

Global Insurance Run-off Survey

2018

In conjunction with:



www.pwc.com/globalinsurancerunoffsurvey

Foreword

Welcome to the latest edition of our Survey of discontinued non-life insurance business. Many of you will be familiar with our Survey and we're pleased to have expanded our horizons this year to incorporate a more global look at the run-off industry. We are delighted to continue publishing the Survey in conjunction with IRLA, and this year also welcome AIRROC's involvement from a US perspective.

I have been struck in recent years by the growing recognition amongst our clients of the benefits of pro-actively managing legacy books and operations. In doing so, they are seeking to meet a number of objectives including releasing capital, managing costs and exiting legacy lines that often distract attention from core underwriting goals.

Consequently the level of non-life run-off market activity has increased significantly. There is now an established and sophisticated band of run-off acquirers and their work increasingly forms an accepted component of the insurance lifecycle, offering a range of solutions to (re)insurers looking to deal with legacy business. A number of (re)insurers have also established specialist run-off teams to extract value and, in some cases, as a precursor to disposals.

Recent editions of the Survey have illustrated that legacy business is no longer confined to long-tail asbestos and environmental liabilities written many years ago. The transparency provided by Solvency II, perhaps with added momentum from IFRS 17 reporting, as well as the interest in new restructuring tools in the US and Brexit planning across Europe, are all shining a light on non-core business of much more recent vintages.

The market is attracting new capital and we continue to see significant interest in run-off acquisition, particularly in Continental Europe and the US. The Asian run-off scene is clearly less developed. The key themes emerging from our Survey underline that the momentum of recent times is set to continue for the foreseeable future. This appears to be the case irrespective of Brexit developments in Europe and the success or otherwise of legislative and regulatory changes in the US.

I hope you enjoy reading our Survey and encourage you to reach out to Dan Schwarzmann, Andy Ward or Alan Augustin in our UK Liability Restructuring team to discuss any questions you have with respect to legacy issues.

Stephen O'Hearn
Global Insurance Leader, PwC Switzerland



Stephen
O'Hearn,
PwC
Switzerland



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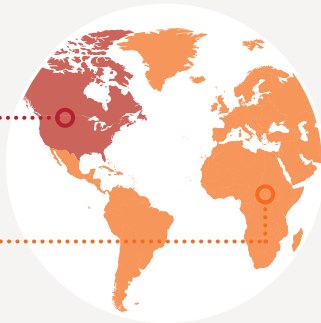


Key findings

Respondents to our Survey emphasised what our clients tell us and what we are seeing in the market – run-off and legacy management are at their most active for many years. Transaction flow in 2017 has been strong, mirroring that of 2016, and the pipeline of deals is set to continue into 2018 and beyond. For the first time our Survey includes an estimate of the size of the global run-off market, suggesting that total non-life run-off liabilities exceed US\$700bn.

The value of the North American run-off market approximately equals that of legacy liabilities for the rest of the world.

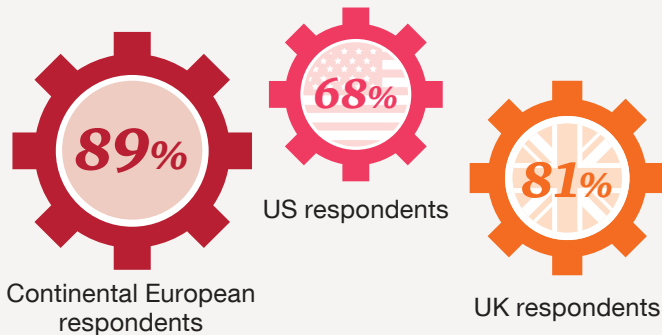
North America
US\$350bn



Rest of the world
US\$380bn

Source: PwC

A significant proportion of Survey respondents in core territories think it likely or highly likely that they will undertake restructuring or exit activity in the next three years.



Source: PwC

Key run-off objectives cited by respondents are consistent with our previous Survey. Adverse loss development has risen to be the primary challenge to the achievement of respondents' run off plans. The regulatory environment and access to exit mechanisms are also prominent challenges. It was encouraging to see Board level engagement for Legacy business drop out of the top three challenges since our last survey.



Run-off objectives

- 1 Orderly run-off
- 2 Releasing capital
- 3 Early finality

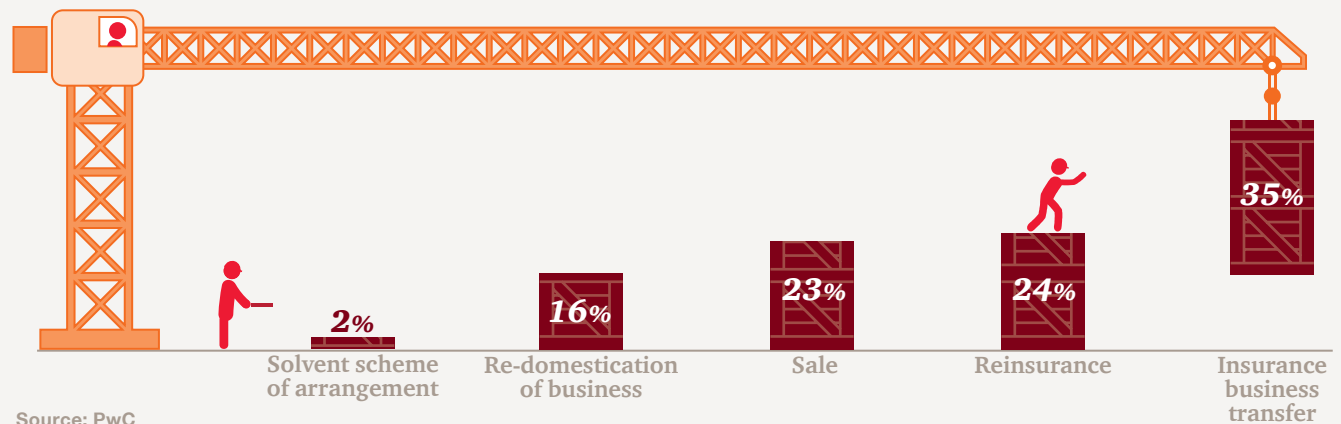
Source: PwC



Challenges to successful achievement of objectives

Source: PwC

Over a third of all respondents expecting to undertake restructuring activity in the next three years anticipate using insurance business transfers (IBT). This includes 41% of US respondents, despite a US IBT mechanism remaining untested.



Source: PwC

A number of factors were cited by respondents as likely to impact the run-off market in the next two years. In the US, insurance business transfers were predicted to be influential whilst UK respondents were more concerned by the impact of political uncertainty, including Brexit, than their Continental European counterparts.

Respondents were asked to consider disposals in 2018 and 2019, including their likely number and value. In terms of the number of deals, Continental Europe is expected to be the most active territory, followed by the UK and US. Larger average deal sizes are anticipated in the US compared to Europe and respondents expect a wide spread of liability types to be included within these disposals.





Nick Watford, PwC UK



Hannah Vaughan, PwC UK

The size of the global run-off market

In this eleventh edition of our Survey we have expanded our view of the run-off market beyond the UK and Continental Europe and estimate global run-off liabilities to be US\$730bn. In particular we have taken a closer look at the US. Unsurprisingly, the US dominates the global run-off market in terms of both new and latent claims run-off. We estimate that it currently has a value of US\$335bn. This compares to our estimate of the current value of run-off in the UK and Continental Europe of approximately US\$275bn, which appears to have remained broadly stable over the last 12-18 months. Our wider review in this Survey also suggests that there is material run-off business across the Asian and South American markets, with liabilities in run-off of approximately US\$80bn and US\$15bn respectively.

US

The US, being a very well-established and mature insurance market, accounts for a material proportion of our estimate of the global value of run-off liabilities. It is important to note that a very significant value of total gross written premiums in the US are associated with long term healthcare costs. However, we have excluded the value of long term healthcare from our analysis of non-life run-off in the US due to the complexity of the US healthcare system and ongoing uncertainties concerning its current status. If the value of health insurance run-off liabilities had been included, it is likely that our US reserve estimates would have approximately doubled in size.

Our estimate of run-off liabilities in the US is driven by general liability, accident and financial loss, and motor insurance. However significant latent claims run-off liabilities remain, being held predominantly by primary insurance carriers and various excess layer (re)insurers.

Survey respondents have noted that their interest in transactions, capital efficiency and potential finality solutions for run-off management in the US continues to grow. These responses seem to indicate that the significant levels of US run-off liability are going to draw increasing attention from owners and acquirers of legacy liabilities for some time to come.

This is the first time we have included an assessment of the US market in our Survey and it will be fascinating to observe how the size and nature of the US market changes over the coming years.

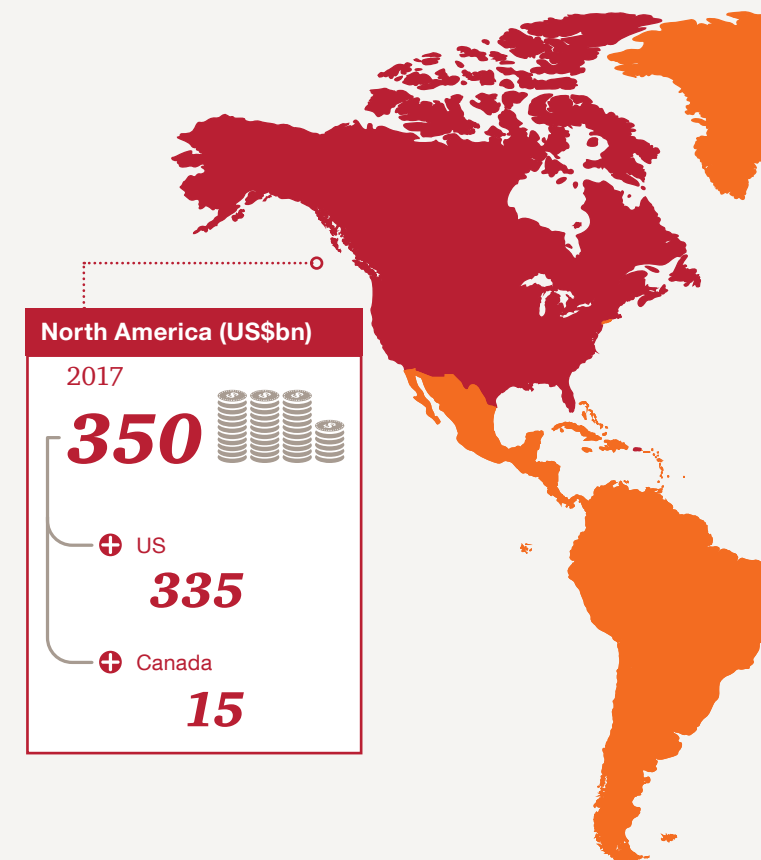
Europe

Figure 1 shows our run-off reserves estimates by territory, together with those from our previous Survey. As before, the dominant markets are Germany and Switzerland, which are driven by a small number of major global reinsurers. A significant part of the German and Swiss run-off market still incorporates latent claims run-off, and these reserves emanate mainly through the reinsurance of US and UK exposures.

