Mutually Yours,

January 2016

This month's newsletter is a little different from the norm. In March we will be returning to the format of a range of articles and member news, but this month's missive reflects a rather different AFM in general.

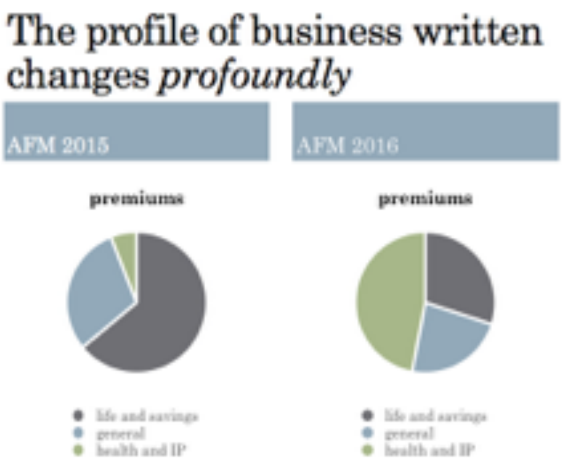
As you will know, AFM spent a good proportion of late 2015 determining its future direction. We held an Extraordinary General Meeting in November, which gave members the chance to vote on the future direction of mutual insurance representation in the UK. My thanks go in particular to Mark Goodale of Reliance Mutual for helping to structure the EGM process.

Generous proposals were put to our members by other insurance based trade associations, reflecting the wider trend for representative bodies to grow scale and reduce costs, as well as to provide a stronger and more co-ordinated voice. [The largest UK banks have recently set out their views on how they would like to see seven bodies integrated to improve the effectiveness of representation in their sector[1].]

Whilst some members saw the attraction of working with other parts of the sector, a majority of member companies supported the retention of an independent AFM. We duly gave the members a choice of whether to leave or remain (to adopt terminology from elsewhere); of 47 members, 38 decided to continue their membership of AFM. And our Associates have been broadly supportive as well: for a list of members, see the end of this note.

So 2016 brings some welcome certainty about the future of AFM, albeit with some notable differences:

- there is a stronger skew in our membership towards small mutuals, including 15 that are outside the scope of Solvency 2,
- the number of policyholders within AFM member companies now amounts to around 5 million, and
- there is a greater concentration of members in health and protection products than in life and savings.



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[1] see: http://media.wix.com/ugd/8fe067_6f600687adf24c3dbbfcdd88f470c1b1.pdf

Of course much of the culture and approach remains the same: AFM members remain committing to working in the interests of their customers; our Annotated Corporate Governance Code remains critical to the maintenance of high standards of governance in the sector; and we seek to inform regulators, politicians and other stakeholders of the importance of retaining a vital mutual sector.

We held a further members' meeting in January to explore what the changes mean to the priorities of AFM. Whilst this is being finalised, one thing that has become very apparent so far is the extra level of engagement from members, and the enthusiasm for finding new ways of working together.

We are also in the process of recruiting a new Board and Committee structure to lead our work in the future.

All-Party Political Group for Mutuals

Following the last general election, a new chair for the APPG was enthroned: Gareth Thomas MP. Gareth was a Minister under the last Labour government, and a Shadow Minister before the election; he also chairs the Cooperative Party and therefore has a long-held interest in mutuality.

At the first full meeting of the group, in December, AFM and the BSA were invited to provide an update on developments in the sector. I thanked the Group for its extensive support in the last parliament, and highlighted the recent growth in mutual insurers: premium income up 40% since the start of the financial crisis, against a 20% reduction in the insurance sector as a whole.

I also explained a particular challenge for healthcare mutuals, with the recent increase in Insurance Premium Tax. The chair asked me for a more detailed briefing, and a copy is attached.

The Group has agreed that its workplace for 2016 will centre on "*An All-Party Group Inquiry into financial services and the contribution that mutuals could make to help build a robust and competitive economy*". The Group will take evidence from a wide range of stakeholders as part of this work, and AFM is keen to support its funding, and is aiming to contribute research into the contribution the sector makes to health and welfare as part of the inquiry.

Mutuals Deferred Shares Act

The work to develop the secondary legislation that underpins the Act is nearing fruition. A consultation should be issued shortly by the Treasury, and it is expected that this will pave the way for mutual insurers to consider raising new forms of share capital next year.

Much will depend on the timing, as it is likely that there would need to be a change to the constitution/ rules first via the AGM- and members are already preparing their AGM packs. Another key consideration is strategy: the regulators would be required to approve the shares first, and would seek reassurance that there is a clear plan in place for using the new capital, and that it doesn't diminish existing members' policyholders' rights.

