MILLIMAN BRIEFING NOTE

Non-Life Part VII Transfers: A Dwindling Trend?

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Since Part VII transfers were introduced in the UK by the Financial Services and Markets Act of 2000, the Court has sanctioned over 200 transfers of portfolios of non-life insurance business. However, 2023 is set to see the fewest transfers sanctioned in any calendar year since the early 2000s. Given the changing profile of the run-off market in recent years, what does the future hold for Part VII transfers?

What are Part VII transfers?

Part VII transfers are Court-sanctioned transfers of portfolios of insurance policies from one insurer to another. They are typically used by insurers as a means of disposing of business that no longer fits with its future strategy, or as a means of consolidating business into a single insurer, often following an acquisition.

The process generally takes a year or more to complete and will begin with notifying the Prudential Regulation Authority (PRA). The PRA must approve the appointment of an independent expert (usually an actuary) who will assess whether any party will be materially adversely affected by the transfer. The independent expert will prepare a report outlining the results of their analysis, which is submitted to the Court ahead of the first of two hearings, known as the "directions hearing." The PRA and Financial Conduct Authority (FCA) will also prepare reports to the Court outlining their respective views regarding the proposed transfer. Following the directions hearing, assuming that the judge is satisfied at the hearing that the transfer process should proceed, the parties to the transfer will notify relevant policyholders and other parties of the proposed transfer, in accordance with a communications plan approved at the directions hearing. Once the notification period has elapsed, the transfer can proceed to the final "sanction" hearing. Ahead of the sanction hearing, the independent expert will submit a further report, providing details of any updates to their analysis since the initial report, including commenting on issues or objections raised during the notification period, and whether this has led to any changes in the conclusions set out in the earlier report. The PRA and FCA will also provide submissions to the court ahead of the sanctions hearing. Any other affected party may also make representations at the hearing. Ultimately the judge has discretion to sanction, or otherwise, the proposed transfer.

TYPES OF PART VII TRANSFERS

As noted above, Part VII transfers are often used as an exit solution for insurers with portfolios of business that are in run-off. Most typically, Part VII transfers are used for portfolios that include long-tailed liabilities that would take many years to run off naturally. Removing the reserve uncertainty associated with this business, as well as the time and cost of managing the business, outweighs the not inconsiderable costs of transferring the business to a third party. There is an active market for run-off books, with a number of specialist insurers, including the likes of Enstar, Compre, DARAG, R&Q and Catalina looking to consolidate run-off portfolios.

Less often, transfers can be used as a means of consolidating existing business into a single operating entity. Particularly after acquisitions, it may be more capital-efficient, or less administratively burdensome, to combine all business into a single operating entity. The introduction of Solvency II motivated a number of such transfers.

