

# FCA guidance consultation on Part VII Insurance Business Transfers

On 15 May 2017, the Financial Conduct Authority ("FCA") issued [GC17/5 - a consultation on new guidance regarding its approach to the review of insurance business transfers](#) pursuant to Part VII of the Financial Services and Markets Act 2000 ("FSMA"). The FCA is seeking feedback by 15 August 2017.

Significantly, the FCA intends to apply its guidance on a "comply or explain basis" akin to the approach used by the European Supervisory Authorities ("ESAs") to implement Level 3 guidance. The FCA does not have the same legal remit as the ESAs to enforce compliance or explanation, but has made it clear that any divergence from the guidance will require explanation, possibly also to the Court. Therefore, firms wishing to avoid additional costs and delays on a Part VII (which could result if the FCA's expectations are not met) should take note of this guidance. [The FCA's key expectations are set out in the annex of this note.](#)

## Context

To appreciate the significance of the guidance, it is necessary to understand the FCA's Part VII remit. The FCA does not take the lead on managing the Part VII process – this is the responsibility of the PRA who actively engage in the Part VII process in a number of areas, including approving the appointment

of the Independent Expert ("IE"), approving notices, issuing the necessary certificates and corresponding with the overseas regulators. Under FSMA, the PRA must consult with the FCA at all stages of the Part VII process and both regulators must provide reports to the Court and can (and often do) attend Court hearings.

## Key points

- The FCA's draft guidance is helpful in light of the increasing number of Part VII transfers that the FCA will consider in coming months.
- The proposed guidance is detailed but practical. Any firm considering, or in the process of a Part VII, is advised to consider the full text of the guidance consultation.
- Applicants may be expected to explain any divergence from the FCA guidance; therefore firms should review the guidance consultation and provide comments for the consultation in anticipation of future Part VII's.
- The guidance supplements the FCA's Principles for Business and [SUP 18 in the FCA Handbook](#). The FCA guidance must be read in conjunction with [the PRA's Approach document on Part VII transfers](#).

## Consumer protection focus

Although the FCA's remit appears relatively limited when compared to the PRA, the amount of guidance issued suggests that the FCA is keen to reinforce its consumer protection objective with respect to Part VII – an approach consistent with the FCA's priorities as outlined in its [2017-8 Business Plan](#). Although the FCA points out that it and the PRA have distinct objectives, there is very clearly an overlap with respect to policyholder protection. The timing of this guidance is also significant – it follows the publication on 20 March 2017 of [the PRA Independent Evaluation Office report on the PRA's approach to its policyholder protection duties](#). That report recommended that the PRA should articulate more fully its strategy and approach to its insurance objective. Given that both

regulators are eager to be seen to do more on policyholder protection, firms should expect more regulatory challenge in this area, including during the Part VII process. However, it remains to be seen as to whether the PRA and FCA can work effectively together to ensure these interests are pursued without placing unduly onerous requirements or expectations on firms for whom a timely Part VII transfer is business critical.

## Framework of Part VII rules

The draft guidance is intended to be read alongside existing chapter SUP 18 in the FCA's Handbook and the PRA's April 2015 statement of policy setting out its approach to insurance business transfers.

Once this FCA consultation is over and the guidance is published in final

form, we expect the PRA to start to give some thought about revising its 2015 statement of policy. We would also expect the PRA to more clearly articulate how it will seek to protect policyholders whose policies are subject to a Part VII.

## Overview

Much of the guidance is helpful. However, the ever increasing number of "expectations" means that firms (and their lawyers) should be prepared for increasing regulatory challenge and they must be able to robustly explain any divergence from the guidance where it is relevant to a particular Part VII transfer.

The guidance is split into the following sections:

- Chapter 2: sets out initial considerations for firms prior to contacting the FCA and what they will need to produce for any pre-application meeting;
- Chapter 3: details the documents that the FCA expects to receive and consider regarding the nomination and approval of the IE;
- Chapter 4: sets out the FCA's overall approach, expectations and key considerations when reviewing the proposed transfer;
- Chapters 5 to 7: provide detailed information and examples of the key documentation, including the scheme document, the IE's report and the communications strategy; and
- Chapter 8: sets out examples and factors for applicants to consider if firms proposing a Part VII transfer intend to make any applications for dispensations from the requirements in the Financial Services and Markets Act 2000 (Control of Business

## When are Part VIIs used?

- In certain circumstances in which policies are transferred from one insurer to another, a Part VII transfer will be mandatory. Part VII transfers should be viewed as flexible tools that can be used to achieve a variety of goals, including:
  - Selling an insurance business to a third party
  - Exiting legacy or non-core business
  - Effecting an intra group transfer
  - Restructuring insurance funds
  - Effecting a demutualisation
  - Achieving finality on a book of business in run-off
  - Conversion of with profits policies to non profits benefits
- The benefits a Part VII transfer can offer include:
  - Better capital management and improved solvency
  - Minimise financial and regulatory reporting
  - Operational costs saving and efficiencies
  - Tax advantages
  - Streamlining the corporate structure

Transfers) (Requirements on Applicants) Regulations 2001 (SI 2001/3625) ("**Business Transfer Regulations**").

