Cosmo Gibson
Redress Policy
Strategy & Competition
Financial Conduct Authority
25 The North Colonnade Canary Wharf
London E14 5HS

31 March 2017

Dear Cosmo,

AFM Response to FCA consultation CP16/42, reviewing the funding of the FSCS

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

   - comment on the proposals in the consultation;
   - set out our concerns about the approach taken to subsidising intermediary costs; and
   - highlight the unwelcome consequences of the proposed approaches for smaller mutual and not-for-profit insurers.

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £16.4 billion, and employ nearly 30,000 staff[1].

3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses[2].

[1] ICMIF, http://www.icmif.org/global-mutual-market-share-2013
[2] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted

4. In addition, the Bank of England and Financial Services Act 2016 now provides an additional Diversity clause for FiSMA, to require the PRA and FCA to take account of corporate diversity and the mutual business model in all aspects of their work[3].

5. The problems of affordability and high failure rates in intermediaries reflects the limitations of current regulation more than the failure of the compensation scheme- brokers have low entry requirements; low levels of capital and a system of PI that has fallen into disrepair. This culminates in too many referrals to the FS Compensation Scheme.

6. Sharing responsibility for the entire distribution chain is a vital role for providers and intermediaries: providers should understand the channels they opt to use, and intermediaries should understand the products they sell, and the nature of the provider.

7. But that does not suggest cross-subsidy is inevitable or even valuable, and we are very concerned that FCA appears to have taken for granted that providers should contribute to failures by intermediary firms. The consultation appears to disregard or downgrade important principles like affinity, and mistakes the potential for a dampening in fluctuations in contributions for a reduction in volatility. There are some specific proposals which we consider have particularly adverse consequences for mutual and not-for-profit insurers.

8. The consultation paper begins to address some longstanding structural issues in FSCS, but we think it could have gone further: for example, it does not explore the future proofing of compensation, such as how will liabilities to FSCS change in future as a result of the impact of fintech; nor the nature of insurance and why continuity of cover rather than compensation is the key factor in resolving insurance failures; nor the risk of mis-selling under pensions freedom.

9. Our answers to the questions raised in the consultation are attached. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

[3] http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted

Responses to specific questions raised in the paper

Q1: Do you agree with the introduction of risk-based levies? Should we also consider other regulatory responses?

The vast majority of intermediaries act ethically and professionally. Only a small minority of firms fail, and result in a claim to the FSCS. But the failings of the minority to provide proper standards creates a reputational risk to the advisor community as a whole. There is a misconception that the polluter pays in the current FSCS levy system, but of course it is the decent and honest firms remaining that the compensation levy hits. As a result, if FCA and FSCS can identify clear causal evidence of behaviours that increase the likelihood of a failure they should act on them.

In our view, the scale of failures amongst intermediaries is an issue for a much wider regulatory response, rather than a simple tweaking of the levies for the FSCS. FSCS should remain the last resort and should not be relied on by FCA as the safety net for a failure to supervise. Hence, we consider greater attention needs to be given to each of five steps in maintaining a robust intermediary sector:

entry	• New authorisations, licences and permissions, to prevent individuals entering the intermediary market where there is evidence of past misbehaviour, or financial failing
supervision	• Scarce resources and light-touch supervision should be deployed strategically, to enable more effective detection of problems and early intervention
capital	• Low levels of capital requirements should be revisited, particularly where the consultation provides strong causal evidence between a deteriorating capital position and the risk of failure
indemnity	• The personal indemnity market is ineffectual: many intermediaries have inadequate or no PI cover, and policies leave too much freedom to deny a claim: if it is not possible to find a proper market solution, then FCA might itself construct a PI insurer
compensation	• Called upon as the last resort, for firms that fall through the net, in spite of an effective regulatory regime

Thereafter, we consider there is a case for exploring risk-based levies. The evidence provided in the consultation appears to suggest there is a correlation between the sale of riskier products and higher levels of mis-selling. As stated in paragraph 4.8, one in four non-mainstream pooled investments (NMPIs) are mis-sold. The regulatory response though needs to be proportionate: by inference, three-quarters of NMIPs are not mis-sold, and a better solution might be higher capital standards and more intensive supervision, rather than higher levies. Currently, FCA does not have the power to ban NMPIs.

