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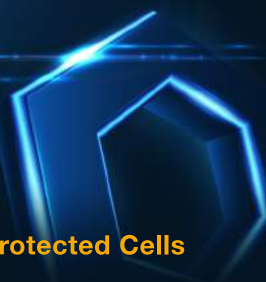

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Roundstone and HUB team up on captive programme

Roundstone Management and HUB International have partnered up to create self-funded medical captive programmes.

The partnership with Hub will allow Roundstone to continue their strategy of helping employers control their healthcare spend, by providing transparency, control and cost containment.

Roundstone focuses on the development, underwriting and servicing of alternative risk products including captives and specialty insurance programmes, while Hub provides property and casualty, life and heath, employee benefits, investment and risk management products and services.

Clint Anderson, president of specialty insurance at Hub, said: "Hub's deep bench of experienced advisors and proven cost containment strategies, coupled with Roundstone's track record of successful captive programmes is a game changer for our clients."

Mike Schroeder, president of Roundstone, added: "Business owners throughout the US are desperately looking for an answer to a second or third line item expense that is doubling as fast as every four to five years."

"It is difficult for an employer to identify the cause of increasing health insurance costs without claims information, but it's impossible to fix when control over the drivers of the cost is removed from an employer."

Sun Life and Pareto launch stop-loss group captive

Sun Life and Pareto Captive Services have teamed up to establish a new stop-loss group captive solution, Legend Re.

The new captive has been set up to reduce claims volatility for small and medium self-funded employers, or fully insured employers transitioning to self-funding.

Legend Re will be available for 1 January 2018 policy effective dates.

According to Sun Life research, four out of 10 fully-insured employers would consider switching to self-funding and, of those, 70 percent would consider using a captive solution when switching.

It also revealed eight out of 10 brokers expect at least one of their clients to utilise a captive in the future.

Brad Nieland, vice president of stop-loss for Sun Life Financial US, commented: "Captives allow employers to pool together to share a portion of their self-funded risk, reducing claims volatility and making them a viable option for small and medium employers looking to self-fund their medical benefits."

"The partnership will draw on Pareto Captive's expertise in the client education, formation and ongoing management of group stop-loss captives, and the strength of Sun Life's stop-loss product and services."

Andrew Cavenagh, managing director of Pareto Captive, added: "Working with Sun Life as our stop-loss fronting carrier partner on this new programme brings added value to both organisations' services."

"Captives make self-funding more accessible for small and medium employers, so it is important to offer a strong stop-loss option that will give those employers the risk protection they need once they've chosen to self-fund."

Cybercrime losses set to increase, says cyber risk expert

Losses from cybercrime are only likely to increase because of far-reaching global connectivity, warned James Trainor, Aon's senior vice president of cyber solutions.

Speaking at the 2017 Guernsey Insurance Forum, Trainor, former head of the FBI's cyber division, suggested a 2014 study by the Centre of Strategic and International Studies that attributed annual losses of $445 billion to cybercrime was now "vastly underestimating the current position".

Trainor explained: "Various organisations have done research, over the last couple of years, and some suggest that that the figure will go up to six trillion."

"The internet of things is a perfect example; there's about six or seven billion devices connected to the internet now. That number could go up to 20 or even 50 billion devices in the next three to five years, so more connectivity means more opportunities to do denial-of-service attacks, more vectors into your network, more opportunities to crypt those devices to make money."

Trainor warned attendees of the forum that there was currently a lack of insurance premiums being taken to cover for the estimated losses from these cyber-attacks.

He said: "I'm not sure six trillion is the real number, but I do know the insurance premiums that are coming in, which is about $3 billion annually on cyber. So, whether it's $445 billion or six trillion, there's only three billion in capital – that's a significant gap. Essentially, companies are absorbing the losses for this."

"That's why I call cyber somewhat of a team sport, meaning that companies have to do a better job of protecting their network, the insurance industry has to bring more capital into the industry to cover the losses and government has to do a better job of disrupting it."

Trainor emphasised the importance of having trusted advisers who could navigate what was becoming an increasingly complicated space.

He stated: "If cyber security's very complicated, cyber insurance is equally complicated. The past is less indicative of the future in cyber. We don't have 350 years of actuarial data to underwrite cyber risk – the threat evolves."

"Ransomware is a perfect example of how the threat has evolved over the last three

years. It went from getting paid from a credit card or PayPal to now having to do the transaction entirely on Tor, which is an anonymised browser, and pay via a virtual currency."

Axial Benefits complete captive deal

Axial Benefits Group has completed a medical stop-loss transaction with QBE North America to enhance its healthcare purchasing coalition operations.

The programme creates a direct relationship between Axial Benefits Group's healthcare purchasing coalitions and QBE.

The deal will lower costs, increase stability, reduce turnaround time on claims and improve process efficiencies that facilitate employer productivity.

Captive management company Strategic Risk Solutions will provide financial reporting, regulatory compliance and programme management services for the coalition premium funds.

Mick Rodgers, principal, and managing partner, Axial Benefits Group, commented: "This is an exciting step forward for the healthcare purchasing coalitions Axial Benefits Group manages."

"The direct relationship with QBE affords us a tremendous opportunity to eliminate administrative steps, gain meaningful efficiencies and ultimately, provide our clients with an opportunity for even greater returns."

Steve Gransbury, president of accident and health of QBE added: "Our primary goal was to fully optimise an already high-performing programme by bringing employers, advisers and carriers closer together."

"We used a collaborative process with feedback from leading advisers and their clients to construct a programme that shares responsibility, risk and success."

In 2016, Axial Benefit's healthcare purchasing coalition returned $3.2 million in surplus assets to coalition members.

According to Axial Benefit, this form of dividend sharing is made possible through a premium pool that the coalition members create by banding together.

First Vermont captive invests in affordable housing tax credits

CPA Mutual Insurance Company of America Risk Retention Group is the first captive insurance company to take advantage of Vermont's Affordable Housing Tax Credit programme.

The captive purchased £133,334 of credits from the Champlain Housing Trust (CHT) and will use the proceeds to create permanently affordable homes in Essex, Vermont.

Vermont's captive legislation expansion was passed by the Legislature in July, allowing captive insurance companies to participate in the Affordable Housing Tax Credit programme.

CPA Mutual's captive management company, Strategic Risk Solutions, worked with the Vermont Captive Insurance Association and the Vermont Department of Financial Regulation to bring the initiative to the legislature.

The purchase of the tax credits will provide a reduction in state tax liability spread out over the next five years, while providing a lump sum up front for CHT to subsidise four condominiums for sale in its signature shared equity programme.

William Thompson, president of CPA Mutual, commented: "This was an easy decision for us. To play a role in increasing the availability of affordable housing in Chittenden County is critical right now, and investing in the tax credits makes good business sense, too."

The four condominiums at Fort Ethan Allen, Vermont, will be available for purchase by households earning less than the area median income, which for a family of four is $82,400.

The revenue from the sale of the credits will subsidise the purchase of the homes.

In exchange for this down payment assistance, buyers agree to share any market appreciation if they decide to sell at a future date.

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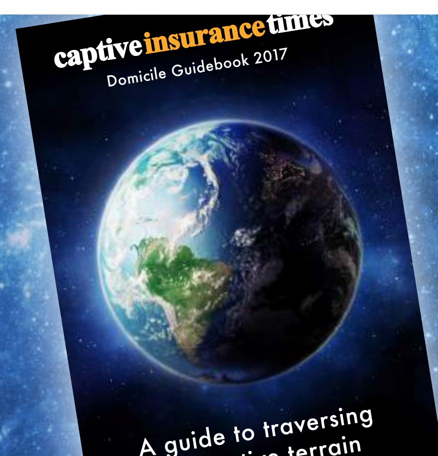

EU and US sign covered agreement

The EU and US have signed the bilateral covered agreement on insurance and reinsurance.

The signature marks the final step in more than 20 years of discussions and a year of formal negotiations between the European Commission and the US Department of the Treasury and Office of the Trade Representative.

The covered agreement eliminates collateral and local presence requirements for qualified reinsurers and meaningfully streamlines group supervision requirements for insurers and reinsurers operating in both jurisdictions.

In a joint statement, the EU and the US said: "The agreement represents a major step forward in US-EU cooperation on insurance and reinsurance, conveying benefits to EU and US insurers and reinsurers operating across the Atlantic, by offering them enhanced regulatory certainty, while maintaining robust consumer protections."

Without a signed agreement, US companies would have been unable to renew or write new business in the EU without first establishing a local presence in each EU member state in which they intend to write business.

A statement from the European Commission said: "EU reinsurers estimate that they have about $40 billion of collateral posted in the US, which could instead be invested to create jobs and growth. The opportunity cost is estimated at around $400 million per year."

It also explained that the agreement brings "prudential benefits" including a change that means EU insurers and reinsurers must prepare only one risk and solvency assessment in light of their specific risk profile. US supervisors will also use this assessment.

US trade representative Robert Lighthizer added: "The agreement with the EU levels the playing field for the US insurance industry, thereby strengthening American competitiveness in the EU."

Gibraltar approves Lottoland PCC

Lottoland has been granted an insurance licence by the Financial Services Commission in Gibraltar for its newly established protected cell company (PCC).

The new PCC, Fortuna Insurance PCC, is believed to be the only company in the gaming sector to establish its own insurance company.

Fortuna Insurance has been set up to underwrite all the bookmaking risks of Lottoland and will be regulated by the financial services commission in Gibraltar and the European Insurance and Occupational Pension Authority.

The insurance company will have a board and management team consisting of five experts who focus on insurance and reinsurance, financial markets and regulation.

Nigel Birrell, CEO of Lottoland, said: "The fact that Lottoland is the first and only company in the gaming sector to have done this highlights our commitment to industry best practice and transparency."

