



Rendez-Vous de Septembre Virtual Conference: Insurance/Reinsurance Transactional and Regulatory Developments

MONDAY 13 SEPTEMBER 2021

4:00 – 5:00 P.M. CEST, 10:00 – 11:00 A.M. ET

Panelists:

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Moderators:

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Agenda

1. Evolutions in coverage and loss patterns
2. Regulatory priorities impacting transactions
3. M&A prospects
4. Reinsurance/portfolio transfers – current developments
 - a. P&C
 - b. Life/annuity/health
5. ILS (securitizations)

1. Evolutions in Coverage and Loss Patterns

- a. Unexpected evolutions – what certainty is possible?
- b. Expected evolutions – who will eventually bear the cost?

Unexpected Evolutions: COVID-19

Immediate impact of Covid-19

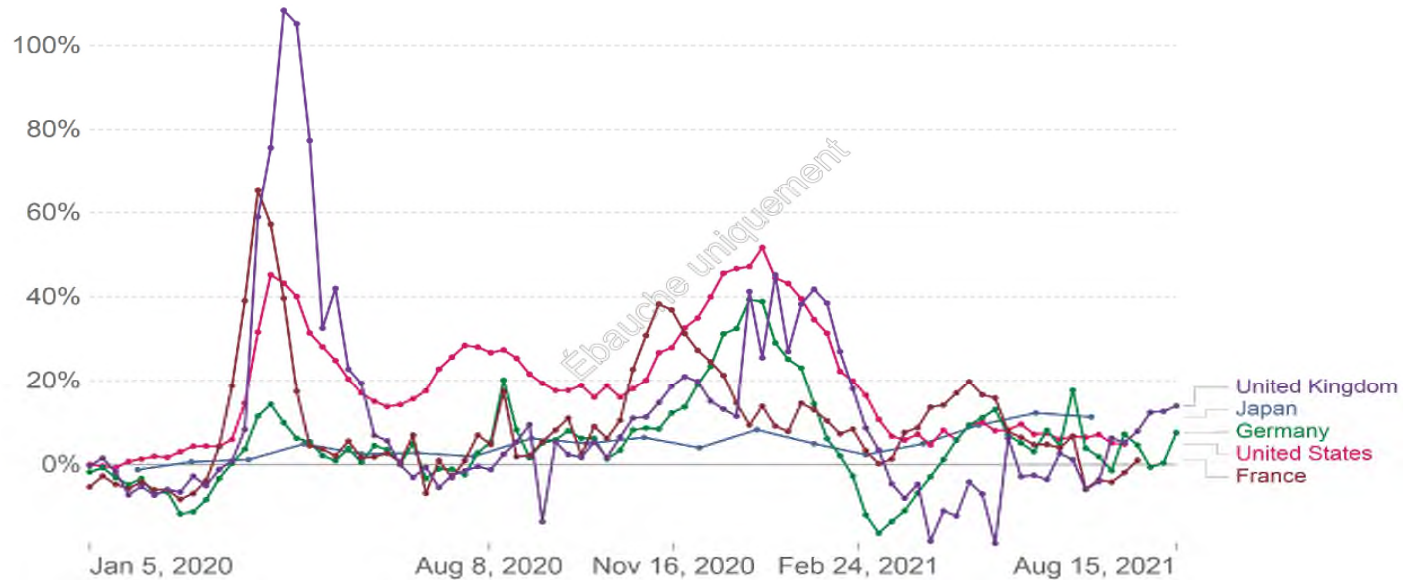
- On global multiline insurers (GML):
 - Increase in claims: business interruption (BI), event cancellation, credit insurance, life
 - Decrease in claims: motor, homeowners/residential
 - \$8B decrease in earnings (not a capital event)
- On top 20 reinsurers: \$20B decrease in earnings
- Impact on earnings from low interest rates

Source: S&P May 2021

Future impact?

Unexpected Evolutions: COVID-19

Changes in mortality during the pandemic compared with prior 5-yr. average (estimated)



What conclusions to reach?

