

Second Edition
February 2008

Unlocking value in run-off

A Survey of Discontinued
Insurance Business in Europe



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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 242 parties during the research for this report.

A year of evolution or revolution for the discontinued insurance market in Europe?

In February 2007 we launched the first edition of PricewaterhouseCoopers' Survey of Discontinued Insurance Business in Europe, in conjunction with the Association of Run-off Companies, and were delighted with the reaction we received from the market. In this second edition of our Survey, we consider developments in the run-off market and summarise the results of a questionnaire which has been completed by a cross-section of insurers and reinsurers from the live and discontinued markets in both Continental Europe and the UK.

In addition, we have included an illustrative case study of a European Group with various portfolios in run-off to bring to life some of the opportunities for change in this area.

There were two key findings from the first edition of the Survey; the first was the tangible differences throughout Europe in the definition of run-off business. The second important area was evidence of a slowly developing, but nonetheless important, change in attitude of a number of European territories as they began to address the challenges of run-off business. This trend is further supported by the results of this Survey and, it is also clear, that more and more organisations across Continental Europe are recognising the potential to unlock value in their discontinued business.

Many are surprised to learn that the solvent scheme of arrangement (Scheme), a UK Court-driven procedure which is widely recognised as being a means to unlock value, has already been used more than 30 times for Continental European discontinued insurance portfolios. Of these cases PricewaterhouseCoopers¹ (PwC) is proud to have been involved as advisers on all but one. Such Schemes have been made possible by using UK legislation and evidencing a "sufficient connection" to the UK, based on, for example, a proportion of UK-based policyholders, reinsurers or brokers.

A key development in this area is the impending launch of the Globale Rückversicherungs-AG Scheme, which is the first Scheme to be proposed in respect of a German domiciled company using "sufficient connection" to the UK. Globale is not alone; we are currently advising a number of clients on new UK "sufficient connection" Schemes for Continental European business. Several of these Schemes will be announced publicly in the coming months and this is an area we expect to see attracting far

more attention from businesses operating in Continental Europe during 2008.

We have recently seen significant developments in restructuring through insurance business transfers both in the discontinued and live markets in Continental Europe. The implementation of the Reinsurance Directive by many EEA states in 2007 has already initiated some further transfer activity. A strong indication of the types of transfer we can expect to see was given in March 2007 by the Swiss Re Group when it announced plans to transfer all of its existing reinsurance and insurance liabilities and assets held in a number of subsidiaries to new carriers domiciled in Luxembourg. In the pure discontinued business market we have seen the transfer of a German portfolio into the UK by Deutsche Rückversicherung and a transaction that moved the discontinued business operations of a Belgian reinsurer to Germany. We are also working with a number of clients on planned insurance business transfers in several other Continental European territories.

So what is driving this activity?

In addition to business transfers and Schemes, we are also increasingly either initiating or welcoming discussions with clients about their preparation for Solvency II's implementation and, as a firm, we are engaged on a number of impact assessment projects. The general activity level over the course of the past year, as supported by our Survey results, shows the following clear themes:

- an increased focus on operational (be it, for example, consolidation, tax or regulatory) efficiencies and the extraction of capital;
- a greater appreciation across Continental Europe of the exit routes available to deal with discontinued business; and
- an increase in transfer activity.

While our observations, together with the results of our Survey, demonstrate that

there is greater impetus in this sector and a run-off market is evolving across Europe, it would be unfair to say that a revolution has yet taken place. Whether 2008 will be a year of step change is difficult to predict, although it is clear that there is growing momentum. We fully expect to see further focus as companies seek to address their discontinued business more pro-actively, particularly through the utilisation of insurance business transfers, which may or may not be followed by a Scheme, as well as "sufficient connection" Schemes.

I would like to extend a personal thank you to all of you who kindly participated in our Survey. I would also like to extend a special thank you to Richard Banks, Robert Bisson and Philip Grant for their contributions in the special report *View from the marketplace* which you will find on page 24 of this document.

We hope that you find this second edition of the *Survey of Discontinued Insurance Business in Europe* enlightening and thought provoking. Please contact any member of our 200-strong team if you would like to discuss further any of the issues or matters highlighted in the Survey.

I wish you all a very successful 2008.



Dan Schwarzmann
Partner

¹"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom)

Key findings from the second edition of the Survey of Discontinued Insurance Business in Europe:

We asked about the length of time it would take existing discontinued books to be run-off in the natural course

Over 70% of the population of respondents estimated it would take more than 10 years to run their business off

We asked the population of respondents how they viewed the likely impact of the Reinsurance Directive's implementation on transfer activity across Europe

Over 80% of respondents believe that the Directive is likely to result in an increase in transfer activity over the next five years

We asked how much of a priority dealing with run-off business is for senior management across Europe

63% of respondents confirmed this was a priority focus for senior management within their organisations

We questioned the level of planning that is being undertaken in respect of dealing with discontinued business

Nearly 75% of respondents confirmed that their businesses either had strategic plans in place or were already in the process of developing these

We asked respondents to share their views of the challenges that are impacting, and likely to impact, run-off business across Europe

The most common responses were around capital that is tied up in discontinued business, the risk of adverse loss development and the level of operational costs

We asked about reserve volatility over the last five years

Almost 60% of the respondents confirmed their reserves had increased over this period and indicated they had experienced volatility

We asked respondents about the level of interest in Solvency II and its expected impact on run-off

Over 60% of all respondents believe that Solvency II will drive an increased focus on run-off business and the exploration of various exit options

We were keen to understand the level of appreciation around the availability of solvent Schemes as an exit strategy for non-UK businesses which have “sufficient connection” to the UK

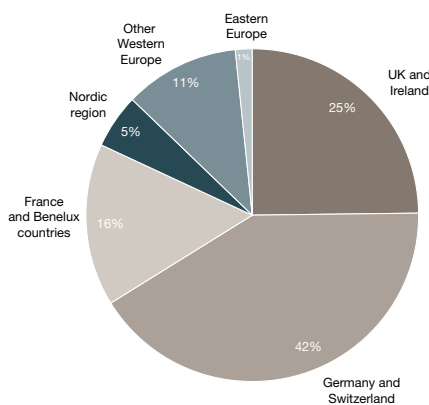
Only 20% of respondents were aware that more than 20 Schemes have already been effected for Continental European businesses

Market size and management:
How does your organisation define
and manage run-off business?

The first edition of the *Survey of Discontinued Insurance Business in Europe* estimated that the size of the European run-off market was Euros 204 billion.

These liabilities were spread amongst both the UK and Continental European markets, with the UK and Ireland, Germany and Switzerland, France and the Benelux countries accounting for the largest shares. We have updated the information in respect of the size of the total market, and also the split between the various countries as illustrated in Figure 1.

Figure 1: Spread of European run-off liabilities



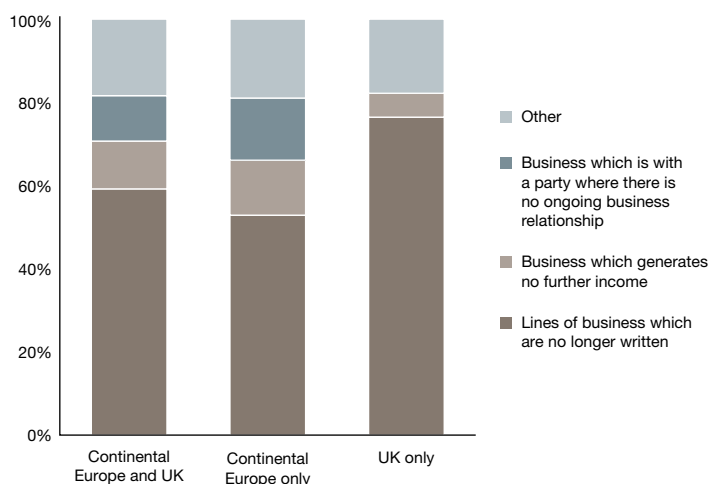
Source: PricewaterhouseCoopers

Whilst the overall size of the estimated European run-off market (Continental Europe plus the UK) has decreased very slightly to approximately Euros 202 billion, this overall reduction is as a result of an increase in Continental European run-off being countered by a relatively significant decrease in the size of the UK market. This is further supported by evidence which suggests that whilst there have not been any significant exits from live underwriting in Continental Europe, there has been growth in the size of the Continental European insurance market as a whole and a corresponding increase in business lines naturally entering the run-off phase. The change in the overall size of the market does not tell the full story as there have also been some, albeit small, changes in the relative proportions of the liabilities between European countries.

The significant reduction in UK run-off is offset by an increase in the size of the Continental European market

How does your organisation define run-off business?

Figure 2: Definition of run-off in Europe



Source: PricewaterhouseCoopers

Views regarding what falls within the definition of “run-off business” differ between individuals in the same territory as well as between countries and this is an ongoing debate amongst commentators in the European market. As Robert Bisson of Syndicat Européen de Gestion de Sinistres (SEGS) recently commented: “In France we had huge trouble translating the term ‘run-off’, and I think it is the same situation all over Continental Europe”.

