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Captives should avoid Washington state if possible, says Queen

Captives that do not have to do business in Washington state should do everything they can to stay out of the state, according to Matthew Queen, general counsel and chief compliance officer at Venture Captive Management.

In December, the Washington Insurance Commissioner announced his plan to offer captives that have 'unlawfully' insured risk in the state the chance to pay a substantially reduced fine and penalty if they self-report the activity.

Commissioner Mike Kreidler is offering such captives an 18 month grace period in which to self-report the activity and pay significantly reduced fines and premium tax penalties.

Following the grace period, which begins 1 January 2019 and closes 30 June 2020, the commissioner will pursue maximum fines and tax penalties.

Queen said the complexity surrounding the field of state and local tax made the position that the commissioner was taking very concerning.

He commented: "What strikes me about the state of Washington is that they're taking the most aggressive position they can on state and local taxes, which is a very concerning position given that the field of state and local tax is in of itself very complex."

"I question whether the position Washington is taking is within the boundaries of the law."

"The real problem with any state or local tax issue is that you can take a position and defend it, and that is not really conducive to good governance."

read more on p6

What financial challenges does your captive have?

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CB-67921-05 05/18

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Published by Black Knight Media Ltd

Company reg: 0719464

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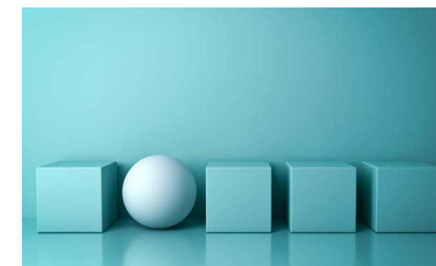

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Captives should avoid Washington state if possible, says Queen

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Queen continued: "There are a couple of states where from a captive insurance standpoint if you do not have to do business there you should do everything you can to stay out of there–New Jersey, Washington and a few others."

"Those states are taking a grey area and then wielding it like a weapon. If you don't need to be there, minimise your exposure there."

Queen suggested that he believed that the commissioner would follow through on his threat to pursuing maximum fines and tax penalties following the 18-month grace period.

"Washington is one of the most aggressive states. What they have done with the Microsoft case is send a message. Microsoft is the big dog in Washington and by going after them, they're telling everyone else to get ready.

"They're actively trying to establish a new regime, and I believe it's on shaky constitutional authority."

Queen said it would be impossible to characterise the state, which had consistently taken an anti-captive stance, as captive friendly.

"If you look back over the past 15 to 20 years of captive insurance in Washington state, it has been a very difficult place to do business. And as a result, if you don't have to be there, don't."

"My advice would be to look at what they're trying to hit you with, if the cost of compliance exceeds the cost of fighting then you fight. It is as simple a calculus as that."

Queen suggested that while some of the traditionally captive friendly states were very unlikely to follow suit, other states could take a similarly aggressive stance.

He added: "To the extent that this does sweep across the country and set some sort of precedent, you should absolutely expect captive managers to start taking a more aggressive position."

But Queen noted that given the complexity of the state and local tax, a decisive victory in one state would not necessarily have any bearing in another state.

He explained: "State and local tax in its varying forms is one of the least visited areas by the US Supreme Court."

"We have a fundamental lack of understanding at the Supreme Court as to what constitutes due process as it relates to the state and their ability to tax companies within their states, as a result, you should not expect any meaningful clarity on this for the rest of our careers."

"This is a great battleground that has existed since the mid-1800s and is just never going to stop."

Automotive sector leads new captive formations in Bermuda

The automotive industry took the top spot for new formations by industry of parent company in Bermuda in 2017, according to the BMA's 2018 Captive Report.

The report highlighted results from statutory financial returns submitted through the BMA's electronic statutory financial return system as of 31 October 2018. The new system officially launched in April 2016 for financial year-end returns for 31 December 2016 onwards.

The report showed that 50 percent of new formations by industry of parent company come from the automotive industry, while 25 percent come from financial institutions. In addition, 13 percent come from education and 12 percent from the energy, power and utility sector.

Although the automotive industry led new formations by industry of parent company, financial institutions continue to be the most significant industry of parent companies, with 16 percent.

Following from financial institutions was the shipping, transport and storage industry with 12 percent, automotive, manufacturing and retail and 11 percent, and healthcare at 10 percent. All other industries represented under 10 percent.

In the report, the BMA stated: "Bermuda continues to be home to a broad range of industries utilising captives as a key risk management tool."

In terms of geography of risk assumption, North America and Bermuda continue to hold the top spot with 67 percent. Europe falls in second place with 21 percent of risk assumption, while Japan sits third with 4 percent.

Central and South America, the Caribbean and the rest of Asia sat at 3 percent, Africa and the Middle East sat at 2 percent and Australia and New Zealand just 1 percent.

The report stated: "In 2017, as in the prior year, the majority of risk assumed by Bermuda captives originated in North America and Bermuda—69 percent—and Europe—19 percent. This is unsurprising considering 75 percent of captives have a parent in these domiciles. The authority observed an increase in business written from the US and a reduction in EU business in 2017 as compared to 2016."

Pure captives continue to dominate as the most popular captive structure and saw an increase of 4 percent for 2017.

Pure captives were also the only captive type to be formed in 2017, compared to 2016 when association captives and 'other' types of captives were created.

Guam governor vetoes captive tax break bill for Core Tech

Guam governor Eddie Calvo has vetoed a bill that granted tax breaks to Core Tech Captive Insurance Corporation (CTCIC), the captive insurer of Core Tech International.

Bill 363, which was passed by the Guam legislature on 17 December 2018, approved the qualifying certificate (QC) negotiated by CTCIC and the Guam Economic Development Authority (GEDA).

The QC programme, which has existed since the 1960s, is an economic incentive to encourage investment in activities that strengthen the island's economy.

The programme offers significant tax breaks, including a 75 percent rebate of corporate income tax for up to 20 years.

In the case of CTCIC and Bill 363, the terms of the QC were altered by the Legislature to increase the income tax rebate to 100 percent and to add an additional abatement of 100 percent of gross receipts tax.

Governor Calvo said the "illegal bill" and the 2019 Budget Law from where it claims to derive its authority "are inorganic and void ab initio".

Calvo added: "The Legislature has impudently taken it upon itself to change the terms of the QC contract that was negotiated by GEDA and Core Tech and approved as to form by the attorney general."

"The Legislature is without power to approve, disapprove, or change the terms of a contract entered into by the executive branch."

"Bill 363 and its enabling section in P.L. 34-116:XIII:8 (the 2019 Budget Law) represent an inorganic legislative encroachment on an exclusively executive power."

