High Court approves Part VII transfer of £12bn annuity business from the Pru to Rothesay, second time round (Prudential Assurance Company Ltd and In the Matter of Rothesay Life plc)

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Insurance & Reinsurance analysis: It was approximately three years ago when the Prudential Assurance Company (PAC) first embarked on its application to the High Court for sanction of a Part VII FSMA insurance business scheme. PAC wished to transfer a substantial portfolio of its long-term insurance products (some 370,000 odd annuity policies) to Rothesay Life plc (Rothesay) for the commercially-motivated purpose of achieving a regulatory capital release. Following a directions hearing at first instance in early 2019, PAC and Rothesay's application came before Mr Justice Snowden in the summer of 2019. Several policyholders (about 15%) had objected to the proposed scheme and several made written and/or oral representations at court. For the first time in history, the High Court refused to sanction the Part VII transfer. In November 2020, the Court of Appeal allowed PAC and Rothesay's appeal and remitted the case to the High Court for a renewed sanctions hearing. In November 2021, Mr Justice Trower considered the proposed scheme and concluded that, in all the circumstances of the case, it was a scheme that he should sanction. Written by Charlotte Eborall, barrister at 3 Verulam Buildings.

Prudential Assurance Company Ltd and In the Matter of Rothesay Life plc [2021] EWHC 3152 (Ch)

Charlotte Eborall of 3VB chambers in London comments on the most recent High Court decision approving the Part VII transfer and the earlier judgments leading to that decision

Background to the application and the original hearing

The 'venerable' PAC, first established in 1848 and part of the Prudential group (referred to in common parlance as 'the Pru') resolved, before 2019, to develop its business in Asia and, accordingly, to demerge so that it could service the mature UK market and growing Asian market separately.

Solvency II requirements obliged PAC to reduce the solvency capital requirement for its UK and European sector business. Accordingly, PAC entered into a Business Transfer Agreement and a Reinsurance Agreement with Rothesay covering about 400,000 retail and bulk annuity policies, with a best estimate of liabilities of about £12.9bn. The commercial and economic effect of these agreements was to transfer the risk and reward of that annuity business to Rothesay. PAC and Rothesay's proposed scheme would complete the exercise, by transferring legal title to Rothesay.

Rothesay was originally established in 2007 by The Goldman Sachs Group, Inc to conduct business as a specialist provider of annuities.

By the date of the renewed application before Trower J:

- the demerger had completed and PAC is now a key subsidiary in the M&G group in the UK and Europe, and
- Rothesay, its shares having been held by a large US private equity firm, Blackstone Group LP; a Singaporean sovereign wealth fund (GIC); and a subsidiary of the Massachusetts Mutual Life Insurance Company (MM), its shares are now held as to 49% each by GIC, MM with the remaining 2% held by an employee benefit trust

At first instance, Snowden J received a number of objections directly from holders of transferring annuities. Their objections ranged from irrelevant matters that the judge was able to dismiss; to matters that the judge considered, but which did not amount to a reason not to sanction the transfer; to other concerns, which the judge concluded were substantive. In short, Snowden J refused to sanction the scheme for two main reasons:

- Rothesay did not have the same capital management policies or the backing of a large well-resourced group with the reputational imperative to support if over the lifetime of the transferring annuity policies
- it had been reasonable, in the light of PAC's sales materials, age and reputation, for policyholders to have chosen PAC on the basis of an assumption that it would not seek to transfer their policies to a third party provider

The Court of Appeal's decision and the approach to the sanction of Part VII applications

The Court of Appeal examined the approach that the court should take to applications under Part VII at paras [75] to [86] of that judgment. In summary, that approach is as follows:

- first, the court should identify the nature of the business being transferred and the underlying circumstances giving rise to the Scheme because different considerations affect different types of business (paras [75] to [77])
- the discretion of the court is unfettered and genuine and not to be exercised by way of a rubber stamp
- nevertheless, the court must take into account and give proper weight to matters that ought to be considered and to ignore matters that ought not properly to be taken into account (para [78])
- the factors to be considered set out in *Re London Life Association Ltd* (21 February 1989, unreported) (Hoffmann J, as he then was) and *Re Axa Equity & Law Life Assurance Society plc* [2001] 1 All ER (Comm) 1010 (Evans-Lombe J, as he then was) were addressed to the particular circumstances of those transfers, which concerned with-profits business—other transfers (such as PAC's annuity transfer) were altogether simpler than in those cases (para [79])
- the paramount concern in a case such as the instant one will be to assess material adverse effect on payment of the annuities and on service standards
- the first duty of the court is carefully to scrutinise the reports of the independent expert and the regulators to understand them, question them as necessary and identify any errors, omissions, or instances or inadequate or defective reasoning (paras [80] to [81])
- in the absence of such defects, the court will always accord full weight to the opinions of the independent expert and the regulators. This does not mean that the court can never depart from them, but there must be significant and appropriate reasons for doing so (para [82])
- an adverse effect is only material if it is:
    - a possibility that cannot sensibly be ignored having regard to the nature and gravity of the feared harm
    - a consequence of the scheme, and
    - material in the sense that there is the prospect of real or significant, as opposed to fanciful or insignificant, risk (para [83])
- a court may still sanction a scheme even if there is material adverse effect, for example, in a rescue situation (para [84])
- after this evaluative exercise, the court will decide whether in all the circumstances, it is appropriate to sanction the scheme (para [86])

