


Slide 1

*Run-off as a business*  
Casualty loss reserving seminar

September 6, 2018  
10:00 - 11:15 AM

A photograph of four people (two men and two women) smiling and standing together. They are dressed in professional attire. The background is dark and indistinct.

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Slide 2

*Run-off as a business*

A small portrait of Warren Buffet, an older man with glasses, wearing a suit and tie.

Source: Wikipedia

“ Reinsurance is ...  
like hell – easy to enter and  
almost impossible to exit.  
Warren Buffet, 2003 ”

Run-off as a business 2


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Slide 3


**Today's panel members**



**William (Bill) Barbagallo**  
Managing Director,  
Actuarial Services, PwC




**Luann Petrellis**  
Managing Director,  
Actuarial Services, PwC




**James (Jay) Votta**  
Principal, Insurance and  
Actuarial Advisory Services,  
Ernst & Young LLP

**Moderator**




**Barbara Murray**  
Director,  
Actuarial Services, PwC




Views of the presenters' are  
not necessarily those of Ernst  
& Young LLP or PwC

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**Polling question 1** 


**What is runoff?**

- A. A continual or prolonged reduction, especially in quantity or supply
- B. An extra vote or contest to decide winner of an election
- C. Part of water cycle that flows over land as surface water
- D. The natural tail of the insurance cycle
- E. All of the above

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**Polling question 2** 

**Do you have experience with insurance runoff?**

- A. Yes
- B. No


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**Polling question 3** 

**Which of the following best describes your interaction with insurance runoff?**

- A. Claim related
- B. Actuarial review
- C. Litigation
- D. Other

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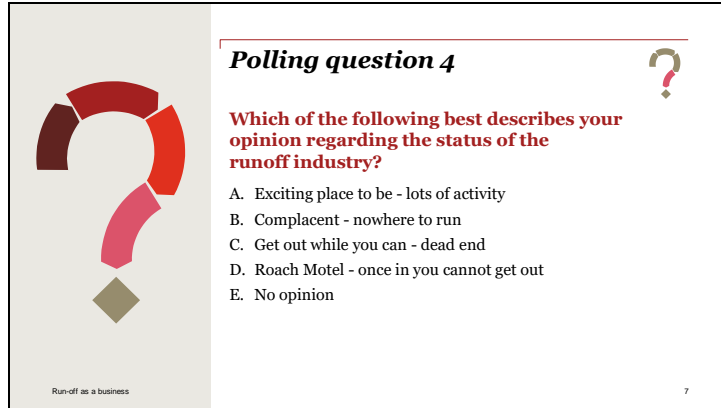
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**Polling question 4**

Which of the following best describes your opinion regarding the status of the runoff industry?

- A. Exciting place to be - lots of activity
- B. Complacent - nowhere to run
- C. Get out while you can - dead end
- D. Roach Motel - once in you cannot get out
- E. No opinion

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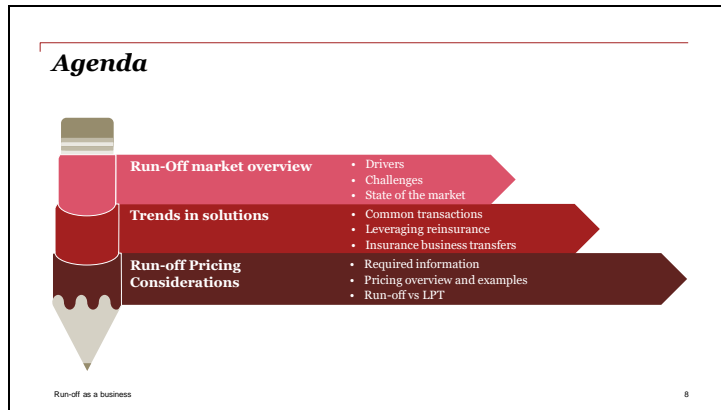
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**Agenda**

