

CAS REINSURANCE

Run-off as a Business

June 2017

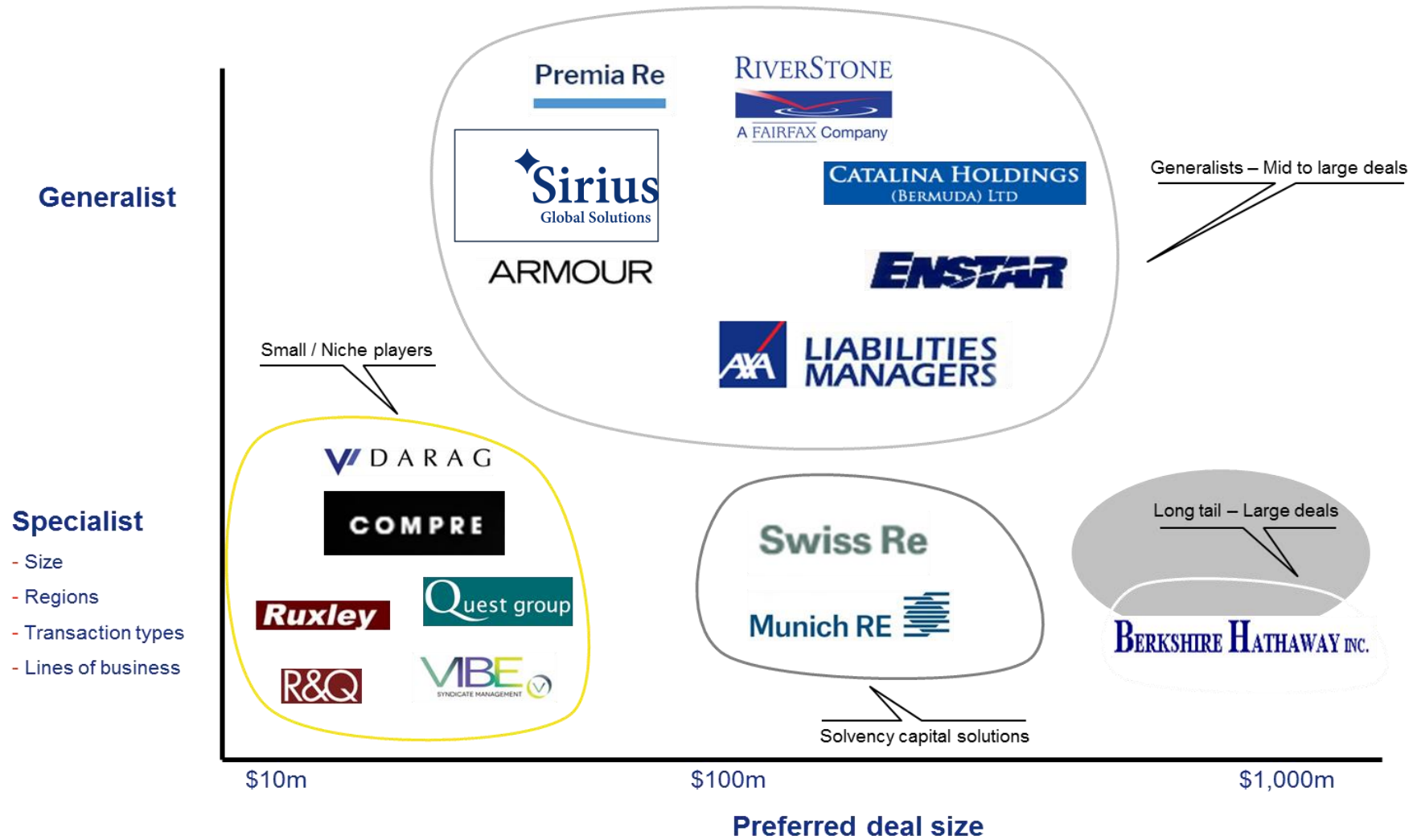
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U.S. Run-off Business – then and now

- Prior to the late 1980s run-off books in the U.S. were passively managed with little focus on strategic run-off plans.
- In the 1990s there were just a few players in the market, primarily dominated by large companies. (Swiss Re, Munich Re, Center Re, Berkshire Hathaway, Gerling).
- Companies began to recognize the significant capital deployed and costs associated with run-off and to take a more active approach to managing these liabilities (i.e. commutations).
- Since the late 1990s the run-off market has expanded to include specialty run-off companies with a wide range of interests (Enstar/Catalina/Armour/Resolution).

THE CURRENT COMPETITIVE LANDSCAPE



UK run-off market

- Because of the impact of legacy liabilities on Lloyds in 1980s, UK market had to act - led to Equitas and UK legislation for Solvent Schemes and Part VII Transfers.
- Numerous Solvent Schemes and Part VII transfers completed.
- UK market is mature, reflected in current pricing of transactions because market is so competitive.
- Now run-off acquirers attracted to US market.

