

Fourth Edition  
March 2010

# Unlocking value in run-off

A Survey of Discontinued Insurance Business in Europe





Cologne Cathedral, Cologne, Germany

# Foreword

The PricewaterhouseCoopers\* (PwC) Survey of Discontinued Insurance Business in Europe, now in its fourth year, has become an important tool in understanding how legacy liabilities are viewed across Europe. Invaluably it also highlights how the stance of stakeholders has changed.



**Paul Corver**

Chairman, Association of Run-Off Companies Limited (“ARC”)

There seems to be an increased desire in Europe to address old legacy books of business exemplified by recent activity such as the sale of BF Rückversicherung and the solvent scheme of arrangement (“Scheme”) promoted by Global Re for its German business assumed from London. Whilst solvent Schemes have seen increased issues in the last year, for example the Scottish Lion decisions, the run-off sector will come out stronger and greater clarity as to the application of the solvent Scheme process will be achieved.

As we rush towards the advent of a new Europe wide regulatory regime in 2012, companies continue to assess how best to organise themselves to maximise capital efficiency. Alongside rationalisation of subsidiaries and branches, a natural pruning of unwanted legacy liabilities is becoming more acceptable amongst the usually more traditional European carriers. Even the companies that choose to retain those liabilities will ensure that they are not the ‘poor cousin’ to active underwriting.

However, there are storm clouds on the horizon with the recent European Court of Justice (“ECJ”) decision concerning Value Added Tax (“VAT”) on reinsurance transfers. Whilst the desire to rationalise ahead of Solvency II will inevitably continue, this issue will have to be addressed.

Commutation activity is on the increase, brought on by companies taking a more pro-active stance towards counterparty credit risk which has been propelled into focus by the economic difficulties of the last 18 months. A well managed and targeted commutation program is an effective way of reducing such exposures. Moreover, with Solvency II looming, the application of the new rules will become far easier with fewer questionable debts on the books. Additionally, with the resurrection of LMX spiral claims arising from the recent judgment on the old Exxon and Kuwait liabilities, there will inevitably be a flurry of commutation negotiations between affected parties that will undoubtedly stretch across into Continental Europe.

The London legacy sector is alive and well – if that is not a contradiction of terms – and we see the European marketplace beginning to recognise run-off as a distinct part of the insurance cycle. As Europe becomes ever closer, so seemingly does the handling and treatment of legacy liabilities.

\* “PricewaterhouseCoopers” refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom).

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# Introduction

Welcome to the fourth edition of the PricewaterhouseCoopers Survey of Discontinued Business in Europe (“the Survey”) which we are once again proud to present in conjunction with ARC. I would like to thank everyone who has taken the time to complete our online questionnaire and share their views on run-off across Europe.



**Dan Schwarzmann**  
Partner, PricewaterhouseCoopers LLP

This time last year we presented our Survey results in the midst of the global financial crisis. During the last 12 months some stability has returned but all areas of the Financial Services sector continue to face challenges.

The insurance industry has weathered the storm better than most but European insurers have been focusing on the key themes of cost containment and enterprise risk management. In addition, the continuing journey insurers face in preparing for Solvency II's implementation is presenting challenges and opportunities. These factors are sparking a marked increase in focus across Europe on discontinued operations and, consistent with the Survey in past years, there has been a growing trend for respondents to have strategic plans in place for legacy operations that

align with overall business objectives. On a day to day basis we are also seeing a growing number of large European companies conduct thorough analyses to implement best practice run-off techniques aimed at delivering real value.

Despite the tough economic conditions we continued to see plenty of activity in terms of run-off transactions. Pleasingly, we were spoilt for choice in highlighting significant transactions in our review of 2009 on pages 7 to 8. For example, last year saw the Equitas Part VII transfer on which PwC advised, alongside consolidation amongst UK run-off providers and a healthy deal appetite from the traditional run-off acquirers. Our Survey respondents also predict that there will be many more deals in the run-off sector over the next two years with over 60% predicting more than five transactions taking place over that timeframe.

2009 also saw some landmark legal decisions which will help influence the run-off strategy of many insurers. The appeal relating to the Scottish Lion solvent Scheme, another matter on which PwC advised, clearly reaffirmed the use of solvent Schemes as an exit, while the decision of the ECJ in relation to VAT on reinsurance transfers provides a further cost consideration to parties seeking to transfer portfolios.

## Introduction

This year in our Survey we posed some new questions around what keeps participants awake at night and what they will do to stay ahead in the run-off market. We received many thought provoking responses and have included a sample of them in this Survey.

From a personal perspective, it is encouraging that Continental European businesses are carefully considering their discontinued operations. However, progress in delivering finality and unlocking value in run-off has been slow. Now is the time to be bold and our Survey suggests that taking positive steps to exit discontinued portfolios will be the next stage for many European organisations.

I hope that you find the Survey stimulating reading and that the results provide some food for thought and continue to widen the debate about discontinued business across Europe. We are very grateful to all those who took part in this Survey and the PwC team looks forward to assisting clients in implementing value focussed solutions throughout the next year.

A handwritten signature in black ink, appearing to read "Dan H.", followed by a long horizontal line extending to the right.

# Summary



Louvre Museum, Paris, France

# Key results

## Run-off challenges and reaction to the financial crisis

Tied up capital remains a challenge for the owners of discontinued insurance business, but concerns around the availability of exit mechanisms and skilled resources have become more pressing than in previous years.

**44%** of respondents have experienced cost reduction initiatives at their organisation as a result of the financial crisis.

Only **12%** of respondents identified the financial crisis as being a major source of claims exposures over the next five years compared to **28%** a year ago.

### Summary findings

The financial crisis was an overriding concern of Survey respondents last year but is expected to have a limited long-term impact. While it has affected the operating structures of many insurers it is not predicted to be a major source of claims exposure.

## Managing run-off

**90%** of respondents have a strategic plan in place for dealing with their run-off business.

Of these strategic plans **78%** include a commutation strategy and **64%** contain exit strategies.

Almost **50%** of respondents have engaged in outsourcing aspects of their run-off business with claims and collection activity being the most frequently outsourced activities amongst Continental European insurers. Only **8%** of respondents had outsourced commutation activity.

### Summary findings

Compared to the findings in previous editions of this Survey, run-off is now more than ever the subject of strategic plans that have an increased focus on exit.

## Restructuring and regulation

Efficient capital management is expected to be the primary driver of restructuring activity in Europe in the next **five** years, consistent with the results of last year.

