

## **Appendix 1**

### **The reattribution: roles and process**

A report by the office of the policyholder advocate in connection with the reattribution of the inherited estates of the CGNU Life and CULAC with profits funds

**June 2009**

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## 1.00 Introduction

A with-profits fund contains assets, some of which are earmarked to pay expected claims made against the firm. The inherited estate consists of assets over and above those which are necessary to pay expected claims. The technical definition of the inherited estate, in the Financial Services Authority (FSA) rules, is the excess of the fair market value of the assets over the realistic value of the liabilities of the relevant fund. The inherited estate may be used to support the funds, for example, by providing capital to smooth payouts to policyholders when there is excessive investment volatility. In the normal course of events, to the extent that a proprietary firm has an excess surplus in the fund (i.e. the assets comprising the inherited estate are greater than those necessary to support the fund), this will be shared out between policyholders and shareholders in the relevant proportions (typically 90:10) in a special distribution. Such distributions normally take the form of extra bonuses to policies rather than cash.

A reattribution is the process by which policyholders are instead offered the chance to sell their right to future special distributions from the inherited estate, usually in exchange for a one-off cash payment. An inherited estate reattributed in this way then effectively belongs to the shareholders.

Aviva is proposing the reattribution of the inherited estates of CGNU Life and CULAC with-profits funds. The reattribution will be achieved in conjunction with an insurance business transfer scheme governed by Part VII of the Financial Services and Markets Act 2000 (FSMA) (Part VII transfer)<sup>1</sup>. The insurance business transfers are being effected by Aviva plc as part of a wider programme to reorganise and simplify its corporate structure. As part of this restructuring, it is proposed that the UK long-term insurance business currently carried on by Aviva plc be further rationalised through several transfers of insurance business. In summary, this will involve transferring the long-term insurance business (including with-

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<sup>1</sup> This is not the only way in which a reattribution of an inherited estate could be achieved. It could also be achieved through a scheme of arrangement under the Companies Act 2006 which is a compromise or arrangement between a company and its shareholders or creditors (i.e. policyholders). It is also technically possible, although more difficult in practice, to seek to vary the rights and interests of policyholders by obtaining explicit consent from each policyholder.

profits) of CULAC, CGNU Life and Norwich Union Life (RBS) Limited to Aviva Life & Pensions UK Limited.

This paper describes the roles and responsibilities of the various participants in a reattribution. It also covers the process for the Aviva reattribution scheme.

Some information in this paper is specific to the Aviva reattribution, for example in the case of the policyholder advocate's terms of reference. The original timetable for the reattribution was determined by Aviva, taking into account legal requirements and those of the other participants in the process and then refined following consultation with the FSA, policyholder advocate and independent expert.

Some of the requirements outlined are necessitated by the fact that the reattribution being undertaken by Aviva is by way of a Part VII transfer. Indeed, since the company is proposing a funds transfer, it would be required to undertake some of the process outlined whether or not there was a reattribution as well as the Part VII transfer. Equally, there are some specific requirements for firms undertaking a reattribution (whether or not it is by way of a Part VII transfer).

These are set out in the FSA's Conduct of Business Sourcebook at COBS 20.2. These rules came into effect on 1 November 2007. On that date the entire FSA Conduct of Business Sourcebook was replaced by new rules largely to reflect the implementation of a new European directive regulating investment services (the Markets in Financial Instruments Directive or MiFID). The COBS rules relating to reattributions (and with-profits more generally) were not impacted by MiFID directly, although the FSA did take the opportunity at the time of introducing the new COBS rules to rationalise the previous COB rules<sup>2</sup> for with-profits which were introduced in 2005 following the FSA's with-profits review. The FSA stated at the time of introducing the new MiFID-compliant COBS rules<sup>3</sup> that it would not undertake a fundamental review of the with-profits material in the previous COB rules until it

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<sup>2</sup> These were known as "COB" as distinct from the new rules which are known as "COBS".

<sup>3</sup> See summary in FSA Policy Statement 07/6 at paragraph 23.1.

had had enough time to see how it works in practice. However, consistent with its general policy on principles-based regulation, it did propose to:

- move to higher-level rules in some areas;
- make some changes in wording, suggested by its experience so far, of how well the rules had operated in practice;
- remove unnecessary guidance, particularly where it was either self-evident or implicit in the rules;
- re-order more logically material that was made at different times; and
- move some material on reattribution onto a new web page.

Insofar as reattributions are concerned, there is little substantive difference between the previous COB rules and the new COBS rules although the FSA did, as it said it would, remove some of the guidance (rather than the substantive rules), most of which was in fact transferred onto an FSA “frequently asked questions” web page<sup>4</sup>.

In some cases the emphasis was changed. For example, whereas previous guidance (COB 6.13.42G) stated that in cases of protracted negotiations, policyholders should receive an update at least every six months, the material on the web page notes that, in addition to the mandatory information to be given to policyholders, firms *might* also issue regular updates, especially where negotiations are conducted over a long timescale. It is worth noting in this respect that firms remain subject to the over-arching requirement in Principle 7 to pay due regard to the information needs of clients and to communicate information to them in a way which is clear, fair and not misleading. The previous guidance also stated that the arrangements for the policyholder advocate’s appointment should require him to communicate and receive views from policyholders before being expected to negotiate with the firm. That guidance was not carried forward into COBS. In the corresponding material on the web page, the FSA notes in the context of when the negotiations will begin and how

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<sup>4</sup> “The Process for Reattribution of Inherited Estates” - <http://www.fsa.gov.uk/pages/Doing/Regulated/newcob/faqs/estates.shtml>. This does not have the status of formal guidance under FSMA, although it is indicative of the FSA’s views and how it might approach questions of compliance with the substantive rules and FSA principles for businesses.

long they will take, that “this depends on the circumstances of the reattribution proposal. ...The PHA will also need to communicate with, and receive views from, eligible with-profits policyholders about the proposed reattribution...”.

