



INSURANCE SOLUTIONS

The UK Run-Off Survey - Non-Life Insurance

September 2004

ADVISORY

The UK Run-Off Survey - Non-Life Insurance

This is the second survey of the UK non-life run-off market which the Association of Run-Off Companies¹ (ARC) commissioned and are proud to be associated with. Now the benchmark for our industry, the survey has been prepared by KPMG LLP (UK) and can only enhance the understanding of the increasingly important amount of run-off in the company and Lloyd's markets.²

David McGuigan, Chairman of ARC

There are approximately 500 firms currently authorised to carry on general insurance business in the UK, including composite insurers who write both life and non-life insurance. Of this number, there are approximately 450 companies for which publicly held information is available.

This is the first year that details of the syndicates at Lloyd's³ which are in run-off (for 1993 and subsequent years of account), have been included in the survey.

UK non-life business of companies from other EU countries has not been included in the survey.

Executive Summary

- The total liabilities of the UK non-life run-off market, including business written at Lloyd's, are estimated at £41.1 billion.
- The liabilities of the non-life run-off market in the UK represent approximately 25 percent of the non-life market as a whole.
- The UK non-life run-off market has increased by 6.2 percent over the year.
- The net assets or shareholders' funds of UK non-life business in run-off total some £3.8 billion.
- Over 1,700 people (2,200 including Equitas) are employed in dedicated run-off vehicles alone.
- Since 1990 the UK insurance compensation scheme has paid a total of approximately £700 million in compensation to policyholders of failed UK insurers.
- Despite the growing trend for solvent companies to finalise their run-off liabilities via schemes of arrangement, this has not, to date, had a significant impact on the size of the UK non-life run-off market.

The total liabilities of Lloyd's Syndicates in run-off are now greater than those of Equitas

Current size of the UK Non-Life Run-Off Market

As shown in Table 1, the liabilities of the non-life run-off⁴ market in the UK represent approximately 25 percent of the non-life market as a whole.

Table 1. The UK Non-Life Market

As at end 2003	Total liabilities (£ billion)	%	Technical provisions (£ billion)	%
Active market	123.8	75%	77.3	70%
Run-off market	41.1	25%	33.5	30%
Total UK Non-Life Market	164.9	100%	110.8	100%

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

The UK non-life run-off market can be divided into four distinct components as shown in Table 2.

Table 2. Main components of the UK Non-Life Run-Off Market

As at end 2003	Total liabilities (£ billion)	%	Technical provisions (£ billion)	%
Lloyd's (1993 onwards)	7.7	19%	7.6	23%
Equitas (Lloyd's 1992 and prior)	5.8	14%	5.3	16%
Other solvent run-off	15.9	39%	12.1	36%
Insolvent run-off	11.7	28%	8.5	25%
Total	41.1	100%	33.5	100%

