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CORPORATE DIVERSITY AND THE PROVISION OF FINANCIAL SERVICES

BY P. GUIJARRO AND D. J. P. HARE

[Presented to the Faculty of Actuaries, 18 February 2002,
and to the Institute of Actuaries, to the Faculty of Actuaries
and to the Society of Actuaries in Ireland, in Dublin, 9 May 2002]

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ABSTRACT OF THE DISCUSSION

HELD BY THE INSTITUTE OF ACTUARIES

THE FACULTY OF ACTUARIES

AND THE SOCIETY OF ACTUARIES IN IRELAND

The President of the Society of Actuaries in Ireland (Mr E. P. Heffernan, F.I.A.): My task this evening, is a simple, but pleasant one. It is to welcome you here to this Joint Sessional Meeting of the Faculty, the Institute and the Society of Actuaries in Ireland.

Mr P. Guijarro, F.F.A. (introducing the paper)**:** Mr Kingston, in his Presidential Address to the Faculty of Actuaries, 'A Learning Profession' (*B.A.J.* **7**, 51-73), stated: "This Presidential Address is a call to arms for the profession. It outlines many areas in which we could be major contributors if we are prepared to undertake the necessary research, discussion and seminar work.''

Our paper is a direct result of that Address. Among the issues affecting the profession, which the President touched upon, is the management of life insurance companies, both as independent organisations and as part of wider entities. Drawing on his experiences with Irish Life, both before and after its demutualisation, Mr Kingston emphasised the particular issue of mutuality and asked, in ¶5.4.14: "What have we, as a profession, got to say on these matters? ... I would like to see the profession doing some work on possible structures, which would combine the best elements of mutuality ... with the best elements of shareholder ownership.''

Dr Hare had separately expressed an interest in what the outcome may be. My own experiences with Scottish Widows, first as a mutual, and then, through the demutualisation, to a shareholder owned organisation, seemed to fit well with the questions being asked. Our aim, as authors, was to produce a corporate structure survey paper which could form a useful background to a panel discussion. We wanted to understand better the different structures that currently exist and the reasons behind the choice of structure for different companies, especially those which have changed recently.

Our research then led us to ponder the position within the financial services industry. Would it matter if there were no mutuals left? Has increased regulation removed one of the historic attractions of mutuality? Are there other issues of public interest here? If so, what involvement should the actuarial profession have in influencing the debate?

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Ms H. Martin (a visitor; President, Institute of Actuaries of Australia; panel member)**:** My comments are on a few aspects of the paper from an Australian perspective. As has been already indicated, the paper primarily focuses on mutual or policyholder ownership in contrast to shareholder ownership, and asks whether the actuarial profession should encourage greater diversity in that respect.

Of course, in Australia we have had more than our fair share of demutualisations. In fact, there are no mutual life insurance companies left. The reasons for the demutualisations have been many and varied, and have included most of those that have been noted by the authors in the paper. The primary ones have been the need to gain access to additional capital to meet revised solvency requirements or to fund expansion, and also the desire to put in place a corporate structure that is perceived to be more adaptable to competitive and changing markets.

In preparing for this discussion, I canvassed views from some actuaries in Australia, and asked them their thoughts on diversity of ownership and mutual versus non-mutual structures. I received some interesting observations from the group, and, not surprisingly, some very differing opinions on the advantages and disadvantages of mutuals versus non-mutuals. I have distilled these and give you my thoughts on them.

Mutuals, particularly in Australia, have traditionally been linked to life insurance, and, in particular, to the with-profits insurance business. In Australia, as has happened elsewhere, there has been a significant shift away from that type of product to non-profit and investment-linked wealth creation products. There has also been a fairly significant shift away from having separate life insurance companies to having financial services conglomerates that provide a range of insurance and wealth creation products within the one structure. Also, the needs and expectations of policyholders (or customers) have changed. They are looking for a diversity of products, and I think that they are also looking for a diversity of structures. It is the broader financial services organisations that are providing that diversity. Given those environmental and market changes, it seems to me almost inevitable that we would have a shift away from mutually owned life insurers. I also believe that it is very unlikely that we will get new mutual life insurers established in Australia. Many of the reasons given in Section 3 for the establishment of these entities either no longer exist or can be met in different ways through different structures. Also, the current capital adequacy and solvency requirements for insurance in Australia have been strengthened, which has raised the barrier to entry and made it more difficult to establish a mutual insurer. You need access to other sources of capital, such as a non-mutual parent company.

The paper raises concerns regarding market concentration. I view this more as a marketplace issue again rather than an ownership issue. There is market concentration in Australia, and this reflects the trend in many sectors of the economy towards having a few major brands supplemented by some niche players in particular areas. The fund management and financial services industry in Australia is a very good example of that phenomenon. We have a smallish number of very well known and large organisations, but also a range of smaller specialist or niche players.

