

# PRA Policy Statement 1/22: Insurance business transfers

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## Introduction

On 12 January 2022 the Prudential Regulation Authority (PRA) published its Policy Statement 1/22 on insurance business transfers<sup>1</sup> (PS1/22), which provides feedback and responses to its Consultation Paper 16/21 released in July 2021 on the same topic. PS1/22 also contains the updated Statement of Policy, “The Prudential Regulation Authority’s approach to insurance business transfers” (SoP).<sup>2</sup>

The purpose of the amendments to the SoP introduced by PS1/22 is primarily to reflect legislative changes following the UK’s withdrawal from the European Union and the completion of the transition period, as well as to provide additional guidance for firms and independent experts on the PRA’s expectations in relation to insurance business transfers.

PS1/22 is relevant to all PRA-authorised insurers, including mutuals, friendly societies, the Society of Lloyd’s and its managing agents.

The main amendments to the SoP introduced by PS1/22 can be broadly categorised as follows:

1. The role of the PRA
2. The Independent Expert
3. The Scheme Report
4. Timing and notice provisions
5. Friendly society transfers and amalgamations

In this paper we set out the key amendments to the SoP that have been introduced by PS1/22 under the categories above, and we consider the potential implications for insurance business transfers. This summary is not a comprehensive list of all amendments to the SoP; it focuses on the amendments that appear to be the most consequential for firms and independent experts.

## The role of the PRA

### KEY AMENDMENTS

The PRA has added further clarification around its role in insurance business transfers, which includes approving the Independent Expert and the form of the Scheme Report (which is prepared by the Independent Expert) and assessing insurance business transfer schemes against its statutory objectives. The PRA also outlines the initial information that it requires when a transfer is initially being considered, including an outline of the transferring business, the proposed timelines, details of the proposed transfer and any related transactions or plans.

The PRA now specifies that schemes involving non-life insurance business in runoff, with technical provisions of more than £100 million and where the scheme would increase the transferee’s technical provisions by more than 10%, will require a Section 166 review into the operational readiness of the transferee to accept the business, except in certain cases such as where a comparable assessment has recently been conducted. This review is required to take place prior to the nomination of the Independent Expert.

The PRA also clarifies the additional factors it may consider when assessing a scheme where the transferee is a firm in runoff. This includes consideration of the uncertainty and risks over the time horizon of the runoff, taking account of the transferring business.

### IMPLICATIONS FOR INSURANCE BUSINESS TRANSFERS

The amendments to the SoP provide firms with clearer guidance on the information that the PRA will expect to receive when a transfer is initially being considered, which may help to make the initial stages of a transfer more efficient.

Clearly the new requirement around operational readiness reviews will have implications for certain transfers of non-life business. This potentially introduces a substantial prerequisite to insurance business transfers, increasing the timeframe, resources and costs associated with the overall process. However, this requirement only applies in limited circumstances, and where it does apply firms may be able to make use of recent assessments on the same topic if available.

<sup>1</sup> PRA (January 2022). PRA Policy Statement 1/22: Insurance Business Transfers. Retrieved 27 January 2022 from <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2022/ps122.pdf?la=en&hash=F7680C1E96E4B64D2C0935F2CE9A5365C8785121>.

<sup>2</sup> PRA (January 2022). Statement of Policy: The PRA’s Approach to Insurance Business Transfers. Retrieved 27 January 2022 from <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/statement-of-policy/2022/the-pras-approach-to-insurance-business-transfers-sop-jan-2022.pdf?la=en&hash=725D581CFE32B904A38BEA2E069658E62DA2BFB0>.

With regard to the additional considerations when the transferee is in runoff, the PRA may look to the Independent Expert's report for any relevant analysis, and therefore the Independent Expert may need to consider projections for the transferee over the full runoff horizon, noting that this analysis often already takes place. This will require firms to be able to provide information on the projected runoff of their business in order to support this analysis.

## The Independent Expert

### KEY AMENDMENTS

Various additions have been made to the SoP to provide further clarification on the PRA's expectations regarding independent experts, both prior to their appointment and for the duration of the transfer process.

- The PRA clarifies its expectations regarding independence of the Independent Expert's employer, and the time and capacity of the Independent Expert to undertake the work.
- It may be appropriate for the Independent Expert to seek independent specialist advice when the transferor or the transferee contains specialist or niche lines of business. More broadly, the scheme report prepared by the Independent Expert must make clear where reliance is placed on others, and why.
- The PRA highlights that the Independent Expert's responsibilities continue until the transfer has become effective. It stresses the importance of the Independent Expert continuing to assess their independence throughout the process, and of notifying the regulators promptly of any perceived change in independence.

