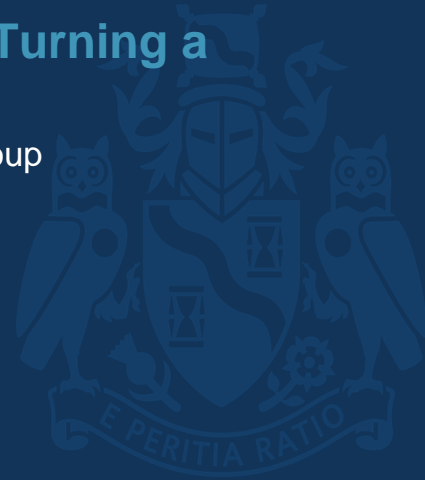




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Part VII Transfers – Turning a Science into an Art

Kevin Edgington, Phoenix Group
David Hare, Deloitte



03 November 2014

Agenda

- Introductions
- Why do a Part VII Transfer
- Recent market action
- What does a Part VII Transfer involve
- Part VIIs in action – our experience
- Challenges and hot-topics
- Questions?

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Introductions

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Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
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Journals
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Why do a Part VII Transfer?

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What is a Part VII transfer?

- Transfers insurance policies, their liabilities, assets and reinsurance arrangements from one legal entity to another
- Part VII transfers are a relatively common mechanism – nearly 100 in the last 5 years across life and non-life
- Legal framework set out in Financial Services and Markets Act 2000 – requires Court approval with key aim of protecting policyholders
- Two primary drivers:

External transfer as part of a transaction

Restructuring within a group

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Why do a Part VII transfer?

- Sell/buy a book of business
- Simplify the structure of a group
- Rationalise policyholder terms and conditions
- Improve operational and/or tax efficiency
- Increase consistency of management practices and principles across the group, resulting in governance and control improvements
- Improve capital efficiency
- Remove barriers to capital flows

SII Benefits

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Alternatives to the Part VII process

- Internal restructuring/reinsurance
 - Introduction of intra-group risks?
 - Compatibility with Solvency II?
- Run-off
 - Unclear timeframe?
 - Capital inefficiencies?
- Scheme of Arrangement
 - Administratively difficult
 - Limited precedents
 - Policyholder opt-out

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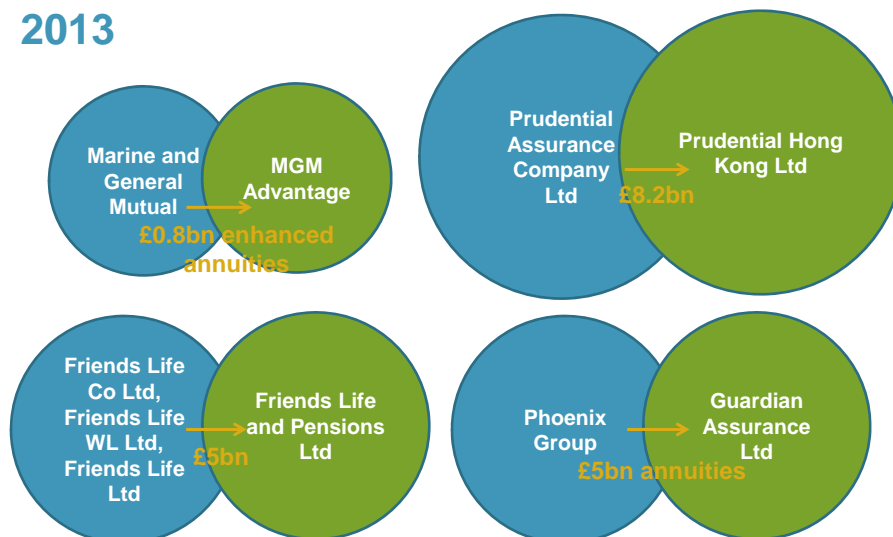
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Recent market action

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A selection of Part VII transfers since 2013



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What does a Part VII Transfer involve

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Description of the Legal Process - What controls a Part VII Transfer?

- *Financial Services & Markets Act 2000* (FSMA 2000), Part VII: Control of Business Transfers (sections 104 to 117) (& associated regulations)
- Specifies legal and regulatory requirements and process
- The consent of the High Court is an important protection for policyholders and others who may be affected.
- Known as “Section 49” or “Schedule 2C” transfers under earlier legislation.
- Supervision Manual SUP 18 gives additional guidance

Key Aim

protect policyholders’ interests – security of benefits / fair treatment

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Description of the legal process - What is specified?

