



Institute
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Part VII transfers

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Lovells



Overview of talk

- Use of Part VII transfers
- Current issues
- Policyholder communications
- International application of Part VIIs
- Issues for Brexit Part VII transfers

Use of Part VII transfers

- Reinsurance and Part VII transfer: classic business transfer structure
 - annuity portfolios, legacy business
 - Demutualisations
- Group reorganisations
- Flexibility to choose what transfers (and to allocate liability)
 - Legacy liabilities for administration and mis-selling
 - Allocation of business liabilities to transferred business

Current issues: the scheme document

- What's transferring?
 - Mis-selling liabilities
 - Liabilities for lapsed, matured, surrendered and expired policies
 - Policies "written and/or assumed by" the transferor
- Amendments to the scheme
 - "impossible, impracticable or inequitable"
 - Are changes in management and actuarial practice covered?
 - Wider amendment provisions with Independent Expert and Court oversight
 - "necessary to secure that the scheme is fully and effectively carried out" (s 112(1)(d))
 - Court's jurisdiction not clear

Current issues: Independent Expert – independence and reliance

- Independent Expert's independence
 - Applied to Independent Expert and their employer
 - Number of insurance business transfers reviewed for applicants
 - Connections with applicants' groups
 - Non-standard fee arrangements (abnormally low fee caps)
- Level of reliance on the parties' own analysis and on the work of other experts
 - Need to demonstrate challenge of the parties' own working and assumptions
 - Need to consider when should obtain own advice (and justify position if not)

Current issues: the "walk-away option"

- Pre-transfer:
 - Transferee can walk away from insolvency of the transferor (and vice versa): but is this realistic given operational and regulatory constraints?
 - Transferor policyholders have first call on surplus assets of the transferor (and vice versa): transfer creates a potential worsening of security for transferor or transferee policyholders
- Impact of pre-transfer reinsurance from transferor to transferee
 - Can reduce value of walk-away option for transferee where termination rights limited
 - Can give transferee exposure to transferor outwards reinsurance
- Impact of transferee being a subsidiary of the transferor
 - Consolidation of transferee in transferor's financial statements
 - Ability to sell transferee subsidiary subject to regulatory approval
 - PRA's ability to require parent to provide capital support to regulated subsidiaries

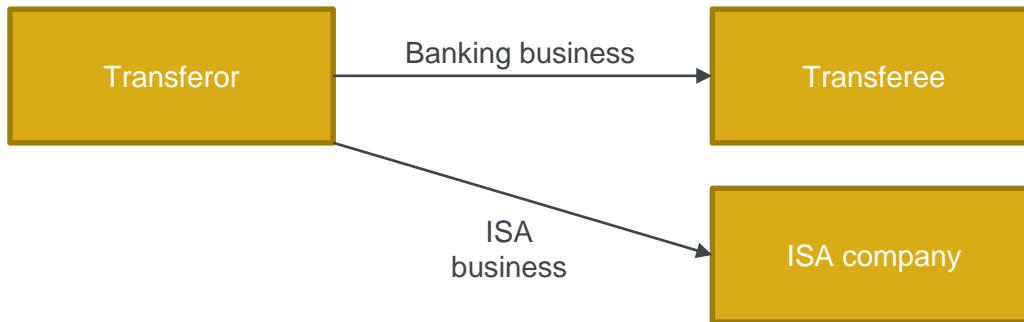
Current issues: reinsurance and security post-merger

- Review of reinsurance preceding a Part VII
- Security post-merger
 - No requirement that the security of transferor and transferee policyholders must be maintained: excess capital in the transferee being less than in the transferor not a reason for court to refuse transfer
 - Nothing sacrosanct about any particular level of excess capital over regulatory requirements
 - Capital available for dividend ignored

Current issues: Solvency II, (not) triggering EU Directives and review of reinsurance

- Does a Part VII trigger the Gender Directive etc?
- Impact of Solvency II
 - Solvency II waivers for transitional measures and matching adjustment
 - Internal model/standard formula
 - Test for notifying EEA regulators: where the contract was formed, rather than the state of the commitment

A restructuring possibility for a Part VII transfer?