## **2.00 The roles of key participants**

### **2.01. The firm**

In its evidence to the Treasury Committee, the FSA summarised the role of a firm in a reattribution as follows:

“Firms who wish to carry out a reattribution must follow a process set out in FSA rules and guidance. The process is designed to ensure that:

- policyholders are treated fairly during the reattribution process, including by ensuring that there is someone completely independent of the firm (the policyholder advocate) representing policyholders’ interests during the process;
- taking account of the circumstances in which the firm finds itself, the reattribution is within the range of reasonable outcomes available to the firm and takes due account of policyholders’ interests and treats policyholders fairly; and
- the process itself is as open as possible.

Specifically, when undertaking a reattribution, we require firms to:

- identify and appoint a policyholder advocate (PHA) to negotiate (on behalf of eligible with-profits policyholders) the benefits to be offered to them in exchange for the rights and interests they are being asked to give up. The PHA must be approved by the FSA;
- notify us of the PHA’s terms of appointment;
- depending on the legal process used, appoint an expert (called an independent expert or a reattribution expert) to assess objectively the

retribution proposals and prepare a report for the benefit of the Court and the FSA;

- send appropriate and timely information to every policyholder that might be affected by the proposed retribution; and
- give eligible policyholders the option individually to accept or reject the proposals or, if the legal process being followed allows the majority of policyholders to bind the minority, to vote on whether the process should go ahead.

We require any firm that does propose a retribution to comply with our Principles for Business. For example, a firm must act with integrity, have due regard to their policyholders' interests, must ensure that their policyholders have adequate information and must avoid or manage conflicts of interest. Policyholders must be treated fairly during the retribution process and as a result of the retribution.

We recognize that firms have different circumstances and may adopt different legal procedures to achieve a retribution. For example, some firms may give effect to a retribution using the transfer of business procedures in Part VII of FSMA. Other firms may use the procedures in Part 26 of the Companies Act 2006. In each case the Court will have a role in deciding whether it is appropriate for the retribution to go ahead. Our rules will accommodate these different legal processes.”<sup>5</sup>

In order to initiate a Part VII transfer (including in this case a retribution), a scheme needs to be drawn up to set out in detail the basis of the transfer and retribution. The organisation responsible for drawing up the scheme is the “scheme promoter”, and this organisation must make the application to effect the transfer and the retribution. In the FSA Handbook, it is stated that the “scheme promoter” may be the transferor company (i.e. the company from which the business is being transferred) or the transferee company (i.e. the company to which

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<sup>5</sup> paragraphs 13-16 of the FSA's written evidence to the House of Commons Treasury Committee, Inherited Estates, Twelfth Report of Session 2007-08, HC 496, June 2008.

the business is being transferred)<sup>6</sup>. In this case the scheme promoter is Aviva Life and Pensions UK Limited, the transferee.

The firm has a duty to keep the FSA informed. This follows from the FSA's Principle 11 of its Principles for Business (Relations with Regulators) which states: "a firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the company of which the FSA would reasonably expect notice". In addition to this, the FSA Supervision Manual (SUP) states that the scheme promoters should discuss the scheme with the FSA "as soon as reasonably practical"<sup>7</sup>. This is so that the FSA is able to consider, as early as possible, the issues that are likely to arise, such as those relating to policyholders' rights or security.

Aviva approached the FSA about the proposed Part VII transfer and reattribution in 2005. Provisional information was also provided to the FSA about the scheme, so that the FSA was informed about the nature of the scheme when approving the firm's nominated independent expert and policyholder advocate.

The firm has a duty to keep other participants in the reattribution process informed, including the policyholder advocate, the independent expert, the with-profits actuary and the actuarial function holder (see the descriptions of their roles below).

As far as policyholders are concerned, the COBS rules (COBS 20.2.49R) state that in a reattribution, the firm must make arrangements so that every policyholder who may be affected by the proposed reattribution will receive appropriate and timely information about:

- (1) the reattribution process, including the role of the policyholder advocate, the independent expert or reattribution expert, as the case may be, and other individuals appointed to perform particular functions;

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<sup>6</sup> SUP 18.2.12G.

<sup>7</sup> Ibid.

- (2) the reattribution proposals and how they affect the relevant policyholders, including an explanation of any benefits they are likely to receive and the rights and interests that they are likely to be asked to give up;
- (3) the policyholder advocate's views on the reattribution proposals and any benefits the relevant policyholders are likely to receive and the rights and interests that they are likely to be asked to give up; and
- (4) the outcome of the negotiations between the firm and the policyholder advocate about the benefits that will be offered to relevant with-profits policyholders, in exchange for the rights and interests that they will be asked to give up.

SUP 18.2.48G states that policyholders should also normally be provided with a summary of the independent expert's report.

Aviva initially contacted policyholders about the reattribution after the appointment of the policyholder advocate on 21 November 2006. The mailing consisted of a letter and a leaflet from Aviva, together with a letter and a leaflet from the policyholder advocate.

## **2.02. The Financial Services Authority**

The COBS rules provide some guidance about the way in which the FSA would expect to be involved in the process. The approval of the FSA is not needed for a firm to complete a reattribution. However the FSA does have the power, for example, to require a firm to modify or refrain from carrying out a reattribution, on the basis that some or all of the firm's reattribution proposals are inconsistent with the published FSA Principles for Business, and in particular, Principle 6 (Customers' Interests)<sup>8</sup>. Furthermore, the FSA is entitled under Section 110(a) of FSMA to be heard at Court when the firm is seeking approval for its Part VII transfer (including, in this case, the reattribution).

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<sup>8</sup> Principle 6 states that: "A firm must pay due regard to the interests of its customers and treat them fairly".

The FSA is involved in nominating or approving the independent expert<sup>9</sup> and the policyholder advocate<sup>10</sup>. In order to form a view about the skills required to perform these roles, the FSA needs to be provided by the firm with information about the nature of the scheme.

The FSA, in its evidence to the Treasury Committee, summarised its role in a reattribution as follows:

“Our role in a proposed reattribution is to scrutinise the fairness of the proposals.

