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Meetings not a spectator sport, says IAIS

The International Association of Insurance Supervisors (IAIS) has voted to scrap "observer membership" status, which included participation in some IAIS meetings, in favour of creating new stakeholder consultation procedures.

The consultation procedures being developed will likely outline how certain stakeholders may participate in portions of some meetings by invitation only as well as the creation of open hearings with stakeholders separate from IAIS meetings.

The National Association of Insurance Commissioners (NAIC) delegation present at the decision was united in its strong opposition to the measure to close meetings to stakeholders.

"I am extremely disappointed in the outcome of [the] vote to end observer status at the IAIS," said Adam Hamm, NAIC president and North Dakota insurance commissioner.

"Observers run the range of consumer advocates, insurance experts, and industry representatives—all of whom have critical input to share on the real-world consequences of decisions made by regulators."

Hamm continued: "Shutting them out of the official process in favour of 'invite only' participation deprives IAIS members and stakeholders alike and could diminish the credibility of decisions made at the IAIS."

Kevin McCarty, Florida insurance commissioner who also serves on the IAIS executive committee, commented: "Over the years, the IAIS has benefitted from the input and ideas provided by our observers, which not only result in quality end products, but also provide our stakeholders with a better understanding of our work and our development processes."

"US state regulators have pushed for more transparency and openness within the IAIS over the years and therefore we are concerned about changes [that] will result in less transparency and openness by closing all meetings to stakeholders going forward."

US state regulators are not alone in their concern with the new process. Congress has introduced a bipartisan resolution calling for openness and transparency by the IAIS.

"At the end of the day, any global insurance standards that are enacted will have a direct impact on consumers and our markets and so they deserve a seat at the table," said Monica Lindeen, NAIC president-elect and commissioner of the Montana office of securities and insurance.

Advantage acquires Southpac Life

Advantage Insurance Holdings has completed the acquisition of Southpac Life Insurance Limited from an affiliate of Southpac Trust Limited.

Established in 2006, Southpac Life specialises in private placement life insurance and annuities for high net worth individuals worldwide.

Advantage's chief underwriting officer, Stuart Jessop, said: "Advantage is pleased to take on the responsibility for providing top-tier service to Southpac Life policyholders."

"Our goal is to make the transition from Southpac to Advantage as seamless as possible for Southpac Life clients. We appreciate the vote of confidence Southpac Trust have given to Advantage by selecting us to continue the business of Southpac Life, and look forward to completing a smooth transition."

David Steens, managing director of Southpac Trust, added: "Over time, our increasing focus on trust and fiduciary services has prevented Southpac from giving our life insurance business the attention necessary for it to grow to its full potential."

"We are pleased to have transitioned the business to Advantage and look forward to working closely with Stuart Jessop, Fiona Moseley and the entire Advantage team to ensure that Southpac's life insurance clients receive the highest possible standards of service."

Southpac Life, domiciled in the Cook Islands, will be operated as a subsidiary of Advantage Life & Annuity Company.

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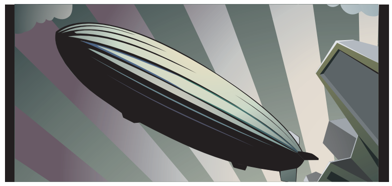

Policy administration has been transferred to Advantage effective 1 October.

Advantage has applied to change the name of Southpac Life to Advantage Life (Cook Islands), to become effective upon receipt of regulatory approvals.

No other changes to Southpac Life are contemplated, according to Advantage, and no employees of Southpac Trust or Advantage are to be affected by the transition.

Still work to do for European insurers

Research by BNY Mellon and Insurance Risk magazine has identified growing pressure on firms as they face more intense demands on collateral, with fewer firms convinced they hold enough assets of suitable quality compared with previous years.

The survey claims European insurers still have work to do in understanding the full implications of the move to central clearing before it becomes effective in the summer of 2016.

Only 29 percent of European respondents said they understood the impact of the move to central clearing and are moving towards operational readiness.

In contrast, 75 percent of US respondents consider themselves fully prepared, with the remainder saying they are still carrying out their impact assessment.

Close to a quarter (23 percent) of European respondents are yet to launch an impact assessment, with 18 percent saying they do not believe they will be impacted by the changes.

The pressures facing insurers is demonstrated by the fact that only 15 percent of all firms surveyed said they are comfortably holding enough assets of the requisite quality to meet collateral posting obligations, compared to 25 percent in 2013 and 41 percent in 2012.

While the survey indicates that the impact of central clearing in the US has been "relatively benign" so far (with 40 percent of US respondents saying they either hold enough assets or comfortably hold enough assets to meet their posting obligations) the figure today for European insurers is 25 percent.

Critically, only 8 percent of European firms said they expect to hold enough assets or comfortably hold enough assets once the reforms come into play.

Kurt Woetzel, CEO of BNY Mellon markets group, said: "With the US regulatory environment being at an advanced stage and more clearly understood, many North American firms have already moved from contemplating collateral optimisation techniques to actually putting them into practice."

"In addition, 20 percent of North American respondents have invested in technology to allow the use of 'cost of opportunity revenue lost' as a proxy for 'most efficient collateral', while one in five North American firms have integrated their collateral management and margining processes across instruments within and across legal entities."

"We would expect a similar picture to emerge in Europe over time, once insurers in the region become European Markets Infrastructure Regulation compliant."

The survey encompasses responses from 111 insurers, of which 59 percent are active in the life sector, 64 percent in the non-life sector and 17 percent in reinsurance.

Forty-four percent of those taking part write business in the Americas and more than 75 percent do so in Europe, while only 40 percent write business in the Asia Pacific region.

The survey represents a broad cross-section of insurers by size, with 13 percent holding more than $500 billion in assets, 36 percent holding between $25 billion and $500 billion and the remainder of the sample holding $25 billion or less.

Gibraltar gets thumbs up from OECD

The Global Forum of the Organisation for Economic Co-operation and Development (OECD) has rated Gibraltar's government as "largely compliant" for transparency and exchange of information for tax purposes.

This classification recognises Gibraltar's solid track record in international tax cooperation and compliance, placing it on par with leading global economies including the UK and Germany and giving international businesses added incentive to operate from the jurisdiction.

The forum's second phase peer review report on Gibraltar examined 10 essential elements of the jurisdiction's record in the exchange of information.

Gibraltar was rated "largely compliant" in three areas and "compliant" in the remaining seven.

No elements were found to be non-compliant, highlighting the strength of Gibraltar's approach to corporate tax transparency.

The rating comes at a time when Gibraltar is strengthening its wider culture of compliance and transparency and continuing to fight tax evasion and fraud.

To this end, chief minister Fabian Picardo signed the Multilateral Competent Authority Agreement Automatic Exchange of Financial Account Information (MCAA) at the Federal Ministry of Finance in Berlin.

Gibraltar, along with approximately 57 countries, has committed to the automatic exchange of information under the MCAA in 2017 and a further 31 countries have extended a similar commitment with an exchange trigger date of 2018.

Picardo said: "[This] underscores Gibraltar's absolute commitment to a culture of compliance with international standards of transparency and reflects our continued emphasis on offering companies a stable environment in which to thrive."

"Gibraltar is a leader when it comes to compliance with modern standards of internationally established frameworks, in particular those within the EU, which is among the most rigorous in the world, making it the perfect home for international business."

Albert Isola, Gibraltar's minister for financial services, added: "Independent reviews by multilateral bodies such as the OECD Global Forum provide us with entirely credible third party assessments of international cooperation and compliance."

"The months of work by officials from various departments of the government and other agencies have resulted in further strengthening Gibraltar's position as one of the most transparent and compliant jurisdictions in the world."

Advantage continues rebranding

Ashley Cooper Life International Insurer, a subsidiary of Advantage Insurance Holdings, has changed its name to Advantage Life Puerto Rico.

The change is effective immediately and completes the rebranding of Advantage's operating subsidiaries that begun in 2013.

