# TRANSFER OF LONG TERM INSURANCE BUSINESS

*by Robert Hildyard QC and Malcolm Davis-White*

Reports of the death of mutuality may be exaggerated; but the recent spate of reorganisations in the life insurance business has certainly injected new life into an old section, section 49 of the Insurance Companies Act 1982, pursuant to which transfers of long term business are effected.

Recent transfers have been of various shapes and sizes. Some have followed on directly from other reorganisations or takeovers (eg. the transfer of life business from Leeds Life to Halifax Life following the Leeds/Halifax merger). Others have been structured so as to attempt to achieve a merger of the assets of the two companies whilst at the same time preserving the identity, goodwill and policyholder expectations of the transferor company by maintaining a sub-fund and accounting separately for the performance of that fund (as was the intention in the case of the transfer of the business of London Life to Australian Mutual Provident Society). Most have involved the transfer of the entirety of the transferor's business. But some have involved the transfer of only specific parts of that business (eg. the transfer of Target Life's unit linked broker fund business to Providence Capitol). Some have reflected the difficulties of attracting new business and have been prompted by a need on the part of the transferor to combine with a stronger fund in order to ensure and enhance policyholder security (eg. the transfer from Providence Mutual Life to General Accident Life). Two at least have involved cross-border considerations outside the EEA (eg. the Eagle Star schemes and the transfer of the business of Confederation Life to Sun Life). One at least has involved the transfer of reinsurance business (the transfer of NRG Victory Reinsurance to Employers Re). All reflect major changes in the market.

This trend of consolidation in the life insurance business seems set to continue; and since both exposure to the court process and the impact of European legislation have revealed or given rise to a number of issues, this seems an opportune moment to reconsider the statutory procedure which enables such transfers.

Since the Life Assurance Companies Act 1870, and the spectacular failure of the Albert Life Assurance Company (after taking over more than twenty other societies) which gave rise to it, sanction of the court has been a pre-requisite to the transfer of life assurance business. As a result of the Third Insurance Life Directive, major changes have been made to the statutory framework regulating the transfer of long term insurance business.

The relevant section is still Section 49 of the Insurance Companies Act 1982 (as amended) ("the 1982 Act"); but the statutory framework has now overgrown a single section and commands a whole schedule (Schedule 2C) to which Section 49 simply refers. This expansion is the product of the pan-European aspects of insurance regulation. Other EEA states are given a role in the statutory procedure in cases where the policyholder was "habitually resident" in the relevant EEA state at the time that the policy was taken out. This, coupled with the absence of records contemporaneous with the inception/taking out of policies directly dealing with that issue, has greatly complicated the relevant considerations when preparing for a transfer of long term business.

A number of particular problems can arise when considering the terms of a scheme and the process required to be followed to obtain court sanction. We outline below the procedure for obtaining court sanction and the persons who will vet the scheme. We then go on to consider some of the problems which have arisen or seem likely to arise.

The starting point for the court is a petition seeking the court's sanction to a particular scheme transfer. This must be accompanied by an affidavit exhibiting the report of an independent actuary. Other substantive requirements that may need to be met prior to the petition being heard include the holding of a meeting of members of the transferring company; the obtaining of tax waivers and clearances; consultation with the DTI; consultation by the DTI with and non-opposition or consent from the regulatory authorities of one or more EEA states other than the United Kingdom; and specific consents in relation to transfers of particular assets.

On presentation of the petition a summons for directions is taken out for the primary purpose of considering the publicity requirements in relation to the proposed scheme. There are three aspects to publicity; first, the question of circulation of what is, in effect, an explanatory statement to policyholders; secondly, advertisement of the proposed scheme in newspapers; and finally, the determination of locations at which relevant documents should be made available for inspection. At the final hearing of the petition the court will need to be satisfied that various procedural and substantive requirements are met and will then go on to consider, in its discretion, whether or not the proposed scheme should be sanctioned.

