Global Insurance Run-off Survey

February 2021

In conjunction with:

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Foreword

Jim Bichard
Global Insurance Leader
PwC UK

Alex Bertolotti
UK Insurance Leader
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Welcome to the 2021 edition of PwC's Survey of non-life legacy insurance business. The legacy market has never been as active as it has since our last Survey, not just from a deals perspective, but also from a legacy management perspective within groups. This year we have asked a number of different questions from our traditional Survey line-up and we hope you will find the results as interesting as we have.

With the transformation of the entire (re)insurance industry spurred on by new regulatory and accounting standards (not least International Financial Reporting Standard (IFRS) 17), consumer demands for digital products, rate hardening and uncertainty caused by the COVID-19 pandemic, legacy management has come up the agenda as organisations look to optimise portfolios and how they deal with or carve out legacy reserves. Coupled with a more sophisticated and growing legacy solutions market attracting new capital, the opportunities for actively tackling legacy issues to make organisations fit for the future have never been as clear.

This year we were unable to ask many respondents to fill in our Survey in person at either the IRLA Congress or AIRROC Annual Forum, so our PwC UK Liability Restructuring team took the opportunity to engage directly with a number of respondents via video calls and email to ensure we received as good a response rate as in previous years. We are delighted to say that we had more Survey respondents than ever this year, so thank you all who took the time to respond.

The responses were positive in regards to the legacy market, with strong belief from respondents that the market will continue to grow and that capital would be made available to ensure that was able to happen. From a PwC perspective, our work in the market supports Survey respondents' views and we suspect this will continue for the foreseeable future.

We are delighted to continue to work across the spectrum of the run-off market with a variety of different clients. More of our professionals than ever are involved in providing insights and services to the market and we can only see this continuing to expand as the market evolves. We hope you enjoy reading our Survey and encourage you to reach out to Andrew Ward, Alan Augustin, Nigel Rackham or Victor Nelligan in our UK Liability Restructuring team to discuss any questions you have with respect to legacy issues.

A view from IRLA

Stephen Roberts
Chairman
IRLA

The PwC Survey is an incredibly valuable review for the market. IRLA was delighted to be asked to comment as we are, perhaps, in a unique position to react to the key themes it has identified, bearing in mind the breadth and experience of our membership.

It would be impossible not to comment upon and resonate with the report findings in respect of the "COVID effect". Despite the obvious dislocation of the market through homeworking and the added burden of communicating via the internet, the legacy market has performed. COVID-19's impact has been felt across our full membership, but it is of note that the legacy acquirers have continued to offer and succeed in completing a variety of legacy deals in a variety of structures. The pandemic has created pricing impetus in the live market, adding an urgency to creating balance sheet efficiency as pricing correction has made insurance an exciting capital play for both traditional and new investors coming to market.

Perhaps the maturity of the legacy market is being truly seen for the first time as legacy carriers prove their transactional capability even in these unprecedented times. Certain sectors are undoubtedly "hot" with a particular focus on Lloyd's restructuring; part performance related, part Brexit related and part opportunity driven, there have been a number of significant Lloyd's transactions completed and more pipeline transactions contemplated than perhaps at any time since the Reconstruction and Renewal plan. The change in tone at the top of the Institution is certainly helping focus minds on the future and on balance sheet and market efficiency (through technology and innovation); IRLA members anticipate further significant activity in and around Lloyd's over the next two, maybe three years as the pace of change continues to increase.

Whilst the mention of Brexit has to some extent been buried beneath the severity of the COVID-19 pandemic, the Part VII transfer of Lloyd's European business to Brussels is adding complexity to handling legacy Lloyd's European business with effect from 31 December 2020, and we might expect further reaction to these changes in 2021 and beyond. The effect of regulatory change has yet to be fully articulated (absent finalisation of the trading rules), so further dislocation has to be planned for. Uncertainty probably drives a positive for the legacy market but may yet delay some deals from completion in 2021.

IRLA has seen a growing membership in the last year despite event postponements and disruption to usual activities. This reinforces the view that effective legacy management is a key element of the insurance life cycle, be that through capital support and reinsurance, through portfolio transfer and reinsurance to close (RITC), or through company purchase. IRLA anticipates significant further transactions as the market responds to a period of deep reflection including both jurisdictional and regulatory change. We foresee continued increased attention both from sellers and capital providers across the whole spectrum of the (re)insurance market.

The fundamentals for run-off are strong with underwriting discipline and pricing driving a need for capital to be deployed in new business opportunities in the live market, so the run-off acquirers, reinsurers and managers see opportunities to come. As the Survey shows, run-off is providing financial strength, choice and longevity through market discipline and professionalism which IRLA both supports and encourages.

Stephen Roberts
IRLA Chairman

A view from AIRROC

Carolyn Fahey
Executive Director
AIRROC

Many thanks once again to PwC for a very telling Survey! These findings echo what we are seeing and hearing from the AIRROC membership. Even in a very challenging time for many industries, the run-off market grew and became even more relevant as a solution for entities with legacy exposure.

The biggest development in the US took place in the third quarter of 2020, which was the much anticipated first IBT (Insurance Business Transfer) which came through Oklahoma. Many years in the making, we are optimistic that these new tools will open the door to more activity and that other states will begin to adopt an IBT and/or Division Statute. Through this activity comes even greater awareness of the value provided by the legacy sector and how it supports the entire insurance industry.

Indications from our membership, and the legacy market, are that the run-off sector will continue to grow. For AIRROC, we are seeing increased interest in membership from a diverse set of companies, including capital firms as more look to invest in this vibrant sector. There has also been growing interest by captives in learning more about exit solutions for their business. The key factors driving AIRROC's membership with respect to restructuring and exit strategies remain consistent with prior years; capital release, disposal of non-core business and managing volatility.

As evidenced by the results of this Survey, as well as the deal reports that PwC issued throughout 2020, the legacy market remained steady, and not hindered by the pandemic. While it might have been more complicated to get the deals done, we persisted. Given our learnings from this year, it is clear that there was one area that was ripe for improvement, which is the limitations that come from working with outdated legacy systems and paper files. However, companies persevered and were able to adjust to scanned documents and remote access to their systems. While there is still room for improvement, there were strides made in this area as companies needed to find ways to complete their transactions remotely.

In closing, 2020 has been a year of adjustments for us all – both personally and professionally. The legacy sector proved its persistence and resilience. We demonstrated how we could adapt and excel. AIRROC is committed to keep finding ways to bring the legacy sector together in 2021 and beyond.

The biggest development in the US took place in the third quarter of 2020, which was the much anticipated first IBT (Insurance Business Transfer) which came through Oklahoma. Several years in the making, we at AIRROC are optimistic that this will open the door to more similar transactions and bring wider awareness of the value provided by the legacy sector and how it supports the entire insurance industry. A look ahead into 2021 will see some great new enhancements to how AIRROC will serve — stay tuned!

Carolyn Fahey
AIRROC Executive Director

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Key findings

Our Survey has included an estimate of the size of the global non-life run-off market for the past three years. Across these years we have seen consistent growth; our 2021 estimate of global non-life run-off liabilities has risen to US$864bn. Survey respondents expect this growth to fuel further activity throughout 2021 and beyond as the global legacy market maintains its strong momentum.

Figure 1: Estimated global non-life run-off liabilities.
Market size – The global legacy market has grown consistently over the past three years.

Numbers rounded to nearest 10s of billion (US$)
Source: PwC

Deal activity

A significant proportion of respondents believe that the three largest territories for legacy deals will experience a similar or greater level of activity over the next two years compared to the previous two. Of these territories, North America displayed the highest proportion of respondents believing there will be a greater number of legacy deals, with 77% of respondents expecting an increase in activity.

Continental Europe	UK & Ireland	North America
93%	**87%**	**99%**
(Greater 40%/ Similar 53%)	(Greater 35%/ Similar 52%)	(Greater 77%/ Similar 22%)

Source: PwC

Market evolution

The majority of Survey respondents believe the global legacy market is in the growth stage of its evolution. While only one in ten believe the market has reached maturity, a noticeable contingent responded that the market is continuing to emerge and take-off.

Figure 2: The majority of respondents believe the global legacy market is in the growth stage of its evolution.

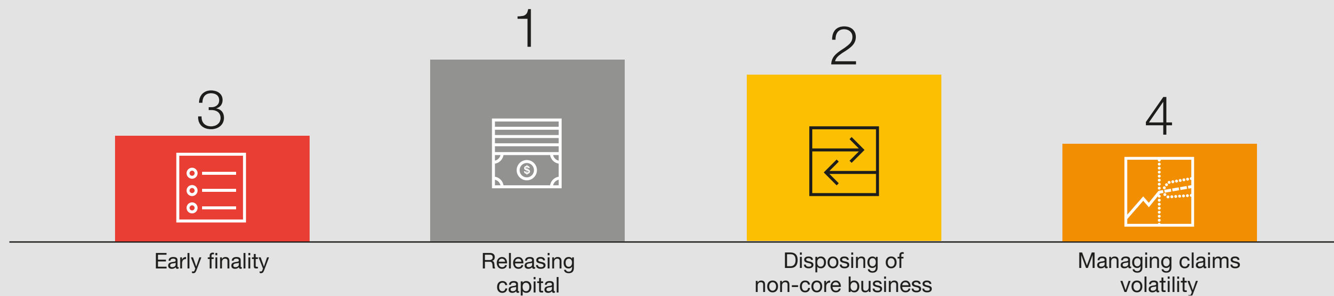
Development
Emerging (take-off)
Growth (shake-out)
Maturity (saturation)
Decline
Re-invention

Source: PwC

Drivers of restructuring activity

Key drivers of entering into restructuring activity are consistent with the deal flow that has been observed in the market over the past two years. Releasing capital continues to be the primary driver, followed closely by disposing of non-core business.

