Association of Financial Mutuals

Corporate Governance Report 2018

September 2018

Introduction

This is the latest report from AFM on corporate governance in the mutual insurance sector. It draws on compliance returns from our members, showing their stated levels of compliance during 2017 with the Annotated Corporate Governance Code for Mutual Insurers.

The primary purposes of this report are to enable our members to benchmark their performance against their peers, as well as to provide an overview to Treasury and the financial regulators on standards of governance amongst members of AFM.

The Code is available to view on the AFM website, and closely follows the Financial Reporting Council's Code for listed companies.

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About AFM

The Association of Financial Mutuals (AFM) was established on 1 January 2010. Financial Mutuals are member-owned and not-for-profit organisations, many of whom have operated for over 100 years, 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 49 members and represents mutual and not-for-profit insurers, friendly societies and discretionary mutuals in the UK and Ireland. Between them, UK mutuals manage the savings, protection and healthcare needs of over 30 million people, and have annual premium income of around £16 billion. For more, go to www.financialmutuals.org.

Executive Summary

This report provides an overview of compliance with the Annotated Corporate Governance Code for Mutual Insurers (the Code) during 2017, by members of the Association of Financial Mutuals.

The annual compliance exercise for the Code is set on a comply or explain approach, and requires companies to complete a detailed questionnaire covering the 54 provisions within the Code, and helps the Board of each company identify how best to comply with each aspect. Where a company does not comply with a Code provision, it documents an explanation in its annual report and accounts. In so doing our approach mirrors that of the largest listed companies, and indeed our Code is currently annotated with very little revision from the FRC's Code.

There were 37 responses to the exercise this year, including six from organisations that were new members and undertaking the exercise for the first time. This partly explains why on average each member complied with 86% of Code provisions, compared to 95% in 2016.

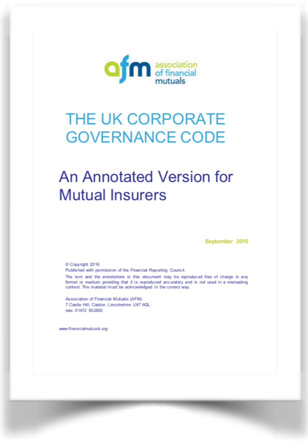
Overall, over half of members complied with at least 90% of the provisions, and five organisations complied with all 54 provisions (one in 2016). That said, most AFM members do not aspire to comply fully, and are comfortably explaining how their established practice allows them to achieve good outcomes for members and customers without replicating the approach of listed companies.

This report highlights some general areas for improvement, including: increasing AGM turnout, improving the clarity of narrative, and the longevity of service of some NEDs. A new section of the report, on the gender pay gap, shows the sector faces further work, in common with the financial services sector overall.

Governance standards in the UK continue to evolve, and AFM is preparing to consult shortly on revisions to the annotated Code, to help support our members in maintaining high standards of corporate governance.

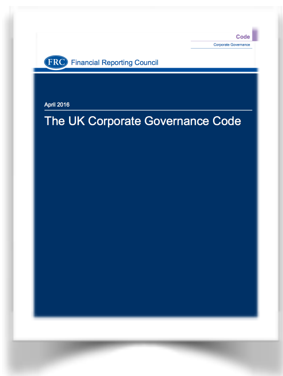
1. The Annotated Corporate Governance Code

The Annotated Code was developed in 2005 following the publication of the Myners' Review in December 2004, which made a specific recommendation for the introduction of a version of the Combined Code for the mutual life insurers.



At the time HM Treasury and the Financial Services Authority agreed that responsibility for producing the Code and detailed guidance for their members on its implementation would rest with the predecessors of AFM. The approach was reviewed post-launch by FSA, who were broadly content with the self-regulatory approach.

The Code adopts wherever possible the requirements and principles of the UK Corporate Governance Code, supervised by the Financial Reporting Council[1]. The annotated Code retains the same set of Principles and Code Provisions as FRC's, grouped into the five sections:



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

Within each section there are a number of Main Principles (27 in total across the Code), and a series of Code Provisions (of which there are 54 in total).

The section headings reflected changes made by FRC to the UK Corporate Governance Code in 2010, which updated the principles in light of the Walker Report. This compliance exercise is based on the version of the annotated Code published in 2016 (see Annex 1 for more details). FRC has just completed a wholesale review of the UK Corporate Governance Code, and AFM will be consulted in Autumn 2018 on changes to our Annotated Code.

AFM members are also expected to demonstrate high standards of corporate governance by, where appropriate, complying with the Code. This report summarised responses from 37 eligible organisations, including a number that became members at the start of 2017. (See Annex 3 for a list of participants.)

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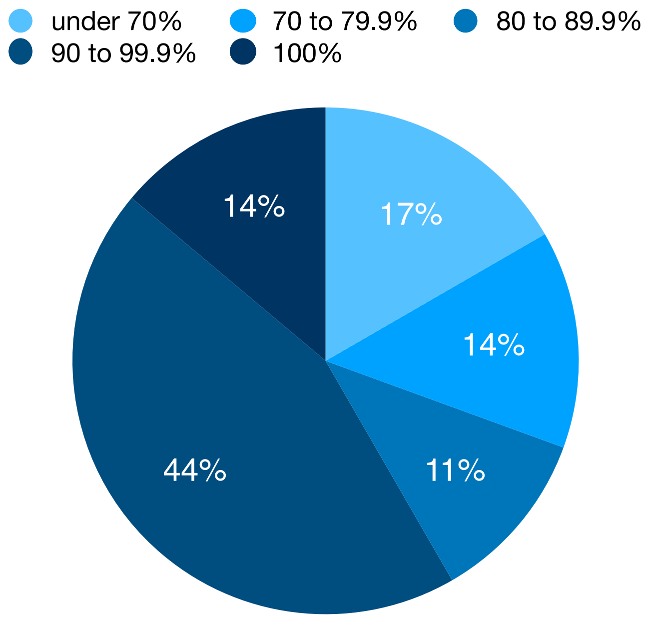
1 http://frc.org.uk/Our-Work/Codes-Standards/Corporate-governance.aspx

2. Compliance with the Code in 2017

There are 27 main Principles in the 2016 version of the Code. The 54 Code Provisions elaborate on the Principles in a more prescriptive way, and set out in more depth the nature of behaviours the Principles expect. The Code anticipates members will have complied with the Code's provisions, or where they have not, expects them to provide an explanation as to why not.   Reporting by AFM members is therefore focused on the Provisions (as it is in listed companies).

2.1 Overall results

The charts below show the distribution of overall results for the 37 members that complied the exercise, and the number of Code Provisions for which they did not comply and were therefore expected to provide an explanation.

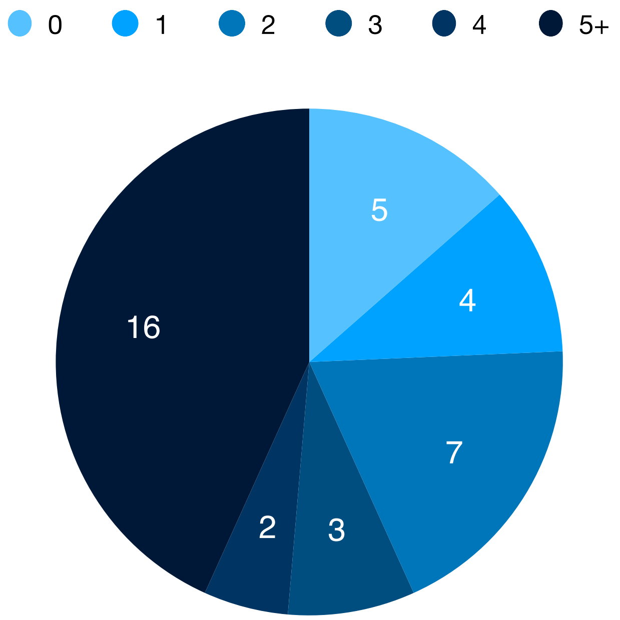


This chart shows the distribution of performance by companies, based on the proportion of the 54 Code Provisions that they complied with.

In 2017, five organisations reported that they complied with all 54 Provisions, compared to one in 2016. The five were: Dentists' Provident, DG Mutual, Scottish Friendly, Shepherds Friendly and UIA. Over half of members complied with more than 90% of the Provisions.

