

The Failure of Insurance Companies

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Introduction

- The Fire, Auto and Marine Insurance Company (FAM)
- Independent Insurance Company

Independent Insurance (various newspaper quotes)

- Premiums '50% below mark' in insurance scandal
- Will you be hit by the Independent debacle?
- FSA 'derelict' in its duty over insurer
- Breathtaking lack of help for insurance victims

Introduction

- The Fire, Auto and Marine Insurance Company (FAM)
- Independent Insurance Company
- Has anything changed?

Why bother about failure?

- The public's attitude to insurance
- The healthy being dragged down by the sick
- Increased regulation

- Failure costs everybody money!

Why do insurance companies become insolvent?

Reasons for failure - Catastrophes

- High exposure
 - Actual exposure was unknown
 - Exposure known but risk taken anyway
 - Event unforeseen
- Reinsurance failure
- Cashflow problems

Reasons for failure - Rapid Expansion

- Large volumes of unprofitable business
- Infrastructure problems
- Poor information on the extent of the losses

Reasons for failure - Outsourcing

- Most parts of an insurance company can be outsourced
- Poor management of the outsourcing can cause problems
- Underwriting presents particularly big dangers

Reasons for failure - Reinsurance

- Over reliance on reinsurance
 - Small net risk
 - But large credit risk
 - Falls apart if the reinsurers do not pay
- Not enough reinsurance

Reasons for failure - Unforeseen Claims

- Good examples are
 - September 11th
 - Asbestos

Reasons for failure - Under Reserving

- Could be deliberate or accidental
- Pressure to manage the reserves
- Especially easy to do on long-tail classes

Reasons for failure - Fraud and Greed

- Insurance is a prime target for fraud
 - Easy business to enter
 - Cash up front and pay later
 - Easy to manipulate the profit

Reasons for failure - Under Pricing

- Under Pricing is a factor in most failures
- It is often connected with:
 - Rapid expansion
 - Unforeseen claim events
 - Delegated underwriting

Reasons for failure - False Reporting

- Could be accidental or deliberate
- Compounds other problems
- Insolvency can be hidden

Reasons for failure - Gross Incompetence

- Insurance is a complicated business
- It is easy to go wrong eg
 - A simple message to grow
 - A badly underwritten risk

Reasons for failure - Investment Failure

- Need to balance risk and return
- Solvency could be put at risk by a drop in asset values
- Liquidity could also cause a problem

Reasons for failure - Expansion into New Areas

- New products
- New geographical areas
- There is a danger of getting carried away

Case Histories - Fire, Auto and Marine (FAM)

- The main reasons for failure were:
 - Rapid expansion
 - Fraud and greed
 - Under pricing

Case Histories - St Helen's

- The main reasons for failure were:
 - Large losses from Hurricane Betsy
 - Asbestos

Case Histories - Transit Casualty

- The Titanic of insurance company insolvencies
- The main reasons for failure were:
 - Rapid expansion into new areas
 - Extensive use of delegated underwriting
 - Excessive reliance on reinsurance
 - Gross incompetence

Case Histories - Drake Insurance

- A top twenty motor insurer
- Put into provisional liquidation in May 2000
- Underwriting losses increased in the late 1990's
- Reinsurance programme cut back in 1996
- Drake did not maintain an adequate solvency margin
- The main reasons for failure look to be:
 - Underpricing
 - Lack of reinsurance

Case Histories - Taisei Marine and Fire Insurance

- Filed for court protection in November 2001
- The main reasons for failure were:
 - Unforeseeable losses from September 11th
 - Poor stock market returns
 - Delegated underwriting

Case Histories - Chester Street Insurance Holdings

- Provisional liquidators appointed January 2001
- The main reasons for failure were:
 - Large asbestos exposures
 - Under reserving

Case Histories - Independent Insurance Company

- The main reasons for failure were:
 - Expanded into France, Spain and the London Market
 - Rapid growth in 2000
 - Allegations that not all claims were recorded
 - Questionable reinsurance contracts
 - Under pricing

Case Histories - Summary

- The causes of failure have not really changed over the last 30 years
- Most questions can be answered by thinking through the different causes of failure

Who will be next?

- Who is expanding rapidly?
- Who is entering new areas?
- Who cedes very little to reinsurers?
- Who cedes a lot to reinsurers?
- Who is run by a larger than life director who has a flamboyant lifestyle?

What can be done to prevent future failures?

- Work out who might be next and then keep an eye on them
- Regulatory changes

Preventing failures

- Catastrophes - realistic disaster scenarios
- Rapid expansion - limit on expansion rate
- Under reserving - Actuarial sign off
- Under pricing - Pricing sign off
- Expansion into new areas - force agreement from the regulator

What part can actuaries play?

- Formal role in signing off reserves
- Formal role in signing off pricing
- Public interest responsibility
- But can we do the job?

Questions and discussion

- Can external actuaries do the job well enough?
- How wide should a formal role for actuaries be?
- Do we want to prevent failure?
- What is the most likely future cause of failure?
- Should underwriters be jailed for not pricing risks correctly?

Useful resources

- The Dingell Report (February 1990)
Failed Promises: Insurance Company Insolvencies, written by
a Subcommittee of the US House of Representatives
- Fraud: The Amazing Career of Dr Savundra
Jon Connell and Douglas Sutherland
- Report of Reinsurers Security Working Party (1990)
- AM Best reports
- Sigma (Swiss Re's publication)
