

Quinn Insurance Limited (Under Administration)

Submission to the Joint Oireachtas Committee on Finance and Public Expenditure

On the application of the Financial Regulator (now Central Bank of Ireland) on 30 March 2010, the High Court made an order appointing myself and Paul McCann as joint provisional administrators to Quinn Insurance Limited. A further order was made on 15 April 2010 for the administration of the Company and we were appointed Administrators. The Company did not contest the appointment of the Administrators.

The Order of the High Court made on 15 April 2010 also provides that we act independently of each other with regard to our duties.

The application was made on three grounds, which will be outlined in further detail below:

- (i) the manner in which the business of the Insurer is being and has been conducted has failed to make adequate provisions for its debts, including contingent and prospective liabilities, and
- (ii) the business of the Insurer is being and has been managed as to jeopardise and prejudice the rights and interests of persons arising under policies issued by the Insurer were to continue as at present there might not be sufficient funds to meet claims made under such policies, and
- (iii) the Insurer has become unable to comply with the requirements of the Supervisory Regulations (as defined in the Insurance (No.2) Act, 1983 (as amended)) (the “Act”) in a material respect.

Separate to the appointment of the provisional administrators on 30 March 2010, the Regulator also directed the Company to cease writing all lines of business in the UK

As officers of the Court, we have and continue to report to the President of the High Court on the matters that arise in this assignment. To date we have lodged over 10 reports with the Court which has kept the President informed as developments occurred. We have also appeared in person earlier this year and answered questions that the President wished to put to us. The Court also oversees and approves the fees and costs associated with the administration

While we are more than happy to appear before this committee of the Oireachtas and answer to the best of our ability any questions that the members may have, it is important to note that we are Officers of the High Court and as such this matter is still in front of the High Court. We may not be able to answer some questions, either due to the confidentiality of certain documents that we have signed, or because matters are still to come before the High Court.

The Administrators share the dismay of all Irish citizens that the current estimate of the deficit in the Insurance Compensation Fund has risen to €1.65bn. It is important to point out that while it took approximately 18 months from the date of our appointment to uncover the €1.65bn deficit level, this deficit always existed and no actions or indeed lack of actions by the Administrators have contributed to this number. Furthermore, the nature of insurance claims means that while we are comfortable with the adequacy of the provisioning now in QIL, the final deficit number will only be known with certainty when the last claim is settled, a process which will take a number of years to complete.

We will now set out some background information which we hope will assist this Committee in getting a better understanding of the issues that we faced upon our appointment, the structure of the deal with Liberty Insurance and reasons why the ICF deficit has risen to its current level. The key issues that we would like to provide information on are:

- Financial position of QIL upon appointment;
- Subsidiary Companies;
- The under provisioning of reserves;
- The Sale to Liberty Insurance

Financial and Operational Position upon appointment

When we were appointed the task as set out in the relevant legislation was to put a plan in place to return the business of the company to a sound commercial and financial footing. Prior to our appointment, discussions had been on-going between the board of QIL and the Company's auditors PWC with regard to finalisation of the audit of financial statements for the year ended 31 December 2009. The draft unaudited financial statements for the year ended 31 December 2009 indicated a loss of €47m for the year, however, the auditors' actuarial review of the provision for claims suggested an under provision of €68m by the Company, thereby indicating a maximum loss for the year of €115m.

These draft 31 December 2009 accounts presented a picture that the Company while loss making in 2008 & 2009, was historically a profitable company. Figures indicated a:

- Surplus of assets over liabilities of €338m before the 2009 loss was posted and if you ignored the impact of the Guarantee Issue (detailed below), and;

This surplus was after the Quinn family (and connected parties) had extracted approximately €200m over the previous two years by way of gifts.

However these draft accounts, and the historical audited accounts, have subsequently turned out to not accurately reflect the true financial position of the Company for the reasons we will highlight today.

We concluded quickly that the sale of the business was the most effective solution and we moved to achieve this by a fundamental restructuring of QIL, which required the following actions:

- The recommencement of certain lines of business in the UK with substantial price increases;
- A significant redundancy programme;
- Adjustment of the cost base of the Company.

As part of our oversight of QIL during this period we unearthed significant operational issues, in particular inadequate file reserving practices, poor underwriting and pricing controls. As a result we carried out a comprehensive review of the claims and underwriting departments which resulted in:

- Fundamental changes in the claims controls and estimation practices;

- Significant improvements in underwriting controls and pricing policy in relation to the UK and to a lesser extent Irish business.

