



## Employee benefit captives climbing

The number of captives writing employee benefits has increased 10-fold since 2007, according to Towers Watson's captive user group.

The Towers Watson captive user group, a specialist forum made up of 650 specialists who meet in Europe and the US every year, found that 77 captives implement employee benefits today, up from just nine in 2004.

Towers Watson polled 41 out of the 77 employee benefit captives operating globally on their current use of captive vehicles and how they anticipate this will change in the next five years.

The main priority for 67 percent of the group is to save cost on employee benefits and other financial benefits. A further 24 percent cited control and improving claims data, which in turn would help to manage benefit costs, according to Towers Watson.

Although "cost containment is always at the heart of any captive decision", according to Mark Cook, director at Towers Watson, the survey also found that 62 percent of those questioned use their captives for death and disability benefits and medical insurance, while 11 percent also include defined benefit retirement savings.

In the future, 48 percent said they are considering a captive pension transaction, either in the next three to five years or within the next 12 months.

Cook continued: "The breadth and depth of captive use continues to expand as more companies realise the potential to mitigate the ever spiralling costs of employee benefits. Companies with a desire to take on additional risk can reap the biggest benefits but careful assessment is vital before launching into any kind of self-insurance as only strong, well-managed captives succeed."

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## London 'unlikely' to become ILS hub

London is unlikely to become a centre for housing insurance-linked securities (ILS), according to Grant Thornton.

Grant Thornton's 2015 Insurance Hubs Report, based on discussions with company leaders across the sector, argued that London's pre-eminence as an insurance and reinsurance centre has rarely been stronger, and in March, the UK government vowed to take the necessary steps to attract ILS business into the country.

As part of the 2015 budget, chancellor George Osborne said that the government would work with the industry and regulators to develop competitive corporate and tax structures to allow ILS to be domiciled in the UK.

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## Strong in longevity risk transactions is Guernsey

Guernsey's position as the go-to jurisdiction for longevity risk transactions was outlined at a Guernsey Finance event in London.

John Coles, head of operations for the BT Pension Scheme, addressed the audience on how BT structured its £16 billion longevity risk transfer and why a Guernsey based structure was used.

"It was important for the trustees that they felt comfortable with the jurisdiction and Guernsey certainly meets that. It has a good legal framework and a good regulatory environment."

He added that Guernsey's utilisation of the incorporated cell company structure was also the most appropriate and practical way of meeting the needs of the transaction.

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**Employee benefit captives climbing**

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He added: “While cost savings are a clear motivation behind setting up a captive in the first place, Towers Watson’s 2014 Multinational Pooling and Captives research study revealed that the success of individual captives varies significantly.”

“While the median annual return for global employee benefit captives was just over 11 percent on total plan premiums, there was a wide disparity in the profitability of individual captives with the most successful yielding 65 percent returns while the lowest performing were left with a –77 percent deficit.”

**London ‘unlikely’ to become ILS hub**

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Osborne also raised the government’s intentions to back financial technology and pursue the possibility of conducting global reinsurance.

But in the UK, special purpose vehicles (SPVs) and protected cell companies (PCCs)—two structures that are key components to an ILS marketplace—are not currently feasible. Primary legislation would be required to facilitate such a marketplace in the UK, according to Grant Thornton.

The UK’s tax environment is also seen by many as being too hostile for those looking to establish an ILS onshore in the UK, according to the report. Although corporate tax rates have fallen, and will continue to do so according to the most recent UK budget, the tax framework has a reputation for being one of the most complex in the world.

Some of the steps that will need to be considered will include ensuring that the proposed corporate vehicle tax is neutral, and that each cell of a PCC vehicle would be a separate taxable entity.

The UK’s regulatory speed of response has also been found wanting. The country is

competing with well-established domiciles, particularly Bermuda, where the regulators are able to turn applications around in days, as well as being able to provide listings capabilities for the vehicles.

Another vital component of ILS is speed to market, and the UK regime is used to taking months, and in some cases a year, to authorise vehicles.

The report argued that it would be necessary to design a regulatory process that can set up a new insurance vehicle in a time scale that makes the UK competitive with other domiciles, without compromising the regulatory objectives of the country’s financial regulators.