Philip Grant of the Association of Run-off Companies (ARC) suggests “business no longer being actively underwritten, is an obvious definition.” As shown in Figure 2, when provided with some suggested options for how “run-off” could be defined there were some interesting differences between Continental European and UK respondents. Whilst over three-quarters

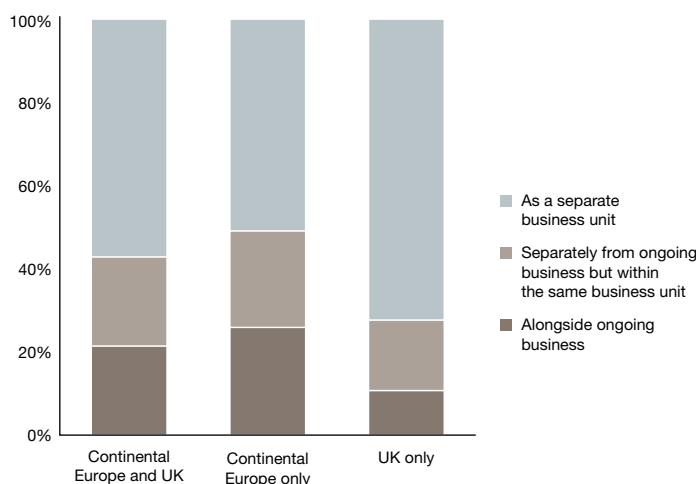
of UK-based respondents selected the option that defined run-off as “lines of business which are no longer written”, this was a perspective shared by only just over half of Continental European respondents. In addition, whilst no UK respondents defined run-off as “business which is with a party where there is no on-going business relationship”, this was a view held by 15% of Continental European respondents. It is also interesting that some 19% of Continental European respondents selected the “Other” definition option, providing answers that ranged from “terminated contracts” to “business placed with reinsurers in run-off”.

These differences in definition are important to our understanding of the size of the market in Europe and also support our view that visible run-off in Europe is “only the tip of the iceberg”.

Views regarding what falls within the definition of “run-off business” differ between individuals in the same territory as well as between countries

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

Figure 3: Management of run-off in Europe



Source: PricewaterhouseCoopers

Continental European run-off often exists alongside live business rather than being dealt with separately as is most common in the UK. The results of the Survey indicate that 26% of run-off in Continental Europe is managed alongside live business, with a further 23% being managed separately from live business but within the same business unit. As indicated in Figure 3, this pattern of responses is quite different from that of the UK, where some 72% of respondents manage run-off business as a separate business unit.

This Survey confirms that some of the many benefits of dealing pro-actively with discontinued business lines are becoming more widely recognised across Continental Europe. Some potential benefits include opportunities to:

- free up and divert capital to more profitable business lines;
- reduce administrative costs;

- minimise tax or regulatory costs throughout a Group;
- provide rating agencies with comfort that discontinued portfolios will not adversely affect financial performance;
- be viewed more attractively by potential acquirers; and
- contribute to an organisation's overall enterprise risk management strategy.

For the reasons highlighted above and as Continental Europe comes to terms with the challenges in preparing for and implementing Solvency II, it seems likely that run-off will begin to receive more focus from senior management which will in turn lead to greater consideration being given to the separation of live and discontinued portfolios.

The separation of discontinued business will allow organisations to more easily obtain the benefits highlighted above.

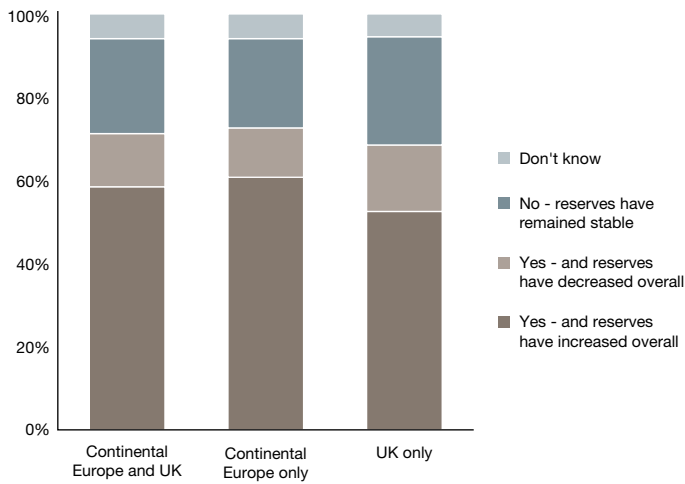
The many benefits of dealing pro-actively with discontinued business lines are becoming more widely recognised across Continental Europe

Time and money: How long will it take your run-off business to reach natural expiry and how volatile is your run-off business?

Once an organisation has defined and understood the extent of its run-off liabilities it can begin to address the specific challenges associated with managing that business. Two important issues involved in discontinued business are the volatility inherent in this business, and the potential length of time such business will take to run-off to its natural expiry.

With regard to your run-off business, have you experienced significant volatility in your reserves over the last five years?

Figure 4: Reserve volatility in Europe



Source: PricewaterhouseCoopers

Volatility should not be confused with adverse loss development. Each organisation will view volatility according to its own risk preferences and, for some, relatively small movements in overall reserve levels will be viewed as material compared to others.

Volatility in run-off business can be viewed as a management issue that is largely within the control of the run-off managers. The use of best practice claims handling techniques and cedant relationship management, as well as reserving and commutation procedures, will provide a framework to help manage volatility for the benefit of all stakeholders.

One of our survey questions asked participants to consider their own experience of volatility in their businesses over the past five years and also overall reserve levels over that period, as to whether reserve levels had increased, decreased or remained stable.

Some 61% of Continental European respondents confirmed that their organisations had experienced reserve volatility over the last five years and had seen the level of their reserves increase overall during this period. This compared to 34% of Continental European respondents who had either seen reserves remain stable or had seen some volatility but an overall reduction in

reserve levels during the last five years. In addition, a small (but significant) number of Survey respondents were unable to comment on the reserve positions of their organisations. This is concerning given that understanding and managing the risk of reserve volatility, especially in the context of Solvency II, will become increasingly important over the next few years.

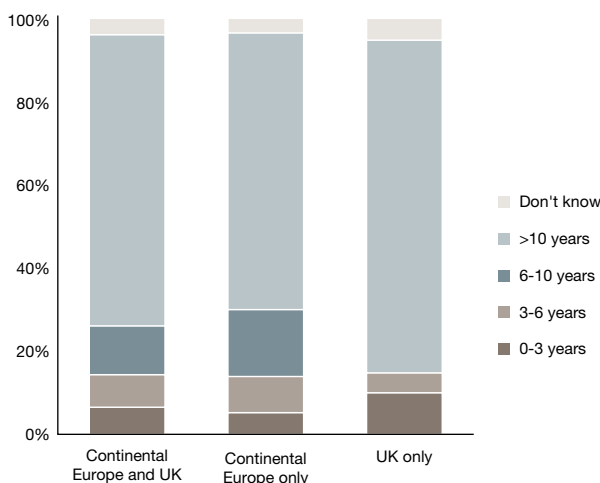
The Survey results demonstrate that Continental European insurers have

generally experienced volatility and seen reserves deteriorate in the past five years. We were surprised by this trend, given that we would not have expected to see such a strong link between these two areas. This suggests that perhaps run-off managers could be using more proactive measures to manage their run-off business. It should be noted that this volatility and reserve deterioration experience does not preclude insurers from attempting to properly exit from this run-off business and unlock value.

Volatility and reserve deterioration experience does not preclude insurers from attempting to properly exit from this run-off business and unlock value

How long do you expect your run-off business to take to reach natural expiry?

Figure 5: European run-off tail



Source: PricewaterhouseCoopers

The potential issue of volatility is compounded by the long-tail nature of many run-off books of business. As explored in the first edition of the *Survey of Discontinued Insurance Business in Europe*, a “typical” Continental European company is more likely to have written a broad based portfolio of mainly domestic risks with some exposure to other European risks. In general, UK companies tend to have greater exposure to worldwide risks through the London Market’s position as a main centre of underwriting for major global insurance and reinsurance business. The principal problem emanating from the worldwide market in recent years is in respect of exposures to long-tail US asbestos, pollution and health-hazard (APH) claims. Our Survey results shown in Figure 5 appear to validate the assumption that the UK run-off market has a longer tail generally than its Continental European counterpart, with some 80% of UK

respondents indicating that it will be 10 years or more until their run-off business reaches expiry, compared to 67% of respondents from Continental Europe.

Both these figures are high and will naturally be an area of concern for senior management. For those in Continental Europe, where the run-off is more likely to sit alongside live business, the potential for long-term discontinued business to adversely affect ratings, tie up valuable capital and detract from the performance of core ongoing operations is clear. Minimising risks associated with discontinued business and maximising the value from it are issues which can have a long term impact on the overall business performance.

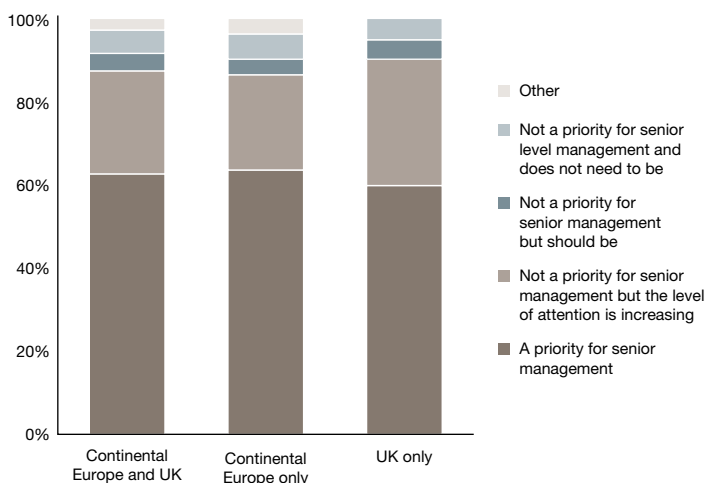
In light of this, are these matters making their way up the agendas of European insurers’ and reinsurers’ Chief Executives and Chief Financial Officers?

61% of Continental European respondents stated that they have experienced reserve volatility over the last five years and that reserves have increased overall during this period

Planning for improved performance and making it happen: Is run-off a priority for your senior management and does your organisation have a strategic plan?

To what extent is the pro-active management of your organisation's run-off business a priority for senior management?

Figure 6: Is run-off a priority for senior management?