Advantage CEO Walter Keenan said: "Projecting a consistent corporate identity across all of Advantage's operating companies helps our clients and their professional insurance advisors understand that they will receive the same high level of service in Puerto Rico as in any of our other locations."

"Advantage Life Puerto Rico is one of our fastest growing companies, and we appreci-

ate the Office of the Commissioner of Insurance's assistance in facilitating our important re-branding effort."

Advantage Life Puerto Rico holds an unrestricted Class 5 Life-Disability license issued under the International Insurance Center Law of Puerto Rico.

It offers a full range of private placement life insurance products and services to the international market, with face amounts of up to $100 million per insured life.

Policy benefits are backed by Advantage Life & Annuity Company SPC and benefit from additional reinsurance coverage from highly-rated, third-party reinsurers.

End of the line for First Keystone

South Carolina-domiciled captive insurer, First Keystone RRG, has been placed into liquidation by the state's circuit court. The order was signed by Judge Casey Manning on 21 October 2014.

The petitioner, Raymond Farmer, as director of the South Carolina Department of Insurance, and his successors in office were appointed liquidator, while Michael FitzGibbons, of FitzGibbons and Company, was designated special deputy liquidator.

All those with claims against First Keystone have been urged to file a verified original Proof of Claim, of which the deadline for submission is 28 February 2015.

By issue of the liquidation order, and pursuant to South Carolina Code of Laws, all First Keystone insurance policies will cancel no later than 20 November 2014.

Also due to the order, First Keystone will no longer defend or pay for the defence of its insureds.

ARM chooses Insurity software

Adventist Risk Management (ARM) has chosen Insurity's Insurance Enterprise View (IEV) software as its data integration platform.

ARM is the risk management company for the Seventh-day Adventist Church delivering services for its captive insurance companies.

The selection of IEV software expands ARM's current portfolio of Insurity solutions, which includes the Insurance Decisions Suite of core processing software to support its domestic and international business in billing and policy administration.

Reporting and integration, data mapping, business intelligence, analytics and a data warehouse for all lines of business are included out of the box in the IEV software suite to be delivered in an Insurity-hosted environment for ARM.

Bob Kyte, president and CEO of ARM, commented: "We chose Insurity's IEV software as it is the most comprehensive and mature insurance data solution on the market specifically designed for insurance carriers."

"We could not have matched IEV's cost/benefit and functional capabilities with any other product or by combining other alternatives."

"The additional value delivered in enabling us to support our churches across the globe provides the pathway and flexibility we need for future growth."

Lani Cathey, senior vice president of sales and marketing at Insurity, said: "Insurity values its partnership with ARM and is excited to have them join our rapidly growing community of IEV software customers to enable data integration, migration and management across the enterprise."

"IEV delivers comprehensive data management for insurers that either require specific components or, similar to ARM, can benefit from the entire solution suite to utilise the role of business data as a strategic asset."

Ratings round-up

Black Gold Re, Balboa Re and more

Fitch Ratings has affirmed the "BBB+" insurer financial strength (IFS) rating and the "AAA(col)" national IFS rating of Black Gold Re (BGRe).

In BGRe's rating, Fitch stated it has considered the full support of its parent, due to the strong linkage and strategic importance of the captive company to its parent, Ecopetrol.

The rating also reflects good operating performance, strong capitalisation and liquidity levels and adequate reinsurance protection.

BGRe's rating remains equalised to its parent's rating, considering that Fitch has categorised this as a "core captive". Ecopetrol has a local-currency issuer default rating (LC IDR) of "BBB+".

Ecopetrol's ratings are also linked to the credit profile of Colombia (local and foreign currency IDRs of "BBB" and "BBB+", respectively), which owns 88.5 percent of the company's total capital.

Ecopetrol conducts business as Grupo Empresarial Ecopetrol (GEE).

BGRe also remains a core subsidiary of Ecopetrol, due to its strategic importance to the risk management and insurance coverage of GEE.

BGRe's support from its parent is evidenced by the Ecopetrol's formal support for BGRe's investment portfolio administration, the provision of resources for optimal operation of the reinsurance company, and the explicit commitment through open notes and the transference of strong corporate governance practices as well as the alignment of objectives and strategy.

These ratings also consider BGRe's capital and liquidity position, which Fitch has stated "provides a strong cushion" against the risks faced by the reinsurer.

Fitch has also affirmed Balboa Re's international IFS at "BBB+", for which the rating outlook is stable.

Fitch has stated that the Citigroup announcement to exit its retail banking and insurance operations in 11 countries has had "no immediate impact" on the international rating of its captive reinsurance company, Balboa Re.

Following the announcement, Fitch changed its view on the strategic importance that Balboa Re has for Citigroup.

Fitch believes that, currently, the subsidiary has "limited importance" to the shareholder, without affecting Fitch's view of the assigned rating.

The rating of Balboa Re is based on the ability and willingness of its ultimate parent, Citigroup, to provide support when needed.

Fitch claims that Citigroup has the ability to financially support Balboa Re, and the willingness to do so will remain unchanged while ownership of the reinsurer is maintained.

As a result, the agency believes that the support of Citigroup will remain while Balboa Re maintains synergies.

The rating may change if Balboa Re is sold to investors with different credit profiles than the current parent.

In that scenario, Fitch has stated that it will evaluate the potential support from its new shareholders.

A.M. Best has placed under review with negative implications the financial strength rating of "A- (Excellent)" and the issuer credit rating of "a-" of Allied Professionals Insurance Company (APIC), a risk retention group based in Scottsdale, Arizona.

This rating action reflects A.M. Best's concerns with the decline in risk-adjusted capitalisation caused by advancement in reserve positions from deteriorating loss experience in the chiropractic specialty along with growth in the overall premium base.

Company management has presented several remedial actions to reverse the negative claims trend and strengthen capitalisation.

A.M. Best has commented that it perceives: "A degree of execution risk involved with the implementation of APIC's plan of improvement and uncertainty regarding the overall impact these actions will have upon the company's balance sheet and income statement in 2014 and 2015."

The ratings are to remain under review pending the implementation of the company's action plan and completion of A.M. Best's analysis on how these initiatives affect APIC's risk-adjusted capitalisation and financial performance in the near and mid-term.

APIC recently emerged victorious from a legal battle after being sued by chiropractor Dr Brett Speece regarding an arbitration provision in his insurance policy.

The case concluded after the Nebraska Supreme Court overruled the district court's decision, citing the Liability Risk Retention Act.

A.M. Best has also assigned a financial strength rating of "A- (Excellent)" and an issuer credit rating of "a-" to Kelvin Re.

The ratings reflect Kelvin Re's strong capitalisation, diversified projected business profile within the natural catastrophe reinsurance market, experienced management and well-designed risk management function.

Offsetting rating factors include the challenges related to the tactical execution of its proposed business plan in a soft market.

A.M. Best claims that the "increased investment risk" brought on by a non-traditional investment strategy could also be an offsetting rating factor.

Kelvin Re's risk-adjusted capitalisation is expected by A.M Best to maintain an "excellent" level, supported by moderate projected underwriting leverage, a reinsurance programme of good credit quality and a contingent capital facility.

Has your captive been rated? Let us know:

stephendurham@captiveinsurancetimes.com

If it ain't broke, still fix it

Although the Cayman Islands has long existed in the upper echelons of the captive insurance industry, its reluctance to rest on its laurels is what many hold as its greatest asset

STEPHEN DURHAM REPORTS

The 22nd Cayman Captive Forum is to be attended by over 1200 people and has often been populated equally by both risk managers and service providers, which is said to be unheard of elsewhere in the captive insurance industry. The client base and infrastructure is large enough to warrant this size of conference, being the second biggest captive domicile worldwide, even though the majority of its industry is made up of US healthcare and hospital system captives.

Linda Haddleton, managing director of Kane in Cayman, comments: "The global captive industry has undergone significant changes in the past decade and Cayman has worked hard to ensure that it remains an attractive jurisdiction. This includes satisfying international regulatory standards, which have a strong banking bias, while sufficiently recognising the unique risk profile of the captive model."

