

Atlanta Actuarial Club

Liquidity and Capital Management for an Insurance Company

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October 27, 2011

Liquidity and Capital Primer

LIQUIDITY

Definition

- Ability to Meet Obligations

Sources

- Cash, receivables, asset sales, securitization

Risks

- Institutional business, cashflow variability, liability volatility, collateral/guarantee calls

CAPITAL

Definition

- Financial Resources set aside as a buffer

Measures

- Regulatory, Rating Agency, Economic

Status Pre-Crisis

Liquidity

- Insurers have a long-term horizon
- Liquidity doesn't matter
- Liquidity calculations done for reporting requirements

Capital

- Economic capital matters; liability focus
- Easy access to Capital Markets
- Capital calculations ~ 1x per year

Holding Company

- Facilitates movements between Operating Companies
- Cash on hand ~ 0
- CP and Debt maturities will be rolled

Debt Structure

- Maximize debt
- Hybrid use

RBC %

- 200 – 350%
- Managed close to targets

Investments

- “Liquid” assets are plentiful; cash and equivalents ~ 1-3% of assets
- Asset liquidity needs are buried somewhere in the Investment Mandate
- Leverage plays, alternatives, and structured products enhance yield

Products

- Actuarial pricing
- Growth in VA, UL, and other high capital charge/high strain/rich option businesses