In relation to the negotiation between the firm and the PA, the FSA also has a duty to oversee the process where appropriate, but we are not party to the negotiation between the PA and the firm. In carrying out this role, we look at whether it appears that the PA and the firm are able to conduct a full and fair negotiation.

Once the PA and the firm have completed their negotiations, we form a view on whether the overall proposals are fair to policyholders. In doing so, we take into account the interests of all policyholders, including the relevant with-profits policyholders, and the implications of the proposals for the financial position of the firm. We consider carefully the detailed information provided to us by the firm and other relevant stakeholders. The information provided by the firm will include the views expressed by the firm’s with-profits actuary. We take into account the report prepared by the independent expert or reattribution expert (who is required to undertake an objective assessment of the proposals and report on this) and the report prepared and the opinions expressed by the PA. We ask the firm to demonstrate to us that the proposals are fair and that they are consistent with all other relevant requirements.

In a reattribution of a 90:10 fund, our assessment of fairness starts with the principle set out in the Ministerial Statement of February 1995 – namely, that the basis of distributions to policyholders and shareholders will be in the proportions of 90% and 10% respectively. If the reattribution proposal is to divide value between

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<sup>9</sup> COBS 20.2.47(1)(a)R.

<sup>10</sup> COBS 20.2.42(2)R, 20.2.45(1)R.

policyholders and shareholders on a basis that is different from this 90:10 starting point, we look at the basis for that proposed division and decide whether it is fair, compared with policyholders awaiting a potential future 90:10 distribution. (There is no guarantee that circumstances will arise in which the inherited estate will become available for distribution. Therefore what is at stake for the current policyholders is the certainty of receiving payment now from the reattribution against the possibility of an uncertain amount at an uncertain time in the future – see also paragraph 10.)

We will also focus on the fairness of the offer being made to policyholders vis-à-vis the overall benefit to the shareholder. One of the ways we approach this is to review the return to the shareholder.

Where the firm and PHA agree that a reattribution deal should be put to policyholders, our assessment of fairness will form part of our submission to the Court (and so will be made public). Our assessment of fairness will include the range of outcomes that we assess to be fair. Making our assessment of fairness public at this stage is consistent with our commitment to act transparently. Should the two parties agree that a deal can be put to policyholders and that it would facilitate the process to know our preliminary view on fairness (including the range of outcomes), we would privately inform the parties at that point.

We will make our assessment of fairness before the reattribution proposals are put to policyholders by the firm. If we conclude that the proposals are unfair to policyholders, we will take steps to prevent the firm from putting the deal to policyholders.”<sup>11</sup>

### **2.03. The Policyholder Advocate**

The FSA’s COBS rules (COBS 20.2.42R) state that:

“A firm that is seeking to make a reattribution of its inherited estate must:

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<sup>11</sup> paragraphs 17-23 of the FSA’s written evidence to the Treasury Committee.  
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- (1) identify at the earliest appropriate point a policyholder advocate, who is free from any conflicts of interest that may be, or may appear to be, detrimental to the interests of policyholders, to negotiate with the firm on behalf of relevant with-profits policyholders;
- (2) seek the approval of the FSA for the appointment of the policyholder advocate as soon as he is identified, or appoint a policyholder advocate nominated by the FSA if its approval is not granted; and
- (3) involve the policyholder advocate designate at the earliest possible opportunity to enable him to participate effectively in the negotiations about the proposals for the reattribution.

The firm should include an independent element in the policyholder advocate selection process, which may include consulting representative groups of policyholders or using the services of a recruitment consultant. When considering an application for approval of a nominee to perform the policyholder advocate role, the FSA will have regard to the extent to which the firm has involved others in the selection process.

The precise role of the policyholder advocate in any particular case will depend on the nature of the firm and the reattribution proposed. A firm will need to discuss with the FSA the precise role of the policyholder advocate in a particular case (COBS 20.2.45 R). However, the role of the policyholder advocate should include:

- (1) negotiating with the firm, on behalf of the relevant with-profits policyholders, the benefits to be offered to them in exchange for the rights or interests they will be asked to give up;
- (2) commenting to with-profits policyholders on:
  - (a) the methodology used for the allocation of benefits amongst the relevant (or groups of) with-profits policyholders and the form of those benefits;

- (b) the criteria used for determining the eligibility of the various with-profits policyholders;
  - (c) the terms and conditions of the proposals (to the extent that they materially affect the benefits to be offered, or the bonuses that may be added to with-profits policies); and
  - (d) the views expressed by the independent expert or the reattribution expert (as the case may be), and the firm's with-profits actuary on the allocation of any benefits amongst the relevant with-profits policyholders; and
- (3) telling with-profits policyholders, or each group of with-profits policyholders, with reasons, whether the firm's proposals are in their interests.”<sup>12</sup>

The FSA summarised its view of the role of the policyholder advocate in its evidence to the Treasury Committee as follows;

“The precise role of the Policyholder Advocate (PHA) will depend on the type of firm concerned and the nature of the reattribution proposals. We developed the PHA role so that with-profits policyholders can have an informed and independent person, properly supported by advisers, who can negotiate on their behalf with the firm; this is particularly important, given the complex nature of with-profits business. The negotiation centres on the value of benefits which will be offered to policyholders in exchange for the rights or interests they will be asked to give up. The PHA can challenge any part of the operation of the with-profits fund in the course of negotiations with the firm.

A key responsibility of the PHA is to explain to policyholders whether, in the PHA’s view, the firm’s proposals are in their interest. In particular, the PHA compares the firm’s proposals for a reattribution with the position as it would be if the reattribution

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<sup>12</sup> COBS 20.2.42 to 20.2.44.

did not go ahead. The PHA takes into account the probability that there may be a distribution of surpluses in the future and other factors such as the value that should be attached to capital retained to finance new business. If the PHA does not believe that the proposals are in the interests of policyholders, he or she should communicate that conclusion to policyholders.”<sup>13</sup>

Aviva employed an executive recruitment agency to suggest suitable candidates for the role of policyholder advocate in this reattribution. The selected candidates were interviewed on a number of occasions including by two policyholders. The involvement of policyholders satisfied the FSA’s stated preference for an element of independence in the selection process of the policyholder advocate<sup>14</sup>.