One of the criticisms of mutuals has been that an absence of external pressure or discipline through shareholders can lead to poor (or less rigorous) internal management and corporate governance. However, as is noted in the paper, poor management and poor corporate governance can happen in all sorts of corporate structures, and not necessarily only in mutuals. One fairly recent high-profile collapse of a listed insurer in Australia is ample evidence of poor management and corporate governance in a non-mutual structure. It can readily be argued that corporate governance and sound management are probably more important to the success of an entity and the value that it adds to the community and policyholders than its ownership structure.

It has also been proposed by some in Australia, and it has also been mooted in the paper, that mutuals are better able to manage for the long term, because they are not subject to the shorter-term pressures imposed by the market and analysts to use capital for short-term benefit

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and minimising the shorter-term volatility of results. However, I would query the extent to which that argument is real. I do not see why policyholders would not equally be interested in the level of bonuses and in the smoothness of the financial results of an entity from year to year. As was again noted in the paper, analysts and commentators scrutinise the operations of all major entities, not just those that happen to be non-mutual or listed public companies, so I think that the pressures and focus on short-term performance are actually fairly universal.

There are actually new types of 'mutuals' being formed in Australia. They are not mutual life insurers — rather they are community banks and the like. With the withdrawal of some of the major banking organisations from some of the regional centres, there has been a trend towards the establishment of community banks where you have an unlisted public company, the shareholders of which are members of the local community. They take the marketing and operational risks for the operation. The banking licensee takes on the credit and systems risk. Profits are shared between the licence holder, the shareholders and, sometimes, community projects. Other mutual-like structures in Australia are industry funds or masterfunds, which have been established in the superannuation area, where you have a union, or perhaps a union in conjunction with sponsoring employers, establishing a mutual type non-profit fund in which to invest the retirement funds of its members.

Typically, these mutuals require the owners or the participants to have a common focus and a direct interest in the success of the enterprise. If that common focus breaks down because the entity expands into providing a broader range of financial services, then the argument for the mutual or non-profit structure starts to dissipate. We can see that happening in Australia with the example of industry funds, which are now becoming more like public offer retail funds and are shifting away from the original mutual purpose for which they were established. It will be interesting to see how those structures evolve over the next few years.

There are also a number of other mutual structures that continue to operate in Australia. There are a number of health funds, building societies, credit unions and friendly societies. They seem to have a common focus, be it a region or a particular market niche or gap that they are filling. I am not sure that that group of organisations is growing, but it certainly has not declined to the same extent as the mutual life insurance industry.

I conclude by saying that, in my view, actuaries should definitely be proactive in shaping the financial services marketplace. I am a very strong supporter of actuaries participating in public policy issues and debates, and I think that we can add much value by raising awareness of the impact of changes in corporate structures and the likely outcomes from alternative structures.

We should also clearly speak up if the profession feels that, for example, a change in regulation will have an adverse impact on some of the players in the financial services sector, and hence their customers or policyholders. I think that that role really goes well beyond the issue of diversity of corporate structure. I think that we also need to be careful not to push diversity just for diversity's sake. We have to be convinced that the benefits outweigh the costs. Often, in those sorts of situations, it is better for the profession to advise on issues and implications rather than to advocate a particular point of view.

Ms J. Wood (a visitor, panel member)**:** I speak from my experience as a line manager in the life insurance business, both in proprietary and in mutual companies. I have continued that mutual association by being on the board of the Chelsea Building Society and on the new board of Equitable Life. So, I am more connected on the mutual side at the moment.

In a general sense, from my experience as a line manager on both sides of the life insurance business, I would say that the management of a well-run mutual is subject to the same internal disciplines as a well-run proprietary, though the latter might be subject to more external scrutiny.

Do I think that mutuals should survive? Yes, I think that the principle of diversity is a good thing, especially where consumers are themselves more educated and able to exercise choice and want choice. However, does mutuality in the life insurance business and the building society business represent a real difference nowadays? As the paper points out, mutual organisations looked very different a long time ago: their roots were local; they were based on self-interest or

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benevolent interest; they were small and connected to their membership; and they were trustworthy in a non-regulated market. They represented a way, as the paper said, of dealing with uncertain future risk and cost by retaining a surplus.

However, is that the position today? Do many of our mutuals in building societies and life insurance business look like opaque proprietaries? They operate under the same regulations as all other companies, so they offer nothing different there. They continue to deal with uncertain future risk cost by retaining a surplus, and how they manage that is shrouded in mystery. Many distribute through open market forces, paying market rate commissions, and, as an aside, one must ask whether this is really in the members' best interests when high commissions are paid on stakeholder pensions producing 1% charges in the United Kingdom market. They have no real local or self-interest connections anymore, and they have not modernised their interactions with their members, many having Articles of Association that have run for hundreds of years. In many cases they have lost the trust of their customers as being a force for difference and for good, and this is most evident in the demutualisation process, when most of the mutual members vote for the money rather than maintain any perceived difference in this particular form of delivery.

It is a sad fact that Equitable Life, with its full distribution policy, its very open benefit statements and its flexible policies, distributing through its own sales force, and drawing on multiple professional connections, represented the best of the modern mutual business, and it was rewarded by the trust and devotion of its members very fully, many of whom are still extremely loyal, despite the difficulties that the Society is going through.