A proposed scheme will be considered by a number of agencies. First, the 1982 Act itself provides that the petition must be accompanied by a report on the terms of the scheme by an independent actuary. The role of the independent actuary is to report on the proposed scheme paying particular attention to the 1982 Act and the professional guidance issued by the Institute of Actuaries. In practice, consideration will be given to the question of whether or not policyholders (with both the transferor and, if relevant, transferee, company) will be adversely affected by the scheme. This involves a comparison of their security and benefit expectations with and without the scheme. Depending upon the particular scheme, the independent actuary may also have to consider questions such as (in the case of a mutual) whether adequate compensation is being provided for loss of mutuality and whether or not any compensation is fairly apportioned amongst different categories of policyholder. A subject dear to every policyholder's heart, likely costs and charges, is an area that will also need careful consideration. So too, where unit-linked business is being transferred, will the question of "matching" linked funds. The independent actuary will not, however, usually have to consider possible alternative schemes, though he may suggest improvements to the scheme he is instructed to consider. The court gives particular weight to the views of the independent actuary. This is because of his independence and because the question of the effect of the scheme is largely an actuarial question. The practice has also developed (to the extent that it is now conventional) whereby there may be a report or reports from either or both of the appointed actuaries of the transferor and transferee companies. This can provide confidence to the relevant classes of policyholders that their particular interests have been considered separately by their company. However, such a practice can give rise to the conundrum that either the appointed actuaries' reports have any differences ironed out to achieve a conformity which can undermine their purpose; or alternatively such differences are allowed to stand, giving rise to the possibility of objectors seeking to say that one or the other is different and/or fails to address adequately issues addressed in another. The conventional may not always be appropriate.

Although the DTI is not required to report to the court the Secretary of State has standing to appear at the hearing and as the person responsible for regulating insurance companies and with access to a large amount of relevant information, his voice is one to which the court will attach great weight. If, as is frequently the case, the DTI considers that it is not necessary to address the court and that there are no objections to the scheme, the court will give weight to that implicit clean bill of health. This reflects the fact that the DTI will have been closely involved with the Government Actuaries Department in the preparation of the Scheme and the process leading to its presentation to the court for sanction. An early approach to the DTI and close cooperation throughout with both the DTI and the GAD is most advisable. The 1982 Act requires that the Secretary of State is served with relevant documentation, that the relevant authority certifies that the transferee company will possess the necessary margin of solvency after taking the proposed transfer into account and, in appropriate cases, that there is a certificate with regard to consultation with other EEA regulatory authorities.

Finally the court itself will consider the scheme. In so doing it will need to be satisfied that various procedural and substantive requirements are met. In then exercising its discretion in deciding whether to sanction the scheme the court will approach the matter as set out by Hoffmann J. in the *London Life Association Limited* case (21st February 1989, regrettably still unreported). Broadly speaking, the first consideration is whether or not a policyholder, employee or other person would be "adversely affected" in the sense that it appears likely that the scheme leaves him worse off than if there had been no scheme. However, the scheme will not necessarily be rejected because it does leave someone adversely affected. At the end of the day, the question is whether the scheme as a whole is fair as between the interests of the different classes of person affected. The court will give due recognition to the commercial judgment entrusted by the relevant company's constitution to its board. The court is not concerned with whether or not the scheme might be improved but whether, taken as a whole, the scheme before the court is unfair to any person or class of persons affected. The court is concerned with the Scheme that is presented to it for its approval and whether or not it is unfair; it is not concerned with the question of other schemes not before it (eg. for mergers with other companies) nor is it concerned with whether the Scheme as presented might be improved in certain respects were renegotiations to take place.

**The position of the board of the transferor company**

The board of the transferor company will throughout need to consider carefully the options open to the transferring company, the terms of any offer or offers presented to it and the alternatives (eg. continuing as a closed fund). Provided that the board is not actuated by improper motives and that the final scheme is, as a whole, not unfair the court will leave the question of the scheme to be propounded and its precise terms to the commercial judgment of the board. A board will need to take care that it at no time limits its right and duty to keep policyholders informed of alternative offers that are made and to provide them with proper advice. This does not mean that the board will necessarily be obliged to recommend acceptance of a higher offer or to propound a new scheme in the event that a higher offer emerges. The board will need to consider all the circumstances of the case and will be entitled to take account of "the bird in the hand" principle.

