

Scottish Lion sets cat among pigeons

The rejection of Scottish Lion's proposed scheme of arrangement has stirred up a controversy that shows no sign of abating. Lord Justice Glennie's ruling appears to say that, in cases where there is no evident 'problem' to be addressed, solvent schemes should require 100 per cent creditor approval. In September, the Scottish High Court found in favour of a small group of US objectors to the Scottish Lion scheme. Lord Glennie wrote in his Opinion that: 'In a situation where the company is sound financially, why should one group of creditors who might wish to enter into a commutation agreement with the company be entitled to force other creditors to participate against their will?'. He added, 'I do not see why [the principle of creditor democracy] need apply in all cases where a scheme of arrangement is proposed. A solvent scheme is an instance of a case where, subject to other considerations, creditor democracy should not carry the day.'

The decision effectively overruled the previous requirement of 75 per cent creditor approval in favour of 100 per cent approval in the case of solvent companies. Thus, or so it would seem, proposed schemes of arrangement for companies that are not financially 'impaired' might effectively be subject to the whim of a single creditor veto – a prospect that has delighted some and disappointed others.

Of the many dissenters, Dan Schwarzmann of PricewaterhouseCoopers, scheme advisor for Scottish Lion, is perhaps the most vocal. Says Schwarzmann: 'According to Lord Glennie if a solvent scheme is to succeed then all creditors who vote must vote in favour of it. This results in creditor democracy being replaced by a single creditor veto which simply cannot be what was intended by the Companies Act.' He adds, 'the ramifications of this judgment are huge.'

Speaking at a roundtable discussion* held by *Run Off & Restructuring*, US lawyer David Strasser of Eckert Sea-



Forrest Krutter



David Strasser



Dan Schwarzmann

mans was concerned about the judgment giving objectors increased powers: 'The way I read the opinion is he's only protecting objectors, he's not protecting no-votes. You can still have a scheme go through if you buy off the objectors. So you're giving the objectors a huge club to come in and say "okay I want four times what everybody else is getting".'

For Philip Hertz of Clifford Chance the real worry was the wider-reaching effects of the judgment: 'I think the most important question is "what does it mean?", as opposed to what it means for Scottish Lion. Because actually this is a judgment that is made in the context of a solvent scheme which could have huge ramifications in other areas. What the judge is basically saying here is unless you have a problem, whatever that means, then effectively you need unanimous consent to do anything for creditors or members.'

According to Reynolds Porter Chamberlain's Vivien Tyrell: 'Insurers are going to be disappointed with this judgment. They will see it as undermining legislation that was designed to introduce creditor democracy for voluntary schemes of arrangement, so that a small percentage of creditors wouldn't have the power to derail a scheme favourable to the vast majority.'

There are those, of course, who have welcomed the decision. Berkshire Hathaway's Forrest Krutter, during the roundtable discussion, dramatically declared: 'I think it is one of the great achievements that will stand along with

the Magna Carta.'

Benedict Lenhart of Covington & Burling, who acted for some of the scheme objectors, told *Run Off & Restructuring*: 'We are pleased that Lord Glennie agreed with the arguments of the objecting policyholders in the Scottish Lion solvent scheme. Lord Glennie's decision is consistent with the earlier rulings in BAIC and WFUM. We continue to believe that the Scottish Lion solvent scheme is both unfair and unlawful under UK and US law. We are gratified that in all three of the contested solvent schemes to date the UK courts have strongly agreed with the arguments of the objecting policyholders.'

Some have tried to find a silver lining. For Ernst and Young's Kevin Gill: 'The uncertainty created by the case around solvent schemes will drive further innovation in the run-off sector. A scheme is a highly flexible solution with wide application and can be adapted accordingly. Perhaps in some cases we will see optionality being provided to creditors. In other cases, we may find that other solutions, such as portfolio transfer or entity disposals will provide better value or certainty for exiting a run-off'. And PwC's Schwarzmann has remarked: 'For me the good thing about the Scottish Lion judgment is that it is in respect of a point of law. [There] is a clear point that can be discussed in the court of appeal.'