"This is a huge step forward not just for Lottoland but also for the gaming industry."

New Coverys syndicate targets risk retention groups and healthcare captives

Coverys is set to establish a new syndicate that will write medical liability insurance and healthcare reinsurance, with a focus on healthcare captives and risk retention groups (RRGs).

The medical professional liability insurance provider will be the sole capital provider for Syndicate 1975, which will be managed by Lloyd's managing agency R&Q Managing Agency (RQMA).

In June, Coverys entered into an agreement with RQMA's parent company, Randall and Quilter Investment Holdings, to acquire the third-party managing agent.

The syndicate, which has received 'in principal' approval from the Lloyd's Franchise Board, is expected to begin underwriting business on 1 January 2018.

Greg Hanson, CEO and president of Coverys, said: "The syndicate will write a balanced portfolio of both medical liability insurance and healthcare reinsurance across a broad range of specialty lines

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in which Coverys has well-established product offerings."

Hanson added: "This reinforces Coverys's commitment to protecting the delivery of healthcare by providing sophisticated insurance and reinsurance capacity to healthcare and provider organisations as well as healthcare captives and RRGs."

GFSC addresses Solvency II and IAIS capital standards project

The Guernsey Financial Services Commission (GFSC) has launched a discussion paper seeking the industry's feedback on the evolution of the island's global and European insurance capital standards and the future of Guernsey's regulatory framework.

The paper considers the International Association of Insurance Supervisors (IAIS) International Capital Standards (ICS) project, which could create a global standard for insurance capital.

The IAIS is currently developing the ICSs, which could potentially create a comprehensive group-wide supervisory and regulatory framework for Internationally Active Insurance Groups (IAIGs), due to come into effect in early 2020.

The ICSs are designed to achieve a greater degree of comparability across jurisdictions and firms, through implementation of the Insurance Core Principles (ICPs).

The discussion paper said: "In due course Guernsey will need to consider its approach to ICS in order to remain in line with international standards."

"Aspects of the draft ICSs resemble aspects of Solvency II, and therefore it is possible that achieving Solvency II equivalence would ease Guernsey's path to ICS implementation. However, this would be true, albeit to a lesser extent, of Guernsey's current risk-based approach to solvency."

The paper also discusses the possibility of Guernsey achieving Solvency II equivalence. The Solvency II directive, applicable to EU member states from January 2016, introduced a "harmonised prudential framework for insurance firms", the paper said.

According to the paper, Guernsey International Insurance Association's focus would be on reinsurance equivalence only.

If there were to be any decision on Solvency II equivalence, insurance-linked securities and captives would be outside of the scope, assuming EU authorities agree bifurcation as they have done in other domiciles, such as Bermuda.

The paper explained that any preference of Guernsey's needs to be considered in the context of the EU equivalence process.

In addition, the European Insurance and Occupational Pensions Authority (EIOPA)

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is obliged to consider the materiality of the appellant jurisdiction.

However, the paper suggested that, at this point, it seems likely that two relevant components of materiality are the comparable size of the Guernsey insurance sector and the extent to which it touches the EU.

Interested stakeholders are invited to respond to this paper no later than 20 October 2017.

Feedback received will be reviewed by the commission and summarised in a follow-up feedback paper.

XL Insurance Company decides on Dublin for its post-Brexit location

XL Group has revealed its plans to move its principal EU insurance company, XL Insurance Company, from the UK to Ireland in 2018, in response to Brexit.

The group has had insurance operations in Dublin since 1990, when it opened its first European insurance company.

In 2006, it then established XL Re Europe, which remains domiciled in Ireland.

Dublin was also the domicile of choice for the XL Group's parent company between 2010 and 2016, before its new holding company, XL Group Ltd, was formed in Bermuda following the group's acquisition of Bermuda-based Catlin Group Limited.

XL Insurance Company is a wholly-owned subsidiary within XL Group and provides the main insurance company platform for XL Group within Europe and Asia, operating through an international network of branches, subsidiaries and third-party fronting partners.

Commenting on the move, Mike McGavick, XL Group's CEO, said: "Since the referendum announcement we have been clear that our top priority is to provide certainty and consistency of service to our clients and brokers."

"Moving XL Insurance Company to Ireland means we deliver on that commitment."

He continued: "[The meeting] with An Taoiseach Leo Varadkar has only served to further enhance our relationship and our commitment to Ireland. Dublin is a natural home for us in Europe."

"We have a long and established presence in Ireland and we understand and respect the high-quality business environment, the regulatory environment and the talent of the people here."

Tennessee updates captive legislation

New captive legislation is to set Tennessee apart from other US captive insurance domiciles, according to the state's Department of Commerce and Insurance (TDCI).

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The department suggested that with "an eye toward increasingly balanced regulation, the TDCI is ushering in new, more modern rules to guide" the state's captive insurance industry.

The new rules, effective 21 December, will allow individual protected cells to go dormant and later to be restarted.

In addition, new captives and cell companies will no longer be required to be audited if they were formed in the last quarter of the year, representing cost-savings for the captives and cell companies.

Finally, a full financial exam will not be required where specific limited questions have arisen about the operation of a captive company.

Julie Mix McPeak, TDCI commissioner, said: "These rule changes represent six years' of lessons learned in licensing and regulating captive insurance companies and again demonstrate Tennessee's commitment to growing an important economic component."

Tennessee's captive insurance sector has generated an economic impact of over $692 million during 2016.

Cayman captives gain strength from teamwork, says IMAC panel

The Cayman Islands' strength in captive insurance comes from "its team approach to captives", according to a panel of experts.

In the recorded panel discussion, organised by the Insurance Managers Association of Cayman (IMAC), members of the local captive industry suggested the island has continued to develop and innovate throughout its 40-year captives history.

Julie Robertson, partner and chair at Honigman Miller Schwartz and Cohn, suggested that this is partly because of the experience of the providers in the domicile.

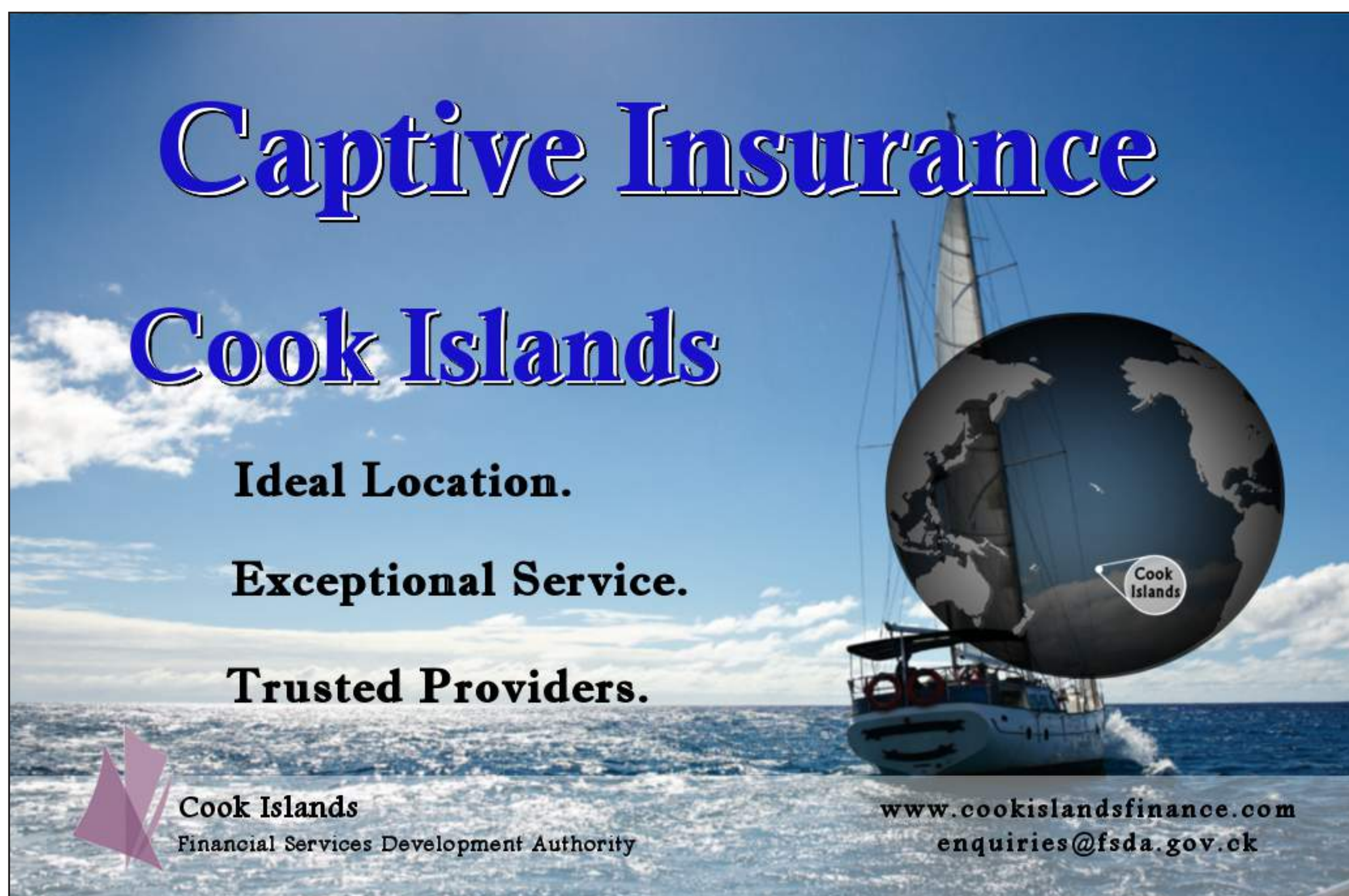
She said: "When you have people who know what they're doing, it makes a big difference. Cayman brings so much more to the table in this regard."