Source: <https://ourworldindata.org/grapher/excess-mortality-p-scores>

Unexpected Evolutions: COVID-19

Impact of Covid-19 on mortality

- Increase due to:
 - Covid-19 infections
 - reduction/delay in other healthcare
 - greater depression, alcohol, drug use
- Reduction due to:
 - reduced mobility
 - fewer non-Covid-19 infections
 - Covid-19 replacing other causes
- Negative correlation between Covid-19 deaths and insured population

Source: <https://ourworldindata.org/grapher/excess-mortality-p-scores>

Business Interruption (BI) – Initial Reactions

FFA (April 2020): epidemics/pandemics, because of “duration” and “scope,” are “uninsurable.”

FCA (April 2020): “Our estimate is that most policies have basic cover, do not cover pandemics and therefore would have no obligation to pay out in relation to the Covid-19 pandemic.”

ACPR (April 2020): review shows that 93% of BI policies require physical damage, 3% have no physical damage requirement or pandemic exclusion and 4% have language which is “uncertain”; insurers are invited “to revise for the future the drafting of all ambiguous contract clauses” and “to inform policyholders clearly of the exact scope of their coverages.”

NAIC (May 2020) cautioned against solvency impact of paying BI claims without regard to policy language.

Legislative proposals made in some jurisdictions (but failed to gain traction).

BI - Interpretations of Policy Language

Issues raised in the courts:

- If BI loss must result from “insured material damages” or “direct physical loss or damage to insured property,” does this include loss of functionality or presence of virus on surfaces?
- Typical exclusions:
 - coverage for BI resulting from closure by administrative order based on named causes including “contagious disease,” unless at least one other business in the same territory is closed for “an identical cause”
 - “epidemic,” “pandemic,” “virus and bacteria exposure,” “natural disaster”
- Allocation of burden of proof as to coverage and as to exclusions

Coverage Issues – Liability

- Liability coverage which may respond includes D&O and general liability
- Examples:
 - Claims against cruise line company for alleged misstatements regarding Covid-19 supposedly made
 - to customers regarding the danger of infection
 - in statements to investors about impact on the company's business
 - Claims against pharmaceutical company for alleged misstatements regarding prospects for developing a Covid-19 vaccine
- Other potential sources of liability include failure to protect employees or customers and breaches of privacy obligations

Coverage Issues – Reinsurance

- Typical or traditional clauses:

“ . . . the true intent of this Agreement being that the REINSURER shall . . . **follow the fortunes** of the REINSURED in all respects under the Policies, [subject to the Excluded Losses . . .]”

“**All loss settlements** made by the REINSURED [provided they are within the terms and conditions of the Policies covered hereunder and of the Reinsurance Agreement] shall be binding upon the REINSURER”

“ . . . **ex-gratia payments** by the REINSURED, where the REINSURED is not liable under the terms and conditions of the relevant Policies, shall be binding upon the REINSURER only with its prior written approval thereof”

“All matters with respect to this Agreement require the **utmost good faith** of each of the parties” **or** “In recognition of mutually negotiated representations, warranties, covenants, remedies and other terms and conditions set forth herein, the parties absolutely and irrevocably waive resort to the duty of ‘**utmost good faith**’ or any similar principle in connection with the formation or performance of this Agreement.”

- Traditional formulations are not always present
- Impact of LPT on reinsurance/retrocession
- Limits, attachment points and aggregation clauses

Expected Evolutions

- Climate, including storms (e.g., Ida), wildfires, rise in sea levels
- Cyber, including digitalization of industry, infrastructures, financial systems, etc. (how far and how fast?), changes in use patterns (including remote work)
- Health, including advances in research and technology, teleconsultation, evolution of cost structures
- Life/annuity, including population trends and mortality/longevity trade-offs
- Increases in liability awards
 - In the US: increase of “nuclear” jury awards (those exceeding \$10M), rise in compensatory awards, explicit awards of punitive damages
 - What trends in other jurisdictions?

→ Will the highest-quality underwriting be reliable?

