Neutral Citation Number: [2019] EWHC 2245 (Ch)

Case No: CR-2018-003686

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND & WALES
COMPANIES COURT (CHD)

Royal Courts of Justice
Rolls Building, Fetter Lane,
London, EC4A 1NL

Date: Friday 16 August 2019

Before :

MR JUSTICE SNOWDEN

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IN THE MATTER OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

AND IN THE MATTER OF ROTHESAY LIFE PLC

AND IN THE MATTER OF PART VII OF THE FINANCIAL SERVICES AND MARKETS ACT 2000

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Martin Moore QC (instructed by **Allen & Overy LLP**) for the **Applicants**
Nehali Shah for the **Prudential Regulation Authority**
Robert Purves for the **Financial Conduct Authority**
A number of policyholders appeared in person

Hearing dates: 10, 12, 13 and 20 June 2019

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE SNOWDEN

MR JUSTICE SNOWDEN:

Introduction

1. The Prudential Assurance Company Limited ("PAC") and Rothesay Life Plc ("Rothesay") seek the court's sanction pursuant to Part VII of the Financial Services and Markets Act 2000 ("Part VII" and "FSMA") for a scheme (the "Scheme") providing for the transfer to Rothesay of about 370,000 annuity policies written by PAC. If sanctioned, the Scheme will mean that the policyholders will no longer be entitled to look to PAC to pay or service their annuities, but will have sole recourse in that respect against Rothesay.

2. The Scheme has been motivated by PAC's desire to reduce its regulatory capital requirements in connection with a planned demerger of the group headed by Prudential plc ("the Prudential group") of which PAC is a significant member. The Scheme makes no changes to the terms of the policies to be transferred and offers no benefits to the transferring policyholders in connection with the enforced change of their annuity provider from PAC to Rothesay.

3. The Scheme has been the subject of detailed consideration by an independent expert as required by Part VII, who has concluded that the Scheme will not materially affect the interests or reasonable expectations of policyholders. The Scheme and the report of the independent expert have also been considered by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"), who do not object to the Scheme.

4. The Scheme is, however, strenuously opposed by a number of annuitants who appeared at the hearing before me. The policyholders contend that they selected PAC as their annuity provider based upon its long history as a leading UK insurance company, its established reputation for prudence, its size, and the fact that it is an integral member of the larger Prudential group which could be relied upon to support PAC if the need ever arose. They also thought that in the same way as they would be unable to transfer or encash their policies, that PAC would likewise be committed to make payments to them for the remainder of their lives, and they told me that they trusted PAC to honour that commitment.

5. The opponents of the Scheme contend that their choice of PAC as the provider of their annuities for the remainder of their lives ought not to be negated by the compulsory transfer of their policies to Rothesay, which, in contrast to PAC, is a relatively recent entrant to the annuity market, is smaller in size and with a less diverse business, does not have an established reputation for prudence, and does not form part of a larger group of companies which could be relied upon to stand behind it if the need arose.

6. In support of the Scheme, PAC and Rothesay contend that there is no reason in principle why transfers of annuities should be treated in any different way from transfers of any other insurance business under Part VII. They contend that the cases on Part VII demonstrate that transfer schemes can be proposed by insurance companies for purely commercial reasons, and that the court should exercise its discretion to sanction such a scheme if satisfied that it will not have a material adverse

effect upon (i) the security of payment of benefits to policyholders and (ii) the service standards and governance applicable to the relevant policies.

7. In relation to security of benefits, PAC and Rothesay contend that the only reliable basis for the court's decision are objective factors, in particular those derived from the requirements of the recast EU Directive on the taking up and pursuit of the business of insurance and reinsurance (2009/138/EC) ("Solvency II"), which measure the financial strength of the companies and form an important basis for regulatory oversight by the PRA. The applicant companies contend that such Solvency II metrics demonstrate that annuitants will have at least as much financial security with Rothesay as they would with PAC, and that factors such as longevity and reputation are much less reliable indicators of whether an insurance company will be able to honour its commitments in the future. The applicants also submit that the ultimate shareholders of Rothesay are substantial entities who have made an investment in it for the long-term, and that in the extremely unlikely event that Rothesay were to be at risk of failure in the future, there is no reason to suppose that such shareholders would be any less willing and able to support it than the other members of the Prudential group would be willing to support PAC.

8. So far as service standards are concerned, the applicants rely on the fact that PAC has already contracted out the administration of the relevant annuities to a third-party administrator. The Scheme provides for the same administrator to be employed for between one and two years before Rothesay has an opportunity to consider whether to continue to use it or engage another service provider. The applicants say that there is thus no reason to suppose that there will be any material change in service standards for policyholders.

Background to the Scheme

PAC and the Prudential group

9. PAC is an English company which is wholly owned by M&G Prudential Limited ("M&G Prudential"), which is itself wholly owned by Prudential plc, which is listed in London, New York, Hong Kong and Singapore. The Prudential group is, by any standards, very large indeed. According to its 2018 consolidated financial statements, the group had assets of over £508 billion, and a group capital surplus for Solvency II purposes of £17.2 billion.

10. PAC has been in existence since 1848, when it was established as The Prudential Mutual Assurance Investment and Loan Association. It became a limited company in 1881, and has, over the years, established a strong reputation in the UK for providing long-term insurance. PAC's business consists of a with-profits fund and a shareholder-backed business, and it is authorised by the PRA and regulated in the UK by the PRA and the FCA.

11. The reputation of PAC and the Prudential group, built up organically over many years, is encapsulated in the following description on the current website of Prudential plc. Although none of the opposing policyholders suggested that they had seen this

particular description, it neatly reflects their submissions as to why they chose PAC as the provider for their annuities,

> "Providing financial security since 1848
>
> Successive generations have looked to Prudential to safeguard their financial security – from industrial workers and their families in Victorian Britain to over 26 million customers worldwide today. *Our financial strength, heritage, prudence and focus on our customers' long-term needs ensure that people continue to turn to our trusted brands to help them plan for today and tomorrow*."
>
> (my emphasis)

12. Although the business of PAC and the Prudential group is venerable, its structure is changing. The international business of the group essentially breaks down into two segments: the UK and Europe on the one hand; and Asia, the US and Africa on the other. The Prudential group sees the market in the UK and Europe as a mature market for its savings and retirement business, whereas Asia (in particular) is a rapidly growing market which offers potential for growth and attractive returns.

13. These considerations led to an announcement by Prudential plc on 14 March 2018 that it was intended to divide the Prudential group into two separate parts ("the Demerger"). The Demerger will ultimately involve the demerger of M&G Prudential from the Prudential group, so that Prudential plc and M&G Prudential will each be an independent listed company heading a separate group of subsidiary companies. M&G Prudential (and its subsidiaries including PAC) will focus on business in the market in UK and Europe, and Prudential plc will focus on business in Asia, the US and Africa. Each of M&G Prudential and Prudential plc will, however, have its headquarters and a premium listing in London.

The sale of annuities and the Reinsurance Agreement

14. As part of the preparation for the Demerger and the separation of business along the geographical lines which I have described, it was necessary for PAC to transfer two Hong Kong subsidiaries to a subsidiary of Prudential plc. One of those subsidiaries made a substantial contribution of excess (surplus) capital to PAC's Solvency II capital position.

15. To address the consequences for Solvency II purposes of the transfer of the Hong Kong subsidiaries to Prudential plc, and hence to enable the Demerger to proceed, it was necessary for PAC to reduce the solvency capital requirement of its shareholder-backed business. To achieve this, immediately prior to announcing the Demerger plan on 14 March 2018, PAC entered into two agreements with Rothesay: a business transfer agreement (the "Business Transfer Agreement") and a collateralised reinsurance agreement (the "Reinsurance Agreement"). A transitional services agreement (the "Transitional Services Agreement") was subsequently entered into on 24 May 2019.

16. The agreements covered about 400,000 retail and bulk annuity policies, including deferred and in payment annuities, with a gross best estimate of liabilities for PAC of about £12.9 billion. Those policies include, but are not limited to, all of the annuity policies proposed to be transferred under the Scheme.

17. At or about the time of signing the agreements, although the contractual obligations in respect of the annuity policies remained with PAC, the assets backing such liabilities were transferred by PAC to Rothesay as part of the premium for the reinsurance to be provided by Rothesay to PAC. Under the terms of the Reinsurance Agreement, the assets transferred by PAC to Rothesay are required to be held in custody accounts by Rothesay to form collateral for the discharge of Rothesay's obligations to PAC. The majority of such assets must be managed by Rothesay so as to comply with the relevant PRA matching tests in respect of the liabilities of the reinsured business.

18. In simple terms, the purpose and effect of the Reinsurance Agreement was to transfer the majority of the economic risk and reward of the annuity business covered by the agreement from PAC to Rothesay. The Business Transfer Agreement expressly contemplated that the parties would cooperate to achieve the actual transfer of that business through the Scheme.

19. The Reinsurance Agreement was described in Prudential plc's Demerger press announcement as follows,

> "In line with this strategy to transition towards a more capital efficient, de-risked business model, M&G Prudential also announces the sale of £12.0 billion of its shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured £12.0 billion of liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The capital benefit of this transaction will be retained within the Group to support the demerger process."

20. For its part, Rothesay announced the Reinsurance Agreement in the following terms,

> "• Rothesay Life is acquiring a £12 billion annuity portfolio from Prudential, covering c.400,000 policyholders, in the largest transaction of its type in the UK.
>
> • The transaction makes Rothesay Life the UK's largest specialist annuity insurer with over £37 billion of assets under management and over 750,000 lives insured.
>
> Rothesay Life, one of the leading life insurers specialising in providing de-risking solutions to UK defined benefit pension schemes and insurance companies, announces today that it has entered into an agreement to purchase £12 billion of annuities from Prudential plc. The transaction has been structured initially as a reinsurance contract and is expected to lead to a Part VII transfer of the underlying assets and policy liabilities to Rothesay Life subject to regulatory and court approval.

> Rothesay Life's shareholders have invested additional equity to finance the transaction.
>
> The transaction will result in a significant increase to Rothesay Life's asset base to over £37 billion. Following completion, Rothesay Life will be the largest specialist annuity insurer in the UK."

21. If the Scheme is sanctioned, then except in relation to any excluded policies and business that the parties agree should not be transferred, the Reinsurance Agreement will terminate. If the Scheme is not sanctioned, the evidence is that the Reinsurance Agreement will remain in place unless terminated in accordance with its terms. Rothesay does not have the right to terminate due to non-sanction of the Scheme, and the current expectation of PAC is that the Reinsurance Agreement will not be terminated in that circumstance, so the annuity policies in question would remain policies with PAC but would continue to be reinsured to Rothesay.