Others take the view that the significance of the ruling has been overstated. Tim Goodger of Elborne Mitchell, for

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Equitas wins case against R&Q

The English Commercial Court has ruled in favour of Berkshire Hathaway's Equitas to recover reinsurance losses from Randall and Quilter's subsidiary reinsurer R&Q Re (UK), formerly known as Brandywine.

The decision follows a three week long case in which a new precedent was set when Equitas was allowed the use of actuarial models to calculate substantial payouts.

High Court judge Mr Justice Gross said: 'I am persuaded that the models are both capable of making the transition from the general to the particular and do go on to provide a reasonable representation of reality.'

Following the decision, Howard Kaye, group general counsel for Resolute Management Services (managers of the Equitas run-off), told *Run Off & Restructuring*:

'We felt strongly that there was no good reason why a well prepared actuarial model should not meet the burden of proof requirements in the making of reinsurance recoveries and the court has now

confirmed that it does.'

A statement released by R&Q said that its board was 'disappointed to note that notwithstanding the very strong legal opinion given to it ahead of the trial, the court has determined that Equitas can use actuarial models.'

The dispute, which involved some 26 test cases representing more than 4,000 claims, largely related to losses following both the 1989 Exxon Valdez oil spill and claims by Kuwait Airways arising out of the first Gulf War.

Payouts are likely to run into the hundreds of millions of pounds, however the ruling does include significant discounts of 25 per cent in the case of Exxon Valdez and 13.5 per cent in the case of Kuwait to be applied to the ultimate costs.

The decision has been much anticipated, and Mr Justice Gross commented that he hoped the notorious LMX reinsurance spiral would be 'kick-started' by the ruling.

Said Kaye: 'The case was fought to enable

the LMX spiral, which had effectively come to a halt in 1996 for Kuwait losses and 1998 for Exxon losses, to recommence turning. In this respect we believe the case has particularly wide market implications since the frozen spiral had prevented other losses being recovered, not just Kuwait and Exxon.'

R&Q has stated it will be working with its financial advisors to 'quantify the potential financial effect of this judgment on the group, which may well include reimbursement of the legal costs incurred by Equitas in the trial', adding that it was considering 'the possibility of a counter-claim to apply a discount to substantial sums previously paid to Equitas and is considering whether the judgment gives appropriate grounds for an appeal in whole or in part.'

In its 2009 interim report, R&Q had previously called the result of the case 'potentially significant' and noted that the legal costs of the dispute in that half year alone amounted to 'approximately £2 million'.

Tawa buys PRO from Swiss Re

Tawa is to acquire the PRO group of companies, comprising PRO Insurance Solutions Ltd, PRO Insurance Solutions, Inc and Participant Run-Off (PRO), Iberica, SLU from Swiss Re.

Announcing the acquisition, Gilles Erulin, chief executive of Tawa, said PRO was a good fit with Tawa as there was hardly any overlap between their current activities and the acquisition would strengthen the group's revenues from recurring fees. PRO's Spanish subsidiary would give the group a further advantage when seeking third party business in Continental Europe.

PRO will continue as a separate brand and operate as the third party service provider within the group, while Tawa focuses on acquisitions. Tawa Consulting will 'probably' be rebranded as PRO.

The £38 million deal comprises an initial cash consideration of £4 million and deferred cash consideration of up to £12 million dependent on PRO's earnings over the five years to 31 December 2014. Prior to acquisition, Swiss Re will receive divi-



Gilles Erulin, Tawa: PRO is a good fit with Tawa

dends of approximately £22 million from the PRO companies. Expected net assets of the PRO group of companies at acquisition are £0.5 million.

As part of the transaction, KX Re, a wholly owned subsidiary of Tawa, will purchase an estimated £7 million of insurance receivables from PRO at the time of closing. Tawa says the acquisition will be funded from its existing cash resources and there will be no change to the board or senior management of Tawa arising from the acquisition.

PRO has offices in the UK, USA and Spain and handles both live and run-off business. In 2008, it generated profits after tax of £7 million and disclosed net assets of £20 million.

