

Opportunities and threats

The findings of *The Insurance Insider's* 2008 legacy survey...



Yes



No

In each of the last two years, *The Insurance Insider* has undertaken a pulse check on the discontinued business sector and how it interacts with the live market.

And in our third annual legacy survey – conducted in April/May in conjunction with the Association of Run-off Companies – our readership has again helped us explore the key issues.

This year the survey is set against a backdrop of uncertainty, with the live market facing multiple challenges as a softening rates coincide with capital pressures from the wider economic climate and the looming inevitability of Solvency II.

So what of the opportunities and threats ahead for the legacy sector?

There was support (62.8 percent) for the view that the softening market – now firmly entrenched across almost all areas of the (re)insurance sector – will fuel significant quantities of new legacy business, as prudent underwriters withdraw from unprofitable lines, and ill-disciplined underwriters increase the potential for loss making businesses and the prospect of corporate failures.

Away from the micro climate of (re)insurance market conditions, the credit crunch is also set to trigger significant volumes of discontinued business, according to around half of our respondents.

Meanwhile, in a related question, 58.5 percent of the 121 respondents said the credit crunch would focus more management attention on

freeing balance sheets through exit/finality mechanisms.

As one lawyer commented in the survey: "Either their own or other counterparties' balance sheets will be affected, so management has to pay more attention to exit strategies."

Solvency II

Solvency II, scheduled for 2012, is also expected to focus management on the burden of legacy business on company balance sheets.

The vast majority – 80.6 percent – of those surveyed said they believed increased capital pressures under the regime will result in (re)insurers looking to segregate their legacy business, while 78.4 percent agreed those companies would actively seek to divest themselves of run-off exposure.

And according to one run-off manager, this could open up opportunities for the sector on the Continent.

"The impact on balance sheets for many smaller European companies will be dramatic if they have not effectively managed or disposed of their legacy business," he predicted.

But despite the increased focus, the majority of responses (59.8 percent) felt (re)insurers still fail to properly manage the impact of discontinued business on their capital efficiency and, as a result, returns on capital.

"Most do not know of the potential of their discontinued book and therefore do not realise the lack of efficiency," a run-off claims practitioner noted.

Nevertheless, an insurance executive responding to the survey said that, with the introduction of ICA, "everyone is aware of the capital issues and implications in the calculation of capital required to support legacy".

"In fact this calculation led to a number of insurers better managing run-off," the argued.

And opinion was divided over whether insurers addressing the issue of discontinued business are better served managing legacy exposures in-house or outsourcing to specialist service providers.

"If the company can develop the internal resource, and outsource on a selective basis, the result is likely to be better longer term," a lawyer observed.

But one run-off practitioner suggested: "As in-house non-core business, this area will always suffer from less capital and management attention."

Standards suffer

There was greater consensus over the thorny issue of service and claims recovery after businesses go into run-off, with 72 percent saying standards suffer.

While one insurance executive suggested the FSA's current scrutiny of claims standards in the sector "is justified", a run-off manager claimed: "The FSA has been known to say that the claims service in run-off companies exceeds that of ongoing business."

A lawyer took a more cynical line, however, commenting: "The active/business/commercial relationship which greased the claims wheel is removed. Why pay a doubtful claim?"

On the broader subject of policyholder protection, 60.3 percent said insureds are afforded adequate protection in the UK, but 24 percent suggested safeguards are not sufficient.

The topic of broker legacy also proved divisive.

Although almost 87 percent agreed servicing legacy is a significant financial and administrative burden for the broker community, the issue of brokers' duties and who should ultimately pay was hotly debated.

A third of those surveyed admitted it was unclear what brokers'

obligations are to service run-off placed by them; but almost two thirds were insistent that the burden faced by brokers didn't justify the charging of a retrospective fee for servicing unexpectedly complex or long-lasting business.

As a run-off practitioner said: "Their obligations are clear, but the lack of contract details means that they can retroactively change the standard because there is no contract term to refer them to."

A lawyer suggested, meanwhile: "But that does not mean that brokers are complying with those obligations. Indeed in most cases they are not."

You said...