- Run-Off market overview**
  - Drivers
  - Challenges
  - State of the market
- Trends in solutions**
  - Common transactions
  - Leveraging reinsurance
  - Insurance business transfers
- Run-off Pricing Considerations**
  - Required information
  - Pricing overview and examples
  - Run-off vs LPT

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*Run-off market overview*



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*Run-off market overview*  
The management of discontinued insurance business

 <p><b>Common drivers</b></p> <ul style="list-style-type: none"><li>• Unexpected losses</li><li>• Poorly performing reinsurers</li><li>• Insured's failure to meet deductible obligations</li><li>• Failed fronting relationships</li><li>• Changes in core business</li><li>• Mergers and Acquisitions</li></ul>	 <p><b>Challenges</b></p> <ul style="list-style-type: none"><li>• Difficult to bring finality to exposures</li><li>• Long tail, volatile claims</li><li>• Ties up Capital</li><li>• Heightened regulatory or rating agency attention</li><li>• Legacy systems/data</li><li>• Securitization of the reinsurance and other assets</li><li>• Lack of broker support</li><li>• Strains resources/limited talent pool</li></ul>
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**Run-off market overview**



Global Insurance Run-off Survey 2018

**pwc**

**IRIA AIRC**

[www.pwc.com/globalinsurancerunoffsurvey](http://www.pwc.com/globalinsurancerunoffsurvey)

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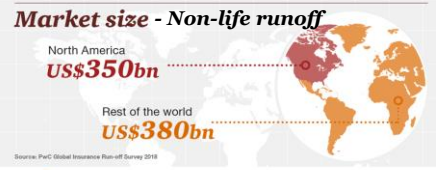
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**Run-off market overview (continued)**

**Market size - Non-life runoff**



Region	Market Size (US\$bn)
North America	350
Rest of the world	380

North America  
**US\$350bn**

Rest of the world  
**US\$380bn**

Source: PwC Global Insurance Run-off Survey 2018

**pwc**

[www.pwc.com/globalinsurancerunoffsurvey](http://www.pwc.com/globalinsurancerunoffsurvey)

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Source: PwC Global Insurance Runoff Survey, 2018 [www.airc.org/pwc-global-insurance-runoff-survey](http://www.airc.org/pwc-global-insurance-runoff-survey)

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**Run-off market overview**  
Key objectives for run-off business




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

*U.S. respondents also gave the management of claims volatility greater importance than other jurisdictions.*

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**Run-off market overview**  
Major challenges affecting the achievement of objectives in 2018 and 2019