Tawa says the acquisition of PRO is in line with Tawa's strategy of building up a portfolio of diversified run-off businesses. 'We look forward to welcoming the PRO team to the Tawa Group where their invaluable knowledge of the run-off market and global platform will be of considerable benefit in achieving our strategic goals,' says Erulin. 'We are also pleased that Swiss Re has confirmed that PRO will enjoy preferred provider status for servicing its run-off operations. The deferred consideration element has been agreed between Swiss Re and Tawa to ensure we work hand in hand to increase the profitability and value of PRO over the coming years.'

Tawa has also announced its interim results for the six months ended 30 June 2009, showing increased profits and reduced gearing.

Market appointments

William Sturge has joined the recently formed law firm Carter Perry Bailey. Sturge joins from the reinsurance group at LG where he acted primarily for London market participants. His practice is in the area of insurance and reinsurance law and international trade and he is admitted as a solicitor both in England and in Australia (New South Wales). Sturge says he is 'truly delighted to be joining Bill, Stephen and Bernadette's new practice. They are a highly innovative team and have exceptional knowledge and expertise in the area of insurance and reinsurance law, which they have made the central focus of the firm.'



William Sturge



Vivien Tyrell

Vivien Tyrell has moved from the London office of Edwards Angell Palmer & Dodge (formerly Kendall Freeman) to Reynolds Porter Chamberlain to head their Restructuring and Insolvency Group. An authorised insolvency practitioner, her experience of insurance insolvency dates back to 1996. She advises on all aspects of insurance and reinsurance restructuring and insolvency, including corporate governance in the context of distress and exit solutions such as solvent schemes of arrangement and Part VII transfers.

R&Q group has appointed **Tom Booth** as corporate finance director. The post, which will sit just below main board and report directly to CEO Ken Randall, is expected to augment the group's M&A capabilities and assist in its future corporate development. Booth joins R&Q from Numis Securities, where he was a director in corporate finance, focusing on the non-life insurance sector. He advised R&Q on its listing on AIM in late 2007 and has worked closely with the company over the past two years.



Tom Booth



Ian D Mason

Ian D Mason has joined law firm Barlow Lyde & Gilbert as a partner from Ashurst. His practice encompasses corporate and transactional work, including acquisitions and disposals, joint ventures and a wide range of commercial contracts, with an emphasis on the insurance and broader financial services sectors. In recent years, Mason has focused on corporate and restructuring work for major insurance groups, and he has expertise in advising on insurance business transfers under the UK Part VII regime, some in the context of group reorganisations.

JMD Specialist Insurance Services (JMD), has formed a new broker services team led by **Alistair Lang**, formerly head of the broker services division of Lambourn, now part of the Capita Group. Lang is joined by **Neil Shaw** who has been appointed as a business development consultant to the team. Shaw was formerly a board director of JH Minet and Co before it was purchased by Aon. The new operation will offer a range of services to brokers, including claims legacy management, wordings creation and policy legacy management, broker replacement and pre and post binding quality assurance. John Dewen, CEO of JMD, says: 'The formation of our broker services team is an exciting new step for the company at a time when the market is looking long and hard at its costs and processes. London's work on process reform has driven the need for brokers to streamline their operations and question whether they are obtaining value for money from both their internal and external support teams.'

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ECJ rules VAT payable on transfers

The European Court of Justice has ruled that VAT is liable on the transfer of reinsurance contracts. The German tax authorities argued that the transfer of a portfolio of reinsurance contracts from Swiss Re in Germany to a Swiss associate company was a supply of service and thus liable to pay the German VAT rate of 19 per cent. The ECJ subsequently ruled in their favour and that decision now applies to all EU member states.

'The ruling applies to transfers of insurance as well as reinsurance contracts pursuant to Part VII of the Financial Services and Markets Act 2000 (and the equivalent procedure in other EU jurisdictions) which, until this decision, had been treated as exempt from VAT or outside the scope of VAT,' Ambereen Salamat of Edwards Ang-

ell Palmer & Dodge told *Run Off & Restructuring*.

