Association of Financial Mutuals

Corporate Governance Report, 2012

September 2012

0. Executive Summary

This report provides an overview of compliance with the Annotated Combined Code for Mutual Insurers (ACC) during 2011, by members of the Association of Financial Mutuals.

The annual compliance exercise for the ACC requires companies to complete a detailed questionnaire which illustrates the main principles of the ACC, and helps the Board of each company identify how best to comply with each aspect of the ACC. Where a company does not comply with a main principle, it documents an explanation in its annual report and accounts.

Overall the stated level of compliance with the main principles in 2011 was 94.5%. The level of compliance for 2010 was 90.5%, but as there were a number of changes to the Code which were reported on for the first time in this exercise, the figures are not directly comparable.

This year all companies were required to complete all sections of the questionnaire- this results from changes to the Code which mean the sections now all have more obvious relevance to all members. As a result there was a marked narrowing of differences between larger and smaller companies results.

Companies scored highest on the section on accountability- as has been the case in previous years. The section on effectiveness, which included a number of revised requirements, achieved the lowest levels of stated compliance- though the principle still achieved an average of 92% across all companies.

This year's report includes a new section on board diversity and composition. This shows that whilst the number of Board directors stayed broadly constant in 2011 versus the previous year, there was a shift towards increasing executive directors at the expense of NEDs. Meanwhile the proportion of female directors, at 12.4% was a very similar to 2010, and a little higher than smaller listed companies, though a gap is opening now to larger PLCS with the introduction of the voluntary target of 25% female directors by 2015.

Contents

1. INTRODUCTION 4
 1.1 INTRODUCTION TO AND PURPOSE OF THIS PAPER 4
 1.2 PURPOSE OF THE CODE 4
2. ANNOTATED COMBINED CODE COMPLIANCE EXERCISE, 2011 5
 2.1 METHODOLOGY 5
 2.2 RESULTS- OVERALL 5
 2.3 ANALYSIS BY SECTIONS OF THE CODE 7
 2.4 REPORTING NON-COMPLIANCE 12
 2.5 CONCLUSIONS 12
3. BOARD COMPOSITION AND DIVERSITY 14
4. REVISIONS TO THE CODE 17
 4.1 AMENDING THE CODE 17
 4.2 REVIEWING THE CODE COMPLIANCE EXERCISE 17
5. CONCLUDING COMMENTS 18
ANNEXES 20
 ANNEX 1 LIST OF CODE STEERING GROUP MEMBERS 21
 ANNEX 2 SUMMARY OF ALL AFM MEMBER RESULTS 22
 ANNEX 3 OVERVIEW OF LARGER AND SMALLER COMPANIES 24
 ANNEX 4 COMPANIES THAT TOOK PART IN THE 2010 COMPLIANCE EXERCISE 26

About AFM

The Association of Financial Mutuals (AFM) was established on 1 January 2010, as a result of a merger between the Association of Mutual Insurers and the Association of Friendly Societies. Financial Mutuals are member-owned organisations, and the nature of their ownership, and the consequently lower prices, higher returns or better service that typically result, make mutuals accessible and attractive to consumers.

AFM currently has 55 members and represents mutual insurers and friendly societies in the UK. Between them, these organisations manage the savings, protection and healthcare needs of 20 million people, and have total funds under management of over £90 billion.

1. Introduction

1.1 Introduction to and purpose of this paper

When formed on 1 January 2010, the Association of Financial Mutuals took over responsibility for maintaining the Annotated Corporate Governance Code for Mutual Insurers ('the Code'), and the associated annual compliance exercise, from its predecessor organisations, Association of Mutual Insurers and Association of Friendly Societies.

This paper summarises the results of the latest compliance exercise and looks ahead to changes in the Code and in the wider governance of mutuals. The intended audiences for this paper are: AFM members, FSA, and HMT only.

1.2 Purpose of the Code

The Code was developed in 2005 following the publication of the Myners Review in December 2004, which made a specific recommendation with regard to the introduction of a version of the Combined Code for the mutual insurance sector. At the time HM Treasury and the Financial Services Authority agreed that responsibility for producing the ACC and detailed guidance for their members on its implementation would rest with the predecessors of AFM.

A steering group is in place to oversee the content of the Code as well as the compliance exercise, and a list of the group members for 2011 is attached in **Annex 1**.

The Code seeks to adopt wherever possible the requirements and principles of the UK Corporate Governance Code which is supervised by the Financial Reporting Council. Following changes to the structure, the Code has 27 principles/ sub-principles and these are grouped into the following five sections:

Section A: Leadership
Section B: Effectiveness
Section C: Accountability
Section D: Remuneration
Section E: Relations with members

These headings reflected changes made by FRC to the UK Corporate Governance Code, which updated the principles in light of the Walker Report, and in particular altered the emphasis within the sections and removed the section on institutional shareholders, which is now part of a separate Stewardship Code. Other changes to the Code which were assessed for the first time in this report are: enhanced requirements for the Chairman's report, and the re-election of Directors.

Since late 2010 compliance with the Code has been a condition of membership of the Association of Financial Mutuals, though as set out in **Annex 3** there are a number of exempted organisations each year: those within the very smallest members, members that have no retail customers or that participate in other corporate governance requirements, and new members.

2. Annotated Combined Code Compliance Exercise, 2011

2.1 Methodology

Members are responsible for evaluating their compliance with the ACC and for completion of a questionnaire which gives detailed information about their compliance.

The Code steering group has relied upon the information provided by members and has not attempted to validate or evaluate the submissions. We ask each member to ensure that the Code questionnaire has been approved by the Chairman, and reviewed and signed off by its Board or Committee of Management. It is also a requirement of the Code that individual companies report their compliance with the Code within their Annual Report and Accounts. Some elements of the Code are subject to review by the company's auditors.

