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More Than Meets The Eye

Captive Reinsurance
A lost art form?

Captive Benchmarking
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Cayman-based insurer takes Advantage of new SC laws

Advantage Insurance subsidiary, Advantage Life USA (ALUSA), will be domiciled in South Carolina.

ALUSA offers traditional private placement life insurance policies and deferred variable annuities to qualified purchasers.

In anticipation of the growth of ALUSA and its other life insurance businesses, Advantage has recently contributed more than $30 million of new capital to Advantage Life & Annuity Company SPC, the parent company of ALUSA.

This new funding provides the required amount of regulatory capital for ALUSA to commence business as well as additional surplus for the benefit of all Advantage life insurance clients.

Advantage CEO Walter Keenan said: “We are very pleased to bring Advantage’s substantial private placement life insurance capabilities directly to the US market.”

“South Carolina has proven to be the ideal location for ALUSA, thanks to its modern insurance regulation and business-friendly climate.”

Jay Branum, director of captives for the South Carolina Department of Insurance, added: “The recently enacted updates to South Carolina’s captive insurance law have allowed companies like Advantage to expand their business here in South Carolina.”

ALUSA is headquartered in Charleston and is led by Richard Kuriger and Simon Kilpatrick.

All of ALUSA’s policies are fully reinsured by its direct parent, Advantage Life & Annuity Company SPC.

The subsidiary offers individual policy limits of up to $100 million per insured life, with a full range of alternative investments available for use within policy structures.

At present, ALUSA policies may only be purchased by legal entities such as companies, partnerships and trusts established in South Carolina.

NRRA to focus on cyber risk

Leaders in the risk retention sector of the insurance industry are to focus on cyber security as a major issue at the National Risk Retention Association (NRRA) conference in Chicago.

“The threat from hackers penetrating private data on policyholders held by risk retention groups has grown tremendously over the last few years. No company is too small to be exposed to cyber attacks,” said Sanford Elsass, chairman of the NRRA.

More than half the 250 risk retention groups (RRGs) in business today are engaged in some form of healthcare, from physicians and hospitals to long-term care facilities.

These policyholders have extensive databases of private information on thousands of individuals, which is at risk of cyber attacks.

A major feature of the conference will be a panel of security experts who will advise attendees how to develop breach and recovery plans to protect their members.

Today, RRGs collectively generate more than $2.6 billion in annual premium.

Another priority of the conference will be to chart a course for growth of the RRG sector in the face of increasing competition from traditional insurance companies.

A major panel of economists, industry executives and regulators will address how to navigate uncertain markets over the next few years.

The conference programme will include a variety of panels and workshops devoted to managing risk retention and purchasing groups, and regulatory compliance, including: how to lower reinsurance costs, enterprise risk management, enhancing capital, compliance with new state regulations, and boards’ best practices.

North Carolina exceeds first-year expectations

Less than a year since its captive-enabling legislation went into effect, North Carolina is making significant progress towards its goal of becoming a leading captive domicile.

To date, the North Carolina Department of Insurance (NCDOI) has licensed 12 captives, including five protected cell captives that have multiple cells, and has 16 licence applications currently under review.

NCDOI experts estimate that, by the end of 2014, North Carolina will have licensed more than 40 captives.

“North Carolina’s captive insurance programme is off to a strong start, but more importantly, we are dedicated to the long-term success of the captive insurance programme,” said North Carolina insurance commissioner Wayne Goodwin at the first annual conference of the North Carolina Captive Insurance Association in August.

In the past six months, Atlas Insurance Management has won mandates to manage six captives.

CITINBRIEF

Captive Insurance Group now manages a newly formed protected cell captive that currently holds nine cells, while Management Services International (MSI) is managing a pure captive that redomesticated to North Carolina.

USA Risk Group is managing a protected cell captive insurer that redomesticated to North Carolina from another onshore jurisdiction, and Willis is managing a newly-formed protected cell captive.

Sixteen captive redomestication applications submitted by MSI clients are also currently under review. These applicants planned to redomesticate to North Carolina by the end of September.

Upon approval of the redomestication of these captives, MSI will become one of the largest captive managers within North Carolina, and the number of captives in the state will increase to at least 28.

Xchanging and Deutsche Bank names pilot members

Willis, Cooper Gay Swett & Crawford (CGSC) and Ruschlikon UK members ACE, XL Group and Generali will participate in pilots of the Netsett platform to demonstrate the value of trading between companies.

Xchanging and Deutsche Bank also announced the signature of a letter of intent with one of the world's top three global insurers, to pilot the Netsett global platform in five business units across North America, Asia and Europe.

The Netsett platform, originally launched as a concept in late 2012, provides global accounting and net settlement using structured data to enable the exchange and settlement of accounting information automatically and efficiently.

A pilot demonstrated significant benefits, halving both the number of steps involved and the number of people who touch each transaction, reducing the settlement cycle from six weeks to two weeks, cutting bank charges, and reducing the payment workflow process by 80 percent, according to Xchanging.

Speaking at the Rendez-Vous de Septembre in Monte Carlo, Adrian Guttridge, managing director of Xchanging Insurance Services, commented: "We are now delighted to welcome such a host of reputable market names to the Netsett platform; their confidence in Netsett's abilities highlights the strength of the proposition."

"We recognise how important it is to work with the insurance sector, and to provide solutions that address its specific needs. Netsett is a prime example of this."

StrucSure chooses Wilmington Trust

StrucSure Risk Management Group has chosen Wilmington Trust as captive manager for its insurance and re-insurance companies, Golden Insurance Company RRG and Four Points Re.

"Wilmington Trust has provided corporate and institutional financial solutions for over a century and is one of the most financially sound and successful companies in the nation's financial services industry," said Kirk Mooneyham, managing director of captive management services at Wilmington Trust.

"Our management of Golden Insurance Compan] and Four Points Re further improves the financial capabilities of those companies and builders can have increased confidence in their management and financial security under this new arrangement."

OnPoint Underwriting will continue to provide underwriting services for Golden Insurance Company under the new arrangement.

Christopher Macaulay, president of StrucSure Risk Management Group, commented: "We are excited about the opportunities new management under Wilmington Trust presents as it comes at a time when revitalisation of the construction industry is in full force and our builder clients are in a period of growth."

"Together, Wilmington Trust and OnPoint Underwriting create a strong management structure that will be an asset to our builder clients today and into the future."

More regulation where that came from, says Aon

The pace of rating agency and regulatory developments is not expected to slow in the near future, according to a report from Aon Benfield.

Over the past 12 months, A.M. Best has released criteria on capital credit of surplus notes, defined surety company stress tests and introduced a national rating scale process.

Additionally, A.M. Best is expected to release an update on its new stochastic capital model by the end of 2014.

Standard & Poor's updates include defining how a company may be rated above its sovereign, and expansion of the S&P Insurance Industry Country Risk Assessment scores.

Moody's published a standardised approach to stress testing, and Fitch reintroduced its enhanced stochastic capital model, Prism, for use on Europe, Middle East and Africa and non-life US insurers.

According to Aon, regulators are also strengthening capital requirements and the emphasis is on more than risk-based capital models. Specifically, own risk solvency assessment is becoming a common framework in the regulatory process.

Strong enterprise risk management was pinpointed as the anchor for companies to address regulatory developments and manage rating agency expectations.

Patrick Matthews, head of global rating agency advisory at Aon, said: "The strong financial results of insurance and reinsurance companies globally has not allayed the concerns of the rating agencies, which believe the record levels of capital in the industry coupled with the low interest rate environment, could make it difficult for firms to achieve sustainable, robust results."

"In addition, exposure to rating agency and regulatory changes is often an underestimated 'event' risk for many companies. Understanding and managing evolving criteria plays an integral component of insurers' success going forward."

Aon's report said that rating agencies' view of the reinsurance sector has changed dramatically over the past year, with Standard & Poor's, Moody's and A.M. Best all revising their respective outlooks from stable to negative.

Insurer and reinsurer underwriting results were shown to have improved, with the median combined ratio expected to reach 94.1 percent by year-end based on equity analyst estimates.

Multiple years of rate increases, especially on property and workers' compensation business, combined with relatively low catastrophe losses so far in 2014, have contributed to strong underwriting results.