**Strong in longevity risk transactions is Guernsey**

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“The regulator and all of the companies in Guernsey recognise the business activity. They understand the risks and that is very helpful. Guernsey is open for quality business,” said Coles.

“From our particular experience we have met and now use a number of very experienced and talented people with both insurance and captive knowledge and they have been very adaptable and flexible in helping us to land what was quite an innovative transaction for the scheme—to actually create its own captive, certainly in a transaction of this size.”

In addition, a panel discussion examined captive insurance solutions, longevity trends, needs and future opportunities, and how Guernsey has been able to position itself so effectively in this area through the use of cell company structures, regulation and reinsurance capacity.

Moderated by captive insurance veteran Malcolm Cutts-Watson, the panel consisted of Ian Aley of Towers Watson; John Dunford of the Guernsey Financial Services Commission; Philip Jarvis of Allen & Overy; Paul Kitson of PwC and Andy McAleese of Pacific Life RE.

**CITINBRIEF**



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## GC Securities completes cat bond for PennUnion Re

GC Securities has placed the Series 2015-1 Notes, with notional principal of \$275 million, through the newly formed catastrophe bond shelf programme PennUnion Re.

The new cat bond will benefit Passenger Railroad Insurance, a Bermuda-domiciled captive and a wholly-owned subsidiary of the National Railroad Passenger Corporation, Amtrak.

The notes represent the first time Amtrak has obtained capital markets-based reinsurance for storm surge and wind from named storms and earthquake protection.

They provide per-occurrence, parametric triggered protection from storm surge and wind resulting from named storms as well as earthquakes affecting the northeast region of the US for a period of approximately 3.17 years.

The transaction is triggered based on key intensity measurements of the physical parameters for each respective peril captured at specific measurement location.

Storm surge water height measurements are captured at seven tidal gauge stations in the Long Island Sound, East River, Lower New York Bay and Delaware River.

Wind measurements are captured and interpolated for 60 ZIP codes along Amtrak's Northeast corridor railways from Washington DC to near Providence.

Earthquake intensity is interpolated to 21 ZIP codes within the states of Delaware, New Jersey, New York, Pennsylvania and Rhode Island.

Gerald Sokol, CFO of National Railroad Passenger Corporation, said: "This is the first time Amtrak has used the capital markets to broaden our base of insurance coverage. The catastrophe bond market provides us with a means to diversify our sources of insurance in a cost effective manner."

Chi Hum, global head of insurance-linked securities distribution at GC Securities, added: "We are pleased at the overwhelming support and oversubscribed offering from the more than 25 participating capital market investors on the PennUnion Re Series 2015-1 Notes."

"This strong support allowed the transaction size to be increased by 37.5 percent from the initial offering size while at the same time pricing at the lowest end of price guidance."

"Capital markets investors continue to offer support to new entrants into the catastrophe bond space, including, not only for diversifying perils but also for unique triggers structures and sponsor types."

## Captive reinsurance measures 'not enough'

The Federal Insurance Office (FIO) has criticised state insurance regulators for not doing enough to address ongoing concerns about captive reinsurance.

The FIO's third annual report on the insurance industry, released at the end of September, criticised the XXX/AXXX Reinsurance Framework, which is being spearheaded by the National Association of Insurance Commissioners (NAIC) until principle-based reserving (PBR) requirements become fully effective, for not addressing all transactions between life insurers and reinsurance captives.

The framework only covers transactions involving cessions of reserves for term life and universal life with secondary guarantees, which, according to the FIO, misses a significant chunk of deals between life insurers and reinsurance captives.

The FIO explained: "Due to its limited scope and its exclusive focus on ceding insurers, the framework does not fully address concerns about the non-uniform prudential regulation of reinsurance captives. Therefore, reinsurance captives would continue to be subject to a wide variety of less stringent requirements across the states with regard to minimum capital, risk-based capital, allowable assets, and accounting practices."

State insurance regulators have also failed to require reinsurance captives to publically disclose their financial statements, and are proceeding to implement the framework with no clear timeframe in place.

"The framework is expected to be implemented in phases, including the development of a new reinsurance standard pertaining to term life and universal life with secondary guarantee products—thereby requiring state-by-state adoption over the course of an uncertain number of years."

