

Mr P Myners
Review of Governance of Life Mutuals
c/o Lowri Khan
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17 September 2004

Dear Mr Myners

Independent Review of the Corporate Governance of Mutual Life Offices: Consultation Document

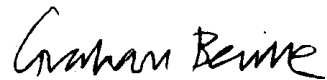
Further to your letter of 9 July 2004, I am pleased to attach the response of the Police Mutual Assurance Society Ltd to your consultation paper.

We have responded to those questions where we feel able to contribute to debate, there are several questions which we did not feel able to respond to.

I am aware how keen you are to draw on the views of as wide a range of people as possible, including our policy holders. In order to draw the document to their attention we undertook two specific pieces of consultation. Firstly we provided a copy of your consultation paper to members of our Committee of Management and to all of our delegate members (some 70 in total). We also provided a summary of the consultation document on the home page of our website, with details of where the document could be viewed. We asked that any views be forwarded to us either electronically or in writing. We have incorporated the views expressed by Committee of Management, delegates and policyholders into our response and included in Appendix 2 their responses.

If you or any of your team would like to discuss further any of the views expressed in our response please do not hesitate to contact me personally.

Yours sincerely



Graham Berville
Chief Executive

**RESPONSE BY
POLICE MUTUAL ASSURANCE SOCIETY LTD
TO HM TREASURY: MYNERS REVIEW OF
THE GOVERNANCE OF LIFE MUTUALS
CONSULTATION DOCUMENT JULY 2004**

17 SEPTEMBER 2004

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Background to Police Mutual Assurance Society Ltd

The Police Mutual Assurance Society Ltd (PMAS) is the largest affinity based friendly society in the UK, set up by police officers in 1922. It is a mutual organisation owned and controlled by policyholders, exclusively providing for the financial needs of the Police family. This market encompasses serving and retired police officers, police staff and their spouses, children and grandchildren. PMAS continues to have a strong relationship with key influential people throughout the Police Service, with a senior police presence on the Committee of Management.

PMAS currently has over 170,000 policyholders and a very high incidence of multiple product holdings by each policyholder. Assets under management exceed £1 billion, with regular premium income of over £150 million in 2003. Last year £138 million was paid out on over 33,000 maturing policies. Expenses are low at under 1% of funds under management.

PMAS plays a key part in closing the savings gap. 62% of all serving police officers in the UK are policyholders with Police Mutual and 96% of them save less than £50 per month – the minimum contribution for most companies. Many save as little as £2 per week.

The Society enjoys a number of strengths over its competitors. A trust has been built up with the policyholders, which is widely viewed as the one distinguishing factor which separates PMAS from the mainstream high street and smaller independent providers. This trust has come from the Society staying true to its charter:

- To enhance the financial understanding and well being of the police family
- To provide relevant, simple to understand and value for money products
- To provide an efficient and consistent service
- To develop life long relationships

Distribution of all the Society's products is by direct offer. A key strength is the Society's network of over 1,000 volunteers within the police service, whose role is to display literature and direct interested parties to our call centre or website. They provide a low cost distribution and advocacy network, which is our single most significant source of competitive advantage, resulting in the Society having very low management expenses.

The range of products that the Society offers includes regular savings, investments, term assurance, mortgage protection, stakeholder pension, home and motor insurance, mortgages and equity loans.

Executive Summary

PMAS is supportive of the need for and benefits of the Myners Review and is keen to continue to be engaged in consultation to improve the governance of financial mutuals. Mutuals like PMAS are able to provide a unique service to their customers that would not be possible within a proprietary company structure and we are therefore very keen to ensure that changes to the governance requirements for mutuals are not anti-competitive and will allow organisations like ours to continue to operate to high standards of governance and provide an excellent service to their policyholders.

The overall governance framework has changed significantly from that which was in place at the time of the issues which led to the Penrose Report. We believe it is vital that these improvements are recognised as part of this review.

A key theme in the Myners Review document is the fundamental strength of institutional shareholders in the proprietary company model. We believe that PMAS can evidence an equally strong model in terms of our Committee of Management and Delegate structure and we would be very happy to elaborate on this further with the review team.

We are very supportive of the benefits of developing a Combined Code appropriate for mutual organisations and in our response have highlighted some areas which we believe could be usefully included in a revised code.

We do not believe there are or should be any fundamental differences in the Board structure or composition for mutuals although the review will need to consider the implications of the specific governance arrangements appropriate to friendly societies. PMAS operates a two tier Board structure with a supervisory Board (Committee of Management) comprising primarily policyholders. Regulatory and financial responsibility is delegated to a professional Board comprising executive and independent non executive directors. We would urge that any proposals developed as part of this review recognise the diversity of mutual companies and the diversity of their business and governance models.

A clear distinction must remain between the roles and responsibilities of policyholders and the Boards of mutuals. Policyholder involvement and voice must be encouraged but must not place policyholders in a position where they are operating in a regulated capacity. The delegate system provides a very powerful mechanism for policyholder involvement and control and we urge the review team to establish whether any of the principles of a delegate system have wider application.

There is clear evidence that mutual companies are able to provide for the needs of many people who would otherwise not have access to savings, investment and protection products. It is in our view vital that this diversity is maintained and encouraged and that any changes to governance arrangements do not inhibit mutual companies from competing effectively.

Detailed Response

This response deals with each question addressed to the PMAS in turn and we have used the same question numbers.

In preparing our response we have sought the views of our policyholders by seeking their views through our website, our Delegates and Committee of Management to whom the consultation paper was sent. We have included in Appendix 2 some of these responses.

