

An aerial photograph of a vast, clear turquoise ocean. In the lower-left quadrant, a small white motorboat is moving towards the right, leaving a white wake. The water's clarity reveals dark, irregular patches of coral or seabed beneath the surface. In the far distance, a small, low-lying island with some buildings is visible on the horizon. The sky is a pale blue with scattered, soft white clouds.

Deloitte Insurance Week

Where Reinsurance Meets

Updates, Trends and Future Developments
in the Insurance Restructuring Market

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Meet our speakers



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Agenda

- General overview - Issues, trends, red flags and recovery
- Specific issues - Segregated accounts companies
- Future developments, new governance and case law



An aerial photograph of a tropical ocean scene. The water is a vibrant turquoise color, revealing dark, irregular patches of coral reefs and seabed. A small white boat with a dark canopy is moving across the water in the lower-left quadrant, leaving a white wake. In the far distance, a low-lying island with some buildings is visible on the horizon. The sky is a clear, pale blue with scattered, fluffy white clouds.

General overview

Issues, trends, red flags and recovery

Current issues

1.

Framework:

- Standards and adopting a co-operative approach across all jurisdictions
- Reporting, deceptive valuations, horizontal reviews and modelling
- Assessment of analysis and reliance on third parties
- Licensing process
- AML regulations
- Corporate governance

2.

Prudent supervision:

- Risk classification
- Adapting to changing markets
- Capital adequacy
- Sharing of information between jurisdictions
- Life vs non-life insurance

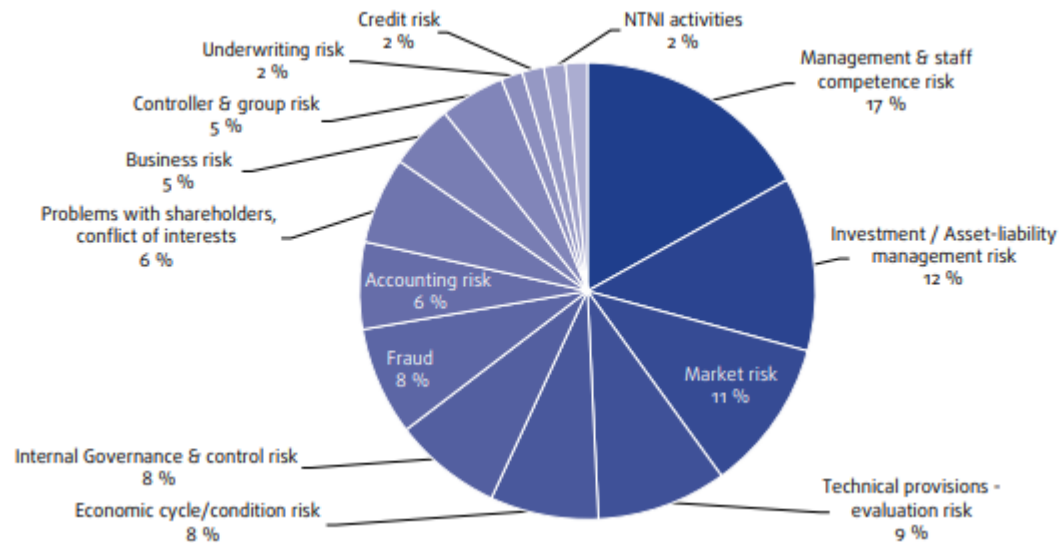
3.

