

FCA FG22/1: The FCA's approach to the review of Part VII insurance business transfers

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On 15 February 2022, the Financial Conduct Authority (FCA) published its Finalised Guidance (FG22/1¹), which sets out the FCA's approach to reviewing insurance business transfer schemes under Part VII of the Financial Services and Markets Act 2000 (FSMA) (Part VII transfers or schemes), updated from the previous guidance on the same topic, FG18/4.² FG22/1 also provides feedback and responses to its Guidance Consultation (GC21/3³) published in July 2021, in which the amendments to the previous Finalised Guidance were first proposed.

The purpose of the amendments to FG18/4 introduced by FG22/1 is primarily to reflect legislative changes following the UK's withdrawal from the European Union and the completion of the transition period, as well as to reflect the FCA's more recent experience across a range of insurance business transfers and feedback from stakeholders. The amendments also clarify the FCA's role and expectations in relation to insurance business transfers, and make clear that the FCA can object to a scheme based on conduct concerns, even if there is no prudential concern.

The main amendments to the Finalised Guidance can be broadly categorised as follows:

- Initial considerations
- Review of the appointment of the Independent Expert
- Overview of the FCA's approach
- Review of the form of the Independent Expert's report
- Review of the communications strategy

In this paper we set out the key amendments to the Finalised Guidance under the categories above, and we consider the potential implications for insurance business transfers. This summary is not a comprehensive list of all amendments to the Finalised Guidance; it focuses on the amendments that appear to be the most consequential for firms.

In January 2022 the Prudential Regulation Authority (PRA) also published its updated approach to the review of insurance business transfers. Our summary of the key changes introduced by the PRA can be read [here](#).

Initial considerations

KEY AMENDMENTS

The FCA has added further clarification around the initial considerations that firms and businesses should take at the outset of a Part VII transfer. It is noted that, following initial review of the proposed timetable for the transfer by the FCA and the PRA, applicants should highlight any subsequent changes to the proposed timetable itself, or any changes to the scheme proposals which may affect the timetable, to the regulators as soon as possible to ensure sufficient time to gain agreement to any changes. This should take place before any dates are rescheduled.

¹ See FG22/1: The FCA's approach to the review of Part VII insurance business transfers at <https://www.fca.org.uk/publication/finalised-guidance/fg22-1.pdf>.

² See FG18/4: The FCA's approach to the review of Part VII insurance business transfers at <https://www.fca.org.uk/publication/finalised-guidance/fg18-04.pdf>.

³ See GC21/3: Proposed changes to guidance on the FCA's approach to the review of Part VII insurance business transfers at <https://www.fca.org.uk/publication/guidance-consultation/gc21-3.pdf>.

The FCA now specifies that its period of document review (including liaison with the firms in relation to questions or comments) generally finishes when applicants submit the documents to the Court ahead of the respective hearings, or when the supplementary Independent Expert report is published ahead of the sanction hearing. The FCA also outlines that the regulators may need a longer period to review documents than the minimum quoted timeframes (six to eight weeks to review the documents for the directions hearing and four weeks to review the documents for the sanction hearing), for example if the scheme is complex or has unusual features. In addition, applicants should factor in time for discussing regulator feedback on the documents, additional iterations of the documents and potential issues within the initial timeline proposed.

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These amendments to the Finalised Guidance provide useful clarification of the FCA's expectations around the timetables for proposed transfers, communication of any potential changes to timetables and the period over which documents remain subject to regulatory review.

There is, perhaps, an increased onus on firms to consider the specifics of their proposed transfer, how this may affect the proposed timetable and what contingencies are needed in the timetable to allow for any challenges raised by the regulator to be dealt with. As a result, detailed planning at the start of the transfer process and allowing an adequate margin within the proposed timetable is key, in particular for complex transfers.

Review of the appointment of the Independent Expert

KEY AMENDMENTS

While the PRA is responsible for approving the Independent Expert, it must consult with the FCA before doing so. Various additions have been made to provide further clarification on the FCA's considerations regarding the appointment of an Independent Expert:

- The FCA specifies that if the proposed Independent Expert intends to work on two interacting projects, either in the capacity as Independent Expert or in another capacity, they must be able to demonstrate that they can act independently.
- The proposed peer reviewer of the Independent Expert's report is required to be sufficiently independent from the work of the proposed Independent Expert. If the Independent Expert's employer is not able to identify a suitably independent candidate for peer review, the firms may consider nominating a peer reviewer from a different firm.

- Evidence of relevant experience of the proposed Independent Expert does not have to include previous work acting as Independent Expert; it can be evidenced, for example, through working on previous transfers as part of a team or acting as skilled person in a Section 166 review.⁴
- The FCA highlights that the requirement of sufficient skill and experience applies across the whole team including the Independent Expert's core support team and peer reviewer.

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While these clarifications are helpful to ensure sufficient information is provided to the PRA and the FCA at the start of the Independent Expert approval process, in our experience most of the items set out above are already typically provided to the regulators at outset. Nonetheless, a clear set of considerations from the FCA should be helpful in ensuring there are fewer unforeseen delays when appointing an Independent Expert.