Q2: Do you believe that risk-based levies could be appropriate in relation to: a) higher risk investment products; b) insurance brokers that choose to place business with unrated insurers; and c) any other types of specific products or services?

Paragraph 4.17 states "given the level of risk associated with placing customers with unrated insurers…". We believe this remark is unfounded, defamatory, unproven and wrong.

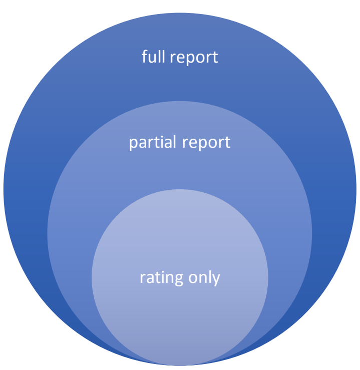
We thereby reject the possibility of introducing risk-based levies for brokers that use unrated insurers. FCA has provided no evidence in the consultation paper that brokers that use unrated insurers are more likely to fail; nor have they provided evidence that insurers that are unrated are more likely to fail.

FCA has indicated that in recent years it has dealt with a number of insurer failures, and that one thing many of these failures- like Enterprise or Gable Insurance- had in common was that they were unrated. But this is too narrow, they also shared: passporting from an overseas base, with resultant limited UK supervision, an inability to meet Solvency 2 standards, and severe capital strains that were only slowly addressed by the firm and the home country regulator.

FCA's comments appear to betray a lack of detailed knowledge of how the rating system operates, and does not address the issue of why large organisations like Bradford & Bingley or AIG failed when they did have a rating.

A rating might be used for various purposes for an insurer. Primarily, for a listed insurer, the rating provides investor confidence and allows the insurer to borrow money or raise share capital on good terms, or for part of their supplier relations. For AFM members, who are all mutual or not-for-profits insurers, and who therefore have no external shareholders, this need does not apply[4].

Rating agencies will provide up to three types of rating service for an insurer:



1. a full participatory rating service, with underlying detailed analysis involving the insurer, and a report for investor purposes, providing valuable insight into the organisation but at high cost;
2. a partial report, providing more limited information and analysis but on public data sources, with the report costing up to £10,000 typically for a small insurer; and
3. a rating only service, using publically available information with no underlying report. This is not commissioned by the insurer and so is used by the rating agency to build up industry data, promote the value of the agency and to encourage insurers to buy the other services.

[4] The government is progressing Mutual Deferred Shares through legislation, which may open up a market for external shareholdings in some mutuals in future. Currently, Royal London Group and LV= (who are not members of AFM) have corporate debt on the market for which they have provided a rating.

Large intermediary networks often require that a life insurer has a rating, to reduce their due diligence of the long-term viability of the company. Smaller intermediaries and non-life brokers have not traditionally sought the same information.

There are a range of agencies offering the first two, commissioned, services in the chart above, but we are only aware of AKG offering the third type of service in the UK. Since AKG does not operate to any great extent outside the life market, and intermediaries do not demand ratings for non-life insurers, there is no apparent market for ratings for small non-life insurers. In addition, many mutuals do not rely on third party distribution: some employ their own salesforce and many do not rely on advised sales at all. Distribution channels therefore might vary widely: some sell new products via direct marketing, some use non-regulated introducers, and a number rely on member-get-member schemes.

Most small mutual insurers do not as a result purchase a rating. The Annex to our response provides a full list of AFM members, along with their product lines, premium income (in 2015) and their corporate rating (where available). This confirms that only life and protection providers are rated by AKG: the ratings provided are largely in the third 'rating only' category above. There is no publically available data for other AFM members from other rating agencies.

Another issue to consider is that a rating, particular based on options 2 and 3 above, will only offer a simplistic view of the organisation's capabilities and strengths. Ratings agencies typically provide lower ratings to mutual organisations (including building societies) because mutuals do not have ready access to external capital.