Failures:

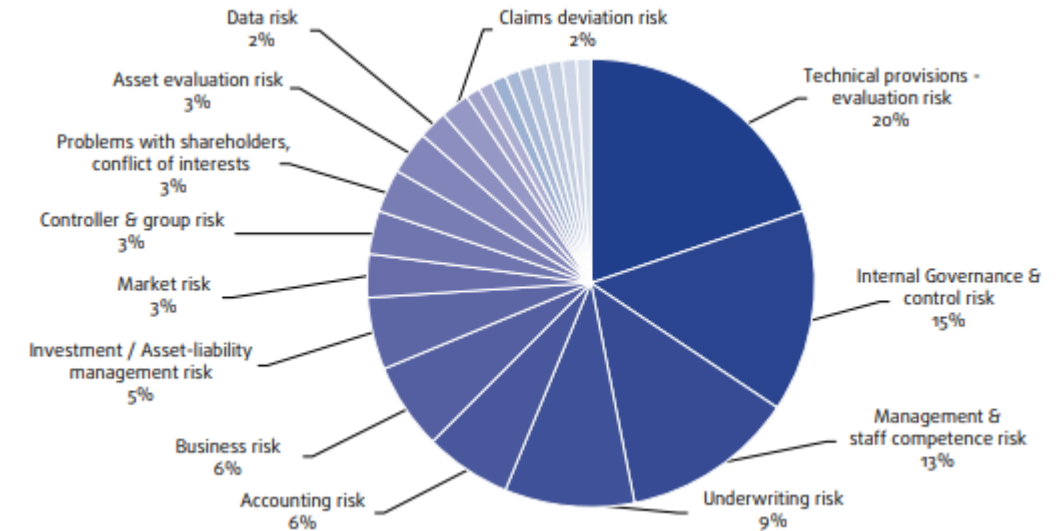
- Employee competence
- Corporate governance
- Risk evaluation
- Accounting risk
- Internal governance
- Investment vs liability
- Early risk indicators i.e. deterioration of capital strength or low solvency margins
- Risk from global or macro events, Covid, and socio-political and economic issues

Historical primary causes of failures for life and non-life companies (* as produced by the EIOPA failures and near misses in insurance 2018)

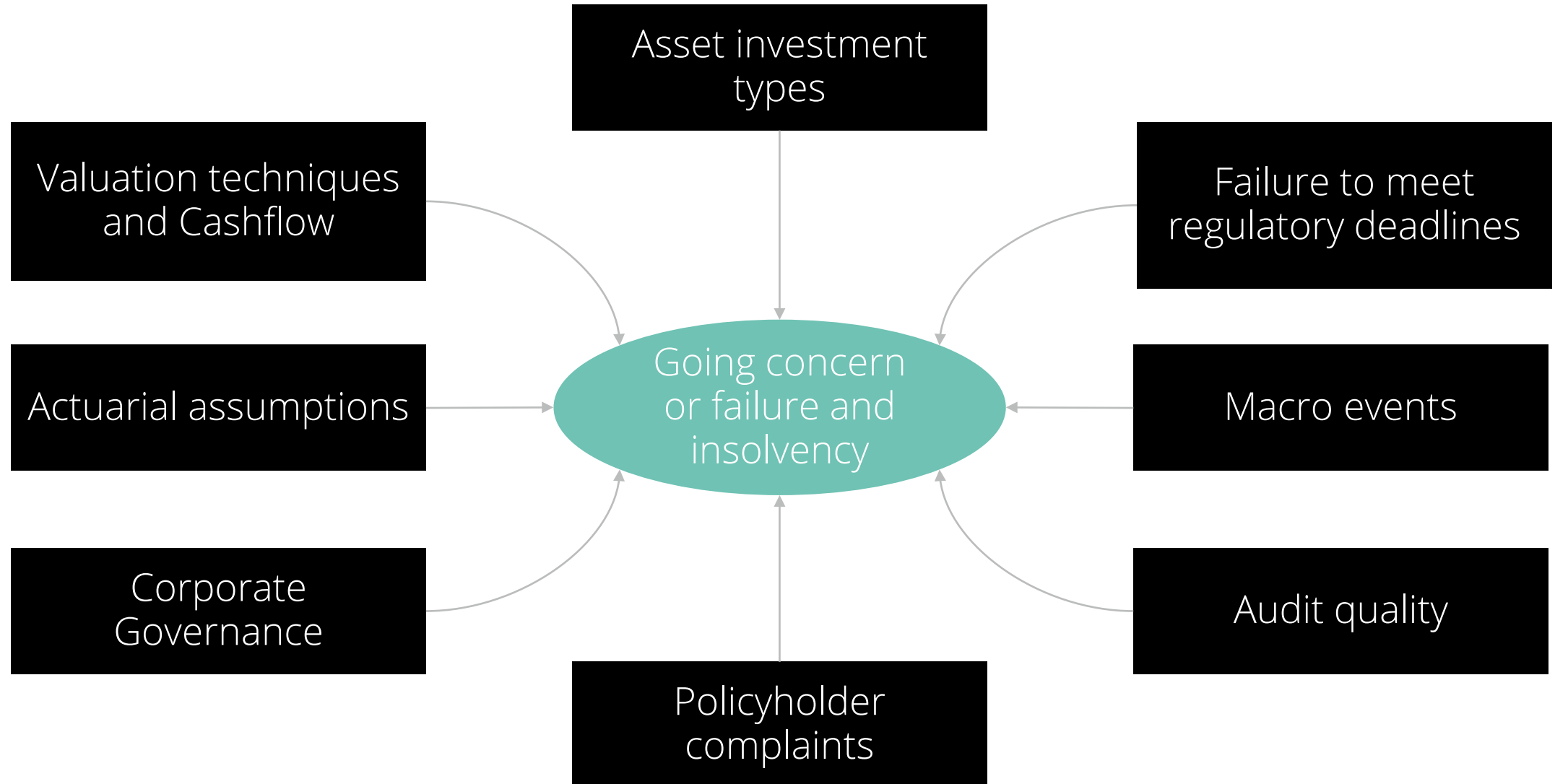
Life companies (1999-2016)



