

MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS

Britannia Building Society welcomes this consultation, and the opportunity to contribute to the debate on corporate governance in the mutual sector.

We believe that the application of all relevant sections of the Combined Code represents a sound framework for the governance of mutual building societies. Key to the effective application of the Code is the appointment to the Board of non-Executive Directors with sufficient integrity and ability to ensure that a building society acts in the best interests of its members, who are its customers, supported by the Financial Services Authority (FSA), whose responsibilities include maintaining confidence in the UK financial system, and securing an appropriate degree of protection for consumers.

Whilst in law the responsibilities of non-Executive Directors (NED's) are the same as those of Executive Directors, NED's have a particularly important role in ensuring that members' interests are protected, as members are individual borrowers and savers, many of whom will not possess the financial acumen of institutional shareholders of Plc's.

Britannia's response to the questions posed by Myners is as follows:

SECURING COMPLIANCE WITH THE COMBINED CODE

Britannia is committed to best practice in corporate governance, and complies with all aspects of the Combined Code relevant to building societies. We believe that all building societies should be required to adopt this position, or explain fully why they choose not to. Where there are any exceptions, the FSA should take steps to satisfy itself that consumer protection is not affected adversely; also that the rationale for such exceptions is clearly explained by the building society concerned in its Annual Report.

BOARD EFFECTIVENESS

Board composition is key to the protection of members' interests. NED's must be in a position to provide effective challenge to the Executive Directors through:

- NED's having skills and experience appropriate to the level of complexity of the organisation's products and financial infrastructure.
- There being a sufficient number of NED's relative to the number of Executive Directors.

Britannia is a complex financial services organisation, which is why the Board includes NED's with considerable experience in managing and overseeing quoted companies, including two chartered accountants, a banker, a leading economist and a senior corporate lawyer. As an absolute minimum we will always have a majority of NED's on the Board; presently we have seven NED's and three Executive Directors.

The Chairman of the Board is responsible for ensuring NED's receive appropriate information and advice in order that they can discharge their responsibilities. At Britannia the Board and its sub-committees supplement internally provided information and advice externally as and when appropriate, and this facility is highlighted in the NED's letter of appointment. The Chairman must also ensure that NED's receive appropriate development and training, and at Britannia we identify requirements through a regular appraisal process, and arrange internal and external presentations, courses or seminars, as appropriate.

MEMBER VOICE

In a mutual building society each member, ie borrower or saver, has one vote at General Meetings. Consequently some critics of mutual organisations have argued that building society members have little influence over their Boards, relative to Plc's whose institutional shareholders possess a significant number of votes at General Meetings. In our view it is easier in practice to maintain a relationship with a small number of institutional members than is the case with 2 million members. In any event, it is the responsibility of a building society Board, overseen by the FSA, to ensure that members are treated fairly and their interests are protected appropriately.

Britannia has led the way in member engagement. As well as ongoing customer satisfaction research and focus groups, we host member evenings across the country, and we have a Member Council which discusses group policy and whose views are reported directly into the main Board. We actively encourage members to vote at our General Meetings, and we have the highest vote participation of any building society.

REGULATION

The regulation and oversight of building societies by the FSA (and previously the Building Societies Commission) has been effective, and building societies continue to be a very safe haven for savings. The FSA supervisory approach continues to evolve in line with the increasingly diverse markets in which building societies operate, and we support the FSA's adoption of a more developed risk based approach to optimise the use of its resources.

On governance, the FSA already assesses the adequacy of Boards of financial services organisations in many respects, and the FSA requires such organisations to have regard to the Combined Code. However, the FSA does not make the Code binding on financial services organisations, nor is there a requirement for such organisations to report publicly reasons for non-compliance. This appears to be at odds with the FSA's objectives, and we believe the FSA should make such a binding requirement. Any areas of non-compliance would then be highlighted in reports to the FSA and in the public accounts of the organisation concerned, for follow up by the FSA as appropriate.

MARKET DISCIPLINES

The highly competitive financial services marketplace in which building societies operate requires them to offer attractively priced products and good quality customer services, and to adopt an innovative approach at all times.

In order to support its lending activities Britannia requires access to cost effective funding from wholesale money markets. The Society's ability to borrow in these markets at competitive rates is dependent upon the market's perception of its underlying financial strength. The Society's financial health is subject to regular review by the major credit rating agencies eg Moodys, Standard & Poors, applying the same assessment criteria as those applied to quoted companies.

We are therefore no less disciplined in these areas than Plc's.

In addition, mutual building societies' activities are closely and constantly monitored by the press and media to ensure that savers' and borrowers' interests are fairly and reasonably treated.

THE POTENTIAL ADVANTAGES OF FINANCIAL MUTUALS

Building societies have two key advantages over their Plc competitors. Building societies do not have to pay dividends to shareholders, so they can operate on lower margins and offer better long term value. Furthermore, because the owners and customers of building societies are one and the same, there is never a conflict of interest between these two groups.

The drivers of demutualisation of building societies claimed by those which have converted to PLC's have been:

- Diversity of business operations and funding streams
- Releasing to members capital locked up in the business (windfalls)
- Relaxing constraints on risk taking
- Enabling closure of branches (although possibly no longer true in the current circumstances)

The result has been higher costs to both members and customers who now must provide enough margin for shareholders over and above that required to run and develop the business. This has meant a cut in service in order to enhance profitability in a competitive world.

CONCLUSION

The primary responsibility for corporate governance rests with the Board of a financial services organisation, whether it is a Plc or a mutual. The Combined Code provides a solid framework within which sound governance approaches can be constructed. It is for the Board to determine how best to apply the Combined Code, taking due account of the nature of its business, the markets within which the business operates, and the size and complexity of the business.

The FSA has statutory responsibilities relating to the protection of financial services customers, and we believe the FSA should strengthen its position on the Combined Code by requiring compliance with the Code, and reporting by exception.

Governance in large building societies is very similar to that in non-mutual financial services organisations. The same commercial pressures and market disciplines apply, including external assessment by rating agencies and the press/media, and organisations such as Britannia adopt best practice in corporate governance. We believe the same governance framework should be applied to all financial services Plc's, building societies and mutual life offices, as a mandatory requirement of the FSA.