

Insurance: Running off to stand still

Solvency II will change the run-off landscape. Those run-off specialists who adapt wisely will be able to propel themselves out of the brutally competitive landscape that they currently find themselves in.

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The diversification debate

The capital benefit derived from business diversification has been a major debate around Solvency II. Initially, the concept was in – probably driven by the greatest proponents of Solvency II, the European majors. A large diverse organization such as Allianz or Axa is set to benefit from a significant capital advantage over a small niche player under such a regime.

Diversification then dropped out of the equation for a while, but in QIS5 it is back. It would appear that the EC has overruled CEIOPS.

Smarten up or become extinct

The net result is that smaller, niche players will need to get smart about how to manage their business, or fall into run-off. A recent AON report suggests that reinsurance is a practical solution for dealing with capital pressures brought about by Solvency II. Certainly BRAVE Partners expects to see a significant uptick in reinsurance activity, especially for more focused players. The exact form of this business is still to be determined.

Jockeying jurisdictions

The notion of Solvency II equivalence will be important. Jurisdictions that wish to attract reinsurers will need to achieve recognition of Solvency II equivalence, whilst maintaining enough flexibility to allow concentrated risks to be capitalised at an acceptable level for the cedants.

It will be interesting to see where Bermuda comes out in relation to Solvency II. “Equivalence is a double edged sword.” Too equivalent makes Bermuda less attractive as a jurisdiction. Enough to be equivalent, but with some flexibility would make it highly attractive.

What about the run-offs?

The run-off players are looking at Solvency II with glee. The standard run-off market has become highly competitive. Any London market or Lloyd’s casualty book will attract at least six serious bidders and possibly around sixteen bidders in the first round. There is certainly a chance that Solvency II will cause more insurers to throw in the towel, especially those with hefty legacy liabilities – the bread and butter of the run-off market.

No slam dunk

Solvency II however will not be a slam dunk for the run-off business. Run-off books tend to be monoline in nature and most run-off companies seek to isolate each run-off into a separate legal entity to prevent losses in one from eating into profits in another. The run-off hold-cos will also tend to be offshore for the tax and regulatory advantages that this brings. Under their current structure, the run-off businesses could be hit by increased capital requirements from Solvency II. This would make their existing business less attractive and their future business harder to buy. A legacy run off might bring diversification benefit to a company that has changed its business over the years. In short, it might be far more capital expensive to hold the run-off outside of the original writer. This certainly can happen and has happened in the Lloyds context.

Run-off strategy

Run-off companies will need to consider their post-Solvency II strategy carefully. Two factors seem to jump out:

1. Run-off companies will want to look at more diverse lines of business than their traditional staple of casualty treaty business. These businesses will need to form partnerships and hire talent to do this.
2. The holding structure and capitalization structure for the European operations of run-off businesses will become critical. If Solvency II allows, as once mooted, a European domiciled holdco to hold capital on behalf of a number of opcos and for the holdco to take the diversification benefit, then this will be ideal. If another system is implemented the run-off specialists will need to undertake some nifty structuring to take advantage of the diversification benefit of their different run-offs, whilst maintaining the segregation of the gains and losses.

Run-off race winner

BRAVE Partners believes that the winners in the run-off business will be those that plan and prepare thoroughly for a post-Solvency II environment well ahead of time. These businesses will have the capability of taking on many lines of business and also taking the capital advantages that this diversification will bring.

Solvency II will change the run-off landscape. Those run-off specialists who adapt wisely will be able to propel themselves out of the brutally competitive landscape in which they currently find themselves.

BRAVE Partners' services

BRAVE Partners has an extensive network of connections that can identify run-off opportunities that originate well outside the main centres of the insurance and reinsurance industry. The firm has access to a broad spectrum of opportunities across a wide range of business lines.

Furthermore, BRAVE Partners has substantial structuring knowledge and experience. The firm can assist run-off specialists to structure

and finance everything from individual transactions to whole businesses in order to operate at the maximum capital efficiency.

Interaction

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- Both the competitive landscape and Solvency II will push run-off specialists towards books of business from new insurance lines.
- New lines will bring more supply to the market, reducing competition.
- New lines will bring diversification to the business, an important factor for Solvency II capital requirements.
- BRAVE Partners LLP is highly skilled and experienced in helping run-off specialists to identify, structure and execute transactions around new lines of insurance run-off business.

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