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UnipolSai re-launches reinsurer

UnipolSai Assicurazioni has re-launched its third-party reinsurer in Dublin to target property and casualty business.

Unipol Re has now become a third-party reinsurer and holds assets of more than €500 million in assets.

It will offer tailored reinsurance coverage to small and medium-sized insurance companies throughout Europe, for a number of risks.

The new company represents UnipolSai Assicurazioni's first venture into reinsurance and the first time it has launched its brand outside of Italy.

Enrico Pietro, chairman of the board of Unipol Re, also holds the position deputy general manager of general insurance at UnipolSai Assicurazioni.

Marc Sordoni, head of reinsurance for UnipolSai Assicurazioni, has been appointed CEO of the reinsurer and will supervise reinsurance for the 16 affiliated companies of Unipol Group in Italy.

Michael Doyle, who is the chief risk officer of UnipolRe, previously worked at the Central Bank of Ireland in various roles in the insurance supervision department.

Simon Wigzell, who was previously a senior reinsurance manager at Fondiara SAI Group, has been appointed underwriting manager of UnipolRe.

Sordoni commented: "As our parent group's first venture outside of the Italian market, this represents an historic moment for the company. It was an important decision for the group to make this move but thanks to the relevant current market share in Italy combined with the incentives Solvency II provides, it is made it a natural one."

"The fact is our parent company has great expertise in certain lines, in particular third-party liability and property business. We believe we can offer insurers very specific and tailored solutions thanks to this expertise, knowledge and database in these types of business."

A.M. Best has assigned a financial strength rating of "A- (Excellent)" and an issuer credit rating of "a-" to UnipolRe. The outlook for both ratings is stable.

A.M. Best assigns ratings to nuclear mutual insurer

A.M. Best has assigned a financial strength rating of "A (Excellent)" and an issuer credit rating of "a" to European Mutual Association for Nuclear Insurance (EMANI).

The ratings reflect EMANI's excellent performance record and strong specialist business profile in the nuclear energy sector.

The track record of strong underwriting results is demonstrated by a five-year average combined ratio of 34 percent, added A.M. Best.

Partially offsetting these strengths are EMANI's exposure to large underwriting losses and the potential for capital depletion following a full-limit loss.

The risk is mitigated by an extensive reinsurance programme, which is placed with a panel of financial reinsurers.

Portfolio review shows risk takers rewarded

London & Capital has published its market forecast for captives' portfolios following the recent market turbulence.

The asset management company cited the Greek debt crisis, a comparatively strong dollar and uncertainty in China, highlighted by the devaluation of the yuan against the dollar by the People's Bank of China in August, as the year's key events causing captives' asset investment headaches.

London & Capital stated: "Equities were affected the most by the rise in volatility because it was expected that a sharp slowdown in global economic activity would have a very damaging impact on company earnings."

"The S&P 500 index was down 11 percent month to 25 August 2015, the low point in the Equity market correction."

London & Capital went on to conclude: "The index with the highest equity weighting had the worst performance, but even here, although the S&P 500 index was down 11 percent, captive Index 3 was only down by 3.77 percent, thanks to the positive contribution from high grade bonds."

"Moreover, capping the maximum equity allocation at 30 percent also helped. The other captive indices fared much better due to their greater exposure to high grade bonds."

"Ultimately, the captive indices did what they were supposed to do—enhance returns, and protect capital the most for those (same) captives that require access to their capital at short notice."

Looking ahead, London & Capital predicted that "the main macroeconomic indicators suggest that the global economy is not travelling head-long into a recession".

"The US service sector is expanding at its fastest pace since before the financial crisis, oil prices are in the doldrums, the yield curve is still positive which is helping

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to boost banks' profitability and their willingness to lend and global company earnings are still growing."

"Consequently, captives with riskier portfolios will see their investment values recover and ultimately prosper, but with bumps along the way."

ACE Software to protect against sanctions risk

ACE Software Solutions has developed a solution for corporates to help manage sanctions risk.

The new solution, Pelican Sanctions, was unveiled at Eurofinance between 23 and 25 September in Copenhagen.

Banks are currently putting pressure on corporates to share the responsibilities for regulatory and sanction requirements.

Breaching sanctions can affect not only the reputation, but also the financial investment risk for any corporate organisation.

Pelican Sanctions provides a full analysis for all decisions taken by corporates to support audit and regulatory requirements.

The solution can accurately screen transactions against any sanctions list, while providing explanations for all positive and negative decision making.

Parth Desai, who is CEO at ACE Software, commented: "The focus on sanctions risk is likely to increase as regulatory and reputational risk are on the rise, which has led to corporates taking a more proactive approach in this area."

"Every corporate should have a responsibility and understanding of the sanctions risks involved and be actively committed to implementing solutions to provide efficiencies and to better manage their business."

"Our solution has intelligence sanctions filtering which provides peace of mind for any global multinational corporation to manage risk and reputation."

TCCP and Gunn Mowery form strategic relationship

The Technology Council of Central Pennsylvania (TCCP) and Gunn Mowery, a captive service provider, have formed a strategic relationship.

TCCP member companies will gain access to comprehensive services that will help them to identify key areas where they can mitigate risk and offset loss.

Chuck Russell, CEO of the TCCP, commented: "We're excited to offer an on-ramp to Gunn Mowery insurance products and services."

"Our members will receive customised services allowing them to offset their risk arising from the use of technology and as they provide technology products and services to their clients."

Greg Gunn, managing partner of Gunn Mowery, added: "Gunn-Mowery is proud to partner with the TCCP."

"Over the past 30 years, in addition to providing line of business insurance and employee benefits, we have developed expertise in several technology areas including cyber liability, technology errors and omissions, cyber security, and privacy."

Gunn added: "This experience, coupled with our outstanding customer service and integrity, allows us to meet and surpass the unique needs of TCCP member businesses."

Global reinsurer capital reaches $565 billion

Aon Benfield has estimated that global reinsurer capital totalled $565 billion at the end of June.

Its report, which analysed the financial results of 28 major reinsurers in H1 2015, showed that on an underlying basis, the capital available to support reinsurance underwriting was flat, with retained earnings offsetting unrealised losses on bond portfolios.

Alternative capital continues to grow, but at a slower pace than before, according to the report, which said that the total rose by 6 percent to $68 billion.

The report found that shareholders' funds reported by the Aon Benfield Aggregate companies fell by 4 percent to $332 billion, but the total was slightly higher at constant exchange rates, driven by solid earnings.

Premium growth is being achieved and in original reporting currencies, two-thirds of the ABA constituents achieved growth in property and casualty premiums in H1 2015.

Underwriting performance remains strong, aided by low global catastrophe losses and favourable prior year reserve development. The combined ratio stood at 91.1 percent.

The report also found that investment returns are still under downward pressure, with little prospect of relief in the near term. The ordinary yield has declined to 2.8 percent.

Headline return on equity has eroded modestly, but remains resilient at 10.7 percent (annualised).

Sector consolidation continues, as companies look to achieve the advantages of scale and diversification, according to the report.

Mike Van Slooten, head of Aon Benfield's international market analysis team, commented: "The landscape of the reinsurance industry is changing, driven by market dynamics in the developed world and the rising influence of Asian capital."

"Discerning reinsurance buyers will continue to benefit in this environment, but the level of complexity is increasing and understanding broader industry trends has never been more important."

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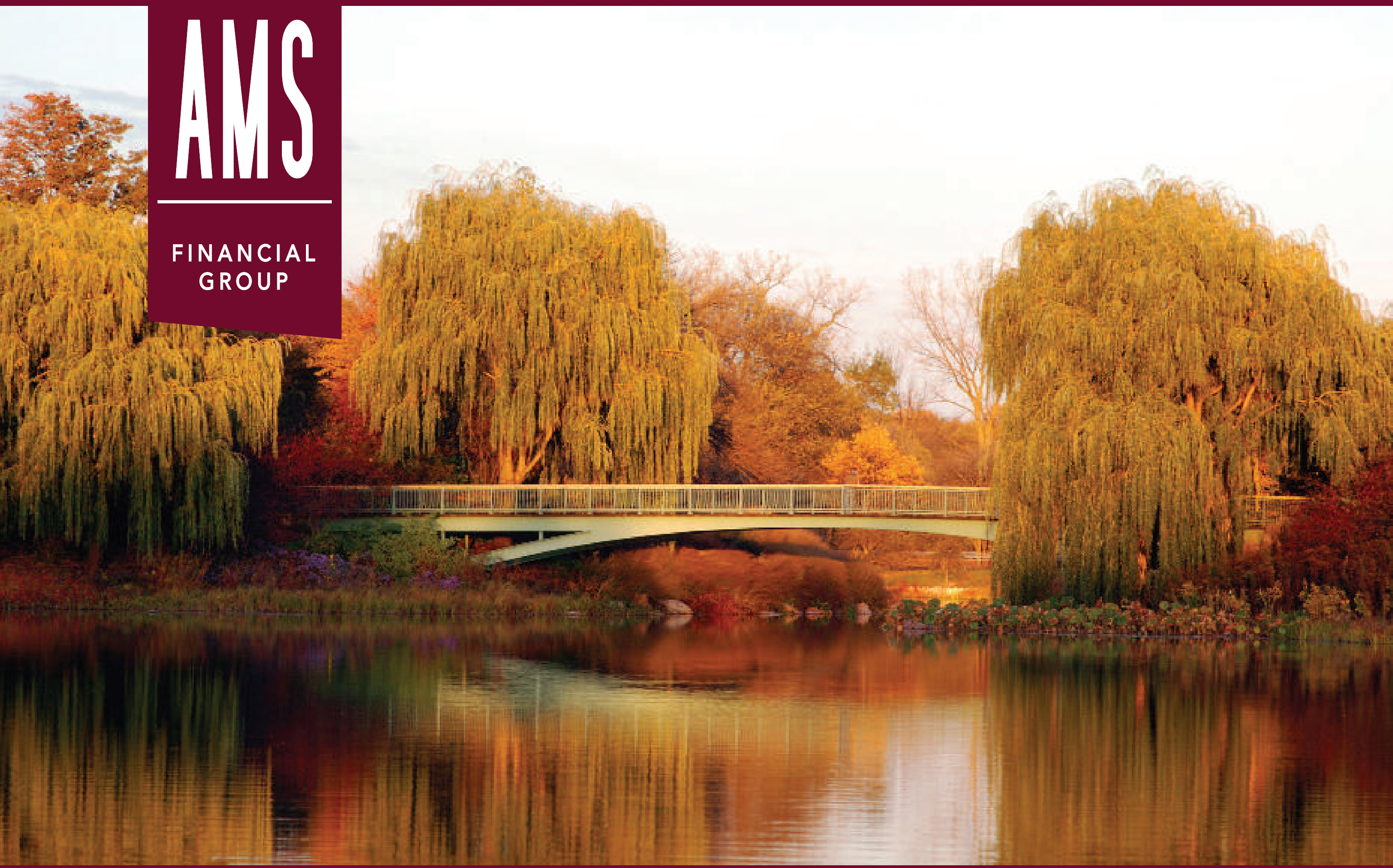

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Premiums on the rise in CAIR member countries

The reported premium of Caribbean Association of Insurance Regulators (CAIR) member countries increased 20.4 percent between 2009 and 2013, rising from $3.6 billion to $4.5 billion, according to a new A.M. Best report.

A.M. Best conducted a five-year survey of CAIR member countries representing close to 7.4 million people, and in 2013, more than $74 billion in annual gross domestic product.

Of the 20 member countries, 18 participated in the 2013 data collection process. As the countries in the region are widely diverse with varying reporting requirements, accounting standards and regulatory requirements, the results varied from country to country on some levels.

In total, there was reported to be $11.7 billion of assets held by insurance companies in the CAIR member countries and reported cash and investments totalled $9.2 billion in 2013.

According to the report, investment risk across the Caribbean region remained relatively conservative, on aggregate, with over 67 percent of the investments held in bonds, cash and short-term investments. The region, though small, is diverse but there is an effort to harmonise local regulations and reporting standards with current and developing international standards.

Lindeen urges Congress to pass PACE Act for mid-sized employers

National Association Insurance Commissioners (NAIC) president Monica Lindeen has testified before US Congress in support of the Protecting Affordable Coverage for Employees (PACE) Act.

The hearing was held on 9 September in the US House of Representatives. The PACE Act would let states define a “small group” for the purposes of health insurance.

The Affordable Care Act changed the definition of “small group” from an employer with 1 to 50 employees to one with 1 to 1,000.

This change would subject mid-sized employers to new rating restriction and benefit requirements. The changes could increase costs to employers, limit flexibility and drive up premium costs for employers, according to the NAIC.

The PACE Act will give states the opportunity to define “small group” in a manner consistent with their state’s demographic needs.

Lindeen, Montana’s insurance commissioner, testified: “The NAIC has endorsed the PACE Act because it would retain state flexibility to set the appropriate limits for the small group health insurance market and ensure stable small group markets that reflect the unique characteristics and dynamics at play in each of the states.”

Lindeen added: “States don’t always agree, and on an issue as controversial as health reform, that is certainly true.”

“What may work in Washington may not be right for Montana, which is why giving states options when it comes to federal rules is critical.”