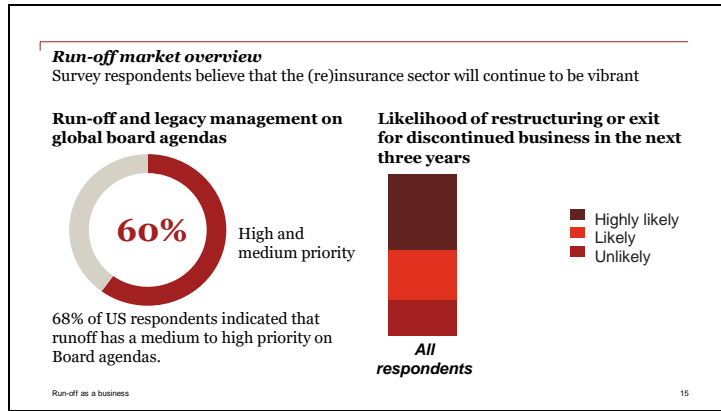


**Regulatory environment   Adverse loss development   Access to exit mechanisms**

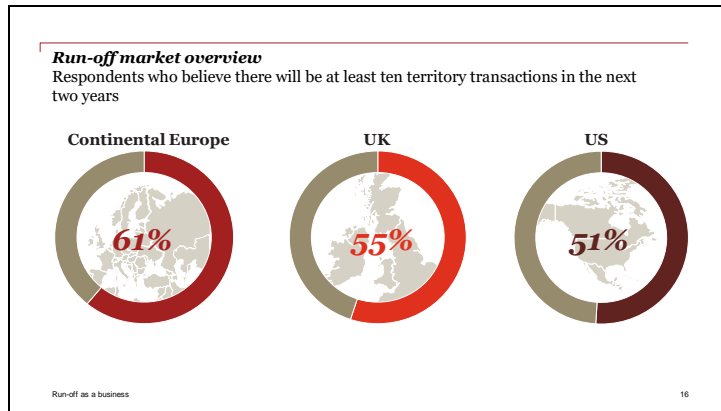
U.S. respondents also cited talent retention as a major challenge.

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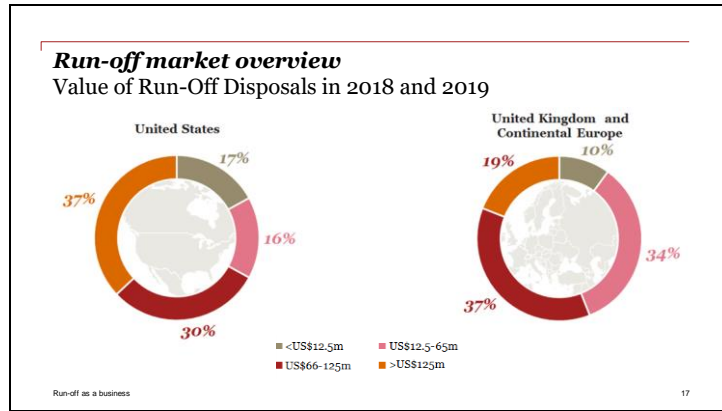


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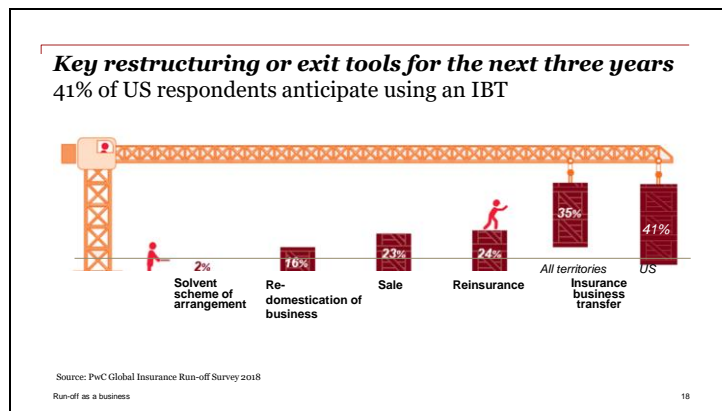




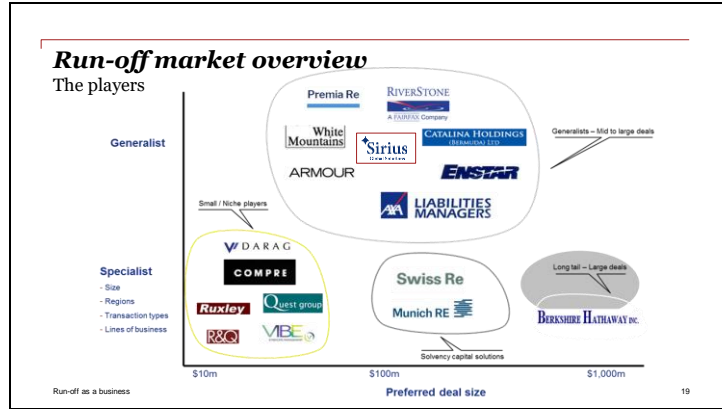
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### Trends in solutions