The regulators now expect to be supplied with information on the skills and experience across the team supporting the Independent Expert, and not just the Independent Expert. This highlights to importance of selecting an Independent Expert with a strong team to support them.

Overview of the FCA's approach

KEY AMENDMENTS

Within the updated Finalised Guidance, the FCA has specified its general expectations for applicants and independent experts when undertaking Part VII transfers. These general expectations include submitting documents to the regulators in near-final form for review, indicating when any outstanding areas will be finalised and confirming adherence to the Finalised Guidance. The FCA also expects applicants and the Independent Expert to consider whether there are any particular issues arising in relation to a scheme which the FCA is likely to wish to consider. In such cases, there is an expectation that applicants proactively provide the FCA with details of these issues in good time.

The FCA has clarified its expectations around the business rationale for Part VII transfers. Specifically, the FCA has highlighted that applicants should not just explain the commercial considerations of why they are proposing a transfer, but also how they have satisfied themselves that the proposal will not have a material adverse impact on policyholders.

⁴ A Section 166 review is undertaken by a third party appointed by the PRA or the FCA to consider specified aspects of a regulated firm's activities.

Changes affecting policyholders

The FCA has specified the importance of applicants and the Independent Expert demonstrating that they have sufficiently considered the impact of the Part VII transfer on policyholders, whether adverse or positive. The FCA has highlighted that it will consider in detail:

- Whether there would be any changes to how the business will be run or operated, for example changes to claims approaches or changes intended to accelerate the run-off of the business.
- Whether applicants and independent experts have considered the impact of the transfer on vulnerable policyholders, and how vulnerability was considered in the design of documents and policyholder correspondence related to the transfer.
- Whether applicants have undertaken sufficient due diligence to identify previous statements they have made which policyholders could rely on to object to the transfer.

Ongoing regulatory requirements

The FCA has clarified that its general expectation is that policyholders do not pay any costs associated with Part VII transfers.

The FCA will challenge provisions for with-profits funds within schemes which are inconsistent with Chapter 20 of the Conduct of Business Sourcebook⁵ (COBS 20), including in cases where such provisions were permitted under a previous scheme sanctioned before COBS 20 came into force. In the updated Finalised Guidance the FCA specifies further that, while there are transitional provisions in COBS 20 which allow arrangements sanctioned before it came into force to continue, the FCA's view is that such transitional provisions are not available where the arrangements form part of a new scheme being implemented after the COBS 20 rules came into effect.

Objections from policyholders and other interested parties

The FCA has updated its expectations around applicant responses to policyholder objections to Part VII transfers. The updated Finalised Guidance sets out the following updates:

- Applicants should respond to objections in a timely manner and should have the resources to deal with policyholder responses, with all staff handling policyholders' queries to be appropriately trained.
- Where policyholders' objections are based on a perceived inconsistency between the applicants' previous statements and the proposed transfer, the applicants should address those concerns adequately.
- The Independent Expert should properly consider objections and significant concerns raised from the perspective of policyholders and consider whether the applicants have done enough to respond to them and address concerns.

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In our experience, the general expectations introduced by the FCA are aligned to the current approach taken in most Part VII transfers. However, they act as a useful reminder of the importance of raising potential issues with the regulators in good time to reduce the risk of delays to timetables, in particular given the generally increasing level of complexity of many transfers.

The additional requirements around policyholder-focused areas such as the treatment of vulnerable customers, previous statements made to policyholders and the proper consideration of objections are all encouraging steps to make sure that applicants place sufficient importance on these areas. Applicants will need to ensure they have adequately tailored their communications and response-handling for vulnerable policyholders. Where a scheme involves the transfer of legacy business, it will be challenging for applicants to achieve complete comfort around the nature of previous statements made to policyholders; however, adequate steps should be taken to address this requirement as far as possible.

The FCA's expectation that provisions are aligned with COBS 20 may be a challenge for applicants where a scheme inherits the provisions from historical schemes. Where this is the case, the FCA will consider modifications or waivers to the relevant COBS 20 rules if applicants can demonstrate that they meet relevant statutory tests under COBS 20. Nonetheless, applicants can expect challenge from the FCA if their proposals are not aligned to COBS 20 for with-profits business.

Review of the form of the Independent Expert's report

KEY AMENDMENTS

The updated Finalised Guidance contains additional factors that the FCA considers in its the review of the form of the Independent Expert's Scheme Report.

There have been several additions regarding the Independent Expert's assessment of policyholder servicing arrangements. The Independent Expert is expected to consider and compare the type and level of service pre- and post-transfer, including factors such as claims and complaints handling, means of access to services and any changes in functionality, general quality, reliability and response times of policyholder support services. The Independent Expert is also expected to provide their view on the adequacy of service levels and the associated governance and oversight arrangements, including where outsourcers are used. The FCA also expects the Independent Expert and firms to scrutinise the possible risks associated with the transfer that may affect policyholder service levels, and set out what could be done to mitigate those risks.

