Kemper's road to exiting insurance

InsuranceTimes, March 18, 2003, Vol. XXIII, No. 6

LONG GROVE, Ill. — After more than 90 years as a premier provider of property casualty insurance, Kemper is getting out, with management opting to focus on loss and claims services over underwriting.

The insurer had taken steps in the past few months to become a smaller and more profitable insurer, shedding various lines of business, and even formulating plans to demutualize.

But last week the company decided that in the face of poor financials and questions from rating organizations, those steps were not enough and that exiting insurance made the most sense.

A new company formed to acquire the remaining commercial lines accounts of the insurer will retain the Kemper name.

The exit came after the insurer posted a year-end 2002 net loss of $312 million, compared with net income of $121 million in 2001. Year-end consolidated surplus fell to $1.0 billion, a reduction of approximately $475 million from Kemper's 2001 year-end surplus of $1.5 billion.

"Three main factors contributed to our surplus decline," said David B. Mathis, Kemper chairman and CEO. "One was substantial adverse prior year loss development on past business, principally from 1999 and earlier. Another was a reduction in our surplus that we were required to record during 2002 as additional funding obligations for the pension plan. And, finally, significant realized capital losses and a drop in investment income in 2002 in part reflect the decline in the general capital markets and also reflect losses and write-offs from company investments in various business ventures."

Just a few months, ago, the company's strategy was very different, prompting Mathis to report, "Going forward, Kemper will have a two-pronged strategy. First, we will be primarily a standard commercial lines insurance provider with deep expertise in the lines of business we offer. The second key component is leveraging the strength of our service platform, both in terms of serving existing Kemper customers and selling our services independently."

The first prong of that strategy fell by the wayside as the financial and rating news worsened.

Moody's Standard & Poor's, A.M. Best and Fitch all lowered the insurer's ratings, with A.M. Best downgrading the Kemper Intercompany Insurance Pool pool to 'B+' from 'A-.'

Then the ratings on Kemper-Lumbermens $700 million in surplus notes were dropped —S&P's to 'BB' from 'BBB' and Moody's from Ba1 to B2.

On a positive note Kemper negotiated a cut through agreement with Berkshire Hathaway's National Indemnity Co.

Management Changes

But sudden management changes at the close of 2002 made credit watchers even more nervous. On Dec. 30 president and COO, William D. Smith, who was slated to take over from Mathis within days, retire d for "personal reasons."

An Office of the Chairman was created. Mathis agreed to postpone his own retirement to continue as Kemper's chairman and CEO for the foreseeable future.

That surprise development fueled a new round of downgrades from Fitch, S&P and Moody's.

The cut-through agreement with Berkshire Hathaway promised Kemper somewhat of a financial boost as it went about its repositioning and downsizing. But it proved insufficient.

Facing a deteriorating financial condition and the likelihood of further downgrades, Kemper's board of directors last week approved a new direction for the company.

Kemper will now sell what remains of its existing insurance lines to a new company capitalized by private equity funds managed by Securitas Capital, LLC, a private equity investment firm affiliated with Swiss Re; The Cypress Group L.L.C.; Gilbert Global Equity Partners; and some members of Kemper's existing management team.

The transaction will include Kemper's middle market offerings, such as workers compensation, package, auto and umbrella in support of these lines, marine and small business accounts, professional liability business for architects and engineers, the Ohio-based Greatland and Kemper's fidelity and ERISA bond operations. These combined commercial lines generated about $1 billion in gross premiums in 2002.

At the same time that the new Kemper will be forming,, the old Kemper will be developing its claim and insurance services platform to sell independently to current and new customers. These services include claim management; medical and disability management; loss control services to control workers' compensation; liability and property insurance costs; and legal bill audit services. This services platform will operate under National Loss Control Service Corp. (NATLSCO, Inc.), now a subsidiary of Kemper. Kemper intends to retain a level of ownership in the service company as well.

"The transaction around our middle market, small business and related specialty lines will support our efforts to enhance our service platform as a third party administrator," said Mathis. "Looking ahead, we will become a much smaller organization. However, there will be opportunities for many employees with the new commercial lines company, with the service platform and in facilitating an orderly withdrawal from lines of business that we are exiting."

The New Kemper

The new Kemper will be led by Robert A. Lindemann, senior vice president of Kemper and president of American Manufacturers' Mutual Insurance Co., as well as other current Kemper executives. In addition, the management teams and much of the existing staff from the lines of business included in the transaction are expected to be involved in the newly formed company.

Kemper is expected to receive $9 million (plus statutory surplus) for certain licensed insurance entities and a commission on renewals in the lines of business included in the transaction as well as other financial benefits.

"We've said for some time now that, while we have strong operating results in our core lines of business, we lack the access to capital we need to maintain our ratings in the critical 'A' category," said Mathis. "We believe the transfer of these businesses to the new entity is in the best interest of our company and policyholders, and will provide for minimal business interruption."

Lindemann commented, "This transaction enables policyholders to continue receiving high-quality service and allows our agents and brokers to continue working with the same management team they know and trust," added Lindemann.

John F. Shettle, Jr., senior managing director of Securitas Capital, said that he expects to close the transaction and have the new company running in the second quarter. He said he has shared preliminary plans with A.M. Best and expects that the new company would qualify for an 'A-' rating or better, "which would enable us to grow what is already an attractive book of business."

The transaction is subject to regulatory and other approvals and consents.

This exit followed months during which Kemper sold off other insurance lines, including the renewal rights to its surety business which it sold to Arch Insurance Group, a division of Arch Capital Group Ltd. Kemper also sold its directors and officers liability insurance, employment practices liability, and other related lines of financial insurance written through Kemper's Financial Insurance Solutions (FIS) division to AXIS Capital Holdings Limited.

It also reached a definitive agreement to sell the renewal rights to its bundled large risk national accounts to Argonaut Insurance Co., a member of Argonaut Group, Inc

It sold its unbundled risk management accounts to Old Republic Insurance Co., a wholly owned subsidiary of Old Republic International Corp. ❒❇✐