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Case No: CR-2018-009677

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

Royal Courts of Justice
Rolls Building, Fetter Lane, London
Date: 30 November 2020

Before :

MR JUSTICE SNOWDEN

- -

Between :

IN THE MATTER OF CERTAIN OF THE MEMBERS AT LLOYD'S FOR ANY OR ALL OF THE 1993 TO 2020 (INCLUSIVE) YEARS OF ACCOUNT, REPRESENTED BY THE SOCIETY OF LLOYD'S

AND IN THE MATTER OF LLOYD'S INSURANCE COMPANY S.A.

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

- -

Martin Moore QC and Mary Stokes (instructed by **Freshfields Bruckhaus Deringer LLP**) for the **Applicants**
Tom Weitzman QC for the **Prudential Regulation Authority**
Charlotte Eborall for the **Financial Conduct Authority**

Hearing dates: 18 - 19 November 2020

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Approved Judgment

COVID-19: This judgment was handed down remotely by circulation to the parties' representatives by email. It will also be released for publication on BAILII and other websites. The deemed date and time for hand-down is 2.00 p.m. on 30 November 2020.

MR JUSTICE SNOWDEN

MR JUSTICE SNOWDEN :

A. INTRODUCTION

1. On 25 November 2020 I made an order on an application by The Society of Lloyd's ("Lloyd's") and Lloyd's Insurance Company S.A. ("LIC") sanctioning an insurance business transfer scheme (the "Scheme") under section 111(1) in Part VII of the Financial Services and Markets Act 2000 ("Part VII" and "FSMA"), together with ancillary orders under section 112(1) FSMA.

2. I indicated when making the order sanctioning the Scheme that I would give my reasons in writing, which I now do.

Lloyd's

3. Lloyd's is not an insurer and does not conduct insurance business itself, but simply admits members to the Lloyd's market who conduct business on their own account through groups of members ("Syndicates") which are identified by a Syndicate number. The Syndicates have no separate legal personality. Thus, each member, former member and estate of a former member (a "Member") is and remains severally liable for their own liabilities.

4. Lloyd's Syndicates are set up on an annual basis. In practice, they usually operate from year to year with active Members generally having the right, but not the obligation, to participate in the same numbered Syndicate the following year. The precise composition of the same numbered Syndicate may thus vary from year to year.

5. The "year of account" is the year (i) in which an insurance or reinsurance contract underwritten by the Members of a Syndicate is allocated for accounting purposes; and (ii) into which all premiums and claims arising in respect of that contract are payable. An "open" year of account is a year of account of a Syndicate which has not been closed by "reinsurance to close". This is reinsurance which closes a year of account by reinsuring all the liabilities that attach to that year of account into an open year of account of the same or a different Syndicate in return for a premium. A "closed" year of account is a year of account of a Syndicate which has been "reinsured to close".

6. The management of the business of Syndicates is conducted by "Managing Agents" who are given permission by Lloyd's to provide various services and advice to particular Syndicates. As part of their role, the Managing Agents may authorise other companies or partnerships who are not Members of Lloyd's to enter into contracts of insurance to be underwritten by the Members of the relevant Syndicate. These other companies or partnerships are known as "Coverholders", and the authorities through which they operate are known as "Binding Authorities" or "Binders".

7. In addition to any reinsurance which might be arranged for Members which provides indirect security of benefits for policyholders, the holders of all policies insured (or reinsured) at Lloyd's also benefit from the Lloyd's "chain of security". This comprises three elements: (i) Members' working capital (all premiums received by the Members of

a Lloyd's Syndicate are held on trust by the Managing Agents until the relevant year of account is closed and profits can be released); (ii) Members' capital deposited at Lloyd's (each Member must provide capital to Lloyd's which is held on trust by Lloyd's to support their underwriting); and (iii) Lloyd's central fund (Lloyd's central assets are available at the discretion of Lloyd's to meet any valid claim that cannot be met from the resources of any Member).

8. Following resolutions passed by the Council of Lloyd's on 20 September 2018, 17 September 2019 and 8 September 2020, and pursuant to The Financial Services and Markets Act (Control of Transfers of Business Done at Lloyd's) Order 2001 (SI 2001/3626) ("the Lloyd's Part VII Order") Lloyd's has designed and co-ordinated the promotion of the Scheme and will act as transferor on behalf of the Members who have underwritten the relevant policies to be transferred.

Lloyd's Insurance Company S.A.

9. LIC is a Belgian company which is a wholly-owned subsidiary of Lloyd's. It is based in Brussels, is authorised to act as an insurer (and reinsurer) by the National Bank of Belgium ("NBB") and is regulated by the NBB and the Financial Services and Markets Authority of Belgium (the "Belgian FSMA"). LIC also has branches throughout the EEA and a branch in the UK.

10. In anticipation of Brexit, since 1 January 2019 (with some minor exceptions) LIC has been writing all new Lloyd's market EEA business from its establishment in Brussels, exercising its passporting rights in all EEA member states to do so. The risks under such new policies are, however, reinsured back to the relevant Members, and LIC outsources the management of such policies back to the relevant Managing Agents of the Syndicates which originated the business at Lloyd's. As at 31 December 2019, LIC had written approximately 800,000 policies representing gross premiums of €2.6 billion in this way, and the intention is that LIC will continue to write such new EEA business in the future.

The reason for the Scheme

11. The Scheme is driven entirely by Brexit. As a result of the United Kingdom's exit from the European Union, Members of Lloyd's will lose their passporting rights under the Solvency II Directive, which have previously enabled them to write and service policies and pay claims in the EEA without the need for separate authorisation in each EEA jurisdiction. Such passporting rights are expected to cease at the end of the Brexit transition period on 31 December 2020.

12. On 21 December 2017 the European Insurance and Occupational Pensions Authority ("EIOPA") issued an opinion on service continuity in insurance in light of the withdrawal of the UK from the EU. 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.

13. The Scheme follows EIOPA's suggestion. In order to avoid the disruption of service that the loss of passporting rights would cause to EEA policyholders whose policies have not been written by LIC, the primary purpose of the Scheme is to transfer to LIC, with effect

from 30 December 2020, those policies (in whole or in relevant part) which were underwritten at Lloyd's between 1993 and 2020 (inclusive) and which have a risk situated or a policyholder resident in the EEA (the "transferring policies"). The intention is that after the Scheme becomes effective, the transferring policies should be able to be serviced and paid by LIC without the Members breaching any legal or regulatory insurance authorisation requirements in the EEA after the end of the Brexit transition period.

14. Lloyd's estimates that the gross ultimate premium of the transferring policies will be approximately £34.8 billion and the gross liabilities will be about £4.1 billion at the date the Scheme becomes effective. The number of transferring policies is not known due to the fact that Lloyd's does not keep central records of individual policies written by Members. It is clear, however, that there are likely to be many hundreds of thousands of transferring policies.

15. So far as recognition of Part VII transfers in the EEA is concerned, the recommendation of EIOPA to the EU27 Member States on 19 February 2019 was as follows,

> "Competent authorities should allow the finalisation of portfolio transfers from UK insurance undertakings to EU27 insurance undertakings, provided that it was initiated before the withdrawal date. For that purpose, competent authorities should co-operate closely with the supervisory authorities in the UK taking into account the requirements of Article 39 of the Solvency II Directive and the provisions of Section 4.2.1. of the Decision of the Board of Supervisors on the collaboration of the insurance supervisory authorities of the Member States of the European Economic Area of 30 January 2017 (EIOPA-BoS-17/014). 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."

16. The Scheme was initiated in accordance with the requirements of this recommendation, and all of the EU27 Member States have either complied or intend to comply with EIOPA's recommendation. That includes Belgium, whose regulators have not opposed the Scheme and have issued the necessary permissions and certificates to enable LIC to take on the transferring policies. It is therefore clear that the Scheme will achieve its principal purpose of enabling the transferring policies to be transferred and liabilities paid after 31 December 2020.

B. THE SCHEME IN OVERVIEW

17. The detailed design and operation of the Scheme has been complicated by the structure of underwriting and reinsurance at Lloyd's. The communications programme with policyholders and reinsurers has also been made more difficult due to the extended time period over which the transferring policies were written, and the fact that Lloyd's does not maintain central data for individual policies issued or reinsurances purchased by Members. There was accordingly considerable detail in the materials placed before me,

which were voluminous. For the purposes of this judgment I shall, however, attempt to distil and summarise the key features of the Scheme.

18. In very broad terms, the Scheme does not make any changes to the terms of the transferring policies, but intends to replicate, in respect of them, a similar structure for security of benefits and policy management as has been employed in relation to the new EEA business written by LIC. In addition to the transfer of the policies, the Scheme has three main features.

19. First, LIC's liabilities attaching to the transferring policies will be reinsured back to the Lloyd's Members who wrote the policies in a year of account which is still open, or to those Members who have assumed liability for the liabilities under the reinsurance to close process. The transferring policyholders will thereby continue to benefit indirectly via the reinsurance from the resources provided by the Lloyd's chain of security.

20. Secondly, the intention is that the Members who provide reinsurance to LIC should continue to benefit from any existing outwards reinsurance which was put into place in respect of the transferring policies at Lloyd's, but that such existing outwards reinsurance will be converted to retrocessional cover with the same reinsurer as retrocessionaire. Effect is sought to be given to this term by an order made under section 112(1)(d) FSMA.

21. Thirdly, after the Scheme becomes effective, the transferring policies will continue to be administered on behalf of LIC under outsourcing agreements by the same Managing Agents who currently administer the policies. This will ensure operational continuity and consistency of administration between transferring and non-transferring policies, including as between the different parts of split policies (see below).

