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Case No: CR-2018-003310

**IN THE HIGH COURT OF JUSTICE**  
**BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES**  
**INSOLVENCY AND COMPANIES LIST (ChD)**

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

Date: Monday 18 March 2019

**Before:**

**MR JUSTICE SNOWDEN**

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**IN THE MATTER OF SCOTTISH WIDOWS LIMITED**  
**and**  
**IN THE MATTER OF SCOTTISH WIDOWS EUROPE S.A.**  
**and**  
**IN THE MATTER OF THE FINANCIAL SERVICES AND MARKETS ACT 2000**

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**Martin Moore QC** (instructed by **Herbert Smith Freehills LLP**) for the **Applicants**  
**Tom Weitzman QC** for the **Prudential Regulation Authority** and the **Financial Conduct Authority**

Hearing date: 14 March 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.

.....  
MR JUSTICE SNOWDEN

**MR JUSTICE SNOWDEN:**

1. Scottish Widows Limited (“SWL”) and Scottish Widows Europe SA (“SWE”) seek the Court’s sanction and ancillary orders pursuant to Part VII of the Financial Services and Markets Act 2000 (“FSMA”) to give effect to an insurance business transfer scheme (“the Scheme”). The Scheme provides for the transfer from SWL to SWE of all of the insurance business written by SWL (or its predecessors) on a freedom of establishment basis or on a freedom of services basis for policyholders having their permanent residence in Germany, Austria, Italy and Belgium. SWL also seeks the amendment of an earlier Part VII transfer scheme which was sanctioned on 26 November 2015 (“the 2015 Scheme”) in order to permit the operation of the new Scheme.
2. In common with a growing number of Part VII transfer schemes that have been sanctioned in recent months by this Court, the purpose of the Scheme is to ensure contract and service continuity for the relevant EEA policyholders of SWL after the United Kingdom leaves the European Union. The Scheme has been proposed to address the concern that SWL might become unable to service such policies as a result of losing its “passporting” rights under the Solvency II Directive (2009/138/EC, as amended) which currently enable SWL to rely upon its authorisation in the UK to carry out regulated activities in other EEA Member States. Such loss of passporting rights would occur if the UK were to withdraw from the EU without any arrangements being agreed in relation to the provision of financial services (a “no-deal Brexit”).
3. The solution that is proposed is that the relevant policies will be transferred from SWL to SWE, which is a newly-formed Luxembourg company which will be authorised and regulated by the Commisariat aux Assurances of Luxembourg (the “CAA”). SWE will then be able to rely upon its passporting rights to continue to service the transferring policies in the other EEA Member States.
4. The Scheme is intended to take effect at 22.59 GMT on 29 March 2019, but there are provisions for that date to be extended by agreement between SWL and SWE until 30 June 2019, and thereafter with the approval of the Court, subject to the proviso that if the Scheme has not become effective by a long-stop date of 30 September 2019, it shall lapse.

SWL

5. SWL is one of the United Kingdom’s larger life and pensions companies. It is part of the group of companies whose ultimate parent is Lloyds Banking Group plc (“LBG”). It has evolved through a series of mergers, acquisitions and transfers. In particular, under the 2015 Scheme all of the UK life insurance and pension business of LBG was consolidated into SWL. In relation to some of its acquired business, SWL trades under the name Clerical Medical, a name which originates from the Medical, Clerical and General Life Assurance Society which was set up in 1824. SWL is authorised by the PRA and regulated by the PRA and FCA.
6. SWL’s business is comprised of three funds: (i) the Scottish Widows With-Profits Fund (“SW WPF”); (ii) the Clerical Medical With-Profits Fund (“CM WPF”); and the Combined Fund. As their names suggest, the first two are with-profits funds. As at 31 December 2017 SWL had about 6 million policyholders and Best Estimate Liabilities (“BEL”) of £112 billion. Of this figure, about £10 billion is attributable to the SW

WPF, £5 billion is attributable to the CM WPF, and £97 billion is attributable to the Combined Fund.

7. SWL's Solvency Capital Requirement ("SCR") under Solvency II as at 30 June 2018 was £6 billion and its Total Own Funds available to meet the SCR were £8.4 billion, giving an SCR ratio of 140%.

### SWE

8. SWE is a subsidiary of SWL and was incorporated in Luxembourg on 19 October 2018 as the entity to take on the business to be transferred under the Scheme. On 1 February 2019 it was authorised by the CAA to carry on insurance business of the classes necessary to enable it to carry on the business to be transferred to it. Had the proposed transfer taken place as at 31 December 2017 (which is the date of the last set of publicly available audited accounts for SWL), the SCR for SWE would have been £125 million and its Total Own Funds available to meet the SCR would have been £175 million giving an SCR ratio of 140%, which would have been the same as that of SWL at the time.

### The Transferring Business

9. The business that is proposed to be transferred (the "Transferring Business") covers policies which were sold between 1995 and 2015 through the branches or former branches of SWL or its predecessors in the EEA or on a freedom of services basis to persons with permanent addresses in Germany, Austria, Italy and Belgium. That business comprises two parts:
  - i) the unitised with-profits business, which is allocated to the CM WPF in general and invested in Guaranteed Growth funds ("GGFs") (the "Transferring UWP Business"). As at 31 December 2018 there were 56,807 relevant policies, with gross BEL of £1.6 billion;
  - ii) the unit-linked non-profit business, which is currently allocated to SWL's Combined Fund ("the Transferring UL Business"). As at 31 December 2018 there were 23,922 relevant policies, with gross BEL of £342 million.

No new business of the types being transferred is being written, except contractual increments and existing options.

10. As a proportion of SWL's business, the Transferring Business is small in terms of policyholders and reserves – being in each case about 2%. Had the Scheme taken effect on 31 December 2017, the SCR ratio of SWL would have been reduced from 140% to 136%.
11. Under the Scheme, on the effective date, SWL will transfer to SWE the assets required to back the Transferring UWP Business, the Transferring UL Business and 10% of the provision made by SWL in respect of the "German Claims" (to which I shall refer below).

