captive insurance times
The primary source of global captive insurance news and analysis
ISSUE122 Conference Issue

Top of its class

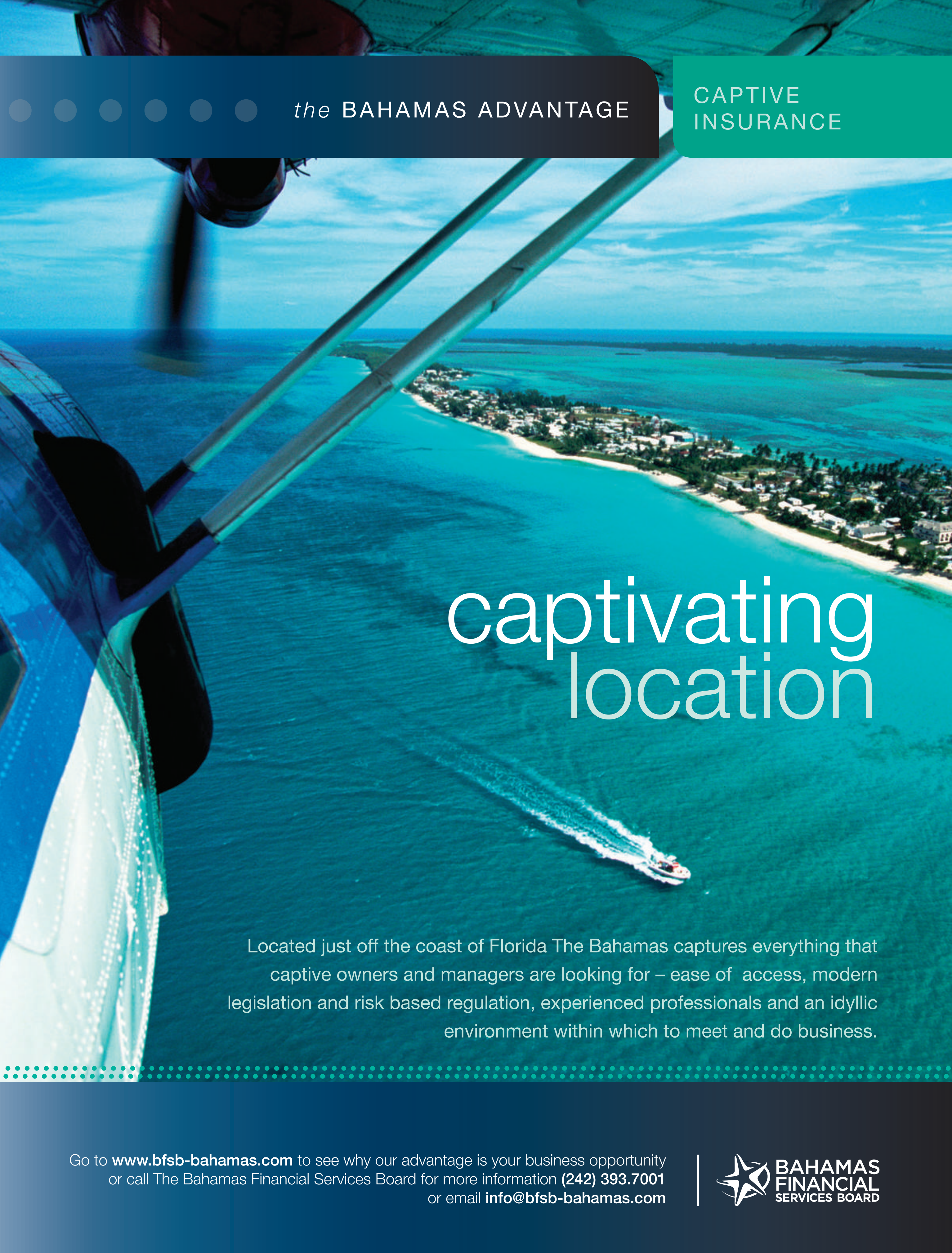
The brains behind Butler University's student-run captive reveals how the new insurer came into being

Reputational Risk
Giving brands a hand

Due Diligence
Getting captives right

Medical Stop-Loss
Expansion of self-funding

Series Captives
Bloom opens for business


the BAHAMAS ADVANTAGE
CAPTIVE INSURANCE
captivating location
Located just off the coast of Florida The Bahamas captures everything that captive owners and managers are looking for – ease of access, modern legislation and risk based regulation, experienced professionals and an idyllic environment within which to meet and do business.
Go to www.bfsb-bahamas.com to see why our advantage is your business opportunity or call The Bahamas Financial Services Board for more information (242) 393.7001 or email info@bfsb-bahamas.com
BAHAMAS FINANCIAL SERVICES BOARD

Court denies Notice 2016-66 injunction

The US District Court for the Eastern District of Tennessee dealt a blow to micro captives and their managers in the run-up to the 1 May deadline to comply with Notice 2016-66.

The district court denied CIC Services and and tax advisory Ryan's request for an injunction to block or delay Notice 2016-66 for micro captives on 21 April.

According to the district court, the lawsuit is barred by the Anti-Injunction Act, which precludes actions against the government seeking to bar the assessment and collection of taxes.

CIC and Ryan filed the lawsuit against the Internal Revenue Service (IRS) and US Treasury in a bid to block the original 30 January deadline, which was eventually pushed back until May after a fierce backlash.

They argued that Notice 2016-66, which formally identifies micro captives as "transactions of interest" and requires extensive reporting back to the IRS, was "unlawfully issued" because it didn't comply with the mandatory notice-and-comment provisions of the Administrative Procedure Act.

Notice 2016-66 is also "arbitrary and capricious and ultra vires in nature", lacking the Administrative Procedure Act's requirement for underlying authority and a reasoned analysis footing, they argued.

Despite the denial, the district court did give CIC and Ryan leave to refile, and the decision can be appealed against before the Court of Appeals for the Sixth Circuit.

Inside captive insurance times

UK general election delays ILS plans

The introduction of insurance-linked securities (ILS) legislation could be delayed after UK Prime Minister Theresa May called a snap general election for 8 June.

A final version of the UK's ILS framework was expected to be published at the end of April, but May's decision to call a general election pushed that back.

Christopher Beazley, CEO of the London Market Group, which led the charge for the UK to make changes to its law to attract ILS business, said: "The government anticipates that the necessary legislation to bring the ILS regime into force will be introduced to Parliament before the summer recess in mid-July."

Two sets of regulations will be laid before both houses of UK Parliament, via statutory instruments, to amend the Financial Services and Markets Act of 2000 and the Finance Act of 2016.

May announced the snap general election outside 10 Downing Street on 18 April, following numerous legal and voting challenges over the UK's vote to leave the EU last year.

Citadel Risk launches Tennessee ICC

Citadel Risk has opened a new incorporated cell captive company in Tennessee, Citadel Tennessee Captive Insurance Management. As part of the new company, Citadel Management Bermuda will become a licensed captive manager, pending final approval from the Tennessee regulators.

According to Tony Weller, group CEO of Citadel Risk, the company decided on Tennessee because of its familiarity with the state regulators.

Weller said: "We were very comfortable with the fair and balanced oversight that they provide to the captive insurance industry there."

"At the end of the day it's about providing the best protective structure that we can for clients who would be interested in renting cells in the Tennessee company. With a protected cell structure and a separate incorporated

Captive business in Labuan on the rise

Labuan's total earned premium for captive insurance business increased by 18.8 percent to $252 million in 2016, despite an overall decrease in total gross premium.

The Labuan Financial Services Authority (LFSA) Annual Report suggested that the increase in total earned premium for captive business was due to higher retention for all sectors, while the 6.9 percent decrease in total gross premiums was experience in the engineering sector.

It also found that most of the total gross premiums for the captive insurance business were derived from outside Malaysia, "reflecting the centre's efforts to promote international business in support of insuring group risks".

According to the report, Labuan is "fast becoming one of the largest captive jurisdictions in Asia".

Since Labuan's first captive was established by a property developer company in 1998, the sector has been "growing rapidly", reaching approximately 40 captives in 2016 and contributing to an aggregated written premium value of $348.6 million.

Within Labuan's captive market, risk owners in Asia have been the main contributors, taking almost 75 percent of the market, while the remainder is made up of EU and US parented captives.

This positive trend is expected to continue as the Labuan International Business and Financial Centre (IBFC) concentrates on "strengthening its grip on Asian captive markets".

Labuan currently offers business owners various options, including the pure captive and protected cell company structures.

The LFSA said in its annual report: "The variety of captive structures to select from, coupled with other business enablers designed to provide legal stability with minimal setup and operating costs, make Labuan IBFC the region's choice for captive market."

In March, Labuan IBFC suggested that the increasing interest among Asian corporates to establish captives as a risk management strategy also presents immense opportunities in offering risk solutions that complement onshore activities.

The IBFC also revealed that it will focus on sectors including leasing, commodity trading and wealth management.

Danial Mah Abdullah, CEO of Labuan IBFC, said: "We believe the changes in the way cross-border investment and trade are conducted due to demands for greater transparency is a business enabler for Labuan IBFC."

"We will be focusing on developing the niches with high-growth potential and these sectors have been showing a positive upward trend in driving the mid-shore centre development in the recent years."

legal identity for each cell it will be simple to make filings for 831(b) status for a cell."

He added: "Not only can the Citadel Risk Group provide consulting services and management services, its Citadel Re company can provide excess insurance placements and aggregate stop loss coverages. In some circumstances Citadel Risk even provides fronting company services through one of its US admitted insurers."

A.M. Best affirms National Grid captive

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and the long-term issuer credit rating of "a" for the National Grid Insurance Company (NGICL), a captive of National Grid.

The ratings agency noted that the outlook of these credit ratings remains stable.

According to A.M. Best, the ratings reflect NGICL's risk-adjusted capitalisation and risk management capabilities within the National Grid group. The ratings also support the insurance company's "strong but volatile" operating performance.

A.M. Best suggested that NGICL's risk-adjusted capitalisation will remain strong, supported by the captive's low underwriting leverage and reinsurance protection.

However, the ratings agency explained that the captive's underwriting performance is subject to "irregularity as a result of exposure to low frequency, high severity losses in its property damage and business interruption accounts".

Between 2012 and 2016 the captive had a five-year average combined ratio of 43.5 percent.

According to A.M Best, the captive is well integrated into the parent's overall risk management framework, with its primary objective to mitigate the National Grid

group's European financial exposure to casualty, cyber, property damage and business interruption risks.