Despite the decision being binding on all EU member states, tax authorities will still retain some discretion in implementing it. However, adds Salamat, 'A favourable interpretation by HM Revenue & Customs is unlikely given the UK government's submission in this case that such transactions do not constitute "banking, financial and insurance transactions" (within the meaning of the Sixth EU Council Directive) and so should be subject to VAT.' Furthermore, as Clyde and Co's Trefor John told *Run*



Ambereen Salamat

Off & Restructuring, 'depending upon how HMRC interprets the decision, it may well review past transactions.'

A further detail requiring interpretation by individual tax authorities will be transfers of going concerns (TOGCs). As John points out: 'It is interesting that the issue of TOGCs was not discussed by the ECJ. In the context of the UK we shall have to wait and see whether HMRC will seek to restrict the availability of TOGC treatment. For example, it may seek to impose VAT other than in circumstances where additional assets/staff are involved in the transfer.'

Ultimately, as Salamat notes: 'The ECJ decision is not good news for insurers and reinsurers as it is likely to increase the cost of transfers of portfolios.'

Scottish Lion <con't>

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instance, says: 'It has been suggested that the judgment means that a single creditor is able to veto a scheme notwithstanding that the requisite majority of scheme creditors have voted in favour of a scheme. The judgment does not however appear to be as draconian as that. The judge states that schemes are to be treated on a case-by-case basis and it is as well to consider this decision in the context of a judgment that provides a clear recital of the objecting policyholders' points in this case.' And consultant Nigel Morson, writing on the Legacy Forum website, described the reaction to the judgment as 'extraordinary hysteria'.

No matter your stance, one thing is certain: the decision is more than just about Scottish Lion. US policyholders objected to the scheme on a number of grounds – vote valuation, the timetable, deadlines imposed and the choice of law and forum. But, as Schwarzmann has pointed out, the Scottish scheme approval process differs from the English one; Lord Glennie's opinion focused not on the Scottish Lion scheme in par-

ticular but on schemes in general: 'The exam question was "forget Scottish Lion, forget any scheme that's come through – can the minority be bound by schemes?" And his [Lord Glennie's] response to that was "not unless it's impaired".'

A further twist is that this decision by a Scottish court is 'persuasive' but not binding in England & Wales, where most UK run-off insurers are domiciled, and legal opinion seems divided as to whether the English High Court will take note.

Since the ruling, a further court hearing saw no further evidence presented on behalf of Scottish Lion, leaving the original decision upheld. A formal appeal has since been lodged, and if this fails to overturn the original decision the case may well go all the way to the Supreme Court. The industry awaits with baited breath.

* Read the full roundtable discussion on Solvent Schemes of Arrangement in the special supplement published with this issue of *Run Off & Restructuring*. That supplement, along with other related articles, can also be found on our website www.runoffandrestructuring.com.

Goldstreet stake sold to R&Q

Randall & Quilter Group has acquired a 70.18 per cent stake in US-based insurer Goldstreet, from Sequa Corporation. Goldstreet has been in run-off since 1987 and comprises mainly assumed reinsurance business with net reserves of around \$8 million and a net asset value of about \$9 million as at 30 June 2009.

R&Q says it will make a cash payment from existing resources of \$3.375 million for the 70.18 per cent stake, and that it is in continuing negotiations to acquire the remaining 29.82 per cent of Goldstreet.

'We are pleased to have successfully concluded the acquisition of Goldstreet, which serves to increase our presence in the US, where we now have three group owned insurance companies,' says Ken Randall, CEO. 'The acquisition also demonstrates our ability to grow the insurance company division on terms which meet our pricing criteria and is earnings enhancing for Randall & Quilter in the current financial year.'

