

Mr P Myners,
HM Treasury,
1 Horse Guards Road,
London.
SW1A 2HQ

Thursday 16th September 2004

Dear Mr Myners,

INDEPENDENT REVIEW OF THE CORPORATE GOVERNANCE OF MUTUAL LIFE OFFICES: CONSULTATION DOCUMENT

Thank you for sending us your Consultation Document dated 9th July.

Please find attached our written response to this consultation. Our response takes the form of an Executive Summary, an outline of a possible code for Mutual Life Offices, a suggested Performance Report for a with-profit office with the equivalent expected for unit linked funds and an appendix containing our responses to your specific questions.

We would be happy to meet you to discuss this matter in more detail if you feel it is appropriate.

Yours sincerely,

Stephen Maran
Chairman

THE MYNERS REVIEW: LIVERPOOL VICTORIA'S RESPONSE EXECUTIVE SUMMARY AND PROPOSED WAY FORWARD

1 EXECUTIVE SUMMARY

- 1.1 Liverpool Victoria Friendly Society, formed in 1843, is the UK's largest Friendly Society. The Liverpool Victoria group of companies has more than 2.5 million members and customers, who trust us to manage approximately £6.9 billion on their behalf.
- 1.2 The society provides a broad range of financial services, including life assurance, general insurance, asset management, banking services, independent financial planning advice and is the only Friendly Society to own a bank.
- 1.3 The Society is the fourth largest mutual organisation behind Standard Life, Royal London and NFU and has an outstanding past performance record in terms of returns for its members (see Appendix 1)
- 1.4 Liverpool Victoria's conclusions in relation to the Review are as follows:
 - (a) To a large extent, the problems that occurred in Equitable Life related purely to the circumstances of that Society and the individuals who were involved with it.
 - (b) A number of changes to the regulatory regime have occurred since then which make the likelihood of a repeat of the Equitable Life situation much more remote.
 - (c) Adding further layers of Governance will place mutuals at a competitive disadvantage and undermine the good practices that exist currently in the mutual sector.
 - (d) While the current Combined Code works reasonably well for PLCs, it is not all directly applicable to mutual offices.
 - (e) Great play has been made of the role that analysts, rating agencies and large shareholders play in providing extra checks and balances for PLCs. We would agree that these bring additional challenges on the Management and Board of a PLC. We are however less convinced, based on the experience of our individual Board Members, that the additional challenge is necessarily a long term beneficial one for the policyholders of the PLC. Over 50% of Liverpool Victoria's business is sold through Independent Financial Advisers who play a significant role in advising their clients in regard to the bonus policies and capital strength of the various product providers, including mutuals.
 - (f) We do not, therefore, see that a new Governance body should be created in addition to the existing Board or Committee of Management to

provide an oversight role. Instead we propose that a document detailing the performance of typical policies should form part of Mutual Life Offices' Report and Accounts. This would show the level to which the organisation is delivering benefits to the policyholders.

- (g) In summary, we would make two recommendations for the strengthening of Mutual Life Office Corporate Governance:
 - A that a Mutual Life Office Combined Code be put in place to provide a governance structure which is equivalent to that applicable to PLCs.
 - B that the Report and Accounts of Mutual Life Offices contain a specific report detailing the performance of its policies over the period under Review.
- 1.5 In Section 2 of this Summary, we provide a proposed Mutual Life Office Combined Code in principle form (in accordance with Recommendation A) and in Section 3 an example of a Performance Report (in accordance with recommendation B).

2 MUTUAL LIFE OFFICE COMBINED CODE

2.1 We would propose that the ‘Mutual Code’ should incorporate the following provisions, shown using the structure of the existing Code:

SECTION 1 COMPANIES	COMBINED CODE MAIN PRINCIPLE	MATTERS FOR THE MUTUAL CODE
DIRECTORS		
A.1 The Board	Every company should be headed by an effective board, which is collectively responsible for the success of the company.	<i>The existing provisions are suitable for inclusion. (NB “provisions” means Main Principle, Supporting Principles and Code Provisions, as appropriate)</i>
A.2 Chairman and chief executive	There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business. No one individual should have unfettered powers of decision.	<i>The existing provisions are suitable for inclusion.</i>
A.3 Board balance and independence	The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board’s decision taking.	<i>The existing provisions are suitable for inclusion. We believe that more prescription is desirable, for example that a majority of directors should be non-executive but that at least one third should be executive.</i>
A.4 Appointments to the Board	There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.	<i>The existing Code provisions are suitable for inclusion.</i>
A.5 Information and professional development	The board should be supplied in a timely manner with information in a form and of a quality	<i>The existing Code provisions are suitable for inclusion.</i>