- Transfer of ISA business to ISA company necessary as a consequence of the way that Santander ran its business. No other practical way to do this
- No explanation of legal rationale in judgment
- Norwich Union case (2004): provided predominant purpose of the scheme is the transfer of business, then no statutory prohibition on the scheme containing other provisions
- Order can cover incidental, consequential and supplementary matters as are necessary to secure that the scheme is fully and effectively carried out (s.112(1)(d))

To what extent can a Part VII be used to amend policy terms and conditions?

- Clear precedents for amendment of rights to linked funds, merger of sub-funds, conversion of rump with-profits business into non-profit and reattributions
- S 112(1)(d) FSMA: Court may make such provision as it thinks fit with respect to such incidental, consequential and supplementary matters as are, in its opinion, necessary to secure that the scheme is fully and effectively carried out
 - Court can only approve what is required to effect the transfer?
- S 112(8) FSMA: Court may make provision as it thinks fit for the reduction of the benefits payable under any description of policy or policies which are being transferred
 - Introduced to deal with transfers where solvency is an issue
 - Transfer of Hearts of Oak business to Reliance Mutual
- Norwich Union: provided the predominant purpose of the scheme is the transfer of business, there is no statutory prohibition on the scheme containing other provisions
- A regulatory issue as much as a legal one?

The Equitable Life/LCCG transaction

"Equitable Life and Reliance Life will now progress a Scheme of Arrangement and Part VII Transfer, which includes a vote by the members of Equitable Life on the conversion of the "with-profits" policies, which will be followed by a Court hearing to approve the transactions."

Equitable Life news release, 15 June 2018

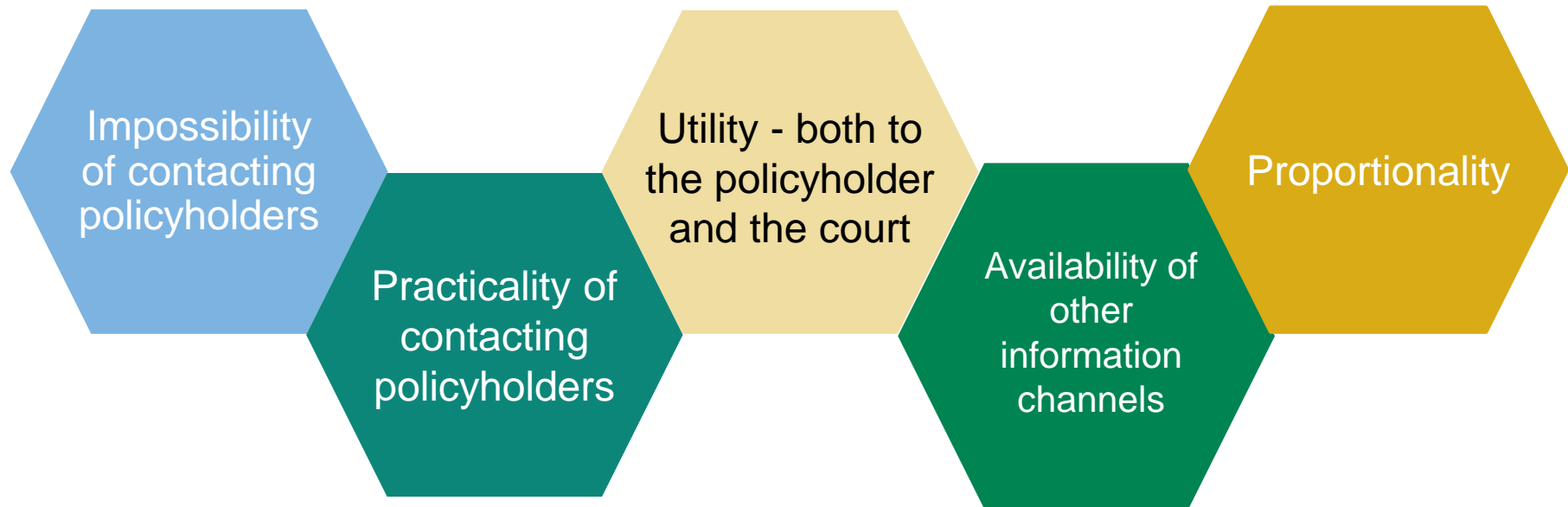
- Background to schemes of arrangement
 - Part 26 of the Companies Act 2006
 - Subject to approval by a majority in number representing 75% of those voting in person or by proxy and by the court
 - Binding on all policyholders it applies to
- Life insurance precedents
 - Equitable Life, Phoenix and Royal London: GAR compromise schemes
 - Sun Life Financial of Canada: with-profits conversion schemes
 - Reliance Mutual: Chrysalis scheme

