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CAPTIVE**INSURANCE**TIMES

ISSUE031
18.09.2013 WEDNESDAY
captiveinsurancetimes.com

Captive managers express their concerns over Solvency II

Captive managers have admitted that improved governance and control need to be considered in addition to supplementary capital requirements under the second pillar of Solvency II, according to audit firm Towers Watson.

Towers Watson explained in a release that Solvency II's second pillar requires captive managers to demonstrate "robust governance and risk management".

Mark Cook, director at Towers Watson, said: "Until now the greatest concern for captive managers about Solvency II has been the solvency capital requirement and the implications of the solvency margin standard formula for the balance between risk retention, capital and reinsurance."

"Now, captive owners realise that improved governance and control also matter, especially when those captives are writing employee benefit risks … One note of caution that has not been clarified as of yet is that the long-term reserving requirements for benefits paid out as annuities are still an area under debate."

Cook added that despite the additional requirements, the improved framework "should" enhance the long-term success of captive programmes if well thought through.

According to Towers Watson, Solvency II governance requirements will create additional work for captive managers. However, additional employee benefit programme governance and risk management shouldn't add too much to the existing costs of Solvency II and compliance for existing captives.

Cook said: "We see many captives that write employee benefits risks having governance frameworks in place already. For example, many will have a captive board sub-committee that has specialist employee benefits knowledge. This committee will focus on the employee

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Simpson & McCrady launches captive spinoff

Simpson & McCrady Alternative Risk has launched Capterra Risk Solutions, a new business unit focusing on captive insurance.

Sandra Fenters, managing principal of Capterra Risk Solutions, said: "We have decided to launch our own brand to reflect our focus on captive insurance products."

"Capterra consists of the same great team of dedicated professionals working in independent risk management and captive management services."

Edward Aiello has been recruited as Capterra's captive consultant and compliance officer. He previously held the role of vice president of global insurance at H.J. Heinz.

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CICA announces advocacy webinar

The Captive Insurance Companies Association (CICA) will host a new webinar, Captives and the Art of Advocacy, detailing key issues and efforts to avert negative impacts on the captive industry.

In a release, CICA explained that as the captive insurance industry continues to grow, and in some cases outperform commercial insurance, it is facing increasing regulatory and legal threats around the world.

The CICA advocacy programme will help "to dispel misinformation and supports continued industry growth".

"By monitoring emerging issues and regulatory changes in the US and around the world, CICA and its advocacy partners can influence laws and regulations that affect the captive industry."

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Captive managers express their concerns over Solvency II
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benefit risks and advise on a variety of topics such as underwriting, pricing, reporting and provider service levels. So this area under Solvency II will be an extension or formalisation of current best practice."

Towers Watson explained that under Solvency II, captive board members have to understand the business they are writing, as well as the associated operating and investment risks. The firm suggested that risk management of employee benefit risks is different from property and casualty (P&C) risks.

Mark Cook said: "In the case of a captive's typical P&C risk exposure, the risks are often highly unpredictable and potentially very volatile, whereas employee benefit risks are somewhat more predictable, higher frequency and lower volatility in comparison."

"Captives writing employee benefit risks should therefore seek to understand the risks of their employee benefit business, determine how they may adversely affect the captive and then take the appropriate risk management steps."

Cook concluded that while risk management and employee benefit programmes in captives will require specialised knowledge, the introduction of employee benefit risks could reduce the risk of the captive becoming insolvent through the addition of an essentially "uncorrelated line of business".

Solvency II's target implementation date of January 2016 may reportedly be pushed back if delays to parliamentary votes on the legislation's text continue.

Simpson & McCrady launches captive spinoff
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At Heinz, Aiello was responsible for the establishment and administration of both direct writing and reinsurance captives in onshore and offshore domiciles including Bermuda, Dublin, and Vermont.

Capterra plans to assign a team of experts, led by a personal relationship manager, to clients to ensure that their needs are being served by a single consistent team.

Thomas Bryan, owner of Bryan Materials Group, explained how his captive has benefitted from working with Capterra.

He said: "After our first meeting together, it became apparent that our captive insurance company could benefit from Capterra's expertise and Sandra's relationship with our captive's domicile regulatory team."

"We transitioned the management of our captive to their firm, and they have provided excellent stewardship to our captive."

Capterra has also launched a new website to educate people about captive insurance. The site provides potential clients with insight into how they can take advantage of the benefits of forming a captive insurance company domiciled either onshore or offshore.

CICA announces advocacy webinar
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Dennis Harwick, president of CICA, said: "The captive industry has become a vital component of the insurance world. We all share the responsibility to support advocacy efforts that protect our industry. If we don't protect what we've accomplished, the captive insurance industry might not exist in the future."

The panel, moderated by Harwick, will include: Steven Chirico of A.M. Best; Michael Mead of M.R. Mead Company; and Skip Myers of Morris Manning & Martin.

Chirico will share insights from A.M. Best's State of the Captive Insurance Market study. Mead and Myers will discuss the most prevalent issues that can impair captive operations, the significance of regulatory advocacy, and the importance of all captives becoming engaged in advocacy efforts to build a stronger voice for the industry.

R&Q acquires Woodcroft Insurance Company

Randall & Quilter Investment Holdings has completed its acquisition of Woodcroft Insurance Company, a Guernsey-domiciled captive insurer.

Woodcroft was previously a captive insurer for British infrastructure developer John Laing and has been in run-off since 2012. It wrote employer's liability, public liability and construction for all risks until 2002.

Its total claims reserves at 30 June amounted to £1.6 million and the company carried a net asset value of £1.2 million. Open claims relate primarily to latent diseases arising from employer's liability coverage.

Ken Randall, chairman and CEO of Randall & Quilter, said: "The acquisition of Woodcroft continues to evidence the desire amongst captive owners to achieve closure where the captive is no longer underwriting yet faces a lengthy run-off from long tail liabilities."

"We are pleased to have provided this exit to John Laing and are talking to a number of other corporates wishing to sell their captive or simply dispose of unwanted years to streamline their captive operation."

CITINBRIEF

Alternative reinsurance demand to continue

The demand for alternative reinsurance instruments is set to continue, according to Fitch Ratings's new report, Alternative Reinsurance 2013 Market Update.

The trend is due to the comparatively high potential returns of catastrophe risk through cat bonds and sidecar investments and the lack of correlation between catastrophe losses and returns on other major asset classes.

Brian Schneider, co-head of reinsurance at Fitch Ratings, said: "The convergence of the reinsurance and capital markets is likely here to stay and should continue to grow in the near term."

"Powerful economic forces have driven acceptance and use of capital market alternatives to traditional reinsurance."

According to Fitch's report, one area of uncertainty is how investors would react to a large unexpected catastrophe loss, or higher risk spreads, either of which could cause investors to pull out of those instruments.

Fitch considers this risk to be higher for hedge fund capital, as pension funds tend to have a long-term investment outlook and more diversified risk exposure.

Third party capital could displace equity capital

The influx of third party capital into the reinsurance market may displace up to $40 billion of traditional equity capital, which could either be returned to shareholders or redeployed elsewhere in the reinsurance market, according to Willis Re.

According to panelists at the recent Willis Re Monte Carlo Rendezvous press conference, the current trajectory of growth in third party capital suggests it could account for up to 30 percent of the global property catastrophe reinsurance market within a few years, representing approximately $100 billion in capacity.

John Cavanagh, CEO of Willis Re, said: "Discussions so far have centred on the effect third party capital is having on rates and the competition it is producing in the property catastrophe reinsurance market. A future influx of $100 billion would, however, have a number of profound consequences. As third party capital enters the property cat reinsurance market, it is going to crowd out conventional equity capital. That equity capital has to go somewhere."

Cavanagh added that if $100 billion of third party capital enters the reinsurance market, then even allowing for significant returns of capital to shareholders, there could be as much as $20 billion excess equity capital to be deployed.

He continued: "You could think of this as being the equivalent of 10 well capitalised start-up companies, and the effect on the market place would be profound. If capital is redeployed, much of it could go into direct insurance businesses. Many of the hybrid specialty reinsurers are already implicitly going down this path."

Also speaking at the event, Tony Ursano, CEO of Willis Capital markets and advisory, said that he expects a very active capital markets and mergers and acquisitions (M&A) environment for the remainder of 2013 and going into 2014.

Ursano said: "On the capital markets side, we expect a very active cat bond calendar, including new and renewal sidecar financings, additional activity around new insurance-linked securities fund formations and strategic partnerships, as well as more new hedge fund sponsored reinsurers."

"We expect activity in the insurance M&A arena to be robust, driven by a number of factors. These include increased CEO and board level confidence derived from higher public valuations, a continued focus on growth, scale and diversification, private equity involvement as both buyers and sellers, and the gradual consolidation of the reinsurance sector driven in part by third party capital involvement."

Munich Re to acquire RenRe weather unit

Munich Re has come to an agreement to acquire RenaissanceRe's weather-related energy risk management unit, RenRe Energy Advisors.

Munich Re has been working with RenRe Energy Advisors for more than three years as a risk capacity provider.

