KEEPING AN OPEN MIND

While Citadel Risk has taken a ratings hit from US commercial auto business, CEO **Tony Weller** says the firm is adaptable enough to keep finding opportunities in a continuing soft market

***Insider Quarterly:* Can you explain the rationale behind the recent AM Best downgrade, and do you think it is reasonable?**

Tony Weller: AM Best's revised "stochastic credit rating methodology" has adversely impacted Citadel's rating for the December 2017 year end. We understand we would have kept our rating had they used their traditional method, and we are still wrestling with making a record profit and getting downgraded. It's a bit like we're defending goal posts that have both moved and become further apart.

AM Best's new rating methodology encompasses four building blocks – balance sheet strength, operating performance, business profile and enterprise risk management. The balance sheet strength block provides the baseline credit rating (e.g. A-), based on a quantitative determination of business risks and the capital adequacy, and this rating is adjusted up or down by the scores given by AM Best to each of the other blocks. For example, the rating from the operating performance building block could result in a rating between two notches higher or three notches lower.

Although AM Best has not yet provided Citadel Re's actual scores from each building block, our discussion with the agency's analysts enables us to provide commentary on how we believe the new rating methodology adversely impacted us.

In short, Citadel Re's continued, very good baseline credit rating relating to our balance sheet strength was significantly impacted by two of the other blocks:

AM Best now looks back over five years and effectively double counts the impact of the adverse development of two programmes written between 2012 and 2014 on Citadel Re's results (balance sheet strength and operating performance),

The rating agency currently has a generic dislike of US commercial auto liability business (business profile), which is the major business line of our principal US operating subsidiary, American Millennium Insurance Company, and has marked us down as a result. Also, in our opinion, insufficient credit is given for the fundamental changes to the group's underwriting programmes and business profile since 2015 and the stability provided by Citadel's non-underwriting risk revenues (business profile).

***Insider Quarterly:* Has the downgrade affected your risk appetite for US commercial auto?**

Tony Weller: Well, one of the qualitative factors AM Best took into account is its belief that US commercial auto is an inherently risky class of business. A lot of companies have had their fingers badly singed by it, so you can understand their concern.

I'd like to think we've always been pretty careful what we wrote even before AM Best's misgivings on the topic, but I think we probably need to be even more selective. They've warned us and if we write a poor risk in the future, the chance of us being upgraded (despite other results) will be compromised.

***Insider Quarterly:* Have you lost any clients as a result of the downgrade? What parts of your business might be affected by this?**

Tony Weller: We have not lost any yet, but I expect we will. The obvious ones are going to be ones where we are only fronting, and they only really want us involved as we had a A- rating. All our clients, without exception, are very supportive as they deal with us whatever the rating, but there are some cases where I expect to meet some resistance.

***Insider Quarterly:* Do you think you can get Citadel Risk back to an A- rating? What needs to be done and how long might this take?**

Tony Weller: The rating agency is telling us it is quite possible, but we made a record profit in 2017 (and a healthy half-yearly profit in 2018) and that was not enough. That said, it has told us what needs to happen.

AM Best's concerns over consistent operating profit is valid enough, and if we keep posting decent combined ratios, our argument is going to be pretty good.

There are a few strange things that turn up, our BCAR (Best's Capital Adequacy Ratio) suffers from using rated reinsurers over unrated carriers that post cash collateral. I sort of understand the logic of that, but then regulators don't really like it, so you're damned whatever you do.

Adjusting our appetite for commercial auto is another action we can take, but our current programmes (as opposed to those in run-off) are running well, and we own a company in the US that doesn't do much else, so it is a bit of a balancing act.

Our BCAR score is still safely in A-territory but qualitative factors have worked against us.

***Insider Quarterly:* Citadel Risk was first founded in 1978. How has the company evolved since then and what is now its key client proposition?**

Tony Weller: In the old days, it was primarily confined to old-style "time and distance" programmes, but FASB113 and the Spitzer investigations were some serious nails in the coffin of that type of business. Happily, at that time, it was easier making money on investment income, so we were at one stage more of an investment entity in truth.

We then started writing a number of smaller run-off programmes that went very well, and the competition for the smaller deals was not as intense as it is today. While some of our programmes were administrative, most involved risk transfer, but the pricing became more and more problematic.

We started writing more prospective business which became a bit easier when we decided to get a rating which opened up a whole new inventory of possibilities.

Since then we have become quite diverse. We write traditional and so-called niche reinsurance programmes, assume run-off risk, and derive service income and investment income – which of course has been drying up over the years.

***Insider Quarterly:* How would you describe the current market environment for reinsurers? How does your firm position itself in the current conditions?**

Tony Weller: Being small and adaptable, I think life is a bit easier for us in some respects than for larger reinsurers. The market is generally soft of course, but there are pockets where some money can be made. It is true that we don't have the capital base of the Munich Res of the world, but, then again, we don't have to write business. If the market is that soft, we are better off looking for something else to do.

***Insider Quarterly:* As mentioned, you're also a player in the legacy market. How do you think that market might evolve and how will Citadel Risk choose to participate in that market?**

Tony Weller: The legacy market is unpredictable. We saw a lot of opportunities at the beginning of the year, and now it seems very quiet. I would not read anything into that, and I don't think there is any reason, it's just that we don't really chase it that hard.

During our last tender, I thought we had dropped the price a bit too much but also thought the deal had some potential. However, one of our competitors was about 40 percent cheaper, when we had always been historically very close. That could have been an aberration of course, but people are fighting hard for the business. If it is super-competitive it is better not to do it at all as we'll only end up losing money, and you can't really derive any investment income if there is a tail on the business. We are seeing some good ones though.

***Insider Quarterly:* Are you seeing any other opportunities in the wider (re)insurance market?**

Tony Weller: Everybody calls us "niche" and I guess that is a fairly accurate description. What that does mean is that it is hard to give a satisfactory answer to that question.

Opportunities tend to be "random" or unpredictable – for example, we wrote a mobile phone warranty programme earlier this year. We had always seen plenty of these, but they always seemed to me to be fairly marginal and I had been wary of it as a class of business. Yet, here we are now having written one.

Now it's possible we've got this one wrong (although so far, so good) but I just tend to keep an open mind. While most people don't want to write Italian medical malpractice, it doesn't mean there aren't some good ones out there.

***Insider Quarterly:* Where would you like to see Citadel Risk in another 10 years' time?**

Tony Weller: I don't see it being much different to how it is today. That presupposes that "things" remain the same, and that I cannot predict.

Tony Weller, CEO of Citadel Risk Group