CORPORATE DIVERSITY AND THE PROVISION OF FINANCIAL SERVICES

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ABSTRACT

The corporate landscape of United Kingdom financial services has changed considerably in the last fifteen years with virtually all the main players now shareholder-owned. The dominance of shareholder ownership may not last for ever and the pendulum could swing back to alternate structures. Should the actuarial profession look ahead and consider what, if anything, could be done to encourage diversity? This paper considers some of the issues involved and raises some questions for the profession to discuss.

KEYWORDS

Building Societies; Corporate Ownership; Credit Unions; Friendly Societies; International; Microfinance; Mutuality; Proprietary; Shareholders

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Variety is the very spice of life — William Cowper

1. Introduction

1.1 The much-heralded wave of demutualisations amongst U.K. insurers has taken place, perhaps to a greater extent than many predicted. The U.K. building society movement has seen a similar change as many companies converted and/or were acquired by plc rivals. This move away from mutuality has been a feature in other countries too, for example, Canada, South Africa and the United States of America.

1.2 Many now wonder whether the concept of mutuality is 'past its sell-by date', at least as far as the provision of financial services is concerned. They see the publicly-listed, shareholder-owned structure as preferable, on the

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grounds of greater transparency (leading, so the argument goes, to greater accountability and hence efficiency), more ready access to additional capital and (potentially, to a greater extent) greater strategic flexibility. Others, of course, hotly deny this conclusion, claiming that mutuality still has its place.

1.3 While much has been written on Building Societies and mutuality (see, for example, Llewellyn, 1999), mutuality in insurance has received much less coverage (hence the bias towards mutual insurers in terms of this paper's content). In their report (Hairs *et al*, 1999), the Closed Fund Alternative Working Party did make mention of the possible public interest issues arising from life office demutualisations and raised the question of how far the actuarial profession should address them, recognising that "given the relatively large number of life insurance companies in the U.K., it is difficult to argue that closure of any one company has major public interest implications." However, is there a public interest issue if there are no mutuals at all? Putting it more widely, is diversity of corporate ownership structures in the public interest? Furthermore, if it is, should the actuarial profession play a part in promoting it, or should we just allow market forces to operate, irrespective of the consequences?

1.4 In his Presidential Address to the Faculty (Kingston, 2000), David Kingston touched on these issues and asked:

> "Are there aspects of mutuality which can be maintained even if the pure form of mutuality has gone? I suspect that the present swing to free markets and to a 'shareholder society' may reverse at some point. It is our job as actuaries to be looking beyond the present state. It seems to me to be desirable that several forms of ownership should survive and that new life companies should be regularly formed. I hope we will have more to say on the matter."

1.5 The purpose of this paper is to continue this discussion. It seeks to shed light rather than generate heat. It is not about which corporate structure is 'best'. Rather, it is concerned with variety of corporate ownership structures and presents some facts and figures which should help inform a debate within the actuarial profession.

1.6 The paper first describes the differences, as far as U.K. company law is concerned, between friendly societies, building societies, credit unions, mutual insurers and shareholder-owned insurers and highlights some of the consequences for corporate governance. The particular case of the U.K. mutual insurance sector is then considered with a brief description of the factors which led to its growth as well as those which have contributed to its recent contraction. The focus of attention then shifts to other parts of the world to identify countries where mutuality is still prominent and the reasons why this may be the case. Finally, some recent alternative thinking in the U.K. and elsewhere is presented before some questions for discussion are posed by way of conclusion. Various appendices follow giving more background detail on many U.K. mutuals (now almost all former mutuals)

as well as a case study on the Japanese market and some background information on friendly societies and credit unions.

2. Company forms and U.K. legislation

2.1 Company ownership can take a variety of structures depending upon the needs of the business. The following table presents a possible classification:

single owner/manager	i.e. self-employed business- man/woman
several owner/managers	i.e. partnership
multiple (investor) owners, employing managers	i.e. plc
multiple (consumer) owners, employing managers	i.e. mutual i.e. retail co-operative
multiple (producer) owners, employing managers	i.e. John Lewis Partnership

2.1.1 From the above, it is obvious how the need for (equity) capital and the source(s) from which it is obtained, has a key influence on the corporate structure adopted for a particular enterprise and for a fuller consideration of such issues, the reader is referred to Ricketts (1999).

2.1.2 It should be noted, though, that ownership does not necessarily mean exactly the same thing in each of these possibilities, at least as far as their implementation in U.K. company law is concerned. In some cases, 'membership' would be a more appropriate term.

2.2 *U.K. Company Law*

2.2.1 The Companies Act 1985 provides for three broad categories of companies, distinguished according to liability and breadth of ownership/membership as follows:

— unlimited companies
— public limited companies (denoted by 'plc' after their name), and
— private limited companies (denoted by 'Limited' after their name).

In each case, the company is defined by two documents. The Memorandum of Association lists, among other things, the objectives of the company, the location of its head office, whether it is public or private and whether it is limited or unlimited. The Articles of the company relate to its internal organisation — for example, the rights of shareholders and/or members, the calling of general meetings and the appointment of directors.

2.2.1.1 Public limited companies are limited by shares — the ownership of the company is through the possession of its shares and the liability of the shareholders is limited to the amount invested and any face value of the equity not fully paid. The shareholders own the company, exercising their control through an elected board of directors, and ownership rights can be bought and sold through dealing in the shares.

2.2.1.2 Private limited companies can be limited either by shares or 'by guarantee'. The former case is similar to that for plcs in that the shareholders own the company. However, legislation does not permit the selling of shares in such companies to the public, and thus the situations in which this form of company is suitable are limited (but could include, for example, family businesses or wholly-owned subsidiaries).

2.2.1.3 Private limited companies limited by guarantee do not have shareholders. Instead, they have members, at least some of whom will share in the control of the company through the exercise of voting rights. Membership cannot be transferred (i.e. bought or sold). Rather, the Articles of the company will lay down the rules concerning how membership (whether voting or otherwise) is acquired and when it ceases. The liability associated with membership will be limited to a fixed amount, typically 50p or £1, and laid down in the company's Memorandum of Association.

2.2.1.4 Unlimited companies can be quick to set up but have obvious drawbacks for their owners should the business not prosper. A public limited company is the only route to follow where it is the intention (or expectation) to raise equity capital from the general public. A company limited by guarantee is a suitable structure for an organisation not designed to make money for members as members, but rather to provide some form of service, perhaps to members and non-members alike, with any profits made either retained within the company or used to improve the service in some way (or reduce its cost). Thus, charities are often set up as companies limited by guarantee.

2.2.2 The Companies Act 1985 also lays down minimum capital requirements for public companies — basically, £50,000, of which at least a quarter must be paid up. The raising of capital, however, (both in terms of the procedures to be followed and the information to be disclosed to would-be investors) is governed by the Financial Services Act 1986 and, more recently, the Financial Services and Markets Act 2000. Where the company is for the transacting of insurance business, then, of course, all the insurance legislation and regulations also apply (and, in particular, the minimum capital requirements), whatever the structure of the company.

2.2.3 The setting up of a company under the Companies Act is a relatively straightforward process involving the completion of certain forms, the drafting of the desired Memorandum of Association and Articles and the payment of the appropriate fee to the Registrar of Companies. In return, a certificate is issued and a company created. This registration process can

even be completed in a single day if necessary (and a higher fee paid!). An even simpler alternative is to buy an existing company 'off the shelf' and then change its Memorandum of Association and Articles if necessary to suit the purpose for which it is desired.

2.2.4 In effect, the Companies Act delegates the setting up of companies to the Registrar of Companies. However, Parliament is still able to create companies directly. This is a much more expensive route, involving a private Act of Parliament, but has the attraction of not having to fit into the Companies Act structure. As well as the private Act (which can only be changed by Parliament), the company is defined by a set of Regulations which, in effect, combine the Memorandum of Association and the Articles, and which can be changed by the company itself following an appropriate member vote.

2.3 *Application to U.K. Insurance Companies*

2.3.1 As already mentioned, most U.K. life offices are public limited companies, some wholly owned by parent groups and others with a wide spread of shareholders. From what has been presented above, it can be seen that 'plc' is the only structure to follow where it is desired to raise external equity capital. There is more choice, however, about the structure of a mutual insurer. It could be an unlimited company, a company limited by guarantee or a company limited by private statute and there are examples of all three types.

2.3.2 Thus, it is not technically correct to talk of 'ownership' of a mutual as if it were the same as share ownership. Membership of a company is not the same as ownership. In fact, no-one can own a company limited by guarantee. Of course, such distinctions in law may be lost if great emphasis is placed on how voting rights can be used to gain a windfall through the changing of the company's structure.

2.3.3 While the Companies Act 1985 does regulate plcs more than limited companies (for example, a quicker reporting timescale), insurance regulation and legislation applies equally. It is sometimes claimed, though, that plcs are subject to greater external scrutiny and are therefore 'better' as insurance companies because of this. This claim is worth further investigation.

2.3.3.1 Whatever their corporate structure, all insurance companies are subject to the scrutiny of financial commentators and journalists, and, where appropriate, independent financial advisors (IFAs). The extent of such attention is probably more to do with distribution patterns than corporate structure.

2.3.3.2 Public limited companies are, of course, subject to the scrutiny of their shareholders, particularly the large institutional shareholders, and the equity analysts operating on their behalf. However, for this scrutiny to benefit policyholders would require the interests of both parties to be aligned

and this need not always be the case. Shareholders are concerned with income and capital values, often with quite a short measurement time horizon, and this can lead to conflicts of interest which need to be carefully managed.

2.3.3.3 Few would argue that external shareholder scrutiny has little effect on the performance of company management teams. At times it would appear to have a very beneficial effect on share performance. While this could be to the benefit of policyholders, it should be noted that it need not be.