22. By these three features, the Scheme is intended to be as economically neutral as possible for all concerned and to make as few operational changes as possible for transferring policyholders and reinsurers who should continue to be able to deal with the relevant Lloyd's intermediaries and Managing Agents as before.

23. The Scheme contains further provisions dealing with the continuity of proceedings which are designed to ensure that after the Scheme becomes effective, any proceedings brought by or against the Members in connection with the transferring policies are continued by or against LIC and that LIC is entitled to all claims, counterclaims, defences and rights of set-off that would have been available to the Members in the proceedings.

24. The Scheme also provides for LIC to succeed to the rights of the Syndicate, Member or agent of a Member in respect of any personal data which relates to the transferring policies. LIC will become the data controller in respect of such data and will be under the same duties with respect to confidentiality and privacy as the Syndicates and the Scheme binds LIC to any consents or any request of the data subject not to use personal data for marketing purposes.

25. Although, in economic and commercial terms, the net effect of the transfer of the transferring policies to LIC and their reinsurance back to Lloyd's Members is intended to be zero, for solvency capital purposes under the EU Solvency II Directive, LIC's asset represented by the reinsurance back to Lloyd's Members will be subject to a solvency

charge of €357 million. This is calculated according to a formula to reflect the counterparty risk of the Members not settling amounts fully when due.

26. In order to counter that solvency charge, on 9 October 2020 Lloyd's made a capital injection in cash to LIC of €207 million, together with a further €46 million to support LIC's ongoing underwriting costs. Lloyd's has also arranged with Barclays Bank Ireland plc an irrevocable Letter of Credit (the "LOC") for the benefit of LIC of €200m which became effective on 3 November 2020 and will expire on 3 November 2025. LIC has received approval from the NBB that the LOC can be used to support the capital requirement of LIC under Solvency II.

C. THE TRANSFERRING POLICIES

27. In broad terms, the transferring policies are non-life policies (or parts of policies) allocated to the 1993 to 2020 (inclusive) years of account which have a risk situated in the EEA and/or an EEA resident policyholder, together with inwards reinsurance policies where the cedant is domiciled or resident in Germany. Those characteristics are a reliable proxy for policies which will be required to be carried out or serviced by an EEA authorised insurer after 31 December 2020.

28. Life policies are not included in the transfer because LIC is not authorised and cannot, under Belgian law, be authorised to carry on life insurance business as well as non-life insurance. Life insurance business represents only a very small proportion of business written at Lloyd's by a small number of Syndicates.

29. The Scheme also does not include any business allocated to 1992 and prior years of account. This is because the non-life liabilities of members, former members and estates of former members in respect of these years were transferred to Equitas Insurance Limited, a member of the Berkshire Hathaway group of companies, under a Part VII insurance business transfer scheme sanctioned on 30 June 2009.

30. Policies which have (or may have) the relevant characteristics have been identified, either individually or by reference to a Binding Authority under which policies were written by a Coverholder in a master list on a secure file (the "Master List") which will be provided to LIC before the date when the Scheme becomes effective. In addition to policies on the Master List, the definition of transferring policies in the Scheme includes a residual category of any "EEA Policy" which is designed to sweep up any relevant policies which have not been specifically captured on the Master List. That definition is as follows,

> "EEA Policy means a Policy or part thereof, effected or carried out by or on behalf of any of the Members as insurer, co-insurer, reinsurer or retrocessionaire on or prior to the applicable Cut-Off Date and originally allocated to a Relevant Year of Account, which will immediately after [31 December 2020] require an insurer authorised by an EEA regulator (including, for these purposes, with respect to Monaco) to carry out or service that Policy (or the relevant part thereof, in each case whether by reason of its terms or the subject matter of the policy or by reason of the identity or location, domicile or residency of the Policyholder, insured or claimant or for any reason whatsoever), in order to ensure no legal or

> regulatory insurance authorisation requirements in the EEA are breached. For the purposes of determining whether a Policy (or part thereof) is an EEA Policy for the purposes of this Scheme, the application of, or any permission granted by, any Temporary Run-off Regime [a temporary regime in an EEA State which would permit a Member to carry out a Policy in that EEA State after 31 December 2020] shall be ignored in respect of that Policy."

31. The independent expert appointed to report on the Scheme (the "IE") and the FCA both reviewed and commented upon the data gathering exercise and method relied upon by Lloyd's to identify the transferring policies in accordance with this definition. The IE concluded that the approach ultimately taken by Lloyd's was sensible and robust and the FCA did not disagree.

32. In these circumstances I am satisfied that, taken together, the use of the Master List and the catch-all definition of EEA Policy provide sufficient certainty for the purposes of giving effect to the Scheme and identifying the policies to be transferred under it.

33. There are two other categories of policy which would otherwise fall within the definition of transferring policies under the Scheme but which have been excluded for reasons of practicality or necessity.

34. The first category is "Excluded Jurisdiction" policies. These are policies (or parts of policies) which are subject to the requirements of a local regulatory licence or other insurance approval granted to Lloyd's in Canada, Australia, Hong Kong, Singapore, South Africa or Switzerland. In order to transfer this business, it would be necessary either for LIC to obtain local regulatory approval and/or for a parallel transfer scheme to be undertaken. These jurisdictions also require assets to be lodged in a local trust fund or otherwise secured locally, and it was not feasible to recreate such structures and obtain local regulatory permissions for LIC before the Effective Date. None of the countries in question has significant EEA business.

35. I am satisfied that there is no unfairness to the holders of such Excluded Jurisdiction policies being excluded from the Scheme. Although this will likely mean that their policies cannot be routinely carried out by the Members after 31 December 2020, Mr Moore QC told me, on instructions, that the view of Lloyd's was that the appropriate EEA regulators might be persuaded to consent to payment of valid claims under such policies, which are few in number, on an ad hoc basis. However, he indicated that if for some reason this was not so, then Lloyd's would take such actions as might be available to it to ensure that Members' contractual commitments were honoured. This might include arranging for payment of valid claims to assignees in jurisdictions in which such payments could lawfully be made, directing any local trust funds to be released to pay the claims, or arranging for a discretionary payment of compensation from the Lloyd's central fund (with an indemnity being paid by the Member or Managing Agent to the central fund).

36. The second excluded category is "Sanctions Policies" under which payment is blocked under the financial sanctions measures of the UK, the European Union, Belgium, the United Nations Security Council or the United States. Only 22 Sanctions Policies have been identified as at 27 October 2020. Since payment of claims under such policies is

prohibited in any event, it is not unfair that they are excluded from a bulk transfer. They will have to be dealt with individually if and when permissible.

37. The specific rights and liabilities which will be transferred with the transferring policies are defined. The rights to be transferred include the rights of Members under Binding Authorities pursuant to which transferring policies have been written will transfer under the Scheme to LIC. So too will their rights under third party administration agreements ("TPAs") in relation to the management of policy claims, if transferring policies are administered under them. Where the Binding Authorities and TPAs relate to policies which are split under the Scheme (see below), the rights under these contracts will also be split in the same fashion as the policies themselves.

38. The liabilities to be transferred essentially include all liabilities of the Members to the extent attributable to or arising from or in connection with the transferring policies or transferring assets, including both the liability of the Members who wrote a transferring policy and the liabilities of the Members of a Syndicate who have reinsured such liabilities in the reinsurance to close process. The important exclusions from this broad definition are any liability arising in connection with the sale, management or conduct of the transferring policies prior to the Scheme becoming effective, and any tax liabilities arising in connection with the transferring business before that date.

39. Multi-jurisdictional policies which have EEA elements (EEA situs risk or EEA resident policyholders) and non-EEA elements will be split under the Scheme, so that part of the policy transfers and part does not. When the Scheme becomes effective, this will result in two policies: a non-EEA policy with the Members of a Syndicate (which can be serviced by the Members without any regulatory breach after passporting rights are terminated) and a separate EEA policy with LIC. There will be a similar splitting of policies under the Scheme where the policy is written by Members and a non-Lloyd's co-insurer: only that part of the policy written by the Members will transfer pursuant to the Scheme. Importantly, the terms and conditions of the split policy (including any deductibles and limits) will apply in aggregate across the two policies resulting from the split, so that policyholders are no better or worse off as a result of having two policies rather than one.

40. This technique of splitting policies has been employed in other schemes: see e.g. re AIG Europe Limited [2019] 1 BCLC 150 at [39]-[41]. Although the technique has not, so far as I am aware, been tested by subsequent litigation, neither has there been any reported difficulties in practice in dealing with split policies. Moreover, the FCA and PRA reported that they had each conducted a review of worked examples of policy splitting provided by Lloyd's and that each was satisfied by them. In these circumstances I see no reason in principle why this technique cannot be employed in the instant case.

D. REINSURANCE

41. As indicated above, the provisions in relation to reinsurance are an important feature of the Scheme. The liabilities in respect of the transferring policies to be transferred to LIC will be fully reinsured by Members under 100% quota share reinsurance agreements, which have been entered into by LIC and the relevant Members in readiness for when the Scheme becomes effective (the "Lloyd's Brussels Reinsurance Contracts").

42. Where the year of account in which the transferring policy was written is still open (which is the case for the 2018, 2019 and 2020 years of account), the reinsurance will be with the same Members who were originally liable on the transferring policy. Where the year of account in which the policy was written has been reinsured to close (i.e. years of account 1993-2017 (inclusive)), the reinsurance will be with the Members of the relevant Syndicate for the (2018) year of account which assumed responsibility for discharging the liabilities which attach to the policy under the reinsurance to close process.

