

WHAT HAPPENS WHEN A CARRIER TAKES LEARNING FROM PAST COMPANY

BY AMY BELL

As multiple financial giants stumble and crumble all around us, the life insurance industry is feeling the shockwaves. This tumultuous environment has obviously stirred up some anxiety among BGAs. Many are wondering what exactly will happen to their business if one of their major life insurance carriers takes a nose-dive.

Luckily, today's BGAs have a lot to learn from past insurance company failures. "We can always learn from our mistakes, and our industry's been very good at that," says Chris Greis, President of Leaders Partners Inc. "The industry has learned dramatically from its mistakes in the past, and it's put in financial safeguards to make sure this stuff can't happen again."



A TUMBLE?

FAILURES

Looking to the past

IN the early 1990's, two major insurance companies, Mutual Benefit and First Executive Corp. (also known as Executive Life), encountered some rough waters. "In the early 90's, interest rates were in the seven to eight percent range generally, and we had some major Wall Street firms that were doing a pretty big job in the junk bond business," explains Greis. "They were called 'high yield bonds' in those days. A lot of life insurance companies were investing in junk bonds, and they were also investing in aggressive mortgages. In those days,

we didn't have risk-based capital standards that we have today."

At the time, First Executive Corp. was a major investor in "high yield bonds," and Mutual Benefit was investing in some aggressive real estate holdings. First Executive's problems started when their junk bonds began to perform poorly and default. In 1991, the company's investment portfolio took a plunge and the ratings agencies immediately took action. Although First Executive had previously enjoyed the highest ratings from A.M. Best and S & P, their ratings fell from superior to miserable practically overnight. Consumer

confidence plummeted, resulting in a "run on the bank."

"There was a major run on the bank, policyholders began to pull cash value out of their policies, terminate annuities, and it made bad things worse from a cash flow perspective of the company," says Greis.

First Executive Corp. was floundering and about to go under when the state of California stepped in, seized the company and put it into receivership. "It was a long process, but none of those policyholders got hurt," Greis says. "The ones that stayed with the company ultimately popped out as Aurora National Life

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Insurance Company, and that company is alive and well, and its policyholders have done well."

The same year, Mutual Benefit also took a tumble. Bending under the pressure of its aggressive realty holdings, the company was eventually forced to demutualize. "They had a lot of realty holdings, and they just couldn't move that stuff," explains Greis. "There was some financial stress with the carrier there in terms of cash surrenders and a number of other things that stressed them in a parallel universe with First Executive. The state of New Jersey had to step in and rehab the company, and that ultimately led to their demutualization."

The company's in-force policies were transferred to MBL Life Assurance Corporation, and Mutual Benefit was liquidated and dissolved in June 2001. Luckily, no policyholders were hurt in either of these failures. "In the case of First Executive,

shareholders took it on the chin but policyholders didn't get hurt. In the case of Mutual Benefit, because it was a mutual company, there were no shareholders, but policyholders actually ended up in a safer place as well," Greis points out. "The people who got whacked in both examples were the agents and distributors of those two companies."

These financially disastrous events put an exorbitant amount of pressure on BGAs. "First Executive was a major player with independent distribution organizations—brokerage firms, such as members of NAILBA, supplier firms and other distributors. Those distribution organizations really went through hell." In the wake of these two carrier failures, BGAs were overwhelmed with producers and policyholders asking for guidance and reassurance.

"Brokerage GA's were suddenly looking at due diligence documents and things that were beyond their level of expertise, and they were placed in a position to try and make people comfortable or provide some verbal reassurance without a lot of tools to work with," says Greis. "It was a very challenging time for people who do what I do."

Market share nightmare

Obviously the failure of a major carrier, such as First Executive or Mutual Benefit, can have a major impact on a BGAs market share. "Depending on the carrier, a [BGA's market share] can get crushed,"

says Greis. "For example, Mutual Benefit was a career system. So a general agent for Mutual Benefit was a general agent only for Mutual Benefit. When that company went out of business, that person was stuck with zero market share. He went from Mutual Benefit effectively being his employer, his lifeblood to zero. That's a situation I can't even imagine."

An independent BGA who works with multiple carriers is a little less likely to suffer a fatal blow from a carrier failure. However, if a specific carrier represents a major portion of a BGA's business, it can be bad news for the BGA if that carrier fails.

"When there's a major hot player out there, that player tends to command a significant market share," Greis explains. "Most of the people who did work at First Executive called First Executive their 'primary carrier'—which means those respective practices they represented owned 10 to 30 percent of their business. When you lose 10 to 30 percent of your bottom line, it's a major hit and it's very difficult to replace that."

The Moral of the Story

There's no question that 1991 was an incredibly challenging year for BGAs. However, there is a silver lining: today's BGAs can learn a number of important lessons from these past failures. Considering the financial industry's current state, these lessons may come in handy sooner rather than later.

"You can see how what evolved [in the 90's] plays very well now because we are in a similar window of time, when pressure on investments overrules conservative judgment," says Gary S. Dworkin, President of DAI (Dworkin Associates, Inc.).

