In conjunction with

A Survey of Discontinued Insurance Business in Europe: *Tenth edition / September 2016*

Unlocking value in run-off

www.pwc.co.uk/discontinuedinsurance

Introduction

Welcome to the tenth edition of our Survey of Discontinued Insurance Business in Europe which is produced once again in conjunction with IRLA. We are extremely grateful to everyone who participated in the Survey.

We have now been producing this survey for a decade. It underlines to me the longevity and continual development of the market as well as the new issues that the run-off industry continually tackles effectively.

This year the run-off market has been buoyant as Solvency II appears to have driven greater focus on discontinued lines of business. This has increased M&A activity amongst some of the larger (re)insurers, and has also begun to create capital challenges for a number of smaller market participants.

As with the other parts of the Financial Services industry, the insurance run-off market in Europe is now waiting to see how Brexit plays out. If we do see any significant impact then I have no doubt the innovative run-off market will be well placed to unlock value from any resulting new run-off opportunities.

Irrespective, the mood of our Survey indicates that run-off is expected to remain a very active sector in the next two to three years and we look forward to further developments and continuing to work with you into the future.

Dan Schwarzmann
Head of Market Initiatives & Industries and Solutions for Discontinued Insurance Business

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Key findings

The last year has been a milestone year for European run-off, from the implementation of Solvency II to the significant number of legacy business transactions seen in the market. Our key findings provide insight into the issues, challenges and opportunities facing European run-off stakeholders, both today and in the years to come.

How likely is it you or your client will engage in ***restructuring or exit activity*** *in the next three years?*

77%

Highly likely or likely

Source: PwC

Run-off for sale?

81% *of respondents think there will be more than 10 disposals in Europe over the next two years*

21% *of respondents think there will be more than 30 disposals in Europe over the next two years*

68% *of respondents think the most commonly disposed portfolio size will be between €10m and €100m*

The types of business most likely to be disposed of include:

life, employers' liability, non-marine, liability, general liability, motor, medical malpractice

In which territories do you think the most disposals will occur?

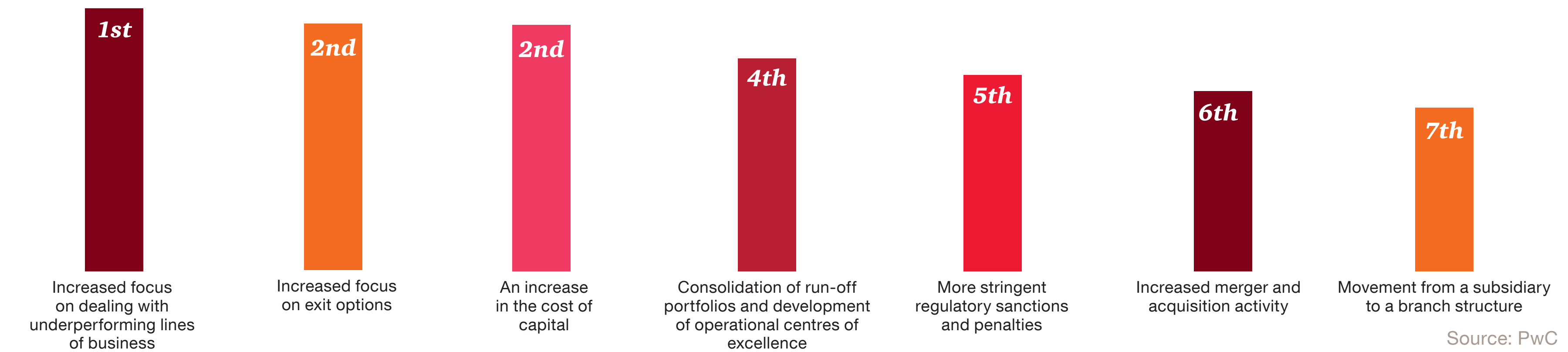
1. UK and Ireland
2. Germany
3. France and Benelux
4. Eastern Europe

Source: PwC

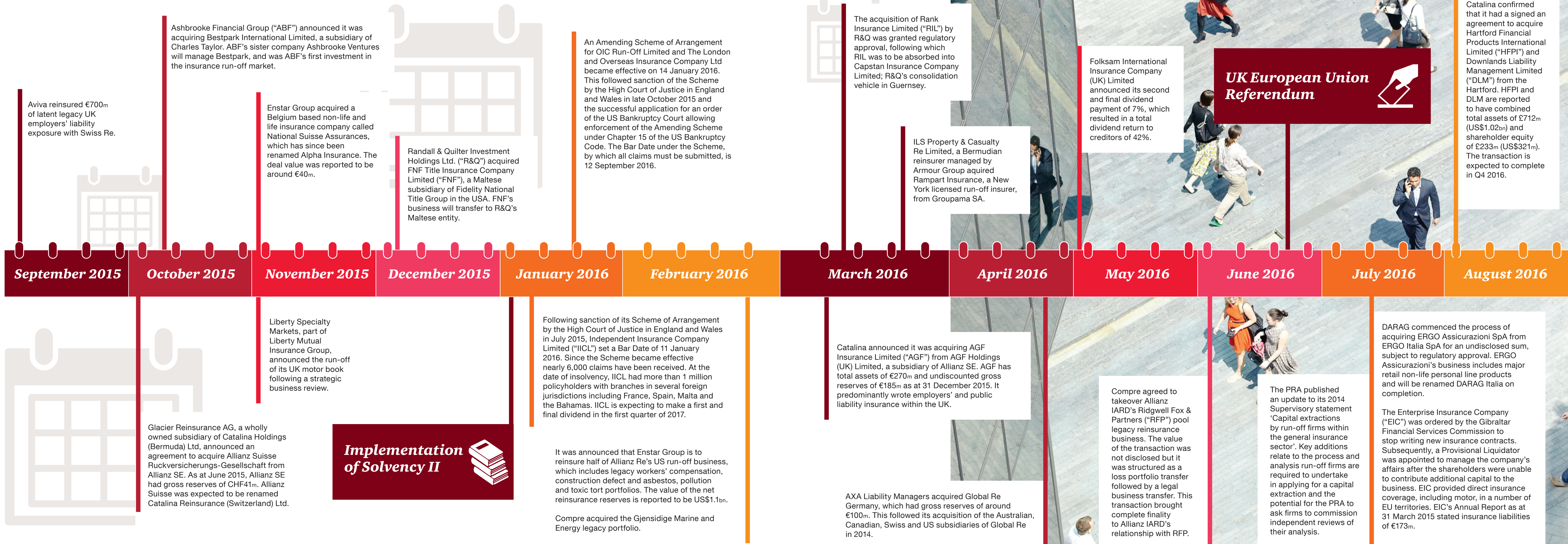
What are the ***top three key objectives*** *of your organisation's or client's strategic run-off plan?*

What are ***the key challenges*** *facing Continental European (re)insurers with run-off business?*

What have to date been the ***practical implications of Solvency II*** *for Continental European (re)insurers with run-off business?*



Run-off highlights from the past year



Aviva reinsured €700m of latent legacy UK employers' liability exposure with Swiss Re.

Ashbrooke Financial Group ("ABF") announced it was acquiring Bestpark International Limited, a subsidiary of Charles Taylor. ABF's sister company Ashbrooke Ventures will manage Bestpark, and was ABF's first investment in the insurance run-off market.

Glacier Reinsurance AG, a wholly owned subsidiary of Catalina Holdings (Bermuda) Ltd, announced an agreement to acquire Allianz Suisse Ruckversicherungs-Gesellschaft from Allianz SE. As at June 2015, Allianz SE had gross reserves of CHF41m. Allianz Suisse was expected to be renamed Catalina Reinsurance (Switzerland) Ltd.

Enstar Group acquired a Belgium based non-life and life insurance company called National Suisse Assurances, which has since been renamed Alpha Insurance. The deal value was reported to be around €40m.

Liberty Specialty Markets, part of Liberty Mutual Insurance Group, announced the run-off of its UK motor book following a strategic business review.

Randall & Quilter Investment Holdings Ltd. ("R&Q") acquired FNF Title Insurance Company Limited ("FNF"), a Maltese subsidiary of Fidelity National Title Group in the USA. FNF's business will transfer to R&Q's Maltese entity.

An Amending Scheme of Arrangement for OIC Run-Off Limited and The London and Overseas Insurance Company Ltd became effective on 14 January 2016. This followed sanction of the Scheme by the High Court of Justice in England and Wales in late October 2015 and the successful application for an order of the US Bankruptcy Court allowing enforcement of the Amending Scheme under Chapter 15 of the US Bankruptcy Code. The Bar Date under the Scheme, by which all claims must be submitted, is 12 September 2016.

Following sanction of its Scheme of Arrangement by the High Court of Justice in England and Wales in July 2015, Independent Insurance Company Limited ("IICL") set a Bar Date of 11 January 2016. Since the Scheme became effective nearly 6,000 claims have been received. At the date of insolvency, IICL had more than 1 million policyholders with branches in several foreign jurisdictions including France, Spain, Malta and the Bahamas. IICL is expecting to make a first and final dividend in the first quarter of 2017.

It was announced that Enstar Group is to reinsure half of Allianz Re's US run-off business, which includes legacy workers' compensation, construction defect and asbestos, pollution and toxic tort portfolios. The value of the net reinsurance reserves is reported to be US$1.1bn.

