David Cheesman
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

12 January 2018

Dear David,

AFM Response to FCA consultation CP17/38:
FCA fees and levies, policy proposals for 2018/19

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; and
   - highlight areas we consider AFM should reconsider where they have more significant consequences for some firms, including some AFM members.

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].

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].

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

5. Our response focuses on the issues raised in Chapter 2, which of course coincide with a similar consultation from PRA (CP16/17), which we responded on in detail; our response is attached as an Annex below. Since FCA issued this consultation, PRA has produced its Policy Statement (PS28/17) and has made modifications to some of its proposals. In part these recognise that some of the proposed modifications, which FCA has mirrored in this consultation, may not have the desired effect, and we encourage FCA to adopt a similar approach.

6. In paragraph 2.3 FCA sets out its objectives for this consultation, stating that FCA aims that revised tariff data should "map as closely to the current tariff data as practicable". We agree with this, though we consider FCA should also have an ambition to ensure changes in actual fees payable by firms are not significant, and are consistent with the actual work undertaken, so as to avoid unfairly penalising firms.

7. FCA's objective of re-setting tariffs with limited change does not necessarily infer that the consequences for firms will be minimal, particularly where changes in tariff are amplified by changes to the weighting applied to those tariffs. Indeed, based on analysis we undertook with regards to PRA's consultation, which in part appear to have persuaded them to modify their approach, variations in fee can be significant, regardless of whether a firm is in run-off or not, and which are not justified by the level of activity undertaken. (Our analysis indicated AFM members might see increased fees of 45% and we do not consider this was appropriate for a firm which is not in run-off.)

8. We have responded to the questions raised in Chapter 2 below, and would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

Answers to specific questions in the consultation

Q1: Do you agree with our proposed tariff data for general insurers for us to calculate their FCA periodic fees from 2018/19? If not, why not?

We agree that the proposed tariff data is appropriate and relevant. The current tariff data is no longer relevant, and the proposals ensure that the FCA collects data based on valid measures of an insurer's size, and uses data which is already provided to it through regulatory returns.

We agree with the alignment between friendly societies (directive and non-directive) with insurance companies.

For some general insurers, the change in tariff may substantially change the actual fee payable. We would have liked to see some analysis from FCA on the range of outcomes for individual firms, and an agreement from the regulator to moderate changes in excess of a specified amount: for example, 20%.

Q2: Do you have any comments on the proposed weightings between premiums and liabilities for general insurers? Should alternative weightings be used and, if so, why?

We agree with FCA that general insurance businesses are primarily premium driven, and that as business is mostly renewed on an annual basis, the weightings should remain strongly weighted towards premium levels.

We were surprised and disappointed that PRA initially took a different view (which it has since reconsidered), and note that it had not presented evidence that the level of supervisory attention (between premiums and liabilities) for general insurers is sufficiently different to warrant a change to the weightings. Though even if it did, where PRA has a prudential responsibility that FCA does not for insurers, it is natural that PRA should have greater focus on liabilities in assessing the viability of an insurer and the risks it presents to policyholders.

Q3: Do you agree with our proposed tariff data for life insurers for us to calculate their FCA periodic fees from 2018/19? If not, why not?

We agree that GWP and BEL represent more relevant bases for setting tariffs.

We would have liked to see some analysis from FCA on the range of outcomes for individual firms, and an agreement from the regulator to moderate changes in excess of a specified amount: for example, 20%.

Q4: Do you have any comments on the proposed weightings between premiums and liabilities for life insurers. Do you believe alternative weightings should be used and, if so, why?

We are concerned that this proposal has not been tested on individual organisations to understand the changes in fees that will result, and whether these are fair. In particular, AFM's life members are well-established insurers who over the course of more than a century in business have accumulated considerable liabilities. In many cases those liabilities are from legacy product lines and represent either: levels of activity from a time where those businesses were considerably larger than they are today; or are a result of acquiring books of business from other friendly societies. With regards to the latter, in many cases, those businesses might have been acquired with encouragement from FSA/ FCA, where the society acted as a white knight for the wider good.

It is not evident from FCA's supervisors' activities that such organisations receive greater supervisory attention. Indeed, where AFM members are largely small and lower risk and are not directly supervised, levels of regulatory engagement are low. Hence, it would be inappropriate for FCA to justify increases in fees based on levels of supervisory activity that are not apparent.

We suggest that at this time FCA should take account of the conclusions made by PRA in their Policy Statement (PS28/17), where PRA has concluded the need for further consideration of options. Alternatively, we consider FCA should only explore altering weighting for fixed portfolio firms, where evidence of activity undertaken should be available to make a better-informed view.

Should FCA be able to collect more information about specific resource utilisation for life insurers that evidences a need to change weightings for flexible portfolio firms, it should return to this issue at a future time. We would be happy to support any analysis of this.

