Remuneration in the Mutual Sector

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in association with

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It should not be used as a substitute for legal advice relating to your particular circumstances. Please note that the law may have changed since the date of this report.
WHAT IS THIS DOCUMENT?

This is a review of board remuneration taken from the accounts of members of the AFM for the year ended December 2015. We have moved on considerably from the purpose of the original report in 2009, started in the wake of the Lehman crisis, to demonstrate that there was not a culture of over-reward in the mutual sector. We are at a point now where trends can be seen clearly and, with the advent of tightened corporate governance, greater interest by members and greater transparency increasingly demanded by the regulators, the report can be used widely by individual societies to see where they are in the sector. It is for that reason that names are given so that subsector competitors can be identified more easily. The report has built a detailed picture of the sector over the years and is used by many societies for their own board deliberations both with and without additional information which Robert Wharton has available.

By definition the information is historic so we have extended the report with a section where we asked society chairmen to look into the glass bowl for their views of where future remuneration is headed. This is particularly pertinent given the implementation of Solvency II, SIMR and BREXIT threats and opportunities.

FEEDBACK FROM LAST YEAR

We had very little feedback on the style of the report last year so we have continued with the trend to show more graphs and less words. Please let us have feedback this year on what content you wish to see in the future.

CHANGES THIS YEAR

1. The biggest change has been the composition of members of the AFM. This has resulted in the “larger” societies reducing in number. As a result there is also a very large “medium” sized group and a much reduced “smaller” group of societies.

2. We have used the gross written premium and total assets figures from the AFM website which have been extracted by others.

3. The figures used in our word summary have been rounded to the nearest £1000.

4. The forward-looking section has been obtained this year by Robert Wharton with a confidential survey of chairmen circulated by Martin Shaw.
THE BRIEF AND THE BACKGROUND

The brief from the Association of Financial Mutuals (AFM) has remained the same namely, to produce a survey of the remuneration of executive and non-executive directors of members of the AFM. It would have been nice to have included every AFM member but this has not been possible because of the way the data is shown in some of the accounts, the lack in the accounts of the data required, country of business or where inclusion (on account of size) would distort the figures/medians etc badly. As a result the review is principally of friendly societies alone although some surveyed are corporations or industrial and provident societies and as a result some of the information is compiled in different ways. For those reasons we have regrettfully not be able to include Anglo-Saxons Friendly Society, Bus Employees Friendly Society, Compass Friendly Society, CUNA Mutual, Grand United Order of Oddfellows, IPB Insurance, Lady Grover’s Fund, Livery Companies Mutual and NRFM Mutual. The Veterinary Defence Society wished to participate but the information needed was not available in the time available.

The information has been obtained from the published reports and accounts for the year ended 31 December 2015 most of which have been obtained from websites. Some members have provided additional information voluntarily for which we thank you.

CLASSIFICATION OF SOCIETIES

“Larger” societies are those where gross premium income exceeded £20m. “Smaller” societies are those with a gross premium income of under £5m (and equating very roughly in part (€5m) to the threshold for a directive/non-directive). In the past we have only used the premium income limit as a way of classification. Now that a non-directive is now defined as a non-Solvency II firm we have included the asset test with the result that no society in the “smaller” section is subject to Solvency II but that all others are subject to Solvency II save for Benenden. As like last year, we have continued to run, at AFM request, with naming the societies researched as we believe that members will find that more helpful to enable boards to make a better comparison with specific industry competitors. The Chairmen’s expectation’s survey was conducted in confidence and therefore the societies have not been named.

As in years past we have shown the chief executive and finance director remuneration as a single year showing a breakdown of basic remuneration, other benefits, pension contributions and bonus. There then follows a three-year breakdown. We have omitted the third executive director as there are relatively few of them across the industry. The Chairman and the second highest paid NED (not always vice-chairman or SID) are also shown in the same manner.
LARGER SOCIETIES

CEO and FINANCE DIRECTOR

There are seven societies in this category. Three of those saw base salary increases for the executive directors in a range which was 10% or above. A further two were in the range of 2/5%, one was flat and one had no previous year figures to compare against. This meant that the median base salary for CEOs in 2014 grew from £161,000 to £187,000 in 2015, that is to say a median increase of 13.8%. However, for total remuneration there was an increase in the median of 43% from £185,000 up to £327,000. This is accounted for by one particularly large bonus and a couple of other meaningful ones.