Compre acquired the Gjensidige Marine and Energy legacy portfolio.

The acquisition of Rank Insurance Limited ("RIL") by R&Q was granted regulatory approval, following which RIL was to be absorbed into Capstan Insurance Company Limited; R&Q's consolidation vehicle in Guernsey.

ILS Property & Casualty Re Limited, a Bermudian reinsurer managed by Armour Group aquired Rampart Insurance, a New York licensed run-off insurer, from Groupama SA.

Catalina announced it was acquiring AGF Insurance Limited ("AGF") from AGF Holdings (UK) Limited, a subsidiary of Allianz SE. AGF has total assets of €270m and undiscounted gross reserves of €185m as at 31 December 2015. It predominantly wrote employers' and public liability insurance within the UK.

AXA Liability Managers acquired Global Re Germany, which had gross reserves of around €100m. This followed its acquisition of the Australian, Canadian, Swiss and US subsidiaries of Global Re in 2014.

Folksam International Insurance Company (UK) Limited announced its second and final dividend payment of 7%, which resulted in a total dividend return to creditors of 42%.

Compre agreed to takeover Allianz IARD's Ridgwell Fox & Partners ("RFP") pool legacy reinsurance business. The value of the transaction was not disclosed but it was structured as a loss portfolio transfer followed by a legal business transfer. This transaction brought complete finality to Allianz IARD's relationship with RFP.

The PRA published an update to its 2014 Supervisory statement 'Capital extractions by run-off firms within the general insurance sector'. Key additions relate to the process and analysis run-off firms are required to undertake in applying for a capital extraction and the potential for the PRA to ask firms to commission independent reviews of their analysis.

Catalina confirmed that it had a signed an agreement to acquire Hartford Financial Products International Limited ("HFPI") and Downlands Liability Management Limited ("DLM") from the Hartford. HFPI and DLM are reported to have combined total assets of £712m (US$1.02bn) and shareholder equity of £233m (US$321m). The transaction is expected to complete in Q4 2016.

DARAG commenced the process of acquiring ERGO Assicurazioni SpA from ERGO Italia SpA for an undisclosed sum, subject to regulatory approval. ERGO Assicurazioni's business includes major retail non-life personal line products and will be renamed DARAG Italia on completion.

The Enterprise Insurance Company ("EIC") was ordered by the Gibraltar Financial Services Commission to stop writing new insurance contracts. Subsequently, a Provisional Liquidator was appointed to manage the company's affairs after the shareholders were unable to contribute additional capital to the business. EIC provided direct insurance coverage, including motor, in a number of EU territories. EIC's Annual Report as at 31 March 2015 stated insurance liabilities of €173m.

Market size

Nick Watford

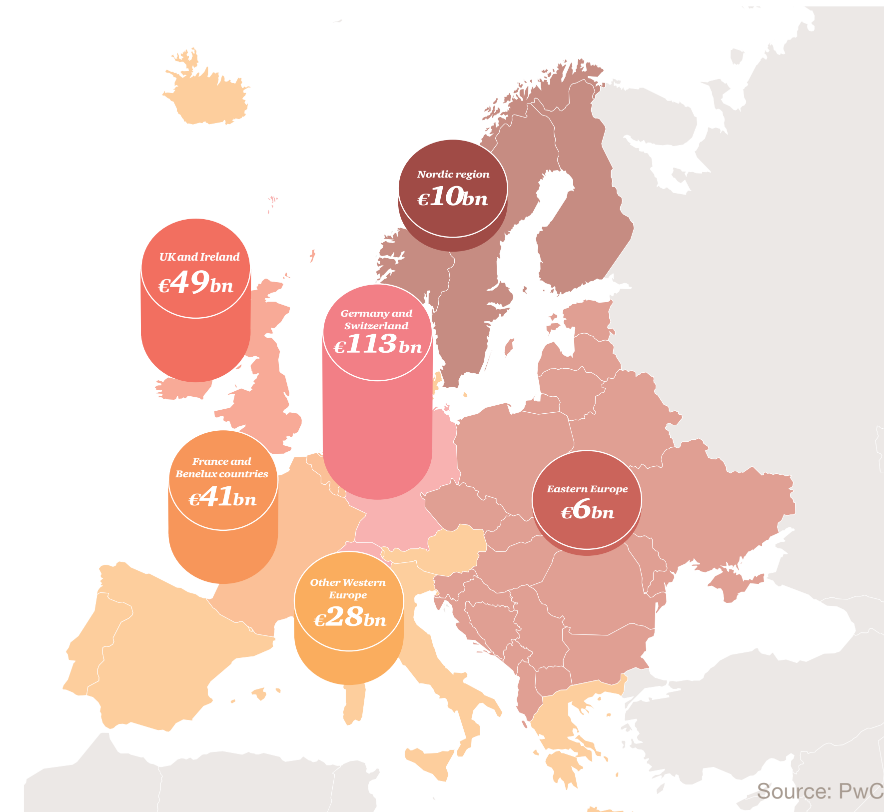
As might be expected, and as confirmed by our Survey participants, Solvency II has continued to drive a focus on capital efficiency and effective legacy management, leading more Continental European (re)insurers to re-classify business as run-off. However, this year we have seen the size of the European market stabilise at €247bn following several years of consistent growth. As shown in Figure 1, increases in legacy business in Eastern Europe and Germany have been offset by a decrease in the UK where, in particular, soft market conditions have limited the growth of run-off in the London Market. Figure 2 shows how the estimated size of the European non-life run-off market has developed over time.

We have seen two key influencers of run-off growth in Continental Europe over the last 12 months:

- The continuation of a very low interest rate environment means insurers are having to focus even more on achieving underwriting profit. This pressure is leading to an increasing number of lines of business being put into run-off.
- The pro-active management of legacy business is becoming more commonplace with Solvency II continuing to throw the spotlight for (re)insurers on the most efficient and optimal use of capital. A pattern is emerging of smaller and locally based organisations starting to classify business as run-off, most notably in Germany. Whilst this has been standard practice for a number of years for larger (re)insurers, an increase in business defined as legacy is being driven by smaller entities taking this approach.

Whilst we see a consistent theme of Solvency II focusing (re)insurers on optimising capital, we have also noted some instances where Solvency II has identified capital shortfalls that have contributed to an exit, or as in the case of Enterprise Insurance Company in Gibraltar, a failure. Capital concerns, alongside (re)insurers' desire to reduce volatility arising from prior year loss deterioration, remain at the heart of the legacy market across Europe.

Figure 1: Estimated size of the non-life European legacy insurance market

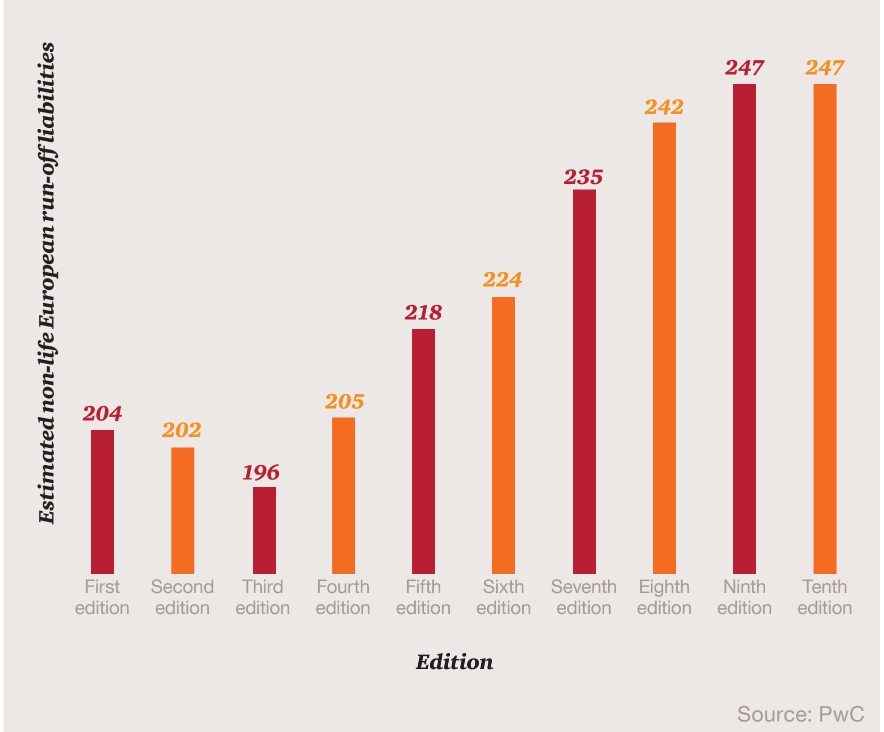


The story in the UK and in the London Market in particular is very different. The last major loss to hit the London Market took place in 2011, and the relatively stable claims experience since then has made it attractive to investors. In recent years this interest has been heightened as a result of low interest rates reducing the level of investment return achievable through more traditional financial instruments such as equities and bonds.

These conditions have resulted in stronger competition for written business and a downward pressure on premium rates. This soft market, together with reduced investment returns, means a tough environment for (re)insurers to achieve their target returns on capital. Consequently an area of focus for some (re)insurers has been to take a closer look at static legacy reserves resulting in reserve releases which have contributed to the overall reduction of run-off liabilities in the London Market. Adjustments to prior year reserves can also benefit capital requirements but the approach is not without risk as it increases exposure to the inherent uncertainty and potential volatility associated with legacy liabilities.