Guarantees given to Subsidiary Companies

As previously stated, we were appointed by the Court as Administrators of Quinn Insurance Limited on the 30th of March 2010. At that time, QIL had over 20 subsidiary companies which held assets such as: hotels in Sofia, Krakow & Cambridge; a windfarm in Derrylin; a landfill site outside Newry. &; a number of commercial properties located in Ireland and the UK. At that point these assets had a net value of approximately €450m, were consolidated into QIL's balance sheet, and formed part of the solvency assets of QIL. While there was no legal impediment prohibiting these asset types forming the asset base within an insurance company, it would be fair to state that this asset type would not typically be held by insurance companies.

Unlike QIL, which was a regulated entity, these companies were not regulated entities. An issue had arisen approximately seven days prior to our appointment when the board of QIL became aware of the existence of guarantees which had been given by a number of directors of the subsidiary companies in 2005 and 2006 as security to loans provided by a syndicate of banks and bonds that funded the wider Quinn Group. As soon as the board of QIL became aware of the existence of these guarantees they notified the Central Bank. These guarantees were for a total of €1.3bn and in the event these guarantees had been called upon, the effect would be to reduce the net assets of the insurance company by €450m. The discovery of these guarantees by the Regulator was a factor in deciding to appoint Administrators to QIL.

In order to gain control of these assets for the benefit of QIL, the joint administrators (or persons nominated by them) were appointed as directors to each of these companies. We also reached a standstill agreement with the banks and bonds in that we would not dispose of these assets and the banks and bondholders would not call in the guarantees.

While there was some doubt over the validity of these guarantees due to the nature of how they were executed, legal opinion was obtained by the joint administrators which confirmed that notwithstanding that proper board meetings had not been convened to approve the signing of these guarantees, it would be difficult to prove them as being invalid and therefore they were enforceable by the banks and bond holders. Following a significant amount of work and negotiations, the banks and bond holders agreed to a payment of €200m in full and final settlement thereby generating a saving to the Irish tax payer of €250m.

The Under Provisioning of Reserves

It should be noted that the Company engaged a third party actuarial provider, Milliman, to calculate the provision for claims required for the 31 December 2009 year end accounts. The Company did not have any in-house actuaries. Upon our appointment in order to address this weakness we utilised the services of the Grant Thornton actuaries based in London who set about developing the necessary controls and procedures in place to ensure that the business written from our appointment going forward was not loss making, and to assist in the overall reserving and underwriting procedures within the Company.

During the pitch process for the sale mandate of Quinn Insurance all three investment banks we met including our chosen advisors, Macquarie Capital, recommended that as part of the sales process we should complete vendor due diligence on the insurance reserves. In this regard we appointed an actuarial firm called EMB to complete this assignment. This exercise was commenced in July 2010. In late August initial findings by EMB caused a major concern as they indicated prior year under-reserving to the tune of €400m. The effect of this was to eliminate the profit reserves of the Company and question whether the Company

had been historically profitable. It also meant that any equity value for the ultimate shareholder of Quinn Insurance had been all but wiped out. Unfortunately on the 5th of November EMB confirmed its position and we re-engaged with both Milliman and PWC. On the receipt of EMB's analysis Milliman and PWC revisited their draft 2009 reserves and ultimately moved to levels in line with those arrived at by EMB.

During mid-2010 we continued to notice an on-going trend of increases in case reserve provisioning and requested that a full and detailed review be made by the claims department to ensure that adequate case provisions existed. The various reviews of file reserves added circa €230m to claims reserves. Prior to our appointment, in our opinion, there was a reluctance to adequately reserve large cases.

These findings resulted us in reporting to the Court in October 2011 that the deficit had increased to €738m and then to €775m in December 2011.

In 2011 we appointed new Auditors, Deloitte, to complete the accounts for the year ending 31 December 2010. Our own actuaries in London and Deloitte were concerned with the continuing volatility being experienced in the claims reserves and formed a view that a new contingency provision was required in the amount of €300m. In addition, by the time the accounts were signed off in May 2012, we had disposed of all of the Company's liquid assets and the Company was largely dependent on the ICF to meet its remaining claims books which were all denominated in sterling. We had approached banks with a view to trying to obtain a hedging facility, however the banks required security from the Minister of Finance which was not possible to obtain. This added a further €215m to the reserves to reflect the potential that sterling could fall to .7 against the euro. Finally, the core reserves had increased by €278m following the independent actuarial review carried out by Milliman on the 2010 and prior year reserves. Also, the underlying tangible assets of the Company and its subsidiary companies had decreased in value by a further €152m, which resulted in the estimated cost to the ICF moving to €1.6bn.

It is important to note that over 90% of these reserve movements are in respect of policies incepted prior to the appointment of the Administrators, and therefore have the effect of completely eliminating substantially all profits that QIL purported to make in its previous five years.

Some of the significant loss making areas include:

- Professional Indemnity – Total earned premiums €93m which compares with total projected claims of €333m;
- UK Commercial Motor was also heavily loss making – total premiums received amounted to €114m and the ultimate cost of claims is projected at €149m;
- The other major class of business private motor was also loss making with the projected ultimate cost of claims exceeding earned premiums over the same period;

In all these cases the losses are before taking account of operating expenses.