Figure 3: What do you think will be the main reasons for entering into restructuring activity?



Source: PwC

Capital flow

93%

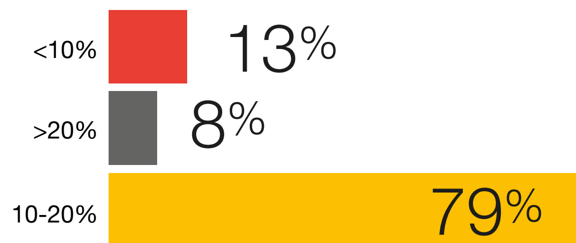
The overwhelming majority of respondents believe new capital will continue to be made available to legacy market players in the current hardening market.

Source: PwC

Expected rates of return

The majority of Survey respondents foresee consolidators pricing legacy deals at target Internal Rates of Return (IRR) of between 10-20%. This is consistent with our experience in the market.

Figure 4: At what target Internal Rate of Return (IRR) do you see consolidators pricing legacy deals?



Source: PwC

Transacting lines of business

Respondents were asked to rank the lines of business they believed most likely to transact over the next three years. Unsurprisingly, Workers' Compensation, Professional Liability and Asbestos, Pollution and Health (APH) were identified as those most likely to transact, broadly in line with what has been experienced in recent years.

Figure 5: Lines of business respondents predict as most likely to transact over the next 3 years.

Source: PwC

Getty Images

Views from the market

Capital and operational efficiency and attention to risk management strategies remain a focal point for insurers and create opportunities for solutions presented by well capitalized legacy market providers. Through 2020, despite COVID-19, run-off transactions continued unabated and the expectation is for continued growth in the years to come.

Arvind Krishnamurthy
Head of US Legacy & Capital Solutions, Allianz Reinsurance America, Inc

The ability of run-off specialists to provide not just traditional ground up Loss Portfolio Transfers but also more bespoke solutions such as capital relief Adverse Development Covers on holistic books of reserves, allowed the industry to use its expertise to satisfy a need that is underserved by the traditional reinsurance markets.

Mahindra Maharaj
Senior Managing Director, Aon

2020 saw a continuation of the trend of buyer markets focussing on specific portfolios within their risk appetite, and not spending time on due diligence for portfolios that fall outside that appetite – a win for all in the industry. Another key trend has been a growing focus by buyers on the long term relationships they are building, reflective perhaps of the longstanding relationships with sellers in the live reinsurance market and the value that brings to reinsurers and cedants.

Connie Tregidga
Head of Retrospective Solutions, QBE Insurance Group Ltd

Dan Schwarzmann
Head of Market
Initiatives and Industries
PwC UK

Dear All

I hope you and your families and friends are well.

A huge thank you to everyone who has contributed to this latest edition of our Global Run-off Survey. Without your valuable contributions and the important support of IRLA and AIRROC, it would not be possible to compile this report.

I am delighted to be introducing a new section of our Survey which puts your views at the heart of the analysis. In previous editions we have highlighted perspectives from the market throughout the report. However, because these insights are so helpful, we have decided to change the format of the Survey this year and we hope this makes for an even more interesting read.

We have been fortunate to receive quotes from across the non-life run-off community – insurers, reinsurers, run-off consolidators and brokers who originate deals. Their insights showcase why this is such an important market, which will continue to lead on cutting-edge innovation, deliver value and attract many stakeholders for the long-term.

As ever, the PwC team throughout the PwC Network are privileged to work with clients across the spectrum of the run-off market. As always, thank you very much for your continued support and we look forward to engaging with you over the coming year.

My very best wishes

Dan

This is an incredibly vibrant time for the legacy market, with a number of market participants and high levels of activity. We are delighted to enter the market during this period of growth.

Phil Hernon
Managing Director of UK and Europe, Carrick Holdings Limited

As the live market starts to experience rate increases across most lines of business, the hard market and the impact of COVID-19 losses creates a market dynamic that favours the legacy market well. Raising capital for the long-term in 2020 was always part of Compre's plan but the type of investor and cost of capital is key to success in the legacy market. Longer-term investment holds and lower weighted average cost of capital is key to building a business for the future that can weather all markets.

Will Bridger
CEO, Compre Group

Transferring discontinued, legacy or just older reserves is now a widely accepted method of reducing risk, improving capital efficiency and finding finality solutions in the Property and Casualty (P&C) insurance and reinsurance world. A combination of well capitalised and professional run-off consolidators, a hardening market and multiple pressures on reserves has accelerated demand over the last twelve months and we expect this trend to continue through 2021 and beyond. Whilst many participants are very small the combined size of P&C run-off consolidators has grown as more capital has been raised, helping to develop the sector. Catalina's size, geographic reach and capital allows us to focus on larger transactions which have a meaningful economic impact for the largest industry players. We look forward to continuing to provide effective solutions for our partners in the year ahead.

Chris Fagan
Former Group Chief Executive, Catalina Holdings (Bermuda) Ltd.

We began to see a substantial uptick in opportunities midway through Q4 2020. Up until then, much of the activity had centred around RITCs, platform buy-outs and large whole account quota share in Lloyd's. There has since been a wide array of opportunities both in respect of lines of business and structure. We have been presented with opportunities encompassing acquisitions of captives and insurers in the likes of Bermuda and Ireland, corporate liability buy-outs and loss portfolio transfers of US and European business, both direct and assumed. There have been commercial auto, motor excess of loss, general liability and specialist line opportunities. In the US, there has been a preponderance of books with construction and New York labour law risks.

Thomas Booth
Group CEO, DARAG Group Limited

With the increasing interest in legacy transactions, it is imperative for counterparties to have confidence in the legacy market to meet their customer's needs. Claims service is critical to this where the legacy players need the scale, experience and expertise to deliver a world class claims offering and a seamless transition. Delivering continuity of service for policyholders now and into the future is essential.

Darren Truman
CEO, Enstar (EU) Limited

Over the last few years there has been a paradigm shift in the run-off industry; an evolution fueled by innovation, technology and most importantly, expanded client goals. This new environment will result in more efficient execution, improved pricing and allow clients to more effectively manage capital and risk.

Eric Haller
CEO, Fleming Reinsurance Ltd

In today's challenging economy and hardening marketplace, the legacy acquirer can be the perfect partner for the captive insurance community. There is an underserved market, especially for the smaller captives and Risk Retention Groups in the US. As Corporates review their business models, and assess needs as well as opportunities, some are looking to release trapped capital by disposing of non-strategic captive vehicles or opting for a reinsurance structure to remove their legacy liabilities.

Brian Johnston
CEO, Genesis Legacy Solutions LLC

There continues to be strong interest from both the London market and Continental European insurers in exploring run-off reinsurance solutions as part of their capital management strategy. Such instruments not only enable companies to free up capital which can be redeployed across core activities in response to improving market conditions, but also to restore solvency ratios that have come under significant pressure in the last 18-24 months due to volatility on both the asset and liability sides of the balance sheet. The structural flexibility offered by loss portfolio transfer solutions and adverse development cover reinsurance is proving very attractive to insurers and reinsurers as they navigate current market uncertainty.

Andrea Piatti
Managing Director Global Risk Solutions, Guy Carpenter

Our focus on legacy covers both risk/capital management initiatives of re/insurers as well as finality transactions. Events in 2020 and the impact of hardened rates has created substantial market demand for risk/capital management facilities which Marco is eager to provide.

Simon Minshall
CEO, Marco Capital Holdings Limited

Clients are increasingly driven by optimising their capital position, improving risk return despite low interest rates, reducing volatility and focusing on their core competencies. These factors are part of the reasons why portfolio restructuring, reinsurance and legacy solutions are ever more meaningful tools for insurance companies to manage their capital base and operational set up efficiently. Brexit and the vibrant mergers and acquisitions market are igniting an increase in retroactive reinsurance and traditional run-off solutions both for pre-and post-acquisition circumstances. In addition, the economic outlook as an effect of COVID-19 and the inherent volatility and constraints for insurers on both the asset and liability side of the balance sheet will contribute to the increased utilisation of bespoke retroactive reinsurance covers as well as a variety of run-off solutions.

Judith Zeleny
Head of Origination Capital Partners Munich, Munich Re

The drumbeat of the need to match the right capital to the right risk will only grow louder in 2021 and beyond. Embracing these capital solutions creates a competitive advantage while also freeing management to focus all their energy on their higher returning, core business. Those that do not embrace this change will start the race for attractive returns at a significant disadvantage – which is a very tough place to be in an extremely competitive industry.

Bill O'Farrell
CEO, Premia Holdings Ltd

Providing solutions for legacy insurance in complex situations in a number of geographies is Quest's core business. In 2020 we provided finality in Brazil for a global international insurance group. Having worked in South America over many years it was Quest's first acquisition of a regulated entity in the region, something which could not have been achieved without the efforts of Ricardo Cantilo, President of Quest in New York working collaboratively with the seller. This is evidence of the potential for legacy solutions in emerging markets and we expect there will be more to come as global insurance groups assess their international operations.