12. The assets associated with the Transferring UL Business will be transferred from SWL's Combined Fund into unit-linked funds that will be set up and retained within SWE. SWL will transfer assets from the CM WPF associated with the Transferring UWP Business, but will exclude assets backing the relevant part of the "inherited estate" (the difference between the assets of the with-profits fund and its policyholder (and other) liabilities) in which the transferring policyholders would be entitled to participate. The assets transferred will be subject to the "Tied Assets" regime and the "Funds Withheld" arrangements to which I shall refer shortly, and the issue of transferring policyholders' entitlement to part of the CM WPF inherited estate will be the subject of the reinsurance arrangements to which I shall also refer below. SWE will also set up notional funds to mirror the GGFs that are currently in the CM WPF.
13. If the effective date of the Scheme had been on 31 December 2017, the value of the transferred assets would have been £2.337 billion. In addition, and to ensure the necessary SCR ratio of SWE, in January and February 2019 SWL provided a capital injection to SWE totalling €81 million.
14. As indicated, there are a number of associated arrangements in relation to the Scheme.

#### The New Reinsurance

15. A "reassurance agreement" (the "New Reinsurance") was entered into between SWL and SWE on 5 March 2019. Its material terms are conditional upon the Scheme becoming effective. Under the New Reinsurance (among other things) the Transferring UWP Business and the with-profit annuities will be 100% reinsured back to SWL's CM WPF.
16. The reason for this is that such transferring policyholders have an entitlement to participate in the inherited estate of the CM WPF. However, it is not practical in the limited time available before 29 March 2019 for SWL to conduct the complex process needed to calculate and apportion to the Transferring UWP Business the relevant part of the inherited estate, and to transfer to SWE the assets representing that part. The reinsurance back to the CM WPF seeks to avoid the need to perform that process. The New Reinsurance also seeks to ensure that the investment experience of the relevant transferring policyholders, as new policyholders of SWE, will replicate the experience that they hitherto enjoyed in the CM WPF.
17. A particular feature of the New Reinsurance is that the premium payable by SWE to SWL for the reinsurance will not, in fact, be paid over to SWL but will be withheld by SWE (the "Funds Withheld Assets" or "FWA"). The retention of these funds will assist SWE in meeting its Luxembourg regulatory requirements. The amount of the FWA will be equal to the greater of (i) SWE's gross of reinsurance Solvency II BEL and (ii) the gross of reinsurance reserves required under Luxembourg GAAP in respect of the relevant policies. The FWA will be "rebalanced" quarterly so that if the amount withheld is less than required, SWL will transfer more assets to SWE, and if the amount withheld is more than required, SWE will release the excess to SWL. Under the New Reinsurance, SWE must invest the FWA in accordance with SWL's CM WPF investment strategy.

18. The FWA will also be identified as part of SWE's "Tied Assets" under Luxembourg law. Such Tied Assets are intended under Luxembourg law to provide security for policyholders in the event of the insurer's insolvency, and are required to be deposited into a custodian bank under a tripartite custodian agreement with the CAA.
19. The New Reinsurance can be terminated by mutual agreement between SWL and SWE, or on the insolvency of SWL. On any termination, the fund split and apportionment of the CM WPF, which the New Reinsurance avoided, will have to take place. The New Reinsurance contains detailed provisions for the determination of the termination amount payable between SWL and SWE in such circumstances. Where the termination is by mutual agreement, these include obtaining the prior approval of an independent actuary, notifying the CAA, the PRA and the FCA, and no objection being received within 60 Business Days from any of the regulators. There are also provisions for referral of disputes to an independent actuary for determination.
20. If the termination is by mutual agreement, the termination amount due shall be offset against the FWA, and the net balance either way shall be payable within 5 Business Days or by agreed instalments. In the event of termination on the grounds of SWL's insolvency, SWE will retain the FWA in any event, and if it is less than the termination amount due to it, SWE will have a claim in SWL's insolvency for the balance.
21. Although the Reinsurance Agreement does not itself provide for policyholders to have the ability to enforce compliance with its provisions relating to determination and payment of the termination amount, following the approach which I outlined in paragraphs [95]-[99] of my judgment in Aviva, Mr. Moore QC indicated that SWL and SWE would give undertakings to the Court to enable their policyholders to enforce such provisions should the need arise.

#### The Charge Agreement

22. If SWL were to become insolvent, although SWE would retain the FWA, it would have to rely upon its contractual rights for any unpaid balance due in respect of the termination amount under the New Reinsurance. In that respect it would rank for payment behind the direct policyholders of SWL.
23. To address this possibility, SWL has executed a floating charge in favour of SWE (the "Charge Agreement") to secure (i) the liabilities due to SWE under the New Reinsurance over and above the amount of the FWA and (ii) any liabilities due to SWE under the Indemnity Agreement (see below). The Charge Agreement also contains a provision that the amounts recoverable by SWE under it will not exceed the amount which SWE would have been entitled to recover if the secured amounts had been insurance debts and hence had ranked *pari passu* with SWL's own policyholders.
24. One consequence of the New Reinsurance and the Charge Agreement is that because SWE will be entitled to retain the FWA in the event of insolvency of SWL, some of SWE's with-profits policyholders might fare better than the equivalent policyholders who had remained in SWL. I shall return to this issue below.