2.3.3.4 Of course, it should also be pointed out that the lack of short term shareholder pressures may not necessarily result in better long term performance from a mutual insurer. Poor management performance can transcend corporate structure.

2.4 *U.K. Friendly Societies*

2.4.1 Any discussion of U.K. insurance provision would not be complete without some reference to friendly societies. There are currently around 300 friendly societies in the U.K., representing at 31st December 2000 some £15bn of funds under management and covering around 5.8m policyholders.

2.4.2 Friendly societies are a form of mutual organisation. Thus, they have no shareholders, but, rather, members. Each society exists for a specific purpose and its management is accountable to the members. When the majority of friendly societies were formed (during the nineteenth and twentieth centuries), start-up capital was generally provided through a form of guarantee bond subscribed to by prominent members of the local community.

2.4.3 Friendly societies are not Companies Act companies. Instead, as described in Appendix C, they are incorporated under their own specific legislation, the Friendly Societies Act 1992. This Act set up the Friendly Societies Commission which over sees friendly societies and, in particular, grants authorisation to carry out insurance business. (It should be noted, though, that under the Financial Services and Markets Act 2000, the powers and duties of the Friendly Societies Commission will, in due course, vest in the Financial Services Authority (FSA).)

2.4.4 Friendly societies and similar bodies are still being formed today, although not necessarily to provide insurance or other financial services, as the examples found in ¶3.4.1 and section 5.3 demonstrate.

2.5 *U.K. Building Societies*

2.5.1 *Legislation.*

2.5.1.1 Building societies operate under their own specific legislation, currently the Building Societies Act 1986 — as amended, especially by the Building Societies Act 1997. Until 1986, building societies operated under

legislation little changed from an Act of 1874 which provided that they raised funds from investing members and used these funds to provide mortgage loans to borrowing members. Any other type of activity was prohibited. These restrictions became increasingly inappropriate during the deregulatory years of the 1980s. Accordingly, the Building Societies Act 1986 allowed societies to offer a wider range of specified services connected with personal finance, housing and housing finance.

2.5.1.2 The 1986 Act set limits on the amount of wholesale funding societies could raise and on the amount of non-residential mortgage business they could undertake. It also introduced the concept of conversion to plc status, an option not previously open to societies. During the 1990s, it became increasingly clear that the prescriptive rules contained in the 1986 Act were ill-suited to cope with the continuing rapid changes in the financial services market. After consultation, the Building Societies Act 1997 was introduced. This was not a free-standing piece of legislation but made substantial amendments to the 1986 Act. The key points are as follows.

2.5.1.2.1 Building societies must hold at least 75% of their business assets (i.e., excluding liquid assets and fixed assets) in the form of residential mortgages. The remaining 25% can be held in any type of asset provided the society can convince itself, its regulator and its members that it has the appropriate managerial and financial resources to move into other areas. The figure of 75% can be reduced to 60% through secondary legislation introduced into Parliament by the Treasury.

2.5.1.2.2 Societies must raise at least 50% of their funds from members who are individuals.

2.5.1.2.3 A society can undertake any activity, as long as it is not expressly prohibited by the legislation and forms part of the memorandum of powers agreed by members. This turned the previous legislation on its head; previously societies could undertake only those activities permitted by the legislation, with anything else prohibited. The prohibited areas now comprise taking positions in the derivatives, commodities and foreign exchange markets.

2.5.1.3 So far, most building societies have not used their powers of diversification extensively. Approximately 95% of all lending undertaken by societies is in the form of residential mortgages, and around 75% of the funds raised are from individual members. A few societies do, however, offer a wide range of additional services.

2.5.2 *Constitutional provisions*

2.5.2.1 Building societies are mutual member-based institutions. Those opening an investment or mortgage account become a member of a society and have the right to receive certain information about the way the society is being run and to attend, speak at and vote at, annual and special general meetings. Each member has one vote irrespective of the amount invested or

borrowed. Members can propose resolutions for consideration by an AGM or SGM if they have support from a sufficient number of qualifying members. (Generally a member will qualify to propose or support the proposal of a motion if he or she has had £100 invested (or borrowed) for two or more years.)

2.5.2.2 The Building Societies Act 1997 made building societies more accountable to their members. Among the changes were the following:

— Borrowers were given the vote on general issues affecting the society (previously they had been able to vote only on proposals to merge or convert).
— Societies are now required to hold polls for the election of directors of the society even if the number of vacancies is the same as the number of candidates.
— A proposal for significant diversification now requires the support of members (expressed at a general meeting) before it can be implemented.

2.5.3 *Size and scope*

2.5.3.1 At end 2000 there were 66 building societies with 17.5m members (15m investors and 2.5m borrowers) within the U.K. Total assets invested exceeded £165 billion and over 34,000 staff were employed in around 2,100 branches.

2.5.3.2 Building societies currently account for about 20% of all outstanding residential mortgages in the U.K. and about 18% of all personal sector deposits held by building societies, banks and National Savings.

2.5.3.3 The market share of building societies used to be much greater, before the wave of demutualisations which have been seen in the last fifteen years. For a discussion of what has happened and the issues involved, set in a corporate governance framework, the reader is referred to Cook, Deakin and Hughes (2001).

2.6 *U.K. Credit Unions*

2.6.1 A credit union is a financial co-operative owned and controlled by its members and run to serve them (rather than generate profits). Membership is limited to those who share a common bond — for example, work for the same employer, live in the same area, are members of the same association (e.g. trade union, housing association or religious group) — and it is this restriction which distinguishes a credit union from a traditional local building society.

2.6.2 Members are encouraged to save their money by purchasing 'shares' in the union. These savings build up a pool of funds from which loans to members can be made. The interest charged on loans is used to meet operating expenses and pay an annual dividend to investors.

2.6.3 A credit union is managed and controlled by a volunteer Board of Directors (all of whom must be members) who are elected by the membership

at the AGM. All members have one vote, irrespective of the size of their savings.

2.6.4 Credit unions operate under the auspices of the Credit Unions Act 1979 which lays down provisions concerning investing and borrowing (as described in more detail in Appendix D). The Act also gave responsibility for registering unions and regulating their operations to the Registry of Friendly Societies. (As with Friendly Societies, these responsibilities will transfer to the FSA under the Financial Services and Markets Act 2000.)

2.6.5 In June 1998, a Task Force was set up by HM Treasury to see how banks and building societies could support the development of credit unions. It reported in November 1999, recommending that a Central Services Organisation be set up to enable all credit unions, irrespective of size, location or affiliation, to provide a wide range of services to their members. The Association of British Credit Unions Limited (ABCUL), the principal trade body of credit unions in the U.K., has been charged by the Treasury with taking this forward.

2.6.6 According to ABCUL (Scotland has more credit unions than any other part of the U.K., but at only 1% of the population (138 unions with 126,500 members), there is a long way to go to catch up with, say, Ireland, where almost half the population are members. The Scottish Executive wants to see the benefits of credit unions being made available to more Scots and is making £1.5 million available over three years to encourage the growth of the movement across Scotland.

2.6.7 Credit unions can be found in many countries of the world, in some cases playing a major role in the provision of certain financial services. Appendix D gives some more detail on this as well as on the U.K. situation.

2.7 *U.K. Industrial and Provident Societies*

2.7.1 An industrial and provident society is an organisation which conducts some sort of business, industry or trade either as a 'bona fide co-operative society' (in which any profits are applied to improve the service or facilities offered) or for the benefit of the community. They can be found in a wide variety of applications in the U.K., including worker and retail co-operatives, working men's clubs, allotment societies and sporting clubs.

2.7.2 Such societies are regulated by specific legislation (the Friendly and Industrial and Provident Societies Act 1968, Industrial and Provident Societies Acts 1965 and 1967) and must be registered with the Registry of Friendly Societies.

2.7.3 Among the benefits to an appropriate organisation of registering as an industrial and provident society are:

— no need for trustees to represent the interests of the organisation;
— the members have limited liability; and
— some grant-making bodies may prefer applicants to be appropriately registered.

2.7.4 The industrial and provident society structure is being increasingly advanced as an appropriate structure for mutual, community-serving initiatives in the U.K., as explained in section 5.3.

3. U.K. INSURANCE AND THE INFLUENCE OF MUTUALITY

3.1 As described earlier, this paper was a consequence of comments made by David Kingston arising from the recent shift away from mutuality in the U.K. insurance world. In order to put the current situation in context, the authors sought to understand something of the history of many of the offices involved. The resulting brief 'pen-portraits' are presented in Appendix A. They show the diversity of origin and history amongst U.K. life offices. Nevertheless, common themes can be seen, particularly in terms of why new life offices are formed in the first place, a particularly appropriate issue given the quotation in ¶1.4.

3.2 *Reasons for Life Office Formation*

3.2.1 The following summarises the main themes underlying the creation of life offices (both proprietary and mutual) in the U.K. over the past 200 or so years.

3.2.2 *Meeting a need*

Simple though it sounds, there is always a belief that there is a need for the services that the company will offer. Examples include:

— offering services to areas of the community that do not have access to insurance (as in the case of friendly societies);
— providing a new type of insurance contract that fills a gap in the market;
— offering services to the local community or a particular geographical area (e.g. Scottish Widows was initially intended to provide insurance cover predominantly for Scottish residents); and
— offering services to a particular section of the population (e.g. Clerical Medical was created specifically to provide insurance cover for members of the clergy and the medical profession).

