

# Can some best practice of the run-off operators become best practice for live underwriters? Why not?

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**The run-off market is considered a dated relation to the live market by some underwriters because the value is locked in the past and there is deemed to be a lack of involvement with current market practices. We would suggest an alternative viewpoint, that because the issues which impact upon portfolios come into more focus once they go into run-off, often a more proactive approach is actually taken by run-off practitioners in managing these issues. This article seeks to share experiences and lessons learned and to provide valuable insights into potential best practice for active underwriters.**

How often is it the case that the small issues which are identified while business is being written become far more problematic once the business goes into run-off? Furthermore, these so called 'small issues' sometimes form the path that can take a live portfolio into run-off. While run-off practitioners rely on that opportunity, we understand that this outcome is not evenly enjoyed among organisations operating in the active underwriting world.

There is an argument which says that proactively dealing with potential issues while the business is underwritten will enable more efficient ongoing management of the business and help circumvent problems arising at a later date and, if the portfolio was ever to go in run-off, ensure a smooth and cheaper downsizing process is adopted leading to eventual closure.

Herein, we consider examples in three key areas where run-off best practice can benefit live business operations:

- 1 managing issues associated with collection of reinsurance assets;
- 2 dealing with static claims; and,
- 3 delegated underwriting authorities.

These are survival rules for run-off practitioners, what if they were adopted by active underwriters?

## Controlling reinsurance collections

There exists a fundamental difference in reinsurance collection strategies between organisations in run-off and those concentrating on live business but suffering from a legacy hangover. The latter, being focused on their core business of underwriting can be less proactive, at the risk of hurting the organisation's financial position; a problem which doesn't go away easily.

Run-off practitioners quite often have no other choice than to change their focus, sometimes quite dramatically, to maintain control of the cash flow. This

often means taking control back from their brokers and directing their own negotiations with reinsurers to ensure (a) better understanding of the problems associated with the billings; and, (b) speedier collection of funds due.

With business being renewed each year, the incentive of brokerage income usually merits the expected service levels from the broking fraternity. Premiums may well be offset against claims due and net accounting can be a fairly effective way of recovering claims. Many brokers will be 'funding' aware and as a result they communicate information to their clients that collections from certain reinsurers were more difficult. In certain cases a joint strategy is employed to try and resolve any impasse.

Less proactive performance from brokers is a well published issue that organisations with legacy issues face when collecting reinsurance assets. Although brokers are obliged to advise on claims there is not the same obligation to collect funds. Indeed many brokers nowadays will want to receive a fee to perform an effective service, which was probably not envisioned during underwriting when brokerage was paid.

There are likely to be other issues faced by organisations in such circumstances that a run-off practitioner has devised solutions to deal with. These may well include:

- not having an effective credit control department set up to handle multiple reinsurers rather than a small number of brokers;
- a limited working knowledge of contacts at reinsurers; and,
- a lack of complete principal to principal ledgers to accurately monitor reinsurers who are not settling their liabilities.

Setting effective solutions to these issues can improve the cash collection ability of any organisation.

The issue of low internal focus by an organisation

in actively managing reinsurance recovery processes often means that late payment of claims by brokers could actually be no fault of the broker. Such a situation exists where there is limited support information for claims or technical queries to be answered by the organisation. The lack of an effective technical query log system in association with brokers not expending time chasing their clients to respond, will inevitably lead to a breakdown in cooperation with the reinsurers involved. This issue, if not addressed, is likely to create a deteriorating aged debt profile in a very short time.

The only practical solution to these issues, as demonstrated on numerous occasions within the run-off market, is to take control of the collection process. Of course there are many practices which can be initiated; these range from dedicating resources (internal or external), to adopting different procedures and investing in technology.

- Establish, from the outset, good effective professional links to all of the organisation's reinsurers and hold regular meetings with at least those who act in a lead capacity;
- set up, again at the outset, systems to advise collection directly with reinsurers who are outside of the market network systems, or whose cash collection performance is not at an acceptable level;
- establish tracking systems for queries received from brokers and/or reinsurers, incorporating the necessary resources to resolve issues in a timely manner;
- replacement of the incumbent broker either by taking all broking functions in-house or engaging a broker replacement service; and,
- finalise reinsurer relationships where there is no incentive for prompt claim settlement due to a non trading relationship. Options are to commute the remaining exposures or sell the reinsurance debt to a third party.

To do all of the above at once, and take complete control over the advising and collection of reinsurance billings, a decision to adopt a product such as STRIPE to 'cut through' directly to the reinsurer; while keeping the broker in the loop needs to be taken. The STRIPE internet based system enables, with little or no IT investment, organisations to automatically upload and present collections electronically, avoiding broker delays, thereby speeding up the collection process while complying with industry messaging standards.

**Action point:** assess the capacity of my organisation to collect or control claims collection in the absence of broker assistance, and set-up a backup business organisation, or low cost but efficient system, enabling me to take control in case issues emerge.

## Dealing with statics

All of us would probably agree that revalidation of static claims is a major issue whatever the status of our business. The subject has become very high profile throughout the past 12 months. This is primarily down to the initiatives which have come out of Lloyd's in an effort to reduce the numbers of static claims in the market.

For most, the task of undertaking such a static claims review may well appear to be a cost negative exercise. Allocating resources to such an exercise does not necessarily create value in the business. However, there are sound commercial reasons for the current interest in conducting regular reviews and indeed for some – as in the case of Lloyd's Managing Agents – it has become a prerequisite exercise.