Bank of England and Financial Services Bill

Lord Naseby, who steered the Mutuals Deferred Shares Act through its early passages in the House of Lords, continues to speak up for the sector in the Upper House. As one-time Chairman of the Tunbridge Wells Equitable Friendly Society (which became The Children's Mutual) he has a strong understand of the need for balanced legislation and regulation.

In December, Lord Naseby secured an amendment to the Bank of England Bill, calling on the PRA and FCA to consider corporate diversity in the way they undertake their general responsibilities. This is a much deeper requirement than the current obligation to take account of any different consequences for mutuals as new rules, as it would commit the regulators to respect different business models through ongoing supervision as well as when consulting on new rules. I've met recently with PRA and FCA and offered to work with them to understand how this might affect their approach.

In the meantime, there remain shortcomings in the way PRA and FCA approach their current obligation to assess the different consequences for mutuals of new rules. We regularly highlight this with the regulators, who presume in most cases that the rules are the same and disregard the cost of achieving them. In my recent meetings with them, I used the analogy in the box below to illustrate this.

Rio 2016

In the aftermath of drugs scandals, various countries are withdrawn from the event, meaning that the final of one of the blue ribbon events is a straight race between Usain Bolt, and me.

As we line up for the start of the race, I make the point that whilst Usain has a straight 100m dash, I will be running 200m hurdles. The officials insist that as we both finish in the same place it is a fair race.

My protest continues that Usain is taller and fitter than me, and has expensive resources to draw on for help, whilst I start in a different place, and have lots of obstacles to overcome. But it is all to no avail, and Usain wins with ease.

My plight is much like that of a small mutual trying to comply with the same requirements as a large PLC. Whilst the end outcome might be the same, the journey may be very different, and this is seldom fully recognised in regulatory consultations.

Demonstrating high standards of corporate governance

The number of questions about governance issues has risen recently: a sure sign that members are busy preparing their latest report and accounts. The evolving process of improving the readability of accounts continues further this year, with a range of new governance and audit requirements.

Our governance newsletter published earlier this month highlighted some of these, and the main development this year is the production of a new viability statement. This sits alongside the confirmation of going concern, and takes a longer view of the prospects of the company. Much of the evidence auditors will be looking for on the reliability of the statement are found in the work insurers have prepared for Solvency 2, including the ORSA and reverse stress testing.

This is picked up further in this year's Annotated Corporate Governance Code questionnaire, which members are asked to complete by 30 June. Those ex-members who departed on 31 December are welcome to use the questionnaire this year, to help prepare their governance report.

Forthcoming AFM events (details to follow):

Spring:	NED conference
Spring:	Associates meeting
June 14:	AFM Tax Training Day
October:	AFM annual conference

please remember to share your news with me

Other AFM communications:

If you would like a copy of either of the Regulation Update or Governance Newsletter circulated earlier in the month, please let me know.

If you want to find our more about AFM, please visit our websites:

www.financialmutuals.org	for members and all professional contacts
www.AFMgovernance.co.uk	for corporate governance
www.funtosave.org	for young children, their parents and teachers
www.savingsquad.org	for 7 to 11 year olds, their parents and teachers

You can contact us by:

- Phone: 01472 852800,
- E-mail: martin@financialmutuals.org, and
- In writing: 7 Castle Hill, Caistor, Lincolnshire, LN7 6QL.

Impact of increase in Insurance Premium Tax on Health Cash Plans

Prepared by AFM for Gareth Thomas MP, Chair of the All Party Political Group for Mutuals

During the APPG for Mutuals meeting on 15 December, the chairman asked AFM to prepare a background note to highlight the impact of the increase in Insurance Premium Tax on Health Cash Plans.

The NHS is a key political issue today and will remain so for the future, with the costs of providing a comprehensive, world class service ever increasing. As insurers know all too well, whilst life expectancy has increased dramatically in recent decades, so too has the prevalence of illness, meaning that the cost of delivering healthcare is escalating at a dizzying pace. And of course when people are of work ill, the cost of welfare also increases and productivity falls.

Insurers provide an important role in helping to bridge the affordability gap, by taking some of the pressure off the state. A wide range of AFM members are involved in providing income protection policies to replace wages when someone is off work sick, or medical insurance to provide early treatment, or health cash plans, to pay for dental and optical care and a wide range of ailments. This is very consistent with the role that mutuals performed in the days before the Welfare State and the NHS.