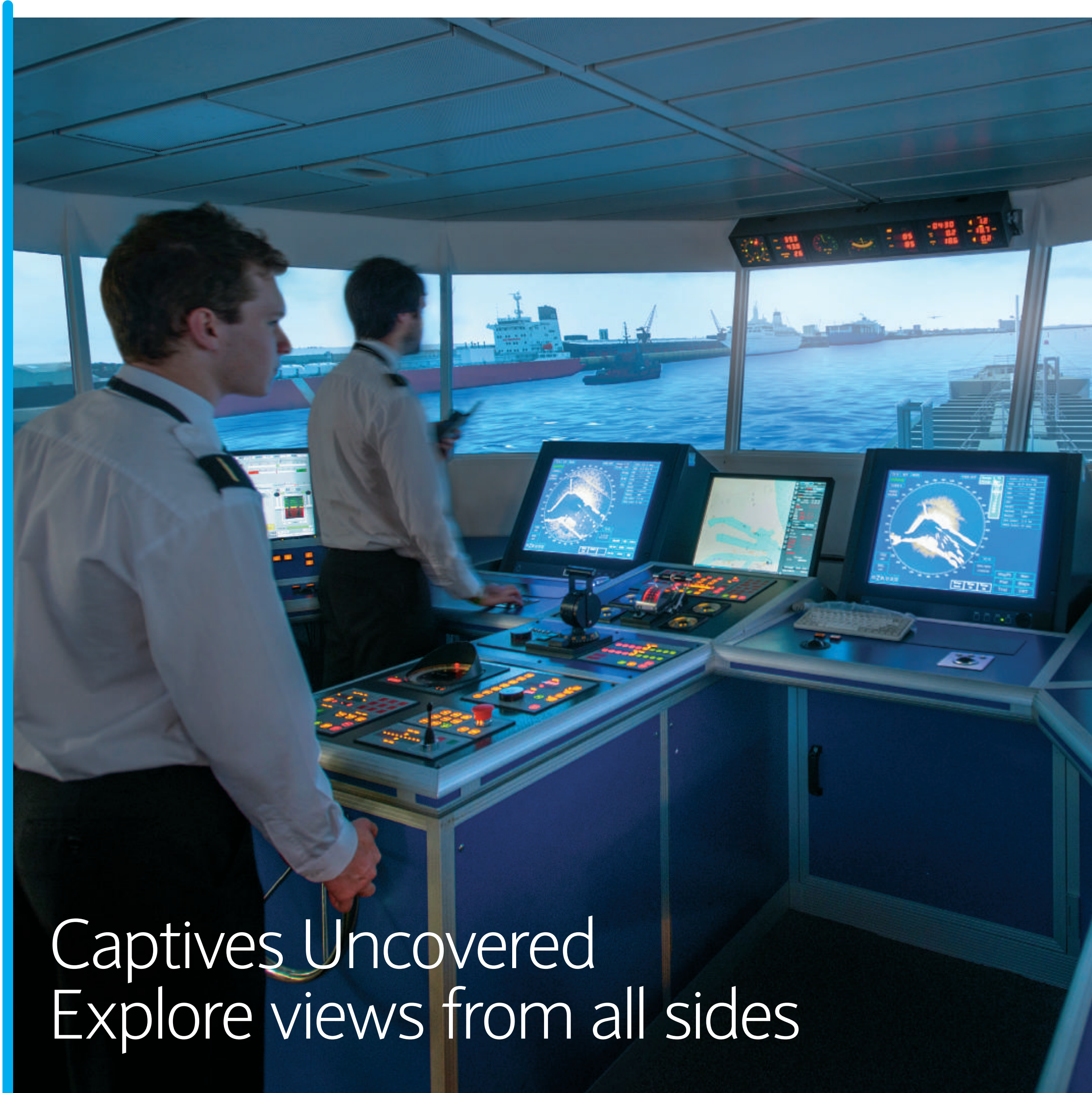
The percentage of companies that reported a combined ratio above 100 has significantly decreased from 60 percent in 2011 to only 14 percent in 2013, with 2014 expected to see a slight uptick to 18 percent.

ILS going from strength to strength

Over the past two years, around $20 billion of new capital has entered the market through investments in insurance-linked securities (ILS), funds and sidecars, as well as the formation of hedge fund-related reinsurance companies and collateralised reinsurance vehicles, according to a new report from Guy Carpenter.

The report also explored how the use of capital markets-based capacity provides cost savings for public entities by helping them build surplus, reduce public debt and limit the risk that natural perils can pose to the state's balance sheet.

"Guy Carpenter and GC Securities have pioneered these innovative forms of risk transfer,


Captives Uncovered
Explore views from all sides

and we are committed to finding the optimal form of risk mitigation for our clients from the vast array of potential solutions across all markets," said David Priebe, vice chairman of Guy Carpenter.

A notable major innovation that occurred in the past year is the transfer of risk directly from the risk-bearing entity to the capital markets, without an intervening traditional insurance company.

The MetroCat Re bond, whose cedent is the captive insurer of the New York Metropolitan Transportation Authority, transferred the risk associated with storm surge and flooding directly to capital markets investors without a traditional insurance company acting as an intermediary.

According to Guy Carpenter, as the quality of catastrophe modeling continues to increase and as capital markets investors become more comfortable with innovative terms and conditions, more types of risk may directly access the capital markets in ILS form.

The amount of limit placed on utilising ILS and collateralised products continues to grow, and some markets are broadening the line of business and product focus.

Utilisation of capital markets capacity in the first six months of 2014 saw a continuation of the growth trends seen in 2013.

Xuber goes Caribbean

Xuber, Xchanging's insurance software business, plans to strengthen its position in the Bermudian insurance market.

An insurance software platform configured for the assumed reinsurance market was launched at an event on 23 September, in Hamilton, Bermuda.

The event also included presentations from the business on the challenges facing the Bermudian market, and issues such as legacy systems and data migration.

The results of Xuber's Bermudian market survey were also be published, following a series of interviews with senior figures from the region.

Chris Baker, managing director of Xuber, commented: "Xuber began its life at the heart of the London market."

"Our local expertise provides the ideal platform to build upon as we strengthen our global position, extending our reach and services to core insurance markets around the world."

"The global insurance market is constantly evolving and local markets must be able to adapt and stay ahead of the curve to remain competitive. We're excited to reveal details of our latest offering in Bermuda, as we cement our position in this market."

Xuber is also enhancing its product offering with Xuber for Reinsurers, designed to directly address the need for software solutions tailored to the complex reinsurance market.

The product offers four functional components, providing users with a common data model and standard integration framework.

The components—Xuber Contract, Xuber Claims, Xuber Billing and Xuber Retro Ceding—can be deployed as standalone products or as part of a complete, flexible, end-to-end software suite.

The pre-configured templates are equipped with complex automated reinsurance calculations as standard and a user interface built around reinsurance terminology.

The software platform allows users to work across different time zones, currencies and languages, supporting reinsurers in the region to compete on a global basis.

Chris Baker, managing director of Xuber, commented: "The global reinsurance market is valued at approximately $570 billion, which presents a huge opportunity for vendors who are able to cater to its complex and varied needs."

"A survey we carried out in Bermuda, the results of which will soon be released, highlighted the amount of capital being invested in the Bermudian reinsurance market, showing its growing importance in the global landscape."

Executive vice president and chief administrative officer of Everest Re and Xuber for Reinsurers customer, Barry Smith, added: "We chose Xuber because of its seamless global capabilities and because the robust functionality of its systems is second-to-none in the reinsurance market."

"Xuber for Reinsurers will enable us to migrate from legacy systems with a modern, configurable and flexible platform to support our growing and changing business needs."

Multinationals on the rise, says ACE

More than eight out of 10 European companies expect to increase their use of multinational insurance programmes over the next three years, according to research published by ACE Group.

This is primarily due to mounting apprehension about the "risk management implications" of their rising exposure to emerging markets.

The survey of 280 risk managers across Europe, part of ACE's ongoing series of European Risk Briefings, also points to heightened concerns regarding the growing complexity of international regulation and the impact of cross-border risk profiles on the companies' loss experience.

Respondents also worry about the changing liabilities their multinational operations face, according to the survey.

Four of the top six risks that they expect to create the greatest risk exposure for their multinational operation in three years' time relate directly to liability issues.

Cyber risk, which has a significant liability dimension was ranked second.

Environmental liability was ranked third, underlining a growing awareness of new and emerging liabilities.

Professional indemnity and directors and officers liability were also in the top six.

Risk managers who took part in the survey cited multinational programmes as a clear way to improve consistency and compliance.

Close to a third of risk managers believe that multinational programmes allow them to make the claims process more efficient and more than a quarter that they can help them to control cost through economies of scale.

Risk managers that took part in the survey stated that they require more practical support from insurers to help manage multinational risks.

According to the survey, fewer than a third of risk managers are currently "very satisfied" with overall service levels on multinational programmes.

New risks for the reinsurance sector

Cyber attacks, terrorism and new compensation structures for long-term bodily injuries are all emerging risks facing the insurance and reinsurance sector, according to Guy Carpenter.

Guy Carpenter's has reported that cyber attacks are now seen as one of the most serious economic and national security challenges facing governments around the world.

They also present a set of aggregations and accumulations of risk that spread beyond the corporation to affiliates, counterparties and supply chains.

Companies are uncertain of how much coverage to acquire and whether their current policies provide them with protection.

Marsh has estimated that the US cyber insurance market was worth $1 billion in gross written premiums in 2013, and could reach as much as $2 billion this year.

The European market is currently a fraction of that, at approximately $150 million, but could reach as high as $1.1 billion by 2018, according to some estimates.

Earlier in 2014, Guy Carpenter launched its cyber solutions specialty practice, which focuses on the development and delivery of cyber reinsurance solutions to address the increasing risks associated with cyber security.

Given the growing population, regional conflicts, the expansive reach of social media for extremists to spread their messages and recruit, as well as the diversity of possible attack modes to cause human and economic loss, Guy Carpenter has also cited terrorism as an emerging risk.

There is uncertainty in the US terrorism market coming from the fact that the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) is scheduled to expire on 31 December 2014, and US lawmakers are yet to authorise a renewal programme.

Guy Carpenter also found that compensation for provision of long-term care for bodily injury is becoming an increasingly challenging problem for society in general and insurers in particular.

For severe bodily injury cases in the UK, claimants are now highly likely to opt for an annuity/periodic payment order rather than a lump sum.

As a consequence, the uncertainties that previously had been transferred to the claimant are now retained by the insurer and to a certain extent, its reinsurers.

Regulatory pressure strengthens Saudi market

The Saudi insurance market continued its strong growth over H1 2014 with gross written premiums expanding 24 percent compared with H1 2013, according to a new Best's Briefing.

The briefing states that independent actuarial reviews imposed by the regulator after a difficult 2013 have had a positive effect on the first two quarters of 2014.

During 2013, the Saudi insurance market underwent extremely challenging conditions contributing to a significant deterioration in operating performance, as highlighted in the Best Special Report, Competition, Growth Dampen Saudi Insurers' 2013 Performance, released in April 2014.