Following the 2010 changes to the Code, we have moved to a single version of the questionnaire for all members. Previously, as certain aspects of the Code were less/ not relevant to small members, we provided a slightly abbreviated version of the questionnaire. However as good practice has increasingly concluded that size alone is not always a strong rationale for not complying with some of the principles, we have seen less reason to differentiate the questionnaire. At the margins, this has meant some additional work to adopt good practice for some organisations.

For reporting sake and to help benchmarking, we have reported on aggregate differences between small and large members. Smaller companies for the purpose of the report are defined as having gross premium income of less than £20 million per annum on average over the preceding three financial years plus assets of less than £100 million on average at the end of each of the last three years.

2.2 Results- overall

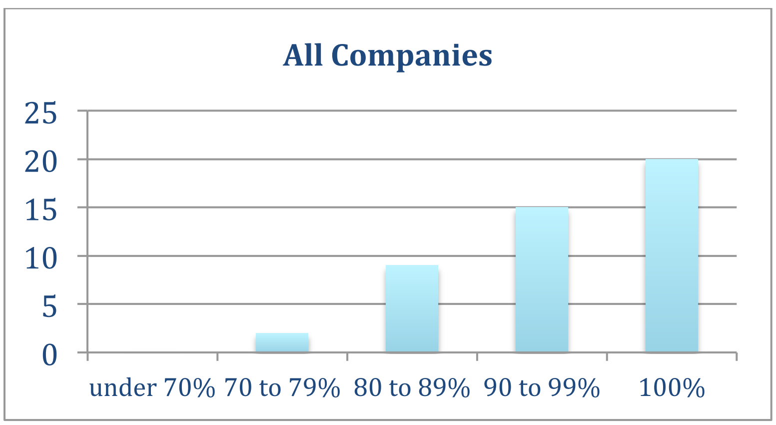
As we have seen in previous years, the level of code compliance is very high. The overall rate of compliance, at 94.5% indicates that the average member reports that they comply with almost all aspects of the Code. However the results are not comparable with previous years (where compliance was around 90% each year), because the figures are based on a revised set of principles, as was explained earlier.

The results though do demonstrate that the strength of governance culture is such that most organisations found it relatively straightforward to incorporate most of the new principles. However that is not to say that all of the changes have been readily adopted, or that the expectations of PLCs are easily incorporated into mutuals. This year's results demonstrate perhaps more clearly that previously, where there are discrepancies in the underlying business model, which organisations seek to maintain because they are consistent with the way they, as a customer-owned organisation, operate.

A small amount of non-compliance is therefore to be expected, and indeed the concept of comply-or-explain is built upon the expectation that variances in approaches to governance are both inevitably and necessary to retaining a diverse marketplace. That said one of the trends we are exploring further is the quality of explanation provided by a mutual when it is unable to comply with a particular provision within the Code. We are keen to learn from the work undertaken in this area by the Financial Reporting Council, which earlier this year published guidance for PLCs, which indicates that big listed companies as well as small mutuals are still learning how to make explanations clearer[1].

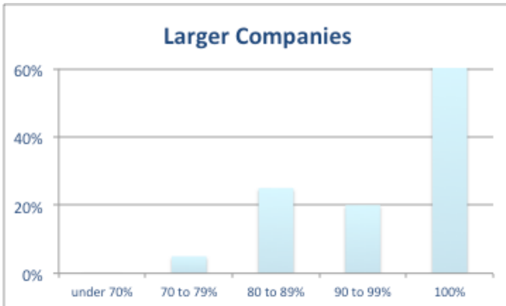
We will explore in more detail below the explanations for non-compliance, but in general terms where a firm is unable to confirm it complies with a specific principle, this reflects one or more of the following: the nature of the business; its size; the practicality of implementing some principles; or the relevance of some principles. **Annex 2** provides a full list of the principles and the relevant scores.

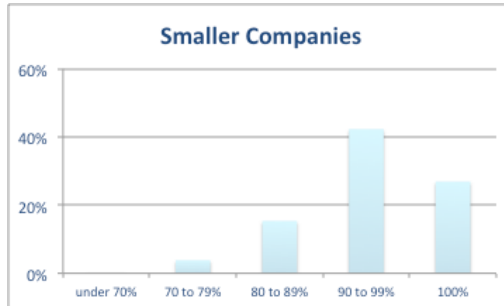
The chart below shows the distribution of overall scores across the 46 members that completed the full exercise for 2011. No firms reported less than 70% compliance, whilst 20 respondees showed 100% compliance. The median score was 96%.



46 companies completed the compliance exercise, details of which are in Annex 4. Of these, 23 came from larger companies, and 23 from smaller ones, with relevant scores for each group summarised in **Annex 3**. This even split by size is different to the previous year (25 large: 21 small), as two larger companies have been removed due to merger, and two smaller, newer organisations have replaced them in this analysis.

[1] "What constitutes an explanation under comply or explain', FRC February 2012





As the charts above shows, the peak for larger companies is at 100%, whilst for smaller companies is in the band 90 to 99%. In line with this, overall stated compliance by smaller companies was 93.4% compared to 95% for larger members: this reverses previous trends, as previously smaller companies were not expected to report on the section on ‘relations with institutional shareholders’ whilst many large companies that did found it did not properly apply to their business. A breakdown of the compliance levels achieved by large and small firms against each of the principles is set out in **Annex 3**.

