SHAKING OFF THE 'VULTURE' REPUTATION

TURNING LEGACY SOLUTIONS INTO A MAINSTREAM PROBLEM SOLVER

Often seen as the "vultures" of the insurance world, the prominence of legacy liability providers has grown continually in recent times. Before now, companies offering a way out for multinationals were either misunderstood or operated under the radar.

Taking legacy liabilities off a captive's book in a bid to enhance the efficiency of the vehicle was not historically seen as an option by multinationals around the world. Whether this is due to reputational fears or a lack of awareness is hard to define; however, interest in such a transaction seems to be increasing and deal flow shows no signs of slowing down.

Over the past two years alone, legacy specialist R&Q has completed more than 10 transactions related to captives, whether through a Part VII transfer or a portfolio novation.

Most recently, the group tied up a deal to acquire the entire issued share capital of Western Captive Insurance Company DAC from the Coffey Group, with CEO Ken Randall citing the transaction as an example of the businesses' "wide range" of legacy solutions on offer.

"We've turned a corner dramatically in the last 10 years," R&Q head of mergers and acquisitions Paul Corver tells this publication. "Run-off is now generally seen as a natural part of the cycle of insurance, which it clearly is. It's the efficient handling of those long-tail liabilities and companies are now a lot more willing to come forward and package up books of liabilities for sale."

In an industry that has been steadily increasing in capacity since the 1960s, and the number of captives sitting at more than 6,000 according to *Captive Review*'s statistics, the Western market is somewhat maturing.

Alongside this, mergers and acquisitions continue to bring multinationals together, which leaves outstanding liabilities searching for a home.

Eric Haller, CEO of the recently launched FlemingRe, notes: "It's definitely a good time to be in the legacy space, which is an expanding and developing part of the industry. The market has evolved and will continue to further innovate and expand."

Haller recently launched Fleming following interest from a private equity firm.

Written by
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After spending three years at R&Q, his new company has just completed its first transaction where it bought up the property and casualty (P&C) liabilities of United SPC Segregated Portfolio 4. The firm has several additional transactions in the pipeline, Haller reveals.

Despite opportunities seemingly abound, this part of the captive insurance world has not always been seen as a viable option for multinationals.

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> Anna Petropoulos

Reputational woes

"Historically, there has been transactions where our segment of the space may not have attracted the best reputation," Haller concedes, referring to the "vultures" tag, which often crops up in conversation between industry professionals.

Anna Petropoulos, CEO and founder of Apetrop USA, a Vermont-headquartered run-off provider for the US market, agrees and says that negative connotations can arise from such transactions.

"Multinational companies are very concerned about their reputations. A clean transaction which allows them to divest a portfolio of run-off liability won't harm the reputation, but the fear of how a transaction may appear if the company has not previously been through one is the issue.

"The negative publicity that could surround such a transaction is what puts companies off. Owners are worried it might make them look like they are going insolvent," she explains.

Navigating the regulatory landscape

Like most financial services around the world, the regulations governing specific industries is continuing to grow. With an increased focus on tax transparency, led by the OECD, and a push by the European Union for greater granularity of financial reporting, captives face taking more responsibility over their decisions rather than passing it on to their parent. This has led corporations around the world to take a closer look at the efficiency of different segments of the business, assessing whether or not it is financially viable.

Corver explains: "Drivers such as Solvency II have given captives a greater focus on what capital is needed. So, we've seen some European captives consider this, and we've done deals because they've determined that it's no longer cost efficient or its too much of a distraction to have the process of quarterly filings and other reporting requirements."

He adds that changes to substance rules in offshore jurisdictions have also spurred captives to question the efficiency of owning a captive. This, paired with continuing low interest rates and a soft market, means that multinationals are reverting to purchasing a number of covers on the traditional market rather than putting it through the captive.

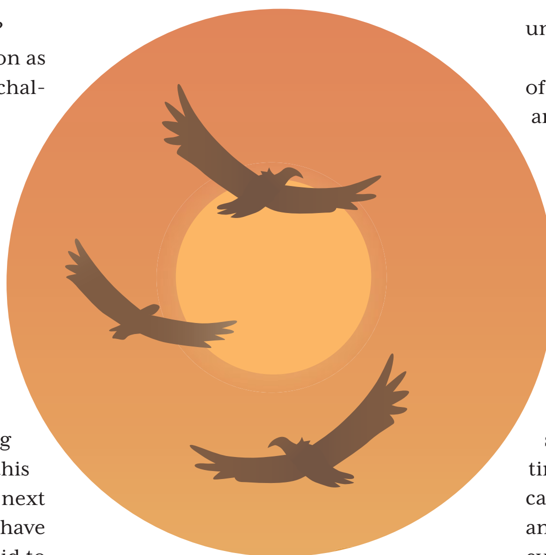
"Overall, regulatory change can make captives less attractive. Perhaps less so for the large captives, but for some small and medium enterprise (SME) companies, there's a growing number of issues out there," Corver says.

