



The Actuarial Profession

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consultation response

Myners review of the governance of life mutuals

September 2004

MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS

The UK Actuarial Profession is pleased to have been invited to respond to the Consultation Paper on the Myners review. A considerable number of members of the profession work, or consult, in mutual life offices and friendly societies which, notwithstanding the problems at Equitable Life, have generally produced good value returns for their policyholders both in absolute terms and relative to their proprietary company competitors.

Many of the questions raised are not strictly within the remit of the actuarial profession, but nevertheless we have supplied answers to all of the questions posed with the exceptions of questions 14, 15 and 16 where either our knowledge of the issue is limited or we believe it is otherwise inappropriate to express a view. Our response to question 12 has been limited to issues of regulation.

Before answering the specific questions posed, we think it is important to emphasise that for most policyholders, their relationship with the life insurer is dominated by the customer/provider link. The ownership aspect of the relationship is very much a secondary consideration, except where demutualisation is an issue and even then only when payment for the buy-out of membership rights is likely to be substantial. We believe that more information might be provided at outset to policyholders explaining the rights and obligations and the risks and rewards from membership of a mutual.

The emphasis on the customer/provider link has to be borne in mind when considering the relative merits of the corporate governance structures of mutual and (particularly listed) proprietary companies. In the latter, with-profits policyholders have no right to any say in the running of the company (although their rights are protected by the FSA Handbook). It is suggested that shareholder scrutiny provides safeguards in a listed company not found in a mutual, but shareholders' interests may run counter to those of (particularly) with-profits policyholders. Hence, the advantages of the corporate governance structure for listed companies may not be all they seem in the context of a with-profits company.

Turning to the questions posed, we would respond as follows:

1. Not all of the requirements of the Combined Code can be readily translated into a mutual environment, for example the elements related to contact with significant shareholders. Further, the scale of many mutuals and the small amounts held by individual savers need consideration. In practice, we believe it would be necessary to produce a bespoke Combined Code for life mutuals largely based upon the code for listed companies but not identical to it; care would be needed to reflect the various types of membership rights found in such organisations. It should be noted that most mutuals already have similar board committee structures to those prescribed in the Combined Code for listed companies.

Compliance with the Code should be made compulsory subject to the requirement to disclose deviations in the annual report. Subject to the caveat below, all members not receiving the full annual report should receive a summary financial statement including the following information:

- A summary of the results for the past year
- If applicable, the capital position statement envisaged by FRED34

- A clear exposition of areas where the Combined Code has not been complied with – with reasons for non compliance
- Details of the company's Annual General Meeting
- A facility for postal voting on key resolutions

The caveat referred to above refers to cost considerations. We believe that a mutual should, on cost grounds, be able to restrict distribution of the summary financial statement, subject to justifying this to the FSA. In this connection, it is important that the FSA recognises the appropriateness of excluding industrial assurance policyholders from this requirement, as otherwise costs charged to asset shares would be disproportionate to the small sums involved.

2. Monitoring of the Combined Code could be undertaken by the FSA. The results of such monitoring could be discussed at the regular Arrow visits.
3. Where a company markets to an affinity group, it is reasonable for non-executive directors to include some representatives of the group. Such representatives, however, must meet normal criteria for non-executive directors, and it might be expected that general training needs could be particularly high in such cases.
4. We believe that appropriate, understandable, actuarial advice is generally available to the boards of mutual life companies. Practitioners' experience is that such advice is challenged by board members, although we do believe it is important for boards to include an actuary (preferably with recent practising experience) amongst its non-executive directors to make this challenge fully effective. The actuarial profession could introduce a certificate scheme for actuaries acting as non-executive directors for life companies to support standards in this area. Trust in the actuarial information provided will also be enhanced by the new audit requirements of the FSA and the introduction, by the actuarial profession, of peer review of the work of the With-Profits actuary. Notwithstanding the above comments, in cases where the system is not working adequately we do believe that it would be a useful safeguard if directors could have the right to seek independent actuarial advice. Such advice would be provided at the expense of the organisation and the mere existence of the right should ensure that management teams are more open.
5. & 6. It seems appropriate to respond to these two questions together. The legal position (which is common to both mutual and proprietary companies) is that the duties of non-executive directors are the same as those of an executive director, and to summarise they should both challenge and support the executive management team. We would not wish to see a change to this position. It is a responsibility of the FSA to check the composition of insurance company boards to ensure that:
 - Each individual is a fit and proper person
 - Taken as a whole, the board is technically competent to fulfil its statutory role including the fair treatment of its customers.

