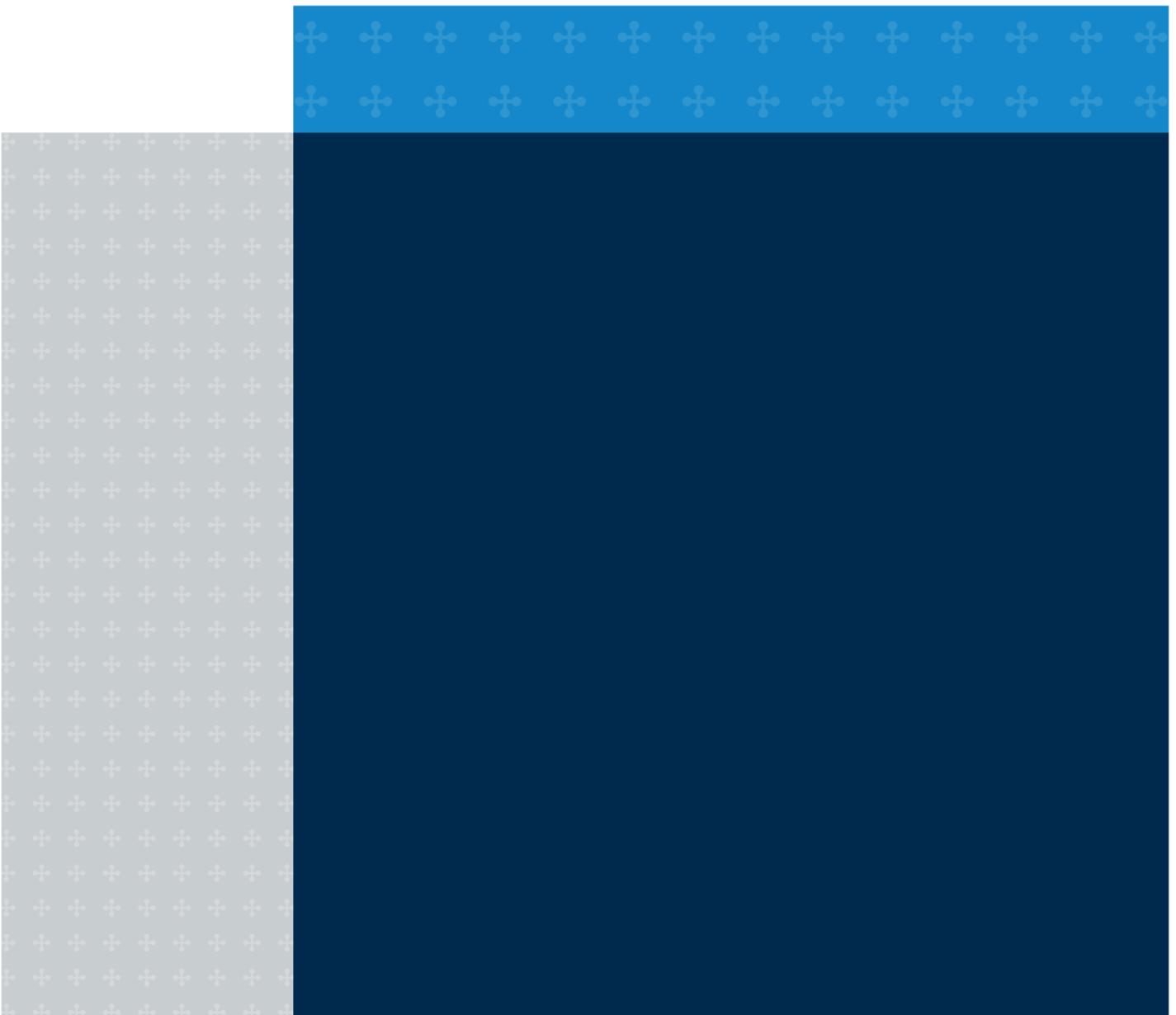




Policy Statement | PS1/22

Insurance business transfers

January 2022





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Policy Statement | PS1/22

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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 16/21 ‘Insurance Business Transfers’.¹ It also contains the PRA’s updated Statement of Policy (SoP) ‘The PRA’s approach to insurance business transfers’ (Appendix 1).