Sean McDermott
Director, Quest Group

It has been another very busy year at Randall & Quilter for legacy deals and we are especially pleased to have effected three major transactions at Lloyd's. The early financial crunch of the COVID-19 pandemic created a wave of liability carriers looking at how to redeploy capital by disposing of legacy. It has been great to see how the legacy acquirers have stepped up to the plate and further strengthened the capability and reputation of the sector.

Paul Corver
Group Head of M&A, Randall & Quilter Investment Holdings Ltd

We are experiencing an ever increasing demand for legacy solutions to provide capital efficiencies for live carriers, which is driven by the recent hardening of insurance rates following a long period of soft market conditions, along with the continuing low interest rate environment and the extra pressure that the pandemic has placed on their balance sheets and operations. With our experience, operational expertise and outstanding track record soon to be allied with a strong and legacy business focused new owner, we have never been better placed to take advantage of the opportunities and we are looking forward to 2021 and beyond with great enthusiasm and expectation.

Luke Tanzer
UK Managing Director, RiverStone Management Ltd

After the stresses of 2020, redefining what core business means and improving capital management is on the forefront of almost every larger insurance group. We do expect this to drive demand for more legacy transactions globally, but particularly in the US, the UK and Continental Europe. We also expect that the low to negative yield environment and increased hurdle rates of many market participants will impact price levels for transactions going forward.

Andreas Schäfli
Director, Transaction Executive, Swiss Reinsurance Company Ltd

At TigerRisk we are seeing best in class insurers using loss portfolio transfers and finality solutions to manage uncertainty and release and redeploy capital more than ever before.

Linda Johnson
Partner, TigerRisk Partners

For many insurers the cost of traditional financing mechanisms like reinsurance is increasing. This isn't surprising given the economic environment, but it does lead management to consider a broader spectrum of solutions as they seek to maximise value for their stakeholders. Companies are increasingly curious to learn about how a retrospective solution might help them resolve a range of challenges. Given the relative strength and maturity of the run-off market there are plenty of opportunities for companies to reduce operational overhead and release/reallocate capital in a way that clearly adds value. Interest in the sector has never been higher, it's an exciting time for the market.

James Mounty
Global Practice Leader – Customised Solutions, Willis Re

The run-off market has shown itself to be both mature and resilient in the light of the challenges faced by the insurance industry as a whole in the last 12 months. Companies reacted quickly to the new ways of working in the light of the pandemic and have continued to service the needs of their customers. Desire from sellers to dispose of portfolios has remained strong and transactions have been maintained throughout the period and with capital continuing to enter the market. This has allowed both new entrants and existing buyers to grow.

Simon Barnes
CEO, Zurich Legacy Solutions

The Continental Europe legacy market will deploy its potential, yet COVID-19 implications, as well as regulatory requirements will accelerate adoption of capital and cost optimization strategies. We expect the market potential to hit EUR€500bn within three years.

Arndt Gossmann
CEO, Gossmann & Cie Group

Legacy market landscape

Andrew Ward
Director
Liability Restructuring
PwC UK

Despite the trials of the COVID-19 pandemic, we have seen the run-off market demonstrate significant resilience over the past year. The growth in legacy activity that was predicted in the last edition of this Survey has materialised and been further boosted by some significant investment in both new and existing players. Deal activity has maintained its momentum throughout the period, with 41 non-life legacy deals being publicly announced between COVID-19 being declared a global pandemic and the end of 2020. Legacy management has continued to integrate itself into the traditional insurance life cycle and market conditions appear conducive to run-off activity levels continuing apace over the next couple of years.

In preparing this edition of the Survey it was natural to ask participants to predict how they saw COVID-19 impacting the legacy sector. Unsurprisingly a sizable proportion of respondents noted the shift in the way we work and the economic pressure of a prolonged downturn, but there was no clearly distinguishable theme in respect of respondents believing that COVID-19 presented any long term threats to the future of the market. On the other side of the coin, it might have been expected to hear respondents citing opportunities for the sector resulting from COVID-19 and the potential for more discontinued lines coming to market as a result of the anticipated pressures on business interruption and professional liability portfolios. While we saw some references to opportunities for the market from COVID-19 the consensus was more muted with a number of respondents seeing this as an opportunity that will take some time to develop, and in some cases notes of caution were sounded around the risks associated with acquiring portfolios with uncertain levels of COVID-19 exposure. It will be interesting to see if the recent Supreme Court decision on business interruption claims in the UK and similar legal decisions in the US lead to opportunities for legacy players as claims issues begin to be unpicked for insurers and their reinsurers over the next 12-18 months.

Beyond the impacts of the pandemic, we also asked respondents what they foresaw as being the major factors that will influence the legacy market over the next two years. One of the most frequently noted responses was the availability of capital, which has substantially increased in recent years through notable investments in a number of existing and new run-off consolidators from top tier investors. This has been a significant development and one which is reflective of how far the sector has come and is viewed by investors as a source of potentially attractive returns. Survey respondents expect that well-priced capital will continue to be made available to the market and we explore the likely impact of this increased availability of capital further on page 12.

Another observation frequently made by respondents is the increased level of deal competition which is being witnessed as a result of the flurry of new market participants and the ongoing demand for new portfolios by the established legacy consolidators. The supply and demand question is a key issue for investors and while it is expected that the level of competition in the market will continue, particularly in the US and the Lloyd's market, Survey respondents anticipate that new entrants will gain access to a higher volume of deals as the live market increasingly turns to legacy solutions to solve capital and operational challenges and established players potentially begin to feel the pinch of a capacity crunch following years of sustained growth.

Survey respondents also noted that the increasing prevalence of intermediaries in the legacy market will continue to influence the growth of the market over the coming years. It has been interesting to note that prospective new participants in the market have not been restricted to acquirers and we have seen an increased focus on the sector from a wider number of brokers, which may lead to further sell-side intermediation of legacy portfolios. To this point, we asked Survey respondents to identify the stage at which they see the legacy sector in its market evolution, as can be been in Figure 2 on page 4. The overwhelming majority of respondents (82%) identified the market as either in its development, emergence or growth stage of its evolution. Just 10% of respondents believe the legacy market has reached maturity.

Consistent with this positive outlook, respondents further suggested that deal activity over the coming couple of years will at the very least continue at its current rates as illustrated on page 4. In line with opinions in previous editions, the US legacy market is expected to be particularly active, with 77% of respondents expecting deal flow to increase over the coming period. As has been witnessed in recent deals, we expect this growth to be supported by major insurance carriers that are starting to utilise the legacy market on a repeat basis. In Continental Europe and the UK, respondents' views of future activity dropped slightly from previously anticipated levels, although the outlook continues to remain overwhelmingly positive with 93% and 87% of respondents expecting similar or increased deal activity respectively.

Whilst the outlook for the legacy market remains buoyant, the need for strict underwriting discipline and claims handling operations that demonstrate the highest levels of conduct remains critical for market participants to ensure the continued success of the market. As the market continues to thrive and grow it naturally attracts greater regulatory interest, as highlighted in the UK by the FCA's recent Dear CEO letter, the implications of which are further discussed on page 23. It is reassuring to note that respondents to the Survey clearly recognise the market needs to continue to address these growing pains proactively in order to maximise the considerable supply of opportunities that exist.

Figure 6: What do you think will be the most significant factors to influence the legacy market over the next two years?

Source: PwC

Run-off strategy

Ainsley Mayhew Seers
Partner
Strategy&
PwC UK

Since 2019, we estimate that there has been over US$5bn of new capital invested in the non-life run-off sector (i.e. excluding capital in non-life run-off specialists that has been recycled and put to use on new deals). This is roughly equivalent to the estimated cumulative investment in the sector over the preceding six years, which is testament to the increasing profile of run-off solutions in the wider insurance landscape, but also of the attractiveness of this alternative market to investors. Using a combination of our Survey insights and our proprietary Run-off Deals Database, we have explored what respondents believe the future holds for the legacy market and why it has proven such a popular investment.

New capital

We asked Survey respondents whether they believe new capital will be made available to legacy market players in the current environment. The responses were clearer than for any other question, with 93% of respondents believing that capital will be made available. This comes as no surprise given the flurry of recent market investments. These have included three new start-ups as well as numerous debt and equity investments from established players seeking capital to deploy towards new opportunities presenting themselves in the hardening market and as the legacy market has matured.

As noted in our deal trends section on page 18, Survey respondents believe there will be a similar or greater number (and value) of deals in the next two years as in the preceding two. Our visibility of the recent market investments as well as the potential for further investments would support this view.

We have not seen initial public offerings (IPOs) of legacy players either to generate an exit for investors or for a quicker route to tap capital and debt markets. However, with two players already listed and other established players continuing to grow, it is possible we will see some in the coming years. The ever-increasing market maturity and the desire for cedants to continue run-off solutions should help to frame the opportunity for investors if and when any market participant seeks to execute an IPO.

Figure 7: Significant new capital has entered the legacy market in recent years. In the current hardening market, do you think new capital will continue to be made available to legacy market players?

Source: PwC

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Returns in the market

A key measure of investments in the non-life run-off sector is the unlevered Internal Rate of Return (IRR) generated on a deal by deal basis. Consolidators' views of actuarial reserves and how those differ to cedants is an important factor in determining price, but the target IRR is ultimately what drives day one pricing. In order to gauge the market's views on the typical target IRR, we asked respondents to comment on where they see IRRs for legacy consolidators when pricing deals. As illustrated in Figure 4 on page 4, a 79% majority of respondents see IRRs in the 10-20% range, with the next most selected choice by 13% of respondents being less than 10%.