"Inorganic laws such as Bill 363 and P.L. 34-116:XIII:8 are void ab initio, or null from the beginning and without any legal effect."

The Core Tech QC application saga has been ongoing for multiple years. CTCIC received its certificate of authority to offer captive insurance services on 1 July 2016 and had its QC recommended by GEDA in January 2018.

New York small employer stop-loss insurance protected

New York governor Andrew Cuomo has signed legislation that protects the state's small employer self-insurance marketplace for two more years.

On 26 December 2018, Cuomo signed legislation protecting the ability of New York-based employers with between 51 and 100 employees to purchase stop-loss insurance for another two years.

Uncertainty and potential prohibition have loomed over small employer stop-loss insurance in New York for the last several years.

The Self-Insurance Institute of America (SIIA) has been fighting to permanently protect the marketplace.

In 2016, a law was passed denying new stop-loss policies to employers with between 51 and 100 employees.

SIIA played an important role in guaranteeing a two-year grandfathering period for existing stop-loss plans and in late 2018 was able to secure legislation that provided for a further five-year grandfathering extension.

However, the governor's office refused to sign the legislation unless the period was reduced, and so a two-year extension was agreed.

A statement from SIIA noted: "This marks the fourth consecutive year that SIIA has been able to keep this marketplace open."

"Unfortunately, a permanent fix remains elusive given powerful forces aligned against SIIA and its allies."

EB captive insurer targeted in first-of-kind class action suit

Class action attorneys have filed a class action lawsuit against two home care agencies, Edison Home Health Care and Preferred Home Care of New York, in the first lawsuit targeting the use of captive insurance companies to provide health benefits.

The suit, alleges that Edison and Preferred used a captive, Healthcap Assurance, to cheat their home care workers out of millions of Wage Parity Act (WPA) dollars.

The suit was brought under the Employee Retirement Income Security Act of 1974 (ERISA), the federal statute governing EB plans, as well as the WPA.

It alleges that Edison and Prefered used the captive to avoid paying their Medicaid funded home care workers the full $4.09 WPA package of additional wages and benefits, instead returning the WPA-credited benefit dollars to the agencies and their owners.

Allegedly, Healthcap Assurance held $35.5 million WPA-credited benefit dollars earmarked to pay for home care worker health insurance benefits for 4,000 workers but paid out less than $10 million between 2015 and 2017.

The remaining dollars were returned as 'surplus' or other financial benefits to the agencies and their owners.

These returned dollars are the focus of the suit, as the WPA prohibits any 'refund' or 'dividend' to an agency of monies contributed toward the WPA package, and an agency must guarantee that the WPA credit taken is not more than the amount of the contribution actually used for benefits.

The lawsuit asserts that the defendants, therefore, violated the WPA by taking a full credit against the WPA package for the entire amount of $35.5 million, despite this amount not being the cost of the benefits actually incurred.

Additionally, it is alleged that all named defendants, Edison, Preferred, Healthcap Assurance, Berry Weiss and Samuel Weiss (owners of Preferred and Edison, respectively), and 15 unnamed individuals are fiduciaries who breached their fiduciary responsibilities and/or parties in interest that benefitted from prohibited transactions.

The repercussions for the defendants could be severe; under ERISA, the agency owners can be held personally liable to make the plan whole for any losses resulting from the fiduciary breaches, and for disgorging assets and profits wrongfully taken.

In addition, there is a mandatory 20 percent civil penalty that is assessable by the US Department of Labor on any recovery for a fiduciary breach.

The parties in interest are also liable for an excise tax penalty with respect to any prohibited transactions they engage in, which ranges between 5 and 100 percent of the amount involved.

Improperly benefiting from the assets of an ERISA, which includes receiving kickbacks or anything of value, is a felony prosecutable by the US Justice Department.

Penalties for not complying with the WPA, which is enforced by the New York State Departments of Health and Labor, as well as the State Attorney General's Office, are also severe.

They include liability for unpaid wages and benefits, withdrawal of an agency's home care license, and potential civil and criminal Medicaid fraud prosecution.

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Gallagher: captive conspiracy class action lawsuit has 'no merit'

Arthur J Gallagher & Co, and its subsidiary Artex Risk Solutions, will fight the class action lawsuit filed against them as it has "no merit", according to a statement from the company.

On 10 December, a group of plaintiffs seeking class status filed a suit against a group of defendants including Artex and Gallagher, accusing them of being part of a massive captive insurance strategy conspiracy.

The suit, which was related to the companies' 831(b) captive business, alleged that the defendants conspired to design, promote, sell, implement, and manage illegal tax-advantaged captive insurance strategies.

Additionally, it claimed that the defendants entered into undisclosed business arrangements with each other and formed a nationwide referral network to funnel clients business to them.

The plaintiffs allege that the defendants unlawfully abused their positions of trust, confidence, and prestige by fraudulently inducing those clients to pay substantial fees for insurance, legal, accounting, tax, and actuarial advice, and services in connection with the strategies.

In a statement, Gallagher said: "Gallagher and Artex are aware of the recent filing of a class action lawsuit relating to our 831(b) micro-captive business."

"We have disclosed the ongoing Internal Revenue Service (IRS) audit and related customer litigation involving our 831(b) micro-captive management business in our Securities and Exchange Commission filings and to our clients."

"This class action lawsuit appears to be related to the IRS audit. We believe it has no merit and will deal with it accordingly."

"Gallagher and Artex have successfully defended individual claims involving similar allegations."

The statement also referenced the legality of 831(b) captives as part of the Internal Revenue's code for decades" and noted that "Gallagher and Artex have diligently and consistently striven to comply with the legal requirements in forming and managing captive insurance companies".

US labour and employment law firm Ford & Harrison noted that as “no prior lawsuit has targeted use of captive insurance companies in this way...the progress of this lawsuit will be closely watched”.

Edison and Preferred did not respond to a request for comment.

Michigan amends reporting requirements for captive insurers

Michigan has amended the reporting requirements for captive insurance companies operating in the state.

SB 898, a partisan bill which was passed on 20 December, amends section 4621 of the Insurance Code of 1956 to alter the reporting requirements for captives in Michigan.

The code has been amended so that a captive insurance company must now submit a “report of its financial condition” no later than “60 days after the end of a captive insurance company’s fiscal year”, as opposed to the 1 March date previously required.

Additionally, all uses of the word “commissioner” in section 4621, have been replaced with “director”.

SB 898 also amends the code so that captives may report using “international financial reporting standards”.

The bill was introduced by Senator Joe Hune on 8 March this year and was passed by the Senate, with 32 yeas, 0 nays, 5 excused, 0 not voting, on 30 May.

