Modern Strategies to Handle Legacy Claims

September 20, 2022 – Casualty Loss Reserve Seminar

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Session Overview

Run-Off Basics

- Size of Runoff Market
- Trends & Outlook
- Transaction Motives
- Benefits Gained

Types of Run-off Firms and Structures Employed

- Recent History of Buyers
- Structures & Types of Liabilities Being Sold/Acquired
- Recent Headlines

Role of the Actuary

- Pricing the Deal
- Understanding Operational Challenges
- Monitoring the Runoff Reserves

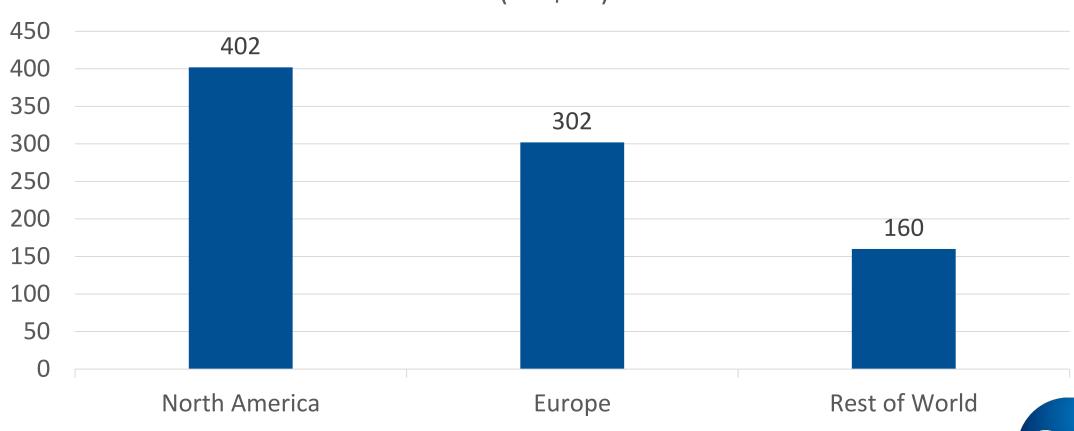
Q&A

Run-off Basics



Market Size - Global Non-Life Run-Off Reserves

(US \$bn)



Market Size – Non-Life Run-Off Liabilities

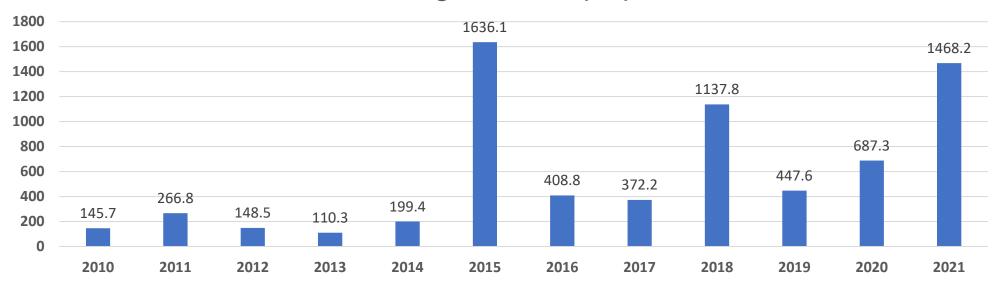




M&A Trends for P&C

Transactions represent US and Bermuda companies making acquisitions on a global basis

Average Deal Value (\$M)



Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
# of Deals	79	72	68	63	65	51	70	53	61	38	52	43