Part VII Transfers effected as of 2016

<u>YEAR</u>	<u>Number of Transfers</u>
2002	3
2003	10
2004	18
2005	26
2006	28
2007	24
2008	18
2009	8
2010	12
2011	24
2012	15
2013	13
2014	11
2015	22
2016	6
TOTAL	238

- *There have been hundreds of Part VII Transfers accomplished to date, none of which have encountered subsequent financial difficulties.*
- *The Part VII Transfer has successfully strengthened and rationalized the UK run-off market improving its position in the global market.*

UK and European non-life legacy insurance market

(in Euros)

UK and Ireland	49bn
German and Switzerland	113bn
France and Benelux Countries	41bn
Other Western Europe	28bn
Eastern Europe	6bn
Nordic Region	10bn
TOTAL	247bn

U.S. run-off market

The U.S. run-off market continues to grow

Commercial P&C

Potential market estimated to be \$200+ billion in legacy liabilities

Long Term Care

Potential market estimated to be \$400+ billion in legacy liabilities

Worker's Comp

Potential market estimated to be \$100+ billion in legacy liabilities

Life Products

Potential market estimated to be hundreds of billions of dollars in legacy liabilities

The need for restructuring legislation in U.S.

- Although the US Run-off market for A&E is a mature business, it has lagged behind the UK and EU run-off markets in transactions largely because the U.S. has no effective restructuring legislation.
- US insurance companies have limited options to address run-off (reinsurance/commutation/sale/outsource administration).
- The US run-off market has been dominated by large reinsurance transactions or sales of companies to run-off managers.
- All lines of insurance would benefit from restructuring legislation and make the US insurance market more attractive for investors.

How to exit from run-off?

*“Reinsurance is...
like hell – easy to enter
and almost impossible
to exit.”*

2003



Top 12 US Asbestos & Environmental Insurers

Runoff Deals Done

Insurer	Legacy Deal Done?	Counterparty (date)
AIG	√	Berkshire Hathaway (2011/2016)
Allianz	√	Enstar (2016)
Allstate		
Berkshire Hathaway		
CNA	√	Berkshire Hathaway (2010)
Fairfax Financial		
Hartford	√	Berkshire Hathaway (2016)
Liberty Mutual	√	Berkshire Hathaway (2014)
Munich Re		
Nationwide		
Swiss Re	√	Berkshire Hathaway (2008/2012)
Travelers		

U.S. run-off/restructuring legislation

- In the past, companies tried different approaches to restructure run-off business (*e.g. AIG internal restructuring primarily through reinsurance to form Eaglestone for legacy liabilities with oversight of PA DOI*)
- PA Business Corporations Law (“Division statute”) (*INA/Cigna/Brandywine deal*)
- 2002 – Rhode Island Voluntary Restructuring of Solvent Insurers Act (*One transaction completed - GTE Re, small transaction tailored to a particular situation*)
- 2014 - Vermont Legacy Insurance Management Act (LIMA)
- 2015 Rhode Island Amendments to Regulation 68 (*Insurance Business Transfers for P&C run-off business*)
- Currently companies are asking regulators to respond to their need to restructure (*e.g. recently passed CT division; pending commutation legislation in OK*)

Where is the U.S. run-off market headed?

EY/AIRROC 2015 (Re)insurance Run-off Survey of US market

KEY FINDINGS OF SURVEY

- **Finality** is at the top of the agenda for managers of run-off business
- **Commutation** is an important part of most run-off plans
- **Adverse loss experience** is the most important challenge facing run-off business
- **A & E** claims continue to plague the industry
- **Restructuring** is becoming more significant in the U.S. run-off market
- **Rhode Island Reg. 68 (IBT)** is the most significant development in the U.S. run-off market

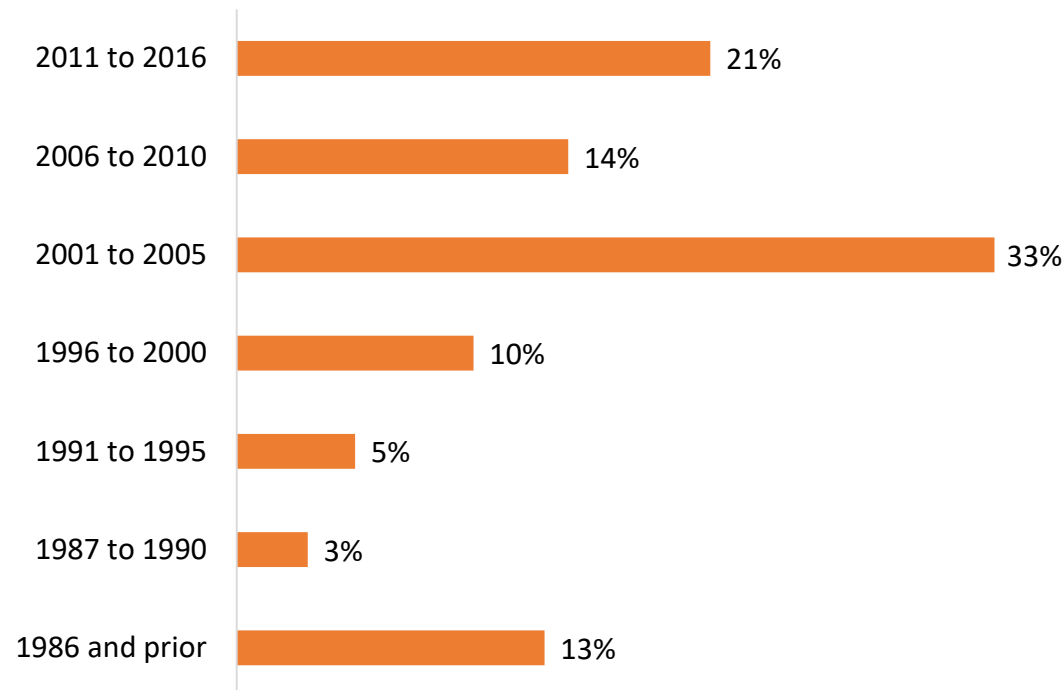
How does your organization define run-off business?