**The detailed expectations and some commentary are set out in the annex to this note.**

### Next steps

The consultation closes on 15 August 2017 and the FCA intends to issue finalised guidance in Autumn 2017.

The FCA has clearly indicated that the guidance applies on a "comply or explain" basis, with an expectation that any divergence will be flagged to the Court. The implications of such an approach will, undoubtedly, have significant implications for firms undertaking a Part VII, or considering a Part VII in the run up to Brexit. For these reasons, we encourage the industry to respond to the consultation.

## How can we help?

- Part VII transfers have become increasingly popular in the last few years as insurers have sought solutions to a number of challenges and as the industry continues to consolidate. We are also seeing Part VII transfers becoming a significant consideration in Brexit planning.
- Clifford Chance is recognised as a market leader in the corporate insurance sphere and has acted on a number of complex Part VII transfers.
- If you would like to discuss the impact of the guidance further or would like assistance in preparing a response to the consultation on your behalf, please feel free to get in touch – contact details are listed at the back of this briefing.

## Annex

The FCA's key expectations are set out below:-

### Initial considerations

Firms contemplating a Part VII transfer should contact both the PRA and FCA as early as possible. This will allow the regulators to agree a timetable and allocate resources accordingly.

The FCA will have an "active role in the process" but it is clear, as confirmed in the [Memorandum of Understanding between the FCA and PRA](#), that the PRA will lead the Part VII process. Therefore, keeping the PRA onside is critical to the successful and timely completion of a Part VII. However, the FCA could disrupt the process if their expectations are not met.

A minimum of 6 – 8 weeks will be required by the FCA to review documents, so the FCA may need longer than the 6 weeks currently required by the PRA (even though the PRA have a wider remit to review). This may be because the FCA has a smaller Part VII team than the PRA. To ensure that delays are minimised, timely submission to the regulators is essential and it is good practice to include a 'delay buffer' into transfer timetables to ensure that hearings are not rescheduled at short notice.

### Appointment of the IE

The PRA remains responsible for approving and nominating the IE, but it is required to consult the FCA before doing so. The FCA will consider the IE's independence and whether the IE has sufficient skill, experience and resources. In

particular, the FCA will consider factors including (but not limited to):

- how many insurance business transfers the IE or their employer has reviewed for the applicant and how recently;
- any work the IE has done for the applicant (e.g. auditing);
- any connections between the IE and the applicant;
- conflicts of interest;
- any non-standard fee arrangements (i.e. are the fees too low? Are the fees capped?);
- specific examples of relevant experience, especially potential conduct risk issues from a particular transaction;
- statements that the IE will be able to allocate sufficient resources, including as part of a wider team, to consider all relevant conduct issues adequately and assess their materiality, collect relevant information, complete the IE report, and provide necessary updates in the agreed time frame. and
- performance on previous Part VII transfers.

Given the extent of the above considerations, it may become more difficult for firms to get regulatory approval for IEs (especially for complex transfers) where there are already a limited number of available and qualified IEs. To avoid protracted dispute on independence on an IE's nomination, firms should have an alternative candidate on standby.

### Overview of the FCA's approach

The FCA will consider and provide comments (to the applicants and the Court) on Part VII documents based on: (i) their objectives; (ii) the business rationale for the Part VII; (iii) background regulatory issues; (iv) competition considerations; (v) changes affecting Policyholders; (vi) ongoing regulatory requirements; (vii) objections; and (viii) any unresolved issues. Each of the factors is considered in greater detail in the guidance document, but points of particular note are:

- The FCA wants to consider the Part VII in context, and to understand the rationale behind the transfer, particularly if the Part VII relates to a proposed group restructuring, or forms one of multiple Part VIIs. In the current climate, we would expect this to extend to any Brexit-related reorganisations. In particular, firms will be expected to demonstrate that they have resources available for the Part VII and to consider whether business as usual services and service standards may be affected or whether any adverse impact on governance arrangements may arise as a result of an increased work-load.
- The FCA expects the applicants and the IE to demonstrate that the transfer will not cause material detriment to policyholders, and that they have adequately analysed the extent of any adverse impact. This would include an analysis of:
  - any proposed contractual protections or proposed

mitigants (e.g. financial compensation);

- how adverse effects are addressed in policyholder communications; and
- whether arguments regarding materiality or proportionality are sufficient.

- The FCA makes clear that it expects to file reports at Court, setting out its views or comments on the transfer, in order to help the Court in its consideration of the Scheme. Any issues not fully resolved in the report will be reported to the Court. A firm will generally want to avoid such a situation otherwise approval of the Part VII will be reliant on a robust legal defence at Court.

## The scheme document

The FCA notes that it has a particular interest in the following parts of the Scheme document and gives examples of provisions where it has raised concerns and how these have been resolved:

### Clarity on business and liabilities being transferred

- The FCA states that the language in the scheme document should leave no uncertainty about the possible liabilities being transferred. The business being transferred must be clearly defined and identifiable.
- The IE must be fully aware of the nature and extent of the transferring liabilities (including for example any mis-selling liabilities) and take account of these in their assessment of the scheme.