2. Regulatory priorities impacting transactions

- a. Market/competition issues
- b. Prudential regulatory issues

Regulatory Priorities: Market/Competition Issues

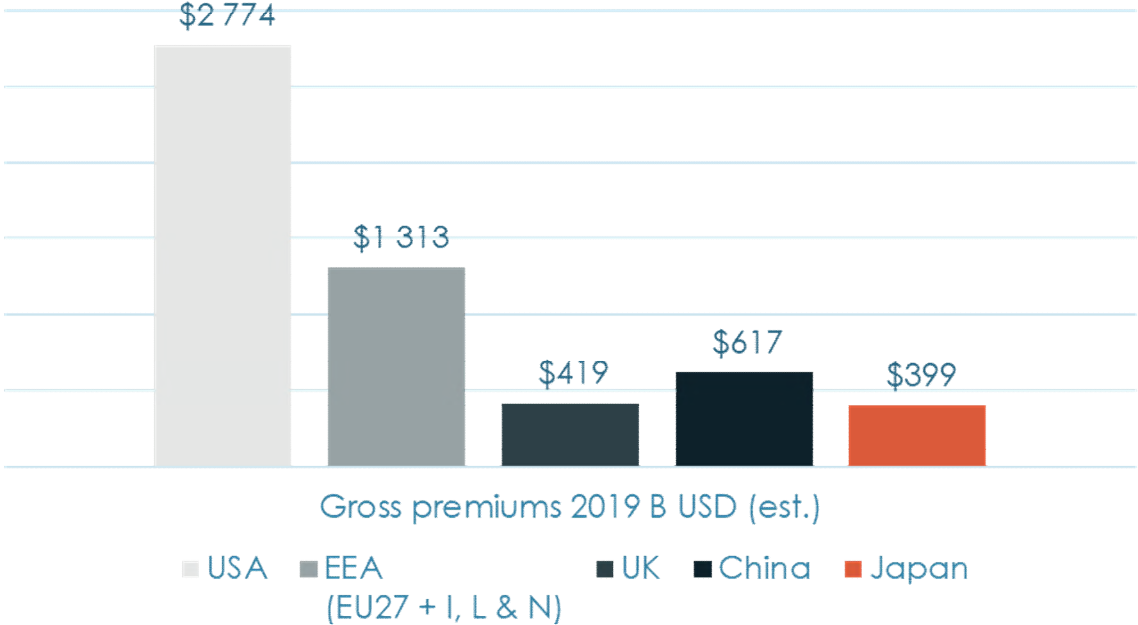
- Brexit-related issues:
 - run-off of pre-Brexit books
 - viability of current post-Brexit structures (including outsourcing)
 - future access UK → EEA, EEA → UK
- Use of AI
 - Pruden v. Lemonade (SDNY, filed August 2021): use of data
 - NY DFS Circular Letter 2019-1
 - discrimination in underwriting

Regulatory Priorities: Privacy/Data

- Civil liability
 - Potential coverage (D&O, E&O)
 - Threat of class actions
- Fines for breaches and violations
 - Some examples: Google €50M (2019), H&M €35M (2020), British Airways £20M (2020), Marriott €20M (2021; breach discovered in 2018, resulting from 2014 beach in target acquired in 2016), Amazon €246M (2021), Google €50M (2021)
 - To what extent are fines insurable?
- Regulatory standards (example: NY DFS Guidelines and Cyber Insurance Risk Framework)

Regulatory Priorities: Prudential Regulatory Issues

Sets of norms



Regulatory Priorities: Prudential Regulatory Issues

- Insurer investments as lever of government for policy goals
 - Covid-19
 - Infrastructure
 - Green agenda
- Credit for reinsurance issues – equivalence/reciprocity
- Insurance business transfers
 - Level of regulatory scrutiny
 - U.S. state reforms such as Oklahoma, Connecticut legislation
 - Part VII in UK technical guidance
 - Global transfer mechanisms

Regulatory Priorities: Review of Solvency II

Expected proposals of EU Commission may include:

- Increase long-term/low-carbon investment by insurers
 - “re-equitisation”
 - Different capital requirements for green/brown assets? Amend risk management requirements?
- Mitigate excessive volatility while enhancing risk sensitivity
 - Volatility Assessment modification; reflect illiquidity of liabilities; fix “risk correction” deficiencies; symmetric adjustment; risk margin component of liabilities
 - Interest rates: impact of negative rates, 100 yr vs. 65 yr spot rate
- Better application of proportionality (i.e., some relief for smaller insurers); principle announced but application not specified; revise exclusion thresholds (set in 2009)
- Improve supervision (including for cross-border activities) and protection against insurer failure
 - “shortcomings in the quality/consistency of supervision and in cooperation between authorities” → mitigate regulatory arbitrage?
 - Insolvency procedures subject to limited harmonization (not subject to Insolvency Regulation 2015/848)
 - No harmonization of guarantee schemes?
- Increase contribution to financial stability in face of systemic risks (macro-prudential vs. micro-prudential supervision)

3. M&A Prospects

M&A Prospects - Insurance M&A Worldwide



- **USA – Targeted Countries:**
USA 3244
Canada 108
UK 105
Bermuda 27

- **UK – Targeted Countries:**
UK 516
USA 33
Ireland 18
Germany 16

- **France – Targeted Countries:**
France 225
Italy 9
Lux 8
UK 7

- **Japan – Targeted Countries:**
Japan 168
USA 16
Indonesia 11
India 9

Certain announced acquisitions of insurers, brokers and related service providers 2011-2020

M&A Prospects

- Motivation for deals
 - Asset management opportunities
 - Permanent capital for fund buyers
 - “the best defense is a good offense”
- Lessons for the future from recent large deals

	target business	price	signing date	closing date
Aon / Willis (terminated prior to closing)	Brokerage	\$80 B combined equity value	March 2020	(terminated July 2021)
Apollo / Athene	Annuity	\$11 B	March 2021	Expected 2022
Blackstone / Allstate Life	Life	\$2.8 B	Jan. 2021	Expected H2 2021
KKR / Global Atlantic	Fixed annuity	\$4.7 B	Jul 2020	Feb 2021

M&A Prospects

- Deal terms in the Covid-19 spotlight, including
 - MAE, giving the buyer “walk rights” – but typical clauses may give the buyer few clear opportunities to refuse to close
- Representations/warranties should account for the specificities of insurance/reinsurance (see next slide)
- Covenants, including interim business operation and post-closing matters
- Use of rep & warranty insurance (RWI or W&I): clean exits for sponsors?
- SPAC/deSPAC transactions
- Future of insurtech deals

M&A Prospects

- In addition to standard issues for any target, issues particularly important for insurance/reinsurance deals include:
 - Product features (including tax aspects)
 - Financial, including capital adequacy, reserves, IBNR, assumptions
 - Risk management processes, approach and adequacy
 - Underwriting processes, personnel and approach
 - Business acquisition (producers/distributors)
 - Claims management and litigation
 - Outbound and inward reinsurance/retrocession
 - IT systems
 - Compliance & regulatory (AML/CFT, data protection, etc.)
 - Expected evolution and synergies
- Issues specific to deals involving life/health companies
 - Competitive space
 - Tax sensitivity
 - Possible securities-law regulations coupled with insurance regulations
 - Redundant (XXX) reserves
- Issues specific to deals involving producers

4. Reinsurance and Portfolio Transfers

a. P&C

b. Life/annuity/health

a. P&C Reinsurance and Portfolio Transfers

- Flow deals for current business
- Run-off deals
 - E.g., Enstar / ProSight (workers' comp LPT)
 - Premia / Elevation Re (first run-off sidecar)
- Recent litigation impacting P&C reinsurance
- Key points for P&C deals include
 - XPLs, ECOs and *ex gratia* (esp. in Covid-19 context)
 - Commutation and unwind rights
 - Reinsurance capacity commitments and ROFOs in MGA deals