Non - life Companies (1999-2016)



Red Flags



Key Considerations

Trending themes on troubled insurance companies

- Failure to file statutory accounts
- Weak or no internal controls
- New auditors or longevity of current auditor relationship
- Old habits die hard
- Lack of continued professional development of staff
- Lack of experienced staff and high attrition rates
- Opaqueness of some jurisdictions
- Company indemnification gives a layer of protection from management wrongdoing and misfeasance

AML/ background checks on directors, officers, and employees

- Identifies previous failures of directors in other insurance companies
- Identifies competency of executives and management
- Ensures suitability of executives and management of new businesses
- Identifies other potential issues such as sanctions or other prohibitions on parties acting in management.

Investments of assets in third party vs associated assets

- Are the assets truly third party bonafide institutions?
- Are the assets connected to the company, management or UBO in any way?
- Are the valuations methods used for asset and liabilities fair, reasonable and prudent?
- What returns are being received on investments? Do they seem too good to be true?
- Has the insurance company over-leveraged its investments on associated parties?
- Are the assets easily liquidated to ensure adequate cashflow to meet liabilities?



Corporate procedures

Inspectorships and independent business reviews

Scheme of arrangement

Provisional Liquidations (for restructuring purposes)

Receiverships (Segregated Accounts)

Court winding-up

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Specific issues
Segregated accounts companies

