



The independent judgement of With-Profits Committees

Gavin Lock considers whether
the judgement exercised is
truly independent.

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FSA rules require, somewhat prosaically, that a firm should maintain governance arrangements designed to ensure that it complies with, maintains and records any applicable PPFM. These arrangements should involve some independent judgement in assessing compliance with its PPFM and addressing conflicting rights and interests of policyholders and, if applicable, shareholders.

In practice, the intention of these rules is that with-profits governance is an important and powerful input to the running of the firm and to securing the fair treatment of policyholders. For most larger with-profits firms, these duties are performed by a With-Profits Committee (WPC), although smaller firms often rely on a single independent person for this input.

Following a thematic review of the governance arrangements of with-profits business in 2007, the FSA generally found that, notwithstanding the actual phrasing of its rules, the independent judgement that had been applied was restricted to monitoring compliance with the PPFM. This was in contrast to the FSA's aim, namely that thought be given to the broader outcome that the governance arrangements are intended to achieve (and in particular when considered in relation to FSA Principle 6 – Treating Customers

Fairly, and Principle 8 – Managing Conflicts of Interest).

The FSA also found examples of potential conflicts of interest, where either the independent reviewers were also involved in other work with the firm or where some (or all) WPC members were executives of the firm. The FSA has recently emphasised that any firm that continues to have a material outstanding issue in any area where the FSA has previously highlighted poor practice is particularly likely to be deemed at significant risk of not treating its customers fairly overall. A further review of with-profits is being conducted by the FSA and governance arrangements will be under the microscope again.

A question of perception

As noted in the previous article on page 7, Watson Wyatt recently conducted a review of with-profits governance arrangements which found that the WPCs of the larger with-profits firms tended to comprise individuals that are more independent (having a higher representation of non-executive directors or other individuals that are independent of the firm) than those of smaller firms.

Whether wholly independent of the firm or not, the WPC members themselves generally felt strongly that their committee composition was appropriate to allow the exercise of independent judgement and that there was sufficient independent challenge from the arrangements set in place. Responses from firms where the governance model involves

a single independent person also indicated a belief that their approach was appropriate.

It would perhaps have been surprising were these opinions not to have been voiced whatever the approach taken. Be that as it may, it must be the case that from an external perspective the models operated by larger firms would appear to offer greater independence.

Obviously, it is difficult to assess whether the judgement exercised by WPCs is truly independent. At one extreme, for WPCs that are wholly independent, this would appear self evident. However, there is almost certainly still reliance on the information and advice provided from within the firm and it is possible that this may not always be completely aligned with what the WPC would have wanted. This reliance on the firm for information is also true for members of WPCs more generally. On the other hand, there may still be limited independent input via recourse to the practices and deliberations of others facing similar issues in different organisations.

We should not forget that the With-Profits Actuary, whether internal or external, is obviously also part of the independence, given that the role involves advising the firm's management on key aspects of discretion and fair treatment for with-profits policyholders.

The real issue would seem to be whether the model of independence adopted really is independent enough. Independence can exist within the



governance model in different ways and all the approaches currently being taken can rightfully claim to be independent. However, at the same time many of them remain exposed to potential conflicts of interest as well as suggestions that they could be more independent. Firms, and indeed individual WPC members, should be asking themselves whether the structure in place facilitates the delivery of independent judgement and challenge, and whether the potential for conflicts of interest can be managed, or seen to be managed, satisfactorily.

Using external advice helps to demonstrate greater independence. We all know that external advice comes at a cost, but it can provide a valuable contribution to the independent judgement as well as useful insights and perspectives from outside the company. It also strengthens the external perception of independence and may reduce the potential for conflicts of interest arising from WPC members that may otherwise have essentially shareholder-focused roles.

Conclusion

The current rules provide significant flexibility regarding how to achieve the independence required for the management of with-profits funds. Since they were introduced, there seems to have been a gradual trend, both as a result of regulatory pressure and emerging market best practice, for with-profits governance arrangements to be more self-evidently independent. It is possible that a 'gold standard' may yet emerge, with a WPC of wholly independent members supported by external advice.

Despite the above, it could be argued that the effectiveness of the exercise of independent judgement has nothing to do with the governance model: it merely depends upon the skills, experience and integrity of the individuals themselves. With this in mind, it will be interesting to see how the forthcoming FSA review looks upon this area.

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