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TRANSFERS OF UNITED KINGDOM LONG TERM BUSINESS

by

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The views expressed in this paper are entirely my own. I am grateful, however, to my partner Ross Fraser for the sections on taxation.

PART I
INTRODUCTION

1.1 Statutory rules governing the ability of a life insurance business in the United Kingdom to transfer its assets, undertaking and liabilities to another party have been with us for over a century. They were first introduced by the Life Assurance Companies Act 1870, which was passed following the failure in 1869 of the Albert Life Assurance Company, which had acquired the businesses of more than 20 other societies. Prior to the passing of this Act, an insurance company could transfer its entire business without the knowledge, let alone consent, of its policyholders, provided only that it took the necessary powers to do so in its constitution and the terms of its policies. The 1870 Act introduced a requirement for a statement setting out the nature of the transfer to be sent to policyholders, together with copies of the actuarial reports on which it was founded, and for the transfer itself to be confirmed by the Court. The Court could confirm the arrangement if it was satisfied that "no sufficient objection to the arrangement" had been established, after hearing the directors and any other persons whom it considered entitled to be heard. The transfer could not be confirmed if more than a tenth by value of the policyholders of the transferring company objected to the arrangement.

1.2 The requirement to include the report of an independent actuary was added by the Assurance Companies Act 1909, but in all other respects the transfer provisions of the 1870 Act remained substantially the same until the Insurance Companies Amendment Act 1973 repealed them and introduced what are now sections 49 and 50 of the Insurance Companies Act 1982 ("the 1982 Act"). These sections no longer contain the proviso by which one-tenth or more by value of policyholders can defeat a petition. The current sections also give a specific right for the Secretary of State and "any person (including any employee of the transferor company or the transferee company) who alleges that he would be adversely affected by the carrying out of the scheme" to be heard on the petition. The section only relates to the transfer of long term business carried on in the United Kingdom. The full text of sections 49 and 50 are set out in Appendix 1.

1.3 Although the procedure for transferring life funds in the United Kingdom has been in existence for so long, and has changed so little over the years, until the merger of London Life and AMP in 1989,[1] there appear to have been no reported judgments on section 49, or any of its predecessors. Even that decision has not reached the regular Law Reports, although the judgment of Mr. Justice Hoffmann is readily available. A further judgment on the question of jurisdiction was given in the Eagle Star Life case in December 1990.[2]

1.4 A number of transfers of life funds have been made over the years, and comparatively recently they have been attracting some publicity and interest. There are likely to be more of them in the future as 1992 approaches. The single European market provides both a challenge and an opportunity for the financial services industry. The European Commission aims, in conjunction with its programme for harmonisation of other financial services, to produce a single European insurance market to provide both for freedom of establishment, whereby an insurer established and authorised in one country can set up an establishment in another Member State, and also freedom to provide services, whereby an insurer established in a Member State can provide insurance across national frontiers to residents of other Member States. The single market objective is to provide full freedom of service on the basis of home country regulation, enabling insurance companies to operate on a single insurance licence. We are still some way from achieving this goal but insurance companies may now be questioning whether they should face a European home market alone, or with partners. Will it be possible to preserve market share in the United Kingdom, or to concentrate on market niches — perhaps to stay mutual and thus free from predators? Will there be a shrinking number of life insurance players in the field in the future? Will insurance companies need to find partners to secure and protect distribution outlets for their products to ensure effective growth?

1.5 For many companies, mutuals in particular, the only effective way of achieving a merger with a chosen partner is likely to involve a transfer of life funds under section 49 of the 1982 Act. The purpose of this paper is to address some of the issues and problems which arise on the transfer of long term business in the United Kingdom, seen from the perspective of a lawyer with some experience of advising upon transactions of this kind

PART II
REASONS FOR A TRANSFER

2.1 The transfer of life funds is, of course, merely a mechanism to achieve an end. It is also a very lengthy, cumbersome and expensive mechanism, and if the required end can be achieved without involving a section 49 transfer, it will almost certainly be preferable to a method which does.

2.2 Where parties wish to merge the assets and liabilities of the United Kingdom long term funds of two separate entities, section 49 is the only solution (short of an Act of Parliament). Reinsurance can of course be used to some extent, but is unlikely to be a long term solution. A section 49 scheme may be useful not only in the consummation of a large merger, but also, for example, in the transfer of the rump of a closed fund. In a merger, one advantage of a section 49 transfer, particularly from the point of view of the minority or weaker party, is that, even if one of the parties disappears as a consequence of the transfer, the arrangements governing the merger can be entrenched by the Court scheme. Accordingly any policyholder aggrieved by suspicions that a party to a scheme is not carrying out its terms would be entitled to complain to the court. In fact, the 1982 Act contains no mechanism for amending a scheme once it has been sanctioned, a point worth bearing in mind when drafting one.

2.3 For many mutuals, the only practical method of demutualisation would involve a section 49 transfer. As set out in the Franklin and Lee study,[3] of 25 mutuals then surveyed 13 were incorporated by Act of Parliament, 11 under the Companies Acts and 1 under the Industrial and Provident Societies Act. Mutuals incorporated under the Companies Acts as companies limited by guarantee cannot convert into companies limited by shares. The legislation does not create any mechanism for changing the constitution of a company in this way. A company can go from being unlimited to limited (and vice versa) and, if it is unlimited can re-register as a company limited by shares. But a company which is already limited by guarantee will find no assistance in the Companies Act to help it to demutualise as a company limited by shares. (It is not possible to convert to an unlimited company and then reconvert to a limited company in a different form). The United Kingdom no longer has the concept, of which National Mutual recently took advantage in Australia, of a company limited by guarantee and also having a share capital. It has not been possible since 1980 to register in the United Kingdom as a company limited by guarantee with a share capital, although some old companies incorporated in this form may still remain.

2.4 If a mutual is incorporated by statute, the private Act may include a mechanism for conversion to a proprietary company. If it does not, again, the only practicable method of demutualisation, short of another private Act, would be a section 49 transfer.

2.5 A section 49 transfer can also be used on a restructuring of a group where arrangements with different classes of policyholders can either be entrenched or the business restructured, as in the recent Irish Life transfer.

PART III
LAW AND MECHANICS

3.1 Jurisdiction

Section 49 only applies to the transfer of long term business carried on in the United Kingdom by an insurance company to which Part II of the 1982 Act applies. Accordingly, if the company carries on business in several jursidictions, several schemes may be involved, one in each jurisdiction where the company carries on business. A number of other countries adopt a system not too dissimilar from that used in the United Kingdom for the transfer of life funds — Canada, Ireland and Australia are cases in point.

3.2 The Rules

There are few written rules. Section 49 sets out the requirement for the sanction of the Court, and various rules for the publication of notices and service of documents upon the Secretary of State. It also requires:-

"except where the Court has otherwise directed, that a statement —

(i) setting out the terms of the scheme;

(ii) containing a summary of the [independent actuary's] report sufficient to indicate the opinion of the actuary on the likely effects of the scheme on the long term policyholders of the companies concerned, has been sent to each of those policyholders and to every member of those companies

The Secretary of State and any person who alleges he would be adversely affected by the carrying out of the scheme is entitled to be heard on the petition. Section 50 enables ancillary matters to be dealt with in the court order sanctioning the scheme. Once sanctioned, the scheme is binding on all parties.

3.3 By an amendment made in 1987, where a section 49 transfer also involves a compromise or arrangement falling within section 427A(1) of the Companies Act 1985 ("the Companies Act") it will also be necessary to comply with the requirements of sections 425-427 (schemes of arrangement) of that Act. Basically this provision deals with certain section 49 schemes involving public companies, when meetings of the members of the transferor company, or any class of them, or of the creditors of the transferor company, or any class of them, may be required. Similar meetings with respect to the transferee company may also be required. The author is not aware of any insurance company scheme under this section to date.

3.4 In times past, statements summarising the scheme and the actuary's report were not always sent to policyholders. However, except where the Department of Trade and Industry is satisfied that policyholders, or a particular class of them, are in practice unaffected by a scheme, it is now normal practice to give wide circulation of the details of a scheme to all policyholders and members. Indeed, a practice appears to be growing of inviting members to approve the proposals, even when it is not required either by legislation or by the constitution of the company concerned.