⁵ COBS 20: With-profits. This chapter of the COBS sets out the FCA's requirements in relation to the management of with-profits business. See <https://www.handbook.fca.org.uk/handbook/COBS/20.pdf>.

Where the Part VII transfer includes employers' liability or public liability claimants and run-off claims, the FCA expects the Independent Expert to include their view of the quality of the firms' employers' liability tracing arrangements in the Scheme Report.

In addition, the FCA expects the Independent Expert to have adequately reflected on significant changes that emerge during the process (for example, pandemic or economic fluctuations) within the supplementary report.

Lastly, the FCA has removed the "Sufficient comparative regulatory framework analysis" section and no longer sets out any specific requirements for the Independent Expert's Scheme Report in respect of this area.

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While it is already standard practice for independent experts to consider the impact of a Part VII transfer on policyholder service levels, the extent to which this area is expected to be considered has grown in recent years, and the updated Finalised Guidance clearly reflects this. In order to support this, applicants may need to be able to provide the Independent Expert with a much greater level of detail on pre- and post-transfer servicing arrangements than has previously been the case.

In today's rapidly changing environment it seems appropriate that independent experts should consider the impact of external events that emerge during the transfer process and whether this impacts their conclusions on the Part VII transfer. For example, it is now commonplace to include commentary on COVID-19 and any implications it has on the transfer. Applicants will therefore need to be able to explain to the Independent Expert how emerging events are impacting their business, and the measures or mitigations being put in place where relevant.

Following Brexit and the end of the transition period, transfers from the UK to any overseas entity (other than entities authorised in Gibraltar) are only permitted to a UK-authorized branch of that overseas entity. Therefore, given UK-authorized branches are subject to FCA regulation, a comprehensive analysis of regulatory frameworks from a conduct of business perspective is no longer required. However, we would still expect independent experts to compare other policyholder protection mechanisms pre- and post-transfer, such as ranking of policyholders in the event of insurer insolvency. We would also expect independent experts to continue to compare solvency regimes pre- and post-transfer as a core part of their analysis. In line with this, we note that under the PRA's guidance on insurance business transfers, it expects the Independent Expert to consider the regulatory capital regime when assessing the effects of the scheme on the likelihood of future claims being paid.

Review of communications strategy

KEY AMENDMENTS

The updated Finalised Guidance provides greater clarity on the FCA's expectations around certain aspects of communications strategies for Part VII transfers.

- Where practicable, if the business to be transferred has been in run-off, the FCA expects the legal notice published in relation to a scheme to include any previous names of firms which the business has been part of.
- The FCA specifies that phone lines should be open at appropriate times to include overseas policyholders, or for firms to provide alternative means of contact if this is not possible.
- Applicants are expected to have transcripts of policyholder calls in relation to a Part VII transfer, and in particular in relation to any policyholder objections, available for the FCA to request and review.
- The FCA has added that it is open, where appropriate, to the wider use of digital communications methods when contacting policyholders regarding a Part VII transfer. However, firms would need to demonstrate that they have appropriately considered aspects such as the policyholder's preferred method of communication, whether up-to-date contact information is held, the reliability and appropriateness of the proposed communication method and the process for managing failed deliveries.

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Overall, these additions to the Finalised Guidance should all act to improve the ability of policyholders to engage with the proposed transfer and make a more informed assessment about whether they wish to raise queries or objections. For firms, while some of these additions may increase the costs associated with Part VII transfers, the ability to use digital communication methods where appropriate could help to significantly reduce costs of communicating with policyholders. In addition, digital communication methods may be more aligned to a firm's environmental policies or policyholder preferences, and may enable the firm to more accurately trace whether communications have been opened by the policyholder.

Conclusion

The amendments outlined in this paper provide useful clarification on the FCA's approach to the review of Part VII transfers, and they reflect the increasing role we have observed the FCA taking alongside the PRA when reviewing transfers.

While there is an expansion to the areas that applicants and independent experts are required to consider, many of the additional areas are typically considered already. Perhaps the most significant changes include the increased level of detail expected to be included in the Independent Expert's Scheme Report when considering the impact of the Part VII transfer on policyholder servicing levels, and clarification that the FCA will challenge proposed carry-over provisions for with-profits funds which are inconsistent with COBS 20. These areas may result in additional information needing to be provided by firms to enable the Independent Expert to conduct their analyses and form their conclusions.

Overall, while there are some areas of Part VII transfers which are now receiving increased focus from the FCA, Part VII transfers remain a useful tool for firms to restructure or simplify their business.

How Milliman Can Help

Milliman has extensive experience in fulfilling the role of Independent Expert and is a market leader in this area. We have multiple Milliman consultants who have performed this role for numerous transfers, as well as an experienced team of people who have supported the Independent Expert on these transfers.

Our experience spans the full range of transfers and schemes of arrangement for insurance business, including cross-border transfers to multiple jurisdictions, very large transfers involving all types of life and non-life insurance business, including with-profits business, and complex transfers involving multiple parties or components.



Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

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