3.2.3 *Market opportunity*

The timing of the founding of some companies was particularly influenced by perceived opportunities in the (then current) market circumstances. For example:

— lack of competition (in particular in the 19th century, where the success of early life insurance companies encouraged others to follow suit);
— low capital requirements to establish a life office (particularly relevant where there is an expectation that more stringent legislation will be introduced in the future);

— out-dated mortality tables in use for premium rates; (This was a key factor in the establishment of, for example, both Equitable Life and Scottish Provident.); and
— concern that delaying the creation of a company would make entry more difficult in the future (i.e. more competition in future so lower chance of success for a late arrival).

3.2.4 *Encouragement of others*

Several insurance companies were established with the encouragement and assistance of existing companies and Acts of Parliament throughout the 19th Century. Examples include:
— Legislation initially provided friendly societies with tax and operational advantages over life offices. This encouraged the rapid growth in friendly societies for local communities across the U.K. This was an active policy pursued by Parliament to provide the poor and working classes with a means of insurance for times of sickness or death.
— Members of Equitable Life's staff provided Scottish Widows with initial advice, including information on the former's structure on which a large part of latter's operational structure was based.
— NPI was established following the success of Friends Provident. Assistance was provided by the latter to create NPI and a strong working relationship existed between the two offices for the next 150 years.

3.2.5 *Success of other companies*

Most company histories make reference to the successes of existing insurance companies in influencing their formation. Examples include:
— Norwich Union was established following the success of its general insurance sister company.
— NPI was founded largely as a result of the success of Friends Provident.

3.2.6 *Mutuality*

Many companies were formed in the 19th and 20th centuries to embrace the principles of mutuality. Mutuality was then seen as a source of competitive advantage, offering the promise/expectation of long term stability and trustworthiness in poorly regulated markets. In other cases, mutuality was seen to be an appropriate way of dealing with uncertain future risk costs, enabling the return by way of surplus distribution any prudential margins subsequently not needed. Other companies were formed using external capital (rather than investments or donations from wealthy benefactors) but became mutual subsequently. Reasons for mutualisations vary. Examples include:
— a desire to remove the conflict of interest perceived to exist between shareholders and policyholders; and
— the threat of nationalisation or other forms of take-over.

3.3 *Reasons for Demutualisation*

3.3.1 A variety of reasons have been put forward for the recent wave of demutulisations in the U.K. and elsewhere. While the list may not be exhaustive, the following gives a flavour of the influences at work.

3.3.2 *Lack of perceived benefits from mutuality*

Many members of the public do not consider it matters whether a provider is mutual or shareholder-owned. The reasons for this are complex, but probably include the following:
— current society's emphasis on individualism;
— increasing significance of non-profit and investment linked products;
— relative performance (or perceptions of) of mutual and proprietary offices;
— increasing regulation removing the historic 'more trustworthy' reputation of mutuals; and
— the rise of 'the brand' as being a key influence on purchase patterns.

3.3.3 *Limited capital*

In some cases, a lack of capital has been a contributing factor to a mutual contemplating a change of structure. Selling the business has generated capital to strengthen the fund or enhance benefits. Alternatively, the new owners (whether they be institutional shareholders or a new parent company) have been willing to supply capital, either equity or debt.

3.3.4 *Lack of critical mass*

In the current competitive '1% world', economies of scale are seen as vital to compete successfully as a major player. Where mutuals do not have the capital to fund rapid growth, joining with another company can be an attractive strategy to reach critical mass.

3.3.5 *Access to distribution*

It may not just be lack of capital which limits a company's growth. Would-be parent companies with large distribution capabilities can prove attractive to mutuals whose managers are keen to grow the business.

3.3.6 *Globalisation*

This is related to the previous points. Globalisation is talked of in a number of industries with many companies seeking to become 'global players' in terms of size and diversity of operation. Strategies to achieve this usually involve mergers and acquisitions and, without equity to raise and/or exchange, mutuals are limited in the extent to which they can take part in such consolidation.

3.3.7 *Carpet-bagging*

Notwithstanding the strategic considerations above, there is always the possibility that some of the current members of a mutual will place more value on the prospects of a windfall than on any future benefits to them (or others) of the company remaining mutual.

3.3.8 While many of these influences are to do with growing businesses

and seeking to increase the potential of existing operations, they do have the consequence that future policyholders of the office concerned will not have access to any benefits mutuality might have brought. Is this loss of choice something we should regret or just the price to be paid for progress? Such issues will be returned to in section 6.

3.4 *Starting a Mutual Today*

3.4.1 Could a new mutual be started today, or are the existing mutuals the last of the breed? The answer is yes, a new mutual could be started today. In fact, one was started in 1995, the Pension Annuity Friendly Society.

3.4.2 The Pension Annuity Friendly Society (PAFS) is an impaired lives annuity provider. It was formed in 1995, the first friendly society to be incorporated and authorised under the Friendly Societies Act 1992, and the first insurance friendly society to be formed since 1987. It has since grown to funds under management of £206m at 31st December 2000.

3.4.3 As a mutual, any surplus which emerges is used for the benefit of current and future members. The company employs a number of staff itself, but some of its management services are provided, at arm's length cost, by Impaired Life Services Limited, a company controlled by certain members of the Committee of Management of PAFS.

3.4.4 An interesting feature of this case study is how the capital needed to start the business and, in particular, to cover the Minimum Guarantee Fund, was obtained. An initial donation of £1m was secured (from a reinsurance company) by the original members. Since then, further donations have been received, bringing the total up to £7.5m as at 31st December 2000. The Society has Quota Share reinsurance programmes with two major reinsurers.

3.4.5 At the time of writing this paper, it was announced that PAFS had raised up to £16m of new capital, to expand its product range and develop new markets, through the issue of an undated subordinated debt loan facility underwritten by Bank of Scotland Corporate Banking. This was the first time that a subordinated debt facility had been issued to a friendly society.

3.4.6 A key consideration for anyone wishing to start a mutual insurance company today would be how to raise the necessary capital to commence operations and cover the Minimum Guarantee Fund. In the past, the friendly society route has had the attraction of having a lower capital requirement, at least initially. Whether or not this continues to be the case, sizeable amounts of money are involved.

3.4.7 The route followed in previous centuries of inviting subscriptions from wealthy benefactors is, in theory, still possible, but probably unlikely in practice.

3.4.8 The route followed by PAFS is probably more practicable, namely, seeking donations from a company or companies who would hope to benefit from the existence of the new mutual and who were prepared to give

money on the strength of this (but with no guarantee). Examples of potential candidates would include reinsurers and management services companies. Whatever the type of donor company, a strong business case would need to be made to them. This has implications for the business plan of the proposed mutual and, in particular, the rates of new business growth expected. This in turn has implications for the products to be offered and the market segments to be targeted and tends to suggest that it would be most likely to be successful in niche market situations.

3.4.9 Interestingly, mutual organisations, (some in the form of industrial and provident societies), are still being started today, as appropriate corporate solutions in certain (non-insurance) situations. A brief description of some of these developments is given in section 5.3.

4. Insurance ownership in other parts of the world

4.1 A comprehensive analysis of international developments affecting mutual insurers is outwith the scope of this paper. Readers wishing more detail are referred to, for example, Swiss Re's recent research report, Swiss Re (1999) and Taylor-Gooby (1999). For an article which considers corporate culture and structure in an international life assurance context, the reader is referred to Simpson (2001).

4.2 For the purposes of this paper, it is sufficient to note that, as Table 1 shows, many of the world's largest insurers are still mutuals. While AXA is shown as proprietary, it is worth noting that, as of 15th March 2001, 21% of its issued ordinary shares (representing approximately 33.6% of the voting power of the company) was held by the Mutuelles AXA, four mutual insurance companies engaged in life and general insurance business in France.

4.2.1 Of the twenty largest insurance groups in the world (by assets) in 1994, five had experienced or were experiencing a change in ownership by 2000. Only two of these involved a demutualisation, that of the U.S. company Prudential and Metropolitan Life, also of the U.S.A. America is one of several countries which have experienced a number of demutualisations recently.

4.3 *The U.S. Insurance Market*

4.3.1 There have been several demutualisations in the U.S. market over the past fifteen years. From 1989 to 1998, five life companies with capital in excess of $500m have demutualised. However, as Swiss Re (1999) report, the decline in the number of mutual offices largely reflects industry consolidation — indeed, the number of U.S. stock life companies declined even more rapidly over the same period. Nevertheless, the effect of the five demutualisations mentioned was the equivalent of reducing the 1997 market share of life/health mutuals by three percentage points.

Table 1. The world's largest insurers

1994 Rank			1994 Assets £bn	1994 Status	2000 Assets £bn	2000 Status
1	Nippon Life	Japan	253	Mutual	294	Mutual
2	AXA/UAP	France	183	Proprietary	288	Proprietary
3	Daiichi	Japan	179	Mutual	203	Mutual
4	Sumitomo	Japan	155	Mutual	160	Mutual
5	Prudential	USA	126	Mutual	195	planning to demutualise
6	Meiji	Japan	108	Mutual	114	Mutual
7	Allianz	Germany	91	Proprietary	296	Proprietary
8	GAN	France	87	Proprietary	n/a	acquired by GroupAMA
9	AIG	USA	82	Proprietary	219	Proprietary
10	Metropolitan	USA	82	Mutual	182	Proprietary
11	Asahi	Japan	81	Mutual	194	Mutual
12	Fortis	Belgium	76	Proprietary	294	Proprietary
13	Travellers	USA	69	Proprietary	n/a	acquired by CitiGroup
14	Mitsui	Japan	67	Mutual	69	Mutual
15	Yasuda	Japan	60	Mutual	69	Mutual
16	Prudential	U.K.	59	Proprietary	165	Proprietary
17	Aetna	USA	56	Proprietary	34	Proprietary
18	Cigna	USA	52	Proprietary	68	Proprietary
19	AGF	France	47	Proprietary	n/a	part of Allianz
20	Aegon	Holland	47	Proprietary	137	Proprietary

Source: Standard Life plus various company websites

4.3.2 In addition to the above consolidation, there has been a decline in the amount of business written by mutual life offices over the past decade. This has been due to their lack of competitiveness in annuities and the growing importance of this business. Over the past decade, the share of annuities written by mutuals has fallen from 39% to 29%. Over the same period annuity sales (as percentage of total business written in the life assurance market) has increased from 40% to 49%.