Q5: Should all non-Directive life insurance firms be exempt from FCA periodic fees, apart from the minimum fee?

We agree.

Q6: Do you agree with the proposals on sourcing the revised tariff data for insurers?

We agree.

Q7: Do you agree with our proposed tariff data for insurers and the proposals relating to the sourcing of the revised tariff data for us to calculate the CJ and VJ Financial Ombudsman Service annual levies from 2018/19? If not, why not?

We agree.

Annex: AFM response to PRA consultation on same issue

Alexander Zaremba
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

20 October 2017

Dear Alexander,

AFM Response to PRA consultation CP16/17, PRA fees and levies

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, and seek further clarity in certain areas;
- highlight significant changes that may result for mutual insurers if the proposals are taken forward without further consideration.

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[4].

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[5].

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[6].

5. The consultation proposes that where PRA has data available from Solvency 2 returns, it uses this as the basis for calculating relevant fees and levies in the

[4] ICMIF, http://www.icmif.org/global-mutual-market-share-2013
[5] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted
[6] http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted

future. We agree that this is the right approach, and that for non-Solvency 2 firms PRA retains existing regulatory returns.

6. PRA is proposing a change to both the definitions of data used to calculate fees, and the weightings applied between sources of premium and liability data. Where overall the intention is to collect the same fees in aggregate from industry, the focus should be on whether the proposed approach is more equitable, whether it resolves existing anomalies, and whether any new anomalies created are fair or need attention. Inevitably, in any adjustment there will be winners and losers, and we have focused on this issue within AFM members and more generally.

How do fees reflect risk and regulatory activity?

7. PRA regulates a relatively small number of insurers. The majority of those firms are in categories 4 and 5, as they are deemed to be small and/ or low risk; these firms are not directly supervised.

8. In our view, it should be possible for PRA to be relatively accurate in calculating the direct costs of supervising each cat 1 to 3 firm, and to derive an aggregate cost of supervising cat 4 and 5 firms. The consultation asserts that PRA fees are set based on the amount of activity and risk, but the commentary does not support this, and indeed the proposing weightings (75%: 25%) appear to be relatively arbitrary. We suggest PRA should offer a more accurate and considered approach.

9. PRA highlights that the proposed changes will produce some significant affects in some cases. It proposes to address these with 'relieving provisions', but as the basis for these is not stated it would appear a non-scientific approach will be taken. In the case of life companies, it is suggested the data is not available yet to accurately map these consequences.

10. This all suggests PRA's approach to fee allocating remains quite crude. Given the very high rate of regulatory fees and levies in the UK today, we would have expected more sophisticated modelling techniques to have developed over time.

11. In particular, it is not clearly established that using a straight line approach to fee calculations is valid. Where cat 4 and 5 firms do not have dedicated supervisory engagement, then the basis for fees and levies should reflect this, and not be linear. Should a firm move up or down between cat 3 and 4, it would see a noticeably difference in supervisory activity which is not reflected in the fees paid.

12. Instead, where the amount of activity devoted to a cat 4 or 5 firm is likely to be capped, we consider that PRA should cap the upper level of fees and levies collected. This would provide a fairer way of resolving anomalies than the 'relieving provisions' proposed in this consultation.

Basis of measurement

13. With regards to the definitions of data, PRA indicates that for *general insurers*, moving from annual gross premium income (GPI) to gross written premiums (GWP), and from gross technical liabilities (GTL) to gross best estimate liabilities (BEL), will not have a significant effect on the fees paid. This is because they represent comparable concepts, allowing for different treatments and definitions in Solvency 2. We have no evidence to indicate this assumption is wrong, though we would ask PRA to satisfy itself by mapping the impact electronically for all general insurers.

14. For *life insurers*, PRA proposes moving from adjusted gross premium income (AGPI) and mathematical reserves (MR), to GWP and BEL. We agree that AGPI is a less relevant measure today, and not one AFM has ever used in reporting or comparing member's relative scale. However, as alternatives to AGPI and MR, GWP and BEL may well be quite different for some life insurers, and the change in approach will produce some potentially significant anomalies. We would like to see some analysis from PRA that it has assessed each insurer individually to consider the implications and whether any differences are fair and reasonable: for example a large change in a measure may be because the previous measurers did not assess the risk involved of the firm, or the amount of activity undertaken.

15. For *non-directive general insurers* who are above the minimum threshold, we agree that the approach taken should mirror that for larger general insurers, and PRA should continue to use existing data. PRA should ensure though that in calculating premiums and liabilities for non-directive general insurers and friendly societies, it only includes those premiums and liabilities relating to regulated business. We agree with the proposal to align the fees of *friendly societies* with a general insurance business with those of other general insurers.