Source: PricewaterhouseCoopers

Our Survey asked if the pro-active management of an organisation's run-off is a priority for senior management and the results shown in Figure 6 are encouraging, with 63% of European respondents stating that senior management viewed pro-active run-off management as a priority. A further 25% of European respondents stated that whilst run-off is not currently seen as a priority, the level of attention directed at this area is increasing. The reasons behind these sentiments are likely to be driven by the opportunities for the

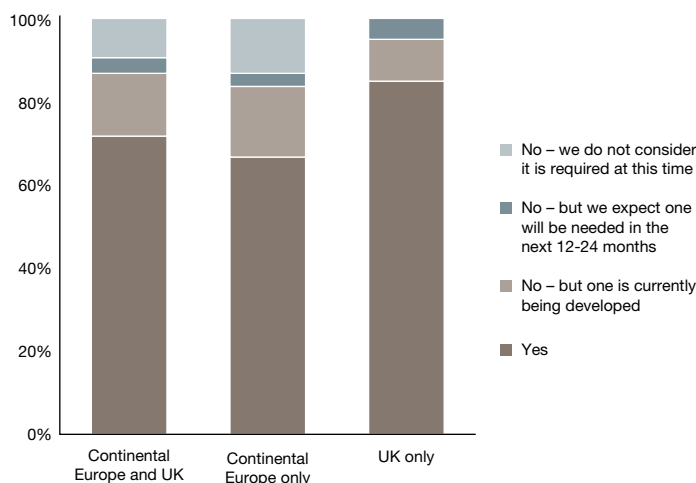
business to realise the benefits provided by pro-active run-off management, particularly in relation to the release of capital. Tied up capital was the most frequently cited example where Survey respondents were asked to rank the main challenges facing Continental European reinsurers.

This is interesting, since we have also had numerous discussions with senior managers, outside of this Survey, who have indicated that their organisations do not view capital as a key concern.

63% of European respondents stated that senior management viewed pro-active run-off management as a priority

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

Figure 7: Does your organisation have a strategic plan for run-off?



Source: PricewaterhouseCoopers

The recognition of the need for pro-active management for run-off was supported by the encouraging response to the question which asked respondents if their organisation had a strategic plan for dealing with its run-off business. Some 67% of Continental European respondents indicated that a strategic plan existed with a further 17% indicating that a plan was either in development or was likely to be needed in the next 12 to 24 months. A strategic plan for run-off seemed to be a near universal “must have” for UK respondents, with some 85% already having a plan and the remaining 15% either developing or planning one. Given the requirement of the Financial Services Authority (FSA) for a Scheme of Operations when entering run-off, it is not surprising that the UK is

well advanced in this area. An interesting difference between UK and Continental European responses is that whilst all UK respondents saw the need for a strategic plan, 13% of Continental European respondents did not consider that this was required at this time. This could mean that these organisations may be missing opportunities to maximise value in this business.

While the responses to this question are encouraging, they appear relatively inconsistent with the level of visible pro-active run-off activity in Continental Europe over the last few years. However, when it is considered that Survey respondents also predict that commutations will be the most frequently used exit mechanism over the next five

It may be reasonable to challenge the sophistication and exit ambition of some of the strategic plans currently being employed in Continental Europe

years, it may be reasonable to challenge the sophistication and exit ambition of some of the strategic plans currently being employed in Continental Europe. In our experience, particularly where run-off is managed alongside live business and where owners of discontinued insurance business do not create a dedicated and thorough plan for dealing with the run-off, the business is often left to drift without any strategic direction.

As we have seen, a significant proportion of Continental European respondents identified that they have experienced run-off reserve volatility in the past five years. This position adds further weight to the view that the strategic commutation plans currently being used in Continental Europe may not have been as successful

as other techniques could potentially be in either containing or bringing closure to run-off business.

A pro-actively managed run-off portfolio needs to be driven by, and monitored against, a strategic plan that is underpinned by a robust financial model and supported by relevant operational delivery either in-house or through a specialist third party service provider. A comprehensive financial model will include assumptions for expected claims payment patterns, anticipated commutation targets and reserve release, appropriate reserve discounting, expected reinsurance recoveries, realistic bad debt provisioning, a plan for resource allocation and cost, asset/liability matching and anticipated

investment income returns. Such a model is invaluable in tracking progress against run-off objectives and in identifying trigger points for a shift in strategy, for example when a policy of individual commutations may be better replaced by a global finality solution such as a Scheme for the benefit of the insurer/reinsurer and its stakeholders.

An effective strategic plan should seek to optimise the use of the various elements of the run-off “toolkit” and explore how complementary options can be utilised to best generate value from the discontinued business.

The following example, introduced in Figure 8, and explored further in Figures 9, 14, 18 and 20, illustrates a fictional pan-European Group with various portfolios of run-off business in order to bring some of these options to life. As we consider the responses to our Survey in the following pages, we will also consider the strategic and operational measures available to the Group in restructuring both live and discontinued operations.

Figure 8: Case study outline



Source: PricewaterhouseCoopers

An effective strategic plan should seek to optimise the use of the various elements of the run-off “toolkit” and explore how complementary options can be utilised to best generate value from the discontinued business

Figure 9: Case study – Implementing a pro-active run-off strategy

German headquarters

To prepare for Solvency II the Group undertakes a Solvency II impact assessment. As a result of this exercise certain portfolios of business are identified in the German headquarters as being expected to require a significantly increased level of capital under the Solvency II regime. In order to optimise the use of capital in the business the Group decides to discontinue writing these particular lines of business.

Given that there are a number of existing, as well as new run-off portfolios based in Germany, the decision is also taken to establish a dedicated run-off “centre of excellence” in Germany. The Group as a whole benefits from economies of scale as a result of this restructuring, reducing its overall run-off administration and regulatory costs and maximising opportunities for commutation leverage. The use of this run-off “centre of excellence” for non-German run-off portfolios is explored further in Figure 14 on page 33.



Source: PricewaterhouseCoopers

Confronting the issues: What are the major challenges facing Continental European reinsurers with run-off business?

Survey respondents were asked to rank a number of potential challenges facing Continental European reinsurers with their run-off business.

We provided the following options and asked respondents to indicate the top three they ranked as the most significant challenges facing European insurers with run-off business:

- adverse loss development;
- availability of exit mechanisms;
- lack of skilled resource;
- operational costs; and
- tied up capital.

Respondents selected the following challenges most frequently:

1. tied up capital;
2. adverse loss development; and
3. operational costs.

Tied up capital

63% of European Survey respondents indicated that run-off business created a significant challenge in respect of the capital tied-up in discontinued operations. Consequently, managers of run-off portfolios will look for ways to release locked up capital through techniques such as business transfers, sales or structured exit mechanisms including solvent schemes of arrangement. Figure 10 provides a brief overview of the advantages and disadvantages associated with such measures, although it is important to remember that the suitability of their application will vary from case to case, depending on matters such as an organisation's strategic objectives as well as the characteristics of the underlying business.

Figure 10: Capital release via exit routes - a summary

	Potential advantages	Potential disadvantages
Strategic commutations	<ul style="list-style-type: none"> • Can take out individual volatile exposures 	<ul style="list-style-type: none"> • Time consuming • Labour intensive • Policyholders may not be compelled to commute • Unlikely to lead to true finality unless there are only a small number of policyholders
Business transfer	<ul style="list-style-type: none"> • Speed – tends to be faster than a Scheme • Business as usual for policyholders • Does not require approval by policyholders and, for many European territories, approval is only required by the home territory regulator 	<ul style="list-style-type: none"> • For many territories, the attaching reinsurance does not also automatically transfer • Liabilities are not extinguished
Sale	<ul style="list-style-type: none"> • Speed • Finality for the risk carrier 	<ul style="list-style-type: none"> • Possibility to retain liability through financial guarantees/indemnities/warranties • Reputational risk if purchaser fails later or delivers unacceptable level of service post sale
Reinsurance	<ul style="list-style-type: none"> • Speed of exit • Removes potential for adverse loss development (up to a certain point) 	<ul style="list-style-type: none"> • Price • Supply • May retain some risk
Scheme	<ul style="list-style-type: none"> • Achieves total finality and certainty for all stakeholders • Early payment • Practical and transparent claims agreement process 	<ul style="list-style-type: none"> • May require transfer to UK (or other jurisdiction with Scheme legislation) if not able to prove there is "sufficient connection" with the UK or another territory with Scheme legislation

Source: PricewaterhouseCoopers

Adverse loss development

59% of European respondents ranked adverse loss development in the top three challenges facing Continental European reinsurers. Reserve deterioration is often a classic symptom of passive run-off management. Run-off best practice dictates that adequate reserve reviews should be undertaken. In addition to providing important data these may initiate or influence commutation discussions. Such reviews will also identify opportunities to release redundant reserves.

Operational costs

Where run-off has been managed alongside live business it is often difficult to calculate accurately the costs associated with the management of just the run-off business. Indeed, there are many costs, such as the opportunity cost of senior management time spent focusing on this area, which are typically overlooked when assessing the true financial impact of run-off business.

Under the recent hard market conditions, where live business has been generating substantial returns, organisations may have faced limited pressure to address the costs associated with

run-off. However, as markets soften organisations will be increasingly motivated to gain a better understanding of the true costs associated with owning and managing run-off business. In this Survey, 56% of European respondents cited operational costs as one of the top three challenges facing Continental European reinsurers. The first edition of this Survey estimated that run-off costs could exceed Euros five billion annually. This number is still a realistic estimate given the current size of the market and it is clearly too significant to ignore.

Operational costs associated with servicing run-off business can be mitigated through consolidation or a Group could create a centre of run-off excellence. The potential economies of scale available through this strategy, which include the prospect of leveraging commutation deals and taking advantage of Group set-off opportunities, are significant. Additionally, specialist run-off outsourcers and advisers may be retained to provide cost effective run-off management. Given that 54% of European Survey respondents were concerned over the availability of skilled resource to manage run-off effectively, these solutions should become more prevalent.

63% of European Survey respondents indicated that run-off business created a significant challenge in respect of the capital tied-up in discontinued operations

Background to the Association of Run-Off Companies (ARC)

Now celebrating its tenth anniversary, ARC is the UK trade body for insurance and reinsurance legacy management professionals. ARC is recognised as the voice of the legacy management sector by a wide range of government and market bodies including the UK Financial Services Authority and the Department of Work and Pensions.