Question 1

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?

- 1.1 Over the past 3 years Police Mutual has been increasingly complying with the Combined Code, acknowledging that there are some areas of the code that are not appropriate to mutuals. Appendix 1 details our views on where we believe the Code is relevant and where it is not.
- 1.2 There are some areas that are not covered by the Code which we believe would have value and relevance to mutual policyholders which are as follows:
 - Clear disclosure in the annual report to:
 - Explain how the mutual engages in dialogue and discussion with its policyholders
 - Explain how individual policyholders can contact the organisation
 - Explain what rights policyholders have and how these can be exercised in relation to the governance and operation of the company
- 1.3 We believe that the comply or explain principle of the Code is equally applicable and relevant to mutual life offices and their policyholders and would form a valuable addition to the Annual Report and Accounts. It would also be a potentially useful source of discussion with policyholders more generally at policyholder meetings. It must be recognised that the level of interest amongst policyholders in this type of subject is relatively limited, although particularly in friendly societies with delegate systems of representation and/or active policyholder engagement, this is a subject area which it may be possible to engage in a more informed debate.

Question 2

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

- 2.1 Although there is no mutual equivalent to the listing rules which make disclosure of compliance with the Code obligatory for proprietary companies, there are several routes which we believe would help to secure mutual life offices' compliance.
- 2.2 The relevant trade bodies could be encouraged to adopt comply/explain with a new mutual code subject to annual verification as is currently the case for ABI members on other important areas of business practice, eg genetics code, endowment reviews. (A combination of ABI and AFS would we believe encompass >95% of mutual life offices.)
- 2.3 There may also be a role that could be undertaken by the External Auditors, being required to make a statement about compliance with a new mutual code as part of their annual report.
- 2.4 Although mutual life companies do not have large shareholder groups who could ensure compliance with the Combined Code, a combination of their policy holders and the media would we believe provide a useful source of scrutiny.
- 2.5 A new mutual Combined Code may be relevant in the FSA's consideration of Treating Customers Fairly and in due course compliance with this code may be appropriately included in TCF proposals.

Question 3

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?

- 3.1 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. One would expect the composition of a Board of a mutual to be broadly similar to that of a proprietary company, assuming that both had broadly equivalent scale and complexity. It may be appropriate to consider whether for mutuals the balance of power on the Board should rest with the non executive directors as is often the case with proprietary companies.
- 3.2 The balance of skills and knowledge of non executive directors for a mutual should be no different in principle to those expected in a proprietary company. It is clearly not possible for all professional disciplines to be represented by non executive directors although one would expect some disciplines to have specific representation (eg finance and actuarial). The balance of skills and knowledge would need to reflect the specific nature of the business, life offices are not homogenous in terms of their scope of activities. The Approved Persons regime provides a good framework for maintaining an appropriate Board structure. It is also worth bearing in mind in the context of Equitable Life that the introduction of the PPFM and the With Profits Committee bring additional safeguards for policyholders.
- 3.3 There is a wide variety of Board structures present within the mutual sector. We do not believe that a one size fits all approach is appropriate. For example, in our case a two tier structure with involvement from policyholders and our affinity market at a 'Supervisory Board level' and a Managing Board mirroring the Board of a proprietary or mutual life company works effectively. However this type of structure would not be appropriate for many mutuals. Critical is whether the Board can adequately discharge its responsibilities.
- 3.4 In our view the policyholders of a mutual company, particularly in a situation like our own where we have a delegate system of representation, are equally if not more able to hold the Board to account as would be shareholders in a proprietary company. It should also be borne in mind that in a proprietary company the policyholders have very little opportunity or right to hold the Board to account for their actions.

Question 4

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?

- 4.1 The advice and information available to non executive directors of life mutuals can be considered in two ways. Firstly the information which is available to them as a matter of course as a result of regulatory and legal requirements and secondly the advice and information that they can independently seek.
- Considerable information is provided to boards of life companies and the quality and appropriateness of this information has been enhanced significantly over the last few years. Specifically worthy of note are the external and internal audit processes, compliance and money laundering reports, the financial condition report and recently introduced realistic reporting of liabilities. Additional information will also be available to the With Profit Committee to ensure fair treatment of policyholders.
 - The Combined Code states that non executive directors should have access to independent professional advice at the company's expense when they consider necessary. Although not bound by the Combined Code we believe this is good practice and the terms of reference for our board/non executive directors give them this facility. We believe that as part of introducing an amended Combined Code for mutuals this would be a valuable additional safeguard.
- 4.2 In our experience there are not significant resource implications if additional information or advice is requested by the non-executive directors. The non-executive directors receive as a matter of course very effective and specific information which enables them to discharge their responsibilities effectively and their ability to request information or advice from external sources without recourse to executive directors provides a fundamental safeguard.

Question 5

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

Question 6

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?

5/6.1 We do not believe there is any fundamental difference between the role of a non executive director in a complex or technical business or that of a non executive director in any other business. As has previously been mentioned it will never be possible for every business function to be represented by a non executive director. The process for nominating, appointing and assessing the competence of board members is clearly very important and the Combined Code makes several recommendations in this regard which would seem to be as applicable to mutuals as any other companies. It is as important that non executive directors are able to identify what they don't know as it is to identify what they do know. Equally important is their independence and strength of character. This allows them to be objective and removes them from the day to day operation of the business and therefore in a better position to challenge executive proposals and decisions. The Approved Persons regime and oversight exercise by the FSA in the composition of boards should provide an additional check and balance that appropriate skills and knowledge are present.