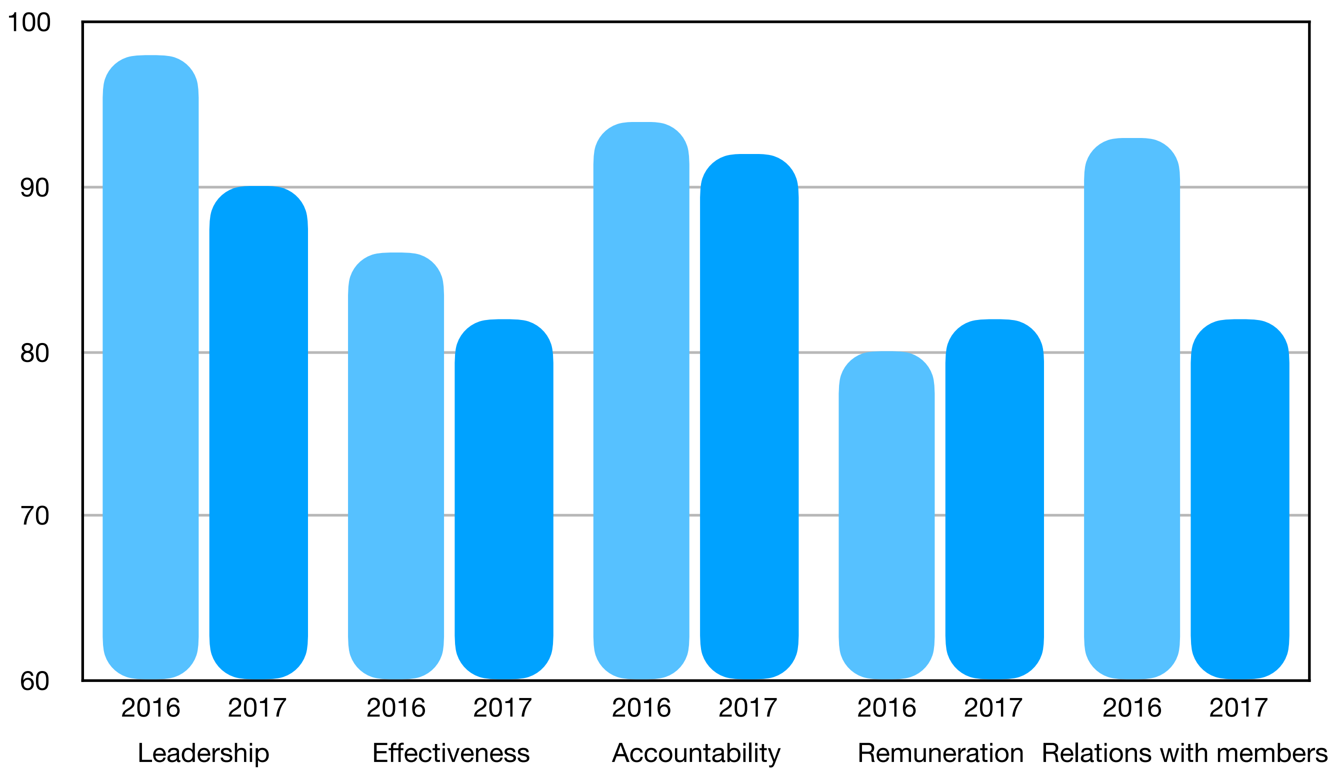
The one-sixth of members achieving a score below 70% include a number of new or relatively new members, for whom this was their first submission. In many cases, as not-for-profit insurers or non-Directive insurers, a number of the Provisions do not apply or else the organisation has adopted a different process to achieve a similar result.

This is illustrated in the following chart, which shows the number of explanations provided by members. This suggests a higher tendency for firms to elect not to comply, where an alternative approach better fits their business.



in 2017, 43%of members register zero, one or two Provisions which they were unable to comply with, which compares with 18% in 2016. Conversely, 43% also reported five or more explanations were necessary in the year.

The Code recognises that members have the option to explain rather than comply, so in itself this does not imply lower standards of governance. A key issue therefore is the quality of the explanations provided, and of the narrative more generally in the report and accounts.

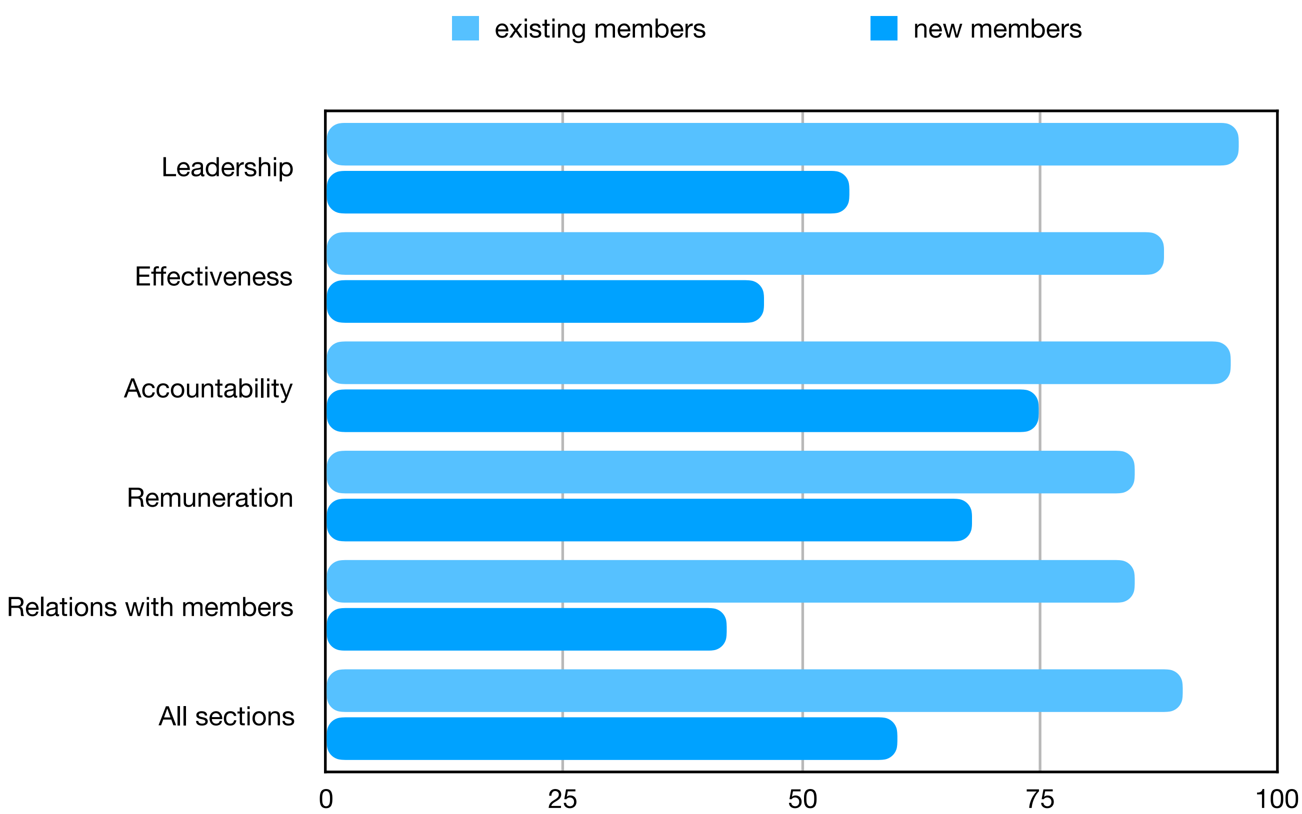


The chart above compares the overall levels of compliance with each of the five sections of the Code, and contrasts the 2017 results with the previous year.