22. In relation to servicing and administration, PAC has, since 1 October 2018, outsourced the administration of the policies covered by the Business Transfer Agreement to Diligenta Limited ("Diligenta"), an English company which is FCA authorised, and is a member of the Tata Consultancy Services group ("TCS"). That decision followed the announcement on 16 January 2018 that M&G Prudential had entered into a ten-year arrangement with TCS to replace Capita as administrator of a large number of PAC's life and pensions policies.

23. The Transitional Services Agreement provides that PAC will continue to be responsible for the administration of the policies, through Diligenta, for between one and two years after the transfer of such policies under the Scheme. Thereafter, Rothesay will be free to move to a direct relationship with Diligenta, or to engage an alternative service provider of its own choice.

24. Pursuant to the Business Transfer Agreement, PAC and Rothesay have also agreed a protocol as to the allocation of mis-selling liabilities relating to the policies to be transferred, which has been replicated in the Scheme. In broad terms, PAC will retain liabilities emanating from the FCA's Thematic Review of Annuity Sales Practices ("TRASP"), as well as liability for fines and penalties arising from pre-transfer acts and omissions imposed by any regulator. PAC will also retain any liability arising prior to the earlier of the transfer date or 31 December 2019 for any mis-sold Transferring Policies which are part of a bulk purchase annuity contract with the trustees of a UK defined benefit pension scheme ("BPA"); and prior to the seventh anniversary of the earlier of the proposed transfer date or 31st December 2019 for any mis-sold Transferring Policies which are not part of a BPA.

Rothesay

25. Rothesay is an English company which, like PAC, is authorised by the PRA and regulated in the UK by the PRA and FCA. In contrast to PAC, which has grown organically since 1848 and has a broad spread of insurance business, Rothesay was established in 2007 by The Goldman Sachs Group, Inc. to conduct business as a specialist provider of annuities.

26. Goldman Sachs sold some of its interests in Rothesay in 2013, at which time a new intermediate holding company was introduced into the group structure and three outside investors acquired interests in that holding company. Goldman Sachs then sold the remainder of its interests in 2017, after which time the shares in Rothesay's holding company have been held by the three investors and an employee and management benefit trust.

27. The investors now hold the shares in Rothesay's holding company in the following proportions: 35.85% is held by a subsidiary of Blackstone Group L.P. (a large US private equity firm); 35.85% is held by a subsidiary of GIC Private Limited (a sovereign wealth fund established by the Government of Singapore Investment Corporation); and 24.67% is held by a subsidiary of The Massachusetts Mutual Life Insurance Company (which is a large and long-established US insurance company). The remaining 3.63% is held by the employee and management benefit trust.

28. Rothesay's existing long-term insurance business comprises (i) the issue of bulk purchase annuity contracts to trustees of UK defined benefit pension schemes, (ii) the issue of individual annuity policies to former members of UK defined benefit pension schemes by way of buy-out of their benefits, and (iii) the acquisition of portfolios of retail annuity policies from other UK insurers. Rothesay also enters into longevity swaps with the trustees of UK defined benefit schemes.

29. Rothesay has undertaken two previous acquisitions of portfolios of retail annuity policies from Zurich Assurance Limited and Scottish Equitable plc. In each case the acquisition followed an agreement to reinsure those policies and was achieved pursuant to a scheme under Part VII: see, in particular, the decision of Warren J in *re Scottish Equitable plc and Rothesay Life plc* [2017] EWHC 1439 (Ch) ("*Scottish Equitable*"), to which I shall return. The Reinsurance Agreement and the current Scheme follow the same model.

<u>The Scheme in Outline</u>

30. The Scheme is a relatively straightforward document. The number and value of the policies proposed to be transferred from PAC to Rothesay under the Scheme has been slightly reduced from that anticipated in the Business Transfer Agreement and press statements to which I have referred. They now comprise 365,791 annuity policies with total policyholder liabilities of approximately £11.2 billion as at 31 December 2018 (the "Transferring Policies"). The Transferring Policies represent about 90% of the business reinsured by Rothesay under the Reinsurance Agreement.

31. Apart from the replacement of PAC by Rothesay as the provider of the annuities, the Scheme will not make any changes to the terms and conditions of the Transferring Policies or the amounts payable thereunder.

32. If the Scheme is implemented, the Reinsurance Agreement will be modified to exclude the Transferring Policies and the collateral arrangements over the assets held in custody accounts will fall away in so far as they relate to those policies. This will release the relevant assets to Rothesay.

<u>Transfers under Part VII of FSMA</u>

33. In *Scottish Equitable* at [29]-[32], Warren J explained the structure of Part VII and the protections for policyholders,

> "29. There are four layers of protection for policyholders in relation to business transfers. First, there are the regulators who have general supervisory functions. They have involvement in the Part VII process through the appointment of the independent expert and the structure of his report. They have involvement in the production of their own reports. They have the entitlement to appear in this court … And the Financial Conduct Authority has an involvement in the communications exercise and the objectives of the Scheme.
>
> 30. The second layer is the independent expert who is charged with assessing the application….
>
> 31. The third level of protection is the communication programme, including a directions hearing and appropriate waivers which can be obtained for good reason …
>
> 32. The final layer of protection is the approval of the court, taking account of all the objections which are raised following the communication exercise.

34. As regards the particular role of the court, as distinct from the role of the independent expert and the regulators, reference is frequently made to the comments of Briggs J in *Re Pearl Assurance (Unit Linked Pensions) Limited* [2006] EWHC 2291 (Ch) at paragraph 6:

> "Notwithstanding that detailed perusal of a proposed Scheme both by an independent expert and by the [regulators] 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…."

35. Section 104 FSMA provides that no insurance business transfer scheme is to have effect unless an order sanctioning it has been made under section 111(1) FSMA. Section 111(1) FSMA sets out the conditions which must be satisfied before the court may make an order sanctioning an insurance business transfer scheme.

36. Section 111(2) requires that all of the appropriate certificates and authorisations to conduct the transferring business shall have been obtained from the relevant regulators. All such certificates and authorities have been duly provided, in the instant case, so compliance with section 111(2) is not an issue.

37. What is in issue in this case is the requirement in section 111(3) that,

> "The court must consider that, in all the circumstances of the case, it is appropriate to sanction the scheme."

38. The approach of the court to the exercise of this discretion has been considered in a large number of first instance decisions. Many of those decisions have taken, as their starting point, the judgment of Hoffmann J in *Re London Life Association Limited*, unreported, 21 February 1989 ("*London Life*"), together with the summary of the relevant points arising from that judgment by Evans-Lombe J in *Re AXA Equity & Law Life Assurance Society plc and AXA Sun Life plc* [2001] 1 All ER (Comm) 1010 ("*AXA*") at paragraph 6, pages 1011 – 1012. That summary is as follows (the references to the 1982 Act should now be read as references to Part VII FSMA, the references to the FSA should be read as references to the PRA and FCA, and the reference to the Independent Actuary should now be read as a reference to the independent expert),

> "(1) The 1982 Act confers an absolute discretion on the Court whether or not to sanction a scheme but this is a discretion which must be exercised by giving due recognition to the commercial judgment entrusted by the Company's constitution to its directors.
>
> (2) The Court is concerned whether a policyholder, employee or other interested person or any group of them will be adversely affected by the scheme.
>
> (3) This is primarily a matter of actuarial judgment 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 Actuary to whose report the Court will give close attention.
>
> (4) 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.
>
> (5) 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 question is whether the scheme as a whole is fair as between the interests of the different classes of persons affected.
>
> (6) 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's directors' choice which to pursue.
>
> (7) 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.
>
> (8) It seems to me to follow from the above and in particular paragraphs (2) (3) and (5) that the Court, in arriving at its conclusion, 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 result on the rights and expectations of policyholders if the scheme is put into effect."

39. Although frequently cited and applied, it is important to appreciate that this is simply a convenient summary of principles derived from one case, and it should not be treated as if it were a statute. So, for example, as David Richards J observed in *Re Royal Sun Alliance Insurance plc* [2008] EWHC 3436 (Ch) ("*Royal Sun Alliance*") at paragraphs 7-10, *AXA* and *London Life* were cases involving the transfer of with-profits business, and the references to "fairness" and "reasonable expectations" must be read in that context. David Richards J concluded (at paragraph 10), and I agree, that in a case involving a scheme for the transfer of general business, it is only really subparagraphs (1) - (4) of Evans-Lombe J's summary that are relevant.

40. As David Richards J also observed in *Royal Sun Alliance*, sub-paragraphs (1) and (3) may require some modification in such cases. In particular, when one looks back to *London Life* it is clear that, when applied to schemes which are not for the transfer of with-profits business, the reference in sub-paragraph (1) to the court giving due recognition to the commercial judgment entrusted to the directors by the company's constitution really serves to emphasise the point made in sub-paragraph (6), that as between several schemes, each of which could be regarded as fair, it is the choice of the directors which scheme to propose. That observation was made by Hoffmann J in the context of the challenge to the scheme in *London Life*, where opposing policyholders were suggesting that they would have preferred the company to promote a scheme with Equitable Life rather than AMP. David Richards J further noted that in the context of transfers of general business, the reference in sub-paragraph (3) to the "reasonable expectations" of policyholders should probably be read as applying to matters such as service standards.

41. I shall return to consider the exercise of discretion under section 111(3) in greater detail later in this judgment. But first, and in light of the obvious importance which the authorities indicate that the court should attach to the report of the independent expert and the views of the Regulators, I should summarise the reports from those sources in this case.

The Independent Expert

42. The independent expert in this case (the "Independent Expert") is Mr Nick Dumbreck, a consulting actuary of Milliman LLP and a member of the Institute and Faculty of Actuaries. Mr Dumbreck produced an expert report dated 21 January 2019 and a supplemental report dated 17 May 2019. He also produced a number of letters during the course of the hearings before me, dealing with a variety of points as and when they arose, including in particular a lengthy letter of 19 June 2019.

43. In his reports and letters, Mr. Dumbreck considered the effects of the proposed Scheme on three groups of policyholders, namely the holders of the Transferring Policies, the existing non-transferring Rothesay policyholders, and the existing non-transferring PAC policyholders. Of these, plainly the most significant are the holders of the Transferring Policies.

44. In each case, Mr. Dumbreck considered the interests of policyholders as regards:

    i) the security of benefits;

    ii) the profile of risks to which the relevant policies are and will be exposed at PAC and Rothesay; and

    iii) the reasonable expectations of policyholders (including in particular the likely effect of the Scheme on the standards of administration, service management, and governance).