Solvency II is expected to have a wide-ranging impact with **62%** of respondents predicting increased acquisition activity and **68%** expecting a growth in focus on discontinued business and exploration of exit options.

Whilst **55%** of respondents anticipate a greater cost of capital as a result of Solvency II, only **16%** expect their own organisations to exit lines of business due to this factor.

### Summary findings

Capital concerns remain a key driver of restructuring activity and these will increase the spotlight on discontinued operations. Compared to last year, Survey respondents indicated that Solvency II is expected to have a more fundamental and widespread impact on insurance business.

## Exit

Commutations continue to be the most widely used exit tool. Respondents believe that commutation activity is likely to decrease over the next **five** years with an increase in structured exits.

Long-tail claims and counterparty interest again feature highly when respondents cited the major obstacles to obtaining finality.

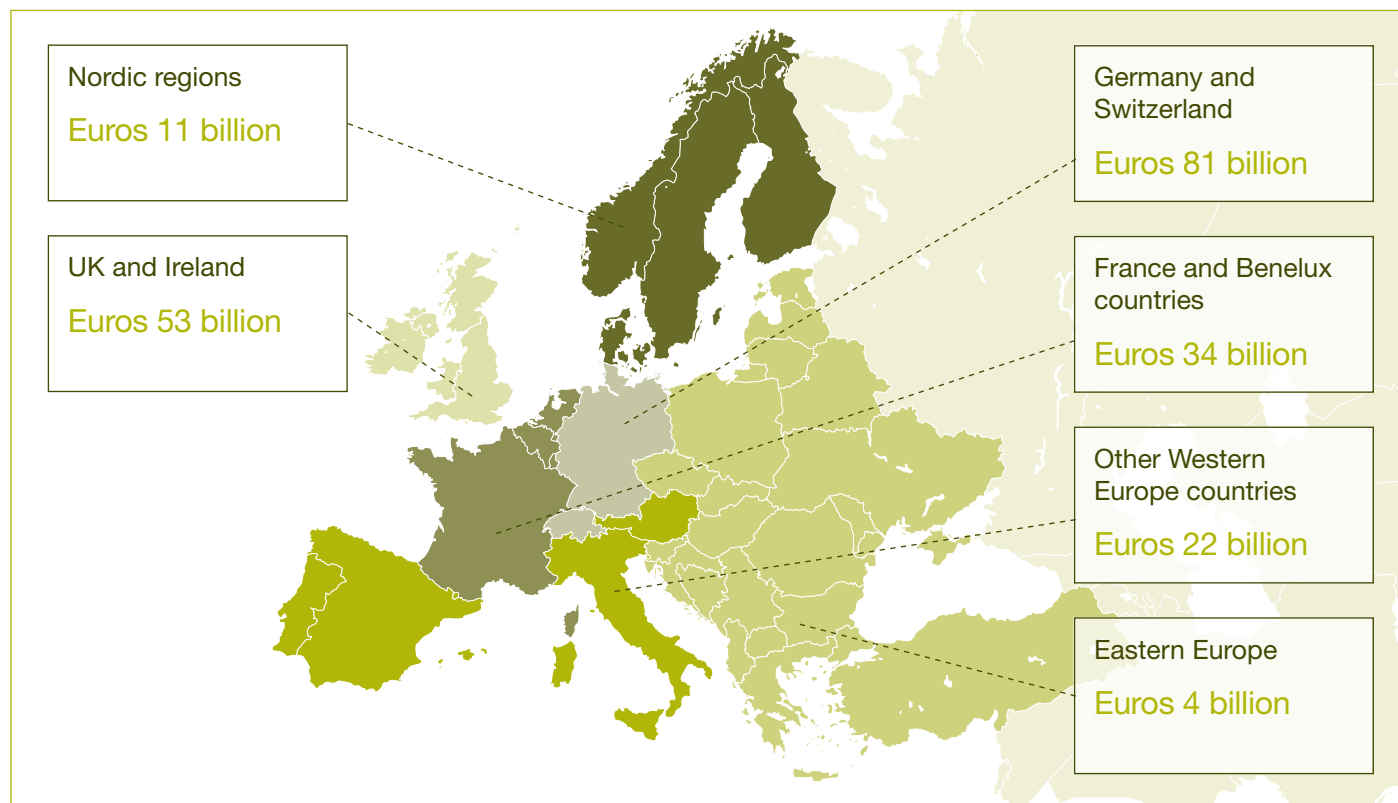
The focus of commutation activity is on inwards exposures with some **16%** of respondents having completed more than **50** commutations in the past year.

### Summary findings

The results suggest that current strategic plans are centred around carefully removing major and potentially volatile exposures. Relative to previous years there is a more emphasis on the future utilisation of structured exits, such as solvent Schemes or transfers, to bring finality to legacy portfolios.

# Market size and review of key developments

We estimate that the size of the non-life European run-off market is now approximately Euros 205 billion. European insurers have ceased writing certain product lines such as financial guarantee and credit insurance and this has driven an increase in run-off which is partially offset by continued commutation activity in the existing run-off sector.



The past year has seen significant developments in the insurance restructuring sector across Europe. This includes acquisition activity, the implementation of strategic initiatives by a number of major industry players and some key legal decisions. We summarise below a selection of transactions from the past year:

### 01 Switzerland and UK: Business exits

There have been numerous exits from discrete business lines and products across Europe in the non-life and life sectors, either in reaction to the financial environment or with an eye towards the impending regulatory changes. Examples include Swiss Re's exit from financial guarantee business and structured credit default swaps, as well as Axa's exit from annuity business which cited anticipated capital requirements under Solvency II and the credit insurance market where a number of insurers have withdrawn cover.

### 02 Belgium: Solvency II developments

The Committee of European Insurance Supervisors ("CEIOPS") continued to publish Consultation Papers throughout 2009 on the key elements of Solvency II. CEIOPS is developing further guidance and is providing assistance to the European Commission with technical input for the Fifth Quantitative Impact Study ("QIS5") due to take place during Summer 2010.

### 03 UK: Solvent Schemes

The Scottish Lion solvent Scheme was challenged in 2009 only for the judgment to be overturned on appeal during January 2010. The clarity of the appeal judgment should ensure that solvent Schemes will continue to feature as a key exit mechanism for insurance run-off portfolios as well as in a much wider non-insurance restructuring context. It also dispels any uncertainty in the marketplace following the BAIC case and makes clear solvent Schemes can be used to compromise insurance arrangements.