#### Common transactions and leveraging reinsurance

01	Policy Buybacks	<ul style="list-style-type: none"><li>Provides for the complete discharge of all obligations under a direct policy</li><li>Agreed between policyholder and insurer</li></ul>
02	Commutations	<ul style="list-style-type: none"><li>Provides for the complete discharge of all obligations under a reinsurance contract</li><li>Agreed between cedant and assuming reinsurer</li></ul>
03	Captives - Deductible Buyouts	<ul style="list-style-type: none"><li>Relieves the Captive from meeting its obligations of insuring the insured's deductible obligation</li><li>Agreed between the Captive and its insured</li></ul>
04	Novations	<ul style="list-style-type: none"><li>Replaces one party with another from inception of coverage</li><li>Requires consent of original policyholder</li></ul>
05	Mergers and Acquisitions	<ul style="list-style-type: none"><li>Consolidation of companies/assets through various transactions</li><li>Includes M&amp;A, consolidations, tender offers, asset purchase, etc.</li><li>In all cases, two companies are involved</li></ul>
06	Loss Portfolio Transfers	<ul style="list-style-type: none"><li>Losses that are already incurred are ceded to new reinsurer</li><li>Two-party agreement</li><li>Does not require policyholder consent</li><li>May include known and unknown claims (BNC)</li></ul>
07	Adverse Development Covers	<ul style="list-style-type: none"><li>Retrospective reinsurance indemnifying the reinsured against losses (net of other reinsurance)</li><li>May include claims control</li><li>Two party agreement</li></ul>

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### Trends in solutions

#### Capital solutions – A look at the UK

#### Solvent Schemes

- Voluntary agreement between a solvent debtor (i.e. insurer) and consenting creditors (i.e. policy holder)
- Debtor's assets and/or income are applied proportionately in satisfaction of the debts
- Governed by the ordinary law of contract
- Serves as a more advantageous alternative to the debtor's bankruptcy
- The debtor insurer will typically commute with its reinsurers and then distribute the proceeds to policyholder claims.

#### Part VII Transfer

- Transfer a portfolio of contracts (the entire business or a subset of it)
- Includes associated assets and liabilities to be legally transferred (novated) from one entity to another
- Transfer can be either within the same group or to an external party
- Multiple transferor and transferee companies are allowed to enable individual and multiple portfolios to be split or combined
- Typically used for:
  - Consolidate acquisitions
  - Exit/transfer runoff portfolios
  - Generate capital and operational efficiencies

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**Trends in solutions**  
**Capital solutions – The US perspective**

The Insurance Business Transfer (IBT) concept, modeled on the UK Part VII transfer regulations, is a restructuring tool with the goal of economic and legal finality for the transferred policies. Its potential benefits include increased capital and greater operational efficiency. The transaction seeks to provide a fair solution that balances the needs of all of the company's stakeholders.

UK Part VII Transfers Over Time

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
Count	3	10	18	26	29	24	18	8	12	24	15	13	11	22	6	12	251

- There have been hundreds of successful Part VII Transfers to date
- The Part VII Transfer and its counterparts worldwide have been used for decades
- The Part VII Transfer applies to all lines of insurance, live and runoff
- Several larger companies have used the Part VII transfer

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**Trends in solutions – The US Perspective**  
**Application of the IBT - A tool with flexibility in mind that yields benefits**

<p><b>Combine similar business from one or more subsidiaries, putting all into a single company</b></p>	<ul style="list-style-type: none"> <li>• Reduces the number of regulated companies</li> <li>• Releases excess capital</li> <li>• Saves ongoing management, regulatory and administrative costs</li> </ul>
<p><b>Separate out different books of business, putting them into separate companies</b></p>	<ul style="list-style-type: none"> <li>• Segregates old liabilities from new business</li> <li>• Potentially more efficient capital deployment</li> <li>• Identifies liabilities to commute</li> <li>• Flags books of business to be sold</li> </ul>
<p><b>Transfer business between third parties</b></p>	<ul style="list-style-type: none"> <li>• Obtain/exit business</li> <li>• More flexible than a sale as it involves only run-off liabilities (not the whole company)</li> <li>• Ability to partner with capital</li> </ul>

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**Trends in solutions – The US Perspective**  
**Legislative actions**

