

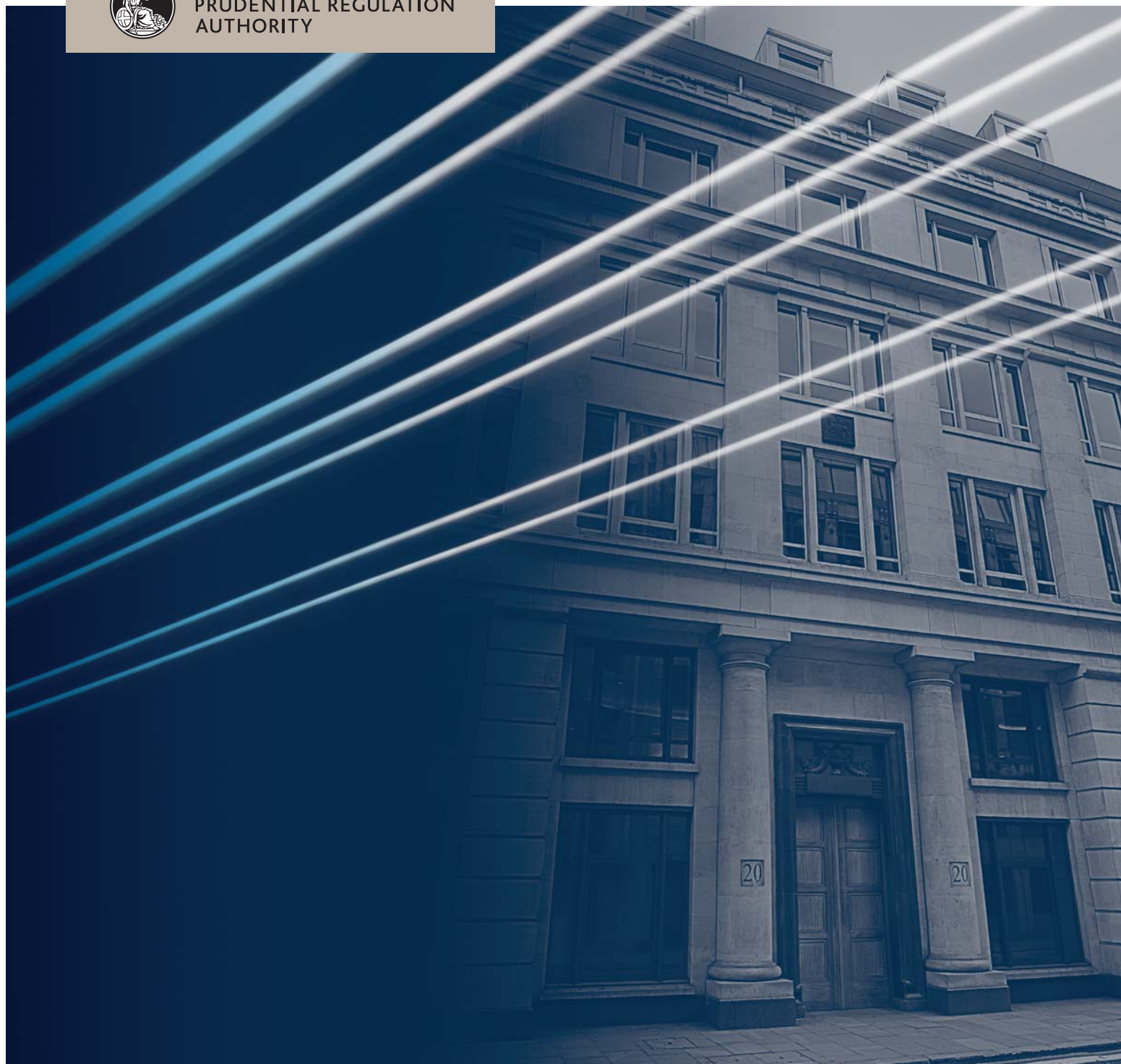
Supervisory Statement | SS3/14

The Prudential Regulation Authority's (PRA's) approach to schemes of arrangement proposed by PRA-authorised insurers under Part 26 of the Companies Act 2006

April 2014



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Introduction

1.1 This supervisory statement sets out the Prudential Regulation Authority's (PRA's) approach to schemes of arrangement proposed by PRA-authorized insurers under Part 26 of the Companies Act 2006.