Despite recent experience, legacy is forecast to increase over the medium term in the UK and in the past year we have seen some strategic decisions to withdraw from business lines such as motor. UK (re)insurers continue to lead the way in managing legacy business. They have been keen to supply the consolidator market with opportunities to acquire long tail legacy liabilities as they implement transactions to dispose of non-core books that produce potentially very significant capital benefits. The last 12 months have seen a marked increase in transactions and restructuring and this trend shows no signs of abating.

Figure 2: Estimated size of non-life European legacy insurance market (€bn)



(Re)insurers' desire to reduce volatility arising from prior year loss deterioration remains at the heart of the legacy market across Europe

Strategic considerations for run-off

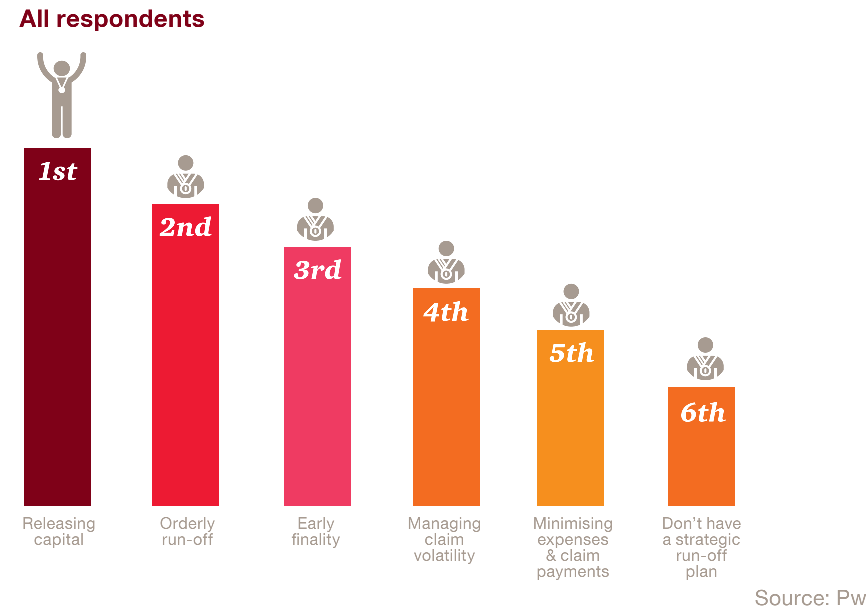
Andrew Ward

During the ten years that we have published this Survey the run-off landscape has seen many developments. From the preparation for and implementation of Solvency II, to the growth and diversification of run-off consolidators around Europe and other territories, the decline in use of solvent schemes and the increasing popularity of reinsurance and insurance business transfer solutions as key tools for providing finality, the market has continually evolved.

The level of run-off activity seen in Europe over the past two years is as high as it has perhaps ever been, with the deals market in particular thriving. In addition we saw what in recent times is a rarity; an insurance insolvency in the form of Enterprise Insurance Company in Gibraltar.

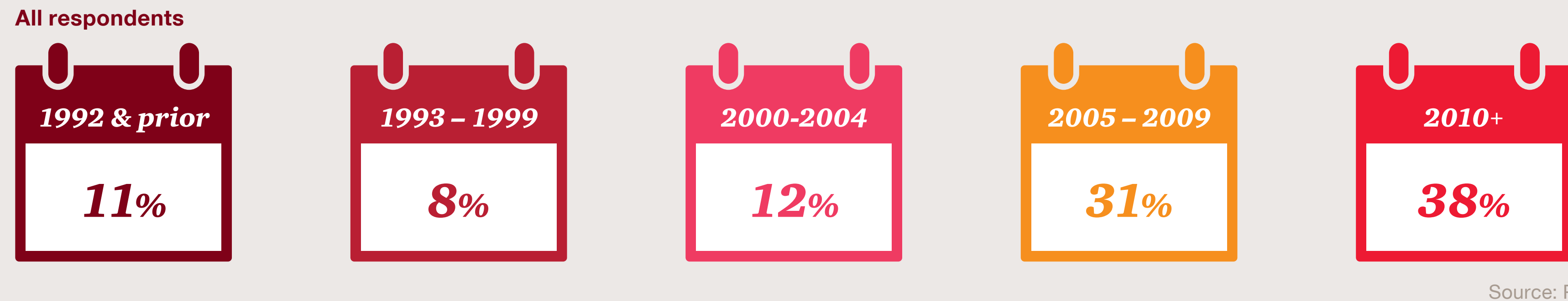
Against this backdrop however, the key strategic objectives for owners of (re)insurance run-off business have been broadly consistent with previous editions of the Survey as shown in Figure 3. Survey participants continue to cite releasing capital, orderly run-off and early finality as the primary objectives of their strategic run-off plans. Managing claims volatility has fallen to fourth in the rankings but this may be explained as being implicit in achieving an orderly run-off that delivers no surprises.

Figure 3: What are the key objectives of your organisation's or client's strategic run-off plan?



Source: PwC

Figure 4: What is the most recent underwriting year that your organisation or that of your client classifies as run-off business?



Source: PwC

These objectives link directly to the fundamental strategic choices that all owners of discontinued business face, namely:

- to keep the business and passively run it off to expiry; or
- pro-actively manage run-off claims using an internal run-off team or an outsource provider, with a focus on delivering value through more efficient claims handling and commutations where appropriate; or
- dispose of the business to a third party.

Preparation for Solvency II and the objective of releasing capital have been key strategic drivers in the recent popularity of the disposal route.

Larger scale businesses that have been able to commit the resources and time to fully comply with Solvency II have been able to take informed decisions regarding their run-off portfolios. Some have elected to dispose of capital intensive long tail books of business, confident that the capital relief they generate will significantly offset any short term transaction cost and P&L hit. Others have invested in the creation of internal centres of excellence and we expect to see more of this as organisations become more sophisticated and selective around the lines of business they discontinue but retain, or discontinue and sell.

The results of the Survey over the past ten years have clearly indicated that there are fewer and fewer (re)insurers following a passive run-off approach. However, the nature of legacy is such that new run-off liabilities are constantly emerging. As indicated in Figure 4 the environment continues to show that more recent years of business are being classified as run-off. Where new run-off occurs in less mature markets that do not have a long track record of pro-active run-off management, then the skills to address the run-off challenge internally need to be developed and this can take time. Consequently, we envisage opportunities for acquirers and outsources to offer alternative run-off or exit solutions in emerging markets such as Eastern Europe.

Figure 5 indicates that engaging stakeholders at board level, adverse claims development and compliance with Solvency II continue to feature as key challenges faced by Survey respondents in trying to achieve their run-off objectives.

Figure 5: Please rank the top challenges facing Continental European (re)insurers with run-off business

Source: PwC

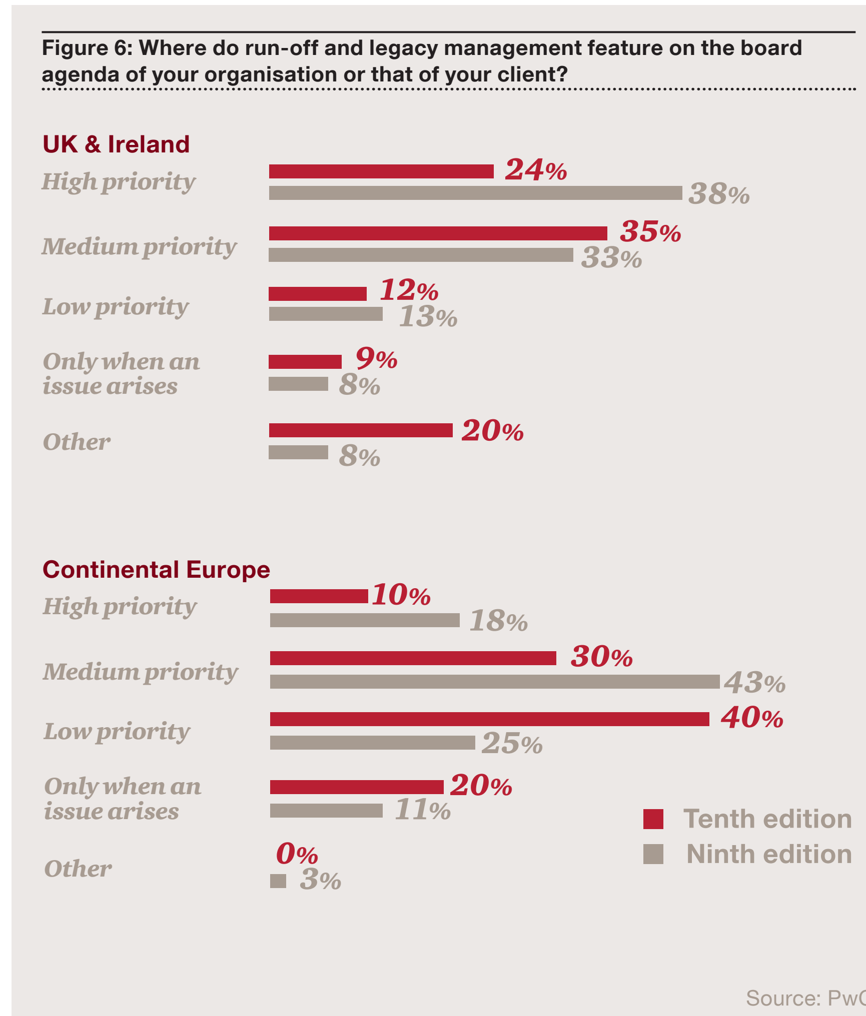
The level of run-off activity seen in Europe over the past two years is as high as it has perhaps ever been, with the deals market in particular thriving

As shown in Figure 6, legacy management continues to be higher up the Board agenda for UK and Ireland based Survey respondents than those in Continental Europe. This is representative of the larger scale run-off transactions seen in the last year that have predominently featured UK portfolios and entities. Given Solvency II's implementation, and the number of European run-off transactions seen in the last year, we are surprised that more Continental European respondents have indicated that run-off is low priority. There is an increase however in Continental Europeans indicating that run-off is prioritised when an issue arises.