43. As indicated above, the Managing Agents of each Syndicate routinely purchase outwards reinsurance on behalf of Members of their Syndicate. In this regard, the Scheme defines "Existing Outwards Reinsurance Agreements" to mean, in respect of any open year Syndicate or Syndicate which has been reinsured to close,

> "… any contract of reinsurance to which the Members comprising the Syndicate are parties as the reinsured, together with any collateral, letter of credit facilities or other security arrangements which have been arranged by the relevant reinsurer for the benefit of the Syndicate, which attaches to all or any part of any of the Transferring Policies and under which any obligations remain to be performed in whole or in part at the Effective Date."

44. Such Existing Outwards Reinsurance Agreements in respect of the transferring policies will not, however, be transferred to LIC. Instead, the Scheme will convert each such reinsurance agreement to a retrocession agreement in respect of the relevant liabilities reinsured by Members under the Lloyd's Brussels Reinsurance Contracts.

45. The central provision of the Scheme dealing with the conversion of such Existing Outwards Reinsurance Agreements into retrocession agreements is paragraph 11.1 which provides as follows,

> "11.1 On and with effect from the Effective Date, all the liabilities imposed on [LIC] by or under the [Court Order sanctioning the Scheme] in respect of the Transferring Policies, including the Transferring Liabilities, shall be reinsured by the relevant Members pursuant to the Lloyd's Brussels Reinsurance Contracts, and each Existing Outwards Reinsurance Agreement (in whole or part) shall be amended and take effect as follows:
>
> (a) the Existing Outwards Reinsurance Agreement shall be treated as a contract of retrocession in respect of the relevant proportion of each reinsurance policy entered into by, or on behalf of, the relevant Members of the relevant Syndicate (as reinsurer) in respect of the Transferring Policies pursuant to the Lloyd's Brussels Reinsurance Contracts (each such Existing Outwards Reinsurance Agreement being, with effect from the Effective Date, a "Retrocession Agreement") and any letters of credit, collateral or security arrangements comprised in or connected to an Existing Outwards Reinsurance Agreement shall include such consequential amendments as are necessary to reflect the fact that those

> arrangements will, from the Effective Date, support a retrocession rather than a reinsurance;
>
> (b) the benefit of each Existing Outwards Reinsurance Agreement shall transfer from the original Member in whose name the policy was issued (as reinsured) to the new Member who has reinsured the original Member's policy under a Lloyd's Brussels Reinsurance Contract, with the effect that (among other matters) the new Member shall be entitled in their own name to collect all amounts recoverable by the original Member under the Existing Outwards Reinsurance Agreement including, where the context requires, liabilities incurred by [LIC] as if it were the original Member; and
>
> (c) the provisions of any Existing Outwards Reinsurance Agreement shall, save as amended in paragraph 11.1(a) above, continue in full force and effect (including in respect of the rights of the reinsurer under the Existing Outwards Reinsurance Agreement as against the new Member and the terms on which the retrocession is provided)."

46. Paragraph 11.2 of the Scheme contains further provisions that aim to ensure that the changes effected by the Scheme to any Existing Outwards Reinsurance Agreement are effective by providing (among other things) that neither the Scheme nor anything done in connection with the Scheme should entitle any person to invalidate, discharge or terminate any Existing Outwards Reinsurance Agreement or Retrocession Agreement.

47. The intended effect of the Scheme in relation to reinsurance and retrocession is shown in diagrammatic form in the Annex at the end of this judgment.

E. SECTION 112(1)(d) FSMA

48. The issue arises as to whether the provisions of paragraph 11.1 can be given effect under section 112(1) FSMA which confers upon the Court the power to make orders ancillary to an order sanctioning a transfer scheme under section 111(1) FSMA.

49. The Court's powers under section 112(1) are expressed in very wide terms. They include the power under section 112(1)(a) to transfer to the transferee of the insurance business the whole or any part of the undertaking concerned and any property or liabilities of the transferor concerned: and section 112(2)(a) provides that this is possible whether or not the transferee otherwise has power to effect such a transfer. Section 112(1)(d) then gives the court the power,

> "… to make such provision (if any) as it thinks fit … with respect to such incidental, consequential and supplementary matters as are, in its opinion, necessary to secure that the scheme is fully and effectively carried out."

50. The power under section 112(1)(a) was used in WASA International (UK) Insurance Co Ltd v WASA International Insurance Co Ltd (Sweden) [2003] 1 All ER (Comm) 696, in which Park J approved an insurance business transfer scheme and made an order

under section 112(1)(a) transferring the rights of the transferor company under its reinsurance contracts to the transferee. In doing so, he noted that it was doubted that the benefit of a contract of reinsurance could be assigned at common law without the consent of the reinsurer, but he held that the effect of the wording of section 112(1)(b) overcame any such difficulty. A similar provision was contained in the order made in re Copenhagen Reinsurance Co (UK) Ltd [2016] Bus LR 741: see my judgment at [38].

51. In Copenhagen Reinsurance I also used the power in section 112(1)(d) to vary the terms of guarantees given by third party guarantors to the Institute of London Underwriters ("ILU") for the benefit of policyholders of the transferor company. The guarantees were amended to refer to the liabilities of the transferee company rather than the transferor. I considered that this fell within section 112(1)(d) because the insurance policies that were being transferred had originally been sold on the basis that they had the benefit of the guarantees to the ILU from companies associated with the insurer. I held that the variation of the terms of those guarantees was a supplementary matter that was necessary to ensure that the full benefits associated with the policies could be maintained.

52. In determining whether the change from reinsurance to retrocession envisaged by paragraph 11.1 falls within section 112(1)(d), it is first necessary to consider what paragraph 11.1 seeks to achieve as a matter of reinsurance law.

53. In Charter Reinsurance v Fagan [1997] AC 313 at 392, Lord Hoffmann said,

> "[A contract of reinsurance] is not an insurance of the primary insurer's potential liability or disbursement. It is an independent contract between reinsured and reinsurer in which the subject matter of the insurance is the same as that of the primary insurance, that is to say, the risk to the ship or goods or whatever might be insured. The difference lies in the nature of the insurable interest, which in the case of the primary insurer, arises from his liability under the original policy: see Buckley L.J. in British Dominions General Insurance Co. Ltd. v. Duder [1915] 2 K.B. 394 , 400."

Further, in WASA International Insurance v Lexington Insurance [2010] 1 AC 180 at [2], Lord Phillips observed, also citing British Dominions General Insurance Co. Ltd. v. Duder, that it was a well-established principle that,

> "… under English law a contract of reinsurance in relation to property is a contract under which the reinsurers insure the property that is the subject of the primary insurance; it is not simply a contract under which the reinsurers agree to indemnify the insurers in relation to any liability that they may incur under the primary insurance…"

54. It is also well established that the term "retrocession" simply describes the reinsurance of a reinsurer: see Commonwealth Insurance of Vancouver v Sprinks [1983] 1 Lloyd's Rep 67 at 87 per Lloyd J.

55. Applying these principles, it would appear that neither the essential nature of the contract nor, critically, the underlying risk which is reinsured by the reinsurer, will change as a result of the amendment of the terms of the Existing Outwards Reinsurance

Agreements to become the Retrocession Agreements under paragraph 11.1 of the Scheme.

56. Moreover, at least in so far as the existing reinsurance relates to a policy which has been written by Members of a Syndicate in an open year of account, the amendment of the contract of reinsurance to a contract of retrocession will make no change to the identity of the parties to the contract. That is because the Lloyd's Brussels Reinsurance Contract will reinsure the risks assumed by LIC under the transferring policy back to the same Members who wrote the insurance policy in the first place. The only change will be in the insurable interest of those Members.

57. In such a case, therefore, I do no not see that paragraph 11.1 of the Scheme makes any substantive change to the relationship between reinsurer/retrocessionaire and cedent/retrocedent. The only changes are of terminology and in the insurable interest of the cedent/retrocedent, neither of which affect the reinsurer.

58. Where the existing reinsurance relates to a policy which has been written by Members of a Syndicate in a year of account which has been reinsured to close, the Lloyd's Brussels Reinsurance Contract will reinsure the risks under the transferred policy back to the Members of the Syndicate that reinsured the original risk under the reinsurance to close process. If the composition of the Syndicate did not change over the intervening period, those Members will be the same as the Members who comprised the Syndicate when the reinsurance was written. In that case the position will be the same as for the amendment of reinsurance written in an open year of account – i.e. there will be no substantive change other than one of terminology and the insurable interest of the cedent/retrocedent.

59. However, the Members to whom the risk arising under the policy will be reinsured under the Lloyd's Brussels Reinsurance Contract may not be the same as those who made up the Syndicate when the policy was written. To the extent that the Members differ, the effect of paragraph 11.1 of the Scheme will be to replace one counterparty to the outwards reinsurance contract (the cedent) by a different counterparty (the retrocedent) and to transfer the benefit of the contract from the cedent to the new retrocedent.

60. Amendments to the provisions of the transferring insurance contracts themselves are routinely made under section 112(1)(d). As I indicated, I authorised a significant variation to a third party ILU guarantee in Copenhagen Re. By parity of reasoning, I consider that an amendment of a reinsurance contract which relates to a transferring policy and which amounts to no more than a change of terminology from the language of reinsurance to that of retrocession and the alteration of the insurable interest of the cedent/retrocedent must plainly be within the potential scope of section 112(1)(d).

61. I also think that the replacement of a cedent by a different retrocedent and the transfer of the benefit of the contract of reinsurance does not, for the purposes of section 112(1)(d), amount to a materially different type of transaction than the simple transfer of the benefit of a contract of reinsurance from transferor to transferee which occurred in WASA and Copenhagen Re. In each case the reinsured risk and the terms of the reinsurance remain the same.