Offshore Jurisdictions

Segregated Cells Structure

Structure Name	Jurisdiction	Legislation	Business	Insolvency Procedures
Segregated Accounts Companies ("SAC")	Bermuda	- Segregated Accounts Companies Act 2000 - Segregated Accounts Companies Amendment Act 2021	- Insurance Business* *Approval from Minister of Finance if non-insurance business.	- Receivership; - Liquidation
	Bahamas	- Segregated Accounts Companies Act 2004	- Business of investment funds; - Business of issuing securities; - Insurance business - Subsidiary of a bank or trust company *Written consent of a primary regulator, who may be prescribed by the Minister, is required in certain businesses.	- Receivership; - Liquidation
Segregated Portfolio Companies ("SPC")	Cayman Islands	- Companies Act (2023 Revision)	- Funds (Hedge funds, Umbrella funds, Master-feeder funds) - Insurance vehicles (Captives) - Debt Issuing Vehicles	- Receivership; - Liquidation
	British Virgin Islands	- BVI Business Companies Act 2004; - Segregated Portfolio Companies (BVI Business Company) (Amendment) Regulations, 2018 - Segregated Portfolio Companies (Mutual Funds) (Revised 2020)	- Licensed insurer - Professional or private fund, or registered public fund	- Termination
Segregated Cell Companies ("SCC")	Barbados	- LRO 2002 CAP. 308	- Financial services activity including insurance, banking and mutual fund activity* *company with activity of a non-financial nature required approval by the Minister	- Administration - Receivership - Liquidation

Legislative Developments



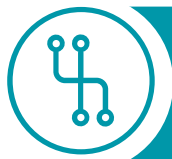
- **Private Acts** – these were entity specific - modifying Bermuda law as respects of an Specific entity and came before the Segregated Accounts Companies Act in 2000 (the “SAC Act”)
- **SAC Act - 2000** - Under the SAC Act, an entity is permitted to create and operate segregated accounts
- **ISAC Act 2019** - ISA has a separate legal personality, a Segregated Account (“SA”), this not being a separate legal person

Key principles

For the purposes of this presentation



Each 'segregated account' is a separate and distinct account pertaining to an identified pool of assets and liabilities which are **legally separated** from the general account of the SAC and other segregated accounts. Functionally, this provides certainty that any asset that is linked to a particular segregated account may not be used to satisfy any liabilities of the general account of the company or of other segregated accounts.



A segregated account is not a separate legal entity but a record or a collection of records detailing transactions relating or linked to each other. The SAC Act therefore enables a **statutory segregation of accounts** within a single company.



When winding up an SAC, **the liquidator is required to deal with the assets and liabilities which are linked to each segregated account only in accordance with the SAC Act** and he shall ensure that the **assets linked to one segregated account are not applied to the liabilities linked to any other segregated account or to the general account**, unless an asset or liability is linked to more than one segregated account, in which case he shall deal with the asset or liability in accordance with the terms of any relevant governing instrument or contract.

How will it work in practice?