FSMA 2000 and SUP 18 specify

- What constitutes a transfer
- Court powers and process
- Qualifications for an Independent Expert (IE)
- Role of IE
- Form of the IE’s Report
- Role of Regulators
- Role of other EEA insurance supervisors
- Notification to policyholders (and other affected parties)

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Role of the independent expert

- Jointly appointed by all companies involved in the transfer and paid for by the companies.
- Approved by the PRA
 - Application from the companies should include reasons for choice
 - The regulator can nominate an independent expert if they disagree with the proposal
- Suitability will depend on the nature of the scheme of transfer
 - Firm and individual should be (and be **perceived** to be) independent
 - Relevant knowledge and experience of types of business being transferred
 - No formal requirement to be an actuary
 - Public choice, so should be credible

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Considerations of an independent expert report

- Has a duty to the Court to consider effects of the Scheme on:
 - transferring and non-transferring policyholders in the transferor
 - existing policyholders in the recipient company
- For each group of policyholders, the independent expert should be aware of the scheme's effect on:
 - financial position and the impact on benefit security and expectations
 - service standards and governance
 - policyholder communications
 - provisions from previous schemes of transfer
 - taxation
 - reinsurance and investment management arrangements

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Form of conclusion

- SUP 18.2:
 - “opinion of the likely effects of the Scheme”
- Unrealistic and misleading to provide absolute conclusions in majority of cases:
 - *“Some objectors have attacked [the Independent Expert's] conclusions, because they are qualified by the words "significant" or "material"... I do not consider this a fair ground of objection. The complexity of the process is such that no one could guarantee a complete absence of detriment in every eventuality and in every single case. Indeed I would be wary of any opinion which purported to do so. What is important is whether there is any detriment of materiality”* (Mr Justice Norris)
- Conclude whether “materially adversely affected”:
 - Likelihood and magnitude of impact considered

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Role of the Regulators (1)

- Approve Independent Expert
- Check Scheme contents against their principles, in particular TCF and management of conflicts of interest
- Liaise with overseas supervisors
- Produce report for court (normally)
- Will review impact of Scheme on policyholders and their security and discuss implications with company and IE. This in turn may lead to changes being made as the Scheme develops and before the start of the court process.
- Therefore, highly unlikely that the regulators will turn up at court and object, though theoretically could

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Role of Regulators (2)

In practice, PRA and FCA assess and consider:

- Potential risk to regulatory objectives
- Purpose of scheme
- Security of policyholders
- Effect on rights and benefit expectations of policyholders
- Compensation if any loss of rights and/or benefit expectations
- Effect on other people
- Policyholder notification (e.g. clarity, adequate time to respond)
- Opinion of IE
- Policyholder views
- They see and comment in advance on all reports, the policyholder mailing, all other documents going to court

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Court Process (1)

- Directions Hearing, at which are presented:
 - The scheme document
 - IE report
 - Reports by AFH and WPA of transferor and transferee company
 - Witness statement giving details of background, history of companies, contracts, policyholder notification plan, draft mailing pack, proposals for any overseas business.
 - Regulators' report(s) indicating no objection at this stage to the Scheme or the policyholder notification proposals.
 - Other legal documents.
- Advertising and policyholder mailing then start.

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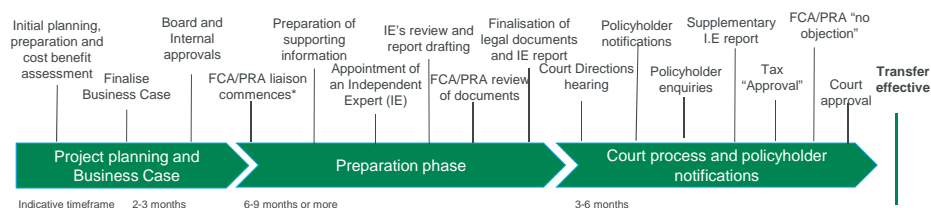
Court Process (2)

- Final Court Hearing, at which are presented:
 - Witness statement giving details of actual notifications, of resulting policyholder contacts, and of all policyholder objections.
 - Supplementary Actuarial and IE reports confirming updated financial analysis and that still happy for scheme to proceed
 - Final Regulators' Report(s) confirming non-objection to scheme
- Following can attend and be heard:
 - Any policyholders who think they're adversely affected
 - Any other parties who think they're adversely affected
 - Regulators
- Separate schemes may be required for non-EEA states, such as Jersey, Guernsey and Hong Kong (if branch business there transferring); all follow a similar process to the UK's.