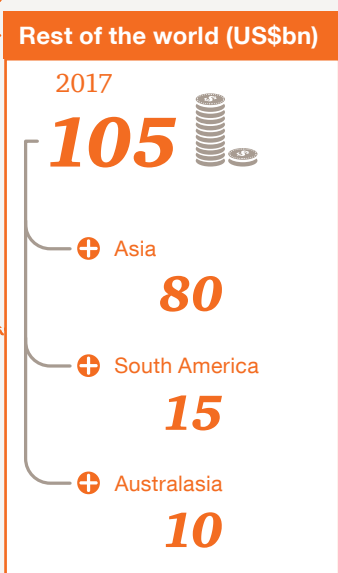
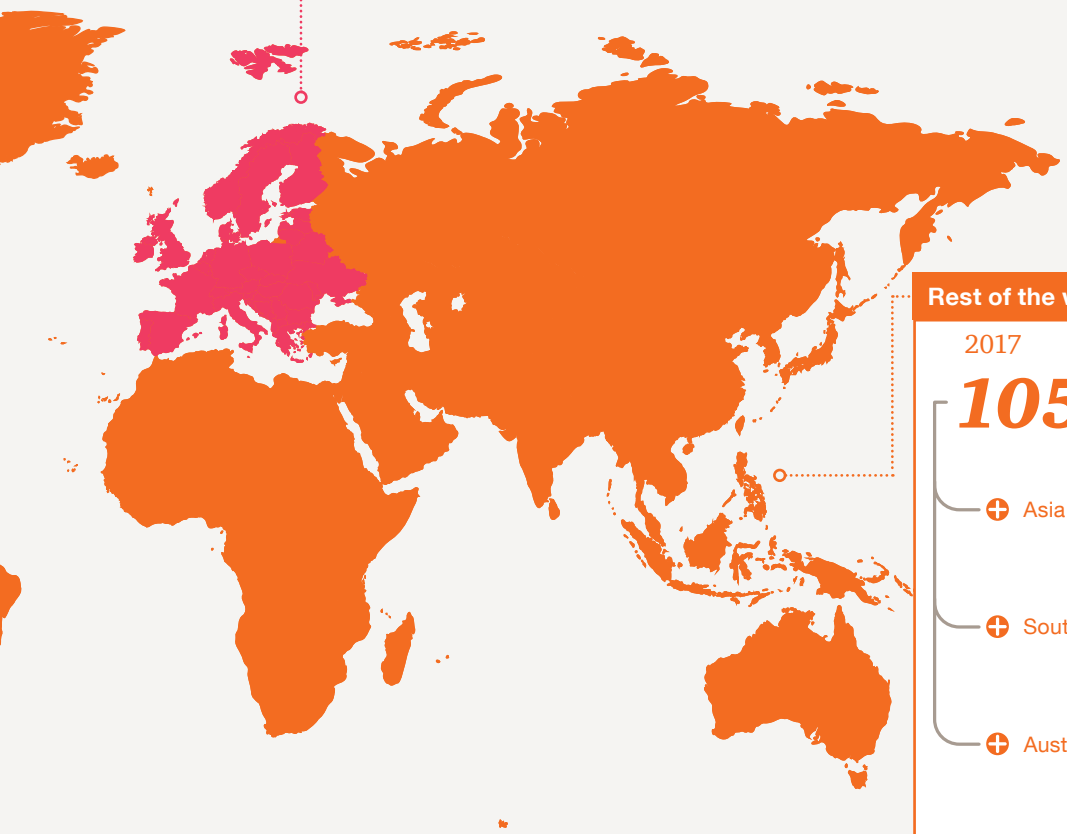
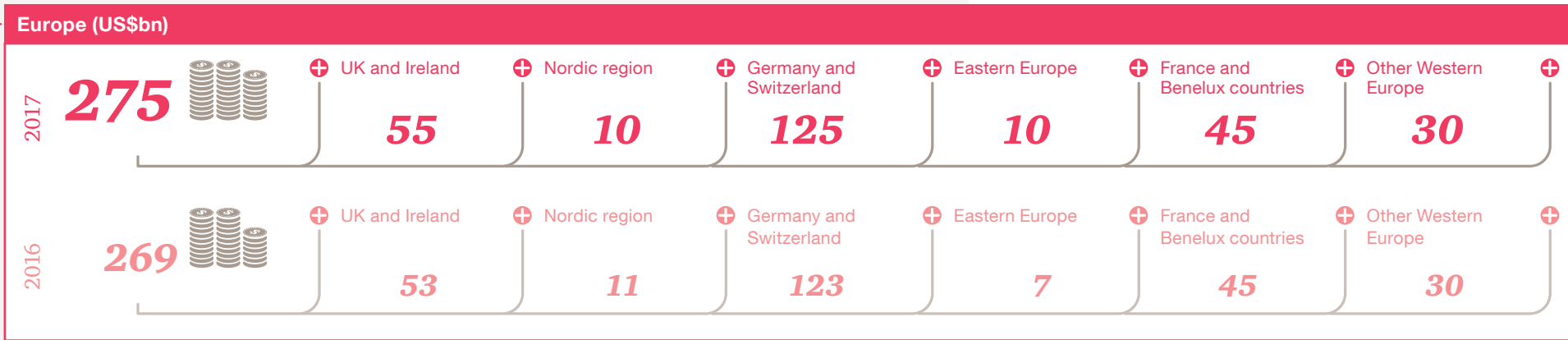
There are significant Continental European run-off liabilities associated with motor and health insurance. Western Europe also has material levels of run-off associated with accident insurance, including losses arising from industrial injury and occupational diseases. The UK is the only territory with any material financial lines run-off business, with these being concentrated within the London Market.

Over the last year, the susceptibility of run-off portfolios to economic and political influences has been even more apparent. For example, the estimate of the size of run-off liabilities in the UK and Ireland has increased from last year, partially as a result of the ongoing uncertainty around the Ogden discount rate. It is not yet clear what impact Brexit will have on the value and location of European run-off in the coming years.

Figure 1: Run-off reserve estimates



Source: PwC



The rest of the world

Beyond the US and Europe, Asia is the continent with the next largest value of insurance reserves in run-off. The vast majority of run-off liabilities in this region have been generated in East Asian markets including Japan and South Korea, principally from motor insurance but also from accident insurance claims. China has been excluded due to a lack of data. Asia has not traditionally seen the same level of focus on legacy business as in Europe and the US. We do not envisage a sea change here in the near future, with run-off acquirers likely to continue to focus on the developed markets. In South America, it is the markets in Mexico and Argentina which predominantly account for the majority of insurance reserves in run-off.

We expect the amount of reserves classified as run-off to grow over the next decade, including through the continued growth of the insurance markets in Asia and Africa. Growing markets can be volatile as insurers enter and exit numerous classes of business, and this gives rise to the potential for further run-off to be generated.

There are many external influences which could change the way insurance is written across the globe. New technology such as self-driving cars, increasing automation and use of technology in other industries, and the growth in cyber risk, could significantly change the underlying risks being insured which will drive the run-off of the future.



Andrew Ward,
PwC UK

The run-off landscape

It is almost 18 months since we published the tenth edition of our Survey and in that time the run-off market has seen considerable activity. In Continental Europe there has been increased momentum with owners of run-off seemingly far more comfortable than ever before in looking to dispose of discontinued portfolios. In the US there have been some legislative developments in relation to insurance business transfers that potentially provide an alternative to traditional pure reinsurance solutions. The market has also seen continued interest from a range of investors, and new start-up entrants seeking to challenge the established consolidators, contributing to the evolving run-off landscape.

Our Survey covers a wide range of run-off issues. These include the importance of legacy management in the current market, the objectives of run-off participants as well as the opportunities and challenges they face in pursuing their strategic goals.

As Figure 2 shows, our Survey indicates that a majority of respondents, 75% in the UK and nearly 60% in the US and Continental Europe, consider run-off and legacy management to be a medium or high priority on Board agendas. Despite this response it is clear others are still to convert to the principle of pro-active run-off management, with almost a third of US and Continental European respondents still identifying run-off as a lower priority in their organisation.

The key objectives for run-off business highlighted most frequently by our Survey respondents were orderly run-off, releasing capital and early finality. As shown in Figure 3 there were slight geographical variations in key objectives with capital release and, in particular, orderly run-off featuring more prominently in UK responses. We find the popularity of orderly run-off in the jurisdiction with the most established exit mechanisms slightly surprising but, along with close regulatory monitoring of the run-off sector, the current uncertainty as Brexit negotiations progress may have contributed to this apparent desire for greater stability in the UK market. US respondents gave the management of claims volatility greater importance than other jurisdictions. Continental European respondents were not as polarised in their views as those from the UK but it is interesting to note that orderly run-off has been given a far lower weighting than in earlier editions of the Survey by this group. This reinforces the impression that the Continental European market is adopting an increasingly pro-active approach to legacy management.

Figure 2: Where does run-off and legacy management feature on Board agendas?

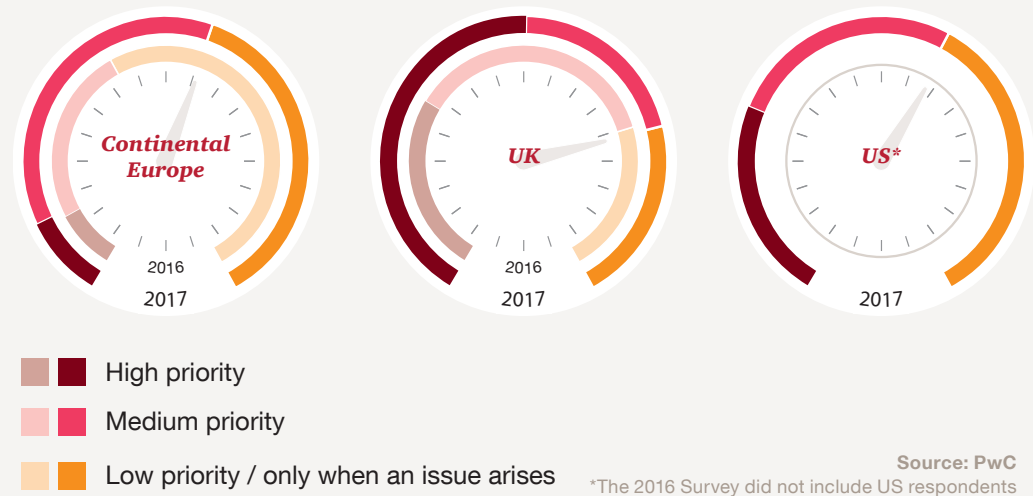
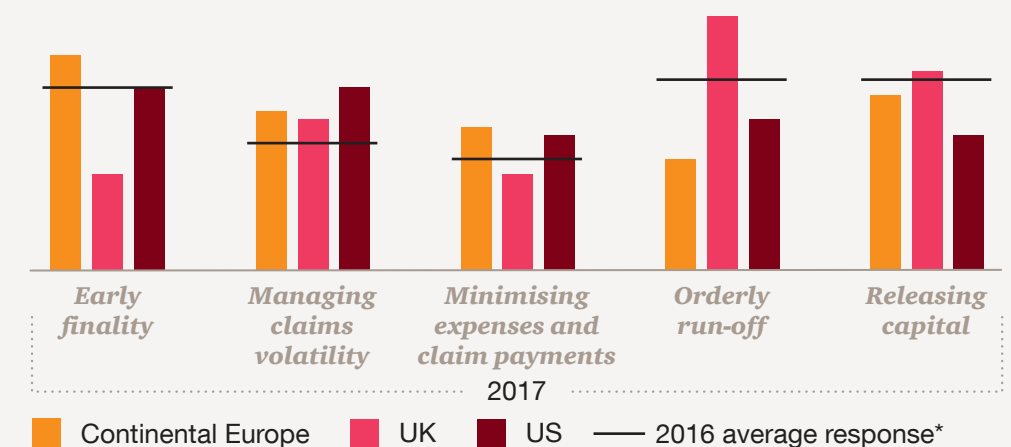


Figure 3: What are the key objectives for run-off business?