2.3 Analysis by sections of the Code

2.3.1 Section A: Leadership

This section of the Code focuses on how well the board takes collective responsibility for the long-term success of the company. There are four principles plus three sub-principles in this section, and the results obtained in the following table reflect results reported for all seven elements:

	all companies	larger companies	smaller companies
Section A	97.2%	96.9%	97.5%

Every Board was satisfied that there is a clear division of responsibilities at the head of the company between running of the board and of the business, and that no one individual has unfettered powers of decision.

Whilst every organisation was satisfied that the Chairman demonstrated proper leadership, some organisations commented that whilst the Board was satisfied that the Chairman was independent on appointment, albeit he/ she had served on the Board for more than nine years and was duly elected annually, or else that the Chairman could not be considered independent on appointment, but that he/ she was appointed from within the membership and this was considered important to the effectiveness of the role.

In a few cases (three or fewer) companies indicated that they were reviewing the way that the Board assumes collective responsibility for the success of the company, and in particular to what extent NEDs have been involved in developing strategic proposals.

However on closer inspection of the comments made, these tend to centre on a) whether the NEDs meet without the Chair to appraise his/ her performance, and b) the basis by which some companies facilitate feed back from their members. With regard to the former, a number of companies indicated this was in development; as regards the latter, by way of example, where one friendly society operates on a delegate-style basis, it has determined that effective dialogue should be maintained via delegates, dispensing with the role of Senior Independent Director.

There were no significant differences between larger and smaller member companies in this section, though smaller members (87%) were less confident that they had accepted effectively and taken collective responsibility for the future success of the company (Principle A1; larger companies scored 100% on this principle).

2.3.2 Section B: Effectiveness

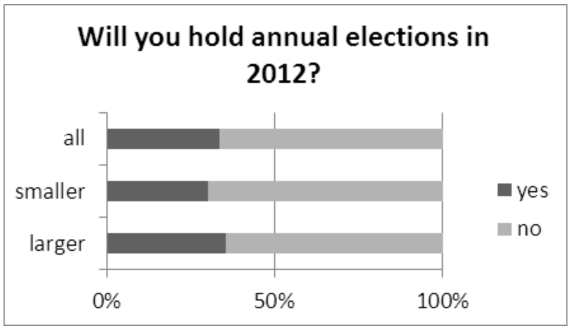
This section considers the balance of skills, experience, independence and knowledge of the Board, as well as appointments to the Board and the effective operating of the Board. There are six principles and two sub-principles in this section of the ACC, making it the most extensive in the Code. The average scores reported for 2011 were:

	all companies	larger companies	smaller companies
Section B	92.4%	91.8%	92.9%

This section scored lower than the one on Leadership, and some of the comments made suggest that the increasing scrutiny by regulators of the effectiveness of Boards, is encouraging companies to review further the composition of their Board and whether it has the right balance of skills and experience.

A number of organisations in particular reported the need to constantly consider and review the independence of some directors where they had served for more than nine years. Whilst many organisations have now changed rules to prevent directors serving for more than nine years, others are content in the short-term to permit annual re-election of long-standing directors- albeit often as a precursor to change in the near future that is delivered in such a way as to avoid destabilising the organisation in the immediate term.

Similarly the sector as a whole has not been quick to embrace annual re-elections of the Board. AFM conducted research amongst members earlier in 2012, and found that a third of members planned to hold annual elections this year, up from 22% in 2011.



The main reasons cited then and in the Code exercise were the need to avoid continuity risk, or for delegate-based friendly societies, the potential for capture from a misrepresentative group.

In relation to the recruitment of NEDs, organisations were content that they were either adopting the Code, or else took account of the scale of the company (eg where they have no Nominations Committee), or the nature of the business (eg where directors are recruited from within the affinity group the company serves). All organisations indicated that they undertake effective induction of new directors, though some conceded that there may be no special arrangements, other than through the AGM, for new Directors to meet members.

The Code also asks about company's approaches to Board evaluation: larger companies indicated that on the whole they undertake regular, audited Board evaluations, often annually. Smaller companies tend to evaluate less frequently and less formally, citing the cost and relevance of the exercise. A number of organisations also confirmed they were introducing new evaluation processes in 2012.

Scores for this part of the code were higher for smaller companies than larger ones: larger organisations tended to be less confident about the range of skills and experience, which may be a factor of scrutiny from FSA supervisors which smaller companies have not yet been subjected to. Smaller companies also tend to explain the lack of annual evaluations due to size and not therefore register an exception.

Section 3. of this report looks at Board composition and diversity in more detail.

2.3.3 Section C: Accountability

The principles in this section relate to how well the Board understands the financial prospects of the organisation and the nature of the risks it is exposed to. The three principles and two sub-principles in this section enjoyed the highest levels of compliance:

	all companies	larger companies	smaller companies
Section C	99.6%	100%	99.1%

All companies were satisfied that the board takes responsibility for determining the nature and extent of the significant risks it is willing to take, in order to achieve the strategic objectives. They were also all content that the board has established formal and transparent arrangements for how they should apply financial reporting and internal controls, and that there are sound systems in place to safeguard members' interests and the company's assets. This is a similar picture to that seen in previous years.

One company only was unable to comply with the principle that the board presents a balanced and understandable assessment of the company's position and prospects- this is because their annual report omitted to confirm that the company was a going concern. Two companies indicated that they had not published the Terms of Reference for their audit and risk committees on the company website, though they are available on request and one of the two plans to correct the omission this year.

