Smaller Businesses Practitioner Panel
Financial Services Authority

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RESPONSE TO FSA CONSULTATION PAPER CP 12/38

'MUTUALITY AND WITH-PROFITS FUNDS: A WAY FORWARD'

DECEMBER 2012

13 MARCH 2013

Introduction

Members of the Smaller Businesses Practitioner Panel have taken a keen interest in developments of plans affecting the classification of with-profits funds in smaller mutuals. Without the regulatory permissions to separate with-profits funds in the business, firms with declining levels of new with-profits business have been facing closure. This is not in the interest of either the firms in question or its members/policyholders.

As such, we are strongly supportive of the FSA's recognition of the importance of this to the organisations concerned, and very pleased the regulator has developed plans to allow mutuals, who do not have access to court-sanctioned schemes of arrangement, to effectively separate their with-profits fund and continue to run business for the benefit of all their members and customers. We welcome this consultation and the opportunity to respond. Our specific comments are outlined below.

Executive summary

- We strongly support the initiative to allow mutuals to effectively separate their with-profits business
- However, we believe the proposal to affect this through regulatory guidance, requiring firms to submit a modification on an individual basis to the rules outlined in COBS 20, is not the most effective way in which to achieve this and will be unnecessarily costly. Our preference would be for a rule change in this area.
- The Panel would welcome wording in the Handbook to the effect that this exercise would not amount to a reattribution. We believe the current wording as proposed in the consultation contradicts the draft Handbook text.
- Smaller mutuals especially are also likely to welcome further regulatory guidance on best practice/regulatory expectations around how best to engage with policyholders on this topic.
- We further have concerns about the practicality of some of the proposals as presented with regard to the Solvency II arrangements on ring-fencing.
- Finally, we are not convinced as to the regulator's assessment of estimated costs to the business, and believe the costs are likely to be significantly higher than those outlined in the Cost-Benefit Analysis.

Detailed response

Q1. Do you agree with this analysis and do you think its conclusions are fair to with-profits policyholders and sustainable for mutual organisations?

As outlined above, the Panel agrees with the analysis that instituting an arrangement to allow mutuals to separate their with-profits business will be beneficial. Requiring a well-run firm to close solely because it is not writing much new with-profits business is detrimental for both the mutual and its members.

The proposal to allow firms to apply for an exemption from the rules would allow mutuals who would otherwise have to close to continue – and therefore improve the sustainability of these organisations and benefit members; however we believe that it would be more beneficial to affect this through a rule change (please see below).

We are also concerned that aspects of the proposed arrangement would not be practical if the Solvency II section on ring-fenced funds comes into effect. This would require firms to treat each fund on the books as a separate, ring-fenced entity for the purposes of capital. It is not clear that this has been taken into account in this policy paper, as the consultation also discusses i) whether and how mutual members' funds could act as support for the with-profits fund, and ii) whether it would be appropriate for certain compensation/redress costs to continue to be borne by the with-profits element of the fund as opposed to the mutual members' fund.

Q2. Do you agree with our approach to a proposed process for recognising mutual members' funds?

Although we support creating an arrangement to allow firms to separate out the mutual fund, we believe that the proposal to apply for a modification to existing rules, rather than for the regulator to implement a rule change, is not consistent with the long term nature of the underlying business. We note that the FSA states that 'waiver application costs are likely to be minimal'. We are not convinced this is the case, and note that the actual cost incurred for a waiver application will depend on the level of advice the firm will require. Professional advice can be relatively costly, and as the firms affected are often small, these expenses can end up being significant. We likewise note similar concerns in relation to the rest of the Cost-Benefit Analysis as presented – especially as relates to the cost of independent experts' reports, where our past experience of engagement has shown significantly higher fees than those estimated, but also in relation to the cost of sending out additional communications to members.

A process whereby a mutual has to apply for a modification to the rules could also involve practical challenges. The FSA states that 'the modification, if granted, will be time limited and therefore capable of being reviewed. However, it should enable mutuals to run off their with-profits business fairly and safely, so the regulator does not anticipate having to revoke or not renew a modification before that occurs'. However, it is uncertain how this would work in relation to longer term products. For instance, life insurance generally has a minimum term of 10-15 years. It is unclear what would happen to the new business that is written prior to run-off.

We would be interested to engage with the regulator to hear more about the rationale for the proposed arrangement, and the reasons why direct rule amendments were not proposed.

We also believe there could be more in the rules to clarify that this process will not amount to a reattribution. This process would involve a separation of the with-profits fund from the mutual members' fund, rather than individual with-profits policyholders choosing to leave. We welcome the statement in the consultation that this does not amount to a reattribution, but believe this is contradicted in the draft Handbook text which states that firms will still have to demonstrate that this will not amount to a reattribution. We would welcome greater clarity in this area.

Q3. Do you agree with the support elements we are proposing for the process and the principles outlined?

The Panel appreciates the recognition of the fact that a voting exercise to demonstrate majority approval for changes in this area is expensive (and often impractical) to run. We therefore support the proposal not to require firms to conduct such an exercise for the purposes of separating their with-profit fund from the mutual members' fund.

We also note that given that there may be policyholder interest, the regulator supports firms developing their own proposals regarding how best to ensure engagement and consultation with policyholders during this time. Although we support the intention to allow firms to tailor this to individual circumstances, smaller firms are likely to welcome greater guidance from the regulator around how this could be done or best practice in this area. A clear regulatory position and statement regarding this would also be helpful in ensuring consistency amongst supervisors when assessing individual firm arrangements.

Conclusion

In summary, we are very pleased to see the FSA respond to the past 6 years of lobbying on this subject, and consult on arrangements to assist firms in separating their with profits fund from their mutual members' fund. However, we believe it would be preferable for the change to be affected through a rule change, rather than requiring firms to apply for an exemption from COBS 20. We have also highlighted certain areas where greater regulatory clarification is required, and possible concerns around the cost assessments and compatibility of the proposals with Solvency II.