Catastrophe bond coverage hit $23.5 billion, says Aon

Catastrophe bond coverage reached a record $23.5 billion on 30 June, according to Aon’s insurance-linked securities (ILS) report.

The report, which analysed the key trends in the 12 months up to 30 June 2015, revealed that annual catastrophe bond issuance reached $7 billion, a decrease on the record breaking prior year of $9.4 billion.

Some 25 transactions, including two in life and health, closed during the period, while $5.9 billion of bonds matured, according to the report.

The 12 months under review saw two other records in the ILS market with a Q1 issuance of $1.7 billion across eight transactions and a record average transaction size of $279 million for any 12-month period ending 30 June.

US exposures dominated the catastrophe bond market, with 22 of the 25 transactions comprising US risk in some capacity. Outside of the US, dedicated Japan risk was covered in two transactions and standalone Europe risk in one transaction.

The report also found that during the 12 months, eight quota share sidecar transactions closed, totalling $955 million for the seven sidecars that disclosed their sizes, and the industry loss warranty market increased from $3.5 billion to an estimated $4 billion.

Paul Schultz, who is CEO of Aon Securities, commented: “The decrease in catastrophe bond issuance ... was in part due to the reaction of the traditional and collateralised reinsurance players to the heightened competition from the catastrophe bond market.”

“This reduction was offset by a sizeable increase in collateralised reinsurance participation,” added Schultz.

“We forecast $6 billion to $7 billion in ILS issuance during calendar year 2015, and expect current pricing trends to continue into 2016 in the absence of substantial catastrophic events that disrupt the supply of capital.”

Reinsurance capital growth eases, says Willis Re

The growth in global capital dedicated to reinsurance stabilised during H1 2015, according to the new Reinsurance Market Report from Willis Re.

Dedicated global reinsurance capital from both traditional and non-traditional sources remains at $425 billion, unchanged from the record level reached at year-end 2014.

The levelling of capital comes as reinsurers accelerate their active capital management strategies as acceptably profitable capital deployment opportunities in the market diminish.

In H1 2015, publicly listed companies within the Willis Reinsurance Index returned virtually all earnings to shareholders, a total of $16 billion.

A number of reinsurers have also committed to returning earnings to shareholders at year-end if they believe additional retained capital cannot be deployed profitably.

Willis Re suggested that capital levels are also being affected as merger and acquisition activity intensifies and transactions are completed. Some 10.5 percent of shareholders' equity reported within the Willis Reinsurance Index is currently involved in major merger activity.

But Willis does believe that, ultimately, the challenge of oversupply remains and market pressures continue to manifest in diminishing returns on equity.

Underlying reinsurer returns on equity during H1 2015 are even lower than during H1 2014, according to Willis.

John Cavanagh, global CEO of Willis Re, commented: "Markets clearly continue to face significant over-capacity and competitive pricing conditions, and overall underwriting margins remain under substantial pressure."

"Ultimately, however, reinsurance remains attractive to investment capital in the long-term despite the diminishing underwriting and investment returns being delivered."

Aon releases free captive ebook

Aon has released a free introductory guide to captives.

The ebook was released after Aon's 2015 Global Risk Management Survey noted an increase in captive owners in the Asia Pacific region, where alternative risk transfer is a fairly new concept.

Aon's ebook is designed to help companies determine if they need a captive and understand why organisations are increasingly investing in these types of alternative risk transfer vehicles.

It will also help them to discover the different ways to structure a captive, understand how to set them up, and learn about the outsourced services that will be required.

JLT Towner backs branch captives

Branch captives are gaining interest as captives domiciled outside of the US seek to provide certain coverages, including employee benefits and terrorism insurance, for their owners' US-based operations, according to JLT Towner.

Tom Stokes, managing principal and US consulting practice leader at JLT Towner, has authored a paper that looks at the increasing interest in, and benefits of, branch captives, particularly for offshore entities.

In many instances, captives may face a requirement to use a domestic entity, and a branch captive is one alternative.

Stokes stated: "Offshore pure captives might form onshore branches when US regulations require that the insurance company writing the coverage be admitted to do business in a US domicile."

"Branch captives are an economical alternative versus establishing a pure US captive or redomiciling from an offshore domicile," added Stokes.

In the paper, Stokes cited Employee Retirement Income Security Act benefits and terrorism insurance as examples of an organisation's need to have a US captive presence.

Branch captives are also increasingly including a variety of traditional and voluntary employee benefits, according to the paper.

SL Green Realty joins Federal Home Loan Bank of NY

Belmont Insurance Company, the captive insurer of SL Green Realty Corporation, has become a member of the Federal Home Loan Bank (FHLB) of New York.

Belmont is the first captive to become a member of the FHLB of New York cooperative.

FHLB members have access to a wide variety of flexible, low-cost funding through its credit products, enabling members to customise advances, interest rates and match asset and liability terms.

Eligible collateral to pledge to the FHLB of New York includes residential, multi-family and commercial mortgage loans, mortgage-backed securities and US treasury and agency securities.

Matt DiLiberto, CFO of SL Green, said: "We are delighted to become a member of the SHLB of New York and appreciate the bank's commitment on this ground breaking step in accepting its first captive member."

He continued: "Access to the diverse array of credit products that the FHLB of New York provides further expands our access to liquidity and provides an alternative means to efficiently finance the debt and preferred equity platform, as necessary, on flexible terms at an attractive cost of capital."

Reinsurance demand to increase in 2016 and beyond

Reinsurance demand will increase slightly in 2016 due to updates to rating agency capital models, the continued privatisation of reinsurable and insurable risks from government pools, and reinsurers and insurers expanding into new lines of business, according to Aon Benfield's market report.

The report outlined areas of expansion opportunity for insurers and reinsurers, including US mortgage risk, annuity risk, privatisation of risk and rating agency criteria changes.

In terms of market dynamics, the report revealed that at the end of Q2 2015, total global reinsurance capital had declines of 2 percent to $565 billion.

Set against an environment of stable operating earnings and light catastrophe activity, the decrease was in part due to currency fluctuations.

Predominantly, this was caused by the weakening of the euro against the US dollar, higher bond yields affecting reinsurer bond investment market valuations, as well as share repurchases and dividends.

The alternative capital segment saw levels of capacity from sidecars ($8.4 billion), industry loss warranties ($4 billion), and collaterised insurance ($32.5 billion), while catastrophe bond capacity contributed $23.5 billion to the total.

Bryon Ehrhart, who is CEO of Aon Benfield Americas, said: "Reinsurance market dynamics in 2015 continue to provide our clients with very high quality options to source accretive underwriting capital—we expect these dynamics to remain through the upcoming 1 January 2016 renewal cycle."

At the end of Q2 2015, insurer capital remained unchanged from year-end 2014, standing at $4.2 trillion.

The report highlighted that mergers and acquisitions activity around the globe increased dramatically during 2015, with deal volume totalling $73.3 billion across 461 deals to 1 September, compared to $16.8 billion across 387 deals in the equivalent prior year period.

At 1 September, global insured catastrophe losses had reached $16 billion, which is below the historical 10-year average of $61 billion.

Global drought losses to surpass $8 billion, says new report

El Niño is set to continue to intensify in the coming months and could force global drought losses above the current forecast of $8 billion in economic damage, according to Aon Benfield's Global Catastrophe Recap Report.

Severe drought conditions have persisted in western regions with total economic losses expected to reach at least $3 billion, mostly attributable to agricultural damage in California.

Drought conditions also affected Eastern Europe, Africa, the Caribbean, and Central America during August, with combined economic losses of more than $2.6 billion occurring in Romania, Czech Republic, and Poland.

Steve Bowen, impact forecasting associate director and meteorologist, said: "As we continue to see the prospect of El Niño becoming one of the strongest in decades, more and more impacts will be apparent around the world."

"This is already true in the form of global drought losses, as several countries have endured a severe lack of rainfall and agricultural impacts."

"On the flip side, tropical cyclone activity in the Pacific Ocean maintained its torrid pace in August due to above-average sea surface temperatures and favourable atmospheric conditions."

He added: "Multiple landfalling storms in Asia-Pacific left considerable damage, and more activity is expected as we enter the peak of the cyclone season."

Elsewhere during August, Super Typhoon Soudelor tracked through Saipan, Taiwan, and China, causing economic losses in excess of $3.2 billion.

Soudelor was followed by Typhoon Goni, which wrought havoc in the Philippines, the Korean peninsula, and Japan, killing at least 70 people, damaging tens of thousands of homes and causing economic losses well into the hundreds of millions of US dollars.

Insurance execs against UK exit from EU

Almost three quarters, 71 percent, of surveyed insurance executives believe a UK exit from the EU would be bad for business in the London insurance market, according to Xuber.

Insurers fear that a 'Brexit' could diminish the London insurance market's position on the global stage, found the Risk Management Survey 2015. The estimated GDP contribution of the London

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market, according to the London Market Group, was £12 billion in 2013, representing 10 percent of UK financial services, 21 percent of London and 32 percent of the overall UK insurance sector contribution.

Justin Davies, a director at Xuber, commented: “It is clear from the responses that remaining in Europe is a priority for a majority of insurers, all of whom want in place economic, political and regulatory conditions in which the London market can continue to thrive.”

“The results also show how companies recognise the need to embrace new technology and tools in order to remain at the forefront of this highly competitive industry.”

“Importantly, the responses have revealed what our clients and the market in general want from their partners and service providers, and where they perhaps need more support than they are currently receiving.”

Conversely, 29 percent of those surveyed disagree that an EU exit would necessarily be bad for the London market. The UK government has promised to hold a referendum on EU membership by the end of 2017.

M&As are a perservation game

A PwC report has set out why alignment with overall company strategy and preservation of value are key to pending and future mergers.

The report, Insurance 2020: On Track for the Payback, Realising Megadeal Potential, outlined the ways in which insurers can address the basics of deal-making in order to withstand the complexities and challenges of large acquisitions.

The report highlighted challenges facing the insurance industry in the midst of a flurry of megadeal merger and acquisition (M&A) activity, including the risk that deal strategy could become defined by size rather than suitability and fit.

Another challenge is the possibility that a technology or telecommunications giant could seek to acquire an underwriting platform and ready-made market share to match its own analytics and distribution capabilities. The industry also faces broad challenges around competing in an increasingly consolidated marketplace.

The report suggested that there is a risk that non-participation in the current M&A wave could make companies vulnerable to takeover themselves.

PwC believes that with the industry transforming, finding ways to sustain growth and keep pace is vital. By focusing on the basics with a clear vision of how and where their organisations intend to compete, boards can fully realise the role M&A can play in reinforcing their competitive platform.

Arthur Wightman, PwC Bermuda territory and insurance leader, said: “Acknowledging these challenges and tackling them headon drives the best chance of success, in particular where bold decisions are being taken in response to today’s M&A market.”

“Decisions need to be fully informed with those responsible being assigned and accepting accountability, from board level through to business unit leaders driving the operations, for the evaluation and delivery of deal objectives. These megadeals can propel businesses ahead of competitors and have the potential to reshape the industry.”

Chinese port explosions are largest insured man-made loss event

Two massive explosions that hit China’s Port of Tianjin could generate insurance losses of up $3.3 billion, according to a Guy Carpenter & Company report.

The report estimated damage to cost between $1.6 billion and $3.3 billion, which was more than double early estimates released by Credit Suisse.

According to the report, the fireball and shock wave from the explosions blasted shipping containers, and incinerated vehicles in the port and on an adjacent highway overpass.

In addition, it also destroyed warehouses, production facilities and dormitories, affected the nearby Donghai Road Railway Station, and blew out windows of residential structures within several kilometres.

James Nash, CEO of Asia Pacific operations at Guy Carpenter, said: “The explosions that occurred in Tianjin, China are likely to constitute one of the largest insured man-made losses to date in Asia and will certainly be considered one of the most complex insurance and reinsurance losses in recent history.”

While access to the site is limited, Guy Carpenter used its satellite-based catastrophe evaluation service, CAT-VIEW, to analyse pre- and post-event satellite high-resolution imagery to determine the extent of the losses.

Cyber market set to boom

The global cyber insurance market could grow to $5 billion in annual premiums by 2018 and at least $7.5 billion by the end of 2020, according to a new report from PwC.

The report, Insurance 2020 & Beyond: Reaping the Dividends of Cyber Resilience, revealed that 61 percent of business leaders across all industries see cyber attacks as a threat to the growth of their business, and 2014 saw an average of 100,000 global security incidents a day.

Paul Delbridge, insurance partner at PwC, said: “Given the high costs of coverage, the limits imposed, the tight terms and conditions and the restrictions on whether policyholders can claim, many policyholders are questioning whether their policies are delivering real value.”

“There is also a real possibility that overly onerous terms and conditions could invite regulatory action or litigation against insurers.”

PwC suggested that insurers, reinsurers and brokers can capitalise on the cyber risk opportunity while managing the exposures by maintaining their own credibility in this area through effective in-house safeguards against cyber attacks.

Robustly modelling exposures and losses will provide a better understanding of the evolving threat and could encourage more reinsurance companies to enter the market by identifying concentrations of exposure and systemic risks in an increasingly inter-connected economy.