2.3.4 Section D: Remuneration

This section focuses on the levels of remuneration as well as the policy for fixing remuneration packages. There are two principles each with a sub-principle in this section, and overall it attracted the lowest scores:

	all companies	larger companies	smaller companies
Section D	87.5%	93.5%	81.5%

Every Board was content that the levels of remuneration are sufficient to attract and retain directors of the quality required to run the business successfully. By contrast, less than two-thirds indicated that this was a result of paying a significant proportion of executive director remuneration that is linked to corporate and individual performance. In the case of smaller companies this was less than half: in every case this is because the company has very little, or no performance related pay for its executive.

This is the same as in previous years, and exposes a significant difference in the approach to remuneration in the sector compared with listed companies, where high levels of bonus are the norm, and where the UK Corporate Governance Code has been obliged to ensure there is a closer link between performance and pay.

Research amongst larger mutuals on behalf of AFM by Thrings LLP indicates that the proportions of both total and variable pay in the sector are significantly lower than non-mutuals of a comparable size.

Companies generally reported that they had in place transparent policies on executive pay, and that the engagement with members via the AGM was supportive on the company's approach to pay. A number reported that they are exploring changes to the process for engaging with members on this, and some smaller companies without a dedicated Remuneration Committee are creating one.

2.3.5 Section E: Relations with members

This section relates to the dialogue with members and the actions taken to encourage participation in the AGM. There are two principles and one sub-principle, with the following aggregate scores:

	all companies	larger companies	smaller companies
Section E	92.0%	92.8%	91.3%

This section of the Code reinforced the previous version with a clearer description of the expectations for effective dialogue with members. Some of the provisions have clearly highlighted the routes by which companies can improve the dialogue with, and engagement of, members. It coincides with new legislation for friendly societies which enables them for the first time to introduce electronic (proxy) voting at AGMs (which has been available to companies for a number of years): a number of friendly societies report that they are securing rule changes in order to take advantage of the change to their legislation.

There were high scores across each of the three principles in this section, which indicates very strong levels of adherence to the way companies seek to engage members, as owners of the organisation, in key decisions. The AGM is the central aspect of this, and is clearly a platform for member participation; some of the companies that do not currently provide a member forum are exploring the potential for doing this in 2012, though others cite concerns on the costs involved.

Many friendly societies were originally constituted on a delegate basis, and this still applies to some societies. In these cases, a proportionate number of delegates are appointed to represent the interests of members as a whole. Delegates take part in a detailed and active Annual General Meeting, which may last up to four days, where the performance and strategy of the organisation are discussed in detail. Delegates vote on a series of propositions, and this ensures that effective democracy is embraced. Members at large do not participate in the AGM and are not invited to vote on the propositions.

As well as collecting member responses to our ACC questionnaire, we have explored other aspects of member engagement in mutuals.

According to data collected for 2012, around 250,000 members participated in AGMs. This equates to around 3.5% of the all members (compared to 3% last year). With a proportion of friendly societies operating a delegate system, where the views of members are represented by a smaller number of delegates, by removing these companies the true figure would be around 4%.

The greatest proportion of members voting was 14%, and two other companies achieving 10%. This shows that a significant proportion of members are engaged in key decisions for the business. Smaller companies are less likely to enable proxy voting and postal voting, due to the significant costs involved, and therefore tend to see lower volumes of members attending the AGM and voting.

A number of companies report taking active steps to explore how to widen member engagement.

2.4 Reporting non-compliance

Where a company is unable to confirm it has fully complied with any one of the Code provisions during a year, it is expected to provide an explanation within the corporate governance statement in its report and accounts. The commentary on the reasons for non-compliance in the previous section is largely drawn from those statements.

This year we asked members to provide a copy of their corporate governance statement so we could begin to identify good practices and to help companies understand better what constitutes a clear and effective explanation. We are continuing to analyse this information and aim to highlight some good examples in due course. In the meantime, it is apparent that this is an issue for listed companies as well, as earlier in 2012 the Financial Reporting Council published guidance on the subject[2]. FRC found that in some cases explanations "can come across as an assertion of difference rather than a full explanation of why the company in question has chosen to deviate from agreed best practice".

The changes to the Code in 2010 also required the Chairman of a company to make a personal statement on how the company has applied the principles on the role and effectiveness of the Board. We have seen many companies introduce this to their report, and it is encouraging to see that whilst some of these statements are process driven, others have made a real effort to explain how the Board is developing and to explore some of the thinking around key governance decisions made during the year. As we begin to benchmark good practice we would expect improving standards in this area.

2.5 Conclusions

We have again seen high levels of compliance with the Code, though due to the changes made to the Code since the last exercise, it is not practical to make direct comparisons with previous years.

In simplistic terms though of 1,238 principles reviewed by 46 companies, 1,170- or 94.5%- were reported to have been complied with. And with all companies expected to address every principle this year, this means that there is an active determination to demonstrate good practice in governance, even in organisations far smaller than those that the FRC's UK Corporate Governance Code for listed companies is intended for.

There have been some changes in practice by individual companies and where appropriate these are reflected in the commentary above. On the whole though performance against the Code has remained stable and resilient, reflecting both the ever-increasing scrutiny of governance standards that have emerged since the banking crisis, as well as an accelerating desire within the sector to demonstrate that mutual organisations are run in the best interests of their members.

[2] 'What constitutes an explanation under comply or explain', FRC, February 2012

Where a company has not complied with a specific principle, it has provided an explanation in its company accounts, and carried that explanation across to this compliance exercise. Each Board has been asked to sign off their report, and ought therefore to have satisfied itself that the survey represents an accurate reflection of performance, and that exceptions to the principles are appropriately described and either relevant to their business, or under review.