### 04 Ireland, Switzerland, Netherlands and Luxembourg: Corporate redomestication

Tax friendly EU jurisdictions continue to attract major insurers re-domiciling from non EU locations. XL Capital chose to relocate its holding company to Ireland from Cayman early in 2009, and that was followed later in the year by both Aviva and Zurich. Brit also relocated its holding company to the Netherlands.

### Market size and review of key developments

#### 05 France and Germany: Run-off acquisition

In December 2009 Axa Liabilities Managers announced its acquisition of BF Rückversicherung, a German non-life run-off. The transaction signalled the intent of Axa Liabilities Managers to expand into the external run-off market.

#### 06 UK: Run-off service provider acquisition

In September 2009 Tawa announced its acquisition of PRO Insurance Solutions from Swiss Re. Tawa stated that the acquisition was in line with its strategy to develop a diversified portfolio of run-off businesses. This, and other transactions such as Charles Taylor Consulting's purchase of Axiom, support the generally held prediction of consolidation amongst run-off service providers.

#### 07 UK: Run-off acquisition

In June 2009 Catalina entered into a share purchase agreement with Alea Group to purchase Alea UK. The transaction was reported to have proceeded at a slight discount to book value indicating that the appetite for run-off books amongst specialist acquirers has not been significantly impacted by the financial crisis.

#### 08 Germany and Switzerland: ECJ ruling on reinsurance transfers

The ruling related to the transfer of a portfolio of reinsurance contracts by Swiss Re in Germany to an associated Swiss company. The decision taken by German tax authorities that found that the transaction was a supply of services and liable to VAT has been upheld by the ECJ and now applies to all

EU member states. The impact of the ruling has yet to play out in terms of its effect on insurance business transfers but will add a further significant consideration in evaluating the benefits of cross-border restructuring activity.

#### 09 UK, Denmark and Sweden: Run-off acquisitions

Enstar continued to expand its stable of European run-off acquisitions through the purchases of British Engine from RSA, Copenhagen Re and Forsakringsaktiebolaget Assuransinvest. Our Survey predicts there is likely to be continued run-off sale activity.

#### 10 Belgium and Netherlands: Bancassurance separation

The continued fall out from the financial crisis impacts the banking and insurance sectors. In November 2009 the European Commission approved a restructuring plan by the Belgian banking and insurance group, KBC, to divest specific insurance and banking units. In addition the Commission also approved a restructuring plan for ING that includes a complete separation of its banking and insurance operations.

# Survey results

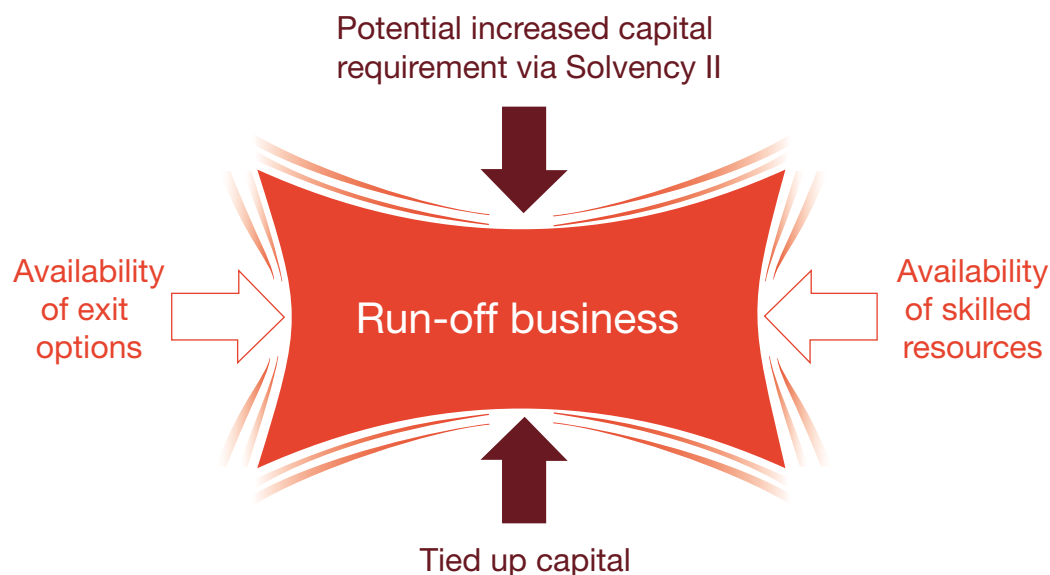


Norwegian Royal Palace, Oslo, Norway

# Run-off challenges and reactions to the financial crisis

In each of our previous two online questionnaires respondents voted tied up capital the most prominent challenge facing Continental European insurers, followed by operational costs and adverse loss development. In our latest Survey respondents again highlighted capital constraints as a significant challenge but also cited the availability of exit mechanisms and skilled resources to deal with the pressures presented by discontinued business as key challenges.

Figure 1: Run-off challenges

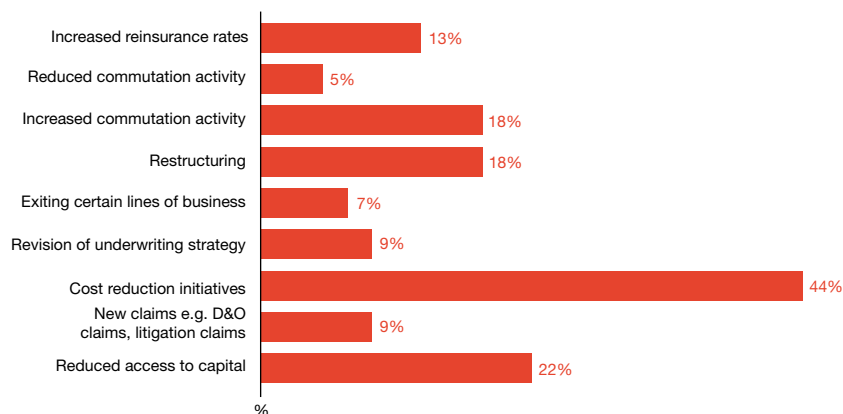


The focus on lack of availability of exit mechanisms initially surprised us. However, as we considered the overall set of Survey responses it was clear that the profile of run-off in Europe and the desire to exit appears to be increasing. As run-off rises up the corporate agenda, the challenges it poses are likely to be considered by executives with less experience of the types of exit mechanism available, which may be driving this result.