Paul Delbridge, insurance partner at PwC, concluded: “For insurers, cyber risk is in many ways a risk like no other. It is equally an opportunity. Insurers who wish to succeed will base their future coverage offerings on conditional regular risk assessments of client operations and the actions required in response to these reviews. A more informed approach will enable insurers to reduce uncertain exposures whilst offering clients the types of coverage and attractive premium rates they are beginning to ask for.”

Investment in technology is key to improving profitability

Major investment in technology should be the top priority for insurance providers when it comes to improving profitability, according to research by Interim Partners.

Interim’s research found that 33 percent of senior insurance executives surveyed said that spending more on technology would boost profitability, followed by 21 percent who thought investing in new staff and developing new products should be insurance providers’ top priority to improve profitability.

This compared with just 6 percent who thought that increasing margins by raising average premiums would help boost profitability.

Ben Johnson, principal of insurance, asset and wealth at Interim, said: “Firms failing to harness the power of new technologies, including big data analytics and social media profiling, could now be putting themselves at a real disadvantage.”

Solvency II Solutions teams up

Barnett Waddingham and Solvency II Solutions have formed a strategic partnership to integrate their SIIMPLIFY and Tabular Solvency II reporting solutions.

Through integration of the systems, insurance operators now have access to a complete end-to-end Solvency II standard formula reporting package for the solvency capital requirement (SCR) and quantitative reporting templates (QRT).


Catastrophic medical claims aren’t just a probability — they’re a reality.
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SIIMPLIFY, Barnett Waddingham's Excel-based solution, enables a calculation of the standard formula SCR under Solvency II.

Solvency II Solution's product, Tabular, is an Excel/Word-based Solvency II narrative and QRT XBRL reporting tool, which has been integrated into Microsoft Office.

Tabular is designed to be a repository for QRT data and allow users to easily load and link source data from existing systems. The integrated solutions enable users to quickly and efficiently import SCR calculations from SIIMPLIFY into the QRTs on Solvency II Solutions Tabular platform.

Kim Durniat, partner at Barnett Waddingham, said: "This integration of SIIMPLIFY and Tabular offers the insurance industry a simple cost effective solution for Solvency II data integration and reporting in a familiar excel environment.

The partnership aims to help insurance companies to reap the benefits of an efficient, repeatable and auditable Solvency II reporting framework with consultant implementation and ongoing support."

John Staines, CEO of Solvency II Solutions, added: "By integrating our solutions, insurance firms now have a simple and complete end to end Solvency II reporting solution which takes the hassle out of reporting requirements."

CICA advises on micro captives

The Captive Insurance Companies Association (CICA) has emphasised the importance of using best practices and qualified experts when designing and operating a micro captive, particularly those that use the Internal Revenue Code 831(b) election.

CICA has published a document, which it is following up with a webinar, outlining the steps that businesses must take when setting up a micro captive in the US, to ensure that they do not fall foul of the Internal Revenue Service's (IRS) rules on their tax obligations.

Dennis Harwick, president of CICA, explained: "Well run captive insurance companies play an essential role in risk management and must be designed and operated to achieve risk transfer and risk distribution."

CICA issued the information document to help its members and the public better operate and understand micro captive insurers.

Harwick said: "Our mission is to be the best source of unbiased information, knowledge and leadership for captive insurance decision makers."

According to the document, for business purposes, the micro captive must have a valid non-tax business purpose centered on effective risk management through valid insurance arrangements.

Most micro captives participate in a risk distribution pool to minimise the impact of large losses, according to CICA's document.

The risk pool operator must be able to explain and document the proportionate share of risk being shifted to and from the pool, along with the actuarial basis for determining the premium.

The pool must also have a method of independently reviewing and approving claims, as well as a method for securing their payment.

Micro captives must also engage one or more qualified experts to determine whether they have a mechanism for distributing risk according to the IRS's test for risk distribution.

The ownership structure of the micro captive has to accomplish the objectives of the business owner, including that this ownership structure meets the IRS's test for risk shifting. Micro captives must not just operate as pass-through vehicles for profits to shareholders.

Ohio licenses Imprise Financial

Ohio has licensed protected cell captive insurance company Imprise Financial.

Through its protected cells, Imprise Financial will allow businesses to insure some of their own commercial risks, realise greater control of their risk-management programmes, and achieve long-term financial stability.

Imprise Financial's first protected cell will insure certain contractual liability risk of NWAN, a third-party administrator of service contracts and warranties for automobiles, recreational vehicles and motorcycles.

Ohio governor John Kasich signed legislation in June 2014 allowing businesses to form captives. The state allows the formation of pure captives that can only insure the risks of their parents, protected cell captives, in which each cell has a separate legal identity, and special purpose financial captives, which assume life insurance risks.

The protected cell structure eliminates market-entry barriers that companies typically face when considering a self-insurance programme.

Mary Taylor, director of the Ohio Department of Insurance, commented: "This is a momentous occasion for Ohio and more specifically, for Ohio businesses. Giving businesses the option to form a captive is another tool designed to help them thrive in Ohio."

Risk retention groups financially stable in Q1 2015

Risk retention groups have a great deal of financial stability and remain committed to maintaining adequate capital to handle losses, according to a Demotech report on their Q1 2015 financial results.

During the last five years, cash and invested assets, total admitted assets and policyholders' surplus have increased at a faster rate than total liabilities, according to Demotech.

Douglas Powell, senior financial analyst of Demotech, said the levels of policyholders' surplus have become increasingly important in difficult economic conditions because they allow an insurer to remain solvent when facing uncertain economic conditions.

Since Q1 2011, cash and invested assets have increased 83.4 percent and total admitted assets have increased 64.6 percent. Over a five-year period from Q1 2011 through to Q1 2015, RRGs collectively increased policyholders' surplus by 64.7 percent.

This increase represents the addition of nearly $1.9 billion to policyholders' surplus.

The reported results indicated that RRGs are adequately capitalised in aggregate and are able to remain solvent if faced with adverse economic conditions or increased losses.

Liquidity for Q1 2015 was approximately 70.6 percent. A value less than 100 percent is considered favourable as it indicates that there was more than a dollar of new liquid assets for each dollar or total liabilities.

This also indicates a slight decrease for RRGs collectively as liquidity was reported at 71.9 percent in Q1 2014. This ratio has improved steadily each of the last five years.

Loss and loss adjustment expense (LAE) reserves represent the total reserves for unpaid losses and LAE.

The cash and invest assets to loss and LAE reserves ratio for Q1 2015 was 223.3 percent, a decrease from Q1 2014 when the ratio was 243.7 percent.

Powell said these results indicate that RRGs remain conservative in terms of liquidity.

Despite political and economic uncertainty, RRGs remain financially stable and continue to provide specialised coverage to their insureds.

A.M. Best affirms ratings of Dorinco Reinsurance

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and the issuer credit rating of "a" of Dorinco Reinsurance Company, which is the captive reinsurance company of The Dow Chemical Company.

The ratings reflect Dorinco's continued strong operating performance, balanced risk profile and strong risk-adjusted capitalisation.

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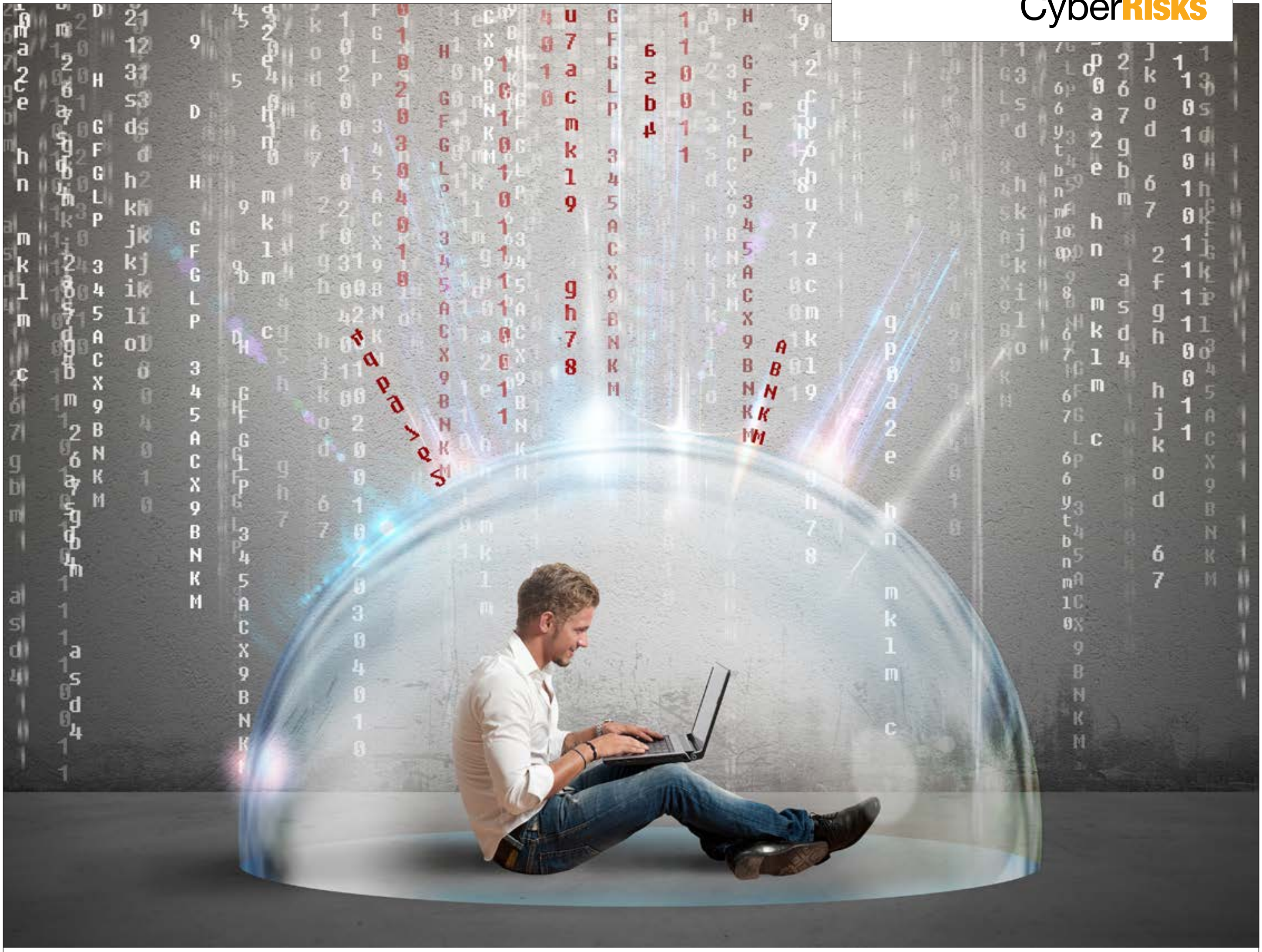


Hope for the best, insure for the worst

Captives need to take a leaf out of the Jack Reacher playbook and order themselves some strong coffee, because they may need to get their retaliation against cyber attacks in first

BECKY BUTCHER REPORTS

The threat of cyber attacks is rising rapidly. A constant source of headlines, the latest victim is infidelity website Ashley Madison. The website, which encourages users to meet like-minded individuals and 'cheat' on their spouses, recently had approximately 37 million personal records stolen. They were subsequently published online, for all the world to see.

At least two other dating sites, Cougar Life and Established Men, which are owned by the same parent group, Avid Life Media, had their data compromised. Along with the actual hacking came threats of further information being released if Ashley Madison and Established Men were not shut down permanently. Avid Life Media is facing a lot of consequences, even if claims for distress are modest. The volume of data stolen and number of individuals affected in this attack could have a critical impact on the company.

Of course, Ashley Madison is not alone.

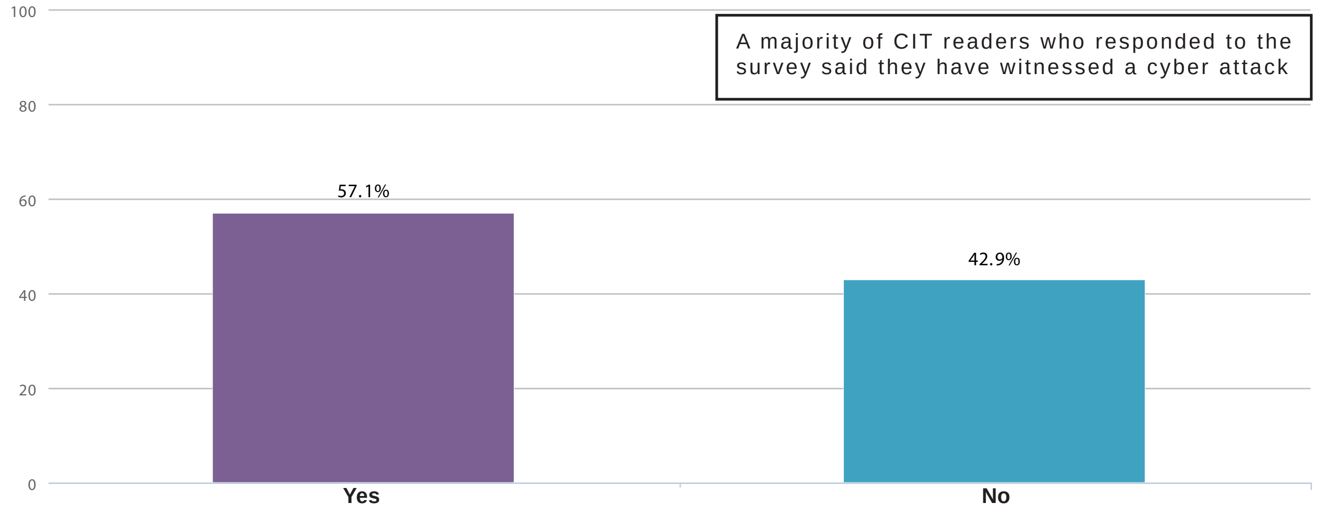
Banking institutions RBS and NatWest also suffered a recent a cyber attack, on what was, for many in the UK, the day they were supposed to receive their salaries. Customers were unable to log on to their online account services for almost an hour, just as monthly cheques were arriving.