We have introduced an electronic signature this year to reinforce need for the Chairman to take personal responsibility for approving the exercise:

> *'DECLARATION: (Q220) this summary is an accurate record of our full compliance review- including the Code questionnaire and the way results from this are transferred into comply or explain statement in the annual report. The Code questionnaire has been approved by the Chairman, and reviewed and signed off by the Board/ Committee of Management.'*

All 46 firms confirmed this was the case.

AFM does not scrutinise individual responses and remains satisfied that, as with the FRC and its approach to listed companies, the responsibility for fair and accurate reporting rests with individual Boards. As a trade body however, we run training sessions on corporate governance, produce guidance to support members, and engage constructively with regulators and policymakers on this important subject.

This year the AFM Board has commissioned an independent review of the Code compliance exercise, to ensure that it continues to provide clarity to member companies on what constitutes good practice and that this report continues to reflect accurately and meaningfully the approach to governance in mutual organisations.

3. Board composition and diversity

This section reviews in greater detail some of the underlying data that supplements the Code questionnaire, on Board composition. This is covered extensively in section B of the Code on effectiveness, as well as elsewhere.

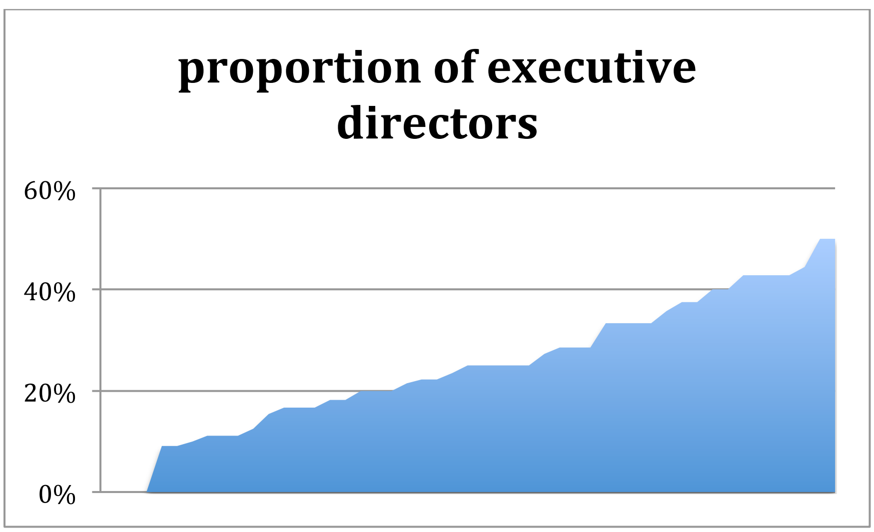
In relation to the number of Directors, we collected the following quantitative data on the breakdown of the Board:

Average number of directors	9.78 (9.8 for 2010)
Number of executive directors	2.49 (2.3)
Number of non-executive directors	7.29 (7.5)

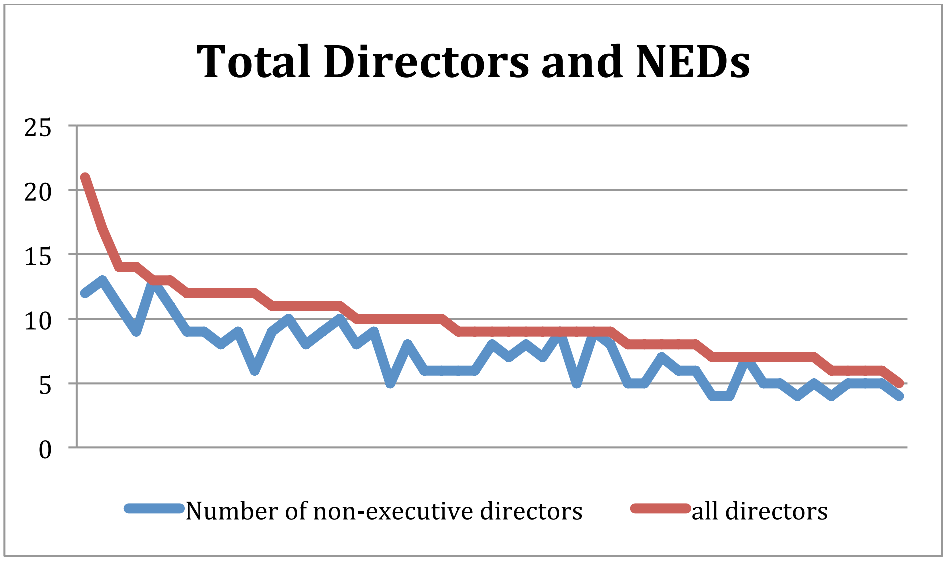
The Average number of directors reduced very slightly in 2011, but this masks a larger shift from NED to executive directors. We have seen some larger companies strengthening their management team in 2011, whilst others have consciously reduced the number of NEDs in light of increasing costs of, and expectations on NEDs.

The results also showed considerable disparity between organisations; for example the proportion of Executive Directors on the Board ranged from zero, in companies where the managing director does not fulfill the company's rules for being a Board member, to two members that have a 50: 50 split.

As the chart below demonstrates, the majority of members have a mix between Executive and Non-Executive Directors close to the sector average of 25% (up from 23% in 2010).