Clare Spottiswoode CBE was nominated as policyholder advocate following approval by the FSA. Ms Spottiswoode’s nomination as the policyholder advocate was announced in Spring 2006 and, following a period of time enabling Ms Spottiswoode to make enquiries about the reattribution and appoint advisers to assist her in her role as policyholder advocate, she was formally appointed as policyholder advocate in November 2006.

### **The Policyholder Advocate’s Terms of Appointment**

In regard to the terms of the policyholder advocate’s appointment, the FSA’s COBS rules state that:

“A firm must:

- (1) notify the FSA of the terms on which it proposes to appoint a policyholder advocate (whether or not the candidate was nominated by the FSA); and
- (2) ensure that the terms of appointment for the policyholder advocate:
  - (a) stress the independent nature of the policyholder advocate's appointment and function, and are consistent with it;

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<sup>13</sup> paragraphs 24-25 of the FSA’s written evidence to the Treasury Committee.

<sup>14</sup> COBS 20.2.43G.

- (b) define the relationship of the policyholder advocate to the firm and its policyholders;
- (c) set out arrangements for communications between the policyholder advocate and policyholders;
- (d) make provision for the resolution of any disputes between the firm and the policyholder advocate;
- (e) specify when and how the policyholder advocate's appointment may be terminated; and
- (f) allow the policyholder advocate to communicate freely and in confidence with the FSA.

A firm may include, within the policyholder advocate's terms of appointment, arrangements for the policyholder advocate to be indemnified in respect of certain claims that may be made against him in connection with the performance of his functions. If such indemnity is included, it should not include protection against any liability arising from acts of bad faith.”<sup>15</sup>

During the period between Ms Spottiswoode’s nomination and formal appointment as policyholder advocate, the terms of reference for Ms Spottiswoode were agreed. These terms of reference:

- a) outlined the appointment and role of the policyholder advocate, including:
  - i) negotiation of the policyholder incentive payment to be offered to relevant with-profits policyholders as part of the reattribution process; and
  - ii) the responsibility of the policyholder advocate to write a report to with-profits policyholders about the terms and conditions of the proposals being made to them by Aviva;

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<sup>15</sup> COBS 20.2.45 to 20.2.46.

- b) detailed how the policyholder advocate, the firm, the FSA and the independent expert would interact;
- c) agreed the provision of information by the firm to the policyholder advocate;
- d) stated that the policyholder advocate could respond to representations and enquiries from policyholders in the way she felt to be most appropriate;
- e) outlined the policyholder advocate's right to appear at Court if either she or the firm considered it appropriate;
- f) agreed the terms of the appointment and scenarios in which the appointment of the policyholder advocate could be terminated by the firm;
- g) agreed how the policyholder advocate and the firm would act in terms of confidentiality, information requests, administrative support and the policyholder advocate's budget; and
- h) agreed the circumstances in which Aviva would indemnify the policyholder advocate.

The terms of reference were published in full on the policyholder advocate's website ([www.policyholderadvocate.org](http://www.policyholderadvocate.org)) when Ms Spottiswoode was formally appointed as policyholder advocate on 21 November 2006.

In terms of consulting with policyholders, the conduct of business rules in force at the time of Ms Spottiswoode's appointment as policyholder advocate (which have subsequently been superseded) stated that, once appointed, the policyholder advocate's terms of appointment should require him/her to communicate with and receive views from relevant with-profits policyholders about the nature of the reattribution<sup>16</sup>. In line with those rules, Ms Spottiswoode communicated with policyholders soon after her appointment was confirmed in November 2006 and subsequently consulted with them and other interested parties over a three month period, including in meetings and by way of an online questionnaire. During this period, the policyholder advocate also received views of policyholders through the policyholder

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<sup>16</sup> COB 6.13.34G (which has no equivalent in COBS).

advocate's helpline and through letters. In all, the formal consultation period lasted from Ms Spottiswoode's appointment to Spring 2007. More information on this can be found in Appendix 24 - "Consultation and communication with with-profits policyholders and other interested parties".

### **The Report of the Policyholder Advocate**

The information which the firm is required to provide to policyholders, referred to above, includes information about the policyholder advocate's views on the reattribution proposals, any benefits the relevant policyholders are likely to receive and the rights and interests that they are likely to be asked to give up. Consistent with COBS 20.2.44G, the policyholder advocate's terms of engagement also provide that she is to comment on:

- the methodology used for the allocation of benefits amongst the relevant with-profits policyholders, or groups of with-profits policyholders, and the form of those benefits;
- the criteria used for determining the eligibility of the company's various with-profits policyholders;
- the terms and conditions of the proposals (to the extent that they have a material effect on the value of the benefits to be offered, or on the bonuses that may be added to with-profits policies);
- the views expressed by the independent expert, and the with-profits actuary on the allocation of any benefits amongst the relevant with-profits policyholders; and
- she must also tell with-profits policyholders, or each group of with-profits policyholders, with reasons, whether the firm's proposals are in their interests.

The FSA, the policyholder advocate and Aviva agreed that, in the interests of treating customers fairly<sup>17</sup>, it would be appropriate for the policyholder advocate to produce a customer-friendly guidance booklet, to be sent to policyholders, which would include

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<sup>17</sup> From Principle 6 of the FSA's Principles for Business: "a firm must pay due regard to the interests of its customers and treat them fairly".

comments on the issues stated in the COBS rules. This was agreed on the basis that a copy of the policyholder advocate's report would be available on request to eligible policyholders during the election period free of charge.

#### **2.04. The Independent/Reattribution Expert**

The COBS rules provide that a "reattribution expert" must be appointed in order to consider the effect of the reattribution. If the reattribution is carried out by way of a Part VII transfer, the independent expert appointed to comment on the terms of the scheme is also the "reattribution expert" for the purposes of the reattribution. Further information on the role of the independent expert in a Part VII transfer is set out below.

