



How to Avoid Swimming with the Sharks

BY GARY VUCEKOVICH

Acquiring this B.S. (doesn't stand for Bachelor of Science), required using a lot of big words like Insolvency, Co-mingling of Funds, Special Deputy Receiver, and Liquidator, who it turns out is sort of like the Terminator.

It started one day as I opened the daily mail in my office at Foresight Services Group (FSG). The first letter was from the Third Judicial District Court of Salt Lake City, Utah. It screamed at me in bold print:

WESTERN INSURANCE COMPANY NOTICE OF ISSUANCE OF LIQUIDATION ORDER.

Well, I recently earned another "honorary degree" from the school of hard knocks, this one in the insurance industry. I thought my other honorary degrees from that school were expensive until now.

It was quite a contrast to my first meeting with the senior management and officers of Western Insurance Company (WIC), less than five years before. At the time, they sported an impressive A.M. Best rating of A- (Excellent). I distinctly recall us gathering in a conference room, much fancier than the one I have at FSG, to discuss a possible business relationship.

FSG reinsures mechanical breakdown service contracts 100% for auto dealers, and the first topic I brought up was to insist that under any agreement, all monies would flow directly from dealers to FSG. We would remit fronting fees to WIC and the dealer's premium

would go straight into a fully segregated trust account held by a **dealer-owned reinsurance company**, one with its own Federal Tax ID and managed by a non-affiliated national bank. Over the course of the full-day meeting, we hammered out the details.

Four years later, WIC was declared insolvent and ordered into liquidation. By then we had set up on behalf of our dealer-clients 17 separate reinsurance custodial trust accounts totaling millions of dollars. What would be the fate of these accounts? Might they be added to WIC's general assets? Would FSG and our clients be made to circle around with other claimants like sharks, waiting for the almighty Liquidator to dole us out a morsel?

It was December 29, 2011 when the decision came down. The Liquidator's investigation had found that our dealer-clients' assets were indeed in properly segregated accounts held pursuant to tri-party agreements. WIC did not control but could only seek distributions from these accounts. As such they should not be considered part of the general assets of WIC's estate. The court agreed and released the funds to their proper owners.

Cue the scene at the end of one of those big legal movies, where everyone comes out of the courtroom cheering. It was, indeed, a big victory for FSG and our dealer-clients. You may even be thinking: 'Gary, that lesson wasn't expensive at all. You came out unscathed.' Read on.

Just prior to leaving that fine conference room at WIC, I was asked to deposit \$100,000 as good-faith security. Fair enough, I thought, but insisted the money be placed in a CD earning interest for FSG. I guess I should have been suspicious when they responded by offering me a CD with a great interest rate through Western Thrift & Loan, a bank associated with, you guessed it, WIC! But hindsight is always 20/20. And I certainly don't recall giving WIC permission to cash the CD and deposit the money in their own account in 2010, which according to the Special Deputy Receiver's attorney is exactly what they did. As I understand it, the individual responsible is now retired somewhere in Hawaii.

Said attorney also mentioned that I was "not the first Western customer that has experienced this type of loss due to Western's failure to segregate funds." My only course of action was "to file a claim with the Liquidator." In other words, start circling with the sharks.

Despite this, I still feel fortunate. There was another company in the WIC liquidation that operates similarly to FSG. They did everything above board and proper, with the exception of having premiums sent directly to WIC. Ouch!

Retro Participation Agreement or Dealer-Owned Reinsurance Company? For most dealers it's a no-brainer!

I have more than 30 years experience in the automotive industry, and 15 years of reading various Retro Participation Agreements. These started as a genius idea for an insurance

company to expand its market share while allowing dealers to share in back-end profits. But today, whether the agreement is provided by an Administrator or insurance company, there is simply a better wealth building structure available. It is called a **Dealer-Owned Reinsurance Company**. My cell phone may start ringing like crazy for saying this, but it's my opinion that Retro Agreements have outlasted their value for all but the smallest of dealers (for whom maintaining a dealer-owned reinsurance company would be cost prohibitive).

Given my experience with WIC, the most glaring concern of Retro Agreements is co-mingling of premiums and reserves to pay future claims. I do not know of a single Retro Agreement available that would prevent a Liquidator from grabbing funds and giving them out at pennies on the dollar if the Administrator or insurance company is declared insolvent.

Having survived 2008 and 2009, I've become more skeptical of companies who tout their history of financial strength and high A.M. Best ratings. Remember AIG? No company can stay on top forever.

In the case of WIC, their undoing had nothing to do with the auto industry. That was the most profitable part of their business. The problem was the Surety Bonds they were issuing for construction projects in states like Nevada and California.

Who has time to audit every aspect of the insurance companies they do business with? That was what ratings were supposed to be for!

Fifteen years ago, I didn't even know how to spell Retro Agreement. But I entered into one anyway. The \$21,000 in back-end profits sure looked like a fine number, but it eventually evaporated into the "terms and conditions" spelled out in the agreement. In my opinion, stipulations such as minimum production, loss ratios, notice of termination and lapse in production often hold the dealer captive or open loopholes which swallow the dealer's share of profits.

I learned my lesson, and five years ago got to apply it by insisting on a full reinsurance structure for my clients as we began our relationship with WIC. I hate to think where I would be now if I hadn't done that. It shows that "honorary degrees," while expensive, can turn out to be worth every penny. ■

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