Global Insurance Run-off Survey

September 2022

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Foreword

Welcome to the latest edition of our Global Insurance Run-off Survey ("Survey"). I am amazed and also very proud that we are now publishing our 14th edition of the Survey and want to extend my thanks to all of our respondents and contributors and to IRLA and AIRROC for their continued support. The overriding sentiment amongst Survey participants is that the market remains buoyant with no shortage of opportunities being marketed to a competitive group of acquirers. That is good to hear for all stakeholders in the market and continues the momentum that we have seen over the past three years with over 150 legacy deals having been publicly disclosed.

A real feature of the market in recent times has been the investment by brokers in creating or expanding existing legacy focused teams. This is great for the sector and I expect it to result in many more deal opportunities being identified and brought to market than ever before. Inflation is on everyone's mind as this Survey goes to press and the market as a whole will be interested in what that does to pricing in what has been an extremely competitive space in recent times.

So with plenty of supply, are we bound to see deal activity surging? I think we will see deal numbers rise and much larger deals being done especially in the US where reinsurance risk transfer deals will continue to lead the way ahead of insurance business transfers ("IBTs") for the foreseeable future. I think capacity remains an issue in the market and scaling operations to meet the demand for legacy solutions is going to be very high on the agenda of the acquirers' CEOs and COOs in the next couple of years. A number of smaller players also continue to look for investors to give them more capacity and there still appears to be no shortage of backers looking for the right platform to partner with.

Overall I think the future of the market is bright – the ever-present gossip of how on earth acquirer A is making money on deal B will probably never stop but I think in general the ever-increasing professionalisation of the sector supported by strong buyers maintaining pricing discipline will see the sector thrive. In addition, I was hugely impressed earlier this year by the increased diversity and participation of a growing number of the next generation of legacy professionals at the IRLA Congress in Brighton. The continued focus on and investment in this talent pipeline will be a massive plus for the sector.

Please reach out to any of the PwC team if you have questions or would like to discuss the Survey or the market in general. The wider PwC insurance network covers a vast array of disciplines and is firmly committed to helping the market continue its exciting growth trajectory. Finally, I'd like to pass on special thanks to Robbie Kerr and Louis Isaacson in our Liability Restructuring team for their fantastic efforts in pulling all of the findings and contributions for the Survey together this year.

Andrew Ward
Partner
Liability Restructuring
PwC UK

Figure 1: Respondents' views on the current state of the non-life run-off market

Exploratory
Frothy
Growth
Surprising
Static
Keen
Stagnant
Quiet
Changing
Chaotic
Flourishing
Active
Opportunistic
Recovering
Varied
Exciting
Soft
Growing
Crossroads
Busy
Advancing
Competitive
Boiling
Uncertain
Maturing
Robust
Stable
Progressing
Volatile
Dynamic
Lively
Shifting
Decreasing
Buoyant
Evolving
Usual
Morphing
Overheated
Stale
Developing
Vibrant
Challenging

Source: PwC

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Key findings

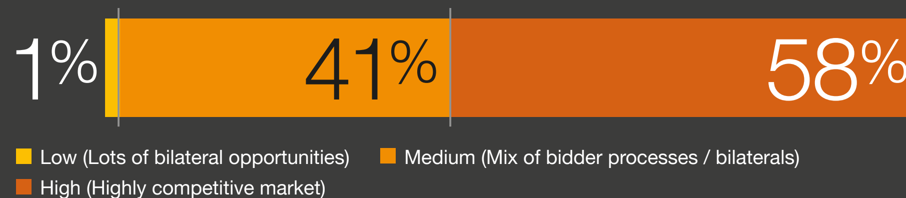
In recent years, we have seen consistent growth in the estimated size of the global non-life run-off market with our estimate of global non-life run-off liabilities rising by US$100bn since the beginning of 2021 to US$960bn in 2022. Over 50% of growth in the last year is estimated to emanate from North America and Survey respondents expect this growth to fuel further deals activity in the North America region in particular as well as more widely around the globe.

Figure 2: Growth in estimated global non-life run-off liabilities

Numbers rounded to nearest US$10billion
*Based on data collected in 2020
Source: PwC

Competition in the market
It is estimated that approximately US$10bn of new capital has entered the non-life run-off market in the last three years. 99% of Survey respondents think that the market has medium or high levels of competition, with more than half of those believing it is currently a highly competitive market.

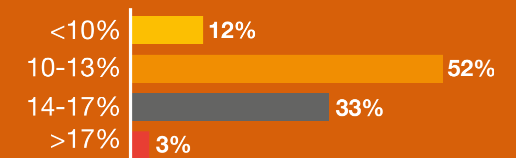
Figure 3: Respondents' views of the current level of competition in the run-off market



Source: PwC

Rates of return
The vast majority of Survey respondents believe that legacy acquirers are pricing legacy deals at target internal rates of return ("IRRs") of between 10% and 17%, with the majority of respondents selecting figures in the 10% to 13% range. Whilst we note that different market players will make vastly different assumptions when pricing deals, the expectation that most acquirers are targeting returns around the low to mid-teens mark is consistent with recent market history.

Figure 4: Respondents' views on the target IRR percentage at which consolidators price run-off deals

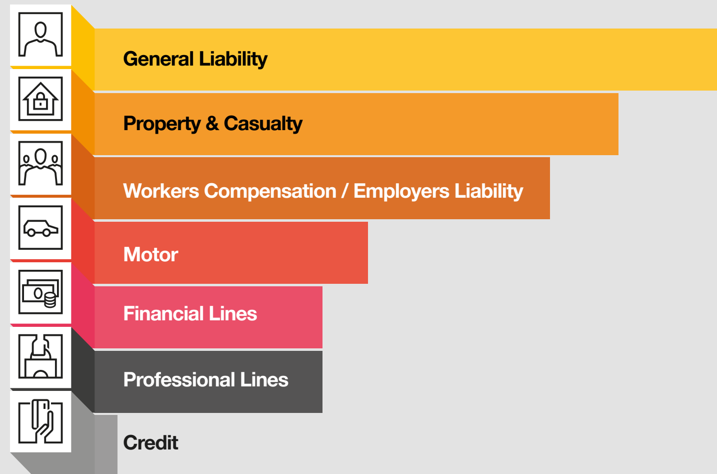


Source: PwC

Appetite for liabilities

Survey respondents selected general liability, property and casualty ("P&C") and workers' compensation as the lines of business likely to attract the most interest in 2022, broadly in line with what has been experienced in recent years. Motor and financial lines make up the top 5 chosen by Survey respondents, reflecting the growing appetite for younger exposures.

Figure 5: Lines of business expected to attract the most interest in 2022 according to respondents



Common operational challenges

84% of market respondents chose data & systems integration / adequacy as a common operational challenge they face when working in the non-life run-off market, with data cleansing and operating model integration / transformation not far behind, reflecting the technological challenges the market is keen to address.

Figure 6: Most common operational challenges respondents experience when working within the non-life run-off market

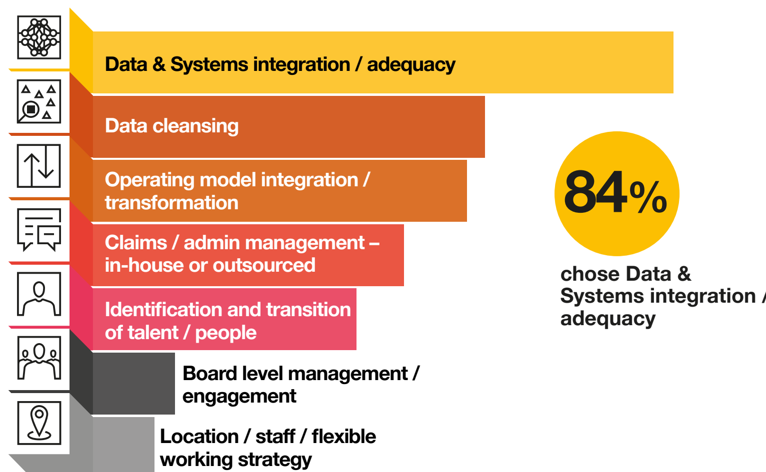
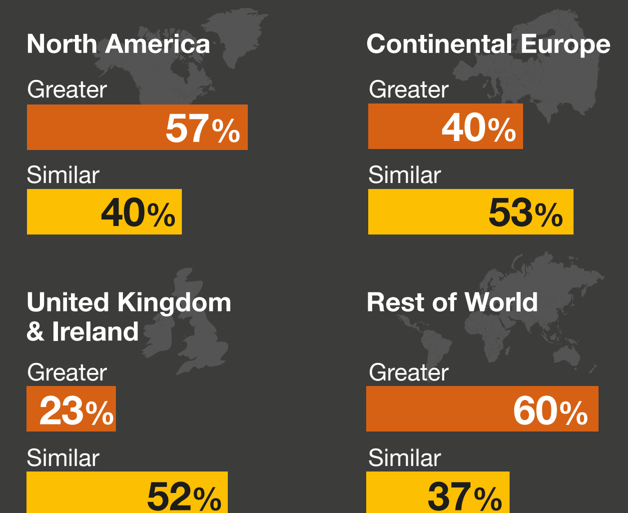


Figure 7: Deal activity



Forecast deal activity

Survey respondents overwhelmingly expect deal activity in the next two years to remain at similar levels or increase across all territories. In particular, nearly 60% of respondents expect the already active North American market to experience greater activity.

Source: PwC

Views from the market I

“

We continue to see strong interest across the globe for legacy transactions of all types, including growing demand for adverse development covers (“ADCs”). In the past year, Enstar has completed a number of significant transactions with blue chip global (re)insurers, which have unlocked meaningful capital benefits for our clients. We believe that interest in ADCs, as well as loss portfolio transfers (“LPTs”), will continue as live underwriting companies look to optimise their deployment of capital. We also expect further development of IBTs in the US, following the successful completion of two transfers, of which Enstar was the first. We look forward to continuing to provide high-quality solutions to the (re)insurance industry, and at a scale that can drive a positive impact on the balance sheets of even the largest (re)insurers.

Darren Truman – CEO, Enstar (EU) Ltd

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The market remains a very attractive proposition to capital providers and will continue to develop and mature especially with the increase in brokers who are providing ever greater deal flow. The popularity of the sector has put additional pressure on pricing and it is imperative that participants retain pricing discipline particularly when considering some of the greener portfolios and less mature exposures that are increasingly marketed. The general immaturity of US casualty, plus the macroeconomic uncertainty and pressures of social and economic inflation are certainly headwinds facing the market but the general stability and resilience remains strong and the legacy market will continue to prosper.

Paul Corver – Group Head of Legacy M&A, R&Q Insurance Holdings Ltd

“

Catalina is moving more towards a speciality reinsurer offering profitable businesses retrospective capital solutions. We are seeing more and more carriers evaluating reinsurance of blocks or business for which clients are seeking to release the capital intense allocation from their business model.

Steve Ryland – Head of Global Distribution, Catalina Holdings (Bermuda) Ltd

“

Like the insurance-linked securities (“ILS”) market before it, the traditional insurance and reinsurance industry has steadily embraced the value provided by the legacy market. With a strong rate environment and choppy capital markets, there has been no better time for traditional (re)insurers to unlock capital trapped supporting reserves via legacy reinsurance solutions to generate meaningful additional capital to support new business. While the form of the transaction may vary, the value of the product remains clear – exchanging risk for stability, finality, and capital flexibility in an uncertain world.

Bill O’Farrell – CEO, Premia Holdings Ltd

“

The way insurers are looking to work with the legacy market is starting to evolve. There seems to be a shift towards considering sustainable partnerships, and the use of back book reinsurance solutions as part of efficient capital management rather than reacting to isolated pockets of reserves or one-off issues. This means the deals are getting larger and have a more strategic focus.

Hannah Farrer Fisher – Head of Capital Solutions, QBE Insurance Group Ltd

“

Over the past 12 months Compre has seen many more transactions involving recent underwriting years, unexpired risk and immature loss development. We are definitely seeing a convergence of the reinsurance market and the legacy market. The rise in popularity of the collateralised LPT solution amongst brokers and active clients is a further signal of this shift. To succeed, particularly in the current economic environment, the legacy market needs to ensure pricing considers broader analytical and exposure-based approaches, as well as established loss extrapolation methods.

Simon Hawkins – CEO Europe, Compre Group

Robbie Kerr
Senior Manager
Liability Restructuring
PwC UK

“

Once again we have collated views from a number of senior players that provide fascinating insights to the state of the market.

Market size

Global insurance run-off market

We estimate that global non-life run-off reserves are US$960bn, representing an 11% increase since our last Survey.

Our estimate of the non-life run-off market continues to increase across all major markets with the US market seeing the largest growth in absolute terms. This is reflective of a number of factors including the fundamental underlying growth in insurance business being transacted around the world, particularly in lines such as motor, with the consequential knock on effect for policies entering run-off and inflation also playing its part.

Whilst our global run-off reserve is a significant number and has grown year-on-year, the subsets of liabilities that will most likely be brought to market as part of a legacy transaction are traditionally those that are non-core or underperforming. As live (re)insurers increasingly view legacy as a key tool to divest such liabilities and realise capital for strategic repositioning and sustainable growth, a more diverse range of risks are reaching the run-off market including far more recently underwritten business.