It also means, according to Haddleton, recognising what onshore (predominantly US) captive jurisdictions have to offer and appropriately differentiating Cayman's value proposition—to the many US corporations that have significant international operations, for example. Besides the island's myriad attributes, the simple fact that it allows tax structures that the mainland US does not is a big attraction for prospective captive owners and managers.

While Cayman has long been receptive to group captives, its segregated portfolio company (SPC) and, more saliently, its forthcoming portfolio insurance company (PIC) legislation, have been introduced to facilitate the wider market with models that work well for small- to medium-sized businesses.

With the changing healthcare environment, particularly the US, the new laws are predicted to be of benefit to the healthcare groups going through restructuring and amalgamation.

At the time of writing, the PIC legislation is close to implementation, after which many in the industry feel a new wave of clients will arrive in Cayman.

One such person is senior vice president of CSI International Underwriting in Cayman, JS De Jager, who says: "We expect positive growth in new business coming to Cayman but the general feeling is that the use of PICs in the short term will come from current SPCs already based on the island converting into PICs. We are very optimistic for an influx of business. Current clients and new entities are all keen to find out when PIC law is coming into effect."

Jason Flaxbeard, senior managing director at Beecher Carlson, adds: "The PIC law has been very well-received. This is because an offshore segregated cell company can now do anything, including the integration of US cells, Japanese cells, non-controlled foreign corporations—each of which can make different tax elections, be treated independently and can borrow capital from a core company."

It is this diversity that makes the law appealing to prospective clients and, as a result, why so many of those based in Cayman have been instilled with confidence by its impending arrival.

The solid US relationships that Cayman has cultivated over the years remain strong, as do those with Canada.

However, now those at the head of Cayman's flourishing industry have their eyes firmly fixed on new and fledgling captive markets.

Recent activity from the Cayman Islands Tax Information Authority reflects this work and has been primarily concerned with negotiating Tax Information Exchange Agreements (TIEAs) with other countries.

Cayman has signed a total of 35 TIEAs and another 15 are currently being negotiated. The purpose is simple: to provide a formal channel for the lawful provision of tax-related information from one jurisdiction to another.

Fiona Moseley, president at Advantage International Management in Cayman, comments: "Modern day Cayman is an open, transparent jurisdiction. As far back as 2001, Cayman was one of the first jurisdictions to sign a bilateral agreement with the US for the exchange of information for tax purposes."

"Since then, requests for information have been made and responded to under this regime. Over the years, Cayman signed additional bilateral agreements and the numbers just mentioned indicate that Cayman continues to progress in this endeavour."

"In 2013, Cayman confirmed its global commitment on the exchange of information for tax purposes, when it joined what was called the G5 pilot, which has since expanded to many more countries."

The majority of these agreements have led to strengthened relationships with countries in North, Central and South America.

Haddleton comments: "When you consider that 55 percent of all captives have North American owners, while 33 percent of all captives have European owners, and that Europe has several mature and well-developed captive jurisdictions, it is not surprising that Cayman captives largely serve US risks."

De Jager says: "Our main focus and market has always been North America, though we are presently taking initiative with organising roadshows in South American domiciles. More and more TIEAs are bing signed with Latin American countries and I see that as the new big market opening up for captive insurance business.

"They are open for this type of business, which they need for their companies to really grow."

So, while the short term sees Cayman's potential markets as being relatively closer to home, is worldwide market share the ultimate goal? Many in the industry would say yes, including Flaxbeard.

He says: "Given the size of the Asia Pacific market, and the relatively few mature and well-developed captive jurisdictions in that region, there is also undoubtedly massive potential for Cayman and other offshore domiciles to penetrate that market."

Although much will depend on insurance regulations becoming more open in Asian countries and risk management techniques becoming more developed, there has already been interest, according to Haddleton, in particular for Cayman to write warranty coverage for Chinese manufacturers and exporters.

While this kind of interest will not change Cayman's captive industry overnight, it is surely a step towards the island becoming a truly global domicile.

Whether it is targeting new markets or strengthening its legislation, it is clear that Cayman is not a domicile content with standing still.

The importance of such legislation is succinctly put by Flaxbeard, who comments: "When people ask me where to domicile their segregated cell, pretty much the first thing out of my mouth is the Cayman Islands."

"Without the new law I would say Bermuda—that's how important it is." CIT

Interest rates: where will they go next?

How is the economic climate affecting captives' bond portfolios? Colleen McHugh of Barclays takes a look

Rise of the interest rates

With their respective economies improving, many may feel that interest rates in the UK and US are long overdue an increase. A UK base rate of 0.5 percent has been in place since 2009 and in the US rates have languished at 0.25 percent during the same period. However, despite the ongoing recovery, the economy is only back to its pre-crisis level and in the UK inflation of 1.6 percent (August 2014) is still below the 'old lady's' 2 percent target.

The need to tread carefully is further enhanced by a lack of slack, ie, minimal wage inflation. Despite the UK unemployment level sitting at 6.2 percent and continuing to fall, stagnant wages and a lack of wage pressure is a conundrum for policymakers. Certainly, noise levels around potential rising interest rates are becoming louder.

In the UK, among voting members of the Monetary Policy Committee (MPC) and in the US the Federal Reserve's policy making committee, voting has shown a lack of consensus. Indeed, in August we saw, for the first time since Mark Carney's arrival at the Bank of England, a dissent in voting with the MPC divided over interest rate policy. Across the pond, members of the Federal Reserve's policy making committee departed publicly from the decision to keep the language surrounding interest rate rises the same.

The most recent FOMC (Federal Open Market Committee) communiqué reiterated that interest rates will remain low for a "considerable time" after the ending of its quantitative easing programme in October. What "considerable time" equates to is difficult to answer, but Federal Reserve chairwoman Janet Yellen has said there is no "calendar date" for a rate rise. Clear as mud then?

However, regardless of market participants scratching their heads in wonder, the focus should be that rates will increase (certainly in the UK and US) sooner rather than later. For what it's worth, we expect the first rate rise in the UK to occur in Q1 2015 with the Federal Reserve likely to raise rates in late Q2 2015.

For captive insurers, once rates do begin to rise, low bond yields look less attractive, so prices tend to fall and yields rise. There are two possible outcomes for captive insurers with bond portfolios. Captives that buy bonds at low yields could be locking in uncompetitive returns or face a capital loss if they sell before maturity.

To address the first scenario, it's imperative that the duration of the bond portfolio be kept relatively short and be actively managed to take advantage of the rising rate environment when it finally arrives, whilst being firmly focused on any potential credit risks. The second outcome can be avoided by formulating a bespoke investment strategy for the captive—matching assets with liabilities, but also remaining vigilant around credit risk (something an active bond manger is paid to do on behalf of the captive). Remove the need to sell a bond prior to maturity and avoid a capital loss in a rising interest rate environment—buy and hold to maturity.

When all is said and done and as already pointed out, central banks appear in no hurry to raise rates. Indeed, in Europe and Japan, bond-friendly monetary policies are still being actively pursued and as a result will continue to offer bond investors in these regions a refuge.

Bond price hike

When quantitative easing began in the UK in 2009, investment experts questioned the wisdom of lending money to the government for 10 years for an annual return of 3 percent. Indeed, you might expect that as governments issue billions of dollars, pounds (trillions of yen…) worth of new bonds to bridge the gap between spending and tax revenue, the prices of those assets would fall.

That's the usual result of a big increase in supply. This scenario partly played out in the UK. In 2010 when yields rose (bond prices fell) to 3.8 percent, the 'Bond King' Bill Gross warned that gilts were "sitting on a bed of nitroglycerine" and were "a must to avoid". By the summer of 2012, 10-year gilts were trading at a yield of 1.4 percent, a record low.