3.5 It is also now normal practice to produce not only a report of the independent actuary as required by section 49, but also one or more additional reports by the appointed actuaries of the transferring and transferee companies. In more complicated schemes particularly, the appointed actuary may in his report delve more deeply into the actuarial history of the business leading up to the transfer and give an added explanation and view of the effect of the arrangements on the policyholders for whom he is in effect responsible. The Board of a company in coming to any conclusions on proposals which involve either disposing of or acquiring life funds, will rely upon the appointed actuary's advice, and policyholders are perhaps entitled to expect his opinion to be given wider circulation than the Board room.

4.1 Five stages

The basic order of events can be set out in five stages, which are not necessarily chronological.

4.2 The Board

The first stage involves the Board of directors of the insurance company seeking to make the transfer. The Board are responsible for managing the affairs of the company and it is their duty to reach a commercial judgment as to whether or not to look for a partner, to choose between rival partners and to negotiate detailed terms for a merger. The Board, in carrying out this task, may be advised by financial advisers, consulting actuaries, accountants and lawyers. A Board cannot act in a totally unreasonable manner. The position of the Board was put succinctly by Mr. Justice Hoffmann in the London Life case:

> "A Board might have a choice of several possible schemes, none of which, taken as a whole, could be regarded as unfair. Some policyholders might prefer one such scheme and some might think they would be better off with another. But the choice is in my judgment a matter for the Board. Of course one could imagine an extreme case in which the choice made by the Board was so irrational that a court could only conclude that it had been actuated by some improper motive and had therefore abused its fiduciary powers. In such a case a member would be entitled to restrain the Board from proceeding.[4] But that would be an exercise of the Court's ordinary jurisdiction to restrain breaches of fiduciary duty; not an exercise of the statutory jurisdiction under section 49 of the Insurance Companies Act 1982."

4.3 Apart from choosing between alternative schemes, in the case of a life fund there is an additional possibility — closing the fund to new business. There is more than one view as to whether, and if so when, a Board ought to close a fund. In recent schemes the Boards of companies have satisfied themselves that managing the fund as a going concern would produce better returns for policyholders having regard to the problems associated with closing the fund. In a scheme involving a life fund with a very substantial estate, however the position might well be different.

4.4 In managing a life fund as a going concern, as in managing any other business, a Board has a duty, which it owes to the company, to act in a way which the Board considers is in the best interests of the company from time to time and not for any collateral purpose. "Company" in this context means (unless the company is insolvent or in danger of becoming so) the corporators, or members, as a general body. Where the company is insolvent, or at risk of insolvency, the directors may be well advised to put creditors interests above the interests of shareholders. A Board also has a statutory duty (which it also owes only to the company) to "have regard" to the interests of employees in general.

4.5 It is of some interest to consider the nature of the duty which directors have to consider the interests of policyholders, in particular with profit policyholders, who (in this capacity) are creditors, and not owners, of the company. In a mutual some (or all) policyholders may also, in a separate capacity, be members (or owners): in a proprietary company members and policyholders will obviously be different groups of people. Much is made of the reasonable expectations of with profit policyholders — a phrase which has no legally defined meaning. But it is considered that policyholders do not, as policyholders, have a legal right to have their reasonable expectations met, either in a mutual or a proprietary company. If reasonable expectations are in danger of not being met, of course, the DTI may exercise its powers of intervention (see paragraph 4.11 infra) but this fact, on its own, does not necessarily imply a breach of the directors' fiduciary duties. In the case of a mutual, where policyholders and members may be substantially the same body of people, the distinction between the interests of creditors and those of the corporators , or members, can become particularly blurred.

4.6 In considering their proper course of action when proposing a merger involving a section 49 scheme, the Board will clearly need to have regard to the reasonable expectations of with profit policyholders, and to the interests generally of all long term policyholders, as well as the interests of the members of the company (whether they are shareholders or members in a mutual). This may involve a consideration as to whether the fund should be closed. But do reasonable expectations include an expectation to share in the estate — the working capital of the company which has been built up by past generations of policyholders with the intention that it should be available to future ones? The term would not normally imply such an expectation while the company is open to new business. Can the Board have a duty effectively to put up the shutters, simply because such a decision might produce a windfall to a particular set of with profit policyholders, which they would not benefit from if the business continued in its then current form, or if it merged with another business. Is such a windfall profit ever part of a policyholder's "reasonable expectations"? The nearest analogy might be requiring the Board of an investment company to recommend winding up its business and distribute its funds to its shareholders on the ground that the shares were trading at a discount to the company's net assets.

4.7 There will clearly be occasions when the Board will determine that closing the fund is the proper course and a better option than carrying on writing new business. However, if the Board reasonably comes to the conclusion that the company should continue trading, but that it would be preferable to merge with another party than to continue alone, it does not appear right that the Board should close the fund simply because with profit policyholders would thereby receive a windfall they would not otherwise get, still less that the Board should be under a duty to do so. As a purely practical matter, of course, if a vote of members is required in order to carry out a scheme, it will be necessary to persuade members of the reasonableness of the Board's view (particularly in the case of a mutual) in order to ensure that the resolution is passed.

4.8 The independent actuary

The second stage involves the independent actuary, who has a crucial role. His task is to report on the scheme in front of him having regard to the likely position were the scheme not to proceed. His role is not to review the decision taken by the Board in preferring one partner over another, or to renegotiate the terms of an arrangement agreed with the chosen partner. He would of course indicate in drafting his report whether any particular provision of the scheme causes him to make reservations, and the parties may then seek to reconsider particular aspects of the transaction in order to remove those reservations. But the actuary, by his professional expertise and experience, is not necessarily in the best position to comment upon schemes and other proposals which the board and its advisers have rejected.

4.9 In June 1990 the Institute issued a Guidance Note[5] on the role of the independent actuary which sets out the Institute's views on the professional responsibilities of such an appointment. The Guidance Note includes advice on the work required in preparing a report, the contents of a report and, in particular, on the matters to be considered in relation to a section 49 scheme. Paragraph 4.4.4 recognises that it is not the independent actuary's role to comment on possible alternative schemes although paragraph 4.4.13 throws some confusion as to whether the closed fund option should be considered in demutualisations. Further comment is made on this aspect below.

4.10 What the Guidance Note does not comment on is the legal responsibility of the independent actuary, although it notes that the purpose of the appointment is to produce a report for the court, and that policyholders and members may rely upon it in determining how to cast a vote or whether to object to the scheme in court. Although recent cases[6] have shown a tendency for the Courts to try to reduce the occasions on which experts, such as auditors, may be liable to large classes of people, there must be a significant risk that in preparing his report, the independent actuary accepts a legal duty of care to all members and policyholders who are entitled to rely upon it, with consequential liability in damages if the report is negligently prepared.

4.11 The DTI

The third stage concerns the Department of Trade and Industry. The Secretary of State has a statutory right to appear in Court on the hearing of the petition under section 49. The Secretary of State, acting through the DTI, has considerable regulatory powers granted to him by the 1982 Act for the purpose of protecting policyholders. He is concerned both to safeguard the public interest and, more particularly, to see that policyholders reasonable expectations are safeguarded. Although policyholders are not given a statutory right to have their reasonable expectations met, the Secretary of State may exercise his powers of intervention under section 45 of the 1982 Act if he considers that there is a risk that a company may be unable to fulfil the reasonable expectations of policyholders or potential policyholders. Again, however, like the independent actuary it is not the DTI's role to make the Board's decision for it, and it is understood that the DTI does not regard itself as being required to second guess the Board's commercial judgment. It will, of course, wish to ensure that the Board has taken its decision after due and careful consideration and has exercised its fiduciary duties and commercial judgment properly. The DTI's view of "reasonable expectations" may be different from the company's. In practice the DTI wields considerable influence because of its right to make its views known in relation to the scheme generally at the Court hearing.

4.12 The DTI is not required formally to "approve" a scheme, and while it may indicate that it has no objection to the scheme going forward, is unlikely to state formally that it has no objection (assuming that to be the case) until the Court hearing, and then only after all other parties, including objectors, have had their say.