Section 109(1) of FSMA states that any Part VII transfer must be accompanied by a report from the independent expert on the terms of the scheme, which should include, among other things, his/her opinion of the likely effect of the scheme on policyholders. The purpose of the scheme report is to inform the Court<sup>18</sup>.

SUP 18.2.32G states that the independent expert should contact the FSA at an early stage to establish whether or not there are particular issues that the FSA would expect to see addressed in his/her report. The FSA did not raise any particular issues in relation to the Aviva transfer/reattribution.

The independent expert should be a person who appears to the FSA to have the necessary skills to enable him to deliver a proper scheme report (the scheme report is discussed in more detail below). He/she must also be nominated or approved for the purpose by the FSA<sup>19</sup>. In order to fulfil this role, the independent expert must:

- be independent of the transferor and the transferee companies<sup>20</sup>;
- have the relevant knowledge of the insurance business and experience of the types of insurance business transacted by the transferor and transferee<sup>21</sup>;

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<sup>18</sup> SUP 18.2.34G.

<sup>19</sup> SUP 18.2.14(2)G, COBS 20.2.47R(1)(a).

<sup>20</sup> SUP 18.2.15(1)G cf COBS 20.2.47(1)(b)R: the expert must be "free from any conflicts of interest that may, or may appear to, undermine his independence or the quality of his report".

- be a Fellow of the Institute of Actuaries or of the Faculty of Actuaries<sup>22</sup>; and
- be an actuary who is familiar with the roles of the actuarial function holder and the with-profits actuary<sup>23</sup>.

In each individual case different criteria will be relevant to determine who would be suitable to act as the independent expert. The FSA will consider the criteria it deems to be necessary on the basis of the information that it has received from the scheme promoters, and will inform the firm accordingly. If the firm nominates a person to act as the independent expert, the FSA may want to have preliminary discussions with the nominee to determine whether he is suitably qualified to address the issues arising from the transfer<sup>24</sup>. Any party nominating the independent expert must give reasons why it considers its nominee to be a suitable person for the role<sup>25</sup>.

In the case of the Aviva reattribution, the appointed independent expert is Nick Dumbreck of Milliman.

### **The Report of the Independent Expert**

The role of the independent expert in a Part VII transfer, including the form and scope of his report, is set out in some detail in SUP 18.2. Where the transfer also involves a reattribution it is implicit in the FSA rules that the independent expert's report will cover the reattribution proposals although SUP does not in fact refer expressly to reattributions.

The rules in COBS 20.2.47-48, which relate to the appointment of a "reattribution expert" in circumstances where a firm is not otherwise required to appoint an independent expert (i.e. where there is no Part VII transfer), merely provide that the reattribution expert must undertake an objective assessment of the reattribution proposals and that the scope and content of his report should be substantially similar to that of an independent expert on a Part VII transfer - as set out in SUP 18.2 and summarised below.

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<sup>21</sup> SUP 18.2.15(2)G.

<sup>22</sup> SUP 4.3.9R.

<sup>23</sup> SUP 18.2.16G.

<sup>24</sup> SUP 18.2.21G.

<sup>25</sup> SUP18.2.20G.

On any Part VII transfer, a scheme is developed outlining the arrangements by the scheme promoter and an independent expert is required to comment on it. The report written by the independent expert is called “the scheme report” and SUP 18.2.39G provides guidance about the scheme report, stating that it should:

- describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits;
- state if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group compares with the value of that dilution and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;
- describe the likely effect of the scheme on the approach used to determine:
  - the amounts of any non-guaranteed benefits such as bonuses or surrender values; and
  - the levels of any discretionary charges;
- describe the safeguards provided in the scheme against subsequent change of approach to these matters that could act to the detriment of existing policyholders of either the transferor or the transferee;
- include the independent expert’s overall assessment of the likely effects of the scheme on the reasonable expectations of policyholders;
- state whether the independent expert is satisfied that for the transferor and the transferee, the scheme is equitable to all classes and generations of policyholders; and
- state whether, in the independent expert’s opinion, for the transferor or the transferee, there are sufficient safeguards to ensure that the scheme operates as presented.

In addition to this, SUP 18.2.36G gives guidance about points which the opinion of the independent expert should include. These points are:

- a comparison of the likely effects if the scheme is or is not implemented;
- a statement of whether or not alternative arrangements were considered by the independent expert, and if so, what;
- how different groups of policyholders are likely to be affected differently by the scheme; and
- the views of the independent expert on:
  - the effect of the scheme on the security of policyholders' contractual rights;
  - the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:
    - § the security of policyholders' contractual rights;
    - § levels of service provided to policyholders;
    - § the reasonable expectations of policyholders; and
  - the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or their reasonable expectations.

SUP 18.2.23G states that firms should co-operate fully with the independent expert and provide him with access to all relevant information and appropriate staff. It should be noted that the rules regarding expert evidence in Part 35 of the Civil Procedures Rules 1998 apply to the independent expert, including rule 35.3, which states that the expert has a duty to inform the Court on matters within his/her expertise and that this duty overrides any obligation to the person from whom he/she has received his/her instructions or by whom he/she is paid, which in the case of a Part VII transfer is the firm.

## **2.05. The Actuarial Function Holder**

All firms which carry on on long term insurance business (including with-profits business) are required to appoint an actuarial function holder. The actuarial function holder:

- must have the required skills and experience to fulfil his/her role; and
- should be a Fellow of the Institute of Actuaries or the Faculty of Actuaries<sup>26</sup>.

The actuarial function holder must advise those who manage the relevant funds about the risks that the firm runs, in so far as they have a material adverse impact on the firm's ability to meet its liabilities to policyholders as they fall due, and on the capital needed to support the business, including the regulatory capital requirements<sup>27</sup>. It is his role to monitor these risks<sup>28</sup>. The actuarial function holder for all the relevant Aviva firms is John Lister. Mr Lister is a Council Member of the Institute of Actuaries.

