



The Actuarial Profession

making financial sense of the future

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Part VII life insurance transfers: Recent Developments

What we said we would do.....

Part VII life insurance transfers: legal and actuarial update and recent developments

- Recent actuarial, legal and regulatory developments in Part VII insurance transfers
- How can lawyers and actuaries work more effectively on a Part VII insurance transfer?
- Role of the Court, the FSA, the Independent Expert and reporting actuaries: developments
- Impact of new regulatory structure on Part VII transfers
 - what does it mean for you?

What we will do.....

Part VII life insurance transfers: legal and actuarial update and recent developments

- Introduction
- Recent legal and regulatory developments including impact of new regulatory structure on Part VII transfers
- Recent actuarial developments
- How the firm, lawyers, actuaries and the Independent Expert can work together more effectively on a Part VII insurance transfer
- Questions & discussion

Part VII Transfers – Recent Legal Developments

NOTIFICATION REQUIREMENTS - REMINDER

- Notice must be:
 - sent to every policyholder of the parties (i.e. transferor(s) and transferee(s))
 - sent to every relevant reinsurer of the transferor(s) (or those authorised to act on their behalf)
 - approved by the FSA

(Regulation 3 of the FSMA (Control of Business Transfers) (Requirements on Applicants) Regulations 2001)
- However, policyholder communications pack typically comprises:
 - a letter
 - questions and answers
 - booklet (i.e. a statement setting out the terms of the Scheme and containing a summary of the IE's Report)
 - the legal notice (referred to above)

NOTIFICATION REQUIREMENTS - WAIVERS

- Waiver from requirement to notify policyholders directly is usually sought, but:
 - subject to the Court's discretion
 - Court has power to impose conditions
 - Court likely to be influenced by FSA's view (and on communications strategy more generally)
- Practice has been mixed. Most often a complete waiver is sought and granted on strength of proposals made in witness statements (and the Court has recently acknowledged this to be appropriate). Sometimes directions order is for a waiver of notice to specific groups only

NOTIFICATION REQUIREMENTS – RECENT DEVELOPMENTS

- Waiver applications (and communications proposals) are now considered more critically; particular issues with affinity/white-labelled products
- Key recent cases
 - Ecclesiastical Life Ltd v FSA [2010] EWHC 3871
 - Direct Line Insurance plc and Churchill Insurance Company Ltd [2011] EWHC 1482
 - Re Aviva International Insurance Ltd [2011] EWHC 1901
 - Provident Insurance PLC [2012] EWHC 1860

NOTIFICATION REQUIREMENTS – RECENT DEVELOPMENTS

- Non-exhaustive list of factors that may be relevant to exercise of the Court's discretion:
 - impossibility (or, conversely, possibility) of contacting policyholders
 - practicality of contacting policyholders
 - utility (to Court and policyholders) of contacting policyholders
 - availability of other information channels
 - proportionality of strict compliance
 - impact of collateral commercial concerns
 - object of the transfer itself and its likely impact on policyholders

(See Norris J in *Re Aviva* [2011]; Henderson J in *Re Provident Insurance PLC* [2012])

NOTIFICATION - TIPS

- Can waiver application be justified by reference to the Aviva factors?
- Ensure basis for the waiver application is clearly and adequately explained in the witness statement evidence
- Wider communications strategy should support the waiver application
- Involve key stakeholders and advisers at an early stage and discuss proposals with the FSA and Independent Expert; but note FSA may not be prepared to express views until it has seen IE report and assessed scheme generally
- Expect more critical assessment of the waiver application (and the communications strategy more generally) by the FSA in light of the above judgments
- Be prepared to disagree with the FSA if appropriate and to ask for a judge to resolve issues at the directions hearing

NOTIFICATION – SHORTCOMINGS IN EXECUTION OF THE COMMUNICATIONS STRATEGY

- Judgment in late 2011 considered this important issue (not reported)
- Company had obtained complete waiver at directions hearing
- FSA argued this waiver contained an implied condition that company's proposals should be fully implemented (otherwise a further waiver was necessary)
- Court preferred company's position and exercised s.111 FSMA discretion to sanction Scheme without remedying the defect – but probably reliant on the particular facts
- This approach endorsed earlier this year by Henderson J in Re Provident Insurance PLC – incomplete compliance is not inevitably fatal but FSA and Court will consider any elements of non-compliance at approval hearing and decide whether further steps needed

TRANSFERS TO AN EEA (BUT NOT UK) INSURER

- Life and Non-life Directives and Reinsurance Directive
 - Right of EEA insurers to transfer “portfolios of contracts” to another EEA insurer:

“if the competent authorities of the home Member State of the [transferee] certify that after taking the transfer into account the [transferee] possesses the necessary solvency margin”
 - Several transfers of non-life business approved on this basis, although FSA/Court have sometimes required capital undertakings contrary to Directive (and wider EU law) requirements
- Solvency II: harmonisation of Solvency Capital Requirement test (Article 100) should bring greater consistency and therefore certainty on solvency margin issues
- Further question for with-profits business: can FSA object to transfers on the basis that the transferee regulator does not have rules like COBS 20?

