Deloitte Insurance Week

Where Reinsurance Meets

Legacy Insurance of Corporate and Captive Liabilities

8 May 2024

Introduction and Panelists

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Special thanks to:

ACTUARIES OF BERMUDA
AoB
NAVIGATING RISKS, CHARTING FUTURES

CAS
Casualty Actuaries Of Bermuda (CABER)

Deloitte.

Agenda

- Introduction and Panelists
- Background – Legacy, retrospective and run-off (re)insurance market
- Background – Corporate and Captive Liabilities
- Guidance Note for Legacy Insurance Groups
- Corporate Liabilities Landscape – Considerations For Solvency Opinion
- Potential Future Impacts – Other Liabilities
- Questions?

Background

Legacy, Retrospective and Run-Off (Re)Insurance Market

The Bermuda Market

- Bermuda is one of the leading jurisdictions for the legacy, retrospective and run-off sector.

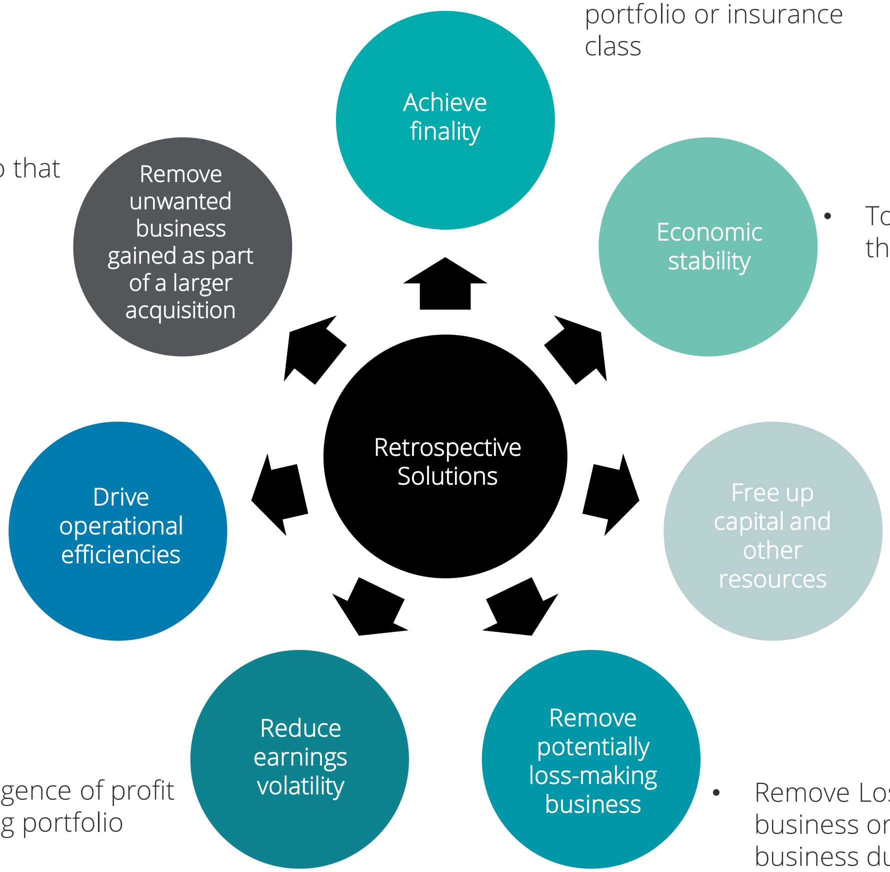
- According to recent reporting the legacy market in Bermuda oversees more than $30 billion in property and casualty insurance and reinsurance liabilities.