Run-off business is most widely defined as lines of business that are no longer written.

- *“All lines of business where premiums are no longer being written.”*
- *“Any discontinued line of business”*
- *“Business that is being wound down and no longer underwritten”*
- *“Closed book of business with no more underwriting”*
- *“2001 and prior”*
- *“Discontinued business”*
- *“Non-core to the group”*
- *“No new written business”*

Increasing classification of more recent business as run-off

What is the most recent underwriting year that your organization classifies as run-off business?

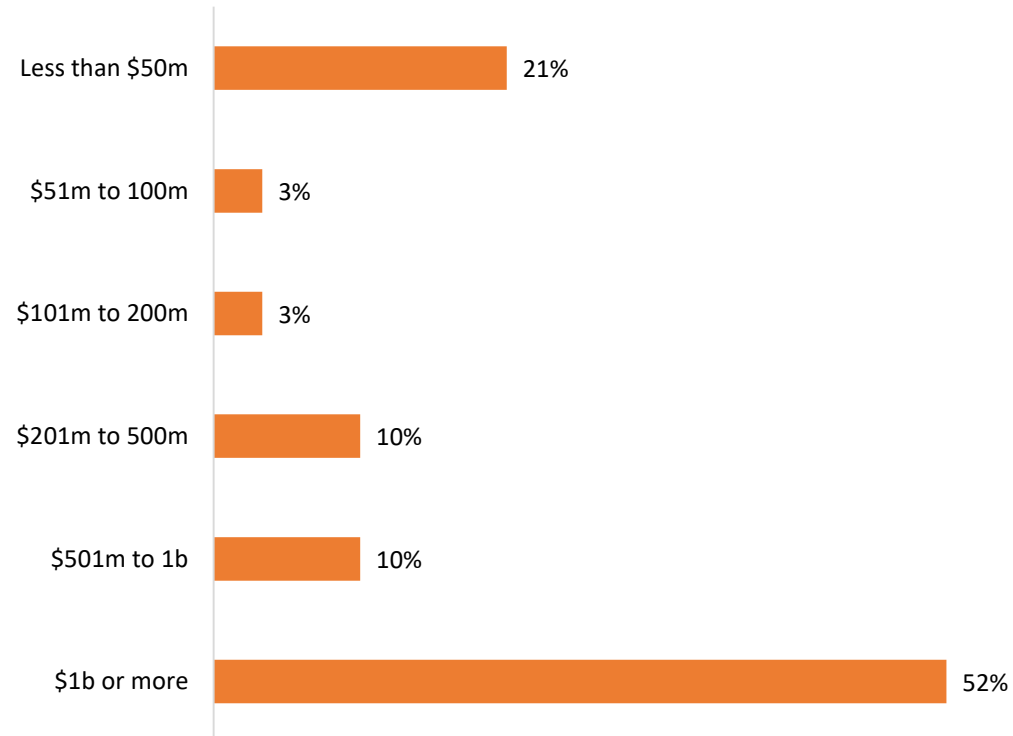


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- ▶ More than two-thirds of respondents classifies the most recent underwriting year for run-off business as within this century.
- ▶ Nearly one third of organizations classified 2001 to 2005 as the most recent run-off years.
- ▶ 35% put in run-off in past 10 years
- ▶ There seems to be an increasing classification of more recent business as run-off.