However, trust, once lost, is very difficult to recover. In the 2002 Reith Lectures on the BBC, Professor Onora O'Neill said that the state governs by three means; by money, by arms, and by trust; and if it is to give up any of them, the last one that it should give up is trust. Trust in our society today is translated as openness and transparency. Consumers must be able to see and to understand what is going on.

In many ways the current mutual structure does not deliver in the way that the modern consumer would like it to do. I would be in favour of attempting to reform it, so that we can maintain this diversity. Much actuarial consulting has gone into the process of aiding demutualisation, but I wonder how much of it has actually gone into helping existing mutuals address these issues of corporate governance and the management of the surplus, or are we going to leave the Sandler report to tell us what to do, which is again more regulation, and perhaps a further reduction in diversity?

The Nationwide Building Society is making a brave effort to focus on the difference of mutuality by offering only one standard variable rate, doing away with discounting. This has meant, of course, that no brokers or market force driven distribution will deal with it, so it expected to suffer a heavy loss in new business. The question is: "Will it have the nerve to stick with the strategy in which it is attempting to deal with all of its members as having equal rights within the society?" It is also attempting to reform its corporate governance. So, we have a brave example of one company trying to get back to the roots about what makes it different, but will it actually be an appealing proposition to the modern consumer, and will it give new life to the mutual concept and the building society world?

The development of new mutuals would be a good idea, because I think that many of the conditions that exist today are the same as those that existed in the 19th century, curiously enough. Today we have the decline of the welfare state. We have low taxation, and individuals are required to take on more responsibility for their own risks. This feeling of isolation and lack of direction could, perhaps, lead to a desire to want to band together. Certainly, most people feel lost in the whole pensions provision for the future.

The question would be: "Who would drive this?" Would you see the Society of Friends today sit down, as it did all that time ago with Friends Provident, and say: "Shall we all throw in so much money to set up a mutual society to provide benefits for groups of people who want to band together in this way?" Who knows? Would it be IT millionaires who would contribute to this? Certainly, somebody will have to drive this if it is going to happen.

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The implication in the paper is that any new mutuals would be small. I do not think that it matters whether they are or not, but I am not sure that it is actually true.

The paper also says that in Ireland 50% of the Irish population are members of credit unions. Why is there not a credit union insurance company providing pensions benefits to the members of credit unions? It meets all the requirements of the benefits to the consumer of a mutual society, and it would provide for low distribution costs. So, it could provide supplemental benefits in the mutual form.

If mutuality is to survive, it has to represent real difference, because that is what the consumer wants, and the real difference will not just lie in the legal structures, it will lie in how it conducts its business in a modern, open way, delivering value to the consumer with a sense of inclusion and shared values.

Mr J. T. Goold, F.I.A.: I have a fairly unusual experience in being part of a life assurance company which managed to achieve a management buyout about four years ago. I suppose that that is something of a different structure. We are the only life company in Britain or Ireland to have done that.

That gives a certain interesting perspective. For a start, when we were looking at this process, we realised that there was very little opportunity for further shareholder capital in the future. The first job, in terms of trying to get the regulator's approval, was to persuade it that we were not likely to need further capital. I suppose that that, to some extent, determines our future strategy. It really confirms us in the role of a niche player. It would be very difficult for a company like us to set up, for instance, a brand new distribution channel, involving a huge amount of capital investment.

Why have many mutuals wanted to offer wider product offerings? It is very often, I suspect, because the senior management just get bored with what they are doing, and they think that they would like to try something else.

In my own company, I have a boss who built the company up from a one-man sales operation. It probably would not be too much of a claim to say that he is probably the best person in Ireland running a direct sales force, but he is also humble enough to think that that would not make him necessarily good at running all sorts of other operations. So, we certainly see ourselves as a niche player operating in a certain market, probably more downmarket, certainly more rural, than most of the other Irish life assurance companies. All of the staff are owners of the company. The boss certainly owns by far the largest part, and is very determined to keep the voting control of the company. However, in terms of profits distribution he is fairly open, and we have been doing fairly well for the past four or five years and have produced large bonuses which staff are encouraged to convert into shares.

Some time ago my boss said that he thought that a lot of the success of the company would be to do with persuading the staff to think of themselves as shareholders rather than as employees. When they were up until midnight processing all the Government sponsored savings plans recently, and not being paid any overtime, I thought that that was probably a good point!

Mr D. Pelletier (a visitor; President-Elect, Canadian Institute of Actuaries)**:** I want to take issue with a couple of points that were made in the paper. One is the question that Ms Martin also picked up: whether a mutual company can potentially be under the same degree of scrutiny of analysts, policyholders and journalists as a stock company. In Canada, we have gone through five big demutualisations in the last three or four years, and the degree of scrutiny and the degree of attention that the companies get now that they are stock companies is far above what they ever got before. Once Manulife might have 'made the paper' two or three times a year; now it 'makes the paper' two or three times a week. Sun, Clarica and Canada Life all now have a far higher profile. When you talk to the people in those companies, it seems that, quarter by quarter, they are struggling to meet expectations. That did not exist before. Policyholders did not exert that kind of scrutiny. So, I think that the degree of scrutiny that one finds in those companies is completely different from that of mutuals.

