HYMANS ROBERTSON

Newsflash

Rothesay and Prudential Part VII transfer and industry next steps

The Rothesay and Prudential Part VII transfer

On 16 August 2019, sanctioning of the proposed transfer of c.370k annuity policies from the Prudential Assurance Company Limited ("Prudential" or "PAC") to Rothesay Life Plc ("Rothesay") was declined. The regulators and Independent Expert had no objections to the Scheme. The judge provided a number of reasons for not approving the transfer:

1. The age and reputation of Rothesay was not as strong as Prudential;
2. Policyholders may have reasonably assumed that Prudential would not transfer the policies to another provider;
3. As the policies being transferred were annuities, policyholders could not change to another provider from Rothesay if they wished to;
4. Although the firms had similar solvency metrics, Rothesay had a different capital management approach to Prudential; and
5. Different levels of external support were available to Rothesay compared to Prudential.

On 2 December 2020 Rothesay and Prudential successfully appealed the judge's decision.

On the first three issues, the Court of Appeal stated:

> *"the judge ought not to have accorded any weight to the facts that the objecting policyholders (a) chose PAC on the basis of its age, venerability and established reputation, and (b) reasonably assumed that PAC would provide their annuity throughout its lengthy term"*[1]

The Court of Appeal felt that this was not a material consideration. It stated that the key consideration in a Part VII transfer is whether policyholders will be materially adversely affected by the transfer.

On the fourth issue, the Court of Appeal stated:

> *"the judge had been wrong to think that the independent expert and the Prudential Regulation Authority were not justified in looking at the solvency metrics at a specific date to support their opinion that there was only a remote chance of parental support being needed in the future"*[1]

It went on to note that the Independent Expert and regulators had considered Rothesay's solvency metrics over the coming year and, given that it would continue to be regulated under the same solvency rules in future years, this was a valid basis for considering Rothesay's future security.

On the fifth issue, the Court of Appeal stated:

> *"The judge had been wrong to find that there was a material disparity between the non-contractual external financial support potentially available for each of PAC and Rothesay… The judge had not accorded adequate weight to the conclusions of the independent expert that the risk of PAC or Rothesay needing external support in the future was remote."*[1]

The Court of Appeal went on to note that the likelihood of non-contractual support being available in the future was not a relevant factor to be considered and that parent companies could never be required to support their subsidiaries' capital.

[1] https://www.judiciary.uk/wp-content/uploads/2020/12/Prudential-Judgment-Summary.pdf

How have Independent Experts responded to the original ruling?

The judge's original ruling on the Rothesay and Prudential transfer prompted industry discussion about the future of Part VII transfers and whether Independent Experts would be required to consider additional areas in their reports.

A number of Independent Experts subsequently considered the Rothesay and Prudential ruling in their reports – for example in the transfers from Equitable Life to Utmost, from Canada Life to Scottish Friendly and from Rothesay to Monument Re.

The Independent Expert for the Canada Life and Scottish Friendly transfer reviewed the key factors of the judge's ruling and considered their relevance in his supplementary report. His considerations included the following:

- While he believed age, reputation and brand strength are a proxy measure for financial strength he considered Canada Life and Scottish Friendly to be comparable on this front.
- Scottish Friendly (like Rothesay) was not part of a large group like Canada Life (and Prudential). However, he stressed that there generally is no obligation for a group to provide additional capital to other firms in the group and therefore that limited weight should be placed on this factor.
- The nature of the transferring business was different to the Rothesay and Prudential transfer. He noted that the majority of policyholders were not annuitants and could therefore change provider as required.

The Independent Expert for the Rothesay to Monument Re transfer also included considerations in his report:

- That the transferring policyholders were not originally policyholders of Rothesay, pointing out that the business had already transferred once.
- That it is more appropriate to consider the capital and capital management policies within the respective companies than the degree of capital support from a parent company given that the necessity of such an event was unlikely.
- The objectives of the proposed transfer cannot be met simply by the existing reinsurance arrangement.

What does this mean for the future of Part VII transfers?

The judge's decision to not approve the Rothesay and Prudential transfer in 2019 was unprecedented. However, it signalled to the industry and policyholders that the court approval process of a Part VII transfer is not a formality and that the court can and will challenge the views of both the Independent Expert and the regulators. This is important as it ensures appropriate levels of scrutiny of a potential transfer and, ultimately, provides policyholder comfort in the security of their benefits.

On the other hand, Rothesay and Prudential's successful appeal will also bring comfort to many in the insurance industry as it removes some uncertainty around the elements that need to be considered in approving Part VII transfers and puts the focus on the test that is required by the regulations – that there is no material adverse effect to policyholders. The Court of Appeal's verdict is also helpful in dispelling the inference that transferring policies who could not change to another provider if they wished to would need to meet some form of higher hurdle. This would have created issues for non-core blocks with product types that simply cannot be bought these days. This latest ruling helps to unlock future Part VII transfers involving such blocks of business.

However, going forward we expect some of the considerations covered in more detail by IEs recently (as set out above) to continue to feature in the assessment of material adverse effect – particularly in relation to the value that can realistically be ascribed to capital support in a group structure relative, say, to capital management policies etc.

If you would like to discuss anything mentioned in this newsflash, please do get in touch.

Nick Ford
Head of Transactions
Nick.Ford@hymans.co.uk

Kirsten Wilkie
Consultant
Kirsten.Wilkie@hymans.co.uk