Property Casualty Intelligence Briefing

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MAIDEN TO STAKEHOLDERS: DROP DEAD

Last week, Maiden announced a series of "strategic transactions", with more details released in a characteristic 10-Q dump after markets closed for the weekend. On Monday, it added a press release claiming the transactions had "materially strengthened" its capital position.

In many ways, this is an interesting case study of just how efficient markets are once you get into the micro-cap space. Following a horrific sequence of losses, Maiden has a market cap of just $42mn despite a ~$5bn balance sheet. However, it also has $465mn of preferred securities, $263mn of face value debt outstanding.

The firm also remains a crucial lynchpin in the complicated and intertwined AmTrust/Enstar industrial complex. To date, Enstar has completed 3 run-off transactions with AmTrust or Maiden, and is a ~7% investor in the re-capitalized private AmTrust holding company Evergreen parent, leading to an incredibly complex set of competing and conflicting interests for stakeholders across the various groups.

Our view is that Maiden's latest actions include some questionable transactions that appear to transfer value away from Maiden's stakeholders to related-parties with limited benefit obvious to us. We are frankly surprised that an independent and non-conflicted fiduciary would sign them off. And recall, this is not even the first time *this year* this has happened, raising significant questions about whose interest the firm is being run for. Details below.

Indeed, the fact the firm took the additional step of press releasing these transactions as achievements, rather than just burying them in a securities filing is hard for us to understand. It speaks to a "purloined letter" approach to evidencing these decisions in plain sight, which seems in line with the firm's frank and rather delightful disclosure in its own securities filings that it could pursue a strategy that "might not be in our best interest" due to the conflict of interests of its principals.

With an ultimate bankruptcy possible in our view, we think it is reasonable to assume these transactions may be at risk of challenge for fraudulent conveyance by some of Maiden's stakeholders. We note the firm already has an activist following the non-payment of its preferred dividends that shows at least one counterparty taking proactive action. Similarly, if the firm does not begin making payments on its preferred securities soon, its preferred holders will have the right to elect two independent directors to the board in 2020, which could act as a catalyst for pro-active protection of Maiden's stakeholder's interest.

The transactions also raise serious questions for **AmTrust** and its private equity backers **Stone Point Capital** and run-off firm **Enstar**. Make no mistake about it, these transactions this year have waded pretty heavily into a murky grey area. Recall, AmTrust also recently burned its preferred security holders by delisting them following the completion of its go-private deal. Assuming that AmTrust's PE backers will eventually want a public market exit, one can only assume these series of stakeholder-burning actions are premised on an assumption that capital markets have a short memory.

Finally, our view is that this raises questions about Bermuda as a serious regulatory jurisdiction. In some ways, we understand the laissez-faire attitude. After all, Maiden essentially only has one insurance counter-party: AmTrust. As such, a transfer of value from Maiden to AmTrust does not harm its net claims paying ability, only its other stakeholders. That said, it is a fairly bad look for Bermuda as a serious domicile for reinsurance business to be so blasé about it.

INSIDE P&C RESEARCH

Gavin Davis, Director of Reserach
gavin.davis@insidepandc.com
(212) 224 3328

Dan Lukpanov, CFA, Research Analyst
dan.lukpanov@insidepandc.com
(212) 224 3326

Gianluca Casapietra, Research Analyst
gianluca.casapietra@insidepandc.com
(212) 224 3495

Index	QTD	YTD
Large Cap	1.1%	22.5%
Regional	(0.2)%	12.0%
Specialty	3.1%	23.0%
Personal	(5.0)%	16.2%
Bermuda	4.7%	31.2%
Florida	(7.4)%	(23.4)%
IPC Select	(1.0)%	9.1%
S&P 500	(3.2)%	13.6%
S&P Fin.	(5.8)%	9.2%

