Our 1984-85 Programme was concluded on Wednesday, 13th March, when Messrs. G.A. Weiss and P.J. Singer of Cork Gully presented a paper on

"MAJOR PROBLEMS ASSOCIATED WITH THE LIQUIDATION OF INSURANCE BROKERS"

This is a slightly abridged version.

The topic upon which I have been asked to speak is "major problems associated with the liquidation of Insurance Brokers". It was not however specified whose problems I was to speak about. All sorts of people suffer problems upon the insolvency of a Broker. The Broker may be holding a claims recovery which is required by the client, or may have been in the process of doing some other thing, details which have not yet been transmitted to the client. An Insurance Company with whom that Broker does business may not know whether premiums have been collected by that Broker, or whether perhaps the Broker has put them on risk for some unpleasent contingency.

The Broker's clients both up and down the line will undoubtedly suffer a period of anxiety and uncertainty and there is no doubt that many of them, in company with the ordinary trade creditors, will be owed often quite substantial sums of money.

Insolvency Accountants, whether they be acting as Liquidators or Receivers, are generally speaking a pretty resilient bunch of people. Being regarded as the corporate equivalent of an undertaker could be considered rather depressing, but most Liquidators rationalise this problem by seeing themselves more as knights in shining armour coming to the rescue of the poor helpless creditors, who are, after all, the innocent victims in an insolvency. However, there is one type of Liquidation that does give me sleepless nights and that is the Liquidation of an Insurance Broker and matters are compounded if that Broker is a Reinsurance Broker and if he happens to be a Lloyds Broker, then I really do have problems.

Until a few years ago when an insurance broker went into Liquidation the Liquidator might find just one bank account, possibly with a credit balance, but always for a sum considerably less than the total of the sums claimed by the various insurance company and client creditors. If there was a credit balance the problem of tracing who was entitled to what was usually impossible and the fund would ordinarily be distributed pari passu among the creditors. It was always entirely possible that there would be nothing in the kitty and it was a hopeless task trying to recover premiums, (whether or not you were entitled to them), for clients. If you did succeed you would be quite likely to find that there was a provision in the agency agreement impressing those premium collections with a trust so that they had to be handed over to the insurer in any event, rather than retained for the benefit of the general body of creditors.

Thus, if a Liquidator were inclined to try and tidy up the books of an insolvent broker, he could find himself doing a great deal of work for little or no reward. I should add that I have serious reservations as to the morality of a Liquidator, in these circumstances, collecting premiums which he does not, in any event, intend to pay on to the insurer. It seems to me that in these types of cases, and subject to market practice, the 1906 Marine Insurance Act and the provisions of individual agency agreements, a contract is made between the insured and the insurer with the broker merely acting as a bare agent, with no contractual entitlement of his own to demand a premium, except for the specific purpose of paying it on to the insurer, subject, as ever, to the deduction of brokerage.

These problems were modified but hardly resolved by a series of pieces of legislation commencing with the Insurance Brokers (Registration) Act 1977 which was followed between 1977 and 1981 by no less than 14 orders including "The Insurance Brokers Registration Council (Accounts and Business Requirements) Rules Approval Order 1979". This was the one, you will recall, which

made it quite impossible for insurance brokers ever again to become insolvent, by introducing into broking the concept of a margin of solvency.

These rules introduced specific requirements as to accounts and accounting records, which principally require the setting up of separate bank accounts designated "Insurance Broking Accounts" into which a broker is required to pay, without delay, all monies paid to or received by him from all sources relating to insurance transactions of any kind. The rules go on to list the many and varied things which a broker may or may not do with the monies contained in the IBA, but nowhere is the account designated a trust account and, moreover, the rules are deafeningly silent on what a Liquidator is supposed to do with the IBA.

Our legislators had a splendid opportunity to set down exactly what should happen to IBA monies in the event of the Liquidation of an insurance broker and they assiduously failed to use it. Perhaps this was their intention, perhaps they don't like the idea of trust accounts and didn't want monies in an IBA impressed with a trust, but if that was the case, why did they create IBA's?