This is in line with our experience of the typical return expectations of investors and so it is not a surprise that there is such a consensus from respondents around this.

The future evolution of IRRs will be impacted by several factors. On the one hand, increasing supply of capital has implications for competition for new deals. However, counterbalancing this as the wider insurance market hardens and the opportunity cost of capital increases for cedants, disciplined cedants (particularly those who can also deploy capital towards live underwriting) may seek higher IRRs.

Conclusion

The legacy market has continued to grow and evolve over the last decade. A new set of investors are focussing attention on the market as an area offering potential for longer term, stable returns in a segment uncorrelated to even the live (re)insurance markets. Over the next decade we will see this evolution continue as new investments help to grow liabilities under management and to transform market players to be fit to respond to this growth.

79%

The majority of respondents foresee consolidators pricing legacy deals at Internal Rates of Return (IRR) of between 10-20%.

Source: PwC

Market size

Nick Watford
Partner
Risk Modelling Services
PwC UK

Hannah Vaughan
Partner
Risk Modelling Services
PwC UK

Global run-off market

In this edition of our Survey, we have updated our view of global non-life run-off reserves. Overall, we estimate that global reserves have increased from US$791bn to US$864bn, representing a 9% increase since the previous edition of our Survey.

The US still dominates the run-off market with a current estimated run-off reserve of US$385bn. Emerging markets continue to grow due to economic growth driving greater demand for personal lines and liability insurance. New opportunities are beginning to present themselves in the Middle East, where we have estimated a run-off reserve for the first time this year of US$13bn. Figure 8 illustrates the geographical breakdown of our estimate of global non-life run-off reserves.

Run-off reserves relate to business already in run-off and so likely to be several years old. These results are therefore unaffected by more recent market events (e.g. Brexit and COVID-19), however we have considered the potential impact of COVID-19 separately.

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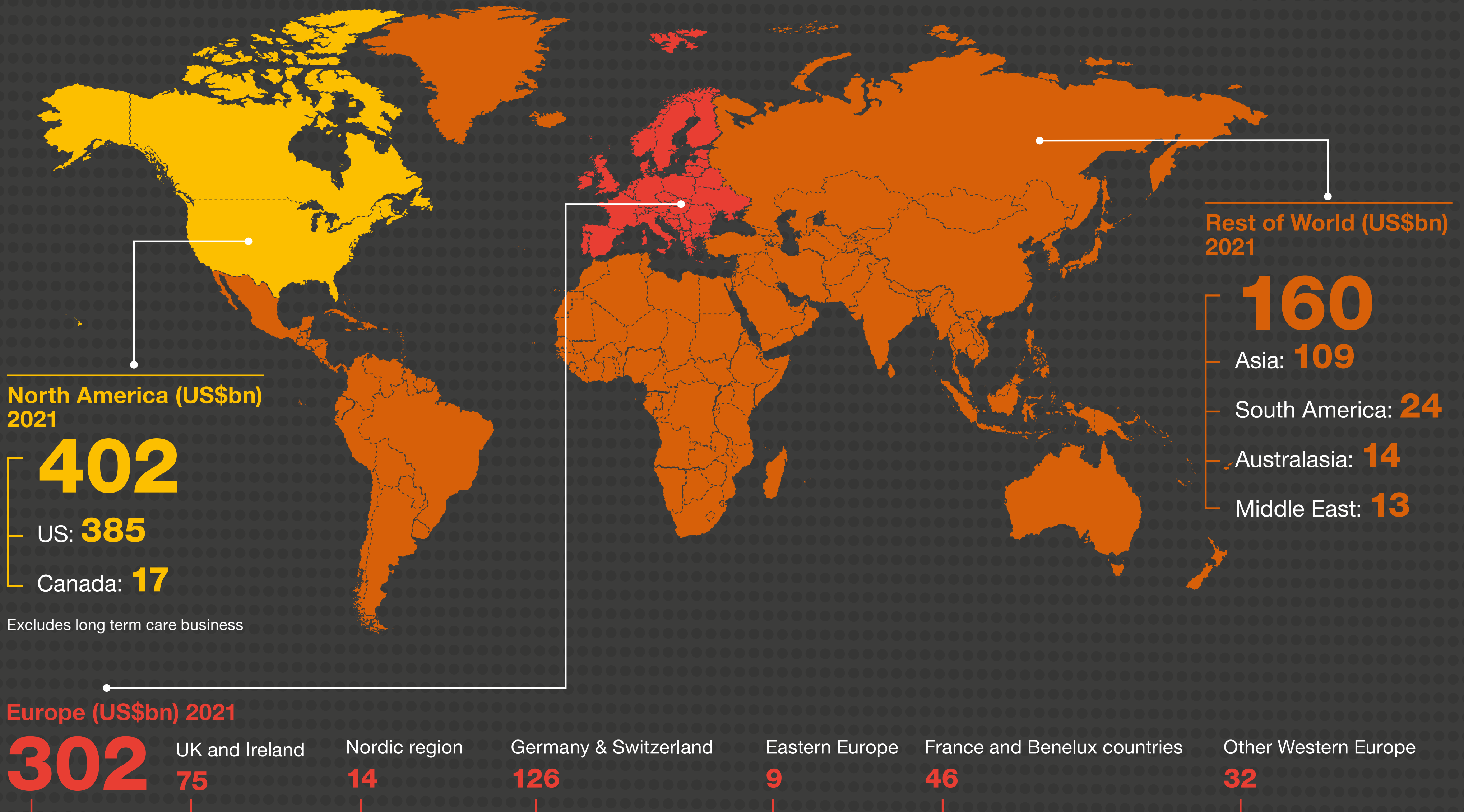
Figure 8: The geographical breakdown of our estimate of global non-life run-off reserves



Source: PwC

US

Our run-off estimate has increased by US$37bn driven by growth in the motor, property and casualty classes of business. We have shown the breakdown of our reserve estimate by state in Figure 9.

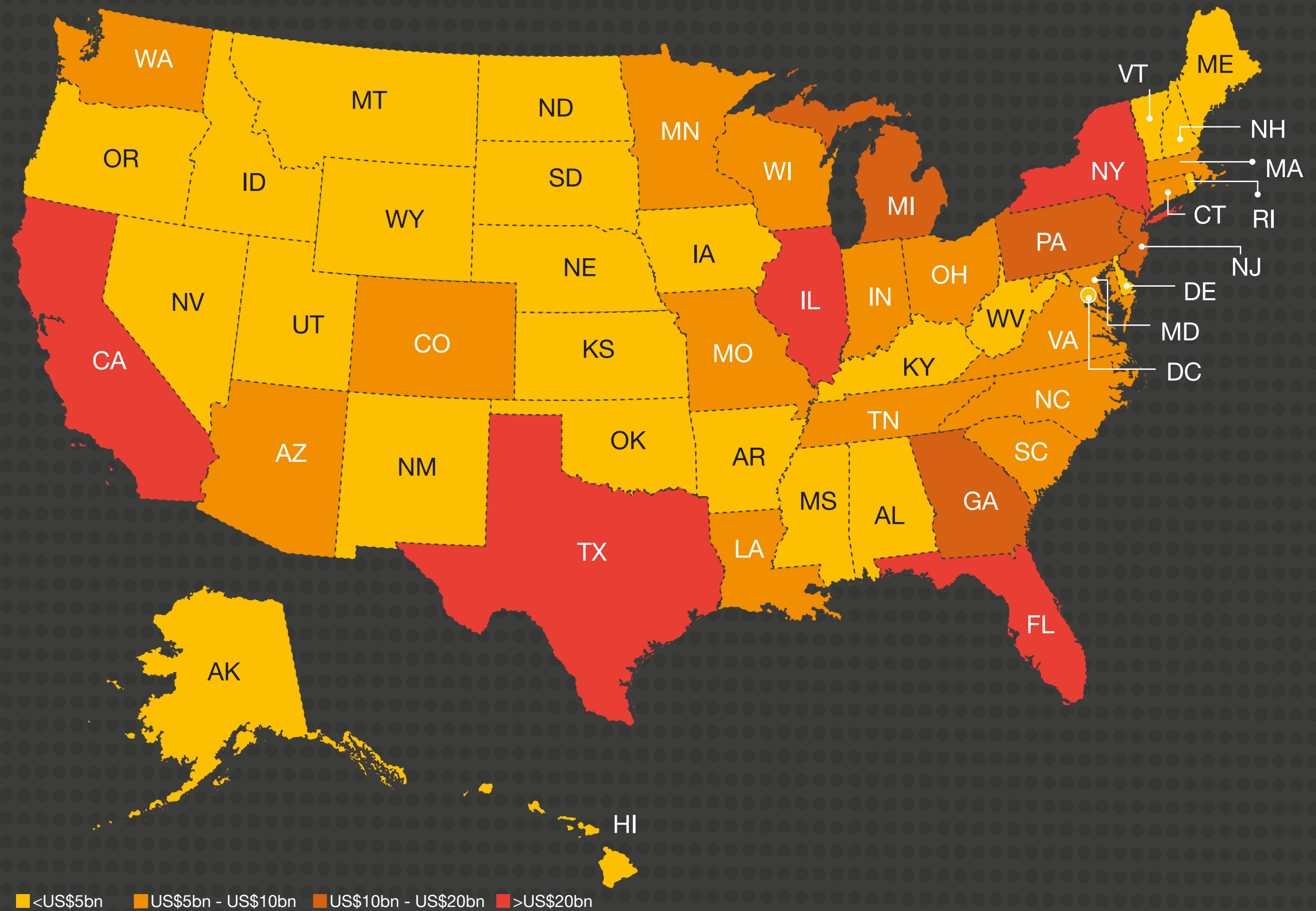
The largest states contributing to the run-off reserves are Florida, California, Texas, Illinois and New York.