4.3.3 Overall mutuals currently account for around one-third of the U.S. life/health market. This is a reduction of about 10% from 1990. Of the numerous life/health start-ups in the last fifteen years, virtually none have been mutuals.

4.3.4 On the other hand (as Swiss Re, 1999 also record), the market share of U.S. property/casualty mutuals has remained stable (at c.30%) for the past three decades. In addition, a substantial proportion of property/casualty start-ups in the last twenty years have been structured as mutuals of various types.

4.4 Other countries (e.g. Australia, Canada and South Africa) have also experienced the demutualisation wave. Among the reasons given for the changes are:

— to enable consolidation (including mergers and acquisitions);
— to take advantage of strategic and distribution opportunities;
— to enable wider access to external capital; and
— to enable organisations to operate in a more competitive environment.

Mutuality is still very strong in the Japanese life assurance market, but, as the following section explains, seems set to reduce in significance.

4.5 *The Japanese Life Assurance Market*

4.5.1 As described in more detail in Appendix B, the life assurance industry within Japan is dominated by mutuals. This was not always the case, but became so when many life companies converted to mutual ownership during the financial restructuring that occurred after the Second World War. This mass mutualisation was intended to spread ownership amongst many individuals. Over the past decade the market share of life mutuals has slowly declined.

4.5.2 Market liberalisation, which began in 1996, has allowed non-life insurers to compete in the life market through subsidiaries. Since then, eleven new life insurers have entered the market, competing heavily with the well-established companies. The legislation introduced in 1996 was silent on a number of key matters that prevented companies from actually demutualising in practice. However, in June 2000, the law was revised to expand upon these practical matters and this enabled companies to implement the detailed work to convert to stock companies.

4.5.3 Currently four mutuals have announced their intention to demutualise. The companies have the stated aims of taking strategic action to improve their financial strength and grow their policyholder base, against a backdrop of a difficult economic climate for the Japanese life insurance industry. Whether the remaining large mutuals will seek to demutualise if the forthcoming conversions proceed successfully remains to be seen, but many expect that they will.

4.6 Despite these developments, mutuality in insurance still has its followers throughout the world, as can be seen from the activities of the various national and international mutual 'umbrella organisations' which exist, one of which is considered below.

4.6.1 The Association Internationale des Societes d'Assurance Mutuelle (AISAM) was founded in 1963 in Amsterdam. Now based in Paris, it has 185 members (2001 figures) drawn from twenty-six countries. Most of the members are mutual insurance companies, but six are national mutual associations (from Africa, Belgium, Chile, Denmark, France and Holland).

4.6.2 The aim of AISAM is to promote the benefits of mutuality across the world. It does this in a variety of ways, including research, political lobbying and international conferences. (The twenty-first congress, in October 2000, was held in Morocco where, for example, one of the main financial players, the MAMDA-MCMA group, is a mutual.)

4.6.3 One of the topics being researched is "To whom do a mutual's own funds belong?" — a question which may seem irrelevant to many U.K. readers, but is put into context by the following quote from Gerard Outters (Outters, 2001), an official of AISAM:

> "It was raised by the start of an initial series of studies which tried to harmonize various national regulations governing the distribution of assets belonging to mutuals in the event of demutualisation. The aim was to try and help British mutualists by allowing them the benefit of laws and rules which are highly protective for mutuality, and which exist not only in continental Europe but also in Latin America. ... [In the event of a demutualisation, policyholders] usually receive nothing in continental Europe, either due to legal provisions, as in France, or due to the company's Articles of Association, as in Spain, for example."

4.6.4 The legal provisions in France, referred to colloquially as the "French lock", prohibit a transfer of assets from a mutual to a proprietary company. Thus, it is not surprising that there seems little pressure to demutualise from members of French mutuals. In France, mutuals play a reasonably significant part in general insurance (37% market share in 1997 according to Swiss Re, 1999) but not in life assurance. Were the legislation to change, it remains to be seen whether this situation would change.

4.6.5 It also remains to be seen what the final outcome of AISAM's research will be. The authors understand that a European Union Draft Regulation (Article 53), concerning the uses to which capital from a mutual can be put, has been under discussion since the early 1990s, but progress was delayed until the December 2000 agreement on the European Company Statute at the Nice Summit. One possible form of wording which implements the "French lock" (and effectively limits to other mutual or pro-mutual organisations any distribution of funds from a liquidated mutual) has been drawn up, but it is understood that not all members of AISAM support lobbying on this basis.

5. Some interesting developments

5.1 In order to demonstrate the variety of application of mutual-type structures, mention is now made of two developments, one international and of many years' standing, the other more recent and U.K.-based. (There seems no end to the material that could have been included here. For a wider-ranging review of U.K. mutuality along with a consideration of its future, readers are referred to Leadbeater and Christie, 1999. Readers

wishing to know more of recent developments in worker co-operatives, are referred to, for example, Felman and Nembhard, 2001.)

5.2 *Microcredit and Microfinance*

5.2.1 Microcredit is the term used for the lending of small loans to people, particularly entrepreneurs, too poor to qualify for credit from traditional banks. As at the end of 2000, it was reported (Druschel *et al*, 2001) that, throughout the world, over 30 million people were clients of over 1,500 microcredit institutions. These clients, two-thirds of whom were amongst the poorest in the world when they took their first loan, are typically self-employed, engaged in small income-generating activities, often from their own homes. They include small farmers in rural areas as well as shopkeepers, street vendors and service providers in urban areas. The money lent to help start or develop businesses can have wide-ranging effects, not just on the income and self-esteem of the recipients, but also on their families and, indeed, their wider communities. Thus microcredit is often seen as an important tool in the relief of poverty throughout the world. The range of financial services provided through this route is broadening (to encompass, for example, savings and insurance) and the term 'microfinance' is typically used to refer to such wider schemes.

5.2.2 One of the earliest and best-known microcredit institutions is the Grameen Bank of Bangladesh, the operational principles of which are used by many other such institutions.

5.2.2.1 'Grameen' means 'rural' or 'village' in the Bangla language and the bank grew out of a research project aimed at delivering credit and banking services targeted at the rural poor in Bangladesh. The project was started in 1976 by Professor Muhammad Yunus, the then Head of the Rural Economics Program at the University of Chittagong, and it grew in coverage until, in October 1983, government legislation transformed the project into an independent bank. Ten percent of its shares are owned by the Bangladesh government. The rest are owned by its borrowers.

5.2.2.2 According to its website, Grameen Bank has more than 2.4 million borrowers, 95% of whom are women. It has 1,170 branches, serving 40,000 villages — more than half the total villages in Bangladesh. Its credit delivery system is focused exclusively on the poorest of the poor and, in addition to its credit activities, the bank has a social development agenda addressing basic needs of its clientele.

5.2.2.3 Loans are small (but seen as sufficient to finance the business activities of the borrowers) and repayable in weekly instalments spread over one year. Eligibility for subsequent loans is dependent upon repayment of the first. Borrowers are organised into small homogeneous groups of five members, only two of whom are granted loans initially. The group is observed for a month to see if the members are conforming to the bank's rules. Only if the first two borrowers keep to their repayment schedule (in the

first six weeks) can, in due course, the other three members of the group become eligible themselves for a loan.

5.2.2.4 Thus, inherent in the system is group pressure to repay loans and it is this, along with the self-motivation of the borrowers and the bank's selection and supervision processes which are said to be responsible for the very high (i.e. 95%) repayment rates claimed by the bank. (Following a November 2001 Wall Street Journal article, the repayment rates currently being experienced by the bank are the subject of debate, the details of which are outside the scope of this paper.)

5.2.3 Such is the interest now being shown in microcredit internationally, that a summit on the topic was held in 1997 in Washington DC. Led by Profess Yunus, it drew 2,900 attendees from 137 countries and launched a nine year campaign to reach 100 million of the world's poorest families, especially women of those families, with credit for self-employment and other financial and business services by the year 2005. Details of the progress made to date can be found in Druschel *et al* (2001).

5.2.4 Much of the growth in microcredit is as the result of NGO (non-government organisations) activity. However, commercial banks can also play a part. For example, Citigroup (the world's largest financial services organisation) has been involved with microlending programs for over fifteen years, including a U.S.$1 million grant for microfinance projects in five Asian countries (Indonesia, Malaysia, Thailand, Philippines and Korea). They are also, for example, reported (Granitas and Sheehan, 2001) to be looking at ways to securitise a loan made to a microfinance group engaged in building new housing in a Bombay slum.

5.3 *Mutual Promotion in the U.K.*

5.3.1 There are a variety of organisations of mutual companies in the U.K. Several of them, the Co-operative Union, the Building Societies Association, the Mutual Insurance Companies Group and the Association of Friendly Societies, along with the Co-operative Group (CWS) have recently set up a joint project, Communicate Mutuality, to promote the mutual sector.

5.3.2 Communicate Mutuality Limited is itself a mutual organisation, registered under the Industrial and Provident Societies Act (see ¶2.7). Operating under its trading name "Mutuo", it is committed to:

— conducting and publishing research on issues of importance to the mutual sector;
— campaigning for a better understanding of the benefits of mutual businesses; and
— developing innovative new mutual businesses.

