Sea change

Greater M&A activity and increasing competition are changing attitudes towards run-off, says Tony Weller

Major P&C legacy transactions

Date	Buyer	Transferee	Size	Details
Oct-06	Berkshire Hathaway	Equitas	$7bn	Lloyd's pre-1993 liabilities
Jul-10	Berkshire Hathaway	CNA Corp	$4bn	Asbestos and environmental liabilities
Apr-11	Berkshire Hathaway	AIG (Chartis)	$3.5bn	Liabilities
Jun-01	Berkshire Hathaway	White Mountains	$2.5bn	Pre-1993 asbestos and environmental OneBeacon liabilities
Nov-00	Berkshire Hathaway	Aviva	$2.5bn	London market exposures from newly merged Aviva
Jul-99	Berkshire Hathaway	Ace	$2.5bn	Asbestos and environmental liabilities from Brandywine subsidiary
Jan-11	Catalina	Glacier Reinsurance AG	$1.2bn	Gross assets
2008	Enstar	Union America	$1.196bn	Total assets
2008	Enstar	Gordion	$1.004bn	
Jun-11	Swiss Re	Zurich	$950mn	Assets & liabilities
2007	Enstar	Inter-Ocean	$634.4mn	Total assets
2007	R&Q	Brandywine	Circa $500mn+	Total assets
Jun-09	Catalina	Alea Holdings UK	$446.5mn	Gross assets
Jun-11	Swiss Re	Ageas	EUR310.1mn	From assets held for sale in Ageas Q1 results
Sep-05	Catalina	Overseas Partners Re Ltd	$362mn	Gross assets
Aug-11	Catalina	Residential Loss Control Holdings	$168mn	Gross assets

Sources: Company websites, *The Insurance Insider*

While change has been relatively absent from the legacy market in recent years it is clear that Solvency II implementation will have an effect on the sector.

It is likely that the Framework Directive is going to cause a big shake-up in the next few years.

But one thing that has changed already is that legacy business is seeing an increase in competition. Run-off is a relatively new solution and a lot of people are getting interested in it. The need for run-off is just as prevalent now as it ever was and it is becoming a more mature industry in locations such as the UK.

As a company, we are focused on the areas of the market that are perhaps less well served by other legacy practitioners, particularly small to medium-sized novations or loss portfolio transfers.

An existing problem with this segment of the market is that while a lot of these standalone insurers, captive insurance companies and risk retention

groups are, on the face of it, quite solvent, some of these entities don't have many outstanding claims and yet have to incur all the administrative costs of running an insurance entity.

It's imperative that a company like this gets closed down as quickly as it can. While it may ostensibly be solvent and have the ability to pay outstanding claims, if it does nothing then the company won't be solvent for that much longer. In short, it would be better off novating the entire risk to someone else.

Large companies aren't necessarily interested in this as a solution because the numbers are too small, but for a tightly held captive insurer it's a real problem. From the legacy perspective that's what we're helping people with – high fixed administrative costs without much claims activity.

There are some occasions when running an insurance company doesn't make sense any more. For example, in the self-insurance market, one factor that has changed is that parent companies are deciding they want to run off captives and similar vehicles due to a continuing soft market. In other words, they may as well get someone else to take on the risk – the captive has served its purpose.

And, increasingly, there are more companies now that are willing to consider run-off as an option and are not afraid to take the step if it proves to be the right one for them. Run-off is not necessarily a badge of dishonour any more.

And, as recent takeover tussles have indicated, in the prospective insurance sector it is currently a great time for M&A activity. Looking at the US P&C market in particular, at the moment there are a number of companies that are trading at 70-75 percent of net tangible assets – in theory a terrific buy.

Potentially, one could buy these insurance companies, run them off and make good money in the process. Interest in this approach to legacy business has partially been driven by the events of recent weeks, where insurance companies, like everyone else, have been pounded by what's happening in the stock markets.

At the same time, there are a lot of investors in the market who are afraid of insurance companies – particularly at this time of the year, when they are wondering if there are going to be any significant hurricanes. And continuing concerns about climate change issues mean that a lot of people never invest in insurance companies.

It may be that growth in the legacy market is slower and less congregative, but with changes in the economic climate, significant regulatory requirements in all sectors and the ever changing "flavours" of new business from reinsurers and insurers alike, one thing is sure… there will always be the need for proactive asset and liability management – in other words legacy or run-off.

Tony Weller is group CEO of Citadel Risk

Case study: Novation of a captive insurance portfolio

A proposal was submitted to the Citadel Group that it should assume by way of novation the entire remaining insurance portfolio of a Vermont captive insurance company. The proposal was made on the basis that:

- The captive ceased underwriting in 1998 and had been seeking voluntary dissolution since 2007
- The loss experience of the portfolio was excellent, with a very small number of open workers' compensation (WC) claims and a general liability account, the last open claim on which was closed more than two years previously
- The transfer of liability from the captive to Citadel had been approved in principle by the Vermont Insurance Department
- The ownership of both the captive and the companies it had insured had changed hands since its incorporation
- There were possible gaps in the contractual documentation produced by the captive and its agents solely in respect of insurance provided separately by third-party carriers to the same entities that it insured and in excess of the coverage limits provided by the captive. It was proposed that Citadel would assist where possible in handling any future claims made under those excess insurance policies

Analysis of the claims data, actuarial reports and financial statements indicated that there was little or no remaining volatility in the company's insurance portfolio. Nonetheless, there was always a contingent possibility that an old claim might reopen or that there had not been full disclosure of the extent of the captive's insurance liabilities.

It was therefore agreed that Citadel would require a premium of $570,000 in consideration of its participation in the RAV, or $495,000 in the event that claims were settled as predicted.

On the basis of the captive company's historic loss record and actuarial advice, Citadel would:

- Reserve in full for the two remaining outstanding WC claims in an amount of $142,600
- Recognise an immediate IBNR of the balance, totalling approximately $352,400
- Recognise income in accordance with any claims advice or trends in future years. That income would be the premium plus interest derived on the premium.

Once the Citadel directors had considered the proposal they resolved to accept the transfer from the captive by reinsurance assumption and, further, to novation of its rights, liabilities and obligations in respect of its entire portfolio of workers' compensation, employers' liability and commercial liability business underwritten between 1992 and 1998.