Aviva's registration number on the European Commission's Register of Interest Representatives is: **86270761494-62**

Re: Aviva response to European Commission Green Paper on "Corporate governance in financial institutions and remuneration policies" (COM(2010) 284 final)

<u>About Aviva</u>

Aviva is one of the world's largest insurance groups, serving 53 million customers across Europe, North America and Asia Pacific.

Our main business activities are long-term savings, fund management and general insurance, with worldwide total sales of £45.1 billion and funds under management of £379 billion at 31 December 2009

We are the largest insurance services provider in the UK and one of the leading providers of life and pensions products in Europe

<u>Boards of directors</u>

General question 1: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the composition, role and functioning of the board of directors, and to indicate any other measures they believe would be necessary.

We agree with the general proposition that boards of directors of financial institutions have a key role as principal decision-making bodies, and also as challengers of senior management, and of the information submitted to them for approval. In general, we also agree that the time commitments, diversity, performance appraisal, and risk management oversight are important issues in considering the makeup of boards of directors. Whilst all of these subjects are matters of legitimate concern, we also feel that any proposed remedies should recognise the fact that firstly non-executive directors are only a part of an overall governance framework which should embrace also regulators and institutional investors; issues of behaviour and culture are as important as prescriptive rules on corporate governance; and the huge range and diversity of types of financial institutions must also be respected. We also feel that the ability of member states at national level to implement rules and procedures which fit within their existing legal and regulatory systems should be respected, since the overlaying of another level of regulation which is too prescriptive may have unforeseen consequences and may simply lead to a "box ticking" approach.

Against the background of the above general comments, our answer to the specific questions are as follows:-

1.1. Should the number of boards on which a director may sit be limited (for example, no more than three at once)?

Financial institutions in the UK are subject to a supervisory regime through the Financial Services Authority which has become more intrusive, and which focuses strongly on the role of the supervisory authority in approving applicants for director status in financial institutions through a detailed interview and assessment process. Recommendation 7 of the Walker Report on corporate governance in financial institutions stated that a chairman of a major bank should be expected to commit a substantial proportion of his or her time, probably around two-thirds, to the business of the entity, and recommendation 3 stated that for a number of the other non-executive directors a minimum expected time commitment of 30-36 days should be clearly indicated in letters of appointment. It is noteworthy that these provisions were proposed by the Walker review for consideration by the Financial Services Authority who, given their more intrusive approach, regarded it as inappropriate to propose specific time commitments, but instead proposed that firms themselves should take time commitments and availability into consideration as one of the aspects of their decision making process, and that in exercising their supervisory function the Financial Services Authority would expect to be satisfied on this point having regard to the particular features of the financial institution concerned. That being the case, we do not think it would be helpful to have prescriptive rules on time commitments or numbers of directorships, but would propose that it would be helpful to ensure that national supervisory authorities had the responsibility of supervising individual institutions in a way which took the general principles into account.

1.2. Should combining the functions of chairman of the board of directors and chief executive officer be prohibited in financial institutions?

We agree that there should be a separation of function between chairman and chief executive officer.

1.3. Should recruitment policies specify the duties and profile of directors, including the chairman, ensure that directors have adequate skills, and ensure that the composition of the board of directors is suitably diverse? If so, how?

We agree with this proposal. The Commission should in our view take the approach that it should be a matter for national authorities to decide on the detail of implementation, but might like to note that in the UK any proposed nominations for board level must be considered carefully by a separately constituted nominations committee of the board, and that it will be expected that there should be a detailed profile drawn up of the proposed skills and qualities required by the board for the role proposed, and that it would also be normal practice to obtain advice from external consultants. It would also be not uncommon for the nominations committee to keep the balance of skills and experience on the board under regular review.

1.4. Do you agree that including more women and individuals with different backgrounds in the board of directors could improve the functioning and efficiency of boards of directors?

We agree with the principle, but would counsel against imposing specific quotas, since the guiding principle must be to choose the right candidate for the role from the talent pool available.

1.5. Should a compulsory evaluation of the functioning of the board of directors, carried out by an external evaluator, be put in place? Should the result of this evaluation be made available to supervisory authorities and shareholders?

