



Binding Authorities Lessons From History

Julian Ward, JTW Connect Ltd
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Treasure Laden Galleons?

- Product Expansion
- Market Penetration
- Delegating to Expertise
- Premium Income



Devil's Chariots?

- Disastrous delegation
- Sasse
- Unicover/SCB workers comp
- Fortress Re
- ABC Construction
- QBE vs Temple
- Lessons learned?



Sasse - the scene

- Sasse Synd 762 old school U/Wr attracted large stamp capacity
- Granted authority to Florida-based Den Har who had access to large property book.
- 1975 & 1976 exposed to massive volume (PI and number of risks) of sub-standard risks undercutting FAIR plan
- Leveraged massively by reinsurance with IRB & others.



New York Tenements

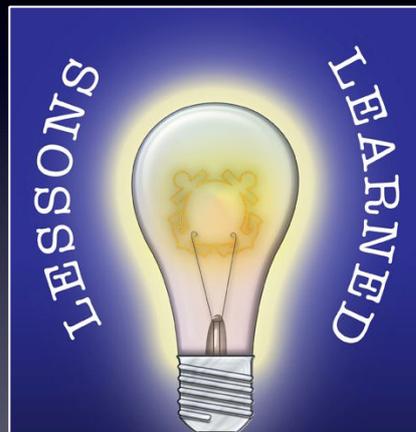
Sasse - the damage

- South Bronx unoccupied tenements torched also computer leasing scandal
- Premiums, accounting, losses concealed between years.
- Lebouef discovered March 1976, notice given July 1976 (ignored) last writings honoured by LPSO December 1976.
- IRB rescinded for non-disclosure & misrepresentation. Sasse's losses \$40m, 2/3 picked up by Lloyd's to settle case



Sasse

- Sasse Stamp Capacity PI targets drove recklessness
- Failures in due diligence investigating prior to granting licence, understanding business, reporting requirements, audit procedures.
- Reliance on R/I
- Brits trusting Brits - not always a guarantee



Sphere Drake vs Euro Intl

- Uncover of NJ scandal preceded this. Spiralling of Workers compensation business. Arbitraging on a massive scale. \$billions lost.
- UK brokers Stirling Cooke Brown were involved with Uncover and the wider "WC carve out" business which they helped spiral.
- Euro International held a binding authority on behalf of Sphere Drake.
- Euro International & SCB conspired to commit Sphere Drake to business which was certain to be loss making.



Sphere Drake vs Euro Intl.

- "Passing the trash" - "Russian Roulette by Proxy"
- Inner circles of spiral guaranteed a profit if outer circle reinsurers of the "leakage" paid up.
- Uncover, SCB and others generated \$billions in fees, commissions and brokerage
- Euro Intl. & SCB held in breach of their fiduciary duty.
- Note the issue of dozens, hundreds of arbitrations needed to unravel & resolve spiral issues and disputes.



Unicover/SCB

- Introduction of large scale arbitrage/spiral business - or was it (LMX)?
- Many of the insurers/reinsurers who granted binding authorities were committed to losing hundreds of millions before they understood what had been written on their behalf.
- "Carve out" equals "Carve Up"



Fortress Re - History

- Kenny Kornfeld, Maurice "Chuck" Sabbah
- Offices in Burlington, North Carolina.
- 20-yr old Wang computer handled 12 digits max.
- Operated an Aviation Reinsurance pool backed by Aioi, Nissan & Taisei
- Wrote many lines at \$50m-\$500m
- Extensive use of financial reinsurance and creative accounting methodologies



Fortress Re - The Damage



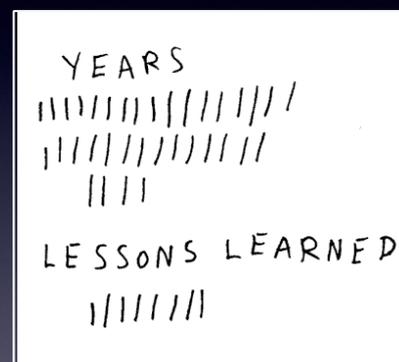
- Not accounting in GAAP, Fortress Re did not need to declare its claims payables under the financial reinsurances.
- No audits so as not to endanger "arms length" status of Fortress Re agreed with US tax authorities.
- In 1999 1st qtr declared combined loss ratio incl IBNR of 30.26%.
- Several air disasters up to and including WTC revealed massive exposure.
- Carolina Re was owned by Fortress Re shareholders. Taisei went bankrupt.



