Case No: 9707 OF 2006

**NEUTRAL CITATION NUMBER: [2006] EWHC 694 (Ch)**

**IN THE HIGH COURT OF JUSTICE**
**CHANCERY DIVISION**
**COMPANIES COURT**

Royal Courts of Justice

Strand

London WC2A 2LL

Wednesday, 14 March 2007

BEFORE:

**THE CHANCELLOR**

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BETWEEN:

**FIRST ALTERNATIVE INSURANCE COMPANY LIMITED** Cl

**- and -**

**ESURE INSURANCE LIMITED** Def

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MR GREGORY DENTON-COX appeared on behalf of the CLAIMANT

THE DEFENDANT did not appear and was not represented

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**JUDGMENT**

THE CHANCELLOR:

1. This is a part 8 claim seeking the sanction of the court to an insurance business transfer scheme for the transfer of policies of general (primarily motor) insurance from First Alternative Insurance Company Limited to Esure Insurance Limited and for ancillary orders under section 112 of the Financial Services and Markets Act 2000.

2. The questions for my determination are those posed by section 111 of the Financial Services and Markets Act 2000, namely, (i) whether the appropriate certificates and authorities have been obtained as required by subsection 2 and (ii) whether the court considers that in all the circumstances of the case "it is appropriate to sanction the scheme". I am satisfied by the quite extensive evidence before

me as to each and all the matters referred to in section 111(2). Thus, the remaining question for my determination is whether I consider it appropriate to sanction the scheme.

3. First Alternative Insurance and Esure are subsidiaries of joint ventures between HBOS and Peter Wood. Each of them carries on motor insurance business with slightly different profiles. They wish to combine their businesses into a single entity, Esure, and to wind up First Alternative Insurance and return its surplus assets to its members. The overall economic effect includes the consequence that some £65 million is removed from their combined businesses and returned to their shareholders. This figure is made up of some £54 million shareholders' funds in First Alternative Insurance and £11 million being the purchase price paid by Esure to First Alternative Insurance for the goodwill attached to the transferred business.

4. On 24 August 2006 the Financial Services Authority approved Mr Peter Copeman, of Price Waterhouse Coopers and an actuary of some 27 years' experience, as the independent expert as required by section 109 of the Financial Services and Markets Act. He reported on 17 November 2006. His conclusions may be summarised as follows. First, First Alternative Insurance's technical provisions, which are in excess of those required by its consulting actuaries, EMB Consultancy LLP, are reasonable for the purpose of describing the effect of the transfer. Second, the change in the profile of Esure arising from the transfer is sufficiently small not to pose a material risk to its existing policyholders. Third, the security for First Alternative Insurance's transferring policyholders is improved as a result of the transfer. Fourth, though the security of Esure's policyholders is reduced, the capital to support them remains in excess of that needed.

5. His overall conclusions are recorded in paragraph 4 of his report in these terms:

"I have considered the Scheme and its likely effect on the policyholders of First Alternative and esure.

“I have concluded that First Alternative policyholders would not be adversely affected by the Scheme and that their security would be improved as a result of the transfer.

“I have concluded that, although the level of security of esure's policyholders would be reduced by the Scheme, the amount of capital held to support the policies would remain in excess of the level of confidence specified by the FSA for UK general insurance companies. I consider that it is extremely unlikely that the reduction in the amount of the excess would have any practical significance, and therefore I consider that esure's policyholders would not be materially adversely impacted by the transfer."

6. On 28 November 2006 the Financial Services Authority approved the notices and the form of the independent expert's report. The claim form before me was issued on 1 December and on 8 December Deputy Registrar Shaffer gave the usual directions for the progress of the claim. These were duly carried out, as shown by the subsequent witness statements, to which it is not necessary to make further reference. On 17 January 2007 the relevant papers were served on the Financial Services Authority. They responded on 23 February 2007 in these terms:

"I refer to the court hearing of the above transfer scheme on 14 March 2007. I also refer to the draft witness statements of [then five deponents were named, submitted under cover of a particular e-mail of 6 February 2007] and to the written representations made [by] Mr Hill and Mr McNeill submitted under cover of your e-mail of 6 February 2007. [They, as will be seen, were the two policyholders who submitted what might be regarded as objections.]

“I would inform you that the Financial Services Authority has no objection to the proposed transfer scheme and therefore will not be exercising its right, pursuant to section 110(a) of the Financial Services and Markets Act 2000 (“the Act”), to be heard at the hearing."

Then, in conclusion, they attached the certificate required under paragraph 2 of schedule 12.

7. No one has appeared at the hearing before me to object to the transfer. Although a number of people telephoned a dedicated helpline or wrote to the claimant's solicitors, only two letters have been identified as relevant. The first is from a Mr Hill in Hemel Hempstead. He is concerned that the scheme may presage a change in underwriting strategy with the consequence that he may no longer be able to obtain cover for his XJ Jaguar. The second is from Mr McNeill of Liverpool. He is concerned that any renewal insurance he may take out with Esure may be more expensive. Replies were sent to both. To Mr Hill it was explained that a change in underwriting strategy was already in train independently of the scheme, but assuring him that he would be able to renew his cover in the normal way. Mr McNeill was assured that there would be no price change arising from the change of underwriter.