We agree with the principle of board evaluation; in the UK this is required to be carried out annually, with an external evaluation being carried out at least once every three years. We disagree strongly with disclosure of all of the outcomes of the evaluation to supervisory authorities and to shareholders, since the result might well be to produce comments which are moderated because of the knowledge that there would be third party disclosure. Boards might be discouraged, otherwise, from free and open debate because of the fear of adverse consequences

1.6. Should it be compulsory to set up a risk committee within the board of directors and establish rules regarding the composition and functioning of this committee?

We agree.

1.7. Should it be compulsory for one or more members of the audit committee to be part of the risk committee and vice versa?

We agree.

1.8. Should the chairman of the risk committee report to the general meeting?

We agree that there should be a risk committee report to the general meeting contained in the annual report and accounts of each institution.

1.9. What should be the role of the board of directors in a financial institution's risk profile and strategy?

We believe that it should be the role of the board to set the risk appetite for the financial institution and to adopt ultimate responsibility for risk oversight and control at an appropriate level.

1.10. Should a risk control declaration be put in place and published?

We agree that suitable wording could be contained in the risk committee report which, as we mentioned above, could be included in the institution’s annual report and accounts.

1.11. Should an approval procedure be established for the board of directors to approve new financial products?

We disagree with this comment as a general proposition. In a large life insurance entity, for example, it would be impracticable and would not serve any purpose for the board to have to individually agree each product, particularly given that in approving such products the directors of subsidiary companies have a primary, and separate duty to regulators and to policyholders. Whilst we appreciate that the position in banking institutions may be different, we have no specific comment to make on that point.

1.12. Should an obligation be established for the board of directors to inform the supervisory authorities of any material risks they are aware of?

We believe that in the UK this obligation already exists and would have no objection to its introduction generally.

1.13. Should a specific duty be established for the board of directors to take into account the interests of depositors and other stakeholders during the decision-making procedure ('duty of care')?

In the UK, such an obligation is imposed by the approved persons regime administered by the Financial Services Authority, but it is important to distinguish between the duties of directors of unregulated holding companies of large institutions with diverse portfolios of businesses, and others. We believe that directors of entities marketing products to the public should indeed have such duties (embodied in whatever form national authorities choose to implement it to fit in with local law and regulation), but that in relation to holding company boards of complex institutions, whilst there should be a duty at a high level, its formulation should be a matter for national authorities. In the UK it is done through a system of control over those exercising "significant influence" at holding company level.

Risk-related functions

General question 2: Interested parties are invited to express whether they are in favour of the proposed solutions regarding the risk management function, and to indicate any other measures they believe would be necessary.

It is important first of all to observe that financial institutions are very diverse, and whilst it is true that some financial institutions (notably banks) failed in their risk management processes, others did not. We should therefore be careful of a "one size fits all" approach to risk management which could have unintended effects in relation to institutions whose processes and controls were satisfactory, or who have a different risk profile to banks who required financial support as a result of the crisis. We also believe that any regulation at European level should purely be at the level of principle, rather than detailed prescription about structures, because of the different legal and regulatory regime applying in different member states.

Having said all of that, we are supportive of the general proposition that the chief risk officer should have an appropriately important status within a financial institution, although we do not agree that the risk officer should necessarily sit on the board of directors (as is implied by the proposal that he should have equal status to the chief financial officer); but he should sit on the executive committee, report at least to the CEO or the CFO, and should have independent duties to the board risk committee and ultimately to the board itself.

We also agree that IT tools should be sufficient to enable proper discharge of the risk function's responsibilities, although the nature of those tools again should not be prescribed in detail because of the very different nature of the institutions to be regulated; this should be a matter for national supervisory authorities.

Turning to the specific questions, we would comment as follows:-

2.1. How can the status of the chief risk officer be enhanced? Should the status of the chief risk officer be at least equivalent to that of the chief financial officer?

The Walker Report in the UK prescribes that the chief risk officer should report at a senior level, and should not be able to be dismissed without a resolution of the main board. Rather than prescriptive regulation as to the precise reporting structure within an organisation, we think that it is sensible to embed the concept of the chief risk officer's independence and separate duties to the risk committee of the board.

