Life after run-off

Presenting a true life adventure story, by **Art Coleman*** of Citadel Risk Management. A journey into the unknown, it starts a long, long time ago in a galaxy…

It was 1989. Or perhaps it was 1991 or maybe 1996. It may have been in Boston. It could have been Philadelphia or maybe it was Chicago. We were auditing a book of business where the underwriting was done by a managing general agent and it had all gone wrong (at least for the reinsurer who was our client, that is). It was late in the evening and a drink may have been involved (read as – yes, drinks

were involved!). I looked over at Jack Ignatowitz and said: 'If ever we have the chance to get paper, we'll know how to write profitable business.' Jack replied: 'From your lips to God's ears, my son. Want another?'

You see, as lifelong reinsurance professionals with a background in claims and inspections we knew it all. We were David to the industry's Goliath; the United Federation of Planets to the Klingons, Dorothy and Friends to the Flying Monkeys – you get it. We could do no wrong.

The intervening years

Over the past 20 plus years we built a franchise for run-off both as part of a large company and then as Citadel Risk Management, an independent run-off manager and consultancy. As an industry we created organisations to represent a new industry within an industry (ARC and AIRROC). We've commuted business, lots of business (we even have commutation 'events').

We audited, collected and created new metrics to report on a new industry – which was and is run-off. We used words like finality and legacy. We understand what ULAE means. IBNR was not enough, we created IBNE. We disputed issues and made law firms rich. We have magazines like *Run-off & Restructuring* that focus on our industry.

We created an industry then created a commodity business out of unwanted business. Seriously, I'm proud to be a part of a group that defined how to measure success in a segment of the industry that had its humble origins in the mid-1980s.

'We were David to the industry's Goliath; the United Federation of Planets to the Klingons … we could do no wrong'

Be careful of what you wish for …

So, it's now May 2011 and we're sitting in a room with our parent, Citadel Re. The topic is how to best utilise our capital. Mike Palmer asked: 'Should we be a buyer of run-off liability in the US?' That had always been in the business plan and something that we had done in the past with a good deal of success.

That said, the discussion that day was on pricing and the competition. The conclusion was that, unless we saw something 'special' we were leaning toward taking a pass for the time being.

At least in the US market, the small to mid-sized players are so hungry for business to feed their hungering masses that there was some silly pricing going on. In our estimation, the ability to make a profit was right up there with being the only person to get all six numbers right on the Mega Millions lottery.

At some point in the conversation, the topic of buying a 'live entity' was raised. 'So we can run it off', I asked? 'Yeah, we could do that, we're good at that, we were a contributing editor to that book,' added Jack.

'No' said Tony Weller (MD of the Citadel Risk Group), 'to run it, profitably,' he added. 'All I've heard for six years is how you guys could do it better.' He then added that he had a candidate in mind.

After looking behind me to see if he was hopefully talking to someone else, the premise started settling in. Tony was right. We did say we could do it better. Say what you want about Australians, they have good memories.

The target was a small, New Jersey based writer of commercial autos (taxis, limos, trucking). It had been successful in the past but had fallen on some hard times over the past few years.

So, for the next five months (interrupted only slightly by Hurricane Irene) we did what we did best. We used our auditing skills to perform due diligence. We looked at each function (underwriting, claims, accounting, compliance, etc.) and applied our best skills at evaluating each function of a live insurance company. These were the skills we had honed and practised for over 20 years.

We learned new skills. Did you ever fill out and file a FORM A? Fill out an NAICC biographical affidavit? Neither did we, but we figured it out because that's what we did – we were the SWAT team. Our VP of operations, Frank Pecht, did such a good job, he basically ran the company for the two months prior to acquisition.

A day that will live in infamy

On an otherwise beautiful day in October 2011, we closed on American Millennium Insurance Company. Since it took all day to get the right people to sign the agreements and transfer the funds, there was no fanfare, no celebratory dinners or champagne. I went home and walked the dog – it was just another day for the Federation.

On 21 October, reality set in. We owned a live insurance company. There were agents to meet, policies to underwrite, policy forms to file with the State, bureaus to report to, regulators that wanted to regulate us and claims that occurred (or were they made…?). There were reinsurers to report to, accountants that wanted to audit and actuaries that wanted us to add IBNR (dastardly people, those actuaries!). We learned that premiums have to be earned and that loss ratios were calculated using premiums that move (in run-off, premium is a static number).

Reality set in and it wasn't even 8am! So, what did we do? After all it took five months to perform the due diligence. We did what any righteous, proper run-off manager would do when facing a new client with an issue. We built a business plan. But not just any old business plan. This one had to work! This was our money! We could lose it!

We created budgets, headcount allocations and held people accountable for them. We looked at functions and systems; we asked how we could automate functions and eliminate headcount. We looked at reinsurance arrangements to see where strategic commutations would reduce transactions as well as repatriate precious IBNR and IBNE. We did something novel; we introduced the underwriters to the claims people. Heretofore, they only met once a year at the Christmas Party.

We looked at overdue premium collection items and allocated staff to bring in the money thus retrieving the asset. We looked at several disputes then negotiated our way out of them to avoid litigation risk as well as legal costs. We advised our reinsurers of anything that could affect them. We reduced 'panel counsel' to those firms that understood our model.

We closed claims that did not need to be open. We allowed the claims staff to manage their case load and gave them settlement authority and encouraged them to open up a dialogue with claimants with an eye to closing claims at the right value. We added reserves to claims that needed a bit more reserve although we made the claims staff sign in blood for any reserve increases.

These were the 'tricks of the trade' that we used to manage run-off successfully for over 20 years.

But, the best thing that happened is a true testimonial that we learned our lesson from all of those years of managing run-off. We re-tooled our existing staff. We asked people to work outside of their comfort zone and learn new skills. As these people had, for the most part, been working with us for years in reinsurance run-off, they had a lot of the basic skills and knowledge emanating from careers in the run-off arena. So, reinsurance accountants learned to calculate and process surplus lines taxes, claim technicians learned to be underwriting assistants, and so on.

'We did something novel; we introduced the underwriters to the claims people'

The next chapter?

So, basically, we're running a live company using a run-off operational model. Has it worked perfectly? Too early to say but we're making progress; in some cases at Warp speed and in others as fast as paint dries – but progress nonetheless.

So, check this space (and the results of American Millennium) and see how we do. Hell, if it doesn't work out we can run it off!

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