Casualty business has continued to deteriorate over the last few years driven by:

- Social inflation;
- Litigation funding;
- Plaintiff venue shopping;
- New claims emergence, such as opioids; and
- Reforms to the statute of limitations for abuse claims.

We have seen property reserve increases from catastrophe-heavy years, such as 2017, being placed into run-off. The California wildfires have also been driving material losses since 2017. US asbestos and pollution losses have remained stable, although the reserves have reduced slightly as claims continue to settle.

Figure 9: Overview of US non-life run-off liabilities by state



Source: PwC

UK and Ireland

Our reserve estimate has increased to US$75bn and this continues to be a vibrant area of deals activity, driven in large part by numerous deals recently executed in the Lloyd's market.

Following a prolonged soft market cycle we have seen the market harden as prominent insurers have begun to exit certain markets and place material lines of business into run-off. This presents a great opportunity for the deals market as insurers seek to streamline their backbooks and become more capital efficient.

Middle East

For the first time this year we have included the Middle East in our global market size. We have estimated a run-off reserve of US$13bn with Saudia Arabia and United Arab Emirates being the largest contributors. As the insurance market in the Middle East is growing, we have already observed increased M&A activity and we expect to see continued growth in the size of run-off.

Emerging markets (Asia & Latin America, excluding China)

There has been a year on year increase in gross premium written for motor, home and liability insurance of c.10%. As these areas develop we see a growing opportunity for deals activity.

The Japanese market is well developed and dominated by a small number of large insurers. This presents an opportunity for run-off consolidators who may be able to assist with streamlining back books to aid capital optimisation.

Rest of Europe

Our analysis suggests that the total level of run-off in the rest of Europe has remained stable as new run-off is generated at roughly the same rate at which claims are paid. We have also observed some insurers preparing for Brexit by redomiciling to Europe. We would expect this to lead to growth in the European run-off market in coming years.

The potential impact of COVID-19

Our estimate of global run-off covers business already in run-off. It does not include factors of COVID-19 as it is too recent to have any impact on the run-off market yet. The pandemic has created a highly uncertain environment in which insurers are trying to operate, and it has also spurred regulatory intervention in how insurance policies should respond to certain personal lines and small and medium-sized enterprises (SME) claims. We expect therefore that the run-off market will play a key role in allowing insurers to clear-up their back book and alleviate capital pressures in order for them to continue underwriting.

US$60bn

Estimated size of corporate liabilities in 2021

Source: PwC

Non insured liabilities

Our global run-off estimate of US$864bn is based on insured liabilities only. There are, however, material legacy liabilities held on the balance sheet of manufacturing companies and other corporations that are only partially insured. There has been increased deals activity in this market as traditional run-off consolidators leverage their expertise in asbestos claims handling to acquire and run-off non-insured, corporate liabilities. Doing so can allow the buyer to take advantage of operational efficiencies and investment opportunities, while the seller is able to achieve finality on liabilities which represent a drag on the balance sheet. We estimate the size of these corporate liabilities to be US$60bn in our 2021 Survey.

Deals landscape

Victor Nelligan
Director
Liability Restructuring
PwC UK

Alan Augustin
Director
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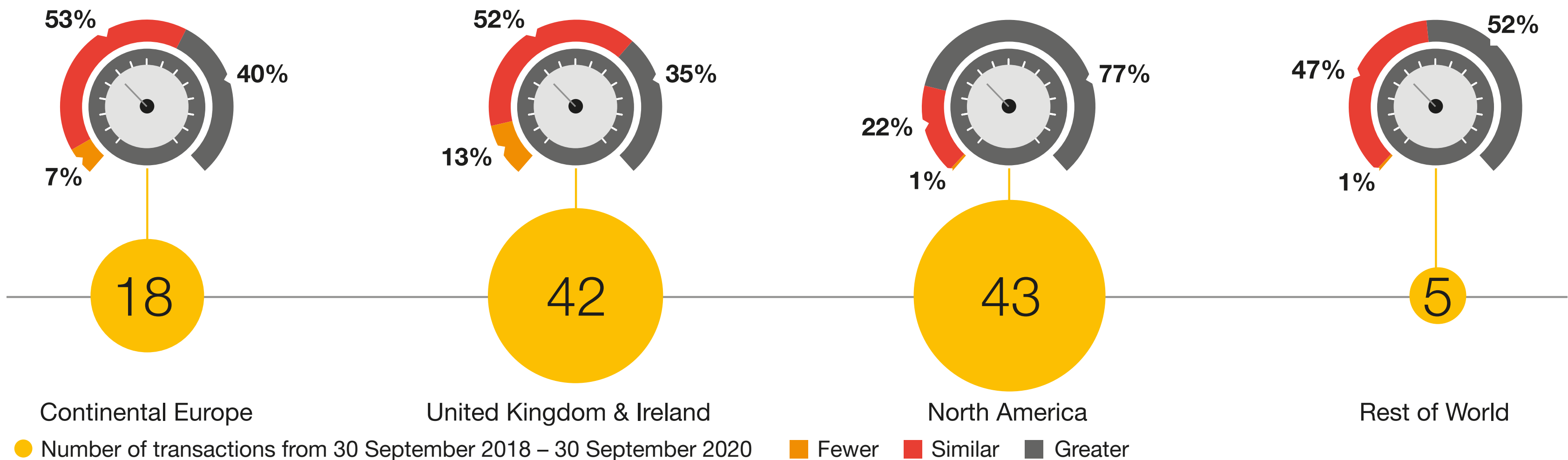
PwC UK

Since the last edition of our Survey we have continued to track non-life run-off deal activity, publishing our updates on a quarterly basis and expanding what our database tracks. Activity has remained at its highest levels ever with 108 deals publicly announced between September 2018 and September 2020.

As in previous years, we asked a number of questions around deal flow forecasts, but this year we have specifically asked how Survey respondents believe future deal flow will compare to the last two years and the responses suggest a strong couple of years ahead for the market. We asked Survey respondents whether they expect fewer, similar or a greater number of deals in the next two years compared to the previous two years, in the four territories we track: Continental Europe, United Kingdom & Ireland, North America and Rest of World.

As Figure 10 illustrates, an overwhelming majority of Survey respondents believe there will be a similar or greater number of deals in the next two years. In North America and Rest of World, the sentiment from Survey respondents is even stronger, with the majority believing that there will be greater activity than the 43 and 5 deals respectively. The North American sentiment is a reflection of the size of the market, but also of new tools and a greater understanding of the use and value of the run-off market by brokers and cedants alike.

Figure 10: Respondents estimated whether over the next two years there will be a lesser, similar or greater number of deals compared to the previous two years.



Source: PwC

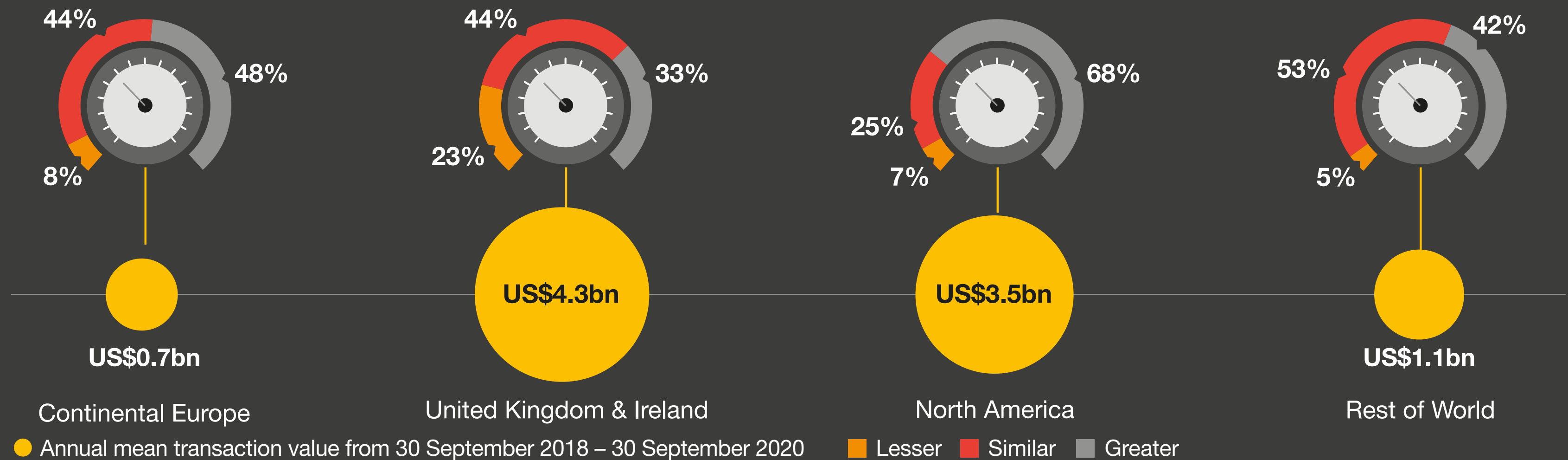
It is likely that the Rest of World figure is driven by the fact that deal numbers have been relatively low, but there is an emerging need for run-off solutions in these markets as multinational (re)insurers retrench from these markets and local market participants become more familiar with the value these transactions can add to both mature legacy blocks and relatively fresh ones alike.

