



## **Chairmen's Business Forum response to the questions posed in the Myners review of the governance of life mutuals.**

The Chairmen's Business Forum (CBF) is an information sharing and networking organisation for chairmen of national and international organisations. It is run by Leeds University Business School, a leading business school which provides international class research and teaching across the full range of management and business disciplines.

The CBF's response is informed by the expertise in corporate governance within Leeds University Business School, in particular Professors Terry McNulty and Kevin Keasey. The CBF is pleased to contribute to the Myners review and its response is detailed below.

**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?**

We agree that it would be valuable to know the extent to which mutual life offices comply with the code. There is a genuine need for research into the patterns of governance. We believe that greater attention needs to be paid to the role of the chair than emerges immediately from the questions posed in the review.

In broad terms, we would prefer the same code to apply to mutuals as to companies and financial institutions. A separate code would be a source of potential confusion for customers, commentators and even, possibly, non-executive directors. They should be able to expect the same standards of probity, integrity and transparency as other organisations.

Generally, customers of mutual life offices purchase through intermediaries or with professional advice. Many will also read newspaper financial pages. There are thus a variety of routes through which "comply or explain" actually exerts a market discipline at least on sales of new policies or on decisions whether or not to increase or top-up existing ones. Reputation is critical to the prosperity of mutuals, who are, if anything, more vulnerable to capital flight than their shareholder capital equivalents.

Multiple classes of policyholders and their diversity and dispersion make an effective dialogue difficult, other than with an unrepresentative minority. We believe that, as a result of increasing scepticism about financial products, mutuals are already having to communicate more effectively with current and potential policyholders.

**Q2. What is the best way of securing mutual life offices' compliance with corporate governance best practice?**

We believe that mutual life offices ought to make a compulsory statement on their compliance with the Combined Code. This could be achieved as part of FSA regulation.

**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 its board? If so how?**

In general, there is no particular reason why the board structure should be different from that recommended in the Combined Code. There should be a majority of Non-Executive Directors, who meet the generally agreed independence requirements.

It is important that at least one of the NEDs has relevant life office specialist knowledge. The other NEDs should possess the quantitative or accounting skills to enable them to understand and evaluate the information presented to them and to identify areas for questions or further information. Being overly prescriptive about specialist knowledge would severely restrict the pool from which NEDs might be drawn and also reinforce a small contained introspective group with a common world view. It is important that there are a range of skills and perspectives for effective oversight of the organisation.

Clearly, mutuals already determine the qualities of potential candidates under consideration and this is generally done well. They should provide the briefings on appointment and regularly subsequently to maintain knowledge of the business and key external developments. However, it should be the responsibility of the NEDs, individually, and to an extent collectively, to determine their own updating requirements. Within reason, this should be funded by the mutual. It is important for NEDs not to be overly dependent on internally provided information and perspectives.

There is a case for one or more committees to review the actuarial and asset position of the mutual in terms of valuations and projected commitments and liabilities under a number of potential business scenarios. A clear distinction would be made with the functions of the Audit Committee.

Previous research (that done by McNulty, Roberts and Stiles, for Higgs Review) has identified that the relationship between the chairman and the chief executive is most fundamental to board effectiveness. It is curious that the Myners Review is silent about the role of the chairman in Mututals and how an effective chairman can help NEDs to be informed, knowledgeable and engaged in even the most complex businesses. Past research suggests that the case for the Myners review to pay more attention to the role of chairman is strong. There may be a case for suggesting that chairmen, perhaps more so than NEDs need expert knowledge suited to the sector.

**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?**

There needs to be a greater use by NEDs of external information and advice. This begs the question of how this might be provided. The FSA might kickstart the expansion by the sponsorship of a series of briefing events. Explicit board development budgets which NEDs could draw on should then ensure the continuation of a supply of suitable development events and material.

We strongly support the separation of the new actuarial roles from the key Executive board positions. Inevitably, however, the mutuals' own actuaries will have been closely involved in developing the specific predictions upon which policy has been based. We believe that at least one NED should have the kind of life office experience to permit an impartial evaluation of the calculations being presented and to identify when external advice would be beneficial. But it has to be recognised that actuaries use robust well-established methods and data-sets and generally will come up with similar calculations in similar situations irrespective of the organisation they work for.

