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The Impact of the Current Financial Crisis on the Run-off Market


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Agenda

- Introduction and scene setting
- Discussion
 - What are the key issues for the run-off market arising from the financial crisis?
 - What is the impact of the financial crisis on run-off strategy?



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Introduction and scene setting

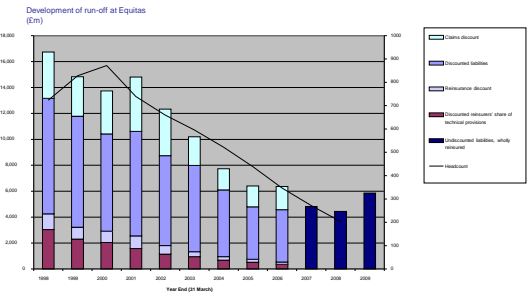
UK non-life run-off market

Total gross liabilities (£bn)	y/e 2004	y/e 2005	y/e 2006	y/e 2007	y/e 2008	30 Jun 09
Lloyd's (1993 onwards)	7.2	7.5	5.2	2.9		
Equitas (Lloyd's 1992 & prior)	4.6	4.4	4.8	4.4		
Other solvent run-off	16.0	15.9	13.2	11.9		
Insolvent run-off	10.6	10.4	9.5	9.1		
Total	38.4	38.2	32.7	28.3		
Active market	130.8	159.9	153.0	156.1		
Total (non-life market)	169.2	198.1	185.7	184.4		
Capital tied up in UK run-off companies	4.0	4.8	4.9	4.6		
US\$ - UK£ exchange rate	1.920	1.718	1.957	1.984	1.438	1.652
UK LIBOR rate (3 months)	2.56%	4.53%	5.36%	5.13%	2.21%	1.19%
US Federal Funds rate	2.25%	4.25%	5.25%	4.25%	0.00%	0.00%

Source: AM Best 2009, KPMG LLP (UK) 2008, Lloyd's 2009

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Equitas – A run-off case study



Source: Equitas Limited and Resolute Management Services Limited accounts

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Objectives for run-off management

- There are a number of objectives for run-off portfolio management:
 - Maximise return to shareholders
 - Achieve finality to the business
 - Timetable
- These objectives may have different priorities for each stakeholder.

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Run-off strategy (1)

- There are six conventional strategies to achieve finality to discontinued business for the risk carrier:
 - Ordinary course run-off to expiry.
 - Accelerated run-off through commutation.
 - Reinsurance (loss portfolio transfer) bringing economic finality to the risk carrier, subject to credit risk. Run-off continues under the control of the reinsurer.

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Run-off strategy (2)

- Part VII transfer. Run-off continues under the control of the transferee.
- Sale of the company. Run-off continues under the control of the acquirer.
- Scheme of arrangement.
- One further decision is whether to outsource the run-off to a service provider.

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Finality transactions

Solvent schemes history

Number of solvent schemes	2002 and prior	2003	2004	2005	2006	2007	2008	Total
By entity	10	4	16	24	9	27	87	177
By pool / portfolio	7	2	11	7	9	10	6	52

Source: KPMG LLP (UK) 2009

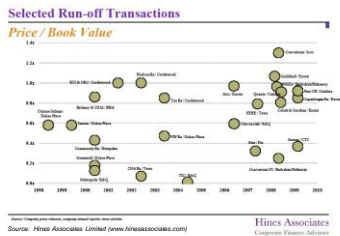
Number of Part VII transfers in the UK non-life insurance market

Dominant portfolio	2002	2003	2004	2005	2006	2007	2008
Active	1	5	5	12	7	6	5
Run-off	2	2	3	4	13	9	7
Total	3	7	8	16	20	15	12
Cumulative	3	10	18	34	54	69	81

Source: KPMG LLP (UK) 2009

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Run-off mergers and acquisitions



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Discussion

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Key issues arising from financial crisis

- Investment write downs and investment income
- Liquidity and finance
- Resources and costs
- Liabilities
 - Discontinued financial guaranty business

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Impact on run-off strategy

- Pressure for liquidity
 - Greater number of commutations
 - Discount rates
- Use of restructuring mechanisms to assist in access to capital
- Only the largest players may have the ability to absorb the short term losses in pursuit of longer term gains
- Greater scrutiny by regulators: capital and Solvency II