UK Policyholders Must Beware Pre-Brexit Policy Transfers
By Richard Mattick (March 7, 2018, 2:45 PM EST)

Recent disclosures by U.K. insurance regulators have highlighted the possibility of an imminent flood of applications by U.K. insurers to the English courts to transfer policies from U.K. insurers to EU-based affiliates of those insurers. Policyholders affected by these transfers will need to scrutinize them closely.

Insurers are reported to be preparing such transfers in order to avoid regulatory pitfalls caused by Brexit, which could include an inability to pay claims to EU entities (including EU subsidiaries of U.S. corporations).

Policyholders need however to be vigilant that the insurer to whom its policies are transferred is suitable, in particular as regards capitalization and claims handling. In particular, policyholders will want to verify that the transferring insurer is not using Brexit as a justification to transfer unwanted risks to an inadequately capitalized EU affiliate, as this poses the risk that the transferee company may be unable to pay claims.

The Factual and Regulatory Background

Currently, U.K. insurers benefit from “passporting” rights that enable them to carry on business, including payment of claims, in all other EU countries without the need to obtain separate regulatory authorization from each country. If such passporting rights were to cease without equivalent rights having been granted by the respective EU states, U.K. insurers would be unable to carry on business within those states. That means that U.K. insurers would be unable to pay claims under existing insurance policies to policyholders domiciled in the EU.

It is estimated that approximately 30 million policyholders based in the European Economic Area would be affected if UK insurers were unable to secure necessary approvals to carry on business in the EU.

The UK Treasury has been working in recent months with the two responsible regulatory branches of the Bank of England, the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”) on options to protect UK policyholders that could be achieved by unilateral action from the UK authorities, although it is not clear whether the regulators are considering options to protect EU policyholders of UK insurers.

If however the regulators can find no solution to the potential problems for EU policyholders (including
EU subsidiaries of US corporations), then insurers will likely find need to transfer UK policies to EU-based insurers by means of a so-called “Part VII Transfer”, i.e. a transfer under the terms of Part VII of the UK Financial Services and Market Act 2000 (“FSMA”). Indeed, it is reported that many insurers have started to prepare for this alternative solution in advance of the current Brexit deadline of March 2019, since the transfer process can generally take anything between 9 and 18 months. The Bank of England (which has overall responsibility for supervision of insurers) also recently disclosed that it had written to the High Court to alert it to the potential for increased numbers of Part VII-related court applications in the coming months. Policyholders may therefore be faced with proposed Part VII Transfers well before March 2019.

The Part VII Procedure

FSMA and associated regulations provide that a transferring insurer must first discuss its transfer proposals with the regulators and agree a timetable for the transfer, then apply to the High Court in London for consent to the transfer, which is dealt with at a court hearing that can take place six to eight weeks after notice to policyholders that the court has been asked to approve the transfer.

Policyholders are therefore not likely to be engaged in the process until the transferring company has held its principal discussions with the regulators and the application to the court is under way. At this stage, it is the practice for the transferring company to provide policyholders with a statement of the terms of the transfer and a summary of an independent expert’s report supporting the transfer. The report of the independent expert must deal primarily with the likely effect of the transfer on policyholders of both the transferor and the transferee. The expert will generally be selected by the insurers, although the appointment must be approved by the regulators.

The expert’s report is usually the main evidence supporting the transfer for the court to consider, although the regulators will also file evidence before the hearing, including reporting on any reactions that they have received from policyholders. However it is not usual for the regulators to play an active part in the court process.

The court has absolute discretion in sanctioning the transfer. In order to approve the transfer proposal, it must be satisfied that the proposal as a whole is fair as between the interests of the different classes of persons affected. This means that it must consider whether a policyholder, employee or other interested person or any group of them will be adversely affected by the transfer, which involves comparing the security and reasonable expectations of policyholders without the transfer with the likely result if the transfer went ahead. Because the court needs to take an overall view of the fairness of the proposal, the court may approve a proposal that it considers fair even though an individual policyholder or group of policyholders may be adversely affected. The court will also not amend the proposal, even if it thinks that individual provisions could be improved upon, since its task is not to produce the best possible proposal.

In practice, the court will likely be strongly influenced by confirmation from the regulators that they have no objection to the transfer and by the evidence of the independent expert filed in support of the transfer. It is also permitted to give recognition to the commercial objectives and judgment of the boards of the transferor and transferee.

Although the FSMA permits any person who alleges that he or she would be adversely affected by the transfer to be heard by the court at the sanction hearing, any party seeking to challenge a transfer proposal will need to prepare very clear and persuasive evidence in opposition to the proposal in order
for the challenge to stand a chance of succeeding, and would also be best advised to engage the
regulators as soon as possible after receiving notice of the proposal.

**Possible Consequences of a Part VII Transfer for Policyholders**

A policyholder faced with a proposed portfolio transfer will principally be concerned with whether (1) the transferee company will have enough money to pay all of its claims; and, (2) assuming adequate
capitalization, the transferee will handle its claim as well as the transferor.

Although most insurers are sufficiently sophisticated to avoid transferring policies to a company that is, on its face, plainly undercapitalized, and the U.K. regulators will be on the lookout for such situations, an
affected policyholder should be concerned not only with the absolute capitalization of the transferee
company, but also the relative or comparative financial positions of the two companies, which is a very
complex question that is difficult even for regulators.

Policyholders with concerns about a proposal or who wish to scrutinise a proposal should therefore be
aware of the potential need — early on in the process — to obtain as much relevant financial
information as possible to evaluate the transferee company’s capitalization and business plan. They may
need to seek additional information to that first circulated by the transferring company and seek expert
accounting or and/or actuarial input.

As regards claims handling, policyholders need to consider the reputation of the new insurer. While such
issues are often hard to pin down, they are of central importance to policyholders and experienced risk
managers will often have a keen sense of this area. Some concerns about claims handling may be
alleviated by specific wording in the scheme documents, but policyholders should assess whether any
such concerns are sufficiently strong to merit raising with the regulators or the court before the transfer
plan is approved.

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