Sidecars for Life Insurers: Planning for the road ahead

By Adam Pyke, Elizabeth (Libby) Corcillo, Brendan Akos

Sidecars are the “shiny new cars on the road” in the life insurance industry, often leveraging outside capital and expertise through an affiliated reinsurance entity.

As RGA knows firsthand, a sidecar strategy can offer many accretive attributes, such as supporting growth and fostering valuable partnerships. In other cases, sidecars can be challenging and lead to too many hands on the steering wheel, perhaps all pulling in different directions. Ensuring alignment across stakeholders involves carefully designing all the features of the sidecar to ensure it runs smoothly. The associated resource allocation requires strong organizational commitment to the strategy; otherwise, getting through fundraising may be insurmountable.

With the expectation that a number of life insurers will explore the use of sidecars in the coming years, this paper lays out important factors and alternatives for life insurers to consider before going down the sidecar route. In particular, the asset-intensive market offers a number of proven, unaffiliated reinsurers that can deliver complete solutions at attractive terms. Assessing the trade-offs between sidecar and traditional reinsurance can help determine the vehicle best equipped for the journey ahead.

The new car on the road

While more than 200 property and casualty sidecars have been announced since they came to the fore after the 2005 hurricane season, they now are gaining significant interest among life and annuity (re)insurers. Traditionally, sidecars serve as risk-sharing vehicles that utilize third-party capital to improve an insurance company’s metrics. In the past five years, several life insurers, often with some level of private equity ownership and/or asset origination and management capabilities, have established their own sidecars:

Year	Lead Co./Asset Manager	Sidecar
2023	RGA / RGA	Ruby Re
2023	Prudential/PGIM and Warburg Pincus	Prismic Re
2023	Athene/Apollo	ACRA 2
2023	Global Atlantic/KKR	Ivy Re 2
2023	Kuvare/Davidson Kempner	Kindly Re
2022	American Equity LIC	AEL Bermuda Re
2022	Massachusetts Mutual/Barings	Martello Re
2021	Security Benefit/Eldridge	SkyRidge Re
2020	Global Atlantic/KKR	Ivy Re
2019	Athene/Apollo	ACRA

While many recent sidecar strategies have focused primarily on de-risking while growing assets under management (AUM) to preserve fee income, several additional reasons to consider a sidecar have emerged:

- Raise additional capital to fuel growth
- Gain access to more favorable offshore capital and tax treatment
- Reduce balance sheet and earnings volatility
- Partner with a specialized asset management firm

Typically, an asset manager desiring a mandate for the sidecar's assets will acquire a stake in the sidecar to reinforce alignment of interests. Beyond access to this AUM, the potential for high, stable returns over a defined period can attract various types of sidecar investors.

Designing the sidecar: Key considerations

In many ways, creating a sidecar is similar to establishing an insurance company. The process often can span 18 months or much longer, requiring high organizational conviction to move down this new path. The design options have real implications for the viability of the sidecar and are deeply interconnected.

When designing the sidecar, thoughtful consideration of the following strategic questions is crucial:

- **What risks will it cover?** The sidecar can reinsure in-force and/or new business for various products at different levels of quota shares.
- **What is the underlying investment strategy?** The sidecar may look to leverage alternative investment strategies that increase portfolio yield.
- **How will the risk transfer be priced?** The economics of the sidecar for the cedant and investors will be significantly impacted by the target returns, products, and fee structure.
- **Where will it be domiciled?** Underlying the economics of a sidecar, typically, is the decision to domicile offshore to make the vehicle more capital and tax efficient.
- **How will the reinsurance be structured?** Structures with trusts, overcollateralization, or onshore assets can mitigate counterparty risk, but each comes with its own set of management considerations.
- **How will it be overseen?** Governance activities, such as management control and voting rights, play a crucial role in ensuring the vehicle's long-term success.