1.2 This PS is relevant to PRA-authorised insurers, including the Society of Lloyd’s and its managing agents. It is also relevant to mutuals and friendly societies.

Background

1.3 In CP16/21 the PRA proposed to:

- update references in the SoP to the PRA’s consultation with European Economic Area (EEA) regulators and transfers from the EEA into the UK, to align with amended legislation;
- provide additional guidance to firms, independent experts, and other interested parties on the PRA’s specific role and approach to insurance business transfers;
- provide guidance on the PRA’s approach to transferees in run-off; and
- provide additional guidance on the PRA’s approach to friendly society transfers.

Summary of responses

1.4 The PRA received 10 responses to the CP. Respondents generally welcomed the PRA’s proposals and the greater clarity they would provide, but also made a number of observations and requests for clarification. Broadly, the responses focused on the use of section 166 of the Financial Services and Markets Act 2000 (‘FSMA’) for certain transfers to firms in run-off; the proposed guidance for independent experts; document submission ahead of court hearings; and the PRA’s approach for friendly society transfers. The PRA’s feedback to these responses is set out in Chapter 2 of this PS.

Changes to draft policy

1.5 After considering the responses to CP16/21, the PRA has made minor changes to the SoP to provide greater clarity on the PRA’s approach in specific areas. The following proposed changes to the SoP have been amended:

- Paragraph 2.13: the proposed list of examples of ‘preliminary information’ in paragraph 2.22 has been moved to paragraph 2.13, and references to ‘preliminary information’ have been changed to ‘initial documentary information’. The PRA considers this will improve readability and clarify it does not expect two separate documentary submissions.
- Paragraph 2.13A: to include examples of what the PRA would consider ‘other means’ as to which it can satisfy itself of a transferee’s operational resilience, and to add a footnote clarifying the quantitative thresholds.
- Paragraph 2.30(15): amended to recognise that multiple permutations should be considered by independent experts where there are concurrent or linked schemes rather than on a single scheme with multiple transferors or transferees where it is unlikely there would be multiple permutations.

¹ July 2021: [CP16/21 – Insurance business transfers](#).

- Paragraph 2.33(3)(aaaa): to encompass situations where a transferee plans to amend its existing capital model ahead of a transfer.
- Paragraph 2.40A: to clarify that the duration between directions hearing and sanction hearing where it may be appropriate for an independent expert to produce an updated scheme report is when this duration is in excess of 6 months.
- Paragraph 2.58(3A): to clarify that transferees in run-off should be adhering to expectations in Supervisory Statement (SS) 26/15 'Solvency II: ORSA and the ultimate time horizon – non-life firms'² for business they have agreed to assume.
- Paragraph 2.70: to allow firms to submit documentation to the PRA a minimum of six weeks ahead of sanction hearing, so that the documents can be 'near-final' and reflect the communications exercise carried out.
- Paragraph 4.6A: to clarify the PRA's approach regarding supplementary reports on friendly society transfers.
- Other minor amendments through the SoP, to improve readability, and increase overall clarity of the PRA's approach.

1.6 The PRA considers that the above changes are not significant. They provide firms with further clarity and improve readability of the SoP. The PRA does not consider these changes will alter the cost benefit analysis presented in the CP. The PRA also does not consider that these changes will have a different impact on mutuals than on other firms.

1.7 In carrying out its policy making functions, the PRA is required to have regard to several matters, as set out in CP16/21 in Appendix 2, 'The PRA's Statutory Obligations'. In CP16/21 the PRA explained how it had had regard to the most relevant of these matters in relation to the proposed policy. Below the PRA provides relevant updates to that explanation, taking into account consultation responses.

Implementation

1.8 The changes to the SoP take effect on the date of publication of this PS on Wednesday 12 January 2022.

1.9 References related to the UK's membership of the EU in the SoP covered by the policy in this PS have been updated as part of this PS to reflect the UK's withdrawal from the EU. Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.³

² October 2018: [SS26/15 'Solvency II: ORSA and the ultimate time horizon – non-life firms'](#).

³ For further information please see [Transitioning to post-exit rules and standards](#).

2 Feedback to responses

2.1 The PRA must consider representations that are made to it in accordance with its duty to consult on its general policies and practices and must publish, in such manner as it thinks fit, responses to the representations.