5.3.3 Some of the current projects involve developing corporate models within the legal structure of an industrial and provident society and registered

with the Registrar of Friendly Societies. A more detailed discussion of the issues involved can be found in Mills (2001). Among the possible applications being investigated for such 'community owned' businesses are the provision of community housing, residential care homes, and pre-school childcare. Another application has already been implemented, Supporters Direct.

5.3.4 Supporters Direct was established in 2000 with £750,000 of public money from the Department of Culture, Media and Sport. Based at the University of London, it offers support, advice and information to groups of football supporters "who wish to play a responsible part in the life of the football club they support". In its first year of operation, Supporters Direct has helped to establish supporters' trusts at 40 football clubs, including Celtic, Tottenham Hotspur and Manchester United, and two clubs, Lincoln City and Chesterfield, are now owned and controlled by community mutuals. All trusts are mutual organisations focused on the community and most are industrial and provident societies based on model rules drawn up by Mutuo and a firm of solicitors.

5.3.5 Other applications of mutual structures have been proposed by others in the U.K. too. See, for example, the proposal for "a people's company" for the purposes of owning and managing Scottish Water (Heriot-Watt University, 2001). The extent to which such developments will affect the provision of financial services has yet to be seen.

6. Some concluding questions

6.1 The purpose of this paper was to survey the existing corporate diversity within the U.K. financial services marketplace, particularly the life assurance sector. In considering the role of mutuality, it was appropriate to gather some facts on the position in other parts of the world, especially those places where mutual organisations, in whatever form, make up a significant proportion of the market. While the international wave of life office demutualisations is likely to continue for some time, it has been interesting to note that mutual ownership is still 'alive and well' in other areas of financial services (and other countries) and proving effective in meeting customer needs, particularly amongst the less affluent.

6.2 Part of the vision of the U.K. actuarial profession is that we be seen to plan for the long term and consider the public interest. Is one aspect of this being concerned about the nature of the financial services marketplace in which we operate, or do our commercial interests make this inappropriate? Certainly, members of the profession must fulfil their commercial duties. Nevertheless, it is to be hoped that there is still room for us to at least debate some of the issues. It may be that there are valuable observations to be made which could help the financial services industry meet the challenges ahead.

6.3 It is intended that this paper form preparatory reading for a panel

discussion at a Sessional Meeting. To that end, we conclude by posing some questions for consideration.

6.4 *Diversity of Company Ownership Structures*

— Is diversity of company ownership desirable? If so, why? Does it depend on product? Are long term savings needs so diverse that it is unlikely that they can all be catered for by one corporate model?
— Do mutuals provide "an important competitive force in the market" as implied in a Financial Times article (Brown-Humes, 1998)?

6.5 *Market Concentration*

— Is it desirable that new life office start-ups should be more frequent than at present? New fund management company start-ups are relatively common. Also, it is said that, in the U.S.A., the number of banks has never declined, despite merger activity. What is different about the U.K. long term savings market, if anything?
— Is the opposite the case and that, in fact, we have too many life offices in the U.K. and is it only a matter of time before there are many fewer?

6.6 *Proprietary Issues*

— Is the trend towards shareholder ownership a natural progression towards a better system, or is the resulting restriction of consumer choice something to be regretted?
— Is the domination of shareholder ownership inevitable, or is it a consequence of Government policy?
— Does external shareholder scrutiny breed short-termism, to the detriment of policyholders? If so, can anything be done to avoid, or at least lessen, this? Will the introduction of Fair Value accounting affect this?

6.7 *Mutuality Issues*

— Are there any real differences between the levels of accountability between mutual and proprietary company managements? If so, in what way?
— Does regulation reduce the advantages of mutuality in terms of the protection of policyholder interests that it is perceived to give?
— Does lack of regulation on the internet favour mutuals, or is company reliability nowadays seen more as a brand issue than one of corporate ownership?
— Should more be done to encourage the development and growth of credit unions, friendly societies etc. in order to do more for the under-insured and the less well-off?
— Is the future for mutuality likely to be predominantly in meeting the needs of the less affluent or is the concept equally valid for high net worth customers?
— What is wrong with small mutuals?

6.8 *Professional Issues*

— Should the profession be concerned with these issues?
— To what extent should the profession be proactive in helping to shape the development of the U.K. financial services marketplace?
— Is there scope for actuaries to do 'pro bono' work in, say, helping to expand the role of credit unions and should the profession actively encourage this?

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APPENDIX A

BRIEF EARLY HISTORIES OF A SELECTION OF U.K. INSURERS

A1 The following provides a brief summary of the creation of a selection of life offices. The summary is not intended as a complete history for each office. Instead the focus is on the constitution of the selected offices together with any subsequent changes that may be of relevance to this paper. More complete treatments can be found in the relevant company's published history. Summaries of the relevant demutualisation schemes can be found in, for example, Cazalet (2001).

A2 *Clerical Medical*

A2.1 Clerical Medical was established as a proprietary company in 1824 specifically to provide insurance cover (life and annuity) for members of the clergy and the medical profession. At the time there were a large number of successful insurance companies operating throughout the U.K., but there had also been a large number of failed offices.

A2.2 Despite this the directors believed that there was a place for a new insurance company specifically covering members of the clergy and the medical profession. As with Friends Provident, there was a belief that the nature of the lives being covered for insurance would enable lower premiums to be charged due to the education and lifestyle of this section of the population. The full name of the company was 'The Medical, Clerical and General Life Assurance Society', at least for one year, before it was changed to 'The Clerical, Medical and General Life Assurance Society' (CMG).

A2.3 To establish the company, shares were issued with total share capital of £1m (10,000 shares with a nominal share value of £100 per share). This level of guarantee was on the assumption that there was a full subscription and that the shares were fully paid up. There was not a full subscription, which resulted in the initial subscription reducing by 50% to £500,000. Initially around 5% of the share capital was called up to be paid by shareholders to cover establishment expenses.

A2.4 To increase the initial subscription level new agents were required to become shareholders and also policyholders. In addition new policyholders were encouraged (but not required) to also purchase shares in the company.

A2.5 In 1920, CMG was acquired by the Employers Liability Assurance Corporation (ELAC), a general insurance stock company. At that time, it would appear that there was a gentleman's agreement that, if ELAC ever was to acquire another life insurer, CMG would be given its independence. Forty years later, in 1960, ELAC merged with Northern Assurance, a life assurance company, triggering the unwritten gentleman's agreement. As a result, all CMG share capital was converted into loan stock and the company became a mutual by private Act of Parliament in 1961.

A2.6 On 31st December 1996, Clerical Medical demutualised, with the business transferring to Clerical Medical Investment Group Ltd, a wholly-owned subsidiary of Halifax plc (the ex-building society but now banking and financial services group listed on the London Stock Exchange). The change was proposed by the board to enable the company to compete in a changing market without being restricted by its size or capital base.

A3 *Equitable Life*

A3.1 The Equitable Life Assurance Society (ELAS) was founded in 1762 following a protracted establishment process. Widely regarded as the first (actuarial) life assurance organisation to be formed under a mutual structure, there were considerable obstacles to be overcome and approval required far more effort than for subsequent societies.

A3.2 The initial costs were met from 48 subscribers of 118 shares at £5 each. The subscribers were eligible to share the 'entrance fee' from each new policy (5s per £100 insured) until the death of the final subscriber. Due to delays in obtaining approval, an additional subscription of a further £295 was required. At the second subscription some members forfeited their subscription, whilst others sold existing rights to other subscribers. Overall there were 21 subscribers to 146 shares.

A3.3 The right to participate in the entrance fee could be argued to have been against the principles of mutuality. Indeed, in later years, friction between the original subscribers and subsequent members of the society resulted in a change in the constitution of the company to replace the entitlement to the entrance fee with a fixed annuity for life.

A3.4 Initially the proposed society was criticised as having a significant chance of insufficient funds being available to meet claim costs. As a result, the subscribers were required to provide the society with an additional amount of capital as protection. This was a very short lived requirement as six weeks after the society was born there were sufficient funds generated from the business written to cover the capital requirements and the initial capital was returned to the original subscribers.

A3.5 Sales at the society were based on demand with no commission being paid to any intermediaries. In the formative years this was probably due to new business levels being so high that there was less need to generate additional sales by way of commission payments to sales agents.

A3.6 The high level of sales coupled with what was ultimately proven to be a very prudent mortality table (in contrast to widespread belief by external critics at the time of its optimism) resulted in an extremely high solvency level. By its 25th birthday the society had a free asset ratio of 250%.

A3.7 More recent events in the Society's history have resulted in significant change to both structure and operations. These are well-chronicled elsewhere.

A4 *Friends Provident*

A4.1 The Friends Provident Institute (FPI) was formed in Yorkshire in 1832 as a friendly society. The 'Friends' were members of the Religious Society of Friends, Quakers, within the Yorkshire region.

A4.2 At the time the company was established, there were several existing life assurance companies within the U.K. and the level of new companies being started was high. Despite this there was a strongly held belief that a mutual friendly society would prosper due to:

- a lack of provision for the working classes in times of ill-health or bereavement (social welfare had not developed in line with the Industrial Revolution of the previous 70 years);
- the lack of impact of the (then recently enacted) 'poor law';
- anticipated lower cost of insuring Quakers due to their lifestyle, which enabled lower contribution levels;
- Parliament's perception of friendly societies as benevolent organisations; and
- the ease with which insurance companies could be created at the time.

A4.3 To establish the society a committee was formed to prepare rules of operation, enquire into appropriate rate tables for use and prepare/ circulate prospectuses amongst Friends. The society was formed as a mutual, a conscious decision being made to avoid shareholder participation.