Aligning these decisions across existing and new stakeholders magnifies the difficulty of arriving at the final design. All stakeholders carry notable influence over the viability of the sidecar and come with different motivations for their participation. For example:

- Sponsoring company
    - Goal: Maximize retained economic value through fees and ceding commissions while releasing capital.
- Investors
    - Goal: Deploy capital quickly, earn a high-risk premium over a finite investment horizon, and, for certain investors, capture lucrative fees for additional services such as asset management.
- Regulators (local, offshore, tax)
    - Goal: Ensure the sidecar complies with regulations and the structure does not exploit the intended framework, leading to risk for policyholders and the system.

With precedents in place and a growing focus on the sidecar space, these stakeholders will be keen on influencing the design. Additional stakeholders, including employees, policyholders, advisors, and the parent company, will clearly want to have input on the sidecar design as well. The individual goals of all stakeholders should be considered as part of the design and decision-making process.

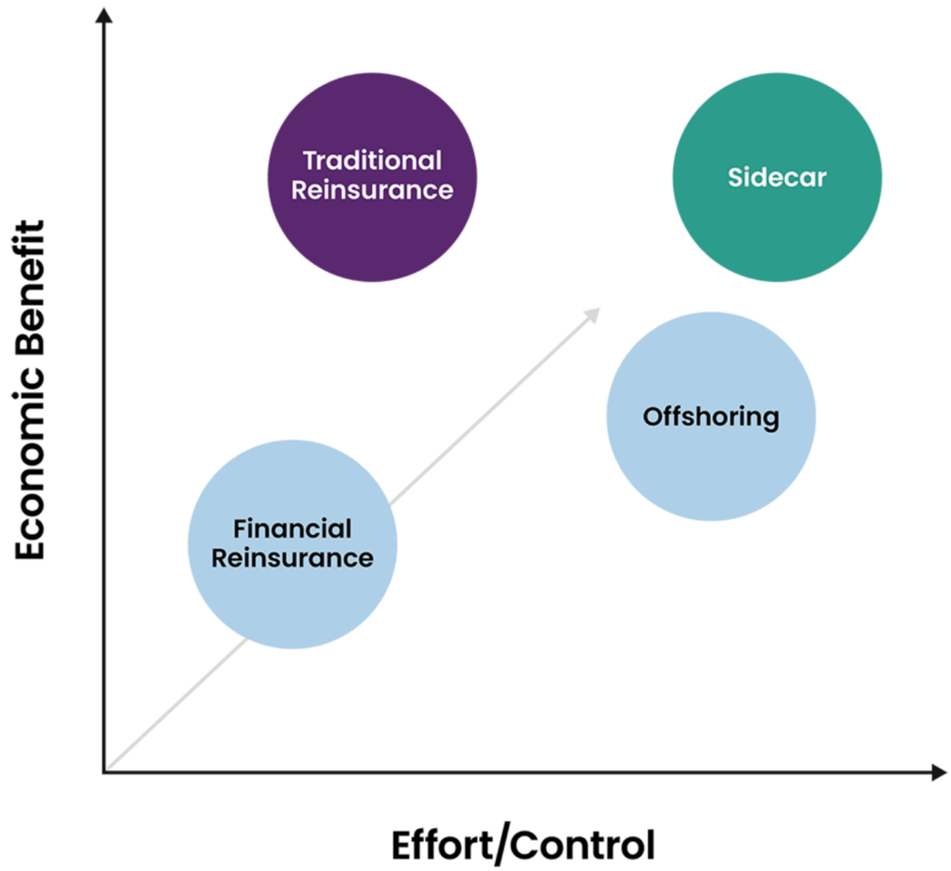
Additionally, sponsors should be conscious of current macroeconomic conditions, which drastically differ from the environment of the past few years that contributed to the popularity of sidecars. The U.S. economy arguably faces tighter funding conditions, higher return requirements, and greater uncertainty. Given the typical timeline of establishing such vehicles, financial conditions may change markedly between the initiation and execution of the sidecar.

> Fundraising for the sidecar can lead to an interesting tug of war as the sponsoring company looks to engage with potential investors without compromising its own financial objectives.

