

# Dealing with debt

**Tom Rennell** finds the market for reinsurance debt continues to attract both buyers and sellers

Three years ago *Run Off & Restructuring* reported on the rise of companies seeking to sell off reinsurance debt to interested parties. Recovery of some debts often required manpower and expertise that perhaps they did not have, and it became prudent to take a hit on the face value to achieve finality and improve liquidity and reduce costs. But how has this market evolved since? Well, generally speaking, interest from both buyers and sellers of reinsurance recoverables has continued to rise.

'The number of parties interested in acquiring debt has certainly increased over the last few years,' says Bill Rookes of Compré. 'There appears to be more of an appetite for ceding companies to consider selling their slow moving debts or indeed their portfolios of legacy business. The burden of run-off cost is weighing heavy and companies are striving to be freed from that burden.'

Whilst in previous years Compré didn't see debt purchasing as a 'central plank' of its business, according to Rookes, 'the emphasis has now changed. Compré Broker Services Ltd (CBSL) is now actively growing its clients base. In addition to our contingent fee collection service / commutation work we see the potential to acquire non performing reinsurance debt as a key additional feature of our market service offering.'

However this enthusiasm is not universal. ReRecovery's Andreas Bachofner told *Run Off & Restructuring* that they were 'less involved today'. He added: 'There frequently is a huge divergence of amounts between the assessment of the buyer and seller. Whereas this is quite natural, I believe that gap is larger than



a few years ago, partly because of the frequent downgrades of major insurance/reinsurance companies.'

Nevertheless, factors such as Solvency II and the financial crisis are making stubborn debts look less and less attractive to companies, and the thought of relieving oneself of them for a one-off cash fee more and more attractive. Vivien Tyrell at law firm Reynolds Porter Chamberlain says: 'There is a renewed inter-

Moran says: 'Creditors want liquidity, either to protect their reinsurance asset from diminishing as a result of time bar limitations or because they would prefer to have cash now rather than waiting for delayed future payments.' Rookes echoes this sentiment, observing: 'The seller receives an immediate cash settlement for a non-performing reinsurance asset.'

For David Hunt, CFO and COO at PRO Insurance Solutions, the bene-

vent schemes of arrangement the sale of the residual debt book allows the affairs of the portfolio or company to be wound up more quickly.'

However, as a buyer, there is also more to offer a vendor than simply a one-off cash payment. According to Hunt: 'It provides the opportunity for the buyer to use its skills to generate a return whilst bringing benefits to the seller. The risk is limited to the purchase price and costs as no reinsurance contract liability is assumed (ie. its not a novation).' He continues: 'It is a simpler and quicker process with less operational cost than buying whole run-off portfolios or companies, although still not directly comparable. This is an asset play, whilst purchasing run-offs is more of a liability play, even though both rely on a proper analysis of the underlying risk.'

Says Prager: 'Some people may simply offer cash. Some people may be a bit short on the cash upfront but offer an overall higher recovery rate which may look attractive to somebody who is looking for some sort of combination. Or someone might say I'm not going to give you x for the debt, I'll give you a percentage of that plus a percentage of what I recover.'



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Bill Rookes, Compre

est in this field, especially spurred by the Lehman collapse where inwards claims are being traded by a number of distressed debt houses.'

However, the eagerness of companies to offload this troublesome debt has not turned this into a buyer's market. The financial crisis has played its part for buyers too, as the capital needed to fund some deals has become less readily available from the beleaguered banks. Ashley Prager of Risk-Resolutions notes: 'A few years back, the money was readily available – banks were happy to lend – now the money's dried up and we can't look to the banks for funds in a purchase.' He continues: 'It's a buyers and sellers market. I would split it straight down the middle.'

In this sense, a balance has been maintained favouring neither party and deals still need to be beneficial for both sides. 'The factors haven't changed very much over the last three years,' says Rookes at Compre. 'A good deal is still a good deal for both parties, why else would it proceed?'

From the perspective of a seller, the option of offloading slow-moving debt has a lot to offer. R&Q's Jim

fits for sellers are loud and clear: 'For all sellers, but specifically in relation to ongoing business where "old" reinsurance recoverables exist, this type of deal brings: immediate accelerated cashflow; immediate balance sheet improvement; certainty of asset value and release of any doubtful debt provision held in the balance sheet; improved solvency position; reduced administration costs; and it allows the company/syndicate



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Vivien Tyrell, Reynolds Porter Chamberlain

to focus on its current core business activities.'