Most respondents have run-off reserves in excess of \$1 billion

What are your or your client's organization's total gross run-off reserves? (Reserves equals case plus IBNR)

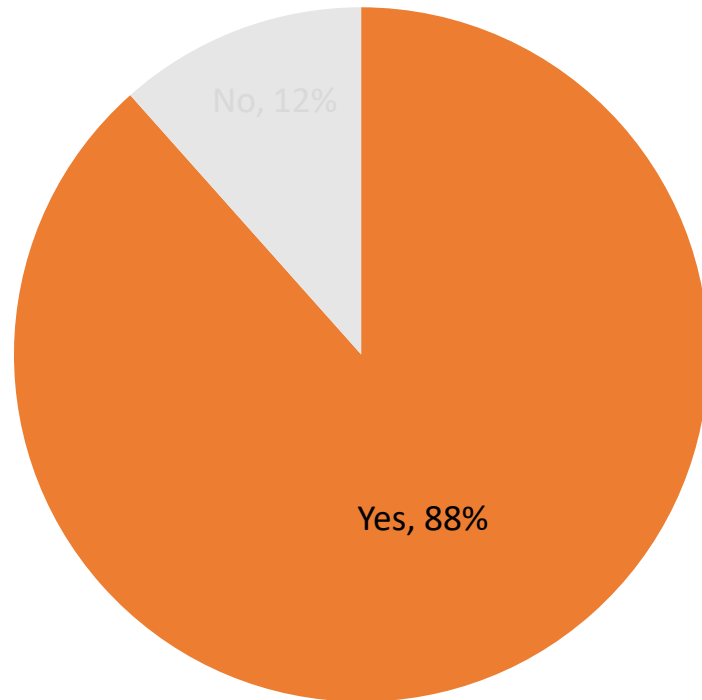


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- ▶ The majority of organizations have total gross-run off reserves over \$1 billion.
- ▶ The second most common amount for run-off reserves is less than \$50 million.

Most respondent organizations have a strategic run-off plan

Do you or your client's organization have a strategic run-off plan?

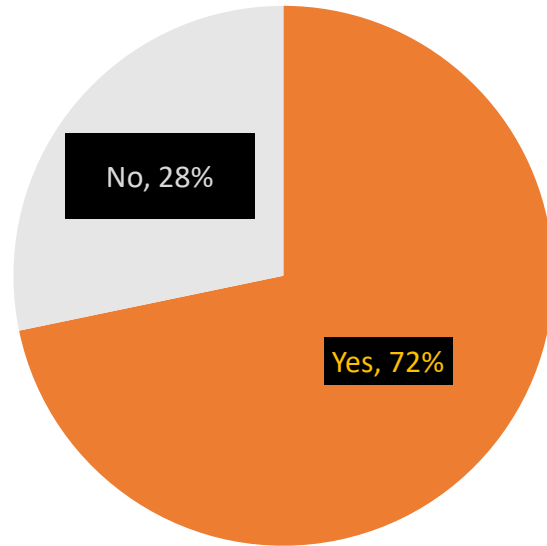


- ▶ A large majority of organizations surveyed have a strategic run-off plan in place.

Numbers may not add due to rounding

Most respondents report considering an exit option – most often commutation

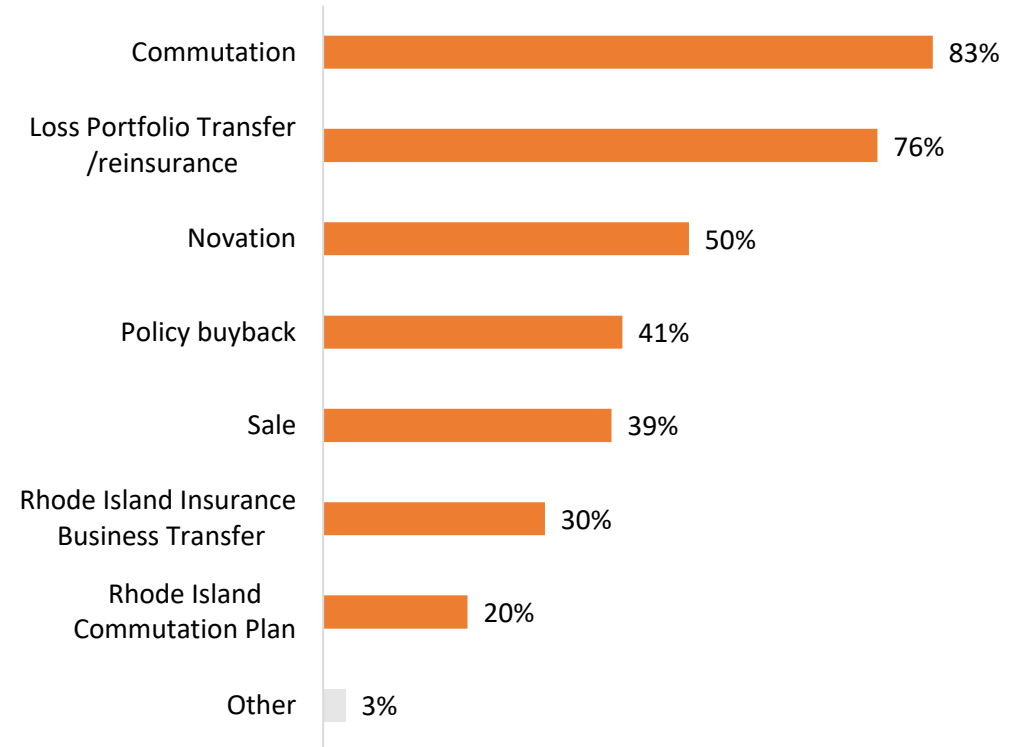
Have you or your client's organization considered an exit option for its runoff business?



