BEST'S REVIEW

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Then There Was One

MERGER VETERAN: William K. Austin, a former risk manager, went through 15 major mergers with Fleet Boston. He said he would first ask himself the reason for the merger and what effect it might have on his company.

David Wells for *Best's Review*

When companies merge, blending their risk management operations requires planning, foresight and tough choices.

by Barbara Bowers

The June takeover of Caesars Entertainment Inc. by Harrah's Entertainment Inc. forged the largest casino operator in the world. Months before the deal was completed, the companies were bringing in consultants to evaluate their separate risk-management programs and report to each team on their findings.

It's all part of the drill in cases like these. For, behind the scenes of mergers and acquisitions, many people work long and hard to make sure all exposures of the newly formed company will be identified and covered well before the transaction becomes final.

"In our situation, it wasn't a case of who had the right program and who had the wrong program," said Lance Ewing, formerly Caesars vice president of risk management and now the man tapped to run the new gambling giant's risk-management operation. "There were many great things that Harrah's had in their risk management department and there were some very, very good things that we did well at Caesars. The idea was how do we put the two of those together in order to make what a new $9 billion

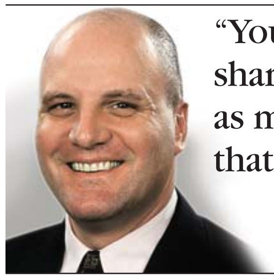
Key Points

- During a merger, risk managers must examine insurance policy renewal dates, changing board members, new products and markets, open claims and staff deployment.
- Managing captives involved in a merger requires decisions about distribution of capital.
- Other considerations include looking at the risk transfer appetites of the merging companies and making moves to streamline risk management units.

dollar company is going to need?"

During the months leading up to a merger, the participating companies will often run on parallel tracks until they reach a definitive insurance policy date, Ewing said. Then a decision must be made on extending the current policy date to meet the new renewal date, he said. "You can prorate certain policies. Hypothetically, one company might have a June 1 renewal and the company being acquired has a Dec. 31 renewal," Ewing said. "What you do is extend from the June 1 to the Dec. 31 renewal and get that extension through the carriers. That's no easy task by any stretch of the imagination."

Then there's the issue of directors and officers insurance. Ewing points out that only some of the board members of the acquired company will transfer to the new board and so there is the need to purchase tail coverage for directors and officers for a certain period "so that if anything resurrects itself, at least that coverage would be there," he said.



"You have to be cautious of what can be shared or what can't be shared. So you do as much of your homework up front before that merger..."

—Lance Ewing, Harrah's Entertainment

Determining What's New

When he was a risk manager for Fleet Boston, William K. Austin went through 15 major mergers. It got so that he created a checklist that he consulted to make sure he covered all the bases before these transactions were finalized. A risk manager must follow the risk management process when integrating risk management and insurance programs, Austin said. "You need to understand loss exposures, the best treatment options for the exposures and then have timely implementation in order to continue best practices for the organization," he said.

As the risk manager of the acquiring organization, Austin first would ask himself the reason for the merger and what effect it might have on his company.

"You have to look at it that way and think in terms of are there going to be new activities that we're going to be entering into, new operations, new products?" Austin said. "In other words, what's the company going to look like as we go forward with this other company being absorbed by us? Are we going to expand services for existing customers? Are we moving into new markets?"

For example, when Fleet bought Bank Boston in October 1999, it meant that Fleet became a world bank overnight. Bank Boston had been a U.S. bank with significant operations in South America and the Far East. So a risk manager in this situation must think in terms of territories, whether domestic, meaning an expansion from one state to another, or international, Austin said. Even with a change in states, he noted, the risk manager must consider the effect of various state laws on such policies as workers' compensation whether it be issues related to self-insurance or procuring coverage from a state fund.

There are other areas that the risk management department should be involved in from the day that a merger is announced, he said. For one, the risk manager of the acquiring company must consider the composition of the surviving entity: Is it an asset purchase or a stock purchase? What will happen to past liabilities? In a stock purchase, they become the responsibility of the acquiring company.

Also, with past liabilities, the risk manager must determine who will handle the closure of any open insurance claims, especially in self-insured programs, he said. "Even more importantly, with the company being acquired, have they adequately reserved for open claims and for IBNR (incurred but not reported), have they accrued on the balance sheet enough reserves for those losses?" Austin asked. "If not, then the acquiring company has to beef up those reserves post-closing date. It has in essence now paid more for that company."

Early Discussions

During a merger, it's important that the risk manager from the acquiring company confer with his counterpart to determine the other company's perception of risk, what model they have been using, whether they have a more conservative posture toward limits and retained losses, and if they have identified and dealt well with all their exposures, said Austin, now principal and consultant at Austin & Stanovich Risk Managers LLC, Douglas, Mass., and Providence, R.I.

