INSIGHT

Run-offs: The new breed

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UK correspondent

As the volume of UK run-offs continues to decline, run-off managers are looking at new opportunities in the US and Europe.

The London market has traditionally been the centre of the run-off business world. But with fewer insurer insolvencies in recent years, the focus of the run-off managers is changing.

The US and Europe are proving to be more fertile hunting grounds for the acquisitions of business in run-off, as the number of insurers going into run-off declines and regulation is tightening in the UK.

Over the past decade, the value of UK insurance liabilities in run-off has fallen to around 13% (or £25.7bn ($43.7m)) in 2011 from more than 27% (or £33.3bn) in 2001, according to data from KPMG.

Paul Corver, head of mergers and acquisitions for UK and Europe at run-off consolidator Randall & Quilter (R&Q) and chairman of the Insurance and Reinsurance Legacy Association (IRLA), the UK market body for legacy management professionals, says: "The UK forged the way ahead and developed the run-off market and its associated tools more than 20 years ago because they had to in the wake of the restructuring of Lloyd's after catastrophic losses.

"The rest of the world is now catching up though, with the larger, younger US market expanding in terms of the number of run-off acquisitions carried out and European growth imminent, while the older UK market – where many obvious deals have already been done – declines in terms of deal numbers."

The wave of insolvencies that engulfed the insurance industry throughout the 1990s up to 2001, largely related to US asbestos and pollution claims, has finished.

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There has been nothing comparable in the UK insurance market.

Even the financial crisis of 2008 and the subsequent depressed economic situation have not led to new insolvencies of any note.

"This lack of UK run-off acquisition opportunities has been exacerbated by the low-interest rate environment over the past six years, which has made deals more difficult. Deals are still happening but are often structured as reinsurance instead to give capital relief to ceding companies," David Whear, a partner at law firm Norton Rose Fulbright specialising in corporate insurance and regulations, says.

Run-off managers are therefore looking elsewhere for opportunities. Peter Carter, director of the corporate financial advisory practice at Deloitte, says the number of European run-off deals is already rising as are US volumes as the UK market declines.

In the US, for instance, run-off specialist Catalina acquired specialty insurer Sparta in March. It has also acquired American Safety Reinsurance. Other examples of US run-off deals include Enstar's acquisition of workers' compensation specialist SeaBright Insurance and life company Pavonia.

In Europe, Axa Liabilities Managers (ALM) the legacy business of Axa, is active. Late last year it acquired the international subsidiaries of German run-off company Global Re, through the Axa DBIO investment vehicle late last year. The firm has now acquired 10 run-off companies and external portfolios in total since 2008, eight of them from German owners.

Carter points out firms based in the London market are often the ones looking elsewhere for global opportunities. In this respect the London run-off market is still strong.

Regulatory changes are also predicted to have an impact on the run-off sector. Imminent tightening of the UK Prudential Regulation Authority's (PRA) rules around schemes of srrangement and capital extraction is also likely to restrict further the flow of such business in London, increasing the attraction of US and European run-off deals instead.

The US state of Vermont recently introduced a new law called the Legacy Insurance Management Act that apes many of the aspects of Part VII transfer rules used in the UK. It is designed to attract run-off business to Vermont, already a large centre for onshore captives in the US.

"A number of big run-off players have been focused on the growing US market for a while. This new Vermont law, which has just been signed and allows Part VII-like transfers in the US for the first time and may consequentially see a falling off in the traditional reinsurance approach prevalent in America, will facilitate an improved US market," Carter says.

The new Vermont law will further encourage the already growing market for US run-off acquisitions, especially if other large captive centres such as Delaware follow suit.

With the bigger books, bigger returns and more insurers available in a younger market, it seems the US is going to be the centre of run-off attention for some time to come.

Solvency II, the pan-European risk-based capital regime due to come into effect on 2016, could increase the amount of business going into run-off in Europe owing to the higher capital requirements it imposes.

Simon Barass, a partner in Deloitte's corporate financial advisory practice, says: "As more capital has to be stored rather than deployed, it could lead to some European insurers falling into

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unprofitability or strategically divesting certain lines of business in the future, as part of a generalised restructuring."

"European run-off deals in particular could rise because of this. Equally it could mean better pricing for specialist run-off acquiring firms, such as Enstar or Catalina," he adds.

Diversification

The increased focus on US and European run-off acquisitions is matched by an increase in the volume of non-traditional run-offs, experts say.

These run-offs are not about the closure of a business, instead certain lines of business are divested as part of a strategic restructuring to re-allocate capital.

A notable example of this trend is the recent activity involving insurer Brit. Brit prepared for its return to the stock market this year by selling off its non-core regional UK business to QBE and running off Brit Insurance Ltd, selling it to RiverStone Insurance. This enabled the creation of the Brit Global Specialty underwriting franchise and Lloyd's syndicate 2987, which has now returned to market after being acquired by private equity companies CVC and Apollo for £888m in 2011.

"This example of an acquirer coming in and effectively slicing a company in half is I think a very good example of what is happening in the run-off market right now as it illustrates the trend to sell off lines of business, instead of traditional 'pure' closure run-off deals," Kevin Gill, a partner at consultancy Ernst & Young in London, says.

The focus of the legacy market, which was traditionally drawn to run-off books with a medium to long tail, is now changing too, as acquirers become receptive to

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shorter-tail businesses in run-off such as motor or personal and commercial lines business, and using a US Chapter 11-style restructuring procedure. This, Gill says, is reflected in "fresher, quicker transactions, with typical turnaround cycles shortening from 10 years down to two or three".

"Run-off isn't just about 'pure' closure deals anymore where firms are shut down and the acquirer manages them for claims pay-outs only," Corver says.

R&Q has acquired seven run-off units over the course of the last year including Flagstone Alliance Insurance & Reinsurance (FAIR) from Bermuda-based Validus for \$24.1m in cash. FAIR went into run-off in 2010 and comprises an international reinsurance business with net reserves of \$16.4m.

Run-off managers, such as Enstar, are now looking for opportunities in "live" underwriting. Enstar, for instance, last year acquired speciality insurer Torus Insurance Holdings. Enstar paid \$415m, with Stone Point Capital contributing a further \$277m, to obtain a 60% stake in Torus Insurance Holdings. It also bought Lloyd's insurer Atrium Underwriting Group in June 2013 for \$183m.

Enstar chief executive, Dominic Silvester, said at the time: "[The deal] represents a further evolution of Enstar's business. Our core focus remains on acquiring insurance and reinsurance companies that are in run-off, however we believe Atrium will provide us with a high quality operation at Lloyd's that includes a skilled underwriting and management team that will help create new opportunities for us to grow and prosper."

R&Q has also launched its own syndicate 1991 within Lloyd's with a capacity of £77m, demonstrating the move towards "live" underwriting and away from dormant books.

The run-off tools developed in London are now being used around the world, as the sector expands in Europe and especially the US. As run-off becomes a strategic mechanism to "slice and dice" units of business to form more focused companies, rather than being just a means to wind down a company, the attractiveness of the market has increased.

The large run-off managers and consolidators such as R&Q, Catalina and Enstar, are now often facing competition from private equity (PE) firms for this reason.

"The box of tools developed in London has made run-off a much more attractive business to others and the segment has gone global," Corver adds. ■

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