### The Indemnity Agreement

25. SWL has experienced claims, mainly in Germany, relating to the transferring business (“the German Claims”). The German Claims seek orders to the effect that the policies sold should be interpreted consistently with, or read subject to, various representations allegedly made to policyholders prior to inception. After the effective date of the Scheme, such claims will be continued against, and become the liabilities of, SWE.
26. To deal with such liabilities, an “Indemnity Agreement” has been entered into between SWL and SWE, conditional upon the Scheme becoming effective, under which SWL will pay 90% of the German Claims and the associated costs and expenses, and SWE will be responsible for 10% of such claims up to an aggregate limit (for SWE) of €60 million, after which SWL will pay 100% of such claims. SWL has also agreed to pay 100% of other claims arising from SWL’s actions in respect of the transferring policies prior to the Effective Date.
27. As mentioned above, SWL will transfer assets to SWE when the Scheme becomes effective to cover 10% of the reserves held by SWL in respect of the German Claims, and SWL’s liabilities under the Indemnity Agreement are secured by the Charge Agreement in favour of SWE. Mr. Moore QC told me, on instructions, that the rationale for this agreement is in effect to provide an incentive to SWE to minimise the liabilities in respect of the German Claims, since if successful in that endeavour, SWE will be entitled to retain the balance of the funds transferred to it by SWL.

### The Service Agreements and new branches of SWE

28. The policy administration of the Transferring Business is currently provided by three outsourcing providers in Austria/Germany, Luxembourg and Italy (Heidelberger Leben Service Management, Pack Assurance Management and ITO/Corvallis). The relevant agreements are governed by English law and will be transferred to SWE under the terms of the Scheme.
29. In addition, a “Unit Linked (UL) Service Agreement” has been entered into between Lloyds Bank plc and SWE to assist with the operations of the Transferring UL Business.
30. As indicated, SWE will be based in Luxembourg. It has also obtained regulatory approval to establish branches in Germany and Italy.

### The Law and Practice

31. The law and practice in relation to Part VII transfer schemes designed to deal with the difficulties of Brexit has been considered in a number of recent cases, including, in particular, re AIG Europe Limited [2018] EWHC 2818 (Ch) “AIG”; The Prudential Assurance Company Limited [2018] EWHC 3811 (Ch) (“Prudential”); The Royal London Mutual Insurance Society Limited [2019] EWHC 185 (Ch) (“Royal London”); and Aviva Life and Pensions UK Ltd (“Aviva”) [2019] EWHC 312 (Ch). For ease of reference, I shall set out those principles again in this judgment.

Part VII Transfers generally

32. 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).
33. Sections 105(1) and 105(2)(a) FSMA provide in relevant part,
- “(1) A scheme is an insurance business transfer scheme if it-
- (a) satisfies one of the conditions set out in subsection (2);
- (b) results in the business transferred being carried on from an establishment of the transferee in an EEA State; and
- (c) is not an excluded scheme.
- (2) The conditions are that -
- (a) the whole or part of the business carried on in one or more member States by a UK authorised person who has permission to effect or carry out contracts of insurance (“the transferor concerned”) is to be transferred to another body (“the transferee”); ...”
34. 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. The conditions are that all of the appropriate certificates and authorisations to conduct the transferring business shall have been obtained from the relevant regulators (section 111(2)) and that the court considers that, in all the circumstances of the case, it is appropriate to sanction the scheme (section 111(3)).
35. Section 112 then provides for the making of orders to give effect to the transfer of the business, including as to the transfer of property, rights and liabilities (section 112(1)(a)), the continuation by and against the transferee of pending legal proceedings by and against the transferor (section 112(1)(c)), and such incidental, consequential and supplementary matters as are necessary to secure that the scheme is fully and effectively carried out (section 112(1)(d)).
36. The general approach to the exercise of the Court’s discretion under section 111(3) FSMA is now well established. It follows the approach adopted under the predecessor of Part VII FSMA, namely Schedule 2C to the Insurance Companies Act 1982. The principles were conveniently summarised 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 pages 1011-1012 as follows,
- “(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 paras (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.”

37. The role of the “independent actuary” referred to by Evans-Lombe J is now fulfilled under section 109 FSMA by a report from an “independent expert” (invariably an actuary) and the role of the FSA is now fulfilled by the Financial Conduct Authority (“FCA”) and Prudential Regulation Authority (“PRA”) together.
38. The approach of the Court to the report of the independent expert and the views of the Regulators was described by Briggs J in Re Pearl Assurance (Unit Linked Pensions) Limited [2006] EWHC 2291 (Ch) at paragraph 6,



“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.... The relevant principles are concisely summarised in the following passage from the judgment of Mr. Justice Rimer in Re Hill Samuel Life Assurance Limited [1998] 3 All ER176, at177:

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

### Part VII schemes and Brexit

39. In AIG, after referring to the approach in the London Life and AXA cases, I considered the effect of Brexit upon the discretionary decision of the Court in the context of an insurance business transfer scheme. I said, at [44]-[46],

“44. ... in considering whether the protections for policyholders are sufficient, it should be borne in mind that the current background is not the one that has often been considered in the past, where the independent expert, the Regulators and the Court are considering a transfer of insurance business which is being undertaken by the company concerned for entirely commercial reasons within its own control. The current situation is different.

45. The evidence of [the transferor] is that the uncertainty over the Brexit negotiations means that if it delayed further and did nothing, there is a real risk that substantial numbers of policyholders would be materially prejudiced in event of a “hard” [“no-deal”] Brexit by the loss of [the transferor’s] EU passporting rights, and a resultant inability of [the transferor] to continue to service policies through its overseas branches or even pay policyholders’ claims in other EU jurisdictions. The concerns expressed by [the transferor] seem genuine and reasonable, and in the absence of any objection or contrary evidence from the Regulators, I am not in a position to second-guess the directors of [the transferor] in this respect.

46. The consequence is that, in applying the tests in the authorities to which I have referred above, I must balance the risk of prejudice to a large body of policyholders in the EEA ... if the Scheme were not to be sanctioned, against any potential risk of prejudice to individual policyholders under the terms of the proposed Scheme. In that regard, as was made clear by

Evans-Lombe J in the AXA case, the fundamental question is whether the proposed Scheme as a whole is fair as between the interests of the different classes of persons affected. The current uncertainty over Brexit means that there may be no perfect solution for the holders of the policies being transferred ..., and the possibility that some individual policyholders or groups of policyholders may be adversely affected in certain respects does not mean that the Scheme necessarily has to be rejected by the Court. It is also worth reiterating that it is not my function to produce what, in my view, is the best possible scheme: as between different schemes, all of which the Court might deem fair, it is the directors' choice which [the transferor] should pursue."