- Since 2000 many of the key legacy players emerged in Bermuda and since 2020 there has been rapid expansion in the number of buyers in the Bermuda market

- Bermuda is expected to continue to be a hub for legacy business:
    - Given the number of legacy insurers and insurance groups on the island
    - The deep talent market
    - The history of innovation
    - Engaging regulator that has kept pace well with changing deal structures

- Earlier this year, the market received a further vote of confidence with the Insurance/Reinsurance Legacy Association (IRLA), launching its new chapter in Bermuda, with representatives from Enstar Group, RiverStone International, Compre Group, R&Q Insurance Holdings and BMS Group.

Need For Retrospective Solutions



- Complete exit from the portfolio or insurance class
- To remove the effects of the underwriting cycle
- Targeted capital release to write new business or explore other ventures
- Remove Loss-leader business or loss-making business due to mis-pricing/adverse experience
- Stable emergence of profit on remaining portfolio
- Reallocation of staff and infrastructure to improve overall operation of the entity
- Removal of a portfolio that was gained as a consequence of an acquisition

Traditional Retrospective Solutions

Loss Portfolio Transfer

Reinsurance agreement in which an insurer cedes policies, often ones that have already incurred losses, to a reinsurer in exchange for a fixed premium.

Insurance Business Transfer

Process by which an insurer may transfer the whole or part of its business to another insurance entity, subject to certain conditions, without obtaining the consent of individual policyholders

ADC

(Re)Insurance contract where the cedant transfers any losses exceeding an established reserve up to an upfront agreed limit.

Novation

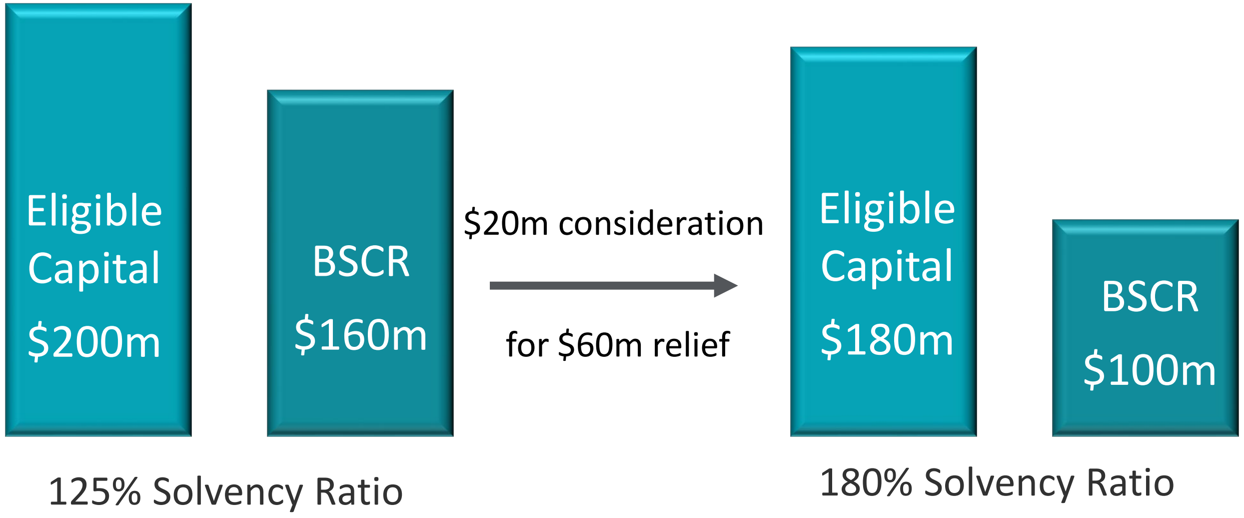
Similar to commuting, an agreement to replace one party to an insurance policy or reinsurance agreement with another company from inception of the coverage period.

Acquisition

Purchase of shares in the insurance company, hence taking over the obligation to pay liabilities associated with the company.