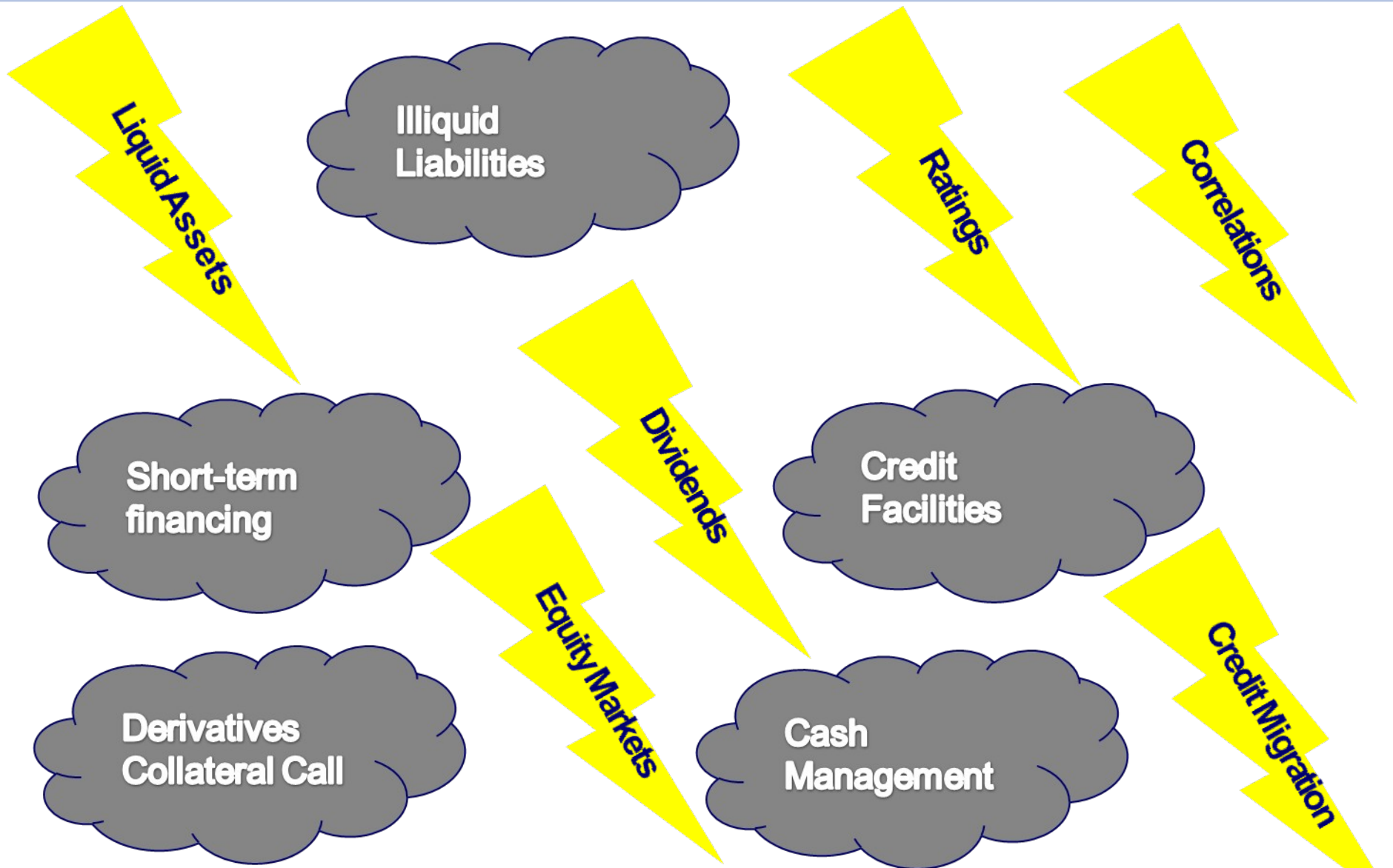
Regulatory/RA's

- Sleepy regulatory environment
- Rating agencies focused on rating structured products

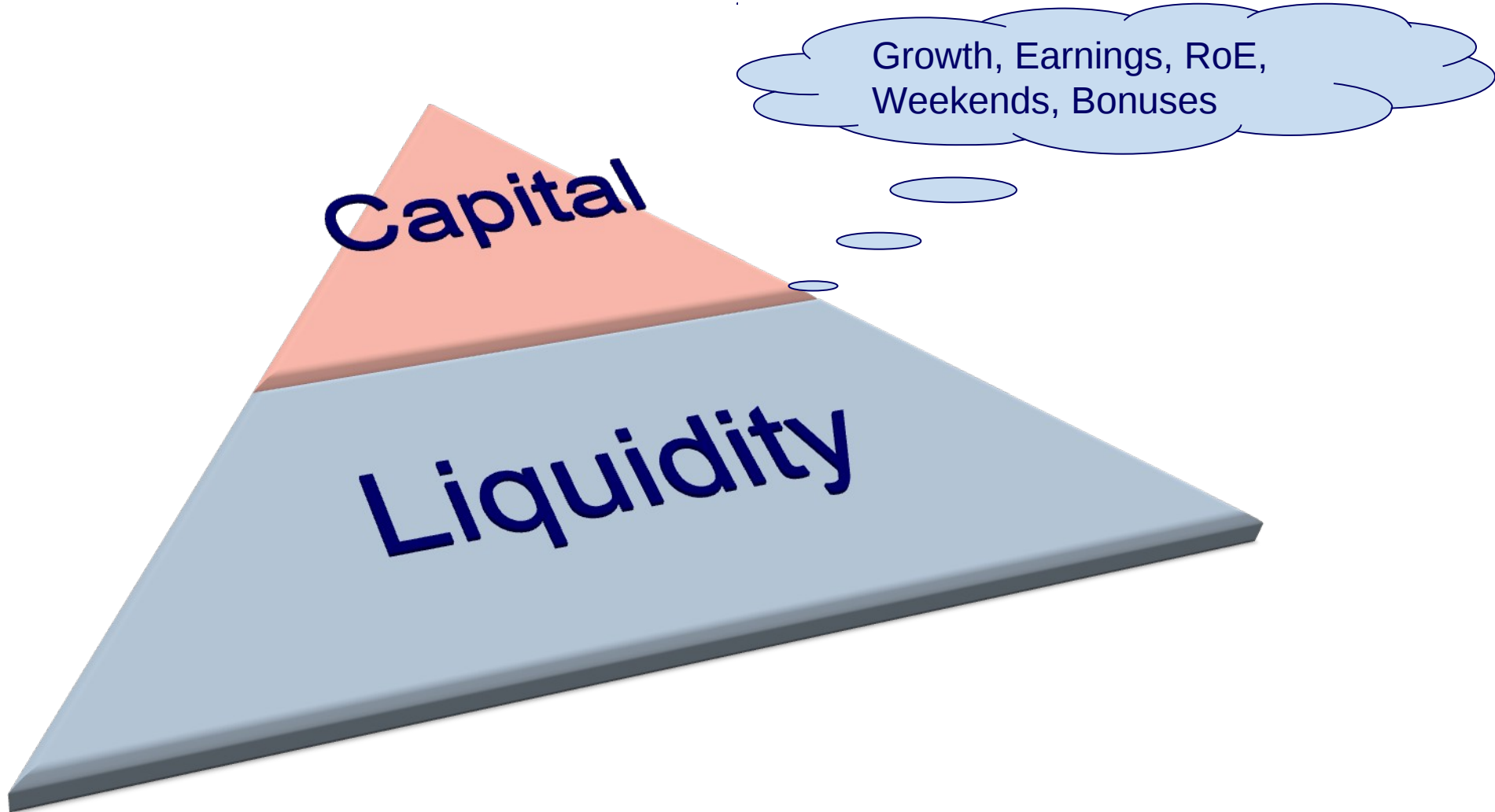
Pre-Crisis Priorities



Crisis – The Perfect Storm



Crisis Priorities



Surviving the Crisis

- Partnerships with Regulators
- SWAT teams for capital and liquidity solutions
- Hording cash
- Asset de-risking
- Diversified funding sources
- Internal and external reinsurance
- Securitization
- Harvesting gains
- Harvesting trapped/hidden capital

