

FCA finalised guidance on Part VII transfers

May 2018

On 29 May 2018 the FCA published its long overdue finalised guidance on Part VII transfers, first consulted on in May 2017. It has made a number of changes to the original guidance - some of these are helpful in clarifying the original draft guidance but others involve new drafting raising additional questions of interpretation. Some key points are summarised below. We also comment on additional FCA expectations in respect of Brexit-related transfers.

FG18/4 - The FCA's approach to the review of Part VII insurance business transfers

“Comply or explain”

The FCA has responded to feedback that the consultation paper suggested a “comply or explain” approach would need to be taken to Part VII transfers which do not fulfil all aspects of the guidance. It states that the guidance is not intended to make the Part VII process more complex or costly, and has provided clarification in the form of additional wording in paragraph 1.3 of the guidance, which states: “The purpose of this guidance is to help firms identify those areas of difference (from expectations and examples set out in this guidance) early enough in the process so that they do not create problems closer to court dates and interfere with timelines”. This does not entirely clarify the extent to which firms need to explain all divergences to the FCA, particularly as paragraph 1.7 still states that the FCA may ask Applicants to confirm that a proposed transfer satisfies the guidance or explain any divergence.

Competition considerations

Some feedback queried the suggestion that the IE report should address competition considerations. The FCA has retained this section but with some amendments to clarify that it does not expect the IE to be a “competition expert”.

Grandfathering of previous Schemes

The FCA has not changed its view that COBS 20 transitional provisions do not allow provisions from previously sanctioned Court Schemes to be replicated in a new Scheme where those provisions do not comply with the current COBS 20 rules. It has added a footnote to the relevant part of the guidance, in paragraph 4.12, commenting that firms may wish to apply for a waiver from the relevant rules to achieve their desired outcome, where the relevant waiver requirements are met.

Identification of transferring liabilities

Some clarificatory amendments have been made to the section of the guidance dealing with identification of the liabilities being transferred. This includes an amendment to the reference to transfer of mis-selling

liabilities, although the FCA has not entirely accepted the point (made in some feedback responses, including the response of the City of London Law Society insurance committee) that these must be separately identified in order to be transferred, as they do not attach to the insurance policies themselves.

Future changes to Schemes

A number of changes have been made to the section discussing future changes to the Scheme. The changes are intended to clarify the FCA's views on when a change would require firms to go back to Court and the FCA's expectations of the IE where a change is proposed, including the need for a further review by the IE. Where future changes relate to the merger, closure or splitting of funds, the FCA has added additional guidance requiring (broadly) the change to be in the interests of policyholders where it involves a change in policy terms. It is not entirely clear why this wording has been added and it is not consistent with the London Life principles for approving a Scheme, on which firms have relied in the past. Provided the scheme as a whole is fair then the proposed changes to policy terms should only need to fall within Section 112(1)(d) of FSMA as being an incidental, consequential or supplementary matter necessary to secure that the scheme is fully and effectively carried out.

Unintended impacts

The FCA has introduced a new bullet point in paragraph 5.12 suggesting that firms might include in the Scheme a provision prompting an application (on the initiative of the firm) for a change in the event of unintended impacts on policyholders, which it suggests would be helpful in a Brexit context. It comments that this would "demonstrate the Applicants' commitment to making only changes that are necessary to allow the Applicants to continue to service their business around the EU".

Changes to the effective date

The FCA has responded to feedback on changes to the effective date of the Scheme to:

- provide that a delay of three months, rather than two months, is likely to require policyholder notifications to be refreshed
- clarify that the need to consider re-notification where the delay is less than three months will be considered on a case by case basis
- clarify that changes to the effective date beyond three months may require re-notification but this will not automatically be the case.

Access to the FOS and the FSCS

The FCA has expanded the guidance on its expectations with regard to the issue of continued access to the Financial Ombudsman Service and the Financial Services Compensation Scheme post-transfer. These points are of particular importance in the context of Brexit related transfers. In particular, the FCA comments that:

- it expects Applicants to aim to preserve the FOS as far as possible to avoid any loss of protections, in the context of Brexit at least until the point of policy renewal. It also comments that "Some firms are able to continue to service contracts from UK branches to preserve continuity". It is difficult to know for certain what the FCA envisages here but this seems at odds with the views of (many) EU regulators that this would constitute the carrying on of business by the UK branch on a cross-border basis without an applicable passport
- it will accept firms taking a proportionate approach to comparing the UK with other EEA regimes e.g. selecting key UK protections (such as FSCS) which are not harmonised in the EEA. Again the FCA suggests

that firms may be able to continue to service contracts from UK branches to preserve continuity of regime until renewal

- in terms of the IE's view of the material impact on policyholders of loss of access to the FSCS, the FCA has made some amendments to its previous guidance to recognise that the capital position of the Transferee may be a relevant consideration. It emphasizes, however, that firms will need to provide evidence of why it is unlikely that the Transferee will default before the time when policyholders have to claim on their policies.

Reliance on experts

The FCA has expanded the section on reliance on the work of other experts, including legal advice, to give more examples of its expectations in different scenarios.

Definition of policyholder

The FCA has chosen not to amend its views on the definition of "policyholder" in light of feedback suggesting that, for example, beneficiaries under pension trusts and employer liability policies are not within the scope of the term. The FCA has maintained this approach for some time so this is not surprising (although legally incorrect). Firms will need to continue to seek dispensation from notification requirements.

Digital communications

The FCA has addressed feedback regarding use of digital policyholder communications by stating that it expects the Applicant to explain "why the contents of a policyholder pack and delivery method is appropriate". This suggests that firms can propose digital rather than hard copy communications, although it would have been more helpful had the FCA stated this explicitly.

Brokers

The FCA has somewhat softened the language in the draft guidance which suggested firms would always be expected to litigate against brokers who refused to assist in a notification process.

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Summary of feedback

Additional points for Brexit-related transfers

In addition to the finalised guidance, we are aware of some additional expectations which the FCA has highlighted for firms carrying out Brexit-related transfers. These include expectations that:

- (i) the Scheme makes explicit that the compulsory jurisdiction of the FOS will continue to apply to complaints relating to pre-transfer acts and omissions and where firms could apply for voluntary jurisdiction in respect of some post-transfer actions they should do so
- (ii) the Scheme includes a commitment for the transferee to comply with the requirements of the Dispute Resolution part of the FCA Handbook (DISP) and with other relevant standards set out in the FCA rules, e.g. COBS 20, where local law does not have standards likely to give the same outcome for transferring policyholders

- (iii) the transferee should seek a confirmation from its local regulator that it will take the commitments in the Scheme to comply with FCA requirements into account when considering taking action against the firm
- (iv) the IE report should address differences in conduct regulation between jurisdictions where transferring policies have been sold on a freedom of services basis, and the impact on policyholders
- (v) the UK regulators will be notified of proposed changes to the scheme post-transfer, notwithstanding that the transferee will not be a UK-authorized entity.



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