Case Study on Exit Strategies

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Financial Disclosure

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We have no real or apparent conflicts of interest to report.
EMRRG: The Beginning

- Crisis in availability and affordability of medical professional liability insurance
  - Particularly for emergency medicine
  - Across multiple states

- Licensed June 2004
  - Four founding shareholders, headquartered in three states
  - Owner driven
  - Financial and operational commitment to risk management
  - Stable membership through 2012
EMRRG: Original Exit Provisions

- Included in written shareholders agreement, with goals:
  - “Glue” during softer market cycles
  - Attract only members who had a long term commitment

- Buy-out price:
  - Forfeited if member exits in first five years
  - Reduction if member exits in years five or six
  - Always reduced by 50% if insufficient notice given or member is terminated for failure to pay premium
  - Paid over four years, no interest
  - Based on book value
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- Expected growth after formation; didn’t occur

- 2009 strategic planning: EMRRG financially healthy and stable, but desire to protect EMRRG in the event of exit
  - Easier to address in the abstract
  - Recognition of risk to EMRRG of accumulating deductibles
  - Changed the shareholders agreement
EMRRG: Exit Provisions Revisited

- New buy-out price: book value with reserves set at 110% of financial statement reserves

- Added a forfeiture provision if members didn’t obtain acceptable tail coverage (provided by EMRRG or carrier acceptable to EMRRG)

- Payment terms remained at four years, but first payment not due until 2 years after termination (rather than 60 days)

- Allowed change in buy-out price: if multiple members leave in that 2 year period, remaining members could vote to dissolve, and departing member would be treated as it would in dissolution

- EMRRG issues a note for payment

- Added offset provisions; allowed EMRRG board to pay more quickly if desired
From the Perspective of the RRG Shareholders

- Our experience is with 2 of 4 owners leaving the RRG in 18 months
- Time period 2011-2012
- Reduced premium dollars by about 1/2
- Expenses projected to be the same
- Multiple problems
Major Problem List

- Expenses out of proportion to new size
- Minimizing pain of exit of Old Shareholders
- Need for New Shareholders
- Reorganization to meet the new reality
- The Soft Market as a confounding variable
Expenses out of proportion to new size

- Needed to reinvestigate all management contracts
  - Essentials (Mgmt, legal, claims handling, broker) vs
  - Non Essential (education, risk mgmt CME)

- Renegotiate largest dollar contracts first
- Brought Risk management education in-house

- Ultimately, we still ended up with a larger % of premium is going to fixed expenses instead of claims
Expenses

• Fortunately we were large enough, with the 2 groups, to absorb the premiums
Minimizing Pain upon the exit of Old Shareholders

- Negotiations with the 2 leaving groups
- We did not want to pick up prior acts, although the agreement was we needed to give a bid
- Amount of the tail was set high, from the very beginning, which allowed a negotiation with the aim of making our proposal unattractive.
- Soft insurance market helped in this case, both groups received better more attractive commercial offers
Need for new Shareholders

- Soft insurance market makes RRG's a tough sell
- Most that want captives, already have them
- Educating smaller player into the benefits of ART and especially an RRG in the EM world
- Working with our brokers to 'sell'
Reorganization to meet the new reality

- Four uneven groups = no problem

- Two uneven groups = problem
  - Capital transfer to make the groups 50/50
  - Only worked well because the groups were approximately the same size
  - Effected through a disproportionate return of dividend
Claims Considerations

• Are your current reserves adequate?
• Who will be paying deductibles/SIRs?
• Anticipate the submission of numerous incidents.
• Ensure that reinsurance reporting is timely.
• Does the departing insured decide counsel selection?
• Will the departing insured maintain consent?
• Will the departing insured maintain a position on the Claim Committee?
• How will existing claims be “run off”? 
The Exit: From the Lawyer’s Perspective

- Reminders about the roles of the parties
- Start with the documents
  - Issues and concerns in some cases
- Know that circumstances change
  - Timing and waivers
- Consider withdrawal agreement if continuing obligations
  - Tail
  - Deductibles
  - Claims run-off
The Aftermath: From the Lawyer’s Perspective

- When the deal is done, step back and think about the RRG as it now exists
  - Restructure, revise if necessary
  - Re-evaluate contracts
  - Reconsider buy-out provisions; run-off costs
  - Allow for flexibility to attract new members
  - Sensitivity testing; volatility

- Governance
  - Streamline operations/governance
  - Review board composition and size
  - Consider succession planning; even more important with fewer members
What Needs To Be Considered: From The Captive Manager Perspective

- Ongoing Financial Viability
- Valuation of Shares
- Notification to Regulators
- Payment of Redemption Proceeds
Ongoing Financial Viability

- Premium Amount
- Capital Amount
- Loss Projections
- Operating Expenses
Valuation Of Shares

- Different Classes of Shares
- Shareholder Agreement
- Adjustment To Loss Reserves
- Letter Of Credit
- Payment Schedule
Notification To Regulators

- Agreements In Draft Form
- Actuarial Review
- Pro Forma Financial Statements
- Actuary Letter Supporting Capital
- Evidence Of Board Approval
- Resignation / Appointment of Directors
Payment Of Redemption Proceeds

- Notify Investment Manager In Advance
- Tax Consequences Of Selling Invested Assets
- Ongoing Compliance With Investment Policy
Lessons Learned:

• We debated our exit strategy from the beginning (have a good and knowledgeable broker to effect this)

• Understand that flux is inevitable

• Figure out how to add new groups to an existing RRG (v. de novo)

• Keep all service providers informed of any changes

• Keep in mind that you will continue to work with the departing member through the run off of their claims
Questions?