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Insurance - Life/Annuity | North America

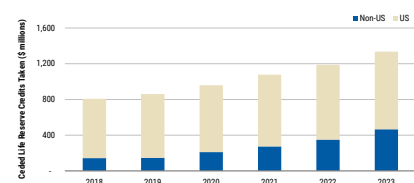
AAT for Offshore Reinsurance: You Can Run, But You Can't Hide

Asset adequacy testing (AAT) was proposed for offshore reinsurers, and, if passed, could serve as a headwind for insurers offshoring due to the increase in reserve charges. While it's too early to size the potential impact, annuity carriers tend to have more exposure given recent product growth.

Background: Earlier this year, insurance regulators shared a [proposal](#) to require asset adequacy analysis for life and annuity reinsurance transactions. This comes in response to the growing use of reinsurance, specifically to offshore entities. Further, offshore entities can have limited disclosure on assets and reserves that are supporting respective lines of businesses. The proposal raises the concern that current reserve levels could be deficient under moderately adverse conditions for insurers who have ceded blocks of business. From our perspective, the Cayman Islands will likely be an area of focus given the regulatory regime there differs somewhat from US and Europe.

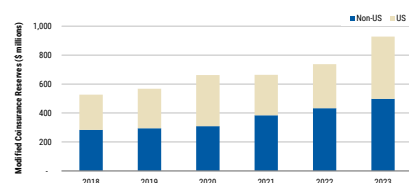
Why now? The use of reinsurance to derisk and free up capital has become increasingly popular in recent years. Reserve credits taken at an industry level are up 65% over the last five years, and modified coinsurance reserves are up 76% for the same period ([Exhibit 1](#) and [Exhibit 2](#)). Specifically, credits ceded to non-US reinsurers have more than tripled since 2018, while credits taken to US-based reinsurers are up 31%, comparatively. Favorable reserve requirements, investment flexibility and tax efficiencies are among a few reasons driving this trend towards offshore reinsurance. Regulators likely want to have better line of sight into the reinsurance agreements for offshore entities. Further ability to have comfort around these reinsurance relationships is also critical.

Exhibit 1: Life Insurance Industry: Last 5 Years, Ceded Life Reserve Credits Taken



Source: SNL, Morgan Stanley Research

Exhibit 2: Life Insurance Industry: Last 5 Years, Modified Coinsurance Reserves



Source: SNL, Morgan Stanley Research

What's the takeaway? While we do not see these proposed regulation changes as an imminent threat to life insurers' earnings or capital, we do think in the near to long term that they could pose a potential headwind. We will need to keep abreast

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INSURANCE - LIFE/ANNUITY

North America

Industry View

In-Line

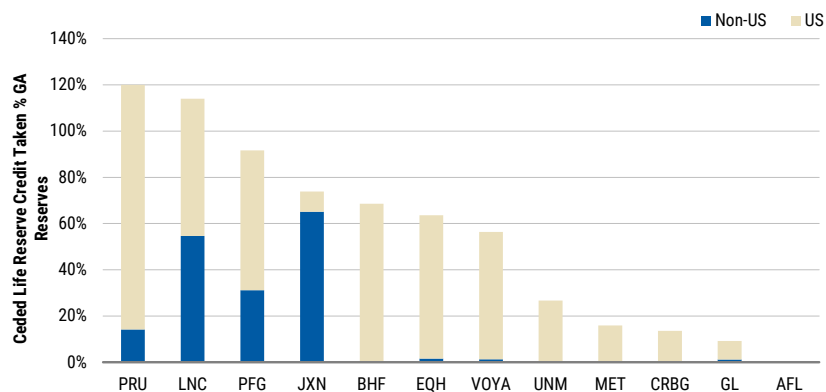
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of the quarterly National NAIC meetings over the next twelve months for more clarity on the potential impact. New guidelines would strengthen the testing of assets backing blocks of life and annuity business ceded to offshore reinsurers. This could require insurers to hold higher level of reserves, which would pose a strain on capital. Additionally, such regulation could dissuade insurers from seeking non-US reinsurers as an option to efficiently free up capital, and they may have to pursue less attractive alternatives. Current proposals suggest targeting certain life insurers that take reserve credits above certain thresholds, for example, credits taken above \$5 billion for reinsurance that does not require a VM-30 memorandum.

Which life insurers have offshore reinsurance exposure? We look at reserve credits taken within the statutory statements relative to total general account reserves to evaluate exposure to offshore reinsurance. At year-end 2023, Jackson, Lincoln, and Principal are a few life insurers that tend to have above average exposure compared to peers. That said, Jackson's exposure is more a reflection of pre-spin off activity, largely by Swiss Re, which is less likely to be under regulatory scrutiny. Lincoln's exposure reflects its 1Q23 Fortitude Re transition to reinsure \$28 billion of in force. For the FY23, Lincoln took a roughly \$38 billion reserve credit, of which about 55% was ceded to Bermuda (Fortitude Re) and about 44% was ceded to its Barbados captive, Lincoln Reinsurance Company Limited. For the FY23, Principal took a roughly \$15 billion reserve credit, of which about 73% was ceded to the Cayman Islands (Talcott Re) and roughly 26% was ceded to its Bermuda Captive, Principal Financial Services. We note that thus far into 2024 we have seen additional reinsurance activity, namely Prudential's GUL reinsurance transaction with Somerset Re (Bermuda). Corebridge began ceding new fixed annuity and index annuity premiums to its affiliated Bermuda reinsurer this past July after receiving all the necessary approvals.

Exhibit 3: 2023 Ceded Life Reserve Credits Taken as a % of General Account Reserves



Note: Jackson's ceded life reserve is mostly through Swiss Re, which is less relevant. Source: SNL, Morgan Stanley Research

What is the proposed timeline? Regulators hope to have a guideline by the end of 2025, and the Life Actuarial (A) Task Force, the task force which put forth this proposal, is on the preliminary agenda for the National NAIC Fall meeting, taking place on November 16-19.

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Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	588	16%	81	11%	14%	238	14%
Total	3,740		771			1687	

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Brighthouse Financial Inc (BHF.O)	U (02/23/2024)	\$48.51
Corebridge Financial Inc (CRBG.N)	E (10/10/2022)	\$31.47
Equitable Holdings Inc (EQH.N)	O (06/04/2018)	\$45.85
Globe Life Inc (GL.N)	E (08/18/2023)	\$110.24
Jackson Financial Inc (JXN.N)	E (12/07/2021)	\$97.41
Lincoln National Corp (LNC.N)	E (11/03/2022)	\$32.82
Manulife Financial Corp. (MFC.TO)	E (11/13/2014)	C\$41.57
MetLife Inc. (MET.N)	O (01/07/2020)	\$84.84
Primerica, Inc. (PRI.N)	E (05/19/2022)	\$276.94
Principal Financial Group (PFG.O)	E (02/15/2024)	\$89.65
Prudential Financial (PRU.N)	E (12/13/2016)	\$125.57
Reinsurance Group of America (RGA.N)	E (05/19/2022)	\$215.26
Sun Life Financial Inc. (SLF.TO)	E (05/25/2012)	C\$78.77
Unum Group (UNM.N)	E (02/17/2010)	\$63.38
Voya Financial Inc (VOYA.N)	E (08/01/2024)	\$82.06

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