In addition the Survey responses this year identified preparation for Solvency II as a major challenge. The current concerns that Solvency II will result in a significant increase in capital requirements, particularly in supporting run-off business, put the capital tied up in run-off into even sharper focus.

In the third edition of the Survey the potential impact of the financial crisis was a key theme. In this edition, we asked participants to identify how the financial crisis impacted their organisation. Some 44% of respondents indicated that they had undertaken cost reduction initiatives and 22% indicated that the financial environment had contributed to reduced access to capital. There has

Figure 2: Impact of financial crisis



Source: PricewaterhouseCoopers LLP

been an acknowledged reduction in private equity interest in the sector and anecdotal feedback suggests banks have been reluctant to provide capital at rates which acquirers consider reasonable. Our Survey also indicated that the economic crisis has resulted in increased commutation activity as reinsurers have been willing to pay for certainty at a price that cedants have considered acceptable in balancing cash versus security.

As Europe begins to see the first green shoots of an economic upturn it will be interesting to see whether the increased focus on discontinued operations continues. The signs we are seeing illustrate that the interest in generating value from run-off portfolios is here to stay.

# Management and structure

## How does your organisation define run-off business?

The results of the Survey indicate that the views of respondents in respect of the definitions of run-off business remain largely unchanged from last year. Some 82% defined run-off as lines of business which are no longer written. 27% of respondents stated run-off is defined as business that is with a party where there is no on-going business relationship. We have noted a growing concentration and consistency of responses to this question over the past three years.

Whilst this Survey concentrates on the non-life run-off market, parallels can be drawn with the life and pensions market across Europe. The definition of run-off when applied to life assurance covers products which are no longer sold but are still on the books, often with premiums still being paid. The difference with non-life business is that these policies may have considerably longer to run-off, often extending to 50 years or more. This represents a challenge in terms of providing capital support, maintaining product knowledge and ensuring cost effective but high quality service to customers.

## At what point in time does your organisation classify business as being in run-off?

A number of respondents to the Survey in previous years suggested time related alternatives when defining run-off. This year's Survey participants were asked to provide information on the point in time at which business is classified as being in run-off. Over 25% classify business as entering run-off at the date of expiry. A further 20% took a more long-term view and considered business to be in run-off only after more than five years from when the policy expired.

Alternative answers indicated that the classification of run-off in a business is also driven by specific portfolio or business line circumstances, rather than on a strict timing basis.

### What keeps you awake at night?

“ To find and structure the right solution in a given case, as each one is different ”

“ None – everything is manageable with the right preparation and expertise ”

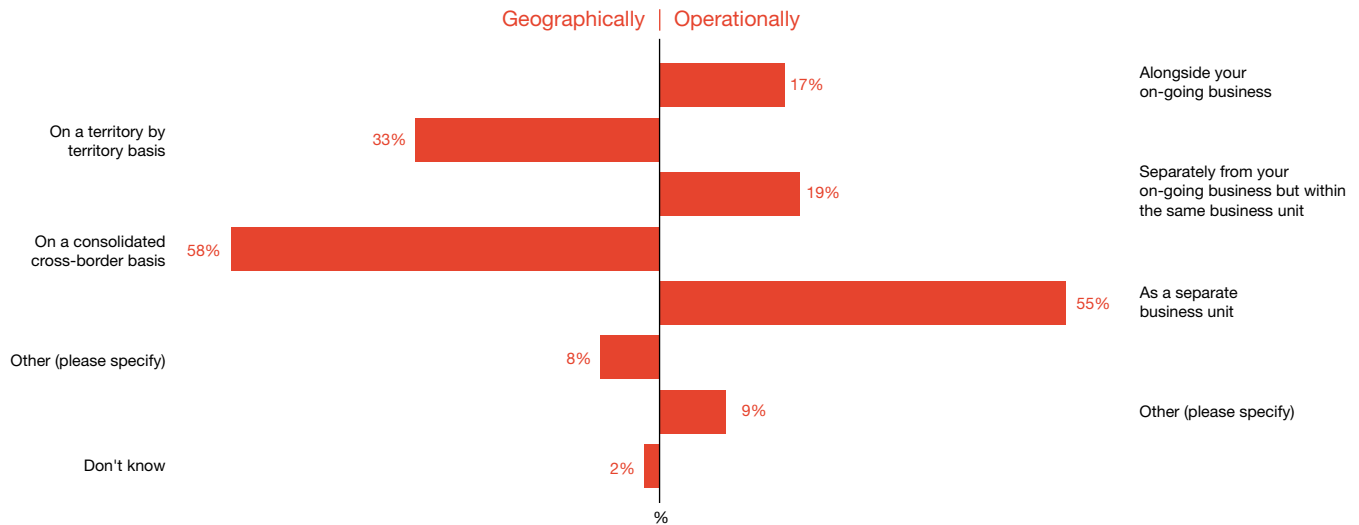
## How is your organisation's run-off business managed?

The Survey indicated that managing run-off as a separate business unit remains the most popular response at 55%, as businesses recognise the specific skills required to deal with run-off.

On a geographical basis there is a stronger trend than last year towards run-off business being managed on a consolidated cross-border basis, increasing from 49% to 58% of respondents. This may explain developments in insurance business transfers as a means to consolidate business. To support

this, in response to the question asking Survey participants to consider 'Has your organisation been involved in any of the following activities in the Continental European run-off market?', 82% indicated that their organisation had been involved in either consolidating entities or cross-border transfers.

Figure 3: Management of run-off business in Europe



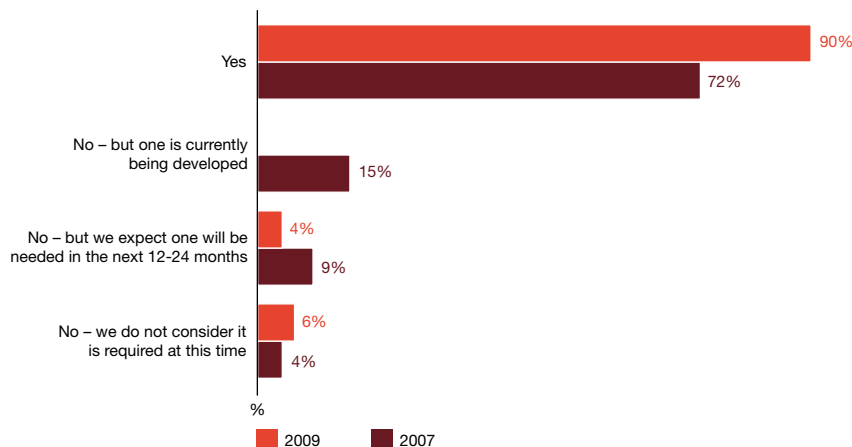
Source: PricewaterhouseCoopers LLP

## Management and structure

### Does your organisation have a strategic plan for dealing with its run-off business?

In the second edition of the Survey we commented on the trend towards an increasing number of respondents having developed a strategic plan for dealing with run-off business, with 72% of respondents having such a plan. This trend has continued in this year's Survey, with 90% of respondents now confirming that such a plan exists.