Transaction Outlook

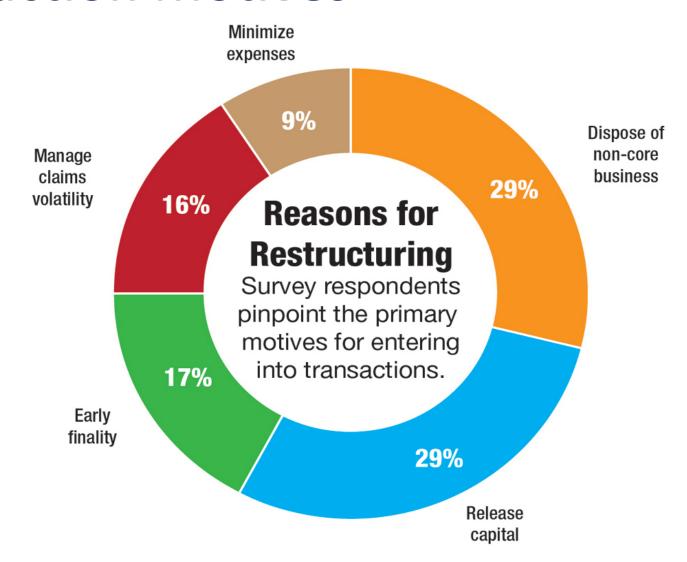
"Strong momentum in run-off sector continues"- PWC

June 20, 2022 By Reinsurance News

"total estimated value of executed deals during Q1 2022 exceeded that of the same period in 2021 (\$4.2bn vs \$3.3bn)...Most of the action was driven by **North America**"



Transaction Motives





Transaction Motives Expanded

If portfolio contains unique risks (asbestos, pollution, black lung) and/or seller is a corporate entity:

- Positive PR and ESG Boost
- Full Finality Eliminate Future Downside Risk
- Create Value and Free Up Resources
- Clean up Financials and Balance Sheet

Types of Firms and Strategies



Who Buys **Run-Off?** Types of **Firms** Present in Market Today

Large Insurance Conglomerate – Berkshire

Legacy Insurer – Insurance company structured and built to acquire run-off insurance

Non-Insurer – Private equity or Investment Bank supported capital to find portfolios to acquire

Examples of Firms Present in Market Today

Prior to 2000 - Berkshire only credible buyer

2000 - 2020 - Legacy Insurers like Enstar and Catalina and later Riverstone and R&Q emerged

Since 2020 – a flood of credible buyers have emerged backed by strong balance sheets, including Broadwell Point, Carrick, Compre, DARAG, Delticus, FARA Recovery, Fortitude Re, Legacy Liability Solutions, Marco and Premia

• Willing to quote on deals of all sizes and exposures

Transaction Structures

Adverse **Development** Cover (ADC)

- A form of stop-loss
- Cede the risk of reserve inadequacy
- Attachment varies – reserve estimate is critical

Loss Porfolio Transfer (LPT)

- Similar to ADC, and usually purchased with one
- Cede the risk of timing and investment return

Commutation

- Reinsurance transaction
- Eliminates obligations of prior arrangement for a new "price"

Novation

- Legal transfer of reinsurance obligations to a third party
- Similar to commuting

Legal Entity Sale

- **Disposal of** all or part of the share capital of an entity containing liabilities
- Common with corporate runoff

Reinsurance to Close

- **Specific to** Lloyd's
- Transfer liabilities that attach to one syndicate in return for a premium

Insurance **Business** Transfer (IBT)

- Legal transfer of insurance policies from one insurer to another via court or regulator
- Oklahoma process



Exposures Being Sold/Acquired

Workers' Compensation, Commercial Auto and Liability (Professional, Construction, etc.)

Asbestos, Pollution, etc. from 1986 and prior General Liability policies Includes sexual misconduct, chemical exposure and other latent claims

Other Emerging risks

- Silica/Talc/Glyphosate
- PFAS forever chemicals
- Opioids and other big pharma products
- Federal Black Lung



Recent Headlines

September 28, 2021 – Insurance Journal. "Religious Partners Fear Boy Scouts' Bankruptcy Plan Leaves Them Unprotected"

November 16, 2021 – Insurance Journal. "Will Forever Chemicals, PFAS, Lead to Never-Ending Lawsuits"

February 25, 2022 – Manufacturer Johnson & Johnson and the "big three" distributors finalized a \$26 Billion Opioid settlement agreement

Recent Public Deals



Swiss Re acquires Champlain Re in legacy deal

18th February 2022 - Author: Katie Baker



Enstar Announces \$3.12 Billion LPT Transaction with Aspen

January 10, 2022 16:30 ET | Source: Enstar Group Limited



CRANE

2022 – Crane (large corporate asbestos liability) acquired by Spruce Lake Liability
Management



Role of the Actuary



Role of the Actuary

- Pricing the Deal
- Understanding Operational Challenges and Opportunities
- Monitoring Results

Role of the Actuary – Pricing the Deal

Runoff specialists have differing views as to what makes a book of business attractive, but a few underlying principals apply:

Line of business and expertise of seller

Structure of the potential deal

Underlying data – is it detailed, accurate and clean for analysis?

