Looking for an exit?

Captive insurance companies play a valuable role helping many entities structure and manage risk, but as the business landscape changes over time, there may come a point when the owner decides that it no longer needs or wants all or part of the captive, as RiverStone's Matt Kunish explains.

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There are a number of reasons that may lead a captive owner to decide it no longer wants to continue operating its captive.

- Mergers and acquisitions activity may lead to multiple captives in the combined entity.
- Captive owners may sell parts of the business and do not want the associated historic insurance liabilities.
- For certain lines of business, such as workers' compensation, pricing in the commercial market may provide better value. Moving back to the commercial space would leave old liabilities in the captive that the owner does not want.
- The owner may have capital and/or collateral tied up in the captive that could better support its operations.
- In group captives, the participants change over time. It may be beneficial for non-current participants to resolve liabilities for older policy years.

Whatever the reason for the change, companies can use run-off transactions as a strategic tool for economic, legal, and/or operational objectives.

There are various strategies available, depending on whether the owner wants to maintain ownership of the captive legal entity (Table 1).

Each of these options has a similar process, and can seem daunting for owners focused on running their businesses rather than navigating through a seemingly complicated insurance transaction. However, many advisors in the captive insurance space are becoming familiar with run-off transactions, and can help guide captive owners.

With any of these strategies, engaging with a run-off provider will follow similar high-level steps.

Aligned interest: initial meeting with a run-off provider

While a run-off provider's main goal is to understand the captive's financials, it is equally important to understand the motivation of the captive owner. The success of the transaction depends on ensuring that interests are aligned, and that there is a clear understanding of the process.

An initial meeting can help advance both of these objectives. The run-off provider will be able to guide the owner through potential options, often bringing a new solution/structure to the owner's attention. Typically, a copy of the latest audited financials and the latest actuarial report is sufficient for the run-off provider to get a sense of the captive's finances.

Once the run-off provider has a basic understanding of the captive's financials, it may want to conduct further due diligence subject to appropriate confidentiality arrangements.

A comprehensive view: additional due diligence

Depending on the type of solution, the run-off provider may request additional information that will help it understand of the insurance risks in the captive. This could include a complete loss run of all open and closed claims, copies of the underlying insurance policies, and any applicable reinsurance contracts.

It is also helpful to have a discussion with the people handling the claims to review the company's reserving and payment philosophy. Depending on the number of claims reported, an individual claim file review may be appropriate. While this may sound like a large amount of work, the due diligence can typically be achieved in a three to four-week period depending on the availability of people and information.

Table 1: Options available to captive owners

	Options		
Captive owner's goal	Sell legal entity	Legally novate all or certain insurance contracts	Reinsurance via a loss portfolio transfer and/or an adverse development cover
To maintain ownership of captive		X	X
No longer wants ownership (of captive or policy liability)	X (captive)	X (policy liability)	

In the case of a sale of the captive, a review of the legal, corporate and tax documents may also be performed.

Run-off options: pricing and structure

Once the due diligence described above has been completed, the run-off provider will be in a position to provide structure and pricing options. In the case of the sale of a captive, this would be its own valuation of the captive balance sheet. When the valuation process is complete, the captive owner is able to assess the valuation of the captive relative to its own view and decide whether to proceed. This part of the process may take four to six weeks.

In the case of a novation or a reinsurance arrangement, loss reserve valuation is key. For the provider, the process is the same, valuing the loss reserves but now taking reinsurance structure parameters into account.

Post-closing: contract language and regulatory approval

When finalising the agreement, contract wording needs to be agreed upon. As run-off transactions become more common, the basic parameters are generally similar (eg, representations and warranties, covenants, and indemnity).

Transaction-specific wording can then be negotiated (eg, claims handling and reporting). At this stage, further due diligence may be needed to validate previously provided information, and regulatory approval may also be required depending on the type of transaction.

Depending on advisor experience level, this can be a relatively simple process, although specific issues may take longer than expected.

RiverStone's expertise

- 20 years of run-off and litigation management
- Successful evolution from the manager of Fairfax legacy business into a global run-off enterprise
- Industry leader in claims resolution, reinsurance recovery, and dispute resolution
- Seven global offices and affiliates across the US and UK
- Dedicated professionals who form a continuously improving run-off team
- Forward-leaning problem-solvers who treat clients' books of business with the highest levels of professionalism, integrity and accountability

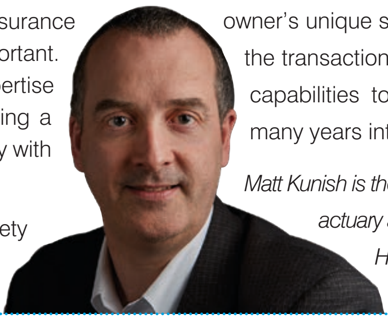
Benefits of partnering with RiverStone

- Highly specialised knowledge
- An established market player with a proven record of delivering effective exits
- Creative solutions in collaboration with our seller-clients
- Expertise in claims administration to remove a burden from captives
- Regulated entities to assume risk while maintaining the reputation of captives and their insureds
- Liabilities assumed either partially or completely, based on partners' needs

Reputation and expertise: what to look for in a run-off provider

A number of run-off providers operate in the captive insurance space. Choosing a provider with a strong reputation is important. Captive owners can validate a run-off provider's expertise and reputation by talking to advisors or regulators. Having a provider with a proven track record of working successfully with regulators will help ensure a smooth process.

The provider should be flexible, and be able to offer a variety of solutions so that the transaction can be tailored to the owner's unique situation. It is also important to ensure that once the transaction is completed, the provider has the operational capabilities to successfully run-off and manage claims for many years into the future.



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"WHATEVER THE REASON FOR THE CHANGE, COMPANIES CAN USE RUN-OFF TRANSACTIONS AS A STRATEGIC TOOL FOR ECONOMIC, LEGAL, AND/OR OPERATIONAL OBJECTIVES."