2.2. How can the communication system between the risk management function and the board of directors be improved? Should a procedure for referring conflicts/problems to the hierarchy for resolution be set up?

We believe that the CRO should report routinely to each meeting of the risk committee of the board, and should have appropriate dialogue between meetings as occasion demands. This should obviously include any problems relating to conflicts or hierarchy.

2.3. Should the chief risk officer be able to report directly to the board of directors, including the risk committee?

We agree with this proposition.

2.4. Should IT tools be upgraded in order to improve the quality and speed at which information concerning significant risks is transmitted to the board of directors?

In general, we agree, but we do not feel that further regulation is needed for insurance companies; this is already well covered within the Solvency II agenda.

2.5. Should executives be required to approve a report on the adequacy of internal control systems?

We believe that there should obviously be regular reports on the adequacies of internal control systems, but believe that, in the UK at least, this is already sufficiently embedded in the regulatory and legal regime.

<u>External auditors</u>

General question 3: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the role of external auditors, and to indicate any other measures they believe would be necessary.

In seeking strengthened cooperation between external auditors and the supervisory authorities in order for supervisors to benefit from external auditors knowledge of individual financial institutions and the financial sector as a whole, it is important to recognise that a firms auditors fulfil a different role to that of the supervisory authorities.

Supervisory authorities are responsible for the supervision of firms and their management to ensure that they comply with prudential and conduct of business regulations. If supervisors do not have an adequate knowledge of the firms they supervise to fulfil their accountabilities under the regulatory system, this would be best addressed through dialog with those firms first hand rather than with their auditors.

The external auditors of a firm are accountable to the firm's shareholders for the accuracy of the firm's accounts and the appropriateness of management discretion exercised in their preparation. They will conduct their work in line with agreed practice, and within the UK the auditor's report is shared with the supervisor. Given that the supervisor is provided with the auditor's report the benefit of further interaction is unclear.

If supervisory authorities consider that the agreed practice that auditors' work to, (which will cover all firms and not just those subject to financial services regulations), or the statements that they make in relation to their audit require enhancement then interaction between supervisory authorities and the standard setters and professional bodies for audit firms, not the auditors, to discuss the agreed practice would seem to be the most sensible route to address this.

We do not believe there is a need to review the role that external auditors should play in relation to risk related information. Supervisory authorities are responsible for supervising firms' compliance with regulations in relation to risk, not firms' external auditors, and supervisors should not seek to effectively contract out their responsibilities. If there are deficiencies in supervisory practice in this respect this would be best addressed by improved supervisory standards. Within the UK firms meet the costs of their supervision, if the role of external auditors were to be extended to cover matters that are rightly the responsibility of the supervisors then this audit cost too would be met by firms, effectively meaning that they are paying twice.

In relation to the specific questions we would comment as follows:-

3.1. Should cooperation between external auditors and supervisory authorities be deepened? If so, how?

As noted above, we do not believe there is a case for extended cooperation between external auditors and supervisory authorities. However, we believe there may be benefit from cooperation between supervisory authorities and the standard setters and professional bodies for audit firms so that supervisors can gain assurance as to the standards that the audit firms are required to work to.

3.2. Should their duty of information towards the board of directors and/or supervisory authorities on possible serious matters discovered in the performance of their duties be increased?

No, the auditor's duty to report is towards all the share holders of the firm, they will discuss their findings with the audit committee of the firm which will be a board committee. Therefore, it is unclear what benefit any additional information requirements could provide.

In relation to information provided to supervisors it is more important that supervisory authorities receive notification of the matters on which they would expect to be informed, rather than the route that the information takes to get to them.
It is perfectly understandable that auditors will discuss their views with firm's management before any potential notification to the supervisory authorities. Within the UK regulated firms are under an obligation to inform the supervisory authority in a timely manner of any matter which they would reasonably expect to be informed. Therefore, following discussions between a firm's auditors and the firm's management, the management are obliged to inform the supervisor of anything that will be material to them. Therefore given that the supervisor is required to be told of anything that will be material to them, it is unclear what benefit any additional information requirements on the auditors could provide.

