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Rewards to Be Made by Claim Recovery in the Insolvent London Market

By David Stern

Insurance Claims in the London Market

Billions of dollars of claims are settled with the London market every year. Many of these claims will have had a portion of the risk underwritten by insurance companies that are now insolvent. To maximize recoveries, claims must be properly presented to both the solvent and insolvent markets.

Recovery from the solvent market is generally approached first, and in some cases it is the only recovery attempted. The recovery of the portion attributed to insolvent insurers is often not seen as worth the effort required to attain it. A myriad of often confusing intricacies of the London market and the perceived low value of such claims mean that not all insureds are willing to take steps to ensure they maximize their returns. Recovery of claims against the insolvent London market is often seen as a logistical nightmare not to be reckoned with.

However, recent experience in the London market shows that significant gains are to be made by those who persevere. Over the past decade, schemes of arrangement have been used as an alternative to liquidation for insolvent carriers. These schemes allow earlier payment to creditors of a percentage of their agreed claims' value. Billions of dollars are currently being paid through these schemes to those with claims against insolvent insurance companies.

Schemes of Arrangement – Market Update

A scheme of arrangement is a compromise between an insurance company and its creditors implemented under Section 425 of the Companies Act 1985.

Schemes are generally one of two types. Often, initially a "runoff" scheme is put in place. The runoff scheme is intended to provide for an orderly handling of the existing business of the insolvent company until all present and possible future claims have been dealt with. The aim of this type of scheme is to allow the periodic payment of interim dividends in respect of established claims while retaining cash assets to enable the companies to pay the same percentage interim dividends in respect of all claims established in the future.

An example of a current successful scheme that was initially a runoff scheme is KWELM.

The KWELM scheme was put in place after the demise of five subsidiary insurance companies of London United Investments Plc, namely **K**ingscroft, **W**albrook, **E**l Paso, **L**ime Street and **M**utual Reinsurance ("the KWELM" companies).

The KWELM scheme has been in effect since December 1993. In the past 10 years, the cumulative agreed claims have grown to exceed $3.0 billion. In 2002 alone[1] $335 million in claims was processed and agreed.

(**Rewards**, continued inside)

Lloyd's — A Shakespearean Tragedy

By Michael D. Jackson

After the disaster of September 11, the insurance market feared for its future. Lloyd's had been in business for more than 300 years but was shaken to its very roots. But Lloyd's, as it has always done, has bounced back with a return to profit last year. Lloyd's does have a certain resilience. At times certain quotations just pop into one's mind, and perhaps what took place then and since can be covered by what Shakespeare had Hamlet say:

To be or not to be: that is the question,
whether tis nobler in the mind to suffer
the slings and arrows of outrageous fortune,
or to take arms against a sea of troubles.

(**Lloyd's**, continued inside)

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Payout levels from the scheme currently range from 38 percent to 56 percent[2] of the total claim values.

At a series of meetings held on January 29, 2004, KWELM creditors voted to implement a revised scheme which includes a cutoff date of September 2004.

A cutoff scheme provides for a claims submission deadline by which creditors' claims must be filed; failure to do so precludes the creditor from the scheme. The rationale for a cutoff scheme is to value and agree all claims as quickly as possible in order to minimize the costs of dealing with the estate so as to maximize returns and provide an early payment of dividends to unsecured creditors.

In the example of KWELM, this approach translates to total payments that are likely to be in the range of 56 percent to 78 percent within the next two to three years, rather than a payment schedule that was likely to run past 2015.[3]

The implementation of the cutoff date for KWELM follows the transition of several other runoff schemes to cutoff schemes, and it is expected that the remaining runoff scheme companies will not take long to follow suit. This places a significant responsibility on the insured. It is imperative for an insured, regardless of whether it has reached settlement with the solvent London market, to monitor the position of these companies and to notify its claims prior to any closure cutoff dates.

Scheme Claims

Once notification of a scheme claim has taken place, liabilities of the insolvent insurers must be established by agreement, negotiation or litigation, subject to the dispute procedure set out in the scheme.

Depending on the specific claim and the approach taken, this can range from a straightforward process to ongoing and time-consuming negotiations and potentially even litigation. The liabilities of the insolvent market generally follow on from settlement of the claim with the solvent London market insurers. Complex allocation formulas are used to determine each London market insurer's liability with respect to a single claim. Once the allocation information is agreed upon in the solvent market, it is important that this information and settlement or judgement information be made available to the insolvent insurers to enable settlement of the insolvent portion of the claim.

At a series of meetings held on January 29, 2004, KWELM creditors voted to implement a revised scheme which includes a cutoff of September 2004.

This is not an automatic process, and without the right approach, lack of solvent market information may hinder the settlement of the claim in the insolvent market. The provision of this information can be key to the success of the claim. To prevent problems regarding the transfer of this information, a co-operation clause can be included in the settlement agreement with the solvent market. This ensures that the solvent London market will cooperate with the insured by assisting in the provision to the scheme administrator of information regarding any insolvent company's share of the total settlement amount and the allocation formula.

The claim can then be negotiated with the insolvent companies. The terms of payment and the percentage of these claims paid are dependent on the financial position of the insolvent company and the type of scheme in operation.

The London Connection

Local London market knowledge can help smooth the claim process by guiding the creditor through the complex and often frustrating environment.