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One other issue that I found interesting was the notion that this could be a temporary 'fad', and that perhaps we are now in a trend to individuality, and, once this 'fad' fades away, then we may be back to thinking more of collective risk. Where is this perception coming from? I think that we tend to be on a one-way street in that respect, and I do not really see the direction in which we are going.

Mr A. P. M. O'Riordan, F.I.A.: I must confess to being of the 'demutualisation is inevitable (given free movement of capital and management talent)' school of thought. I now give a number of reasons for demutualisation, additional to those given in the paper.

The purpose of mutual institutions in insurance is difficult to define in today's markets. Essentially, the original ethos was that members would provide capital to allow risks to be shared among the membership. This was at a time when capital was scarce, capital markets were not particularly well organised, and the products in question were not widely available. Each of these three conditions has changed. The product is widely available from a range of product providers, capital markets are efficient generally, and capital is available at the right price and subject to the right business plan. In today's world there is much less obvious purpose for the existence of mutuals providing insurance and savings products. The one recent establishment quoted by the authors, the Pension Annuity Friendly Society (PAFS), provides a product which is not widely available and where the market and quantification of risk has not progressed to allow the provision of comprehensive customer choice.

Identification of the priority stakeholder is also a problem with mutuals. In the life business, many of the traditional mutuals have been associated with with-profits business. With the advent of non-participating types of business, the number of members with a shared interest in the organisation reduces. It becomes difficult for management, in those circumstances, properly to identify to whom they are accountable. This can lead, in some instances, to the agenda of the company becoming the agenda of the management of the day rather than of any other stakeholders. In this context, it is hard to argue that the basic human failing of greed among management, policyholders and account holders has not been to blame for some demutualisations where the logic was otherwise not compelling.

The availability of management is another issue. There is a strong case to be made for organisations such as Credit Unions or the PAFS to exist where there is product deficit. Unfortunately, these organisations can suffer from shortage of management talent. The best managers tend to be attracted to the best financial rewards. The interests of shareholders in maximising the financial performance of proprietary companies means that proprietary companies will pay what is required to attract the best talent. This leads to two divisions of management talent, and, if shareholders select properly, this should eventually lead to proprietary companies outpacing mutual companies.

Another trend which erodes some of the logic for mutuals in financial services is the blurring of boundaries between different types of financial services. Mutuals trade most effectively as virtually one-product companies, to provide a service of mutual interest to their members. The blurring of boundaries means that one-product companies have less strategic force than multi-product companies with access to a variety of distribution channels.

All in all, the issues that I have raised and a number of others conspire to make the mutual structure unstable in today's markets. There are, of course, exceptions to every rule, and I would say that today's mutual, with scale and the right attitude and strategic direction, can do better than survive going forward. However, the conditions are not right for new mutuals. I also believe that the current trend to demutualisation will continue, and that a re-run of the world's largest insurer table in 2010 will see virtually all of the top 20 being proprietaries.

Mr T. J. Barry, F.I.A.: I was quite taken by Mr Pelletier, who said, considering Canadian companies, that there is a lot more pressure on them now that they had demutualised. A few years ago, as a mutual, we (I work for a Canadian company) thought that the management group acted in the same way as if it were a plc, but now I know that we were wrong.

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I am a pro-plc person. One of the reasons why is the very practical one that, having demutualised, and having completed all the work involved, I know that I would never re-mutualise. Anyway, we would lose half our actuarial staff as well if we did do that!

I was also taken by words of Ms Wood. Many mutuals argue that they are managed just like plcs, whereas, if mutuals are to exist going forward, they have to try to differentiate themselves from plcs. They should only exist if they are offering something different from the plc, and I, at this stage, have not seen exactly what that is.

That is the big picture. In terms of the smaller picture, the story about the Grameen Bank of Bangladesh (Section 5.2.2) was absolutely lovely. It is doing terrific work. It is giving such joy, hope, alternatives and options to people, and I am all for that. I hope that some of us have the courage to give a year to an organisation like the Grameen Bank. I am not sure that we do enough, all of us, in our plcs or mutuals, for society as a whole.

Mr A. J. Jeffery, F.I.A.: In today's world, many people believe that corporate culture is not serving them well. However, while we all see corporate culture as being necessary, important and vital, we are not getting that message across to a great many people — neither the people who vote for the far right in France, nor the people who turn the City of London into a battlefield in May, with their protests against capitalism and globalisation.

I think there is a way round that, and that is globalisation from below. There is a need to have corporate diversity in our organisations. This may not mean companies, but there is a need to build links and structures and organisations that will allow people to feel part of the world. In that respect, we can be proud to be one of the first global professions, and I think that we must all seek to find global links and try to build that social capital from below.