3.3. Should external auditors' control be extended to risk-related financial information?

No, as noted in our response to the general question above, supervisory authorities are responsible for supervising firms' compliance with regulations in relation to risk, not firms' external auditors, and supervisors should not seek to effectively contract out their responsibilities. If there are deficiencies in supervisory practice in this respect this would be best addressed by improved supervisory standards. Within the UK firms meet the costs of their supervision, if the role of external auditors were to be extended to cover matters that are rightly the responsibility of the supervisor then this audit cost too would be met by firms, effectively meaning that they are paying twice.

<u>Supervisory authorities</u>

General question 4: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the role of supervisory authorities, and to indicate any other measures they believe would be necessary.

We believe in general that it is appropriate for supervisory authorities to pay attention to the proper functioning of boards of directors as an important part of the oversight mechanism within financial institutions. However, we think that any proposals made by the European Union in this respect should be at the level of general principle and should not prescribe detailed rules which may impose an unnecessary extra layer of regulation on top of existing local rules, and may have unintended side effects. In the UK, the Financial Services Authority already has a supervisory power over the boards of holding companies of financial institutions through the approved persons regime, and we do not think anything further is necessary. We also think it is important for that power to be exercised in a sensible and proportionate way to avoid producing the wrong results (see our comments above on board evaluation processes, for example).

Specific questions:

4.1 Should the role of supervisory authorities in the internal governance of financial institutions be redefined and strengthened?

We have covered this point above; we think any EU initiative should be restricted to broad statements of principle to be implemented in member states, and respecting effective controls already in existence in those states.

4.2. Should supervisory authorities be given the power and duty to check the correct functioning of the board of directors and the risk management function? How can this be put into practice?

We agree with this comment in relation to the risk management function, but in relation to boards of directors we think the proposal should go no further than to ensure that local supervisory authorities have the power to supervise boards of directors in a sensible and proportionate way which avoids producing the wrong outcomes.

4.3. Should the eligibility criteria ('fit and proper test') be extended to cover the technical and professional skills, as well as the individual qualities, of future directors? How can this be achieved in practice?

We agree. Appointments of supervisory board/non-executive directors should require regulatory processes which take into account these criteria.

Shareholders

General question 5: Interested parties are invited to express their view on whether they consider that shareholder control of financial institutions is still realistic. If so, how in their opinion would it be possible to improve shareholder engagement in practice?

Shareholders, as the providers of risk bearing, equity capital, are essentially the owners of companies and, as such, have a clear interest in seeing them run in an effective, sustainable way. This is true whether or not they are financial institutions. However, shareholders' ability to monitor companies, and ensure that this is the case, is dependent on (i) effective disclosures and (ii) meaningful (tangible) rights and protections. One without the other impairs their ability to undertake that role effectively, exacerbates agency problems and information asymmetries. Equally, therefore, many shareholders willingness to commit time and resource to such activities, pragmatically and over the long term, will be influenced by that.

European Member States offer a wide and varying range of investor rights and protections and there would be merit in reviewing these and the extent to which they do (or should) contribute to an effective dynamic between shareholders and insiders around the stewardship of the business. Such rights range from softer advisory votes, through binding votes (e.g. on Related Party Transactions or severance packages) to regulatory and legal measures that (i) enable participation (e.g. Swedish nominations committees) or impose restrictions (e.g. on premiums/discounts to be paid on share repurchases/issuance). It's notable that even shareholder rights to vote on the financial statements or planned use of distributable profits/dividends are very mixed. We would also note that this is not be an area where maximum harmonisation would be appropriate.

Equally, the relationship, expectations and duties that exist between 'investors' and under-lying beneficiaries (whether they be pension funds, life funds or retail consumers) plays a critical role in this dynamic. As a result we believe there is scope for greater focus on this area, including consideration of the broader adoption of measures like the UK's Stewardship Code.

In relation to the specific questions we would comment as follows:-

5.1. Should disclosure of institutional investors' voting practices and policies be compulsory? How often?

We support the principle of voting disclosure and make such disclosures ourselves. However, we would be concerned if this was mandated in a way that imposed potentially significant administrative and financial burdens on shareholders (which would likely be diverted away from meaningful dialogue and engagement with companies). We therefore believe that this should be a matter for inclusion in the approach adopted on the introduction of Stewardship Codes and be subject to a comply or explain requirement.