4.13 The policyholders and members

A fourth requirement concerns the policyholders and the members — in a proprietary company, the shareholders. The 1982 Act requires that the petition, scheme and independent actuary's report be on display and available to any who ask for a copy. Affected policyholders and members will normally receive a circular explaining the scheme, and they may have the opportunity to debate the issues at an extraordinary general meeting. A meeting, as mentioned before, is not required under the 1982 Act except in the case of certain schemes involving public companies. Any policyholder or member can write to the company requesting that his letter be put before the Court on the hearing of the petition, or may appear in person, or by counsel, at the hearing.

4.14 The Court

The final stage involves the Court itself. Again, the role of the Court is best summarised in the judgment of Mr. Justice Hoffman referred to above:-

> "Although the statutory discretion is unfettered, it must be exercised according *to* principles which give due recognition to the commercial judgment entrusted by the company's constitution to its Board. The court in my judgment is concerned in the first place with whether a policyholder, employee or other person would be "adversely affected" by the scheme in the sense that it appears likely to leave him worse off than if there had been no scheme. It does not however follow that any scheme which leaves someone adversely affected must be rejected. ... 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."
>
> ... "Under the 1982 Act the Court cannot, any more than under the Act of 1 870, sanction a scheme subject to the making of amendments.[7] It must be either confirmed or rejected although no doubt the Court in

rejecting a scheme could indicate that it thought the vice lay in some particular term and that a fresh scheme without that term was likely to be acceptable. I am therefore not concerned with whether, by further negotiation, the scheme might be improved, but with whether, taken as a whole, the scheme before the Court is unfair to any person or class of person affected."

4.15 In reaching a decision the Court will take particular note of the views of the independent actuary and the Secretary of State. Evidence at the hearing is upon affidavit. It would be unusual on a hearing of a scheme for witnesses, such as members of the Board or of the independent actuary, to be cross-examined by disaffected policyholders.

PART IV
SOME ISSUES

5.1 Timing and announcement

One problem in carrying out a section 49 transfer is the time that it takes to do so. For the client, that time will begin with the initial work in choosing a partner, or in restructuring the group, depending upon the circumstances. The structure of the new group and the balancing of competing interests will take time to resolve. The author would generally expect that from the moment that parties reach agreement in principle, it will take a further minimum of six months before the merger is likely to become effective. From presentation of a petition it will take at least six weeks — longer if a meeting is required. The period will depend on the complexity of the transaction, and also the availability of dates in Court. Although it is possible, if the circumstances justify it, to obtain hearings during Court vacations, it may not be advisable, particularly if the petition is likely to be contested. Compare this timing with the maximum period of 60 days (absent competitive offers) in a public takeover bid.

5.2 Against this background, the client will need to determine when to make an announcement. Generally speaking, unless one company is in a position where it needs to announce that it is taking action to resolve some perceived difficulty, the parties may prefer not to make an announcement until all matters are agreed and documents can be posted to policyholders. The shorter the period of public uncertainty the better it is likely to be for business. At the heads of terms stage the scheme will not have been negotiated in every detail, and it is possible that the actuarial work required in order to finalise the precise terms of the scheme will not have been completed. The parties may require accountants' reports on each other in relation to their systems, financial controls and so on. There may be lengthy investigations into each company's assets and business, title to properties, material contracts etc.

5.3 If an announcement is made at the heads of terms stage, this does relieve the parties from the difficulty of explaining to their staff why the office is suddenly crawling with outside firms of accountants and actuaries. If no announcement is made, the necessity for full actuarial and accountancy investigations may make it difficult to keep the matter confidential. If the merger involves the issuing of full listing particulars under the Financial Services Act 1986, because shares in the merged company are being listed on The Stock Exchange, it is likely to be extremely difficult to keep the matter confidential up until the moment of posting of documentation. It must be very unlikely that a private company can go public with a full blooded flotation on The Stock Exchange without anybody noticing that it is going to do so until the day it issues its prospectus.

5.4 Other matters might also impose on one or other party an obligation to make an announcement at an earlier stage. If one party is part of a group which already has a listing on The Stock Exchange, that party may become obliged under its listing agreement with The Stock Exchange to make an announcement at an earlier stage.

5.5 Where an announcement is made some time in advance of full agreement on a scheme and of the posting of documents to members and policyholders, whether or not there are listed shares involved, the directors of the companies concerned may come under pressure to comment more fully upon the proposals. Any such comment runs the risk that it may, at the end of the day, prove to be not entirely accurate and may return to haunt the directors at the Court hearing. From the lawyer's point of view, of course the ideal solution is to gag the Boards of the companies entirely. Even lawyers will admit, however, that this will not be a practical solution, especially where the company concerned is still carrying on business and still writing policies. Applicants who wish to take out a new policy with a company which has announced that it is proposing to merge with another life company, or other financial institution, will clearly wish to know on what basis their policy is being issued. What will happen to it if the merger does or does not take place? There may well be critical, and possibly ill informed, comment in the press. If is not a problem with any easy answer and is one most likely to bring the legal adviser into direct conflict with the PR consultant.

6. Consents

6.1 Although he Court procedure enables liabilities to be transferred, this does not of itself make very much difference to the amount of investigation that needs to be carried out into what is actually being transferred. It will be necessary to determine whether there are foreign assets which an order of the High Court in England and Wales would be incapable of transferring for want of jurisdiction. These assets will need to be transferred by separate documents in accordance with local laws. They may also give rise to additional costs, such as stamp duties or taxes, and may require foreign governmental consents.

6.2 The requirement for the consent of a third party, whether it be governmental or not, can also affect the ability to transfer specific assets. Although the Court probably has jurisdiction to transfer an asset situate within the United Kingdom,[8] even if its transfer is subject to a requirement for a third party consent, it is likely that, if the Court is made aware that such assets are included within the scheme, it would refuse to order the transfer without at the very least allowing the third party the opportunity to make representations as to why the requirement for its consent should not be set aside.

6.3 Similarly, where the transfer of an asset is subject to rights of pre-emption — common in unquoted securities — a transfer of the asset concerned, and in some circumstances the proposal to transfer the asset concerned, could trigger a right of a third party to acquire the asset on terms which may or may not be advantageous to the transferring company.

6.4 The independent actuary in particular will be concerned to ensure that a material proportion of the assets are not going to be left behind in the transferring company, or sold at less than market value, because a consent to transfer, or approval to waive a pre-emption right, cannot be obtained. The extent to which this might present a problem will clearly depend upon the particular portfolio of investments held by the transferring company.

6.5 Where assets are left behind for subsequent transfer if and when a consent is obtained this may have the effect of producing an apparent reduction in the value of the fund. One solution which has been adopted in the past is to provide that the transferring company should remain in existence as a subsidiary of the transferee company after the scheme takes effect. To achieve this, amendments may be required to the rules for membership in the transferring company's constitution, requiring a resolution in general meeting.

7. Mutuals

7.1 As mentioned above, the most effective way of demutualisation for many companies will involve a section 49 transfer. Demutualisations pose their own particular structural problems and it is beyond the scope of this paper to delve into the actuarial problems that can arise. Where the transaction requires either some benefit to be given directly to policyholders — perhaps by way of a special bonus — or where the consent of members is required to a transfer, or where it is intended to compensate members for the loss of, or diminution in value of, membership (whether or not the scheme involves a demutualisation) additional problems can occur.

7.2 Members and policyholders may not be identical. In Franklin and Lees study[3] it is recorded that about two-thirds of the mutuals studied had a membership definition which encompassed all policyholders, with the remaining third offering membership only to with profits policyholders. Again, about two-thirds gave one vote per member or per policy, while the other third gave voting rights depending upon policy size, based upon varying formulae with or without maximum numbers of votes. In fact, when one looks closely at the definition of membership, even where membership is granted to all members who take out a policy, regardless of whether it is with profit or not, the relevant rules will not necessarily literally mean that every policyholder is a member for the duration of the policy. For example, where there are joint policyholders, membership may be granted only to the first named, or to one of the policyholders nominated by the |oinl policyholders. The policy may be capable of assignment, but membership may still continue in the name of the original policyholder.