ILS market firing on all cylinders

Q1 2017 saw $1.7 billion of non-life catastrophe bond capacity issued through five insurance-linked securities (ILS) transactions, Willis Towers Watson Securities has reported.

This was down slightly year-over-year, although Q1 2016 was a record-breaking quarter for issuances, with $2 billion issued through nine deals.

"The ILS market is firing on all cylinders in early 2017," Willis Towers Watson Securities commented in its ILS market update.

"There is a robust pipeline with nearly a record level of deals completed. ILS funds are raising capital and putting it to work. Sponsors are responding to the attractive spread environment by seeking new protection backed by liquid ILS (cat bonds) as well as continuing to ramp up protection in other forms. A record year seems possible."

The firm added: "While spread levels have exited free fall, they continue to decline as investors put more money to work and grab market share. The breadth of the ILS market continues to expand not only by products and perils but also in the diversity of ILS investor risk-return appetites."

Bill Dubinsky, head of ILS at Willis Towers Watson Securities, said: "As expected, assets under management have continued to grow at roughly the same pace as in 2016. This is against a backdrop of challenging market conditions as competition among various players intensifies. Looking ahead we can be confident that the ILS market will continue to expand and grow as reinsurers and other players invest in this space."

"The breadth of the ILS market continues to expand not only by products and perils but also through increasingly differentiated risk-return appetites among the various investors."

Cat losses at $8.1 billion so far, says Macquarie Research

Macquarie Research's catastrophe loss model estimates that losses for Q1 2017 currently stand at $8.1 billion, compared to $9.3 billion during the same period in 2016.

Of the total estimated losses this year, $1.3 billion relates to Cyclone Debbie, $1.1 billion to South American flooding, and $2.6 billion relates to severe weather in the US.

During the same period in 2016, the industry had already incurred more than $3.4 billion in losses from two severe storms in the US and $5.9 billion from the Japanese earthquakes, contributing to global insured catastrophe losses of $17 billion.

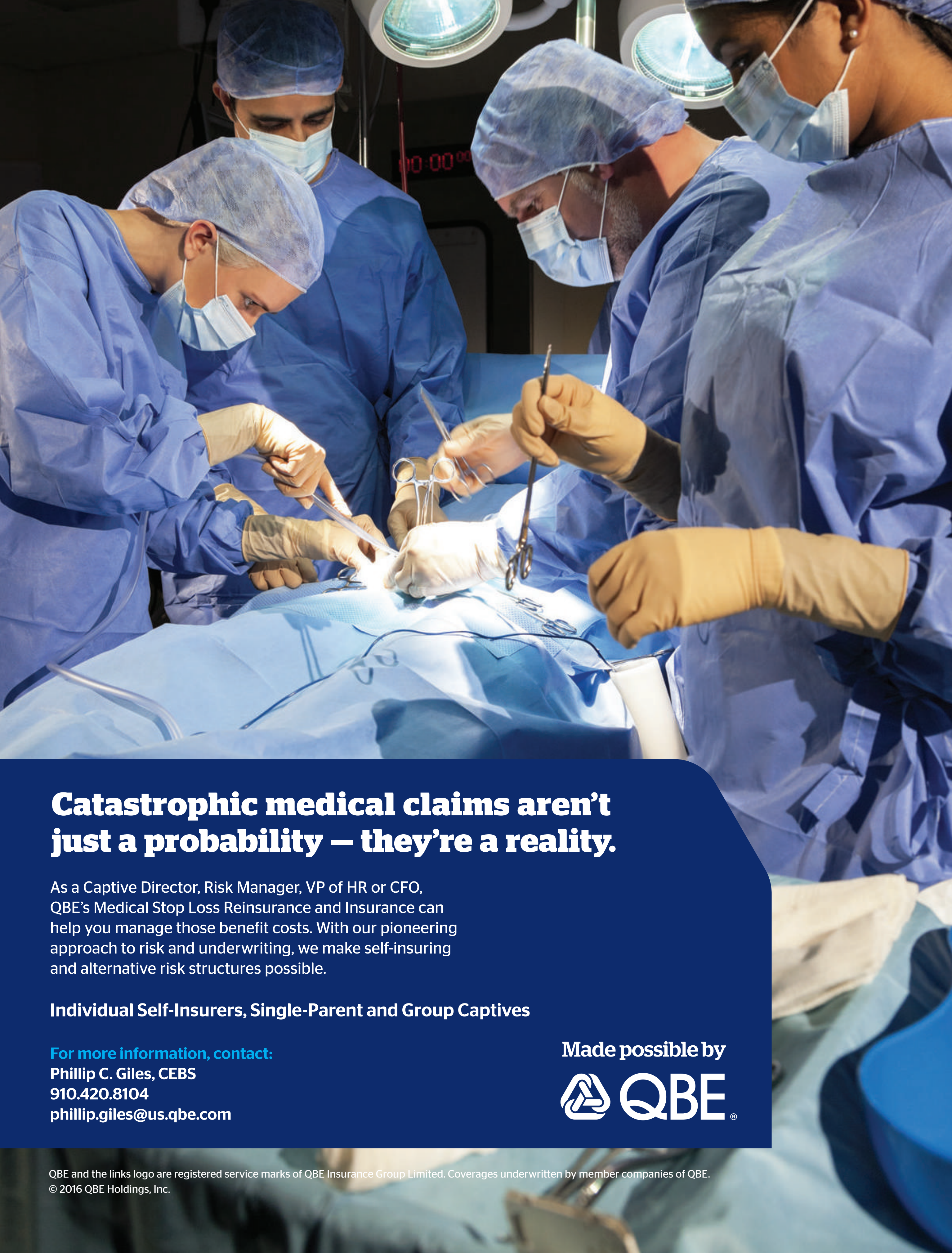
Macquarie said: "While it is still early in the year and catastrophe loss events can occur at any time, with little or no warning, 2017 has thus far been relatively calm. We consider recent year loss events such as Cyclone Debbie to be earnings, rather than capital event, assuring us that neither dividends nor share buybacks are in question. As such we reiterate our positive view of the reinsurance sector."

R&Q more than triples pre-tax profits

Randall & Quilter (R&Q), the Bermuda-based non-life insurance investor, saw its year-end profits triple for 2016.

The group's year-end results showed a pre-tax profit of £8.5 million for 2016, compared to just £2.8 million in 2015.

Included in the pre-tax profit was a £7.9 million contribution of net reserve release in run-off insurance companies, however, this



Catastrophic medical claims aren't just a probability — they're a reality.
As a Captive Director, Risk Manager, VP of HR or CFO, QBE's Medical Stop Loss Reinsurance and Insurance can help you manage those benefit costs. With our pioneering approach to risk and underwriting, we make self-insuring and alternative risk structures possible.
Individual Self-Insurers, Single-Parent and Group Captives
For more information, contact:
Phillip C. Giles, CEBS
910.420.8104
phillip.giles@us.qbe.com
Made possible by
QBE®
QBE and the links logo are registered service marks of QBE Insurance Group Limited. Coverages underwritten by member companies of QBE.
© 2016 QBE Holdings, Inc.

figure has decreased from the £8.3 million recorded last year.

The group also reported "excellent contribution" from 15 completed legacy transactions, with especially strong growth in North America.

It also experienced continued "good performance" in its UK operations of the insurance services division but "widening losses" in the US as a result of further investment in the healthcare initiative.

The results found that the group's return on equity last year was 13.5 percent, an increase on 2015's 4.4 percent, while its investment return increased to 2.7 percent compared with 1.1 percent the previous year.

According to R&Q, the overall mission and purpose of the group is "to offer investors profits and capital extractions from legacy non-life insurance acquisitions/reinsurances, and grow service revenue and commission income from its licensed carriers in the US and EU/UK writing niche and profitable business, largely on behalf of highly rated reinsurers".

Ken Randall, chair and CEO of R&Q, commented: "I am pleased to report that, as indicated in the recent placing announcement, the group traded very well in H2 2016 with full-year profits ahead of board expectations and significantly higher than the prior year."

Randall added: "In addition, the balance sheet was boosted by further foreign exchange-related gains, partly offset by adverse movements in the international financial reporting standard calculation of the pension deficit."

"Completion of 15 legacy transactions during the year and further net reserve releases from the insurance companies in run-off were the primary drivers."

"The simplification of the group's business model continues, with certain non-core operations identified for disposal. This will enable a renewed focus on our core business areas where we believe there is exciting growth potential, the likes of which we have not seen for some time."

"These areas include the acquisition of run-off portfolios and building recurring commission revenue from using our licensed carriers in the US and EU to write niche and profitable books of property and casualty business, largely ceded to highly rated reinsurers."

Capital supporting reinsurance is on the increase, according to Willis

Aggregate shareholders' funds for companies making up the Willis Re index increased by 4 percent to $344.1 billion in 2016, according to a Willis report.

The Reinsurance Market Report revealed that, taking into account capital from alternative markets and a pro-rata share of capital from insurance groups where reinsurance makes up more than 10 percent of their total premium, the revised figure for 2016 is $449 billion, an increase of $22 billion on the previous year.

The report also found that aggregate net income for companies making up the Willis Re index dropped to $26.6 billion from $30.3 billion, resulting in a reduction of the headline return on equity of 8 percent, down from 9.3 percent at the end of 2015.

It suggested that, in the face of testing market conditions, reinsurers have continued to actively manage their capital through dividends and share buy-backs, which totalled $16.4 billion for the Willis Re index.

John Cavanagh, global CEO of Willis Re, said: "The continued challenging conditions of the market further impacts pressure on margins. However, buyers can take comfort from the fact that the market balance sheet and headline figures remain robust in the face of persistent market softening due to continued reasonable net income and measured capital management strategies."

Great American Insurance opens new motor captive facility

The Great American Insurance Group has launched a captive offering aimed at motor carriers with independent contractor fleets.

The Great American Advantage Captive offers motor carriers member-owned group opportunities or single-parent captive opportunities that feature flexibility in the risk-sharing structure, low-cost entry and the ability to share in underwriting profits.

The captive allows motor carriers with large independent contractor fleets to have access to coverages from the Great American Insurance Group, including non-trucking liability, physical damage, occupational accident, contingent liability and workers' compensation.

Randal Smith, divisional senior vice president of Great American's trucking division, said: "We're delighted to offer this new product to motor carriers across the country. By participating, they have the opportunity to earn both underwriting profit and investment income, while protecting their independent contractors through a comprehensive insurance programme."

Smith suggested that the new captive offering is "ideal for motor carriers with 50 or more independent contractor units that have an appetite for risk, are financially strong, and prioritise safety and successful claims management".