RenRe Energy Advisors specialises in covering and trading weather risks. Its clientele mainly consists of energy companies in the US requiring coverage against fluctuations on income due to adverse weather conditions.

The business also includes the trading of commodity contracts in oil and natural gas, with the aim of offering one-stop risk solutions.

Thomas Blunck, the Munich Re board member responsible for this segment, said: "With the acquisition of RenRe Energy Advisors, we are actively expanding our know-how and product range of weather risks and investing in a promising and profitable market."

"The new unit is an ideal complement to our expertise in the field of weather trends and weather risks, and also to our existing business model with solutions for weather risks."

The transaction is expected to close in Q4 2013.

Guy Carpenter invests in new Greek venture

Guy Carpenter has made a strategic investment in a new venture designed to help develop business in Greece, Cyprus and adjacent countries.

The new company will be known as Carpenter Turner and as of 9 September will take over all renewing business from Guy Carpenter's office in Athens.

Guy Carpenter said in a release that the new venture would combine the "significant regional knowledge" of the Turner family with Guy Carpenter's analytical resources and access to international markets.

Nick Frankland, CEO of EMEA operations at Guy Carpenter, said: "In order to further develop our business and to provide enhanced support to our Greek and Cypriot clients, we have today announced a strategic decision to invest in a new venture set up by the Turner family."

"The Turner family has an exceptional insight into and relationship with the Greek and Cypriot insurance communities, and we firmly believe that our investments in their enterprise will prove extremely beneficial for our clients."

Alex Turner, managing director of Carpenter Turner, added: "We are delighted that a firm of the caliber of Guy Carpenter has chosen to make such a significant investment in our new company, Carpenter Turner."

"The firm's excellent standing in the international arena coupled with their market-leading analytical expertise will prove invaluable to the overall success of our venture."

Chemical reinsurance captive gets top ratings

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and the issuer credit rating of "a" of Dorinco Reinsurance Company.

Dorinco is the captive reinsurer of the Dow Chemical Company. The outlook for both ratings is stable.

In a recent release, A.M. Best explained that Dorinco's ratings reflect its continued strong operating performance, balanced risk profile and "excellent" risk adjusted capitalisation.

The ratings also consider Dorinco's strategic importance within the Dow organisation and its successful mitigation of Dow's worldwide, long-tail and volatile risks through its short-tailed uncorrelated non-standard auto reinsurance business.

"Partially offsetting these positive rating factors is Dorinco's limited profile in the reinsurance market, which is a function of its hybrid captive nature."

"Another offsetting factor is Dorinco's exposure to Dow risks, many of which are worldwide and long tail in nature A.M. Best believes that Dorinco is well positioned at its current rating level," said A.M. Best.

Factors that could lead to a downgrade of Dorinco's ratings include: a decline in its risk-adjusted capitalisation, unfavourable operating profitability trends, or an outsized catastrophe loss.

Alternatively, factors that could lead to rating upgrades include continued favourable operating profitability trends coupled with improved risk-adjusted capital levels.

A.M. Best downgrades Montana-based RRG

A.M. Best has downgraded the financial strength rating to "B (fair)" from "B+ (Good)" and issuer credit rating to "bb" from "bbb-" of National Contractors Insurance Company (NCIC)—a risk retention group (RRG) based in Bigfork, Montana.

The outlook for both ratings has been revised to negative from stable.

NCIC focuses exclusively on builders, contractors and sub-contractors. The RRG was formed specifically for the purpose of pooling contractor general liability risks.

NCIC provides general liability insurance to builders and contractors across the US.

The rating action reflects NCIC's significant decline in policyholders' surplus and risk-adjusted capitalisation over the first half of 2013.

"The decline is attributed to a single claim, which fell outside of NCIC's reinsurance coverage. While the company has maintained its underwriting discipline and management expects to recover much of the capital through litigation, NCIC's current surplus level leaves it in a vulnerable capital position," said the rating firm in a statement.

Other negative rating factors include NCIC's concentration risk, particularly in California, and its dependence on reinsurance.

"Partially offsetting these negative rating factors is NCIC's conservative management of its loss reserves and its niche business profile as a provider of contractors and artisans general liability coverage."

ILS Fund Services has good client growth

A Bermudan fund administrator has announced a client base exceeding $1 billion in assets under administration.

ILS Fund Services, which provides fund administration and valuation services to funds that invest in insurance linked securities, said that its client base has exceeded $1 billion in AuA 18 months after the company began operations.

“We are delighted that the services ILS are providing funds that invest in this niche asset class have been well received by the community,” said Andre Perez, director of ILS Fund Services.

“Our assets under administration have grown incredibly quickly over the past 18 months and we are optimistic that they will double in the next year. It proves that the model we set up, a fund administrator with deep understanding of reinsurance transactions and valuation works and is being extremely well received by fund managers and investors alike.”

ILS Fund Services’s client base consists of global institutional investment managers that invest in catastrophe bonds, sidecars, collateralised reinsurance and other insurance linked derivatives through Bermuda-registered investment companies.

Bermuda has emerged as a strong competitor in the insurance linked securities space, due to a flexible regulatory environment.

In the first quarter of 2013, 8 out of 13 new insurers registered in Bermuda were special purpose insurers (SPIs) with total premiums of more than $93 million.

This included three SPIs underwriting more than $1 billion of catastrophe bonds and insurance linked securities.

Healthcare RRG is alive and well

A.M. Best has assigned a financial strength rating of “A- (Excellent)” and an issuer credit rating of “a-” to Mountain States Healthcare Reciprocal Risk Retention Group.

Mountain States’s primary focus is to provide hospital and medical professional liability insurance to hospitals and employed physicians in the Rocky Mountain region and adjacent states.

The ratings reflect Mountain States’s supportive risk-adjusted capitalisation, history of favourable operating results, prudent reserving practices, adherence to strict underwriting standards and defined market focus.

In a recent release, A.M. Best said: “These positive rating factors are partially offset by the inherent challenges associated with the hospital and medical professional liability insurance sector as they relate to regulation, increased competition, legislative reform and loss cost trends.”

A.M. Best expects the ratings for Mountain States to remain stable in the medium term.

VCIA heralds a bumper year

This years Vermont Captive Insurance Association (VCIA) conference attendance reached over 1100 participants. Twenty-eight percent of the attendees were captive owners, which also attested to the high level of captive insurance education the conference offers.

This year, VCIA welcomed participants from six countries and 39 US states as well as the District of Columbia. The association also topped its seminar total at this year’s conference, offering 24 seminars and educational forums.

Further signs of growth were the 110 exhibiting companies in attendance, and VCIA’s successful introduction of a mobile app for use on smartphones and tablets.

“The mobile app was custom built to increase efficiency for attendees, enabling them to access all conference information, receive up to the minute alerts and notices, download session materials, schedule their time, and more. Virtual polling was also used in some conference sessions this year, allowing for more interactive and timely discussions,” commented the VCIA in a recent release.

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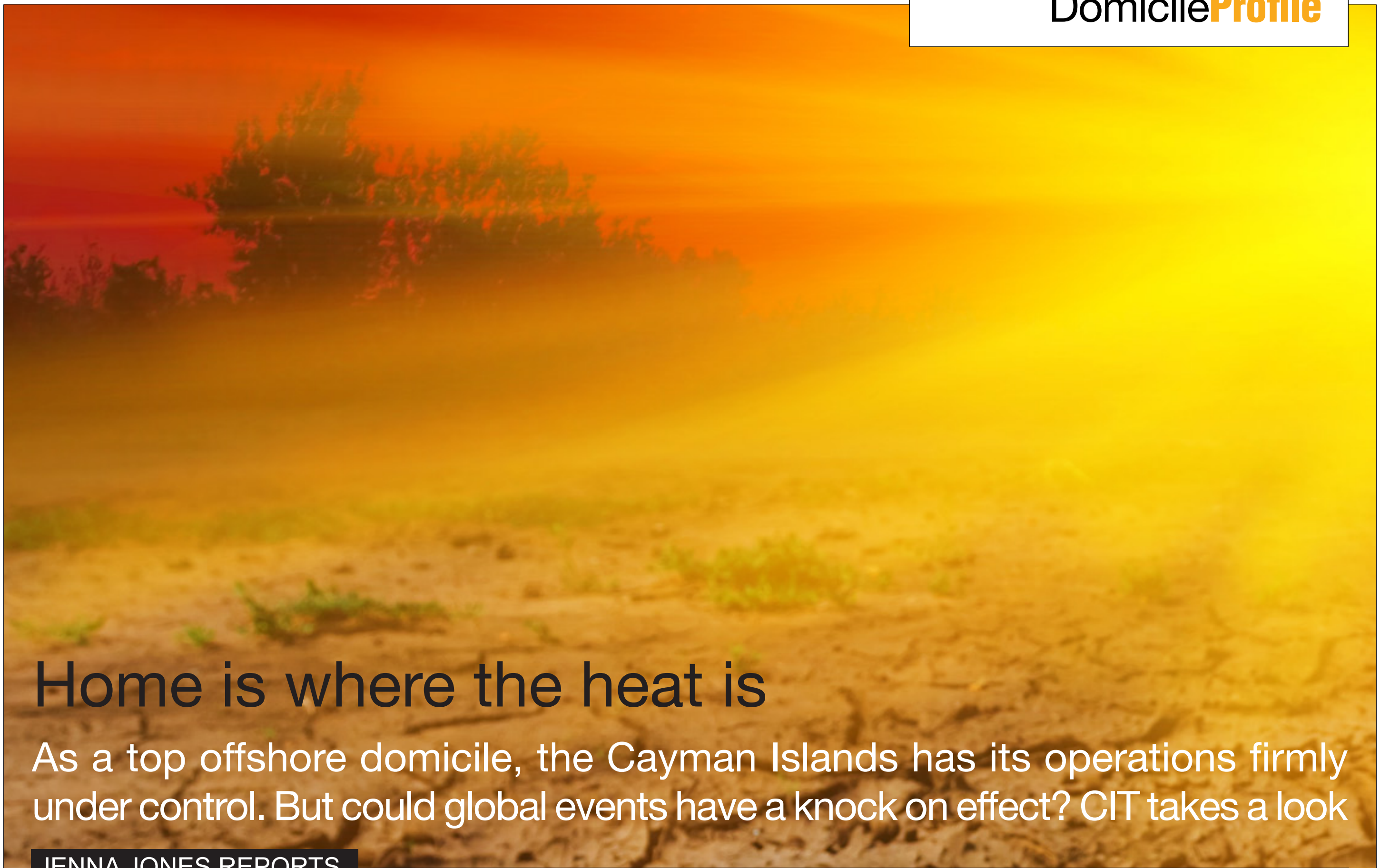