The Court of Appeal concluded that Snowden J had erred in the following respects:

- the judge 'took a wrong turn' and was not justified in dismissing the independent expert's view that there was, in essence, no disparity between the financial strength of PAC and Rothesay (paras [90], [99] and [102]); prudential assessment under the regulatory solvency rules involves consideration of the future and is not limited to one year (para [100])
- the likelihood of non-contractual parental support was also not a relevant factor (paras [103] to [106])
- the judge failed to give adequate weight to the independent expert's view that the risk of PAC or Rothesay needing external support was remote (para [107])
- the judge did not give adequate weight to the non-objection of the regulators (para [109])
- subjective factors relied upon by the policyholders (such as the age and venerability of the Pru and that they reasonably assumed that Pru would be their annuity provider for life) are not relevant to the exercise of the court's discretion (paras [119] and [121])

Accordingly, the Court of Appeal remitted the matter to a judge in the High Court for a renewed sanction hearing.

The sanctions hearing before Trower J

Following the Court of Appeal's judgment, additional evidence was filed in respect of the remitted sanction hearing, updating the Court of the current position (including the changes to the applicants' corporate structures noted above).

After identifying that the technical aspects of the application had been satisfied (paras [12] to [21]) and setting out the Court of Appeal's approach to the exercise of the court's discretion in Part VII transfers (paras [22] to [24] and [30] to [33]), Trower J considered the following aspects of the scheme.

Status of the independent expert report

First, (at para [42]), the judge reiterated the observations of Pumfrey J in *In re Eagle Star Insurance Company Ltd* [2006] EWHC 1850 (Ch) (*Re Eagle Star*) at para [13] that:

> 'The foregoing considerations demonstrate that although the independent expert's report shares certain features of experts' reports prepared for the purpose of inter partes litigation, that is not its real nature. It is intended to be, and the FSA takes care to ensure that it is, an objective assessment of the scheme by a person to whom the importance of retaining their independence and objectivity has been repeatedly emphasised.'

The judge noted that full weight must be given to the expert report, but, as the court was not a rubber stamp, he was required to delve deeper into the expert's conclusions and reasoning. The judge therefore analysed the independent expert's analysis of policyholders' reasonable expectations and service standards and security of benefits in the judgment (paras [50] to [58]).

Matching adjustment—a peacock's feathers?

One of the concerns raised by the policyholders who attended the renewed sanctions hearing was that, although both PAC and Rothesay had permission from the PRA to use an actuarial technique to value its long-term insurance liabilities using a discount rate, known as a 'matching adjustment', Rothesay used this for a much larger proportion of its business than PAC (paras [59] to [62]).

In their oral submissions, one policyholder described the matching adjustment as 'simply flattering the appearance in the way that a peacock's tail feathers make it look bigger, but it actually doesn't help the peacock to be fitter or stronger' (para [64]).

This point raised the following sub-issues:

1. *Entitlement to be heard on a Part VII transfer*

Two individuals (a former PRA employee (Dr Buckner) and an academic) attempted to be heard before the court to make their own representations concerning the matching adjustment. They claimed an interest on the tenuous basis that the effect of the scheme was that a call on the FSCS was more likely, leading to increased premiums for other insureds. The judge understandably gave this argument short shrift, agreeing with the applicants that FSMA did not entitle such persons to be heard on a Part VII transfer and there was an insufficient basis for asserting that they were entitled to participate (paras [68] to [71]).

2. *Right to adduce expert evidence*

To circumvent the fact that Dr Buckner was not entitled to make his own representations before the court, one policyholder submitted two reports of Dr Buckner, purporting to be expert reports.

