Court of Appeal restates the legal principles applicable to the sanction of Part VII transfers of insurance business

The Court of Appeal has today upheld the joint appeals by The Prudential Assurance Company Limited (PAC) and Rothesay Life Plc (Rothesay) against Snowden J's refusal to sanction the transfer of a portfolio of annuities from PAC to Rothesay under the provisions of Part VII of the Financial Services and Markets Act 2000 (FSMA) for insurance business transfer schemes. This is the first occasion in the 150 years since the Life Assurance Companies Act 1870 first introduced court approval for insurance transfers that the law governing such transfers has been considered by the appellate courts.

The Court of Appeal (Vos C, David Richards LJ, and Patten LJ) has upheld PAC and Rothesay's appeals that Snowden J made a number of errors in the exercise of his discretion under Part VII of FSMA in refusing to sanction the transfer of a portfolio of annuities from PAC to Rothesay. This is the first occasion on which the law governing such transfers has been considered by the appellate courts, and the Court of Appeal took the opportunity to review the existing case law and restate the principles applicable to the exercise of the court's discretion to sanction such transfers. In particular the Court emphasised that for transfers of long-term insurance business that do not vest a discretion in the insurer, the court's paramount concern should be to assess whether the transfer will have a material adverse effect on the receipt by policyholders of their benefits. The judgment is likely to become the definitive statement of the law in this area.

The Court of Appeal's restatement of the law emphasises the importance of the Independent Expert and the regulators' reports in the exercise of the court's statutory discretion, and confirms that subjective factors should play little or no role in the court's decision making. The judgment should promote certainty as to how the scrutiny of future transfers will be approached by the courts, reinforcing the utility of the Part VII process for insurance companies.

Recap – Part VII and Solvency II Regimes

Part VII of FSMA sets out the statutory mechanism for enabling transfers of insurance business. It permits insurers and reinsurers to transfer general and long-term insurance business between different legal entities, subject to the court's sanction. Under section 111(3) of FSMA, the court must consider that *"in all the circumstances of the case, it is appropriate to sanction the scheme"*. Section 109 of FSMA requires that an application in respect of an insurance business transfer scheme must be accompanied by a "scheme report" which may be made only by a person (the Independent Expert) who (i) appears to the PRA to have the skills necessary to enable a proper report to be made; and (ii) is nominated or approved for the purpose by the PRA. The PRA and FCA also have an important role in advising the court on whether an insurance business transfer scheme should be sanctioned, and such advice is typically provided to the court through written reports.

The financial strength of the transferor and transferee required under Solvency II forms an important part of the Independent Expert's consideration of any insurance business transfer scheme. Solvency II requires insurers to hold a minimum amount of capital in addition to the assets backing the liabilities to policyholders. Insurers must also be able to demonstrate that they can satisfy their regulatory requirements under Solvency II and pay policyholder claims in adverse scenarios. These solvency requirements reflect specific risks faced by each insurer and form an integral part of the Independent Expert's consideration of an insurance business transfer scheme.

Background and High Court judgment

In March 2018, Prudential plc announced its intention to demerge M&G Prudential, its UK and European savings and investments business, and to list it as an independent company on the London Stock Exchange. In support of this demerger, Prudential proposed that approximately 370,000 annuity policies would be transferred from PAC to Rothesay under Part VII of FSMA (the **Scheme**).

PAC and Rothesay applied to the High Court for sanction of the Scheme. The application was heard in June 2019, and judgment was handed down in August 2019. Snowden J exercised his discretion not to sanction the Scheme. In doing so he concluded that, contrary to the opinions of the Independent Expert and the regulators on the basis of PAC and Rothesay's Solvency II metrics, there was a material disparity between the external future support likely to be available to PAC and Rothesay, and that the risk of either company requiring such support could not be said to be remote. He also took into account the comparative age and venerability of PAC and Rothesay, which had been emphasised by a number of affected policyholders who objected to the Scheme.

Snowden J granted PAC and Rothesay permission to appeal his judgment and both companies appealed to the Court of Appeal on the same grounds. These appeals were the first time a Part VII transfer has been appealed to the appellate courts in the 150 years since the Life Assurance Companies Act 1870 first legislated for court approval of insurance business transfers. There were a number of significant procedural issues to be addressed, including the participation of objecting policyholders as interested parties and whether, if the appeal was successful, the Court of Appeal should then re-exercise the discretion to sanction the scheme. At a directions hearing on 18 June 2020, Lord Justice Patten directed that the appeal should be a two-step process: the Court of Appeal would first consider whether to uphold the appeal and, if it did so, the question of sanction would be remitted back to the High Court. The Association of British Insurers was also granted permission to intervene in the appeals.

The Court of Appeal's judgment

The Court of Appeal emphasised that the range of businesses that may be transferred under Part VII, and the range of circumstances that might occasion a transfer, mean that the application of the court's discretion under section 111(3) FSMA cannot be reduced to a single test or list of factors to be applied in all cases. The court drew two key distinctions relevant to the approach to exercising its discretion: (1) between general insurance business and long-term business; and (2) between polices that vest a discretion in the insurer (in particular with-profits policies) and those that do not. It confirmed that the discretion under section 111(3) of FSMA is not *"a rubber stamp"*, but emphasised that the court must only take into account and give weight to matters that ought properly to be considered.