ARC's activities range from industry consultation with government to promotion of the sector's skills and expertise. In particular, the ARC Academy provides top quality, competitively priced training that is fully accredited by the Chartered Insurance

Institute, a professional training organisation for the general insurance industry. More recently, ARC has also established its own annual awards designed to promote and recognise excellence in legacy management.

With some 200 members spanning reinsurers and insurers with discontinued business (both solvent and insolvent), service providers and associated professionals such as accountants and lawyers, over the past decade ARC's membership has also grown and broadened to include companies from Continental Europe and the US, so highlighting the

development of the legacy management sector globally.

ARC welcomes dialogue with all companies or organisations from both the UK and overseas legacy management sector which share its vision of enhancing the professional skills of the legacy management sector and promoting the value of those skills to the broader financial services industry and those who regulate it.

To find out more about ARC and its wide range of member benefits go to www.arcrunoff.com

Background to Syndicat Européen de Gestion de Sinistres (SEGS)

SEGS was established in 2006 by a number of run-off and live companies dealing with claims portfolios in the French and European marketplace.

The association has several key objectives which include:

- Bringing together major players in the French market and promoting the run-off profession in France and Continental European Markets;
- Becoming the voice of the market when dealing with government and authorities, as well as other organisations in the insurance marketplace;

- Defining best practices and a quality standard for claims management;
- Setting up common tools and delivering training sessions for claims professionals; and
- Being instrumental in steering run-off management contracts towards global financial solutions.

SEGS is currently working on a significant project to evaluate the French run-off market, gathering information which will be analysed and distributed to the market in the near

future. A series of training sessions is also being established for claims handlers, to ensure best practices are implemented and adhered to within the industry. In conjunction with this initiative, a claims management database is being created which will gather data related to the management of run-off, claims and legal information.

To find out more about SEGS go to www.segs.eu

View from the marketplace

Richard Banks, Editor of Insurance Day, met Philip Grant, Chairman of ARC and Robert Bisson, Chairman of SEGS, to discuss the state of the European run-off market.

Europe is waking up to the benefits and opportunities that the run-off community can offer, but challenges remain in spreading the word about this useful resource. A number of factors, including regulatory and economic pressures, are pushing the issue of managing discontinued portfolios of business to the top of the agenda for insurance executives across the continent. For Continental European businesses in particular, the knowledge that there can be a pro-active approach to managing legacy business, has been something of an epiphany.

Robert Bisson, Chairman of the nascent French run-off association SEGS, is clear as to the change in attitude.

“As far as the French market goes, we have noticed that people – especially on the insurance side – are now conscious that old claims are a potential bomb on their balance sheet and in their relationships with their clients,” he explains.

Today run-off business is as likely (if not more likely) to be the discontinued

portfolio of a live insurer as a company that has closed entirely to new business, so successfully managing relationships with counterparties who might still be clients is paramount.

It marks a significant change in attitude in Continental Europe where there has been a basic reluctance to embrace run-off. Philip Grant, Chairman of the UK’s ARC, believes an early understanding of the benefits of outsourcing, when it comes to managing legacy business, has given the UK the edge historically.

“The development of an outsourcing culture has proceeded much more quickly in the UK, that’s to my mind one of the keys to innovation,” Grant claims. “It’s been crucial to the development of the London Market, because if you have concentration of liabilities and concentration of expertise you’re much more likely to get that intellectual ferment.”

Hurdles exist to outsourcing in Europe, not least long and often complex negotiations with trade unions over how any transfer of responsibilities and staff is managed. Equally several European countries, unlike the UK, charge VAT on outsourcing services which means that cost savings have to be even more significant to counter this.

Grant believes that pressure on the performance of run-off managers will force these service providers and outsourcers to come up with ever more innovative solutions, including adapting

existing legislation to a run-off situation. “I really do see outsourcing as a driver to all sorts of creative legacy management activities,” Grant suggests.

And Bisson agrees, adding outsourcing gives additional flexibility: “If you’re outsourcing you can put more pressure on your third party administrator to deliver. It’s far easier for the management to put additional pressure on the outsourcer as you would never be in a position to put such pressure on internal staff.”

Nevertheless Bisson is aware of the uphill challenge he and his colleagues face getting wider acceptance and understanding of run-off in Europe.

“For us the big challenge is to be fully recognised as a sector in the market. It seems like a simple objective, but it’s not simple to achieve,” he acknowledges.

Although the concept of run-off in the UK is better established, a central challenge remains understanding how the function is evolving. So-called old-style run-off of discrete balance sheets of closed business is tailing off and a new phenomenon of portfolios embedded in on-going businesses is emerging. In this legacy environment, practitioners may not take the same type of aggressive attitude to claims settlement as was traditionally favoured, meaning commutations will not be as significant a tool and solvent Schemes may be less applicable as an immediate solution.



Robert Bisson

“As far as the French market goes, we have noticed that people are now conscious that old claims are a potential bomb on their balance sheet.”

Crucially new and imminent regulation plays a key role in driving the evolution of the run-off market. In particular, although its full implementation is still several years away, Solvency II is expected to crystallise new run-off activity. Imaginative solutions to address the challenges of Solvency II will be especially in demand in Europe where a plethora of small and medium sized companies, that specialise in specific lines of business, may find themselves hit hard by the new capital requirements.

For many companies the new standards are not only going to be tough to meet in financial terms but they will also require a degree of expertise within the business in order to calculate the required capital levels. These compliance requirements are likely to be expensive and could be a driver of consolidation. The Solvency II framework will equally intensify the scrutiny of portfolios embedded within live businesses. Indeed under the new regime it is more likely that Chief Executives and Chief Financial Officers will play a greater role in uncovering areas of the balance sheet requiring attention.

As Grant explains: "It will not only create new run-off portfolios, but those portfolios that are already in run-off, and embedded portfolios will become a focal point. Insurance company boards are likely to question why they are spending millions of regulatory capital on supporting business that is not only not making money but is actually costing the business money."

Ensuring that insurance company managers finding themselves in that position are confident in their understanding of the options and opportunities open to them is a central challenge for today's run-off community, even in the most mature of markets. In the UK, run-off proponents have also identified awareness raising as a priority for 2008. In particular, the challenge is persuading all stakeholders that run-off is a perennial rather than one-off phenomenon. Education – including the activities of ARC's Academy – has a crucial role to play.

"Professionalism is one of the keys to getting recognition for what we do," Grant insists. "I'm very sure that the skills we've learnt as an industry sector have tremendous application going forward, but we need to make sure we adapt to take on that role which is partly what the education is all about."

Already there are signs that run-off awareness is rising among European regulators. In the past, they have been able to ignore run-off because in several countries if a company has gone into run-off the regulator expected the rest of the insurance market to pick up the pieces. In a post-Solvency II world, where we expect to see a lot of portfolios placed in run-off, regulators will not be able to ignore the issues because run-off liabilities will be at the heart of the risk assessments that they are overseeing. Grant believes what is really required is finding one or two influential figures

within the regulatory sphere to take an interest in the same way that the UK FSA's Paul Taylor has.

Even before the onset of the Solvency II regime, regulators and the risk carrying community have to adapt to the provisions of the European Reinsurance Directive.

Generally the Directive brings reinsurance much more within the regulatory mainstream and from a run-off perspective provides interesting opportunities to transfer portfolios of business to different jurisdictions within the EU for consolidation or ultimately an exit.

Such transfers are of course allowed in the UK under Part VII of the Financial Services and Markets Act 2000, and the extent to which other jurisdictions give the go ahead to the practice could increase the chances of forum shopping among acquirers of portfolios.

There has already been transfer activity in the run-off sphere in 2007 and early 2008 as the Reinsurance Directive is being implemented in some territories and to date transfers have been seen from Germany to the UK and also from Belgium to Germany.

2008 is already shaping up to be a pivotal year in the evolution of run-off across Europe and it is clear that ARC and SEGS intend to play a full part in the development of the European run-off market.



Philip Grant

"It [Solvency II] will not only create new run-off portfolios, but those portfolios that are already in run-off, and embedded portfolios will become a focal point."

Paving the way for change:
What impact will the Reinsurance
Directive and Solvency II have on
European run-off business?

Has your jurisdiction implemented the Reinsurance Directive?

Prior to the introduction of the Reinsurance Directive legislation in December 2005 pure reinsurance entities across the EEA had not been subject to a homogenous regulatory framework. Indeed, some territories did not regulate reinsurance business at all. The Directive extends to pure reinsurers the concept of a “single passport” regime, allowing reinsurers to conduct business throughout the EEA without requiring the establishment of a subsidiary in individual territories. This facility had already been provided to insurance entities under the Third Non-Life Directive implemented in 1994. The Reinsurance Directive was required to

be implemented by EEA member states by December 2007 and over the course of the past year there have been efforts by many member states to integrate the Directive into local legislation. Figure 11 provides a summary of the status of the Directive’s implementation across a number of major European territories and the specific features of each as at 30 January 2008. The table illustrates the staggered approach across the member states to the Directive. The results of the Survey indicated that there is a lack of clarity regarding the status of the implementation of the Reinsurance Directive in a number of territories that were surveyed.

Figure 11: Status of implementation of the Reinsurance Directive

Territory	Reinsurance Directive implemented	Date Directive implemented/expected to be implemented	Key features in relation to business transfers
UK	Yes	31 December 2006	Court approval and formal notification to policyholders required. Need to advertise proposals in EEA national newspapers if there are policyholders in that territory. “Part VII lite” approach where Court approval may not be required for straight forward and uncontested transfers. Critically, the UK interpretation of the Directive enables attaching reinsurance to be transferred along with the underlying liabilities.
France	No	Expected first quarter 2008	This is expected to replace the current process that is tied to dissolution and merger activity.
Germany	Yes	28 May 2007	Regulatory approval required. No policyholder notification required.
Ireland	Yes	16 July 2006	Regulatory approval required where an Irish company is accepting the transfer.
Luxembourg	Yes	31 December 2007	Regulatory approval required where the accepting company is based in Luxembourg.
Netherlands	No	Expected first quarter 2008	Regulatory approval based on solvency requirements. Need notification in government publication.
Spain	Yes	9 December 2007	Regulatory approval required based on minimum solvency requirement of accepting company (deemed to be given if no response is received) and notification requirements in the Spanish Official publication.
Sweden	No	Expected April 2008	Expected to closely mirror the standard Directive.