Mr C. Fagan. F.I.A.: I enjoyed the paper, especially Appendix A, which gave a brief history of a number of the United Kingdom mutual insurance companies. I was particularly impressed by the enterprising Mr Bignol, the creator of Norwich Union, who got it written into the terms of establishment of the life assurance company that he would receive 5% of all the premiums. Nice if you can get it! However, the experience of Mr Bignol makes one wonder whether self-enrichment should have been added to the list of reasons given in Section 3.2 for the formation of new mutual life assurance companies.

I was also interested by the revelation that the initial subscribers to Equitable Life got a nasty shock when they found out that they had to pay an additional £295 on top of their original £5 subscription fee. Some things have not changed!

Mr J. MacGinnitie (a visitor; President, Society of Actuaries)**:** I draw an example from my own experience in the medical malpractice insurance business in the United States of America, and perhaps illuminate the issue of diversity and whether mutuals can provide unique services.

We in the U.S.A., as I am sure many of you are aware, have a privately funded paid-for healthcare system, and that leads to medical practitioners needing to concern themselves with their own insurance arrangements when it comes to professional liability. We also have a tort system which we think we inherited from the U.K., at least with respect to the common law, but we think also that a number of Irish/American lawyers have succeeded in developing that system well beyond anything that has yet been seen back here. So, one of the results is that a typical medical practitioner in private practice in the U.S.A. will see anywhere from 10% to more than 50% of his or her gross income being used to satisfy the insurance requirements for professional liability. The 50% specialists are the neurosurgeons — speciality surgery of almost any kind will carry very large premiums, and the system varies by state as well.

In 1975 we had a real crisis in medical malpractice insurance. The traditional companies, both stock and mutuals, essentially withdrew from the business because they could not price the product — at least they were convinced that they could not — and because it takes a long time to settle those claims when things go bad; they go bad, not only your new claims, but on your inventory of unsettled claims. That can be, as you will appreciate as actuaries, a very difficult situation.

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The medical profession tends to be organised state by state. The previous professional liability programmes had, by and large, been organised state by state, and so, in the ensuing chaos, a large number of new specialty companies were organised, typically one per state, and most of them took the form of mutual insurance companies. Some are reciprocal insurance companies, which is a form, perhaps unique to us, certainly not widespread around the world, that is essentially mutual in the ways that it thinks about things. Some were also owned by the association of the medical society in that state, but again, they thought like mutuals. The great majority of these companies have been very successful. The doctors contributed capital to get them started; they have been content to retire and leave their capital there. Effectively, there is no means of pulling it out when you retire. The real service that these companies provide is not a financial one, although it is most important, it is handling claims. The claims handling process is very intense. It takes a lot of money and effort. I serve on the board of one of these companies. The doctor members of the boards spend two days a month in the claims advisory committee reviewing cases, deciding which ones are defensible, how to secure the best experts to help defend them, and the loyalty of the insureds, the members, is incredible. Also, perhaps unique in the business of property casualty insurance, or general insurance, the loyalty of those who have had a claim is higher than those who have not.

Twenty five years later, some of these companies, having been so successful, decided that it was time to demutualise, often driven by managements which had greed as one of their motivating factors. Most of these demutualisations have stubbed their toes; they got into some additional things that they were not good at, and have, in the last 18 months, suffered some of the consequences, and pulled back.

Within the last six months, the largest stock traditional carrier of medical malpractice coverage in the U.S.A. abruptly decided to withdraw — the St Paul insurance companies — because they concluded that they could not get the prices right nor provide the right kind of claims service. Now we have mutuals who will step in to fill that void. From at least one perspective, mutuality can provide a unique and valid service, and the members will attest to that and reward it with loyalty.

Mr I. J. Kenna, A.I.A. (in a written contribution that was read to the meeting)**:** The paper raises the question: “Should more be done to encourage the development and growth of credit unions, friendly societies, etc., in order to do more for the under-insured and the less well-off?” (¶6.7). Perhaps more should be done. Who, though, is going to do it?

Brand new institutions have setting-up expenses and lack economies of scale. They need to be insured against the risk of failure. Leading figures and professionals do not come cheap. If such people are willing to give their services for next to nothing, all well and good. This may be the case in Eire, in Euskadi (the Basque country) or even in Scotland. I cannot see it happening in England.

Judging from the U.K. stakeholder pension, the Government wants to put an annual ceiling on expenses of 1% of funds. This is rather less than the net interest rate margin of a long-established, well-run building society.

Under political pressure, the Bank of England has decreed a base rate of 4% associated with a target inflation rate of 2.5%. Pre-tax rates of interest generally follow this base rate. 4.0% less 0.8% tax less 2.5% inflation = 0.7%. From this 0.7%, expenses and return to investors have got to be found. If any sort of reasonable expenses are to be charged, the return to investors will be heavily negative. This would be a public relations blunder if the chief executive of the new friendly society and his professionals were to receive the rate for the job.

There will be few new mutuals in England. Perhaps we should be asking ourselves how many existing societies are going to go out of existence.

A base rate of 4%, combined with an inflation target of 2.5%, are disastrous for new developments as they are for future pensions provision. The ceiling of 1% on expenses is also ridiculous in a market economy. They should all be abolished. The market should decide. Until these rates are abolished the financial services industry should be pressing for a base rate of, say, 8% and simple monitoring of inflation and expenses.

