INSURANCE CORPORATION OF IRELAND

'The Can of Worms at ICI' was the headline in the Irish business magazine 'Business and Finance' of 8th November 1984. The article to which it referred to severe under-reserving by the company and poor underwriting performance, particularly in its London office. Rumours were already circulating in the London market, following a marked change in renewal policy, cutting back and refusing to lead where it had before. It was even suggested that the company was to close its London office, though this was emphatically denied by ICI.

The company did admit that it had an under-reserving problem. This was stated to relate primarily to liability business in the domestic Irish market. As a result, a loss reserving committee was set up, and, following a review by accountants Coopers and Lybrand, reserves were increased by IR £23 million. The parent company, Allied Irish Banks, was, as a result, compelled to put up extra funds in order to increase ICI's share capital to IR £40 million.

ICI had been a wholly-owned subsidiary of Allied Irish Banks since September 1983. In 1981, AIB had acquired a 25% stake and in July 1983, Continental Corporation of New York offered its 7.6% holding to AIB. AIB then successfully made an offer for the remainder of the shares.

The main worries related to the book of reinsurance business written through the company's London office, which accounted for nearly half the company's premium income in 1984. It was heavily involved in writing bloodstock business in the US, where gross losses amounted to US $7 million in 1983 and 1984. This was subject to an action, eventually settled out of court, because ICI was refusing to pay claims on the grounds that the small facultative account it thought it was writing turned out to be a treaty account of $20 million. In addition, the company had become involved in satellite reinsurance. ICI stated that it was never intended to do so, but the business came hidden in a large treaty contract. Gross exposure had amounted to about £1 million.

Early in 1985, the company was reported as saying that its approach to reinsurance accepted would be more guarded than previously, as its renewal policy evidenced. It expected premium income for 1985 to be £50 million, compared to £150 million in 1985. In particular, poor returns from US property business and a mixture of risks, including reinsurance of Lloyds syndicates, prompted ICI to reduce sharply its activities in these areas.

On the 15th March 1985, it was announced that the Irish government had stepped in to prevent the collapse of ICI. Serious under-provision for business placed through the London office was reported as being at the heart of the company's troubles. A company controlled by the government acquired ICI for a nominal sum 'to ensure the continuation of the insurance business and the protection of policyholders'.

Investigations of the adequacy of loss reserves had brought to light significant additional deficiencies, over and above those which had necessitated the injection of additional capital in late 1984. When the scale of the problem became apparent, AIB informed the authorities, because the scale of the reorganisation measures required was beyond their resources. Its investment in ICI, amounting to IR £183 million had to be written off. It could not resolve the problems of ICI without putting its core banking activities at risk.

The Irish government quoted a preliminary assessment of the under-provision as being IR £50 million. Insurance market sources, however, were quoted as saying that the final figures would be much higher. The London Market Newsletter of 2nd April quoted a report that 'London insurance market experts estimate that total losses could be as much as £500 million'. This compares with a figure of £200 million used by the Irish government.

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The ICI London office developed a reputation for keen rating. It has been suggested that the Dublin management put pressure on the London operation to increase its market share. In the competitive London markets, it opted for taking risk covers, much of which had previously been turned down by more established underwriters and reinsurers. It set out to undercut systematically existing rates to uneconomic levels. The gross premiums achieved in this way were then reinsured. The London Market Newsletter states that out of gross premiums of £157 million for 1983, nearly £128 million was paid away in reinsurance premium. The Post Magazine of 4th April 1985 suggests that many of the risks assured were reinsured at above average cost. It is also reported there that the London operations were allowed 'an extraordinary degree of independence' despite the fact that it generated such a significant proportion of ICI's total business. It appears to be the combination of dubious underwriting, inflated reinsurance costs, inadequate reinsurance protection and negligible accountability to head office that brought about ICI's downfall.

Insurance companies in Ireland have to report to the Licensing Authority. In July 1984, figures were provided by ICI which showed that insufficient provision had been made in the 1983 accounts for outstanding claims on Irish liability business. Meetings were held between the Authority and the company during August and September and it was decided to send in a firm of consultants. In November, ICI was formally notified that it was below the statutory reserve ratio and it was this which led to AIB subscribing further capital. The Authority enquired at this time about the London operation and were given assurances that though there were problems corrective measures were in hand. There was no indication of concern about the London operations by the DTI, which apparently seemed to satisfy the Authority.