- PA Business Corporations Law ("Division statute") (INA/Cigna/Brandywine deal)
- 2002 – Rhode Island Voluntary Restructuring of Solvent Insurers Act (One transaction completed - GTE Re)
- 2014 - Vermont Legacy Insurance Management Act (LIMA)
- 2015 Rhode Island Amendments to Regulation 68 (Insurance Business Transfers for P&C run-off business)
- October 1, 2017 – Connecticut House Bill 7025 effective, authorizing domestic insurers to divide
- May 1, 2018 – Oklahoma Senate Bill 1101 passed, insurance business transfers apply to life, health and P&C
- July 2018 - Rhode Island amends Regulation 68 to clarify definition of "voluntary restructuring".

Run-off as a business

**Trends in solutions – The US Perspective**  
**Restructuring legislation – Key points by state**

**Rhode Island**

- Applies only to commercial P&C runoff
- Assuming company must be RI domestic company
- Transferring policies must have expired at least 5 years prior to filing for IST
- Regulatory and judicial approval process
- No opt outs or policyholder consent required

**Vermont**

- Assuming carrier must be domiciled in VT
- Restricted to closed blocks of non-admitted commercial property and casualty insurance and reinsurance
- Process is solely regulatory
- Opt-outs permitted

**Connecticut**

- Allows a domestic insurer to divide into two or more insurers and allocate assets and obligations to the new companies (a de-merger)
- Only requires regulatory approval of the Plan of Division
- Applies to any type of business and is not limited to closed blocks
- Each "resulting insurer" is responsible individually for liabilities allocated to it under the plan of division
- Plan of division cannot become effective unless approved by the Commissioner after reasonable notice and a public hearing, if the Commissioner determines notice/hearing are in the public interest


**Oklahoma**

- Assuming carrier must be domiciled in OK
- Applies to all lines of business
- Not restricted to run-off
- No waiting period for transferring policies
- No opt outs or policyholder consent required
- Regulatory and judicial approval process

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***Run off pricing considerations***



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***Run off pricing considerations***

**Information to populate**

<input checked="" type="checkbox"/> Lines of business	<input checked="" type="checkbox"/> Deductible (incl. Corridor, aggregate, etc.) obligations and collateral
<input checked="" type="checkbox"/> Premium written	<input checked="" type="checkbox"/> Reinsurance balances due, collection and dispute risk, penalties
<input checked="" type="checkbox"/> Loss reserving (case and IBNR) and payment patterns	<input checked="" type="checkbox"/> Reinsurance collateral
<input checked="" type="checkbox"/> Reserving discounts	<input checked="" type="checkbox"/> Commissions
<input checked="" type="checkbox"/> Net Present Value	<input checked="" type="checkbox"/> Taxes
<input checked="" type="checkbox"/> Ceded reserve and ibnr distribution	<input checked="" type="checkbox"/> Penalties
<input checked="" type="checkbox"/> Retro/loss sensitive premium	<input checked="" type="checkbox"/> Quantitative and qualitative claims information

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### Run off pricing considerations

#### Pricing overview

Both the transferring and assuming companies must consider:

- Reserve Adequacy
- Expected Expenses
- Expected payment pattern
- Investment yields

Run off Deals are similar to LPTs

To price the deal, the assuming company must also consider:


- Required capital (variability of portfolio, diversification impacts)
- Required Return

As well as:

- Knowledge of business (underlying risks/claim and litigation trends)
- Ceding Company claims capability
- Ceding Company commitment to the deal

To assess the deal, the ceding company must consider:

- Regulatory
- Accounting
- Tax Position



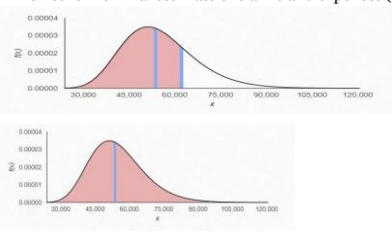
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### Run off pricing considerations