The banks, unaware of the identity of the perpetrators, have now been the victims of cyber attacks multiple times over the last few years. This begs the question: what are they doing to protect themselves from a threat that they have so far been unable to avoid?

Size of the prize

PwC recently released a report on the current cyber insurance market, predicting that the global market could grow up to a staggering $5 billion in annual premiums by 2018, and at least $7.5 billion by the end of the decade. Previous research also revealed that 61 percent of business leaders across all industries see cyber attacks as a threat to the growth of their business, and 2014 saw an average of 100,000 global security incidents a day.

CIT Cyber Survey: Has your organisation, or an organisation you work with, ever been the subject of a cyber attack?



Businesses appear to be aware of the cyber threat, and are seeking insurance protection as a final resort to manage the risk, but, as Paul Delbridge, insurance partner at PwC, explained at the time of the report's release: "Given the high costs of coverage, the limits imposed, the tight terms and conditions and the restrictions on whether policyholders can claim, many policyholders are questioning whether their policies are delivering real value."

Delbridge explained that if no action is taken, "there is also a real possibility that overly onerous terms and conditions could invite regulatory action or litigation against insurers".

"As boards become increasingly focused on the need for safeguards against the most damaging cyber attacks, insurers will find their clients questioning how much real value is offered in their current policies. If insurers continue to simply rely on tight blanket policy restrictions and conservative pricing strategies to cushion the uncertainty, they are at serious risk of missing this rare market opportunity to secure high margins in a soft market. If the industry takes too long to innovate, there is a real risk that a disruptor will move in and corner the market with aggressive pricing and more favourable terms."

Captive insurance could be one such innovator, of course, although that too appears to be slow to meet the threat of cyber attacks. According to Aon in 2014, only 1 percent of captive owners are funding cyber risk through their captives. But in May of this year, Marsh reported that the number of captives under its management that wrote cyber liability in 2014 grew by 18 percent, suggesting a slow uptake but an increase nonetheless.

Christopher Lay, president of Marsh Captive Solutions, said in May: "As more companies use data and analytics to better quantify their emerging risks and optimise their retained risk, the utilisation of a captive to finance retained traditional and emerging risk is a logical next step."

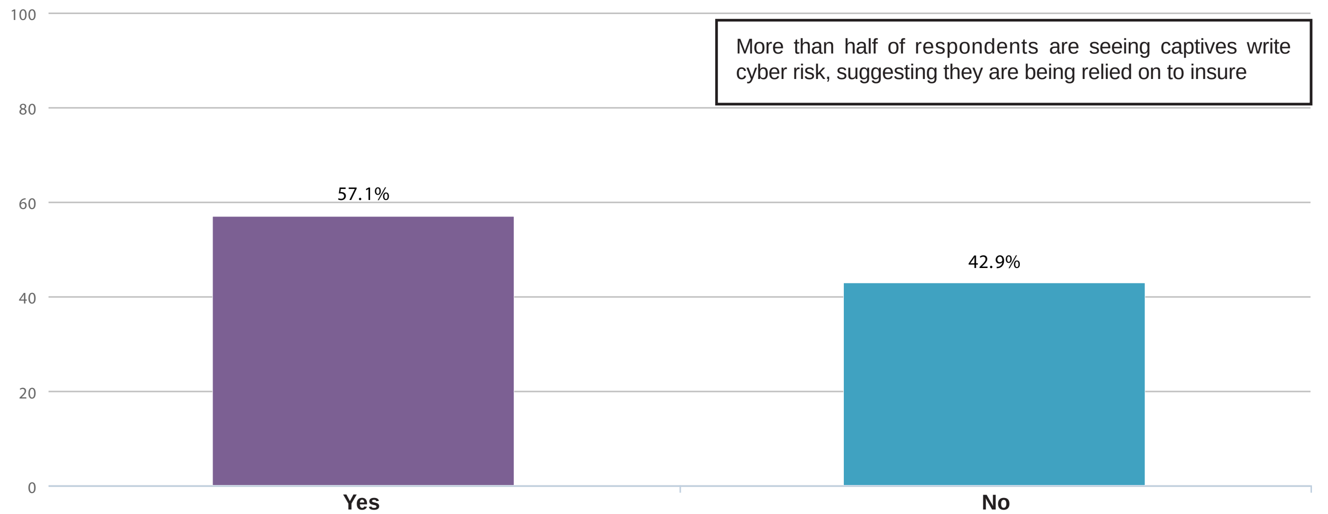
Captives and cyber

Salil Bhalla, head of global fronting in Europe, the Middle East and Africa at AIG, adds: "Cyber is a relatively new product and while only a few captives are currently used to fund cyber risks, we have seen considerable interest from captive owners for placing cyber risks in their captives."

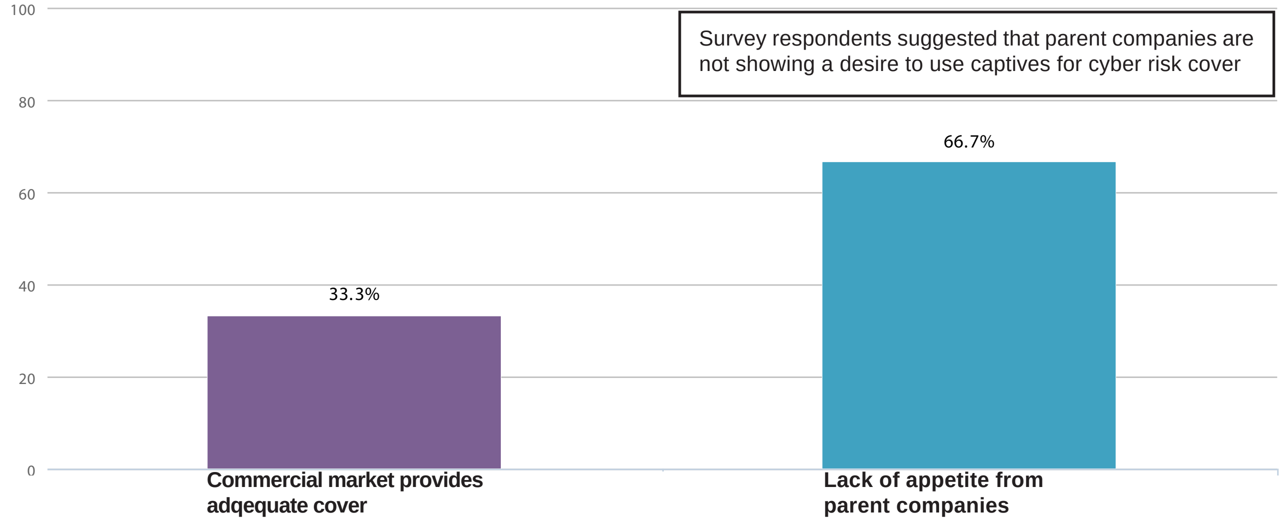
"In the past two years we have seen growth in the number of cyber programmes that we front for captives and expect to see this trend continue.

She expands: "This growth is driven by a number of factors such as the diversity benefits from a Solvency II perspective but also from a desire by risk managers to show that their captives are innovative and provide real value to the parent organisation."

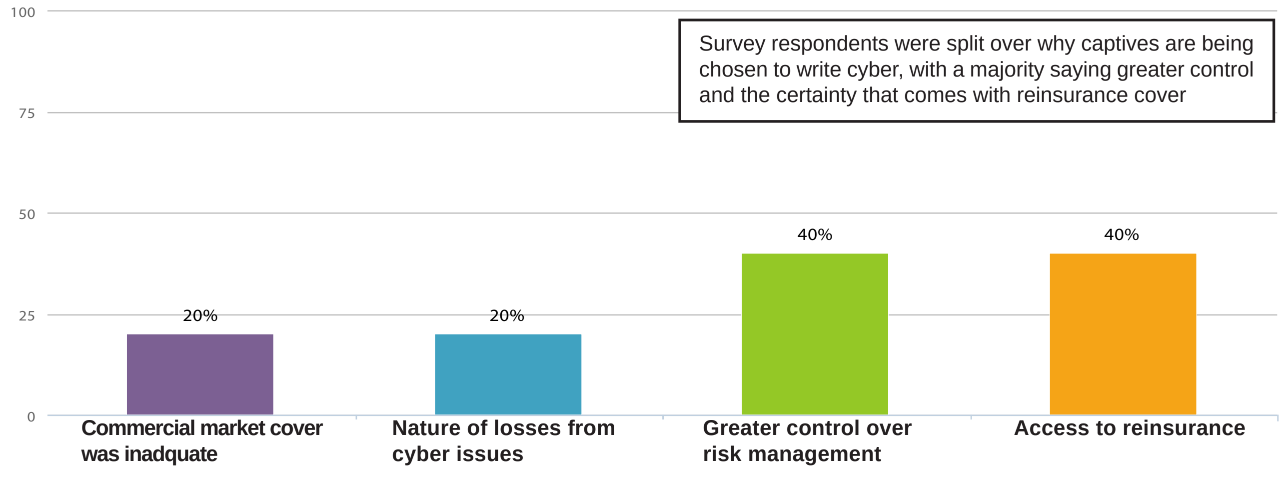
CIT Cyber Survey: Does your captive, or a captive you work with, cover cyber risk?



CIT Cyber Survey: Why was the captive concerned not used for cyber?



CIT Cyber Survey: What was the most important reason for the captive being chosen for cyber risk?



In Vermont, the number of captives writing cyber as increased, and the state now has a standalone entity dedicated to the risk. Sandra Biggleston, director of captive insurance of Vermont Department of Financial Regulation, says: "As corporations and other organisations begin to understand and better evaluate their risk for cyber liability, we may see more captive programmes include cyber coverage."

"Commercial carrier offerings will likely pick up as well, and a captive would still be a good risk management tool for financing a portion of a company's cyber risk."

"In particular, a group captive programme might begin offering cyber coverage as an added benefit to its members."

"If a group captive can service its membership in more innovative ways, membership retention will likely increase, especially given the duration of the continuing soft commercial market cycle."

A cyber subscriber

Companies need to identify the risks of their business before they can tackle the cyber problem, according to Mark Elliott, committee member of the Guernsey International Insurance Association (GIIA).

He says: "If the company doesn't fully understand the risks they face and the measures they have to combat these you are unlikely to explore a self-insurance route."

Ellen Charnely, managing director at Marsh, also believes that companies are not fully aware of their exposures and therefore are unable to measure risks.

"Once they do understand their exposure they then need to ascertain how they wish to manage the risk, do they retain it or do they transfer it, or some combination of the two."

"All of this needs to be evaluated and understood before they can then formalise the funding of any retained cyber risk through a captive."

"Remember that a captive is a formalised mechanism for financing self-insured risk, and not a form of risk transfer. It's important to evaluate what (if any) benefit would accrue to the organisation from placing their cyber exposure into a captive before actually doing so."

Cyber risk is only going to increase in size and will continue to pose a serious threat to government, corporations and individuals around the world.

What's more, data breaches are very difficult to predict and the target of the next cyber attack is unknown.

The best solution is probably to hope for the best but plan for the worst, and many appear to be doing this, only at a slow and steady pace. CIT

Playing where the risk is going to be: using a captive for cyber losses and liability

It was Wayne Gretzky who said a good hockey player plays where the puck is, but a great player plays where the puck is going to be. The same applies to cyber risk, says Frederick Turner of Active Captive Management

It seems like everywhere you look these days—on the news, in articles, on social media, in blogs and in insurance newsletters—there is something written or said about cyber risk and the serious danger that it poses to just about every business, to governmental or company infrastructure, and to both local and world economies. In today's internet savvy and cyber connected world, cyber risk and liability issues loom large and are increasingly prevalent. It's safe to say that of all the many contingencies a company should plan and prepare for, cyber concerns are currently one of the most important issues for any company's management to address.

But understanding cyber risk can be overwhelming as the variety and type of risk classified as 'cyber' in nature is in itself varied, and sometimes obscure. Threats or loss caused by hackers, cyber thieves, competitors or employees misusing, misappropriating, losing or improperly disclosing data or confidential information are just some of the risks companies face.

Expenses associated with cyber-related class actions or other lawsuits, business interruption or data restoration, or regulatory compliance costs in the form of notification and credit monitoring expense, can result in losses valued in the millions. In fact, the financial impact of a cyber breach can be significant. Per a 2013 study conducted by the Ponemon Institute, the average cost per record for a data breach is $188—this study does not include the cost of outside counsel or settlement payments if the breach event winds up being litigated.