We believe that the membership of all boards of insurance companies (particularly life mutuals) needs adequate actuarial and accounting representation in order to challenge

executive management. However, given the training which all non executive directors should receive, other directors can still play their part in board affairs. The extent of such required training could usefully be codified and monitored by the FSA and perhaps be extended to cover all insurance companies.

7. It is difficult to see how day to day policyholder participation in the running of a life mutual could be compatible with the FSA's "fit and proper" persons requirements. Very few policyholders would have the relevant experience to challenge the running of a life mutual or contribute to such a debate meaningfully. Instead, specific events might be arranged on a regular basis at which the directors of mutual insurers could be questioned by analysts and the recording of the briefings and questions and answers could be open to members and recorded on websites.

Members should, however, be able to register approval (or not) of the actions of directors by being able to vote at general meetings. There should, therefore, be a requirement for them to be able to vote even if they are unable to attend the meeting itself.

8. We believe that this does place limits on the way in which it is appropriate to invest the long-term fund. We are content that the proposals contained in the FSA's Consultation Paper 04/14 "Treating with-profits policyholders fairly" adequately address this issue.
9. We would broadly agree with the sentiments expressed by Lord Penrose in this area. Major advances for the larger mutual organisation include:

- The realistic reporting regime
- Introduction of Principles and Practices of Financial Management
- Introduction of an internal capital assessment
- The audit of actuarial liabilities
- Work done on treating with-profits customers fairly

These advances might be extended to smaller mutual organisations at some time in the future when the techniques are more fully developed and the costs of implementation are commensurately lower.

10. In our answers to earlier questions we have suggested that the FSA could do more to assist in improving corporate governance for life mutuals.
 - Drawing up of a Combined Code suitable for mutuals based largely on the existing Code for listed companies
 - Monitoring the requirement to provide summary financial statements and the use of exemptions on the distribution of these
 - Drawing up a code for the training of non-executive directors and perhaps being more critical of board composition where this does not contain adequate actuarial and accounting expertise
 - Policing the Combined Code and training code through Arrow visits

11. The market forces most relevant are those which impact on the customer proposition. As is mentioned above, it is the customer/supplier relationship which dominates the business model of a life mutual rather than the concept of ownership rights.

The three most important factors, all of which are the subject of review by surveys conducted by the trade press and independent consultants, are:

- Past performance
- Balance sheet strength. This is increasingly measured from the FSA's realistic balance sheet where this is available
- Expense ratios

12. We would comment here that we are concerned at one of the rules proposed in the above-mentioned FSA Consultation Paper 04/14. This is rule 6.12.107, which states that a company cannot write non profit business where profits will emerge after the lifetime of the with-profits business.

This would be a serious constraint if the market for with-profits business decreases. Life mutuals currently write a large volume of non profit business (most of it either unit linked or immediate annuities) and indeed most offer membership rights to the relevant policyholders. The rule implies that sales of this business would have to be limited if new with-profits business is restricted. Most mutuals would probably wish to continue to write non profit business in these circumstances.

13. In practice, the forces which have driven past demutualisations have come from two sources:

- A wish by the management of weaker organisations to improve financial strength by either raising new capital (in other than subordinated debt form) or by seeking an acquirer.
- A desire by the members of strong organisations to crystallise the value of their membership rights. This value is derived from a combination of goodwill (the value ascribed to future new business written on a proprietary basis) and access to the organisation's inherited estate.

The result of demutualisation is that a mutual life company is replaced by a proprietary one. With-Profits pay-outs from mutual companies tend to be higher than those from proprietary companies, reflecting the absence of a shareholder distribution. However, proprietary companies may offer greater security because of the existence of shareholder capital which can, if needed, be utilised to support the long term fund.