

Part VII transfers and the FCA's approach to the review

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What involvement does the FCA have in Part VII transfers and what are its current expectations?

The Financial Conduct Authority (FCA) has published a guidance consultation paper, '[GC17/5: Proposed guidance on the FCA's approach to the review of Part VII insurance business transfers](#),' on its approach to the review of Part VII transfers.¹ Whilst the Prudential Regulation Authority (PRA) takes the lead in the Part VII transfer process, the FCA plays a key role:

- The FCA is entitled to be heard on an application to sanction a Part VII transfer
- The FCA's assessment of the Part VII transfer given to the High Court (the Court) is based on its own statutory objectives, distinct from those of the PRA

This summary produced by Milliman consultants highlights the key points of the FCA's approach alongside insight from our experience of Part VII transfers and our response to the consultation paper.

Initial considerations

It is key to keep both the PRA and the FCA (together referred to as 'the Regulators' in this paper) informed not only when first considering a Part VII transfer, but also of any changes throughout the transfer, and not assuming they will contact each other. Firms should adhere to the agreed timetable; submitting all documents on time. Typically the FCA requires between six to eight weeks to review final reports.

Review of the appointment of the Independent Expert

The PRA is responsible for approving the Independent Expert (IE), after consulting the FCA. The FCA requires the IE to demonstrate independence alongside sufficient skill, experience and resources.

Considerations for independence will include other work carried out by the IE for the applicants, how recent it was and the materiality of the work. Potential conflicts of interest will also be investigated at this stage.

In assessing the IE's skill, experience and resources the FCA will look at, amongst other things:

- Relevant experience or advice (particularly if the transfer includes a non-UK jurisdiction) of the IE, and also the experience of the wider team and peer reviewer
- Performance on previous Part VII transfers
- The IE's other commitments (particularly other Part VII transfers currently in progress)

Furthermore the PRA or FCA may not approve the firm's first choice, and alternative candidates should be borne in mind. Firms should also provide some justification for the selections of their candidates.

Overview of the FCA's approach

What does the FCA consider?

Applicants should clearly explain the reasons for carrying out the Part VII transfer and why the transfer is necessary. Details of how the transfer relates to any other transfers within the group or as part of a restructuring within the company should also be included.

In addition, any relevant background regulatory issues will be considered by the FCA, where they may be of interest to the Court.

The applicants and the IE must consider whether there are any adverse consequences on competition, such as:

- Changes which affect a policyholder's ability to switch providers
- Clauses in the Scheme document that have the effect of reducing competition

The FCA does not make clear exactly to what types of reduction in competition they are referring. Indeed, there may be synergies or cost savings to policyholders that more than offset the impact of any notional reduction in competition.

¹ A transfer of part or all of the insurance business from a UK insurer to another insurer is governed by Part VII of the Financial Services and Markets Act 2000, and is referred to as a 'Part VII transfer.'

The applicants and the IE must demonstrate that there is sufficient consideration of the extent of any adverse impacts on policyholders. This includes considering protections and compensation in transfer documentations and whether the description of the Scheme is sufficiently clear, fair, detailed and prominent.

It is not clear whether or not the latter point regarding the description of the Scheme refers to general policyholder communications or the IE Scheme Report. We would not expect the descriptions to be the same and particularly expect that the IE Scheme Report may be longer and more detailed than general explanatory policyholder communications.

Firms must show that there will be no material adverse impact, whilst the IE must define what material means in this context and assess whether policyholders will be affected.

It is important to remember that the FCA may take a different view regarding the objections raised by policyholders from that of the IE or applicants.

The Scheme document

Changes to the Scheme

There are several ways in which changes to Scheme documents can occur following the approval of the Part VII transfer. The Regulators need to consider the impact of such potential amendments and applicants should be aware of their expectations, particularly when drafting the provisions of the Scheme, and the need to notify the PRA and the FCA of any previous Schemes that may be superseded by the current one. Possible changes include:

- Minor or technical amendments made without returning to the Court. The documents may state if this is allowed.
- Some documents may have provisions for amendments that require the Court's approval, and the FCA will need to be informed of them.
- Clauses may be added to allow for future changes with the Court's approval.
- The Scheme document may allow for changes to be made in specific circumstances, such as the Transferee expecting to need to merge, close or split funds.

Any significant changes should be captured by an updated IE report detailing any possible further impacts on all groups of policyholders. Policyholder interest must be taken into consideration before any changes are made.

