

A case study — The demutualisation of NRMA Insurance Ltd ensuring responsible corporate governance

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- 🌀 **Overview of original governance structures**
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When the doors opened for business on Monday 24 July 2000, it was an exciting day for what had been the NRMA Group. There were now two groups of companies — independent and unrelated — where the week before there had been one group.

The NRMA Insurance Group, headed by NRMA Insurance Group Ltd ('NIGL') offers insurance and financial services through 32 related companies whilst NRMA Ltd ('Association') is Australia's largest motoring organisation. Both now have their own Group Secretary and General Counsel, Chief Executive and senior management team.

One 'NRMA' — a brief history

The National Roads Association Ltd was established in 1920 to lobby government for better roads, and was renamed the National Roads & Motorists' Association Ltd (Association) in 1923. Road Service began in 1924. In 1925, NRMA Insurance Ltd (Insurance) was established as a subsidiary to provide general insurance protection to the members of the Association, and in 1926 it was reconstituted as a separate mutual.

The NRMA Group therefore comprised two mutual companies, ie companies limited by guarantee, and their wholly owned subsidiary companies. As you are aware, a mutual company does not have share capital as ownership comes from membership which is based on acquiring a product or service rather than contributing capital.

In 1987, there was an integration of Association and Insurance under one chief executive officer and a new management

structure. It was thought that this would help the group and its staff to focus on providing integrated membership and insurance services and de-emphasise the growing differences between the two mutuals.

However, while it has been recognised that this structure did assist to develop an integrated approach to customer relationship management, it did not resolve the many corporate and membership structure issues which needed to be addressed.

The need for change

The Association and Insurance boards had been considering changes to the corporate and membership structure of the NRMA Group for a number of years. The growth of the NRMA Group, the changing profile of its operations and deregulation of the financial services industry in Australia resulted in the boards looking at a number of options.

Insurance had grown significantly over time and had become a complex general insurance business operating in a highly competitive market. Effective corporate governance was identified as fundamental to the future performance and success of Insurance.

Further, the skills and experience of directors was identified as being critical. The Association board was elected by its members. The Insurance board was appointed by the Association board with the majority of Insurance directors also directors of Association. This meant that commercial control of Insurance rested with Association since Association appointed the board of directors of Insurance.

In 1994, the NRMA Group failed in its attempt to demutualise both Association and Insurance. There was significant disruption to the activities of the boards, management and staff, and the business was adversely affected. The public perceived that the NRMA Group had lost its focus on serving members and customers. This perception was further strengthened by the



NRMA Group's financial performance in the 1995 financial year.

What were the risks to insurance of remaining a mutual?

The reasons for trying to demutualise did not disappear merely because a flaw was found with the process adopted. In early 1998, in an effort to maximise the potential of the group, both boards commissioned McKinsey & Co to report on a proposal entitled 'One Mutual', based on rolling the two NRMA mutuals (NRMA Ltd and NRMA Insurance Ltd) into one company.

As part of the report process, the Boards received legal advice in June 1998 that they were legally obligated to examine all options for structural reform open to the NRMA Group, not just the One Mutual proposal. The boards commissioned Credit Suisse First Boston (CSFB) to prepare the CSFB report on corporate, organisational and membership structures for the NRMA Group.

Five months later, in November 1998, CSFB submitted its report to the boards of NRMA Ltd and NRMA Insurance Ltd. The report contained seven options for structural reform and recommended Option 6, which was called 'Remutualisation and Listing'. This option involved retaining the mutual status of NRMA Ltd and demutualising and listing NRMA Insurance on the Australian Stock Exchange.

The proposal was developed with the assistance of a number of external experts, and importantly, the Association Board and the Insurance Board received separate legal advice.

Remaining a mutual left Insurance open to the following risks:

- The risk of a minority or sectional interest group of Association members seeking to exercise undue influence over the affairs of Insurance by achieving board representation or control. It was identified that the interests of

Association and Insurance members were different. Association members valued service, while Insurance members focus was on receiving a competitive price for their insurance needs. This risk was made worse because of the historically low participation of members in board elections and AGM's (between 5% and 10% until 1999 when there was an increase to 26%).

- The election process for director selection for the Insurance Board was inappropriate in view of:
 - the size and complexity of the business
 - the lack of a significant number of Insurance directors who were independent of Association
 - the inability of Insurance members to elect the Insurance Board.
- The risk of a takeover offer. The dual mutual corporate and membership structure of the NRMA Group failed to shield Insurance from a takeover offer. Further, it was recognised there was a risk that members may accept an unsolicited restructure proposal which could release less value than appropriate to members.
- The current size and complexity of the insurance market. A mutual organisation is established in the belief that a group of people can operate together to achieve and benefit greater than if they acted alone. Initially Insurance was established to provide low cost insurance to Association members. Today, to survive in the market the focus needs to be on being competitive for both product offerings and pricing.