2.2 The PRA has considered the responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions.

2.3 The PRA received ten responses. The responses, and the PRA's feedback to them, have been grouped as follows:

- the use of s166 FSMA for certain transfers to firms in run-off;
- guidance for independent experts;
- friendly society transfers;
- document provision ahead of sanction hearing; and
- other responses.

The use of s166 FSMA for certain transfers to firms in run-off

2.4 In CP16/21 the PRA proposed that for certain schemes, it would utilise its powers under s166 of FSMA to assess the transferee's operational readiness.

Clarifications

2.5 Four respondents requested clarification as to the 'other means' by which the PRA could satisfy itself that a S166 review would not be required for transfers captured by the thresholds in the proposal. Two respondents requested further clarification regarding the technical provision threshold in the s166 proposal.

2.6 Having considered the above responses, the PRA considers that firms would benefit from further clarity in these areas. The PRA has therefore decided to add further clarification into the SoP that 'other means' refers either to a recent previous s166 assessment in the same area, or an equivalent assessment by an independent body or regulator. The PRA also confirms that the technical provision threshold will refer to gross technical provisions, not taking account of any post-transfer reinsurance; and that in cases where transferor and transferee have a different valuation of the technical provisions being transferred, the higher valuation will be used in determining the threshold will be triggered. The PRA considers that firms would benefit from greater clarity on this aspect, therefore a corresponding footnote has been added to the SoP.

2.7 Two respondents requested clarification as to how the PRA would consider the independence of the individual(s) and firm(s) that perform the s166 review and act as independent expert for the Part VII transfer. One respondent requested clarification as to whether independent experts would be able to rely on the Skilled Person review for their conclusions. The PRA considers that any potential conflicts of interest will be reviewed by it (and the Financial Conduct Authority (FCA)) based on the facts specific to the case at the appropriate time, however it is unlikely that it would permit the same individual or same firm conducting both reviews. The PRA considers that the question of which materials to place reliance on should be a matter of judgement for the independent expert.

2.8 One respondent requested clarification as to whether the PRA's proposals applied to schemes which involve either a transferor or transferee in run-off, or schemes involving non-life insurance business only. The PRA considers that the proposals relate to non-life insurance schemes where the transferee is in run-off; this is usually characterised by a scheme of operations, absence of premium income, and lack of an effecting contracts of insurance permission.

Rationale

2.9 Two respondents noted that the PRA already has powers to implement s166 reviews. The respondents therefore felt it was unclear why this proposal had been included in the proposed changes to the SoP. One respondent also stated that operational readiness can be assessed by the PRA through the usual submissions to court, such as the independent expert's report, and evidence to court, rather than through a specific review.

2.10 The PRA confirms the change to the SoP is in order to notify firms transparently that it is changing its approach to transfers involving certain run-off firms, and in future intends to exercise this power in the circumstances outlined in the proposed amended SoP. This change in approach is due to prudential risks the PRA has identified with regard to certain transfers to firms in run-off.

2.11 The PRA further considers that operational readiness can also be assessed through other documentation, such as the independent expert's report, but considers that in the circumstances highlighted in the amended SoP it would be appropriate for a s166 review to be performed to ensure the issue had specific focus.

2.12 One respondent stated that the PRA's proposal regarding operational readiness of run-off transferees should apply to all potential transferees. One respondent requested clarification as to why the operational resilience proposal did not apply to live-writing transferees, who it stated may have similar risks to the PRA's objectives. The PRA considers that while operational readiness is a focus of its assessment of all insurance business transfers, the rationale behind the policy is to recognise that a targeted assessment of operational readiness on some run-off transferees will help ensure firms are appropriately ready for the books they are acquiring, thereby reducing risk to the PRA's objectives.

2.13 One respondent commented that, in their view, the PRA does not need to introduce a formal requirement regarding performing s166 reviews on certain transfers into the Part VII process, as the existing process is robust and meets the PRA's statutory objectives. The PRA considers that the overall process is robust. However, the PRA identified some risks with regard to certain transfers to firms in run-off. Therefore, in certain transfers, a s166 report would assist the PRA to carry out its role in assessing schemes against its statutory objectives, and strengthen that process. The amendments to the SoP set out the PRA's general approach when it undertakes s166 reviews. The PRA considers it will exercise its s166 powers on a case-by-case basis, taking account of the circumstances of each proposed transfer.

