RIVERSTONE
A FAIRFAX COMPANY

RiskSmart Run-Off℠ Solutions

KNOWING THE DIFFERENCE BETWEEN RISK AVERSION AND RISK CONTROL DRIVES SUCCESSFUL EXITS

For potential sellers, it is vital to understand factors affecting both the seller and the buyer as they navigate the strategic and tactical issues behind why and how to conduct the right run-off transaction and optimize outcomes for all parties.

There is a difference between risk aversion and risk control in run-off. For sellers and buyers alike, it takes the right alignment between each party, coupled with the right assets, capabilities, and experience to succeed. Understanding risk for this industry has never been more important. According to a recent report cited in Forbes, "M&A transactions for run-off portfolios, particularly in the US and Europe, are expected to surge, as insurers divest capital-intensive legacy insurance products... with billions of inactive books of insurance business..."[1]

Based on the industry's annual survey from PwC, the reasons for using third-party run-off providers have remained consistent over the last few years: capital release, organized and professional management of run-off, and early finality. Additionally, the implications of Solvency II in the UK, growing regulation in the EU, and the pending Rhode Island legislation in the US will significantly transform industry requirements and business practices in run-off. Ultimately this will be good for the run-off market. However, balancing risk and reward in run-off will continue to become more complex.

For sellers looking to run-off, there are multiple factors to manage when putting any portion of their portfolio and claims into run-off. Simultaneously, buyers face a reciprocal set of risks for each claim, exposure, or financial risk to be transferred by sellers. There is a seller's view and a buyer's view of run-off in this most unique industry, where the traditional customer role is somewhat turned on its head. For potential sellers, it is vital to understand factors affecting both the seller and the buyer as they navigate the strategic and tactical issues related to conducting the right run-off transaction.

THE SELLER'S VIEW

Typically, run-off deals for sellers are driven by one or more factors such as changes in leadership, the need for capital efficiency, or the need to focus the business away from non-profitable or "distracting" lines of business. At the same time, sellers must meet their obligations to various constituents - regulators, vendors, and most importantly policy holders.

[1] *http://www.prnewswire.com/news-releases/insight-report-ma-in-the-global-insurance-industry-300328322.html*

So, what is the strategic imperative for an insurer or reinsurer considering run-off? What is the nature of the legacy business being sold and what is the status of outstanding policies and claims – volume, exposure, shifting regulations, management drag? And last but not least, how does the insurer exit the portfolio to meet its goals, while also managing the equally important imperative of caring for claims?

At the end of the day, sellers are looking for various forms and degrees of certainty.

- ***Deal Certainty:*** Sellers must know that prospective run-off providers will not abandon them when trying to form an agreement. This issue often manifests itself when a buyer quotes an initially low price at the start of a negotiation process, only to raise that price following "further analysis" and deeper due diligence.
- ***Financial Certainty:*** Sellers need terms that ensure they do not exceed the coverage limits offered and they can fully achieve the desired capital release. When sellers and buyers need only worry about the extremes, that's RiskSmart.
- ***Security Certainty:*** Sellers must be assured that the buyer will "be there" for them, paying all valid claims in a timely manner. When prospective run-off providers focus too heavily on financial mechanisms to achieve business goals, instead of helping manage the operational aspects of assuming a legacy book, then sellers can face undue risk.
- ***Legal Certainty:*** Run-off deals are not complete when the seller and buyer both agree. The deal must also earn approval from the legal system and regulators, who must often deal with changing laws and the need to stay ahead of the curve to understand evolving approaches to run-off. Sellers need buyers who are in good standing with regulators.