Solvency II metrics

45. Mr. Dumbreck explained that under Solvency II, an insurer is required to calculate its best estimate liability ("BEL"). The expected future obligations of the insurer are projected over the lifetime of the contracts using the most up-to-date financial information and best estimate actuarial assumptions, and the BEL represents the present value of these projected cash-flows. The BEL and a risk margin (designed to be the amount another insurer would require to be paid to take over the obligations) represent the "Technical Provisions" of the insurer. The amount by which the assets of the insurer, measured in accordance with Solvency II, exceeds the liabilities of the insurer allowing for any other relevant factors, is known as the insurer's "Own Funds".

46. An insurer is required under Solvency II to hold eligible Own Funds at least equal in value to its Solvency Capital Requirement (SCR). Mr. Dumbreck indicated at paragraph 4.11 of his main report that this is intended to be the amount required to ensure that the firm's assets continue to exceed its Technical Provisions over a one year time frame with a probability of 99.5%. In calculating the SCR most firms use the "Standard Formula" prescribed by Solvency II, but Solvency II also permits firms to use their own internal models or a combination of the two, provided that this is approved by the appropriate regulator (the PRA).

47. The insurer's eligible Own Funds divided by its SCR is known as the insurer's "SCR coverage ratio" and is usually expressed as a percentage number (so that an SCR coverage ratio of 100% would mean that the insurer's Own Funds equalled its SCR). It should be appreciated, however, that what might appear a material difference in SCR coverage ratio may not equate to a material difference in the likelihood of remaining solvent for a year. So, for example, Mr. Dumbreck calculated that in the case of Rothesay, an SCR coverage ratio of 100% equates to a likelihood of its assets being sufficient to cover its Technical Provisions in one year's time of 99.5%; an SCR coverage ratio of 130% would equate to a likelihood of its assets being sufficient to cover its Technical Provisions in one year's time of 99.96%; and an SCR coverage ratio of 150% would equate to a likelihood of its assets being sufficient to cover its Technical Provisions in one year's time of 99.994%. So a reduction in SCR coverage

ratio from 150% to 130% would only mean that the risk of insolvency after one year has increased by 0.034%.

48. The net amount by which an insurer's Own Funds exceeds its SCR represents the surplus (or excess) capital of the insurer for Solvency II purposes. At least in theory, an insurer could seek to distribute any such surplus or excess. It is, however, common for insurers to commit extra capital to be held in addition to the SCR. This additional level of capital is intended to provide a company with comfort that even if a moderately severe event occurred, it would still have sufficient capital to cover its SCR in full. The amount of such additional capital is determined by the insurer's capital management policy which is reviewed by the PRA.

PAC's and Rothesay's Solvency II metrics

49. Prior to the transfer of the two Hong Kong subsidiaries in preparation for the Demerger, as at 30 June 2018, PAC's consolidated assets amounted to about £212 billion. In terms of its shareholder-backed business, as at 30 June 2018 PAC had assets for Solvency II purposes of about £72.5 billion, Technical Provisions of about £57.6 billion, Own Funds of £14.9 billion, an SCR of £7.2 billion, and an SCR coverage ratio of 207%.

50. The effect of the transfer of the two Hong Kong subsidiaries was to reduce the excess capital of PAC's shareholder-backed business by about £4 billion. At 31 December 2018, the assets of PAC's shareholder-backed business were about £60.7 billion, its Technical Provisions were about £51.9 billion, its Own Funds were about £8.8 billion and its SCR was about £5.1 billion. The SCR coverage ratio of PACs shareholder-backed business was thus reduced to about 172%. PAC's consolidated SCR coverage ratio was reduced from 162% as at 30 June 2018 to 140% as at 31 December 2018.

51. As at 31 December 2018, for Solvency II purposes, Rothesay had total assets of about £36 billion, Technical Provisions of about £32 billion, Own Funds of £3.89 billion and a SCR of £2.16 billion. Its SCR coverage ratio was thus 180%.

52. The figures set out above include the effect of the Reinsurance Agreement. If the Scheme is implemented, the effect (measured by reference to the figures as at 31 December 2018) will be very slightly to increase the SCR coverage ratio of PAC's shareholder-backed business from 172% to 175%. Rothesay's SCR coverage ratio (180%) will not change, since the business to be transferred under the Scheme is already included within the Reinsurance Agreement.

53. In his supplemental report, Mr. Dumbreck observed that the consolidated SCR coverage ratio of PAC before the implementation of the Scheme (140%) is less than the SCR coverage ratio of Rothesay would be after the implementation of the Scheme (180%). Mr. Dumbreck therefore concluded that both companies have a very high level of security for policyholders, but that Rothesay will have a "somewhat stronger financial position than PAC, measured by SCR coverage ratio" after allowing for the transfer of the two Hong Kong subsidiaries from PAC to the subsidiary of Prudential plc.

Capital management policies

54. Rothesay's capital management policy was disclosed in the materials before me. Rothesay targets an SCR coverage ratio of between 130% and 150%. If its coverage ratio exceeds 150%, Rothesay regards itself as having excess capital that can be deployed or returned to shareholders: if it falls below 130%, then actions would have to be taken to improve its solvency position. Mr. Dumbreck made the point that Rothesay has always in fact maintained an SCR coverage ratio higher than 150%.

55. PAC's capital policy was not disclosed in the materials placed before me, apparently on the grounds that such policy was confidential and commercially sensitive. PAC did, however, provide full details to Mr. Dumbreck, who explained in his main report that PAC targets a slightly higher SCR coverage ratio than Rothesay and uses a "solvency intervention ladder" at which different management actions are required to be implemented to increase solvency if the SCR coverage ratio falls below a series of set levels.

56. Because of the different approaches in their capital policies, and because the two companies use different approaches to calculating their SCR, Mr. Dumbreck was of the view that a direct comparison between the capital management policies of PAC and Rothesay is difficult. However, based solely on current risk levels, he stated in his main report that PAC's approach provides a slightly higher level of security for policyholders than Rothesay's capital management policy.

Corrective actions and parental support

57. In addition to reviewing the capital management policies of PAC and Rothesay, Mr. Dumbreck considered the actions that would be available to PAC and Rothesay in the event of a breach of their target capital ranges. He was of the opinion that the options open to the two companies were different.

58. As regards PAC, and in addition to the steps in the solvency intervention ladder, Mr. Dumbreck noted that Prudential plc had entered into a capital support arrangement ("CSA") with PAC in 2013. The CSA was amended in 2016 to reflect the introduction of Solvency II, and provides PAC with capital support up to an agreed (but undisclosed) maximum aggregate level in the event that its solvency falls below specified levels. The CSA does, however, also cover costs relating to mis-selling by PAC of with-profits pensions.

59. Although Mr. Dumbreck observed that there was no legal or regulatory obligation upon Prudential plc to support PAC beyond the limits in the CSA, he regarded it as unlikely, for reputational reasons, that Prudential plc would fail to provide any necessary further support to PAC if it were able to do so. In that regard, Mr. Dumbreck noted that the financial resources potentially available to Prudential plc to support PAC are significant, and included liquidity of over £3.2 billion in cash and short-term investments as at 31 December 2018.

60. Mr. Dumbreck also made two further points in relation to the support that PAC could expect to receive from Prudential plc. The first was that in an extreme scenario that would be sufficiently adverse to threaten PAC's solvency, the financial resources of Prudential plc available to support PAC might well be similarly constrained. The second was that the planned Demerger means that as a subsidiary of M&G Prudential,

PAC will no longer be able to benefit from parental support to the same degree as is currently the case with Prudential plc as its ultimate parent.

61. In paragraph 8.27 of his main report, Mr. Dumbreck noted that, in contrast to PAC, Rothesay's parent company is not listed, and its level of financial resources is "relatively low". In paragraph 42 of his letter of 19 June 2019, Mr. Dumbreck clarified that,

> "… no significant financial resources are available to Rothesay from its parent holding company, whereas those potentially available to PAC from its parent, Prudential plc, are significant."

62. Mr. Dumbreck went on, however, to make a number of points which he considered mitigated this difference between PAC and Rothesay. First, he indicated that Rothesay's capital management policy itself sets out a list of potential actions that might be available to it in the event that its solvency was threatened. These include changing its investment mix, ceasing new annuity transactions, increasing the levels of hedging of its solvency position, increasing its use of longevity reinsurance, calling on a £300 million loan facility available to the parent company, and reducing discretionary expenses. In relation to the use of longevity reinsurance, however, Mr. Dumbreck noted that Rothesay already makes significant use of such reinsurance and that its scope to undertake more may therefore be limited (although not zero).

63. Secondly, Mr. Dumbreck expressed the view that whilst Rothesay's immediate parent does not currently have any significant financial resources that could be used to support Rothesay, it does have a track record of raising capital from its existing shareholders and from the debt markets when needed. He expressed the view that even in adverse conditions, there would be a strong incentive for such shareholders to provide capital to protect the value of their existing investment, and that the process for raising capital in Rothesay would in general be simpler and faster than for a listed company.

64. Mr. Dumbreck concluded that these corrective actions and possible capital raising activities were,

> "credible actions that have the potential to be effective in counteracting a deterioration in [Rothesay's] solvency."

65. Pulling these points together, in his letter of 19 June 2019, Mr. Dumbreck concluded as follows,

> "In summary, given that:
>
> - both companies' capital management policies provide a very high level of security for policyholders, even without allowing for management actions;
>
> - both companies actively manage their solvency coverage on a continuous basis, and the capital management policies

simply provide a framework within which this management takes place;

- management actions are available to both PAC and Rothesay to mitigate a deterioration in solvency … and this reduces even further the likelihood that they will be unable to meet their liabilities; and

- scenarios which could lead to the entire own funds of either company being dissipated are so extreme that any comparison of probabilities is subject to very high degree of uncertainty,

I concluded in … my main report that the protection provided by Rothesay's and PACs capital management policies were broadly comparable and I remain of this view."

Size and risk profile

66. Mr. Dumbreck also addressed two other matters of particular concern relating to policyholders' security, namely the risk of Rothesay breaching its capital management policies due to (i) its smaller size and (ii) its lack of diversity of risks, when compared with PAC.

67. As regards Rothesay's size, Mr. Dumbreck first made the point that whilst PAC has, in absolute terms, a greater capital surplus than Rothesay, the levels of surplus relative to the amount of its technical provisions are of the same order of magnitude for both companies. He expressed the view that it is this relative cover for liabilities that is material, rather than the absolute surplus.

68. As regards the profile and diversity of risks, Mr. Dumbreck contrasted the risks faced by PAC, which is a multi-line insurer with a wide variety of life and pensions business, with Rothesay, which is a mono-line insurer whose liabilities arise only from in-payment and deferred annuity policies. This means that PAC is exposed to a wide variety of risks to which Rothesay is not exposed, such as mortality risk on life insurance and adverse policyholder behaviour (since in-payment annuities can only be surrendered in very limited circumstances).

