Neutral Citation Number: [2023] EWHC 2612 (Ch)

Case No: CR-2022-000458

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

Rolls Building
Fetter Lane,
London, EC4A 1NL

Date: 19/10/2023

Before :

MR JUSTICE RICHARDS

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Between :

IN THE MATTER OF PHOENIX LIFE ASSURANCE LIMITED
-and-
IN THE MATTER OF STANDARD LIFE ASSURANCE LIMITED
-and-
IN THE MATTER OF STANDARD LIFE PENSION FUNDS LIMITED
-and-
IN THE MATTER OF PHOENIX LIFE LIMITED
(together the "Claimants")

-and-
IN THE MATTER OF THE FINANCIAL SERVICES AND MARKETS ACT 2000

Martin Moore KC (instructed by **Linklaters LLP**) for the **Claimants**
Nehali Shah for the Prudential Regulation Authority
Theodor van Sante for the **Financial Conduct Authority**
Mr Roland Baker, Mr Mick McAteer, Mr Peter Bloxham, Dr Dean Buckner and Mr Eric Marshall, policyholders of various of the Claimants appeared in person

Hearing dates: 4 October (reading day) and 5 to 6 October 2023

Approved Judgment

This judgment was handed down remotely at 10.30am on 19 October 2023 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

MR JUSTICE RICHARDS :

1. These are applications by Phoenix Life Assurance Limited ("PLAL"), Standard Life Assurance Limited ("SLAL"), Standard Life Pension Funds Limited ("SLPF") and Phoenix Life Limited ("Phoenix" and together the "Parties") commenced by Part 8 Claim Form dated 27 April 2023. The Parties seek:

    i) An order under s111(1) of the Financial Services and Markets Act 2000 ("FSMA") sanctioning an insurance business transfer scheme (the "Scheme") which effects the transfer to Phoenix of the entire insurance businesses of PLAL, SLAL and SLPF.

    ii) Ancillary orders under s112 of FSMA, including orders that vary orders made by this Court in connection with previous insurance business transfer schemes

2. The Parties have made their application on the basis that the Court is being asked to approve a "Scheme" (singular). Since, as will be seen, I propose to sanction the entirety of the proposals that are put forward as the "Scheme" I need not determine whether that "Scheme" should be categorised as three separate schemes.

3. The Scheme is opposed by some holders of policies in the Parties. I have had written and oral submissions from policyholders named on the front cover of this judgment and have also considered objections from policyholders who chose not to attend Court. I described the people objecting as "policyholders", but that is not quite accurate in the case of Dr Buckner. He does not himself hold a policy in any of the Parties. However, his wife does. Dr Buckner argued that the Scheme would reduce his wife's security of benefits which would, in turn, result in him suffering an adverse effect since payments on his wife's policy will make an important contribution to household finances. I concluded that this amounted to an "allegation" of an adverse effect that was sufficient to give Dr Buckner standing to address the Court in his own right under section 110(1)(b) of FSMA.

4. At the beginning of the hearing, I disclosed that I was, until 2013, a partner in Linklaters LLP, the solicitors who act for the Parties. I have long since ceased to share in the profits of Linklaters. When at Linklaters, I did not advise on insurance regulation and accordingly have not given any advice to the Parties which could have any bearing on the present proceedings. I therefore confirmed that I saw no reason to recuse myself from hearing the Parties' application and no-one present at the hearing argued otherwise.

THE COURT'S JURISDICTION ON PART 7 TRANSFERS

Threshold questions of jurisdiction

5. As will be seen, the Court has a wide-ranging discretion to sanction, or decline to sanction, a scheme that is put before it under Part 7. However, before the Court's discretion is engaged, the scheme put forward must be one that the Court has power to sanction. Accordingly, there are some threshold points of detail, albeit important ones, that must be satisfied before I consider the exercise of the Court's discretion in this case.

6. The Scheme is an "insurance business transfer scheme" described in s105 of FSMA. It follows that, by s107 of FSMA, the Scheme requires the sanction of the Court. Of the transferors, PLAL is incorporated in England and Wales. SLAL and SLPF are

incorporated in Scotland. Phoenix, the transferee of all the insurance businesses is incorporated in England and Wales. The combined effect of s107(2) and s107(3) is that the application for sanction of the Scheme is properly before the High Court in England and Wales.

7. Section 108 permits the Treasury to make regulations imposing requirements on applicants seeking sanction of the Court for insurance business transfer schemes which may include provisions enabling the Court to waive a requirement. The relevant regulations are The Financial Services and Markets Act 2000 (Control of Business Transfers) Requirements on Applications Regulations 2001 (the "Regulations"). Section 108 also provides that, if a prescribed requirement is not satisfied, the Court may not sanction the Scheme.

8. Regulation 4 of the Regulations provides that the Court may not sanction a scheme unless the following requirements are satisfied:

    i) Regulation 3(2)(a) requires notice to be published in national newspapers and has been complied with. Regulations 3(2)(b) and 3(2)(c) require notice to be given to every policy holder of the transferor and transferee and also to various reinsurers. However, by order of 5 May 2023, ICC Judge Greenwood dispensed with both of these requirements as permitted by Regulation 4(1).

    ii) Regulation 3(3) requires the notices in question to be approved by the "appropriate regulator" (in the present case the Prudential Regulation Authority "PRA") before they are sent or published. I am satisfied that this requirement has been met.

    iii) Regulation 3(6) requires that certain documents are given to the PRA and to the Financial Conduct Authority (the "FCA") within applicable time limits. I am satisfied that this requirement has been met.

9. Section 109 requires a "scheme report" to be provided in a form approved by the PRA following consultation with the FCA. I have a report prepared by Mr John Jenkins (the "Independent Expert"), a Fellow of the Institute and Faculty of Actuaries and a Principal at Milliman LLP. The Independent Expert's appointment was approved by the PRA following consultation with the FCA and so has the form of report. The requirements of s109 are accordingly met.

10. There are two further technical requirements:

    i) S111(2)(a) requires that an "appropriate certificate" has been obtained. That is a certificate under paragraph 2(1)(a) of Part I of the Schedule 12 to FSMA given by the PRA confirming that Phoenix will, taking the proposed transfers of insurance business to it into account, possess the necessary margin of solvency before the Scheme takes effect. Such a certificate has been provided.

    ii) Section 111(2)(b) requires that Phoenix has the requisite authorisation under FSMA to carry on the business transferred. The PRA has confirmed satisfaction of this condition.

11. It follows that the necessary preconditions for the Court to consider the Parties' application are satisfied. That leaves the requirement of s111(3) with which much of this judgment will be concerned, namely whether the Court is satisfied that in all the circumstances of the case it is appropriate to sanction the Scheme.

The proper approach to the exercise of the Court's discretion

12. *Re Prudential Assurance Company Limited* [2020] EWCA Civ 1626 ("*Prudential CA*") contains guidance, binding on me, on the proper approach to the statutory question set out in s111(3). I have borne the entirety of the Court of Appeal's guidance in mind and will simply summarise the essence of the approach I should follow in this case.

13. The Court has a wide discretion indeed under s111(3). Moreover, that discretion must be exercised against the backdrop of the fact that stakeholders have had no opportunity to "vote" on the Schemes. The present application, therefore, is very different from (for example) an application under Part 26 of the Companies Act 2006 which creditors or members have already approved. Since the discretion is so broad and since stakeholders have not been given any opportunity to vote on the Schemes, it is not possible to set out general criteria that will determine how the discretion should be exercised in any particular case.

14. A critical first step is to identify the nature of the business being transferred and the underlying circumstances giving rise to the Scheme. That is largely to identify the stakeholders whose interests are to be considered, the respective interests of those stakeholders and the extent to which any question of fairness as between competing interests of different stakeholders could arise.

15. The Court's discretion is unfettered and is not to be exercised by way of a rubber stamp. That said, the Court has the benefit of evaluations performed by the Independent Expert, the PRA and the FCA (together the "Regulators") and the boards of directors of the Parties. The Independent Expert has considerable expertise and has drawn on the expertise of other highly experienced professional advisers before reaching his conclusions summarised in paragraph 38 below and considered later in this judgment. The Regulators do not suggest that the Court should not approve the Scheme. These opinions are not determinative, but full weight must be accorded to them so that the Court should not depart from them without significant and appropriate reasons – particularly as regards financial and actuarial assessments that have been performed on the security of financial benefits. The Court should take the same approach when considering more general comparisons between the positions that would exist with or without the Scheme in respect of security of policy holder benefits and standards of service or corporate governance. In that connection, the Court should consider contractual rights and reasonable expectations of policyholders, including the standards of service and governance that can be expected if the Scheme is implemented.

16. The Independent Expert has a status that is <u>similar</u> to that of an expert witness in adversarial litigation whose duties are governed by CPR 35.3. However, the present application is not made in the context of normal adversarial litigation in which opposing parties can call evidence (including expert evidence) and test each other's evidence by cross examination. The statutory code therefore envisages a somewhat different role for the Independent Expert from that performed by an expert witness in adversarial litigation. In the words of Pumfrey J in *In re Eagle Star Insurance Company Limited*, [2006] EWHC 1850 (Ch), the report of the Independent Expert is intended to be "an objective assessment of the scheme by a person to whom the importance of retaining their independence and objectivity has been repeatedly emphasised".