Topical considerations which may arise in the case of a mutual company whose directors are considering a transfer and resulting demutualisation are first, whether some special weight is to be given to the benefits of mutuality both as a concept (an end in itself) and in terms of there being no competing shareholder interest; secondly, and in that connection, what would be required in order to compensate members as ultimate owners of the business for the loss of those ownership rights and their entitlement to surplus; and thirdly, whether the directors have a duty beyond the current policyholders and employees to consider the future needs of their society and potential future members and customers. A "company" analysis purely in terms of the interests of the company as a whole does not take into account the special features of mutuality and may not be directly applicable. Nevertheless, the board is probably best regarded as being in each case required to maximise "value to the owners" and to consider and gauge alternatives by reference to this financial criterion. Thus, for example, in the absence of some express provision in a mutual's constitution enabling a broader view, it seems likely that any emotional, philosophical or historical attachment to the concept of mutuality can only be taken into account to the extent that mutuality is considered likely to promote "value to the owners" in economic terms.

**Meetings**

Consideration will have to be given to whether the memorandum of association of the transferor or transferee needs to be altered and whether a meeting needs to be called to deal with this. In the case of demutualisation, a general meeting may need to be called to deal with changes to the Articles of Association of the transferor. In addition, it may be that the terms of the transferor's constitution is such that a resolution passed at a general meeting of members is necessary, whether or not demutualisation forms part of the proposals.

If a meeting is to be convened it will be necessary to allow for the attendance of the maximum number of those entitled to attend. Sensibly those policyholders not entitled to attend and vote as members might also be invited to attend so that there is an opportunity for them to express any concerns and for the board to explain the scheme to them. Life being as it is, arrangements to book a venue are quire capable of resulting in under provision (as with the London Life meeting where the meeting room booked at the Barbican complex proved too small, leading to a case in the Court of Appeal) or cavernous over-provision (as with the Provident Mutual Life Assurance meeting which took place at the London Arena).

**The EEA**

There is not in this Article space to consider the issues which arise where transferor or transferee is situated outside the United Kingdom but within another EEA state. Even where both companies are situated within the United Kingdom thorny problems arise in relation to EEA issues. The Third Directive requires focus on the "habitual residence" of a transferring policyholder at the time that a policy was entered into. If the relevant habitual residence was an EEA state other than the United Kingdom then the court will be unable to sanction a transfer which includes any such policy unless satisfied that the relevant regulatory authority in the EEA state concerned has been consulted and has either agreed to the transfer or alternatively not refused consent with a relevant 3 month period. With regard to EFTA policies (as defined for the purposes of the 1982 Act), the position is worse: the supervisory authority in the relevant EEA state must actually consent to the transfer. One major difficulty is that at least in relation to policies entered into prior to the Third Directive, insurance companies within the UK usually have no records contemporaneous with the taking out of policies which deal with the issue of the policyholder's then "habitual residence" (although they should now revise their application forms to address the point for the future). The result is that there are three main options. The first is to assume there may be policies within each EEA state and to ask the DTI to confer with all the relevant regulatory authorities (something the DTI may be reluctant to do). The second is to take a view. If it is considered that there is satisfactory prima facie evidence upon which the court will act, to the effect that no transferring policyholder was habitually resident in any particular EEA state at the relevant time, then proceed on the basis that this is so. Advice should be sought as to any risks in this course. The third is to proceed in line with the second option but, as a belt and braces exercise, to exclude from the transfer any policies which subsequently prove to be policies where the habitual residence of the policyholder at the relevant time was an EEA state in relation to which the relevant consultation has not taken place. The third option seems superficially attractive but can give rise to great practical problems. If an indeterminate number of policies are "left behind" with the transferor company, will the transferor company retain authorisation and a sufficient margin of solvency? How will the terms of the non-transferring policy be dealt with given that the assumption will be that the policy has been transferred and the policy will be treated as transferred (eg. in relation to mandates and the like)?

If consultation with the regulatory authorities in any EEA state is the course pursued then it is important to start the process as soon as possible: indeed it may be possible to start this process prior to the presentation of any petition to the court. It is important that the certificate provided by the DTI is in terms closely following the wording set out in the 1982 Act: eg. that the supervisory authorities in the relevant states have been notified and identifying those that have consented and those that have failed to object within the three month period. It is undesirable that the court should have to construe the certificate (eg. to determine whether the three month period has in fact passed).