Source: PricewaterhouseCoopers

While not all EEA member states have complied with the initial implementation deadline of December 2007, reinsurers themselves have been quick off the mark to recognise the potential restructuring benefits provided by the Reinsurance Directive. In March 2007, Swiss Re announced that it would optimise its structure in the EU through the formation of three legal entities. These entities are based in Luxembourg and will operate as the main risk carriers for its European reinsurance and insurance business. This new model is expected to be fully operational by the middle of

2009 and this new branch structure is expected to improve the alignment of Swiss Re's regulatory and economic capital requirements. In addition, further efficiencies in capital management, administration and reporting are expected. A further example has been in Ireland where Partner Re announced in 2007 that from 1 January 2008, under the single regulatory framework provided by the Reinsurance Directive, Partner Reinsurance Europe Limited will be its principal reinsurance carrier for business underwritten in France, Ireland and Switzerland.

A key element of the Reinsurance Directive is the ability to transfer portfolios of reinsurance business throughout the EEA

Business transfer summary

A business transfer involves moving the whole or part of a company's business from one carrier to another. Businesses may be transferred within the same country or to another EEA territory, and either to another member of a Group or to an external entity.

The availability and application of the Reinsurance and Third Non-Life Directives as tools for dealing with run-off business provides European Groups with the ability to achieve an exit. This may

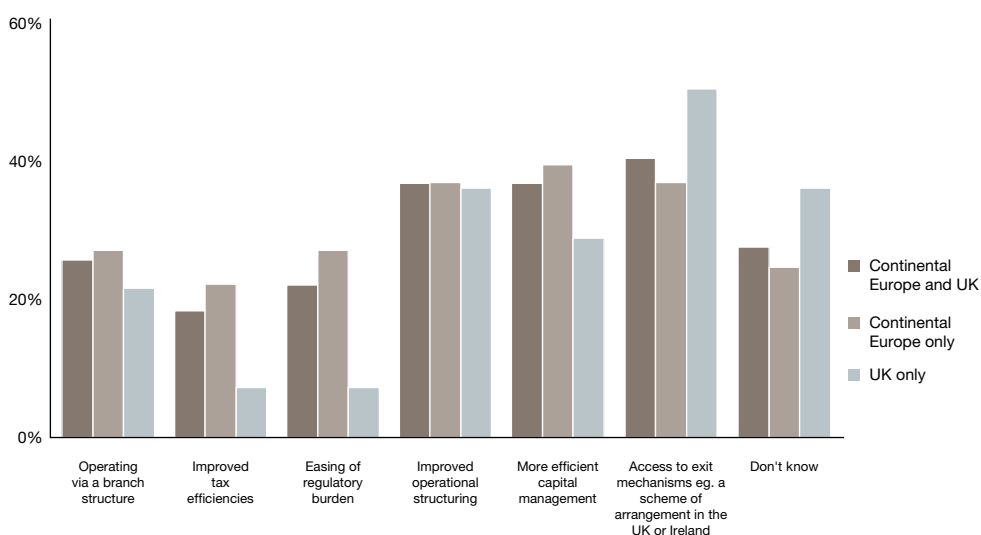
be either as an immediate measure in the form of a business transfer to an external entity, or as part of a two-step plan to move business into a territory in order to access another exit mechanism available in that member state. This may include, for example, a transfer of business to the UK, where Solvent Schemes of arrangement enable a full and final exit for all stakeholders.

The availability and application of the Reinsurance and Third Non-Life Directives as tools for dealing with run-off business provides European Groups with the ability to achieve an exit

Have you considered using the Reinsurance Directive or the Third Non-Life Directive to achieve any of the following:

- operating via a branch structure;
- improved tax efficiencies;
- easing of regulatory burden;
- improved operational structuring;
- more efficient capital management; or
- access to exit mechanisms e.g. a Scheme in the UK or Ireland?

Figure 12: Uses for the Reinsurance Directive and Third Non-Life Directive in Europe



Source: PricewaterhouseCoopers

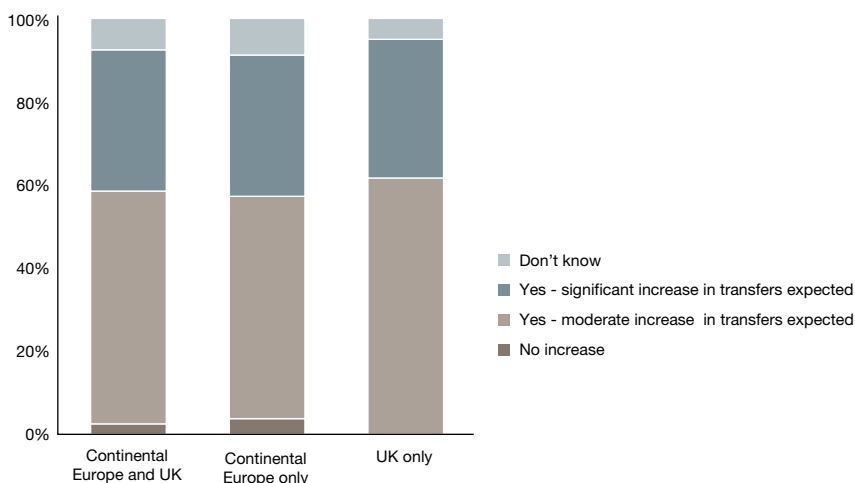
The results of this question are shown in Figure 12. European respondents are already considering how they can make use of the flexibility of location of operations created by the European Directives. One of the drivers for the use of the European Directives which was not so regularly cited was that of

tax efficiencies. There are tangible tax benefits in the deployment of business transfers as a strategy. However, there are also a number of potential pitfalls which need to be considered carefully when developing a strategy in order to maximise the opportunity to realise tax benefits.

European respondents are already considering how they can make use of the flexibility of location of operations created by the European Directives

Do you anticipate that the implementation of the Reinsurance Directive will increase the level of insurance business transfers in Continental Europe over the next five years?

Figure 13: Impact of Reinsurance Directive on transfer activity in Europe



Source: PricewaterhouseCoopers

Our Survey results as shown in Figure 13, indicate that 88% of Continental European respondents and 95% of UK respondents consider that the Reinsurance Directive will result in either a moderate or significant increase in transfer activity in Continental Europe in the next five years. The reason UK respondents are slightly more likely to think that there will be increases in activity than the Continental European respondents may be because they have been more exposed to transfer activity. Over 100 business transfers

have already been effected under Part VII of the Financial Services Markets Act 2000 (FSMA) in the UK. These transfers have been applied to both live and discontinued business including direct and reinsurance business and have been driven by many of the reasons and drivers for change discussed in this Survey. One key difference between the UK's implementation of the Directive and the implementations to date in other territories, relates to the ability for organisations to transfer attaching reinsurance along with the liabilities.

Case law in the UK has supported the contention that attaching reinsurance assets transfer with the underlying liabilities. It is expected that this point will be confirmed in the forthcoming revisions to FSMA which are expected in early 2008. It seems reasonable to assume that the volume of UK Part VII transactions undertaken have at least been, in part, due to the ability to transfer attaching reinsurance.

As the legislation enacted in other European territories is either silent or unclear on the transfer of attaching reinsurance it will be interesting to see in the absence of legal precedent how this will impact on transfer activity in Continental Europe. It would not be difficult to imagine some future revisions to the relevant local laws in Continental European territories, where there is significant reinsurance, to more clearly facilitate the transfer of attaching reinsurance.

In November 2007, the first example of a Continental European company using a business transfer in the discontinued business space was seen in Germany. Deutsche Rückversicherung successfully transferred its third party reinsurance run-off to its UK subsidiary through a business transfer following the Reinsurance Directive's entry into German law within the German Insurance Supervisory Act VAG that came into force on 2 June 2007. Deutsche Rückversicherung's Chief Executive, Jurgen Rehmann, was quoted recently in *Insurance Day* as saying "the key benefit of this initiative is it enables us to fix a maximum cost for the run-off liabilities and to concentrate those liabilities in the UK, so insulating Deutsche Rückversicherung's balance sheet from any potential future adverse loss deterioration from these portfolios."

A further run-off business transfer was announced in January 2008

Case law in the UK has supported the contention that attaching reinsurance assets transfer with the underlying liabilities

when Compagnie Euro-Belge de Réassurances S.A. confirmed that it had transferred its entire reinsurance portfolio of discontinued business to Hanseatica Rueckversicherungs-Aktiengesellschaft in Germany. The transfer took place in accordance with the Reinsurance Directive and consolidates the Belgian entity's run-off business within a specialist run-off entity in Germany. These transfers provide an illustration of how the Reinsurance Directive's implementation can enable the separation of live business from run-off business and provide a platform for dealing with the discontinued element. This is explored further in our case study in Figure 14. Our Survey clearly indicates that further examples of this type of transaction are very likely to be seen in Europe during 2008 and 2009. Almost 40% of Survey respondents from Continental Europe identified business transfers and/or sales as being the

exit mechanism expected to be most frequently used in Continental Europe over the next five years.

Alternative transfer mechanisms may also be explored through so called "spin-off and merger" approaches that can be used to potentially separate run-off from ongoing business. The Cross Border Mergers Directive which became effective in December 2005 facilitated consolidation of companies across EU member states and we have seen the creation of "Societas Europaea" or European Companies (SEs), most notably in Allianz, to take advantage of advantageous regulatory conditions. SEs may be created by mergers in various ways and could be utilised to establish a platform for dealing with run-off business.