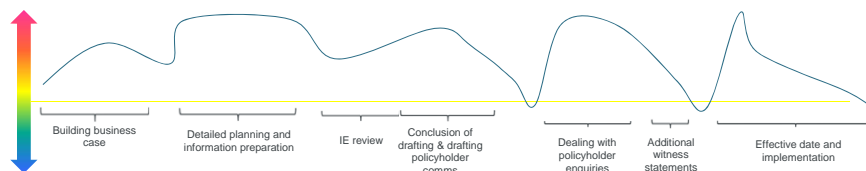
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Part VII transfer – illustrative timeline



Illustrative effort levels for companies involved



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Part VII in action – our experience

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The process (1)

- This is a multi-functional project involving:
 - A legal process
 - Actuarial analysis
 - Reviews of past products, policyholder residence, quality of address information
 - Policyholder communications
 - Implementation into BAU

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The process (2)

- It involves managing many external stakeholders:
 - The High Court, lawyers, Counsel
 - The Board and WPC
 - Regulators
 - HMRC
 - The IE
 - Policyholders
 - Reinsurers, Outsourcers and other contracted parties
- As well as internal teams

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Keys to Success (1)

- Success in part is going to rely on all the normal contributors to a successful project:
 - Detailed business case, costs and benefits
 - Good project management skills
 - A robust timetable, know what you're doing and by when
 - Deliver what you say you are going to do on time and clearly
 - Communicate
 - Budget management
 - Do contingency planning

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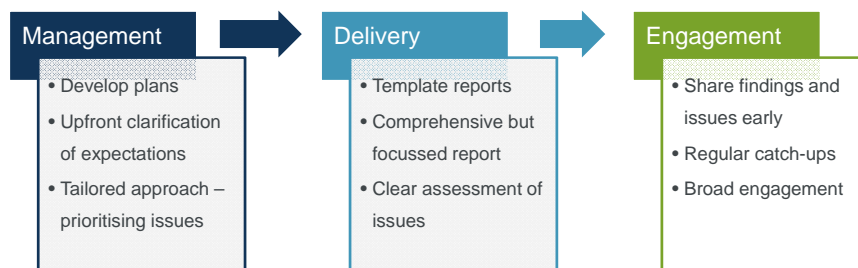
Keys to Success (2)

- But also:
 - Make sure those at centre of project have wide understanding of all aspects of the business
 - Know what is important to your business – if time to implementation is important, keep the scheme simple
 - Plan upfront what you want the scheme to achieve before engaging external parties
 - Don't get drawn into discussions where the scheme is not changing the outcome
 - Focus on policyholders, what you say to them and the way in which you respond to them
 - Recognise that being able to implement the scheme is as important as getting through the legal process

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IE providing robust challenge in an efficient manner



- Deep understanding of technical issues, overlaid with understanding of commercial rationale
- Consideration of each group/class of policies separately
- What information will be required/available and when?
- Remember your audience – public document!

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IE providing robust challenge in an efficient manner

- “Matrix” approach
 - Cover each group of policyholders
 - Separate conclusions for each area of potential impact
- PRA theme of rigour
 - Don’t assume general conclusion applies equally to all policyholders in a given cohort
 - Danger of throwaway comments
 - Examples of limited consideration of the asset side of the balance sheet
 - Requirement to consider whether independent legal advice is required

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Challenges and “hot-topics”

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Challenges and “hot-topics”

- Move to Solvency II:
 - how to reflect scheme impact in a public report, when no public figures?
 - dealing with uncertainty
- Split of PRA and FCA:
 - More focussed challenge
 - Overlap of challenge
 - Time availability
- Policyholder engagement
 - Difficulty in genuinely engaging
 - Appropriateness of print-press as a means of communications
 - Increasingly targeted communications
 - Bespoke call centre

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Questions

Comments

Thank you for listening

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Contact details

Kevin Edgington

Phoenix Group

kevin.edgington@thephoenixgroup.com

www.thephoenixgroup.com

David Hare

Deloitte

dhare@deloitte.co.uk

www.deloitte.com