



INSURANCE SOLUTIONS

The UK Run-Off Survey - Life Assurance

September 2004

ADVISORY

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This is the second survey of the UK life run-off market which the Association of Run-off Companies¹ (ARC) commissioned and are proud to be associated with. This industry sector is poorly understood and this survey which has been prepared by KPMG LLP (UK) is an important step forward in highlighting how sizeable and important this sector has quickly become.²

David McGuigan, Chairman of ARC

There are now approximately 329 entities that are authorised to carry on life assurance business in the UK, including composite assurers who write both life and non-life business, and friendly societies. Of these, approximately 10 percent by number, account for over 75 percent of the total value of long term liabilities.

The survey is based on a study of over 130 UK life assurers and friendly societies, which included all those with long-term technical liabilities (hereafter referred to as "policyholder liabilities") in excess of £500 million. The entities surveyed represent over 97 percent of the total value of UK policyholder liabilities. UK life business of companies from other EU countries and from Lloyd's syndicates has not been included in our survey.

Executive Summary

- Total policyholder liabilities of UK life assurers in run-off exceed £124 billion, an increase of almost £16 billion since 2002.
- Life assurers in run-off account for approximately 14 percent of the policyholder liabilities of all UK life assurers.
- Some £8.5 billion of capital is tied-up in life run-off business, an increase of £3.0 billion on 2002.
- The number of life assurers in run-off has increased to 44 from 35 in 2002.
- The life run-off market continues to consolidate and the 44 companies in run-off are currently held within 16 corporate groups.
- The life run-off market expended approximately £1.0 billion in administration costs in 2003. This represents a reduction of some £215 million over 2002 and was achieved despite the increase in the number of entities and size of the policyholder liabilities under management.

Current size of the UK Life Run-Off Market

There are 44 UK life insurers that are in run-off³ and write no new business.

Table 1. Size of the UK Life Run-Off Market

As at end 2003	Number of companies	Policyholder liabilities (£ billion)	%
Active Market	285	769	86%
Run-Off Market	44	124	14%
Total UK Life Market	329	893	100%

Source: A.M. Best's Statement File Life - UK, KPMG LLP (UK) 2004

In addition to the life insurers in run-off, there are active life insurers that have placed a significant part of their business (for example, their with-profits fund) into run-off. We have identified 19 such UK life insurers in "partial run-off" but information on the value of the run-off portfolios within these insurers is not publicly available. As a result, our survey is likely to underestimate the true size of the UK life run-off market.

Our survey reveals that as at the end of 2003 policyholder liabilities of the UK life run-off market were £124 billion and represented approximately 14 percent of the total policyholder liabilities of all UK life insurers.

Change in size of the UK Life Run-Off Market

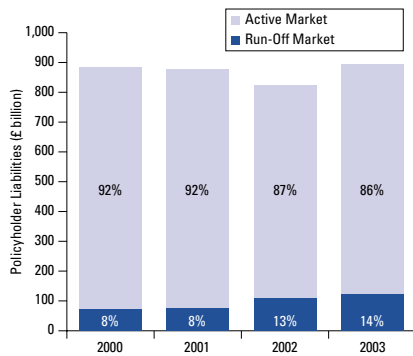
The survey shows that the number of life insurers in run-off has increased to 44, from 35 at the end of 2002. Over the same period, the policyholder liabilities of the UK life run-off market increased from £108 billion to £124 billion and the run-off market now represents almost 14 percent (2002 13 percent) of the total policyholder liabilities of the UK life market.

Table 2. Change in the UK Life Run-Off Market

Policyholder Liabilities (£ billion)	2001	2002	2003
Active Market	805	716	769
Run-Off Market	74	108	124
Total UK Life Market	879	824	893

Source: A.M. Best's Statement File Life - UK, KPMG LLP (UK) 2004

Change in the size of the UK Life Run-Off Market



Source: A.M. Best's Statement File Life - UK, KPMG LLP (UK) 2004

The UK life run-off market is not comprised of small players who found they were unable to compete with the larger assurers, but is a mixture of assurers, including companies with substantial life funds who, until recently, were major players in the market

This survey also reaffirms that the UK life run-off market has grown significantly since 2000:

- The number of life assurers in run-off more than doubled between 2001 and 2003;
- Policyholder liabilities of UK life assurers in run-off have increased by over £50 billion, or almost 70 percent over the same period; and
- Policyholder liabilities in run-off increased from 7.8 percent of the total life market in 2000 to 14 percent in 2003.

