AFM response to feedback on consultation on changes to the annotated corporate governance code

December 2018

Introduction

The AFM Consultation on revisions to our corporate governance code was launched at the AFM Conference on 15 October and ran for one month. We received 13 responses in total, all from AFM members (see annex): these were representative of AFM members, and whilst some people have questioned whether we should have received more responses, by contrast, of the 51 public responses to the FRC's consultation on The Wates Principles, only 7 were from businesses (out of a projected 1,700 organisations in scope to apply the principles).

In general terms, responses were supportive of the approach, and whilst some concerns were raised, we do not consider any of them were sufficiently widely held, or sufficiently strong, to require an extensive review of our approach.

This document should be read in conjunction with the AFM corporate governance code (version December 2018), which is available to download from the AFM website.

The next section of these notes summarise the feedback received to the questions raised in the consultation, as well as providing our response. This is followed by a list of other changes made from the proposed principles and guidelines which, as well as taking account of feedback received, also reflects wider recent developments, including the FRC's amended principles for larger private companies.

Overview of feedback received

Question raised	Feedback	AFM response
1. Does the rationale for change set out in the paper address the key issues our review should be considering?	Most responses agree with the rationale provided, though two suggested that the difficulty experienced by some in complying was not in itself a compelling reason for change.	The feedback is helpful and offers broad support for the decision to review our approach.
2. Are the objectives set out in section 3.1 appropriate?	The objectives were broadly agreed, though three responses suggested there should be an additional objective relating to good customer outcomes and greater transparency. Proportionality in approach was also stressed, as was the need to avoid AFM defining what is appropriate.	The references to good customer outcomes and transparency are valid and should be built into the objectives covered in the introduction to the revised Code.
3. Is the ambition to retain a 'Code for AFM members' right, or is this better positioned as a less formal set of good practice guidance?	With the exception of one response which argued for a best practice guide, responses felt that the ambition of retaining a code was important. This would retain the progress made in the past, and help benchmarking with other organisations. One respondent indicated it might take some organisations some years to comply, and another response highlight the importance of not making the report and accounts too long or illegible.	The support for retaining a Code, notwithstanding the wider focus on governance in recent years offers helpful validation of AFM's work in this area.

4. Is the analysis of other Codes and regulatory requirements valid, and is anything missing?	Responses agreed that the analysis was valid. One response considered that notwithstanding the expected requirements, there may be a tendency for auditors to ratchet up standards. Another raised a concern about a mandatory ‘apply and explain’ approach compared to the current approach with well-explained departures from ‘comply or explain’.	We would have liked feedback from auditors on how they would interpret the approach being taken, but as none was forthcoming we will continue to liaise with them. AFM will explore with members how they construct ‘apply and explain’ statements, to set out how they interpret the Principles and whether and how this might lead to reasonable departures. It is not expected that every item of guidance is mandatory, so we consider the approach retains the freedom for organisations to demonstrate and explain how an approach that fits their business model would be an equally valid method of meeting the high-level Principles.
5. Is the conclusion that aligning a Code for AFM members with that expected for large privately-owned companies, rather than listed companies, right?	Of 13 responses, 8 agreed with the proposed approach. The other five responses shared some misgivings: two felt the current code was not overly onerous; and two highlighted concerns about the proposals for large privately-owned companies, given that membership is not generally widely dispersed as it is in mutuals, and that some people had expressed doubts that the FRC proposals met government expectations for private companies. One response suggested that an alternative would be to retain the current alignment to the UK Corporate Governance Code, with more exemptions to reflect practice in listed companies	We recognise the different opinions provided by respondents. We continue to view that the proposed AFM Code incorporates all relevant aspects of the UK Corporate Governance Code for listed companies, and all relevant aspects of PRA’s supervisory statement on board responsibilities. We have attempted to draw these together into a format that <u>all AFM members</u> can accommodate: today, this includes friendly societies and mutual insurers with a wide membership base, mutual insurers with a discrete and limited membership, delegate-based friendly societies, discretionary mutuals, non-directives, and not-for-profit companies.

	that does not translate to mutual and not-for-profit organisations. One response in favour indicated that the proposed approach may not apply equally well for any larger mutuals that choose to apply the code, or who become AFM members in future.	The alternative would have been to retain an approach based on the UK Corporate Governance Code, which either accepted large elements would not be complied with by many members, or else to create a complex matrix of requirements, with exemptions intended to fit different audiences.
6. Are the proposed Principles set at the right level to ensure they are meaningful and robust, while at the same time enabling widespread adoption by AFM members and other mutuals?	All responses agreed, with one stressing the need for proportionality, and another highlighting the risk that whilst the Principles are meaningful, the guidance needs to be formalised within the Principles to be robust.	We would expect that whilst the Principles will broadly correspond with those for private-owned companies, to allow benchmarking where that is helpful, the detail, particularly within the guidance will evolve to meet the needs of and expectations on, our members. The government's 2017 green paper on Corporate Governance assumed that large mutually-owned organisations would be within the scope of FRC's review. Whilst the Wates' working group did not act on this, the recognition that mutuals have characteristics in common with both listed and private companies, as well as those bespoke to the sector, was a key driver for the approach taken.
7. Does the guidance supporting each of the Principles cover the main issues AFM members should be addressing in their 'apply and explain' statements?	There was general agreement that the approach would support good governance, for example by improving transparency, and by shifting the focus from a compliance mid-set to an outcomes focused approach. Three responses highlighted that with the different nature of 'apply and explain', there is a concern in the way different AFM members	The general support for the guidance is helpful. The specific comments highlighted are useful and we will consider whether the guidance needs revision. Some of the points raised around more ambiguity in the guidance reflect our intention where appropriate to continue to align with the provisions in the UK corporate governance code

