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AFM Response to FRC consultation “The Wates Corporate Governance Principles for Large Private Companies”

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 for large privately-owned companies; and
 - Explore how a similar approach might apply to mutuals.
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 staff¹.
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 businesses² and to take account of corporate diversity³.

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

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

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

4. AFM welcomes the extensive work undertaken by the Coalition Group, as well as the impetus provided by the Government and FRC. Few would disagree that large privately-owned companies need to demonstrate more clearly that they adhere to high standards of corporate governance.
5. When the government consulted on corporate governance in November 2016, we noted that they included mutually owned organisations within the definition of privately-owned businesses. In our response to BEIS we suggested it was not appropriate to think of mutual organisations in the same space as privately-owned companies, since their ownership is very wide. However, we acknowledge that The Companies (Miscellaneous Reporting) Regulations 2018 offers the opportunity for companies to state which corporate governance code, if any, they have applied.
6. In that context a mutual organisation may consider that applying the proposed code for privately-owned companies might be a better fit with its business model than options such as the UK Corporate Governance Code, or indeed AFM's annotated version of that. In particular, larger mutual insurers, who are not included in our Code compliance process, should consider the merits of adopting either a Code intended for listed companies, one set for private companies, or what other alternative approach it elects to follow. We have approached our responses to the questions raised in the consultation in this light.
7. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,



Chief Executive
Association of Financial Mutuals

CONSULTATION QUESTIONS

1. Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

We recognise that the principles are written at a high level, which gives the freedom for a firm to explore expansively how the principle is applied in practice.

We consider the principles should be developed for the long-term, and that they should be robust and comprehensive enough to avoid regular amendments.

In our view, the principles are capable of achieving this. The supporting guidance provides important context and detail that will help a firm interpret the principle and to set out clearly how it applies the principle in practice.

2. Are there any areas in which the Principles need to be more specific?

In our view, the areas where the principles were significantly lighter in treatment, compared to the revised UK Corporate Governance Code, were in relation to the value and role of non-executives (UK Corporate Governance Code principles H and L): and in formalising the role and composition of board sub-committees (in particular audit and remuneration).

This is illustrated figuratively in the chart below, which seeks to compare the principles in the UK corporate governance code with the guidance in the proposed private companies code, which accompanies each of the six principles.

UKCGC sections	UKCGC principles	Private companies
Board leadership and company purpose	3 bars	3 bars
Division of responsibilities	3 bars	3 bars
Composition, success and evaluation	3 bars	3 bars
Audit, risk and internal control	3 bars	3 bars
Remuneration	3 bars	3 bars
		2 bars

The chart shows that a comparison of the guidance with the principles in the UK Corporate Governance Code is substantially aligned. Where there are a small number of uncoloured boxes in the 'private companies' column, this suggests the principle is not clearly duplicated.

There are also a couple of elements of guidance that we considered where less evidently present in the provisions within the revised UK Corporate Governance Code, than in the guidance for the proposed code for privately-owned companies. These were guidance relating to:

- how the values of the organisation inform the expected behaviours of all company employees, and
- the sustainability of the business.

We think these are worthwhile inclusions, and would be happy to share our analysis in more detail. To illustrate, an abbreviated version of our assessment of principle 1 is provided below.

PRINCIPLE		New Code Principles	GUIDANCE FOR CONSIDERATION	New Code provisions
1	PURPOSE	An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.	A well-defined purpose	28
			expected behaviours of all company employees	
			effective board that develops a strategy and business model to generate sustainable value	1, 3
			healthy company culture	2

3. Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?

The examples given in paragraph 19 (large family-owned company, private equity-owned company and the subsidiary of a UK-listed company) are relatively narrow. It is not clear therefore whether and how the Coalition group has explored other organisations that might be in scope. That may reflect the interests of Coalition Group

members, though we would like to see a more explicit list from FRC of the types of companies it might expect to be in scope, and whether and how those have evolved from the list put forward in the BEIS green paper in 2016:

Table 7: Categories of large, privately-held businesses

- Private company subsidiaries of UK-listed parent companies (e.g. Tesco Stores Limited)⁶⁶
- Large companies owned by private equity investors (e.g. Monarch Airline Limited)
- UK subsidiaries of foreign parent companies (e.g. ASDA Group Limited)
- Significant “founder” or family-owned businesses (e.g. Warburtons Limited)
- Large mutuals and co-operatives (e.g. Co-Operative Group Limited)

In particular, companies with foreign parents, and mutuals and co-operatives have different ownership structures and accountabilities, which are only partly reflected in principle 6 at present.

4. *Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors’ remuneration?*

We consider that they give a good deal of transparency. It is not evident to us that every privately-owned company needs to be completely transparent in the way directors pay is set, unless they are undertaking work for the public good.

5. *Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?*

We would expect firms to describe this in the most appropriate way, and adding more explicit content to the principle will make it less relevant to all potential subscribers.

6. *Do the Principles enable sufficient visibility of a board’s approach to stakeholder engagement?*

We would expect the company to be able to interpret from the guidance the nature of stakeholders they need to be accountable to, and to set out their approach in light of this. For example, a family-owned firm that undertakes work for the local council or via a government contract has a different set of stakeholder accountabilities to one that does not, just as the board of a mutually-owned organisation has a set of accountabilities to the members of the mutual.

7. *Do you agree with an 'apply and explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?*

We think an 'apply and explain' approach is a very effective way of reporting. This is preferable given the six overarching principles in the proposed code. By comparison, where a 'comply or explain' approach in the UK corporate governance code, this reflects the expectation that a listed firm will consider whether they have complied with each of the 41 code provisions.

We consider FRC should actively monitor adoption, and to review the approach taken by private companies from the first year of implementation, to assess how effective the principles are in encouraging the adoption of good practice, and how well companies have approached the 'apply and explain' exercise.

8. *The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?*

Given the roots of the exercise, ie concerns amongst the public and in government at the governance arrangements in some large privately-owned companies, we consider that where a company is of a comparable size to a FTSE 350 listed company, it should be submitted to a similar monitoring exercise by FRC to a listed company.

In other circumstances, a more proportionate approach might be to include elements of compliance in audit requirements, with the remainder open to public scrutiny, by requiring subscribers to the code to publish their report and accounts, including their 'apply and explain' statements on their website.

9. *Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?*

The test for this will be to observe how over time the principles engender greater transparency and accountability by relevant unlisted companies. The Principles certainly offer a big step towards closing the gap in governance arrangements, so long as they applied thoughtfully and thoroughly.

10. *We welcome any commentary on relevant issues not raised in the questions above.*

AFM's annotated corporate governance code is currently aligned to the 2016 version of the UK Corporate Governance Code. We are launching a consultation this autumn to review our current approach, and intend to explore whether and how the revised code for listed companies fits the needs of our members best, or whether an alternative, such as the proposed code for private companies, might be closer to the business models of our members.