Need for Retrospective Solutions - Trends

- Currents trends are moving away from the just distressed portfolio, traditional run-off liabilities and P&L protection.
- Increasingly deals are driven by capital optimization with many firms using legacy solutions as core part of their business-as-usual capital strategy.
- This has seen more deals focused on redeploying capital in the hard market, particularly where there is a significant contribution to the Bermuda Solvency Capital Requirement (BSCR) from reserve risk.
- Though some recent deals are seen covering less aged portfolios and lines of business that the insurer continues to write. These transactions can operate more like a partnership or structured reinsurance deal with multiyear solutions in place and claims handling staying with the original insurer.
- The below shows how paying a premium for a legacy transaction that reduces the BSCR can improve solvency ratio



Background

Corporate and Captive Liabilities

Corporate Liabilities

- Liabilities of non-insurance corporations, sharing risk characteristics that are like traditional insurance liabilities but legally not classified as insurance obligations.
- May be similar to captive liabilities but cannot be transacted in the same way with reinsurance solutions
- For public companies, the liabilities may be causing the company's stock to trade at a significantly lower price than it otherwise would.
- Historically, one solution for corporations has been to ring fence these into LLCs to manage in bankruptcy
- Notably this can have adverse reputational impacts as public perception can be that this abuses the bankruptcy system and is designed to prevent plaintiffs from getting paid for the injuries caused

J&J puts talc liabilities into bankruptcy

By Mike Spector and Dan Levine

October 15, 2021 12:50 PM ADT · Updated 3 years ago

Aa

Georgia-Pacific unit's "two-step" bankruptcy survives dismissal, again

By Dietrich Knauth

February 22, 2024 8:29 PM AST · Updated 2 months ago

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Types of Corporate Liabilities

- Risk characteristics are similar to insurance risk in that there is uncertainty in the timing, frequency and severity of the obligation.
- Transactable corporate liabilities could extend to any liabilities have a predictive emergence and pay out pattern.
- Typically, they have been latent liabilities where there is a significant delay between the original exposure and the manifestation of liability.
- There are 4 stages of a latent Liability:
  - The unknown stage: Risk exists but the identity of a latent claim is unknown (e.g. PFAS 10 years ago)
  - Potential: Information about the possible identity of a claim has emerged with no clear lability being established. (PFAS bodily injury)
  - Emerging: Claim has emerged as a latent claim but the full extent of the liability is still developing. (PFAS Environmental)
  - Emerged: The latent claim has occurred and fully developed or is developing in a predictable way. (Asbestos)

Corporate Liabilities Transactions

- These have gone to both legacy insurers and private equity firms

insurance insider

Premia and Global Risk Capital subsidiary Canvas acquires SPX asbestos assets

Rachel Dalton 04 November 2022

BorgWarner Announces Divestiture of BorgWarner Morse TEC LLC to Enstar

NEWS PROVIDED BY
BorgWarner →
Oct 30, 2019, 08:30 ET

Crane Holdings to divest legacy asbestos liabilities

16th August 2022 - Author: Jack Willard

Cleaver-Brooks Announces Divestiture

September 10, 2021 10:00 AM Eastern Daylight Time

THOMASVILLE, Ga.--(BUSINESS WIRE)--Cleaver-Brooks has divested Cleaver-Brooks, Inc. (the "Company"), a wholly owned subsidiary that holds asbestos and certain other assets and liabilities, to Cleaver Brooks Acquisition LLC, an affiliate of the Global Risk Capital Group of Companies ("GRC").