17. The Court must carefully scrutinise the reports of the Independent Expert and the Regulators, not with a view to substituting its own expertise for theirs, but so that it can understand and test their reasoning. That will enable the court to identify any errors,

omissions, or instances of inadequate or defective reasoning that might undermine the weight to be given to those opinions.

18. Those guidelines set out the parameters within which the Court must address the crucial question of whether the Scheme will have any material adverse effect on policyholders, employees or other stakeholders. For these purposes, an adverse effect will be material to the Court's consideration only if it is: i) a possibility that cannot sensibly be ignored having regard to the nature and gravity of the feared harm in the particular case, ii) a consequence of the Scheme and iii) material in the sense that there is the prospect of real or significant (as opposed to fanciful or insignificant) risk to the position of the stakeholder concerned.

19. Even if the Court finds that the Scheme will have a material adverse effect on some stakeholders, it may still sanction the Scheme in the exercise of its discretion. If there are differential effects on the interests of different classes of person affected, the Court will need to consider whether the proposed Scheme is fair as between those interests.

20. The Court's choice is between sanctioning the Scheme and declining to sanction it. It cannot require applicants to vary or alter the Scheme (although applicants may choose to do so in order to address concerns identified by the Court). In a related point, the Court should not withhold its sanction of a scheme on the basis that a better scheme could have been found. The question is whether the Court should sanction the scheme that is before it.

OVERVIEW OF THE SCHEME

The parties

21. The Parties to the Scheme are all direct or indirect wholly owned subsidiaries of Phoenix Group Holdings Plc ("PGH") and so are members of what I will call the "PGH Group". Therefore, all the insurance business transfers proposed are transfers intra group rather than between independent enterprises. The rationale for the Scheme is, at least in part, a "group rationale" – namely to rationalise the number of regulated entities within the PGH Group to give rise to long-term capital operational and administrative efficiencies.

22. PLAL is incorporated in England and Wales. It carries on long term life assurance business, although it is closed to new business. It has previously accepted business by way of Part 7 transfer. As at 31 December 2022 PLAL's business consisted of 700,000 policies held in five funds, four of which are with profits and the fifth is a "non-profit" fund. As at that date PLAL's Best Estimate Liabilities ("BEL") which, as will be discussed later, represents the present value of its future liability cash flows was approximately £7.9bn.

23. SLAL is incorporated in Scotland. It was established following demutualisation of The Standard Life Assurance Company ("SLAC") in 2006 (the "SLAC Demutualisation Scheme"). SLAL also in 2011 received a transfer of business to it under Part 7 from Standard Life Investment Funds Limited. SLAL carries out long-term insurance business. As at 31 December 2022 it had issued 4.3m policies which were held in five funds, four of which are with-profits. Its BEL (net of reinsurance) at 31 December 2022 was £112.9 bn.

24. SLPF is incorporated in Scotland. It carries on a long term insurance business that is much smaller than that of PLAL and SLAL. As at 31 December 2022, its business

consisted of approximately 360 annuity contracts held in a single fund. Its BEL (net of reinsurance) was nil because its liabilities were entirely reinsured to SLAL. Its assets on that date were some £17m and it had a surplus over its regulatory capital of some £7.5m. The share capital of SLPF is held as an asset of the SLAL Heritage With Profits Fund (the "Heritage WPF").

25. Phoenix (the proposed transferee) has accepted business following Part 7 transfers on several occasions. As at 31 December 2022, its business consisted of approximately 3.7 million policies which were held in 11 funds, 10 of which are with-profits. Its BEL (net of reinsurance) was £42.2 bn as at 31 December 2022.

The Scheme itself

26. The Scheme is a complex document reflecting the fact that it is dealing with the transfer of a large number of policies, held in a large number of funds and that a number of the policies have been the subject of previous Part 7 transfers. Moreover, the Scheme seeks, in large measure, to supersede the provisions of previous Part 7 schemes and so addresses the interaction with those previous schemes. Accordingly, the Scheme is not susceptible to a short summary and I summarise the broad areas in which it has effect.

27. Insofar as it deals with the transfer of policies of insurance from PLAL, SLAL and SLPF (the "Transferors") to Phoenix, the Scheme is what is frequently described as a "lift and drop" scheme. It operates to transfer the legal rights and obligations of the Transferors relating to the transferring policies, associated assets and liabilities and certain reinsurance contracts with non-group companies to Phoenix. The overall intention is that, subject to some exceptions and variations, policyholders are to have the same rights after the Scheme as they had prior to the Scheme albeit that, as regards policies that are transferred, the policyholders' rights are against Phoenix rather than the Transferors.

28. With-profits policies are allocated to new ring-fenced with-profits funds in Phoenix which will mirror the ring-fenced with-profits funds in PLAL and SLAL from which they have been transferred. Similarly, "linked funds" in PLAL and SLAL which are currently used to calculate policyholder benefits will be replicated in Phoenix albeit that all the non-profit business not allocated to with-profits funds will be allocated to Phoenix's non-profit fund. The Scheme does not simply transfer assets: it transfers liabilities as well. The liabilities transferred include most notably liabilities under policies of the Transferors but also include liabilities for mis-administration or for mis-selling.

29. There is no change to the administration of the policies of the Parties as a result of or under the terms of the Scheme.

30. The Scheme contains customary provisions intended to ensure continuity of proceedings, references, mandates and pension schemes so that, very broadly, Phoenix steps into the shoes of the Transferors as regards the transferred policy, asset or liability in question.

31. That said, there are some aspects in which the Scheme does not effect a pure "lift and drop". For example:

    i) the Scheme envisages that some policies might not be capable of moving: for example policies owned by persons sanctioned under the Russian Sanctions Regulations. Such policies are described as "Excluded Policies" and remain liabilities of the relevant Transferor. However, such liabilities are fully re-insured

into Phoenix so that they are, at least contractually as between Phoenix and the relevant transferor, a liability of Phoenix.

ii) The NPI WP Fund is an existing fund of Phoenix which has allocated to it the with-profits investment element of policies held in the Phoenix Non-Profit Fund which element has been wholly reassured to the Pearl WP Fund maintained by PLAL. Once that becomes a fund of Phoenix, the reinsurance arrangement collapses and the internal equivalent arrangements can be effected between the Phoenix Non-Profit Fund and the Phoenix Pearl WP Fund without any NPI WP Fund being needed.

iii) SLPF's liabilities are currently 100% reinsured into the Heritage WPF. Therefore, post-Scheme, SLPF's assets and liabilities will be allocated to the Phoenix Heritage WP Fund. The reinsurance arrangement presently in place between SLAL and SLPF will, accordingly, not be replicated following the Scheme.

32. Part E of the Scheme contains detailed provisions for the operation of the funds within Phoenix, including as to merger and closure and the distribution of surpluses. These provisions give rise to the possibility that particular categories of policyholder might be subject to some difference in treatment after the point at which they become policyholders in Phoenix as compared with their pre-Scheme position. For example:

i) The Scheme allows Phoenix to re-allocate non-profit business out of its with-profits funds at fair market value and with the approval of the "With-Profits Committee". Certain policyholders, including policyholders whose policies transferred under previous Part 7 Schemes, will not have been affected by a similar provision before. That said, the SLAC Demutualisation Scheme contained specific provisions relating to reallocation out of the Heritage WPF and the Scheme replicates that protection.

ii) For the with-profits funds not currently held in SLAL, the provisions relating to the merger and closure of those funds ("sunset clauses") will largely be harmonised to a common standard although the Heritage WP Fund, will continue with its own bespoke closure regime subject to some minor adjustment.

iii) As regard the linked funds that are not currently with SLAL, the Scheme removes the threshold at which Phoenix can consider closure or winding-up so as to give Phoenix greater flexibility in managing funds which are of a decreasing scale. The Scheme includes safeguards applying to the exercise of this power, including a requirement that the action in question complies with applicable laws and regulations, is not prohibited by the terms of the relevant policies and is equitable between policyholders having regard to the advice of the Phoenix Chief Actuary (or a Customer Director). Linked funds currently held within SLAL are not currently subject to a threshold limit before they can be closed but the safeguards just mentioned will apply to the former SLAL linked funds following the Scheme.

iv) As is to be expected, PLAL, SLAL and Phoenix, adopt broadly similar capital policies since they are part of the same group. However, those capital policies are not entirely aligned partly for reasons of history. For example, the SLAC Demutualisation Scheme (which affected SLAL only) imposed on SLAL a requirement to carry on its business, to the extent reasonably practicable, in such a way as to avoid a foreseeable risk of a "Capital Event". The harmonised capital policy provided for by the Scheme, very broadly, "levels up" by taking the most

onerous requirements that applied in the separate capital policies that PLAL, SLAL and Phoenix currently employ and also incorporates the requirement relating to the avoidance of a Capital Event that previously affected SLAL only.

v) Certain of the Part 7 schemes to which the Parties are currently subject require an annual certification of compliance with the applicable scheme and/or with specific provisions of the applicable scheme. Considering that these requirements simply duplicate ongoing compliance processes which will be ongoing independently of any formal certification requirements, it is proposed that these requirements will not be included in the Scheme.

vi) The provisions for the retention of units in the linked funds of SLAL will be modified. For unit linked business in the Heritage WPF, the SLAC Demutualisation Scheme requires the shareholder to hold units in the linked funds at least equal to the value of the units allocated to policyholders. However, that has been overtaken by changes in regulation since the date of that scheme which allows a firm to retain a lower value of units, in recognition of the value of future management charges that will emerge over time, a process known in the industry as unit matching. The Scheme contains provisions which enable unit matching to be carried out in this business.

vii) Previous Part 7 schemes contained provisions under which those schemes could be modified. There were some differences in detail between the wording of these various modification provisions. The Scheme will contain a modification provision to the effect that any amendment must not "materially adversely affect the security or reasonable expectations of affected policyholders". The wording in previous schemes (for example the PLAL 2015 Scheme) referred simply to an "adverse" effect without mentioning the concept of materiality.

viii) The Scheme will make some changes to the existing "Principles and Practices of Financial Management" ("PPFM documents") that apply to the transferors and to Phoenix, largely to update them to a common standard and update terminology.

