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The All-Party Parliamentary Group for Mutuals

Inquiry into the planned demutualisation of LV=

April 2021

A Statement from The All-Party Parliamentary Group for Mutuals

The All-Party Parliamentary Group (APPG) for Mutuals

The All-Party Parliamentary Group for Mutuals has over one hundred members from both Houses of Parliament.

The purpose of the Group is to discuss and support mutuals.

Mutuo provides pro bono services to the APPG including acting as administrative secretary.

This short inquiry report was authored by Peter Hunt and Mark Willetts of Mutuo, in the interests of furthering the general understanding of the issues raised and facilitating a contribution from Parliamentarians, in the public interest.

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1. The All-Party Parliamentary Group for Mutuals Inquiry Panel

Listed below are all the Members of Parliament who participated in this inquiry.

Gareth Thomas MP - Chair
Harrow West

Steve Baker MP
Wycombe

Bob Blackman MP
Harrow East

Kevin Hollinrake MP
Thirsk and Malton

Tony Lloyd MP
Rochdale

Christina Rees MP
Neath

Lord Curry of Kirkharle

Viscount Trenchard

Lord Wrigglesworth

2. Introduction Gareth Thomas MP

The All-Party Parliamentary Group for Mutuals is disappointed to have to conduct this inquiry into the planned demutualisation of Liverpool Victoria. We have acted to investigate this issue because we believe that our inquiry is in the public interest.

We are motivated by a desire to shed light on the reasons for the proposed demutualisation because we do not believe that a strong case has been presented by the company's leadership to justify this drastic action.

Liverpool Victoria has a proud history of helping ordinary people. The former friendly society, set up 178 years ago to help working class Liverpool families avoid the stigma of a pauper's funeral, will have its future determined by a relatively small number of people. Regulators and courts will have more say than individual owner members and the company has ensured that a simple majority of those voting will suffice.

In order to help the ordinary owner members to weigh up the issue before them, we have collected evidence and conducted interviews with some of the key people involved. We note that every demutualisation of a financial mutual in the last 35 years has been driven by the board not by the members. Information is only provided to members by the leadership proposing the demutualisation, so we feel that there is an imbalance to be addressed.

We also remember the negative experience that demutualisation has brought to former members of mutuals, their customers and the wider economy.

Demutualisation is bad for members, for consumer competition and choice and for financial market stability. The UK economy needs mutuals. More importantly, customers need mutuals. It is incumbent on us all to ensure that individual mutuals play their part as responsible and well governed businesses. Our report highlights where we think the planned demutualisation of LV= falls short.

The sequence of events at LV=, where the company converted from a friendly society with assurances about its mutual status, and then was put up for sale less than twelve months later, requires proper scrutiny, and we hope that this Inquiry has added to the knowledge that members can draw upon.

I would like to extend my thanks to all of those who took the time to engage with this inquiry, either as witnesses or by making a submission.

I would also like to thank my Parliamentary colleagues from across the political divide, in both Houses, who participated in this inquiry. We have reached a consensus on our findings.

3. Timeline of events to date

21/3/19 Annual Results 2018 published, £136 m profit and announcement of plans to convert from a Friendly society to a Mutual Company Limited by Guarantee (CLG)

https://www.investegate.co.uk/lv-/rns/lv--announces-2018-full-year-results/201903210700195555T/

22/5/19 Special General Meeting approves conversion to CLG

https://www.lv.com/-/life/media/pdfs-lvfs/group/members/document-for-vote-1/sgm-resolutions--conversion--membership-changes.pdf?la=en&hash=5B144643185D852841E41ED0494496FD3024C1F8

31/5/19 LV= agrees sale of final 30.1% of General Insurance business to Allianz for £365m

https://www.lv.com/insurance/press/lv-agrees-sale-of-remaining-shareholding-in-lv-gi-to-allianz

11/12/19 Richard Rowney steps down as CEO

https://www.londonstockexchange.com/news-article/market-news/richard-rowney-steps-down-as-lv-chief-executive/14343975?lang=en

20/12/19 Mark Hartigan appointed CEO

https://www.londonstockexchange.com/news-article/market-news/lv-appoints-mark-hartigan-as-chief-executive/14357683?lang=en

19/3/20 LV= Announces 2019 Annual Results and publishes Annual Report to Members

https://www.lv.com/about-us/press/lv-announces-2019-financial-results

Mark Hartigan, CEO: 'As a mutual we are run for the benefit of our members and are pleased therefore to be able to transfer £127 million to the Unallocated Divisible Surplus and allocate a mutual bonus of £27 million to qualifying members. Our capital position is strong, and our Capital Coverage Ratio has increased to a very healthy 244% which includes the impact of the sale of the general insurance business. This takes our capital position above the top end of our risk appetite range of up to 200% and we are currently considering how best to utilise this surplus capital.'

'2019 was a pivotal year in the history of LV= and 2020 will be no less important. The full effect of the COVID 19 crisis is still to be understood but we are in an exceptionally well-capitalised position and as we face the challenges ahead, we will continue to work hard for the benefit of our customers and members.'

Alan Cook CBE, Chairman: 'Last year I said that in order to have more flexibility and freedom to compete, we wanted to make some changes to LV='s structure and composition. Fundamental to these was our plan to convert to a company limited by guarantee...I would like to reassure you that conversion to a company limited by guarantee does not alter our mutual status.'

'I am pleased that we were able to act swiftly in appointing Mark Hartigan as our new chief executive officer, effective from 1 January 2020...The board believes Mark is the ideal candidate to lead LV= as we move forward as a standalone life, pensions and investments business. He brings a wealth of knowledge of the life sector and has a strong track record of delivering financial success and business transformation in challenging and fast-changing market conditions.'

'We have achieved a lot over the last twelve months with the successful sale of the general insurance business and conversion to a company limited by guarantee. I look forward to supporting Mark and the executive team as they build on this platform to continue to serve our members, customers and partners.'

3/2020 LV= explores a sale of the business as it retains the services of Fenchurch Advisory Partners.

'The work - running through to the June Board meeting – focused on a strategic assessment of both organic and inorganic options open to LV= with a primary focus on what would be in the best interests of members. This entailed the evaluation of options from remaining 'as is' through to the consideration of third-party external investment. To support this analysis through April and May Fenchurch tested the market by contacting potentially interested parties of which twelve expressed an interest.'
LV= Supplementary letter to the inquiry, 29 March 2021.

11/6/20 Sky News Reports LV= is exploring an end to independence

https://news.sky.com/story/177-year-old-mutual-lv-explores-end-to-independence-12004979

'LV=, the former friendly society that is one of Britain's biggest financial services mutuals, is exploring a sale of its remaining operations in a move that would bring the curtain down on its 177-year status as an independent business.'

15/6/20 LV= issues the first public statement on this story

https://www.lv.com/about-us/press/lv-statement-regarding-press-speculation

'The board of Liverpool Victoria Financial Services Limited ("LV=") notes the recent press speculation regarding a possible transaction in relation to its business.

LV='s Board is fully committed to maximising long-term value for its members and is therefore assessing a wide range of strategic options following the disposal of the general insurance business to ensure that the remaining business continues to be operated in the best interests of all its members. Some but not all of these options may involve a transaction with a third party.

No conclusions have yet been reached as to the most appropriate option to pursue and there can be no certainty that this review will result in any transaction being agreed or with whom.'

28/9/20 LV= Announcement to London Stock Exchange that it is in 'ongoing discussions with a number of companies.'

https://www.investegate.co.uk/lv-/rns/lv--reaction-to-media-speculation/202009280700082658A/

30/9/20 2020 AGM held. In private.

https://www.lv.com/-/life/media/pdfs-lvfs/group/agm/lvfs-agm-2020-09-30-minutes-vfinal.pdf?la=en&hash=65EEDCA4A42B919E29F9FF46C1ED0D7B3849FDA3

2/10/20 LV= Announcement to Stock Exchange that it is in exclusive talks with Bain Capital

https://www.londonstockexchange.com/news-article/market-news/lv-statement/14707281

15/12/20 LV= Agrees transaction with Bain

https://www.londonstockexchange.com/news-article/market-news/lv-agrees-transaction-with-bain-capital-credit/14793253?lang=en

15/12/20 LV= leadership writes to members for the first time, to inform them of the sale

https://www.lv.com/-/life/media/pdfs-lvfs/non-product/337782020-a-day-letter-v103-for-web-141220-2242hrs.pdf

3/2/21 LV= Member Virtual Event

https://www.lv.com/members/member-virtual-event

8/2/21 APPG for Mutuals decides to undertake an inquiry into the proposed demutualisation of LV=

4. Terms of reference for the inquiry

On 15 December 2020 LV= announced that it had reached an agreement on the terms of a sale to Bain Capital, a leading U.S. private investment firm specialising in private equity.

LV=, one of Britain's biggest financial mutuals, founded in 1843 and trading for most of its life as Liverpool Victoria, is well known across the UK.

LV= has justified its decision as follows:

'Having completed the sale in 2019 of the General Insurance (GI) business to Allianz – releasing the value and capital that we'd built over the previous decade in growing this franchise - it was clear to the Board that the business faced a challenge. The life and pensions market was becoming increasingly dominated by large insurers with access to capital. The scale of investment needed for LV= to remain competitive meant there was insufficient capital to both ensure the interests of with-profits members were met and support the investment needed for the future growth of LV=. Without investment the new business franchise would lose market share and eventually become unviable.

Ultimately, structured as a mutual, it is capital provided over time by our with-profits members which would be needed to fund this investment and growth. However, the time taken to deliver the returns means many with-profits members would not see the rewards before their policies came to an end – most within the next eight or nine years. We are also not able to raise further debt.

Early in 2020, with this in mind, the Board began a strategic review of the business. This was a comprehensive and rigorous process that had members' interests at its core.

Taking the investment required into account, the Board concluded that continuing 'as is' was not in our members' best interests. The Board then considered the option of closing to new business and running off the existing policies. This would have destroyed the value that LV= had built in its franchise over the years. After an extensive review against strict criteria, the Board decided that LV= needed to explore the option of seeking external investment from a third party.

In the Spring, we started a structured process to determine external interest in acquiring whole or part of the LV= business. Initially we received 12 formal bids from interested parties – a great testament to the attractiveness and potential of LV=. The Board explored each proposal thoroughly, with support from financial, legal and actuarial advisers, and compared options using a detailed assessment framework that had been shared with the Regulators. We narrowed the bids down to four by June. Following an extensive period of analysis with these parties, we further reduced this to two bids by the late summer.

Once we knew we could achieve an excellent financial outcome for members, in their statutory duty as directors, the Board also looked at other benefits the bids could bring to LV= and all our other stakeholder groups. These included our employees, the communities we serve and the opportunity to continue to operate in the life and pensions market.

Having considered these groups carefully, the Board came to the unanimous decision that the transaction with Bain Capital presented:

1. Benefits for all our members - giving them a one-off member payment and the opportunity for enhanced customer experience through long term investment.

2. An excellent financial outcome for with-profits members, who will see:
   - Enhanced returns as a direct result of the transaction through higher payments when their policies end
   - A ring-fenced with-profits Fund that cannot be accessed by Bain Capital and will be insulated from new business risk

– Greater certainty around costs, with a fixed cost schedule for both administration and investment management charges – particularly important in the context of a with-wrofits Fund with declining member numbers.

3. The continuation of our culture, values and ethos for our employees and the opportunity for them to be part of a growing business with a commitment to our three sites.

4. The opportunity to retain the LV= brand in the UK life and pensions market – with significant investment that will benefit competition and customer choice.

The Board recognised that moving forward with this transaction meant LV= would no longer be a mutual – a decision that was not taken lightly. However, it is our duty to put the interests of our members first, and having completed a robust and rigorous process, it is clear that the proposed transaction with Bain Capital provides the best possible outcome for members.

As a result, LV= will continue to play an important role as an employer and provider of financial resilience to our customers today and long into the future.'[1]

The APPG for Mutuals is seeking to explore the reasons for the sale as well as its wider potential impact.

The APPG will consider, and is keen to understand:

1. The context of why at this time the status quo is not good enough, given LV='s brand strength, capital and momentum.

2. The impact that the sale will have on LV='s members, the insurance industry and the implications for competition and choice in financial services more widely.

3. The rationale that supported the decision by the Board of LV= to sell the business to Bain Capital, and whether other options were considered fully.

4. The motivation behind LV='s recent conversion from a friendly society to a mutual company, including how this is connected to the proposed demutualisation.

5. The wider legislative framework for Friendly Societies and Mutual Insurers, with a particular focus on barriers to raising capital, protection from demutualisation and attitude of Government and regulators.

[1] Written submission to this Inquiry from Liverpool Victoria (LV=)

5. Executive summary including recommendations

The spectre of demutualisation has not been seen in the UK since before the financial crisis. It is no coincidence that the idea of dismantling long established mutuals and accessing their legacy assets has been out of favour since that time. It seems that memories are short, and people need reminding of the negative experience that demutualisation brought to former members, customers and the wider economy.

The All-Party Parliamentary Group for Mutuals is therefore dismayed to have to conduct this inquiry into the planned demutualisation of Liverpool Victoria (trading as LV=). We find it perverse that at a time when mutuals are growing in strength in most parts of the world, we should witness the re-importing of this failed exercise in the re-allocation of intergenerational assets. Demutualisation is bad for members, for consumer competition and choice and for financial market stability.

The UK economy needs mutuals. More importantly, customers need mutuals. It is incumbent on us all to ensure that individual mutuals play their part as responsible and well governed businesses. Our report highlights where we think the planned demutualisation of LV= falls short.

Summary findings

1. It is very difficult for an individual member of LV= to be able to assess whether the demutualisation proposal is in their interests or not.

The lack of information provided so far means that no realistic judgement of the merits or otherwise of the proposed sale, can be made by individual members, regardless of their personal stake in the business. Yet the decision to conclude the deal with Bain has already been taken by the board. This is a problem because members are next required to vote on the proposal, inevitably on the basis of a recommendation from the leadership of LV=. It is impossible to assess any alternative routes for the firm when no information is provided to make such a judgement. As with all demutualisations, this is a major flaw in the process.

We can say, however, that the experience of past demutualisations is that members do not benefit from this change and that short term payments for loss of membership rights are soon recouped through higher costs and lower benefits, in a proprietary firm.

LV= says that it needs capital but will not disclose how much, or for what purpose. It has not shared even the outline of a business plan with members and it appears unwilling to do so.

The recent sale of the final part of the general insurance business to Allianz has strengthened the balance sheet significantly. In the space of one year, LV= has made a number of inconsistent statements to members in relation to its capital position. On the one hand, both before and after the Allianz deal was concluded, it stated that it is a well-capitalised business, but then on the other hand, that it is unable to raise sufficient capital as a mutual to continue trading independently.

Both statements cannot be correct. Indeed, had no deal for sale been reached, LV= itself indicated that it expected to continue as an independent entity.[2] Members would be forgiven for their confusion.

We cannot identify a ‘burning platform’ to force such a sale and found no evidence of any regulatory pressure to demutualise the business.

In deciding their vote, members are expected to rely upon the judgement of others who it could be argued have a conflict of interest. The directors and senior management at LV= are conflicted because they may have a personal interest in pursuing demutualisation.

Whilst members will find it difficult to judge the merits of the sale to Bain Capital, it is clear that for other stakeholders in this deal, the equation is more straightforward. Bain Capital is clearly interested in making a profit from the acquisition, through the implementation of

[2] https://news.sky.com/story/177-year-old-mutual-lv-explores-end-to-independence-12004979

the management's business plan. Executive management may well likewise benefit from enhanced remuneration and incentives attached to this and we might expect departing directors to be compensated for loss of office.

It is likely that the rewards to Bain and the leadership will dwarf any payments made to members. It is likely that the money for the payments will come from member's own money.

We were not convinced by the explanations proffered by Mr Hartigan or Mr Popoli for the demutualisation of LV= and its sale to Bain.

We regret that the sale to another mutual appears not to have been a possibility.

2. On the basis of the evidence available to us, we have concluded that the Leadership at LV= has not been open and transparent with the members about its intentions for the company.