Home is where the heat is

As a top offshore domicile, the Cayman Islands has its operations firmly under control. But could global events have a knock on effect? CIT takes a look

JENNA JONES REPORTS

In July, the Cayman Islands Monetary Authority (CIMA) announced that the islands' captive insurance industry had amassed $13.5 billion in total premiums and $82.8 billion in total assets. The results marked a milestone in the domicile's history, as the highest ever-recorded figures.

Gordon Rowell, head of CIMA's insurance division, attributes the impressive figures to growth in the hedge fund market.

He says: "Cayman now accounts for approximately 80 percent of the world's offshore hedge funds. This influx of capital helps provide increased confidence in Cayman as a domicile. The country also maintains an extremely broad base of financial services, as evidenced by its strong banking, fiduciary and funds services."

Figures aside, Mark Kay, senior account manager at Atlas Insurance Management, highlights Cayman's leading offshore reputation—second only to Bermuda in terms of the number of licensed captives—as another driving factor in the domicile's success.

Kay adds: "It is a very sophisticated jurisdiction with service providers in the banking, legal, investment and insurance sectors all of the highest caliber. A client establishing a captive in Cayman has the comfort to know that through the chosen licensed insurance manager, they will be employing specialists in their fields with many, many years of experience and the ability where necessary to call on any number of equally experienced professionals to support the needs of the insurance company."

Paul Scrivener, a partner at the law firm Solomon Harris, also commends Cayman for the strength and depth of its service providers, pointing out its "amazing pool of talent" across captive managers, law firms, audit firms and banks.

Scrivener adds that the domicile's solid legal foundation, based on English law, and the political stability of the jurisdiction have also played a vital roles in Cayman's commendable history.

Regulation renovation

Cayman's regulatory environment, which Scrivener describes as "modern, business friendly and robust", has been one of the main reasons the domicile has managed to hold on to its successful offshore reputation.

Scrivener says: "Cayman has always been very successful in striking the right balance between a strong regulatory regime and creating the appropriate environment to attract potential captive owners and their onshore consultants."

Rowell explains that Cayman's regulatory framework reflects recognised international standards, as set by the International Association of Insurance Supervisors (IAIS), and "unlike some other regulatory bodies, open communication is encouraged as part of the regulatory process to cultivate, and maintain, positive relationships with licensees, service providers and international agencies associated with the domicile".

Kay reiterates the domicile's relaxed regulatory approach. He says: "CIMA and in particular the insurance supervision division, works closely with all licensed insurance managers and their clients to provide a regulatory framework that provides the requisite levels of regulatory control but with an open door policy and a pro-business approach."

"The new Insurance Law 2010 and more recent amendments [also] give credence to the fact that the Cayman Islands continues to move forward as a world leader in the offshore captive insurance industry."

The Insurance Law 2010, which came into force late last year, has been well received, says Rowell. He says that the revisions to the insurance law are "broad based" and include "stricter reporting and solvency standards for domestic insurers".

The amendments include: a restructuring of Class 'B' companies into three categories, depending on the amount of related party business; a new class of insurer for reinsurance companies and insurance linked securities; and a harmonisation of solvency provisions that are appropriate to the type of risks being undertaken.

Rowell and the team at CIMA are confident that the new law will "significantly strengthen" Cayman's supervisory framework, and also present new business opportunities.

"[Cayman] has always benefited significantly from having modern, innovative and practical legislation. Since the legislative framework of a domicile is fundamental for a successful, sophisticated business environment, this is recognised as being an ongoing requirement to the country's future growth as a market leader," adds Rowell.

In Kay's opinion, the Insurance Law 2010 and subsequent amendments, including the Insurance (Amendment) Law 2013, have brought a number of significant changes to enhance the quality, and ability to do, business in Cayman. Kay also highlights the greater level of oversight that the new legislation has offered to CIMA.

Kay explains that the Insurance (Amendment) Law 2013 further enhanced segregated portfolio companies (SPC) and clarified capital requirements at the core and cell level.

"The Insurance (Amendment) Law 2013 also introduced the portfolio insurance company (PIC) which in essence will allow a cell within an SPC to incorporate a PIC and where the insurance business will then be conducted by the PIC. The PIC will be a separate legal entity (an exempted limited company), able to contract with other cells or PICs within the SPC and allow a separate board of directors. The regulations from CIMA with respect to licensing as a PIC are expected to be issued [soon]," adds Kay.

Growing concerns

As industry growth continues at a steady pace, competition becomes an increasingly prevalent talking point—even for the most established domiciles.

Kay feels that the there will be a clear impact on all offshore jurisdictions as the US continues to develop its onshore captive legislation state by state. But despite the competition, his firm is equipped to cater to either option.

Kay says: "Atlas … is one of the few independent insurance managers that is able to offer both onshore and offshore options and will always look to provide what works best for the client. That being said not all [US] states have such legislation and with Cayman continually seeking to improve and expand on its insurance sector with such improved legislation, Cayman will continue to grow as a leader in the offshore captive insurance market place."

Rowell feels that Cayman's recent figures have clearly shown that increased competition has not been an issue for the jurisdiction.

He says: "It is fair to say that simply creating a framework for licensing captives is not sufficient and, as such, a number of US jurisdictions will need to hire competent resources and develop internal standards to meet the standards created by Vermont, Bermuda and the Cayman Islands."

"Regardless, the groundwork and recent growth established over the last five years for the insurance sector remain sound and the industry, in general, has been relatively resilient given the challenging market environment, with subdued global captive formations ranging from 30-40 per jurisdiction annually. However, 2012 ended with tremendous growth resulting in a total of 48 application submissions and 53 licensed by 31 December 2012."

And while the increase in domiciles doesn't seem to be fazing Cayman, Rowell does fear that the global challenge of captive growth, including limited collateral options and competitively priced primary markets—that will have a knock on effect for captive owners—could ultimately effect Cayman's performance.

He adds: "The general-accepted consensus that economic growth may not recover for several years poses yet another challenge. If this occurs, the captive industry will need to seriously contemplate its asset risk exposure."

But despite the potential challenges, Rowell and CIMA have faith in the strength of a captive industry that has been built on a solid foundation of rigorous risk management.

"Certainly in the last four years, captives and insurance managers have been very efficient at maximising value. We propose that good fundamentals will continually lead to an increase in the usage of captives." CIT

Supporting the system

CIT talks to Pierre Sonigo of FERMA ahead of the federation's upcoming forum to talk risk management, agendas and helping new recruits

JENNA JONES REPORTS

What is FERMA and why was the association originally set up?

The Federation of European Risk Management Associations (FERMA) today represents 22 national risk management associations in 20 European countries, which among them have about 4500 individual members. FERMA began in 1974 under the name of the European Association of Industrial Insureds, and held its first meetings in association with the US Risk and Insurance Management Society. With the growth in risk management associations across Europe, the organisation became a federation to bring them together at pan-European level.

FERMA's role is to promote the role of risk management and the interests of risk managers with EU institutions, especially the European Commission, and work in partnership, with other European associations on areas of mutual interest. Among these partners are the European Confederation of Institutes of Internal Auditing (ECIIA) and the European Confederation of Directors Associations. Through these relationships FERMA is able to strengthen the voice of risk management in Europe by increasing its contacts with their members and through joint representation to the European Commission.