	<p>appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.</p>	
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A.6 Performance evaluation	The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.	<i>The existing Code provisions are suitable for inclusion.</i>
A.7 Re-election	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.	<i>The existing Code provisions are generally suitable for inclusion. Voting should include provision for delegates or other representatives.</i>
REMUNERATION		
B.1 The Level and Make-up of Remuneration	Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.	<i>The existing Code provisions are generally suitable for inclusion. Provision B.1.2 and reference to options in B.1.3 are inapplicable for mutuals like Liverpool Victoria.</i>
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.	<i>The existing Code provisions are broadly suitable. Re B.2.4, the Listing Rules apply but appropriate disclosures should be made.</i>

ACCOUNTABILITY AND AUDIT		
C.1 Financial Reporting	The board should present a balanced and understandable assessment of the company's position and prospects.	<i>The existing Code provisions are suitable for inclusion but reference in the Supporting Principle to "price-sensitive public reports" is not appropriate.</i>
C.2 Internal Control	The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.	<i>The existing Code provisions are suitable for inclusion.</i>

C.3 Audit Committee and Auditors	<p>The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.</p>	<p><i>The existing Code provisions are suitable for inclusion.</i></p>
RELATIONS WITH SHAREHOLDERS		
D.1 Dialogue with Institutional Shareholders	<p>There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.</p>	<p><i>New requirements on mutuals:</i></p> <ul style="list-style-type: none"> - <i>establish an appropriate members' group with which it should have active engagement to communicate performance, policies, strategies and developments</i> - <i>all members should be able to volunteer for membership of the group and any selection process should open and based solely on the individual's commitment to the organisation and its membership</i> - <i>use of Report & Accounts to disclose performance of policies against certain key criteria (and possibly indices) to be established on a clear, consistent and industry-wide basis</i> - <i>AGM approval of Remuneration Committee report</i> - <i>publishing of the Report and Accounts on the internet</i> <p><i>Note that, for a mutual, the</i></p>

		<p><i>chief executive and the membership services director are likely to have a key role in relation to member contact.</i></p> <p><i>Requirements must be proportionate and cost-effective. For example, given typically very high membership numbers, documents such as the Report and Accounts should be made available on request and not sent automatically to all members.</i></p>
D.2 Constructive Use of the AGM	The board should use the AGM to communicate with investors and to encourage their participation.	<i>References to investors would more appropriately be references to members.</i>

SECTION 2 INSTITUTIONAL SHAREHOLDERS		
E.1 Dialogue with companies	Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.	<i>We do not believe that these matters are strictly relevant to the Mutual Life Office Code.</i>
E.2 Evaluation of Governance Disclosures	When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention.	<i>We do not believe that these matters are strictly relevant to the Mutual Life Office Code.</i>
E.3 Shareholder Voting	Institutional shareholders have a responsibility to make considered their votes.	<i>We do not believe that these matters are strictly relevant to the Mutual Life Office Code.</i>

Note that, in general, references in retained parts of the Code to “(major) shareholders” should be changed to references to members throughout.

3 PERFORMANCE REPORT

See attached.

Appendix

Replies to the Specific questions posed by the Review

Corporate governance guidance

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 would welcome information on the extent to which mutual life offices currently comply with the Code.

In what ways might a new code be tailored to better suit the circumstances of mutual life offices? It would be helpful if you could identify any specific aspects of the current guidance that you consider are either not relevant to or inappropriate for mutual life offices as well as any additional measures that you think would be more suited to the mutual life form.

We would particularly welcome your perspective on the relevance to mutual life offices of the “comply or explain” principle in the Code. The principle, which is designed for public limited companies, has at its foundation the existence of an on-going dialogue between the company and its shareholders. How relevant is it to the different circumstances of the mutual life sector?