Despite repeated assurances that there was no intention to alter the mutual status of the company, it is clear that plans were well advanced to seek alternative arrangements which could include a change of corporate status, if not a full demutualisation.

Not only will the business ultimately be sold to Bain Capital, a private equity investor in a full demutualisation, but LV= had been exploring potential sales to other non-mutuals at the same time as the company provided public reassurance to its members. The public pronouncements from the chairman and chief executive could arguably be seen as misleading by members. We do not expect any business to give a running commentary on matters in the boardroom, but in this case, the LV= leadership chose to re-affirm its commitment to mutuality at the precise moment that it had instructed its advisors to seek a purchaser of the business, regardless of its ownership status.

Indeed, the membership would have been completely unaware of what was happening had the story not been reported in the media, and even then, it took four days for LV= to make any public comment.

Equally concerning to us is the manner in which the company converted from a friendly society to a company limited by guarantee in 2019. Throughout this process, members were reassured that there were no plans to alter the mutual status of the business, yet just a few months later, it put in train the process which led to the demutualisation we are examining now.

Members accepted a change to a company limited by guarantee and accepted the executive team's leadership. They placed their trust in the leadership and can be forgiven for being confused by the mixed messages they have received.

The board has swung from praising its capital strength to justifying its demutualisation within the space of a year. We feel that this represents a pattern of behaviour where the leadership at LV= was less than candid with its members.

Bain confirmed that it has conducted due diligence on LV=, examining company information in detail including its forward plan, which Mr Hartigan described to the APPG as 'embryonic.'

Even now it appears the planned future owners of LV= have been given more information about the Board's proposed business plan and its alleged capital needs, than the current owners.

We are not convinced that either the board or the executive team genuinely have the interests of the current owners at heart.

3. The fact that the board will move ahead to conclude a deal with Bain Capital in advance of providing any meaningful information to its membership shows a disregard for the interest of members and a cavalier attitude towards the member governance of this business.

Mutuals are owned by their members and no one else. Boards are responsible to those members and must act in members' interests, but this cannot happen without the presence of trust and confidence which is built through transparency and shared experience.

The decision to demutualise the company through a sale to Bain Capital is of course a major step. Yet the level of information provided to members throughout was barely existent. Apart from public media releases and answers to some questions raised after the (privately held) AGM in September 2020, no information was provided to members. Yet LV= had instructed advisors to find a purchaser in March 2020.

The announcement of exclusive talks with Bain on 2 October 2020 and the finalisation of that deal on 15 December 2020 would have been a shock to most members. The first member event was not held until 3 February 2021.

The decision to hold the 2020 AGM behind closed doors with only the board and two employee policy holding members is an example of a missed opportunity to be open with members about these plans. Under the cloak of COVID-19 the leadership chose not to hold a normal AGM. The LV= approach was certainly legal, but definitely inadvisable, given everything that was happening.

In 2020, most UK mutuals, by contrast, held virtual meetings on the basis that they wished to involve members in the meeting still, even if they were prevented from attending in person. Even small organisations tended to record the meeting to allow members to watch it afterwards.

We might have expected the UK's second largest mutual insurer, in the throes of negotiating the sale of its business, that it had not so far justified to its members, to take this obvious opportunity to explain what was going on to its owner members. Instead, the AGM was held with 12 people in attendance, approved 14 resolutions, considered 31 questions, and lasted a total of 10 minutes.[3]

On the subject of good governance, we are concerned at the manner in which the leadership has sought to get around the preceding high standard of member engagement for such a major decision.

Previously, a turnout threshold of 50% of members was required to approve a demutualisation. Having reassured members that it was no longer necessary to protect the business from a small group of members 'intent on carpetbagging and demutualising the firm.' (regardless of the fact that any demutualisation had never been proposed outside a boardroom) and re-affirmed its commitment to mutuality, members placed their trust in the leadership and accepted the change. Less than a year later we are now witnessing a small group of executives and non-executives, intent on demutualising the business.

In a revealing excerpt from the only member engagement event so far, held on 3 February 2021, some weeks after the decision to sell to Bain was announced, the chairman Alan Cook CBE acknowledged the impossibility of achieving the board's objectives without having removed the higher threshold of member participation that had been prudently put in place some years before.

We expect a higher standard of openness from a member owned firm than we have seen and do not believe that LV= has been candid and co-operative with its member owners.

The current owners do not appear to have been given full and frank information at any point since March last year when the board launched a search for new investment on the board's rationale and plans for the future of LV=.

4. The planned demutualisation damages the diversity of financial services providers in the UK and weakens the mutual sector unnecessarily.

As the UK's second biggest mutual insurer, founded in 1843, LV= is an important business, for members and for diversity in the financial services sector. The loss of a large mutual to become yet another proprietary business

[3] https://www.lv.com/-/life/media/pdfs-lvfs/group/agm/lvfs-agm-2020-09-30-minutes-vfinal.pdf?la=en&hash=65EED-CA4A42B919E29F9FF46C1ED0D7B3849FDA3

means that it will lose its foremost purpose of serving the interests of its customers.

Apart from the benefits that a mutual option offers individual customers, who see an ever more homogenised corporate sector from which to choose, members can also rest assured that there is never a conflict of interests between customers and shareholders in a mutual because they are the same.

The popularity of this choice is reflected in the growth of mutuality around the world, particularly in insurance. Mutuality is, after all, the original form of insurance and this is reflected in high market shares for mutuals in major economies. For example, in the US and Japan it is around 40% and in France and Germany over 50% each. Yet in the UK, arguably the inventor of modern mutual insurance, it is only around 10%.[4] This has to be caused by more than market forces.

Policy, legislation and regulation all have a part to play in setting the business environment for mutuals. It is fair to say that this is not a high priority of HM Treasury or either of the two regulators.

It is clear that there is little policy focus on mutuals, which would translate into a broader understanding of the role that mutuals play in providing diversity and stability in financial services. This also impacts on legislation. The lack of flexibility in the Friendly Societies Act was given as the reason by LV= for its decision to convert to a company limited by guarantee in 2019. This started the series of events that led to this demutualisation proposal.

All legislation should be kept up to date, and any deficiencies in the Friendly Societies Act must be addressed so that it is not responsible for such consequences, intended or otherwise.

Similarly, the stalling of progress on implementing the Mutuals Deferred Shares Act has removed what would have been a useful option for LV= to consider as an alternative way of funding its business. All of these inactions have consequences that impact on markets and consumers.

5. Regulatory authorities do not appear to have so far acted fully in the interests of members, consumers and the wider economy.

We recognise that the regulatory authorities are expected to do a very difficult job in these matters, however, we believe that their attitude to demutualisation should alter fundamentally.

We were surprised that regulators had not undertaken any review of previous demutualisations in financial services businesses and their role in helping to create 'institutions too big to fail' before the financial crash. We felt that an analysis of who gained and who lost from previous demutualisations and the extent to which the long-term future of the businesses had genuinely benefited would be essential to informing policy. It is impossible to have a sophisticated understanding of the market without this information.

We were not convinced that the regulatory authorities understood, or were giving sufficient priority, to the significance of the part of their role that involves defending the immediate and long-term interests of the current owners of this mutual.

The role of regulatory authorities appears to be not to take any view on the appropriate ownership structure of a business seeking to demutualise. We believe that the presumption should be that it is bad for customer owned institutions to demutualise and the onus should be on proving that it is beneficial.

The current process of assessing the merits of this deal involves regulators, independent experts and the leadership of the mutual and the bidders. At no point does it involve the owners of the mutual, who are presented with a binary choice but supported only by a positive case for justifying it. No alternative view is either facilitated or communicated to members.

We were not convinced that regulators have a real appreciation of the importance of the different business approaches that mutuals and proprietary companies take, and how this

[4] ICMIF https://www.icmif.org/wp-content/uploads/2020/11/MMS-ENG-1.pdf

affects the behaviours of markets and impacts consumers.

It was interesting and encouraging that the regulatory authorities were supportive of the efforts to increase mutual insurers' options to raise capital. Clearly the blockage in this is more with the attitude of HMRC.

Recommendations

1. This proposed demutualisation must be urgently considered in more detail by parliamentary committees

With the limited time and resources available to this All-Party Group, we believe that we have identified a number of serious concerns related to the interests of members and the wider financial services market, but we are not equipped to pursue them further.

We believe the House of Commons Treasury Select Committee and/or the Economic Affairs Committee of the House of Lords should urgently investigate the proposed demutualisation of LV= and its implications for policy towards financial mutuals.

In particular we think these committees should consider the role of the board of LV= in proposing this demutualisation, and that the actions of the chairman and non-executive directors warrants further examination.

The role of so-called 'independent' experts (appointed and paid for by the leadership of the demutualising entity) to nominally decide how much current owners should receive and whether their wider ownership interests are protected, is a further area of concern which time and resources did not allow us to explore.

We also feel it would be beneficial for these parliamentary committees to explore the implications for future policy and legislation towards financial mutuals such as on capital raising, on regulation and whether the assets of mutuals built up over many generations should be protected from being taken over by non-mutuals, or that the incentives to distribute these assets should be curtailed.

The implementation of the Mutuals Deferred Shares Act 2015 should also be considered.

2. Legislation for friendly societies and mutual insurers is inadequate and must be reformed in a number of areas

As outlined above, the legislative framework for friendly societies and mutual insurers requires updating, particularly in relation to the flexibilities available to friendly societies and the capacity of both types of mutual insurer to raise capital.

New legislation should examine global best practice around demutualisation and enact changes that remove the incentives driving demutualisation by offering options for securing legacy assets.

3. The role of regulators in demutualisations should be reformed

We recommend that regulators should urgently review how they oversee the proposed demutualisation process to ensure that owner members have more information and more say in the outcome.

The issue that we see is that the regulatory approach seems entirely transactional. Both regulators have a responsibility to look at the overall impact on markets, but this seems to be a lower priority than assessing the narrow criteria of the transaction and the manner in which it is conducted. Much of what is assessed depends on the information provided by boards and management, which is always going to be partial. There is no voice for the owners in this process and this needs to be addressed.

There is less focus on whether the transaction is a good thing or has broader consequences, unintended or otherwise. In particular, the Financial Conduct Authority (FCA) should consider the impact that a changed business model will have on consumers, and actively seek to preserve the diversity of providers in financial services.

4. The Competition and Markets Authority (CMA) should give an opinion on the impact of this proposal on competition in the UK financial services industry

Beyond its own customers, the proposed demutualisation will also impact the wider insurance industry and competition and choice. For the market as a whole to work for the benefit of all requires that the various corporate models each enjoy the necessary critical mass, defined as the degree of market share necessary to enable that model to operate successfully and thus to provide real competitive pressure on the other players within the market.

The existence of mutuals in a market dominated by large profit-maximising insurers means that they are able to provide the only meaningful competition on the basis of service proposition and price.

We are concerned that this proposal will have a detrimental impact on corporate diversity and consumer choice and recommend that the CMA should investigate the impact it will have.

6. Mutual insurance today

Mutuals are businesses with purpose

Mutuals have played an important part in the development of the UK economy. From the earliest days, citizens have co-operated in business, combining self-help, with the common sense to work together for the common good.

Mutuals have been in business for the long-term, focused on their core purpose of serving their members and the wider community. They are important. They are home grown. They deliver competition and choice and spread the benefits of business far beyond investor shareholders into the wider population.

Mutuals are owned by UK citizens, pay their taxes in the UK and contribute to our nation's prosperity, yet too often their contribution to the UK economy and society has been overlooked. As a result, the level of appreciation of mutual business by government is surprisingly low, which has made doing business harder for these firms.

The UK needs the corporate diversity that these businesses bring, helping to spread risk, and build resilience. There is a new opportunity for economic policy to be re-cast in order to better manage markets, protect consumers and taxpayers as well as to promote sustainable wealth creation, for a fairer country.

Life and General Insurance

Friendly societies and mutual insurance companies are firms that are owned by their policyholders. The absence of a need to distribute money to shareholders enables them to offer better services to their customers, as they can afford to take a longer-term view in managing risk.

Friendly societies and mutual insurers:

- Increase customer trust and accountability
- Give consumers more choice and increase competition in insurance markets
- Contribute to corporate plurality and diversity
- Promote economic resilience and sustainability

Increase customer trust and accountability

Because of their different purpose, mutual insurers help to increase customer trust and drive greater accountability. Their members are their owners, and they have a degree of influence over the way in which the insurer operates.

Give consumers more choice and increase competition in insurance markets

Mutual insurers provide additional choice in the marketplace. They do not pursue short term goals and are able to provide stability and consistency in a highly developed market. They focus on delivering high-quality products, often designed with and for their customers/ members.

Contribute to corporate plurality and diversity

Mutual insurers' different business purpose permits them to pursue different business objectives which helps them contribute to corporate plurality and diversity. This contrasts with listed firms that require shareholder-led short and medium-term business strategies.

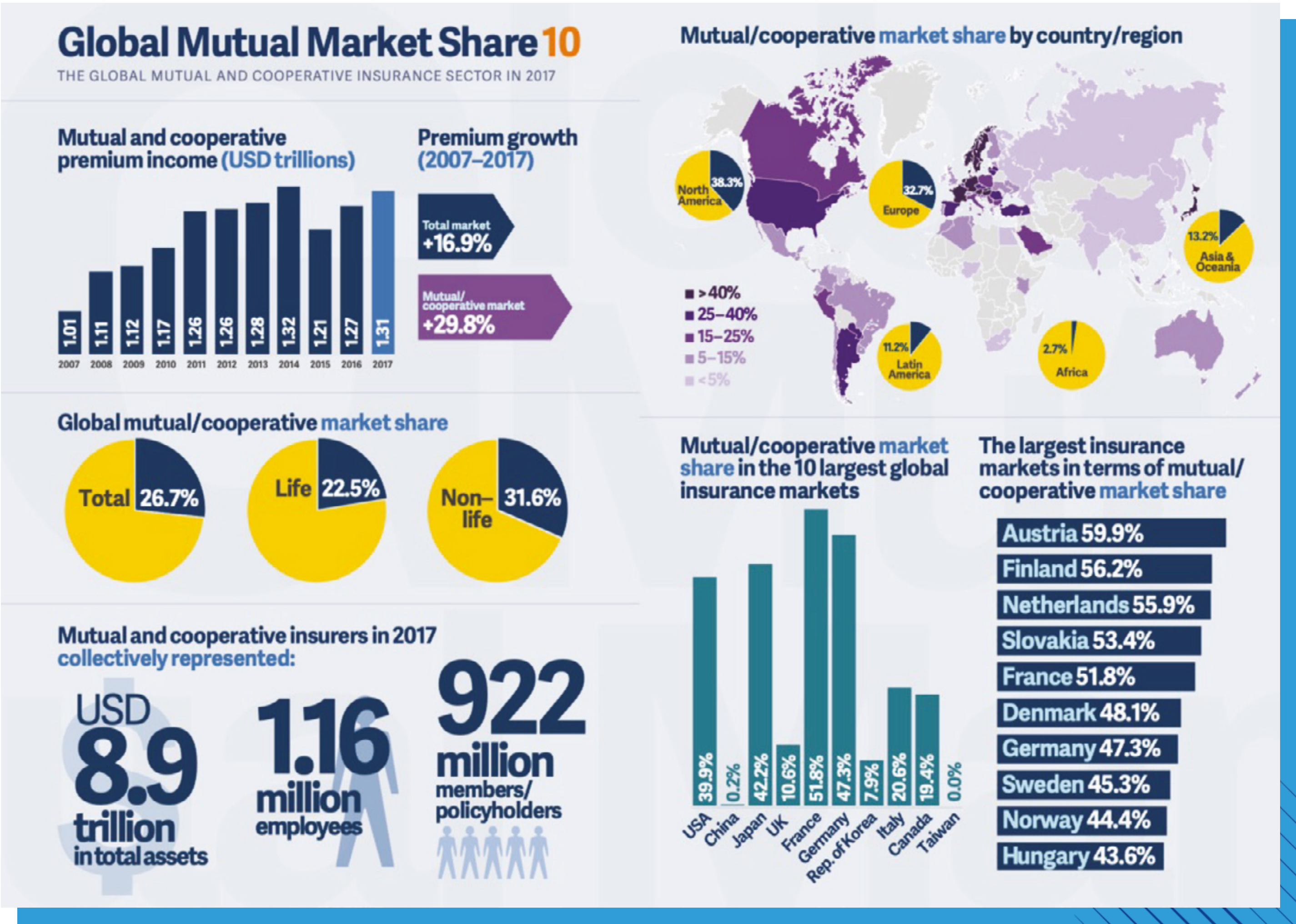
Promote economic resilience and sustainability

The evidence of the economic downturn is that mutuals and co-operatives have generally been more resilient than listed firms. Mutual insurers play an essential role in the global economy, especially in time of crisis, by combining profitability with solidarity; creating high-quality jobs; strengthening social; economic and regional cohesion; and generating social capital.