A.M. Best downgrades MSH RRG

A.M. Best has downgraded the financial strength rating of the Mountain States Healthcare (MSH) Reciprocal Risk Retention Group (RRG).

The RRG's financial strength rating has fallen to "B++ (Good)" from "A- (Excellent)", while its long-term issuer credit rating has been downgraded to "bbb" from "a-".

The rating downgrades are a result of "deterioration in the company's risk-adjusted capitalisation and operating performance in 2016, following significant adverse loss reserve development on prior accident years, primarily 2015 and 2012". A.M. Best added that it is concerned about the possibility of additional deterioration in risk-adjusted capitalisation if operating performance does not improve in 2017.

Validus ILS business receives generous inflows in Q1 2017

AlphaCat, the insurance-linked securities (ILS) and third-party reinsurance capital business of Validus Holdings, increased its assets under management to $2.9 billion in Q1 2017.

The increase over Q4 2016's $2.7 billion in assets under management was attributed to capital inflows from third parties, which increased by $200 million during the following three months.

Third-party assets under management at AlphaCat stood at $2.7 billion on 1 April, up from $2.5 billion at the beginning of the year.

Higher third-party capital inflows into AlphaCat helped Validus to write more reinsurance premiums.

Validus ceded $200.1 million in reinsurance premiums for the three months ending 31 March, an increase of $32.3 million over the same period in 2016.

Going through charges

Having the ability to stabilise regulatory and fiscal certainty through self-funding will continue to drive expansion of the self-insured and medical stop-loss captive markets, says Phillip Giles of QBE North America

In March, the US House of Representatives, by an overwhelming majority, passed the Self-Insurance Protection Act. Although the act does not materially alter the regulatory status quo, it does provide a path to legislation that will eventually affirm and preserve an employer's ability to self-fund employee benefit healthcare insurance.

Self-funding of employee healthcare coverage has been one of the insurance industry's fastest growing segments over the past several years. The accelerated interest, largely attributable to the Affordable Care Act (ACA) and subsequent reform-related insecurity, has also induced the expanded use of captives for medical stop-loss and a commensurate expansion in the demand for medical stop-loss itself.

Continued legislative uncertainty surrounding the ACA reform has fuelled a revolution of evolution in self-funding and the medical stop-loss market; changing the dynamics of both.

Evolution: Regulatory anxiety drives expansion

The current executive administration's attempts to transform its predecessor's reforms continue to increase regulatory anxiety and drive further expansion of the self-funded market where employers can increase their level of control and certainty over regulation and stabilise costs. Legislators have been myopically focused on regulating insurance rather than appropriately addressing the root cause of rising costs. In healthcare terms, this is essentially, the regulatory equivalent of suppressing symptoms rather than working to actually cure the illness.

The cost of insurance directly reflects charges for healthcare; which, for this discussion, is defined the charges for all procedurals and pharmaceuticals by providers. Reform attempts will be successful only if they are based on addressing the charges for healthcare, itself rather than the cost of insurance.

Healthcare cost versus billed charges

All hospitals maintain a 'chargemaster', which is a hospital's comprehensive listing of all procedural charges and serves as the starting point for the 'billing charges' that are assessed to the general public for treatment. There is virtually no regulation of chargemasters, which leaves providers with a nearly unbridled flexibility to define prices.

A recent study found that the average hospital had an overall charge-to-cost markup ratio of 4.32, meaning, the average hospital set a chargemaster price of $4.32 against a Medicare-allowable procedure cost of $1. Some specialty procedures had charge-to-cost markup ratios approaching 28.5. In order to maximise revenue, US hospitals typically mark up prices more than 20-fold knowing that they are likely to receive much less from commercial insurers based on negotiated discounts.

The charges within the same facility can be completely different depending on the network agreement with each insurance carrier. To put this in perspective, different people with the same medical condition, that go to the same doctor in the same hospital, are likely to be assessed and charged completely differently for the exact same treatment simply because they have different medical insurance cards. The actual cost of healthcare is largely irrelevant, as the insurance carrier will only respond to the pre-negotiated charge with the provider.

The solution for containing cost through healthcare reform needs to be based on developing a systemically consistent, referenced–based, approach to the pricing of charges from providers for all procedurals. The reference point for all charges needs to be based on a consistent base standard nationally. Using Medicare with a realistic margin, for example, Medicare plus 50 to 60 percent+, and appropriate geographic cost-of-business adjustments would be a logical charge basis. The reimbursement formula should also acknowledge the qualitative patient outcome performance of the provider. This will help contain costs while still fostering qualitative-based competition—both of which will serve to mitigate the cost of insurance. It would effectively put every segment of the healthcare chain on an equal playing field. Providers would have the ability to receive an appropriately consistent profit margin while competing via operating efficiency and qualitative effectiveness.

This referenced-based approach has been adopted by an increasing number of self-insured health plans, which are currently the only healthcare payers that can feasibly employ the plan design structure.

Achieving certainty in an uncertain environment

While there is no reform solution on the horizon for systemically justifying the inconsistent basis for healthcare charges, the approach for many employers has centered on attaining the ability to assume control of what they actually can. This is the primary reason behind the tremendous growth in both pure self-funding and medical stop-loss captives over the past several years.

Self-funding has long proven to be the most efficient form of healthcare financing and is the only way to effectively assuage insurance-related legislative anxiety by providing stabilising certainty within an unstable regulatory environment. A self-insured plan has the unique ability to supersede most benefit mandates promulgated by state insurance regulations that would be applicable to a fully insured benefit plan. The ability to preempt state insurance and benefit mandates provides a self-insuring employer with an enormous amount of flexibility to tailor a benefit plan design that best fits the needs of its specific employee population.

Self-insured employers can also adopt a more advanced cost containment initiatives that are not typically pursued or otherwise available within more conventionally regulated insurance arrangements. This includes, as outlined earlier, implementing a pre-negotiated referenced-based pricing approach to more definitively define provider charges.

Revolution in medical stop-loss market

The evolutionary expansion within the self-funded market has led to a correspondingly significant revolution in the medical stop-loss market. The stop-loss market is estimated to have grown to a $14 to $15 billion market, up from $8 to $10 billion (prior to the ACA) in 2010. It is further estimated that the top 10 medical stop-loss carriers now control nearly 70 percent of that $15 billion market, whereas, in 2010, the 70 percent market share is estimated to have been spread among the 25 carriers.

The following examples illustrate the rapidly evolving dynamics of the medical stop-loss market over the past year alone:

- In 2015 and 2016, three major writers of stop-loss were purchased by larger carriers
- In early 2016, one of the world's largest insurance organisations entered the stop-loss market under the direction of a group of senior executives formerly with another large direct-writing carrier
- In January 2017, a major managing general underwriter (MGU)-based stop-loss writer signalled its intent to establish a direct-writing platform, making this the fifth major medical stop-loss carrier since 2010 to do the same
- In February, a specialty carrier exited the mainstream stop-loss market and will only write stop-loss in partnership with select community health plans
- At least two significant direct-writing carriers currently outsource their stop-loss underwriting to MGUs and, in March, a third major stop-loss carrier announced its immediate intention to do the same—the distinction should be made that this is only for backroom underwriting services rather than a comprehensive MGU relationship
- Also in March, one of the industry's largest multi-line carriers announced the purchase of a mid-size MGU to enter the medical stop-loss business
- In April, one of the largest life and disability insurers announced an intention to begin writing medical stop-loss for a 1 January 2018 effective date

This is only the tip of the proverbial iceberg for expected market changes in 2017. Much of the expected evolution will come from increased volatility within the MGU market in response to the larger market dynamics mentioned above.

Several new MGUs have been formed and several more will be either acquired, abolished or are seeking new issuing carrier relationships.

Market expansion by way of contraction

If interest in self-funding and the need for medical stop-loss has grown so significantly, why has the number of stop-loss carriers contracted so significantly?

The number of carriers has not really contracted but rather this is a definitive trend of large carriers acquiring more market share to enhance their ability to efficiently compete within what is a highly competitive market. As discussed earlier, the failure of reform proposals to appropriately address how the cost of healthcare is charged to health plans, the cost of claims, especially large claims, will continue to increase.

The frequency of large claims penetrating the specific stop-loss deductibles of self-funded programmes has risen to unsettling levels for both plan sponsors and underwriters. The market continuously pushes for aggressive pricing and contract terms, while costs within an uncertain regulatory environment push in an incompatible direction. Medical stop-loss is a line of business that increasingly needs to be written by carriers having the financial strength and stop-loss portfolio large enough to absorb losses.

Having the ability to stabilise regulatory and fiscal certainty through self-funding will continue drive expansion of the self-insured and medical stop-loss captive markets. Continued growth will be especially strong from employers having less than 500 lives and with group captives catering to smaller and mid-sized employers. CIT

Phillip Giles
Vice president for sales and marketing
QBE North America

Spring blooming

Spring Consulting's new captive is attracting interest from parties looking to fund medical stop-loss, although Karin Landry anticipates a healthy mixture of risks in the future

Karin Landry, Managing partner, Spring Consulting

What was the main driver behind setting up the Bloom Insurance Company, Spring Consulting's new series captive?

From the work we have done with our clients over the years, we saw a real market need for a turn-key captive solution that can be enjoyed by companies of all sizes that want the benefits of captive funding without the commitment and expense of starting one from scratch, particularly in the benefits arena.

How will the series captive work and what risks will it cater for?

Each company or group of companies that choose Bloom will rent a series within the captive structure. All series will share Bloom's pre-selected vendors including wellness, voluntary benefits, captive management and accounting services, which will save them significant administrative costs in the long run.

While we have seen the most interest in Bloom's early stages coming from companies looking to fund medical stop-loss, we anticipate a healthy mix of risks covered within the captive.

Are you seeing an increase in multinational pooling and captives being used to limit the cost of insurance employee benefits globally?

As captive consultants with an international client base, we are definitely seeing a movement globally to consolidate employee benefits portfolios among multinational employers by utilising pooling along with captive programmes.

Many global organisations have their own captives. For those that do not, a series or cell company is a possible solution.

Aside from the inherent cost and resource efficiencies gained in consolidating benefit plans, such a move also provides an employer with much better data and the ability to use the data to make more informed decisions.

Above and beyond cost savings, how else are captives being utilised to deal with employee benefits?

While cost savings are a big consideration in moving benefits to a captive, there are a number of additional areas that make such a funding structure desirable.

First and foremost is greater control over an employer's benefit plan design, data and funding arrangements after moving them to a captive.