Figure 14: Case study – Implementing a pro-active run-off strategy (continued)

Spanish subsidiary

Following the establishment of the German run-off "centre of excellence" the Group has now considered the options for this book of international reinsurance business. In order to further maximise the potential economies of scale provided by the run-off centre of excellence, the Group has decided to take advantage of the new opportunity to transfer the business of the subsidiary to the German headquarters. This transfer is effected via the local Spanish law used to implement the Reinsurance Directive. The Spanish subsidiary will then be closed, removing the need for the Group to support specific capital requirements in Spain and the need to comply with local regulatory requirements.



Source: PricewaterhouseCoopers

What do you think the practical implications of Solvency II are likely to be for Continental European reinsurers?

PwC's first *Survey of Discontinued Insurance Business in Europe*, launched in February 2007, considered the broad implications of the implementation of Solvency II ahead of the launch of the draft Framework Directive by the European Commission in July 2007¹. Although the full formal implementation of Solvency II has been pushed back from 2010 until 2012, it remains one of the hot topics on the agenda of insurers and reinsurers throughout Europe. We are seeing increasing activity in preparation for the transition to Solvency II at many of our clients as they begin to analyse where they may need to implement changes in order to be compliant with Solvency II's potential requirements. In addition, many forward thinking organisations are embarking on assessments to model their potential future capital requirements under the new framework and some are also participating in the Quantitative Impact Studies to provide feedback on the suitability of current capital calibrations.

Solvency II's primary objective is to strengthen policyholder protection by aligning capital requirements more closely with the risk profile of an individual company. It further seeks to embed risk awareness into the frameworks for governance, operations and decision making within the business. The Directive also forms an important part of the drive towards a European single market for insurance, with more open competition and greater opportunity for policyholder and investor scrutiny as a result of increased transparency.

Most commentators expect Solvency II to result in increased levels of discontinued business as insurers seek to rationalise their portfolios and withdraw from lines of business that require disproportionate capital support compared to other, more profitable lines. It is also likely to focus greater attention on existing run-off business as insurers contemplate ways to bring finality to this business and recycle the capital that had been used to support this business into new, more profitable areas.

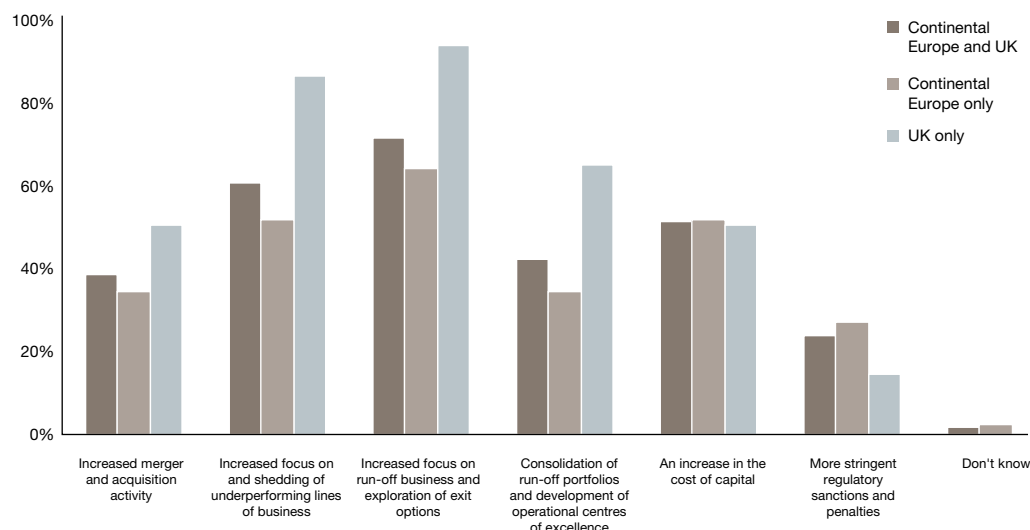
Our Survey results, as shown in Figure 15, indicate that 51% of Continental European based respondents anticipate that Solvency II will result in an increased focus on, and the potential shedding of, underperforming lines of business compared to 86% of UK based respondents. It must be noted however, that in another question some 63% of Continental European respondents did not believe that Solvency II would result in their own organisations withdrawing from certain lines of business. This suggests that whilst it is recognised that the market is set for change because of Solvency II, some parties have not as yet reached the conclusion that exits for their own businesses may be stimulated by this catalyst.

Additionally, 63% of Continental European Survey respondents believe that Solvency II will result in an increased focus on run-off business and the exploration of exit options while some 34% also believe that the Directive's implementation will result in

¹ For further information on Solvency II please see the PwC publications *Countdown to Solvency II* and *Gearing up for Solvency II* at www.pwc.com/SolvencyII

Forward thinking organisations are embarking on impact assessments to model their potential future capital requirements

Figure 15: Practical impact of Solvency II in Continental Europe



Source: PricewaterhouseCoopers

the consolidation of run-off portfolios and development of run-off “centres of excellence.” This is markedly different to the UK responses where 93% of Survey respondents believe that Solvency II will lead to increased attention being given to run-off business and the exploration of exit options, whilst 64% consider that the Directive’s implementation will drive consolidation activity for run-off portfolios and creation of run-off “centres of excellence.” These are significant differences and may be explained by the “commonality” and focus of attitudes and approach in the London Market versus the broader spectrum of views across Continental Europe.

If Solvency II does result in increasing withdrawals from live underwriting,

organisations across Europe may further consider the merits of outsourcing run-off business if it provides a cost effective alternative to in-house management. To date, run-off outsourcing in Continental Europe has been limited, due in no small part to local employment legislation and the local taxes which are applied to outsourced services. In comparison, the UK outsourcing market for run-off has been extremely active.

It is clear that discontinued business will feature heavily in the decision making processes that organisations will be required to undertake when implementing Solvency II as our Survey shows that nearly 67% of Continental European insurers and 80% of UK based respondents anticipate their

run-off business will take over 10 years to reach natural expiry. Solvency II’s implementation and focus on capital efficiency and risk management imply that a passive approach to run-off will not be an optimal approach.

Organisations that begin to take steps pro-actively to deal with their discontinued operations will provide themselves with the opportunity to develop a competitive advantage over their rivals. As seen with the introduction of Basel II in the European banking sector, organisations that waited for the Directive’s actual implementation appear, with hindsight, to have left it too late to engage optimally in the process.

63% of Continental European Survey respondents believed that Solvency II will result in an increased focus on run-off business and the exploration of exit options

Making the connection:
How can you use a UK
scheme of arrangement to exit
from Continental European
discontinued run-off business?

Scheme of arrangement summary

Schemes of arrangement have, over the course of the past decade, developed into a tried and tested method to deliver finality for discontinued insurance operations. Globally, over 100 such Schemes have been sanctioned by Courts, most in the UK but also in other territories that share Commonwealth based legal systems, such as Bermuda and Australia.

Scheme of arrangement legislation is set out in Section 425 of the UK Companies Act 1985 and, in simple terms, is a mechanism by which a company may effect a compromise with its creditors – a deal. Fundamentally, a Scheme provides for a wholesale commutation of business that is subject to the Scheme and requires creditors to vote on proposals made by the company in respect of the terms of the deal being offered. A majority of creditors representing at least 75% of the value of claims of the creditors actually voting are required to vote in favour of the Scheme in order for it to be approved.

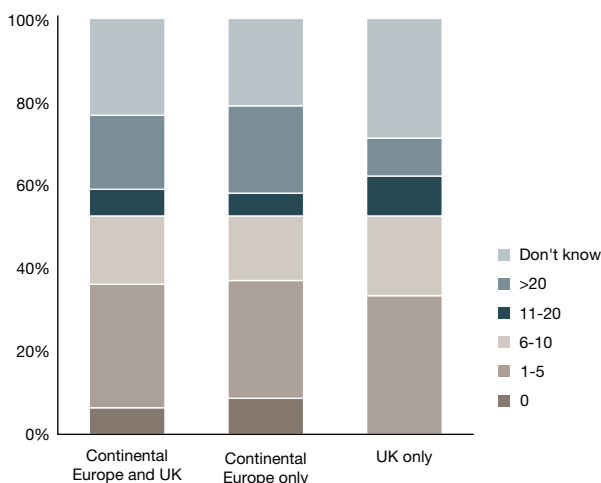
Once approved by creditors, the Scheme will proceed for sanction by the Court. Once sanctioned it then becomes effective and binding on all creditors and the company in respect of business subject to the Scheme. The Scheme process from design to promotion to implementation typically takes around 12 to 24 months.

One of the major benefits of a Scheme is that it can be applied not only to a whole entity in run-off but also to specific portfolios of relevant run-off business. For example, a major European-based, life insurer may have participated in a reinsurance pool at some point in the past, a common occurrence for Continental European insurers writing in the 1970s and 1980s. The flexibility of a Scheme means that, for example, it is a tool capable of being employed in relation to a specific portfolio of pool business only, leaving the company's other business untouched.

One of the major benefits of a Scheme is that it can be applied not only to a whole entity in run-off but also to specific portfolios of relevant run-off business

Survey participants were asked if they knew how many solvent schemes of arrangement had been effected for Continental European run-off insurance business to date.

