



INSURANCE SOLUTIONS

The UK Run-Off Survey - Non-Life Insurance

September 2005

ADVISORY

The UK Run-Off Survey - Non-Life Insurance

This is the third survey of the UK non-life run-off market that the Association of Run-Off Companies Ltd¹ (ARC) has commissioned. Prepared by KPMG LLP (UK), the survey sheds valuable light on an often overlooked industry sector and highlights how sizeable and important it has become.

We hope that you find this survey to be a valuable tool in your work. Should you have any comments or suggestions, please let us know, as we are always looking to extend and improve the accuracy and coverage of the survey.

Philip Grant, ARC Director, September 2005

There are approximately 530 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 470 companies for which publicly held information is available².

As in previous surveys, 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's³, are estimated at £38.4 billion, a reduction of £2.7 billion since 2003.
- The liabilities of the non-life run-off market in the UK represent approximately 23 percent of the non-life market as a whole, compared to 25 percent in 2003.
- The net assets or shareholders' funds of UK non-life companies in run-off total some £4.0 billion, an increase of approximately £0.2 billion on 2003.
- Over 2,300 people (over 2,700 including Equitas) are employed in dedicated run-off vehicles alone.
- From the first use of solvent schemes until the end of 2004, the total liabilities of UK companies whose entire non-life insurance business were eliminated through a solvent scheme of arrangement were approximately £100 million.
- Since 1990 the UK insurance compensation scheme has paid over £820 million in compensation to policyholders of failed UK insurers.

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

As shown in Table 1, the liabilities of the UK non-life run-off⁴ market represent approximately 23 percent of the non-life market as a whole.

The UK non-life run-off market is estimated at 23 percent of the non-life market as a whole

Table 1. The UK Non-Life Market

As at end of 2004 (£ billion)	Total liabilities	%	Technical provisions	%
Active market	130.8	77%	79.9	72%
Run-off market	38.4	23%	30.8	28%
Total	169.2	100%	110.7	100%

Source: A.M. Best's Statement File - Non-Life – UK, S & PThesys – SynThesys Non-Life, KPMG LLP (UK) 2005, 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

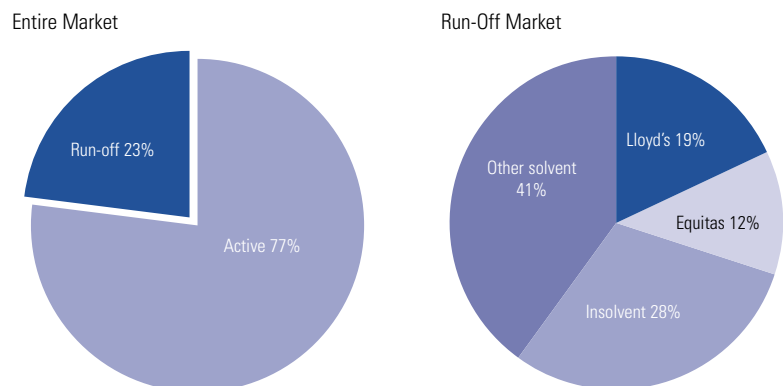
As at end of 2004 (£ billion)	Total liabilities	%	Technical provisions	%
Lloyd's (1993 onwards)	7.2	19%	7.2	23%
Equitas (Lloyd's 1992 and prior)	4.6	12%	4.4	14%
Other solvent run-off	16.0	41%	11.9	39%
Insolvent run-off	10.6	28%	7.3	24%
Total	38.4	100%	30.8	100%

Source: A.M. Best's Statement File - Non-Life – UK, S & PThesys – SynThesys Non-Life, KPMG LLP (UK) 2005, Lloyd's

At the end of 2004, the total liabilities of Lloyd's syndicates in run-off in respect of 1993 and subsequent years of account were £7.2 billion across 104 open syndicate years. This is a reduction of £0.5 billion on 2003, and exceeds Equitas' total (discounted) liabilities of £4.6 billion (undiscounted £6.4 billion).

As in 2003, the largest proportion of run-off liabilities at Lloyd's relates to the 2001 year of account, in which there remains a significant level of US casualty and World Trade Centre related losses.