### IMPLICATIONS FOR INSURANCE BUSINESS TRANSFERS

The requirement to demonstrate not only the independence of the nominated Independent Expert but also of their employer may introduce an additional burden in the Independent Expert selection process; however, in our experience this is already something that is typically provided to the PRA during the Independent Expert approval process.

Typically, an Independent Expert would have the required experience to consider the implications of the transfer on the full portfolio of transferring business and therefore specialist advice on particular lines of business should not be necessary in most cases; nonetheless, this clarification is useful if such a circumstance were to arise. Perhaps more common are cases where the Independent Expert has sought independent legal advice on points of legal interpretation that are material to the transfer and for which there is no, or limited, precedent.

Given the relatively long timeframe over which most transfers take place, the PRA raises a valid point that the Independent Expert should ensure they remain independent throughout the process.

## The Scheme Report

### KEY AMENDMENTS

#### Minimum expectations for the Scheme Report

The SoP sets out the minimum expectations for the contents of the Independent Expert's Scheme Report, with the following new additions.

- Where the transferor or transferee considers it inappropriate to disclose information that the Independent Expert considers relevant to include, this should be explained in the Scheme Report.

In addition to considering the likely effects of the scheme on transferring policyholders, policyholders whose contracts will remain with the transferor and policyholders of the transferee, the Independent Expert should consider whether any further groupings within these categories is appropriate.

- The Scheme Report should include the Independent Expert's definition of "material adverse effect" in the context of the impact of the transfer on affected groups of policyholders.
- If a scheme has concurrent or linked schemes, analysis should be included on the likely effects of the different permutations on policyholders.

#### Areas for the Independent Expert to assess

The updated SoP also sets out some further areas that the Independent Expert should assess, at both firm and policyholder levels, when forming their opinion on the likely effects of the scheme.

- How groups of policyholders are affected differently by the scheme and, where effects for certain groups are considered material, how this affects their overall opinion.
- An assessment of the stress and scenario testing carried out by the firm(s) and of the available management actions. The Independent Expert should also consider whether it is necessary to conduct their own stress and scenario testing, or whether they should request the firm(s) to conduct further testing.
- The transferor's and transferee's respective abilities to measure, monitor and manage risk, and to take corrective action if there is a material deterioration of their balance sheets.
- The likely effect of the scheme in relation to risks falling outside of the regulatory capital regime, including risks likely to emerge after the first year or that are not fully captured by the regulatory capital requirements.
- An assessment of the appropriateness of the transferee's existing capital model following the scheme.
- The likely effects of the scheme on capital management and claims reserving in relation to policyholder security, service levels and reasonable expectations.
- The likely impact of changing risk profiles and/or risk exposures resulting from the scheme or related transactions.

In addition, where a transfer forms part of a wider chain of events or corporate restructuring programme, the PRA expects the Independent Expert to comment on how such plans would impact the likely effects of the scheme at firm and policyholder level.

### IMPLICATIONS FOR INSURANCE BUSINESS TRANSFERS

While the additions to the scope of the Independent Expert provide useful clarification, in our experience they largely cover areas that the Independent Expert already includes within the Scheme Report. For example, it is common to consider the effects of a scheme on with-profits, unit-linked and nonprofit policyholders separately, as well as considering the effect on other parties such as cedants under inward reinsurance contracts and counterparties to other contracts that would be transferring under the scheme.

Independent experts may, however, consider enhancing their analyses of certain aspects of the scheme in response to these updates. For example, analyses of risk management approaches, risks outside of the regulatory capital regime and the range of stress and scenario tests assessed may all expand. Firms will therefore need to be prepared to provide further information to the Independent Expert to support this analysis.

It is becoming increasingly common for insurance business transfer schemes to be one of multiple concurrent schemes or transfers, or to be part of wider restructuring programmes. It is therefore important that, where this is the case, firms are able to provide the Independent Expert with information on the various scenarios in terms of how the different components may play out, including where the order of events is different from what has been planned. This is likely to add complexity to the Independent Expert's assessment of the scheme.

## Timing and notice provisions

### KEY AMENDMENTS

The updated SoP contains additions relating to policyholder representations and the timing and nature of reports submitted to the PRA and the court.

- The PRA specifies that the notice of the transfer sent to policyholders and other relevant parties should provide details of how and when any representations should be made in order to be considered by the court.
- Where policyholder representations or material issues arise after the publication of the Independent Expert's supplementary report, the PRA would expect updated versions or addendums to the supplementary report to be prepared closer to the scheduled hearing date.
- The PRA confirms that it expects to be provided with near-final documents a minimum of six weeks before the documents are submitted to the court (or, in the case of

the Independent Expert's supplementary report, a minimum of six weeks before its planned publication), and that failure to do so may result in postponement of the court hearing.