TRANSFERS TO AN EEA (BUT NOT UK) INSURER

- Commission Interpretative Communication 2000/C43/03 makes clear that financial supervision is a matter for an insurer's home Member State
 - Is COBS 20 a matter of financial supervision? At least in part
 - Changes proposed (in CP12/13) to COBS 20 expressly envisage in more detail the application of COBS (although only from when Solvency II comes into force) to EEA insurers with with-profits business
- Insurance Guarantee Schemes
 - 17 out of 27 Member States have an extensive IGS and some others have IGS for limited categories of business
 - Inconsistent application of these IGS to cross-border activities
 - UK: FSCS has very wide application on cross-border basis
 - Draft directive on the way, but in the meantime need to consider position on any cross-border transfer

AMENDMENT OF SCHEMES

- Process for amending schemes is established by scheme terms
 - Court approval usually required other than for technical/minor amendments
 - Extra-judicial ability to make changes with FSA/IE sign-off?
- Amendment of existing scheme in context of new scheme
 - Re Windsor Life [2007] EWHC 3429
 - Section 112(1)(d) FSMA – are changes "incidental, consequential and supplementary" in context of new scheme?
- Formal court process for amendment (outside context of separate Part VII transfer) is straightforward but early engagement with FSA is important
 - What information does the FSA require?
 - What communication does the FSA expect with policyholders?

WITH-PROFITS: TRANSITIONAL PROVISIONS

- COBS 20 TP 2.9 currently permits pre-January 2005 schemes to prevail over COBS 20 to the extent of any inconsistency
- Examples can include charging provisions, provision for allocation of compensation and tax costs and retention of strategic investments
- Recent FSA focus on the effect of TP 2.9 and its treatment on subsequent court applications
- In CP12/13 the FSA proposes that, on future applications to Court, should be obliged to ask the Court to consider whether “appropriate” to permit continued reliance on TP 2.9
- Uncertainty as to scope of applications caught and basis for Court’s decision

TIMETABLE AND OTHER MISCELLANEOUS DEVELOPMENTS

- FSA resource constraints, volume of transfer schemes and complications arising from regulatory architecture reforms mean FSA is requiring much longer to review schemes
- In all but simplest schemes, FSA now requires review period of perhaps 10-12 weeks after receiving complete package of documents
- CP 12/24 proposes amendment of SUP 18 guidance
 - “Near final” documents should be provided at least 6 weeks before final hearing
- Increasing use of cross-border mergers under the Cross-Border Mergers Directive (2005/56/EC) but still rare out of UK given need to comply with Part VII in addition, as confirmed in amendments to SUP 18 guidance

UK REGULATORY REFORM – IMPACT ON SCHEMES

- From April 2013, FSA will cease to exist
- Two new regulators for insurers
 - PRA - prudential regulation
 - FCA - conduct regulation
- Both PRA and FCA will have an interest in Part VII transfers under new structure
 - Reflected in proposed amendments to legislation and FSA guidance (SUP 18)
 - MoU between PRA and FCA
- Transitional provisions expected to deal with incomplete transactions at legal cutover

UK REGULATORY REFORM – IMPACT ON SCHEMES

- PRA will take the lead on Part VII transfers
 - But, FCA involved throughout, including on appointment of IE and form of IE report and before approving press/policyholder notices
 - PRA provides statutory certificates
 - Both PRA and FCA entitled to make representations
- Implications
 - Timetable
 - Duplication
 - FCA/PRA resources

Part VII Transfers – Recent Actuarial Developments

SOLVENCY II: IMPACT ON THE PROCESS

- Implications for transfers taking place in period leading up to implementation:
 - Explicitly provide for transition into Solvency II
 - Sensitivity over information disclosure in public documents
 - Treatment of long term fund / ring-fenced funds / capital tiering
 - Uncertainty relating to Matching Adjustment
 - SII readiness
 - Friends Life: extra-judicial ability to amend schemes to reflect Solvency II via actuarial/FSA sign-off