It was passed by the Michigan house on 12 December and approved by the state Governor on 19 December.

Chubb completes France move as part of Brexit preparations

Chubb European Group has redomiciled to France from London, effective 1 January, as part of its Brexit preparations.

The move, which was approved in July last year, provides Chubb clients with “continuous and uninterrupted” service whatever the outcome of the Brexit negotiations.

David Furby, regional president, Chubb European Group, said: “Chubb has focused on delivering clarity, continuity of service and certainty for our customers, brokers and other partners, regardless of the final outcome of Brexit.”

“We’re pleased that the redomicile of Chubb European Group’s businesses to France has been completed as planned.”

Bermuda captive insurance market profitable in 2017

The Bermuda captive market was profitable in 2017, according to the BMA’s Captive Report 2018.

The report highlighted results from statutory financial returns submitted through the BMA’s electronic statutory financial return system as of 31 October 2018. The new system officially launched in April 2016 for financial year-end returns for 31 December 2016 onwards.

The report’s statistics on profitability ratios in the domicile showed that the captive market was profitable in 2017, with the median loss ratio and combined ratio for general business captives at 54 percent (an increase from 49 percent in 2016) and 77 percent (an increase from 75 percent in 2016).

The BMA noted that the loss ratio increase reflected insurers paying claims “primarily related to natural catastrophes in 2017”.

According to the report, the combined ratio is relatively unchanged as insurers restructured in a bid to increase operational efficiency.

In 2017, 53 percent of all business written by Bermuda captives was property coverage, down from 55 percent the year before.

The primary property lines were property and casualty catastrophe (43 percent, up from 38 percent in 2016), warranty and residual value (21 percent, no change), and property damage and business interruption (15 percent, up from 12 percent).

Casualty lines made up about 47 percent of all business written, in comparison to 45 percent in 2016.

The main casualty lines written in 2017 were general liability (26 percent, up from 21 percent in 2016), workers’ compensation and employers liability (24 percent, down from 29 percent), and motor (20 percent, down from 24 percent).

In terms Bermuda captives assets’, the BMA noted that they’re primarily “held in investments and intercompany investment advances, however, the combined percentage of the two has decreased from the prior year, as insurers reallocated their asset mix”.

Additionally, the report revealed that the majority of Bermuda captives’ investments are in investment-grade securities, with 73 percent in bonds (down from 81 percent in 2016) and 17 percent in equities (up from 12 percent in 2016).

Matching the figures from 2016, 17 percent of limited purpose insurers reported having segregated accounts in 2017.

More than half of business written in these cells related to workers’ compensation, motor, and general liability.

The BMA commented that the market is “adequately positioned to pay claims from reserves and capital and surplus when due”.

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POLISHING THE EMERALD ISLE

The future of Ireland is tied to a number of factors, including Brexit and Solvency II

Ned Holmes reports

Ireland's captive insurance industry has become static in recent years, remaining in a strong and stable place but with little growth. However, the domicile has begun to develop an insurance and technology ecosystem that is focused on innovation, with insurtech, regtech and fintech startups popping up all over Dublin.

This injection of innovation into the sector could be the impetus needed to cement the insurance industry's place as the jewel of Ireland's financial sector, and allow the Emerald Isle to shine brighter on a global stage.

A solid market

Ireland's captive market is in a solid place, there are currently 78 captive (re)insurers licensed in the domicile with total assets of €6.4 billion, as of 31 December 2017. At that same date, gross written premiums were €1.227 billion with €800 million retained within the captives, while gross technical provisions were €600 million with €400 million retained. While solid, however, the market appears to have been stagnant over the past two years—just two captives were licensed in 2017, while in 2018 none were licensed and three captives withdrew.

Despite a lack of market growth in terms of formations, there has been a rise in interest in diversifying the uses of the captives active in the domicile.

"More and more companies are looking at other options and uses for their captives," says Trevor Madden, managing director of Willis Towers Watson's captive team in Dublin.

"Particularly to make better use of the capital employed in the vehicles, be that employee benefits, cyber, or customer related risks."

Brian McDonagh, client operations leader and office head for Marsh in Dublin, notes that he has seen a similar diversification amongst captives.

He explains: "We are seeing a trend of existing captives adding additional lines of business and becoming more sophisticated in their captive utilisation. We are also seeing an increased interest in captives accessing the commercial reinsurance market for those seeking 'capacity'."

"Additionally, we are seeing an uptick in requests for captive feasibility studies to assist clients in their ongoing evaluations to determine whether a captive could achieve optimal balance for them in the long-term, between retained and transferred risk."

Solvency II

One of the factors that has limited the growth of the Irish captive market has been Solvency II. The legislative programme was implemented 1 January 2016 and introduced a harmonised EU-wide insurance regulatory regime. Regardless of size, captives activities are supervised to the same extent as commercial insurers under Solvency II and are held to the same reporting requirements, which has increased the burden for many captives and seemingly slowed the growth of Ireland's captive market to a near standstill.

McDonagh comments: "The protracted implementation period of the Solvency II regulatory regime was a struggle for the Irish captive industry."

The initial bedding down period for Solvency II has now passed, and Kevin Thompson, CEO of Insurance Ireland, the domicile's insurance industry representation, says the industry is becoming more confident of what the regime means for them.

"Solvency II was a huge thing to get implemented," he says. "I think people firstly just wanted to get it implemented and now we have had a period of bedding down. I think people are a bit more sure footed in terms of their obligations under Solvency II and what that means for them."

The lack of proportionality in Solvency II is an issue that has been regularly brought forward by the captive industry, and with a major review of the regulation upcoming at the end of 2018, we could see some improvements in that area for captives.

"There are Solvency II reviews coming up and that gives us a chance to refine the regulation," notes Thompson. "The reviews are important because they will be an opportunity to refine Solvency II and give us the opportunity to reinforce the idea of proportionality."

Solvency II has not, however, been all doom and gloom for the Irish market as McDonagh explains it has put Ireland "ahead of the regulatory curve".

He adds: "Principles such as substance, robust governance, and transparency are well embedded into the operational DNA of the captive industry in Ireland, and indeed across the EU, so existing and potential new captive owners will be very well placed to meet those challenges."

Regulation

On a local level, Ireland's financial services sector, including its captive industry, is regulated by the Central Bank of Ireland (CBI). The CBI's supervision of regulated firms is based around the probability risk and impact system (PRISM). Under PRISM, the firms that have the greatest impact on the financial stability of the economy and the consumer receive the highest level of supervision, while firms with the lowest potential impact are supervised reactively or using thematic assessments.

In this sense, the PRISM framework recognises the principle of proportionality, as reinsurers ranked as 'low' or 'medium low', such as captives, are subject to less onerous requirements. For example, lower down the framework, the CBI allows for fewer directors and less frequent board meetings.