Status Post-Crisis

Liquidity

- Links to Capital and Risk Management
- Holistic view; focus on both Holding and Operating Companies
- Scenarios and stresses

Capital

- Links to Liquidity and Risk Management
- Focus on Regulatory/Statutory Capital
- Holistic view; focus on both Holding and Operating Companies

Holding Company

- Working capital/cash-on-hand for about 25 months
- Maximizing dividend potential/flexibility from Operating Companies

Debt Structure

- Drastically reduced reliance on CP market
- Prefunding of long-term debt

RBC %

- 400 – 600+%
- Calculated at least quarterly

Investments

- Starting to reposition/re-risk
- Capital and liquidity embedded in asset allocation process
- Leverage plays down significantly

Products

- Closing/repositioning of businesses
- Re-filings

Regulatory/RA's

- Continued regulatory reform; Dodd-Frank
- S&P stress capital, Moody's liquidity stress

Post-Crisis Priorities



What Does the Future Hold?



What Does the Future Hold?

“The improvement in capital position is clear from a quantitative perspective; however, the improvement in the quality of the capital is not. The ability of the life insurance industry to generate pre-crisis returns and revenue growth is also uncertain in the near term.”

AM Best; Life/Annuity Insurers Regain Ground as Economy Strengthens; February 21, 2011

“Capital adequacy for the life sector weakened substantially during the financial crisis, shifting from a source of strength for the overall industry to a source of weakness. Although the industry has now rebuilt capital to mostly adequate levels, there seems to be a collective view that insurers need to manage capital differently. In addition to holding higher levels of capital as a starting point, insurers are taking efforts to manage the capital volatility associated with credit and equity market risk.”

Standard & Poor's; How The Credit Squeeze Has Changed U.S. Life Insurers' Capital Management Strategies; July 28, 2010

What Does the Future Hold?

“The Dodd-Frank rules’ margin requirements would potentially soak up significant amounts of liquidity and create volatility in available liquidity for life insurers if their OTC derivatives transactions moved against them. This would constrain liquidity and financial flexibility for those companies with significant amounts of affected OTC derivatives. We also expect life insurers to hold more liquid assets under the new rules, which would be a drag on investment income.”