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Mr N. J. Dumbreck, F.I.A.: I attended a discussion at a professional meeting about 15 years ago about the relative merits of mutual and proprietary companies for with-profits business. At that time the conclusion was that, in theory, mutual policyholders ought to have higher benefit expectations, and proprietary company policyholders ought to have better security. However, in practice there was not very much observable difference in that neither category seemed to feature more strongly than the other in with-profits past performance tables, and there had been very few, if any, recent instances in which shareholders had been called upon to provide support for with-profits funds in proprietary companies.

My sense is that things have changed somewhat in the intervening 15 years, and that now practice is rather more in line with the theory. In the U.K., mutuals do now tend to feature pretty strongly towards the top of past performance tables, despite there being fewer of them. Conversely, some proprietary companies have been called upon to provide support for with-profits funds — for example, Sun Alliance and Scottish Mutual — and some mutuals have clearly suffered because of the lack of access to that kind of support.

It is hard to argue with the proposition that, if you are buying a with-profits policy, then a strong mutual is likely to give the best return, provided that you can count on the mutual remaining strong. However, in today's climate it is easier to turn a strong mutual into a weak one than it is to do the opposite.

So, while I believe that it is in the consumer's interest that there should continue to be serious competition from mutual life assurers and mortgage banks, to keep proprietary companies on their toes, it does not seem very likely to me that there will be a resurgence of the mutual sector or a large number of new mutuals being formed.

The Pensions Annuity Friendly Society is an interesting example. My understanding is that the reason why that was set up as a mutual had more to do with the lower capital requirements for establishing a new friendly society as opposed to a proprietary insurance company. Even so, it has been quite successful, and it would be interesting to see more examples of the same type.

Mr J. L. Massé (a visitor; President, Canadian Institute of Actuaries)**:** I spent 15 years of my life with a mutual company and 15 years with a stock company. The first was an insurance company, the other one was a railroad. I was amused by the comments that the mutuals are a little opaque in their administration. I would venture to say that the calculation or the determination of dividends by a railroad stock company — at least the one that I knew — was equally opaque.

From my point of view, I think that the question that we should ask ourselves is: "What is good for the public; to be a mutual or to be a stock company?" I think that the answer is: "What is good for the public is a well run company, whether it is a mutual or a stock company." I have seen that, when there is a need for the public that is not filled by stock companies, a mutual would be created. It is not a question of capital; it is not a question of efficiency of capital. I have seen big railroads get together in North America in the mid-1980s. They were looking for general insurance because the market had dried up on them. Money was not the question; they needed the coverage. Price was irrelevant. So they worked together to form a club. There were no new entrants. They would cover each other, and it turned out to be very successful. However, greed finally killed it. They were so successful that they could not leave all the hundreds and millions of dollars lying in a bank account offshore; but that is beside the point.

Consider 11 September 2001 — have any of you tried to get capacity insurance these days? The market is dry. Premium is not an issue, there is just no coverage. I see more mutuals being created as a result of it. There is a movement afoot in Canada at the moment. Insurance companies are trying to work together to get some coverage. There is a need which is not filled, whether it is by a mutual or by a stock company.

You associate stock companies with profit seeking. In my view, profit is not always the answer. The service to the public is more important.

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Mr B. N. Maxwell, F.I.A.: In a similar way to Mr Massé, I too have practically 30 years' experience: 15 years in a mutual and 15 years in a stock company. The difference between us is that it is the same company.

As I read the paper I was thinking how my experiences would blend into this. My company was quasi-mutual, and then it became a proprietary company. In the past 12 years or so it has certainly been very different working in a stock company than working in a mutual company. Then I stopped myself and said: "But I am looking at the question from the inside out; should I not be looking at it from the outside in? What difference did it make to the user?"

That made me think that, if you look at this from the perspective of what I call the user of the financial institution, nobody actually says: "I bank", or: "I have insurance", because they want it. They are really necessary evils. I think that the benefit for users of these financial institutions is largely around the fact that they exist. The users avail themselves of the benefits of the collective and pooling approach, but after that the user comes quite a long way down the list of the beneficiaries. Management and intermediaries are usually at the very top; staff and shareholders come next; and maybe users come in the third division. Maybe users were always in the third division.

Insurance and banking are collectives, and the individual user gains from that, whether it is a mutual or a proprietary. The fact that we became a proprietary certainly meant much more discipline in our number crunching; much more discipline on expenses and costs; much more interest in the use of capital; and so on. The users have certainly benefited in the last ten or 12 years from being involved with the company, but that is not because of the proprietory set up, it is because of the competitive environment. That would have happened whether it was a mutual company or a stock company. It did not have anything to do with the corporate structure.

I think that mutuals may have been better from a traditional with-profits perspective, but when I consider the distribution of inherited estates, where current policyholders and current managements get large benefits, what was the point of the mutuals for the previous generation of policyholders? What difference did it make to them?

The mutuals certainly enabled the development of the traditional with-profits business, but I wonder if that era is over now, as others have said, and hence the need for the mutuals does not still survive.