Question 7

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?

- 7.1 The Treasury will be aware that engaging policyholders in the activity of a life mutual is not an easy or straightforward challenge. The relative level of interest is very low and when interest is expressed it is often driven by specific self interest rather than the interests of the policyholders as a whole.
- 7.2 We operate a delegate system organised on a police force basis. The delegates in addition to carrying the votes of the policyholders in their force at general meetings are also actively involved in the business of the Society. This dual nature of their involvement does in our experience create balance, very active participation and a more meaningful and detailed dialogue than would be the case without a delegate system. We have experimented with more open communication events with non delegate policyholders but even on issues which are potentially quite contentious have found levels of interest to be very low. As has been suggested earlier in this response we believe that better disclosure of how policyholders can participate would be a meaningful step forwards but we need to recognise that no one solution would be appropriate for all mutuals.
- 7.3 It is important to bear in mind that ultimately policyholders cannot run mutual life companies. This would place them in a position of carrying significant risk and liability and a clear distinction needs to be drawn between consultation and active involvement in the operation of the company.
- 7.4 It may be the case that geography is a material inhibitor to participation by policyholders. Some mechanism by which policyholders could participate in general meetings without needing to travel to one central location may be helpful. This could be achieved by regionalised meetings arranged as a part of Annual General Meeting process. New technology, for example the use of websites for question and answer dialogue and for those who can afford to invest in the technology, webcast could be useful additional methods of overcoming geographical restrictions.
- 7.5 From feedback from our own policyholders we know that the factors which enable them to engage and participate effectively include a delegate system which provides them with a local contact to whom they can refer questions and receive information, a regular newsletter available to members updating them on progress made, and comprehensive annual statement for all policyholders. For information we attach a selection of recent policyholder communications.
- 7.6 It is our usual practice to consult with policyholders prior to embarking on any major strategic initiatives. This includes specific qualitative and quantitative research amongst representative groups, policyholder workshops and as appropriate formal presentation to and discussion with delegates at the Annual General Meeting and Special General Meetings. We believe that mutuals should consult with their policyholders when planning any major strategic developments given that policyholders are the source of capital for mutuals.
- 7.7 See also Appendix 2.

Question 8

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?

- 8.1 One would generally expect that mutual companies would be more risk averse than a typical 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 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.
- 8.2 We communicate our business strategies to policyholders in a number of ways
- Our business plan is presented annually to delegates and subject to challenge and debate by them. We also discuss with delegates performance against plan and any new strategic initiatives.
 - A summary of the plan and current performance is sent through our volunteer network to all locations in the UK where police staff work. We also issue other communications during the year, distributed primarily through work sites updating policyholders on developments, new products, maturity values and any other relevant information.
- 8.3 The board and committee of management are keenly aware of the attitude to risk of our policyholders and this informs our actions and how we manage the Society. Where the board have made decisions which have needed to balance risks and benefits to policyholders we have clearly communicated our approach to our policyholders.
- 8.4 See also Appendix 2.

Question 9

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?

- 9.1 We believe that the FSA has very effective tools at its disposal to oversee and evaluate the corporate governance of mutual life offices. In particular the Approved Persons regime gives the FSA powers to review the executive and non executive directors performance, to challenge the overall composition of boards and the balance of skills and knowledge that they hold. These powers include the ability to remove approval of individuals that it considers are not fit and proper. The FSA have the power to meet with and question any of the individuals involved in the management of a regulated firm be they executive or non executive. The recent Project Arrow visits undertaken by the FSA focused on identifying key areas of risk and standards of governance was one of the areas reviewed. In addition there have been significant changes made to the governance of with profit funds, eg the creation of With Profit Committees and the introduction of PPFM's.

Question 10

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

- 10.1 Given the powers already held by the FSA we would not be in favour of these being increased further and indeed it is difficult to see where this could effectively be done. In our view the issue at hand is how these powers are exercised and the degree to which active oversight is undertaken by the FSA. We would certainly not be in favour and indeed believe it would be inappropriate and unnecessary for the FSA to have additional powers in relation to mutual companies than they have in respect of proprietary companies.

Question 11

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?

- 11.1 In our experience policyholders act as very effective judges of the performance of our Society. They are well informed about our performance. The nature of our market and our high penetration within this market makes them a well informed and very effective control.
- 11.2 The risk of takeover (through demutualisation) has in recent years acted as a similar discipline to that which would operate in a proprietary company. Boards of mutual companies have and do need to justify to their policyholders that they can produce equivalent or better value than would be the case on their transfer to public ownership. A well informed mutual would see this challenge as one that it would need to regularly address with its policyholders.
- 11.3 It is 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.
- 11.4 Historically mutuals have enjoyed a competitive advantage to proprietary companies and their performance is reported in market surveys, newspapers and trade journals. There are clearly concerns about the inappropriate use of past performance information as a guide for consumers, particularly in relation to purchasing new products. This information is both relevant and available to existing policyholders. Comparative data about expense performance is widely available to the public through information provided at the point of sale and the FSA's website.

Question 12

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

and

Question 13

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

12/13.1 Data produced by ICMIF would suggest that the theoretical advantage enjoyed by mutuals in terms of not needing to reward shareholder capital is reflected in policyholder benefit for mutual policyholders. (see ICMIF response) We do not believe that any specific barriers exist to the success of mutual businesses in the UK.