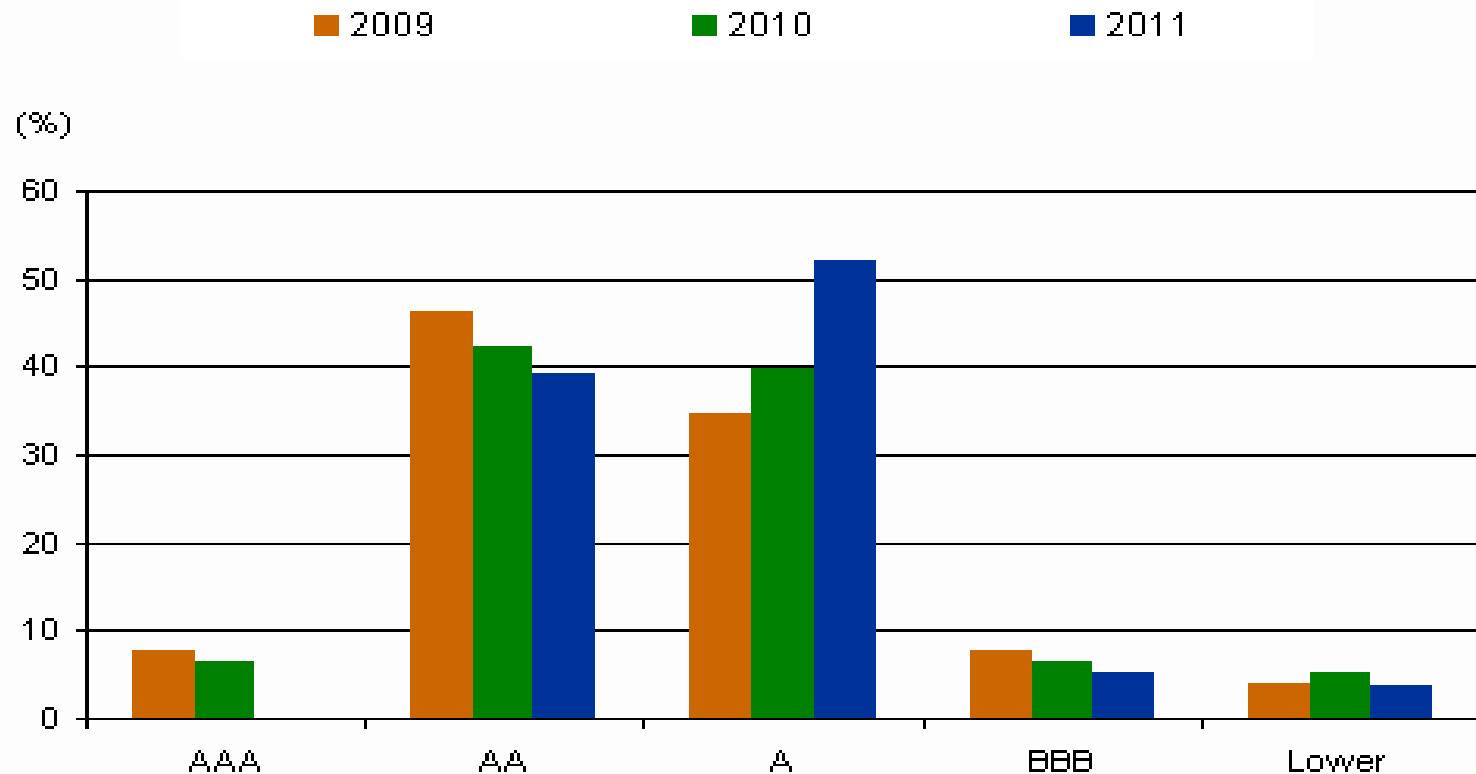
Moody’s; Delay of Proposed Dodd-Frank Derivatives Rules Buys Time for US Life Insurers, a Credit Positive; June 20, 2011

“U.S. life insurers have become more financially conservative as they seek to maintain higher normalized capital levels, ample holding company liquidity, and excess cash (or contingent capital) to protect against unforeseen events.”

Standard & Poor’s; How The Credit Squeeze Has Changed U.S. Life Insurers’ Capital Management Strategies; July 28, 2010

What Does the Future Hold?