We believe that future legacy deals will see many more and much larger back book type transactions covering a variety of underwriting lines and years. This will provide a really interesting opportunity for run-off consolidators who are able to diversify their own books whilst leveraging already existing expertise and economies of scale.

The COVID-19 pandemic and inflation have had (and continue to have) a significant impact on the live (re)insurance market, with inflation in particular causing continuing uncertainty. Run-off reserves relate to discontinued business, although the trend towards the transaction of more recent years of account may result in newer exposures such as COVID-19 exposures being transacted. This will be even more eminent for transactions that involve unexpired risks. The impact of these recent market events on the non-life run-off market is highly uncertain and we have not made explicit adjustments in our results below. We have, however, considered the potential impact of inflation separately.

Inflation

Triggered by supply-chain issues due to the COVID-19 pandemic and exacerbated by the impact of the war in Ukraine, inflation levels have increased significantly in the most advanced economies globally over the last two years. Levels of inflation are expected to remain high in the nearer term and there is considerable uncertainty in the inflation forecast over the next few years.

The impact of the high inflationary environment on insurance business and, in particular, the run-off market is unclear. In some respects high inflation may present an opportunity for run-off consolidators: the uncertain environment and pressure from regulators for insurers to increase reserve strength could stimulate more transactions as live insurers need to alleviate capital pressures and streamline their back-books.

On the other hand, the increased uncertainty is also reflected in the run-off market, which may prove problematic when valuing reserves and pricing transactions. The run-off market is likely to experience similar pressure on its reserves to live insurers and will need to be creative and strategic in how it handles this pressure.

When estimating reserves, it is often assumed that claims inflation is implicit in the projection techniques. This relies on the assumption that future claims inflation will reflect the average rate of inflation experienced historically. Given the long-tail nature of much of the run-off reserves, it is clear that even just an extra 1% of inflation in each future year could have a material impact on reserve levels.

Nick Watford
Partner
Risk Modelling Services
PwC UK

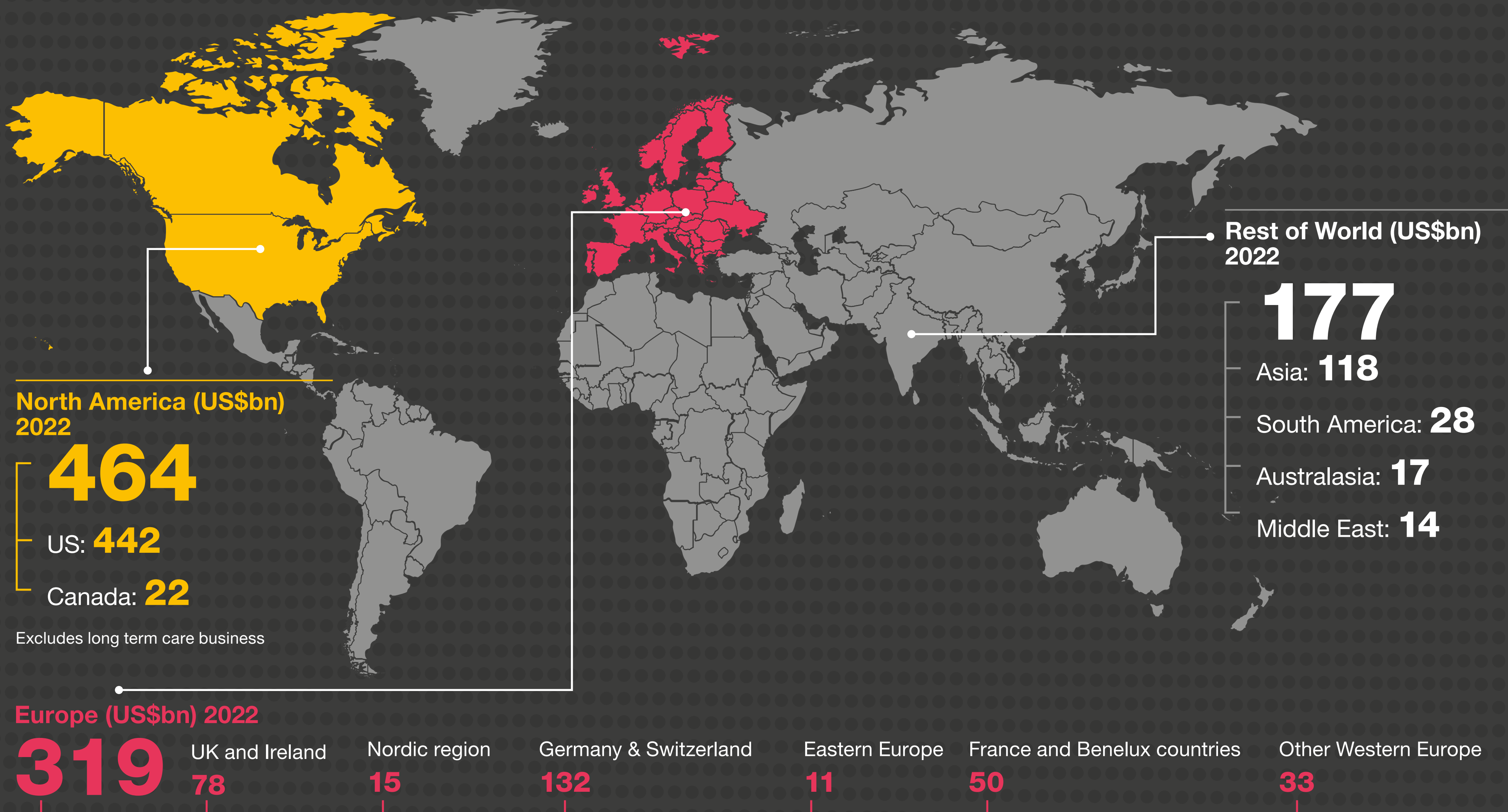
Hannah Vaughan
Partner
Risk Modelling Services
PwC UK

11%

increase in the estimated global run-off reserve from US$864bn to US$960bn.

Source: PwC

Figure 8: The geographical breakdown of our estimate of global non-life run-off reserves



Source: PwC

US

Our non-life run-off reserve estimate has increased by US$57bn, primarily driven by growth in the motor and P&C classes of business. Motor business in particular has experienced a notable increase in premium over the last ten years. California, Illinois, New York, Texas and Florida continue to be the largest states contributing to the run-off reserves.

Casualty business continues to be an area of focus in the US, resulting in reserve strengthening. A key driver of this has been social inflation which is likely to be heightened by the current inflationary environment. Other factors include new claims emergence (such as opioids), ongoing trends of litigation funding, plaintiff venue shopping and reforms to the statute of limitations for abuse claims.

The 2017 and 2018 underwriting years were significantly impacted by natural catastrophes, with events such as Hurricane Harvey, Hurricane Irma, Hurricane Maria and the California Wildfires driving material losses. The magnitude and succession of these events led to slower settlements than usual. This has resulted in increases in estimated run-off reserves on property classes of business as these years move into run-off.

Figure 9: Breakdown of US reserve estimates by US state

<US$5bn
US$5bn-US$10bn
US$10bn-US$20bn
>US$20bn

Source: PwC

Figure 10 illustrates the estimated split of non-life run-off reserves by high-level line of business for North America, Europe and the rest of the world. All three regions have significant estimated motor and general liability reserves. This is as expected given the size of premiums written for these lines and the potential for long-tailed claims e.g. Periodic Payment Orders ("PPO") and latent claims.

Accident and Health ("A&H") insurance makes up a large portion of the run-off reserve estimated in Europe and the rest of the world, again driven by the size of premiums written. We have excluded A&H from our estimate of North American run-off reserves. US A&H is dominated by health insurance which is subject to greater regulatory scrutiny and so less easily transacted from insurer-to-insurer. This is consistent with our estimates in prior years.

UK and Ireland

The UK and Ireland continues to be an active market for deals activity, with 37 publicly disclosed run-off transactions in the two years since 1 April 2020. A significant number of these deals have been executed in the Lloyd's market as syndicates seek to streamline their back-books, exit unprofitable lines of business and become more capital efficient. We have similarly seen increased activity in the personal and commercial insurance markets.

Continental Europe

Across continental Europe we have estimated steady increases in non-life run-off reserves. We have observed an increase in A&H premium in France since 2016, driven by a change in regulation that requires employers to provide collective health insurance for their employees. This increase in premium is likely to lead to increased run-off reserves in France in future years.

Emerging markets (Asia, Latin America and the Middle East, excluding mainland China)

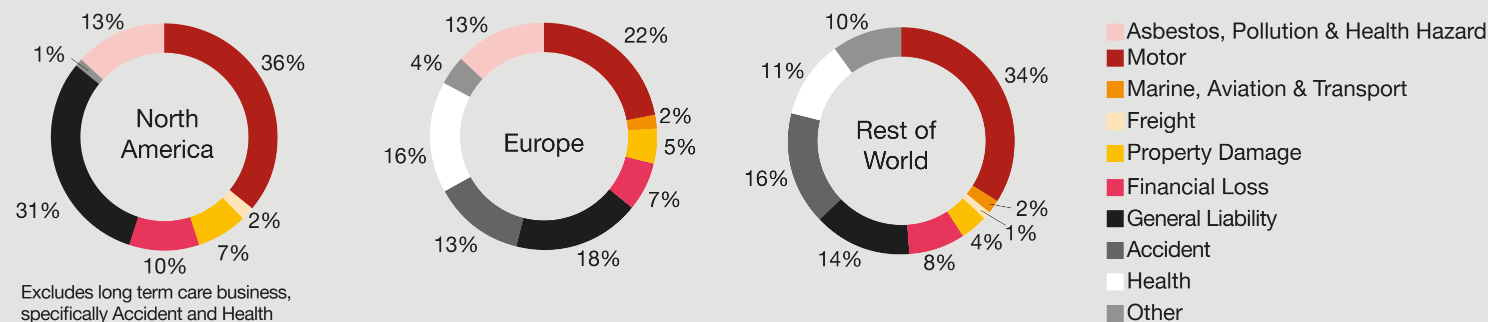
There has generally been an upward trend in gross premium written for motor, property and liability insurance of approximately 8%. As these areas develop we continue to see a growing opportunity for deals activity.

Under the tenure of a progressive regulator and with global pressures to strategically refocus on core business, insurers in Hong Kong are increasingly exploring exit strategies including run-offs, partial disposals and portfolio transfers.

Since we first estimated the Middle East run-off reserves in our last Survey, our reserve estimate has increased to US$14bn. Saudi Arabia and the United Arab Emirates continue to be the largest contributors with notable growth in health insurance premiums. We expect this region to continue growing due to the increasing demand for insurance and attention from regulators to improve the insurance environment.

The Hong Kong and Middle East markets are considered further in the Global Spotlight section of this Survey.

Figure 10: Reserves split by line of business for North America, Europe and the rest of the world



Source: PwC

Deals landscape

As our previous Survey predicted, the market has remained very active. Of the 400+ publicly disclosed deals completed in the last ten years, 150+ have been in the last three years and we are observing an increasing number of US$500m to US$1bn+ transactions, driven by strong, long-term capital being deployed and both buyers and sellers becoming more innovative when designing legacy solutions.

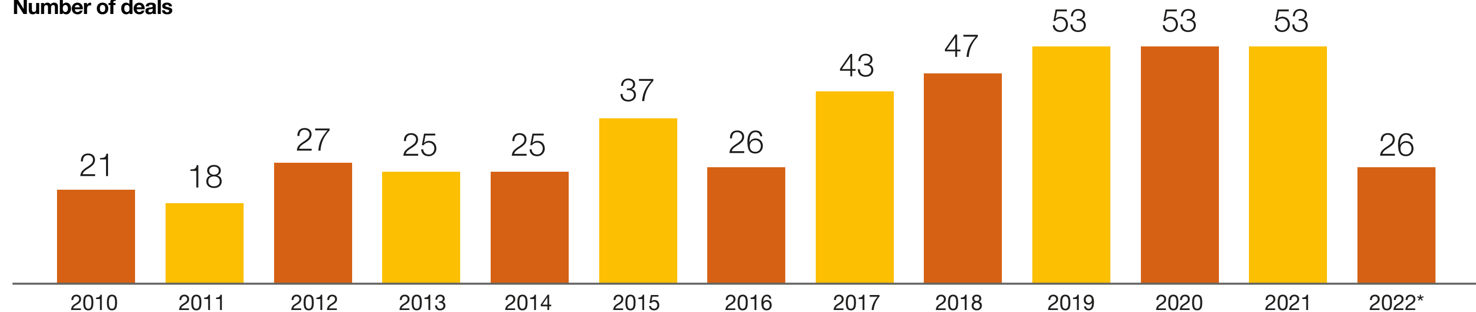
We are seeing high levels of deal flow for all transaction sizes, a growing variety of lines of business coming to market and pockets of unexpired risk increasingly being a feature. This is matched with an abundance of capital and expertise being available to be deployed by both new and established acquirers.

The availability of capital in the market and growing number of players is resulting in many participants seeing deals being increasingly competitive, with concern that parts of the market are overly saturated, especially at the sub US$100m transaction size. As a result, in some instances, acquirers have had to become more flexible with their pricing strategies to be competitive.