12/13.2 It is our view that the demutualisation trend of the 1990s was primarily driven by the management of mutuals and often resulted in significant financial reward for them. The members of mutuals were attracted by very short term gains but we believe management had a responsibility to and could have been more effective at generating a better understanding of the long term benefits to policyholders of retaining mutual status.

12/13.3 Certain types of mutual businesses only exist because of their mutual status and this includes Police Mutual. The nature of our engagement with the wider police family, our ability to provide financial education, and the significant cost advantages accruing from our volunteer network can only exist in a mutual organisation. Therefore in our particular case demutualisation would lead to significant long term detriment because a shareholder owned company would not be given the access to policyholders and potential policyholders that we currently enjoy.

12/13.4 See also Appendix 2.

Question 14

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 feel able to comment on this question.

Question 15

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

- 15.1 We believe it is important to differentiate between small and affinity based as the two factors are not inextricably linked. 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 and there would seem to be a potential trade off here. We believe that an affinity based organisation will typically need to evidence better standards of governance and performance because of their structure and homogeneity of customers. In our case because we are an affinity based business we are easily able to engage with and involve representatives from our target market. A failure to demonstrate good standards of corporate governance or performance would very quickly be business critical because of the ease of communication within our target market and the active involvement of delegates and volunteers. In conclusion we believe that affinity based mutuals will often face different governance issues from the largest firms in the sector and because of their structure will often need to demonstrate better governance standards in order to maintain their business.
- 15.2 See also Appendix 2.

Question 16

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 do not feel able to comment on this question.

MAIN PRINCIPLE	SUPPORTING PRINCIPLES	CODE PROVISIONS	Comments
<p>A. DIRECTORS A.1 The Board Company should be headed by an effective board, which is collectively responsible for the success of the company.</p>	<p>Board's role:</p> <ul style="list-style-type: none"> ▪ Provide entrepreneurial leadership within framework of prudent & effective controls so risk assessed and managed. ▪ Set strategic aims, ensure financial and human resources in place to meet objectives and review management performance. ▪ Set values & standards & ensure obligations to shareholders & others are understood & met. <p>All directors must take decisions objectively in the interests of the company.</p> <p>As part of a unitary board, NEDs should:</p> <ul style="list-style-type: none"> ▪ Constructively challenge & help develop proposals on strategy. ▪ Scrutinise performance of management in meeting goals & objectives & monitor reporting of performance. ▪ Be satisfied on integrity of financial information & that financial controls and systems of risk management are robust & defensible 	<p><u>Provision A.1.1</u> Board should meet sufficiently regularly to discharge duties. There should be a formal schedule of matters specifically reserved for its decision. Annual report should include statement of how board operates, including high level statement of decisions to be taken by the board and those delegated to management.</p> <p><u>Provision A.1.2</u> Annual report should identify chairman, deputy chairman (if there is one), CEO, 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.</p> <p><u>Provision A.1.3</u> Chairman should hold meetings with NEDs without executives. Led by the senior independent director, NEDs should meet without the chairman present at least annually to appraise chairman's performance & on such other occasions as are deemed appropriate.</p> <p><u>Provision A.1.4</u> Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure their concerns are recorded in the board minutes. On resignation, a NED should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.</p>	<p>May not be appropriate for small mutuals to appoint a SID.</p>
<p>MAIN PRINCIPLE</p>	<p>SUPPORTING PRINCIPLES</p>	<p>CODE PROVISIONS</p>	<p>COMMENTS</p>
	<ul style="list-style-type: none"> • Be responsible for determining appropriate levels 	<p><u>Provision A.1.5</u> Company should arrange appropriate insurance</p>	

	of remuneration of executive directors and have a prime role in appointing, & where necessary removing, executive directors, & in succession planning.	cover in respect of legal action against its directors.	
<p>A.2 Chairman and CEO Should be clear division of responsibilities at the head of the company between running the board and executive responsibility for running the business. No one individual should have unfettered powers of decision.</p>	<p>Chairman responsible for:</p> <ul style="list-style-type: none"> ▪ Board leadership, effectiveness & agenda. ▪ Directors receiving accurate, timely and clear information. ▪ Effective communication with shareholders. ▪ Facilitating effective contribution of NEDs & ensuring constructive relations between executive & NEDs. 	<p><u>Provision A.2.1</u> Roles of chairman & CEO should not be exercised by same individual. Division of responsibilities between chairman & CEO should be clearly established, set out in writing & agreed by the board. Decision to combine Chairman & CEO must be publicly justified.</p> <p><u>Provision A.2.2</u> Chairman should on appointment meet the independence criteria set out in the Code. CEO should not go on to be chairman. If exceptionally a board makes that decision, it should consult <i>major shareholders</i> before & set out its reasons in the annual report.</p>	<p>Could consult with members through members forum.</p>
<p>A.3 Board Balance & independence The Board should include a balance of executive and NEDs (particularly independent NEDs) so no individual or small group dominates the board's decision taking.</p>	<p>Board should not be unwieldy but of sufficient size that the balance of skills & experience is appropriate for the business & that changes to composition can be managed without undue disruption.</p>	<p><u>Provision A.3.1</u> Board should identify in annual report each independent NED & determine whether the director is independent in character & judgement & whether there are relationships or circumstances likely to affect, or appear to affect, judgement. Board should state reasons if it determines a director is independent notwithstanding relationships or circumstances which may appear relevant to its determination, including if the director:</p>	

