FINITE REINSURANCE CONTROVERSY RESURRECTS AN EXPERT'S NEARLY FORGOTTEN BOOK

by

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RANCHO SANTA FE, Calif. April 18 (BestWire) — The widening investigations into reinsurance transactions among some of the world's largest insurers and reinsurers are stimulating renewed interest in ideas and decisions made years ago, and how finite reinsurance evolved as an innovative tool to solve thorny financial problems.

Amid state and federal investigations in the United States and Australia into the use of finite reinsurance by the likes of American International Group Inc. and Berkshire Hathaway Inc.'s General Reinsurance Corp., insurance lawyers' renewed interest in the workings and origins of finite reinsurance even has dusted off the fortunes of an out-of-print textbook on the subject.

Written by Andrew Barile, a 40-year insurance and reinsurance veteran who now runs a consulting firm in Rancho Santa Fe, Calif., "A Practical Guide to Finite Risk Insurance and Reinsurance" was published in 1995 by John Wiley & Sons. The 341-page book went out of print after its initial, 5,000-copy first edition. Insurance lawyers now apparently are scrambling for the book, bidding as much as $400 or more for used copies.

The book is listed on Amazon.com's Web catalog with a readers' rating of 4 1/2 out of 5 stars. The book's original list price was $145 on Amazon.com. The online book retailer advertises a limited supply of used copies, but it doesn't give a price. Interested buyers are directed to enter the maximum price they are willing to pay, if a used copy becomes available.

Barile's book, along with an earlier book Barile published in the early 1990s,
titled, "A Practical Guide to Financial Reinsurance," are of interest to attorneys now because they include examples of actual documentation on finite reinsurance agreements, including "side-letter agreements" that have surfaced as controversial in the current investigations, in both Australia and the United States.

Barile himself is somewhat bemused by the sudden interest in his book. Hearing that copies were fetching high prices in bidding on eBay's online auction site, a friend of his put a copy up for auction, just to see what happened. "He said there was a lot of interest, and he ended up selling to a bid of about $400," said Barile.

He said the book lays out the logic and philosophy behind finite reinsurance, why it was developed and how it is used. What he is reading in the media now, he says, is mostly misguided or just plain confused when it comes to describing what actually is occurring.

"I wish more people would have just read the book so they wouldn't make the comments about the AIG-Berkshire deal with such rapidity, that it's not even correctly stated as to what's really going on here," he said.

Barile said there are several types of legitimate finite reinsurance agreements available in the market, but the published comments he has seen about the 2000-2001 deal between AIG and General Re give the impression that finite reinsurance is sort of a monolithic tool used for little else than to hide weak financial results.

"It appears that people consider the AIG deal a loss-portfolio transfer reinsurance deal, which if they looked at my book, they would see that's only one of about four or five types of finite reinsurance agreement that exist in the market," he said.

Barile added that the AIG-General Re deal always is referred to as a "$500 million deal," but no one has addressed precisely to what that figure refers. "The technical question is, $500 million of what? Paid losses? Incurred losses? Losses on malpractice policies? Directors and officers liability? No one is talking about the detailed, technical transactions involved," he said.

Another issue about the AIG-General Re deal that hasn't been clarified is exactly how the $500 million figure is defined. "What is the valuation of the losses, and by who's value? Is that General Re's value of $500 million, or is it AIG's valuation of the ultimate payout?" he said. "I've seen cases where three actuaries came up with three different estimates of ultimate payouts on the same book of losses. It gets very complex."
Barile, who said he helped develop some of the first finite reinsurance transactions in the Bermuda market in the late 1970s, is angered by what he sees as an oversimplified explanation of finite reinsurance in the published reports on the current investigations. "It would be great if someone would say in the press that these are the real issues here, and this is why it's so complicated," he said. "Instead, we'll all look like fools; it's as if we don't know what we're doing in the insurance business."

Or worse, "it makes us in the industry look like all we do is sit around and look for ways" to cheat investors, he said. "I've had people ask me if these aren't 'dodgy' transactions, and I say, 'what are you talking about?''"

Barile said he has no idea whether the AIG-General Re deal is legitimate, since not enough information has been made available about it. The issue of whether there was a side-letter agreement that may have laid out the terms for General Re to recoup the premium it paid to AIG is the most troubling aspect, as far as he could tell. "If there was such an agreement, it would look bad," he said.

Side-letter agreements, in which the parties of a reinsurance transaction agree to certain terms not included in the actual contract, go back years in the reinsurance business, to a time when most deals were handwritten on plain sheets of paper, said Barile. They had their purpose in working out details after a contract was agreed upon.

But with the complexity of finite reinsurance deals, side-letter agreements often look suspect to outside observers, he said. "I would say that any agreement between the parties belongs in the actual contract," he said.

The insurance industry's silence, as New York state Attorney General Eliot Spitzer and other state and federal officials push insurance executives into resignations and even confessions, is puzzling, said Barile. "Where are all these organizations that are supposed to protect our image?" he said. "Everyone runs and hides. Somebody's got to step up and defend the industry."

Barile said his decision to write a textbook on reinsurance was motivated by what he saw more than 10 years ago as a need to publish some kind of definitive explanation for what finite reinsurance is and how it works — exactly the kind of clarity that is so hard to find amid the controversy right now. "Some of the newer Bermuda reinsurers even incorporated what read as sections of my book in their prospectuses, to sell investors on raising capital for this type of product," he said.

A key element of his book is a chapter describing exactly why companies would want to use finite reinsurance transactions, said Barile. "It would usually cover..."
something very difficult, something the traditional insurance market would not want to insure," he said.

One example is a deal Barile worked on about 20 years ago, involving economic risk for a gambling casino. The policy covered the casino against a shortfall in revenue caused by a general economic slowdown. "Nobody would write that coverage in a traditional policy, so we did it through an offshore company," he said. "It was approved by the accounting firm and the law firm, and nobody said 'boo' about it," said Barile. "It wasn't dodgy; it was a solution."

As a creative approach to solving difficult insurance problems, finite reinsurance was a natural fit with the developing Bermuda market, where innovation was always one of the main selling points for companies domiciled there. Barile said finite reinsurance is still a very important tool, but he is concerned that too many people have come into the industry ill-equipped to understand its limits or proper boundaries.

He also sees a lack of understanding prevalent among corporate risk managers who would buy such products, and among regulators in many U.S. states. As he said with a chuckle, "I guess we could use more copies of my book."

(By David Pilla, senior associate editor, BestWeek: David.Pilla@ambest.com)

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