33. As foreshadowed in some of the analysis above, it is proposed that the Scheme is to become the governing scheme for all of the existing business of Phoenix and for the business that is transferred to Phoenix pursuant to the Scheme. As a result of this harmonisation, certain earlier schemes under which insurance business was transferred to a company that was, or is now, a member of the PGH Group will either be superseded completely or will be amended so as to operate in the new environment. However, and importantly, where a previous scheme is one under which obligations are owed by a member of the PGH Group to a third party the relevant obligation owed to that third party will either continue to be, or will become, owed by Phoenix.

34. The Scheme provides that, if sanctioned, it is to become operative in accordance with its terms at 23.59 BST on 27 October 2023. It contains provisions designed to ensure that the Parties (as distinct from third parties affected by the Scheme) can treat the Scheme as having taken effect at 23.59 BST on 30 September 2023. That is achieved by Clause 38 of the Scheme which introduces the defined phrase "with effect from the Effective Date", making it clear that this means simply that as between the Parties they will, so far as possible, treat the scheme as effective from the earlier date with the concept having no effect on third parties.

Stakeholders affected by the Scheme

35. In my judgment, the principal categories of stakeholder whose interests should be considered are as follows:

    i) Policyholders in the Parties (to include those whose policies are transferred to Phoenix and persons already holding Phoenix policies). They have an interest in the following matters:

        a) ensuring that benefits due under their policies are paid;

        b) ensuring that their existing reasonable expectations in connection with "with profits" policies remain;

        c) ensuring that they retain the benefit of comparable standards of service, administration and governance applicable as they had prior to the Scheme.

    ii) Some individuals who do not themselves hold policies in any of the Parties are nevertheless stakeholders because the Scheme will affect previous transactions with some of the Parties. The most significant stakeholders in this category are (i) certain policyholders in SL International DAC ("SL Intl"), a designated activity company incorporated in Ireland and (ii) a class of persons ("Property Linked Beneficiaries") who hold property-linked reinsurance policies issued by SLAL. SL Intl and Property Linked Beneficiaries currently have security under floating charges granted by SLAL, a Scottish company. There are some doubts as to whether the Scheme can operate to convert those floating charges into floating charges of Phoenix with the result that Phoenix has granted new floating charges to SL Intl and the Property Linked Beneficiaries. However, a "hardening period" applies to those new floating charges with the result that there will be a period after the Scheme during which SL Intl and the Property Linked Beneficiaries are unsecured.

    iii) External shareholders in the PGH Group who will wish to ensure that the Scheme does not erode their economic interests by, for example, giving rise to excessive costs or tax charges that are not offset by countervailing benefits.

    iv) Employees of the PGH Group generally who will be interested in the effect that the Scheme has on either their terms or security of their employment.

    v) Reinsurers who will be interested in the extent to which the Scheme could affect their liabilities under existing reinsurance contracts.

36. Since the Scheme affects with profits policies, conceptually at least, questions could arise as regards fairness between different classes of with profits policyholder, and between with profits policyholders and shareholders. However, in my judgment, there are reasons why such considerations of fairness do not arise in this case:

    i) The proposal is that all of the Transferors transfer their entire businesses to Phoenix. Some policies may have to be left behind (for example those owned by sanctioned individuals) but they will be the overwhelming exception. Accordingly, it is not necessary to engage with the question of whether any constituency of with-profits policy holder is adversely affected by a decision to transfer some policies but leave others behind.

ii) The “lift and drop” nature of the Scheme means that there is a strong structural reason why transferring policyholders’ expectations of the performance of with profits policies after the Scheme will be similar to their expectations of such performance before the Scheme.

iii) Similarly, the “lift and drop” nature of the Scheme means that incoming Phoenix policyholders will be allocated to a new with-profits fund that replicates the fund to which they were allocated in the relevant Transferor. It follows that existing Phoenix policyholders need not be concerned that the profitability of their existing with profits policies will be diluted as a consequence of transfers of business into Phoenix.

STAKEHOLDER ANALYSIS – POLICYHOLDERS IN THE PARTIES

37. The Independent Expert has produced two reports. His main report (the “First IE Report”) was dated 18 April 2023. He has supplemented that with a further report (the “Second IE Report”) dated 20 of September 2023 and two addenda (the “IE Addenda”) dated 2 October 2023 and 4 October 2023. The reports and addenda are impressive and detailed. I have no doubt that the Independent Expert is eminently well qualified to perform the important statutory role entrusted to him. I am reassured that the PRA and FCA evidently agree since they have approved his appointment.

38. For obvious reasons, the Independent Expert has placed the analysis of policyholders’ positions right at the heart of his two reports. In the First IE Report, he expresses the following conclusions:

i) that the Scheme will not have a material adverse impact on the reasonable benefit expectations of any type or group of policyholders (see paragraph 2.42);

ii) that the Scheme will not have a material adverse impact on the security of benefits for any category of policyholder (see paragraph 2.44);

iii) that implementation of the Scheme will not have a material adverse impact on standards of service administration, management and governance (see paragraph 2.46).

39. In the Second IE Report, the Independent Expert reflects on further information that has become available since the date of the First IE Report, including updated financial information to 30 June 2023 and confirms that the above conclusions remain unchanged (see Section 8 of the Second IE Report).

40. In my judgment, the Independent Expert has adopted a careful and rigorous approach before reaching his conclusions. As I have explained, those conclusions should be accorded full weight not least since they are to a large extent dependent on specialist financial and actuarial assessments which the Court is simply not equipped to perform for itself. That said, it is right that I enquire more deeply into the basis for the Independent Expert’s conclusions not least to check whether the various challenges and objections raised by objecting policyholders demonstrate a flaw in reasoning.

Security of benefits

Applicable principles of the regulatory regime

41. The Independent Expert's conclusions on the security of benefits can only be understood by reference to certain key concepts of the prudential regulation of companies carrying on long-term insurance business under the "Solvency II" regime which remains largely applicable in UK despite its departure from the EU.

42. Pillar 1 of Solvency II deals with a market consistent framework for valuing assets and liabilities. The determination of liabilities results in the calculation of the "BEL" to which I have referred in paragraph 22. That "best estimate liabilities" is determined by calculating a net present value ("NPV") of expected future obligations under insurance contracts using up-to-date financial information and best estimate actuarial assumptions. The NPV calculation itself is performed by discounting cash flows at risk-free interest rates. To this is added a "Risk Margin", an adjustment designed to reflect the fact that another insurer would require an additional incentive to take over and meet liabilities in an arm's length transaction. The sum of the BEL and the Risk Margin is referred to as the "Technical Provisions".

43. As noted, BEL is calculated by discounting future cash flows at risk-free interest rates. However, an insurer can apply to the PRA for permission to use a "Matching Adjustment". That reflects an increase in the discount rate used in the calculation of BEL and allows firms to take credit for the additional investment return in excess of the risk free rate that they expect to earn from a "hold to maturity" investment strategy for less liquid assets that are used to back their most stable and predictable liabilities (such as non-profit in payment annuities).

44. Solvency II imposes a "Solvency Capital Requirement" ("SCR"). An insurer must hold capital ("Own Funds") sufficient to ensure that its assets continue to exceed its Technical Provisions over a one-year time frame with a probability of 99.5%. This is a high degree of assurance. It means that after the occurrence of a one in 200 year adverse event, the insurer could both meet its outgoings during the following year and, having done so, retain sufficient resources to meet its Technical Provisions. A further way of understanding this is that one year after the occurrence of a one in 200 year adverse event, the insurer would retain sufficient resources to enable it to transfer its obligations to a third party on payment of the necessary Risk Margin.

45. Also important is the minimum capital requirement ("MCR") which is calculated more formulaically than SCR. Its function is somewhat different from the SCR: it is simpler and less risk-sensitive than the SCR and is designed to identify a point at which intensive regulatory intervention would occur.

46. In addition to the above requirements that are imposed by the PRA, firms typically have their own capital policies which prescribe how much capital above the SCR they choose to hold and, as Mr Moore KC helpfully summarised it, a series of "traffic lights" that enable management actions to be taken if it appears that the capital policy might be breached.