U.S. Life Insurer Ratings Distribution

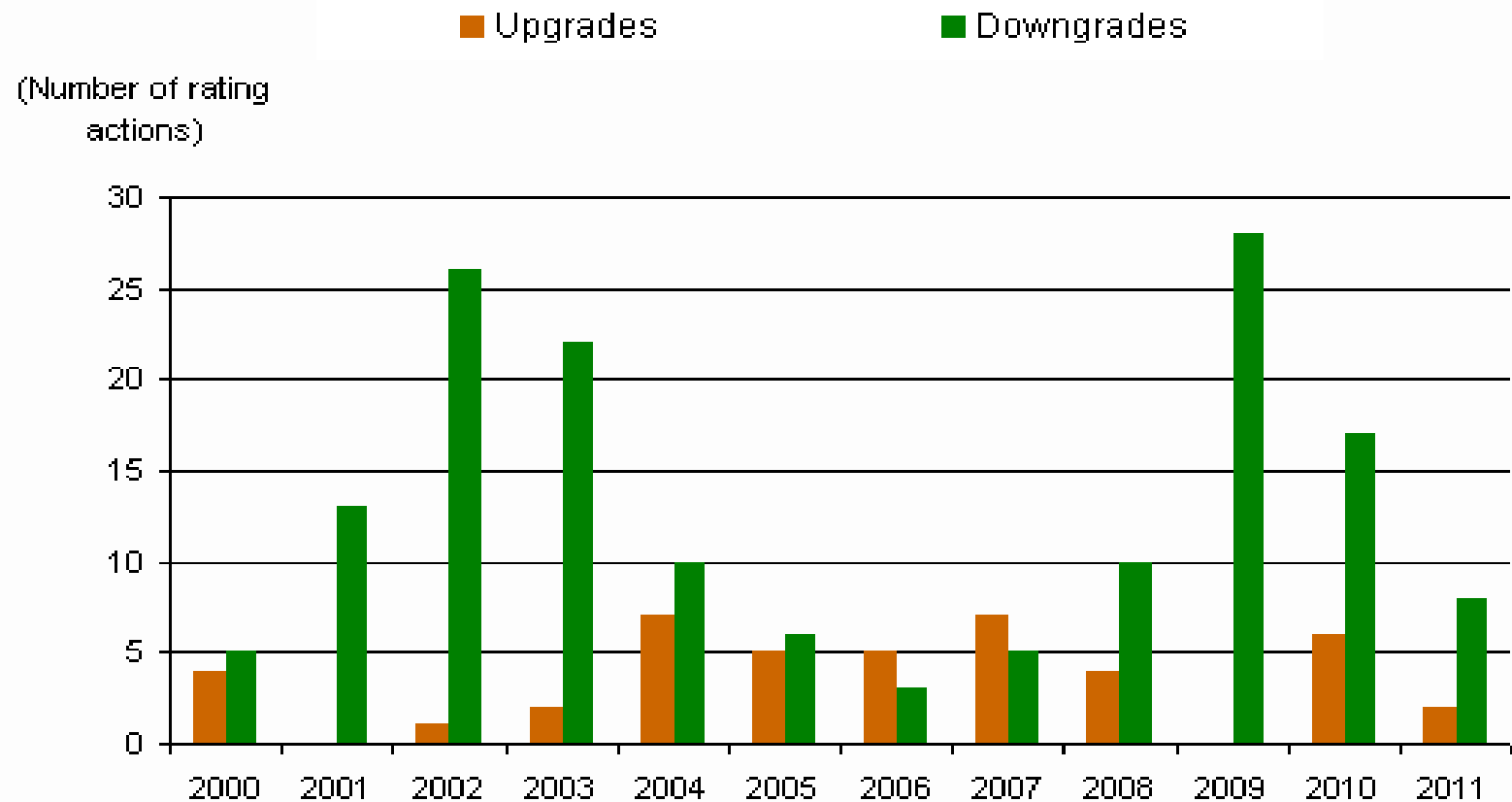


Data as of Sept. 30 each year.

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What Does the Future Hold?

