Institute and Faculty of Actuaries

G3: Insurance Business Transfers in a Solvency II World

4 November 2016

Institute and Faculty of Actuaries

Insurance Business Transfers in a Solvency II World

Adam Levitt – Ashurst
Phil Simpson – Milliman

4 November 2016

Agenda

- **Quick Refresh on Part VIIs – Objectives and Process**
- Quick Refresh on Part VIIs – Participants
- Recent Legal Developments and Case Studies
- The Independent Expert's Perspective
- Other types of IBT

Institute and Faculty of Actuaries

Regulatory Objectives

PRA

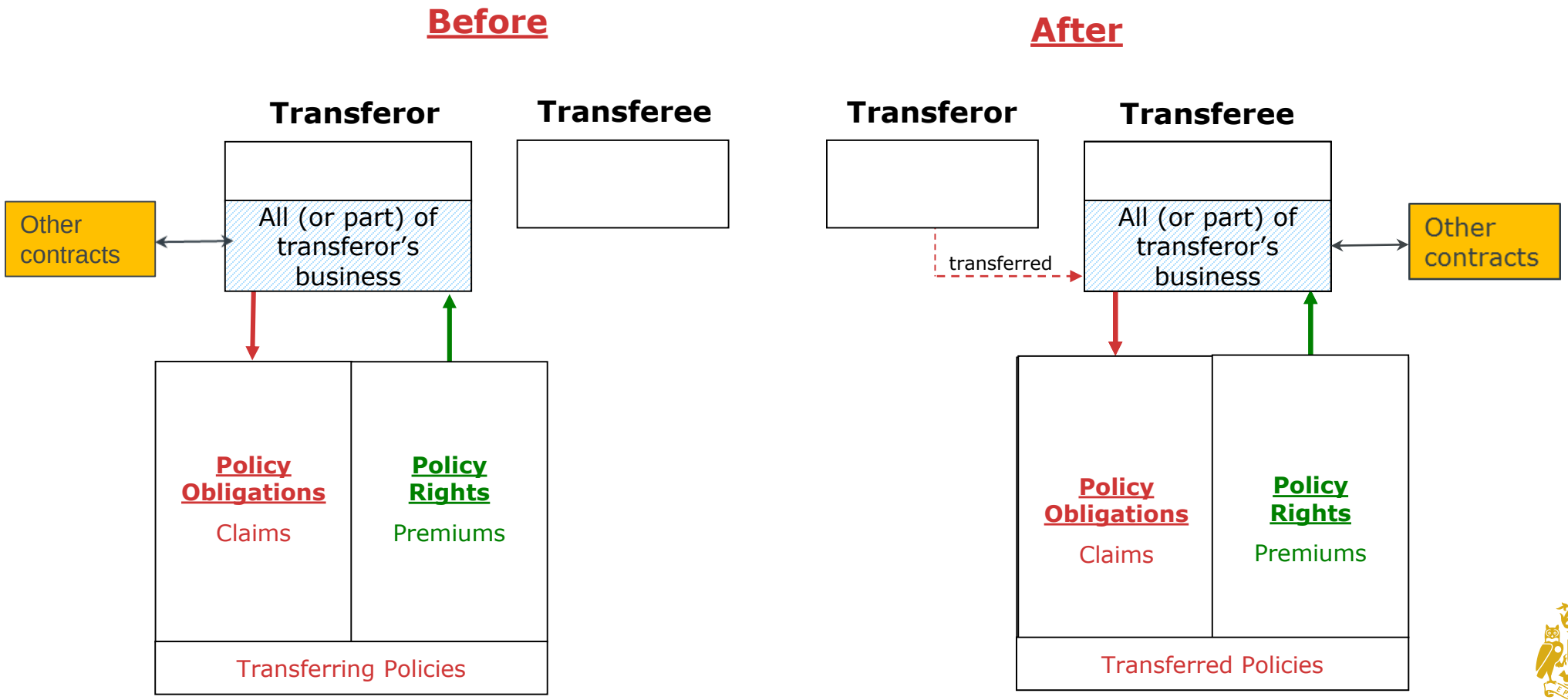
- Promoting the “safety and soundness” of regulated entities
- For insurers, “securing… an appropriate degree of protection for those who are or may become policyholders”
- Secondary objective: facilitating “effective competition”

FCA

- Objectives include “operational objectives”:
  - “Securing an appropriate degree of protection for consumers”, which includes the general principle that consumers “should take responsibility for their decisions”, but recognising that different levels of consumer sophistication and product sophistication exist
  - “Promoting effective competition in the interests of consumers”
  - “Consumers” not confined to retail

