AFM Corporate Governance Code

Guidance for Boards, *to support them in applying the Code*

(v.1, September 2024)

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THE AFM Corporate Governance Code: overview of Principles

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3	**DIRECTOR RESPONSIBILITIES**	The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.
4	**OPPORTUNITY AND RISK**	A board should promote the long-term sustainable success of the organisation by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.
5	**REMUNERATION**	A board should promote executive remuneration structures aligned to the long-term sustainable success of an organisation, taking into account pay and conditions elsewhere in the organisation.
6	**STAKEHOLDER RELATIONSHIPS AND ENGAGEMENT**	Directors should foster effective stakeholder relationships aligned to the organisation's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

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Introduction

The AFM Corporate Governance Code was launched in 2019, to support AFM members in delivering high standards of corporate governance. It draws on good practice across the Financial Reporting Council's UK Corporate Governance Code (the FRC Code) and the Wates Principles for large private companies, as well as regulatory expectations and legislative requirements. The AFM Code is principle-based, and adopts a format of 'apply and explain' to encourage boards of mutuals to satisfy themselves how best they meet the six principles in the AFM Code.

In early 2024 we consulted members on whether we should conduct a full review of the AFM Code, in light of changes made by FRC to the UK Corporate Governance Code, and regulatory developments in the five years since the AFM Code launched. Members agreed that there was not a need for a full review, but that we should consider the issue again in 2026; however, members agreed that extra guidance would be useful now, to support good practice.

This guidance supports the boards of AFM members in delivering high standards. The guidance is sourced from our own experience of supporting members, as well as from guidance issued by FRC (which is regularly reviewed and updated), and the latest requirements from the PRA and FCA. *It is non-mandatory and does not form a part of the AFM Code. It should not be considered as a checklist of good practice*. The guidance covers some elements only of each Principle.

Opening messages

The AFM Code is designed to help mutual insurers and friendly societies to adopt high standards of corporate governance, and to be able to describe to their members and other key stakeholders how the organisation and its board work to ensure good governance, and that the business is run with customers' and members best interests at heart.

The focus of this guidance is on corporate governance practice, not reporting. Nonetheless, it is vital that the report and accounts fairly and accurately describe corporate governance arrangements within the organisation, and comply (as appropriate) with s172 obligations[1]. In a mutual organisation, the key readership of the annual report is the membership of the organisation, not external commentators, rating agencies or the wider market. In this guidance we have taken account of the range of actions that the Government is embarking on to simplify corporate reporting; regardless of this though the annual report of a mutual should be written with members in mind, be readable by them, and encourage them to take an active role in their mutual.

Whilst the executive may be responsible for presenting governance reports, it is vital that the Board agrees the report and shares the corporate culture, and that it fully engages with the corporate governance process.

[1] As covered in the AFM Code; for more about s172 statement, see: https://www.icaew.com/technical/corporate-reporting/section-172-1-statement

Purpose and Leadership

Values and Culture

1. The Board is responsible for developing and describing the culture of the mutual, and for establishing the values and behaviours that support a positive culture, and how it is delivered.

2. The Board needs to maintain a common and consistent language around the culture. As per the table below, there are widely recognised signs of a positive culture, and warning signs of a problem with the organisation's culture[2].

Attributes of a positive culture	Signs of a culture problem
• *Honesty* • *Transparency* • *Respect* • *Adaptability* • *Reliability* • *Recognition* • *Acceptance of challenge* • *Accountability* • *A sense of shared purpose* • *Diversity, equity and inclusion* • *Positive behaviours* • *Psychological safety* [source: FRC Code guidance]	• *Silo thinking* • *Dominant chief executive* • *Pressure to meet the numbers* • *High staff turnover* • *Lack of access to information* • *Low levels of meaningful engagement between leadership and employees* • *Lack of openness to challenge* • *Tolerance of regulatory or code of ethics breaches* • *Short-term focus* • *Misaligned incentives* • *Fear of speaking up*

3. There is a range of metrics that the executive and the Board can draw on, to provide insight into culture. Examples are provided in the table below.

Sources of culture insight and metrics (source: FRC)
• *Data analytics, including on learning and development* • *Diversity, equity and inclusion initiatives and strategy* • *Recruitment, reward and promotion decisions* • *Use of non-disclosure agreements* • *Whistleblowing, grievance and 'speak-up' arrangements and findings* • *Member feedback* • *Employee annual and pulse surveys and direct engagement* • *Board interaction with senior management and workforce* • *Health and safety incidents and near misses* • *Promptness of payments to suppliers* • *Attitudes to regulators, internal audit and employees* • *Turnover, absenteeism rates and exit interviews*

[2] Throughout this guidance we have drawn on the extensive and very useful guidance provided by FRC. For more, see: https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/corporate-governance-code-guidance/

Corporate Strategy

4. The Board must have a broad understanding of how the business creates and maintains value, and how the strategy supports this. In recent times we have seen increasing regulatory interest in how the strategy of a mutual has been set, and how it envisages growth in income and the management of costs.