ARC Awards & appointments

The Association of Run-off Companies (ARC) has announced the winners of its annual awards and has made two new appointments to its board. The 2009 ARC Awards were presented at the annual members' dinner by ARC chairman, Paul Corver. The winners were:

- Industry Initiative of the Year - Watson Wyatt Ltd for its Simulum ICA Model
 - Company of the Year - The Randall & Quilter Group
 - Mid-Sized and Smaller Company of the Year – Ambant Ltd
 - Advisory Services Provider of the Year – Clifford Chance LLP
 - Services to Legacy Business – Jim Moran
- Watson Wyatt was felt by the judges to have engaged with the run-off community and provided a good initiative into the ICA modelling requirements for companies in run-off.

Randall & Quilter was named company of the year for its pre-eminence in the legacy sector, for its initiative in diversifying into new areas and for supporting the market Rendezvous.

Ambant, winner of the mid-sized company award, has quadrupled in size over two years to its current 16 employees.

Advisory services provider of the year Clifford Chance was one of several nominees involved in the Equitas Part VII transfer to Berkshire Hathaway and the judges felt it had probably the most difficult role in the transfer process.

Jim Moran won the individual award for services to legacy business for his role in creating a market facility that has helped to make commutation a respected market practice.

ARC's AGM saw two new appointments to the board: Bill Hook, operational director at Tawa, and Rhydian Williams, owner and director of RI-Solve. Darryl Ashbourne (KPMG) was re-elected to the board and Julian Miller (Beachcroft), who had been acting as a co-opted member, was formally elected.

Retiring from the board were: Tony Bamber (company secretary), Bill Bower, (ARC Academy chair) and David McGuigan (founding member of ARC).



Mid-Sized and Smaller Company of the Year – Ambant Ltd



Advisory Services Provider of the Year – Clifford Chance LLP



Services to Legacy Business – Jim Moran



Company of the Year - The Randall & Quilter Group



Industry Initiative of the Year - Watson Wyatt Ltd for its Simulum ICA Model

events

26 January

Solvent Schemes of Arrangement: Latest Developments in the UK and US

30 Rockefeller Plaza, New York, NY, USA
Contact: www.litigationconferences.com

27 January

Internal Models for General Insurers – Getting Your Model Approved Under Solvency II

Dexter House, London
Contact: www.infoline.org.uk

27-28 January

Asbestos Claims & Liability

Guoman Charing Cross Hotel, London
Contact: www.c5-online.com

3 February

AirSP Band Night with the Rendezvous Band

Venue tba, London
Contact: www.airsp.org

23 February

ARC Congress 2010

Merchant Taylors Hall, London
Contact: www.arclegacy.eu

23-24 February

5th Annual Insurance Regulation

Millennium UN Plaza Hotel, New York
Contact: www.americanconference.com

24 February

AirSP AGM

London
Contact: www.airsp.org

24 February

Asbestos Litigation: A Crash Course for Associates

Hub Cira Center, Philadelphia, USA
Contact: www.litigationconferences.com

3-4 March

AIRROC Commutation Day / Membership Meeting

Dewey & LeBoeuf, New York
Contact: www.airroc.org

4-5 March

3rd Annual Emerging Trends in Asbestos Litigation

Ritz-Carlton, Marina del Rey, CA, USA
Contact: www.litigationconferences.com

8-10 March

Cologne Rendez-vous

Mariott Cologne, Germany
Contact: www.rqjh.co.uk

24-27 March

17th Annual Insurance Insolvency & Reinsurance Roundtable

Scottsdale, Arizona, USA
Contact: www.litigationconferences.com

18 May

Reinsurance Claims Management

London
Contact: www.falconbury.co.uk

7-8 June

Reinsurance Contract Wordings and Disputes

Charing Cross Hotel
Contact: www.falconbury.co.uk

7-10 June

Norwich Rendez-vous

St Andrews Hall, Norwich
Contact: www.rqjh.co.uk/rendezvous

Exchange rates distort run-off figures

The results of KPMG's seventh annual survey of the UK non-life run-off market reveal a staggering increase in the size of that market, up by one third over the previous year. Gross liabilities at end-2008 were £37.4 billion compared to £28.3 billion at end-2007, with tied-up capital of £5.4 billion compared to £4.6 billion at end-2007. The reasons for this dramatic increase, says the survey, are largely due to the monoline insurers and the drastic reduction in their financial guarantee market – accounting for £7.1 billion of run-off – plus of course the impact of the 27 per cent change in the dollar and 24 per cent change in the euro exchange rates against sterling.