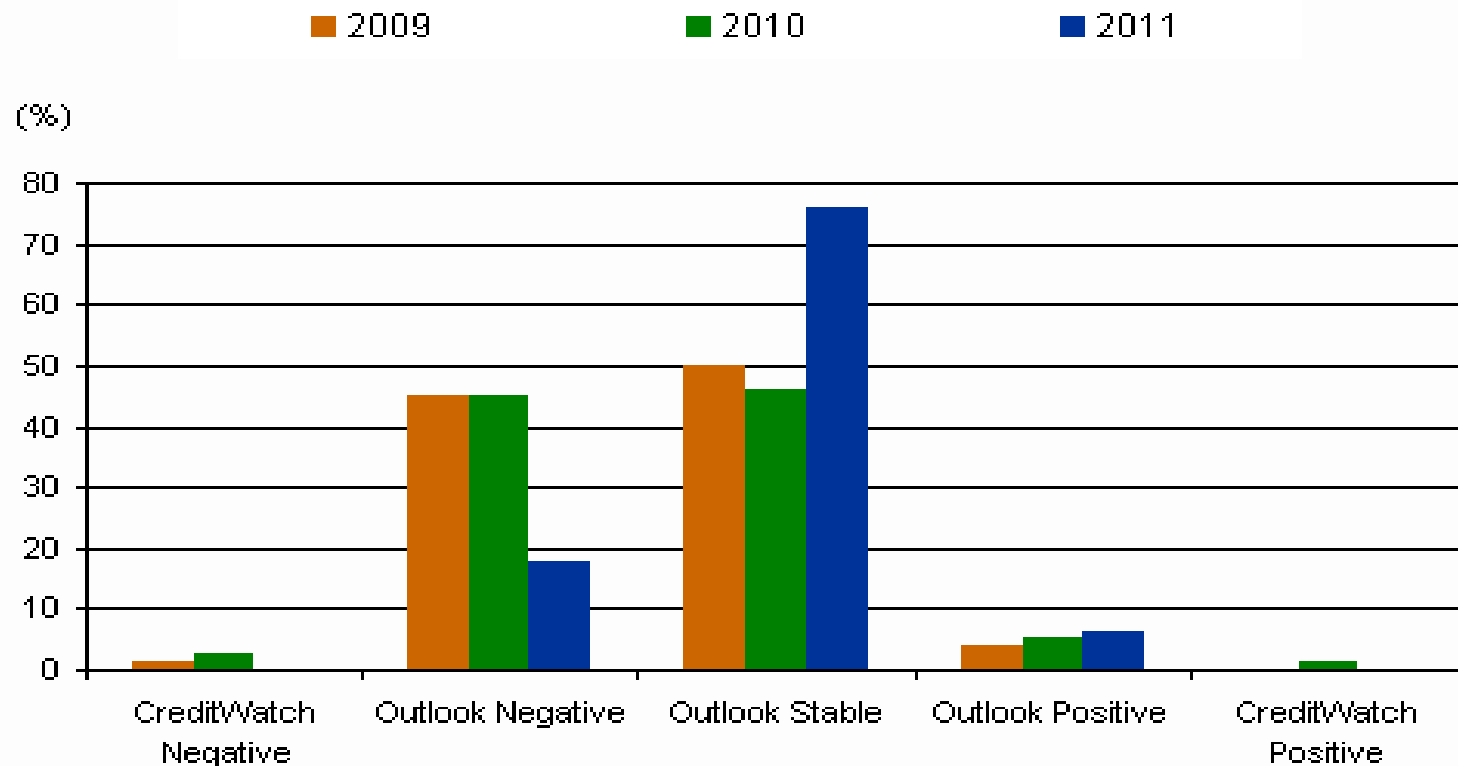
U.S. Life Insurer Rating Actions



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What Does the Future Hold?