A4.4 As a result of its mutual status, capital was required to be raised through an alternative route. A 'Guarantee Bond' was issued to which 45 prominent Quakers subscribed between £50 and £1000 each. The total initial fund raised was £10,700. This was used to assist in meeting potential claims within the early years. In return for their subscription the members received 5% of their investment each year with final repayment when the established funds were deemed adequate. A further bond was later issued to cover 'Outfit of the Establishment'. Twenty-four members subscribed £42 each.

A4.5 The principle underlying the society was straightforward – the working class member would pay a small regular contribution that would cover times of need (illness or death). Initially the society was only open to Yorkshire Quakers, however, in 1915 non-Quakers were granted entry rights.

A4.6 Right from the start, part-time agents were employed to encourage sales, in return for a commission payment. These agents were regularly assessed for levels of new business achieved and were quickly replaced if unsuccessful. The two most successful agents (William Hargrave and Joseph Marsh) later left the friendly society to establish the National Provincial Institution (NPI) in London. A close link remained in place throughout the next 150 years as the two organisations operated on the basis of mutual assistance. In 1918 the society acquired 'The Century Insurance Company Limited'.

A4.7 In 2001, Friends Provident demutualised and listed on the London Stock Exchange. The reasons given for the change were:

- increased financial flexibility, enabling future development opportunities to be taken advantage of;
- increased financial strength leading to greater investment flexibility for the with-profits business;
- greater recognition of the separate interests of customers and owners; and
- easier comparison of performance with listed competitors.

A5 *National Provincial Institution (NPI)*

A5.1 The NPI was formed in 1835 out of the success of two of Friends Provident's (FPI) key sales agents. Unlike FPI, NPI was immediately open to individuals from all religions (not only Quakers) and with no limit on a person's geographical location (unlike FPI which was initially only for Yorkshire residents).

A5.2 Apart from these eligibility differences, NPI largely copied the successful FPI operating model and rules of operation, which included being run as a mutual friendly society. As with FPI, there was a belief that a need still existed for a means for lower working classes to make provision for adverse conditions.

A5.3 Despite the high level of insurance company failures at that time, minimum capital guarantee requirements for U.K. life assurance companies were still relatively small. The company realised that the key to its early success would be to provide the public with the image of a well-financed company.

A5.4 To do this capital was provided by NPI's founders (a combination of NPI's directors and solicitors together with Members of Parliament, further enhancing the institution's credibility). Each subscriber provided a guarantee of up to a maximum of £1000 if so required. In return for this guarantee a payment of 1% of the guarantee was paid each year to each guarantor. This resulted in the unusual situation where guarantors received income without actually making any up-front investment – although the security did exist in principle.

A5.5 It is likely that NPI's establishment costs were greatly reduced by the re-use of the FPI model. The initial prospectus was issued at 1 shilling per copy to cover initial expenses and the company made use of the first year premiums to cover expenses and salaries of staff.

A5.6 The Friendly Society Act, which existed at the time FPI and NPI were established, provided friendly societies with significant advantages over other life insurance companies:

- exemption from stamp duty;
- advantageous terms for investing in national debt; and
- tax advantages.

These advantages received criticism from competitors at the time and, in particular, NPI received criticism through the press. The result of this (together with the petitioning of Parliament by several life offices) was a change to the Friendly Society Act that removed certain advantages completely and restricted others (i.e. tax benefits) to small policies only.

A5.7 The decision to retain certain benefits for small policies only is believed to have been intended to encourage individuals who would only be able to make smaller contributions (typically the working classes). These individuals had historically made provision through friendly societies, as they did not tend to have access to cover through insurance companies.

A5.8 In 1999, NPI announced it was to demutualise and be acquired by AMP Limited (a life assurance and other financial services company listed on the Australian Stock Exchange, itself an ex-mutual). The NPI Board had concluded that joining with a strategic partner with sufficient financial capacity to increase investment flexibility and develop the business was the best way of realising NPI's full value for its members and policyholders. After a competitive tender process, AMP was selected and the demutualisation proposed.

A6 *Norwich Union (NU)*

A6.1 Norwich Union's life assurance operation was formed following the success of its general insurance sister company (Norwich Union Fire Society – founded in 1797). The life assurance company was formed seven years later in 1804. The company was established as a mutual where profits (after expenses, commission and salaries) were distributed to members every seven years.

A6.2 The creator of both organisations was a Mr Thomas Bignol. The terms of the establishment of the life assurance company were that 5% of all premiums would pass to Mr Bignol. At the time the company was established there were relatively few mutuals, Equitable Life Assurance Society being by far the largest and most successful. NU traded on its mutual values right from the start.

A6.3 In 1866 NU acquired the Amicable, the oldest U.K. mutual insurance company. It could be argued that this technically made the NU the oldest U.K. mutual life assurance office (prior to its demutualisation in 1997).

A6.4 In 1997, Norwich Union became the first U.K. mutual to demutualise and list on the London Stock Exchange. Among the reasons presented for the change were:

— increased ability to raise capital to develop the business;
— greater recognition of the value of subsidiary operations; and
— improved with-profits investment flexibility through passing certain business risks to shareholders.

A7 *Scottish Equitable*

A7.1 Scottish Equitable's origins date back to a meeting in Edinburgh on 29th March 1831 of local businessmen who, in their own words, "deemed it expedient to form a Life Assurance Society upon the principles of the Scottish Widows' Fund Society of Edinburgh and the Equitable Society of London".

A7.2 The company was started as a mutual, the Scottish Equitable Life Assurance Society (SELAS), and twelve ordinary directors were appointed. (Presumably any necessary capital was provided, or at least sourced, by the consortium of local businessmen.)

A7.3 During the next 150 years, the company transacted conventional life assurance and annuity business and, by 1982, had become one of a group of small to medium U.K. mutual life offices, all pursuing similar product and distribution strategies.

A7.4 In the 1980s and early 1990s, SELAS successfully developed its unit-linked and unitised with-profits business, particularly in pensions, establishing a strong market position with what was felt to be considerable potential for growth. The board, however, were of the view that additional capital would be required to take full advantage of the development opportunities.

A7.5 This led to them proposing, in 1993, that the society (gradually) demutualise and be acquired by AEGON nv, a listed major international insurance group, based in Holland, and with a similar background and philosophy to SELAS.

A7.6 On 1 January 1994, Scottish Equitable plc (SE plc) was born, with AEGON purchasing (for just over £200m) a 40% interest in the profits of the non-participating business (predominantly profits arising through the charging structures of unit-linked and unitised with-profits business). In what was considered an innovative structure, all investment profits arising under traditional and unitised with-profits business were retained within a mutual with-profits sub-fund (WPSF) for the benefit of the with-profits policyholders, along with the profits arising from the remaining 60% interest in the non-participating business.

A7.7 At the same time, a Voting Trust Company was set up to protect those policyholders with a financial interest in the WPSF. This was largely achieved through a Special Share being granted to the Voting Trust Company, enabling it initially to exercise 60% of the voting rights.

A7.8 Since its initial investment in the WPSF of SE plc, further injections of capital have been made by AEGON, in return for which it now has a 100% interest in the non-participating profits.

A8 *Scottish Life*

A8.1 Scottish Life was established as a proprietary life office in 1881. Nominal capital of £500,000 was proposed (100,000 shares of £5 each)

although only 50,000 shares were actually issued, partly paid at £1. One of the uses to which the £50,000 was put was to deposit the required £20,000 with the Court of Chancery (a requirement introduced for all insurance companies by an Act of Parliament in 1870 — the result of numerous insurance company failures over previous decades). Shareholders were entitled to 10% of distributable surplus from the Life Assurance and Annuity Fund.

A8.2 By 1912 the fund had grown substantially and the office decided (in the interests of policyholders) to reduce the shareholder entitlement to surplus from 10% to 5%.

A8.3 By 1966 the Life Assurance and Annuity Fund had grown to exceed £60m. Despite this significant growth, the company was still relatively small compared with other life assurance operations and the directors were aware of the risk of takeover that this presented. The risk was further increased by the relatively small share capital – in theory the control of the Fund could be acquired by the purchase of share capital at relatively low cost (50,000 shares, now £1 10s paid up). As a result of this, and in particular to remove the risk of a hostile takeover, the company mutualised in 1967, by means of a private Act of Parliament which received Royal Assent in 1968.

A8.4 In 2001, following a strategic review, the directors recommended to members that the company demutualise and be acquired by another mutual, Royal London. Amongst the anticipated benefits were:

- increased payouts for existing with-profits policyholders;
- enhanced reputation for the Scottish Life brand;
- greater cost efficiency in the combined business; and
- more rapid development of products and the business as a whole.

A9 *Scottish Mutual*

A9.1 Scottish Mutual began life in 1883 as the Scottish Life and Temperance Association Limited, a proprietary company founded by A. K. Rodger, a Glasgow businessman. Had Rodger had a private fortune, he might have started the company as a mutual office. He did not, however, and so needed shareholders to subscribe the £20,000 needed to register the company (under the 1870 Act mentioned above).

A9.2 In 1921, the company entered into an alliance (basically for cross-selling purposes) with a general insurance company (British General Assurance Company Limited) by means of a share transfer. The British General was to transfer 100,000 of its shares to the Scottish Temperance and all 100,000 Scottish Temperance shares were to be transferred to the British General. The Scottish Temperance shareholders were effectively bought out by their company for 15s per share (of which 5s had been paid up). (In fact, only 99,287 shares were transferred – the owners of the other 713 either refused to sell or could not be contacted!)

A9.3 The alliance was not a success and ended in 1924. The 99,287 Scottish Temperance shares were returned, not to the shareholders, but to the life company itself and held by a subsidiary company, 'The Holding Trust, Limited' (since it was illegal for a company to hold its own shares), on condition that future dividends would be limited to 5 per cent.