Source: S&P Global, Inside P&C

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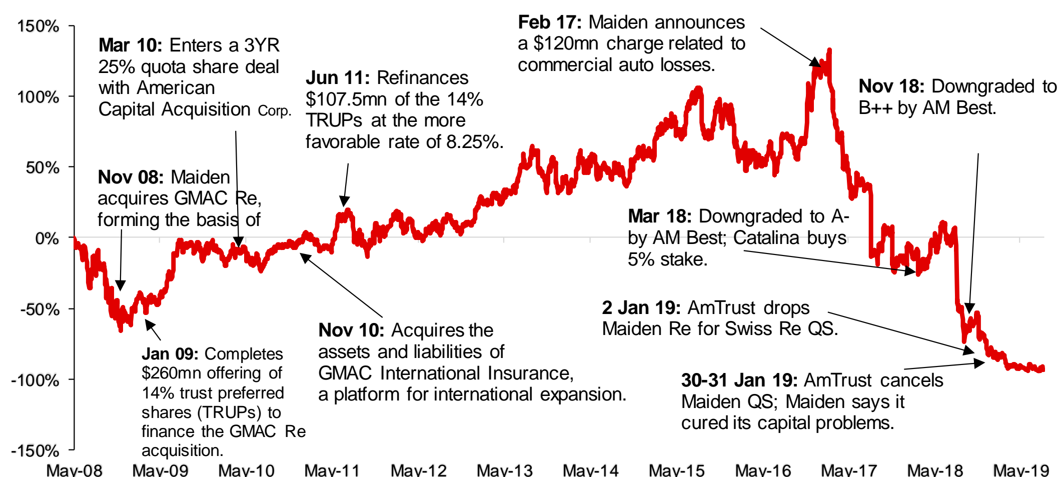
In many ways, this is an interesting case study of just how efficient markets are once you get into the micro-cap space. Following a horrific sequence of losses, Maiden has a market cap of just $42mn despite a ~$5bn balance sheet. Even so, it has $465mn of preferred securities, $263mn of face value debt outstanding.

EXHIBIT: MAIDEN SHARE PRICE PERFORMANCE AND TIMELINE

Source: Company reports, SNL, Inside P&C



Recall, Maiden is in a pretty bizarre situation. Its founding shareholders the Karfunkel-Zyskind family still own ~20% of the company (though now a nominal value relative to other conflicted holdings) and Barry Zyskind is chairman.

Arguably, historically the family has been able to wield *de facto* control over the company by the fact that it controlled AmTrust Financial (where Zyskind is CEO), which was the source of 70-100% of Maiden's premiums for most of its existence.

Even so, with Maiden now in run-off, and having sold its third party book, the firm's near entire source of value is a zero sum game *against* AmTrust Financial.

If the firm was run for the benefit of Maiden's common equity holders, preferred equity holders, or debt holders alone, the optimum strategy would likely be to adopt an *adversarial* stance with AmTrust and manage down its liabilities as much as it can – either through challenging claims, litigation, or slowing payments.

In fact, in many ways, many of Maiden's stakeholders would arguably be better served by bankruptcy and liquidation and some brinkmanship in its claims settling with its #1 counterparty AmTrust. It's a fairly safe bet in our view that's how Enstar would run the company more like this if they owned 100% of it and none of AmTrust (Enstar owns ~7% of AmTrust).

Note, this conflict of interest is rather delightfully disclosed in Maiden's 10-K:

> *"The interests of our significant shareholders may not be fully aligned with our interests, and this may lead to a strategy that is not in our best interest," the firm told its own shareholders."*

We suppose upfront disclosure is one form of defense, but we're not sure it's a particularly good one.

Indeed, our view is that a couple of the transactions announced represent a significant transfer of value away from Maiden to other related party companies in the Karfunkel insurance industrial complex.

For it to be viewed as improving the firm's true economic capital position relies totally upon ignorance. Perhaps the accounting metrics have improved in some box-ticking way, but economically, we struggle to think how these could be thought of as economically positive for Maiden

Though the company announced a series of transactions, we are going to focus on just two.