2.14 Three respondents stated that the PRA's proposal to request s166 reviews in certain transfers would result in firms being disincentivised to conduct insurance business transfers, due to the additional time and cost it would add to the process. One respondent stated that they did not consider that there was material risk to the PRA's objectives that could not be mitigated without the use of s166 in this manner. One respondent stated that, in their view, the proposal was not in line with the PRA's secondary competition objective. Two respondents requested additional detail on the timing and sequencing of the S166 review to understand whether the PRA would expect any findings of a s166 review to be fully remediated before an independent expert could be approved.

2.15 The PRA considers that the use of Part VII of FSMA to transfer insurance business can confer a number of benefits for the insurance industry, and it does not seek to either incentivise or disincentivise the appropriate use of this mechanism through its proposals. The PRA considers that its proposal would mitigate risks to its primary objectives arising from the transfers targeted by the policy, such as the risk that transferees cannot appropriately manage the targeted portfolio due to operational deficiencies; and the proposal would furthermore enhance transparency.

2.16 With regard to the impact of the proposal on the PRA's secondary competition objective, as noted in the CP, the PRA assessed the proposals and considered that they do not have a significant impact on effective competition. Ensuring acquirers have an appropriate level of operational readiness helps facilitate effective competition, and thereby is consistent with the PRA's secondary competition objective.

2.17 The PRA considers that in general only material feedback points from any s166 review would need to be remediated prior to a transfer proceeding, but the timing of when an independent expert could be approved would have to be considered on a case-by-case basis. Similarly the PRA cannot give guidance on the expected timetable for completion of a s166 review, as that timetable would depend on the particular circumstances of each transfer, and would be communicated to the skilled person at the time of appointment.

Scope

2.18 Three respondents commented on the appropriateness of the quantitative thresholds the PRA has set for the circumstances in which it would require a s166 report on operational readiness of transferees. One respondent considered that a 10% increase in technical provisions was immaterial and that a s166 report should be reserved for transformative transfers. One respondent considered the proposals would unfairly target smaller firms and new entrants who have less technical provisions thereby limiting competition and competitiveness. Two respondents requested the PRA share further detail as to how it calculated the thresholds. The PRA considers its proposals would not specifically target smaller firms; bigger firms would also be captured if the transfer met the thresholds. When setting the proposed thresholds the PRA considered how to capture the transfers that posed more significant risks to the PRA's primary objectives while also ensuring that a disproportionate number of cases were not captured.

2.19 One respondent suggested that a s166 review of operational readiness would not be appropriate for intragroup transfers and that such transfers should be explicitly carved out of the policy. The PRA considers that it would be unlikely that an intragroup transfer would require a s166 review of operational readiness, as the risks it seeks to mitigate are less likely to emerge within the same group; however, significant risks may be present. The PRA therefore considers it would need to assess this on a case-by-case basis.

2.20 One respondent asked for clarification that the scope of the s166 review would be proportionate to size of the firm and nature of the transferring business relative to the transferee's existing business. One respondent asked for further guidance as to the scope of the s166 review and for the skilled person. The PRA considers that the scope of the s166 review would be proportionate to the firm in question, and that it would provide further specifications on a case-by-case basis at the time of the appointment of the skilled person.

Guidance for independent experts

2.21 In CP16/21, the PRA proposed to provide additional guidance regarding the areas that should be included in the independent expert's scheme report.

2.22 One respondent highlighted that there are circumstances where a transferee is revising their capital model prior to a transfer, so suggested amending the new paragraph 2.33(3)(aaaa) to reflect these circumstances. One respondent suggested that it is unclear the permutations the PRA would expect independent experts to consider in paragraph 2.30(15).

2.23 The PRA considers that it would be appropriate to reflect circumstances where a transferee is revising their capital model prior to a transfer, and will therefore make the appropriate changes in the SoP. The PRA also considers it beneficial to amend the focus of the proposals in paragraph 2.30(15) from a scheme with multiple transferors and transferees, to connected schemes, in order to reflect that with the latter here may be multiple permutations for policyholders in these situations.

2.24 Four respondents stated that the additional guidance the PRA proposed in relation to scheme reports, such as guidance relating to independent experts considering whether it was necessary to conduct their own stress testing, would significantly expand the responsibilities of the independent expert, and goes beyond the requirements of the court. In addition, these respondents suggested that the proposals would limit the pool of independent experts.