- ▶ The majority of respondents have considered an exit option.
- ▶ The most commonly considered exit options include Commutation, and Loss Portfolio Transfer.

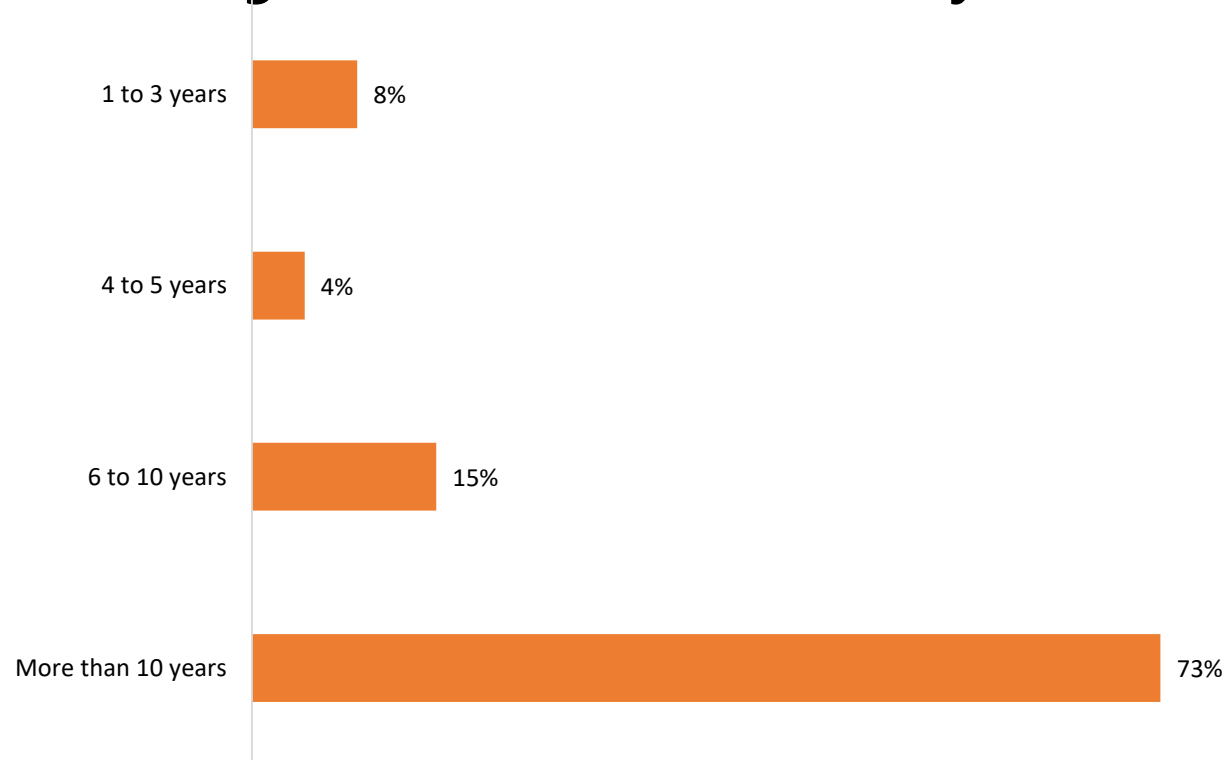
Numbers may not add due to rounding, multiple responses allowed

Which exit options have been considered?



Finality is a long game - most expect run-off to finality to continue for more than 10 years

What is the anticipated duration of your or your client's organization's runoff to finality?

