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Insurance and Insolvency

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Corporate Insolvency & Restructuring Forum

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› Setting the Scene

- Insurance is ‘reverse production’ and notoriously difficult to determine insolvency – may be able to meet debts now and for next year but what about those 3-5 years out
- Distinguish inadequate capital buffer from traditional insolvency
- Insurers and banks prudentially regulated so the supervision of the discharge of liabilities is a prudential issue focusing on policy holders or depositors – the idea of a resolution plan
- What we are discussing today are the powers of APRA and the Federal Court to frame a resolution without a winding up.
- Post AIG in the USA the life insurance mechanism of judicial management applied to general insurers including branches (2008) and a financial claims scheme was introduced
- APRA has many powers to deal with financial distress before judicial management and it plays a key controlling role in any judicial management – this is our theme

› What will happen when the next insurer faces financial distress

- The HIH provisional liquidation, liquidation and scheme pathway is now less likely unless there is hopeless insolvency
- The new pathways are controlled by APRA and then by APRA and the Federal Court
- What are these pathways of resolution?
- How are they likely to play out within Australia and across borders?
- How do these processes link to a traditional insolvency?

› What are the new pathways?

- Recapitalisation orders
- Forced portfolio transfers
- A wide power of investigation and menu of directions relating to policies and assets
- Run-off
- Judicial Management
- Different application to:
 - the 3 classes of insurer under the *Insurance Act* : general insurer, foreign general insurer (branch) and Lloyd's underwriters,
 - Non-operating Holding Company (NOHC) of a general insurer, or subsidiaries of the general insurer or NOHC, or
 - Corporate agent of foreign general insurer.

› Recapitalisation

- s103A – 103N *Insurance Act*
- Applies to a general insurer with share capital not in judicial administration (in Judicial management the manager has wide powers to reconstruct shareholdings)
- Triggers
 - May or becomes unable to meet obligations
 - May or suspends payment
 - APRA considers unable to carry on insurance business consistent with policy holder interests or with the stability of the financial system
- APRA directs issue of shares or rights
- Provisions to determine fair value
- Offence for insurer or officer not to comply without reasonable excuse
- Most useful to enforce contingent capital arrangements or where NOHC with surplus
- Important consideration in resolution plans

› Portfolio Transfers

- If APRA wishes to revoke an authorisation of general insurer or foreign general insurer it may require a transfer of liabilities in respect of insurance business to other general insurers – s17 *Insurance Act*
- Requires willing recipients of liabilities
- Unclear as to how it works – many questions eg why would anyone accept liabilities without matching assets and how will these be valued; issues as to power to force transfer of matching assets; constitutional questions etc.
- Offence not to comply
- Compare voluntary transfer process under Division 3A

› APRA Investigation

- Investigation of general insurer (including foreign general insurer) and NOHC if it appears to APRA that:
 - Is or unlikely to meet liabilities
 - Contravened *Insurance Act* or *Collection of Data Act* or an APRA direction
 - Risk to security of assets
 - Sudden deterioration in financial condition
 - Information in APRA's hands calls for investigation
- Wide powers of inquiry
 - Report can inform further action – authorisation conditions, directions or judicial management

› Run-off of insurance liabilities

- APRA may at any time impose conditions or additional conditions that relate to prudential matters on general insurer's authorisation – s13
- “prudential matters” means matter relating to the conduct of the insurer's affairs in such a way as to keep it in a sound financial position or so as not to cause or promote instability in the Australian financial system or that relate to the conduct of its affairs with integrity, prudence or professional skill
- Authorisation conditions can be used to place insurer in run off so that it cannot write new business.