1) **The loss corridor:** Maiden announced a post-termination endorsement to cap the max value of "loss corridor" on the quota share contract between Maiden and AmTrust covering specialty program business. The cap occurred at $40.5mn, or the value of carried reserves at Maiden.

2) **Workers' comp commutation:** A commutation of certain workers' compensation reserves that was settled at $331mn, essentially the level of carried reserves on the business, less paid claims since the last balance sheet date. Maiden also paid an additional $6.1mn in interest related to the commuted reserves to reflect the time value of money between 1 January 2019 and the transaction closing date.

At first blush, both of these transactions may seem like nothing-burgers (both settled at "carried reserves" = seems reasonable). However, a closer inspection raises significant questions.

Before we begin however, it is worth noting these transactions are not the first time that Maiden has taken actions this year that appears wildly at odds with its stakeholders interests but that seemed to benefit AmTrust.

Recall in January the firm agreed to pay a 5% higher ceding commission for its AmTrust quota share. This decision came after years of horrendous, company-destroying results and a flood of yet-settled adverse development.

Significantly, it also came after the business mix ceded appeared to have been significantly worsened by AmTrust completing a separate quota share deal for the majority of its book with Swiss Re that excluded its worse performing lines, including commercial auto.

The Maiden deal, with the higher cede, appeared to be for the remaining book with a worse mix.

This deal was ultimately canceled less than a month later, in part because of Maiden's capital position. However, it is worth noting the increase in ceding commission was applied retroactively and therefore represented a significant cost (~$400mn UEPR X 5% increase in cede = ~$20mn cost to Maiden).

Ultimately, it signals significant questions around the decision making at Maiden, and whose interest the company is being run in – per the company's own risk disclosures.

Loss corridor background

Long suffering devotees to Maiden's story will recall that loss corridor is one of the only major sources of possible value left at Maiden. For perspective, a term of the Enstar-Maiden LPT transaction explicitly stated that Maiden could not alter the terms of the loss corridor unilaterally without Enstar's approval.

Recall, the loss corridor relates to the specialty program part of the AmTrust quota share only.

This clause meant that if the inception to date loss ratio for the specialty program business exceeded 81.5% then the losses would stay with AmTrust until the loss ratio exceeded 95%, when they would be shared again pro-rata in line with the quota share agreement.

Note that the loss corridor excluded workers comp premiums from 2007 to 2012 making a precise estimate of the potential value of the loss corridor impossible.

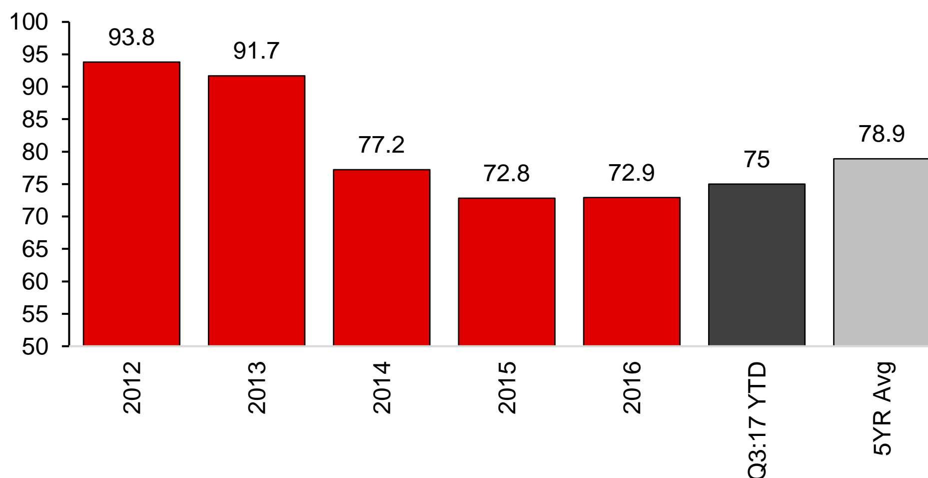
However, the minimum earned premium base on 2013-Q2:19 is $1.7bn, based on Maiden's 10-K filings. We estimate non-workers comp was around 60% of the specialty program business based on other 10K disclosure (reserve triangles). To be conservative, we are calling it 50%. This provides another $172mn of premium subject to the loss corridor, for a range of $1.7bn to $1.9bn.