FERMA also promotes the risk management profession by encouraging the development of risk management education and qualifications and support for young risk managers.

What has been on the agenda for FERMA this year?

This has probably been FERMA's most active year ever. In addition to organising the biannual risk management forum that is its biggest event, FERMA held a joint event with the European law association AIDA Europe in Paris in June to discuss very topical insurance law issues, such as trade embargoes. It worked with Harvard Business Review Analytics and insurer Zurich on three research projects covering cyber risks, environmental risk management and risk management leadership.

The working group on certification has continued its examination of a possible pan-European certificate of competence for risk managers, and is expected to present a progress report to the forum that starts on 29 September.

FERMA also hired its first staff European affairs adviser, Julien Bedhouche, and his presence is greatly increasing the support that FERMA can give to its members in relation to European Commission and Parliament issues, such as the revision of the Insurance Mediation Directive and discussion on compulsory financial guarantee funds for environmental liability.

At the general assembly in June, FERMA also agreed an important change to its bylaws. It agreed to allow individuals and organisations that have a strong interest in risk management in Europe—but are not eligible to join one of the member associations—to become members of FERMA.

What work has FERMA been doing on behalf of its members captive insurance and reinsurance companies?

Many FERMA members have captive insurance and reinsurance companies. FERMA does not get involved in operational issues, but has been representing the interest of its members who have captives in relation to Solvency II. FERMA has pressed the European Commission to make the application of Solvency II proportional to the low policyholder risks posed by captives, which insure only their owners. FERMA also notes that the continuing delay in the adoption and implementation of Solvency II makes it difficult for captive owners to plan for future development.

Enterprise risk management is an integral tool for any organisation—how has this practice developed during your time in risk management, and what does it achieve for businesses today?

FERMA supports its use, particularly through the publication in partnership with the ECIIA on the risk management provisions of the 8th European Company Law directive. These are available from the FERMA website.

What can we expect from this year's FERMA forum? Are there any particular speakers/panel discussions that attendees should look out for?

For people with an interest in captives, the keynote speaker Karel Van Hulle should be especially interesting because he was the head of insurance and pensions for the European Commission and lived with Solvency II from 2004 until his retirement in 2011. There will be three panel discussions starting with risk managers who will talk about their current issues and throw down a challenge to the broker and insurer panels on subsequent days.

There will also be 15 workshops organised and run by risk managers and these include topics such as innovative solutions for cross-border health and benefits programmes, non-physical damage business interruption and enterprise risk management—fact or fiction. CIT

Pierre Sonigo
Secretary general
FERMA

Be careful what you wish for

Could captives be victims of their own success? CIT asks the opinions of a cross section of experts to see how the land lies

What are the possible downsides of captives' increasing popularity?

Simon Kilpatrick
Senior vice president of business insurance
Advantage Insurance Management

Growth in an industry is usually beneficial as it fosters innovation, leads to increased efficiency and ultimately boosts profitability. However, growth that occurs too quickly or that is poorly managed can lead to problems.

More and more domiciles are getting into the captive business with the aim of bringing in additional tax revenues, creating local jobs and enjoying the perceived multiplier effects of increased payrolls, hotel and restaurant revenues. This works well in theory, but we are reaching a stage where there could be too many domiciles and not enough captives to support them. For a domicile to be effective it needs to have in place a well-staffed regulatory department and a network of experienced and skilled service professionals. A large number of captives are needed to generate the revenue stream to support this infrastructure. The fear is that domiciles that do not reach their critical mass will have to cut corners to stay in the game. This could lead to regulatory bodies without the manpower or the expertise to effectively monitor the captives under their supervision. The smaller domiciles may also have trouble attracting quality service providers such as captive managers, attorneys, actuaries and tax professionals.

The danger here is that without a high quality operating environment captives may not be structured or set up correctly, they may operate improperly and problems may not be seen early enough to correct them. Lower quality captives, with an increased failure rate could result in image problems for the industry at large.

Certain types of captives are growing in popularity as well. In the US, small captives that take advantage of the 831(b) election are being formed at a breakneck pace. As the numbers grow there is a danger that more of them could be set up for the wrong reasons such as primarily for income tax reduction rather than for risk financing. It is hard to know what percentage of these companies are currently being set up incorrectly. However, if this was ever deemed to be a large enough problem then, in addition to any reputational damage the industry may suffer, it is likely laws would be changed to remove the incentives for abuse. Changes such as lowering the allowable premium or disallowing dividends at qualified rates from companies taking the election could reduce the incentives for abuse. However, these changes would also serve to decrease the utility of these captives for the legitimate majority.

The captive industry has thrived over the last 30 years because it has been adequately but not over-regulated. As the industry's growth accelerates it seems that the amount of regulation is also rapidly increasing. The distinctions between the laws that govern captives and the laws that govern the traditional insurance industry are becoming smaller every day. Captives are typically far smaller than traditional insurers and the increasing cost of regulatory compliance is much harder for them to bear. The thought among the world's regulatory bodies is that increased regulation and standardisation will make it easier to monitor existing captives. That may be the case, but it could also serve to stifle the very innovation that helped the industry grow.

With all of these threats out there current and prospective captive owners can best protect themselves by making sure their chosen domicile and service providers have a good reputation and a proven track record.

Simon Marquis
Business development manager, alternative risk management and director
ARM Malta

It is somewhat unusual to find myself commenting on the negative implications of captive insurance vehicles, having spent most of my career seeking to promote them.

The captive industry should thrive from the increased interest it is receiving and it is difficult to see what potential negative sides there are. One concern would be the implication it could have on the application process with local regulators. Would a large increase in applications result in longer approval periods? A significant increase in captives or cells could result in a higher staffing requirement for the regulator to meet the day to day supervision needs of the industry, however, you would hope that the licence fees would cover the cost of additional staffing. The same could be said of the captive manager, it is increasingly difficult to find appropriately qualified staff within the captive domicile that, I am sure, is a problem shared by both managers and regulators.

The concern is whether an increase in the timeframe to achieve formation of a vehicle in a particular domicile will drive captive owners to utilise a less regulated jurisdiction where management expertise is not as skilled as the better-established jurisdictions.

It is, however, fair to say that alongside the many positive benefits a captive can provide to the insurance or reinsurance market there are a few risks that theoretically exist. Domiciles such as Guernsey and Bermuda have a long history of insurance and the regulation and legislation that has evolved over time serves to ensure that captive insurance vehicles are appropriately managed and that they observe a high level of governance. Likewise, European domiciles such as Malta have implemented a high standard of regulation. Some emerging domiciles with untested and relatively immature regulatory frameworks could present a risk to the consumer and the general insurance market. Will their interests be protected by the legislation in the event of a dispute? Has the capital level of the vehicle been appropriately assessed?

A self-insurance vehicle typically seeks to share the profitable part of the overlying insurance programme within the market. Arguably, this reduces the profitability of the risk for the insurer. At the same time, it does present a cost saving to the insurer, a large deductible will remove small losses that are costly for an insurer to administer. You would also expect the risk management procedures of the parent company to improve as a result of owning a captive as it is effectively their money at stake. With that a reduction in the propensity to make a claim should also follow.

In conclusion, I believe that the popularity of self-insurance, whether through a captive or an element of risk retention by the corporate, is a positive for the industry. The risk that the captive cannot pay claims due to underfunding or regulatory uncertainties are not insurmountable problems but should be considerations for the underwriter when rating or accepting the overall risk. Perhaps a way to gain comfort and control would be for insurers to form their own protected cell for use by their insureds, for which I would happily recommend a good manager!

Peter Kranz
Managing director, head of east coast captive operations
Beecher Carlson

The value and effectiveness of captive insurance companies is unquestionable. Their impact has been broad-based, across the entire insurance industry. However, that does run the risk of negative impacts if not managed appropriately.

As the use of captive insurance increases, a

greater amount of risk is removed from the traditional insurance marketplace, resulting in excess capacity and pricing pressures on carriers. While these consequences have had a positive contribution to a prolonged ‘soft’ market, and even mitigated the pricing increases that have been pushed through, it has also resulted in higher loss rates for traditional carriers, which has in turn created ongoing pressure on their capital requirements.

The traditional insurance market needs to make the required adjustments to their business plans to reflect this new reality—an example of which would be utilisation of their available capacity to offer more reasonably priced fronting solutions and retention of risk at higher levels (ie, stop loss or multi-line aggregates) that would respond to pressures captive owners are feeling as a result of the unintended uncertainties created by the US Non-Admitted and Reinsurance Reform Act of 2010.

There has also been an influx of new domiciles joining the captive marketplace as jurisdictions have seen opportunities to generate revenue and good-paying jobs. With this growth in the number of jurisdictions, a competitive environment has been created that fosters creativity. However, when you combine creativity and the pressures of a sluggish economy, there is a risk that an unintended result can be an aggressive pursuit of cost mitigation strategies that are outside the ‘norm’ of the industry as a whole. In response, managers and consultants, law firms, auditors, actuaries, regulators, investment managers, etc, need to act accordingly to protect the integrity of captives as a valuable, legitimate risk-financing tool.