2.25 The PRA does not consider that its proposals are expanding the responsibilities of the independent expert, as it would already expect independent experts to include the areas in question in their reports. The purpose of the PRA's proposal to provide additional guidance in the SoP was to further clarify the PRA's approach. The PRA does not consider that these additions would have an impact on the availability of independent experts, and considers that the proposed clearer guidance would enhance the ability of new independent experts to perform the role to the required standard.

2.26 Two respondents requested further guidance on the PRA's definition of 'material adverse effect'. The PRA considers that it is for the independent expert to assess and define material adverse effect.

2.27 One respondent requested further clarification concerning the PRA's proposal for an independent expert to seek independent specialist advice on specialist or niche lines of business. The PRA considers that this proposal is intended to cover situations where a transfer contains highly specialist business that very few individuals have expertise in. The PRA's proposed approach is not for a further report to be produced, but simply for the independent expert to seek advice where appropriate.

2.28 One respondent suggested that the PRA should consider requesting independent experts to consider the impact of transfers on members as well as policyholders. This approach is already contained within the existing SoP, and will remain in the amended SoP.

2.29 One respondent requested that the PRA provide further clarification on how the independent expert should constitute groups of policyholders for their assessment of the effect of a scheme. The PRA considers that it is the decision of the independent expert as to the most appropriate way to constitute the groups.

2.30 One respondent suggested that a number of the PRA's additional guidance points for scheme reports should be subject to materiality thresholds. As the PRA would always consider materiality when reviewing scheme reports, this proposal remains unchanged.

Friendly society transfers

2.31 CP16/21 proposed that where there had been material financial developments, or policyholder representations between the member vote and confirmation hearing, the PRA may request a

supplemental report. The report could have specific procedural implications, such as necessitating further member communications and/or additional advertising. It could also lead to a requirement for a further member vote.

2.32 Two respondents requested that the PRA provide further guidance on the circumstances that would warrant further member communications, additional advertising, or a further member vote, as this could result in significant costs. The PRA considers that as this would be dependent on the circumstances of particular cases, it cannot provide more specific guidance. The PRA considers, however, that the supplemental reports would only be requested in certain instances, for example when circumstances of the firms or policyholders had changed materially in the period between the members' vote and the confirmation hearing. Therefore, it is less likely that the PRA would request a supplementary report when the date the relevant report is provided is close to the final hearing. The PRA considers that, based on evidence to date, very few transfers would trigger the above approach being adopted. The PRA has considered these responses and amended the wording of paragraph 4.6A of the SoP to provide enhanced clarity to firms.

2.33 One respondent asked for clarification as to the PRA's approach to assessing whether there is substantial risk that the transferee will not be lawfully able to carry out the engagements transferred to it, for example where there are overseas expatriate policyholders transferring. The PRA considers that the risk in this regard can only be considered on a case-by-case basis, because it is a question of local law and will depend on a number of factors, including the specific nature of the business being transferred and the local regulatory perimeter.

2.34 One respondent suggested the PRA should continue to take a proportionate approach to whether it requires a report under section 88 of the Friendly Societies Act. The PRA confirms that as set out in paragraph 4.6 of the SoP the PRA will take into account the scale and complexity of a transfer in its decision whether to require a report.

Document provision ahead of sanction hearing

2.35 In CP16/21, as part of providing additional guidance to firms, the PRA proposed to amend the timeline for firms to provide documents to the PRA ahead of the sanction hearing from requesting documents six weeks ahead of the hearing date, to requesting the documents six weeks ahead of the planned publication of the independent expert's supplementary report (generally published two weeks prior to the sanction hearing).

2.36 One respondent suggested that, in their view, it is not workable to provide near-final documents so far in advance of the sanction hearing, as the documents would not reflect the communications exercise or policyholder objections. The PRA has considered this response and acknowledges that as the supplementary report is generally published two weeks prior to sanction hearing, documents (including supplementary reports) would therefore be submitted a minimum of eight weeks prior to the sanction hearing. This would mean that on most occasions it is unlikely the documents would be able to properly reflect the communications exercise, resulting in several iterations of documents needing to be reviewed. The PRA has considered this response and has amended the wording of paragraph 2.70 of the SoP to allow firms to submit documents a minimum of six weeks prior to the sanction hearing to allow more time for the communications exercise.