On the face of it, four of the five sections attract lower overall outcomes than the previous year, with only the section on Remuneration showing an increase. Reasons for this include:

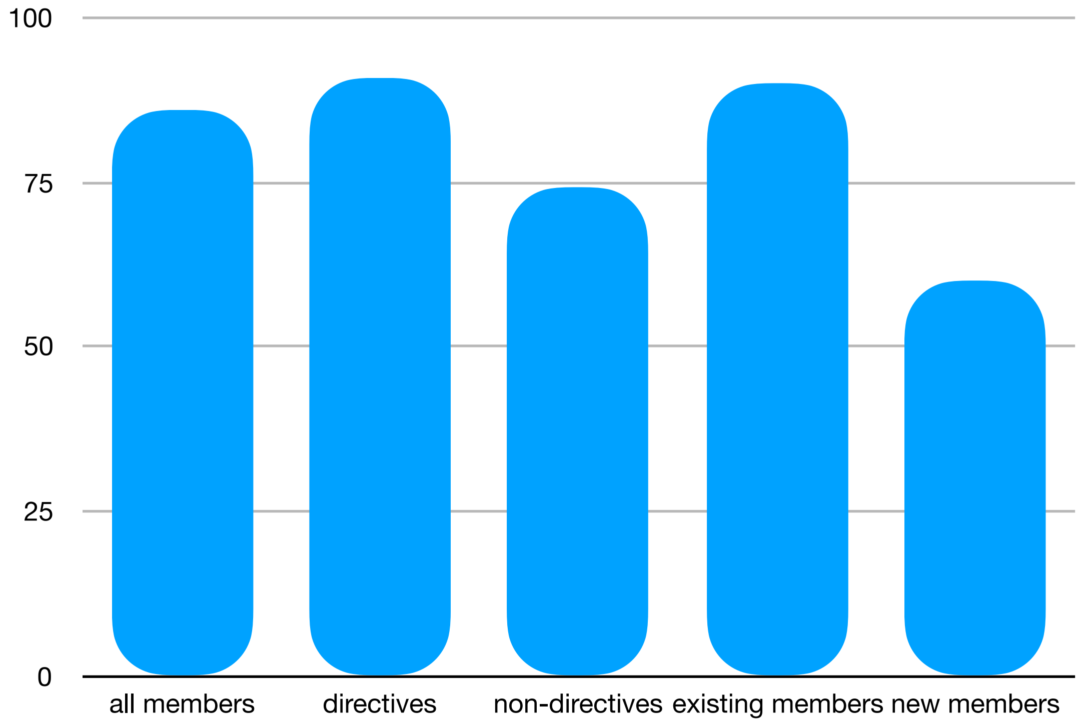
- changes to the Code introduced in 2016 which were first measured in 2017;
- we have also taken a broader assessment of compliance with each Provision in this year's exercise, which therefore accentuates variations in approach; and
- a significant number of new members that have completed the exercise for the first time.

With regard to the final point, six (16%) of those completing the exercise were doing so for the first time. We have always viewed compliance with the Code as a journey, which may take some time for organisations to complete. More particularly, none of the six new organisations were mutual insurers/ friendly societies, so elements of the Code may be less relevant or not applicable. This is illustrated in the chart below:



As in previous years, the sections on Leadership and Accountability have scored most highly, and Effectiveness and Remuneration have been less readily applied in the sector. Relations with Members fell significantly in the year. Annex 2 provides results for each of the provisions in the Code.

Overall compliance with the Provisions in 2017 was 86%. This compares to 95% the previous year, and as well as the rationale above, more detailed analysis is included in the next section of this report. Broken down by particular groups, the results are:



2.2 Compliance with sections of the Code

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 eight provisions in this section and they continue to attract amongst the highest scores overall, albeit with a reduction from previous years:

SECTION A	all companies	directives	non-directives
2017	90%	93%	82%
2016	98%	98%	97%
2015	99%	100%	99%

There was no Provision where all members fully complied, though for two of the eight provisions, a member failed to comply in part for procedural reasons only.

Of the remainder, the Provisions with the greatest frequency of non-compliance were:

- chairman's independence on appointment (provision A.3.1, 6 instances), where in some cases the Chair had served more than nine years as a Director before being appointed;
- appointment of a Senior Independent Director (provision A.4.1, 6 instances): not-for-profit organisations in particular tend not to appoint a SID, as the role is not relevant where there are no members/ shareholders;
- publication of Director details and attendances in report and accounts (provision A.1.2, 5 instances), where Director attendances was not included in the report and accounts.

In 2017 the average size of the Board was 8.9 people (9.1 in 2016), with a range between 5 and 15. A typical Board consists of 2.1 executives (with a range of between zero and five), and 6.8 non-executive directors (with as few as three and as many as 12).

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 it.

This is the most extensive section in the Code, with 17 provisions. This section witnessed a reduction in compliance in 2017 for non-directives:

SECTION B	all companies	directives	non-directives
2017	82%	89%	65%
2016	86%	89%	75%
2015	87%	94%	82%

No AFM member achieved compliance with all provisions in this section, though there was a marked difference between directives and non-directives, as per the table above, and between existing and new members (88% versus 46%). The latter reflects some of the more procedural aspects of the Code that are not ordinarily expectations for non-listed companies, such as to appoint a nominations committee, or to broaden the terms of appointment of an NED. Equally, some of these procedural requirements would necessitate a change of rules to implement, and there was not time for members joining AFM on 1 January 2017 to do this.

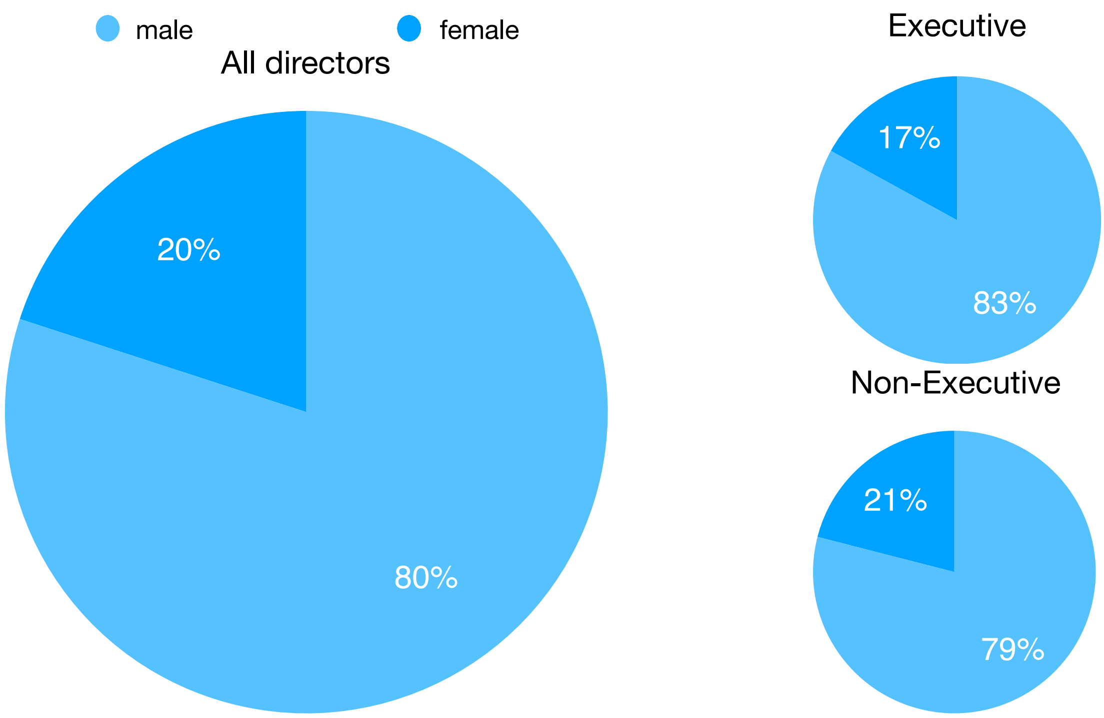
More generally, whilst some of the provisions were almost universally adopted in full (such as ensuring at least half the Board is independent: provision B.1.2, and access to advice for NEDs: provision B.5.1), the two provisions with the lowest levels of full compliance were also contained in this section. Low scores were observed in:

- provision B.2.4, covering a description of the work of the nominations committee, board policy on gender, and the use of external search consultancies for appointment of a NED. There were 13 instances of partial or non-compliance (35%), though with the wide-ranging nature of this provision, the explanations were varied. The absence of a diversity policy was the most cited reason;
- provision B.6.2, on externally facilitated board evaluation, which had 12 instances of non-compliance. Many of these were from non-directive societies, who can exempt themselves from this element of the Code. More positively, 72% of Directives indicated they comply with this requirement, compared to around half in 2016, and with three other organisations indicating they are reviewing their current approach for 2018.

- provision B.7.1 on initial election at the AGM, and regular re-election of directors, with 10 organisations recording partial or non-compliance in 2017. This included a number of not-for-profits, for whom an AGM is not a legal requirement. There were two organisations who have not implemented internal rules permitting the annual election of directors who have served more than nine years.

With regard to the distribution of directors by gender across the sector, the charts below show that within AFM members in 2017, 20% of directors were female. This compares with 18% in 2016 and 16% in 2015. Whilst this falls some way short of the 29% achieved by listed companies in 2018[2], it does represent a significant increase in recent years. However, five organisations recorded no female directors at the end of 2017, and in many cases their explanations indicated recruitment was based on merit, with no targets for board diversity in place.