Our overall feeling, however, is that underwriting discipline has generally remained strong without the requirement of arbitrary changes to pricing and modelling assumptions to compete. It is also our view that acquirers have remained aligned to their strategic priorities but this has meant that some acquirers may have not been able to execute on the number of deals they hoped.

In addition, buyers are becoming more selective at evaluating and participating in deals due to the higher volume coming to market. If processes don't feel right, don't deliver the strategic fit desired or match return expectations, then buyers are walking away. This has manifested itself in many deals being left on the table and how the market reacts to this on both sides will be interesting to see.

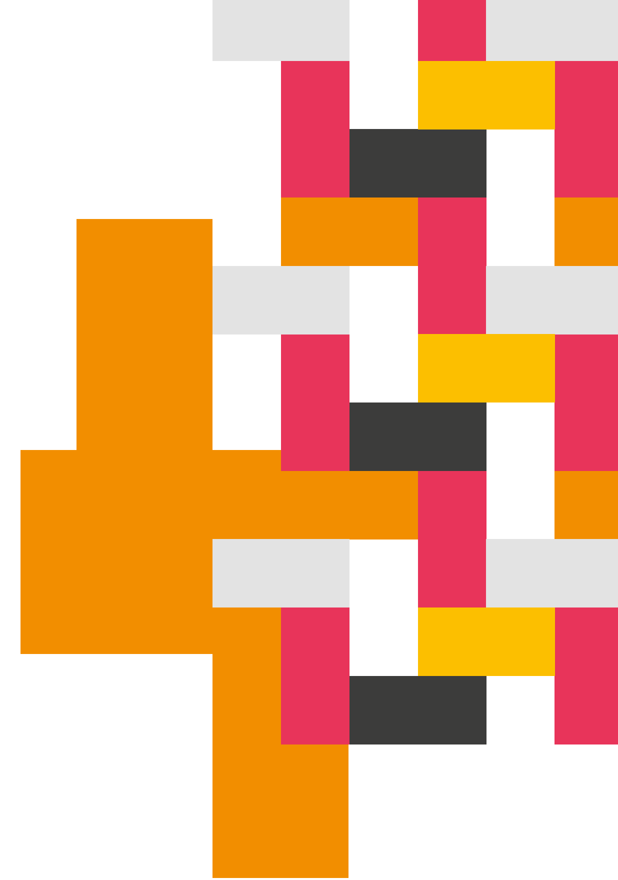
Figure 11: Publicly disclosed deal activity since 2010



*Year to date as at the end of August
Source: PwC

Alan Augustin
Director
Liability Restructuring
PwC UK

Laura Pearson
Senior Manager
Liability Restructuring
PwC UK



Looking forward, we expect the momentum in the market to continue and this is echoed by respondents to the Survey and in the opinions shared in the 'Views from the market' sections.

Of the more established markets, North America, perhaps predictably, again continues to be seen by Survey respondents as the most likely to see a growth in transaction activity, with 57% of respondents predicting a greater number of transactions in the future and a further 40% expecting a repeat of current volumes. This is in large part driven by the increasing demand for and availability of sophisticated reinsurance solutions and it will also be interesting to observe the impact on deal flow and deal type as a consequence of the evolving IBT environment – two IBTs have now been completed in Oklahoma with a number of others believed to be in progress.

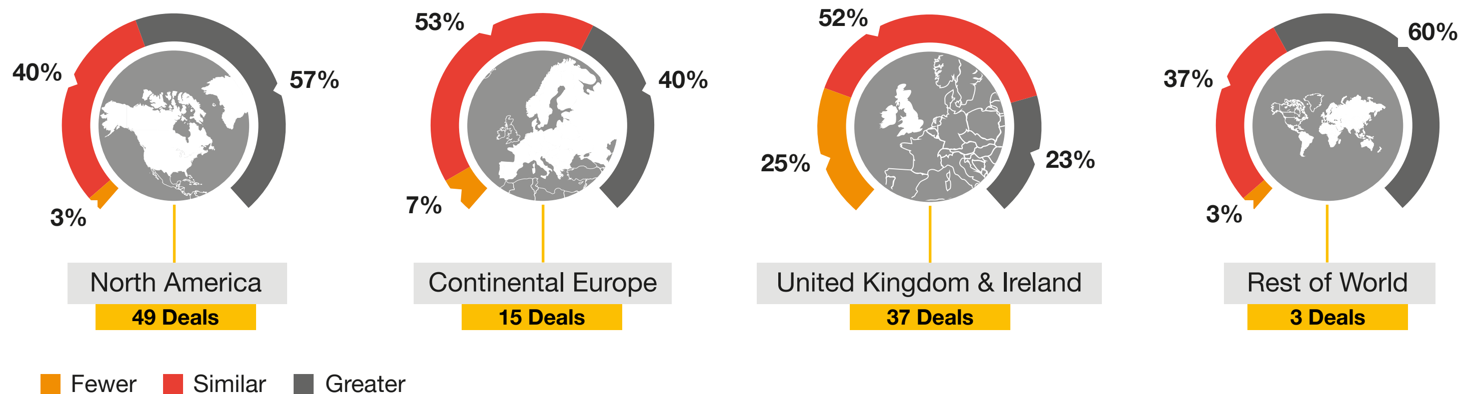
Continental Europe remains relatively close behind North America in terms of forecast deal activity, but with a slightly less optimistic view than in our previous Survey.

This is possibly due to the feeling that the European non-life market has not yet delivered on its potential, perhaps as a result of insurers not yet fully appreciating the value that legacy can play in the insurance lifecycle. It has, however, been encouraging to see some continental European deals announced in what is shaping up to be a busy third quarter.

The majority of respondents expect that UK and Ireland deal activity will be similar or higher in the next two years, however 25% expect the market will not sustain the high level of deal activity seen previously. We think current indicators show that the UK will continue to see its fair share of a wide variety of legacy transactions in the next 12 months.

60% of respondents expect a greater number of deals to be completed in the rest of the world, with less developed markets offering many future deals to those who are prepared and able to invest in the education of regional (re)insurers, establish local operations and develop relationships to unlock opportunities there.

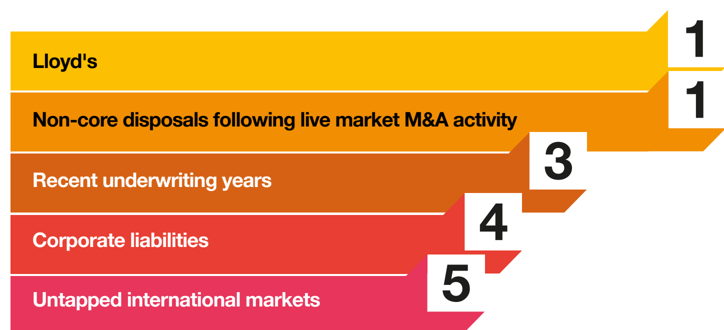
Figure 12: Respondents selected how they predict the relative number of run-off transactions will change in each territory over the next two years in comparison to the previous two year period



Source: PwC

Continuing the theme of untapped potential, our Survey also asked respondents about emerging trends in deal types with Lloyd's legacy and 'Non-core disposals following live M&A activity' coming out as the joint top two predictions. Transactions involving recent underwriting years, corporate liabilities and untapped international markets also made up the top five.

Figure 13: The biggest areas of opportunity for the non-life run-off market according to Survey respondents



Source: PwC

Lloyd's legacy deals remain a popular prediction which is likely largely attributable to the view that an increasing number of reinsurance to close ("RITC") deals, LPTs and ADCs will be executed in the coming years. Despite the first-of-its-kind split RITC transaction completed between MS Amlin and RiverStone earlier this year, it is unlikely that the confidence in Lloyd's market deal activity stems from a view that there will be an uptick in split RITCs. This is due to the existing inability of syndicates to split transaction messaging by class of business where there is both ongoing and discontinued business within the same underwriting year.

After an active few years for live insurance M&A, many (re)insurers are assessing their strategic priorities which is likely to result in an uptick in non-core business disposals. We anticipate this will continue as whilst insurance deal activity cooled off in early 2022 due to geopolitical and macroeconomic instability, we expect a rebound in the sector due to continued interest from PE buyers and well capitalised acquirers.

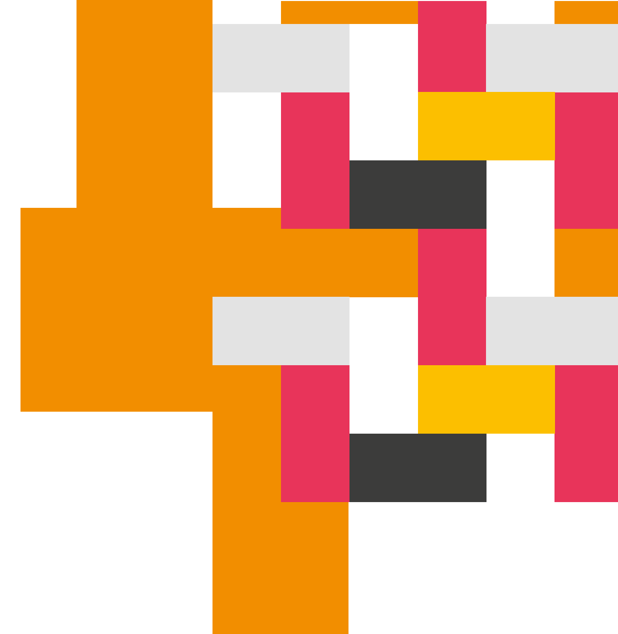
In terms of the other noted areas of opportunity, although it is great to see new deal types emerging it should go without saying that these do not come without risk and potential challenge. For many, these will involve non-traditional legacy lines which require specialist skills, new approaches and perhaps bravery to take emerging opportunities with less of a track record to rely upon. Detailed yet efficient diligence and amassing sufficient understanding of the deal at hand will therefore be of increased importance.

This is especially the case where there are unexpired risk elements and a marked reduction in the average portfolio duration, with shorter-tail books being transacted. Such transactions can result in greater profit volatility for the acquirer, particularly at the lower end of the deal size range. Similarly the dynamics of a corporate run-off book can be subtly different from a wider insurer book and specific care and attention will be needed in both pricing and operation of the book when acquired.

Driving deal value post transaction is continually key and a focus on operational claims excellence and investments into technology enabled solutions to deliver returns are also becoming ever more important.

To conclude our thoughts, as the non-life run-off deal landscape continues to evolve, the market will continue to deliver opportunities alongside an array of challenges. For transactions to be successful in the growing market, deal solutions will increasingly need to be bespoke, well thought through and, for acquirers, pricing discipline and operational excellence are critical.

Against the backdrop of the greatest level of macroeconomic uncertainty in recent years, it will be interesting to see how the current Survey predictions and wider unknowns play out by the next time we sit down to write this Survey contribution!



Look out for PwC's European Life Insurance Mergers, Acquisitions and Restructuring Outlook Survey 2022 to be published in November this year.

Balancing act: Addressing regulatory concerns while encouraging growth

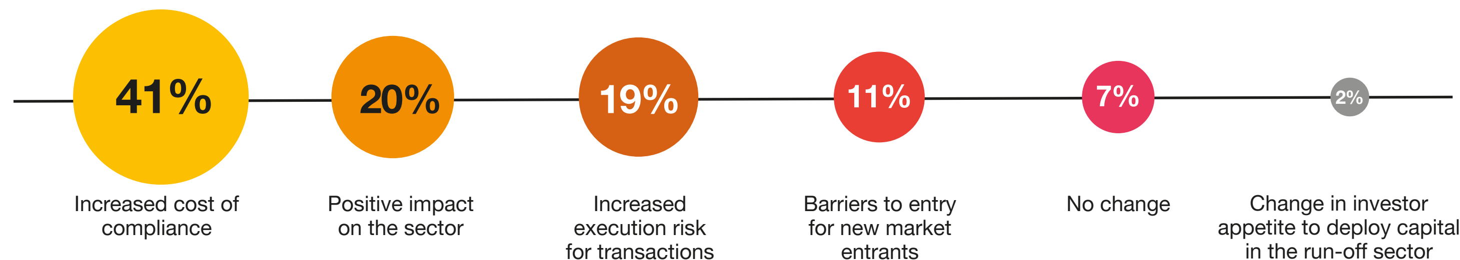
As the size and scale of the legacy sector continues to grow we have seen new regulatory developments targeted specifically at run-off firms introduced over the last 12 months. Whilst these developments mark an important milestone recognising the growth and prominence of the run-off insurance sector, it also raises the risk of unintended consequences that could compromise the competitiveness of the run-off market and increase regulatory and compliance costs for firms. However, as highlighted in our Survey results, greater regulatory scrutiny has its benefits. Regulatory attention enhances the reputation of the run-off market which in turn builds confidence among capital providers and sellers of legacy portfolios, creating new growth opportunities for the sector.