The political uncertainty that is engulfing the West has proved to be another factor in the number of opportunities placed in front of legacy providers. As businesses bid to map out their futures, cliff edge scenarios are forcing their hand.

"We've seen interest there," says Corver, citing European businesses planning their Brexit contingency plans. "We have had discussions with captives for potential contingencies. For example, Irish captives set up by UK parent companies will be writing UK risk on a direct basis, so they will be faced with challenges on how they can continue writing it – do they go through a front? What do they do with the

historic legacy they have to maintain?

"Clearly they're in the same position as any other insurer facing the Brexit challenge."



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Regulation innovation

Across the pond however, the story is different. With captives regulated at state level, and the market being arguably more mature, onshore jurisdictions are increasingly bringing in legislation to accommodate dormant and captives in run off.

Despite Vermont, the US's leading onshore domicile, deciding earlier this year to defer its run-off bill until the next legislative session, other jurisdictions have begun implementing their own in a bid to make themselves more attractive.

Back in 2018, *Captive Review* revealed that Oklahoma had proposed a bill that would allow for the novation of policies from one insurer to another in what would be the US equivalent of a Part VII Transfer provision in the UK.

This was followed soon after by Rhode Island's legislature, which moved to clarify Regulation 68 in June 2018 to allow for insurance business transfers in the state.

As states across the US increasingly look at updating their statutes to accommodate such transactions, captives will have greater awareness of the liquidity alternatives made possible by legacy providers and the perception of legacy providers will continue to improve, asserts Haller.

He explains: "Along with enacted legislation in Rhode Island and Oklahoma, I think having a large captive jurisdiction like Vermont planning to introduce something like this bodes well for what we're doing in the captive space and it helps with the overall awareness of legacy providers.

"There are captives out there that retain their legacy liabilities, which requires them to continue paying operating expenses. It's not necessarily the most economically efficient thing to do, but it keeps being done as many do not know solutions exist to help resolve their issues. We are looking to build upon what has historically been done with innovative structures and tools to create solutions that are mutually beneficial. We have seen a significant amount of demand from the corporate M&A process and our strategy, company, and business model is uniquely suited to address those customers' needs," he adds.

"The market has changed; people are now looking at this as a liquidity tool and it's helping them look at their risk management in a new and exciting way."

The UK and US compared

As the Western captive insurance market matures, it's clear to see that opportunities are increasing and the need for run off service providers is not likely to wane. However, providing run off solutions in Europe and the US does not allow for "one size fits all", according to Petropoulos.

Petropoulos recently moved over to the US market and soon realised that the UK and European model doesn't work in the US, she claims, and that UK acquirers must understand that.

"The US has relied heavily on two types of transactions: an outright purchase or an insurance business transfer (IBT). Typically, an IBT is a loss portfolio transfer where insurance is made on an unwanted portfolio. There is no understanding that these transactions are structured really differently in the UK than to the US," she explains.

Awareness

Overall, a greater awareness that exit solutions are on offer is needed for multinationals and businesses operating with captives to free up capital and operate in an increasingly scrutinised industry. However, it is not yet perfect, says Tom Booth, CEO of Darag Group.

"It's about people being aware they can exit their liabilities through these transactions. People aren't yet aware they can get out.

"Sometimes people aren't sure they want to get rid of the liabilities. They may think there's a future value to come out of running off their liabilities and there's not really a big motivation to monetise their assets. There's a number of reasons people decide to retain it, but in a lot of cases, it's actually a win-win because we can do a more proactive job of managing the claims handling," he explains.

Service providers need to take a longer-term approach when providing finality for a captive's run off liabilities though, claims Petropoulos.

"There is appetite, but if someone would take the time to explain the opportunity, it would be evident that financially, it is a really good way of freeing up capital going forward.

"Each captive is set up to manage its parent's own risks and cover what they want with different parameters. There now needs to be a fact finding as to what the challenges are," she says.

Corver echoes this, concluding that while there is "demand and it is increasing", a continued effort to educate captives of exit solutions is needed.

"We're no longer seen as the vultures picking over the bones of a dead insurer. We're providing solutions to live active insurers and captives who want to free up capital by removing legacy liabilities."