“Legacy management should be a deliberate and specific strategy, with a focus on optimising the balance sheet, by identifying portfolios for workout and executing through the use of pro-active run-off plans and market leading techniques.”

Artur Niemczewski, Chief Executive Officer, Pro Global

It is clear that challenges remain for market participants in meeting their objectives, as can be seen in Figure 4. In particular, US respondents cited adverse loss development as their most significant challenge. This is consistent with US carriers remaining very much on the front line of asbestos claims deterioration. Indeed, almost 60% of US respondents highlighted asbestos as the claims type they were most concerned about. Access to exit mechanisms was the second most significant challenge for US respondents however this was less prominent for UK and Continental European respondents who have access to, and can more easily implement, insurance business transfers as a tried and tested route to finality.

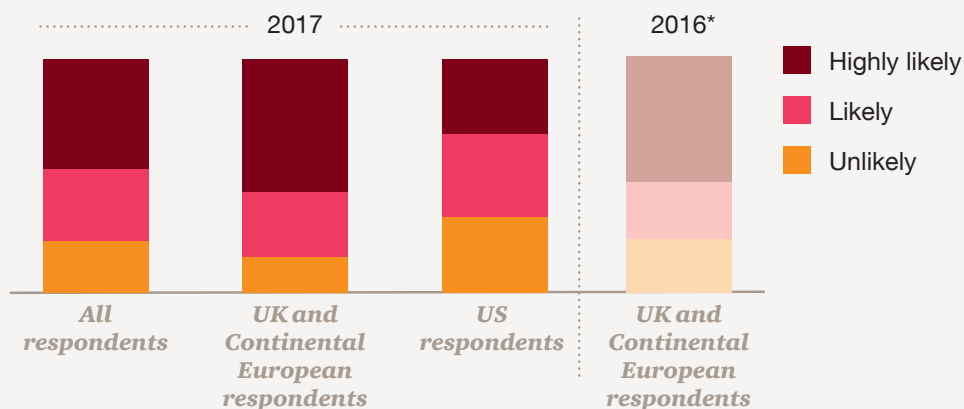
UK respondents appear to be far more challenged by the regulatory environment than those in the US, and it was also interesting to note that Continental European respondents were more concerned by pressure on costs in achieving run-off objectives than their UK or US counterparts. UK respondents also highlighted the challenges arising from political uncertainty, including Brexit, although this concern was only shared by a quarter as many Continental European respondents. Our own experience is that whilst Brexit planning and restructuring is well underway for many UK entities and a number of major Continental European players, any significant impact on the wider run-off sector has yet to materialise.

Figure 4: What is the most significant challenge affecting the achievement of run-off objectives in 2018 and 2019?

Source: PwC



Figure 5: How likely is respondents' engagement in restructuring or exit activity in the next three years?



Source: PwC

*The 2016 Survey did not include US respondents

While it is clear that legacy management is not without its challenges, our Survey indicates that run-off will increasingly be in the spotlight for many (re)insurers. As shown in Figure 5, almost half of respondents across all territories indicated that it is highly likely that they will engage in restructuring or exit activity in the next three years. Transactional activity in the UK and Continental Europe over the past two years has unquestionably been driven by the implementation of Solvency II which has prompted and facilitated more pro-active decision making in order to effect exits and free up and redeploy capital more productively. This may well continue to influence restructuring activity in Continental Europe as Solvency II is increasingly embedded within mid-tier (re)insurers and provides greater transparency over underperforming or non-core business lines. There is currently greater focus on restructuring and exit activity in the UK and Continental Europe than in the US, which provides an indication of the relative development and maturity of the respective run-off markets on both sides of the Atlantic.

It is worth noting that while sales and insurance business transfers move liabilities around effectively, they do not extinguish liabilities. It was interesting to note that several respondents remarked that they would like to see a return to solvent schemes as a means of crystallising liabilities to gain true finality in response to the question of what they would like to see change in run-off. While the level of restructuring activity looks set to be significant in the near term, the run-off industry remains restricted in gaining true finality for liabilities on a significant scale.



Jane Portas,
PwC UK



Stephen Arnold,
PwC UK

Brexit restructuring and the future for run-off

The drivers for run-off transactions and proactive legacy management in Europe are increasingly influenced by the regulatory landscape, in addition to the strategic and operational objectives of (re)insurers. The run-off market in Continental Europe in particular has taken a long time to develop but is now showing increased signs of activity. Potential future disruption to the insurance market caused by Brexit, ongoing Solvency II adaptation, operational integrity and/or continued cost pressure may be further catalysts for increased run-off activity in Europe.

For live firms, Brexit has added further fuel to the fire of disruption to business. It has focussed the attention of Boards on their overall strategy and the shape and direction their businesses should take. With regulators taking a keen interest in the Brexit plans of insurance companies (including contingency planning), some Boards have taken this as an opportunity to reassess the widest view of their operating models, not just the part which could be impacted should there be a “hard Brexit”. A range of questions have all needed to be answered, including:

- What impact will Brexit have on legal and capital structures across the UK and Europe?
- Which products, markets and geographies will drive the strategy?
- Where is future profitability coming from?
- Which locations deliver the best talent at the most optimal cost?

These Board reviews have drawn increasing attention to firms’ lines of business in run-off, or indeed live business which no longer forms part of a core strategy, may be operationally troublesome, or where the tied-up capital could be better deployed elsewhere in more profitable ways. In some cases, the reviews have led to particular lines of business being placed into run-off as the decision is taken to exit certain products, markets or geographies.

Such strategic and operational reviews are not confined to the live sector. The prospect of Brexit has triggered a need for the run-off consolidator market to take a fresh look at their operating models. Consolidators need a legal entity and operating structure that will provide the scalability and flexibility needed to handle future run-off transactions, potentially with some live components, within both the remaining 27 member states of the EU and the UK.

The consequences of Brexit for (re)insurers’ business, and the potential impact for the run-off industry, will depend on the type of Brexit achieved. The current level of political uncertainty weighs heavily on the industry and was cited by Survey respondents in Figure 6 as a significant factor to influence or impact the run-off sector in the next two years. At the date of writing this article, most substantive issues resulting from the UK’s eventual exit from the EU have no known resolution:

- Soft or hard Brexit?
- Preservation of contract certainty?
- Transitional market access?
- Availability of third country branches?
- Ability to perform cross border portfolio transfers?
- Achievability of cross-border claims fulfilment and payment?
- Post-Brexit regulatory co-operation (resolvability and group supervision issues)?

“In the UK the uncertainty of Brexit still looms with no one really sure of its impact.”