8. I see nothing in either of these complaints to lead me to the conclusion that it would not be appropriate to sanction this scheme. What has caused me to hesitate is the consequence to which I have referred. The return of £65 million to the shareholders involved in the implementation of this scheme would suggest that either the businesses were substantially overcapitalised or that the necessary security for the combined policy obligations of Esure has been underestimated. My concerns are compounded by the fact that neither the independent expert nor the Financial Services Authority have alluded to this, as I understand it, accepted consequence. Accordingly, the dilemma to which I have referred has not been directly faced by either of them.

9. For the reasons I gave in Re Alba Life Limited [2006] EWHC 3507 and notwithstanding the provisions of paragraphs 18.2.51 to 18.2.53 of the FSA handbook, I am unable to take the terms of the FSA letters dated 28 November 2006 and 23 February 2007 as sufficient to allay my concerns. The first merely approved the form, not the contents, of the report. The second is purely negative. It makes no reference to the independent expert's report or to any part of it or to any of the conclusions expressed in it. My concerns must be allayed, if at all, by the body of the independent expert's report.

10. In paragraph 3.3.4 the independent expert deals with capital requirements. He explains Individual Capital Assessments (ICAs) as being the level of capital required to ensure that a company is less than 0.5 per cent likely to become insolvent within one year. These, that is to say ICAs, are periodically reviewed by the Financial Services Authority which will issue to a company an Individual Capital Guidance (ICG). This is aimed at the same target, namely, odds against insolvency within the year of more than 200 to 1, but represents the FSA's view rather than that of the company. The independent expert refers at paragraph 3.3.4 to the fact that:

"As part of the work to determine whether or not to proceed with the Scheme the companies have performed another ICA calculation in order to determine the level of capital that esure would need to hold if the transfer were implemented. The conclusion from this post-transfer combined entity ICA was that esure holds capital materially in excess of the level that is considered to be needed in order to take on the transferring business and still maintain its ability to meet its obligations to the level of confidence prescribed by the FSA."

11. The independent expert then explained at some length that this is a complicated process which he has reviewed. He explains the processes and what he has reviewed at some length. His conclusion in this section is:

"I consider the methodology and modelling techniques used by the companies in assessing the combined entity ICA to be appropriate and in line with current market practice. The assumptions used in any ICA calculation are a matter of judgment, but the result of my assessment of the reasonableness of the assumptions and results is that the combined entity ICA calculated by the companies is extremely unlikely to be understated to an extent that would invalidate the conclusion that the capital held exceeds it.

“In addition to the approach based on modeling, I have compared the level of esure's post-transfer capital against a level of post-transfer ICG calculated as the same percentage of ECR as currently.”

12. I interpose to observe that ECR is the acronym for Enhanced Capital Requirement which he had explained earlier on that page. His conclusion continues:

"I found that the level of capital materially exceeds this level of ICG.

“Based on the work and conclusions described above, I consider that esure holds sufficient capital to take on the transferring business and still maintain its ability to meet its obligations to the level of confidence prescribed by the FSA for UK general insurance companies."

13. The independent expert then considered the security available to the policyholders of First Alternative Insurance. He said at paragraph 3.4:

"I have considered the likely effects of the Scheme on the security of First Alternative policyholders, by comparing their position if the Scheme were or were not implemented.

“If the Scheme were not implemented, First Alternative policyholders would remain with a company that is younger and smaller than esure.

“The implication of this is that First Alternative is more volatile than esure in terms of financial results and therefore, ultimately, policyholders security. Insurance companies, however, hold capital in order to mitigate such risks and still pay policyholders' claims as they fall due. Policyholders' security depends, therefore, not solely on the level of risks to which an insurance company is exposed, but also on the level of capital it holds relative to these risks.

"First Alternative holds more capital than its assessment of the capital that it needs (the ICA), and more capital than the FSA’s guidance as to the level of capital it would expect First Alternative to hold (the ICG). However, the level of capital held by First Alternative pre-transfer, relative to its risks, is not as great as that held by esure relative to esure's risks post-transfer. First Alternative policyholders would therefore be policyholders of a stronger company if the transfer were implemented than if it were not implemented."

14. I infer from that last passage that the resolution of the dilemma to which I have referred is that both companies have been substantially overcapitalised. The business in question is that of general insurance, specifically motor insurance, rather than either long term or life business so that no question of reserves or bonuses arises. The surplus capital represents shareholders' funds to which they are entitled. It follows that the extent of the overcapitalisation is no reason to withhold sanction from the scheme, rather it provides a clearer rationalisation for the scheme itself.

15. It is also apparent from that last passage that it is the clear opinion of the independent expert that the security for the insurance liabilities of all policyholders if the scheme is sanctioned will be in excess of that required by the currently accepted standard, that is, odds against insolvency within the year of more than 200 to 1.

16. Accordingly, sufficient provision has been made for the liabilities of Esure and I conclude that it is appropriate to sanction this scheme and I do so. I will make an order in the form of the draft put before me with the various amendments discussed in the course of argument.