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AFM Response to consultation on the mandatory climate-related financial disclosures

5 May 2021

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:
 - Register support for the Government's ambitious roadmap; and
 - Seek clarity on the scope of the proposals, and to highlight their consequences for small mutual insurers.

About AFM and its 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 £19.6 billion, and employ nearly 30,000 staff¹.
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 businesses² and to take account of corporate diversity³.

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

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>

Introductory comments

4. We applaud the leadership shown by the UK government on climate change, and recognise the imperative for business and industry to fully engage on helping the UK meet a challenging roadmap. We recognise that for the government to have confidence in the rate of engagement, more effective disclosures are critical.
5. As a trade association that supports small organisations with a non-standard business model, we have sought to regularly inform and support our members in understanding how they can effectively manage the financial risks of climate change. This has included provided tools to support implementation of rules from the Prudential Regulatory Authority (PRA), and an extensive series of webinars and panel sessions to share good practice and address common challenges.
6. Whilst our members have rapidly gained awareness of the financial risks of climate change, it has been difficult to gain consistent engagement with the various initiatives that government and regulators have put in place. This is because we have been overlooked in the development of industry working groups, such as TCFD, or the PRA/ FCA industry groups, which as a consequence have set out recommendations that display a lack an understanding of the mutual business model, and the impact on small businesses. As a result, mutuals are included in requirements for which they are not a key audience, or face unintended consequences because policymakers have not sought to understand how business models affects how a firm might apply new requirements.
7. To illustrate, the scope of this consultation is very ambiguous; for the purposes of contributing to the discussion therefore, we have responded cautiously, as we are not clear whether our members are in BEIS's intended scope. Further, on 29 April, AFM and the Association of British Insurers had a long-sought meeting with BEIS on the definition of a Public Interest Entity (PIE), to seek to explain how small insurers are currently caught in the scope of standards which have been set with very much bigger organisations in mind.
8. We would welcome further dialogue on scope to explore further in the context of these proposals. In the meantime, we have responded to a narrow range of the questions posed in the consultation.

Comments on the proposed scope (Q1)

9. The government's roadmap paper set out an expectation that all insurers would be brought into the scope of mandatory TCFD disclosures, at

some time around 2023 to 2024. Our initial reading of the scope in this consultation appeared to indicate that amongst insurance companies, only listed companies and those with more than 500 employees are in scope. AFM wrote to the PRA and FCA in April, on the understanding that this scope excluded AFM members, who all have fewer than 500 employees, and to ask whether and how the regulators planned to consult on closing any gaps in scope. The regulators have not been able to clarify the intended scope of the BEIS document, though PRA has confirmed it has no intention to consult on similar ground to close any potential gaps.

10. To explore this point further, the proposed scope of the proposals includes the following paragraph:

- All UK companies that are currently required to produce a non-financial information statement, being UK companies that have more than 500 employees and have transferable securities admitted to trading on a UK regulated market³⁴, banking companies or insurance companies (Relevant Public Interest Entities (PIEs));

11. We consider this is ambiguous and needs clarity. Subsequent paragraphs suggest the intended audience may be UK companies with more than 500 employees, and which either have transferable securities admitted to trading on a UK regulated market, or are a banking entity, or are an insurance company. However, the errant comma after the footnote reference 34 is confusing, and could be construed as suggesting the employee threshold only applies to traded companies.

12. Given listed insurance companies are addressed by separate rule proposals from the Financial Conduct Authority, we seek to understand from BEIS whether unlisted insurance companies with fewer than 500 employees (including all AFM members) are:

- a. all below the threshold of the roadmap (ie the roadmap was unclear), or
- b. outside the scope of this consultation (ie the consultation is unclear), or
- c. likely to be outside the scope of Public Interest Entity (as we have explored with BEIS in relation to their consultation on Audit), or
- d. to be subject to a further consultation from PRA/ FCA (though this may not appear be in their planning).

13. The ambiguity of scope is an unhelpful complication, and makes an extensive discussion of many of the other proposals difficult. Our advice to members therefore has been to assume they will be in scope, and will therefore be expected to meet mandatory disclosure requirements for year-end 2023.

14. However, we recognise that the small scale of our members puts them at a competitive disadvantage in meeting expectations for which they are a secondary target at best, and on which they were not consulted in the early stages of development.
15. To illustrate, a small mutual insurer is currently defined as a Public Interest Entity if it is within the scope of Solvency 2. The threshold for Solvency 2 is not based on employees, but is developed based on current income received, and past assets accumulated. One AFM member in the scope of Solvency 2 has a very simple business model, income considerably below the threshold, but assets just above, and is therefore defined as a PIE, even though it has only five employees. It is therefore likely to have to comply with rules which elsewhere the government has deemed are only applicable to a business one hundred times its size⁴. Each incremental compliance requirement adds extra stress on the business, and places additional cost on each of its policyholders.
16. In short, we consider that the scope is unclear. Even if we assume the paramount threshold of this paper is 500 employees, that suggests there remains a group of organisations with fewer than 500 employees, who may still be in the scope of the roadmap, for whom a further consultation, either from government or regulators is necessary.
17. Alternatively, where the consultation appears to assume that a PIE with fewer than 500 employees (regardless of whether it is a traded entity, a bank or an insurer) is outside the scope of non-financial disclosures, we suggest the definition of PIE is revised to coincide with the working assumption of BEIS, as set out in this consultation.
18. If our members fall outside scope of this consultation, and fail to receive remedial attention by government or regulators, we would not expect this to diminish our appetite to act on climate change, and on the value of reporting publicly on what we are doing to mitigate the impact. As customer-owned businesses, we are entirely committed to pursuing the best interests of our customers, and our research increasingly demonstrates that people wish to buy insurance (and other products) from organisations they trust, which have a strong ethical base, and which are actively looking to support government policy on climate change.

⁴ The secondary threshold suggested in the consultation of turnover of £500 million is more than 100 times the organisation's income.

The nature of disclosures (Questions 4, 6 and 7)

19. We agree that the Strategic Report is the relevant part of the report and accounts for firms to set out their climate-related disclosures. We believe that reporting set at the level of the four pillars will be sufficient to meet the needs of most stakeholders. However, with regards to 'metrics and targets' we consider that the expectation should be more explicit that firms report on their actual performance against each KPI, and that they spell out what action is being taken to close the gap if performance is below target.
20. We note that many of the proposals are set out with reference to the current requirements of the Companies Act, and refer to expected changes to that statute. However, friendly societies are subject to separate legislation, which has not been extensively reviewed since 1992, and which may provide obstacles to those societies complying, unless there is a commitment from government to undertake a much-needed refreshing of the law relating to friendly societies.
21. 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 'MS', written in a cursive style.

Martin Shaw
Chief Executive
Association of Financial Mutuals