



The Actuarial Profession
making financial sense of the future

34TH ANNUAL GIRO CONVENTION

CELTIC MANOR RESORT, NEWPORT, WALES



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Schemes of Arrangement

Jon Francis, Neil Golding

George Maher, Jamie Reid

Speakers

- Jon Francis, Whittington Insurance
- Neil Golding, Freshfields Bruckhaus Deringer
- George Maher, Tillinghast Towers Perrin
- Jamie Reid, Tillinghast Towers Perrin

Agenda

- What is a Scheme of Arrangement (Neil Golding)
- The Views of a Practitioner, Creditor and Debtor (Jon Francis)
- Legal Issues (Neil Golding)
- Actuarial Issues (George Maher, Jamie Reid)
- Questions and Discussion

What is a Scheme of Arrangement

Neil Golding

Freshfields

What is a Scheme of Arrangement?

- Procedure set out in section 425 CA 1985
- Been around for 100+ years
- Equivalent/identical procedure in many other jurisdictions – Australia, Bermuda, Hong Kong, Singapore etc, etc

What is a Scheme of Arrangement?

- Key elements:
 - Any arrangement
 - Between a company and its creditors (or members)
 - Which is approved by the requisite majorities and sanctioned by the Court
 - Is binding on all creditors (or members), regardless of whether they supported/opposed/were apathetic about the scheme, and regardless of whether they even had actual notice

What is a Scheme of Arrangement?

- Other key procedural points:
 - Does not need to be all creditors (members). Can be a class of them
 - Voting majorities = $\frac{3}{4}$ in value plus majority in number of those who vote at meeting
 - Class issues: those with similar rights = in same class. If class issues are wrong, Court has no jurisdiction to sanction

What is a Scheme of Arrangement?

- Uses in general
- Uses in insurance market for insolvent estates
- Uses in insurance market for solvent companies

Solvent Schemes of arrangement: the views of a practitioner, creditor and debtor

Jon Francis

Whittington Insurance Markets Limited

The practitioner's view – a means to an end

It used to be just run-off:

- Stopping underwriting – just the start of closure
- Run-off can last for years
- Run-off has an uncertain outcome

But now we have solvent schemes!

- UK has an appropriate mechanism combined with sophisticated and willing regulators
- European Directive/ Part VII transfers

Practitioner's view – planning is everything

- Understand the portfolio
 - Prescribed classes, compulsory insurances
 - Direct insureds
 - Long tail and IBNR
- How long would it take to run-off? How much would it cost?
 - Active run-off – commutation and early settlement
 - Passive run-off – sit on the assets!
- How long will it take to scheme – and how much will it cost?

Practitioner's view – planning is everything

- Identify policyholders that are potential creditors
- Pre-scheme settlement and commutation
- Dealing with reinsurers
- Principle to principle accounting
- Process for agreement of claims
- Data quality – proof of effort to identify creditors
- Evidence of lack of prejudice to creditors

Practitioner's view – big picture

- Pitfalls
 - Over-ambitious time-scales
 - Creditor revolt!
 - Poor data
- Upsides
 - Pro-active management
 - Accelerated cash-flow
 - Exit!
- Downsides
 - Maintaining Staff motivation
 - Costs
 - Reputational risk – are you too solvent?

Creditors' view

- Pros
 - Cash sooner rather than later
 - Instils risk management discipline
- Cons
 - Am I reasonably certain about my ultimate liabilities?
 - Uncertainties
 - changes in law
 - Unknown exposures
 - Hassle!