Run-off consolidators who acquire legacy books are not immune to challenges of their own. Their strategic plans will consider the most advantageous location for their operations, the most appropriate business model and the ability to extract capital and keep investors happy. In particular it will be interesting to see if more of the consolidators begin to adopt a live to legacy model to expand their service offering and explore new markets.

With Solvency II continuing to present opportunities to some and threats to others, the introduction of EU wide tax changes and the uncertainty around Brexit's impact, it is clear that there are significant drivers for the legacy sector that will influence strategic choices for some time to come and maintain the high level of activity the market is currently experiencing.

Figure 6: Where do run-off and legacy management feature on the board agenda of your organisation or that of your client?



Source: PwC

Kurt Mitzner

"From a German perspective I am seeing a number of trends in the market. Importantly there now seems to be less of a reputational concern about run-off by German insurers. Pro-active run-off management is increasingly seen as a valid part of the insurance lifecycle and requires appropriate attention as cost pressures continue to be felt on existing business lines. This is being driven by insurers taking a much greater risk / return approach in assessing their portfolios and I think will result in more transactions overall. There is certainly interest in German run-off from both private equity and strategic investors and we are also now seeing interest in the life sector as well as on the non-life side."

The changing tax landscape

Stuart Higgins

The efficient use of tax losses is frequently an important part of maximising the value from run-off portfolios but new rules proposed in the most recent UK budget impact this approach. The proposals restrict the utilisation of tax losses and follow the implementation of similar rules across Europe including in Germany, France and Spain. The new rules would mean companies can only use carried forward tax losses against up to 50% of their profits above £5 million in any one period.

The UK proposals, as with the rules already in existence across Europe, will most likely extend the period over which losses are utilised. Critically for legacy business this could mean that full value is not realised before the business has completely run-off. There can also be important knock-on implications for the recognition of deferred taxes in financial reporting and Solvency II capital calculations. Run-off businesses with significant carried forward losses will need to assess the impact of these rules on their business forecasts and capital models.

A key influence on international tax policy has been the finalisation of the OECD's Base Erosion and Profit Shifting ("BEPS") project. The project sought to reform international taxation by addressing situations where profits are perceived as geographically divorced from activities.

From a run-off perspective we have witnessed a trend for run-off groups to explore the use of intra-group reinsurance structures in locations such as Malta which are able to deliver increased returns. The BEPS proposals will in general increase the standards around substance and documentation in these structures, alongside improving tax transparency through the implementation of country by country reporting.

Tax policy is continually changing and run-off businesses will need strategies in place to monitor and adapt to these changes to ensure successful optimisation and risk mitigation are achieved.

Stephen Arnold

Baljit Goraya

Run-off in the Solvency II and Brexit era

After years of preparing for Solvency II and beginning to deal with life after implementation, the insurance industry now faces a new challenge from Brexit. We anticipate a prolonged period of uncertainty before there is sufficient clarity around what exactly Brexit will mean for both the UK and the rest of Europe. Although on the surface nothing has currently changed and the industry has largely taken the news in its stride, the coming months will be a critical period for the market as a whole to take stock, prepare for and then navigate any necessary changes.

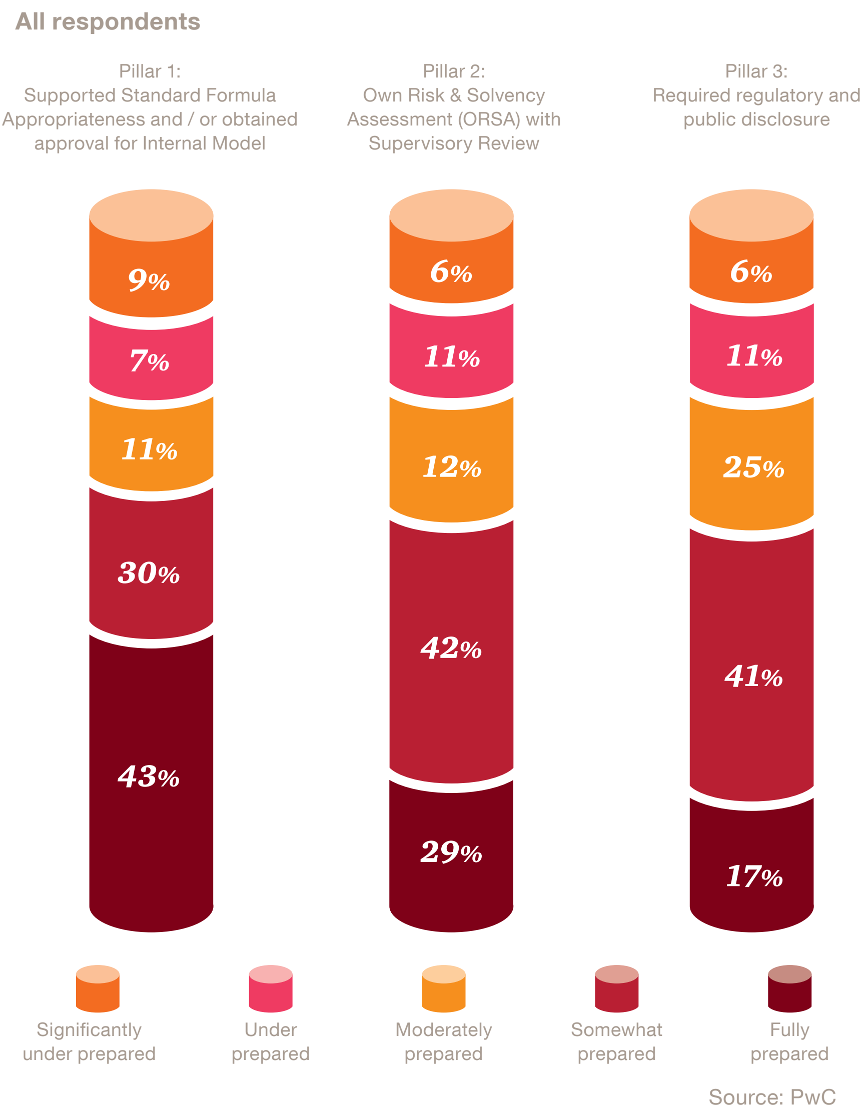
In many ways Brexit is just another disruptor that (re)insurers need to deal with. It is however, a disruptor which, instead of impacting market share or profitability, may drive more significant changes. While the insurance industry in Europe deals with the uncertainty of Brexit the full impact of Solvency II's implementation has yet to emerge.

Our Survey indicates that organisations have focussed on getting to the line to be "compliant" with Pillars 1 and 2 with just over 70% of Survey respondents stating they are either ' somewhat prepared' or 'fully prepared'. However there remains a great deal to do in preparing sufficiently for and releasing all the public disclosure information required for compliance with Pillar 3. This is targeted for 2017 and only 17% of Survey respondents felt 'fully prepared'.

The increased disclosure requirements under Pillar 3 will make comparisons between entities more transparent and potentially highlight opportunities for acquirers of legacy books at the same time as shining a light on those who may be more vulnerable.

There is still some time for (re) insurers to get their houses in order before the full disclosure of information becomes public, but that opportunity is quickly disappearing. It is clear that a model of 'wait and see' may no longer be viable.

Figure 7: Please rate your or your client's Solvency II preparedness for Pillars 1, 2 and 3 on a scale of 1 to 5, with 1 being significantly underprepared and 5 being fully prepared.



It is interesting to consider the anticipated implications of Solvency II that our respondents predicted back in the second edition of this Survey compared to now when Solvency II is in operation. As shown in Figure 8 the most significant area of divergence is in the area of more stringent regulatory sanctions and penalties. The results suggest that these may have been more severe than expected. The predicted level of focus on dealing with underperforming lines of business has been consistent and in line with previous respondents' expectations.