7.3 When contemplating a section 49 transfer, issues of this kind can produce some curious results. First, if compensation is to be offered for loss of membership, how is that compensation to be valued? The value of membership should be distinguished from the value of a particular policy and requires a consideration of the rights that accrue to a member qua member. The only practical rights that a member has in a mutual that is carrying on business as a going concern will be the right to cast a vote or votes. Members may also have rights in a winding up although many mutuals make no provision for the rights of members on a winding up. If the constitution is silent on this point, is the membership of a person who has acquired membership as a consequence of a with profit policy with one vote worth more than the membership of a person with a non-profit policy with the same number of votes? This problem can become acute in a demutualisation if a mutual wishes to offer compensation to members quae members. As it is principally the with profit policyholders whose interests are affected on demutualisation, giving the same value to all members, who may include a large proportion, if not a majority, of non-profit policyholders, and may indeed include persons who no longer hold policies at all (because of assignment) might at first blush appear inequitable. Further, if a member is a professional trustee of a large number of schemes and only has one vote regardless of the number or value of policies held, he will only be compensated once and will be in some difficulty deciding what he is going to do with the compensation.

7.4 Another problem which can cause difficulties when compensating members for loss of membership is identifying precisely who the members are. Where every person who takes out a policy becomes a member, it is relatively straightforward (assuming that accurate records have been kept). Membership is not, However, usually an issue. It is doubtful whether policyholders who take out policies with mutuals know what their rights as members are nor indeed whether they are members at all. They will receive documentation in their capacity as policyholder but may not be entitled to receive notices of annual and extraordinary general meetings as these may be capable of being given by advertisement. They may not be entitled to be sent copies of the accounts, unless they specifically ask for a copy.

7.5 When a vote is required to enable a section 49 transfer to take effect, and probably even more if compensation for loss of membership is on offer membership becomes an issue, and the company itself may be in the position of having to circulate its members (as opposed to its policyholders) for the first time in many years. Tidying up a little used membership register so that what is recorded in dusty files is put into a computerised list is a task that may take some time and organisation. Where membership is determined by a particular type of policy held, reconciling who is and who is not a member can be particularly difficult as membership rules do not tend to keep pace with the design of policies and some curious results may arise which may suggest the need for amendments to the membership rules to clarify or amend the position.

7.6 It is worth noting at this point that section 49 does not require an independent actuary to comment upon the effect of a transfer upon a policyholder in his character as member, still less upon the effect of the scheme on members who are no longer policyholders. In practice however independent actuaries have sometimes commented upon membership rights where mutuals have been involved in section 49 transfers and the Institute's Guidance Note now requires that the independent actuary should comment upon the effect of the scheme on the proprietary rights of members of the company and

> "in particular, the significance of any loss or dilution of the rights of those members to secure or prevent further constitutional changes which could affect their expectations as policyholders (for example, conversion to a closed fund). He should state whether, and to what extent, members will receive compensation under the scheme for any diminution in their proprietary rights, and comment upon its appropriateness. Also, when commenting upon the fairness of the scheme, he should pay particular attention to any differences in treatment between policyholders with voting rights and those without."

7.7 There is still some confusion in this paragraph of the Guidance Note between membership rights and policyholder rights. There is also an assumption that members can influence the activities of the Board through the exercise of voting power — presumably by appointing new directors of a more sympathetic nature. (It would after all be a decision of the Board whether to close the fund, not the members.) This is of course correct in theory, but in practice the voting power in a mutual is dispersed among so many people that it is far more difficult to wield that power effectively than it is in a company with a share capital. It is also for consideration whether it should be an actuary's role to comment on the value of membership of a company, which is not an actuarial matter.

8. Policyholder protection

8.1 The extent of protection afforded to policyholders on transfers of life funds will be dealt with in some detail in a forthcoming paper to the Institute on demutualisations. The nature of protection will depend upon the transaction concerned, whether a fund is to continue or be closed, how it is to be managed in future, how it is to be financed and what management's objectives are. The principal areas where policyholders may require protection are:-

— bonuses for with profit policyholders and the maintenance of reasonable expectations

— security

— fairness of initial allocation of funds

— equity between policyholders in the operation of funds having regard to their different interests

— the ability to change the scheme without reverting to policyholders or the Court

— the ability to move assets between funds or to shareholders funds, or to use assets in one fund to support another

— how the strain of new business is to be financed and where the risks and rewards should fall.

8.2 Provisions governing these protections will be included, to the extent that they are considered necessary in a particular arrangement, in the scheme documentation. The types of provisions vary considerably. Some protection goes no further than what is effectively inherent in the 1982 Act itself — that is to fulfil reasonable expectations. Others go further by setting out investment or bonus strategies and guarantees.

8.3 From the lawyer's perspective it appears that what one person may consider protection, may be interpreted with considerable licence by another. A client may dislike giving an undertaking to the Court which is couched in objective terms because of the possibility of argument as to whether such an undertaking is being complied with. Conversely, an undertaking which is subjective, or is based upon a general actuarial principle (such as asset shares) relies heavily upon the views of the actuary and Board of the company concerned and may well be genuinely capable of interpretation in more than one way, with possibly materially different effects upon policyholders.

9. Whose consent?

9.1 As already explained, the only party whose consent is required by law to a section 49 transfer is the Court. In practice, a company is most unlikely to put forward a scheme without an indication that the scheme will not be objected to by the relevant regulatory authority and a favourable, or at least a not unfavourable, report by the independent actuary. The requirement for Court consent might nowadays be considered anachronistic in an insurance company scheme. After all, assuming the Board is not acting unreasonably, the DTI is content with the scheme, the independent actuary issues a favourable report in accordance with the Institute's guidelines and the technicalities required by the law are correctly complied with, it must be fairly unlikely that a minority of policyholders will be able to persuade the Court that the scheme should not be sanctioned. This is not to say that the Court merely rubber stamps a petition put forward which contains all the right paperwork — it does not. However, an objecting policyholder has a daunting task if he wishes to persuade the Court that the scheme is unfair when ranged against him are statements from an independent actuary, supported in effect by the Department of Trade and Industry, that it is not.

9.2 Of the parties involved in the separate stages referred to in Part III, — the Board, the independent actuary, the DTI, the policyholders, the members and the Court — whose consent to a transfer should be necessary? Clearly the Board will need to support a scheme, but few would propose that the Board should have the final say.

9.3 Similarly, the author sees no reason to change the role of the independent actuary, but should a favourable report from the independent actuary and the agreement of the Secretary of State be sufficient? Only the Secretary of State's consent is required to transfers of general business.[0] the Secretary of State is required to take into account written representations concerning the transfer of general business but there is no provision for an oral hearing, nor, of course, for any confirmation by the Court. If the Court is unlikely to refuse to sanction a scheme if the independent actuary's report is sound and the DTI, after hearing the representations in Court of objectors, chooses not to oppose the petition, why is it necessary to keep the Court's sanction as a requirement? Whether such a view has any merit or not, removal of the requirement for Court consent would probably not shorten by very much the time taken to effect a scheme, nor reduce the paperwork significantly. It would also take away a method of testing not just the independent actuary's but also the DTI's views as to the fairness of a scheme.

9.4 One other group whose consent should perhaps be required is the policyholders. In the case of a mutual, whether their consent is required at present will depend on whether the Board has power under the company's constitution to carry out a section 49 scheme, or to carry it out on the terms proposed without any consequential amendments to its constitution, and (if a resolution is required) on whether 'policyholders and members entitled to vote at an extraordinary general meeting' are the same body of people. Even if not required, the Board may seek a vote of members to ensure that it has support for its proposals. In the case of a proprietary company, a general meeting may be necessary not only because of changes required to the constitution but also because Stock Exchange rules may impose a requirement to obtain shareholders approval to the proposal. If a meeting is held, it will be the shareholders who vote upon the proposal and not the policyholders.