Again, in terms of the size of deals, as illustrated in Figure 11, a strong majority of respondents believe that in most territories the aggregate value of deals over the next two years will be similar or greater than the last two years.

The only territory where a greater proportion of respondents (23%) believe that deal values will be lesser in the next two years is the UK & Ireland. This is likely driven by the estimation of some that the activity in the Lloyd's market, which has been growing in the last two years, cannot be sustained.

In our Survey we considered respondents' views on the composition of these future deals by line of business, asking them to rank which lines they felt would be most likely to transact over the next two years. The top three chosen were Workers' Compensation, Professional Liability and APH, with Workers' Compensation featuring most frequently in first and second place when ranked by most likely to transact.

Figure 11: Respondents estimated whether the liabilities transacted over the next two years will be lesser, similar or greater than the previous two years.



Source: PwC

This is in line with historical trends in the market and so it appears that respondents believe there will be a significant continued deal flow from the tried and tested business lines.

The other interesting aspect to consider in the composition of future deals is how many will come from repeat users of run-off solutions. Our database of publicly announced run-off deals indicates that the proportion of deals coming from repeat sellers has remained roughly the same in the 2019-20 period as in the 2017-18 period at 29%. Continued growth in the market will rely on repeat users and so if this increases in the future period, then we would see that as an indication of the increasing relevance of run-off solutions.

Given the events of 2020 and the stresses on both held and new reserves, it is reasonable to expect that there will be at least some increase in repeat users as cedants look to more creative solutions to tap capital to take advantage of the hardening market. Beyond the more obvious use of run-off solutions for capital release, the need for operational improvement and efficiency is likely to drive additional run-off transactions. Particularly post larger deals in the live market, we anticipate an increase in overall legacy management focus, which will see more consideration for both active consolidation of run-off deals as well as other methods of managing legacy.

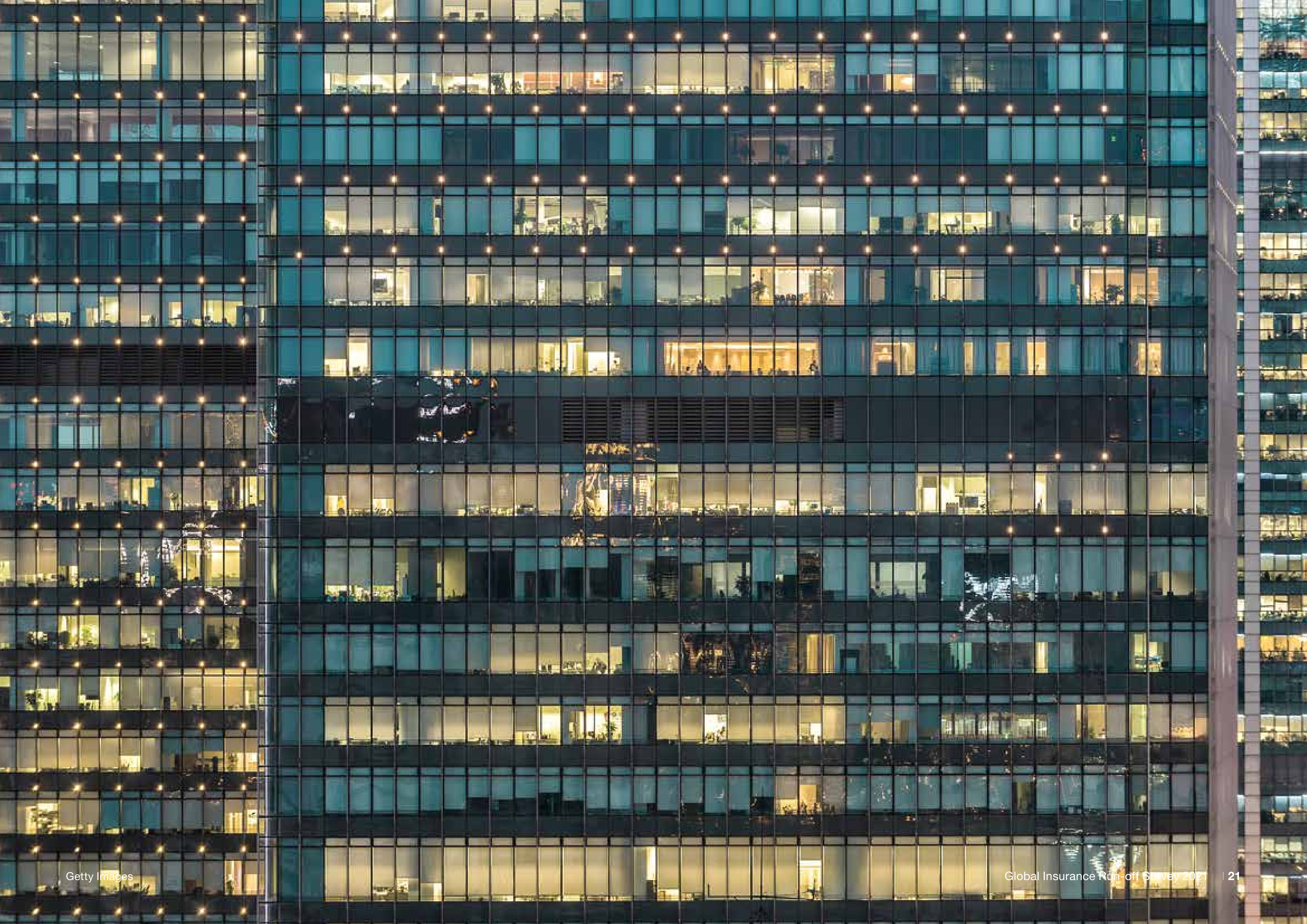
Increased innovation and expertise will be needed to transact and drive value out of run-off deals, for example where there are new lines of business being transacted. The appropriate technical skills, such as relevant claims handling experience, will be needed to execute deals and deliver planned returns. Deal structuring technology and flexibility will also be of increased importance at Lloyd's, where class of business RITC solutions will need to be developed to meet market needs.

Effective management of legacy blocks has come up the agenda in many (re)insurance organisations and, alongside this, so has the use of run-off solutions as the only true route to finality for companies. Given the increased investment in the sector over recent years, the efforts of IRLA, AIRROC and their memberships, we can only agree with Survey respondents in believing that there will be significant activity over the next two years – in line with or greater than the 100 plus deals that were announced since our last Survey.

100+

deals were announced since our last Survey

Source: PwC



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Anirvan Choudhury
Senior Manager
Assurance
PwC UK

Insurance firms continue to face a complicated and evolving regulatory agenda in 2021, with COVID-19 only amplifying the complex regulatory and operational considerations. It is clear that regulators are seeking to make progress on big ticket cross-sectoral concerns such as climate change and operational resilience and insurers will need to make significant progress in these areas to meet regulatory expectations.

Risk management and compliance

One area that is attracting significant regulatory attention is the effectiveness of firms' control functions. As more legacy liabilities build up on the balance sheet of run-off consolidators, the message from regulators is clear – they expect second and third line functions to be appropriately staffed and resourced before they give their approval for new transactions. This will require run-off firms to develop forward-looking resourcing plans for their compliance, risk management and internal audit functions and consider associated cost implications when pricing new acquisitions.

Recently, The European Insurance and Occupational Pensions Authority (EIPOA) published its Opinion on the Review of Solvency II, which will inform the European Commission's legislative proposals on the revision of Solvency II. In addition, the UK Government launched its own Call for Evidence to review certain features of Solvency II taking into consideration the unique characteristics of the UK insurance sector. In the future as run-off firms enter cross-border transactions and expand their geographical footprint they will need to adhere to potentially divergent regulatory and compliance requirements. Therefore, firms will need to assess the skill-set and expertise of their risk and compliance personnel to meet different sets of regulatory rules and requirements.

In Q4 2020 the Prudential Regulation Authority (PRA) issued a "Dear CRO" letter highlighting an increasing risk of reserve deficiencies, particularly for long-tailed lines of business, and noting that exposure management frameworks for non-property classes are less mature than for property classes. Since run-off firms typically have material exposure to long-tailed lines and non-property classes, they may wish to conduct detailed analysis to assess their existing exposure management capability and reserving practices against the PRA's expectations.

Governance

Regulators expect the board to include individuals with a mix of skills and experience that cover the major business areas in order to make informed decisions and provide effective oversight. This is particularly relevant for fast growing run-off firms planning to expand their business across different lines of business and in multiple jurisdictions. In addition, as part of the continued focus on governance arrangements regulators expect subsidiary boards to be involved in all key decisions impacting their respective legal entities. Therefore, where necessary firms need to take steps to reduce commonality of board members across the group and subsidiaries, to demonstrate to the regulators that subsidiary boards are not subject to any undue group influence.

Conduct risk

Another sign of increased regulatory attention is the Financial Conduct Authority's (FCA's) Dear CEO letter published in November 2020, that states that the conduct regulator plans to carry out an in-depth review to assess run-off claims handling with a focus on retail/SME policyholders. Where the FCA finds poor outcomes, they will use the Senior Managers and Certification Regime (SM&CR) to hold senior managers accountable. Therefore, firms should act now to assess their existing risk management frameworks focussing specially on conduct risk indicators. Firms may also wish to review their claims handling policies and procedures to ensure that they have appropriate controls in place so that they can demonstrate to the FCA during any future regulatory scrutiny that claims settlement decisions are taken with a view to treating customers fairly. Furthermore, run-off consolidators should expect greater regulatory scrutiny of their conduct risk framework when acquiring new portfolios.

