

# THE RHA REVIEW

ROUTE TO:

Vol. 15, No. 2, First Quarter 2009

A publication of Robert Hughes Associates, Inc., an international litigation support, actuarial, risk management and insurance consulting company.

## WHEN ZOMBIES WALK THE NIGHT

by Robert N. Hughes, CPCU, ARM

Zom-bie 2 a ; a person held to resemble the so-called walking dead. (*Webster's New Collegiate Dictionary*)

Body snatcher, a person who exhumes dead bodies to sell them. (*Wikipedia, The Free Online Encyclopedia*)

It's a typical Bram Stoker story line ... everything is lovely in the resort. The weather is beautiful. Lovers stroll the beach and God is in His heaven. Then the sun goes down and the horror begins. Ghouls invade the graveyards. Zombies, the walking dead, maim and kill with abandon. The zombies have the functions of living beings but have no reason to behave and are without human responsibilities. All this, of course, makes for good fun in the movies or in books, but we all know it isn't real. Well, at least not as I have described it it isn't, but few people realize that persons and entities very similar to zombies and body snatchers exist in parts of the world of insurance that are not generally known of and are

certainly never seen by the ordinary person.

Let us start with the "everything is lovely" scenario and work forward. Fifty or sixty years ago the world of insurance was one of "ultimate good faith" and straightforward dealings. Insurers generally believed they owed

---

***"Ultimately, the workers' compensation and third-party liability claims arising out of asbestos and pollution resulted in what, in my opinion, was the largely undeclared bankruptcy of the entire insurance industry."***

---

a fiduciary duty to their policyholders and behaved accordingly. Claims were investigated and paid promptly. Misunderstandings about coverage were usually resolved in a fair and equitable manner. Policyholders almost never sued their insurers. Insurers made reasonable profits. They were pleased to be in the business and wished to remain in the business. As a result, they acted in good faith and were highly conscious of their public image.

Everyone, companies and insureds alike, was generally happy.

Then in the 1970s the first of the black plagues of insurance struck. Asbestos, previously thought of as the miracle substance, was identified as a quiet but inexorable killer. Soon thereafter another blow was struck - unrelated to asbestos but equally detrimental to the insurance world - when our astute Congress passed the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), otherwise known as the Superfund. Ultimately, the workers' compensation and third-party liability claims arising out of asbestos and pollution resulted in what, in my opinion, was the largely undeclared bankruptcy of the entire insurance industry. Almost no U.S. company was spared, and Lloyd's of London tiptoed near financial collapse until Equitas saved it by reinsuring all the pre-1993 claims. The companies that did survive did so through mergers and by completely remaking their corporate personalities. Old-time insurance people were "out." "In" were the money people who concentrated on cutting costs and hanging on to cash as long as possible. Large claims were regularly controverted, and lawyers took over the claims departments.

**ZOMBIES** continued inside)

### IN THIS ISSUE:

- **When Zombies Walk the Night**
- **Next Generation in Risk Management and Insurance**
- **New RHA Associate**

**ZOMBIES** cont'd from cover)

Now let's think a moment about what normally happens when insurers get into serious financial straits without becoming actually insolvent. The first thing they usually do is to suspend underwriting and enter into what is known as "run off" mode. That is to say, they don't sell any new business but remain an operating company in order to finish paying (or "running off") all the outstanding claims. As one can imagine with lifetime medical workers' compensation claims and "long tail" liability claims, this can take years.

Some companies don't have that luxury, however. They are broke and must liquidate. Often this decision is made for them by regulators. In such cases, the company is put under the supervision of a receiver, and its affairs are managed until all the claims are paid. (In London such plans are known as "schemes of arrangement" and operate very similarly to U.S. companies in receivership.) These are not the companies I wish to discuss here, however. They are dead, and generally they stay that way. Their assets are distributed as equitably as possible to the policyholders, and anything that is left over goes to the creditors. Transit Casualty is a well-known example of this sort of insurer "dead body."

What about "run-off" companies, however? Well, I'm happy to say that some of them have behaved very well, particularly in London. Their managers, feeling they still have a responsibility to the policyholders, have concentrated on equity and fairness and have generally done an excellent job of paying their claims.