The increase in female representation was most marked amongst Executives, where the proportion of female directors has increased significantly, from 12% in 2016 to 17% at the end of 2017. Meanwhile, the proportion of female non-executives, increased from 19% to 21% in the year. Greater gender diversity in some of our newer members contributed to this trend.



[2] https://www.gov.uk/government/news/ftse-350-urged-to-step-up-to-meet-2020-women-on-boards-targets

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.

Overall performance across the 14 provisions was similar to 2016:

SECTION C	all companies	directives	non-directives
2017	92%	96%	83%
2016	94%	97%	83%
2015	94%	97%	85%

This section of the Code witnessed the highest level of compliance overall, despite the changes made to the Code in 2016, which resulted in a number of new requirements in this section, intended to raise the skills and performance of the audit committee.

The only two provisions which all members stated they fully complied were in this section: provision C.1.1 (that the annual report and accounts are fair, balanced and understandable and provide information necessary for members to assess the position and performance of the organisation, as well as its business model and strategy) and C.1.3 (that the accounts state any material uncertainties for the organisation's ability to remain a going concern over the preceding 12 months). In addition, only one organisation recognised it had not yet fully constructed a clear explanation on how it generates value over the longer term (provision C.1.2), or what action it is taking to mitigate the principal risks to this (provision C.2.1).

Amongst those areas where compliance levels were lower, around 20% of small (mainly non-directive) organisations had no audit committee, or had not published its terms of reference (provision C.3.1 to C.3.3, C.3.8). In these cases, the board as a whole undertook responsibility for audit issues. The difficulty in this approach is the expectation that discussions on audit issues should not be chaired by the company chairman (provision C.1.1), and the explanations offered to non-compliance with this provision did not set out whether and how this was enacted.

The average size of the Audit Committee in organisations is 3.9. Nine organisations included executive directors in the Audit Committee membership, and a further five discussed audit issues in front of the full Board. The Code assumes the audit committee is only populated by independent NEDS: three for directive insurers and two for non-directives, provision C.2.2): five had fewer than the expected minimum independent NEDs, largely due to the limited pool of independent NEDs to select from.

Section D: Remuneration

This section focuses on the levels of remuneration as well as the policy for fixing remuneration packages.

Results in this section, which has nine provisions, were higher than in previous years; the one section where this was the case:

SECTION D	all companies	directives	non-directives
2017	82%	88%	69%
2016	80%	81%	75%
2015	80%	81%	75%

Results in this section of the Code have consistently highlighted that the set of practices that have been developed with a view to trying to curb the worst excesses of the listed sector, have much less relevance in the mutual arena. Scores in this section are generally low, albeit improving, and this is partly because in many AFM members flexible remuneration is not a feature of executive pay. The 2018 version of the UK Corporate Governance Code devotes over a quarter of all provisions to remuneration practice, including further areas of limited relevance to members of AFM.

For each of the provisions in this section there were a number of organisations that did not fully comply. Amongst those with lowest levels of stated compliance were:

- the design of performance-related remuneration for executives (provision D.1.1): in 12 instances the organisation offered no performance-related pay;
- the role and independence of the remuneration committee (provision D.2.1): there were 8 instances of partial/ non-compliance, where either the role of the remuneration committee was undertaken by the board as a whole, or the number of independent directors was low (which often coincided with an organisation that had no performance-related pay arrangements);
- the approval of new long-term inventive schemes by members (provision D.2.4): 19 organisations stated that they either had no long-term incentives, or had not made any changes, and a number of not-for-profits clarified that they had no members to provide approval.

Our annual remuneration report, produced by Robert Wharton, analyses trends in director remuneration in more detail[3].

[3] http://www.financialmutuals.org/mutual-governance/governance-reports

Section E: Relations with members

This section relates to the dialogue with members and the actions taken to encourage participation in the Annual General Meeting.

There are six provisions in this section, which have seen a significant reduction in scores during 2017:

SECTION E	all companies	directives	non-directives
2017	82%	87%	69%
2016	92%	92%	88%
2015	92%	93%	87%

This section of the Code provides a range of procedural aspects intended to ensure mutuals maintain effective relations with members, particularly around general meetings of the organisation. Not-for-profits are permitted to exempt themselves from this section, as the only 'members' of the organisation are the board themselves.

Equally, in some cases the business model of the organisation prevented full compliance: in particular, those organisations with a delegate voting system (where individuals are nominated to attend the AGM on behalf of other members of their branch or court) cannot provide for proxy voting for the general population of members (provision E.2.2).

For those organisations completing this section, the significant reduction in scores for this section reflect in part the change in methodology adopted for the exercise this year, where AFM members are asked to assess compliance with each provision in full, rather than by completing a wider set of closed questions that approximate the effect of the provision. The broader assessment is more challenging and holistic, and this has contributed to lower levels of compliance.

Procedurally, all organisations ensured the chairs of board sub-committees were available at the AGM to answer queries (provision E.2.3). Elsewhere, the provisions with lower levels of compliance were:

- the chairman should ensure the views of members are communicated to the board as a whole and via member meetings for NEDs (provision E.1.1): a third of organisations did not fully comply, for a variety of reasons including non-directives who are exempted; delegate-based friendly societies, where member engagement is primarily through representatives of all members; and through the impracticality of arranging member panels in small businesses;

- the notice of AGM should be sent with relevant papers 20 working days prior to the meeting (E.2.4): the five exceptions here confirmed the organisation had complied with its own rules, or friendly society law (which stipulates two weeks notice).

As part of our compliance monitoring, we ask organisations to report the AGM turnout of members voting. The best performing organisation in 2017 achieved a turnout of 9% of eligible members; though we are aware of one organisation that has achieved a 12% turnout in 2018. On average, 3.5% of eligible members voted, which is an increase on 2016 (3%): however, it is difficult to be definitive, as many friendly societies operate a delegate system, and others have a range of Child Trust Fund policyholders, where the beneficial owner is under the age eligible to vote at the AGM.

2.3 General observations on governance reporting

2.3.1 Explaining non-compliance

As stated above, five AFM members was able to claim full compliance with every single Code Provision throughout 2017; all other organisations would therefore be expected to provide at least one explanatory statement in their report and accounts.

As the guidance notes to the Code exercise state, an 'explain' statement should "set out the background, provide a clear rationale for the action it is taking, and describe any mitigating actions taken to address any additional risk and maintain conformity with the relevant principle". Non-directive mutuals may for example "judge that some of the provisions are disproportionate or less relevant in their case"; though where size is presented as a reason for non-compliance, the company should explain the hurdle it faces, and set out in its opinion how it achieves a comparable aim in a less onerous manner. Hence an explanation gives insight and describes what alternative arrangements are in place to safeguard members' interests.

As part of the Code exercise, companies were asked to provide the draft explanation to accompany provisions for which they did not comply. We observed over 250 instances were a member was unable to satisfy themselves on full compliance of a particular provision. This compares to a total of over 1,600 instances where organisations stated full compliance. For pre-existing members, the number of explanations provided, of around 150, was very similar to 2016. For new members, the numbers were proportionately, and understandably, greater.

It is pleasing to see that many of the explanations were written in expansive form, rather than a simple statement of size or omission. However not all statements were carried across to the report and accounts, and indeed some explanations provided in the compliance questionnaire were written after the annual report had been produced. There was also a tendency amongst some of the smaller non- Directives to not offer an explanation, or to simply state the provision did not apply to them due to scale.

2.3.2 The quality of narrative reporting

The report and accounts of a mutual are either sent directly to, or made available online or on request, to members of the organisation. There is therefore a greater imperative for clear and concise explanations about the performance and prospects of the business, because the report and accounts are written for what is, in the most part, not a professional investor audience. Mutuals proudly describe their wide democracy: millions of people are eligible to vote at the Annual General Meeting of mutual insurers, so making the report easy to access, easy to read and easy to understand is a vital part of effective member engagement.

In recent years a great deal of attention has been given by organisations to improving the readability of the report and accounts. Much of this is instigated by the Code, with added requirements to ensure the accounts are 'fair, balanced and understandable', as well as expectations that the accounts provide an overview of business model and strategy, and cover the resilience of the organisation, the key risks it faces and how they are mitigated.

Significant increases in the amount of non-financial information required by the Code to be included in the report and accounts has inevitably added to their length. A typical AFM member now produces an annual report of over 60 pages, though amongst some small non-directive friendly societies there was a tendency to produce the minimum statutory requirements, with many reports under 20 pages in length.