For finance directors the base salary increase was smaller than chief executives and the median rose from £115,000 to £119,000 a percentage of 3.3%. On total remuneration the median rose from £134,000 up to £149,000, a 10% increase. Again there was one particularly good bonus but in very broad terms the finance directors did not fare as well as their chief executives.

There were no new appointments or departures.
**CEO Total Remuneration over 3 Years**

**Large Societies**

**Finance Director 2015 Total Remuneration**

- **UHA (Ims)**
- **Scottish**
- **Heathshield**
- **Exeter**
- **Cornish Mutual**
- **CS Healthcare**
- **Benenden Healthcare**

**Salary**
- **Pension Contributions**
- **Other Benefits**
- **Bonuses**

Median Salary £119,000
Median Total Remuneration £149,000
CHAIRMEN and NEDs

Chairmen remained very steady with no meaningful changes for four out of the seven in the category. However, the remaining three chairmen saw rises of between 13% and 20%. That pushed the median from £31,000 in 2014 to £41,000 for 2015, some 24%. However, that picture is distorted by one chairman receiving no remuneration and one newly arrived chairman on a part year salary. When they are removed the average becomes £51,000 with a range for 2015 stretching from £30,000 up to £75,000. The picture was very similar for the second non-executive director where the median rose from £18,000 to £25,000 which was a movement of 28%. There was no distortion in this case.
In medium societies the story is more clear. Of the seventeen in the category six saw flat or negligible increases in base remuneration for CEOs or finance directors and a further 6 saw limited increases to 5% or under. Only two showed increases of between 5% and 10% and one was marginally down. However that contrasted with one particularly large base remuneration increase for a CEO. As a result the median moved up 9% from £103,000 to £114,000. On total remuneration the picture was very similar and across the page the majority of bonuses were something between £5,000 and £12,000 which led to the median rising from £139,000 to £147,000, which was a rise of 5%. Only eight of the seventeen societies had finance directors and their picture was distorted in the median by three new appointments and a couple who were just into their second year which explains why the median on base remuneration fell from £74,000 to £64,000, and on total remuneration fell from £100,000 in 2014 to £77,000 in 2015. Like their larger cousins the finance directors did not benefit as much from meaningful bonuses.
**CHAIRMAN and NEDs**

The trend here showed an even more marked picture of ten chairmen and NEDs who saw their fees stay extremely flat and only a couple moved up by less than 5%. There were three who saw a change up to 15% but it must be noted that one was from a very low base. The median for chairman at £16,900 moved up only £50 from 2014. The median for the next best paid NEDs moved up £750 to £17,750. These medians have been pulled down by a couple of societies who have very low starting points and in two cases the information is not available. I cannot explain why in 2014 and 2015 the NED2 had a higher median than the chairman. The figures have been checked. In practice the two parties are very close in pay anyway. The actual range for chairmen was from £3500 to £48,000 and individual chairmen’s fees very much depended upon the style and any particular trade connection of the society in question.
In smaller societies the picture is tricky with two of the CEOs in the group of four seeing slight reductions in their base salary and their total remuneration. One society was able to pay a helpful bonus and regretfully the medians (2015 base remuneration £78,000/total remuneration £91,000) were distorted upwards by one new arrival and so the 2014 medians of £72,000 (base salary) and £85,000 (total remuneration) are probably more representative of the true picture. There was only one finance director so we have not included that as a graph.
CHAIRMAN and NEDs

The picture for chairmen and NEDs was completely flat (in rounded £000) although one society was able to raise fees for their NEDs by 3%.
BOARD COMPOSITION COMMENTS

FEMALE REPRESENTATION ON THE BOARD

We saw from our early reports that on the whole, women were well represented on boards across the whole sector, and some societies were ahead (at that time) of the Lord Davies 2015 target (25%) for FTSE100 companies (which are now at 25.9%). However, in 2014 there was a slight drop in the percentages that has happened again in 2015. So as a whole the sector is falling behind. There are seven boards (up from four in 2014) with no female representation at all. Across all AFM members (including those not in this report) there are sixty-five executive directors, of whom eight are female (or 12%), and a further 248 non-executives of whom 42 are female (17%). While figures have been fairly consistent during our seven years of reporting, the upwards trend has reversed, whilst by comparison female representation on FTSE 100 companies has doubled in the last four years. The current figures for females on the board by size are: 8% in larger societies; 15% in medium societies; and 6% in smaller societies.

