



The business of buying



Arndt Gossmann, CEO

of German legacy acquirer

DARAG talks to **Barbara**

Hadley about the legacy market

approach to acquisitions – and what

the live market needs to know....

The world of legacy acquisition has changed considerably over the past few years, as Gossmann makes clear: 'Irrespective of whether you are buying active or legacy business, recent surveys indicate that 30 per cent of all liabilities in the non-life market is related to legacy and so, unless you specifically exclude it or sell it separately to someone like DARAG, you always buy legacy when you buy insurance business.'

That 30 per cent figure, Gossmann points out, is a dramatic increase on the 20 per cent average figure of between 1996 and 2007. One of the reasons for the rise, he says, is that companies now look in much more detail at their business and so strategic decisions are taken more easily and more thoroughly: 'Companies

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used to stick with a broad business mix but today every line of business is under increased scrutiny and the decision to stop writing certain lines is taken much more frequently and much more quickly.

‘Ten years ago nobody cared about the legacy in a company or portfolio they were buying, the key thing was the active business and legacy was accepted as a collateral impact.’

This has changed, says Gossmann, because of the increase in the amount of legacy on the balance sheets and the increase in the amount of pain that it can cause. In addition, over the last ten years companies have achieved a better understanding of their businesses, including the legacy side – and Solvency II, he stresses, will increase that level of understanding of exactly what companies have on their books, and force them to make key decisions.

In fact the impact of Solvency II is something that Gossmann cannot emphasise enough: ‘A 30 per cent chunk of old business in the “wrong” line of business that is taken over along with the exciting, active business may require more capital under Solvency II in 2013 than the 70 per cent active business that was the reason for the entire transaction,’ he points out.

And this disproportionate amount of capital needed will be even higher for those portfolios with high volatility and high duration, he adds. Solvency II will bring about more transparent transactions and a more professional business.

So lesson number one for the live market acquirer, says Gossmann, is always to assume legacy is there and calculate the capital implications accordingly: ‘You have to anticipate

Solvency II, so if you acquire an active company always assume legacy is there, and if you don’t exclude it or sell it to someone else then you have to value it separately and be prepared for the disproportionate capital that will be required for that part of the business.’

A few years ago the question used to be: ‘Why have you stopped writing this line of business?’ to which the answer used to be ‘because of adverse claims development’. And the next question was ‘when did you start to manage the legacy?’ to which the answer was ‘when things got worse’.

‘When you buy legacy indirectly you should also take a look at it separately’

‘Today you don’t wait for it to become more painful because we know that it will become more painful. The live market has developed its understanding of legacy in tandem with the run-off market and has matured significantly in the past few years,’ says Gossmann.

‘Which is good news for a company like ours which is acquiring legacy business and offering one particular solution. We are a business to business company and any good business is based on maximum transparency. I have always condemned the deal which is based on the hope that either one of the parties doesn’t fully understand certain things. That results in one lucky transaction for one party, but it is a bad transaction for the market.’

‘We have had quite a few transactions and we always have been quite

transparent about our assessment of the value of the business, and nobody condemns us when we point out the part which is our margin. Obviously there is some negotiation but the other side understands the basis of the deal and that we charge an additional cost in return for full finality. It’s a game with equal weapons and this should always be the case. An overall healthy market is better for everyone.’

For a company like DARAG which is focused purely on buying legacy business, its approach to assessing the value of an acquisition is somewhat different from the live market as the pricing rules that you would apply for active business would not apply to legacy.

As Gossmann explains: ‘We start by asking the normal questions and look at both the volatility and the maturity of the claims, and what

types of business? What has the underwriting quality been like in the past? What developments have there been in the overall claims environment?

‘We then combine all of this information to give us an idea of the volatility and duration of the portfolio which then we apply to the current amount of technical liabilities and use as a base for evaluation.’

The next move, says Gossmann, is to create the equivalent of a magnetic resonance image (MRI): ‘We cannot open up the legacy box completely so we take pictures from as many angles as possible to help towards finding out where in the matrix field we are going to end up. We look at the reserves and whether they are adequate to pay the claims from today’s perspective, we examine claims from an actuarial perspec-

tive and from bottom up, and we extrapolate data from random individual claims, we look at asset development and also what the impact of Solvency II will be. Every “photo” we take gives us another data point on our matrix.’

capital implications, produce an ‘MRI’ to look at it from all perspectives: actuarial, random claims selection, potential and major events, court proceedings, with as much data as possible. ‘So when you buy legacy indirectly you should also take a

that live part, or we would wind it down. It depends on the size of the portfolio of course – if it was large enough we would try to leverage the value of it – but we would not keep it for eternity. Because if we were to take on the live business parts and run them, then in a couple of years we would end up with a bit of live business here and a bit of live business there – a bit of a mixture, and that can’t work in today’s market environment – it’s not efficient and not focused.’

So where does Gossmann see DARAG in a few years’ time?

‘I would like to see us have a dominant position in the legacy market– certainly in Europe. Although we have not yet seen a transaction which has been totally Solvency II driven, we are seeing a marked increase in interest in Solvency II issues and we are already seeing a significant flow of transactions being offered to us.’

In conclusion, Gossmann stresses that buying run-off is about achieving transparency and the key is that

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And so, lesson two for active market acquirers, says Gossmann, is when you have isolated the legacy business and need to calculate the



look at it separately. It does not follow the normal rules of the game but it is always part of it.

‘If you mix up the live and the legacy it doesn’t anticipate either the value pockets or the challenges,’ observes Goss-

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mann. Managing run-off and managing active insurance business are two different things, which is one reason why DARAG has no interest in acquiring live business along with the legacy.

‘Our business model is geared to legacy so if we were to find ourselves in a situation where we had to take the live business in order to acquire the legacy we would look for someone to buy

you cannot look into the future. ‘You are dealing with professional parties: it is not about waiting for the counterparty to make a mistake; it is about having the same understanding and comparing individual pricing.’ And his major lesson for the live market when it comes to acquisitions which will inevitably include legacy is: ‘Don’t simply take it over. Identify it, value it separately and if necessary exclude it from the deal or include a player with legacy appetite such as DARAG.’ ●