5. In taking a long-term view of the health and sustainability of the business, a Board may wish to satisfy itself that it is doing some or all of the activities in the table below.

Taking a long-term view
• *How we know that management is identifying and addressing future challenges and opportunities, for example, changes in technology, business-relevant environmental and social matters, or changing stakeholder expectations* • *The proportion of Board time spent on financial performance management, versus other matters of strategic importance, such as product development and sales planning* • *Reporting on outcomes from strategy days/ events* • *The balance between the focus on immediate issues and long-term success* • *Whether there is sufficient board time allocated to idea generation, opportunity identification and innovation* • *How we use scenario analysis to help us assess the strategic importance and potential impact of our challenges and opportunities* • *How we assess and measure the impact of our decisions on financial performance, the value for members and the impact on key stakeholders*

Board Composition

Balance and diversity

6. Directors are likely to make good decisions if they contribute a range of perspectives and experiences, in order to support the organisation's strategy. Diversity in the boardroom reduces the risk of group think, and strengthens the quality of decision-making. For mutuals, their members and the workforce are likely to be the primary stakeholders to consider when assessing the viability and success of the strategy.

7. Within AFM members, those with a regular introduction of new NEDs tend to show higher levels of diversity and less group think, and there is growing evidence that mutuals with more diverse Boards- and who encourage greater equity, diversity and inclusion amongst the workforce- generate better business performance. Independent NEDs[3] provide challenge within the board and use their skills, experience and knowledge to drive productive discussions. NEDs should not ordinarily stay in post longer than nine years, and where they do by exception it may be harder to assert their independence. For Chairs, who should be independent on appointment, the nine years commence from the point where they become a Board member.

[3] An 'independent NED' is unlikely to have worked for the business in the last five years, not had a material business relationship in the last three years, not be receiving any remuneration other than director's fees, and not served on the board for more than nine years (FRC Code, Provision 10).

8. In 2023 the PRA and FCA both issued consultation papers on diversity and inclusion, and this confirm that firms will be placed under closer scrutiny on their approach to diversity. The table below suggests actions the Board may wish to take.

Actions mutual can take to continually support equity, diversity and inclusion
• *Regularly assessing the skills and attributes in place and needed for the organisation and reviewing the quality of directors and future candidates* • *The chair and board members receive appropriate training, to promote open discussion and to embrace differences of opinion in order to operate effectively* • *Making a commitment to increase the diversity of the board by setting targets* • *Dedicated initiatives with clear objectives and targets, for example in areas of the business that lack diversity* • *Introducing mentoring and sponsorship schemes* • *Introducing a commitment to more diverse shortlists and interview panels* • *Creating procedures or policies to assist board members (and other employees) by providing, for example, better accessible functions, services or assistance for individuals when requested* • *Signing up to initiatives such as Women in Finance; GAIN; Progress Together* • *Consider candidates from outside the sector to increase director diversity*

9. Diversity of personal attributes also matters to the effectiveness of the Board. Those attributes to consider, which are most likely to support high performance might include: *courage; openness; honesty; tact; ability to listen; strength of character; and judgment*. Adopting a Board skills matrix (covering the experience, knowledge and skills of Directors today and in the future) may be useful in identifying any gaps in competencies, and determining whether these can be filled by training plans or in future appointments to the Board. This will help inform succession plans and verify that the board continues to contain the skills needed to lead the business in the future.

Effectiveness

10. There should be a commitment by the Board to a regular review of its performance, both as individuals and as a whole. For an individual NED or Chair, their commitment and contributions to the agenda of the Board should be assessed each year, and prior to their re-appointment the nomination's committee (or the Board in its absence), should assess the individual's skills, knowledge, experience and performance, and their contributions to the effectiveness of the Board.

11. Much of the work on evaluating Board effectiveness can be undertaken internally, as an external review is likely to be expensive and very time-consuming. External reviews should occur regularly; whilst good practice is every three years, before deciding on an external review, it is important to consider how well the reviewer understands your business, and to be clear on what you want them to achieve. If the board agrees an external review is not appropriate, it should minute the conversation and the reasons for deferring an external audit.

12. The table below considers some of the elements that may be included in a Board effectiveness review, whether internal or external. For a more detailed assessment of good practice in independent board evaluation, look at this report from the Chartered Governance Institute.