The independent actuarial reviews imposed by the regulator meant that many insurers were required to materially strengthen claims reserves by year-end 2013.

This resulted in weakened operating performance and, consequentially, a reduction in risk-adjusted capitalisation for most market participants.

Following the actuarial review of the medical and motor business segments, the main driver for growth has been price increases on these lines.

Oklahoma authorises ACM

Active Captive Management (ACM) has been approved as a captive insurance manager in Oklahoma.

The firm has already added North Carolina to its roster in 2014, following the states of Hawaii, Nevada and Oregon in 2013.

The approval makes ACM one of just nine approved captive managers in Oklahoma.

Recent legislative changes to the domicile's captive regulations include the opportunity to obtain a provisional licence and the ability to cover worker's compensation risk, among other benefits.

Oklahoma now provides low cost premium tax rates capped at $100,000—reported to be a primary driver of the increased captive business in the state.

ACM's Fred Turner said: "ACM is very pleased to be among a handful of firms selected to support Oklahoma's business base with the economic development tools of custom insurance coverage and asset protection offered through captives."

Ratings round-up

A.M. Best

A.M. Best has placed the financial strength rating of “A- (Excellent)” and the issuer credit rating of “a-” of Gulf Reinsurance Limited under review with negative implications.

The action follows an accepted appeal by Gulf Re where new information was provided outlining enhanced strategic initiatives that are expected to be implemented by the company.

The ratings will be reviewed again by the end of November.

The under review with negative implications status reflects the weak technical performance of Gulf Re, coupled with the company’s ability to finalise stronger alignment with its joint shareholder, Arch Capital Group Ltd (ACGL).

A.M. Best stated: “Gulf Re’s underwriting performance remains under strain, with technical losses in four out of five full years of operation.”

“The weak performance reflects high expense costs associated with the start-up operation, combined with a higher than expected frequency of large losses in recent years.”

Gulf Re has also experienced two large claims in 2014, forecasting the loss ratio to rise above 100 percent for the year, which will result in capital and surplus falling below the $200 million with which the company was founded.

In response to weakening technical performance, efforts are being made to produce a technical profit in 2015 and reduce underwriting volatility within Gulf Re’s profile.

Further measures enhancing ACGL’s support to Gulf Re are being finalised.

A.M. Best has also affirmed the financial strength rating of “A (Excellent)” and the issuer credit rating of “a” of First Capital Insurance.

The ratings reflect First Capital’s adequate risk-adjusted capitalisation and consistent operating performance.

First Capital's reported surplus continued to grow in 2013 and maintained a no-dividend policy over the past five years.

The company's Singapore local capital adequacy ratio increased in 2013, well above the statutory minimum ratio.

First Capital has consistently generated positive operating results in the five-year period that ended in 2013.

The five-year average loss ratio and combined ratio are well below 100 percent, with only slight volatility.

The company's underwriting profit in fiscal year 2013 exceeded the five-year average between 2009 and 2013.

Offsetting these positive rating factors are the increasing insurance market competition in the Asia-Pacific region and First Capital's decreasing investment yield.

First Capital's portfolio was mainly composed of marine hull, fire and motor in fiscal year 2013, and the proportion of gross premium generated from the offshore insurance fund was approximately half of the overall revenue.

Some regional insurers have continued to grow their marine hull business for diversification purposes, which has increased competition and placed stress on First Capital's profitability and market share in this business line.

A.M. Best commented: "Due to the continued low interest rate environment and increased investment allocations to fixed deposits, First Capital's overall investment yield in 2013 has decreased considerably. The company expects low interest rates to continue in 2014."

Finally, A.M. Best has affirmed the financial strength rating of "A+ (Superior)" and issuer credit ratings of "aa" of Factory Mutual Insurance Company and its subsidiaries, Appalachian Insurance Company and Affiliated FM Insurance Company.

All companies are members of FM Global Group and domiciled in Johnston, Rhode Island.

The ratings reflect FM Global Group members' superior level of risk-adjusted capitalisation, historically strong operating performance, its leadership position in the commercial property market and the benefits gained from its advanced approach to loss prevention and property conservation.

These positive rating factors are partially offset by FM Global Group's significant exposure and susceptibility to natural and man-made catastrophes. In addition, the group maintains elevated common stock leverage that, while manageable, adds some volatility to its overall balance sheet and earnings.

Demotech

Demotech has affirmed the financial stability rating of "A, Exceptional", assigned to Global Hawk Insurance Company RRG.

This level of financial stability rating is assigned to insurers who possess exceptional financial stability related to Demotech's criteria.

These include maintaining positive surplus as regards policyholders, liquidity of invested assets, an acceptable level of financial leverage, reasonable loss and loss adjustment expense reserves, and "realistic pricing".

The financial stability rating of 'A' (A Prime), Unsurpassed, assigned to Broome Co-Operative Insurance Company has also been affirmed by Demotech.

This level of financial stability rating is assigned to insurers that possess unsurpassed financial stability related to Demotech's criteria.

Has your captive been rated? Let us know:
stephendurham@captiveinsurancetimes.com

Getting to know the neighbours

Guernsey, the Isle of Man and Jersey are working harder than ever to promote themselves as the go-to jurisdiction and capitalise on new opportunities

STEPHEN DURHAM REPORTS

Guernsey's strength as a captive domicile has been decades in the making, with the country's first captive being established in the 1920s. It stands as the number one captive jurisdiction in Europe and the fourth worldwide, licensing 99 new captives in the year ending March 2014 alone. Despite this established industry, Guernsey is still driven by looking for solutions to what clients require.

Kate Storey, counsel in the corporate and commercial department at Appleby, comments: "Guernsey pioneered the protected cell company (PCC), in which the assets and liabilities of each cell within the company are segregated by law, and this structure has been widely used with great success in the insurance sector. We are now seeing a trend towards Guernsey's incorporated cell company (ICC), as the legal segregation offered by each cell being a separate company

PUERTO RICO

Why Puerto Rico Captive ?

Fully accredited United States jurisdiction

Strong insurance market and one of the largest in Latin America

Access to United States and Latin America

Experienced regulators with pro-business vision

Competitive and secure tax environment

Proven captive jurisdiction

MATOS, GELY & HO
PUERTO RICO INTERNATIONAL INSURANCE

MGH is Puerto Rico's leading captive insurance service provider, offering a wide range of management services, in-depth regulatory understanding and groundbreaking risk solutions. Our professional team combines legal, tax and risk management expertise to design and implement captive insurance programs in Puerto Rico.

MGH prides itself on being responsive, results-driven and experts in captive insurance. Our group has special expertise in designing Pure-captives, Association Captives and Protected Cell structures.

To learn more, contact Ruben A. Gely at +1 (787) 565 3046
email rgely@prcaptives.com
or visit our website: www.prcaptives.com

is perhaps more easily understandable for clients from some jurisdictions."

Guernsey's ICC is also proving increasingly popular for a range of insurance structures, including captives, rent-a-captives, transformers and insurance-linked securities (ILS).

Storey states that, in the last 12 months, there has been a massive increase in enquiries regarding ILS structures. Although these vehicles have traditionally been done out of Bermuda, there has been a shift emanating from London law firms and sponsor insurers to begin focusing on Guernsey as the jurisdiction of choice for ILS.

Under Guernsey law, there is no risk of insolvency for ILS, as the loss cannot exceed the level of exposure, so the regulator is informed and the collateral is secure.

There has been interest in recent months from Europe and worldwide, and the recent Guernsey Finance-fronted ILS conference in Zurich was also "well received by major investment and insurance players", according to Storey.

Further clout has been put behind this push through the establishment of dedicated departments. Compliance director for Heritage, Martin Le Pelley, says: "The Guernsey International Insurance Association (GIIA) and Guernsey Investment Fund Association (GIFA) have teamed up to put together an ILS sub-group designed to explore the broader opportunities for Guernsey from a two pronged attack—the insurance market and selling it to investment markets."

Although others such as Malta and Gibraltar have been jumping on the ILS bandwagon, compared with the likes of Bermuda and Guernsey, the EU domiciles could be at a disadvantage due to the impending implementation of the Solvency II.

Storey continues: "We worked on a major marine reinsurance ILS structure at the end of 2013, where we acted for the fronting insurer. That involved use of a Guernsey special-purpose vehicle (SPV) to act as reinsurer, with capital markets investors investing into and funding the structure. We have also recently dealt with an ILS structure for insuring lotteries risk."

Referrals to Guernsey are common from London law firms, but sponsor insurers or companies that have captive requirements have recently been coming from Spain, the US, France and the Middle East. Appleby also recently had an enquiry from a Singapore-based captive insurer that was keen to employ ILS through Guernsey.

While the Internal Revenue Service (IRS) in the US is pursuing a crackdown on captives—Guernsey has no such worries. The UK's revised controlled foreign company rules now allow a Guernsey-based company to make

£500,000 per year in profit in a cell without having to pay tax until it is distributed.

Le Pelley explains: "The US IRS is scrutinising captives because they are so popular. I've often said any company that manages its risks better can make more profits, which themselves are taxable, rather than taking big risks and incurring either big profits or big losses. This makes captives more stable, if anything, from a tax revenue generating perspective."

In second place, chronologically at least, on the list of the UK's neighbouring captive domiciles is the Isle of Man. The island has been transacting insurance since 1980, leading the sector to become one of the major contributors to the island's economy and amounting to around 15 percent of its GDP.

Although the country does not possess the experience of Guernsey, many feel that it is fast becoming a popular alternative.

Colin Freeman, relationship manager at Barclays in the Isle of Man, says: "It is an exciting time with interest potentially rising in the US and elsewhere. In the Isle of Man, with the euro flat on its face, our customers have a great deal of cash and have to make hard choices. There are limited choices about financial institutions they are comfortable with and what options and returns they have available."