#### Simplified Pricing Example

- LPT of \$50 million claim liabilities
- Reinsurer nominal estimate of claims and expenses (LAE and Brokerage) = \$55 million



- 75th Percentile: 62,199
- 99th Percentile: 94,039

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**Run off pricing considerations**  
**LPT Pricing Using Cost of Capital – Conservative Scenario**

Year	LLAE Reserves	Payments	Required capital	Required return on Avg capital	Assumptions
0	55,000	-	39,039		Supporting Capital Factor 71%
1	49,500	5,500	35,135	3,709	Cost of Capital 10%
2	44,000	5,500	31,231	3,318	Discount Rate 2%
3	38,500	5,500	27,327	2,928	
4	33,000	5,500	23,423	2,538	
5	27,500	5,500	19,520	2,147	
6	24,750	2,750	17,568	1,854	
7	22,000	2,750	15,616	1,659	
8	19,250	2,750	13,664	1,464	
9	16,500	2,750	11,712	1,269	
10	13,750	2,750	9,760	1,074	
11	12,650	1,100	8,979	937	
12	11,550	1,100	8,198	859	
13	10,450	1,100	7,417	781	

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**Run off pricing considerations**  
**LPT Pricing Using Cost of Capital – Conservative Scenario (continued)**

Year	LLAE Reserves	Payments	Required capital	Required return on Avg capital	Assumptions
14	9,350	1,100	6,637	703	Supporting Capital Factor 71%
15	8,250	1,100	5,856	625	Cost of Capital 10%
16	7,150	1,100	5,075	547	Discount Rate 2%
17	6,050	1,100	4,294	468	
18	4,950	1,100	3,514	390	
19	3,850	1,100	2,733	312	
20	2,750	1,100	1,952	234	
21	1,650	1,100	1,171	156	
22	550	1,100	390	78	
23	-	550	-	20	
<b>Total</b>		<b>55,000</b>		<b>28,069</b>	
<b>Present Value</b>		<b>48,029</b>		<b>24,977</b>	
<b>Price</b>				<b>73,006</b>	

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**Run off pricing considerations**  
LPT Pricing Using Cost of Capital – Optimistic Scenario (continued)

Year	LLAE Reserves	Payments	Required capital	Required return on Avg capital	Assumptions
0	55,000	-	7,199		Supporting Capital Factor 13%
1	49,500	5,500	6,479	547	Cost of Capital 8%
2	44,000	5,500	5,759	490	Discount Rate 3%
3	38,500	5,500	5,039	432	
4	33,000	5,500	4,319	374	
5	27,500	5,500	3,600	317	
6	24,750	2,750	3,240	274	
7	22,000	2,750	2,880	245	
8	19,250	2,750	2,520	216	
9	16,500	2,750	2,160	187	
10	13,750	2,750	1,800	158	
11	12,650	1,100	1,656	138	
12	11,550	1,100	1,512	127	
13	10,450	1,100	1,368	115	

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**Run off pricing considerations**  
LPT Pricing Using Cost of Capital – Optimistic Scenario (continued)

Year	LLAE Reserves	Payments	Required capital	Required return on Avg capital	Assumptions
14	9,350	1,100	1,224	104	Supporting Capital Factor 13%
15	8,250	1,100	1,080	92	Cost of Capital 8%
16	7,150	1,100	936	81	Discount Rate 3%
17	6,050	1,100	792	69	
18	4,950	1,100	648	58	
19	3,850	1,100	504	46	
20	2,750	1,100	360	35	
21	1,650	1,100	216	23	
22	550	1,100	72	12	
23	-	550	-	3	
<b>Total</b>		<b>55,000</b>		<b>4,141</b>	
<b>Present Value</b>		<b>45,141</b>		<b>3,652</b>	
<b>Price</b>				<b>48,823</b>	

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***Run off pricing considerations***  
LPT versus Run Off

Unlimited Exposure

Reputational Risk

Entity Purchase

Acquired Claims Influence

Run-off as a business

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***Thank you!***