Credit unions certainly appear to fulfil a need, but even with 50% of the Irish people being members, the Irish credit union movement is running into management and organisational problems, and splits are appearing. It is possible that they will eventually return to a market of small credit unions concentrating on their local areas.

The mutual has to provide something that its users want and that they focus on, and this has also been said. It is not a 'value for money' issue. I always thought that industrial branch business was excellent value for money. The value in that was that people knocked on your door and collected your money, so that eventually somebody somewhere, whether it was yourself or your survivors, had some money. However, even that is dying a death.

I think that there is a place for mutuals, but it will only be where small groups of people feel the need for a service which is not being provided somewhere else and where it can be provided at some reasonable cost.

Mr J. Goford, F.I.A.: I have a couple of analyses: one of legal relationships and one of governance. I think that mutuals should survive or die on market forces. What really hurts is when it is the activities of carpetbaggers that trigger the demise of mutuals. What is wrong is the legal structure of mutuals. After all, at the end of the day, the deal between the company and the customer is pretty much the same for a proprietary and a mutual. How many mutual new policyholders understand that they have this power of ownership as well? It is not that big a deal. So, I started to explore this with Ms Marion Pell, who was a Senior Partner in a law firm in London, to see what mutual structure, what legal structure, would actually express the deal better where there are no shareholders. The straw man which we came up with was to put the estate and the value of new business, which were the parts that the existing customers do not

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need after they have finished, into a trust for the benefit of future policyholders; so that as soon as you take out a policy you are no longer entitled to any benefit from that trust. It seemed to do the right thing, and, indeed, it had shades of Mr Ian Lumsden's views, expressed when he was reporting to the Select Committee at the House of Commons. When asked by the Select Committee what the directors thought, he said: "Well, they think about existing policyholders and future policyholders." Thinking about future policyholders was a new idea to the Select Committee, but it began to make some sense.

So, we explored this a bit further and found that one of the problems under English law is that a trust has to have a residual beneficiary, and frankly the only candidates for a residual beneficiary are the existing policyholders, so you get back to where you started. So that did not work. Then we came up with idea of shifting all of Standard Life's money to the Dutch Antilles via the Cayman Islands, but we did not think that that would go down terribly well as a marketing exercise! We did stumble across the fact that under Scottish law a trust does not have to have a residual beneficiary. So, we played with that a bit, and I am not quite sure what happened, except that Marian Pell retired.

As far as analysis of governance is concerned, I thought about the interested parties (and let us assume that we do not have to worry about intermediaries, as they can well look after themselves). The interested parties in a with-profits fund, whether it is proprietary or mutual, are existing policyholders of all sorts. They are not homogenous by any means. Future policyholders have an interest in the estate; the shareholders do in a proprietary; but also there is money left over, which is the estate, the ownership and governance of which is very poorly defined. We have seen the beginnings of recognition of this in some of the FSA papers, where they ask, particularly in mergers and acquisitions, if you should have a policyholder advocate fighting for a share of the estate. There is recognition that there is an estate that does not have representation. I ask the question: "If you are an actuary and your sole job is to represent the estate (you are not interested in policyholders, you are not interested in shareholders, you are not interested in future policyholders, but you are interested in the estate), what sort of report would you come up with about the recent activities of proprietaries and mutuals about the way the estate has been used?"

Mr Guijarro: I think that the point raised on niche players is relevant here. In our research we analysed company histories as far back as the late 18th century. Most of the companies are now major players, but started off as very small organisations, not dissimilar to what we would classify as niche players today. Whilst I agree that the world is now a much different place, who is to say that some combination of new niche mutual organisations will not grow into a large, mutual organisation over the next couple of centuries?

I think that it comes down to demand, in particular whether the flexibility of niche players is sufficient to create demand going forward. This competitive edge is more important than before, as increased regulation, at least in the minds of policyholders, appears to have reduced one of the perceived benefits of mutuality.

Dr D. J. P. Hare, F.F.A. (replying)**:** One of the things that you learn when you look at history is that things move in cycles, and that you are not always able to anticipate through logic what the next cycle is going to be. Also, who knows what changes there will be in society? I certainly had not thought of trying to draw inferences from the May Day riots, as Mr Jeffery did, but it is a very interesting point that there is a more and more vocal group of people who feel that the current corporate system is letting them down, and where would that lead to? Who knows? However, if actuaries are meant to be making sense of the future, then it is probably good that we are thinking and asking the questions.

What I thought might be helpful is to tie in some of the thoughts that came out of the Faculty discussion with some of the points that have come out of this discussion. While I am not sure that we are any nearer to answering all our questions, I am not sure that there are answers to some of these questions; but I hope that we will understand the issues better. Some speakers

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have said that it is a shame when carpetbaggers drive demutualisation through. I think that it is useful to stand back and realise that, just because something is right for one company, it does not mean that it has to be right for every other one, and we certainly were not trying to say that there should be no mutuals and that they should all be plcs. Nor were we trying to say that everything should be mutual and there should be no plcs. If we were trying to say something, it was that there is a space for well-run companies of both types.