69. However, Mr. Dumbreck also pointed out that an insurer such as PAC, with exposure to a larger number of unrelated risks, is less likely to be materially affected by the manifestation of any particular risk (i.e. it has a greater diversification of risk); whereas an insurer such as Rothesay, facing only one or a small number of risks, is more likely to be materially affected by the occurrence of one of the limited number of risks that it faces (i.e. it will have less resilience).

70. Mr. Dumbreck then made the point that the SCR of an insurer is intended to reflect both the level of exposure to each individual risk to which a company is exposed, and the level of diversification of risk. To this end, Solvency II allows an insurer facing more than one risk to assume that the different risks are not fully correlated, and to take advantage of a formula based upon the level of diversification to reduce its

overall SCR. This means that PAC will have a proportionately lower SCR than Rothesay.

71. Taking these matters together, Mr. Dumbreck concluded that on the basis that the SCR coverage ratios of PAC and Rothesay are broadly equivalent, the overall level of protection provided against risks is similar, and so the change in risk profile to which the Transferring Policyholders will be exposed as a result of the Scheme will not have a material effect upon the benefit security of such policyholders.

Policyholders' reasonable expectations

72. Mr. Dumbreck identified a number of reasonable expectations of Transferring Policyholders:

> "The Transferring Policies are non-profit in-payment annuities, and therefore policyholders' reasonable expectations in respect of their policies are principally that:
>
> - they receive their benefits as guaranteed under the policy, on the dates specified, from the point of purchase;
> - the administration, management, and governance of the policies are in line with the contractual terms under the policies; and
> - the standards of service received are at least as good as those they currently receive."

73. As I have outlined above, Mr. Dumbreck was of the opinion that the financial security provided by PAC and Rothesay is comparable, and the terms and conditions of the Transferring Policies will not change. For these reasons, Mr Dumbreck concluded that the reasonable expectations of policyholders of the Transferring Policies regarding receipt of benefits under their policies will not be materially adversely affected by the Scheme.

74. Mr Dumbreck also noted that both Rothesay and PAC will continue to be subject to UK regulations and governance after the implementation of the Scheme, including being subject to the regulation of the FCA and PRA. For this reason, he concluded that the administration, management and governance of the Transferring Policies will continue to be of the same standard following the implementation of the Scheme.

75. As regards service standards, it should be noted that any outsourcing of the administration of policies to a third party is subject to compliance with regulatory requirements, and ultimate responsibility for the administration of the policies remains with the insurer. That said, Mr Dumbreck considered that because PAC had decided, independently of the Scheme, to outsource the administration of the Transferring Policies to Diligenta, it was appropriate to compare the service standards enjoyed by the policyholders of the Transferring Policies before and after implementation of the Scheme, rather than comparing them to the earlier time when PAC was directly administering the Transferring Policies.

76. The Scheme envisages that Diligenta will continue to administer the Transferring Policies for a period of between 12 and 24 months, although it is possible that this period may be foreshortened by transferring the ultimate responsibility for provision of administration services from PAC to Rothesay as quickly as possible, provided that Diligenta provide services to the standard required by Rothesay. Thereafter, Rothesay will decide whether to continue engaging Diligenta to administer the Transferring Policies, to engage a third party administrator of its own choice, or to administer the Transferring Policies itself.

77. On the basis of these arrangements, Mr Dumbreck expressed the view that there is no reason to believe that the level of service experienced by Transferring Policyholders will change after the Scheme or during this transition period. Mr Dumbreck also reviewed Rothesay's own standards for administering policies and believed these to be acceptable.

Effects of implementation of the Scheme on holders of non-transferring policies

78. So far as non-transferring PAC policyholders are concerned, Mr Dumbreck's opinion was that their policy benefits will be unchanged and the transfer from PAC of policies to Rothesay will have no material effect on the solvency of PAC or the security of benefits for the remaining policyholders of PAC. Mr Dumbreck also noted that the reasonable expectations of non-transferring PAC policyholders will not materially change because there has been an injection of capital to meet increased administration expenses as a result of the resulting increase in the relative size of PAC's with-profits sub-fund.

79. With regards to the existing policyholders of Rothesay, Mr Dumbreck was of the opinion that there will be no material impact on the security of their benefits or their reasonable expectations.

Overall conclusion

80. Mr. Dumbreck's overall conclusion was:

> "The implementation of the Scheme will not have a material adverse effect on:
>
> - the security of benefits of the policyholders of PAC and Rothesay, including the Transferring Policyholders;
> - the reasonable benefit expectations of the policyholders of PAC and Rothesay, including the Transferring Policyholders; or
> - the service standards and governance applicable to the PAC and Rothesay policies, including the Transferring Policies."

<u>The position of the FCA and PRA</u>

81. The FCA and PRA each produced two reports regarding the Scheme. The FCA and PRA both stated that they do not object to the Scheme and certified that the

requirements of section 111 FSMA as regards the obtaining of relevant certificates (e.g. from overseas regulators) have all been satisfied.

82. The PRA also produced a third report dealing more specifically with some of the issues that arose during the hearing. I shall return to those points when considering the objections of policyholders below.

Policyholders' objections to the Scheme

83. PAC received in the region of 7,300 communications from policyholders in response to approximately 258,000 policyholder packs that were sent out. Of those responses, about 1,000 (i.e. about 15% of the responses or 0.4% of the total communications) could be characterised as an objection. Although not large in proportionate terms, this is nevertheless a significant level of objection from policyholders in the context of a scheme of this type.

84. Mr Dumbreck responded to the general themes of the points of objection by policyholders in his supplemental report, and the objections and Mr. Dumbreck's responses were also reviewed and commented upon by the PRA and FCA. They were also dealt with in additional evidence and submissions on behalf of PAC and Rothesay.

85. As I indicated at the start of the judgment, I also received a number of objections directly from holders of Transferring Policies, both in writing and through submissions made in person at the hearing. The policyholders who appeared at the hearing included Mrs. Rosemary Harper, Mr. Anthony Kell, Mr. David Mitchell, Mr. Thomas Copsey, Dr. Jay Ginn, Mrs. Penelope Howell, Mrs. Kornelia Robertson and Mr. John Barrow.

86. I have considered all of the points made in writing and orally, but it would be impossible for me to deal with every objection in this judgment. I can deal shortly with some of the subsidiary issues that arose, and will then focus on the main points of objection which I summarised at the beginning of this judgment.

Notice of the Scheme

87. A number of policyholders questioned why they had only been informed of the existence of the Scheme in February 2019, given that Prudential plc had announced its intention to promote such a scheme when it announced the Reinsurance Agreement and the proposed Demerger in March 2018.

88. I accept that there was no legal obligation upon PAC to keep its policyholders informed or involved during the development of the Scheme, provided that policyholders were given sufficient time to consider and respond to the finalised Scheme proposal and to participate fully at the hearings before me if they chose to do so. The FCA was satisfied that sufficient time was given to policyholders in that regard, and I am also satisfied that this was the case.

The independence of Mr. Dumbreck

89. Some policyholders questioned whether the Independent Expert could genuinely be considered to be independent, given that his fees were being paid by PAC and Rothesay. This is an issue that is frequently raised at scheme hearings, but there is nothing in it. Mr Dumbreck's appointment was, as it had to be, approved by the PRA after consultation with the FCA, and there is no realistic alternative to him being paid by the applicants. Mr. Dumbreck is suitably qualified and experienced, having been the independent expert in a number of other scheme cases, including *Scottish Equitable*. I have no reason to doubt that Mr. Dumbreck understood the importance of his role and the need for independence, and he expressly acknowledged that he was aware of and had complied with his overriding duty to the Court.

Records and data

90. A number of policyholders expressed a concern as to the continued availability of their records and data following the implementation of the Scheme. Concern was expressed that there might be a loss of PAC's 'corporate memory' meaning that issues raised by policyholders might become harder to deal with if policyholders were dealing with Rothesay. There was also a concern expressed about policyholders' personal data being sent outside the UK after the Scheme.

91. These are aspects of ensuring that the reasonable expectations of policyholders as to service standards will be met following implementation of the Scheme. In that regard the Business Transfer Agreement contains provisions designed to ensure that there is continuity of records (including in relation to any TRASP claims), and there is no specific indication that the Scheme would cause any change in the current approach to data management and processing. Mr. Moore QC also made the point that, in common with PAC, Rothesay will be subject to the GDPR.

Irrelevant issues

92. Some of the objections were either simply mistaken as to the effect of the Scheme, or otherwise not relevant to the issues that I have to decide.

93. As examples of the former, some policyholders complained that the Scheme would affect the payments due to them under their policies or their entitlement to compensation under TRASP or the Financial Services Compensation Scheme ("FSCS"). As I have explained, that is not the case since the Scheme does not alter the terms and conditions of the policies, there is a carve-out for TRASP liabilities, and in the event of failure of Rothesay, the policies would currently be covered by the FSCS to the same extent as if they were with PAC.

94. As examples of matters that are irrelevant to the issue that I have to decide, some policyholders (in particular Mr. Kell) complained of supposed deficiencies in general communications by companies in the Prudential group which allegedly did not make clear which particular company was involved, or which related to earlier transfer schemes within the Prudential group with which I am not concerned. Others (such as Mr. Mitchell) saw the Scheme as the opportunity to complain of alleged maladministration of their own policies. Whether or not well-founded, those are simply not matters which could possibly affect the decision that I have to make on this application as regards the Scheme.

Selection of Transferring Policies and opt outs

95. A number of policyholders questioned how the selection of the Transferring Policies had been done by PAC, and asked why they could not each be given the ability to opt out of the Scheme.

96. The Independent Expert considered the process by which transferring policies had been selected, and reported as follows,

> "The Transferring Business was selected in order to achieve a target level of capital release to support the proposed demerger of M&G Prudential. Various practical constraints were taken into account in the original selection process, including the need to avoid separating policies covered by a single reinsurance arrangement.
>
> In order to finalise the selection of transferring policyholders under the Scheme, a number of modifications have been made to the original selection, to ensure that the composition of the Transferring Business meets the commercial requirements agreed between PAC and Rothesay. In addition, modifications … have been made to ensure that the transferring business can legally and effectively be transferred by means of the Part VII transfer.
>
> There is no single selection approach that can be considered fairer to policyholders than any other, and so choosing the Transferring Policies on the basis of commercial, practical and legal considerations is in my view reasonable."