Institute and Faculty of Actuaries

FSMA Part VII – Transfers of business



Institute and Faculty of Actuaries

FSMA Part VII – Parameters

- Part VII applies when **“whole or part”** of transferor’s insurance business transfers
- What is “part”?
  - (Series of) novations
  - Regulatory stance/objectives
- Part VII generally compulsory, but is optional for:
  - Non-EEA risks
  - Consenting group company policyholders
  - Consenting reinsurance cedants
- Part VII does not apply to friendly societies
- Post-Brexit: loss of cross-border transfers?
  - Treasury select committee review of Solvency II

Institute and Faculty of Actuaries

Agenda

- Quick Refresh on Part VIIs – Objectives and Process
- **Quick Refresh on Part VIIs – Participants**
- Recent Legal Developments and Case Studies
- The Independent Expert's Perspective
- Other types of IBT

Institute and Faculty of Actuaries

Independent Expert

- Must be competent (e.g. an Actuary)
- Proposer will nominate and advise PRA/FCA of choice
- PRA generally lead regulator on transfer
- PRA will consider suitability of nominee
- PRA entitled to make own choice
- PRA/FCA may set out further criteria (in addition to those supplied by the company and IE) for expert to consider based on preliminary information supplied

Institute and Faculty of Actuaries

Independent Report on the Scheme

- Prepared to consider the merits of the Scheme, and contains:
  - summary of the terms of the Scheme
  - likely effect on policyholders of both transferor and transferee
  - opinion on likely effects if the Scheme is or is not implemented
  - whether any alternatives were considered
- Relied on (together with the summary report) by:
  - policyholders in deciding whether to object to the proposals
  - the Court in deciding whether to sanction the Scheme
  - satisfying the PRA/FCA

Institute and Faculty of Actuaries

Regulator Report

- In June 2007 FSA agreed to provide an additional reports to the court setting out:
  - The most significant issues in a proposed transfer
  - The basis on which it does, or does not, object to a proposed transfer
- The PRA will produce a report to the Court
- The FCA is also likely to produce a report to the Court for most transfers
- Most significant report is for the directions (preliminary) court hearing which in particular deals with the communications form
- Final report for the sanctions (final) court hearing which may just be a rewording of earlier report unless material issues or objections have arisen since
- Draft copies provided to parties prior to hearing
- Report finalised after PRA/FCA has:
  - seen IE report
  - considered written representations from policyholders