Healthcare products provided by mutuals save the NHS many £ millions every year, by funding treatment. They also have an increasingly important role in rehabilitation that gets people back to work sooner, and in education and other aspects of living more healthily.

During the July Budget, the Chancellor raised the cost of Insurance Premium Tax by 58% (from 6% to 9.5%). The main focus was on home and vehicle cover and other quasi-compulsory insurances where insurers have readily passed on the higher costs to customers.

But there has been a significant consequence on mutuals, and in particular health cash plan providers. These policies generally have very low prices: often starting at a pound or two a week. They can be purchased by individuals to help manage healthcare costs, but they are also popular with small businesses where they are seen as a very valuable way of providing support to the workforce and in improving morale and staff retention.

Martin Lewis's Moneysavingexpert website states that *"used correctly healthcare cash plans allow you to recover these costs and can pay you back up to six times what you spend on them each year".* Health cash plan providers are specifically established on a not-for-profit basis, and their profits are ploughed back into the communities they serve via significant charitable donations.

All this does mean that it is a very cost sensitive product, and demand from consumers is price inelastic. So these small providers have found themselves having to foot large bills for extra tax: they are reluctant to pass the costs onto policyholders and small businesses, and therefore they face a real threat to their survival and to the charitable donations that are such a significant feature of the market.

The sector itself predicts that the total tax take from cash plans will reduce as a result of the higher rate, both because volumes of sales will fall but also because companies that buy these products will shield remaining policies via trusts.

Possible solutions

1. We've seen some local MPs write to the chancellor already suggesting health cash plans should be exempted from IPT; some competitor products are exempt and have a real price advantage now.

2. An alternative solution would be to reclassify the product, so that it is no longer treated as a medical insurance policy: which in the traditional sense of insurance a health cash plan is not, as you do not have to be ill to claim (you might merely have been to the dentists or opticians for a check up to receive a payment).

Impact

As we suggest above, the impact of removing health cash plans for IPT is likely to be cost neutral for the exchequer.

But for consumers and small businesses the benefits of making the product more competitive is that many more people will take action to manage their future health needs better, relieving many £millions of cost from the NHS and from welfare benefits. Equally, these changes will secure the large contributions made by the sector to charities.

AFM is undertaking further work to demonstrate the healthcare savings provided by the sector.

Action

It would be very helpful to our case if members of the All Party Political Group for Mutuals were able to contact the Chancellor to ask him to review the decision to impose Insurance Premium Tax on health cash plans.

For more information, please contact Martin Shaw, Chief Executive, Association of Financial Mutuals (martin@financialmutuals.org; 0788 754 7195)

About AFM

The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or 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.

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.

AFM members, 1 January 2016:

Anglo-Saxons Friendly Society	Lady Grover's Fund
Benenden Healthcare Society	Livery Companies Mutual
British Friendly	Metropolitan Police Friendly Society Ltd
Bus Employees' Friendly Society	National Friendly
C S Healthcare	NFRN Mutual, The
Cirencester Friendly Society Limited	Original Holloway Friendly Society Limited
Compass Friendly Society Limited	Paycare
Cornish Mutual Assurance	PG Mutual
Cuna Mutual	Railway Enginemen's Assurance Society Ltd
Dentists' & General Mutual Benefit Society	Red Rose Friendly Society Limited
Dentists' Provident Society Limited	Scottish Friendly Assurance Society Limited
Exeter Friendly Society Ltd	Sheffield Mutual Friendly Society
Foresters Friendly Society	Shepherds Friendly Society Limited
Grand United Order of Oddfellows Friendly Society	Sovereign Healthcare
Health Shield Friendly Society	The Oddfellows Manchester Unity Friendly Society
Healthy Investment	The Veterinary Defence Society
IPB Insurance	Transport Friendly Society Ltd
Kensington Friendly Collecting Society Limited	UIA (Insurance) Ltd
Kingston Unity Friendly Society	Wiltshire Friendly Society Limited

AFM Associates:

Architas
Baker Tilly
Barnett Waddingham
Charles Taylor plc
Deloitte
EY
Fidelity International
First Flight
Hogan Lovells International LLP
Investec Wealth and Investment
Keystone Law
KPMG
M&G Advisory
Mazars
Mercer
Milliman
Moore Stephens
Northern Trust
OAC
Pinsent Masons
Quilter Cheviot
Rathbone Investment Management
Red Crake
Redtag
Steve Dixon Associates
Towers Watson Limited
Vestra Wealth