As new captives continue to be formed, and in new jurisdictions, there can be a resultant downward pressure on service provider fees. While ensuring fees are aligned appropriately with the services provided (not too high, not too low) is crucial, the deliberate underpricing of fees to gain market share doesn’t serve the industry in a positive way. It may seem, in a new domicile or to a new service provider, to be a good way to gain a foothold by getting some clients on board, it ultimately harms the client because the service provider is unable to deliver the high quality level of service that captive owners deserve and pay very good money for. If a management firm, as an example, under prices work to ‘get it in the door’, the resources allocable to that client are then limited, which means the client will not receive the proactive consultation and responsiveness that they should.

At the end of the day, as with any challenge, the growth of the captive industry will bring with it risks of negative impacts. The key is how we handle those risks so as to continue to grow as a valuable and effective industry that meets the needs of the stakeholders.

Fiona Le Poidevin
Chief executive
Guernsey Finance

The global financial crisis and the subsequent economic downturn have led to institutions adopting an increased focus on risk management. The fact that captives can potentially play a very important risk management role means that they have come to feature more heavily on the radar of key decision makers within organisations. In addition, the growing signs of a hardening market—particularly within some specific sectors—means that captives are also gaining further popularity as a cost control mechanism.

This growing interest in captives is increasing awareness of and knowledge in the concept, which can only be positive for its ongoing success. Of course, the traditional markets of Europe and the US are quite mature and therefore, despite Guernsey’s innovation of the cell company concept widening the potential pool of business, the scope for significant further growth in the numbers of captives being established remains somewhat limited.

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However, what we are seeing is that there is increased interest in the captive concept within the emerging markets, in particular China and Latin America. There are still barriers to doing business in these regions and they bring with them inherent risks but this is part of the process of opening up new markets.

This untapped stream of business is attracting more domiciles to legislate for captives. In a sense, we worry that unsuspecting clients may view all captive domiciles the same but ultimately, as a traditional domicile, we believe that competition is positive in that it drives up choice and ensures that standards are maintained, if not enhanced. New entrants provide us with a challenge but they also give us an opportunity to demonstrate our experience and expertise gained over many years.

Indeed, it is important to remember that a captive is not an off-the-shelf product but a fully regulated insurance company with sophisticated risks. Some domiciles, which may have a law but not necessarily the requisite infrastructure or expertise, may try to offer a cheaper product. However, especially considering they are managing risk, clients need to be conscious that price should not be the main consideration if they wish to receive quality provision for a sophisticated service.

Guernsey has built its position as the largest captive insurance domicile in Europe and fourth globally by offering unrivalled infrastructure, expertise and innovation. Today, the island is host to captive managers ranging from the globally renowned names to independent, boutique firms that can utilise both the Guernsey-pioneered protected cell company and incorporated cell company. In essence, Guernsey offers the widest range of options, provided by experts at competitive rates.

Of course, it might be that the increasing popularity of captives does bring about greater scrutiny of associated regulation and tax. Yet, again, this may be a blessing for a domicile such as Guernsey, which is able to demonstrate that it works to the highest international standards, including the insurance core principles of the International Association of Insurance Supervisors (IAIS) while continuing to offer proportionate regulation for the very specialist captive insurance market.

Malcolm Cutts-Watson
Chairman of global captive practice, Europe
Willis

It is with a sense of déjà vu that I consider how to respond, as this question gets raised every time a change in the market cycle is predicted. At the moment, we are in a soft market with new capital entering to put even more downward pressure on pricing. Yet the number of captive formations is close to an all-time high. Surely this is counter-intuitive as one would expect insurance buyers to select the market instead of retaining risk? The answer is, I think, that captive owners do not view captives as a direct substitute for the purchase of risk transfer but rather as an integral part of a strategic risk financing play.

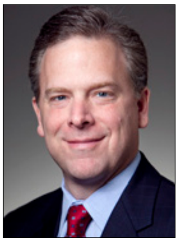
So let's start by dispelling a few old fashioned myths. Captives are not dodgy offshore money boxes. They are well run retention vehicles that adhere to the highest standards of governance, regulation and transparency. In fact, the fastest growing segment of the captive market is found in US states!

We do not see captives as being in competition with the commercial market. Rather, we see the two working as a partnership where each party has a different role to play and offers mutual support. As examples, captives are dependent on the insurance industry to satisfy local compliance issues, provide loss handling and risk engineering services, and of course to accept the risks that fall outside the captive's appetite. Captives also require a range of ancillary services to perform effectively such as loss adjusting, legal advice, reinsurance broking, and actuarial advice.

In turn, captives have a role to play where the market is not able or willing to deliver risk transfer solutions. This may be in industries where market capacity cannot match the value of assets at risk or buyer demand. Risks with poor loss experience, difficult-to-model exposures or new risks without loss history may find a home in a captive to enable the industry time to arrive at a market solution. Captives can retain the predictable losses, avoiding costly dollar swapping, so that insurers' capital can be focused on real risk transfer. Captive participation typically signals a preferred risk: the insurance buyer has real skin in the game while demonstrating ownership and governance of the risk. This must be a positive for all stakeholders.

As the captive industry expands, are there implications? Well, the proliferation of captive domiciles (now approaching 100) means that management and regulatory expertise may be thinly spread. That could, in theory, lead to a lowering of standards. However, the concentration of business into a relatively small number of domiciles shows that clients and their advisers are wise to this risk. In addition, regulators have adopted a pragmatic phased approach to the captive industry establishing the necessary local infrastructure and the insurance industry houses a wealth of expertise that can easily be transferred to captives.

We believe that in response to the constantly changing risk environment, companies today demand the flexibility that comes with a well-equipped toolbox of risk management tools. Those who will be most successful in meeting clients' demands will be those who most readily embrace this and are able to cooperate effectively with others to deliver effective programmes combining risk transfer, risk financing and programme delivery and management. Captives are here to stay and are enhancing substantially the value proposition of the insurance industry—and the informed insurers know this and welcome it.



Richard Klumpp
President and CEO
Wilmington Trust SP Services

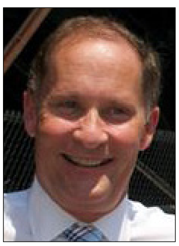
The increase in popularity of captives has created what I'll call, 'The good, the bad, and the ugly':

The good: overall, the more people learn about captives the better. Regulation is traditionally improved, the market becomes more efficient, the use of captives becomes more accepted, and the market continues to grow.

The bad: we have passed a saturation point as the number of domiciles continues to grow. The industry is simply not big enough to be able to supply an adequate regulatory environment and service provider network in every state that has a captive law and a minimal number of captives on the books. As prospective captive owners survey the market, the number of domiciles also acts as a distraction. Questions arise, such as: onshore or offshore? Establish in my home state? What's the regulatory environment? How about ease of operation? And the answers become tougher. Also, as with anything that becomes more popular, it can become a lightning rod for its opponents. New York's superintendent of financial services would not be coming out so strongly against the use of captives if they were still in the shadows of the traditional market.

The ugly: the worst part about the popularity of captives is the race to the bottom that begins to happen when more and more people become aware of the market and try to capitalise on it. There are more questions: do we really need 24-hour approval? Does every self-proclaimed expert qualify as an approved service provider? Can you really setup an 831(b) captive with maximum premium for a company with $5 million in revenue? Are terrorism pools a good thing? Of course, the answer to all of these questions is a resounding 'no'. All of these items lead to increased skepticism by our opponents and an increased level of scrutiny from the Internal Revenue Service, both of which could lead to very undesirable consequences.

The industry—as well as the past, present and future users of captives—needs to take a cautious long-term view of the market, establish a base level of expertise, and not diminish their credibility/reputation in order to make a quick profit. Eventually, the strong domiciles will prevail, the 'get-rich quick folks' will move on to the next best thing, and those with a long-term view of captives will still be strong. There are certain to be some hiccups along the way. But if a captive is established for the right reasons and with the right service providers, those involved will be well rewarded.