- Where the duration between the directions hearing and the final court hearing is six months or more, the PRA may expect the Independent Expert to produce an updated Scheme Report rather than a supplementary report.

### IMPLICATIONS FOR INSURANCE BUSINESS TRANSFERS

Under the approach of the Financial Conduct Authority (FCA) to insurance business transfers, it is already an expectation that firms make clear to policyholders how they can make representations relating to a scheme, and therefore this is already a key area of focus for firms when drafting their policyholder communications. In addition, independent experts are already required to ensure they have considered all policyholder representations made up until the date of the final court hearing, and firms are required to continue providing the Independent Expert with this information up until this date.

The point around policyholder representations or material issues arising after the publication of the Independent Expert's supplementary report seems particularly relevant in our current volatile and rapidly changing environment. While it has always been the case that independent experts should continue to consider relevant developments up until the transfer takes place, after the Independent Expert's supplementary report has been produced there is usually no formal requirement to document this assessment. However, in our more recent experience, it has often been necessary to prepare a letter after the supplementary report has been published, and as close to the final court hearing as possible, in order to provide an up-to-date opinion on the impact of evolving matters on the scheme, such as COVID-19 implications and policyholder correspondence.

The clarifications around the timing of reports submitted to the PRA and the court are useful for firms when planning a transfer. In our experience it is preferable to submit near-final documents to the PRA well in excess of the six-week minimum timeframe, particularly for large or complex transfers. Further, ongoing dialogue between the firms, the PRA and the Independent Expert should minimise the risk of material issues being raised by the PRA following submission of these documents.

Firms are, in most cases, keen to keep the timeframe between the directions hearing and the final court hearing to less than six months, and the PRA has historically been sceptical of transfer plans which entail longer timeframes. However, material issues or external developments may arise which make extended timeframes unavoidable, and as such the PRA's clarified expectations in these circumstances are useful for firms when planning transfers and considering contingency plans.

## Friendly society transfers and amalgamations

### KEY AMENDMENTS

The updated SoP provides greater clarity on the PRA's approach to transfers involving friendly societies. In particular:

- The PRA confirms that where the transferor is a friendly society, the transfer is governed by the Friendly Societies Act 1992 rather than the Financial Services and Markets Act 2000 (which governs insurance business transfers where the transferor is not a friendly society, including where the transferee is a friendly society).
- The PRA will consider the scale and complexity of the transfer when deciding whether it requires a report from an independent actuary on the likely effects of the transfer on policyholders or members that may be impacted by the transfer. The PRA may also require an additional supplementary report to be prepared where there have been material financial or other developments prior to the members' vote or confirmation hearing.
- The PRA, in consultation with the FCA, must approve the statement sent to members containing information on the transfer. The statement should be provided to members a minimum of 14 days prior to the vote. The PRA may expect a longer period in certain circumstances, such as where the friendly society has a very large membership or where the transfer is particularly complex.
- In addition, the statement to members should include information as to how members can make representations, and the PRA would expect the friendly society to communicate in writing before the hearing to those that have made representations. The PRA would also expect the friendly society to share summaries of these member communications.

### IMPLICATIONS FOR INSURANCE BUSINESS TRANSFERS

The improved clarity around the PRA's approach to transfers involving friendly societies is likely to be welcomed by relevant firms, who will now be able to approach such transfers with greater degrees of certainty around what will be expected. Confirmation that the PRA will consider the scale and complexity of the transfer when deciding whether it requires a report from an independent actuary may make small and straightforward transfers involving friendly societies a more feasible option going forward.

## Conclusion

The amendments outlined in this paper provide useful clarification on the PRA's approach to insurance business transfers, and a number of the additions resonate with our experience of some of the key issues that have arisen on recent transfers.

The new requirement around operational readiness reviews for certain transfers of non-life business is arguably the most significant addition to the updated SoP, and something that affected firms will need to factor into their plans when considering insurance business transfers.

Whilst the scope of the Independent Expert's work has increased under the updated SoP, in our experience the additions mostly cover areas that the Independent Expert already includes within the Scheme Report to some extent. There may, however, be an increase in the level of information that firms will be required to provide to the Independent Expert in the areas of risk management, analysis of the interaction of transfers with other transfers or projects, additional stress and scenario tests, risks falling outside of regulatory capital requirements and runoff plans for transferees in runoff.

Overall, in most cases we do not expect that the updated SoP will have a significant impact on the work required by firms to implement an insurance business transfer, and insurance business transfers remain a useful tool for firms to restructure or simplify their business.

## How Milliman Can Help

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

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

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