A9.4 The company had, thus, effectively become mutual. Legal mutualisation came in 1952, through a private Act of Parliament creating The Scottish Mutual Assurance Society. The company had tried to operate as a mutual as much as possible almost from the start. Indeed, a prospectus at the turn of the century had claimed that policyholders had "practically all the advantages of a mutual office with the substantial guarantee offered by the Shareholders' capital in addition." Nevertheless, it took the threat of nationalisation to finally encourage the legal change.

A9.5 By the early 1990s, the board of the Society believed that the company would have "difficulty in achieving more than slow growth from the present scale of operations" and that "in such an environment, control of expenses is difficult and that it is likely that increasing expenses will have an adverse effect on future bonuses." The board considered its options and when, in due course, it was approached by Abbey National (a former building society which had listed on the London Stock Exchange in 1989) and the terms of a deal were agreed, it recommended demutualisation to the members. This took place at the end of 1991.

A10 *Scottish Provident*

A10.1 Scottish Provident was founded in 1837 as a mutual institution. At that time, there were extremely low capital requirements (by the end of September 1837 the total charge for establishment amounted to £34 – to put this in context, a typical manager's salary at that time was £400 per annum). To cover this small initial cost the patrons and prospective directors contributed an establishment fee, repayable when sufficient funds became available. Unlike some other companies, Scottish Provident immediately introduced agents to attract new business. The agents received a form of commission payment, the cost being met from initial premium payments.

A10.2 By the time Scottish Provident was established there was already a large number of successful life assurance companies within the U.K. (both proprietary and mutual). The main reason stated for the establishment of the society was a belief that a more equitable approach to the management of premium levels and bonus distribution policy could be introduced than was considered currently available from other life assurance offices.

A10.3 The institution was incorporated in 1848. The society has recently demutualised to enable acquisition by Abbey National plc. The reasons for the demutualisation have been quoted as:

— enhanced distribution opportunities;
— extension of the range of products available; and
— release of accrued value to members.

A11 *Scottish Widows*

A11.1 Scottish Widows was founded in 1814 as a mutual society. This was at a time when the vast majority of new life offices were being established as proprietary companies. At the time there were extremely low capital requirements to establish a life office. The directors and advisors provided services free of charge, although discretionary payments were made in later years. The only initial costs were initial administration fees and advertising. To cover these costs, patrons and prospective directors contributed an establishment fee, repayable on the first or second decennial review provided sufficient surplus assets were available.

A11.2 The reasons for the establishment of the society were:
— a belief that a need existed for the provision of life insurance cover predominantly for Scottish residents;
— the continued rapid growth in the number and size of life insurance companies within the U.K. (There was a concern that this growth could ultimately make a new Scottish-based mutual life company more difficult to establish successfully.); and
— the then recent successes of Equitable Life (The Scottish Widows' structure was influenced by that of Equitable Life.).

A11.3 There were no minimum solvency requirements and, as the Equitable Life model was largely being re-used, no commission was paid (although commission was introduced later).

A11.4 The early years saw a slower than anticipated growth in new business with the resulting solvency levels being lower than might prudently be set aside. This changed with the introduction of agency sales and the first decennial valuation (both of which resulted in a significant increase in new business levels). Very shortly after these events the surplus assets of the society grew to become sufficient to meet prudent reserving bases and support bonus distributions to holders of with-profits policies.

A11.5 The society continued as a mutual until its demutualisation in March 2000. The demutualisation was required to allow Lloyds TSB Group to acquire the Scottish Widows brand and organisation. The reasons given by the Society for the demutualisation were:
— enhanced distribution opportunities;
— release of accrued value to members; and
— a wider potential product range.

A12 *Standard Life*

A12.1 Standard Life was established in 1825 as a partnership with

issued capital of 10,000 shares, each with a nominal value of £50. Only £1 (of the possible £50) was ever called up. The remaining £49 was later reduced as surplus was credited to the shareholders' account. Until Standard Life was converted into a limited company in 1910 the shareholders remained personally liable for its debts. When the conversion took place, each share was split into five and a formal stock exchange listing was obtained.

A12.2 The company was mutualised in 1925 (as the centrepiece of its centenary celebrations). The plan was to raise the bonus to policyholders by cutting out the shareholders' entitlement to a proportion of the profits and to make Standard Life as much like Equitable Life as possible. The Equitable was renowned at the time for its success and the Standard Life directors believed a change in structure would attract more custom, particularly of with-profits business.

A12.3 Since then, Standard Life has grown to become the largest mutual assurer in Europe, resisting an attempt in 2000 by some of its members to force a stock market flotation.

APPENDIX B

OVERVIEW OF JAPANESE INSURERS

(The authors are grateful to Mr Charles Garnsworthy for assistance in producing this Appendix.)

B1 *The Japanese Financial Market Place*

B1.1 There is a wide variety of financial service providers within the Japanese Market. The regulatory environment is fragmented and complicated.

B1.2 The size of the potential market is extremely large. Whilst the private sector for finance is significant compared with the U.K., the vast majority of funds currently maturing originate from governmental Financial Institutions operating under the Ministries of Finance, Post and Telecommunications and Construction.

B1.3 Within the private sector the following headings cover the type of organisations:

— commercial banks;
— specialised institutions;
— securities companies; and
— insurers.

B2 *Life Companies — Historic Position*

B2.1 Prior to World War 2, the majority of Japanese life insurance companies were stock companies, with just three mutual insurers (Daiichi Life, Chiyoda Life and Fukoku Life). In the years following the war, all of the major Japanese stock life insurance companies mutualised. In fact, during 1947 and 1948, thirteen companies transferred business into new mutual company entities.

B2.2 The companies concerned sought to focus on the domestic life insurance market, without needing to compete with major global stock companies on the capital markets. A collection of significantly smaller stock life companies remained, many as subsidiaries of non-life insurance companies.

B2.3 Thus, as at November 2000 the life insurance market place was dominated by old, traditional mutuals. Seven companies had some 70% share of the market. Total premium income for 2000 was JPY 26.9 trillion. Table B1 gives details of the largest players:

Table B1. Japanese life companies

Rank	Company	Status	Assets (£Bn)
1	Nippon Life	Mutual	294
2	Daiichi	Mutual	203
3	Sumitomo	Mutual	160
4	Meiji	Mutual	114
5	Asahi	Mutual	194
6	Mitsui	Mutual	69
7	Yasuda	Mutual	69

B3 *Companies Demutualising*

B3.1 The Japanese Insurance Business Law was completely revised in 1996. At that time, articles were introduced that made it legal for mutual companies to demutualise. Prior to this point, demutualisation was not an option for the existing mutual companies.

B3.2 The 1996 Law was, however, silent on a number of key matters that prevented companies from actually demutualising in practice. In June 2000 the law was revised to expand upon these practical matters and this enabled companies to implement the detailed work to convert to stock companies.

B3.3 Currently four mutuals have announced their intention to demutualise, namely: Daido Life, Taiyo Life, Yamato Life and Asahi Life. The companies have the stated aims of taking strategic action to improve their financial strength and grow their policyholder base, against a backdrop of a difficult economic climate for the Japanese life insurance industry.

B3.4 Within the Japanese market demutualisation is seen to enable:

- a more flexible legal structure (for example mergers with stock companies);
- wider access to capital (including stock exchange capital); and
- distribution channel and strategic opportunities.

In addition to these reasons, stock companies in Japan have more freedom to determine the level of policyholder dividend payout. Mutual companies are restricted in the amount of non-participating (non-profit) business that they may sell and are required to distribute a certain level of profit as dividend to their participating policyholders. Stock companies are not subject to these restrictions.

B4 *The Future*

B4.1 The Japanese life insurance industry is in a difficult position, with most companies exposed to significant volumes of so-called 'negative spread', i.e. policies where the implied crediting rate to policyholders is greater than the rate the companies are actually earning on their investments. Japanese accounting rules recognise the cost of this negative spread as it emerges, in each year that investment earnings are lower than the rate being credited. Six

Japanese life insurance companies have failed since 1997, with negative spread and hidden (unrealised) asset losses being the principal reasons cited.

B4.2 Companies may view demutualisation as a means to raise capital to help them stay financially strong through the current difficult economic climate. However, should the poor economy persist, the companies will need to do more than simply raise capital: they will need to take strategic action to reform their underlying profitability. Capital raised can be used to implement these strategies. Potential new shareholders will of course need to be convinced that the money they invest will be used wisely to produce an acceptable return.

B4.3 In terms of the process itself, the Institute of Actuaries of Japan is currently studying several practical matters relating to demutualisation (e.g. policyholder protection and compensation allocation equity) and is expected to report at end 2002.

APPENDIX C

U.K. FRIENDLY SOCIETIES

C1 *What is a Friendly Society?*

C1.1 A friendly society can be either an unincorporated or (since the introduction of the Friendly Societies Act 1992) incorporated body of persons, unlimited in number, who join together to achieve a common financial or social purpose, or both. The members voluntarily bind themselves to rules which are capable of variation in the future, subject to a majority of such members agreeing.

C1.2 The distinctive features of a friendly society are as follows:

— A financial benefit is payable according to a table of contributions and benefits designed to assist members upon the happening of specific contingencies or in adversity.
— The rules engender a spirit of self-help and self-reliance and discourage dependence upon the state or charity.
— Government of a society is by members, for members, subject to the rules devised by the members.
— There exists equality between each member, subject to the rules, irrespective of the size of a member's individual stake in the society. 'One member, one vote' generally prevails.
— The rules provide for variation, by restriction or extension, of the rights, privileges or terms of membership. Therefore, the ability to preserve financial solvency exists provided that there is a willingness among the members to make additional contributions or to reduce benefits, as circumstances may demand.
— The provision of benevolence and charitable gifts to distressed members beyond that to which they are strictly entitled under the benefit tables may be provided for in the rules.