Teresa Ready, senior supervisor at the CBI, suggests there is a "strong ongoing engagement between the CBI and the industry". She adds that the CBI "endeavors to be open and transparent in its communication and has issued a number of industry letters in recent times providing feedback on key areas of risk, noting examples of best practice".

Providing the industry perspective, Madden said the current relationship works well "on a practical and day-to-day operational level", but that "as an industry group, the captive managers would certainly welcome much more of a dialogue with the regulator particularly around proportionality for captives and low prism entities".

Brexit means uncertainty

As the UK's closest neighbour, Ireland has had a front row seat for the Brexit negotiation debacle and the main feeling in the Irish insurance market about surrounding the situation appears to be the same as with everywhere else–uncertainty. "From an insurance industry viewpoint, the Brexit mechanisms and timing are still far from clear," says McDonagh.

"Other than local policy considerations around the mechanism of using freedom of services to issue cover from captives into the UK, there has been little direct impact on the captive industry."

It remains uncertain whether or not the UK will leave the EU, and what sort of consequences any final deal will have for Ireland, but Ready says the CBI "requires firms to have sound and adequate Brexit plans in place regardless of the type of Brexit implemented".

Madden notes that as "a significant number of Irish captives will have some level of UK-based risks in their portfolio, Brexit will require these captives to consider their options and make amendments to the current arrangements".

He continues: "It's likely that the use of a fronting partner in the UK will be the simplest solution for most, though this will have a cost impact for clients in terms of increased fronting fees and collateral requirements."

In keeping with Brexit's unofficial theme, Thompson adds: "Brexit creates uncertainty for all insurers. The main issue is the lack of certainty on future regulatory frameworks between the UK and the EU."

What the Irish insurance industry appears united on is that Brexit will provide opportunities, and to some extent is already. According to McDonagh, Ireland is one of the domiciles that appears to be faring well from the "UK based insurers/reinsurers that are seeking to relocate aspects of their business into other EU locations in preparation for Brexit".

He explains: "The potential relocation of insurance expertise and talent out of the London market will no doubt have a positive effect on overall activity in the domiciles, including Ireland."

John Quinlan, Insurance Ireland non-life council chair and CEO of Aviva Ireland, describes Brexit as "an obvious opportunity", and emphasises that the domicile "needs to make sure we have the right regulatory and tax regime in place to make the most of what is a really big opportunity."

The arrival of talent from the UK due to Brexit adds to a talent pool that the industry already views as one of its key strengths. Madden suggests that the "experienced and highly talented pool of captive expertise is one of the main factors that sets Dublin apart".

He expands: "Be that from a captive management, actuarial, audit, legal or investment perspective, Ireland has some of the most creative, innovative and customer focused captive people around. This is a service-led sector and clients buy and trust the people that manage their business."

A chance to shine?

Thompson believes Ireland will grow exponentially as an insurance hub over the next few years. He argues that it has the necessary talent and the regulatory and technological infrastructure present to continue to grow in its place as "an international hub for insurance".

McDonagh echoes the sentiment, noting that there is significant potential for growth across the European captive domiciles and that Ireland will hopefully gain its share of that growth. He also predicts 2019 will see growth in the insurance-linked securities (ILS) sector.

He says: "Within Ireland we should see the continued use of ILS structures. With the likely growth in alternative captive structures this will broaden access to captive structures beyond multinationals to the small and mid-size enterprise organisations."

Thompson warns, however, that 2019 is unlikely to see much growth in the captive market, rather that it would continue its "stable status" as "there is enough volatility out there from all different quarters".

The Irish government is currently drafting IFS2025, the strategy for the development and promotion of the financial services up until 2025, and Insurance Ireland, believes the central aim should be to move insurance and financial services up the value chain.

Thompson comments: "We see this as being critically important for existing insurers in the market and for potential new entrants."

McDonagh suggests that for the Irish captive industry to survive and thrive in the global market changes need to be made to implement a regulatory regime that includes proportionality for captives.

He explains: "There is a prevailing concern among practitioners that supervision of the industry could become an exercise in data analytics which provides limited value to any stakeholder and is certainly not in keeping with the principles of proportionality."

McDonagh adds: "As an industry, we must focus on what truly needs to be protected, otherwise it will be a lot harder for the captive industry in Ireland and the EU to survive and thrive in a global environment."

Ireland's insurance sector undoubtedly appears to be moving in the right direction, but though the promise is there, it seems work is still needs to be done to allow the Emerald Isle to shine to its full potential in the global captive market. **CIT**

Not all custodian banks are created equal

Marvin Turner and Dale McCann of Comerica Bank explain why choosing a custodian bank when setting up a captive is one step that should not be taken for granted

After months of feasibility studies, negotiations with captive managers, fronting companies, actuaries and investment managers, you are finally ready to fund your captive and start writing policies.

Now you must choose a bank to handle all your financial transactions. Selecting a bank to act as custodian, trustee or letter of credit issuer may be the last step when setting up a captive insurance company, but it is one step that should not be taken for granted.

While it may be tempting to make a quick selection, finding the right custodian bank can significantly affect the ease of operation and profitability of the captive and should not be made without proper due diligence. The criteria listed in this article on selecting a custodian bank has been compiled to help you become familiar with key factors that may save precious time, money, and energy.

What is a custodian bank?

A custodian bank is a financial institution that may perform tasks including the safekeeping of captive assets, either onshore or offshore; securities trade settlements; and accurate, timely reporting of all captive financial transactions, including movement of cash and securities.

A custodian bank may also offer investment management services, as well as trust services, including Regulation 114 trusts.

A tri-party trust agreement between a captive, a fronting insurance company and the bank trustee is typically required.

Custody accounts versus trust accounts

When a custodian bank is also designated as a trustee, the bank assumes fiduciary responsibility for the assets of the trust. The captive may choose to utilise a reinsurance trust for purposes of collateral with its fronting insurer.

Under a reinsurance trust agreement, the bank serves as trustee and is the gatekeeper on behalf of the ceding company or beneficiary, thereby limiting the access to the account by the captive or the grantor.

Only banks chartered in the US may act as trustee for a New York State Regulation 114 trust, which is a common arrangement utilised by many captives.

What is the criteria for making the right choice?

Armed with some knowledge of the role and responsibilities of a custodian bank, the next step is to compare and evaluate potential providers to make the best choice for your captive insurance programme.

Onshore versus offshore

You may first want to determine where the custodian bank is based (for example, onshore or offshore), and which alternative is best for your captive programme.

Offshore captives often use offshore banks or offshore branches of US banks.

