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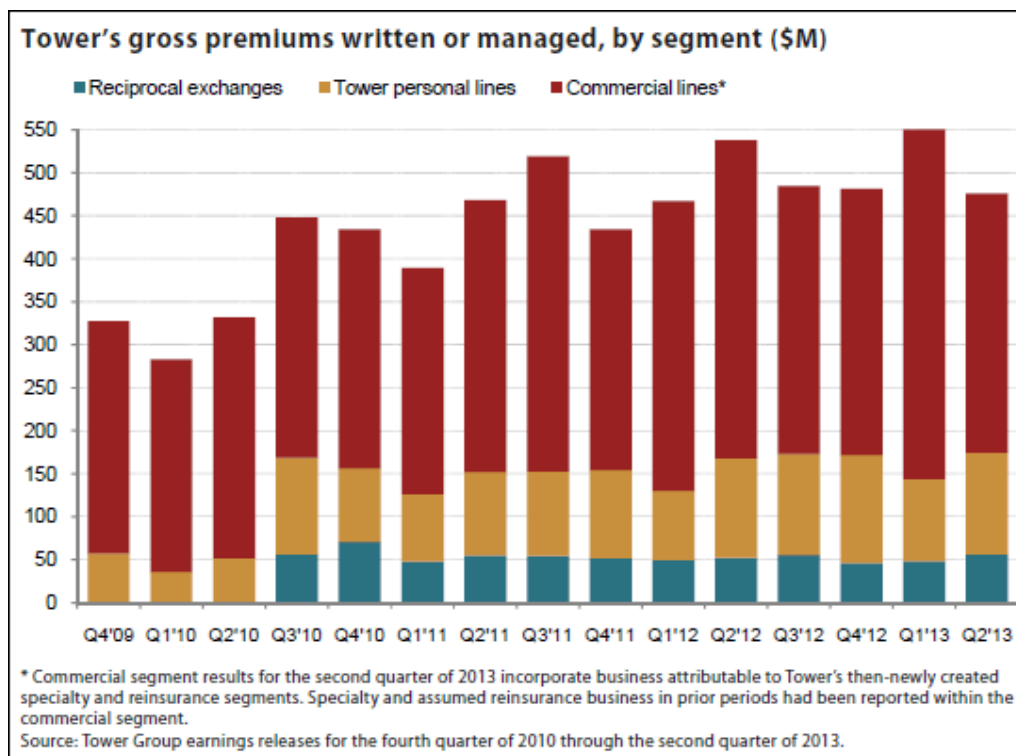
Managers of Tower's reciprocal exchanges part of merger deal

By Tim Zawacki

The future of two [Tower Group International Ltd.](#)-managed reciprocal exchanges is one of the longer-term questions left unmentioned by Jan. 6 announcements of a series of merger, acquisition and reinsurance transactions with [ACP Re Ltd.](#), [AmTrust Financial Services Inc.](#) and [National General Holdings Corp.](#)

A Tower spokesman confirmed that [New Jersey Skylands Management LLC](#) and [Adirondack AIF LLC](#), the attorneys in fact for [New Jersey Skylands Insurance Association](#) and [Adirondack Insurance Exchange](#), would move to [ACP Re](#) as part of the Bermuda-based reinsurer's agreement to acquire the embattled holding company.

Primarily focused on private-passenger auto and homeowners multiperil insurance distributed through independent agents in New Jersey and New York, respectively, New Jersey Skylands and Adirondack Insurance are reciprocal exchanges owned by members rather than Tower and do not serve as part of the company's U.S. property and casualty pool. The Tower-owned attorneys in fact provide underwriting, actuarial, accounting and administrative functions in exchange for a fee of 14% of gross premiums written of the two exchanges and their individual stock company subsidiaries, according to disclosures contained in their 2012 statutory financial statements.



Tower attributed \$56.1 million of its \$174.5 million in gross premiums written and managed by its personal lines segment to the reciprocal exchanges in its [earnings report](#) for the second quarter of 2013, the most recent such document issued by the company. The reciprocal exchanges have accounted for an average of 34.6% of Tower's gross personal lines premiums written and managed and 11.4% of total gross premiums written and managed during the 12 quarters through June 30, 2013, during which they had been affiliated with the company.

Terms of an [agreement](#) between Tower and National General Holdings call for the latter company to acquire the renewal rights and assets of the former's personal lines insurance operations. National General's Jan. 6 news release did not specifically reference the reciprocal exchanges attorneys in fact, and the company's CFO did not return a message seeking comment. The combination of nine Tower stock subsidiaries along with Adirondack Insurance and New Jersey Skylands

generated the \$617 million in direct premiums written that SNL attributed to the Tower U.S. P&C group in 2012, with Adirondack Insurance accounting for the largest amount of business volume associated with any one of the individual entities.

Adirondack Insurance had \$121.9 million of direct premiums written across business lines during the first nine months of 2013, according to SNL, up from \$113.4 million in the year-earlier period. Quarterly statutory data for New Jersey Skylands is unavailable, but Demotech reported on its website that the reciprocal exchange generated \$50.6 million in gross premiums written for the period ended Sept. 30, 2013.