9.5 It is interesting to compare the requirements of a similar type of scheme involving the transfer of an undertaking under the Companies Act, and certain types of section 49 scheme involving public companies. In a Companies Act scheme, it will be necessary to have meetings, convened by the Court, of both shareholders and creditors, or classes of shareholders and creditors if the scheme affects classes in different ways. Each meeting will require a vote in favour of the scheme of persons representing a majority in number and 75% by value. It is clear that the legislature has not considered it necessary to impose this additional requirement in the case of a transfer of life funds, (except in certain public company schemes) instead taking the view that the matter requires the view of an independent actuary and no more. Cogent reasons can be advanced in favour of not requiring the consent of policyholders, who may not understand the actuarial niceties of particular transactions, but one is bound to wonder whether, if the information is properly presented to a policyholder, he should not be capable of understanding it, or seeking advice from other members of the actuarial profession or from financial advisers, as to whether it is in his interests to support or oppose a particular scheme. The information which the policyholder would need in order for such a requirement to be feasible is a matter to which this paper returns below, but it is presumably not that much more difficult to present than that which The Stock Exchange would require if the company were listed and required shareholder approval to the proposal.

9.6 There are however technical difficulties in adopting a system similar to that required in Companies Act schemes for all transfers of life funds. There may well be a problem in determining the classes of members or policyholders which should be entitled to vote at separate meetings in respect of their own separate interests, and also in determining how the votes should be attributed. Voting at an extraordinary general meeting is relatively straightforward inasmuch as one would obviously look to the constitution of the particular company, whether it be mutual or proprietary. Where notions of voting by class and by value are brought into the equation however, it would be difficult to determine the basis upon which individual policyholders would be entitled to vote either at a class meeting of policyholders or (in a mutual) at a meeting of members. Indeed, although the parties may take a view as to how to value individual policyholder's interests in the company (in either capacity), such a requirement may well produce a technical weapon for a disaffected policyholder. It may be quite impossible to prove to a Court that the statutory requirement of 75% by value has actually been complied with.

9.7 On the other hand, to require a vote of policyholders which bears no resemblance to individual interests is lacking in both logic and equity. A simple vote of members in a mutual, while it may cloak a transaction with respectability, can also be inequitable for that very reason. Who is or is not a member is an accident of the company's constitution and if one is principally concerned with the interests of a policyholder qua policyholder, it is illogical to require a vote of members which (if a mutual works on the basis of membership regardless of the nature of a policy) would be capable of being passed as a consequence of votes in favour by 'non-profit' members notwithstanding that every 'with-profit' member votes against it.

9.8 The problems alluded to in paragraph 9.6 are already a feature of a section 49 scheme carried out by a public company to which section 427A of the Companies Act applies. By a new provision inserted into section 49 in 1987 in order to comply with EC Directives on mergers and divisions of public companies,[10] any transfer of long term business by a public insurance company which falls within section 427A must be made in accordance with both section

49 of the 1982 Act and sections 425-7 of the Companies Act. The salient parts of the text of section 427A are set out in Appendix 1. The section applies, for example, to a transfer by a public company to another public company which already has a business of its own where the consideration for the transfer includes shares in the transferee company receivable by members of the transferor company. In such a case, court convened meetings of shareholders and creditors of the transferor company will be required under section 425, and the court also has power to order meetings of shareholders and creditors of the transferee company. Schedule 15B of the Companies Act sets out requirements for a directors' report and an expert's report complying with the terms of that schedule to be available to members and creditors. While casting no opinion as to the merits of the EC Directives, there is a certain lack of commercial logic in having one regime for a public insurance company and another for a substantial mutual. The responsibility of managing a large mutual is not, after all, unlike that of running a public company.

9.9 In short, in the author's opinion, the difficulties associated with obtaining policyholders' consent at a meeting of policyholders considerably outweigh the potential benefits of extending democracy this far. Neither does it appear appropriate to require a meeting of members in a mutual if an extraordinary general meeting is not otherwise necessary, although such a meeting can be held with relatively little difficulty if the Board wishes to convene one. As a general principle, the author also sees no reason why in a proprietary company shareholders' consent should be required if the constitution gives the directors the power to carry out the transfer without referral to them, and the company is not required by law or Stock Exchange rules to obtain their consent.

10. Disclosure

10.1 Questions addressing the disclosure of information upon mergers have already been considered at length in the paper presented to the Institute on the AMP/Pearl merger.[1] Although this paper was directed principally at takeovers of share capital it also reflected upon other mergers, including section 49 transfers. The authors point out the different requirements between a takeover of share capital and a section 49 transfer by reference to the somewhat inadequate provisions of The Take-over Code in relation to the former and the role assigned to the independent actuary in the latter. Although the rules relating to section 49 transfers are undoubtedly clearer, particularly following the issue of the Institute's Guidelines, there is still room for debate as to the extent of disclosure which ought to be made in circulars to policyholders and members in section 49 schemes. The statutory rules are minimal. Apart from the requirement to summarise the scheme and the independent actuary's report, there are no rules equivalent to The Take-over Code or The Stock Exchange Yellow Book to dictate what should or should not go in a circular to policyholders and members. It is therefore left very much to the views of the individual client and its advisers as to how much disclosure over and above the strict legal requirements is appropriate. There is still no clear practice.

10.2 The level of disclosure is likely to depend upon the nature and complexity of the transaction proposed. It is also likely to depend on whether or not an extraordinary general meeting is called and the consent of members requested. In legal terms, if consent is requested at a meeting of members then a greater level of disclosure is likely to be required than the very limited information specified by section 49 itself. In order for any member to be able to take a decision as to which way to cast his vote on a resolution to approve a scheme, it is necessary for the Board to give him sufficient information to enable him to take that decision.

10.3 The amount of disclosure will also depend on whether the company is part of a listed group and the transaction is sufficiently large to require a circular to shareholders; or whether or not listing particulars are required under the Financial Services Act 1986, because, for example, listing is sought for shares issued on a demutualisation; or on whether an explanatory statement is required under section 425 of the Companies Act because the scheme involves a public company and falls within section 427A.

10.4 Explaining a section 49 transfer to policyholders is inevitably more complicated than a straight takeover of shares, particularly if the fund is to be divided and sub-divided into a number of funds, some of which may be closed some of which may be continuing, some of which may be new How is a policyholder able to take a view whether or not he should object to the scheme? The average policyholder may be inadequately equipped to come to any educated decision on the matter — he will certainly be unable to do so if he is not given sufficient information upon which he can even take advice. In a public company takeover, the shareholder is at least able to compare the price which he is being offered with a quoted price prior to the offer being made. A policyholder in a section 49 transfer has no such luxury. Neither does he have the option of realising his investment, except on terms which will probably penalise him for doing so. He must rely upon the independent actuary.

10.5 But even section 49 requires only a summary of the independent actuary's report to be circulated. The summary now tends to be longer than was common in the past. It must be "adequate" and must not give a misleading impression of the findings in the full report.[12] But it is still only a summary, and may not include all the information which a policyholder would find useful if he were actually to take an educated view of the proposal being put to him, and which he will only obtain by asking for a copy of the full report. Should the entire report be published? We take for granted that a short form accountants report in a Stock Exchange circular is to be published in full. Why should actuary's reports be treated any differently?

10.6 *In order to take an informed view as to whether it is appropriate to object to a* scheme, it is arguable that a policyholder or member should be entitled to the same information as if he was being asked specifically to consent to it at a meeting. It seems illogical that the extent of disclosure to policyholders and members in a section 49 scheme should depend upon whether or not an extraordinary general meeting is being held, or shares are to be issued, or the company is a public company. It increasingly goes against modern practice to take the view that it is all too difficult for the layman to understand and that section 49 transfers should be left to the experts.

10.7 The legislation for transfers of life funds in the United Kingdom is by no means unique. Similar arrangements appear in other common law jursidictions. Ireland still works on the basis of the Assurance Companies Act 1909, although it has been expanded by the Insurance Act 1989 to include a provision equivalent to section 50 of the 1982 Act. Australia also adopts a similar system[13] but if anything the practice there is still for even less disclosure than is now the practice in the United Kingdom. The recent merger and demutualisation of Capita Financial Group into MLC Life, creating the third largest life insurance business in Australia was carried out without any circulation of policyholders and on the basis that any interested policyholders could obtain an explanatory document if they requested it. It is understood that only a few hundred did so. Also, in Australia, the independent actuary can be, and frequently is, an employee of the company whose fund is being transferred.