Keep in mind that no matter where the custodian bank is based, US assets are typically held in the US in book-entry form at US depositories. Time zone differences and hours of operation may also factor into your decision.

Target market relative to your size

How large is the custodian bank? What is its target market? Are these factors consistent with the size and needs of your captive? It is important to know where you fit in the client base of a prospective custodian bank.

For example, many custodian banks may direct clients with smaller assets—typically less than $50 million—into a service model that does not provide the service levels and flexibility that your captive may require.

Experience and commitment

This may be your most important consideration. You've gotten to this point utilising the skills of professionals committed to the captive industry. You don't want to jeopardise all the work involved to set up your captive by choosing a custodian bank that is not familiar with captive industry laws, rules and regulations.

A custodian bank with a staff dedicated to working with captive insurance clients will likely speak your language and understand your captive's needs. It may be important to know if the custodian bank is active with captive industry groups and regularly attends captive industry conferences and seminars.

Reporting needs

Insurance companies have specific reporting needs. Make sure your custodian bank is aware of those needs and is capable of meeting all your compliance requirements. Ask if the custodian bank provides:

- Daily or monthly reporting and monitoring? What are its electronic capabilities for each?
- Segregated cell or separate portfolio arrangements? Does the bank understand the need to maintain separate accounts or provide 'plan accountings' so that assets, earnings and claims may be allocated and reported on a cell-by cell-basis?
- Amortisation/accretion and impairment reporting
- Reporting systems that have the capability to aggregate separate accounts together into a single consolidated statement

Impact of FATCA

Much has been written about this US regulatory hurdle, the Foreign Account Tax Compliance Act (FATCA). This US federal legislation, passed in 2010, requires that non-US financial institutions report assets of and identify foreign entities with indicia of US person status, such as US residency, place of birth, and so on.

Non-US captives must identify beneficial owners of Internal Revenue Service (IRS) Form W-8BEN-E.

Additionally, if a non-US captive qualifies as a “foreign financial institution” as defined by the IRS and holds US securities or receives other US source income of any kind, then special US tax reporting is required.

You want to confirm that your custodian can comply with the reporting requirements under FATCA.

Investment management

Does your custodian offer investment management services? This is a question you might ask to either lower your expenses through a bundled service or to consolidate your vendor/service provider base.

Be sure that you know what your custodian bank can and cannot do in terms of investment management. Will the bank provide the services your programme needs, or do they require you to hire a third-party investment manager?

Global custody

If there is any chance the captive may invest in foreign securities, it is vital that the custodian bank have access to global settlement. This can be done via a proprietary in-house network of foreign banks or through a contracted global custodian.

Expect to pay additional fees for this service. Be sure that you understand the custodian bank’s reporting capabilities, including multi-currency accounting or local currency accounting.

Fees

Once the field of bank custodians is somewhat narrowed, it is time to evaluate fees. Custodian banks are usually paid on a market value-based fee schedule, which may also include transaction fees and an overall minimum.

It is worth the time to compare fee schedules, as they may vary widely and directly affect the profitability of the captive programme. Pay attention to minimums, what is included in the base fees, and confirm if there are charges for additional services. The least costly is not always the best value.

Selecting a custodian

As you can see, selecting the right custodian bank is a critical decision and should not be taken lightly. Your current banking relationship may not be able to meet the needs of the captive. An effective working relationship with your custodian bank is critical to the ongoing operations of your captive. Custodians come in many shapes and sizes, and you want to find one that will be a valued partner in the operation of your captive. **CIT**

Marvin Turner, vice president and senior relationship manager, international trust, **Comerica Bank**

Dale McCann, relationship manager, **Comerica Bank**

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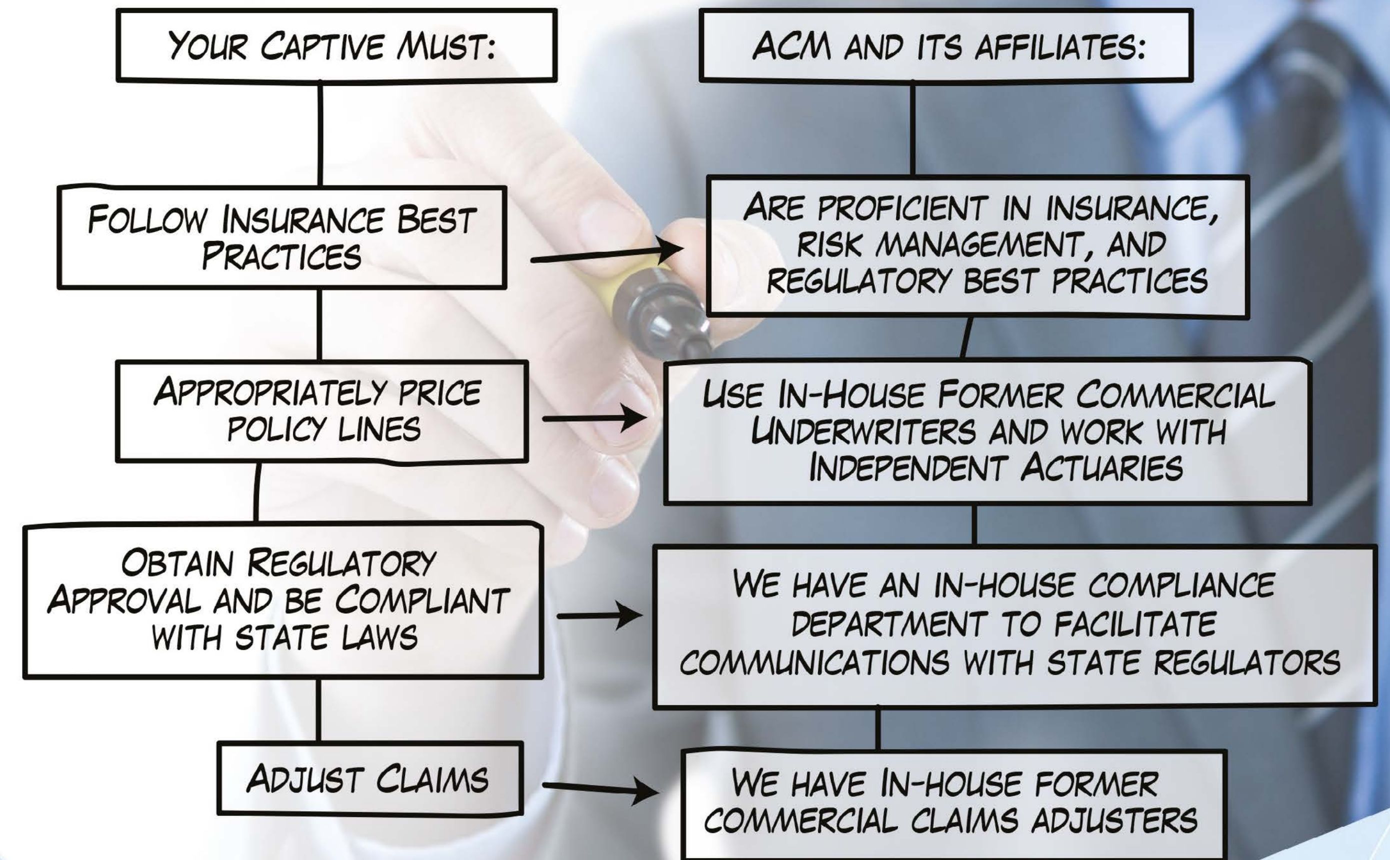
Captives Are For Risk Management