Perversely, the rating is based more on this issue of access than whether there is any risk of needing more capital. All UK insurers must have sufficient capital to meet a one in 200-year event, which is very strong evidence of creditworthiness (as is required by Solvency 2/ the PRA). It is also true that many insurers with a credit rating have poorer solvency positions than those without one: for example, in the aftermath of the 2007/08 financial crisis, eight of the ten insurers with the highest free asset ratios were mutual. So a rating does not give the assurance of quality FCA appears to assume, and the absence of one is no evidence to the contrary.

In our view therefore, there is no justification at all for FCA to suggest that because an insurer is unrated, any broker selling their products should face extra levy costs. Indeed we view this as anti-competitive: were this to happen, we assume most good brokers would be less-inclined to use unrated insurers. As a result, in circumstances where the insurer provides unique or competitively priced products, consumers may no longer be able to purchase cover at reasonable terms. Mutual insurers would have to make significant and expensive changes to their operations, to suit the rating system- with no apparent benefit to their business or customers more generally. They might for example either have to withdraw from third party distribution, or to pay for a rating. Due to the inherent bias in the system, this may have no effect of the actual rating given, but would increase costs to policyholders.

We are equally concerned that the proposal from FCA infers that unrated insurers sell more risky products. We see no evidence of this amongst AFM members, and mutuals by their nature tend to be run in a conservative, risk-averse manner.

Q3: Do you agree in principle that product providers should contribute towards FSCS funding relating to claims caused by intermediary defaults?

We do not consider the economic case for this proposal is proven in the consultation. We note however that the policy is driven less by the normal rules of affinity and fairness, and more by a concern by FCA to ensure the sustainability of the intermediary sector. The proposal introduces market distortion and cross-subsidy beyond that normal permitted under FSMA, without a more reasoned and reliable business case.

We recognise that the high cost of FSCS compensation levies for intermediaries is unwelcome, and increasing costs have an impact on their bottom line. It is also inevitable that those costs are borne by firms that maintain high standards rather than those that fail. And as we state above, it is also the case that the level of compensation costs are a result of ineffective regulation, and underspend on capital provision and PI cover.

We would like to understand more clearly the scale of problem for intermediaries: within the consultation, paragraph 7.21 suggests strong growth of earnings, as the number of intermediaries paying the minimum fee has fallen by nearly 50% in the last five years. The average FSCS cost for smaller intermediaries is given as £750 a year, whilst paragraph 7.23 indicates that if a minimum levy of £850 were applied, then this would exceed the amount currently paid by 82% of firms. If, as FCA alludes to, the intermediary model is becoming increasingly less sustainable, the scale of current FSCS levies would suggest there are other issues with a greater effect on profitability, and that therefore the proposal is the wrong solution to a different problem. Otherwise, if an annual bill of £750 is causing firms to fail, then their financial robustness was already questionable.

The consultation draws on the issue of 'affinity', which FSMA recognises as firms with particular characteristics in common, in relation to the types of activity they perform. In this way, affinity provides the basis for how firms are arranged into particularly classes for the purpose of paying levies. Paragraph 2.6 suggests that the affinity principle is being revisited, to a) 'find out if it is possible to identify factors that increase the risk that a firm poses to the FSCS' (paragraph 2.38), and b) to 'better reflect the affinity between product providers and the firms that distribute their products' (paragraph 2.40). In our view, a) is not a question of affinity, and b) may not be compatible with the regulatory principles applied in FSMA.

The consultation paper largely assumes there is a strong and viable 'affinity' between insurance providers and brokers, though it does not explore this issue thoroughly to justify this new position. Where there is a relationship between a provider and distributor, it is initiated by the advisor who selects the preferred provider from the marketplace. Ordinarily, the advisor continues to own the customer relationship, and prevents any proactive engagement from the provider. For the provider therefore, the product sale is transactional rather than relational, and reactive rather than proactive.

We would agree that there is an onus on providers to understand the distribution channels they operate in, but this is different ordinarily from taking responsibility for the appropriateness of sales, or the rectification of mis-selling, if they are not actively involved in the sale. Where there is evidence of a provider being responsible in part for, or contributing to, misconduct or mis-selling by an intermediary, there are already powers for FCA to step in and take action against the provider to help rectify the situation.