U.S. Life Insurer Outlook Distribution

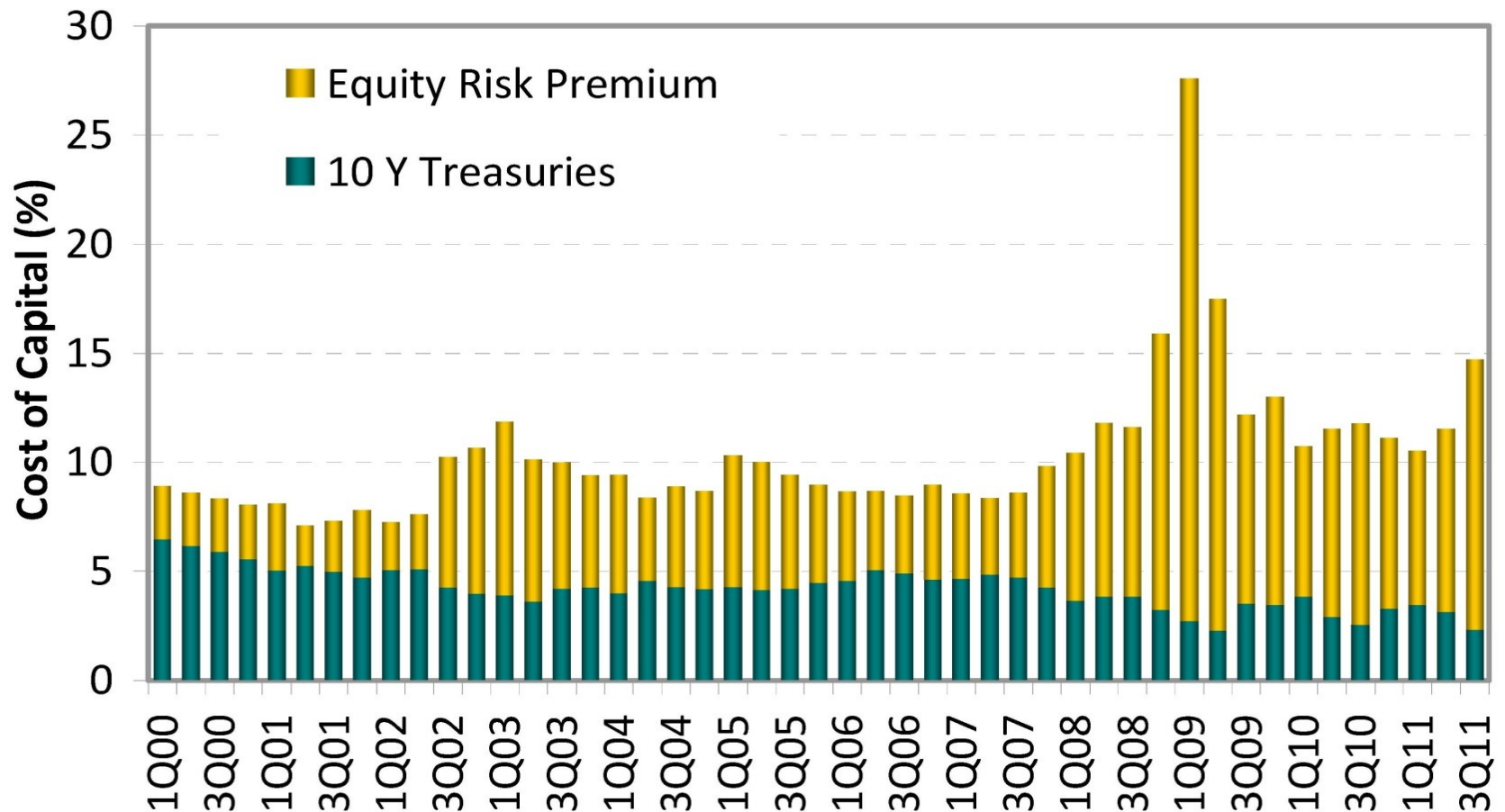


Data as of Sept. 30 each year.

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What Does the Future Hold?

Implied Cost of Equity Capital has Soared to 15%

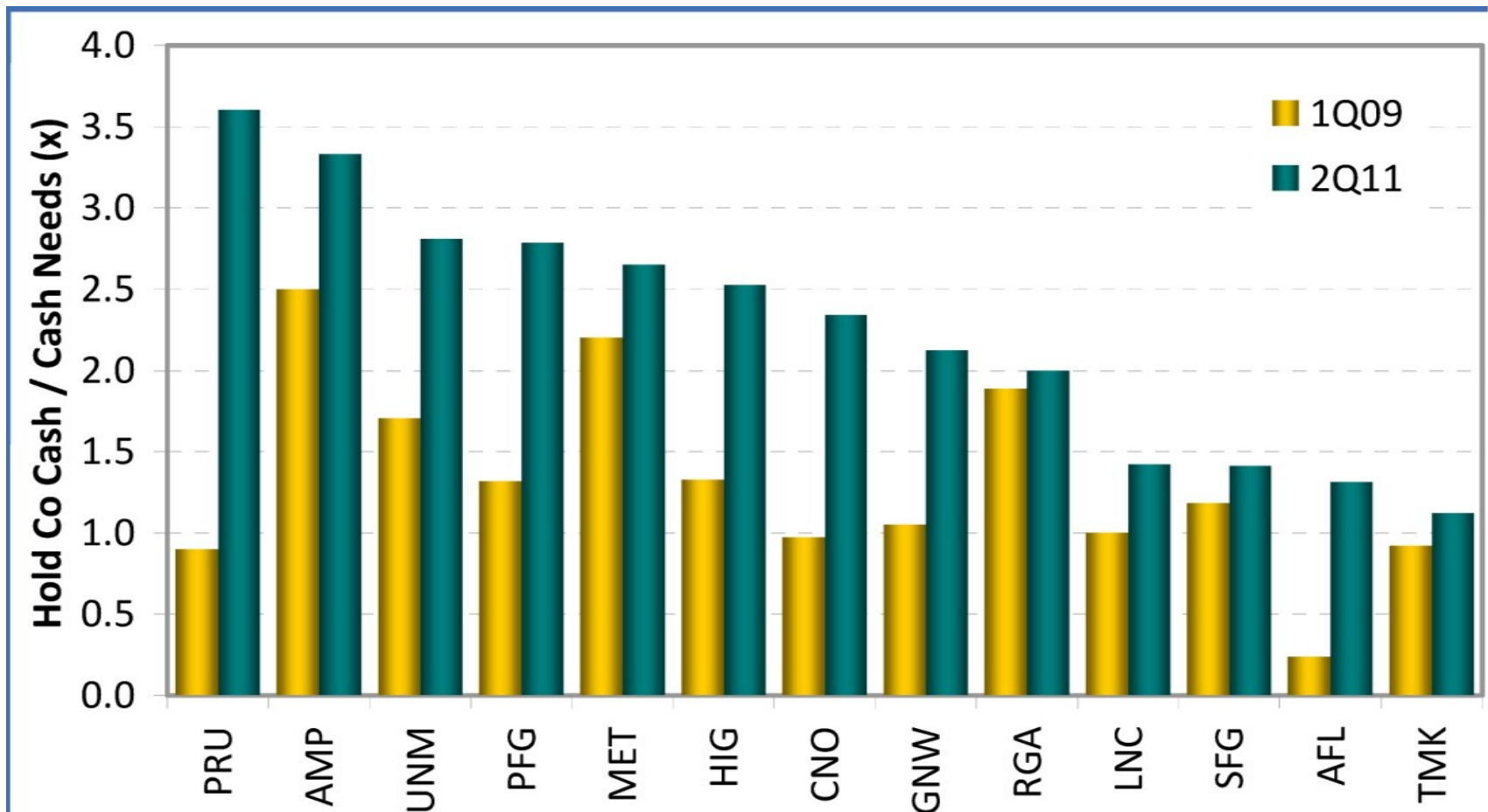


Source: FactSet, Morgan Stanley Research

What Does the Future Hold?