"The NAIC expects that the incentives to create reinsurance captive transactions will 'be almost, if not fully, eliminated' once PBR becomes effective, although insurers have not conceded that expectation. A.M. Best has noted that 'given the uncertain timeframe for adoption of PBR', the 'stopgap' measures established in the ... framework may become the new regulatory reality and, thereby, not eliminate the use of reinsurance captives."

## Willis releases forecasting tool for third-party motor risk

Willis Group has launched a tool that enables risk managers to forecast third-party motor risk across Europe.

The Dynamic Casualty Forecast tool uses Willis's data so that a client with significant motor exposure of any vehicle type and any country mix across Europe can now have an improved understanding of their risks, and a customised view of loss potential.

This clearer understanding of risks can then be overlaid across company financials to give tangible and real-time decision support to drive risk transfer strategy, according to Willis.

The product was launched at the Federation of European Risk Management Associations (FERMA) Forum in Venice.

Ben Fidlow, global head of core analytics at Willis, said: "Willis handles more than one million vehicles across Europe, and we have a significant presence with dedicated teams in many key countries. We understand our clients' business and the industry's unique needs."

"The Dynamic Casualty Forecast engages clients at all levels with clear, concise visuals and financials. For the first time, auto fleet managers will now have data-driven decision support to proactively engage the insurance markets on a country-by-country and aggregated basis across Europe."

"This approach breaks down the segmentation for motor liability across countries and markets to provide better risk insight and decision support for our clients."

## Aon: captives not concerned enough about brand damage

A significant number of captive directors are underestimating the severity of threats to brand reputation, according to an Aon Risk Solutions survey.

The survey of executive and non-executive captive directors, conducted as a follow-up to the 2015 Global Risk Management survey to assess whether Aon has correctly identified certain risks as underrated, revealed that only 44 percent of those surveyed believe that damage to reputation should be viewed as a significant business risk.

More than half of captive directors in the Europe, Middle East and Africa region did agree that reputation and brand damage should be a prime business concern, although this fell to 35 percent in the Americas.

Rory Moloney, CEO of Aon Global Risk Consulting, commented: "Damage to brand and reputation can become a significant business risk. The speed of technological advancement, coupled with societal, economic and political changes means that reputational damage is an increasing concern."

The survey also revealed that 78 percent of captive directors believe the risk readiness level for cyber risk has, or may have been,

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vastly overstated, while 63 percent said that political risk had been seriously underrated.

Some 70 percent of surveyed captive directors also agreed with Aon's assessment that it is imperative for senior executives to communicate with risk managers and take an active role in assessing and covering the company's risk exposure.

Stephen Cross, chief innovation officer at Aon Risk Solutions, said: "The current world of risk is predictably unpredictable. The interconnectivity of traditional and emerging risks means organisations can no longer evaluate individual risks in isolation but must look at all the top risks and people in a more holistic way."

### Advantage and Captive Experts do management deal

Advantage Insurance Management USA (AIMUSA) has agreed to acquire the insurance management business of Captive Experts.

As part of the deal, Captive Experts will transfer management of the Harbor Risk Pool Association and a portfolio of captive insurance entities to AIMUSA.

The financial terms of the acquisition, which is subject to regulatory approval, were not disclosed. Following the transfer of the Harbor Risk

Pool Association and the individual captive insurance entities, which is to be completed this month, Captive Experts will focus on its core business of providing consulting services to business owners throughout the US.

Tom Cifelli, owner of Captive Experts, commented: "I have known Simon Kilpatrick and the Advantage team for many years and have great confidence that they will provide excellent service to our mutual clients."

"By transitioning its day-to-day captive management duties to Advantage, Captive Experts will be able to dedicate itself to its core captive insurance consulting business."

Kilpatrick, president of AIMUSA, added: "The transition to Advantage will deliver an expanded range of insurance capabilities to Captive Experts's clients, while providing Advantage's clients access to a proven, diversified risk pool."

### Northwind notes get a thumbs up

A.M. Best has affirmed a rating of "a" on \$800 million worth of insurance notes issued by Unum Group subsidiary Northwind Holdings.