Is the Equitable Life scheme of arrangement a game-changer for with-profits?

- CP6/13 (September 2013)
 - Distinction between solvent and insolvent scenarios
 - Risk of policyholders having their cover terminated against their wishes or their claims (or guarantees) terminated at less than full value (the problem of compulsion)
- Royal London
 - GARs compromised to give policyholders greater flexibility to take advantage of pension freedoms
 - Note right to opt-out
- Benefits from conversion of with-profits to unit-linked
 - Weak with-profits fund with constrained investment and bonus policy
 - Gives policyholders investment choice
 - Crystallised distribution of estate for policyholders
 - No loss of life and pensions policy, although guarantees may have to be compromised
 - Reduces regulatory burden and capital requirements for company
- Should the minority trump the majority, especially where the Independent Actuary confirms no material adverse effect?

Policyholder communications: principles for grant of waivers

- "Aviva factors" – from *Re Aviva International* (2011)



- Key question: what is a reasonable and proportionate approach to ensuring that policyholders who have an objection to a transfer have the opportunity of raising it?

Some examples

Direct Line (2011)

- Third party branded/sold policies: parties should contact third parties before asking court for a waiver
- White label policies – position should be explained in the advertising
- Large format adverts, not in legal notices section
- Waiver from mailing of transferee policyholders despite tripling size (£10+ million and business short tail)
- Recent contact and potential impact on sales not factors

Paternoster and Rothesay Life (2011)

- Large number of buy-in and buy-out bulk annuity contracts with DB scheme trustees
- Waiver from mailing underlying members
- Arguments included fact that members may not be aware of the contract; contract may only apply to a proportion of the liabilities of the scheme; insufficient address information; trustee's fiduciary duty to members
- Engagement with trustees before Court application to confirm they agreed with approach

Points to note

- Parties need to:
 - Carry out more preparatory work before presenting their strategy
 - Consider waivers in the context of the overall comms proposition
- FCA guidance (May 2018)
 - Argument that costs of communication would be disproportionate to their utility to be backed by "detailed analysis of the actual costs involved"
 - Likely to challenge tracing arrangements if gone-aways higher than the FCA "reasonably expects"
 - Absence of any material adverse effect is unlikely to be sufficient in itself to justify granting a waiver from notifying non-transferring policyholders
 - Pension scheme members: need to provide "reasonable assistance", including financial assistance and mailing packs. Name trusts/employers in newspaper advertising?

International application of Part VII transfers

- Business transferred must be carried on from an establishment of the transferee in an EEA state; AND
- Either – the whole or part of the business carried on in one or more member states by a UK authorised person who has permission to effect or carry out contracts of insurance is to be transferred to another body
- Or – the whole or part of the business carried on in the UK by an authorised person who is neither a UK authorised person nor an EEA firm but who has permission to effect or carry out contracts of insurance is to be transferred to another body
- Case 3: recognition of foreign transfers of non-EEA business from UK authorised persons