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Emerging Talent

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Ram Patel, captive analyst, CIC Services

Personal bio

I currently live in Lenoir City, Tennessee, a town right outside of Knoxville. In my freetime, I love to play golf, play competitive volleyball, and watch all University of Tennessee sports. In addition to sports, I have a passion for business and, most importantly, spending time with my friends and family.

Professional profile

I am a proud graduate of University of Tennessee-Knoxville, and have a degree in supply chain management with a minor in marketing. After college I started my career in the consulting industry and gained valuable experience but realised I wanted to pursue a career with a more business or finance focus. This realisation led me to the insurance industry as a compliance manager.

How did you end up in the captive industry?

I was introduced to the captive industry by an uncle of mine who was a property and casualty agent. This sparked my interest, so I started doing some research to better understand the industry and what it entails. I was immediately interested when I found CIC Services.

Some may think that not having specific industry experience would hinder them from being able to get into a field that interests them, but networking and work ethic go a long way. I convinced a manager at the firm that I was the right man for the job. I got the opportunity to show that I wanted to learn, and that I had a natural knack for numbers and business. The rest was history.

What is your impression of the industry?

The captive industry is innovative, fascinating, and very versatile. In this ever-changing worldwide economy, it becomes very important for businesses to manage and mitigate risks as best as possible. Over the years, the industry has adapted so that even small-medium businesses, rather than just Fortune 500 companies, can afford to create captive insurance companies, which opens countless doors for both small businesses and the captive industry.

What advice do you have for someone considering a role in the industry?

First and foremost, be ready to learn and adapt. The industry is still very new compared to other major industries out there, so it is constantly changing. It is a unique opportunity to be on the forefront of an industry like this. Your contribution today could shape its future. Ask questions, learn, and get involved beyond just your day-to-day responsibilities.

I also think networking is incredibly important. You never want to go into any situation thinking you are the smartest person in the room. Take advantage of every opportunity to learn from somebody new in the industry or anybody willing to offer their perspective on business.

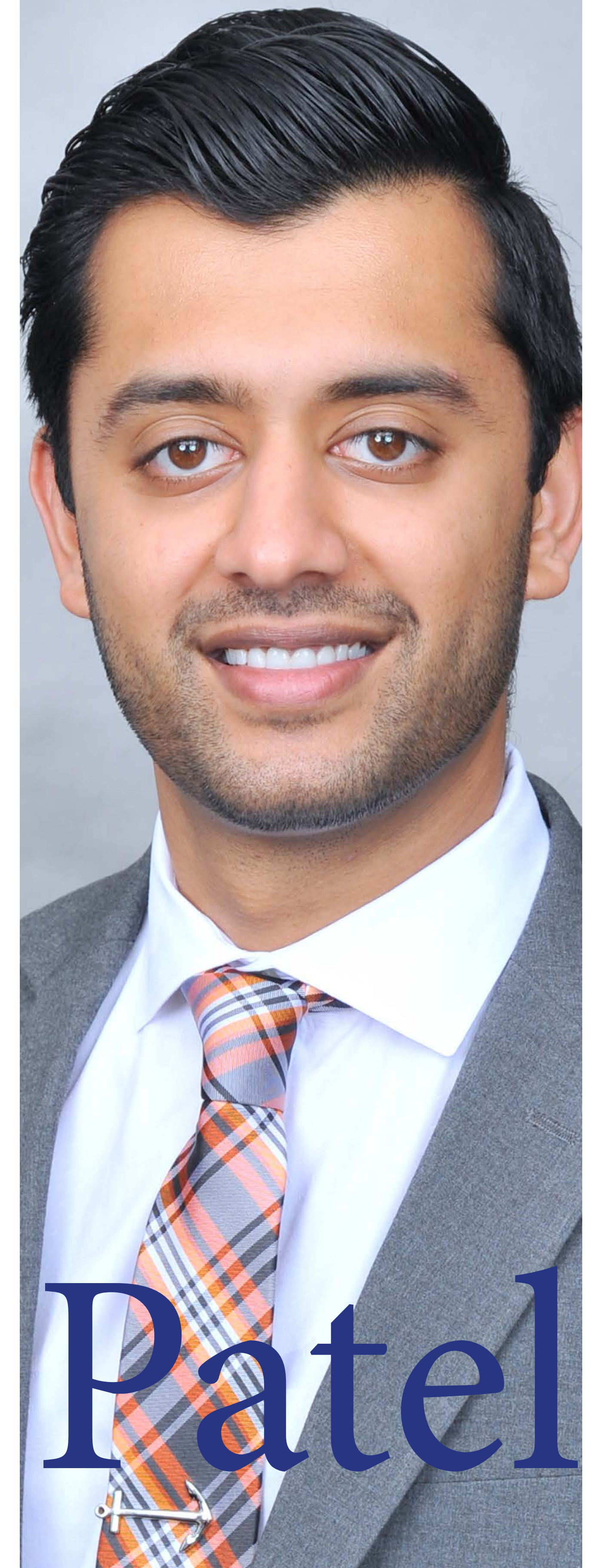
These insights will inevitably help mould you into a very valuable asset for your company. It is not just about what you know, who you know is equally important.

Lastly, do not be bound by what your college degree or previous experience says you should be pursuing. You can develop knowledge and expertise in any area if you have a passion for it and the will to learn. Captive insurance companies are eagerly looking for new talent. If you are business-minded, curious, and hard-working, it is worth taking a leap of faith!

“Ram Patel reached out to me and I was impressed by his energy, charisma, intelligence, and interest in captive insurance. CIC Services interviewed him and hired him straight away.

He is brilliant, hard working and made an immediate impact on our business. He joined CIC Services as a captive analyst and began doing modelling work on captive programmes for prospective captive owners. He has helped CIC Services close more sales and deliver back-to-back record years. In his two years at CIC Services, he has already learned enough to be able to develop and present a captive insurance company strategy to a risk manager, CFO or business owner–and this is a complex sale. He is destined to be a leader in the industry.”