Additionally, during 2017, the Solvency 2 directive added to the information available to members of a mutual insurer, with a new requirement to publish a SFCR (Solvency and Financial Condition Report). These reports may run to a similar length as the report and accounts, though AFM research indicates the readership of the SFCRs of AFM members is very low, suggesting they have limited value for members of mutual organisations.

More generally, it is pleasing to witness significant efforts by many organisations to make their report and accounts more readable, with clearer reporting, better layout and more visually attractive presentation. Moreover, with new audit requirements in the Code, new requirements under the Audit Regulation and Directive, and current requirements by the Prudential Regulatory Authority for external audit of the SFCR, the assurance provided to members of the viability of the organisation, as well as the assessment of key risks and the mitigation undertaken by the board, has never been greater.

3. Gender Pay Gap reporting

During 2017/18, the Government introduced legislation requiring companies with more than 250 employees to include a summary in their report and accounts of their gender pay gap[4]. AFM members tend to fall below the threshold for this reporting, but we continue to strive for good practice wherever practical, and have collected similar data from our members.

We identified two practical difficulties for our smallest members: it would be possible to identify the rate of pay for individuals in some circumstances, and the results would be heavily biased by single person changes in an organisation. We therefore concluded that the exercise should be voluntary for organisations with fewer than 20 staff, and also concluded that we should only produce results in aggregate.

A total of 18 members provided a return for this section of our online survey, which reflects the sensitivity of the exercise in its early stages, and the challenge of producing accurate data. The main results were:

Average Mean Hourly Pay Gap	36%
Highest Mean Hourly Pay Gap	55%
Average Median Hourly Pay Gap	23%
Highest Median Hourly Pay Gap	54%
Average Mean Bonus Pay Gap	32%
Proportion of males receiving a bonus in 2017	71%
Proportion of females receiving a bonus in 2017	73%

According to AFM Associate member Willis Towers Watson, the financial services sector has a higher pay gap that most sectors: 26.6%, against an average for all sectors of 14.5%[5]. One the face of it therefore, the average gender pay gap for AFM members is significantly greater than that for financial services as a whole.

[4] For an overview, see: http://www.acas.org.uk/index.aspx?articleid=5768

[5] See: https://www.towerswatson.com/en-GB/Insights/Newsletters/Europe/Executive-Pay-Matters-UK

The effect of being small companies though again skews the results: across those members participating, the average number of staff employed was 80. With numbers so small, we had feedback that the results were distorted in some cases where even one person moved jobs or left employment. It is also the case that compared to average pay rates in financial services, mutuals tend to pay lower wages, attracting employees who recognise the value of the mutual business model.

And whilst 90% of the organisations in the sample indicated that female employees made up 50% or more of the lowest quartile of staff ranked by pay, 37% indicated more than half of the best paid staff are female.

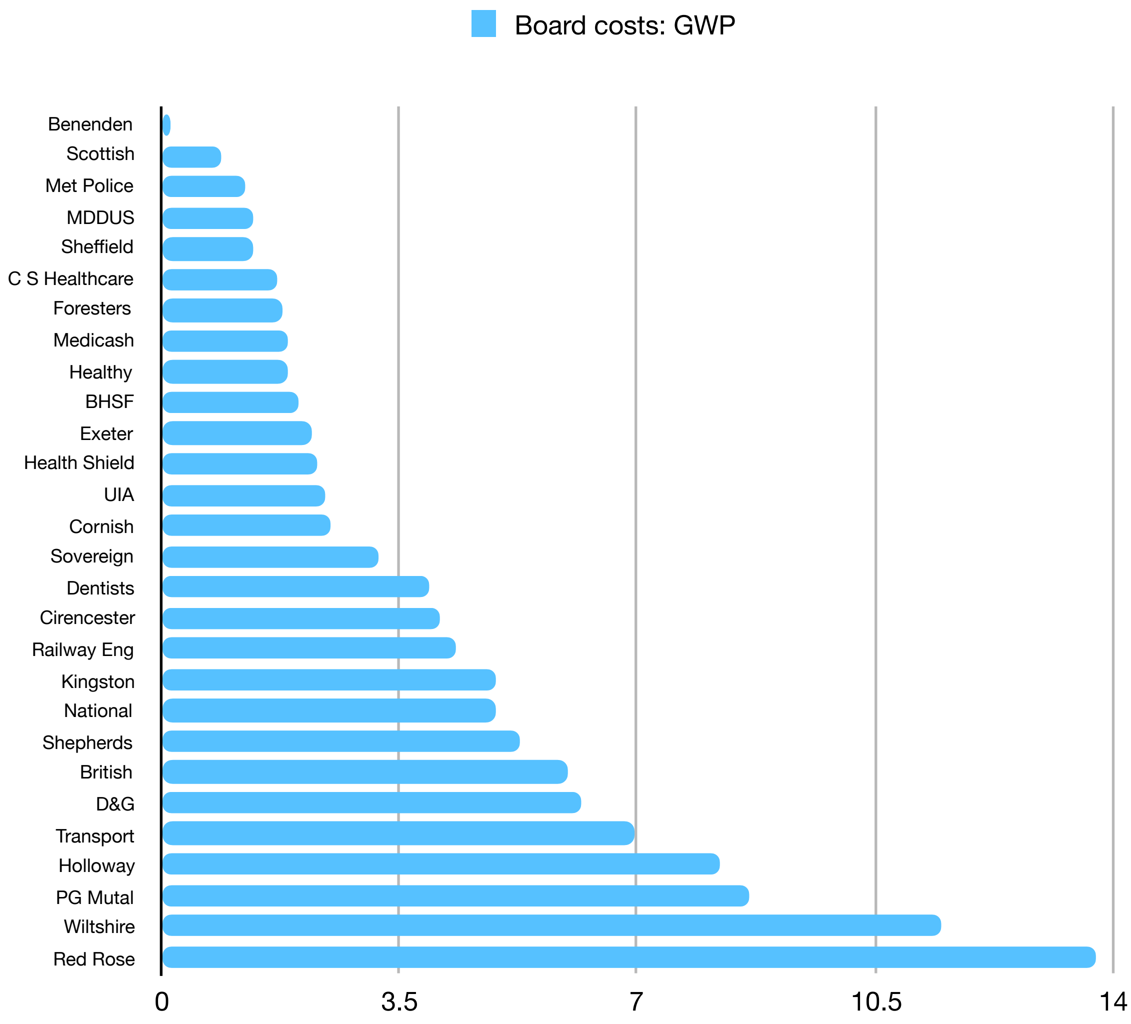
That said, with a commitment to continue gender pay gap reporting annually, and with suggestions from government that they may seek to reduce the threshold size of firms reporting in the future (potentially to as low as 50), this will continue to be an area of scrutiny, and one where mutuals will need to shows signs of closing the pay gap.

4. Board remuneration

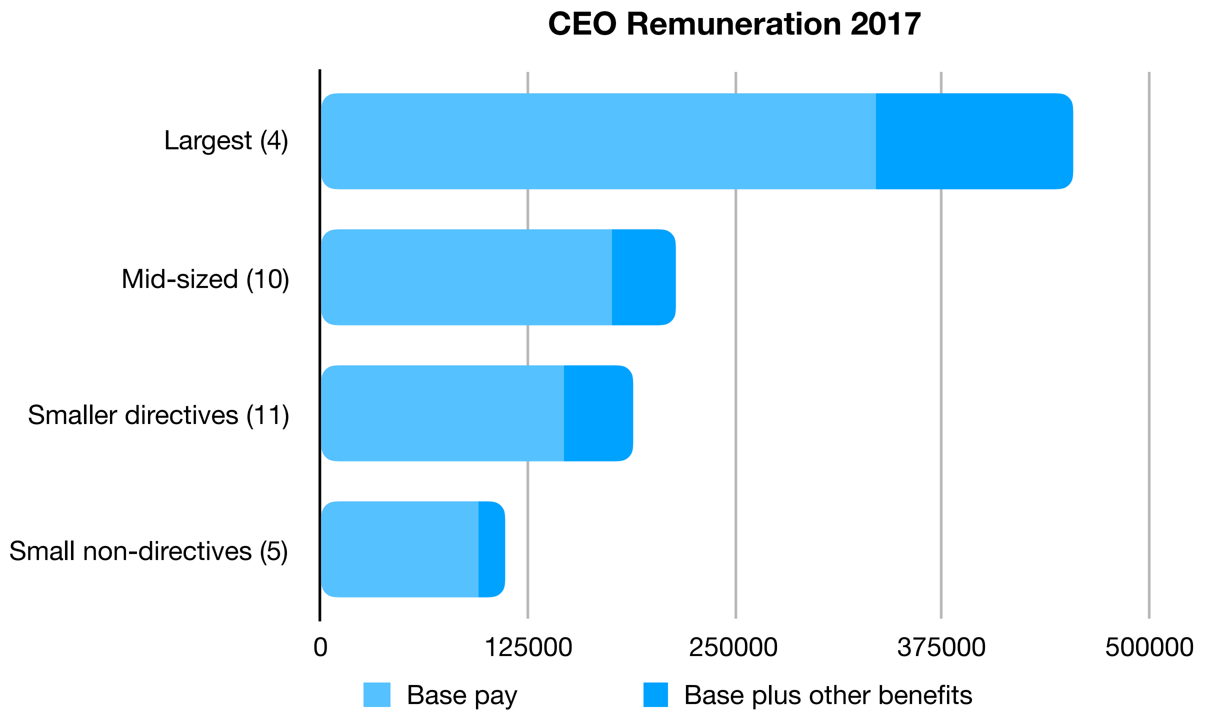
This section of the report is produced in association with Robert Wharton of Keystone Law, and summarises a wider report on board remuneration in the sector in 2017. The data is collected via the same corporate governance questionnaire as the rest of the report.

