

**DLA'S EXPERIENCE IN CONNECTION WITH
SOLVENT SCHEMES FOR POOLS**

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DLA - SOLVENT SCHEMES OF ARRANGEMENT FOR POOLS

Introduction

1. The Insurance & Risk Solutions ("I&RS") team at DLA is a market leader in advising on and implementing insurance and reinsurance run-off exit strategies. The members of the I&RS team have been at the forefront of the development of solvent schemes over the past ten years, bringing together a unique breadth and depth of experience in the field. The team commonly advises on the four key phases of solvent schemes of arrangement.
 - Strategy: conducting a high level review of the scheme company's business identifying any factors which might influence its "schemeability" and confirming that a solvent scheme is the optimum solution for the company in the circumstances.
 - Scheme development and promotion: drafting a bespoke scheme (and ancillary documents) to meet the company's circumstances and objectives and addressing issues raised by interested parties, including the FSA and other regulators, as well as key creditors and reinsurers.
 - Court process: drafting the "practice statement letter" to be sent to creditors, preparing the application to the Court for leave to convene the meeting(s) of creditors, advising on the meeting of creditors itself, preparing the sanction petition and the supporting evidence.
 - Implementation: advising on issues which arise whilst the scheme is being implemented.

The I&RS Team

2. DLA's I&RS team consists of Nigel Montgomery, Adrian Savage, Michelle Kierce, Kirstin Pickering, Antony Newman, Michael Clarke, Mel Sims and Theresa Zacharias. We work closely with our reinsurance and insurance litigation partners, Charles Gordon and David Murphy and five other solicitors. In addition to the core capabilities required to advise on a solvent scheme, the team encompasses FSMA and EU regulatory and general corporate and commercial expertise in the insurance sector. We regularly advise on insurance services agreements, process out-sourcing, IT issues and employment law. The I&RS team is part of DLA's London Corporate Group, which consists of a total of 18 partners and 35 solicitors and other fee earners and encompasses further insurance industry expertise.

3. The I&RS team works closely with DLA's insurance and reinsurance litigation practice. As a full service firm, DLA has the expertise to deal with any legal issues which might arise outside the insurance field as well as within it. DLA has a presence in 33 cities in over twenty jurisdictions in Europe and Asia: a resource which can be called upon should there be an international dimension to an assignment.
4. Our relationships with US practices enables us to obtain, with the assistance of US counsel experienced in the area, protection of schemes of arrangement under S304 of the US Bankruptcy Code, and to deal with the release of US Trust Funds.

Background

5. The relatively recent use of schemes of arrangement pursuant to section 425 of the Companies Act 1985 to deal with the liabilities of solvent insurance companies had its origins in the context of insurance insolvencies in the early nineties. In short, insurance companies could not be placed in administration, and other formal insolvency procedures, such as liquidation, were considered to have features which made them detrimental to creditors' interests. Section 425 schemes provide a flexible alternative which can be adapted to address the circumstances and requirements of individual companies and their creditors and shareholders.
6. Our experience is summarised below under the following headings:
 - Insolvent schemes and I&RS
 - Solvent schemes and I&RS
 - I&RS experience with underwriting pools
 - Other scheme experience
 - Summary

Insolvent Schemes and I&RS

7. The first major scheme of arrangement was that proposed in relation to five insolvent subsidiaries, the KWELM companies, of the LUI Group plc, which was itself in administration: when the KWELM scheme was proposed in 1993 it was estimated that the companies' liabilities could total between \$6 and \$11 billion. The KWELM scheme was used as the basis for several of the "run-off schemes" which followed.

