GLOBAL INSURANCE LAW CONNECT

RUN-OFF IS A GLOBAL TREND, BUT LOCAL EXPERTISE IS THE KEY TO SUCCESS

One area of insurance law where there is a clear global trend is the field of runoff. No matter what country you consider, there is awareness within the local insurance and legal community of an increasing number of run-off deals that may come to market by the end of 2020.

THIS ARTICLE WAS PUBLISHED IN INSURANCE DAY MAGAZINE IN OCTOBER 2020

IF YOU'D LIKE TO FIND OUT MORE ABOUT GLOBAL INSURANCE LAW CONNECT, CONTACT ONE OF OUR MEMBER FIRMS, OR OUR CHAIRMAN, JIM SHERWOOD AT JIM.SHERWOOD@GLOBALINSURANCELAW.COM

WWW.GLOBALINSURANCELAW.COM

In 2019 PwC's Global Insurance Market Run-Off Survey estimated global non-life run-off reserves at circa $790bn, with legacy management expected to become part of the "new normal". The drivers are different in different regions, but the underlying trend is the same – a new focus on run-off, supplement with a growing awareness that the legislative environment is changing, meaning that deals are demanding and require technical expertise to price and complete successfully.

Europe under pressure from Brexit and Solvency II

In Europe the current post-transition Brexit outlook and the requirements of Solvency II continue to act as potential drivers. PwC's 2019 Global Insurance Market Run-Off Survey anticipated deal values of $101 to $300m in the UK alone over the period 2020 to 2022.

The current hardening of the insurance market will further increase growth. The European insurance industry benefits from specialised legacy carriers and service providers and there is a continent-wide awareness that run-off transactions contribute to supervisory goals, such as the strengthening of financial stability and liquidity in financial markets.

On the flip side, some of the main challenges for European clients concern the quality of available data and Solvency II requirements (e.g. rules on outsourcing in light of the organisational requirements). The run-off market is very diversified in terms of business models so legacy solutions are always tailor-made, which impacts the price of the individual transaction and makes deal completion extended and techcnical in nature.

Asia – a growing focus

In Asia, run-off has traditionally been the preserve of the big international buyers, and that trend continues. In China, the regulator and the government are under pressure to 'manage out' the risks from a number of mid-sized local insurers with poor regulatory and reserving histories.

Meanwhile in Australia the run-off market is starting to gain more traction and seems likely to continue to grow and gather momentum. Large global players are looking to run-off specialists to acquire legacy portfolios, which enables them to have a clean and decisive exit from lines of business which are taking up capital and capacity and not making the returns that are needed.

As markets have consolidated in Asia we have seen less players across particular lines and insurers offloading those lines which are not core to where they want to be in the market. Some recent examples are Enstar completing the transfer of portfolios from Great Lakes Insurance SE and HSB Engineering Insurance Limited (both subsidiaries of Munich Re), and the NSW CTP portfolio from Zurich.

COVID a global driver

In 2019 COVID-19 has dealt a blow to many insurers' reserves, permanently changed the P&L calculations of some significant lines of business; and forced everyone in the industry to examine contract wordings, both historic and current.

With all this in mind, many consider that we are likely to see more insurers putting up the 'exit' signs, shutting books and hoping to sell to willing run-off buyers.

Deals tough to achieve

How will this growing global wave of run-off go for insurers and their run-off counterparties? The cost of claims is, of course, a critical issue for the profitability of run-off deals; and, in the last year, most claims have become less easy to predict than they once were. Costs have risen in many supply chains, healthcare systems are under pressure with rising prices, and businesses themselves are seeing fluctuations in their own pricing and profitability, making long-tail claims harder to predict. Overall, uncertainty is making all run-off deals harder to price, and this could challenge the market in bringing planned deals to completion.

It is clear that for the expected 'new generation' of run-off deals to be successful on both sides, the real need is for buyers to ensure that they have cast an extremely thorough and expert eye over both the structure of the deal itself, and the nature of the insurance contracts contained within it. Though historically associated with longer tail liabilities, increasingly portfolio transfers involve more recent books across a wider range of lines of business. As run-off players expand, with models necessarily focussed on managing cost, on the claims side the challenge will be to ensure the skill base is there to meet the full gamut of technical issues, and to anticipate and prepare for a host of emerging risks.

Run-off business will not be immune from wider global claims trends, including the rise of group and class action and litigation funding activity, and run-off players need to invest now in the expertise required to keep ahead of developments across key jurisdictions. Legal risks are being increased by the shifting legislative and judicial landscape, and the increase in US-style litigation trends spreading globally means that buyers need to beware in numerous countries. In essence run-off acquirers need access to advisers or teams who know the local claims and litigation environment for each line of business to keep themselves safe from likely nasty surprises in the future.

This need has brought change to law firms as well as insurers. International law networks like our own, where members have established experience in their own jurisdictions of the issues facing the run-off market are now being asked to consider, not just individual deals, but also the possibility of becoming long-term empanelled partner providers to major run-off specialists, and this makes it clear the scale of the work that could be required.

Successful transactions can be put together, but the challenges will lie in managing the details and quantifying the risks, country by country, with up-to-date local knowledge of each jurisdiction involved. If this can be achieved, the run-off market may find itself in a time of great opportunity. Let's hope for the benefit of all sides, that the 2020 generation of run-off deals can be structured, analysed and brought to a successful conclusion.

This article was authored by Jim Sherwood, Chairman of Global Insurance Law Connect, Alexander Hamels of Lydian, Gillian Davidson, Partner and Chris Wood, Partner of Sparke Helmore and Chris Fletcher of BLM.