62. Nor do I consider that the width and thus potential utility of section 112(1)(d) should be limited by reference to the fact that the terms of section 112(1)(a) as regards transfer of property to the transferee are expressly extended by the statute to permit the transfer of property in circumstances where the transferor might not have the capacity to make the transfer or where the transfer might require the consent of another person: see sections 112(2) and 112(2A). Section 112(1)(d) is, by its own terms, of very broad scope, and is clearly designed to act as a catch-all for matters not expressly referred to in the earlier sub-paragraphs of section 112(1). I consider that sections 112(2) and (2A) have been included to deal expressly, and thus for the avoidance of doubt, with some of the issues that are most likely to be encountered in a business transfer. If anything, I consider that they support the proposition that the legislative intention is that section 112(1) should be read broadly. That conclusion is further supported by section 112(2C) that provides that nothing in subsections (2A) or (2B) is to be read as limiting the scope of subsection (1).

63. In these circumstances, and applying the ordinary and natural meaning of the language of section 112(1)(d) to the particular features of the Scheme, I consider that all of the changes sought to be made by paragraph 11.1 of the Scheme are supplemental matters which are necessary to secure that the Scheme is fully and effectively carried out.

64. Reinsurance is commonly used by insurers as part of the means by which to provide security of benefits for policyholders. The transfer of the benefit of any reinsurance relating to the insurance policies to be transferred under a Part VII scheme is therefore inherently likely to be "necessary to ensure that the scheme is fully and effectively carried out" because it is essential for any such transfer scheme that the policyholder should, so far as practicable, enjoy materially the same or better security of benefits after the transfer of their policy as before. In that regard, however, I see no reason to limit section 112(1)(d) as applying only to what is necessary to achieve the transfer of the insurance policy to the transferee; or even to what is necessary to achieve a simple transfer of existing associated reinsurance to the transferee of the insurance policy.

65. In this case, and for good reason given the unique structure of Lloyd's, the view has been taken that transferring policyholders will be best served by LIC reinsuring their policies back to the relevant Members in the Lloyd's market. Among other things, this will ensure that transferring policyholders continue to benefit (indirectly) from the Lloyd's chain of security. In addition, having the administration of the policies outsourced back to the Managing Agents will promote operational continuity and consistency of administration and the payment of claims between transferring and non-transferring policies and between the different parts of split policies.

66. Accordingly, in my view the concept of what is "necessary to secure that the scheme is fully and effectively carried out" in section 112(1)(d) must be read broadly so as to encompass the whole of the Scheme, including the arrangements for reinsurance back to Members at Lloyds. And I consider that it is plainly necessary to ensure that those arrangements are "fully *and effectively* carried out" (my emphasis) that existing reinsurance relating to the transferring policies should continue to be available to the relevant Members who provide such reinsurance.

67. I should add that I do not think that this conclusion is in any way affected by my decision in Barclays Bank plc [2019] EWHC 129 (Ch). In that case I held that I could not use section 112(1)(d) to transfer some of the parts of an investment banking

business conducted by a third party (BCSL) that had no factual connection to the banking business of the transferor (BBPLC) that was to be transferred under Part VII. The fact that the applicants thought it might be commercially desirable for the Barclays group to transfer the unconnected parts of the investment banking business to the same transferee did not mean that it was *necessary* to do so to secure that the scheme for transfer of the deposit taking business was fully and effectively carried out. The close and obvious factual connection between the transferring policies and the existing outwards reinsurance, and the essential features of the Scheme which have been designed for the benefit of policyholders to which I have referred, mean that the cases are plainly distinguishable.

F. THE REQUIREMENTS OF PART VII AND DISCRETION

68. In addition to satisfying the particular jurisdictional requirements of the Lloyd's Part VII Order in this case, the basic requirements for sanction of an insurance business transfer scheme under Part VII FSMA are as follows,

    a. the requirements of the Transfer Regulations made under section 108 FSMA have been complied with;

    b. the application must be accompanied by a report on the terms of the scheme by an independent expert (section 109 FSMA);

    c. the Court must be satisfied that the appropriate certificates have been obtained and that the transferee has the authorisation required to enable the business which is to be transferred to be carried on in the place to which it is to be transferred (sections 111(1) and(2)); and

    d. the Court must consider that, in all the circumstances of the case, it is appropriate to sanction the scheme (section 111(3) FSMA).

69. 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 (I have up-dated the references to the identity of the regulators),

> "(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 [PRA and FCA] by reason of [their] 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 [PRA and FCA].
>
> (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."

Brexit Schemes

70. In AIG Europe Limited [2018] EWHC 2818 (Ch) 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."

71. For the purposes of the instant case, Mr. Moore QC particularly emphasised the points that the impact of Brexit means that there may be no perfect solution; the possibility that some groups of policyholders may be adversely affected in certain respects does not mean that a scheme necessarily has to be rejected by the Court; and that provided that the proposed scheme is fair, it is not the function of the Court to produce what, in its view, is the best possible scheme.

72. Mr. Moore QC also reminded me of what I said in relation to an issue arising in relation to the design of another Brexit scheme, Aviva Life and Pensions UK Limited [2019] EWHC 312 (Ch) at [86], which I accept also applies in this case,

> "… this is not a Scheme designed to achieve a commercial advantage for [the transferor]: it is not a scheme that [the transferor] would have promoted were it not for the uncertainties caused by Brexit. It is also not a scheme

> under which some policyholders are being prejudiced in order to provide benefits to other policyholders: the potential prejudice to policyholders arises from an external source. Some latitude is therefore required."

73. Mr. Weitzman QC for the PRA and Ms. Eborall for the FCA were content that I should follow the same approach to the exercise of my discretion in the instant case.

74. I therefore turn to consider the Scheme in the light of the formal requirements and principles to which I have referred.

G. PUBLICITY UNDER THE TRANSFER REGULATIONS

75. The Transfer Regulations include (i) requirements for the advertisement of the scheme; (ii) requirements for the notification of policyholders of the parties and reinsurers; and (iii) other requirements with regard to the availability and provision of documents. These requirements were considered by Trower J in May 2020, who gave directions for compliance with most of the relevant Regulations and for dispensation from others: see re The Society of Lloyd's [2020] EWHC 1388 (Ch). In particular, Trower J dispensed with the obligation to notify the non-transferring policyholders of Members at Lloyd's and of LIC.

76. As regards advertisement, the evidence demonstrates that the Scheme has been advertised in a wide variety of UK, European and international publications in local languages. Lloyd's also established and maintained a dedicated website giving information about the Scheme and its progress. Lloyd's also made relevant documents available through that website and directly to the regulators as required by the Transfer Regulations.

77. In relation to notification of transferring policyholders, about 300,000 policyholders whose individual details were available as a result of what was termed a "match and attach" process carried out by an agency using information provided by market participants, were directly notified by post and email in two rounds (each with several tranches) earlier this year. Lloyd's also followed a programme of issuing "Notification Instructions" to other relevant intermediaries, including, in particular, Coverholders, informing them of the Scheme and asking them to put a notice on their own websites available to transferring policyholders with a link to the dedicated Lloyd's Scheme website.

78. Although there were some glitches in the execution of this communications programme to transferring policyholders, I am satisfied that these were minor and, where practicable, corrected. It also appears from a rough sample review that only about half of the larger Coverholders in various EEA jurisdictions complied with the request to place a notice on their websites. These entities were not, however, under the control of Lloyd's.

79. The rates of response and objection to the Scheme from transferring policyholders who are known to have received due notice of the Scheme were very low indeed. This tends to suggest that any minor deficiencies in notification of other policyholders by indirect means, or who only received notification closer in time to the Scheme hearing would

have been unlikely to have prevented any, or any further significant issues being raised in relation to the Scheme that had not already been raised.

80. The position in relation to notification of reinsurers under the Existing Outwards Reinsurance Agreements is potentially important in relation to recognition in other relevant jurisdictions of the provisions of the Scheme which convert those contracts to Retrocession Agreements (see below).

81. The issue for Lloyd's was that it does not maintain a central database of every reinsurer who might have reinsured a policy in the Lloyd's market over the years of account affected by the Scheme. However, from data available to it, Lloyd's compiled a list of 1,085 reinsurers who are known to have been generally active in the Lloyd's market. Of these, Lloyd's was able to verify the names and contact addresses for 676 reinsurers who were responsible for 99.99% of global reinsurance reported by Syndicates at 31 December 2019 and 100% of premium reported under the in-force reinsurance programmes of Syndicates at 1 January 2020. The remaining 409 reinsurers without verified names and addresses were thought to be either legacy reinsurers, who have not participated on a reinsurance of a Lloyd's Syndicate for many years, or entities which have merged with other reinsurers on the list. Managing Agents then reviewed the verified list of 676 names and added a further 72 reinsurers.

82. Letters were sent out to all 1,157 reinsurers on 27 August 2020. Of those letters, only 62 (5.8%) were returned, of which 60 were reinsurers on the unverified list. None of the reinsurers contacted have raised any objections to the Scheme, either with Lloyd's or the regulators.

83. Although primarily based upon reinsurers recently active in the Lloyd's market rather than reinsurers active over the entire period since 1993, I consider that the notification programme to reinsurers is likely to have reached the overwhelming majority of reinsurers who might claim to be affected by the Scheme. I also have in mind that reinsurers are market professionals who would have had the opportunity to see the advertisements relating to the Scheme placed in relevant national newspapers and trade publications, and who would be most unlikely to be unaware of the Scheme proposals which have been widely publicised for several years.