We have now carried out a review of the previous year's reserve accounts and our analysis would indicate that at the end of 2010 the reserves were under estimated as follows for year each

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|---------------|-------|
| Prior to 2006 | €215m |
| 2007 | €168m |
| 2008 | €289m |
| 2009 | €264m |

Total €936m

While I mentioned earlier, the ultimate cost to tax payer will only be known when the final claim is settled we believe that based on all of the information available appropriate reserves are now in place. We are comforted by the fact that we have engaged two UK experts who independently reviewed 35% of the value of current case files and their findings are that the case files accurately reflect the information available to the case handlers.

Sale to Liberty

In June 2010, having conducted an extensive selection process we appointed the London investment bank Macquarie Capital to advise and assist in the sale of the Insurance Company. An Information Memorandum was prepared and over the summer months over 91 parties expressed interest in acquiring QIL. By the time of the deadline for formal expressions of interests in September 2010, this number had reduced to 8. During the months of November and December, following access to data rooms and due diligence performed, the number of interested parties was reduced to a handful. By late 2010 it became apparent to us that there was a real possibility that no sale could occur which would have resulted in the loss of over 1,500 people and an even greater call on the ICF.

It had been widely reported that the Joint Administrators s had received an offer for Quinn Insurance from the Quinn Group (then under the control of the Quinn family). I can confirm that we did receive a letter from the Quinn Group on the 5th of April 2011, which set out at a very high level, and with significant conditions, how they intended to refinance the Company and improve the operations of the QIL going forward. It should be noted that the letter was received very late in the process and indeed after the relevant deadlines for expression of interests had passed. Together with our advisors, Macquarie, we formed the view that we would not engage in relation to this “offer” due the significant level of conditionality attached and the uncertainty around the extensive source of funding required.

Following extensive negotiations in the intervening period we managed to secure a purchaser for the Irish business. In early 2011, Liberty were selected as the preferred bidder as their offer allowed for the following:

- As a new entrant the maximum number of jobs would be preserved;
- As they were willing to take the ROI reserves it would significantly de-risk the exposure for the ICF;
- A goodwill payment of €88m;
- A facility to administrate the remaining UK claims in the most efficient and cost effective manner;
- A solution to the Guarantee issue , and thereby create value for the Irish Taxpayer of circa €248m;
- QIL was indirectly allocated a 25% stake in the new enterprise and IBRC had a further direct stake of 25%, meaning that should the Company be successful, the Irish state would benefit.

While their proposal was extremely complex to implement, we worked through the issues and on 14 April 2011 we announced the sale of the business to Liberty. A significant amount of regulatory work, and operational issues were still required to be implemented, including a formal Court application for the transfer of the ROI portfolio, before the transaction could complete.

As mentioned above, the reserves continued to be extremely volatile and this was beginning to cause significant concern to Liberty. In addition, when we agreed the sale in April 2011, the asset purchase agreement included a number of Material Adverse Conditions (MAC clauses,) that if breached would have allowed Liberty to terminate the agreement. By the time we were in a position to complete the sale in October 2011, both macro and micro conditions had dis-improved which put the whole deal in jeopardy.

All of the above resulted in a renegotiating of the deal with Liberty in early October 2011 prior to completion. Instead of the economic ROI reserves risk transferring to Liberty on closing, we agreed that three years post closure the claims position would be reviewed and a “true up” would determine the correct claims position. If the claims had been over-provided then a payment would be made by Liberty to QIL. The converse is also the position in that should the assets transferred to Liberty not be sufficient then QIL will be responsible to make good any shortfall.

A significant attraction of the deal with Liberty was the fact that it ensured the Joint Administrators had a robust solution for the run off of the UK claim book, which remained with QIL, in a going concern environment through the execution of a Transactional Services Agreement. We are confident, based on third party expert advice, that the run off of the UK book in this fashion will ultimately result in significant savings for the ICF.

We remain convinced that the deal to Liberty represented the best deal available for all stakeholders including the over 1,500 employees of the companies and the Irish taxpayer through the funding of the ICF.

We are also confident that we now have appropriate controls and procedures in place to ensure that the remaining business of QIL is managed in an efficient and cost effective manner as possible. This includes the appointment of a full time executive team including a new CEO who has extensive experience in the insurance industry to oversee the operation of the TSA and particularly the settlement of claims. In conjunction with the Department of Finance, we have also availed of the expertise of Ciaran Breen in the State Claims Agency who sits on our Claims Advisory Committee, which has been set up to guide and advise the Joint Administrators and QIL management on future claims strategy and policy.

Thank you for your attention and we are happy to take questions