We would welcome innovative thoughts on how the “comply or explain” principle might be made more effective for mutual life offices, for example through fostering a more meaningful dialogue with policyholders or their representatives. Alternatively, should it be replaced?

Introduction

Liverpool Victoria believes that good corporate governance is best delivered through:

- a strong, effective board of directors with a significant and appropriate non-executive presence;
- a robust and all-encompassing risk management process; and
- an effective internal audit function and an audit and compliance committee with a broad remit and the ability to challenge management on key issues.

Combined Code

Liverpool Victoria regards the existing Combined Code as a valuable contribution to good corporate governance in the UK. The Society already complies with many aspects of the Code and, although not bound by the Combined Code, is moving to compliance with the provisions that are appropriate to mutuals over the next 12 months.

We anticipate that there is wide divergence across the industry in respect of mutual offices’ governance practices and Code compliance, as there will be among unlisted proprietary companies.

While we believe that the principles of good governance are generally applicable across different types of organisation, we would welcome a new code of good governance specifically designed for mutual organisations, to ensure that it is effective, relevant and proportionate.

Provisions requiring a new approach would include those where, even with the substitution of “member” for “shareholder”, the provision will not work. For example, it would not be possible to consult with “major shareholders” or have dialogue with “Institutional Shareholders” as envisaged by the Code.

Similarly, translating the requirements for communication with shareholders into communication with members would need careful consideration as membership organisations may have many more members than an equivalent-sized proprietary company would have shareholders.

For example, Legal and General, a company significantly larger than Liverpool Victoria Friendly Society, had (at 31 December 2003) 62,214 shareholders compared to Liverpool Victoria’s nearly 1 million members. While communication is vital, the potentially disproportionate costs that might be faced by membership organisations having to undertake the same communication exercises (for example sending a copy of the Report and Accounts to each shareholder) could be a poor use of the members’ money.

Governance should establish minimum standards to help avoid problems affecting the whole industry. Beyond that, we believe that good corporate governance should be a matter of commercial differentiation and advantage but this should result from the organisation’s superior performance in governance and not from the application of different regimes to different organisations. Similarly, disproportionate cost disadvantages result from the application of the governance regime.

Subject to the specific matters set out above, we believe that a new “Mutual Code” should broadly follow the existing Code but with carefully thought through requirements for engagement with the membership, a point which we cover in our reply to question 7. We believe that inclusion in the Report and Accounts of details of the organisation’s approach to member involvement might be a requirement of a new Code.

“Comply or explain” and monitoring

Recognising that organisations vary widely in many ways, we believe that the “comply or explain” principle should continue to be incorporated in any code specifically created for membership organisations. This will enable action to be taken to ensure that compliance with the Code is appropriate to the specific organisation. Compliance with the Code should be subject to self-certification in the Report and Accounts. Review of this matter could also be included in subsequent FSA “Arrow” visits.

Monitoring of the principle is necessary to ensure that the “explain” option is not used simply to avoid disclosures that the organisation would prefer to be kept secret. We would not favour any “enforcement” of the code. The issue of any aspects of the Code not complied should be raised by members at the AGM and it should be for the board to discuss with the membership the continued use of the “explanation” option.

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

As noted in the introduction, listed companies are required by the listing rules to make a statement on their compliance with the Combined Code. No such arrangement currently exists for mutual life offices, whose adherence to the code is entirely voluntary. In what ways might current or any new guidance be made more binding?

We believe that good compliance is best achieved through the integrity of the offices' boards, the involvement of the organisation's membership and the FSA.

The FSA is already involved to what we believe is an adequate extent through its Approved Person's programme and its risk and control initiatives, as evidenced by its recent "Project Arrow" visits. However, monitoring of mutuals' compliance with any specific code applicable to them could be achieved in the same way as the FSA monitors listed companies' compliance with the existing code.

A new code for mutuals could be made compulsory, as is the current code for listed companies. We believe that our approach to the "comply or explain" principle (in reply to question 1 above) will reinforce compliance with both the letter and spirit of the Code.

Board effectiveness

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 particular:

Does it have any implications for the balance on the board between executives and non-executive directors?

How important is it that the non-executive directors of life mutuals should possess specialist knowledge? What specific types of knowledge are most relevant to the conduct of life business in a mutual ownership framework? In what ways might life mutuals establish the relevance of candidates' knowledge and see that it is kept up to date?