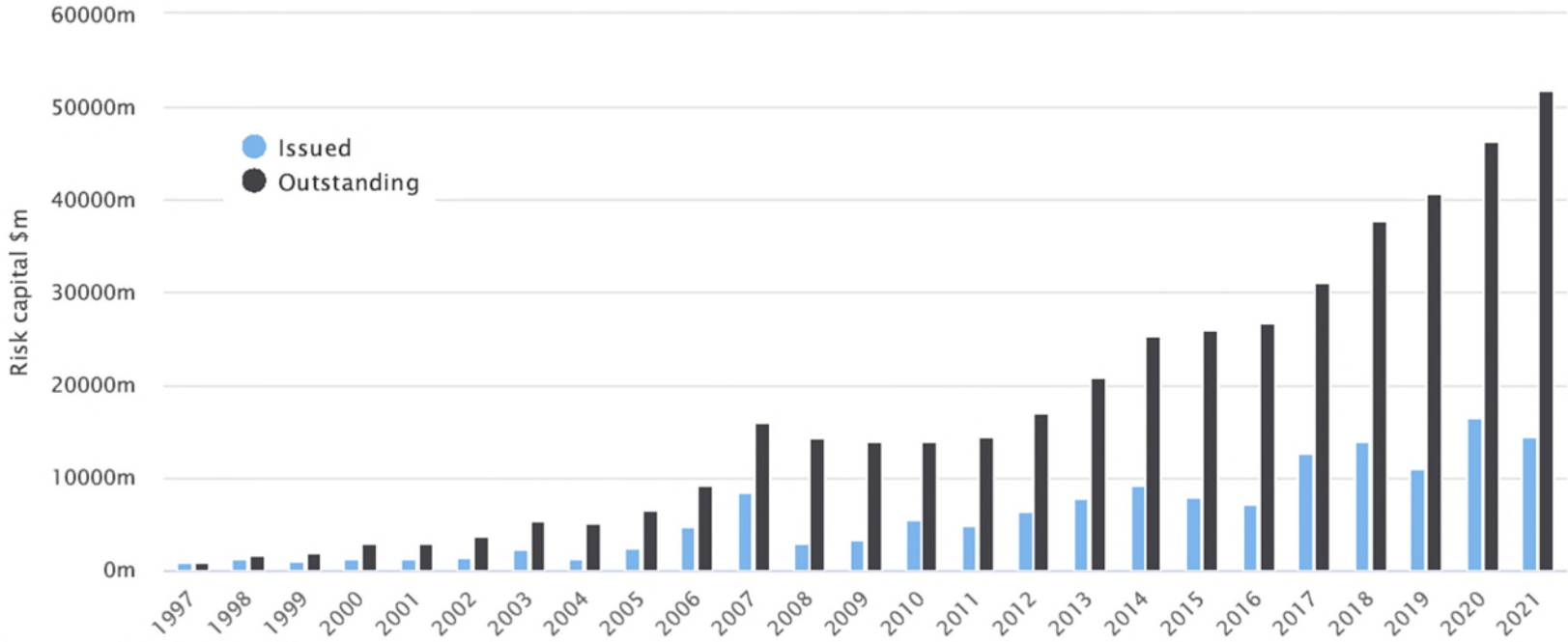
b. Life/Annuity Reinsurance and Portfolio Transfers

- Impact of mortality trends
 - attractiveness of annuity blocks and annuity businesses
 - pension de-risking
- New actors in the market
- Key points for L&H deals include:
 - do the reinsured liabilities include insurance/death benefits attaching upon annuitization?
 - servicing and admin
- Reserves: reserve trusts, Modco, funds withheld, etc.