Randy Sadler, principal, CIC Services



Ram Patel

Ratings Update

You’ve got to be kind to be Kroll

We check in with KBRA a year after its European launch to talk about the global captive market, its first 12 months in Europe, and its customer service-based approach

What captive trends have you seen this year?

Carol Pierce: There is still interest in captive formations, but in the US the formations tend to be among small- and middle-market-sized enterprises. Occasionally, a publicly traded company sets one up, but I would say that is not as prevalent as it was 15 to 20 years ago when there were more traded companies forming captives. The industry has expanded and a different level of company is forming and benefiting from owning a captive.

That said, in terms of ratings and why captives seek ratings, the current market is no different from the past. On the multi-owner captive side, they seek a rating to get validation in the market because they’re competing for members against commercial companies that all carry ratings—that hasn’t changed.

In terms of single parent captives, what we are seeing is that they seek ratings for specific reasons. They either have a customer contract that requires a rating, or they have a specific reinsurance arrangement that requires them to have a rating. That is primarily where we are seeing interest at the moment. The interest is not broad and the single-parent captives do not seek ratings like multi-owner captives or like commercial companies do. Just as a captive is formed for a very specific risk management reason, ratings are sought for very specific business needs.

What are the key factors in the rating process?

Pierce: When we put the KBRA captive rating methodology together we wanted to make it hand-in-glove with our existing insurance methodologies for commercial companies. We made a well-defined split between companies to be rated under the captive methodology and companies to be rated under the global insurer methodology, so there would be no confusion in the market. Also, as some captives have evolved into commercial companies over the years, it enables us to move a company between methodologies without too much disruption. I think that is a real key to how we set the whole thing up.

We do fundamental and technical financial analysis, but we don’t have a proprietary capital model that we are using in any of the insurance sectors. We do stress testing, and our methodologies tend to look at qualitative and quantitative components equally. In the case of a startup, the qualitative aspects are key. In terms of the qualitative factors, we don’t have a bias against some of the types of assets that captives would own, for example, letters of credits and loan-backs.

Obviously, we do a lot of due diligence on the credit quality of whatever types of assets are owned. As captives generally are not profit orientated we look at profitability as a cost of risk metric, rather than on an underwriting profitability basis. We expect the captive to charge enough money to breakeven, but we do not expect captives to be profit centres within their organisational structures. However, they do need to provide value to their owners and cost of risk is probably a better metric for measuring that.

We do a formal assessment of the owners as part of the rating process. For group captives we look at their by-laws to see what additional capital they can access if it’s needed. In the case of single-parent captives, we have a corporates team that does the analysis on the parent company, but that assessment is not a ratings ceiling for the captive insurance company; it is just one of many things that we look at as we come up with a rating and that goes for sovereign risk as well.

Sovereign ratings apply to the debt of the country and are not ratings on the country itself; therefore, they also do not act as a ceiling on the financial strength ratings for captives.

What was the motivation behind setting up KBRA’s European office and what have you been up to?

Mauricio Noé: We received our registration from the regulator, the European Securities and Markets Authority (ESMA), almost exactly a year ago and that is really when the gun was fired in terms of us going after business in Europe. We decided to come to Europe now because we started reaching saturation point in a few markets in the US–which is a high class problem to have as you can imagine. What we were looking to do was expand.

The ratings business was mostly dominated by a few very large players whose market share appeared somewhat unaffected by the crisis. It was deemed that setting up a new rating agency in Europe was a good idea, as it was for us in the US eight years ago. We have been here now for a year and have made enormous progress. We have rated a number of deals, most of them private, but a few fairly high profile public transactions in the asset-backed securities, residential mortgage-backed securities and commercial mortgage-backed securities space. Issuers and investors alike are very keen to see us and there is an enormous amount of goodwill being directed towards us. I feel that we are really at the start of something meaningful in terms of disrupting the ratings business.

What are you expecting to be the impact of Brexit?

Noé: Being headquartered in Dublin was mostly a Brexit-related decision. We are regulated centrally by ESMA in Paris, there is no local regulatory oversight like an insurance company or a bank might have. So, we needed to be in the EU 27 when we set up our business.

We eagerly await the outcome of the Brexit negotiations but we will be opening a UK regulated entity as well post-Brexit, irrespective of the flavour of Brexit that emerges.

The soon-to-be regulator in the UK, the Financial Conduct Authority (FCA), is incredibly pragmatic and business-minded. They are very keen to avoid any interruption of regulatory capital treatment that our ratings afford to investors. That is a really important consideration–if you are a UK insurance company and you are using our ratings for your regulatory capital treatment, the FCA is determined to ensure there is not a moment’s gap in coverage and impact on balance sheets as a result, which is a good thing.

We aren’t expecting Brexit to have a specific impact on ratings. We rate the UK itself and so publicly discuss Brexit and the implications on the UK economy. I think the number of ratings we issue in the UK will be entirely correlated to the strength of the UK economy in terms of the number of banks and securities being issued. We don’t really see it having a huge amount of difference. Specific risks to the UK economy are detailed in our rating of the UK where we have a negative outlook because of Brexit.

Did you set targets up for your first year? And have you achieved those targets?

Noé: Yes, we certainly have. Our targets are numerous, they don’t just relate to the number of transactions. Our goal is to spread the word and really evangelise our business and the need for a disruptive force in the ratings business and that was really our goal in the first year.

> “In terms of ratings and why captives seek ratings, the current market is no different from the past”
>
> **Carol Pierce, director, insurance, KBRA**

> Our goal is not to react in a knee jerk manner either downgrading or upgrading, we try to look to the long term and have a smooth trajectory rather than a cliff edge
>
> **Mauricio Noé, head of Europe, KBRA**

We got that message across and are virally affecting the market and making people realise that there is another approach. There are firms out there like us that are putting customer service first we realise in the long term that is the way to build a sustainable business.

Giles O'Flynn: I joined KBRA in June this year, having been at Moody's for 20 years, and it has been exciting to join a smaller company that focuses on customer service, being nimble and responsive to issuers, bankers and investors. The market welcomes another agency and competitor because for a long time it has been dominated by two or three big firms and people want more choice.

Does having a range of experience from staff who witnessed the crisis in 2008 give you an advantage in seeing how things should be done now?

Noé: Yes. It gives us perspective, it gives us the ability to look at the cycle over the long term not just based on short term, idiosyncratic events. Our goal is, for example, on the ratings side, not to react in a knee jerk manner either downgrading or upgrading, we try to look to the long term and have a smooth trajectory rather than a cliff edge.