40. That approach was not challenged by the PRA in Royal London or Aviva, and the PRA's second report confirms that this remains its position and that it does not contend that the Court should adopt a different approach in the present case.

#### The Independent Expert

41. The Independent Expert in this case is Mr. Tim Roff, a partner at Grant Thornton LLP and a Fellow of the Institute and Faculty of Actuaries. He has over 30 years' experience in the life assurance sector. This includes acting as Independent Expert in a number of Part VII transfers, including in the Royal London and Aviva cases. His appointment as Independent Expert was approved by the PRA. The PRA has, as is normal, also approved the form of Mr. Roff's reports.
42. Although some policyholders who responded to communications (see below) questioned Mr. Roff's ability to carry out multiple assessments of companies promoting Part VII schemes to deal with Brexit, neither the PRA nor FCA saw fit to doubt Mr. Roff's competence in this regard, or the resources available to him to perform his role satisfactorily.
43. I have no reason to second-guess that assessment. Mr. Roff's reports appear to be careful and thorough. As is conventional, he examined the effect of the Scheme on the security of benefits, benefit expectations, regulatory governance and service standards of the two groups of policyholders concerned: those transferring to SWE, and those remaining with SWL.
44. I do not consider it necessary to summarise the detailed reasoning in Mr Roff's reports in this judgment. His conclusions were conveniently summarised in an executive summary as follows:

"1.17 I am satisfied that the implementation of the proposed Scheme, along with the Associated Arrangements, will not have material adverse effects on the security of benefits or the future benefit expectations for Transferring Policyholders or Non-transferring Policyholders.

1.18 It is also my opinion that the Transfer will have no material adverse effect on the governance or service standards

experienced by the Transferring Policyholders and the Non-transferring Policyholders.

1.19 In forming these conclusions, I have taken into account the loss of Financial Services Compensation Scheme (“FSCS”) protection that is currently given to all of the policyholders of the Transferring Business. The FSCS provides protection to policyholders of UK based insurers and EEA branches of UK based insurers throughout the terms of their policies. After the Transfer, the policyholders of the Transferring Business will hold policies with a Luxembourg based insurance company and they will lose entitlement to this protection (although if a claim results from an event which occurs prior to the transfer it will continue to be covered by the FSCS). The purpose of the Scheme is to enable the continued servicing (e.g. receiving premiums and paying claims) of the Transferring Business regardless of the outcome of the Brexit negotiations. In my opinion, having the certainty that policies in the Transferring Business can continue to be serviced lawfully after Brexit is very important. The loss of FSCS protection is a consequence of achieving this certainty. In addition, the FSCS provides protection to covered policyholders in an insolvency event. Given that SWE will be well capitalized and will comply with Solvency II Directive (Solvency II) in EU law, the likelihood the insolvency of SWE is, in my opinion, remote. I will provide an update in my Supplementary Report on the latest relevant Brexit negotiations, and the impact of these on my conclusions regarding the loss of FSCS protection for the Transferring Policyholders.

1.20 The Reinsurance Agreement and Charge Agreement form an important part of the Transfer as they are being put in place to ensure that the Scheme does not result in the need to split the CM WPF or manage business materially different to the current management of these policies. It is my opinion that the Reinsurance Agreement allows the policyholders of the Transferring UWP Business (Transferring UWP Policyholders) to continue to benefit from the funds in which their policies are currently allocated. Provisions within the Reinsurance Agreement for the [FWA] in Luxembourg together with the Charge Agreement provide security for SWE in the unlikely event that SWL fails to meet its obligations under the Reinsurance Agreement or Indemnity Agreement.

1.21 In the event that Reinsurance Agreement is terminated in the future, I am satisfied that there is adequate protection for policyholders to ensure that they are treated fairly.

1.22 The Unit Linked Service Agreement will enable [LBG] to provide SWE with back office functions relating to the calculation of the unit price and box management activities for the Transferring UL Business. It is my opinion that the enable

the UL business to operate in the same way before and after the Transfer.

1.23 In addition, the Indemnity Agreement is also an important part of the Transfer, which protects SWE against any claims arising from SWL's conduct prior to the Transfer. The Charge Agreement also secures payments due under the Indemnity and provides further protection in the remote event of SWL becoming insolvent.

1.24 The Transfer does not result in any change to the administration of the Transferring Policies as they continue to be serviced by the existing outsourcing companies under the same outsourcing agreements.

1.25 Luxembourg regulations require insurers to hold the maximum Solvency II technical provisions or Luxembourg GAAP reserves as Tied Assets with a custodian ban. In the unlikely event of SWE's insolvency, the Transferring Policyholders will have priority ranking on the Tied Assets. Further, if the Ties Assets are insufficient to meet policyholder liabilities, the Transferring Policyholders will have preferential rights on the remaining assets of SWE. These provisions provide security to meet SWE's policyholder liabilities in the unlikely event of SWE's insolvency.

1.26 The reinsurance premium covering the reinsurance of the Transferring UWP Business, including vesting annuities, will be retained within SWE and be known as [FWA]. In the unlikely event of SWL's insolvency, SWE will keep the [FWA], up to the amount owed to them by SWL, to pay the liabilities for the Transferring UWP Policyholders. This will result in the Transferring Policyholders ranking higher than the Non-Transferring Policyholders in respect of liabilities covered by the [FWA]. However, as the Transferring Policyholders represent only 2% of SWL's overall business and the likelihood of SWL becoming insolvent is very remote, I consider the impact of this higher ranking, of Transferring Policyholders on the benefit expectations of the Non-transferring Policyholders in the case of SWL's insolvency, to be immaterial.

1.27 I am also satisfied that the change made to the 2015 Scheme to ensure that the payments under this Scheme related to the Reinsurance Agreement qualify as allowable payments, will not impact the maintenance and operation of the funds for the Non-transferring Policyholders."