What board committee structure do you consider to be effective? Is there a case for any new or different type of committee?

We would welcome any examples you may have of good practice as well as ideas on how best to achieve the desired outcomes.

Please note that all our responses reflect the views of the whole of the Society's board but those to Questions 3, 4, 5 and 6 are specifically endorsed by our non-executive directors.

Structure

In general, we do not believe that the ownership structure of an organisation such as a life mutual should necessarily affect the composition or structure of its board but we do believe that the nature of its business should have a strong influence on the board's constitution.

Board composition

Liverpool Victoria has a majority of non-executive directors on its board and believes that this as an appropriate model for all mutuals. However, we also recognise the importance of a strong executive representation on the board to ensure an appropriate balance.

All of Liverpool Victoria's non-executive directors have relevant professional qualifications and experience (two are Actuaries, two are Accountants and all have considerable experience at senior levels of the retail financial services industry).

Clearly, the financial and actuarial disciplines have major roles to play in the running of life companies and we believe that professional qualifications of this sort are extremely valuable. However, we also appreciate that other qualifications and experience are equally valuable to the functioning of the board, for example operational, administration, legal, sales, general management and marketing.

We do not believe that any particular professional qualifications should be made mandatory for such appointments. Of more importance are the calibre, experience and behaviour of the individuals appointed to the board and the board's balance in skills, expertise and experience. We do not believe that it is the function of a board to reproduce all the skills present in the management of the company.

The existence of relevant expertise and experience of directors should be verified at the time of appointment through the recruitment and appointment processes. Continuing education should be made available to directors through the company itself and by access to outside courses and monitored by an annual review process.

In accordance with the Combined Code, brief career biographies of board members should be supplied to members and policyholders as part of the election and re-election process.

Committee structures

The Liverpool Victoria board has a Remuneration and Nominations Committee, an Audit Committee and a committee focusing on the life business in the group. Our experience is that this structure works very well in supporting the strong governance regime that exists in the Society.

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?

What factors determine the quality and relevance of the information and advice used by the non-executives of mutual life offices?

What role might use of external information and advice play in better equipping the non-executives of mutual life offices to perform their duties?

In its recent consultation document¹, the Morris review of the Actuarial Profession looks at specific issues surrounding the FSA's plans to re-define the role of actuaries within life offices (particularly plans to replace the role of appointed actuary with new actuarial roles) and whether non-executive directors have sufficient expertise and information to challenge actuarial calculations. This review is concerned with all of the responsibilities of the board of a life mutual, including oversight of the actuarial function.

We do not believe that it is possible to generalise as to the information and advice available to non-executive directors of life mutuals - no doubt practice varies widely across the industry. We anticipate that the challenges faced by non-executive directors in the life industry will be similar to those faced in other complex and technical businesses and believe that, in all cases, the skills, experience and effectiveness of the non-executive directors are of prime importance.

Inadequate directors are unlikely to perform competently, irrespective of the information they are given. Directors of the right calibre, with the right induction and continuing development, will be able to identify and obtain the necessary information, in terms of clarity, quality and relevance, if that is not already being supplied by management. It is vital that the non-executive directors challenge management on issues such as the provision of sufficient and clear information and not merely accept what they are given.

Liverpool Victoria uses the services of an external actuarial consultancy to fill the Appointed Actuary role and believes that this structure gives the non-executive directors a valuable independent source of information and advice, as does access to the company's external auditors. The non-executive directors are able to seek other independent input that they feel necessary.

The new rules state that an actuarial review should be carried out as part of the audit process. Directors will review this, together with any other independent review of liability valuations and capital adequacy statements. We echo the Penrose view that directors should not necessarily be able to perform such calculations but must be capable of understanding them.

Liverpool Victoria's board has no hesitation in seeking more information or advice if it feels it necessary; resource and cost implications being of secondary importance to the need for the board to have sufficient information and advice.

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?

The Penrose report highlights the practical challenges faced by non-specialist non-executive directors in overseeing technically complex aspects of the life insurance business. How are these challenges met in your experience? Are there some specific areas of business that are more challenging than others? Do similar considerations apply in other businesses?

Question 5

We do not believe that the solution to the challenges posed by any complex or technical businesses is to have a board able to reproduce all of the functions of the company's management.