The requirement is more for an informed oversight of these calculations and challenges to the decisions that are based on them and the market assumptions that underpin. Such challenges may be made by individuals with a strong business/economics background who have the general mathematical or statistical knowledge to grasp the technical material. The issue of "informed independence" is quite difficult to resolve in the short term given the technical skills needed and may need a longer term perspective.

There is a danger of over compliance burdening what has been a very innovative industry. The effects of this can already be seen in other areas of business and we are quickly rolling back from our benefits of being an enterprise driven economy. It is a delicate balance to strike between compliance and enterprise.

**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?**

And

**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?**

Firstly, similar considerations apply in a wide range of other businesses either through sheer size and multiplicities of business and markets or through the specialised scientific or technological nature of their activities. The long term nature of life mutual policy contracts present distinct, but not unique, challenges to boards. Assumptions that seemed reasonable in the past may appear rather less so in hindsight, but the mutual will still be living with the consequences of them. Without some way of restricting the personal liabilities of NEDs it will become increasingly difficult to find well-qualified individuals for these positions. We are a little sceptical about the possibilities of codifying what is reasonable and realistic in this context, firstly because it will encourage symbolic “covering one’s back” behaviour (and even a shield for those with dubious motives) and secondly, because it would do little to restrict the scope for litigation when things do go wrong,

**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?**

We are sceptical about roles of policyholders in the running of the companies. It is unlikely that these would be representative and the net effect would be to promote the interests of specific groups of policyholders rather than those of the companies.

**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?**

Mutuals’ members are there because they provide a competitive service – the provision of risk capital is a secondary issue. If they cease to be competitive, then their members will move on. This illustrates why mutuals should be exposed to the same regulatory burden and governance costs as other organisational forms competing in their sector.

**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?**

We agree that the current supervision addresses the key problems.

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

The FSA is already imposing large costs on these organisations and we do not believe that there is a further role for the FSA.

**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?**

Mutual life offices have had to adapt considerably to the changed environment since the events at Equitable Life and the decline of the attractiveness of with-profits policies. This has resulted in a significant increase in communication with interested parties. Belatedly, we now have a form of market discipline and this should be left to run its course. The real threat to mutuals is that their members leave as a consequence of uncompetitive services.

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

**And**

**Q13. What are the forces that drive de-mutualisation? What are the implications of de-mutualisation for members and customers?**

Long-established mutuals were based on a strong geographical or other affinity, which located them within a community, however defined, which provided context and also leadership. As they have grown and become national, indeed international, those ties and roots have largely gone. As a consequence, the apparent advantage of not having to provide returns to shareholders is probably outweighed by the reduction of the discipline that applies to a quoted company. The advantage is more apparent than real, however, as the introduction of shareholders expands the risk capital available to the enterprise and changes the risks for the policyholder.

The attractions of demutualization are not just based on the potential introduction of a new source of risk capital. It is also a way of releasing a proportion of accumulated reserves, which are not available for distribution within the mutual framework and are not necessarily being used effectively.

The position in other European countries depends on the legislation that applies in the various jurisdictions. Where there are not obvious significant barriers to demutualization, we expect the trend to be seen progressively elsewhere in Europe.

**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 have sufficient information about the governance arrangements for other financial mutuals to offer a specific response. This is a clear area in which the review could undertake the research to enlighten the debate.

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

There is the potential for greater strength, based on closer links with policyholders or a key affinity group or community. However, this is only realised if there is clear commitment from key external figures and the actual committed sums are of sufficient magnitude for members to pay close attention to what is actually happening in the firm.

**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?**

There is an absence of research in the whole of this area and consequently we are not aware of other nations' governance regimes for mutuals. Leeds University Business School, has a wealth of expertise in corporate governance issues and would be very interested in exploring the research opportunities further at a later stage of this review.

Research reference:

McNulty, T., Roberts, J., Stiles, P.(2002) "Creating Accountability in the Boardroom: the role and effectiveness of non-executive directors". Research report commissioned by the Higgs review.