#### Policyholder communications

45. Following a directions order of Deputy ICC Judge Middleton made on 26 November 2018, in excess of 85,000 letters were sent out to transferring policyholders over about

a month between 5 December 2018 and 4 January 2019 and the Scheme was advertised in newspapers in the UK, Austria, Germany, Italy and Luxembourg. As at 1 March 2019 1,436 communications had been received from policyholders, but of those relating to the Scheme, only 131 could be categorised as an objection (127 being written objections and 4 being oral objections). All were from transferring policyholders.

46. Summaries of all of the policyholder objections were included in the evidence before me, and my attention was specifically drawn by Mr. Moore QC to the correspondence with a number of objectors who had requested that should be done. Those objections had also been reviewed and commented upon by the Independent Expert, the PRA and the FCA. In addition, I also received directly a letter of objection dated 12 March 2019 from a German company, Versorgungskasse Hirschvogel e.V. (“Hirschvogel”) as the holder of 226 life insurance policies which hedge the retirement benefits of its employees. No policyholders appeared at the hearing before me.
47. The main points made by the policyholder objectors can be grouped under a number of themes as follows.

#### The need for a transfer scheme

48. A number of objectors questioned the need for a transfer of their policies at all, and some suggested that such a transfer could await the outcome of the Brexit process.
49. The background to this issue is that on 21 December 2017 the European Insurance and Occupational Pensions Authority (“EIOPA”) issued an opinion on service continuity in insurance in light of the intended withdrawal of the UK from the EU. EIOPA’s opinion was that, in the absence of a political agreement between the EU and the UK, UK insurance undertakings would lose their right to conduct business in the Member States of the EU by way of freedom of establishment and freedom to provide services under Solvency II. EIOPA stated that in such a situation, unless UK insurance companies took “mitigating actions” before Brexit, they would usually not be able to ensure the continuity of their services with regard to cross-border insurance contracts concluded prior to the date of the UK’s withdrawal from the EU.
50. The clear import of EIOPA’s communication was that unless there was a deal between the UK and EU, UK insurance companies with policyholders in EEA Member States would need to take “mitigating actions” in order to be sure of being able to provide continuity of service for such policyholders after Brexit. One of the options suggested by EIOPA to ensure service continuity was the transfer of insurance contracts of UK undertakings with policyholders in the remaining 27 EU Member States to an insurance subsidiary established in an EU27 Member State.
51. The UK regulators took a similar approach. In Royal London, the PRA gave the Court a helpful statement of its position, which included the following,

“In the absence of an EU/UK withdrawal agreement, UK firms’ passporting rights to other EEA jurisdictions will end at the point of the UK’s exit from the EU – which is currently scheduled to be on 29 March 2019.

In the absence of such passporting rights, there is uncertainty as to whether UK firms can lawfully continue to carry on insurance business in such other EEA jurisdictions, which uncertainty extends to the payment of claims.

Having regard to such uncertainty, it is reasonable for UK firms to take steps to achieve certainty, including the carrying out of Part VII transfer schemes.”

52. Since I last approved a similar Part VII scheme in Aviva, there have been a number of further developments.

53. In particular, EIOPA issued a further paper on 19 February 2019 entitled “Recommendations for the insurance sector in light of the United Kingdom withdrawing from the European Union”. That paper made a number of recommendations including (i) for regulators “to apply a legal framework or mechanism to facilitate an orderly run-off of business which became unauthorised” or to require the insurer “to immediately take all necessary measures to become authorised under Union law”; (ii) for the insurer to apply for authorisation to carry out cross-border business through a branch under Article 162 of Solvency II; (iii) for regulators to apply the provisions of Article 144(1)(a) of Solvency II on lapse of authorisation, and (iv) for regulators to allow the finalisation of a portfolio transfer from UK insurers to EU27 insurers “provided that it was initiated before the withdrawal date”. In that latter respect, EIOPA called for cooperation with the supervisory authorities in the UK, and stated,

“Competent authorities should deem a portfolio transfer to be initiated in case the UK supervisory authorities have notified them about the initiation of the portfolio transfer and the UK insurance undertaking has paid the regulatory transaction fee to the supervisory authority(s) in the UK and appointed an independent expert for the transfer.”

54. It also appears that Germany and Italy have now issued draft legislation which, in the event of a no-deal Brexit, would allow UK insurers and reinsurers a transitional period until December 2020 to continue to service the business sold in those countries under EU passporting rights.

55. The Independent Expert has referred to these developments, and in particular to the draft regulations in Germany and Italy. However, he has concluded that,

“I am satisfied that it is reasonable for SWL to proceed with the Scheme given that these draft arrangements are for a transitional period only with no certainty beyond December 2020, that they are not finalised, and that the Scheme continues to provide SWL with certainty that the Transferring Business can continue to be lawfully serviced post-Brexit.”

To that comment I would add that there are no draft regulations in Austria or Belgium.

56. The PRA has also considered these developments. It has stated that it does not consider the Independent Expert's conclusion as regards the need for the Scheme to be unreasonable and that,

“It is not unreasonable for [SWL] to take the view that the time has now been reached when [it] should proceed with the present Part VII transfer in order to achieve certainty.”

