Benefits of Division Statutes and Insurance Business Transfers

NAIC Restructuring Mechanisms Working Group – Summer Conference

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Key Benefits

- Release management resources currently being occupied with the oversight of related business

- Prior to Division Statutes, certainty only possible through the sale, novation or commutation

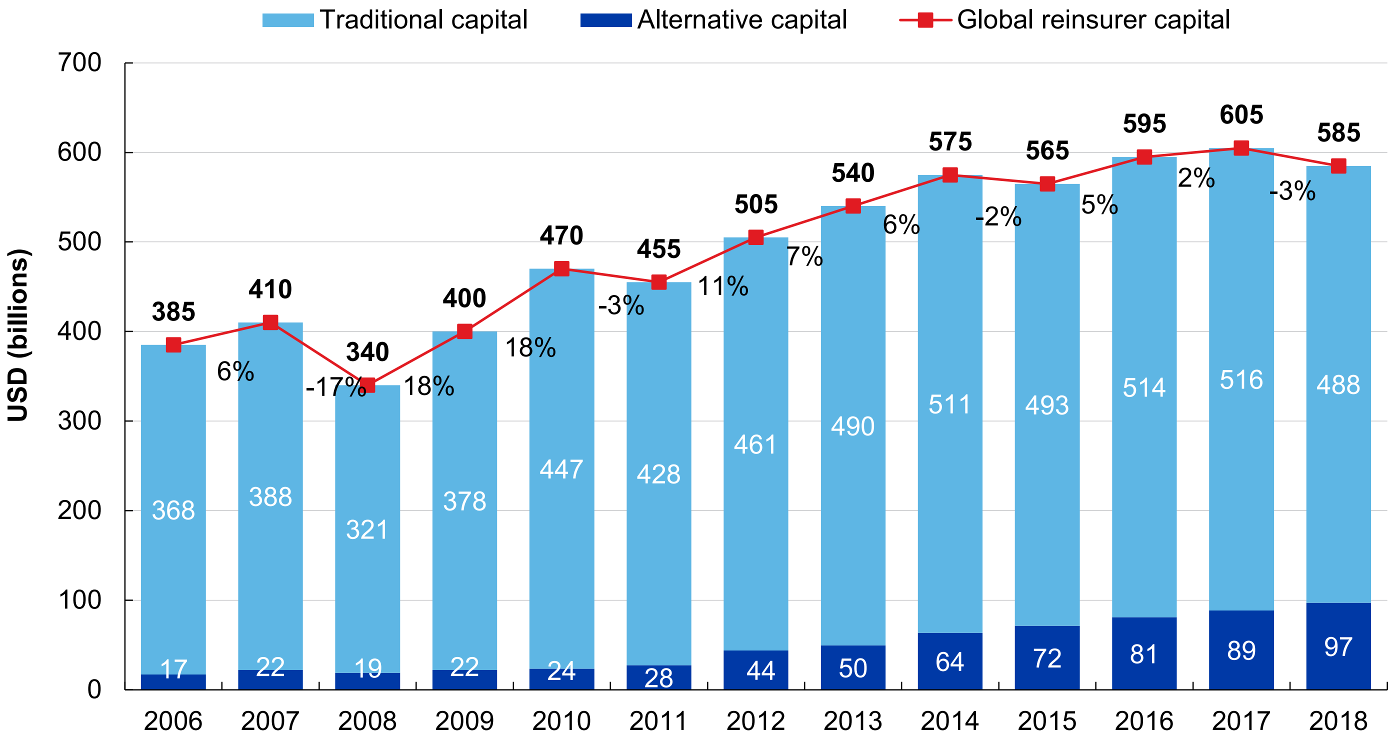
- Legacy run-off liabilities can “trap” capital, creating inefficiencies

- Increase administrative, claims, regulatory, etc. efficiency under a focused entity

Track Record of Success in the UK via Part VII Transfers

- Division statute laws are modeled after UK's Part VII transfers
- Over 250 Part VII transfers have been done since 2002 (Source: Sidley Austin)
- Brexit driving increased use of Part VII transfers
- Allow industry to identify more efficient structures to drive capital optimization and pricing
- Key Attributes include:
  - Use of independent expert to represent policyholder interests in evaluating liabilities
  - Often used to tidy up corporate structure and resources of large organizations (e.g., post M&A)
    - There is no benefit for policyholders to be trapped in a smaller, run-off division of a large company; Minimal resources and run-off is often expensive
    - Capital inefficiencies, especially if like liabilities are spread across legal entities throughout the group
  - Policyholder must be in an equal or better position post transfer!
  - Reinsurance is often used to provide additional protection in determining capital ("belt and suspenders")

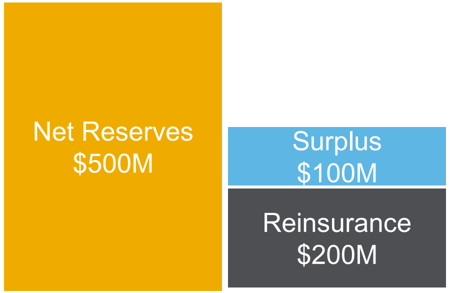
Ample Reinsurance Capital to Support Divisions / Transfers



Reinsurance as an Effective Source of Capital

Company A

Company B



- Risk based capital (RBC) does not adequately consider capital provided from reinsurance, especially adverse development covers (ADCs)
  - Company A has $500m in net reserves and $200m of PHS
    - Adjusted capital = $200m
    - Probability of exceeding surplus = 0.50%
    - RBC = 400%
  - Company B has $500m in net reserves, $100m of PHS, and $200m ADC protection
    - Adjusted capital = $300m
    - Probability of exceeding surplus = 0.02%
    - RBC = 200%
    - Adjusted RBC = 600%

Key Messages

- As business and markets evolve over time, use of Divisions or Transfers reflect a healthy, innovative market to properly match risk and capital that facilitates:
  - Capital management, Economic certainty, Management focus, and Operational efficiency
  - Use of Divisions / Transfer is tested and well developed in the global market

- Capital requirements based upon risk-based capital (RBC) to ensure consistency with regulatory model
  - Set target RBC to ensure policyholders are in a similar or more favorable position post-transaction as a well capitalized company
  - Incorporate reinsurance capital more explicitly in RBC calculation, specifically as respects adverse development covers that protects against reserve development
  - RBC target range for the industry should be set to ensure less-capitalized companies are not held to a lower standard while a well-capitalized company requirements are prohibitive

- Develop model law that carries existing state licenses on policies divided or transferred into new company so policyholders maintain same protection under guaranty funds