

THE LORD BLACKWELL

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Review of the Governance of Life Mutuals
HM Treasury
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Dear Paul

Governance of Life Mutuals

In providing a personal contribution to your review of the governance of Life Mutuals, I would first emphasize that I fully support the perspectives set out in the formal response to your questions submitted by Standard Life, of which I have been a non-executive Director since last summer. Rather than repeating the same ground, I thought therefore it might be most helpful to give you a purely personal perspective on the main conclusions to be drawn for the future.

I start with a general view that governance in any organisation, while focussed on the Board, depends for effectiveness on the interaction of a number of pressures for transparency and scrutiny. While institutional shareholder scrutiny may be unique to a plc, other factors – including market and competitive pressures, press and customer scrutiny, debt rating agencies, regulators, auditors, etc are of course common. Furthermore, the performance of the Board is heavily dependent on the style of the Board, the quality and independence of the non-executive and executive Board members, and their access to relevant information that has been subject to expert external scrutiny. Prescriptions about the rules and regulations by which governance should operate can be a helpful support, but are no substitute for – and no guarantee of – these real determinants of the quality of Board contribution and challenge.

Although my specific experience at Standard Life has been relatively short, I share doubts about whether all of these conditions have generally been well met in Life Mutuals – or indeed some other Life Companies – in the past. In particular the general opaqueness of historic financial and actuarial reporting in life companies, and the absence of any requirement for Mutuals in particular to report on ‘achieved profit’ measures, together with the relative ambiguity of accounting for liabilities, is likely in the past to have made it particularly difficult for non-executives (or external analysts) to understand and challenge the true state of the business performance. Nevertheless, my experience over the last year would encourage me to believe that many of the conditions which may have permitted weak governance in the past have now already substantially changed.

First, the new reporting requirements of the realistic balance sheet, despite its difficulties, together with the responsibilities placed on Board Members to review and approve the information, does now create a situation where visibility and scrutiny has been greatly improved. The requirement for the full realistic balance sheet to be externally audited, including independent actuarial scrutiny of the liabilities, is also a crucial new condition which will help avoid over-dependence on a single source of internal actuarial expertise.

Second, I would suggest that the heightened awareness of the responsibilities and liabilities of non-executive Directors in the wake of the Equitable Life case reinforced by the increased regulatory scrutiny, will have had a major and salutary effect in ensuring that – whatever may have been the norm in the past – all non-executives of Life Mutuals should now be fully aware of the importance of their scrutiny role.

The current state of governance should also be seen against a context where I believe the external pressures on the Board for effective governance are strong. Given that Life Mutuals operate in highly competitive markets, and with limited capital, it has of course always been the case that they have faced strong pressures for effective market and economic performance. While they may not have had the discipline of equity market analysts and investors, their performance has faced strong scrutiny from financial advisors, from press commentators and from both existing and potential policy holders. The financial standing of those with debt securities has been subject to scrutiny by the rating agencies. Their financial accounts have also been subject to both independent auditor and regulatory review. All of these pressures will have been considerably strengthened by the improved information flow on financial and balance sheet performance, which might be expected to generally reduce the time delay before changes in underlying economic performance are visible in published results.

While it would clearly be wrong to be complacent, I would suggest that the effect of this scrutiny combined now with the enhanced awareness of the responsibilities of non-executive Directors, the greater availability and publication of meaningful financial data, and the increased role for independent actuarial scrutiny does already create a new and more transparent governance environment. The increased scrutiny provided by the FSA, with its emphasis on ‘Treating Customers Fairly’ provides a still further level of additional public interest review. It will be important, therefore, to ensure that any prescriptions adopted today are not addressing yesterday’s problem.

In addressing governance issues generally, I do believe a careful balance needs to be struck between the desirability of codifying rules that sensible governance should observe and the risk that excessive prescription and regulation actually detracts from effective governance by focussing attention on ‘meeting the rule’ rather than ‘challenging the substance’. While any genuine improvement in governance is of course to be welcomed, against the background of recent changes I would suggest any new proposal you might consider will need to be very carefully scrutinised to ensure that it does address a real remaining concern – and does not simply add to the burden of box-ticking compliance.

Lord Blackwell

