

Bermuda Court reinforces the integrity of the Segregated Accounts regime

Following a directions hearing lasting 5 days, Hargun CJ delivered an important judgment concerning, and upholding, the integrity of the statutory regime governing the creation and operation of Segregated Accounts Companies (**SACs**) in Bermuda. That judgment provides the first comprehensive review of the statutory regime under the Segregated Accounts Companies Act 2000 (**SACA**).

The application for directions was made to the Supreme Court by Rachelle Frisby and John Johnstone, the Joint Provisional Liquidators (**JPLs**) of two insolvent companies, Northstar Financial Services (Bermuda) Ltd (**Northstar**) and Omnia Ltd (**Omnia**).

Each of Northstar and Omnia had operated, or purported to operate, segregated accounts, in respect of policies of insurance and other investment products provided by them under Private Acts and, in the case of Northstar, also under SACA.

With numerous variations on the themes, in essence Northstar and Omnia had issued two categories of policies and investment products, namely fixed investment plans (**fixed plans**) and variable investment plans (**variable plans**).

Variable plans entitled policyholders to invest in a range of different mutual fund assets, with the return being “variable”, in the sense that the return would depend upon the performance of an underlying mutual fund investment.

By contrast, fixed plans sought to guarantee a particular defined return to policyholders over a set period. Under those plans, the policyholder would provide funds to the relevant company, which company would invest those funds with a view to using the proceeds of those investments to pay to policyholders the guaranteed return. Unlike the variable plans, the fixed plans did not offer policyholders a choice of underlying investments.

The Chief Justice reaffirmed that the linkage of assets and liabilities to particular accounts is a fundamental feature and the essence of the statutory regime under SACA. He found that the touchstone for “*linkage*” is the ability to identify in the company’s accounting records an asset or liability with a given segregated account (by writing or other conclusive indication), rather than the segregation of funds (for example by the maintenance of separate bank or securities accounts). Indeed, he found that it is not necessary that the assets “*linked*” to an account can be demonstrably derived from an original investment. Segregation simply requires that the segregated assets can be identified.

The primary consequences of linkage are set out section 17 of SACA. That provides that where a liability of a SAC to a person arises from a transaction relating to a particular segregated account, that person shall, in respect of that liability, be entitled to have recourse only to the assets linked to that segregated account, and not to the assets of any other account.

On the facts, the Chief Justice found that Northstar and Omnia did establish segregated accounts in respect of all those policies in which they represented that they would create segregated accounts. In relation to the creation of segregated accounts, he found that at the very moment the policies were entered into and funds committed there was a liability linked to the account being the liability under the policy, the funds invested being an asset of the account. Even if no 'underlying asset' was purchased with the sums invested, the companies' books would record the funds committed both as an asset and a liability of the segregated account. Further, the Court found that the fact that underlying investments were not linked or subsequently ceased to be linked did not result in a segregated account ceasing to be a segregated account.

Accordingly, the Court found that those policyholders with segregated accounts do not have a claim against the general account assets of the companies.

As to the issue of linkage, and the question of what, if any, assets were to be treated as segregated for the benefit of a segregated account, the Chief Justice found that, in respect of variable plans, there was sufficient connection in the companies' records between the underlying investments and the particular policies in respect of which those investments had been made for those investments to be classed as segregated assets. In contrast, the necessary record-keeping for the purposes of effective segregation was not present in relation to the investments that had been made pursuant to fixed plans.

The judgment will repay careful reading.

Michael Todd KC (of Erskine Chambers) appeared with Christina Herrero of Marshall Diel & Myers Limited (Bermuda), who were assisted by Tom Hall (of Erskine Chambers), for the JPLs.

Edward Davies KC (of Erskine Chambers) appeared with Jennifer Howarth of MJM Ltd (Bermuda) for the variable class.

30.07.23