The UK Non-Life Market



Source: A.M. Best's Statement File - Non-Life – UK, S & PThesys – SynThesys File - Non-Life, KPMG LLP (UK) 2005, Lloyd's

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

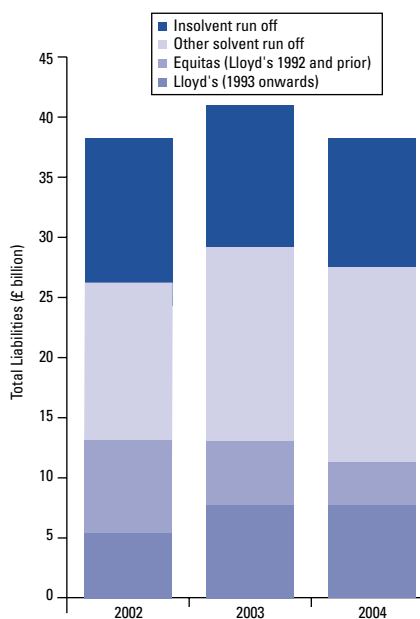
The change in the size of the UK non-life run-off market over the last three years is shown in Table 3.

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

Total liabilities (£ billion)	2002	2003	2004
Lloyd's (1993 onwards)	5.4	7.7	7.2
Equitas (Lloyd's 1992 and prior)	7.6	5.8	4.6
Other solvent run-off	13.4	15.9	16.0
Insolvent run-off	12.3	11.7	10.6
Total	38.7	41.1	38.4

Source: A.M. Best's Statement File - Non-Life - UK, S & P TheSys - SynThesys Non-Life, KPMG LLP (UK) 2005, Lloyd's

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



Source: A.M. Best's Statement File - Non-Life - UK, S & P TheSys - Synthesys Non-Life, KPMG LLP (UK) 2005, Lloyd's

Overall, the UK non-life run-off market reduced in size by approximately six percent measured by total liabilities, mainly as a result of the continued efforts by Equitas to eliminate its US asbestos and environmental exposures. There were no new significant run-offs commencing during 2004 and progress made in settling existing run-off liabilities was offset by a number of new, smaller discontinued operations identified in the market.

Significant reductions in US Dollar denominated reserves occurred during the period due to the US Dollar weakening against UK Sterling by eight percent between the end of 2003 and the end of 2004. This has the effect of depressing US Dollar liabilities when expressed in UK Sterling.

Over the year, gross liabilities of UK insolvent companies reduced by £1.1 billion. This is due to the decrease in the gross liabilities of the KWELM group of companies following the September 2004 claims submission deadline. There was an increase in the gross liabilities of Chester Street Insurance Holdings of approximately £0.9 billion following a reserve review of its (predominantly) UK asbestos exposures, which was offset almost entirely by reductions in the total liabilities of the rest of the UK insolvent companies.

The number of new insolvencies during the period has remained low: the only UK non-life insolvency in 2004 was in respect of AA Mutual Insurance Company.

Equitas' gross discounted liabilities have reduced by 21 percent since 2003

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

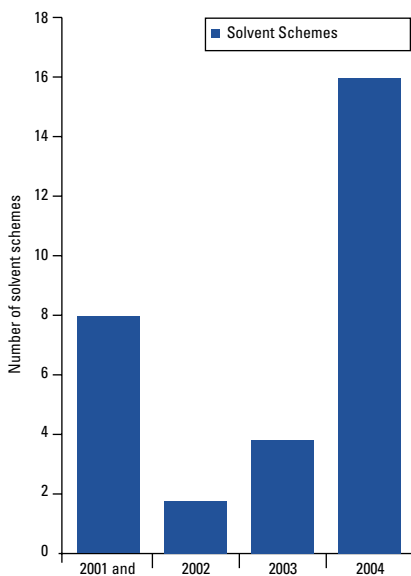
Costs of run-off

The largest single run-off in the UK market, Equitas, incurred run-off costs of approximately £81 million in the year ended 31 March 2005 (2004: £91 million). This represents a reduction of some 11 percent on the previous year and has been achieved principally through savings in employee costs as the number of employees has reduced to approximately 440 (2004: 520). Over the same period Equitas' gross discounted liabilities reduced by some £1.2 billion (21 percent).

2004 saw a continuance of the trend for companies in the market to outsource run-off operations to specialised run-off providers. Excluding Equitas, total fees charged by the largest run-off providers were nearly £200 million in 2004. The number of staff employed by specialist run-off providers was 2,300 employees in 2004 (2003:1,700). The increase observed in outsourced run-off costs and headcount is due mainly to the inclusion of three run-off service providers in the analysis, for which information was not available at the time of last year's survey publication.

The outsourced run-off costs in the UK non-life run-off market may be subject to a step increase when the UK tax authorities implement the recent ruling of the European Court of Justice, which held that VAT should be charged on certain services, including services provided by run-off agents to insurers.

Solvent Schemes of UK Non-Life Business



Source: KPMG LLP (UK) 2005

Solvent Schemes

2004 saw a significant increase in the use of solvent schemes to accelerate the run-off process and for companies to achieve finality for the whole or part of their business. The chart opposite plots the number of solvent schemes of UK businesses over time, represented by calendar year.