R&Q and Obra Capital form new JV to acquire MSA Safety's legacy liabilities

6th January 2023 - Author: Luke Gallin

businesswire

Zurn Elkay Water Solutions Corporation Announces Divestiture

Business Wire
Fri, Dec 15, 2023 • 3 min read

ITT's Asbestos Liabilities Removed With InTelCo Divestiture

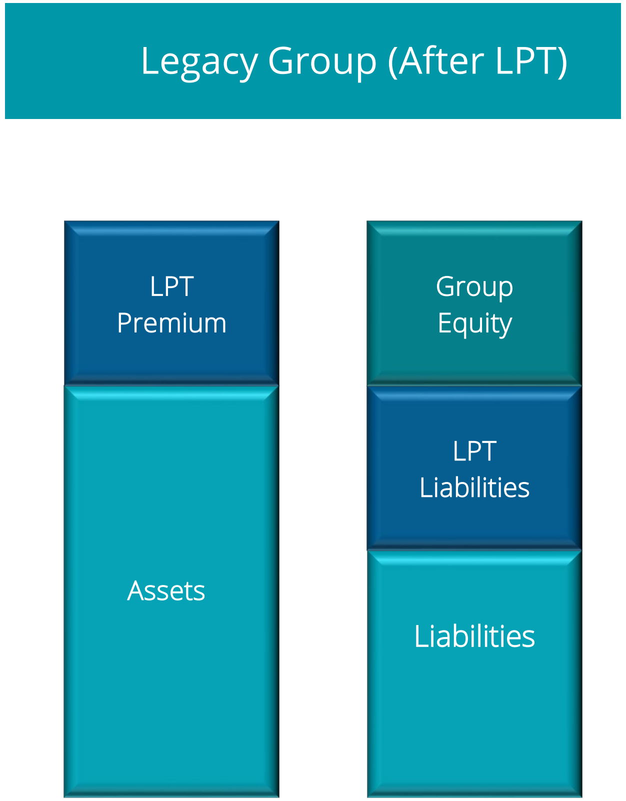
Zacks Equity Research
Fri, Jul 2, 2021 • 3 min read

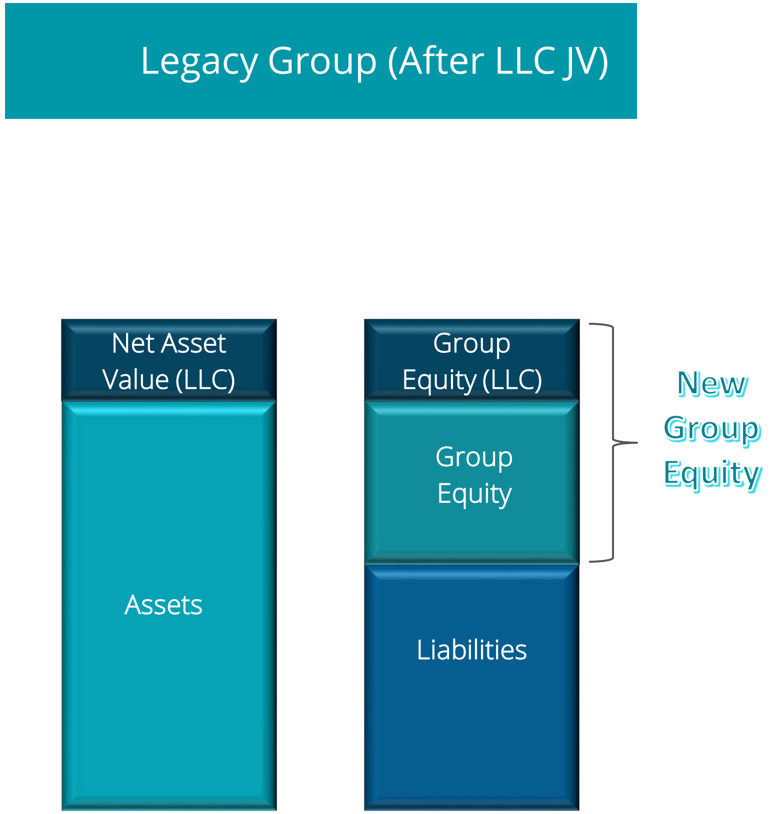
Acquiring Corporate Liabilities: an example