1.2 In this statement, the PRA:

- provides responses to the feedback received on its consultation on the draft statement in PRA consultation paper 6/13 (the CP) — this statement should be read with that document;
- clarifies its view of schemes of arrangement;
- explains its role in assessing schemes of arrangement; and
- gives supplementary information on interaction with the Financial Conduct Authority (FCA) as well as the PRA's complementary supervisory statement on capital extractions.

1.3 This statement explains some of the factors which the PRA will take into account when judging whether, in promoting a scheme, an insurer is acting in a manner consistent with the PRA's statutory objectives. Specifically, the PRA seeks to ensure that insurers are able (with a high degree of likelihood) to meet claims from policyholders as they fall due and that where firms wish to exit the market they do so in a way which takes proper account of the need to provide an acceptable degree of continuity of cover for policyholders.

1.4 This supervisory statement expands on the PRA's general approach as set out in its insurance approach document⁽¹⁾ and is designed to help advance both the PRA's general objective of promoting the safety and soundness of the firms it regulates and its insurance objective of contributing to the securing of an appropriate degree of protection for policyholders.

2 Feedback on the consultation's responses

2.1 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to have regard to any representations made to the proposals in the consultation, and publish an account, in general terms, of those representations and its responses to them.

2.2 The PRA received 16 responses to the CP and addresses in this document the most significant issues raised by respondents. This statement also provides clarification of issues of uncertainty raised in response to the consultation.

2.3 Respondents queried the extent to which the PRA has powers to approach schemes in accordance with the

consultation's proposals. Although the PRA is not given a specific role or specified powers in relation to schemes either in the Companies Act 2006 or FSMA, it has a regulatory interest in ensuring that when promoting a scheme, insurance firms authorised by the PRA act in a manner which is consistent with the PRA's statutory objectives of safety and soundness and policyholder protection. Accordingly the PRA must maintain appropriate arrangements to enable it to supervise PRA-authorized insurers proposing schemes. This supervisory statement provides some clarification of the approach that the PRA will adopt in carrying out this function.

2.4 The consultation's responses included concerns that the approach consulted upon indicated that a hard and inflexible approach would be adopted by the PRA in all cases and that the PRA would prejudge all cases without first taking account of all relevant circumstances. This is not the PRA's intention. The PRA recognises the importance of understanding and considering in each case where a scheme is proposed all facts and circumstances relevant to that scheme. This will include, for example, taking account of the diversity of insurers and the need to apply its approach to the particular business of the insurance firm or firms involved in a proposed scheme. The supervisory statement has been amended to express the PRA's consideration of these concerns and to clarify the PRA's intentions.

2.5 The PRA received feedback that it was not appropriate to emphasise, in relation to the insurance objective, the issue of continuity of cover. The PRA considers that the degree of emphasis on this element of the insurance objective is appropriate.

2.6 Some respondents questioned whether it was an appropriate use of the PRA's resources to review its role in relation to schemes and to set out a different approach to that of the Financial Services Authority. The PRA is a new regulator with its own statutory remit and objectives. It was especially important in this case for the PRA to review its approach on schemes given that it does not have a specified role under statute.

2.7 The PRA has considered the feedback that it clarify whether the approach applies to life business. The PRA's insurance objectives apply equally to both general insurance and life business. Likewise schemes can be used to deal with both general insurance and life business or a combination of the two where the firm is a composite. For each type of firm the PRA seeks to ensure that policyholders are appropriately protected where firms propose mechanisms which may accelerate the return of capital to shareholders.

(1) The PRA's approach to insurance supervision is available at www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

2.8 Some respondents were concerned that if a hard line is taken by the PRA on schemes this could have a negative impact on innovation and investment in the UK insurance sector. The PRA considered competition issues when developing the approach.

2.9 When formulating the approach and considering how best it should be implemented, regard was given to the need to minimise any adverse effect on competition, in line with the PRA's duties prior to 1 March 2014, which applied when the consultation was published. We have considered this again in light of the PRA's new secondary Competition Objective. Competition will be a relevant issue for consideration and will be considered in each case in accordance with the requirements of that secondary objective. Insofar as it is different, the extent to which consideration should be given to questions concerning innovation and investment in the UK insurance sector will be considered on a case-by-case basis in line with the PRA's statutory objectives and in accordance with all legal obligations in force at the relevant time.

