September 2019

Global Insurance Run-off Survey

In conjunction with:

irla INSURANCE & REINSURANCE legacy association

AIRROC

Methodology

This year marks the twelfth edition of our Survey. As in previous years the focus is on the non-life run-off market. The methodology followed is outlined below:

Our online survey was sent to a cross section of individuals at (re)insurers, legacy business acquirers, brokers, service providers and other stakeholders in the non-life legacy insurance market. Responses are anonymous and we do not collect any data on the respondents. This publication includes a summary of the results along with quotes provided to free text questions. We have also included quotes approved by industry participants and contributions from a number of PwC individuals that work in the legacy insurance market.

Where appropriate, we have rounded results to ensure the totals add up to 100%.

The research was conducted by PwC UK.

Jim Bichard
UK Insurance Leader
PwC UK

Foreword

I am pleased to welcome you to the twelfth edition of our Survey of non-life legacy insurance business. In 2018 our team expanded its focus outside of Europe as the appetite for disposing of legacy liabilities gained momentum. We have seen that trend continue with nearly 100 non–life legacy deals being completed since our previous Survey.

We have observed tremendous growth in the run-off sector in the last decade and witnessed it develop into a key component of the global insurance macro market. The sector continues to be a great example of PwC supporting its clients across a wide range of disciplines and I am pleased to see a number of colleagues contributing their subject matter expertise to this edition of the Survey.

I am particularly delighted that my counterpart in the US firm, Matt Adams, has contributed his views on the deals landscape in the US, reflecting the huge opportunity we see in that market for value creation through run-off solutions.

Survey responses suggest that the legacy market should continue to be busy in the coming years. Levels of new investment are estimate to increase and regulatory developments are expected to fuel more demand for legacy solutions. Legacy acquirers are seeing significant deal flow in the established markets and this should be boosted by opportunities in both emerging and niche markets such as Lloyd's. We also see significant potential from non-insurance corporates who are only beginning to discover the options available to dispose of long tail liabilities.

The variety of market opportunities is challenging consolidators to innovate and adapt their operating models to the evolving legacy landscape, which now features an increasingly younger vintage and a variety of business lines and liability types.

From a PwC point of view, we continue to see increased activity as a result of the degree of disruption that exists in the wider insurance market. I was really interested to see responses to the Survey which suggest that disruption caused by technological advances in the live market will boost legacy deals activity, and I couldn't agree more with this sentiment. The traditional insurance sector is now experiencing many different forms of disruption, not just driven by new technology. It will be fascinating to see how long it will be before there is a legacy cyber business sale, or other intangible products becoming a staple part of the run-off food chain.

As insurance groups continue to embed the culture of repeatedly selling legacy insurance portfolios to drive capital efficiency, profitability or operational savings, and acquirers continue to realise value, I believe this market will continue to grow. I am a huge proponent of PwC's contribution to the sector and very supportive of our continued investment as a firm in this space.

Enjoy reading the Survey and if you have questions on the sector more generally, please do not hesitate to reach out to our team led by Dan Schwarzmann, Alan Augustin and Andy Ward.

Paul Corver
Immediate Past Chairman
IRLA

A view from IRLA

This is likely the last piece that I will write for the Survey having handed over the role of Chairman of the Insurance & Reinsurance Legacy Association at the annual Congress in June after ten years in the role. The first time I wrote for the Survey was in 2009 when it focused purely on the European market and whilst much has changed since then, that is not the case across the board.

Looking back at that Survey ten years ago, most of the respondents' expectations for development of the sector seem to have materialised. These included more focus on run-off business, an increasing number of companies managing run-off in a dedicated unit with a strategic plan, greater focus on efficiencies and capital extraction, and an expected growth in the use of insurance business transfers. Whilst we have seen the latter continue in the UK, the expectation of greater transaction activity in Continental Europe has never materialised to the extent expected by respondents in the early editions of this Survey.

It is therefore appropriate that PwC extended their Survey to have a global reach as Europe seemed to be reluctant to fully engage or endorse the benefits of proactive run-off management. Whilst there has been some transaction activity it has not reached the scale that had been expected.

The run-off market now attracting more attention is the US where individual states have enacted legislation for insurance business transfers and the National Association of Insurance Commissioners ("NAIC") has a working group looking at how this develops with a possible countrywide approach.

Whilst Europe has benefited from the transfer mechanisms of the Reinsurance Directive for over ten years, the US is only just starting its legislative development in that area. The dichotomy of the two regions amuses me – Europe has the tools although they are infrequently used whilst the US has yet to fully develop the tools but has a market of potentially endless opportunity. The road to a cohesive insurance business transfer process in the US will have its difficulties but at least there is a desire across the industry to discuss this tool.

This sentiment is reinforced by the results of this year's Survey where respondents expect the US to be the busiest territory in terms of both deal volume and size. Respondents also expect further restructuring activity to be driven by the objective of capital release and non-core disposals.

Whilst overall the Survey is upbeat, cited barriers to activity continue to be Board engagement and reputation. These are both perennial issues although the latter is possibly unwarranted in today's market. Perhaps there is concern about the growing influx of capital looking for opportunities, although it is unlikely that new money will complete significant transactions without partnering with an existing and reputable acquirer.

Well, that's it. My ten years as Chairman of IRLA has been truly memorable and I am delighted with how the sector has grown alongside the membership and interest in IRLA itself. The effective management of legacy liabilities is well established in the insurance industry and long may that last.

irla
INSURANCE & REINSURANCE
legacy association

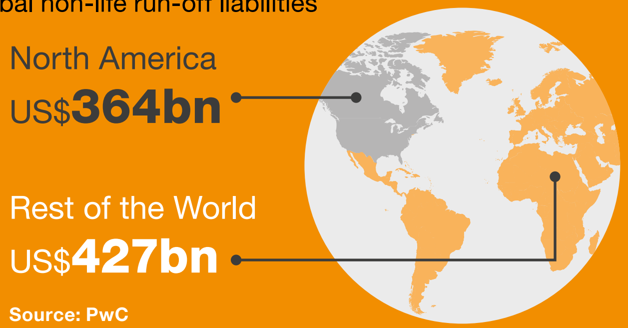
Contents

Key findings

This year's Survey results suggest that the global non-life legacy insurance market is expected to maintain its recent momentum. Our estimate of non-life run-off liabilities has risen to nearly $800bn. Survey respondents predict increased restructuring and investment in the sector, as well as continued growth in run-off deals, particularly in the US.

Figure 1: Estimated global non-life run-off liabilities

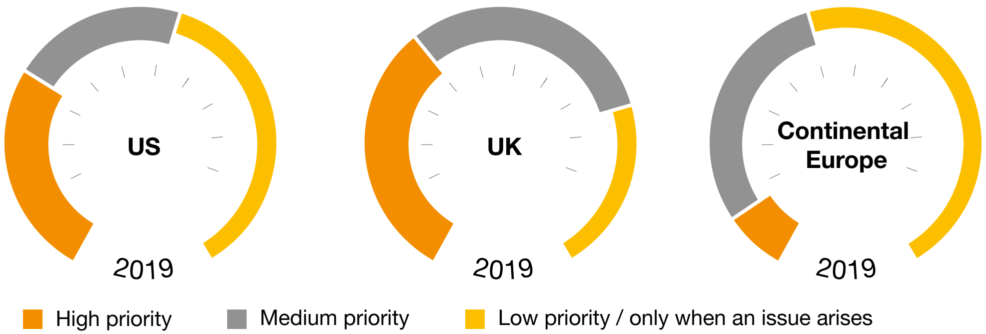
Market size
The North American run-off market represents nearly half the size of the global legacy market.



Source: PwC

Board priority
UK and US respondents continue to cite legacy management as being higher on the Board agenda than their Continental European counterparts. Despite growing numbers of publicly disclosed run-off transactions, the Survey results (Figure 3) do not indicate legacy management to yet be universally a high priority.