An employer can create a plan structure that is most suited for their particular needs and has more direct access to their data, allowing them to make more informed decisions about the plan.

Additionally, captives offer an employer risk diversification and this includes benefit funding as well as property and casualty funding. CIT

Is your Manager listening?
THE RELATIONSHIP BETWEEN A CAPTIVE AND ITS MANAGER CAN DETERMINE A CAPTIVE'S SUCCESS.
Active Captive Management provides the following services:
• Captive consultation and risk analysis
• Feasibility studies
• Domicile recommendation
• Capital and collateral evaluation
• Access to national service provider network
• Company licensing and formation
• Underwriting and policy administration
• Captive financial reporting
• Claims administration
• Annual compliance and regulatory management
• Annual underwriting review
To request a risk analysis, visit us online at: www.activecaptive.com or call 800-921-0155
Active Captive Management provides management services in the onshore domiciles of: Alabama, Delaware, District of Columbia, Florida, Hawaii, Montana, Missouri, Nevada, New Jersey, North Carolina, Oregon, Oklahoma, South Carolina, Tennessee, and Utah. Off-shore domiciles include: Nevis.
ACTIVE CAPTIVE MANAGEMENT

The model student

The MJ Student-Run Insurance Company could become the model for risk and insurance education programmes, says Butler University's Zach Finn

Where did the idea come from to set up a student-run captive insurance company?

I was a risk management and insurance major in college and went on to have a whole career in risk management, which was fantastic and exposed me to all the areas of our industry. One of the best experiences of my career was managing a Bermuda captive. I also helped with the implementation of a second captive in South Carolina. For me, the opportunity to work with an insurance company on that scale was great.

When I started out, some of the accounting and investment classes didn't initially register with me because I lacked context. Working on captives exposed me to everything it takes to run and operate an insurance company, and how it all interfaces with a risk management programme.

After my career as a risk manager, I started the risk management and insurance degree programme at Butler University. One of the attractions of Butler was the full experience of learning. The students do two internships for academic credit, which is unique in the US. We have finance students at the university managing $2 million and making real investments with real risks, and I thought to myself, why can't we do this with a real captive?

What processes did students go through to set up the captive?

I have done many feasibility studies throughout my career, so with my guidance and that of another former risk manager, Kevin Thompson, who used to work at Eli Lilly, we put together the captive experience for the students.

Last year, our students carried out a full captive feasibility study. We had two teams and assigned four domestic domiciles and two international domiciles to each. They completed a good analysis on capitalisation, surplus ratios, liquidity requirements, and all of these different things. I then asked students to contact all of the regulators, as I wanted to see who reached back to them, who treated them like adults, and who treated them like real business partners and not just students.

We heard back from Vermont and Bermuda within four hours, but did not hear from a single other domicile. We were actually looking at other domiciles that we wanted to go to but because of their lack of response, it showed us they were not going to be the kind of innovative regulator we wanted to work with.

What service providers have you used in the process?

First, we want to thank MJ Insurance here in Indianapolis for financing this idea and getting the whole ball rolling. Once we began, we did the entire feasibility study ourselves, so where other firms might spend $30,000 to $50,000 on that, we didn't spend a dime. As a part of that process, we did a full-blown request for proposals for a captive manager. We spoke to Marsh, Strategic Risk Solutions, Willis and Aon. They were all fantastic and supportive, and each had a unique offering in their own way, but in the end we chose Aon.

We thought Aon had the most innovative approach. Aon was willing to not only see this as a transaction of managing captives, but also add an educational component to this so that we can train students on the processes of how to run and operate a captive, as well as get them engaged with all of the background material.

We appointed Aon as our captive manager and then Kevin and I travelled to Bermuda and met with various law firms. We also met with banks and auditors such as HSBC, which we decided to select as our on-island banking partner. We chose KPMG to be our auditing firm.

What steered you towards choosing Bermuda as the captive domicile?

A couple of advantages stood out. Top of the list was Bermuda's concentration of reinsurers and its position as a global centre for insurance. I know that some get the sense that the US is in an isolationist mood right now, but we are not training students for how some hope the world may be, we are training them for the world that actually exists, and we're a global economy. I wanted to provide students with a global experience and access to an international market.

The second advantage was Akilah Wilson, assistant director of licensing at the Bermuda Monetary Authority, and knowing that we were working with a regulator with a risk management degree from Temple University.

There are 400,000 jobs in the insurance industry that need to be filled, but the supply side is largely ignored. There are 1,900 accounting programmes in the US, there are 950 finance programmes, and there are 82 insurance risk programmes. To have so few graduates relative to demand is a heck of a supply chain risk for an industry that prides itself on being stewards of risk for the entire economy. In fact, I sometimes find that job descriptions are too basic for what my students can do. By working with someone like Wilson, who graduated from the fantastic programme at Temple University, we know she understands the power of this educational opportunity.

Thirdly, the Bermuda Business Development Agency went gangbusters to help us build relationships on the island, as we want to take on Bermudians at our undergraduate programme at Butler and we want students to intern and work in Bermuda, and vice versa. We are really trying to just bring those two countries together and provide opportunities for everybody.

When will the MJ Student-Run Insurance Company officially open for business and what is it going to insure?

We received approval on 7 April from the Bermuda Monetary Authority. We are licensed subject to a few little follow-up items, but apart from that, we are good to go. We will be accepting business as of 1 August. We are providing the first $150,000 on our fine arts, musical instruments and theatre props, and we are insuring our live mascot Butler Blue III, our very famous mascot for basketball, as well as our bomb-sniffing dog, Marcus.

We are also insuring our student-run businesses for the first $50,000 of commercial general liability exposure up to an aggregate of $100,000. We are insuring our planetarium and telescope.

It is amazing. We are an insurance class doing a loss control visit for the planetarium and identifying that for our telescope, the risk is water, so currently the dome closes whenever there is perspiration in the air, unless the power goes out. We have been able to insure that risk and for $2,000 put in a redundant power generator on the planetarium dome, so that it will never stay open in rain.

By setting up this captive, we were also able to identify that we are actually under-insured by $1 million and for a $2,000 investment, we could protect the oldest and largest telescope in the state of Indiana because our students identified those kind of recommendations.

With a quarter of the insurance workforce set to retire by 2018, do you think other universities will consider doing something similar in the future?

We are going to continue to run and operate our captive, so this will be an ongoing project. We will be doing renewals for the university every year and will continue to write and underwrite our exposures, and reinvest the captive's profits into loss control projects.

In addition, we want to structure a reinsurance programme, but ultimately in our fourth year of operation we are going to do another feasibility study to become a Class 2 captive and move to third-party business.

The industry is always looking for ways to support the talent crisis, but I see a lot of insurance companies trying to recreate the wheel on training and recruiting millennials.

What they really need to understand is the undergraduate programmes out there are doing a fantastic job. The industry needs to support more insurance and risk management degrees, and more insurance classes and programmes like ours. Our hope is that our student-run captive will become the model for risk and insurance programmes and that's exactly why we wanted to do it. **CIT**

Zach Finn
Clinical professor and director of the Davey Risk Management and Insurance Programme
Butler University

Running into trouble

Due diligence is needed to make sure that a captive is set up for the correct reasons and is handled by an experienced insurance professional, says Kim Bunting of River Oak Risk

How can captives run into trouble?

We will often be asked by a trusted adviser or a captive owner to review an existing captive that was set up without the adviser's involvement to determine if it was formed and operated properly. This is often triggered once the adviser becomes aware of the captive and learns facts that raise a concern.

When we do these reviews, we look at the formation documents, the business plan, the policies, financials, claims activity and documentation, as well as any other information available. Many times, especially for captives formed and operated offshore, there was very low capitalisation of the captive when it was formed and first became operational. The amount of capital we often see is far below what would be acceptable in a US domicile. This is a weakness that could subject the captive to risk if examined by the Internal Revenue Service (IRS).

It is also not unusual to see a captive without any apparent actuarial support for premiums, which exceed a reasonable amount given the size of the companies being insured and the risks being insured. Policies often do not conform with insurance industry standards and appear to be drafted by persons without any insurance experience. Many captives also have no risk distribution or inadequate risk distribution such that there is little to no chance of exposure to third-party claims. Claims are often non-existent and there is no claims programme or procedures in place in the captive programme.

These issues can lead to the conclusion that the captive is not a real insurance company. Not all of these issues are present in every captive we review, but the majority of the captives we review have some of these problem areas.

How do captives get into these kinds of situations?

Business owners are not accustomed to, or familiar with, running an insurance company and may not recognise how to choose a qualified manager, someone with extensive insurance and risk management experience. Also, key trusted advisers are not always involved in the process from the beginning to ensure that proper due diligence of the captive opportunity and the captive manager is done. Due diligence is needed to make sure that the captive is set up for the correct reasons and is handled by an experienced insurance professional.

It is critical for a business owner interested in a captive to insure his or her business to carefully consider who they will work with on the project and that the manager selected has the skillset based upon past experience to advise and perform the necessary captive management functions correctly. If the captive manager is hard selling a captive or selling tax benefits, this is a red flag that the manager is not in the business for the right reasons and probably does not have the right skill set. Business owners should avoid these types of captive managers.

What advice would you give to a captive owner in that situation?

In some situations, the best advice is to shut down the existing captive and then start a new captive that is set up properly from the beginning. Depending upon the owner's risk tolerance, another alternative is to change captive managers and have the new manager clean up the programme on a going-forward basis. We have been involved in both situations and in some instances the work needed to clean up an old programme equals or exceeds the amount of work in setting up an entirely new captive.

However, if the owner wants to be able to continue to utilise the capital and surplus built up in the original captive, this may be more desirable than shutting down the captive and starting over. The review and decision as to how to move forward is always a collaborative process between River Oak, the owner and the owner's trusted advisors as to what is the best alternative.

If the owner chooses to continue to operate the existing captive, we will completely overhaul the programme: implement a new business plan, with new policies, claims procedures and reinsurance based upon how River Oak operates a captive programme. The actuaries we work with will review, underwrite and price the new programme based upon River Oak's and their standards.

To avoid captives running into trouble, do you think there should be more education provided for potential captive users?

There is quite a bit of information available online about captives, however, it is hard for inexperienced people to determine the good information from the bad. Most US domiciles have information available on their department of insurance/captive division websites. The information provided there is useful and informative, and is a good starting point for someone interested in captives to learn about how the different domiciles operate and the differences in regulations in various states. There are also many opportunities at the US domicile annual conferences, along with the annual Captive Insurance Companies Association (CICA) International Conference, for people wishing to learn more about captives.

