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Insights

A TICK IN ALL THE BOXES: THE ROTHESAY DECISION - ARE PART VII TRANSFERS NOW RESTRICTED?

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Part VII of the Financial Services and Markets Act 2000 is the mechanism by which books of insurance policies can be transferred from one insurer to another. Some doubt has been cast over the situations in which this process can be utilised by the *Rothesay* decision in August 2019. In this case, the High Court blocked a proposed transfer of annuity policies by Prudential Assurance Company Limited ("PAC") to Rothesay Life plc ("Rothesay"). The Independent Expert's view (undisputed by the regulators) that the transfer would not have a material adverse effect on policyholders was not enough to satisfy the Court. However, the judge said other factors, not quantifiable by an actuary or regulators, also had to be taken into account. The parties have lodged an appeal.

The proposed transfer

The proposed transfer involved around 370,000 annuity policies with estimated liabilities of £12 billion. There were to be no changes to policy terms, and the policies would continue to be administered (at least initially) by the existing service provider.

Value of the independent expert and regulators' conclusions

While it has always been clear that Court approval for a Part VII transfer is not a rubber stamp, it is highly unusual for a transfer to fail if, as in this case, neither the Independent Expert nor the regulators identify any issues with it. Mr Justice Snowden felt that the Independent Expert's and the regulators' analyses were limited to actuarial and Solvency II regulatory principles, and the Court should take account of broader questions.

The court's approach

In line with earlier cases, Mr Justice Snowden's stated approach was to strike a balance between the parties' commercial rationale and policyholder interests. However, some of the factors he took into account were not obviously directly relevant to the impact of the transfer on policyholders. These included:

- Policyholders originally chose PAC for its age and established reputation. Rothesay, a relative newcomer, did not share those attributes
- It was reasonable for policyholders to assume from PAC's literature that it would not seek to transfer their policies
- PAC had already achieved its commercial objective of releasing regulatory capital to support a proposed demerger through a pre-transfer reinsurance with Rothesay.

Mr Justice Snowden was also influenced by the relative size of the parties – the Prudential Group has assets of £508 billion, compared to Rothesay's post transfer asset base of £37 billion – and the fact that annuity policies may provide the only source of income for a policyholder.

Is lack of adverse impact no longer enough?

The Court's approach to date has always been to determine whether the transfer will have a material adverse effect on policyholders and to have regard to real, not fanciful, risks. Mr Justice Snowden however was influenced by the fact that PAC had qualities (longevity and reputation) not shared by Rothesay; and by the impact on policyholders if Rothesay should fail, even though the Independent Expert considered the risk remote.

The judge's approach seemed to be that if the transferor would be better able to withstand a shock than the transferee, the transfer ought not to be sanctioned. This differs from the previous approach that if the transferee is financially strong, it should not matter that the transferor has more assets. Mr Justice Snowden acknowledged his view might have been different if PAC's commercial purpose for the transfer was different; the transfer was proposed to policyholders on different terms; or, if there was less disparity between the transferor and transferee in the characteristics policyholders consider important when selecting an annuity provider.

If Mr Justice Snowden's approach is correct, an insurer would need to find a counterparty that is not just financially strong, but has the same financial strength, longevity and reputation as the transferor. This significantly reduces the pool of potential acquirers. It could also make it difficult for a specialist run-off acquirer to take on even a relatively small book from a substantial live underwriter. This could have the effect of almost entirely undermining the purpose of Part VII transfers.

Recent developments and conclusion

Just two months after the *Rothesay* decision, in October 2019 Mr Justice Morgan sanctioned "without hesitation" a Part VII transfer of insurance business in *Re Canada Life Ltd.* The *Rothesay* decision in his view was clearly distinguishable. There were proper commercial reasons for the transfer. Canada Life wanted to divest itself of a non-core business, and was disposing of it to a

specialist provider actively focused on that business. Mr Justice Morgan held that was likely to be of real benefit to policyholders.

Further, in December 2019, the High Court distinguished the *Rothesay* decision and approved a Part VII transfer by Equitable Life to Utmost Life and Pensions Limited, notwithstanding that (i) it was a transfer of long-term life assurance and pensions business, and (ii) the transferee, like Rothesay, is a relatively new entrant to the market and does not have the same long-standing history as Equitable Life.

In sanctioning the Part VII, Mr Justice Zacaroli cited the following five grounds for distinguishing the *Rothesay* decision:

(i) transferring policyholders would be free to switch to another annuity provider following the transfer;

(ii) there had been no prior transfer of economic risk and reward pursuant to a reinsurance agreement;

(iii) the transfer would benefit the transferring policyholders as a whole;

(iv) Utmost (the transferee) would have access to its parent for capital support, if needed; and

(v) whilst the transfer itself had not been approved by policyholders, the transfer would be part of proposals which have received overwhelming support from those transferring policyholders who voted in favour of the scheme of arrangement.

Accordingly, if a clear benefit to policyholders can be shown, *Rothesay* should not be an issue, but simply showing that there is no financial prejudice to policyholders may no longer be sufficient.

This article updates an article that first appeared in BCLP's Emerging Themes in Financial Regulation 2020 publication – an extensive collection of articles around the themes of supervision, governance, financial crime and investigations, and digital.

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