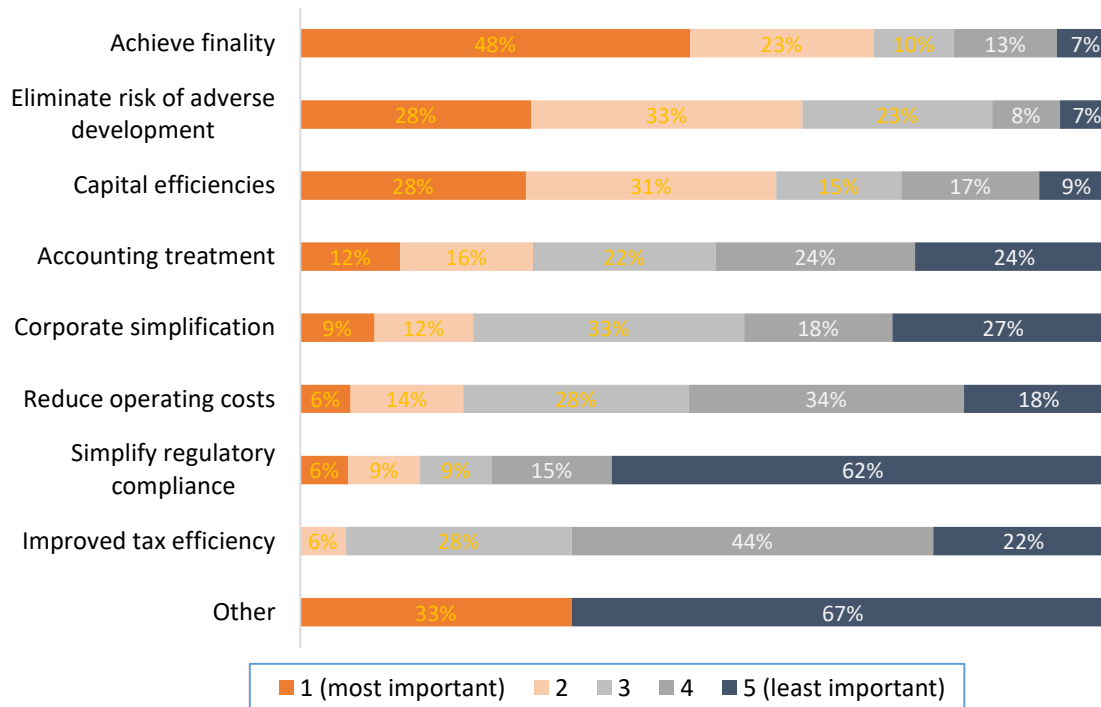


Numbers may not add due to rounding

- ▶ The duration of most organization's runoff to finality is anticipated to be more than 10 years.
- ▶ Less than 30% of organization's runoff to finality is expected to continue for less than 10 years.

Achieving finality is a key influence in run-off restructuring activities

What are the key drivers that influence or would influence your or your client's organization's run-off restructuring activities? Please rank the drivers on a scale of 1 to 5, with 1 being most important.

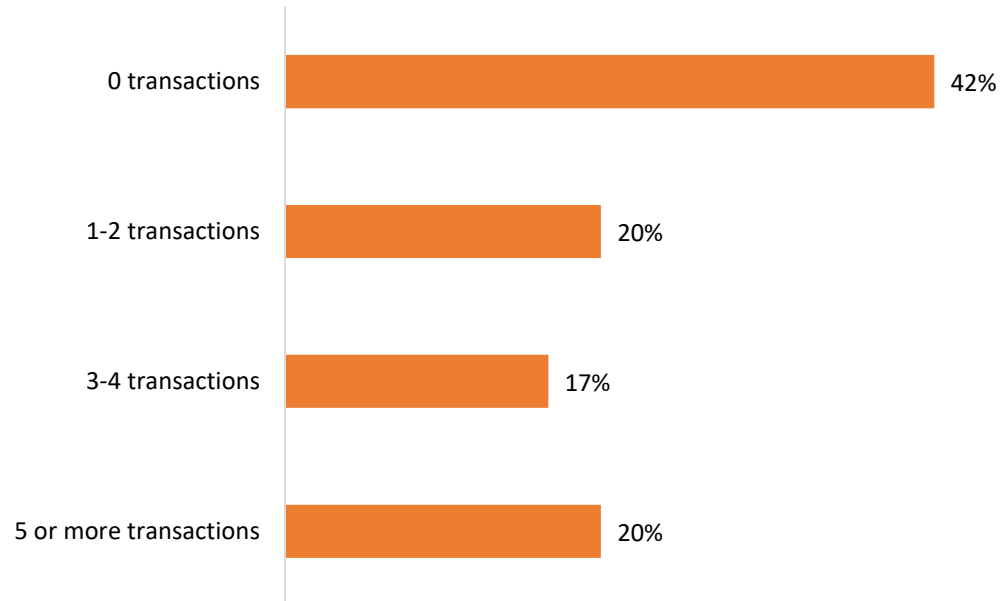


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- ▶ Many respondents cite achieving finality as the most important influence in restructuring.
- ▶ Eliminating risk of adverse development, and capital efficiencies are also key influences.

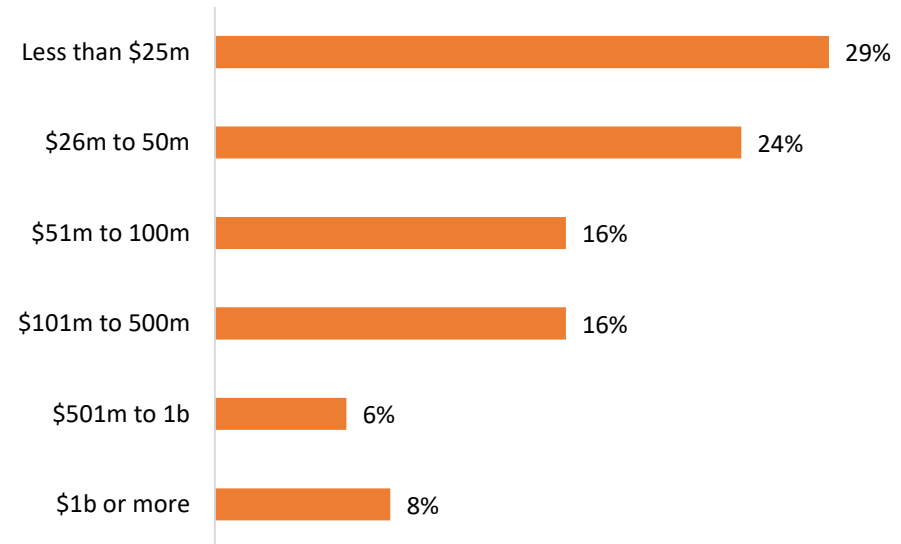
Most organizations had at least 1 restructuring transaction in the last 3 years

In the last 3 years, how much restructuring activity in the run-off market has your organization been involved in?