Another good reason for conferring as early as possible is to get the measure of the other staff. In a merger, a risk manager will be charged like any other departmental manager with identifying his or her best employees. "Unfortunately, when a merger takes place, especially if there are redundant operations, people are going to be laid off," Austin said. "You want to get an appreciation of the other staff so that as you go forward, the risk unit, much like the rest of the organization, is stronger, not weaker."

However, in the case of the Fleet/Boston Bank merger, Austin couldn't discuss any of these topics with the other risk manager since Fleet regulators imposed a quiet period once the deal was announced. This meant that neither side could contact the other for nearly two months.

But the risk management community is pretty small and friendly, and Austin already knew his counterpart. "In fact, six months before Fleet and Bank Boston announced the merger, he and I were at an unrelated function talking about what we were going to do if the organizations ever came together," Austin said.

With the Harrah's and Caesars merger, it was sometimes difficult to keep each side informed because the Federal Trade Commission considered them competitors to the day the transaction was completed, Ewing said. State gaming requirements also prohibited the companies from sharing certain information, he said.

"That's a little tougher," Ewing said. "You have to be cautious of what can be shared or what can't be shared. So you do as much of your homework up front before that merger and that will make the transition period shorter and a little bit more comfortable for everybody."

Often risk managers involved in these transactions can be too comfortable with their own strategies and programs, Ewing said. That's when an objective third party comes in handy. During the Fleet/Boston Bank merger, for instance, Austin and his counterpart hired an outside consulting firm to help both risk managers reach decisions on several key coverages. Neither of them knew who would get the risk manager job post-closing, so they needed to work together to make sure the new organization would have the best program in place, taking the best of Fleet and the best of Bank Boston, Austin said.

"We didn't want either Fleet's or Bank Boston's pride of ownership—that being mine or the other risk manager's—to cloud what we thought was the better program moving forward," he said. "So we used an outside party to help us make that decision."

A consulting firm also reviewed how Fleet and Bank Boston handled casualty claims. Each bank used different third-party administrators and needed someone with extensive claim expertise to help decide what would be best practices to follow after the closing. "We did not want any bias or preconceived ideas to complicate our joint decision-making process," Austin said. "Outsourcing can be a very good way to obtain independence in decision-making so that the organization, even down to the risk level, is stronger post-merger," he said.

Reviewing the Situation

Companies planning to merge often will call for assistance from Accenture, the global management consulting, technology services and outsourcing firm. When that happens, Accenture will recommend that its clients consider five key points, said Glenn A. Sieber, global managing partner of Accenture's Insurance Group. These points include:

• Looking at the risk transfer appetites of the merging property/casualty companies and making adjustments as necessary. This would involve, among other things, reviewing policy terms and conditions, self-insurance limits and insurance attachment points; rebalancing deductibles and similarly reconciling employee benefits coverages, Sieber said. "Typically, what we've seen is that companies would look at doing this almost as part of evaluating what a merged entity will look like and the risks and exposures they would have," he said.

Glenn A. Sieber

• Going over purchasing and coverage strategies, motivated by cost-savings opportunities, especially in the areas of employee benefits and corporate property and casualty. "I would expect them to look at things and intensify things such as their price shopping, frequency for coverage, leveraging the enhanced buying power that a new company would have, and re-evaluating the level of risk that would be associated with the merged entity," Sieber said.

• Assessing the new service support requirements of the merged company. Sieber said that there is a tendency these days for many companies to consider outsourcing certain functions that they may not regard as being key differentiators for them. "So one of the things they may look at is activities they want to keep in-house, vs. outsourcing to the brokers, or insurers or niche providers," he said. These activities can involve claims administration, loss analysis statistical reporting, captive company management and tax consequences.

• Deciding roles and responsibilities of the risk managers in the new entity. Typically, Accenture has been seeing a substantial amount of overlap here, especially in companies as comparable as Caesars and Harrah's. If the merged entity determines it will keep risk managers in-house, it will need to refine the levels of responsibility, with perhaps one manager overseeing property, another looking at liability or dividing responsibilities by site location.

In the insurance industry these days, Accenture is seeing more carriers considering the creation of an overall risk manager to declare a philosophy, style and approach for their merged companies. "But I do see quite a bit of research, collaboration and cooperation in the risk management area, because if you are acquiring a company in a particular market space or business that's different from yours, you do need to rely on the trust, judgment, influence and research of that risk management department on what the particular exposures could be and what purchasing coverage strategies make the most sense for that company," Sieber said.

• Making moves to streamline risk management units. Even if a company decides not to outsource some of its functions, there are usually substantial opportunities for streamlining risk management organizations of the merged entity where warranted, Sieber said. "If a merger is of two separate entities that are relatively dissimilar in terms of scope, keeping two separate risk departments may make sense on a stand-alone basis," he said. "Other times, it makes a lot of sense to merge the two and then decide responsibilities for property/casualty and employee benefits placements."