As a result, the Court of Appeal emphasised that the existing case law – which had been considered authoritative as to the approach to be taken by the court in exercising its discretion – had to be evaluated in light of the particular insurance business being transferred in each case. The Court of Appeal specifically addressed the leading decisions of Hoffman J in *Re London Life*[1], Evans-Lombe J in *Re Axa*[2], David Richards J in *Re Royal Sun Alliance*[3], and Warren J in *Re Scottish Equitable*[4], and the related decision of Vos C in *Re Barclays Bank plc*[5] (which considered the transfer of a ring-fenced banking business under a comparable provision for the transfer of such schemes in Part VII of FSMA). It explained that *Re London Life* and *Re Axa* should not be treated *"as if they were a comprehensive statements of the factors that should be applied by the court in all insurance business transfers"*, but viewed as cases primarily relevant to the transfer of with-profits business. For transfers of long-term insurance business that do not vest a discretion in the insurer – such as the annuities in this case – the court's *"paramount concern"* should be to:

"assess whether the transfer will have a material adverse effect on the receipt by the annuitants of their annuities, and on whether the transfer may have any such effect on payments that are or may become due to the other annuitants, policyholders and creditors of the transferor and transferee companies".

[1] Re London Life Association Ltd (21 February 1989, unreported)
[2] Re Axa Equity & Law Life Assurance Society plc and Axa Sun Life plc [2001] 1 All ER (Comm) 1010
[3] Re Royal Sun Alliance Insurance plc [2008] EWHC 3436 (Ch)
[4] Re Scottish Equitable plc and Rothesay Life plc [2017] EWHC 1439 (Ch)
[5] Re Barclays Bank plc [2018] EWHC 472 (Ch)

An adverse effect will only be material if it is:

(a) a possibility that cannot sensibly be ignored having regard to the nature and gravity of the feared harm in the particular case;

(b) a consequence of the scheme; and

(c) material in the sense that there is the prospect of real or significant, as opposed to fanciful or insignificant, risk to the position of the stakeholder concerned.

The Court of Appeal explained that the court should conduct this assessment by scrutinising the reports of the Independent Expert and the regulators, and the evidence of any other person with a right to be heard, including transferring policyholders. However, it should accord full weight to the opinions of the Independent Expert and the regulators, in the absence of errors or defects in their reports, and should not depart from their recommendations *"without significant and appropriate reasons for doing so."* The Court of Appeal emphasised that judges should not substitute their own opinions on actuarial and specialist issues for the expert opinions required by FSMA. The court will also be concerned to assess whether there will be any material adverse effect on service standards, and whether the circumstances of the case require consideration of any other factors.

Applying this approach to the Scheme, the Court of Appeal held that Snowden J had been wrong to conclude that there was a material disparity between the external future support available to PAC and Rothesay and to regard such a disparity as a material factor in the exercise of its discretion. In so concluding, it held that Snowden J had failed to accord adequate weight to the conclusions of the Independent Expert that the risk of either company requiring such support was remote, and the regulators' non-objection to the scheme. Snowden J had correctly accepted the Independent Expert's conclusions that, applying the Solvency II metrics, the relative financial strengths of PAC and Rothesay were comparable, but incorrectly held that those metrics were only informative of the current position and not of future solvency risks. It held that Snowden J then incorrectly substituted his own speculation as to future solvency risks for the views of the Independent Expert and the regulators. It also held that relative likelihood of non-contractual parental support being available in the future was not a relevant factor to take into account, and full weight should have been given to the fact that the PRA had considered the scheme in light of its statutory objective, which includes its forwards-looking approach to regulation.

The Court of Appeal held that Snowden J accorded too much weight to factors such as the relative age, venerability, and reputation of PAC and Rothesay, and their role in policyholder choice of PAC as annuity provider. The court acknowledged that these subjective factors may be a sensible basis for consumers to make decisions, but are not relevant factors for a court with the benefit of detailed financial information, Solvency II metrics, and the opinions of experts and regulators to take into account. It expressly approved Warren J's statement in *Scottish Equitable* that age and reputation were irrelevant factors, and disapproved Snowden J's departure from *Scottish Equitable* on that point.

The Scheme will now be remitted back to the High Court for a different Chancery Division judge to consider whether it is appropriate to sanction it, in light of the law as restated by the Court of Appeal.

Allen & Overy LLP act for PAC, one of the successful Appellants.

Key contacts

Lawson Caisley
Partner – London
Tel +44 20 3088 2787
lawson.caisley@allenovery.com

Philip Jarvis
Partner – London
Tel +44 20 3088 3381
philip.jarvis@allenovery.com

Kate McInerney
Partner – London
Tel +44 203 088 4459
kate.mcinerney@allenovery.com

Russell Butland
Senior Associate – London
Tel +44 203 088 4862
russell.butland@allenovery.com

India Jordan
Associate – London
Tel +44 203 088 3146
india.jordan@allenovery.com

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales. The term **partner** is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2020. This document is for general guidance only and does not constitute advice.

UK
CS2012_CDD-62246