SLAUGHTER AND MAY/
BRIEFING NOTE
AUGUST 2020
INSURANCE

Part VII transfer from LGAS to ReAssure

BACKGROUND

On 20 August, Zacaroli J sanctioned the transfer of the mature savings business from Legal and General Assurance Society Limited (LGAS) to ReAssure Limited (ReAssure) under Part VII of the Financial Services and Markets Act 2000. The business comprises approximately 900,000 policies and assets valued at approximately £30 billion, making it one of the largest Part VII transfers ever undertaken.

The sanction hearing was originally scheduled for March 2020, but was adjourned at the last minute while the parties assessed the impact of the COVID-19 pandemic. The hearing subsequently went ahead remotely over Skype on 13 and 14 August 2020, with a number of policyholders and both the PRA and the FCA in attendance.

Slaughter and May acted for LGAS and Herbert Smith Freehills acted for ReAssure.

KEY ASPECTS OF THE JUDGMENT

The judgment given by Zacaroli J is a helpful summary of the various considerations the court will take into account when determining whether to sanction an insurance business transfer scheme. It touches on a number of points that are pertinent to all Part VII transfers and draws together some of the recent case law in this area. It is especially notable because of the way it distinguishes the particular facts of the recent *Prudential/Rothesay* transfer, which Snowden J declined to sanction in an important and unexpected decision last summer.

Rationale for sanction

Zacaroli J made clear that the balance to be struck is between the commercial interests of the transferor/transferee and the interests of the policyholders. Ultimately, he concluded that the balance came down in favour of LGAS and ReAssure. It should not be fatal to a scheme that it promotes the commercial self-interest of the parties, provided that is not outweighed by policyholder detriment. In this case, Zacaroli J was satisfied that there are sound commercial benefits in the consolidation of the transferring business in ReAssure, which specialises in the run-off of closed books of business, and that the motivation of LGAS (namely, strategic re-organisation) was within the proper purpose of the legislation. This is an important distinction from the *Prudential/Rothesay* transfer, where the primary motivation for the transfer (namely, regulatory capital benefits) was

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considered to be satisfied in large part by the reinsurance arrangements that were already in place.

Distinction from *Prudential/Rothesay*

The decision of Snowden J in the *Prudential/Rothesay* transfer in August 2019 sent shockwaves through the industry, particularly for firms specialising in closed books of long-term business. Zacaroli J helpfully made clear that Snowden J's conclusions do not constitute binding precedent and that no two cases are the same. This will likely lead to a re-liberalisation of the Part VII market, provided applicants are able to distinguish their own transfers sufficiently from the particular facts of the *Prudential/Rothesay* transfer.

One of the most important distinctions highlighted by the applicants was that, although the transferring business includes annuities, they constitute less than 1% of the total number of policies being transferred. Moreover, the majority are with-profits annuities (rather than fixed annuities), which stood to benefit from the scheme as a result of provisions designed to address the problems of a diminishing fund.

The second major difference submitted by the applicants and accepted by Zacaroli J was the business objective of the transfer (as noted above). It is therefore important for applicants to be clear on the commercial rationale for transfers and consider whether the same outcome can be achieved through other means, particularly where a transfer could result in policyholder detriment.

The third key difference related to the question of likelihood of parental support. Zacaroli J distinguished between the <u>ability</u> to obtain parental support and the <u>incentive</u> for parental support. On the first point, he took comfort from the fact that ReAssure is part of a substantial and well-capitalised group and would continue to be so following its sale from Swiss Re to Phoenix. Nevertheless, he recognised that firms like ReAssure, and by analogy, Rothesay, are particularly dependent on retaining existing policyholders because they operate closed businesses and are incapable of attracting new customers. The incentive to protect policyholders through the provision of parental support is therefore a similar level to the transferor. It is also worth noting that parental support is likely to become more of a concern where transferring policyholders are tied in for a long time (such as annuitants).

Policyholder protections

A number of objections related to the lack of representation for policyholders and disproportionate "firepower" available to the applicants. Ensuring that policyholders are adequately protected is one of the most important points for the court to consider when exercising its discretion, taking into account not just the impact of the scheme on policyholders, but also the process leading up to sanction. In his judgment, Zacaroli J set out a reminder of the safeguards for policyholders that are built into the Part VII process and devoted a considerable portion to dealing with objections raised by policyholders.

Zacaroli J reiterated the important and special role played by the independent expert in Part VII transfers. He rejected suggestions that being paid by the companies or working on previous Part VII transfers could undermine the expert's independence or the integrity of the process, emphasising the difference between working "with" companies and working "for" companies. Notwithstanding the thorough investigations undertaken by the independent expert on this transfer, Zacaroli J also emphasised the vital role played by the court in ensuring that the interests of policyholders are protected. At various points throughout the hearings, he required additional papers to be submitted to explain how the expert had arrived at certain conclusions and so that the court could be satisfied that his conclusions are soundly based. This underlines the point made by Briggs J in *Re Pearl Assurance (Unit Linked Pensions) Limited* that the exercise of the court's discretion is in no way a rubber stamp.

Use of section 112(1)(d) ancillary orders

Section 112(1)(d) orders are used for matters that are incidental, consequential or supplementary to the scheme and must only be made where necessary to secure that the scheme is fully and effectively carried out. Some

doubt was cast on the extent of the scope of these ancillary orders by Snowden J in the Brexit-related Barclays banking business transfer, where he concluded that it was not appropriate to order the transfer of all of the business of a related Barclays entity that did not accept deposits (and therefore did not fall fully within the scope of Part VII).

In the present case, LGAS was seeking to transfer all of its SIPP business, which includes elements of non-insurance business, and its stakeholder pensions to ReAssure. Zacaroli J accepted the applicants' submissions that, while the transfer of the non-insurance elements of the SIPP business could be effected outside the scheme, the arrangements were clearly incidental to the relationship between the policyholders and LGAS and their transfer was necessary to achieve the purpose of the scheme and to avoid confusion among policyholders, who could otherwise be left with two different providers. He also concluded that the transfer of the stakeholder pensions clearly fell within the ambit of section 112(1)(d) because securing the same tax treatment for members is essential to the effective transfer of the policies.

Sunset clauses

Zacaroli J also considered the application of certain "sunset" clauses, which are increasingly common in transfers of with-profits business. In this scheme, they provide for the merger of the transferring LGAS with-profits fund with existing ReAssure funds and the conversion of with-profits policies into non-profit policies once the value of the fund falls below certain thresholds. He concluded that it was appropriate to permit these modifications to the rights of policyholders because the provisions activate in only limited circumstances and are designed for the benefit of policyholders, with multiple safeguards included.

CONCLUSION

This was a significant and complex transfer, made particularly difficult by the COVID-19 pandemic, which hit just as the parties were preparing for sanction. The judgment addresses issues that often arise not just in life transfers, but insurance and banking transfers generally. As such, it is a helpful guide to the points that should be considered by applicants in future schemes. Most importantly, it has clearly distinguished the *Prudential/Rothesay* decision, which had created considerable uncertainty in the industry and arguably confines it to its specific facts.

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