She added: "Stability also becomes the driving force. We're always very comfortable recommending Cayman because of the advantages that come with its stability."

Kieran O'Mahony, senior vice president and client services leader at Marsh Management Services, commented: "In other domiciles, the one-size-fits-all regulatory regimes may not be as appropriate for businesses."

"Here, we differentiate and discriminate by the amount of risk that an entity has."

The recorded panel discussions are set to become a quarterly event in the Cayman Islands.



The future's bright, the future's captives

Newly-appointed chairman of CCIA Michael Maglaras suggests that the future is bright for state's captive industry

Could you describe the current captive insurance industry in Connecticut? Are you experiencing a lot of positive activity?

Connecticut is a relatively new domicile, but with 15 captives licensed, and the parents of those captives in a variety of businesses, we think the future is pretty bright.

We're noticing a phenomenon that we're proud of: captives are coming to Connecticut, and those captives are choosing to come here because we have developed the reputation for being "the thinking person's domicile".

Captive owners have lots of choices for domiciling their captives and if they decide to come to Connecticut, it's generally because they've engaged with some of our great professionals in this state, who bring a wealth of experience to the captive process.

In August, the state licensed its first healthcare captive, have you seen any more movement in this sector?

In fact, we have. When news of the re-domestication of Keystone Indemnity Company was announced within days our office received a number of calls.

The parent organisation of Keystone has also received calls, particularly from captives domiciled in the Cayman Islands. Candidly, the idea that if you are a tax-exempt provider of healthcare services, your captive must be domiciled in Cayman, is an idea perpetuated by service providers and, in our current time, has little basis in fact.

Connecticut fact box

- Captive legislation passed in Connecticut in 2008
- The state welcomes all types of captives, including pure, association, industrial insured, sponsored and special purpose financial, and RRGs
- 15 captives licensed in the state, as of 30 September 2017
- It licensed its first healthcare captive, Keystone Indemnity, in August

> We're going to focus our efforts on riding the insurtech wave, because we believe that true insurtech innovation can't and won't work without a strong captive voice at the table

Michael Maglaras
Chairman
Connecticut Captive Insurance Association

How have numbers of licensed entities increased over the last year? And do you expect this to continue?

There have been several new formations in Connecticut in the past 18 months. The state's governor Dannel Malloy revealed on 4 October that the latest captive to be licensed is Stamford-based Charter Communications, a cable company.

The captive, Spectrum Communications Indemnity, is the largest of 15 captives licensed in Connecticut and provides coverage for the company's workers compensation, auto liability, general liability and employment practices liability. I'm also aware that other formations are in the pipeline, but are yet to be announced.

On a worldwide basis, the average number of captive formations each year is, statistically, on the decline, but despite this, Connecticut is getting its fair share. We think it tells a great story.

Connecticut is hosting its annual conference in October, what can attendees expect from the event?

Attendees can expect debate, dialogue and disruption. If I had to choose one captive event to attend this year, I would choose the Connecticut Captive Insurance Association Collaborative. I'm not just saying that because I am CCIA's chairman, my colleagues and I have crafted an agenda that is designed to have no boundaries.

Let me give you an example, we are going to blow up the notion that 831(b) captives are a poor solution to businesses' risk financing needs. I think we're all aware of 831(b) abuses—and the so-called professionals who are behind these abuses need to be drummed out of our industry.

The fact about Internal Revenue Code Section 831(b) is that it is a brilliant way, in the right hands, for moderate-sized commercial businesses to assume risk in a controlled environment. Connecticut is going to stake its claim as the domicile of choice for 831(b)s. We're going to do this by scrupulous business plan oversight that is also business friendly.

The idea that we have allowed, in our industry, a group of charlatans to take over and demean the 831(b) concept is a disgrace to the captive industry—and we in Connecticut are going to create an environment that sets that right.

Looking ahead to 2018, what will the association be working on?

We've got a big agenda and big plans. First, we're going to continue to promote Connecticut as the domicile of choice for smaller independent businesses.

Secondly, we have a number of healthcare providers in Connecticut with captives domiciled elsewhere, and we're going to ask these providers of healthcare services to give Connecticut a second look.

Next, we're going to focus our efforts on riding the InsurTech wave, because we believe that true InsurTech innovation can't and won't work without a strong captive voice at the table as, in the future, ecommerce insurance solutions will be underwritten by captives. We know this is the case, and we are here to support that revolution. **CIT**

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RBP plans: A healthy alternative

Reference-based pricing plans can be a highly effective form of alternative provider network, if they are implemented in a reasonable way to all parties involved, according to Phillip Giles of QBE

Self-funded employers are uniquely empowered with the ability to design plans that have an increased focus on controlling risk within their underlying benefit plan, to generate greater loss-cost savings. This is especially true of employers using or participating in a captive for their medical stop-loss coverage.

One strategy that is gaining popularity with self-insureds and stop-loss captives is the use of referenced-based pricing (RBP) schedules within the plan of benefits. In RBP, the healthcare plan sets the maximum amount it will cover for a particular healthcare service. RBP plans provide a more defined, or at least a less ambiguous, fee structure—as opposed to “usual and customary” definitions—by tying provider reimbursements to a specific reference point, such as a Medicare fee schedule, plus a defined margin. The margin is usually between 40 percent and 100 percent, for example, Medicare plus 60 percent.

RBP plan design can also take the form of a defined benefit schedule. This type of schedule specifically defines the maximum dollar amount assigned by the benefit plan for each specific treatment or procedure. Some hybrid plans will use usual and customary schedules for most procedurals but incorporate RBP defined schedules to specifically target and limit high-margin hospital charges such as infusion and dialysis treatments, durable medical supplies, and multi-night hospitalisations. As self-funded plans have more plan design flexibility, RBP designs have become increasingly prevalent as a cost-containment strategy. RBP plans can help an employer reduce plan costs by targeting specific areas of excessive cost leakage for containment through defined procedural schedules.

Common RBP plan-design approaches

The first method is a defined, or capped, price schedule for procedurals. The caps can be limited to specific procedures or apply to all treatments. Any charges above the plan’s defined maximum become the responsibility of the insured individual. This approach is frequently paired with a high deductible plan structure and designed to encourage increased-price shopping, aka consumerism, on the part of employees for treatment. Even with increased provider price transparency and increased availability of user-friendly platforms supporting enhanced consumerism, this RBP format has been slow to catch on. Many individuals do not yet feel confident or comfortable shopping for medical services and prefer to seek direction from their trusted primary physician. Without a dedicated plan advocate to provide insureds with plan navigation and appropriate provider advice, this RBP structure will continue to experience difficulty in adoption.

A second, and more common, approach is one that seeks to augment or ultimately replace a preferred provider organisation network through deeper procedural discounting from providers. As mentioned earlier, the reimbursement structure is normally based on Medicare as the reference base with an additional defined profit margin. It is important to point out that, in order for this approach to be viable, the potential for “balance-billing” must be eliminated. Balance-billing occurs when a provider expects a larger reimbursement than the amount actually received from the self-insured plan. The provider subsequently sends a bill for the remaining balance to the insured individual. To be effective, RBP structures should be pre-negotiated (or simultaneously, or post-

treatment, in a non-adversarial manner) with providers. Unpaid or contested balances can lead to financial duress and negative credit implications for insureds, and spur litigation between the insureds, employer and providers, and ultimately dilute the value of the health plan as an employee benefit.

Contributions and complications to consumerism

The increased use of RBP plan structures, require employees to become better educated healthcare consumers for non-emergency procedures. Insureds will need to shop for practitioners willing to provide services within their plan's RBP fee schedule. As mentioned earlier, without appropriate advocacy guidance, insureds prefer to seek referral direction from their primary physician.

Complicating efforts to objective consumerism is that few truly independent practitioners actually exist anymore; most have become employee practitioners after being acquired by larger health systems. Care referrals from these physicians are now likely to be directed to facilities within the physician's domestic health system in order to pyramid revenue generation.

The good news for consumers is that providers are facing increasing pressure to publish their pricing structures, making them more accessible to consumers, thus allowing covered employees to shop for the best price. There is a significant variation in medical prices, even for the most common procedures, within most geographic areas. Increased provider transparency will ultimately contribute to more competition, lower costs and reduced spending.

Many large insurance carriers are now publishing the fee schedules of their contracted providers. A number of online 'transparency tools', such as Castlight Health, Mpower360, and Healthcare Blue Book, make provider pricing information widely available. With enhanced transparency, more providers are becoming increasingly willing to negotiate and accept realistic Medicare Plus structures.

It is also important to note that there is usually little correlation between quality and price with regards to medical care. However, insureds should not select providers based solely on price. Just as pricing has become more transparent, so have the qualitative patient outcome scores of providers.

These scores measure the success and related complication and readmission rates against the number of the specific procedures performed by providers to determine a qualitative score. Precise qualitative scoring is currently a difficult measurement, however, when available, it can be paired with pricing data to effectively find the best care at the best price.

Continued evolution

For many self-funded plans, preferred provider organisation networks will gradually evolve into or be replaced by negotiated RBP networks. These will contemplate both pricing and quality of care into the provider reimbursement schedule. RBP plans can be a highly effective form of alternative provider network if they are implemented to mutual equitability for all involved such as, insureds, providers and plan sponsors.

Larger self-funded employers, including single-parent captives and group captives, having greater concentrations of employee populations in specific geographic locations can work locally to develop deep discount RBP arrangements with select providers in return for increased or exclusive patient steerage from the employer. RBP plans are most effective in higher density population areas where provider selection, competition and the potential for leveraged discounting is strongest.