So, if a business is going badly it will be a gradual process, if it is going well it will be a gradual process. Too often we see a cliff effect, usually on the way down. It is just a case of trying to have some perspective, have a long term view on the market and providing all of our stakeholders with something that is useful to them. Saying a rating is one thing one day and one thing the very next day, is not really offering anyone much value.

Essentially what we are trying to do is provide our issuers, investors, regulators and all market participants a product that is useful to all of them and reflects the creditworthiness of an issuer or an asset in real time.

What are the plans from KBRA in the European market moving forward?

Noé: We are shifting gears and starting to rate all the asset classes that we hope to rate, and become a full service rating agency over here as we are in the US.

Our targets are about penetration of the market by winning over the hearts and minds of our stakeholders because that is how you build a long term sustainable business. Given that we have a strong platform in the US we are looking to replicate that.

O'Flynn: We are well known in the US with significant market shares in certain asset classes, and our model is to replicate our expertise and focus in the US to Europe and build upon that as a strong base to in time rate other asset classes.

The good news is that investors are familiar with KBRA in Europe based on KBRA's achievements in the US in a short space of time and that is a great springboard. CIT

> The market welcomes another agency and competitor because for a long time it has been dominated by two or three big firms
>
> **Giles O'Flynn, director of European investor relations, KBRA**

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Captive industry dates for your diary

Event	Location	Dates	Website
World Captive Forum	Miami, FL	February 30-01	businessinsurance.com
CICA 2019 International Conference	Arizona	March 10-12	cicaworld.com
Bermuda Captive Conference	Bermuda	June 10-12	bermudacaptiveconference.com
VCIA Annual Conference	Vermont	August 05-08	vcia.com

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Industry Appointments

Comings and goings at Energi, Aon Captive and more

Katharine Wade will step down from her role as Connecticut insurance commissioner, effective 19 December 2018.

Life and Health director Paul Lombardo will serve as acting commissioner until a new commissioner is appointed by incoming governor-elect Ned Lamont.

Wade has spent nearly four years in the role, having been appointed in March 2015.

Prior to taking the role, Wade spent 21 years at Cigna, most recently in the role of vice president of public policy, government affairs and US compliance.

Connecticut governor Dan Malloy thanked Wade for her "honourable service" and said he was proud to call her both a colleague and a friend.

He commented: "As home to the 'insurance capital of the world', Connecticut needs a world-class insurance regulatory agency and under commissioner Katharine Wade's leadership, that's just what we have."

"Building upon our existing assets, she strengthened consumer protection creating better network standards for health insurance, expanding choice in the marketplace, and increasing consumer education and outreach."

Malloy continued: "Her endeavours and accomplishments helped to solidify the state's standing as an important voice regarding insurance regulatory matters on the national and international stage."

"During her tenure, Wade championed Connecticut as a centre of excellence for innovation and InsurTech, highlighting the state's deep pool of insurance industry and tech talent."

Energi, the parent company to multiple specialised insurance programmes, has appointed Michael Windstein as chief underwriting officer (CUO).

Windstein will be responsible for supporting the underwriting operations with the recent launch of Energi's eCaptiv programmes for the energy and transportation industries.

A Vermont-based captive insurance company, eCaptiv is aimed at energy companies in fuel distribution, energy transportation, energy construction, renewable energy, agriculture cooperative, and utilities.

Windstein has been named CUO after spending more than six and half years at Energi, previously serving as assistant vice president of underwriting, and director of underwriting.

Prior to joining the company, he was assistant vice president and underwriting manager at Victor O. Schinnerer and was an underwriter for the Global Energy Middle Market programme at AIG specialising in the oil and gas industry.

Timothy Kolojay, president and chairman of eCaptiv, commented: "Windstein has been a strong asset to the underwriting operations at Energi."

He added: "His experience and knowledge of the insurance and energy industry will be critical in the success of the eCaptiv programmes."

JLT UK & Ireland Employee Benefits CEO, Bala Viswanathan, will join Marsh & McLennan Companies (MMC) subsidiary, Mercer, as COO, following MMC's successful completion of JLT.

Viswanathan will report to president and CEO of Mercer, Julio Portalatin, and become a member of Mercer's global executive leadership team.

He will work across Mercer to drive enhancements to the company's offshore, technology and systems capabilities, as well as client satisfaction and user experiences.

Prior to his current role, Viswanathan served as JLT's COO.

Commenting on the new role, Viswanathan said: "I look forward to taking on the COO role at Mercer and adding my perspective and insights to the strategic direction and success of the firm."

Portalatin added: "Pending the outcome of the regulatory process, we look forward to welcoming Viswanathan to Mercer in this strategically important role."

"His successful career at JLT and his understanding of both operations and the global employee benefits market will further enhance our industry leadership, client relationships and organisational effectiveness. He will be a valued addition to Mercer's executive team."

Adriana Scherzinger has been appointed as regional head of international programme business commercial insurance for Zurich Latin America, effective 1 January.

Scherzinger's current role is head of captive services Latin America and senior captive portfolio manager for the Middle East, Spain and Switzerland at Zurich.

Previously at Zurich, she has also served as a reinsurance specialist for the Switzerland business unit and captive fronting manager global corporate for the Asia Pacific.

In her new role, Scherzinger will look at prospect international programmes and captive business by supporting the local initiative; responsible for the servicing of the international business to ensure excellent service delivery to international customers; and leveraging capabilities, relationships, expertise and strong brand reputation.

Aon Captive and Insurance Management has appointed Anup Seth to the newly created role of global leader of underwriting solutions.

The move is part of the company's realignment of its organisational structure to support future growth in response to the continued convergence of the commercial reinsurance and insurance-linked securities (ILS) markets.

In addition to his current role as managing director of Aon Insurance Managers (Bermuda), Seth will be responsible for leading Aon's newly created underwriting solutions line, which includes its global commercial re/insurance, White Rock and ILS management businesses.

The appointment is subject to immigration approval in Bermuda.

Prior to joining Aon in April 2016, Seth spent more than 10 years at Ace Bermuda International.

In the role, Seth will be supported by Paul Sykes, managing director of Aon Guernsey; Dermot Finnerty, managing director of White Rock Group; and Steve Britton, managing director of Global ILS Management.

John English, CEO of Aon Captive and Insurance Management, commented: "Anup Seth has achieved impressive results in the Bermuda market over the past three years and his commercial market experience and track record of delivering growth will be key to driving further success."

Seth stated: "I am delighted to lead our global underwriting solutions line which integrates our commercial re/insurance, White Rock and ILS businesses and was created in response to our clients' underwriting needs."

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