57. The further developments to which I should refer briefly occurred in the two days before, and in the evening after the hearing before me last week.
58. As is well-known, on Tuesday 12 March 2019 the UK Parliament rejected, for the second time, the Government's withdrawal agreement negotiated with the EU; and on Wednesday 13 March 2019 Parliament passed a resolution to the effect that it rejects the UK leaving the EU without a withdrawal agreement and a framework for a future relationship.
59. On Thursday 14 March 2019 Parliament passed a further resolution agreeing that in light of the two earlier resolutions, the Government will seek to agree with the EU an extension to the Article 50 period beyond 29 March 2019. That resolution indicated, however, that the Government might bring its negotiated withdrawal agreement back before Parliament for a third time on or before Wednesday 20 March 2019, and, depending on the outcome, will seek either a one-off extension from the EU to 30 June 2019 to pass the necessary exit legislation, or envisages that the EU will require a clear purpose for any longer extension.
60. These developments aside, as Mr. Moore QC emphasised, the current default position in UK and EU law is that the UK will leave the EU without a deal at the end of next week, at 23.00 GMT on Friday 29 March 2019.
61. Against this background, it is, in my judgment, essential to remember that this is not a scheme that SWL has decided to propose for its own commercial purposes at a time of its choosing. Like others before it, SWL is rightly concerned to ensure continuity of contract and service for its EEA policyholders, and has been forced to take action by the continued (or, as Mr. Moore QC put it, “extreme and intensifying”) uncertainty over the outcome of the Brexit process which the UK has initiated.
62. As I indicated in AIG, the question of how and when an insurer should respond to such a situation is essentially one for the business judgment of its directors. In that respect, the simple fact is that there is still no clarity as to what will happen in the Brexit process, a no-deal Brexit remains the default position, and time is now running very short indeed. SWL would be taking a very great risk indeed on behalf of its EEA policyholders if it were not to pursue the Scheme. The Scheme provides some flexibility to SWL and SWE as to whether, and if so, when to make it effective: but the bottom line is that the Scheme guarantees that SWL can provide certainty to its EEA policyholders that their policies will continue to be able to be serviced, irrespective of the outcome of the political process.

63. Accordingly, I accept the views of the Independent Expert and the PRA that for SWL to propose the Scheme now is a reasonable (or as the PRA would put it, a “not unreasonable”) step to take in the interests of SWL’s EEA policyholders.
64. That conclusion would not, of course, justify the Court sanctioning a scheme that was unfair to certain policyholders. The role of the Court is to ensure that if the directors choose to propose a Part VII scheme, it should be a fair scheme; and the exigencies of Brexit would not justify an insurer acting in a manner which is unfair to its policyholders. But Brexit is the critical background to an analysis of the fairness of the Scheme and the specific issues which the objectors have raised.
65. The highly unusual circumstances of Brexit require the Court to consider the risk of harm to policyholders if nothing is done and there is a no-deal Brexit, balanced against the solution proposed under the scheme. As I have indicated in other cases, the very nature of Brexit and the current uncertainties over its terms means that there may be no perfect solution for everyone. I also reiterate that it is not the Court’s function to reject any scheme that does not conform to its own idea of the best possible scheme, and the possibility that some individual policyholders or groups of policyholders may be adversely affected in particular respects does not mean that the scheme necessarily has to be rejected by the Court.

#### Security of Benefits

66. Some policyholders expressed concern over the security of their policies once transferred to SWE, which is undoubtedly a smaller company than SWL. Although it might be expected that SWL would stand behind and support its subsidiary in the event of financial difficulties, it will have no legal obligation to do so. The risk of failure of SWE has therefore been carefully considered by the Independent Expert and the PRA.
67. The Solvency II regime requires insurers to maintain capital reserves so that they can survive extreme events that are expected to occur only once in every two hundred years. The SCR and SCR ratio are measures used in this respect. SWL’s current SCR Ratio of 140% comfortably exceeds the minimum requirements of Solvency II, and as indicated above, SWE will be capitalised so as to have the same SCR ratio of 140% after the Scheme takes effect. For transferring policyholders there will therefore be no change in the SCR ratio of their insurer as a result of the Scheme.
68. Mr. Roff has also considered the implications of the change in company size and risk profile to which the transferring policyholders will be exposed at SWE, together with the governance surrounding the operation and investment management of SWE’s funds. He has also considered the risk that SWE will be exposed to a proportion of the liabilities in respect of the German Claims and higher administrative expenses as the transferred books of business, which are closed to new business, run-off over time with limited scope for increasing charges to meet such expenses. His conclusion is that SWE will be well able to manage these risks.
69. Mr. Roff has further analysed the counterparty risks to which SWE is exposed as a result of the Reinsurance Agreement with SWL and has taken into account how they are mitigated by the terms of the FWA and the Charge Agreement. In particular he has considered the circumstances in which the Reinsurance Agreement might be terminated and the arrangements for determination of the termination amount in that event. It is,



of course, significant that in practice the counterparty risk only extends to the amounts which might become due under that agreement from SWL in excess of the amount of the FWA which SWE will hold, and which will be rebalanced quarterly. Moreover, in relation to the Charge Agreement, Mr. Roff has taken independent advice from Mr. Barry Isaacs QC, who has concluded that although untested in an actual insolvency, he is of the opinion that the Charge Agreement should work as intended.

70. The overall result, as outlined in the executive summary to which I have referred, is that the Independent Expert is of the opinion that SWE will be a well-capitalised entity, that it can manage the risks of the business being transferred to it (including the German Claims), and that the risk that it will become insolvent is remote. Mr. Roff also considers that the counterparty risk of SWL to which SWE is exposed in respect of the amounts which might become due under the Reinsurance Agreement and the Indemnity Agreement is adequately mitigated by the terms of those agreements (including those as to termination of the Reinsurance Agreement), the arrangements in relation to the FWA, and the Charge Agreement.
71. The PRA has reviewed the Independent Expert's reports in these respects and sees no reason to object to the Scheme on this basis. I am of the same opinion.
72. In addition to the position of the transferring policyholders of SWE, I should also briefly mention the position of the non-transferring policyholders of SWL. As I have indicated, the implementation of the Scheme will see a decrease in SWL's SCR ratio from 140% to 136%, which is essentially attributable to a decrease in the SCR ratio of the Combined Fund.
73. Mr. Roff has considered this and has concluded that this reduction in SWL's SCR ratio is not material, that SWL will remain well capitalised before and after the Scheme, and that its risk of insolvency is and will remain extremely remote. Especially having regard to the very small proportion that the transferring business forms of SWL's overall business, Mr. Roff is of the opinion that the Scheme will therefore have no material impact upon the security of benefits provided to the non-transferring policyholders of SWL. The PRA does not differ from that assessment, and I also accept it.
74. Mr. Roff's reports also draw attention to the fact that the terms of the Reinsurance Agreement and the Charge Agreement would permit SWE to retain the FWA in the event of the insolvency of SWL. This means that the Transferring UWP policyholders would be likely, in effect, to do better in the event of an insolvency of SWL than their equivalents who are not being transferred from SWL.
75. The terms of the Reinsurance Agreement which enable SWE to retain the entirety of the FWA in the event of SWL's insolvency might, on one view, potentially engage the anti-deprivation principle discussed by the Supreme Court in Belmont Park v BNY Corporate Trustee Services [2012]1 BCLC 163 (SC). However, Mr. Moore QC advanced a strong argument that they are in fact necessary to enable SWE to continue to retain the necessary capital to comply with its own regulatory requirements, and that they are part of a commercially sensible transaction entered into by SWL in good faith to deal with the problems of Brexit rather than with the intention of evading the insolvency legislation. On that basis they would not fall foul of the anti-deprivation principle: see per Lord Collins in Belmont at [74]-[79].