The Independent Expert's reasoning on security of benefits

47. The length and detail of the Independent Expert's reports means that they are not susceptible to any short summary. However, Table 4.1 in the Second IE Report (extracted

below) contains figures that are important to the Independent Expert's overall conclusions:

Table 4.1 - Phoenix, SLAL and PLAL UK Solvency II balance sheet as at 30 June 2023

£m	Pre-Scheme				Post-Scheme	Difference
	Phoenix	PLAL	SLAL	Total	Phoenix	
Own Funds (**A**)	3,929	1,485	4,396	9,809	9,791	(18)
RFF Restriction (**B**)	358	311	1,398	2,067	2,009	(58)
SCR **(C)***	2,275	751	1,900	4,927	4,434	(493)
Excess Own Funds (**D=A-B-C**)	1,295	422	1,097	2,815	3,347	532
Solvency Coverage Ratio – as per regulatory returns ((A-B)/C)						
	157%	**156%**	**158%**	**N/A**	**175%**	**N/A**
Solvency Coverage Ratio – Shareholder (Actual)**						
	175%	**230%**	**184%**	**N/A**	**220%**	**N/A**
Solvency Coverage Ratio – Shareholder (Actual, Adjusted for Comparison with Capital Policy Target)***						
	175%	**230%**	**163%**	**N/A**	**210%**	**N/A**
Solvency Coverage Ratio – Shareholder (Capital Policy Target)***						
	139%	**146%**	**135%**	**N/A**	**138%**	**N/A**

48. This table does the following:

i) It compares various individual Solvency II metrics of Phoenix, PLAL and SLAL as at 30 June 2023 with the same solvency metrics of Phoenix that would arise if the Scheme had been effected on 30 June 2023. (As a small point of detail, the metrics assume that certain loans made by PLAL and SLAL to their parent companies were actually dividends since the evident intention is that those loans will be "converted" into dividends once the distributable reserves of PLAL and SLAL are confirmed.)

ii) Having calculated Solvency Coverage Ratios on a "shareholder" basis, both on a pre-Scheme basis and a post-Scheme basis, it then makes adjustments to those calculations so that they can sensibly be compared with the Capital Policy Target. The last two rows of the table accordingly show Solvency Coverage Ratios materially in excess of 100% (demonstrating that the SCR is significantly exceeded) and also significantly in excess of the Capital Policy Target.

49. The Independent Expert notes that the Solvency Coverage Ratios of Phoenix on a "shareholder" basis (post-Scheme) are lower than the corresponding ratios of PLAL (pre-Scheme) and considers whether this produces a material adverse effect for PLAL policyholders consisting of a greater risk of policy benefits going unpaid following the Scheme. He concludes that there is no such material adverse effect for at least two reasons:

i) PLAL's Solvency Coverage Ratio prior to the Scheme was in excess of the Capital Policy Target. Similarly, Phoenix's Solvency Coverage Ratio following the

scheme is projected to be materially in excess of that target. If the Scheme did not take place, the shareholder in PLAL would be entitled, subject to applicable regulatory constraints, to access the amount of capital that was in excess of the Capital Policy Target. The same would be true of Phoenix following the Scheme. Accordingly a PLAL policyholder could have no assurance that the significant excess over the Capital Policy Target would be retained with the result that the modest decrease in the amount of that excess cannot fairly be described as a material adverse effect.

ii) Even if, contrary to the point made in paragraph i) above, some significance is to be attached to capital in excess of both SCR and Capital Policy Target (albeit that the Independent Expert attaches none), there can be no material adverse effect in reducing the magnitude of that excess since simply meeting SCR alone already gives a high level of assurance to policyholders.

50. I do not consider that either of these conclusions involves any flawed analysis or defective reasoning. The proposition in paragraph 49.i) follows from principles of insurance company regulation that are described in the Independent Expert's reports. Moreover, both that proposition and the one set out in paragraph 49.ii) have been accepted in in judgments of the High Court previously (see, for example, paragraphs [46] and [47] of the judgment of Snowden J (as he then was) in *Re HSBC Life (UK) Limited* [2015] EWHC 2664 (Ch) and paragraphs [33] to [39] of the judgment of Henderson J (as he then was) in *Re Rothesay Assurance Limited* [2016] EWHC 44 (Ch)).

<u>Dr Buckner's and Mr McAteer's criticisms of the Independent Expert's conclusion on security of benefits</u>

51. In his written submissions, Dr Buckner explained that he has experience in the Matching Adjustment aspect of the Solvency II capital regime and in the valuation of equity release mortgages derived from over 30 years that he has spent working in the financial services industry. He has worked at the Bank of England, the (then) Financial Services Authority and the PRA. His submissions were of real use to me.

52. Mr McAteer's submissions echoed Dr Buckner's concerns. Rather than focusing on the technical or policy aspects (as Dr Buckner did), Mr McAteer drew on his many years of experience, both as a consumer advocate and in senior roles within the FCA and its predecessor, the Financial Services Authority, to provide a valuable perspective on what he saw as adverse effects for policyholders.

53. This is not adversarial litigation in which the Court is asked to choose, as a factual matter, between the competing views of two experts. That is firstly because the Court's role that I have summarised in paragraphs 12 to 20 is very different from the role that it has in adversarial litigation. Moreover, despite their undoubted expertise, neither Dr Buckner nor Mr McAteer is sufficiently independent to qualify as an expert witness for the purposes of CPR 35, even if either had purported to provide an expert report to which CPR 35 applies, which they have not. Therefore, I approach both Mr McAteer's and Dr Buckner's submissions on the basis that they do not represent independent expert opinion given by persons who owe a duty to the Court, but rather instead as a guide to my own review of the Independent Expert's reports and areas in which those reports might contain errors, omissions, or instances of inadequate or defective reasoning.

54. That introduces a further point. Given the full weight that has to be given to the conclusion of the Independent Expert, I should not decide to refuse to sanction the

Scheme simply because Dr Buckner expresses a disagreement, even a strong and cogent disagreement, with the views of the Independent Expert on a question of judgment or opinion. Professionals can disagree on such questions without one, or the other's reasoning being flawed or defective.

55. In his detailed criticisms of the reports of the Independent Expert, Dr Buckner did not challenge the conclusions as to the significance of "excess" capital summarised in paragraph 49, which provides me with further reassurance that those conclusions are not flawed. Rather, Dr Buckner aimed at different targets arguing that the following factors meant that Phoenix's capital position was much less secure than the Independent Expert's reports suggested:

    i) Phoenix's use of the Matching Adjustment (a construct that Dr Buckner argues is fundamentally flawed).

    ii) The Independent Expert's Table 4.1 shows that the SCR of Phoenix post-Scheme reduces by some £493 million following the Scheme as compared with the aggregate SCRs of PLAL, SLAL and Phoenix prior to the Scheme. Some £354 million of that reduction is said to be supported by diversification benefits generated by the consolidation of the policies previously held in three separate companies. Dr Buckner argues that these diversification benefits are materially overstated.

    iii) Phoenix's exposure post-Scheme to unrated debt has, Dr Buckner argues, not properly been reflected in the Independent Expert's conclusions.

    iv) There is incremental risk associated with the prospect of falls in value of residential and commercial property that have not been properly reflected in the Independent Expert's conclusions.

    v) Phoenix has impermissibly mis-stated its exposure to its "No Negative Equity Guarantee" ("NNEG") given in connection with its equity release profits by factoring in future increases in property values.

56. Dr Buckner introduced his oral submissions on the issues above by asking two questions of the Court which he considered should be answered in its judgment. His first question was whether the "source" of an adverse effect mattered. His second was whether the Court was equipped to deal with some highly technical matters and, if so, whether it should address those matters as part of its evaluation. Dr Buckner raised his first question because he evidently considers that the Matching Adjustment is a "source" of a material adverse effect even though it is part of the regulatory landscape. He raised his second question to test the extent to which the Court was prepared to consider the detail of his objections which raised technical issues, on matters of actuarial calculations and regulatory theory. However, I do not consider that Dr Buckner's abstract questions need an answer. The question for the Court is whether the points that Dr Buckner raise indicate that, applying the approach outlined in paragraphs 12 to 20 above, the Court should withhold sanction of the Scheme.

57. Mr McAteer joined in Dr Buckner's criticisms of Phoenix's use of the Matching Adjustment and the assumed availability of diversification benefits. However, he left the detailed criticisms based on the technical application of the rules, or considerations of policy, for Dr Buckner to pursue. Mr McAteer stressed the effect on policyholders. He submitted that, whether the Matching Adjustment is sound in principle or not, and

whatever the merits of the debate on diversification benefits, the position is at least debatable. He argued that the Independent Expert has not adequately dealt with the controversy in his reports and, that given the controversy, the Court should not sanction the Scheme which will result in a material reduction in the SCR of Phoenix post-Scheme as compared with the position of the Parties pre-Scheme.

The Matching Adjustment

58. Dr Buckner made written submissions explaining why he considers the Matching Adjustment to be a flawed construct. I mean no disrespect to him in not setting these out in full. However, for reasons that I will now explain, I consider that I should not make any determination as to the validity or otherwise of Dr Buckner's arguments on this issue.

59. The fundamental point is that the regulatory regime applicable to the Parties permits them to use the Matching Adjustment within appropriate regulatory constraints. The Independent Expert is evidently satisfied that Phoenix's proposed use of the Matching Adjustment falls within those constraints. The PRA has performed its own review of the Scheme and the Independent Expert's conclusions which are set out in the PRA's detailed reports. The PRA evidently had no concerns that Phoenix will be using the Matching Adjustment impermissibly or excessively or it would have said so in those detailed reports. Moreover, both the Independent Expert and the PRA have reflected on possible changes to the Matching Adjustment regime that are currently subject to consultation.