Harry Rodgers
Vice president of business development
USA Risk Group

.USA Risk Group is of course very enthusiastic about the surge of growth in captives of all types. We are staffing and deploying management and IT systems to stay in front of it. However, certain negative consequences nearly always emerge from rapid growth in any industry, and the alternative risk finance business is not immune to it. Our concerns, not necessarily ranked in order of their importance, are:

- The profusion of domiciles, particularly in the US, has created additional complexity for captive managers, advisors, and current and prospective captive owners. The domicile selection process was fairly simple several years ago. But geographic proximity, politics, and (in a few cases) the threat of double taxation require greater scrutiny, which translates into time and cost. Domicile change costs time and money for both owners and managers.
- The 'me too' approach has prompted some states to rush legislation they are not yet prepared to support with service and expertise. While we are domicile neutral by mission, we caution our clients to carefully evaluate the attributes of a domicile before deciding.
- New regulations have created new opportunities for the captive industry, particularly regarding employee benefits and enterprise risk. The downside is that this profusion of regulation adds significant cost and management burden to all organisations. This can divert time and funding from other risk management projects (such as captives). The complexity and confusion created by the astounding growth of regulation also creates confusion and inertia. 'Paralysis by analysis' has delayed client decisions about venturing into captive solutions.
- The competitive landscape is changing. A growing number of tax accounting and law firms have established captive advisory and management practices. These are primarily in support of establishing and profiting from micro captives. While this has created new opportunity for the industry, we caution that misunderstanding and even abuse of the tax code may damage our profession's reputation and lead to a possible political backlash. USA Risk applies the core principals of insurance to all new and existing captives, and will not entertain those whose sole purpose is tax reduction.
- The hardening insurance market is traditionally a boon to captives. The negative implication for captives is that fronting and reinsurance markets also tighten their belts, and some have failed, while others have exited the market.
- Rising insured losses will impact captive results and put pressure on surplus and collateral requirements. Captive managers, actuaries, and advisors must monitor losses and prepare their clients prospectively for potential capital calls. CIT

New foundations

Despite significant delays, Luxembourg is going ahead with its implementation of Solvency II. Ernst & Young's Brice Bultot takes a look

Future or existing captive owners have their own thoughts on captive domiciles. Selection of country of establishment is often difficult to make as pros and cons may compensate. That is why, in the end, either cultural proximity or service providers lobbying attracts the final decision.

Uncertainties around Solvency II—both from an enforcement date perspective and extent of application to captive companies—have placed the European economic area domiciles on hold in the minds of captive owners and new captive setup project managers. While the Solvency II 'excuse' has been referred to for awhile, the probable target for application of the directive is now set for 2016 with a certainty for incremental implementation actions in 2014 and 2015. In the meantime, some offshore domiciles announced that they would not adopt Solvency II equivalent regulation.

In 2013, the company offshoring topic raised in temperature. As a result, UK-preferred offshore domiciles (Guernsey and the Isle of Man) were subject to strong comments from UK politicians. Simultaneously, new rules for controlled foreign companies were established that potentially result in a new competitive advantage for onshore domiciles (Luxembourg, Dublin and Malta).

This is where Luxembourg—the EU leader for onshore captive companies—is back on the map of the new captive setup projects. Requests for consultation on relocation have increased recently. Most questions relate to existing regulation, development trends or taxation framework. Along with these requests and in the context of new captives setups or acquisitions, accounting and regulatory consulting professionals had to clarify frequent misunderstanding around the rationale and mechanics of the equalisation provision.

Luxembourg's insurance regulator and Solvency II

From 2009, the Commissariat aux Assurances (CAA, the Luxembourg insurance and reinsurance sector regulator) has been following insurance and reinsurance entities closely in the early stages of Solvency II implementation. The CAA first ensured significant involvement of the companies in a series of quantitative impact studies. Afterwards, quantitative information has been progressively integrated into annual regulatory reporting for all insurance and reinsurance companies or captives. The present version of the regulatory reporting comprise the following Solvency II quantitative elements: best estimate of technical provisions, balance sheet prepared under the economic value principle, basic solvency capital requirement under the standard model, and capital requirement calculation including risk margin and eligible elements classification.

For regulatory returns filed in 2013, the CAA introduced a specific report on governance. Actually, this first version is an assessment of the sector's readiness for Pillar II requirements. As declared by the CAA, individual debriefs with insurance and reinsurance entities will be conducted during the second half of 2013. This announces quite transparently a progressive set of actions on internal control, governance and risk management.

Foreseen guidance by the regulator on Pillar II will not be as precise as for Pillar I. Nevertheless, each insurance and reinsurance company will be monitored by the CAA on the progress made and milestones reached for a smooth transition to Solvency II application.

On the Pillar II area, most captives are closely accompanied by Luxembourg-based captive management companies and external advisers in a full Pillar II package project management strategy.

Solvency II transposition

On 25 July 2012, the draft of the new law on the insurance sector was submitted to Luxembourg Parliament. This new law is described as a new foundation for the insurance business in Luxembourg and will replace the law of 6 December 1991 as amended.

This draft law is the transposition of the Solvency II Directive into the Luxembourg legal framework.

A portion of the full text has been enacted already, on 12 July 2013, with the creation of the insurance sector professional (ISP) status. This early adoption is intended to permit these ISPs to obtain their licences and begin offering their services. Some of the ISP professions were already active in the Luxembourg market (brokers, actuaries, captive managers), but some intend to propose Solvency II control/risk management framework-related services, which captive owners may consider useful for Pillar II and Pillar III implementation.

The accounting law will also be amended to incorporate the equalisation provision as an accounting principle (rather than a regulatory principle). Such an update of the law turns to a certainty that the equalisation provision will be maintained in Luxembourg.

This significant change will succeed an (almost unnoticed) amendment to the existing regulation on the equalisation provision that occurred in 2013. The basics and condition for the impact of a change in business plan, or most importantly change in shareholding (through the acquisition of a captive), were enshrined in the text.

As a result, the common rule is now that a captive will not automatically benefit from the prior multiples. Consequently, due diligence on captives being bought must include a more precise calibration of the target captive to acquire.

This will be a new but not unrealistic challenge for experienced risk managers, as long as they seek expertise in the Luxembourg legal and regulatory framework for reinsurance. **CIT**

Equalisation provision: reinsurance companies must establish an equalisation provision based on the allocation of technical and financial results to this provision. This principle is mandatory until a ceiling is reached. Such a ceiling is determined by the average of premiums over five years x a multiple allocated by the regulator. The equalisation provision is released at the termination date of the reinsurance business.

Brice Bultot
Senior manager
Ernst & Young Luxembourg

Onshore opportunity

Gibraltar deserves to become the captive insurance industry's European domicile of choice, says Derren Vincent of Willis Management

Geographically, Gibraltar is an isthmus not an island, and as such it is a part of mainland Europe, attached to the Iberian peninsular, and it enjoys both a Mediterranean climate and a central European time zone.

Politically, it is also a part of Europe. As a self-governing overseas UK territory with separate legal jurisdiction, it is a member of the EU with its parliament solely responsible for the transposition of all EU directives as well as the enactment of all domestic laws.

It is this geopolitical situation that provides the foundation for the Gibraltar insurance opportunity.

Direct writing

Put simply, EU membership affords 'passporting' rights to a Gibraltar licensed insurance vehicle to underwrite risks across all 31 EU and European economic area member territories.
For pure captives, this provides, among other things, the opportunity to avoid fronting costs and associated letters of credit. There are also cash flow and counterparty benefits.

However, more strategically, it affords greater control over coverage and appointments of third party service providers, such as claims service providers, whose interest can be aligned with that of the captive. Crucially with this control, the whole claims process can be designed from incident to settlement so that it complements the parent's desired enterprise risk management outcomes and customer experience.

Establishing an EU-licenced vehicle affords open market insurers a foot in a market of more than 500 million people from one central overhead and without fear of double regulation. This is an attractive opportunity for capital providers, both in terms of investing in startups or for existing insurance capital looking to expand into Europe.

Reputational risk—onshore underpinned by EU directives

Gibraltar is not only geographically onshore but it is also clearly and demonstrably fiscally onshore.

Corporate reputations are forged over long periods of time and with great endeavour, but they can be lost in a moment. When tax cases go to court, media interest is high and public perceptions are made. With corporate transactions coming under public scrutiny, corporate responsibility is now extending to affect choice of domicile.

With regards to its taxation policy, the European Council of Economic and Finance Ministers of the EU member states (ECOFIN) has endorsed Gibraltar's Income Tax Act as being compliant with the EU code of conduct for business taxation. Therefore, Gibraltar's tax system has been fully endorsed by both the code group and ECOFIN. The EU code of conduct has become the yardstick by which harmful tax measures within the EU and in the overseas territories of EU member states are assessed.

As already mentioned, Gibraltar is subject to, and has enacted, all EU directives. Specifically, Gibraltar has transposed EU Directive 2011/16 on the exchange of information on tax matters, which are recognised by the Organisation for Economic Co-operation and Development (OECD) itself as being equivalent to a tax information exchange agreement (TIEA), thereby providing OECD-equivalent exchange mechanisms with the 28 EU member states.

This is in addition to the 26 bilateral and voluntary TIEAs already in existence with both EU member states and other major OECD member countries.

Gibraltar's long established and growing market

Ignoring domestic insurers, Gibraltar's international insurance roots go back further than the current 1987 Insurance Companies Act. It's oldest captive has been trading for nearly 30 years.

Over the past 20 years the number of Gibraltar insurers has expanded from 12 to the 56 that are underwriting new business today.

In 2011, Gibraltar's insurers wrote $6.1 billion, an increase of nearly 20 percent over 2011 with collective assets of more than $14.4 billion and taking some 10 percent market share of the UK motor market.

What's different to the rest of Europe?

Having made the case to locate in Europe, what is the Gibraltar insurance proposition?

The benefits of domiciling in Gibraltar include:

Speed of doing business: the speed in obtaining either a licence, or a regulatory decision, is second to none and facilitates rapid access to what is an extremely dynamic marketplace. It is not only the initial access to market, but also the ongoing ability for insurance firms to make rapid business plan decisions and changes, that sets Gibraltar apart.

