

# Where pools rush in...



Chiltington's David Burns and Eddie Marshall look at some of the complex problems surrounding the run-off of insurance pools

Murky waters  
Running off insurance pools can cause major headaches for the for the run-off manager

THERE ARE INDIVIDUAL insurers in run-off and then there are pools in run-off. Of course there are similarities in the administration of both but the problems encountered in running off pools always seem to be out of all proportion to the number of pool members involved. This article looks briefly at some of the obstacles encountered in managing a pool run-off.

When in active mode, insurance pools have long been recognised as an effective means to mobilise capacity and concentrate expertise. At a market level Pools have or are being widely used to cover major concentrations of capital and exposures such as Oil risks, Nuclear facilities, Terrorism, Natural Catastrophes, Earthquakes, Environmental Impairment, War Risks, Workers Compensation, Professional Indemnity and so on. These major facilities generally meet the definition that a pool involves a predetermined level of exposure by identifiable risk carriers and commits them to a direct share in the business written.

By way of contrast are the less well-defined ad hoc groupings of insurers which may also have been known as 'pools' but on closer inspection turn out to have been merely groups of insurers who entrusted their capacity to the same agency. Sometimes it emerges after a pool goes into run-off that members who thought of themselves as part of a pool were actually being used to front for the rest. Sometimes it emerges that the agency to which an insurer gave their pen continued to use their name even when the insurer thought they had withdrawn from the Agency Agreement. This can be difficult to prove in later years and can give rise to protracted arguments with other pool members and cedants.

Another complication of fronting is the multiplicity of stamps used by some agencies. There might be one Pool stamp and say twenty five combinations of 'pool' members fronting for the others with different insurers involved in different underwriting years with varying pool shares and fronting shares. If electronic records are not available, the task of reconstituting records of inter-pool indebtedness alone can be daunting.

The number of pools in existence is little short of astonishing. Chiltington can claim to have made contact with more than 300 pools in a consulting or outsourcing role but this is a modest score when compared to

Equitas which has had dealings with more than 2,500 pools and Managing General Agents relative to the syndicates they represent. And with each involvement comes a need to maintain data on the current service providers, the identity and financial status of the members and the cost effectiveness of any action in pursuit of a collection or commutation.

Another key issue facing run-off managers is the control of and access to pool records which remain the property of all the members. Where the erstwhile pool members split into factions and/or appoint different service providers it can be difficult to agree where and by whom the records should be kept or even in which country. One solution is to set up a trust, which owns the records, and make them available on an equitable basis to all members and their representatives. Sometimes the member with the largest Pool share will undertake the job free of charge. Sometimes a scenario develops where access to the records is hampered by the actions of one or other party who originally had possession of them. There is no easy solution. This is a particularly difficult issue where the records are stored in one country and the majority of the pool members and their service providers operate from another. Result: additional costs incurred in copying and requests to intermediaries, cedants and reinsurers for documents at every turn.

## Herding cats

A regular difficulty encountered is in achieving a consensus quickly or at all on any given issue. A well-known lawyer of our acquaintance with many years of experience of dealing with pools, describes the process as 'like trying to herd cats'. This aptly sums up the patience which may be needed to get Pool members to agree on a single course of action. World travel, email and video conferencing can facilitate communication but the concept of how best to run off a Pool's affairs can vary markedly from one company to another. For one insurer a proactive approach and a rapid commutation of their inwards and outwards book may be seen as a desirable strategy.

For another, a reactive approach may be preferred and is equally appropriate to their circumstances. The run-off manager needs to understand these differences and convert them into an effective strategy for his clients. To do this he must first establish the trust of his clients who may have lost money heavily from the pool's underwriting activities.

Apportioning the cost of the run-off can also cause friction. Where there is a degree of co-operation and good will amongst those concerned, it may be possible to average their annual pool shares over the total underwriting years to arrive at a percentage for sharing the cost. Where a member participated in a limited number of years, they may see little point in contributing in this way and prefer to run-off their involvement themselves.

The economies of scale achievable with a dedicated service provider sometimes point towards in house run-off ultimately being the more costly option if experienced staff are assigned to the work. The service provider will need to ensure that widely divergent requirements from pool members do not result in an unfair apportionment of costs.

