Downgraded

BUT NOT OUT

Citadel Risk saw its ratings unexpectedly downgraded by A.M. Best in November. Tony Weller and Mike Palmer discuss the cause of the downgrade, its impact, and the importance of a strong response

Citadel Risk was blindsided by the announcement in November that A.M. Best had downgraded the financial strength rating from A- (Excellent) to B++ (Good) and the long-term issuer credit rating from "a-" to "bbb+" of Citadel Reinsurance, but is determined to ensure the news is by no means a knockout blow.

The downgrade was a result of A.M. Best's new building block rating methodology, specifically the fact that the ratings agency now looks back over the last five years. Captive Insurance Times spoke to Citadel Risk group CEO, Tony Weller, and senior consultant, Mike Palmer, to get their reaction.

When did Citadel find out the rating had been downgraded?

Tony Weller: On Monday 19 November we got the notification that the downgrade was confirmed and it was a complete shock to us.

The rating committee met the Thursday before, but the decision had been passed to a more senior rating committee and we'd given them some further information on a contract we had won, which we were confident would nudge the rating back up.

It didn't and we were completely blindsided by that. We had no idea the downgrade was coming following a record year in 2017 and the stellar results we had to June in 2018. We weren't expecting it, particularly following 2016 when we had kept our A rating but made a loss.

Our A.M. Best analyst seemed surprised as well, but there is a new building block process, which I think has given A.M. Best different readings and some companies different ratings. This has been a shock to them too.

Before the ratings, you never really see the workings behind the Best's Capital Adequacy Ratio score and what has been presented to the committee. The committee is somebody that as a client you never meet, so, it was a complete surprise.

How will this rating downgrade effect Citadel on the whole?

Weller: We are looked upon as a niche company, so, to a certain extent, for some of our clients it just doesn't matter.

However, if we are a small participant on a slip where there are other Lloyd's syndicates, there may be a large broker who won't deal with anyone A- or less.

Those kind of programmes, where we have small participation, are the ones where there will be some problems if the ratings are essential. But with a lot of our programmes, they are not.

In some cases, a rating isn't important because the client is more concerned about the improved strength of our balance sheet.

But there are some committees that insist on a minimum rating and sometimes there is not much flexibility. In those cases, we will most likely lose some business.

There might be future business that we could have done that we won't do now and that we won't be able to quantify.

Mike Palmer: Our business falls into three categories. First, the business that is so niche and individual that the company or our client have come to us because they know our balance sheet security and our historic claims, allowing them to feel comfortable with us. In that case, the downgrade is not a problem.

There is a middle section where there is an expectation for an A- but it is down to client selection. Some of those will continue and some will not.

Finally, there is some business that is absolutely not going to happen. Fronting,for example. If we are fronting and offering an A- paper, that's not going to happen without another A- carrier.

So far, it is fair to say we have had zero losses.

We are not naive enough to think there won't be any negativity, but as of now, we haven't had one single client or broker's client that has said the business can't be renewed.

How does this impact your captive operations?

Weller: In terms of clients that we act as captive managers for, it makes no difference at all.

People are concerned about whether we are delivering accounts and advice to them on a timely basis, in that sense it makes no difference whether we are rated A- or B++.

Palmer: If we look at what Citadel is today compared to a week ago, it has exactly the same management, ownership, capital, risks, and level of risk management.

We aren't doing anything differently, we still use actuaries to analyse every risk, we still have the same in-house controls and we'd like to think that the service levels for our clients won't be affected by this.

Weller: If anything we have to try even harder. Now we can't just be complacent and rely on our A-, there is more much pressure to do even better.

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What are Citadel's plans moving forward?

Palmer: We are reasonably confident that our end of 2018 results are going to follow our mid-year performance, which has been pretty stellar.

What we will be very keen to do is produce audited versions of those as quickly as possible and hope that we can submit those speedily to A.M. Best so that next year's review can happen a little earlier.

Weller: We will certainly have this rating for a year. A.M. Best has outlined a number of things that need to be done for the rating to go back up. If you lose your A rating it is harder to get back there, so it is a self-fulfilling prophecy, to a certain extent.

I was slightly mournful when it was confirmed, since then things have looked up. We haven't lost the clients that I feared and I am going to do my damndest to make sure that this is just a temporary setback for Citadel.

We find ourselves here at the end of November and there is nothing to suggest that there is anything surprising in our claims or any skeletons in the closet.

I think we should be able to provide a decent set of results for the end of 2018 and see A.M. Best's reaction.

Are those suggestions made by A.M. Best going to become a priority for Citdael or does the company feel if it keeps moving on, business as usual, those things will fall into place?

Weller: I think it's very much the latter. We can't sit around and focus on the few areas in which A.M. Best has suggested we can do things differently.

Having had it happen and having learned what their concerns are, I don't think there is much we can do because we were addressing all of them anyway. It is good to know what they are because we won't, in theory, be so blindsided next year.

Our problematic years were 2015 and 2016, primarily down to one programme, which is now down to nine claims left with less than a million dollars in total.

It is not a huge issue and we will run them off as best we can. Hopefully by next year those nine are down for three.

Is this evidence that A.M. Best's methodology still requires some work?

Weller: Only A.M. Best can answer that one, but time should heal these wounds. If these years drop off and are no longer part of the five-year equation then in theory, we will go back to an A rating.

Palmer: We were told that if the analysis had been done on last year's set of rules we would've kept the rating.

The rules are the rules, we can't change them but it does seem like we have fallen foul to a new set of mechanisms, which we were told would have no impact

Although our current years are also profitable, across the five year piece we haven't achieved quite the same profitability, despite the fact that 2017 and 2018 marked a huge turnaround.

Weller: We have got to stand up and deal with it. We can make all the excuses we want and bleat on about how inequitable it is, but it did happen.

The question is: are we going to fight on and do the best we can to get it back? Well yes, that is exactly what we are going to do. **CIT**

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Mike Palmer, senior consultant, Citadel Risk