Fortress Re



- Lack of due diligence.
- Aggregation of exposures.
- Reinsurance gearing.
- Creative accounting.
- Cultural factors contributed.
- Audit, audit, audit .
- Generosity of key players.



ABC Brokers Ltd

- Contractors All Risks
- Coverage up to \$1m EML
- Coverage : Worldwide excl USA
- Full reinsurance clause excluding rate & retention
- XYZ authorised to bind & agree terms/rates
- Brokerage insurance 25%, reinsurance/retro 30%
- Signed lines to stand in full
- First loss or excess of loss may be bound
- Bordereaux to include insured/reinsured, period, limit, premium amount
- EPI limit US\$1.5m



ABC Brokers - The Fallout

- \$20m losses over two years
- Almost exclusively Middle East, first loss declarations where ABC also placed the excess of loss open market.
- Brokerage often 50-60%
- Prior facility & experience not disclosed.
- Danger of using the "F" word with E&O underwriters.



QBE vs Temple - History

- ATE legal expenses underwriting authority granted by QBE to Temple
- Effective 1st Jan 2006, Temple authorised to delegate authority to cover holders.
- Solicitors handling claims reported to Temple.
- Relationship deteriorated, QBE gave required 240 days notice on 11th August 2006.
- On 1st October 2006 Temple given authority by another insurer and ceased writing for QBE altogether.
- On 4th January 2007 QBE wrote to Temple advising that it was taking back all claims handling and administration for the run-off.
- Temple refused to hand back the run-off administration asserting its right under the contract that it was entitled to do so.



QBE vs Temple - The Damage

- Contracts of Insurance were between QBE and Individual litigants.
- QBE and Temple relationship one of principal and agent, which can be revoked even if agreed not to do so.
- QBE was entitled to force Temple to administer the run-off but not obligated to do so.
- Temple's position had centred on protecting its commercially essential relationship with its coverholders. Successful in other disputes.
- The practical difficulty for QBE was access to coverholder records, who had agreements with Temple, not QBE (records for run off & audit).
- High Court ruling upheld in Court of Appeal



QBE vs Temple

- Profitable business can be as problematic as loss-making business
- Sub-delegation. Legal duties, loyalties, access to records problems
- In drafting contracts consider all permutations of events upon termination.



To whom do brokers owe duties and when?

- Line slips and BA's not contracts of insurance hence per se no UGF owed (HIH Casualty vs Chase).
- In *Pryke v Gibbs Hartley Cooper* the insurer suspected unauthorised insurances were being bound and asked for a particular risk to be cancelled. The broker countered it would investigate then failed to relay findings of suspected practice by coverholder.



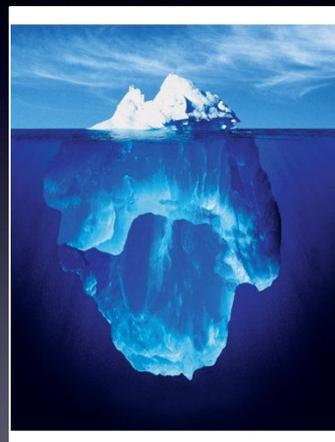
Pryke v GHC

- In placing business broker held to be agent of the coverholder, not the insurer.
- Brokerage is consideration for sourcing and placing NOT servicing. However ...
- GHC created agency responsibilities in undertaking the investigation.



Spotting Icebergs

- Deviations from EPI projections.
- Significant RPs, especially late in year.
- Vague conditions, untimely, unclear reporting, especially of premiums.
- Insufficient contractual controls.
- Restructured programmes.
- Sub-delegation.
- Expired authorities.
- Reinsurances of binders.
- Leveraging of reinsurance.
- Emphasis on relationship.



Keep believing!



JTW Connect Ltd



- Julian Ward
- jward@jtwconnect.com
- T +44 20 7183 6652
- M +44 7971 648366
- www.jtwconnect.com