A 2016 study published by the Employee Benefit Research Institute concluded that RBP plans can "save billions in healthcare costs". The combined advantages associated with self-funding and implementation of a well-planned RBP schedule can ultimately deliver decreased provider charges and improved patient outcomes to significantly enhance a plan's overall financial performance. **CIT**

"The combined advantages associated with self-funding and implementation of a well-planned RBP schedule can ultimately deliver decreased provider charges and improved patient outcomes to significantly enhance a plan's overall financial performance"

Phillip Giles, Vice president for sales and marketing , QBE North America

FERMA regulation

Laurent Nihoul of FERMA's Captive Working Group suggests regulatory developments should not be described as a negative trend, but an opportunity to improve professionalism

What trends and developments are you seeing in the European captive insurance market?

I would highlight three major trends. The first one is about the regulatory environment. The maturing of the industry over the last decades has been logically accompanied by a growing level of professionalism and regulatory challenges. For example, the International Financial Reporting Standards (IFSR) consolidation rules and Solvency II for European captives, which have already changed the captive landscape. I do not see this trend slowing down. Solvency II is now up and running, the Organisation for Economic Co-operation and Development's (OECD) base erosion and profit shifting (BEPS) principles are obviously already a hot topic but let us also think about IFRS 17 and the US-EU agreement on insurance and reinsurance. That will add complexity to the captive industry, but this is the price to be paid by a mature industry to keep on growing.

The second trend I see is on the technical side. New risks and new solutions are more and more developed through captive entities. Employee benefits and cyber covers are currently on the front page and will keep on growing, but more sophisticated and innovative solutions will continue to appear.

The third trend will undoubtedly be about how risk managers and captive owners will adapt to the changes in the set of skills needed to cope with reporting (transfer pricing), tax (BEPS), regulatory (Solvency II) or internal financial aspects (being challenged by the chief financial officer about consolidation impacts). The continuous soft market we are facing, coupled to those increasing regulatory constraints, hence increasing running costs, will narrow the traditional positive contribution of captives to their parent companies, for example, financing frequency to lower the total cost of risk, and consequently risk managers will have to switch more and more from that old 'insurance oriented' model to more sophisticated approaches and skill sets (corporate finance analysis) in order to meet their senior management's expectations in terms of captives' return or profit. I do believe this will be a key, but interesting, challenge for our profession in the coming years and professional education will have a huge role to play.

Are captives still experiencing a complex regulatory environment in Europe?

The regulation surrounding captives has constantly been extended in the recent past and this is not expected to decrease in the future. So yes, and without a doubt, captives are experiencing a complex regulatory environment, and not only in Europe because that trend is global.

Solvency II was obviously the major change for European captives and we are now going out of the first years after implementation. What we see is that the market has finally positively adapted to the new set of rules and we have not experienced the disastrous consequences predicted before Solvency II Directive enforceability. In the very beginning, the new regulatory constraints were presented as the scariest threat captive owners would ever have to face.

European domiciles were predicted to be abandoned because of various arguments such as inadequacy between the new regime and captives' specificities; increased capital requirements; uncontrollable and unmanageable governance processes; and higher management costs. Obviously, the market has not avoided the closing of some dormant structures or the move of some frightened companies to non-EU domiciles but globally it is now working well.

This is a lesson for future regulatory developments: that should not be always seen as a negative trend but also as an opportunity to constantly improve the professionalism of the captive industry. With strict regulation comes a better governance. With better governance, you have far more solid business processes and rationale. And all of this gives you credibility and maturity to constantly improve the scope of your captive business in

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uncharted areas. The key is obviously to maintain the principle of proportionality and a constructive dialogue with the authorities to match the captive industry's specificities.

Has FERMA received positive feedback on its BEPS guidelines, released in June?

The Federation of European Risk Management Association's (FERMA) BEPS paper was indeed positively received by the OECD tax department. The OECD now recognises the role of captives as a genuine risk management tool and the related insurance benefit for companies. We have established a fruitful dialogue with the tax department and FERMA's paper has been passed on to the OECD transfer pricing and financial transaction working group. As such, we do believe that risk managers' concerns are now fully part of the discussion.

We will continue our dialogue with them to support a consistent multilateral approach by national authorities. Obviously FERMA wanted to dispel misperceptions about captives through detailed explanations about how and why they are used as a risk management tool by companies, but our main objective was and remains promoting consistency in the way BEPS principles will be applied to captives. At the core of our paper are the proposed guidelines, which are meant to support national authorities when transposing BEPS actions into their national laws. The guidelines cover three areas that raised certain questions of interpretation by the OECD members during the implementation stage of the BEPS actions published in 2015: commercial rationale, substance and governance, and transfer pricing. The objective of our guidelines is therefore, mainly to avoid creating a patchwork of diverging national legislations inspired by BEPS. We will continue to be involved and to follow up with the support of all national associations composing FERMA.

Are there any future plans to produce similar guidelines for other industry challenges?

FERMA's BEPS paper has been transformed into the first volume of a new collection, FERMA Perspectives, which we will be launching during the FERMA Forum in Monte Carlo mid-October. This first one is titled Captives in a Post-BEPS World and once a year we will publish a new volume gathering the thoughts and work of industry experts about topical matters.

We will undoubtedly continue to produce such guidelines and share knowledge with and for the industry, but it will not exclusively relate to captives and their challenges.

How will the signing of the US-EU covered agreement on insurance and reinsurance help captive entities in the European space?

According to its very specific nature, this agreement will mainly affect the global insurance and reinsurance market rather than the captive industry. It contains three substantive areas: group supervision, exchange of information and reinsurance, the latter being the most visible one for risk and insurance managers.

The removal of collateral requirements for EU reinsurance carriers operating in the US will certainly result in more additional capital available for the reinsurance industry, thus additional capacity for insuring and reinsuring risks. That could have an interesting impact on market prices for corporate insurance buyers and captive owners.

EU reinsurers' collateral burden in the US is estimated at approximately $40 billion. Even though the collateral relief will not be absolute or complete, and will have to meet several critical conditions, that could have an interesting impact on the reinsurance market capabilities in the coming years.

As such, we believe this is a valuable new step as we always promote regulatory changes aimed at improving market competition and flexibility because it globally helps FERMA members to achieve their objectives.

What will FERMA be working on over the next 12 months?

I was elected as a FERMA board member last June and was appointed as the new board leader for our Captive Working Group during our last meeting on 19 September. I will soon meet with my fellow working group members to draft our agenda for the next years.

On the captive side, we will obviously continue our dialogue with the OECD in respect of BEPS questions and their further developments as well as pursuing our monitoring of Solvency II practical impacts and potential solutions to be developed to help our national associations and their members in coping efficiently with the new regulatory framework.

We should also focus on IFRS 17, as it is expected to be another main challenge for captive owners in the next few years. After Solvency II, that will be the next big shift for insurance operations.

In short, this will represent a significant change in the way insurers have to calculate their best estimate for provisions and will involve in-depth actuarial tasks. With an implementation date expected for 1 January 2021, we have to start to focus right now.

Beyond the captive industry challenges, the workload for FERMA is still substantial: from Brexit to cyber risk developments, from environmental regulation to risk governance, the agenda is already full of exciting and interesting challenges.

Education is also key for us and the RIMAP (the European professional certification FERMA created over the past few years) being now up and running, we definitely have some more than interesting years to come for the European risk management community. **CIT**

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Stemming innovation

Ian-Edward Stafrace of Atlas Insurance PCC in Malta gives insight into how cells in Europe are promoting innovation in the insurance market

The ever-growing and varied uses of protected cells are a testament to their flexibility. In the EU, Malta is enabling cells not only to be used in traditional captives, reinsurance or insurance linked securities (ILS) models, but also in directly writing consumer business or as fronting vehicles.

Cell formations in Malta, and globally, already outnumber those of standalones. Budding insurance technology firms are learning the opportunities of protected cells as platforms to experiment, incubate or launch new technology-driven business models.

These are exciting times to work in this sector, surrounded by so many new, innovative ideas that would not have been possible just a few years ago.

As a full EU member state, Malta enjoys the freedom to provide services and directly cover risks throughout the European Economic Area (EEA). It is already common for captives and cells in Malta to be profit centres by including customer and ancillary business. Besides added revenue, the diversification enables capital efficiencies.

Disintermediation

Capital is flooding into the hundreds of new insurtech start-ups around Europe and the world. Technology has the potential of transforming the entire insurance value chain including product development, customer acquisition, underwriting and claims management.

Insurtechs can accelerate the disintermediation of traditional distribution channels. While the strategy of large incumbent carriers has tended to include acquisition or investment in such ventures, our experience is that protected cells are helping those with an intermediary or technology background to take over the primary risk carrier role.

The desire from some brokers and intermediaries with successful profitable schemes to move from a focus on commissions and fees to a focus on underwriting profits through protected cells has been further boosted by the introduction of the EU Insurance Distribution Directive (IDD).

When an organisation realises that it has more data, risk or technology knowledge and ideas than the primary carriers, and it is confident in the potential profitability, it begs the question, why not become the principal and tap into the reinsurance market for support?

This is an old idea for captives, but one that is dawning on intermediaries, insurtechs and organisations outside the insurance sector.

With the increasing purchasing power of millennials and digital natives, more insurance is being purchased directly online. With

> **Cells can enable new ideas to be incubated or new business models to be attempted at a far lower cost than a standalone insurer, and without the dependency on a third party principal**

Ian-Edward Stafrace, Chief risk officer, Atlas Insurance PCC

full access to the EU single market, cells based in Malta are ideal digital insurers.

Cells targeting consumer business are a growing niche for Atlas PCC with its origins, expertise and risk appetite as an insurer. Atlas traces its almost 100-year history to family businesses representing well-known British and French insurance companies.