MAIN PRINCIPLE	SUPPORTING PRINCIPLES	CODE PROVISIONS	COMMENTS
	<p>To ensure power & information are not concentrated in one or two individuals, there should be a strong presence of both executive and NEDs.</p> <p>Value of ensuring committee membership is refreshed & undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.</p> <p>No one other than committee chairman & members entitled to be present at meetings of nomination, audit or remuneration committee, but others may attend by invitation of the committee.</p>	<ul style="list-style-type: none"> ▪ has been an employee in last 5 years; ▪ has in the last 3 years, had a material business relationship with the company directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company; ▪ has received additional remuneration to director's fee, participates in share option or performance-related pay scheme, or is a member of pension scheme; ▪ has close family ties with any advisers, directors or senior employees; ▪ holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; ▪ represents a significant shareholder; or ▪ has served on the board for more than 9 years. <p><u>Provision A.3.2</u> Except for smaller companies, at least half the board, excluding chairman, should comprise independent NEDs. Smaller company should have at least 2 independent NEDs.</p> <p><u>Provision A.3.3</u> <i><u>Board should appoint one independent NED to be the senior independent director (SID) who should be available to shareholders for concerns which have not been resolved through chairman, CEO or FD or where such contact is inappropriate.</u></i></p>	<p>May not be appropriate for small mutuals to have a SID</p>

MAIN PRINCIPLE	SUPPORTING PRINCIPLES	CODE PROVISIONS	COMMENTS
<p>A.4 <u>Appointment to the Board</u> There should be formal, rigorous & transparent procedure for appointments to the board.</p>	<p>Appointments should be made on merit & against objective criteria. Appointees should have enough time available to do the job, particularly in the case of chairmanships</p> <p>Board should satisfy itself plans are in place for orderly succession to board and senior management, so as to maintain balance of skills and experience within company & on board.</p>	<p><u>Provision A.4.1</u> Nomination committee should lead process for board appointments & make recommendations. A majority of nomination committee should be independent NEDs. Chairman or an independent NED should chair the committee, but not when it is dealing with successor to the chairmanship.</p> <p><u>Provision A.4.2</u> Nomination committee should make available its terms of reference, explaining role & authority delegated to it by the board. Nomination committee should evaluate balance of skills, knowledge & 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><u>Provision A.4.3</u> For chairman appointment, nomination committee should prepare job specification, including assessment of 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 commitments should be reported to the board as they arise, and included in annual report. <i><u>No individual should be appointed to a second chairmanship of a FTSE 100 company.</u></i></p>	

MAIN PRINCIPLE	SUPPORTING PRINCIPLES	CODE PROVISIONS	COMMENTS
		<p><u>Provision A.4.4</u> T&C of appointment of NEDs should be made available for inspection. Letter of appointment should set out expected time commitment. NEDs should undertake to have sufficient time to meet requirements of role. Other significant commitments should be disclosed to the board before appointment, with a broad indication of time involved with the board informed of subsequent changes.</p> <p><u>Provision A.4.5</u> Board should not agree to a full time executive director taking on more than one NED role or chairmanship in a FTSE 100 company.</p> <p><u>Provision A.4.6</u> Annual report should separately describe work of nomination committee, including process for board appointments. An explanation should be given if neither external search consultancy nor open advert used in appointment of chairman or a NED.</p>	
<p><u>A.5 Information & professional development</u> 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 & refresh their knowledge.</p>	<p>Chairman is responsible for ensuring directors receive accurate, timely and clear information. Management has an obligation to provide but directors should seek clarification or amplification where necessary.</p> <p>Chairman should ensure directors continually update skills & knowledge & familiarity with</p>	<p><u>Provision A.5.1</u> Chairman should ensure new directors receive full, formal & tailored induction on joining the board. <i><u>As part of this, the company should offer to major shareholders the opportunity to meet a new NED.</u></i></p> <p><u>Provision A.5.2</u> Board should ensure directors, especially NEDs, have access to independent professional advice at company's expense where they judge it necessary</p>	

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	<p>company required to fulfil their role on board/committees. Company should provide resources for developing and updating directors' knowledge and capabilities.</p> <p>Under chairman's direction, company secretary responsibilities include ensuring good information flows within the board/its committees & between senior management & NEDs, as well as facilitating induction and assisting with professional development as required.</p> <p>Company secretary should be responsible for advising the board through the chairman on all governance matters.</p>	<p>to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.</p> <p><u>Provision A.5.3</u> All directors should have access to advice and services of company secretary, who is responsible to board for ensuring board procedures are complied with. Both appointment & removal of company secretary should be matter for board as a whole.</p>	
<p><u>A.6 Performance Evaluation</u> Board should undertake formal and rigorous annual evaluation of its own performance & of committees & individual directors.</p>	<p>Individual evaluation should aim to show whether each director continues to contribute effectively & to demonstrate commitment to the role (including time commitment). Chairman should act on results of evaluation by recognising strengths & addressing weaknesses of board &, where appropriate, proposing new members be appointed/seek resignations.</p>	<p><u>Provision A.6.1</u> Board should state in annual report how performance evaluation of board, committees & directors conducted. NEDs, <i>led by SID</i>, should be responsible for performance evaluation of Chairman, taking into account views of executive directors.</p>	