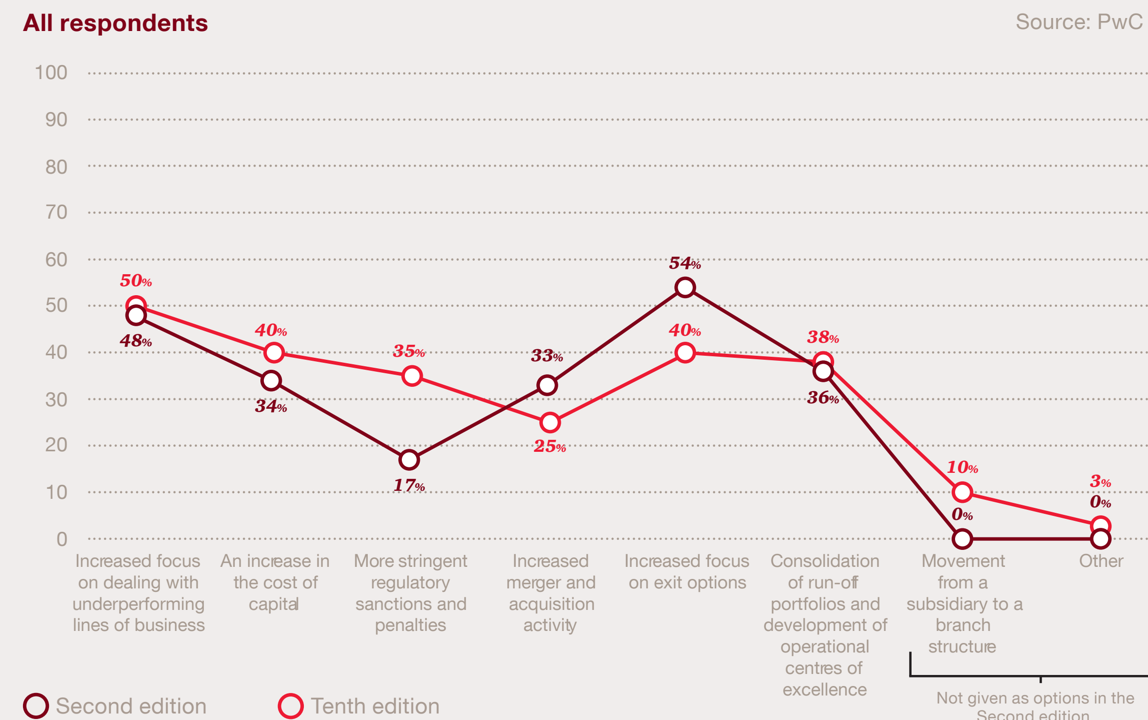
Surplus capital in the live market, rate pressure through an absence of substantial natural catastrophes and persistently low interest rates means there has never been greater pressure to operate as efficient a structure as possible.

As a result many organisations are now turning their attention to how to "optimise" their business to ensure they deliver the level of returns their shareholders are demanding. As foreseen in earlier editions of the Survey, the increased focus on dealing with underperforming lines of business, shown in Figure 8, is one of the approaches (re)insurers are undertaking to deliver these returns.

It is clear that resolving legacy business issues can deliver material value in the short-term and make a significant contribution to overall corporate objectives. Internal rationalisation and optimisation can yield significant benefits but requires (re)insurers to articulate what is fundamental to the business, assess the operational and financial cost of the various options, and then execute that new strategy effectively.

From a capital perspective, this may mean optimising existing resources or accessing new capital as well as changing the risk profile of the business. For some, access to new capital may not be possible and this could lead to new run-off situations. However, the variety of options available today are potentially wider and less costly than at any other point in time, and we expect restructuring activity to respond accordingly.

Figure 8: Practical implications of Solvency II – what was expected and what has been the reality?



The full impact of Solvency II implementation has yet to emerge

Significant developments in the legacy sector over the last ten years

Key features of the legacy sector in 2026

Loss of solvent scheme as an exit mechanism

The increase in the M&A market

An increase in US asbestos and environmental claims

UK employers' liability divestment activity

Source: Survey respondents

Paul Corver

IRLA Chairman

What has been the most significant development in the run-off market since this Survey launched ten years ago?

The most significant development is the continuing change in attitude to run-off and the proactive management of legacy liabilities. Once considered a dirty word and denied by many live carriers we now see dedicated run-off divisions created in many large insurers and reinsurers with an increasing willingness to dispose of those liabilities. This change in attitude is reflected in the growing membership of IRLA where the education, development and networking provided by the Association are becoming increasingly recognised not just in the UK, but across Europe and beyond. Run-off is no longer hidden in the basement.

What will be the key features of the run-off environment in 2026?

I envisage continued development of trading platforms for the transfer and disposal of legacy liabilities with more investors and carriers wanting to participate. Innovation and development of tools for pro-active run-off management will continue and hopefully enable the strategic development and deployment of run-off solutions especially across the USA, where we see significant opportunities held back by lack of process. IRLA will continue to provide valuable education and networking for members and will extend its reach even further into Continental Europe and The Young Professionals Group will have developed into the next generation of senior practitioners.

Scale and permanence of the major run-off players

The addition of new claim types such as fracking

Increased use of technology to settle claims more quickly

Source: Survey respondents

2006 ········· 20 16 ········· 2026

The growth of Part VII transfers

Acceptance of run-off as a risk management issue, a profit centre and a cost ratio reducer

The amount of capital available to the sector

Source: Survey respondents

Dan Schwarzmann

Head of Market Initiatives & Industries and Solutions for Discontinued Insurance Business

What has been the most significant development in the run-off market since this Survey launched ten years ago?

I took the opportunity to look back to our first Survey and was struck by the relatively low profile of run-off business in Continental Europe at that time. While this Survey shows that board level engagement still remains a challenge for Continental European (re)insurers, the last ten years have seen Continental European run-off come far more into the spotlight. We have seen run-off transactions occur in many territories over that time as live (re) insurers have dealt with legacy business to reduce cost, manage volatility and achieve capital efficiencies. Clearly, Solvency II is currently a big factor here and I expect that to continue as the transparency it provides facilitates clear decision making over lines of business that (re) insurers may wish to exit.

What will be the key features of the run-off environment in 2026?

I think that the run-off market will still be significant in 2026. (Re)insurers in Continental Europe will continue to recognise the need to develop run-off centres of excellence, making the run-off cycle more predictable as companies manage portfolios pro-actively before seeking an exit though disposals or restructurings. I expect run-off consolidators to continue to widen their appetite for different types of business as they have with employers' liability, and in particular I think that in the future there will be an established market for the trading of PPO liabilities. From a geographical perspective I expect to see run-off developing in Eastern Europe as the insurance market there matures, and further afield the US could see significant activity if Rhode Island's Insurance Business Transfer initiative gains traction.

The growth of the market as (re)insurers transform and rid themselves of legacy IT, products and distribution systems

Hopefully a regulatory environment which recognises the benefits that a thriving run-off industry provides

Source: Survey respondents

Alan Augustin

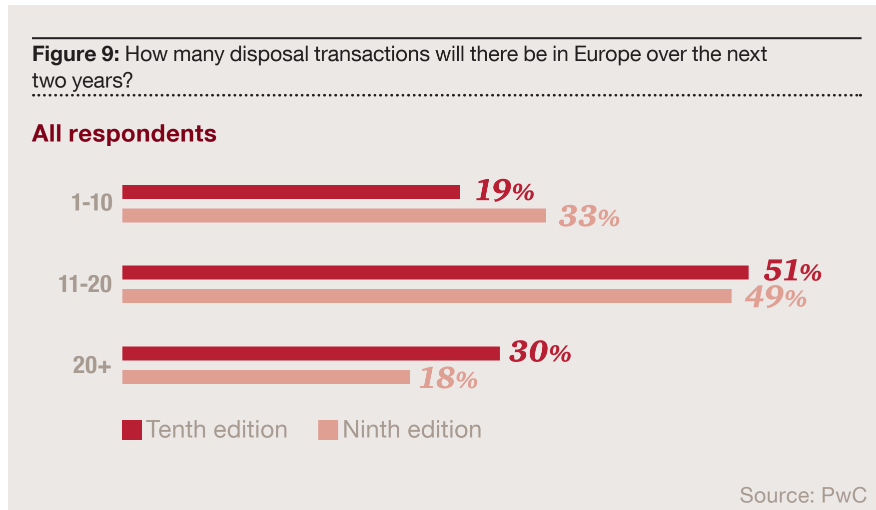
The legacy transactions market

By common consensus the past year has seen almost unparalleled levels of M&A activity in the legacy sector, with most of the established players concluding transactions. Our Survey indicates that this will continue. Some 77% of Survey respondents expect that they or their client are likely or highly likely to engage in restructuring or exit activity in the next three years.

Without doubt, the run-off transaction landscape is now the busiest that it has been in years. What has been most interesting to see from a geographical perspective is the increased activity across Continental Europe alongside a very lively UK market. The long awaited arrival of Solvency II has added impetus to company boards when assessing their portfolios and considering the capital implications of holding or disposing of certain lines of business. This is reflected in our Survey results which show in Figure 9 that respondents expect the high levels of disposals to continue. Over 80% expect there will be more than ten disposals over the next two years with 30% expecting more than 20 disposals. Furthermore, almost a fifth of respondents believe that there will be in excess of 30 disposals.

This level of optimism has been a significant shift in the way Survey respondents have answered this question in recent years with more participants on a year-on-year basis predicting ever higher levels of disposal activity. This illustrates the increased confidence within the seller community to propose transactions, the continuing strong appetite of acquirers of run-off portfolios and the increased expectation of more deals being concluded.

Figure 9: How many disposal transactions will there be in Europe over the next two years?