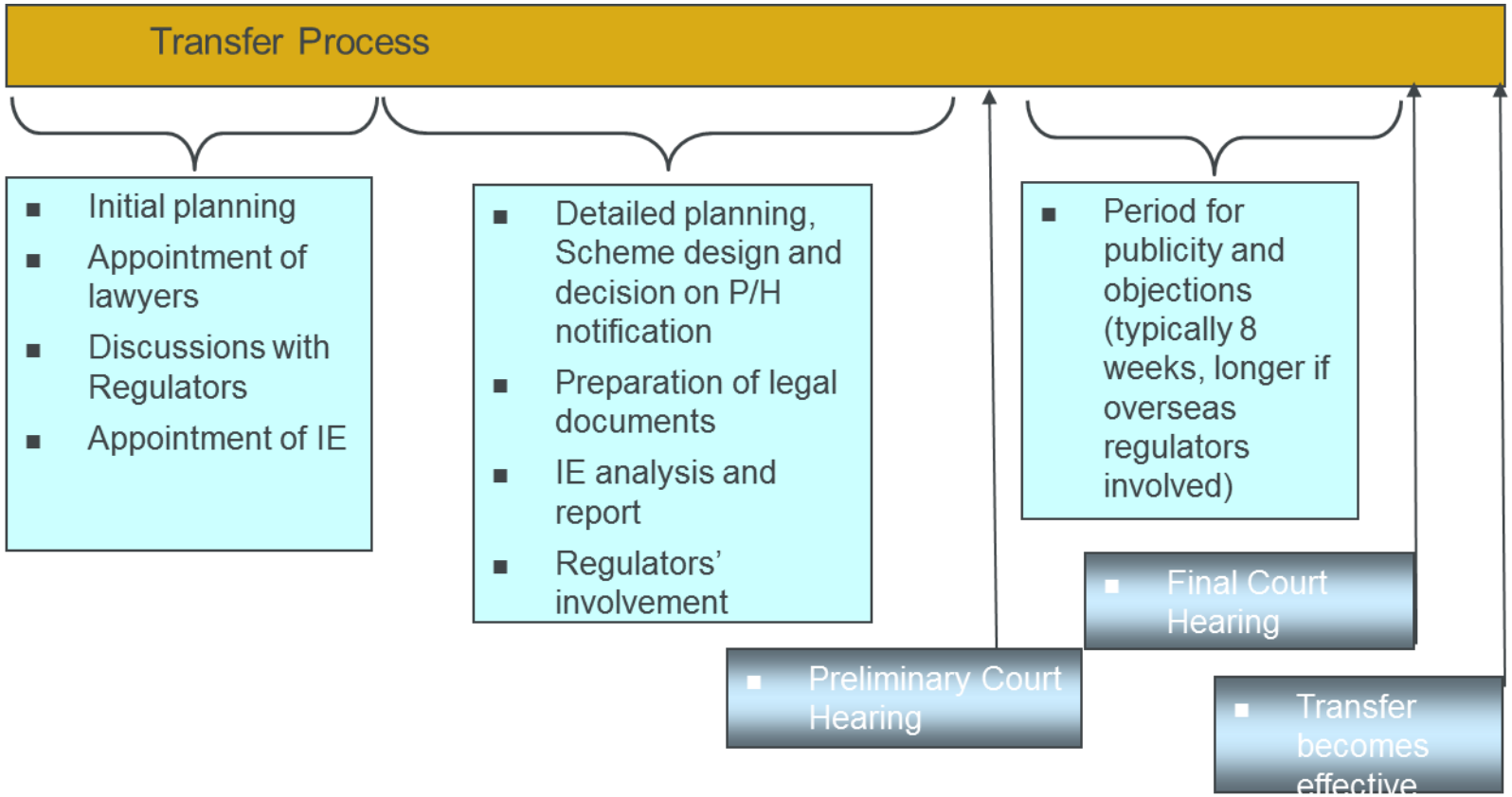
Institute and Faculty of Actuaries

Sanction of the Court

- Evidence at the final hearing usually given by counsel
- Proof that the various matters to be carried out have been so carried out
- Prescribed certificates have been obtained
- Hear any objector to the Scheme
- Know the views of the regulators on the proposed Scheme (regulators reports)
- Can sanction transfer of outwards reinsurance

Institute and Faculty of Actuaries

Typical timeline and key tasks



Total time varies from < 6 months to 2 years plus

Notification to overseas regulators may begin prior to the preliminary court hearing

Institute and Faculty of Actuaries

Agenda

- Quick Refresh on Part VIIs – Objectives and Process
- Quick Refresh on Part VIIs – Participants
- **Recent Legal Developments and Case Studies**
- The Independent Expert's Perspective
- Other types of IBT

Institute and Faculty of Actuaries

Case Studies

1. **HSBC Life transfer to ReAssure (formerly Windsor Life) – 2015**

- Mostly linked business under the transfer
- Various changes would take place:
  - Change to pricing basis
  - Change to valuation timing
  - "Lifestyling" to take place annually over five years, rather than monthly over that period
  - Loss of online switching and ability to make additional contributions online
  - Loss of branch bank network
- Judgment in London Life (1989)
  - "In the end the question is whether the scheme as a whole is fair as between the interests of the different classes of persons affected. But the court does not have to be satisfied that no better scheme could have been devised."

Institute and Faculty of Actuaries

Case Studies

- Judgment in Axa Equity & Law (2001)
  - Whether the security and reasonable expectations of policyholders will be adversely affected “is primarily a matter of actuarial judgement”

Conclusions

- Despite lack of clarify on whether ReAssure would obtain matching adjustment/transitional approvals and no obligation on Swiss Re Group to retain or comply with its target capital framework, etc., Snowden J. followed precedent (Norwich Union [2004] and Royal & Sun Alliance [2008])
  - The judge quoted David Richards J. in Royal & Sun Alliance: “The court is not concerned to address theoretical risks…. What the court is concerned to address is the prospect of real, as opposed to fanciful, risks to the position of policyholders”
  - Transferee “comfortably meets” Solvency II requirements: should not matter if transferee solvency is lower than transferor solvency
  - Policyholder objections: the judge said that policyholders “should not be discouraged by concerns over costs”

Institute and Faculty of Actuaries

Case Studies

2. Rothesay – 2016

- Transfer intra-group from Rothesay Assurance Limited to Rothesay Life Limited. RAL was formerly MetLife
- RAL had greater financial strength under Solvency II
- The judge (Henderson J.) noted that transferor could reduce its level of excess capital by writing new business or taking on reinsurance
- Independent expert “entitled to great respect” and a court “will normally be slow to differ from” his conclusions
- Policyholders have “no legal right to the maintenance of any particular level of excess cover once… regulatory capital requirements were met”
- The judge said “there is nothing sacrosanct about any particular level of excess capital over regulatory requirements”
- There is no “right level of excess capital”, so long as regulatory requirements are met (and these incorporate “a substantial margin of safety”)
- If the independent expert (and regulators) are content with the transferee’s level of capital, there is no prospect of real risk to transferring policyholders