RUN-OFF DEALS REQUIRE DIFFERENT TYPES AND LEVELS OF CERTAINTY

RiskSmart Means Getting Certainty for Multiple Factors

THE DEAL	THE FINANCIALS	THE SECURITY	THE LEGALITY
Will your prospective run-off provider stick with you and give you a reliable price?	*Will you get the capital release?*	*Will your policy holders (and liabilities) be managed well?*	*Will the deal hold up in the eyes of regulators?*

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THE BUYER'S VIEW

The run-off partner to which any insurer cedes legacy claims should first and foremost demonstrate a willingness and ability to assess and pay all valid claims in a timely manner. To reiterate, those "partners" who treat run-off as purely a financial transaction raise huge red flags for the health of the portfolio, claims, and a seller's liabilities over the long term.

First, there is the ethical imperative to do the right thing. Neglecting the legitimate needs of policy holders can also have dire consequences for the original insurer's reputation, with secondary and tertiary impacts on regulatory scrutiny, litigation, and even stock price. In the end, the proper professional ethos from the buyer translates into better service for claimants and greater risk control for insurers and reinsurers.

In general, buyer needs should reflect and derive from seller needs, right? While buyers certainly seek returns, they also care about protecting their reputation. Buyers want motivated and potentially repeat sellers and understandably prefer to deal with them directly, although there are cases where facilitators help to make the process more efficient and effective for all parties. Astute buyers embrace Requests for Proposals as a means to sort out what matters to the seller and highlight those factors that play to any given provider's strengths. We should all want deals that perform well for everyone.

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As part of any prospective deal, it is important for sellers (and facilitators) to understand the buyer's need for accurate information to enable responsible and credible decision-making when arriving at a fair offer. Sellers should be wary of prospective buyers who do not engage in proper due diligence. The extra effort and scrutiny in the short run pays huge dividends for both sellers and buyers in the long run. Sellers should expect to be asked for, and to share, detailed information on the actual policies and claims that will go into the deal. If the buyer gets their analysis wrong it may ultimately cost something to the seller. We are always surprised when other parties close on transactions with the books left unexplored... that is not RiskSmart.

THE KEY INGREDIENTS FOR SUCCESSFUL RUN-OFF

When it comes to understanding and controlling risk, while driving maximum capital efficiency in a run-off transaction, sellers and buyers both need to assess one another. This effort starts and ends with trust, underwritten by open and direct communications. It is also important that buyers and sellers operate at similar levels of sophistication.

We give insurers and reinsurers creative and compelling solutions that provide the right combination of people, processes, and technology to help balance all the key ingredients for successful and sustainable run-off.

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The expertise of facilitators may be needed to provide guidance to sellers, who strive to match up (and catch up) to buyers, especially buyers that have been through multiple deals. At the same time, when key issues cause excessive facilitator involvement, trust and understanding between seller and buyer can be affected. Both sellers and buyers must ensure their mutual interests are aligned before signing any deal.

And so, there is indeed a difference between risk aversion and risk control. It takes the right philosophy along with the right assets, capabilities, and experience to help determine what makes for the "right fit" for a particular seller. Sellers and buyers each benefit from deals that have a transparent, collaborative, and partnership-oriented approach...from the initial exploration of any deal, through the due diligence process, to implementation and execution.

And while transactions are always about price, factors like reputation and finality matter a great deal. At RiverStone, we embrace this ethos of responsible run-off in our RiskSmart Run-Off Solutions. That is one reason why we typically accept only about 10% of the deals we assess. But when we do engage, we give insurers and reinsurers creative and compelling solutions that provide the right combination of people, processes, and technology to help balance all the key ingredients for successful and sustainable run-off.

ABOUT RIVERSTONE

RiverStone is a group of insurance, reinsurance, and service companies specializing in the management of legacy and run-off insurance businesses and portfolios. With nearly 500 professionals with deep industry expertise in claims, customer service, litigation, and financial restructuring, we offer creative and varied deal structures to deliver sustainable outcomes you can count on. We lean forward to develop and deliver innovative exit solutions to help manage capital and meet board-level mandates to help focus an insurer's business. We know that reliability, security, and finality all come from an ability to not only assess the risk up front but to execute the deal at the scale and speed required by the business.

For more information, please visit our website at *www.trg.com.*