

Deloitte.

ADDLESHAW GODDARD

Part VII Transfer Seminar

Current Developments - 7 March 2007

Deloitte.

ADDLESHAW GODDARD

Chairman's remarks

Simon Twigden, Addleshaw Goddard

Agenda

- Introduction – Simon Twigden, Partner, Addleshaw Goddard
- The use of part VII transfers as a finality and restructuring tool - Mark Adams, Partner, Deloitte
- Part VII Transfers, key legal issues – Richard Leedham, Partner, Addleshaw Goddard
- Panel session – Current developments and recent challenges:
 - Ian Clark, Partner, Deloitte
 - Ken Randall, CEO, Randall & Quilter
 - Richard Leedham, Partner, Addleshaw Goddard
 - David Hindley, Partner, Deloitte

The Context – Available “exit” solutions

- Run-off to expiry
- Sale
- Commutations
- Reinsurance
- Scheme of Arrangement
- Portfolio transfer - Part VII FSMA (2000)

Part VII transfers – “hot” issues

- Effect on Reinsurance?
 - S.112 (2) (a) FSMA
 - In Re Cater Allen: re Premium Banking Limited (2003)
 - Wasa (2002) ALL ER(D) 127
 - Treasury consultation process and proposed changes
- Lloyd’s Syndicates – alternative to RITC?
- US based assets?
 - Re Petition of David Rose 318B.R.771
 - Re Riverstone Insurance (UK) Limited 05-12678 (RDD)
 - Chapter 15 US Bankruptcy Code?
- European Union/EEA ramifications?

Deloitte.

ADDLESHAW GODDARD

Commercial Drivers

Mark Adams, Deloitte

Introduction

- A process to transfer liabilities and assets
 - Subject to Court approval, an identified book of business is transferred to another approved insurer
 - Governed by ss.104-117 Financial Services and Markets Act 2000 ("FSMA")
 - FSA provides guidance in handbook (Sup 18)
 - Replaced 'Sch.2C' transfers
 - UK legislation derived from EU directive
 - Similar legislation required in all EU states
- Not a Scheme of Arrangement
 - Does not change obligation to meet claims in the normal course of business
 - Does not introduce 'cut-off' finality for policyholders
 - Does not require a policyholder vote, although provides opportunity for objection at Court sanction

Part VII Transfers

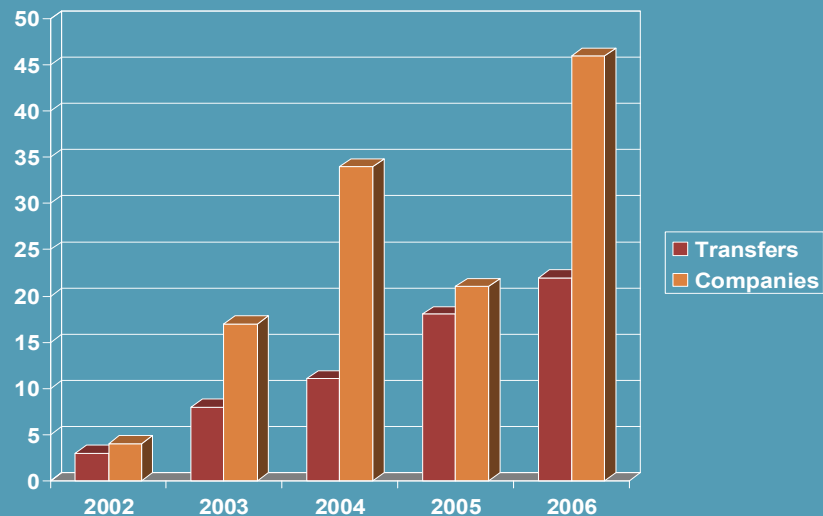
Parties involved

- **Court**
 - Order Sanctioning Scheme (after hearing objections, if any made)
- **FSA**
 - Integral to the process and may object (in Court)
- **Independent expert**
 - Generally an accountant or actuary
 - Must consider impact on:
 - Policyholders being transferred
 - Policyholders left behind
 - Existing policyholders of transferee company
- **Policyholders**
 - Requirement to notify
 - Opportunity to object at Court hearing
- **Reinsurers**
 - No legal obligation to notify, but likely to do so in practice (as indicated in FSA guidance)
 - Have objected to some transfers at Court hearing

Part VII Transfers

General insurance transfers to date

- Legislation introduced at N2 – 30 November 2001



Year	Transferors	Transferees	Transfers
2006	46	24	22
2005	21	22	18
2004	34	11	11
2003	17	8	8
2002	4	3	3

Source: www.gazettes-online.co.uk; Deloitte analysis

A number of transfer arrangements include more than one company transferring or receiving business

Part VII Transfers

Typical uses of Part VII

Run-off Exit Solution for Capital Provider

- Sale of run-off portfolio
- Equitas
- Lloyd's of London
- Part of 'redomestication' of foreign portfolio to UK for subsequent transfer

Group Simplification/Restructure

- Amalgamation of run-off portfolios within a group to create a specialist unit
- Simplification of complex group structure
- Transfer of business between EU jurisdictions, including consolidation under a single regulator

