

## **Myners Review Consultation: Submission by The Standard Life Assurance Company**

### **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?

**A1** *The evolution of modern corporate governance standards has largely been a direct response to corporate failures in the (proprietary) quoted sector but, in our view, compliance with best practice in relation to corporate governance is a key factor in the success of all well run companies and is equally applicable to the mutual sector. Standard Life has, for a number of years, applied the Combined Code as if it were a quoted company. The internal discipline inculcated by this practice has fostered the evolution of board selection and training procedures, access to independent professional advice and the use of robust committee structures to enhance the effectiveness of the board. Mutual companies, by definition, do not have institutional shareholders, and the parts of the Combined Code which relate to institutional shareholders are not readily applicable to mutuals. The remaining parts of the Code are, however, relevant and useful.*

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

**A2** *We believe that the best approach would be to require mutuals to report on adherence to the Combined Code (with minor adjustments to reflect the structural differences between mutuals and plcs) on a "comply or explain" basis, in the same way as is currently required of listed companies. Mutual companies have been criticised in the past for a lack of transparency in their governance arrangements and such a reporting requirement would do much to remedy this.*

### **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?

**A3** *In our view, the composition and structure of an effective board should be determined by reference to the business needs of the company in question and in this respect there is no difference between proprietary and mutual companies. Save to the extent already prescribed by the Combined Code, we do not believe that it would be in the interests of companies or their members for the composition of boards to be determined by reference to the category into which a particular director falls, whether as the representative of a particular group of stakeholders, the holder of a particular professional qualification or otherwise. Mutual life companies are, of course, regulated by*

*the FSA and in this respect they may well differ from the listed holding companies of life companies in the proprietary sector. In the latter case, the holding company, while subject to the Listing Rules (and the Combined Code) may not itself be regulated. The governance of its regulated life company subsidiary would not normally be subject to the requirements of Combined Code. If mutual life companies were to be subject to the Combined Code as suggested above, the directors of these companies would be subject to both regimes.*

**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?

**A4** *Again, the provisions of the Combined Code are highly relevant, particularly the following :*

*A.1.3 “The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman’s performance (as described in A.6.1) and on such other occasions as are deemed appropriate.”;*

*A.5 “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 and refresh their skills and knowledge.”;*

*A.5.2 “The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company’s expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.”; and*

*A.6 “The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.”*

*We consider that appropriate adherence to the provisions of the Code should allow non-executive directors to exercise effective oversight of the executive. Access to independent professional and other expert advice is important for non-executive directors both in mutuals and in proprietary companies and this is of particular significance in complex businesses. It may well be appropriate, in certain circumstances, for the non-executive directors to meet with relevant professional or other expert advisors without executive directors being present.*

*Compliance with the Combined Code in a complex business requires a significant time commitment on the part of non-executive directors and it must be borne in mind, in this context, that the role of non-executive directors in a unitary board is not merely to exercise oversight of the executive but to assist*

*the board in driving forward performance of the company to create value for its members.*

- 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?
- A5** *We endorse the guidance for non-executive directors appended to Combined Code which, we believe, is applicable regardless of the structure of a company or the nature of its 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?

- A6** *Some care requires to be taken when using the word “owners” in the context of mutual companies. It has been a convenient short hand to describe policyholders as “owners” of a mutual company but the use of this expression can tend to suggest that the relationship between policyholders and a mutual company is the same as the relationship between shareholders and a proprietary company when, in fact, there exist important differences. Policyholders own policies which may confer rights such as the right to vote at company meetings and the right to receive a share of surplus on the winding up of the company. Shareholders in proprietary companies own shares of the company itself and these shares may also confer rights on the holders such as the right to vote and the right to participate in a surplus on winding up.*

*The legal duties of executive and non-executive directors should be the same. As much of the law governing the duties of directors is common law, it can be difficult for directors - and the company members to whom they are accountable - to obtain clarity on the nature and extent of those duties. The promulgation of general principles by which directors should be bound, as set out in Schedule 2 of the draft Companies Bill published in July 2002, would be of considerable assistance in this area.*

### **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?
- A7** *With profit policyholders, who provide capital for a mutual life company and assume the associated risk of doing so, should be entitled to vote at general meetings of the company and there should be provisions in the constitution which allow members to call special meetings without undue difficulty.*