Debtors' view

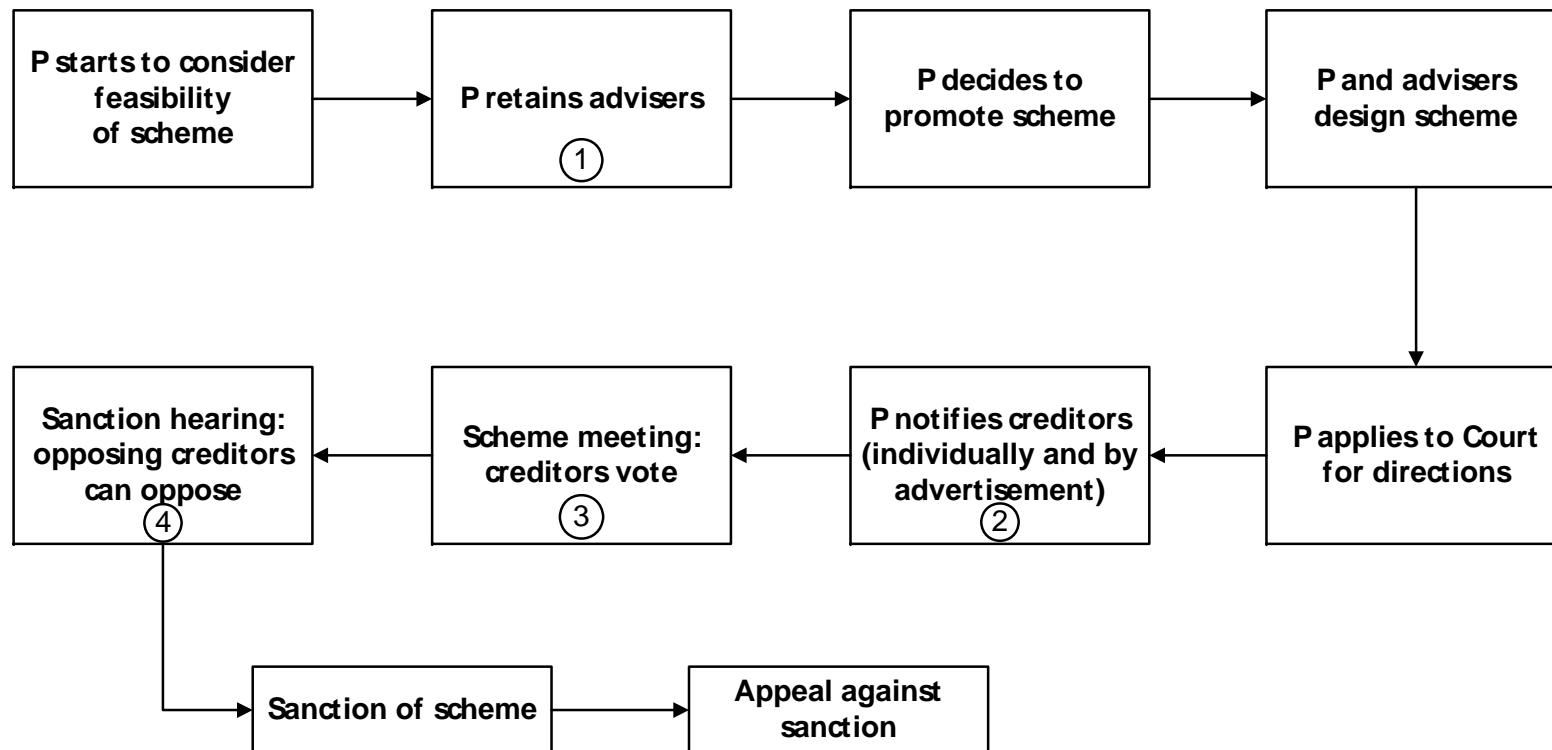
- Reinsurers:
 - Why should I pay now? Discount please!
 - Why should I believe your ultimates?
 - How can you allocate IBNR to your excess of loss program?
 - You're making ex-gratia payments to creditors: insureds & reinsureds
- Other debtors:
 - Why play ball until you force me?

