



William Hewitson
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

1 November 2017

Dear William,

AFM Response to PRA consultation CP14/17, extension of SM&CR to insurers

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.
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 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.

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

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

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 FCA to take account of corporate diversity and the mutual business model in all aspects of their work³.
5. We accept the statutory obligation placed on PRA to extend the SM&CR to Solvency 2 insurers as set out in the Bank of England and Financial Services Act 2016. We accept also that it is appropriate to take the current model of SM&CR for banks as the working basis for insurers. We also accept that as well as Solvency 2 insurers, it is appropriate to include ISPVs and large non-directive firms.
6. However, there are some anomalies in the approach, and the style of PRA consultation, which relies on complicated and text-based, heavily-caveated descriptions, fails to make it easy for firms to understand the extent of its proposals. To provide some examples:
 - Paragraph 2.3 proposes the scope for extending Certification into insurers should rely on banking rules that apply to a firm's remuneration policy.
 - Paragraph 2.4 indicates all key function holders will be in a certification function, unless the function is a PRA S(I)MF, a FCA controlled function, or they are a NED. As a result, for many AFM members the list of excluded staff may be larger than the list included in this definition.
 - PRA's aversion to the use of charts, diagrams or tables does little to clarify this: the charts on page 141 and 142 are useful in this respect, but are buried unnecessarily at the end of the paper.
 - In short, whilst FCA is making strenuous efforts to improve clarity and understandability, PRA has plenty of scope to engage more effectively.
7. To interpret the confusing layers of explanation in the PRA paper and the possible contradiction with FCA's, we have adopted the summary chart produced by Herbert Smith Freehills⁴ (though would welcome any clarification from PRA if it feels this oversimplifies their position):

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

⁴ <http://sites.herbertsmithfreehills.vuturvevx.com/56/14793/landing-pages/extending-the-smcr-to-insurers.pdf>

SUMMARY APPLICATION OF THE NEW REGIME					
Category of person	Senior Managers Regime	Certification Regime	Regulatory References	Fitness and Propriety	Conduct Rules
Senior Managers, including NEDs performing an SMF	✓		✓	✓	✓
Notified NEDs			✓	✓	✓
Certified Employee* (incl a KFH who is not also a Senior Manager)		✓	✓	✓	✓
Other, non-Certified Employees performing a key function (PRA only)				✓	✓
All other employees (except ancillary staff**)					✓

8. PRA also intends to include material risk-takers as certification functions in large firms, though we believe this will not apply to AFM members, as this requirement is restricted to companies with ‘annual premium income (gross of reinsurance)’ of more than £1 billion or assets over £10 billion. PRA should be aware that since these definitions were introduced in CP8/17, a more recent consultation, CP16/17 proposed replacing the use of API with gross written premium (GWP), and we suggest the ensuing Policy Statement addresses this.
9. We agree with the application of conduct rules to employees in a certification function. We also agree with the requirement to notify PRA within seven days where disciplinary action is invoked in relation to a breach of PRA’s conduct rules.
10. We suggest the phrasing of paragraph 2.22 might be improved if the order of the four bullets were changed: the trigger for PRA to take action for misconduct should be that a firm contravenes a regulatory requirement, not that an individual occupies the role of senior manager. More generally though, we consider the copying across of the duties for individuals in banking into SS35/15 is appropriate.
11. We agree with the proposed changes to prescribed responsibilities to fit the new certification regime, and for the renamed ‘management responsibilities maps’, and for other changes proposed for Solvency 2 firms and large NDFs. We note the PRA-specific prescribed responsibilities place greater focus on firm culture: we agree that this is important, and would welcome more insight from PRA on what they consider an effective culture is in an insurer (given this is an area where FCA has recently been active, despite this not being a shared PR).

12. With regards to extending SM&CR to small NDFs, we note PRA plans to extend requirements for regulatory references. For very small organisations this will increase considerably the work required in appointing a new senior manager.
13. PRA has estimated in its cost-benefit analysis that the implementation of SM&CR (for firms that are not 'large') is likely to affect between five and seven individuals on average falling into a certification function. Costs are estimated at £50,000 initially, plus £25,000 annually. There would also be additional costs for extended requirements for regulatory references, and for updates to SoRs and governance (management responsibilities) maps. We also believe there will be extra training costs, to support staff in understanding changes to the regime.
14. We consider these costs to be significant, particularly where the benefits offered are limited. Many AFM members do not have an internal HR function, and as this is the focus of the additional costs, many firms will either need to outsource the work or recruit staff. We believe some of these costs would have been reduced if there was better coordination between PRA and FCA, including a joint consultation, as well as clearer agreement on roles and definitions.
15. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,



Chief Executive
Association of Financial Mutuals