84. The FCA dealt with the communications programme in its reports to the court and did not consider that any of the issues that had arisen required it to object to the Scheme being sanctioned. In these circumstances, I am also content that there has been as extensive a communications programme as the structure of business at Lloyd's and the available data reasonably permits, and that there has been compliance with the terms of the Transfer Regulations as modified by Trower J's order as regards notification of the Scheme to transferring policyholders and reinsurers.

H. THE INDEPENDENT EXPERT'S REPORT

85. The IE in this case is Mr. Carmine Papa. He is a Fellow of the Institute of Chartered Accountants in England and Wales. Although he is not an actuary, he has 35 years of experience of the Lloyd's insurance market, including the assessment of Syndicates' insurance liabilities and the quality of their actuarial projections. Mr. Papa's

appointment as the IE was approved by the PRA, as was the form of his reports, in each case following consultation with the FCA.

86. The IE produced a first Report dated 1 May 2020, a helpful summary of it, and a Supplementary Report dated 10 November 2020.

87. As is conventional, the IE's Reports consider the effect of the Scheme on four groups of persons potentially affected by the Scheme: (i) transferring policyholders; (ii) non-transferring policyholders remaining at Lloyd's; (iii) current policyholders of LIC; and (iv) outwards reinsurers.

88. With respect to each group of policyholders, the IE considered the effect of the Scheme on (i) the security of the contractual rights of the policyholders, (ii) the regulatory and governance framework affecting their policies, and (iii) the administration and service standards in relation to their policies. In relation to outwards reinsurers, the IE considered the effect of the Scheme on their economic exposure under the Existing Outwards Reinsurance Agreements.

89. The overall conclusion of the IE was that none of the groups of policyholders or outwards reinsurers would suffer any material adverse effect as a result of the Scheme. The IE defined "no material adverse effect" as follows,

> "I consider an event or outcome to not have a material adverse effect if, in my opinion, the expected impact of the event is very small, such that it would not influence the decisions of a reader either on its own or in conjunction with other similar defined events. In assessing whether an event impact is very small, I have considered the following:
>
> - the very low probability of the event occurring
> - a very low financial impact of the event
> - a combination of the two matters above.
>
> Similarly, I consider an event to have low probability if, in my opinion, the chance of it occurring is so small that it would not influence the decisions of a reader of this report. I consider an event to be unlikely if it has a low probability of occurring."

90. The IE's Reports are detailed. I shall simply provide a summary of their main points, the views of the Regulators on them, and deal with the main issues arising from them.

Solvency II Capital Regime

91. Before doing so, I should briefly explain the concepts underlying the EU Solvency II regime as regards the capital required to be held by an insurer. Belgium operates and will continue to operate under Solvency II, and at least immediately after 31 December 2020, the UK solvency regime for insurance companies will be essentially the same as Solvency II (which was itself closely modelled on the previous UK regime).

92. Under Solvency II, the solvency requirements for an insurance company start with the quantification of the Best Estimate of Liabilities ("BEL"), which represents the present value of all future liabilities in connection with the policies for which it is the insurer

on a realistic basis. To that amount is added the "risk margin" which is intended to reflect an additional amount which would have to be paid to another insurer to take over the policies and run them off. This is calculated on the basis of unhedgeable risks that a buyer would need to be compensated for to take on the business. The net result is referred to as the insurer's "Technical Provisions".

93. The amount by which the assets of the insurer, measured in accordance with Solvency II, exceeds its Technical Provisions and other liabilities is known as the insurer's "Own Funds". An insurer is required to hold Own Funds at least equal in value to its "Solvency Capital Requirement" ("SCR"). This is the amount required to ensure that the firm's assets continue to exceed its Technical Provisions and other liabilities over a one-year time frame with a probability of 99.5%. The SCR is either calculated on the basis of a standard formula, or is calculated on the basis of a more bespoke internal model and depends upon the model chosen by the firm and approved by the relevant regulator. In either case, it is calculated by reference to the quantifiable risks that firms generally run and that the firm itself is running. The SCR is underpinned by the "Minimum Capital Requirement" ("MCR") which is a prescribed lower amount of assets (with an absolute floor currently set at €3.7 million) which all insurers must hold.

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

95. The net amount by which an insurer's Own Funds exceeds its SCR represents the "Excess Capital" of the insurer for Solvency II purposes. Insurers invariably commit to retain a certain (target) level of Excess Capital in addition to the SCR. The target amount of such Excess Capital reflects the chosen "risk appetite" of the insurer and is determined by the insurer's capital management policy or "CMP". This additional level of capital is intended to provide comfort that even if a moderately severe event occurred, the insurer would still have sufficient capital to cover its SCR in full and to meet its obligations to policyholders. The capital management policy also operates as an early warning system to the directors of the insurer to enable them to take appropriate actions, such as changing asset mixes or hedging strategies, to mitigate the risk that the SCR might be breached.

96. Thus, taken together, the protection for policyholders by way of the level of assets an insurer has to hold to meet policyholders' claims is determined by a combination of the Solvency II concepts referred to above, including in particular the Technical Provisions, the SCR and the capital management policy.

The impact upon transferring policyholders

97. The IE considered the impact of the Scheme on transferring policyholders under three headings: (i) security of benefits from LIC, (ii) the operating procedures that LIC intends to adopt post-transfer, and (iii) the regulatory regime that applies to LIC together with the ability of transferring policyholders to have recourse to compensation schemes post-transfer.

Security of benefits

98. In the summary of his first report, the IE dealt, as a matter of concept, with the security of benefits for transferring policyholders and indicates why he considers that the Scheme will have no material adverse effect upon them as follows,

> "Transferring Policyholders currently have policies with Lloyd's. Lloyd's financial resources currently exceed its regulatory capital requirements. Further, these Policyholders are secured by Lloyd's unique capital structure, including the Central Fund, which potentially provides additional security to Policyholders (the Lloyd's Chain of Security). The Central Fund is available, at the discretion of Lloyd's, to meet any claim that cannot be met from the resources of any Member.
>
> After the Proposed Scheme, Transferring Policyholders will be Policyholders of LIC, a company whose level of financial resources is projected to exceed the regulatory capital requirements. Further, LIC is projected to meet its target financial resources, which is an enhancement over and above the regulatory capital requirements.
>
> Transferring Policyholders, after the Effective Date, will be insured by LIC and will no longer be directly insured by Members. However all insurance and reinsurance contracts underwritten by LIC will be 100 per cent reinsured (or retroceded) by the Members. LIC will benefit as a Policyholder from the protection available to Members provided by the Lloyd's Chain of Security including the Central Fund."

99. A key factor in this analysis is the efficacy of the Lloyd's Brussels Reinsurance Contracts. The IE reviewed those contracts with the benefit of legal advice. On the basis of that advice, the IE concluded that the Lloyd's Brussels Reinsurance Contracts have been drafted in a manner which should give effect to their purpose. The PRA agreed with this assessment, although I did not understand it to have obtained independent legal advice about the efficacy of the contracts.

100. The only issue raised by the PRA in relation to the Lloyd's Brussels Reinsurance Contracts related to a clause in the agreements under which the Members of a Syndicate could, in certain events, be required to post collateral with LIC to secure their obligations. In such event, the parties would be required to discuss in good faith and agree the terms on which that collateral should be provided. LIC would, however, ultimately be entitled to determine the form of the collateral and to require that it complied with the relevant legal and regulatory requirements applicable to LIC.

101. This provision plainly does not prejudice the transferring policyholders who would benefit indirectly through LIC. However, the PRA takes the view that this right of LIC might be prejudicial to non-transferring policyholders of Lloyd's, because in a stressed scenario, the transferring policyholders would, through LIC, ultimately have a right to what the PRA termed "preferential access" to the assets of the Members.

102. To address this possibility, the PRA has been given an assurance by Lloyd's that it will endeavour to renegotiate the relevant provisions of the Lloyd's Brussels Reinsurance Contracts with LIC. I was told that LIC's board has agreed in principle to amend the relevant provisions, but no precise form has been agreed.

103. This is not an entirely satisfactory position, because there is no assurance that a suitable amendment will be found which both addresses the concerns of the PRA as regards the non-transferring policyholders, but will also not prejudice LIC or the transferring policyholders and will satisfy any requirements of the NBB as LIC's regulator. For its part, however, the PRA accepts that there is a possibility that no amendment will be agreed, and it does not regard amendment of the Lloyd's Brussels Reinsurance Contract as essential to its decision not to oppose the Scheme.

104. Since I am satisfied that this issue would only arise in a very remote circumstance, and even then would only have any impact if the parties cannot agree on the provision of the form of collateral having negotiated in good faith, I do not consider that there would be any material adverse prejudice to non-transferring policyholders if the Lloyd's Brussels Reinsurance Contracts remain unamended, and certainly none that would cause me to withhold sanction for the Scheme.

105. In these circumstances, although I was not provided with, or invited to review the terms of the Lloyd's Brussels Reinsurance Contracts, I am content to accept the views of the IE and the PRA that they will achieve the desired result of reinsuring the liabilities under the transferring policies back to relevant Members at Lloyd's.

106. In his reports, the IE specifically also dealt with the capital injection made by Lloyd's to LIC and the provision of the LOC to LIC so as to ensure that, taking into account the solvency charge to reflect the risk of default by Members of Lloyd's under the Lloyd's Brussels Reinsurance Contracts, LIC would be able to meet its target SCR coverage ratio. He concluded that LIC's SCR coverage ratio would be 133% for 2020 and would increase to 147% by 2022, which would exceed LIC's target SCR coverage ratio of 125%. His conclusion was that the capital injection by Lloyd's of €207 million and the provision of the LOC of €200 million until 2025 will cater for any reasonably foreseeable underestimation in the insurance liabilities being transferred to LIC. In reaching this opinion, the IE also took into account Lloyd's current intention to provide enough funding to LIC to enable it to operate and meets its SCR in future. The PRA did not dissent from this view, and also pointed to the fact that the NBB has given a certificate of solvency in respect of LIC. I accept that evidence.