Many AFM members specifically select against third-party distribution, and in so doing accept full responsibility for the customer relationship, and for the appropriateness of the product sale. They therefore have no affinity with independent intermediaries, who are not part of their value chain. These AFM members may have broker permissions already, and therefore any requirement to pay into the intermediaries' pot as a vertically-integrated provider would mean double payment.

Most AFM members sell a very narrow range of products: none for example sell pensions, so again it would be inequitable to include them in a compensation class that includes pension mis-selling.

More generally, the nature of insurance, and insurance regulation, is different:

- Insurers are very heavily regulated, with significant capital requirements that are designed to ensure they survive a one in 200-year event. It is estimated by Treasury that insurers have spent £2.6 billions complying with Solvency 2, and have enormous reserves of capital. This provides a very effective form of consumer protection.
- Sections 216 and 217 of FSMA relate to continuity of long-term insurance policies, and insurers in financial difficulties: FSMA highlight the different role FSCS should undertake in these circumstances- in particular in 'securing continuity of insurance for policyholders'. Historically, FSA has further avoided the risk of an insurance failure to FSCS, by encouraging white knight insurers to take over ailing companies (such as Royal London's acquisition of the life books of Royal Liver and Co-operative Insurance). This removes the risk of a default and claim on FSCS. Often the white knight incurs costs they would not have otherwise suffered, and this is generally recognised as being for the greater good.
- FSCS is focused on compensation rather than continuity of cover (as per paragraph 2.28), so it could be argued that on insurer defaults it is not always delivering the best outcome for consumers, because it is incentivised to seek compensation solutions that it can easily recover, rather than retention of insurance cover, which benefits the customer, but which incurs arrangement costs of FSCS which are not directly recoverable from the levy.

In sections of the consultation, such as paragraph 4.18, FCA infers there is an industrywide view that providers should subsidise intermediaries' levy costs. It appears that FCA is hiding behind phrases like 'some firms' and 'consulted industry' to justify their approach. However much of this engagement was conducted with the advisory sector only, through and following FAMR, so the views expressed are narrow, and it is disingenuous of FCA to suggest they reflect the views of industry as a whole. FCA should state more clearly when making such phrases that the views it reports are sourced from a sub-sector. This will help avoid misleading statements, and similarly where Q3 above is a closed question, FCA should avoid simply reporting the response by weight.

Q4: Do you have any views about the current effectiveness, or otherwise, of PII cover including in reducing the number and cost of claims on the FSCS, and about the role of PII in providing compensation to consumers who have claims against failed firms?

Q5: Do you have any views or suggestions about the possible features of more comprehensive, mandatory PII insurance? Do you have any suggestions about other possible tools, remedies or approaches which could be used to reduce the scale of funding currently required by the FSCS?

Q6: Do you have any views on the impact of a requirement on PIFs to hold more comprehensive PII? For example, what would be its impact on the PII market, the financial advice market and on consumers in general?

Professional Indemnity cover has been a necessary feature of the intermediary market for a long time. It is a valuable means of providing protection to intermediaries from claims of negligence. Whilst it is not therefore designed primarily to protect consumers, in circumstances where an intermediary fails and has insufficient capital to cover any losses, it helps to resolve the problems associated with that insolvency.

The PI market is currently operated by a small number of insurance suppliers, on a risk-based, economically-rational basis. Where providers see an increase in risk they will increase prices, and where purchasers (ie intermediaries) see prices increase they will be tempted to reduce cover or avoid taking out a policy altogether.

If, as stated in paragraph 3.8, PI premiums paid by financial advisers amount to just £50 million a year, there is perhaps little wonder that the policies do not provide adequate protection, when FSCS compensation costs suggest the true need for PI is unlikely to be met adequately by premiums of this order. By comparison, AFM member MDDUS provides indemnity cover to doctors and dentists (a need which is of course secondary to their main purpose) and collects premiums of over £80 million a year from their 44,000 members: ultimately you get what you pay for, and the FCA figures suggest the average cost of indemnity cover for each insurance intermediary is low.