Survey respondent

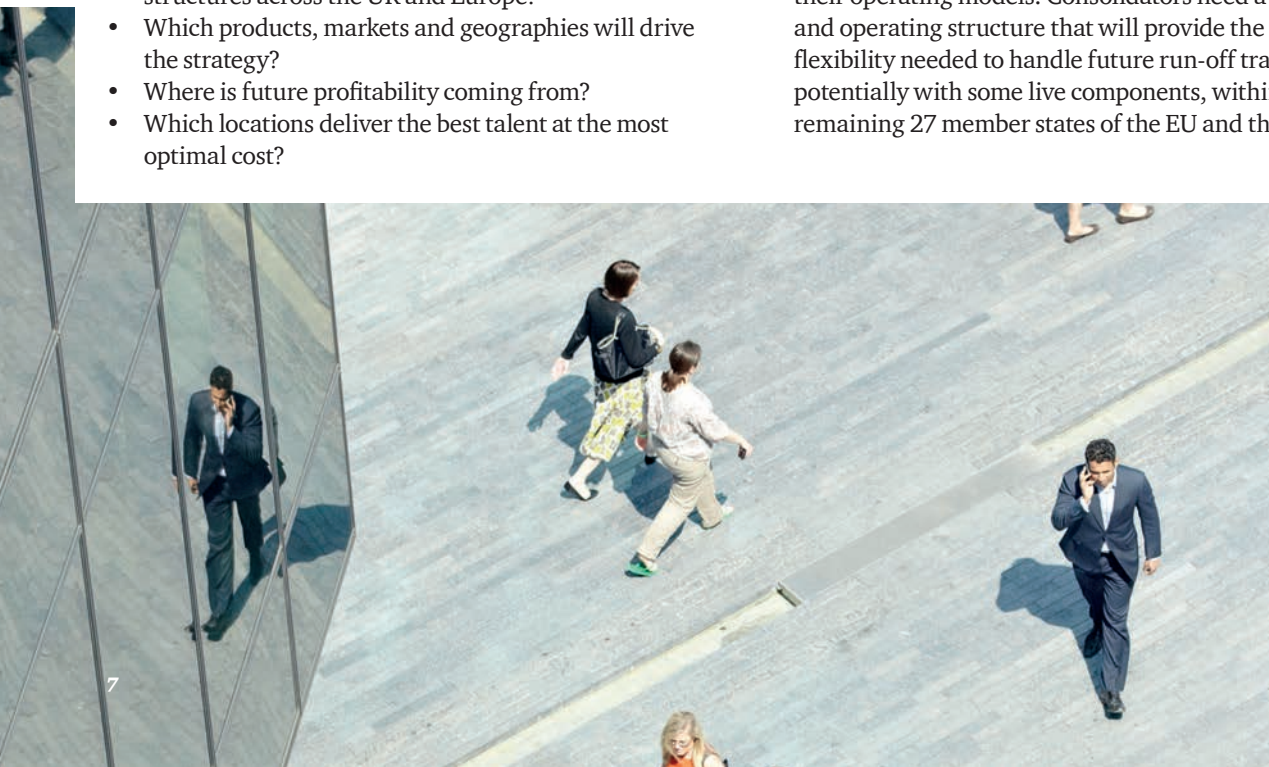
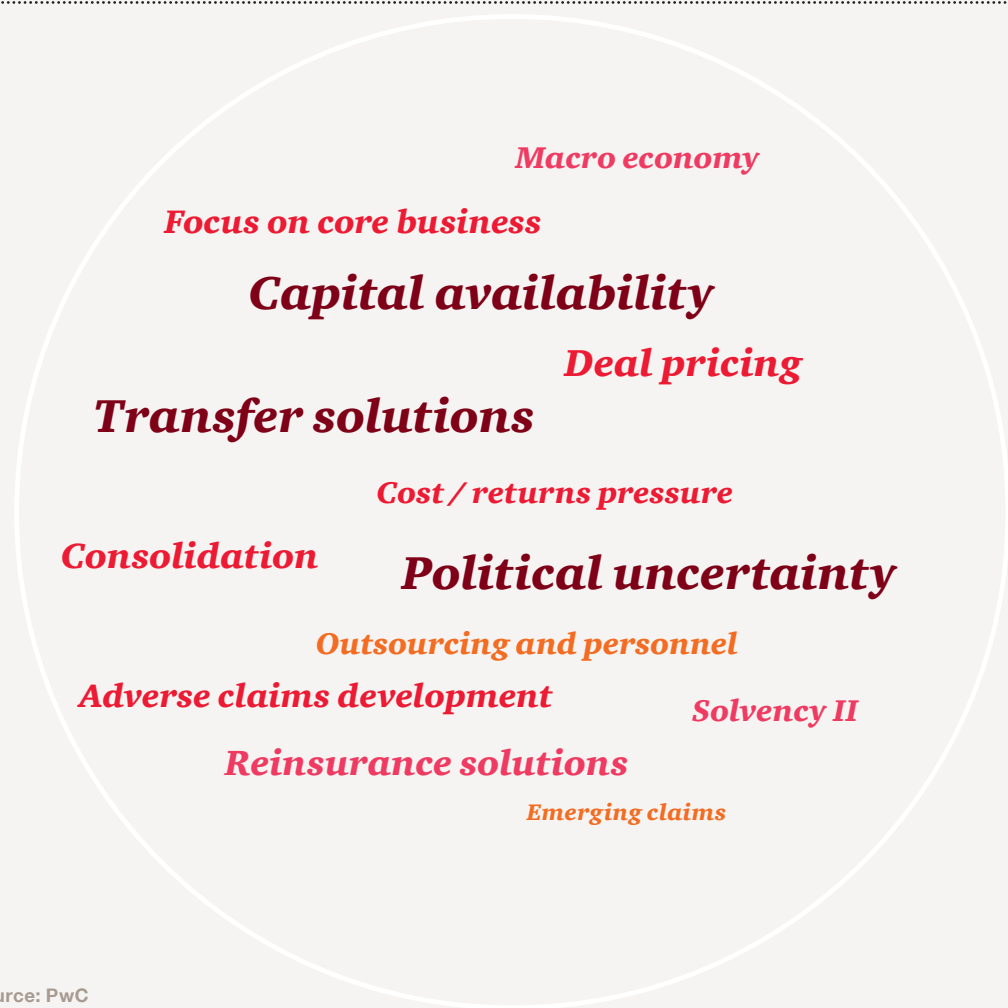


Figure 6: What do you think will be the most significant factors to influence or impact the run-off sector in the next two years?



Source: PwC

“Brexit is of course a big concern that is creating lots of planning and implementation issues. There are potential technical complexities including future claims administration under policies covering European risks if the UK is treated as a 'third country' as well as the potential loss of cross-border restructuring mechanisms.”

Geraldine Quirk, Partner, BLP



As market participants begin to anticipate a hard Brexit and implement Brexit plans we are seeing businesses select different restructuring tools ranging from Part VII transfers, the creation of Societas Europaea entities combined with cross-border mergers, as well as thinking about creating third country branches. The use of third country branches as part of Brexit transformation plans has reignited the debate around recovery and resolution planning, and the consistency of consumer and insolvency protection across Europe, following the UK leaving the EU.

UK Part VII transfers have been a core restructuring tool used extensively in both the live and legacy sectors since their inception in the Financial Services and Markets Act (2000) (FSMA). Part VII transfers, and their wider European equivalents, are the tools most frequently utilised to move portfolios of run-off business to acquirers. Uncertainty exists as to the availability of cross-border transfers post Brexit. Without them the legacy market, and live businesses implementing restructuring activity more widely, would be significantly limited. Consequently, (re)insurers and legacy acquirers may need to think innovatively to facilitate cross-border transfer mechanisms through other means, perhaps including the utilisation of schemes of arrangement.

Without appropriate and timely action, political agreement, and clear regulatory guidance around unanswered questions, the risk that claims could be stranded in the ‘wrong place’ in the event of a hard Brexit is high. The honouring of valid claims in a timely manner must be at the centre of all parties’ considerations. It is hoped that an element of common sense will ultimately prevail in the deal which is achieved. However, getting to that end is currently far from certain.



Alan Augustin, PwC UK



Victor Nelligan, PwC UK

European deal activity

The run-off transactions market in 2017 followed the upward trend of 2016 deal activity, and early signs indicate that the strong market is poised to continue through 2018. As predicted, many of the European deals completed in the last 18 months have been driven by Solvency II with sellers looking to find solutions for their legacy books. We also anticipated that a more varied mix of opportunities would come to market and a number of classes of business including medical malpractice, employers' liability, housebuilders' liability and motor have increasingly been transacted. Indeed, since our last Survey, motor has replaced asbestos as the area of most concern to more than 60% of Continental European respondents and we expect to see more transactions for this class emerging. The market has also seen development in the sale of several captives, as well as (re)insurers divesting non-core business lines to ensure the ongoing focussed and optimised use of capital, which we anticipate will continue.

Germany, Italy and the UK all saw deal volumes increase in the past year. Where publicly disclosed, the value of gross liabilities in individual deals has also generally grown, although the greatest volume of deals transacted involved gross liabilities of less than €40m. However, as shown in Figure 7 a greater proportion of UK and Continental European respondents are predicting disposals in Continental Europe of greater than €50m, compared to our last Survey.

Globally, more deals are in the queue for completion in early 2018 and the largest proportion of Survey respondents continue to believe there will be 11-20 transactions in the next two years. However as Figure 8 illustrates, the share of Continental European respondents who believe that there will be more than 20 European transactions has doubled, reflecting the increased optimism in this area of the market.

In particular, Germany has seen more auction processes in the past year than ever before. This has been influenced by both the changing attitudes towards disposing of run-off business and an uptick in activity from brokers and run-off specialists which has contributed to the further opening up of the market. In contrast, the expectations of UK respondents for large numbers of disposal transactions in the more mature UK market have decreased although there has been increased legacy activity, seen at Lloyd's in particular, in 2017.

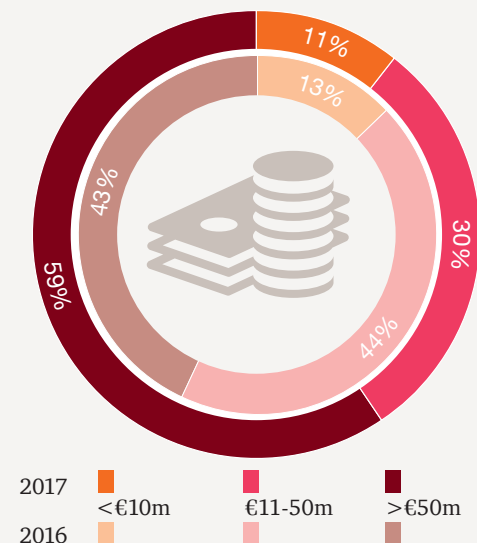
As the legacy market has evolved, participants on both the buy and sell sides have become increasingly sophisticated in their approaches to transactions. With run-off portfolios often embedded in their wider businesses, sellers have looked at combinations of insurance business transfers and reinsurance to achieve economic and legal finality. Bespoke solutions, often involving interim collateral structures, are also becoming more prevalent. Greater focus during the deal process has therefore unsurprisingly emerged in areas such as investment risk and returns, counterparty exposure and claims handling to drive deal value. As a result, there has been more innovation in the funding of and approach to transactions. Partnerships with pension funds, private equity, reinsurers and outsourcers have also increased to feed the growing need for flexibility and capacity, especially for larger sized transactions.

These more sophisticated approaches have also led to some buyers sacrificing return in the short term to win deals and enable them to grow their portfolios. This is a strategy designed to build reputation and market relationships and position buyers for the next deal, at times with the same seller. Continued growth of the consolidators is key to their ongoing business success and this has benefited sellers and the vibrancy of the market in general. This highly competitive environment may not last forever but, in the meantime, will continue to fuel a very active marketplace and the ongoing flow of run-off transactions for the foreseeable future.

“Sellers are becoming more educated and often taking value out of books before they come to market and, when combined with the competitive environment, margins are reducing so it is important for acquirers to maintain their pricing discipline.”

Luke Tanzer, Managing Director, Riverstone UK

Figure 7: Respondents in the UK and Continental Europe are starting to anticipate an increase in the value of the most commonly disposed portfolios in Continental Europe



Source: PwC

Survey respondents were asked to consider what is the one thing they would like to change in the legacy market...