There has been significant activity in the UK market with landmark transactions in the Employers' Liability ("EL") space led by Swiss Re's reinsurance of Aviva's liabilities, and Allianz's disposal of AGF to Catalina. Just a couple of years ago UK EL seemed to be a bridge too far for both sellers and consolidators. This has changed though with the coming together of a number of factors; (i) increased Solvency II capital charges for long tail classes of business; (ii) further reform and legal certainty in the courts; and (iii) a change in appetite and the scale of legacy consolidators. This has resulted in many of the major UK EL books changing hands with transactions for the remaining books expected to be initiated in the next year.

The acquisition environment in the UK is as competitive as ever and some buyers appear willing to sacrifice returns to maximise deal flow, perhaps to attract new investors or to bolster balance sheets and profile with an eye to a future public offering. Continental Europe has not experienced deals on quite the same scale but there has been activity across the board with a number of pivotal transactions taking place. Figure 10 illustrates the lines of business respondents think are most likely to be the subject of future run-off transactions with many the domain of Continental European insurers. Wider reach has also been observed with deals being executed in less traditional run-off locations such as Italy and Greece and deal pipelines beginning to feature opportunities in Eastern Europe.

Figure 10: Which lines of run-off business are most likely to be sold?

Source: PwC

Our Survey forecasts that activity in the next two years is likely to be experienced in the UK and Ireland, Germany, France and Benelux and also Eastern Europe as shown in Figure 11. The Survey also anticipates that the most commonly transacted portfolio size will be €11-50m with 44% of respondents expecting deals in this range as illustrated in Figure 12. There has also been a trebling in the proportion of respondents who believe portfolios over €100m are the most likely to be disposed of over the next two years demonstrating confidence in deal flow at the top end of the market.

One of the interesting features of the past 12 months has been the different structures that sellers have been willing to consider and indeed that buyers have inventively put together. Sellers commonly cite the fundamentals of price, speed and execution risk as their key objectives in concluding a deal but other considerations such as capacity, security and the treatment of policyholders are every bit as important. The ever increasing demands from sellers and the competitive landscape has meant that buyers have stepped up to access new providers of capital such as pension funds and ILS vehicles to provide greater bandwidth and flexibility. Partnering and fronting arrangements with reinsurers are also expected to become more prevalent. Protected cell structures based in Malta, the Channel Islands and as far afield as Bermuda are also now more common and private equity investment, especially amongst the emerging, hungry, mid-tier players is here to stay, though margins are perhaps less healthy as competition for books intensifies. Whatever the need, buyers are now much more adept at leveraging their resources and relationships to offer the best price and most acceptable structure from both a transaction and regulatory perspective.

We have also seen a continued trend towards run-off transactions involving portfolios or books of business that sit within live entities, rather than share sales of standalone run-off entities (which are now relatively few and far between). Whilst the economic interest in these books is typically being transferred by way of reinsurance, there is a decision for the counterparties as to whether a transfer of the legal obligation is also required, in order to deliver complete finality.

Figure 11: In which territories do you think the most disposals will occur?

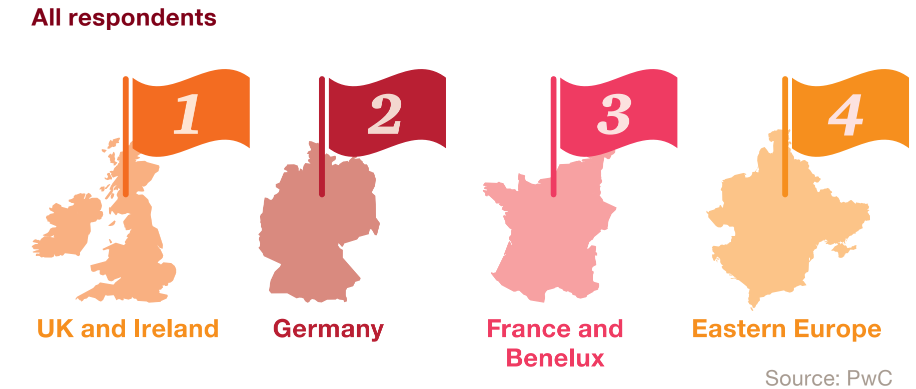
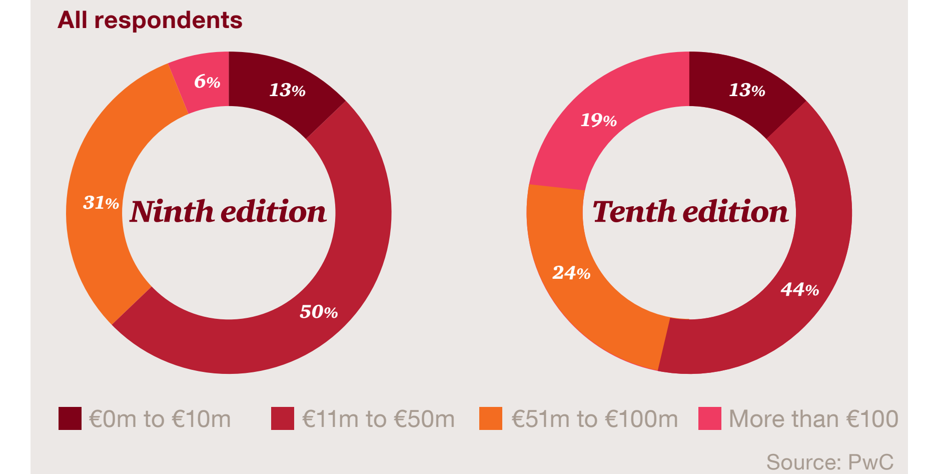


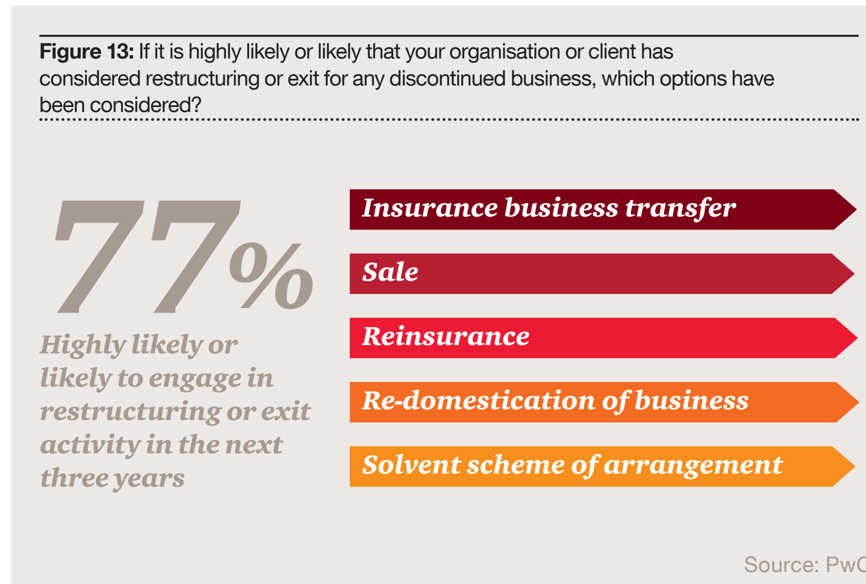
Figure 12: What portfolio liabilities sizes will be most commonly disposed of by way of a sale or portfolio transfer over the next two years?



There are different schools of thought here and recent transactions have seen some sellers actively wanting to maintain legal title and claims handling, allowing them to retain a high degree of control to manage reputation and conduct risk. In other instances there has been a desire for a completely clean break and in this case, the time and expense associated with a Part VII type transfer needs to be considered. The level of these costs needs to be factored into the transaction pricing which is of particular importance for smaller deals.

If recent activity is a measure however, we expect Part VII transfers (or their equivalent in other European territories) to remain a key tool in restructuring run-off liabilities going forward. As Figure 13 shows, 77% of the respondents indicated they are likely or highly likely to restructure discontinued business in the next three years, with Part VIIs and sale being the most likely options considered in order to meet shareholder objectives.

Figure 13: If it is highly likely or likely that your organisation or client has considered restructuring or exit for any discontinued business, which options have been considered?



Source: PwC

James Tye

The impact of legacy business on live market deals

Given that reserve sufficiency is one of the most judgmental areas of value for risk carriers, it is generally a point of debate between sellers / management and potential buyers / investors. Within the live market this issue is naturally more acute for organisations with longer tail or more volatile legacy books.

Concerns around legacy business have been known to cause deals to abort, either because of difficulties in agreeing the value of the legacy books or because these portfolios create uncertainty in buyers' minds when considered in the context of the overall 'live' strategy of the group. The availability of a variety of run-off tools can bring certainty, as well as value, to both parties.