The report looks at the total remuneration of the CEO and second highest pay director of each organisation, as well as that of the Chair and the Board as a whole. Data was provided by 30 organisations, in part or in whole.

The chart below shows the total board costs for 2017 as a proportion of gross written premium (GWP) in the year. The average cost of the board was 4% of GWP, though this varies between 0.2% and nearly 14%.

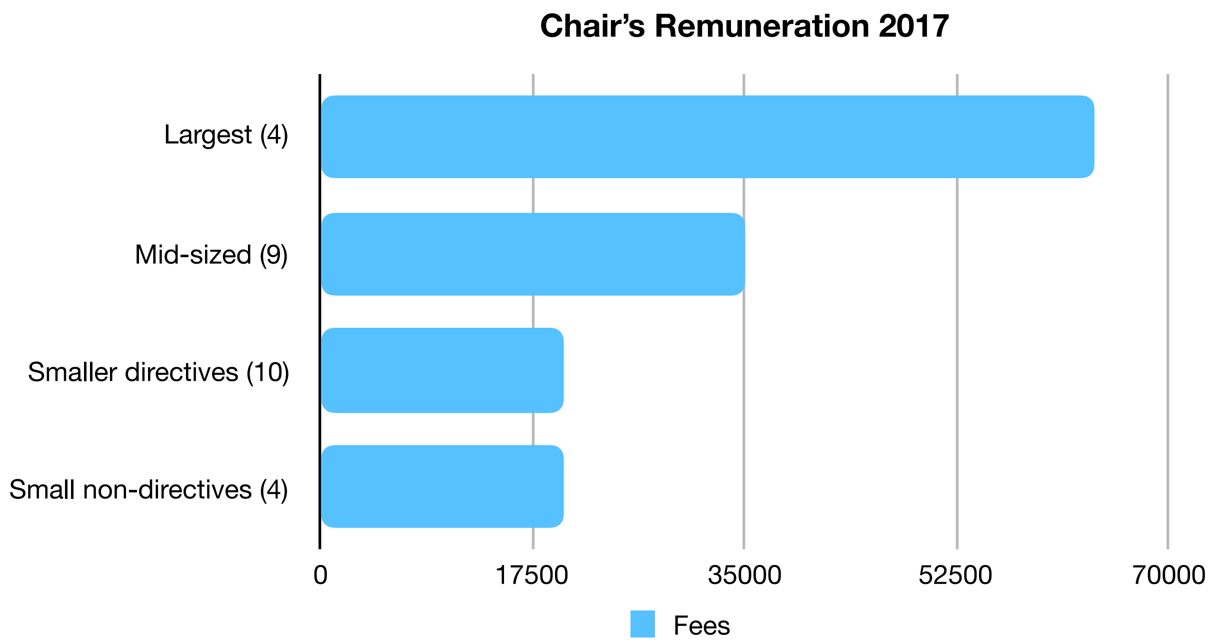


Inevitably, smaller organisations tend to report a high proportion that larger ones, though as the remaining charts show, they also pay lower average pay.



This chart above shows average CEO remuneration for four groups (the largest with GWP of over £50M, then £15M to £50M, directive insurers with GWP less than £15M, and small non-directives). Other benefits includes pension contributions and bonuses. The gap between the mid-sized and smaller directives is narrowed by greater benefits.

The chart below shows the median fees paid to the Chair for the same groups (though the sample is smaller as not all chair's are paid, and those paid only receive a base salary). The figure is the same for small directives and non-directives.



For the full report, go to: http://www.financialmutuals.org/mutual-governance/governance-reports

5. Changes to the Code

4.1 Changes to the Code in 2016

In April 2016 the Financial Reporting Council (FRC) made a small number of changes to their Code, which were incorporated into AFM's Code in the version issued in September 2016[6], and are included in this compliance exercise. Amongst a small number of changes was the expectation that the audit committee as a whole should have competence relevant to the sector in which the company operates.

At the time FRC did not envisage any major changes to their Code until 2019. Since then however it has announced a wholesale review of the Code, in light of further developments in corporate governance, and in particular in response to the government Green Paper on Corporate Governance Reform.

4.2 Evolving standards in corporate governance

As mentioned above, a 2017 government Green Paper put forward some significant proposals on corporate governance in the UK[7]. This led to an extensive consultative exercise by FRC, and a significantly revised UK Corporate Governance Code was finalised in July 2018[8]. The new Code includes a greater focus on the workforce and other stakeholders, a reiteration of the importance to the board of creating the right culture, greater focus on board diversity, and further focus on executive remuneration.

The government Green Paper also asked FRC to develop a corporate governance code for privately-owned companies, and FRC is consulting on proposals for this, which it seeks to apply voluntarily to private companies with more than 250 employees[9]. Larger mutuals may be in the scope of this.

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[6] http://www.financialmutuals.org/files/files/Annotated%20Combined%20Governance%20Code,%20v%20September%202016%20v2.pdf

[7] https://www.gov.uk/government/consultations/corporate-governance-reform

[8] https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf

[9] https://www.frc.org.uk/directors/corporate-governance-and-stewardship/governance-of-large-private-companies

In addition, regulators continue to add greater focus on corporate governance. For example, PRA's supervisory statement on Board Responsibilities is being revised to incorporate the broadened Senior Managers and Certification Regime.

The AFM Board is undertaking an extensive review of the annotated Code in light of these developments. We plan to consult on a revised Code in October 2018, with a view to launching by the end of 2018.

6. Conclusions

Our corporate governance compliance exercise had its roots in the failure of Equitable Life in 2000, and has been running now for over ten years. During this time we have seen a series of governance failures in companies large and small, and in response government and regulators have intervened to further ratchet up standards.

For small mutual and not-for-profit organisations, the Code offers a combination of, on the one hand, good practice in managing their business well, and on the other detailed compliance procedures, often set in the context of listed companies. The high levels of compliance witnessed in this report are commendable therefore, and in particular, with five organisations stating full compliance, the commitment of the sector to high standards of governance is clear. Equally, were many organisations continue to diverge from PLC-type practices, that should not be seen as a sign of failure where they can deliver the same outcomes more cost effectively and with more sensitivity to their business model.

A number of new members of AFM have completed the compliance exercise for the first time, and inevitably have more areas of non-compliance. Many of these will conform over time, though the greater diversity in AFM's membership, and the continuing small scale of our members, leaves us to consider that full compliance with a Code developed for PLCs should not be our aspiration.

That said, there are areas where AFM members can add greater focus now, including:

- AGM turnouts are low in some organisations, with improvements possible both in communication of the event, and in the relevance of membership;
- the clarity of narrative reporting should continue to evolve, to provide a compelling account of the performance of the business, and to explain aspects of governance that diverge from recognised good practice;
- our new analysis of gender pay gap reporting; and
- the longevity of service of some NEDs.

AFM is working with members to raise awareness of these issues, and to adapt our corporate governance compliance processes in response to the changing environment. We are consulting later in 2018 on revisions to our Code.