In April 2022, European Insurance and Occupational Pensions Authority ("EIOPA") set out several expectations in relation to the supervision of run-off firms relating to investment management, reinsurance, capital adequacy and conduct of business. For example, EIOPA requires National Competent Authorities to consider imposing a capital add-on if they have concerns about a run-off firm's regulatory capital requirement calculated using the standard formula under Solvency II. It will be interesting to see if EIOPA, as part of the ongoing Solvency II review, implements any changes to the internal model approval process that would allow non-life consolidators to apply for internal model approval, as this would allow run-off firms to accurately capture idiosyncratic risk within their capital models thereby mitigating the need for capital add-ons.

With the growing involvement and investment from private equity firms in the run-off sector, EIOPA also flags potential risks that could arise due to the shorter investment horizon of private equity firms compared to more traditional shareholders. However, in practice, it would be inaccurate to assume that the investment horizon of all private equity investors is shorter than that of other shareholders. In fact, private equity firms often deploy 'patient capital'(e.g. investments from pension funds) to invest in the run-off sector which mitigates the risk of mismatch between the duration of liabilities and investment horizon of the capital provider. Although it is not an immediate concern, as evident from our Survey results, over time additional regulatory scrutiny of private equity investors in the run-off sector creates the risk of discouraging the flow of new capital, which would limit competition.

Anirvan Choudhury
Senior Manager
Risk Assurance
PwC UK

Figure 14: How Survey respondents described the impact of regulatory changes in the run-off market



Source: PwC

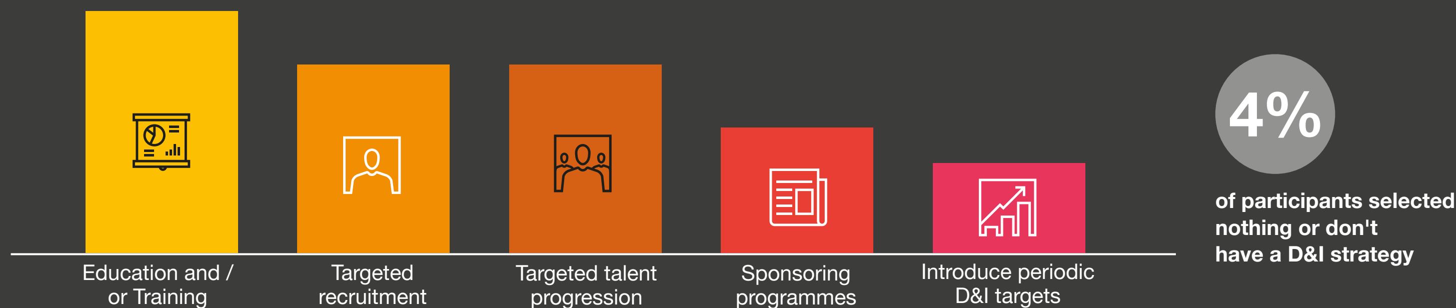
In the UK, the Prudential Regulation Authority ("PRA") recently announced that for non-life IBTs that involve transferees in run-off, the PRA may use its powers under section 166 ("s.166") of the Financial Services and Markets Act 2000 ("FSMA") to assess the operational readiness of the transferee. The scope of a s.166 may include an assessment of the run-off acquirer's systems and IT capabilities, governance arrangements, effectiveness of control functions and ability to withstand financial and operational stress. A s.166 would be triggered for portfolios with technical provisions over £100m and where the portfolio will increase the transferee's technical provisions by at least 10%.

It could be argued that the £100m and 10% threshold introduced by the PRA for using its powers under s.166 to assess operational readiness, runs counter to the PRA's objective of facilitating effective competition and HM Treasury's aim for the UK to develop a regulatory system post-Brexit that meets the needs of small and medium sized insurance firms and new entrants. Under these new rules, smaller run-off firms are potentially more likely to be subject to a s.166 for transactions whereas larger incumbents would not meet the trigger for a s.166 for the same transaction. This could materially increase the time, effort and cost associated with executing IBTs and could potentially create barriers to entry for new firms, as well as limiting competition by potentially increasing the concentration of run-portfolios on the balance sheets of larger incumbents.

Finally, as the UK and the EU proceed with their review of the Solvency II rules, it presents a unique opportunity to strike a balance between: increasing regulatory scrutiny to protect policyholders and creating a prudential regime that continues to encourage the inflow of new capital. Continued investor appetite is crucial for a well-functioning run-off insurance sector that offers live insurers an efficient mechanism to release and redeploy their capital to drive innovation and invest in long-term productive assets.

Beyond the run-off sector specific regulatory developments mentioned above, regulators are also seeking to make progress on big ticket cross-sectoral concerns that are likely to have implications for the run-off sector such as environmental, social and governance ("ESG") and operational resilience and insurers will need to make significant progress in these areas to meet regulatory expectations. For example, the Financial Conduct Authority ("FCA") in its Dear CEO letter issued in September 2021 notes that there is still a long way to go before the insurance sector becomes a truly diverse and inclusive sector while the International Association of Insurance Supervisors says that it will focus on diversity, equity and inclusion, particularly in the context of insurers' culture and governance. In respect of their diversity & inclusion strategies, our Survey respondents cited education and / or training and targeted recruitment / talent progression as key elements.

Figure 15: D&I strategies being employed by respondents' organisations



4%

of participants selected nothing or don't have a D&I strategy

Source: PwC

A view from IRLA

It only takes a glimpse at the responses from this year's Survey respondents to really see how firmly the legacy sector is embedded in the overall insurance industry. There are increasing appetites from investors and sellers alike as well as from brokers who are now fully cognisant of the rewards that an active legacy market can bring.

Deal structures are evolving and it is no surprise to see that ADCs and high layer LPTs are the expected growth area as these provide capital efficiencies to sellers and invariably allow sellers to continue claims handling for portfolios that may be with ongoing clients. This brings challenges to the legacy acquirers who have over the years established a model which incorporates proactive claims handling as an area of income. Without this, the transaction relies heavily on actuarial projections and investment returns. The third leg of the stool is missing.

Whilst this has not slowed the pace of investors entering the sector, it may have future consequences. As observed in the Survey, 58% of respondents believe that competition is high and only 1% think it is low. Expected returns on capital from the sector have historically been reported in the mid-teens yet over half the respondents think that these are now in the 10% to 13% range and only a third report that they are in the 14% to 17% range. As rates have been hardening significantly for the live market, is the opposite happening for the legacy market and is that a problem?

If investors are happy with lower returns than in prior years and the increased risk of taking on portfolios with no claims handling, then that may be acceptable. But add in the trend towards portfolios getting ever greener, recent years of US casualty being highly exposed to social inflation and portfolios of reinsurance of that same business that are at least one step removed, then those acquirers who can stick to pricing discipline and not compete in a race to the bottom will be the ones around to manage that legacy through to natural expiry.

The sector has done so much to create the vibrant and buoyant market that we witness today but it needs to ensure that over-indulgence in a wealth of deals does not affect this hard won reputation.

This is where IRLA is invaluable to its members which come from all sides of the legacy community. An extensive program of education and networking ensures legacy professionals keep close to developments and trends. Active engagement with regulators and coordinated lobbying ensures the sector has a voice. A vibrant young professionals group benefits from their own networking but also the IRLA mentor scheme to ensure skills and experience are transferred to the upcoming sector leaders. And IRLA is always scanning the horizon for the next trends and moves in the sector. The days of simply addressing asbestos and other torts are long gone with members now focussing on what will bring the next opportunities and how they will adapt.

The word 'buoyant' is prevalent throughout Survey responses and that equally applies to IRLA.

Paul Corver
Director
IRLA

"The sector has done so much to create the vibrant and buoyant market that we witness today but it needs to ensure that over-indulgence in a wealth of deals does not affect this hard won reputation.

Views from the market II

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The legacy market remains extremely buoyant with several large and innovative transactions having been completed over the past 18 months and a very active pipeline of new opportunities. Over the past year, RiverStone has benefited from our new owner's focus and support of our economically viable and sustainable objectives. CVC Capital Partners' holistic approach and insight into all areas of business operations complements our deep understanding of the disciplines and standards required to operate successfully in the legacy market. Our shareholder recognises that RiverStone's success over the past 23 years has been built on our track record of high service standards, policyholder protection and dedication to maintaining our clients' reputation and they fully embrace our continuing focus on these fundamental principles.

Luke Tanzer – CEO, RiverStone International

"

We're happy to participate in traditional legacy auction processes and to solve for our clients' episodic needs, but we're equally focused on developing long-term strategic relationships with insurers and reinsurers that are adopting legacy strategies as an integral part of their ongoing re-underwriting cycles. We believe our very large, rated balance sheet, our deep expertise in asset-liability management, and the capital diversification benefits we enjoy from our Bermuda composite structure make us a particularly well-suited counterparty for these larger strategic initiatives.

James Bracken – CEO, Fortitude Reinsurance Company, Ltd

"

Most major insurance groups now have experience in disposing of legacy business having completed at least one transaction in recent years for reasons most likely linked to a desire to reduce reserve volatility, but surprisingly few have been repeat sellers. It is only now starting to become fully appreciated that active management and disposal of historic liabilities is an important tool for capital efficiency.
When companies are running with capital levels in excess of their targets, a legacy transaction can bring instant relief. This is a growth area and I expect to see much more repeat business including major transactions in the future.

Simon Barnes – CEO, Zurich Legacy Solutions

"

In light of the latest statements of the EIOPA, addressing the concerns and expectations of run-off undertakings, reinsurance support of a legacy transaction can provide comfort to all involved stakeholders (seller, buyer, policy holders, supervisory bodies) due to the financial credibility and expert knowledge of reinsurers. Combining the joint capabilities of a reinsurer and a run-off provider can deliver a sustainable and scalable solution for the insurance markets by achieving an efficient capital base in a challenging and volatile macroeconomic environment. In addition, reinsurers might offer a different perspective on markets, clients, exposures and 'greener' years where a run-off provider may have less diverse experience. In these instances, a joint offering can be a true game changer for the markets.

Judith Zeleny – Head of Origination Capital Partners Munich, Munich Re (Group)

"

What has fueled the expansion of legacy market activity? There are numerous explanations but they all come down to capital. Carriers are reluctant to continue supporting non performing lines of business. They explore reinsurance solutions to improve their capital position and strengthen their balance sheets. Investors seek an asset class that does not correlate to broader financial market activity and have invested heavily in run off acquirers and consolidators. Those run off acquirers use additional third party capital for ancillary structures to expand their capital base and increase the types of capital solutions they can provide. Corporations, with exposure to their own retained liabilities, seek to separate and sell these exposures to preserve their own capital position and increase shareholder value. All of these market participants seek to maximise capital through traditional and innovative solutions. We are here, to use our market knowledge, experience, and expertise, to serve as our clients' trusted advisor, and to help them on their path to improved capital health.

Andy Rothseid – Head of Legacy, Gallagher Re

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At Guy Carpenter we are seeing an increasing adoption, by the leading insurers, of legacy solutions as a capital management tool. Those insurers that have seen the benefits of such solutions in freeing up capital are returning to the market repeatedly. Such a recycling of capital is becoming a core strategy of the best run insurance companies. The growth we are seeing in the number of more tailored legacy solutions being placed is a reflection of the flexibility of the legacy market participants seeking to match insurers' needs with their own risk appetites.

Ronnie Carroll – Managing Director, Global Strategic Advisory, Guy Carpenter & Company Ltd

Driving deal value: Boosting run-off returns by evolving the focus on value creation

Ed Johns
Partner
Transaction Services
PwC UK

Investment opportunities are still attractive in the non-life run-off market. But while traditional ways of creating value remain important, market participants are now considering wider value creation levers. From actuarial and claims automation to more agile data-enabled decision making, harnessing new and enhanced sources of value will help investors and practitioners to maximise return potential. Evolving the approach to value creation will also provide the basis to take on the new, significantly larger and more complex types of run-off books coming to market.

The healthy appetite for run-off deals shows no signs of letting up. This is complemented by an influx of private capital, both through setting up new greenfield (re)insurers and direct investment from private equity and funds.

Figure 16: Estimated capital investment in non-life run-off acquirers in the last five years

Company	Owner / Partner	Estimated capital commitment in last five years	Most recent capital commitment*	Details
R&Q Insurance Holdings Ltd	Listed on AIM	US$630m	2022	Publicly listed. Raised new capital in 2020 and 2022. Established a US$300m sidecar in 2021.
Compre Group	Cinven, British Columbia Investment Management Corporation ("BCI")	Undisclosed + US$200m	2022	Sale to Cinven and BCI in 2020. Debt raise of US$200m in 2022.
Fortitude Reinsurance Company, Ltd	The Carlyle Group, T&D Insurance Group ("T&D")	US$4.8bn	2022	Initial US$500m investment by Carlyle in 2018. Subsequent US$2.2bn investment by Carlyle and T&D in 2019. US$2.1bn capital raise from existing investors in 2022.
Enstar Group	Listed on NASDAQ	> US$2bn	2022	Publicly listed, has raised funds via debt issue in 2022. Completed sale and recapitalisation of Starstone US in 2020.
Premia Holdings Ltd	Arch Capital Group, Kelso & Co, Aquiline Capital Partners	US$1bn	2021	Sponsored by Arch and Kelso & Co. Initial and side car capital raises followed by undisclosed equity investment by Aquiline in 2021.
RiverStone International	CVC Capital Partners ("CVC")	US$750m + US$250m contingent	2021	RiverStone International (formerly RiverStone Europe) acquired by CVC from Fairfax and Ontario Municipal Employees' Retirement System ("OMERS").
Carrick Holdings Ltd	Sequentis Capital, Bank of Montreal	US$100m + US$40m	2021	Initial capital of US$100m from Sequentis and US$40m from Bank of Montreal in 2021.
Marco Capital Holdings Ltd	Oaktree Capital	€500m	2020	Marco Capital launched in 2020 with committed equity capital from Oaktree.
Catalina Holdings (Bermuda) Ltd	Apollo Global Management, RenaissanceRe	US$700m + undisclosed	2018	US$700m equity capital investment by Apollo and minority stake investment by RenaissanceRe, in 2018.
DARAG Group	Aleph Capital Partners, Crestview Partners, Keyhaven Capital Partners	€260m	2018	€260m equity funding provided by Crestview and Aleph Capital in 2018. Keyhaven portfolio company.
Quest Group	Mangrove Partners	US$300m	2018	Set up a Bermuda based vehicle with Mangrove to support legacy deals, in 2018.
Hampden plc	Hampden Group	Undisclosed	N/A	Ownership is a combination of family owned and undisclosed cornerstone investor(s).