The Isle of Man's legislation currently caters for pure captives, PCCs and ICCs, as well as accommodating general insurers that write third-party business. At last count there are 225 licensed insurance entities on the island, covering a range of insurance structures, which are all regulated by the Isle of Man Insurance and Pensions Authority (IPA).

On 8 May, the Isle of Man released a public consultation document, put together in partnership between the insurance sector and government, to begin the process of legislating for ILS.

KPMG Isle of Man director Simon Nicholas comments: "A number of key advisors in our industry have worked in other offshore jurisdictions, such as Bermuda, and have experience of ILS and catastrophe bonds already.

The demand on the Isle of Man is coming from past, present and future clients, especially some of the larger life and reinsurance companies, that will now be able to do establish ILS entities using a regulatory framework which is appropriate for the nature of the risk."

The Isle of Man is by no means becoming an ILS jurisdiction in the mold of Guernsey or Bermuda and, while no real business seems to be leaving, according to Freeman, the country is beginning to target onshore European domiciles that may be nervous about Solvency II.

The Isle of Man, much like Guernsey, has a more flexible regulatory regime and is hoping that the numbers will follow. The consensus is that the majority of new business has been ascribed to that factor.

Big players such as Aon, Marsh and Willis have offices on Guernsey and the Isle of Man, so they have no interest in favouring one domicile over the other. Freeman claims that the choice is more client driven, and their decisions regarding each jurisdiction's regulations, convenience, sister companies and associations are more likely to swing the vote.

Vice president of treasury and brokerage at Barclays in the Isle of Man, Peter Downey, says: "Given how cash heavy the captive market is in the Isle of Man, there are two elements to consider. Global events such as the projected Bank of England and Federal Reserve interest rate hikes over 2015 should factor into captives' plans, in terms of how they position themselves for these market events. Secondly, captives need to decide what they want from their policy and what they want to achieve in terms of liquidity requirements."

Practitioners on the island of Jersey are keen to develop the country's fledgling captive industry on the back of its other, more established sectors such as banking and investment.

Although the legal infrastructure and regulatory framework to transact international insurance business has existed for many years, the captive industry is yet to be prioritised.

Richard Packman, managing director of Vantage, confirms: "Jersey is a little behind Guernsey and the Isle of Man in terms of numbers of clients at the moment. We are working to put Jersey on the map as far as recognition for establishing captives or transacting alternative risk management structures are concerned. Regardless, everything is here and ready to be used, it's just attracting businesses to make use of the skillsets that are already here."

Aside from Vantage, others that have an interest in developing the insurance sector have generally been law, audit and other consultancy firms—though it remains far from their prime focus.

The regulation and legislation on the island is similar to neighbouring Guernsey, while similar FATCA-esque agreements with the UK.

The island's cell company legislation also means that it could accommodate ILS, as it could treat them similarly to a segregated accounts company. Despite this, there remains a shortage of clients, and the ones in the pipeline have generally been sourced through coincidental or personal connections.

Packman continues: "Business is slowly picking up. Vantage currently has a very small number of captive clients but we are looking to develop through the other contacts that we have. Vantage is looking to market our independence from the big broking firms, which will be our USP, much like Heritage did in Guernsey before their acquisition by Gallaghers."

"Historically, Jersey's captive sector has been more reactive than proactive in terms of attracting new insurance business. Work is now underway to turn that around and I think Jersey has a good chance to build up a solid block of insurance business." CIT

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For over 65 years, AIG has been providing innovative fronting solutions to help our clients retain risk throughout the world. Today, we're one of the leading global fronting providers. Our international network transacts billions of dollars of premiums and processes over 100,000 claims for captives every year. Whether you're looking for a fronting provider for a captive, a rent-a-captive, a fully funded or indemnity program, we have the resources and expertise you need. To learn more, go to **www.aig.com/captives**

AIG

Bring on tomorrow

Captives' Rosetta Stone

London & Capital's new indices could provide an invaluable edge for owners and managers alike, as William Dalziel explains

STEPHEN DURHAM REPORTS

What are the primary uses of London & Capital's new suite of proprietary indices for captive insurers?

It is not always easy for captive owners to see how their portfolios fare compared to how the market is doing. It is easier to see, for example, what the equity markets such as the S&P 500 are doing, but not so obvious as to how short duration bonds fared. What we are trying to do is make information more accessible and more relevant. I am surprised how often captive owners don't seem to have a sense of what a reasonable return might be.

Perspective is often difficult to achieve. For those who have investment portfolios, it will give them an independent view of what those portfolios should to be doing.

A lot worry that their investment managers pick and choose benchmarks that are not entirely appropriate. I am convinced that well-managed portfolios will make a meaningful difference to the performance of the business over time, yet I see relatively few captives take that option.

Can you give some insight into the development of the indices? Why release it now?

We have been working on the indices for about a year following conversations with some insurance consultants. Their issue was that, as they were looking at different types of business, they didn't have one source of data that would give them and the potential captive owners a sense of the return they could expect.

By May, we had tried a number of different approaches, both passive and dynamic, to create an index. We then tested the data going back 10 years and realised we had a useful tool.

The next month or so was spent thinking how we could get this into the hands of the wider industry and confirming that we had the resources to publish the results consistently.

I get the sense that there is increasing pressure on boards to demonstrate good governance and on the industry to demonstrate that is delivering value to orders. That means there is a lot of demand for benchmarking services of all sorts, in terms of the operation of captives.

Every year there are a couple of big surveys published by the industry that are very helpful in that area, but everything that comes out on the investment side is very weak and doesn't seem to be particularly consistent. It also tends to be very dated and, as a result, does not provide much insight.

We thought, rather than trying to produce benchmarking data from captives' performance, we would look at the indices of the assets they hold. This enables us to be more accurate, complete and up-to-date.

What logistical support and human capital is necessary for these indices to function? Are all three run independently?

We recognise that, while publishing one set of numbers might be interesting, it does not really help anyone. To give a full picture we need to publish updates on a regular basis, and that is exactly what we intend to do.

We have the resources and captive expertise in-house already, so we are very fortunate. The other thing is that the investment industry is very data-rich. We have granular data that goes back decades—it shows us market trends and how they related to the economy as a whole.

While getting data is not a problem, how to assemble it in a relevant way is. Part of what we are planning to do is publish a concise quarterly analysis that can explain what the numbers mean in a wider context.

Captive owners are very keen to understand what is a reasonable return under very constrained risk conditions and that is what we will try to do.

If a board has an unrealistic expectation of what an investment portfolio can deliver, they should be freed of that notion pretty early on. By the time they see the results, it is usually too late to take action. Eventually we will get to that further down the road.

When can the first quarterly report be expected?

The data we have published so far takes us up to Q1 2014 and the first update of the entire series will be during the second week of October. That will include the updates for Q2 and Q3.

After that, we expect to publish the updates within two weeks of the end of each quarter. We believe that it lends itself to being accessed online, so that is what we are doing via our website.

We also have a mailing list of industry contacts that will receive it and have had many more sign up following the original announcement.

Are you aware of any competition in the market? If so, what is London & Capital's edge?

There are no benchmarks specifically geared towards captives. The Barclays aggregate benchmark is a very well-understood and reputable source of information about bond holdings.

The problem about this is it has some components that captives would not be happy to invest in, while the duration of this benchmark seldom matches that of a captive portfolio.

The duration of the Barclays aggregate index might be five to seven years. A property and casualty captive with a short-duration portfolio will need a benchmark that has a duration of two years.

Our edge is that we understand and have experience of working with captives and are a well-resourced firm.

What kind of feedback have you had from the industry following the announcement?

We launched the London & Capital indices at the Vermont Captive Insurance Association Conference in August and people were very welcoming of it. What has been interesting to see is how different people plan to use it.

We have spoken to insurance managers that have asked us whether we will provide a one-page quarterly update summarising both data and analysis, which we intend to do. They are planning to use that as part of their reporting packs for their clients.

The other useful feedback has been from our direct competitors as asset managers. We have already had a few calls from firms wanting to explore how the indices are constructed. I got the impression that some are looking to use them as part of their captive offering.

Even on the first run through there are people suggesting how this can be developed in the future, and we see this as a real sign of acceptance.

Some captive owners have even enquired as to whether we could provide a personalised index for their particular portfolio and, of course, the answer is yes. CIT

William Dalziel
Head of institutional clients
London & Capital

Live long and prosper

Self-funding has long proven to be the most efficient form of financing healthcare insurance, says Phillip Giles of QBE North America

Kahn: Kirk? You're still alive my old friend?
Kirk: Still, "old friend!" You've managed to kill everyone else, but like a poor marksman, you keep missing the target!
Kahn: Perhaps I no longer need to try, Admiral.

Many of you will recognise that famous dialog from the movie Star Trek II. Now, just envision the same conversation in the context of the US healthcare system under the Affordable Care Act (ACA), and substitute Kahn for US President Barack Obama and Kirk for much of the insurance industry and you might just have a reasonable view of how the new order for healthcare access has progressed this first year from an industry perspective.

President Obama has met one of his platform objectives—increasing access to healthcare by way of the ACA. However, like the poor marksman mentioned above, the act completely misses one the primary targets: achieving sustainable affordability. Now in the autumn of his presidency, and with a rapidly increasing level of lameness (not covered under ACA), perhaps Obama is no longer motivated to try.

Universal access needed to improve. One of the primary problems inhibiting access is the cost that is charged for care. The root problems of healthcare pricing are much too complex to breakdown in this discussion, however, I feel comfortable in saying that, over the years, buying healthcare in the US has denigrated to a process that is similar to purchasing an automobile, the sticker price has no relevance to reality.