C2 *Regulation*

C2.1 The key statute is the Friendly Societies Act 1992. It set up the Friendly Societies Commission, whose general functions are:

— to promote the protection by each friendly society of its funds;
— to promote the financial stability of friendly societies generally;
— to ensure that the purposes of each friendly society are in conformity with the Act and any other enactment regulating the purposes of friendly societies;
— to administer the system of regulation of the activities of friendly societies; and
— to advise and make recommendations to the Treasury and other government departments on any matter relating to friendly societies.

C2.2 A friendly society may not carry on in the U.K. any insurance business or non-insurance business unless it is authorised by the Commission to do so. Schedule 2 to the Act sets out in full the prescribed activities of friendly societies.

C2.3 The regulatory regime is fairly similar to those applying to other incorporated organisations in the U.K. Comprehensive management and procedural provisions, (covering such matters as memoranda, rules, membership, management, meetings, resolutions, auditing and dissolution/winding-up) are all dealt with under the legislation.

C3 *Establishment*

C3.1 The procedures involved in setting up a friendly society are covered in Schedule 3 to the 1992 Act.

C3.2 Any seven or more persons may establish a society under the Act by taking the following steps:

— agreeing upon the purposes of the society and upon the extent of its powers in a memorandum, the provisions of which comply with the requirements of this Schedule;
— agreeing upon rules for the regulation of the society which comply with the requirements of Schedule 3; and
— sending to the central office three copies of the memorandum and the rules, each copy signed by at least seven of those persons (or, if there are only seven, by all of them) and (unless the secretary is to be elected) by the intended secretary.

C3.3 The 1992 Act also enables friendly societies to incorporate (s.91), take on new powers and provide a larger variety of financial services through subsidiaries. Now, the purposes, powers and procedures of a friendly society are set out in its memorandum and rules, with specific issues to be covered being set out in Schedule 3.

C3.4 In due course the powers and duties of the Friendly Societies Commission will vest in the FSA under the Financial Services and Markets Act 2000. At the time of writing, the current proposed date for the transfer is 1 July 2002. From that date, therefore, the FSA will assume responsibility for the regulation of friendly societies.

APPENDIX D

CREDIT UNIONS

For a fuller treatment of this topic, the reader is referred to the websites of ABCUL (the Association of British Credit Unions Limited) and WOCCU (the World Council of Credit Unions) from which the following material is drawn.

D1 *Background to Credit Unions*

D1.1 A credit union is a mutual non-profit financial institution (sometimes referred to as a financial co-operative) organised to provide checking and savings accounts, loans, and other financial services to its members/owners. Membership in a credit union is limited to people who share a common bond. There are five prescribed 'common bonds':

— *Employment* — all members work for the same employer or group of employers, or carry out the same occupation.
— *Live or work* — all members live or work within a defined geographical area.
— *Residential* — all members live within a defined geographical area.
— *Associational* — all members belong to the same association, e.g. trade union, housing association or religious group.
— *Live or association* — all members live within a defined geographical area or have an association with a specific organisation in the area. This may be an employer with sites outwith the area or a trade union or housing association with tenants in other areas.

D1.2 This common bond is the main difference between a traditional local building society and a credit union. Membership rules can vary and some credit unions are community-chartered so that anyone living in a particular community can join that credit union. Experience has shown that the common bond produces a strong form of customer loyalty.

D1.3 Credit union members are encouraged to save their money by purchasing 'shares' in the union. These savings build up a pool of funds from which loans to members can be made. Credit union members enjoy equal rights to vote (one member, one vote) and participate in decisions affecting the credit union, without regard to the amount of savings or deposits or the volume of business.

D1.4 The credit union is managed and controlled by a volunteer board of directors (all of whom are members of the union) who are elected by the membership at the AGM. As mentioned above, all members have one vote, irrespective of the size of their savings. While they employ staff to manage the credit union on a day-to-day basis, control lies firmly within the hands of the members through their elected representatives on the board.

D2 *Market Presence – Worldwide*

D2.1 Credit unions thrive throughout the world. The international credit union movement is made up of over 100 million people in over 80 countries, served by around 36,000 credit unions.

D2.2 In the United States, they are major players in the financial services markets. Credit unions provide cheque accounts, credit cards and mortgages to 25% of the American population.

D2.3 In Ireland, half the population belong to their local credit union. Again, a wide variety of financial services is provided.

D2.4 Credit unions also thrive in Australia, and many countries in Africa, Asia and South America. One of the fastest growing movements at the moment is in Poland, where in less than ten years, 220 credit unions have grown to serve almost 300,000 people.

D3 *Market Presence – United Kingdom*

D3.1 According to ABCUL (the Association of British Credit Unions Limited), the past twenty years of credit union history in Britain has seen something of a fractured credit union movement. This fragmentation enabled others to dominate the development of credit unions into 'poor man's banks' which were set up in deprived communities to offer a local alternative to 'loan sharks'. Local authorities viewed credit unions as part of their anti-poverty strategy, whilst also recognising their potential to help the development of a community and the building of skills in local people. It was believed that a credit union could be run without any start up capital, without IT equipment or resources, from the back of a church hall or community centre and without any adequate form of security.

D3.2 The most significant piece of research into the British credit union movement "Towards Sustainable Credit Union Development" (Jones 1998) highlighted this view of credit unions as being one of the most significant factors holding back the development of British credit unions. The report identified the following ingredients as necessary for the success of a credit union:

— a large and diverse common bond (which includes savers as well as those looking for credit);
— sufficient start up capital to enable the credit union to be fully resourced;
— IT systems;
— shop front, accessible and visible premises;
— paid staff to provide services at the times that people want them (i.e. at least 9am to 4pm five days per week);
— sponsorship from a credible employer or organisation within the community (e.g. local authority, housing association, union, or community organisation);
— visionary and entrepreneurial leadership; and
— a clear view of a credit union as a financial co-operative.

D3.3 A recent Treasury Task Force advocated the development and expansion of credit unions to serve over 2 million people in Britain.

D3.4 According to the ABCUL (in the press release announcing the opening of Britain's first purpose-built "people's bank", the new premises of the Dalmuir Credit Union on 17th December 2001), the Scottish Executive wants to see the benefits of credit unions being made available to more Scots and is making £1.5 million available over three years to encourage the growth of the movement across Scotland.

D4 *Regulation*

D4.1 Credit unions operate under the auspices of the Credit Unions Act 1979. Under that Act, the Registry of Friendly Societies assumed responsibility for registering unions and for regulating their operations. Under the Financial Services and Markets Act 2000, the powers of regulation of credit unions are extended and, as with friendly societies, transferred to the FSA. On 1 July 2002 (it is intended that) the FSA will regulate and supervise all credit unions in Britain.

D4.2 The Credit Unions (Authorised Investments) Order 1993 specifies the types of investments credit unions can make. These are traditionally very secure investments such as government gilts and bonds or high interest building society accounts.

D4.3 The Financial Services and Markets Act 2000 made a number of primary legislative changes to the 1979 Act (see Schedule 18). These are due to come into force on 1 July 2002.

D5 *Operating Restrictions*

D5.1 The 1979 Act (as amended) sets out the rules and parameters under which credit unions may operate. The key provisions are described below.

D5.2 *Investing*

D5.2.1 Each share in a credit union is fixed by statute at £1. The union may accept deposits only as subscriptions for its shares.

D5.2.2 The maximum permitted saving is £5,000 or 1.5% of the total shareholding of the credit union, whichever is the greater.

D5.2.3 It may pay a dividend on shares, not exceeding 8%, after all expenses and taxes have been accounted for. The normal range of dividend payments among employment-based unions is between 3% and 5%. Community unions typically pay dividends in the range 1%-3%, once established. Many pay no dividend at all for the first three years, or indeed ever.

D5.3 *Borrowing*

D5.3.1 In most credit unions, loans may be made to members up to a

maximum of £5,000 in excess of their share capital, although under the Financial Services and Markets Act 2000 there will be no maximum legal limit on the size of loan — the FSA itself will establish regulatory limits. Thus, for example, a member with the maximum 5,000 shares may currently borrow up to £10,000.

D5.3.2 Loans are repayable over three years if unsecured, and over seven if secured.

D5.3.3 Special dispensation may be obtained from the regulator to allow greater amounts to be loaned to individual members over longer periods.

D5.3.4 Interest charged may not exceed 1% per month on the reducing balance (12.68% APR maximum).

D5.4 *Number of Members*

The minimum number of members is 21. The maximum number is currently 5,000 (although this will be abolished on 1 July 2002).

D6 *Establishment*

D6.1 The ABCUL gives the following practical guide for setting up a credit union:

— assemble an organised group — a steering group with a relevant skills mix, and representative of the likely membership;
— gain support — involving initial market research to assess viability (ABCUL suggests that 500-1000 pledges of membership should be secured);
— develop a business plan;
— decide on a 'common bond' — the regulator must be convinced that the proposed membership shares a common bond;
— sponsorship — sponsorship can give a project credibility and help with start-up costs;
— organising training and support;
— write the policy and procedures manual — written policies and procedures are required by the regulator, including policies on eligibility for membership, how cash is handled, rules for awarding loans, etc.
— decide on officers;
— register the credit union — following a pre-registration visit and the submission of business plan and policy/procedures manual, the regulator may give approval to submit an application; and
— launch and marketing.

D6.2 Overall, the ABCUL estimates that it can take anything between 6 months and 18 months to complete this process.