More could be done in terms of providing educational materials to business publications other than in the insurance industry to inform and educate business owners regarding captives, the benefits, costs and operational requirements. This has started to occur on a more frequent basis as the interest in captive insurance has spread to the middle market business owner and advisers. CIT

Kim Bunting
Chief operating officer
River Oak Risk

A noughties hit

SACs in Bermuda, first crafted in the statute in 2000, are a useful tool for both captive and commercial insurers, says Kim Willey of ASW Law

Segregated account companies (SACs), known as protected cell companies in other jurisdictions, have been a feature of Bermuda corporate law since the structure was first pioneered by private act of the Bermuda Parliament in the early 1990s. Although certainly not new, SACs continue to be a useful tool for both captive and commercial insurers. This article aims to reintroduce the concept of SACs by providing a refresher to readers on the structure and the merits of this corporate mechanism.

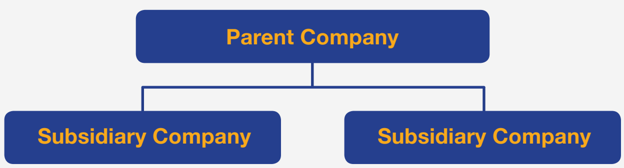
Although SACs could previously be established by private act, the current SAC regime was introduced by statute in Bermuda in 2000 through the Segregated Accounts Companies Act. Since the introduction of the SAC Act, Bermuda's SACs have been a popular vehicle in the insurance industry, both as a standalone structure, and via the 'rent-a-captive' model. A captive can either be registered as a SAC and set up its own segregated accounts, or use a segregated account of an existing Bermuda provider for a particular business programme, for example, a rent-a-captive.

What is a SAC?

The key concept is that the SAC Act permits a Bermuda company to set up separate accounts, the assets and liabilities of which are statutorily segregated from any other accounts and the general business of the company. This allows an insurer to place certain business, for example, a programme related to political risk in a developing country, in a different account than, say, business related to a worker's compensation programme in the US. The insurer is, therefore, able to ringfence its insurance business without going through the expense and complexity of setting up a new company.

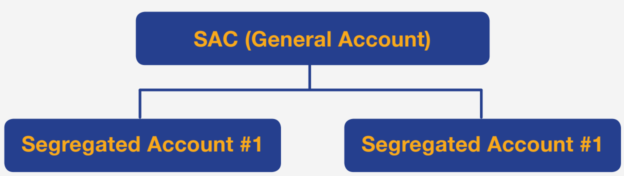
A traditional company/subsidiary structure would appear as indicated below in Figure 1:

Figure 1: Company/Subsidiary Structure



A segregated accounts structure, by contrast, would look as below in Figure 2:

Figure 2: SAC Structure



The SAC structure was successfully tested in the Bermuda courts in the case of BNY AIS Nominees v New Stream Capital Fund in 2009 known as the Gottex case. As illustrated, the segregated accounts are accounts, and not incorporated entities. A segregated account does not have a separate legal personality like a company. However, the SAC Act does provide that a SAC can enter into contracts, and sue and be sued in respect of a particular segregated account.

To evidence this process, the SAC will execute any contracts on behalf of its segregated accounts. For example, ABC Insurance acting on behalf of Segregated Account number one. Further, in the event of insolvency of a particular segregated account, it is possible for a receiver to be appointed in respect of that segregated account only without affecting the integrity of the rest of the structure.

How to set up a SAC

A party could either: (i) Set up a Bermuda exempted company and register it as a SAC; or (ii) rent a segregated account from an existing Bermuda SAC.

To set up a SAC, the party would need to incorporate a Bermuda exempt company and have a company licensed as an insurer by the Bermuda Monetary Authority (BMA) under the Insurance Act of 1978 and its related regulations. Captive insurers are generally registered as Class 1, 2 or 3 for general business, or Class A or B for long-term business. These classes of insurers are considered non-commercial, and are consequently exempt from the enhanced capital and solvency requirements applicable to Bermuda's commercial insurers under Bermuda's Solvency II equivalence regime.

The captive will need to hold an insurance licence, and comply with the ongoing requirements applicable to its relevant licence classification. This requires holding the minimum statutory capital in the general account, and collateral related to the business programmes in each segregated account. Only one licence is required even if the company has multiple segregated accounts.

The SAC is also required to appoint and maintain a segregated account representative in Bermuda who must be approved by the finance minister. In the case of an insurer registered under the SAC Act, this is typically the principal representative who is already appointed under the Insurance Act.

Rather than setting up a SAC, a party may elect to use an existing SAC structure. This rent-a-captive approach may be advantageous as it is relatively quick and easy to implement and the account owner will only pay its pro rata share of the operating expenses of the SAC. The account owner, however, will generally not have control over the SAC, although it may have authority to direct the operations of the segregated account if set out in the governing instrument, for example, through an advisory committee.

Regardless of whether a separate SAC or a rent-a-captive structure is used, the ownership of the segregated account will need to be documented. The SAC has considerable flexibility in how the ownership of segregated accounts may be structured. The parties

can craft documents that are suitable to their needs and the only essential requirements are that the governing instrument should be subject to Bermuda law and legal process.

The relationship between the account owners of a segregated account, the segregated account and the company can be: (i) contractual only; or (ii) by way of ownership of shares linked to a segregated account. In both cases, it will be governed by a governing instrument.

In the case of a contractual arrangement, this relationship will be documented by a participation agreement. In the case of a share arrangement, this will be evidenced in the bye-laws of the company, or a shareholders' agreement, or both.

A contractual participation agreement is generally the most straightforward structure, although there may be tax reasons as to why a share structure is preferred.

In the contractual structure the account owners enter into a participation agreement with the SAC and the segregated account, as illustrated in Figure 3.

Figure 3: SAC Structure - Participation Agreements

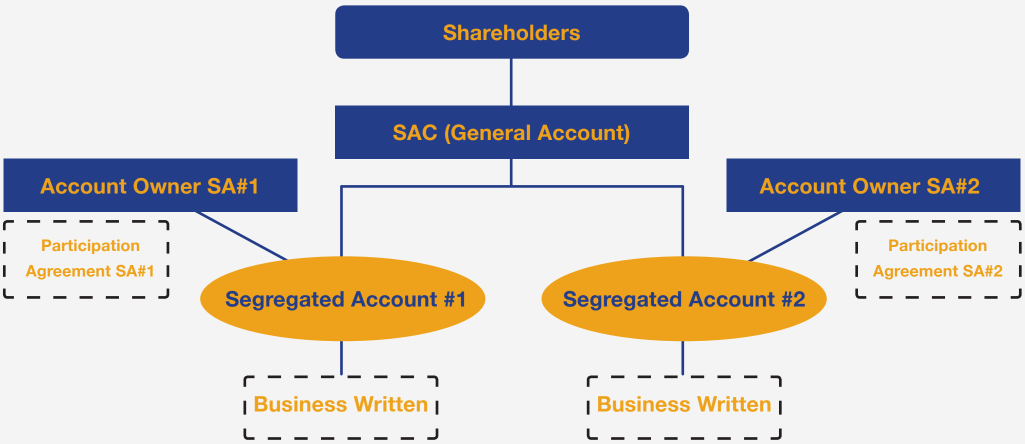
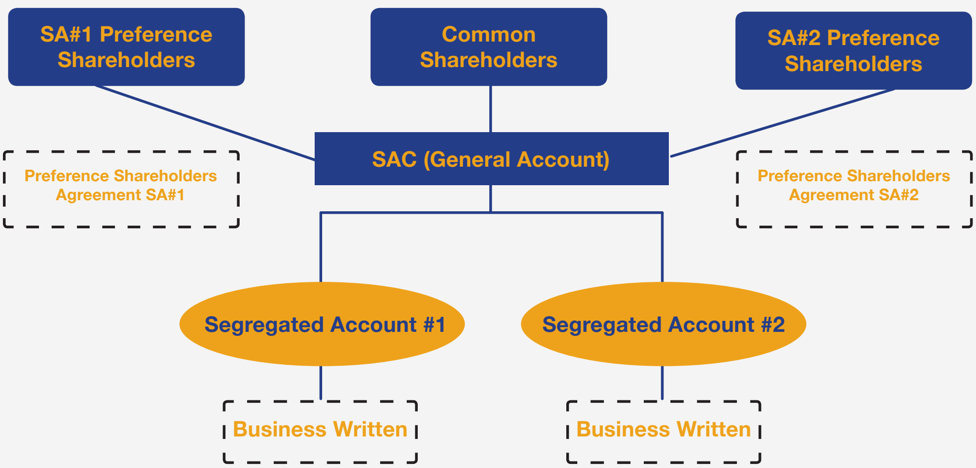


Figure 4: SAC Structure – Preference Shareholder Agreements



For share arrangements, generally preference shares of the SAC are issued, which are then linked exclusively to the segregated account, as shown in Figure 4.

The SAC Act provides significant flexibility in how the segregated accounts are structured. The parties are also free to draft bespoke terms on how profits and expenses are allocated, how business is written, and generally how the business of each account is managed.

SACs have also been used to house fully collateralised special purpose business, and to separate active and run-off programmes.

Consequently, SACs continue to be a useful tool facilitating innovation for captive and commercial insurers.

The BMA is also considering adding a further structure: incorporated segregated account companies (ISACs). ISACs will facilitate segregation through separate incorporated segregated accounts.

ISACs would have separate legal personality, but are expected to have a simplified incorporate and insurance regulatory process with the BMA.

ISACs and the success of the SAC structure demonstrate Bermuda's continued commitment to excellence and innovation in the captive and commercial insurance space. CIT

Kim Willey
Senior legal counsel
ASW Law Limited


R
I
S
K

The Far West

Ross Elliott of the Utah Captive Insurance Association discusses what attendees can expect from this year's Western Region Captive Insurance Conference

How are the likes of Arizona, Utah and Missouri faring in the current captive insurance industry?

All three states are experiencing solid growth in the number of captives being formed, despite the increasing number of states with captive legislation has increased the choices for a company to domicile. This past year's Internal Revenue Service initiatives have also affected the existing captive base as some companies have elected to voluntarily dissolve rather than attempt to comply with the burdensome regulatory demands. It is interesting to note that the regulatory staff in all three states has continued to mature and to add substantial depth of experience and knowledge.

How many attendees are you expecting at this year's conference? And is this an increase on last year?

As of now, we are expecting about 150 attendees. Our early registration count is up significantly over last year (about 20 percent).