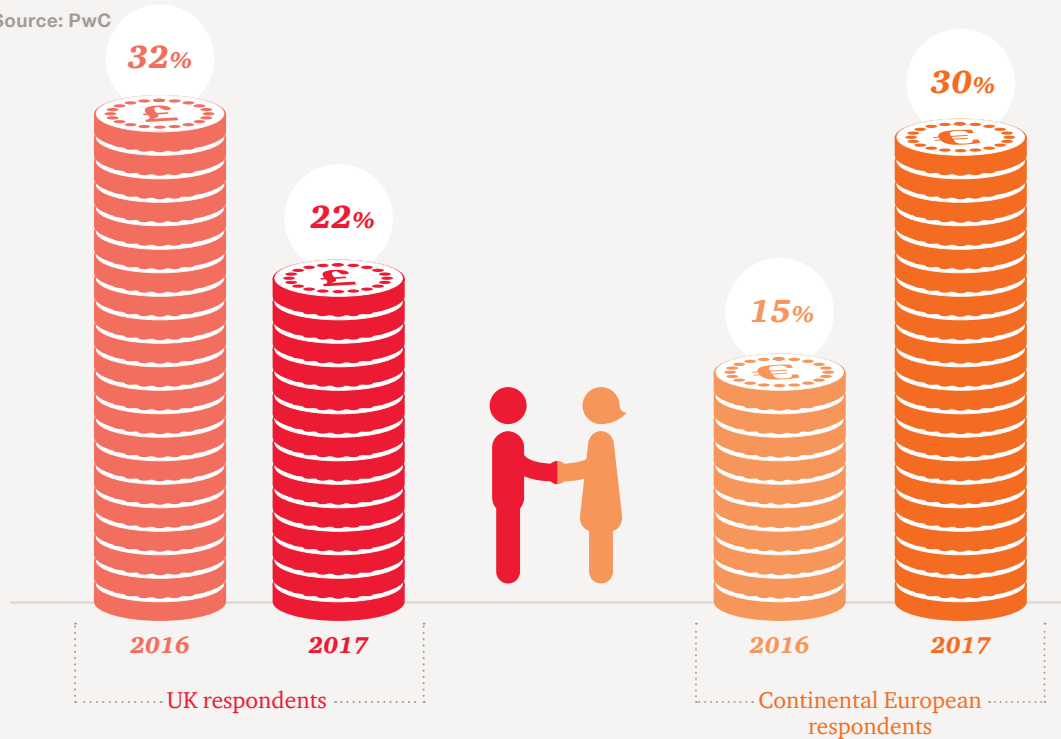
...speed up the regulatory process for approving transactions and business transfers.

...find a way to move the reinsurance asset with European portfolio transfers.

...rehabilitate solvent schemes of arrangement – the best route to achieving finality.

Figure 8: Respondents who believe there will be more than 20 European disposals in the next two years

Source: PwC



"The run-off market is buoyant, particularly in Europe where insurance business transfer legislation is well-established, but also in the US where reinsurance solutions remain prevalent.

Sellers are becoming more active in progressively managing both run-off portfolios and back books, with more and larger portfolios coming to market. Buyers are increasingly well-capitalised, mature in their operational capability and so able to take these larger portfolios. Meanwhile the regulatory bar keeps being raised such that extensive seller due diligence on financial, conduct, claims handling, and operational issues, is critical to successful transactions."

Neil Freshwater, CEO, Zurich Legacy Solutions



Leslie Fenton,
PwC
Corporate
Finance LLC



Ritendra Roy,
PwC
Corporate
Finance LLC

US property & casualty run-off deals

The property and casualty sector has seen mega legacy insurance transfer deals over the past year, headlined by AIG’s US\$9.8bn (plus interest) reinsurance with National Indemnity to take on pre-2015 long-term risks in excess of US\$25bn from legacy commercial policies. More generally a group of legacy reinsurers led by National Indemnity, part of Berkshire Hathaway, and including run-off specialists Armour Re, Catalina, Enstar, R&Q and RiverStone, continue to have a very active presence in the US.

As our timeline on pages 13-14 shows, there were a number of key reinsurance transactions including legacy US liabilities in 2017. In addition this year saw new entrants to the acquirer market, for example Sunpoint Re (a Bermuda domiciled company backed by Fosun International), Kayla Re (backed by Enstar/StonePoint with investments managed by Hillhouse), Premia (backed by Arch/Kelso) and ProTucket (Rhode Island-domiciled subsidiary of Pro Global, focused on the Rhode Island insurance business transfer legislation). Such entrants have been formed in part to specifically target non-core books of business and entities, and run-off liabilities on a worldwide basis including in the US.

The global insurance industry continues to be challenged by significant pressure on both sides of the balance sheet. Historic levels of profitability have attracted new capital driving down prices even in a soft market while investments are under pressure due to persistently low interest rates. Additionally, insurers continue to see a shift in risk exposures as a result of advances in technology and increased cyber vulnerability. Finally, there is heightened scrutiny of entities’ risk exposure to climate change and the impacts of ageing infrastructure and workforce. These factors, all relevant in the US market, separately or in combination, may well cause more entities or specific books to be placed into run-off.

“New entrants and new capital into the run-off market have increased recently. We see this as a positive development as the increasing number of options for sellers and increasing size of the larger consolidators is helping the market to grow. The market is becoming larger, more liquid and more sophisticated, offering a broader range of attractive options for sellers.”

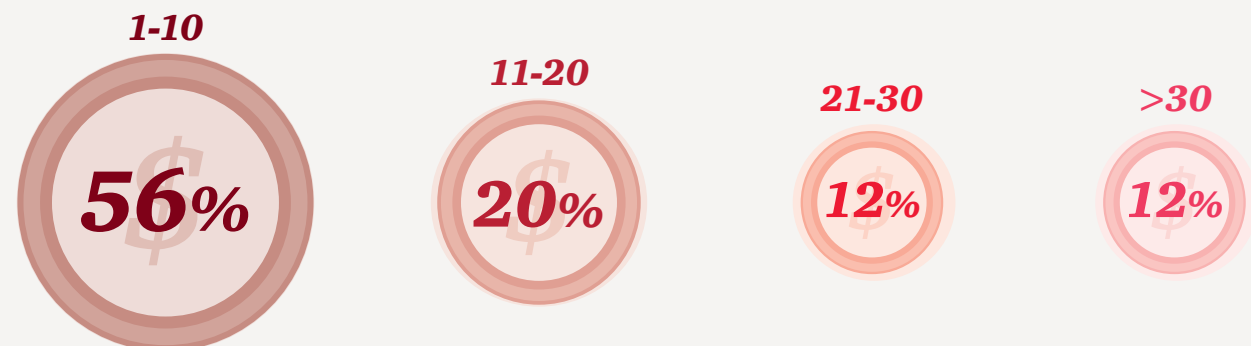
Chris Fagan, Chief Executive Officer, Catalina

As shown in Figure 9, less than half of US respondents believe there will be more than ten insurance run-off disposal transactions in the next two years. There was slightly more optimism when considering the view of all respondents, with just over half expecting more than ten US transactions in the same period. This may indicate an increasing focus on the US market from global run-off acquirers and it will be interesting to see how this develops in the year ahead.

Our Survey also asked respondents for their view of the most commonly disposed liability size of discontinued portfolios over the next two years. For US disposals, Figure 10 illustrates that 60% of US respondents believe the most commonly disposed portfolios will exceed US\$65m. Moreover, more than half of this number believe the value of portfolios to be disposed of will exceed US\$125m.

Figure 9: How many insurance run-off disposal transactions do US respondents think there will be in the US over the next two years?

Source: PwC





This result is reflective of the overall scale and higher value of the US run-off market, which leads to an expectation of higher liability value disposals. In comparison, respondents predicted transactions in Continental Europe will be lower in value but greater in number than in the US.

Traditional M&A transactions remain a viable exit route for US entities in run-off and in contrast to some of the retrospective reinsurance mega deals, activity at the smaller end of the corporate entity scale has been vibrant with acquirers looking at captives and risk retention groups as well as (re)insurance companies.

For example, December 2017 saw the acquisition of American Safety Risk Retention Group by SOBC Sandell, a transaction which allowed the previous owners to obtain an exit without the possibility of future risk reversion. US corporate entities with legacy asbestos and pollution liabilities on their balance sheets are also recognising the appetite of run-off specialists to acquire such liabilities and further transactions in this space over the next year appear likely.

Survey respondents were asked to consider what is the one thing they would like to change in the legacy market...

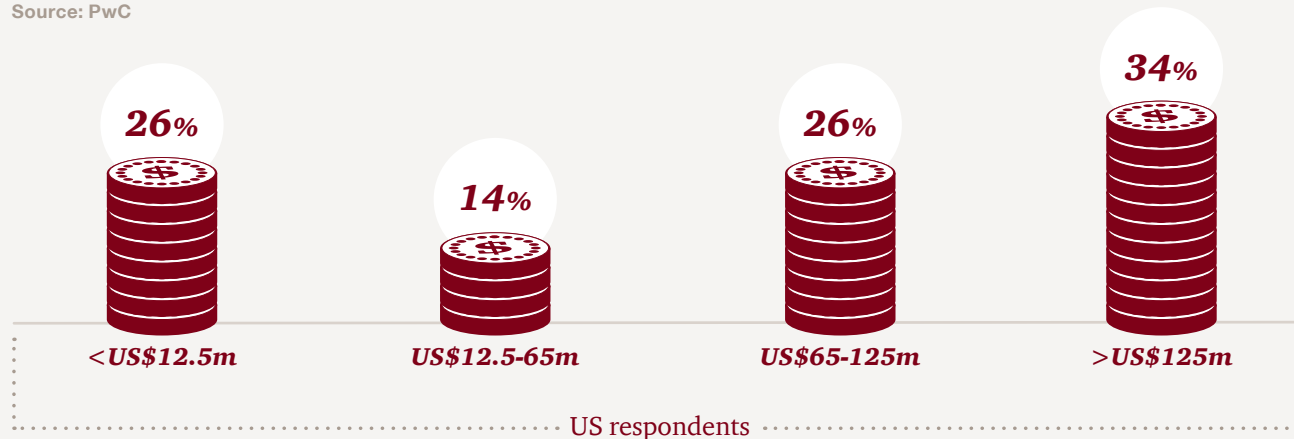
...onerous reporting and regulatory structures in the US are a challenge to restructuring objectives.

...alignment between US states on the need for a portfolio transfer mechanism.