8. Having qualified as a chartered accountant in the audit practice of Coopers & Lybrand Deloitte (later Coopers & Lybrand, a predecessor firm of PricewaterhouseCoopers) Adrian Savage transferred to the firm's insolvency practice, Cork Gully, in May 1992. He spent the next two years in a central co-ordinating role on KWELM. His role in connection with the scheme included being the primary point of contact with the lawyers drafting the scheme and he was closely involved in developing many of its key provisions. His role also included ensuring that the systems being developed to administer the scheme would be able to implement its provisions. He subsequently spent four months in Chicago working on major pieces of KWELM litigation.
9. The first cut-off or crystallisation schemes for insolvent insurers in the UK were proposed simultaneously in relation to RMCA Reinsurance Limited and ICS Reinsurance (Private) Limited in 1993. Nigel Montgomery was instructed by the Insurance Corporation of Singapore to act generally and to develop and draft the schemes. They were the first schemes to incorporate an actuarial methodology for the valuation of long-tail claims and involved the parallel implementation of schemes in the UK and in Singapore.
10. In June 1993, provisional liquidators were appointed in respect of The Charter Reinsurance Company Limited ("Charter"). Coopers & Lybrand instructed Nigel Montgomery to develop and draft a scheme and to act generally. Charter was a London market reinsurer which was enmeshed in the LMX spiral. There was a high level of commonality between Charter's cedants and reinsurers. The most efficient way of dealing with the estate was to crystallize each cedant's claims and to off-set reinsurance recoveries and reinsurance recoverable from them in their capacity as Charter's reinsurers. As well as accelerating finality, this approach was projected to result in very significant cost savings as compared to a continuation of the run-off.
11. A barrier to adopting this approach was the "pay as paid" clause which, in a variety of forms, was standard in London market excess of loss contracts. On one construction, it required Charter to pay claims before it could recover from its reinsurers, notwithstanding its inability to do so by reason of its insolvency.
12. The strategy developed by Nigel was to bring a test case to establish that the trigger for reinsurance recoveries becoming collectible was the establishment of Charter's liability to pay its cedants, rather than payment. This construction was confirmed by the House of Lords and a scheme which incorporated a complex actuarial valuation methodology was then implemented.

13. At that time Michelle Kierce was at Coopers & Lybrand and was involved in the development of the Charter scheme and others. She also provided in-house legal advice. Michelle, Adrian and Nigel have advised on all aspects of the development and implementation of a significant number of insolvent schemes in addition to those referred to above. In Michelle's case these include:

- *Fremont Insurance Company (UK) Limited*
- *BAI (Run-off) Limited*; and
- *Municipal General Insurance Limited* (development only)

14. In Adrian's case these include:

- *Monument Marine and General Insurance Company Limited* (development only);
- *Orion (OIC Run-off Limited and The London and Overseas Insurance Company Limited)* (implementation only);
- *Sovereign Marine & General Insurance Company Limited*.

15. In Nigel's case they include:

- *The Hawk Insurance Company Limited*;
- *Municipal General Insurance Company Limited*;
- *The Insurance Corporation of Singapore (UK) Limited*.

16. In the case of Hawk, Nigel advised the provisional liquidators on what became the leading authority concerning the identification of classes of creditor in schemes of arrangement.

17. The I&RS team are currently acting for Pacific & General Insurance Company Limited, Marina Mutual Insurance Association Limited and UIC Insurance Company Limited in developing and implementing schemes.

Solvent Schemes and I&RS

18. Through their involvement in the development of these schemes Nigel and Adrian were closely involved in the evolution of schemes for insolvent insurance companies during the

1990s. A significant tangential development was the use of schemes as an exit route for solvent insurers, either whole companies or specific portfolios of business.

19. In order to achieve the objective of finality, solvent schemes are inevitably cut-off schemes. In any run-off of long-tail liabilities there is likely to come a point at which the administrative costs are not justified by the diminishing level and value of claims activity.
20. It may be difficult to identify when the last claim has been paid - unless every policy is commuted, which is likely to be impractical. Capital is likely to be trapped in a run-off company indefinitely, to the extent it is not dissipated. A scheme which is implemented for the whole of a company's run-off is an efficient and powerful means of dealing with all of its residual liability enabling it to be wound up and its capital unlocked and redeployed. The basic technology of a solvent scheme is the same as that in an insolvent cut-off scheme, save that payment in full in one or more instalments is made in respect of the full value of the estimate of each scheme creditor's claims.
21. Before joining DLA, Adrian was involved with the development of solvent schemes for:
 - *Transcon Insurance Limited* - A Bermudian-registered "captive" subsidiary of Ford which wished to terminate its non-Group insurance liabilities with a scheme formally effective in the United Kingdom as well as in Bermuda;
 - *The Dunedin Pool* - A book of business written on behalf of a pool of four companies;
 - *Municipal Mutual Insurance Company Limited* - This company is not insolvent, but its continuing solvency was in doubt when it ceased underwriting in 1992. Having previously been part of the audit team whilst at Coopers & Lybrand, Adrian was closely involved in the conceptual development of the "contingent scheme" put in place by the company as a precaution against insolvency. In the event that the directors ceased to foresee a solvent conclusion to the run-off, the scheme provided for and enabled a smooth transition to an insolvent run-off without the usual disruption occasioned by insolvency. In short, small creditors would have continued to be paid in full, whilst major creditors (approximately 700, mainly local authorities) would have been paid the largest percentage of their claims thought to be sustainable.
22. Nigel developed the first solvent scheme in the United Kingdom for *HIR (UK) Limited*. He has since advised on the development and implementation of solvent schemes for *The Nichido Fire and Marine Insurance Company Limited* - a major company incorporated in Japan which