We are also very appreciative of the substantial increase in the number of corporate sponsors and exhibitors. Using these early trends as indicators, we anticipate an extremely successful conference.

What can conference attendees expect from this year's conference?

From a content perspective, we have designed a two-track series of sessions—one track for owners and one for providers—that will engage, educate, and challenge them.

We have observed the value of networking and have incorporated time, both during the conference and at some fun events, which will allow us all to form and strengthen our mutually beneficial relationships to further the work of this fascinating industry.

What is the main focus of this year's conference and what topics will the agenda cover?

We have recognised the ratio of providers to owners in other conferences and have created sessions that will be beneficial to both groups, especially given the developments of the past year in political, taxation, economic, and technological arenas. For example,

one session will be presented by the Self-Insurance Institute America's chief lobbyist and will address the taxation issues from a political policy perspective.

Another session will address the insurance challenges of the sharing economy experienced by companies such as Uber, Lyft, or Airbnb. A third session will address the distinctions between insurance and business risks. Finally, there will be a session presented by a five-state panel of regulators as they respond to questions about current industry developments.

What conference sessions are you most looking forward to?

This is a difficult question for me as we have packed the conference with so many fascinating sessions with specific topics that are very relevant to providers, owners, and investigators. Honestly, one of the events that, as a 'people person', I am really looking forward to is the minor league baseball game on Tuesday evening at Smith's Ballpark. One baseball commentator said that this ballpark is one of the most beautiful parks in the country with a spectacular view of the Rocky Mountains just a few miles away. Going to the game should be on everyone's bucket list.

What do you think are important issues to tackle in the captive industry at the moment?

I have watched the explosive growth in this industry over the past few years and I hope that the relevant experience to form, manage, regulate, and analyse the results of these companies will mature and expand at an equally rapid pace.

Next, the impact of technological change appears to be having a positive impact, including cloud services, communications, software and social networking, and a negative impact, such as security and cyber vulnerabilities.

It needs to be harnessed for maximum beneficial use. One final observation is that many of our seasoned professionals appear to be ageing out of the industry and the need to attract and integrate their younger replacements seems to be growing each year. **CIT**

Ross Elliott
Vice president
Utah Captive
Insurance Association

Cityscapes Downtown_S_Greenwood

Power to the brand

Reputation insurance is an important part of any company's risk management strategy, according to Dr Nir Kossovsky of Steel City Re

News of the US Internal Revenue Service's (IRS) investigation of Caterpillar for its use of overseas tax shelters should have been a warning siren for corporate America that it's now time to review any special purpose financial instruments and vehicles to ensure they meet the stringent requirements of the US tax code.

This could create a specific challenge for firms that have created captive insurance companies as a means of both risk management and capital efficiency—and particularly as it relates to a relatively new product: reputation insurance.

The concept of reputation insurance arises out of a recognition that typical forms of business coverage, including directors and officers coverage, do nothing to protect companies, directors and executives in the court of public opinion. It's becoming increasingly evident that reputational damage is closely linked to tangible, measurable financial damage.

In fact, recent research by Steel City Re found that financial losses linked to reputational damage at public companies have increased by 461 percent over the past five years, due to a combination of generalised public anger, outsized expectations about corporate performance (leading inevitably to disappointment), and the weaponisation of social media.

This analysis of 7,500 companies over the five-year period, included more than 60 million data points, concluded that, in a world where anger, false news and unrealistic expectations all battle with truth for the minds of stakeholders, companies need a strategy for defending themselves before negative tweets and rumours start to circulate. Anger directed at companies is being personalised, placing directors and executives at greater risk than ever before. Companies need to communicate the quality of their governance with tools that insulate their brands and their leadership teams before damaging insinuations, moves by activist investors, and potential governmental involvement erode stakeholder confidence and depress share price.

Compounding these issues are that, when a reputational crisis hits, companies almost always underestimate the impact. Initial losses in market cap may seem small and a preliminary assessment of stakeholder reactions may seem muted. But as time goes on and the news sinks in, especially when government officials threaten to intervene, losses mount significantly, not only for the companies, but also for the officers and directors who often personally become targets.

Most commercial insurance policies available in the market today don't cover reputational risk, even though it applies to every company and its impact can translate into disloyal customers, disengaged employees, distracted suppliers, distrustful creditors, dismissive investors, determined litigators and regulators.

Clearly, though, given the trends we've described, reputation insurance products are a worthy part of any company's risk management strategy. When the reputation insurance products offered by commercial carriers are not sufficient in terms of capacity or other technical requirements, captive insurance solutions are useful alternative strategic instruments. Issues may arise, however, when the IRS scrutinises such policies offered by captive carriers.

The IRS requires companies and their captive insurers to show an actuarially sound basis for pricing, an underwriting process for accepting the risk, and clear indemnification terms for when events trigger claims. If they fail that test, the IRS could determine that investments in the captive insurance company were simply an effort to evade taxes and assess large financial penalties and potentially pursue criminal actions.

How does one meet that standard? And how does one provide expressive value—signalling to both the IRS and stakeholders that the coverage is based on sound principles and, so, reducing the likelihood of a challenge? Our experience of working with hundreds of captives may be instructive.

Corporate reputation is the sum of stakeholder expectations of corporate performance, which leads stakeholders to behave in financially relevant ways, such as how creditors set borrowing rates, how suppliers set terms, how customers respond to products and prices and how effectively employees perform their jobs. Reputation value lost, which is the cost of disappointment, is similarly the sum of economic value arising from behaviour. Simply put, angry stakeholders destroy value.

Reputation protection solutions must manage emotions, measure the financial impact objectively and indemnify going-forward losses, which most commercial insurance products today don't do. They may measure financial losses or the costs incurred in trying to repair a firm's reputation, but they do not address the emotional element, nor are they designed to address going-forward losses.

Steel City Re has been measuring this behaviour for more than 15 years and has created indexed measures of reputation value evidenced by the telltale signatures left by stakeholders. That enables us to form actuarially sound conclusions about insureds based on information that includes:

- Schedules of enterprise governance, risk and compliance processes and procedures
- Board oversight procedures if applicable
- Notices of non-compliance from any governmental authorities
- The presence of any adverse media or non-governmental organisation reports
- Events which may have been considered reputational events

From these metrics, we conduct underwriting, set rates and provide products that offer clear instrumental value as well as credible expressive value, communicating the quality of governance and deterring attacks in much the same way as a security alarm sign in front of a house.

Clearly, we are in an environment where more and more companies are looking at captives as an attractive option. They can allocate equity in the captives to key executives and directors, giving those individuals greater incentive to make decisions and take actions that reduce risks and avoid claims that adversely impact the long-term value of the firm.

This can also address some of the weaknesses in traditional compensation plans that are mainly short-term oriented and provide greater assurance that the amount and timing of payouts reflect long term results and value creation.

How to structure the coverage captives provide, however, particularly as it relates to reputation insurance, requires a rigorous approach, utilising public market based parametric triggers/indicators and parameters applicable to captive based risk bearing.

But this is not merely an exercise in how to structure a complex loss-absorption vehicle in ways that meet IRS muster. With the changing communications and political landscape, reputational insurance products can provide valuable protection, not only to the business entity, but to individuals in leadership positions.

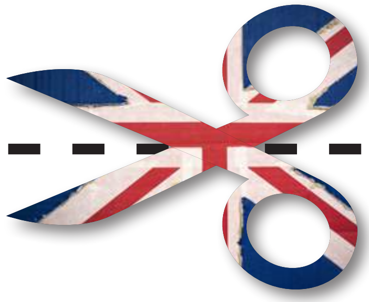
Today, it's not only brands that are at risk—it's personal. And whether it is fake news or real news, attacks by a small number of individuals or a significant portion of the marketplace, it can permeate the environment and cause massive damage in a short period of time.

Directors are learning the hard way that they may personally be more vulnerable than the well-known corporate brands they oversee. Directors are being targeted and replaced, with 16 percent of board members at companies we studied having been replaced after reputational events.

On average, a corporate board member makes about $250,000 per year to sit on a board and usually serves on more than one. If a reputational attack leads to that board member stepping down—and potentially not being asked to serve on additional boards—it could represent significant lost personal income.

For all these reasons, companies are finding reputation insurance a timely form of protection and the captive an attractive vehicle for providing it. The key is designing products that provide both instrumental and expressive value, as well as the many benefits that captive insurance vehicles can offer, while standing up to increasing regulatory scrutiny. **CIT**

Dr Nir Kossovsky
CEO
Steel City Re



A cut above

Richard Paris-Smith of Willis Towers Watson explains how the UK's recent changes to the Ogden discount rate will affect captive insurers

The UK chancellor has recently announced a significant reduction in the Ogden discount rate, which is used to adjust lump-sum compensation awards to injured parties, to account for future income through investing the pay-out. The cut from 2.5 percent to -0.75 percent was far more dramatic than expected.

With the rate having remained unchanged since 2001, this decision might be viewed as overdue and over-done. Even while the insurance market absorbs this change, and the full impact is as yet uncertain, the position may be set to change again in the near future.

Under considerable industry and media pressure, the government has announced a new six-week consultation to review the process for setting the discount rate. Some reports are indicating that claimants are anticipating that the discount rate will go back up, and many are settling claims at positive discount rates.

In the meantime, the commercial market has been considering the chancellor's original decision. Motor insurers and reinsurers are likely to be most affected, but writers of other liability lines will also be affected. Exposed companies will consider:

- Making a one-off provision increase for unsettled claims relating to business already underwritten, affecting their results for the year
- Assuming higher claims costs when reserving for future business, and therefore adjust their premium pricing models accordingly

This decision seems likely to counter the positive effect on claims costs of recent whiplash reforms, and to result in material rate increases in the motor sector. Ahead of the announcement, some of the UK's largest motor insurers had already stated that they had provisioned for an expected reduction in the Ogden rate to somewhere between 1.5 percent and 0 percent. With the rate actually falling to -0.75 percent, insurers may have to further strengthen their provisions.

Some sources predict significant hikes in motor premiums, with one off reserve increases of more than £5 billion. Even so, as most large insurers have portfolios that are well diversified by geography and business line, the impact of this change on overall earnings and capitalisation is likely to be limited.

Captive insurers also need to understand the impact of this measure on their reserves and future business models.

The exposure of many captives is limited through policy limits or reinsurance protection to both 'any one claim' and 'aggregate' limits. To this extent, the effect on captive reserves may be to push certain individual claims up to their claim limit, and in so doing, push the aggregate claims up to (or towards) the relevant aggregate limit.

