

# Surplus Note Overview

## Market Observations

Historically low interest rates, specific investor interest in mutual insurance companies, and a multitude of strategic benefits have driven an increase in the issuance of surplus notes over the past 5 years.

A surplus note is similar to debt, with interest payments being made by the issuer to investor(s) on a periodic basis. However, the principal amount of a surplus note is treated as surplus on a company's balance sheet under statutory accounting rules. This note is also subordinate to all other policyholder liabilities.

In addition, the issuer's respective insurance commissioner in its state of domicile must approve issuance and each subsequent interest payment.

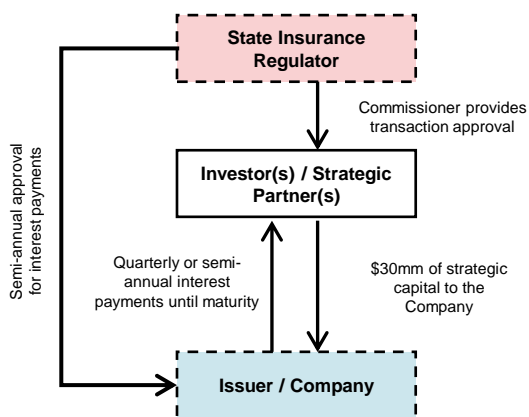
## Use of Surplus Note Proceeds

An Issuer can utilize a surplus note for any of the following strategic benefits:

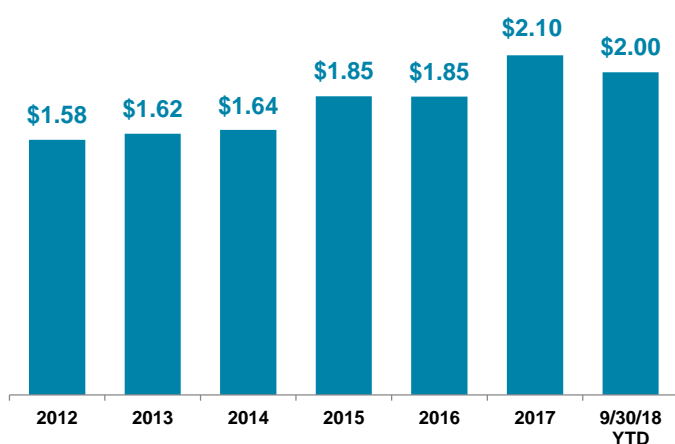
- Expansion into additional products and markets through organic growth or acquisition
- Improving A.M. Best capital position
- Re-financing existing surplus notes
- Diversifying capital source
- Technology system upgrades

As an established leader in its field, Aon Securities specializes in structuring and placing surplus note transactions for mutual insurance companies.

## Surplus Note Transaction Structure (\$30mm)

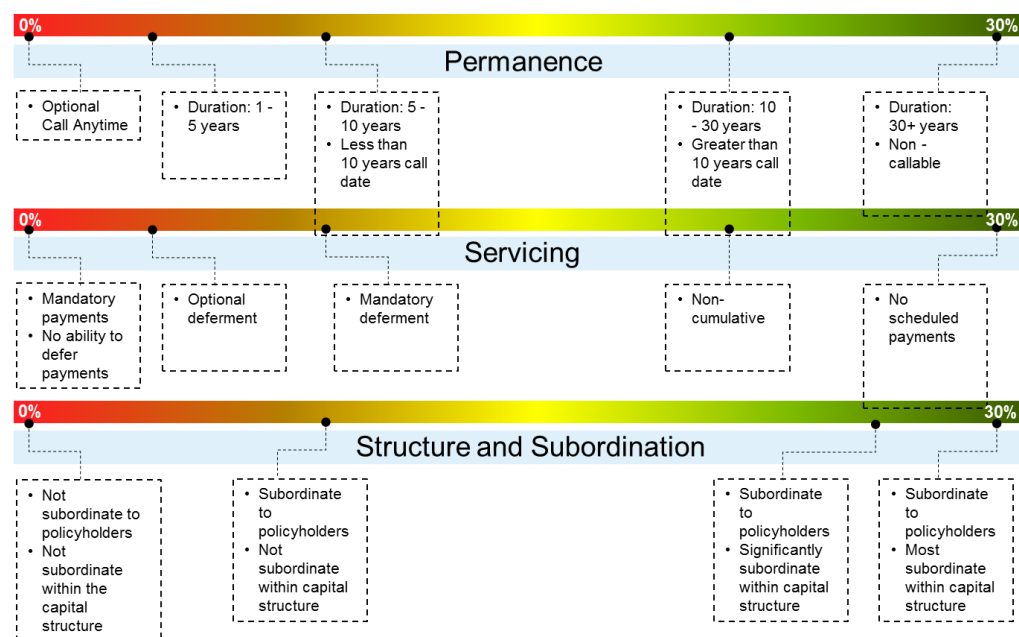


## P&C SME<sup>(1)</sup> Surplus Notes Outstanding (\$ bn)



Source: SNL Financial

## A.M. Best Rating Considerations



The maximum capital credit for a surplus note is 90% of the principal value of the notes. When issuing a surplus note, an issuer must assess the following structural items in order to obtain and maintain maximum capital credit from A.M. Best.

- Permanence** – maturity and call provision
- Servicing** – insurance regulator must approve each interest payment, coverage ratios, capitalization
- Structure and subordination** – surplus notes are subordinate to all other policyholder liabilities

**Notes:** (1) Small and medium sized enterprises represents insurance companies with 2017 surplus between \$20 and \$500 million.

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