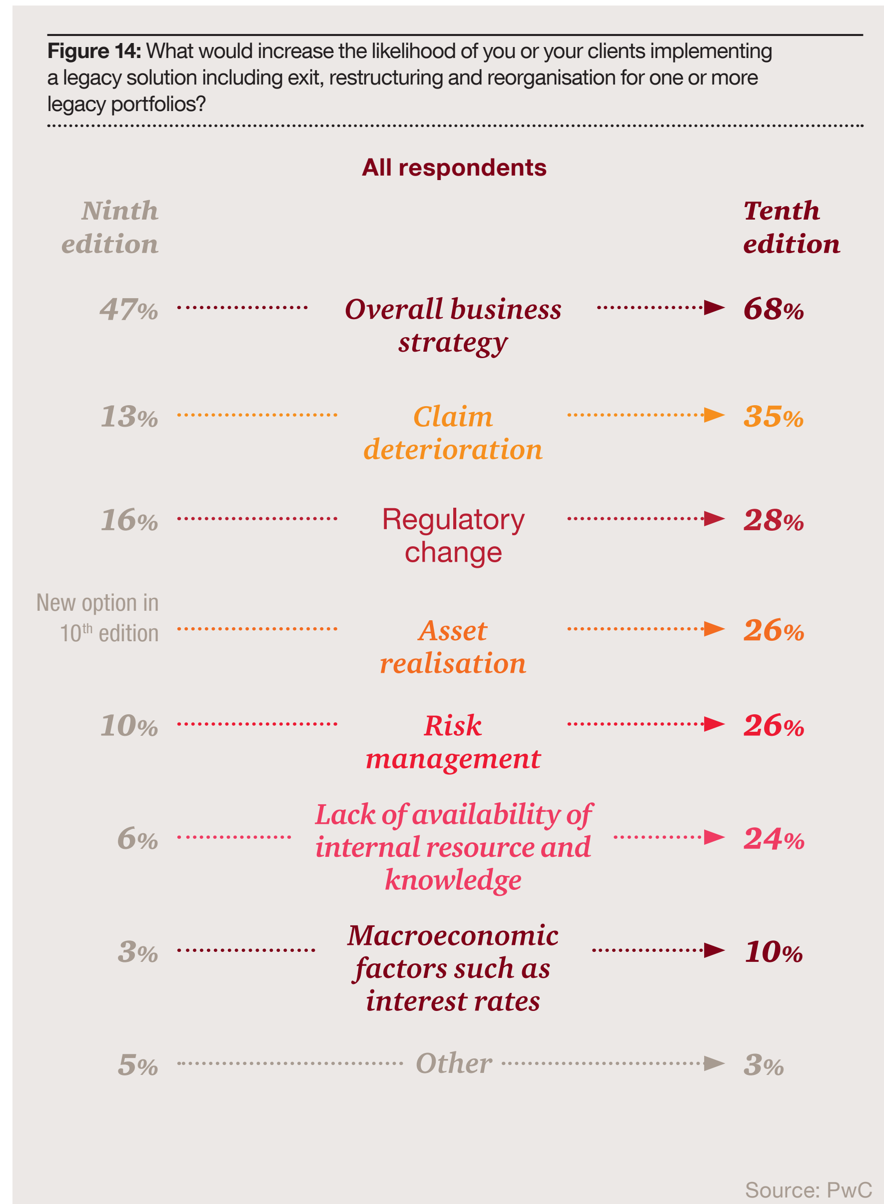
The legacy sector is well known for its innovation and flexibility, and the uncertainty provided by Brexit to the transactions landscape will also be exercising participants' minds. This includes getting to grips with an environment that may make transfers of UK acquired business to European destinations a thing of the past. Decreasing bond yields will also put pressure on pricing but on the bright side a new pipeline of transaction opportunities may emerge if, for example, passporting rule changes result in business lines being discontinued and territories being exited.

Figure 14 illustrates the factors that may influence restructuring or exit activity and it is no surprise that overall business strategy tops the list. It would seem highly likely that this will retain its prominence as (re)insurers come to terms with the implications of Brexit.

With the forays of some players into both live insurance underwriting space and the life assurance market, the signs are strong that the legacy transaction market will continue to be inventive and active in the foreseeable future. With the competitive nature of the buyer environment and the increased propensity for sellers to transact, the outlook remains bright in the discontinued insurance business world.

The acquisition environment in the UK is as competitive as ever and some buyers appear willing to sacrifice returns to maximise deal flow

Figure 14: What would increase the likelihood of you or your clients implementing a legacy solution including exit, restructuring and reorganisation for one or more legacy portfolios?



Source: PwC

Michael Cook

Claims: Past, present and future

Continuation of the soft market and a further decline in investment returns have contributed to the CEOs of (re)insurers focusing on cost reduction and claims costs. Our recent CEO survey found that 70% of insurance CEOs are planning to implement a cost reduction initiative over the next 12 months.

The narrowing profit margins of (re)insurers have also put pressure on reserve levels in a number of markets, with Regulators warning (re)insurers to ensure that they are adequately reserved, not just for the losses they already have on their books, but also those that may come. This warning follows a number of years of relatively benign catastrophe losses, although we have seen increased attritional losses in a number of classes.

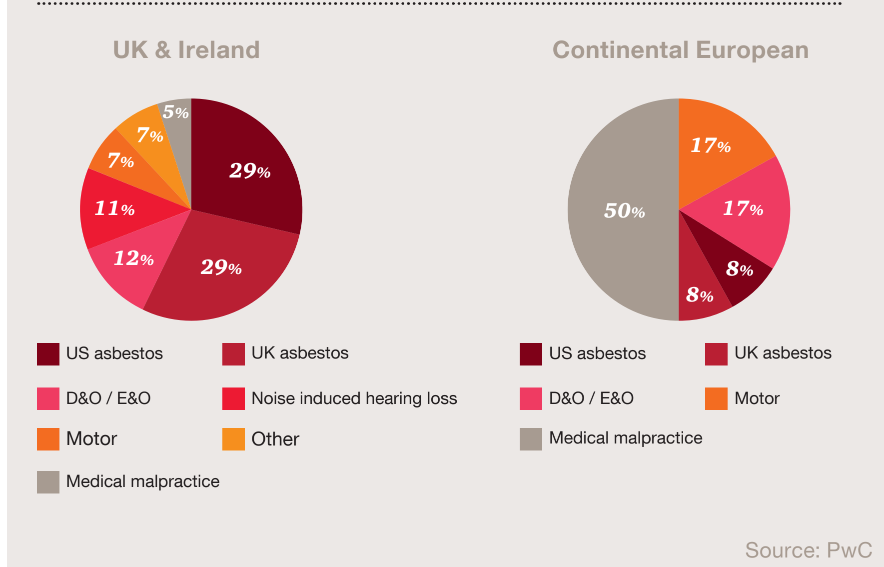
The US P&C market is predicted to have a combined ratio of 99.5% this year and a number of global, European and Asian (re)insurers have cited increased losses in Q2 earnings as a main reason for declining profits. However, we were therefore surprised to note that only 21% of Survey respondents noted that they had experienced significant increases in legacy claims volumes over the last year. It will be interesting to see if increased loss experience results in more business lines being discontinued in the next underwriting year.

These are not the only pressures impacting the claims functions. (Re)insurers are striving to remain relevant, differentiate themselves from competitors as well as retain and attract new customers in a highly regulated environment.

Customers are also demanding better and more convenient ways to engage with their insurers, especially during the claims process. While CEOs are focused on cost reduction we are seeing many (re)insurers reinvest those savings in new approaches and technologies. Globally, (re)insurers are expected to invest billions of dollars in technology over the next year, a significant proportion of which will be spent in Europe. Key areas of technology investment include core application replacement, customer digital tools and data analytics capabilities.

It is not yet clear how much of this investment will flow through to the legacy market, but the results of the Survey indicate that the challenges of obtaining high quality data continue to have a significant impact in the run-off environment, for example in the area of commutations.

Figure 15: Which of the following claim types has caused you, or your client, the most concern in the last 12 months



Source: PwC

Globally, (re)insurers are expected to invest billions of dollars in technology over the next year, a significant proportion of which will be spent in Europe. Key areas of technology investment include core application replacement, customer digital tools tool and data analytics capabilities