The judge also regarded that as an unsatisfactory approach, citing again from *Re Eagle* Star, in which Pumfrey J explained that:

> 'Where it seems that the independent expert has identified the possible problems with a particular scheme and has, on what appear to be satisfactory grounds, rejected them, it seems to me that rather more than the normal requirement to give the opponent an opportunity to impugn the report is required before permitting that opponent either to see the independent expert's detailed workings or to instruct a further expert. It seems to me that there must be strong grounds for supposing that the independent expert has mistaken his function or made an error before a challenge to the report can be mounted.'

Dr Buckner's report did not identify an error of the type foreshadowed in *Re Eagle Star.* Nevertheless, in his discretion, the judge decided to hear from Dr Buckner because his points had been voiced as concerns by some of the objecting policyholders (para [75]).

3. *'root and branch' attack on the matching adjustment*

Having listened to Dr Buckner's criticisms of the nature of the matching adjustment (which Dr Buckner had made in other Part VII proceedings, and which had been described as a 'root and branch attack on matching adjustment' (para [76])), the judge concluded that:

- although there was academic debate about the appropriateness of applying matching adjustment in different contexts, there was nothing to suggest that this affected the applicants' respective financial positions (para [81])
- moreover, the Part VII proceedings were not a suitable vehicle for the question of whether the matching adjustment was flawed as a matter of principle (para [82]), a matter which was in any event, under review (paras [83] to [84])
- it was not for the court to apply anything other than the regulatory regime as it exists, or to go behind the legislation (para [87])

Other objections to the scheme

The objecting policyholders (of which there were many in number (some 1,374, albeit few by proportion of the transferring business) only 0.5%) continued to object on grounds of the age and venerability of the Pru and the relative youth of Rothesay, which the Judge excluded as 'legally irrelevant' as made clear by the Court of Appeal (para [99]) and on the basis that they had specifically chosen PAC for life, which, as Trower J noted, the Court of Appeal had also stated must be excluded as a matter of principle (para [110]).

Other concerns regarding an apparently riskier asset base on Rothesay's part than PAC's, and the fact that Rothesay 'put all its eggs in one basket' by being solely an annuity provider (paras [11] and [114]) were also rejected by the judge, as they had no effect upon financial strength.

The oft-cited objection based on the lack of independence of the expert was also summarily dismissed (paras [116] to [118]).

The judge's conclusions

Having noted and given full weight to the non-objections from the two regulators, the judge therefore concluded that he was satisfied that, in all the circumstances of the case the scheme was one that he should sanction.

On 15 December 2021, the remaining 348,000 annuity policies in PAC will therefore transfer to Rothesay.

Comment

Trower J's decision carefully applies the Court of Appeal's ruling, distinguishing between those factors that the Court of Appeal regarded as relevant and legally irrelevant and steering a course through the many points, including those of a technical actuarial nature, that the policyholders (supported by non-policyholders) raised.

However, what the judge's meticulous application of the Court of Appeal's commercially focused decision proves is that, although what may be referred to as the 'fourth layer of protection' (the statutory right for objecting policyholders to make representations) still allows those voices to be heard, mere objections will not prevent a scheme from being sanctioned. Those objections must have substance—they must materially adversely affect (in broad terms) financial strength, reasonable expectations or service standards. On that basis, it is hard to see a case in which a person claiming to be adversely affected will alter the determined path sought by the companies, where the regulators and the independent expert have already pored over the scheme in the months (and sometimes, years) prior to the final sanction hearing. This does provide certainty for the applicants, in a jurisdiction where time and costs expended are heavily front-loaded, but judges must be careful (as Trower J was) to ensure that the court still opines on the robustness of those conclusions, and carefully considers the views of policyholders and interested persons with a right to be heard, to avoid the risk of being perceived as the 'rubber stamp' which the Court of Appeal has emphatically disavowed the court to be.

This is the end of the road for those disappointed annuitants who chose, and trusted, the Pru with their savings and who believed that they would be provided for by that insurance company with their fixed income for life. The inability to switch annuity providers means that, although PAC can transfer those policies to Rothesay, the policyholders are involuntarily bound to Rothesay without any comparable right of moving away from a company they did not choose and do not want.

On the other hand, one might regard this decision as only the beginning for insurers, providing clarity and reassurance to the industry of the relevant and irrelevant factors that the court will consider, and of the primacy of the views of the independent expert and the regulators. This is understood to be the largest annuity transfer to date, but it is unlikely to be the last.

Case details

- Court: Chancery Division (Companies Court)
- Judge: Mr Justice Trower
- Date of judgment: 24 November 2021

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