60. Dr Buckner's position is that the Matching Adjustment should not be permissible at all. That is a question of policy that is for regulators to determine in the light of their detailed understanding of the issues to which the Matching Adjustment gives rise. It is not something that this Court can or should determine, particularly given the Court's function which I have summarised in paragraphs 12 to 20 above.

61. I respectfully agree with the conclusions to similar effect that Trower J expressed at [86] of his judgment in *Re Prudential (No. 3)* and conclude that the concerns of Dr Buckner and Mr McAteer relating to the Matching Adjustment should not cause me to decline to sanction the Scheme.

Diversification benefits

62. A highly simplified example illustrates the nature of this disagreement. Suppose that Company A has a business that gives it £1000 of exposure to Risk 1 and Company B has a business giving it £1000 of exposure to Risk 2. If regulators require both Company A and Company B to hold £100 of capital against their respective risks then Company A and Company B between them are required to hold £200 of capital. However, suppose that Risk 1 and Risk 2 are mutually exclusive: if Risk 1 transpires, Risk 2 will not and vice versa. In that case, if the businesses of Company A and Company B are brought together in a third company (Company C), the mutually exclusive nature of the risks means that Company C has exposure to only £1000 of risk and so requires only £100 of capital. In short, the bringing together of different risks, previously run by separate companies, into a single company can reduce the amount of capital needed to be held against those risks with the amount of the capital saving dependent on the correlation between the risks in question.

63. In paragraph 9.23 of the First IE Report, the Independent Expert concludes that the diversification benefit implicit in the determination of Phoenix's SCR post-Scheme is plausible. Dr Buckner criticises that conclusion, arguing that it is based on a flawed assumption (made manifest in Table F.1 in Appendix F of the First IE Report) that there

is a 50% correlation between the respective risks of SLAL, PLAL and Phoenix. More generally, Dr Buckner argues that the risks of these companies cannot be as uncorrelated as the Independent Expert suggests since all of them are significantly exposed to two principal risks, namely credit risk and mortality risk. In those circumstances, he argues that the principle of "stochastic dominance" applies with the result that combining all of those risks into a single company cannot produce anything like the diversification benefits that the Independent Expert considers to be plausible.

64. I am not satisfied that these criticisms demonstrate errors, omissions, flaws or defective reasoning that should cause me to reduce the weight given to the Independent Expert's reports. I do not agree with Dr Buckner's point that the Independent Expert's analysis is based on an assumption of a 50% correlation in the respective risks. The Independent Expert has explained in paragraphs 15 to 22 of his Second Addendum to the Second IE Report that the 50% figure used in Appendix F was a simplification designed to explain the concept of diversification benefits rather than to underpin the calculation of the actual diversification benefits arising in Phoenix.

65. Moreover, the Independent Expert has, in Table 4.5 of the Second IE Report, shown an awareness that Phoenix, PLAL and SLAL are subject to the same kinds of risk. However, his point is that they are subject to those risks in differing proportions. So, for example, in PLAL what the Independent Expert characterises as "insurance risk" predominates, accounting for 59% of PLAL's risk exposure. By contrast, in Phoenix, "credit risk" predominates (accounting for 45% of Phoenix's total risk) with insurance risk accounting for just 22% of total risk. I am not, therefore, satisfied that the Independent Expert's reports overlook the matters to which Dr Buckner refers. Rather, as I understand it, the Independent Expert acknowledges that the aggregate portfolio of risks suffered by the various companies is the same, and recognises the concept of stochastic dominance, but concludes that once the magnitude of the respective companies' exposure to these various risks is taken into account, there remain diversification benefits when all those risks are combined in Phoenix. Perhaps there can be different approaches to the calculation of the diversification benefits so arising but I am not satisfied that there is a flaw or defective reasoning in the Independent Expert's approach

66. Paragraph 9.25 of the First IE Report also makes an important point that the diversification benefits of which Dr Buckner is critical are already reflected in the calculation of capital at the PGH level. Accordingly, the calculation of diversification benefits has been subjected to previous scrutiny of the PRA. In those circumstances, I see no flaw of reasoning in the Independent Expert's conclusion in paragraph 9.25 and 9.26 of the First IE Report, taking into account those benefits at the Phoenix level does not result in any material adverse consequence for policyholders.

Unrated debt

67. Dr Buckner noted that the proportional exposure of Phoenix to unrated debt will be greater than the exposure of PLAL and SLAL. He made two points in connection with that:

    i) He argued that this highlighted the riskiness of the Matching Adjustment position since claiming a Matching Adjustment as regards unrated debt is inherently a more debatable proposition than it is in connection with rated debt. That point is already addressed in my conclusions on the Matching Adjustments set out above. Claiming a Matching Adjustment as regards any debt is subject to the satisfaction of regulatory requirements imposed by the PRA and so this aspect of Dr Buckner's

criticism also amounts to an assertion that the Matching Adjustment and/or the regulatory restrictions on its use are flawed.

ii) He argued that the higher exposure means that transferring policyholders in PLAL and SLAL would therefore be taking on greater risk in their capacity as policyholders of Phoenix than they were previously. However, the incidence of exposure to unrated debt is a factor that will be taken into account in the calculation of Phoenix's SCR and own funds. Dr Buckner may well disagree with the significance of that factor, but it does not follow that the Independent Expert has made any flaw of reasoning in his conclusions as to the adequate capitalisation of Phoenix post-Scheme. Moreover, as Ms Shah explained in her submissions on behalf of the PRA, unrated debt is not necessarily a "bad" investment and is quite capable of being a sensible component of a wider portfolio.

Other points raised by Dr Buckner and Mr McAteer

68. Dr Buckner criticised aspects of the Independent Expert's reports which refer to "stress tests" or "sensitivity analyses" as being confused. He argued that a "sensitivity" analysis involves an enquiry as to what the effect would be of a particular event on a set of figures without any analysis of the probability of the event in question. By contrast, a "stress test" is concerned with the effect of large, but plausible, changes in risk factors. However, beyond mentioning differences in terminology, this aspect of Dr Buckner's criticisms did not demonstrate a specific material adverse effect which the Independent Expert's reports overlooked.

69. Dr Buckner made the specific point that in his analysis of either the "stress" that a fall in property values would have on his conclusions (or the "sensitivity" of those conclusions to a fall in property values), the Independent Expert had been unduly optimistic. He suggested that in Table 9.7 of the First IE Report, the Independent Expert had factored in the effect of just a 15% reduction in commercial property values which he suggested was inadequate in view of the fact that available data suggested that all-property capital values have fallen by 20% since July 2022.

70. I do not consider that this reveals an error, omission or instance of defective reasoning in the Independent Expert's reports. The Independent Expert has based his conclusions on financial information as at 30 June 2023. Falls in value of the Parties' holdings of commercial and other property will be reflected in those figures and so reflected in the Independent Expert's calculations. Moreover, I do not consider it accurate to say that the Independent Expert has limited his sensitivity or stress analysis to a 15% reduction in commercial property. Paragraph 9.28 of the First IE Report suggests that the effect of a fall in property values of 33% has been considered. Moreover, the table in paragraph 9.7 refers to "Additional Sensitivities" being considered that include a 20% fall in the value of commercial property.

71. Dr Buckner referred to the basis of valuation of the NNEG given in connection with the PGH Group's equity release mortgage business as disclosed in the 2022 Group Annual Report. He suggested that this impermissibly took into account assumptions about future house price inflation. However, I do not consider that this reveals any flaws in the Independent Expert's reports. Accounting standards will determine the way in which derivatives are to be valued in financial statements which might well differ from the basis to be used for prudential regulatory purposes. Accordingly, the fact that future house price inflation was factored into a valuation used in the Group's accounts does not of

itself suggest any problem with the way in which the Independent Expert has approached that valuation for the purposes of the calculation of SCR which is prepared on a different basis from the accounts.

72. Finally, in an email sent to my clerk during the hearing, Dr Buckner referred to the following note in the Group's 2022 Annual Report:

> The net adverse investment return variances and economic assumption changes on long-term business and owners' funds of £2,673 million in 2022 (2021: adverse £1,125 million) reflect IFRS losses arising as a result of rising yields and inflation, and a widening of credit spreads. The impact of equity, interest rate and inflation movements on future profits in relation to with-profit bonuses and unit linked charges is hedged in order to benefit the regulatory capital position rather than the IFRS net assets. The impact of market movements on the value of the related hedging instruments is reflected in the IFRS results, but the corresponding change in the value of future profits or Solvency Capital Requirements is not. Such items are actively valued under Solvency II requirements but are either not recognised on an IFRS basis or are not revalued unless there is evidence of impairment (e.g. AVIF). This leads to volatility in the Group's IFRS results. (2022 AR p.189).