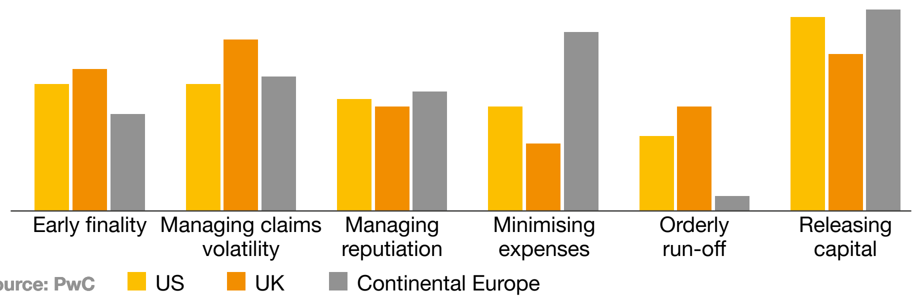
Figure 3: Where does run-off legacy management feature on the Board agenda?



Source: PwC

Objectives
Respondents consistently stated releasing capital as a key objective, with managing claims volatility also featuring strongly (Figure 2). Those in Continental Europe placed greater emphasis on minimising expenses compared to other respondents.

Figure 2: What are the key objectives of your or your client's legacy business?



Source: PwC

Investment and restructuring activity
Survey respondents believe restructuring and investment activity in the legacy market will increase over the next two to three years.

70%

Respondents believe that the level of investment activity in the legacy market will increase over the next two years.

79%

Respondents consider it likely or highly likely that they, or their client, will engage in restructuring activity in the next three years. This represents a slight increase on last year's results, with increased anticipated activity in the US the major driver.

Source: PwC

Deal confidence

Expected number of deals by Survey respondents and most likely deal size by territory over the next two years

Continental Europe	United Kingdom	United States
1-10	**11-20**	**20+**
$51m – $101m	$101m – $300m	$101m – $300m+

Source: PwC

Significant deal activity is expected by Survey respondents over the next two years with Survey responses being broadly consistent with actual experience since the beginning of 2018.

Respondents expect US and UK deal sizes to continue to outstrip Continental European deals.

Figure 4: Challenges faced by buyers and sellers

Survey respondents commented on the biggest challenges buyers and sellers of legacy portfolios experience with one another. Pricing is the single most common factor for both parties.

Source: PwC

Figure 5: Estimated active areas of the legacy market

According to respondents the most active areas of the legacy market over the next 12 months will be:

Source: PwC

Legacy management – the new normal?

Andy Ward
Director,
Liability Restructuring
PwC UK

The last edition of our Survey suggested that the momentum of the non-life legacy sector would continue. With nearly 100 non-life legacy deals being publicly announced since the last Survey was issued in 2018, and new deals being announced weekly if not daily, that analysis would appear to have been well founded.

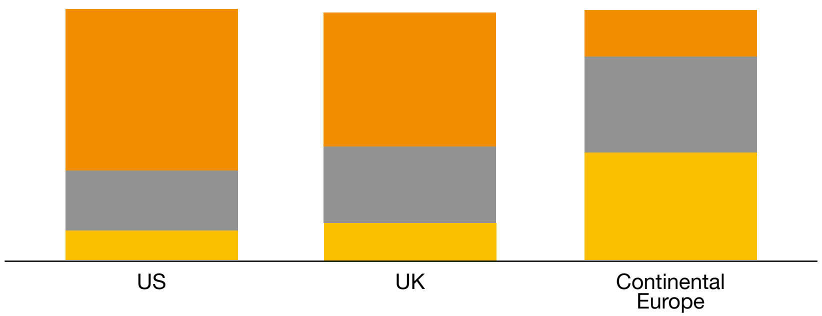
Reflecting on the root causes of this activity, I am left scratching my head to think of a definitive event or regulatory change that can be pointed to as a single driver. After all, it has been three years since Solvency II's implementation in Europe and the market is yet to see an insurance business transfer successfully completed in the US. So without a tangible driver, does the activity level we have seen point to legacy management truly being the new normal with the disposal of non-core lines now an organic part of the insurance lifecycle?

The Survey suggests (Figure 6) that activity is expected to continue at least at current rates for the foreseeable future with nearly 80% of all respondents being highly likely or likely to be involved in restructuring or exit activity over the next three years.

The US is expected to be particularly busy with some 88% of respondents expressing this view compared to 68% in the previous Survey. In contrast, Continental European and UK respondents' views of activity dropped slightly from the previously anticipated levels but still remain upbeat. The major reasons driving this expected continued restructuring and exit activity were broadly consistent by territory, with disposals of non-core business and releasing capital being the most popular responses followed by early finality and managing claim volatility (Figure 7).

As a consistent thread from previous Surveys, we noted that Continental European respondents appear more concerned with restructuring as a way to drive expense reductions than their counterparts from other territories.

Figure 6: How likely is it that you or your client will engage in restructuring or exit activity in the next three years?



Source: PwC ■ Highly likely ■ Likely ■ Highly unlikely

Figure 7: What are the key objectives of your or your client's run-off business?

29% Disposing of non-core business

29% Releasing capital

17% Early finality

16% Managing claims volatility

9% Minimising expenses

Source: PwC

Survey comments

What would you like to change?
"Wider acceptance of legacy as an integral part of the insurance life cycle by more live players."

From the industry's perspective this seems a positive outlook but, as noted on page 12 section of this report, the number of repeat sellers of discontinued portfolios in publicly disclosed deals remains relatively low. There is still a need for much greater diversity of (re)insurance sellers that utilise legacy solutions on a regular and repeated basis if the market is to reach its full potential.

With this in mind we asked Survey respondents to consider the biggest barrier preventing sellers from commencing a legacy transaction. Figure 8 illustrates the most frequent responses. Board engagement consistently rated highly across all territories suggesting that, despite the considerable activity, legacy is still not the standing Board agenda item the market might like it to be. Reputation was cited as the second biggest barrier.

This may be a reflection of the market's development with personal lines policyholders increasingly being the subject of run-off transactions and where sellers remain sensitive to the treatment of policyholders and any associated brand impact.

US respondents to the Survey expressed less concern about reputation as a barrier to legacy sales. This may be indicative of the types of transactions seen in the US to date, namely reinsurance deals rather than the full legal transfer of portfolios.

The PwC run-off team is frequently contacted by investors that are considering entry to this market which has historically strong rates of return. One Survey respondent termed run-off i.e. "recession-proof", and respondents this year generally appear to think that investor interest in the sector will continue to be healthy. Over 70% believe investment activity will increase in the next two years and it will be interesting to see where investment activity is targeted in the next stage of the market's development.

In this regard, we asked respondents where they expected legacy markets to develop outside of the traditional hubs, over the next five years. Overall the responses were split broadly evenly between those expecting new markets to emerge and those who expect the prevalence of the UK, US and Continental Europe to continue. Of those respondents that expect the wider development of run-off markets, Asia was the clear first choice, followed by Australasia and the Middle East.

It seems likely that active legacy management is here to stay, cementing its role in the wider market. However, encouraging a wider pool of sellers to test the market and become comfortable with undertaking repeat transactions will be a critical factor in the sector's future growth.

> "We are seeing a strategic shift in insurers streamlining their portfolios to deploy capital more efficiently. Essentially this means proactively identifying legacy liabilities to be sold. Establishing a mechanism that continuously outsources historic policies will help optimise the capital base, reduce operational expenses and allow focus on current and future policyholders.
>
> **Judith Zeleny**
> Head of Origination – Capital Partners Munich, Munich Re

Figure 8: The biggest barrier preventing sellers from commencing a run-off transaction

35% **Board engagement**

28% **Reputational concern**

11% **Counterparty risk**

11% **Regulatory hurdles**

8% **Lack of proven restructuring tools**

7% **Choice of buyers**

Source: PwC

Market size

Nick Watford
Partner,
Risk Management
Services
PwC UK

Hannah Vaughan
Director,
Risk Management
Services
PwC UK

In this twelfth edition of our Survey we estimate that global non-life run-off reserves are approximately US$790bn representing an 8% increase since the previous edition in 2018.