The FCA offers an example where diminishing fund size, once business has transferred out of a fund, will adversely affect policyholders due to increased costs. This could be interpreted as implying that it is not sufficient for a change to have no effect on

policyholders' interests. For example, the power, once a unit-linked fund becomes relatively small, to merge it with another unit-linked fund with similar investment objectives, has a sound financial objective, but it will not necessarily benefit holders of policies invested in the fund, which is subject to charges that are fixed. It would be helpful if the FCA were to indicate that it is not proposing that clauses facilitating such mergers will not be permitted.

Review of the form of the IE Scheme Report

The PRA has ultimate responsibility for approving the form of the IE Scheme Report, but this is after consultation with the FCA.

The report must be easy to read and understandable by its intended audience. It must also contain sufficiently detailed analysis and challenge to the applicants' positions so that the FCA may be satisfied that the Court may rely on the conclusions drawn in the IE Scheme Report.

The FCA will consider the following areas when reviewing the IE report:

- The level of reliance on the applicants' assessments and assertions
- Sufficient comparative regulatory framework analysis
- Balanced judgements and sufficient reasoning
- Sufficient regard to relevant considerations affecting policyholders
- Commercially sensitive or confidential information
- The level of reliance placed on the work of other experts
- Ambiguous language or a lack of clarity
- Demonstrating challenge
- Technical actuarial guidance

The following sections detail how the applicants and the IE can work together to ensure they comply with some of the key requirements the FCA has when producing an IE report.

Applicants' assessments and assertions

The IE must show that the adequacy of any assessments or assertions provided by the applicants have been questioned, and explain the nature and outcome of any challenges they have made.

Areas that might be contended include legal opinions, any calculations, service levels, governance arrangements and post-transfer resources. Applicants can help with this process by providing the IE with relevant supporting documentation throughout the transfer.

Judgements and reasoning

The FCA needs to see evidence of the IE's reasoning that led to the conclusions. This needs to be done when referencing certain features of the Scheme.

The IE needs to be clear about the certainty there will be no material adverse impact or, if there is no certainty, that this conclusion is based on best judgement.

The IE must check that any documents relied upon are the most up-to-date when finalising the report.

If market conditions have changed significantly then applicants and the IE are expected to discuss any resulting changes and update the report if necessary.

Considerations affecting policyholders

The IE needs to ensure that the groups of affected policyholders have been identified correctly and that all relevant issues have been considered. This must cover policyholders for all applicant firms in the transfer.

The IE must also review and give opinions on alternatives where a loss is expected for a particular group of policyholders, supported by appropriate analysis. The efficiency of the Part VII transfer process can be improved if the applicants suggest and discuss with the IE ways of mitigating any such adverse impacts should they be likely to occur.

It is noted here that the usual role of the IE is to comment on the Scheme as it is presented, not to comment on alternatives that might have been presented. If the applicants are unhappy with the likely conclusions of the IE then they may reconsider the detail of the Scheme.

It is not sufficient for the IE to consider a balance of probabilities. Each subgroup of policyholders must be considered individually. The Part VII transfer should not materially adversely impact a group of policyholders and the IE must support this conclusion in the Scheme Report with evidence and reasoning.

Sensitive or confidential information

Where sensitive or confidential information is used by the IE in the decision-making process, the FCA expects to see any analysis and the information relied upon.

The IE may here choose to consider providing the Court with separate documents with further details, not for public disclosure.

This is a practice which has been used on several occasions in recent years and it allows, in particular circumstances, the IE to make comments to the Court that would be difficult to make in public documents. However, one of the core virtues of the Part VII transfer process is that it is public and transparent. Therefore the use of separate communications to the Court should be the

exception rather than the rule, whilst clear guidance from the Regulators and the Court on when their use is appropriate would be welcomed.

Reliance on work of other experts

The FCA expects the IE to carry out a review of any work provided by other experts. Where this lies outside the area of expertise of the IE, the IE must decide whether to seek independent advice or to use the advice sought by the applicants.

In general this applies mostly to legal advice, and the IE must provide copies of any legal advice obtained. The IE may need to justify any reliance upon the applicants' legal advice, or why it was not considered necessary to obtain independent legal advice.

The IE must also consider any contingency plans the applicants have made if the risks identified in the legal advice occur, especially if it has an adverse effect on policyholders.

In the case of cross-border transfers to countries with limited legal and actuarial resources it can be difficult to find experts in that country who are completely independent. There may be a trade-off between expertise and independence when an IE chooses an overseas advisor.