Table 4 highlights the change in assets and liabilities of UK companies subject to solvent schemes by comparing year end results before and after the respective scheme bar dates. The analysis is restricted to accounts filed for solvent schemes of UK companies with bar dates falling on or before 31 December 2004 and excludes companies where only certain parts of the business have been schemed. Non-UK companies have been excluded from the analysis.

Table 4. Change in total assets and total liabilities following bar dates for UK solvent scheme companies

(£ million)	Year end immediately preceding bar date	Increase / (reduction)	Year end immediately following bar date	Increase / (reduction) %
Total assets	633.4	(37.0)	596.4	(6%)
Total liabilities	107.7	(77.3)	30.4	(72%)
Net assets	525.7	40.3	566.0	8%

Source: KPMG LLP (UK) 2005
 Note: Where relevant, dividends paid to shareholders have been added to calculate net assets

Those companies subject to solvent schemes with a 2004 or prior bar date collectively increased reported net assets by over £40 million. Whilst still representing a very small proportion of the solvent non-life run-off market, solvent schemes are tending to grow in size and complexity and, even taking into account the recent failure of the British Aviation Insurance Company to obtain court sanction, it is expected that they will continue to grow.

Compensation paid by the FSCS

The Financial Services Compensation Scheme (FSCS) is the statutory fund of last resort for customers of financial services firms and deals with claims against defaulting insurers.

The FSCS insurance compensation sub-scheme and its predecessor under the Policyholders' Protection Board (PPB) is funded (on a cash flow 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 5.

Table 5. Payments and levies by the FSCS and PPB

(£ million)	Industry levy (non-life)	Compensation payments (non-life)
PPB 1990-2001	341.5	418.7
FSCS 2001-2004	285.6	401.5
Total	627.1	820.2

Source: FSCS, PPB

The total amount of compensation paid to protected policyholders of failed UK insurers in the year to 31 March 2005 was £112.9 million, mainly in respect of protected policyholders of Independent Insurance and Chester Street (2004: £131.2 million).

The levy received in the year to 31 March 2005 was £140.1 million (2004: nil), charged to the UK non-life industry in anticipation of future compensation payments. The levy is based on insurers' premium income, and is supplemented through income earned on FSCS deposits and dividend recoveries from failed insurers.

Total shareholders' funds or net assets of solvent UK companies entirely in run-off were £4.0 billion

Capital tied-up in run-off

At the end of 2004, total shareholders' funds or net assets of solvent UK companies entirely in run-off were £4.0 billion (2003: £3.8 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 £2.3 billion (2003: £2.2 billion) on a Financial Services Authority (FSA) returns basis, primarily due to the application of asset valuation regulations.

Tied-up capital may increase in future as the FSA introduces changes to capital requirements for insurers.

Conclusions

Many run-offs that contain legacy problems such as US asbestos and pollution continue to be managed effectively, although at varying rates of progress. This is evidenced by the number of settlements being achieved by Equitas, the implementation of commutation strategies and cut-off schemes for the solvent and insolvent estates.

Whilst there is a very high level of commutation activity, particularly as reflected in the figures for Equitas and the KWELM companies, and whilst solvent schemes are beginning to have some impact, these are to a large extent being replaced by new portfolios.

The continued level of run-off costs and dedicated personnel indicates that run-off remains prominent on the insurance industry agenda.

A further indication of this concentration of effort is the continuing consolidation of run-off portfolios, especially within complex groups. These are visible through the use that is being made of the court to sanction these transfers under the Part VII procedure of the Financial Services and Markets Act 2000.

The picture that is emerging is that of an industry now seriously getting to grips with its legacy issues and increasingly diverting resources to enhance efficiency and utilise capital.

1) Association of Run-off Companies Ltd is the UK run-off insurance industry's trade association. It is a limited company with its members as shareholders. The association has been in existence since 1998 and has in excess of 200 members.

2) This survey is based on an analysis of publicly available financial information, including regulatory returns submitted to the Financial Services Authority (FSA), utilising A.M. Best's Statement File – Non-Life –UK product, S&P Theysys – SynThesys Non-Life 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).

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.

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 ceased underwriting. Nevertheless, premium income will, in general, reduce substantially shortly after a company ceases underwriting.

KPMG LLP (UK)'s participation and contribution in this regard is not an endorsement, sponsorship or implied backing of ARC and its products and services.

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For further information on this survey, please send enquiries and comments to info@runoffsurvey.co.uk.

The survey is available at www.runoffsurvey.co.uk

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