What you might see & hear

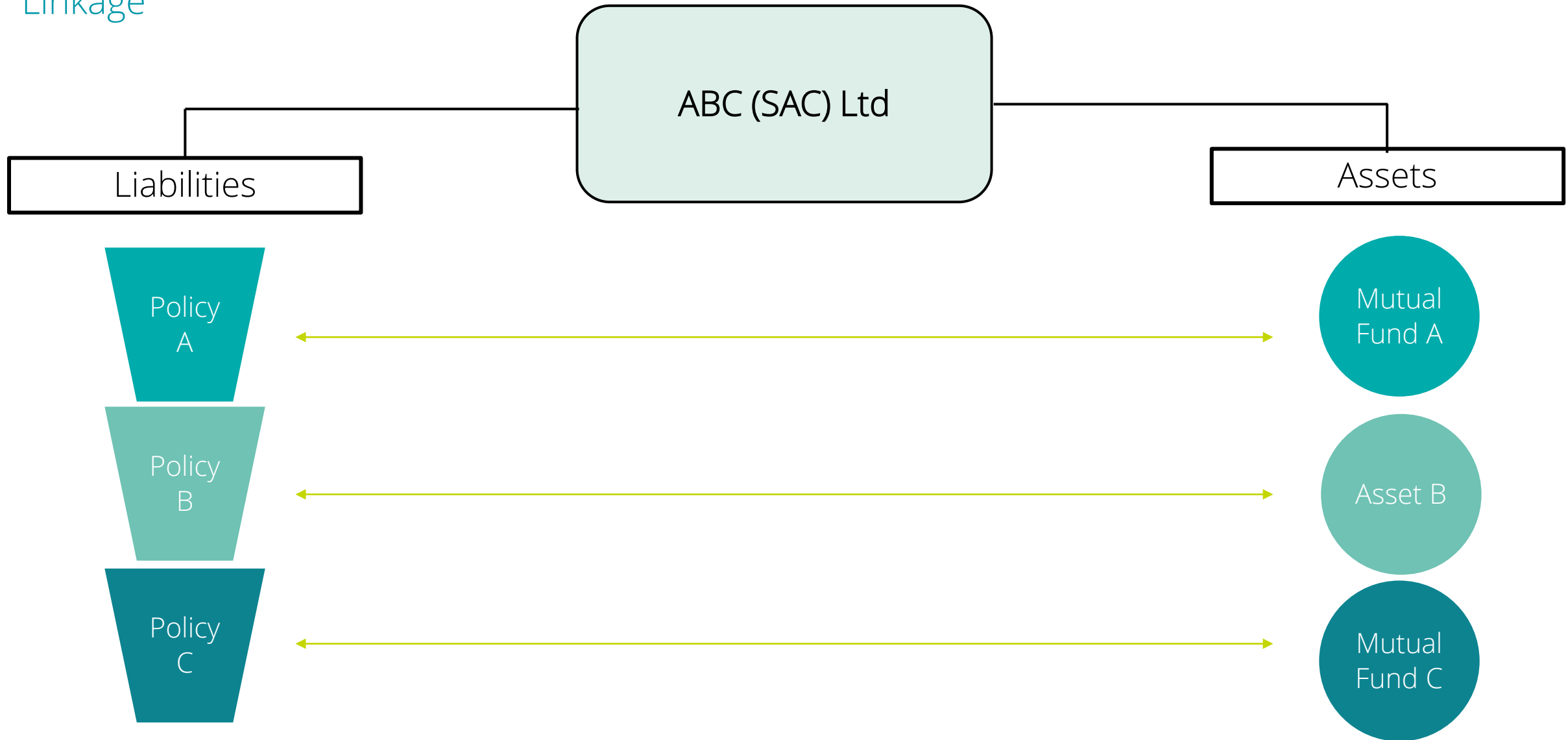
Life Insurers may issue policies which are issued under Private Acts of SACA, policies note 'Segregated Accounts'