UK mutual insurance market share today is around 8%, with 80% plus of assets held by Royal London alone. The remainder of the market is generally small and specialist, with many enjoying strong growth in recent years.

Mutuality is very strong in many other countries. In many European countries, including France and Germany, mutuals make up around 50% of the market, whilst in Japan and even the US, the mutual market share is still over 40%. In some countries like Finland, around 56% of the insurance market is mutual.

Martin Shaw, Association of Financial Mutuals



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[5] ICMIF Global Mutual Market Share, www.icmif.org

> The mutual status of an insurance company is precious, creating value for customers of today and tomorrow. We believe that the relevance of the role that mutuals can play in the market is every bit as strong today as it has been historically. Customers have an increasing desire to be part of something that is a force for positive change in society; for example in the shift towards responsible investment. The benefit of this mutual ethos applies to all customers not just members.
>
> **Barry O'Dwyer, Royal London**

How important are mutuals to consumer choice and corporate diversity?
Mutuals in a market tend to keep it honest and working in the best interests of customers.

> A recent EU paper indicated that the proportion of turnover that is redirected to shareholders increased from 1% in 1992, to 4% in 2018. That means that mutuals have an advantage, because that economic value is retained in the business. It can be used to enhance value to customers and members, or to provide value to the community in which the mutual operates.
>
> - Mutuals provide better service and claims experience (e.g. Income Protection: 95% claims paid, versus 85% for non-mutuals in 2019).
> - Better investment performance (e.g. with profits payouts @ 25% better).
> - In 2008/9 mutuals proved resilient to the market falls and were able to build market share very rapidly (4% in 2007 to 8% in 2012), because they could hold prices and maintain presence when others couldn't.
> - Mutuals are open to all and serve customers that might otherwise go underserved (e.g. friendly societies account for around half of all CTFs and most Revenue Allocated, because they could afford to support a low value product for the long term).
>
> **Martin Shaw, Association of Financial Mutuals**

7. The Inquiry

At a meeting held on 8 February 2021, the All-Party Parliamentary Group for Mutuals decided to undertake an inquiry into the proposed demutualisation of LV=.

Witnesses were invited to attend four oral inquiry sessions where MPs and peers where able to ask questions about these proposals.

The four sessions took place online in order to comply with COVID-19 restrictions.

Sessions were held as follows:

1. 2 March 2021
Martin Shaw, CEO, Association of Financial Mutuals

John Gilbert, M&G Advisory Services

2. 9 March 2021
Barry O'Dwyer, CEO, Royal London

3. 22 March 2021
Charlotte Gerken, Executive Director for Insurance Supervision, Prudential Regulation Authority

Matt Brewis, Director of Insurance and Conduct Specialists, Financial Conduct Authority

4. 23 March 2021
Mark Hartigan, CEO, LV=

Matt Popoli, Global Head of Bain Capital Insurance Solutions, Bain Capital

In addition to the oral evidence, letters were written to a number of the participants with a range of background questions.

Letters were sent to, and replies received from the following:

Mark Hartigan, CEO, LV=

Matt Popoli, Global Head of Bain Capital Insurance Solutions, Bain Capital

Charlotte Gerken, Executive Director for Insurance Supervision, Prudential Regulation Authority

Matt Brewis, Director of Insurance and Conduct Specialists, Financial Conduct Authority

Barry O'Dwyer, CEO, Royal London

A number of uncanvassed representations were received from organisations and individuals with an interest in the inquiry. This included a number of individual members of LV=.

Details of all of those who took the time to engage with this inquiry are included in the final section and the Group would like to record our sincere thanks to them for the thoughtful contributions received.

7.1 The context of why at this time the status quo is not good enough, given LV='s brand strength, capital and momentum.

Summary

The APPG is not convinced that there is a compelling case for the demutualisation of LV=.

Taking into account all of the evidence in the public domain, alongside statements from the LV= leadership, owner members have no way of assessing whether the company would be better off pursuing an independent future, merging with another entity or being sold.

The stated rationale for this demutualisation is that the existing business neither has, nor can raise, sufficient funds to invest in the future of the business, without this imposing an unfair financial burden on with profits members.

Yet, when asked, the LV= leadership was unable to quantify the amount required or even describe what it would need to be spent on, short of vague comments around the costs of digitisation.

The recent sale of the final part of the general insurance business to Allianz has strengthened the balance sheet significantly. In the space of one year, LV= has made a number of inconsistent statements to members in relation to its capital position. On the one hand, both before and after the Allianz deal was concluded, it stated that it is a well-capitalised business, but then on the other hand, that it is unable to raise sufficient capital as a mutual to continue trading independently.

Both statements cannot be correct. Indeed, had no deal for sale been reached, LV= itself said that it expected to continue as an independent entity.[6] Members would be forgiven for their confusion.

We cannot identify a 'burning platform' to force such a sale and found no evidence of any regulatory pressure to demutualise the business.

We note that every demutualisation in the past has emanated from the boardroom. In many cases, the argument was proffered that demutualisation was necessary to raise the capital needed that would not otherwise be available to the business. The actual experience, however, was that demutualisation led to immediate rewards for board and executive management, followed soon after by the demise of the business as an independent entity as they were merged into larger businesses that played a major role in the economic crash of 2008.[7]

We cannot see how this scenario is different and can only conclude that the decision to demutualise the business suits one stakeholder group best – the leadership of LV=, who may have a personal interest in the outcome that far outweighs that of individual members.

[6] https://news.sky.com/story/177-year-old-mutual-lv-explores-end-to-independence-12004979

[7] http://www.mutuo.coop/wp-content/uploads/2013/03/windfallsorshortfalls.pdf

Justifications offered by LV= for the proposed demutualisation

In its written submission to this inquiry, LV= wrote:

> Having completed the sale in 2019 of the General Insurance (GI) business to Allianz – releasing the value and capital that we'd built over the previous decade in growing this franchise - it was clear to the Board that the business faced a challenge. The life and pensions market was becoming increasingly dominated by large insurers with access to capital. The scale of investment needed for LV= to remain competitive meant there was insufficient capital to both ensure the interests of With-profits members were met and support the investment needed for the future growth of LV=. Without investment the new business franchise would lose market share and eventually become unviable.
>
> Ultimately, structured as a mutual, it is capital provided over time by our With-profits members which would be needed to fund this investment and growth. However, the time taken to deliver the returns means many With-profits members would not see the rewards before their policies came to an end – most within the next eight or nine years. We are also not able to raise further debt.
>
> Early in 2020, with this in mind, the Board began a strategic review of the business. This was a comprehensive and rigorous process that had members' interests at its core.
>
> Taking the investment required into account, the Board concluded that continuing 'as is' was not in our members' best interests. The Board then considered the option of closing to new business and running off the existing policies. This would have destroyed the value that LV= had built in its franchise over the years. After an extensive review against strict criteria, the Board decided that LV= needed to explore the option of seeking external investment from a third party.

In the Spring, we started a structured process to determine external interest in acquiring whole or part of the LV= business. Initially we received 12 formal bids from interested parties – a great testament to the attractiveness and potential of LV=. The Board explored each proposal thoroughly, with support from financial, legal and actuarial advisers, and compared options using a detailed assessment framework that had been shared with the Regulators. We narrowed the bids down to four by June. Following an extensive period of analysis with these parties, we further reduced this to two bids by the late summer.

Once we knew we could achieve an excellent financial outcome for members, in their statutory duty as directors, the Board also looked at other benefits the bids could bring to LV= and all our other stakeholder groups. These included our employees, the communities we serve and the opportunity to continue to operate in the life and pensions market.

Having considered these groups carefully, the Board came to the unanimous decision that the transaction with Bain Capital presented:

1. Benefits for all our members - giving them a one-off member payment and the opportunity for enhanced customer experience through long term investment.

2. An excellent financial outcome for With-profits members, who will see:
   – Enhanced returns as a direct result of the transaction through higher payments when their policies end
   – A ring-fenced With-Profits Fund that cannot be accessed by Bain Capital and will be insulated from new business risk
   – Greater certainty around costs, with a fixed cost schedule for both administration and investment management charges – particularly important in the context of a With-Profits Fund with declining member numbers.

3. The continuation of our culture, values and ethos for our employees and the opportunity for them to be part of a growing business with a commitment to our three sites.
4. The opportunity to retain the LV= brand in the UK life and pensions market – with significant investment that will benefit competition and customer choice.

The Board recognised that moving forward with this transaction meant LV= would no longer be a mutual – a decision that was not taken lightly. However, it is our duty to put the interests of our members first, and having completed a robust and rigorous process, it is clear that the proposed transaction with Bain Capital provides the best possible outcome for members.

As a result, LV= will continue to play an important role as an employer and provider of financial resilience to our customers today and long into the future.[8]

[8] LV= written submission to this Inquiry

The Chairman, Alan Cook CBE – in his letter to members, December 2020 wrote:

We are now a smaller standalone life and pensions company but with the same ambitions for growth and success. One year in, we're already seeing the results of this focus with delivery of new products to market, improved cost efficiencies and better ways for IFAs to do business with us. However, in a market dominated by global insurers, LV= requires significant long-term investment to realise these ambitions.

It has become increasingly clear to myself and the Board of Directors, that if we continue as we are structured today, many of our With-profits members would not benefit from the return on that investment. The size and scale of the investment required and the time taken to deliver growth, together with the age profile of our With-profits policies, means that many of these members would not see the rewards before their policies mature. As a consequence, we needed to explore different ways to release the benefits earlier.[9]

LV= offers two linked justifications for the proposed demutualisation

Firstly, LV= is saying that the business has a need for capital investment in order to continue trading.

'Without investment the new business franchise would lose market share and eventually become unviable.'[10]

LV= then asserts:

'It is capital provided over time by our With-profits members which would be needed to fund this investment and growth. However, the time taken to deliver the returns means many With-profits members would not see the rewards before their policies came to an end – most within the next eight or nine years.'[11]

If we accept the assertion that the business needs capital investment (which we will look at in more detail below), we immediately find ourselves unable to quantify how much capital is required, and to how it would be spent. We asked LV= to provide this information, even in general terms, but they were not prepared to divulge these details. Asked what level of investment the LV= future strategy now requires,

Mr Hartigan: 'Well, that strategy is only in embryonic form, really.'

[9] https://www.lv.com/-/life/media/pdfs-lvfs/non-product/337782020-a-day-letter-v103-for-web-141220-2242hrs.pdf?la=en&hash=9BE1F91F508B51E8B33318B3168B25807B79D419
[10] LV= written submission
[11] ibid

Members do not know how much capital is required. Members do not know what it might be required for. Members do not know the forward plan for existing and new products.

The following exchange from one of our Inquiry sessions is a good illustration of how difficult it is to get any precise understanding of the rationale for the sale that owner members are to be required to vote upon.

Q: When will you publish the plan? When will you give that to the members? It's gone to the regulators, I understand. When will it go to the members?

Mr Hartigan: Well, we don't publish business plans to the membership and never have.

Q: But they've got to vote on this, haven't they? They've got to agree to scheme of arrangement. How will they know whether it's the right thing to do if they don't have an understanding of where you can take the business organisation?

Mr Hartigan: Well, the reports and accounts that we deliver every year are very open to members, and they can see all of the things that we're doing and intend to do in the future. But specific to the sale, the member pack will contain all the information that's needed to vote for the transaction, and that will also—

Q: Sorry. No. I'm confused. You said that the members will know what you're going to do in the future but you're not going to share the business plan with them. Is that right?

Mr Hartigan: Yes. The fundamentals of whether the members want to vote for the transaction with Bain Capital, all the information they need to secure that vote will be in the member pack.

Q: Why not publish the business plan?

Mr Hartigan: Well, it's not something that we do. We don't plan to publish the plan, and we-

Q: Is it a secret document? Does it contain secret things in it?

Mr Hartigan: Well, if it's pertaining to the transaction and the transaction will be voted for by the members, if they choose to vote for it, then we'll stop being a mutual and we'll become a private company, and that private company will choose, and the new board will choose, whether it wants to share the business plan or not.

Q: But they won't know your future plans. You said a minute ago that members will know your future plans. They won't know your future plans because they won't have access to the business plan. It's a pretty fundamental part of your future plans, a business plan, isn't it?

Mr Hartigan: Well, they will know we'll be able to continue to do what we do today, and we'll explain that and a lot more in our member pack, because they'll know we're able to continue because they'll also know that we have access to the capital we don't have today. And we'll explain that, and we'll explain the benefits of the transaction with Bain Capital in the member pack.

There appears to be a pattern to the communication from LV=, which appears reluctantly provided, sporadic, sometimes contradictory and ultimately partial. We want to be able to understand the logic for this major change to the UK's second largest mutual insurer, but we have not been provided with the information necessary to do this.

Similarly, individual members will not be able to make a balanced judgement on the basis of this approach.

LV= does not state that it cannot raise the funds required for its investment. Instead, it says that it would not be in the interests of with-profits policyholders to raise the funds in the normal mutual way.

'The size and scale of the investment required, and the time taken to deliver growth, together with the age profile of our With-profits policies, means that many of these members would not see the rewards before their policies mature.'[12]

This is an unusual take on the prospects of a 178-year-old business. For its entire history, like other friendly societies and mutual insurers, LV= has used the inherited estate as its source of working capital, and throughout that period it has discharged its obligation to treat all customers fairly, including with-profits policy holders.

For clarity, the working capital of the business has been contributed to by all members and customers for approaching 200 years. From the original pennies collected to protect against the fear of a pauper's grave to the profit gained from the sale of the general insurance business, these funds are held mutually, in common. All members benefit from the contributions made before them, they enjoy this during their membership, and they pass it on to the next generation of members.

> Mutual capital is largely build up by the accumulation of profits over time. In LV='s case, nearly 200 years of capital has been accumulated through the intergenerational transfer. Over time, a large number of mutuals have transferred engagements to LV=, because of LV='s strong capital position, and this has widened their membership and help grown their assets further.
>
> **Martin Shaw, Association of Financial Mutuals[13]**

This is the essence of mutuality. It is the duty of the directors of mutuals to understand, cherish and protect this. Their stewardship responsibility is to act as custodians to all members, past, present and future.

The board of LV=, and indeed any mutual, cannot address its long-term investment needs on the basis of a single snapshot of the perceived interests of one class of policyholders. No member would have taken out a policy with a mutual whilst worrying that the continuation in trading of that mutual was a threat to their personal wellbeing.

As long as policyholders are treated fairly, and there are robust regulatory standards that ensure this is the case, it is both acceptable and desirable that the business should be able to continue to trade as a going concern: innovating, investing and developing according to its corporate purpose into the future.

[12] ibid
[13] Evidence session 1

The capital position of LV=

One particular area of confusion for members is the current capital position of LV=. From reporting on its capital strength to justifying demutualisation because of its capital weakness, both within the space of a year, members might struggle to understand the actual situation.