10.8 In Canada, federal legislation is similar to United Kingdom legislation except that only the Minister's consent is required.[14] The Court is not involved. Contractual liabilities are not legally transferred but would be the subject of indemnity by the transferee.

PART V
TAXATION SUMMARY

11.1 One item which gives rise to particular complication is tax. Transfers of long term funds in the United Kingdom have been made easier from a tax point of view by the Finance Act 1990, although unfortunately the opportunity was not taken to clarify all the potential pitfalls on transfers. Some problem areas still remain. Taxation is dealt with in summary below and in more detail in Appendix 3.

11.2 Although a section 49 transfer by its nature involves a disposal by the transferring company of its assets for the purposes of corporation tax on chargeable gains, comprehensive relief is now provided so that the transfer under the scheme is treated as being for a sum equal to the transferring company's base cost, so that no gain accrues to the transferring company and the transferee company "inherits" the base cost of the transferring company. This relief does not, however, specifically apply to classes of long term business which are charged on other, income, bases. In the past, tax charges have been avoided by the use of policyholders' reservations, although the new regime introduced by the Finance Acts of 1989 and 1990 means that the rules for reservation are now more detailed and inflexible and it will therefore be interesting to see how the practice under the new regime will develop in relation to transfers. An alternative approach may be to rely on technical provisions relating to the discontinuance of a trade. These difficulties are particularly acute in relation to permanent health insurance, which is regarded for the purposes of insurance companies legislation as long term business but for the purposes of tax legislation as general business. It is to be hoped that the Revenue will in practice apply concepts similar to those underlying the relief for corporation tax on chargeable gains in relation to assets of such business.

11.3 The Finance Act 1990 now provides relief in relation to expenses of management and losses and for the transfer of capital allowances, which should no longer constitute a problem.

11.4 Value added tax does not normally pose any problems although there are potential pitfalls relating to the transfer of buildings and land.

11.5 So far as stamp duty is concerned, this duty in the future will only be relevant in relation to land and buildings, following the proposed abolition of the duty on stocks and shares upon the introduction of TAURUS, the paperless system for Stock Exchange dealings. Stamp duty would only be payable on a section 49 transfer if it constituted a conveyance or transfer on sale. In the past, the Revenue have accepted that it does not, although care needs to be taken if it is proposed to grant benefits direct to policyholders. While a special bonus does not appear to constitute a problem, different considerations might apply to other forms of benefit, such as the issue of shares.

11.6 The tax position of the policyholders themselves will require consideration but the extent to which problems arise will depend upon what is offered to policyholders, and in what capacity they receive it, whether as policyholder or as member. Policyholders will also be concerned to ensure the continuance of life assurance premium relief, and in practice, provided that the scheme is appropriately drafted, continuance of life assurance premium relief should not constitute a problem.

PART VI
CONCLUSION

It will be apparent from the above that the issues which arise or require consideration in a section 49 transfer can be extensive. This paper cannot deal with all of them, but tries to address some of the more interesting topics. As is the case with commercial transactions generally, no two schemes will be the same — each will produce its own particular problems, and readers will no doubt be able to contribute to the store of interesting intellectual conundrums and practical advice. It is hoped that this paper will provide an opportunity for them to do so.

NOTES

1 In Re The London Life Association Limited and Australian Mutual Provident Society: Judgment delivered 21st February 1989

2 In Re Eagle Star Life Insurance Co. and Eagle Star Life Assurance Co. Limited: Judgment delivered November 23 1990: The Times Law Report December 7 1990

3 Demutualisation by N.A.M. Franklin and W.E. Lee: 14th April 1987

4 Howard Smith Limited v. Ampol Petroleum Limited [1974] AC 821, 835

5 GN 15 : Transfer of Long Term Business of an Authorised Insurance Company — Role of the Independent Actuary

6 Caparo Industries plc v. Dickman and others [1990] 1 All ER 568
James McNaughton Paper Group Ltd v. Hicks Anderson & Co: The Independent 11th September 1990

7 Re Argus Life Assurance Company (1888) 39 Ch.D. 571,580

8 S.50 Insurance Companies Act 1982

9 S.51 Insurance Companies Act 1982

10 EC Directives 78/855/EEC and 82/891/EEC

11 Reflections on a Takeover of a United Kingdom Insurer: A Case Study by I. L. Salmon and A.E.M. Fine

12 GN15: para 4.2

13 S.73 Life Insurance Act 1945

14 SS.137-139 Canadian and British Insurance Company Act R.S.C. 1985 I-2

APPENDIX I

INSURANCE COMPANIES ACT 1982, SS.49 AND 50

Sanction of court for transfer of long term business

49.- (1) Where it is proposed to carry out a scheme under which the whole or part of the long term business carried on in the United Kingdom by an insurance company to which this Part of this Act applies ("the transferor company") is to be transferred to another body whether incorporated or not ("the transferee company") the transferor company or transferee company may apply to the court, by petition, for an order sanctioning the scheme.

(1A) If any such scheme involves a compromise or arrangement falling within section 427A(1) of the Companies Act or Article 420A(1) of the Companies (Northern Ireland) Order 1986 (application of provisions about compromises and arrangements to mergers and divisions of public companies), the following provisions, namely —

(a) sections 425 to 427 of that Act, or

(b) Articles 418 to 420 of that Order,

shall have effect, as regards that compromise or arrangement, as provided by section 427A(1) or Article 420A(1) (as the case may be), but without prejudice to the operation of the provisions of this section in relation to the scheme.

(2) The Court shall not determine an application under this section unless the petition is accompanied by a report on the terms of the scheme by an independent actuary and the court is satisfied that the requirements of subsection (3) below have been complied with.

(3) The said requirements are —

(a) that a notice has been published in the London, Edinburgh and Belfast Gazettes and, except where the court has otherwise directed, in two national newspapers stating that the application has been made and giving the address of the offices at which, and the period for which, copies of the documents mentioned in paragraph (d) below will be available as required by that paragraph;

(b) except where the court has otherwise directed, that a statement —

(i) setting out the terms of the scheme; and

(ii) containing a summary of the report mentioned in subsection (2) above sufficient to indicate the opinion of the actuary on the likely effects of the scheme on the long term policy holders of the companies concerned,

has been sent to each of those policy holders and to every member of those companies;

(c) that a copy of the petition, of the report mentioned in subsection (2) above and of any statement sent out under paragraph (b) above has been served on the Secretary of State and that a period of not less than twenty-one days has elapsed since the date of service;

(d) that copies of the petition and of the report mentioned in subsection (2) above have been open to inspection at offices in the United Kingdom of the companies concerned for a period of not less than twenty-one days beginning with the date of the first publication of a notice in accordance with paragraph (a) above;

(e) in the case of any such scheme as is mentioned in subsection (1A) above that copies of the documents listed in paragraph 6(1) of Schedule 15A* to the Companies Act or in paragraph 6(1) of Schedule 15A* to the Companies (Northern Ireland) Order 1986 had been served on the Secretary of State by the beginning of the period referred to in paragraph 3(e) of that Schedule.

(* Now Schedule 15B)

(4) Each of the companies concerned shall, on payment of such fee as may be prescribed by rules of court, furnish a copy of the petition and of the report mentioned in subsection (2) above to any person who asks for one at any time before an order sanctioning the scheme is made on the petition.

(5) On any petition under this section —

(a) the Secretary of State, and

(b) any person (including any employee of the transferor company or the transferee company) who alleges that he would be adversely affected by the carrying out of the scheme,

shall be entitled to be heard.

(6) The court shall not make an order sanctioning the scheme unless it is satisfied that the transferee company is, or immediately after the making of the order will be, authorised under section 3 or 4 above to carry on long term business of the class or classes to be transferred under the scheme.

(7) No such transfer as is mentioned in subsection (1) above shall be carried out unless the scheme relating to the transfer has been sanctioned by the court in accordance with this section; and, except in the case of any such scheme as is mentioned in subsection (1A) above, no order shall be made under any of the provisions specified in paragraph (a) or (b) of that subsection in respect of so much of any compromise or arrangement as involves any such transfer.