This year was supposed to be different with many financial commentators predicting the 10-year gilt would move closer to 3.5 percent. Yet again the experts have made the wrong call on bonds as prices have risen and not fallen, with the UK 10-year currently around the 2.4 percent level. The movements of bonds has been even more dramatic with 10-year German bonds yields below 1 percent for the first time. Debt sold by European countries that once faced a forced exit from the eurozone has attracted levels of interest that would have seemed incredible two or three years ago. Greece, for example, sold €3 billion of five-year debt in April at a borrowing cost of 4.95 percent, and so the onward march of Teflon bonds continues.

Set against a supposed improving economic climate, there are many explanations for the conundrum of falling bond yields and rising bond prices. The list compiled below is non-exhaustive, but it does highlight some of the more logical arguments put forward to explain the riddle:

- Regulation: governments want banks and insurers to hold more capital in safe assets as a guard against future turbulence. This has led to 'financial repression' obliging companies to hold more bonds, whether or not they consider them good value.
- Safe-haven trade among geopolitical unrest in Iraq, Syria and Ukraine.
- US treasuries and UK gilts do surprisingly offer some carry against other developed sovereign debt. For example, 10-year German bonds and Japanese government binds are yielding approximately 0.90 percent and 0.50 percent respectively, 2.4 percent on the equivalent US and UK paper is positively marvellous.
- As the US deficit fell this year from 10 percent of GDP in 2013 to more like 2 percent in 2014, the US has issued fewer treasuries. At the same time, demand has remained steady so there is a classic demand and supply issue at play, with bond prices edging up on less supply.
- Demographics: ageing populations in the developed world will always ensure a steady demand for bonds.
- In Europe, Mario Draghi has convinced investors that the European Central Bank will stand behind debt issued by eurozone countries, making Greek bonds for instance look safer.

Beyond the reasons highlighted above, an implicit belief exists among some that the bond market has it right and low yields are the new norm.

Notably, a conviction held by the bond management giant PIMCO explains that economies will generally grow more slowly, due to a deleveraging of historically high debt levels across the globe. So the theory goes that because fragile economies and consumers cannot handle normalised interest rates, central banks will be unable to raise them.

For those having difficulty falling asleep at night you can always refer to a recently published report from the Centre for Economic Policy Research (CEPR) called Secular Stagnation. It highlights the ongoing "unmistakable signature of the growing shortage of safe assets [and] the secular downward trend in equilibrium real interest rates".

If the supply and demand characteristics for high-grade government debt have changed, along with expectations for any interest rate increases, we can further understand why both US and UK government bonds have rallied, and perhaps why they'll continue to perform. Worst case, the reading will put you soundly to sleep. CIT

Colleen McHugh
Captive investment manager, wealth and investment management, Barclays

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Insurer's perspective: the evolution of cyber

Despite a rise in the number of insurers writing cyber risk, an air of trepidation remains, says Jamie Bouloux of AIG

STEPHEN DURHAM REPORTS

Cyber risk is often characterised as being a high-severity, low-frequency sector. Is this the case and, if so, has it affected uptake?

High-severity, low-frequency events definitely exist—just look at the Target or Home Depot cases in the US—but statistics released by the UK government regarding cyber crime state that the cost of business in the UK is £21 billion and somewhere between eight and nine out of 10 small- to medium-sized enterprises (SMEs) in the UK have had some sort of cyber security issue. I think it's fairer to say that, while high-severity, low-frequency events do not necessarily represent the majority of claims, they do tend to get all of the headlines.

We are expanding quite rapidly in the SME space. One thing that insurance companies battled with was getting the right pricing for that space and making cyber affordable—but I think that has happened now. At AIG, we have backed the UK Cyber Essential programme with the view that, for companies that understand and mitigate their cyber security exposures by getting accredited through the UK government-backed initiative, we wanted to be able to offer them indemnification and support in the event that they do suffer. When we first entered the market, cyber was only purchased by companies that really needed it (or those who were perceived to) such as financial, telecommunications and retail institutions.

What are the main differences between first- and third-party losses? Is one more common than the other?

It depends on the geographic split of where the particular organisation is domiciled or earns revenue. A retail company in Europe, the Asia Pacific or Australasia would probably be more concerned with the first-party loss associated to them, rather than the third party. By that I mean that business interruption, cyber extortion, data restoration, and IT forensic support are the biggest reasons we are talking to companies about cyber—in the European Market Infrastructure Regulation (EMIR)-affected region, at least.

There is a gap within traditional property and casualty policies that has allowed a first-party cyber market to develop in Europe, especially around concerns where we cover the non-physical business interruption associated with networks being taken offline and, subsequently, entities not being able to trade via the internet.

If you look at the situation with Target, the experience is very different in the US. There were first-party costs to the entity in cleaning up the system and launching an investigation into what data was stolen and how. Also, in the US, affected individuals have to be notified via post and credit and identity theft insurance provisions have become the norm and were provided. However, there was a huge third party element to it as well. Affected parties of the breach filed class actions against Target from individuals whose personal data was exposed, to banks looking for recourse, to various other affected vendors and, ultimately, the shareholders themselves.

So is the industry as a whole still reluctant to write cyber? If so, is there a reason for this?

I don't think this is necessarily the case either, to be honest. If you look at the US, there are more than 50 insurance markets offering cyber insurance and in London we're not that far behind. For some carriers there is an element

of trepidation to offer large limits or make the investment to hire an underwriting team that understands the risk to be able to underwrite to a profit, which is why we are seeing the growing strength of cyber-specific managing general agents in this space.

> "While the retailer earns less revenue than the manufacturer, a primary limit would potentially cost the retailer more than the manufacturing client as there is more incentive for a malicious insider or third-party criminal to steel credit card information for use or to sell on"

This model allows insurance carriers that don't want to invest in the capital to underwrite this class on a standalone basis to get a piece of the growing pie. The reality, however, is that the market believes this is the next essential insurance, and all I am seeing at the moment is more carriers coming to market.

What are the capital requirements and premiums associated with this kind of risk?

In the most basic sense, the capital requirements vary and there are many factors that affect this. For example, I might look at a $2 billion manufacturing risk against a $300 million retail risk and decide the retail is higher exposure due to collecting and transacting personal information and credit card details. A manufacturer's exposures tend to be tied to the non-physical business interruption element of cover (such as attacks against supervisory control and data acquisition (SCADA) systems). This means that while the retailer earns less revenue than the manufacturer, a primary limit would potentially cost the retailer more than the manufacturing client as there is more incentive for a malicious insider or third-party criminal to steel credit card information for use or to sell on.

That would mean the smaller company would pay the higher premium and we would expect better risk management around the exposure because you are dealing with individual consumers, as opposed to the corporate clients that the manufacturer might be dealing with, in the event of a breach.

That being said, we would certainly underwrite to the disaster recovery and mitigation plans that the manufacturer employs. It is important that we understand the risk management around dealing with an event so we can offer meaningful limit options for the client and price accordingly.

Has the sector become more populated by clients and providers in recent years?

The growth numbers are phenomenal. If you look at AIG alone, in 2013 we saw 1500 submissions and in H1 2014 we've seen 1300 submissions. We are expected to double the submissions for this year versus last year and this is indicative of more and more people understanding the risk of cyber and subsequently coming to market.

Unfortunately, this means there will also be a lot of competition. We are already seeing the pricing squeeze in this area, which is a concern because, with a new product, you would hope to be able to build up a substantial pool of clients and premiums to be able to offset the large amount of claims that are inevitable in this space. Luckily, AIG has the critical mass that we are able to do this but I worry that some of the other insurance carriers that ultimately might feel the effects of a few more large breaches like Target or Home Depot.

The competition is healthy and also drives innovation in this space. It is hugely important that new products do not remain static, that they understand the risks of the client and continue to adapt and grow.

As companies look to become more global and serve clients in jurisdictions where they might not have as much of a presence, the way that they execute their business plans is becoming more virtual, which has its own inherent risks. Consumer protection laws and other administrative regulatory actions also need to be understood.