Many providers will charge a grossly inflated price knowing that they are likely to receive only 60 percent of billed charges from a commercial insurer (much less from Medicare and Medicaid) based on negotiated discounts.

The value of preferred provider (PPO) arrangements has also been reduced as competition and the demand for increased provider access has diluted the concept and value of in-network steerage. This further contributes to, rather than helps contain, the cost of healthcare delivery.

It should be noted that, under ACA, Medicare/Medicaid money is distributed to providers based, in part, on size. Larger health systems having more physicians and treating more patients will receive a bigger slice of the federal pie.

Consequently, bigger healthcare systems are purchasing smaller systems and independent specialty practices at a record rate allowing them to pyramid internal income from all phases of healthcare, increase market control and receive more in governmental funding.

As healthcare systems consolidate and grow, the value of differing pricing structures (and PPOs) will become more irrelevant. What sense does it make for several different people having the same medical condition, going to the same providers, within the same healthcare system to be charged completely different costs for the same treatment simply because they have different medical insurance cards?

The solution for affordability is not simply increasing access to insurance and then redistributing costs and providing low-income subsidies. This approach is 'cost spreading' as opposed to 'cost solving' and only provides a temporarily disguise for the problem as opposed to permanently resolving it. Socialised cost shifting is analogous to a governmental Botox injection. In time, the temporary beautification will wear off and a deeper financial problem will be revealed.

Suppressing the symptoms should never be confused with providing a cure for deteriorating beauty. The cost of insurance is a direct reflection of the expected costs charged for healthcare. The only way to make health insurance more affordable is to make healthcare itself more affordable.

The cost solution will only come from developing a more realistic, systemically consistent single referenced–based approach to pricing from providers and also having a reimbursement formula that acknowledges the level of patient outcome quality performance of the provider.

Controlling what you can

While there is no immediate solution on the horizon for mitigating the cost of healthcare, the logical focus for most employers will centre on mitigating the cost of health insurance provided to employees.

Self-funding has long proven to be the most efficient form of financing insurance. As mentioned above, the cost of health insurance is largely based on the expected cost of claims, plus carrier overhead and profit. By self-funding, an employer only pays for the actual cost of claims, related administrative overhead and stop loss insurance. What the employer doesn't pay in claims is kept, either in general assets or in a designated trust to offset future plan costs. The 'profitability' of the plan accrues to the benefit of the employer rather than to an insurance carrier. This typically translates to lowering the ultimate cost of benefit delivery to employees.

Employer self-insurance has enjoyed tremendous growth over the past several years. At the beginning of the millennium, less than 48 percent of employers were self-funded. Growth exceeded the 60 percent level in 2014. A recent A.M. Best report predicts continued increases in employer self-funding and the medical stop-loss market fueled by ACA mandates for the forseeable future.

Captivating opportunities for stop loss

As interest in employer self-funding increases, market momentum for stop-loss captives is also rapidly increasing. The two basic types of captive structures that comprise this market segment are large single-parent captives and group captives.

Large single parent captives

Most employers large enough to have an existing captive are already self-funding their employee healthcare benefits. Many employers of this size previously did not purchase stop loss, but since the enactment of ACA and unlimited lifetime benefit maximums, they now purchase high (unlimited) levels of coverage and assume lower layers into their captive.

Stop-loss coverage by itself would not generate enough premium to justify forming a captive solely for that purpose, however, it can be used to effectively expand the use and enhance the efficiency of an existing captive. It is important to note that stop loss is not considered to be an employee benefit coverage and so not generally considered to be unrelated (third party) business by the Internal Revenue Service for tax purposes.

Group captives

There generally are two types of group captives: heterogeneous and homogeneous (like industries). Both types strive to replicate the risk profile of a larger employer to spread risk, promote stability, and achieve cost savings from different service providers.

Heterogeneous groups require a larger size in order to achieve appropriate spread of risk among diverse participants. Typically 'open market' programmes in terms of membership participation.

As homogenous groups are more industry-specific in their composition, they can be smaller as the underlying risk and underwriting profile is similar. The required size to achieve an appropriate spread of risk is not as great as in heterogeneous groups. Group captives are especially effective when formed by closely aligned groups of like-minded employers within the same industry.

Risk retention groups (RRGs) are a form of homogenous group captives. RRGs are only authorised by the Federal Liability Risk Retention Act to cover liability risks, but the potential exists for groups of employers participating in RRGs to form parallel group captives for medical stop-loss coverage.

Each employer purchases specific and aggregate medical stop-loss coverage according to its own risk appetite. The stop loss is purchased from the common insurer or reinsurer that will provide coverage to each member of the captive. The stop-loss carrier will then cede a layer within the collective stop-loss portfolio, attributable to all participating group members, to a captive owned jointly by all participating members. The actual captive participation level will be determined by the collective risk appetite of the insured members and can be structured either on an excess or quota-share basis.

Interest in self-funding and group captives will grow significantly as medical costs continue to rise and the uncertainties related to ACA healthcare reform threaten the cost and amount of control that employers are able to maintain within more conventional insurance structures. Hopefully, the legislative marksmanship relative to healthcare reform will also sharpen to the point of actually hitting the correct targets. CIT

Phillip Giles
Vice president, sales and marketing, accident and health
QBE North America

A lost art form?

Ken MacDonald of Miller Insurance Services provides a brief history of the origin of captives before outlining how large organisations can maximise their risk management approach

In the 1960s, Frederic Reiss devised a revolutionary risk management concept that he named "captive" insurance. In doing so, he became widely recognised as the inventor of the modern captive. Today, captives are a well-established risk financing tool used by organisations.

Through hard and soft market cycles over more than 50 years, captives have continued to grow in number and evolve.

What many overlook is that Reiss also pioneered the concept of captive reinsurance. This idea was even more revolutionary; using an insurance subsidiary to access the exotic world of professional reinsurance.

How have things changed?

Since their creation, captives have continued to evolve in sophistication and size. However, it has been noted that there has been a steady decline in the application of captive reinsurance with some estimating that less than one-in- three captives buy any reinsurance at all.

Roy Baumann, director of captive solutions at Swiss Re, endorses this view: "The current market favours net strategies. Also, higher risk maturity and the regulatory frameworks seem to have shifted captive optimums to net positions in many instances."

He continues: "Net captives are the predominant form of captive operating today."

Why utilise reinsurance?

In examining the benefits of using captive reinsurance, it is helpful to revisit how reinsurance influences, and in many cases, drives the main benefits that organisations enjoy when utilising captives. This viewpoint can best be illustrated through the eyes of a global conglomerate such as A.P. Moller-Maersk Group (Maersk).

Maersk utilises the concept of a 'private placement' for its captive, Maersk Insurance A/S (MIAS), which is based at its headquarters in Copenhagen, Denmark. The captive writes a large gross line of primary and low excess coverage, and partners with specific reinsurers to optimise its cost of risk and risk appetite.

Below are some of the benefits of using Maersk's structure:

Control

The insurance value chain for any major corporation can be complex and include one, or a combination of: insurers, reinsurers, retrocessionaires, intermediaries, adjusters, risk management advisers and consultants.

The provision of capacity that addresses an organisation's risk profile is one of the key roles of the risk manager. A captive rather uniquely consolidates this risk information and imparts discipline on the various service providers and other stakeholders to facilitate an effectively functioning risk and insurance programme.

Control of reinsurance is therefore a key ingredient in accomplishing corporate objectives.

Within a conglomerate such as Maersk, this is an even more complex challenge, due to the diversity of its risk profile. In addition to being a leading independent energy company, Maersk runs the world's largest shipping fleet and is a top-three global marine port/terminal operator.

"Our captive's ability to control the deployment of capacity on our account has better enabled us to build more strategic relationships and leverage our broad spread and diversity of risk. This has benefitted both Maersk and our partner (re)insurers," comments Lars Henneberg, who is vice president and head of risk and insurance at Maersk.

A large complex insurance programme is a bit like an onion: layers of reinsurance, retrocession and facultative reinsurance can make identifying the risk retaining party difficult. Using a captive to buy this reinsurance directly mitigates this problem.

In addition, any premium arbitraging or frictional transactional costs can be accrued to the captive's benefit.

Risk management

Captives transform insurance from a cost into a profit and loss item. This in itself heightens the profile of risk management within any organisation, demonstrating the maxim, 'what gets measured gets attention'. Captives convey to carriers a more sophisticated approach to risk management through deployment of capital corporate risk appetite and risk-sharing. This is attractive to reinsurers.

David Ball, major and global risks director at HDI-Gerling Industrial Insurance, comments: "We see clients that utilise captives with real 'skin in the game' as particularly attractive partners and long-term players and we look to deploy our capacity in a meaningful way for such clients."

"The private placement mentality undoubtedly builds stronger relationships with the market, which only benefits buyers in the long-term."

Reinsurance also enables the development of a broader selection of market relationships.

In a conventional arrangement there is generally a lead carrier that sets the terms and writes a significant share of the programme.

By using reinsurance, there is still a lead carrier but the captive can also partner with markets on key parts or layers of its reinsurance programme.

Not only does this give diversity to a panel of markets, it creates a natural succession plan for the lead market(s).

Henneberg comments: "Our captive gives us the ability, through our retrocession programme, to partner with markets that deploy meaningful capacity in key layers which would otherwise be difficult to achieve."

Cost reduction

Underwriting is both an art and a science. While models can guide decision making, they only act as a barometer. What is also clear is that underwriters have different appetites, growth pressures, return-on-capital-employed targets and many other external influences. This means that a captive retrocession programme can give underwriters the opportunity and flexibility to deploy their capacity in the most competitive way possible. Some call this arbitrage between insurance and reinsurance but we prefer to call it optimisation.

