THE M&A EFFECT

Eric Haller of Fleming Re determines how M&A activity is influencing the run-off marketplace

Captive Review (CR): The expectation for the future of M&A activity is one of continued growth. What does this mean for run-off?

Eric Haller (EH): As we approach the start of a new decade, it is clear that 2019 was another year of positive growth in global M&A activity. E&Y reported that global M&A annual value has reached over $2trn since 2015, with a total of $2.6trn in 2018. Developed countries tend to dominate most cross-border M&A activity with the top countries being the United States and the UK. Corporate M&A trends point to further acceleration of deal flow, including the number and size of transactions. This is set to extend several years of record M&A activity.

Drivers of run-off transactions vary and include not only discontinued lines of business or companies but more recently an increased demand for finality solutions driven by M&A activity. M&A is increasingly occurring both within the insurance and reinsurance industry as well as in the broader corporate market across different industry sectors. There are distinct advantages to seeking a run-off solution for a book of business or even a company as a strategic corporate solution, as well as additional benefits specific to M&A transactions.

Specifically, with corporate M&A transactions, the acquiring company may not want to assume the exposures and other obligations related to the company being acquired. These exposures can be held in a variety of structures and we have seen a significant amount held within captive structures. A legacy transaction is perfectly suited to accomplish this goal.

During the last few years, there has been an increased level of appreciation of the benefits surrounding run-off. It is gaining wider recognition as a viable liquidity and financing solution that works for non-insurance corporates, insurance companies and captives. Market disruptions are also driving demand for new products and solutions. Run-off is becoming more readily accepted as a strategic tool for the overall efficient management of capital.

Eric Haller

Eric Haller is CEO of Fleming Re, a specialist run-off reinsurer based in Bermuda. Haller's reinsurance experience spans more than 20 years and includes business development, underwriting, treasury, accounting, investment management, risk and regulatory compliance. Haller has held senior roles at various companies, including Safe Harbor Re (CFO & CRO), Randall & Quilter Investment Holdings (head of North American M&A), Athene Holdings (head of strategic planning), XL Capital's Investment Management Group, and Deloitte & Touche. He graduated with honors from Marquette University.

The challenges include determining which legacy providers have a strong understanding of the corporate M&A process, and which can achieve the clients' goals and also deliver a solution within the established deadlines. It is extremely likely that the high frequency of M&A activity will continue and the counterparties will look more at run-off and finality transactions as a viable solution. Corporations will favour solution providers who have a proven track record, continue to innovate and help the market evolve.

CR: How does Fleming Re address legacy liabilities in a corporate M&A process?

EH: In a corporate M&A transaction, the acquiring company typically requires economic and legal finality of the historical liabilities. Acquirers prefer to have a clean start instead of assuming capital requirements, exposures and other obligations from liabilities not related to their ongoing business. The process for a legacy transaction supporting an M&A transaction requires a holistic, streamlined approach to determine the goals of the transaction, structural and jurisdictional considerations as well as the ability to transfer these liabilities within an expected timeframe that coincides with the final execution of the M&A transaction.

As an example, Fleming Re structured a run-off transaction to support a corporate M&A process. The client had several goals for the transaction – the most important of which was certainty of closure by the execution date of the overlying M&A transaction; timing was imperative. It should be noted that the secondary transaction can also be executed in advance of the corporate transaction closing so the transactions will be effective concurrently. We performed full due diligence, received regulatory approval, and finalised the transaction documentation within 30 days to achieve the client's goals.

Adding an additional entity into a transaction can also increase the complexity. This can be mitigated with clear communication between the parties. An important step in the communication process is to agree an established transaction timeline. Also critical is that the requirements of the run-off transaction are known and understood by each party involved. Knowledge of and experience in jurisdictional requirements and approval(s) is also an important factor in managing the process. As with any transaction, there could be multiple regulatory approvals required. Finally, providing complete information on a timely basis in order to facilitate the due diligence process is imperative.

CR: In corporate M&A transactions, what should acquirers understand about the process and benefits of run-off?

