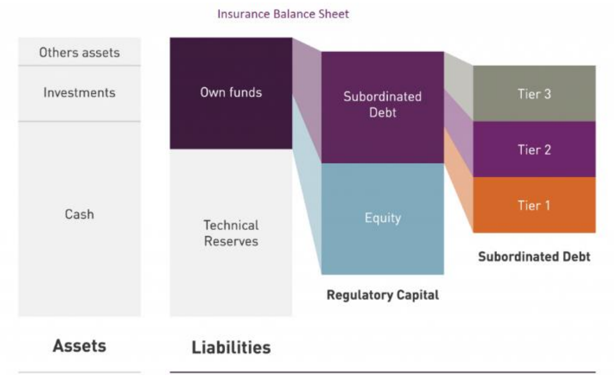
Subordinated Debt for Mutuals

Subordinated Debt is a prudent approach for Mutual insurance companies seeking to ensure judicious capital management and maintenance.

The Solvency II Directive, issued by the European Union required insurers to transition to a more risk-based capital framework. Under the Directive, Tier 1 and Tier 2 Subordinated Debt is included as own funds and is eligible as regulatory capital.



Subordinated debt is allowable by insurance regulators as regulatory capital.

For a Mutual, issuing subordinated debt has a number of significant advantages:

- Unlike senior debt, sub debt will be compliant with Solvency II's requirements, subject to meeting certain conditions (e.g. min. 10 year term), and will count towards the Mutual's own funds (Tier 2 capital)
- No dilution of members' control as holders of sub debt do not have any voting rights
- It is a structural and long term solution for a Mutual's capital requirements
- As subordinated debt will increase the Mutual's own funds and its overall SCR coverage, the Mutual can distribute more of its surplus to existing members
- No credit rating by a major credit rating agency is required to issue subordinated debt via private placement
- Subordinated debt can be issued to replace some existing debt which may not be Solvency II compliant
- Subordinated debt can also be used for further business growth, organic or through acquisitions, and will help to achieve a more favourable credit rating by rating agencies
- The only impact on the P&L is the tax deductible interest cost, the amount of which is known in advance for the full term of the loan

Subordinated debt used as Tier 2 capital enhances the financial standing of the company in the eyes of its financial regulator, its existing members and potential new clients

Subordinated Debt meets the characteristics of Tier 2 capital as outlined by EIOPA

Subordinated debt is less expensive than equity but with similar qualities as cash, it is transferred directly to the insurer and sits on their balance sheet. It is a quick and easy process with a simple loan note. Repayable after a minimum of five years, at the issuer's discretion and with no restrictions on its use, it can be used as regulatory capital but can also be used to fund growth.

1. For Mutual insurers the capital challenge under Solvency II is to achieve the optimal capital mix for their risk profile while strengthening their regulatory solvency position.
2. Mutuals coming under pressure to moderate price increases can forgo retained earnings by taking on subordinated debt as an alternative.
3. Subordinated debt can protect the Mutual status by bolstering the capital base thus protecting it in case of financial stress.
4. Subordinated debt can protect members from price increases and/or capital calls which in turn helps to stabilise dividends.

The implementation of Solvency II has led Mutual organisations to focus on both their capital and risk management structures as they responded to its requirements. In order to meet the capital demands of the regulations a blend of quota share reinsurance and subordinated debt options can be utilised to optimise the capital structure in a cost effective and cohesive way.

Issuing Subordinated Debt

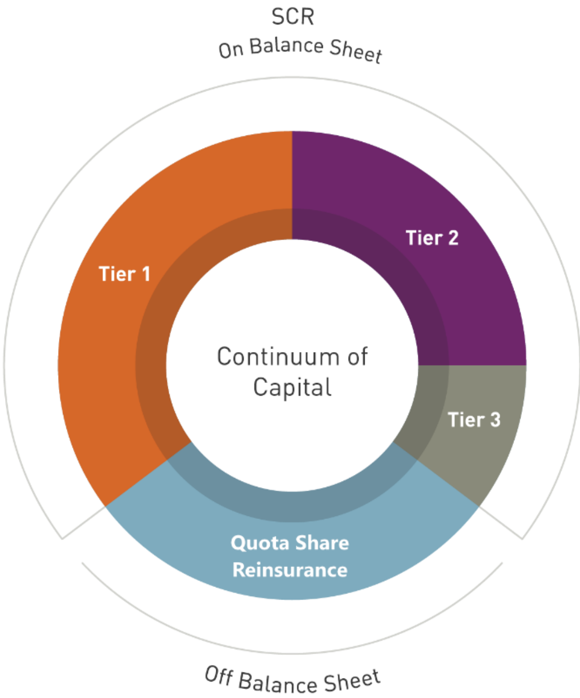
Subordinated debt can be issued as any of the three capital tiers under Solvency II, subject to the eligibility criteria. This is eligible up to a maximum of 50% of the SCR, depending on the amounts of other tiers of capital held. The most common subordinated debt issued is Tier 2 Subordinated debt, not callable for at least 5 years.

Accessing the Subordinated Debt Market

- work with the client to understand their business and business drivers
- undertake a detailed credit analysis
- analyse the client's underwriting process and its existing reinsurance protection
- propose financial and legal terms, draft the legal documentation
- put in place the subordinated debt programme and organise the funding
- provide ongoing reporting
- have regular interaction and discussions with the client to monitor the programme

The Maiden/IRC partnership is uniquely positioned to support Mutual organisations, and has the expertise and capabilities to work with them through this process.

The Continuum of Capital



Tier 1

- Tier 1 must make up a min of 50% of the SCR
- Debt can make up max. 20% of the Tier 1
- Tier 1 Sub Debt is issued for a minimum of 30 years, non call 5

Tier 2

- Can be composed of equity and/or Sub Debt
- The amount of Tier 2 must be greater than the amount of Tier 3
- Tier 2 Sub Debt is issued for a minimum of 10 years, non call 5

Tier 3

- Can be composed of equity and/or sub debt
- Tier 3 must not be greater than 15% of SCR
- Tier 3 Subordinated Debt is issued for a minimum of a 3 year bullet

QSR

- Proportional sharing of premium, losses and expenses

Contact Us

Email: business@insuranceregcap.com

Insurance Regulatory Capital

MAIDEN