Ah, but that brings us to the fall of night when the "beasties prowl." What about the run-off companies that couldn't care less about the policyholder? What about the "zombies" of

the insurance world that have cash and outstanding claims reserves but have no further reason for being? Many of these companies have been acquired by investors who see an opportunity to make money in two ways. First, they hope to increase investment income on their reserves. Second, they hope to eventually pay out less in claims payments than the amounts for which they were reserved at the time of acquisition. Let's take a look at both of these methods.

---

***"Fortunately, most individuals and companies will not encounter these zombies or body snatchers because they don't have old claims they are trying to collect from them. On the other hand, however, almost every large commercial entity, medical facility or religious institution will encounter one or more of these 'beasties' sooner or later."***

---

The only income a run-off company has is the investment income on its reserves. This income can be enhanced in only two ways. First, you can simply try to make a higher return on your invested capital than did the previous owners of the company. Frankly, the potential gains in this area are small because most insurance-company financial managers have been pretty good at their job. Second, however, you can try to keep your cash longer than was expected in the calculation of the acquisition cost of the company. In other words, in calculat-

ing the price of an insurance-company acquisition, one must determine how long it will take to pay out the claims, what the rate of pay-out will be and what rate of return can be expected on the invested reserves. Once the acquisition occurs, however, the new owners may attempt to restructure the dynamics of the price by simply keeping the cash longer than was expected.

These companies are the "zombies," and their owners are the "body snatchers." They have no connection with the policyholders. They don't feel they owe them any fiduciary duty. They generally feel no responsibility for retaining records that will assist policyholders in perfecting their claims. They are solely in the business of managing the cash reserves of the company, keeping the money as long as possible and making as much interest as they can while they have it. They purchase legal defense on a wholesale basis and instruct their attorneys to make life as miserable as possible for policyholders who are attempting to perfect their claims against them.

Fortunately, most individuals and companies will not encounter these zombies or body snatchers because they don't have old claims they are trying to collect from them. On the other hand, however, almost every large commercial entity, medical facility or religious institution will encounter one or more of these "beasties" sooner or later. All they can do, in my opinion, is to hire good lawyers, hope the courts will hold these companies to an appropriate standard of "good faith" and keep their crucifixes handy. **RHA**

*Robert N. Hughes is founder, chairman of the board, and chief executive officer of Robert Hughes Associates, Inc.*

---

# The Next Generation in the Risk Management and Insurance Industries

By Robert Puelz, Ph.D., Ch.F.C., CLU

The scale of the global insurance marketplace is enormous; the practice of corporate risk management has moved from the days of insurance policy analysis to an integrated practice in which insurance is one of many components to be considered and in which agent and broker distribution systems have been supplemented, not replaced, by direct buying alternatives. The insurance industry alone collects more than \$1 trillion in premiums, and pays out nearly \$200 billion in wages to about 2.3 million people in the U.S.<sup>1</sup> Yet there is anecdotal evidence that few industry participants can attribute their higher education to a curriculum of study in a university setting. This is, of course, partly attributable to the supply-side practice of business schools not offering a curriculum in risk management and insurance. Business schools don't often think about specialty education because it can be bad business. Hiring a faculty, developing a curriculum and then putting no students in the seats is a loss-making proposition that no dean can afford. Stay with more encompassing business school disciplines such as accounting, finance and marketing, and those are "projects" that help pay the bills. Recent evidence suggests, however, that risk-management and insurance education may gain significant traction.<sup>2</sup>

SMU's Cox School of Business in Dallas has experienced such industry interest from risk managers, insurers and brokers that its faculty voted in favor of a new undergraduate major in risk management and insurance (RMI) that will begin in the fall of 2009.

Alumni are eager in wanting Cox to move into modern-day risk-management education. More recently, there

are a large number of individuals and firms in Texas that look to Cox as a potential partner once a program is established.

It has become clear that a new risk-management and insurance major (RMI) would support two key areas that distinguish Cox in the world of business education. First is strategic location. The University of Pennsylvania, the University of Georgia and the University of Wisconsin are the leaders in risk-management and insurance education in the U.S.. However the presence of significantly sized business firms in Texas gives Cox a special niche to serve.<sup>3</sup> Large corporations have corporate risk-management departments, and we know that any commercial enterprise needs to be well informed about how to manage risk including its insurance buying needs. We believe the "buyer side" of risk-management services to have as much promise as the insurance-company side for our students, and the Metroplex has proven to be a well-thought-of location for corporate headquarters. Second is the opportunity for Cox faculty to structure a new and innovative program that takes as inputs both academic leanings and the interests of the industry. We believe that business schools at private institutions of higher education have the ability to be more agile, with better speed to market for new ideas, than our public school counterparts, and we were able to move relatively quickly in developing our program.