3 The PRA's view of schemes of arrangement

3.1 A scheme of arrangement (scheme) is a compromise or arrangement under Part 26 of the Companies Act 2006 which may allow companies to reach a binding compromise with their creditors to discharge all remaining assets and liabilities. If certain majority approval thresholds are met, the terms of the scheme (once sanctioned by the Court) are binding on the company and on all creditors, regardless of whether individual creditors originally voted for the scheme.

3.2 Schemes proceed under the Companies Act 2006 rather than FSMA. However, **the PRA has an interest in the potential use of schemes by insurers because of its statutory objectives, and in particular its objective to contribute to securing an appropriate degree of protection for insurance policyholders.** For example, the PRA has explained in its Approach Document that it wishes to ensure that firms are able to exit the market in an orderly manner. In such circumstances, the PRA wishes to ensure that policyholders have an appropriate degree of continuity of cover against insured risks.

3.3 **The PRA recognises that, in some circumstances, the use of schemes of arrangement by insurance companies may be compatible with its statutory objectives.** For example, the use of a scheme by an insurer in insolvency may be in the interests of policyholders generally due to the effect of the maximisation of the pool of assets available to distribute to creditors or in allowing a quicker distribution.

3.4 **However, the PRA also believes that, in other circumstances, the use by insurance firms of schemes of**

arrangement may not be compatible with its statutory objectives. For example, where a firm proposes the use of a scheme when the firm meets its regulatory capital requirements and expects to be able to continue to meet all legitimate claims as they fall due. Such a firm may be more likely to want to exit from a particular portfolio of business for commercial reasons. This may not be compatible with the PRA's statutory objectives — in particular, the insurance objective — given the way in which such schemes may compromise policyholder cover in situations where the firm could otherwise pay claims in full as they fall due.

4 The PRA's role in assessing schemes

4.1 As they proceed under the Companies Act 2006, the PRA does not approve schemes. Also, it is for the Court to determine whether to sanction schemes. However, **the PRA will review all schemes proposed by insurance firms to assess the risks to its statutory objectives. Having assessed a scheme proposal the PRA will consider in each case whether it should inform the court of its view of a scheme and if so, what form that communication should take.**

4.2 In accordance with Principle 11 of the Principles for Businesses (Relations with regulators)⁽¹⁾ and to enable its review **the PRA expects insurance firms which are considering the use of a scheme to inform the PRA in advance, in a way which allows sufficient time for the PRA to assess the proposals.** The firm should explain to the PRA the nature of the business included in the scheme and the nature of the underlying policyholders. The PRA expects firms to be able to explain to the PRA the reasons why they believe the use of a scheme is compatible with the PRA's statutory objectives and, in particular, what steps have been taken or could be taken to ensure that policyholders have an appropriate degree of continuity of cover for the risks against which they are insured. For example, depending on the nature of the business and the nature of the policyholders, the PRA may ask firms to explain what arrangements they have considered for policyholders who do not support the scheme.

4.3 In assessing a proposal from an insurer to use a scheme and in deciding whether or not it wishes to present its views to the Court, **the PRA will consider each proposed scheme bearing in mind all facts and circumstances relevant to that scheme.** The PRA recognises the diversity of insurers and the need appropriately to apply its approach:

- to the particular business of the insurance firm or firms involved when assessing any adverse effects which may result from any disruption to the continuity of financial services; and

(1) Or incoming Fundamental Rule 7 in the PRA Rulebook.

- when considering the extent to which policyholders would have an appropriate degree of continuity of cover for the risks they are insured against if the scheme were to be approved by the Court.

5 Supplementary information

5.1 The FCA is also likely to have an interest in proposals by insurance firms to make use of schemes, given the FCA's consumer protection objective. **In addition to discussing their proposals with the PRA, firms should discuss their proposed use of schemes separately with the FCA.** The PRA would also

expect to liaise directly with the FCA on any proposed scheme of arrangement.

5.2 The PRA has also produced a supervisory statement⁽¹⁾ explaining the approach it takes to assessing proposals from general insurance firms in run-off to extract capital as a run-off progresses. Run-off firms are also encouraged to review that statement. Both statements address different issues but there is a common theme as both explain how the PRA intends to ensure that policyholders are appropriately protected where firms propose mechanisms which may accelerate the return of capital to shareholders.

(1) Capital extractions by run-off firms within the general insurance sector — SS4/14.