5. ILS/Securitizations

ILS/Securitizations

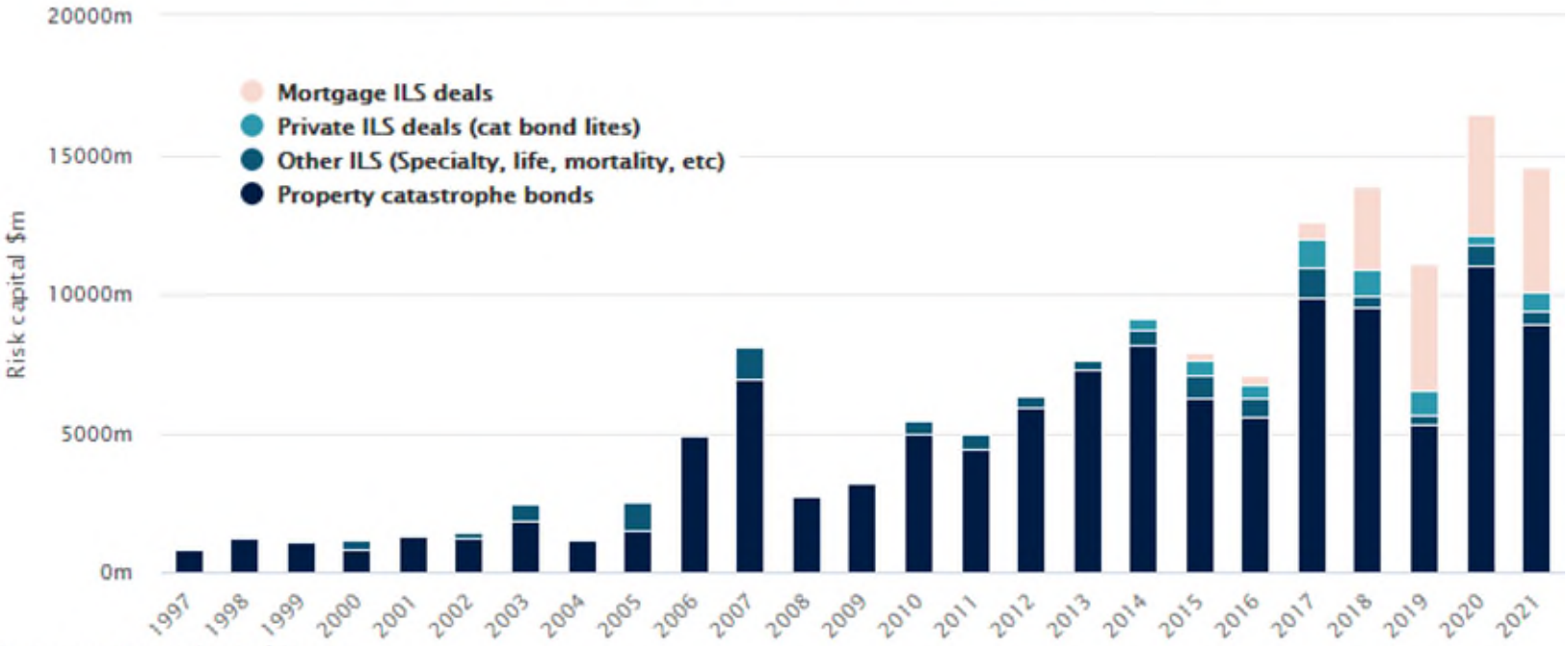
Catastrophe bond & ILS risk capital issued & outstanding by year