Case reserving adequacy/philosophy changes over time

Variability in future outcomes ("risk margin")

Reasonable internal rate of return ("discounting")



Actuarial / Operational Challenges and Opportunities



More-effective management of legacy books creates the potential for considerable efficiency gains.



Role of the Actuary – Managing Runoff Reserves

Examples of functions critical to the successful management of runoff liabilities:

Data / IT – technical excellence

Claims expertise – specialized skill set required to manage legacy WC, Asbestos and GL claims (among others)

Ability to track results

Insurance coverage implications



Insurance Coverage Implications

The situation gets more complex given the age of relevant policies. Often, grainy photocopies of decades-old documents are all that remain. These complications produce considerable legal expense.

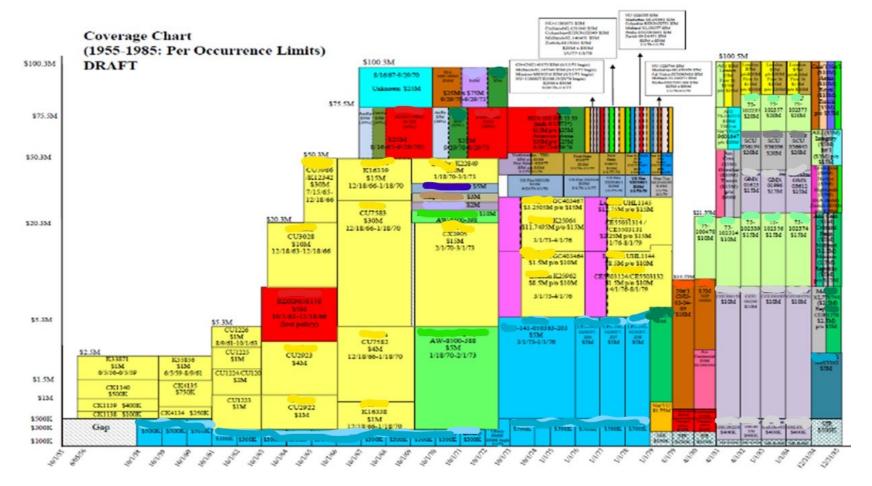
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#### **Insurance Allocation: A Difficult Task**

Insurance coverage detail can get incredibly complex with multiple parties, missing documentation, insolvent insurers, disputed coverages, and other complications. Insurers' exposure often arises via small portions in various layers of loss across dozens of different accounts.





## Insurance Allocation Simplified – All Sums

#### **All Sums Allocation Example**

Total Claims \$3,000,000 Total Limits \$6,000,000

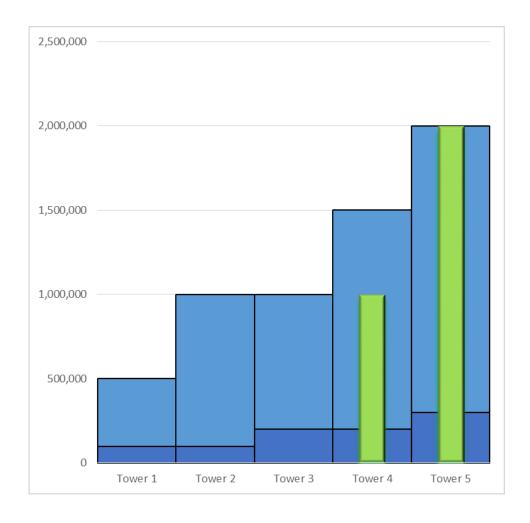
**Tower LimitsTower Costs** 

Tower 1 \$500,000 \$ Tower 2 \$1,000,000 \$ Tower 3 \$1,000,000 \$

Tower 4 \$1,500,000 \$1,000,000 Tower 5 \$2,000,000 \$2,000,000

All Sums Allocation is the simplest allocation type to conceptualize and calculate.