Life Insurer

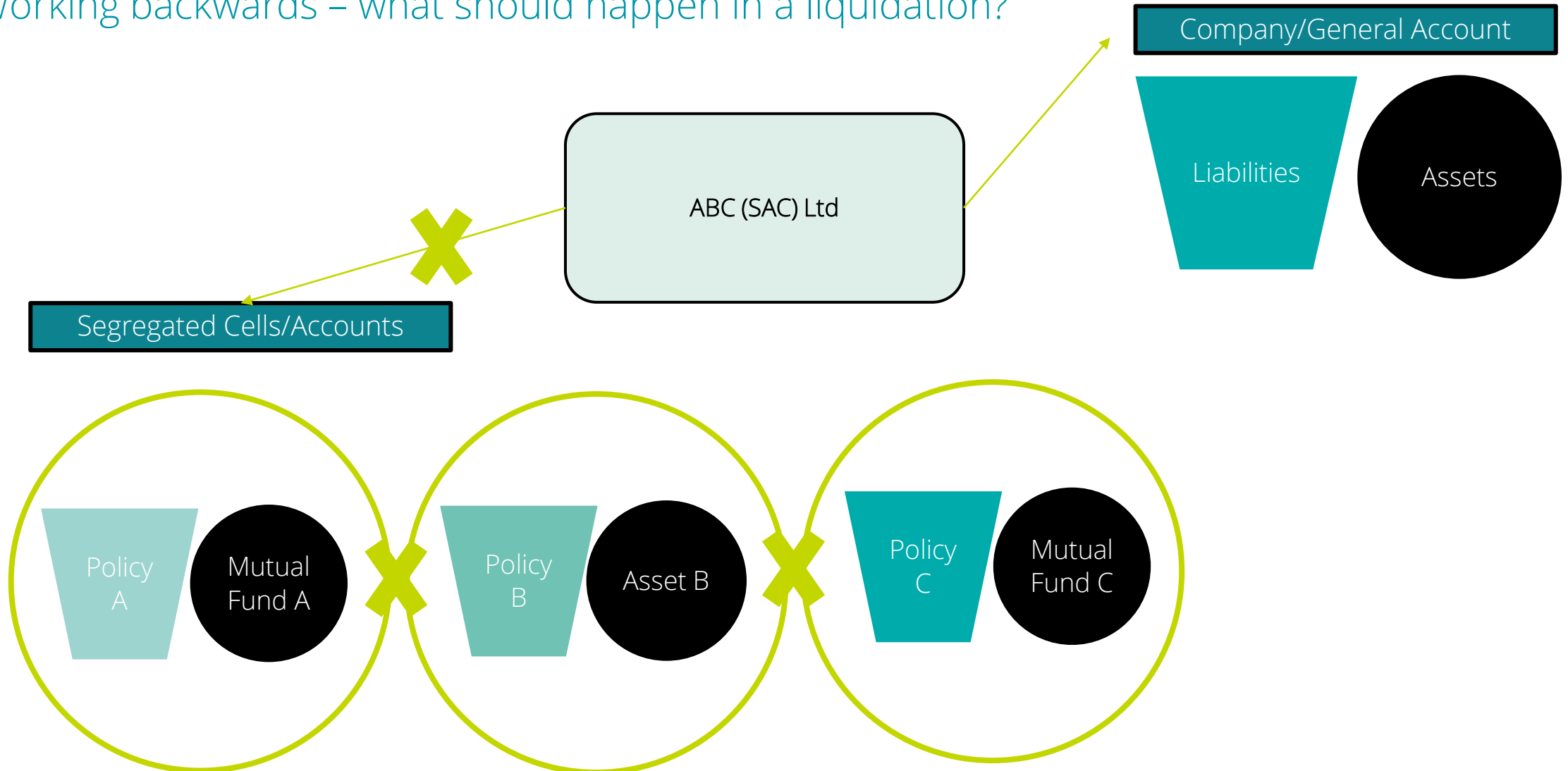


Key Issues Linkage



When a SAC is insolvent

Working backwards – what should happen in a liquidation?



Examples of what we have seen



Challenges of one bank
account



Timing – can you reconcile
an account?



'Fake Solvency' –
consolidate accounts



Linking pooled investments



What defines a unit?



Segregated via accounting –
is it enough ?

What are the risks?



Linking assets

Where is my money?



Proper record keeping and accounting



Proper governance documents



Test for consistency of contracts with execution



Forensic review of the flow of funds



Analyze and review underlying investments



Evaluation of controls as well as SAC representative/Insurance Manager functions

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Future developments, new governance
and case law

Judgment Northstar/Omnia

History

Northstar and Omnia had purported to establish segregated accounts. Following the identification of various issues in relation to those accounts, the JPLs brought an application to the Supreme Court of Bermuda seeking the Court's direction as to whether the Companies had established segregated accounts for policyholders and, if they had established them, what assets were linked to them.

What are the requirements of the SACA for the establishment of a “segregated account”?

“A segregated account can and should be treated as having been established in respect of a particular Policy (or Policies) where, (a) the relevant contractual materials for the Product in question evince an intention that there should be segregated account, (b) particular assets (being assets of a kind that the relevant Policy provides may be segregated) are connected in the company's records to the Particular Policy (or Policies). Commingling of funds does not preclude the operation of segregation.”

Judgment Northstar/Omnia

What are the requirements for “linkage” of assets, rights, contributions, liabilities and obligations to an account?