73. Dr Buckner referred to the note as "alarming". However, I do not read it that way and nor do I consider that it reveals any flaws in the Independent Expert's conclusions. As I read the note, the Group is disclosing that it enters into instruments with a view to hedging the impact of equity, interest rate and inflation movements on future profits in relation to with-profits bonuses and unit linked charges. It enters into those instruments to benefit its regulatory capital position. The effect of hedging in this way is that profits or losses on the hedging instrument are recognised in the IFRS accounts but the corresponding losses or profits as regards the effect on with profit bonuses, unit linked charges and SCR are not recognised in the accounts. This asymmetry results in accounting volatility even though the instruments in question serve as an economic hedge. I do not consider that to be "alarming", but rather simply as reflective of the general point that IFRS and Solvency II balance sheets can differ. Moreover, I do not consider that it is indicative of a material adverse effect on policyholders who would have been exposed to the economic effect of the above point before the Scheme, just as much as they are after the Scheme.

Reasonable benefit expectations

The Independent Expert's conclusions on reasonable benefit expectations

74. In paragraph 2.42 of the First IE Report, the Independent Expert concluded that the Scheme will not have a material adverse impact on the reasonable benefit expectations of any type or any group of policyholders. He confirmed that this remains his conclusion in paragraph 8 of the Second IE Report. The Independent Expert's conclusions in this regard took into account the various areas in which it might be said that there was some change to the position of policyholders that I have summarised in paragraph 32 above.

Challenges to the Independent Expert's conclusions

75. Mr Marshall explained in his written and oral submissions to the Court his concern that he would lose protections that he currently had as a policyholder under the Phoenix 2009

Scheme. He was also concerned that the Scheme would result in an increase in charges imposed on him as a policyholder. I consider those concerns to be largely misplaced. I see no flaw of logic or reasoning in paragraph 10.13 of the First IE Report in which the Independent Expert concludes that the Scheme will not have any impact on the operation of policies, charges and expenses that applied to policies and funds including asset management charges. In short, the Independent Expert concludes that whatever rights Mr Marshall currently holds as a policyholder under the Phoenix 2009 Scheme will be replicated following the Scheme. If, in his current capacity as a policyholder under the Phoenix 2009 Scheme, higher charges can be imposed either on Mr Marshall or on linked unit-linked funds, that will continue to be the case following the Scheme. Therefore, the Independent Expert is not offering Mr Marshall any guarantee that charges will not go up in the future. However, his reasoning does indicate that Mr Marshall would not suffer a material adverse effect consisting of reduced reasonable benefit expectations.

76. Mr Baker was concerned about the change summarised in paragraph 32.vii). He was concerned that applications could now be made to the court for the approval of changes that result in an "adverse effect" that falls short of being "material". He argued, therefore, that he would suffer an unwelcome reduction in the threshold that needs to be overcome before future amendments could be put to the Court. I do not consider this change in threshold requirement to be a material adverse effect on either Mr Baker or on policyholders in a similar position for the following reasons:

    i) Both the existing Part 7 schemes and the Scheme itself require an independent actuary to provide a certification of that actuary's opinion. The Independent Expert explains in Appendix C of the First IE Report that an actuary would expect to take into account the concept of materiality in performing such a task. I do not go so far as to say that as a matter of <u>construction,</u> a Part 7 scheme that contains a threshold condition expressed by reference to an "adverse effect" is always to be interpreted as meaning a "material adverse effect". However, Appendix C suggests to me that if an independent actuary is asked to express an <u>opinion</u> as to whether a particular "adverse effect" is present, that actuary will in framing the opinion, have regard to the concept of materiality. Accordingly, it seems to me that the practical difference between a "material adverse effect" and an "adverse effect" is likely to be minimal.

    ii) The relevant amendment provisions in both previous Part 7 schemes and the Scheme itself simply prescribed a threshold which must be overcome before an application can be made to the Court to amend a scheme. If, hypothetically, following the Scheme, Phoenix proposed an amendment which would result in policyholders like Mr Baker suffering an "adverse" effect, but the independent actuary certified that the effect was not "materially" adverse, the Court would retain full discretion not to sanction the amendment.

77. Mr Baker criticised the proposed changes to "sunset clauses" suggesting that, it would be much fairer, if Phoenix wished to invoke the clause, to pay some financial inducement to policyholders whose funds had been marked for closure. However, in my judgment that argument does not identify a "material adverse effect" for policyholders. Rather, it amounts to a suggestion that the Court should decline to sanction the Scheme because a "better" Scheme (at least in Mr Baker's opinion) could have been put forward. Given the approach mandated by the authorities which I have summarised in paragraphs 12 to 20 above, I do not consider I should do that. More generally, I see nothing to suggest that there is a flaw of logic or reasoning in the Independent Expert's conclusion in paragraphs 10.31 to 10.45 of the First IE Report to the effect that changes in the "sunset clauses"

will not give rise to a material adverse effect on policyholders' reasonable benefit expectations.

The effect of the Scheme on standards of service, administration, management and governance applicable to policies

The Independent Expert's conclusions

78. The Independent Expert concludes in paragraph 2.47 of the First IE Report that implementation of the Scheme will not have a material adverse impact on the standards of service, administration, management and governance applicable for any types or groups of policyholders. The Second IE Report confirms that the Independent Expert continues to hold that opinion.

79. The Independent Expert's conclusions in this regard were reached following analysis of the administration, management and governance arrangements in place prior to the Scheme and those that will be in place following the Scheme. The analysis also takes practical considerations into account and addresses specific areas (such as the proposed amendments to PPFMs and the removal of annual certification requirements) which will result in the post-Scheme position differing somewhat from the pre-Scheme position.

Challenges to the Independent Expert's conclusions

80. A number of objecting policyholders referred to instances of what they alleged to be poor customer service that they had received in the past. In their oral submissions, both Mr Marshall and Mr Baker referred to what they saw as Phoenix's poor customer service. Mr Baker suggested that the Court should seek some sort of assurance about the quality of Phoenix's future administration before sanctioning the Scheme.

81. It is natural that the process by which the Parties seek sanction of the Scheme results in policyholders who feel that they have had poor service coming forward to register an objection. However, the FCA has confirmed that while there have been instances in which complaints against the Parties made by policyholders have been justified, it does not consider that there are systemic failings in Phoenix as regards the quality of service administration and management. Therefore, while I quite accept that individual policyholders may well have suffered poor service on occasions, I do not consider that to be a reason to withhold sanction of the Scheme. More generally, I see nothing to call into question the Independent Expert's conclusion that there will be no material adverse effect on policyholders consisting of a decline in standards of service or administration.

SLPF

82. SLPF's liabilities are currently entirely re-insured to SLAL. The shares in SLPF are currently an asset of the Heritage WPF. The reinsurance arrangement means that the Independent Expert's conclusions to the effect that SLAL policyholders will not suffer a material adverse effect on the security of benefits or on reasonable benefit expectations also hold true in relation to SLPF policyholders. His conclusions on standards of service, administration, management and governance also apply to SLPF policyholders as well. I see nothing to doubt the logic of this conclusion and, accordingly, am not concerned that the Independent Expert does not address SLPF policyholders separately in great detail in his reports.

More general objection by policyholders

83. In my analysis above, I have referred to specific criticisms of the Independent Expert's central conclusions that policyholders (including policyholders who attended the hearing) have raised. In this section, I address more general objections, including matters that have been raised by policyholders not attending the hearing.

84. A number of objecting policyholders were concerned about the concept of a "material adverse effect" and both Mr Bloxham and Mr Baker made points in this regard in their oral submissions. The objections included the following:

    i) Some policyholders were concerned that the Independent Expert had certified only that the Scheme would not have a "material adverse effect". They noted that this left open the possibility that policyholders might suffer an adverse effect, but one that was not material, and that in view of this risk, the Scheme should not be sanctioned. However, there is nothing in that objection given that *Prudential CA* confirms that the relevant consideration is whether stakeholders will suffer a "material adverse effect".

    ii) In addition to his concerns discussed in paragraph 76 above, Mr Bloxham had another concern about the concept of "material adverse effect". He noted that some policyholders have already been subject to multiple Part 7 transfers. He canvassed the possibility of both an earlier Part 7 transfer and the Scheme itself giving rise to an adverse effect (though not a material one). He argued that conceptually the two Part 7 transfers might between them result in a material adverse effect even though neither such scheme did so individually. However, this was simply a "thought experiment" on Mr Bloxham's part. He did not explain how either he or other policyholders had suffered such an outcome. In any event, I considered the thought experiment to be flawed. Even if an earlier scheme did result in some kind of "adverse effect", it operated to reset policyholders' expectations. Accordingly, the position following the first scheme provides the "benchmark" which applies when determining whether the Scheme results in a material adverse effect. As *Prudential CA* confirms, I must address the effect of the Scheme. I do not consider that I am required to consider whether, following the Scheme, policyholders could be said to be in a materially worse position than they were at any point during which they have held a policy that has been subject to previous Part 7 transfers. In my judgment that would be an unworkable test.

85. Mr Bloxham thought that there was something unclear in the Independent Expert's confirmation in various places that he is "satisfied that the Scheme will not have a material adverse effect". I see no lack of clarity and conclude that the Independent Expert is providing a clear opinion. He could not be expected to give an unequivocal guarantee on a question that relates to future events and is outside his control. Mr Bloxham also expressed concern that the Independent Expert's statement to the effect that his report should be read as a whole somehow diluted the conclusions that he expressed in the Executive Summary and introduced a variety of qualifications by the back door. I do not agree. The First IE Report is a long and complex document. The injunction to read the document as a whole is inevitable and does not water down the conclusions that are expressed which are repeated later in the document with supporting reasoning.

