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AFM Response to PRA consultation CP16/21, Insurance Business Transfers

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 encourage PRA to explore further opportunities to ensure insurance transfers can be completed by small mutuals more effectively.

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>

AFM comments on the proposals

4. The consultation seeks to update PRA's approach to insurance business transfers, in relation to both Part VII of FSMA, and via the Friendly Societies Act 1992. We are pleased to confirm therefore that the proposals, which are necessary following the UK's withdrawal from the EU, are relevant to most AFM members.
5. We also recognise the relatively narrow policy base for this consultation, which does not consider or address many of the transfer issues raised in AFM's letters of April 2019 ("addressing obstacles to transfers in the sector"), or February 2021 ("transfers of engagement and overseas customers"). However, as we have had recent dialogue with PRA on these, and assurances of a response in the near future, we have not attached that correspondence to this note.

Proposals relating to consultation with EEA supervisors

6. We have no comments on these amendments.

Independent Experts

7. We agree with the proposal for PRA to take account of the capacity of an Independent Expert (IE), to produce a report on time and to the required standards. We also consider it would be useful for PRA to produce clearer guidelines on its expectations of a scheme report, and we consider this would save time and cost in the process. We note that in draft paragraph 2.33(3) of the Statement of Practice (SoP), the IE should consider a wide range of tools to consider the transfer; as we suggested in our April 2019 letter, for friendly society transfers, we would hope the PRA will continue to take a proportionate approach and not require an independent actuary's report under s88 of the Friendly Societies Act 1992, as the cost to the parties will often outweigh any benefit for members. Where a report is required, a shared report for both the transferor and transferee ensures there is less duplication of cost in undertaking any analysis.
8. We have previously observed (including in our April 2019 letter), that one of the major added costs to a transfer have been late interventions from supervisors: we consider that the proposed guidelines would enable the IE report to cover the information expected by PRA and FCA

in a more usable format, and thus reduce the necessity for supervisors to pose last minute questions.

9. We would appreciate clarity on PRA's thinking in paragraph 2.20 of the draft revised SoP, what forms of specialist or niche business may necessitate further specialist advice, given that this will already have been taken into account in appointing the IE. We would be wary of PRA seeking a further 'independent specialist' report, where that adds extra costs, and the nature of the business would have been considered in making the appointment.
10. The All-Party Parliamentary Group for Mutuals (APPG), in its report on the 'Inquiry into the planned demutualisation of LV=⁴', stated that:

“The main problem with the process of an Independent expert is that they are not independent enough. One criticism of this is that it's very rare for such an expert to oppose the logic behind a demutualisation. They are appointed by the leadership of the business seeking to demutualise and they are paid by that organisation - following a successful conversion they will remain in the market, available to work for other such businesses. It is simply not in their interests to advise against plans of a board. This is not to impugn their integrity but merely to point out flaws in the process.” (page 43)
11. AFM explored the role of IE in our April 2019 letter. We also established a working group this year, to consider the recommendations of the APPG. We concluded that the APPG's concerns with regards to the IE are valid, and we recognise the limitation that the IE opines solely on the proposal put in front of them. However, we also think it is important to rely on the professional integrity of the IE.
12. We note that the SoP considers the content of the IE's scheme report in a range of areas: paragraph 2.33 in particular seeks to broaden the scope of the review, though whilst this will address the concern about the narrowness of the report currently, in our view the high costs, and the time involved, makes it impractical for the IE to consider a wide range of alternatives. One other possibility might be to expand paragraph 2.30(11), (13) and 2.33(2A) of the SoP, to include the effect of a scheme on *members* of a mutual, as well as on *policyholders*.

⁴ <http://appgmultipals.coop/wp-content/uploads/2021/04/APPG-Multipals-LV-report-April-2021.pdf>

Friendly society transfers

13. Unlike some other aspects of the consultation which are prompted by Brexit, we note that the proposals around friendly society transfers are not a direct consequence of the UK departure from the EU, but of the need to address shortcomings in the current process. We welcome the intention from PRA to clarify its transfer process and the information to be provided to members, for transactions covered under the Friendly Societies Act 1992. We note the concerns raised by the APPG in relation to the information provided by LV= to its members. We also note that the PRA is constrained in the flexibility it can exercise on friendly society transfers by the legislative framework set out in the Friendly Societies Act 1992.
14. The experience of AFM members is that this framework has multiple shortcomings and, as the PRA will be aware, the AFM has made representations to HM Treasury about addressing those shortcomings, some of which are also touched upon in our April 2019 and February 2021 letters. We hope the PRA will support this exercise as we believe that the streamlining of the transfer process for friendly societies will be in the best interest of members/ policyholders and in furtherance of the PRA's insurance objective.
15. We accept the need to respond to policyholders that have made representations during the transfer process, and we encourage mutuals to respond constructively to representations from policyholders, both in respect of their role as policyholders, as well as their role as members.
16. We note however that in some circumstances, certain representations could trigger the need for wider member communications or even a further member vote (as per draft paragraph 4.6A of the SoP). Such outcomes would lead to very high additional costs, as well as delays, and may in some cases make the economics of a transfer unattractive, and therefore be detrimental to the interests of members in their capacity both as members and as policyholders. We would wish to see clear guidelines from PRA (and FCA) on situations in which this might be necessary, and other solutions available to resolve those situations.

Conclusions

17. Whilst this consultation has been described as being triggered by the UK's departure from the EU, the more significant changes- relating to the role of the IE, and expectations for friendly society transfers- are borne of practical experiences of supervisors in handling transfers in recent times. Whilst many of the proposals offer clearer guidance to

firms considering a transfer, it is surprising that the opportunity to engage more directly with industry prior to consultation was not taken up, particularly as AFM has written twice to PRA on obstacles presented by the regulatory approach to transfers.

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

Yours sincerely,



Martin Shaw
Chief Executive
Association of Financial Mutuals