The whole point of the IBA is, after all, to keep insurance funds separate from a broker's ordinary funds, and one might think that this was done in order that those funds might be applied, in a particular way, should the crunch ever come.

Having speculated thus, I came to the conclusion that the whole point seemed to be a purely accounting one relating principally to solvency. By keeping insurance funds separate the broker could keep a fairly immediate eye on his cash position and avoid, in the mistaken belief that he was trading profitably, using clients' funds for the purposes of his own business.

Within days of my reaching that conclusion the decision in the Multiguarantee case was reported and I quote from Mr. Justice Harman's judgement: "the BIBA Rules were designed to show that a broker was solvent and to ensure solvency; there was nothing in them which dealt with payments in a Liquidation...... The insurance broking account was an asset of Multiguarantee which vested in the Liquidator for general purposes. No part of it was held subject to any duty to account either by reason of trust or of the Rules or any particular circumstances".

I suppose it is gratifying to know that the Judge agreed with my view so fully, but it was very frustrating to find out that all my original thinking was not so original after all.

In practice one finds that this has been Lloyds view too, since they are now insisting, for reasons dating back to 1938, and with which you are probably much more familiar than I, that U.S. Dollar IBA's should be subject to a separate trust deed. Had they thought that IBA's, as constituted under the 1979 Rules, were trust accounts they would not require separate trust deeds. Since I am speaking on the subject of a Liquidator's problems let me digress a little on the subject of U.S. Dollar IBA's subject to trust deeds.

Under the Lloyds trust deed, which, I might say, my lawyers have looked at and don't think much of, the powers of the trustees are delegated to the broker. If the broker goes into Liquidation, the broker's delegated powers are rescinded and Lloyds as the Trustees resumes its powers. So we have a situation where a Liquidator is trying to run-off his Liquidation with Lloyds trying to get their hands on the books so that they may collect the Dollar balances. The Liquidator naturally does his best to hang on to the books in order to collect Sterling balances. Lloyds say the books are also subject to the trust. The Liquidator says he has a statutory duty, Lloyds say they have a fiduciary duty. It's all a bit of

a mess, but a compromise will eventually be worked out. However, if the Liquidator should collect Dollars, he has to hand them over to Lloyds.

Once this is all sorted out and collections are made, the Liquidator ends up with all the collectable Sterling balances and the trustee ends up with all the Dollars. The Dollar creditors will be entitled firstly to claim on the trustee for payment out of the Dollar funds and secondly, in the event of a Dollar shortfall, to claim on the Liquidation for a share in the Sterling fund, whereas creditors for Sterling (and other non-Dollar currencies) can only claim on the Sterling fund. Over the years, and even at this moment, Parliament and the Courts have sought, quite properly, to create a system by which creditors are treated equally. But by creating a trust for U.S. Dollar IBA's Lloyds have not only sought to give a measure of added protection to U.S. Dollar creditors, they have also created a scheme to positively discriminate against and disadvantage non-U.S. Dollar creditors. To paraphrase Napoleon the pig in George Orwell's "Animal Farm", "All creditors are created equal, but some are created more equal than others".

I said earlier that my lawyers did not think much of the trust deed and I sometimes wonder in my idle moments whether, if the opportunity arose, it would be worth a liquidator's time and effort to challenge the trust.

The Court, I think, if it found the trust deed defective would be on the horns of a dilemma and it is just possible it might say: "Mr. Liquidator, you are right in law but wrong as regards the public interest". The Court would have to decide whether the public interest lay with preserving the trust, thus enabling Lloyds to continue to attract U.S. business, or in preserving equity and ensuring the equal treatment of all creditors, by terminating the trust.

Given that IBA's were set up to maintain a broker's solvency,

what has gone wrong? Why should there be a deficiency in the IBA Account unless there has been positive dishonesty?

It is, in fact, quite easy to identify the problem. Take for example a solicitor's client account, also established by legislation. In this case there is a prohibition against the monies of one client being used for the purposes of another, so that when your solicitor collects the deposit, or even the total proceeds of sale of your house, or winds up your grandmother's estate, he cannot lend it to me to help me to complete my purchase. He can only make transfers from client account to office account against specific bills. Therefore, when he has his annual audit, as required by Statute, the auditor must be able to identify every penny in the client account against a specific liability to a named client.

