

## Consultation on expanding the dormant assets scheme: response sheet

### RESPONDENT INFORMATION

<p><b>Respondent(s)</b>  <i>When responding, please state whether you are responding as an individual, or on behalf of an organisation, multiple individuals or multiple organisations. Joint responses with like-minded stakeholders are encouraged. If responding on behalf of multiple individuals or organisations, please make it clear who you are representing and, if applicable, how their views were assembled.</i></p>	<p>Association of Financial Mutuals (AFM)</p> <p>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 £19.6 billion, and employ nearly 30,000 staff<sup>1</sup>.</p> <p>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> and to take account of corporate diversity<sup>3</sup>.</p> <p>This response is intended to represent the views of the 50 members of AFM; for more, see: <a href="http://www.financialmutuals.org">www.financialmutuals.org</a>.</p>
<p><b>Sector (if applicable)</b></p>	<p>Private</p> <p>Insurance &amp; Pensions</p>
<p><b>Future contact</b>  <i>May we contact you to discuss your response to this consultation, if necessary?</i></p>	<p>Yes</p> <p>Martin Shaw          Chief Executive, Association of Financial Mutuals  <a href="mailto:martin@financialmutuals.org">martin@financialmutuals.org</a>;          01472 852800</p>
<p><b>Date</b>  <i>Please ensure your response is received before 23:59 on 16 July 2020.</i></p>	<p>July 2020</p>

<sup>1</sup> ICMIF, <https://www.icmif.org/publications/market-insights/market-insights-uk-2016>

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

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

## RESPONSES

PLEASE NOTE: If you leave a response blank, we will take this to mean that you have no comment on that question.

### 1. Do you have any comments on the proposed scope of assets in an expanded scheme (subject to ensuring tax neutrality)?

Question	Response (delete as applicable)	Comments
1	YES	<p>We have previously discussed the scope of the proposals with DCMS and HM Treasury, who reiterated that it was not the intention of this consultation to expand scope beyond that which was previously established by the Commission for Dormant Assets.</p> <p>In Chapter 2 of the Commission's 2017 report<sup>4</sup>, a clear set of exclusions was set out. These included with-profits funds and mutual funds. We welcomed this conclusion, which mirrored AFM's 2016 response to the Commission's consultation<sup>5</sup>.</p> <p>The current consultation accepted the views of the 'Industry Champions', in proposing to exclude products that 'do not crystallise to cash', and in excluding 'mutual funds'. The 'Industry Champions' did not include any mutual insurers, and as a result the terminology used was imprecise. However, we consider that the intention expressed in their report<sup>6</sup> was consistent with the Commission's final report (and AFM's prior response).</p> <p>This would indicate that at a product level, the Tax Exempt Savings Plan (TESP), a form of savings endowment only available from friendly societies, would be included in the proposed exemption. TESP's benefit from limited, but valuable, taxation concessions, subject to the plan meeting legislative definitions and requirements. Hence, whilst the consultation suggests 'participants in their sector consider amending their practices, where possible, to enable crystallisation to occur', we conclude this would require a change to TESP legislation, via the Friendly Societies Act (which has remained unaltered since 1995) and HMRC instruments. The tax consequences also mean a firm could not contractually change the product design of pre-existing plans.</p>

<sup>4</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/596228/Tackling\\_dormant\\_assets\\_-\\_recommendations\\_to\\_benefit\\_investors\\_and\\_society\\_1\\_.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/596228/Tackling_dormant_assets_-_recommendations_to_benefit_investors_and_society_1_.pdf)

<sup>5</sup><https://financialmutuals.org/files/files/AFM%20response%20to%20Commission%20on%20Dormant%20Assets.pdf>

<sup>6</sup> [Dormant Assets Scheme: A Blueprint for Expansion](#)