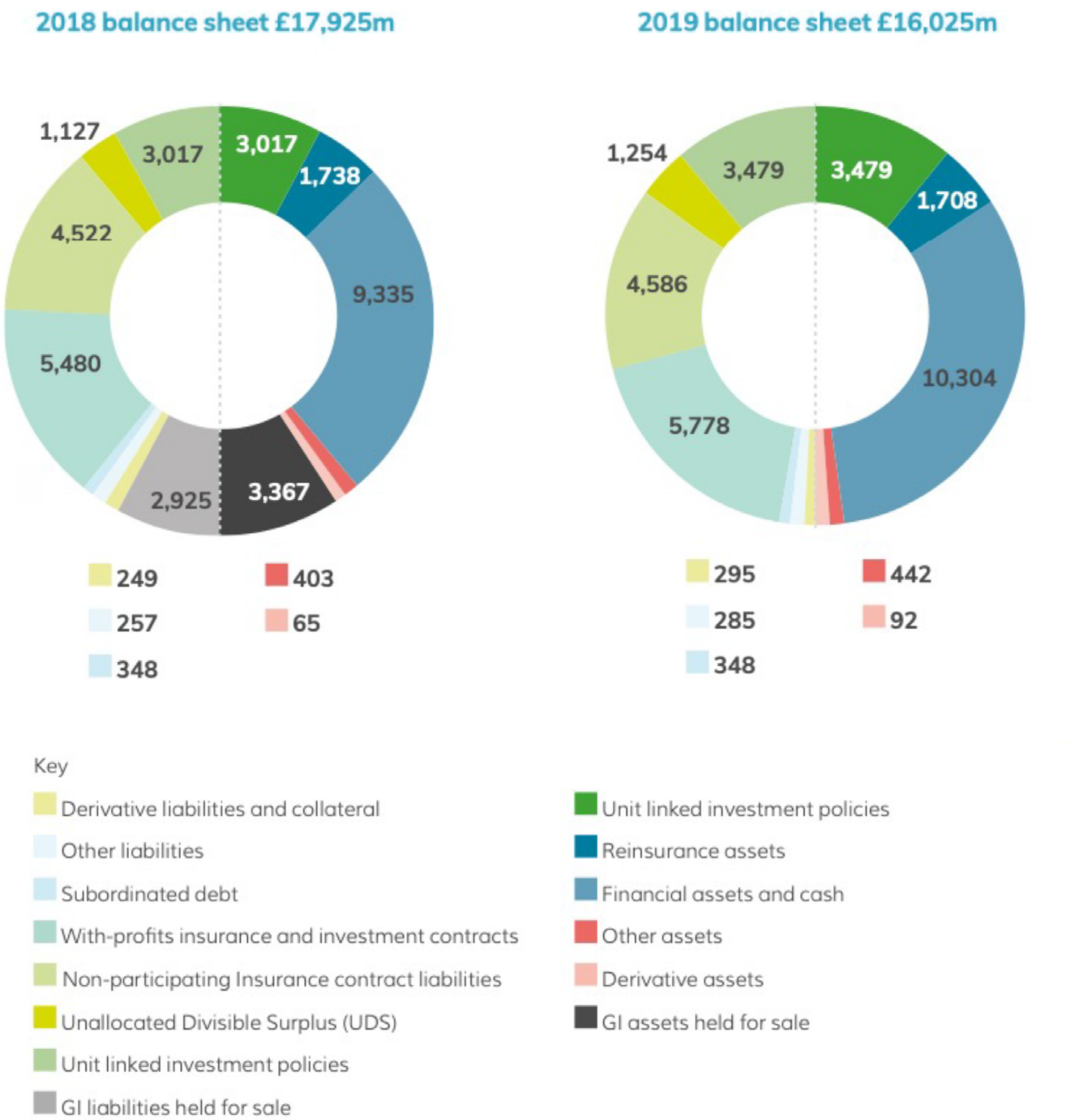
We heard in oral evidence that LV= had gained a large capital injection from the sale of its general insurance business to Allianz.

Q: Can you tell me how much you raised from the sale of the general insurance business to Allianz?

Mr Hartigan: £1.1 billion

In 2019 alone, the final 30.1% of the business was sold for £365 million. The proceeds from the sale of the GI business were allocated to a group subsidiary, LV Capital.

IFRS Balance Sheet



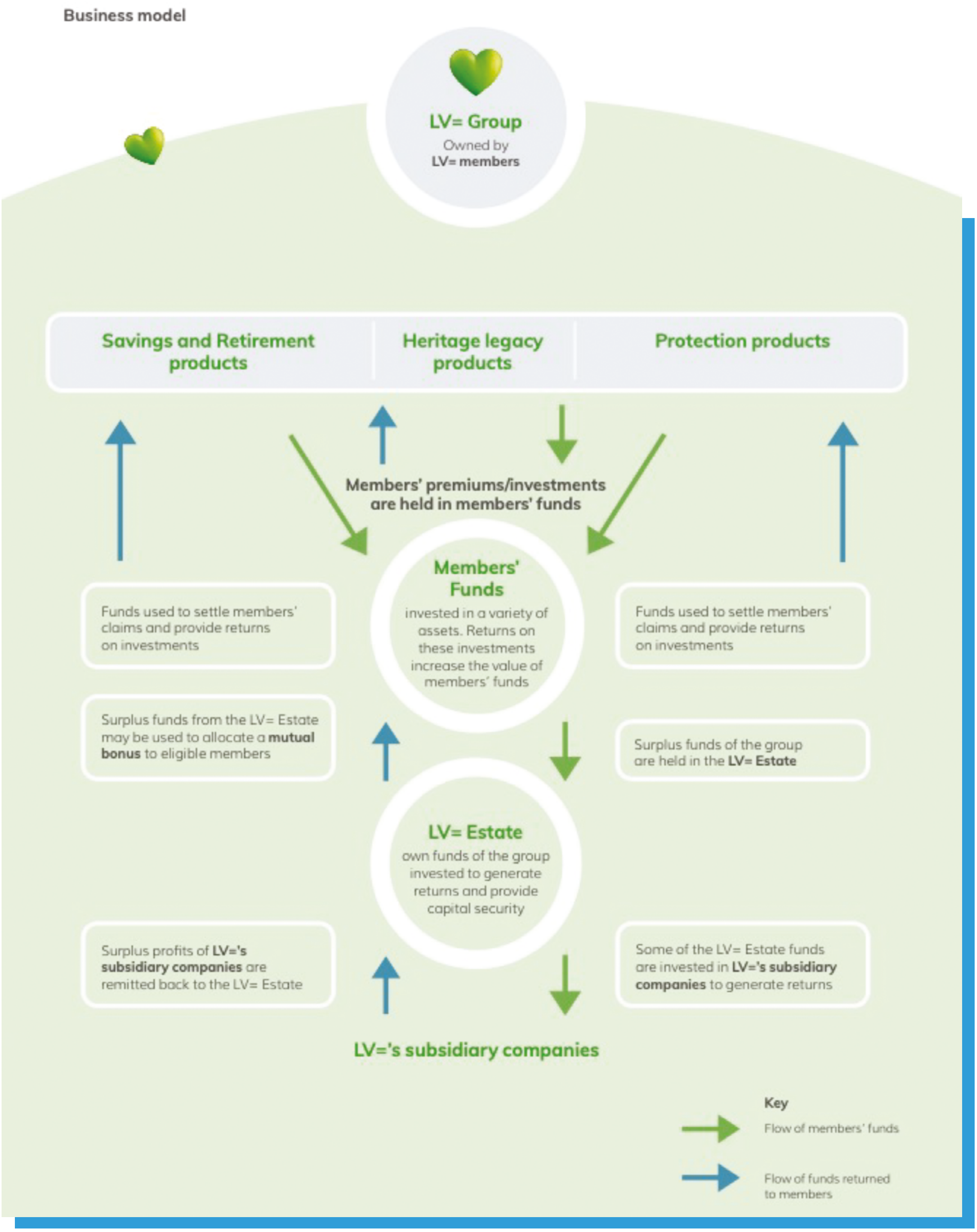
The overall size of the balance sheet has reduced following the disposal of the general insurance business. This is partially offset by increases in insurance and investment related assets and liabilities as policyholder assets have been increased by market movements. [14]

As a result of this, at the publication of the Annual Report for 2019, published in March 2020, CEO Mark Hartigan was able to report on an excellent capital position for the business,

[14] https://www.lv.com/-/life/media/pdfs-lvfs/group/annual-reports/2019/annual-report-2019.pdf?la=en

'As a mutual we are run for the benefit of our members and are pleased therefore to be able to transfer £127 million to the Unallocated Divisible Surplus and allocate a mutual bonus of £27 million to qualifying members. Our capital position is strong, and our Capital Coverage Ratio has increased to a very healthy 244% which includes the impact of the sale of the general insurance business. This takes our capital position above the top end of our risk appetite range of up to 200% and we are currently considering how best to utilise this surplus capital.' [14]

To help to understand the capital flows in the business the following diagram is helpful:



[15] https://www.lv.com/-/life/media/pdfs-lvfs/group/regulatory-returns/year-end-2019/lv-group-2019-sfcr.pdf?la=en

In the annual Solvency and Financial Condition Report, the company provides a more detailed description of its capital position. This includes how it manages surplus funds, which are built up across the group of businesses.

'Surplus funds of the group are held in the LV= Estate. This is made up of unallocated divisible surplus accumulated in prior years as well as the cash received as a result of the sale of our general insurance business to Allianz. Estate own funds are invested to generate returns and provide the LV=group with a capital buffer. When the financial performance and financial and capital strength of the LV= group allows, surplus funds from the LV= Estate may be used to allocate a mutual bonus to eligible members.'[16]

In our verbal hearing, we asked Mr Hartigan about the capital needs of the business going forward. He was asked if he thought that the previous chief executive missed the significance of that capital need, or whether things had so dramatically changed since he took over that his predecessor and his executive team would be absolved from blame for missing these things.

'Mr Hartigan: Well, I'd like to answer that by saying that I think that the previous CEO did an excellent job in achieving a great price for the general business, which, as you know, he had to sell. And he'd been in the company for many years, and at the end of the sale of the GI business, I think it was appropriate time for him to step down. I'm sure that he and the board at the time, as you've heard them say, had every intention to, following the sale of the general business, continue to operate as an effective mutual. I think it was only when we examined against the criteria the requirements that a stand-alone life and pensions-- a small stand-alone life and pensions business was going to need to be survivable in the long term in the market that we had to take this position.'

We note from the 2019 Annual Report that the departing CEO, Mr Richard Rowney, was paid a year's salary and retained bonus rights upon his resignation. In contrast, the departing Finance Director was not compensated beyond his three months' notice and all LTIP rights lapsed.[17]

Taking this information into account but given the aforementioned rationale from the company for seeking an external injection of capital, we believe that the average member would be left confused.

If there is indeed 'surplus capital' are we to assume that it is insufficient to cover the investment needs of the business going forward, or just that the board does not want to use it for that purpose?

> **The main reasons for demutualisation in the past have been lack of capital or lack of scale. And essentially, I'm struggling to think of a demutualisation that wasn't justified on one of those two reasons, and, by their own admission, neither of those two reasons are applicable to LV=, which is very interesting.**
>
> **Barry O'Dwyer, CEO, Royal London**

[16] https://www.lv.com/-/life/media/pdfs-lvfs/group/regulatory-returns/year-end-2019/lv-group-2019-sfcr.pdf?la=en
[17] https://www.lv.com/-/life/media/pdfs-lvfs/group/annual-reports/2019/annual-report-2019.pdf?la=en

Without even a ballpark estimate of the investment requirements it is impossible to come to a view on this and the reluctance of the leadership of LV= to share any information on this is a source of frustration.

Some members will have taken the time to read all of the corporate information published in March 2020. In the 2019 Annual Report there is a Risk Management section which considers the potential emerging risks to the business. In it, we are surprised that there is no mention of an existential threat to the business as a result of an inability to remain independently in business.

Emerging risks

As well as monitoring near-term risks, the Risk Committee also considers potential risks, threats and opportunities which may impact LV= at some point in the future. This process normally takes place twice per year (with more frequent assessments taking place as and when required) and captures emerging risks such as the key risks described below:

Key emerging risks	Description
New market entrants/ disruption from digital	New players enter the market, most likely in the protection sectors.
More sophisticated financial crime	This could include an organised crime attack on customer pension or savings data, which could impact a significant number of customers, create severe brand damage and require significant resource to remediate the situation.
New regulation	Regulators introducing new regulation (e.g. in the pension transfer market or more onerous capital standards), or raise the bar in terms of the standards expected for compliance.

Each emerging risk is assigned to an executive team owner, who regularly reports to the Risk Committee and with an updated assessment of the emerging risks assigned to them. This will include (where appropriate) how the risk is being tracked, the actions that can be taken to respond to the risk and the triggers for the action to be considered.

From the regulatory returns quoted[18], we must conclude that LV= is indeed a well-capitalised business and that the opinion expressed by the board that this capital should not be used to invest in the business because of their perceived short-term interests of a class of with-profits policy holders is unconvincing.

No evidence has been submitted to this inquiry that suggests that LV= is anything but a well-capitalised business capable of moving forward as a standalone mutual business. It is reasonable for any member to take that view in the light of the public pronouncements of the leadership, including on the appointment of Mr Hartigan, little more than a year ago, on 20 December 2019, just 9 days after the resignation of Mr Rowney.

> Mark Hartigan is the ideal candidate to lead LV= as we begin life as a standalone life and pensions business.[19]
>
> **LV= Chairman Alan Cook CBE**

[18] https://www.lv.com/-/life/media/pdfs-lvfs/group/regulatory-returns/year-end-2019/lv-group-2019-sfcr.pdf?la=en
[19] https://www.cityam.com/military-man-to-take-over-as-lv-shifts-focus-to-pension-provision/

7.2 The impact that the sale will have on LV='s members, the insurance industry & the implications for competition & choice in financial services more widely.

Summary

The proposed demutualisation of LV= will inevitably alter its corporate purpose. It will no longer be committed to delivering the best value to customer members and instead will join the majority of financial services businesses as one that is proprietary and focussed on delivering value to its shareholders – in this case Bain Capital.

The impact of demutualisations in the past has been to the detriment of customers, particularly over the longer term. The requirement to service shareholder capital is a drain on business and means that there will be less money for members to benefit from. Demutualisation has not occurred in the UK insurance market for some years so the experience of previously demutualised insurance mutuals is instructive.

The complicated nature of financial services businesses also means that members are often not well-placed to make a judgement about whether a vote for a conversion is in their interest. They rely on the advice of others.

Members are not given even-handed information by boards in order to allow them to make an informed decision. It is unlikely that an objective case can be properly put without an alternative view being provided to that of the current leadership. After all, the information provided is designed to ensure that a conversion takes place.

In demutualisations of mutual insurers there is the concept of an 'independent expert' who is not connected to the demutualising company. The idea is that they give a verdict on the assumptions and methodologies used in proposals and information provided to members.

We would recommend that this is one area that is considered for reform, allowing such Independent Experts to report and work for members, rather than boards.

Beyond its own customers, the proposed demutualisation will also impact the wider insurance industry and competition and choice. For the market as a whole to work for the benefit of all requires that the various corporate models each enjoy the necessary critical mass, defined as the degree of market share necessary to enable that model to operate successfully and thus to provide real competitive pressure on the other players within the market.

Over time, mutuals consistently provide better value products to their customers because their businesses are focussed on long-term plans enabling them to provide price competition against profit maximising competitors. The existence of mutuals in a market dominated by large profit-maximising insurers means that they are able to provide the only meaningful competition on the basis of service proposition and price.

Mutuals operate different business strategies, helping to mitigate against the overall risk of the sector to the economy. It benefits economies if this diversity of risk means that businesses are not all chasing the same business objectives, and risking herd mentality.

Spiralling executive remuneration in financial services brings with it the added agency risk of short-term performance being linked to pay. This has driven behaviours that are not present in mutuals, where salaries are cash based rather than incentivised by shareholding.

Demutualisation is bad for members, for consumer competition and choice and for financial market stability.

> I note that the deal with Bain Capital is referred to in this answer as a 'partnership', rather than a purchase. However, I have been unable to find any information from LV= explaining how exactly this 'partnership' will work. This concerns me, because if the sale goes ahead, LV= will no longer be a Mutual run for the benefit of its members. Rather, it will be owned by Bain Capital, whose first priority must surely be to its shareholders.
>
> **LV= Member**

Diversity in the financial mutuals sector

Diversity of ownership types and business models creates a corresponding diversity in forms of corporate governance; risk appetite and management; incentive structures; policies and practices; and behaviours and outcomes. It also offers wider choice for consumers through enhanced competition that derives in part from the juxtaposition of different business models.

