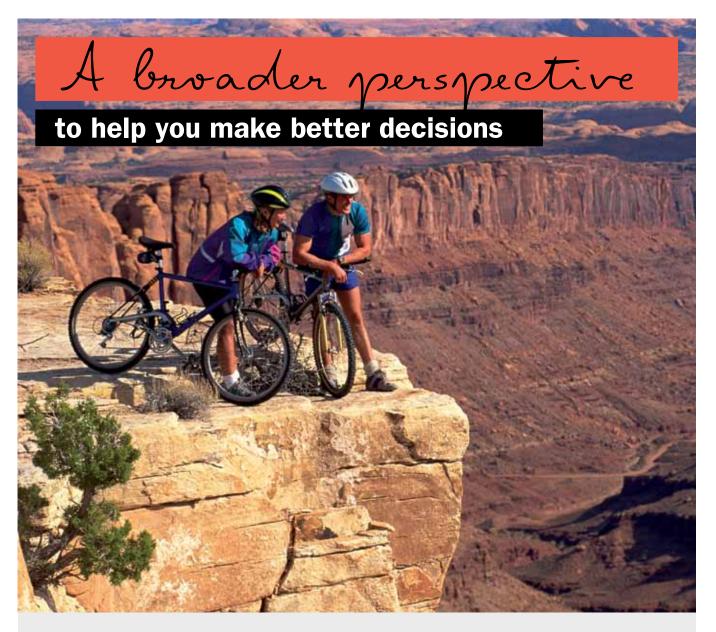




Pressure change?

Forecasts for run-off in 2010...



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A mixed forecast...

What can the P&C legacy industry expect in 2010?



Dear Reader

The (re)insurance industry is once again near to completing the annual ritual that is the full year financial earnings season.

What has that got to do with the business of running off legacy liabilities, I hear you say? In fact, quite a lot.

A year ago, the icy chill winds were whipping through the financial markets. In the (re)insurance sector, even experienced old hands were openly questioning the future of industry leviathans. Indeed, the very essence of (re)insurance – confidence – was slipping away from many organisations as asset values, balance sheets and counter-party security were all being scrutinised, and doubted.

Conversely, it was widely expected to be a boon time for the legacy market which, as is its way, tends to do well when the live sector is suffering. It didn't take the divining skill of Mystic Meg to forecast that a flood of run-off would inevitably follow these financial shockwayes.

Yet a year on, and the (re)insurance industry looks remarkably stable. Assisted by the bounce-back in the investment markets and last year's gentle claims environment, 2009's financial results are very impressive. In many cases, they are at near-record levels and all the more remarkable considering the depression that had set in a year ago. Excess capital is, again, the issue *du jour* and there is little expectation now of an imminent flurry of new run-off.

As one of the participants in our annual barometer remarked, it is a "hard pill to swallow for the industry, which widely anticipated an influx of new business on the back of the global crisis".

Nor has the Continental European run-off market developed as many had hoped. So what does the future hold for the sector? Is it destined to wither on the vine, like a shrivelled grape in the blistering sun?

In fact, the forecast is not quite as bleak as it may first appear. Yes, there are great uncertainties – the confusion over schemes of arrangement following the Scottish Lion decision and UK asbestos liabilities, for example – and it is also true that, as business gets closed down, the market is effectively shrinking. But many of our barometer's contributors believe there are also opportunities.

Not least of these is Solvency II. Will it be the legacy market's great saviour? Not everyone agreed. One correspondent remarked "Solvency II is like the millennium bubble, over baked by consultants!", but that is the minority view. Most predict it will throw up new opportunities as (re)insurers are forced to reshape their capital structures.

Providing services and outsourcing functions to the live market – in the form of claims, processing etc – was also widely seen as a growth area.

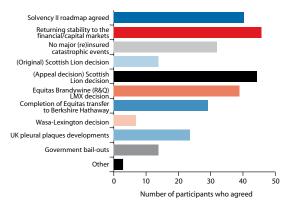
Indeed, you don't need me to tell you the results of *The Insurance Insider's* 2010 Legacy Barometer. Simply read on. I think you will find it a fascinating snapshot of the legacy P&C market at a time of continuing change.