Northwind Holdings was formed to hold the stock of Northwind Re, a special purpose financial captive insurance company

domiciled in Vermont, as well as issuing insurance notes.

Northwind Re provides reinsurance coverage to Unum subsidiaries Provident Life and Accident Insurance Company, The Paul Revere Life Insurance Company and Unum Life Insurance Company of America.

It also facilitates the funding of a portion of the capital required to support a closed block of individual disability income policies.

The rating of the Series A Floating Rate Insured Notes due 2037 took into consideration the adequacy of the excess cash flows at Northwind Re available to be transferred as dividends to Northwind Holdings to service the notes.

A.M. Best also took into the consideration the ability to meet or exceed certain benchmarks relative to Northwind Holdings's plan and forecast, as well as the performance of its investment portfolio, which primarily consists of investment-grade securities and is the primary source of funds to pay ongoing claims.



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# The life of a captive

AMS Insurance director Derek Lloyd discusses the reasons behind captive formations, re-domiciliations and liquidations

BECKY BUTCHER REPORTS

## How often are captives re-domiciling these days? Is it common? And which domiciles are they gravitating towards?

In our experience to-date, captive re-domiciliation is not commonplace. One AMS Insurance client in 2014 elected to re-domesticate its captives to a US state for a combination of reasons, while one or two others are presently looking at their options this year, although not one has commenced the process so far.

Equally though, we continue to see a movement of business from other jurisdictions to the international finance centres.

## In your opinion, why do re-domiciliations typically happen?

I believe that several factors drive the movement of captives from one domicile to another. Some of these factors apply in tandem, while others may be specific to the captive itself and the current or new domicile.

Undoubtedly, there is far more choice available to today's captive owners than there were some years ago. Secondly, and as above with North Carolina as an example, some of the more recent US states enacting captive legislation are offering significant incentives to both existing and new captive entities to re-domicile or set up in their

state. Domiciles such as Texas and Missouri appear to be specifically targeting parent companies located in their own states that may have been domiciled elsewhere in the US or in the established international financial centres.

With competition on choice normally comes competition on pricing. Again, captive owners that may have had limited choice originally are now becoming more discerning in evaluating the operational expenditure for the captive and that may ultimately result in a change of domicile.

In certain quarters, there is also a view held with regard to US business in particular that the revenue authorities are much less likely to audit a US-based captive than a similar entity in an international finance centre. Whether that perspective is true or not, time will tell.

I certainly do not share that view but it would be naïve not to appreciate that since the global economic meltdown in 2008, the governments of the leading nations, their revenue authorities and international regulatory watchdogs have certainly sought to impose and enforce higher regulatory standards on some of the smaller members of the global financial community than they are willing to implement in their own backyards.

## What about captive liquidations?

Within a management portfolio of around 150 companies, we would typically expect

to see three to five liquidations per annum offset each year by perhaps 15 to 20 new captive formations.

Looking purely at our own book of business and the typical lifecycle of a captive, I would say that 2014 was a little higher than average in terms of liquidations, but equally, new formations and continuances were up and significantly exceeded the number of liquidations.

This year has reverted to type with a couple of liquidations to date, one ongoing continuance in from the US and eight new approvals or ongoing applications.

Typically much of the new business formation also takes place in Q4 and all the indications are that the end of 2015 will mirror previous years, with a flurry of new business activity anticipated over the coming weeks.

## How common is consolidation, when a parent has multiple captives?

Over the years we have probably had no more than five or six parent companies of sufficient size and diversity to warrant the establishment of separate captives for their diverse operations.

While you see the occasional consolidation through mergers, it is not commonplace at all. **CIT**



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## That would be ideal

Captives are increasingly including employee benefit schemes in their businesses, notes Ludovic Bayard of Generali Employee Benefits Network

### BECKY BUTCHER REPORTS

#### Are you seeing an increase in employee benefits being funded through a captive?

We have been observing a trend towards a growing inclusion of employee benefits schemes into captive arrangements, and this trend has been intensifying over the last few years. From about 20 such arrangements only a few years ago, we count today well over 80 captives writing employee benefits business.

