Schemes of Arrangement - Creditor Schemes in Life Insurance

There have been several high-profile cases of Creditor Schemes converting with-profits policies into non-profit and/or compromising with-profits guarantees. Notable examples include Equitable Life's GAR compromise Scheme in 2001, Phoenix GAR compromise Scheme in 2009, Scottish Life's GAR compromise Scheme of 2018 and Equitable Life's endgame in 2019.

An increasing number of firms appear to be using Creditor Schemes to transform their business. Will we see this trend continue in future?

What is a Creditor Scheme?

The rules around Creditor Schemes are set out in Part 26 of the Companies Act 2006. They enable companies to alter their contractual agreements with their creditors subject to certain criteria being met (e.g. voting thresholds).

Rationale – Why would you implement a Creditor Scheme?

Potential for better policyholder outcome:

- Helps to **avoid the tontine** – improved inter-generational fairness and replaces uncertain future distribution with **immediate** and **certain distribution**.
- Attractive **conversion terms** must be offered in order to secure the required voting thresholds. Fairness alone is not good enough.
- The low interest rate environment means that a **high value placed on with-profits guarantees**. i.e. converting at historically high price.
- Policyholders will benefit from these through **pay-out enhancements** – this may be a great outcome where options are unlikely to be exercised (e.g. GAOs on small pots).
- Could be used to offer **greater investment freedom** – which, in turn, may result in significantly improved outcomes for those investing for the longer term

Potential for better commercial outcome for the insurer:

- **Removing capital-intensive product features** on policies can improve the capital efficiency of the business. This, in turn, may make the business **more attractive to potential acquirers**.
- Against a backdrop of increasing regulation, **simplifying the back book** may reduce future administration and compliance costs.
- Creditor Schemes are **flexible** and conversion terms can allow for the needs of different stakeholders. E.g. different policyholder cohorts. Creditor schemes have a **tried and tested legal process**.
- **Opt-outs** can be included to offer greater optionality. Allowing policyholders to opt-out ensures they are not disadvantaged and should make it easier to gain policyholder and regulatory approval.
- Many funds have "sunset clauses" with specified conversion terms. Creditor Schemes may allow conversion to be **accelerated or on more attractive terms to both insurer and policyholders**.

Challenges facing firms considering a Creditor Scheme

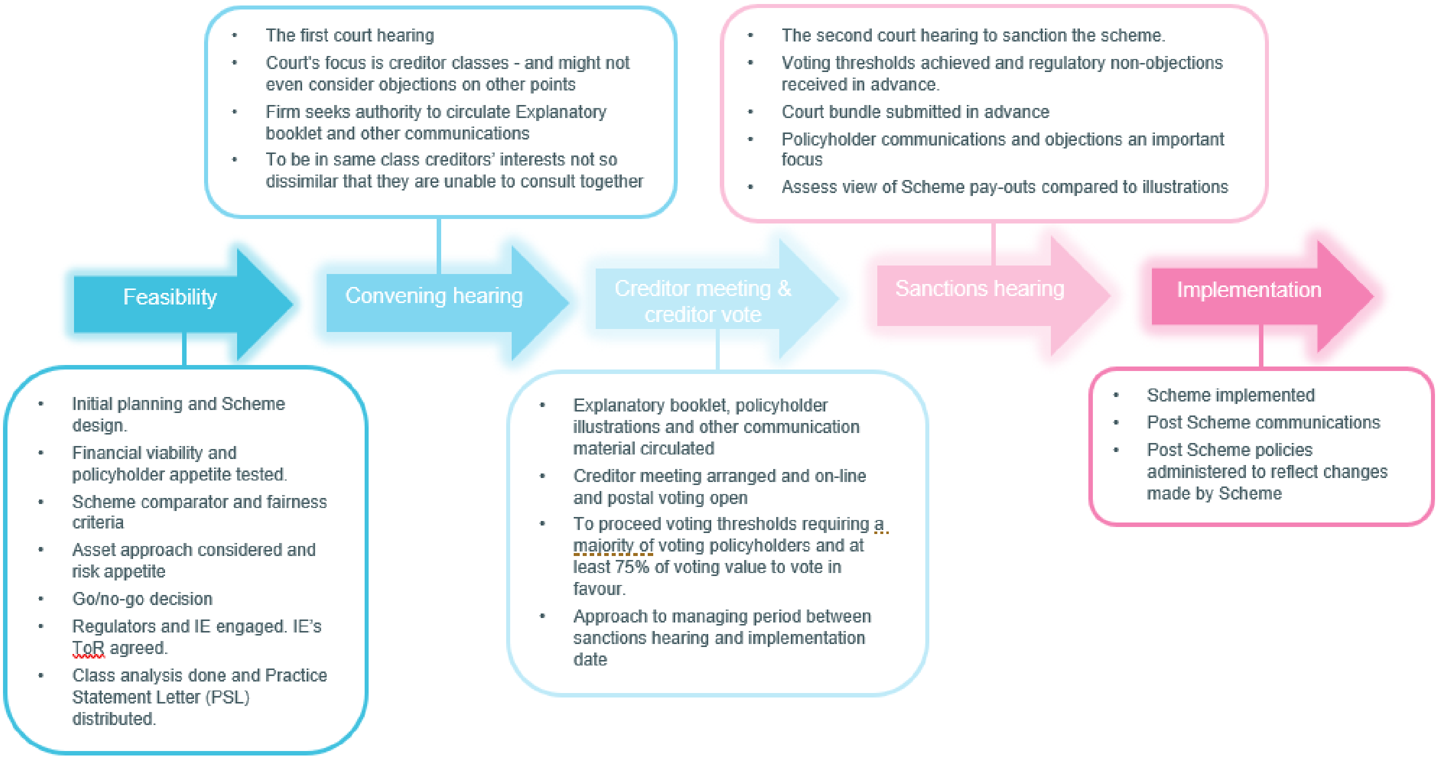
- **Reattribution?** If the scheme constitutes a reattribution, additional onerous legal and regulatory requirements are triggered (e.g. Policyholder Advocate). However, it may be possible to obtain a waiver from these requirements.