* In order of most recent capital commitment
Source: PwC

It's clear why the opportunities are attractive. Few other segments of mature insurance markets worldwide are achieving anything like the mid-teens IRR generated by run-off acquisitions in recent years. Returns in this space are also more certain than in the live speciality deals market.

Most of the respondents in our Survey believe that these 10% plus IRRs will continue, though less than 40% of respondents indicated they are looking ahead to 14% or more. Whilst these rates of return are unleveraged, it is common to see investors and acquirers leveraging debt and other instruments to boost returns.

Figure 17: Return expectations

Source: PwC

Despite all the private capital dry powder searching for targets, we have seen a real emphasis on maintaining pricing discipline which reflects well for all stakeholders. This is critically important for the future reputation of the market.

Will this private capital investment endure in the years ahead? Private equity and funds have invested time as well as money in the market, building up their expertise and sophistication in the process. They will want to make the most of this investment and so we do not see any signs of withdrawal of this capital any time soon.

It's also important to note that a lot of the capital moving into the run-off market is coming from new funds. Many of them have longer time horizons and different return expectations to the traditional buy-out funds. Other 'patient' investment capital funds (e.g. from pension funds) also have greater flexibility with their investment horizons. Both trends point to patient and stable participation in the run-off market.

Many new targets / books to aim for

If the capital coming into the run-off market is abundant and enduring, so, to date, has been the supply of targets which has seen significant impetus from brokers in recent years.

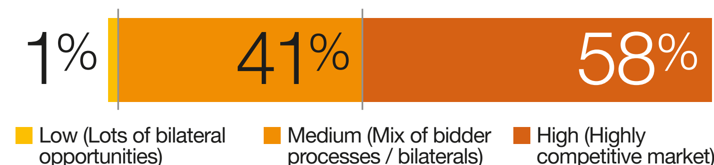
Pro-active run-off management can free up the capital tied up in legacy books, allowing live insurers to write new business, taking advantage of hardening rates in recent years. Lloyd's is also continuing to focus on improving profitability across the market, with numerous sales of businesses which have withdrawn from the market and reinsurance / run-off deals supporting this.

There is still a lot of untapped potential in the US and European markets, especially with many insurers and reinsurers currently assessing what business is core and non-core. Elsewhere, we're seeing increasing awareness and acceptance of run-off solutions in new geographies and new classes of business.

Returns are harder won

With the evident potential comes challenges. Our Survey highlights the growing maturity of the run-off market and competition for targets, with the 'supernormal' returns in early market years much harder to come by. This is being further challenged by the current combination of price and claims inflation.

Figure 18: Competition is mounting



Source: PwC

Complexity is increasing

The market is also becoming increasingly complex as new types of run-off books come up for sale. This includes a lot more shorter tail business, which requires more active and potentially costly servicing. Another key characteristic of the current market and books being put up for sale is the level of unexpired risk in the portfolios which presents both operational and strategic challenges to acquirers as they look to maximise returns while minimising down-side risk.

Platform for growth

With competition, complexity and risk all rising, the need to review and augment strategies for value creation is becoming ever more pressing.

As a starting point, traditional value levers need to be pulled harder. This includes using experience of specific business lines to price more keenly and increase upfront releases. Smart buyers will spot the opportunities as part of their due diligence and look for quick wins.

Through a combination of active negotiation and proactive claims management, it is also possible to accelerate payment and commutation. The effective commutation of asbestos liabilities was one of the catalysts for the initial growth of run-off dealmaking and could now be applied in other classes.

The increase in short-tail books, such as motor, coming on to the market could in turn help to diversify run-off holdings and reduce capital demands.

On the asset side, opportunities also exist to boost returns and efficiently manage investment risk by leveraging the expertise of sponsors invested in the market.

Taking returns to the next level

As important as these traditional value levers are, they're really only table stakes in the pursuit of return. Front-runners are going further and faster in pulling a new and additional set of value levers.

Modernised operating platforms are at the heart of this 'value-plus' approach. This includes the automation of actuarial processes and enhanced claims technology. The proactive players are also harnessing advanced data and analytics capabilities to help make pricing and claims assessments more efficient.

Underpinning this modernisation is the move to intelligent outsourcing and more scalable target operating models. These lean approaches equip buyers with the capacity to pursue bigger deals, take on different types of books and service them effectively and flexibly whatever the demands.

As the run-off deal market continues to expand and mature, these 'value-plus' approaches are going to become ever more important.

The benefits include the ability to target new and different types of books as geographical markets open up and changing stakeholder expectations in areas such as ESG shift the strategic focus.

The growing potential and importance of these emerging value creation strategies underline the need to think about how these businesses can generate further momentum. The pace-setters are already reaping the rewards from applying a combination of new and traditional value levers. Market participants need to challenge themselves as to what they need to do now to make sure they lead the charge in five years' time rather than struggle to keep pace.

With competition, complexity and risk all rising, the need to review and augment strategies for value creation is becoming ever more pressing.

Keys to a successful claims operation in modern day run-off

Claims management has always been at the heart of the success of the run-off market and with continued regulatory focus, cost / indemnity pressures and customer / client expectations, never has it been more important for claims management functions (either insourced or outsourced) to have a clear strategy in place. Focusing on three key areas; processes, technology and people, is fundamental in achieving success.

Processes

Reviewing individual processes throughout the claims lifecycle will undoubtedly lead to streamlining of the function, identifying and minimising risks and creating cost efficiencies. Ideally processes should be designed around the customer/clients as well as the claims function to improve the experience and ultimately support faster and more effective resolution of claims. Achieving appropriate standardisation also enables automation, increasing the amount of 'once and done' claims and better enabling the claims handlers for more complex cases.

Technology

The Survey results indicate that data and systems are the most common operational challenges faced by management. Continuous investment is needed to modernise systems and cleanse data in order to meet regulations, improve claims handling and provide a better experience. Inheriting multiple legacy systems, maintaining them and deciding whether to migrate these onto one platform is one of the key challenges faced by management. We are now in an era where technology can work the way we want it to, thus enabling better processes, consumption of more data and delivering better outcomes for all. There are now many new technology solutions that can enhance or replace core claims systems, however, the key decisions regarding the core claims system still include whether to replace software, or build and maintain systems fit for the future.

People

Upskilling and retaining talent is critical. Technology and the better use of data will speed up processes but the run-off industry will always require skilled individuals to evaluate complex claims and negotiate settlements. Employees' wellbeing, technical development, team diversity, upskilling and coaching need to be at the forefront of management's minds in order to create a culture that their employees thrive in. The required skills mix is also changing with more data and technology literate folks sitting within claims functions to provide insight and deliver improvements.

Having always relied on proactive claims management as a key pillar of their operating models, it will be interesting to see how legacy acquirers adapt in light of the increasing number of LPTs coming to market in which the seller often retains some or all control over claims handling. It is likely that we will see more integrated operating models between sellers and buyers which will need to flex based on the specific details of each deal and there will be a greater need for clear governance and oversight especially for sellers in order to manage regulatory and reputational risks.

For companies who do not have the capabilities to transform their processes and technology, partnering with experienced teams of claims professionals can provide the opportunity to modernise and optimise claims handling functions. A partnership can also provide support when dealing with unexpected claims events. Not all companies have the necessary scale, infrastructure or resources available at these critical times, which is vital in order to minimise brand and reputational damage. There is also an increasing trend towards consumption of services as opposed to outsourcing, shared service or inhouse models.

Michael Cook
Partner
Claims Advisory Leader
PwC UK

Natalie Pearce
Director
Liability Restructuring
PwC UK

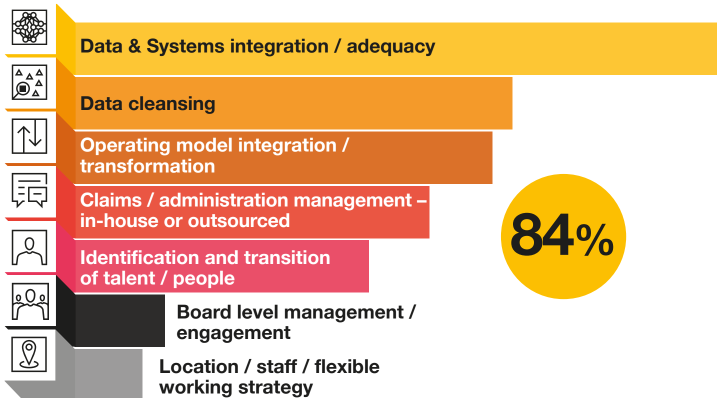
PwC has a strong team of experienced claims professionals located throughout the UK which recently onboarded and transformed the Chester Street Insurance Company claims handling service. The service has been revolutionised through digitising paper files, creating a bespoke claims handling system and streamlining processes across the claims lifecycle.

After the deal: operational implications of legacy insurance transactions

In the aftermath of negotiating a deal, buyers and sellers quickly need to refocus their attention on a new challenge: planning and executing the separation and migration of the in-scope operations that support the transferring book. The complex programme of activities required to transplant people, systems and data – while ensuring operational continuity at the point of transfer – can require extremely careful planning. This is especially true given the heightened regulatory scrutiny around the operational aspects of run-off portfolio transfers, both from the PRA and EIOPA – with the PRA proposing s.166 assessments of non-life IBTs that meet certain thresholds.

Our Survey respondents cited the adequacy and degree of integration of IT systems and data as the greatest operational challenge in the non-life run-off market – with 84% of Survey respondents identifying it as a key issue. In addition, concerns about data quality and the need for data cleansing were highlighted by 56% of respondents. We're seeing these topics become even trickier as the run-off industry evolves and the nature of the transferring business often strays further from the traditional legacy sectors, meaning that it's often less well delineated from the active elements of the seller's business.

Figure 19: Most common operational challenges respondents experience when working within the non-life run-off market



Source: PwC

In our view, there are three specific factors which mean that systems and data are a disproportionate source of difficulty for buyers and sellers in the non-life run-off industry:

- Firstly, legacy portfolios are typically administered on heavily customised third-party platforms or bespoke in-house systems. The elevated operating costs associated with such systems give both buyers and sellers a strong incentive to migrate onto alternative platforms. However, key-person risk and reliance on a small handful of senior system experts can put the brakes on data migration activity, which can become an increasingly lengthy, costly and risky process as a result.
- Secondly, given the vintage of some of the portfolios transacted in the non-life run-off industry – especially in the more traditional legacy risk classes – it is rare that all in-scope data is held in a consistent and centralised way. We often see large volumes of data – of variable quality and completeness – dispersed across multiple systems and sources, including repositories of unstructured data. This can make it extremely tricky for sellers to delineate the data perimeter corresponding to the transferring business, which can mean an ongoing 'voyage of discovery' during the migration process, as additional documents and data sources come to light.
- Thirdly, we continue to see smaller non-core portfolios administered using off-system 'shadow IT'. Poorly controlled and inefficient spreadsheet-based processes make it difficult for sellers to extract accurate snapshots of in-scope data with clarity and certainty, and pose obvious difficulties for those charged with transferring that data into the buyer's IT environment.

Nick Pattison
Partner
Advisory
PwC UK

Sapna Patel
Director
Tax
PwC UK

In addition to the challenges arising from systems and data migration, reviewing the workforce strategy ahead of a non-life run-off transaction is essential to retaining key skills, talent, and managing people-related risks. In our view there are two main considerations for buyers and sellers:

1. Securing and ensuring the right skills and talent make-up are retained, to support a successful non-life run-off transaction. This includes early identification of those individuals in the perimeter who:
   - have legacy or third-party systems knowledge
   - hold key relationships with existing / transferring customers
   - are critical leaders / influencers of teams, or
   - will operationally support the transaction (e.g. Finance, HR).

Securing retention agreements for these people, providing additional incentivisation including non-financial mechanisms as outlined in the PwC Hopes & Fears Survey, and ensuring early and ongoing engagement with key talent, helps mitigate risks of individuals not transferring as part of the transaction.