Source: www.Artemis.bm Deal Directory

ILS/Securitizations

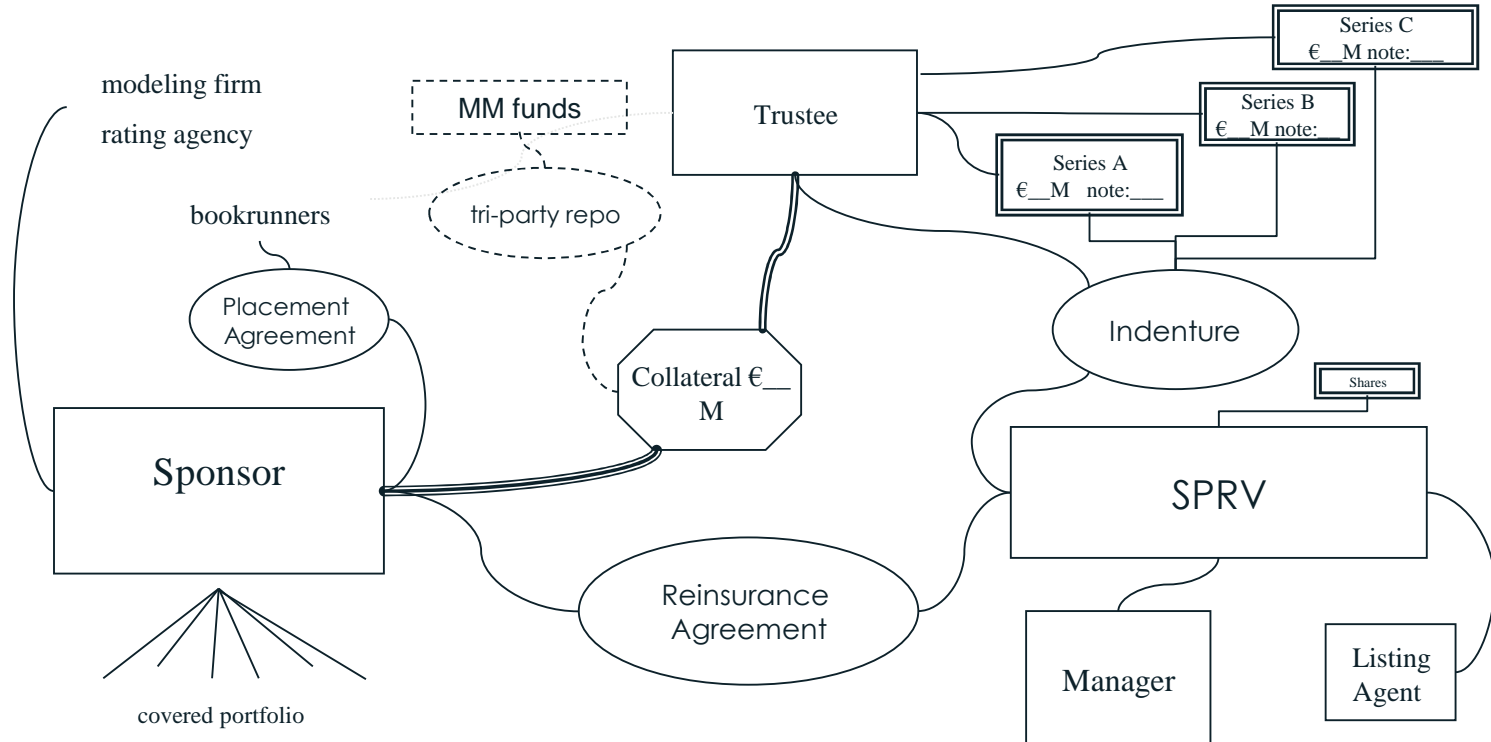
Catastrophe bond & ILS risk capital issued by type & year



Source: www.Artemis.bm Deal Directory

ILS/Securitizations

- Insurance-linked securities (ILS): structuring example



ILS/Securitizations

- **Insurance-linked securities (ILS) – steps on the timeline**

- Key preparatory documents including actuarial, modelling, due diligence and preliminary market intelligence
- Term sheet
- Informal presentation to regulator(s)
- Offering memorandum
- Bond indenture
- Deed of charge/pledges
- Placement
- Closing and issuance

ILS/Securitizations

- Pandemic cat bonds: World Bank (IBRD) \$325M issuance
 - features
 - parametric (WHO) trigger: number of deaths, geographic distribution, spread across borders, growth rate
 - Class A \$225M at 6.9% with cap per occurrence
 - Class B \$95M at 11.5%
 - also issued: \$105M pandemic-linked swaps
 - Not triggered by DRC Ebola outbreak
 - Covid-19 triggered both classes April 17, 2020 for \$196M total (swaps also paid out) – proceeds benefit Pandemic Emergency Financing Facility

Panelists



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