

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

16 September 2004

Dear Sirs

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

As the company that has led to this review, Equitable Life has a particularly strong interest in the issues raised in the consultation document.

Before turning to our detailed responses, we should say that we believe that the current corporate framework (with adherence to the relevant parts of the Combined Code) is satisfactory. Past problems suggest failures to adhere to best practice, rather than a weakness in the framework. Where there are weaknesses in the framework, they generally apply to both mutual and proprietary companies.

We would not support ideas that have been floated by others for additional committees to represent policyholders. That is the job of the board, and in a mutual there is no conflict for the board between the interests of policyholders and shareholders. Many directors in a mutual will also be policyholders. Additional committees would add expense and delay for little value. The board should consider, and keep under regular review, its communications with policyholders to understand their issues and to satisfy them that the board acts in their interests.

**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?**

The Combined Code can, to a large extent, provide as appropriate a framework for mutual companies as it can for public companies. The need to "comply or explain" is a good discipline and should provide stakeholders with notice of divergence from good practice.

Certain aspects of the Combined Code, however, do not translate directly to the circumstances of a mutual, in particular, those relating to relations with shareholders. A mutual will, typically, have a large membership base, which makes effective dialogue with members and knowledge of their views more difficult than for a company where they can have dialogue with and canvass the views of major shareholders. Some mutuals (including us) have held "roadshows" to understand the views of members. This is expensive and not particularly representative. We

have also had both regular and ad hoc meetings and correspondence with some policyholder groups but they too are unlikely to be fully representative. See also the answer to Q7.

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

We consider that the best way is to require mutual life offices to comply with the Combined Code and to explain any divergence from this. A supplementary section for mutuals (in place of the section "relations with shareholders" relating to public companies) should be developed (e.g. should all policyholders, not just members, receive summary financial statements and information about the AGM?)

**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?**

The ownership structure and the nature of the business should affect the composition and structure of the board. For example, the board of a small "affinity group" mutual providing simple contracts would not necessarily need the same skills and experience needed by the board of a major life mutual providing a wide range of complex products to a large market.

There should be a non-executive majority. Collectively the non-executives should be able to understand and question the operation of the business in all areas. In addition to our comments on questions 4 and 6 there needs to be sufficient experience of life business to understand the context in which issues arise. There should be at least an annual review of each non-executive Director's performance and skills and that the non-executives in aggregate have the relevant up-to-date capabilities. The committee structure should be appropriate for the company. In our case, because of our litigation, we have a Legal Audit Committee. Most companies would not require such a committee.

**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 non-executives in other complex businesses, such as wholesale banking or science-based businesses?**

A criticism of the former position at the Equitable could be that the non-executive directors neither asked for nor received sufficient information and advice to enable them to identify relevant issues, in particular actuarial issues, and to exercise effective oversight of the executive.

It is important that the board as a whole receives relevant, comprehensive and comprehensible information and advice.

Life boards have been very heavily reliant on the information and advice they have received from their appointed actuary. With the changes being introduced by the FSA (requiring various actuarial roles to be held by different persons), the board should be less reliant on the information provided by and advice of one individual.

Testing by the Board of the quality and extent of information and advice received can be aided by ensuring a good range of knowledge and skills within the board. For example, it might be appropriate to have directors who have good knowledge and experience in, say, the actuarial, accounting and legal fields, who can question the extent or quality of the information provided relating to their particular speciality.

We are sure that similar considerations apply in other complex businesses.

**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?**

This is partly covered in the answer to Q4 above, in that the non-executive directors can be aided by having some of their number with relevant knowledge and experience of pertinent areas. However, it is up to each director to satisfy himself that he has a sufficient grasp of the information put to him and is in a position to challenge the executive if necessary.

**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 owners of a complex or technical business can reasonably expect that the board as a whole is sufficiently knowledgeable and experienced to be able to run the business effectively on their behalf and can expect a sufficient span of knowledge and experience to enable the non-executive directors, as a whole, to challenge and oversee the executive effectively.

The limitations a non-executive director could face include being reliant on the information provided by the executive, both its extent and quality, and not being expert in the more complex and technical aspects of the business.

As for codifying steps that might be taken, it would be appropriate to require the board (and the chairman in particular) to satisfy itself that the non-executive directors, taken as a whole, had the appropriate range of knowledge, skills and experience to oversee the business and the executive effectively. The board should be required to make a statement to this effect in the Corporate Governance statement in its annual report and accounts, including its reasons for considering this to be the case or, if not, the actions taken to remedy any deficiencies.

Executive and non-executive directors should have the same legal duties to the company, in respect of their roles as directors. Any change from this would be divisive.

**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?**

Members should receive appropriate information, so that they can participate in dialogue with the company, either at general meetings or by correspondence. All members should be given

the opportunity of voting at general meetings, and proxy forms should be issued as a matter of course to all members.

We suggest that each mutual life office should issue a report at least annually to its members. This report should, at the least, be equivalent to a summary financial statement required to be issued by a public company.

Each year the board should consider what additional communication is required with policyholders, proportionate to the issues it faces and appropriate for its size and ability to meet the costs. Attitudinal research of members and policyholders' which we undertake regularly, helps to inform this debate.

