Realising Value

Enstar Group Limited

M&A Trends, Role of Actuary in Due Diligence

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An Overview

We have evolved from the industry's largest standalone run-off consolidator to an insurance group with legacy and specialty underwriting capabilities, and we have a vision to grow further.

$12.7bn
Assets
June 30, 2016

$3.2bn
Market Capitalization
June 30, 2016

16%
CAGR
Book Value Per Share

$8.6bn
Total Cash & Investments
June 30, 2016

$1.4bn
StarStone & Syndicate 609
2015 Gross Written Premium

19%
Debt to Capital Ratio
June 30, 2016

$7.7bn
Total Reserves
June 3,0 2016

$220m
Net Earnings
December 31, 2015

73
Acquisitions
To date

Enstar Background

- Overwhelmingly the run-off targets are property/casualty portfolios
- Size from $2 million to multi-Billion
- Many different lines of business
- Global Scale
  - UK and European Continent
  - US
  - Australia and NZ
  - Far East
  - Others

- This presentation will reflect the more limited considerations that are typical of run-off targets

Full time Due Diligence Team

- Finance (accountants) are the central resource
- Multi-disciplinary team:
    - Accounting
    - Claims (including full run-off costs)
    - Actuarial
    - Capital Requirements
    - HR
    - Legal
    - IT
    - Underwriting (for continuing operations only)
    - Tax
- Typical process includes two rounds of bidding
- Full time participants facilitate good sharing and communication
- Financial modelling for IRR is end product.

Due Diligence Challenges

- New Projects Constantly
- Deadlines are inflexible
- Specialists required, use best available personnel – out-source if required
- Control DD costs – success rate for DD is low
- Communicate well despite decentralized personnel
- Plan transition – key factor for success
- Personnel – chemistry check? Shift to profit model?
- Intangible value for continuing operations- synergy value for Acquiror, overlap with existing business

Actuarial DD Role

- Request/Collect Data and reports – Everything
- Request updated data for mid-period review
- Reconcile data
- Examine consistency of Actuarial Review process
- Pattern of shortfalls or surpluses?
- External reports – long history or new commission?
- Watch out for “Seller’s Reports”
- Review the Actuarial Process at the target

- Meetings/calls with actuaries at Target - understand their process and assumptions; listen more, speak less.

Actuarial DD workproduct

- Concise Findings – no one reads the hundreds of pages of typical actuarial reports. Get to the point, literally.
- Point estimates are required. No waffling
- Payment cash flow is also required. This affects future capital modeling and investment portfolio structuring.
- Unusual characteristics should be highlighted – e.g. unusual uncertainty or riskiness.

What makes a “bad” actuarial report?

- No summary exhibits
- No balancing/reconciliation
- Excessive fragmentation
- Inconsistent methods from prior years/ inconsistent data
- No Actual versus Expected testing, no explanation of exceptional results
- Invisible Data
- Reinventing the wheel – obscure bespoke methods
- BF with incorrect IELR
- Excessive bias

What makes a “good” actuarial DD process?

- Consistent reports year to year
- Actual versus Expected Testing, best = multi-year progression of estimates
- Complete reconciliation
- Description of data anomalies
- Clear identification of assumptions
- Clear Gross-to-Net discussion

Simplified Claims Run-off Model for Profitability

			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
	Assets												
80%	Invested Assets	19,840	15,918	11,993	8,906	6,542	4,721	3,501	2,586	1,900	1,385	98	-
	Cash	4,960	3,980	2,998	2,226	1,636	1,180	875	647	475	346	24	-
		24,800	19,898	14,991	11,132	8,178	5,901	4,377	3,233	2,375	1,731	122	-
	Liabilities		Payments = 25% of prior reserves									All claims close in Yr 10	
25%	Loss reserves	20,000	15,000	11,250	8,438	6,328	4,746	3,560	2,670	2,002	1,502	-	-
	ULAE	800	600	400	200	-	-	-	-	-	-	-	-
	Total Liabilities	20,800	15,600	11,650	8,638	6,328	4,746	3,560	2,670	2,002	1,502	-	-
	StartingSurplus	-	4,000	4,298	3,341	2,495	1,850	1,155	817	563	372	229	122
	Profit(loss) for year		298	221	165	122	-111	-132	-149	-162	-171	-178	
	Dividends (capital release)	4,000	0	-1,178	-1,011	-767	-584	-206	-105	-29	28	71	-122
20%	Ending Surplus	4,000	4,298	3,341	2,495	1,850	1,155	817	563	372	229	122	-
		=======	=======	=======	=======	=======	=======	=======	=======	=======	=======	=======	=======
		24,800	19,898	14,991	11,132	8,178	5,901	4,377	3,233	2,375	1,731	122	-
	Statement of Income												
	Incurred Losses (Perfect adequacy)		0	0	0	0	0	0	0	0	0	0	0
	G&A Expenses (before ULAE offset)		-200	-200	-200	-200	-200	-200	-200	-200	-200	-200	0
	Offset to ULAE		200	200	200	200	0	0	0	0	0	0	0
1.50%	Investment Income		298	221	165	122	89	68	51	38	29	22	-0
			=======	=======	=======	=======	=======	=======	=======	=======	=======	=======	=======
	Profit(loss)		298	221	165	122	-111	-132	-149	-162	-171	-178	-0
	Capital Flow		-4,000	1,178	1,011	767	584	206	105	29	-28	-71	122
			***										
	IRR ===>>	-0.9%											

Assumptions:

- Invested assets = (100%- paid % + 5% (optimistic cash flow)) * total Assets
- Dividends = Prior year surplus - (Prior year reserves * Capital Charge %)
- Dividends are paid at the beginning of the year and therefore reduce available assets for investment income
- *** The initial capital charge is made on December 31st of year 0; (optimistic)
- Loss reserves are perfectly adequate - no surplus, no shortfall
- The only drivers for profitability are: investment income, Expenses, ULAE adequacy
- The payment tail is limited to 10 years as a model simplification; remaining surplus at year 10 is returned at the beginning of year 11
- G&A expenses include claims oversight, finance, stat accounting, yearly actuarial review, etc. Reducing volume is offset by inflation.
- There are zero income taxes

Run-off Economics

- Reserves Consume Capital
- ULAE is rarely adequate for full run-off
- Reserve run-off is drag on earnings

Run-off Solutions

- Create a “Living Will” plan similar to banking regulations– increase ULAE
- Look for increased investment income options
- Settle claims faster
- Create synergies in Run-off portfolios
  - Reduce capital charge through diversification
  - Reduce G&A due to larger critical mass
- All of these will not eliminate earnings drag

- Consider creating positive margin in loss reserves (not US GAAP)
- Divest run-off