Article Title: ARCHIVE | Criteria | Insurance | General: Solvent Schemes Of Arrangement Data: (EDITOR'S NOTE: — This criteria article is no longer current. It has been superseded by the article titled "Criteria | Insurance | General: Insurers: Rating Methodology," published on May 7, 2013.) Solvent insurers regularly have problems closing run-off books of business, branches, or subsidiaries, due to the possibility of new claims being reported many years after the end of the policy period. Companies have a number of alternatives available to them to deal with this issue: natural run-off to expiry; commutations; reinsurance arrangements; or the sale or transfer of the obligations. In each of these methods, there is no change to the terms and conditions of the original contract unless both parties come to an agreement. For England- or Bermuda-domiciled companies, or companies in countries with similar legislation, an alternative way to resolve the issue of long-term run-off is through the implementation of a 'solvent scheme of arrangement'. Such schemes are similar to multiple commutations. However, schemes of arrangement only require approval by a majority of affected creditors, and therefore may become binding upon any creditors who voted against the scheme. A pressing question for Standard & Poor's Ratings Services is whether the binding of the scheme upon creditors who have not voted in favor would constitute the equivalent of default on creditors' obligations, in which case the lowering of the long-term counterparty credit rating to 'SD' (selective default) may need to be seriously considered. Solvent Schemes Of Arrangement A scheme is possible under section 425 of the U.K. Companies Act 1985, section 99 of the Bermuda Companies Act 1981, or similar legislation in other countries, thereby giving a company power to compromise with creditors or a class of creditors in order to achieve a court-sanctioned and enforceable resolution with creditors, including policyholders, with respect to variations from the original contract. There are very few statutory requirements for a scheme, allowing its scope and valuation to be proposed in such a way as to attract maximum support from the majority of creditors involved. Where such a scheme is proposed for insurance contracts, the creditors are offered an evaluation of their liabilities on a 'fair and consistent' basis. If the majority by value and number (as defined by the relevant legal system) vote in favor of accepting the proposed scheme, the company can apply to the High Court to sanction it and make it binding to all creditors concerned and to the insurance company. If approved and sanctioned, the scheme will bind all cedents and insureds detailed under the scope of the scheme--representing either an entire company's business, individual books of business, or participations in pools. This would obligatorily include any creditors who voted against the scheme, who did not receive notice of the scheme, or who were unaware of the proposals. The scheme will also include a bar date, after which new claims will not be admitted. If the scope of the scheme covers business written in the U.S. and the company has assets located in that jurisdiction, the company may obtain an order under section 304 of the U.S. Bankruptcy Code to prevent any claim over the companies' assets; although relating to insolvency, the code has occasionally been used to protect solvent schemes. Equivalent procedures exist in some, but not all, other jurisdictions. If a 'sufficient connection' can be demonstrated with England or Wales, then foreign-incorporated and foreign-domiciled companies can, under section 221 of the U.K. Insolvency Act 1986, implement a scheme under English law. Dispute Resolution In contrast to a 'traditional' contract-by-contract commutation, there is no guarantee under an approved scheme that all creditors have agreed to the proposed variation of their original contract. Once the scheme is in force, there will normally be legal preventions to the subsequent use of arbitration or court action to resolve disputes with regard to the valuation of contingent and future claims. The situation can thus arise that a minority of creditors find themselves obliged to accept a settlement they do not consider to be fair, or in their best interests, and they are without legal recourse to contest the scheme. Impact Of Solvent Scheme Of Arrangement On The Rating Methodology Upon a scheme coming into force following the successful agreement and sanctioning of the scheme, Standard & Poor's will assess the following factors when considering whether the action is the equivalent of a selective default: Management intent must be to achieve finality, and not explicitly to minimize creditor obligations or to disadvantage individual creditors or classes of creditors. The scheme must have obtained clear agreement among the majority (by value and number) of creditors or classes of creditor. There must be no significant dissent among voting creditors. If applicable, management must have displayed willingness to address the reasonable concerns of any dissenting voters prior to the scheme coming into force. The scheme must contain adequate safeguards and mechanisms to resolve any disputes

over the quantum of any settlements made. Although some of the companies proposing a solvent scheme of arrangement may be in run-off, many will still be actively underwriting new business. Standard & Poor's therefore has to consider the value of making an adjustment to the current counterparty credit rating to reflect the problems of the past. As long as perceived management intent is benign and the undisputed aim is to fairly honor all creditor obligations without repeated recourse to aggressive commutations or schemes, rating committees are unlikely to treat the one-off implementation of a scheme as equivalent to selective default. Group E-Mail Address
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