Yet, no matter the monetary size of the cyber loss, a cyber claim can have many direct points of impact—on the company financials, intellectual property rights, the day-to-day operation of the company, insurance and risk management, and even customer or third-party confidence in the company and the services it provides. Proactively defining a company's cyber risk as part of a corporate risk management function, where the end result is a cyber loss prevention and safety/mitigation plan, which includes insurance, could markedly reduce the average cost to the company when a cyber breach or loss occurs.

There are many commercial insurance policies on the market nowadays covering cyber risk. But those policies can be less than perfect. So perfect risk management protection against cyber risk has to involve more than just commercial market insurance. In fact, it's often the case that companies should consider alternative risk management in the form of having a captive insure cyber risk.

The way to be a great risk manager when it comes to protection against cyber loss is to have a triangulated risk management programme where the three points of the triangle are: (i) cyber risk management in place at the corporate/company level; (ii) cyber insurance from the commercial market where it's cost effective to bind such coverage and where such coverage exists and fits the risk; and (iii) captive insurance rounding out the insurance programme or replacing the commercial insurance entirely if the commercial market doesn't have the appetite for the risk, isn't appropriately or fully covering it, or where commercial prices are cost prohibitive.

An internal cyber risk management plan

Company management needs to assume responsibility for monitoring the company's points of vulnerability or attack relative to cyber risk. For example, management needs to understand the financial risk to the business if there is a breach of security and data is lost or compromised. A business generally needs to understand the type of information and data it controls and maintains, how valuable it is to the performance and ability of the company to conduct its business, and whether and how the company can absorb costs to cure or correct any data or information breach or loss. This means that company management needs to be proactive in confirming that steps are being taken to identify, prevent, and mitigate against cyber related risk and losses.

Management needs to be committed to understanding all laws and regulation applicable to the company relative to cyber privacy and security and/or data exposures. It also needs to routinely and continually pose questions to senior executives and key decision makers to determine and address the company's preparedness for cyber loss and continue to monitor cyber risk management protocol on a going-forward basis. And management needs to generally understand how the company is insured (or not) for cyber exposures.

Prior to developing any actual cyber risk plan, company management should seek to foster a proactive corporate culture where cyber risk is studied, monitored and understood. This includes a heightened awareness of security risks from senior management through the to the lowliest employee levels and encouraging the timely and accurate reporting of security breaches. The only way for mitigation to work in the event of a cyber breach or loss is for crisis management to begin within hours, rather than days.

This cannot happen unless there is a mitigation plan in place before any such breach occurs. Some oversee cyber risks through the function of the IT committee, whereas others use the audit committee.

Every company today should think about cyber and should understand its risk and how to prevent against it. Just recognising that there is indeed a risk is the first step, then both internal and external resources can be used to develop a comprehensive risk management and response plan. So, what would external resources be? A key resource is insurance coverage.

A solid insurance programme includes captives

Company management also needs to know the extent of a company's insurance relative to cyber risk and loss. This can be easier said than done. Commercial market coverage for cyber risk has been around since the early 1990s, but even today—years in the making—commercial forms can be hit or miss in terms of what is intended to be and then actually covered. Standard ISO-form commercial general liability coverage is not really designed to cover cyber risk and all its iterations, and nowadays these policies typically exclude cyber claims and losses. Many commercial carriers are now writing cyber coverage on very specific and tailored forms, but even then, such forms are still evolving as the risk continues to evolve, with no standard language and generally, no one form that covers all angles of the risk.

One recent example out of an Illinois Appellate Court holds that the claim was excluded under a professional liability policy that offered coverage under a cyber endorsement. The claim involved coverage for costs and fees associated with a class action lawsuit alleging damages due to unsolicited text messages sent to various cell phone customers for discounted medical procedures (Doctors Direct Insurance v David Bochenek, No 1-14-2919, 3 August 2015). In this case, the court held that the policy's US Telephone Consumer Protection Act exclusion applied to the cyber portion of the coverage even though the class action claim clearly fell within the policy's definition of "privacy wrongful act". This can be typical, where exclusions really can be quite extensive and can dramatically narrow the coverage. With commercial cyber, policyholders can pay hefty premiums for what is really pretty thin coverage.

Moreover, commercial market underwriting can often be overwhelming and time consuming for cyber lines. The process can be extensive where insured companies have to 'prove' to the commercial underwriter that they have a risk management plan in place, and in the event that such plan is not in place and coverage is written, this could result in a coverage denial.

Recently, the US Court of Appeals for the Third Circuit ruled in favour of the Federal Trade Commission (FTC v Wyndham Worldwide Corp, No 14-3514, 24 August 2015). The court held that Wyndham's published privacy policy governing how the company safeguarded personal and confidential information must match its actual practices. When the written policy was proven to be a "paper tiger" in that it did not match what was actually happening at the company to protect data and confidential information, the court held Wyndham liable for losses and damages associated with the data breach,. The court found it unfair of Wyndam to have advertised privacy practices in order to attract customers only to fail to actually uphold these practices. Had Wyndham had commercial cyber coverage, its failure to uphold written policies on privacy protection could also have resulted in a denial of any claim made to the commercial carrier, if the privacy practices were disclosed to the carrier as part of underwriting and if they were a condition precedent to coverage.

> **"Businesses should work with commercial brokers to define and negotiate commercial coverage as a starting point and then could look to a captive to write cyber coverage to fill in gaps in the commercial market policy"**

What all this largely means is that even those companies that seek to purchase commercial market cyber coverage, and in the end do obtain some form of commercial cyber line, are likely still self-insuring much of this kind of risk. Of course, businesses should work with commercial brokers to define and negotiate commercial coverage as a starting point and then could look to a captive to write cyber coverage to fill in gaps in the commercial market policy, covering what cannot be obtained from that market or what is excluded under the commercial lines, or even covering an excess layer. In the world of cyber, being able to write high limits excess to a first dollar defending commercial primary could be a nice idea, enabling the insured to have higher limits for a cyber loss at a lower cost and transfer the risk to both a commercial carrier and a captive programme.

A captive could also write the cyber coverage on either a third- or a first-party basis and could create a highly tailored policy that perfectly fits the company's risk, which is different than what the commercial market would be able to do and is key to this line of cover because the risk itself can be so individualised.

Further, in the captive world, arms-length premium pricing models need only contemplate the risk of the entities inside the corporate 'family tree'—this can make the coverage generally far more cost effective, even for those members of the family that have the greater risk. Whereas in the commercial world, many forms of cyber coverage are just expensive, perhaps cost prohibitively so, especially when you consider how many lines an insured might be required to purchase out of the commercial market to satisfy outside parties that require rated, commercial carriers.

So, if the insured has to carry a heavy programme load of rated general liability or other lines, there might not be much room in the budget to pay for an expensive cyber line on top of that, even if such a line is needed. A captive could literally come to the rescue in that situation, enabling the insured to have it all, relative to insurance coverage, and build out a complete coverage programme utilising both commercial and captive insurance.

Where's the risk going to be?

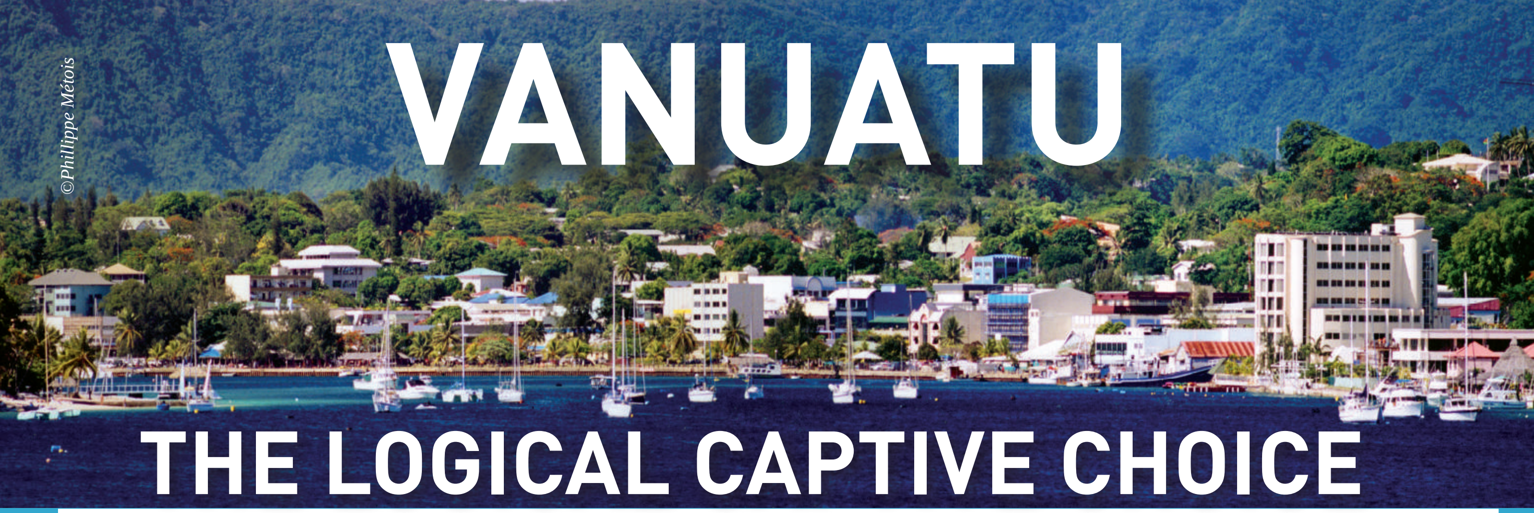
Managing cyber risk means that a company implements cyber best practices that start with company management and an overall awareness of the risk itself, then the company can and should develop a contingency and response plan in the event of a cyber incident.

Risk management should also ensure that the company has a thorough insurance programme in place as protection against fortuitous or unplanned cyber loss. Even the best laid cyber risk mitigation or management plans can nevertheless result in loss, liability or damage.

Being a good cyber risk manager involves good contingency planning. Being a great cyber risk manager involves insurance as part of that contingency planning where the programme includes not just commercial insurance, but also captive insurance rounding out the programme and filling in coverage for those troublesome areas of risk where the commercial market cannot suffice to cover (or affordably cover) all angles of the risk.

Play your insurance where the risk is going to be—plan ahead. With cyber, planning ahead is everything. CIT

Frederick Turner
Founder
Active Captive Management



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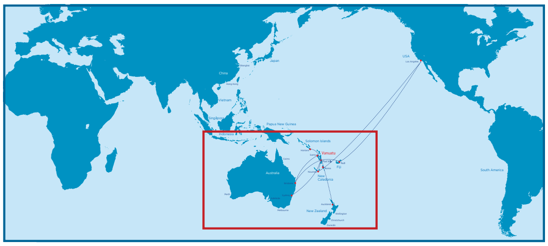

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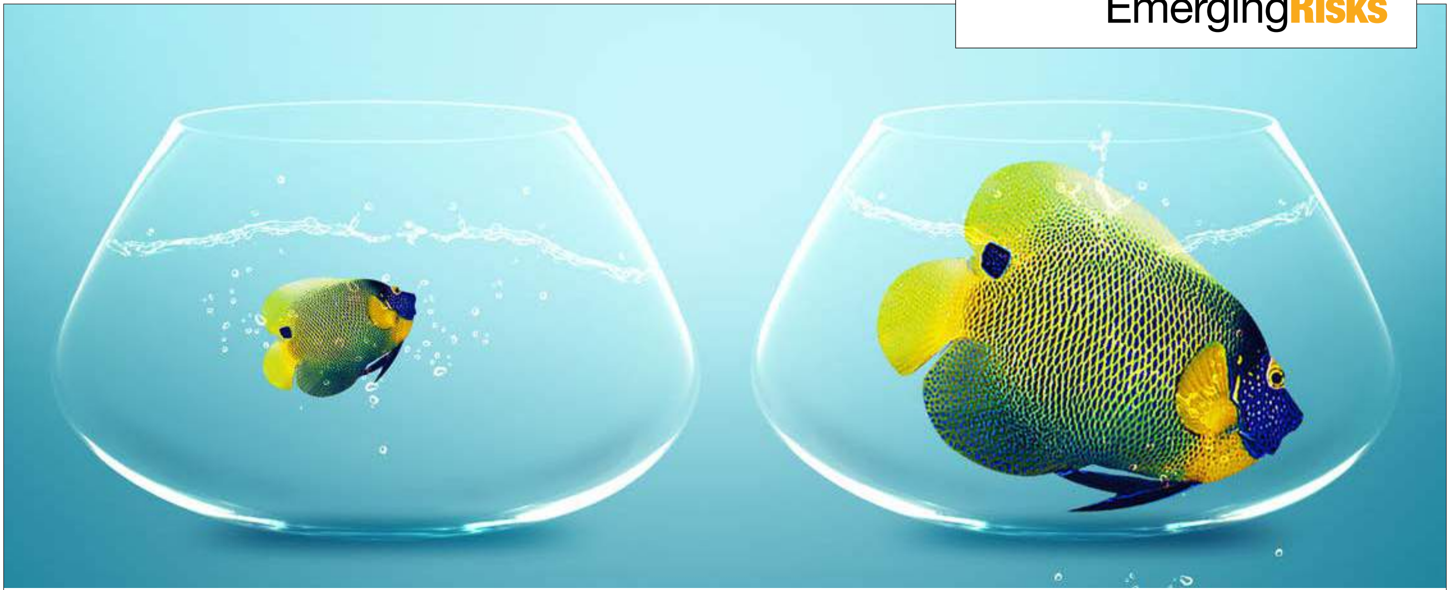

A ‘growth industry’ for captive insurance?