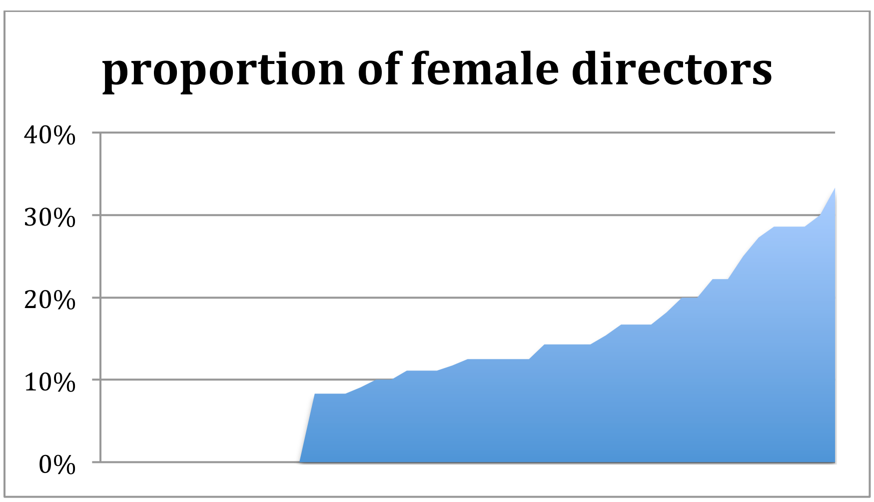
There is a wide range of size of Boards, from 5 at the smallest, to the largest Board having 21 directors. The average number of NEDs on the Board was 7.29, but as the following chart also shows, individual members varied from 4 up to 13 NEDs (though in 2010 one company reported having 20 NEDs). Those particularly large Boards tend to reflect the nature and the primary source of membership of the company.



This year we collected data from members on Board diversity (gender)- this reflects both the growing interest in this subject, as well as consultations from Treasury and the Financial Reporting Council, on gender policy for Boards.

Of the 429 Directors included in the analysis within this report, 53 were women, or 12.4%. In average terms, the typical Board of 7.29 Directors includes 1.23 female Directors.

The figures are broadly similar to those reported for 2010 in a report on remuneration in the sector by Thrings solicitors. At that time, diversity in mutuals was broadly equivalent with that in the listed sector: figures from the Department for Business indicate a figure for 2010 of 12.5% for FTSE 100 companies. Since then however, listed companies have been given the voluntary target of 25% of Boards being women by 2015, and this resulted in a big increase in FTSE 100 companies in 2011, to 16.7%. However BIS also report figures for smaller listed companies of 10.9% in 2011, only slightly higher than the year before.



As the chart above shows, a number of AFM members already exceed the voluntary target of 25%- with the largest proportion being a third. However, off the 46 companies in the survey 12, or more than a quarter, had no women executive or non-executive directors.

We are aware that organisations are consciously considering gender diversity on their Boards, with a number of smaller organisations recently reporting difficulty in hiring suitable women directors. However the sector is moving more slowly at present than listed companies, which is perhaps surprising for member-owned organisations; we asked companies to report in general terms on their board diversity policy:

- One-third indicated they have a formal diversity policy, of whom three indicated they reported against this in the remuneration committee's report in this year's report and accounts;
- Similarly another third indicated that they plan to introduce a gender policy in 2012;
- The final third said they had no plans to introduce a policy.

AFM aims to help members that are keen to introduce a gender diversity policy, with a paper on emerging good practice in this area due before the end of 2012.

4. Revisions to the Code

4.1 Amending the Code

A revised version of the Code was released in October 2010, to take effect for financial years commencing from 1 January 2011 onwards.

In 2011 the Financial Reporting Council consulted on changes to the UK Corporate Governance Code, seeking a change to the nominations committee report to include the company's gender diversity policy. Legislative changes alongside this will require companies to report on the number of female NEDs and senior executives.

This will be formally reflected in the Code once FRC has finalised its own changes. We expect these changes to be incorporated before the end of 2012, and will strive to issue an updated version of the Annotated Code shortly afterwards. As long as this is available before the end of 2012 the new requirements will become part of the Code for financial years commencing 1 January 2013, meaning they will be included in the version of this report issued in 2014. In the meantime we included an advisory question on the likely changes this year (as reported in section 3).

4.2 Reviewing the Code compliance exercise

In the Pre-Budget Report in December 2009, the then Labour Government announced that it planned to review governance codes in mutuals. This commitment was carried forward by the new coalition Government, and during the spring of 2010 a panel was established, chaired by FRC, to explore the scope for a single code of corporate governance for financial mutuals.

However the panel has not met since 2010 and the work appears to have been de-prioritised in Treasury. In the expectation that this work would in time have lead to a significant change to the Code we delayed any further changes to the compliance exercise. Given that the Treasury project has been suspended, as explained in an earlier section we are taking the opportunity to thoroughly review the compliance exercise.

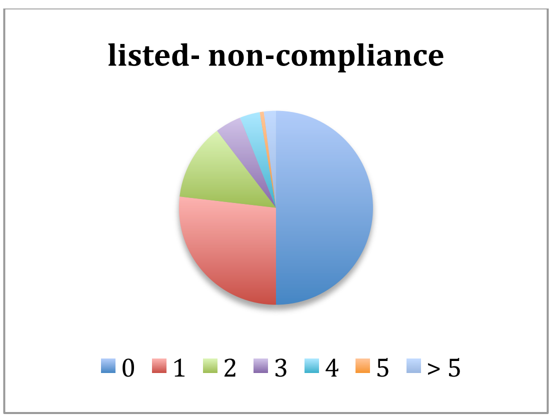
Should the panel be re-instated, AFM will remain an active supporter.