LIC's operating procedures

107. As to the outsourcing agreements and LIC's operational framework to service the transferring policies, the IE noted that the new operational process required for LIC to service the transferring policies has been designed with input from Lloyd's as well as regular consultation with market participants with the intention of minimising any

disruption to transferring policyholders. The IE expressed the opinion that overall this design should ensure that a transferring policyholder will not need to navigate any new or unfamiliar processes. He also noted in particular that the outsourcing agreements between LIC and the Managing Agents will mean that the transferring policyholders will see no material change in the handling of their claims following the transfer.

108. The FCA also expressed the view that the intended LIC operating model would provide continuity of servicing and consistency of administration for the transferring policyholders, for example, by claims handling and complaints management services continuing to be provided in the same way as pre-transfer.

109. One point to which the IE drew specific attention was the fact that transferring policyholders are likely to have been introduced to Lloyd's Members through intermediaries. After the end of this year, as long as that intermediary has the necessary regulatory authorisations to service EEA insurance business where required under the European Insurance Distribution Directive (the "IDD"), the transferring policyholder will be able to continue to interact with the same intermediaries as before the Scheme becomes effective. Where an intermediary connected to the transferring policies does not have the requisite authorisation to service that business, the IE reported that LIC and Managing Agents have confirmed that they will ensure alternative arrangements for LIC's servicing of the business through an authorised intermediary under the IDD.

110. The FCA and PRA also picked up this point, stating that they are aware that LIC has been in communication with the Belgian regulators about the proposed outsourcing arrangements so as to ensure compliance with the IDD and Belgian law, and that Lloyd's is taking steps to safeguard against any material risk of Managing Agents undertaking IDD-regulated activities in Belgium for which the Belgian FSMA might consider authorisation or registration is required. The FCA and PRA did not consider that this matter required them to object to the Scheme.

111. In relation to administration costs, the IE noted that the receipt of the transferring policies will bring with it a significant increase in the business of LIC, which was only originally designed to service new EEA business. The additional burden imposed on LIC by the Scheme will be accentuated by the fact that LIC's new business is done electronically but the transferring business relates to policies going back to 1993 and is a mature book which will require development of new systems for LIC to deal with it.

112. The IE reported that to deal with these additional costs, Lloyd's and LIC have agreed to enter into a Costs Agreement under which Lloyd's will make certain payments to LIC as reimbursement for the costs associated with running off the liabilities under the transferring policies, as they arise. LIC's management have estimated the incremental costs LIC will incur as a result of the transfer: the upper end of that estimate is €45m, with the costs expected to be incurred over the next fifteen years. LIC's management have also projected that the liabilities under the transferring policies will decrease by 98% over that same period.

113. The IE stated that he had reviewed these projections and was of the view that the total aggregate cost that LIC is likely to incur over the next 15 years will be covered by the Costs Agreement entered into. He was also of the view that the cost of settling the remaining 2% of such liabilities after 15 years will have no material adverse effect on LIC's financial resources.

114. The result is that the IE concluded that the Scheme will have no material adverse effect on the transferring policyholders in respect of matters such as administration, claims handling, and levels of service. The FCA is also satisfied that there will be no material adverse effect to policyholders in relation to the provision of administration services relating to the transferring policies.

115. In these circumstances I am also satisfied that the Scheme will not have a material adverse effect upon the service standards experienced by transferring policyholders.

Compensation regimes

116. As regards the change in the compensation regime which transferring policyholders will experience in moving to LIC, the first point that the IE noted is that although transferring policyholders will lose direct access to the Lloyd's Central Fund, they will not be materially adversely affected, as LIC will have access to the Central Fund as a policyholder of the Members under the Lloyd's Brussels Reinsurance Contract.

117. The IE also dealt with the impact of the transfer on the transferring policyholders' protection under the UK Financial Services Compensation Scheme ("FSCS") and the UK Financial Ombudsman Service ("FOS").

118. The position with regard to FSCS is relatively straightforward. Post-transfer, transferring policyholders are expected to remain eligible for compensation under the FSCS in the event of LIC's insolvency.

119. Transferring policyholders who are eligible claimants with protected claims against the Member that arise out of acts or omissions occurring before transfer will continue to be covered under the FSCS by the PRA's successor rules. In addition, if LIC remains a "Relevant Person" for the purposes of the Policyholder Protection part of the PRA Rulebook then eligible policyholders with protected claims would have the right to claim such compensation if LIC were to become insolvent, whether arising out of acts or omissions occurring pre- or post-transfer. LIC will continue to be a "Relevant Person" provided that its currently established passported UK branch remains an authorised branch. That will be the case under the UK's Temporary Permissions Regime ("TPR") that is currently expected to last for three years following the end of the Transition Period. LIC also intends to seek full UK authorisation before the end of the TPR period for its UK branch. There is no indication why LIC should not obtain such authorisation in due course, and the IE therefore considered that the risk that transferring policyholders will lose FSCS cover is not a material risk. The FCA did not disagree.

120. The position in relation to FOS is less straightforward. The FOS has a two-part system, a compulsory element applying to complaints relating to the acts or omissions of an authorised insurer carrying on regulated activities and a voluntary element which applies to complaints not covered by the compulsory jurisdiction and which relates to the acts or omissions of an insurer which has opted into the FOS's voluntary jurisdiction.

121. What is clear is that transferring policyholders who currently can access the FOS voluntary and compulsory jurisdiction schemes will continue to have access to those

schemes following the Scheme becoming effective in respect of complaints relating to acts or omissions occurring prior to the transfer.

122. It also appears that where the act or omission complained of takes place after the Scheme becomes effective, the FOS compulsory jurisdiction scheme will have jurisdiction in relation to LIC provided the act or omission takes place in the UK or in the EEA, provided the services are being provided into the UK, and provided LIC's UK branch has a deemed UK authorisation under the TPR or, once the TPR ends, the branch is fully UK authorised. There is thus a risk that some transferring policyholders might lose access to the FOS's compulsory jurisdiction scheme if any of these conditions are not satisfied.

123. For an act or omission that takes place following transfer the FOS voluntary jurisdiction scheme will not apply unless (i) the activity which is the subject of the complaint is carried on by LIC in the UK; or (ii) the activity which is the subject of the complaint takes place in the EEA and all of the following applies, (a) the activity is directed wholly or partly at the UK; (b) the insurance contract is subject to English, Scottish or Northern Irish law; and (c) LIC has informed the Belgian regulator of its participation in the voluntary jurisdiction regime. LIC has decided to enter into the FOS voluntary jurisdiction and will inform the Belgian regulators accordingly, but again there is a possibility that some transferring policyholders will lose access to the FOS voluntary jurisdiction scheme after the transfer.

124. The IE was of the opinion that any loss of access to the FOS schemes is somewhat mitigated by the internal complaints management scheme which LIC is intending to implement following the proposed Part VII transfer, which should result in claims being handled in a similar manner as now. He also drew attention to the fact that policyholders of Belgium-domiciled firms can apply to two non-binding complaint resolution services in Belgium.

125. However, the main point made by the IE was that the risk of loss of access to the FOS schemes in the limited circumstances set out above is far less than the risk that it may become illegal for Members to pay valid claims if the Scheme is not sanctioned. Although the FCA does not explicitly go as far as this, it notes the IE's view and does not disagree with him or indicate that the position in relation to the FOS causes it to object to the Scheme.

126. For my part I agree with the IE. The potential loss of access to the FOS in no way outweighs the prejudice that is likely to be suffered by the transferring policyholders in being unable to have their policies serviced or claims paid if the Scheme is not sanctioned.

<u>The impact upon non-transferring policyholders</u>

127. The main issue considered by the IE in relation to the non-transferring policyholders was the effect of the Scheme on the security of benefits under their policies. Of necessity, the IE could only address this issue by reference to how Lloyd's will be able to ensure that the operations and capital relating to the underlying Syndicates and their Members are overseen in such a way that the overall market continues to comply with its solvency capital requirements.

128. The IE explained that to comply with Solvency II, Lloyd's has used the Lloyd's Internal Model (the "LIM") which is a purpose built model designed to address all the types of risk to which Members at Lloyd's are exposed through the business written and assets and liabilities of the Syndicates and their aggregation and link to Lloyd's. This is used to calculate the SCR for the Lloyd's market as a whole.

129. Lloyd's is required to calculate two SCRs as follows:

(i) The Market Wide SCR ("MWSCR") – this includes all risks of Members of Lloyd's across the market and all risks to which Lloyd's itself is exposed. This requirement can be covered by eligible funds from all three links in Lloyd's chain of security, i.e. those arising from Syndicate activities, Members' Funds at Lloyd's and the Central Fund.

(ii) The Lloyd's Central SCR ("CSCR") – this captures only the risks faced by the Central Fund in the event that Members fail to meet their liabilities. Only eligible capital available to Lloyd's centrally may be used to cover the CSCR.

Eligible funds (both market level and centrally held) exclude any assets which are ringfenced for Lloyd's overseas subsidiaries, including LIC.

