

THE PENSION ANNUITY FRIENDLY SOCIETY LIMITED MYNERS REVIEW OF LIFE MUTUALS

Q 1. Combined Code

The current guidance on corporate governance, taken with the FSA's requirements, is the basis of our practice. PAFS feels that the number of sub-committees is excessive, eg nomination. Some of these roles can be carried out by the main board in a small company.

Q 2. Enforcement of Code

The best way of ensuring compliance is enforcement by the FSA.

Q 3. Structure of Board

There are several roles on our board:

Firstly the chairman, who is responsible for the running of the board, but not of the company.

Secondly the executive management who are responsible for the running of the company. The distinction between the roles of chairman and chief executive should be absolutely clear.

Thirdly, those non-executives brought in for their expertise in a particular area. PAFS has non-executive directors with reinsurance, tax and banking experience. These directors are seen by the code authors as primarily there for corporate governance purposes, but historically that has not been the case. A change of role would affect job descriptions and recruitment processes.

Fourthly, policyholder representatives.

PAFS does not think that its mutual status has led to a different composition to what would apply to any proprietary company, except for the policyholder representatives.

Q 4. Information and advice

PAFS non-executive directors have commissioned independent advice on several occasions, from actuaries, lawyers and others. The advice offered to the board by the appointed actuary, Watson Wyatt, is believed to be invaluable by our non executive directors. They are concerned that in the future non executive directors will be expected

to take decisions on complex matters without the benefit of independent actuarial advice. In practice we will retain Watson Wyatt, but this will not be a requirement.

Q 5. Role of non- executive directors

The non executive director should bring independent advice and judgement to the deliberations of the board and be prepared to raise concerns at the instigation of policies which may be against the long term interests of the members.

The non executives should be appointed so that they bring to the board expertise in particular areas - selling, accounting, actuarial - where it is essential that they know enough to understand what the executives are doing and talking about. They must be able to understand the reports presented to the board, and this entails that the reports are provided in a way which is intelligible.

Q 6. Practical limitations

The owners of a complex or technical business can expect honesty and diligence from non executives. No more codes please. Legal duties may be identical but independent expert advice must be available in at least actuarial, financial and company law matters.

It is not reasonable to expect non executive directors to stop a determined effort to deceive them by the executive. They do not have access to sufficient information not provided by the executive.

Q 7. Policyholder influence

Policy holders should be encouraged to attend the annual general meeting and be given the genuine opportunity to comment upon agenda items during the meeting. The practical barriers are the unwillingness of members to attend the meeting and become involved, and the complexity of the rules under which life mutuals operate. Policyholders should do more and have more say - it is up to management to devise imaginative ways of facilitating this. However, policyholders will never be able to police management.

Q 8. Policyholders as source of capital

Penrose wrong re policyholders providing capital, as this only applies where management apply returns on with-profit funds to other lines of business. In PAFS case policyholders have not supplied any capital. This has been sources from reinsurers and banks. Policyholders are owners but not capital providers.

Q 9. FSA success in corporate governance

No. We are cynical about the genuineness of the commitment to corporate governance, rather than their own wellbeing, of the managements of many large UK companies. The FSA has to prove that it can enforce appropriate standards.

Q 10. Role of FSA in mutuals

See question 6 above, where we are sceptical about how effective even the best non executives could be if the whole executive sets out to deceive them as to the true picture. We believe that the same limitation will apply to the FSA but to a greater degree. The FSA will never have sufficient resources to be so close to what is going on that they could second guess a sufficiently determined management team.

The only group who can make sure a life mutual is well run is ultimately the executive management. Policyholders and non executives can not provide a full policing role as they will not have the time or resources.

The question therefore is who will ensure management is well behaved in a mutual, and it is here that there is a clear role for the FSA. The FSA will need to be able to make poor management personally very uncomfortable if they are to be effective.

Q 11. Market forces for mutuals

Mutuals are generally subject to market forces in their customer and supplier markets. The main market force is the need to generate sufficient profit on trading to maintain solvency.

Q 12. Barriers to success of mutuals

The specific barrier to the success of mutual businesses in the UK is the lack of access to tier 1 capital. International regulators could usefully design a form of capital which they would consider to be equivalent to tier 1 but which is not equity. The debt markets have no appetite for undated securities, but will issue very long dated securities. The maximum 50% rule makes this route of limited use.

Q 13. Forces for demutualisation

The main 'push' force behind demutualisation is lack of capital. Are there any life mutuals which have demutualised because policyholders wanted them to, as opposed to management?

Q 14. No comment.

Q 15. Small affinity mutuals

Small companies usually face the twin problems of lack of facilities for proper division of duties and separation of controls, and lack of control over the chief executive. They may well also have inadequate internal audit. There is an issue relating to costs of compliance and regulation v something which has worked satisfactorily for centuries in some cases.

Q 16. Other countries

Mutuals exist in much of Europe with much less regulatory focus than in the UK.