Figure 4: Any strategic run-off plan? 2007 and 2009



Source: PricewaterhouseCoopers LLP

What will you be doing to stay ahead in the run-off market in 2010?

“ Focus on our competitive advantages and strengthen human and financial resources ”

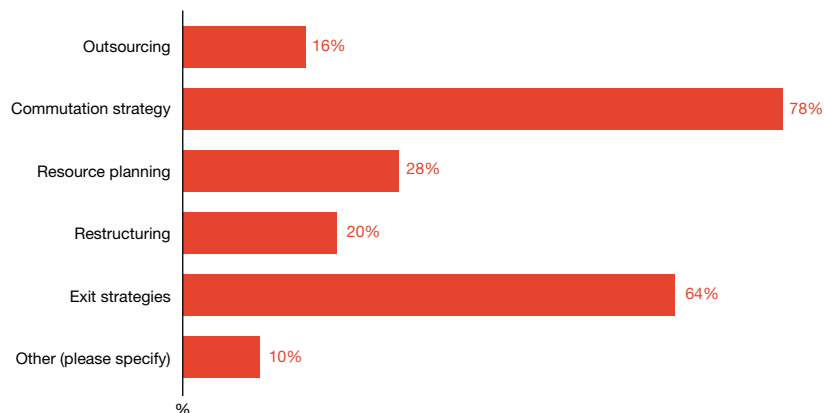
“ Reassess, adjust if necessary, and follow-up on the strategy ”

“ Continue implementing the specified strategy for the different run-off portfolios ”

## What are the key features of the strategic plan?

Overall, the two most popular responses to this question were commutation strategy with 78% of respondents, and exit strategies with 64%. Whilst 59% of Continental European Survey participants indicated that exit strategies were a key feature of their plan, 89% of UK based respondents took this view. This suggests Continental Europe is less certain as to the availability and applicability of exit mechanisms that have been a feature of the London Market approach over the past decade.

Figure 5: Key features of strategic plan



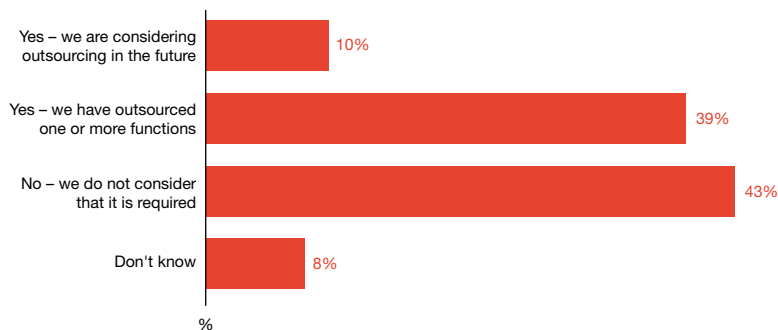
Source: PricewaterhouseCoopers LLP

## Management and structure

Has your organisation considered outsourcing any of its functions?

Which areas have you outsourced already or are considering outsourcing?

Figure 6: Considered outsourcing?

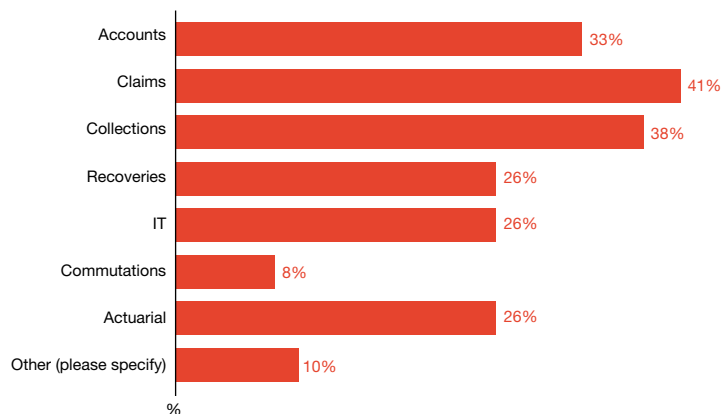


Source: PricewaterhouseCoopers LLP

In the context of strategic run-off plans, one of the suggested options for business with discontinued operations was outsourcing. Whilst only 16% of respondents took this view, over half had already outsourced or were considering outsourcing certain functions. This suggests that respondents believe outsourcing to be more of an operational, rather than a strategic, decision.

Survey participants were also asked to confirm the functions that they had already outsourced or were considering outsourcing. In this area there were some significant differences between Continental Europe and the UK. Perhaps the most significant was the average number of functions outsourced, with an average of less than two functions in Continental Europe, compared to over three in the UK.

Figure 7: Areas outsourced or considering outsourcing



Source: PricewaterhouseCoopers LLP

There was also variation in the functional areas being outsourced. In Continental Europe, the two most popular options for outsourcing were claims and collections, compared to the UK where the two areas of focus for outsourcing were accounts and IT. The differences here may be in part caused by the contrasting skilled resources available in those areas.

# Claims

How much longer on average do you expect your run-off business to take to reach natural expiry?

6%	0-3 years
10%	3-6 years
32%	6-10 years
47%	>10 years
5%	Don't know

A potential benefit of a strategic run-off plan is the reduction in the time it will take for a business to reach natural expiry. A proactive plan is, for example, likely to feature commutation and exit activity that will accelerate closure. The Survey indicates there has been a slight reduction in run-off business expected to expire in more than 10 years, from 52% to 47%. This is followed in popularity by business being expected to expire in between 6 and 10 years time. The Survey has posed this question over the past three years,

and the responses do not indicate a material year on year reduction in the amount of time that respondents think their run-off business will take to expire. The limited changes in this answer suggest that the majority of Survey participants are not planning to implement portfolio wide exits in the near term. This is supported by the results of other questions asked in the Survey, including for example that commutations are expected to remain the most popular exit mechanism over the next 12 months.