Both reciprocal exchanges own stock subsidiaries: Adirondack Insurance is the parent of [Mountain Valley Indemnity Co.](#) after purchasing the insurer from a Tower subsidiary in 2012; [New Jersey Skylands Insurance Co.](#) is owned by New Jersey Skylands.

Neither stock company generated direct business to speak of in 2012, but Adirondack Insurance reported in the management's discussion and analysis section of its most recent [annual statement](#) that it planned to have Mountain Valley Indemnity begin to write personal lines business in states outside of New York in 2013. The New Hampshire-domiciled stock company, which maintained active licenses in 24 states as of Sept. 30, 2013, reported direct premiums written of a negative \$291 during the first nine months of the year in its latest [quarterly statement](#).

Adirondack Insurance and Mountain Valley Indemnity were the lone entities within the Tower U.S. P&C group as it is constructed by SNL to have reported favorable prior-year loss and loss adjustment expense reserve development for the first three quarters of 2013, a period in which Tower's stock subsidiaries combined to generate \$261.4 million in unfavorable prior-year development, according to SNL.

"As reciprocals focused on homeowners and personal automobile insurance business, they have not been subjected to the loss and loss adjustment expense reserve strengthening that has adversely impacted the commercial lines carriers within the Tower Group," Demotech said upon [indicating](#) in December 2013 that its ratings reviews for New Jersey Skylands, Adirondack Insurance and their stock subsidiaries remained ongoing. The rating agency had withdrawn its ratings for various Tower subsidiaries, citing the combination of the reserve-building and the holding company's "inability to prepare and file reliable, timely financial information." But the two reciprocal exchanges continue to hold financial strength ratings of A.

Adirondack Insurance's policyholders' surplus totaled \$60.9 million as of Sept. 30, 2013, down 0.8% from June 30, 2013, and 10.3% from Dec. 31, 2012. The year-to-date decline resulted from the combination of a \$2.9 million net loss, fueled by a \$9.8 million net underwriting loss, as well as negative changes in deferred income taxes, nonadmitted assets, and unrealized capital gains and losses. The reciprocal exchange's surplus tumbled 16.7% in 2012, in part as a result of losses attributable to Superstorm Sandy. New Jersey Skylands maintained surplus of \$26.3 million as of Sept. 30, 2013, according to Demotech, down slightly from \$26.5 million at year-end 2012. The authorized control level risk-based capital ratios of Adirondack Insurance and New Jersey Skylands on a standalone basis at year-end 2012 were 356% and 518.6%, respectively.

Senior Financial Analyst and Chief Ratings Officer Barry Koestler II told SNL that Demotech has not yet held discussions with the prospective new owner, but he characterized the Jan. 6 announcement as "probably" representing "a positive development."

Robert Warren, Demotech's client services manager, said he anticipates the separation of the reciprocal exchanges' operations from those of its manager's parent company would continue, but he added that the rating agency will be "interested in seeing" whether that remains the case. To the extent Demotech finds "something that causes concern" as it engages in regular monthly reviews of the exchanges' financials, Warren said, the agency would take "fairly immediate action." Otherwise, he said, Demotech expects to "wait and see how it pans out."

The ACP Re deal will put the reciprocal exchanges' attorneys in fact under a third owner since their formation in the 2000s.

Tower acquired New Jersey Skylands Management and Adirondack AIF in July 2010 as part of its [\\$166.6 million purchase](#) of [OneBeacon Insurance Group Ltd.](#)'s personal lines business. Also transferred in that transaction were the \$70.7 million surplus note issued by Adirondack Insurance to [Homeland Insurance Co. of New York](#) and a \$31.3 million surplus note issued by New Jersey Skylands to [Camden Fire Insurance Association](#). The notes had been used as initial capitalization for the two reciprocal exchanges.

In conjunction with the 2010 transaction, Adirondack Insurance cancelled the existing note and issued five new notes in an aggregate face amount equal to the value of the original Homeland note to [Tower Insurance Co. of New York](#), [CastlePoint Insurance Co.](#), [Hermitage Insurance Co.](#), [CastlePoint National Insurance Co.](#) and [CastlePoint Reinsurance Co. Ltd.](#) The latter entity purchased the New Jersey Skylands note from Camden Fire.

Adirondack Insurance ranked as the 23rd-largest U.S. P&C company structured as a reciprocal exchange, based on 2012 net assets. [United Services Automobile Association](#), [Farmers Insurance Exchange](#) and [Erie Insurance Exchange](#) ranked as the three largest and, arguably, best known entities to employ that structure.

USAA has a downstream attorney in fact; [Farmers Group Inc.](#), a Zurich Insurance Group Ltd. company, serves as the attorney in fact to the Farmers exchange; the publicly traded [Erie Indemnity Co.](#) is managing attorney in fact for the Erie exchange.