A key factor in these increases was the move of several large well known ex-mutuals and with-profit companies into run-off following stock market falls, low interest rates and the identification of mis-selling liabilities.

Other features of the UK Life Run-Off Market

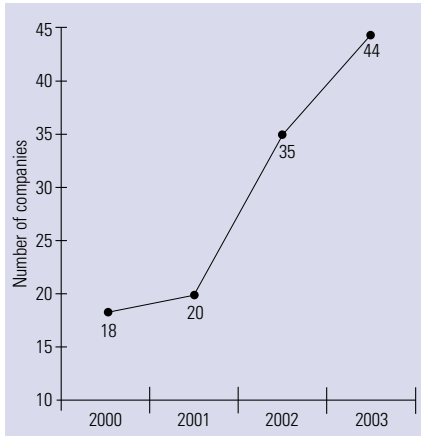
The UK life run-off market is not comprised of small players who found they were unable to compete with the larger assurers, but is a mixture of assurers, including companies with substantial life funds who, until recently, were major players in the market. In particular, the UK life run-off market is now dominated by five groups with major run-off businesses.

The survey demonstrates that the UK life run-off market has had significant success in reducing its non-commission expenses since 2002. Non-commission expenses have reduced by 18 percent to £0.9 billion while the remainder of the UK life market has reduced its expenditure by 8 percent to £5.1 billion. This indicates that the life market has become more cost efficient, with the run-off market achieving the greater savings.

Our analysis also shows that there are some other features characteristic to the UK life run-off market:

- Assurers in run-off have a smaller proportion of their assets invested in equities (2003: run-off 16 percent, active 33 percent) and this proportion reduced significantly for run-off assurers, but not active companies, in 2003

UK life insurers in run-off



Source: A.M. Best's Statement File Life - UK, KPMG LLP (UK) 2004

(2002: run-off 20 percent, active 35 percent). This reflects that run-off companies adopt a more prudent investment strategy. However this limits their ability to participate in future increases in equity markets.

- The solvency strength of life assurers in run-off remains below that of active life assurers, although the strength of the UK life run-off market, as a whole, has improved.
- Life assurers in run-off continue to receive significant premium volumes, in excess of £4.5 billion in 2003.

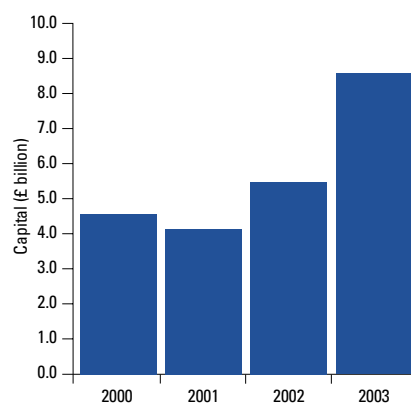
Capital tied-up in run-off

Our analysis demonstrates that by the end of 2003 some £8.5 billion of capital (measured on an FSA Return basis) was locked into life run-off businesses in the UK. This is a 56 percent increase over 2002 and is principally due to the move by two large, stronger assurers into run-off.

With these funds likely to take well in excess of 25 years to run-off in the normal course, this is a significant amount of corporate capital to be tied-up with significant exposure to investment and mis-selling risks, and limited scope for enhancement of shareholder value.

Reflecting the increase in capital, the solvency position of the UK life run-off market has increased by over a quarter from 2002.

Capital locked into UK Life Run-Off



Source: A.M. Best's Statement File Life - UK, KPMG LLP (UK) 2004

Recent developments in the UK life Run-Off Market

There has been significant merger and acquisition activity within the UK life run-off market in the last 18 months. As the run-off market has grown in size and become more mature the benefits of some form of consolidation have become apparent. In particular, combining run-off activities provides scale efficiencies, while also permitting existing shareholders to release capital that may otherwise be tied up for many years.