2. Ensuring that the right legal and HR requirements and entitlements (e.g pensions and benefits) are understood and planned for, including hand-offs between both parties for systems and payroll, as well as communication touch-points with employees to facilitate a smoother transfer in the timelines agreed.

Given these intrinsic systems, data and people challenges, how can buyers and sellers best approach a migration process in the aftermath of a transaction? We recommend three golden rules:

Start by understanding the existing organisation in detail

To maximise efficiency, sellers have to do the groundwork to systematically set out the as-is operating model that supports the in-scope business – including key people, systems, data and third-party services. Once this information is available in a structured way, the process of developing a plan for operational migration becomes much more straightforward. It's important for leaders on both sides of the transaction to fight the natural tendency to start planning and doing; instead, we recommend focusing on establishing a clear and common understanding of the as-is operational and people landscape – as well as the prevailing corporate culture – to serve as the foundation for joint planning. A key output of this exercise will be to understand those key individuals and teams to retain and engage.

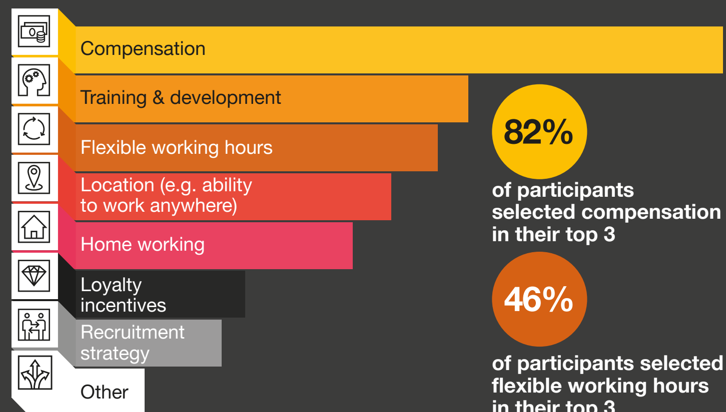
Establish migration principles early

Particularly on larger, more complex separation and migration projects, buyers and sellers need to agree on guide rails for the programme early and include agreed principles for treatment of employees and employee matters. These are top-down design decisions which everyone in the programme should know about. Without clearly articulated principles, different workstreams will pull in different directions on the basis of conflicting assumptions – leading to rework, frustration and wasted cost and effort.

Build goodwill with the counterparty

While both parties will obviously need to remain mindful of their own commercial interests, a constructive and collaborative approach to joint planning can make an enormous difference. Both sides will inevitably encounter unforeseen problems, and in our experience affording your counterparty a little leeway and goodwill – without conceding any commercially material points – makes for a much more effective project and helps to assuage the tensions that can arise under the pressure of transaction timelines.

Figure 20: Respondents' most important factors in retaining talent



Source: PwC

Optimising your capital using the right tools

The non-life run-off market continues to grow. New entrants as of a few years ago are now established players and previously small teams initially focused on getting licenced, funded and proving the business case, now have greater capability, larger balance sheets and are focusing on bigger deals. In many cases, acquirers are now under new ownership and / or have secured additional funding and have significant growth aspirations. This all demonstrates a sector that continues to thrive, with increased importance placed on the sector within the wider insurance industry.

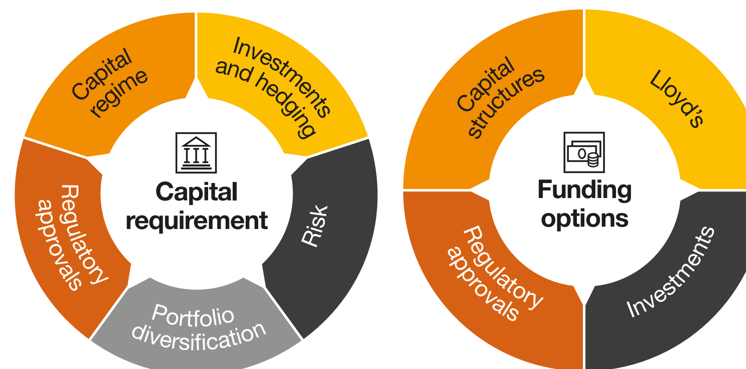
As well as greater capacity and competition in the market, opportunities for new transactions are also increasing. In the UK, traditional insurers are more open and trusting as the reputation and capabilities of non-life run-off providers have improved, while other international markets are opening up to the opportunity of managing legacy business in a different way. As a result, increasing numbers of run-off providers are operating across multiple regulatory jurisdictions.

Globally, the market has secured approximately US$10bn of new capital in the last three years, providing opportunities to grow in scale. There is now an opportunity, and an impetus, to deploy this capital in an efficient manner. As competition increases, those firms that can optimise will likely prove the ultimate winners. At the end of the day, pricing of deals is based on expected return on capital and hence capital efficiency leads directly to better margins and / or more competitive pricing.

The key challenge at the heart of the sector is that it is ultimately a deals business, hence capital requirements and solvency coverage ratios will naturally be volatile. For the same reason, traditional methods of managing capital requirements, i.e. through tailored and approved internal models, are less available.

Instead, we see many groups making effective use of different underwriting platforms and jurisdictions to transfer and pool diversified risks. In this context, understanding the interplay and trade-offs between capital regimes is crucial when deciding how to deploy group capital.

Figure 21: Capital requirements and funding options



Peter Thomas
Director
Assurance
PwC UK

Rupert Perrier
Director
Assurance
PwC UK

Meanwhile, having access to efficient sources of funding and capital agility / fungibility are just as important as minimising absolute capital requirements. CFOs need to be able to build strong commercial partnerships with finance providers and build their capital structure using a mix of equity, debt and contingent financing in order to manage the dual risk of (i) having a capital inefficient structure; and (ii) not being able to finance the next big deal.

At PwC we have developed a capital optimisation toolkit, which gathers the various tools that can be used to engineer capital efficiencies. By taking each element in turn, we can assess the level of maturity of an entity's capital structure and potential opportunities for optimising the capital position. For some entities, this will focus more on the capital requirements, whilst for others the focus will be on capital resources and funding. Like any skilled tradesperson, it's important to use the right tools for the right job!

Regulatory perspective

The growth of this sector has not gone unnoticed by regulators, and whilst regulators are generally supportive of the role of run-off firms, the greater scale and activity brings additional scrutiny. We have seen this in the UK, most recently through the PRA's policy statement on IBTs (PS 1/22) and from EIOPA's April supervisory statement on the supervision on run-off undertakings. Any firm looking to make changes that will significantly change their capital requirements or resources will need to take regulators on this journey with them. However, all the capital optimisation tools are in use today and each aligns to regulators' objectives of regulated firms being financially sound, profitable and having a strong understanding of their risk profile and risk management structures and techniques.

A view from AIRROC

Active, competitive and buoyant were the most common words used by respondents when asked to describe the state of the run-off market in this year's Survey. A strong statement on the resilience of the sector as we all begin a return to a world that seems a bit more 'normal' but also a world that has adapted and changed markedly in the last few years. The run-off market has grown and thrived as the solutions for entities with legacy exposure have continued to pick up momentum.

Every indication from the members of AIRROC is that the run-off sector will continue on the current path. With several IBTs now completed in Oklahoma, and several more in the pipeline, this process is getting more interest from companies seeking a legal finality solution. AIRROC is seeing that companies want to be out there engaging with counterparties to get the job done, or to keep abreast of what is going on.

As evidenced by the results of this Survey, as well as the quarterly deal updates that PwC issued throughout 2021 and 2022, the deal rate is steady. Consistent with prior years, the key factors driving AIRROC's membership with respect to restructuring and exit strategies are capital release, disposal of non-core business and managing volatility. The legacy sector is creative and vibrant. There are appetites for every type of deal size and tools that can work for any situation.

As the market has developed, we have increasingly seen sellers and acquirers becoming more selective around the parties that they do business with and the deals that they are participating in respectively. This indicates a market where partnerships are developing between buyers and sellers with the prospect of repeat business as legacy solutions continue to be seen as more commonplace transactions for capital efficiency than purely resolving a problem. On the buyer side the willingness to pass on deals that are not a strategic fit is also illustrative of a disciplined underwriting approach. As supply to the market continues to increase deal diversity both from intermediaries and market developments such as the implementation of International Financial Reporting Standards 17 – Insurance Contracts ("IFRS 17"), these trends will be important features in the market's next stage of development.

In closing, 2022 and beyond is looking bright for the legacy sector. Thanks to PwC for once again compiling a report that truly showcases the potential in legacy. AIRROC is proud to be the representative body for non-life run-off in the US. We are committed to bringing the legacy sector together in 2022 and we look forward to hosting our annual networking event in New Jersey in October 2022 where we hope to see as many of you as possible.

Carolyn Fahey
Executive Director
AIRROC

> "The legacy sector is creative and vibrant. There are appetites for every type of deal size and tools that can work for any situation.

Views from the market III

"
One of the interesting developments that we have seen in the recent past is the growth of the reinsurance buyer as the key individual leading a legacy deal from a client's perspective, as opposed to the CFO or Treasurer. This is not surprising given the increased awareness of the legacy market and because many of the legacy acquirers are increasingly seeking to identify themselves as speciality reinsurers. This is impacting deal structures – where we are continuing to see a growth in ADCs and other terms that are more familiar to reinsurance buyers – but also in deal processes. Reinsurance buyers typically expect non-binding indications ("NBIs") to hold and subsequent due diligence to be more confirmatory in nature; so it is important to spend time with this type of client to help them to understand the importance of the extensive due diligence undertaken in the 'binding bid' phase to the overall determination of pricing and key terms & conditions. This may also lead to the provision of more information earlier in the process; if this is the case, then legacy acquirers will need to gear up to undertake more comprehensive due diligence in the NBI phase.

Barry Gale – Head of Legacy, Aon plc

"
The current inflationary environment has created very challenging market conditions. Inflation has, on the one hand, contributed to an increased demand from live (re)insurers for run-off covers, whilst on the other, also created uncertainty for those pricing the deals. As a result, sophisticated risk selection, underwriting / claims expertise and pricing discipline will be key in the coming years.

Andreas Schäfli – Director, Transaction Executive, Swiss Reinsurance Company Ltd

"
DARAG continued to consolidate its leading position in Continental Europe last year with further transactional activity and investment in local specialist claims managers. DARAG is the only established legacy player to have a balance sheet dominated by an increasingly diverse book of European Economic Area ("EEA") risks and to have its core carrier based in Germany. Transactional activity included writing a large LPT covering Scandinavian Workers' Compensation liabilities and executing the first third party portfolio transfer in France.

DARAG has also continued its parallel focus on the captive / self insured market in North America and offshore UK where distribution and structures are less well known and margins consequently higher. Increased investment yields will generate more activity from corporates as disposal terms look more attractive against carried reserves. Opportunities are aplenty in our niche areas, having reached or exceeded pre-pandemic levels. Social inflation especially has lessened our appetite for certain lines of business in the US, especially commercial auto and certain parts of general liability. The level and length of heightened general (and medical) inflation is also affecting pricing for longer tail books, especially those with wage and medical inflation exposed annuities, despite the welcome rise in interest rates which provides some mitigation.

Sector leading investment in transforming our data landscape and machine learning to improve due diligence and post-deal claims management / reporting is producing exciting results.

Tom Booth – CEO, DARAG Group

"
The last twelve months have seen the legacy sector's importance to the wider insurance market continue to grow. The size and volume of deals have increased. With the flow of opportunities into the market set to continue, the sector's pricing discipline will have to be steadfast particularly as inflation challenges return.

Phil Hernon – UK and Europe Managing Director, Carrick Holdings Ltd

"
Much has been written that the non-life legacy market is in a soft phase in the pricing cycle including terms & conditions. Marco has passed where transactions don't stand up from a risk and / or returns perspective and anticipate, with the onset of inflation as a key variable, increasing pricing discipline as the year develops.

Financially driven legacy transactions, especially where there is substantial unexpired risk, can be challenging for the market. Marco's technical and structuring approach to underwriting is intended to provide robust solutions to our clients.

The non-life legacy market works in a different way to large commercial risk placements in the live market – it's 'winner takes all' after all have invested in pricing and in due diligence. The outcome might seem to be 'best price' for the run-off seller but purely cost based decisions aren't always optimal and syndication of the run-off transaction will also diversify risk from the seller's perspective. Brokers place live risk on a syndicated basis every day – why not legacy?

Simon Minshall – CEO, Marco Capital Holdings Ltd

"
Artificial Intelligence and data analytics will change the surface of the insurance industry – profoundly. Taking advantage of these technologies, to make claims files machine readable, will reveal new insights leading to a wave of new run-off. Digitisation changes the approach to run-off, making claims management much more efficient and allowing complete portfolio audits, prioritisation of severe claims and pre-emptive handling. Short and mid-tail lines might qualify more for in-house run-off. Those insurers and run-off acquirors that digitise fast, will gain competitive advantage even faster.

Arndt Gossman – CEO, DGTAL

Global spotlight

US market

The US market continues to be a significant source of opportunity for non-life run-off deals as evidenced by the 49 North American publicly disclosed deals completed since 1 April 2020 and the estimated volume of non-life run-off liabilities of US$464bn. The entry of new acquirers and the growth of committed capital has increased the competitiveness in getting deals across the finish line and has created a sellers' market.