The Board review may consider:
• *the mix of skills, experience, and knowledge on the board, in the context of developing and delivering the strategy, the challenges and opportunities, and the principal risks facing the company* • *clarity of, and leadership given to, the purpose, direction and values of the company;* • *succession and development plans* • *how the board works together as a unit, and the tone set by the chair and chief executive* • *key board relationships, particularly chair/chief executive, chair/senior independent director, chair/company secretary and executive/non-executive directors* • *effectiveness of individual directors* • *clarity of the senior independent director's role* • *effectiveness of board committees, and how they connect with the main board* • *quality of the general information provided on the company and its performance* • *quality and timing of papers and presentations to the board* • *quality of discussions around individual proposals and time allowed* • *the capability of the chair in ensuring sufficient debate for major decisions or contentious issues* • *effectiveness of the company secretary/secretariat* • *clarity of the decision-making processes and authorities, possibly drawing on key decisions made over the year* • *processes and framework for identifying, monitoring and reviewing risks* • *how the board communicates with, listens and responds to, members and other key stakeholders*

Director Responsibilities

Committees and effective meetings

13. The AFM Code highlights the range of Board committees that may be used to support the work of the board as a whole. The terms of reference for each board committee should be set out clearly and reviewed regularly. The composition of each committee should ensure it has a range of relevant skills and achieves independence (from the executive and the Chair of the Board, where appropriate), as well as the professional qualifications and experience relevant to the committee's role[4].

14. The Board and its committees need to have confidence in the quality of information provided to them. Papers presented to the Board or committee should be accurate, clear and focused, and enable the reader to gain sufficient knowledge of the subject matter, the expected outcomes, as well as what is expected of them.

[4] For example, as per the AFM Code, at least one member of the audit committee should have recent and relevant financial experience, and at least two members of the remuneration committee should be independent NEDs.

15. Thorough induction training should be provided to new directors, covering the business and the wider sector, and the culture of the organisation[5]. Regular training should be provided to board members, to ensure they are aware of developments in the sector, corporate reporting and regulation, and the responsibilities of individual directors.

16. Resources should be devoted to the Board and its committees to ensure they can fulfil their functions. This includes access to the Company Secretary, for assistance including:

    - helping the Chair in planning the board/ sub-committee's work
    - advising the Board on all governance matters
    - drawing up meeting agendas
    - taking minutes
    - drafting of material about its activities for the annual report
    - collection and distribution of information, and
    - provision of any necessary practical support.

17. The Chair should ensure that sufficient time is provided in Board meetings for the committees to report (including by providing minutes). Whilst the Board may delegate some actions to the Committees, the responsibility remains with the Board for key decision-making.

Opportunity and Risk

Risk management and internal controls

18. The Board is responsible for setting the risk strategy, risk framework and the risk appetite. Recent changes to the FRC's UK Corporate Governance Code included new requirements for the risk management and internal control framework. The role of the framework is to manage risk rather than eliminate it; elements that may be included in the framework are set out in the table below.

The risk management and internal control framework should
• *be tailored and appropriate to the organisation* • *be considered as part of its purpose, strategy, business model and governance* • *be embedded in the operations of the organisation and form part of its culture* • *be capable of responding quickly to evolving risks to the business, whether they arise from factors within the company or from changes in the business environment* • *be changed and adapted in line with changes to the company's objectives and other internal and external factors* • *meet regulatory expectations, including the need for reporting*

[5] Consider for example the AFM NED Toolkit: https://financialmutuals.org/resource/afm-ned-toolkit-2nd-edition/

> - *not be seen as a periodic compliance exercise, but instead as an integral part of the company's day-to-day business and governance processes*
> - *include procedures for reporting immediately to appropriate levels of management any significant concerns that are identified, together with details of appropriate action being undertaken.*

19. The audit and/ or risk committee should review the company's internal financial controls, that is, the systems established to identify, assess, manage and monitor financial risks. In future we anticipate that there will be greater regulator expectation that an organisation's internal audit function is subject to quality assurance, and the audit committee will expect to lead this process.

Viability statements and going concern

20. In AFM's 2022 Corporate Governance Report, we noted that 90% of AFM members in the scope of Solvency 2 provided a viability statement in their latest report and accounts, which set out the long-term prospects of the business, alongside the short-term going concern statement[6]. Most mutuals elected for a five-year horizon, though this varied according to the organisational strategy. A clear viability statement sets out what factors have been taken into account in assessing future viability, and what risks are considered that might impact on that. Setting out how this assessment correlates with the approach taken to the ORSA (Own Risk and Solvency Assessment) is also useful.