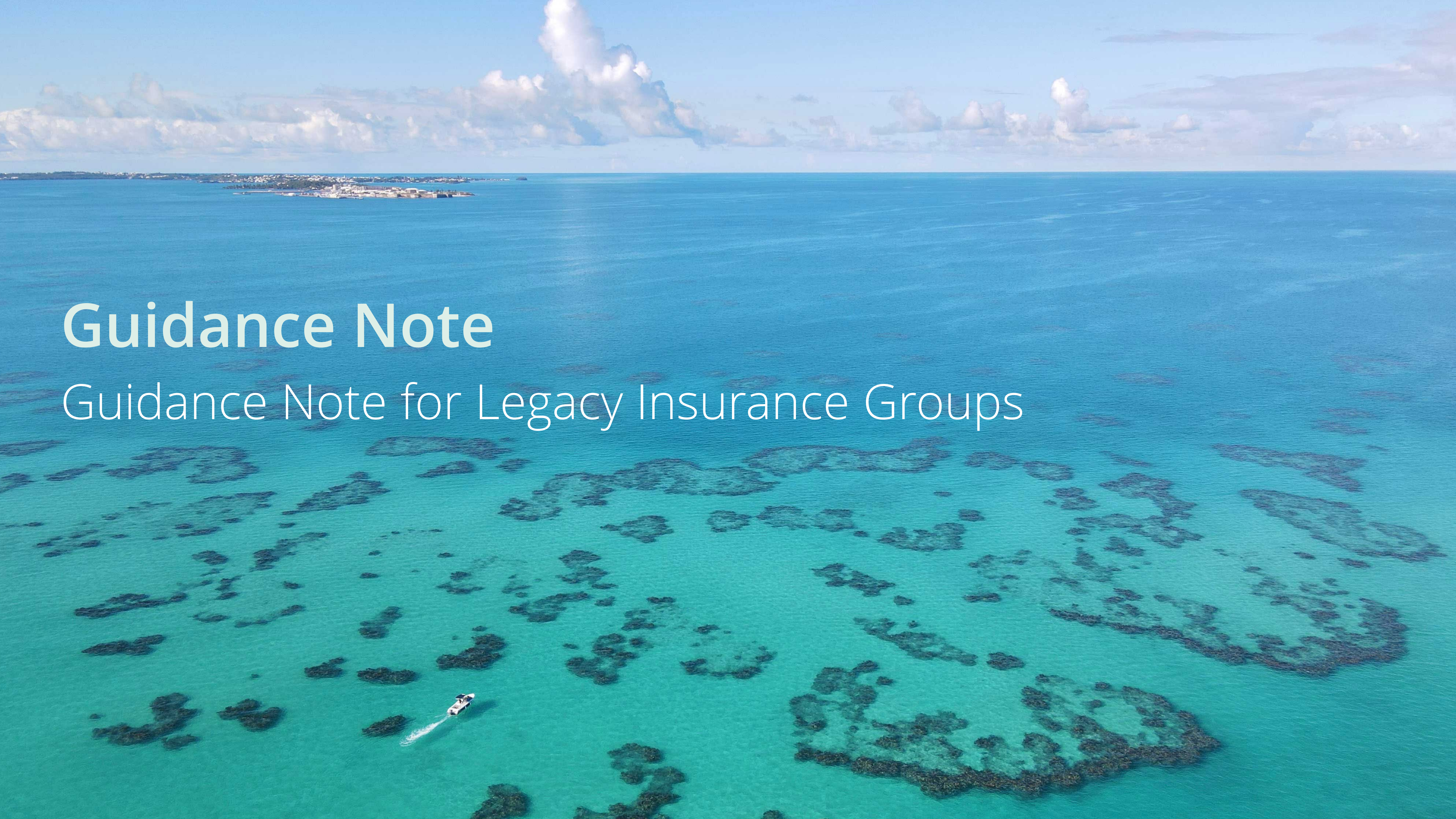
- Acquiring the LLC can be used as an effective method for transferring corporate liabilities.
- Legacy insurance groups can purchase the shares of the LLC, hence taking over the obligation to pay liabilities associated with the company.
- The below hypothetical example would be a for a joint venture (JV) with a partner and the group would be exempt from consolidation under business combination accounting.