Some parts of the world are inherently more exposed to the elements and, therefore, catastrophe risk claims than others. Are there any particular countries that are more susceptible to cyber risk?

I think you've raised two issues here, the geographic and the systemic. In terms of the geographic issue, the US is the biggest cyber market to date, because there are 47 different individual state laws about notifying individuals. There is also guidance, such as that from the Securities Exchange Commission, which requires any company listed on a US stock exchange to identify what the operational and financial implications of a cyber breach could be and disclose whether they are buying insurance to offset that risk. By having this guidance and mandatory notification, you are already opening up the potential for systemic loss, as you have to report and notify.

In Europe, that does not necessarily happen, as we are still waiting for the EU data legislation to be passed, which will offer mandatory notification requirements. That will change the landscape of cyber in UK and across Europe and other EMIR-affected areas. The conversation will move from business interruption and first-party costs to the company, to first-party costs affecting individuals.

As far as real systemic loss, the insurance industry is moving towards covering third-party outsourcing services. There was a survey that indicated that by 2015, something like 98 percent of SMEs across Europe will use some form of outsourcing. This has invited huge pressure on insurance industry to look at the business enterprise risk of outsourcing and provide some kind of insurance solutions—whether that is business interruption cover or electronic data retrieval insurance. CIT

Jamie Bouloux
Cyber liability underwriting manager
AIG UK

Sixty years and still going strong

Nuno Antunes of AIG Global Risk Solutions explains why the captive fronting market is as dynamic as ever

Captives have been around for more than 60 years. Today, more than 6000 captives operate in more than 50 domiciles. We are also currently experiencing a prolonged competitive insurance market and a more challenging regulatory environment. With that as a background, one might think that captive fronting is a mature, staid marketplace with not much happening. In fact, nothing could be further from the truth.

Today, we are seeing a dynamic fronting marketplace with increased activity being driven by:

- Multinational expansion;
- Captives participating in a broader range of traditional insurance coverages, for example, trade credit and employee benefits;
- The emergence of new risks that may not be covered by traditional insurance markets, for example, non-damage business interruption, cyber risk, and pandemic coverages; and
- Increased interest in alternative structures that offer similar benefits to owning a captive at a lower cost.

From emerging markets in Latin America and Asia to the more well established markets in the US and Europe, risk management continues to become more entrenched in corporate cultures. Senior management increasingly look to their risk managers to play an important role in the company's business strategy and to protect the company from the various risks it faces. Many of those risk managers tell us that their use of captives will continue to grow.

This is supported by a recent multinational survey conducted by the Federation of European Risk Management Association (FERMA), which found that 30 percent of respondents were considering implementing a captive programme or expanding the use of an existing one.

So now, let's take a look at what we see as four key drivers of the increased activity in captive fronting.

Multinational expansion

There is no question that we are living in a globalised world that will continue to become more integrated regardless of the challenges involved.

The globalisation trend is evidenced in almost everything we read today.

Consider the fact that by 2025, emerging markets are expected to have about half of the largest corporations in the world.

In a recent study AIG conducted in the UK, more than 20 percent of respondents said that they would be expanding internationally in the next two years.

Similarly, the Institute of Export surveyed UK businesses and found that 69 percent of respondents thought their dependence on exports would increase in the next five years.

Rising living standards generating consumer demand combined with emerging technologies expose companies to global markets and consequently, to different regulatory environments at a time when doing business abroad is more challenging than ever.

As a result, companies today realise early on that improvising around local solutions and policies has become too time consuming, complicated and costly and may expose them to regulatory, tax or legal problems.

This is, we believe, one of the factors that explain the growing interest in multinational programmes in general and more particularly, in multinational captive fronting programmes.

Not without its challenges in terms of the quest for the four Cs (consistency, contract certainty, claims handling and compliance), multinational programmes are, and will very likely continue, being an integral part of the agenda of most captive owners.

Less traditional (in terms of captive usage) lines of coverage

Until recently, only a few and usually very large, sophisticated clients would consider using their captive for anything other than their traditional property and casualty lines. Today, we see an increasing number of clients retaining risks such as liability, trade credit, environmental liability, product recall and employee benefits (specifically benefits solutions and medical stop loss coverage in the US, in the wake of the Affordable Care Act).

This presents challenges and opportunities, but one thing is unquestionable; adding these new lines helps companies to have greater diversity and stability in their overall captive programmes. Risk diversification is important, especially for companies facing Solvency II on the horizon.

Expanding a captive programme with additional lines of business can also strengthen the financial benefits that the captive provides to its parent as premium levels usually increase significantly and exposure to loss is diversified.

Risks falling outside the appetite of the traditional insurance market

As risk managers' profiles continue to rise within their own organisations, we also see captives taking on a more important role in their companies' business strategies.

Often tasked with driving a risk management culture throughout the organisation, risk managers are now being asked to provide risk retention solutions when the traditional insurance markets cannot provide the coverage, capacity or efficient pricing that senior management views as necessary to achieving its strategic objectives.

Events such as the volcanic ash cloud, the Fukushima disaster or the floods that every year occur in many parts of the world have disrupted business through their impact on the circulation of people and goods.

With non-damage business interruption firmly on their radar, some captives have been working with us to create fronted programmes that would enable them to retain the risk in a more formalised and structured way, so that they can appropriately fund for that coverage and allocate the cost among their various business operations.

Cyber and pandemic risk are two more examples of new risks that clients are retaining via their captives.

Let's start with the rationale for retaining cyber liabilities.

Traditional cyber risk transfer programmes are becoming very popular, but there is still uncertainty around all of the types of exposures that might result from a cyber breach and some perils may not be covered.

So, programmes where the captive not only retains the primary layer or deductible of a traditional cyber liability policy, but also expands the coverage provided, are coming to us on an ever more reoccurring basis.

As regulators and rating agencies are now routinely publicly discussing cyber risk exposures, we expect to see more of these programmes in the future.

Recent news coverage highlights the potential effect of a pandemic spread. The 2014 outbreak of Ebola seems the most serious since the virus was first identified nearly four decades ago. We expect to see captives continuing to play an important role in the way pandemic risk is financed in the future.

The fast track captive programme: 'rent-a-captive'/cell captives

As mentioned before, risk management is becoming more strategically integrated with the company's business objectives, and companies are considering risk financing/retention at an earlier point in their lifecycles than in the past.

But at this stage, small- to medium-sized companies may not be ready to commit the capital and resources needed to form and manage their own captive. For these companies, a 'rent-a-captive' or captive cell is usually the easiest solution.

We continue to see important growth in cell captives around the world. Bermuda created this concept more than two decades ago. Other jurisdictions have implemented similar structures such as the sponsored captive insurance company in Vermont and other parts of the US, protected cell companies in Guernsey, and series limited liability companies in Delaware and other US domiciles.

In very simple terms, the owners of these cell facilities are allowed to create multiple cells and then 'rent' them out to participants.

By paying a 'fee', participants gain access to a portion of a cell facility owner's capital, surplus, licences and administrative services and can use those to insure or reinsure a portion of their risks.

Participants may be required to post collateral to satisfy the credit requirements of the front and/or cell facility.

These cell programmes can be formed quickly with minimal start-up costs and are available for virtually any line of business. The assets and liabilities of each cell are legally segregated. A cell programme can be easily converted to a standalone captive if a company later decides to form its own captive.

Closing

The captive fronting market is a dynamic market place. We expect that trend to continue and in fact, accelerate in the future. Companies are using captive programmes to meet a wide variety of today's needs, and in the future, new needs will emerge.

Tailoring the design and administration of a programme to effectively meet those needs can be challenging, and for that reason, the choice of the right insurance partner is one of the keys for success. CIT

Nuno Simão Antunes
Global risk solutions executive, EMEA
AIG

Who dares wins

Hot on the heels of the Rent-A-Center case earlier this year, Ian Bridges of Global Captive Management explains the decisive factors in the latest victory

STEPHEN DURHAM REPORTS

What happened in the Securitas case and what are its implications for the industry?