5.2. Should institutional investors be obliged to adhere to a code of best practice (national or international) such as, for example, the code of the International Corporate Governance Network (ICGN)? This code requires signatories to develop and publish their investment and voting policies, to take measures to avoid conflicts of interest and to use their voting rights in a responsible way.

As indicated above, we support the concept and introduction of Investor Codes, although for practical purposes they need to be adopted on a comply or explain basis and enable mutual recognition/passporting across Member States. Both the UK Stewardship Code and the ICGN Code offer examples that merit consideration in this regard.

5.3. Should the identification of shareholders be facilitated in order to encourage dialogue between companies and their shareholders and reduce the risk of abuse connected to 'empty voting'?

As a general matter, we believe that it is important that both companies and the markets should have reasonable information available to them about shareholders direct and indirect holdings (i.e. including "gross" cash-settled contracts for difference and other financial instruments having a "similar economic effect" such as convertible bonds, warrants, nil-paid rights, cash settled options and relevant baskets of securities). Similarly, some disclosure of net short positions in given circumstances (e.g. rights issue periods) has merit. In our experience, however, the current European arrangements create two issues. Most significant, is the plethora of different arrangements that exist across markets and within markets (at the company level, such as in France), which can create unnecessary administrative burdens for some. In addition, we note that some jurisdictions are introducing unduly punitive sanctions to selectively disenfranchise shareholders who do not notify them of interests, within what can be unduly short timeframes. Care will be needed in this area to ensure that such arrangements do not become abusive in their nature or use.

We would also highlight the mechanism available in the UK under Section 793 of the Companies Act. This provides a mechanism through which companies can seek disclosure of underlying investors, which might usefully be made available across Member States.

5.4. Which other measures could encourage shareholders to engage in financial institutions' corporate governance?

Beyond investors' own interest and commitment to promoting good corporate governance practices and risk mitigation, the primary drivers of institutional investor interest in this area are client demand (or lack thereof), investment consultant (dis)interest, and the nature of investment mandates. Market capitalisation weighted benchmarks, related tracking error restrictions and other factors, while all serving particular purposes, can have a distorting effect on behaviour and in aggregate may inhibit the ability of the body of shareholders as a whole to exercise sufficient influence to be effective.

We believe that further investigation and analysis of such factors would have merit. In contrast we do not believe that there is merit in pursuing proposals involving enhanced dividends or voting rights for 'selected' shareholders. Such measures would be open to abuse, risk adding additional entrenchment hurdles and creating a disincentive to engage. We share the view that such measures would further erode the principle of equality of treatment and be detrimental.

Equally we would urge caution in imposing mandatory requirements, without first considering the potential administrative or behavioural implications of doing that. The US ERISA requirement to vote, is a commonly encountered example of the un-intended consequences of that (default voting to a template, often operated by Risk Metrics), which now also believed to be having an impact in the European markets.

Effective implementation of corporate governance principles

General question 6: Interested parties are invited to express their opinion on which methods would be effective in strengthening implementation of corporate governance principles?

The general view on the proposal here is that we think it is obviously appropriate for supervisory authorities to have oversight over senior management and directors who have a significant influence (or indeed a more hands-on role) in relation to the activities of financial institutions where they may cause damage to consumers or may have wider adverse economic effects. We agree, however, with the comment in 5.6 of the Green Paper that any increase in management civil or criminal accountability should be examined carefully having regard to member states competence on matters of criminal law. Moreover, we do not think that all of these issues are matters for the criminal law as opposed to civil sanction. In the UK, for example, the Financial Services Authority, through its supervisory powers, has the authority to investigate and where necessary to impose civil penalties on approved persons whom it considers have breached its general principles of conduct, or any of its more specific rules. Our view is that those provisions are more than adequate for the purpose if properly deployed.

Specific questions:

6.1. Is it necessary to increase the accountability of members of the board of directors?

See above.

6.2. Should the civil and criminal liability of directors be reinforced, bearing in mind that the rules governing criminal proceedings are not harmonised at European level?

See above.

<u>Remuneration</u>

General question 7: Interested parties are invited to express their views on how to enhance the consistency and effectiveness of EU action on remuneration for directors of listed companies.