Figure 16: Views on the number of “sufficient connection” Schemes in Continental Europe



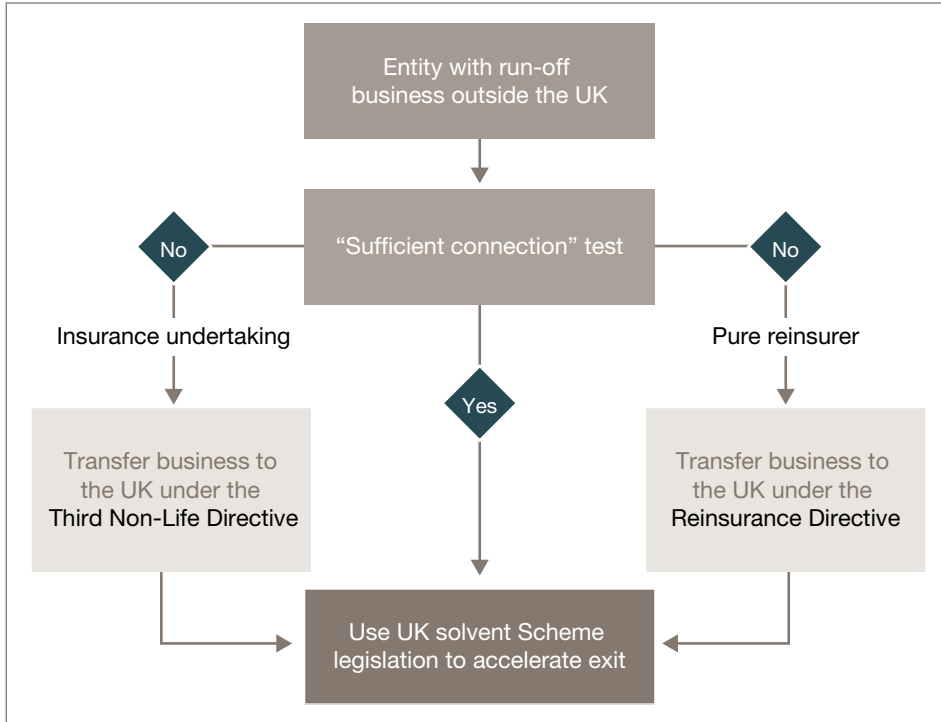
Source: PricewaterhouseCoopers

The actual answer to this question is that over 30 Schemes have been effected for Continental European companies as at January 2008. As the responses to this question illustrate in Figure 16, this remains a relatively little known fact amongst European respondents. Some 21% of Continental European participants answered “don’t know” and, excluding these responses from the sample, some 73% of the remainder underestimated the number of Schemes

that had been made effective for Continental European business. Some participants were unaware that any such Schemes had been effected with 9% answering that to their knowledge no such Schemes existed. Some confusion is perhaps understandable when faced with this question, as a natural reaction would be to question how, for example, a Scheme using UK law may be applied to a German domiciled reinsurance run-off portfolio?

Once the claims valued by the Scheme have been paid by the company the Scheme terminates, after which surplus capital may be released to shareholders

Figure 17: Solvent Schemes – options for European business



Source: PricewaterhouseCoopers

Figure 17 illustrates how an owner of Continental European discontinued insurance business may access the UK Scheme mechanism to bring finality to its run-off liabilities.

As Figure 17 highlights, there are two distinct routes for a portfolio of run-off business to access a Scheme. The first involves establishing a “sufficient connection” to the UK.

The second route is a two step process, involving the use of business transfer legislation, either that implemented under the Third Non-Life Directive or the Reinsurance Directive, to transfer the business into the UK prior to a Scheme being proposed. Therefore, in principle, any discontinued Continental European

business can potentially now use Scheme legislation without needing to prove “sufficient connection” to the UK.

In our Survey, some 23% of Continental European respondents identified solvent Schemes as being the exit mechanism they expected to be most frequently used in relation to run-off business in Continental Europe over the next five years. In addition to this, there is a strong indication that respondents also consider transfers of business to be an important exit tool in the future with some 37% citing this as a mechanism likely to be used most frequently in Continental Europe. This may also be an indication that organisations are already considering the use of these two exit instruments in conjunction with each other.

If “sufficient connection” can be demonstrated, there is no requirement to transfer the business to the UK to access Scheme legislation

The test of “sufficient connection” is not set down in any prescribed set of rules and regulations. It focuses on establishing whether an entity can show enough of a connection with the UK for the Court to be comfortable it has jurisdiction to sanction a Scheme. Typically this would include one or more of the following bases:

- policies have been underwritten through a UK business presence such as a UK branch;
- business written was produced by London Market brokers;
- creditors are domiciled in the UK; or
- reinsurers or other assets are located in the UK.

An example of how an organisation could use a Scheme to reach finality through “sufficient connection” is shown in Figure 18.

Enforceability of “sufficient connection” Schemes

One common area of interest both to companies promoting a “sufficient connection” Scheme and to policyholders involved in any Scheme is the enforceability of a UK sanctioned “sufficient connection” Scheme in the home territory of the Scheme company. PwC has advised on all but one of the “sufficient connection” Schemes made effective for Continental European portfolios and our experience to date supports the fact that policyholders have been satisfied with the commercial terms of the Schemes proposed.

The enforceability issue has been the subject of discussion, particularly in Germany. The consensus of opinion from market commentators appears to be that, whilst untested, there are a number of strong legal arguments that suggest the German Courts would be minded to recognise a Scheme for a reinsurance book that had been approved by creditors and sanctioned by the UK Court.

Figure 18: Case study – Implementing a pro-active run-off strategy (continued)

French subsidiary

The review of this subsidiary by the Group has identified that the most practical and efficient way to deal with this business is to take different approaches for the discontinued and live elements. The live business could be retained in France but by using a branch structure this will optimise capital and regulatory efficiencies. The portfolio of London Market reinsurance business, which was written as part of a pool, should be closed through a “sufficient connection” Scheme, perhaps as part of a wider pool Scheme promoted by all of the member organisations.

UK branch

Having reviewed this business it is determined that it is appropriate for the live international reinsurance book to remain within the UK branch. The reinsurance run-off business may be Schemed in the normal fashion in the UK and the continuing operation of the branch provides the Group with a dedicated vehicle to accept transfers of run-off business from the German headquarters at appropriate points in the future, assuming the businesses transferred are suitable for Schemes.



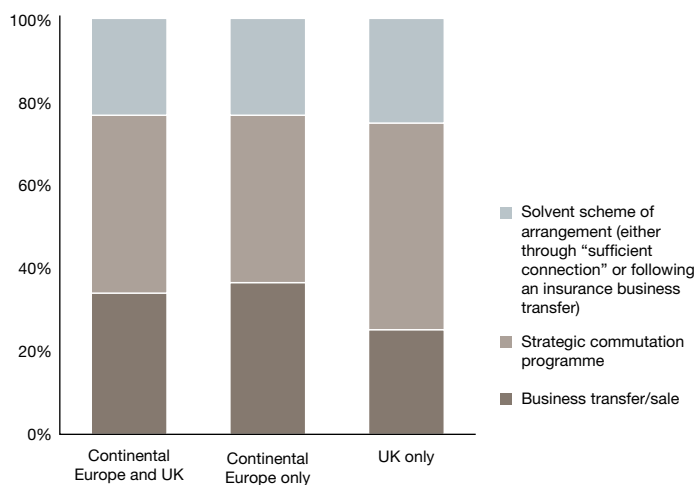
Source: PricewaterhouseCoopers

PwC has advised on all but one of the “sufficient connection” Schemes made effective for Continental European portfolios

Run-off business in Europe:
Exit route options summary and
Survey conclusions

We asked Survey participants which exit mechanisms they thought would be the most frequently used in relation to run-off business in Continental Europe over the next five years.

Figure 19: Most frequently used exit routes over the next five years in Continental Europe



Source: PricewaterhouseCoopers

The responses to our exit mechanism Survey question as represented in Figure 19 show a broad spread of opinion exists.

Some 40% of Continental European respondents selected strategic commutation programmes as the mechanism they consider will be utilised most frequently over the next five years and 50% of UK respondents mirrored this thought. This result is surprising given the level of exit activity already taking place in the UK through Schemes and business transfers. Perhaps the UK Survey respondents interpreted this as the number of individual deals that need to take place to achieve an exit.

Commutations will always play a central role in the management of run-off operations and market commutation events in the UK, Europe and the USA are gradually attracting more interest from European insurers and reinsurers. As evidence of the increasing interest of Continental European businesses in these types of event, the Cavell Commutation Rendez-Vous held each summer in Norwich in the UK attracted 20% more European based participants in 2007 than in 2002.

It should be recognised, however, that the use of commutations in isolation as a sole mechanism for exit will take a considerable time to deliver that objective, on anything other than the smallest portfolios. A correlation may be seen between this observation and the responses to our Survey which support the view that over two thirds of European run-off will last for at least a further 10 years along with the expectation that commutations will lead the way as the most popular exit mechanism.

As previously mentioned, 37% of Continental European respondents anticipate that business transfers and/or sales will be the most frequently used exit mechanism in Europe in the next five years. This preference supports the significant numbers of respondents who anticipate that following the implementation of the Reinsurance Directive, Continental Europe will see either moderate or significantly increased transfer activity. As we have discussed earlier in this Survey organisations are likely to utilise business transfers for many reasons including as a means to deal with discontinued books of business. In the context of run-off

business, a business transfer either internally within a Group or externally to a third party, is unlikely to be an isolated transaction and may well be a platform for the implementation of a further exit mechanism such as a Scheme.

In considering sales of run-off portfolios it is fair to say that there has been a healthy volume of activity in the London Market but less evidence of this so far in Continental Europe. The ranks of specialist acquirers have swollen in recent years and, as competition has increased in London so, if market intelligence is to be believed, have acquisition prices. It therefore appears inevitable that acquirers will increasingly turn their attention to run-off portfolios in Europe.

Philip Grant, Chairman of ARC, in considering trends in run-off acquisition states that "Low-hanging fruit has now already been plucked or is very expensive as we have to work harder to make our money. I think the answer is, now that the extraction mechanisms are increasingly available, so the acquisition activity will start to ramp up, and of course you have to see vendor appetite as well as buyer appetite. The vendor appetite will start to be there because the CFO who drives these sorts of things will be seeing the commercial logic of it."