97. Responding to a particular question raised at the hearing, Mr Dumbreck also provided the following further report in his letter of 11 June 2019,

> "I have reviewed the approach used by PAC to determine which portfolios of annuities should be covered by the Reinsurance Agreement and the proposed Part VII transfer. I am satisfied that there was no "cherry picking" aimed at skewing the re-insured or transferring business in terms of the age or health profile of the annuitants, or at selecting annuities that were particularly onerous from a capital perspective. In particular, I note that more than half of the liabilities included in the Reinsurance Agreement were already subject to longevity reinsurance with third-party reinsurers, which means that their capital requirements are likely to be lower than average."

98. I accept Mr. Dumbreck's evidence to the effect that there was no discrimination on the basis of age or "cherry picking" of annuities in the selection of the Transferring Policyholders. I also accept Mr. Moore QC's submission that it is not for the court to insist that the proponents of the Scheme should provide an opt-out which in effect would lead to a different scheme than that for which the applicants seek sanction.

That point reflects the approach outlined by Hoffmann J in *London Life* when he observed that it is not for the court to suggest amendments or improvements. The court's role is simply to decide whether to confirm or reject the scheme placed before it. The same point was also made specifically in relation to opt outs by Lindsay J in *Norwich Union Linked Life Assurance Limited* [2004] EWHC 2802 (Ch) at [26].

99. What, however, Mr. Dumbreck's comments make explicit, is that the question of whether a particular policy was selected by PAC to be included in the Reinsurance Agreement, and then to be transferred to Rothesay under the Scheme, depended entirely on whether or not it suited the commercial requirements of PAC and Rothesay. In particular, the selection of the affected policyholders was designed to provide PAC with its target level of regulatory capital release in order to facilitate the Demerger.

The main objections to the Scheme

100. I summarised the main objections raised by policyholders to the Scheme at the start of this judgment. In essence, they were to the effect that it should not be legally permissible, or at least it is not appropriate, that persons who specifically selected PAC as their annuity provider for life should be transferred against their will to a smaller insurer with a very different history and reputation, and without a larger group to support it, simply in order to further the commercial purposes of PAC.

Can annuity policies be transferred under Part VII?

101. A number of policyholders contended either that it should not be possible for PAC to transfer their annuity policies at all, or that it was a breach of contract for PAC to seek to do so.

102. For the applicants, Mr. Moore QC contended that the annuity policies in question were governed by English law and hence that a transfer of the policies was plainly possible as a matter of law under Part VII; and that it was not a breach of contract for PAC to seek to transfer the annuity policies under the Scheme.

103. I accept that a significant number of decisions show that the transfer of annuity policies is within the scope of Part VII FSMA: see e.g. *Re Equitable Life Assurance Society* [2007] EWHC 3128 (Ch) and *Scottish Equitable* (above). I also accept the point made by Mr. Purves for the FCA, that it is important for regulatory purposes that annuity policies should be capable of being transferred under Part VII, because there may be cases in which just such a mechanism might be needed to protect policyholders in the event of potential failure of the insurer.

104. Mr Purves also submitted that it is implicit in the power of the court under section 112(2A) FSMA to make provision in an order under Part VII for the transfer of liabilities that would not otherwise be capable of being transferred without a person's consent or concurrence, that the operation of Part VII cannot be prevented by contractual mechanisms. I accept that submission.

105. Mr Purves postulated that an insurer could, in theory, include a contractual clause in its policies, or make a sufficiently clear statement to its policyholders, that it would not seek to transfer its policies under Part VII. Mr. Purves submitted that if this had

been done, but the insurer nonetheless sought to promote a Part VII scheme, the FCA would wish to understand the reasons for that change. He also acknowledged that this would be a factor which the company proposing the scheme would be obliged to bring to the attention of the court, and that the court would have to take into account when considering whether or not to sanction the scheme. However, he reiterated that this could not be an absolute bar to the use of Part VII. Again, I accept that analysis.

106. In the instant case, I was referred by opposing policyholders to various statements made by PAC in their contractual documents which they contended amounted to a contractual promise by PAC not to seek to transfer their policies. I was also provided by PAC with specimen copies of an Annuity Policy for various personal retirement plans (T66, T76, T86 and T96) and two Key Features documents which contained various statements of the same type as identified by the opposing policyholders from their own documents.

107. By way of example, the first sentence of the Annuity Policy stated,

> "You have used your benefits under the Scheme to buy *a lifetime annuity with Prudential*."
>
> (my emphasis)

108. The Key Features document for PAC's Guaranteed Pension Annuity from 2006 contained the following statements on the first page,

> "Its aims
>
> - *To pay you a regular guaranteed income for the rest of your life.*
>
> ...
>
> Your commitment.
>
> - You buy your guaranteed pension annuity with money from your pension scheme. Once you have done this you cannot move the money back again.
> - If you're entitled to take tax-free cash from your pension scheme you must take it when you buy your annuity. You cannot do it afterwards.
> - *Once your annuity starts, you are committed to receiving an income from Prudential for the rest of your life. You will not be able to exchange your annuity for a different annuity with us, or anyone else.*
> - The only money you can take out of your annuity is your retirement income."
>
> (my emphasis)

109. A more recent Key Features document from 2015 contained similar statements about PAC's Guaranteed Pension Annuity,

> "Its aims
>
> - *To pay you a regular income for the rest of your life*
>
> …
>
> Your commitments
>
> - *To give us some or all of your pension pot in return for a regular income for the rest of your life.*
> - To take any tax-free cash that you're entitled to (and want) when you buy your annuity. You can't take it later.
> - To choose the options you want to include in your annuity when you buy it. You can't choose or change these options later.
> - *You can't transfer/switch your annuity to another provider or cash it in."*
>
> (my emphasis)

110. None of the documents to which I was referred contained any reference to Part VII FSMA. Nor did the sections headed "Risk Factors" or "Your risks" in the Key Features documents mention the possibility that PAC might seek to transfer its obligations under the policy to another insurer.

111. I accept the submissions made by PAC and the FCA that none of the documents to which my attention was drawn contain a sufficiently clear statement which could amount to a contractual promise that PAC would not seek to transfer the annuity policies to another insurer under Part VII.

112. The closest to such a promise is probably the statement in the 2006 Key Features document that,

> "Once your annuity starts, you are committed to receiving an income from Prudential for the rest of your life."

But this statement is headed "Your Commitment" and deals with the commitment of the policyholder to receive an income from PAC for the rest of his or her life. It is also followed by a sentence that explains that the policyholder will not be able to exchange their annuity for a different one with another provider.

113. Although it is clear from the documents that PAC thereby expected policyholders to be committed to it for their lifetime, the simple fact is that there is no express statement that PAC was making any corresponding commitment to its policyholders. It would, in my judgment, be stretching the principles of interpretation of contracts or

of implication of terms too far to read such a binding contractual promise on the part of PAC into the annuity policies.

General approach to the exercise of discretion under section 111(3) FSMA

114. I have set out above Evans-Lombe J's summary in *AXA* of the general approach of the court to the exercise of discretion under section 111(3) and the observations of David Richards J on that summary in *Royal Sun Alliance*. In the overwhelming majority of cases, this approach means that the court's inquiry will focus on the questions of whether policyholders' security of benefits and reasonable expectations of service standards will be adversely affected by the proposed scheme. As the authorities also indicate, the court will regard the first of those issues as "primarily" a matter of actuarial judgment, and in that respect will give close attention to the views of the independent expert and the regulators.

115. In my judgment, however, it is clear that this is not the full extent of the factors that the court may take into account in the exercise of its discretion under section 111(3). As section 111(3) itself states, the question for the court is whether it is "*appropriate*" to sanction the scheme, and the court is required to take into account "*all the circumstances of the case*". The authorities such as *London Life* and *AXA* acknowledge that this confers a very broad discretion, and I do not consider that it is constrained by the same actuarial analysis or regulatory criteria derived from Solvency II that necessarily shapes the approach of the independent expert and the regulators. If that were the case, then there would be little purpose to the role of the court in a Part VII scheme. As Briggs J said in *Re Pearl Assurance* (above), the court has a discretion of very real importance, which is not in any way intended simply as a "rubber-stamp" for the opinion of the independent expert or the views of the regulators.

116. In that regard, and in the context of a scheme for the transfer of annuities, I would also refer to the general approach suggested by Warren J in *Scottish Equitable*, who commented, at paragraph [56],

> "Any scheme of this nature is instigated by the commercial parties concerned, not by the policyholders. Parliament has seen fit to introduce legislation providing for business transfers, one statutory result of which is that the contractual obligations of the transferor are extinguished, with corresponding obligations being imposed on the transferee. Sometimes different policyholders are treated in different ways, in which case a balance has to be struck between their interests, and in all cases the policyholders must be treated properly. The four layers of protection which I have mentioned are there to ensure that policyholders are treated properly. But policyholders are not given a veto over what the commercial parties wish to do. *Instead the appropriate balance has to be struck between the interests of the policyholders on the one hand and the commercial parties on the other hand, just as it has to be struck between different groups of policyholders amongst themselves*."
>
> (my emphasis)

117. I agree with Warren J that the fact that Part VII exists means that policyholders are not given a veto over what insurers wish to do for commercial reasons. But neither, in my judgment, is there any presumption in favour of a transfer for such reasons. In each case a balance has to be struck, and it must be for the commercial parties to the proposed transfer to satisfy the court that "in all the circumstances of the case, it is appropriate" to sanction a change to the contractual status of the policyholders.

118. I would also accept that in striking the balance of interests to which Warren J referred, any purely subjective likes or dislikes of policyholders carry little or no weight. That was, I believe, what Warren J had in mind in paragraph [63] of *Scottish Equitable* when he gave, as an extreme example, a policyholder who objected to a scheme for the transfer of business from a Scottish company to an English company. It was also the reason why (at paragraphs [95]-[98]) Warren J rejected the objection from a policyholder that he simply "did not like" Rothesay, and had made a number of unsubstantiated allegations about Goldman Sachs which, at the time, was a shareholder of Rothesay. But as I have indicated, I do not consider (and I do not believe that Warren J decided) that the only factors that the court can take into account are those that can be reduced to part of an actuarial or risk-based analysis.

119. With those introductory observations, I turn to what I consider to be the relevant factors in the instant case.

The nature of annuity policies

120. Although I have reached the view that policyholders had no contractual rights which would prevent PAC from seeking to transfer their policies to Rothesay under Part VII, this does not mean that I cannot take the inherent nature of the annuity policies into account in the exercise of my discretion under section 111(3). On the contrary, I think that the particular nature of an annuity policy represents an important factor in the exercise of my discretion.

121. The purchase of an annuity is, for many people, one of the most important financial decisions that they will ever make. An annuity policy is often purchased on retirement with a large single premium payment derived from a person's pension scheme. In return for that lump sum, the annuity provider promises to make regular periodic payments to the policyholder (and in some cases their spouse or partner) for the remainder of their life (or lives). For many people, the annuity policy will provide the only, or the main, source of regular income for the rest of their life in retirement. In most cases, and certainly in relation to the contracts in issue in this case, once an annuity contract is purchased, the policyholder cannot encash the policy and take a lump sum out again. Nor can they change annuity provider.