Following the significant economic and financial crisis we have seen over the last 24 months, we have welcomed many of the requirements in the field of Executive Remuneration and believe that they will contribute to improving the oversight and governance of remuneration arrangements, as well give greater prominence to ensuring reward outcomes are appropriately risk adjusted.

However, as the Commission will be aware, there are so many new and compounding requirements being developed that there is, in our view, a not inconsiderable risk that the required codes and directives could squash any distinguishing reward strategy to the point where all reward structures coalesce around a common platform, therefore not reflecting each company’s own business strategy and reward philosophy.

We would therefore be very cautious, at this time, in adding any additional burdens of regulation which could make companies within the EU uncompetitive in a global marketplace for talent.

Specific questions:
7.1. What could be the content and form, binding or non-binding, of possible additional measures at EU level on remuneration for directors of listed companies?

Any new measures at the EU level should only be non-binding.

7.2. Do you consider that problems related to directors' stock options should be addressed? If so, how? Is it necessary to regulate at Community level, or even prohibit the granting of stock options?

Whilst our own remuneration arrangements, as an on-going element of the reward package, do not utilise stock options, we do recognise that many companies choose to deliver reward using this platform for very legitimate reasons. We therefore do not believe stock options require further regulation and should not be prohibited.

7.3. Whilst respecting Member States' competence where relevant, do you think that the favourable tax treatment of stock options and other similar remuneration existing in certain Member States helps encourage excessive risk-taking? If so, should this issue be discussed at EU level?

We do not believe any favourable tax treatment for stock options encourages excessive risk taking. This is a view to be taken by the Remuneration Committee of each relevant company. We do not believe this requires a European perspective.

7.4. Do you think that the role of shareholders, and also that of employees and their representatives, should be strengthened in establishing remuneration policy?

Remuneration policy for Executives is a matter for shareholders in the UK through the requirement to have the annual remuneration report voted on by shareholders. We believe this is an effective and adequate control mechanism in managing executive pay. We do not believe adding employee representative into the decision making process would help enhance this control and oversight.

7.5. What is your opinion of severance packages (so-called 'golden parachutes')? Is it necessary to regulate at Community level, or even prohibit the granting of such packages? If so, how? Should they be awarded only to remunerate effective performance of directors?

In our experience any ‘golden parachutes’ only exist as they reflect employee and management contracts held across all relevant employee levels. Aviva does not approve of reward for failure and is committed to performance based pay. We do not believe there is a need to regulate on this issue across the EU.

General question 7a: Interested parties are also invited to express their views on whether additional measures are needed with regard to the structure and governance of remuneration policies in the financial services. If so, what could be the content of these measures?

No specific comment.

Specific questions:

7.6. Do you think that the variable component of remuneration in financial institutions which have received public funding should be reduced or suspended?

This is a matter for the shareholders of each company to decide. We do not believe it is in the long term interests of the taxpayer to reduce or suspend variable pay. However, we would encourage all companies to ensure variable pay fully reflects the level of business performance.

Conflicts of interest

General question 8: Interested parties are invited to express whether they agree with the Commission's observation that, in spite of current requirements for transparency with regard to conflicts of interest, surveillance of conflicts of interest by the markets alone is not always possible or effective.

We agree in principle that conflicts of interest are an inherent problem in financial institutions but we would question the extent to which detailed supervisory rules made at EU level would necessarily address the position because of the very different legal and regulatory regimes in different member states. We therefore believe that any harmonisation should be at the level of general principle rather than detailed rules except, possibly, where cross border sales are concerned. Where retail financial services products, for example, are sold by an institution or its subsidiary purely in its own member state under national regulations it is not obvious why detailed regulation imposed from European Union level would produce a more beneficial outcome for consumers than regulation at local level which harmonised with existing local laws and principles.

Specific questions:

8.1. What could be the content of possible additional measures at EU level to reinforce the combating and prevention of conflicts of interest in the financial services sector?

No specific comment.

8.2. Do you agree with the view that, while taking into account the different existing legal and economic models, it is necessary to harmonise the content and detail of Community rules on conflicts of interest to ensure that the various financial institutions are subject to similar rules, in accordance with which they must apply the provisions of MiFID, the CRD, the UCITS Directive or Solvency 2?

No specific comment.