

Maximise the value in your
discontinued insurance business*



*connectedthinking

page Contents

1	Introduction
2	What exactly is run-off?
2	Why is the management of run-off important?
4	What is different for a company with discontinued insurance business?
5	Stakeholders in the run-off
6	What are the key strategic areas to consider?
7	What are the key operational areas to consider?
8	The outsourcing option
9	What will the regulator be looking for from a company in run-off?
10	Conclusion

Introduction

The size of the insurance discontinued business or run-off market has grown significantly over recent years both in the UK and worldwide with liabilities in excess of \$180 billion and growing at 10% per annum*. It is an industry in its own right with business drivers that are very different from the active insurance market. Dealing with discontinued insurance business requires a change of focus as management need to address the challenges of a different commercial environment.

It has been demonstrated that run-offs can effectively deliver certainty and value for stakeholders provided that the run-off is properly controlled. This includes establishing an effective claims process focused on overall cost reduction, managing relationships with reinsurers, seeking commutations, retaining key staff, and considering finality options. However, experience has shown that many run-off portfolios have been passively managed and have often been characterised by lack of focus, operational inefficiency and ultimately loss of value. It is therefore critical to take control.

What exactly is run-off? What is different for a company with discontinued business? Why is the management of run-off important? Which are the key areas to review? Should the run-off be managed in-house or outsourced? What is the regulator looking for? This brief guide considers these questions. It is important that these questions are considered not only by companies contemplating run-off but also as a timely reminder for existing run-off companies and those with run-off portfolios.

This guide cannot be exhaustive of every situation or all issues that may arise, but seeks to highlight some of the issues that should be considered. This is a generic document and does not constitute specific advice; circumstances vary and are subject to a variety of features that will not have been considered for the purpose of this guide. You may wish to consider engaging us to provide specific advice in relation to your circumstances.

PricewaterhouseCoopers LLP ("PwC") provides innovative tailored solutions for the discontinued insurance business market. Our approach focuses on unlocking and protecting value. We have an unparalleled track record of delivering solutions for clients that draw on our global network and expertise.

We hope that this guide will be of help to you. If you have further questions or need advice on your particular circumstances, please contact any of the people whose names are set out at the back of this guide.

* Swiss Re, in the publication 'The run-off phenomenon', dated 2000, stated that the value of the worldwide run-off market is estimated at USD 184 billion and expected to increase at an annual rate of some 10 per cent.

What exactly is run-off?

Run-off is the process where insurance liabilities arising from business no longer written are concluded over time. Run-off is most commonly associated with the situation where a company exits from the market completely. However, run-off also arises where a company withdraws from underwriting new business, ranging from a specific class to particular contracts, but is otherwise continuing to underwrite business in other areas. In any of these run-off circumstances the existing and future liabilities of the company will need to be properly managed to bring them to finality.

Why is the management of run-off important?

Irrespective of whether a company ceases to write any new business or simply withdraws from a portfolio of business, the way in which the run-off is subsequently managed will greatly impact the eventual outcome.

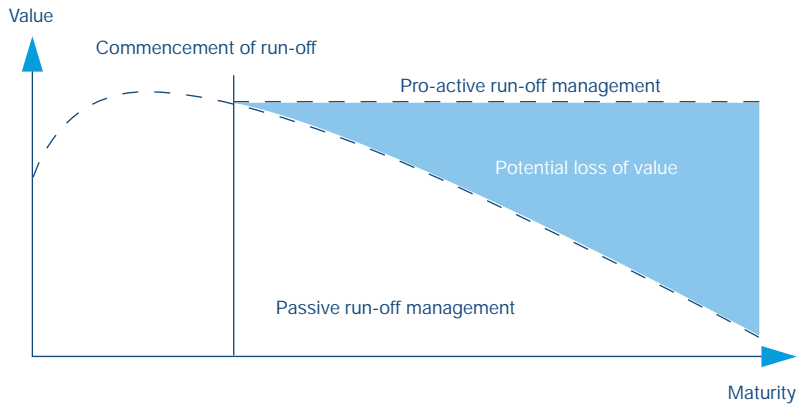
A run-off that is passively managed and does not address the changed environment of run-off may potentially reduce or destroy value remaining in the company.

Indicators of passive management include:

- Lack of a demanding business plan with focus on protecting and enhancing value
- Cash management including reinsurance collections, receives less attention
- Informal, unstructured business practices
- Lack of tight control over financial management
- Staff lose sense of urgency
- Lack of control over external relationships e.g. outsourcers.