This is the second in line of taxpayer-favourable cases that have come out this year and another feather in the cap of those trying to set up captive insurance companies in the face of the various ruling put in place by the Internal Revenue Service (IRS). The Securitas case relies on the outcome of the Rent-A-Center case from earlier this year.

In both cases, the entities were not set up in a way that would meet the safe harbour rules that were introduced by the IRS in 2002. These rules focused on risk transfer and risk distribution and were and continue to be an obstacle to setting up new captives—which includes making sure the for-profit insureds are eligible for a tax deduction for premiums paid to the captive.

Typically, to obtain insurance treatment for tax purposes, there are a few factors. Firstly, it is important that you have an insurable risks and secondly that you are shifting these risks from one entity to another, in a balance sheet analysis. The third factor is the distribution of risk that is viewed in the eyes of the insurer—the more risk it has and can distribute amongst independent loss events, the less chance there is that one claim, when it is paid out, will exceed the premiums of all the policyholders.

The last factor is this notion of an 'insurance company' in the commonly accepted sense, meaning the entity has a separate balance sheet, income statement, management and follows the correct regulatory restrictions and requirements.

Over the past 10 years, many of the small- and medium-sized companies have been tripped up by the 2002, and subsequent, revenue rulings on how they can attain both risk transfer and risk distribution. When a potential client comes to GCM, one of the first things we do is analyse if the programme can fit into one of the three 2002 safe harbor revenue rulings: either the "parent/sub", the "brother/sister", or a "group captive" model. Typically, with these small and privately-owned captives, they fall into the parent/sub model but are unable to bring in third-party risk which is problematic.

Their parent/sub models is where you will find third-party risk from the use of reinsurance pool structures. Usually these pools are designed to take a parent/sub captive and cede some level of risk into a third-party reinsurance pool then in turn the captive will reinsure the pool. The reinsurance assumed by the captive is likely to be considered third party risk to the extent it is not the captives own risk being reinsured. That is how the parent/sub captives attempt to meet the risk distribution hurdle from the IRS revenue rulings.

In the case of Securitas, the US parent of foreign company Securitas had bought a number of companies and, for business purposes, had merged them during the years under examination. The programme went from having 11 insureds, one of which had 37 percent of the business in 2003, to having only 4 insureds in 2004 after a number of these consolidations took place, with one insured having 88 percent of the business.

Under the Revenue Ruling 2002-90, you would need 12 brother/sister corporations in order to meet the safe harbour. Interestingly, the court never awknowledged this IRS requirement for risk distribution even though it appears the taxpayer never met the safe harbour ruling in 2003 nor in 2004.

In the eyes of the court, risk distribution is determined actuarially as evidenced by the number if independent loss events such as more than 200,000 employees and 2000 vehicles insured under five types of risk: workers' compensation, automobile, employement practice, general and fidelity liabilities.

As the size of the pool increases, the potential for the loss per policy to deviate from the expected loss by a given amount declines.

The court highlighted this position: "This [the risk] does not change, merely because multiple companies merged into one. The risks associated with those companies did not vanish once they all fell under the same umbrella."

This quote really sums up the court's opinion of what constitutes risk distribution. Hopefully it will force the IRS out of the opinion of 'the more insured corporations/policyholders, the better'.

Could clients then use this case as a motive to do things they may have been reluctant to beforehand?

Absolutely. If this judicial trend continues, we could really see a significant increase in new captive formations, particularly among those parent-sub captives who were hesitant on using pooling facilities.

Many possible captives have been shelved over the past few years because those stakeholders involved were reluctant to enter a pooling facility and did not think they could meet the IRS' risk distribution requirements in another manner.

I am ready back on the phone with these potential clients relaying the significance of Securitas and Rent-A-Center and how they can benefit.

Clearly these cases can go on for some time but, considering that victories for Rent-A-Center and Securitas have been less than a year apart, could this be the last one for a while?

Perhaps, however if the next case that arises is also a taxpayer favorable decision I would think this would change the landscape in captive taxation if it has not been done so already.

We knew last year, from hearing a number of the captive taxation experts at the Cayman Captive Forum, that there were a couple of cases to come.

If the trend continues and the IRS continues to lose these cases in the courts, I think the IRS may need to revisit these safe harbor revenue rulings similar to what the IRS did in 2001 to the economic family theory in Revenue Ruling 2001-31.

In 2002, we as an industry were trying to figure out how to make captives work under the then new rulings. Since then, with the advent of pooling facilities as a potential stop-gap, we are finally beginning to see cases in favour of the taxpayer against the rulings.

As a former tax practitioner and someone whose business is trying to set up and manage captives effectively, I really see this as a big positive for the industry. CIT

Ian Bridges
Head of office, Cayman Islands
GCM

New Speece of life

Michael Schroeder of Allied Professionals Insurance Company shares his insider's perspective on the case of the risk retention group in Nebraska

STEPHEN DURHAM REPORTS

What did the Speece case involve?

The legal issue at the centre of this is related to the fact that risk retention groups (RRGs) that incorporate in one state, with a few minor exceptions that don't apply here, cannot be regulated by any of the other states. Sometimes people try to apply these state laws regardless. We have had some great success vindicating this legal point of view in federal court. For example, some states have direct action statutes, where they allow people making a claim to not only sue the person who they think hurt them, but to sue the insurance company directly, even if there is not a coverage issue.

This is a big waste of money to no purpose. They have this law in Florida and New Jersey, and in some cases these direct actions were brought against our insurance company, Allied Professionals Insurance Company (APIC). We took it to federal court and said, "I'm sorry but you just can't sue us—regardless of liability, regardless of coverage" under this type of law.

We won in the trial court in New York. It was called Zeigler v Wadsworth, and APIC was the insurance company there. They appealed up to the Court of Appeals for the Second Circuit and we won again. The same thing happened in Florida in a case called Kong v Costello. We were sued and went to a federal court, in a case that we ended up winning. Subsequently, they appealed to the Eleventh Circuit and we won again. These are the two highest courts that have ever ruled, but we still didn't have a ruling from a prestigious state Supreme Court.

It was then that the Speece case came along. In this case, they filed an action against the insurance company directly and we maintained that we could not be sued as we had an arbitration provision in our policy. They claimed that there was a Nebraska law that says insurance policies cannot have an arbitration agreement. We were fully aware of this, but we were also sure that the Nebraska state law did not apply to us. The trail judge ruled against us in this case, which led us to appeal to the Nebraska Court of Appeals.

This is when something unusual happened. The Nebraska Supreme Court reached down and took the case themselves, preventing the state's Court of Appeals from ruling on it. While we did not expect this, the important thing is that we prevailed on the legal issue, that Nebraska does not have the ability to apply its law preventing arbitration agreements in insurance policies against an RRG. Now we have a state Supreme Court and two Federal Court of Appeals all saying the same thing.

How did the Liability Risk Retention Act help with this?

The way it helped is that we could point to the Liability Risk Retention Act (LRRA) to support our claim. It sets out a very narrow list of things that you can regulate an RRG for in your state. If it is not on this list then you cannot do it. In this situation, it backed the RRG industry up and the court agreed. This benefits the entire industry because now other RRGs are not going to have to go all the way to the Supreme Court and bear all that expense—they can simply point to these rulings and say, "you are going to lose, so don't do it".

Was the support from the National Risk Retention Association indirect or did they go out of their way to support you?

They went very much out of their way to support us. They actually hired a law firm and filed amicus curiae briefs. That is a formal brief that raises the point with the court that this particular case has the potential to affect the broader industry. This changes the judge's perception a great deal, when suddenly a big association is raising this kind of point with a well-written brief. If we had said this ourselves it would not carry nearly as much weight with the court.

I think that we have now reached a critical mass of decisions where it will affect the whole industry, as this body of law is now fairly clear. The three I have mentioned, Zeigler v Wadsworth, Kong v Costello and the Speece case, have all come down in the last year and I believe this has created a seismic shift.