Legal Issues

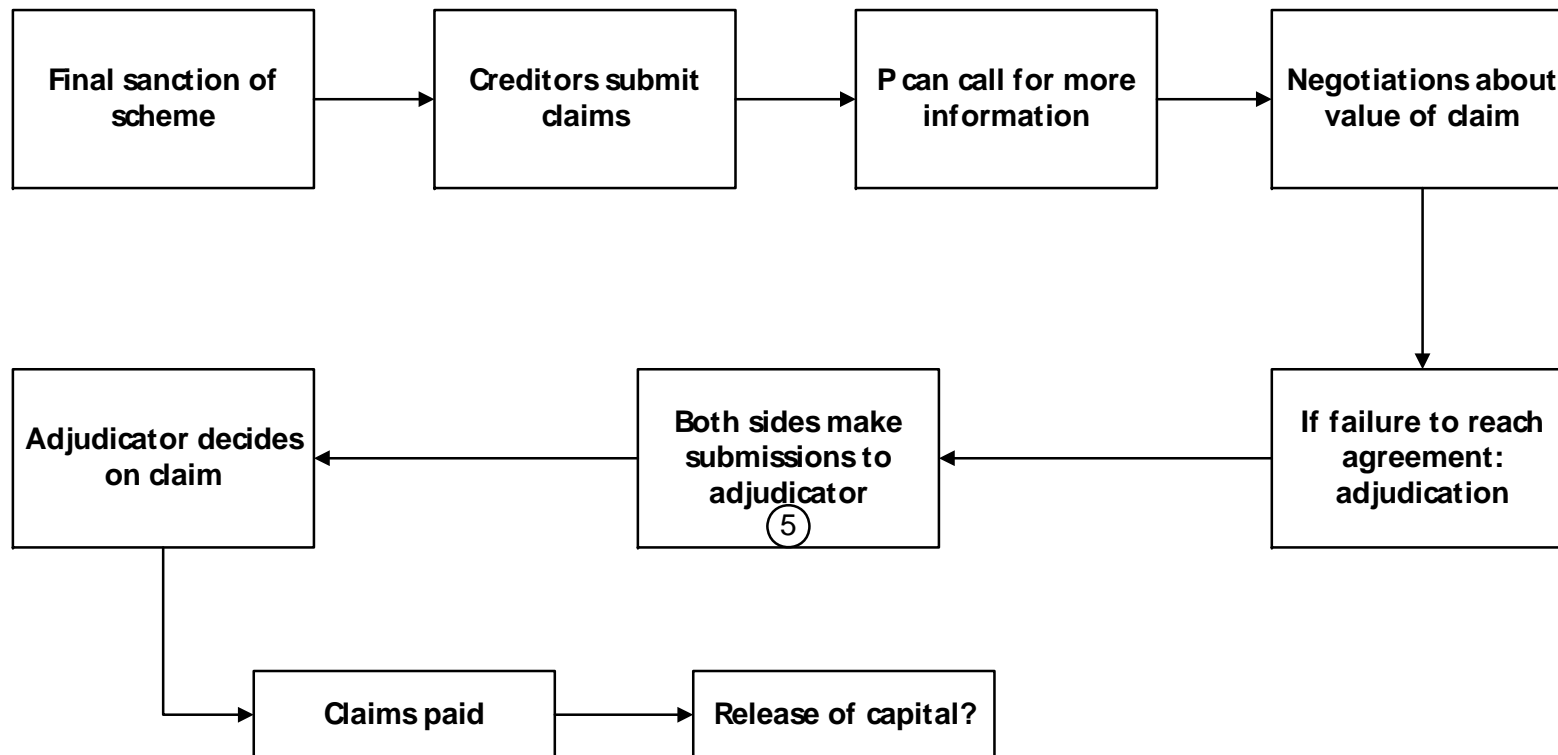
Neil Golding

Freshfields

Legal Issues



Legal Issues



Actuarial Issues

Jamie Reid, George Maher

Tillinghast

Role of Actuaries in Schemes of Arrangement

- Engaged by Scheme Company
 - Scheme Actuary
- Engaged by Creditor
- Independent Roles
 - Scheme Adjudicator
 - Vote Adjudicator
 - Expert Witness

Scheme Actuary

- Assists scheme company in actuarial matters
- Key areas of work include:
 - Assisting in scheme planning and design, in particular the estimation methodology
 - Reviewing votes and claims submitted, particularly IBNR claims
 - Assisting in commutation of outward reinsurance
 - Estimation of claim liabilities, both in total and at individual creditor level
 - Negotiation with creditors and their representatives
 - Discussion of all of these matters with company management and other advisors

Possible challenges for the Scheme Actuary

- Scheme receives a claim for full policy limits with no details on calculations
- A scheme creditor alleges exposure to a new type of latent claims
- Scheme creditor submits complex, multi-parameter model
- Prepare evidence for court hearing

The Creditor's Actuary

- Might be employee or consultant
- Prepares IBNR valuation for voting purposes or for claim
- Assists creditor in negotiation of appropriate claim size

Responding to a Scheme of Arrangement

- Consider whether to support or oppose schemes on a case by case basis
- Try to engage with the scheme early in the process
 - Potential to commute on favourable terms when scheme company wishes to complete run-off
- Avoid temptation to use spoiler tactics
 - Expensive and time consuming for both scheme company and creditor
 - Extreme spoiler tactics have the potential to be counterproductive

Adjudication

- The scheme document will specify the adjudication procedures
 - Typically creditor and scheme company each able to make submissions
 - Adjudicator can request additional information
 - Adjudicator's determination is final and binding
- Creditor and scheme company have greater flexibility to reach a settlement prior to adjudication
 - Few claims reach the adjudicator, although the number is increasing
- Potential for creditor and scheme company to agree parts of claim before adjudication
 - Reduces the uncertainty of adjudication
- Consider adjudication expenses

Other Roles

- Vote Adjudicator
 - Relatively new role – scope of work evolving
 - Provides an additional level of review to all of part of the voting process
- Expert Witness
 - Provides opinion to court