130. The IE summarised his review of the solvency position of Lloyd's prior to the Scheme becoming effective as follows,

> "As at 31 December 2019 Lloyd's had a MWSCR [coverage] ratio of 156% and a CSCR [coverage] ratio of 238% and for 30 June 2020 the MWSCR was 155% and the CSCR was 250%. The MWSCR [coverage] ratio and the CSCR [coverage] ratio noted above were based on Lloyd's audited financial statements as at 31 December 2019 and on its interim financial statements as at 30 June 2020 which was subject to a limited assurance report from its auditors.
>
> Lloyd's has however identified that it should make an adjustment to allow for the current economic conditions and the impact the COVID-19 pandemic has had on the corporate bonds spread and equity valuations. Lloyd's are of the opinion that this will lead to reduced future investment returns and this results in a significantly greater market risk capital charge in its SCR. Therefore, Lloyd's decided to change its MWSCR and CSCR, as calculated by the LIM, to recognise this higher risk.
>
> Two adjustments (Capital Add-ons) were made to the LIM, one to the MWSCR and the other to the CSCR. These were approved by the PRA on 26 August 2020. These Capital Add-ons only come into effect when approved by the PRA. They are required to remain in place until their removal by the PRA. Had these Capital Add-ons been applied retrospectively it would reduce the 30 June 2020 MWSCR [coverage] ratio by 11% and CSCR [coverage] ratio by 50% to 144% and 200% respectively. The above [coverage] ratios are both compliant with a risk appetite of at least 125% for MWSCR [coverage] ratio and 200% for the CSCR [coverage] ratio."

131. The IE then noted that, as set out above, in connection with the Scheme, Lloyd's has made a capital injection to LIC from the Central Fund of €253 million, of which €46 million is to cater for future underwriting and €207 million is to support the proposed Part VII transfer. Lloyd's has also arranged the LOC of €200 millon.

132. The IE reported that the effect of this capital injection from Lloyd's to LIC has led to a small reduction to Lloyd's MWSCR coverage ratio of 1% but a greater reduction to Lloyd's CSCR coverage ratio to 188%, which is below its risk appetite of 200% (although still well above the SCR i.e. a coverage ratio of 100%). To address this reduction in its CSCR coverage ratio, Lloyd's has carried out the following mitigating actions:

    (i) Lloyd's has de-risked the Central Fund assets which has the effect of decreasing the SCR (by approximately 4%); and

    (ii) Lloyd's has collected further Tier 1 capital in the form of syndicate loans to restore the eligible assets in the Central Fund from £3.8bn to £4.0bn.

133. Following these mitigating actions, Lloyd's MWSCR coverage ratio and CSCR coverage ratio will increase to 144% and 207% respectively as at the date the Scheme becomes effective. After this date the CSCR coverage ratio is forecast by Lloyd's to increase to 215% and 224% by December 2021 and 2022 respectively.

134. On this basis the IE concluded that the transfer of policies under the Scheme would not have a material adverse effect on the ability of the Members of the Lloyd's market and the Lloyd's chain of security to meet obligations to non-transferring policyholders.

135. The PRA reviewed the IE's report, and concluded as follows,

> "The PRA's expectation is that Lloyd's and the Managing Agents will, in the event the Scheme is approved and implemented, continue to meet the PRA's Threshold Conditions (the conditions against which the PRA assesses firms in order for them to be permitted to carry on the PRA regulated activities in which they engage …). Thus, it is the PRA's view that Lloyd's and the Managing Agents will following the implementation of the Scheme continue to have (the same) appropriate resources to measure, monitor and manage risk and will also continue to be fit and proper to conduct their business prudently. In addition they will, of course, continue to be subject to supervision by the PRA.
>
> In the circumstances the PRA considers that Lloyd's will continue to have appropriate financial resources and that Lloyd's (and the Managing Agents) will also continue to have the appropriate non-financial resources in the event that the Scheme is approved and implemented."

136. I see no reason to disagree with either the IE or the PRA on this assessment.

The existing policyholders of LIC

137. The IE takes the view that the position of the existing policyholders of LIC is essentially unaffected by the Scheme. They will be insured by the same legal entity, with the same governance structure, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to the Scheme. Moreover, as indicated above, because the Scheme is designed to be economically neutral and LIC is anticipated to meet its regulatory capital requirements by a significant margin after the Scheme becomes effective, the IE is of the opinion that there should be no material adverse effect upon the security of benefits of existing LIC policyholders.

138. Although there will be additional operational requirements and administrative costs for LIC to service the transferring policyholders, the IE also expresses the view that because the increased administrative costs which LIC will incur to service the transferring policies will be funded by Lloyd's, there should be no additional financial burden on LIC which could be detrimental to LIC's current Policyholders.

139. Neither of the regulators disagrees with the IE's assessment that the Scheme will have no material adverse effect on existing policyholders of LIC, and nor do I.

The effect of the Scheme on reinsurers

140. I considered in Section E above whether I had the power to make an order under section 112(1)(d) FSMA giving effect to the conversion of the Existing Outward Reinsurance Agreements into Retrocessional Agreements.

141. In so doing I explained why, in my judgment, the provisions of the Scheme for conversion of outwards reinsurance contracts to retrocession agreements would have no material economic effect upon reinsurers. The IE and the regulators agreed with this conclusion.

142. As indicated above, the IE and the regulators also gave consideration to the question of whether for reinsurers which are domiciled outside the UK, the court system in their country of domicile would recognise an order under section 112(1)(d) and permit enforcement of the Retrocessional Agreements against them; or whether the courts abroad would not recognise such order and hence would not permit enforcement of the Retrocessional Agreements against the relevant reinsurer.

143. At its heart, this question is a prudential one. If Members were not able to recover under the Retrocession Agreements this might affect their ability to meet their obligations under the Lloyd's Brussels Reinsurance Contracts (and also under non-transferring policies). If Members of particular syndicates found themselves in this position, the Lloyd's Central Fund would be available, at the discretion of the Council of Lloyd's, to step in to ensure that policyholders' valid claims were met. Nevertheless, a potential risk to policyholders would remain if the problem were to exist in the major jurisdictions in which reinsurers are domiciled.

144. The IE's analysis and figures provided to me at the hearing in a "Technical Briefing Note" from the head of outwards reinsurance, risk aggregation at Lloyd's shows that

the four countries of domicile in which reinsurers have the greatest aggregate exposure to transferring liabilities are: Bermuda (37.3%); the UK (21.2%), the United States (15.4%) and Germany (9.5%). As such, these jurisdictions together represent about 83% of the reinsurance in respect of the transferring liabilities. Lloyd's accordingly obtained legal advice from Bermudan, US and German counsel concerning the recognition of the Court order in each of those jurisdictions. That advice can be summarised as follows.

Bermuda

145. The advice from Bermuda is that whilst there is no authority on the question whether a Bermudan Court would, on the basis of comity, recognise the English court order converting reinsurance to retrocession, Bermudan counsel referred to the following factors which they considered would weigh with a Bermudan court in favour of recognition;

a. the English order would have considered the interests of all parties, including reinsurers, and would be aimed at maintaining the status quo for all parties;

b. the conversion of reinsurance to retrocession is not a means to an end in itself but is merely one element of the Scheme;

c. the Scheme is not being undertaken to target Bermudan reinsurers and is non-discriminatory;

d. the Scheme is designed to deal with Brexit and not to benefit any class of market participants at the expense of another;

e. Lloyd's has sought to give adequate notice of the design of the Scheme and the court process to all market participants and reinsurers;

f. no objections have been voiced by any reinsurers; and

g. Bermuda law also permits a transfer scheme for long-term insurance business, which is broadly analogous to Part VII.

146. The legal advice also observed that the prospects for recognition would be strengthened if the reinsurance agreement in question was subject to English law. In this regard, Lloyd's review of reinsurance contracts indicated that for reinsurers domiciled in Bermuda the majority of their reinsurance contracts are subject to English law and jurisdiction clauses.

The United States

147. The advice from US counsel also noted that whilst there are no precedents directly on point and the inquiry by a Federal or State court would likely be highly fact sensitive, a court in the US would, on the basis of comity, likely recognise the English court order in respect of the reinsurance agreements, whether the reinsurance agreement was governed by English or US law; and likewise should do so in respect of collateral, whether governed by English or US law. The opinion expressed greater uncertainty about this conclusion if the reinsurer were to become insolvent and if the question concerned collateral located in the US.

Germany

148. The German advice was that the point concerning recognition of the order under section 112(1)(d) converting reinsurance to retrocession was untested in Germany. It also noted that Article 39 of Solvency II speaks in terms of "transfer of portfolios of contracts", and that the scope of the portfolio transfer itself and its mandatory recognition as set out in Article 39(6) of Solvency II is therefore likely limited to the insurance contracts as such, and does not extend to associated assets and liabilities. The opinion suggested that this view is in line with the approach taken by the German legislator and that it is commonly accepted by German scholars that the German law on portfolio transfers (transposing Article 39(6) of Solvency II) does not require (or allow) the parties to transfer anything other than the inwards contracts. The transfer of all other assets and liabilities under German law cannot be achieved by the statutory transfer, but depends on obtaining individual consents from the relevant parties.

149. The opinion also expressed the view that if the judgment sanctioning the Scheme were to be regarded as a judgment in a civil or commercial matter within Article 1(1) of the Recast Brussels Regulation on Jurisdiction and Judgments (EU) No. 1215/2012, it should be recognised by a German court under Article 36 provided that the decision was given before the end of the transitional period. The opinion went on to record, however, that although English law would regard the judgment sanctioning a portfolio transfer under Part VII as a judgment in a civil and commercial matter, the prevailing view in Germany is that portfolio transfers of insurance policies are merely administrative matters which are expressly excluded from the scope of the Recast Brussels Regulation by Article 1(1). That said, the opinion recognised that the interpretation of the Regulation required an autonomous interpretation.