The question of “linkage” was a central issue before the Court and is a fundamental feature of the statutory regime under SACA. The Court confirmed that the term “linked” is defined in broad terms and is satisfied by a written instrument or an entry or notation in the company’s records, or even an unwritten but conclusive indication of linkage. The Court further noted that SACA does not prescribe any test or standard of proof for establishing linkage.

Application to the facts of Northstar/Omnia – establishment of segregated accounts

Most policies stated that company would “establish and maintain a separate account for the Contract . . . The rights and interest in the property of the Contract Separate Account shall be determined by the terms of the Contract” or similar language.

There was a separate account per contract (or group of contracts). (Some policies did not have segregated account language or, therefore, segregated accounts.)

Variable products vs fixed products

The Chief Justice found that the requisite “linkage” of investments in mutual funds selected by variable product policyholders was present. The linkage was demonstrated by “accumulation units” being a measure of value referred to and employed in the variable investment product wordings. Value of variable asset corresponded to value of variable policyholder claim. This linked variable assets to variable segregated accounts.

Application to the facts of Northstar/Omnia – linkage (continued)

However, there was no linking of fixed investments. The fixed investment product wordings did not provide any basis for linkage nor was there any in the companies' books and papers. Moreover, there was no correspondence between value of a fixed investment and value of fixed policyholder claim. The value of fixed policies was set by reference to a guaranteed interest amount; it was distinct from the value of fixed investments.

Implications of not linked?

The fixed segregated accounts were “empty”. Policyholder had a claim against the segregated account which had no assets to satisfy that claim.

Not only that, because the fixed investments were not linked to a segregated account, they were linked to the general account. Because of statutory and contractual ringfencing, the fixed segregated account owners had no recourse to them, because segregated account creditors have no recourse to general account assets.

Fixed policyholders without segregated accounts were better off than those with segregated accounts.

An object lesson for insurers that use segregated accounts but do not explicitly identify segregate account property in contracts and/or records.

Future Developments

Court Appointed Restructuring Officer (CARO)

Law reform proposal to replace/supplement existing techniques where distressed company needs to restructure.

What happens now when a distressed company needs to restructure?

- No equivalent of UK administration – no formal procedure for the survival of a distressed company which includes a moratorium on proceedings.
- Instead, where a winding up petition is presented, court appoints Provisional Liquidator (PL) which triggers a stay of proceedings; court limits PL powers to monitoring and reporting on a restructuring
- Creates a de facto “debtor in possession” restructuring; independent oversight; stay of proceedings – known as “light touch” PL or PL “for restructuring purposes”

Shortcomings of light touch PL – terminology; sometimes viewed as a device to defeat foreign winding up petition even though no real prospect of a restructuring

CARO would have similar powers to a light touch PL but with mandatory reporting on whether:

- Restructure would be a better outcome for creditors than liquidation
- Support is likely from the necessary proportion of creditors
- Real prospect of the restructuring occurring within a reasonable timeframe

Future Developments

Insurer Resolution Regime

The Insurance Core Principles (ICP) of the International Association of Insurance Supervisors requires members to introduce legislation for the resolution of insurers that are no longer viable or are likely to be no longer viable and have no reasonable prospect of returning to viability.

Too early to say what the BMA will propose BUT ICP calls for absorption of losses and stabilization using tools such as

- Restructure or write down liabilities in line with statutory waterfall (i.e., shareholder equity, subordinated debt, general creditors (outwards reinsurance/senior debt), insurance creditors etc. (“bail-in”)
- Transfer of all/part of the business of, or shares in, the insurer, to another insurer or to a “bridge institution”

Tools currently available to BMA

- Supervisory - conditions on license (require BMA approval of transactions)
- Intervention - give "such directions as appear to it to be desirable for safeguarding the interests of clients" where there is significant risk of insolvency, regulatory breach, etc. (Directions such as cease or restrict new business, prohibit investments, remove a controller or officer.)
- Investigations
- Apply to court for winding up order

Consultation late 2024/2025

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Questions?



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