As Steve Goodlud of KPMG explains: 'A large proportion of run-off claims come from overseas – particularly the APH claims – and so companies reporting in sterling are facing a significant distortion of results.' So, for example, he points out in the case of Equitas its liabilities rose to £5.9 billion at its year end March 2009 compared to £4.5 billion at year-end 2008 – the highest in the seven years of the survey.

Although overall the survey points to the fact that the run-off market escaped relatively lightly in the recession, there is no doubt that the impact of depressed investment income – and substantial investment



Steve Goodlud

Darryl Ashbourne

write downs on the balance sheet – is taking its toll. This, plus the liquidity constraints and pressure on capital, is definitely leading towards a change of run-off strategy in the future, said Goodlud.

Darryl Ashbourne of KPMG commented on the findings of the survey when it came to the different strategies to extract capital, pointing out that commutations, for example, are seeing far more activity: 'Commutations are more attractive at the moment with companies pushing at an open door with counterparties who are facing capital liquidity issues.' Ashbourne also stressed that, for many companies surveyed, the process of commutation is seen as relatively straightforward and less costly than other tools.

There is clearly continuing interest in schemes of arrangement and Part VII transfers, however. Up to the end of 2008 there

were a total of 177 schemes, although that figure includes 82 separate entities in the EW Payne pool scheme. Notwithstanding the outcome of the Scottish Lion scheme, the survey indicated that schemes would continue to be used as an effective exit strategy in the right circumstances.

As far as Part VIIs are concerned, the survey findings suggest that from now on they will be used more as an external rather than internal mechanism; this is probably because most internal restructurings have been completed and now companies are looking to divest themselves of redundant portfolios to third parties.

The impact of Solvency II is definitely expected to bring greater challenges to the run-off sector; regardless of the directive's stance on run-offs, the FSA has made it clear that it will be applying Solvency II to UK run-off companies without the exemptions relating to age or size of run-off. However, the survey responses showed that companies are 'well engaged' in the compliance process, said Goodlud – a process which, he points out, will cost the entire UK insurance industry £50 billion, according to a recent announcement by the ABI, which is roughly equal to the market's capitalisation.

As for new business emanating from Solvency II, the survey predicts another wave of transfers/restructurings before 2012 including the 'identification of under performing business.'

The survey noted changes in run-off buying trends, with the Unionamerica sale representing the high point of buyer interest, following which there has been less buyer interest and lower prices. KPMG's John Wardrop also suggests that some former acquirers may even leave the market. But, he stressed, although prices are low, the amount of business on offer is growing and so 'the trick is to align the price to availability.'

As far as run-off management company consolidation is concerned, Wardrop says that there are a number of drivers present at the moment, including economies of scale and the wish to expand into new areas – which may mean we see more unions along the lines of Axiom/CTC and PRO/Tawa.

High Court sanctions Trimark Pools schemes

The Trimark 1968 and Prior Years Pools schemes have been sanctioned in the High Court of England & Wales by Mr Justice Henderson. Scheme creditors voted overwhelmingly in favour of the schemes at meetings held on 9 October and 30 October 2009.

The Trimark Pools schemes comprise 48 companies representing 61 original underwriting entities from various countries including Austria, France, Germany, Italy, Portugal, Switzerland, UK and USA. The Trimark Pools have been in run-off for over 40 years having underwritten business from 1932 -1968.

Scheme adviser Mike Walker, head of KPMG's Restructuring Insurance Solutions practice in the UK, describes the sanctioning of the schemes as 'a clear indication that schemes of arrangement continue to be an effective mechanism to obtain genuine finality. These schemes were proposed following extensive consultation with creditors, which clearly contributed to the virtually unanimous support they received.'

KPMG is the scheme advisor, Clifford Chance is the legal advisor, Aon is the scheme manager and Axiom Consulting is the designated agent of the scheme manager.