In the litigious society we now see, it is more important than ever that professional firms manage risks properly. FCA adopts a relatively laissez faire approach to the PI market, which appears to have been as a result of problems in intermediaries finding cover in the past- but it is also a reason why the PI market does not manage risk as well as it should. This failure, combined with weak capital standards and limited supervisory focus, means more firms fall to the FSCS to resolve.

Were FCA to impose mandatory standards on PI cover, such as minimum levels of cover and a link between minimum capital requirements and policy excesses, this would help reduce the volumes going to FSCS, as long as FCA also takes action to help transform the supply side of the PI market.

FCA should engage with PI suppliers as a matter of urgency to explore how that market might work more effectively. In the unlikely scenario that suitable products do not emerge, FCA should consider how it can more meaningful influence supply, such as by providing PI cover itself.

To explore this issue further, FCA's work on its Mission cites the development of Flood Re as the basis for intervention in other markets, i.e. there might not be a market-based solution without intervention, and the same might be said of the PI market.

Additional features in PI cover, such as those covered in paragraph 5.12, appear sensible, though inevitably they will increase the cost of cover. Extra cost here though should reduce compensation levy costs, as of course at present the stripped down PI policies that most intermediaries purchase appear to have a direct impact on the higher FSCS levy costs they endure.

The same can be said of more effective capital standards for intermediaries. FCA analysis in Appendix 3 of the consultation suggests a causal link between a deteriorating capital position and the likelihood of failure. It is surprising therefore that FCA has dismissed the value of further action on capital requirements (in paragraph 3.3). We do not think the arguments here are cogent or consistent: for example, the view that high capital standards create a barrier to entry (in paragraph 2.9) disregards the imposition of high minimum capital requirements in other sub-sectors, and that this in part is supportive of the consumer protection approach. Equally, the dimensions of cost include internal compliance, audit and regulatory supervision; levels of capital; provision of PI cover: funding of FSCS: there is a direct correlation between these issues, so the costs of higher capital standards will be offset by savings elsewhere.

Q7: Would you support an increase to the FSCS compensation limit in relation to any or each of the investment provision, investment intermediation and life & pensions intermediation classes? If so, do you have any views on what those limits should be?

Q8: Would you support a proposal to differentiate between investment provision and investment intermediation, and to introduce higher limits for either? If so, do you have any views on what those limits should be?

Q9: Would you support a proposal to seek to make a distinction between pensions-related investment business and non-pensions investment business, and apply higher limits for pensions-related investments? If so, do you have any views on how the distinction might be made and what those limits should be?

With the threat that our members might be exposed to higher levy costs, as per the concerns we highlight above, we have taken a cautious view on limits.

The current compensation limits for investments looks very low, and from a consumer protection perspective, this appears to be without grounds. As the boundaries between different types of products become blurred, and their uses become more interchangeable (for example in relation to ISAs and pensions, or between cash and equity ISAs), there is greater justification in equalising limits.

We consider limits for investment products might be equalised with deposits, at £85,000, assuming FCA's proposals to increase that limit are finalised. We recognise this will increase the future levy but, all other things remaining the same, this gives more effective consumer protection. Indeed, based on figure 6.3, this would cover all investment provision claims and about 97% of investment intermediation claims/ 96% of life and pensions intermediation claims.

We would not agree with an increase to only investment provision claims, as the data in figure 6.3 shows that the low volume of provision claims means little additional consumer protection would be afforded. By comparison, leaving intermediation claims at their current levels leaves 3,517 claims affected, and this is the area in more obvious need of effective solution.

We agree with FCA that trying to identify investments used for retirement savings, and providing a higher level of protection that non-pensions investments would be difficult and unhelpful. With changing perspectives over time of what investments are targeted for, this would leave FSCS in a difficult position.

> *Q10: Do you have any comments about the possible risks to investors posed by crowdfunding and whether these might justify introducing FSCS protection?*

We agree with FCA that the risks here are low, and consider that the onus of FCA's attention should be on clearer disclosure.

