The Legacy Market

Resistance. Protection. Equivalence. Vision. That Order.

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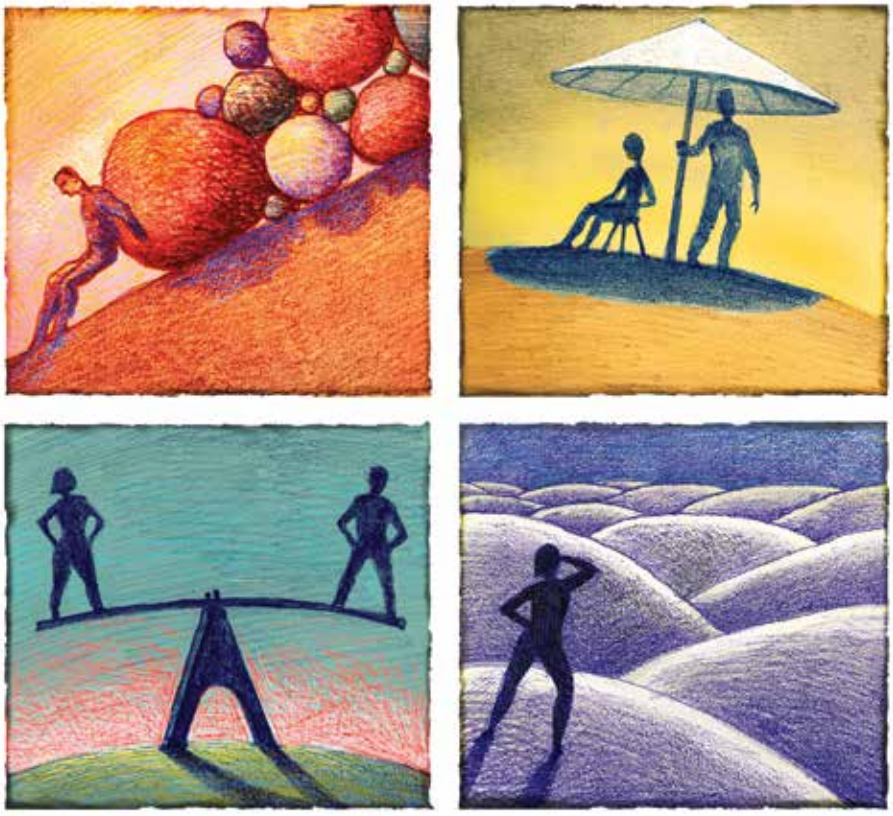

In The Legacy Market article that ran in the Spring 2017 issue, we discussed the various exit and capital release tools available to the European insurance market with each providing different degrees of finality and capital relief. The second Legacy Market article which ran in the Fall issue, discussed the first finality statute available in the U.S. and steps taken by other states to adopt a similar framework. This third article in the Legacy series will discuss where we are today and the concerns and challenges we understand are currently being discussed in the market.

While approaching the end of another busy year, the European legacy market can look back and be proud for the transactions signed, approved, closed, and, of course, last but not least, for those rumoured to be in exclusive discussions with the various acquirers. The year may end with some surprising results, all of which will add to the growing attraction of the legacy space and the increasing trust and consequent collaboration between sellers and buyers.

The mechanism is long established, tried and tested, and with no failures. The legacy acquiring market can proudly boast zero failure. This, without any qualification or footnote, delivers the certainty and reputational promise made to clients and, most importantly, to policyholders.

Across the Atlantic, more than two years on, the Rhode Island statute remains "unused," while rumours that the first transaction will be announced in the early part of 2018 are widespread. This will be a welcome step in the right direction. But why is it taking so long? Why is the U.S. market not as enthusiastic as the European market about the availability of legal and/or economic finality for non-core or unwanted portfolios? Certain concerns have been consistently raised that provide valid and varied reservations of a market that is normally state-focused and state-managed and one that has consistently resisted federal legislation on any insurance aspect. I outline below some widely-discussed concerns and offer some thoughts from experience gained in the last few decades in Europe.

Reputation

Insurers are understandably concerned about their reputations when considering the transfer of a portfolio. This is particularly relevant when considering a transfer of a line of business that they wish to continue to underwrite. How will the acquirer treat their customers? Who may still have a policy with the insurer (a concern that is especially relevant in relation to direct policies, such as automobile or homeowner's policies)? Who will handle their claims? Will the acquirer unduly delay payment of claims? Will the acquirer try to treat policyholders less fairly given that the acquirer would not be interested in any future business?