The third most frequently cited anticipated exit mechanism after commutations and business transfers/sales identified by some 23% of Continental European respondents

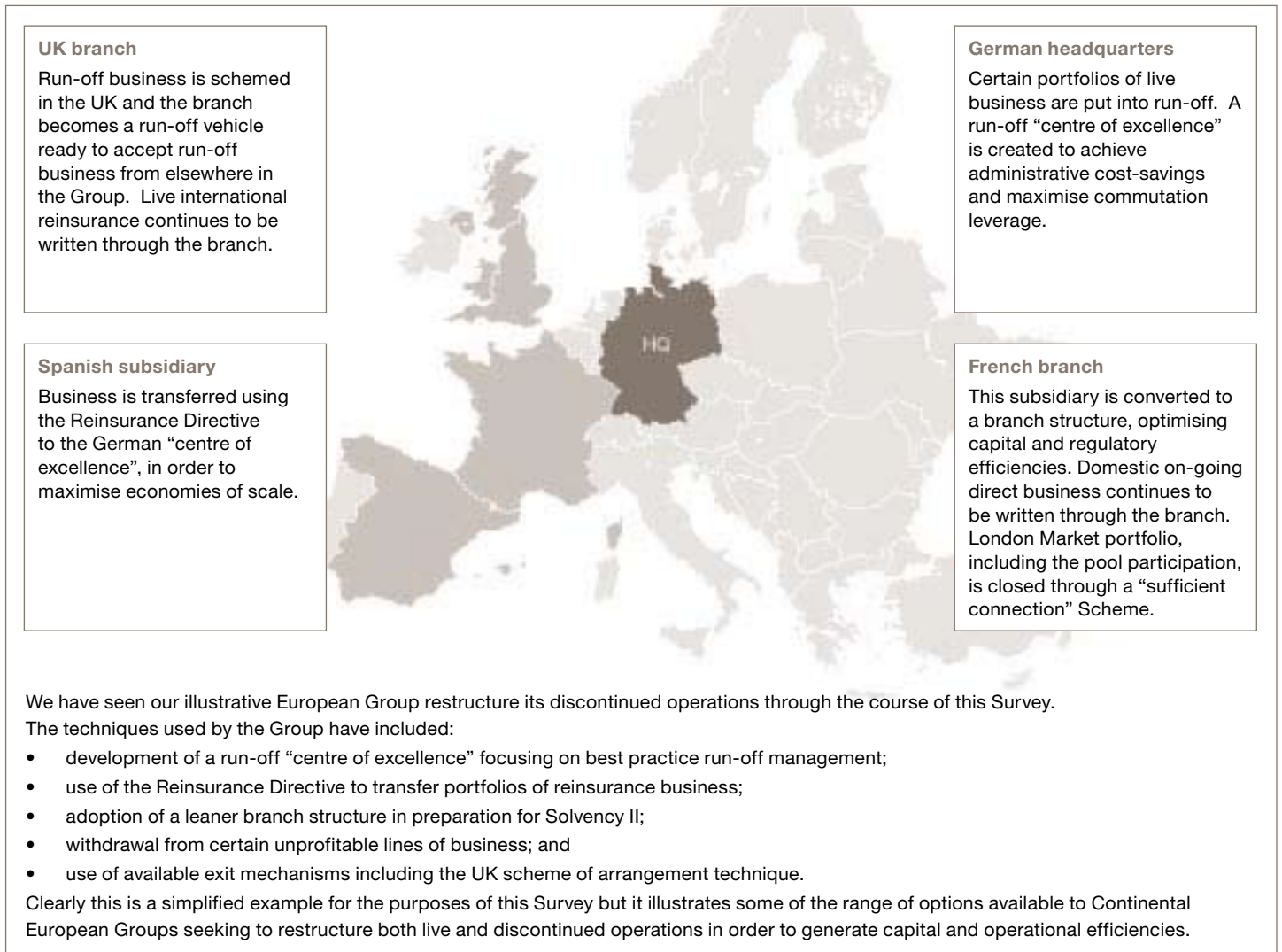
was a scheme of arrangement. As we have already shown there has been significant Scheme activity in relation to European run-off. It is reasonable to anticipate a future steady flow of such Schemes as increasing numbers of Continental European insurers and reinsurers with appropriate legacy portfolios fully appreciate that this tried and tested finality route exists and, more importantly, is applicable to their business.

One of the more interesting developments in the coming months and years will be the interaction between business transfers and Schemes. Where the grounds for a "sufficient connection" Scheme do not exist but the underlying business is capable of being Schemed then a business transfer to an appropriate jurisdiction followed by a Scheme is now a realistic option for owners of Continental European run-off business. Transfers that are completed as a precursor to Schemes will be a fresh and exciting development in the run-off market. Such hybrid transactions will be watched closely by regulators and policyholders alike but, conducted fairly and transparently, should provide another option for exit from discontinued insurance business across Europe. These types of development continue to illustrate that an industry which focuses its attention on legacy issues is not frightened of innovation - quite the contrary - it embraces change and is finding new ways to deal with its issues.

It will be fascinating to see how the areas of restructuring and exit management for run-off business evolve and how the Continental European companies start to use the now more complete run-off "toolkit" at their disposal. As our Survey results indicate there is a clear expectation that European companies will react positively to the legislative and regulatory opportunities and challenges that will exist as a result of the Reinsurance Directive and Solvency II. However, the realisation that a practical and flexible framework is taking shape that facilitates true exit planning across Europe will take time to be absorbed by all of the market.

We believe it is too early to talk of a revolution in run-off in Continental Europe, but there are clear indications of steady evolution in terms of the way in which discontinued business is now being viewed across Europe. The continued use of Schemes for Continental European run-off portfolios, the utilisation of the Reinsurance Directive to transfer European run-off portfolios and the Solvency II projects that we are increasingly seeing our clients undertake, all support the continued momentum in terms of the way in which European discontinued business is being dealt with. We expect and look forward to further evolution and more in the way of innovative developments for the run-off market in Europe in 2008.

Figure 20: Case study – The results of implementing a pro-active run-off strategy



Source: PricewaterhouseCoopers

Glossary

ARC – the Association of Run-Off Companies is the UK trade body for insurance and reinsurance legacy management professionals.

Continental Europe – for the purposes of our Survey this is all countries in Europe excluding the UK. The countries included in our statistics, other than the UK, are as follows: Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, European Russia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Montenegro, The Netherlands, Norway, Poland, Portugal, Romania, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and Ukraine.

EEA – the European Economic Area which includes all member states of the EU (as listed below) as well as members of the European Free Trade Association (EFTA). Members of the EFTA are Iceland, Liechtenstein, Norway and Switzerland however Switzerland is not included in the EEA.

EU – the European Union is a community of 27 members seek to create a single market by a system of laws that apply in all member states. The members of the EU are currently Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

Europe – any reference to Europe means Continental Europe plus the UK (as defined below).

FSA – the Financial Services Authority is an independent body which is given statutory powers by The Financial Services and Markets Act 2000. It is the single regulator for the financial services industry in the UK.

Part VIIs – these are insurance business transfer schemes that are effected in line with the terms of Part VII of the Financial Services and Markets Act 2000 which took effect in the United Kingdom at the end of 2006. This legislation replaced and extended the former regime which was set out in Schedule 2C of the Insurance Companies Act 1982.

Reinsurance Directive – the European Commission's Directive on the supervision of pure reinsurance companies - published in December 2005 and expected to be implemented in the EU member states by the deadline of December 2007.

Run-off / discontinued business – in line with the definition we used in the first edition of our Survey (published in February 2007) this includes entities that are wholly in run-off as well as discontinued business which forms part of continuing operations. Branch business is included in the domicile in which the branch is regulated. The terms run-off, discontinued and legacy business are used interchangeably.

SEGS – the Syndicate Europeen de Gestion des Sinistres is a French trade body for insurance and reinsurance claim management and legacy business professionals

Solvency II (the Proposal for a Directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance – Solvency II) – a draft Directive forming part of the European Commission's drive for a single European market and the modernisation of regulation. It will create a single risk sensitive EU-wide regulatory framework. The Solvency II project was initiated by the European Commission in 2001 and the Directive is now expected to be implemented in 2012.

Third Non-Life Directive – the European Commission's Directive on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance – published in June 1992 with an implementation deadline of July 1994.

UK – United Kingdom includes England, Northern Ireland, Scotland and Wales.

PricewaterhouseCoopers' insurance 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; and
- the need to benchmark the claims and reinsurance functions to assess their effectiveness or otherwise.

To find out more please contact any of the team below or visit our website:
www.pwc.co.uk/discontinuedinsurance

Dan Schwarzmann



daniel.schwarzmann@uk.pwc.com
020 7804 5067

Mark Batten



mark.c.batten@uk.pwc.com
020 7804 5635

Peter Greaves



peter.j.greaves@uk.pwc.com
020 7804 4061

Andrew Ward



ward.andrew@uk.pwc.com
020 7213 3197

Clare Whitcombe



clare.l.whitcombe@uk.pwc.com
020 7804 4844

Kirsteen Hodge



kirsteen.j.hodge@uk.pwc.com
020 7804 0994

Neil Gayner



neil.h.gayner@uk.pwc.com
020 7212 6117

Nigel Rackham



nigel.d.rackham@uk.pwc.com
020 7212 6270

Patricia Clarkson



patricia.clarkson@uk.pwc.com
020 7804 4829

Steve Richardson



steve.j.richardson@uk.pwc.com
020 7804 1597

Bryan Joseph - AIMS



bryan.rp.joseph@uk.pwc.com
020 7213 2008

Jim Bichard - Regulatory



jim.bichard@uk.pwc.com
020 7804 3792

Huw Jenkins - Tax



huw.d.jenkins@uk.pwc.com
020 7212 5480

Mark Allen - AIMS



mark.allen@uk.pwc.com
020 7212 4631

Mark Speller - Corporate
Finance



mark.k.speller@uk.pwc.com
020 7213 1154

Simon de Young - Tax



simon.de.young@uk.pwc.com
020 7804 5890

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