16. For *non-directive life insurers and friendly societies* with life business, PRA proposes all are moved to the minimum fee. However, for non-Directive life insurers, the 11% discount would be removed. This was only introduced in June 2016 via PS18/16, in response to AFM's feedback to CP10/16, which highlighted that PRA has unfairly penalised non-directives by raising all fees by the cost of Solvency 2 implementation fees. The grounds for that discount still apply, and PRA has not provided any rationale for removing it so quickly. We ask PRA to set out a clearer basis for increasing fees for this population and/ or to reinstall the discount.

Weighting between premiums and liabilities

17. Currently the weighting adopted in calculating fees for *general insurance* is 90% premium to 10% liability measure. PRA does not consider this reflects the amount of risk firms represent or the amount of work it undertakes. We accept that this might be the case, but would like to see evidence of how PRA's workload varies as a result of premiums and liabilities. At present the options set out in paragraph 2.17 do not suggest there is detailed analysis to support the

case. Equally, the potential fees set out in paragraph 2.18 for each of the options are based on GPI and GTL, rather than GWP and BEL, which reinforces the impression that the exercise has been undertaken too quickly and without thorough analysis.

18. Hence, whilst we accept the general argument to move to a weighting that more accurately reflects the amount of work undertaken, it is not possible to assess what that might be based on the incomplete approach taken. PRA has indicated in would welcome views on alternatives, and as we state before we would argue that it should be possible to produce much more accurate weightings based on solid analysis, even if these do not produce the neat roundings PRA favours in the consultation. If this means PRA should delay introducing its approach for a year, we believe this would be worthwhile, and would be happy to support any detailed exercise to provide a transparently fair solution.

19. For *life insurers*, PRA plans to changes the basis of data collected, and the weightings, with the latter proposed to move from 75:25 (premiums to liabilities) to 50:50. PRA concludes that moving to 50:50 will better reflect the use of its supervisory effort, but has not evidenced this.

20. The consultation states that it will use ‘relieving provisions’ to address any inequities, but that it expects these to be limited to ‘firms in insolvent run-off’. However, we explored the proposal in relation to our life members above the Solvency 2 threshold, who all remain solvent and viable, but where in some cases historically their business was much larger than it is today, and hence liabilities are relatively large where the scale of premiums today is relatively small. This produced a wide range of changes, based on approximates of the data PRA plans to use:

Fee change	frequency
Fall by more than 10%	14%
Fall between 0 and 10%	35%
Increase between 0 and 10%	14%
Increase between 10% and 20%	0
Increase over 20%	35%

21. Whilst the sample size is quite small and the data approximate, the results of our analysis indicate a much greater tendency for the proposed changes to produce significant increases in the cost of regulation. The range of change was -12% to +45%, comparing current and proposed splits. Since our members are all cat 4 and 5 firms, we can see no evidence that this is supported by a current mismatch between the levy paid now and the amount of supervisory work undertaken.

22. In fact, the main distortion seems to affect companies that have been in business longer, and who have therefore built up historic liabilities (as well as reserves to cover them). By contrast, failures in recent times have been more apparent in younger life insurers who would be expected to benefit from a reduction in fees under the proposed new weightings.

23. We also conclude that 'relieving provisions' will not be a satisfactory solution, and as we know, the relieving provision PRA made only 15 months ago for small mutual life insurers (as per paragraph 16 above), can be readily and rapidly removed without supporting evidence.

24. This supports our view that PRA should take longer to assess these changes, use real data to estimate impacts thoroughly, and introduce a cap for cat 4 and 5 firms to reflect the actual work undertaken by PRA supervisors.

FSCS Levies

25. Where PRA proposes to move to similar data sources for FSCS levies as its own, but retain current weightings, the comments above apply, and we do not feel we can offer a great deal of insight until PRA has more thorough analysis and accurate data available.

26. We offer no detailed comments on chapter 4 of the consultation, since none of our members operate an internal model. However, the scale of model application and model maintenance fees seems very high, and we would urge PRA to satisfy itself that there is no double counting of effort between these costs and normal supervisory activity.

27. We have no comments on chapter 5.

Indicative rates for 2017/18

28. Since drafting this response for review by members, PRA has published an additional note (13 October) providing indicative fees for 2017/18. The additional note is intended to assist life insurers in interpreting its proposals; however, the indicate fee rates for GWP offer a range of between £190 to £290 per £1 million of GWP, and this is too wide a range to provide any reliable or practical support.

29. We accept the challenge PRA is facing in determining accurate rates, due to the large number of reinsurance transactions that occurred in 2016. Given this, we suggest PRA's note reinforces our calls both to delay action to change the weightings used, and to adopt a fairer approach to fee setting for cat 4 and 5 firms, who will not have contributed in any significant manner to the transactions that are causing PRA problems in setting rates.

30. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Chief Executive
Association of Financial Mutuals