Captives can access a greater diversity of capacity and the increased supply and competition normally results in reduced costs. In a challenging economic climate this can be of huge value to an organisation.

Example of deployment of a private placement

A company, or captive, (both illustrative) has a risk appetite of $10 million, and wishes to buy a limit of $100 million, inclusive of its risk appetite. A conventional captive programme structure would generally be marketed in two parts:

- A direct (or normally fronted) programme for the captive layer of $10 million, in excess of deductibles; and
- A direct policy by the carrier for $90 million (excess $10 million).

Deploying the captive in writing a larger gross line involves a direct (or fronted) policy of $100 million.

The difference in these two structures can be dramatic in terms of both impact and profile. The captive can now:

- Deploy its $10 million risk appetite in multiple ways: retain all or a part of the first $ 5 million, take a quota share of other layers, or ventilate its exposure;
- Tailor its reinsurance capacity to the markets with the appropriate appetites in the lower or upper ranges of the gross retention;
- Arbitrage its inwards gross written premium with its outwards reinsurance premium;
- Increase competition;
- Generate more influence on wording enhancements; and
- Create a natural succession plan for the lead markets, as the leading reinsurers can effectively sit on the 'warm up bench'.

Henneberg comments further: "At Maersk, we are serious about risk taking and therefore risk management. We have a fair risk appetite and deploying our captive in such a way that we engage with a broad segment of the insurance and reinsurance market is key to our strategy."

Are captive owners missing a trick?

Captive reinsurance structures as described above could not necessarily be applied to every programme and there are hurdles that would need to be overcome, especially with regard to fronted programmes and the security needs of the fronting carrier."

"At Miller, we believe that organisations that are serious about their captive approach should consider using reinsurance to engage strategically with the insurance market and create a high profile for, while reaping the benefits of, their risk management efforts.CIT

Ken MacDonald
Head of property and casualty
Miller Insurance Services LLP

More than meets the eye

Although Puerto Rico may be the new kid on the block, Ruben Gely of MCH Advisors reveals that it is gaining popularity

Puerto Rico has one of the largest insurance industries in Latin America. According to annual reports from the Office of the Commissioner of Insurance, total written premiums reached $10.7 billion in 2013, 72 percent of which was in health and disability.

With emerging markets in Latin America continuing to expand, Puerto Rico offers a unique opportunity for international insurance companies to capitalise on its political status. As an unincorporated territory of the US, the banking industry is regulated by US federal system and protected by Federal Deposit Insurance Corporation (FDIC). Despite this, taxes are imposed by Puerto Rico authorities and not the Internal Revenue Service (IRS).

Tim O'Connor, managing principal at Risk Financing Alternatives, LLC, comments: "Certainly Puerto Rico's location and culture, as well as its bilingual populace, makes it an attractive domicile for both the US and Latin America. As a US commonwealth, it shares the US legal system, which is an important consideration. The tax structure initiated in Puerto Rico under Law 399 and Act 98 compares very favourably with most other domiciles. Additionally, Puerto Rico is recognised by both the National Association of Insurance Commissioners (NAIC) and its South American counterpart ASSAL. All this gives great confidence to groups looking to place their captives in Puerto Rico."

Not new to captive insurance business, Puerto Rico is home to more than 100 US captives and is rapidly expanding into Latin American countries, with new legislation on hand that incentivises exportation of international insurance products by offering attractive tax exemptions and legal protection under both the US and the Puerto Rican constitution.

Unprecedented growth in Puerto Rico's captive insurance arena during recent years has been a main driver for legislative projects designed by the Office of the Commissioner of Insurance to improve opportunities for US captives.

Other laws designed to attract captive managers and service providers into the island, have also helped generate international interest for the jurisdiction.

While taxes seem to be one of the most important factors, captive owners in Puerto Rico also benefit from a well-developed banking and investment industry. "Being in a US jurisdiction like Puerto Rico will allow the captive owner to make investments through registered representatives and have access to both domestic and international securities, just like they do in Wall Street. Not only there is a knowledge of US laws and regulations when it comes to investments but to local and international statutes as well," adds Manuel Diaz Collazo, senior vice-president at Santander Securities.

"Here in Puerto Rico we have the capabilities and technological advantages to compete with any other major jurisdiction. In terms of brokerage firms, financial institutions and registered personnel, we have the same controls and regulations that the US delivers plus the local oversight of the Puerto Rico Commissioner of Financial Institutions. The Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) oversee the suitability of security transactions and the qualifications of registered representatives that work for brokerage firms in Puerto Rico."

All international insurers enjoy a $1.2 million exclusion from Puerto Rico's tax regime. Net income that exceeds the $1.2 million mark has a preferred 4 percent tax rate, which is an attractive figure considering the island's political and structural ties with the US. This means that a large group of US captives will pay no taxes at all on their earnings under the Puerto Rico jurisdiction. Benefits under this tax treatment will be assured over a period of 15 years and it is renewable for 2 additional periods.

While Puerto Rico's captive growth has mainly come from US companies re-domiciling from other offshore jurisdictions, government officials as well as captive managers involved in Puerto Rico believe that a strong market will eventually be developed with Latin America.

"A large area of opportunity for Puerto Rico lies with Latin America. Though the notion of captives has taken root in Latin America, its potential far exceeds actual progress in forming captives for Latin American companies. There are many reasons for this, including restrictive trade laws in some Latin American countries, but Puerto Rico is well positioned I believe, to attract this business when it develops," says O'Connor.

From a US standpoint, Puerto Rico offers an attractive opportunity for captive managers to set up operations in Puerto Rico. Ryan LLC in particular has set up a number of captives in Puerto Rico and has worked closely with the insurance commissioner to help update legislation and promote the domicile internationally.

Ken Kotch, principal at Ryan LLC, states: "Since Ryan was introduced to Puerto Rico's department of insurance, we have invested in a physical office and a permanent agent in San Juan, which is a component part of being a captive manager there. We have also sponsored a Class 3-agency arrangement in Puerto Rico."

"At Ryan we have 85 clients right now, some of which are based in other jurisdictions, that have selected Puerto Rico as the place to establish their insurance facility and on a bona fide basis, and transact property and casualty insurance."

While the island does represent an interesting opportunity for both US and Latin American captives, it is certainly not a jurisdiction for every type of captive.

Particularly, Puerto Rico imposes a minimum capital requirement of $500,000 for pure captives, which is a figure much higher than other offshore jurisdictions.

This requirement, according to the Office of the Commissioner of Insurance, has been a long-term strategy to avoid the regulatory implications of having under-capitalised insurance companies.

Local captive managers also view these requirements as a positive element to help protect the jurisdiction's reputation. "Puerto Rico's higher capitalisation requirement does limit the scope of captives that wish to enter into the jurisdiction, but it also serves as a tool for screening possible prospects and helps us assure that we're attracting legitimate insurance operations," comments Howard Ho, CFO at MGH Advisors.

However, an alternative to Puerto Rico's capitalisation requirement lies within protected cell arrangements that already play an important role in the expansion of captives in the island. Puerto Rico legislation allows for a parent company to setup under a special licence (Class 3) that allows it to rent cells to interested parties. By doing so, the parent company absorbs the capitalisation requirement and therefore allowing smaller captives to domicile in Puerto Rico.

Although not new to the industry, protected cell arrangements are quickly gaining popularity in Puerto Rico and opening doors for smaller sized captives to do business in the jurisdiction.

"This is a phenomenon not unique to Puerto Rico. In the US, the captive industry has matured for single parent captives. Most of the large corporations and other large entities that a captive makes sense for have already formed captives."

"The growth area for captives is in small- to medium-sized organisations whose segregated or protected cell structure makes better economic sense due to its lower operating and capital costs. These captives are frequently set up under the 831(b) structure for which risk sharing to achieve the IRS required risk distribution can oftentimes be easier achieved in a protected cell arrangement," adds O'Connor.

As the captive insurance industry continues to expand into new areas, other domiciles will also continue to develop their legislation to attract new business and ultimately stay competitive.

While the Office of Commissioner of Insurance of Puerto Rico's most important task will be to maintain updated legislation in line with the industry, local service providers also have the responsibility of positioning Puerto Rico's legislation internationally and serving as facilitators to new projects.

"We cannot expect for captives to find out about Puerto Rico on their own. As any other business, we must be consistent in promoting Puerto Rico and need to take full advantage of every opportunity to expose the benefits of our legislation, whether it is a booth at a conference or reaching out to other captive managers. We need to take the first step," says Jose Matos, president of MGH Advisors.

What exactly is ahead of the road for Puerto Rico's captive arena? The jurisdiction's success will depend on how well both Puerto Rico regulators and service providers can work together to continually design new opportunities for the industry while also focusing on expanding the island's professional workforce in related areas.

O'Connor states: "As always, nothing breeds success like success. Puerto Rico is relatively new to the captive domicile arena. As the unique advantages provided by Puerto Rico are better understood, more will gravitate to it as a captive domicile."

"Work needs to be done to expand the infrastructure of service providers in the area of captive management, auditors, bankers and attorneys with captive expertise. As the domicile grows, these services will expand organically. In the meantime, there are plenty of service providers willing to bring their expertise to Puerto Rico." CIT

Captain Cayman

There has been an increasing demand from Cayman captives to place their assets with on island investment managers. JS de Jager of CSI International Underwriting (Cayman) and Scott Elphinstone of Five Continents Financial get down to brass tacks

Why should Cayman Islands captives and those domiciled elsewhere turn to Cayman to invest surplus premiums and/or capital?

I think the main reason is industry experience. With captive insurance being a large industry in the Cayman Islands, local investment managers have extensive experience of dealing with captive portfolios. They understand the local regulatory requirements, the considerations when the portfolio is pledged against credit facilities and the often complex tax rules that captives operate under.