Several converging factors are driving this trend, starting from the growing role played by employers in providing social security against the backdrop of shrinking state budgets. The growth of the employee benefits market has certainly helped put this sector on risk managers' radar. So, while areas traditionally

covered by captive arrangements, such as property and casualty and workers' compensation, are still predominant, we see that new lines of business, from healthcare to life and accident, are acquiring a larger share within the risks placed with the captive.

Perhaps even more tellingly we see that more and more requests for proposals regarding pooling solutions specifically enquire about the captive capabilities of the provider. This means that companies are keenly considering this approach while adopting a long-term vision.

They are aware that transferring employee benefits to captives is a complex process, which requires thorough preparation and planning, as well as a very careful selection of the right partner.

#### What are the key advantages to placing employee benefits in a captive?

Funding employee benefits through a captive can create value for a company in several ways, depending on specific priorities and needs. A first key advantage for the parent company is the opportunity to achieve risk diversification in the captive's portfolio, thus reducing the volatility of the overall financial experience.

Including employee benefits adds to the portfolio a large number of risks that are of relatively low severity, geographically spread and often uncorrelated to casualty exposures. Employee benefits, with their additional premiums and relative stability of

results, represent an 'ideal candidate' to help the captive achieve risk diversification, meet capital requirements and ultimately finance the company's risks.

It is further increasingly relevant for risk managers and HR managers to use the captive as a strategic tool to manage more effectively the growing relevance of their employee benefits solutions worldwide. Owning the risk allows them more central control on a wide range of areas, from underwriting terms and benefits design to pricing decisions and claims management. For some of our clients, the captive has increased transparency and accountability in handling claims in order to control costs and allowed them to directly respond to emerging challenges, such as rising healthcare costs.

Favourable tax treatment and overall cost savings, from improved cash-flow and interest on reserves, are certainly part of the debate. All these aspects should be carefully evaluated in the context of such a complex and strategically relevant decision. It is important for companies to start with a high level evaluation of the overall enterprise risk management strategy, in order to establish priorities and objectives, and then to assess their experience over time, to make well-informed decisions in the implementation of their plans, for example, countries to be included, pricing assessment, and so on.

## And are there any drawbacks?

We can consider as a drawback the higher effort and level of involvement required of the parent company, in terms of risk management expertise and understanding of insurance, to grasp the advantages we have just discussed.

To justify this effort, two main factors should be considered: size, in terms of critical mass of employees needed to make the captive economically viable, and central control and coordination of the local subsidiaries, in order to collect data and cascade the implementation of the insurance local plans.

Data analytics and reporting capabilities are among the services captive's parents are most interested in when evaluating a service provider. Companies need to have access to meaningful data, to gain both a global overview at head office level and insight into local performances. They have to establish central underwriting control and ensure that each local quote is aligned to the overall underwriting results of the global programme. The reporting and monitoring framework is key to facilitating understanding of the experience over time, and sustaining long-term planning, as well as to promptly addressing emerging issues.

Local compliance requirements represent another key aspect companies need to look at. Locally admitted insurers must issue

employee benefits contracts in order to comply with local labour and fiscal regulations. Relying on a network of commercial insurers as fronting vehicle allows for each local contract to be issued on a fully admitted basis, thus benefiting from the best fiscal treatment possible and complying with local provisions.

“ **Solvency II provisions on capital assessment and governance should be applied to captives, according to the principle of proportionality, in a simplified manner compared with commercial insurers, and based on the specific business model of the captive** ”

This explains why the geographic match between the company's global presence and the network's geographic reach is another important criteria in the selection of the provider.

## What are the regulatory implications of placing employee benefits in a captive insurer?

Regulatory implications need to be considered from the very beginning, starting from the choice of the domicile. The location where the captive is based will have direct implications on the fiscal treatment, solvency requirements and overall regulatory provisions. While offshore jurisdictions are still the most popular choice, mainly because of their lower capital requirements, we expect to see a trend of increasing captive formation in onshore domiciles, particularly in Europe with the Solvency II regime, but also in US-based captives.

The Solvency II regime, to be implemented as of January 2016, will harmonise the prudential framework for insurance undertakings across Europe and third-party countries that have been granted equivalence, starting from a first

package approved in June by the European regulators and including Switzerland, Australia, Bermuda, Brazil, Canada, Mexico and the US.

