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Dear Catherine,

**AFM Response to FRC consultation on revisions to the UK Corporate Governance Code**

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
  - comment on the proposals, and
  - explores the implications of the changes to the Code for the annotated version we maintain for AFM members.
2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £19.6 billion, and employ nearly 30,000 staff<sup>1</sup>.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses<sup>2</sup>.
4. In addition, the Bank of England and Financial Services Act 2016 now provides an additional Diversity clause for FiSMA, to require the PRA and FCA to take account of corporate diversity and the mutual business model in all aspects of their work<sup>3</sup>.

<sup>1</sup> ICMIF, <https://www.icmif.org/publications/market-insights/market-insights-uk-2016>

<sup>2</sup> Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

<sup>3</sup> <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

5. We consider ourselves to be active stakeholders in the consultation, although we recognise that the UK Corporate Governance Code (the Code) itself is targeted mainly at listed companies. We do though currently maintain an annotated version of the Code, which we expect our members to adopt as good practice in corporate governance. We will be reviewing our annotated Code in light of changes to the approach for listed companies.
6. We have restricted our comments to those aspects of the consultation relating to the UK Corporate Governance Code, since we consider that most aspects of the UK Stewardship Code do not relate to smaller mutual insurers that outsource fund management.
7. With regard to the Code, we acknowledge the value this has generated for the last 25 years, and the importance of preserving aspects of the UK approach to governance that are proven to work well. But we also recognise the constantly evolving environment and the justification for change, as set out in the Executive Summary.
8. Our responses to specific questions raised in the consultation are attached below. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Chief Executive  
Association of Financial Mutuals

## Our responses to specific questions raised in the consultation

*Q1. Do you have any concerns in relation to the proposed Code application date?*

We agree with the proposed timescale; i.e. that firms should aim to comply with the revised Code for financial years beginning on or after 1 January 2019. We would expect our annotated version to work to similar timescales, and that therefore where our members report on compliance for the first time it will be for report and accounts issued during 2020.

There is a risk though, if the final version of the Code is issued later than planned, that firms will not be able to change processes and procedures to meet the new requirements on time. For AFM, where we expect to have to consult with members and key stakeholders on an annotated version of the Code, and that this can only take place once the FRC's final version is published, those timescales will be reduced significantly.

*Q2. Do you have any comments on the revised Guidance?*

The draft revised Guidance on Board Effectiveness constitutes an important part of the overall governance regime in the UK. The clear and conversational tone of the Guidance helps bring more of the Code to life, and provides a helpful checklist for Boards of the activities that underpin good governance.

Where elements of the current Code have been removed and either deleted altogether (because they are now seen as self-evident good practice), or moved to the guidance, this has helped to focus the Code on the key aspects firms may need to focus more on.

As a consequence the content of the guidance will become more important in ensuring boards deliver high standards. The risk though is that important issues (such as refreshing membership of the board and committees) are attached less importance because they sit in the guidance rather than the Code, and this might be misinterpreted as a softening of expectations. As the Guidance is non-mandatory and not subject to comply or explain reporting, there is potentially greater scope for firms to avoid good practice.

We think this risk will be addressed by clear signposting between the Code and guidance, and more encouragement for companies to focus attention on both documents.

*Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?*

As the government has identified, it is important that companies take proper account of the interests of a wide range of stakeholders. This is particularly the case for the employee base, without whom the corporate strategy and culture will not of course be delivered effectively.

Principle 3 provides options for companies to pursue in achieving meaningful employee engagement: we agree these are the most relevant, and that a 'comply or explain' approach still enables organisations to pursue alternatives where they prove workable and effective.

Financial firms should already have in place an effective whistleblowing process, and a director with responsibility for oversight: this aspect of Provisions 3 therefore helpfully reflects good practice.

*Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?*

The issue of sustainability is important in the content of corporate governance, and companies should be encouraged to consider how they contribute to society at large. In our view, particularly for smaller organisations, the UN SDGs are too broad to be usefully incorporated into the Code or Guidance.

However, more company specific consideration of sustainable business practices, perhaps in the guidance, would make a useful contribution. This might encourage firms to focus on the immediate environment in which they operate, so that large multinational firms and small, local firms might each consider how to foster good practice.

For smaller organisations, such as those AFM represents, sustainability might focus on supporting the interests of the workforce, the customers and the local communities in which they operate.

*Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?*

We agree that 20% is 'significant' in the context of votes against a resolution, and that firms should record fully the actions they intend to take. An update, six months after the vote, will encourage firms to act responsibly, though in practice this may be too soon for evidence of effectiveness, and the next annual report should provide more detail of action taken.

*Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.*

We agree with the removal of exemptions for companies below the FTSE 350. In our annotated version of the Code, we expect all our companies- none of whom would meet the scale of the FTSE350- to comply with with all the provisions, except for our very smallest organisations, who are non-directive insurers with typically fewer than 20 staff and a board made up of volunteers. Even so the range of exemptions we provide is small (around 10% of all provisions). We are also now providing an exemption to our cash plan providers from section E of the current Code as they have a different governance structure (no shareholders or members).

We consider the removal of exemptions should include the need for an independently facilitated board evaluation every three years. We see this as a different role to the

statement in paragraph 50, which omits the word ‘facilitated’: we note this is included in the draft Code and we think this distinction is important.

Within the annotated version of the Code we maintain, we expect all members to consider the need for externally facilitated board evaluation every three years. Last year, 45% of our members reported they have engaged external support, and this remains one of the least complied with provisions. Cost and relevance are the two main obstacles, though we encourage members to consider how they can overcome this and continue to work with members to increase uptake. We will consider this further in amendments to our annotated version of the Code, given that there has not emerged a form of external board evaluation yet that appears to meet the needs of our smaller members.

*Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?*

*Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?*

We agree that the nine-year rule is useful in helping to define when a director may be independent (notwithstanding other criteria as set out in Provision 15). Many organisations already apply that as a rule of thumb.

With regard to annual elections, this is another area some of our members have not been able to comply with the annotated Code, but in those circumstances we encourage the firm to seek annual elections after nine years. We note though that this is not an issue for (nearly all) listed companies.

We agree that it is not necessary to provide a maximum period of tenure where there are other requirements that ensure firms think seriously about succession planning and the appropriateness of longstanding directors.

*Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?*

We agree, though it is important that Boards continue to feel they can recruit and promote on merit (as per Principle J), and that for small companies in particular they do not have to discriminate against eligible candidates merely to fill quotas.

*Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.*

We agree.

*Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.*

We are concerned that such a requirement, even in big companies, might lead to a compliance-led approach, such that pipelines are developed which do not in themselves yield new appointments. Even for large companies it is difficult to replicate an ethnicity balance within the executive that reflects the distribution of the UK population.

That is not to suggest more action is not appropriate, particularly in FTSE 100 companies, and we would like to see that start with the development of a culture that embraces diversity in the round.

*Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?*

We agree, and consider this provides helpful focus for firms.

*Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.*

We do not think this change will alter behaviour, and publishing the terms of reference for committees is now largely embedded.

*Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?*

The wider remit for the remuneration committee anticipates them taking responsibility for workforce practices and procedures. Whilst this is not a perfect fit with the current responsibilities, we agree that for small organisations in particular, this is a practical solution, and better than creating new committees.

*Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?*

Most of our members either do not offer bonuses to executives, or ensures they represent a small amount of total pay, or else ensures that they focus on corporate performance more than individual performance.

*Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?*

The revisions provide new insight into the effective governance of an organisation and will encourage board to think more strategically about their role. There is a risk that adding too many new responsibilities to NEDs places them at risk of conflict with the roles of the executive. The Code does seek to reinforce these differences.