Significant transactions in the past year have included the following:-

- Acquisitions by Admin Re (a subsidiary of Swiss Re) of the closed books of business of Zurich Life Assurance Company in August 2003 for US\$240 million and Life Assurance Holding Corporation Limited (including its life insurance subsidiary, Windsor Life Insurance Company Limited) in July 2004 for £333 million. The Zurich Life book involves some 225,000 policies while Windsor Life administers more than 800,000 policies with total assets of more than £5.2 billion.
- Demerger of the closed life companies (London Life, Pearl and NPI) of the AMP UK Group, and other ex-AMP UK business, into a new UK-listed group headed by HHG Plc in December 2003.
- Demerger and UK-listing of Chesnara Plc, parent of Countrywide Assured which includes a significant closed life book, in May 2004 and its subsequent appointment of Marlborough Stirling as outsource provider for its legacy business in July 2004.
- Acquisition by Resolution Life Group of the closed UK life operations of Royal & SunAlliance in July 2004 for £850 million.

In addition to the above, there have been a number of transactions and proposed transactions involving transfers of business within the same group (often involving the provisions of Part VII, Financial Services and Markets Act 2000), reinsurance of part or entire closed life portfolios to third parties, and outsourcing of the administration of life funds to specialist outsourcing companies.

It is likely that there will be further consolidation in the UK life run-off market, as several companies have publicly expressed a desire to acquire closed funds, while the increasing use of specialist outsourcing companies (possibly in conjunction with consolidation activities) is anticipated to continue.

It is noteworthy that the 44 companies that our survey reveals as being in run-off, are now all contained within 16 groups.

Many of the difficulties facing the UK life market remain and the industry together with government and other key stakeholders, needs to rebuild the confidence of consumers in the overall pensions and savings industry

Conclusions

The size of the UK life run-off market has grown still further in 2003, following substantial growth since 2000, both in absolute terms and in relation to the size of the entire UK life market. However the rate of growth has slowed and this reflects improvements in the active market, including strengthening of equity markets, the impact of the industry's work on mis-selling and guarantee liabilities in prior years, and the exit of large, weaker players in the period 2000-2002.

Many of the difficulties facing the UK life market remain and the industry, together with government and other key stakeholders, needs to rebuild the confidence of consumers in the overall pensions and savings industry. A key part of this is demonstrating that those individuals with policies held by life assurers in run-off are fairly and properly dealt with, without excessive and adverse strain on the active market and the next generation of policyholders.

In this context there has been a shift in the market and there is now a clear recognition of the differing needs of the UK life run-off market. A number of purchasers and outsourcers have become established with a value-driven focus on effective administration of life run-off business. Methods where appropriate, to accelerate and close the run-off of closed life portfolios, while protecting both policyholder and shareholder interests, remain under development by the market. This presents a major challenge for management of, and advisors to, the life run-off market.

Steps have been taken by the overall UK life industry in recent years to recognise and address the challenges of mis-selling issues, guaranteed liabilities and realistic capital requirements. Provided equity markets at least remain stable and there are no new mis-selling scandals, a significant further increase in the UK life run-off market in the near future appears unlikely.

¹ The Association of Run-off Companies is the UK run-off insurance industry's representative body. It was set up in 1998 with a founding membership made up of senior claims representatives from London market companies in run-off or active companies operating a run-off account.

² The survey is based on an analysis of publicly available financial information, including regulatory returns submitted to the Financial Services Authority (FSA), utilising 'Best's Statement File Life-UK', and from audited statutory accounts filed at Companies House. This information has not, however, been verified or validated in any way by KPMG LLP (UK).

Due to the long-term nature of life assurance contracts, an insurer that has ceased to actively underwrite new life insurance contracts may continue to receive regular premiums, accept increments to existing policies, accept new members under existing group contracts and issue new contracts in accordance with existing contractual commitments for many years. Thus, depending on the maturity profile, funds can continue to grow for a number of years after they have been closed to new business.

³ In this survey life assurers classified as "in run-off" comprise only those companies that have ceased to actively underwrite new life insurance contracts. Companies that have closed a substantial, identifiable element of their business (e.g. with-profit business, pension business, etc.) as well as UK life insurers that have ceased writing certain products, or relatively small product lines have been defined as 'active' because an analysis between active and run-off business is not readily obtainable.

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