> *Q11: Do you have any comments about the scope of the FSCS and whether promoting financial products, or any other activities, should be included within its coverage?*

Where such firms are outside the jurisdiction of FSCS, we consider FSCS should not use money of firms inside jurisdiction to compensate losses.

> *Q12: Do you agree that it would not be justified for the FSCS to utilise a credit facility to further smooth levies, given the costs involved?*

Yes, we agree. This is partly an issue of the costs of the exercise, but also that it introduces a degree of pre-funding that is unwarranted and beyond the current powers of FSCS.

In similar vein we are concerned that FCA has considered a product sales levy (paragraph 2.32). This is outside the scope of FCA powers, and the example of Insurance Premium Tax offered is not appropriate for reasons outside the scope of this paper. The same section of the paper suggests in paragraph 2.34, that an extra sales tax would incentivise providers to design products that are understood by intermediaries and benefit customers. This suggests some intermediaries sell products they do not understand and we do not consider this to be the case- at least in insurance, where the degree of financial engineering is low.

> *Q13: Do you believe that we should seek to reduce the number of funding classes, in order to reduce volatility of FSCS levies?*

We disagree.

Paragraph 7.7 refers to 'industry concerns' about variability: we consider FCA should be clearer that in this context it is referring to the intermediary/ broker community only. It is misleading, in common with many other parts of the consultation to imply that the financial services industry as a whole has experienced these problems or expresses this view. This is borne out by the chart in figure 2.5.

It is a function of a 'last stop' compensation arrangement that costs will be uncertain and vary, as the incidence of claims should be low where other parts of the regulatory system are working well.

Reducing the number of funding classes should reduce the volatility, because it increases the frequency of claims experienced in the new class structure. It does not address the issue of the severity of claims, which is the key issue. By necessity, widening the funding base also introduces cross-subsidy, as more firms are drawn into paying each claim, including those with little or no 'affinity' to the claim firm.

Q14: What are your views on the different funding classes we have set out here? Do you have any alternative proposals?

As per our previous comments, we are not persuaded that FCA has provided a logical and reasonable argument for changing the funding classes.

In particular, it is unclear what the basis is for assuming providers will be included in same funding classes as intermediaries. FCA has not properly argued the case for this, it has merely assumed it is the right solution. The proposal does not take account of how different providers have different business models: specifically with regard to providers that do not use intermediaries, either because they employ their own agents or only sell direct online or are closed to new business- in which case there is no case to say they share an affinity with intermediaries or that intermediaries' costs should be subsidised by providers.

With regard to intermediaries, the focus of FCA's analysis seems to be on the levy as a proportion of AEI, with an apparent desire to equalise this. However, the role and level of risk in investment and life and pensions intermediation is much greater than for general insurance: this is reinforced by FSCS's historic awards. Equalisation of AEI does not solve this disparity, it merely passes the cost of failure to a wider group of payees. If anything, this might increase the incidence of future failures.

In our assessment, each of Options 1 to 3 introduces payments from insurers to subsidise intermediaries- hence, the link between polluter and who pays in these circumstances is broken. The options reinforce the problem in trying to combine intermediary classes in a way that contradicts the nature of these businesses.

FCA helpfully provided some analysis in March of the impact on each of the options set out in chapter 7, of the recent interim FSC levy. The table is copied below, and broadly shows:

- In the current approach, the need for the supplementary levy is a result of the life and pension intermediation pool being fully utilised: the spillover is picked up widely across the pools, including those classes with little affinity. The cost to GI providers is much greater than their historic average, but well below the funding class threshold of £600m. The Life and Pension Intermediation class levy of £100m in 2016-17 is significantly greater that the long-term average of £44m, suggesting that the reasons for a significant redrafting of the levy may be an overreaction to a potentially short-term issue.