However, the UK financial services sector is dominated disproportionately by a single business model, namely the large, proprietary company. This domination of proprietary business – whose purpose is to maximise financial returns to the shareholders – proved a lethal combination with the financial deregulation, the creation of new financial instruments and the concomitant rising levels of debt over the past twenty years. Ever greater risks were taken to drive up financial returns and 'shareholder value', culminating in the global financial crisis of 2007-2008.

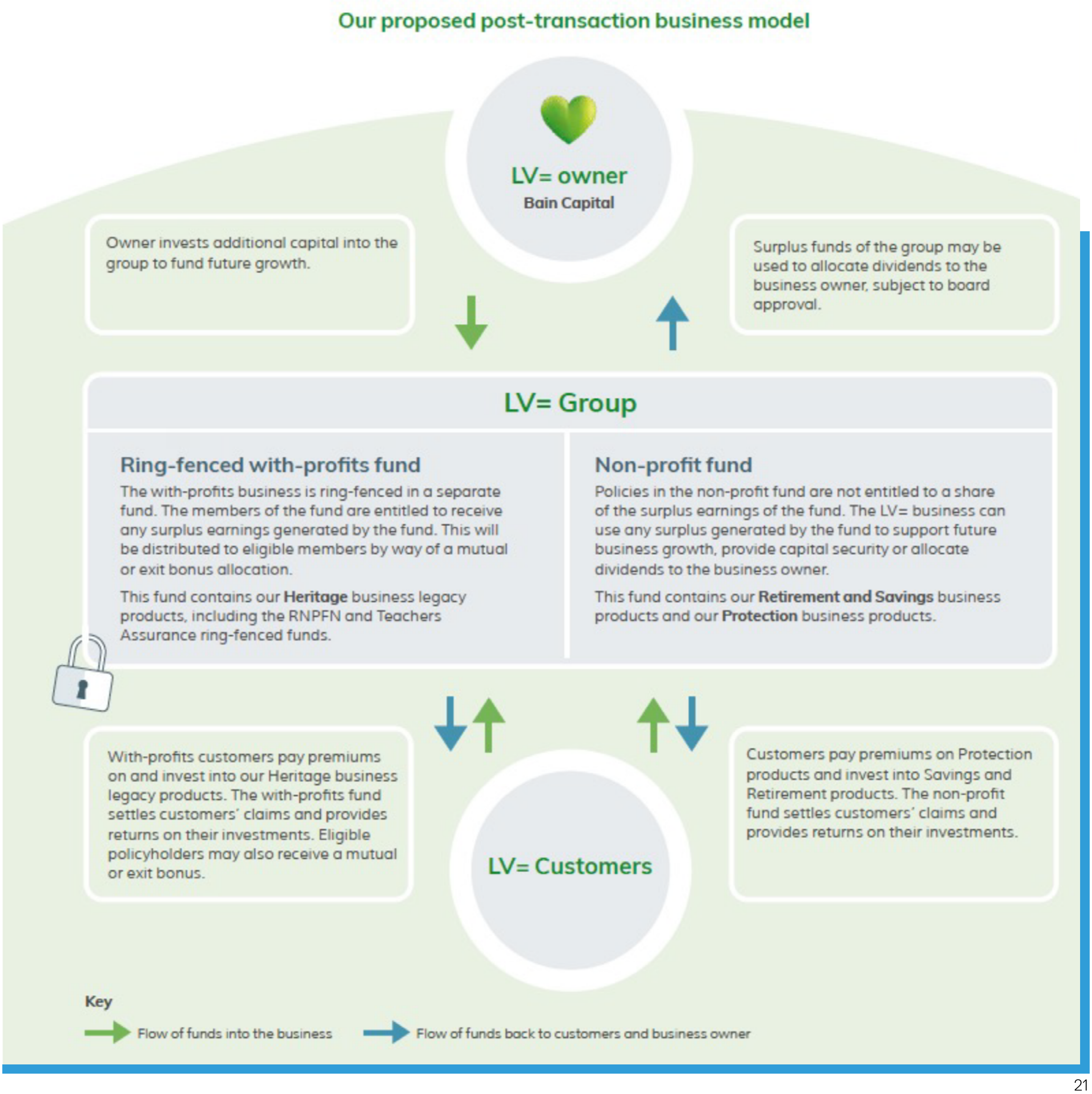
For the market as a whole to benefit requires that the various corporate models each enjoy the necessary critical mass, defined as the degree of market share necessary to enable that model to operate successfully and thus to provide real competitive pressure on the other players within the market.

The mutual insurance sector in the UK, at 10 per cent of the total insurance market, compares badly to the 30-50 per cent typical of the other large insurance markets globally. There is a fundamental attitude problem within the UK amongst the media and regulators, with the shareholder owned company being regarded as the 'normal' or 'natural' way of doing business. Other ownership models may be accepted, yet all models tend to still be judged against criteria appropriate for the shareholder ownership model.

There is a bias against the mutual corporate form. At least in part, this is because of its inability to easily raise capital, despite the fact that this reduces their risk appetite and thus means that a financial services sector with a strong mutual sector will have a greater diversity of risk appetite, which is a positive outcome in terms of creating a stable and robust financial services sector.[20]

[20] https://www.financialmutuals.org/wp-content/uploads/files/Corporate_Diversity_Report.pdf

LV= itself, in its 2020 Annual Report, helpfully illustrates the different business model that would be operated after demutualisation:



The telling line in this diagram is 'surplus funds may be used to allocate dividends to the business owner, subject to board approval.'

Given that capital growth and profit is the purpose of proprietary business, then this should be considered an under-statement of the facts. Bain Capital will expect a return on its investment. That is the whole point.

[21] https://www.lv.com/-/life/media/pdfs-lvfs/group/annual-reports/2020/annual-report-2020-3.pdf?la=en

What regulators say about competition and choice and this deal

We asked both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) what criteria they will be using to assess if Bain's takeover & demutualisation of LV= increases or decreases competition in insurance services. We set out their responses in full here:

The PRA has a secondary competition objective and has regard to the Government's economic policy when discharging its general functions, as explained above. The discharging of general functions is distinct from individual supervisory decisions.[22]

Certain PRA decisions are also subject to specific constraints. For example, when assessing a proposed change in control the PRA is required under section 185(2)(c) of the Act to disregard the economic needs of the market.

The Competition and Markets Authority may consider the competition impact of proposed mergers.[23]

For the FCA:

'The FCA will consider the impact of LV's transaction with Bain Capital Credit LP (Bain) on effective competition in the interests of consumers. Before setting out what some of our considerations would be, I thought it would be helpful to provide some context as to the basis for these and the stage of the transaction that these considerations will apply to.

LV's transaction with Bain will have a number of distinct steps to it. One of these will be Bain's acquisition of the mutual business of LV via a transfer of business under Part VII of the Financial Services and Markets Act 2000 (FSMA). The FCA considers the impact of any Part VII transfer on effective competition in the interests of consumers. We have had regard to the regulatory principles in Section 3B of FSMA, in setting out our approach to the review of Part VII insurance business transfers (FG18/4 - (https://www.fca.org.uk/publication/finalisedguidance/fg18-04.pdf). Our approach in general (set out in Annex 1 of FG18/4) provides useful context in how this approach takes into account our duty to discharge our functions in a way which promotes effective competition in the interests of consumers.[24]

[22] The Annual Competition Report provides examples of how the secondary competition objective has been implemented: https://www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective.
[23] PRA Written submission
[24] The FCA has a duty (Section 1B FSMA) in discharging its general functions, to act, in so far as is reasonably possible, in a way which is compatible with its strategic objective and which advances one or more of its operational objectives (see Annex 1). The FCA's general functions include determining the general policy and principles by reference to which it performs particular functions under FSMA including the policy and principles by which it will carry out its functions in relation to Part VII of FSMA, and in particular the functions of considering what, if any, representations to make to the Court (given its right to be heard in Section 110), and also the FCA's functions in responding to consultation requests from the PRA.
The FCA also has a separate duty to discharge its general functions in a way which promotes effective competition in the interests of consumers, in so far as that is compatible with acting in a way which advances the consumer protection objective or the integrity objective (Section 1B(4) FSMA).
The FCA has determined that the principles by which it will carry out its particular functions in relation to Part VII are to assess whether a proposed transfer of business poses any threat to any of its operational objectives, to its duty to promote competition described in paragraph 2 above, or threatens to be inconsistent with its strategic objective.

Additionally, our guidance in FG18/4 includes the competition considerations we expect to see from both the firms involved in the transfer as well as the Independent Expert (IE). We expect that their consideration should include whether there may be any adverse impact on effective competition in the interests of consumers or other competition issues.

The FCA has also recognised the potential benefits to competition in the interests of consumers in maintaining the diversity that mutuals add to the provision of retail financial services, e.g. in our Policy Statement on Mutuality and with-Profits Funds (PS14/5 https://www.fca.org.uk/publication/policy/ps14-05.pdf).

Taking this all into consideration, in the case of this specific transaction involving LV and Bain, which would involve the demutualisation of LV, the competition considerations as part of the Part VII transfer might include:

- The impact of the transfer on the range of products or services that LV provides in the market, considering the significance of LV in the markets which it operates in (e.g. if the firm has a large market share in any products or services).
- Whether LV as a mutual company limited by guarantee provides products or services that are specific to particular groups of consumers, or niche areas, which would be impacted by the transfer.
- The potential impact of a new shareholder, providing new capital, in the UK life and pensions market (in the form of Bain) on the overall prospects for competition in the interests of consumers in this market, taking into account the plans that Bain Capital has for the business going forward.

Another step in the transaction will be Bain's 'takeover' of the specific subsidiary of LV that it is proposing to acquire, which requires them to submit a change in control application. The FCA's assessment of the change in control application will be carried out against specific tests set out in FSMA, which are covered in more detail in response to your third question.

It is also worth noting that the transaction is likely to be counted as a qualifying merger that the Competition and Markets Authority (CMA) could look at.

Impact on LV= members including fair price

We asked if the PRA and FCA will make an assessment of the value of LV='s insurance business including whether Bain are offering its owners a fair price for their shares?

The PRA responded:

As set out above, the PRA will assess the transaction in light of its objectives and the specific statutory criteria applicable in relation to any regulatory approvals. While this would include assessing any implications that the offer has for the safety and soundness of the firm and the protection of policyholders, assessing the commercial value of the offer is outside the PRA's remit.

The FCA's approach is also set out in Chapter 18 of the Supervision Manual of the FCA's handbook of rules and guidance (SUP 18). The most relevant parts of this policy are the same as those in the PRA's Statement of Policy on its approach to insurance business transfers issued in April 2015.

The FCA responded:

The FCA is considering the fairness of the transaction with Bain in a number of ways.

The FCA will consider the fairness to policyholders of the transfer (under Part VII of FSMA) of LV's business to the entity that Bain is proposing to acquire. This consideration of fairness will include an assessment of whether there are any material adverse effects to policyholders (or groups thereof) as a result of the transfer e.g. with respect to the security of their benefits, the expected level of their benefits or the governance and servicing standards they will experience after the transfer. We will give particular consideration to the fairness to with-profits policyholders, including that their interest in the inherited estate is appropriately recognised through the terms of the Part VII Scheme, and that they benefit from appropriate protections and strong governance in a ring-fenced fund after the Part VII transfer. We will also consider the assessment of the IE of the fairness of the transfer to policyholders as opposed to the alternative should the transfer not proceed.

The FCA will also consider the fairness to members of the amount of LV's planned cash payment to them in order to compensate them for loss of mutual membership, upon completion of the transaction.

In addition to this and more broadly in applying our rules and principles as part of our ongoing supervision of LV, we have considered the range of options they have explored and the process they have followed to date in deciding to sign a deal with Bain. Over the last couple of years as LV have been considering their future strategic direction, we have made clear to the LV Board our expectation that they must be able to show that their chosen strategic direction for the business is appropriate, meets our rules and principles (including Principle 6 "treating customers fairly"), and evidences that outcomes for policyholders have been explored and robustly analysed before any decisions are made.

Specific elements we have been considering include:

- Whether they are considering a comprehensive range of strategic options side by side, including, for those options involving an external party, whether they are running a competitive process to generate potential bids for the business.
- Whether there is a clear articulation of how the interests of different stakeholders are weighted in their decision-making framework and whether this is fair to with-profits policyholders.
- Whether there is evidence of a fair basis used for decision-making between the various strategic options.
- Evidence of how they have satisfied themselves that assumptions behind decision-making are credible so that whatever option is chosen is sustainable.

- Whether the With-Profits Committee and the With-Profits Actuary have been engaged with in a timely manner and whether their views have been made clear to the LV Board in advance of decisions being made.
- Whether there is clear documentation of proposals, discussion and challenge, and decisions made.

> I think the benefits of mutuality are much greater than just the compensation for the loss of voting rights that I think LV= may be implicitly assuming.
>
> **Barry O'Dwyer, CEO, Royal London**

The idea of a fair price for the loss of mutual membership rights is considered by an Independent Expert.

> Providing the Bain Capital deal is voted through, we as members are being promised an unspecified one-off payment to recompense us for the loss of our mutual membership. Rather than feeling like an incentive, to me personally this feels like a bribe.
>
> **LV= Member**

The complicated nature of financial services businesses also means that many people are not really in the position to make a judgement about whether their votes for a conversion is in their interests. They rely on the advice of others.

Members are not given even-handed information by boards in order to allow them to make an informed decision. It is unlikely that an objective case can be properly put without an alternative view being provided from that of the current leadership. After all, the information provided is designed to ensure that a conversion takes place.

In demutualisations of mutual insurers there is the concept of an independent expert who is not connected to the demutualising company. The idea is that they give a verdict on the assumptions and methodologies used in proposals and information provided to members.

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.

Regulators seem satisfied that independent experts are discharging the responsibility of impartiality. As a result, they stand back and accept this judgement in the same way that members are expected to. As long ago as 2006, an earlier All-Party Parliamentary Group report[25] recommended reform to the process of Independent Expert appointments to give members more of a say and two separate the reporting process from the company.

[25] http://www.mutuo.coop/wp-content/uploads/2013/03/windfallsorshortfalls.pdf

> As an LV= member, I am not aware that any detailed information has been provided to members on the thinking behind the With-profits Committee's original objections, or their subsequent acceptance of the deal, even though such information might help to throw some light on the situation.
>
> **LV= Member**

7.3 The rationale that supported the decision by the Board of LV= to sell the business to Bain Capital, and whether other options were considered fully.

Summary

As has already been expressed in this report, one of the most frustrating aspects of the proposed demutualisation of LV= is the lack of information that the company has shared with its members and other stakeholders.

We re-iterate the point that without more transparency, it is very difficult for members to make a reasoned judgement about what is in the best interests of their mutual.

At every stage, as with any demutualisation, the only information available is provided by the company itself, which is a clear conflict of interest. The role of the 'independent expert' is also unsatisfactory, for the same reasons that this was pointed out by a previous APPG report in 2006.[26]

We have constructed our own timeline (see chapter 3) to better understand the sequence of events.

It was finally confirmed that the business was put up for sale in March 2020.[27] This was initially vague because when we asked the CEO when precisely LV= engaged advisors, he said he could not remember. If we take that date as the beginning of the process, which incidentally coincided with further assurances to members about the continuing mutual status of LV=, 12 bidders had shown an interest by June, when the story was reported in the media.

By August the shortlist of bidders was down to two and Bain Capital entered exclusive talks from 2 October. The Board decision to sell to Bain was reported on 15 December 2020.

The speed of this whole process, which began in the first 12 weeks of the new CEO's tenure shows remarkable dedication and efficiency, if that was all the time available to them. From concept to execution, this sale negotiation was extremely rapid and smooth. Likewise, Bain Capital was able to complete its due diligence work from first indications of LV='s availability to concluding a deal in less than six months.