All these areas can be addressed by exacting, proactive management.

Run-off Value



Pro-active management of the run-off, including the setting of strategic objectives and the implementation of a focused plan for their achievement, will enable the company to more effectively manage the discontinued business and maximise the return for stakeholders.

What is different for a company with discontinued insurance business?

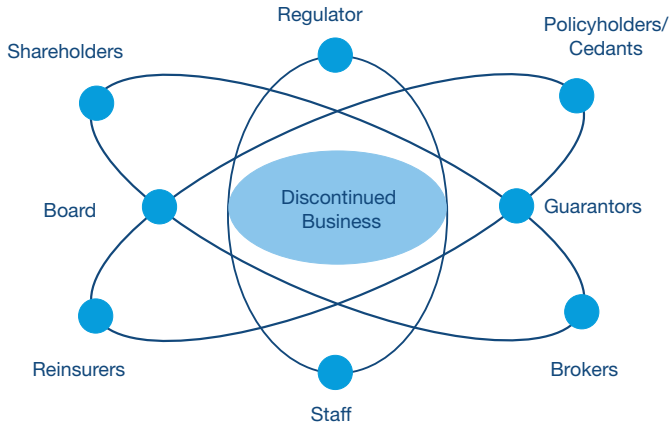
When an insurance company ceases underwriting new or renewal business the environment in which it operates will fundamentally change. Management will need to change the way in which they manage the discontinued business to ensure value is preserved and steps are taken to enhance value. The consequences of run-off can include:

- Lack of commercial leverage with reinsurers and brokers
- Possible reduced levels of service from brokers and other service providers
- Increased risk of claims escalation and leakage
- Enhanced focus on cost reduction with less emphasis on service
- Potentially inadequate information to set reserves effectively
- Greater focus on utilisation of capital with reduced income stream
- More interest from the regulator
- Reduced senior management time – the run-off operation can be forgotten about
- Diversion of people and time away from core business activities
- Poor staff motivation/high staff turnover
- Different skill base required
- Outsource relationships not effectively managed
- Potential adverse impact on continuing business
- Perception that the company may be financially impaired

These issues are particularly important when run-off is being contemplated. In addition, failure to effectively manage them at an early stage in the run-off will limit the opportunities for maximising the value contained in the discontinued portfolio, whilst increasing the pressure from stakeholders on management. These issues are also relevant for existing run-off companies and serve as a reminder of the opportunities which exist to enhance value.

Stakeholders in the run-off

When the decision is taken to place certain business or the whole company into run-off, there must also be consideration of the impact on the various stakeholders involved. The key stakeholders that need to be considered are:



In handling the run-off, management will need to balance all stakeholder needs and accommodate these within the run-off plan. Some of the issues concerning stakeholders include:

- **Shareholders** – will be concerned about the value of their investment in the company and will wish to ensure existing value is maximised.
- **Board** – will need to ensure that integrity and reputation is preserved when dealing with the consequences of run-off.
- **Regulators** – will want to ensure policyholders' interests are satisfied and will review and monitor the run-off strategy and its implementation.
- **Guarantors** – will want to ensure that any calls upon guarantees are avoided or minimised.
- **Policyholders/Cedants/Brokers** – will want to ensure that current and future claims will be met in full and on a timely basis.
- **Reinsurers** – will want to know that claims are being agreed and presented to them fairly and in a timely manner.
- **Staff** – may become unsettled about the prospect of working in a run-off environment and will want to know what their role in the run-off is and what their future career prospects may be.

What are the key strategic areas to consider?