In January 1985, the consultants appointed by the Authority reported that the reserves in relation to the Irish business were now adequate. It was the persistent rumours in London that prompted AIB to ask Coopers and Lybrand to investigate in February 1985. Their initial report was that losses for the second half could be as much as £20 million, four times the original figure. A special investigation was commissioned which revealed not only an increased level of losses and under-provisions but also that inadequate records and information had been maintained. The extent of the under-reserving was such that AIB itself would be threatened if it attempted to absorb the losses. The Irish Government were informed and decided to take over ICI because it held a 25% share of the Irish employers liability market and could not therefore be allowed to fail.

AIB announced its plans to sue Ernst & Whinney, the former auditors of ICI. They had been dismissed in December 1984, when they were replaced by Coopers and Lybrand.

The package which was announced to the Irish Parliament on the 15th March included

- a total write-off of AIB investment in ICI, amounting to IR £86 million

- any damages awarded to AIB from its law suit against its auditors to be shared with the Exchequer

- provision by AIB of an IR £50 million loan to the State over three years, with IR £6 million interest subsidy

- a further IR £20 million non-interest bearing loan

- the sale of AIB's 20% holding in the profitable and healthy life subsidiary of ICI

- the biggest share of any across the board bank levy which the Government might impose.

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In April, it was reported that the DTI agreed to hold an Inquiry into ICI's UK operation, following criticism in Ireland that it failed to alert the Irish authorities to any problems at ICI's UK operation. The Irish Department of Industry requested information in November 1984 about ICI's reserves but the DTI gave the Irish authorities the all clear.

AIB have been criticised for acquiring control of ICI without making the purchase conditional upon the standard post-acquisition review. The most recent accounts available at that time referred to exceptional losses at ICI's London branch. In addition, AIB already had two directors on the ICI board prior to the takeover, because it was a substantial shareholder, though their experience of the insurance industry appears to have been limited.

In July 1985, the Irish Minister for Industry announced that losses so far established for ICI amounted to nearly £200 million. This compared with a maximum of £125 million estimated at the time of the Government takeover. Despite this, the Minister felt that the loss could be dealt with through the banking system, and no levy on insurance companies was imposed, as had been feared.

The balance sheet drawn up by the Administrator appointed by the Minister showed a deficit of IR £164 million. However, this was after taking account of IR £27 million received for the sale of ICI's life operation. The Minister stated that the company was now trading profitably and that future profits would be set against past losses. The actual cash injection required would be about IR £100 million, of which between IR £50 million and IR £70 million would be required in 1985 and the remainder over a number of years. This could be met within the funding arrangements made by the Central Bank.

However, the insurance industry is suspicious of the fact that the Minister quoted only parts of the Administrators' report. It is felt that publication would have allayed many fears. Non-publication has been interpreted as concealing additional losses, possibly in respect of business written after the 31st December 1984, the date for which the Administrator drew up his balance sheet.

The latest development at the time of writing (September 1985) is that AIB have announced their intention to sue the state-owned Industrial Credit Corporation (ICC). The suit concerns allegedly misleading advice given by ICC to AIB which prompted the bank to make a second, successful bid for ICI in 1983. AIB is suing for the difference between its first and second bids but the question of damages and compensation could arise. ICC denies responsibility for AIB's losses and says it will defend and resist any action.

This case illustrates dramatically that even when a company appears to meet the solvency requirements satisfactorily, with a margin to spare, it may in fact be tumbling into insolvency. Far from the supervisor being able to recognise the situation, the company may not itself know what is happening. In this case there were warning signals from within the market, but no-one seems to have acted upon them. The London business was too immature and growing too rapidly for any realistic assessment of the true position to be made from the accounts or from the returns to the supervisory authorities. The rate of growth of business should perhaps have rung bells, as should the market gossip about ICI's underwriting policy, or lack of it.

ICI management appear to have been at fault in failing to monitor closely the activities of the London office, to find out what business was being written, whether adequate reserves were being established and to monitor the true profitability of the business. The reinsurance program appears also to have been inadequate, having been purchased at above the market rate, but still providing insufficient protection when the losses on the gross account began to emerge.