122. The consequence of these characteristics of an annuity policy is that when purchasing such a contract – especially with the proceeds of a pension scheme – policyholders will be particularly concerned to select a company with a good reputation and financial standing who they trust, because once selected, they will have no choice but to rely upon that company to provide them with essential income over a potentially very long period which could run into several decades.

123. These considerations were apparent throughout the representations that I received from opposing policyholders. Many of them explained that they had invested their

pension pot into the purchase of an annuity policy from PAC, they stressed the need for reassurance that their annuity would continue to be paid, and they told me of the importance that they had attached to PAC's longevity, its established reputation for financial prudence, its financial size and its place in the wider Prudential group.

124. Mr. Moore QC did not challenge those statements, but sought to downplay them by observing that no-one buys an insurance policy of any description if they do not have confidence that the company will be able to pay when called upon to do so. That is of course true to some extent, but I think that there are a number of material differences, for example, between a person who buys an annuity policy, and a person who buys a general insurance policy against the occurrence of a particular event.

125. The purchaser of an annuity policy hands over a very large lump sum which may be the product of pension contributions throughout their working life, in return for a promise to provide a specified income stream over a long period. The purchaser of a general insurance policy hands over a much smaller annual premium in return for a promise that if the insured event occurs, the insurer will indemnify him against his losses. In the case of an annuity, the policyholder knows that the annuity payments will definitely be required, and is relying on them being paid over a lengthy period. In the case of general insurance, the policyholder hopes that the insured event will not occur, and so payment will never be required to be made under the policy. In the case of an annuity, moreover, the policyholder is bound to the policy for life once they have entered into the contract and parted with their pension pot. The policyholder who buys general insurance can usually cancel or simply not renew the policy each year and seek an alternative insurer in the marketplace.

126. Accordingly, it must be appreciated that the impact upon policyholders of the proposed Scheme for the transfer of annuities is very different, for example, to the effect of a scheme for the transfer of general insurance policies. The annuitants invested a very substantial sum and chose PAC as their annuity provider for life. If transferred under the Scheme, the annuitant will, like it or not, become bound to Rothesay for life. That is very different for example, to the effect of a transfer scheme on the holder of a general insurance policy or even a workplace pension policy, who can, if they do not like the transferee, change insurer. That latter point was made very clearly by the Chancellor in *Re Zurich Assurance Limited and Scottish Widows Limited* [2019] EWHC 1778 (Ch) at paragraph [12], when he observed that the holders of workplace pension policies with Zurich who were concerned about having to change providers were making a "reasonable point", but would be at liberty, if they did not wish to remain with Scottish Widows after the scheme took effect, to change to another provider.

The reasonable expectations or assumptions of policyholders

127. I have set out in paragraphs [38]-[39] above how the expression "reasonable expectations" was used by Evans-Lombe J in sub-paragraph (3) of his summary in *AXA* and how it was explained by David Richards J in *Royal Sun Alliance*. In the context of Part VII, the concept of the "reasonable expectations" of policyholders is generally understood to relate to <u>how</u> an insurer will perform its obligations under the policy, in order that a comparison can be made between the position of a policyholder before and after a proposed transfer of their policy under a Part VII scheme. As such, I do not think that it assists in the context of Part VII to ask the question whether

policyholders would have a "reasonable expectation" that their insurer would not seek to transfer their policy.

128. That said, and although I have rejected the argument that PAC made a contractual promise to policyholders that it would not seek to transfer their policies to another provider, I consider, for the following reasons, that there is considerable force in the submissions made by the opposing policyholders that they reasonably assumed that PAC would not transfer its obligations under the annuity policies to any other company.

129. First, I consider that it would be entirely unrealistic to assume that the average person who was considering investing their pension pot in buying an annuity would have any independent knowledge of the possibility of transfer of the policy under Part VII FSMA. There is also no legal principle that requires me to assume such knowledge. On the contrary, firms operating in the financial services industry are generally required to explain the features and legal effect of the products that they offer in plain terms to customers without assuming that the customers have a detailed background knowledge of the law. In this case, as I have indicated, none of the Annuity Policy or Key Features documents to which I have referred made any reference whatever to Part VII or to the possibility that PAC might seek to transfer the policy to another insurer.

130. Secondly, against that background and given the nature of an annuity policy to which I have referred, I consider that it was entirely reasonable for policyholders reading statements which indicated, for example, that policyholders were buying "*a lifetime annuity with Prudential",* or that they had given PAC "*some or all of your pension pot in return for a regular income for the rest of your life",* to make the assumption that if they gave their pension pot to PAC and could not change that choice, it would be PAC and no other company that would be providing them with the resultant annuity for the rest of their life.

131. Whilst, for the reasons that I have explained, this does not mean that as a matter of law PAC could not seek to transfer the annuity policies under Part VII, I nevertheless consider that it is a matter that can and should be taken into account in the exercise of my discretion under section 111(3).

Current SCR metrics

132. I have summarised above Mr. Dumbreck's opinion that, measured by their SCR coverage ratios, the relative financial strengths of PAC and Rothesay are currently comparable, or indeed that Rothesay could be considered to be slightly stronger than PAC. I have also outlined Mr. Dumbreck's view that it is the relative cover for liabilities (i.e. the SCR coverage ratio) that is material in terms of policyholder security rather than the absolute level of capital in excess of the SCR. In consequence, the fact that PAC is larger than Rothesay does not, of itself, mean that policyholders would have less security of benefits at Rothesay. Although I note Mr. Dumbreck's opinion that Rothesay is less resilient than PAC due to having less diversification of risk, Mr. Dumbreck has also explained that this should be taken into account through Rothesay having a proportionately higher SCR.

133. These points were not disputed by policyholders and were supported by the PRA. I therefore see no reason to doubt Mr. Dumbreck's analysis based upon the current SCR coverage ratios of PAC and Rothesay, and recognise that it is to be given considerable weight in the exercise of my discretion.

134. But as the scope of Mr. Dumbreck's reports also indicated, the SCR metrics of the two companies at any particular point in time cannot provide a complete answer to the question of security of benefits for policyholders. It is also necessary to consider the respective capital management policies of the two companies and to understand how they might each react to an unexpected deterioration of their financial position.

Capital management, corrective actions and likely support from other sources

135. As summarised above, Mr. Dumbreck noted that PAC operates a solvency intervention ladder requiring different management actions if its SCR coverage ratio were to fall below a series of set levels. Mr. Dumbreck's view was that this provides a slightly higher level of security for policyholder benefits than Rothesay's capital management policy, albeit that after taking into account a number of additional reasons summarised in the paragraph from his letter of 19 June 2019 that I quoted at paragraph [65] above, he considered that the protection provided by the two capital management policies was broadly comparable.

136. One of those reasons cited, in general terms, a number of actions that might be taken by Rothesay to restore its SCR coverage ratio in the event it was to fall below 130%. In the nature of things, Mr. Dumbreck could only express the opinion that such measures by Rothesay were "credible" and could have the "potential" to be effective, and there is no indication that equivalent actions could not also be taken by PAC or are not already included within PAC's solvency intervention ladder.

137. Importantly, Mr. Dumbreck was also of the view, which I share, that in the event of a deterioration in PAC's financial position it is likely, for obvious reputational reasons, that Prudential plc would provide the necessary financial support to PAC, and that there are very considerable resources available in the Prudential group which have been built up over many years and which could be used for that purpose.

138. The likelihood that such resources would, for reputational reasons, be used to support PAC in times of difficulty is entirely in accordance with the reasoning and conclusions of another independent expert, and the way in which PAC presented its case to me in respect of another Part VII scheme for the transfer of some of its insurance business to an Irish subsidiary in the context of Brexit: see *Re Prudential Assurance Company Limited* [2018] EWHC 3811 (Ch) at paragraph [36].

139. Although Mr. Dumbreck rightly pointed out that the Demerger will result in a reduction of the resources available to M&G Prudential for such purposes, no-one suggested that this would mean that very substantial resources would not still be available within the M&G Prudential group of which PAC will be a member in the future.

140. Mr. Dumbreck also suggested that in an adverse scenario in which PAC's solvency might be threatened, the financial resources of Prudential plc might be similarly constrained. I accept that as a general caveat, but in his letter of 19 June 2019, Mr.

Dumbreck clarified that this was not intended to imply that all scenarios in which PAC's solvency was threatened would inevitably also deplete the capital resources of Prudential plc. He fairly accepted, for example, that an increase in annuitant longevity in the UK would not materially affect the Prudential group more widely.

141. In contrast to the likelihood that PAC could rely upon financial support from the wider Prudential group if the need arose, Mr. Dumbreck pointed out that Rothesay's parent company does not have any substantial resources that could be made available in the event that Rothesay's solvency was threatened.

142. To address this obvious difference between PAC and Rothesay, Mr. Dumbreck expressed the view that, even in adverse conditions, the investors in Rothesay's parent company would be motivated to protect their existing investment in Rothesay by providing more capital if the need arose. This possibility was also addressed in a witness statement from Mr. Andrew Stoker, the Chief Financial Officer of Rothesay. Mr. Stoker noted that Rothesay had raised funds from the shareholders of its parent company on a number of occasions for its business acquisitions, including the reinsurance of the Scottish Equitable business and the PAC business in issue in this case. Mr. Stoker stated that he had,

> "no reason to believe that such support would not be forthcoming in respect of the future development of the business or that such investors would not be motivated to protect their existing, significant, financial investment in [Rothesay] should it require further capital in the future."

143. Mr. Stoker also set out the nature of the three current investors in Rothesay's parent company, drawing attention to the fact, for example, that Blackstone holds its investment in its long term strategic opportunities fund; that MassMutual is a substantial US life insurance company of comparable age to PAC; and that GIC includes "long-term investing" as one of its investment principles on its website.

144. I do not doubt that these views are genuinely held, but they are still essentially supposition as to the possible future actions of Rothesay and those institutions who are currently interested in it. I consider that the opposing policyholders were justified in their submission that such matters do not provide equivalent comfort to the existing availability of capital in the Prudential group and the commercial imperative that would motivate the other Prudential group companies to stand behind PAC. The provision of capital to enable the initial development and expansion of Rothesay's business by acquisition of annuities from other insurers is not the same as the provision of restorative capital to make good an unexpected deterioration in the financial position of the company or to avoid its insolvency. Moreover, the business operations, names and reputations of Blackstone, GIC and MassMutual (or any investors that might replace them) are not integrated with, or inherently tied to the business of Rothesay in the same way as the business operations, name and reputation of other parts of the Prudential group are tied to the business of PAC.

