

Unlicensed Reinsurance – Uncollectable Dilemma

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Résumé de l'article

Recouvrer une réclamation d'un réassureur, qu'il soit ou non agréé, peut s'avérer compliqué dans les trois cas suivants : - lorsque le réassureur est incapable de payer; - lorsque le réassureur refuse de payer; - à la suite d'une catastrophe ayant pour effet de réduire la liquidité du marché. Quoiqu'un grand nombre d'entreprises canadiennes devront faire face à des problèmes de réassurance non recouvrable, seules quelques-unes d'entre elles en subiront des conséquences graves. Au Canada, le marché des réassureurs agréés n'a pas connu de faillites, et les réassureurs qui se sont retirés du jeu l'ont fait d'une manière responsable. Les problèmes actuels seraient principalement liés aux réassureurs non agréés; toutefois, même dans les années 70, lorsque le marché de la réassurance agréée était considérablement plus restreint qu'aujourd'hui, il était rare que les affaires proportionnelles fussent placées auprès de réassureurs non agréés, et la majorité des affaires en excédent de sinistres, surtout celles exposées au risque, étaient également placées sur le marché agréé.

Unlicensed Reinsurance – Uncollectable Dilemma⁽¹⁾

by

Christopher J. Robey⁽²⁾

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- lorsque le réassureur est incapable de payer ;*
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The collection of claims from reinsurers, whether licensed or unlicensed, can be of concern in three circumstances :

- where the reinsurer is unable to pay ;

⁽¹⁾ This article was originally published in 1989, in the technical bulletin of the Canadian Insurance Accountants Association.

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- where the reinsurer is unwilling to pay ;
- following a catastrophe which undermines the liquidity of the market as a whole.

The situation with a reinsurer in liquidation, where it is known that it cannot pay its debts, is the most straightforward. The ceding company knows that it will not receive 100 cents on the dollar for monies owed and this is reflected in its financial statement.

In addition, the reinsurer will give little commercial consideration to items in dispute. Indeed, the liquidator could be charged with failing in his duty if he pays out money for which the reinsurer is not clearly responsible.

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It can be disconcerting for a ceding company suddenly to find itself discussing, either directly or through an intermediary, with someone who has absolutely no reason to be accommodating and this can put a severe strain on the sometimes too loosely drafted wording of the reinsurance contract.

Dealing with a reinsurer able but unwilling to pay is much less straightforward.

Normally, such a reinsurer is solvent, but has lost a lot of money dabbling in reinsurance. It is either being run off completely or, as often as not, it continues to write an insurance portfolio while running off its reinsurance acceptances.

Again, the ceding company finds itself dealing with a reinsurer who has no reason to be accommodating. Often, the run-off is handled by a lawyer or accountant who, while fully competent to apply the letter of the contract, has little understanding of, or desire to understand, the commercial climate in which it was negotiated.

Protecting the cash flow and reducing the ultimate liability can become the key considerations. This will normally take the form of ensuring that every letter of the contract is followed, with every "i" dotted and every "t" crossed, before parting with any money. The nature of the reinsurance business is such that an approach of this kind can generate substantial delays, along with substantial investment income on the funds withheld.

In the rare case, the tactics can go to the point of bad faith. It is not unknown for a reinsurer to acknowledge the validity of a debt to

a ceding company, but offer to pay only 50 cents on the dollar, arguing that, if the ceding company had to force payment through the courts, it would in any case only realize about that amount after expenses.

534 Insurance Solvency International, which analyses the financial statements of insurance companies around the world, estimates that the world-wide surplus of insurance companies is overstated by U.S. \$10,000,000,000 because of unrecoverable reinsurance. In the United States in 1986, reinsurance recoverables equalled 85% of total policyholders' surplus and it has been suggested that 10% to 20% of this may be uncollectable.

Such is the nature of reinsurance that the impact of uncollectable amounts is felt more strongly by the weaker insurance companies. Those are the companies needing most reinsurance and more likely to be price rather than security conscious in their reinsurance buying. Inevitably, they are therefore more exposed to reinsurers which fail.

Even more exposed are the reinsurers themselves, since the weaker reinsurers would have been unable to attract the better quality business and would have had a portfolio which would tend to compound their problem. In the wide open market of the 1970's, the business available would often have been the retrocessions of other weaker reinsurers, creating the danger of a chain reaction of failures.

While many companies in Canada will have some problems with uncollectable reinsurance, these problems would be serious only for a very few of them. The licensed Canadian market has not seen any bankruptcies amongst reinsurers and those which have withdrawn have done so responsibly.

Those problems which exist would be with unlicensed reinsurers, however even in the 1970's, when the licensed reinsurance market was by no means the size it is today, it was rare for proportional business to be placed with unlicensed reinsurers and the bulk of excess of loss business, particularly at the working level, would also have been licensed.

Those insurers with the greatest difficulties would be the ones which accepted reinsurance themselves, since their retrocessions would have been placed more on the unlicensed market and, inevita-

bly, in some cases with reinsurers now in one form of difficulty or another. Nonetheless, even for these companies, the damage is not fatal, since their reinsurance writings were a small part of their overall volume.

It is true that unlicensed reinsurance has been held responsible, in part, for the failure of some insurance companies in Canada in the last few years. However, the problems were caused more by the unconventional nature of the reinsurance than the fact that it was unlicensed.

It is unlikely that Canadian insurers are building future problems for themselves with unlicensed reinsurers, partly because of the ready availability of reasonably priced licensed reinsurance for most exposures today and partly because of the advance notice received, over several years, of tightened regulations from the Office of the Superintendent of Financial Institutions.

However there is one area where the use of unlicensed capacity could prove a blessing for a Canadian insurer – in the wake of a major natural disaster, such as an earthquake in Vancouver or Montreal.

Not only would Canadian reinsurers suffer substantial losses in their catastrophe treaties, but also from their proportional book. Hurricane Gilbert in Jamaica has underlined the size of the catastrophe exposure lurking in quota share and surplus treaties.

The sudden need for cash to pay claims would far exceed the liquidity of the insurers and reinsurers affected. Banks would have their own problems and may not be overly eager to extend credit to an industry which has suddenly suffered a crippling financial blow.

Governments would be more interested in putting money directly into the hands of individuals, and would in any case be facing enormous demands on their welfare, unemployment insurance and possibly workers' compensation funds.

The only other recourse for insurers and reinsurers would be to liquidate some of their own investments.

But they would be selling into a market already devastated by the disaster itself and the subsequent unloading of securities by others. Insurance companies dumping millions of dollars of investments

into such a market would only exacerbate the problem, while at the same time reducing the value of those investments to which they hold on.

The ceding company which has its catastrophe protection placed with unlicensed reinsurers in Germany, Japan or Switzerland however is in a different position. These reinsurers would have only a small amount of Canadian business and almost none of their investments in Canada. Their means of communication would still be intact, their banks unaffected.

536 Suddenly, unlicensed reinsurance would seem the most collectable reinsurance of all.

In practice, however, such is the international nature of the licensed reinsurance market in Canada that Canadian insurers can have the best of both worlds. Licensed catastrophe reinsurance is readily available from reinsurers which have head offices or parent companies outside Canada, insulated from a Canadian disaster almost to the same extent as an unlicensed reinsurer. Such is the standing of these reinsurers in the international insurance community that they can be counted on to provide whatever immediate succour would be needed by their Canadian operations.

It is one time when the almost total lack of Canadian-owned reinsurance capacity would be welcomed.