Symptoms of Insolvency

Insurance company insolvencies do not happen overnight. They are the result of poor decisions, unforeseen events and lack of focus on what is important.

Below is a discussion of three types of insolvencies (based somewhat on actual companies), each occurring for a different reason, but with one overarching factor in common: CULTURE.

Case 1 – Vision, Identity

A regional company, over many years had transformed itself several times. At times it was a diversified company with both P&C and Life insurance businesses, at other times it was a reinsurance company, then a multiline personal lines company and finally, a property catastrophe writer.

The company appeared to be trying to find its niche in the market. The frequent changes in strategy took a toll financially and included acquisitions and divestitures of various business segments. Management of the company did not seem to focus on the strategic issues, rather focused on what was best for management. Over time, management changed, but it seemed that each successive group followed a similar path to the one before. Each management team had excesses, although they did seem to decrease with each change.

The company's Board was not entirely effective and not all were independent – there were clear loyalties by some of the longest tenured directors to the CEO.

Operating processes and controls were very loose, expenses were out of control and surplus was decreasing. When the company was hard hit by successive natural catastrophes, it was not in a position to recover.

It is unclear whether the company made a strategic decision to focus on the property catastrophe business or whether that was just the business segment they could not sell and settled on it by default. The company did not create its identity, they just accepted what it became.

There were many signs of pending trouble, issues that, if addressed timely, could have resulted in a different outcome. By not having a clear vision, the company seemed to evolve on its own, rather than be the product of a strong vision and well executed strategy. This culture of loose and seemingly indifferent management played a significant role in the ultimate insolvency of the company.

Case 2 – Ownership Overreach

A single state property insurance company was privately owned by two individuals with no insurance background. They hired a very experienced executive as CEO. The company was a de novo start-up and the CEO put it all together. For a couple of years the company grew rapidly – not always a good thing for insurance companies. To compound the risks, the company was capitalized mostly from debt – again, not always a good thing for insurance companies.

The company was doing well thanks to the CEO having a solid strategy and execution plan. The difficulty began when the company's owners started increasing the pressure to grow. The CEO counselled against a rapid growth plan, but it went unheeded. The owners, instead of accepting the advice of their CEO, entered into a business deal to significantly grow the business at a very rapid rate. Not only did this put pressure on the company's surplus, but the majority of the added business was underpriced and unprofitable.

By establishing a culture of disregard for the counsel of experienced management, the owners of the company put the company on a path to insolvency and the company was eventually liquidated.

Case 3 – Lack of Investor Commitment and Vision

The company was a de novo start up backed mostly by private equity. The company was a multi-line P&C company operating in one state with significant catastrophe exposures. Other than for the property coverages, the remainder of the market was very competitive with national companies putting downward pressure on rates. To compound the issues facing the company, the initial capital raise was very small and could not support the company's writings.

In early development meetings with investors and management, the investors were told that while it could begin operations with the current capitalization, the company would need to grow and expand to other markets to ultimately be successful. As the company engaged in operations in the first state, it was clear that capital was insufficient to continue at the current level.

To ease the pressure on the company's surplus, rather than increase capital in the company, the Board and major investor approved entering into a high level quota share reinsurance agreement. Additionally, the company was also writing commercial lines business which left it exposed to large losses that had a negative impact on surplus. To combat this, the company entered into a managing general underwriter agreement for most of its commercial lines business, writing on another company's paper.

The investors' lack of commitment and vision to execute the company's initial strategy of growth through state expansion left the company undercapitalized and vulnerable to catastrophe losses and competitive pressure from much larger companies.

The company ultimately lost its high level quota share and did not have sufficient surplus to remain viable.