Over the course of the last 2-3 years the market has witnessed an investment by a number of brokers in establishing or growing existing legacy deal teams, boosting deal flow to the legacy acquirers. We have seen deal numbers grow consistently in the US and perhaps more importantly, the size of the deals being done is accelerating, with US$500m to US$1bn+ LPT and ADC deals no longer viewed as outliers for the market.

These large transactions can provide significant capital relief to insurers for their legacy portfolios, but they are often complex deals which require significant planning with respect to transaction structuring, capital treatment, risk transfer analysis and accounting / tax assessments. As these deals often span across several US and global jurisdictions, early regulatory engagement is a key aspect of the overall deal process.

The inherent nature of the US market, comprising 50 states with varying regulations and legal landscapes, requires actuarial and claims teams working together to determine the appropriateness of case reserving and the cost of defending, administering and overseeing portfolios. The market has seen examples of portfolios underperforming expectations, and in many cases, those initial expectations were overly optimistic at best. It is vitally important that acquirers engage with and leverage their experts in the valuation process.

49

publicly disclosed deals announced in North America between 1 April 2020 and 1 April 2022.

Source: PwC

Keith Palmer
Partner
Risk Modelling Services
PwC USA

Frank Pecht
Senior Manager
Risk Modelling Services
Claims Advisory
PwC USA

Business Transfers

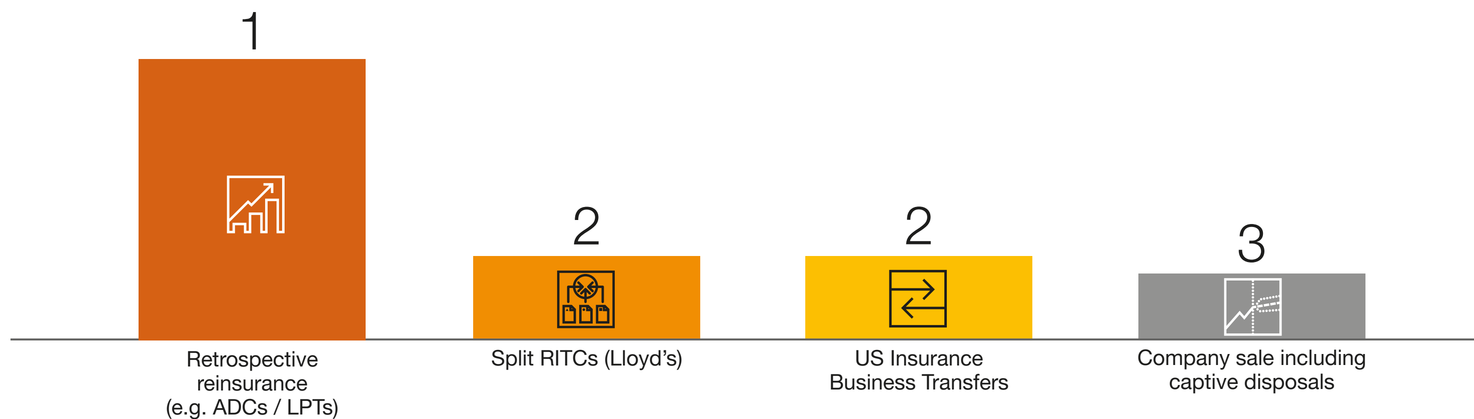
Achieving true finality for sellers has continued to see momentum build as two IBTs out of Oklahoma have been completed since the state passed its statute in 2018. Feedback from companies involved in these deals has been mixed – there has been some frustration with the overall length of time it took to complete the first transactions, while also providing positive reviews of the thoroughness of the process and an indication of willingness to use an IBT in the future.

One of the key considerations for parties contemplating the use of an IBT is the requirement to notify policyholders and the feasibility of such an undertaking. While policyholder consent is not required under the Oklahoma IBT law, for large populations of policyholders, this requirement may come across as onerous, costly and a time consuming exercise to prospective sellers. Parties to IBTs are therefore tasked with identifying efficient and accurate methods to identify the contacts and this is an area where technology and data analytics can provide significant value.

In the near term, it's plausible that 'first mover' IBTs will address wrapping up single parent captives and assumed reinsurance portfolios, including pool liabilities (as was the case with Sentry selling its liabilities in the Excess & Casualty Reinsurance Association pool ("ECRA") to R&Q last year), in which the notification requirements may not be overly burdensome in terms of time and expense.

The market is generally optimistic that IBTs will see growth over the next two years. While Survey respondents believe the use of retrospective reinsurance, in the form of ADCs and LPTs, will be the leading transaction structures, IBTs can now enter the conversation as a proven and effective means to full finality. Furthermore, promoting the legacy market's innovation capabilities to bring new solutions to address the needs of stakeholders should attract more interest from sellers, capital providers and talent pools. As stated in our last Survey, given the US market's maturity and historical significance to the legacy market, Survey respondents appear to believe IBTs can be a driver of continued growth.

Figure 22: Types of transactions which respondents think the market will see the largest growth in over the next 2 years



Source: PwC

Corporate Considerations

Companies which self-insure risks are more frequently inquiring about how to expand their insurance programs to include lines of business that are seeing significant price increases in the wider market such as directors & officers liability and cyber liability. There is considerable appetite amongst corporates to learn how shedding older year legacy liabilities can free up capital by shifting the risk profile and reducing overall premium spend.

One topic potential sellers of self-insured liabilities have consistently raised is the reputational risk of moving the responsibility of settling claims to a legacy acquirer and the perception that the acquiring party may not have claimants' best interests in mind. It is important for the market to continue to be vocal in promoting the integrity and expertise of claims practitioners and that the interests of both sides of any deal are aligned to ensure that claims are paid fairly and in good faith.

There is a further trend in the US for companies to deal with non-insurance legacy liabilities held on their balance sheets.

Hannah Vaughan
Partner
Risk Modelling Services
PwC UK

Corporate Liabilities

Our global run-off estimate of US$960bn is based on insured liabilities only. There are, however, material legacy liabilities held on the balance sheet of manufacturing companies and other non-insurance corporations. Transacting these liabilities represents an exciting opportunity for run-off consolidators, as well as the corporations themselves. We estimate the size of these corporate liabilities globally to be US$68bn in our 2022 Survey, with a significant amount of these liabilities being in the US.

There has been significantly increased deals activity in this market in recent years, including the following transactions:

- Enstar acquired Dana Incorporated's legacy asbestos liabilities in 2016
- Borg Warner Inc. transferred its asbestos liabilities to Enstar in 2019
- Delticus Group (an affiliate of Warburg Pincus LLC) acquired ITT Inc.'s asbestos liabilities in 2021
- Crane Holdings, Co. announced in August 2022 that it had agreed a transaction to sell its asbestos liabilities to Spruce Lake Liability Management (an affiliate of Global Risk Capital LLC)

Benefits for the buyer

- Operational efficiencies and increased economies of scale
- Ability to benefit from significant investment returns from the assets backing the liabilities
- Diversification benefits
- Opportunity for innovative pricing and corporate structures

Benefits for the seller

- An opportunity to achieve finality on its legacy liabilities
- Reduce potential volatility of financial results
- Remove the administrative burden from management to free up resources
- Potential opportunity to realise a profit if a price is agreed that is lower than the seller' pre-transaction provision

We expect the number of these deals coming to market to grow as corporates become increasingly aware of the benefits associated with an orderly disposal of legacy liabilities.

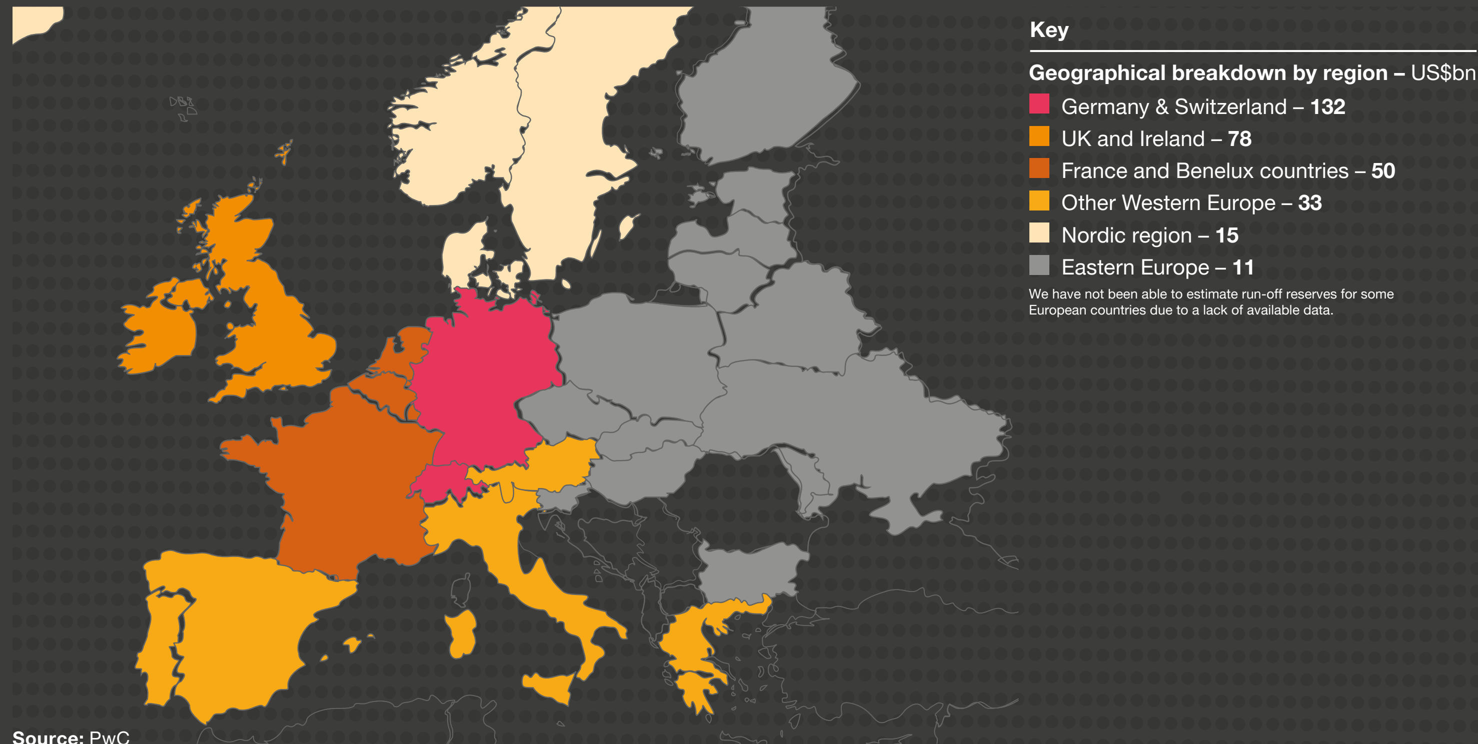
Continental Europe

Introduction

For years, experts have been predicting that the run-off market in continental Europe and especially in Germany would soon pick up speed. But where do we currently stand? Without doubt, the European insurance market is on the move. As in previous years, many potential transactions are being discussed, but despite the undoubted underlying potential we have observed relatively few deals.

In the two years between 1 April 2020 and 1 April 2022, 15 non-life run-off deals have been publicly disclosed in continental Europe with estimated gross liabilities of US$684m transferred. This represents a realised potential of only 0.3% when compared to the estimated volume of non-life run-off reserves in the region of US$241bn, over half of which emanate from Germany and Switzerland.

Figure 23: Breakdown of Continental European non-life run-off reserve estimate by region



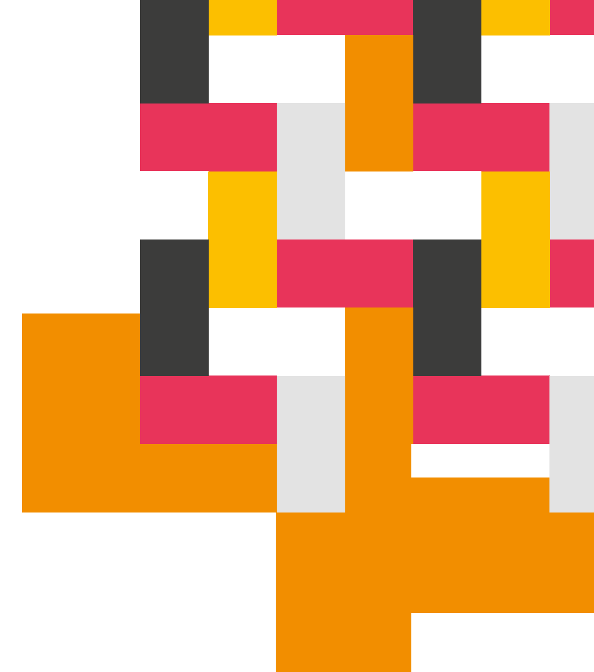
Source: PwC

Tim Braasch
Partner
Advisory
PwC Germany

15

publicly disclosed deals announced in continental Europe between 1 April 2020 and 1 April 2022.