Was this the only proposal?

There were a number of different proposals considered by the board. These included:

- **Creating a single mutual (ie merging Insurance and Association)**

This would have created one mutual with a single board controlling the NRMA Group. This would have addressed some of the corporate governance issues because there would be only one board, however it may have required a number of member categories to be established which would have added extra complexities.

- **Distribution of wealth through rebates**

This would have involved retention of the dual mutual structure with the distribution of a portion of the capital to members through rebates. However, the ongoing provision of rebates would have been unable to release as much value to members as the issue of shares, would have given little or no value to Association members who were not also Insurance members (ie 40%), and would have led to the establishment of a 'false' price expectation in relation to insurance premiums.

- **Full demutualisation and listing**

This proposal was put to members in 1994 but was suspended due to legal action. It was not the preferred option for restructure this time as the board felt that it failed to recognise the value which members assigned to the heritage of Association.

The proposal to leave Association as a mutual, but demutualise Insurance and then list a new holding company on the ASX was chosen. Ernst & Young Corporate Finance Pty Ltd was appointed to prepare an independent financial expert's report for Insurance members with respect to the proposal.

For Association members, Deloitte

Corporate Finance Pty Ltd was appointed. Pricewaterhouse Coopers were the consulting actuaries for the proposal. Both independent experts agreed that the proposal was in the best interests of the respective members.

The reasons for this were:

- demutualisation and listing would likely encourage a more disciplined environment for the management and direction of Insurance's affairs, due to increased scrutiny if the share price did not perform.
- members would have more effective corporate control over management because the stricter financial disclosure required by regulators would make it easier to assess how the company was being run.
- there would be separate boards and senior management teams for Insurance and Association allowing each to focus on the core businesses of their respective groups, reducing the potential for conflict between the interests of Insurance and Association.
- a close relationship would continue between Association and Insurance — it would be a commercial arrangement.
- there was no material reduction in the capital base of Insurance.
- shares were allocated to members allowing access to the wealth of Insurance.
- the rights of members were not affected and they were able to realise some value from the companies.
- there was a more limited potential for an unsolicited restructure proposal for Insurance which might release less value than appropriate.

Importantly, the boards also recognised that it was possible that the proposal might not be approved and so they also prepared a plan in case it failed. NRMA Group strategies were developed and implemented which were not dependent on the

success of the proposal.

How did they go about it?

As well as choosing a different solution to 1994, it was also decided to have each step in the process carefully monitored by submitting the process to the courts for review. The complexity of the changes to both the corporate and membership structure meant that a number of mechanisms had to be chosen for the proposal to be implemented. These included special general meetings of members, court ordered meetings in relation to court approved schemes of arrangement and a statutory demutualisation.

Briefly, the process followed was:

- Association altered its constitution — including imposition of a duty on Association directors to do everything necessary to implement the proposal.
- Association schemes — three schemes of arrangement were entered into by Association and Insurance members which allowed for the surrender of member rights.
- Insurance altered its constitution — including imposition of a duty on Insurance directors to do everything necessary to implement the proposal.
- Insurance members approved the financial benefits given to Association under the business relationship agreements.
- Insurance Schemes — Insurance members entered into schemes of arrangement under which members were to receive shares from NRMA Insurance Group Ltd.
- Insurance demutualised — Insurance changed from a company limited by guarantee to a company limited by shares. Insurance became a wholly owned subsidiary of NRMA Insurance Group Ltd and shares were allocated according to the share allocation rules published in the information memorandum issued

to all members prior to member approval of demutualisation.

- Insurance repealed its constitution and replaced it with the replaceable rules in the Corporations Law. Thus Association no longer had special rights as a member of Insurance and Insurance was permitted to pay dividends and return capital to members.
- Listing — NIGL was listed on the ASX.

The proposal could only succeed if the schemes of arrangement and the special resolutions were approved by the requisite majorities of members (ie more than 50% of the votes cast by members eligible to vote in the case of the class of members for each scheme and more than 75% in the case of the special resolutions before the special general meetings). If the companies had not been mutuals, the schemes of arrangement would have had to be agreed to by a majority in the number of members, and also by 75% of the votes validly cast on the resolutions. The key points were:

- the schemes of arrangement were approved by the Court and became effective and
- ASIC changed the details of Insurance's registration after its demutualisation.

As you know, all of these steps are now complete and as of 24 July 2000, there are two independent and unrelated corporate groups with separate boards of directors and management teams. NIGL then listed on the ASX on 8 August 2000.

Board committees of NIGL

With demutualisation came a reorganisation of the management structure of Insurance and its related companies. A number of the Governance Committees which existed prior to demutualisation have been reconstituted as they were joint



committees of the Boards of NRMA Ltd and NRMA Insurance Ltd.