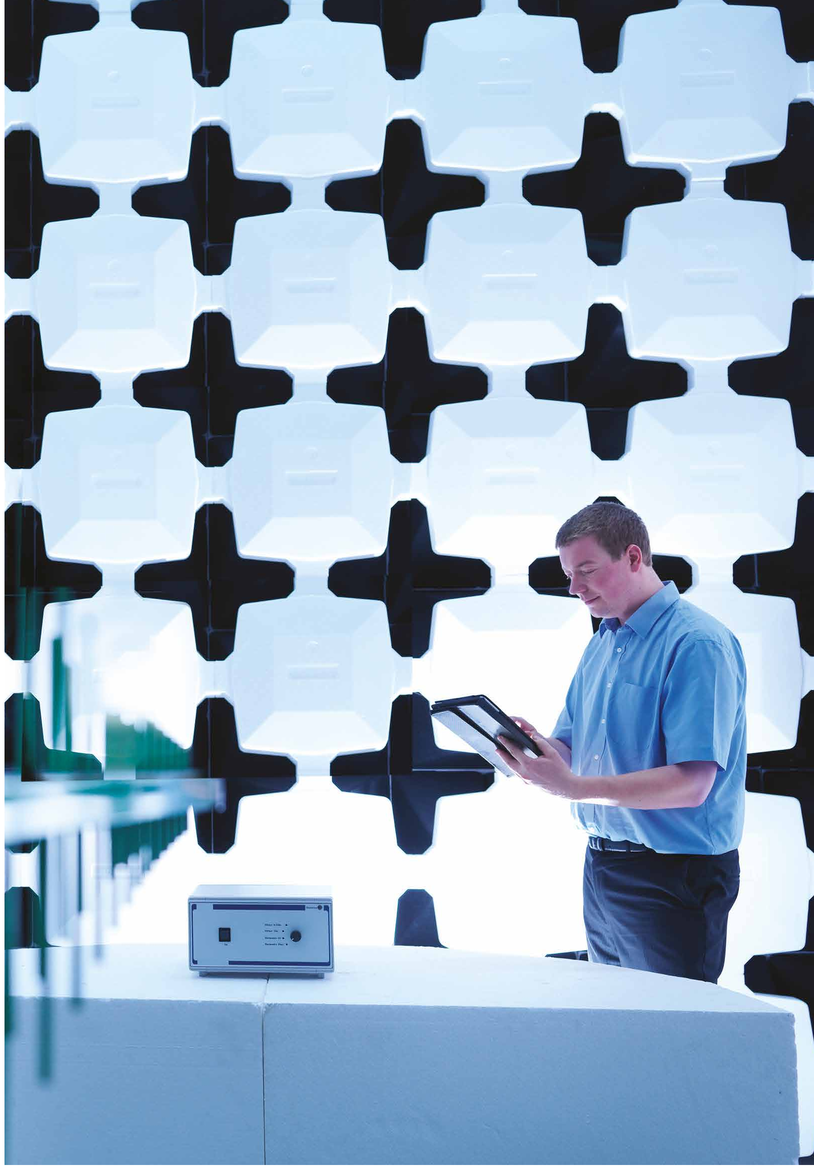
A key driver of this rise relates to the emerging markets of Asia and South America, which have increased by US$28bn. As in our last Survey, overall the US market continues to dominate, both in terms of new and latent claims run-off, with an estimated reserve of US$348bn. Figure 9 illustrates the geographical breakdown of our estimate of global non-life run-off reserves.

US

Our estimate suggests that the US run-off market has grown significantly since our last Survey. This is likely due to the increasing amounts of auto and general liability (including workers' compensation) business being written and subsequently run-off.

Material latent claims run-off liabilities remain, being held predominantly by primary insurance barriers and a selection of excess layer (re)insurers. These liabilities are slowly decreasing in size as claims continue to be paid.

While a sizeable proportion of this block of liability has been the subject of large loss portfolio transfer deals, our Survey results suggest there will be significant deal activity to come across both traditional and non-traditional run-off lines. We have taken a closer look into the profile of US run-off liabilities this year, which is illustrated on page 17.



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The interest of our global clients in run-off solutions has grown exponentially over the last several years and this continues. We expect that loss portfolio transfers, adverse development covers, insurance business transfers and divisions will become an integral element of our clients' capital and risk management strategies.

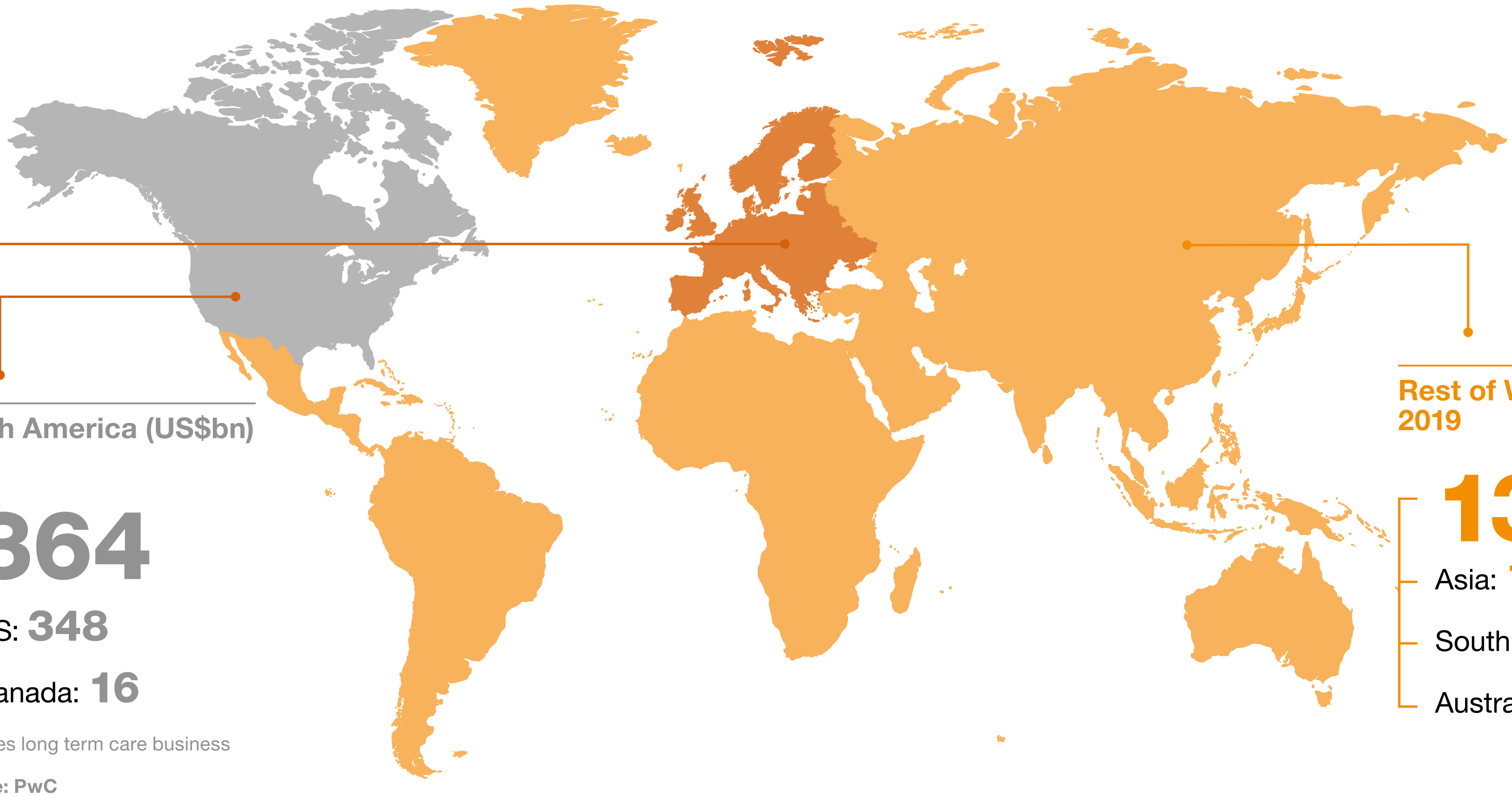
Mahindra Mahara
Senior Managing Director, Aon

Europe (US$bn) 2019

292

UK and Ireland	Nordic region	Germany & Switzerland	Eastern Europe	France and Benelux countries	Other Western Europe
66	14	125	9	46	32

Figure 9: The geographical breakdown of our estimate of global non-life run-off reserves



North America (US$bn) 2019

364

- US: **348**
- Canada: **16**

Rest of World (US$bn) 2019

135

- Asia: **101**
- South America: **21**
- Australasia: **13**

Excludes long term care business

Source: PwC

UK and Ireland

Our estimate for the UK and Ireland has increased by US$11bn. Our analysis suggests this has largely been driven by the prevailing soft market conditions, which have put pressure on profitable underwriting and led to the increase of discontinued, poorly performing lines of business. This has been highlighted by the increased legacy activity of Lloyd's of London as a result of the Lloyd's 'Decile 10' review. Consequently a number of syndicates have ceased writing material lines of poorly performing business, including cargo and construction. There have also been three cases where a whole syndicates has been placed into run-off.