Certain insurers are shying away from the legal marijuana industry, leaving a gap that could be filled by captives. Michael Schroeder of Roundstone Management examines the issues surrounding this controversial topic

One of the primary reasons a captive insurance company is formed is a lack of capacity in the traditional insurance market. Where traditional insurers raise their premiums, reduce their coverage or simply do not entertain the underwriting of certain risks, you are certain to find the captive insurance industry. Examples of past limitations in market capacity that led to an increase in captive formations include medical malpractice captives in the 1980s, professional liability coverage for nursing homes in the early 2000s and, more recently, trucking liability captives.

Captive insurers offer an alternative to the traditional market, especially when that market steps away from an entire class of business. This is what happened over the summer when Lloyd’s instructed its underwriters to cease issuing new policies and to not renew existing policies for businesses involved in the marijuana industry.

Thousands of dispensaries in California and Colorado were suddenly searching for new business operations coverage. Prior to its exit, Lloyd’s was the largest writer of marijuana-related business coverage. Opinions of industry participants maintain that they experienced favorable underwriting outcomes with outsized rates.

More than 20 US states have established medical marijuana regulatory regimes. Four have legalised marijuana under state recreational marijuana laws. Still, businesses involved in the production and distribution of marijuana in states where medical and recreational use is legal operate in a grey market because federal law does not yet recognise the legality of such enterprises. Banking and insurance needs for these businesses pose substantial challenges, as both involve significant regulation on a state and federal level. Yet, these businesses have legitimate exposures that require coverage should a loss arise. What to do when insurers abstain or exit the space entirely? Many businesses are turning to the captive industry. If no one else will insure your business, then why not start your own insurance company? After all, the one requirement for forming a captive insurance company is capital and these businesses appear to have plenty.

The coverage

The coverages needed by marijuana-related businesses are not unique to the insurance industry. Coverage, such as general liability, property, surety, workers’ compensation and business interruption, are all relevant to a business producing, manufacturing, or distributing cannabis-related products. Any traditional insurance underwriter should be able to quickly assess and rate these risks. They do so for barbershops and manufacturers of widgets every day.

Companies selling into the marijuana industry also confront insurance challenges. What does a supplier of equipment, a landlord or finance company do when it discovers the purchaser of its goods or services is lacking basic insurance coverage? Captive insurance company solutions appear to be a viable alternative. After all, what vendor wants to place equipment with another business that is unable to show proof of insurance? What happens when a run-of-the-mill fire or theft destroys the financed property that is not covered by the insurance of the business possessing the property? The answer is obvious—most vendors quickly look to obtain their own coverage, either through the traditional market or an alternative, such as a captive insurance facility. Captives that indemnify vendors for their uninsured exposures that arise when selling into the marijuana industry are growing. Imagine a process and coverage form similar to collateral protection insurance you see in the auto and home financing markets.

The feds

The marijuana industry presents many businesses with an interesting question: what can or should legitimate businesses do when confronted with the fact that a customer is operating in the state-legalised marijuana industry? While legal according to the state of the business’ domicile, the federal government maintains laws, namely the Controlled Substance Act, directly prohibiting the business’ operations (ie, marijuana production and sale). Legitimate service providers and suppliers of essential business tools, such as computers or garbage disposal, struggle to determine how to proceed. Likewise, insurance providers are confronted with the question of what they can or cannot do when they get a call from a business operating in the marijuana industry. Fortunately, the federal government recognised the quandary and offered some insight for businesses looking to maintain compliance with federal law when confronted with a state-legalised marijuana business customer. The state-federal conflict created by state marijuana laws has been the subject of four different Department of Justice (DOJ) memoranda that date back to 2009. The memoranda articulate the DOJ's approach to the state-federal conflict by confirming marijuana remains a dangerous, illegal drug under federal law, but also indicating that the federal government will not pursue legal challenges against states so long as the state and local governments maintain strict regulatory enforcement controls.

The DOJ went further in its 2013 memorandum and instructed federal prosecutors not to consider the size or commercial nature of a marijuana business alone in determining whether to pursue enforcement of federal law.

Rather, the DOJ identified several factors that should be considered when deciding to pursue a civil or criminal enforcement action for violation of federal law.

The activities that are the priority or focus of federal enforcement include preventing:

- The distribution of marijuana to minors;
- The sale of marijuana to criminal enterprises, gangs, and cartels;
- The diversion of marijuana from states where it is legal under state law in some form to other states;
- State-authorised marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Violence and the use of firearms in cultivation and distribution of marijuana;
- Drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- The growing of marijuana on public lands and attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Marijuana possession or use on federal property.

Additionally, because federal law continues to prohibit the deposit or withdrawal of proceeds derived from the distribution of marijuana and any other controlled substance, it is not surprising that state-legalised marijuana providers have historically experienced difficulty securing banking services.

Recently, however, the US Treasury has issued guidance to banks, incorporating the DOJ's enforcement priority memoranda and directing financial institutions that provide services to marijuana-related businesses to file specific transactional forms.

One of these is used when the institution determines, after the exercise of due diligence, that its customer is not engaged in any of the activities that violate state law, or that would implicate the DOJ's enforcement priorities listed above.

It would appear that the federal government has essentially given the 'green light' to banking institutions to handle the monies associated with the state-legalised marijuana industry, albeit not without strict, and arguably burdensome, regulations.

Is the above guidance enough to encourage the standard insurance market to participate in covering the marijuana industry? Will other markets after Lloyd's fill the void with policies sufficient to cover the real life exposures of a business producing or distributing cannabis products?

This remains to be seen, but no doubt the captive industry can offer solutions. CIT

Michael Schroeder
President
Roundstone Management

Seeking certainty in uncertain times

For captives, aggregate stop-loss programmes can deliver a greater degree of financial certainty in an increasingly volatile risk environment, says Todd Cunningham of Zurich Global Corporate in North America

MARK DUGDALE REPORTS

What does Zurich's aggregate stop-loss programme offer to captives?

The programme does two things: firstly, it may cap off volatility on a catastrophic basis, through excess reinsurance for any number of risks, including property, casualty and cyber. Secondly, it may have a stop-loss feature, which is a cross-class aggregate, that can cap the frequency of severity in the risks the captive retains. This second feature provides the captive manager with greater certainty in the captive's worst year.

What do you mean by 'worst year'?

The worst year could be if the captive had a loss frequency or severity issue. The stop-loss capability of the programme would deliver certainty to the financial performance of the captive. It's not unlike what a general insurance company would do with reinsurance to manage its catastrophe exposure and reduce the volatility in its portfolio.

How important is that certainty to captive managers?

I think the last thing a risk manager wants to do is to have to go to the CFO and request more cash to cover the kind of event we're talking about. Captives are funded by their parents with surplus, and that surplus needs to be balanced with the risks that are taken on. It's tantamount to dipping into your savings—that capital really should be safe and sound and not subject to tremendous amounts of pressure.

How much of this pressure on capital would you say is regulatory driven?

With Solvency II being implemented in Europe at the beginning of 2016, more pressure is being applied to a captive's capital. Captive managers, who are not financial professionals but risk managers first and foremost, want to know how their captives are going to handle surplus in terms of insurance cover and potential risks.

They are looking at the potential for bolstering frequency of loss or severity as a means of meeting capital requirements. More and more, they are looking at multi-line, multi-year integrated risk programmes to cap off the worst day, which in turn alleviates some the regulatory pressure.

How are captive insurers employing these programmes?

Captive managers are often being asked by their owners to find ways of putting multiple risks under one roof, so to speak, so they may look to embed their employee benefits, long-term disability and other similar coverages in the programme.

Doing this helps to minimise volatility because different non-correlated risks are being brought in to the captive, and at the same time, there may be some capital relief under provisions of Solvency II because they are non-correlated risks.

What about emerging risks?

I think captive managers are being called upon to look at risks beyond the typical exposures and consider what the parent organisation is facing, be it cyber, brand or reputational. It could also depend on the segment. A utility, for example, may face entirely different exposures than say a manufacturer.

The captive needs to determine what risks are appropriate to reinsure and whether to retain them or to look for a retrocessional reinsurer to spread the risk. Stop-loss programmes can be adapted to deal with these divergent risk needs.

With more emerging risks, such as a serious cyber attack, an organisation may dismiss the notion of purchasing hundreds of millions of dollars of coverage because it's a rare event. Instead, it makes sense to put that risk into a captive, so that the organisation can finance that potentially sizeable loss if and when it happens. But when you introduce emerging risks into a captive, you introduce more volatility.

Therefore, giving the captive a large amount of net capacity and a large limit could act as a stabiliser in the event of a very low probability but high severity catastrophe. This is where these programmes can really function through the stop-loss feature, which ringfences some of those risks being put into the captive. CIT

Todd Cunningham
Head of strategic risk solutions
Zurich Global Corporate in North America

Stronger together, but different apart

Joining a group captive can be a rewarding decision, but it's not one to be entered into lightly, says Brenda Pickering of USA Risk Group (BVI)

One of the basic concepts of insurance is pooling risk. Any large insurance company relies on the distribution of risk or 'the law of large numbers' to (hopefully) have enough individual risks to be able to take in more premium than it pays out in claims.

For larger entities such as Fortune 500 companies, the insurance risks within their own organisations are generally substantial and diverse enough to support a wholly owned captive. These companies have significant financial resources and risk management infrastructure to efficiently manage their own risk.

The group captive concept takes a similar approach but on a smaller scale. Many smaller companies may see a captive as a potential benefit for their organisations. However, they lack sufficient risk diversification and/or risk management infrastructure to support a captive on their own. This is where the group captive comes in.

When several like-minded organisations can come together to share risk and resources, a captive solution becomes more viable. So, for a group captive, the five key elements of a captive, namely, stability of insurance cost, stability of insurance coverage, access to the reinsurance market, focus on risk and loss control, and retention of premiums and the ability to earn underwriting profits and investments, apply as follows:

Stability of insurance cost: this advantage over a single parent captive is that the group captive has the ability to stabilise insurance cost through risk sharing of all participants and therefore, minimising the cost of insurance through pricing and reinsurance.

Stability of insurance coverage: this means that the premiums are taken from the participants own loss experience, which they have the ability to control.

Access to the reinsurance market: for certain coverages, such as property and group health stop-loss, access to reinsurance markets can be critical. By forming a group, entities can gain buying power that would be unavailable on an individual basis.

Focus on risk and loss control: companies can share risk management resources such as loss control consultants, data analytics and risk management information systems.

The cost for some of these resources would be prohibitive on an individual basis but become cost efficient when shared with multiple companies.

Retention of premiums and the ability earn underwriting profits and investments: if the group is able to efficiently manage the combined risks, then members retain the underwriting profits that would otherwise go to commercial insurance companies.

What type of groups can be formed?

The group captive can take two basic forms: homogenous or heterogeneous. In a homogeneous group, the entities making up the captive come from a similar, if not identical, industry such as roofing, food distribution or nursing homes.

While there may be some slight variation within the individual operations, all of the group members will share some key characteristics.

The potential benefits of this structure include: the ability to apply standard underwriting criteria across the group; the ability to apply standard loss control and claim management resources; and member familiarity with industry facilitates focus on 'best-in-class' operations.

Potential drawbacks to this structure include: a lack of risk diversification; an economic downturn could affect all members at once; a mass recall or other catastrophic exposure could affect many members; competitors may refuse to participate together; and insufficient number of qualified companies within the industry.

In the heterogeneous structure, companies from a variety of industries join together to form the group. Unlike the homogeneous group, the members may have little in common, either operationally or in terms of their risk profile.

Potential benefits to this structure include: more risk diversification; industry/geographic variety; less exposure to industry-specific risk; the ability to draw potential members from a much larger pool of entities; and the ability to learn from different industries and adopt new loss control techniques.

Possible drawbacks to this structure include: the need to apply a variety of underwriting criteria; it may be difficult to efficiently share loss control and claim management solutions due to varying needs of members; and member cohesion may not be as strong.

What type of risk is shared?

The type of risks can vary from group to group. However, the coverages most commonly written through group captives are worker's compensation, general liability and auto liability. Group captives may write one or all of those coverages. Additional coverages sometimes written through group captives include auto physical damage, commercial property, and group health stop-loss, which is now becoming more common.

How much risk is assumed?

The amount of risk assumed varies from programme to programme. Most commonly, group captives assume per claim risk of $250,000 to $500,000. Above that amount, group captives will have reinsurance for catastrophic claims. Most group captives also purchase aggregate coverage, which protects the group in the event of adverse loss frequency.

How is risk shared?

In general, a group captive risk in a group captive can be shared either pro-rata or hierarchically.

In a pro-rata structure, risk is shared among the group based on their overall share of the programme. For example, if there are 10 members with equal premium, each will have 10 percent of the risk. If there are 10 members but one member has 25 percent of the premium, they will assume the same percentage of the risk. This form of risk sharing may be the easiest to apply and possibly the most equitable, assuming the premium accurately reflects individual loss experience.