The permanent committees of NIGL are:

- NIGL Audit and Risk Management Committee
 - comprises up to five non-executive directors from NIGL
 - oversees and monitors communications between NIGL Board and senior financial management and auditors
 - assists NIGL Board with reporting of financial information, accounting policies, financial management, internal control systems and business policies and practices.
- NIGL Board Committee
 - comprises up to five directors and the chairman of NIGL
 - considers all matters relating to corporate governance of NIGL and its subsidiaries
 - responsible for ensuring that NIGL Board continues to operate within corporate governance guidelines.
- NIGL Remuneration Committee
 - comprises the chairman of NIGL and up to four other directors
 - makes recommendations to NIGL Board for remuneration of the CEO and has the authority to approve the remuneration of the executives who report directly to the CEO.
- NIGL Compliance Committee
 - comprises up to five NIGL directors and the chairman of NIGL can also attend all meetings
 - reviews and monitors the effectiveness of management systems designed to ensure compliance with legal requirements (other than the financial reporting obligations for which the audit and risk management committee is responsible), recommends to the board appropriate systems

and procedures to ensure compliance with the requirements of applicable law, including the Corporations Law and Listing Rules, and monitors the adequacy of insurance cover obtained to protect NIGL and its directors and officers.

The ongoing relationship — ‘two NRMAs’

The close historical relationship which has existed between Insurance and Association continues through a series of contracts between Insurance, Association and NIGL. These contracts are referred to as the business relationship agreements (‘the Agreements’), and allow for both groups to continue to enjoy the benefits of cooperation.

There are six major Agreements covering the following issues:

- selling of the Association products through the shared use of NRMA Insurance branches, telephone service centres and website
- the scope of activities of the two groups
- use of the NRMA brand — Association is the owner of the NRMA trademark for motoring and related services; Insurance owns the NRMA trademark for use with insurance and financial services. Insurance is also licensed to use the trademark for certain other specific areas. Insurance and Association have also developed a set of guiding principles which are designed to ensure that it is always clear from which company a product or service has come. There has been strong emphasis on this as it is very rare for two companies to be using the same trademark.
- shared support services such as human resources, media relations and technology
- joint use of assets
- joint presentation of products — products or services may be presented together in a package

although clearly indicating their source

- cross-selling of products — each party is free to develop its own product strategies and product marketing programs, but products and services may be bundled.

The Agreements came into effect on demutualisation of Insurance. Alliance managers have been appointed by both Insurance and Association to manage the day-to-day operations of the Agreements. In the event that there is any dispute, both parties are required to continue to provide services under the Agreements while the dispute travels through the dispute resolution mechanisms of negotiation, mediation and then if necessary the courts.

Through these Agreements the parties have committed to strengthening the NRMA brand and ensuring that it remains a strong and well respected name, while recognising that they are now separate and unrelated organisations with different business interests.

What was the result?

It is clearly too early to say, however, we are confident that:

- the focus of the boards and senior management of both Insurance and Association will be squarely on their separate business interests which should assist them to maximise continued growth and success
- there will be a smooth transition in day-to-day operations as the alliance managers oversee the business relationships between the two groups
- the Agreements will ensure that resources are clearly and fairly allocated to each party through consultation.

Litigation and directors

This has attracted media focus and it was clear from the information

memorandum that not all directors shared similar views about the desirability or otherwise of demutualisation.

However, the bulk of the litigation between directors during my time at the NRMA Group (since mid 1998) was around the 1999 director's election which was itself seen at the time as a proxy for whether there was widespread support for demutualisation of Insurance.

The Members First team won all eight of the directorships available at the 1999 election and the new appointments to the Insurance board were fully supportive of demutualisation.


Litigation by directors then largely stopped after the 1999 election, with the exception of Richard Talbot who took up the opportunity to put his views to Mr Justice Santow at the demutualisation hearings and proceedings on related matters.

As you can imagine litigation by directors adds an extra layer of complexity to corporate governance. Our experience with litigation by directors has been that:

- dealing with the directors becomes more cumbersome as secretariat takes extra care to ensure that each director is given access to only that information to which he/she is entitled. Often requests by directors for information are referred to legal advisers causing further delays. This extra care to protect the interests of both parties often leads to further tension
- media coverage increases thus affecting public perceptions and increasing the pressure on the corporate areas
- general day-to-day operations are slowed as each step, conversation etc, is documented
- once before the courts, information which would not

normally be released is divulged and so public scrutiny increased.

In conclusion, the key lessons which can be taken away from the whole process are:

- the need for strict adherence to a proper governance process, getting separate legal advice on behalf of each company as well as the Project Solicitors and often, obtaining and arranging payment for independent legal advice for directors personally
- independent financial experts were critical to the success of the process as each signed off on behalf of the two companies that the restructure was in the best interests of the separate companies
- the maintenance of a co-operative relationship with the regulators and
- Court approval of each step of the process. 

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