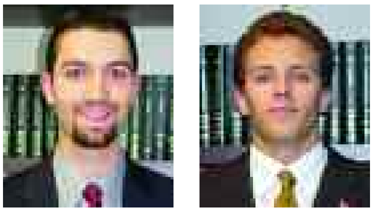
There are many impediments that can frustrate a company in run-off from converting its reinsurance receivables into cash. David I Presley and Bradford P Barron, attorneys with US law firm Bazil McNulty, **argue that outsourcing the recovery work or selling the receivables can serve to increase shareholder value**



Collecting the cash

With millions of dollars in outstanding reinsurance assets, companies in a scheme of arrangement and run-off in particular, have a large base of collectible receivables with which to increase their cash reserves. While companies in a scheme or run-off are focused on converting these receivables into cash as quickly as possible, a number of factors can impede this process.

Sometimes it can take years for a company in a scheme or run-off to collect from its reinsurers, most of which are spread throughout the world. With one of the major goals of any scheme or run-off being the maximisation of shareholder value, any scheme or run-off administrator should make the recovery of receivables a top priority. This is especially true for the scheme or run-off intermediaries which are hired by the administrator to handle the daily activities of the estate. Two options exist for facilitating the most efficient collection of reinsurance assets for these situations: first, outsourcing the recovery work to third parties; second, selling the reinsurance receivables to a third party. These two options, preferably in conjunction with one another, can best assist the administrator with realising the overall goal of maximising shareholder value.

Option 1 – third party outsourcing

Intermediaries hired to handle the daily operations of companies in a scheme of arrangement or run-off should strongly consider outsourcing the collection of at least a part of the receivables. The part of the receivables that should be considered first for outsourcing includes both those receivables with inherent collection difficulties as well as receivables that are in jeopardy of becoming time barred because they may not receive adequate attention. Additionally, intermediaries should attempt to outsource all receivables before they are to be written off.

Perhaps a one year review can be conducted by the administrator to identify what if any receivables should be outsourced to a third party in order to expedite the process more efficiently. Finally, after identifying which receivables to outsource, the ▷

intermediary should give the collection work to a third party with a proven track record and ability to handle these collections.

Intermediaries will have receivables which are categorised as difficult if not impossible to collect. These collections may be arduous, due to a variety of factors including language differences, time zone differences, a reinsurer's unwillingness to pay or even respond and, most importantly, a lack of familiarity with the reinsurer. A solution to this problem of difficult collections is hiring a third party.

Obviously, the third party should have experience working with that reinsurer or at least that part of world. This will allow the third party to have greater success and at a quicker rate than would the intermediary. The third party's success is normally due to a solid relationship with the debtor, cultural experience, and additional market knowledge or having 'people on the ground.' By employing a third party on these difficult receivables, the intermediary is not only able to focus its energy on the receivables that it can collect, but the intermediary is also more likely to receive a profitable return than if it tried to do it in-house.

In addition to outsourcing difficult receivables, intermediaries should also consider outsourcing receivables which may be neglected. In most estates, the vast number of receivables to collect means that the intermediary will likely focus on the largest and easiest receivables first, and then work down to the smaller and more difficult receivables.

While this is a sound business practice, it also means that many receivables are left stale for years. As a receivable languishes, its value constantly diminishes due to myriad factors, including loss of documentation, possible insolvency of the reinsurer, and increased time sensitivity. In order to prevent the estate from losing value, intermediaries should focus on speed of recovery.

Increased speed of the recoveries will provide two distinct benefits: first, it will keep the receivables' value high and, second, it will enable creditors to receive their dividend sooner. This increased speed can be obtained by hiring third parties to assist the intermediary in the collection efforts. Thus, in order to provide the largest dividend to creditors, intermediaries should outsource the lower end receivables to third parties.

Finally, to maximise the dividend to creditors, intermediaries should outsource business to third parties before it is written off. Obviously, this is only advantageous if the third party works on a no win, no fee basis. Provided the intermediary can secure such a payment plan, the intermediary has nothing to lose and everything to gain by giving these soon-to-be-written-off receivables to a third party.

While a debt that is considered uncollectible or written-off may make a balance sheet look more presentable, it does not accomplish the overall goal of earning a higher dividend for creditors. It is not uncommon to receive a creditor's quarterly statement from a company in a scheme that explains that a dividend will be less than expected because, for example, a large percentage of balances in South America have been uncollectible and thus written-off.

Unfortunately, it is common practice that this same company is not willing to outsource this business to a third party that may be better suited to handle these claims. If the administrator reviews the activities of its intermediaries on an annual basis, for example, the exact types of receivables which may require third party outsourcing can be confronted on an ongoing basis. In order to take full advantage of all assets, the intermediary should strongly consider hiring a third party to collect on both receivables which have been written off and receivables which will be written off.