Germany and Switzerland

Since our previous Survey run-off liabilities in Germany and Switzerland appear relatively flat. This is likely due to an offsetting impact from an increase in recent run-off, mainly motor and liability business, and a corresponding drop in latent liabilities as these continue to be run-off and/or commuted.

Emerging markets (Asia and South America)

We estimate that the emerging markets of Asia and South America have seen the largest increase in run-off reserves since our last Survey. Whilst relatively small in comparison to the US and Continental Europe, we expect legacy to develop as demand for insurance products in these regions increases, particularly for personal and commercial lines business.

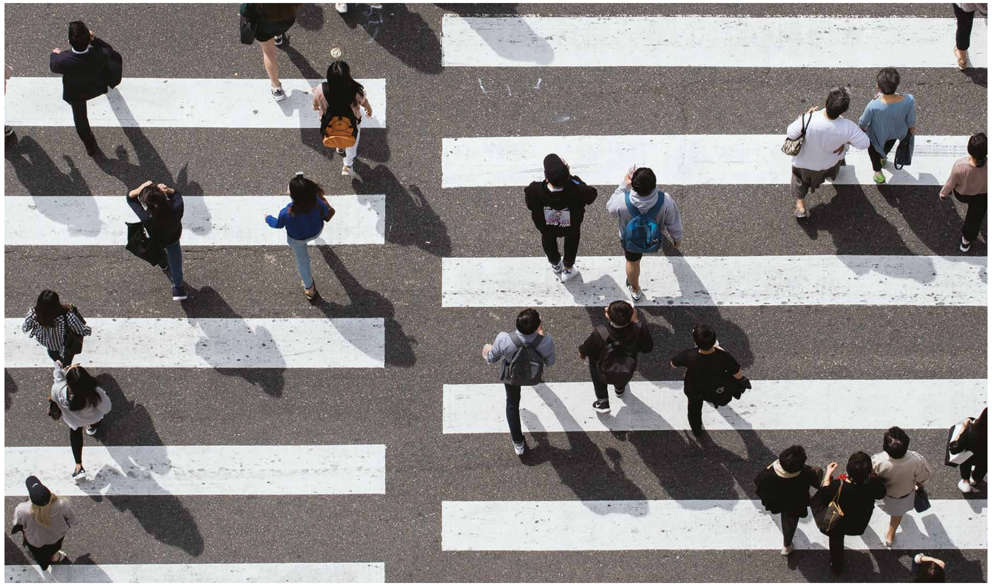
In our estimate, the main countries driving the increase in Asia are Korea and Japan where there has been a rise in the amount of motor and health business written. Consistent with our last Survey, China continues to be excluded from our analysis due to lack of available data.

In South America, Brazil and Argentina are driving the increase in our run-off reserve estimate. These territories are seeing more motor and accident business being written, respectively. We have also begun to see some legacy deal activity in the area although to date run-off liabilities have tended to be assumed by local (re)insurers along with the renewal rights for ongoing portfolios rather than by the established legacy consolidators.

Non insured liabilities

Our estimate of the global non-life run-off reserves is based on insured liabilities only. There are however, other material long-tail liabilities, including asbestos, that are held on the balance sheets of manufacturing companies and other corporations that are not, or are only partially, insured. We conservatively estimate the value of these liabilities to be US$50bn in the US and proportionately less, but still a significant amount in the UK.

We are beginning to see corporate clients discover the techniques used by the legacy sector to provide finality for such liabilities. We consider that there may be significant activity in this space in the coming years to mirror the developments the market has seen in the disposal and acquisition of insured liabilities.



Deals landscape

Victor Nelligan
Director,
Liability Restructuring
PwC UK

Alan Augustin
Director,
Liability Restructuring
PwC UK

Over the last two years we have actively tracked publicly announced deals in the global non-life run-off sector. A link to our latest quarterly update is included here which has a list of all these deals. One of the most interesting outputs of the Survey for us is to understand how respondents forecast future deal flow in the non-life run-off sector compared to the actual trends we have seen.

In our Survey, we asked respondents to indicate the most likely number of deals (1 – 10, 11 – 20 or over 20) there will be over the next two years in four territories: Continental Europe, UK, US and Rest of World. Figure 10 illustrates the most popular ranges of deals predicted by our Survey respondents and compares the responses to actual publicly announced deal activity between January 2018 and August 2019.

Overall, the answers of Survey respondents appear to be broadly consistent with actual deal activity seen over the last 20 months. This is positive news and with the enhanced profile of the run-off market, we are confident that momentum in the sector will continue and will again see over 100 deals over the next two years worldwide.

Figure 10: Estimated and actual deal volume

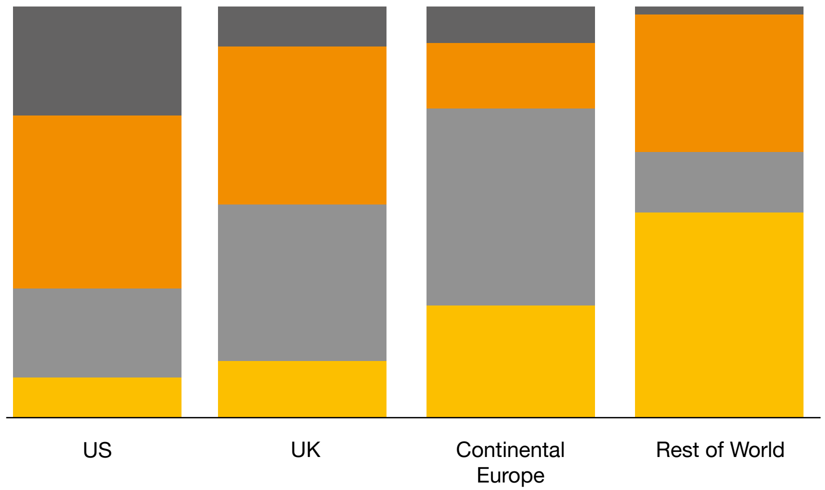
Territory	Percentage of respondents	Estimate range over next two years	Actuals* over last 20 months
UK	86%	1-20	19
Continental Europe	86%	1-20	13
US	71%	11-20+	33
Rest of World	69%	1-10	4

*Publically announced deals January 2018 – August 2019

Source: PwC

Supporting recent trends, Survey respondents see most activity in the US. This extends to deal size where Figure 11 indicates US deal sizes are expected to be larger than other territories. The UK also continues to produce significant deals through developments at Lloyd's and innovative deals on newer run-off lines of business such as motor and professional indemnity. Reflective of ongoing market experiences, deal sizes in Continental Europe are estimated by respondents to be more modest, between US$51m – US$101m.

Figure 11: Respondents' estimates of deal size by territory over the next two years



Source: PwC

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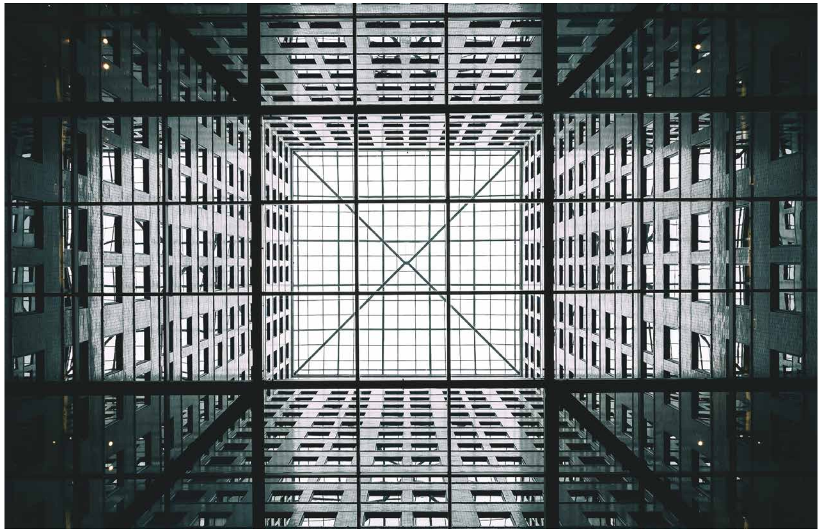
Legacy reserve management is widely recognised as a solution for insurers of all sizes, with larger than ever portfolios being brought to the market. We expect to see continued growth in 2020 and beyond as sellers seek counterparties that are well capitalized with an established track record and possess industry expertise and a sophisticated approach to claims handling.