Yours sincerely,

Mark Geoghegan Editor, *The Insurance Insider*

The Insurance Insider surveyed the views of subscribers and key participants in the legacy market between 15 and 18 February. There were 75 respondents giving a powerful insight into the expectations of the year ahead...

What were the three most significant events to have taken place in the legacy sector in the last year?

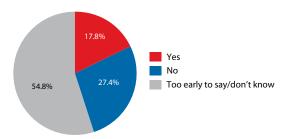


The ongoing recovery in the financial markets has had a huge impact on the sector and after the turmoil caused by the credit crisis in 2008/09, it is easy to see why. But the year was also punctuated by a number of significant events, many of which are continuing to reverberate today. Here's a selection of your comments:

"The key drivers of recent results have been no cats and investment returns" "Although heralded as bringing clarity, the Scottish Lion appeal decision opens up the necessity for fairness and transparency in solvent schemes, which has previously been lacking"

"UK pleural plaques developments are frightening and the incidence of development from pleural plaque to full blown mesothelioma is much higher than recognised or admitted by the market"

Bearing in mind the cost of implementation to the legacy industry, will Solvency II be as great a boon as some are predicting?

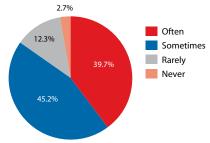


A "wait and see" stance was taken by many of our respondents – the consensus is that it is too early to say what impact the Solvency II regulatory initiative will have.

"Solvency II is like the millennium bubble, over baked by consultants!" "Initial analysis is highlighting the need for far greater capital - this will mobilise the industry to lobby for less onerous demands"

"There is continuing uncertainty over the amount of capital that needs to be held"

Do you believe claims standards generally suffer when live business goes into run-off?

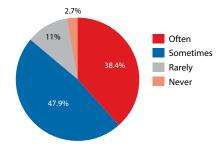


We asked this question last year, and it would seem that the industry's perspective has changed little. Clearly, there is still much work to be done here.

"Entities in run off lose their commercial interest in business. Speedy claims payments and expensive claims departments are no longer in their agendas" "Different drivers and cost considerations make it hard to justify paying for the appropriate level of expertise"

"The unwillingness of the broker market to support non-live clients is a serious problem and leads to significantly impaired service" "It is difficult to keep staff motivated and retain staff"

Do you believe claims standards generally suffer when business is sold to run-off managers/third-party owners?



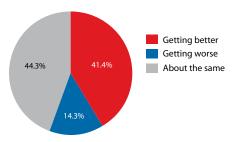
Echoing their answers to the previous question, 86.3 percent of respondents said claims standards suffer sometimes or often when business is sold to run-off managers. This is not good news.

"Run-off managers make their business from delaying or simply not paying claims. This is a simple fact and explains the abominable service which they generally provide"

"In terms of proper compliance with terms and conditions, standards improve"
"Run-off acquirers have better processes and legacy is the focus of their
business rather than being a difficult book within a live company"

"Third-party acquirers often lack first-hand knowledge of the portfolio and the type of company purchasing run-off is generally opportunistic and extremely aggressive in claims settlement"

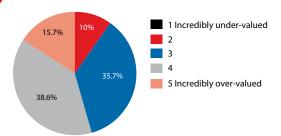
Do you believe claims standards for live and run-off business are getting better, worse or roughly staying the same?



Sticking with the theme of claims, the majority thought standards had roughly stayed the same, although many were optimistic that things were improving.

"Live standards are better, while run-off is about the same"

On a scale of 1 to 5 where do you currently rate the pricing of legacy books of business?



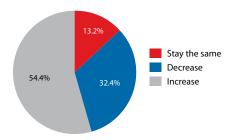
This question provoked some strong reactions. Our barometer thinks current pricing is still on the high side, trumping last year's expectations that prices would fall.

"There still seems to be a free for all when it comes to the purchase of legacy portfolios, with unrealistic pricing levels"

"Where run-off is more over-priced than live companies trading at 20 percent less than book, something is wrong"

"The prices which have been paid in the past have defied the numerical logic"

Do you think the prices paid for legacy books of business is set to increase, decrease or approximately stay the same in 2010?