Part VII Transfers

Example – M&A transaction

- Chevanstell Limited / Oslo Reinsurance Company (UK) Limited – parallel transfers to Hillcot Re
- Participation in the Hillcot Underwriting Management Limited pool along with:
 - Hillcot Re (formerly Toa Re UK)
 - Fieldmill (formerly Harleysville UK)
 - Longmynd (formerly Security UK)
- Hillcot, Fieldmill and Longmynd all owned by Castlewood
- Liabilities principally US APH, medical malpractice and general catastrophe liability
- Overall £2.8m transfer of liability to Hillcot
- Transfer provided finality for previous 'reinsurance to close' arrangement between Oslo Re Ltd 1988 HUM Pool members
- Hillcot Re (including post transfer Chevanstell liabilities) reinsured into Bermuda protected cell
- Independent Expert considered security offered by Hillcot Re post both transfers

Part VII Transfers

Example – corporate simplification

Royal & Sun Alliance

- Transfers from 16 companies to British Engine Insurance Limited, an R&SA company
- Requirement to consider impact of possible future sale of British Engine
- Transfers total £299m (£217m net of reinsurance)
- Policies have benefit of group guarantee before and after transfer
- Deloitte acted as independent expert
- FSA letter on change of control published with Independent Expert opinion
- Impact on ILU guarantees

Part VII Transfers

Example – Equitas / Berkshire Hathaway

Two-stage transaction announced, with second stage agreed in principle subject to changes in the law

Phase 1

- National Indemnity (a BH company) has agreed to provide Equitas with \$5.7bn of reinsurance in addition to its 31 March 2006 reserves
- Equitas pays all of its assets, less £172m and Lloyd's contributes £72m

Phase 2

- A Part VII transfer of policies from Lloyd's names to Equitas or a BH company, with a further \$1.3bn of reinsurance for a premium of £40m from Equitas including £18m from Lloyd's
- Lloyd's members approved the transaction by 99.77% to 0.23% on a 65.7% turnout – announced 23 February
- HM Treasury consultation on a change to the law to allow Part VII transfers of old Lloyd's business closed on 26 January
- Phase 1 dependent on Equitas trust funds transferring to Berkshire Hathaway by 31 March 2007.
- Independent expert will compare situation post Phase 1 with position post Phase 2
- Additional \$1.3bn of adverse loss development cover will be compared to theoretical ability of policyholders to cut through to Names or New Central Fund

Deloitte.

ADDLESHAW GODDARD

Part VII Transfers Key Legal Issues

Richard Leedham, Addleshaw Goddard

Overview

- Section 111(3) FSMA - *“Court must consider that in all the circumstances of the case, it is appropriate to sanction the Scheme.”*
- Increasingly popular mechanism with evolving jurisprudence on what circumstances may effect sanction.

Overview cont...

- Aim of this session:
 1. To highlight guidance from the English Court on objections raised by focusing on two recent landmark decisions: British Engine (“BE”) and Equitable Life (“EL”).
 2. Update on Treasury consultation process and amendments to Part VII.
 3. Update on US/European position.

Objections

Backdrop: Hoffman J principles summarised in *Axa Equity and Life* (2001):

- Absolute discretion conferred on Court.
- Court concerned about adverse affect on policyholder, employee or other interested person.
- Primarily a matter of actuarial judgment.
- FSA expected to be able to express an informed opinion.
- If policyholder(s) may be adversely affected this does not mean scheme has to be rejected.

Objections cont...

- Not a function of the Court to produce what in its view is the best possible scheme.
- Details of the scheme are not a matter for the Court.
- *“The fundamental question is whether the scheme as a whole is fair as between the interests of the different classes of persons affected”.*

Objections cont...

1. Effect on financial security of policyholders:

- where transferee is protected by parent company guarantee (example: BE, with focus on change of control powers and what FSA would do in situation where guarantee no longer effective).
- transferee's new liabilities not ring fenced- EL.
- non-transferring policyholders adversely affected.

2. US policyholder concerns re legality of process/recognition in US:

- BE: answer – transfers are legal in the UK.
- Open question if recognised in US: contrasting decisions in Aviva/RiverStone (SDNY Bankruptcy Court) and the effect of new Chapter 15 provisions.

Objections cont....

3. Ratings issues

- for US cedant, reduction in surplus due to additional S & P charge for drop in value of reinsurance recoveries moving from A- reinsurer to unrated: BE.
- Lloyd's syndicate cedants- lack of/lower rating and impact on results/funds to be deposited by the syndicates: BE.

4. Notice requirements

- broker not being able to identify all policies/notify policy holders- BE.
- objectors not consulted in form of meetings-EL.

5. Other "prejudicial" issues

- Transferee is subsidiary of foreign co – EL.
- Transfer is premature- EL.

Treasury consultation process and proposed changes

- To put beyond doubt that reinsurance policies transfer over.
- To override contract terms that prevent transfer or assignment.
- To oblige notification to all reinsurers of transfer.
- Lloyd's- to cover former members.
- Timetable for changes.

EU

- EU Reinsurance Directive 2005/68.
- Effect and implementation.

Deloitte.

ADDLESHAW GODDARD

Current Developments & Recent Changes

Ian Clarke, Deloitte

Ken Randall, Randall & Quilter

Richard Leedham, Addleshaw Goddard

David Hindley, Deloitte

Deloitte.

ADDLESHAW GODDARD

Closing Remarks

Simon Twigden