Benefits of Division Statutes and Insurance Business Transfers

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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

**Traditional capital**

- 2006: 385 USD billions (6% growth)
- 2007: 410 USD billions (18% growth)
- 2008: 400 USD billions (18% growth)
- 2009: 470 USD billions (-3% growth)
- 2010: 455 USD billions (11% growth)
- 2011: 505 USD billions (7% growth)
- 2012: 540 USD billions (6% growth)
- 2013: 575 USD billions (2% growth)
- 2014: 565 USD billions (5% growth)
- 2015: 595 USD billions (2% growth)
- 2016: 605 USD billions (-3% growth)
- 2017: 585 USD billions

**Alternative capital**

- 2006: 64 USD billions
- 2007: 72 USD billions
- 2008: 81 USD billions
- 2009: 89 USD billions
- 2010: 97 USD billions

**Global reinsurer capital**

- 2006: 17 USD billions
- 2007: 22 USD billions
- 2008: 19 USD billions
- 2009: 22 USD billions
- 2010: 24 USD billions
- 2011: 28 USD billions
- 2012: 44 USD billions
- 2013: 50 USD billions
- 2014: 64 USD billions
- 2015: 72 USD billions
- 2016: 81 USD billions
- 2017: 89 USD billions
- 2018: 97 USD billions

USD (billions)
Reinsurance as an Effective Source of Capital

Company A

- Net Reserves: $500M
- Surplus: $200M

Company B

- Net Reserves: $500M
- Surplus: $100M
- Reinsurance: $200M

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