Size of the domicile affords an accessible form of regulation underpinned by the regulators service level agreement with its stakeholders. The Financial Services Commission seeks to determine an insurance licence application within 18 weeks of a full submission and publishes its performance levels in this regard.

Competitive tax measures: business agility is complemented with a competitive 10 percent rate of corporation tax that has the endorsement of the EU.

Additionally, there is no capital gains tax and zero VAT that serves to make up a truly unique opportunity within the EU and no tax on investment income.

Protected cell and special purpose vehicle legislation: the ability to have an alternative option to a wholly owned, full blown insurance subsidiary is also clearly attractive given the 32 cells that are currently under management. The cell option can offer a capital and cost efficient way of accessing all the advantages of the European passport without the additional governance and capital requirements that go along with owning your own captive.

Special purpose vehicle legislation also exists under the Insurance Companies (Special Purpose Vehicles) Regulations 2009. In the first half of 2013, we have seen global catastrophe bond issuance reported to be at $4 billion, the highest in the last six years. With collateralised reinsurance coverage from the insurance linked securities markets continuing to offer more competitive pricing than the traditional reinsurance market, there is an opportunity for Gibraltar to leverage their competitive EU positioning.

Strong economy: despite the European and global economic downturn, Gibraltar is forecast to deliver a GDP rise of 7.8 percent for 2012/13. Gross public debt fell by 27.5 percent. Net debt has also fallen and stands at approximately 24 percent of GDP. Gibraltar has produced a recurrent budget surplus that was £20 million higher this year. This strength in economy allows Gibraltar to invest further in its financial services sector and infrastructure ensuring a first class service.

So what business has been done and what about the future?

Captives: examining the captive sector, Gibraltar has well capitalised captive vehicles owned by blue-chip listed parents. In many cases, their size determined the fact that the direct writing opportunity delivered a fronting cost and letter of credit saving.

However, size is not everything, as many cell owners will testify. Many use the Gibraltar cell to front their European risks and then consolidate their worldwide risks through reinsurance back to their main captive vehicle domiciled elsewhere.

Some captive owners with a well-developed customer base have extended their direct writing opportunity to write customer risks, thus creating additional revenue streams or reducing leakage in existing programmes. Once again, there is the strategic advantage of being able to react more quickly to customer needs and market developments without the friction of fronting.

Many column inches have been given over to so-called emerging risks and other non-traditional captive lines, eg, cyber, environmental liability, reputational risk and crisis containment. Much work is being done to identify, quantify, and mitigate their impact. The freedom provided by the ability to direct write is entirely complementary with providing protection in these areas. Evidence of this is already emerging in Gibraltar.

Reinsurers: in the last couple of years we have seen three major global reinsurance capital providers put vehicles in Gibraltar, not just to be nearer the Gibraltar open market insurers whose treaties they participate in, but also to offer a more capital efficient co-insurance position as an alternative to quota share with Solvency II in mind.

Run off vehicles: the first run off vehicle was licensed in the last year in Gibraltar. It is the recipient of a book of business from Ireland.

Estimates suggest that the market in discontinued insurance is approximately €220 million. If European insurers determine that long-term run off is not viable particularly ahead of Solvency II, or if they simply deem some lines as no longer core to their business, the restructuring activity is likely to increase.

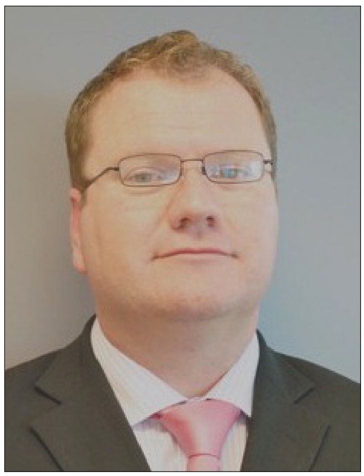
The competitive rate of Gibraltar corporation tax is clearly attractive to investors in specialist run off vehicles.

A final added point of interest in this area is the European Court of Justice (ECJ) decision relating to the case involvng the transfer of a portfolio of reinsurance contracts between Swiss Re entities; from Germany to Switzerland. The ECJ rules that the transaction was a taxable supply of services that makes argument for VAT exemption difficult. it is noted however that the court was not asked to address the question of whether the transfer was one of a 'going concern' and therefore outside of the scope for VAT purposes. Nevertheless, although this case is related to a transfer of a portfolio of reinsurance contracts, ther is the possibilty that this decision could be applied to the transfer of other types of financial contracts, where the transfer does not fall within the VAT exemptions.

With effect from 1 January 2010, the change to the place of supply rules means that the place of supply of such transactions is the place of the recipient. This means that if the supply was deemed to be taxable, an EU recipient would be required to account for reverse charge VAT. With Gibraltar being outside of Europe for VAT, the Swiss Re decision may be an interesting offer.

Open market insurers: last but by no means least, we have seen consistent growth in the number of insurers wishing to write third party risks from Gibraltar. Its first insurers primarily wrote UK risks but now we see Gibraltar insurers participating in all the major EU markets across a variety of classes.

As markets shift and capacity changes in differing classes and in differing territories, opportunities exist especially for those agile enough to enter the market at the right point of its cycle or at the right moment. Despite the worldwide regulatory and economic backdrop, we foresee that Gibraltar is well placed to attract new licensees in this sector. CIT



Derren Vincent
Executive director
Willis Management

The right route

Stuart King of FR Global Advisors, an affiliated company of FiscalReps, looks at the matters that captive managers should consider in their line of work

Captive formation in recent times continues to be flat to moderately up, reflective of a mature market. With plentiful capital in commercial insurance markets, continued innovation in capital market products and no sign of a hardening market, this trend is likely to continue for the foreseeable future.

The captive management industry has responded well by developing and promoting alternative cost effective self-retained risk vehicles, such as: 831(b)s, risk retention groups and protected and incorporated cell companies. These structures grant access to middle and lower market organisations that seek to manage and participate in their own risk for economic benefit at a lower cost than maintaining a wholly owned captive. Growth in these alternative structures is offsetting the decline in wholly owned captives.

On paper, a captive insurance company often looks economically disadvantageous and is often referred to as "left pocket to right pocket" when viewed at the consolidated financial group level. In times gone by, the taxation planning benefits of transferring risk (and premium profit) from higher tax regimes to lower tax regimes improved the economic optics. However, tax rule tightening and global tax harmonisation (such as controlled foreign company (CFC) legislation), increased scrutiny of internal arrangements (transfer pricing challenges) and general good corporate reputation (less established offshore domiciles) has led to a captive's core strategy being primarily to manage ever more complex global insurance programmes.

These factors all make for challenging business conditions for a captive management firm, and as with any economically viable business, revenue growth and cost control is important for success.

Large firms have responded to these challenges by becoming more connected with their broking networks to drive cross sales and develop and offer complimentary services, also seeking to drive down cost bases by investing in new technologies and client service standardisation.

Small firms, which pride themselves on broker independence and a bespoke approach to client service, often lack large budgets to invest in operational efficiencies and are more reliant on opportunistic appointments by captive owners that move their service provider (even more so in a maturing market versus new formations). Operational matters such as attracting future talent, key staff dependency and continuity and availability of expertise in responding to regulatory changes challenge smaller firms, often distracting them from their dedicated client-driven focus.

Big brand or boutique independence?

There is often no consistency in the selection of a captive manager by a captive owner. One would think that large blue chip organisations would limit both reputational and continuity risk by selecting a blue chip service provider (often at a premium cost). By and large this is true, however, there are large organisations that use smaller firms as they consider themselves sophisticated enough to manage their own insurance affairs with little reliance on a broker and therefore consider independence important.

Captive manager duties and competitive edge

In a tender situation, captive owners often disregard a firm's value proposition with respect to providing financial and regulatory reporting in a timely and accurate manner, and think that all providers can and should fulfil basic management duties that broadly include:

- Insurance programme administration: policy management/certificate issuance, claims administration and liaising with actuarial teams to establish insurance provisions;
- Financial reporting: maintenance of accounting records and submissions to head office to consolidate captive results;
- Treasury: administering captive assets and maintaining cash books;
- Regulatory: engaging with regulators and compliance with regulatory filing requirements; and
- Governance: company secretarial duties, such as, maintaining registers and filing statutory accounts and company changes. Holding board meetings (often providing a director) and organising board materials for clients.

It is the 'added-value', a firm's approach to innovation and staff put forward in a tender response that very often differentiates service providers. Traditionally, a relationship between owner and manager is one that remains in-force for long periods of time, even if broking engagements change. In fact, it is common for captive owners (risk managers, financial officers, treasurers) to form strong relationships with the teams that are engaged in the day-to-day activities of their captive, where they are considered an extension of the owner's team.

Captive management business model

A typical firm's business model is relatively simple and predictable in broad terms, ie, annual management fee inwards and fixed costs, such as: office, computer equipment and staff salaries outwards. However, with an increasing numbers of new domiciles enacting captive legislation it raises new challenges for firms in justifying a business case to establish and staff operations locally, particularly where regulatory bodies require local representation.