SUP 18.2.58G provides that on a Part VII transfer, the Court would usually be given a copy of a report on the transfer produced by the actuarial function holder. Although the COBS rules do not require the report of the actuarial function holder to address the reattribution, his report would, in practice, cover the reattribution proposals as well as the other elements of a Part VII transfer.

## **2.06. The With-Profits Actuary**

All firms that carry on with-profits business are required to appoint a with-profits actuary.

The with-profits actuary:

- must have required skills and experience to fulfil his role; and
- should be a Fellow of the Institute of Actuaries or the Faculty of Actuaries<sup>29</sup>.

In the case of Aviva, the with-profits actuary (of all the relevant Aviva firms) is a member of the Institute of Actuaries.

SUP 4.3.17R (4) states that a firm is required to request the advice of the with-profits actuary about the likely effects of material changes in the firm's business plan on the rights and reasonable expectations of the relevant classes of with-profits policyholders.

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<sup>26</sup>SUP 4.3.9R.

<sup>27</sup> SUP 4.3.13(1)R.

<sup>28</sup> SUP 4.3.13(2)R.

<sup>29</sup> SUP 4.3.9R.

SUP 18.2.58G expands on this and states that a Part VII transfer would be considered “material” unless the liabilities transferred were not material relative to the total liabilities of the firm. The advice on a Part VII transfer would normally be in the form of a formal report by the with-profits actuary. In a reattribution, the FSA’s COBS rules state that the policyholder advocate should comment on the report of the with-profits actuary<sup>30</sup>.

SUP 18.2.58G provides that on a Part VII transfer, the Court would usually be given a copy of the report on the transfer produced by the with-profits actuary.

Although the COBS rules do not require the report of the with-profits actuary to address the reattribution, his report would, in practice, cover the reattribution proposals as well as the other elements of a Part VII transfer.

## **2.07. The European Economic Area Regulators**

Part VII of FSMA broadly permits a UK person with permission to carry on insurance business in the UK to transfer an insurance business carried on in one or more EEA member states to another body. Such a transfer must result in the business transferred being carried on from an establishment of the transferee in an EEA member state.

Part 1 of Schedule 12 to FSMA effectively gives to regulators in those EEA member states:

- (i) in which there is an establishment from which any of the business to be transferred is carried on; or
- (ii) which are the “states of commitment” for policies to be transferred,

a three-month period to object to the transfer. Only if there is no objection may the scheme be approved by the Court.

The expression “state of commitment” is defined by Schedule 12 to mean:

- a) where the policyholder is an individual, the EEA state in which he had his habitual residence at the date that he took out the contract; and

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<sup>30</sup>COBS 20.2.44(2)(d)G.

- b) if the policyholder is not an individual, the EEA state in which the establishment of the policyholder to which the policy relates was situated at the date on which the policy was taken out.

The definition of “habitual residence” is unclear and the insurance company is very unlikely to have gathered information as to habitual residence when a policy was taken out. As a result, practice has shown that the Court and the FSA (and its predecessors) are prepared to be pragmatic in the application of these requirements. Firms typically consult their computer records to identify the number of policyholders with a current residential or registered address in a particular EEA state and, depending on that number, conduct an examination of original paper files to investigate whether the policyholder was resident in that EEA state when the contract was taken out. In order to invoke the requirement for consultation in relation to a particular EEA state, it is necessary to find only one policy to which the requirements apply. It is therefore customary to err on the side of caution and consult, unless it is fairly clear that a requirement cannot apply to the relevant EEA state.

The FSA therefore must be provided with necessary information from the firm to pass to the relevant EEA host state regulators. This information should include the identification of the parties to the transfer and the transfer agreement (or draft transfer agreement or a summary of the transfer agreement)<sup>31</sup>. If an EEA host state regulator does not respond within three months, its consent is assumed. The FSA will have to certify to the Court that the relevant EEA host state regulators have been consulted<sup>32</sup>.

### **3.00 Court Process**

This section briefly describes the Court process for a Part VII transfer. There is no requirement for the Court to sanction a reattribution as such but where, as in the present case,

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<sup>31</sup> SUP 18.2.28G.

<sup>32</sup> Once the certificate has been given by the FSA, it does not matter that there may in fact have been more policies subject to the requirement in that EEA state than were identified to the relevant EEA regulator. It is usual to include in the scheme document wording which excludes from the transfer any policy to which these requirements apply and in respect of which the relevant certificate has not been given by the FSA. The interests of holders of these “excluded policies” are protected by means of a reinsurance contract entered into between the transferor and transferee.

a reattribution is effected concurrently with a Part VII transfer, the Court process for the Part VII transfer will effectively also apply to the reattribution.

### **3.01. Preparation of Material for the Preliminary Court Hearing (the Case Management Conference)**

The Court process is initiated with the filing of a claim form in accordance with Section 107 of FSMA and the relevant rules of procedure.

Before the Court process begins, the scheme, the independent expert's report, a statement setting out the terms of the scheme (the scheme summary) and a summary of the independent expert's report and the reports of the with-profits actuary and the actuarial function holder should be finalised. Section 109(3) of FSMA states that the FSA should approve the form of the independent expert's report, although not the report itself. Also, before the commencement of the Court process, notice to policyholders and a notice to be placed in newspapers and gazettes should be in near final form<sup>33</sup>. All witness statements submitted to the Court should be provided to the FSA by the applicants.

In advance of the preliminary Court hearing (known as the case management conference) a first witness statement is prepared, which will include the following:

- information about the transferee and the transferor and their insurance business;
- the purpose of the scheme;
- the transferor and transferee proposals for policyholder notification;
- details of the policyholders to whom it is proposed not to send the notice;
- policies and business about which relevant European Economic Area (EEA) host state regulators need to be consulted;

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<sup>33</sup> As noted above, it may not always be possible to contact all policyholders and the Court has the power to grant dispensations to the firm if this is the case. The notice of the application should be published in the London, Edinburgh and Belfast Gazettes and in two national newspapers in the UK and in two national newspapers in any other state that is the "state of commitment".