Numbers may not add due to rounding

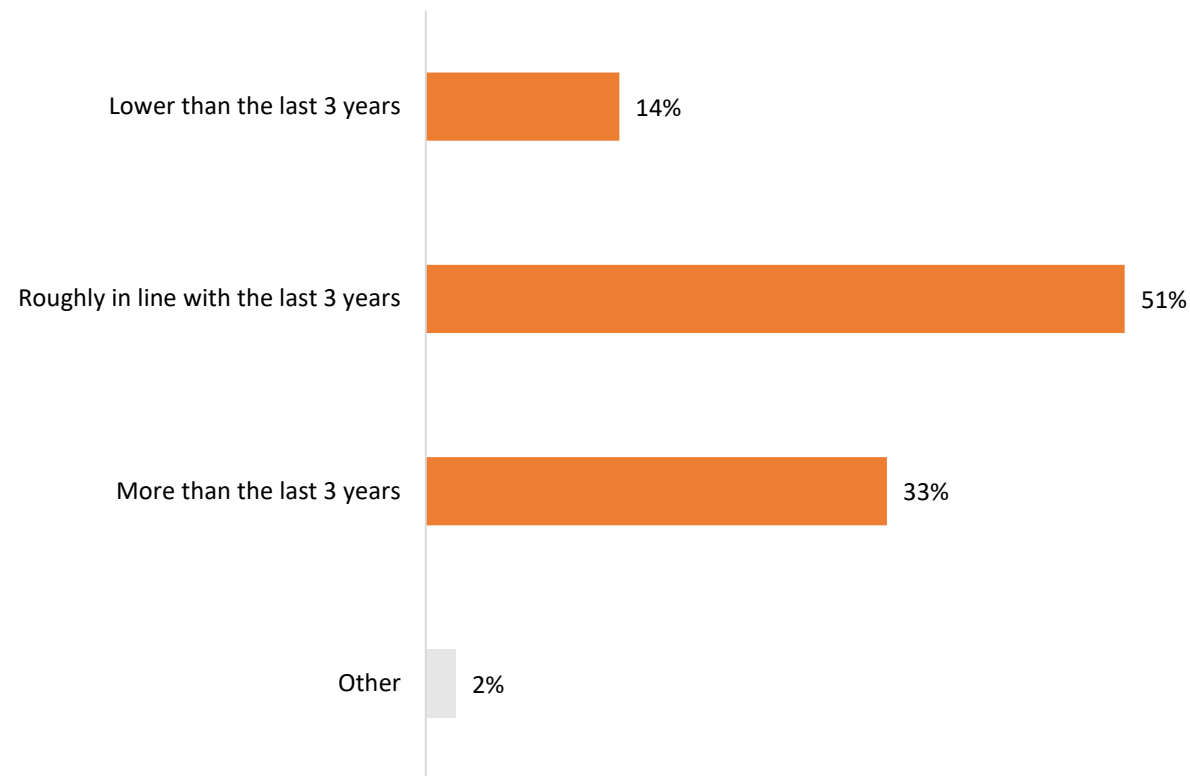
If you answered 1 or more to the previous question, what is the average deal size for these transactions?



- ▶ Many organizations have not restructured in the last 3 years.
- ▶ For those who have done restructuring, the majority of deals average less than \$50m.

Most respondents expect restructuring activity to remain constant or to increase

How much insurance restructuring activity do you expect to take place in the U.S. over the next 3 years?



Numbers may not add due to rounding

- ▶ Most respondents expect the amount of restructuring activity to remain roughly constant with the last 3 years.
- ▶ More respondents expect an increase in restructuring activity

What do you expect will be the single most significant development in the U.S. run-off market over the next 3 to 5 years? (Sample responses)

The industry speaks:

"An influx of capital from regions outside of US and Europe to purchase runoff companies and portfolios e.g. from Asia"

"Utilizing RI Reg 68 becomes a simplified process to end future liabilities"

"Enactment of statutes similar to Rhode Island IBT in other jurisdictions"

"Expansion of programs similar to RI IBT to most states"

"Hopefully, companies will begin to use the RI plan or other plans like it that may develop to help create an exit strategy for US reinsurers similar to what they have in Europe"

"Ease of finding exit strategies for unprofitable accounts"

"Spread of Rhode Island type regulation"

"Rhode Island's new 'Part 7' law"

"Hopefully the Rhode Island exit plan"

"Continued adverse development"

"Interest rate movement"

"Merging of companies"

"CTE Exposure"

"Exit mechanism with favorable regulatory and accounting"

"Growing appetite to acquire run-off"

Overview of the Rhode Island IBT

What is it?