Therefore, the max potential recovery on the loss corridor is conservatively estimated at $234mn to $258mn (13.5% x $1.7-$1.9bn). Subtracting the $40.1mn capped value, that leaves potential value given up of $195mn to $218mn.

Of course, this is only potential value given up, and one plausible defense of the transaction is that it was unlikely to be triggered. However, given adverse development trends at AmTrust and the level of loss ratios at more developed years, this seems implausible that this could be considered a remote risk.

Though separate results have not been consistently disclosed, we note that a Q3:17 filing by AmTrust revealed horrific results on more mature and developed accident years in specialty program.

EXHIBIT: AMTRUST SPECIALTY PROGRAM LOSS RATIOS DISCLOSED Q3:17



Maiden has subsequently disclosed adverse development in its AmTrust segment, consistently citing specialty program business and commercial auto.

Now we don't have full data. But it does not take a master's degree in actuarial science actuary to see the direction of traffic for development on the AmTrust book has been wildly negative. And any industry observer knows that adverse development tends to be serially correlated ("bad years get worse").

Without any other data, it seems implausible that anybody would want to give up the option value of waiting for the book to mature – given that the $40.5mn of carried reserves shows that management is already assuming pretty bad things.

Note that the firm's disclosure points to the fact that development above the loss corridor will be picked up by the Enstar loss portfolio transfer and adverse development cover. However, the firm only has an ADC with $155mn value, and the specialty program book is only a small portion of its outstanding liabilities.

The ADC can only be consumed once, and therefore any development elsewhere would be eaten by Maiden's stakeholders, starting with its common and preferred equity holders.

Our view of the ADC is that it's priced for a total loss anyway. Therefore, we're not sure what this transaction does other than put further development on the specialty program book with Maiden's stakeholders (e.g. pref holders) rather than AmTrust's shareholders (e.g. the Karfunkel-Zyskind family, Enstar-backer Stone Point Capital, and Enstar).

And finally, it is worth making this clear. There was no apparent consideration for the substantial potential value given up, nor any explicit explanation of why it was done at zero consideration.

Workers compensation commutation

Recall, the second transaction we wanted to flag is a commutation of certain workers' compensation reserve that was settled at $331mn, essentially the level of carried reserves on the business, less paid claims since the last balance sheet date. The transaction did not impact the specialty program segment.

Maiden also paid an additional $6.1mn in interest related to the commuted reserves to reflect the time value of money between 1 January 2019 and the transaction closing date.

This seems at least questionable to us. In P&C insurance, reserves are carried on the balance sheet at their future value. This is why nearly all comparable run-off transactions are done at significant discount, reflecting the time value of money.

Below, we highlight Berkshire Hathaway run-off transactions, typically priced at around 50% of ultimate liabilities ("nominal RoL"). These are by no means perfect comparisons, but illustrate the point

