THOMSON REUTERS
PRACTICAL LAW™

Pollyanna Deane's insurance column: August 2021

by Pollyanna Deane, Partner, Financial Services Regulatory Team, Fox Williams LLP

Status: **Published on 09-Aug-2021** | Jurisdiction: **United Kingdom**

This document is published by Practical Law and can be found at: **uk.practicallaw.tr.com/w-032-2131**
Request a free trial and demonstration at: **uk.practicallaw.tr.com/about/freetrial**

Pollyanna Deane is a Partner in Fox Williams LLP's Financial Services Regulatory Team, and is also a member of Practical Law Financial Services' Consultation Board.

In her column for August 2021, Pollyanna considers the proposals set out in the PRA's July 2021 consultation paper on updating its Statement of Policy (SoP) on its approach to insurance business transfers (IBTs) under Part VII of the Financial Services and Markets Act 2000 (FSMA) and the Friendly Societies Act 1992 (CP16/21).

Part VII transfers and the recent CP

Reading the new consultation paper (CP16/21) issued by the PRA on Part VII transfers and the proposals it is making to incorporate the changes that need to be included to reflect the reality of Brexit, I was surprised to see so little change being proposed.

Given that we have essentially gone through "peak Part VII transfer" season, following the withdrawal of the UK from the European Union, surely there were many lessons to be learned from it. I have heard one large life assurer's Board, reflecting on its most recent Part VII experience, express the view "Never again"! I have a lot of sympathy with that. What used to be an interesting transaction, which had the merit of ensuring that an insurer really knew its business, has become a time-consuming nightmare that leaves everyone including the policyholders dissatisfied.

The minor tweaks proposed by the PRA to update the Part VII process are as follows:

- Updating references in the SoP to the PRA's consultation with European Economic Area (EEA) regulators, and transfers from the EEA into the UK, to align with amended legislation.
- Providing additional guidance to firms, independent experts (IEs) and other interested parties on the PRA's specific role and approach to insurance business transfers.
- The PRA's expectations of transferees in run-off.
- Providing additional guidance on the PRA's expectations for friendly society transfers.

It is the sentiment expressed in paragraph 1.6 of the CP which really aroused my ire:

> "1.6 The proposals in this CP relate to the PRA's approach to insurance business transfers and friendly society transfers. By providing a greater degree of clarity and transparency with regard to the PRA's approach and existing practices, the proposals would assist firms and IEs in the preparation of documents and will allow the PRA's assessment of transfers to be more efficient, as risks would be mitigated sooner. Therefore, the PRA considers that the proposals set out in this CP advance its objectives. Costs for firms in implementing the proposals are expected to be minimal in the majority of instances; most proposals are clarifications of existing PRA expectations, to which firms already largely adhere. Where proposals would create additional costs for firms, the PRA considers that the benefits of mitigating risks to its objectives outweigh any additional costs incurred".

And so it goes on – this cost benefit analysis is meretricious and unworthy of the PRA, and continues to be so at every stage of a new process.

Well, let's do a cost benefit analysis on the back of my hand. Let us go back to how Part VII transfers used to be, when they were conducted under Schedule 2C of the Insurance Companies Act 1982. They took 6 months – now we look at 18 months from the outset. They involved the Court process only for life transfers, general transfers were handled by the DTI, Board of Trade or whatever moniker it then had. An independent actuary (IA) was involved for life transfers, with general business transfers being put together largely with the help of the insurance company's internal advisers, rather than a raft of externals. The regulator's involvement was to some extent that of a

benign guide, focused on the overall outcome, and far less abusive of the participants in the process. Seeking to rely on the views of the IE, while actually undermining it to such an extent that the Court now prefers the views of the regulator (see *AXA Equity & Law v AXA Sun Life [2001] All ER (Comm) 1010* and following), and the regulator refusing to take responsibility, is always going to create problems. Not to mention:

- There are now two regulators, two reports and double or triple the work to do.
- The emasculation of the two key elements of the process – the Court and the Independent Actuary. The robust questioning that the Masters in Court would engage in and the Court's role in protecting policyholders backed up by the Independent Actuary (which now has to do several reports given the length of time which the process takes) were crucial. I do not recall the system short-changing policyholders or being found to be unfit for purpose.

Indeed, one can only conclude that the UK regulator looked across to the other systems of transfer in the EU and thought that it would like to have more of the cake, without the resources to manage it. Do the Courts themselves now regret asking the FSA, as it then was, to take a more active role in Part VII transfers than it used to do? The people from the FSA involved in the *AXA* case were unhappy at being given more responsibility by the Court. When the Court criticised the regulator for its failure to attend a hearing, this triggered the shift to the FSA attending every substantive hearing. This has almost certainly extended the process and increased costs exponentially, at a time when the Courts are doing everything they can to help those who use the court service to reduce their costs. Accordingly, the cost benefit analysis which does not take into account the system that has grown like a triffid over the past 20 odd years, without assessing the real costs to the insurance industry, is worse than useless. Those real costs include the impact of "Never again". Does it assist the industry to have a system of transfer that is now so complicated, time consuming and burdened by extra hoops to jump through that business will be left to atrophy? Many insurance practitioners and policy makers have long criticised the German insurance industry for failing to sort out its books of business, something the UK did in the latter decade of last century. Surely we can't let ourselves fall behind in flexibility and speed of operation, when we had a perfectly useable system that the regulator could resuscitate without issue, being part of the real cost benefit analysis.

Turning to the CP, much of it is reiterating what is either common sense to reflect changes (such as there no longer being the same need to consult with EU regulators) or well known among practitioners (for example, the PRA's guidance as to its role). One has to say that if the PRA is still having to clarify this, it has signally failed to do so in all its previous publications. The only interesting part of this paper is the treatment of run-off firms, who perhaps always feel that they come late to the party. The PRA is concerned to ensure that transfers of run-off business do not, by their nature, destabilise the transferee, especially those run-off companies where acquiring books of business in run-off is part of their business model. This is obvious and understandable. However, run-off companies and friendly societies are not the mainstream business (one suspects that if they were, the PRA would be somewhat more concerned).

As a result, the use of Part VII transfers and the ability to shift books of business is likely to be stuck for some time in the doldrums, until the PRA decides to stop relying on the past and innovate for the future. If the regulators wanted to change the process to take general insurance out of the Part VII process, they would have to amend the FSMA. But that is not impossible. HM Treasury could back them and present it as a Brexit bonus, giving the UK a regulatory system that is fit for the UK market and the future. As part of this, the regulator would become the key port of call for policyholders looking to object to the general business transfer. This might remove their right to a day in court, but the relatively less formal approach and proper application of the regulators' principles do not suggest that policyholders would be disadvantaged. To state otherwise would imply that the regulators would not take the necessary care, and give adequate consideration, to the policyholder points.

Should the regulators wish to undo some of the complexity, reduce costs and save time, they would need to get the Courts on side. However, if the Courts now regret the direction these transfers have taken over the last 20 odd years, that might not be too difficult and would be in line with the current approach the Courts are seen, and being seen, to take, using cheaper and speedier ways to resolve issues (mediation for example), as a way to reduce the backlog of cases which has arisen.

Would it be too much to expect the regulator to stand back, identify that the direction of travel has been too firmly in the way of "regulation for the sake of it" and acknowledge that the previous system had much to recommend it, not least a true vindication of the "cost benefit analysis" that should have been done.