SOLVENCY II: IMPACT ON THE PROCESS

- Past transfers:
 - Amendment to reflect application of new regime e.g. abolition of long term fund; new capital requirements
 - COBS 20 implications
 - Existing schemes may incorporate automatic update for legal and regulatory developments but...
 - Need to bring schemes back to court
 - Likely to lead to some complex issues such as the need to re-express capital policy and translate triggers
 - Potential impact on previously designed Capital Support mechanisms

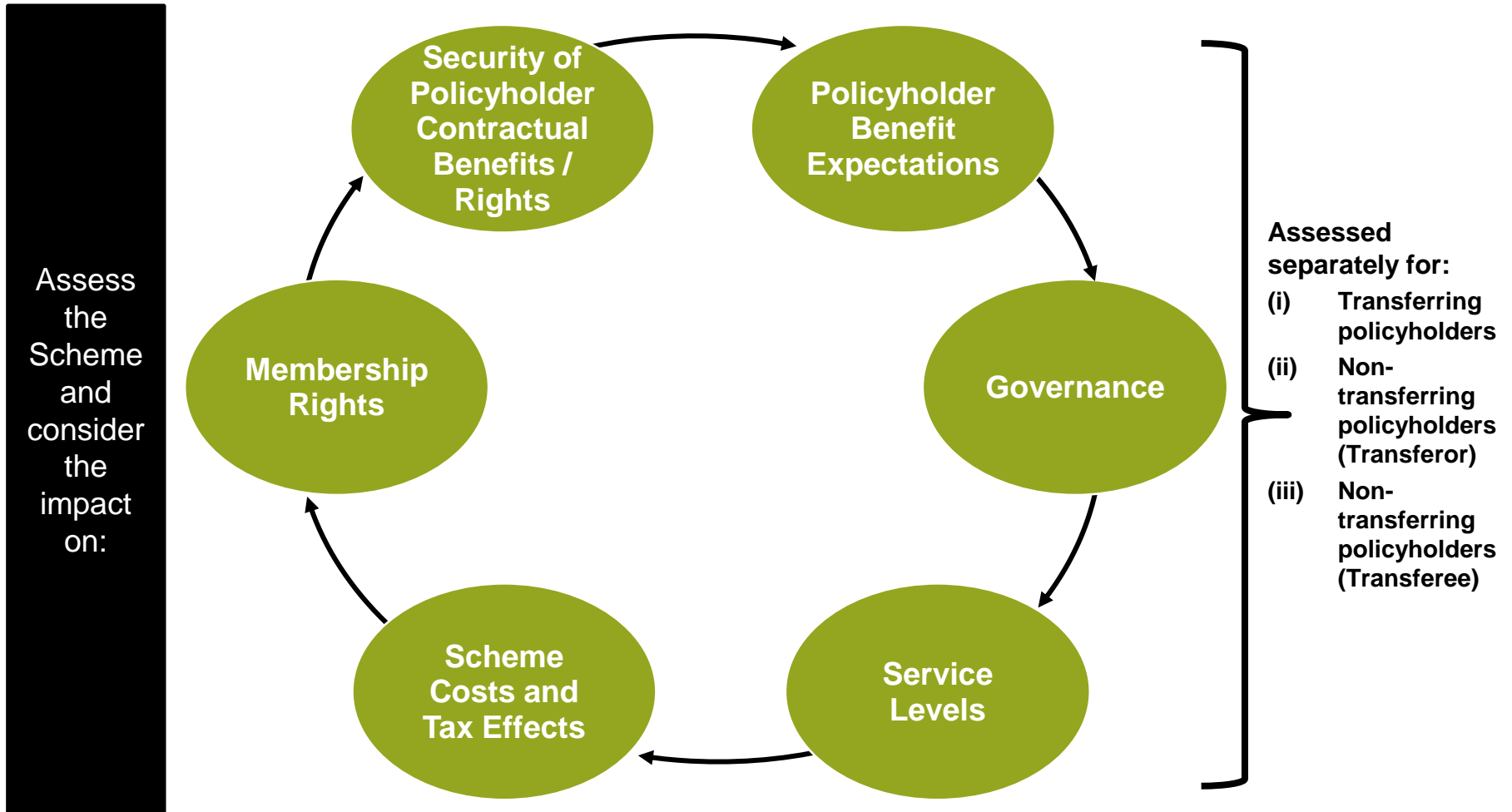
FRIENDLY SOCIETY TRANSFERS - I

- Different process to a Part VII set out in the Friendly Societies Act 1992
- Rather than being Court based the process relies on an FSA Tribunal
- The Independent Actuary (not Expert!) acts for the Regulator rather than the Court
- Higher degree of supervisory engagement than on typical Part VII
- Fundamentally the same issues of fairness but need to think clearly about Governance and mutuality