To improve operating margins and focus on strategic client development, many larger firms have invested in standardised technology and in-sourced more routine operational tasks to lower cost domiciles. In principle, this is a sound business decision and one that notwithstanding cultural and integration troubles appears to be beneficial.

However, reporting captive performance quicker and cheaper is not overly important to captive owners. Rather, it's the interpretation of the data and understanding the trends that is of strategic importance to aid captive owner's negotiations with underwriters to lower premium or improve terms and/or take further decisions on risk retention.

You could think that the majority of firms focus too heavily on administering a client's captive rather than deploying resource to drive additional revenues from using captive data to improve the financial position of their clients. There is a continual debate globally on consolidating data and its use, however, one would expect that many captive owners would permit the use of their data (save for commercially or personally sensitive) if it directly benefits their own positions. In that respect, for firms, having trained and experienced staff to analyse this data is key to operational success.

Captive management firms and risk management

Risk for firms is primarily mitigated through service level agreements (SLAs), which traditionally list services provided, including key performance indicators. Some regulatory authorities are prescriptive on the requirements of an SLA. There is often a conflict with negotiating limits of liability (which typically follow other professional services firms as a multiple of fee) where there is a wider group relationship, for example, with a broking firm—in this case one could argue it unreasonable to expect a captive manager (whose primary role is administration) with a relatively low level of capital available to assume broker placement liability limit levels when the management fee charged is disproportionate.

Regulatory non-compliance is a key area that represents a significant risk to firms. Many firms act as directors for a captive and manage the conflict between acting as a director of a captive and not being too involved in the actual business of the captive owner. However, no firm wishes to be linked to regulatory breaches and/or fines. In practice, this risk is typically managed via detailed board packs and robust minute taking, however, it is challenging to strike the right balance between risk mitigation for firms and not providing too much information, which can disengage clients. Firms would be best to focus on key decisions in board meetings and focus efforts on working with owners to identify growth opportunities by utilising the captive. For example, there is a growing trend to use a captive to provide customer-focused insurance linked to products purchased, generating external revenues and improving customer loyalty.

Insurance premium tax compliance of a captive is an area that represents a significant risk to a firm. Delays in tax payments and/or non-filing of returns can result in substantial penalties and fines. While premium tax settlements are the responsibility of the insured it is often a grey area between manager and owner as to where the fault often lies. By and large, a firm's loss results in an error and omission claim or a direct economic loss to a firm's profit and loss account. However, the relationship damage can often lead to a manager move, resulting in loss of recurring revenue. For smaller firms, absorbing a loss can have a significant impact on the firm's financial wellbeing.

If managed well, insurance tax compliance is in itself not overly complex and is often the responsibility of less experienced staff, traditionally the organisational layer that experiences higher staff turnover. There is no consistency in the approach of firms to manage this risk; some outsource the risk entirely and some rely on internal controls to manage a multitude of tax firms across a number of jurisdictions.

In summary, firms may wish to consider the following as they seek to grow client revenues and reduce operating costs:

- Leverage existing clients by analysing data providing insight to identify opportunities for captive use, giving owners improved data for decision making;
- Deploy staff skill levels that are commensurate with the task freeing up more experienced staff to foster closer client engagement to grow revenues;
- Determine tasks that are key to client service with more routine tasks consolidated via improved technological infrastructure or outsourced to lower cost locations; and
- De-risk firm balance sheets by seeking to limit contractual liability and non-compliance matters via well drafted SLAs. CIT

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FERMA Risk Management Forum 2013

Date: 29 September - 02 October 2013
Location: Belgium
http://www.ferma.eu/ferma-forum-2013/

The FERMA Forum is the only event that brings together risk managers from across the whole of Europe. The forum is the ideal environment to meet and share experiences with over 1500 risk professionals from all over the world.

TRIA Captives Seminar

Date: 8 October 2013
Location: Washington, DC
www.dccaptives.org

Captive insurance companies play an important role today in providing for terrorism-related coverage for companies in various industries and geographic locations. Learn everything you need to know about TRIA captive structures, prospects for congressional action and licensing considerations in the District of Columbia.

SIIA 33rd Annual Conference

Date: 21-23 October 2013
Location: Illinois
http://www.siia.org

The SIIA National Conference & Expo is the world's largest event focused exclusively on the self-insurance/alternative risk transfer marketplace, typically attracting more than 1,700 attendees from throughout the US and from a growing number of countries around the world.

DCIA 2013 Fall Forum

Date: 6-7 November 2013
Location: Hotel du Pont, Wilmington, DE
www.delawarecaptive.org

Delaware is one the leading captive domiciles in the world and has experienced steady growth over the last several years. DCIA's Fall Forum is the premier educational and networking event for those doing business in this domicile.

Industry appointments

Guy Carpenter & Company has appointed **John Woods** as co-chairman of the firm's recently formed mutual company specialty practice.

Woods will be based in New York and work alongside John Haldeman, the other co-chairman of the practice.

Prior to joining Guy Carpenter, Woods was the managing director of North American brokerage at Towers Watson.

Andrew Marcell, CEO of US operations at Guy Carpenter, said: "Woods brings a wealth of expertise that will complement our team's own unparalleled depth and breadth of knowledge about the mutual company marketplace."

"As the leading mutual insurance company broker in the US with more than 300 clients, Guy Carpenter is using our 90 years of experience working with mutual insurers to deliver products and services designed to help our clients reach their growth and profit potential."

Beecher Carlson, the account insurance broker division of Brown & Brown, has announced the promotions of three key members of its firm.

Scott Davis has been promoted to president of property and casualty. He joined Beecher Carlson in 2004 to help grow operations in Nashville and the large account casualty practice.

As part of his new role, Davis will focus on the expansion of the firm's west coast operations.

Steve Denton, CEO of Beecher Carlson, said: "Over the last eight years, Denton has been a valued partner as we have built the premier brand in the risk management brokerage arena. He is well respected by colleagues, clients and carrier partners alike."

Frank McKenna is being promoted to president of healthcare. He previously held the role of executive managing director of the firm's healthcare practice.

Denton explained that under McKenna's leadership, Beecher Carlson's healthcare practice has become "highly recognised for its innovative solutions and technologies specific to the healthcare industry".

"McKenna and his team have built the premier healthcare practice in the brokerage industry and we are excited to add more capabilities and resources to this platform," added Denton.

Finally, **Robert Bothwell**, who served as executive managing director of Beecher Carlson's energy practice since 2005, has been promoted to president of energy.

"Bothwell has successfully brought together an exclusive team of experts in the energy industry. Their dedication and passion has led to one of the highest client retention rates in the industry," said Denton.

International insurance and investment services group Thomas Miller has appointed **Kevin Sweet** as group marketing director.

He will be based in London and be responsible for global marketing and planning for the group.

Sweet first joined the Thomas Miller as a consultant in 2010. Prior to joining the firm, he was director of marketing for the specialist life assurer partnership and also held the role of head of marketing at Cofunds.

Bruce Kesterton, CEO of Thomas Miller, said: "Sweet's broad marketing and strategy knowledge makes him the ideal person to develop Thomas Miller's brand presence internationally. This is crucial to the successful implementation and delivery of our ambitious corporate plan."

Commenting on his appointment, Sweet added: "I am very heappy to be given the responsibility of developing Thomas Miller's external profile at this important and exciting time for the business."

PwC has recruited **Lindsay J'afari-Pak** as a partner to lead the firm's tax services to the life insurance industry.

J'afari-Pak previously held the role of group tax director at Friends Life Group and previously trained with Herbert Smith and PwC.

Colin Graham, UK insurance tax leader at PwC, said: "We are really excited that Lindsay has joined PwC and look forward to the huge contribution that she can bring to our life insurance clients gained from her extensive experience."

J'afari-Pak added: "PwC is a market leader in advising insurance groups. It has excellent relationships within the insurance industry and I look forward to expanding and developing the services we offer to the life sector."

Guy Carpenter & Company has named **Barbara Bufkin** as the new COO of the firm's global strategic advisory group.

Bufkin will be based in New York and report to David Priebe and Richard Booth, vice chairmen of Guy Carpenter. She will be responsible for delivering the firm's integrated offerings to insurance companies.

Prior to joining Guy Carpenter, Bufkin was executive vice president of corporate business development for Argo International Holdings.

She has also served as director of Swiss Re new markets, and as chairman, president and Corporation and Facility Insurance Holding Corporation.

Alexander Moczarski, president and CEO of Guy Carpenter, said: "Our strategic advisory group is helping clients make the most of new forms of capital and build more diversified portfolios. We are helping insurers enter new markets and develop the differentiated products, distribution channels and alliances that will produce sustainable results."

"Bufkin's extensive international and industry experience will support us as we continue to deliver these critical strategies to insurers seeking to achieve profitable growth." **CIT**

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Provident House, 6-20 Burrell Row
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Company reg: 0719464


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