You will realise that unless the whole system is revised there is no easy solution. When you compare the number of transactions going through a broker's books with those of even the busiest solicitor, you may even think that a change in the system, if it were possible theoretically, probably would not work anyway.

Having given you those thoughts let me now offer you another. I had anticipated that when registration for insurance brokers became mandatory I would have a trail of brokers, who had failed to gain the respectability of EBC status, beating a path to my door in order that they might be wound up. That simply did not happen. Any enterprising gentlemen who did not wish to, or could not become, PIB's and those companies that could not, or would not, become EBC's, simply dropped the name "broker" from their title and called themselves "insurance consultants"; if the 1977 Act sought to protect the public and get rid of cowboys, it singularly failed to do so.

After these diversions let me conclude by outlining the position of the Liquidator of any ordinary insurance broker

writing ordinary, non-marine, company business. The Liquidator cannot collect premiums where he is not contractually entitled to them or, if he does, he must pay them over to the insurer subject only to the deduction of commission. Funds already in the broker's bank, including those in IBA's, are available to creditors generally, subject to a possible caveat in cases where there is a trust provision in the agency agreement, and where the insurer might seek to trace premiums paid to the broker which have not yet been paid on to him. Any insurer wishing to try this has my admiration and sympathy. Tracing monies is frequently an impossible task, with or without the application of Clayton's Rule, but in any event something else may well have happened on Liquidation to defeat the companies' best efforts in any event.

Once a creditors' meeting is called, or a petition presented, the Bank will freeze all the Broker's bank accounts including the IBA's. Having regard to the decision in the Multiguarantee case, once the company is wound up, IBA's lose their special status and the Bank will be required, following the decision in the Halesowen case, to set off the credit balance in the IBA against any overdrawn account which the broker has. If the broker is in financial difficulties, then it is probable that the office account will be overdrawn, so that the likelihood is that there will be little or nothing left in the IBA once set off has been applied.

If I am dealing with an insolvent reinsurance broker and limiting my remarks to a reinsurance broker dealing with the company market rather than with Lloyds or the ILU, my problems seem to increase exponentially. My biggest problem in these circumstances is the fundamental misunderstanding of my position as Liquidator by both reinsured and reinsurer. You may consider it to be a gross over-simplification, but in cases such as this I simply invite the two principals to deal direct with each other, without using me as the intermediary, but of course paying over to me any brokerage to which I may be

entitled, or refunding to me any claims which the insolvent reinsurance broker may have initially funded.

It seems to me that in a case such as this I really have only one type of insurance creditor and that is the party who has paid money to the reinsurance broker prior to Liquidation, in its capacity as an intermediary, for payment on to a known recipient, and where it has not been paid on.

The broker, subject to market practice, the 1906 Marine Insurance Act and the provisions of agency agreements, cannot possibly be responsible for claims payable or premiums receivable where he has not himself first collected that money, and it simply is a waste of time for a client to try and make a claim in the Liquidation for uncollected balances. Other than that my problems are much the same as they would be for the ordinary broker.

The problems which I have just mentioned alter fairly dramatically if the broker in question happens to be a Lloyds broker or is transacting business through the Institute of London Underwriters. I need hardly tell you that in such cases brokers act as principals and not as agents and that they are responsible for the premiums payable to insurers on business which they have negotiated. That means that if there are premiums which have not been collected from clients then I am entitled to collect them without worrying too much about trusts, implied or otherwise, or whether the insurer remains unpaid.

That I think lays out ground rules under which I have to act in the insolvency of an insurance broker and I think that you will appreciate that life becomes very much more difficult after liquidation. I should like to give you a couple of examples taken, as they say, from real life to just give you the flavour of some of the other problems which I have had to face.

