



# THE PERFECT STORM FOR RUN-OFF SOLUTIONS

Eric Haller of Fleming Re addresses how run-off solutions can support recent changes in risk management strategies and the impact of the global coronavirus pandemic

**D**uring 2019, the run-off market saw a significant amount of corporate M&A activity-driven transactions. This trend was expected to continue in normal market conditions. At the end of 2019, the insurance market experienced a hardening market for certain lines of business and in response, many risk managers adjusted their overall strategy by increasing retentions to capitalise on the changing market. The change to the overall strategy was seen as beneficial but faced the challenge of requiring additional capital. In order to facilitate the capital requirement, some risk managers looked to a run-off solution to release encumbered capital.

As we entered 2020, the global economy began to experience unprecedented market conditions due to the Covid-19 pandemic. Many market sectors encountered significant volatility and were compelled to alter operational aspects of their busi-



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nesses. These conditions have brought about the most recent factor that is driving demand for run-off transactions. We have started to see the initial wave of companies looking for run-off solutions to support company operations as a result of the

coronavirus pandemic. We anticipate the increased demand for run-off solutions to continue throughout 2020.

Motivations for run-off transactions can vary based on specific needs. Recent trends indicate a significant driver for restructuring, in approximately 30% of transactions according to the 2019 PwC Global Insurance Run-off Survey, continues to be the releasing of encumbered capital. The combination of this recognised run-off benefit with the increased need for liquid capital to address the current market conditions will be the 'perfect storm' for demand in the run-off sector.

#### **Tumultuous times**

Market disruptions are always challenging and most of the time require liquidity and capital to successfully survive in trying times. Covid-19 is no different and it's likely the world economy will see a significant continued downturn with the inter-

national monetary fund managing director, Kristalina Georgieva, stating recently: “We anticipate the worst economic fallout since the Great Depression.” During times of market turmoil, we expect companies will look at various potential sources of capital to meet their needs. Traditional capital sources can be both challenging and expensive during market disruptions. An often-overlooked source of capital is the encumbered assets supporting an entity’s insurance liabilities; and one of the primary goals of run-off solutions is to release that capital.

Global economic shocks, such as we are experiencing, often lead companies to pivot their focus on their core businesses and examine the financial benefits of consolidation, restructuring or exiting certain ancillary operations or lines of business that are no longer appealing or viable. This may involve re-evaluating the strategy related to insurance liabilities of related parties with affected operations. The insurance industry and transaction counterparties have recognised that run-off can be used to enhance their risk management strategies, liquidity and regulatory capital ratios. Examples of this could include insurance companies looking to use run-off transactions as a less-costly form of financing compared to the equity and debt markets or a corporate operating company looking to release capital from its captive in order to provide liquidity and support their operations in these uncertain times.

It is likely that many organisations will face challenges continuing business operations throughout and following the Covid-19 pandemic. Despite the many issues surrounding this unprecedented event, it will put a spotlight on risk management and building resilient business strategies to enable companies to survive global market disruptions. While we are distressed that the world is facing such catastrophic upheaval, there are areas in which Fleming Re can help our clients and perhaps lessen their burden, so they can focus on their core businesses going forward which in turn benefits the communities in which they operate.

**Identifying the right solution**

First and foremost, at Fleming Re, we work with our clients to identify their motivations and specific goals to determine if a run-off transaction is appropriate for

them. We have the ability to quickly assess and understand the counterparties’ objectives, clearly define their needs and then structure unique solutions that are better aligned to accomplish specific goals. This customised approach will facilitate clients being able to respond quickly to the specific impacts of this pandemic on their business.

One important aspect of a successful run-off solution that needs to be considered is the structure and/or type of transaction. The most important factor is that the selected structure is aligned to the specific goals outlined at the onset of the transaction. The more common goals are access to encumbered capital, removing the ‘tail’ of liabilities and reduction of operational expenses. There are numerous transaction structures that can be employed, but this will be partially

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dependent on the current entity structure of the client and jurisdiction. Some common types of structures are: acquisition; novation; loss portfolio transfer (LPT); assumption; adverse development cover and deductible reimbursement policy. It is important to understand that no single structure is perfect for every situation. The most critical aspect is that there is open communication between the run-off provider and the client to establish goals and discuss the best structure to achieve those goals. No matter how complex the entity structure, Fleming Re will find a solution that is appropriate for the client and with our expertise, will limit any execution risk.

**Mitigating Covid-19**

Our team has industry knowledge across various jurisdictions and lines of business coupled with significant experience in structuring customised solutions tailored to the legacy and corporate M&A sectors. We are assisting client organisations in mitigating the impact of Covid-19 on their businesses, especially when they are seek-

ing to unlock encumbered capital to provide liquidity which has become a critical consideration responding to current market volatility.

Fleming Re itself has not experienced a significant impact from illiquidity, operational disruptions or financial loss. As such, we are in an opportunistic position to assist and support other companies to successfully navigate the market disruptions caused by Covid-19. We benefit from a large network of clients and industry service providers who know our company and the value we provide. While it is always more productive to meet face-to-face, new and existing online tools and video conferencing are rapidly adapting to a virtual office environment and will certainly assist in maintaining relationships. In today’s circumstances, we are using new and creative ways to stay in contact.

**Impact on Bermuda**

While Bermuda may be relatively physically isolated, we are facing the same restrictions as many countries around the world. Undoubtedly, this pandemic is likely to change how businesses operate for the foreseeable future and technology will be a crucial tool in engaging customers. Like much of the world, the island was put on lockdown and ‘stay in place’ protocols were implemented in early April. However, for the financial services industry, including the insurance market, it is ‘business as normal’ in Bermuda for the most part.

Bermuda has a long history of weathering storms and this situation is no different. The Bermuda Government is working with the international business sector to ensure registered companies have business continuity plans in place and are monitoring the impact to all regulated industries. As Bermuda is a large insurance hub, our infrastructure has always been of a high quality and we have been able to successfully manage the transition to working from home. While this has required some changes and business travel has been halted for the foreseeable future, the people and businesses of Bermuda are managing the trying times with great efficiency. Investments in IT infrastructure and business continuity planning by the international business sector have paid off. The future is certainly going to be challenging, but also full of opportunity. 