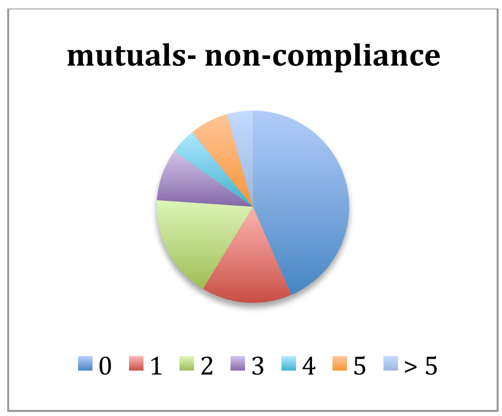
5. Concluding comments

This report on corporate governance in the mutual insurance sector draws on results reported by members of the Association of Financial Mutuals to a compliance exercise focused on the UK Corporate Governance Code Annotated for Mutual Insurers.

The report provides evidence of a strong commitment to high standards of governance, and that as organisations owned by their customers, companies and their boards are culturally aligned to ensuring the organisation is run in the best interests of its members- both as owners and customers.

A report issued by Grant Thornton in November 2011 reviewed corporate governance standards in FTSE 350 companies[3]. The report indicated that around 50% of listed companies could not state full compliance with the Code, but that most were able to comply with all but one or two aspects. Combining the Grant Thornton analysis with ours, the following comparison emerges; the charts showing the frequency of stated non-compliance with Code provisions, as a proportion of listed companies and AFM members (for example, 50% of listed companies state compliance with every principle, versus 43% of mutuals):





Overall the pattern is quite similar, though with a larger tail of mutual organisations unable to comply with a larger number of principles. On the whole this reflects the smaller nature of most AFM members, as well as those areas of the Code that translate less effectively to the mutual business model (such as remuneration). Grant Thornton's report also suggested four areas for renewed focus for listed companies:

1. **Tone from the top**: there remains an opportunity for chairman to take personal ownership of the governance agenda

2. **Board diversity – and transparency:** reflecting the proportion of female representation on boards, as well as the production of a clear gender diversity policy

3. **Quality over quantity in annual reports:** relating to the ever-increasing length of and clutter in annual reports, though many are also making efforts to make accounts more intelligible for members

[3] http://www.grant-thornton.co.uk/pdf/corporate_governance.pdf

4. Risk reduction and business strategy: the recognition and disclosure of principal risks is well established, but more can be done to align risks to business strategy.

This is a valid list for AFM members to consider as well. Further work by AFM and members over the coming months will seek to support members in providing the highest standards of corporate governance, in reporting accurately on compliance, and in fostering a governance culture that helps promotes the values of the mutual business model.

Association of Financial Mutuals, September 2012

Annexes

1. List of ACC steering group members
2. Summary of all AFM member results
3. Overview of larger and smaller companies
4. Companies that took part in the 2011 compliance exercise

Annex 1 List of Code steering group members

Jonathan Dick, NFU Mutual (Chair)
Gareth Evans, Royal London
Derek Fickling, The Children's Mutual
Alan Goddard, Cornish Mutual
Andrew Horsley, Engage Mutual
Joe Roderick, Wesleyan
Martin Shaw, AFM

Annex 2 Summary of all AFM member results

Main Principle	all companies
Principle A1: (Q1) Is the Board satisfied that it has (and can demonstrate that it has) operated effectively and assumed collective responsibility for the success of the company?.	93.5%
Principle A2: (Q18) Is the board satisfied that there is a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business?	100.0%
Principle A2a: (Q19) Is the board satisfied that no one individual had unfettered powers of decision?	100.0%
Principle A3: (Q22) Is the board satisfied that the chairman demonstrated leadership of the board?	100.0%
Principle A3a: (Q23) Is the board satisfied that the chairman ensured the board's effectiveness on all aspects of its role?	97.8%
Principle A4: (Q34) Is the board satisfied that non-executive directors constructively challenge proposals on strategy?	100.0%
Principle A4a: (Q35) Is the board satisfied that non-executive directors helped develop proposals on strategy?	95.7%
Principle B1: (Q50) Does the board have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively?	93.5%
Principle B1a: (Q51) Does the board committees have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively?	89.1%
Principle B2: (Q66) Is there a formal, rigorous and transparent procedure for the appointment of new directors to the Board?	93.5%
Principle B3: (Q79) Is the Board satisfied all directors can allocate sufficient time to the company to discharge their responsibilities effectively?	95.7%
Principle B4: (Q84) Do all directors receive induction on joining the board and do they regularly update and refresh their skills and knowledge?	89.6%
Principle B5: (Q96) Is the board satisfied that it is supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties?	100.0%
Principle B6: (Q108) Does the board undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors?	84.8%
Principle B7: (Q116) Are all directors submitted for re-election at regular intervals, subject to continued satisfactory performance?	89.1%
Principle C1: (Q124) Does the board present a balanced and understandable assessment of the company's position and prospects?	97.8%
Principle C2: (Q132) Does the board take responsibility for determining the nature and extent of the significant risks it is willing to take in achieving the company's strategic objectives?	100.0%
Principle C2a: (Q133) Is the board satisfied that there is in place a sound system of internal control to safeguard members' interests and the company's assets?	100.0%
Principle C3: (Q137) Has the board established formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles?	100.0%

Principle C3a: (Q138) Has the board established formal and transparent arrangements for maintaining an appropriate relationship with the company's auditor?	100.0%
Principle D1: (Q163) Is the board satisfied that levels of remuneration are sufficient to attract, retain and motivate directors of the quality required to run the company successfully and that the company is not paying more than is necessary for this purpose?	100.0%
Principle D1a: (Q164) Is a significant proportion of executive directors' remuneration structured so as to link rewards to corporate and individual performance?	64.4%
Principle D2: (Q180) Is there a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors?	93.5%
Principle D2a: (Q181) Can the board confirm that no director is responsible for fixing his or her own remuneration?	95.7%
Principle E1: (Q195) Can the board confirm that: a dialogue with members takes place; and this dialogue is based on a mutual understanding of objectives?	93.3%
Principle E1a: (Q196) Does the board as a whole take responsibility for ensuring that a satisfactory dialogue takes place?	89.1%
Principle E2: (Q205) Does the board use the AGM to communicate with members and encourage their participation?	95.7%