- **Overall objectives and business plan** – The success of a run-off is driven and directly influenced by the objectives set. These need to recognise the financial and other requirements of stakeholders. These objectives together with financial projections and an implementation plan can form the basis of a robust business plan.
- **Organisational structure and staff** – The foundation of an efficient and effective run-off is a focused management team and clear direction of sufficiently trained and motivated staff. The resource mix and structure required for an efficient run-off is different to that required in a live company. It is essential that key personnel with critical knowledge required for the run-off are identified and either retained or recruited by the company. This is likely to require the development of staff incentive and retention plans, which may include creating a future for them outside the existing run-off.
- **Underwriting exposures** – The underwriting exposures of the company or portfolio should be reviewed in order to assess the impact of unexpired risks as these could trigger further liabilities. In addition to the loss of future premium income, exposure per risk increases in relative terms. If the run-off business was underwritten through delegated authorities or binders these should be reviewed and the ongoing management of the business considered in terms of meeting the run-off objectives of the company.
- **Claims handling strategy** – This should be clearly set out and as tightly defined as possible. The aim of any company should be to minimise claims leakage, but in a run-off environment it is even more important as the company's income flow, which may have been previously used to mitigate such risk, is reduced.
- **Case reserving** – In assessing the financial position of the company, the case reserving philosophy should be reviewed and reserves interrogated to assess whether they are sufficient, and equally that any redundancies are identified.
- **Reinsurance protection** – Procedures should be reviewed so that the reinsurance asset is maximised in view of the consequences of run-off. Potential exhaustion and the need for additional run-off reinsurance protection should also be considered.
- **Reinsurance receivables** – Given the likely increased reliance on reinsurance as an income stream, it is important that recoveries are made on a timely basis. In run-off there is a general slowdown in payments resulting in a proportionately increased risk of bad debt. Set-off opportunities should be sought to reduce this. Given these risks it is important that the company has a focused collections strategy.
- **Commutations** – A strategic programme of commutations should be established to remove inward liabilities and exposures and to secure value from the outwards reinsurance programme. This should reduce the size of the run-off and reduce the risk of claims deterioration and the consequences of a reinsurer failure.

- **Operating expenses** – Expenses should be tailored to meet the needs of the run-off. The setting of realistic provisions for future run-off costs is also required. This needs to take into account the expected development of the run-off and related resource requirements.
- **Cash flow investment management** – Managing cash and investments to pay all claims when they fall due, whilst maximising returns from the investment portfolio will also be important, as will the management of any other investment risks.
- **Finality and exit options** – A structured run-off plan should include an analysis of when the run-off will conclude and what will be the most appropriate method to achieve finality for the portfolio or company. This can include, run-off to extinction, sale, portfolio transfer or a scheme of arrangement. The company will consequently have to give active consideration to what might provide the best option to achieve the run-off objectives. If a finality decision has been made then it should be incorporated into the run-off plan.

What are the key operational areas to consider?

Sufficient time should be invested on a regular basis in a considered analysis of the run-off to ensure that strategic objectives can be met and confirmation obtained that the run-off can be conducted efficiently and effectively. Key operational areas to focus on are:

- **Business planning** – As noted above a business plan reflecting the strategic objectives of the company and the intended timescale for achievement is imperative to ensure a clear focus. The business plan should provide the direction for the operational management of the run-off.
- **Operational management** – It is important that resources are matched to the run-off plan, therefore an early review of the structure of the organisation and the roles required is essential. Staff management must form an essential part of the operational day to day management plan.
- **Milestones and measurement against objectives** – Challenging but achievable short-term goals and departmental objectives are important in determining progress and securing motivation. The consideration and implementation of key performance indicators will assist in the measurement of achievement and highlighting of areas requiring increased focus.
- **Protocols and working practices** – Defined and unambiguous guidelines to staff and instructed third parties should assist to ensure consistent delivery to the run-off plan.

- **Financial modelling and scenario testing** – Robust financial projections of the run-off development and cash flow forecasts are integral to a managed run-off. Solvency “breakpoint” analysis should also be undertaken so that the financial position of the company can be measured against a number of different scenarios.
- **Management reporting** – Operational reporting requirements will have a different focus from that of an active company. Information is critical in determining measurement of performance and efficiency of the run-off operations. Management will require enhanced reporting to assist them with monitoring activity, organising resources and supporting future decision-making.
- **Communication plan** – In order to manage stakeholders’ concerns and expectations of the run-off it is important that the company has a clear communication plan that provides consistent and reliable information on a timely basis. The company should consider the most suitable method of communication for each stakeholder, internal and external.
- **IT** - It may be necessary for the company to consider the rationalisation of existing systems or the development of alternative systems to support the needs of the run-off.

The outsourcing option

Whether to outsource the administration of a run-off or to perform it in-house is a matter that should be given serious consideration. Outsourcing enables the day-to-day handling of the business to be administered elsewhere, so that greater focus can be given to achieving the objectives of the run-off. It must be recognised, however, that whilst the administration can be delegated, the responsibility and accountability for the business still remains with the company’s management. Where business is outsourced it is essential that strong management control is exercised over the outsource provider to ensure they deliver to the requirements of the run-off.