Paul O'Shea
President, Enstar Group



A key reason for the deal activity we have seen since our previous Survey is almost certainly ongoing competitive pricing, particularly for well reserved portfolios. In these instances sellers appear able to achieve a cost effective deal which releases capital and allows the profit and loss account to stay close to breakeven. Indeed, based on publicly available data, pricing on average for a share sale of a run-off entity is close to 100% of net asset value (adjusted for any capital extracted before or at the point of sale). Premiums paid on loss portfolio transfers, i.e. the total amount of assets paid to support the transferring liabilities, are on average 95% of undiscounted net reserves, based on publicly available information.

Activity suggests deals are completing which provide sellers with a benefit whilst still allowing buyers to achieve a reasonable margin. Accordingly, it is interesting to note our Survey respondents' views that pricing is the biggest challenge facing both sellers and buyers. The sheer volume of activity casts some doubt on the size of this expectation gap between counterparties, but closing this gap should result in even greater deal numbers. The wider macro-market may be starting to show signs of hardening, but the dynamics aren't necessarily the same for the legacy market. Only when there is a strategic or operational imperative, is it likely for a run-off deal to command a significant pricing premium.

Market dynamics in the recent past are almost certainly indicators of a clear seller's market, and the question may be whether enough sellers have been familiar enough with the run-off market to take advantage?

This appears to be underlined by our Survey respondents suggesting that sellers still face a number of challenges with buyers, including reputation and execution, which for some, may be as important as price. Figure 12 also shows issues buyers face in dealing with sellers of legacy liabilities. These appear to focus more on the operational challenges and convincing sellers of the value proposition associated with legacy solutions.

With that in mind, our analysis of publicly announced deals illustrates there have been only 20 transactions completed since 2017 from repeat sellers, with Zurich Legacy Solutions a prominent vendor.
In our view, for the market to truly reach its potential more multinational (re)insurers need to understand the benefits of utilising legacy solutions as a routine part of their underwriting cycle.

The professionalism and track record of legacy acquirers continues to develop confidence in the sector. As consolidators become larger and more like the businesses they transact with in terms of scale, governance and technological sophistication, the more widespread the use of legacy solutions is likely to become. On even a very conservative estimate, with over US$25bn of gross liabilities currently managed by legacy consolidators, including Armour, Catalina, Enstar, and Riverstone, it is already a very substantial marketplace. With an estimated US$8bn of funds available to fuel further deals and more investment expected, the sector is well placed to grow further.

Survey comments

What factors will influence the legacy market?
"Continued investment into this sector seems certain. The measures being driven through in Lloyd's of London can only have a positive impact on this market."

What would you like to change?
"More education of insurance company Boards of the benefits of a legacy solution."

Figure 12: Respondents' views on key issues buyers face with sellers of legacy liabilities

Source: PwC

"It was fascinating for us to run the sale process for Global Re and see, from the other side, how the legacy market operated. It just reiterated for me the specific skills we all have and how well placed we are to provide flexible and innovative solutions to the (re)insurance market. For AXA LM we have demonstrated how we can bring full value to our funds with acquisition, legacy management and then sale.

Sylvain Villeroy De Galhau
Chief Executive Officer, Axa Liabilities Managers

Deals – the operational challenge

Nick Pattison
Director, Delivering
Deal Value
PwC UK

As buyers of legacy portfolios increasingly focus on transactions outside of the traditional run-off space, their commercial opportunities and the associated challenges are broadening. Our Survey indicated planning and executing the separation and migration of the operations that support a transferring portfolio as a key challenge for vendors and acquirers. In our experience key areas to consider include:

Defining the data perimeter

As the scale and complexity of the data held by insurers increases, this challenge will continue to escalate with data typically needing to be extracted from multiple legacy IT systems. Separating unstructured data, such as documents and emails between buyer and seller, poses a uniquely difficult puzzle often requiring specialist software to identify and sequester data relevant to the transferring portfolio. The cost can increase further when extensive archives of physical records exist and requires careful and pragmatic upfront planning. This issue was important to a number of Survey respondents who cited assessment of data and data quality as being the biggest challenge buyers faced in dealing with sellers.

Technology's legacy

Digitalisation is transforming the insurance market and certain firms are sitting uneasily between digitally-driven and the legacy systems of the past. New entrants are looking to leverage technology to disrupt how traditional products are sold and serviced. Where insurers are unable to embrace innovation or connect with customers across multiple channels they may not be able to continue to operate in this changing market. Alternatively they may wish to dispose of legacy books and /or systems to allow them to focus on future business opportunities.

Fostering a collaborative approach to separation and migration planning

Buyers and sellers will often fail to make the necessary efforts to instil a collaborative working relationship between their respective teams, in order to support joint planning efforts.

If the transaction relies on independent approval – for example, under a Part VII transfer process – it is vital for the parties to be able to demonstrate that they have co-created a plan which ensures operational continuity at the effective date of the transfer and beyond, with no disruption to policyholders or claimants.

Ensuring readiness for transitional services

To bridge the interim period between the effective date of a portfolio transfer and completion of the operational and technology migration, a Transitional Services Agreement ("TSA") is frequently used. Buyers and sellers often underestimate the effort. involved in preparing to operationalise a TSA. Defining the services to a level of quality and granularity appropriate for a third-party service contract can represent a significant step up from existing internal service level agreements. Negotiating the extent to which the seller will commit to service quality levels, as opposed to making reasonable endeavours is a common challenge.

Managing the employee journey

A disposal announcement can herald a period of uncertainty for employees and an increase in workload, as key personnel may become important to managing the transfer. Collaboration with the buyer to ensure a considerate and proactive programme of employee communications is developed, coupled with the resource to support separation and migration, can make the difference between a disaffected workforce and a team remaining engaged and motivated.

> Advancements in technology in the general insurance sector present a wealth of opportunities to insurers. However, they face a significant risk from the slow pace of change caused by the weight of their operational history, leading to disruption from leaner markets. As a result, legacy solutions may be likely to have a greater focus on operational finality, rather than purely economic, over the next 5-10 years.

Simon Hawkins
Chief Financial Group, Compre Group

Avoiding impact on the retained business

For sellers, significant management bandwidth may be consumed by planning and managing a successful portfolio transfer and must be balanced with focusing on the retained business. Establishing a well-resourced, efficient and structured programme to define and oversee separation and migration activity is important in minimising the impact on business as usual and avoiding undue management distraction.

In summary, as the market continues to evolve, both buyers and sellers face an array of challenges in planning and executing the operational separation and migration of a transferring portfolio. These are not insurmountable but require a comprehensive and systematic approach. Through detailed upfront analysis of the existing operating model and technology environment, the key challenges specific to a particular portfolio transfer can be identified, isolated and resolved.

In our experience this will help to provide greater earlier clarity as to the cost, timeline and delivery risks associated with executing the migration.

Survey comments

Biggest challenge buyers face when dealing with sellers?

"Assessing the quality of seller's data, exposure and talent pool in a compressed amount of time under omnipresent competitive pressure."

