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Hallmark confirms deal with Core Specialty to sell E&S operation for $59.9mn

Jairo Ibarra *October 7, 2022*

Hallmark Financial has struck a deal to sell its E&S operation to Core Specialty for $40mn in cash, plus a ~$19.9mn consideration for the acquisition costs related to some net unearned premium reserves.

The news follows this publication's report earlier this week that the companies were in late-stage discussions for Hallmark's ~$450mn specialty portfolio.

The transaction includes nine business units that operated within Hallmark's specialty segment and the transition of 200 E&S employees, but it excludes any loss reserves associated with the acquired E&S businesses, which Hallmark will retain.

Hallmark will also retain its commercial and personal lines divisions, its aerospace unit, the exited binding primary auto segment and any business produced by third-party program managers.

The deal with Hallmark will take Core to almost $1bn of E&S premiums on a pro forma basis, making it among the 20 largest surplus lines writers, based on AM Best figures.

It is understood that the portfolio Core has acquired in this deal spans excess casualty, specialty property, commercial auto, financial lines and healthcare – all areas where Core already plays.

Through the transaction, Hallmark's subsidiaries will enter a quota share reinsurance agreement with a Core subsidiary to assume 100% of Hallmark's unearned premium reserves associated with the acquired E&S businesses, net of third-party reinsurance.

The agreement also includes the acquisition of Hallmark's agency subsidiary Heath XS, which operates as Hallmark E&S, and all data, agency relationships, intellectual property, lease arrangements and personnel related to the acquired E&S unit.

With the procedures, Hallmark said it expects to increase its statutory capital and to strengthen its balance sheet. The deal is effective September 30. Raymond James advised Hallmark on the deal and Olshan Frome Wolosky served as legal counsel.

AM Best rating action

Immediately after Hallmark confirmed the deal, AM Best placed the carrier's insurance subsidiaries' A- financial strength rating and a- long-term issue credit ratings (ICR) under review with negative implications. The ratings agency argued the transaction exposes Hallmark to potential adverse reserve development from its commercial auto book of business.

Further, AM Best noted that the deal "mitigates a material capital decline" in 2022, related to significant adverse reserve development on an existing loss portfolio transfer (LPT).

That legacy deal took effect January 1, 2020, for accident years prior to December 31, 2019, with several Darag subsidiaries on Hallmark's commercial auto liability policies up to an aggregate $240mn, AM Best said.

The agency added that in the legacy deal, Hallmark resumed the handling of the claims administration function effective August 2022 and is in arbitration with respect to the overall contract terms.

"In the event that the arbitration panel rules favorably on Hallmark's behalf, Hallmark could potentially attach up to $40mn from a letter of credit posted by Darag, but the final decision is not expected until the second half of 2023," AM Best said.

"While a favorable decision with the existing transaction will help stabilize the balance sheet, AM Best notes that the LPT cover has been breached and is no longer available, which exposes Hallmark to further potential adverse reserve development from the book of business," the agency added.

AM Best also put Hallmark Financial Services' a- long-term ICR under review with negative implications.

The agency added that "significant execution risk remains related to restoring profitability across Hallmark's retained lines, particularly standard commercial insurance and personal nonstandard auto, which have had historically high net underwriting loss ratios".