The challenge must be met by the appointment of individuals with the intelligence, skills and experience to understand well presented, appropriately simple and clear explanations of complex or technical issues.

They should be able to question and challenge the content and nature of any material presented by management. If it is not adequate, appropriate, well presented and clear they should have absolutely no hesitation in saying so and demanding the information they need to discharge their responsibilities.

They should aim to have an overview of the business and not get bogged down in unnecessary detail.

Question 6

The owners of any business should be able to expect their non-executive directors to meet the requirements of the role described in answer to Q5 above. Owners must be able to expect diligence and integrity in performance of this function.

Non-executive directors lacking the necessary skills and experience, or those reticent about challenging management will not fulfil the role adequately.

Clearly, the key challenges facing a non-executive director of a life company is the technical and complex nature of the business, most particularly in respect of accounting, actuarial, legal and regulatory matters. These challenges are magnified by the fact that he or she is not involved in the business on a day to day basis. The non-executive directors should not try to run the business at a detailed level but should help to set

strategy and question and challenge management to ensure that they are also fulfilling their roles correctly.

We understand that some codification of the role of directors is proposed and anticipate that this could usefully incorporate further guidance on the roles of non-executive directors. We believe that executive and non-executive directors should have the same legal duties.

An outline of relevant skills and experience valuable to the boards of life companies could form part of any code in this area. However, it should be illustrative and not prescriptive, as the exact constitution of a board should be left to the company and the board, in the light of specific requirements and available resources.

Policyholder voice

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?

In what ways are policyholders currently engaged? Do you have any practical suggestions on how we could achieve a better dialogue between life mutuals and their owners across the sector? Is there a role for better disclosure of information? We would particularly welcome any examples of good practice that you can provide.

It would be helpful if you could also consider what the consequences would be of increasing policyholder involvement. In particular, what checks and balances would there be against narrow policyholder interests prevailing to the potential detriment of the interests of other groups of policyholders? It is worth noting that not all policyholders share the same interests – different types of policyholders may have different objectives for the company – and not all policyholders are voting members of life mutuals (for example investors in unit linked funds and annuitants may not be members).

What role should the board play in ensuring equity between different groups of policyholders? Is there a role for other organisations or groups to act on policyholders' behalf? If so, what organisations or groups would be best suited to such a role?

Role of members

We note that non-shareholding policyholders play no role in the running of proprietary life companies and believe that this should also apply to policyholders who are not members of mutual insurers.

Mutual life company members should be able to play a similar role in the running of the company, as would their shareholder equivalents in a proprietary organisation. This includes the opportunity to question the board at any AGM or EGM, to join together to propose resolutions and to vote on issues at company meetings.

Beyond this, we feel that mutual organisations could do more to develop relationships with members, while recognising that it is the board of directors that runs the company. To help develop these relationships Liverpool Victoria operates free member telephone help lines and also offers a number of valuable membership discounts on policies. Liverpool Victoria also finances a hardship fund for the benefit of members, administered by a committee of members.

Further services should be investigated to assist members and so build closer links with them. These might include membership newsletters and support services, for example through further development of approaches to help policyholders avoid unnecessary lapsing or discontinuance of policies.

Liverpool Victoria's Invited Members Group

All Liverpool Victoria's Members are invited to put themselves forward as a potential member of the "Invited Members Group".

While the name of the Group might suggest that Group members are hand-picked by the company, possibly with the expectation that it will not challenge the organisation, this is not the case. The selection process imposed in respect of membership of this group seeks only to achieve quality of contribution and avoidance of potential conflicts, for example where a member is an employee of a supplier to Liverpool Victoria.

This group has a current membership of 58 and meets twice a year to provide a forum for business presentations on Liverpool Victoria's financial performance, strategy and new developments. It also provides members with the opportunity to make comments and ask questions of executives. One of these meetings is arranged for the morning of the Society's AGM, which members are also encouraged to attend. Some members of this group are also invited to act as tellers at the AGM, if a poll is required.

Currently, 45 members are on the waiting list for the invited members group and these individuals are invited to take part in regional focus groups and so participate in meetings and surveys, providing feedback on new and existing products and services.

