discharging its responsibilities (C.3.3);
	<ul style="list-style-type: none"> where there is no internal audit function, the reasons for the absence of such a function (C.3.5);
	<ul style="list-style-type: none"> where the Board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the Board has taken a different position (C.3.6); and
	<ul style="list-style-type: none"> an explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded (C.3.7).

	<p>The following information should be made available (which may be met by making it available on request and placing the information available on the company's website):</p> <ul style="list-style-type: none"> • the terms of reference of the nomination, remuneration and audit committees, explaining their role and the authority delegated to them by the Board (A.4.1, B.2.1 and C.3.3); • the terms and conditions of appointment of non-executive directors (A.4.4) ; and • the terms of reference of any remuneration consultants, together with a statement of whether they have any other connection with the company (B.2.1).
	<p>The Board should set out to qualifying members in the papers accompanying a resolution to elect or re-elect:</p> <ul style="list-style-type: none"> • sufficient biographical details to enable qualifying members to take an informed decision on their election or re-election (A.7.1). • why they believe an individual should be elected to a non-executive role (A.7.2). • on re-election of a non-executive director, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role, including commitment of time for Board and committee meetings and any other duties (A.7.2).
	<p>The Board should set out to members in the papers recommending appointment or reappointment of an external auditor:</p> <ul style="list-style-type: none"> • if the Board does not accept the audit committee's recommendation, a statement from the audit committee explaining the recommendation and from the Board setting out reasons why they have taken a different position (C.3.6).