Key elements of success are:

- ensuring that scheme cutoffs are monitored so that claims are made prior to the closing of any cutoff schemes and generally that notice has been given to the scheme companies;
- monitoring payout percentages and increases in dividends in conjunction with underlying claims values to determine projected recoveries;
- including appropriate clauses in settlement agreements to enable information transfer from the solvent to the insolvent market;
- determining whether to negotiate insolvent claims before or after settlement with the solvent market; and
- ensuring an effective, knowledgeable approach in the submission and negotiation of claims.

Access to counsel with extensive experience in presenting and negotiating such claims with the insolvent market and who have developed close relationships with scheme administrators and runoff managers can enable these elements to be achieved. Counsel is able to monitor the changing corporate landscape and to conduct the right strategy from the outset. They can provide a road map to creditors which will not only simplify this process, but may also impact on bottom-line corporate profitability.

Commercial prudence dictates

(**Rewards**, continued opposite)

(**Lloyd's**, continued from cover)

Much of this quotation can be taken to refer to what has happened then and since, both in the insurance world and in the world as a whole. The market has suffered outrageously and has recovered. Lloyd's began its long and troubled passage through history in the late 1600s. It has seen many disasters, both man-made and natural. The world Trade Center disaster was the biggest ever suffered, at approximately £1.98 billion ($3.5 billion). Nick Prettejohn was quoted as saying, "We never envisaged such a horrific scenario coming to pass … it was a terrible, tragic example of how unpredictable and complex risk is in the world today."

But what is risk? My dictionary defines it as "possibility or likelihood of danger, injury, loss, etc.; hazard …." So without risk, then the insurance market would not be needed. So when disasters take place, the market must respond. London has in the past done all in its power to help. Back in 1906, when the earthquake hit San Francisco, Cuthbert Heath swept all hesitancy aside and paid all claims, developing the tremendous reputation that Lloyd's, from that moment on, attracted. The nightmares of the late

Lloyd's has been around for three centuries, and, if the reforms that it is now subjecting itself to are successful, it should survive another three.

1980s and early 1990s, which emanated from pollution losses and asbestos claims, have tarnished that reputation. Fraud was alleged. This consumed the market with lawsuits and gossip, and disputes and gossip, and restructuring and gossip.

However, Shakespeare comes to the fore again with Henry V standing boldly and saying:

Once more unto the breach, dear friends.

The London market has stood firm and reformed and kept the world-renowned marketplace a major player in the industry.

Henry rallied his troops, who believed they were outnumbered by the opposition, with a speech, some of which I quote and believe is relevant to what is happening now:

That he which hath no stomach to this fight,
Let him depart;…

He that shall live this day, and see old age,
Will yearly on the vigil feast his neighbours …

But he'll remember, with advantages,
What feats he did that day.
Then shall our names,
Familiar in his mouth as household words- …

But we in it shall be remembered-
We few, we happy few, we band of brothers; …"

Those that remain in the market after September 11, and continue in business, will look back at some point and realize what has been achieved against increasing competition and larger opposition.

Lloyd's has been around for three centuries, and, if the reforms that it is now subjecting itself to are successful, it should survive another three. These reforms include the amending of a very old tradition of three-year accounting and changing to annual auditing. Names with unlimited liability will become obsolete.

The breach has been filled, the market has had the stomach to fight, and those that continue will live to underwrite another day.

Shakespeare wrote much. Let us all hope that we have already had the *tragedies* and that *comedies* do not follow.

Michael D. Jackson is a former underwriter and member of Lloyd's. He currently serves as managing director of London-based MDJ Consultants, Ltd., an affiliate of Robert Hughes Associates, Inc.

(**Rewards**, continued from opposite)

that now is the time to act. This will ensure that the opportunities available today are not cut off by some arbitrary date and that creditors are not left with the knowledge that a claim which could have been monetized is simply written off as bad debt.

[1] http://www.kwelm.co.uk, viewed Jan. 22, 2004
[2] http://www.kwelm.co.uk, viewed Jan. 22, 2004
[3] http://www.kwelm.com/pdfs/Press%20Release%2020031215.pdf , viewed Jan. 23, 2003

David Stern is an international barrister and head of chambers at Settlement Counsel, specializing in the recovery of London market claims. David has a master's in law in international commercial insurance law from Jesus College, Cambridge.

ROBERT HUGHES ASSOCIATES INC.
508 TWILIGHT TRAIL, SUITE 200
RICHARDSON, TEXAS 75080
(972) 980-0088 FAX (972) 233-1548

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Michael D. Jackson
Managing Director
MDJ Consultants, Ltd.

Mr. Jackson began his insurance career with Alexander Howden, Ltd., in 1967 and held various positions within the London market, including, but not limited to, underwriting manager and senior underwriter, before forming RHA (UK).

Mr. Jackson has provided consulting and expert witness testimony for many United States-based insureds with regard to Lloyd's and the London market.

For more information about MDJ Consultants or Robert Hughes Associates, please call Mike Jackson at (UK) 01923-223162 or John Oakley in Dallas at (972) 980-0088.

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Editor .... John R. Oakley
Assistant Editor .... Alice H. Oakley

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For more information, contact
John R. Oakley, Editor
508 Twilight Trail, Suite 200
Richardson, TX 75080
Tel. (972) 980-0088.