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<p><u>A.7 Re-election</u> 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.</p>		<p><u>Provision A.7.1</u> All directors should be subject to election at first AGM after appointment, and to re-election at intervals of no more than 3 years. Names of directors submitted for election should be accompanied by sufficient biographical details & other relevant information to enable <i>shareholders</i> to take an informed decision.</p> <p><u>Provision A.7.2</u> NEDs should be appointed for specified terms subject to re-election & <i>Companies Acts provisions relating to the removal</i>. Board should set out to shareholders in AGM papers why they believe an individual should be elected. Chairman should confirm when proposing re-election that, following performance evaluation, individual's performance continues to be effective and is committed to role. Any term beyond 6 years (e.g. two 3 year terms) for a NED should be subject to particularly rigorous review, & take into account need for progressive refreshing of board. NED may serve longer than 9 years (e.g. three 3 year terms), subject to annual re-election. Serving more than 9 years could be relevant to the determination of a NED's independence.</p>	Members
<p><u>B Directors' Remuneration</u> <u>B.1 The level and Make-up of Remuneration</u> Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a companies should avoid paying more than is Necessary for this purpose. A</p>	<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</p>	<p><u>Remuneration Policy</u> <u>Provision B.1.1</u> Performance-related elements of remuneration should form a significant proportion of the total package for executive directors & should be designed to align their interests with those of <i>shareholders</i> & give these directors keen incentives to perform at the highest levels. In designing schemes of performance-related remuneration, the</p>	Members

MAIN PRINCIPLE	SUPPORTING PRINCIPLES	CODE PROVISIONS	COMMENTS
<p>significant proportion of executive directors' remuneration should be structured to link rewards to corporate and individual performance.</p>	<p>to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.</p>	<p>remuneration committee should follow the provisions in Schedule A to this Code.</p> <p><i>Provision B.1.2</i> <i>Executive share options should not be offered at a discount except where permitted by Listing Rules.</i></p> <p><u>Provision B.1.3</u> Levels of remuneration for NEDs should reflect time commitment & responsibilities. <i>Remuneration for NEDs should not include share options. If, exceptionally, it does, shareholder approval should be sought & shares acquired should be held until at least 1 year after leaving the board. Holding share options could be relevant to NED independence.</i></p> <p><u>Provision B.1.4</u> Where an executive director serves as a NED elsewhere, the remuneration report should state whether the director will retain such earnings and, if so, what the remuneration is.</p> <p>Service Contracts and Compensation</p> <p><u>Provision B.1.5</u> Remuneration committee should carefully consider compensation commitments (including pension contributions & all other elements) directors' terms of appointment would entail in the event of early termination. Aim should be to avoid rewarding poor performance. Should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.</p> <p><u>Provision B.1.6</u> Notice or contract periods should be set at 1 year or less. If it is Necessary to offer longer to new directors recruited from outside, such periods should reduce to one year or less after the initial period.</p>	<p>N/A to Mutuals</p> <p>N/A to Mutuals.</p>

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<p>B.2 Procedure 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.</p>	<p>Remuneration committee should consult chairman &/or CEO about proposals relating to remuneration of other executive directors. 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 remuneration committee, care should be taken to recognise and avoid conflicts of interest.</p> <p>Chairman of board should ensure that company maintains contact as required with principal shareholders about remuneration in same way as other matters.</p>	<p><u>Provision B.2.1</u> Board should establish remuneration committee of at least 3, or in the case of smaller companies 2, members, who should all be NEDs. Remuneration committee should make available its terms of reference, explaining its role and 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><u>Provision B.2.2</u> Remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. <i>Committee should also recommend & monitor level and structure of remuneration for senior management. The definition of 'senior management' should be determined by the board but normally include the first layer of management below board.</i></p> <p><u>Provision B.2.3</u> Board itself <i>or, where required by Articles, shareholders,</i> should determine remuneration of NEDs. Where permitted by Articles, board may delegate this to a committee, which might include the CEO.</p> <p><u>Provision B.2.4</u> <i>Shareholders</i> should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) & significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.</p>	<p>This may not be appropriate for small mutuals.</p> <p>Members – may not be applicable to small mutuals</p>

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<p>C <u>ACCOUNTABILITY AND AUDIT</u> C.1 <u>Financial Reporting</u> The board should present a balanced and understandable Assessment of the company's position and prospects.</p>	<p>The board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.</p>	<p><u>Provision C.1.1</u> 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> <p><u>Provision C.1.2</u> The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.</p>	
<p>C.2 <u>Internal Control</u> The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.</p>		<p><u>Provision C.2.1</u> The board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to <u>shareholders</u> that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.</p>	<p>Members</p>
<p>C.3 <u>Audit Committee and Auditors</u> 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 auditors.</p>		<p><u>Provision C.3.1</u> 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. Board should satisfy itself that at least one member of the audit committee has recent and relevant experience.</p> <p><u>Provision C.3.2</u> Main role & responsibilities of AC should be in written terms of reference & include:-</p> <ul style="list-style-type: none"> ▪ Monitor integrity of financial statements & any formal announcements relating to financial performance, reviewing significant financial reporting judgements contained in them. ▪ Review internal financial controls & risk management systems (unless risk addressed by separate risk committee) 	

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		<ul style="list-style-type: none"> ▪ Monitor & review effectiveness of internal audit function ▪ Make recommendations to board, for it to put to shareholders in general meeting, in relation to appointment, re-appointment & removal of external auditor & to approve remuneration & terms of engagement of external auditor ▪ Review & monitor external auditor's independence & objectivity & effectiveness of audit process, taking into consideration relevant UK professional & regulatory requirements ▪ Develop & implement policy on engagement of external auditor to supply non-audit services, taking into account relevant ethical guidance; report to board, identifying any matters in respect of which action or improvement is needed & making recommendations on steps to be taken. <p><u>Provision C.3.3</u> ToR of AC, including role & authority delegated to it, should be made available. Separate section of annual report should describe work of committee in discharging responsibilities.</p> <p><u>Provision C.3.4</u> AC should review arrangements by which staff may, in confidence, raise concerns about possible improprieties in financial or other matters. AC's objective should be to ensure arrangements are in place for the proportionate & independent investigation & appropriate follow-up.</p>	