76. I cannot, and do not need to, decide this point. It is not obvious that the anti-deprivation principle would be infringed, and the possibility of the question even arising is remote given that the insolvency of SWL is remote. Moreover, Mr. Roff takes the view, and I agree, that because the transferring business represents only 2% of SWL's overall business, this extra potential benefit to the transferring policyholders would in any event make very little overall difference to SWL's remaining policyholders in the event that SWL was to fail.
77. Accordingly, I do not consider that the Scheme will cause any material adverse effect to any policyholders of SWL in terms of the security of their benefits.

#### Policy performance and administration

78. Some concerns were expressed about changes to the terms and conditions of the policies being transferred, together with the likely performance of the with-profits policies. However, there will be no material change to the terms of any of the transferring policies, and as I have explained, the Reinsurance Agreement ensures that there will be no material change to the investment strategy and bonus distribution for transferring with-profits policies. Likewise, the administration of the transferring policies will be unchanged by reason of the transfer of the three outsourcing agreements and the entry into of the UL Service Agreement to which I have referred. The Independent Expert is satisfied that the Scheme will have no material adverse effect on policyholders in these respects, the FCA and PRA do not dissent, and I accept those opinions.

#### Loss of FSCS Protection

79. A large proportion of the objections received related to the loss by the transferring policyholders of the protection of the UK's Financial Services Compensation Scheme ("FSCS") as a result of the Scheme. The FSCS is a 'fund of last resort' in the UK for private policyholders and small businesses when an insurer is unable to fully meet its liabilities.
80. If SWL were to become insolvent and was unable to pay claims in full to its policyholders, the FSCS would provide compensation for financial loss to protect 100% of the long-term insurance benefit. That will remain the position for claims arising out of acts and omissions prior to the Scheme becoming effective. However, as a result of transfer of policies to SWE, which is a Luxembourg authorised and regulated entity, it must be assumed that the transferring policyholders will lose FSCS protection in respect of acts or omissions occurring after the effective date of the Scheme.
81. As I have indicated, Mr. Roff explains in his reports that the prospect of SWE becoming insolvent is remote. The need for FSCS protection is therefore also remote. Mr. Roff is of the opinion that the possibility that transferring policyholders might lose FSCS protection in that remote situation is more than outweighed by the far greater risk of real and immediate prejudice to such transferring policyholders if the Scheme were not to be implemented and there were to be a 'no-deal' Brexit. In such a case, the transferring policies could not be serviced, which might include claims not being paid.
82. The FCA's view in this regard is that it would not generally regard strong solvency to be a sufficient protection for consumers losing FSCS rights, in a purely commercial transfer, but would expect other mitigations to be considered. However, this is not a

purely commercially motivated transfer, and as such, the FCA's view is that avoiding uncertainty as regards the ability to service policies in the EEA post-Brexit is a sufficiently positive benefit, coupled with the strong solvency position of SWE, that Mr. Roff could properly conclude that there is no material adverse effect to policyholders in this regard.

83. Mr. Roff also considered a possible mitigation which would have involved SWE applying for authorisation to set up a branch in the UK. However, he concluded that proceeding without such a mitigation was reasonable because setting up such a branch was not required for SWE to carry out its day-to-day activities, there would be no assurance that such a branch would be authorised by the PRA because of its size, and there would also be no assurance that such an arrangement would qualify the relevant policies for FSCS protection for longer than the period of any transitional period agreed between the UK and the EU.
84. I accept those opinions. It appears to me that the loss of FSCS protection is highly unlikely to lead to any material prejudice to policyholders in practice given the strength of SWE, and that SWE's decision not to attempt to establish a branch in the UK for the sole purpose of preserving FSCS protection for what might be a limited period is entirely reasonable.
85. The letter from Hirschvogel particularly raised the loss of FSCS protection and objected that this would increase its own potential exposure to its employees. It suggested that SWL could have chosen to establish a subsidiary in an EU Member State that did offer a comparable scheme to the FSCS rather than Luxembourg which does not. Hirschvogel did not identify such a country, but I was told by Mr. Moore QC that Germany itself might have a similar scheme.
86. However, Mr. Moore QC explained that establishing a subsidiary in Germany rather than Luxembourg would have had more immediate and direct disadvantages for policyholders not resident in Germany, because German law would require the new insurer to withhold in excess of 25% of all taxable payments to policyholders on account of German tax. Whilst that would make little or no difference to Hirschvogel or other German policyholders, who could seek a refund or credit in respect of such amounts in their tax returns in Germany, it would force policyholders in other Member States to seek to reclaim the tax paid in Germany or possibly to rely upon some double tax treaty.
87. Given those competing factors, I do not regard the choice of Luxembourg rather than, say, Germany, as the place to incorporate SWE, as unfair to policyholders as a whole because of the potential loss of FSCS protection. It seems to me that this is a good example of how a scheme to deal with the problems caused by Brexit cannot be a perfect solution for all policyholders. In my view, the loss of FSCS protection is too remote a potential prejudice to policyholders to warrant refusing to sanction the Scheme which will provide the means by which, if required, SWL can provide the far more immediate benefit of certainty of continued service to all its EEA policyholders.