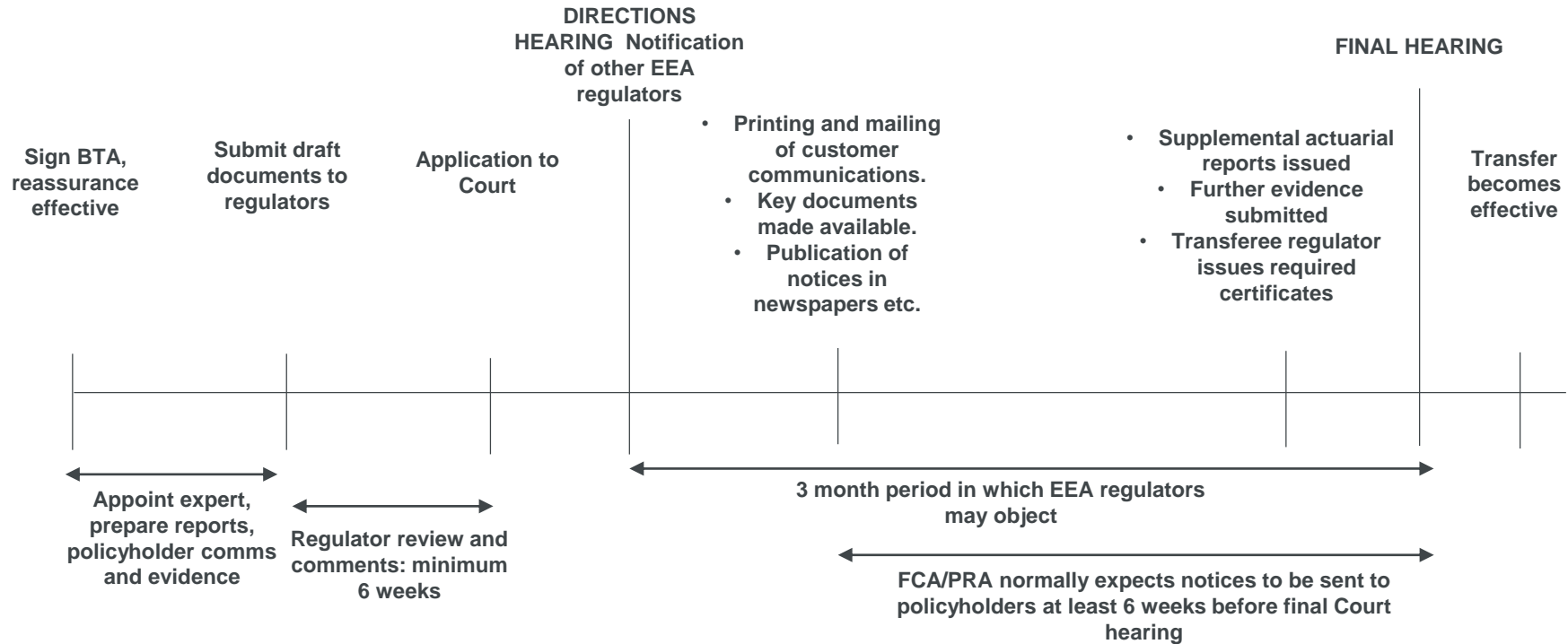
Prudential domestication of Hong Kong business

- Parallel transfer processes
 - Under Hong Kong law (sections 24 and 25 of the Insurance Companies Ordinance)
 - Under Part VII (Case 3)
- Case 3 requirements:
 - Transferor is UK authorised person
 - Business to be transferred under the scheme is carried on in one or more countries (none of which is an EEA state) and does not include policies of insurance against risks arising in an EEA state
 - Scheme approved in country other than an EEA state
- Reasons for Case 3 application:
 - Recognition of the HK transfer
 - UK forum for policyholders to object
- Points to note:
 - Joint Independent Actuaries' Report
 - Attribution of estate (no policyholder advocate)
 - Principles of Financial Management for with-profits business

