COURT OF APPEAL DELIVERS BOOST TO PART VII TRANSFERS

Court's decision in Rothesay/Prudential transfer provides insurers with much-needed clarity

By James Cashier (Senior Associate)

The High Court's refusal to sanction the Part VII transfer of a large annuities book from Prudential to Rothesay last year gave rise to significant questions about the execution risk of Part VII insurance business transfers, particularly in the life sector.

In a move that will be welcomed by the sector, the Court of Appeal has overturned the decision and, at the same time, provided much-needed clarity in a robust judgment that was issued last week.

Finding the High Court had ruled incorrectly on the vast majority of the substantive points raised, the Court of Appeal delivered an excellent result not just for Prudential and Rothesay but also for the wider market and for annuities and closed life book insurers in particular.

The High Court's refusal in this case to sanction a scheme that had been endorsed by the independent expert and the regulators was unprecedented. It posed questions as to the scope of judicial discretion and the extent to which the court could conclude differently from the independent expert and the regulators. The High Court decision caused particular concerns for transfers involving more recent entrants to the run-off sector, particularly closed life, as the court's reasoning seemed to be weighted against transfers to more recently established insurers.

Clarification

The Court of Appeal judgment not only addresses these concerns but also provides helpful clarification of the Court's role that will assist Part VII transfer processes in the years to come. The judgment makes four important points:

The court will not simply "rubber stamp" Part VII transfers but there are limits to how it should apply its discretion. The court will test the conclusions presented to it by the independent expert and the regulators but should give "full weight" to their opinions unless there are "significant and appropriate" reasons to determine otherwise.

This means although the court can take into account factors that have not been considered by the independent expert or the regulators, in practice, it should not opine on matters beyond its competency or without supporting evidence from an expert. The court should be particularly cautious when approaching actuarial matters and should give full weight to Solvency II risk and capital assessments when considering questions of policyholder security. The same principle applies to service standards and corporate governance assessments undertaken by experts.

The subjective views of policyholders should not be given material weight by the court. An objective view is required and, when considering questions of policyholder security, the conclusions of the independent expert in their report are key. Policyholders who raised objections about Rothesay's reputation compared to Prudential or who believed Prudential should be the insurer for the full term of their annuity were largely dismissed on this basis.

The court must look at the facts and circumstances of each transfer and determine what is relevant to its assessment of the transfer accordingly. For example, although a particular group of policyholders may be materially adversely affected by the transfer, this does not always mean the court should refuse to sanction a transfer if the facts and circumstances demonstrate this would be an unfair outcome looking at the transfer in the round (for example, in a resolution scenario or where there are competing policyholder interests).

Rothesay and Prudential still need to return to the High Court next year to obtain the order to sanction the scheme but the Court of Appeal's judgment will greatly assist them and will also provide some much-needed certainty to the wider market.

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