There may be no better evidence that risk-management and insurance education in a university setting is a good idea than looking at the industry's support. At SMU, the new program

has already received financial commitments that include the funding for a new lecturer devoted to risk management and insurance, and the addition of nine new undergraduate scholarships that will be available to students who major in RMI in the fall of 2009. The Cox school plans to deliver a high-quality product to the industry that has been so gracious in support of its efforts, and, if expected trends become well known, other universities will follow. While individuals from a variety of backgrounds will enter the risk-management and insurance world, there is a critical mass of future employees, with the advantage of a fast start through specialized training, who hold the prospect of advancing the practice of risk management and insurance at an intellectually accelerated pace. RHA

#### (Footnotes)

<sup>1</sup>Insurance Information Institute, "A Firm Foundation: How Insurance Supports the Economy," at <http://www.iii.org/economics/toc/>

<sup>2</sup>See "Risk Management Moves to the Front of the Class" in *Financial Week* (July 28, 2008), which discusses how the recent financial markets crisis has brought risk management to the forefront, and "B-Schools Tackle Risk Management," *BusinessWeek*, which discusses the growth of risk management among selected business schools in the U.S.

<sup>3</sup>Rankings from *U.S. News & World Report*, 2007.

*Dr. Robert Puelz is the Dexter Trustee Professor of Risk Management and Insurance at Southern Methodist University in Dallas, Texas, and an associate with Robert Hughes Associates, Inc.*

---

**ROBERT HUGHES ASSOCIATES INC.**

508 TWILIGHT TRAIL, SUITE 200  
RICHARDSON, TEXAS 75080  
(972) 980-0088 FAX (972) 233-1548

PRSRT STD  
U.S. POSTAGE  
PAID  
RICHARDSON, TX  
PERMIT NO. 1380

ADDRESS SERVICE REQUESTED

## RHA, Inc., Adds New Associate

Robert Hughes Associates is pleased to announce that Mr. Anthony (Tony) Provenzale has become associated with the firm. Tony has an extensive background in the reinsurance brokerage arena and has more than 37 years of insurance industry experience. He has been directly responsible for producing and sustaining substantial reinsurance and brokerage revenue derived from super-regional insurance companies, specialized insurers, single-state operations and residual market companies.

His experience includes composing and interpreting reinsurance contracts and various styled adjustments. Tony

has worked with key industry executives both in the United States and abroad and will provide consulting and expert testimony in many areas of the insurance industry, including, but not limited to, reinsurance, brokerage operations, coverage, ceded and assumed reinsurance, treaty and facultative reinsurance, and the design and development of innovative reinsurance products.

Tony can be contacted via our main office at (972) 980-0088 or at his home office at (214) 801-5203. You can also e-mail him at [provenzale@roberthughes.com](mailto:provenzale@roberthughes.com) or [txtonypro@aol.com](mailto:txtonypro@aol.com). 

### THE RHA REVIEW

Publisher ..... Robert N. Hughes  
Editor ..... John R. Oakley  
Assistant Editor ..... Alice H. Oakley

*The RHA Review* is published quarterly by Robert Hughes Associates, Inc. — an independent international litigation support, actuarial, risk management and insurance consulting company based near Dallas, Texas, with offices in Houston, Texas, as well. The purpose of this publication is to offer insurance-related information and critical comment pertinent to the clients, friends and fellow professionals of Robert Hughes Associates, Inc. This publication is available free to interested parties. The information contained in this publication is intended to be general in nature; readers should obtain professional counsel before taking any action on the basis of this material.

*The RHA Review* is a refereed publication. The peer review board consists of  
Joseph Launie, Ph.D., CPCU,  
Amy Puelz, Ph.D.,  
Robert Puelz, Ph.D., ChFC, CLU, and  
Tim Ryles, Ph.D.

Copyright © Robert Hughes Associates, Inc., 2009. All rights reserved.