OLD MUTUAL

5th Floor, Old Mutual Place, 2 Lambeth Hill, London, EC4V 4GG
Tel: +44 (0)20 7002 7217 Fax: +44 (0) 20 7002 7207
andrew.birrell@omg.co.uk
Andrew Birrell, Group Risk and Actuarial Director

8 July 2011

Mr Marek Grabowski
Sharman Inquiry
c/o Financial Reporting Council
Aldwych House
71-91 Aldwych
London
WC2B 4HN

Dear Mr Grabowski

Request for Evidence – Sharman Inquiry

I am writing to you in my personal capacity as the Group Chief Risk Officer of Old Mutual plc, in response to the request for evidence that you sent to me. My responses are based on my experience in the financial services industry (covering life insurance, general insurance and stockbroking) over a period of 21 years, particularly over the period that I have been with Old Mutual plc, from July 2008 to the present time.

In respect of the questions posed, I would like to respond as follows :

1. I believe that it is critical to draw the distinction between capital adequacy / solvency and liquidity.
    - Capital adequacy addresses the issue of whether an organisation has sufficient qualifying capital resources to cover the financial consequence of a range of uncertain adverse outcomes (risks) that may transpire
    - Should these uncertain risks crystallise, it does not follow that the organisation will need to use liquid resources to deal with the consequence. For example, in the case of a life insurer, if a financial risk crystallises such that policyholder assets are diminished and inadequate to cover policyholder liabilities, it is possible that the shareholders could transfer non-liquid capital resources to policyholder assets in order to cover any shortfall, thus increasing policyholder assets and diminishing shareholder assets
    - Liquidity is required where the organisation needs to transfer liquid funds to third parties, for instance in the event that customers, suppliers, employees or other creditors need to be settled.
    - Capital may not always take liquid form, and it is possible for an organisation to be able to demonstrate that it is solvent ie has adequate available capital resources of sufficient quality to cover the required capital, but for the organisation to be constrained in terms of liquidity since the available capital is comprised of assets with low liquidity.
    - Typically this lack of liquidity leads to increased costs to access liquid funds, and in the extreme to failure. During the recent crisis this was clearly observed in a number of high profile banks, where emergency liquidity had to be made available in order to prevent more severe adverse outcomes. A key contributor to the increased level of distress was the closure of bond

Old Mutual plc is a public company limited by shares. Incorporated in England and Wales under registered number 3591559. Registered office as above.

markets, a factor that had previously been poorly understood in respect to the business model of these organisations.

Accordingly, it would appear to me that a key lesson for companies and stakeholders is that there is a need to fully understand the extent to which an organisation's current liquidity sources are able to withstand increased demands, along with a clear understanding of how the organisation would access additional liquidity at a time that their customary sources of liquidity are unavailable.

This would imply a requirement for organisations to clearly understand :

- their sources of liquidity (along with durational information, if these liquidity sources are not immediately accessible),
- the liquidity stress tests and measures which are used to determine the Adequacy of the liquidity arrangements (including the key metrics and targets)
- the contingency plans that would be implemented should these liquidity resources be inadequate during times of stress.

It is likely (but not certain) that this information would currently be covered in the material presented to an audit committee or board of directors in order for the organisation to demonstrate that it is a going concern. It may be appropriate to set a minimum standard that requires all companies to provide such information to their Audit Committees and Boards.

The information covered above is also likely to be of interest to outside stakeholders (eg shareholders), and it is necessary to determine whether publication of such information would lead to any adverse outcomes for organisations (for example, whether such information could be used in a detrimental manner by a competitor) prior to concluding on whether such disclosures should be mandatory

The going concern review is currently expressed in terms of the ability to continue trading for a period of 12 months from the signature of the financial statements. Given recent experience where debt markets were closed to issuers for a longer period than 12 months, it may be worth considering whether the 12 month time horizon for the going concern review should be increased to 18 or 24 months. This would give external stakeholders a greater level of comfort that an organisation would be able to withstand unforeseen liquidity stresses, exacerbated by debt market closure, notwithstanding the current liquidity stresses that may be considered in the finalisation of the going concern review.

