Sidecar for life insurance business in Asia – A solution to unleash the potential of your business

Introduction

Reinsurance sidecars, or "sidecars" in short, refer to the reinsurance vehicles formed by a sponsoring insurer with the support of third-party investors infusing capital and, in some cases, providing other services such as asset management. Recently Milliman published an article - Life & Annuity Sidecars: From Sidebar to Headline Topic - providing an overview of a typical set-up of a sidecar, analysing the key factors driving the interest in sidecars from various stakeholders, including sponsoring insurers, reinsurers, and investors, as well as setting out key considerations when developing such sidecar transactions.

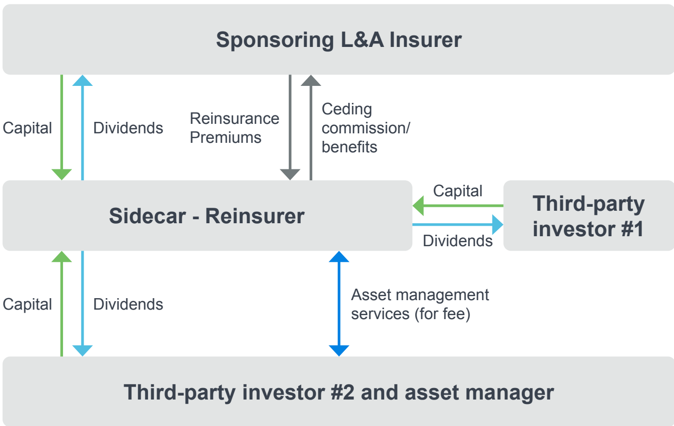
Sidecars are commonly used in the US insurance market, predominantly in the property and casualty ("P&C") segment. However, they have recently gained more traction in the life and annuity sector (e.g. SkyRidge Re in 2021, Ivy Re in 2020, and ACRA in 2019). Historically there have also been some successful examples of sidecars in Europe, but this is yet to become a common tool employed by life insurance companies in Asia.

In this e-Alert, we provide a recap of the set-up and benefits of a sidecar, as examined under the Milliman article mentioned above, and highlight the key reasons why this could become a sensible option for some lines of life insurance business in Asia, with a particular focus on Hong Kong and Singapore.

Typical sidecar structure

A hypothetical sidecar structure is presented in Figure 1 below. It is typically formed by a sponsoring insurer, and the key proposition behind this is to unbundle the core return drivers underlying the block of insurance business in order to allow the insurer, reinsurer and investors to utilise their core competencies in managing the insurance business. In other words, insurers and reinsurers can focus on insurance risk underwriting and management, while investors are typically able to bring asset management expertise (for asset managers), lower cost of capital for funding (for some private equity firms), and other forms of capabilities depending on the nature of the investors.

FIGURE 1: HYPOTHETICAL STRUCTURE OF A SIDECAR



Sidecars in the context of life insurance business in Asia

There have been some examples of P&C insurers in Asia using sidecars to manage selected risks, such as catastrophic risk, as illustrated by a recent arrangement in late 2021 in Singapore (Phoenix 2 Re). However, they are yet to become more popular for Asia life insurance businesses. That being said, with the ongoing regulatory developments of capital regimes, the implementation of IFRS 17, the existence of savings in-force blocks of business with material financial risks, and the increased volatility in the macroeconomic and financial environment, sidecars are expected to become an important tool to optimise balance sheets and ultimately better protect solvency positions of life insurers in Asia.

DIFFERENCES IN CAPITAL REGULATIONS

Despite several regulators in the region introducing new risk-based capital ("RBC") regimes or enhancing their existing RBC frameworks to be more in line with global solvency standards, such as the International Capital Standard ("ICS"), there are still some notable differences across various capital regimes in Asia (for details, please refer to our report on Life Insurance Capital Regimes in Asia).

Sidecars are typically seen as an efficient approach to optimise free surplus. They are typically set up in jurisdictions with relatively less onerous capital regimes (e.g. Bermuda). In particular, sidecars could support the overall solvency position of life insurance companies with certain capital-intensive blocks of business. Specifically, some technical aspects of RBC regulations, including those listed below, could have a material impact on the level of reserves, capital requirement, and ultimately the free surplus and could therefore be optimised:

- The determination of the illiquidity premium (fixed amount prescribed by regulators and applied to all insurance companies vs prescribed closed-form formulae but depending on the asset liability management of a particular company);
- The contract boundary;
- The level of reserve flooring (if any); and
- The level of stress considered to assess the standalone capital requirement.

ASIA FOCUS ON SAVING BUSINESS

In several markets across Asia, such as Hong Kong and Singapore, there have been historically a material proportion of savings life insurance products sold with a high level of financial options and guarantees. The financial performance of these products has been negatively affected by the low interest rate environment in recent years, although they still make up a significant proportion of the in-force book of certain life insurers.

Setting up a sidecar to cede the existing portfolios to investors who have a higher appetite for investment risk and have the capability to better optimise the asset return and volatility could be a sensible option for certain insurers as it could reduce their own financial risk and, therefore, support the reallocation of capital to other risks and initiatives perceived as being better rewarded. For lines of business with discretionary benefits such as participating business and universal life business, bringing in asset management and investment capabilities through a sidecar arrangement may also allow companies to offer higher non-guaranteed return and enhance the competitiveness of these products while ensuring lower volatility both shareholders and policyholders.

Ultimately sidecars could benefit both shareholders and policyholders as a result of a more resilient solvency position.

VOLATILITY OF BALANCE SHEET

As a result of recent developments in the macroeconomic environment and growing geopolitical risks in Asia and globally, the financial markets have been more volatile, leading to volatility on the balance sheet of some life insurance companies in Asia.

For insurers that are more inclined to focus on managing insurance risks and therefore look to reduce their exposure to financial risks, the unbundling effect of a sidecar arrangement could be an ideal solution.

Conclusion and next steps

Sidecars could be a solution for lines of business of some life insurance companies in Asia. However, such an approach also comes with risks that need to be carefully analysed. Based on our experience in reviewing and vetting sidecars in other markets, detailed strategic planning, feasibility studies, detailed planning of the implementation process, and ongoing management of the sidecar are all crucial areas that need to be considered before making a decision. To discuss this e-Alert further, please reach out to the authors or your usual Milliman consultant.

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