Annexes

Annex 1: Methodology

Members are responsible for evaluating their compliance with the Code and for completion of a questionnaire, which gives detailed information about their compliance. The exercise was conducted this year via Survey Monkey, and consists of a number of section, with overview information of the organisation, data on the composition of the Board, director remuneration and gender pay, and a breakdown of compliance with each Code provision, as illustrated below:

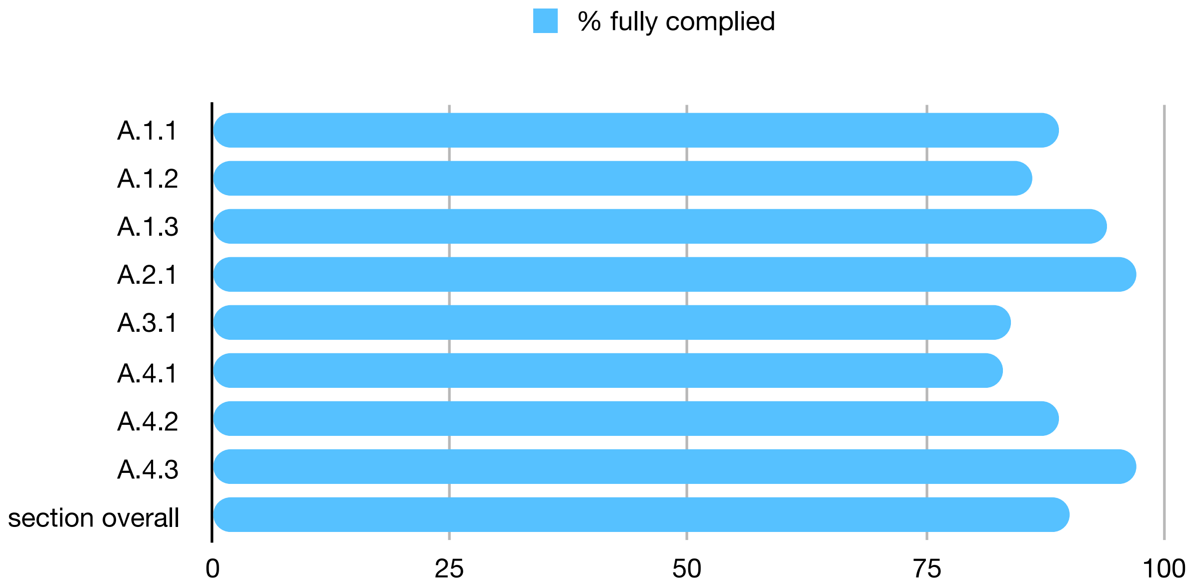
> 14. A.1.1 The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.
>
> ○ Fully complied
>
> ○ Partial / not complied
>
> Where complied, what is the evidence? Where you did not comply, what is the explanation?

In completing this report, AFM has relied upon the information provided by members and has not attempted to validate or evaluate the submissions. It is also an expectation of our approach 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.

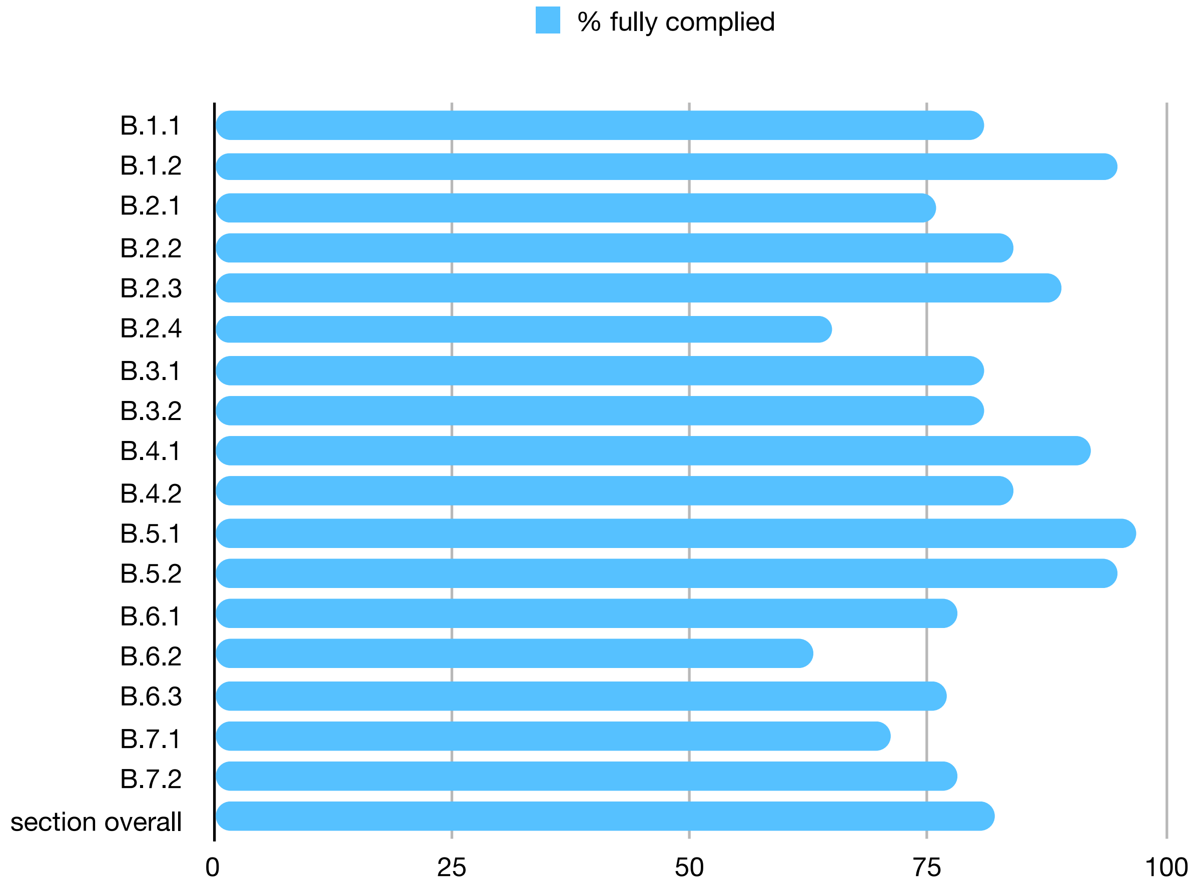
The Annotated Code recognises differences in regulatory requirements for non-directive societies (those that fall outside the scope of Solvency 2): some of the Code compliance requirements are voluntary for non-directives. We also provided some exemptions for not-for-profit organisations, where the provisions do not apply to their business model.

Annex 2: Breakdown of compliance in each section[10]

