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Policy Buybacks Call for Cautious Approach

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Risk managers who are dealing with runoff insurers may want to consider policy buybacks, but they also should proceed cautiously, observers say. Buybacks are contractual agreements under which the policyholder accepts a lump sum payment in exchange for giving up the rights to any future claims under the policy.

Runoff insurers encourage a policy buyback because it means they can take the potential liability off their books, say observers. But that does not necessarily mean it is always in an organization's best interest.
Risk managers should consider a policy buyback "if the claims haven't matured yet because, in general, most runoff companies either fail or make some kind of an arrangement with their creditors" that could limit how much a policyholder recovers, said Mary Cannon Veed, an attorney with Arnstein & Lehr L.L.P. in Chicago.

If risk managers "have any concerns about whether they think (a runoff insurer) ultimately can succeed, can run off as a solvent entity, they probably need to think about policy buybacks, or getting their major claims out of the way," said Jonathan Bank, an attorney with Lord Bissell & Brook L.L.P. in Los Angeles.
"A policy buyback involves undertaking a realistic assessment of the economic viability of the insurance company," said Bruce C. Shulan, managing director at the Stamford, Conn.-based Princeton Partnership L.L.C., which works with runoff insurers.

If it appears the runoff insurer can remain solvent and avoid rehabilitation or liquidation, then the risk manager must decide if he or she "would rather have the benefit of the return premium—recognizing that any future losses that would have been covered by that policy now belong to the insured"—or the benefit of knowing that any unforeseen losses would be insured, Mr. Shulan said.

If, though, it appears that the insurer will become insolvent, it "makes a lot of sense to negotiate a policy buyback so that the insured is getting some money, which can be used to defray future exposures," said Mr. Shulan. "The problem is that it can be very difficult for an insured to undertake a realistic evaluation of what the true economic viability of the insurer is," although industry experts can help determine "whether a policy buyback makes sense" and at what price, Mr. Shulan said.

The advisability of a buyback could depend on the particular policy, said Rachel S. Kronowitz, an attorney with Gilbert Heintz & Randolph L.L.P. in Washington. If it is a primary policy providing coverage for multiple lines such as general liability, workers compensation and property, "I'd be very, very careful" in considering a buyback because there could be claims generated in the future, Ms. Kronowitz said.

"But if you're talking about a higher-level excess aggregate policy" with defense costs within the limits, the risk manager "can at least weigh the economic value of that policy and determine whether or not it makes sense to get paid today and get paid a few cents on the dollar" rather than take a chance that the insurer will become insolvent, which could lead to years of waiting for payment, Ms. Kronowitz said.