These merged to form one of the major local insurers in Malta. EU accession and local protected cell company (PCC) legislation provided the opportunity of international expansion through third party owned cells. In 2006, Atlas became the first direct insurer to convert to a PCC in the EU, and the first licensed PCC in Malta.

Incubation

Cells can enable new ideas to be incubated or new business models to be attempted at a far lower cost than a standalone insurer, and without the dependency on a third-party principal. This helps organisations that are often wary of indirectly providing intellectual property to insurance principals or fronters.

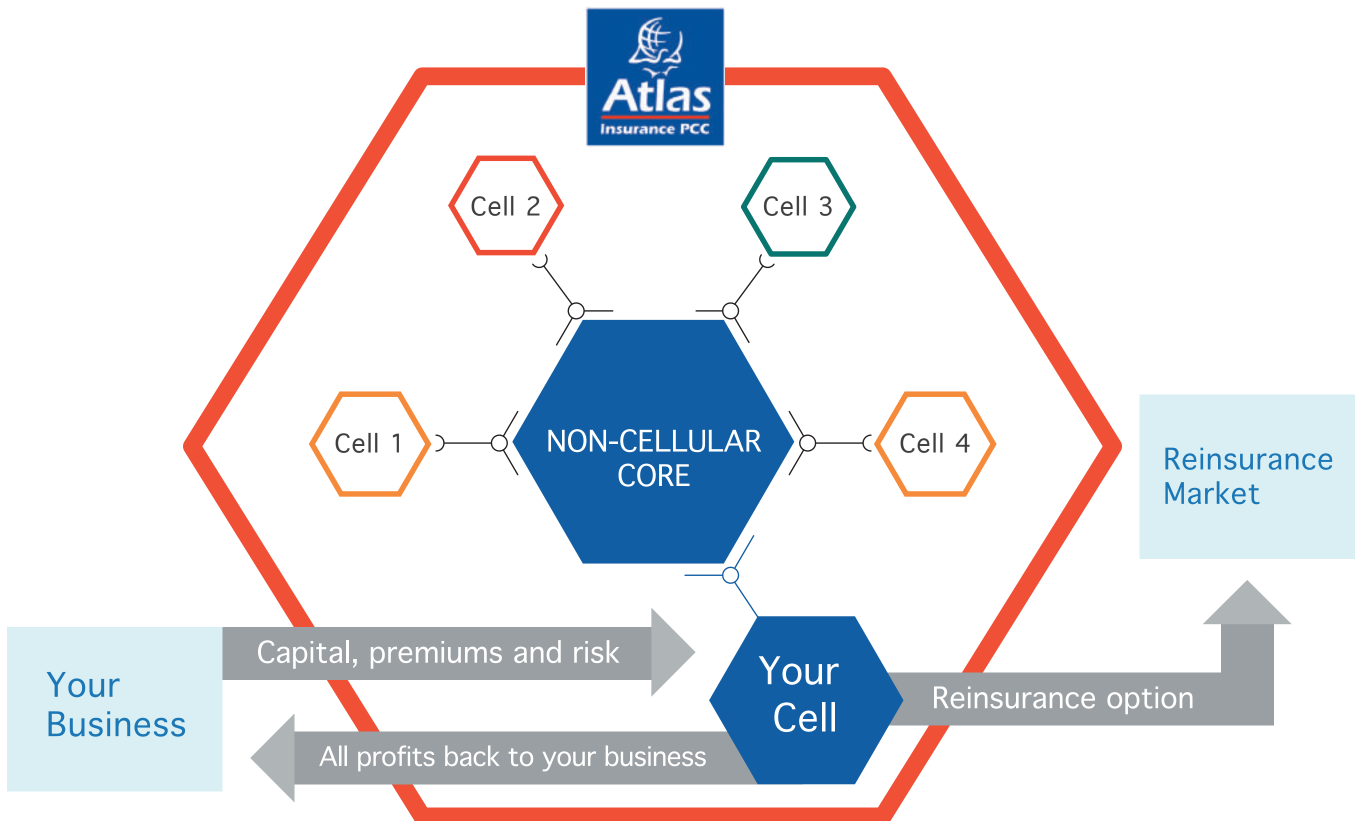
In order to spur innovation, insurtechs often adopt a philosophy to fail fast, fail cheap, and learn continuously. Fitting with this philosophy, should ventures turn out to be unviable in practice, despite different model iterations, these can typically be closed faster in a cell than in a standalone company, and the whole enterprise would have come at far lower cost and up front capital commitment.

Breaking barriers

PCCs help break the barrier to entry for new captives or start-up insurers unintentionally created by regulation. A new breed of regtechs are emerging in time to reduce such burdens, however no solution presents as much promise as protected cells thanks to their capital, cost and governance efficiencies especially in a Solvency II environment.

Well-resourced PCCs can provide cells with the regulatory expertise, infrastructure and economies of scale that can only usually be found in well-developed incumbent insurers. Over the past decade, in preparation for the Solvency II regime that went live in 2016, Atlas kept adapting its risk governance and reporting procedures in a way that allows cells to focus on their specific risks and business plan while its core provides broader support to ensure regulatory and good governance requirements are met. As a single legal entity, Atlas has one board, yet a degree of autonomy is provided to cells through committees that have representatives of the cell owner together with Atlas representatives under the board's delegated authority. This enables a faster decision-making process.

Common key functions including actuarial, risk management, compliance and internal audit apply across the PCC together with common processes such as the Own Risk Solvency Assessment required under Solvency II. The same applies to reporting and disclosure requirements, with one Regulatory Supervisory Report and Solvency Financial Condition Report and all resources in place to meet other quarterly and annual reporting as one single legal entity.



Capital

Under Solvency II, a cell owner will typically only need to invest own funds equivalent to the cell's notional solvency capital requirement, which, with small undertakings, often falls far below the typical standalone insurer minimums.

As one of the leading insurers in Malta, Atlas maintains substantial unrestricted surplus core funds over Solvency II capital requirements that, subject to our risk appetite, can be lent to cells. At all times, cells retain full protection of their assets, from liabilities of the core or other cells per legislation (See diagram).

Soft market

The prolonged soft market and increased regulatory requirements could on the surface reduce the captive appeal. Cells, however, can enable more efficient risk financing. Thanks to current lower reinsurance prices and wider capacity, risk managers are reviewing which risks to retain and which to cede. Diversification with additional lines helps improve capital efficiency, whether targeting own or third-party risks for added profits. Captives also help better manage deductibles, claims handling processes and data on risks and losses. Improved control extends to policy terms and choice of claims service providers. The built earnings create further capacity for greater risk taking for the parent.

Brexit

The uncertainty behind Brexit, particularly on what market access the UK and Gibraltar will be granted, is an opportunity for Malta to provide support and solutions. In the medium term, Malta will likely be the only member of the EU single market with insurance protected cell legislation. UK and Gibraltarian companies can ensure they maintain direct access to the 30 member states of the EEA through Maltese cells, which could retain or reinsure back the risks.

Expertise

Atlas PCC's team has built expertise over the past decade in this specialised sector, having assessed and implemented a variety of direct third-party, reinsurance and captive cells.

This is also recognised by leading global insurance management companies that use our independent facility for their clients with management outsourced back to them.

Where there are barriers to entry for captives and start-ups including insurtechs, PCCs are enabling such new entrants into the insurance market promoting innovation. With such flexibility, and the various solutions PCCs can offer to challenges not even yet identified, this structure has only scratched the surface of its full potential. **CIT**

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Martin Ellis of Comerica Bank explains why letters of credit are still the most popular collateral type used by the captive insurance industry

I've been writing banking articles for many years and, according to various industry surveys, the most popular collateral type used by captives continues to be letters of credit (LOCs). The less popular options include reinsurance trusts, followed by funds withheld by the fronting carrier.

Collateral required on fronted programmes

Captives are generally required to provide collateral on fronted programmes. In a fronted programme, the fronting insurance carrier, who is usually highly rated and licensed in the applicable US state to issue insurance, issues the insurance policy such as workers' compensation directly to the owners of the captive, and then reinsures some of the liability such as the first $150,000 on all claims with the captive. Since the fronting carrier issued the policy, they are legally responsible for paying claims to the insured, whether or not they can collect from the captive. As a result, the carrier requires collateral to mitigate this risk. Also, the collateral allows the fronting insurance carrier to exclude these reserves for losses from its balance sheet for regulatory purposes and avoid the Schedule F penalty on statutory statements, which is triggered when premium is ceded to an unauthorised reinsurer.

The captive is generally considered unauthorised, since it is not licensed in most states in the US. Finally, to avoid this Schedule F penalty, banks issuing the collateral must be approved by the National Association of Insurance Commissioners (NAIC).

Why fronting carriers prefer LOCs

Some of the reasons LOCs are still the most popular collateral option, according to fronting carriers, are their simplicity and ease of use, evergreen or automatic renewal feature, and irrevocable nature.

Also, most fronting carriers prefer to use LOCs should the captive go bankrupt, because the LOCs are irrevocable, from a third party—the bank—and becuase the issuing bank's obligations under the LOC are independent from those of the captive.

Attorneys generally agree that trust assets could very likely be pulled into a bankruptcy by the captive and possibly split among all creditors to the detriment of the fronting carrier.

Why captives prefer LOCs

Although LOCs are more expensive than reinsurance trusts in most cases, captives prefer LOCs because of their investment flexibility. Banks issuing LOCs will generally allow some high-yield bonds and equities to secure their LOCs, which should result in more investment income offsetting any added costs. Many argue that the investment flexibility offered by LOCs far outweighs the difference in cost. A portfolio of 70 percent bonds and 30 percent stocks actually has less volatility than a portfolio of 100 percent bonds over the long term, and returns an extra 3 percent annually, according to industry statistics.