We are unclear about the role of the LV= with-profits committee, following media reports that it had favoured a sale to fellow mutual, Royal London. We note that it has not said that the Bain capital deal is the best for members and has equivocated instead.

We simply cannot know if the sale process undertaken was sufficiently thorough, except to remark on the speed of its execution. That all of this was achieved without any engagement with owner members is to be regretted.

We remain interested in understanding more about the sequence of events, when precisely advisors were first approached and then instructed, the brief they were given, and the manner in which they were incentivised, would all be of interest to owner members.

We believe that this timeline of events and decisions requires further clarity and that owner members deserve to be informed of decisions that were being taken on their behalf.

[26] http://www.mutuo.coop/wp-content/uploads/2013/03/windfallsorshortfalls.pdf
[27] LV= supplementary letter to APPG 29 March 2021

> One of the reasons why the selection of Bain by the LV= board came as such a surprise is that one cannot imagine two more divergent capitalist structures than the mutual organization and the private equity model.
>
> **LV= Member**

> The sector regrets the loss of every mutual brand. In recent years we have seen a number of other mutuals exit the sector, e.g. Equitable Life and Reliance Mutual, but those were largely closed businesses, and LV= has always been regarded as a more forward-looking business by the sector. With the sale of its GI business, LV= is now a relatively small life insurer, with what was perceived to be a sufficiently strong capital base.
>
> The sector is concerned about the deal. In particular that an apparently competitive/ potentially better deal from another mutual was rejected, but also that where LV= had historically built-up protection from a demutualisation, via a mutual lock, the organisation has found a way round that- first by converting from a friendly society to mutual insurer in 2020- then by aiming for court approval of a method to bypass its own rules.
>
> This opens up precedents that other mutuals are uncomfortable with.
>
> **Martin Shaw, Association of Financial Mutuals**

The speed of this whole process is of concern to Group members

We sought clarity on the timeline of events and we were surprised that this information was difficult to obtain.

Q: Mr. Hartigan, can I ask you when you took the decision to engage advisers to look for a sale? I mean, was that March last year, May last year? What was the timescale?

Mr Hartigan: I can come back to you on it exactly, but I can't remember exactly. I mean, it might have been April, May.

We asked Matt Popoli of Bain the same question:

Q: Can you remember when you were first approached by Liverpool Victoria? You said, I think, in your letter, about a year ago. I wonder if you could be a bit more clear?

Mr Popoli: We can get you the specific time period. I believe that we were contacted by the company's advisers in the early second quarter of last year, but I can get you an exact date

It appears that regulators were first informed of the process in June 2020, around the time that media reports first appeared.[28]

This is important because we find it remarkable that the new CEO, a mere 12 weeks into running what he apparently expected to be a standalone mutual business could rapidly conclude that the firm needed to be put up for sale, and had contacted advisors, even as the business continued to report on its surplus capital position and commitment to mutuality on 19 March 2020.[29]

We believe that this timeline of events and decisions requires further clarity and that owner members deserve to be informed of decisions that were being taken on their behalf.

We asked the PRA if it will investigate LV='s need to raise capital via a sale to a company as opposed to another mutual, and indeed what other options LV= had to raise capital such as via debt.

We asked the PRA if it will investigate LV='s need to raise capital via a sale to a company as opposed to another mutual, and indeed what other options LV= had to raise capital such as via debt.

The PRA replied:

In line with the requirements of Solvency II, the PRA expects insurers to take responsibility for maintaining at all times an adequate level and quality of capital, taking into account the risks to which they are exposed, and consistent with their safety and soundness and the protection of policyholders. The PRA considers the adequacy of capital as part of its forward-looking assessment of risk.

This area of supervision includes assessment of the appropriateness of firms' appetite for, and approach to, debt with consideration of the sustainability of any debt (servicing and repayment), firms' income generation and obligations to policyholders.

Within this, firms have the discretion to set their own strategies and take commercial decisions; however, we are assessing the transaction in accordance with our responsibilities, taking a forward-looking view of the prudential risks and available mitigants.

[28] https://news.sky.com/story/177-year-old-mutual-lv-explores-end-to-independence-12004979
[29] https://www.lv.com/about-us/press/lv-announces-2019-financial-results

We also asked the FCA if it would investigate LV's need to raise capital via a sale to a company as opposed to another mutual, and indeed what other options LV= had to raise capital such as via debt?

The FCA replied:

As noted above, in applying our rules and principles as part of our ongoing supervision of LV=, the FCA has considered the range of options LV= have explored and the process they have followed to date in deciding to sign a deal with Bain. The criteria we considered are set out above. One of these was whether they considered a comprehensive range of strategic options side by side, including running a competitive process to generate potential bids for the business. Our focus has been in ensuring that the process they have followed will enable decisions that are fair to their policyholders and members, and that recognise the particular interests of with-profits policyholders, many of whom will be maturing over the short to medium term.

Throughout this process, we have emphasised the importance of their governance processes being robust, including the specific governance arrangements designed to protect the interests for with-profits policyholders – the With-Profits Committee and With-Profits Actuary. Our rules also make specific provision for the With-Profits Committee to notify the FCA of the decision of the Board to depart from their advice or recommendation if they consider that the issue is sufficiently significant, which LV='s With-Profits Committee has not done in connection with this decision.

It is worth noting that our engagement with LV= on their future strategic plans for the business as part of our normal supervisory activity dates back a number of years. It includes their decision to sell a majority stake in their General Insurance business to Allianz in 2017 (and the remainder of their stake by the end of 2019). A key part of our supervisory focus following this sale was on ensuring that LV='s use of the proceeds of this sale reflected the interests of the with-profits policyholders, particularly those long-standing policyholders whose policies are maturing over the short to medium term.

Bain Capital

The suitability of Bain Capital as the purchaser of LV= has been the subject of some concern to members. Their experience in UK insurance, with mutuals in general, and the potential change in corporate ethos have all been raised as issues.

LV= said in December 2020:

'While we will no longer retain our corporate structure as a mutual, our culture and values will remain the same. We will continue to put customers, employees and financial advisers at the core of everything we do. Bain Capital is fully bought into what LV= stands for and is committed to our plans and strategy for growth. Together we are excited by the opportunities that lie ahead in this next phase of LV='s journey.' [30]

Bain Capital has acquired a very wide range of businesses over many years. This includes the UK insurer esure. This business also includes Sheila's Wheels. There is no evidence of an understanding of mutuality or demutualised businesses elsewhere in its portfolio, and as its ownership of esure is quite short, there is no evidence of what that has delivered.

We think that any rational consideration of mutuals and private equity would recognise that these are polar opposites in terms of business objectives, commercial models and culture.

Mr Popoli was asked to set out what Bain's corporate purpose is.

> Our hallmark of how we interact with our portfolio companies is to be partners. Our values are built around a desire to build successful partnerships with the companies in which we invest. As we make those investments, we work closely with the management teams of our companies. We like to challenge conventional thinking, focus on driving performance, and we think we're pretty good at solving complex problems which we believe a number of businesses, including LV=, are facing in this environment. Everything we do is underpinned by good character. We prize personal integrity, humility, and we believe we act with empathy and conviction. We believe quite strongly in the importance of living our values.
>
> **Matt Popoli**

[30] https://www.lv.com/members

In further questioning, Mr Popoli was pressed on this:

Q: Most people would view private equity as being in there for what it can get out of it, the maximum possible returns that it can achieve and applying all the maximum pressures in order to attain that. So, how do you see yourself fitting in with an organisation that's this old and has been a mutual for all these years?'

Matt Popoli: 'The fact that the company is changing corporate form will not change the values of the company from our perspective."

The notion that LV='s 'culture and values will remain the same' stretches credibility to its outer limits, and whilst we have no argument with Bain Capital, we think that members would be better served if LV= employed less hyperbole in seeking to convince them of this proposal.

Mr Popoli was then asked if Bain's objective were to obtain maximum returns from the investment.

Our objective is really, I guess, summarised by one word which is growth. We focus on growth. And if we look at the LV= brand, as you all are aware, LV= is one of the best insurance brands in all of the UK. And again, we are quite excited to be partners with the management team and the board, and we'll be good stewards of that brand. We believe that there is a significant opportunity to expand LV= within the UK to a broader set of policyholders, and so our objective would be to meaningfully increase the number of consumers that have access to LV='s quite valuable products that help them protect themselves when they lose a job or when a loved one passes away.

Matt Popoli

The Group noted that this was the most detail they had so far seen on the future plans for the business.

Turning back to LV='s description of Bain when announcing the deal, it said:

In addition, the Bain Capital Insurance team has a strong track record successfully growing and supporting similar businesses and is one of the most experienced demutualisation investors in the industry globally.'[31]

[31] ibid

We find this a bold claim. In our research we have found scant evidence of Bain Capital's involvement in demutualisations and would doubt the particular value of it. More accurately, Bain's team members have been involved in demutualisations with previous employers.

> The Bain comment in the press release struck me as somewhat curious. It is somewhat asymmetrical with your own letter, as it does not talk of supporting LV's proposed business plans but of providing "long term support to LV's board of directors and management team".. Can you explain what is meant by this formulation? I infer that the current board and management team will retain their roles under the Bain banner.
>
> **LV= member**

LV= Leadership future roles

The Group was interested in asking about the future roles and remuneration of the current LV= leadership, in the new business.

Q: 'What about the executive team? Have you had discussions about future remuneration, long-term incentive plans, and the rest of it? Will this be an attractive deal going forward for you and your team financially?'

Mr Hartigan: We haven't seen the basis upon which we'll be remunerated in the future.

Pressed on this, Mr Hartigan was asked if he had had discussions with Bain about his own future remuneration as and when they take over, whether that is shares, a straight salary, or long-term investment plans.

Mr Hartigan: No. We've talked around it. If I'm selected by LV, obviously, to lead the business forward, there's been general discussions, but no detail of any remuneration plans have been provided to me

We might expect that Mr Hartigan would have been comforted by Mr Popoli's assurance that he would like to see him as part of the future.

Mr Popoli: Again, in our capacity as board members, the board will ultimately be responsible for selecting management, hiring, and making decisions like that. Certainly, at this point, I, as an individual hopefully to be on the board, would certainly support continuing to retain Mark.

Mr Popoli confirmed to the Group the manner in which Bain seeks to compensate its staff:

Mr Popoli: We generally try to link performance of the company to management compensation, I guess, generally speaking. But in the case of LV, any remuneration framework or compensation levels or structure will ultimately be determined by the independent remuneration committee at LV=.

Turning to non-executive directors, Mr Popoli was asked what plans had been made for retaining directors.

Mr Popoli: A small number of the existing board members are likely to carry over to the board post-closing, but I would expect that many will not be retained

Do you expect to retain the chair?

Mr Popoli: I believe, at this point, we expect that Alan (Cook) will continue on the new board

Asked if Bain would be compensating the departing directors for loss of office, he replied:

Mr Popoli: I do not believe that there's any compensation being paid to departing directors, but I don't know that 100%.

It is clear from these exchanges and public documents[32] that the current executive management is expected to continue in post following any sale to Bain. Indeed, it has been said that is part of the attraction for their investment.[33] We now know that there have also been some discussions about future remuneration, so we would expect that executives are in some position to judge whether they wish to stay on with the business and under what broad terms.

As far as the non-executives are concerned, it is clear that many will stand down, though we do not know which. Mr Popoli does not expect them to be compensated for loss of office by Bain. We were not able to ask if they are likely to be compensated by LV= from members funds before the final transaction is completed.

[32] Bain Capital submission to the Inquiry
[33] ibid

It appears to have been negotiated that the Chairman will continue in his position. He has held the position of Chairman since before the conversion to a company limited by guarantee, throughout the sale process, and now it seems, at the demutualisation destination to a Bain owned company.

We did not have the opportunity to speak to Mr Cook.

With-profits Committee

We noted media reports of an apparent disagreement between the with-profits committee and the board over the latter's preference for selling to Bain.

> **'A £530 million plan to sell one of Britain's biggest insurance mutuals is set to raise fresh concerns as it emerged that a key panel representing 340,000 policyholders initially vetoed it.**
>
> **The Times has learnt that the committee representing holders of LV= with-profits policies rejected the offer from Bain Capital, an American private equity group, in favour of a rival offer from Royal London, another mutual.**
>
> **It was only when LV= executives went back to Bain and secured further reassurances that the committee changed its position and dropped its resistance to the Bain offer.**
>
> **Even now, however, it is not clear that the committee approves of the Bain offer. LV= stops short of claiming it has the committee's blessing, saying only: "The with-profits committee has been extensively involved in our strategic review process and advised the board at each stage.'[34]**

We are unclear about the role of the LV= with-profits committee, following media reports that it had favoured a sale to fellow mutual, Royal London. Compared to Bain's offer of £530m, Royal London made an offer of £540m, though it may be more complicated to compare the two. We note that it has not said that the Bain Capital deal is the best for members and has equivocated instead.

> **It is extremely difficult for me to explain the deep fear and misgivings I have for my financial future should this Bain takeover be allowed.**
>
> **LV= Member**

> **A question which therefore arises is what guarantees can be offered that these bonuses will not be lost or reduced after the Bain transaction, if it goes ahead.**
>
> **LV= Member**

[34] The Times, 4 January 2021

Members who wrote to us remain concerned, however and we would urge the company to address these worries directly.

> It is not clear who has been looking out for the interests of the with-profits policyholders in this process, or what happens if the Independent Expert decides that either of these negotiations produced an unfair result. There may be considerable commercial pressure on the Independent Expert to come to the “right” result.
>
> **LV= Member**

> An important risk for with-profits policyholders results from the legal nature of bonuses added to a policyholder’s policy. These are not guaranteed and so are at the risk of being reduced at any time prior to policy maturity and payment. I understand that this will also apply to any bonus resulting from the Bain deal, if it goes ahead.
>
> **LV= Member**

> I should add that LV=’s mutual status was a key factor in my choice of annuity provider and having spoken to my Financial Advisor I realise that I have no power to move my Annuity elsewhere, even if the sale to Bain Capital goes ahead without my vote, which leaves me feeling like a pawn with no voice, rather than a valued member.
>
> **LV= Member**

Likewise, LV= pensioners have expressed their misgivings:

> LV= is paying a contribution of £5 million per year to the pension fund and this has been agreed until 2028, along with levies and exceptional expenses. This to eliminate a deficit found in 2018. My concern is whether Bain capital will continue to fund the scheme if they take over LV=. The Trustee relies on LV= providing additional support.
>
> **LV= Member**

We asked the PRA if they will be discussing with Bain their plans for the future of LV's insurance business including whether they will be increasing the total debt stock of the business, reducing jobs & offices & if they plan to retain ownership beyond the next five years.

The PRA responded:
The PRA has commenced engagement with LV and Bain on the proposed transaction. When reviewing the transaction, we will be assessing the prudential implications and risks in line with our remit and responsibilities. The PRA will take a forward-looking approach to assessing risk to its objectives by reviewing the implications of the transaction on, amongst other things:

- the short, medium and long term strategy;
- the business plan and the resilience of the target firm's business model, including the impact of any investment into the business;
- the forecast financial position for three years, including the level of debt;
- the ongoing adequacy of capital;
- the adequacy of non-financial resources;
- governance (including Board membership/composition, committee structure); and
- systems and controls.

> If it is truly the case that the clincher for Bain was its commitment to retain the three sites and some or all of the LV= staff, then it becomes important to make sure that the commitments to this effect are enduring, robust and enforceable.
>
> **LV= Member**

7.4 The motivation behind LV='s recent conversion from a friendly society to a mutual company, including how this is connected to the proposed demutualisation.

Summary

The story of how LV= converted from a friendly society to a company limited by guarantee in 2019 has caused considerable concern to our inquiry in the way that it demonstrates the manner in which LV= engages with its membership.

We consider that the board must have known, or should have known, that there was a possibility that they would very soon be considering the future ownership of LV= and that this should have been communicated to the owner members. Yet, they continued through to March 2020 to provide assurances of the leadership's commitment to mutuality.

We do not think that we have received a satisfactory explanation for this. If the timeline of events bears even the slightest examination, we must assume that there was active consideration of the potential for a demutualisation in the few months following the conversion to a company limited by guarantee.