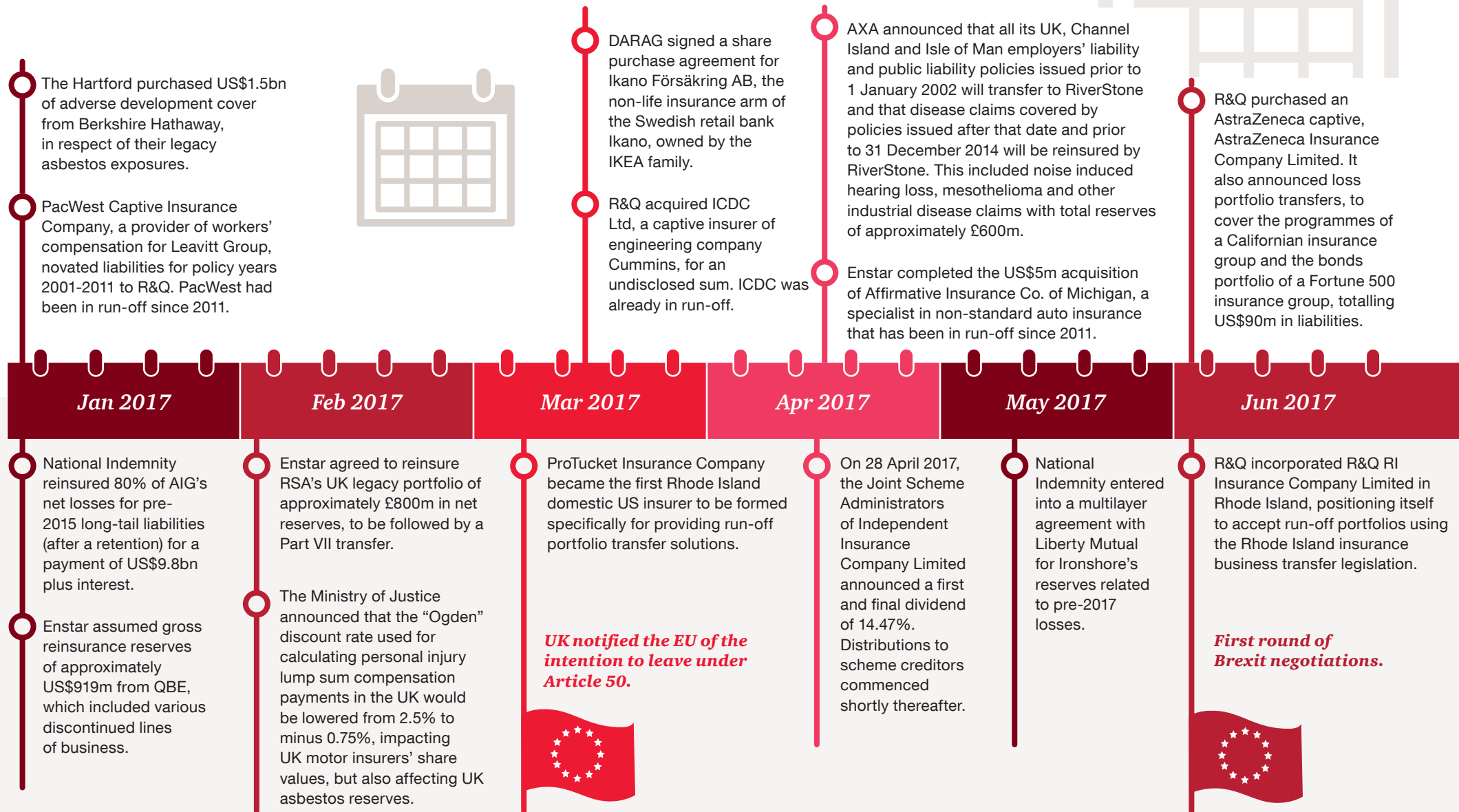
...greater transparency on run-off costs and reserve deterioration.


Figure 10: What will be the discontinued portfolio liability value most commonly disposed of in the US, over the next two years?

Source: PwC



2017 legacy market highlights





Premia Reinsurance Limited entered into an agreement to reinsure AmTrust Financial Services, Inc with respect to its first quarter 2017 and prior net reserves. These amounted to assumed net reserves of US\$625m in excess of US\$5.96bn.

Jul 2017

Aug 2017

Following four acquisitions of legacy portfolios from Equinox CA Europe and Norwegian insurer, Gjensidige Forsikring ASA earlier in the year, Compre acquired AXA Insurance Ltd's participations in the RW Gibbon pools.

Hurricanes Harvey, Irma and Maria caused devastation across the Caribbean and US Gulf Coast, with modelled industry insured losses for all three events in the region of US\$100bn.

Sep 2017

Catalina entered into an agreement for the transfer of US\$190m of legacy US liabilities from Samsung Fire & Marine Insurance Co.

The Joint Scheme Administrators of OIC Run-off Limited announced a 7% increase in its payment percentage, taking the total paid to date to 65%.

Oct 2017

Enstar acquired Great Lakes Casualty Insurance in the US.

Catalina agreed to reinsure Zurich's German medical malpractice book.

Nov 2017

Compre acquired APH and some UK EL portfolios from the UK and US branches of Assicurazioni Generali S.p.A. The portfolios represented combined liabilities of around €300m.

Dec 2017





Luanne Petrellis, PwC US

Insurance business transfers in the US – a new dawn?

Most people working in the insurance industry look at the US market in terms of what it is, rather than what it could be. Although the US property & casualty run-off market is large and growing, it has lagged behind the UK and Continental Europe in terms of restructuring and run-off transactions. The primary reason for this is the lack of effective tools available to companies wanting to restructure their operations or run-off liabilities.

There are large pockets of business requiring finality solutions, in particular for long-tail coverages such as workers' compensation, mass tort such as asbestos and environmental liabilities, as well as for reinsurance pools. To date, exit solutions have largely consisted of adverse development covers and/or loss portfolio transfers. However, it has been difficult to achieve complete finality with these arrangements as, in most cases, the transferring company retains exposure for amounts in excess of policy limits and for disputed or otherwise collectable reinsurance.

The UK Part VII transfer (or its counterparts in other EU jurisdictions) is currently the most reliable restructuring tool to execute run-off transactions to achieve finality whilst also providing adequate protection of policyholders.

The relatively newly introduced Insurance Business Transfer legislation in Rhode Island in the US (RI IBT) is modelled on the UK Part VII transfer and is being closely considered by many US and global (re)insurance companies to address their commercial run-off business.

The market is waiting for the first successful RI IBT transaction although there has been an apparent degree of reluctance to be the first to propose such a transfer. If market rumours are to be believed, then the industry may not have to wait too much longer to see whether the RI IBT provides a solution that a number of Survey respondents seem to be hoping for. Whilst (re)insurers do not like to get too far out in front, they also hate being left behind. It will also be interesting to assess whether recent US tax reforms provide (re)insurers with a reason to consider insurance business transfers, as they come to terms with the new regime.

It is important to note that the RI IBT is not the only restructuring initiative that has been established. Other states including Oklahoma, Connecticut and Pennsylvania have all introduced measures that may assist the pro-active management of, and exit from, legacy portfolios. We also note other US states are considering their own versions of insurance business transfer legislation that would apply to all lines of business.

The results from our Survey show that whilst amongst some respondents there is a strong belief that there will be a large number of US legacy transactions, others are more cautious. This seems to highlight the pivotal, but binary nature of successful US insurance business transfer legislation – simply put, if one of the US states delivers a successful series of transfers, there may be many such transactions. If not, there may be very few.

Figure 11: The lines of legacy business most likely to be disposed of over the next two years in the US.



“The most obvious gap in the global run-off toolkit is a viable and replicable bulk novation mechanism for the US market. Recognition of the need is increasing, and with it, I expect to see a transaction test the concept soon.”

David Scasbrook, Transactions Executive, Swiss Re



Marc Oberholtzer, PwC US

The US legacy market – economic or legal finality?

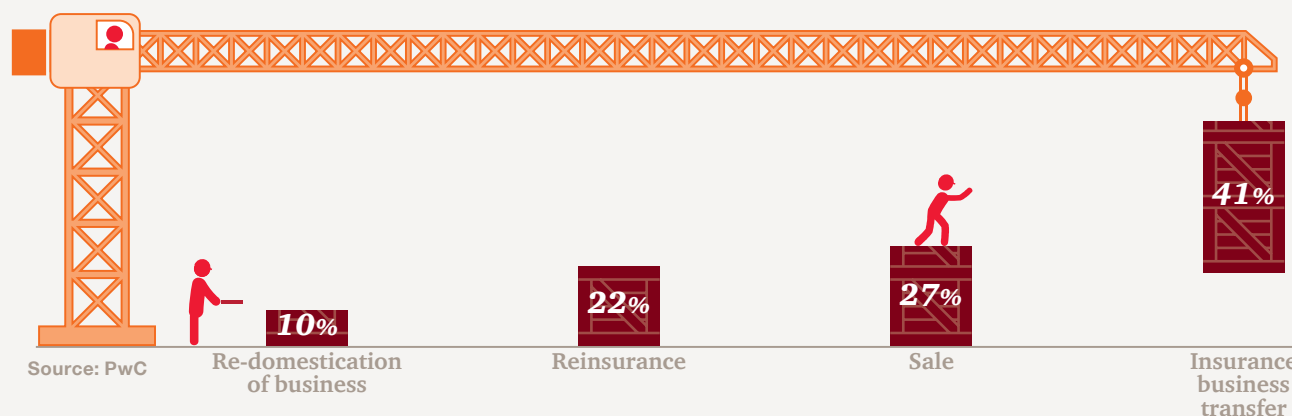
As its name indicates, retroactive reinsurance provides coverage for events that have already occurred, in essence providing indemnification and hopefully economic finality for the risk of adverse claims development.

In the US, it is relatively common for insurance companies to use retroactive reinsurance to achieve some degree of certainty as regards the resolution of unpaid claims or business that is in run-off. For example, many have entered into retroactive reinsurance covers to address uncertainties around unpaid liabilities from asbestos-related and environmental pollution claims. These covers are often large, involving premiums and liabilities valued at billions of US dollars. Others have entered into similar transactions in respect of unpaid workers' compensation claims. In many cases, the reinsurer not only assumes responsibility for unpaid claims, but also has strong expertise in the negotiation and settlement of the specific claim type being reinsured.

Retroactive reinsurance has some advantages. It is well used and understood in the US by the insurance sector, regulators, rating agencies and analysts, generally has minimal transaction costs and regulatory approval time, and is flexible enough to be used to address any coverage. The alternative now available for the first time in the US, for certain types of liability, is an insurance business transfer based on a new law passed in Rhode Island (RI IBT). Although insurance business transfers take more time and have higher execution costs, they potentially have more favourable financial reporting and capital impacts than retroactive reinsurance. Most significantly however, they enable both economic and legal finality to be achieved. It should not be forgotten that, in many cases, policy limits are eventually reached on retroactive reinsurance covers even when these are originally set at what is perceived as a high level, whereas having the risk revert in this way is simply not a concern with an insurance business transfer.

When asked what restructuring or exit tools will be used over the coming three years, and as illustrated in Figure 12, 41% of US respondents anticipated using insurance business transfers. This is interesting as it is higher than the response of the UK and Continental European participants who anticipated using insurance business transfers, and is particularly interesting when a US insurance business transfer has yet to be successfully completed. It suggests there is some level of expectation that a US mechanism will prove to be successful in the next year – be that in Rhode Island or through equivalent legislation succeeding in other US states.

Figure 12: 41% of US respondents are anticipating using insurance business transfers as a restructuring tool over the next three years.



“The one thing in the legacy market I would change is to find a way to support US market/regulators see the positives of having an ability to transfer books of business.”

Survey respondent

Life run-off – a wave of consolidation across Europe

The European life insurance industry continues to go through a period of change. The results of PwC UK's Survey of Life Insurance Back Book Management indicate that management of run-off business is expected to become an increasingly active strategy being pursued by life insurance firms.

The past 18 months have been an exciting time for M&A activity across the life insurance sector. The life run-off survey sought to understand the drivers of both recent and future activity in the market and the results support our view that further consolidation is on its way with the UK, Germany, France and Italy expected to be the key markets for activity in the near term.