Also, captives like the fixed-dollar amount on LOCs, which caps their liability with the front. Finally, LOCs are usually better for group captives where participants get LOCs from their banks and pledge them as collateral for the LOC the captive has issued to the carrier. These are called back-to-back letters of credit and are common under the LOC option, but not the trust option.

Reinsurance trusts

A reinsurance trust, also known in the captive industry as a Regulation 114 Trust, is an alternative to an LOC. It is adopted from the New York Department of Insurance regulations and is a three-party agreement between a captive, a fronting insurance company, and a bank.

Reinsurance trusts are cheaper, but have investment restrictions not only imposed by regulation, but also from fronting carriers. For example, some fronting carriers will only allow cash in the trust. Also, trusts generally do not allow equities or other risky assets.

Some carriers have begun to limit the amount of collateral they will accept in trust form, because of the extra work required to

monitor the trusts. In addition, some carriers have begun to charge trust administration fees of up to 125 percent and are requiring that captives pay for expensive portfolio monitoring software to make sure the assets in the trust are in the required form.

A common complaint with reinsurance trusts is that the captive often times has trouble removing excess assets from the trust. The front will claim that their liability has increased and is reluctant to release assets until an actuarial calculation can be performed. Also, some leading industry experts characterise trusts as complex legal agreements with vague provisions that often do not surface until many years later when the captive and its owner are most in need.

Security

The LOCs issued by the bank on behalf of the captive are almost always secured by collateral in the form of marketable securities (for example, cash equivalents, US government and agency securities, corporate fixed income securities, equities, and so on). The reason for this is that there is generally no recourse back to the parent company, since the captive should be a standalone entity with its own financing to support the premium deductibility by the parent.

Also, pricing for secured LOCs is generally much cheaper than pricing for unsecured LOCs. Pricing for secured LOCs varies, depending on the type of collateral pledged by the captive. In the event of a draw on an LOC, the bank can liquidate the collateral to reimburse itself for funding the LOC obligation. Similarly, with a reinsurance trust, the captive must fund the trust account with marketable securities although somewhat more conservative.

Haircuts

For LOCs, banks apply different advance rates or collateral margins on the collateral to provide some cushion against market fluctuations. Cash usually has a 100 percent advance rate, whereas a bank will generally only advance up to 70 percent on equities. Similarly, reinsurance trusts usually require over-collateralisation of up to 110 percent of the amount of the obligation.

Amendments

The process of making a change to an LOC is fairly simple. It is done via an amendment request submitted by the applicant to the issuing bank. The issuing bank would then issue the amendment, which must be approved by the beneficiary.

The most common changes to an LOC are the amount and the expiration date. The fees to amend an LOC are usually nominal. Reinsurance trusts are complex legal agreements, so amendments are much more expensive.

Funds withheld

The least popular collateral option for captives is funds withheld, which are cash and/or premiums that are due to the captive, but held by the fronting company as security. Although this is the cheapest option, it is also the least popular, since investment returns (if any) are minimal, the captive has no control over its investments, and it is often difficult for the captive to get this cash back from the carrier.

LOCs are still the most popular collateral choice for captives. Fronting insurance carriers prefer LOCs for their simplicity and ease of use, as well as the evergreen feature and the irrevocable nature.

Captives prefer LOCs because of the investment flexibility, which generally offsets any added costs, and the fixed-dollar amount caps their liability with the front.

Reinsurance trusts appear to be cheaper, but all costs, including administration charges by the fronting insurance carrier to monitor trust assets, lower investment income, and extra legal costs need to be considered. CIT

“Captives prefer LOCs because of the investment flexibility, which generally offsets any added costs, and the fixed-dollar amount caps their liability with the front”

Martin Ellis, Senior vice president, Comerica Bank

Maximising efficiency

Captives must demonstrate they are both efficient and cost effective. Colin Freeman and Peter Downey explain what Barclays can do to help

What trends are you seeing from the banking side of the captive industry on the Isle of Man?

Colin Freeman: A captive has to justify its existence by being a cost-effective and an efficient risk vehicle, both in terms of its insurance liabilities and in the management of its assets. The parent company could of course find alternative coverage in the market, so a key consideration for the captive must be how to maximise its efficiency, including the return it achieves on cash and investments. We are seeing more parent companies wanting to reduce the funding of their captives, which means captives are searching for more cost effective management of their reserves, surplus cash and of their collateral costs.

Many captives lend funds back to their parent company because they believe that is the best way to assist their group and to make the captive relevant. In a low-interest rate environment, that may be seen as the most effective thing to do, but they also need to be mindful that captives need to meet their regulatory obligations and their cash flow needs to have cash available and liquidity for claims and expenses. Plus, they must ensure sufficient diversification of their investments (including cash) and so many are looking for viable alternatives.

With the progressive reduction in the number of rated banks offshore in recent years, captives are finding fewer options for spreading their liquidity in the Isle of Man. More than ever, captive owners want to prioritise safety and Barclays has seen significant inflows of captive deposits over the last 12 months because of its strong rating and its competitive deposit rates. We have responded by tailoring a wide range of deposit and investment options to meet the needs of all captives, whether depositing for the short, medium or longer term.

In the current low-interest rate environment, achieving investment returns is quite challenging. Money market rates are rising steadily now in the US, but they remain at rock bottom in the UK. In the eurozone, rates are negative and banks therefore lose money accepting euro deposits, a cost they will pass on to their clients.

As such, it is very difficult for EU-domiciled captives to gain meaningful enhancements to their revenues through cash deposits. Many captives are now discussing with us whether investment management could be a better way to go where they have cash, which is unlikely to be required in the medium to longer term.

We are also seeing more captives actively exploring ways to reduce the need to provide collateralised letters of credit (LOCs) to fronting companies, and here they seek either to reduce their LOCs to a minimum or to agree direct guarantees or security trust arrangements whereby the front and captive hold collateral in a trust at lower cost. The benefit here is that there are no credit fees to pay, just a trust fee. Such arrangements have been common in the US for many years, but are only just starting to be used in Europe, which is surprising, given the cost advantages.

Peter Downey: A key objective for both the corporate and the vehicle is that the captive is efficient. Captives need to balance prominent returns with rationale for the vehicle; essentially, risk management. Everyone wants the silver bullet of high-level returns with low levels of risk, but in a captive scenario it is potentially quite inherent.

For example, in Europe, the European Central Bank has introduced negative deposit interest rates, and as financial institutions pass these negative charges to captive clients we are beginning to see conversations and approaches from captives evolve. Yes, banks have solutions, but these have to be the right fit for the client.

It comes down to what the captive wants to achieve and where they are in their lifecycle. New captives, set in the last three years, might be more risk averse, whereas a developed or established captive might be interested in a wider conversation about the alternatives.

What services and insight does Barclays offer SMEs in the Isle of Man looking to set up captive insurers?

Freeman: Captive banking requirements tend to fall under four headings:

- Transactional banking: Deposit taking and payments, meeting the needs of captives by providing them with a safe (highly rated and global), reliable and responsive banking service they can trust

- Investment management: When captives that have built up significant surpluses look to put them to more efficient use and review their shorter- and longer-term liquidity needs. Sometimes this is because they have to tie up collateral for letters of credit

- Letters of credit: A key conversation here is around how we manage that collateral for them in a way that suits their needs and makes the most of the longer-term duration of the liability

- Insurance trusts: These can be more cost effective than LOCs because the trust is an arrangement between the beneficiary and the captive to which the bank acts as a trustee, and the client pays a fixed fee for those services. Insurance trusts are becoming increasingly mainstream on the European side. They have been dominant over LOCs in the US for many years. But we advise captives considering use of a trust to look at the overall cost/return of the arrangements, as the beneficiary may insist that the assets held are kept in low-yielding short-term deposits, denying the captive the chance to invest those monies more freely, something that may be possible via a bank LOC

For all of the above services it is important that the chosen bank offers a relationship manager with experience and expertise in the captive industry.

By way of example, our captive insurance team has a long-standing relationship with a captive that provided cover for an S&P 500-listed corporation. Initially, the captive insurer required asset diversification, but as the company evolved, an LOC to collateralise their fronting insurance obligations was needed.

Not only was Barclays able to provide the LOC, but we also gave the option to use either cash or a discretionary managed portfolio comprised of high-quality bonds as collateral. By opting for the discretionary bond portfolio, the client benefited from credit diversification and yield enhancement versus cash, they made no compromise of capital preservation and liquidity and received active management from our team.

We worked with the client to review and amend their investment guidelines to reflect the evolving nature of their captive business and balance the requirement for prudent collateral management.

This has subsequently led to the introduction of a bespoke equity component to the portfolio, which reflects the underlying shareholder appetite for growth while protecting on the downside.

Our solution of a high-rated, short-duration bond portfolio and conservative equity product provides collateral for LOC in a very efficient and cost-effective way.

How are their funding and capital challenges different to the traditional Fortune 500s?

Freeman: Captives are generally not profit centers. Their goal is to be cost-effective and dynamic insurance vehicles that safely protect their parent groups as far as is practical and economic.

In recent years, captives have responded to economic change and new and emerging insurance risks by expanding the areas they insure, for example, by going into new areas such as cyber risk and making sure they are offering options to protect their owners against other emerging risks.

Again, the captive must demonstrate its efficiency, value and relevance to the parent company by competing with the alternative routes to insurance.

Captives are highly regulated and need to demonstrate a strong commitment from the parent company for effective risk management.

The captive has to make commercial sense to justify its existence, which means delivering on its insurance coverage, claims experience and on managing its costs as well as it possibly can.

