INSURANCE COMPANIES NEED VERY EXPERIENCED INSURANCE DIRECTORS

by

Andrew J. Barile, MBA, CPCU
Email: abarile@abarileconsult.com

The insurance industry company universe continues to change brought about by technological innovation. On the basis we have some 6,000 captive insurance companies, 3,000 life insurance companies, and 2,000 property casualty insurance companies, all under some type of regulatory scrutiny, we need to examine the board.

Why is it still we have insurance companies being formed where regulators have not questioned "Why is there no board of director on this insurance company who has worked in an insurance company in his or her career?" Operating an insurance company is still very complex and owners need to pay for prior insurance industry experience when retaining much needed experienced directors.

Rating agencies will also need to focus more on the insurance experience of the company's board of directors. In the future, will they be required to interview in person directors, the way insurance department examiners do as respects their triennial examinations?

We need to examine some of the major concerns of chief executive officers of insurance companies and look at where an insurance experienced director can be of important assistance:

(a) Selection of an Actuarial Firm … Improper loss reserving has been one of the largest causes of insurance company insolvency. … Does the actuarial firm have the required expertise to understand the specifics of your insurance company's unique insurance product? Where does the actuarial firm get its industrywide data? How often should you change actuaries? Does the actuary understand your underwriting guidelines? Does the actuary understand your insurance company's reinsurance structure? Does the actuary understand the insurance product you are selling?

(b) Selection of a Reinsurance Broker … Experienced directors can help with the selection process of a reinsurance broker. Who manages the reinsurance buying process – the chief financial officer, the ceded reinsurance manager, or the chief executive officer in his or her spare time? Recently a captive insurance company failed to collect its reinsurance recoveries after a hurricane occurred. Who was responsible in the captive insurance company for reinsurance buying and structure? Was it delegated to the captive manager? Who read the reinsurance requirements and what was their experience? How often should you change reinsurance brokers? How do you document the retention of a reinsurance broker? Who reviews the reinsurance market presentation being forwarded to the global reinsurers?

(c) Selection of Underwriting Executives … The need to select underwriting executives that understood the philosophy of the particular insurance company; each insurance company management is unique whether it be a captive insurance company writing terrorism insurance, a life insurance company writing long-term annuities, or a property-casualty insurance company writing workers' compensation insurance for grocery store owners. Insurance company product differentiation will dictate the amount of underwriting experience. Experienced directors can play an important role in the selection of underwriters and the analysis of pricing and underwriting guidelines. Directors that are active can come up with corrective suggestions that have been used in their prior affiliations.

(d) Selection of Investment Advisors … The low interest rate environment has not been kind to the insurance company that depends upon investment income to offset insurance underwriting losses. The investment portfolio must meet with regulatory scrutiny. How many times do you need to change investment advisors? Who partakes in the decision making process? Should the insurance company go into equities to increase investment income?

(e) Selection of the Captive Insurance Manager … With the expansion of the growth of captives, singles parent, associations, agent owned, bank owned, and cell captive, the captive manager needs more scrutiny than ever. The captive needs to act as a traditional insurance company. Directors need to not only attend the meeting but also participate and contribute to the decisions. Insurance department examiners in New York have been critical of captive board members not attending the board meetings.

(f) Selection of the Distribution System … Experienced insurance company directors are aware of the advantages and disadvantages of using different insurance product methods of distribution; retail insurance brokers, wholesale insurance brokers, excess and surplus lines brokers, managing general underwriters; and managing general agents. Building a successful and profitable distribution system creates the franchise value whereby an insurance company is purchased for a multiple of book value. As competition among insurance companies continues to increase, we are witnessing the purchasing of the smaller insurance companies by the larger insurance groups.

(g) Selection of the sophisticated computer systems to augment insurance company profitability. All disciplines operating within an insurance company are going through technological improvement. Whether it be analyzing the loss ratios of the insurance company's retail brokers, or rating insurance policies, or disability claim payments, computerization is necessary to cut operating expenses.

(h) Selection of an Insurance Merger and Acquisition Specialist … When a captive insurance company is looking to exit the insurance business, it is important that they retain the services of an experienced insurance merger and acquisition specialist. It is equally important that the captive owner have an experienced director to negotiate the terms and conditions of both the fee agreement and the purchase agreement. Once again, we see the need for an experienced insurance company director.

The experienced insurance company director should be given the opportunity to go into significant details of the insurance company. As a specific example, the process of selecting the actuarial consultant and the need to review the actuary's work papers; to meet with the actuaries on different occasions and discuss their specific experience, and industry loss trends. Regulators and rating agencies should be more proactive with directors and calling on their expertise. Some rating agencies do not even send board of directors copies of press releases as respects the rating change of the insurance company.

Finally, experienced insurance company directors who have spent substantial parts of their careers with reinsurance companies, or with reinsurance brokerage firms can provide needed insight into the structure of your company's reinsurance program. Whether you are a capital insurance company buying per risk excess of loss reinsurance, or a property-casualty insurance company buying quota share reinsurance for financial reasons, or a life insurance company buying catastrophe reinsurance protection, the need is there for you, the owner of the insurance entity, to comprehend the art of reinsurance negotiation. Buyers of reinsurance, today, need to understand the reinsurance marketplace. As reinsurance are now owned by hedge fund management, reinsurers are global in nature, and reinsurers accept business from either reinsurance brokers, or directly from ceding insurance companies, and reinsurers have expanded into the primary insurance business, and through the advanced technology, are, in some cases, competing with their reinsured clients. There are very few reinsurers that only write reinsurance left in the market. Alternative sources of capital, and the low interest rate environment have created more sources of capital for the reinsurance buyer. Even Warren Buffet has commented that reinsurance companies, in the future, will not be as good a business as it has been in the past.

In conclusion, insurance companies need very experienced insurance company directors and chief executive officers would be wise to retain them as another cost of doing a successful business.

Andrew Barile Consulting Corporation, Inc.

www.abarileconsult.com

Tel.: 619-507-0354

Email: abarile@abarileconsult.com