		<p>In any event, should mutuals and friendly societies be excluded from the widening of the dormant assets scheme, this would avoid any need for a product level exemption.</p> <p>At an organisational level, we continue to believe that mutual insurers and friendly societies should be excluded from the extension of the dormant assets regime. Whilst the consultation makes no mention of mutuality, our view is consistent with the Commission's and the Industry Champions' reports.</p> <p>Our comments reinforce the different business model and economics of a mutual insurance company, compared to a PLC insurer, or indeed a building society:</p> <ol style="list-style-type: none"> <li>a. When a consumer buys a product from a mutual insurer, they will typically also become a member of the organisation. This means that in addition to their contractual rights as a customer, they assume ownership rights of the business. Those ownership rights may realise a monetary value only in certain circumstances; generally when the mutual business wishes to extract surplus capital and share it with members, or in the event of a sale or winding up of the business. Otherwise, the rights and value within the business are seen as being held in perpetuity, for the benefit of not just current, but future generations of members. Such rights may be lost if the member ceases to be a customer. Furthermore, the constitutions of friendly societies typically provide that membership rights are lost if a policy is assigned to anyone other than the original policyholder. Any transfer to a dormant assets fund will therefore destroy part of the value of the policy being transferred.</li> <li>b. The business model of mutuals means they tend to market and retain product lines that attract lower unit value for much longer than their PLC counterparts. This is because they can tolerate a lower level of profitability, because they do not have to generate short-term value to appease the market and to satisfy the need for dividend income from shareholders. Longstanding products held in a mutual are ring-fenced for future payout to the policyholder or their beneficiary, but their retention in the business improves the general efficiency and performance of the business as a whole. This has always been a feature of mutual insurers; policyholders will have bought their policies in the reasonable expectation that they will continue to benefit indirectly from the retention of assets allocated to otherwise "dormant" policies. To strip these out of the mutual would be counter to the regulators' objective of ensuring customers are treated fairly.</li> </ol>
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		<p>c. There are some other dimensions of mutual organisations that mean they are characteristically different from other insurers:</p> <ul style="list-style-type: none"> <li>• The proportion of mutuals that are small organisations is greater than the sector as a whole, meaning that proportionality is a key issue for our sector,</li> <li>• the value of their holdings are generally much smaller than PLC counterparts: for example, old 'industrial branch' products may only have a realisable value of £20, so that the cost of extracting the asset and undertaking the legal transfer would exceed the value of the product, particularly with the ongoing possibility that the mutual may have to re-appropriate the funds at a future time to pay a claim from the beneficiary,</li> <li>• in mutual organisations the costs of this work can only be derived from policyholder funds, so that impact is felt directly by all policyholders,</li> <li>• a with-profits mutual's common fund (or with-profits fund as it is known by regulators) houses the interests of members as policyholders, their interests as members, as well as the accumulated surplus/ capital of the mutual. These monies are not generally separately identifiable due to their long-term accumulation.</li> </ul> <p>d. Mutuals accumulate capital largely through generating an operating surplus: they do not have external shareholders to draw on, so they must act prudently to retain a strong capital base to take account of downside risks. The current generation of policyholders benefit from the intergenerational transfer which for most mutuals has seen capital accumulate across millions of customers over more than 100 years. It would be wrong therefore to attempt to extract funds today that have been accumulated over the long term and which are critical to the capital requirements of the mutual. A mutual risks failing PRA/ Solvency 2 rules if it undermines its solvency position.</p> <p>e. The financial regulators, PRA and FCA, has provided extra measures to recognise the nature of mutual capital, as well as the different ownership rights and customer rights which often sit in the same common fund within a mutual. Any approach to removing assets from the common funds would most likely need regulatory approval.</p>
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**2. Do you have any comments on the proposed definitions of assets?**

Question	Response (delete as applicable)	Comments
2	YES	Covered in 1 above.

**3. Are there alternative ways of defining the assets?**

Question	Response (delete as applicable)	Comments
3	YES	Covered in 1 above.

**4. Do you have any objections to excluding insurance products that do not crystallise to cash from an expanded scheme at this time?**

Question	Response (delete as applicable)	Comments
4	YES	We agree that insurance products that will not crystallise to cash should be excluded. Otherwise, the process of evaluating what amount to transfer will be difficult or impossible, and transferring at the wrong time (via a forced sale) will bring the scheme into disrepute.