Captive bankers offer a number of banking options and we recommend that captive boards regularly review these to make the very best of their financial planning. CIT

Colin Freeman
Vice president of captive insurance
Barclays Isle of Man

Peter Downey
Vice president of corporate investments
Barclays Isle of Man

Exploring Europe

Kate Kennedy
Senior managing director and
head of media relations at KBRA

As Kroll Bond Rating Agency's US operations continue to grow, it has expanded into the European market, as Kate Kennedy explains

What motivations were behind KBRA's expansion to Europe?

KBRA currently has 275 employees and offices across the US, located in New York, Pennsylvania, and Maryland. In addition, KBRA has published over 8,000 ratings totalling $750 billion. Given this growth and success in the US, we are expanding into Europe to provide the global capital markets with the same timely, accurate and transparent credit analysis that we've been providing over the past seven years.

What services will the European office provide?

The European group will begin focusing on residential mortgage-backed securities, asset-backed securities, infrastructure/project finance, as well as banks and financial institutions. The office currently has six employees including the head of our European operation, a compliance officer and then analysts focusing on the aforementioned asset classes. In addition to the six employees, we plan to grow the office rapidly, as the business dictates.

KBRA also provides market participants with thorough rating reports and topical research, free of charge.

What opportunities will the European office bring?

The European office will provide us with the opportunity to grow our business, which we've achieved so far by hiring experienced rating analysts who can focus on more complex and challenging asset classes and ratings. It will also afford us the opportunity of becoming a thought leader by providing the European market with insightful research.

As well as Europe, KBRA looks to expand into other geographies such as Asia and Latin America over the next few years.

Who will benefit from the European offering?

The market as a whole will benefit from KBRA entering Europe, but investors will benefit most. Since KBRA's launch in 2010, we have been focused on providing investors with the most detailed, thorough analysis to assist them in making informed investment decisions.

We look forward to providing investors in Europe with the same type of analysis and responsiveness that has helped us differentiate ourselves from the other rating agencies in the US.

What made you select Dublin for the new office location?

KBRA was very excited to open its first international office in such a vibrant city as Dublin. The city's growth over the last few years has been amazing and we look forward to adding to that growth.

There is a great talent base in Dublin from which we will draw as we continue our strategy of hiring the best analysts and providing them whatever resources they need to provide best-in-class credit work and research. KBRA is also active in aviation from both an asset-backed security and corporate perspective, and Dublin is a large hub for this sector. **CIT**

IT TAKES VISION

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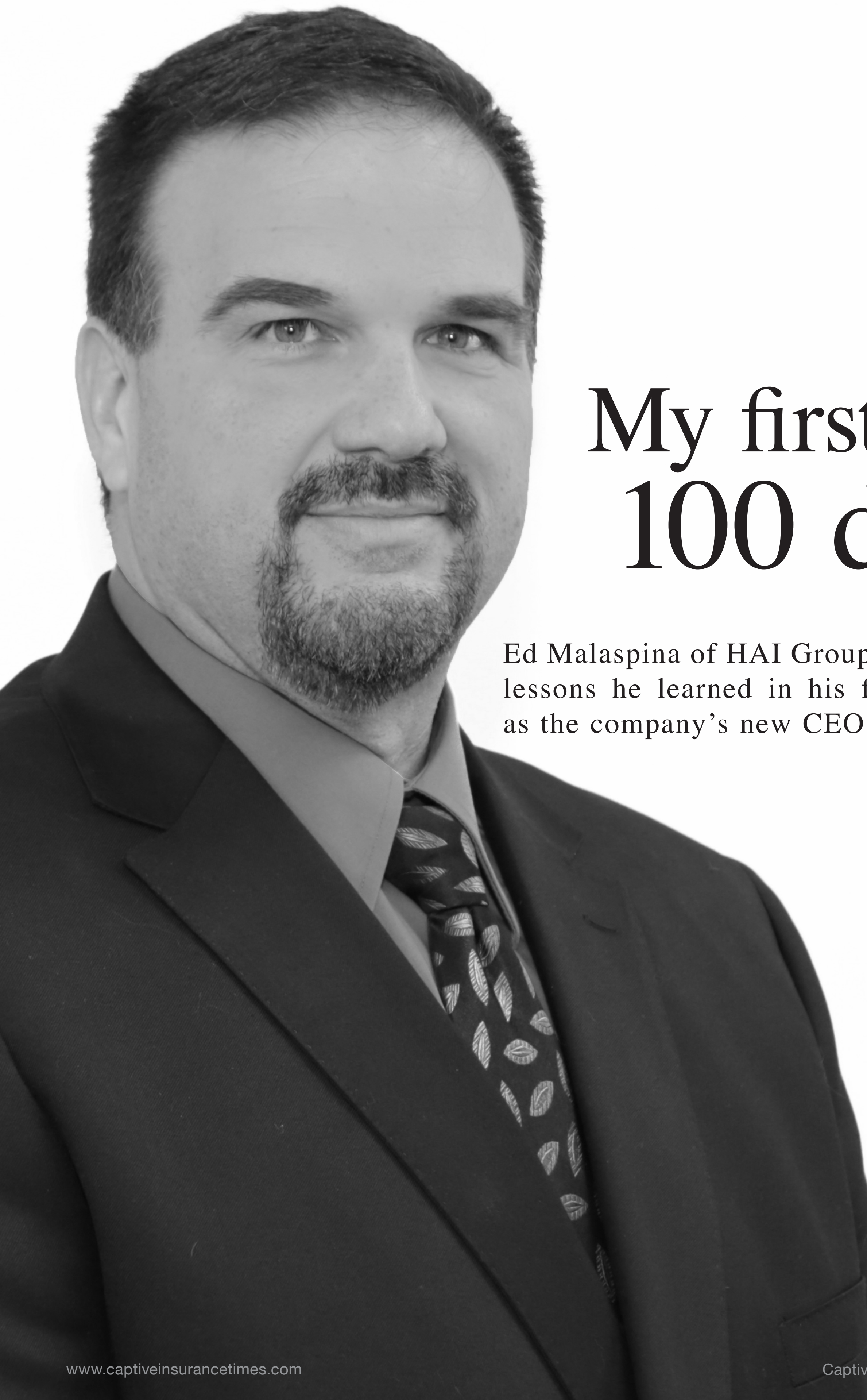

My first 100 days

Ed Malaspina of HAI Group discusses the lessons he learned in his first 100 days as the company's new CEO and president

As a CEO of a captive, you are bound to find yourself in unexpected situations, so you'll need to prepare for uncertainty. The importance of this became clear to me as not one, but two 500-year mega-storms came barrelling down on the properties of our members during my first 100 days as president and CEO of HAI Group. With several more potentially damaging storms on the horizon, I quickly appreciated the value of being prepared, learning one of my first lessons as CEO.

HAI Group is a member-owned insurance company, controlled by housing authorities, providing solutions to public and affordable housing agencies across the nation. Like most insurance companies, we strive to predict the risk and mitigate it, and during these recent catastrophes, our preparedness served us well. Our risk mitigation and management programmes were more valuable than ever, as were the measures we take to ensure strong underwriting discipline.

Our company as a whole has built lasting connections with its members, which extend well beyond the typical policyholder relationship with an insurance provider, deepening our understanding of our customers' needs.

Our members have a vested interest in the success of our company and by extension share an interest in supporting my success. I had the chance to experience this firsthand as members reached out to ask me what they could do to support me in my new role. Being an employee of the captive before my appointment also gave me a unique opportunity to establish professional connections and robust networks in the public and affordable housing industry. The portfolio here at HAI Group is diverse, and each organisation has its own specific needs depending on its size, structures, units and resident populations. Taking all of this into consideration helps us keep our coverages relevant and allows us to remain a steadfast and trusted partner in developing solutions to address these changing needs.

“As a CEO of a captive, you are bound to find yourself in unexpected situations, so you'll need to prepare for uncertainty”

Risk management has always been an integral part of the services we provide to support our members, and we had a plan of action ready to be rolled out as necessary. Members in harm's way were proactively sent communications with tips and resources to begin preparation and to ready themselves for the impending storms, as we confirmed the readiness and capacity levels of our adjusting teams within the areas anticipating impact.

Our employees continuously monitored the storms, keeping a close eye on the path and projection as they unfolded. In the aftermath of each storm, we began calling members in affected areas to check in and see what they might need, but most importantly to make sure they were safe. It is unusual for a nation-wide insurance company to follow up with their members personally rather than wait for a claim to come in, but this is one of the many unique ways we build personal connections with our members. We work hard to ensure we have a positive impact because we understand our members count on us most when situations are worst. These catastrophes served to remind me that insurance has an impact on people's lives, and this leads to the next lesson I've learned, about the value of building relationships.

HAI Group has a unique culture. It's one of the things that sets us apart from traditional insurers. The community engagement and grass-roots participation of our members, committees, and board of directors have always provided us with an advantage of having a deeper understanding of the issues our industry faces.

Finally, I would say the most important lesson I have taken away from my nearly 30 years in the captive insurance industry is the value of building trust. It is an integral part of the insurance business, particularly in a niche market where customers depend on you as much as you depend on them. I believe that insurance is a transaction of trust. As captives, we don't sell a product; we sell a promise. Members will not invest in something or someone that they do not trust.

For me, this means the relationship we establish with our members includes a commitment on our part to ensure they understand what they are buying, their options, and any trade-offs that may exist. HAI Group has a solid history of assessing insurance needs and in developing creative programmes that meet those needs. Our staff members spend a considerable amount of time learning about and understanding emerging issues and sharing these trends. For more than three decades, when members and the industry faced turmoil or challenges, HAI Group is the place they can go to find help.