Finally, in order to navigate the complex and evolving regulatory agenda and satisfy regulatory expectations, run-off firms need to ensure that their top-line growth does not outstrip the capability of their control functions. This will require firms to invest in appropriate governance, risk management infrastructure and controls. Failure to timely invest in these areas is likely to hinder firms' ability to secure regulatory approvals for new transactions and/or attract enhanced regulatory scrutiny.

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Tax focus

Andrew Rosam
Partner
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Sarah Robinson
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Tax is increasingly a key focus area when doing legacy deals – both in how tax can add value to a deal process and in how tax risks in a business can chip away deal value.

Typically run-off businesses may have historic tax losses. We are seeing more potential buyers look to gain a level of certainty around whether they can unlock any of this value post-acquisition, especially due to some of the changes to the loss rules in recent years. Businesses can also gain value by considering structures, including value added tax (VAT) recharging, at an early stage. Wider commercial value can be gained by considering whether a finance and tax outsourcing solution would be appropriate, taking cost out of the model, creating more agility and flexibility in upscaling and allowing management to concentrate on commercial issues.

On the flip side, areas in which tax risk can arise include permanent establishment and residency, given the international footprint of businesses where the location of insured risk and where management takes place may not coincide. Whilst the COVID-19 pandemic has changed the business traveller landscape, at least temporarily, the "home worker" landscape has shifted dramatically and there is a desire from some to make international flexibility a feature of the talent war – this comes with tax consequences for individuals and the business.

Whilst these are largely commercial arrangements, tax legislation and practice in this area can be very complex. Related to this, the UK's Diverted Profits Tax and transfer pricing around reinsurance transactions are also areas in which we typically see a large proportion of the time spent on tax diligence focussed. Scrutiny should also be given during the due diligence phase to the historic and future VAT arrangements, especially on claims costs, where historic issues can give rise to large potential VAT liabilities.

There are also a number of recent tax developments which will affect businesses in the run-off space. The Organisation for Economic Co-operation and Development (OECD)'s BEPS 2.0 project addressing the tax challenges of the digital economy has important implications for the sector. Pillar II of the Blueprint documents, released in October 2020, addresses the basis for future agreement between member jurisdictions on development of global minimum tax rules. These apply to larger groups with annual revenues in excess of EUR€750m. The objective is to ensure that global income, wherever sourced, is subject to a minimum tax rate. This has clear implications for the sector, where there are often entities resident in low or no tax jurisdictions, often chosen for their less onerous regulatory and capital regimes.

Whilst there is still a level of uncertainty around the requirements as they are still to be extensively debated, the OECD itself has suggested that a minimum tax rate may be around 12.5%. For groups where the effective tax rate in financial models relies on profits arising in the lower tax jurisdictions and for modelling the returns on future acquisitions, the future impact of Pillar II needs to be carefully considered. Survey respondents typically expected to target an IRR of 10-20%, so it is crucial to understand the impact of tax on this. Businesses may already have made changes to operating models with knock-on impacts on effective tax rates in preparation for Brexit. Even for unaffected organisations, there is likely to be a significant compliance burden as a result of these new regulations.

Cost optimisation

Michael Cook
Claims Advisory Leader
PwC UK

Nick Donovan
Director
Advisory
PwC UK

As the run-off market has grown over the last three years, the profile of a typical operator in the sector has changed significantly. One evolution is around portfolio composition: portfolios used to be relatively homogenous, with a high proportion of US APH claims. This book profile allowed management teams to focus on doing two things well: handling a large volume of quite similar claims as effectively as possible and finding and executing new deals.

However, the success of the sector in consolidating much of the US APH liabilities and the overall drive for growth led to greater competition for new deals beyond the traditional APH market. This has coincided with the desire of the live market to transfer an ever-broader range of portfolios to legacy specialists to free up capital and reduce their own operational costs. In order to be a viable option for these non-US APH portfolios (such as UK Employers Liability and direct/indirect to customer liabilities), sellers and regulatory requirements have changed how the run-off sector looks. First, we now see firms incorporating portfolios with liabilities as varied as construction defect, motor and marine. Second, some of the older APH portfolios are running down, leaving only a rump of really long-tail and complex claims. Third, players are facing an ever more complicated systems and data landscape as a result of each incremental deal arriving with new information technology (IT) challenges. Finally, it was far easier to achieve some form of consolidation when the transactions related to the relatively homogenous US APH liabilities, however, the more recent transactions have not seen the same degree of integration.

The combination of these changes has significantly added to operating costs and left management teams facing new challenges: how to organise and equip their teams to handle a much wider spread of claim types as effectively as possible? What to do about the dwindling but persistent (and expensive to handle) longest-tail claims? How to respond to the increasingly spaghetti-like IT framework which each additional system ‘integration’ has created? And overall, how best to tackle the steadily increasing cost burden all these changes are creating? We are working through these challenges with run-off firms and it is notable that many of the tactics being adopted in response are similar to those we have seen in the live insurance environment.

Run-off firms are adapting to support a more flexible claims handling team and operating model as, for example, in-house claims handlers are being complemented with third party suppliers with expertise in particular fields. Firms are also professionalising their approach to claims workflow and wrapping workflow tools around core platforms: it is no longer cost effective to allocate claims between handlers and rely on ad hoc updates on claim progress and available capacity for additional work. Legacy providers are deploying similar workflow technology to that we’ve seen in live non-life insurers.

Firms vary in how they choose to use the savings they identify through process and workflow optimisation: again like the live market, some choose to take the savings immediately to reduce reported costs, others are reinvesting in their IT estate. The latter is seen in firms grasping the nettle of the legacy IT estates they have created, as the costs of not doing so have become unsustainable. System migration and decommissioning are now explicit goals, with budgets allocated to replatforming and 2-3 year IT transformation plans now the norm.

A number of options are being tried to address the portfolios of small but annoyingly persistent longest-tail claims, including resale and more focus on operating expense when reviewing the trade-offs in settlement strategy. Other players have grown their way out of the problem, targeting new portfolios with similar liabilities to recreate a sustainable scale of claims in any given area.

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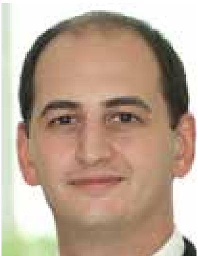
A Lloyd's perspective

Jerome Kirk
London Markets Lead
Partner
PwC UK



Edward Johns
Director
Transactional Services
PwC UK

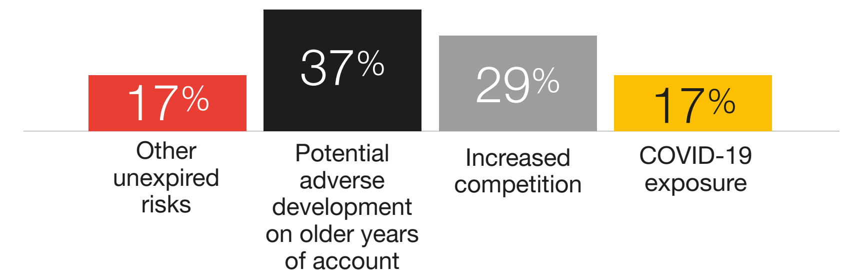
The Lloyd's market has continued to see high levels of legacy transactions, continuing the trend from the past two years. In the time since our Global Insurance Run-off Survey 2019 up to the end of 2020, there have been nine legacy transactions in the market, transferring liabilities of US$2.3bn. Survey respondents have noted they anticipate this will continue, driven in part by the uncertain impact of the COVID-19 pandemic, (re)insurers seeking to release capital from legacy business (allowing them to write new business where the market is hardening) and the continuing profitability drive by Lloyd's which has led to lines of business and whole syndicates being placed into run-off.

Figure 12 illustrates respondents' views on the biggest issues affecting pricing on Lloyd's portfolio opportunities. The most important issue is potential adverse development on older years of account, with 37% of respondents believing this is the biggest issue. This is unsurprising given that soft market conditions of 2013-17 have placed increased pressure on reserves for these years and we have already seen reserves strengthening in some areas. Given the increased desire for run-off participants to enter the Lloyd's market, it is not surprising that second place is seen as increased competition, with 29% of respondents seeing this as the biggest issue. A number of legacy consolidators have established or acquired Lloyd's platforms, with several others seeking to gain entry. The Survey also identified that a relatively large proportion of respondents believe COVID-19 exposure is having an effect on pricing of portfolios; however as the impacts of COVID-19 become clearer, its influence on the pricing of portfolios will lessen in significance.

After nearly two decades, the rating environment in the Lloyd's insurance market is hardening across most major lines of business, witnessed most prominently across Property and Casualty lines. This is a response to the run of catastrophe losses (e.g the California Wildfires, and Hurricanes Maria, Irma, Harvey and Laura), consistently low interest rates and years of excess supply which has come to characterise the market. These market conditions, already prevalent at the start of 2020, have been compounded by the onset of COVID-19 as syndicates look to recoup potential losses and reconcile themselves to the inevitable economic downturn.