Other responses

2.37 Three respondents requested the PRA to define what it considers a 'long duration' in reference to circumstances that may warrant an updated scheme report, rather than a supplemental report. One respondent suggested that the list of 'preliminary information' provided in paragraph 2.22 of the SoP could potentially introduce confusion, as 'initial documentary information' is mentioned in

paragraph 2.13 in the same context. Three respondents requested further guidance regarding the proposal for transferees to demonstrate they have considered risks they are acquiring over the ultimate time horizon.

2.38 The PRA considers that firms would benefit from further clarity in these areas. The PRA will therefore amend the SoP to note that 'long duration' is where the gap between directions hearing and sanction hearing is greater than six months, and in these circumstances it may request an updated scheme report, rather than a supplemental report. The PRA has also moved the list of 'preliminary information' to paragraph 2.13, and made the terminology consistent. With regard to providing further guidance on the proposal for transferees to demonstrate they have considered risks they are acquiring over the ultimate time horizon, the PRA considers that this proposal reflects its expectations under Supervisory Statement (SS) 26/15 'Solvency II: ORSA and the ultimate time horizon – non-life firms'. The PRA has amended the SoP to make this point clearer.

2.39 Two respondents asked about the PRA's approach towards independent experts between sanction of the scheme and the effective date. The PRA considers that its approach concerning the ongoing independence of the independent expert would, for example, be relevant in a situation where a scheme needs to be amended post-sanction and a further report needs to be produced. The PRA has amended the SoP to make this point clearer.

2.40 One respondent requested the PRA to restructure its proposals in a manner to maintain or reduce existing timelines. The PRA considers that the overall process is largely firm and court-driven. Where there are regulatory timelines, the PRA considers that the additional guidance for firms and independent experts provided in the SoP will help make regulatory engagement more efficient. The PRA considers its proposal to require a s166 review ahead of certain transfers will impact timelines for captured transfers. However, the PRA considers that the s166 review is necessary to mitigate the possibility of risks crystallising that could cause serious detriments to policyholder protection or safety and soundness of firms.

2.41 One respondent asked whether the PRA's definition of a 'firm in run-off' in paragraph 2.58 of the SoP extended to firms which were not in run-off but had run-off books of business. The PRA confirms 2.58(3A) applies to firms in run-off, this is usually characterised by a scheme of operations, absence of premium income, and lack of an effecting contracts of insurance permission.

2.42 One respondent queried whether PRA references in the SoP to 'policyholder representations' refer to policyholder objections to the transfer. The PRA confirms this is the case.

2.43 Two respondents suggested that there are often practical or operational reasons why there may be a delay to communications being sent to policyholders after the directions hearing. The PRA does not consider these responses are incompatible with paragraph 2.53 of the SoP.

2.44 One respondent requested quantitative information concerning the PRA's cost benefit analysis of its proposals, as the respondent considered the proposal for independent experts to produce an updated scheme report where there had been a significant gap between the directions hearing and sanction hearing would cause additional costs. The PRA considers additional costs would be incurred only when such a gap exceeds six months. The PRA does not consider such an increase in cost to be significant, given the independent expert would be producing a similar report for the sanction hearing concurrently.

2.45 One respondent suggested there should be clearer information provided as to how the PRA engages with the FCA. The PRA considers this is sufficiently clear in the SoP (in the case of insurance business transfers), and, more generally, in its Memorandum of Understanding with the FCA.⁴

2.46 One respondent asked how objections from third-party service providers should be considered. The PRA considers that unless the objections from third-party service providers impact its objectives, this matter is not within its remit.

2.47 One respondent asked for clarity on the PRA's approach towards 'independence' and 'expertise' when considering independent experts. The PRA considers its SoP provides sufficient guidance on this.

2.48 A number of respondents made comments concerning the readability and consistency of terminology throughout the SoP. The PRA has considered these responses and made minor drafting changes to enhance readability and consistency.

⁴ July 2019: [Memorandum of Understanding: Between the Financial Conduct Authority and the Bank of England \(exercising its prudential regulation functions\)](#).

Appendix

- 1 Statement of Policy 'The PRA's approach to insurance business transfers', available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-insurance-business-transfers>
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