145. Prima facie, I consider that this disparity between the external support potentially available for PAC and Rothesay is a material factor affecting the interests of policyholders to be taken into account in the exercise of my discretion. That was not, however, the view of Mr. Dumbreck, who stated in his letter of 19 June 2019,

> "…any comfort that may be drawn from the potential for capital support from Prudential plc must be considered in the context of the likelihood of it being called upon, which is remote. Therefore it should not be considered material in comparison to the comfort that can be drawn from the capital resources of, and the strength of the regulatory capital requirements and capital management policies applicable to, PAC and Rothesay."

146. The PRA's comment in its third report upon Mr. Dumbreck's analysis as regards the parental support for PAC and Rothesay was as follows,

> "Under the Solvency II regulatory framework, solo insurers such as [PAC and Rothesay] are required to hold sufficient capital and liquid resources to meet their liabilities as they fall due, independently of resources which may be present in other group entities. Insurers are further required to hold a capital requirement (i.e. the SCR) corresponding to a value-at-risk of basic own funds subject to a confidence level of 99.5% over one year (in more broad brush terms, this can be thought of as sufficient capital to absorb the impact of a 1-in-200 year stress event within the next twelve months). Given that the Scheme is not expected to threaten either [PAC or Rothesay]'s ability to maintain their respective SCRs, the PRA's view is that there is no material impact upon policyholders' reasonable expectations as to their security of benefits as a result of the transfer.
>
> With respect to [Rothesay], given the strength of its balance sheet as at the date of figures quoted in the Scheme Report (and there being nothing to suggest any imminent deterioration of its balance sheet such that group support would be required) the availability of possible group support was not considered necessary for the purposes of the Scheme."

147. On this point, Mr. Moore QC relied upon comments of David Richards J in *Royal Sun Alliance* at paragraph 11, as follows,

> "Accordingly, in approaching this application I shall be concerned to see whether there is any material adverse effect on the position of policyholders in any of the three groups to which I have referred. The word "material" is important. The court is not concerned to address theoretical risks. It might be said that a transfer of business from a very large company to a large company involved a reduction in the cover available to the transferring policyholders, but assuming that the transferee is in a financially strong position it matters not that the level of cover in the transferee is less than that in the transferor. What the court is concerned to address is the prospect of real, as opposed to fanciful, risks to the position of policyholders."

Based upon this dictum, Mr. Moore QC submitted that the risk of failure of either PAC or Rothesay was fanciful, and hence questions of the relative lack of availability of parental support for Rothesay were not material.

148. I am not persuaded by these points. The Independent Expert and the PRA both appear to rely upon the SCR and SCR coverage ratios of PAC and Rothesay as at 31 December 2018 as the basis for suggesting that the likelihood of parental support being needed by either company in the future is remote. The PRA also appears to have relied upon the strength of Rothesay's balance sheet as at 31 December 2018 and "there being nothing to suggest any *imminent* deterioration of its balance sheet" (my emphasis) in deciding not to take the availability of group support into account when assessing the Scheme.

149. It may very well be the case that the current SCR and SCR coverage ratio of both companies means that there is a very high degree of confidence (in excess of 99.5%) that neither company will fail to maintain capital assets at least equal to its Technical Provisions in the next year. I equally have no reason to doubt the PRA's statement that there is nothing to suggest any "imminent" deterioration in Rothesay's current balance sheet. But some of the annuities in this case will require payment for decades, and I simply do not think that there can be anything like the same level of confidence that a material deterioration of the balance sheets of either company might not occur at some time over such an extended period.

150. Moreover, in addition to considering the risk of insolvency occurring, it is necessary when assessing the materiality of any difference for policyholders, to have regard to the impact which any such default would have upon policyholders. For the reasons that I have given, the annuitants who will be dependent upon the insurer for income for their lives are extremely, and justifiably, risk averse. Even assuming, by reason of the current capital resources, regulatory capital requirements and capital management policies applicable to the two companies, the risk of either company needing parental support in the future was remote, if such risk were, against the odds, to eventuate and the support not be available, the result for policyholders would be catastrophic.

151. As such, while I would agree with Mr. Dumbreck's observation that the comfort to be drawn from the potential for capital support for PAC from Prudential plc must be considered in the context of the likelihood of it being called upon, I do not think that he accurately completes the analysis. When the consequences for policyholders are taken into account, I do not consider that the likelihood of support being available for PAC, and the relative uncertainty of whether it would be available for Rothesay, can be dismissed as an immaterial factor.

152. I would also not agree with the comparison which Mr. Dumbreck seems to draw between the comfort to be obtained from the current capital resources, regulatory capital requirements and capital management policies of the two companies on the one hand, and the potential for parental support on the other. The two are not alternatives: the availability of parental support is capable of providing additional comfort in the event that the comfort to be derived from the current financial strength of the two companies proves misplaced.

153. Finally, I would observe that David Richards J's comments in *Royal Sun Alliance* about the court being concerned with "the prospect of real, as opposed to fanciful,

risks to the position of policyholders" were made in the context of the transfer of a portfolio of short-term general property, motor and liability insurance where policies were renewable annually and 70% of claims were settled within three years. The focus in the case was on the extent to which reliance could be placed on the different regulatory requirements in Ireland, where the transferee was based, to ensure that it had adequate capital for a three year period during which any outstanding claims would be settled, and policyholders would have the opportunity to renew their insurance with another insurer. The contrast with the instant case is obvious: the duration of the annuity policies are many times greater, the impact of a default upon annuitants would be catastrophic in comparison with the likely losses under a general insurance policy, and if transferred from PAC, the annuitants will not have the opportunity at any time to renew with any other insurer than Rothesay.

154. In short, I do not consider that I can disregard as fanciful the possibility that PAC or Rothesay might require external financial support over the lifetime of the annuitants in this case. In that respect there is a material difference in the potential availability of assistance for the two companies: if the need arose, PAC would be likely to be supported from the very substantial resources of the Prudential group; but no equivalent measure of comfort is available in relation to Rothesay.

155. I should add that, in my view, this conclusion is not affected by the fact that, in the event of failure of Rothesay, the FSCS might pay compensation in full to policyholders. The relevant question in this respect is whether the Scheme makes a material change in the security of benefits for policyholders as a result of the change from PAC to Rothesay. If the possibility that the FSCS might step in and compensate annuitants in full in the event of failure of an insurer could be taken into account, then it would apply in all annuity cases, and there would be no purpose in any detailed analysis of the respective financial strengths of the transferor and transferee companies. That is not an approach which has been adopted in any previous case. Moreover, I do not consider that it can be right that commercial parties should be able to rely upon the potential availability of a public or industry fund of last resort such as the FSCS – the rules of which might in any event be changed over the lifetime of the annuities – as a solution to any shortcomings in their schemes.

The age and reputation of the transferor and transferee

156. Mr. Moore QC also submitted that in assessing the security of benefits for Part VII purposes, the relative age and established reputations of the transferor and transferee were irrelevant. In that respect he referred to the way in which Warren J dealt with a similar point in *Scottish Equitable* at [114]-[116] as follows,

> "114. [A representative of an opposing policyholder] emphasises the unfairness, as she sees it, of compelling her elderly father to transfer to a new company from the venerable [Scottish Equitable] which he deliberately chose. He wants to be given a choice, in particular to transfer to [Legal & General] rather than to [Rothesay].
>
> 115. There are two points to make. Firstly, the venerable position of [Scottish Equitable] is not, I am afraid, of itself a relevant factor. Even venerable institutions can fail as those

> who work in this area of the law are well aware. In any case, [Scottish Equitable] is part of a group, about the age and venerability of which I have no idea. So the point, if it had any force, is not made good.
>
> 116. Secondly, a newish body, that is to say, [Rothesay], is not to be regarded as an unsuitable provider simply because it is new, otherwise we could never have new entrants into the market for transfers. The question is not its age but its financial strength, record and expectations. As to this, the independent expert and the regulators are clearly satisfied about its financial strength, there is no criticism made of its record, and I have no reason to think that it will not be properly and prudently managed into the future."

157. With respect, I do not agree with the view that Warren J expressed in paragraph [115] that the respective ages and reputations of transferor and transferee are not relevant factors for the court to consider under section 111(3) in a Part VII scheme for the transfer of annuities: or more accurately, I consider that where consumers have made a choice of annuity provider based on such factors, this is something that the court can take into account in exercising its discretion under section 111(3).

158. I accept, as Warren J indicated, that history shows that even venerable institutions can fail (e.g. Barings and Lehman Bros). But, with respect, that is not the point. No-one can ever guarantee that a financial institution cannot fail.

159. I also entirely understand why intangible factors such as longevity or an established reputation for providing secure financial benefits cannot be included in the risk-based assessment of the regulators or reduced to numerical values by the independent expert. In that regard, the position was explained by the PRA in its third report as follows,

> "[In accordance with its statutory objectives] … in broad terms … the PRA assesses whether the insurers will have appropriate financial resources; appropriate resources to measure and manage risk; be fit and proper to conduct their business prudently; and be capable of being effectively supervised by the PRA.
>
> The PRA considers each insurance Part VII transfer on its own merits, in accordance with [such principles] whether in relation to a general or long-term insurance business transfer, to include (in the latter case) the transfer of annuity business. It takes a risk-based approach to supervision and assessment of the impact of the transfer and takes account of the nature of the business being transferred. The long-term nature of annuity business is reflected in the regulatory regime, including (but not limited to) the amount of capital insurers writing annuity business are expected to hold under applicable regulatory requirements, which will vary between the different types of business being carried on.

> …
>
> In evaluating a scheme, the PRA does not place weight on the fact that one firm may have a longer history or perceived better reputation than another. Neither does the PRA's approach to supervision and risk assessment place a capital value on a firm's venerability, reputation or policyholders' perception of the firm's strength and firms are not permitted to claim an explicit capital benefit for these intangible concepts."

160. But the fact that the PRA (or an actuary) cannot quantify a firm's venerability or reputation in capital terms, does not mean that it also has to be disregarded by the court. I have already made the point that the court's role under section 111(3) is not simply intended to replicate, or to be limited by, the risk-based approach of the regulators to the assessment of the scheme, or the actuarial approach of the independent expert.

161. It should be borne in mind that consumers who wish to buy an annuity policy are not generally given access to the detailed financial information and Solvency II metrics to which the regulators have access. Consumers are entitled to assume that all insurers comply with those metrics and the requirements of the regulators. Instead, consumers are expected to make the decision as to which insurer to select based upon other factors. In that regard, I do not think that the purchaser of an annuity policy who decides to place some reliance on the longevity and established reputation of an insurer can be said to be acting irrationally or unreasonably, and I consider that the court is entitled to have some regard to the reasons for their choice when considering the alternative that they are being presented with under a Part VII scheme.