*The Articles Association which governed Equitable Life during the period reviewed by the Penrose Report made it effectively impossible for members to put any matter on the agenda for consideration at general meetings without the support of the board. As Lord Penrose remarks in paragraph 54 of chapter 20, “the constitutional position of Equitable may be unusual”. It certainly differs materially from the constitution of Standard Life. The constitution of Standard Life has never contained structural barriers which prevent members who wish to requisition a Special General Meeting from doing so and we note that paragraph 54 of chapter 20 of the Penrose Report refers, favourably, to the rights of our members to requisition business. Under our Regulations, adopted in 2002, a Special General Meeting may be requisitioned by one thousand members who are entitled to vote at general meetings. This is not a difficult hurdle to overcome, particularly with use of the internet by members’ campaign groups, as demonstrated by Mr Stonebanks’ campaign in the summer of 2003. Prior to 2002, fifty voting members could requisition special General Meetings and, indeed, a Special General Meeting was held in June 2000 upon a requisition of members.*

*In 2000, Standard Life began the practice of sending to voting members, prior to general meetings, voting packs with information about the business of the relevant meeting and proxy forms. The pack, which is despatched to members prior to the Annual General Meeting, also contains a summary Annual Report and Accounts. The effect of instituting this practice was a dramatic increase in member engagement in general meetings of the company. Mutuals who wish to comply with Combined Code would require to follow a similar practice.*

**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?

**A8** *The dependency of a life mutual on with profit policyholders as its principal source of risk capital means that a decline in the volume of with profits business as a proportion of the mutual’s total business may have significant consequences for the mutual and its policyholders, reducing the capital available to the company to support and develop its business and increasing the proportionate effect of the mutual’s business risks on the with profit policyholders.*

## **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?

**A9** *The period since 1997 has seen very considerable change in the regulatory framework in which life companies operate, improving the processes*

*governing the identification, reporting, assessment and management of risk and thereby enabling corporate governance to operate more effectively.*

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

**A10** *While the FSA undoubtedly has a key role in the continuing evolution of corporate governance in the regulated sector (both mutual and proprietary companies) in relation to risk, it is important to recognise that corporate governance is not concerned solely with the control of risk. Rather, it is more generally concerned with the effective operation of companies in a way which creates value for the companies and their members.*

*While, as suggested above, we believe that a formal obligation on mutual life companies to adopt a "comply or explain" approach to relevant aspects of the Combined Code would be beneficial, we do not believe that it would be in the interests of policyholders for the FSA's role in the corporate governance of life companies to be increased, as there is a significant difference between the statutory objectives of the FSA and the objectives of mutual life companies. In particular, the FSA has no statutory objective to maximise returns for policyholders.*

*There would also be a concern that increased involvement in the governance of a mutual life company by an external organisation, even a regulator, would render less clear the responsibilities of a unitary board; in extreme cases, questions might arise as to where the responsibility of the Board ended and that of the FSA began.*

### **Market disciplines**

**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?

**A11** *Mutual life offices are under constant scrutiny from the financial media, who influence customers, prospective customers and intermediaries, the behaviour of all of whom is central to the success or failure of the mutual.*

*Because, by definition, the voting members of a mutual are also its customers, the performance of the mutual's products, and the way in which they are regarded by the financial media, will tend to influence the behaviour of voting members. It is not possible, in a mutual, for individual dialogues to take place with a limited number of institutional shareholders who, together, control the exercise of a significant proportion of the voting membership of the company. Accordingly, mutuals must work hard to communicate with their policyholders in order to obtain their support.*

### **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?

**A12** *Mutuals have restricted access to capital markets. This can inhibit growth, particularly at times when life business is increasingly capital intensive.*  
and

**Q13** What are the forces that drive demutualisation? What are the implications of demutualization for members and customers?

**A13** *The main drivers for demutualisation have been the desire of companies to have greater access to capital markets and the reallocation of business risk to equity shareholders.*

### **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?

**A14** *We are unable to comment.*

### **Market structure**

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

**A15** *We are unable to comment.*

### **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?

**A16** *We are unable to comment.*