Past retroactive transactions – Berkshire Hathaway

	Century/ Ace	Potomac/ OneBeacon	Equitas	Equitas Option	Equitas Combined	CNA	AIG	Utica Mutual	Liberty Mutual	The Hartford	AIG – announced Jan-17 retroactive to Jan-16		
Transaction parameters	**Jun-99**	**Jun-01**	**Nov-06**	**Jun-09**	**Jul-09**	**Jul-10**	**Apr-11**	**Sep-12**	**Jul-14**	**17-Jan**	**As of YE 15**	**As of YE 16**	**Note**
Form of transaction	HYBRID	LPT	LPT	ADC	LPT	LPT	LPT	LPT	HYBRID	ADC	Hybrid - 80% Placed	Hybrid - 80% Placed	
Lines Covered	A&E	A&E	A&E	A&E	A&E	A&E	A&E	A&E	WC + A&E	A&E	Casualty ex A&E	Casualty ex A&E	
Cedant net reserves	3,550	955	8,100		8,100	1,600	1,850	236	15,800	1,700	35,700	41,000	(a)
Attachment	2,300	0	0	13,800	0	0	0	0	12,500	1,700	25,000	25,000	
Attachment as a % of reserves	64.8%	0.0%	0.0%	170.4%	0.0%	0.0%	0.0%	0.0%	79.1%	100.0%	70.0%	61.0%	
Limit provided	2,500	2,500	13,800	1,300	15,100	4,000	3,500	na	6,500	1,500	25,000	25,000	(b)
Limit as a % of reserves	70.4%	261.8%	170.4%	16.0%	186.4%	250.0%	189.2%	na	41.1%	88.2%	70.0%	61.0%	(b)
Exhaustion	4,800	2,500	13,800	15,100	15,100	4,000	3,500	na	19,000	3,200	50,000	50,000	(b)
Exhaustion as a % of reserves	135.2%	261.8%	170.4%	186.4%	186.4%	250.0%	189.2%		120.3%	188.2%	140.1%	122.0%	(b)
Reinsurance premium	1,250	1,322	7,100	66	7,166	2,000	1,650	241	3,000	650	12,250	12,750	(b), (c)
Premium as a % of reserves transferred	100.0%	138.4%	87.7%	0.8%	88.5%	125.0%	89.2%	102.1%	90.9%	na	114.5%	79.7%	(b)
Nominal ROL	50.0%	52.9%	51.4%	5.1%	47.5%	50.0%	47.1%	na	46.2%	43.3%	49.0%	51.0%	
Estimated pricing metrics													
Reserves ceded	1,250	955	8,100	0	8,100	1,600	1,850	236	3,300	0	10,700	16,000	(b)
Treasury rate as of transaction date	6.0%	5.4%	4.6%	na	4.6%	3.0%	3.5%	1.6%	3.0%	2.45%	2.62%	2.62%	
Present value of ceded reserves	519	565	5,181		5,181	1,195	1,317	202	1,824	na	7,265	10,863	(b)
Implied risk premium (RP less PV of ceded)	731	757	1,919		1,985	805	333	39	1,176	650	4,985	1,887	(b)
Limit provided excess of carried reserves	1,250	1,545	5,700		7,000	2,400	1,650	na	3,200	1,500	14,300	9,000	(b)
Calculated risk ROL	58.5%	49.0%	33.7%		28.4%	33.5%	20.2%	na	36.8%	43.3%	34.9%	21.0%	

All figures $mn
All figures based on publlicly available data from Annual Statement filings and press releases.
(a) Carried Reserves at YE 15 of $35.7b + 2016 adverse development of $5.3b
(b) Figures presented on a 100% basis
(c) Includes $0.5b of interest from January 1st, 2016 and December 31st, 2016.
Source: Willis Re

Of course, a simple interpretation here is that both parties are expecting significant adverse development on the carried reserves.

Back of the envelope math assuming a 10-12 year tail implies the economic present value of the reserves are closer would be around $60-65mn lower. This is either a transfer of value from Maiden to AmTrust, or raises significant questions about Maiden's reserve disclosures to investors. Indeed, the additional interest rate payment for the six month period that Maiden held the reserves, with no corresponding assessment of the likely 10-12 years AmTrust will, seems questionable.

Note, Maiden announced it had received a letter of no objection from the Bermuda Monetary Authority.

In some ways, we understand the laissez-faire attitude. After all, Maiden essentially only has one insurance counter-party: AmTrust. As such, a transfer of value from Maiden to AmTrust does not harm its net claims paying ability, only its other stakeholders. That said, it is a fairly bad look for Bermuda as a serious domicile for reinsurance business to be so blasé about it.

This research report was written by Insider Publishing's Research team which includes Gavin Davis, Gianluca Casapietra, and Dan Lukpanov.

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