Deals – a US perspective

Matt Adams
US Insurance Leader
PwC USA

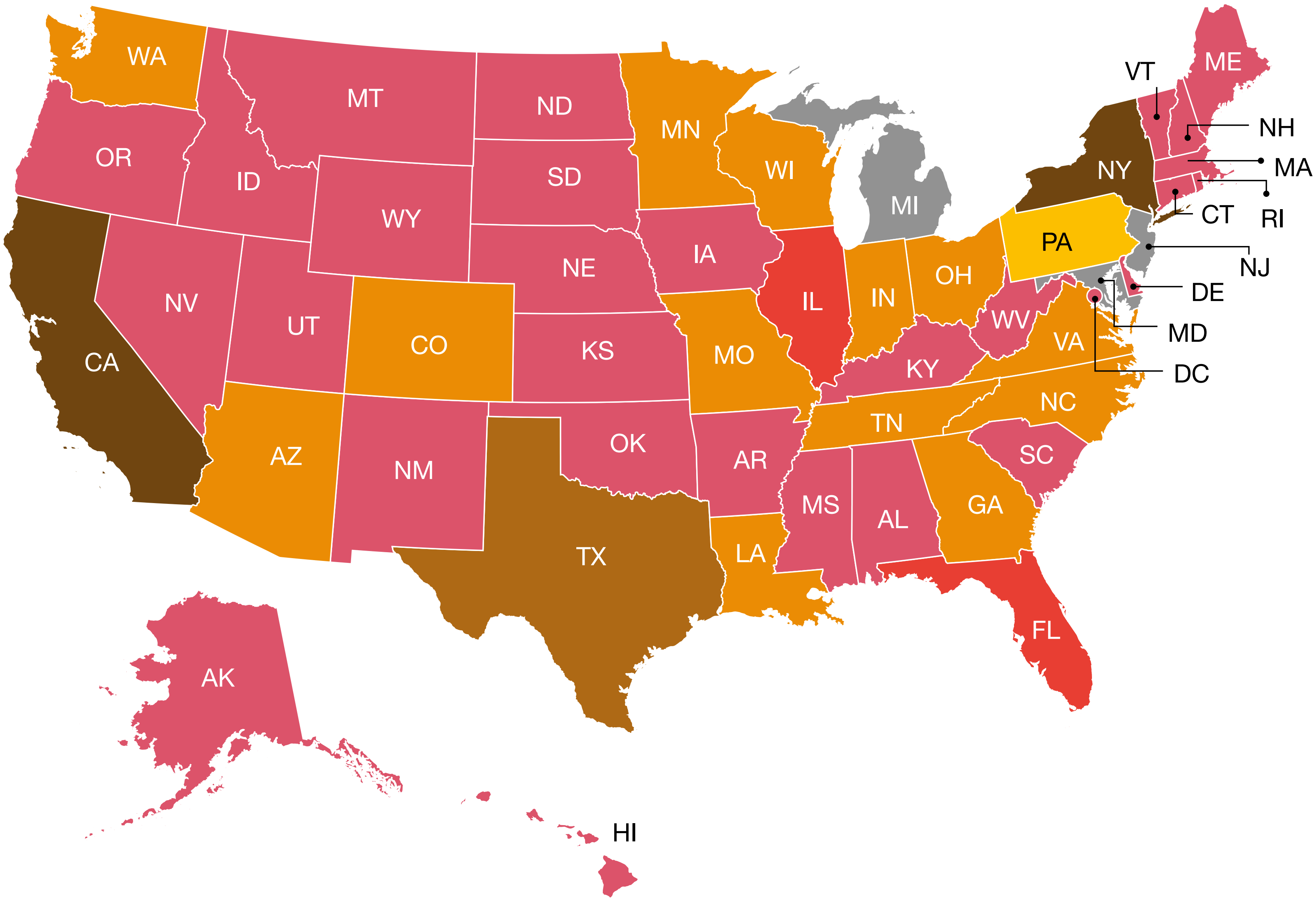
As a large and mature (re)insurance market, it should be no surprise that North America, and the US in particular, is a highly active environment for run-off. However, the focus on run-off has intensified in the past two years and increasingly brokers are heavily involved in the market, alerting their clients to legacy solutions. Regulatory changes such as insurance business transfers and division legislation in certain states, as well as new accounting rules for long duration insurance contracts, are also prompting increased discussion around run-off liabilities.

All of these developments coupled with the size of the US market, estimated at US$348bn, have meant that the global run-off consolidators are focusing on the US. Figure 13 illustrates how this estimate breaks down across US states. While deals have always taken place on run-off books in the US in the past, these have primarily been focused on US Asbestos, Pollution and Other Health Hazard ("APH") books. Often these were portfolios of business that companies had to dispose of in order to survive or ones they preferred to offload in order to keep volatility capped.

Over the past 18 months though the story has changed. Over that period, just over half of the publicly announced run-off deals have been in North America and most of these have been in less traditional run-off lines. The most commonly transacted lines in the US are now: workers compensation, commercial auto and professional indemnity.

There are still APH transactions as (re)insurers want to exit a class that seems to continue to need reserve strengthening, however these deals are now less commonplace.

Figure 13: Overview of US non-life run-off liabilities by state



>US$26bn | US$23bn-US$26bn | US$19bn-US$22bn | US$16bn-US$18bn | US$12bn-US$15bn | US$8bn-US$11bn | US$5bn-US$7bn | >US$5bn

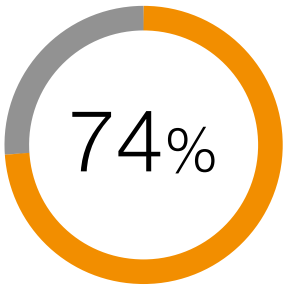
Source: PwC

So why is there such a boom? The market dynamics appear to be driving a focus on run-off, there is more awareness all the way up to the NAIC, with working groups now specifically set up to look at what insurance business transfers and division legislation means for the wider industry.

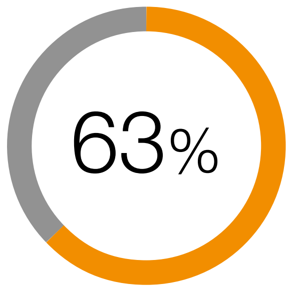
While the industry waits to see the implementation of an insurance business transfer or division transaction, their discussion has focused attention on run-off and how to deal with it. Meanwhile, as current market activity indicates, there appears to be an appetite to pursue loss portfolio reinsurance solutions by US insurers as part of their capital management strategies. Participants in our Survey largely agreed that the US will continue to be a highly active market and also feature deals of a significant size, as shown in Figure 14.

> “There needs to be greater emphasis on cooperation amongst legacy market players. Promoting the benefits of legacy transactions collectively will help develop the market by expanding the number of potential sellers. In the US we need greater cooperation and coordination of key messages to ensure regulators are comfortable with all forms of legacy deals.
>
> **Richard Lawson**
> Pro-Global, Head of Client Engagement

Figure 14: US deals estimations



Percentage of respondents from the US that estimate there will be 11 or more deals in the USA over the next two years.



In terms of liability size, 63% of respondents from the US estimate that the most commonly disposed of discontinued portfolio in the US will be US$101m or greater.

Source: PwC

US deal activity

As the most populous states in the US, California, Florida, New York and Texas account for a significant proportion of US run-off liabilities. There have been a number of run-off deals in California and New York in recent years, including Enstar's loss portfolio transfer for Allianz's California based Fireman's Fund, AXA LM's disposal of Global US Holdings Inc. to R&Q and Quest's purchase of United Americas Insurance Company in New York. There have also been a number of deals in Florida, including SOBC Darag's purchase of Peachtree Casualty Insurance Company.

In the Midwest, we see significant blocks of latent liabilities, including asbestos. Run-off deals seen in the Midwest include transactions involving mutuals, such as Sunpoint's loss portfolio transfer with CUNA Mutual Group in Wisconsin and Premia's purchase of Public Service Insurance Co. in Illinois.

"

In the US, reserve covers are no longer seen as a sign of failure, rather it is understood to be a proactive capital management tool used by industry leading insurers.

Linda C. Johnson
Partner, TigerRisk Partners

"

Historically, legacy transfers in the US were seen as a means to release capital and reduce earnings volatility. Today, insurers are recognizing the operational, as well as financial, benefits and giving these transactions a fresh look.

Edward Torres
Executive Vice President, Willis Re

Survey comments

What factors will influence the legacy market?

"US insurance business transfer legislation – boom or bust!"

"Increased interest and capital in the legacy market will increase competition and lower returns on one hand and on the other should increase the seller appetite to bring portfolios to market."

What would you like to change?

"Clearer guidelines for a successful insurance business transfer in terms of capital requirements."

"Collectively we manage billions of dollars of exposure and we should be working together in a more concerted way to influence regulatory matters wherever possible."

Regulatory drivers

63%

Nearly two-thirds of Survey respondents expect regulatory developments to drive increased legacy activity over the next two years.

