



**The Association of Friendly Societies**

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Doug Thow Secretary

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

17 September 2004

Dear Mr Myners

***Consultation Document - Myners review of the governance of life mutuals***

I refer to that above document published in July and have pleasure in submitting the comments of the Association.

The Association of Friendly Societies (AFS) is the representative body for Friendly Societies. The societies for which it speaks exemplify the huge diversity of the Friendly Society movement, covering numerous different types of society which offer their members a wide range of insurance, savings and other products. They have over 5 million members and total funds under management are around £16 billion. Friendly Society members come from all walks of life, including those of modest means not otherwise reached by financial services providers as well as substantial investors.

Earlier in the year, in April, the AFS forwarded a paper to the Review team containing views on the areas to be covered by the review and commenting on the position of friendly societies who in most cases are mutuals of long-standing in this country. In now responding specifically to the more recent consultation document we uphold the points made previously which should be read in conjunction with this later submission.

On a general basis much attention is focused in the consultation document on the Penrose Report into Equitable Life and the structural and cultural differences between plcs and mutuals. We would maintain that to a large extent the problems faced by Equitable Life, although a mutual, related specifically to the circumstances of that company and in not representative of the way that a typical life mutual is run today. Moreover, given the number of regulatory changes that have occurred since the chances of a repeat of the Equitable Life situation ever happening again is remote.

Similarly, given that there are clear and fundamental differences between proprietaries and mutuals this should not be used as pretext for believing that one model is intrinsically better than the other in terms of corporate governance.

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Instead, their diversity should be seen as a strength in providing healthy competition in the market place enabling consumers freedom of choice in seeking life insurance and savings cover – an area where it is widely acknowledged people are still not making adequate provision. Any measures constraining mutuals would only undermine competition and further exacerbate the savings gap.

That said, the AFS is very willing to work with the Myners review, HM Treasury and others to ensure that life mutuals have a secure future and not be put at a competitive or commercial disadvantage with plcs through legislation or regulation either within the UK or in an international context. We have therefore given serious consideration to the questions raised in the consultation document and attempted to respond in a constructive light as conveyed in the appendix.

Yours sincerely

D A R Thow

## APPENDIX

***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?***

Although devised essentially to identify and reflect the interests of shareholders in the conduct of affairs within proprietary companies most friendly societies either adhere to or have adapted the code as appropriate to their relationships with members/policyholders.

In addition, we believed that the “comply or explain” principle could be suitably extended to mutual life offices either as an addition to the Annual Report & Accounts or in a more informal manner at other policyholder meetings and forums providing for more direct inter-reaction. The annual report could also include clear disclosure on :-

- how a mutual engages in dialogue with its policyholders
- how individual policyholders can contact the organisation
- the rights of policyholders and how they can be exercised

Such recommendations could then be incorporated in the existing Combined Code to widen their application to mutuals and friendly societies.

***Q2 What is the best way of securing mutual life office’s compliance with corporate governance best practice?***

To an increasing extent this is being achieved by the level of supervision exercised by the FSA over regulated firms, including friendly societies, through its Approved Persons programme, individual “Arrow” visits and policy initiatives/ pronouncements eg. Treating Customers Fairly (July 2004). As a further example the recent introduction of PPFMs (Principles and Practices of Financial Management), and consumer-friendly PPFMs brings additional safeguards for policyholders.

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

We do not believe that there should be fundamental differences in the balance of executive and non-executive directors in proprietary or mutual companies. All directors have a responsibility to represent the interests of stakeholders, be they policyholders and/or shareholders. The composition of a Board of a mutual should be broadly similar to that of a proprietary company, assuming broadly equivalent scale and complexity. We believe that the balance of power on the Board should rest with the non-executive directors as is often the case with proprietary companies. However, we do believe that an appropriate number of Executive Directors should be on Mutual Boards.

The criteria set by the FSA for vetting directors is fundamentally sound. Any changes to the balance of skills and knowledge would need to reflect the specific nature of the business taking into account that friendly society activities are not homogenous. In this context, we do not believe that any particular qualifications should be mandatory and that of more importance are the individual skills, experience and expertise that new members can bring to a Board.

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

It is difficult to generalise as to the scope of information and advice that should be available to non-executive directors of life mutuals in the same way as for any other area of business which is technical in nature.

The volume and variety of information supplied to directors has increased substantially in recent years in response to new and on-going regulatory and legal requirements. Such examples include the process of external and internal audit, compliance and money laundering reports, financial condition statements with additional information, where appropriate, also being provided for with-profits committees.

Where external advice is required the provisions of the Combined Code in allowing non-executive directors to have access to independent, professional advice at the company's expense could be extended to mutuals as is already accommodated in the terms of reference of several friendly societies.