In a hierarchical risk sharing structure, each member assumes a combination of its own risk and that of the group. For example, if the group captive has a $250,000 retention, each individual member may be responsible for the first $100,000 for each claim it incurs and the group shares risk for all claims between $100,000 and $250,000.

This structure is often referred to as an 'A/B fund' where the 'A' fund is the individual retained risk and the 'B' fund is the shared layer of risk.

How are group captives owned and governed?

Ownership is generally pro-rata, based on the amount of premium a company contributes to the group. Since risk is usually shared pro-rata, this is the most equitable way to return underwriting profits to the owners. If profits were to be shared evenly, members with lower premiums may receive an inequitable amount of the profits while the higher premium paying members assume more of the underwriting risk.

While ownership may be pro-rata, governance is typically more evenly distributed. Different classes of shares may be issued to account for the amount of premium paid into the group captive, but in most group captives, each member will receive one share of voting stock regardless of overall percentage of ownership.

While this may seem unfair, this ensures that all members have an equal say in the operation of the captive and interests remain aligned. Members are fully aware of the structure going in.

In order to ensure the optimal performance of the captive, group members must develop guidelines and procedures for all of the key operational areas. The owners are able to determine the best course of action for the captive by selecting a board to oversee the day-to-day operation of the company. The board's tasks will include underwriting, loss control, claim management, finance and auditing.

Depending on the size of group, individual committees may be formed to oversee some or all of these areas. These committees are often the backbone of the captive by making financial decisions and investment with the backing of the board of directors to determine the long-term goals of the captive.

Group captives can be a highly effective risk management tool for companies that are interested in participating in a captive, but may either be too small to form their own captive or would like the benefit of more risk distribution and being able to share best practices with other companies.

Group captives can be structured in a variety of different ways in terms of who can participate, which risks are covered, how risk is shared and how much risk is assumed.

Participation in a group captive can involve a significant financial commitment and a potential for financial loss. When a company is considering joining a group captive, it needs to take a number of factors into consideration.

With the variety of group captive options available, it is critical for potential members to properly evaluate the merits of each programme and structure.

The prospective member needs to understand the terms of participation and the financial implications should they decide to leave the programme. It should review captive financials and know who is participating in the group and how each member is underwritten.

Successful group captives typically have highly engaged owners who actively oversee the various aspects of the captive operations to ensure optimal performance. A prospective member should ask to attend a board meeting.

Are the members active and engaged? Or do service providers seem to be calling the shots? Joining a group captive can be a rewarding decision, but one not to be entered into lightly. **CIT**

Brenda Pickering
Account manager
USA Risk Group (BVI)

Solvency II and you

With not long to go until Solvency II's 1 January 2016 deadline, insurers are going through the last stages of implementation in time for the big day

BECKY BUTCHER REPORTS

With pressure mounting in Europe in the run up to 1 January 2016, when Solvency II will be fully implemented, Insurance Europe recently conducted a survey to see how insurers are progressing.

The survey revealed that although many insurers are making good progress, a fair number are concerned about the pressure they face due to additional last-minute requirements being imposed in the run-up to the regime coming into force.

The survey, which covered companies that account for 90 percent of European insurance premium, found a clear majority are making good progress in implementing the first two pillars of Solvency II. Positive results uncovered that the majority of insurers feel that risk management and governance have already improved as a result of the introduction of the new regime.

But many respondents were still concerned that the final version of the quantitative reporting templates, which insurers need to comply with for the third pillar of Solvency II, will only be adopted by the European Commission in September, just four months ahead of when the new regime starts.

The head of prudential regulation at Insurance Europe, Igotz Aubin, says: "It is encouraging to see that Europe's insurers have made such substantial progress in their journey towards implementing Solvency II, especially given that this task has been completed during a particularly challenging time for the industry. However, this survey has also revealed a number of serious issues that need to be acknowledged."

The concern keeping insurers up at night is that most national supervisors are intending to fully comply with approximately 700 guidelines issued by the European Insurance and Occupational Pensions Authority (EIOPA). To add to the pressure, the guidelines are going to add approximately 1,100 pages to Solvency II and increase the implementation burden.

The work to comply with further additional requirements set by member states, which augment Solvency II, is slowing down the implementation process, with several respondents reporting that their member state is "gold plating" Solvency II when transposing it into national law.

Due to the volume of items that require approval from supervisors under Solvency II, a flurry of applications for approval could be submitted at a time when supervisors' resources are already considerably stretched.

The extensive documentation requirements are also delaying the approval process of internal models, with nearly all respondents warning that supervisors' demands in this area are too burdensome.

Since the implementation process of Solvency II began, insurers are finding that risk management has evolved.

But according to Aubin, Solvency II "has become very much a rule-based system and extremely expensive to implement and operate". He argues that even though the industry is pleased that risk management has been improved, the enhancement could have been achieved without Solvency II becoming quite so dogmatic.

Aubin believes that this requires them to allocate a huge amount of resources and so, given the challenging environment that they face externally, the fact that so many insurers are doing so well really stands as testament to the European insurance industry's commitment to making Solvency II work as intended.

But Solvency II has imposed a huge drain on the resources of insurers of all sizes.

According to Aubin: "Some very small companies will not actually be covered by Solvency II, so it depends on the individual company as to the exact effect that Solvency II will have."

Captive connotations

Solvency II is meant to establish a common ground between regulatory requirements throughout the EU, according to Dirk Wegener, vice president of the Federation of European Risk Management Associations (FERMA).

"Ideally, there will be no difference between EU-level and local laws. Although, realistically we will see local interpretations of the EU-regulations, and moreover, their application in the regulation process as such may be different."

He believes that captives are in a good position to ride out the EU-national mismatch, as they are mostly domiciled in one location and do not operate subsidiaries as opposed to multinational companies.

However, he says, inter-country mismatches are a concern and expected to be at least an additional cost burden.

European insurers had €9.9 trillion in assets under management in 2014, according to Insurance Europe, and Solvency II could exaggerate the risk that insurers' long-term investments present.

This would make it unnecessarily expensive for insurers to continue making these investments, which will limit their ability to continue delivering such a significant contribution to society.

Aubin says: "We hope that, as part of the EU investment plan to stimulate growth in Europe, the European Commission will adjust the calibration of capital charges on insurers' long-term investments under Solvency II so that they are commensurate with the actual risk posed by these investments."

He adds: "We also ask that regulators and supervisors stop imposing additional requirements on insurers at a time when they only have a few months left to implement Solvency II." CIT


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New horizons

Vanuatu is a friendly jurisdiction willing and ready to do business, according to Kevin Lindsay, chairman of the domicile's captive insurance association

In March 2015, our beautiful island country Vanuatu was hammered by tropical Cyclone Pam. A category five cyclone, it was the largest in recorded history to ever hit our South West Pacific Islands. Port Vila, our capital, came through relatively unscathed, an endorsement of our sturdy infrastructure. Communications with our offshore clients were not disrupted and it was business as usual.

The event did, however, provide a stark reminder of the impact that a 'one-off' event can have. It also provided a dramatic illustration of the dangers that can be avoided by critically examining your risk protection programme on an ongoing basis. An appropriately tailored captive insurance programme should be an essential part of that thought process. Incorporating your capital insurance entity in Vanuatu presents a number of benefits and advantages.

Since its beginnings as a financial centre in the 1970s, Vanuatu has been at the forefront of commercially driven legislative reform. Whether you are seeking to establish a captive programme or converting from another jurisdiction, we can facilitate the process easily and seamlessly.

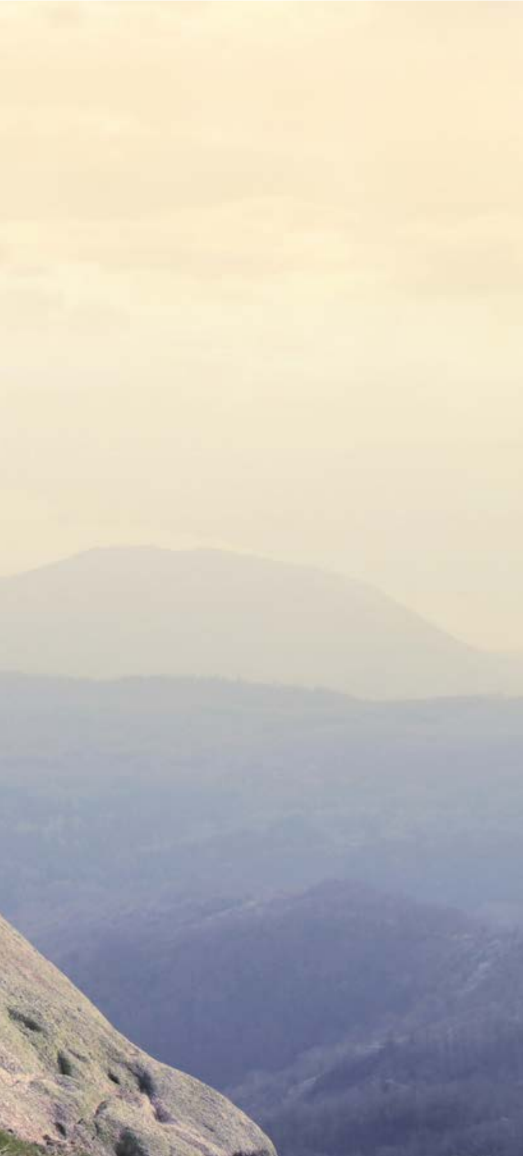
We are an accessible, vibrant and reputable domicile. Our regulators and legislators work with our licensed captive managers to enable them to achieve their client's objectives. Our captive clients benefit from this proactive approach.

Flexibility for captives

Vanuatu's captive legislation has been purposely designed to offer a full suite of insurance options including incorporated insurance companies and incorporated and protected cells.

Capital requirements and reporting systems are similar to other well regulated offshore jurisdictions. As in other jurisdictions, resident insurance managers, licensed by the regulator, are required to manage captives.

A significant feature of Vanuatu's legislation is its ability to deliver flexibility while understanding the challenges faced and outcomes sought by the captive insurance industry.



Although flexible and accessible, our regulators must be satisfied that the reputation of any new applicant for a licence will add to the credibility and integrity of our financial service industry.

It is this adherence to prudent regulation that has maintained the confidence of our international client base in Vanuatu as a business-friendly environment. Minimal compliance costs provide an accessible and stable platform from which to launch any captive insurance programme. Some of the captive options are detailed below.

PCCs and ICCs

Until recently, the path most travelled by risk managers and their service providers was to undertake a feasibility study on incorporating a separate parent captive company with the consequence that the protected cell company (PCC) and incorporated cell company (ICC) structures were overlooked as options. Given that risk managers face the ongoing challenge of keeping their corporate captive structure 'fit for purpose', it is surprising how frequently PCCs and/or ICCs are excluded from a risk manager's potential arsenal.

There are two possible reasons for this trend. For one, not every jurisdiction has a regulatory environment that is conducive to the effective operation of PCCs and ICCs. However, even in those jurisdictions that do, risk managers and their advisors may not be fully aware of the potential uses a PCC or ICC has, beyond the most conventional of scenarios.

Vanuatu and the professional advisors that operate within it are attuned to these issues.

For captive owners and sponsors, PCCs and ICCs can offer significant economies of scale: (i) a single board of directors; (ii) consolidated capital, accounting, auditing, management and reporting protocols; (iii) reduced lead in time to establish the captive; and (iv) reduced client management time, energy and capital.

Financial reporting around cell structures can present challenges and this highlights the need to select a service provider that has a good track record in managing cells. The lessons from our own recent ICC experience have been as follows.

Having decided that the ICC was the appropriate structure to house certain risks, the first step was to present the regulator with the draft application for one captive licence for the ICC setting out one business plan for each of its three incorporated cells. The regulator approved the one captive licence along with written approval for each incorporated cell.

In its business plan, the client identified a risk class to be written in an additional cell that would come on-stream at a future point in time, if and when market conditions allowed. As the client already had the captive licence issued and business plan approved, the directors of the ICC were in a position to create and activate the additional incorporated cell when convenient for them, without having to reapply for approval.

The most practical advantage for the client was that each incorporated cell, with its own separate legal entity, could contract in its own right. Each incorporated cell, having its own legal identity and limited liability, was easily understood and allowed the client to have confidence in the architecture of the arrangement being implemented.

The PCC, by contrast, offers a diluted form of separate identity and liability that is unfamiliar to many potential clients.

The directors of the ICC (the core) and each incorporated cell were the same, giving rise to 'governance' economies of scale. The ICC can also commercially (and conveniently) loan, if needed, additional risk capital to each incorporated cell.

Furthermore, the client's business plan, as signed off by the regulator, identified the option to establish additional incorporated cells in the future and thereby created flexibility and certainty for the client. The client had a tidy arrangement with one captive licence for the ICC and its cells (standard in Vanuatu) with no cell fees resulting in no additional regulatory cost.

Agency captives

This type of captive can be described as "formed and owned by one or more independent insurance agents and or insurance brokers to write high quality risks that they control".

I have managed a variety of agency captives. In each case the advantages have been: (i) the agent or broker has influence and control over the book of business that would otherwise be under the sole dictate of the insurer; (ii) the convenience of writing business 'in-house'; (iii) creating an insurance product that is unique and meets all the requirements of the client; (iv) flexibility around the scope of coverage and pricing; and (v) to cement their market position.