	choose to 'apply', where in some places the guidance is light and open to different interpretation. Amongst the issues raised were: • the regulatory of externally facilitated board evaluation (in the current Code given as three yearly); • terms such as 'value', long-term' and 'material'; • for directors that have served more than nine years, that they would require annual re-election and would not count towards the minimum two independent NEDs; • some cash plan providers do not have an AGM; • the reliance of boards defining for themselves independence within the board; and • the separation of the role of CEO and chairman. One response highlighted the need for clarity of what to report on, to avoid extending the length of report and accounts too much, for example if a statement was needed against each item of guidance.	(for listed companies). The latest version of the Code (July 2018) is more principle-driven, with fewer provisions and more scope for interpretation by boards. For example, our language on externally facilitated board evaluation, and on the chair and CEO not being occupied by the same person, matches that now adopted by FRC for listed companies. With regard to the independence of long-serving directors, this is not always as prominent in privately-owned companies, though is highlighted in the final Principles. In listed companies, where annual elections are now the norm, the issue has largely dropped away, though PRA's board responsibilities stress that 'even smaller firms should ensure they have at least two independent non-executives'. Our proposed guidance therefore sought to interpret how best to address independence and PRA's expectations in particular, in the context of AFM members, some of who have some very long-serving directors. We propose to retain this requirement, but to add the following to the guidance (which reflects FRC's approach to long-serving chairs): 'To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time. A clear explanation should be provided.'

8. How should the AFM seek evidence that its members are actively reviewing and reporting on their application of the proposed Principles	Responses felt that the focus should be on transparent publication of the 'apply and explain' statements in the report and accounts and/ or members' websites. One response also suggested AFM should consider continue to collect data via an annual questionnaire.	It is not our intention to provide an extensive compliance exercise to support implementation of the revised Code, but if this would help members to develop and refine their 'apply and explain' statements, we will explore this further during 2019.
9. Is the proposed date for implementation, of financial years starting from 1 January 2019, reasonable?	Responses agreed that whilst the timeline was tight, the requirement to report for the first time in accounting periods ending 31 December 2019 offered a year to prepare. Two responses highlighted that with the alignment with the Principles for privately-owned companies, the launch of the AFM code was reliant on the final publication by FRC of those Principles.	FRC launched its finalised Wates Principles for large privately-owned companies on 10 December. We have reviewed the changes and incorporate those as relevant into our final revised Code (see below).

Other revisions made to the proposed principles and guidelines in the AFM Corporate Governance Code

On 10 December 2018 the Financial Reporting Council formally launched The Wates Principles (for large privately-owned companies). These are the principles that the AFM Code is developed from, so we have carried across changes as appropriate to the principles and guidelines as well as the introduction to the Code. Specific changes include:

- the principle headings have been updated for the AFM Code in line with amends to the Wates Principles, designed to make them more meaningful (for example, Principle 6 is now headed 'Stakeholder Responsibilities and Engagement', as opposed to just 'Stakeholders');
- the wording of principles 3 to 6 is amended reflecting feedback and evolution to The Wates principles, without changing the intent;
- the implications of section 172 of the Companies Act and other corporate governance developments are set out more fully in the introduction, since this significantly influenced the format of the AFM Code and where the legislation provides a legislative rationale for good compliance by AFM members with the Code;
- Principle 1 adds reference to leadership as well as purpose, and highlights the role for directors in setting the right tone, and in monitoring culture;
- Principle 2 highlights more clearly the importance of independent NEDs, and breaks down the aspects of board composition clearly;
- Principle 3 now highlights how individual directors are accountable, as well as the board as a whole;
- Principle 4 advocates risks management systems that inform decisions on environmental, social and governance matters (as below);
- The title for Principle 6 has been broadened, with greater prominence given to workforce engagement.

In October and November, UK supervisors, the PRA and FCA, as well as the European Insurance regulator, EIOPA, set out their views on how insurers should be demonstrating how they risk manage the impact of climate control on their business, as well as the potential impact of long-term investment decisions on sustainability, and to take account of their policyholders' preferences with regard to environmental, social and governance factors. The final guidelines take account of this.

At the AFM Conference in October 2018 we launched the concept of "The Loyal Company", which sets out how mutual and other organisations should demonstrate how they are engaging meaningfully with their key stakeholders. We have restructuring the guidelines for principle 6 to support this.

Annex: list of formal responders

Benenden Healthcare

BHSF

Cornish Mutual

CS Healthcare

Healthy Investment

Kingston Unity

MDDUS

PG Mutual

Shepherds Friendly

Sovereign Health Care

Tees Mutual

The Oddfellows

Veterinary Defence Society