86. Some policyholders were concerned that the proposals had received insufficient objective scrutiny. There was a concern that the Independent Expert might not truly be independent, that both he and the Regulators might have been given insufficient time to

consider the proposals, that the Independent Expert necessarily had to rely on information provided by the Parties or that the Independent Expert's views could be coloured by the fact that he is not assuming personal liability to policyholders for the contents of his reports. Mr Bloxham dealt with a number of these points in his oral submissions stressing that his criticisms were of the process rather than of the Independent Expert personally. Dr Buckner raised similar points.

87. I have considered these points carefully as objective scrutiny, both by the Regulators and by the Independent Expert is right at the heart of the statutory process for implementing Part 7 transfers. I am not satisfied that these concerns mean that I should decline to sanction the Scheme. As I have said, the Independent Expert's analysis is rigorous and detailed. Neither the PRA nor the FCA have expressed concerns as to the timetable within which they were required to work. I do not doubt the Independent Expert's independence. It would not be realistic to expect the Independent Expert to assume personal liability to some 4.7 million policyholders and I do not consider that the quality of his analysis is reduced by the absence of such liability. It is correct to say that the Independent Expert does have to rely on information provided by the Parties. However, much of that information has either been subject to external audit or has itself been considered by the Regulators. It simply would not be realistic to expect the Independent Expert to verify each and every piece of financial or other information with which he is provided.

88. A number of policyholders raised objections based on what they considered to be previous unsatisfactory experiences involving Phoenix. In some cases, that objection was put slightly differently, namely as a concern that Phoenix might lack, or choose not to provide, the administrative and other resources necessary to give a proper service following the Scheme. I have dealt with those points in my analysis of Mr Baker's similar concerns in paragraph 81.

89. Some policyholders were concerned, like Mr Marshall, that costs and charges to which they are directly or indirectly subject would rise as a result of the Scheme. I have dealt with that point in paragraph 75. This was an aspect of more general concerns voiced by some policyholders to the effect that Phoenix should be required to share the financial benefits of the Scheme either by reducing charges or by leaving a greater surplus in with-profits funds. I do not consider that to be a good reason for withholding sanction to the Scheme. My task is not to devise a Scheme that might strike these particular objecting policyholders as "fairer". Rather, my task is to decide whether to sanction the particular Scheme that has been put forward with the central question being whether stakeholders suffer a material adverse effect.

90. More generally, I have considered the 36 objections to the Scheme that are referred to in paragraph 6.12 of the First IE Report. Many of those objections raise themes that I have dealt with previously in this judgment. To the extent they do not, I simply note that I see no flaw in the Independent Expert's response to those objections: they are dealt with by his general confirmation as to the absence of a material adverse effect on policyholders' reasonable benefit expectations or security of benefits.

STAKEHOLDER ANALYSIS – STAKEHOLDERS OTHER THAN POLICY HOLDERS

91. The Independent Expert concludes that the Scheme has no material adverse effect on SL Intl and Property Linked Beneficiaries even though they run some incremental risk as a consequence of being able to rely on the new floating charges granted by Phoenix only

after the "hardening period" has concluded. The rationale for that conclusion is that, since Phoenix is well capitalised, its ability to discharge its unsecured obligations is secure. There is a clear logic to that conclusion and I do not consider that it betrays any flaw in reasoning. I have considered whether the very fact that SL Intl and Policy Linked Beneficiaries might, for a period at least, be unsecured creditors, having previously been secured creditors, is of itself a material adverse effect. However, in circumstances where neither the FCA, the PRA or the Independent Expert has any concerns on this issue, I see no reason to depart from the Independent Expert's conclusion.

92. External shareholders in the Group have an interest in ensuring that the Scheme, which has cost a large sum to implement, represents a good use of resources. Directors in both PGH and the Parties have obviously concluded that the Scheme is a sensible commercial transaction. Care has been taken to validate that conclusion: for example external advisers have been engaged to confirm that no adverse tax charges arise. The directors' conclusion is reasonable and so the interests of shareholders provide no reason why I should withhold sanction of the Scheme.

93. I note that similar administrative, service and management arrangements will be in place after the Scheme as were in place prior to it. Accordingly, to the extent that the provision of those services involved employees of the Group there is no reason to conclude that those employees would be materially and adversely affected by the Scheme. More generally, it is for the directors both of the Parties and of PGH to consider the interests of employees. No adverse effect on employees has been drawn to my attention and accordingly, I do not consider that their interests provide any reason why I should withhold sanction of the Scheme.

94. The Independent Expert has considered the position of external reinsurers. He concludes that there is no material adverse effect on them on the basis that their rights and obligations simply transfer to Phoenix under the Scheme. I see no flaw in that analysis.

OTHER MATTERS RELEVANT TO THE SCHEME AND OVERALL CONCLUSION

Interaction with proceedings at the Court of Session

95. Some amendments to previous Part 7 schemes (the SLAC Demutualisation Scheme, the SLAL 2011 Scheme and the SLAL Brexit Scheme) require the consent of the Court of Session. Considerations of comity caused the Court of Session to require that specific matters are drawn to the attention of this Court and I am grateful to the Court of Session for doing so. The matters in question were fully set out in the skeleton argument of Mr Moore KC. For completeness I summarise those matters below. To the extent that I have not commented on them specifically, that is because I do not consider that they suggest any reason why I should not sanction the Scheme:

    i) As regards the SLAL Brexit Scheme:

        a) the issue relating to floating charges that I have discussed in paragraphs 35.ii) and 91above;

        b) renewed undertakings given on behalf SL Intl in connection with amended deed polls governed by Irish law;

c) the undertaking given on behalf of Phoenix to assume all outstanding rights and obligations of SLAL under the SLAL Brexit Scheme;

d) a change in the identity of the person at the Court of Session who is to be notified of certain future amendments to the SLAL Brexit Scheme.

ii) As regards the SLAC Demutualisation Scheme and the SLAL 2011 Scheme (which are to be superseded):

a) the specific obligation in Clause 3.7 of the Scheme under which Phoenix assumes the obligations of SLAL under a "mortgage endowment promise". This obligation is enforceable under private Scots law but may not be enforceable under English law. Clause 3.7 makes it clear that Phoenix is to assume the obligation in question;

b) the issue relating to floating charges granted to Property Linked Beneficiaries;

c) Clause 39.4 of the Scheme which is intended to ensure that amendments to the Scheme which are effected otherwise than by order of the Court are properly brought to the attention of relevant people even though the English Court has no analogue of the "court reporter" of the Court of Session to whose attention amendments of the SLAC Demutualisation Scheme and the SLAL 2011 Scheme were previously brought.

Error in the calculation of SLAL's Own Funds

96. It was brought to my attention that, shortly before the hearing, SLAL's "business as usual" work resulted in it identifying an error in its internal modelling which resulted in an overstatement of the Own Funds and an understatement of the SCR of the Heritage WPF. Since those figures fed into the Independent Expert's conclusions, he produced a further Addendum to the Second IE Report that took into account the effect of the error and confirmed that it did not alter his conclusions.

97. In absolute terms, the error involved a material sum. Its effect was to overstate the Own Funds of the SLAL WPF by some £45 million and to understate its SCR by some £65 million. Moreover, the effect of the error will be more pronounced after the Scheme since Phoenix will not be continuing with the use of a volatility adjustment which applied within SLAL prior to the Scheme. Accordingly, the effect of correcting the error in the Heritage WPF in Phoenix following the Scheme will require an addition of £110 million to the SCR.

98. However, the error is not a consequence of the Scheme. Moreover, the Independent Expert has confirmed in his Addendum that, given the ring-fenced nature of the Heritage WPF, the effect on SLAL prior to the Scheme and on Phoenix following the Scheme, is very small. The Independent Expert confirms that the effect of the error on his analysis of the Scheme on matters of financial security is "immaterial".

99. The Independent Expert has also considered, quite properly, whether the error causes him to doubt the quality of information that has been provided to him in other respects. He concludes that he has no such concerns and that the quality of information provided to him has been of a high quality generally. Moreover, as I have noted in paragraph 87, much of that information has been externally audited or been considered by the PRA.

The Independent Expert is better placed than me to assess the quality of information he has received. I see no defect or flaw in the Independent Expert's conclusions in this regard. Accordingly, I have concluded that the error should not cause me to withhold approval of the Scheme.

Alleged defects in drafting of the Scheme

100. Mr Baker criticised the provisions of the Scheme that relate to the adoption of the new capital policy. He points out that clause 27.1 of the Scheme requires Phoenix to adopt that policy (referred to in the Scheme as the "PCP"). However, the provisions of Schedule 1 that set out the relevant capital policy tests are prefaced with the words "Phoenix intends to hold assets sufficient to satisfy… [various capital quality tests]". Mr Baker suggested that an "intention" was not enough: what was needed was an absolute requirement. I do not consider that a reason for me to withhold sanction of the Scheme. Any policy could be described as setting out an "intention" (namely an intention to act in accordance with the policy). Mr Baker's narrow drafting objection overlooks an important function of the PCP, namely to provide a series of "traffic lights" that help to determine whether management action is needed to enable requirements to be met. An absolute requirement, invariable in any circumstances, runs the risk of reducing flexibility for desirable management action. Moreover, it would necessitate detailed additional drafting to deal with circumstances where the requirement could legitimately be varied. I am reassured to note that neither the PRA nor the FCA suggested that the PCP was in any way deficient. Finally, I note that the same wording relating to "intention" has been used in earlier schemes affecting Mr Baker's policy, so he is in effect asking the Court to withhold approval on the basis that there might be a "better" Scheme (at least in his view). I have already explained why that is not the correct approach.