Here are a few of the important lessons today's BGAs should take away from past carrier breakdowns:



Lesson #1: Don't put all your eggs in one basket.

In the wake of the 1990's carrier failures, BGAs learned that their survival could depend on working with more than one (or even a handful) of carriers. After all, if you write all of your business with one carrier, and that company falls from grace, you're going to find yourself in a sticky situation.

"For a BGA, as long as they have a large stable of carriers, there's really no impact at all of companies going either into receivership and/or going out of business altogether," says Michael Walls, Vice President of Resource Brokerage, LLC.

Walls points to Penn Treaty Insurance as an example. "Penn Treaty was a fairly major brand name in the long-term care insurance business," he says. "They recently went into voluntary receivership with the state of Pennsylvania. But because the agency I operate works with eight or nine different long-term care companies, there's really no impact on our busi-

ness because we have other companies we can recommend."

In other words, BGAs who work with 15 or 20 major carriers are much less likely to feel a negative impact when one of those carriers goes into receivership. "As a BGA, your only liability comes from if you don't have other name brand carriers for brokers to pick from for consumers," he stresses. "That's really where your responsibility lies: to make sure you're not just focusing your business on one or two or three or four carriers."

"It really does speak to having diversification," says Robert G. Erzen, Area Vice President of Arthur J. Gallagher & Co. Insurance Brokers of California, Inc. "One of the things I've noticed is that an insurance company will develop a product line that's particularly attractive—whether it's performing very well or it's marketing itself very well or it has generous payout to brokerage general agencies. And there's a movement to that

product, a concentration," says Erzen. "Whenever you have that kind of concentration, you leave yourself in a very dangerous position."

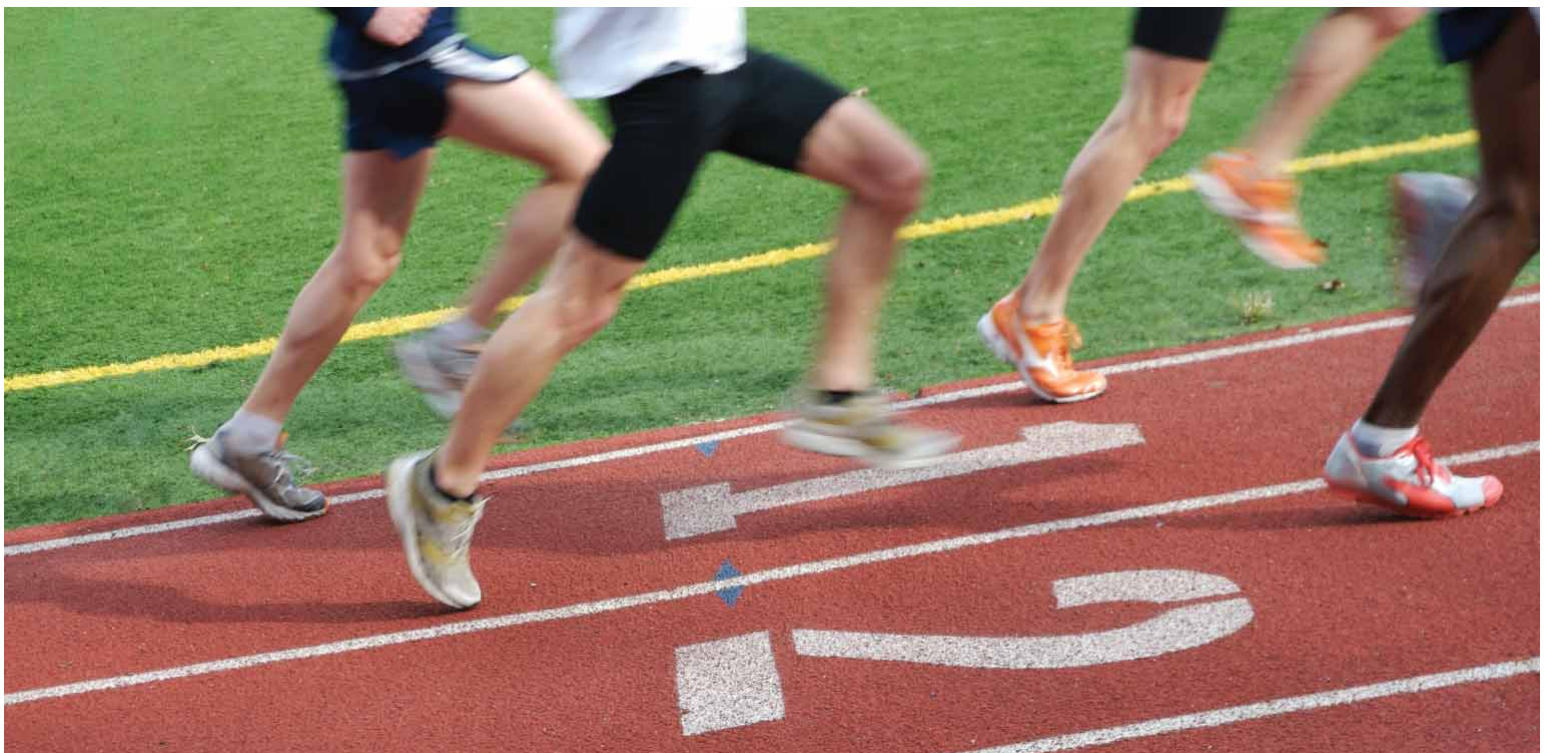
Lesson #2: Stay ahead of the curve.