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

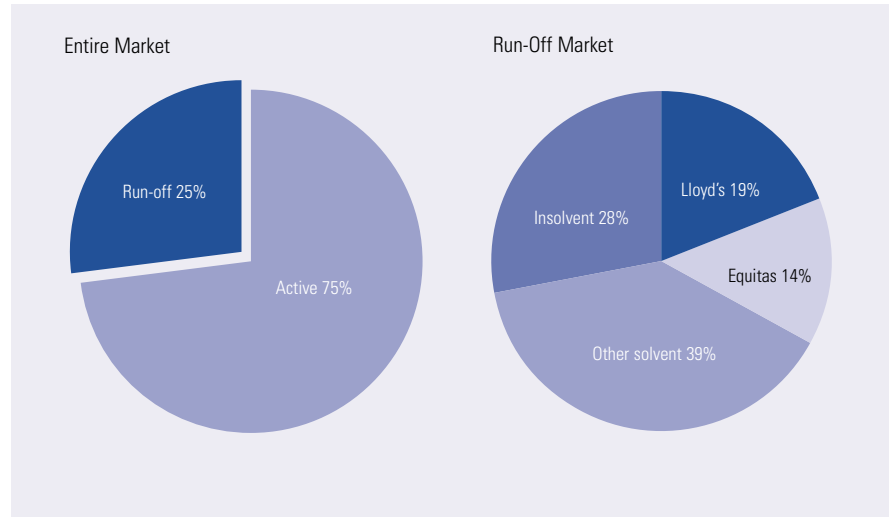
Lloyd's Syndicates in Run-Off

The total liabilities of Lloyd's Syndicates in run-off in respect of 1993 and subsequent years of account is £7.7 billion and comprises 96 open Syndicate years. The total liabilities of the Lloyd's run-off syndicates are now greater than those of Equitas, the vehicle established to deal with Lloyd's 1992 and prior run-off business.

Lloyd's has recognised that run-off is a significant issue for the market and has established a dedicated run-off department.

Although the total liabilities in run-off have increased marginally since 2002, excluding Equitas there has been a 13.5 percent increase in the total liabilities of other business in run-off

Non-Life Market



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

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

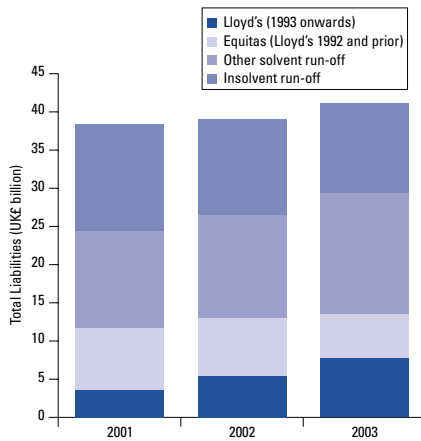
The change in the size of the UK non-life run-off insurance market over the last three years is shown in Table 3.

Table 3. Change in size of the UK Non-Life Run-Off Market

Total liabilities (£ billion)	2001	2002	2003
Lloyd's (1993 onwards)	3.6	5.4	7.7
Equitas (Lloyd's 1992 and prior)	8.1	7.6	5.8
Other solvent run-off	12.7	13.4	15.9
Insolvent run-off	13.9	12.3	11.7
Total	38.3	38.7	41.1

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

Changing size of the UK Non Life Run-Off Market



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

Although the total liabilities in run-off have increased marginally since 2002, excluding Equitas there has been a 13.5 percent increase in the total liabilities of other business in run-off. This increase in the non-Equitas run-off market reflects a combination of factors, but is due principally to the increase in Lloyd's run-off and new entrants to the run-off market in 2003. The reduction in Equitas' liabilities reflects its continuing focus on settling its major US asbestos exposures.

It should be borne in mind that the UK non-life run-off market has significant US Dollar denominated exposures. The US Dollar weakened against UK Sterling by 11 percent over the period, which artificially reduced the UK Sterling reported exposures for the relevant businesses.

Over the same period, the gross liabilities of the UK insolvent companies decreased. This can in part be attributed to a low number of new insolvencies. The largest new insolvency in 2003 was The Home Insurance Company (UK branch) which had gross liabilities estimated at £267 million.

Other features of the UK Non-Life Run-Off Market

Costs of run-off

The largest single run-off in the UK market, Equitas, incurred run-off costs of approximately £91 million in the year ended 31 March 2004. This represented a reduction of some 10 percent over 2003 and has been achieved principally through savings in employee costs as the number of employees has reduced from approximately 600 to 500. Over the same period Equitas' gross liabilities reduced by some £1.8 billion (23 percent).

There has been an increasing trend in the market for companies to outsource run-off operations to specialised run-off providers. Fees charged by the largest run-off providers increased to over £160 million in 2003 compared to £150 million in 2002. The growth of this sector is even more apparent when looking at the number of staff employed by specialist run-off providers, 1700 in 2003 as opposed to 1400 in 2002.

Solvent Schemes

2003 saw increased use in the market place of solvent schemes to accelerate the run-off process and achieve finality. Three solvent schemes were approved by the UK Court in 2003 in respect of solvent run-off insurance operations while a further seven solvent schemes proposed in 2003 were approved in 2004. Although these schemes have predominately been used in respect of small insurance operations, the market is beginning to recognise their potential for use in larger and more complex run-off operations.