wished to use a scheme only for the business written in its London branch. He has also advised on the use of solvent exit solutions for a major London market pool with both insolvent and solvent members and the sale of pool participant companies to a run-off vehicle.

23. In addition Michelle was involved in the development of a solvent scheme by I&RS for *Aviation & General Insurance Company Limited* and she and Nigel advised on the corporate reorganisation of *The Taisei Fire & Marine Insurance Company Limited*.
24. The I&RS team is currently advising on a number of solvent schemes, including:
 - a solvent scheme for 18 companies in a pool with some £1bn of liabilities. The companies include subsidiaries of a number of major well known international groups;
 - solvent schemes and associated business transfers for four unrelated international insurance groups involved in the London market;
 - a solvent scheme for a European pool with 11 participants;
 - the reorganisation of two major overseas insurance companies, involving Part 7 Transfers and solvent schemes of arrangement;
 - A solvent scheme of arrangement for a major European reinsurer.

I&RS Experience of Underwriting Pools

25. The I&RS team's experience of underwriting pools is extensive. As well as working on the English & American pool and the RMCA pool, we have experience of a number of pools the names of which cannot be disclosed in this document. These include pools with both solvent and insolvent members, pools with non-UK participants and pools with US and other non-EU members. The issues with which we have dealt include:
 - Creation of inter-participant agreements to cover funds handling, administration of claims and "ownership" and allocation of reinsurance;
 - Treatment of fronting and roll-forward, ownership of and access to pool records;
 - Negotiation and drafting of contracts for outsourcing pool run-off management and related regulatory issues;
 - Legal issues arising from systems conversion and migration of records;

- Integration of insolvent pool participant's administration and (insolvent) scheme of arrangement within on-going pool administration and pool-wide solvent scheme of arrangement;
- Reconstruction and documenting of inter-participant relationships, obligations and participations;
- Interlinking of pool wide schemes of arrangement, as well as devising schemes for parts of pools.

Scheme Experience

26. We have experience of dealing with ILU Guarantees, including negotiations for their replacement. We are also experienced in reorganising run-off business within groups to place discontinued business within separate companies. We are familiar with issues arising from solvent schemes for companies with policies subject to compulsory protection by the Financial Services Compensation Scheme.
27. We have considerable experience in drafting inwards, outwards and "two-way" commutation agreements in the context of schemes.
28. We have worked extensively with US Counsel on obtaining protection for schemes in the United States under S.304 of the US Bankruptcy Code. This work has included the construction of pool scheme wording to deal with participants not eligible for S.304 protection.
29. We have experience of dealing with US Trust Fund issues and the release of these Funds and the LOCs collateralising them.

Summary

30. The foundations of I&RS's ability to deliver a solvent scheme (and other exit routes) lie in the breadth and depth of the experience of the members of the team. I&RS does not offer solvent schemes as a standard package, each one is developed and designed to meet the circumstances and objectives of the client. We consider that among our key strengths is a flexible and innovative approach which enables us to develop optimum solutions for our clients.

31. A solvent scheme may be only one element of a broader exit strategy or reorganisation. I&RS has the capability to combine a solvent scheme with Part 7 business transfers, company sales, novations, commutations and other mechanisms to achieve the overall result required.
32. Our multidisciplinary background and experience mean we have the skills to understand the business to which the scheme will be applied and to tailor it accordingly. We have long experience of working in teams with accountants, actuaries and insurance industry professionals.

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