As a BGA, you must keep the lines of communication open with each of your carriers so you are always aware of any potential problems. That way, you will be well-informed and you can in turn keep your producers and policyholders up to date.

"A BGA must maintain a sufficient relationship [with the home office] so that you will be alerted to any changes that may affect the clients and the producers," says Dworkin. "The other side of it is maintaining the responsibility that goes with having a producer's trust. You've got to be worthy of that trust...you've got to be somebody that knows the changes at least as early as everyone else if not a little earlier. You've got to be proactive."

Erzen reflects that sentiment. "As a brokerage general agency or any insurance agent, be on the forefront of the news," he says. "Be the one to deliver the news to the client...don't wait for that headline to come out if you can." Erzen, who writes property and casualty insurance for BGAs, is intimately familiar with this scenario. "Eighty percent of my book of business on the property and casualty side is written through AIG—so I'm living through this moment right now pretty heavily."

Less than a week after AIG announced that they may go into bankruptcy, Erzen was in their New York offices talking to the people involved in his insurance companies. "We were talking to the heads of those companies to find out really what the truth is...to be able to deliver that to your client is just paramount. We wrote to our clients about what's real, how it affects them personally. That goes a long way. We haven't had a single client leave AIG in the last 90 days



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because we were able to calm them down, walk them through what's going on and what makes sense for them. If you don't do that, you'll lose your customer."

Lesson #3: Lend your producers a hand.

If a carrier does take a tumble, it's absolutely vital for a BGA to guide their producers through the turbulent time.

"The First Executive issue allowed NAILBA member agencies to validate their value to producers," says Dworin. "We're not just sunshine patriots, we're not just here to write the cheap term and disappear. We're here to represent you and represent your concerns and do everything necessary to maintain your confidence in us and in brokerage distribution. And it was a very important and necessary effort to take at that time. And now you're seeing a lot of these same agencies and many, many more take that very seriously."

When a carrier is faltering, it's important to reassure your producers—however, you shouldn't offer them false comfort. "The challenge is that we're in the people business, and our producers are looking for a lot of verbal comfort," says Greis. "You have to safeguard not to provide comfort that doesn't exist. The BGA has to make sure that he doesn't put himself in a position where he's effectively underwriting the security or he's providing more comfort than exists within the financial voracity of the company."

Lesson #4: Know your liability.

In the event that a major carrier does go south, it's important to understand your liability as BGA. "In terms of raw liability, or in terms of a customer saying I'm going to sue you, I don't see a BGA in a challenging position there because generally what goes on financially from the carrier level is beyond our ability to predict or control," says Greis. "That said, if you're a life insurance broker or you're a financial advisor and you're recommending a product offered by First Executive and as a consumer I accept your recommendation and then First Executive goes belly up, are you going to get sued? Yeah, probably. So I guess it depends on your level of recommendation—for a BGA, not a big liability but for a retailer, probably a significant one."


However, Erzen says you can greatly decrease your risk by avoiding over-concentration in a specific product. "If you put too many of your clients into one particular product or have too much of a client's assets in one particular product, you do subject yourself to a dramatic increase in potential litigation against you and your firm," says Erzen. Even if a firm is not found guilty, the cost of legal fees alone could be enough to drive a BGA out of business.

"We've seen cases in the past where an insurance agency—although they're not primarily responsible, they're not the ones that drove the company into bankruptcy—just the process of defending themselves can take tens of thousands of dollars to get themselves out of the case. And each of these brokerage general agencies have deductibles between \$5,000

and \$25,000, so they're still going to have to pay that cost of defense in most cases to get themselves out. It's costly, it's burdensome, it's bad all the way around."

The Safety Net

Although a failing insurance carrier is never good news, the insurance industry has several sturdy safety nets to help soften the blow. "As an industry, we really take care of our own," says Greis. "When a carrier becomes stressed, the various states can step in and place an insurance company into receivership and they try and manage the carrier to ultimately have it pop out of receivership. So, we've had very few carriers that have actually gone south—but if that were to occur, all the states also have a guaranty fund whose job it is to kick in to make sure that death benefits and cash values are preserved. So it's kind of a two-tiered safety net."

Armed with these safety nets and the crucial lessons learned from past mistakes, BGAs are pretty well-protected. "We've had some speed bumps along the way, but we've been blessed in our business," says Greis. "We've had a lot of carriers do some things that have been financially awkward, but no policyholder has ever been hurt—and that's really a beautiful thing." 

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