- The RI IBT is modeled on the UK Part VII Transfer.
- The RI IBT is an insurance department approved and court-sanctioned legal transfer (novation) of some or all of the commercial insurance or reinsurance business of one company (need not be a RI insurer) to another company (must be a RI insurer) including attaching reinsurance.
- The IBT applies to reinsurance of any line of business other than life and insurance of any line of business other than life, worker's compensation and personal lines insurance.
- All transferring policies must have an expiration date more than 60 months from the date of filing for approval of an IBT plan and be in a closed book of business or reasonably specified group of policies.

Procedural requirements for the RI IBT

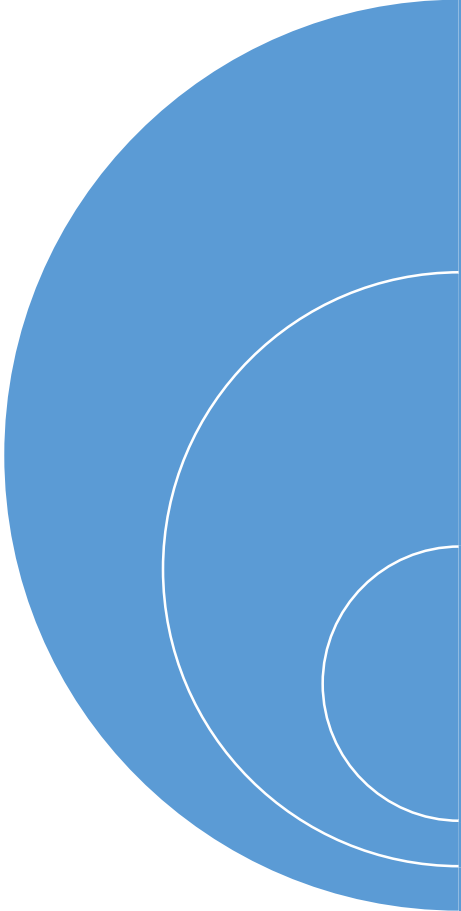
The RI IBT approval process is a multi-layered, transparent process that balances the needs of all stakeholders.

The main requirements for the RI IBT approval process include

- 1) notification to all affected policyholders;
- 2) an independent expert report that evaluates the impact of the transfer on affected policyholders;
- 3) review and approval from the Transferring Company's state of domicile;
- 4) review and approval from the RI Division of Insurance;
- 5) a hearing and an opportunity to be heard; and
- 6) review and approval by RI Superior Court.

Application of the RI IBT

A key feature of the RI IBT is its flexibility



Combine similar business from one or more subsidiaries, putting all into a single company

- Allows a corporate group to reduce the number of its regulated companies.
- Release excess capital for use elsewhere.
- Save ongoing management, regulatory and administrative costs.

Transfer business between third parties

- To obtain business.
- To exit business.
- More flexible than a sale as it only involves the run-off liabilities apart from the whole company.

Separate out different books of business, putting them into separate companies

- Separate old liabilities from new business, putting them into separate companies.
- More efficient capital deployment.
- Separate out liabilities that can be held to expiry or can be commuted.
- Separate out books of business to be sold from those to be retained.

Selected benefits of the RI IBT

The RI IBT provides a range of benefits for both the transferring and assuming company

TRANSFERRING COMPANY



- Capital efficiency
- Group restructuring
- Regulatory and operational efficiency
- Corporate simplification/Consolidation of legacy business
- Removal of non-core lines
- Economic and legal finality
- Favorable consideration from investors

ASSUMING COMPANY



- Regulatory and operational efficiency
- Potential opportunity for tax savings
- Market presence/increased share
- Creation of center of excellence
- Profit from efficient management/exit
- Consolidation of legacy business
- Rational process to enter run-off market at opportune time

What is the economic value of a RI IBT?

The RI IBT can reduce capital committed to legacy liabilities

- A RI IBT can be a catalyst for achieving operational and financial improvements for both the transferring and assuming parties.
- In many run-off portfolios, run-off and new business liabilities are carried at higher capital levels than necessary to support the legacy liabilities on a stand alone basis. Based on general industry capitalization standards for reserves to capital there may be an opportunity to free up excess capital.
- In an internal group restructuring, the RI IBT provides a mechanism to segregate run-off liabilities into a RI run-off company that can significantly reduce the statutory capital committed to support the run-off.

Status of Rhode Island IBT activity

- Companies forming in RI.
- A lot of interest from large global insurers that used Part VII in UK to restructure.
- Why have there been no transactions? Companies hanging back – reluctant to go first and concerned about regulatory process.
- What could drive IBT? Pressure points in industry (Long term care (LTC)/life) are pushing regulators to consider expansion of IBT to other lines of business. LTC is driving US industry and regulators to recognize the need for new restructuring tools. Current need in industry for solutions to LTC, life and WC.

Thank you

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