



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP6/13

Schemes of arrangement by general insurance firms

September 2013

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1 Introduction

1.1 This consultation seeks views on the Prudential Regulation Authority's (PRA) draft supervisory statement (see below) which explains the stance the PRA will take where insurance firms are proposing schemes of arrangement for solvent insurers ('solvent schemes'). It replaces the previous guidance issued by the Financial Services Authority (FSA). It is intended that the material in this paper will be adopted by the PRA as a supervisory statement once the consultation period closes and subject to any responses received.

1.2 The PRA understands that the Financial Conduct Authority (FCA) will take its own view on schemes of arrangement depending on the risks it considers schemes will pose to its objectives.

1.3 The PRA has considered equality and diversity issues but has not identified any impacts arising from these proposals. Accordingly, the PRA has concluded these proposals do not give rise to any equality and diversity issues.

1.4 The PRA welcomes all views on the draft statement and in particular responses on its presentation and clarity.

1.5 Please send any comments to beth.rees@bankofengland.co.uk by 26 October 2013.

2 Draft supervisory statement on the use of schemes of arrangement by general insurance firms

Purpose

2.1 This statement outlines the PRA's approach when reviewing schemes of arrangement proposed by PRA-authorized insurers. The material expands on the PRA's general approach as set out in its Approach Document, and is designed to help ensure the PRA meets its statutory objectives in its supervision of insurers.

2.2 **The purpose of this statement is to explain some factors which the PRA will take into account when judging whether, in promoting a scheme, an insurer is acting in a manner consistent with the PRA's statutory objectives of safety and soundness and policyholder protection.** Specifically, the PRA seeks to ensure that insurers are able (with a high degree of likelihood) to meet claims from policyholders as they fall due, and that where firms wish to exit the market they do so in a way which takes proper account of the need to provide an acceptable degree of continuity of cover for policyholders.

The PRA's view of schemes of arrangement

2.3 A scheme of arrangement (scheme) is a compromise or arrangement under Part 26 of the Companies Act 2006 which

may allow companies to reach a binding compromise with their creditors to discharge all remaining assets and liabilities. If certain majority approval thresholds are met, the terms of the scheme once agreed are binding on the company and all creditors, regardless of whether or not individual creditors originally voted for the scheme.

2.4 Schemes proceed under the Companies Act 2006 rather than the Financial Services and Markets Act 2000. However, **the PRA has an interest in the potential use of schemes by insurers because of its statutory objectives, and in particular its objective to contribute to securing an appropriate degree of protection for insurance policyholders.** For example, the PRA has explained in its Approach Document that it wishes to ensure that firms are able to exit the market in an orderly manner, but in such circumstances, it wishes to ensure that policyholders have an acceptable degree of continuity of cover against insured risks.

2.5 **The PRA recognises that, in certain circumstances, the use of schemes of arrangement by insurance companies may be compatible with its statutory objectives.** For example, the use of a scheme by an insolvent insurer may be in the interests of policyholders generally, by maximising the pool of assets available to distribute to creditors, or allowing a quicker distribution.

2.6 **However, the PRA also believes that, in other circumstances, the use by insurance firms of schemes of arrangement is unlikely to be compatible with its statutory objectives.** These circumstances are likely to include cases where a firm meets its regulatory capital requirements and expects to be able to continue to meet all legitimate claims as they fall due. This is because the binding nature of the compromise reached with creditors in a scheme is such that some policyholders may have their cover terminated against their wishes, and/or policyholders may have their claims or potential claims settled at less than full value. The PRA is concerned that the use of a scheme in these circumstances could undermine the traditional shareholder/creditor hierarchy by allowing shareholders effectively to extract capital from the firm at the same time as policyholders are subject to a binding compromise in respect of actual or potential future claims.

The PRA's role in assessing schemes

2.7 As a Companies Act mechanism, it is open to any company to ask the Court to sanction a scheme of arrangement with its creditors. However, **where an insurance firm is contemplating a scheme the PRA will expect the firm to provide details of the proposed scheme to the PRA, before any application to the Court. The PRA will review all schemes proposed by insurance firms to assess the risks to its statutory objectives, and having assessed a scheme proposal it expects to inform the Court in all cases whether it has any objection to a proposed scheme.**

2.8 As a result, **the PRA expects insurance firms which are considering the use of a scheme to inform the PRA in advance, in a way which allows sufficient time for the PRA to assess the proposals.** The firm should explain to the PRA the nature of the business included in the scheme and the nature of the underlying policyholders. The PRA expects firms to be able to explain to the PRA the reasons why they believe the use of a scheme is compatible with the PRA's statutory objectives and, in particular, with the PRA's focus on ensuring continuity of cover for policyholders.

2.9 In assessing a proposal from an insurer to use a scheme, and in deciding whether or not it wishes to object to the proposal based on the risks to its statutory objectives, the PRA will consider any adverse effects which may result from any disruption to the continuity of financial services, and will take into account its focus when protecting policyholders on ensuring that policyholders have an appropriate degree of continuity of cover for the risks they are insured against. In particular:

- a. **For insurance firms which meet regulatory capital requirements, the PRA's starting point will be that the use of a scheme is unlikely to be compatible with its statutory objectives,** other than where there are compelling reasons to take a different approach in order to secure an appropriate degree of policyholder protection or where alternative safeguards are put in place to ensure an acceptable level of continuity of cover for dissenting policyholders.
- b. **For insurance firms which do not meet regulatory capital requirements, are insolvent or where other doubts exist about whether sufficient assets will remain available to meet liabilities to policyholders in full, the PRA's starting point will be that the use of a scheme may be consistent with its statutory objectives.** For example, where a scheme is designed to facilitate an orderly resolution of the firm and to achieve a better outcome for policyholders than other alternatives. In such circumstances however, the PRA would expect to discuss with firms the detailed terms of the scheme in order to ensure that an appropriate degree of protection for policyholders is achieved in the circumstances.

Other

2.10 The FCA is also likely to have an interest in proposals by insurance firms to make use of schemes, given the FCA's own consumer protection objective. **In addition to discussing their proposals with the PRA, firms should discuss their proposed use of schemes separately with the FCA.** The PRA would also expect to liaise directly with the FCA on any proposed scheme of arrangement.

2.11 The PRA has also published a supervisory statement explaining the approach it takes to assessing proposals from general insurance firms in run-off to extract capital as a run-off progresses. Run-off firms are also encouraged to review that statement. The two statements address different issues but there is a common theme as both statements explain how the PRA wishes to ensure that policyholders are protected as appropriate where firms propose mechanisms which may accelerate the return of capital to shareholders.