What keeps you awake at night?

“ APH liabilities, unknown unknowns ”

“ New latent claims ”

“ Asbestos, pollution, new pharmaceutical products ”

## What do you think the major claims exposures from Continental European (re)insurers will be over the next five years?

41%	Climate related e.g. floods and hurricanes
12%	Asbestos
12%	Financial crisis
12%	D&O claims
8%	Don't know
8%	Pharmaceutical claims
6%	Other (please specify)
2%	Lead paint

Over the past year there have been significant movements in the views of what the major claims exposures are likely to be for Continental

European businesses. Climate related claims, such as hurricane and flood damage, remain the most frequent response. However, there has been a large jump in the proportion of respondents that have this viewpoint, changing from 30% to 41%. This may reflect the fact that the relatively quiet catastrophe seasons in recent years means more organisations have exposed themselves to significantly more risks in this area. Our results indicate a swing in popularity towards this answer alongside a drop in the proportion of Survey respondents who identified the financial crisis as being the source of major claims exposures over the next five years. We have not yet experienced a significant rise in D&O claims as a result of the financial crisis and our respondents indicate that they do not expect this to constitute a significant risk in the future. Our own experience suggests that it may be too early in the claims experience of these classes to be certain that this is the case.

## Where will these claims exposures emanate from?

45%	United States
33%	Continental Europe
12%	Don't know
8%	London Market
2%	Asia

Whilst respondents still consider that the USA will be the most likely source of claims, they have moved away from suggesting the London Market will be a major source of claims. Instead, respondents believe that claims are more likely now to emanate from Continental Europe.

# Drivers for change

Which of the following drivers do you believe will influence the restructuring activities of Continental European (re)insurance groups over the next five years?

Compared to last year, there is more of a trend towards respondents identifying drivers for restructuring. For 79% of Survey participants, more efficient capital management remains the driver considered to be most influential. This suggests that the economic and regulatory climates are continuing to focus the minds of respondents on capital issues and effective utilisation of this scarce resource.

The second most popular answer remains, as last year, the ability to deal more effectively with discontinued business. There has been a significant increase however in the popularity

of this response, with an increase from 41% to 53%. This jump is driven by a particularly significant movement in opinion in Continental Europe, changing from 36% to 52% of respondents. This suggests that Continental European insurers are recognising that passive management of discontinued operations is not a viable option. This also ties in closely with other Survey results that indicate a greater focus on strategic run-off plans.

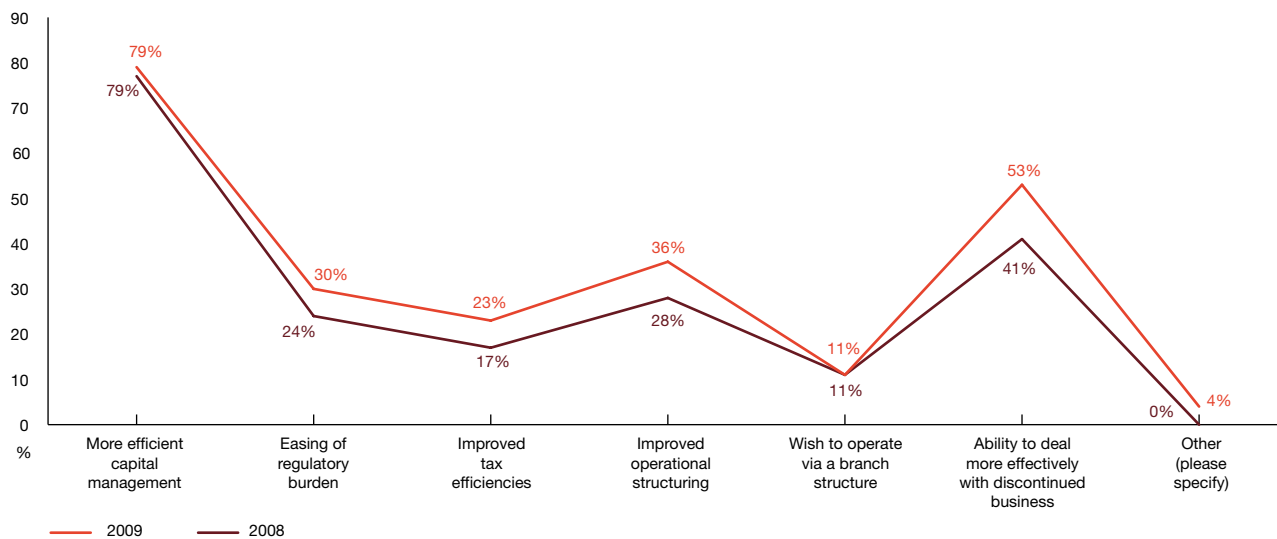
What will you be doing to stay ahead in the run-off market in 2010?

“ Active participation in the market wide discussions of finality options and specific individual discussions / negotiations with counterparties ”

“ Learn more about Solvency II ”

“ Reduce costs ”