Moving from design to production to make the sidecar a reality is the most challenging part of the process. The right design is certainly a major part of being ready to deploy the capital and operate the vehicle.

Other reinsurance vehicles: Evaluating trade-offs

A sidecar can be viewed as just a variation of other forms of reinsurance, such as a traditional full risk-transfer treaty with an unaffiliated, established reinsurer. The market for traditional reinsurance is both wide and deep with established players offering competitive solutions that often can access the same benefits and features provided by sidecars. While both sidecars and traditional reinsurance can be designed to cover the same risks using similar structures, the effort, economics, execution risk, and expertise involved can be quite different for each.



Effort: Which vehicle will require the least effort to set up and manage?

Winner: Traditional third-party reinsurance

Sidecar	Traditional third-party reinsurance
Major undertaking to launch, typically requiring at least 18 months from strategy to execution. In addition to ongoing management efforts, it may be difficult to change the course as conditions and needs evolve over time.	Once the strategic decision is made to move forward, a well-defined process for finding a reinsurance counterparty follows that can be done in three to six months.

Economics: Which vehicle is most economical?

Winner: To be determined; both likely can achieve similar structural advantages and risk coverage, so the implementation details will drive relative economic advantages.

Sidecar	Traditional third-party reinsurance
Expect high investor interest but also pressure to maximize returns for outside investors. Economic analysis should consider the role of fees and counterparty credit risk, which may offset pricing leverage.	Established players with leading capabilities and risk appetite can translate into favorable economics for the cedant.

Expertise: Which vehicle can best utilize partners with complementary capabilities?

Winner: Sidecar

Sidecar	Traditional third-party reinsurance
Potential sidecar investors may have complementary capabilities on the liability, asset, or structuring side. The sidecar can be conducive to such arrangements as there is mutual interest in performance, but the impact on fees and control must be considered.	Leverages the expertise of the reinsurer for the treaty's design and fulfillment. Experienced reinsurers can further enhance partnership via a lead role in ongoing product design and management, sharing an interest in maintaining the policyholder base with the ceding company.

Execution: Which vehicle offers certainty and simplicity in execution?

Winner: Traditional third-party reinsurance

Sidecar	Traditional third-party reinsurance
While there are examples of sidecar launches, execution risk persists across the sidecar lifecycle, stemming from a range of areas, such as stakeholder alignment, investor exit options, and regulatory oversight.	Execution risk is typically lower, given a shorter time frame, bilateral (in lieu of multilateral) negotiations, and certainty of coverage.

Buyer's Guide

A sidecar might be a good addition to the holistic reinsurance and capital management strategy of a company that:

- Has a sizable balance sheet
- Has a sophisticated capital management team and solid relationships in the capital markets
- Is able to divert several senior leaders from their "day jobs" to the sidecar project for at least 18 months
- Is willing to give investors an asset management mandate to achieve targets for specific asset classes and has the ability to perform due diligence
- Has a seed block that fits the liability profile of the sidecar
- Is prepared to make a long-term commitment to cede liability flows

On the other hand, seeking a tailored reinsurance solution can be the prudent choice for a company that:

- Has a near-term need to free up capital
- Desires high flexibility in managing capital and risk retention
- Values the counterparty strength of a diversified, experienced reinsurance company
- Seeks to leverage an asset-intensive reinsurer's expertise to improve the economics in a more defined arrangement

- Would prefer not to warehouse liabilities on the balance sheet for the 18 months or more it will take to stand up a sidecar
- Seeks product expertise and the flexibility to shift product emphasis to address distribution needs, evolving buyer preferences, and market conditions

Quick Recap

While sidecars can deliver significant value under the right circumstances, the costs – whether in terms of time, resources, capital, or other elements – and execution challenges should be thoughtfully and realistically considered prior to pursuing.

Early prioritization of objectives is essential in the development of the third-party capital strategy. This will inform the assessment of the notable trade-offs in pursuing the sidecar vs. other alternatives, such as traditional asset-intensive reinsurance.

Following this process will ensure that you select the right car to get to your desired destination.

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