How has the Speece case affected APIC specifically, in terms of moving forward?

For one, it affirms our particular policy format, as we were the company and it was our policy that was affirmed as being legal and proper. It is pretty powerful stuff to tell the next court judge that. In New Jersey, somebody filed a direct action. We told them to dismiss it to avoid unnecessary legal costs, and they did. I think that is an indication of how this case could cut down on a lot of frivolous and fruitless litigation in the industry. CIT

Michael Schroeder
Vice president
Allied Professionals Insurance Company

PUERTO RICO

Why Puerto Rico Captive ?

Fully accredited United States jurisdiction

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Access to United States and Latin America

Experienced regulators with pro-business vision

Competitive and secure tax environment

Proven captive jurisdiction

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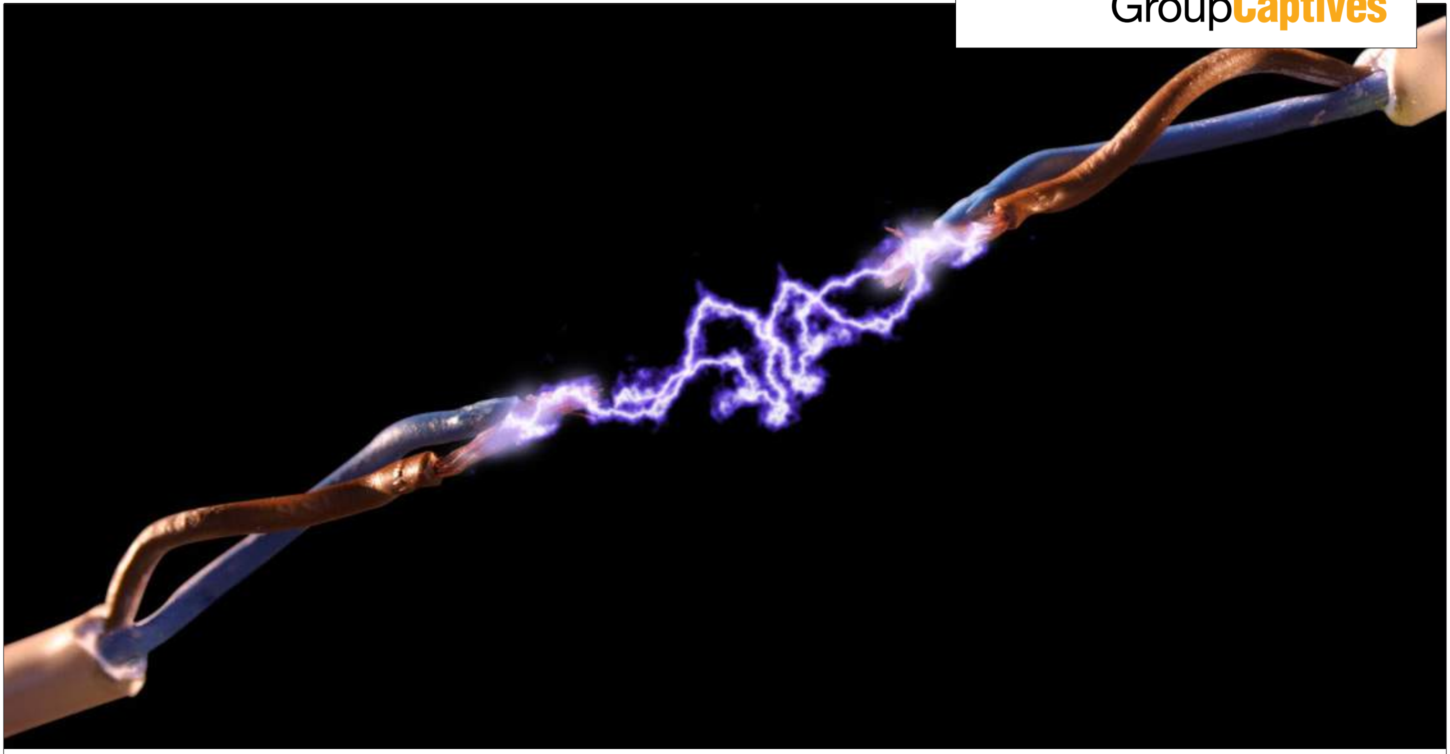

Group captives: on the verge of a growth surge?

SMEs are adopting a group mentality when they consider captive solutions, says Clayton Price of Marsh Management Services Cayman

Single parent captives have had a long-standing history in providing risk solutions for Fortune 1000 and Global 500 organisations. While group captives have been in existence for several years, participation by small- and medium-sized employers (SMEs) has been on a very limited basis.

As the concept of a captive has become more mainstream as a risk management tool, SMEs are seeking greater participation.

As a result, for the past three years, growth in group captives has exceeded the formation of single parent captives, aside from 831(b)s. It is estimated that currently only 3 percent of the SME market participates in a captive insurance solution.

A brief history

Several group captives have been formed in the Cayman Islands, dating back to the 1980s. By pooling assets and sharing risks in a group captive, the captive provides the coverage required by its members. Typically, the structure of a group captive also allows for members to deduct premiums for tax purposes by providing risk distribution and risk transfer. This structure also provides members with access to the reinsurance markets for transferring certain risks, typically at a lower cost than in the traditional insurance market.

Member equity group captives (MEGs) differ from other group captives in that they provide for member assessments for frequency losses, risk sharing for severity losses, sharing of expenses, and individual equity statements for the members.

Each member is both an owner, with the ability to appoint one representative member to the captive's board and/or steering committee, and an insured.

Member premiums are allocated to fund their frequency and severity layers as well as fixed costs.

According to the premium formula, the maximum amount of premiums that a member could pay in a policy year is typically:

Maximum Premiums = Frequency Layer Loss Funding (x2 for assessments) + Severity Layer Loss Funding + Fixed Costs

Market overview

Typical members of a group captive are best-in-class middle-market companies from the construction, food and beverage, hospitality, manufacturing, real estate, retail and wholesale, service, and transportation industries.

As of 31 March 2014, there were 128 group captives domiciled in Cayman with approximately $1.7 billion of premiums and $5.3 billion of assets.

Although the Cayman Islands Monetary Authority does not make public the number of MEG captives, it is estimated to be in the range of 35 to 45 captives (out of the total number of 128 group captives).

Marsh Management Services Cayman has experienced growth in the number of MEG captives under management, having recently been involved in the formation of Heavy Highway Insurance Solutions for road pavers, and RightPath Insurance for SME employers to insure their medical stop-loss exposures. We have also seen organic growth in the number of members in existing MEG captives.

Ideal SMEs for participation in a MEG captive:

- Minimum premium: annual insurance premium spend of at least $350,000 combined for workers' compensation (WC), general liability (GL), and auto.
- Placement: currently buying guaranteed cost insurance or a retrocessionaire plan.
- Loss control: potential and willingness to improve loss experience through better loss control.
- Peer review: willing to comply with safety and loss control standards/protocols established by the group members.
- Risk sharing: willingness to share a layer of risk with other members of the group.
- Commitment: long-term focus and willing to commit to the programme for at least three years.

Advantages of participating in a MEG captive

Group captives provide several advantages:

- Reduced insurance costs: premium pricing formulas and leveraging group purchasing power reduce premium costs to member companies.
- Less pricing volatility: the captive structure limits a company's exposure to market risk. It results in improved predictability for future premium costs. Premium calculations are based primarily on members' loss history, not on industry averages.
- Opportunity to share in capital investment income and underwriting results: profits (and losses) related to underwriting and capital investment results are shared by the member companies.
- Greater control in managing risk: each member of the group captive company participates on the board and/or steering/advisory committee (depending upon structure) and is able to fully engage in all decisions regarding claims and risk control. This is particularly important for many middle-market, family-owned companies.
- Best practice knowledge sharing: each captive member actively promotes its best safety practices and network with other members.
- Greater control of claims: each captive member has direct access to individuals involved in the settling and adjustment of claims.