Remuneration

21. The Board of a mutual, alongside the remuneration committee where there is one, is responsible for ensuring that there is alignment between executive remuneration and the long-term success of the business. The metrics used to judge performance should include a range of financial, non-financial and strategic measures, aligned to how the business delivers value to members over the long-term. Executive remuneration should also take account of pay and conditions across the workforce.

22. AFM's annual report on Board remuneration and composition, also collects data on the gender pay gap in AFM members. Members may also find it beneficial to benchmark pay from other sources to ensure Executive and NED remuneration is competitive. Pay gap reporting is voluntary for AFM members, and statutory rules in the autumn of 2024 will mean only the biggest organisations will need to report their gender pay gap publicly. However, we encourage AFM members to monitor their own gender pay gap, to support fairness and equality. Workforce motivation may be enhanced where the board is able to positively present the results of the gender pay gap to staff, and explain how executive pay is geared to the success of the business, and how it supports an effective culture.

[6] A viability statement is required by the Companies Act, and considered by AFM to be good practice for friendly societies.

Stakeholder Relationships and Engagement

Positive outcomes for customers and other key stakeholders

23. The AFM Code explores the range of key stakeholders that a Board should ensure there is a productive dialogue with. Reporting to stakeholders should highlight the outcomes that have been achieved: for members/customers in particular, where this is consistent with the approach in the FCA's Consumer Duty. It also links with our commitment to delivering high standards of care and outcomes for all customers, especially vulnerable customers. Collecting information from customers might include customer satisfaction surveys and analysis of complaints and retention data.

24. For other stakeholders, an outcome-based approach will reinforce the commitment of the business to working towards clear and tangible strategic objectives, and that the business treats suppliers and employees fairly and prioritises effective working relationships. Where relevant, this should be captured in the s.172 statement.

Employee Engagement

25. The AFM Code recognises that the workforce is one of the key stakeholders for a mutual. There are a range of ways a Board can ensure it captures the 'employee voice' in the boardroom, as per the table below.

Examples of employee engagement used in mutuals
• *hosting town halls and open-door days* • *listening groups for workers and supervisors* • *focus or consultative groups* • *meeting groups of elected workforce representatives* • *inviting colleagues from different business functions to board meetings* • *employee AGMs, or inviting staff to the corporate AGM* • *involvement in training and development activities* • *annual and pulse surveys, and direct engagement* • *digital sharing platforms* • *establishing mentoring between non-executive directors and middle managers.*

Suppliers and business partners

26. All AFM members have a supply chain to manage, include professional advisers and service providers. Working with suppliers effectively and productively is likely to be a critical success factor for a mutual. This includes adopting good payment practices, including paying bills on time, maintaining proper oversight of processes and potential risks, retaining key responsibilities and monitoring requirements under modern slavery legislation.

Climate change and ESG

27. The AFM Code sets out how AFM members are expected to report on environmental, social and governance issues in a way that takes account of members' and stakeholders' priorities. Since the AFM Code was launched, there has been significant extra focus on managing the financial risks associated with climate

change, and AFM members also need to meet PRA, and other upcoming regulatory, expectations. We continue to observe increasing coverage in the report and accounts of mutuals on the way they are working to address climate concerns.

28. In AFM's 2022 Corporate Governance Report, we provided an assessment of climate change reporting, adopting the main headings in PRA's 2019 requirements, covering governance, strategy, risk management and metrics. We noted limited evidence of the outcomes of climate change activities, though in our July 2024 Mutually Yours newsletter, we noted the rapid progress made since. PRA's 2024 business plan includes a commitment to review its 2019 supervisory standards, and mutuals should continue to strive for more evidence to support good practice in their business.

Member engagement

29. The Chair has an important role in fostering relationships with members, both through the AGM and other forms of member engagement. Some members have found that member panels and member webinars have been useful ways of engaging with more members other than through the AGM. AFM members can contact AFM to receive slides and videos from recent AFM webinars on the subject of member engagement, which highlight the actions that individual mutuals are taken to engage outside the AGM.

30. This guidance is focused on good practice in corporate governance, rather than on reporting. It is worth noting though that there has been significant encouragement by the government to regulators, to simplify corporate reporting requirements and to reduce bureaucracy. Whilst this might mean many mutuals will no longer have to produce a Strategic Report as part of their Directors' Report, we consider that the necessity for the report and accounts to present a clear assessment of the performance and prospects of the business will remain, and that as part of this mutuals should ensure their report and accounts is understandable by members, and helps motivate them to take up the democratic rights and responsibilities. [At the time of writing, the new Government has not yet set out whether and how it plans to take forward the simpler corporate reporting initiative.]