At HAI Group the values of our company aren't just something we display on our walls, they're a reflection of our commitment to the service and respect we provide to our members and each other as employees. I've learned that building lasting relationships, and the trust gained by cultivating these relationships, is a key to long-term success, and what sets HAI Group apart from the rest. **CIT**

Diversification effect

Jim Swanke of Willis Towers Watson explains why understanding interaction of captive risks has been one of the most important breakthroughs he has experienced in his captive consulting career

You wrote last year that the risk community is increasingly focused on emerging risks, as penetration of the captive concept increases. Are you now seeing these trends feed on one another?

We are seeing all different types of emerging risks being placed in captives today including product warranties, healthcare provider risk, employee benefits, cyber, excess workers' compensation, wage and hour, and marine risks. Many of these emerging risks are not correlated with the standard captive risks of workers' compensation, general liability and auto liability, so captive owners are interested in how these risks interact with one another and the diversification effect.

The diversification effect is similar to what you can achieve in an investment portfolio when you take non-correlated assets and pool them together to achieve diversification and greater stability. In a captive, the diversification effect of non-correlated risks leads to a reduction in required captive capitalisation and annual funding. Understanding the interaction of captive risks including these emerging risks and measuring the diversification effect is one of the most important breakthroughs that I have experienced in my 36-year captive consulting career.

Does it then follow from this that captives have to 'optimise'? If so, how and why?

What I find from talking with captive owners is that their captives were optimal when they were set up, but have operated for years without refinement. So decisions on deductibles, retentions, reinsurance attachment points were optimal at inception but not revisited and refined for changes at the captive owner, insurance market conditions, and so on.

It is imperative that captives be monitored and refined continuously to keep the captive operating on an optimal basis. From a practical standpoint, this should be done at least annually.

Furthermore, the captive optimisation should be done on a holistic basis and not by coverage line, which was the typical method for captive optimisation 10 years ago.

Optimising towers of risk and then summing up annual funding and capitalisation requirements by tower fails to recognise the interaction of risk and diversification effect. Fortunately, at Willis Towers Watson we have developed a new software called Igloo to better understand the interaction of risk on an aggregated basis, and which allows for captive optimisation on a continuous basis.

What is the 'diversification effect' of putting non-correlated risks in captives? What are the advantages of this effect?

One of the findings of studying the diversification effect from non-correlated risks is that many captives are over-capitalised. We have found that captive owners are generally satisfied with the savings generated by their captives annually and they assume

their captives are operating fine, but in the back of their minds they wonder about capital adequacy.

Many captives accumulate capital and surplus over the years and we find when studying diversification effect that there is what we call 'surplus surplus'.

That 'surplus surplus' can be redeployed in covering other emerging risks within a captive or increasing captive retentions. Still, other captive owners choose to lower premiums on a forward-going basis because of this over-capitalisation.

As the emerging risks typically are not as correlated, captive owners have a diversification opportunity for the first time to measure.

Is the diversification effect almost like a balancing act?

It's a balancing act, as you can now model and measure the diversification effect with the software that's available. So you can play various 'what-if' scenarios.

A captive owner and its team of risk management, treasury and financial personnel can sit around the table with the software and add and subtract coverages, change deductible levels for the corporation, change captive retained limits and study alternate reinsurance attachment points all done in real time, facilitating better captive decision making.

What can now be done in a single day, previously took many weeks utilising the spread sheet tools from 10 years ago.

What about disadvantages? With diversification comes cost—how can optimisation of the captive help in this regard?

Of course, there's a cost of utilising software. The software can either be run by your actuary or the captive owner can purchase the software and run it themselves. The software can range in cost from $100,000 to $200,000.

But, once you have paid that front-end software cost you can run the software regularly with minimal additional cost.

Once you have all the data inputted, doing the 'what if' scenarios will help companies with their captive decision-making process. In addition, it keeps your captive on the cutting edge, which should be the number one goal for all captive owners.

In the article you wrote last year, you predicted what's ahead. Looking to 2018, what change do you expect to see?

We've had a couple of manufacturing companies and restaurant chains talk to us about putting commodity risk in their captives and still other companies are exploring putting business risks into their captives.

Next year should also be a big one for companies putting their employee benefit risks in captives. There has been considerable interest in medical stop-loss, group life and long-term disability.

There has also been increasing interest in post-retirement medical. Outside the US, an increasing number of employers are studying the feasibility of putting their pension risks in captives.

As I look into my crystal ball, I see 2018 as the most active year for forming captives and placing emerging risks in captives in years.

Even in today's soft insurance market, companies continue to look for more ways to take advantage of their captive tools. So, I think you'll see the upcoming year as one of tremendous captive growth and opportunity. **CIT**

"As I look into my crystal ball, I see 2018 as the most active year for forming captives and placing emerging risks in captives in years"

Jim Swanke, Director of risk consulting, Willis Towers Watson

Comings and goings at DARAG, Green Mountain, David Riley and more

European run-off insurance company DARAG has appointed Tullio Ferrucci as CEO of DARAG Italia, following the acquisition of ERGO Assicurazioni.

Ferrucci has served in a range of leadership roles in both the insurance and management consultancy sectors.

The acquisition of ERGO Assicurazioni marked the company's first transaction in Italy and was part of its European growth strategy.

Stuart Davies, chairman of DARAG, said: "Italy is one of DARAG's core markets and one in which we see significant growth opportunity. Following our acquisition of ERGO Assicurazioni in 2016, we expect to expand our activity in the country."

"Tullio Ferrucci's appointment as Italian CEO is a statement of our intent, with his energy, passion and drive set to support our efforts. I am therefore delighted to welcome Ferrucci to the DARAG team and look forward to working with him in the future."

Green Mountain Sponsored Captive Insurance Company has appointed Chris Kramer as its managing director.

Kramer, who has over 30 years experience in the property casualty and alternative risk financing industry, has been hired to lead the firm's development and expansion plans.

He has previously helped with the set up of various captives, risk retention groups and start up profit centres for private and public enterprises. In addition, he has been responsible for the development of several cell captives, including Global Re, a cell captive domiciled in Barbados.

Green Mountain is an affiliate of Strategic Risk Solutions (SRS) and was formed in 2012 to provide clients and brokers with a cell facility.

Commenting on his appointment, Kramer said: "I am thrilled to have an opportunity to take Green Mountain to the next level and assist clients and brokers in putting together new programmes. Working with SRS and having a Vermont based facility like Green Mountain presents some exciting opportunities to do creative programmes on an efficient and turn-key basis."

Brady Young, CEO of SRS and a board member of Green Mountain, added: "We have been pleased with the progress we have made with Green Mountain but with Chris Kramer leading the effort on a full time basis, the owners of Green Mountain are confident we will see significant growth in several areas including medical stop-loss captives, traditional single parent programmes and agency captives now that these captives can be formed in Vermont."

David Riley has joined Robus Group as a risk consultant in Guernsey.

Riley will be working on the set up of what is believed to be the first fully independent longevity swap incorporated cell company (ICC) for the group.

He most recently worked on an innovative longevity swap transaction using an incorporated cell approach.

Commenting on his appointment Riley said: "Guernsey is a domicile of choice for such complex insurance transactions, seen as conveniently accessible from the UK and with a mature community of advisers and lawyers."

He added: "We have the right expertise, the right location and significant momentum."

"Robus will have the ability to offer pension schemes the opportunity to use ICCs to carry out longevity swaps as effectively and efficiently as possible in a simplified format."

Riley has a range of expertise, from captive insurance companies to insurance-linked securities, as well as setting up and running an office in Malta, giving him experience working in a Solvency II compliant onshore domicile.

Richard Le Tocq, CEO of Robus Group, said: "David Riley's insurance career track record speaks for itself. He brings to Robus a deep understanding of the processes and practicalities of longevity swaps which will be an asset to the growth and development of this new area of business for us."

Is your Manager listening?

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ACTIVE CAPTIVE MANAGEMENT

Michael Scott has joined Allison & Mosby-Scott as a partner of the firm.

Scott will head the firm's business law practice, as well as serving as president of Allison & Mosby-Scott Risk Management, the company's risk management consulting practice.

His practice areas include business and commercial litigation, business organisation and transactions, mergers and acquisitions, The Employee Retirement Income Security Act, contracts and captive insurance company taxation, formation and regulation.

In addition to his role at Allison & Mosby-Scott, he also works as a senior risk advisor at Hanover Stone Partner, where he advises clients on various insurance and risk management issues.

MetLife has appointed Mark Baldwin as business development director for its UK employee benefits business, in a bid to strengthen its market presence.

Baldwin will drive the company's distribution strategy, focusing on enhancing strategic partnerships with employee benefits consultancies.

He has served in other roles at MetLife for the last six years, gaining experience in the employee benefit market.

Adrian Matthew, employee benefits director of MetLife UK, said: "Mark Baldwin's track record of business development and strategic sales growth will enable us to further accelerate the momentum we have built in the market."

Commenting on his appointment, Baldwin added: "There is a real opportunity for organisations to align their benefits strategy with their business strategy and MetLife has a major role to play in helping existing and new customers maximise the value they get from their benefits spend."

Peter Hewitt has retired from his role as client director at FiscalReps, after serving at the company since 2012.

Taking on Hewitt's role will be Peter Hore, who currently serves as director of Indirect Tax Services Limited.

Hore has previously worked in the industry as chairman of both the UK and European industry bodies' indirect tax committees.

Commenting on Hewitt's retirement, Mike Stalley, CEO of FiscalReps, said: "We would like to thank Peter for all he has contributed in helping to make our VAT and gambling levy compliance and consulting business such a success. We wish him all the very best for his retirement." CIT

Have an industry appointment we should cover? Let us know via: beckybutcher@blackknightmedialtd.com

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