Conclusions on recognition

150. The conclusion that I draw from these opinions is that there is a very good prospect of the conversion of the reinsurance contracts to retrocession contracts being recognised in Bermuda and in the US, but the prospects for recognition are more uncertain in Germany.

151. Any uncertainty as to the strict legal position in Germany is, however, mitigated by the fact that a very significant proportion of the reinsurance of the transferring liabilities written by German reinsurers is attributable to the largest and the seventh largest external reinsurers operating in the Lloyd's market. I was told that it has been estimated that the reinsurance recoveries from those two reinsurers on the transferring business is likely to amount only to about 10% of the premiums that they will receive from reinsurance business at Lloyd's in the first seven months' of this year.

152. To those figures, reference should be added the IE's opinion, which was that reinsurers are unlikely to challenge the Court order converting their reinsurance to retrocession, as to do so would risk serious commercial and reputational damage. That must be so given that the conversion does not make any substantial change to the risks that have been reinsured and the reinsurers will have collected the relevant premium. The IE commented,

> "Any reinsurer who successfully challenges the Court Order to convert Outward Reinsurance to retrocessional cover would be

> unlikely to continue to trade with the Lloyd's Market as they would be perceived by the Lloyd's Market not to have met valid claims. This should, in my opinion, discourage those reinsurers who currently trade with the Lloyd's Market of launching such a challenge."

153. Mr. Weitzman QC indicated, and the PRA's third report confirmed, that the PRA had not itself taken foreign legal advice, but had considered the materials which I have outlined. He said that whilst recognising there was a degree of uncertainty, the PRA accepted that the legal opinions obtained by Lloyd's appeared reasonable, as was the view of the IE that reinsurers with substantial business in the Lloyd's market would be unlikely to risk the reputational damage of disputing the conversion of their reinsurance to retrocession.

154. Mr. Weitzman QC then drew attention to the conclusion of the PRA in this respect that

> "…it is not possible to quantify accurately the likely potential exposure in relation to the possible unenforceability of the outwards reinsurances following their conversion into outward retrocessions. However, on a worst case scenario that exposure would, on the basis of Lloyd's assessment of the liabilities reinsured be of the order of £1.2 billion. The PRA's understanding is that that is an exposure, which could be absorbed by the Lloyd's financial resources but emphasise that this is, in the PRA's view, an extremely unlikely scenario."

155. In fact, as Mr. Weitzman QC pointed out, the figure of £1.2 billion was a worst case scenario because it included reinsurance ceded to a reinsurer related to the ceding Syndicate. Lloyd's was of the view, which Mr. Weitzman QC emphasised, that it was materially less likely that such reinsurers would challenge the conversion of the reinsurance to retrocession. If such related reinsurance was excluded, the reinsurance relating to the transferring liabilities with unrelated reinsurers was £0.7 billion. As both Mr. Weitzman QC and Mr. Moore QC emphasised, that is significantly less than the resources available to the Lloyd's market or even to the Lloyd's central fund.

156. On this basis, Mr. Weitzman QC reaffirmed the PRA's conclusion that,

> "In the circumstances, whilst the PRA recognises that there is a risk that the conversion of the outwards reinsurances into outward retrocessions pursuant to the Scheme may not be legally recognised or enforceable in one or more relevant jurisdictions, it does not consider that this gives it reason to object to the Scheme."

157. In my judgment, these are compelling arguments. Whilst the points advanced in the foreign law opinions on the prospects for recognition in overseas jurisdictions of the conversion of the reinsurance to retrocession under paragraph 11.1 of the Scheme give rise to some uncertainty, there are powerful legal arguments for recognition as a matter of comity in the two most significant of those jurisdictions (Bermuda and the US). There are also powerful arguments why reinsurers with a major part of the reinsurance in the third country (Germany) would not wish to risk the reputational damage of mounting such a challenge. That commercial reason also applies to any significant

reinsurers in Bermuda and the US, and when taken together with the fact that a significant proportion of the reinsurers are likely to be related to the cedent Syndicates, I consider that it is reasonable to believe that the risks of a successful challenge are small. Moreover, even in a worst case scenario, it is likely that the resources of the Syndicates, coupled with the resources of the Lloyd's central fund would be sufficient to absorb the effect and mitigate any prejudice to transferring or non-transferring policyholders.

158. One point of detail in relation to foreign recognition was raised by Mr. Moore QC. He noted that in a footnote to their opinion, US counsel had drawn attention to two federal cases in which Equitas had taken the position that that the 2009 Equitas Part VII transfer was ineffective in the US in the absence of a US Bankruptcy Court order granting recognition to the transfer, as well as two state trial court decisions in which the courts noted issues as to the enforceability of the Equitas transfer in the US. One of those state court cases was Lloyd's v Navigators Management Co Inc, decided on 25 October 2011 in the Supreme Court of New York. In that case, in an attempt to avoid liability for interest on subrogation recoveries, a cedent (Navigators) had asserted that the only proper claimant following the transfer of the reinsurance pursuant to the Equitas Part VII transfer, was Equitas. Apparently, Lloyd's had then argued that since it had not sought recognition of the transfer scheme in the US, the scheme should not be recognised and hence Lloyd's was the correct claimant. That was, to say the least, a surprising argument, which in the end the New York court did not have to decide.

159. As the US opinion foreshadowed, to avoid such a possibility in relation to the Scheme, Mr. Moore QC readily offered an undertaking on behalf of both Lloyd's and LIC that neither would seek to challenge the enforceability of the Scheme in any jurisdiction. I accepted those undertakings.

I. THE VIEWS OF THE REGULATORS

160. Neither of the Regulators opposed the sanction of the Scheme. The PRA stated in its third report,

> "The PRA acknowledges that it is appropriate for Lloyd's to take some form of action to ensure that the transferring policies can be lawfully serviced over their lifetime. The PRA does not have reason to object to Lloyd's proposed solution of transferring the transferring policies to LIC pursuant to the Scheme."

161. The FCA also did not object to the Scheme. In its second report to the court, the FCA stated,

> "In this case … the purpose of the Scheme is to ensure that Transferring Policies can continue to be serviced, and that claims can continue to be paid. In its consideration of the Scheme, and as part of its reasoning for not objecting to the proposed Scheme, the FCA has taken account of the fact that the Scheme is driven by the (now fast-approaching) expiry of the transition period after which the transferring policies would no longer be

able to be serviced or claims paid by the Members at Lloyd's, and that the Scheme enables the lawful continuation of that EEA business."

J. OBJECTIONS FROM POLICYHOLDERS

162. As at 3 November 2020, the Scheme had attracted 1,519 queries. Only three queries amounted to objections. Those objections were (i) that the Scheme would reduce the amount of tax paid in the UK, and therefore have a detrimental effect on healthcare, education, justice and infrastructure; (ii) that the policyholder objected to transfer of her policy without giving reasons but then withdrew her challenge after corresponding with Lloyd's, and (iii) that the Scheme would change the governing law of the transferring policy from English law.

163. Those objections are without substance. As to the first, the economic effect of the Scheme is essentially neutral: and the third is factually incorrect since the Scheme does not make any changes to the terms or governing law of the transferring policies.

K. CERTIFICATES

164. The appropriate certificates have been obtained under section 111(2)(a) FSMA. They are:

(1) a certificate under paragraph 2 of Schedule 12 from the NBB confirming that LIC will, taking the proposed transfer into account, possess the necessary margin of solvency; and
(2) certificates under paragraphs 3 and 3A of Schedule 12 from the PRA concerning consultation with or the consent of the relevant regulatory authorities in the other 30 EEA states (excluding the UK).

L. CONCLUSION

165. The Scheme has been proposed by Lloyd's to deal with the prospect that after Brexit and the imminent expiry of the transitional period on 31 December 2020, Members and Managing Agents at Lloyd's will no longer be able to service and pay claims on policies with EEA risks or EEA policyholders. The obvious prejudice that this will cause for policyholders has to be addressed. To that end, Lloyd's has devised the Scheme as an economically neutral solution for policyholders which will enable EEA policies to be serviced on an outsourced basis by Managing Agents without noticeable change in procedures and valid claims paid by LIC.

166. The regulators view the Scheme as an appropriate solution to the problem caused by Brexit, the Scheme has been widely consulted on over a long period, it has been well publicised to policyholders, reinsurers and the market generally, and there have been no objections of any substance. The IE is satisfied that the Scheme will cause no material adverse effect, whether in terms of security of benefits, service standards or the availability of compensation, for transferring and non-transferring policyholders of Lloyds and for the existing policyholders of LIC. The PRA and FCA consider the IE's

conclusions to be not unreasonable and have not objected to the Scheme, and the NBB has also concluded that LIC will be appropriately funded for the future.

167. The novel feature of the Scheme – the conversion of the existing outwards reinsurance in relation to the transferring policies into retrocession is within the scope of an order under section 112(1)(d). Such an order is untested in other jurisdictions, but I consider that the conversion makes no material economic or legal difference to reinsurers and the evidence suggests that it has a good chance of not being challenged or, if challenged, of being recognised and the retrocession enforced, in the most important foreign jurisdictions in which the great majority of Lloyd's overseas reinsurers are domiciled.

168. To reiterate what I said in the AIG case, in deciding whether to sanction a Brexit scheme such as this, I must balance the inevitable prejudice to a large body of EEA policyholders of their policies not being able to be serviced or paid after the end of this year if the Scheme were not to be sanctioned, against any potential risk of prejudice to individual policyholders or reinsurers under the terms of the proposed Scheme. There may be no perfect solution, but in my judgment this Scheme is an entirely appropriate response which is highly unlikely to cause material prejudice to any interested party.

169. For these reasons, I determined to sanction the Scheme and made the ancillary orders as requested.

ANNEX

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