FRIENDLY SOCIETY TRANSFERS – II

- Need to report to and communicate with the “Delegates” / Members as well as the FSA and management
- “Delegate” or Member vote is a key step
- Leads to challenges around the clarity of role - “As our independent actuary previously said.....”
- Risk of a disconnect between supervisory team and reviewing tribunal needs to be managed

What the expert needs to do....



<http://fsahandbook.info/FSA/html/handbook/SUP/18/2>

Current Topics - I

- **Staff Pension Scheme Funding Risks**
 - Measure on IFRS or Scheme Funding Basis? Often provide significantly different results
 - Scenario Testing – Challenges in quantifying risks / Generally large amounts of trustee discretion around investment strategy
 - Treatment on Regulatory Capital Measures (e.g. ICA, Solvency II)
- **Role of the Pension Regulator**
 - Extensive powers to levy charges across groups or previous sponsoring employers

Current Topics - II

- **Assessment of Eurozone Currency Re-denomination Risk**
 - Important to quantify exposure to specific countries (PIIGS)
 - Are transferor or transferee are heavily exposed?
- **Complex Reinsurance Structures**
 - How much benefit under Pillar 1 / Pillar 2 / Solvency II?
 - How much collateral coverage? What is nature of collateral and how is it managed? (Cash can be difficult to manage)

Current Topics - III

- **Assessment on both a Pillar I and Pillar II basis**
 - Important to look at both measures of financial strength, but.....
 - How much confidence can the IE have in comparability of Pillar II results?
 - Firms may carry significantly different risks and apply different levels of stress
 - Pillar 2 not audited
 - May have significantly different treatment of: staff pension schemes, deferred tax assets, subordinated capital instruments, intra-group loans & reinsurance

Current Topics - IV

- **Greater focus on administrative processes**
 - Plans for out-sourcing arrangements & likely service standards
- **Quality and tiering of capital**
 - Tier 1 vs Tier 2 vs Tier 3
 - Sub-debt treatment varies
 - Solvency II uncertainty
- **Investments (subsidiaries) of the fund e.g. Annuity providers, GI businesses, Equity Release Providers, etc**
 - How has “value” been treated in financial strength assessment?
 - Has risk been adequately reflected?

Current Topics - V

- **Impact of Group Structure and Group Capital on Security**
 - Requires assessment of intra-group dependencies
 - Not just loans and financial support, but needs consideration of operations / administration / governance / covenants
- **Governance of the WP fund**
 - PS 12/05 – How have firms responded?
 - “Legacy” WP governance committees
- **Impact on policyholders of changes to existing schemes**
 - Line by line analysis of old vs new scheme provisions

Part VII Transfers – Managing the process

Four Main Reasons for Difficulties in Execution of Projects and Transactions*

- Failure to formulate objectives properly at the outset
- Failure to identify possible obstacles and plan effectively to overcome them
- Silo and/or herd behaviour results in ineffective responses to problems as they arise
- Failure to make the most of an advantageous negotiating position

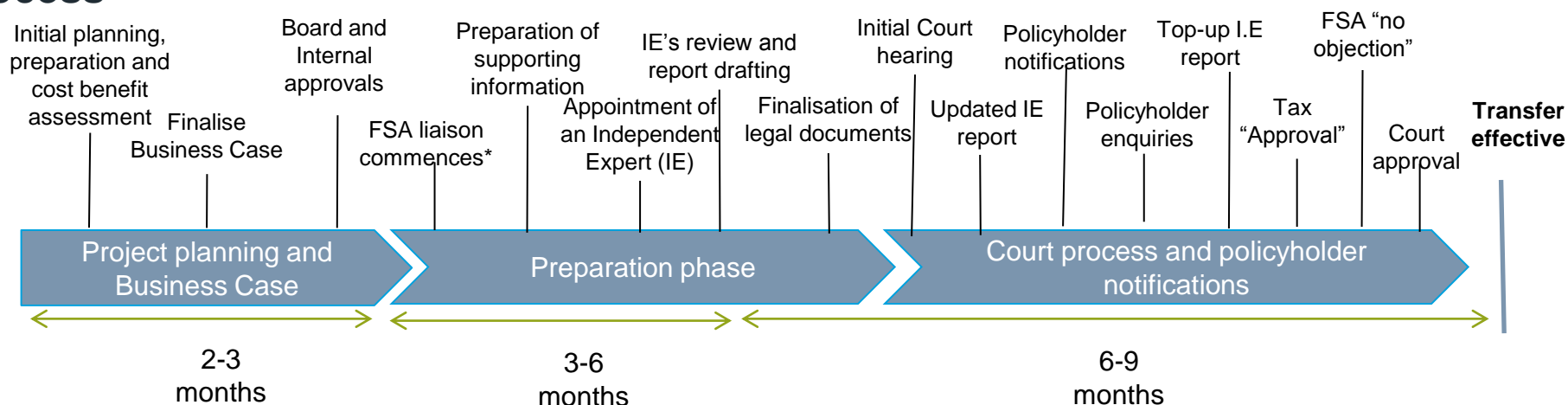
* Effective Execution of Projects and Transactions Murray et al Life Convention 2011

