Over to you?

Anthony de Garr Robinson QC discusses the principles governing the transfer of insurance business to other insurers

IN BRIEF

▸ *Re Prudential Assurance Co Ltd*: recasting of the principles to be applied on an application for sanctioning an insurance transfer under Part VII of the Financial Services and Markets Act 2000.

The insurance business transfer regime under Part VII of the Financial Services and Markets Act 2000 plays an important role in the UK insurance industry. It is widely regarded as providing a stable mechanism by which UK insurers can transfer portfolios of insurance contracts to other insurers. Established in a long line of first instance cases starting with *Re London Life Association Ltd* [1989] Lexis Citation 1731, the principles applied by the courts in determining whether to sanction a transfer have been seen as clear (albeit increasingly elaborate). This has allowed insurers to be confident about when they can safely invoke this expensive process.

This was thrown into doubt by the decision of Snowden J in *Re Prudential Assurance Co Ltd* [2019] EWHC 2245 (Ch), [2019] All ER (D) 83 (Aug). He refused to sanction Prudential's (PAC's) transfer of some 370,000 annuity contracts to Rothesay Life Plc (Rothesay), despite the independent expert's view that it would have no material adverse effect on the security of benefits enjoyed by the relevant policyholders and despite the regulators having no objection to it. Both insurers were well capitalised and had equivalent regulatory capital metrics (under the Solvency II Directive), but the judge held that, over the long lifetime of the relevant annuity contracts, the risk of either insurer failing could not be disregarded and Rothesay's prospects of obtaining voluntary financial support from its parent companies would then be lower than PAC's prospects of obtaining support from the Prudential Group. He also held that, given the importance to policyholders of their choice of annuity provider, it was relevant that they had reasonably chosen a 'venerable' company such as PAC on an assumption that it would retain their annuities for life.

Consternation

This decision caused consternation in the market. It was seen as introducing unpredictability into the transfer process and as putting some insurers at a competitive disadvantage, depending on whether they were more or less 'venerable'.

In December 2020, PAC's and Rothesay's appeal was allowed (*Re Prudential Assurance Co Ltd* [2020] EWCA Civ 1626, [2020] All ER (D) 32 (Dec)). Among other things, the Court of Appeal held that: (i) there was no material disparity between the voluntary financial support potentially available to the two insurers; (ii) a disparity in such support was not a material factor anyway; (iii) the judge failed to accord adequate weight to the views of the independent expert, to the views of the regulators and to the future regulation of Rothesay; and (iv) the factors relied on by policyholders in choosing PAC as their annuity provider were not relevant to the judge's discretion.

This judgment is not simply a return to orthodoxy. Rather than affirming the long line of first instance cases referred to above, the court saw these cases as possible causes of misunderstanding and confusion. As it was the first time the approach to sanctioning transfers under Part VII had been appealed, the court explained how the sanction jurisdiction should generally be exercised. In particular, it explained that:

- The first instance cases have wrongly been treated as establishing principles governing all sanction applications; in fact, different factors are relevant to different applications. In order to determine which factors are relevant, the court must identify the nature of the business being transferred and the circumstances giving rise to the transfer. Thus:
  - Long term business (such as life assurance and annuities) raises different issues from general business (such as motor and household insurance). And policies which vest a discretion in the insurer raise different issues from those which do not.
  - Commercial transactions for the benefit of the insurance companies involved should be distinguished from transactions occasioned by external events, such as Brexit, or transactions driven by an insurer's financial position, such as a rescue.
- Where in-payment annuities are being transferred, the paramount concern should be whether the transfer will have any material adverse effect on the prospect of payment of the transferring policyholders, the other policyholders of the relevant insurers and also the creditors of such insurers.
- An adverse effect is material if it is a possibility that cannot sensibly be ignored having regard to the nature and gravity of the feared harm and it involves the prospect of real and significant, as opposed to fanciful or insignificant, risk for the relevant stakeholders. In that regard:
  - The court's first duty is to scrutinise the reports of the independent expert and regulators, with a view to identifying any errors, omissions or other defective reasoning.
  - Without such defects, the court should 'accord full weight' to their opinions. It should not depart from them without 'significant and appropriate' reasons for doing so. In particular, it should not substitute its own expertise in relation to financial and actuarial assessments of the security of policyholders' financial benefits.
  - Moreover, the court should recognise the significance of the Solvency II capital metrics applied to UK insurers and of such insurers' continuing regulation by the Prudential Regulation Authority (PRA). It is striking how much emphasis the judgment gives to the PRA's role as their prudential regulator to require timely corrective action in the event of financial deterioration.
- In exercising its discretion, the court can take into account a wider set of factors than the actuarial factors guiding the independent expert and the regulators. However, as regards the security of the policyholders' benefits, those factors must go to the question whether the transfer will have a material adverse effect on them. They do not include speculation as to what future owners of an insurer may or may not wish to do to support their regulated subsidiary. Nor do they include factors relied on by policyholders in choosing their insurer, even if the insurer marketed itself on this basis (eg on its venerability).

Comment

This judgment raises issues to be explored in future cases, such as when a transfer which has a material adverse effect on some policyholders will be sanctioned, when the interests of insurers' employees, shareholders and other stakeholders intrude and when a regulatory capital analysis and/or the regulatory regime offer inadequate support for sanctioning a transfer. Its recasting of the principles to be applied provides a coherent framework within which to assess these issues. NLJ

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