Source: PwC

Stephen Arnold
Partner, Insurance Capital and Restructuring
PwC UK

Baljit Goraya
Senior Manager, Liability Restructuring
PwC UK

Almost two-thirds of our Survey respondents expect regulatory developments to drive increased legacy activity over the next two years. In the US regulators at the NAIC are considering how restructuring tools and legislation might play a role. In the European market, regulators are focusing on a number of areas which may impact the run-off sector.

Brexit

There is considerable uncertainty for both live and run-off (re)insurers around the impact of Brexit. The UK Government's preparation for a 'no-deal' Brexit with the announcement of the Temporary Permissions Regime ("TPR") and the Financial Services Contracts Regime ("FSCR") has helped reduce some of the risks for inbound firms operating in the UK post Brexit.

The TPR provides inbound firms with the ability to continue regulated activities in the UK for a maximum of three years. The FSCR, which runs in parallel with the TPR, was launched to function as a back-stop to mitigate contract continuity risks. Firms falling within the scope of the regime will be expected to run-off, close out, or transfer obligations arising from insurance contracts within 15 years of entering FSCR.

While the FSCR provides a mechanism for inbound firms there is no current equivalent EU-wide mechanism. In February 2019 European Insurance and Occupational Pensions Authority ("EIOPA") recommended that authorities should apply a legal framework or mechanism to facilitate the orderly run-off of business which becomes unauthorised due to Brexit, or that they should require firms to take all necessary measures to become authorised under EU law. Certain individual Member States, as highlighted in Figure 15 have acted to implement legislation to prepare for a no deal Brexit and provide UK outbound firms with the ability to continue to service claims arising from European risks in an orderly manner. This is welcome news for run-off providers and policyholders alike.

Figure 15: Brexit planning

Ireland

General Scheme of Miscellaneous Provisions for UK Withdrawal from EU on 29 March 2019 (January 2019).

UK insurance firms permitted to service existing run-off contracts for three year period.

France

Brexit Law (February 2019).

Applies from the date of exit from the EU in event of no-deal.

UK insurers entitled to continue performing insurance contracts validly entered into pre-Brexit notwithstanding loss of passporting rights.

Germany

Legislation adopted (February 2019).

Provides a transitional arrangement and allows extension of passporting for 21 months to enable the transfer or termination of existing insurance contracts.

Italy

Decree in case of no-deal Brexit (March 2019).

Provides 18 month transition period following exit date.

UK insurers able to continue management of contracts which are pending at the date of exit from the EU.

Source: PwC

Impact of non-Brexit related regulatory and legal developments on legacy activity

The London and Lloyd's markets have experienced a heightened focus on performance following the recent letters issued by the Prudential Regulation Authority ("PRA") to specialist general insurers. The performance review process by Lloyd's, covering optimism in pricing, maintaining underwriting discipline and reduction in reserve strength, may continue to lead firms to exit non-performing lines of business and portfolios. As part of the 2019 Syndicate Business Planning process, we saw many syndicates submit plans with a material reduction in underwriting volume and Lloyd's requesting that many exit underperforming classes of business following the 'Decile 10' review.

The PRA's latest business plan continues to list sustainability and operational as well as cyber resilience as key focus areas, indicating that regulatory action will continue in this space. Regulators are using data to benchmark firms against their peers with 'SpotCheck' and resilience questionnaires sent to a range of firms. In some cases, the responses to these have resulted in follow-up supervisory action. It is possible this may result in opportunities for the legacy sector, as remediation or restructuring is carried out.

On the legal front, a recent UK High Court decision saw a significant closed-life book Part VII Transfer between Prudential and Rothesay Life rejected despite being approved by regulators and the Independent Expert. While the decision may go to appeal, it is too early to tell whether this may have a wider impact on non-life legacy transfers more generally. However, it appears likely to be an important consideration for deals that contemplate the legal transfer of significant personal lines portfolios.

Carlos Rebuelta
EMEA Insurance Risk and Regulatory Leader
PwC Spain

EIOPA puts run-off on its agenda

In their report on Supervisory Activities for 2018, it was interesting to see EIOPA highlight its desire to supervise run-off undertakings, bringing this further up Continental European regulators' agendas.

Historically, there have been divergences in the way these regulators have approached run-off leading to diverse outcomes and uncertainty both from buyers and sellers in terms of whether they will get regulatory approval for transactions and under what conditions.

Focus areas for EIOPA range from broad financial stability issues to individual policyholder protection. Such concerns link to the individual insurer (seller) business model, but also to that of the buyer. Understanding the rationale of the operation beyond a mere capital optimisation exercise will remain high on the regulator's radar.

It is within this context that for the first time, EIOPA has decided to step in to enhance convergence amongst supervisors in respect of run-off.

The approach will cover an assessment of risk transfer mechanisms, including recognition of risk mitigation techniques, combined with understanding of new risks stemming from the operations, from counterparty to reputational risk. Governance around the operation, both on the buy and sell sides will be assessed, including around investment policies and the so called "search for yield" approaches, with relevance both within life and non-life activities.

Survey comments

What factors will influence the legacy market?

"Disruption caused by technology in the ongoing markets forcing companies to exit business segments."

What would you like to change?

"Increased regulatory engagement with industry participants."

"Clarity from US regulators and Lloyd's on future legacy strategy."

Deals – the conduct lens

Michael Cook
Claims Advisory Leader
PwC UK

Historically, transactions in the legacy market related mainly to underlying US based exposures involving APH. These claims were against corporations in the US under either product or general liability coverage for events that happened many years if not decades ago.

These types of claims generally do not attract a high level of UK regulatory scrutiny in terms of the customer or conduct agendas. This is because they do not involve UK customers or policyholders. The claims are between sophisticated corporations in the US and their insurers and often the underlying liabilities, especially for asbestos, have long been resolved. The legacy acquirers are well equipped to handle these types of claims and run-off transactions have demonstrated this for many years.

However, as a number of recent legacy transactions have shown, the type of claims included are no longer just US APH, with a wide of different exposures and claims such as UK employers liability, public liability and general liability.

These claims not only involve UK policyholders, but in many situations the insurer is dealing directly with the policyholder/customer and/or their appointed representative. These factors change the regulatory focus and also provide an additional area of consideration for the insurer, as it is their reputation and ultimately brand that will be impacted if there are any major issues, complaints or failures. It has been interesting, but not surprising to see the FCA announce a review of legacy claims for the first time. There is an expectation that management information for claims and complaints are of sufficient detail and that they focus appropriately on the policyholder.

The combination of regulatory focus together with reputational concerns means that conduct and any associated risks are a key consideration during transactions. The acquiring organisation should ensure the appropriate governance, controls and processes are in place to manage claims in a way that meets regulatory requirements. They also need to meet the expectations of the selling insurers appropriately so as to ensure service continuity in customers' claims being handled as they would have been if the transaction had not taken place.

Given their history and the characteristics of traditional run-off liabilities, the operations and capabilities of legacy consolidators can be quite different to the average large active general insurer. As the profile of legacy transactions continues to involve more personal lines business, in particular, acquirers may need to adapt in order to be able to provide the requisite level of service continuity to customers and meet regulatory expectations.

The work needed should not be underestimated especially when much of it will need to be completed within the confines of the dates agreed as a part of the transaction. It is also likely that UK regulators will focus more on these areas during the early stages of the sales process and the selling insurers will require a level of comfort from any potential acquirer.

> “As the legacy market broadens we continue to invest in growing our operational platform and the associated governance and processes required to treat stakeholders fairly across multiple lines of business and jurisdictions. Balancing our infrastructure with the agility to react quickly to the characteristics of the increasingly varied portfolios coming to market is essential in delivering maximum value to sellers, service to policyholders and returns to investors.
>
> **Hannah Farrer Fisher**
> Chief Operating Officer, Armour Group Ltd

A view from AIRROC

Carolyn Fahey
Claims Advisory Leader
AIIROC

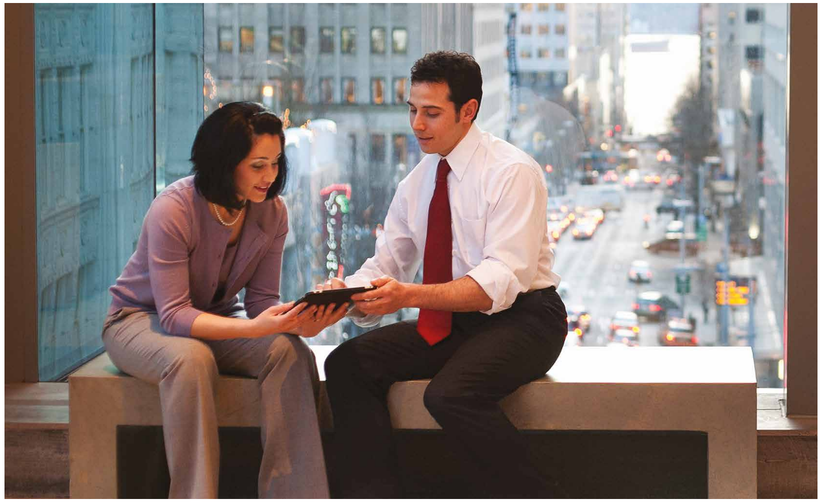
The developments seen by AIRROC in the US run-off market are consistent with this year's Survey results. As we all know, the US run-off market has remained less flexible in terms of exit strategies when compared to its UK and European counterparts. AIRROC's membership anticipates that the current level of activity within the US will increase over the coming years with the majority of members expecting regulatory activity to drive additional deal activity.