Option 2 – selling of reinsurance assets

An additional way for an intermediary to turn receivables into cash quickly is to sell the receivables. Normally, receivables are sold at the winding down of the estate as a last effort to add to the coffers before finalising the business. This occurs because companies in a scheme are realistic and realise that, eventually, the cost benefit analysis will dictate that the remaining assets are sold towards the end of an estate, rather then engaging in continued collection work which may yield little return while incurring further expense. This is normally the point where a business decision must be made as to when to finalise an estate as diminishing returns become apparent. There is no scientific timetable which can dictate the right time for an estate to sell individual assets or the remaining reinsurance receivables. Of course, selling their receivables at an earlier date will often result in an increased sale price for the estate. Regardless of when the receivables are sold, the estate should keep in mind factors that will affect the receivables' value in the market.

'The estate must consider the possibility that assets are or will become time barred'

First, the estate must consider the possibility that assets are or will become time barred. As anyone in the reinsurance industry knows from first hand experience, the time bar defence is a constant issue affecting the ability to collect reinsurance receivables. Once a receivable becomes time sensitive, its selling price drops accordingly as the market will not bear full value for an impaired claim.

Receivables which are governed by UK law, for example, have a relatively short period before they are time barred as a six year statute of limitations will apply. As such, if a company prolongs the sale of the remaining reinsurance assets of the estate, particularly involving those claims with a low likelihood of recovery in relation to the cost involved pursuing the debt, the creditors will realise a reduced dividend because of the decreased sale price. Thus, speed is again of great importance, as the sooner a sale takes place the higher the return on the receivables.

Second, documentation may greatly affect the value of receivables. Documentation or the lack thereof, is always a major concern of any purchaser as it dictates the ability to substantiate the claim. One of the largest factors affecting documentation is the age of the last activity on a receivable. The more recent the receivable has had activity on it, the more likely it is that documentation will be readily available. The longer the receivable sits, without any action, the more likely it is that documentation will be lost, misplaced, or destroyed.

An intermediary can avoid this situation by selling the receivable, thereby avoiding any more delay on recovering the asset. This also prevents the receivable from losing value, as the sooner a sale takes place, the more likely supporting documentation will be available for the purchaser. Thus, the intermediary must sell receivables sooner rather than later in order to gain maximum value.

Third, market conditions such as unfavourable court cases can affect the collectabilty of assets of an estate. For example, recent court decisions in the UK which have rendered certain pollution claims uncollectible have caused countless claims to lose value. It is clear that many companies in a scheme or run-off could have earned a greater purchase price for assets had the claims been tendered for bidding before the claims were subject to damaging court adjudications. Accordingly, the longer companies wait to sell their receivables, the more likely the receivables will be affected by an adverse court ruling.

Finally, administrative costs will affect the value of receivables. All receivables carry an administrative cost, whether this is in the form of maintaining the documentation, working on collecting the receivables, or the cost of involving an intermediary or third party collection firm. Sometimes these costs and the time involved will outweigh the desire to retain the receivables.

‘The sale of receivables is especially apt for claims against insolvencies which may not pay out a dividend for years’

While broker replacement and intermediary services can be cost effective and assist in streamlining a scheme or run-off, the selling of reinsurance assets is a viable first option. This is especially true for companies that do not want to focus unnecessary time and money on collecting certain receivables, or do not have the necessary funds to run-off the company internally over an extended period of time or through a third party.

The sale of receivables is especially apt for claims against insolvencies which may not pay out a dividend for years. The sale of these receivables can bring finality to these matters while recovering funds for creditors without years of waiting for a payment from the insolvent estate. The buying and selling of reinsurance assets over recent years has allowed many companies to realise value from many claims which would otherwise yield no return, or at least not for some time in the distant future.

Conclusion

In practice, it can be understood that reinsurance intermediaries are preoccupied first with collecting the larger balances due the estate; however, the smaller and more difficult claims also have value. Whether hiring a third party to collect the reinsurance assets at the outset is the best option, or selling these assets outright, both options can greatly increase the dividend for creditors. Both alternatives will be more profitable if companies in a scheme or run-off and their administrators and intermediaries are cognisant of the myriad issues which can affect the marketability of assets of the estate.

Striking a balance between maximising creditor’s profits through third party outsourcing and the expertise of an intermediary can greatly improve the dividend paid to creditors. This is not only beneficial to the creditors, but also an extremely successful result for those managing the estate.

Obviously, no single approach will work in every situation. As the development and popularity of solvent schemes have increased, so has the readily available resources to better maximise the profits for all parties involved in a time and cost effective manner.

Administrators are encouraged therefore to continue to take an active role in working with intermediaries to assess the reinsurance assets of the scheme or run-off, annually at a minimum, to determine what if any receivables should be outsourced or sold to third parties. In order to maximise dividends to creditors, intermediaries should strongly consider both selling and outsourcing receivables to third parties throughout the scheme and run-off process. ●