We regret that it is outside the regulators' responsibility to consider this sequence of events and that once specific hurdles have been crossed there is no review process. Members are left alone in this situation, without access to independent advice and support. They have no recourse other than to accept what they are told by the leadership of their mutual. This again brings into question the value of the role of the Independent Expert, whose opinion on the conversion to a CLG was self-evidently dated less than a year after it was given.

We do not go so far as to accuse the LV= leadership of actively misleading the membership about their plans for the business because we have no evidence for this. However, it is regrettable that the LV= leadership did not consider it necessary or desirable to be more open and transparent with the company's owner-members between May 2019 and June 2020, when the sale plans were leaked to the media.

Indeed, this pattern of non-information continued right through until December 15 2020, when members were finally directly informed of the decision to sell to Bain Capital.

We take some small comfort from the regulator's comment that it is not yet a 'done deal' though we fear that for ordinary members it must appear that way.

> Our Annual Report goes beyond what the regulations require us to provide because we believe in being open and honest with our customers, members, investors and other stakeholders, providing them with the information required to understand our business and how it is performing.[35]
>
> **LV= 2020 Annual Report**

[35] https://www.lv.com/about-us/company-information/annual-report

On 22 May 2019, LV= completed the process to convert from a Friendly Society to a Company limited by Guarantee.

In advance of this decision, which was passed by a member vote of (89,022 members voting in favour, on an 8% turnout of eligible members)[36], the LV= leadership produced an information booklet, 'The future of your mutual, Our proposals for change.'[37]

This booklet explained the motives for the conversion and parallel rule change.

We are a mutual and proud

'The concept of mutuality and importance of membership is at the heart of LV=. It is because of our mutual ethos that we are able to focus on the needs of our members rather than shareholders, and it is you who have a say in how we are run.

We want to offer people valuable financial solutions to help them live confident lives and for everyone who is a member to benefit from being part of a mutual, regardless of what product they buy.

However, the laws and regulations that govern us as a friendly society have become outdated. We believe in the future this could stop us running your business effectively and in your best interests. So, in order to have more flexibility and freedom to compete in today's marketplace and to better protect and preserve LV=, we need to make some changes.'

Alan Cook CBE, Chairman

If we become a company limited by guarantee

- We would still be the same legal entity, under a new name and different legal structure.
- We would still be a mutual.
- Members would continue to own the company.
- Policy conditions and benefits would be the same.
- We would still be responsible for any policy liabilities.
- There would be some obligatory and some non-compulsory changes to our constitution.

[36] https://www.lv.com/-/life/media/pdfs-lvfs/group/members/lvfs-sgm-2019-05-22-minutes.pdf?la=en&hash=D2F4A1542B5ED18872BDB53AFDDF5B93E273D074
[37] https://www.lv.com/-/life/media/pdfs-lvfs/group/members/member-statement-booklet.pdf?la=en&hash=2FE541539C95B54682C99CBBD7E9FA51ED003F6C

- Members and policyholders would deal with us in the same way as they do now.
- We would run the business in the same way as we do now.

Independent Expert, Oliver Gillespie

The main motivations for the conversion are that the post-conversion company would be able to undertake an expanded range of strategic initiatives, and that after the conversion some of the competitive disadvantages that Liverpool Victoria Friendly Society currently experiences, as a friendly society, would not exist.

These expanded strategic initiatives include schemes of arrangement that are part of the proposed future plans referred to above, and insurance business transfers from other non-friendly society companies.

Change a rule in our constitution

In the 1990s quite a few mutuals found it difficult to compete for business in a crowded marketplace. Because of this, it became common for mutuals to merge with other financial providers, just so they could survive. Or they even sold the whole business as they believed this was in their members' best interests.

A pattern started to emerge where people thought that if they bought a policy in an existing mutual, they could come together with fellow members to orchestrate a de-mutualisation and benefit financially (by receiving a windfall). This practice is commonly known as 'carpet-bagging'.

In 1999 the management of Liverpool Victoria Friendly Society felt it was necessary to implement a Rule in our constitution to protect the Society from being forced to change its mutual status by a small minority of members.

The Group wanted to explore what it considers the extraordinary about-turns in the position which the board or the business has taken. As can be seen from the statements above when the company was converted to a business limited by guarantee as recently as 2019, it was said,

'Why we want to change the Rule
First of all, we want to reassure our members that we have no plans to give up our mutual status, nor do we have any reason to do so – we have a strong capital position, and we continue to sell attractive products.'[38]

Mr Hartigan was asked if that was wrong or whether circumstances had changed.

'I think it was well meant, sir, when it was said. The change to the structure that you referred to was done in a bid to split the with-profit fund from the new business and, again, create that sort of surety of delivery and not risk it to fund the new business, and so they wanted to create a with-profit fund and a mutual capital fund. In the end, they didn't have the capital and the solvency to achieve that split. So having done the change, they weren't able, in the end, to complete the split of the two funds. So, I think, at the time, it genuinely was absolutely their intent and was certainly well meant, and it was only really as a result of it that we then faced ourselves into the predicament that we're in today following the sale of our GI business.'

Mark Hartigan

As we have already set our earlier in this report, we find it hard to see the situation as the 'predicament' as described. Again, we know this is a well-capitalised business which had received a near £400 million injection of cash between the decision to convert to a CLG and the decision to change executive leadership and sell the business. The judgement that the large reserves could not be used for investment is a strange judgement that does not view the business as a mutual going concern.

Moreover, the sale value and date of the GI business was known at the time of the conversion, we note the assurances to members around mutual status and are perplexed that the situation would be such a surprise to the board that less than a year later, they would authorise the CEO to instruct advisors to find a purchaser.

Members and Parliamentarians are not alone in finding this confusing.

[38] ibid

> But the reality is they sold their GI business to Allianz for a very substantial price. I think it was over a billion pounds. If you look at their ratios, they're one of the most well-capitalised life insurance companies in Britain.
> I mentioned earlier that by their own admission, they don't require to demutualise in order to raise capital.
>
> **Barry O'Dwyer, CEO, Royal London**

We believe that in the light of the subsequent events, the ordinary member could consider this whole episode to be misleading or confusing at least.

The LV= business was put up for sale in March 2020. This is less than a year after the rule change and corporate conversion took place. In the meantime, in the six months following the conversion to a company limited by guarantee, LV= underwent some major changes. The departure of the long serving chief executive officer was swiftly followed by the appointment of Mark Hartigan as the new CEO.

Anyone with knowledge of the process of senior executive appointments will understand that this appointment would have been the culmination of an exhaustive process over the previous several months. During that time, the board would have sought a new chief executive who would be able to implement their plans for the future. It stretches credibility therefore that Mr Hartigan would have taken up his post in January 2020 with no knowledge that significant change could be afoot. We would expect that the board, or leading members of the board, must have had this knowledge.

It is noteworthy that by his own admission, Mr Hartigan has no previous experience of working with, or knowledge of mutual business and it certainly looks like he was appointed without that expectation needing to be met.

> I've no experience at all of previous mutuals as an operator, as a business leader. This was the first leadership position in a mutual that I've undertaken.
>
> **Mark Hartigan**

Within 12 weeks of taking up his post, Mr Hartigan had instructed advisors to find a purchaser for the business. We would be very interested to see the instructions that were issued to the advisors to undertake this task. Clearly, there was no requirement for the business to remain a mutual in their instructions. We would also like to see how the advisors were to be compensated for their services and how 'success' was to be measured.

Present throughout this period in a leadership position was the chairman, Alan Cook CBE. We have not had the opportunity to discuss any of these matters with Mr Cook, but we believe he will certainly be best placed to shed the maximum light on this affair.

It appears from the outside that the leadership's attitude to member engagement is driven by necessity alone. Where it is a legal requirement to seek member approval, this has of course been complied with. Great effort appears to have gone into the preparations to convince members that they should support the conversion to a CLG and the rule change above. Of course, they may have unwittingly facilitated this demutualisation.

> It is with some concern that I understand that LV= does not intend to seek votes from at least 50% of the membership as required under the Articles but providing its gets 75% of those members voting in favour, it intends to apply to the Courts to over-ride this provision. This cannot be right, surely.
>
> **LV= Member**

But engagement has ended there. In his verbal evidence, for example, Mr Hartigan seemed genuinely confused that we would have expected LV= to hold an accessible AGM in 2020.

The Group relayed to Mr Hartigan that concern had been expressed about the behind-closed-doors annual general meeting in September 2020, as an example of a missed opportunity to communicate with members about all these plans. It was noted that other mutuals held meetings with members, despite the lockdown.

Yet LV= held an annual general meeting with only 12 people (Board plus two qualifying employee members) in attendance, approving 14 resolutions, considering 31 questions, and lasting a total of 10 minutes.[39]

Mr Hartigan responded with details of the 3 February 2021 member event,

> We had 250 members join out of our 1.25 million membership. They were, each and every one of them, free to do so, but they chose not to. I mean, that's normal. We normally don't have more than a couple of hundred attendees that are members. It wasn't secret. It was open to 1.25 million. We put the outcome of it on the website. We put all the questions that were posed and answered on the website. In no way was this a behind-closed-doors event. It was our normal event. It was open to members. Any members of the press that were members would have been delighted to be able to attend. In fact, I'm surprised that I didn't see any on there because many of them told me that they were members and I was looking forward to seeing them.
>
> **Mark Hartigan**

It was clarified that he was being asked about the AGM, which took place two days before the announcement of Bain as exclusive bidder.

[39] https://www.lv.com/-/life/media/pdfs-lvfs/group/agm/lvfs-agm-2020-09-30-minutes-vfinal.pdf?la=en&hash=65EEDCA4A42B919E29F9FF46C1ED0D7B3849FDA3

> I can't comment to what other members of mutuals have done. I think had they held a member panel in the middle of the transaction, we, as you know, couldn't discuss the transaction or elements of it anyway. We've got traded debt in the market, and we're restricted by stock market rules to discuss the transaction.
>
> **Mark Hartigan**

It appears that Mr Hartigan is unfamiliar with the expectations of communication with owner members and engagement in a mutual business.

Over this whole period, communications with members have not been clear and candid. Instead, the minimum information, legally required, has been provided around what is the most momentous decision in the 178 year history of Liverpool Victoria.

We asked the PRA and the FCA if they will be judging whether the decision to demutualise was in keeping with the rules & spirit of LV='s Articles of Association. As before, we reproduce their response in full.

> 'While the PRA sets rules and expectations for the governance of regulated firms to ensure they are run in a way which advances our objectives and by individuals who are fit and proper, it does not determine firms' compliance with their articles of association, which is principally a matter of company law rather than prudential regulation.'

The FCA

> 'LV= plan to amend their Articles of Association via a Scheme of Arrangement (SoA) to enable them to proceed with a process of demutualisation. This will necessitate a member vote. The FCA will consider the interests of policyholders and members as part of our assessment of the fairness and transparency of these changes and the process LV will follow, and also as part of our assessment of the impact of demutualisation on policyholders and members. Our assessment of each of these aspects will be informed in part by the assessment of an IE.
>
> In considering the process to enable the demutualisation to proceed, key considerations will include inter alia: whether communications are clear, fair and not misleading; whether sufficient efforts have been made to trace gone-away members and policyholders; whether members and policyholders have had sufficient opportunities to make representations; and, whether proposed voting classes for member votes are appropriate, etc.

In considering the impact of demutualisation on policyholders and members, key considerations will include: the differing impact of the demutualisation on policyholders and members; the fairness to members of the proposed compensation for their loss of membership; and the differential impacts, including both benefits and risks, of the demutualisation on different groups of policyholders.'

We also asked whether the FCA will investigate the timeline of LV='s decision to convert to a company limited by guarantee and the decision to seek to sell the insurance business to Bain rather than, for example, to another mutual.

'The FCA has been engaged with LV on their plans for the strategic future of the business for a number of years. As part of this, during the course of 2019 we considered their proposal to convert from a friendly society to a mutual company limited by guarantee. We considered this both from the perspective of the FCA's statutory role under the Friendly Societies Act 1992 (FS Act) and more broadly, as our statutory objectives were engaged by the conversion proposals and because the conversion needed to be overseen as part of our ongoing supervision of LV.

This broader consideration is important to note as the FCA's statutory role under the FS Act is more limited than that of the PRA. The FS Act required the conversion to be approved by LV members (via a special resolution) and to be confirmed by the PRA before being registered by the FCA. The PRA was required to consult the FCA on certain aspects of the conversion including approval of the content of the member statement, and confirmation of the conversion. The FCA reviewed and challenged where appropriate the terms of the conversion and the member statement (communicating the conversion to members) and IE report.

As part of this, we gave consideration to the broader strategic plans and intentions of LV=, which formed the context for the conversion proposal. This was particularly reflected in our consideration of the member statement and member vote process, to ensure clear, fair and not misleading information about the conversion and that its aim was in large part to expand the range of future strategic options available to LV, including a possible Scheme of Arrangement to amend LV's Articles of Association.

At the time of the conversion, the strategic option being pursued by LV did not include specific plans to sell the insurance business to a third party. The decision to consider this as part of their range of options was taken subsequently by the firm, with input from its With-Profits Committee. Our assessment is that this decision by LV was made with appropriate consideration of the interests of their policyholders and members. We have throughout made clear to LV= our expectations of them and how we will be assessing that they have appropriately and fairly considered the differing interests of stakeholders in their decisionmaking, and in particular that their decision-making recognises the interests of with-profits policyholders.

Given the engagement we have already had on this issue, we do not intend to investigate further the timeline of LV='s decision to convert to a company limited by guarantee and the decision to seek to sell the insurance business to Bain rather than for example to another mutual.'

Royal London's comment sums up the view of this Group:

> We are disappointed that a fellow mutual has decided to demutualise. Royal London supports the view that a decision by any current generation of management to recommend giving up its mutual status should only be made in exceptional circumstances.

7.5 The wider legislative framework for Friendly Societies and Mutual Insurers, with a particular focus on barriers to raising capital, protection from demutualisation and attitude of Government and regulators.

Summary

Significant demutualisation has not been seen in the UK since before the financial crisis. It is no coincidence that the idea of dismantling long established mutuals and accessing their legacy assets has been out of favour since that time. Demutualisation brought a negative experience to former members, customers and the wider economy.

The All-Party Parliamentary Group for Mutuals is therefore dismayed to have to conduct this inquiry into the planned demutualisation of LV=. We find it perverse that at a time when mutuals are growing in strength in most parts of the world, we should witness the re-importing of this failed exercise in the re-allocation of intergenerational assets.

The Coalition Government recognised the positive role that financial mutuals can play, including referencing this in the Coalition Agreement post financial crisis. The subsequent few years marked the high-water mark of policy and regulatory support for mutuals. The sector enjoyed a strong understanding from the PRA in particular, though this seems to have faded more recently.

In 2015, this culminated in Treasury and Bank of England support for the Mutuals Deferred Shares Act, which was intended to provide options that would avoid the argument for demutualisation in mutual insurers on the grounds of access to working capital.

Unfortunately, this was never enacted due to a dispute with HMRC on the taxation status of mutuals. Policy support has certainly been less forthcoming since that date, and we are now faced with a crisis in the sector brought about by this proposal.

It is essential that all authorities redouble their efforts to facilitate a fair business environment for mutuals. It is not a massive task, but it is an important one that must be addressed urgently.

Demutualisation

Proposals to demutualise in the UK have always emanated from boardrooms. In most cases, they have cited the inability to raise capital as the rationale for the change. An analysis of what happens after demutualisation is instructive, however, with almost all mutuals ceasing to trade as independent entities soon after converting.[40]

> “Only one demutualised insurer or building society has remained independent (Norwich Union- now Aviva), meaning that every other demutualising organisation- which indicated it needed to cast off mutuality to gain access to capital and freedom to operate- has both given up that freedom, and had to merge with another organisation to preserve its capital position.
>
> **Martin Shaw, Association of Financial Mutuals**”

[40] http://www.mutuo.coop/wp-content/uploads/2013/03/windfallsorshortfalls.pdf

Speaking to the All-Party Parliamentary Group for Mutuals in 2014,[41] the then Deputy Governor of the Bank of England, Andrew Bailey said, 'The demutualised building society model failed.'