The Waiting Game

In the case of some extremely complex mergers, risk managers might be wise in biding their time before making decisive moves. That's the advice of Sheila Small, risk manager for Verizon Communications, who was involved in a merger in 2000 that brought with it some captives.

"The first thing I did was to do nothing," she said. "I felt I needed to have a better understanding of the risks involved in all the different captives. The ones that we were presented with during the merger were captives that really handled very different types of risk."

One captive, for example, was a reinsurance company which reinsured non-related, third-party business on the open market. Small spent about a year gaining a better understanding of what the risks were with this company and how the payment processes worked. This captive had not written any active premium for 12 to 15 years and essentially was in run-off. Meanwhile, Verizon had its own captive, established in 1995 in Vermont, which was used for the parent company's active business.

In time, Small and colleagues started to take a look at combining the captives. The one with the volatile business had extra surplus that Small wanted to utilize more effectively in the other Vermont captive. But as it turned out, the idea of bringing the captives together proved out of the question.

"We brought in some outside opinions and we realized that because

Direct Premiums Written by Line, Property/Casualty, United States—2004

($ Thousands)

Business Line	Direct Premiums Written	% of Total	% Chg	Adjusted Loss Ratio 2004	Adjusted Loss Ratio 2003	Leading Writer	AMB #	% Market Share	% of Writer's Total DPW	Second Leading Writer	AMB #	% Market Share	% of Writer's Total DPW
Private-Passenger Auto Liability	$94,673,604	20.3	4.1	62.7	66.6	State Farm Group	00088	18.0	36.3	Allstate Ins Group	00008	10.2	39.1
No-Fault	11,203,125	2.4	3.6	76.8	88.2	State Farm Group	00088	17.0	4.0	Allstate Ins Group	00008	10.8	4.9
Other Liability	83,470,479	17.9	4.2	60.9	63.7	State Farm Group	00088	18.2	32.3	Allstate Ins Group	00008	10.1	34.2
Private-Passenger Auto Physical Damage	65,877,795	14.1	2.4	53.4	58.3	State Farm Group	00088	18.5	25.9	Allstate Ins Group	00008	10.6	28.4
Workers' Compensation	53,796,936	11.5	7.4	69.3	74.8	State Comp Ins Fund CA	04028	15.3	100.0	Amer Intl Group Inc	18540	10.3	19.5
Homeowners Multiple Peril	53,071,557	11.4	9.5	65.9	59.5	State Farm Group	00088	22.5	25.3	Allstate Ins Group	00008	11.3	24.3
Other Liability	50,081,562	10.8	4.0	71.4	76.7	Amer Intl Group Inc	18540	19.7	34.8	Zurich Finl Svcs NA	18549	7.8	29.4
Commercial Multiple Peril	32,572,091	7.0	3.6	54.3	50.2	St. Paul Travelers Cos	18647	9.4	13.8	Hartford Ins Group	00048	6.1	17.5
Nonliability	19,414,591	4.2	2.0	56.5	45.4	St. Paul Travelers Cos	18647	9.1	8.0	Hartford Ins Group	00048	6.6	11.4
Liability	13,157,500	2.8	6.1	51.0	57.7	St. Paul Travelers Cos	18647	9.9	5.8	Hartford Ins Group	00048	5.2	6.1
Commercial Auto Liability	22,397,866	4.8	4.4	55.7	61.4	St. Paul Travelers Cos	18647	9.3	9.4	Progressive Ins Group	00780	6.2	10.1
No-Fault	561,038	0.1	3.6	55.6	53.3	Progressive Ins Group	00780	11.2	0.5	Amer Transit Ins Co	04660	10.9	23.7
Other Liability	21,836,829	4.7	4.4	55.7	61.6	St. Paul Travelers Cos	18647	9.4	9.2	Progressive Ins Group	00780	6.0	9.6
Medical Malpractice	11,366,007	2.4	5.5	63.8	82.8	Amer Intl Group Inc	18540	8.1	3.2	MLMIC Group	18439	8.0	96.5
Inland Marine	11,211,114	2.4	3.9	43.1	43.3	Amer Intl Group Inc	18540	10.4	4.1	St. Paul Travelers Cos	18647	7.5	3.8
Fire	8,705,892	1.9	-4.1	32.8	38.7	Amer Intl Group Inc	18540	13.8	4.2	St. Paul Travelers Cos	18647	7.0	2.8
Commercial Auto Physical Damage	7,566,351	1.6	0.1	47.3	47.9	St. Paul Travelers Cos	18647	6.8	2.3	State Farm Group	00088	6.7	1.1