LENGTH OF SERVICE

Length of service has not been a concern in the larger societies during the period of our reports. Indeed this year the position has improved again where no director has been in place for ten or more years (save for one society where five NEDs have been in post for over seventeen years). However every society in this group has appointed one to three new appointees in 2014/2015. And there have been six new appointments (in this group of seven) in 2015, so it can be seen there is much refreshment going on.

In the medium societies there is a clear divide. Nine societies are clearly regenerating and several commented in their accounts on appointments in progress including females. That should be set against five societies where there is very little evidence of regeneration. Indeed there are twenty six NEDs across thirteen societies (who have a total of eighty eight NEDs) who are at or over the 12 year mark and a noticeable number extending over the 20 year mark. The longest serving NED has done 43 years. Some of these are those societies who were in the smaller category last year but are now subject to Solvency II and so now in the medium category.
In smaller societies, with the change in composition of this grouping the picture is very different to last year with 2 newcomers to the review process. There are a number of newish NEDs. A chairman of 35 years has retired but there are a number of others who are at or over the nine year recommended limit.

**STRATEGIC AND CORPORATE GOVERNANCE REPORTS**

Within the larger societies the strategic reports were, on the whole, good, well presented and an easy read, although in one case the words strategic report did not appear but the information was all there. Ditto comments on the formal corporate governance reports.

In the medium societies there were two clear camps. Those (the majority) which produced absolutely excellent reports, following the recommended format, clear and informative and those where the minimum of information was put in. Again one society did not even use the words “strategic report”, but the relevant information was to be found. The corporate governance and committee reporting showed a very similar picture. Overall and looking back at the 2013/4 accounts there has been a good improvement in the quality of information produced in accounts generally.

Of the smaller societies it is pleasing to see all of them have both strategic and corporate governance reports although the amount of information is thinner due to their size.

**BONUS SCHEMES**

Six of the seven larger societies have formal bonus schemes most of which are documented in the accounts. They are a mixture of pure discretionary (2) or a combination of short term and long term plans (4). One has none. It is in 2014 and 2015 that payments are now being made by those societies who put long term plans (3 years and over) in place earlier than others and hence the meaningful bonuses at some societies.

Seven of the medium societies have no form of bonus scheme. A further five have discretionary schemes and five have documented short or long term schemes. The introduction of schemes appears to be filtering down the chain and we are seeing more new and improved/retargeted schemes as each year goes by. Detailed information is not usually published in accounts but many set out clearly the criteria being used.

Only one of the smaller societies has a discretionary bonus scheme, the rest have none.
BOARD COSTS

This information has been not been taken (as last year) from the “board costs” line of the information on the AFM key statistics data because in years past the interpretation of what was included in those figures has varied. This year we have compiled the figures shown from our own remuneration reports for 2014 and 2015 and used our own spreadsheets. This will enable us to build a year by year comparative figure. The percentages are set against the gross premium income written and also against the total assets (those figures having come from AFM). The graphs speak for themselves. However they require a knowledge of the industry to explain why some societies are out of kilter with others. The obvious one is where a closed book of business is run so little premium income is there but it is large in assets. Other anomalies are caused by the type of business written. The aim must be to see a decreasing cost where possible or at least a parallel increase in all/both respects. When looking across all the pages we do see a reducing number of NEDs and in some cases, reducing number of executives, suggesting a big effort to cut board costs. That has to be balanced against the quality and refreshment of the board. Maybe there is a flight to a more professional type of NED leading to a reduction in numbers but of a different quality. The information in the accounts does not allow us to examine that theory in any depth. It must not be forgotten that a good number of NEDs carry out their duties unpaid or at very low rates.
Medium Societies

Board Costs as % of Gross Premium Written

- Transport
- Sovereign
- Shepherds
- Sheffield Mutual
- Railway Engineers’
- Paycare
- Oddfellows
- National Friendly
- Met Friendly
- Kingston Unity
- Holloway
- Healthy
- Dentists Provident
- Chichester
- British
- Foresters
- DG Mutual

Percentage %

Small Societies

Board Costs as % of Gross Premium Written

- Wiltshire
- Red Rose
- PG Mutual
- Kensington

Percentage %

# = N/A
THE FUTURE OF REMUNERATION

We asked Chairmen to gaze into the crystal bowl for their views on where remuneration was headed in their view. Martin Shaw sent a short questionnaire for voluntary responses. Seventeen Chairmen responded. The answers were given in confidence. Of the seventeen responses twelve were directive societies, four were non-directive and one was a corporation. Two were larger societies, two were smaller societies and the rest were medium sized societies. In the following responses the answers may not always add up to seventeen as some questions were not directly answerable by all societies.