The effect of this process was disastrous for the members, the mutuals themselves and ultimately for the UK public that had to bail out the plc banking sector. For mutual insurers, the story is similar for customers, who have paid the price in higher costs and lower benefits.[42]

> **So it is really, really important when something seismic like this happens where the second biggest mutual in this part of the market decides to demutualise. I think this inquiry is representing a very clear public interest.**
>
> **Barry O'Dwyer, CEO, Royal London**

Legislation

Government should act to safeguard mutual ownership by removing incentives for Demutualisation. Demutualisation does not occur where there is no access to legacy assets. In the UK, mutuals are a target for people looking to liberate the legacy asset by 'demutualising' the entity and taking over its business for private benefit. This happens through the mechanism of converting it to a proprietary company.

UK mutuals legislation does not ensure that capital is preserved for the purpose it was intended. The law facilitates the demutualisation of a mutual and its assets being distributed. In other countries the situation is different and mutual reserves are protected. 23 of the 27 EU states consider protection of capital reserves to be sufficiently important to justify specific provision in their legislation.

This disinterested ownership feature of mutuals results in the building up of a legacy or inter-generational asset, which is held by current members on trust for themselves, future members and generations, to further mutual purposes. Nobody is intended to have a personal entitlement to this asset. It is a significant factor in the strength of mutuals in those countries.

Mutuals should be able to opt-in to statutory measures that disincentivise demutualisation by preserve the legacy assets for the purpose they were intended.

> **From a customer perspective, two case studies are informative**
>
> - **Before its demutualisation in 2000, Scottish Widows had a well-deserved reputation for paying out more on with-profits maturities than any other insurer. At demutualisation, it paid members £6,000 each, and after mutualisation, payouts fell to one of the lowest in the market, in absolute terms decreasing from £101K in 1998, to £28K in 2001**
>
> - **Standard Life held an industry acclaimed reputation as best for customer service until it demutualised in 2006, and we soon begun to hear of drastic cuts in service and increasing levels of dissatisfaction.**
>
> **Martin Shaw, Association of Financial Mutuals**

[41] House of Commons, Tuesday 29 April 2014
[42] https://www.mutuo.coop/windfalls-or-shortfalls-the-true-cost-of-demutualisation/

Friendly Societies Act 1992

It is 30 years since the Act was updated and industry tells us that it is desperately out of date. As we have seen in this inquiry, this puts certain restrictions on more ambitious friendly societies, such as LV=, and imposes problems that the Companies Act has overcome in the intervening period. This includes modern forms of doing business, and also retains requirements that risk societies being unable to apply other legislation or take advantage of regulatory advances.

The Mutuals' Deferred Shares Act 2015

In March 2015, the UK Parliament approved landmark legislation for friendly societies and mutual insurers to permit them to issue share capital for the first time.

These financial services mutuals conduct insurance and savings business in the interest of their members, but they currently have no share capital, with member funds instead owned collectively by policyholders.

They raise working capital through retained earnings over time and some issue debt in the form of bonds. In a business environment that expects minimum levels of capital adequacy and liquidity, this means that such member owned firms are at a disadvantage to their stock market listed competitors, which have separate investor share capital.

Deferred shares will enable individuals and institutions to invest in mutual businesses, providing new funds for:

- tactical acquisition and growth strategies
- innovation in new investment areas
- new product development
- alternative strategies to demutualisation

The Mutuals' Deferred Shares Act deals with the challenge of how to raise additional external capital in a co-operatively owned business, whilst maintaining its core mutual purpose of providing the best service and quality for the member owners.

The legislation ensures that:

- New deferred shares are permanent
- They confer membership on the holders
- They could be owned either by individuals or institutions
- No member would have more than one vote as a result of holding the shares
- Investing members that did not trade with the business would be excluded from any member votes related to mergers or dissolution
  In addition, it was agreed with UK Regulators that deferred shares will qualify as solvency grade capital in the regulatory assessment of the strength of these financial institutions.

Unfortunately, this legislation has not been fully enacted (it requires Orders to be laid by HM Treasury) because HMRC has taken the view that issuing MDS will alter the tax status of mutuals. This effectively makes the instrument unusable without this being resolved.

The sources of capital available to mutuals, both at start up and as mature businesses, are limited. While many mutuals were set up through capital injection by their original members to support their communities and interest groups, the level of capital required to establish a financial mutual today is many-fold greater than in the past, and so the likelihood of mutual start-ups is low.

This severely limits the entry of new mutual challengers and the growth of existing mutuals. The extensive demutualisation of building societies and mutuals from the 1980s onwards was as a direct result of this capital limitation.

A proposal to develop Mutual Deferred Shares, as a means of allowing mutuals to raise capital was developed in 2014/15 – however the initiative stalled at secondary legislation. OneFamily recommends that the extensive work undertaken to develop Mutual Deferred Shares be resurrected, as the principles of the original legislation hold strong as a way of supporting fund-raising for future growth.

OneFamily Friendly Society

Mr Hartigan was asked, if during his considerations of the future of the business, he had any discussions with HM Treasury about the potential for raising new permanent capital.

I haven't. I'm aware of the Mutuals' Deferred Shares Act of 2015, but I'm also very cognisant of the fact that, in practical terms, it's of little use to us in these circumstances in which we find ourselves. Dividends paid as a consequence of the acquisition of shares under the act are subject to HMRC tax rules, so it defeats our advantages as a mutual and actually means that the capacity to utilise those shares are pretty much defunct.

Mark Hartigan

Mutual Capital Instruments - Australia

New legislation in Australia[43] has enabled all types of mutuals to raise permanent capital without the risk of demutualising

In April 2019, the Australian Corporations Act was amended to allow mutual companies to issue mutual capital instruments (MCIs). MCIs are a new permanent capital instrument that can only be issued by eligible 'mutual entities.' This new type of equity share will enable them to attract investment capital, whilst protecting their co-operative ownership structures.

Mutuals will use the new capital to fund their growth and innovation plans, developing new products and making tactical investments. The legislation facilitates mutual companies to manage the funding arrangements and capital position of their mutual effectively and invest in its services to members, enhance existing programs and developing organisational systems including customer service and technology systems. MCIs will provide additional flexibilities and capacity to increase firms' positive impact and fully realise their potential as a member owned firm, without losing its status as a mutual.

The legislation permits flexibility in mutuals so that Board can determine the number of MCIs issued, and decide the terms of those MCIs – including any voting rights (within the set requirements) and the dividend rights.

Some of the key points are:

- MCI holders will have no right to vote on winding up the organisation or propose or vote on any demutualisation measures. In the unlikely event that the organisation was wound up, MCI holders will only be entitled to dividends that have been accrued but not paid, and any additional amount specified in the terms of the MCI (limited to the issue price).
- MCIs can be transferred and may be able to be quoted on a securities exchange. The Board will have the power to issue different series of MCIs, with different terms.
- MCIs will be subject to the capital reduction and share buy-back rules of the Corporations Act (which have been modified to accommodate MCIs).
- The Corporations Act contains a standardised member approval process. This allows the Company to amend its constitution to provide for the issue of MCIs, and to set out the rights and obligations of MCIs.
- Issuing MCIs does not alter the tax status of the mutual.

The inaugural issue[44] of $120 million of MCI was completed in December 2020 and is quoted on the ASX.[45]

As can be seen, action needs to be taken to ensure that UK mutuals legislation is fit for purpose. It requires the political will to do this and HM Treasury should carefully consider the consequences of not acting.

[43] Treasury Laws Amendment (Mutual Reforms) Act 2019 https://www.legislation.gov.au/Details/C2019A00037
[44] https://www.australianunity.com.au/about-us/mutual-capital-instruments
[45] https://markets.ft.com/data/equities/tearsheet/charts?s=AYUPA:ASX

Responsibilities of regulators

The Bank of England (PRA) set out the Regulatory position to us.

The PRA's objectives

The Act sets out the objectives of the PRA. The PRA has a general objective of promoting the safety and soundness of the firms it regulates, primarily through ensuring that firms' business is carried on in a way which avoids any adverse effect on the stability of the UK financial system, minimising the risk firms' failure would pose to UK financial stability. The PRA also has an insurance objective of contributing to the securing of an appropriate degree of protection for those who are or may become policyholders.

When discharging its general functions in a way that advances these objectives, the PRA must, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by the firms it regulates.

In discharging its duties, the PRA also has regard to certain aspects of the Government's economic policy, as set out in the letter from the Chancellor to the Governor of the Bank in accordance with the Bank of England Act 1998. The most recent letter, sent in November 2019[46], makes recommendations with respect to competition, growth, competitiveness, innovation, trade, and better outcomes for consumers.

Supervision of mutual insurers

Our approach to the supervision of mutual insurers is broadly consistent with the approach adopted for other insurers, as set out in the PRA's approach to insurance supervision.[47] It reflects variety in the sector, for example different constitutions, governance frameworks, and policyholders. It also recognises that there are issues that are specific to the mutual sector, for example constraints on raising external capital.

The Act places an obligation on the PRA, when making rules, to consider whether the impact on mutual societies would be significantly different from the impact on other firms and, when exercising its general functions[48], to have regard to the differences in the nature of, and objectives of, businesses (including mutual societies).

Twin peaks regulation

The PRA works alongside the Financial Conduct Authority ("FCA") creating a "twin

[46] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844467/PRC_Remit_2019.pdf
[47] The Prudential Regulation Authority's approach to insurance supervision (bankofengland.co.uk).
[48] Making rules and technical standards and issuing codes under the Act, and determining the PRA's policies and principles for exercising its functions under the Act.

peaks" regulatory structure in the United Kingdom. The FCA is a separate institution and not part of the Bank of England,and has different objectives under the Act. The FCA's objectives concern ensuring that markets for financial services function well, protecting consumers, protecting and enhancing the integrity of the financial system and promoting effective competition. A Memorandum of Understanding is in place between the FCA and PRA to facilitate co-operation between the regulators in relation to their separate mandates.

The PRA's approach to transactions

In line with our remit and objectives, we will consider the transaction between LV and Bain Capital in our capacity as the prudential supervisor of LV's PRA-authorised entities. We will assess any risks that the transaction may pose to our statutory objectives and how they may be mitigated.

In addition, transactions such as this often require specific approvals from the regulators, which are subject to procedures set out in legislation. For example, before an acquisition of a PRA-regulated firm is effected, the acquirer must apply to the PRA for a "change in control" approval. The Act sets out the procedure that the PRA must follow, which includes consulting the FCA, and the criteria that it must apply in assessing the application, including considering the impact of the proposed change in control on the firm's ability to meet prudential requirements.[49]

The transaction between LV and Bain Capital is also anticipated to involve court processes, including a "scheme of arrangement" under Part 26 of the Companies Act 2006 and a transfer of insurance business under Part VII of the Act. These processes will be subject to court decisions and may facilitate the changes to LV's membership and the ultimate demutualisation. The PRA will input into these processes where necessary to further its statutory objectives having assessed the prudential implications. The PRA also has a specific statutory role in relation to Part VII transfers.[50]

[49] Further information on the change in control process can be found here: https://www.bankofengland.co.uk/prudential-regulation/authorisations/change-in-control.

[50] Further information on:

- the PRA's approach to insurance business transfers can be found here: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/statement-of-policy/2015/the-pras-approach-to-insurance-business-transfers-sop.pdf.
- the PRA's approach to schemes of arrangement can be found here: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2014/ss314.pdf.

We asked the PRA and the FCA what assessment they had made of the benefits of demutualisation of past financial mutuals for the wider public interest, the management proposing demutualisation and for consumers?

The PRA said:

The PRA has not conducted any dedicated reviews of past demutualisations – our remit has limited overlap with the direct impact of demutualisation on consumers - but we continue to assess entities post-demutualisation in accordance with our supervisory approach. We also assess transactions on a case-by-case basis in accordance with relevant legislation and statutory responsibilities as set out above.

Through its wider activities for regulated firms, the PRA's supervision covers the suitability of financial and non-financial resources, including firms' governance and management. For example, the PRA sets expectations and rules for the Senior Managers and Certification Regime, and remuneration.

We understand that you have also written to the FCA. Aspects of this question more closely align with their remit.

The FCA said:

For past demutualisations, the FCA (and our predecessor regulator the Financial Services Authority) has been guided by our objectives in considering the merits of the specific demutualisation. This would take into account the impact on the range of policyholders and members of the mutual, as well as the implications of the demutualisation for competition in the interests of consumers.
We would also consider the reasons for the demutualisation, the other options considered and whether the option to demutualise was in the interests of policyholders and members. There are a number of reasons that a mutual might seek to demutualise, which could inter alia relate to their ability to raise capital to invest in their products, services and IT systems in order to compete, or to their ability to address the issue noted in our Policy Statement on mutuality and with-profits (PS14/5 - https://www.fca.org.uk/publication/policy/ps14-05.pdf) regarding declining volumes of new with-profits business written into a single common fund.

In practice, we have not conducted any dedicated ex-post reviews of past demutualisations to assess the benefits they have in practice delivered for the wider public interest, the management proposing demutualisation or consumers. Our primary focus has been on ensuring a robust analysis of the proposal to demutualise, including the potential benefits to competition in the interests of consumers in maintaining the diversity that mutuals add to the provision of retail financial services. Post-demutualisation, we have continued to supervise demutualised firms and sought to address any issue or concerns as part of our normal approach to supervision.

The issue that we see with this approach is that it is entirely transactional. Both regulators have a responsibility to look at the overall impact on markets, but this seems to be a lower priority than assessing the narrow criteria of the transaction and the manner in which it is conducted. Much of what is assessed depends on the information provided by boards and management, which is always going to be partial. There is no voice for the owners in this process and this needs to be addressed.

There is also less focus on whether the transaction is a good thing or has broader consequences, unintended or otherwise.

We note that this was recognised in a 2014 FCA policy statement[51] that there are deeper considerations:

'2.13 If a mutual does not wind up its non-profit business, the business may well be transferred to a proprietary company. If this happens, it may not participate in the market in the same way as it did before. For example, it may focus on the most profitable lines of business, dropping lines that are marginally profitable or not aligned to its business model. As was mentioned in CP12/38, there is evidence that non-profit ownership plays a role in limiting firms' incentives to exploit consumer biases. Therefore, the presence of mutuals in markets can reduce the social costs that may result from consumers' mistakes. Finally, having a wide variety of different business models may lead to greater innovation compared to insurers more generally. Losing some of this diversity may reduce the scope for innovation in the longer term and lead to worse long-term outcomes for consumers. Reduction in products or services directed at particular consumer groups or niches may make it harder for those consumers to access financial services, especially where they are affected by social or economic deprivation.'

This does not seem to feature in the Regulators' assessment of the LV= proposed demutualisation.

This speaks to a gap between Regulatory action and policy, which must be bridged.

The final word belongs to the Bank of England:

> **Certainly, I do not see the transaction as a done deal. It is a complex proposal. The change in control application will need to be satisfied that the transaction meets those criteria. As Matt says, there are those members' votes, a scheme of arrangement to be approved by the court and Part VII transfer subject to court approval as well. So yeah, no, this is not a done deal.[52]**
>
> **Charlotte Gerken, PRA**

[51] FCA PS14/05
[52] Oral evidence to the Inquiry

8. Names and dates of witnesses examined and evidence submitted

Witnesses examined

2 March 2021	Martin Shaw John Gilbert
9 March 2021	Barry O'Dwyer
22 March 2021	Charlotte Gerken Matt Brewis
23 March 2021	Mark Hartigan Matt Popoli

Submissions received

Organisations:

Bain Capital
Financial Conduct Authority
Liverpool Victoria (LV=)
OneFamily Friendly Society
Prudential Regulatory Authority
Royal London

Individuals:

Peter Bloxham
Ken Chatfield
Rosemary Clark
Clarissa Johnson
Brian Moss
Frank Ogier
Colin Peters
John and Jane Sheppard
Greg and Nicola Snow
Laurence Whitehouse

appg mutuals