These are all valid concerns, but express a failure to see the transaction in its entirety, which includes looking at it from the acquirer's point of view. Acquirers' core business is insurers' non-core or unwanted business. In order for them to be in a position to succeed, to continue to grow, to meet their business plans, to satisfy their shareholders' expectations and to achieve the plethora of business goals that all businesses have, they have to build a reputation of reliability and credibility so that they can continue to acquire more portfolios and to grow their own balance sheet. The reputation of the seller is only one side of the same coin. The acquirer is just as keen to preserve its own reputation in order to gain more business from the same client, new clients, to grow, and

The Legacy Market (continued)

to avoid any regulatory issues that may follow from policyholder complaints. It is obvious how the parties' interests in any transaction are aligned.

Policyholder protection

Policyholder protection is a key driver in any transaction approval process. It is quite rightly the most important driver for the approving regulator or court. The approving regulator or court must be satisfied that policyholders will be protected in the hands of the new owner. The examination process before approval is long and thorough, whether this is done by a regulator in the EU, or by a judge in the U.K. or Rhode Island. The Independent Expert's report, commissioned by the Rhode Island Department, would consider all interested parties, and will be an important element of the process as to whether or not the transfer is sound; the regulator will only approve a transfer if satisfied that policyholders will be just as protected, if not better protected, after the transfer. Equally, the acquiring insurer must show that its own solvency is sound pre- and post-transfer. Regulation 68 provides that both the home and the receiving regulators be involved in the approval process and that the court's approval is required to effectuate the transfer. Any new process is bound to be encountered with reluctance or doubt. The success of the process will be entirely dependent on the actual success of the transactions themselves. And this can only be seen once the process is used.

State v. Federal legal framework and regulation

In the Legacy article published in the Fall 2017 issue of AIRROC Matters, I questioned whether or not a EU-style legal finality would be possible in the absence of Federal legislation on this aspect of insurance law. State commissioners are understandably protective of their insurance industry and their policyholders. A uniform system would ensure that all transactions are reviewed in the same way and are decided within the same legal and regulatory framework, thus rendering state issues less relevant. In a uniform system, business transactions would be completed with certainty, not concerned with potential challenges by other states that do not have similar legislation; they would not be dependent on judicial interpretation on whether or not another state court's decision should receive full faith and credit. Reciprocity and equivalence are key ingredients to a level playing field in business transactions from which certainty would flow. Certainty is key to business transactions and to business success.

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U.S. and EU Covered Agreement

The Bilateral Agreement between the U.S. and the EU on Prudential Measures Regarding Insurance and Reinsurance, in short, the "Covered Agreement," provides a level playing field between U.S. and EU insurers that, principally, removes the need for authorisation and collateral in each other's jurisdiction. This is certainly a major step in terms of recognition, reciprocity, and equivalence that enables insurers and reinsurers to engage in transactions in each other's territory acknowledging each other's regulatory framework, noting the benefits of enhancing regulatory certainty and acknowledging that group supervision of insurers and reinsurers enables supervisory authorities to form sound judgments of the financial position of these groups. The Covered Agreement further "encourages the exchange of information between supervisory authorities in order to supervise insurers and reinsurers in the interest of policyholders and other consumers." In plain English, it says: if you are regulated by a sound regulatory system and respect basic insurance principles, then we trust that you do without further checks. And that's a good thing in terms of a global industry like insurance.

It would seem to me that this step goes a long way to recognising that regulators, no matter where they are, and insurers, no matter where they are, have a common goal: "to supervise insurers and reinsurers in the interest of policyholders and other consumers." It should follow from this, that any regulator, whether a U.S. state commissioner, a regulator of a EU member state, or the U.K. courts would review, assess, and approve a transfer with the same overriding principle. Does it not then follow that all we need in order for the Rhode Island process to be embraced by the industry and other states is a relatively small leap of faith?

Status quo or utopia?

In the EU, 28 member states (until Brexit, hard or soft, hits us) have a uniform legal framework and a set of rules that governs statutory portfolio transfers. The U.S. and the EU Covered Agreement commits that stated based collateral will be eliminated for EU insurers and reinsurers that meet the consumer protection standards set out in the agreement. So, if the EU and the U.S. can reach agreement on reciprocity based on the mutual respect of each other's legal and regulatory frameworks, can U.S. states perhaps achieve this reciprocity, in time? Or perhaps, take an even bigger leap of faith and find a way to agree that this aspect of insurance law and regulation will be governed on federal level? This would certainly achieve a level playing field for insurers, states, and commissioners while providing uniform and equal protection for policyholders. Is that not what we would call "win win" situation? ●

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