2. The information relating to current stresses and management of such stresses is typically of interest to rating agencies during the annual rating review process, when a substantial corporate action is being undertaken, or prior to the issue or placement of a new debt instrument. Such processes tend to operate under strict confidentiality, and are encompassed in the final rating determined by the agency.
3. Prior to 2008, there was some evidence to indicate that liquidity concerns did not give rise to the same level of concern as that evidenced post 2008, where it would appear that a number of parties (investors, rating agencies, regulators, debt holders, auditors) took far greater interest in liquidity and the arrangements in place to ensure adequate access to liquid funds. Given the increased level of scrutiny and concern post 2008 it would appear that there have been limited, if any, instances of major companies that have been reported as going concerns and then subsequently failing as a

consequence of inadequate liquidity. This would lead one to believe that the current process for demonstrating that organisations meet the requirements of going concern have been effective in signalling their financial condition.

4. No comment to make in respect to this question
5. In respect of the items raised under this question :
   - The organisation I work in has implemented a Risk Committee, which took place by splitting the previous Audit and Risk Committee into a separate Audit Committee and a separate Risk Committee.
   - As a brief summary of the separate Terms of reference for these committees, the Audit Committee considers all matters relating the financial statements (IFRS and supplementary disclosures such as MCEV), financial reporting standards, and all matters relating to controls. The Risk Committee considers stress tests, evaluates risks which may occur and reviews issues that have crystallised and caused the organisation to incur unexpected losses.
   - There are some matters which overlap between the Risk and Audit Committees and in order to ensure that these are dealt with appropriately the Chair of the Audit Committee is a member of the Risk Committee and vice versa.
   - Each committee receives reports dealing with the matters that fall under the Terms of Reference of the Committee. In the case of the Audit Committee, these reports are typically authored by the Accounting function and the Internal Audit function. In the case of the Risk Committee, the reports typically authored by the Risk and Regulatory compliance functions
   - The Audit committee deals with matters relating to the going concern statement. The Risk committee regularly reviews the outcome of a variety of stress and scenario tests, which would also include liquidity related stresses and scenarios, as well as regular reports covering a number of risks, which include liquidity considerations. The work undertaken on the stress and scenarios tests, and the regular liquidity risk reports would inform the going concern work presented to the Audit Committee.
   - The stress and scenario tests, regular risk reports, and going concern considerations would be considered in the business planning process and the business plan would be finalised subject to satisfactory consideration of a number of matters concerning stress and scenario tests and a number of risks (which would include liquidity risk).
   - Old Mutual does not rely on regularly accessing debt markets in order to fund the business. Funding arrangements (eg the Group's Revolving Credit Facility) tend to be put into place and renewed over multi year periods to ensure that dislocations in markets do not call the organisation's ability to access liquidity into question. In cases where other organisations rely on frequent access to debt markets in order to obtain liquidity, I would suggest that it would be useful for the management and boards of such organisations to test closure of such markets when determining the resilience of the business model, for periods in excess of 12 months. This could give better insight into likely outcomes if customary liquidity is not available. It may also be valuable to external stakeholders if such organisations clearly indicated the impact of inability to access customary liquidity (eg wholesale markets) in either

their risk reports or going concern statements, and provided some indication of the contingency plans and resultant resilience of the organisation in such instances.

- As a more general point, there is a balance to be found between mandating a generic approach to disclosure versus the factors that will impact an individual organisation's liquidity and going concern risk, which will be very specific to that organisation. It is difficult to establish a generic approach to detailed disclosures required to be applied across all organisations that would ensure clarity in respect of their top risks. The Addison review of Risk Reporting published in 2009 indicated that UK companies tended to be implementing risk reporting in a more detailed manner than many others, although it also highlighted a number of areas where improvements could be made. In particular, they commented that a large number of public companies tended to report their risks in a relatively standardised and generic manner. As a consequence, there may be some merit in requiring organisations to disclose their top risks (including those relating to liquidity and ability to continue as a going concern) in a manner that is individualised and specific, at a level of granularity that would allow an external stakeholder to better make considered judgements on the risk profile of an organisation.

I have no comments in respect of the rest of the questions. I trust that the above points are useful to the Inquiry

Yours sincerely

Andrew Birrell