Section A: Leadership

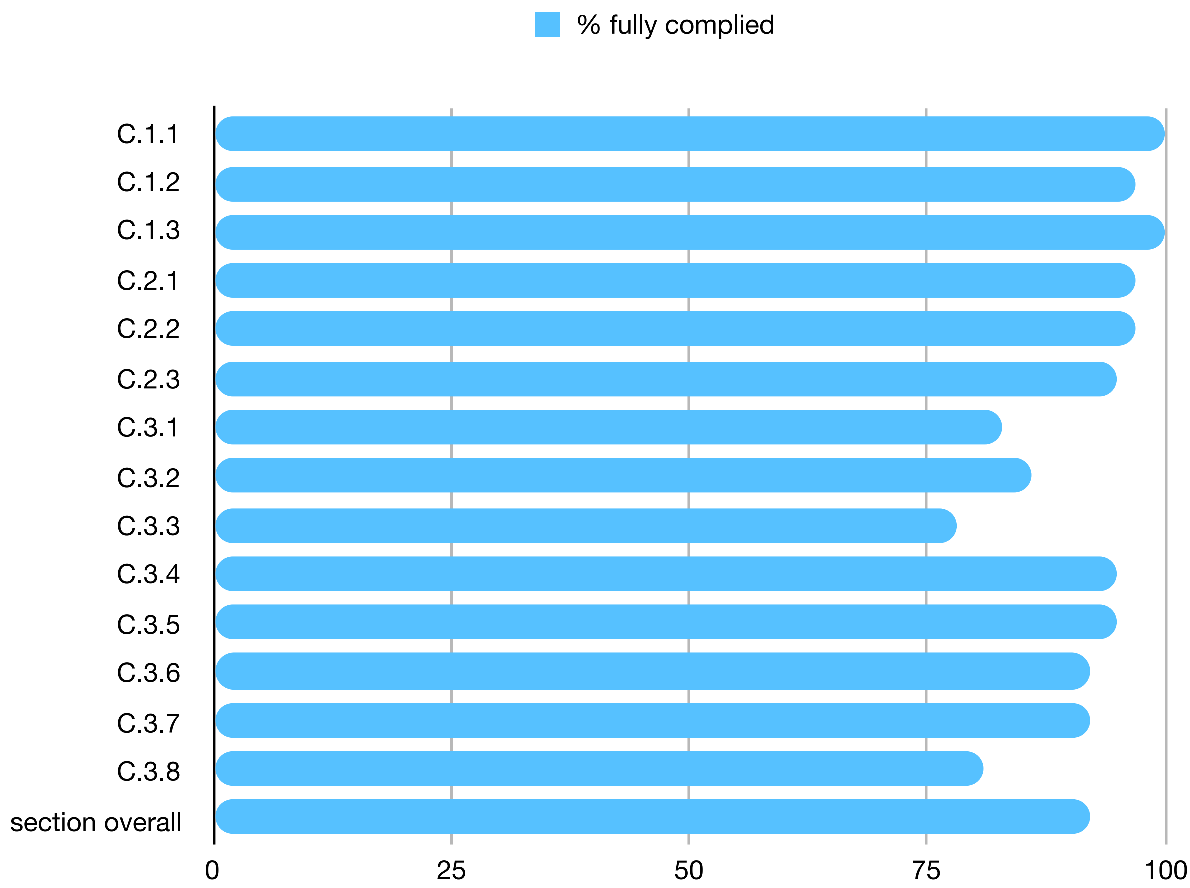


Section B: Effectiveness

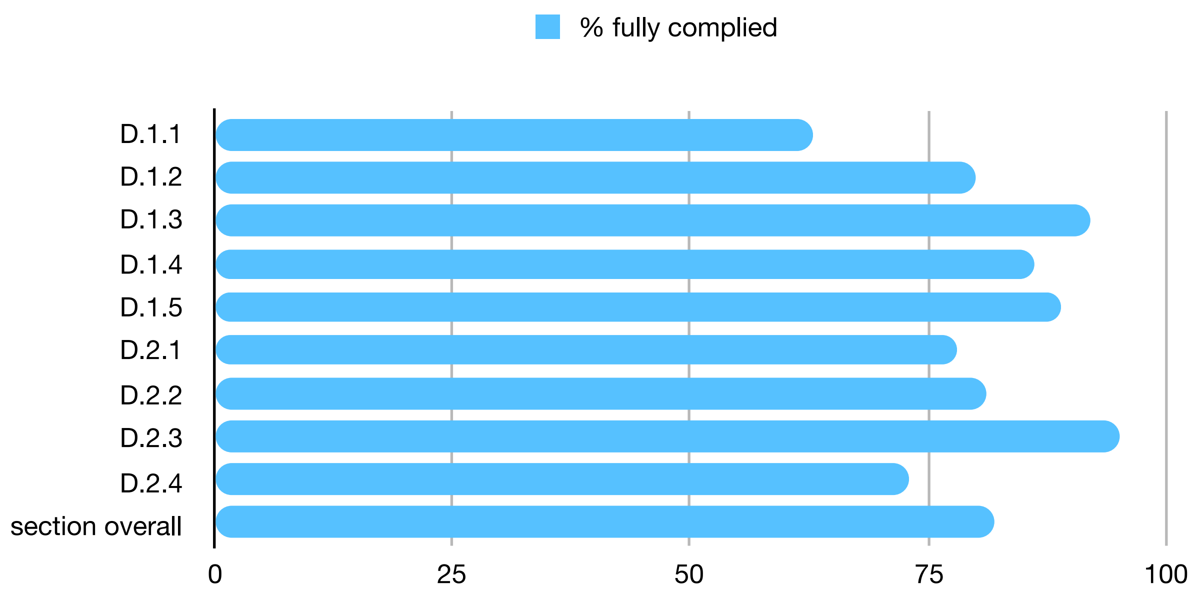


[10] For a full description of each Code Provision, see the Code document: http://www.financialmutuals.org/files/files/Annotated%20Combined%20Governance%20Code,%20v%20September%202016%20v2.pdf

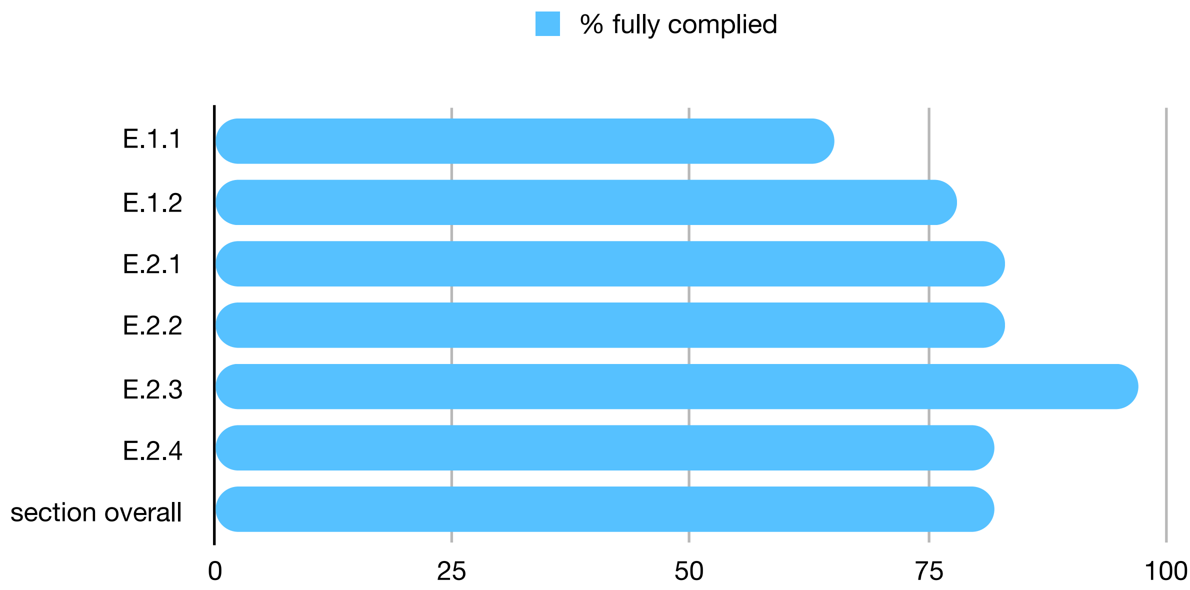
Section C: Accountability



Section D: Remuneration



Section E: Relations with members



Annex 3: Companies that took part in the 2017 compliance exercise

We restrict this Code compliance exercise to those of our members who are authorised and regulated by the Prudential Regulatory Authority and / or the Financial Conduct Authority, and who have retail customers (by which we mean individual policyholders, named on an insurance contract or account).

We excuse members with no retail customers, members in their first full year of membership, and those that abide by comparable codes.

This year, 37 members completed the compliance exercise, with a small number of new or very small businesses who felt unable to complete the exercise thoroughly.

Those companies providing a return were:

BHSF Ltd
British Friendly Society
Bus Employees Friendly Society
Cirencester Friendly Society Limited
Civil Service Healthcare Society Limited
Compass Friendly Society Limited
Cornish Mutual Assurance
Dentists Provident Society Limited
DG Mutual
Exeter Friendly Society
Grand United Order of Oddfellows Friendly Society
Health Shield Friendly Society Limited
Healthy Investment
Kensington Friendly Collecting Society Ltd
Kingston Unity Friendly Society Limited
Medicash Health Benefits Ltd
Metropolitan Police Friendly Society Limited
National Deposit Friendly Society Ltd
Paycare
Pharmaceutical and General Provident Society Limited t/as PG Mutual
Plutus Health

Railway Enginemen's Assurance Society Limited
Red Rose Friendly Society
Scottish Friendly Assurance Society Limited
Sheffield Mutual Friendly Society
Sovereign Health Care
The Ancient Order of Foresters Friendly Society Limited
The Benenden Healthcare Society Limited
The Independent Order of Oddfellows Manchester Unity Friendly Society Limited
The Medical and Dental Defence Union of Scotland (operating as 'MDDUS')
The Original Holloway Friendly Society Limited
The Shepherds Friendly Society Limited
Transport Friendly Society Limited
UIA Insurance Ltd
Welsh Hospitals & Health Services Association
WHCA trading as Orchard Healthcare
Wiltshire Friendly Society

Association of Financial Mutuals
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Caistor
Lincolnshire
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