In particular, the findings of the life survey suggest that European consolidation activity is driven by a number of factors, including:

- Increased focus on the cost base of insurers who are running on old platforms no longer fit for purpose, and the subsequent challenges of the management of the expenses of the business and subsequent diseconomies of scale in a firm no longer writing new business;
- Continued interest from private equity firms, particularly from Apollo, Blackstone, Cinven, CVC, and other longer term private capital;
- Continuing interest from large Asian insurers such as Anbang Insurance Group, Dai Ichi Life and Fosun International looking to increase their international footprint, with other investors on the horizon;
- Traditional insurers looking to dispose of non-core insurance businesses across Europe, such as Generali (considering the disposal of assets in Germany and having exited the Netherlands) and Aviva (successfully disposing of non-core assets across Italy and Spain);
- Historic high guarantees on European products – with a market shift to selling new business on products with fewer guarantees and lower capital requirements;
- Consolidation of the insurance mutual sector where business can be sub-scale, have limited access to external capital and need to explore alternative methods to compete;
- Increased reinsurance activity as insurers seek to redeploy capital across their businesses using more sophisticated tools; and
- Ongoing disposal of annuity books by companies seeking to improve the capital efficiency of their balance sheet with notable disposals by Aegon, Equitable Life and Zurich, a trend which we expect to continue.



Julie
Pallister,
PwC UK



Stephen
Harrison,
PwC UK

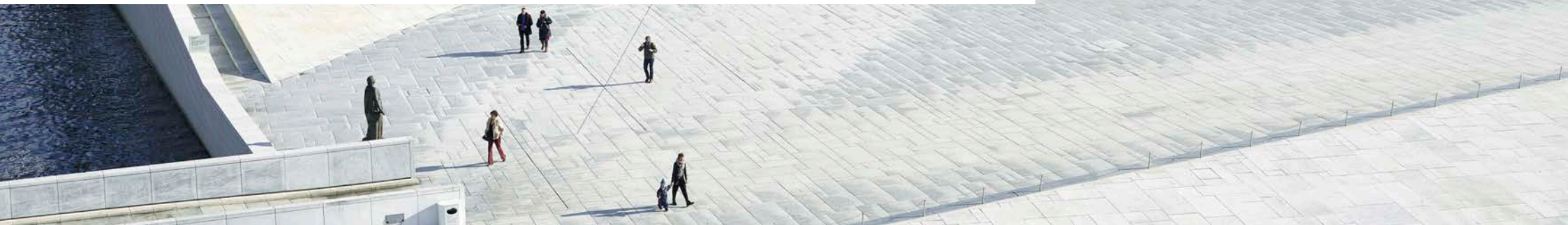
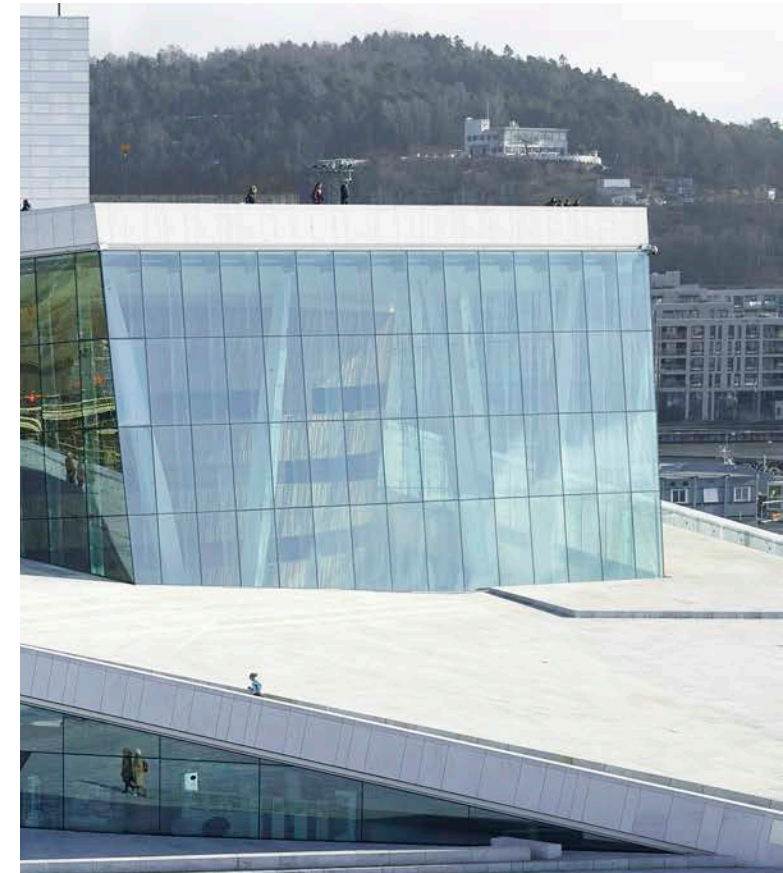


Figure 13: What are the top three challenges facing the management of life run-off business?

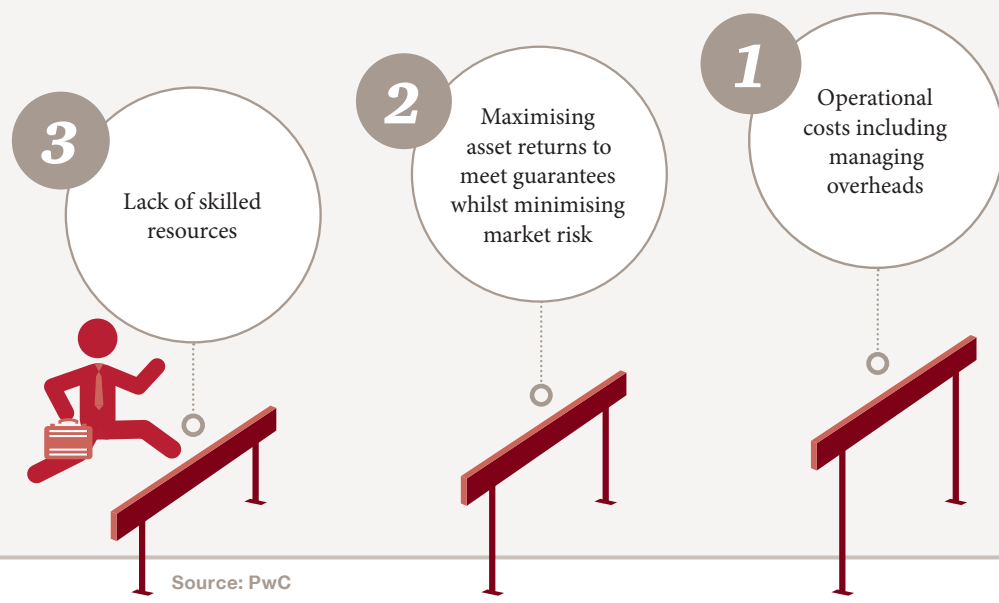
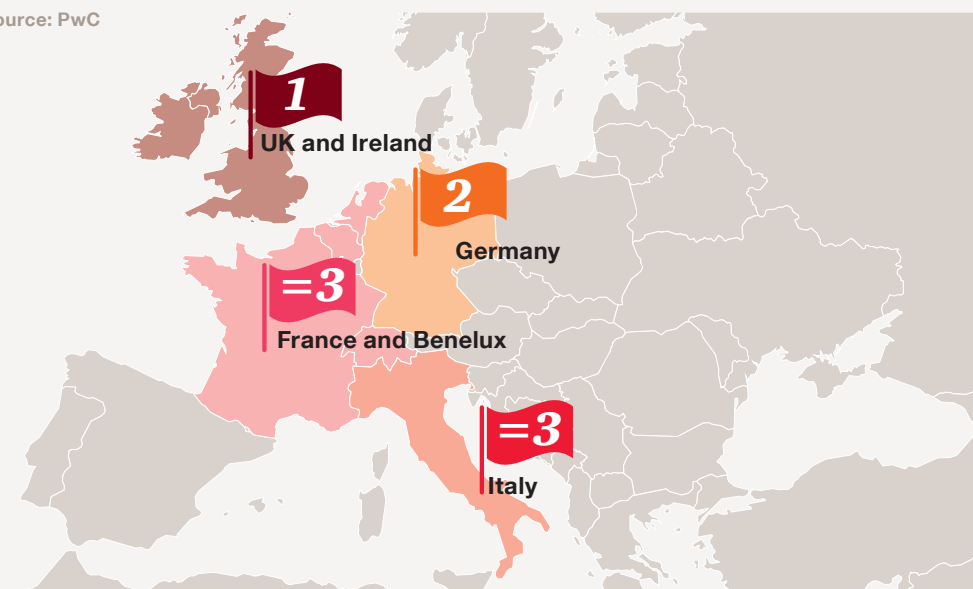


Figure 14: Where do you see the most European life run-off restructuring activity occurring?

Source: PwC



The UK life industry is still the largest and most complex in Europe, but specialist business such as UK annuity writers is growing quickly and providing solutions to take on liabilities that larger, multinational insurers no longer want. These specialist businesses are more able to manage the risks of specific products and are indicative of a more segregated industry where specialists are the key. Despite consolidation activity in the UK over the last three decades, there are still more UK life insurance companies than in any other part of Europe.

There remains scope for further consolidation and we expect there to be further activity, largely focused on the UK annuity market, consolidation in the with-profits sector, and consolidation in the sub-scale mutual sector.

In Germany, the life insurance market has begun a phase of consolidation as external capital has started to enter the market. The opportunity for consolidation is clear given the wave of insurers closing to new business and the stark low interest rate environment which makes new business highly unattractive. Germany's closed life businesses appear to be entering a phase of "consolidate or be consolidated".

In France, the changes introduced by Solvency II are a turning point however the life run-off market is expected to be slow to gain momentum and the regulatory environment appears less favourable to external investment than in the UK and Germany. Initial consolidation activity is therefore likely to be very focused as companies seek to better optimise their capital position or solve a specific problem within a portfolio.

In Italy, the life insurance market is a market in decline, driven by historical capital inefficiency issues, products with high guarantees and an economy expecting little growth in the short to medium term. Efficient management of life insurance back books to extract more from the existing business will be critical as insurers seek to generate capital efficiencies and a return for shareholders.

A copy of PwC UK's Survey of Life Insurance Back Book Management can be found at www.pwc.co.uk/lifebooksurvey.html.

Spotlight on Bermuda, Middle East and Asia

While Europe and the US dominate the run-off environment, in this section we take a brief look at the run-off profile in three other territories – Bermuda, the Middle East and Asia.



Bermuda – the nexus of ILS and (re)insurance run-off
James Ferris, PwC Bermuda

Bermuda is, and has been for a number of years, the home of many of the global consolidators of non-life run-off liabilities such as Catalina, Enstar and Armour. With the formation of entities like Premia Re in January 2017, Bermuda's position in the run-off market shows no sign of abating, not least because it has sustained good returns despite the generally low return environment. However, the global (re)insurance market, including here in Bermuda, continues to experience operating and capital cost pressures. This has greatly increased the appeal of using fully collateralised funds – essentially vehicles containing sufficient capital to cover potential claims in full. They allow non-insurer funds to participate in major (re)insurance programs and access a broad range of insurance risk.