"Reinsurance is too easily available at the right price"

On whether 2008/9 will see new developments in packaging legacy exposures to the capital markets

"It all depends on insurers' target rates of return. They will do what they thing is most likely to help achieve those goals. Sentimentality is unlikely to be an influential factor"

On whether insurers should outsource or look after legacy in-house

"It should do, but they will just become more adept at hiding the rubbish"

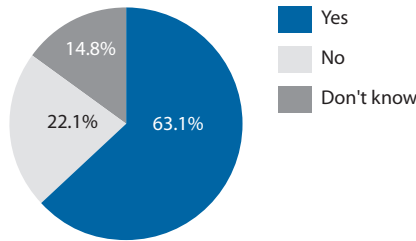
On whether Solvency II will result in more companies segregating their legacy business

"Companies tend to focus on live business within a group and take their eye off the run-off exposures. Brokers provide little service once an account goes into run-off"

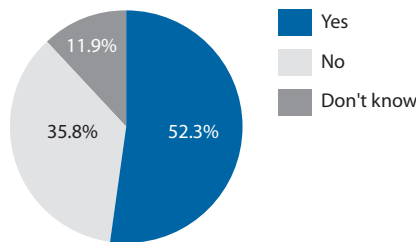
On the question of slipping service and claims recovery standards when a business goes into run-off

The Insurance Insider conducted its 2008 legacy survey between 30 April and 16 May. There were 121 responses drawn from across different segments of the market.

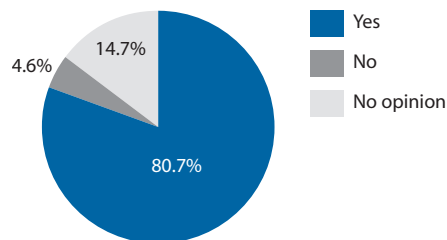
Will the softening market lead to significant quantities of new legacy business?



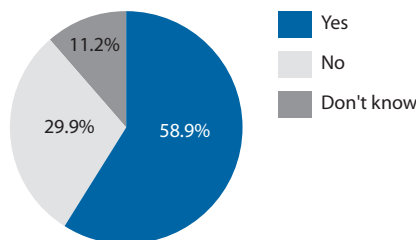
Will 2008/9 see new developments in packaging legacy exposures/recoverables with the capital markets?



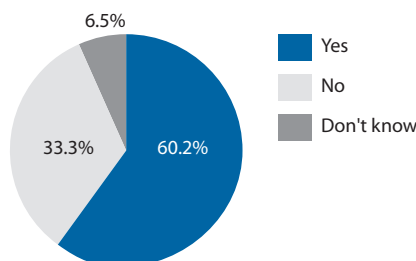
Do you believe that Solvency II will result in more companies looking to segregate their legacy business?



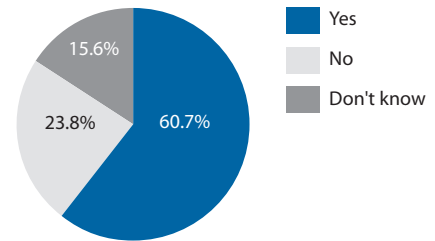
Will the current credit crunch focus more management attention on freeing up balance sheets through exit/finality mechanisms?



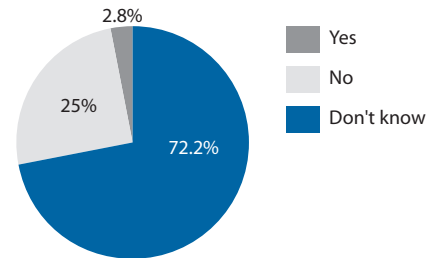
Is it clear to you what brokers' obligations are to service the run-off of business placed by them?



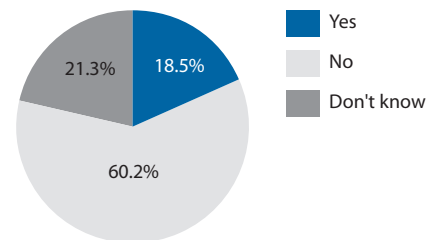
In the context of legacy business, does the UK give enough protection to insureds?



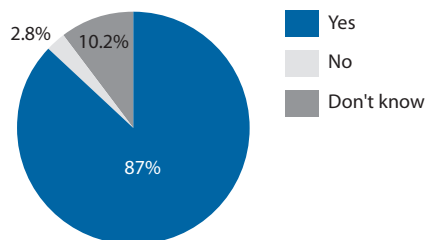
When businesses go into run-off, do you believe service and claims recovery standards suffer?



Do (re)insurers properly manage the impact of legacy business on capital efficiency and returns on capital?



Is servicing legacy business a significant financial and administrative burden for brokers?



Should brokers be entitled to charge a retrospective fee for servicing unexpectedly complex or long-lasting business?

