

FSA Schemes guidance – July 2007

Key points from the FSA's paper issued on 31st July 2007 - "FSA process guide to decision making on Schemes of Arrangement for insurance firms"

The FSA's process guide published on 31 July 2007 explains how the FSA engages with Schemes of Arrangement ("Schemes") and, in particular, its process for reviewing Schemes for the firms it regulates and the criteria used in that assessment. The document offers a guiding set of principles for those proposing Schemes which recognises that the nature and substance of each Scheme can vary considerably and allows for the individual circumstances of a particular Scheme to be consistently appraised in line with the FSA's 11 Principles of Business.

Key points to highlight:

Companies proposing a Scheme must advise the FSA of their intentions (this means both the company's normal FSA supervisor as well as the Scheme contact in the Wholesale Insurance Run-Off team). The FSA will then consider any Scheme proposal in line with what is laid out in their document

Scheme documentation should be sent to the FSA in near-final form for review at least 8 weeks before the application for leave to convene a meeting of creditors is heard by the Court. The FSA has now established an internal committee to ensure consistency in its approach to all Schemes.

The FSA consider a range of issues when reviewing a proposed Scheme including the business subject to the Scheme, the reason for proposing a Scheme, the type of firm proposing the Scheme and its degree of solvency as well as the policyholders impacted by the Scheme. We have focused on some of these issues in more detail below:

Types of policyholders involved

The types of policyholder impacted by a Scheme will be considered by the FSA when assessing the Scheme. Greater FSA scrutiny is usually needed where direct policyholders are involved and, in particular where these are individual direct policyholders, than may be required where the policyholders are themselves commercial organisations including insurance and reinsurance firms.

Degree of solvency of entity proposing a Scheme

- **Insolvent firms** – the FSA would normally be supportive of a Scheme for an insolvent firm providing the Scheme treats policyholders fairly.
- **Marginally solvent firms** – a firm is defined as marginally solvent if its capital resources are below the lower of its own Internal Capital Assessment ('ICA') or FSA Individual Capital Guidance ('ICG'). The FSA would normally support a scheme for a marginally solvent firm providing, having regard to the firm's resources, the Scheme treats policyholders fairly.
- **Substantially solvent firms** – a firm with capital resources at or above 'ICG' would need to demonstrate that the intended outcome of a Scheme is to place policyholders in no worse position that they would be in a solvent run-off.

Type of business being Schemed

The FSA would not normally object to a Scheme for either short or long tail business providing the Scheme treats policyholders fairly.

Age of liability exposures subject to Scheme

The FSA recognise that business which has been in run-off for a longer period is likely to be more stable and hence may be more suitable for a Scheme. The main issue here is that the value of any business being schemed needs to be reasonably ascertainable.

Pools

The FSA recognises that pools can be very complex and there are benefits to policyholders of pool members acting together. In this regard it will base any decision regarding a pool Scheme on the position of the pool as a whole.

Policyholder Advocate

The FSA also raise issue of the potential appointment of a Policyholder Advocate if the proposed Scheme affects the interests of private retail policyholders or small commercial policyholders or if a Scheme is likely to be complex or controversial. The Policyholder Advocate would liaise with the firm on behalf of the relevant policyholders in this type of situation. The Policyholder Advocate should have the necessary and specific skills required to perform the role for that particular Scheme and is likely to both provide advice to policyholders on the Scheme and prepare a report.

Conclusion

Whilst it is not the role of the FSA to approve Schemes, any Scheme which poses a risk to the achievement of their objectives will be objected to by the FSA. As such, early consultation with the FSA has long been a prudent and necessary step in the formulation and development of Schemes

The paper provides useful guidance to companies considering Schemes around the areas for regulatory focus. The FSA also state that despite the decision making criteria outlined in their paper, they also may not to object to a Scheme if the proponent of a Scheme demonstrates that the Scheme treats policyholders fairly, for example through suitable additional benefits for policyholders and/or safeguards for dissenting policyholders. This further illustrates the fact that Schemes should be appraised on their individual merits and that a principle based approach allows for both consistency and flexibility of approach in line with the FSA's approach to regulation in general.

Note

The FSA's document makes reference to the FSA's eleven "Principles for Businesses" which were published in April 2007 and a link is provided here to the document which contains details of these principles (see page 11)'. <http://www.fsa.gov.uk/pubs/other/principles.pdf>

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