2017/17	Current Levy Before Threshold	Current Levy - Spillover	Current Levy - Total	Option 1	Option 2	Option 3
General Insurance Intermediation	*£8m*	*£8.21m*	£16m	£72m	£7m	£7m
Life and Pensions Intermediation	*£100m*	*£.00m*	£100m	£27m	£47m	£74m
Investment Intermediation	*£44m*	*£4.11m*	£48m	£36m	£64m	£31m
Home Finance Intermediation	*£21m*	*£1.09m*	£22m	£11m	£10m	£10m
Investment Provision	*£2m*	*£5.47m*	£7m	£17m	£28m	£14m
Home Finance Provision	*£m*	*£1.23m*	£1m	£11m	£11m	£11m
L&P Provision	*£m*	*£1.92m*	£2m	£17m	£31m	£52m
GI Provision	*£154m*	*£.96m*	£155m	£163m	£155m	£155m
Deposits	*£24m*	*£3.01m*	£27m	£25m	£26m	£25m
Total			£379m	£379m	£379m	£379m

- Option 1 introduces a significant shift in funding from the life and pensions intermediation class to, in particular, general insurance intermediation. The average rate for L&P intermediaries in 2011-16 was £81m, so a reduction to £27m seem counterintuitive. There are also transfers from intermediaries to providers. Equalising intermediary rates, by reducing the number of classes, does not address the issue of historic relative risk, and this is well-illustrated in the table.
- Option 2 passes some of the L&P intermediary levy to L&P and investment provision. Levies for many intermediary classes are more than halved- and for L&P intermediation return to the five-year average rate. Option 2 broadly assumes that the cost of failure of providers is paid for by providers, whilst the cost of failure of intermediaries is shared between intermediaries and providers.
- Option 3 offsets part of the home finance intermediation levy to home finance provision, and passes the reduced levy cost for GI and L&P intermediation to the L&P provision class. In common with the other Options, the levy by Deposit classes remains unchanged, and very low by recent standards.

The implied assumption, by introducing provider class contributions to the cost of failure of intermediaries, is that in some circumstances at least, where an intermediary fails, part of the blame falls to the providers which that intermediary used, because the intermediary did not fully understand the product they advised on. That defence raises questions about professional standards: whilst consumer protection has moved against caveat emptor, it is not clear that a caveat venditor defence is credible if a product has been mis-sold. There would be no such defence in FSCS rules for a provider that failed as a result of intermediary mis-selling.

An alternative option that FCA has not explored is to consider a point other than the first pound of claim, where provider contributions are made. This might mean FSCS can call on provider contributions earlier than at present, and at a point where the impact on the levy on intermediaries passes a level deemed unacceptable or unaffordable. This might involve either an assessment of the savings to the intermediary class of low capital levels and ineffective PI cover, or else where contributions paid exceed the previous five years moving average.

Q15: Do you agree with our intention to keep the current class thresholds for intermediary classes, merging the thresholds if appropriate to adopt a revised class structure?

Q16: Do you agree with our intention to keep our current class threshold of £200m for the investment provision class?

We agree with the intention to retain current class thresholds, but we do not agree the case for merging classes has been proved. We are content that the overall retail pool threshold remains the same.

Q17: Do you have any views on the idea of a fixed levy for smaller firms?

We do not see a case for introducing a fixed levy for smaller intermediaries.

Q18: Do you have any comments on the mechanism by which we would propose to incorporate product provider contributions into the intermediary claims classes, for the various different class structure options described?

Chapter 8 explores the proposed contributions of insurers and other providers to the costs of intermediary levies. It does not therefore set these contributions alongside their existing contributions. General insurers for example under options 2 and 3 would pay 100% of the cost of claims for general insurance provision, and 10% of claims for general insurance intermediation (up to the retail pool limits).

As we mention above, we would prefer to see an option where intermediaries continue to pay claims from the first pound without provider contributions, until the cost of claims exceeds the five-year moving average.

Taking option 3 as an example, this would mean general insurers pay 0% of the first £40m of general insurance intermediation claims, followed by 11.9% of the next £295m of claims (plus 100% of general insurance provision claims). Life and pensions providers would pay 0% of the first £44m of life and pensions intermediation claims, and 55.5% of the next £126m. These figures would be reviewed annually.

Q19: Do you agree with our proposals to include protection for client money for debt management activities within the scope of FSCS protection and our proposed funding arrangements?

Q20: Do you have any views on whether or not coverage should be extended to negligent advice provided by debt management firms?