Companies Now have Substantial Excess Liquidity

Hold-Co Cash Relative to Annual Needs (1Q09 vs. 2Q11)

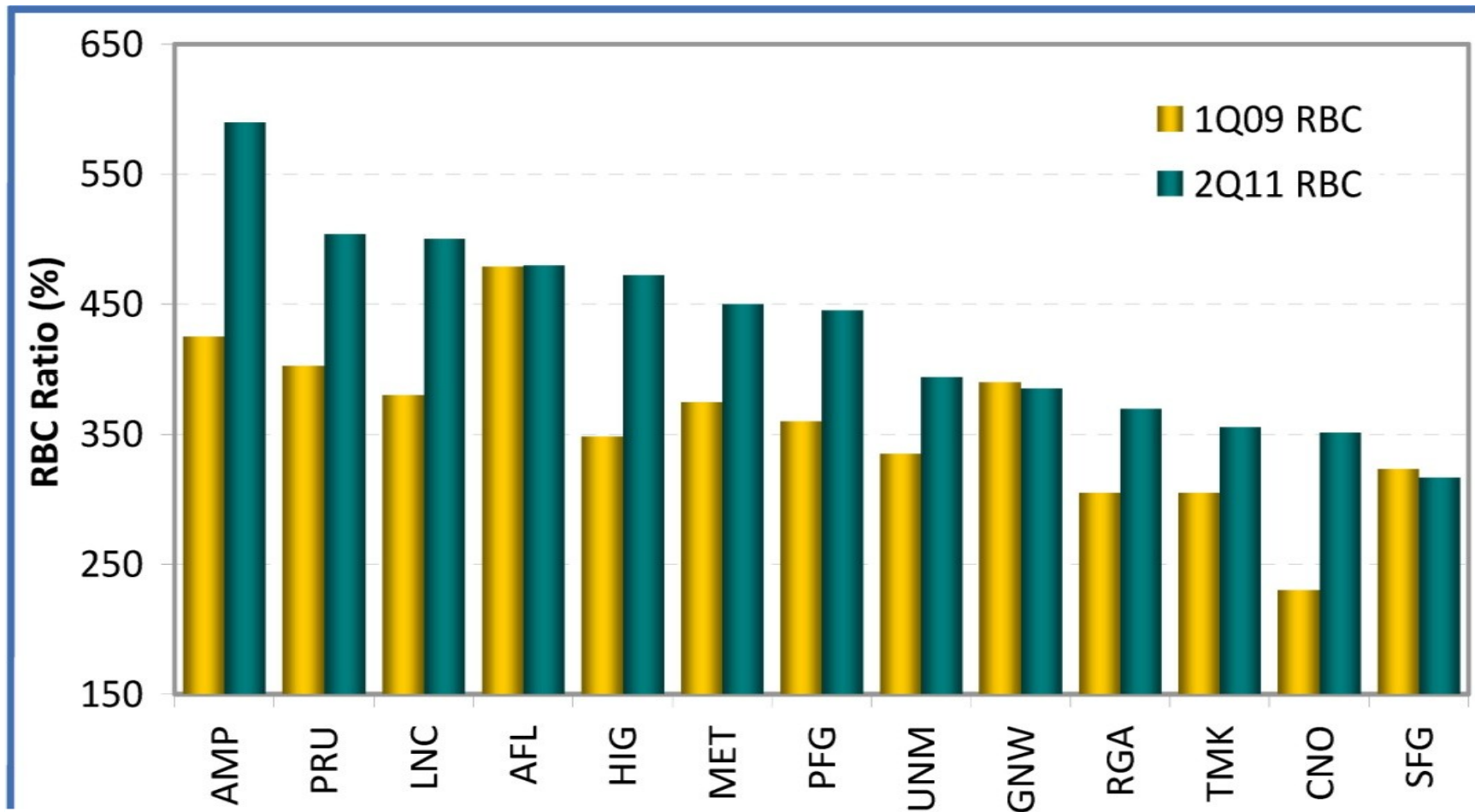


Source: Morgan Stanley Research, Company data

What Does the Future Hold?

Risk Based Capital Ratios Are Similarly Up Substantially

RBC Ratios (1Q09 vs. 2Q11)



Source: Morgan Stanley Research, Company data