**5. Do you have any objections to excluding pensions from an expanded scheme at this time?**

Question	Response (delete as applicable)	Comments
5	YES	No AFM member has a significant book of pensions business, but we consider that in general terms, pension funds should be treated like other long-term investments.

6. Are there any other assets that the government should consider for inclusion in an expanded scheme?

Question	Response (delete as applicable)	Comments
6	NO	

7. Do you have any comments on the proposed definitions of dormancy?

Question	Response (delete as applicable)	Comments
7	YES	Subject to confirmation that the scope excludes mutual insurance societies, we have no further comments on definition.

8. Do you have any comments on the proposed scope of participants in an expanded scheme?

Question	Response (delete as applicable)	Comments
8	NO	

9. Do you have any comments on the proposed reclaim values?

Question	Response (delete as applicable)	Comments
9	YES	The nature of investment return on insurance contracts within the scope of the proposals is likely to include products for whom accrued interest may not accurately reflect the change in value since the policy entered an ARF.

10. Do you agree that legislation should make reference to participants making proportionate and reasonable efforts, based on best practice within their relevant sector, to reunite the asset with its owner before it can be transferred into the scheme?

Please consider whether there are any other ways that suitable tracing, verification and reunification practices could be encouraged and enabled in participants.

Question	Response (delete as applicable)	Comments
10	YES	Subject to confirmation that the scope excludes mutual insurance societies, we have no further comments on reunification, except that to say mutual societies utilise proportionate approaches to reunification, but that for our sector, with a long tail of very low value products, this means the form of de minimus level as proposed by the Industry Champions (of £100) is a practical level.

11. Do you foresee any barriers to participation in the scheme or have any comments on its operation?

Please consider the feasibility of including eligible assets that are held within Stocks & Shares ISAs.

Question	Response (delete as applicable)	Comments
11	YES	Subject to confirmation that the scope excludes mutual insurance societies, we have no further comments on operations.

12. Do you agree that the existing practice in the event of a participant's insolvency should be extended to all assets in an expanded scheme?

Question	Response (delete as applicable)	Comments
12	NO	

**13. How could legislation on trustee, director or agent duties be amended to enable the proposed participants, as set out in Table 3, to take part in an expanded scheme?**

Question	Response (leave blank if no response)
13	

**14. What protections might a trustee, director or agent need in such circumstances?**

Question	Response (leave blank if no response)
14	<p>Subject to confirmation that the scope excludes mutual insurance societies, we have no further comments, except to say that as friendly societies are subject to their own legislation they would be excluded from changes to companies' legislation. However, mutual insurance companies are governed under the companies' act, so any change to primary legislation may need to carry over exclusions in scope.</p>

**15. What do you think the set up and ongoing costs of the expansion would be for participants?**

Question	Response (leave blank if no response)
15	<p>Assuming an exclusion for mutual insurers and friendly societies, we have not explored the costs of expanding the dormant assets scheme.</p> <p>We consider though that, whilst we expect members of AFM should be excluded from the changes to the scheme, this does not remove the obligation on them to take reasonable steps to trace lost policyholders and reunite them with their funds. There are limited options that provide a proportionate solution to this at present, and these start with writing to the last known address of the policyholder.</p> <p>We are encouraged therefore that pilot work on digital identities by the government might make this easier in the future, alongside proposals to develop best practice in tracing, verification and reunification. Even where our sector may be exempt from the dormant assets scheme, we would be keen to participate in any further co-ordinated work in this area.</p>

**16. What do you think the initial and ongoing benefits of the expansion would be?**

In particular, we welcome estimates from potential participants on the value, number and age of dormant assets that they currently hold and could transfer into an expanded scheme, as well as how these figures are expected to evolve over time.

Question	Response (leave blank if no response)
16	

**17. Are there any other significant impacts of the expansion that the government should consider?**

Question	Response (delete as applicable)	Comments
17	NO	Subject to confirmation that the scope excludes mutual insurance societies, we have no further comments.