The quest for growth

MEG captives vary in membership size, ranging from fewer than 10 to some exceeding 100 members. The obvious benefit of increasing a group captive's membership is to reduce the individual member's fixed costs as the captive secures greater negotiating leverage based upon the premium volume with its fronting insurer.

Each state where the member insureds have operations for statutory insurance, such as workers' compensation and automobile liability, requires a licence that can be provided by the fronting insurer.

It is also customary for the fronting insurer to provide excess insurance above the captive's retention, and in some instances, aggregate stop-loss insurance. Often, the captive is able to select an independent claims adjusting firm (referred to as 'unbundling') instead of relying on the fronting insurer's in-house claims services.

The ability to unbundle provides the membership with greater control over the claims handling process and usually gives the member insured more control over the selection of counsel.

Active participation is key to the MEG's success and a soft benefit of increasing the membership size of the captive is the diversity of ideas and the opportunity for more members to become involved. Most MEG captives have the following operating committees (with some of their respective responsibilities):

- Executive committee: usually comprised of the chair from each of the other committees. It calls to order the board and shareholders' meetings.
- Finance committee: reviews the financial statements, analyses the equity statements, establishes the investment policy, and reviews the investment performance and the credit ratings of any member that may be on a credit watch. It also makes recommendations to the executive committee about whether particular members should be retained as a member insured. Depending on the financial performance of the MEG, the finance committee may make recommendations for the distribution of a dividend.
- Risk control committee: monitors the memberships' risk control assessment (RCA) scores. It also conducts workshops and recognises members with awards, such as most improved RCA score, active participation, and attendance at workshops. In addition, the establishment of watch list criteria, including monitoring and review, is a typical activity of the risk control committee.
- Claims committee: usually reviews the lag time of the member insured's reporting, trends emerging in the claims experience, managed care cost containment reports, litigation management, and the overall service provider satisfaction report.
- Underwriting committee: responsible for the placement of the insurance in coordination with the broker for the terms and conditions and premium charges of the fronting insurer and, in some instances, the umbrella programme as well. The committee will also undertake placement of the directors and officers insurance for the MEG captive. Other duties include the establishment of an underwriting review process for prospective members in conjunction with the membership committee, which may be a separate committee or a sub-committee of the underwriting committee. This is key to the growth of the captive as the best source of new members comes from the recommendation of existing members.

Depending on the membership and size of the group captives, other committees, such as nominating committees and travel committees, may be formed.

While growth can have its advantages, growth for the sake of growth can bring uncertainty as well as the membership becoming less 'collegiate'.

Although the acceptance of a new member is made upon the quality of the prospective member's risk profile, financial condition, management and references, there remains the uncertainty of how the new member may impact the overall loss experience of the group captive.

If the MEG were to grow too fast to manage this risk, then there is a possibility that the overall group's loss experience could be negatively affected, which may result in the opposite objective of reducing the individual member's fixed costs.

Prior to joining a MEG captive, the prospective member should undertake its own due diligence by getting to know the members who they intend to share their insurance risk with. When losses occur, membership loss distributions and member assessments are possible .

Furthermore, the prospective member should thoroughly review the memorandum of association and articles as well as the company's by-laws. While joining a MEG captive can provide multiple benefits, knowing the protocols for an exit strategy is of equal importance.

Ensuring that the MEG captive has a process in place for closing out old years that may have either a tail fund or a formalised commutation process can have immeasurable benefits for an existing member, which will seek a return of its collateral. The return of collateral usually occurs over a prescribed number of years to ensure the exiting member's claims have fully matured.

MEG captives provide SMEs with the opportunity to participate in a captive. When compared with a single parent captive, MEGs provide the additional benefit of mitigating loss volatility due to the larger number of participants in the group captive.

As the concept of a captive continues to become a more widely accepted insurance solution for SMEs, Marsh Management Services Cayman believes that Cayman will see many new formations of MEG captives reflecting broker portfolios, association participation on both a regional and national membership basis, and for SMEs simply seeking a captive solution. CIT

Clayton Price
Head of office, Cayman Islands
Marsh Management Services Cayman

Cayman Captive Forum 2014

Location: Cayman Captive Forum 2014
Date: 2-4 December
www.imac.ky/ccf-home.aspx

At the 22nd Cayman Captive Forum, 1,300+ specialists from around the world will converge in the Cayman Islands to discuss the issues most pressing to the captive insurance industry. This is the event to connect, learn and share insights and best practices.

35th Annual National Educational Conference & Expo

Location: Washington DC
Date: 18-20 October 2015
www.siia.org/i4a/pages/index.cfm?pageid=1

SIIA's National Educational Conference & Expo is the world's largest event dedicated exclusively to the self-insurance/alternative risk transfer industry. Registrants will enjoy a cutting-edge educational program combined with unique networking opportunities, and a world-class tradeshow of industry product and service providers guaranteed to provide exceptional value in three fastpaced, activity-packed days.

Industry appointments

Barbican Insurance Group has appointed **John Sawyer** as underwriter to lead property binders within the firm's international property division, with immediate effect.

He will report to underwriting manager, international property, David Slade.

Sawyer brings almost 30 years of insurance experience to the role, spanning both the property and casualty sectors.

Most recently, he was a property binding authority underwriter at Faraday Syndicate 435, having originally joined the firm in November 2003.

Sawyer has also been broker/underwriter at MD Jensvold and underwriter for the property and casualty binding authority business at Sphere Drake (Odyssey Re).

He began his insurance career at JL Dodson Syndicate 660 in 1985.

Slade said: "The international property sector is a highly competitive and specialist environment, which demands the highest standards of underwriting expertise."

"Bringing [Sawyer] into the team, someone with such a considerable breadth and depth of market experience, is a very positive development, and we look forward to capitalising on his insight to further strengthen our position."

Sawyer added: "I am very pleased to be joining Barbican at such an exciting stage in their development."

"The company has a very clear strategic vision combined with an agility and willingness to innovate."

"I look forward to playing my part in building on the strong foundations that [Slade] and the rest of the property team have put in place."

Marsh has appointed two executive recruits, **Michael Cormier** and **Michael Poulos**.

Cormier, who recently led Marsh risk consulting, has been named head of portfolio development.

The new role, which is based in New York, involves supporting Marsh in accelerating growth and development through acquisitions, strategic alliances, and partnerships in line with the firm's strategic priorities.

Poulos has joined the firm as head of client advisory services.

The role will oversee Marsh risk consulting and claims advocacy with responsibility for aligning these offerings.

He joins from Oliver Wyman, an operating company of Marsh & McLennan, where he was most

recently head of the New York office and the leader of the firm's financial services business in the Americas.

Peter Zaffino, president and CEO of Marsh, said: "Cormier and Poulos are proven leaders with excellent track records of delivering sustained growth and world-class advisory services."

"With these appointments, Marsh will be better positioned to expand the firm's capabilities to assist our clients to thrive in today's increasingly challenging risk environment."

Paul Kerner has been appointed as a director of the board for Heritage Insurance Solutions Limited (HISL) in London.

With more than 20 years of experience in the insurance industry, Kerner is renowned for his expertise in the areas of professional risk with financial institutions onshore and in the Channel Islands, the Cayman Islands and Malta.

He worked for 12 years at James Hallam Insurance Brokers, latterly as professional risks director, followed by Miller Insurance in a similar role.

Guernsey-headquartered Heritage Insurance managing director, Karl Bradley, said Kerner's addition to the board as a director completed the HISL's focus on ensuring that the board reflected the breadth and depth of expertise demanded of a specialist insurance broker.

Bradley commented: "Heritage Insurance has been focused for some time on building a stable of excellence both in our staff and our board."

"[Kerner's] appointment is part of our strategy to build our reputation for the highest standards and innovative services available in the international insurance broking market."

"We are anticipating increasingly busy times and we believe we have the board to ably lead our UK business and execute our strategy to provide our clients with the highest level of insurance expertise across all services." **CIT**

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