

Mutual deferred shares: response to the consultation on technical policy details

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Chapter 1

Introduction

- 1.1 This paper sets out the government's response to the consultation paper 'Mutual deferred shares: consultation on technical policy details', published on 4 August 2016. That consultation invited views on the government's proposed Mutuals' Deferred Shares Regulations which would allow mutual insurers to issue a new type of capital ('Mutual Deferred Shares (MDS)') created by the Mutuals' Deferred Shares Act 2015. The government is grateful for the engagement of stakeholders in this consultation.

Chapter 2

Summary of responses

- 2.1 The government received nine responses to the consultation. The respondents are listed in Annex A.
- 2.2 All respondents referred to one or both of two over-arching issues that needed to be resolved before MDS issuance could proceed:
- clarity on the taxation arrangements for mutual insurers that issued MDS – specifically, that the current taxation arrangements for mutual insurers would not change and that, if a mutual insurer issued MDS, it would not become subject to corporation tax
 - the need for ‘segregation of funds’ for ‘with-profits’ mutuals – that is, the segregation of a mutual insurer’s combined fund between members as members, members as policyholders and MDS investors
- 2.3 Although respondents took different views, their responses were clear that mutual insurers would require greater certainty on these issues before they would be able to issue MDS.
- 2.4 A summary of the responses to each question in the consultation is set out below.

1. Do you agree with the definitions and limitations of the two types of mutual deferred share (MDS)?

- 2.5 The majority of respondents acknowledged the case that MDS should qualify as restricted or unrestricted Tier 1 own funds under Solvency II but suggested that, nevertheless, the requirement could be excessively restrictive. These respondents noted that not all mutuals may need MDS to meet Solvency II capital requirements (e.g. they may use MDS to finance the purchase of a subsidiary rather than to serve as regulatory capital). They suggested that designing MDS to meet the requirements of Tier 1 own funds would make them less attractive to investors. Instead, such respondents argued that each MDS issuance should be judged by the regulator on a case-by-case basis.
- 2.6 The majority of respondents expressed concern that an issuer of MDS could only issue one type of share (that is, either ordinary or preference shares), indicating that it could be excessively restrictive. In relation to the possibility that multiple types of shares could confuse ‘less sophisticated’ potential investors, five respondents indicated that, as many listed companies were able to issue multiple classes of securities that could be bought by such investors, and that no similar safeguards are in place in these circumstances,

the risk of confusion among potential investors was low. These respondents suggested that requirements about making the features of each class clear to investors could be made subject to regulatory approval, on a case-by-case basis, rather than included in the regulations per se.

- 2.7 One respondent noted that the issue was linked to that of segregation of funds. Should a mutual insurer be able to segregate its funds, the proposed restriction on issuance of one type of share only did not seem justified.

2. Do you agree with the conditions for issuance of mutual deferred shares?

- 2.8 All respondents indicated concern about the requirement for segregation of funds. The proposed requirement for segregation of funds was viewed as excessively restrictive. For example, not all mutual insurers were 'with-profit' mutual insurers so the conditions were viewed as restrictive for 'without-profits' firms. In addition, respondents suggested that there was no single way to approach the issue of segregation of funds and to do so would be excessively burdensome. Respondents suggested that regulators approach the issue on a case-by-case basis.

3. Do you agree with the approach to defining distributable items?

- 2.9 The majority of respondents raised issues in relation to the definition of 'distributable items' as a distribution out of profits (available for the purpose) under section 830 of the Companies Act. A particular concern was the treatment of mutual insurers that are friendly societies for which the provisions of the Companies Act do not apply and for which this is a new concept.

4. Do you agree with the proposed features of ordinary mutual deferred shares?

- 2.10 The majority of respondents referred to their responses to question 1. Some respondents were content with the proposed features.

5. Do you agree with the proposed features of preference mutual deferred shares?

- 2.11 The majority of respondents referred to their responses to question 1. Some respondents were content with the proposed features.

6. Do you agree with the criteria and process for the regulators' consent?

- 2.12 Respondents agreed with the involvement of both regulators. Several respondents qualified their response by reference to responses to other questions.

7. Do you agree on the voting restrictions on mutual deferred shareholders?

- 2.13 Several respondents raised various technical issues relating to the clarity of the draft regulations. For example, these respondents questioned the drafting of the regulation for a restriction of 'the shareholder member being prevented from exercising their voting right as a shareholder member in relation to any vote or resolution in connection with a transfer of the issuer

for the purposes of demutualising the issuer'; they suggested that there should be more precise drafting.

8. Do you have any comments on the other provisions of the draft regulations?

2.14 Several respondents drew attention to the need for clarity/consistency regarding various definitions in the draft regulations. One respondent noted the risk of a 'tipping point' – that is, whether there could be, in relation to the relative size of MDS issuance, a potential threshold in relation to the point at which the 'not for profit' nature of a mutual insurer could be brought into question.

9. What upfront and ongoing costs would an individual mutual face to issue mutual deferred shares, and which of these are directly from regulations?

2.15 Various costs were indicated by respondents, including:

- the need to seek permission of members to change a mutual's rules
- legal and IT expenses
- costs of effecting a segregation of funds (if required)
- the need to engage expert advice (e.g. legal, actuarial and marketing and public affairs)
- costs of issuance itself
- costs of complying with market rules
- costs of maintenance of a share register

2.16 One respondent commented that the costs of issuance were likely to be very large and that MDS issuance would only be viable for a very small number of mutual insurers.

10. What quantifiable financial benefits would a mutual obtain from issuing mutual deferred shares, and which of these arise directly from draft regulations?

2.17 None of the respondents provided a quantified estimate of the financial benefits obtained from issuance of MDS. A few respondents indicated that the financial benefits would depend on the use of the funds raised and listed potential uses for MDS.

11. How many mutuals plan to issue mutual deferred shares, in what volume and how frequently?

2.18 None of the respondents indicated that a mutual insurer had a plan to issue MDS. The majority of respondents stated that other issues needed to be resolved before a mutual insurer could prepare plans to issue MDS (see paragraph 2.2).

12. Do you have any views on the potential tax implications of the issuance of mutual deferred shares?

- 2.19 All respondents indicated that certainty regarding the taxation treatment of mutual insurers that issued MDS was required; there was ongoing concern that a mutual insurer that issued MDS could become subject to corporation tax (see paragraph 2.2).

Chapter 3

Government response

- 3.1 The government has considered the issues raised by respondents carefully. Since the consultation closed it has held a number of meetings with mutual insurers and their representatives. Those meetings considered, in detail, the essential features that MDS needed in order for issuance to be a viable proposition for mutual insurers. During these meetings, industry representatives informed the government that mutual insurers would only issue MDS both if they qualified as Tier 1 regulatory capital and would not alter the tax treatment of any mutual that issued MDS. Following extensive work, it has not been possible to design MDS which meet both these criteria.

Next steps

- 3.2 The government has, therefore, decided not to lay the regulations. The government would reconsider its position if any material factors changed in the future.

Annex A

List of respondents

A.1 Responses were received from:

- The Association of Financial Mutuals
- Mutuo
- The Association of British Insurers (ABI)
- Price Waterhouse Coopers
- Barnett Waddingham
- OAC
- Liverpool Victoria
- Peter Bloxham
- NFU Mutual

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