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		<p data-bbox="932 280 1444 477"><u>Provision C.3.5</u> AC should monitor & review effectiveness of internal audit activities. Where there is no internal audit function, AC should consider annually whether there is a need for one & make a recommendation to board. Reasons for absence of functions should be explained in annual report.</p> <p data-bbox="932 509 1455 764"><u>Provision C.3.6</u> AC should have primary responsibility for making recommendation on appointment, re-appointment & removal of external auditors. If board does not accept recommendation, it should include in annual report, and any papers recommending appointment or re-appointment, statement from AC explaining recommendation & set out why board has taken different position.</p> <p data-bbox="932 797 1444 911"><u>Provision C.3.7</u> Annual report should explain to <i>shareholders</i> how, if auditor provides non-audit services, auditor objectivity and independence is safeguarded.</p>	<p data-bbox="1480 850 1577 873">Members</p>

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<p>D <u>RELATIONS WITH SHAREHOLDERS</u> <u>D.1 Dialogue with Institutional Shareholders</u> Should be a dialogue with shareholders based on mutual understanding of objectives. Board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.</p>	<p>Whilst recognising most shareholder contact is with CEO & FD, chairman (& SID & other directors as appropriate) should maintain sufficient contact with major shareholders to understand issues and concerns.</p> <p>Board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.</p>	<p><u>Provision D.1.1</u> Chairman should ensure views of <i>shareholders</i> are communicated to board as whole. <i>Chairman should discuss governance & strategy with major shareholders. NEDs should be offered opportunity to attend meetings with major shareholders & should expect to attend if requested by major shareholders. SID should attend sufficient meetings with a range of major shareholders to listen to views in order to help develop a balanced understanding of the issues & concerns of major shareholders.</i></p> <p><u>Provision D.1.2</u> <i>Board should state in annual report steps taken to ensure board members, in particular NEDs, develop understanding of views of major shareholders, eg through face-to-face contact, analysts' or brokers' briefings & surveys of shareholder opinion.</i></p>	<p>Members N/A as it stands but could be amended to involve membership forums.</p> <p>As above comment</p>
<p><u>D.2 Constructive use of AGM</u> Boards should use AGM to communicate with investors and encourage participation.</p>		<p><u>Provision D.2.1</u> <i>Companies should count all proxy votes & except where a poll is called, should indicate level of proxies lodged on each resolution & balance for & against resolution, after it has been dealt with on a show of hands. Company should ensure votes cast are properly received & recorded.</i></p>	<p>Not all rules will allow for voting by proxy.</p>

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		<p data-bbox="932 280 1094 305"><u>Provision D.2.2</u></p> <p data-bbox="932 310 1440 418">Companies should propose separate resolutions at AGMs on each substantially separate issue & in particular propose a resolution relating to report & accounts.</p> <p data-bbox="932 456 1094 480"><u>Provision D.2.3</u></p> <p data-bbox="932 485 1413 594">Chairman should arrange for chairmen of audit, remuneration and nomination committees to be available to answer questions at AGM & for all directors to attend.</p> <p data-bbox="932 631 1094 656"><u>Provision D.2.4</u></p> <p data-bbox="932 660 1444 737">Companies should arrange for AGM Notices & related papers to be sent to shareholders at least 20 working days before the meeting.</p>	

There is a further section of the Combined Code which is headed up Institutional Shareholders. I have assumed that this would not be relevant in a Combined Code for Mutuals.

Individual Responses from members of Committee of Management, Delegates and Policyholders

General Comment

- I suspect the average Joe Soap policy-holder (i.e. me!) will not understand the detail of these questions, being too far removed from governance of the PMAS, I guess policyholders are looking for safety, trust, like-minded persons to invest with - hence the strengths of mutuals. (*Response from policyholder*)

Question 7

- Obviously, you will give a largely descriptive answer to this question. I am not sure that policy holders should play a greater role in the governance of the Mutual, but there need to be mechanisms to guarantee the professional competence of the executives. (*Response from member of Committee of Management*)
- I feel strongly that policyholders should have a role in the running of mutual life companies. I can only comment on the PMAS, but feel that the structure we have in place i.e. the A.O. network and Committee of management really does bind the role of the Police Mutual with that of its policy holders. Within the PMAS I do not see the need for any further "effective engagement". (*Response from delegate*)
- As an authorised officer and multiple policyholder, I was pleased to see an annual update on each plan held, and felt that this was an example of good practice, albeit at a time when returns were not as good as in previous years. The AO monthly newsletters were useful in explaining the financial processes taken to reduce the risks in the equity markets during the recent market fluctuations, as are the articles in the regular publications such as 'Lifeline'. (*Response from delegate*)
- In my opinion Policy holders should not take an active part in the actual financial decisions made by better qualified personnel. However I do feel that it would be beneficial for Policyholders to be able to ask simple questions and get simple answers of their Mutual Society. Similarly if inversely a particular decision or view was sought by the Mutual from the policyholders it would be beneficial if they too could ask the members simple questions to help them formulate tactics and plans. This could be done by having a regular chats/meetings with a representative group of their investors to exchange views and ask questions of each other. Of course we already have this system set up at PMAS with our unique way of working having unpaid independent Policyholders attending regular meetings with representatives from the society to do as