## The effect of transfer orders on assets and liabilities other than policies

Although the scheme will detail the assets and liabilities to be transferred the transfers will be effected by the court under the ancillary powers set out in paragraph 5 of Schedule 2C to the 1982 Act. Questions can arise as to whether a particular asset is capable of transfer at all and, if it is, whether or not the transfer of the same by court order under the 1982 Act (and whether of the legal or just the beneficial interest) will trigger other third party rights, such as rights to forfeit leases or pre-emption rights. Much will turn on the precise instrument under which the rights in question arise. At the end of the day, if there are any doubts then prior consent of the relevant party is best sought. Prior consent may also be sought as a matter of prudence where the asset is situated abroad and there are questions as to whether the jurisdiction of the English courts would be recognised. As regards reinsurances there seems to be no reason in principle why they should not be transferred by court order, but it will be necessary to check carefully the precise terms, governing law and location of the contracts or treaties concerned. In practice, individual consent or novation is a safe course and the one more usually adopted.

**Publicity**

The court has power to dispense with the requirement that a statement, summarising the scheme and the independent actuary's report, is sent to each member of the transferor and transferee companies and to each policyholder of those companies. It is usual to seek dispensation of the specific requirement on the basis of a particular proposed circular which is produced to the court. Such dispensation disposes of any argument that the circular sent does not comply with the detailed statutory requirement. Where the member of a company is a holding company itself intending to appear at the hearing and/or give undertakings then dispensation is a matter of course. So far as the policyholders of the transferor company are concerned, it may not be necessary to send them a copy of any explanatory statement if the court can be satisfied that the scheme has such a marginal effect on their security and benefit expectations that they could not be said to be adversely affected by the scheme on any view and that therefore they do not need to be circularised.

It is compulsory to advertise the petition and the offices at which documents will be available for inspection in the official gazettes. However, the court now has power to dispense with the requirement that these matters are advertised in two national newspapers in the UK and as otherwise required where the state of the commitment of any transferring policy is in an EEA state, in two national newspapers in the EEA state in question. The court has been persuaded to dispense with advertisement in EEA newspapers where the number of policies of which the state of the commitment is such state are comparatively small and the costs are likely to outweigh the benefits. Where advertisement in a foreign newspaper does take place the advert can receive a prominence not always anticipated. In a recent case an advertisement in a Portuguese national newspaper appeared in the midst of a number of illustrated advertisements for "personal services".

The advertisement and the explanatory statement must contain details of the offices where relevant documents will be available for inspection. Although the wording of the relevant provisions is unsatisfactory it is prudent to ensure that the advertised list of locations includes any locations overseas where the documents will be made available. The Act does not stipulate what language the advertisements abroad are to be in; the view has usually been that the language of the policy (presumably English in the case of a UK insurer) will suffice.

### Objectors

The court must satisfy itself that the scheme should be sanctioned, regardless of whether or not there are any objections. Its role is never merely ministerial. It is very important to keep a close check on precisely what objections are made, by whom and what response is given on behalf of either company. It is usual to indicate to the court the nature of any objections that remain outstanding and to have available for the court any relevant correspondence. Given the potentially confidential nature of the correspondence and/or information contained within it, care must be taken in publicising such matters.

## CONCLUSION

The transfer of long term business is not a straight-forward matter.

Unlike transfers of general business under Section 51 of the Act, which are not reviewed by the court, transfer of long term business must always be sanctioned by the court. Specialist advice is essential on all but the simplest schemes, and perhaps even then. European legislation has greatly added to the complexity. Furthermore, and for obvious reasons, such transfers typically generate considerable policyholder interest, and often considerable concern too. It is right that there should be careful scrutiny in such a context, and the statutory provisions are designed to ensure this.

Two points likely to emerge for consideration by the court may be first, whether some greater sense can be brought either by judicial intervention or redrafting of the Act to the requirements with respect to persons habitually resident abroad;

and secondly, how directors of mutuals in particular are to respond to the siren calls of amalgamation and demutualisation, and the prospect of competing bids.

The section shows no signs of returning to obscurity (despite the best efforts of the Law Reporters to ignore it); and the obscurities within it and the European legislation which envelopes it may soon need to be addressed.

*Robert Hildyard QC and Malcolm Davis-White*
*practise at 4, Stone Buildings, Lincoln's Inn*