Cayman's investment managers use this knowledge to manage portfolios to be compliant with all of these essential requirements. For some Cayman captives, hiring a local investment manager is an important step to establishing the required 'mind and management' in the Cayman Islands rather than another country that might seek tax revenue from that captive.

How do investment requirements for those domiciled in Cayman differ from those elsewhere?

There is considerable flexibility in the Cayman regulations on captive investment portfolios compared to most onshore regulatory environments. The investments that can and cannot be held by a captive are generally not defined in the law or regulations. Investment managers often work with captive managers and their clients to assist in the preparation of investment policies that are presented to the Cayman Islands Monetary Authority (CIMA) for their approval.

How are captive investments taxed in Cayman?

There are no taxes imposed by Cayman law on investments held by captive insurance companies. However, many captives located in Cayman have very complex tax arrangements with the countries from which their premiums are paid.

This often results in investment income being taxable in that foreign country. It is critically important that investment managers fully understand the tax situation of their client and act to minimise the impact of those taxes on the portfolio.

What are the most attractive investment options for captives at the moment?

A traditional mix of bonds and equities remain the most attractive investment strategy. With the US Federal Reserve adopting a zero interest rate policy, investments in bonds are not as attractive as in the past. Investing in common equities has provided the majority of return in captive portfolios for the last few years and this continues to look attractive in a low interest rate environment.

We feel that a captive portfolio should continue to hold liquid, short duration, high quality, fixed income instruments to reduce portfolio risk and provide a ready source of cash to make claim payments.

The equity portfolio should also be globally diversified and contain the shares of very large global companies to reduce risk and enhance liquidity.

What do captives need to bear in mind when taking these routes?

Equity prices are much more volatile than bonds so, over the short term, the portfolio could decline materially. Over the long term, which is where captive portfolios should be focused, the volatility of annualised returns on equities prices tend to be lower.

Even portfolios exposed to equities during the financial crisis have recovered very well as long as they stayed invested.

Insurance-linked securities are gaining traction around the globe—what is attractive about these instruments?

They are an attractive way for risk capital to enter the insurance market. Investors can avoid the cost and complexities of setting up their own reinsurance company or captive insurance company and enter into a market that has an attractive return on capital, in a low interest rate environment.

How are some of the more traditional Cayman Islands investment options faring at the moment, some five or six years after the financial crisis?

Both traditional equity and fixed income investments have done very well in the post-crisis period as the US Federal Reserve and other central banks have flooded the market with liquidity. Returns well in excess of bank deposits have been easily achievable over this period. In addition to this, taking risk in captive investment portfolios has also been very well rewarded. CIT

Coordinating global captive fronting programmes

Karen Amos and Donna Smith of AIG Global Risk Solutions in Bermuda look behind the curtains of multinational captive fronting programmes

Behind every successful global fronting programme, there is a strong and deep partnership between the client and the fronting carrier. This relationship is based on trust, excellent communication and an efficient flow of information between the parties. The fronting carrier, an insurance company, issues policies and cedes premium and liability to a captive insurance company. A fronting carrier's success with large global fronting programmes depends on its ability to deliver information and transfer funds in an accurate and timely fashion. A multinational client expects its insurance carrier to have a globally coordinated network that issues policies, reports on claims and provides cash flow services.

To do that well, the network needs superior technology and experienced staff. The management and coordination of large global fronting programmes is a complex process requiring a great deal of information and knowledge. Numerous issues may arise, ranging from more complex ones such as customised coverage requirements, to more basic subjects such as premium tracking.

Central administration

Successful fronting carriers standardise and automate as much of the process as possible. Dedicated fronting administration hubs equipped with sophisticated technology and experienced teams are essential for centralising and coordinating all aspects of global fronting programmes. Owning a worldwide network of policy issuing companies is clearly an advantage in global fronting since it is difficult to standardise, automate and have the same level of control over a program when policies are issued by companies outside of the corporate family.

At AIG, fronting administration hubs are used in every stage of a fronting programme's lifecycle. With a complete picture of the global network, these hubs are well positioned to provide information about best practices and servicing issues prior to binding, including, programme structure, country-specific restrictions that may affect the programme and policy wording concurrency issues. Having a centralised administration hub helps to ensure that the documents reporting premiums and losses to the captive are standardised in a single format and language. It also provides a central location that can address any queries that arise.

Effective administration hubs are run by seasoned insurance professionals with many years of global fronting experience. There are always changes at the country level and an experienced staff understands the impact of these changes on the programmes that they manage. AIG's hubs provide a single access point into AIG should captives and/or captive managers have queries about premium or claims reporting. Within our hubs, each account has a dedicated account manager who coordinates the service delivery for each client.

The legal structure of global fronting carriers can be complex, so knowledge of the current reinsurance procedures for all issuing offices is critical and changes must be closely monitored. With policies issued in many countries, financial reporting can be overwhelming without a continuous review of reinsurance transactions to ensure that premiums and claims flow smoothly and are booked correctly to the appropriate legal entity, and that the various statutory filing requirements in different countries are met.

Key performance metrics are typically established and agreed with a client in the relevant contract documentation prior to the inception or at renewal of a programme. These may include metrics for policy issuance, premium invoicing, premium cash flow guarantees, premium and claims reporting and billing. A hub should monitor its performance against these metrics.

Policy issuance

Once a global fronting programme has been bound, policy issuance instructions must be disseminated to the network of policy issuing offices. We believe that issuing the instructions to all offices electronically is the most efficient way to accomplish this process within the key performance standards agreed with the client. Ideally, the release of instructions is tracked electronically and the appropriate issuing office is notified regarding what policy form needs to be issued, to whom it should be issued, the premium to be collected and the reinsurance to be used to cede to the captive.

Regardless of whether the issuing office is in Russia or Argentina, at AIG instructions go out in the same format, at the same time. Since our issuing offices update the administration hub electronically, the hub can easily identify, follow up, escalate and resolve issues. With these processes, we can efficiently manage our network's performance and report progress to the client.

The teams at our issuing offices have extensive expertise with local regulations and policy forms. These teams guide clients through the complexities of a multinational programme with coverage that meets local regulatory requirements and structures that streamline the management of global programmes.

Premium collection, movement and reporting

One of the main concerns of global fronting clients is the speed at which premiums can be collected and moved through the car-

rier's network to the captives. Each fronting programme has different requirements, and each client has different stress points about timeliness of premium movements. It is critical that the carrier agrees clear performance metrics with each client since different clients have different perspectives. For example, a captive with retrocessions to third-party reinsurers may be focused on receiving sufficient premium to satisfy payment warranties, whereas another captive may want to receive all premiums prior to their fiscal year-end. Understanding the individual needs of each and every client is important in order to ensure that they are satisfied with the cash movement on their programme.

Cash teams within the administration hub monitor the various collection and remittance of premium to the captive. Premiums take into account different country requirements as they relate to tax, mandatory local retentions, local brokerage and the fronting fee charged. Captives are provided with premium advices documenting all deductions and retentions.

Many programmes have set cash flow guarantee requirements that specify the dates by which premiums must be paid to the captive to avoid incurring interest penalties. Regardless of where in the world premiums are paid to the fronting carrier, the administration hub must be able to trace local premium invoicing and collection through its multinational network and track where the premiums are at any point in time. The speed of premium collection and payment to the captive determines whether reinsurance obligations are met, foreign exchange exposure is mitigated and investment income is maximised. Managing this process must be done carefully so that funds are available when required, foreign exchange exposure is reduced, and manual administration is kept to a minimum.

At AIG, the same technology used to issue instructions to the network of policy issuing offices is used to create the programme's cash flow reports. These reports give the captive, at a glance, details of each policy and premium in its programme. These reports also show policy issuance and premium invoicing information, plus a gross to net premium calculation in locally invoiced currency and payment to captive currency. Clients can view policies and premiums in a consistent and easily understood format through direct access to a client portal containing all information relating to their fronting programme. Real time, accurate reporting should be the goal of an administration hub.

Claims reporting, billing and collection

The volume of claims on some large fronting programmes can be very high. Therefore, it is critical that they are booked only once by the policy issuing offices and not re-keyed by any other office at a later date. At AIG, claims data from the policy issuing offices is received electronically in a standard format thereby avoiding the time and human error issues inherent with the manual re-keying of data. The ability to manage, report and accurately bill is extremely important for the carrier to be able to collect quickly from a captive, minimise the funding of losses, and reduce foreign exchange exposure.

With the volume of claims in the hundreds of thousands, the majority of claims are settled upfront by the insurance carrier and then billed to the captive. However, large claims may be requested from the captive when they arise so that the captive and fronting carrier are not exposed to material foreign exchange loss and the carrier is not out of pocket for extended periods of time. AIG agrees any cash call provisions in the reinsurance agreement with the captive and documents any client-specific claims reporting requirements in a claims bulletin. The claims bulletin is issued globally to ensure global fronting programmes are handled uniformly in all countries.

An administration hub should include a dedicated team to coordinate the reporting, billing and collection of claims. The administration hub's position allows the central collection of claims data for a programme as a whole, rather than piecemeal on a country-by-country basis.

With its central role in the process, the administration hub is able to track and monitor any programme aggregates that have been agreed for the policy year and report to the appropriate captive or other reinsurer. Managing per occurrence and per annum reinsurance aggregates on a multinational global fronting programme requires expertise and state-of-the-art systems as multiple countries are simultaneously reporting losses that can breach an aggregate. The hub is tasked with monitoring aggregates and advising reinsurers when they are breached.