162. In that respect, it is worth recalling the statement on Prudential plc's current website to which I referred at the start of this judgment,

> "Providing financial security since 1848 … Our financial strength, heritage, prudence and focus on our customers' long-term needs ensure that people continue to turn to our trusted brands to help them plan for today and tomorrow."

163. It is, indeed, one of the ironies of this case that opposing policyholders were keen to praise PAC's reputation for financial strength and prudence, and to stress their desire to remain with it for the long-term, thereby very much echoing PAC's own projection of its virtues. In contrast, PAC's submissions to me were essentially that I should not pay any, or only minimal, regard to those considerations because they were not objectively based or numerically measurable, and that PAC policyholders would be just as well-off with a new entrant to the market which had broadly equivalent Solvency II metrics.

164. In any event, the facts of the instant case are clearly distinguishable from those which Warren J considered in *Scottish Equitable.* Warren J indicated at para [115] that he had no evidence about the age and venerability of Scottish Equitable and its group, so that he was unable to make any comparison with Rothesay as transferee. The facts of the instant case present a stark contrast: PAC is one of the oldest and most respected UK insurance companies which has built up its business organically over about 170

years. Rothesay is one of the most recent entrants to the annuity market and has acquired the majority of its policyholders by portfolio transfer from other insurers.

165. In that regard, I would stress that I am not making any value judgment on the suitability of Rothesay to provide annuities. That was apparently an argument made to Warren J in *Scottish Equitable*, and was rejected by him at paragraph [116] with the comment to the effect that a newish body like Rothesay is not to be regarded as an unsuitable provider simply because it is new. That comment must of course be right. I also accept the further point made by Warren J – which was emphasised to me by Mr. Purves on behalf of the FCA - that it is no part of the court's function under Part VII to discourage new entrants who bring fresh capital to the insurance market.

166. But those points were not the basis upon which any of the opposing policyholders made submissions to me in this case. Their argument is that they chose PAC on the basis (among other things) of its age and established reputation and were acting rationally when they did so; that the company to which it is now proposed to transfer their policies does not have those attributes which they considered of real importance; and that I should give some weight to their exercise of contractual choice when exercising my discretion. I accept that argument.

The Reinsurance Agreement

167. Mr. Moore QC's skeleton argument contained a prominent submission that by reason of the Reinsurance Agreement,

> "...the economic risk and reward has already passed to Rothesay and the purpose of the Scheme is to give legal form to approximately 90% of that economic reality since it seeks to transfer about 90% of the business reinsured under the arrangements."

168. This statement prompted the obvious response from the opposing policyholders that although the Scheme might be intended to give legal form to the economic reality that had already been created as between PAC and Rothesay by the Reinsurance Agreement, it entirely failed to take into account the fundamental change which the Scheme would cause in the relationship between PAC and the Transferring Policyholders.

169. But this submission highlights a further issue which I consider to be of real relevance to the exercise of my discretion. The Reinsurance Agreement has already enabled PAC to achieve its main business purpose, namely to reduce the SCR of its shareholder-backed business so as to facilitate the Demerger. Consistent with the evidence to which I have already referred, Mr. Moore QC's skeleton argument indicated,

> "If the Scheme were not to be sanctioned, the reinsurance arrangements are expected to endure in their entirety, not least because to terminate them would involve the loss of the capital benefits PAC gained by reason of them."

Mr. Moore QC also confirmed that, except perhaps in relation to its timing, the Demerger was not in any way dependent upon the Scheme being sanctioned.

170. In those circumstances, it seems to me that in striking the balance to which Warren J referred in *Scottish Equitable* between the interests of policyholders and the interests of the commercial parties, I can take into account that PAC has already achieved its substantial business purpose, and if the Scheme was not to be sanctioned, those capital benefits to PAC would not be lost.

171. When this point was raised at the hearing, evidence was produced describing other prejudice which it was said would be caused to PAC and Rothesay if the Scheme was not sanctioned. So far as PAC is concerned, the evidence was that if the Scheme was not sanctioned and the Reinsurance Agreement was to continue in full force, (i) PAC would have to continue to hold regulatory capital of not less than £100 million in respect of its credit risk exposure to Rothesay which it would be unable to utilise to pursue other opportunities, and (ii) PAC would be required to incur operational costs reporting on Rothesay's management of the collateral that is required to be held to support its obligations to PAC under the Reinsurance Agreement.

172. I accept that these are matters that I should take into account, but I do not consider that they are of major significance in the exercise of my discretion. A continuing regulatory capital requirement of £100 million represents a very small proportion of the capital benefits which PAC obtained by the Reinsurance Agreement; alternatively, and if and to the extent that PAC contends that such a requirement is significant, it reflects the credit risk of Rothesay that the Scheme seeks to pass onto the Transferring Policyholders. PAC cannot have it both ways. I was not given any specific details or breakdown in the evidence of the amount of the continuing operational costs to PAC of reporting on Rothesay's management of the collateral, but I have no reason to suspect that Rothesay's conduct in that regard is likely to necessitate significant costs for PAC.

173. So far as Rothesay is concerned, the prejudice was said to be (i) additional costs of about £6.05 million per annum of continuing to administer the policyholders under the Reinsurance Agreement (or about an extra £16 per policyholder per year, rather than the £7 per policyholder per year that Rothesay says that it currently spends on administering its existing policyholders), (ii) the opportunity cost of being unable to use the collateral backing the transferring policies "in accordance with [Rothesay's] wider investment strategy"; (iii) the inability to manage the longevity risk associated with the transferring policies by obtaining direct reinsurance, and (iv) the fact that Rothesay considers itself to be an insurer rather than a reinsurer, and only entered into the Reinsurance Agreement in the expectation of obtaining a transfer of the policies under the Scheme.

174. The overriding point in relation to all these points is that Rothesay entered into the Reinsurance Agreement knowing that the Scheme was subject to the sanction of the court. Rothesay could not have presumed that the Scheme would inevitably be sanctioned. There is a distinct air of bootstraps in Rothesay suggesting that it would be prejudiced if the Scheme was not sanctioned, by being deprived of the opportunities which it would have for saving administration costs, managing risks, or for using different or more innovative investment techniques for the assets that back the transferring annuities, which it would be able to do if the Scheme was sanctioned.

Service standards and governance

175. Although the opposing policyholders drew attention to the fact that taking on the Transferring Policyholders would in effect double the number of policyholders for which Rothesay is responsible, I have no basis on the evidence for concluding that Rothesay would be unable to manage that expansion of its business. PAC has already outsourced the administration of the Transferring Policies to Diligenta, and given the arrangements for that or a similar arrangement to continue if the policies are transferred to Rothesay, I see no reason to conclude that policyholders will be adversely affected by the Scheme in relation to the standards of service that they are likely to experience.

176. I would also reject any suggestion that by reason of the nationality or location of Rothesay's directors, the standards of management or regulation of Rothesay will suffer by comparison to those of PAC.

Conclusions

177. Pulling the strands together, I acknowledge that the Independent Expert is of the opinion, with which the Regulators do not disagree, that the implementation of the Scheme will cause no material adverse effect upon the security of benefits and reasonable expectations of Transferring Policyholders as regards service standards and governance. As the authorities indicate, that opinion is entitled to considerable weight.

178. However, such views are not determinative of whether it is appropriate in all the circumstances for me to exercise my discretion to sanction the Scheme as required by section 111(3). For the reasons that I have given, the court's discretion is not constrained by the same actuarial factors which guide the analysis of the Independent Expert and the statute-based mandate of the Regulators, but can take into account a wider set of factors in striking a balance between the interests of policyholders and the commercial interests of the transferor and transferee.

179. In this case, as I have explained, there are a number of factors which weigh heavily against the exercise of the court's discretion to sanction this Scheme.

180. The purchasers of annuity policies such as those in the instant case make a significant investment of some or all of their pension pots, and have no option to change the insurer upon which they will be dependent for life. In that context, it was entirely reasonable for policyholders to have chosen PAC as the provider for their annuities based upon its age, its established reputation and the financial support which it would be likely to receive from the accumulated resources of the wider Prudential group if the need were ever to arise. I also consider that in light of the way in which their policies were described in the relevant documents, and in the absence of any clear statement to the contrary, it was entirely reasonable for policyholders to have assumed that PAC would not seek to transfer their policies to another provider. These factors mean that the choice of policyholders to take their lifetime annuities from PAC itself carries significant weight.

181. In contrast, in terms of the criteria that the opposing policyholders relied upon to select their annuity provider, Rothesay is very different from PAC. It is a relatively

new entrant without an established reputation in the business. Although it may currently have SCR metrics which are at least equal to those of PAC, it does not have the same capital management policies or the backing of a large group with the resources and a reputational imperative to support a company that carries its business name if the need were to arise over the lifetime of the annuity policies. I cannot dismiss as fanciful the possibility that such support may be required over the very long duration of these policies, and I consider that the reliance which policyholders would then have to place upon an uncertain capital raising exercise from the investors in Rothesay or the markets more generally, is a material disadvantage of the Scheme to Transferring Policyholders.

182. On the other side of the balance, PAC's reasons for selecting the Transferring Policyholders were entirely driven by a need to release regulatory capital to support the proposed Demerger. PAC has achieved that commercial objective by the Reinsurance Agreement, which will continue even if the Scheme is not sanctioned. PAC and Rothesay could not presume that the Scheme would be sanctioned, and I do not regard the additional costs which they will incur, or the fact that Rothesay will not have the commercial opportunity to use different techniques to exploit the assets which support the Transferring Policies, are significant prejudice when set against the fundamental change in status and material disadvantage that they seek to impose on the Transferring Policyholders.

183. For completeness I should also indicate that I do not accept Mr. Moore QC's submission that the effect of my refusing to sanction the Scheme would be to make it very considerably more difficult for PAC ever to utilise Part VII in relation to these annuity policies, or to make it very considerably more difficult for Rothesay to acquire further annuity policies. I have held that such policies are transferrable as a matter of law and contract, and that although policyholders might reasonably have assumed that PAC would never transfer them, that is simply a factor to be taken into account. The result might be different if, for example, PAC's commercial purpose for the transfer was different, if the transfer was proposed to policyholders on different terms, or if there was less disparity between transferor and transferee in the characteristics that policyholders reasonably considered important when selecting PAC as their annuity provider. Likewise, there is no reason why Rothesay should not be able to acquire portfolios of annuities from other insurers with different characteristics or on different terms.

184. For those reasons, I do not consider that it is appropriate in all the circumstances to exercise my discretion to sanction the Scheme.