The hardening market conditions will likely create further interest and focus on releasing capital from back years as (re)insurers seek solvency capital to write new business at the improved rates and terms, thereby creating further opportunities for legacy transactions. However, this particular opportunity for the legacy market may be lessened due to the availability of capital from equity and debt issuances at the right price. Due to high levels of capital availability, there have been instances where legacy transactions with a purely economic aim (that is, no operational finality through the transfer of claims handling) have not progressed because new, adequately priced capital was sourced instead. Either way, we expect the current and recent market conditions will continue to drive an active market.

Figure 12: What do you think are the biggest issues affecting pricing on Lloyd's portfolios?



Source: PwC

Global spotlight

United States

Keith Palmer
Partner
Assurance
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Melissa Holt
Director
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Market size and opportunity

The US continues to be the largest single-country market of legacy liabilities, with the estimated amount of legacy liabilities in the US increasing from US$348bn to US$385bn since our last Survey, though this should be of no great surprise given the size of the US economy and the relative penetration of (re)insurance products. While legacy market consolidators have long operated in the US market, a significant proportion by virtue of legacy APH books written through the London market with largely US policyholders, many are exploring opportunities to assess and act on growth strategies within the domestic US market.

The drivers for these opportunities include the need to grow beyond the traditional London market portfolios that have been transacted in for decades along with a greater appreciation amongst brokers and cedants as to how run-off solutions can assist them in the execution of their own business plans. The market provides for a range of flexible reinsurance options that offer cedants the right level of security and operational finality that can, among other benefits, release capital and allow management greater time to focus on areas more aligned with their organisations' strategies. Given the current hard-market conditions, the combination of the redeployment of capital while competing on bottom line operational expenses is likely to intensify the market for legacy liability transactions.

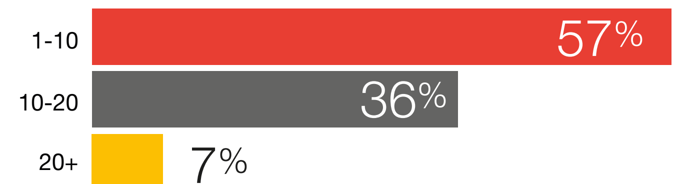
As part of the growth strategy, in order to actively manage legacy claims effectively, legacy market participants are more likely to partner with or acquire claims handling operations with multi-state and line of business expertise. This may be a beneficial aspect of any growth strategy in the US given the diverse nature of regulatory and legal regimes across the 50 states where cedants operate. As legacy market participants further demonstrate their expanding expertise and capabilities to effectively and efficiently manage a more diverse range of claims, it will expand the burgeoning opportunities in the market as brokers' and cedants' confidence in legacy market participants' abilities grows.

Finality

The same drivers that have increased reinsurance transactions in the US market have given rise to further consideration across a number of states as to how full legal finality may be achieved to supplement the benefits of reinsurance. Legislation including IBT and Division Statutes has been enacted across a number of states, but to date is still relatively untested. Through December 2020, there have been two IBTs that have been approved by the Oklahoma commissioner – one being a transfer between intra-group companies and another between two unaffiliated entities.

In order to gauge market sentiment regarding the potential for more transfers to follow these, we asked Survey respondents how many IBTs and/or divisions they believe may occur over the next three years. As illustrated in Figure 13, respondents largely believe that there would be a limited number of these transactions, with 57% saying there will only be between 1 – 10. Only a small minority, 7%, believed that there would be 20 plus transactions of this nature. This sentiment is likely due to the untested nature of these types of transactions in the US legal system and a hesitance as to how quickly cedants will desire to move away from the traditional reinsurance solutions that have been in the market for decades. Whether or not there are many IBTs and/or divisions over the coming years, it is clear that Survey respondents believe that this will be a very active market as noted in our deals section. Given the US market's maturity and historical significance to the legacy market, Survey respondents appear to believe it could be a driver of continued growth of the market.

Figure 13: How many IBTs and/or divisions do you think will occur over the next 3 years?



Source: PwC

Sanjay Jain
Partner
Middle East Insurance Lead
PwC Middle East

Middle East

The Middle East insurance market continues to be characterised as fragmented and under-penetrated. Profitability remains difficult to maintain due to sustained downward pressure on pricing, coupled with high expense ratios and increased regulatory scrutiny – this is particularly true for the smaller operators within the region. These market conditions continue to result in sustained levels of run-off activity, a recent example of which being a prominent regional reinsurer placed into run-off during the third quarter of 2020.

It is pleasing to see the inclusion in the Survey of a run-off reserve estimate for the first time and, at US$13bn (see Figure 8), highlights that the Middle East has developed into an important market. Increased run-off activity within the region is also beginning to shift the perception that run-off is an indicator of failure; it is no longer associated with the instant demise of a market participant. This heightened activity in the market is further attracting the attention of increasingly sophisticated regulators who are invested in ensuring orderly run-offs.

With the growing activity and increasingly sophisticated regulatory landscape, it is becoming progressively more attractive to run-off consolidators frequently seen in more developed run-off markets. Although, for now, penetration remains low with minimal deal activity, opportunities are becoming ever more present.

COVID-19 has displayed a major impact on insurers' priorities within the region, with strategic consideration being brought to the forefront of the agenda. Given the need for scale and significant investments required in digital/technology upgrades, COVID-19 is clearly acting as a catalyst for the much-needed consolidation in the region. This has been witnessed particularly in the United Arab Emirates and the Kingdom of Saudi Arabia, with the announcements of a number of insurance M&A transactions in the last 12 months and the trend is only expected to gain further momentum across the region.

Dennis Schnittger
Senior Manager
Assurance
PwC Germany

Germany

Over the past years and months, legacy measures continue to play an important role on the agenda of executive management in the German insurance industry driven by regulation and the low interest rate environment. While legacy transactions in the life insurance industry had strong publicity, the non-life legacy business was often handled internally by the insurers.

Facing the Solvency II capital requirements and the impact of the Solvency II review, we see insurers reassessing their business decisions leading to additional portfolios stepping into run-off.

In the non-life sector we are seeing capital intensive business become subject to run-off, while in the past run-off was mainly an option for long tail business or specific risks such as Asbestos or Medical Malpractice.

Furthermore, there are tendencies to clean up the portfolio mix and focus on key areas, subsequently portfolios which are already in run-off, and where scaling effects are decreasing over time, will be sold.

Given this increased variety in legacy portfolios, external run-off might become a more attractive solution for insurers, as they look to free up their capital to focus on growth in their key business segments. Legacy solutions are therefore moving further in the focus of insurers and legacy specialists are offering a wide range of solutions from traditional run-off solutions to roll over solutions, which are tailored to the individual needs of their clients.

However, insurers need to have a clear view on the capital and financial impact of the different kind of solutions based on available data and enhanced data analytics procedures.

James Ferris
Partner
Advisory
PwC Bermuda

Bermuda

2020 saw the continual growth of Bermuda's reputation as a place for run-off excellence. The likes of Compre established its Bermuda operations in the year, along with a capital raise, and we saw Darag's Bermuda entity established in 2020 increase its deal flow.

We expect further establishment of Bermuda entities from run-off players into 2021 pointing to the Bermuda Monetary Authority (BMA) becoming a significant regulator in respect of run-off operations globally, as well as group supervisor of significant amounts of US and UK/European liabilities.

With this critical mass, we expect the Bermuda market stakeholders to continue developing the next generation of innovation for Bermuda to keep it at the forefront of legacy solutions. While 2020 saw a Bermuda domiciled consolidator complete its first US IBT, Bermuda has not yet developed its own framework for IBT akin to the Part VII process, something which may be required in time to support the industry.

The year also saw Bermuda being placed on the National Association of Insurance Commissioners (NAIC) List of Reciprocal Jurisdictions effective 1 January 2020, which we expect to only increase the attractiveness of reinsuring into the territory and the solutions that can be developed.

We may see strong demand for Bermuda specific legacy solutions in the coming years as the 2021 renewal season suggests pricing of new contracts is hardening, which will put those reinsurers with capital intensive legacy business in the spotlight. To maximise investor returns, established insurers should be looking at ways to effectively pass legacy liabilities into the run-off market and recycle the capital into more profitable underwriting.

Alan Augustin
Director
Liability Restructuring
PwC UK

Asia-Pacific

The Asia-Pacific region has continued to experience a large variation in run-off activity. In certain markets, such as Australia, Singapore, Hong Kong and Malaysia, there has been development in legacy activity where transactions have been executed, for example the significant Asia Capital Reinsurance Group (ACR) acquisition that touched many territories. However, in the most part, there has only been modest appetite and uptake of run-off solutions, particularly with local (re)insurers, with little synergy or collaboration across countries.

This though may change with the evolution of more sophisticated regulatory regimes in territories such as South Korea and Hong Kong, fuelled by IFRS 17 and the shift towards risk-based capital frameworks, which are emerging alongside progressive restructuring processes too. For example, in Singapore, C142 of the Insurance Act allows for the transfer of (re) insurance business, with much similarity to the UK Part VII process.

This development of the market is leading to more established participants considering and implementing capital-driven legacy solutions and global players familiar with restructuring success in other territories have sought exits in the region. However, transaction volumes have remained relatively low compared to other territories, in particular given the lack of significant latent reserves locally.

As a result, much effort has been around raising awareness of run-off solutions rather than being transactions led but it is expected that, with positive engagement, this is a region with much promise and our view is that deal volumes will increase as the market continues to evolve.

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Methodology

This year marks the thirteenth edition of our Survey. As in previous years the focus is on the non-life 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 individuals 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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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.

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