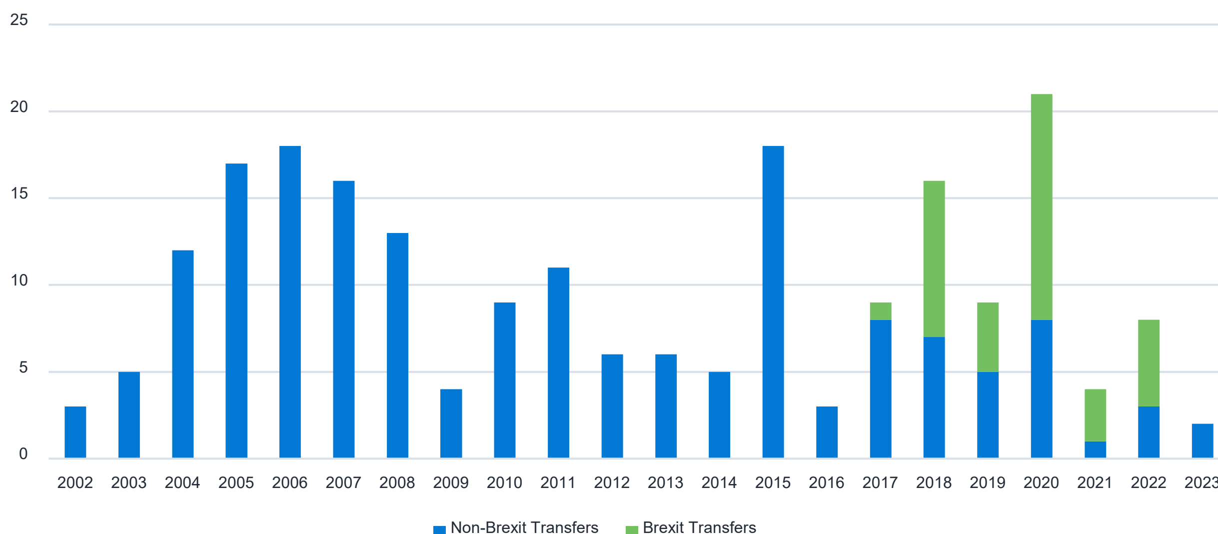
Brexit

Prior to the UK's exit from the European Union (EU), it was possible to use Part VII legislation as a means of transferring business from the UK to anywhere else in the European Economic Area (EEA) and, for business carried on in the EEA outside of the UK (by a UK-authorised person), into the UK. Pre-Brexit, we saw a number of examples of cross-border transfers that included UK insurers disposing of insurance portfolios written elsewhere in the EEA (e.g., in 2015 RSA transferred its Italian business to Italy's ITAS Mutua), as well as run-off insurers consolidating portfolios to entities outside of the UK (e.g., R&Q transferred several portfolios of UK business to its Maltese entity).

As can be seen from Figure 1, which shows the numbers of transfers sanctioned in each calendar year since 2002, Brexit itself led to a flurry of Part VII transfers (shown by the green bars), as UK insurers sought to transfer business written elsewhere in the EU into an EU entity.

Post-Brexit, the revised Part VII legislation only allows for transfers of business carried out in the UK, by UK-authorised persons, to another firm in the UK, or in Gibraltar.

FIGURE 1: NUMBERS OF NON-LIFE PART VII TRANSFERS BY YEAR OF SANCTION



Numbers shown are estimates made by Milliman based on transfers advertised in the Gazette.

Recent trends

As can been seen in Figure 1, volumes of non-life Part VII transfers reached an all-time high in 2020. More than half were motivated by Brexit. In the period from 2010 to 2020, non-Brexit-related non-life transfers tended to number around five to 10 per year. The spike in 2015 arose, at least in part, due to the impending introduction of Solvency II in 2016, with firms wanting to ensure that transfers (many of which would have eventually taken place anyway) were effected before the new solvency regime was introduced, in order to avoid the potentially increased capital requirements and additional reporting burden of Solvency II.

Since 2020, non-Brexit non-life transfers have numbered fewer than five in each year, and we expect only two transfers in be sanctioned in 2023. This raises the question of whether this is a trend of fewer transfers that is likely to continue, or whether we are likely to return to similar volumes of transfers as seen pre-Brexit.

We detail below some of the reasons we have heard industry practitioners put forward for why we may see smaller numbers of Part VIIs going forward. We then go on to examine them further and give our own thoughts as to what the future may hold for Part VII transfers.

Reasons for fewer transfers

BREXIT

One obvious reason why there may be fewer transfers going forward is that Brexit has removed the possibility of transferring business outside of the UK (with the exception of Gibraltar), thus limiting insurers' ability to undertake transfers motivated, for whatever reason, by seeking a different domicile. Moreover, with UK firms now no longer able to write business in the EU on a basis of freedom to provide services or freedom of establishment, there is simply less business being written that falls within scope of Part VII legislation and is thus capable of being transferred.

FEWER TRADITIONAL RUN-OFF PORTFOLIOS LEFT

Traditionally, run-off business has been associated with very long-tailed claims, in particular those relating to asbestos, pollution and other health hazards (APH). Back in 2019, we wrote about how many of the large portfolios of UK employers' liability policies, which have given rise to costly asbestos-related claims, had already been transferred to the legacy market (see here). With increasing amounts of this business having already transferred, there are simply fewer of these legacy portfolios left to dispose of and, therefore, there are likely to be fewer transfers in the future.

DEVELOPMENTS IN THE RUN-OFF MARKET

In the last few years, the run-off market has seen a number of big, high-profile transactions involving business written more recently. These transactions have included, for example, Enstar's loss portfolio transfer (LPT) with Aspen; Riverstone's reinsurance to close (RITC) deal with MS Amlin and Compre's LPT of Sirius Point.

