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Gibraltar Insurance Insolvency: Provisional Liquidation

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The last 2 years have seen substantial growth in the number of insurance companies set up in Gibraltar and now writing business across the EU including the UK. This article describes the use of provisional liquidators as an efficient insolvency procedure for insolvent insurance companies under Gibraltar law.

Provisional liquidation

There is no concept in Gibraltar law of administration or rehabilitation proceedings whereby a debtor can effectively freeze the rights of creditors.

The effect of appointing a provisional liquidator in Gibraltar pursuant to Section 165 of the Companies Ordinance (CO) is the same as under the UK – the appointment of a provisional liquidator results in a mandatory stay of proceedings being brought against the company (except by leave of the court and subject to such terms as the court may impose).

The appointment of a provisional liquidator by the court may be made at any time after the presentation of a winding-up petition (Section 171 (2) CO) and before the making of a winding-up order (Section 171 (2) CO). The court may limit and restrict his powers by order appointing him (Section 171 (3) CO).

As in England, the court's power to stay any pending action or proceedings on the appointment of a provisional liquidator when coupled with a Scheme of Arrangement allows an insurance company to preserve the status quo whilst an agreement with creditors is negotiated. In the English case of *Re English and Amercian Insurance* Mr Justice Harman stated that the procedure is

> all part of the developing practice of the court of using a petition by the company for its own winding up as the basis for the appointment of provisional liquidators. That practice has been developed to mitigate the difficulties caused by the fact that administration procedures are not available in respect of insurance companies and is a practice which several of the Chancery judges have dealt with and approved of. It seems to me a useful practice and I do not wish in any way to cast any doubt or discredit upon it. It is a good system, particularly in cases such as this where there is a hope that in the future there will be a scheme of arrangement under Section 425 of the Companies Act 1985.

In insurance insolvency cases, Gibraltar follows English law practice and a Gibraltar court is unlikely to regard provisional liquidation as repugnant if it is intended to achieve a more efficient insolvency mechanism than an immediate liquidation.

Appointment of provisional liquidator

Although provisional liquidation is intended as an interim measure, the provisional liquidator can remain in office for a number of years, during which time the petition is adjourned. A provisional liquidator's powers are derived from the court order appointing him. The draft order will invariably request the widest powers possible (akin to those of an administration) to manage the company and to take over the preparation and implementation of a Scheme of Arrangement. These powers are likely to be granted by the court.

It is also likely that the application to court will be made after consultation with the Gibraltar regulators (the Financial Services Commission) and the application should state that the regulators, having been consulted, raise no objection to the application. When an insurance company faces severe financial difficulties the regulators have few choices. The shareholders may not be willing (or indeed able) to restore the financial soundness of company through the injection of further capital, whilst the issuance of Notice of Requirements by the regulators requiring the company to substantially reduce the amount of premium written will not protect the company from its creditors and may worsen rather than improve the financial position of the company. As a result, provisional liquidation may be the only sensible option for all concerned whist an independent insolvency practitioner takes control of the business of the company to protect its assets from dissipation and safeguard the rights of policyholders. If the company's business can continue in future with reliable income from which to meet claims and therefore without prejudicing current and future policyholders, the company may successfully complete a run-off.

The provisional liquidator will adjourn the winding-up petition periodically whilst he considers the financial position of the company and investigates the circumstances surrounding its insolvency.

The combination of provisional liquidation with a Scheme of Arrangement has been very successfully used in the UK in relation to insurance companies over many years. The development of this procedure is something akin to an administration order procedure for insolvent insurers, allowing provisional liquidators to put the company in run-off without resorting to formal liquidation.

As in the UK, in order to appoint a provisional liquidator under Gibraltar law, a winding-up petition would be made to the court stating that the company is unable to pay its debts and insolvent and that it is just and equitable that the company be wound up. The petition must be verified by a sworn affidavit from a director setting out the reasons why the court should appoint provisional liquidators. The petition would be accompanied by an ordinary application to appoint provisional liquidators and an insolvency analysis based on the most recent financial information on the insurance company.

By the very nature of the procedure, it is possible for an insurance company petitioning for provisional liquidation to reverse its position. Even if it is not reasonably practicable for the company to be rescued, provisional liquidation provides a 'soft landing' option for the directors not otherwise available in formal liquidation. Provisional liquidation may obtain a better result for creditors, such as, for example, by allowing the company to trade over a short period of time to enable claims handling operations to continue, premiums to be collected and reinsurance recoveries to be effected or whilst the provisional liquidator considers whether the company can be sold as a going concern, subject to the injection of additional capital by the new owner(s). Further, in many cases of insurance insolvency, it may take years before all claims materialise and some time before reinsurances are recovered. In these circumstances provisional liquidation offers a better alternative to an immediate liquidation.

Schemes of Arrangement

Whilst the provisional liquidator is in office, the provisions in Section 145 CO for compromises or arrangements ('Arrangements') allow the insurance company to conclude a run-off. These are Arrangements agreed by creditors and, in some cases, shareholders of a company. The courts will not sanction the Arrangements unless reasonable efforts were made to notify those creditors whose rights would be affected by the scheme of the meeting to approve the Arrangements. Approval at the creditors' meeting of the terms of the Arrangements does not require unanimity of the affected creditors, whether or not present at the meeting. Such Arrangements could affect both set-off rights of creditors and the value of claims the creditors may have against the company. Section 145 is similar to Section 425 of the Companies Act 1985 (England).

Section 145 as a stand-alone insolvency procedure does not provide for a stay on claims by creditors against the company whilst the scheme is being prepared and approved. Therefore it remains open to any creditor to present a winding-up petition or commence or continue other proceedings against the company prior to the sanction of the court to the scheme being obtained. Furthermore, there is no mechanism under the scheme procedure whereby an insolvency practitioner can be appointed to manage the company's affairs pending the approval of the scheme. This is why a scheme when combined with provisional liquidation offers such a useful tool.

Conclusion

There is no doubt that, where the financial position of an insurance company is gravely uncertain, the directors would risk breaching their fiduciary duties if they did nothing. The directors should therefore act quickly and the appropriate step in most cases would be for them to request an injection of additional capital from the parent or its shareholders. Consultation with the Gibraltar regulators at a very early stage is also advisable because the insolvency of the insurer will not be readily apparent to the regulators other than through the submission of quarterly management accounts. It is likely that the regulators themselves would seek a restoration of the financial position of the company with a new injection of capital, except that there is no obligation on the shareholders to do so. Therefore, failing this, the directors would need to consider carefully whether they should invoke an insolvency process. If they did not, they run the risk of legal action being taken by creditors or policyholders against them if any substantial payments are effected to any particular creditor. In these circumstances, provisional liquidation may provide the company and its directors with the protection they need whilst an independent insolvency practitioner takes over the management of the business and considers the trading position of the company. If the directors ignore the insolvency position of the company, they obviously do so at their peril.

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