One thing that was said at the Faculty was: "Let the market decide." However, markets are not free; they operate under regulations. When you have a very interventionist regulator, there is the law of unintended consequences, and that can shape markets and can shape the sort of companies that we end up with. So, I think that there is certainly a role for the actuarial profession in highlighting to the regulator the possible implications of what it might be trying to do. It seems quite brave to say: "This is how competition should work, write a report on it, and then that is how competition works." I hope that the world is as simple as that!

One of the points made at the Faculty and here is that there is not a lot of evidence on the relative performance of mutuals versus plcs, because the world is not as simple as that. Big companies can perform better than small companies because of economies of scale. Strong companies can perform better than weak companies in a with-profits environment if they have a better equity percentage, and equities perform well. So, you have to take a lot of the figures that we have with a pinch of salt, small in number though they be.

Concerning issues of relative levels of scrutiny, again I do not think that we actually said that mutual companies were under the same scrutiny as plcs. I certainly think that mutual companies — the few that are left in the U.K. — are under the same scrutiny from certain people. Obviously though, equity analysts are not crawling over the numbers for Standard Life or Liverpool Victoria in the same way as they crawl over the numbers for plcs.

It is suggested that mutuals are more opaque than proprietaries. When Mr Guijarro and I discussed the annual report and accounts of various well-known proprietary companies, we wondered whether anyone could actually make any sense of how they are making money out of some of the business that they are writing.

I agree entirely with Ms Wood that, sadly, transparency is replacing trust in our society. I do hope it works, but I do not think that you can say that the proprietaries are transparent at all. If they were, then they would have nothing to fear from fair values, but I am sure that everybody is quite concerned about what fair value could do for them.

Policyholders do not own mutuals. You cannot own a company limited by guarantee. You can be a member of it; you may have a voting right that gives you rights on windfalls when a company closes down, but that is not quite the same as ownership in the common parlance of the word, and it would be nice if we were precise about that.

Another point that was made at the Faculty, that has also come out here, is that, if the actuarial profession is going to have any role in this, then maybe it is in ensuring that the current market and current structures do work effectively. Also, in helping people to understand that there are laws of unintended consequences, we can make comments to try and highlight to people the consequences of what they are doing. In the U.K. we wrestle with what acting in the public interest means; but maybe that is one aspect of acting in the public good, both in making comments where existing arrangements do not work effectively, but also in trying to help people to understand the implications of possible changes.

We have talked much about competition and how desirable it is. I think that there is no doubt at all that a large well-run strongly capitalised mutual can actually be quite a competitive force in the market place, and might keep plcs on their toes.

One suggestion made at the Faculty was that those actuaries who are really keen should form an advisory panel to help mutuals which want some advice. I am not volunteering to go on this panel, but there was at least one man in the audience who was. So, if anybody else wants to join him that would be great, because there could be issues where we could do pro bono work and help.

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The President of the Faculty of Actuaries (Mr T. D. Kingston, F.F.A.): It is very satisfying when something that one said almost two years ago comes back in a broader forum, although things never come back quite as you originally stated them! My original concept concerned thinking about capital structures; in fact we have gone into quite a number of issues in this discussion, like policyholder perceptions, catering for gaps, and so on, which certainly fill me with many other thoughts and ideas. That seems to me what this is all about.

One of the things that I feel very strongly about as a profession, as has been mentioned earlier, is that we ought to be considering major ideas, not just doing the 'technical stuff'. We must think about why structures are the ways they are, why they might be different, what makes things efficient and why there are large needs not being satisfied. We must think about how our society might be organised in ten, 20 or 50 years' time. These are matters of importance, and matters which we should think about, even if they do not have very immediate answers. They will lead us to do sensible things in other directions. So, I am very grateful to the authors of this paper, which has now been discussed four times. That is a reflection, in itself, of the quality of the paper. I am grateful to the panel this evening, and at the Faculty, to all of you who have contributed and to everybody who has thought about it. As Dr Hare rightly said, nearly everybody who is here has read the paper. That, of itself, is a good thing. Let us go on thinking.

The President of the Institute of Actuaries (Mr P. N. S. Clark, F.I.A.): I shall consider one or two related issues that have come up. There is the thought about being a one-way street to individuality. I certainly hope not. That way leads to the sort of things that Mr MacGinnitie was talking about, where you do not pay 50% of your income in insurance — you end up paying almost all of it in insurance. I hope that it is more of the cycle that Dr Hare was talking about, and we are moving towards one end of the pendulum and we may start swinging back.

I thank Mr Barry for highlighting the point about the Grameen Bank. For those who are not aware, the International Actuarial Association is looking at an Actuaires Sans Frontières project to see whether there are ways that those actuaries who have earned a million can plough back some of their technical and professional capabilities to help things like micro-finance initiatives in the Third World. There are one or two projects that we are looking at to see whether we can make that work.

So, what I would like you to do is to join me in thanking, first of all the authors for having put all that work in to produce such a stimulating paper, and to the other members of the panel for what they have contributed in this discussion, to what I think we can all agree has been a very, very enjoyable and successful discussion.

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