



Karen Northey  
Asset Management and Funds Policy  
Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

29 September 2017

Dear Karen,

**AFM Response to FCA consultation CP17/18, Implementing asset management market study remedies**

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 explore the consequences for our members, where FCA is considering whether to extend proposals to other retail investment products.
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<sup>1</sup>.
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<sup>2</sup>.
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

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<sup>1</sup> ICMIF, <http://www.icmif.org/global-mutual-market-share-2013>

<sup>2</sup> Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

FCA to take account of corporate diversity and the mutual business model in all aspects of their work<sup>3</sup>.

5. We note that in paragraph 26 of annex 3, FCA's compatibility statement accepts that it has not actively considered the different impact its proposals might have on mutual societies, since they are not directly relevant. We note though that the consultation explores extending proposals for asset management into other retail investments in chapter 6. This is the area we are responding to now, albeit we recognise you will need to produce a further consultation in due course to explore the consequences for new audiences.
6. As mutual businesses, our members have no external shareholders, and are run entirely to support the best interests of their customers. The conflicts that FCA seeks to address in this paper do not apply therefore in the same way.
7. The nature of unit-linked and with-profits products are very different from authorised funds, and the regulatory regime for insurers is completely different too. Any attempt to overlay the proposed remedies for asset managers onto the existing regimes would duplicate current governance arrangements.
8. We can see no plausible reason why an authorised fund manager would try to circumvent the proposed new asset management rules, by setting up their retail products under an insurance shell, as suggested in paragraph 6.13. The added regulatory costs and complexity would be significant, particularly for with-profits contracts. Indeed, it would be virtually impossible for an investment firm to establish a with-profits fund.
9. Further, in relation to with-profits:
  - a. The consultation does not appear to recognise that with-profits products are at a relative competitive disadvantage currently from a regulatory and operational perspective, and that the new proposals will only narrow that difference marginally. Much of the higher costs of maintaining a with-profits product are covered in the consultation, and elsewhere in our response.
  - b. Some of our members maintain a separate With-Profits Committee, though on the whole product governance is maintained by the Board, and defined by the Principles and Practices of Financial Management (PPFM), and with the committee replaced by an independent NED. As per the UK Corporate Governance Code, the Board of a Solvency 2 insurer will have a strong independent presence, and is supported by the WPA. This means that product governance issues fall within the responsibility of the Board in small mutuals, and benefit from independent scrutiny via independent NEDs on the Board.
  - c. It is a concern to us that FCA states it does not have a 'full view of whether governance structures in with-profits funds are able to drive

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<sup>3</sup> <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

better outcomes for investors'. This statement presumably compares governance arrangements in with-profits with unit-linked contracts, but the language is vague and ambiguous. Equally, given the long-term nature of these arrangements, the risks they are intended to mitigate, and the close attention FCA has given to with-profits governance, it seems inappropriate supervisors cannot provide the 'full view' expected.

- d. We are also concerned that FCA appears to view all with-profits products in the same way. The nature of with-profits in a mutual is entirely different from that in a proprietary insurer: a mutual's with-profits fund also acts in most cases as the insurer's main or only source of capital; the management of a mutual is unable to divert money from the with-profits fund to external shareholders, as there are none; and the governance of the with-profits fund is consistent with that of the mutual overall. In light of these differences, investors in a mutual with-profits fund habitually enjoy greater returns on their investment, compared to either a proprietary insurer, or an equivalent unit-linked product<sup>4</sup>. Also as a result of these differences, first FSA, then FCA and AFM have had extended discussions over many years on the nature of with-profits governance in mutuals, via Project Chrysalis. In our view, the issues raised in this paper risk re-opening those discussions.
  - e. Further, many AFM members offer Holloway contracts. These are defined by FCA as with-profits products, though they are exempt from COBS 20. We would expect the same exemptions to apply to any changes made as a result of this consultation.
10. Where FCA seeks to address potential concerns it has with fund management, then AFM members, who all outsource investments, act in a similar fashion to investors, in placing their portfolio with an authorised fund manager. Our members all apply specific criteria to the investment decisions, and on using the right managers: for example many apply ethical and other screening to investments. However as small organisations our members do not tend to actively adopt stewardship principles.
11. This also means that any attempts therefore to impose similar requirements on a mutual insurer are likely to duplicate the effect, and the additional layers of regulation will make it more difficult for insurance products to compete. During the implementation of Solvency 2, our members had to liaise extensively with fund managers, to ensure they received the right data in the right format, for regulatory reporting and to produce their Solvency and Financial Condition Report. This led to some AFM members reviewing investment mandates to ensure their data requirements could be met. AFM also led negotiations on behalf our members with credit rating agencies, in relation to the licenses required to use ratings data. We successfully negotiated low, and in many cases zero, costs for members with certain

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<sup>4</sup> For example, our review in 2015 found mutual with-profits contracted returned on average over 20% more than an equivalent contract from a proprietary.

agencies and fund managers, and this has reinforced that approach of retaining effect fund managers.

12. With regards to unit-linked contracts:

- a. We consider FCA should monitor the market for unit-linked insurance policies after the implementation of its proposals for asset management. If the remedies do have a positive impact on reducing costs in asset management, then through competitive forces this might in turn promote cost reductions in unit-linked contracts.
- b. The nature of unit-linked contracts have some similarities to fund management. Historically, investment firms have set up insurance subsidiaries, and large life insurers employ similar techniques to fund managers. Recently, Standard Life and Aberdeen Asset Management announced a merger which infers more transfer and acquisition activity is likely.
- c. The vast majority of AFM members are not members of the ABI, and do not therefore formally apply the code referred to in paragraph 6.6. We do not consider it appropriate for them to apply that Code, partly because ABI did not consult with AFM or our members on its applicability to them, and because as a consequence the ABI code does not adequately take account of the differences in scale and ownership that make most AFM members distinct from those of ABI. We have not been able to review the ABI Code as the link from the consultation is broken, and/ or the guide has been removed.

13. AFM members apply the UK Corporate Governance Code, annotated for mutual insurers. This ensures there are robust governance arrangements in the round, albeit this does not have affect at the level of product governance, which instead is addressed predominantly by Solvency 2 rules, and FCA's COBS rules.

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

Yours sincerely,

A handwritten signature in black ink, appearing to be the initials 'AB' followed by a long horizontal stroke.

Chief Executive  
Association of Financial Mutuals