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

***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?***

Taking these two questions together the emphasis should be on what is reasonable. Three basic requirements should be that non-executive directors should be able to understand, question and if necessary challenge but bearing in mind that they are not involved full-time in the running of the business they should not be expected to have detailed knowledge of every facet. Any attempt to codify these attributes should recognise this situation and provide for suitable flexibility.

The process for nominating, appointing and assessing the competence of Board members is well covered in the Combined Code and could be usefully extended to

mutuals. Elsewhere the FSA approved persons regime provides an additional check and balance that appropriate skills and expertise are present. Further, all board members should have the same legal duties to the company, be it proprietary or mutual.

***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 interests of mutual policyholders and plc shareholders are similar – they have an interest in the well-being of the company but not in running it. It also has to be recognised that there is in any one company a limited number of people – be they policyholders or shareholders - who wish to be actively involved beyond attending the odd AGM. On the other hand, traditional friendly societies foster active participation at AGMs either through one man-one or delegate voting systems in which an individual member or policyholder can seek office or influence decisions. Others have set up special forums eg. to stimulate the process of communication and engagement allowing for a free flow of ideas and feedback.

All companies will be looking at how they can communicate better with their policyholders in the future due to the need to further develop its business. Friendly societies were forged on the principles of trust and collective self-responsibility on a member-get-member basis which still holds good today. However, they are also looking as to how that can be built on for future generations.

***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?***

Risk capital in mutuals is built up over time and thus in managing such assets the board would tend to be more risk averse than an average proprietary company. In using capital provided by policy holders the board would need to give careful consideration to risk and rates of return in relation to their view of their policyholders attitude to risk. In moving forwards the recently introduced PPFM describes the way in which capital can be used and gives the policyholders a clearer explanation of the circumstances under which capital will be used. In risking capital in new ventures the board will need to consider the implications to policyholders of the full range of potential outcomes and should be prepared to justify their decisions to policyholders. Equally, the new Individual Capital Assessments, introduced through the FSA will reinforce this common approach to risk and risk management.

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

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

We agree that FSA's rules and guidance have contributed to enhanced corporate governance through Arrow visits, PPFMs, approved persons regime and realistic reporting and so forth. However we do not believe that the powers of the FSA should be increased further in this direction and that more important is the effective monitoring of the controls and changes that have been introduced.

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

It would be wrong to assume that mutuals are totally immunised or isolated from the pressures that can impact upon plcs because ultimately they are all competing in the same marketplace and where the bottom line is one of profit or returns on investment. Boards of mutual companies have and do need to justify to their policyholders that they can produce equivalent or better long-term value than would be the case say if they were to demutualise. A well informed mutual would see this challenge as one that it would need to regularly address with its policyholders. It is also important not to underestimate the influence exerted by journalists and the media, independent analysts, IFAs and credit agencies on the mutual sector. To varying degrees all of these bodies perform the same role as they perform in the proprietary sector.

Mutuals do have a good track record on returns on investment as regularly conveyed by market surveys and published in newspapers and trade journals. However coverage could be broadened to include key statistics and indices against a benchmark in company reports and accounts though care would need to be exercised in presenting this data in respect of friendly societies serving small or niche markets.

***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 de-mutualisation? What are the implications of de-mutualisation for members and customers?***

We do not believe that there are any major barriers to the success of mutuals as evidenced by the market surveys mentioned above which has been aided and abetted by wider research undertaken by the Association of Co-operatives and Mutual Insurers in Europe (ACME) in its report "Valuing Our Mutuality" (versions I and II) demonstrating that mutuality delivers insurance products to customers more efficiently in both life and non-life products in Europe.

Notwithstanding, the highlighted troubles of Equitable Life has inevitably provided some of the media to declare "open season" on all mutuals without foundation coupled with the more recent news that another large mutual has announced its intention to "go public" in two years time. Within the friendly society movement demutualisation has not been a threat (destroying as it would the whole ethos) but this could be put under pressure in the future if access to traditional capital through with-profits funds was to be constrained either as a result of diminishing sales or regulatory action.

***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?***

We do not comment on this question as it is outside our province.

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

We believe it is important to differentiate between small and affinity-based as the two factors are not inextricably linked eg. some affinity-based friendly societies are relatively large. In our experience small mutuals will often have a much closer relationship with their customers. For the very small however, complex governance structures are becoming prohibitively expensive especially in relation to the size and nature of their business.

Turning to affinity-based organisations they may typically need more stringent standards of governance because of their structure and homogeneity of customers. A failure to demonstrate good standards of corporate governance would very quickly impact on the business because of the relative ease of communication and the active involvement of delegates and volunteers. We therefore do not believe that the principles of governance are inherently different according to size or customer base.

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

We see little benefit in mutual models adopted outside of the UK but for a fuller understanding please contact ACME.

End.