CEO Future Salary

The first question related to the Chairman’s expectations for the future salary increases of the CEO. The vast majority (10) expected there to be a “cost of living” increase of anything up to approximately 5% in 2017. While one expected the CEO’s salary to reduce, the work level was expected to stay much the same. However, what was interesting was a number of comments that the salary would be looked at more in the light of performance of the business as a whole. Indeed nine of those seventeen had established bonus schemes in place ranging from fully discretionary to tailored schemes. There were six who had no bonus arrangements in place. That picture was reflected for other executive directors where the vast majority were expected to see “cost of living” or inflationary increases only.

Chairman’s Fees

The next question related to the Chairman’s expectations of his own fees and the vast majority (8) expected them to stay at the same level and indeed in a further four cases there were specific budgetary restraints (which also applied to the executive team as well). There were three Chairmen who expected their fees to increase by more than 10%. The reasons given were the current lower than average pay and the increasing regulatory responsibilities and workloads. When looking at other NEDs the picture was slightly different in that the Chairmen expected the majority of the NEDs to stay at the same fee level with a small number seeing a cost of living increase only.

Summary on £

Throughout all of those first four questions there was a clear trend by five of the respondents which gave a very positive messages in that it was the performance of the business which mattered the most and where performance was good then it would be rewarded. In four cases there were strong indications of budgetary constraints for both executive and non-executive increases.
Time Input

There were questions about the time input by both the Chairman and other NEDs. The majority of the Chairmen were putting in three or four days a month with a further five inputting five to seven days a month. Not surprisingly all of them had seen an increase in their workload although eleven of them expected that had peaked and the future workload would stay at the same higher level. When looking at the reasons they almost all cited regulatory and corporate governance requirements, although there was a strong showing of time spent on coaching, monitoring and individual support of executives. However, when it came to the NEDs the majority were only doing one or two days a month and eleven of the seventeen expected that not to change for NEDs. Those who did see NED time increasing cited the same regulatory and governance reasons and general board effectiveness.

SIMR Impact

We asked a question about the impact of SIMR and ten of the seventeen respondents confirmed that it had been implemented with very little change of personnel or effect on the business. A further five undertook the change with only a reasonable amount of effort. Two societies found it a substantial effort. Were there any remuneration changes as a result? In only four cases, yes and some of those were one-off payments to recognise some extra responsibility. In all other cases there was no change in remuneration. However, ten societies did delegate some of the SIMR responsibilities to non-director level personnel but again no remuneration changes took place save in three instances.

Diversity and Bonuses

The question on diversity of the board and frequency of review of remuneration arrangements revealed that fourteen of the seventeen had fixed structures in place. While all of them confirmed they regularly reviewed the diversity and remuneration position, (many had been driven by SIMR), eleven of the seventeen confirmed that they expected no change to take place in the immediate future. However, it should be noted that one society specifically raised fees to NEDs for the purpose of recruiting higher calibre people and the comment was that it was “highly successful”.
Remuneration Comparators

The final question was on the general structure of future remuneration and how it is reviewed. Of the seventeen societies, three use external advisers but the vast majority use this AFM report and their own researches to carry out, what in most cases, are annual reviews. Three of the societies had fixed three-year remuneration plans with one undertaking benchmarking only every “3 to 5 years”.

Summary

This was very much a response from the medium sized societies. The tone going forward and across the page was enlightening in that it showed some four or so societies with a very positive attitude to remuneration, rewarding performance (or not as the case may be) with regular reviews of qualities and abilities of all concerned and noting that under-remuneration is not an incentive to good performance and governance. The other extreme was marked by three or four societies were there may be financial constraints on what can be done to increase financial reward for all concerned. The remainder gave the impression that it was very much "business as usual" with cost of living being taken account of and annual reviews being undertaken.

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We have a team of 15 partner level lawyers who work directly in the financial services arena all with specialist expertise in insurance, regulation, fund management, finance arrangements and corporate governance.
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