- as an exhibit, the claim form appended to which there should be the scheme, the draft order for directions and the draft final order; and
- as an exhibit, the scheme summary, the scheme report, the reports of the with-profits actuary and the actuarial function holder and the form of notice and information to be published and to be sent to policyholders (including in this case, information from the policyholder advocate).

### **3.02. The Case Management Conference**

At this hearing, directions are to be sought on the publication of notices to policyholders and the advertisements in newspapers in the UK and EEA, if applicable. The date of the final Court hearing may also be discussed.

### **3.03. Actions Following the Case Management Conference**

Following the case management conference:

- statutory notices (approved by the FSA) are published in gazettes and newspapers. These should not be made less than six weeks in advance of the final Court hearing<sup>34</sup>;
- a circular will be sent to policyholders. This will include information from Aviva, the policyholder advocate and the independent expert;
- the summary of the scheme will be made available to policyholders<sup>35</sup>;
- the policyholder advocate's report will be made available to policyholders;
- the independent expert's report will be made available to policyholders<sup>36</sup>;
- a copy of the claim form, the policyholder advocate's report, the independent expert's report and the policyholder circular will be sent to the FSA; and
- correspondence with objectors to the scheme should be collected<sup>37</sup>.

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<sup>34</sup> SUP 18.2.42 – 18.2.47G.

<sup>35</sup> SUP 18.2.48G.

<sup>36</sup> SUP 18.2.48G.

Policyholders will also be asked to vote on whether or not they wish to accept the reattribution proposals put to them by Aviva. The policyholder advocate will conduct more public meetings during this period, to help inform people of her views.

The FSA would not normally consider adequate a period of less than six weeks between sending the relevant information to policyholders and the date of the final Court hearing<sup>38</sup>. In relation to a reattribution, the FSA requires that policyholders normally be given at least 8 weeks to vote on the reattribution offer.

Section 110 of FSMA provides that any person who alleges that he would be adversely affected by the carrying out of a scheme under Part VII is entitled to be heard at Court. In practice this means that a policyholder who believes that he would be adversely affected by the reattribution or the fund transfer is entitled to be heard at Court (in person or represented by counsel or by way of a written representation). There is no particular formal procedure for appearing at Court; the policyholder does not for instance have to give formal notice to the Court. However, it is expected that in the policyholder circular sent by Aviva, the company will, in addition to informing policyholders that they are entitled to appear and object, also ask policyholders to notify either the company (or their lawyers) if they intend to appear at the hearing. There is no provision in FSMA dealing with a policyholder's costs of appearing at Court and so the policyholder would have to bear those costs unless the Court ordered otherwise<sup>39</sup>.

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<sup>37</sup> Section 110(b) of the FSMA provides that any person who alleges that he or she would be adversely affected by the scheme is entitled to be heard at the hearing. In practice, a firm may receive objections to the scheme before the court hearing.

<sup>38</sup> SUP 18.2.46G.

<sup>39</sup> The decision of the Vice Chancellor in *Re The Royal London Mutual Insurance Society Limited (2000)* (unreported) indicates that the court is likely to apply the principle that a person who in answer to the publicity given to a scheme, appears and raises objections which are not frivolous in nature, should ordinarily receive his costs from the promoters as his argument had been helpful to the Court. However, costs are ultimately in the discretion of the court and objectors cannot rely upon their costs being paid: see *Re Alliance Assurance Co Ltd* [2006] EWHC 2947 (Ch).

### 3.04. Preparation of Material for the Final Court Hearing

Under the relevant regulations<sup>40</sup>, the FSA should receive the scheme report and the statement of the terms of the scheme and the summary scheme report at least 21 days before the final Court hearing<sup>41</sup>.

The firm will prepare a final witness statement which should include:

- proof that the matters set out in the directions hearing have been dealt with. This includes the posting of materials to the policyholders and the publication of notices in newspapers;
- a certificate under section 111(2)(a) of FSMA confirming that the transferee will have the required margin of solvency after the transfer has been effected (details about this certificate are given in Paragraph 2 of Schedule 12 of FSMA);
- confirmation of the authorisation of the transferee (section 111(2)(b) of FSMA);
- proof that any conditions to which the scheme was made subject, such as the receipt of tax clearances, have been satisfied or waived<sup>42</sup>;
- responses to the content of any material objections to the scheme which have been intimated to the firms;
- a summary of any views expressed by the FSA (unless the FSA has indicated that it intends to attend and be heard at the Court hearing);

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<sup>40</sup> The Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001.

<sup>41</sup> It should, however, be noted that in the case of *Re Sun Life of Canada Assurance Company* 1999 (unreported), Neuberger J held that the equivalent provision in Schedule 2C to the Insurance Companies' Act 1982 was not a mandatory requirement but was for the benefit of the FSA, who could if it wished waive non-compliance. Even if the FSA did consider that insufficient notice had been given and chose not to waive non-compliance, it would still be open to the court to consider whether any real prejudice had been suffered by the FSA as a result of non-compliance. If the Judge found that there had been no prejudice suffered, it would be open to the court to hold that there had been substantive compliance with the requirement.

<sup>42</sup> It may be the case that the scheme is subject to conditions which by their nature cannot be satisfied until a later date e.g. a listing condition. Section 111(2)(b) of FMSA makes it clear that authorisation of the transferee to carry on the business need only be in place by the time that the scheme is effective.

- any further argument, as may be necessary, as to why it is appropriate for the Court to sanction the scheme; and
- an update of any facts evidenced in the first witness statement.

It should be noted that in the Aviva reattribution process, the policyholder advocate intends to submit a witness statement attaching her report. The policyholder advocate also expects to produce a supplementary report before the High Court hearing and if she does, this will also be made available for the Court (and on the policyholder advocate's website).

### **3.05. Final Court Hearing**

The final Court hearing will be heard by a Judge, before an open Court. Section 110 of FSMA grants the FSA the right to be heard. The FSA has stated that it will prepare a report to the Court and also that "the FSA may, subject to the Court, also wish to address the Court through Leading Counsel".