The insured targets specific year(s) of coverage and damages "spike" up through tower(s).





## Insurance Allocation Simplified – Pro Rata

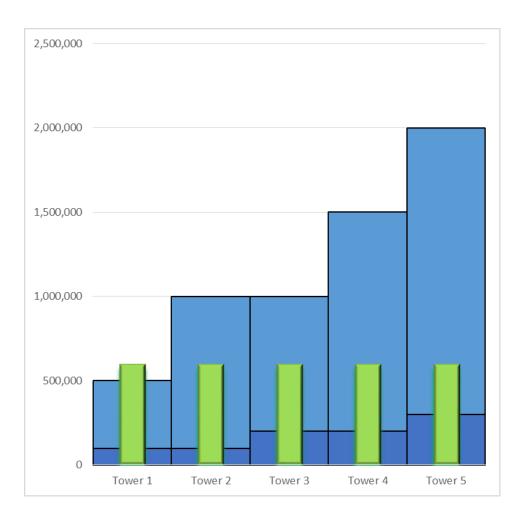
#### **Pro-Rata Allocation Example**

Total Claims	\$3,000,000
Total Limits	\$6,000,000

	Years	Damages/	Tower
	Year	Damages	
Tower 1	1	\$3M/5 =	\$600,000
Tower 2	1	\$3M/5 =	\$600,000
Tower 3	1	\$3M/5 =	\$600,000
Tower 4	1	\$3M/5 =	\$600,000
Tower 5	1	\$3M/5 =	\$600,000

Pro Rata Allocation is where the allocation is based on damages divided by years of coverage and then allocated up through each tower.

Allocating can be fairly simple. Only need to know damages, trigger period, and the policy limits/attachments. The entire coverage chart is not needed.





## **Insurance Allocation Simplified – Bathtub**

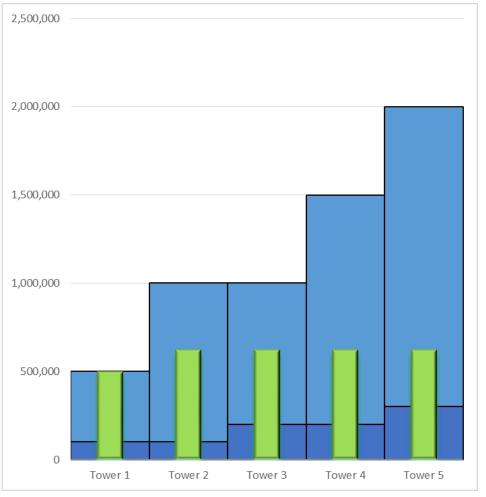
#### **Horizontal Allocation Example**

Total Claims	\$3,000,000
Total Limits	\$6,000,000

	<b>Primary Lims</b>	Ex < \$500K	Addl Tower	Total
Tower				
Tower 1	\$100,000	\$400,000	\$	\$500,000
Tower 2	\$100,000	\$400,000	\$125,000	\$625,000
Tower 3	\$200,000	\$300,000	\$125,000	\$625,000
Tower 4	\$200,000	\$300,000	\$125,000	\$625,000
Tower 5	\$300,000	\$200,000	\$125,000	\$625,000

Horizontal allocation is over the entire trigger Period.

Typically, primary limits are exhausted before umbrella/excess limits are impacted. Damages are allocated up through the coverage in a straight horizontal line.





## Insurance Allocation Simplified –Carter-Wallace

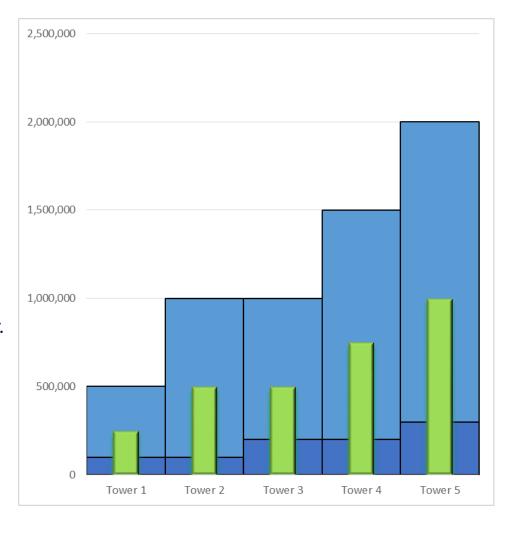
#### **Carter-Wallace Allocation Example**