#### German Withholding Tax

88. The communications to transferring policyholders and the Independent Expert both dealt with a further point which arises concerning German withholding tax. Although

SWL does not have a German branch, by reason of Luxembourg (CAA) data protection requirements, SWE will be required to establish a branch in Germany. It seems that this will have tax consequences for policyholders domiciled in Germany, who will receive the payments from SWE net of German withholding tax, rather than receiving them gross from SWL and then including them in their German tax return as is currently the case.

89. The critical point, however, is that the amount of tax paid by German policyholders will not change as a result of the Scheme. The point is merely a timing point as to when tax is paid. On that basis I do not consider that the issue of German withholding tax gives rise to any unfairness or is a reason to decline to sanction the Scheme.

#### Regulation in Luxembourg

90. Some policyholders expressed concern about the transfer of their policies from a UK company to a Luxembourg company. Specific issues included concerns over prudential regulation and conduct of business regulation in Luxembourg as opposed to the UK, and dispute resolution procedures.
91. So far as prudential regulation is concerned, there should be no material prejudice to policyholders if their insurer is regulated by the CAA rather than the PRA. Both regulators have operated under Solvency II and there is no reason to believe that the CAA is any less efficient in that respect than the PRA. It also requires insurers to operate the Tied Assets regime to which I have referred, and Mr. Roff has concluded that Luxembourg insolvency law gives policyholders materially the same priority as does English law.
92. In relation to conduct of business, Mr. Roff and the FCA note that the Transferring Business is subject to the FCA's Conduct of Business Sourcebook ("COBS"), which is more detailed than the Luxembourg equivalent, which also does not include any reference to the conduct of with-profits business.
93. However, the Independent Expert and the FCA have both noted that for so long as SWE remains within the LBG group it will be subject to LBG policy that requires its business to comply with COBS provided that it is not contrary to applicable Luxembourg or local laws or regulations. On that basis the FCA does not differ from Mr. Roff's conclusion that that the potential change in application of COBS will not be materially unfair to transferring policyholders.
94. In relation to governing law, although a number of (mostly German) policyholders complained that Luxembourg law should not apply to their policies and any disputes in relation to them, that complaint is misconceived. The Scheme does not purport to change the governing law of the transferring policies, so that if they were written under German law, German law will continue to apply to them.
95. So far as dispute resolution is concerned, EEA policyholders who acquired their policies as a result of SWL operating on a freedom of services basis and who had a complaint that could not be resolved by agreement with SWL would, in addition to using a local system of complaints handling, also be able to refer their complaint to the UK Financial Ombudsman Service (the "FOS"). The FOS is an independent body whose decisions are legally binding on insurers (subject to appeal to the Courts).

96. If the Scheme becomes effective, although transferring policyholders will still be able to access the FOS in relation to activities carried out by SWL on a freedom of services basis prior to the effective date (and in that respect SWE will undertake to comply with the FCA DISP rules relating to complaints to the FOS), they will lose access to the FOS in relation to activities carried out by SWE after the effective date. Such policyholders will, however, continue to be able to access their local complaints systems and will, in addition, be able to make complaints to the CAA and the Luxembourg Ombudsman Service (“LOS”) which is a collective mediation service run (inter alia) by the insurance industry in Luxembourg and the CAA.
97. Although decisions of the LOS are not legally binding, they can be used as persuasive evidence in the courts in Luxembourg, and Mr. Roff is of the opinion, with which the FCA does not disagree, that the replacement of access to the FOS with access to the LOS is not sufficient to amount to a material adverse effect upon transferring policyholders.
98. Taken together, the conclusion reached by the Independent Expert is that the Scheme does not materially prejudice transferring policyholders in relation to regulation and dispute resolution. The PRA and FCA also see no reason to object to the Scheme on that basis. I also do not consider that any of the matters raised in these respects amount to a potential detriment or unfairness that would justify my refusing to sanction the Scheme and depriving all transferring policyholders of the benefits of certainty in relation to the impact of Brexit to which I have referred.

#### Costs of the Scheme

99. Some policyholders were concerned that the costs of the Scheme might have an adverse effect on their policies. The simple answer is that the costs of promoting the Scheme, and of setting up and operating SWE, will not be met by policyholders but by the shareholders of SWE and SWL. There is thus no prejudice to policyholders in this respect.

#### Statutory requirements and certificates

100. All the necessary formalities required by FSMA and the relevant regulations have been complied with. In particular, I have received the appropriate certificate from the CAA as to SWE’s margin of solvency; and certificates from the PRA as to the consultation with, and the consents, tacit consents or no substantive responses, from the relevant EEA regulators.

#### Conclusion

101. The statutory requirements having been satisfied, for the reasons that I have outlined above, I conclude that this is a Scheme that I should exercise my discretion to sanction. I shall therefore do so on the basis of the undertakings to which I have referred. I shall also make orders under section 112 which are necessary to give effect to the terms of the Scheme and shall consider a summary of the Scheme to be annexed to the order.

Amendment of the 2015 Scheme

102. The Scheme cannot be made effective without an amendment to the terms of the 2015 Scheme. The 2015 Scheme contained a list of permitted debits and charges that could be made to the CM WPF, and the restriction on any other use would be infringed by the transfer of any assets to SWE under the Scheme.
103. Happily, however, the 2015 Scheme contained a provision under which SWL could amend the scheme with the consent of the Court, having given notice to the PRA and FCA, and having obtained a certificate from an independent actuary that the proposed amendment would not have a material adverse effect on the security or benefit expectations of policyholders. The PRA and FCA were duly notified of the application for such consent, Mr. Roff has given the appropriate certificate as an independent actuary, and for the reasons that I have outlined which justify approving the Scheme, I am also content to approve the proposed amendment to the 2015 Scheme.