- **Time and Effort** – Creditor Schemes require significant time and effort and a high-level of technical rigour. Key elements of the scheme design are often refined through iteration to best meet scheme objectives. These projects can be far reaching and require specialist input from different areas from actuarial modelling to regulatory liaison and from investment management to legal.
- **Complexity** –Conversion terms must be attractive to different creditor cohorts e.g. premium paying/non-premium paying policies, group/individual business and other potentially non-standard policy features.
- **Voting risk** – The proposal need to be sufficiently attractive to achieve the voting thresholds. i.e. being fair isn't enough! The legal creditor class analysis determines the number of voting classes which is fundamental to the proposals and can impact execution risk.
- **Policyholder communications** – the proposals need careful communication to policyholders which comply with COBs rules and which communicate complex concepts in a simple way that policyholders can understand. Particular care is needed to look after vulnerable customers. Well-crafted and compassionate responses tend to be helpful for those policyholders who write to the firm and/or court to better understand the proposals or are minded to object.
- **Assets** – Careful management of the assets may be required in the lead up to implementation to simultaneously meet BAU prudential requirements and the investment objectives of the scheme. There tends to be a period of time between the date at which the scheme becomes legally effective and the date of implementation. Assets will need to be carefully managed during that time.

These challenges may seem daunting, but with support from experienced individuals who understand the process and complexities faced, Creditor Schemes can be an effective and efficient means of removing the risks faced in managing a with-profits fund in run-off and should ultimately benefit both the insurer and the policyholders.

The process

Creditor Schemes can be complex and usually require a significant amount of work. We estimate that a standard project takes around 18 months, with the main stages and milestones shown below.



How Hymans Robertson can support you

Our award-winning team of life insurance experts can offer support at all stages of the Creditor Scheme process. We have hands-on experience of leading insurers through Credit Schemes. For example, **Dan Diggins**, our Head of Regulated Roles, was the strategic advisor to a large simultaneous creditor scheme and Part VII transfer where he advised on the commercial and technical aspects of their Creditor Scheme, Part VII transfer and Brexit solution including scheme design, asset advice, structuring and risk transfer. He also led on commercial aspects of the deal, drafted Business Transfer Agreement schedules including the commercial basis balance sheet and worked closely with the firm's legal advisers on policyholder communications and objections.

We recognise that projects like these can be resource-intensive and we can provide additional support on an **advisory** or a **secondment basis** to augment your project team and allow the process to run alongside your business as usual operations.

We currently have a 40-strong team of dedicated insurance specialists who are able to offer the deep expertise across the actuarial spectrum.

- **Regulated Roles**: we can act as Independent Experts in business transfers (e.g. most recently the £20bn transfer of Zurich work-based pensions book to Lloyds Banking Group) or carry out other reserved roles such as Chief Actuary, Actuarial Function Holder, Reviewing Actuary and With-Profits Actuary.
- **Transactions and Structuring**: we have experience with the largest and most complex transactions in the life insurance industry and can guide you in the most efficient way. We have advised on almost all major bulk annuity transactions in the market.

- **Risk and Capital Management**: we can help you make more efficient use of your valuable capital, support you in understanding your risks and the impact these will have on your balance sheet and keep up with the ever-changing regulatory environment.
- **Asset & Liability management**: we can offer support on investment strategy and capital optimisation approach and are specialists at advising firms on Matching Adjustment.
- **Longevity management**: we can build on the extensive data, models and expertise we have developed through our ground-breaking longevity analytics service, Club Vita, to help you with any longevity related matters. Our tools and insights are provided to 7 out of 8 bulk annuity writers and 8 out of 10 reinsurers.
- **Product and Innovation**: our team have specific knowledge of developing and pricing products. We are leading in thought leadership such as Generation Rent and Wealth management tools through our Guided Outcomes technology.

We are proud to have won InsuranceERM's awards for both 'Actuarial team of the year' and 'Mortality/Longevity team of the year' in 2018, 2019 and 2020.

We are also pleased to confirm that we are members of the FCA/PRA's Skilled Persons' Reporting Framework preferred panel for Insurance.

Our wider team also brings extensive representation on industry bodies. Members of our Life and Financial Services practice chair or sit on many IFoA working parties, including Matching Adjustment, and Transitional Measures on Technical Provisions, and two of the team sit on the IFoA Life Board. We also serve on Investment and Life Assurance Group's Board and Regulatory and Financial Reporting practitioner working groups, where we have contributed to numerous IFRS and Solvency II consultations.

If you would like to discuss any of the points made in this article further, please get in touch.

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