Comparison to traditional legacy insurance

- A traditional LPT will gross up both sides of the balance sheet and attract associated capital charges.
- Whereas the group after joint venture (JV) in an LLC only adds the NAV.







Guidance Note

Guidance Note for Legacy Insurance Groups

Guidance Note: Background

- In response to recent rising within the legacy industry regarding the acquisition of US companies (LLC transactions) with corporate liabilities the BMA produced:
  - A Consultation Paper in October 2023 to get market feedback by November; and,
  - A final Guidance Note in December 2023 to apply prospectively with effect from 1 January 2024.

GUIDANCE NOTES

LEGACY INSURANCE GROUPS
ACCOUNTING AND CAPITAL TREATMENT FOR CORPORATE LIABILITIES

- The guidance was written with asbestos liabilities in mind but should apply equally to all corporate liability transactions.

- The guidance notes applies specifically to LLC transactions made by Bermuda-regulated Legacy Insurance Groups - individual insurers would need to approach the BMA on a case-by-case basis.

- The guidance note aims to:
  - Provide clarity to legacy groups to use in the pricing and due diligence of such transactions
  - Create a level and fair playing field for legacy groups in the Bermuda market
  - Allow Bermuda legacy groups to be competitive with corporate providers when considering these sorts of deals

- The BMA believe this is the first specific guidance a regulator has provided on corporate liability transactions.

Guidance Note: Requirements

- The Bermuda Monetary Authority (Authority or BMA) has taken the stance that all LLC transactions, including partial acquisitions or joint ventures, will require prior approval by the Authority.

- For a legacy group transaction to be approved, a detailed pre-approval application of the assessment and approval of LLCs should be submitted to the BMA.

- Transaction Approval:
  - An assessment showing that exposures from the Liabilities **are no more than 15% of the existing total** net insurance reserves of the acquiring Legacy Group;
  - An independent/**third-party solvency or financial opinion on the LLC**;
  - A **run-off plan** detailing how management intends to run down the ultimate Liabilities, inclusive of stress scenarios;
  - Submission of a modelled BSCR proforma for review to ensure that the minimum capital factor is appropriate based on the exposures. The capital requirement for these types of investments will be subject to a floor.

- Reporting Requirements (these will apply to all transactions retroactively, irrespective of the acquisition date):
  - For BSCR disclosure, a schedule similar to the Schedule of Segregated Accounts will be required to be on a per-transaction basis.
  - Corporate Liabilities should be assessed within the Group Solvency Self-Assessment
  - Corporate assets and liabilities per LLC are to be disclosed within the audited GAAP financial statements

Guidance Note: Accounting and Capital Treatment

- Capital charges associated with these transactions the LLC will be accounted for using the equity method (net asset value (NAV)) versus a consolidated basis due to their legal structure.

- For BSCR, the Legacy Group will:
  - Input the NAV of the LLC on line 4(c) (unregulated financial operating entities) of Form 1EBS: and;
  - Will consider the value as *Type 2 Equity Holdings – Other Equities* (capital factor of 45%).

STMT. LINE No.		2024 ('000)	2023 ('000)
(a)	Unregulated entities that conduct ancillary services	-	-
(b)	Unregulated non-financial operating entities	-	-
(c)	Unregulated financial operating entities	-	-
(d)	Regulated non-insurance financial operating entities	-	-
(e)	Regulated insurance financial operating entities	-	-
(f)	Total investments in affiliates (equity)	-	-
(g)	Advances to affiliates	-	-
(h)	Total investments in and advances to affiliates (equity)	-	-