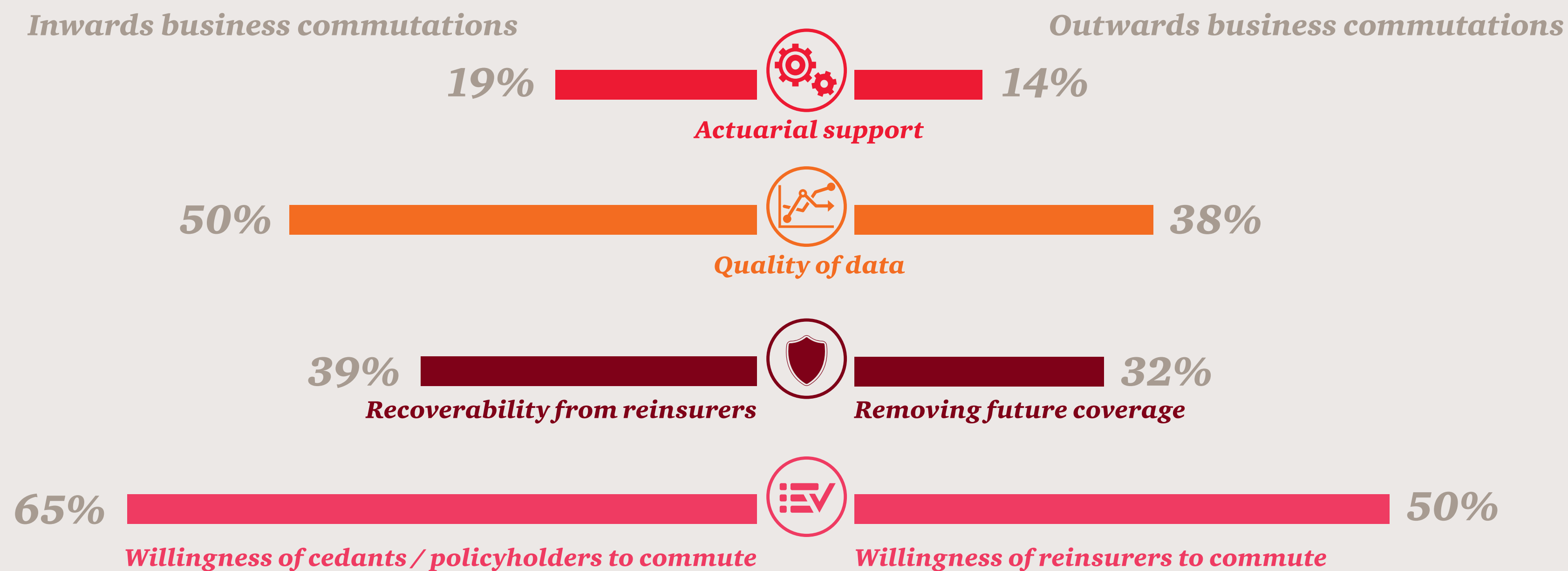
Even amongst live (re)insurers, cost savings alone are unlikely to provide the funding for such a material spend, further fuelling the drive from (re)insurers to explore opportunities to better deploy capital to achieve higher returns. When combined with the demands of Solvency II it is therefore no coincidence that a number of major (re)insurers across Europe have been involved in transactions to dispose of books of legacy business. In particular, many 'legacy' claim types such as Asbestos, US Pollution and Noise Induced Hearing Loss continue to see new claims and, in our experience, in a number of instances increases in case and IBNR reserves.

Figure 15 illustrates the claim types that have caused (re)insurers the greatest concern over the last 12 months, and it is notable that many of these have been at the centre of the recent run of legacy disposals.

The demands of managing claims effectively and efficiently continue to impact the legacy sector. We have seen outsourcing options pursued where, for example, owners of UK EL legacy business have targeted the need for specialist claims support. As the legacy market grows (re)insurers will need to be open minded to new approaches. Those taking a longer term approach to legacy management could reap the benefits of investing in technology that gives them a competitive advantage.

The Survey results also show that commutations continue to play a critical role in the delivery of the run-off strategy of 83% of respondents. Often they are the main tool used by consolidators to secure quick wins and reserve releases when acquiring traditional books of run-off businesses. As shown in Figure 16, nearly two thirds of respondents cite counterparty interest as a challenge to securing inwards commutations. With many significant run-off books now owned by the run-off consolidators it may be that counterparties now see these players as a long-term part of the industry with strong balance sheets rather than as acquirers of stressed entities with marginal solvency where there might have been more of an incentive to conclude a deal.

Figure 16: If commutations form a key part of your or your client's run-off strategy, what are the key issues you face in completing inwards business and outwards business commutations?



Source: PwC

Julie Pallister

Stephen Harrison

Life insurance: closed book management

The last 12 months have seen increased levels of activity in the European life insurance market as insurers have continued to prepare for the introduction of Solvency II. Now that Solvency II is live, an increasing number are considering the options available for optimising capital and managing the profitability of back books.

A range of tools are available to facilitate this including asset strategies such as interest rate hedging and credit protection in addition to approaches such as reinsurance, business transfers and mergers and acquisitions. A clear trend, in line with the non-life sector, is that insurers are actively looking to dispose of underperforming assets that under Solvency II attract high capital requirements. As shown in Figure 17, Solvency II has heralded a reduction in solvency coverage ratios for a number of insurers across Europe. This has largely been as a result of increasing capital requirements for products with guarantees, or those providing cover against longevity risk.

In the UK, Solvency II's implementation has led to a number of annuity portfolio sales to a consolidating market which still has an appetite to invest in this business. Rothesay Life, Canada Life and Legal & General have been the most active acquirers seeking to better manage the asset portfolios of these annuity liabilities through investing in longer dated and higher yielding infrastructure and alternative assets.

Other insurers continue to seek to divest with some exiting entire markets as they look to redeploy capital into emerging territories or alternative, more profitable lines of business. For example Axa recently sold its UK and Isle of Man life insurance operations to LCCG as part of a strategy of focusing on emerging markets such as the Philippines and Brazil.

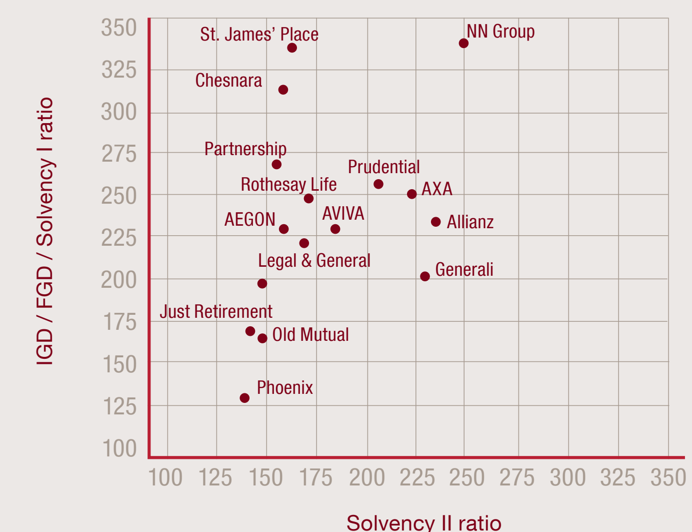
Adding to this, the backdrop of a low interest rate environment that provides a challenge for insurers in meeting guaranteed returns on their back books means we anticipate further disposals of non-core business in the UK. Legal & General has divested its smaller sub scale insurance operations with the sales of its French, Egyptian, and Irish operations to APCIL Prévoyance, Axa and Canada Life.

To date the consolidation market in the UK is considerably more active than in Continental Europe. The challenge of servicing policyholders in multiple languages, a lack of outsourcing partners and until recently, capital measurement being performed on a non-economic basis have meant consolidators have not prioritised this market.

The pressures of Solvency II and the low interest rate environment are also being felt in Continental Europe and we anticipate this will trigger a wave of consolidation. To some extent this pattern of activity began in the southern European markets as a result of the financial crisis. Outsource providers who have found success in the UK life market now have an opportunity to further develop their businesses into Continental Europe, in a move that would likely be welcomed by those seeking consolidation opportunities there.

The pressures of Solvency II and the low interest rate environment are also being felt across the continent and we anticipate this will trigger a wave of consolidation across Europe

Figure 17: Solvency II vs Solvency I



Source: PwC

In the last couple of years, private equity ("PE") investors such as Apollo, Cinven and JC Flowers with an investment horizon of up to five years have invested more heavily in the insurance sector. This has been particularly visible across the distressed economies of Italy, Portugal and Spain where insurance assets appear relatively cheap and there is limited acquisition appetite from traditional insurers. We anticipate more transactions of this type as PE houses gain deeper insight into the market but there are some interesting differences between their experience in Continental Europe and that of the consolidators in the UK.

PE houses investing in Continental Europe have not yet achieved the full potential benefits that flow from integrating their acquisitions. These include taking advantage of capital and operational synergies, tax efficiencies and opportunities to optimise asset and liability management. This may be a deliberate strategy to keep operations separate in order to ease disposal at the end of their investment horizon. This may however be limiting the returns they achieve.

Throughout 2015 and into 2016, we have seen further new investors in the life insurance market from China and Hong Kong such as An Bang, Fosun and Legend Holdings. This is driven by a continuing appetite from the Chinese market to diversify investments outside of the US and local markets. New longer dated money, typically in excess of fifteen years is also now looking at the life sector, with investors from North American pension funds considering this market. Following the EU Referendum in the UK, whilst there appears to be ongoing uncertainty about the long term impact on the UK economy, the immediate consequences have been that UK assets now appear relatively cheap due to sterling's depreciation.

A further consideration for insurers examining their options is the impact of the transitional arrangements that were introduced as part of the Solvency II regime that offer companies the ability to gradually integrate the economic effects of moving from a Solvency I to a Solvency II capital regime over a 16 year period.

Insurers that have applied the transitional measures over technical provisions (TMTP) need to carefully consider the impact of any reorganisation or optimisation on the capital position in their balance sheet. This may mean that where transitional arrangements are in place, insurers' appetite to manage capital through merger and acquisition activity is reduced. However, at least in the short term, the overall outlook for consolidation and transaction activity in the life market looks strong.

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The PwC team

The Solutions for Discontinued Insurance Business 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
- Providing transactional support ranging from due diligence, claims reserving, debt provisioning and tax considerations.

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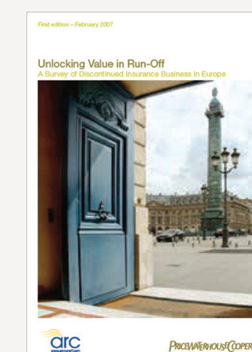

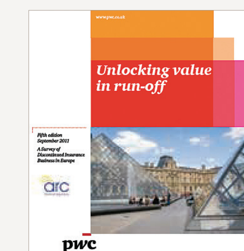

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