Some of the reasons a company might choose to outsource its discontinued business include:

- Economic efficiency
- Resource availability and/or risk to resource base
- To separate discontinued business from ongoing business within the company

The construction of the outsourcing arrangement is critical to its success and it is important that there is a shared incentive towards achieving the objectives of the run-off. The process should therefore be carefully controlled and some of the key aspects to consider are:

- **Selecting an outsource provider** – It is important that a structured approach is adopted in the selection of the outsource service provider to identify the provider most suitable to meet the requirements of the company. One of the ways this can be achieved is by use of a well-drafted “request for proposals” document. This should ensure that responses focus on the required criteria and that bids of all potential suppliers can be measured consistently against the overall objectives of the run-off.
- **Contract and service level agreements** – The run-off contract and service level agreements must be explicit in, amongst other matters, the roles and responsibilities of each party, the measurement of performance, termination arrangements, system considerations, retention of the appropriate skills and experience of staff, and how and on what basis the service provider will be rewarded (or penalised). Generally the most effective contracts are where the remuneration of the service provider is aligned to the achievement of the objectives of the run-off.
- **Review and control** – Strong management and control of the outsource relationship is critical to maximising value from the outsourcing arrangement and to provide confirmation that it is complying with the overall run-off plan and objectives. The company will need to have the right skills or assistance to manage the outsourcing arrangements to ensure that the provider is performing as expected.
- **Staff and TUPE** – It is essential that the legal requirements of TUPE (“Transfer of Undertakings (Protection of Employment)”) are complied with. Therefore, when considering outsourcing the impact on staff and any associated effects on the company will be a major issue. It should, however, be recognised that outsourcing can provide a future for staff outside the existing run-off.

What will the regulator be looking for from a company in run-off?

When a company ceases to effect new contracts of insurance in the UK, the Financial Services Authority requires a run-off plan to be submitted to them within 28 days. This plan will contain a “Scheme of Operations”, and an explanation of how, or to what extent, all liabilities to policyholders will be met as they fall due. Provided the company has considered all the consequences arising from the decision to discontinue underwriting and has modelled the impact on its financial position, then the requirements of the regulator should not be too onerous. Failure to prepare an adequate run-off plan, however, will probably result in increased supervision and reporting obligations.

The regulator will have a keen ongoing interest in the progress of the run-off so it is important that an open and trusting relationship is formed with the regulator at an early stage and regular communication is maintained throughout the run-off.

The Scheme of Operations needs to show how the run-off of the business will be conducted in order that solvency is maintained and should include:

- A description of the company's business strategy
- Financial projections (including appropriate scenarios and stress tests)
- Details of the assumptions which underlie the financial projections, and the reasons for adopting these assumptions
- Any material group or external transactions effected or proposed that will impact on the company's financial position.

It is likely that the regulator will be seeking assurance that there is a clearly thought out and structured approach to the run-off, with well defined objectives and a strategy for their achievement. Robust financial modelling and scenario testing will provide assurance that the plan is achievable and realistic under all likely eventualities. In other jurisdictions a similar plan is likely to be required by local regulators to address the same needs.

Conclusion

A tailored and focused approach is needed to deal with the consequences of run-off. Pro-active management of discontinued business will assist in ensuring that stakeholders' needs are addressed and that certainty, finality and maximum value are delivered to shareholders.

PricewaterhouseCoopers experience

PricewaterhouseCoopers LLP is one of the leading firms of professional advisors to the insurance industry and is a recognised leader in the run-off environment. We advise clients with both in-house and outsourced run-off activities. We are also responsible for the run-off strategy of many discontinued insurance businesses with over \$8.6 billion of liabilities in total, for many of which the day-to-day run-off activities have been outsourced.

Contact details

If you wish to discuss how you can maximise the value in your run-off, please contact one of the following:



Peter Box



Dan Schwarzmann



Patricia Clarkson



Robert Hardy



Sarah Redgers



Alan Augustin

at Plumtree Court, London, EC4A 4HT, England.

Telephone number: +44 (0) 20 7583 5000

Facsimile number: +44 (0) 20 7822 4652

You can also look up our website: www.pwc.com/discontinuedinsurance

Alternatively, email your questions to us at discontinuedinsurance@uk.pwc.com

Another publication that may be of interest is:

Solvent Schemes of Arrangement for Discontinued Insurance Business

Please contact any of the above to obtain a copy