A further key development in Bermuda is that recent large catastrophe losses, including those brought by the 2017 hurricane season, have prompted a much increased level of interest from the Insurance-Linked Securities (ILS) market. ILS structures provide investors with opportunities relating to the risk arising from the catastrophe and life markets, which is uncorrelated to the risk in the financial markets. Bermuda is well-positioned to bring together the best of the ILS and run-off markets, having the greatest global market share of ILS and being a traditional centre for (re)insurance run-off entities.

Given the current developments in the UK, where ILS regulations have recently passed into law, an interesting conundrum for Bermuda will be to see how the market develops in London and whether the traditionally innovative run-off community there looks to establish protected cell company structures in the UK as they have done in Bermuda and other offshore territories in Continental Europe, notably Malta.



The Middle East – a region ripe for consolidation?
Alan Augustin, PwC UK

The Middle East has previously been seen as an emerging insurance market, and one offering considerable opportunity. This was due to increasing levels of compulsory insurance, a greater number of available products, low customer penetration rates and subsequently the entry of a large number of both Takaful (Islamic compliant) and conventional insurers to the region.

What has transpired in reality is a fragmented and often loss-making market as a result of overcapacity, competitive pricing, squeezed profit margins and tighter regulation. These challenging conditions have caused a number of participants, for example Zurich, Generali and Takaful Re, to exit the market. Others, like state backed Abu Dhabi Investment Council, continue to weigh up their ongoing investment in the region.

Decisions to discontinue writing insurance have led to the emergence of a community of participants who need to understand and access the solutions and techniques available to effectively run off their businesses. The importance of leveraging experience from other territories when developing and executing robust run-off plans, is fast gaining traction. The benefits of a solid run-off plan are increasingly seen as a key strategic element in ensuring value is not eroded during the run-off.

Capital and operational consolidation is clearly commonplace in more developed run-off markets and it will be interesting to see if consolidation becomes the defining feature of Middle East insurance run-off in the coming years.



Asia – a sleeping run-off giant?

Peter Greaves, PwC Singapore

Whilst Asian businesses are driven by familiar commercial considerations, the power of relationships and the importance of reputation can mean that what appears to be the most expedient solution may not be the favoured one. This leads to cultural differences in dealing with run-off in Asia where a pro-active approach, such as that which has become more widely used in Europe, has yet to prevail.

Whilst cultural differences should not be underestimated, other factors seem to be at play including the stance and powers of local regulators and the availability of exit mechanisms. For some, perhaps it is case of once bitten, twice shy. One example that comes to mind concerns the collapse of the Fortress Re pool, and the subsequent strengthening of Japanese (re)insurers' resolve to keep run-off behind closed doors. The Fortress Re experience brought home to Japanese (re)insurers that they had perhaps gone too far in terms of the extent to which direct control of their stamp had been ceded.

Our Survey estimates that Asia accounts for up to US\$80bn of run-off liabilities, with a significant proportion of that relating to the Japanese motor market. However, it is difficult to see a thriving run-off transactions market develop any time soon against the cultural conservatism that exists, particularly in the continent's largest market. In some other territories we have seen limited examples of run-off deals like Singapore's Overseas Union Bank selling its insurance subsidiary, and a project PwC UK undertook recently in Malaysia to develop a local insurer's run-off plan for submission to its regulator.

This sleeping run-off giant does not look like stirring any time soon however given the estimated value of run-off liabilities in the territory, an awakening will surely come at some stage.

“Large insurance groups are beginning to recognise that the benefits achieved from successful legacy management in Europe and the US could potentially be replicated in other territories. The key challenge in more untested territories does not appear to be economic given the increasing availability of legacy focussed capital, but how best legacy solutions can be deployed from a resource perspective, and how to demonstrate positive impacts to the satisfaction of customers and the regulators.”

Simon Hawkins, Group Head of Retrospective Solutions, QBE Insurance Group

Survey respondents were asked to consider what is the one thing they would like to change in the legacy market...

...there is a lack of respect for data controls and protocols in the insurance market. The lack of good quality data in live business leads to issues for the run-off market.

...acceptance by some companies that they have legacy books allowing greater openness to run-off acquisition/sale approaches.

...to see more informed coverage of legacy in the industry and mainstream press.



Paul Corver,
Chair of
IRLA

A view from IRLA

When I started my life in run-off back in 1990 I could never have envisaged that 27 years on the sector would be so vibrant and well established. But it is a wonderful place to work and, certainly for most, the long dark days of handling distressed and insolvent portfolios are far behind us. What has remained a constant thread through those years is the toolbox used by run-off companies and advisors to provide efficient solutions for legacy liabilities. These mechanisms and solutions have developed and been enhanced through innovation over the years and brought flexibility to the run-off market.

The breadth and size of run-off transactions continues to impress – whether they are UK employers' liability, German med-mal or US long term care. Transactions are no longer mostly the disposal of companies already in run-off. In recent years we have seen major insurers, on both sides of the Atlantic, disposing of risk either entirely through transfers or economically through reinsurance protection. The wider (re)insurance sector is increasingly appreciating the positive effects of capital influx and the operational efficiencies arising from disposals of discontinued business lines.

This year's Survey, which now expands its horizons beyond Europe, demonstrates the growth of the sector with vibrant levels of restructuring and transaction activity continuing to be reported. We are certainly seeing this growth at the Insurance & Reinsurance Legacy Association with rising member numbers and attendances at our events.

There have been some obvious drivers for the increased European activity, with Solvency II focusing attention on capital requirements. We also now have the uncertainty brought by Brexit, which could lead to further activity as the market adapts to the changing political landscape. In the US the appetite for disposal is increasing, and all eyes are on Rhode Island to see if this is a successful solution for run-off acquirers and consolidators. Survey respondents expressed optimism, however a lot is riding on the first movers carefully picking the right portfolio to prove the process works.

I have no doubt that effective run-off management will continue to be increasingly recognised and adopted across the insurance industry so that in another 27 years it will be part of business as usual.

Paul Corver
Chair of IRLA



A view from AIRROC



Leah Spivey,
Chair of
AIRROC



The US run-off market has historically been less flexible and more hesitant than its UK and Continental European counterparts to engage with creative practices to manage its legacy liabilities, assets and address overall capital requirements. This may be the result of having 50-plus regulators and few regulations favourable to run-off in the US. Alternatively, rating agencies and regulators at state level may be better positioned than nationwide organisations to identify troubled companies before they face the necessity of a restructure. Whatever the reason, it is common knowledge that restructuring has been less popular among US companies than loss portfolio transfers, adverse development covers or outright sales.

The responses to the Survey remind us of how important it is to collaborate with regulators and counterparties throughout the run-off of all books of business. In this way companies can best deal with the issues facing run-off and overcome the challenges to successful management for their respective entities. This is especially true given the range of today's disrupters to the (re)insurance industry. Innovations in the form of digitalisation, artificial intelligence and mobility changes are hitting the heart of the (re)insurance market. The run-off of this industry may have only just begun.

Historically, the (re)insurance market has lagged behind the technological and other advances of the rest of the business world. Today, we are encountering more elements of rapid change than ever before and these are bound to increase the volume of companies searching for capital relief and alternative runoff strategies. In particular, auto insurance and labour intensive processes are predicted to experience the greatest impacts. It was promising to see that over half of the US companies responding to the Survey view run-off and legacy management as a medium or high priority, as that responsibility is expected to continue to grow.

In the US, staying close to your business partners and regulators and encouraging both creative exit solutions and the legislation of more accessible run-off mechanisms is a must. Doing so in a safe environment that promotes cooperation through networking and education is the very vehicle AIRROC provides to its members and friends that will help carry us forward well into a very exciting future.

Leah Spivey
Chair of AIRROC





Dan Schwarzmann,
PwC UK

Conclusion

I would like to thank everyone who responded to our latest run-off Survey. This publication would not be possible without your valuable contributions. I would also like to thank IRLA and AIRROC for their support with this Survey.

It is clear from the responses we received that the global run-off market remains extremely buoyant. A significant proportion of respondents have signalled that run-off is a priority for their organisation and that further restructuring activity is likely in the forthcoming years. There is considerable deal flow anticipated through 2018 in multiple jurisdictions and this is driven by a range of local and global factors. These increasingly involve operational considerations, but capital efficiency remains a central theme.

The Survey also highlights that during 2018 the effects of an increasingly imminent Brexit will continue to be felt in the UK and Continental European (re)insurance markets, with the uncertainty potentially acting as a catalyst for restructuring activity. As the date for the UK leaving the EU draws closer, it is likely that preparatory transfer and transaction activity will increase further still and this could well feature run-off portfolios.

As I reflect on the contributions to our Survey this year I am conscious that some cultural differences still exist between the core run-off markets. For example, restructuring initiatives are generally viewed in a constructive light in Europe whereas, in the US, the concept of restructuring is often seen in more distressed situations. Our Survey reflects that in the US however there is a growing appetite for a transfer mechanism that will allow US run-off owners to benefit from the legal finality which is available through transfer mechanisms in the UK and Continental Europe. I believe successful proof-of-concept transactions will be key here and the sector needs to see such a transaction soon in order to maintain momentum.

It looks likely that the next year or two will see further significant changes in the run-off market and the wider business environment in which it operates. That is a genuinely exciting prospect for all of us who work in this market and I am optimistic that the legacy sector will, as it has consistently done in the past, continue to innovate and deliver value for all stakeholders.

Our teams across the PwC Network are grateful for your continuing support and look forward to engaging with you throughout 2018.

Dan Schwarzmann

Head of Market Initiatives and Industries, PwC UK



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The Insurance Liability Restructuring team has access to more than 200 specialists focusing on providing restructuring and operational consulting services to companies in the (re)insurance industry with run-off business.

Issues being faced by operations around the world where the team is able to provide advice, support and assistance include:

- Releasing capital from run-off;
- Bringing finality to run-off and extinguishing liabilities for underwriters and brokers;
- Restructuring through sale or insurance business transfers;
- Project managing complex transactions and securing key stakeholder buy-in;
- Rationalising operations to achieve efficiency;
- Pro-actively managing outsourced run-off, including the development of a robust outsourcing contract;
- Benchmarking the claims and reinsurance functions to assess their effectiveness; and
- Providing transactional support ranging from due diligence, claims reserving, debt provisioning and tax considerations.

*To find out more, please contact Dan Schwarzmann, Andrew Ward or Alan Augustin.
For an electronic copy of this Survey visit: www.pwc.com/globalinsurancerunoffsurvey*

www.pwc.com/globalinsurancerunoffsurvey

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