(8) In this section "the court" means the High Court of Justice in England except that it means —

(a) the Court of Session if the transferor company and the transferee company are both registered or both have their head offices in Scotland; and

(b) the High Court of Justice in Northern Ireland if the transferor company and the transferee company are both registered or both have their head offices in Northern Ireland; and

(c) either the High Court of Justice in England or the Court of Session if either the transferor company or the transferee company is registered or has its head office in Scotland; and

(d) either the High Court of Justice in England or the High Court of Justice in Northern Ireland if either the transferor company or the transferee company is registered or has its head office in Northern Ireland; and

(e) either the court of Session or the High Court of Justice in Northern Ireland if the transferor company or the transferee company is registered or has its head office in Scotland and the other such company is registered or has its head office in Northern Ireland.

Provisions supplementary to section 49

50.- (1) Where the court makes an order under section 49 above sanctioning a scheme the court may, either by that order or by any subsequent order, make provision for all or any of the following matters —

(a) the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of the transferor company;

(b) the allotting or appropriation by the transferee company of any shares, debentures, policies or other like interests in that company which under the scheme are to be allotted or appropriated by that company to or for any person;

(c) the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company;

(d) the dissolution, without winding up of the transferor company;

(e) such incidental, consequential and supplementary matters as are necessary to secure that the scheme shall be fully and effectively carried out.

(2) Where any such order provides for the transfer of property or liabilities, that property shall, by virtue of the order, be transferred to and vest in, and those

liabilities shall, by virtue of the order, be transferred to and become the liabilities of, the transferee company, and in the case of any property, if the order so directs, freed from any mortgage or charge which is by virtue of the scheme to cease to have effect.

(3) For the purposes of any provision requiring the delivery of an instrument of transfer as a condition for the registration of a transfer of any property (including in particular section 183(1) of the Companies Act, section 56(4) of the Finance Act 1946, section 75 of the Companies Act (Northern Ireland) 1960 and section 27(4) of the Finance (No. 2) Act (Northern Ireland) 1946) an order which by virtue of this section operates to transfer any property shall be treated as an instrument of transfer.

(4) Where a scheme is sanctioned by an order of the court under section 49 above the transferee company shall, within ten days from the date on which the order is made or such longer period as the Secretary of State may allow, deposit two office copies of the order with the Secretary of State.

(5) In this section "property" includes property, rights and powers of every description, "liabilities" includes duties and "shares" and "debentures" have the same meaning as in the Companies Act or the Companies Act (Northern Ireland) 1960.

COMPANIES ACT 1985, S.427A(1) TO (4)

427A. Application of ss 425-427 to mergers and divisions of public companies

(1) Where —

(a) a compromise or arrangement is proposed between a public company and any such persons as are mentioned in section 425(1) for the purposes of or in connection with, a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies,

(b) the circumstances are as specified in any of the Cases described in subsection (2), and

(c) the consideration for the transfer or each of the transfers envisaged in the Case in question is to be shares in the transferee company or any of the transferee companies receivable by members of the transferor company or transferor companies, with or without any cash payment to members,

sections 425 to 427 shall, as regards that compromise or arrangement, have effect subject to the provisions of this section and Schedule 15B.

(2) The Cases referred to in subsection (1) are as follows —

Case 1

Where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement in question is proposed are to be transferred to another public company, other than one formed for the purpose of, or in connection with, the scheme.

Case 2

Where under the scheme the undertaking, property and liabilities of each of two or more public companies concerned in the scheme, including the company in respect of which the compromise or arrangement in question is proposed, are to be transferred to a company (whether or not a public company) formed for the purpose of, or in connection with, the scheme.

Case 3

Where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement in question is proposed are to be divided among and transferred to two or more companies each of which is either —

(a) a public company or

(b) a company (whether or not a public company) formed for the purposes of, or in connection with, the scheme.

(3) Before sanctioning any compromise or arrangement under section 425(2) the court may, on the application of any pre-existing transferee company or any member or creditor of it or, an administration order being in force in relation to

the company, the administrator, order a meeting of the members of the company or any class of them or of the creditors of the company or any class of them to be summoned in such manner as the court directs.

(4) This section does not apply where the company in respect of which the compromise or arrangement is proposed is being wound up.

APPENDIX 2
OUTLINE GUIDE

1. PRELIMINARY

(a) Basic structure and principles agreed.
Confidentiality undertakings exchanged.
Consider principal actuarial, legal, taxation and accounting issues.
Preliminary discussions with DTI/GAD.
Prepare preliminary timetable.
Appoint advisers and independent actuary.

(b) Check constitution of transferor for power to dispose and membership issues.
Check (or prepare) constitution of transferee.

(c) Investigate assets, contracts, reinsurance treaties, agency arrangements, etc.
Check for overseas aspects.

(d) Prepare application to DTI for authorisation of transferee to conduct appropriate classes of business, approval of controller and/or managing director pursuant to 1982 Act.

(e) Consider LAUTRO, IMRO etc issues.

(f) Consider logistics
— addresses of members/policyholders
— deduplication of registers
— printing and posting timetables

2. PREPARATION OF SCHEME

(a) Draft:-

— scheme
— appointed actuaries' reports

- independent actuary's report
- circular to policyholders/members (including summaries of scheme and actuaries' reports)
- petition
- summons for directions as to advertisement and circulation of documents
- affidavit of director in support of petition and summons
- press release
- circular to employees/agents etc.

(b) Apply for tax and stamp duty clearances

(c) Obtain provisional clearance from DTI

(d) Hold Board meetings to approve documentation, swearing of affidavits and presentation of petition.

3. **COURT PROCEDURE** (Illustrative timetable assuming extraordinary general meeting on 21 clear days notice)

	Present s.49 petition and summons for directions	D DAY
	Hearing of summons for directions	D + 10
	Settle form of advertisement and order on summons.Set down s.49 petition for hearing.	D + 12
(1)	Bulk print and begin mailing	D + 13
(2)	Serve s.49 petition, independent actuary's report and circular to policyholders on DTI (21 days to elapse between date of service and court hearing).	
(1)	If applicable advertise EGM	D + 18
(2)	Advertise hearing of s.49 scheme in the London, Edinburgh and Belfast Gazettes and national	

	newspapers as the court has directed.	
(3)	Copies of the petition and the independent actuary's report to be available for inspection (for at least 21 days prior to court hearing).	
	If applicable, hold EGM	D + 41
(1)	File affidavits as to compliance with summons and passing of resolutions if appropriate.	D + 42
(2)	File affidavit verifying the availability of the documents for inspection.	
(3)	File affidavit as to objectors to the Scheme (if any).	
	Court hearing of the petition.	D + 45
	Settle s.49 Order.	D + 47
	S.49 Order available to be sent to the DTI (2 office copies of the Order to be served on the DTI within 10 days of the date the Scheme is sanctioned by the Court).	D + 49
Effective date of scheme		As ordered

APPENDIX 3

TAXATION

1.1 Corporation Tax

A section 49 transfer will by its nature involve a disposal by the transferring company of its assets, both investment portfolios and operational assets (and, to the extent that it exists, goodwill) to the transferee company. Application of general tax principles would entail:-

(a) that the transferring company be regarded as making a disposal, probably at market value, of its assets for the purposes of corporation tax on chargeable sales ("CGT");

(b) that any losses or excess management expenses incurred by the transferring company could not be set off against income of the transferee company for periods after the transfer;

(c) that assets outside the scope of CGT (such as those attributable to annuity business, the profits of which are charged to tax under Case VI) would be disposed of at market value.[15]

1.2 In practice, a Section 49 transfer is most unlikely to have such dramatic results.

1.3 So far as CGT is concerned, comprehensive relief is now provided for by Section 267 and 267A Income and Corporation Taxes Act 1970. These provide that, so long as the scheme is sanctioned by the Court, and the following conditions are satisfied:-

(i) the transfer is of the whole or part of the long term business of the transferring company;

(ii) the transfer is to another company;

(iii) any gain accruing to the transferring company on disposals of assets in accordance with the scheme and any gain accruing to the transferee on a disposal of the relevant assets immediately after its acquisition in accordance with the scheme would, apart from this relief, be a chargeable gain forming part of the profits of the transferor or the transferee (as the case may be) for corporation tax purposes;

(iv) in relation to assets which are disposed of after the transfer of business has taken place any gain on such disposal would, apart from this relief, be a chargeable gain forming part of the transferee's profits for corporation tax purposes;

(v) no gain of the type mentioned in (iii) or (iv) above would be a gain exempted from United Kingdom tax under any double taxation arrangement;

(vi) the transfer takes effect after 5th April 1970; and

(vii) the transferring company receives no part of the consideration for the transfer (otherwise than by the transferee company taking over the whole or part of the liabilities of the business),

the transfer under the scheme is treated as being for a sum equal to the transferring company's base cost so that no gain accrues to the transferring company but the transferee company "inherits" the base cost of the transferring company.