Our members believe insurance business transfers and/or division statues will gain traction, leading to several transactions in the near term that will open the door to increased activity. AIRROC's membership also expects a consistent level of deals in Europe, which generally has been more active than the US market over the last several years.

The key factors driving AIRROC's membership with respect to restructuring and exit strategies remains consistent with prior years: capital release, disposal of non-core business, and avoidance of distraction.

One area that is gaining a greater focus is technology because when dealing with discontinued lines, companies often find themselves with dated legacy systems. These older systems are difficult to maintain and lack reporting capabilities found in current insurance/reinsurance systems. Costs and risks associated with maintaining these systems are growing. The ability to eliminate these concerns is a key driver for sellers while the ability to migrate and effectively manage the business is a key opportunity for buyers.

Lastly, for AIRROC, the ability to collaborate with stakeholders, including business counterparties, regulators and service providers, remains a critical component of our market. The interaction allows companies to deal with the issues facing run-off together and overcome the challenges. Staying close to your business partners and regulators, developing creative exit solutions, and promoting legislation to enable more accessible run-off mechanisms remains important. Doing so in an environment that promotes cooperation through networking and education is the vehicle AIRROC provides to its members and friends that will help carry us forward well into a very exciting future.



AIRROC

Spotlight on Bermuda, Middle East and Asia

James Ferris
Director, Advisory
PwC Bermuda

Bermuda – ready for the future of run-off

Bermuda's value to the global run-off market continues, attracting those looking to consolidate global non-life, and also life, reinsurance books. We are also seeing more of the run-off players from the UK and Europe looking at establishing insurance operations in Bermuda for the purpose of consolidation and access to the US markets.

Bermuda-based operations are well-placed to take advantage of US opportunities should the US market embrace insurance business transfers. We are already seeing commercial finality solutions where the Bermuda run-off players are servicing the needs of US carriers.

Looking at Bermuda's own market, ILS continues to look ripe for run-off participation, with 2018 being another year of significant catastrophe losses and 2019 having seen the entry into run-off of CATCo. and Blue Capital Re. There are now significant legacy portfolios in the ILS market, with run-off for periods of 3-7+ years in some cases. Once the economics are resolved, these portfolios may be considered prime run-off books. We see value being released from illiquid investment funds in similar situations, and it seems only a matter of time before that value proposition translates to ILS.

Alan Augustin
Director,
Liability Restructuring
PwC UK

Middle East – conditions ripe for legacy activity?

Over the past 18 months, the Middle East region has continued to experience challenging conditions and increased run-off activity.

The market still suffers from low rates, excess capacity and lack of penetration into customer bases, for example in the Takaful sector, meaning profitability has remained strained in many classes. Added to the move in various territories such as the Kingdoms of Saudi Arabia and Bahrain to a risk-based capital regime with a higher cost of compliance, solvency margins have been squeezed and capital requirements have increased as a result.

This has caused many groups to consider their ongoing strategy, resulting in companies such as Chubb, Qatar General and HDI Global putting their local operations into run-off. This trend is continuing with others, including Arig, considering doing likewise.

Regulators have responded by requiring robust run-off plans to be developed with increased scrutiny on capital extraction, dividends and management fees. There is consequently no surprise that opportunities exist for acquisition and outsourcing solutions and the recent sale of Emirates Re's Retakaful business to Axa LM is an example of the future activity and opportunity we expect to see for the run-off sector in the region going forward.

Peter Greaves
Partner, Advisory
PwC Hong Kong

Legacy in Asia – a longer term target?

Our Survey respondents believe that Asia represents the most likely emerging legacy market to develop outside of the UK, Continental Europe and the US over the next five years Figure 16.

Since the publication of our last Survey, the Asian run-off market has experienced the largest growth in our estimate of liabilities, increasing by 26% from US$80bn to US$101bn. Much of that growth is attributable to the motor and health insurance markets.

The Japanese insurance industry has demonstrated a strong appetite for deals in recent times including the acquisitions of Amlin and HCC by Mitsui Sumitomo and Tokio Marine respectively. Japan's desire for acquisitions almost certainly stems from its need to ease the effect of the Bank of Japan's negative interest rate policy, which was introduced to encourage spending and investment activity.

To date there has been relatively little domestic Japanese restructuring of legacy business. We have however seen Mitsui Sumitomo dispose of an Irish run-off subsidiary and Tokio Marine announce the impending run-off of a UK subsidiary. It would not be a surprise to see further restructuring of legacy operations linked to broader market activity in this market.

An Asian legacy market appears to have significant potential in terms of size and the existence of well understood restructuring tools including Schemes of Arrangement and business transfer) that feature in territories such as Hong Kong, Singapore and Malaysia. There remains uncertainty as to whether legacy restructuring will become widely utilised in the near time, and it will be interesting to monitor how seriously legacy consolidators target the region when traditional markets remain very active.

Figure 16: Emerging markets

Will new run-off markets develop outside of the UK, US and Continental Europe over the next five years? If so, where?

Yes – 48%

1. Asia
2. Australasia
3. Middle East

No – 52%

Source: PwC

"What we might call the 'run-off market' in Asia is extremely diverse, reflecting its wide array of developed and developing markets, levels of experience and transfer mechanisms available. Run-off books are often "greener" (i.e. less mature with limited loss experience data) than Europe and the US, with companies changing strategy and restructuring more often. This is especially evident in the high growth markets, representing a key motivation for transactions.

Adam Horridge

Senior Portfolio Manager, Swiss Re Asia Pte Ltd

Conclusion

Dan Schwarzmann
Head of Market Initiatives
and Industries
PwC UK

I am grateful to everyone who took part in our latest Survey which is only made possible by your valuable contributions. I would also like to thank IRLA and AIRROC for their support with this Survey and I hope that you found it an interesting and topical read in what has been a year of considerable activity in the sector.

Reflecting on the market, I echo Jim Bichard's introductory comments that legacy has become an integral part of the wider global insurance market and has evolved significantly since we started this publication over a decade ago. The Survey results illustrate that there is plenty more change to come as new sellers discover the legacy market and buyers deliver solutions in new territories.

We see a healthy deals pipeline and recognise that consolidators, some of whom are now very large insurers in their own right, will likely continue to evolve so as to optimise these opportunities. This may involve scaling their operations as well as investing in technology, governance and compliance in order to enhance the growing reputation of the sector and attract an even greater volume of sellers.

From a PwC perspective, as clients have sought to deliver value and manage risk from discontinued, non-core operations, we have worked on a number of complex restructuring projects involving legal transfers and Schemes of Arrangement for both insurance and non-insurance clients. Solvency II has continued to be challenging for some smaller European run-off players and there remains a challenge for the industry to find the right structure and mechanism to end run-offs in an efficient and effective manner. I expect this to be a feature of the market over the next few years.

We assessed last year that the US would see major growth and that has been the case even though it has taken longer than expected for the first US insurance business transfer to be completed. We anticipate the volume of opportunities for legacy reinsurance deals will continue at pace across the Atlantic over the next year or two.

The PwC team throughout our Network are privileged to work with clients across the market. Thank you for your continued support and we look forward to engaging with you over the coming year.

Kind regards

Dan Schwarzmann

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The 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;
- Proactively 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.

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Design Services 32063 (07/19).