Captives may find that the claims most likely to be affected are life-changing injuries and will be relatively few. These may already have breached their per-claim limit, and therefore not lead to any deterioration in the captive's results.

Because of this, the impact on existing captive reserves and the provisioning for future claims may be limited. If a captive continues to write the same limits, it is logical to conclude that the number of claims approaching the limit, or the probability that aggregate limits will be breached, may increase—but not to the extent suffered by the commercial market with its larger and more open-ended exposures.

Nevertheless, the impact should be examined based on each captive's programme, with an accompanying review of current reserves and pricing for the captive policy.

For captive owners, the dynamics around retained and externally insured risk may change as higher projections of future claims performance lead to increased 'ground-up' premiums, and a change in the levels and terms at which commercial insurers and reinsurers are willing to offer cover in excess of captive retentions.

As liability market prices increase as a result of this development, the price for captive policies dealing with these risks will also increase.

However, arguably, the merits of a self-insured captive approach could actually be enhanced, as parent organisations deal with pressures to purchase adequate policy limits at increased rates. And if captive balance sheets hold their own following the Ogden decision, they should remain well placed to assist their parent companies to deal with this risk. **CIT**

Richard Paris-Smith
Executive director
Willis Management
(Guernsey) Limited


RISK IS EVERYWHERE.
IT TAKES VISION
In today's world, complacency has a cost. Unforeseen risks can even bring down a company. To go beyond oversight and bring insight, rely on one of the global leaders in actuarial and risk consulting. Because the status quo really isn't an option. To learn more, visit milliman.com/captives.
Milliman

Resolvent-cy II

Many captive owners are exploring alternative forms of capital in order to strengthen their capital base in a more efficient manner, says Brian McDonagh of Marsh

How well is the Ireland insurance industry doing? Are numbers still on the up?

A review of the list of regulated insurance and reinsurance undertakings produced by the Irish regulator, the Central Bank of Ireland, shows that overall numbers for licenced insurance and reinsurance entities are down year on year, 2016 to 2017. Behind that headline number are myriad stories and views. For instance, this is a reversal of the positive developments during the 2015 to 2016 period when Ireland experienced an increase in the number of new captive authorisations issued by Central Bank of Ireland.

The continuation of the soft insurance market is probably the main driver, a story that resonates globally. Ongoing consolidation of regulated entities owned by multinationals (both captive and non-captive) could be another factor in the downward trend. However, one should not assume a trend based on a one-year review.

Surprisingly, the number of captives increased during 2015 in advance of the implementation of the new Solvency II regime. However, it does appear that the market is currently waiting to see an appropriate application of the proportionality principle to the regulation of captives (as defined within that legislation) in the new Solvency II era.

Dialogue between European Insurance and Occupational Pensions Authority, local supervisors and the insurance industry needs to be reflected in a proportionate approach to the supervision of captives and lower-risk entities to ensure the continued growth of ‘onshore EU’ as a sustainable location for captives.

What trends are you currently seeing in the captive insurance market in Dublin?

Under the banner of Solvency II, many captive owners are exploring alternative forms of capital, second- and third-tier capital, in order to strengthen their capital base in a more efficient manner. To date, options including the use of letters of credit, parental guarantees, subordinated debt, and unpaid share capital have received regulatory approval.

We are seeing a greater call for the services of captive managers and advisors as captives address evolving aspects of the solvency capital requirement optimisation and focus further on a fully integrated service solution across all three Solvency II pillars.

The owners and managers who have fared best through implementation are those who have invested in integrated IT platforms to ensure maximum automation with respect to solvency capital requirement calculation and reporting. This again has proved to be crucial as we move through the first annual reporting cycle due in mid-May.

Multinational organisations have increased their focus on consolidation and alignment of their global employee benefit costs, which continues to be the single biggest growth area for these firms. Many multinationals are involved in projects and feasibility work or have gone to the implementation phase, which often involves using a captive for portions of that retained employee benefit risk.

There appears to be little doubt that the sophistication by which non-life covers have been managed by multinationals for many decades will be replicated in the employee benefits space over the medium term.

Cyber is the other high profile risk area. This is reflected in the increase in the number of captives underwriting that specific risk.

Finally, there are many conversations around the virtual captive concept and once again that will continue to be an area for rapid growth.

How is the reinsurance industry developing in Dublin? Are you still attracting new clients?

My personal view is that aspects of the continued development of the reinsurance industry market have been 'on hold' for a number of years as the uncertainties of how the Solvency II regime will be supervised in each EU location continue to play out.

That uncertainty may now be offset by opportunities created in the aftermath of the Brexit vote and the triggering of Article 50 in the UK. Brexit represents an opportunity for the reinsurance industry and the larger international financial services industry in many EU locations, including Dublin.

Specific to the Dublin reinsurance market is the continued growth of the insurance linked-securities (ILS) sector. There have been many repeat bond issuances replacing the typical three-year cycle afforded to each catastrophe bond programme and Dublin has seen new entrance to this specialised market in the past 12 months.

How is Ireland faring against economic uncertainties at present?

There never will be, nor should there be, a period when world economic uncertainties do not have an impact on how people go about their business. How one reacts to those uncertainties determines whether these are threats or opportunities. Since the 1950s, Ireland has pursued a strategy of attracting foreign direct investment essentially to provide employment opportunities to a growing population. Since that time, Ireland has managed to remain an attractive location for multinationals by providing a well-educated English-speaking workforce and a stable commercial, business, and tax environment.

This strategy has remained the cornerstone of every government since that time and has proved to be a successful strategy even up to today. As a result, it is likely that adapting to each new global reality has been subsumed into the fabric and culture of the international financial services sector here.

How has Brexit affected Ireland as a captive insurance and reinsurance domicile?

To date, the Brexit project has being an exercise in contingency planning. While some operations currently based in London have made decisions on where and how they may reorganise themselves in a post-Brexit environment, most are still researching and/or considering their options.

The decision of 'where' is the opportunity for other EU financial centres, including Dublin, and we are keeping as close as possible to those prospects.

The existence of an international insurance market, combined with a regulator who has staffed up in expectation of new applications, make me optimistic that Dublin will land more than its fair share of those opportunities.

As a further angle to this, EU captives who access the UK commercial reinsurance market will also need to follow developments closely. Current thinking is that it is likely the UK will look to achieve "equivalence" similar to Bermuda, Australia, Japan, and Switzerland.

This equivalence status would be necessary to ensure appetite for EU companies to access the UK reinsurance markets.

In addition, credit ratings for reinsurers and insurers should also be closely monitored for potential downgrades and knock-on effects of the captive's solvency capital requirement under Solvency II. **CIT**

Brian McDonagh
Managing director
Marsh Captive Solutions Dublin

Change the game

Attendees of this year's European Insurance Forum can expect a full and comprehensive agenda. Eddy Van Cutsem explains

The European Insurance Forum (EIF) is Ireland's flagship international reinsurance and insurance event that has been in the calendar of insurance executives since 1999. The conference has built a reputation for considering the strategic trends and challenges affecting the reinsurance and captive industry. It is Dublin's opportunity to bring together local industry executives, leading international speakers including global industry experts, thought leaders and change makers, to debate and consider how our industry is positioned for the future. This year will be no different. At the conference, speakers, exhibitors and participants will descend on Croke Park, an iconic Irish sporting venue, to share their thoughts on the strategic topics of the day under this year's conference theme 'Change the Game'.

Our industry challenges, which are forcing us to re-examine some of our business fundamentals, include the impact of low yield investments, changing international taxation, base erosion and profit shifting (BEPS), Brexit and geopolitical uncertainty and of course an ever evolving regulatory framework. EIF gives executives time to consider the path to the future and share ideas and experiences.

Keynote speakers

Eoghan Murphy, Irish minister of state at the Departments of Finance and Public Expenditure & Reform, will explain IFS2020, the ambitious strategy and action plan for Ireland's international insurance and financial services sector. The Irish government's strategy aims to to ensure Ireland continues to compete on the world stage and has the skills and infrastructure to be a domicile of choice for financial services organisations—whether that's start-ups looking to build a business or companies looking to avail of freedom of services (FOS) and freedom of establishment (FOE) to write cross-border business in the EU from an Irish base.

The conference will also feature Denis Kessler, chairman of the board of directors and CEO of SCOR SE. We are thrilled to have Kessler whose reputation and track record position him as one of our industry's global leaders. We have invited award-winning British journalist, broadcaster and author Paul Mason to give us his insights on what drives current political trends of nationalism and populism in the US, UK and Europe. He will look, slice by slice, at the demographic layer cake that has emerged in recent elections and asks, for the eurozone and the UK—where will the next five years lead?

The low yield world: How well is the industry coping?

Low long-term investment returns for 'safe investments' have been around for close to a decade now and, in Europe, the European Central Bank may keep yields low for some time to come. With a panel including an investment manager, a retail banker, an annuity provider and a rating agency, we should be able to cover all aspects of this dilemma.

International taxation

Where to start? The Organisation for Economic Co-operation and Development (OECD) has rolled out its BEPS plan, the EU is still tinkering with the common corporate tax base, the UK's tax strategy is likely to be affected by Brexit, and the Trump administration has announced changes in US tax rules and lower tax rates. The panel's tax practitioners will attempt to make sense of it all.

Innovation and technology

Can we distinguish the hype from real industry trends? How can we spot the game changers and how can we become game changers ourselves? The answers to these questions may well determine the survival of your company.

Remember Sony's Betamax video standard? It was technically superior, but the VHS standard won nevertheless. Or more recently, BlackBerry and Nokia handsets have become obsolete as these once leading manufacturers did not keep up with the smartphone trend. Investing in relevant technology and anticipating consumer and industry trends are not a luxury but essential to thrive and be successful. Technological innovation brings significant efficiencies but also new risks. Captives can and should play an active role in managing and financing technology risks.

Brexit

The impact on the shape of Brexit is uncertain, except that regulators want companies to prepare, and sooner rather than later. The Bank of England has written to UK financial services firms asking them to send a summary of their contingency plans for Brexit to the Prudential Regulatory Authority (PRA) by July. The PRA believes planning is "uneven", and "plans are not being sufficiently tested against the most adverse potential outcomes".

Sam Woods, chief executive of the PRA, said it expects the industry to undertake "appropriate contingency planning" for Brexit and send the PRA written confirmation that management has considered contingency plans by July this year, along with a short summary of these plans and assurance that they address a wide range of scenarios.

The PRA will use the responses in its own planning and will share the information with the Financial Conduct Authority. While this concerns the UK only we can expect EU regulators to request similar planning for companies with business in the UK which will be affected by Brexit. Captives will not be immune to Brexit-related changes and captive owners will need to be well prepared.