Figure 8: Drivers influencing restructuring activities



Source: PricewaterhouseCoopers LLP

# Regulation and restructuring

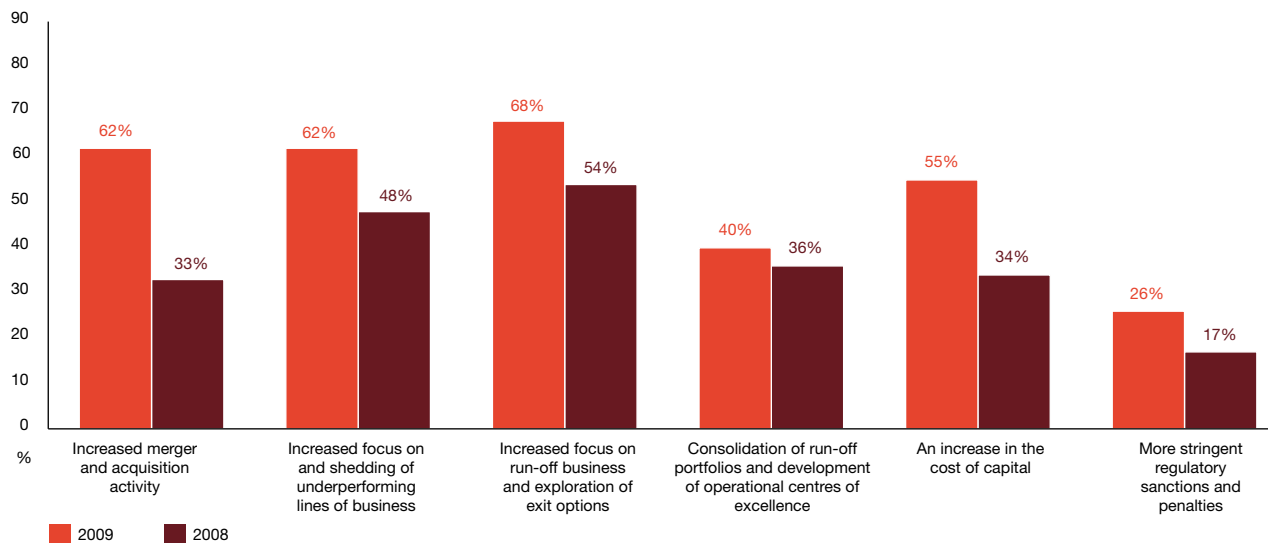
The opportunities and challenges presented to the European insurance community through the implementation of Solvency II in 2012 are gaining increasing focus. We have compared the results from the last two Surveys for the question ‘What do you think the practical implications of Solvency II are likely to be for

Continental European (re)insurers?’ and the results are illustrated in the graph below.

Insurers have digested, and are responding to, the feedback from the European Commission’s QIS4 and the technical material published by CEIOPS over the past 12 months.

As the graph indicates there has been an increase in all of the areas that respondents believe Solvency II will impact. In particular, 55% of respondents believe that Solvency II will result in a greater cost of capital compared to 34% last year. Recent studies have indicated that this cost could increase by as much as 60%

Figure 9: Practical implications of Solvency II



Source: PricewaterhouseCoopers LLP

and, with discontinued business commonly expected to be a capital intensive area, it is little surprise that some 68% of respondents predict that Solvency II will result in an increased focus on run-off and the exploration of exit options. As highlighted earlier, this is already happening with exit strategies being a core component of the strategic plans for dealing with run-off.

While 62% of respondents anticipated that Solvency II will result in an increased focus on and shedding of underperforming lines of business, only 16% of respondents expected Solvency II to result in their own organisation exiting certain lines of business. This would seem to be something of a mismatch and may indicate that insurers are not yet fully reconciled with the extent to which Solvency II will impact their own underwriting plans.

The impact of Solvency II on run-off business specifically has not been the subject of clear and defined technical advice from CEOIPS to date. Whilst the European Commission has welcomed and encouraged the interest of trade bodies such as ARC in seeking

to clarify the impact for run-off entities, responsibility remains with individual insurers to help bring the issues for run-off business into focus. There has been a significant increase in interest in taking part in the QIS exercises by respondents, but it remains concerning that 40% are not planning to take part in QIS5 and only 22% of those planning to participate will consider legacy business separately.

Over the last three years this Survey has indicated a growing awareness of run-off in Europe. This attitude is not confined to non-life business

as Solvency II is also driving activity within life companies. Life assurance business, with its high up front costs and new business strain issues, means that there is no place for 'wasted' capital supporting non-core portfolios in today's financial world where capital is at a premium. This will force life insurers to look at their legacy books, at the value that they are providing and at ways to release capital, such as reinsurance or sale. Ring fenced funds, such as "with profits" funds, will also need to capture restrictions or frictional costs incurred through moving capital.

What keeps you awake at night?

“ Solvency II ”

“ Regulatory changes ”

“ Inertia in Europe ”

# Exit

Our Survey indicates that exit considerations feature in two-thirds of the strategic plans respondents have in place for discontinued operations.

64% indicated that they had considered reinsurance or loss portfolio transfer options perhaps suggesting that economic rather than legal finality is a principle consideration. 61% of respondents advised that they had considered a sale or a solvent Scheme to deliver an exit.

Our review of key developments in 2009 indicates a steady flow of run-off sale transactions. Nearly a third of

respondents believe this trend will continue and predict more than 10 run-off sales will occur over the next two years.

The outlook for solvent Schemes as a core exit mechanism was clouded in 2009 by the opposition to the Scottish Lion solvent Scheme in the Courts. The overturning by the Appeal Court of the first instance decision at the end of January 2010, clarifies that solvent Schemes are a viable exit option that are capable of compromising insurance arrangements. This decision dispels any uncertainty in the marketplace following the BAIC case. It seems likely 2010 and beyond will

see an increase in solvent Schemes coming to market that were deferred pending the Scottish Lion appeal.

Surprisingly, given the predicted surge in activity in previous Surveys, only 48% of respondents identified insurance business transfers as a preferred exit option. The impact of the ECJ's decision on VAT applying to the transfer of reinsurance contracts may provide some justification for this apparent change in stance around transfers.

It is encouraging to see that discontinued business owners are increasingly considering structured

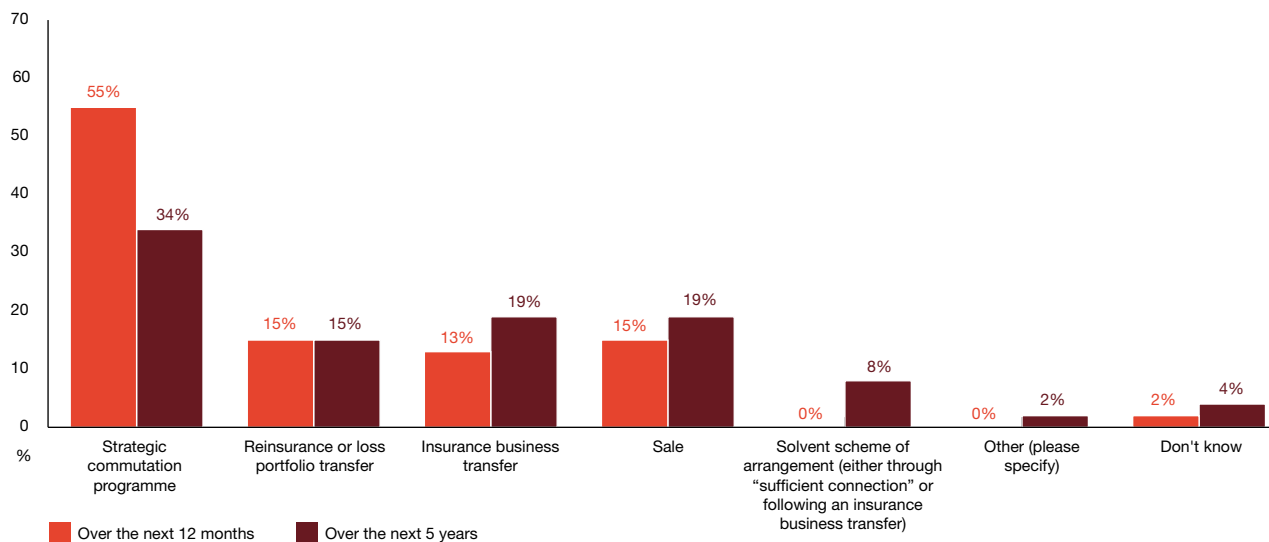
What keeps you awake at night?