Institute and Faculty of Actuaries

Case Studies

3. Scottish Widows/Clerical Medical – 2015

- Consolidation of eight LBG insurance businesses into one
- Rose J.'s judgment explains various bones of contention with the PRA (whether court approval for merely "desirable" modifications to the scheme is necessary; effective date flexibility; whether a future court can agree to any amendment or only "necessary" ones)
- Categorisation and discussion of objections: forum for very old grievances
- Discussion of FCA's role: TCF/communications (including reviewing how enquiries are handled and training of call centre staff)

Institute and Faculty of Actuaries

Case Studies

4. PA(GI) – 2015

- Court had to decide whether liability for mis-selling transferred under a series of insurance business transfer schemes
- Liability under common law (tort), such as negligent mis-statement, and statute were already time-barred
- Liability, however, might arise under the Financial Ombudsman Scheme to pay compensation (not subject to statutory time-bar)
- Relevant transfer scheme provided for liabilities "under or attaching to" transferred policies to transfer
- Andrews J. applied the natural meaning of the words:
  - "Under" referred to the obligation to pay claims under the policies
  - "Attaching to" was not the same as wording with wider scope, like "relating to" or "in connection with"
  - Including FOS liability would be "an unnatural interpretation of the language"
  - This conclusion was supported by it being "inherently unlikely" that the parties intended such liability to transfer

Institute and Faculty of Actuaries

Case Studies

5. Excess/Hartford – 2015

- Court had to consider three transfers within the same scheme
- Certain policyholders benefited from a “Deed of Guarantee” expressed to be in favour of Excess policyholders
- Objections were based on the loss of the guarantee
- However, the transferee would, according to the independent actuary, “have much more capital relative to its size”
- Security would be improved, notwithstanding loss of the guarantee, as transferee would have new ADC Reinsurance
- Henderson J. analysed the guarantee and decided that the position of the (supposedly) guaranteed policyholders “will in fact be significantly improved”

Institute and Faculty of Actuaries

Case Studies

6. Copenhagen Reinsurance – 2016

- Copenhagen Reinsurance policyholders benefited from guarantees, in case the company could not pay claims
- As part of an intra-group transfer, the question was whether the beneficiaries under the guarantees could be amended by the Court
- The guarantor entities had objected to the guarantees being amended so as expressly to benefit the policyholders once they had become policyholders of the transferee
- Snowden J. concluded that:
  - section 112(1)(d) FSMA empowers the Court to do whatever is necessary to ensure that a transfer scheme is "fully" carried out
  - the objection by the guarantor entities was "an opportunist attempt to terminate contractual obligations"
  - the Court Order would override the guarantor objections

Institute and Faculty of Actuaries

Agenda

- Quick Refresh on Part VIIs – Objectives and Process
- Quick Refresh on Part VIIs – Participants
- Recent Legal Developments and Case Studies
- **The Independent Expert's Perspective**
- Other types of IBT

Institute and Faculty of Actuaries

Part VII Transfers – Impact of Solvency II

- Change in key metrics
- The various permissions on transfer
- Transitional measures
- Quality of assets
- Ring fenced funds
- Information sources

Institute and Faculty of Actuaries

Part VII Transfers – Regulatory Developments

- Change in regulatory rules
- Increased emphasis on communications
- Focus on independence
- Legal advice
- Regulatory resources
- Regulator challenge

Institute and Faculty of Actuaries

Part VII Transfers – Market Activity

- Levels high after constraints of last year
- Increased scrutiny lengthening timetables
- Movement of annuity funds
- Transfer of non core business
- Regulatory stability for a while
- Impact of Brexit

Institute and Faculty of Actuaries

Impact of Brexit on restructuring

- UK businesses more attractive
- Do we need European subsidiaries (again)?
- Product redesign
- Distribution
- Fewer hurdles to jump?
- Solvency II Lite?