We see this approach as a possible starting point for the development of member involvement in their company. A new Code for mutuals might require an explanation of members' rights and the organisation's approach to member involvement to be included in its Report and Accounts.

We agree that it is important to appreciate that the interests of members may not accord in all respects and have already recorded our reservations in respect of the apparently widely-held view that the involvement of large institutional shareholders is a major asset in the good governance of proprietary companies.

The role of members' groups

We do not believe that seats on the board for representatives of members' groups would better serve the interests of members. This could lead to narrow policyholder interests prevailing to the potential detriment of other groups of policyholders and might put an invidious burden of potential liability on any member-nominated directors. The severe difficulties faced by the non-executive directors of Equitable Life, who were experienced and able individuals, illustrates that the role might be beyond the abilities and experience of the majority of members, irrespective of their other skills and backgrounds.

We believe that the members' interests are best represented by the existing board structures. However, we would always encourage communication and contact between the directors (particularly the non-executive directors) and members.

Balancing the interests of different groups

Life company boards will be used to balancing the interests of different generations of policyholders, for example in with profit funds, and a competent board should equally be able to balance the interests of different groups of policyholders. We do not see a difference in this respect between mutual and proprietary companies and believe that the creation of the new PPFM documents will assist in this area.

Lack of member involvement

It is open to debate as to how many members want to become actively involved in the running of the relevant organisation.

We see lack of specialised knowledge and experience, lack of interest and concern over personal liabilities as the key barriers to increasing involvement in the running of organisations. We believe that these factors will apply regardless of whether they are shareholders of proprietary companies or members of mutual organisations.

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?

What implications does the mutual form have for the way in which a firm conducts life business? For example, should mutual life offices be more risk averse than their proprietary counterparts? Is there evidence that they are more risk averse?

What information is supplied to policyholders on the business strategies of their offices?

In what ways are policyholders made aware of the risks attached to the strategic decisions of their Boards? What account is taken by boards of policyholders’ attitude to risk?

We do not believe that it is necessarily correct to equate the position of members with that of shareholders. The free assets of a mutual insurer will have been built over a large number of years and members will not have subscribed specific risk capital to the organisation, as would a shareholder.

In a proprietary company, there will be constant tension between the interests of policyholders and shareholders. Some individuals will fit into both categories but it is likely that the majority will fit into only one with owners who are not policyholders and policyholders who are not owners.

With a mutual office there is likely to be a greater incidence of ownership and policyholding as all of the owners will be policyholders, although there may be some holders of policies that do not confer membership rights.

While we recognise that a difference lies in the ability of shareholders who are policyholders to realise their investment in the company while retaining their policies, it is our opinion that matters of approach to risk are substantially common to mutual and proprietary organisations. All life companies have to identify the needs and interests of both their owners and their policyholders and manage the business according to the legitimate interests of both constituencies. We believe that the new Individual Capital Assessments, which closely link risk and capital, will reinforce this common approach to risk and risk management.

We do not believe that it is helpful to set out areas where a mutual life office might be different from a proprietary office, just because of its mutual form. The differences that do exist will be influenced, primarily, by the organisation’s specific position in terms of capital, trading position, strength and philosophy rather than by its ownership or structure. All companies will give careful consideration to the attitude to risk of its members and investors.

Regulation

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?

In what ways, in your experience, is supervision by the FSA currently concerned with mutual life offices' corporate governance? How effective are the instruments currently at its disposal?

The FSA's guidance on risk and systems of management and control and individual responsibility for regulated functions have helped to set the appropriate frameworks for life offices.

The Society's recent "Arrow" visit has also been a helpful "audit" of Liverpool Victoria's progress in this respect. We also note the FSA's role in the new Individual Capital Assessment requirement that has further emphasised the importance of risk management.

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

If so, what form might this take, and what would the practical consequences be? In particular, what safeguards would exist to ensure that, in doing so, a proper distinction remained between the responsibilities of the FSA as a regulator and the responsibilities of the life mutual's own board?

In general, we do not believe that any further direct FSA involvement in corporate governance is warranted, except perhaps in cases of severe deficiencies being identified in an office's approach or performance in this area where intervention is necessary to protect the interests of members. The FSA's current involvement in matters concerning the fitness of directors should continue and might be enhanced further, after consultation with the industry.