.4 In contradistinction to the general relief for company reconstructions or amalgamations in section 267, it is not necessary that both companies are resident in the United Kingdom, nor that the transfer be part of a scheme of reconstruction or amalgamation. Further, the protection of section 267A will be available even where the assets of the transferring company are treated as trading stock (an argument can be made that, because of potential Case I corporation tax liabilities, all assets of a life company fall into this category). In its statutory form, the relief was introduced by Finance Act 1990 but previously relief had been granted by virtue of a published extra-statutory concession.

.5 A transfer of long term business will, of course, not only involve the transfer of life assurance business in relation to which the CGT relief will remove most of the problems, but may also involve other classes of long term business which are charged on other, income, bases. Since the new relief applies only for purposes of capital gains taxation, it is at least theoretically possible that the transfers of such other types of business may crystallise a tax liability. The new regime introduced by the Finance Acts of 1989 and 1990, the application of which is in some respects still somewhat untried, may considerably reduce the problems which would otherwise have arisen. This is particularly the case in relation to mutual companies. Before the introduction of the new rules the Inspector was sometimes prepared to accept that, in accordance with the somewhat liberal previous provisions for reservations, policyholders reservations[16] could be made to cancel out any liability which might otherwise have resulted from the realisation of the relevant assets. The rules about reservation are now much more detailed and inflexible, and it will therefore be interesting to see how the practice under the new regime will develop in relation to transfers. An alternative way of dealing with the problem might be to rely on the provisions of section 100 ICTA 1988 whereby trading stock belonging to a trade at its discontinuance is valued at "the amount realised on the sale or the value of the consideration given for [its] transfer" in a case where the stock is transferred for valuable consideration to a person who carries on or intends to carry on a trade in the United Kingdom and who is entitled to deduct the cost of it as an expense in computing for tax purposes the profits or gains of his trade or intended trade. As explained in relation to stamp duty, below, it is arguable that the consideration for which the relevant assets are transferred is some proportion of the liabilities assumed by the transferee, but if the transferring company and the transferee company agree a particular value, such that no profit will arise on the transfer, it may be that that value would be accepted by the Revenue as being the valuable consideration for which the relevant assets are transferred. There must, of course, remain some doubt as to whether parties can, by what is an essentially self serving agreement, decide for themselves what consideration is attributable to the relevant assets, particularly as the Court order will not normally make any particular apportionment of values between different assets.

1.6 The difficulties outlined above in relation to long term business which is not life assurance business are particularly acute in relation to permanent health insurance, which is regarded for the purpose of insurance companies legislation as long term business but, for the purposes of tax legislation, as general business, the profits of which are chargeable on a Case I basis. It is to be hoped that the Revenue will in practice apply concepts similar to those underlying the CGT relief in relation to assets of such business.

1.7 Further relief is provided by the Finance Act 1990 in relation to expenses of management and losses of the transferring company which are treated as expenses of management or losses of the transferee.[17] Similarly, the transferee steps into the transferor's shoes in relation to capital allowances,[18] without the transfer itself being regarded as an event bringing about a balancing charge or balancing allowance on the transferring company.

1.8 Anti-avoidance provisions are included to ensure that the CGT and management expenses reliefs are only available where the transfer is, broadly speaking, a genuine commercial operation. The familiar prior clearance procedure, which exists in relation to section 88 CGTA 1979 is substantially adopted for this purpose and will normally need to be used.[19] It is noteworthy that the relevant applications for clearance must be made by the transferee rather than the transferring company though in practice the Revenue do not seem to insist rigidly on the application being made by the correct person.

1.9 Value added tax ("VAT")

So far as the transfer of assets under the scheme is concerned, VAT does not normally pose any particular problems, since the transfer will be of a business as a going concern, and the usual relief for such transfers will be available.[20] There is, however, a controversial area relating to buildings and land. The new system created by the Finance Act 1989 has, in the official view, the effect that a transfer of an interest in buildings and land in relation to which the transferring company has made an election to charge VAT cannot be the subject of a going concern transfer unless the transferee also makes the appropriate election. It is, however, further understood that the whole question of the interaction between the going concern transfer rules and the Finance Act 1989 regime in relation to buildings and land is being reviewed at the moment and modifications to the practice are possible.

1.10 Stamp duty

Stamp duty is payable ad valorem on conveyances or transfers on sale of most assets, though once TAURUS, the paperless system for stock exchange dealings, has been introduced it will no longer apply to stocks and shares.[21] Thus, stamp duty is likely to be less of a consideration in future in relation to section 49 transfers, though it will continue to be relevant in relation to land and buildings. On the face of it, the order of the Court under section 49 seems quite unlike a conveyance or transfer on sale but the technical position is more involved. It should not automatically be assumed that there will be any substantial liability to stamp duty in relation to a section 49 transfer, and in straightforward cases it appears possible to obtain a favourable advance indication from the Revenue to the effect that the liabilities assumed by the transferee company will not be counted as part of the consideration.

1.11 Other considerations may arise when, as is not unusual, the transferring company considers it appropriate to declare a special bonus to policyholders on the occasion of the transfer. Again, in the case of a demutualisation, the (proprietary) transferee company may wish to issue shares to policyholders on favourable terms. It is understood that the Revenue have been prepared to indicate that a special bonus will not be regarded as consideration in a number of cases. The author is not aware of any cases involving the issue of shares to policyholders.

1.12 Policyholders' personal position

The tax position of the policyholders themselves also needs careful consideration. The extent to which problems arise will clearly depend upon what is offered to them, and in what capacity they receive it (whether as policyholder or as member).

• 1.13 Life assurance premium relief ("LAPR")

It is quite likely that the transferee will have issued policies which confer on their holders the right to relief under CTA 1988 section 266, although premiums paid under policies issued after 13th March 1984 will not normally qualify. Such relief can in certain circumstances be lost if a new policy is issued in substitution for the existing one or the terms of the existing policy are varied.[22] A possible analysis of the effect of an order under section 49 might be that policies issued by the transferring company are "novated", that is to say, cancelled and substituted by new policies in appropriate terms issued by the transferee company, and if this analysis were appropriate, LAPR could in certain circumstances be lost. It is therefore important to ensure that the scheme is drafted in such a way as not to constitute a novation (i.e. release and re-creation) of liabilities but a transfer of liabilities by operation of law. In these circumstances the Revenue are normally prepared to confirm that LAPR will remain undisturbed by the transfer.

Notes

[15] I.e. the value of the liabilities assumed by the transferee — Income and Corporation Taxes Act 1988 s.100

[16] Income and Corporation Taxes Act s.433 (as originally enacted)

[17] Finance Act 1990 Schedule 9 paragraph 4, inserting a new s.444A into the Income and Corporation Taxes Act 1988

[18] Finance Act 1990 Schedule 9 paragraph 5, inserting a new s.152A into the Capital Allowances Act 1990

[19] Income and Corporation Taxes Act 1970 s.267(3A) and Income and Corporation Taxes Act 1988 ss.444A(7) and (8)

[20] Value Added Tax (Special Provisions) Order 1981 (S.I. 1981 No. 1741, as amended) Article 12

[21] Finance Act 1990 s.108; the "abolition day" is to be prescribed by statutory instrument under s.111(1)

[22] Income and Corporation Taxes Act 1988 Schedule 15 paragraphs 17-20