Domestic and international outlook in the age of ultra-regulation

Gerry Cross, the Irish Central Bank's director of policy and risk, will address the conference and explain the Central Bank of Ireland's approach to insurance regulation and current priorities regarding supervision.

Cross will also join international speakers from the European Insurance and Occupational Pensions Authority, the US and international industry, in a panel session to discuss international regulatory cooperation, coordination and harmonisation, the likely future of Solvency II in an autonomous UK, and the announced roll-back of the Dodd-Frank Act in the US. CIT

Do you want to be effective, or do you just want to follow the rules?

Rule-focused decisions have kept captives from delivering full value, say Carrie Lam and Steve Prince of Collins Barrow

Fort McMurray, earthquakes, ice storms and floods—we have all seen the headlines about natural disasters and how they affect individuals, businesses, and whole communities. When you are involved in running a captive insurance company, these issues are not just something you read about in the paper, they affect your company, your operations, and your personal credibility as a manager or executive of that operation. The big questions are always: how ready are you, and how do you know you are ready?

But we complied with all the rules

In many captives, risk management has become a generic concept. It focuses on compliance with the rules—whether the captive has enough cash on hand, completed the requisite forms and filings, and followed company protocol. But when a financial disaster hits your captive, it will be little comfort to the board if you tell them that even though they are now insolvent, it is not your fault. After all, you complied with all the rules, what more did they want? The answer is quite a bit, actually. Boards expect management to be prepared and proactive, not merely compliant.

So it is not surprising to find boards asking, just how safe are those government rules? Does the regulatory capital limit protect us from a 1-in-10-year event or from a 1-in-100-year event? The regulatory rules do not answer that question for you. It may very well be that the government rules are more than adequate, but you may want some sort of analysis to support that statement, rather than just take it as a given.

To do this, you need your own assessment of how much risk you are exposed to, how likely you are to draw on your capital, and whether your capital is sufficient. You would also need to determine and justify at what point can you sleep well at night knowing that you are prepared.

Risk management does not mean risk avoidance

Some companies we work with respond to the concern of adverse claims by passing off even more of their risk to reinsurance companies. A good reinsurance programme will certainly reduce your downside risk, but it comes at a cost in the form of reinsurance premiums that are paid even when times are good. What is the right trade-off?

The same risk assessment models that help you decide whether your capital is adequate can and should be used as tools to help you strike an optimal balance of risk and reward in your reinsurance strategy. If you had access to more capital, you could retain more risk and spend less on reinsurance. Conversely, with more reinsurance, you could release some of your capital to your owners or stakeholders.

In determining the optimal reinsurance strategy, the board needs to consider whether it could withstand some year-to-year fluctuations if that produced a lower overall cost, or do they want stable results every year? Adding further sophistication, is there some way to diversify the risks, rather than just think in terms of the one-dimensional more/less view?

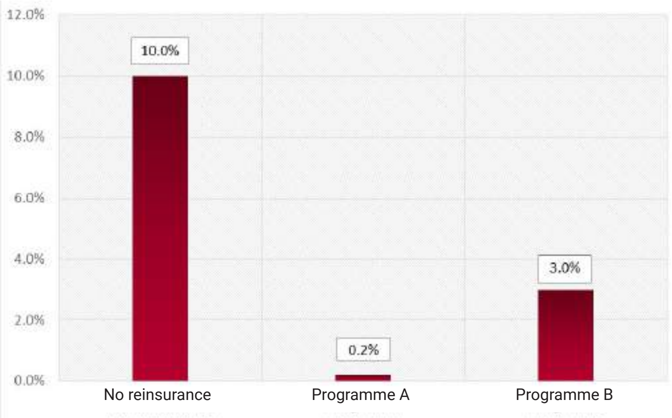
Complex math, understandable explanations

We, as actuaries, have a tendency to come up with rather complex math as a way to analyse and quantify risk. While some statistics might disagree, our charts are some of the best in the business.

However, the analysis and charts are just tools, the objective of all this complex math is to help management do a more effective job of managing their business.

For example, you are running a captive and worried about the downside of adverse claims, and trying to decide between reinsurance programme A and reinsurance programme B. As a baseline, you also look at results without any reinsurance, what are the odds of losing money overall under none, A and B options? The answer to in this Chart 1.

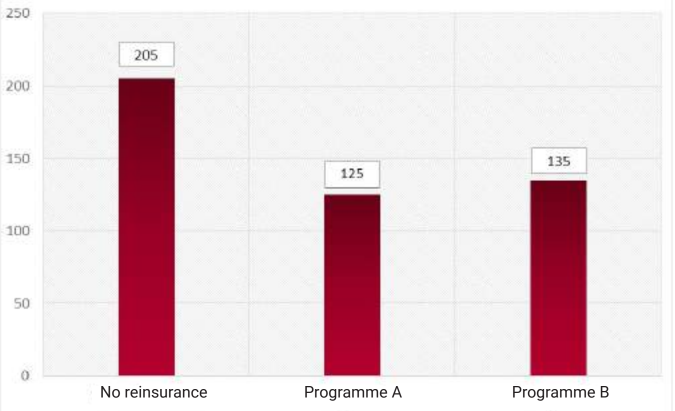
Chart 1: Probability of losing money



The no reinsurance option looks like it will result in a loss once every 10 years, which is probably not acceptable, but now you have quantified your exposure in a meaningful way rather than just saying it would be "too risky".

Programme A looks like the clear winner, with a loss less than once in every 100 years, but at what cost? Chart 2 shows the average profit of the three options.

Chart 2: Average profit



Programme A costs $80 per year, but the question is whether that is an acceptable cost given the fifty-fold reduction in the odds of losing money. Programme B does not look nearly as enticing given that it costs $70, however has a much higher chance of losing money.

Neither of these charts answer the question of how much reinsurance is the right amount, but the point is that you have numbers to work with and base your decision on. If the losses under programme B are considered manageable, given its lower cost, it might still be a better fit.

Maybe you can live with the downside?

The right risk analysis can lead to some surprising insights and show that sometimes concerns are overstated. Yes, there is an exposure, but it may not be as likely or not as severe as you think.

The right analysis can put some numbers on it. In one case we worked on, the 'worst case' that everyone was worried about translated into a 25 percent increase in fees for their members.

A 25 percent increase is presumably something that management would like to avoid, but hardly the end of the world as worst cases go. With that analysis in hand, the company was able to move forward with more confidence than it had previously.

Your actuary can be your friend

Everyone agrees there is risk out there and it needs to be managed, however there is a smart way to do it beyond just following the rules or avoiding risks.

With help from your friendly neighborhood actuary, risk can be your friend if you are prepared for it. The right risk analysis can help you navigate the way forward. **CIT**

Steve Prince
Head of the stochastic modelling unit in Toronto
Collins Barrow

Carrie Lam
Senior manager of actuarial services practice in Toronto
Collins Barrow

Jo Willaert, the president of the Federation of European Risk Management Associations (FERMA), has been elected as the president of the International Federation of Risk Management Associations (IFRIMA) for a two-year term.

The election took place at the IFRIMA meeting during the annual RIMS conference, held between 23 and 26 April in Philadelphia.

Willaert said: "During my presidency at IFRIMA, I want to focus on strengthening and reinforcing the dialogue and cooperation among risk management associations worldwide—so ensuring coherence in the actions and development of risk management globally."

"To do this, I will build on my experience as president of FERMA representing a network of 22 associations in 21 European countries."

During the meeting, IFRIMA also revealed the admission of a new member, the German risk management association GVNW.

The addition of GVNW brings IFRIMA's membership to 21 risk management associations worldwide.

Patrick Walsh has been named the new executive vice president and chief claims officer of York Risk Services Group.

York is a provider of claims management, managed care, specialised loss adjusting, alternative risk programmes, pool administration and other insurance services.

Walsh will take on the responsibility of York's national claims operations, as well as leading its risk management practices group.

Commenting on his appointment, Walsh said: "I'm very excited to be taking on this responsibility. York is unique in the market, with a broad service and product set focused on delivering solutions customised for our clients."

He added: "We have the tools that enable us to provide the highest level of service and make sure we are capable of constantly helping people and businesses."

John Harris has joined Brady Risk Management to head up the company's newly formed Brady Risk Program Managers.

Harris will serve as managing director of Brady Risk Program Managers, which has established a health care risk management solution to assist healthcare companies with their risk management and to take advantage of the inefficacies in the marketplace, specifically with regards to workers compensation.

He has worked in various roles for national insurance companies, and brings knowledge of the alternative risk transfer market.

In the past, Harris has presented at industry events including the Captive Insurance Companies Association conference and the Vermont Captive Insurance Association.

A statement from Brady Risk Program Managers said: "We are excited to help companies across the country with the unique and proprietary solutions they have developed and employed."

Ian Davis has replaced Dan Towle as the new director of financial services in Vermont.

Davis, who took over from Towel toward the end of April, is responsible for the marketing and business development for Vermont's captive insurance industry. CIT

captive insurance times

Editor: Mark Dugdale
markdugdale@captiveinsurancetimes.com
+44 (0)203 750 6017

Deputy Editor: Stephanie Palmer
stephaniepalmer@blackknightmedialtd.com
+44 (0)203 750 6019

Reporter: Becky Butcher
beckybutcher@blackknightmedialtd.com
+44 (0)203 750 6018

Associate Publisher/Designer: John Savage
johnsavage@captiveinsurancetimes.com
+44 (0)203 750 6021

Publisher: Justin Lawson
justinlawson@captiveinsurancetimes.com
+44 (0)203 750 6028

Marketing Director: Steve Lafferty
design@securitieslendingtimes.com
+44 (0)203 750 6028

Office Manager: Chelsea Bowles
accounts@securitieslendingtimes.com
+44 (0)203 750 6020

Office fax: +44 (0)20 8711 5985

Published by Black Knight Media Ltd

Black Knight Media Ltd
Provident House
6-20 Burrell Row
Beckenham
BR3 1AT, UK

Company reg: 0719464

Stay connected with Captive Insurance Times on Twitter, Facebook and LinkedIn

www.captiveinsurancetimes.com

PARIMA is the Pan-Asia Risk and Insurance Management Association. It is a not for profit professional association dedicated to develop risk management as a profession and provide a platform for Risk & Insurance managers to connect. We aim to strengthen and enhance the culture of risk management by creating opportunities for education and dialogue within the community. Join us to get access to risk management tools and receive exclusive invitations to major regional events, workshops and educational seminars.