No comment

Q21: Do you agree with our proposals to extend FSCS protection to structured deposits intermediation and to fund it through the Investment Intermediation and Investment Provision classes?

Yes

Q22: Do you agree with our proposed approach to provide FSCS protection for claims relating to fund management?

Yes

Q23: Do you agree with our proposed new approach to Lloyd's of London?

No comment

Q24: Do you agree with our proposal for a new reporting requirement on higher risk products in the RMAR?

Yes- and thought should be given to increasing capital requirements for these firms.

Q25: Do you agree with our proposal to remove the rule relating to paying FSCS levies by quarterly direct debits or should we consider other options?

No comment

Q26: Do you have any comments on our proposed class threshold and tariff measures for the new debt management claims class?

No comment

Q27: Do you have any comments on our proposed tariff measures and metrics for calculating the deposit taker contribution for direct sales in relation to structured deposits?

Q28: Do you have any comments on how, in future, we might calculate any provider contributions required from deposit-takers, in relation to structured deposits, if we were to consult in detail on this approach?

No comment

Q29: Do you have any comments on our decision to maintain the current tariff measures, except for life and general insurers?

Q30: Do you have any comments on our proposal to bring the tariff bases for insurers into line with the PRA's approach?

This appears appropriate and there is no evidence that the PRA tariff approach has produced any unfairness.

Q31: Do you agree with our proposal to require firms that must pay some of their FCA/PRA levies on account to also make a payment on account in respect of their FSCS levy?

We agree.

Annex: AFM members, with products, premiums and rating data

	ISA/ unit trust	Junior ISA	Tax Exempt Savings Plan	Pensions/ annuities	Income Protection/ Holloway	Health/ Medical & sickness	Other protection	Home insurance	Motor Insurance	premiums (£Ms, 2015)	AKG rating
Activities Industry Mutual							1			3	
Ancient order of Foresters	1	1	1			1	1	1		18	**c**
Anglo Saxons FS			1							0.05	
Benenden Healthcare						1	1			88	
BHSF						1				39	
British Friendly Society					1					6	**c**
Bus Employees Friendly Society						1				0.03	
Cirencester friendly					1					16	**b-**
Civil Service Healthcare Society						1				30	**c**
Compass FS			1							0.05	**d**
Cornish Mutual							1	1	1	21	
CUNA Mutual					1	1	1			1	
Dentists & General Mutual Benefit Soc					1					4	**c**
Dentists Provident Society					1					14	**b-**
Exeter Friendly					1	1				63	**b-**
Grand United Order of Oddfellows			1			1				0.01	
Health Shield FS						1				31	**b-**
Healthy Investment	1	1	1			1				14	**b-**
HSF Health Plan						1				25	
Independent Order of Oddfellows Manchester Unity		1	1							2	**c**
Irish Public Bodies Mutual							1	1	1	83	
Kensington Friendly Collecting Society			1							0.8	
Kingston Unity Independent Order of Oddfellows FS		1	1				1			9	**c**
Lady Grovers' Fund						1	1			0.1	
Livery Companies Mutual							1			3	
MDDUS							1			82	
Medicash						1				23	
Metropolitan Police FS	1	1	1			1	1			16	**c**
National Friendly	1		1				1			12	
NFRN Mutual							1	1		3	
Orchard Healthcare						1				0.01	
Original Holloway FS			1		1					5	**b-**
Paycare						1				7	
Pharmaceutical & General Provident Society					1					3	**c**
Plutus Health						1				0.7	
Railway Enginemens Assurance Society		1	1							4	**c**
Red Rose FS			1							1	**c**
Scottish Friendly Assurance Society			1							81	**b-**
Sheffield Mutual FS	1		1			1				13	**c**
Shepherds FS		1	1		1					9	**c**
Sovereign Health Care						1				11	
Transport FS		1	1							2	**c**
UIA Insurance							1	1	1	23	
UK Healthcare						1				0.01	
Veterinary Defence Society							1			11	
WHA Healthcare						1				3	
Westfield Health						1				57	
Wiltshire FS					1					2	**c**
TOTAL	**5**	**8**	**17**	**0**	**10**	**22**	**15**	**5**	**3**		