As has been noted, FSMA does not contemplate reattributions and so there is no provision for a policyholder advocate to be heard at Court. The right under section 110 of FSMA referred to above for persons alleging they would be adversely affected by a fund transfer scheme is unlikely to extend to the policyholder advocate. Nevertheless, the policyholder advocate assumes (on the basis of legal advice) that she will in practice be permitted to attend and give evidence at Court and her terms of reference with Aviva envisage that she may do this if she considers it appropriate. Ms Spottiswoode does in fact intend to be present at Court, represented by separate counsel (i.e. she would not be represented by Aviva's counsel).

It should be noted that the Aviva reattribution is the first which has been undertaken since the FSA rules relating to the requirement to appoint a policyholder advocate came into force (in 2005) and there is therefore no precedent for the role of the policyholder advocate in Court. The FSA rules do not cover the role of the policyholder advocate in Court.

### **3.06. Powers of the Court**

The powers of the Court in relation to insurance business transfer schemes are set out in section 112 of FSMA and effectively permit the Court to override contractual rights, such as

prohibitions on the assignment of contracts, in connection with an insurance business transfer scheme.

### **3.07. Approach of the Court**

In *Re London Life Association Limited* (1989 unreported), Hoffman J considered the power of the Court in the context of an insurance business transfer. Subsequently, in *Re AXA Equity & Law Life Assurance Society plc*<sup>43</sup>, which concerned an insurance business transfer involving a reattribution, Evans-Lombe J said that the following principles emerged from Hoffman J's judgment:

“The 1982 Act<sup>44</sup> confers an absolute discretion on the court whether or not to sanction the scheme, but this is a discretion which must be exercised by giving due recognition to the commercial judgement entrusted by the company's constitution to its directors.

The court is concerned with whether a policyholder, employee or other interested person, or any group of them, will be adversely affected by the scheme. This is primarily a matter of actuarial judgement involving a comparison of the security and reasonable expectations of policyholders without the scheme with what would be the result if the scheme were implemented. For the purpose of this comparison, the 1982 Act assigns an important role to the independent expert, to whose report the court will give close attention.

The FSA by reason of its regulatory powers can also be expected to have the necessary material and expertise to express an informed opinion on whether policyholders are likely to be adversely affected. Again, the court will pay close attention to any views expressed by the FSA.

That individual policyholders or groups of policyholders may be adversely affected does not mean that the scheme has to be rejected by the court. The fundamental

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<sup>43</sup> AXA Equity & Law Life Assurance Society plc and AXA Sun Life plc, Re [2001] 1 All ER (Comm) 1010.

<sup>44</sup> This case related to the insurance business transfer provisions of the Insurance Companies Act 1982 which were replaced by the transfer provisions under Part VII of FSMA.

question is whether the scheme as a whole is fair as between the interests of the different classes of person affected.

It is not the function of the court to produce what, in its view, is the best possible scheme. As between different schemes, all of which the court may deem fair, it is the company directors' choice which to pursue.

Under the same principle, the details of the scheme are not a matter for the court provided that the scheme as a whole is found to be fair. Thus, the court will not amend the scheme because it thinks that individual provisions could be improved upon.

The court, in arriving at its conclusions, should first determine what the contractual rights and reasonable expectations of policyholders were before the scheme was promulgated and then compare those with the likely effect on the rights and expectations of the policyholders if the scheme is put into effect.”

Although the London Life and AXA cases related to the insurance business transfer regime under the Insurance Companies Act 1982 (which was superseded by the Part VII regime under FSMA), in a later case<sup>45</sup>, Evans-Lombe J affirmed that his earlier summary of the power of the Court applied equally to business transfers under FSMA.

Briggs J also explained as follows in *Re Pearl Assurance (Unit-Linked) Limited* [2006] EWHC 2291 (Ch):

“Notwithstanding that detailed perusal of a proposed Scheme both by an independent expert and by the FSA are conditions precedent to the exercise of the court's discretion to sanction it, the discretion remains nonetheless one of real importance, not to be exercised in any sense by way of rubber stamp. The principles to be applied by the court in considering whether to exercise its discretion are well settled. They were first set out by Hoffmann J (as he then was) in [Re London Life Association Ltd] and more recently reaffirmed by Evans-Lombe J in [Re AXA

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<sup>45</sup> Re (1) Equitable Life Assurance Society (2) Canada Life Ltd [2007] EWHC 229 (Ch).

Equity and Law Life Assurance Society plc]. The relevant principles are concisely summarised in the following passage from the judgment of Rimer J in *Re Hill Samuel Life Assurance Ltd* [1998] 3 All ER 176, at 177:

“Ultimately what the court is concerned with is whether the scheme is fair as between different classes of affected persons, and in arriving at a conclusion as to whether or not it is, amongst the most important material before the court is material which the Act requires to be before it, namely the report of an independent actuary<sup>46</sup> as to his opinion on the scheme.”

### **3.08 Differences of Opinion between Interested Parties**

*Evans-Lombe J* also gave an indication of what would happen when the parties before the Court were not in agreement. He stated:

“The court has no actuarial skills and is in no better position (in fact in a much worse position) to forecast future relevant events and market movements than are those parties. Accordingly, my approach is to accept the views of the independent actuary and the FSA as advised by the government actuaries department<sup>47</sup> in preference to those of AXA and the objectors where they are in conflict except if there were a compelling reason, based on proven fact, or demonstrable mistake in calculation or forecast, which points to a contrary view. Where the views of the FSA or the independent actuary conflict I propose to prefer those of the FSA.”

In *Re Eagle Star Insurance Company and Others* [2006] EWHC 1850 (Ch), the Court stated that objections to the independent expert could only be mounted where there were strong grounds for supposing that the independent expert had “mistaken his function or made an error”.

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<sup>46</sup> now called the “independent expert” (see paragraph 2.04 above).

<sup>47</sup> The FSA is now advised by its own actuaries.

### **3.09 Appeals**

There is no specific provision in FSMA (or in the related regulations) which deals with the possibility of an appeal against an order of the Court which sanctions a scheme but objectors will have the same ability to appeal against an order as exists under general law in relation to any other Court order.