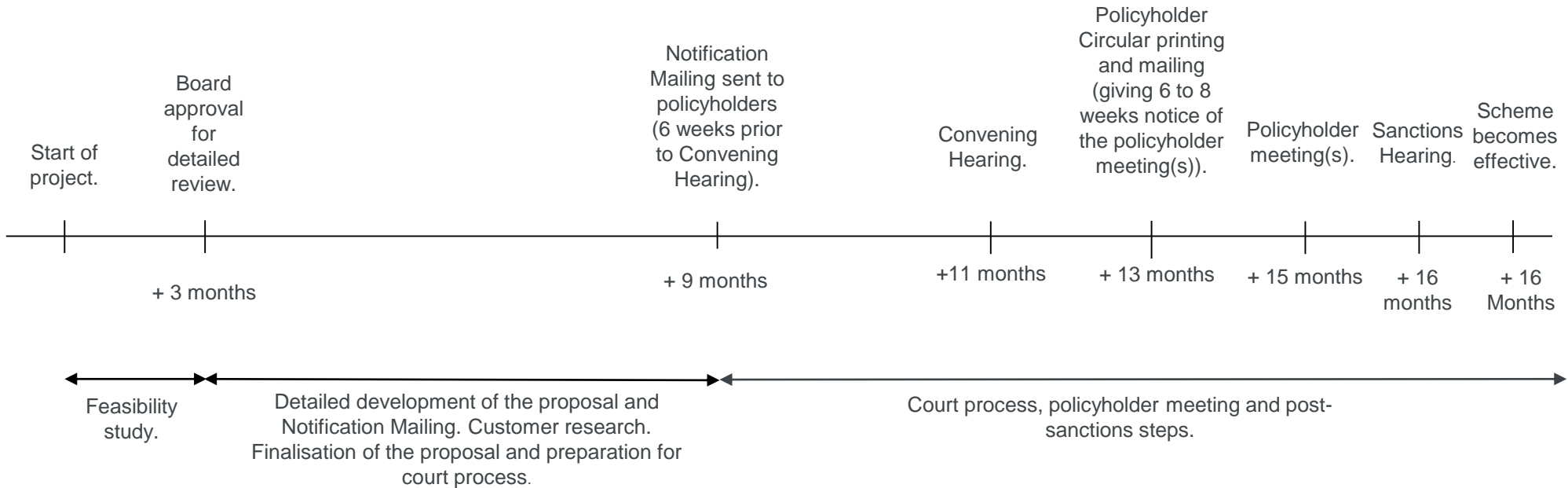
Issues for Brexit Part VII transfers

- Do you need to do a Part VII transfer?
- Part VII applies:
 - Business transferred must be carried on from an establishment of the transferee in an EEA state
 - the whole or part of the business carried on in one or more member states by a UK authorised person who has permission to effect or carry out contracts of insurance is to be transferred to another body
- FSCS and FOS
- Analysis of comparative regulatory framework
- Recognition of transfer
- Authorisation of transferee
- An alternative: Societas Europea

APPENDIX 1: Part VII Timetable



APPENDIX 2: Scheme of Arrangement



Court process: 5 months

Development of proposal: 9 months

Notification mailing to court process: 2 months

Total: 16 months

About Hogan Lovells

Hogan Lovells is one of the largest law firms in the world with over 2,800 lawyers and 48 offices covering the US, Europe, Asia, Africa and the Middle East.

We have one of the leading insurance teams in the UK and the rest of Europe. The corporate insurance team is ranked in Band 1 by Chambers and Legal 500 and we were Who's Who Legal's Insurance Law Firm of the Year in 2016. The team has advised on more Part VII transfers than any other law firm and has specialist expertise in life insurance and with-profits.



Charles Rix (e: charles.rix@hoganlovells.com, d: 0207 296 5425) is recognised as a leading corporate and regulatory adviser with over 20 years' experience in the insurance industry. His practice covers domestic and cross-border mergers and acquisitions, joint ventures and corporate reorganisations as well as Part VII transfers, schemes of arrangement and advice on with-profits businesses. He is the editor of 'A Practitioner's Guide to the Regulation of Insurance' (Sweet & Maxwell, 2014). Charles became a partner in a predecessor firm of Hogan Lovells in 2001.



Jonathan Russell (e: jonathan.russell@hoganlovells.com, d: 0207 296 5812) is a senior associate in our Corporate Group in London, where he advises on cross-border and domestic M&A, re-organisations and other corporate matters. Jonathan has particular experience in the insurance sector, advising insurers and other market participants on a range of transactions and regulatory matters, including Part VII transfers and schemes of arrangement. Jonathan has been recognised as an "Associate to Watch" in Chambers UK for both M&A and insurance (non-contentious).



Questions



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