Shareholder communications

101. The Parties have sent over 5 million communications to policyholders in connection with the Scheme. Some 4.3 million of these consisted of hard copy documents sent through the post. That communication exercise has not proceeded perfectly. Regrettably, communications were sent to some 4,000 deceased annuitants. Some confusion was also occasioned by instances where communications were sent to the spouses of annuitants. Those mistakes will certainly have been upsetting for the families of the annuitants involved and the Parties, through counsel, expressed their great regret that the mistakes occurred and caused distress. I should not be thought to be glossing over matters when I note that in a communications exercise of this scale, it would be surprising if everything proceeded perfectly. In its second report, the FCA carefully noted defects in the process of communicating with policyholders. Its overall opinion was that these defects would not cause it to object to the Scheme. Moreover, the Independent Expert has also considered these mailing incidents and concluded that they are not indicative of any material adverse effect on policyholders.

102. The Parties have taken steps to contact policyholders whose addresses have changed ("gone aways"). Approximately 1.6% of mailing packs sent to policyholders were returned undelivered. That figure, together with the outcome of "seed mailings" undertaken by the Parties suggests to me that the overwhelming majority of mailing packs sent out to policy holders reached their intended recipient.

103. The FCA's guidance indicates that policyholders should receive communications no later than six weeks before the Court hearing to sanction the Scheme. Given the size of the

mailing exercise, the mailings had to be staggered. Therefore, a number of policyholders will have received their documents much more than six weeks before the Court hearing. Policyholders whose documents were mailed out towards the end of the exercise will have received their documents just more than six weeks before the hearing. I consider that there is no concern with excessively short notice being given to policyholders that should cause me to refuse to sanction the scheme.

104. Some policyholders expressed concern at an inability to communicate with the Parties by email about the Scheme. I am not particularly concerned about that. There would have been significant cyber security concerns if a large number of policyholders had been given an email address with which to communicate at the start of the process. A web portal was provided that would enable policyholders to communicate electronically. Moreover, as the process unfolded, those policyholders who had identified themselves as having concerns about the Scheme that required correspondence were provided with an email address.

Conclusion on the Scheme

105. In the light of the analysis set out above, I am satisfied that in all the circumstances of the case it is appropriate to sanction the Scheme.

THE AMENDMENT APPLICATION

106. The insurance business presently carried on by both PLAL and Phoenix has resulted from previously sanctioned insurance business transfers under Part 7 of FSMA. The Scheme is intended to harmonise certain requirements relating to the ongoing treatment of those businesses and, accordingly, contains provisions that are in some respects slightly different from the requirements imposed under previous Part 7 Schemes. Examples of those differences are set out in paragraph 32 . This harmonisation objective means that a number of the previous Part 7 Schemes ("Previous Schemes") are, pursuant to paragraph 30.1 of the Scheme, to be superseded completely.

107. All of the Previous Schemes contained provisions pursuant to which they could be amended. The precise wording of those provisions varied from one Previous Scheme to another. However, they typically permitted an application to the Court for a variation provided that the application was accompanied by a certificate from an independent actuary to the effect that in that actuary's opinion the proposed amendment would not "adversely affect" or "materially adversely affect" the reasonable expectations of the holders of policies transferred under the scheme in question.

108. The judgment of the High Court in *Re Windsor Life* [2007] EWHC 3429 (Ch) (see paragraphs [25] to [26] and paragraphs [29] to [32]) suggests that, even though it is paragraph 30.1 of the Scheme that causes Previous Schemes to be superseded, the Court's approval of the Scheme is not sufficient to result in the Previous Schemes being superseded. Rather, there also needs to be an application to the Court under the amendment provisions of the Previous Schemes. In his oral submissions, Mr Moore KC invited me to depart from the conclusion in *Re Windsor Life* or to distinguish it as not applying to the current circumstances which do not require amendments to the Previous Schemes to be approved by a "Supervisory Board" by contrast with the provisions set out in paragraph [25] of *Re Windsor Life*. While I thought there was some force to Mr Moore KC's submissions in this regard, I will not depart from or distinguish *Re Windsor Life* as I have not heard full argument on the point that has been tested by the articulation of a contrary point of view.

109. I therefore proceed on the basis that SLAL and Phoenix have rightly applied to this Court under the amendment provisions of the Previous Schemes. The Independent Expert has signed certificates expressed to comply with the relevant provisions of those Previous Schemes. Two questions arise:

    i) What approach should the Court follow in deciding whether to allow the application for amendment pursuant to the terms of the Previous Schemes?

    ii) Do the certificates that the Independent Expert has provided for the purposes of those amendment applications meet the requirements of the Previous Schemes?

110. As to the first question set out in paragraph 109.i), Mr Moore KC submits that the Court should apply precisely the same approach to the amendment applications as it does to the question whether to sanction the Scheme itself. There is a logic to that approach. The amendment applications are necessary only because the Scheme proposes to supersede the Previous Schemes. Accordingly, anyone affected by the superseding of the Previous Schemes is a stakeholder whose interests are taken into account in the Court's decision whether to sanction the Scheme. Therefore, there is an intuitive force to Mr Moore's argument that, if the Court is prepared to sanction the Scheme, there is no reason not to approve the formal amendment of the Previous Schemes.

111. However, that approach is not without difficulty which can be illustrated by reference to the terms of the Phoenix 2017 Scheme. Before any amendment can be made to that scheme, an independent actuary must certify that the amendments in question will not materially adversely affect the reasonable expectations of "policyholders of <u>Phoenix</u> including those whose policies were transferred from AXA Wealth Limited pursuant to the Phoenix 2017 Scheme". In theory the Court might be concerned that despite the provision of an independent actuary's certificate there is a material adverse effect on <u>Phoenix</u> policyholders. Conceptually, the Court could still sanction the Scheme in those circumstances (see paragraph 19 above) but it might feel unable to sanction an amendment to Phoenix 2017 Scheme. Accordingly, in theory, there could be a difference between the approach that the Court adopts when deciding whether to sanction the Scheme and its approach to amendments of the Previous Schemes.

112. However, in the circumstances of this case, I see this distinction as being theoretical rather than real. There is no suggestion that policyholders in PLAL and Phoenix (the parties to the Previous Schemes) are in any materially different position from other policyholders. I entertain no concerns about the Independent Expert's provision of certificates pursuant to the terms of the Previous Schemes as the Independent Expert has considered fully in his report the effect of the Previous Schemes being superseded.

113. The question of the adequacy or otherwise of the certificates given by the Independent Expert in connection with the Amendment Application arises because certain of the Previous Schemes require the independent actuary to confirm, in that actuary's opinion, that the proposed amendments will not "adversely affect" the reasonable expectations of the policyholders of PLAL or Phoenix. The Independent Expert has given certificates confirming that to be his opinion which are reproduced in Appendix C of the First IE Report. However, before giving those certificates, the Independent Expert states as follows in paragraphs C.2 to C.4 of the First IE Report:

> *I note that the required opinion wording in the certificates varies for each of these schemes. Of particular note is that some of these schemes require an opinion that there is no <u>material</u> adverse*

> *effect on policyholders, while others require the opinion that there is no adverse effect on policyholders. The modification provisions of the Phoenix 2009 Scheme, the Phoenix 2012 Scheme, the PLAL 2012 Scheme, and the PLAL 2015 Scheme all require the latter form of the opinion excluding the "material" qualifier.*
>
> *C.3 As set out in paragraph 3.24 of this Report, it is standard practice for independent experts to take into account the concept of materiality in carrying out their work and forming their conclusions. Furthermore, there is precedent from the exercise of modification provisions from other insurance business transfer schemes that the approach of assessing "no adverse effect" is considered in practice to be unduly restrictive. It is almost inevitable that in any proposal there will be some advantages and some disadvantages, and that such advantages and disadvantages will be given different weighting according to their materiality and the likelihood of their occurring. A key consideration is whether those advantages and disadvantages are equally balanced.*
>
> *C.4 Therefore, I have provided the certificates for the Phoenix 2009 Scheme, the Phoenix 2012 Scheme, the PLAL 2012 Scheme, and the PLAL 2015 Scheme in the required form excluding the "material" qualifier, but I note that in providing my opinion in these certificates, I have considered the impact on policyholders "in the round". This consideration is in line with the approach adopted throughout this Report where I have sought to assess whether policyholders would be materially adversely affected.*

114. In my judgment the Independent Expert has given a compliant certificate in relation to all of the Previous Schemes. Where necessary he has certified that he holds the opinion that the proposed amendments will not "adversely affect" the reasonable expectations of relevant policyholders. Where that is the threshold, he has not given a certificate confirming only that the changes will not "materially adversely affect" the policyholders. The extracts set out above simply explain why he holds the opinion set out in his certificates. They do not call into question the genuineness or reasonableness of the opinions he records and do not suggest any misdirection as to the matter he is required to certify.

115. As well as sanctioning the Scheme, I will approve the amendments to the Previous Schemes.