Managing the Part VII Process - Challenges

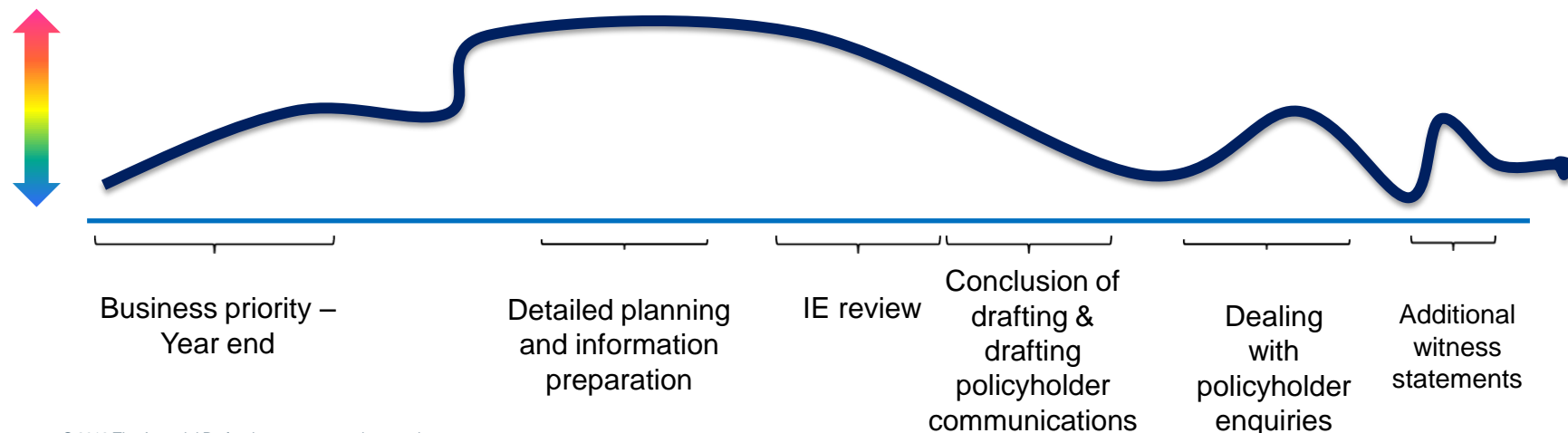
- Recognition that there are business wide implications and that its not just a legal and actuarial “thing”
- Challenging timescales
- Often front ended in Q1
- Actuarial stretch in the business
- Lack of perfect information
- Regulatory pressure
- Court Timetables

Process roadmap and potential Company impact

Process



Illustrative internal effort levels



Managing the Part VII Process – Opportunities to make it better for everyone

- Clear, realistic and robust plans
- Strong (and knowledgeable!) project management
- Strong corporate sponsor
- Disciplined communication process:
 - Regular tri-partite meetings and calls
 - Open dialogue with the regulator
- Honesty around delivery of materials and drafts
- Regular re-cuts of the plan
- Try to get things right first time

Managing the Part VII Process – Opportunities to make it better for everyone

- Get to know the teams:
 - The Independent Expert isn't just the person that signs the report there will be a team supporting them!
 - The legal team at all levels
 - The Regulator
- And this all becomes more difficult in the context of a third party transaction.....

Managing the Part VII Process – Avoiding Pitfalls

- Be honest about delivery
- Respect EVERYBODY's position but....
- Know your boundaries
- Communicate, communicate, communicate!

Questions

Happy to answer questions

