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Solvency II to feed subordinated debt demand

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15 September 2015

How much of an effect do you expect Solvency II to have on the use of subordinated debt by the EU re/insurance community to manage capital / mitigate risk?

As the implementation date for Solvency II approaches an increasing number of small and mid-sized insurers are calculating their Solvency cover. Many insurers are now realising that a good, or excellent cover under Solvency I does not necessarily translate across to Solvency II and the treatment of most balance sheet items is not the same under both regimes. Some are finding themselves either short of capital or in a grey area under the new regime.

In addition to increased capital requirements, Solvency II also brings a requirement for insurance companies to publish their SCR. With the drive towards harmonisation and more transparent reporting Europe's insurers are going to be much more open to comparison. The emergence of a sub debt market for the smaller and mid-sized players opens an additional option for the small and mid-sized insurance companies to secure regulatory capital relatively cheaply.

How useful and flexible is subordinated debt, considered as a "tier 2" option, within the regulatory context?

Sub debt is a pre-approved form of capital that is available to small and mid-sized insurers, effectively easing the transition to Solvency II without calling on shareholders or customers to provide additional capital. Issuing sub debt is a streamlined and easy process with a simple loan note (compared to an equity investment). It is repayable after 10 years and there are no restrictions on its use.

That said, insurers have been advised by Regulators not to wait until the last minute before understanding their capital requirements and securing capital.

What sort of take-up or indications of demand can you see at IRC, and from whom (which sizes/types of re/ insurers)?

The interest in sub debt issuance by small and mid-sized insurers has increased in the last year, which we believe is being driven by the requirement for increased regulatory capital under Solvency II and that Tier 2 sub debt is now eligible as own funds.

Subordinated debt has always been used by the largest insurers in Europe to enhance their capital surpluses. In fact the 30 largest insurers report on average 25% of their regulatory capital in the form of subordinated debt. This form of capital has only been available with capital markets issuances, usually in excess of €300m. The smaller or mid-sized insurer seeking to raise €5-100m of subordinated debt has traditionally been excluded from this market. Insurers in all lines of business and with a variety of ownership structures are eligible to issue subordinate debt, and a formal rating is not required. All categories of insurer are eligible, including: non-life (e.g. motor, home, liability, pet), health, life and any ownership structure, i.e. listed, state owned, privately owned, captives and mutuals. Subordinated debt can benefit a wide range of issuers with different capital requirements. Additionally, subordinated debt provides privately owned insurers with a simple and straightforward form of capital that is non-dilutive and enhances their return on equity. Companies that are profitable, the debt can facilitate an equity release, or dividend stabilisation. Subordinated debt also benefits companies in run-off by replacing equity allowing shareholders to extract capital at a quicker rate. For mutual companies, subordinated debt allows the companies to maintain their independence and/or avoid cash calls from their members. Captives utilising subordinated debt can enhance their parent's return on equity and validate their model to regulators.

How does your subordinated debt product blend with Maiden's broader suite of other risk transfer/management products?

Maiden and IRC offer a continuum of solutions designed to meet the capital and risk management needs of insurance companies. Our vision is to ensure all insurance companies can easily access capital products such as subordinated debt and quota share reinsurance in the context of their risk and capital programmes.

With Maiden's long history and expertise in the reinsurance business combined with IRC's in-depth knowledge of the insurance industry, we plan to provide insurers with a continuum of capital from the provision of reinsurance products through to a comprehensive subordinated debt programme. We believe in establishing long term partnerships providing compelling and committed capital solutions.