Source: PwC



The introduction of Solvency II in January 2016 was expected to trigger a large number of transactions in the region due to a need to release and / or move capital. This has not materialised and now, more than six years later, changing customer behaviours, in particular the demand for more customer-focused and digital services, is seen as a primary driver for run-off deal activity as portfolios / entities with poor customer journeys and poor digital offerings are increasingly viewed as non-core.

Against the backdrop of a transforming insurance market, the idea of divesting legacy assets can quickly arise to free up operational capacity and capital for urgently needed corporate restructuring activity. (Re)insurance executives also often note that the obsolescence of underlying IT systems and expected reinvestments play an important role in making run-off related decisions. It is expected that the introduction of IFRS 17 will further fuel this argument.

Legacy acquirers must also develop significantly, for example through more intensive use of state-of-the-art data analytics to better assess portfolio risks, to support pricing and to further reduce the information asymmetry that exists today between buyers and sellers.

Observed challenges

It must be noted that, particularly still in continental Europe, run-off options today are not seen by many insurers as an integral or meaningful part of their value creation strategy despite many years of market education, both by consultants and run-off acquirers themselves. Here however, the large run-off transactions within the life insurance market seen in the region may help to change perceptions.

As a result of the low transaction volume in Europe, it has been observed in recent years that existing European run-off acquirers have tried to compensate with deals in other territories, such as the UK or the US. An unpleasant ‘result’ of this compensation strategy is the high degree of operational complexity that must be managed by the run-off acquirers today, be it the number of risk carriers or portfolios bought, the territories in which one is active, the number of regulators under whose jurisdiction one is working or the number of different IT systems that must be managed.

Further complicating matters is the arrival of new competitors often with private capital backing, on the scene, creating an increasingly competitive marketplace.

It is evident that there is a huge market potential, many existing players, a constantly changing competitive landscape and more than enough available capital for transactions, but with relatively few deals in continental Europe, the market is clearly behind expectations!

But what are the reasons for this problem? Is it a problem of awareness on the part of the potential sellers, or a problem of supply, attractiveness and/or pricing on the part of the buyers, or perhaps an implementation problem due to high regulatory requirements or feared reputational losses on the part of the sellers? It is probably a combination of these factors that are ultimately responsible.

The way forward

Whilst it is appreciated that it may take some time to overcome the observed hurdles with respect to seller awareness and the fear of reputational loss, it is important for existing market participants to continue to drive the education of European sellers in this respect. A strong focus on value generation frameworks that take account of factors such as the sellers’ strategic motivations, regulators’ objectives, pricing and operational considerations including onboarding, potential outsourcing and IT optimisation will all help to educate and reassure sellers and key stakeholders on the benefits of a legacy deal. Providing assurance that a deal will be done in the ‘right way’ both operationally and from a seller reputation perspective will be key to seeing the continental European legacy market realise its potential.

Hong Kong

In the region, insurers are challenged by a crowded market and are facing up to pressure from competition, the COVID-19 pandemic, low interest rates, the increasing compliance burden from the likes of IFRS 17 (coming in 2023) and a fully International Association of Insurance Supervisors ("IAIS") compliant risk-based capital framework (expected in 2024), as well as the increased capital strain that this may bring.

The market is also characterised by insurance groups that hold more than one Hong Kong insurance licence, where there is an opportunity to rationalise to a single licence entity to reduce compliance costs on top of insurers increasingly experiencing global pressure to strategically refocus on core business and rationalise their portfolios. All this together means that partial disposals and portfolio transfers are very much on the cards. Some large exits are pending for both life and general insurers, either in their entirety or in relation to significant portfolios.

Exit strategies from the Hong Kong market are conducted via either an outright sale of the company, portfolio transfer, run-off or accelerated run-off. For general insurance portfolios, the transfer process takes several months and requires detailed planning. Contrastingly, for life portfolios, the transfer process requires court sanctions, is far more complicated, and can take up to several years.

Additionally, where the Hong Kong insurer is a branch of an overseas company, it may face the separate challenge of court and / or regulator sanction being required in the home jurisdiction and the process must run in parallel with the Hong Kong process.

In the case that a run-off is required, the run-off candidate must actively communicate with the Hong Kong Insurance Authority ("HKIA") by presenting a plan and its effect on the Hong Kong market (e.g. the capital repatriation). Accelerated run-offs in Hong Kong for general insurance are available either via individual policy endorsement, commutation/ early settlement of claims on a policy-by-policy basis or through the available solvent scheme process. Ultimately, low exit risk is achieved by appropriately navigating Hong Kong's Laws and Regulations as well as effectively communicating with the HKIA.

Peter Greaves
Partner
Advisory
PwC Hong Kong

Peter Whalley
Partner
Advisory
PwC Hong Kong

Middle East

The Middle East insurance market continues to be characterised as fragmented and under-penetrated compared to global markets. The COVID-19 pandemic resulted in an economic slowdown and several (re)insurers exited Middle East markets in the last 12-18 months. The COVID-19 pandemic has also taken a toll on many insurers' reserving positions and altered the profitability of some lines of businesses, with most insurers examining and re-examining their contract wordings.

Insurers are now altering their pricing to offset losses and manage volatility, hardening global reinsurance prices and low interest rates, trends which are being witnessed globally. A silver lining for the Middle East region has been the recent spurt in oil price due to the ongoing geo-political crisis, which has resulted in renewed government spending on the infrastructural development agenda.

More recently, as economies reopened and businesses returned to the 'new normal', the importance of scale has become very evident, resulting in some major M&A activity in the region. The deals during the last two years comprised of cross-border and intra-regional acquisitions as insurers look to form stronger and consolidated entities to offset weak profitability. The deals space is active across both the takaful and the conventional operations.

We expect this momentum to continue as regulators become more and more active with their regulatory supervision and enforcement actions, fueled by IFRS 17 going live in January 2023.

Whilst the consolidation drive, partly led by the regulatory developments and partly business-led, is expected to continue, the peculiar nature of the Middle East markets (e.g. new licence moratorium in place in some of the key markets) means that we see less movement of business for specific 'run-off' activity and more of the 'mergers, portfolio transfers, and acquisitions' type activity within existing local participants. We expect this trend to continue in the short term as the market, currently estimated at US$14bn in non-life run-off reserves, gains greater scale and maturity. Regardless of the 'means' to reach consolidation, the priorities for most of the insurers' boards remain directed towards value creation through achieving scale and modernization through technology transformation.

Sanjay Jain
Partner
Middle East
Insurance Leader
PwC Middle East

Bermuda

Bermuda's run-off sector has seen significant activity during the last year with established players using their Bermuda reinsurance carriers to undertake a number of significant transactions in the period. This has been in part driven by insurers and reinsurers seeking to use run-off solutions to manage risk, free up capital and improve returns.

The island remains attractive as a hub for run-off acquirers with ready-made infrastructure and resources complemented by a regulatory environment that has a track record in supporting the sector. Since our last Survey was undertaken, Compre has redomiciled to Bermuda, whilst RiverStone International has established a Bermuda operation, providing them with platforms to play increasingly in the US and Lloyd's legacy markets. Enstar, long domiciled in Bermuda, has this year entered into agreements for two very large ground-up LPTs involving combined total estimated liabilities of close to US$4bn. Compre, Catalina, Fortitude Re and R&Q have all also entered LPT agreements in Bermuda so far this year.

We expect further establishment of Bermuda entities from run-off players in and beyond 2022 with the Bermuda Monetary Authority ("BMA") continuing to set the standard for regulation in respect of run-off operations and Bermuda run-off reinsurers continuing to set the pace with run-off transactions that are both innovative from a structuring perspective and of a scale that the market has not seen before.

Joseph Gordon
Director
Advisory
PwC Bermuda

Australia

Historically, Australia has been a relatively quiet market for run-off activity. We estimate the size of the Australasian non-life run-off market to be US$17bn.

There are currently 13 general insurers authorised solely to conduct run-off business by the Australian Prudential Regulatory Authority ("APRA"), only one of which is an active acquirer of run-off portfolios / companies. However, competition is provided for acquisitions of run-off business by live (re)insurers, who identify these portfolios / companies put into run-off by others as aligning with their broader underwriting strategies.

As run-off insurers are not able to write 'live' business in Australia, they are not able to rely on future underwriting profits in times of stress. APRA is therefore able to determine a supervisory adjustment to a company's capital requirement, under paragraph 36 of Prudential Standard GPS 110 – Capital Adequacy ("GPS 110"). This can increase a run-off insurer's capital requirement in order to provide APRA with comfort that a run-off insurer's capital resources are appropriate in a stressed scenario. This can be seen by run-off insurers as competitively disadvantageous versus live (re)insurers when it comes to acquisition processes. As such, options such as 100% intra-group reinsurance arrangements have been explored successfully to manage capital requirements following acquisitions.

Activity in the run-off market, including an increasing number of portfolios being put into run-off by general insurers (and other financial institutions) has grown as a result of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, which was established in 2017 and final report submitted to the Governor General in 2019. The report recommended a number of findings around conduct, culture and governance. As a result of the recommendations from the report, a number of companies within the Australian market undertook reviews of their business models and strategies. This has in turn resulted in a number of portfolios either being deemed non-core to strategies or determined to be too risky from a treating customers fairly ("TCF") point of view. Some companies have also determined that for certain portfolios, the increased cost of managing the portfolio following the Royal Commission outweighs the underwriting performance of the portfolio.

These conditions provide the potential for an uptick in deal activity in the Australian run-off market and we expect this to develop further over the next few years.

Adam Hilliker
Manager
Assurance
PwC UK

Contacts

Jim Bichard
Global Insurance Leader
PwC UK
E: jim.bichard@pwc.com
T: +44 (0) 7841 562560

Alex Bertolotti
UK Insurance Leader and
Global IFRS 17 Lead
PwC UK
E: alex.bertolotti@pwc.com
T: +44 (0) 7525 299263

Dan Schwarzmann
Head of Market Initiatives and
Industries
PwC UK
E: dan.schwarzmann@pwc.com
T: +44 (0) 7778 211006

Andrew Ward
Liability Restructuring
PwC UK
E: ward.andrew@pwc.com
T: +44 (0) 7902 792216

Robbie Kerr
Liability Restructuring
PwC UK
E: robert.d.kerr@pwc.com
T: +44 (0) 7841 786570

Edward Johns
Deals Partner
PwC UK
E: edward.johns@pwc.com
T: +44 (0) 7720 037315

Nick Watford
Risk Modelling Services
PwC UK
E: nick.r.watford@pwc.com
T: +44 (0) 7595 610487

Hannah Vaughan
Risk Modelling Services
PwC UK
E: hannah.m.vaughan@pwc.com
T: +44 (0) 7850 516301

Alan Augustin
Liability Restructuring
PwC UK
E: alan.augustin@pwc.com
T: +44 (0) 7720 425892

Laura Pearson
Liability Restructuring
PwC UK
E: laura.p.pearson@pwc.com
T: +44 (0) 7483 422839

Michael Cook
Claims Advisory Leader
PwC UK
E: michael.g.cook@pwc.com
T: +44 (0) 7711 562567

Natalie Pearce
Liability Restructuring
PwC UK
E: natalie.h.pearce@pwc.com
T: +44 (0) 7730 596929

Anirvan Choudhury
Risk
PwC UK
E: anirvan.choudhury@pwc.com
T: +44 (0) 7483 423721

Keith Palmer
Risk Modelling Services
PwC US
E: keith.w.palmer@pwc.com
T: +1 301 237 5706

Frank Pecht
Risk Modelling Services
PwC US
E: frank.pecht@pwc.com
T: +1 609 558 6230

Tim Braasch
Advisory
PwC Germany
E: tim.braasch@pwc.com
T: +49 1514 6709012

Peter Thomas
Assurance
PwC UK
E: peter.m.thomas@pwc.com
T: +44 (0) 7595 610099:

Nick Pattison
Advisory
PwC UK
E: nick.pattison@pwc.com
T: +44 (0) 7738 845422

Sapna Patel
Tax
PwC UK
E: sapna.patel@pwc.com
T: +44 (0) 7483 421685

Peter Greaves
Advisory
PwC Hong Kong
E: peter.greaves@hk.pwc.com
T: +852 2289 1826

Peter Whalley
Advisory
PwC Hong Kong
E: peter.whalley@hk.pwc.com
T: +852 2289 1192

Sanjay Jain
Middle East Insurance Leader
PwC Middle East
E: sanjay.jain@pwc.com
T: +971 56 676 5946

Adam Hilliker
Assurance
PwC UK
E: adam.hilliker@pwc.com
T: +44 (0) 7483 384942

Joseph Gordon
Head of Deals Advisory
PwC Bermuda
E: joseph.gordon@pwc.com
T: +1441 5176267

Louis Isaacson
Liability Restructuring
PwC UK
E: louis.isaacson@pwc.com
T: +44 (0) 7805 235949

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.

Methodology

This year marks the fourteenth edition of our Survey. As in previous years the focus is on the non-life insurance 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 partners and staff 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.

Estimated market size

Run-off reserves have been estimated using publicly available premium information. Assumptions have been made regarding the ultimate loss ratios and payment patterns in order to determine the level of unpaid claims. Judgement has also been used to establish the years of account assumed to be in run-off, based on the nature of the liabilities, plus manual adjustments for liabilities not in the data.

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