For the run-off manager, approval of a particular course of action, a commutation or a claim payment can be very burdensome with a large group. If members are willing to elect a Steering Committee to resolve day to day issues with the run-off manager and other service providers, there is a good chance that the run-off will proceed smoothly. Without such a focal point, progress can be painfully slow as the need to consult at every turn slows decision making and adds to cost.

### Reinsurance adds to complexity

External reinsurance is an area where pool members expect appropriate activity at an early stage from their run-off manager. Aside from the difficulty of establishing who has commuted what and with whom after a number of years, it is important to identify the impact of the common account reinsurance and any specific protections so that accounts can be prepared on a principal to principal basis.

Internal reinsurances which ad hoc pools used to pass shares between fronting companies and other pool members can add a layer of complexity to an already confusing situation in which original pool shares are reworked through a series of quota share treaties. Unravelling such arrangements to achieve a fair allocation between members is definitely not for the faint hearted.

Where solidarity reigned in the days of the original pool manager who controlled both the gross and net lines of the members, the reality of the situation in run-off means that the fronting company is faced with effecting a fully documented reinsurance recovery against his fellow 'pool' members. This cosy original relationship may be quickly forgotten when losses surface and the fronter may be forced to absorb the poor security from among the so-called 'pool' members.

A service provider who aims to add value to the process of managing a pool in run-off (and the above is a brief selection of obstacles which are encountered) will need a good understanding of the markets in which the pool operated, the ability to give the pool members individually tailored and truly independent advice, international representation in key overseas markets and above all an endless supply of tenacity and aspirin.

## End in sight for Trenwick?

THE NEW YORK Stock Exchange confirmed last month that Monday 24 March would be the last day of trading in Trenwick's listed stock. Shares in the insurer have collapsed from a June 1998 high of almost \$39 to a mere \$0.20 as a legacy of poor underwriting, management and under-reserving threaten to overwhelm the company. In February the firm received a de-listing notice from the NYSE after its share price had fallen below its 30-day average requirement of \$1.

The embattled insurer confirmed that it would look to have its stock traded on the over-the-counter Bulletin Board. However, the company's senior management are currently preoccupied in trying to renegotiate \$75mn of Trenwick America Corporation's loan notes which are due on 1 April, 2003. The insurer was supposed to have restructured the debt by the 1 March as part of its agreement with the syndicate of banks supplying its Lloyd's letters of credit. Standard & Poor's placed Trenwick's CCC- counterparty credit rating under review earlier this month after concluding that the insurer's chances of restructuring the senior debt are "remote." The extended deadline for completing the restructurings expired on Friday 21 March without any positive news.

The rating agency Moody's compounded the company's difficulties last week when putting its B-performance ratings on Syndicates 839 and 44 under review for possible downgrade. Trenwick's Lloyd's operations are now the insurer's only meaningful underwriting unit, although a remnant of its US operations struggles on with a business producing arrangement with Chubb Re. Although supported by Berkshire Hathaway, the majority of Syndicate 839's £328mn capacity is supplied by Trenwick and Moody's explained that there was "considerable doubt over the ability of Trenwick to support syndicate 839 from 2004". Syndicate 44 is a smaller life syndicate with a 2003 stamp of £4.5mn. In 2001, the insurer brought in Michael Watson - the Chartered Accountant who sold Sphere Drake to Fairfax - to head up its Lloyd's operations.

In its 8-K SEC filing, the insurer revealed that its US arm, Trenwick America's Reinsurance Corporation, saw its risk-based capital fall to the "regulatory action level". The reinsurer stopped underwriting in November and then, after agreeing the producing deal with Chubb Re, agreed to seek regulator's approval before taking various actions, including disposing of assets, paying dividends or entering into reinsurance contracts. Another US unit, Insurance Corporation of New York, stopped trading last year after its risk-based capital fell to the "mandatory control level".

The insurer unveiled a 2002 net loss of \$386.1mn, compared to a net loss of \$154.4mn for 2001. The majority of the deficit - some \$223.5mn - was caused by boosts to prior year loss reserves.