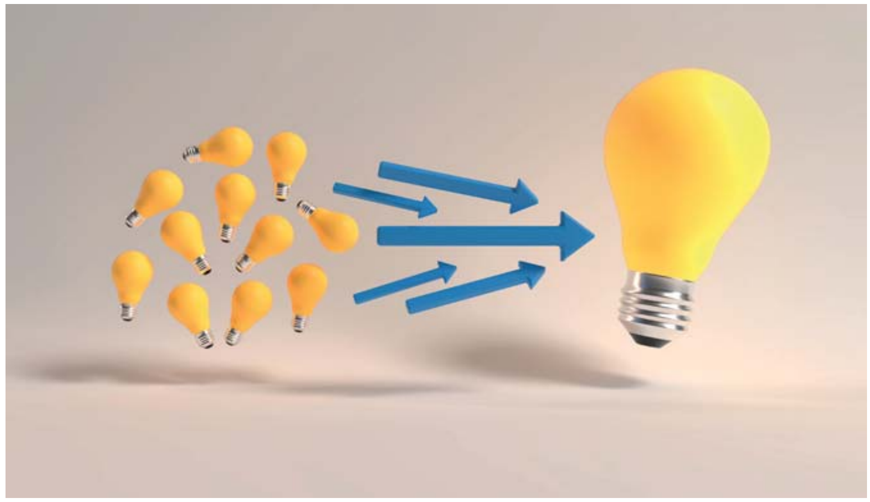
EH: Typically for run-off transactions that provide full finality, transaction structures take the form of acquisitions, loss portfolio transfer (LPT) with assumption (assumed risk), or novation. These solutions offer both economic and legal finality. Sometimes, to accommodate the M&A timeline, solutions that offer economic finality initially and then move towards full finality may need to be used. This would be done because economic-only transactions can usually be completed more quickly. For example, the run-off transaction can start with a reinsurance agreement (achieving only economic finality) and at a later date, the liabilities can be assumed through the established structures to provide full finality.

The transaction process is very similar to a typical run-off transaction. It will involve an initial evaluation of the transaction which includes identifying the client's goals, structuring options and an overall risk assessment; execution of a letter of intent to finalise the structure and outline the agreed-upon terms and timeline of the potential transaction; perform due diligence and ensure appropriate regulatory approvals are obtained; and finalise the transaction. Within this general process, any specific items required to accommodate the M&A transaction will be addressed.

Examples of benefits that can be achieved through legacy transaction solutions range from capital relief, full finality from liabilities, improved solvency and reduced burden of operating expenses resulting in more effective capital structures. We expect that captive owners will continue to consider the wide-ranging benefits achieved through successful run-off transactions.

CR: What differentiates Fleming from its peers?

EH: Over the last decade, solutions in the run-off market have evolved and are now more focused on the benefits that can be offered to counterparties versus transactions focused on toxic liabilities or solvency issues. Fleming Re has focused on three things that differentiate us: specialisation, cost structure/cost of capital, and flexible structuring. We are highly focused on the market we know best, which includes captive structures, US P&C liabilities and portfolios on the smaller end of the size spectrum (<$100m) where there are lower economies of scale and less willingness for large competitors to transact. We are most competitive in this segment because we have private capital with a long-term, patient orientation, fewer arbitrary annual return hurdles to manage and ultimately a lower combined cost of capital.



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As a newer entrant to the market, we have a lean expense structure and have avoided the high legacy cost burden of established competitors whose strategies have either creeped into live underwriting or are saddled with public listing compliance costs and quarterly earnings targets. We have developed a hybrid resource infrastructure platform driven by innovative technology, where critical functions are controlled in-house and processes like routine claims administration can be outsourced with proper in-house oversight. These factors all amount to a sustainable competitive advantage in this growing sector.

Our specific focus for M&A transactions is to address the inefficiencies in the market by providing competitive solutions that are easy for the counterparties to understand, execute and be completed within the agreed timeline. We pride ourselves on our ability to quickly assess and understand our counterparties' objectives and then structure unique solutions that are better aligned to accomplish those specific objectives – whether it be maximising liquidity, shared risk taking, speed to closing and move toward finality.

Our team has industry knowledge across various jurisdictions and lines of business coupled with significant experience in structuring customised transactions both in the legacy and corporate M&A sectors. We work with our clients to understand and clearly define their needs and then specifically tailor solutions to achieve their goals.

Fleming Re is at the forefront of identifying, structuring and implementing innovations that will advance the sector. We are able to streamline processes in order to move the market to the next level as it continues to evolve. With regards to M&A transactions for corporations, Fleming Re is uniquely positioned to provide customised, tailored solutions to entities with the most complex structures and risks in order to achieve clients' goals in a very efficient and effective way. Key differentiators such as these will make the process and structuring of run-off transactions more favourable and available to the general market.