Total Claims \$3,000,000 Total Limits \$6,000,000

	Tower Lims/	Tower	
	<b>Total Lims</b>	C-W Share	<b>Tower Damages</b>
Tower 1	\$500K/\$6M	8.33%	\$250,000
Tower 2	\$1M/\$6M	16.67%	\$500,000
Tower 3	\$1M/\$6M	16.67%	\$500,000
Tower 4	\$1.5M/\$6M	25.00%	\$750,000
Tower 5	\$2M/\$6M	33.33%	\$1,000,000

Carter-Wallace Allocation distributes damages based on proportion of total limits in each tower.

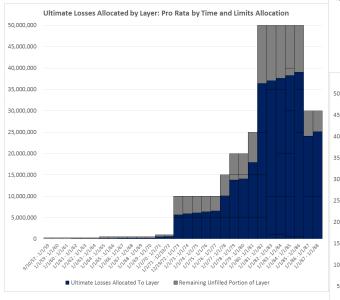
Carter-Wallace share of damages are then allocated vertically up through each tower.

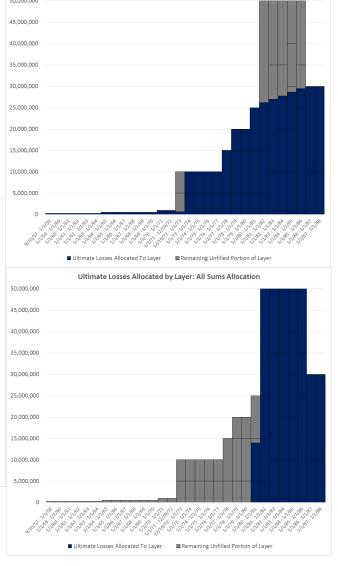




## Allocation of Loss to Policy: Without **Insolvencies**

After deriving ultimate claims, loss must be allocated to policy. Different allocation methods can produce dramatically different indications per policy. The appropriate allocation method is a matter of legal interpretation and detailed scrutiny of policy language. Need to interact with claims to understand which law applies.





Ultimate Losses Allocated by Layer: Pro Rata by Time Allocation

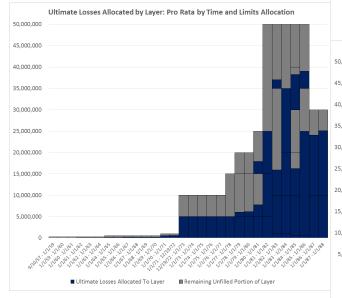


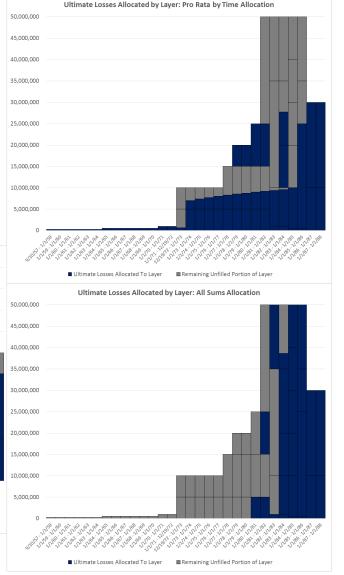
## Allocation of Loss to Policy: With Insolvencies

Insolvencies complicate the allocation. Losses are allocated to policies in the same manner as before, however, coverage holes appear where losses are allocated to insolvent insurers. Coverage gaps can be spread to remaining solvent insurers or back to the defendant to retain without coverage.

Additionally, currently insolvent insurers may have partially paid loss before insolvency. The examples shown here allocate currently paid loss to all insurers, but future unpaid loss to solvent insurers only.

Need to interact with claims to know about insolvencies.







## Questions?

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