A business that does not carry up to date claims reserves faces challenges in terms of reporting capabilities and actuarial IBNR valuation, let alone negotiating commutations (the domain of run-off practitioners). Carrying a current reserve provides greater clarity and probably better accuracy in calculating the level of capital which organisations are required to hold. Quite a benefit when working towards the promised land of Solvency II, is it not?

An intriguing point is that it has taken until relatively recently for static claims revalidation to find itself high on the agenda for active underwriters. By comparison, dealing with non moving reserves has been tackled proactively within the run-off market for many years. An understandable focus when solvency capital is critical in some run-off and when there is no future premium income stream to fund those static reserves. Critical before entering in commutation negotiations which, needless to say, are usually better handled on the basis of current and valid reserves.

Relying upon reserve updates through the normal course of business unfortunately does not get us there. Although active underwriters get a better response from their brokers, supplying reserve updates is not an essential activity and therefore more creative practices need to be considered. It is also important to understand that a reasonable level of resource, internal or external, must be dedicated to undertaking the exercise on a regular basis because anything other than a totally committed effort will not yield the results required.

One solution, utilised in the run-off arena, is to send teams with extensive claims knowledge across a wide range of business classes into the brokers' offices to review and revalidate claims. This process overcomes the requirement for them to physically present the claims file to an adjuster; send an update by mail or pull live files from the market that are already with a claims adjuster. Even better; it also

enables a considerable number of reserves to be reviewed within a relatively short timeframe rather than the piecemeal results otherwise achieved.

An alternative solution for achieving superior results is to circumvent the broker and contact the client directly, but that requires a relationship with the cedants, quite often non existing in active underwriting companies. So why not outsource that to run-off practitioners who often have an established relationship with the ceding companies on the basis that this is the most efficient method of getting their job done. They are therefore best placed to obtain reserve updates on a direct basis quickly and efficiently.

**Action point:** Initiate, as a priority, a contact with all cedants, just so it's there. Second: assess the capacity of my organisation and the internal or external support to be invested in an exhaustive initial review of static claims. Third: assess necessary ongoing support needed to keep these claims current on regular basis.

## Managing delegated authorities

While a programme of delegated business is being written, interests are aligned and it is generally beneficial for all parties to continue writing the programme.

Managing programmes of delegated business in run-off often means that all peripheral considerations fall away leaving just the claims exposure to be steered to conclusion. At this time it is a relatively simple process for a run-off practitioner to manage their exposures in order to determine the ultimate performance of a programme. However, experience demonstrates that while a greater focus upon claims can minimise losses, the ultimate programme performance is as much an issue of the controls in place at the time of underwriting as it is of claims management.

To state the obvious: minimising problems, as a programme matures, requires underwriting activity to be monitored and consistently compared with the Binding Authority agreements. Very early stringent monitoring of the business placed enables capture of essential records; encourages close adherence to underwriting guidelines; and is easier than dealing with the consequences of incorrectly bound risks. Can one of us say that this is really optional?

Although a new claim could legitimately be covered by the policy issued there may be further aspects to consider such as whether the risk covered was of the type, value or location contemplated by the Binding Authority Agreement? It is possible that a Policyholder may have selected against the carrier or that a risk may have been bound outside the terms of the Binding Authority Agreement.

All these aspects have to be promptly investigated and acted upon in order that no rights are waived. Ability to assess these issues becomes extremely difficult unless the relevant underwriting records are available. The prior monitoring of a coverholders' adherence to underwriting guidelines will increase your capability to definitively respond to these issues and properly follow through on coverage issues.

One question is whether the extra cost and burden is worth it if everything looks fine. From a run-off practitioner's stand point – i.e., being paid to unwind some of these books – it probably is if you consider the overall costs incurred as a result of delaying dealing with these issues. Because parties and interests change over time then any claims issues need to be uncovered at the earliest possible opportunity.

A fast and robust claims procedure is essential to controlling exposures; the relatively small expense of an early investigation is often a good investment. Evidence needs to be reviewed and statements taken at the earliest opportunity. This is just as relevant for seemingly low value claims. Chances to do so will diminish and the value of a claim can greatly increase if the opportunity is lost. Long tail exposure and plaintiff's counsels' contingent fees translate into staying power for many claims even if they initially appear to lack merit. Which is probably why, dare we say, a good TPA should be entirely independent from the coverholder? They should have a close working relationship with the risk carrier and should be able to use their initiative and any localised skills to manage the claims efficiently.

Conducting early and regular investigation also enables ongoing exposures to be properly valued in the context of the whole programme performance and any payment of profit commission to the coverholders.

Agreement of service requirements with TPA's should be standard procedure at the time of the contract being written. Proactive account management and monitoring of the TPA performance against these standards is an essential ongoing task. Where performance is not maintained at satisfactory levels then the appropriate business changes may need to be implemented and in certain cases consolidation of claims TPA's must be considered. The advantages which we have encountered through proactive management and consolidation of claims handling are numerous and range from a fresh and impartial new view on legacy claims to improved reporting and turnaround time of referred claims, realising cost savings through greater efficiency and easier administration of global loss funds.

**Action point:** Consider the procedures for regular review of underwriting delegated outside the

organisation and resources thereto. Improve early stage controls of TPA claims management.

## A helping hand

Although the run-off market may not be leading edge there are clearly a number of areas where good practitioners seek out solutions and do things differently. This may well be because the benefits that can be realised are proportionally greater in the run-off environment. During a soft market, is it not wise for every organisation to be as proactive as possible in managing their business using some of the practices detailed here, to deliver the most profitable results? Overall, run-off practitioners have worked against the

odds to create value within run-off portfolios and their experiences can also be of benefit to live underwriters.

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