above, and we know it works well. I would think it difficult for other Mutuals to set up similar activities. However perhaps a similar system could be set up using on-line web sites. Mutuals could have interactive sites where members could be updated with news and investment decisions and perhaps individuals could be 'polled' regularly to ask their views on certain aspects of their Society. These members could either be selected at random or a certain number of them could be selected and 'groomed' as independent 'judges' and asked to help run their mutual society as unpaid volunteers/monitors/pollsters. I feel too that any such Website should be accessible to all members who can put questions formally at any time to their Mutual. The questions AND answers from the Mutual should be able to be viewed by everyone. (similar to the 'Any Questions' site we have on our Intranet). Such exchanges of information will no doubt prompt other questions and discussions - some aspects of which will be of great interest to both Mutuals and the policyholders alike. It will show where active policyholders interests lie and whether their views are narrow minded or in fact supported by many others. Such activity will encourage harmony and trust between the 2 groups - both feeling that they are listening to each other and working alongside each other for 'Mutual' benefit. *(Response from policyholder)*

- Guess an improved voice representing policy holders that board members can listen to - could be achieved perhaps by a Q and A area of the PMAS Website? *(Response from policyholder)*

Question 8

- I think policy holders in mutuals would expect them to be more risk averse and I think that applies to PMAS. *(Response from delegate)*
- In my opinion this is very simple, it is the policy holders capital, it is the policy holders mutual company and it is the policy holders risk. so I feel there is a real need for a very close relationship between a mutual and the policyholders. bearing in mind the obvious need of the professional guidance and leadership required. *(Response from delegate)*
- The vast majority of colleagues taking out savings plans do not look on these as a form of risk investment, simply as direct savings schemes, similar to holiday fund programmes operating locally over a 12 month period – albeit with better returns. The younger officers tend to be more streetwise in their knowledge of financial matters, far less trusting and more inclined to question returns, products and even motives. The PMAS financial advisers appear to take a risk-averse stand in any case, reducing exposure to equity markets during the wildly fluctuating years, and continuing to pay out 100% of the true value of the policies at completion, despite this having the adverse effect on returns. *(Response from delegate)*

- I feel that a mutual should be more risk averse as it should have more of a responsibility to its members - that is why it is a mutual. Members invest in it as they hope and trust that their society is going to look after them and that they are treated as the No: 1 priority. Whereas persons who invest in 'normal' financial institutions will (or should) instinctively know that the company/its shareholders/ etc. come way ahead of them in importance value. Due to this they expect and hope possible higher returns than a Mutual because in their 'heart of hearts' they know that more risk will be taken to get bigger returns but that due to this risk there is actually more chance of losing their money. Short answer - yes I think Mutuals should be more risk averse than their counterparts. Regarding business strategies/risk information - Mutuals should supply more information than as it is now - see answer to Q7. Members could be polled regularly re potential risk and investment decisions to get their overall views which will help Mutuals decide what to do. *(Response from policyholder)*
- Regular communication of performance/risk to policyholders - PMAS does this with its annual statements (good practice?) *(Response from policyholder)*

Question 13

- It seems to me that the great strength of PMAS is the fact that it is a mutual. It is this which makes it attractive to its customer base. The answer here is connected to the answer at Question 15 in that PMAS reflects a 'particular affinity base'. *(Response from member of Committee of Management)*
- Very basic – profit for the management and cost effectiveness of the given mutual. This obviously is impacted on any benefits that the policyholder receives during mutuality and post mutuality. In the case of the PMAS the whole essence is one of mutuality, and really could not exist outside the Police Mutual umbrella. *(Response from delegate)*
- In my view, the forces that drive de-mutualisation are greed. I am aware of individuals that invest in mutuals with a specific view to force votes on de-mutualisation, which brings with it the (previously) large payouts to the existing members. I have seen little evidence that policyholders benefit much following demutualisation. In the case of PMAS, one of the main cost reducers is the network of authorised officers who receive no pay or commission. In the event of demutualisation, who would continue working for a company for nothing? Would our current employers allow us the facilities to do so? I think not. The fact that savings and provision for the future of members and their immediate families can and does have a positive effect on the morale and financial wellbeing of the workforce gives us leeway in using organisations facilities, such as internal e-mail, internet access and the use of wall space, meeting rooms, as well as the all important work time of ourselves and our colleagues. *(Response from delegate)*

- Drive for de-mutualisation - growth/market share/greed? (cynic). Implications - members become customers, with accompanying change of relationship. *(Response from policyholder)*

Question 15

- I don't think I can answer the question about governance as I don't know about other mutuals. Obviously smaller organisations might be less professional, but in larger ones more bad practice can go on without it being noticed. The governance of PMAS seems to me to be very good. *(Response from member of Committee of Management)*
- I am afraid, I do not feel qualified to comment on this, at this moment in time. *(Response from delegate)*
- Mutuals with certain policyholder bases may attract member loyalties more easily than those open to the general public. In the case of PMAS, having premiums deducted at source from pay, prior to it reaching the bank account is one of the most positive ways of allowing members to save easily. It is unlikely that major employers would allow similar payment schemes to other general product providers to be deducted in this way. As so many of the general population is failing to save, or to save enough, and credit debt is escalating, I believe the Government must re-evaluate its positions on savings, and where possible, reduce hurdles to saving schemes such as those provided by Friendly Societies. *(Response from delegate)*
- I do not really understand the question here so will not attempt to answer it. *(Response from policyholder)*
- Sorry, no idea on this one. *(Response from policyholder)*