He adds: 'In the case of insolvent estates, it allows sellers to close the book of business by taking the residual debts off the books, which may in turn result in an increased return to their creditors. Similarly, for sol-

In contrast it can be complicated, costly and time-consuming for companies to pursue their recoverables themselves, especially if they lack the required expertise in a given field. Bachofner at ReRecovery says: 'Regularly, it needs a different mindset to pursue the debt. Many com-

panies are not used to knocking on doors and putting pressure on companies to pay. Certainly, most companies don't have the experience and resources to deal with liquidators in various countries.'

For companies where debt recovery is not their core business, selling or contracting out to specialised firms can save a lot of time and money. These firms in turn can hope to generate more capital out of the debt than the seller. Rookes observes: 'Often it is the attendant staff costs and time involved in pursuing small individual debts that makes it uneconomic for a company to pursue its own debts. Whereas specialist firms such as ours can consolidate and coordinate efforts to recover monies for a number of parties from the same debtor, thus achieving economies of scale.'

From the buyers' perspective, if their assessment of the risk and recovery strategy is robust, purchasing debt can offer a good return on



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Ashley Prager, Risk-Resolutions

an investment. Nonetheless, debt purchase is not without risk and buyers are well-advised to conduct a thorough investigation of just what it is they intend to buy.

As Rookes points out: 'Caveat Emptor – let the buyer beware – and due diligence is the key. It is essential the purchaser of the debt completes a detailed investigation into the circumstances resulting in the debt, including technical disputes, time bar issues etc, before concluding the transaction.' Thus in most transactions, notes R&Q's Moran, 'the debt purchaser will require warranties as

to the actual value of the debt, such as the validity of claim recoveries, offset owed to the reinsurer or the age of the debts.'

As far as Hunt at PRO is concerned, 'the ability to build professional and trusting long term relationships between the buyer and seller is key to a successful deal. The seller needs to be able to trust the buyer, know that there will be a clean cut-off with any ongoing relationship being clearly explained and agreed, and that the buyer is prepared to accept the agreed element of risk and will not come back with any claims against

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the seller if the deal does not yield the returns they expect.'

In this regard the lawyers play a vital role in any successful deal. Says Tyrell at RPC: 'We have acted for a number of purchasers of inwards insurance and reinsurance claims and outwards reinsurance recoveries of insolvent re/insurance companies' adding that lawyers are 'very important as each transaction needs to be assessed against the facts. There are questions of enforceability of rights of recovery on assignment in the event of the assignor being dissolved, as well as questions of notice and subrogation.'

So what does the future hold then for debt purchasers and sellers? On this question there does not seem to be widespread agreement. Prager at Risk-Resolutions, for instance, is optimistic. 'I think there will be an increase in this type of business. So long as there is value to be had for the buyer and they can realise that asset and the deal is structured cor-

rectly, then it will remain attractive to both sides.'

For Bachofner, Solvency II should also help to encourage activity on the part of the vendors: 'In view of Solvency II, more companies should look at their reinsurance receivables. The pressure is growing on the quality of reinsurance protections, both at the time of signing a contract as well as later during run-off.'

PRO's Hunt has definitely noticed an increase in competition/demand for debt purchase, 'partly driven by the current financial situation but also by increased education as to the simplicity of the process, time and cost involved for the seller versus the benefits that can be achieved.'

Consequently he foresees a continuation of good opportunities for both buyers and sellers: 'We also believe that the market will grow over the time as debt sale becomes a more normally accepted practice for realising problematic debt, but even more so for old debts in the

context of improving liquidity and certainty.'

Tyrell's optimism is more guarded: 'A bright future in the medium term. Insurers and reinsurers may wish to realise as a cash asset existing cover by selling their outwards reinsurance contracts. Also the increased use of Part VII transfers (as well as the equivalents in other jurisdictions) will give rise to a number of reinsurance policyholders wishing to sell their positions.'

Conversely, Rookes is more sober about future prospects, predicting: 'Over the next 5-10 years I see a contraction in the number of market players purchasing reinsurance debt.' He nonetheless adds: 'However, debt sales will still feature as an option for ceding companies wishing to rationalise and receive value for their outwards reinsurance portfolios.'

As with all predictions, only time will tell. Besides, as Yogi Berra once said, 'prediction is very hard, especially about the future.' ●

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