I wonder how many of you recall the case of D.O. Howell (U.K.) Limited, where an insurance broker set up a scheme insuring heavy goods vehicles, particularly those engaged in continental freight business. This is the sort of risk which is not generally welcomed with open arms by insurers and in order to get premiums down to what clients regarded as a reasonable level the broker arranged a special scheme. To the insured this appeared to be a straightforward comprehensive commercial vehicle insurance, but in reality it was somewhat less straightforward. What was offered was a split cover arrangement with an insurer ostensibly offering comprehensive cover but, in practice, merely retaining the third party risks whilst reinsuring the ADF and T risks 100%. The reinsurance was also arranged by the same broker who accounted to reinsurers on a monthly bordereaux. The same broker was also responsible for handling the ADF and T claims as they arose and thus accounted to reinsurers for premiums received net of claims paid. The arrangement worked well enough until the original insurer decided that it no longer wished to front the ADF and T risks and terminated the arrangement, retaining only the Third Party business.

The broker cast around for someone else to carry on the fronting arrangement but failed to find anyone. You can guess what happened next, the broker simply ceased to bother with the ADF and T insurance, but still carried on with the 100% reinsurance, collectng premiums from the "insureds" and accounting to the reinsurers net of claims paid. This carried on for a year or 18 months until the absence of a primary ADF & T insurer eventually came to light almost by accident.

You can imagine what happened next. Reinsurers claimed that since there was no primary insurer there was no primary insurance and as there was no insurance there could be no reinsurance for the reinsurer to hold. They therefore avoided their essential ADF and T cover; claims of course continued to roll in and to some extent they were handled by E & O

underwriters. But what about the premium position? Even where insureds had had the "benefit" of quasi ADF and T Cover for a period, but had not paid the premium, how could I possibly enforce a claim for the premium? Where they had paid the premium how should their claim for a refund be calculated? Were they entitled to receive the whole of their ADF and T premium back or simply pro rate the unexpired period? Alternatively, should they be entitled to the cost of claiming replacement cover? Should they be entitled to the cost of replacement cover plus a refund of premium? A case such as this really does give a Liquidator a headache.

In this particular case I found myself in the High Court earlier this year facing a claim from one broker who had himself funded the payment of a substantial number of claims and who had also met the cost of finding replacement cover for his clients. I, for my part, put in the counterclaim in respect of outstanding premiums. The Court came to what I consider to be one of its quirkier decisions when I was informed that I was not entitled to pursue my counterclaim since although part of my claim was for good and effective insurance, another part of it was for unplaced ADF and T cover and that as a consequence the good part of my claim was tainted by the bad part, so that the whole became uncollectable. Nevertheless, the Court also took the view that if a shopkeeper serves you with bad goods you are not entitled to claim the cost of replacement until you have first paid for the bad goods so that whilst I was not entitled to recover my counterclaim it had to be deducted from the amount of the plaintiffs claim. If you can follow the logic of that you are doing better than me.

One final twist to this story is that much of that Broker's business was placed with Lloyds Underwriters. It was not itself a Lloyds Broker and its business was placed through its parent Company which was. Naturally, Lloyds Underwriters looked to the parent for payment of premiums which the parent had not collected from its subsidiary, and had no hope of so

doing once it went into liquidation. As far as I am aware, the parent was a properly run, reasonably healthy, company, but the burden of this additional debt, which ran into hundreds of thousands of pounds, rapidly pulled it down into liquidation itself. A cautionary tale for those who front for others in Lloyds.

Whilst I am supposed to be talking to you about the problems of a Liquidator, I do not think that I can let this opportunity pass without mentioning another case where I am presently involved. On this occasion I was asked to act as Advising Accountant to the Board of Directors of a Lloyds Broker which was unable, at least in the short term, to meet its obligations. This was a small, and as far as I could see respectable, broker transacting business in Lloyds with the ILU, and with companies both in Sterling and in Dollars. In addition it placed business in the London Market on behalf of an American broker in the capacity of broker whilst at the same time acting as an agent in respect of business placed by that same American broker under binding authorities of its own. It was the directors view that given time, and some forbearance, by their creditors they could probably pay them in full. It remains to be seen whether they can, but their creditors have indicated a willingness to give them some time and have granted a moritorium.

In this case the company is by definition insolvent because it cannot meet its obligations as they fall due.