› APRA Directions

- Wide power to give directions to general insurer (including foreign general insurer) and NOHC – s104 -108
- Strict liability offence for company and any officer for each day it continues
- Direction may be secret
- Triggers – APRA has reason to believe:
 - Has or is likely to contravene *Insurance Act, Data Collection Act*, prudential standard, regulation, condition or direction
 - Necessary in interests of policyholders
 - Is or may be material risk to assets
 - Deterioration in financial condition
 - Conducting affairs in improper or financially unsound way
 - Failure to give direction materially prejudice policyholders
 - Conduct may cause instability in Australian financial system

› APRA Directions

- Contents
 - Comply with legislation , condition or direction
 - Remove director or senior officer or appoint a person as director or senior officer
 - Remove auditor or actuary
 - Not give financial accommodation or borrow
 - Not issue or discharge policies
 - Carry out actuarial investigation
 - Not repay shares or pay dividends
 - Make provisions in accounts
 - To do or refrain from doing any act relating to affairs
- Direction can relate to a subsidiary

› Judicial Management

- APRA or a general insurer may apply for a general insurer to be placed in judicial management
- Applies to foreign general insurer in relation to insurance business in Australia
- Does not apply to NOHC or related companies
- Grounds
 - After investigation it is in the interests of policyholders
 - Court satisfied that:
 - Is or unlikely to meet policy or other liabilities (in the case or a foreign GI out of its assets in Australia)
 - Failed to comply with prudential standard or direction
 - Financial condition or management unsatisfactory

› Barriers to Normal External Administration

- Judicial management ousts any external administrator including receivers
- No step to go to external administration without notice to APRA
- It is the judicial manager who may move the company to external administration if approved by the court
- APRA has a strong role in any step
- BUT what is it?

› What is judicial management?

- Based on South African Corporations and Insurance legislation – a process a little like DOCA
 - If position clear that no reasonable prospect of company's position being put on a sound footing ought be wound up – Fullagar J, *Insurance Commissioner v Associated Dominions (1953) CLR 78 at 91*
 - A temporary administration akin to provisional liquidation but temporary - may still mean a fairly long time – Lockhart J, *ISC v Occidental Life (1991) 101 ALR 511*
 - Not for plain insolvency or mere embarrassment - Perram J, *APRA v ACN 000 007 492 (2010) 272 ALR 185*
- But do the provisions really reflect this – prudential purpose focused on protection of policyholders over other creditors – is it appropriate in all but the hopeless case – APRA has the initial call
- Triggers not just solvency issues in the Corporations Act sense – could be poor management or failure to have adequate capital buffer
- How does it work if other group companies in normal external administration? Is this a factor in court's decision? Should powers be over Level 2 group (NOHC plus subsidiaries involved in insurance business?)

› Moratorium Provisions

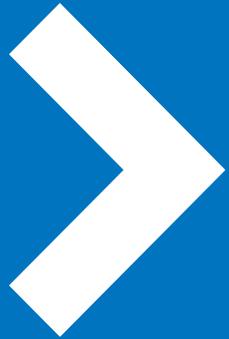
- Judicial management
 - Stay of proceedings without manager or court consent
 - Right to disclaim onerous property
- Judicial Management and Directions
 - In relation to a contract governed by Australian or foreign law the appointment of a judicial manager, the exercise of powers relating to shares by the Judicial manager or an APRA direction does not allow a party to
 - Deny any obligation
 - Accelerate any debt, or
 - Close out any transaction.

› Cross Border issues

- Will judicial management be treated as an insolvency proceeding and attract the assistance of courts in other jurisdictions? Compare the HIH experience?
- How will the moratorium provisions play out in proceedings in other jurisdictions?
- How effective will it be in relation to foreign general insurers where the company itself may be under external administration outside of Australia?

› Incongruities

- S116(3) providing that assets in Australia must be applied to meet liabilities in Australia only operates on winding-up so is it possible to ignore this in a judicial management
- If there is a liquidation after judicial management the provisions of the Corporations Act don't knit well with the prior judicial management – relating back provisions



“It is always to be kept in mind that the procedure [judicial management] is a reconstruction procedure.”



Perram, J. – APRA v ACN 000 007 492 9 (2010) 272 ALR 185 at para [39].

› Questions?



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- the 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007 and 2008 Annual Reviews of Insolvency & Restructuring Law.

Also, the second edition of Allens Arthur Robinson "Directors Duties During Insolvency" is available now from Thomson Law Book Co.

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