In our opinion, the running of a company is the responsibility of the company's board and it is not appropriate for the FSA to play any further role in governance beyond promoting understanding of the issues through its educational programmes and the monitoring of performance in this area. As with other aspects of governance, we feel that the involvement of the FSA should be consistent, irrespective of the business' ownership structure.

We believe that the processes referred in respect of Q9 above should continue and that the "Arrow" process could be developed further to cover more aspects of governance.

If any Code required a report on the organisation's performance in the area, submission of that report to the FSA could be made mandatory as part of a monitoring role on the part of the FSA.

We believe that some form of certification from the FSA as to compliance with these various requirements would be of benefit to members.

Market disciplines

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

What scope is there to enhance the external disciplines on mutual life offices? For example, can you think of a body or group that might behave in a similar fashion to the large shareholders of a public limited company?

Could more independent monitoring of life mutuals have a role to play? If so, by whom? What information might they need to perform this function?

We would welcome innovative and practical ideas.

We note that considerable emphasis appears to be placed on the beneficial role of large institutional shareholders in ensuring good corporate governance, to the benefit of individual shareholders, but do not agree that this will always be the case. The interests of such institutional shareholders will not always be aligned with those of the individual investor.

For example, the current take-over bid for the Abbey Bank is likely to be accepted, if at all, by the votes of institutional shareholders even though it might be unattractive to individuals who may not want to hold shares denominated in Euros and listed on a foreign stock exchange.

Although we understand that some mutuals' rules work in this way, we do not believe that individuals with larger premiums, investments or a greater number of policies should be given greater influence over the Society, in the way that owning more shares might give greater influence over a proprietary office.

In respect of possible take-over, there are many external and competitive forces that could influence a decision on demutualisation, including the need for scale, capital requirements and policyholder sentiment.

In the past, it might have been difficult for members to form sufficiently large groups to influence such matters as these but the first demutualisation vote in respect of Standard Life illustrates that they are not insurmountable.

The advent of the Internet has also made it much easier to form pressure groups and advertise their existence to large numbers of members. This makes it easier for individual members to create a body capable of acting like a major shareholder.

One issue facing members is being able to determine the relative strength and performance of their company in order to form a view as to the wisdom of its continuation as a mutual or the possible benefit of an alternative trading approach.

More readily comparable key information might be of benefit to members if certain industry indices could be compiled on an agreed, clear and consistent approach. A trade body approved by the FSA might produce this information which could be made available to members, for example in the Report and Accounts. We believe that this is a

matter affecting the whole industry and, if adopted, should apply to proprietary offices as well as mutuals.

The role of Independent Financial Advisers, and organisations compiling their “best advice lists”, should not be overlooked in respect of scrutiny of mutual offices. Over 50% of Liverpool Victoria’s business is sold through IFAs who play a significant role in advising their clients in regard to the bonus policies and capital strength of the various product providers, including mutuals.

In addition, there are a number of influential surveys and league tables produced by market commentators, the FSA and firms of accountants that must be taken into account by organisations seeking commercial success.

Although it is true that many members take little or no interest in the running of the company, the role of members should not be ignored. An increasing number of members are aware of governance principles and good practice and members have the ultimate sanction of pushing for demutualisation.

The potential advantages of financial mutuals

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 demutualisation? What are the implications of demutualisation for members and customers?

Theory suggests that financial mutuals should enjoy certain inherent advantages.

Consistent with this, some individual mutual businesses have enjoyed notable success.

Nonetheless empirical evidence suggests that overall the main trend in the UK is towards demutualisation. In the UK, some 12 major life insurers have demutualised since 1990. A similar trend has been observed in the US as well as in Canada, South Africa and Australia, though the same is not the case in most other European countries.

Why, in your view, is this the case?

What competitive or other business advantages does mutuality confer? Do you consider that particular types of financial sector business lend themselves to mutual ownership structures?

In your view, what new business opportunities exist for mutually owned businesses in the financial sector? What, if any, are the barriers to these opportunities being exploited?

What are the practical consequences of demutualisation, particularly for the interests of the firms' members and their customers?

In answering questions 12 and 13 we have confined ourselves to consideration of the mutual life sector which is the area of our expertise.

Q 12

We believe that barriers to success apply more by reference to the strategy, philosophy, strength and management of companies than to their trading style.

