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global view

Making the Case for Run-Off: As reserve releases tail off, voluntary exits will take over.

By Jeffrey T. Bowman

In the wake of reduced claims frequency and investment income caused by the recent economic slowdown, insurers worldwide have been working to bolster profitability. One way they have done so is by releasing reserves, which reduces their liability and improves profits. However, analysts are warning that the reserve release boom may be over, and a trend toward adding reserves may develop soon.

Another way to improve profitability that may have more staying power is voluntarily placing low-margin business into run-off. In a recent survey involving major U.S. carriers and reinsurers, 90% of the survey participants indicated that they are in the process of applying improved analytics to identify business segments, lines of business and geographic markets to exit and place into run-off.

The U.K. run-off market is far more mature than that in the United States and may well have peaked earlier this decade. According to the recently released KPMG run-off survey of U.K non-life insurers, the non-life run-off market has shrunk steadily since 2003 (except during the extreme economic conditions of 2008). However, while the traditional London run-off market may be in permanent decline, "longer term business strategies adopted by some carriers suggest that a residual element of run-off will persist for many years to come," the report says.

In addition, the potential for significant run-off business exists elsewhere; the German run-off market has increased from €75 billion to €115 billion since 2007, KPMG says, and the continental European run-off business is in its infancy.

That run-off business may be further bolstered by Solvency II, which will set out new, strengthened requirements for capital adequacy and risk management for insurers in European Union countries. Solvency II, which becomes effective October 31, 2012, is meant to increase policyholder protection by requiring that insurers demonstrate they have adequate financial resources to meet obligations, among other provisions. This will result in more focus on the risk and reward of business lines and should lead to increasing consideration of run-off options.

One of the critical factors to take into account in run-off scenarios is claims management. The issues around claims in run-off tend to focus on three areas: reserves, staffing and personnel management, and, most critical, claims closure. As run-off claims remain open over longer periods of time, the probability of adverse case development increases exponentially; reserves are incrementally and progressively increased, particularly if they were inadequate in the first place, which is sometimes the case with run-off books of business; and the opportunities surrounding quick and fair settlement through productive negotiations rapidly diminish.

In Europe, run-offs are most often managed in an outsourced arrangement, while in the U.S. to date, insurers tend to use internal resources. Because additional voluntary run-offs are on the horizon, we expect that U.S. insurers will turn more often to outsourcing not just to control fixed costs, but also to take advantage of the specific skills necessary to manage a run-off book of business.

Run-off claims need experienced, well-paid desktop handlers in an industry that generally sees field adjusting as a higher calling. As a book of business matures, insurers and administrators are left with the more complicated files which require specific expertise to handle. And, if not incented properly, claim handlers are not necessarily inclined to close business and put themselves out of work.

When fully understood and well-executed, runoff can be an effective strategy to help insurers get their financial houses in order. The key phrase here, though, is "well-executed." Insurers and outsourcers alike need to make certain that the positive aspects of voluntary run-off aren't cancelled out by the pitfalls that exist in managing run-off claims.

Jeffrey T. Bowman is president and CEO of Crawford & Company, the world's largest independent provider of claims management solutions with $970 million in revenues and 8,900 employees based in 63 countries. He also serves on the Board of Directors of The Institutes, the organization that develops courses and confers the CPCU designation. He can be reached at info@us.crawco.com.