TYPE OF EQUITY INVESTMENTS	STATEMENT SOURCE	ASSETS							Without Mgmt	With Mgmt Actions	CAPITAL FACTOR
		Long Exposure		Short Exposure							
				Qualifying as Assets held		Not Qualifying as Assets		Before	After Shock	After Shock	
		Before Shock	After Shock	Before Shock	After Shock	Before Shock	After Shock	Before Shock	After Shock	After Shock	
Subtotal - Type 1 Equity Holdings		-	-	-	-	-	-	-	-	-	
Type 2 Equity Holdings											
Strategic Holdings - Unlisted	Sch IIB, IIC, IID, IIE and IIF Line (27)	-	-	-	-	-	-	-	-	-	20.0%
Other Equities	Sch IIB, IIC, IID, IIE and IIF Line (28)	-	-	-	-	-	-	-	-	-	45.0%
Letters of Credit	Sch IIB, IIC, IID, IIE and IIF Line (29)	-	-	-	-	-	-	-	-	-	20.0%
Intangible assets	Sch IIB, IIC, IID, IIE and IIF Line (30)	-	-	-	-	-	-	-	-	-	20.0%
Pension Benefit Surplus	Sch IIB, IIC, IID, IIE and IIF Line (31)	-	-	-	-	-	-	-	-	-	20.0%
Equity Derivatives on Type 2 Equities	Sch IIB, IIC, IID, IIE and IIF Line (32)	-	-	-	-	-	-	-	-	-	45.0%

Corporate Liabilities Landscape

Considerations For Solvency Opinion

Deloitte considerations for the third-party opinion

- Some similarities to Independent Expert reports on Insurance Business Transfers (IBTs, e.g. Part VIIs) but with a missing party as the LLC does not have other policyholders.
    - IBTs require policyholders and creditors on both sides of the transaction are no worse off including consideration of claims administration and policyholder communications etc.

- We expect the opinion for corporate liabilities transaction to focus more on the solvency of the buyer

- May need to conclude that existing policyholders and other stakeholders of the acquiring insurance group are not adversely affected by the transaction

- Will need to be wider ranging than a typical reserving exercise, potentially covering a range of topics including:

    - An actuarial reserving analysis on the liabilities. Challenges include
        - Need for non-traditional methodologies
        - Lack of accurate and complete data given the age of the liabilities
        - Latency/ age of claimants

    - Understanding and evaluating any existing insurance asset associated with the latent liabilities:
        - Complex with many years of exposure, multiple parties and old or missing documentation
        - Gaps in coverage from insurers
        - Creditworthiness of insurers, if they even still exist
        - Historic coverage in place and settlement agreements

    - Stress and scenario testing of the assets and liabilities of the LLC considering correlation analysis with existing acquiring group's existing portfolio

    - Capital adequacy and liquidity analysis

Potential Future Impacts

Other Liabilities

Potential Future Impacts

- The BMA guidance note, though framed around asbestos related liabilities, could extend to many other types of corporate liabilities that are not insured.

- There have already been deals publicly acknowledging mature perils such as coal dust and silica exposures.

- Other mature liabilities may include self Insured liabilities (non-captive) such as
  - Worker's Compensation
  - General Liability
  - Auto Liability

Other legal liabilities that may become suitably mature in the future include:

- Cosmetic Talc:
  - Liability for personal injuries associated with the use of cosmetic talc (talcum powder, other cosmetics).

- PFAS:
  - Liability relating to per- and polyfluoroalkyl substances (PFAS) known as the forever chemical.
  - Includes cleanup costs, property damage claims, and health-related lawsuits from affected communities.

- Abuse Claims:
  - Legal liabilities arising from allegations of sexual abuse or misconduct.
  - Where reviver statues are known and stable these could be transactable.

Other potential claims, such as those relating to opioids, flammable cladding, pharmaceuticals, talc, herbicides/pesticides and microplastics may emerge in the future – who knows what the next asbestos will be...


Questions?