“ Commutation appetites ”

“ The unwillingness of some cedants to start actively finalising their reinsurance liabilities ”

“ We believe the pricing of run-off portfolios has become too competitive ”

Figure 10: Exit mechanisms used most frequently



Source: PricewaterhouseCoopers LLP

exit strategies. That said, over the course of the next 12 months over half of our respondents indicated that downsizing run-off portfolios through commutation activity would be the most popular form of exit. Perhaps influenced by the Scottish Lion first instance decision, respondents did not anticipate any new solvent Scheme activity in the next year. There was an even split of around 15% of

respondents selecting sale, business transfer or reinsurance as the most commonly used exit mechanism. Looking to the future, the popularity of commutations is expected to decline somewhat with 34% of respondents still expecting commutations to be the most commonly used exit tool over the next five years. 8% of respondents predicted that solvent Schemes would be used most

### Exit

commonly in that timeframe with 20% of predictions identifying sale or insurance business transfer as the future exit mechanism of choice. This indicates that European insurers remain content to deal with significant exposures on a piecemeal basis in the short term but will consider utilising structured exits to bring finality to their run-off books in the longer term.

In terms of commutation activity, Survey responses were aligned with the findings of previous years. 62% of respondents had completed up to 30 inwards commutations over the past year. A further 26% of respondents had experienced an intensive 12 months of deal-making, confirming that over 30 commutations had been

concluded. On the reinsurance or retrocession front we saw less widespread activity with 47% of respondents having completed up to 10 outwards commutations and a further 31% commuting between 10 and 30 reinsurance relationships.

We once again asked Survey participants what the single most important concern is influencing their ability to gain finality. Consistent with the findings of last year, long-tail claims proved the most frequent answer, being chosen by 40%.

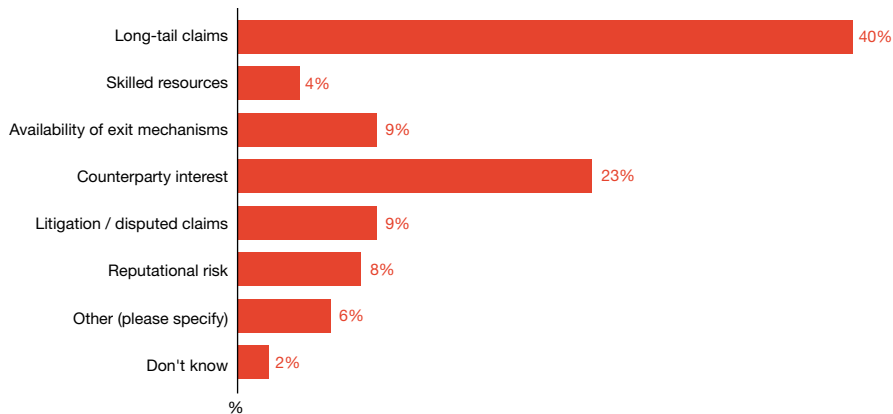
The second most selected response, also mirroring last year, was counterparty interest, which was chosen by 23% of Survey participants.

However, this reflects a 3% decrease from 12 months ago. Considering the volume of commutation activity that has taken place in the last year, this decrease might have been expected to be more considerable.

We also asked respondents to provide information on what they were doing to overcome the concerns associated with gaining finality for run-off.

While adequate exit solutions were acknowledged to exist, certain respondents stated they had chosen to retain the run-off risk to expiry. A number of respondents made it clear that they are utilising run-off specialists and seeking to recruit staff with particular run-off expertise.

Figure 11: Most important concern influencing ability to gain finality for run-off



Source: PricewaterhouseCoopers LLP

We also noted comments from live insurers that attaining commutations on discontinued lines with cedants was problematic because of the perceived strength of their security. Other respondents confirmed there were few targets or time limits in place for live organisations to bring finality to their discontinued lines.

As this Survey has indicated over the last three years, this view may reflect a traditional Continental European approach where

discontinued operations typically exist alongside ongoing business. However, as we have seen there has been a growing trend over the last three Surveys that indicates Solvency II and general capital management concerns are beginning to signal a change in this type of approach to run-off.

# Looking forward

“Much bigger „

“Much more consolidation of business into run-off excellence centres „

“Very specialised multi-skilled concentrated professional well recognised industry all over Europe „

“Continental Europe and the USA are the main markets with Asia growing „

One of the most fascinating opportunities to see the run-off industry's diversity of views was in response to the question 'What will the run-off market look like in 2015?'

While we noted a number of themes and trends the variety of responses indicate that we do not all share a common vision. We set out below a sample of the responses we received.

“Wider acceptance of exit strategies and commutations in Continental Europe ,”

“Transactions will be a normal event ,”

“Less run-off reinsurance portfolios. More run-off in primary insurance portfolios ,”

“Smaller than today ,”

“It will be dealt with as an opportunity to create value ,”

“More concentrated ,”

# The PricewaterhouseCoopers team

## Unlocking value in run-off

The Solutions for Discontinued Insurance Business team has access to more than 200 specialists focusing on providing restructuring and operational consulting services to companies in the 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:

- the need to bring finality to run-off and extinguish liabilities
- the requirement to release capital from run-off and consider options such as sale or transfer of liabilities
- the need to rationalise operations to achieve operational efficiency
- the need to proactively manage in-house or outsourced run-off, including the development of a robust outsourcing contract to maximise shareholder value
- the need to benchmark the claims and reinsurance functions to assess their effectiveness

To find out more, please contact any of the team or visit our website:

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## Survey credit

We would like to thank everyone who took the time to participate in our Survey. In total we surveyed over 500 parties during the research for this report.

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