The administration hub should provide the captives with comprehensive reporting that includes paid loss amounts due, open loss reserves and incurred losses. Clients should be able to view their loss data in real time, so they can analyse their losses, report to their reinsurance panel, identify and address any risk management issues as they occur. If there is a significantly high volume of claims, there should be a method of data delivery or recommended third-party administrator that can provide the data to the captive in an agreed format.

Audit and control

An effective administration hub will have a rigorous system of checks and balances to ensure that it is compliant and meets all agreed key performance indicators. Certification by an external management system standards organisation (eg, ISO) is a means by which such compliance is monitored and maintained.

Certification requires that all of the administration hub's processes are documented in detail and catalogued. These processes must be annually audited by the external standards organisation. Certification also requires self-audits throughout the year in order to review and revise procedures as technology and industry practice changes.

The fronting company's certification demonstrates its commitment to maintaining quality standards as part of its normal business process and validates that this philosophy is embedded in the core values and culture of the organisation.

Technological innovation continues to play an important part in reducing the manual administration of fronting programmes and allows consistent, timely tracking and reporting. Sophisticated technology, coupled with well managed, centralised administration hubs, creates the economies of scale needed to streamline operations and standardise procedures.

This combination creates a win-win situation for all parties in the global fronting arrangement and enables the fronting carrier to demonstrate to clients the substantial value being delivered 'behind the curtain'. CIT

Donna Smith
Vice president and operations manager
AIG Global Risk Solutions, Bermuda

Karen Amos
Vice president and manager of reinsurance services
AIG Global Risk Solutions, Bermuda

Industry appointments

JLT Specialty Insurance Services (JLT USA), the US subsidiary of Jardine Lloyd Thompson Group (JLT), has appointed of a number of leading cyber risk specialists to form a new cyber risk team.

Florence Levy, previously at Lockton in Denver, **Lauren Cisco**, who worked at Lockton in Chicago, and **Shannon Groebber**, formerly at Lockton in Philadelphia, have all joined the team.

The trio joins existing JLT USA employees Pat Donnelly and Colin Daly, both existing cyber risk practitioners.

These appointments follow JLT's announcement of plans to expand its US specialty capabilities into the group's key specialty areas including energy, construction, financial lines, credit, political and security and aerospace.

Colin Daly, head of financial lines at JLT Specialty Insurance Services, added: "We look forward to working with our new colleagues to take our winning proposition to clients."

Following the appointments in Philadelphia, JLT Re has recruited **David Unsworth** as senior vice president to join its new Tampa, Florida office.

Unsworth joins from Guy Carpenter where he served as senior vice president.

George Daddario, COO of JLT Re, said: "We are very excited that he will be based in our new Tampa office. He brings key capabilities to our business and embody the entrepreneurial client first attitude of JLT Re."

Unsworth said: "For me this is a great opportunity to ensure that clients receive reinsurance solutions that are aligned to their business objectives."

Eurobase Insurance Solutions has welcomed **Stuart Elliston** and **Muriel Hardie** to its insurance team as insurance development director and development manager, respectively.

Elliston will be responsible for the coordination, support, mentoring and development of Eurobase's team members.

He previously served as head of product development at Northdoor, the IT consultancy firm.

Hardie will be responsible for ensuring the company's Insurance Services Office standards are implemented across all client work and will report to Elliston.

John Wilson, chairman and CEO of Eurobase International Group, said: "Elliston is a highly experienced insurance market technology specialist. His contribution will support the continued growth of synergy2."

USA Risk Group (Malta) has appointed certified public accountant **Sue Caruana Domancich** as account manager in its Valetta, Malta office.

Domancich's professional background includes audit work with PriceWaterhouse Coopers in Malta and insurance management work on general insurance companies, life companies and cell structures for both Heath Lambert and Heritage in Malta.

She returns to the insurance management field after a brief sabbatical taking care of her young family.

USA Risk Group (Malta) director, John Tortell, commented: "I worked with Domancich at one of her previous companies and [I am] very pleased she has chosen to join our management operation here in Malta."

"She will provide in-depth accounting experience to our office as it expands with Malta domiciled insurance companies."

The National Association of Insurance Commissioners (NAIC) has appointed **Adam Hamm**, NAIC president and North Dakota insurance commissioner, to a two-year term as the state insurance commissioner representative on the Financial Stability Oversight Council (FSOC).

In this role, Hamm will represent the interests of the nation's state insurance regulators on the council.

Hamm replaces Missouri Insurance Director John Huff, who is stepping down after serving two terms as the state insurance commissioner representative on FSOC. Hamm's selection was ratified in an NAIC plenary meeting.

"As NAIC President, Hamm has demonstrated leadership on a variety of issues that are important to the work of the council both here in the US and internationally," said Huff.

"I am confident he will be a conscientious and thoughtful advocate for state regulation—a system that has served policyholders and the insurance market exceptionally well."

The FSOC is a 15-member body comprised of the nation's chief financial regulators.

The council was created by the US Dodd-Frank Act in 2010 to monitor the safety and stability of the nation's financial system, identify risks to the system, and coordinate a response to any threats.

The council has the authority to identify financial firms, financial market utilities and systemic payment, clearing, or settlement activities whose failure could potentially pose a risk to the financial system. **CIT**

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We've grown in line with people's confidence in us.

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Gibraltar embraced captive insurance in the 1980's and in 2001 became the first EU jurisdiction to offer Protected Cell Company (PCC) legislation – widely used within insurance company structures writing both general and life insurance business.

In 2012, captive insurers achieved total gross premium income of nearly £800m. Three are PCCs managing over 30 cell companiwes. One insurance manager has created 50 cells with its PCC being the largest in the EU providing solutions for cell captives and fronting cells.

Gibraltar's vibrant insurance sector has almost 60 insurance companies currently writing new business and in 2012 wrote over £3.8bn of gross premium income – with Gibraltar motor insurers accounting for 16% of the UK market.

Gibraltar offers bespoke insurance solutions for companies not currently domiciled with the European Union.

For more information visit the Gibraltar Finance website::
gibraltarfinance.gi

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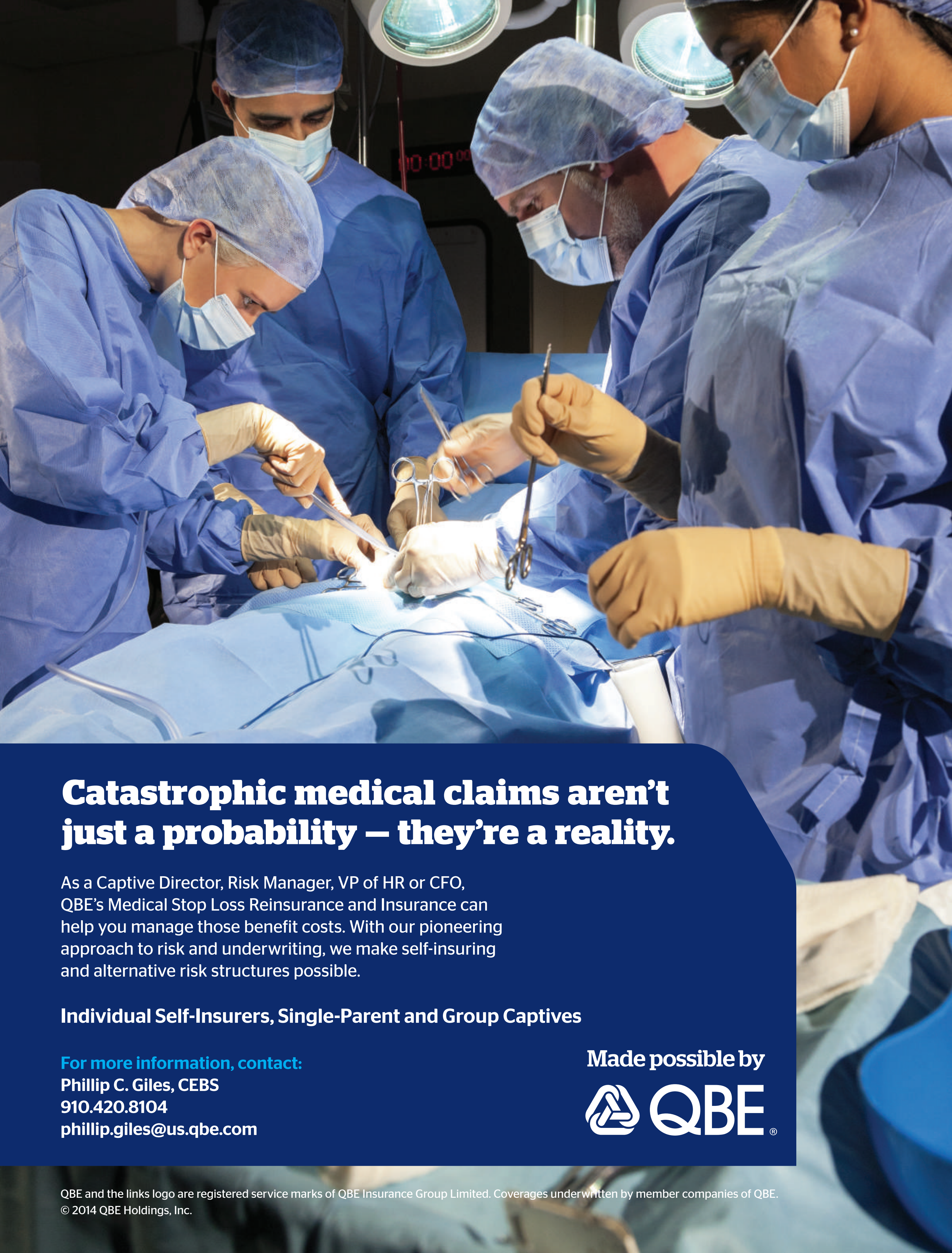
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