That said, a key advantage of mutual offices is the absence of the need to provide a return to shareholders. We note that the comments accompanying this question refer to “theory” suggesting that mutuals “should” enjoy some advantages but we believe that this key advantage is very real and significant and is well exploited for the benefit of the membership. For Liverpool Victoria, these benefits include enviable investment returns, a members’ help line and hardship fund, membership discounts and an approach to claims that puts the emphasis on helping the claimant.

Benefits also exist where a mutual is able to serve a small niche market that might otherwise be overlooked or treated less favourably by proprietary offices.

We would refer you to an article in the Daily Telegraph on Saturday 24th July which showed that the top 5 companies in terms of return on 25 year endowments maturing in 2004 were mutual offices. Liverpool Victoria was the company giving the best returns.

The key disadvantages of mutuality might include:

- **the current unfavourable media focus on the mutual sector (and with profits business in particular) as a result of issues in just two companies;**

- the possible difficulty of raising capital in the market; and
- the unavailability of share option schemes for staff.

We believe that a successful outcome to the work of the Review should be positioned to assist in tackling the first of these disadvantages. Restoring the position of trust widely enjoyed by mutual insurers will also help to address the issue of the UK population's savings gap.

It is our very strongly held view that the benefits of mutuality outweigh the potential disadvantages. It should be borne in mind that a number of proprietary insurers have found themselves in severe difficulties in recent years. The current issues with Equitable and Standard Life should not be allowed to undermine recognition of the general success of the mutual form of trading.

It should also be noted that we believe that a healthy mutual sector is of significant benefit to the UK population by having a moderating effect on premiums across the whole market.

Q 13

We believe that previous demutualisations have resulted from either financial weakness due to an inappropriate strategy or the lack of capital, or the receipt of a particularly attractive approach from another organisation.

While a generation of members is able to realise their proprietary interest in the organisation, our view is that this is likely to prove to be a short-term gain taken by relatively few at the cost of long-term disadvantage of generations of policyholders.

We would welcome investigation into approaches that might deter "carpet-baggers" in order to safeguard any free estates built up over many years being enjoyed by only one generation of policyholders. We believe that this would enhance the stability of mutuals. We understand that there is an approach in France that ring-fences some part of this free estate on a demutualisation, transferring it to another mutual organisation.

General governance principles for financial mutuals

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?

The review's terms of reference give it the task of considering what general governance principles might be applied to other types of mutual. We would, in particular, welcome information on any governance arrangements that are specific to other types of financial mutual, as well as your views on whether any of the generic options outlined in paragraphs 3.34 to 3.47 of this document might have some relevance to those mutuals.

This is a matter outside our direct experience.

Market structure

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

The UK life market is the largest in Europe and the third largest in the world, with total premiums of £35bn in 2003-04. Although a number of large mutual insurers converted to stock ownership in the 1990s, mutuals still account for a significant proportion of UK life business and include four of the top twenty life offices by total UK net premiums in 2002. At the same time, the mutual life sector contains many much smaller firms that are often based on particular affinity groups.

In your view, is governance inherently stronger in firms of a certain size or with a certain policyholder base? It would be helpful if you could provide specific examples to illustrate your response.

In principle, we do not believe that small mutual offices face different governance issues but the experience of some Liverpool Victoria directors would suggest that, in practice, differences may exist in terms of the way the challenges are addressed.

These may result from the dependence on one source of business or the difficulty faced by small organisations in engaging the range of skills and the diversity of experience necessary for today's difficult business and regulatory environments. We anticipate that this is also likely to be true of smaller proprietary offices.

Practice in other countries

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 are interested to know to what extent the UK differs from other countries in terms of the governance of its mutual life firms. While the principles of governance of stock companies are broadly similar across the OECD, it is less clear whether there are separate governance requirements for life or other mutuals either in addition to or instead of the arrangements for stock companies. We would welcome any examples from overseas from which we might learn. Are you aware of any specific examples of good practice among individual mutual organisations overseas?

This is a matter outside our direct experience but we anticipate that organisations such as The Association Internationale des Societies d'Assurance Mutuelle at 114 rue la Boetie, F-75008 Paris (tel: 0033 142 560449) will be able to provide information and assistance.