All of these cases include business written in Lloyd's. Due to the RITC mechanism in the Lloyd's market, a Part VII transfer is not needed for syndicates to realise the full benefits of a run-off transaction. The run-off market's increasing focus on Lloyd's, as well as bigger international deals, where the underlying business may not fall under the scope of Part VII, may also mean it is it less likely to be interested in smaller UK-centric deals that could lead to a Part VII. This would appear to be the case with the likes of Enstar and Riverstone, and increasingly so with Compre, which has focussed on larger transactions since its acquisition by private equity firm Cinven and a Canadian pension fund in 2021. Other run-off firms have run into difficulties in recent years, including: Armour, which, following group companies East West and Elite entering administration, was eventually taken over by Premia; R&Q,

which has recently announced the break-up of its programme management and legacy businesses following its R&Q Re subsidiary entering liquidation; DARAG, where reserve deteriorations have led to it being put up for sale and likely to be taken over by a larger competitor; and Catalina, which recently announced it was pulling back from the brokered non-life legacy market and would refocus on life transactions. All of this potentially points to a reduction in capacity in the non-life run-off market, particularly in firms that might have transacted on smaller, UK-focussed deals.

Our thoughts on future Part VIIs

All of the points outlined above are perfectly valid observations, and it may well be that there are relatively fewer transfers in the next few years. However, we think Part VII transfers will continue to be used and would not envisage a significant fall in numbers as compared to pre-Brexit.

It is certainly the case that Brexit has restricted the scope of transfers and that may lead to there being fewer transfers in total, albeit that cross-border transfers (other than those motivated purely by Brexit) were always a minority. The fact that it remains possible to transfer business to Gibraltar raises the interesting possibility that it could become a hub for run-off companies. Gibraltar, with its favourable tax regime, is already home to a significant portion of UK motor insurers. One of the Part VII transfers that has been sanctioned this year is a portfolio of aviation reinsurance business from Aioi Nissay Dowa Insurance (ANDI) that was transferred to Gibraltarian company Beacon Insurance (which is managed by the Quest group), although the transfer was into its UK branch. We are also aware of one other potential future transfer into a Gibraltarian insurer.

It is also worth noting that the revised legislation does not totally preclude business originally written outside the UK from being transferred under Part VII. The reinsurance business transferred from ANDI to Beacon was originally written out of Japan. ANDI subsequently established a UK branch and switched administration of the business from Japan to the UK, thus bringing it within scope of the Part VII legislation. This is a model that has been adopted by a number of Japanese insurers (including Tokio Marine and Sompo) to enable them to use the Part VII process to dispose of legacy business.

Whilst there are now fewer of the traditional APH portfolios that have not already been transferred to the legacy market, transfers of such business are still in fact taking place. The other non-life transfer that was sanctioned this year was of a legacy pool participation of Allianz to a company in the Marco group. The remaining claims on this business were almost entirely APH. All three of the non-Brexit-related transfers in 2022 involved APH claims. Two of them were disposals to the run-off market and one was a consolidation of business within the Catalina group.

It is also worth noting that, of the large UK employers' liability portfolios discussed in our 2019 paper, the Zurich portfolio has not yet been legally transferred to Catalina, although the economic liability has lain with Catalina since 2018 via an LPT. It is possible that that portfolio could also yet be transferred via a Part VII transfer.

One thing that is clear from recent developments is that the live market is increasingly seeing disposing of business to the legacy market as a part of the normal insurance business life cycle. Some insurers, such as Zurich and QBE, have teams dedicated to finding exit solutions for legacy business and have brought multiple legacy portfolios to the market. Part VIIs will not always be necessary or feasible to dispose of all portfolios, but the fact that insurers are increasingly aware of and experienced with the legacy industry can surely only increase the chances of more portfolios being brought forward.

How Milliman can help

Milliman is the leading provider of independent experts for Part VII transfers, having acted on more transfers (both non-life and life) over the past 10 years than any other firm. We have worked on a wide range of transfers of varying size and complexity. They have included transfers of traditional UK and US APH portfolios, as well as transfers of much more recent business across a wide range of lines. We have worked on disposals to the major run-off insurers, as well as internal consolidations for major UK insurance groups. Aside from our work on Part VIIs, we also have extensive experience with run-off business, including buyer and seller due diligence support in legacy transactions, reserve reviews and commutation valuations.

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