Institute and Faculty of Actuaries

Agenda

- Quick Refresh on Part VIIs – Objectives and Process
- Quick Refresh on Part VIIs – Participants
- Recent Legal Developments and Case Studies
- The Independent Expert's Perspective
- **Other types of IBT**

Institute and Faculty of Actuaries

Friendly Societies

Friendly Societies Act 1992

- A friendly society ('FS') can:
  - **Transfer its engagements** to FS; Industrial and Provident Society; or company
  - **Convert** into a company
  - **Amalgamate** with another FS

Voting

- In each instance a **special resolution** (75% of members voting) must be passed
- In addition, where part of business transferred – need an **affected members resolution** (75% of those members whose contracts are being transferred)

FSMA

- FSs cannot transfer business under the FSMA Part VII
- So flexibility of transfer scheme (e.g. changing policy terms/benefits) cannot be done unless FS converts into a company and uses FSMA

Institute and Faculty of Actuaries

Friendly Societies

Regulator

- PRA confirmation is required for a transfer/conversion/amalgamation and policyholders can make representations

Actuarial Report

- Long-term insurance business
  - A report from an independent actuary on terms of proposed transfer and likely effects on policyholders

Institute and Faculty of Actuaries

Industrial and Provident Societies

Statutory Overview

Co-operative and Community Benefit Societies Act 2014 ('CCBS')

- A registered society (Industrial and Provident Society, Co-operative Society or Community Benefit Society) can:
  - **Convert** itself into a company
  - **Amalgamate** with a company
  - **Transfer** its engagements to a company or another registered society
- If insurance business is being transferred – must use FSMA Part VII
- A vote is not required to effect a transfer under FSMA *(UIA (Insurance) Limited)*

Institute and Faculty of Actuaries

Industrial and Provident Societies

Transfer of Engagements under CCBS (not FSMA) – Voting

IPS → IPS: a special resolution for transferring engagements between societies must be passed:

- At first general meeting
  - By two thirds of members actually voting on the resolution, whether in person or by proxy
- At second general meeting
  - By a majority of the members who actually vote in person or by proxy at that meeting

IPS → Company: a special resolution for converting into, amalgamating with or transferring engagements to a company must be passed:

- At first general meeting
  - By 75% of the members actually voting on the resolution, whether in person or by proxy
  - With at least 50% of all members entitled to vote at the meeting casting their vote

Institute and Faculty of Actuaries

Industrial and Provident Societies

Transfer of Engagements – Voting

- At second general meeting
  - By a majority of the members who actually vote in person or by proxy at that meeting

NB: the above voting is not required for an insurance business transfer under FSMA

Non-FSMA transfers

Transfer of engagements

TRANSFEROR		TRANSFEREE
Friendly Society	S86, Friendly Societies Act 1992 →	Friendly Society
Friendly Society	s86 (1)(b), Friendly Societies Act 1992 →	Industrial and Provident Society
Friendly Society	s86(1)(c), Friendly Societies Act 1992 s.105 (3) Case 1, Financial Service and Markets Act 2000 (Carve-out) →	Company
Industrial and Provident Society	s110, Co-operative and Community Benefit Societies Act 2014 →	Industrial and Provident Society
Industrial and Provident Society	s105, Financial Services and Markets Act 2000 → OR transfer non-insurance engagements under **s112 (1), Co-operative and Community Benefit Societies Act 2014**	Company

Schemes of Arrangements

Companies Act

- **Statutory procedure** under Companies Act 2006 Part 26
- Allows companies to reach a **compromise with creditors** (e.g. policyholders)
- Requires **majority approval of creditors** (or class of creditors) (**75% in value** and **50% in number** of those who vote) and **court approval**
- **Opt out** facility can improve chances of getting creditor approval
- Terms of the Scheme are **binding on the company and on all creditors**, regardless of whether individual creditors originally voted for the Scheme
- Can be used to **remove GARs** (provided some alternative benefit is granted)
- **Available to UK-incorporated companies** (i.e. not Friendly Societies, Industrial and Provident Societies, Co-operative Societies)

Institute and Faculty of Actuaries

Classes of creditors

Actuarial Function

- Actuarial report **not required** under statute
- However, can be used to give Scheme added **credibility** *(Equitable Life Assurance Society)*

Institute and Faculty of Actuaries

Schemes of arrangement

Regulatory approach

- Companies Act 2006 does not give PRA/FCA specific role or powers (PRA policy statement sets out its approach)
- Statutory objectives of PRA/FCA likely to lead to:
  - policyholder fairness discussions
  - solvency capital discussions
  - regulatory input into structure of scheme and possible opt-outs
  - need for independent actuarial view of effect of proposals and conclusions being disclosed to policyholders
  - scrutiny of circular to policyholders explaining scheme and voting thresholds
- Creditor **class** issues will be key

Institute and Faculty of Actuaries

Contact Details

Adam Levitt – Adam.Levitt@ashurst.com

Philip Simpson – philip.simpson@milliman.com

Institute and Faculty of Actuaries