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# **Solvent Schemes of Arrangement**

## **A Run-off Exit Strategy**

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## How to exit from run-off?

*“Reinsurance is...  
like hell – easy to enter  
and almost impossible  
to exit.”*

2003





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## **Solvent schemes: an exit strategy**

- 2003: 11 solvent schemes
- 2008: 191 solvent schemes

An effective exit strategy for insurance  
and reinsurance run-off



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## **Run-off issues & risks**

- Claims deterioration
- Credit deterioration/failure of reinsurers
- Diversion from current business
- Ongoing management & regulatory costs
- Capital tied up for many years
- Skills needed to manage the run-off



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## **What is a solvent scheme?**

- Court-approved deal between company & its cedants/policyholders (creditors)
- Needs approval by 50% in number & 75% by value of creditors voting
- Binds all creditors if approved
- Needs no objection from APRA & ASIC
- Does not bind reinsurers



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## **Legislation**

- In Australia: S 411 of the *Corporations Act 2001*
- Part 26 of the *Companies Act 2006* of Great Britain
- Similar legislation in Bermuda, HK, Singapore, NZ, Malaysia & Rhode Island



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## **Why do a scheme?**

- Certainty & finality; no claims allowed after scheme
- Save run-off management costs
- Release capital
- Focus on current business
- Flexibility



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## **Why creditors agree to schemes**

- Receive earlier payment in full
- May share in some of the cost savings
- Simplified claims agreement process
- Certainty of recovery





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## **Potential disadvantages for creditors**

- No claim by Bar Date → no payment
- May receive less (or more) than if run-off.

**Key: design a fair & reasonable claims agreement process**



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## **What books can be schemed?**

- Can be valued fairly
- Small number of large creditors or fairly evenly spread?
- Reinsurance? Credit quality? Set-off?
- Litigation/unresolved market issues generally excluded



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## **What business cannot be schemed?**

- Compulsory/protected classes of insurance eg workers' compensation
- Personal lines insurance

**Reinsurance** of these classes can be schemed



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## Implementing a solvent scheme

**Distribute scheme to  
cedants/ policyholders**

**Agree claims  
(or refer to Adjudicator)**

**Design and promote scheme  
9-12 months**

**Scheme  
Effective**

**Implement scheme  
6-9 months**

**Scheme  
Terminated**

- Gain support from major stakeholders:
  - cedants/ policyholders
  - reinsurers
  - regulators
- Draft scheme document
- Consider IBNR allocation

- Send Practice Statement Letter
- Court hearing for leave to hold scheme meeting
- Notice of meeting to cedants/ policyholders
- Creditors' meeting(s)
- Court sanction

Cedants/  
policyholders  
submit claims  
(up to Bar Date)

Make scheme  
payments



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## **To consider during the scheme process**

1. Consultation
2. One class of creditor or two?
3. Independent Vote Assessor
4. Bar Date



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## **1. Consultation**

- Scheme should balance needs of each stakeholder
- Must consult with a good cross-section of creditors



## **2. One class of creditor or two?**

**Creditors' ability to consult together with a view to their common interest**

- In Australia creditors with IBNR & non-IBNR claims held to be in a single class
- In English cases (BAIC, NRG & WFUM) IBNR & non-IBNR sometimes held to be in separate classes & sometimes allowed to vote together



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## **3. Independent Vote Assessor**

- Ensure consistent, fair & transparent valuation of creditors' claims for the scheme vote(s)
- Now global best practice to appoint an Independent Vote Assessor - often an actuary





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## **4. Bar Date**

- Bar Date now typically 6 months from date scheme is effective
- Scheme effective once copy of court order is delivered to ASIC  
(after court & creditor approval)
- Time to bar date must be fair & reasonable



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## **Other exit strategies for run-off**

1. Portfolio transfer
2. Sale
3. Commutations
4. Reinsurance



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## **Actuarial work in a solvent scheme**

- Estimation guidelines
- Identify & consult with IBNR & non-IBNR creditors – if 2 classes
- Allocate IBNR to creditor level pre-Bar Date, at the latest
- Individual creditor valuations
- Adjudicator & vote assessor



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## **Conclusion**

- 3 schemes completed in Australia with more in pipeline
- Adaptable & effective exit strategy
- Global financial crisis → more schemes as reduced buyer appetite for run-off books
- Can boost insurer's depressed ROE