Demonstrating challenge

The FCA expects to see challenges from all involved parties in the report, including evidence of any challenges made by applicants of the IE. It is also expected that the IE will engage with the FCA or PRA approved persons of sufficient seniority at the applicant firms at all stages of the process.

Review of the communications strategy

Applicants should recognise that the requirement to notify policyholders and advertise the Scheme is a fundamental protection within the Part VII transfer process.

It is imperative that policyholders are given the opportunity to fully consider the Scheme and any possible impacts on them, and to make notifications of their views to the Court. The IE should include details of the communications strategy in the Scheme Report. The IE should also challenge any communications that are not clear and fair, and do not explain the impact of the transfer to policyholders.

Key considerations for the FCA when reviewing the communications strategy include:

- The definition of the policyholder
- Demonstrating, subject to dispensation applications, that all reasonable effort to identify, trace and contact policyholders has been made
- Content of communications

- Individual notifications
- Including sufficient information with sufficient prominence
- Document translation
- The need for further communications before the Sanctions Hearing
- Deficiencies in notifications

Content of communications

All communications from applicants must be clear, fair and not misleading, to allow policyholders to make informed opinions, and they must direct policyholders to further material where appropriate.

Including information

The covering letter should provide an overview of the transfer and the Court process, and advise policyholders as to which documents to read and how to make their views heard or get their questions answered.

Attachments should include any material changes or risks that could be relevant. Policyholders should not have to read the full IE Scheme Report to assess any potential risks to their policies.

Other documents that should be sent to policyholders include: the IE Scheme Report summary; supporting documents such as an FAQ to give policyholders further details; summary of the Scheme terms; and a description of the effect of the main provisions.

Need for further communications

The FCA now expects a Supplementary IE Report to be produced on all transfers, whether or not there have been any changes. It should reiterate the main points of the original report as well as confirming or updating the conclusions.

Policyholders must be given sufficient time, at least two weeks, to review the Supplementary IE Report prior to the Sanctions Hearing.

The publication of the Supplementary IE Report at least two weeks ahead of the Sanctions Hearing, whilst beneficial to policyholders, introduces other complications. It is noted that any further policyholder objections or representations should continue to be monitored and considered by the IE up to the Sanctions Hearing. We are aware of instances where the IE has written a supplementary letter to the Court (at the FCA's request) to assert that the IE did not consider any new or material issues to have been raised since the finalisation of the report.

Applicants are required to report to the Court and the Regulators on how they have complied with the Directions Order or, where they have not been able to comply, what steps they have taken to resolve the issues.

The FCA expects applicants to analyse any returned notifications against their estimates. If the number of returns is significantly higher than expected this needs to be investigated, and may show more systemic issues.

Applicants aware that they may have a significant number of 'gone aways' within their portfolios can mitigate any potential future obstacles in the transfer process by starting a tracing exercise early on in the Part VII transfer process.

Applications for dispensations from the Transfer Regulations

Where applicants are unable or unwilling to notify all policyholders, the FCA will judge whether to raise an objection to an application for dispensation from the Transfer Regulations.

The following criteria will be used by the FCA to make a judgement:

- General arguments to support limited notification
- The Aviva judgement
- Impossibility
- Practicality
- Proportionality
- Utility
- Availability of other information channels
- Notification of non-policyholders and reinsurers

The Aviva judgement

The FCA sets out its view on the judgement of Norris J (the Aviva judgement), given that it is often used as a starting point for dispensations:

- Where it is impossible to contact a policyholder, for example if contact information is lost
- Where it is not practical to contact policyholders, which may include instances where policyholder contact information is available but it is not practical to use those details to notify policyholders
- Considering how useful the information will be to policyholders
- The proportionality of the communication cost versus the level of interest to the policyholders
- The availability of other information channels, for example email, website or advertising more broadly than the Transfer Regulations require.

The FCA will challenge applicants' proposals where requests for dispensations are not supported with sufficient evidence or argument.

How Milliman can help

Milliman is a market leader in the provision of Independent Expert services for insurance business transfers. Milliman consultants have acted as Independent Expert for a large number of transfers over many years for small and large insurers and friendly societies, and we have a supporting team of consultants who have a track record of delivering these complex and lengthy projects with a high level of quality, and who keep up-to-date with emerging regulations and best practice for such assignments.

If you have any questions or comments on this paper or any other aspect of insurance business transfers, please contact any of the consultants listed below or your usual Milliman consultant.



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