Allied	6,791,474	1.5	-4.3	92.6	48.4	FM Global Group	18502	12.9	41.8	St. Paul Travelers Cos	18647	8.0	2.5
Group Accident & Health	5,459,690	1.2	-24.7	71.0	71.0	Anthem Ins Cos Inc	00607	21.2	49.4	CNA Ins Cos	18313	11.5	5.8
Mortgage Guaranty	5,010,708	1.1	1.1	39.9	38.3	Mortgage Guar Group	03014	27.9	100.0	Radian Group	18150	18.0	82.0
Product Liability	4,259,133	0.9	14.9	98.6	100.4	Zurich Finl Svcs NA	18549	15.2	4.9	St. Paul Travelers Cos	18647	10.4	2.0
Multiple Peril Crop	4,187,994	0.9	28.5	69.9	85.6	Ace INA Group	18498	20.3	13.2	Centurion Ins Group	18188	14.6	99.2
Surety	4,163,364	0.9	6.9	60.6	51.2	St. Paul Travelers Cos	18647	21.8	4.1	CNA Ins Cos	18313	8.4	3.2
Financial Guaranty	3,000,930	0.6	-8.5	18.8	5.7	Ambac Finl Group	18449	27.3	99.5	MBIA Group	03166	24.0	100.0
Other Accident & Health	2,699,300	0.6	-16.1	64.0	66.1	State Farm Group	00088	29.3	1.7	CNA Ins Cos	18313	17.7	4.4
Ocean Marine	2,693,017	0.6	4.8	62.3	64.0	St. Paul Travelers Cos	18647	10.0	1.2	Amer Intl Group Inc	18540	9.6	0.9
Farmowners Multiple Peril	2,288,888	0.5	5.7	56.8	61.0	Nationwide Group	05987	8.0	1.3	State Farm Group	00088	6.6	0.3
Aircraft	1,962,843	0.4	-19.3	38.5	41.8	Amer Intl Group Inc	18540	25.2	1.7	XL America Group	18491	14.7	9.5
Earthquake	1,922,087	0.4	6.4	9.4	14.3	CA Earthquake Authority	12534	24.2	100.0	State Farm Group	00088	9.3	0.4
Federal Flood	1,767,811	0.4	9.2	99.6	37.7	Fidelity Natl Group	18606	18.1	74.4	State Farm Group	00088	15.6	0.6
Fidelity	1,277,015	0.3	7.1	45.7	37.7	Amer Intl Group Inc	18540	20.0	0.9	Chubb Group of Ins Cos	00012	18.9	2.5
Federal Employees Health	1,160,820	0.2	31.2	93.9	93.6	Anthem Ins Cos Inc	00607	74.5	36.9	Rocky Mountain Hospital & Medical Svc	68817	25.5	33.8
Boiler and Machinery	1,103,932	0.2	-6.4	23.2	22.4	FM Global Group	18502	23.1	12.2	Amer Intl Group Inc	18540	15.0	0.6
Credit	994,403	0.2	31.8	47.8	42.2	Euler Amer Credit Indemnity Co	02097	12.7	100.0	Allstate Ins Group	00008	10.3	0.4
Burglary and Theft	130,189	0.0	10.3	25.5	24.4	Chubb Group of Ins Cos	00012	23.7	0.3	St. Paul Travelers Cos	18647	20.7	0.1
Miscellaneous	3,626,924	0.8	-3.6	65.8	70.6								
Total P/C Industry	**$465,821,300**	**100.0**	**3.9**	**61.3**	**62.9**	**State Farm Group**	**00088**	**10.1**	**100.0**	**Amer Intl Group Inc**	**18540**	**6.1**	**100.0**

Source: A.M. Best Co.

there was so much volatile, third-party business in one of the captives, it didn't make financial sense to combine them," she said. "One of the goals was to not allow this unrelated, very volatile business to bleed into the captive that we use for our ongoing business, to drain our reserves that we needed to handle people's workers' comp and related business. It was very critical that we kept them apart."

But she still wanted to pull out the excess surplus from the captive and use it more effectively in the other captive that was expanding and writing more of the parent company's risks. How to get it?

After studying many scenarios, Small and her staff decided that restructuring offered the best answer. They determined the amount of surplus the captive would need to pass regulatory scrutiny in order to keep its third-party business, and then divided the captive into third-party, unrelated business and related business. The related business kept all of the surplus that Verizon needed. "Then we combined that piece with our ongoing operational captive," she said. The non-related business was formed into a stand-alone captive which can be sold off if Verizon so chooses, Small said.

With merged companies, risk management strategy is likely to change simply because the previous exposures of the acquiring and acquired companies have now changed, Ewing said. "In any merger and acquisition, the philosophy, and even retention levels and deductibles, can be different," he said. BR

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