The Companies Act requirements for requisitioning resolutions at general meetings or requisitioning a general meeting are particularly onerous for members of mutuals. A lesser requirement is probably appropriate. For example, in 2003 The Equitable amended its Articles so that such requisitions need now only be made by 1000 members having the right to vote at general meetings.

It can be regarded as being at the heart of mutuality that one body of members should not have the ability to exercise undue influence over others. This can largely be achieved by having a limit on maximum voting rights.

In relation to Equitable Life, various action groups have been established to represent members but care needs to be taken as, in many instances, these groups may have their own "agenda" and not be representative of the wider membership. They can cause disruption and unnecessary expense to members generally.

A prime responsibility of the board is to ensure equity between different groups of policyholder. This must be to the forefront of all its decision making and the board should seek to explain to policyholders how it has achieved this. It is unclear how other organisations or groups could act effectively on policyholders' behalf given the overriding need for the Board to ensure equity between policyholders. The Regulator monitors the decisions of the Board in this respect.

**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 life mutual and its policyholders?**

The members of a mutual are the effective source of risk capital. Unlike individual shareholders of a public company, they do not have the comfort of major shareholders applying some oversight of the company's activities. This creates a particular need for the board to be fully aware that it is likely to be the only body exercising effective challenge of the executive and to satisfy itself fully on the risks being run and the effect of them crystallising. Also, the board should ensure that the members receive a proper return for supplying the risk capital. The board should conduct a formal review of this at least annually.

**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?**

A number of changes introduced by the FSA have improved the position. For example, the "approved persons" regime requires clear identification of those responsible for specific aspects of running an insurance company and the responsibilities they are undertaking.

The requirement for the FSA to approve persons taking these roles should ensure, at least, a minimum standard for those holding the positions and that no one person should hold such a range of roles that would give him an inappropriately influential position. As referred to in the answer to Q4 above, the changes to requirements relating to actuarial roles which are shortly to be introduced by the FSA will add to this diversification of roles.

There is now the requirement to publish the document called Principles and Practices of Financial Management and for the board to certify that the with-profits business has been run in accordance with it. This can be regarded as a useful tool to focus the board as a whole on its duties to policyholders and an encouragement for it to scrutinise carefully the evidence for the statements made.

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

The FSA's role at present is, largely, to identify whether or not individuals are "fit and proper" for the roles that they take. It is not immediately obvious that further involvement by the FSA would be constructive. Care needs to be taken that the FSA does not, in effect, become a shadow director of the life office. In particular the suggestion from Lord Penrose, repeated at 3.12 of the consultation document, would be likely to put the directors in an impossible position. At times the discharge of the FSA's general responsibilities may not necessarily be well aligned with the interests of a specific organisation. There would be very considerable risks in extending FSA involvement.

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

A highly relevant market force for most mutual life offices is the ability to acquire new business and to retain its existing business. However, this is not necessarily as effective a market force as it would be in, say, a building society. As pointed out in the consultation document, policyholders cannot easily withdraw their policies without apparent loss because of the way in which bonus, investment risk and expenses are spread over the lifetime of the policy. It is therefore far more difficult for customers to "vote with their feet".

Having said this, the board of a life office is obliged to consider the reasonable expectations of policyholders and to ensure that customers are treated fairly. Its conduct should reflect this. Should this not be the case, the FSA could be expected to intervene. In addition, policyholders can vote on directors and so change the running of the company. With modern communications this is a real power and policyholders can organise a lobby group cheaply.

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

The most significant barrier to the success of mutual businesses in the UK is the lack of ready access to capital, for example to enable further development of the business. While it is possible to utilise members' funds for such development (and to give an appropriate return for this), this increases the risks being run by them.

It seems unlikely that any major new mutual organisation will be established as access to sufficient start-up funds is unlikely to be available and the return on capital employed would be unlikely to be commercially viable.

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

The most likely driver for de-mutualisation is the need for capital. The diminishing proportion of with-profits business also means that the capital base of the business may become inadequate, or inappropriate.

The implications for members and customers will vary, depending on the circumstances of the mutual in question. If it is an efficiently run company providing good returns, it could be to the detriment of members and customers for it to de-mutualise. However, where the mutual would not otherwise remain viable, with costs being shared over too small a client base, or where solvency requirements would limit investment flexibility, there could be significant benefits to members and other customers from de-mutualisation. Members may also be persuaded to support de-mutualisation as a way of making a short term gain through realising the value of goodwill in the business.

**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 mutuals sector? What would the consequences be?**

We suggest that all financial mutuals should be required to comply with the Combined Code (or explain any non-compliance). As mentioned in the answer to Q2, a revised section of the Code (to replace "relations with shareholders") should be developed for mutuals.

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

With small, affinity group-based, mutual life firms there is likely to be a closer relationship between the board and the members.

As mentioned in the answer to Q3, the board of a small affinity group-based mutual may not need to have such a wide range of skills and experience.

**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 do not consider that we can comment usefully on this question.

We have discussed some of these matters with you at the various meetings you have already had with us, but would of course be happy to meet with you further to discuss these issues more fully.

Yours faithfully

Charles Thomson  
Chief Executive