The new provisions update the assessment of the risk with a more sophisticated approach where the diversification benefits we were discussing before are recognised as key to contributing to the optimal allocation of capital. Solvency II provisions on capital assessment and governance should be applied to captives, according to the principle of proportionality, in a simplified manner compared with commercial insurers, and based on the specific business model of the captive.

US companies that wish to include employee benefits in a captive arrangement need to seek prior approval from the Department of Labor as employee benefits may constitute a prohibited transaction according to employees' protection rules.

## Do you think the popularity of using a captive to fund employee benefits will continue to increase or decrease?

We expect that the employee benefits industry will continue to grow and to gain importance in companies' risk strategies. They will be increasingly part of employers' corporate social responsibility strategies, as business players are called on to step in their involvement in ensuring societal wellbeing, and of their talent acquisition and retention strategies to improve their global competitiveness.

Employers are willing to contribute to delivering innovative solutions to respond to societal challenges and to sustain their growth objectives.

They are willing to discuss and explore new lines of business that can be included in the captive's portfolio such as voluntary coverages, wellness and assistance solutions. [CIT](#)



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# Industry Events

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## Industry appointments

State governor Doug Ducey has appointed former Arizona Representative **Andy Tobin** as director of the Arizona Department of Insurance.

Tobin has served as director of the Arizona Department of Weights and Measures, where he has been instrumental in consolidating into other areas of state government to cut down on bureaucracy.

He brings experience in insurance banking and public policy. Previously, Tobin owned and operated local farmers' insurances and more recently owned his own employee benefits company.

Ducey commented: "I'm pleased to announce Andy Tobin will continue his service to the state in this new role. I know he will serve the people of Arizona with the same energy, diligence and reform-minded attitude for which he is known and trusted."

Tobin added: "I'm honoured to continuing serving the people of Arizona as a member of governor Ducey's administration. I thank the governor for this opportunity and look forward to working with him and the department to protect Arizona consumers."

**Ben Nelson** has decided he will not renew his contract as CEO of the National Association of Insurance Commissioners (NAIC).

His current term ends on 31 January 2016 when he will then return to his private law practice in Nebraska and Washington DC.

Nelson plans to be available in a consulting role to the NAIC as needed during the transition.

He commented: "I have truly appreciated the opportunity to return to the NAIC following my retirement from the US Senate [and on] 1 October 2015 [it] marks 50 years since I commenced my work supporting state insurance regulation."

He began his career with the Nebraska Department of Insurance as supervisor of claims and inquires, then followed as director of the Nebraska department. He has also served roles as executive vice president of NAIC, governor of Nebraska and as a US senator.

Monica Lindeen, NAIC president and Montana insurance commissioner, commented: "On behalf of the officers and members of the NAIC, I want to thank Nelson for his service to our organisation."

ANV Underwriters has appointed **Florian Tischer** to its mergers and acquisitions (M&A) insurance team.

Tischer, who brings five years of legal experience to ANV, focuses on the M&A, corporate and commercial fields. She will be



based in ANV's Barcelona office and will report to Thomas Mannsdorfer, underwriting director of M&A insurance.

She has previously served as a lawyer at international law firms including Field Fischer Waterhouse and Weil, Gosthal and Manges.

Mannsdorfer commented: "We are very pleased to welcome Tischer. ANV has a strong and established presence in Europe, and this is an ideal time to build our business and client base."

"Her expertise in the M&A and private equity sector as well as familiarity with the German-speaking market make him an excellent addition to the team."

JLT Re has appointed **Eve Dartigues** as client manager in Paris.

Dartigues began her career in aviation insurance at La Reunion Aerieenne.

She also has experience in property catastrophe reinsurance at Liberty Specialty Markets in Paris, where she worked on analytics and underwriting.

She has also worked in North America and is a member of the French Institute of Actuaries.

Commenting on the appointment, Jean-François Delon, head of JLT Re Paris, said: "Dartigues is a great addition to our team in Paris bringing great experience and an ability to connect with the clients at a high level which will help us to continue to bring innovative and market leading solutions to our clients and partners." **CIT**

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