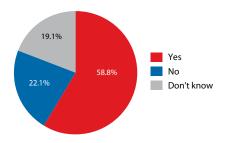
And, following on from the last question, practitioners do not see much room for improvement this year in terms of pricing.

"As long as there are buyers prepared to pay over the odds for legacy business, prices will stay high"

"Stop paying silly money or nothing will change"

"I see a future where the number of purchasers will reduce through mergers and acquisitions, and with less competition prices may reduce"

Was the November 2009 Equitas (R&Q) LMX decision in the UK High Court useful in giving clarity to resolve LMX business?



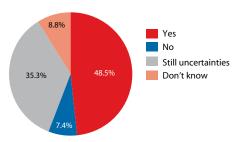
Already flagged up earlier as a crucial event for the industry, the majority of respondents felt the sanctioning of a modelled loss to prove LMX liabilities provided clarity. Who is next on Equitas' list though?

"The decision was landmark and made a fundamental change to the degree of proof of loss"

"Decisions based upon actuarial opinion are not necessarily sound, and without the appeal that was required to add further weight to this change of direction, then such a deviation from accepted market practice seems shallow"

"We haven't seen a single new Exxon/Kuwait advice since the decision"

Was the January 2010 Scottish Lion appeal decision helpful in giving clarity to the construction of solvent schemes of arrangement for run-off (re)insurers?



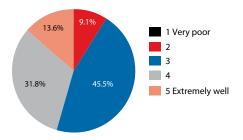
What was helpful about a Scottish judge's erroneous first instance decision throwing the market into disarray before being overturned on appeal? Well, we now know that single creditors cannot derail entire schemes. All eyes are on Scottish Lion's sanction hearing to see how the story ends...

"There is a clearer point of law but still uncertainties remain regarding fairness – the case is yet to be heard"

"All that the Scottish Lion Appeal decision does is to reaffirm that schemes of arrangement can be utilised by solvent companies"

"The additional transparency now required in regard to voting values, and demonstrating that there is genuine benefit for creditors must clean up a number of the more 'murky' practices that have developed"

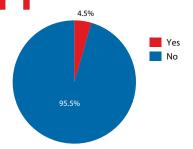
Phow well do (re)insurers manage the impact of discontinued business on their capital efficiency and returns on equity?



A bit of an eye-opener. Our audience obviously feels there is much to be desired in the handling of discounted business, perhaps the prospect of a long-term low interest environment has some influence.

"In recent years, run-off has been demonstrated as a significant contributor to bottom line profits"

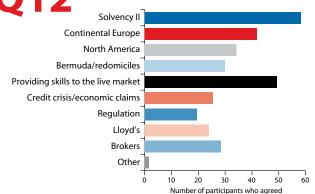
Did the global credit crisis lead to as much new legacy business as expected in 2009?



"A hard pill to swallow for the industry, which widely anticipated an influx of new business on the back of the global crisis"

"Some predicted that a huge amount of businesses would be put into run-off, but did not realise the mechanisms available as well as the guile of accountants in the groups and the desire to keep the businesses active" "Despite the global credit crisis, we have not seen a significant increase in numbers or values of legacy portfolios entering the market"

Where will the growth opportunities be for the legacy sector in 2010 – 2012?



The responses here demonstrate a firm belief that Solvency II will drive growth for the sector – especially important as the industry increasingly looks to Continental Europe. But diversification also seems to be the name of the game, and we expect to see a growing trend in the near future of run-off practitioners branching out into the live market to offer their support as service providers. Here are some closing thoughts from our audience of industry sages:

"Much of the industry is still deluding itself with regard to "long-tail" underwriting results, the worse is yet to come!"

"Legacy business has real problems – too many buyers chasing insufficient assets and the belief that Europe is the saviour is misconceived"

"The market has been very tough in the last 12 months with continuing consolidation and a lack of new business. In the future, a further contraction of people working in the sector and business opportunities is likely to continue"



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