Compensation paid by the FSCS

The Financial Services Compensation Scheme (FSCS) is the statutory fund of last resort for customers of financial services firms. The Scheme was set up under the terms of the Financial Services and Markets Act 2000. FSCS deals with claims against authorised firms (those regulated by the FSA), including insurers, that are insolvent and are no longer trading. The FSCS absorbed the previous insurance guarantee scheme operated by the Policyholders' Protection Board (PPB).

The FSCS insurance compensation sub-scheme and its predecessor the PPB scheme, is funded (on a cashflow basis) by annual levies raised against active UK insurers. Levies raised and compensation payments made since 1990 in respect of non-life insurance are summarised in Table 4.

Table 4. Payments and levies by the FSCS and PPB

	Industry levy (non-life) (£ million)	Compensation payments (non-life) (£ million)
PBB 1990-2001	341.5	418.7
FSCS 2001-2003	145.5	288.8
Total	487.0	707.5

Source: FSCS, PPB

The total amount of compensation paid to protected policyholders of failed UK insurers in the year to 31 March 2004 was £131.2 million. The levy is based on insurers' premium income, and through income earned on deposits and recoveries from failed insurers.

A small number of large insurance insolvencies account for in the majority of compensation payments made by both the FSCS and the PPB. These are summarised in Table 5.

Table 5. Large compensation payments made by FSCS and PPB

Company	Date of insolvency	Largest type of claim funded	FSCS / PPB payments to date (£ million)
KWELM companies	1992	Professional indemnity	220.5
Drake	2000	Motor	102.7
Chester Street	2001	Employers' liability	30.3
Independent	2001	Employers' liability / public and professional indemnity	195.6

Source: FSCS, PPB, KPMG LLP (UK) 2004

Total shareholders' funds or net assets of solvent UK companies entirely in run-off was £3.8 billion

Capital tied-up in run-off

At the end of 2003, total shareholders' funds or net assets of solvent UK companies entirely in run-off was £3.8 billion (2002 £4.3 billion), excluding companies with run-off portfolios that are mixed with other live business. The net asset figure as calculated for regulatory solvency purposes is restricted to £2.2 billion (2002 £2.6 billion) on an FSA returns basis, primarily due to the application of asset valuation regulations.

Conclusions

Many run-offs that contain 'old' problems such as US asbestos and pollution are being managed effectively. This is evidenced by the number of settlements being achieved by Equitas and the implementation of a cut-off scheme for the KWELM companies.

Whilst the effect of this is to decrease the size of the run-off market this has been more than compensated for by the arrival of new entrants and growth in run-off at Lloyd's.

The market response to run-off management appears to be predominantly one of consolidation whereby separate run-off business within a group are combined into a single run-off entity. There has also been a further increase in the use of solvent schemes to finalise run-off portfolios.

There is no reason to assume that the increase in the size of the run-off market will reverse although the rate of that increase is difficult to predict. What is clear is that rather than being a diminishing issue for the insurance industry it is one that will continue to require active management in order to ensure that value is preserved and trapped capital is released.

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 This survey is based on an analysis of publicly available financial information, including regulatory returns submitted to the Financial Services Authority (FSA), utilising 'Bests Statement File - Non Life -UK product, 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 inherent delays in the reporting and accounting of financial transactions in non-life insurance business, and in particular reinsurance, premiums (including adjustment and reinstatement premiums) may continue to be received long after a company ceases underwriting. Nevertheless, premium income will, in general, reduce substantially shortly after a company ceases underwriting.

³ Lloyd's is not an insurance company but a Society of members, both corporate and individual, who underwrite in syndicates, on an annual joint venture basis.

⁴ In this survey insurers classified as "in run-off" comprise those companies that have ceased to actively underwrite new business. Whether a company has ceased underwriting has been determined by reference to public announcements by the applicable companies or in the absence of such information, by application of a premium volume test.

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