I should stress that in a moratorium the company continues in business and operates at the direction of its board of directors so that if I say that I did this or I did that this is merely convenient verbal shorthand because as Advising Accountant I have no executive authority and the board of directors simply act on my advice or recommendations if they choose to do so.

The first thing that I arranged was for the sale of the company's principle asset, and one, which incidentally did not appear in its balance sheet, namely its goodwill. Goodwill in this case was represented by the Company's portfolio of clients which has now been sold to another broker. I also arranged for that same broker to run off the company's accounts. The company's work force were dismissed and its premises vacated.

You can see what has been done. We have reduced the company to a bare shell leaving it with its assets and liabilities, but virtually no overheads. The directors believe there are grounds for hoping that the assets will ultimately realise somewhat more than has been estimated and that liabilities will prove to be less so that eventually the deficiency will disappear thus enabling creditors to be paid in full.

So what is my problem? The problem is the run off, and at the last count, I had instructed the broker doing the run off to collect premiums in no less than 5 different ways and that ignores claims. Let me just quickly outline those instructions.

As previously mentioned the company wrote U.S. business both on its own account, and for an American broker. It also acted as UK agent for that same American broker. Premiums collected on the direct U.S. Dollar business have to be paid into a U.S. Dollar IBA where it is subject to a trust with Lloyd's as trustee. However, where it simply acts as the London handling agent for the American broker premiums received from America must be paid over to the insurer or underwriter immediately, subject only to the deduction of the company's commission. The company cannot hold on to the money because it does not belong to them and to retain it would effectively represent the taking of credit. The company is not permitted to take credit when it knows itself to be insolvent since to incur a debt when you know that you can't pay all your creditors in full constitutes fraudulent trading which is both a criminal as well as a civil offence.

With the company's Sterling business it rather depends upon the market in which the business is placed. If the business is with Lloyds then the company acts as principal and is entitled to collect premiums and retain them. This is not fraudulent trading because the premium represents a debt due to the broker even though the broker may not in turn have paid the Lloyds underwriter. If the business is placed through the ILU then the position is the same since again the broker acts as principal.

With companies and, subject to my caveats concerning Market practice, Marine business and agency terms, premiums collected must be paid to the insurer subject only to the deduction of commission, since in such cases the broker acts only as agent and has no contractual right to retain the premiums. If it did so, it would be trading fraudulently.

The Insolvency of an insurance broker, as you can see, poses many problems and each new case with which I deal seems to have new problems to which new solutions have constantly to be found.

In this talk I have deliberately avoided making any mention of fraud, but I think that you will appreciate that in cases involving fraud, most of the problems which I have mentioned are themselves exacerbated and I have, in addition to the problem of trying to unravel these problems, to cope with a quality of bookkeeping which owes more to art than to science. Perhaps on another occasion you might invite me to talk to you about problems associated with fraud, since I doubt that you will wish to hear me speak on my other special subject which is the insolvency of Insurance Companies.

In closing may I say that, over the years I have received a tremendous amount of help in overcoming many seemingly intractible problems and achieving equitable results from among others Lloyds, the ILU, the BIA, the BIBA, many insurance companies, and many others too numerous to mention. I should

like to take this opportunity of thanking the market for all its help and assistance.

CHOICE OF LAW IN TORT

A special meeting of BILA members and guests, chaired by Sir Maurice Bathurst, Q.C., was held at the Institute of London Underwriters, 40, Lime Street, London, EC3 at 5.30 p.m. on Monday 15th April to hear Professor Aubrey Diamond's comments on the Law Commission's Working Paper and the Scottish Consultative Memorandum on the law to be applied in actions arising out of torts committed in the U.K. and overseas.

Professor Diamond began by stressing that a case for domestic change had already been made in proposals to rationalise English and Scots. Law. The position could be complicated further: for example an English serviceman driving a private car in Malta injures a Scottish colleague on a motor scooter. Should suit be brought in England, Scotland or Malta? Comparable examples would be an action for defamation in Guernsey and injury to a British employee in Libya. Furthermore, the effect of EEC Law within the original six Member States had complicated the questions of jurisdiction, enforcement and choice of law.