- The draft guidance specifies examples of circumstances where specific provisions must be included in the Scheme document. There is a risk that in providing these examples, applicants might include the examples in the Scheme with the risk of adding complexity to the Scheme.

### Continuity of proceedings

- The FCA expects to see a standard clause included in the Scheme document that proceedings which are in train, pending, threatened or in contemplation will continue against the Transferee.

### Changes to the Scheme

- The FCA expects to be notified where changes are made to the Scheme that may require Court approval. The FCA asks to be given “ideally 28 days” to object, although this time frame is not found in statute.
- Upon notification, the FCA will consider whether the change is minor or technical, or is ‘required’ by a law or regulation which allows no discretion as to how it is effected. In these instances the FCA will consider whether it is likely to have had any impact on a policyholder’s decision of whether or not to object to the Scheme, had they been informed at the time the FCA were considering the Scheme. The FCA will raise objections if it is not satisfied.

### Changes to the ‘effective date’ of the Scheme

- The FCA expects that changes to

the effective date of the Scheme clauses should only be used in “exceptional circumstances and only after all other options have been explored”.

## Review of the form of the IE's report

The FCA will review the IE report from the perspective of the policyholder (so far as possible). The draft guidance states that the FCA’s review will not be limited to a high-level check of whether the report covers the appropriate topics, but that it also aims to ensure that there has been sufficiently detailed analysis and challenge of the applicants’ position to allow the FCA to be satisfied that it would be appropriate for the Court to rely on the conclusions made by the IE.

The FCA considers that IE reports often lack detailed analysis, critical review or reasoning to support the conclusion that there is likely to be no material adverse effect of policyholder groups. Accordingly the FCA sets out its requirements of the IE report (e.g. comparison of reasonable benefit expectations, type and level of service and management, administration and governance arrangements) which will significantly increase the burden on the IE and will no doubt have cost implications on producing the report.

## Review of the communications strategy

The FCA expects IEs to include consideration of the proposed communications strategy and any supporting requests for dispensations from the Business Transfer Regulations in their report. The FCA now also expects to see evidence that

the IE has challenged proposed communications that are not clear and fair and do not adequately explain the transfer and the potential impacts on policyholders and how these have been addressed.

The draft guidance notes that the communications form a large part of the FCA's overall conduct consideration and accordingly the FCA sets out its expectations relating to a number of key topics including:

#### The definition of "policyholder"

- The FCA considers the FSMA definition too broad, but welcomes applicants using dispensations to take a different view to the definition.

#### Identifying and tracing policyholders and other relevant persons

- The FCA expects that applicants should be able to confirm and demonstrate, subject to dispensation applications, that they have made all reasonable efforts to identify, trace and contact policyholders and other relevant persons.

#### Content of communications

- The FCA is interested to ensure that applicants' communications (including the formal Legal Notice required by the Business Transfer Regulations, the individual policyholder communications, website material and any advertising) are clear, fair and not misleading.

#### Individual notifications

- The FCA's review of the notifications will include the tone,

content, clarity and conciseness of the literature.

- The FCA expects policyholder notifications to be transparent, balanced and not misleading.

#### Including sufficient information with sufficient prominence

- The draft guidance requires all the communications give prominence to any aspect of the applicants service which may be changing or where there are particular risks to policyholders as a result of the transfer.

#### Document translation

- The FCA expects, as a minimum, that individual notifications and attachments should be in the appropriate language for their audience.

#### The need for further communications before the Sanctions Hearing

- The FCA expects a Supplementary Report to be produced on all transfers, whether or not there are any changes to the Scheme or to the IE's conclusions.
- The Supplementary Report should reiterate the main points of the original IE report as well as confirming or updating the IE's conclusions.

#### Deficiencies in notifications

- If the FCA considers the number of returned notifications is significantly higher than anticipated, then this may reveal more systemic issues with the notification process.

- These issues may be grounds for the FCA to request that the Sanctions Hearing is postponed and request that a re-notification exercise is undertaken.

## Applications for dispensation for the Business Transfer Regulations

The FCA recognises that there will be occasions where applicants are unable or unwilling to notify everyone who falls under the definition of policyholder. In practice, every Part VII is subject to some form of dispensation request. The draft guidance sets out how the FCA will judge whether to object to an application to the Court for dispensation from the Business Transfer Regulations.

The draft guidance notes that where applicants seek dispensation on the basis of the costs of notification or advertising, the FCA will expect to see reasonable estimates of the costs of notification and will challenge applicants if the FCA believes that applicants have not shown enough effort to estimate these costs.

*Re Aviva International Insurance Limited* [2011] EWHC 1901 (Ch.) is often used as the starting point for dispensations and the FCA notes that it will challenge applicants' proposals where they have not taken into account the factors set out in the judgment, namely:

- the ability to contact policyholders;
- the practicality of contacting policyholder;
- how useful the information would

be to policyholders;

- the cost to the firm of contacting policyholders and whether it is proportionate; and
- the availability of other information channels to publish notifications more widely than the Business Transfer Regulations require.

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