Annex 3 Overview of larger and smaller companies

Principle	larger companies	smaller companies
Principle A1: (Q1) Is the Board satisfied that it has (and can demonstrate that it has) operated effectively and assumed collective responsibility for the success of the company?.	100%	87%
Principle A2: (Q18) Is the board satisfied that there is a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business?	100%	100%
Principle A2a: (Q19) Is the board satisfied that no one individual had unfettered powers of decision?	100%	100%
Principle A3: (Q22) Is the board satisfied that the chairman demonstrated leadership of the board?	91%	100%
Principle A3a: (Q23) Is the board satisfied that the chairman ensured the board's effectiveness on all aspects of its role?	91%	100%
Principle A4: (Q34) Is the board satisfied that non-executive directors constructively challenge proposals on strategy?	100%	100%
Principle A4a: (Q35) Is the board satisfied that non-executive directors helped develop proposals on strategy?	96%	96%
Principle B1: (Q50) Does the board have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively?	91%	96%
Principle B1a: (Q51) Does the board committees have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively?	87%	91%
Principle B2: (Q66) Is there a formal, rigorous and transparent procedure for the appointment of new directors to the Board?	91%	96%
Principle B3: (Q79) Is the Board satisfied all directors can allocate sufficient time to the company to discharge their responsibilities effectively?	100%	91%
Principle B4: (Q84) Do all directors receive induction on joining the board and do they regularly update and refresh their skills and knowledge?	96%	91%
Principle B5: (Q96) Is the board satisfied that it is supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties?	100%	100%
Principle B6: (Q108) Does the board undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors?	83%	87%
Principle B7: (Q116) Are all directors submitted for re-election at regular intervals, subject to continued satisfactory performance?	87%	91%
Principle C1: (Q124) Does the board present a balanced and understandable assessment of the company's position and prospects?	100%	96%
Principle C2: (Q132) Does the board take responsibility for determining the nature and extent of the significant risks it is willing to take in achieving the company's strategic objectives?	100%	100%
Principle C2a: (Q133) Is the board satisfied that there is in place a sound system of internal control to safeguard members' interests and the company's assets?	100%	100%

Principle C3: (Q137) Has the board established formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles?	100%	100%
Principle C3a: (Q138) Has the board established formal and transparent arrangements for maintaining an appropriate relationship with the company's auditor?	100%	100%
Principle D1: (Q163) Is the board satisfied that levels of remuneration are sufficient to attract, retain and motivate directors of the quality required to run the company successfully and that the company is not paying more than is necessary for this purpose?	96%	100%
Principle D1a: (Q164) Is a significant proportion of executive directors' remuneration structured so as to link rewards to corporate and individual performance?	87%	39%
Principle D2: (Q180) Is there a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors?	96%	91%
Principle D2a: (Q181) Can the board confirm that no director is responsible for fixing his or her own remuneration?	96%	96%
Principle E1: (Q195) Can the board confirm that: a dialogue with members takes place; and this dialogue is based on a mutual understanding of objectives?	87%	96%
Principle E1a: (Q196) Does the board as a whole take responsibility for ensuring that a satisfactory dialogue takes place?	91%	87%
Principle E2: (Q205) Does the board use the AGM to communicate with members and encourage their participation?	100%	91%

Annex 4 Companies that took part in the 2010 compliance exercise

From the list of AFM members below, those that provided a full response to the ACC compliance exercise for 2011 are listed in blue. Companies in red have been defined as below a de minimus level required, and those in green are new members for 2010/11.

• Ancient Order of Foresters Friendly Society Limited • Anglo-Saxons Friendly Society • B&CE Benefit Scheme* • Benenden Healthcare Society Ltd • British Friendly Society Ltd • Bus Employees' Friendly Society • Cirencester Friendly Society Ltd • Civil Service Healthcare Society • Compass Friendly Society Limited • Cornish Mutual • CUNA Mutual • Dentists and General Society • Dentists' Provident Society • Druids Sheffield Friendly Society • Ecclesiastical * • engage Mutual Assurance • Equitable Life • Exeter Friendly Society Ltd • Family Investments • Foresters Life* • Grand United Order of Oddfellows Friendly Society • Health Shield Friendly Society Limited • Healthy Investment • Kensington Friendly Collecting Society Ltd • Kingston Unity Friendly Society • LV= • Metropolitan Police Friendly Society • MGM Advantage	• National Friendly • Newbridge Road Assurance Society • NFU Mutual Insurance Society Ltd • Original Holloway Friendly Society Ltd • Paycare • Pharmaceutical and General Provident Society Ltd • Police Mutual • Railway Enginemen's Assurance Society Ltd • Railway Friendly Society • Red Rose Friendly Society Ltd • Reliance Mutual • Royal London Insurance Group • Royal Standard Friendly Society • Scottish Friendly Assurance Society Ltd • Sheffield Mutual Friendly Society • Sovereign Health Care • Sunderland Marine Mutual Insurance Company • Teachers Assurance • The Children's Mutual • The Oddfellows • The Shepherds Friendly Society Ltd • Transport Friendly Society Ltd • UIA (Insurance) Ltd • Veterinary Defence Society • Wesleyan Assurance Society • Wiltshire Friendly Society Limited

* Organisations that have a different governance structure or overseas ownership that apply the most appropriate governance code for their circumstances.