Challenges

- Granular work
 - Reserving actuaries generally work at class and underwriting year level, rather than individual creditor level.
 - Data might be very limited
 - Creditor claiming for unspecified types of latent claim.
 - Creditor trying to be as unhelpful as possible.
- Gaming and hidden agendas
 - Creditors wishing to maximise payout, or possibly derail the scheme
 - Scheme company clearly wants scheme to succeed
 - Actuaries required to maintain professional standards

More Challenges

- Working with other professionals
 - At granular level, policy specific claims, legal and other issues can have key impact
 - Greater potential for detailed scrutiny of work to by non-actuaries, including courts
- Communication
 - Need to explain methods to “non-financial” people, for example, lawyers and judges
- Unusual roles
 - Actuary as adjudicator

Case Study and Discussion

Jon Francis

Biography

- 25 years experience in insurance
- 12 years in forensic accounting, inspection of records and litigation support
- Fact/ expert witness in litigation and arbitration
- 2002 - present - Chief Executive of Americas Insurance Company in Run-off – domiciled in Louisiana, USA
- Chartered Insurer
- Licensed Casualty Adjuster (All Lines) Connecticut, USA

Neil Golding

Biography

- Partner in Freshfields
- In charge of Insurance Solutions: dedicated team specialising in run off, insurance company insolvencies and related topics
- Cases have included: HIH, EMILCO, North Atlantic, Pender, Equitas, La Salle Re.

George Maher

Biography

- Consulting actuary with the Tillinghast business of Towers Perrin and a principal of Towers Perrin.
- Extensive experience in reserving and capital assessment for insurance and reinsurance companies.
- Specialises in market entry, reinsurance pricing, merger and acquisitions, demutualisations and capital restructuring.
- Has been involved in a number of Schemes of Arrangement, including work as Scheme Actuary, Scheme Adjudicator, Vote Adjudicator and Expert Witness.

Jamie Reid

Biography

- Consulting actuary with the Tillinghast business of Towers Perrin.
- Assignments with Tillinghast have included reserve valuations and estimation of capital requirements across many lines of business. His clients include insurers and reinsurers writing in the UK, Continental Europe, and North America.
- Specific expertise in estimation of latent claims and in Schemes of Arrangement.
- Professional activities include membership of the General Insurance Current Issues Committee, GIRO Organising Committee, and Board of Examiners.

Case Study 1

- Megasure is proposing a Scheme of Arrangement
- Mobile Co. is a policyholder of Megasure
- Consider the information on Megasure and Mobile Co. set out below
- You are a director of Mobile Co. Decide whether:
 - You will vote for scheme, vote against scheme, or ignore scheme
 - (If time) the value you would attribute to your vote

Company Proposing Scheme of Arrangement

COMPANY NAME

Megasure

BACKGROUND

Megasure wrote insurance from the mid-1980s to the late-1990s, specialising in liability business.

FINANCIAL STRENGTH

Megasure's liabilities are guaranteed by its parent, an insurance company with a strong credit rating.

Creditor

COMPANY NAME

Mobile Co.

BACKGROUND

Has been manufacturing mobile phones since the late 1980s.

INSURANCE COVER

Megasure participated in excess liability layers purchased by Mobile Co. between 1990 and 1995.

- All coverage was written on an occurrence basis
- Megasure only participated on policies excess of £50 million
- Megasure's share of policy limits in these years is £20 million

LIABILITIES

Mobile Co. has never been made a claim on any insurance.

It is concerned about potential future claims relating to health risks of mobile phones. However, no claims have been made to date and it is not aware of any claims pending.

Case Study 2

- Minisure is proposing a Scheme of Arrangement
- AsbCorp is a policyholder of Minisure
- Consider the information on Minisure and AsbCorp set out below
- You are a director of AsbCorp. Decide whether:
 - You will vote for scheme, vote against scheme, or ignore scheme
 - (If time) the value you would attribute to your vote

COMPANY NAME

Minisure

BACKGROUND

Minisure wrote insurance and reinsurance across many lines of business for almost 100 years before going into run-off in the mid-1990s.

FINANCIAL STRENGTH

Minisure has unpaid claim liabilities of £100 million, free reserves of £10 million and no sources of further funding.

Creditor

COMPANY NAME

AsbCorp

BACKGROUND

Manufactured asbestos containing products during the 1960s before diversifying into other areas.

INSURANCE COVER

- Insured by Minisure during 1960s
- All coverage was written on an occurrence basis
- Minisure's share of the total policy limits is £2 million, and outstanding claims are currently £1 million

LIABILITIES

AsbCorp has commissioned detailed actuarial analysis on its asbestos liabilities. The studies were prepared on a best estimate basis only, and show that the Minisure policies are expected to be exhausted.

In the absence of prior settlement, payments from Minisure would be due over the next 5-20 years.