The key to success is to deal with agents and brokers who have the combination of the entrepreneurial spirit, skill, knowledge, experience and reputation both with insurers and clients. Interestingly, most of the successful agents and brokers I have come across possess all of these traits.

Finally, as with any captive programme, there is the need by them to commit and buy-in to understand any downsides as well as the benefits.

Vanuatu is a friendly jurisdiction willing and ready to do business. Given the many options available, the appropriate vehicle for forming a captive and the specific architecture of that programme is complex. The simple starting point for a corporate or small- and medium-sized client, agent or broker is to consider all structures and thereby create new horizons. CIT

Kevin Lindsay
Chairman of the Vanuatu Captive Insurance Association
President and CEO of Riskman International

Crystal clear

There are many advantages to domiciling in the Bahamas. Aliya Allen of the Bahamas Financial Services Board explains

More than 80 years of thought, effort and cooperation have produced ideal conditions for the efficient management of wealth in the Bahamas—in comfort and style.

Its mature financial services industry, established infrastructure, progressive government, tax neutral environment and luxury lifestyle all have been carefully cultivated to satisfy the specific needs of the most exclusive clientele.

The advantages of doing business in the Bahamas are as clear as the crystal waters surrounding the 700 islands of the archipelago.

Strategic location

The Bahamas is situated at the crossroads of the Americas, just 65 miles off the east coast of Florida, and on the same time zone as New York and Toronto.

It is an ideal hub for regional investment and business in the Eastern US and Canada, and much of Central and South America, offering a favourable location for ownership of intangible assets, and the operation of corporate offices and businesses involved in international trade.

Political and economic stability

The Bahamas has an outstanding record of political and economic stability, progress and stewardship, with more than 285 years of uninterrupted parliamentary democracy.

It has been an independent nation since 1973, and retains a Westminster-based system of government and an English-based legal system. It maintains a high ranking for civil liberties and political rights from the World Bank.

Regulation

The Bahamas encourages the growth of its financial sector through adherence to internationally accepted regulatory principles, and efficiency in their administration. Independence is maintained through the separation of roles of policymakers and regulators.

Regulation and regulators are subject to independent assessments by the Caribbean Financial Action Task and the International Monetary Fund.

Wealth and asset management options

The Bahamas offers owners of capital a broad choice of financial institutions that deliver myriad services, including banking, private banking and trust services, investment fund administration, capital markets, investment advisory services, accounting and legal services, ecommerce, insurance, and corporate and maritime services.

It is home to more than 250 licensed banks and trust companies including 16 of the top 100 global banks. The Bahamas is a favourable jurisdiction for the establishment of family offices, which help wealthy families achieve their goals while dealing with increased regulations, and complex issues of taxation, distribution planning and charitable giving.

The range of professional investment management services available in the Bahamas continues to grow. There are more than 145 broker-dealers and investment advisory firms that offer investment management services, custodial services, corporate services and registrar and transfer agent services. More than 60 fund administrators provide fund administration, corporate services and registrar and transfer agency services. In excess of 800 funds are licensed in the Bahamas, with assets under management totalling more than $135 billion.

Taxation

The Bahamas remains committed to a tax neutral platform upon which international persons receive the same tax benefits as Bahamians. The Bahamas adheres to the principle that persons have a right to privacy with respect to the conduct of their affairs.

As such, it will only share information on agreed and transparent protocols under bilateral agreements to which it is a party.

Investment policy and incentives

The government is committed to building an economic environment in which free enterprise can flourish. Its National Investment Policy is designed to support an investment-friendly climate and complements Bahamian and overseas investments. Investors may acquire publicly-owned lands for approved developments on concessionary terms, and lease low-cost industrial space.

People

The Bahamas has a highly educated local workforce and a long tenure in financial services excellence, which has created a deep pool of skill and experience that is recognised and trusted worldwide. With more than 6,000 experienced financial professionals committed to the local community, clients can expect to build deeper and more lasting relationships and receive more consistent service in the Bahamas than in locations largely dependent upon imported skills.

Public-private sector partnership and innovation

Government and business interests in the Bahamas act in close partnership to respond to market needs and at the same time adhere to international standards. Spearheaded by the Bahamas Financial Services Board (BFSB), this partnership has created a wide range of innovative products such as Smart@Funds, the Bahamas Executive Entity, and most recently, the Bahamas Investment Condominium (ICON) to establish the Bahamas as an innovative choice for wealth and asset management.

Lifestyle

The Bahamas is located in one of the most idyllic settings in the world and has many attractive features for those who may wish to relocate permanently or establish a second home. Gated waterfront communities packed with lifestyle amenities from golf and tennis to spas and marinas are attracting more second and third-home buyers from North and South America, Europe and the Far East.

The Bahamas is a service economy that provides concierge residential management services for homeowners who are not in residence. Direct flights are available to the Bahamas from all major US cities, Canada, the UK, Europe and Panama, and the country has numerous ports of entry and marinas.

US pre-clearance for commercial passengers exists from Nassau, while commercial passengers, private jets and goods shipped from Freeport also enjoy pre-clearance to the US.

The Bahamas is easy to get to, with six major airports and more than 50 other airports situated throughout the archipelago, as well as countless ports of entry and marinas that can accommodate the largest yachts.

Permanent residency opportunities

The Bahamas has a liberal process for granting economic permanent residency (EPR) that makes it easier for individuals to 'follow their money' with respect to where they live and work. Persons with permanent residence are for all intents and purposes treated like Bahamians, except for the right to vote.

Economic permanent residence is available for persons who spend a minimum of $500,000 on a residence. For more substantive investments of $1.5 million or greater, there is accelerated consideration of applications.

Work permits and immigration

The Bahamas has a flexible immigration policy that encourages companies to develop Bahamian talent but recognises the needs of international firms, individuals and families to recruit additional people abroad.

The country welcomes non-Bahamians with specialised skills and expertise that are not otherwise locally available.

Physical resources

The Bahamas has developed its land, premises and fit-for-purpose infrastructure with the singular focus of facilitating international business.

Modern office facilities are connected globally through three separate, fully redundant, self-healing, fibre optic cable networks, with data protection at the Organisation for Economic Co-operation and Development standard. All of these advantages may be summed up very simply: the Bahamas is committed to growth and developing its natural resources and cultivated assets to create an environment that supports business and the enjoyment of life in equal measure. Individuals, companies and family offices will all find a warm welcome when they come to the Bahamas.

The captivating advantages

The captive environment in the Bahamas is supported by a highly experienced and diversified asset and wealth management industry. The jurisdiction has developed a reputation as a leader in these areas, which has enabled it to facilitate synergies with the insurance market.

With this wealth management pedigree unmatched in the region, the Bahamas continues to strategically nurture captive insurance as an important addition to its growing and impressive array of financial services.

The Bahamas always has had market-friendly insurance legislation but legislative changes in recent years consolidated this jurisdiction's approach to the sector.

The Insurance Act provides a system for licensing and regulating domestic insurers based on international standards. The Insurance Commission of the Bahamas was established under this act.

The act allows for the Insurance Commission to function as an independent supervisory authority holding powers of regulation, inspection and supervision over insurance companies.

A unique cell-ing point

Cell legislation is a prime example of the jurisdiction applying its wealth management environment to the captive market.

The Bahamas's cell legislation provides robust statutory protection to ensure that the assets and liabilities of each account are truly separate and distinct.

Cell captives benefit from the natural economies of scale created within such structures.

The regulatory regime in the Bahamas is a clear response to the demand for a cost-effective means of entering into captive or self-insurance for small- to medium-sized enterprises while satisfying international standards. CIT

Aliya Allen
CEO and executive director
Bahamas Financial Services Board

Navigating diverted profits tax

Matthew Fountain of AIG discusses the UK's diverted profits tax

In response to concerns about multinational corporations shifting profits out of the UK, the government has enacted a new diverted profits tax (DPT), which targets a number of areas of perceived profit shifting, including certain arrangements involving captive insurers. DPT targets UK companies transacting with affiliates in low tax jurisdictions that lack sufficient economic substance and foreign companies avoiding a UK taxable presence. DPT was announced in December 2014 and is effective for transactions occurring from 1 April 2015. Her Majesty's Revenue and Customs (HMRC), the UK tax authority, has issued interim guidance to assist taxpayers in the application of DPT with further updated guidance expected by the end of the year.

There are several common insurance transactions that could be caught by the DPT rules. This article will provide an overview of the legislation and then examine how it could apply to captive arrangements. There may be other transactions caught by the rules, and all transactions with affiliates should be reviewed for DPT applicability. The comments in this article are only intended as a general discussion of the issues. Companies should carefully examine each of their transactions with their own tax advisors before coming to a conclusion.

The rules provide that DPT arises in two scenarios: (i) transactions with affiliates in low tax jurisdictions; and (ii) where non-UK companies avoid a taxable presence in the UK (known as a permanent establishment).

The first scenario is where a UK company is party to a transaction or a series of transactions with an affiliated company that both produces a tax mismatch and lacks economic substance.

Broadly, the tax mismatch arises when the affiliate's corporate tax rate is less than 16 percent (for example, Ireland has a corporate tax rate of 12.5 percent and therefore transactions with an affiliate in this country would potentially be caught by the rules), such that the corporate tax deduction in the UK is higher than the corporate tax paid in the affiliate's jurisdiction.

However, the detailed rules focus on the actual tax rate applied, rather than merely looking at the statutory corporate tax rate in the affiliate's jurisdiction. For example, differences in reserving methodology could be a factor.

Insufficient economic substance arises if it is reasonable to assume that the transaction was designed to secure a tax reduction. To avoid this characterisation, two conditions must be met: (i) the tax benefit is less than all other financial benefits; and (ii) more than half of the affiliate's income from the transaction is attributable to the affiliate's employees, including externally provided staff (contractors), as opposed to other assets. This assessment requires considerable judgement and the conclusion reached will need to be documented.

If there is a tax mismatch and the affiliate has insufficient substance, the UK company is subject to 25 percent DPT on the diverted profits (plus an amount equivalent to interest). When calculating the DPT charge, HMRC would look to the relevant alternative provision—the transaction that would be reasonable to assume would have taken place with an affiliate had tax not been a relevant consideration.

The second scenario applies where a non-UK company carries on a trade, and a person is carrying on activity in the UK in connection with supplies of services, goods or other property by the non-UK company in the course of that trade.

This provision is effected when two conditions are met: (i) it must be reasonable to assume that the non-UK company has structured its activity in such a way as to ensure that it is not treated as carrying on a trade through a UK permanent establishment (with the result that it does not have a UK corporation tax liability); and (ii) it must also be reasonable to assume that arrangements are in place to avoid UK corporation tax or that the non-UK company is party to arrangements with an affiliate that produces a tax mismatch and lacks economic substance.

If the second scenario applies, DPT arises at 25 percent of the profits that are just and reasonable to assume would have arisen if the activities in question had been carried on through a UK permanent establishment. The DPT charge will also include an element equivalent to interest, and can be collected from UK affiliates. There are some exemptions, including de minimus rules and for certain debt transactions.

Captive insurance

In this example, a UK manufacturing company pays insurance premiums to a group captive insurer located in a jurisdiction with low or no corporate tax, for instance, Bermuda. It is possible that the first part of the legislation may be triggered as it would produce a tax mismatch. The UK manufacturer would therefore be required to demonstrate that the group captive insurer has sufficient economic substance, including the contribution from staff to the insurer's income.

The interim DPT guidance issued by HMRC includes a captive insurance example, but the fact pattern is weighted towards a scenario where there is low substance, including low claims history, the insurance risk is managed by the parent, the risk is not reinsured externally by the captive, and little activity is carried out by the captive's employees. The answer also assumes that there are no capital efficiencies arising from the transaction.

In order to demonstrate the substance of the transaction, groups with captive insurers in low tax jurisdictions may wish to consider supporting their position with reference to their economic substance. This could involve highlighting:

- Capital and premium savings that arise from pooling group global risks and reinsuring this more diversified risk to the market;
- The captive insurer being a regulated entity;
- Employment of staff with underwriting or actuarial experience; and
- The potential for losses (as well as profits) to arise.

Captive insurers will also need to demonstrate that more than half of their income is attributable to its employees or contractors. Given that the specific captive example in the interim guidance does not favour captive structures, UK companies that feel they can demonstrate the economic substance of the captive may still wish to notify HMRC to test their view, rather than rely on their own judgement without notifying HMRC. Whether or not the UK company decides to approach HMRC, it should maintain documentation to support its conclusions.

When calculating DPT, HMRC would look to the transaction that would be reasonable to assume would have taken place with an affiliate had tax not been a relevant consideration. The aim would be to demonstrate to HMRC that the alternative provision would have resulted in the same expenditure as under the actual transaction, for example, insurance premiums paid to another group company.

The inclusion of a third-party insurer as an intermediary between the UK manufacturer and the group captive insurer may not change the analysis. In this case, there is a series of transactions between the UK manufacturer and the group captive (instead of a direct transaction) that might be caught by the DPT rules, with the result that the outcome would be the same.

> "DPT targets UK companies transacting with affiliates in low tax jurisdictions that lack sufficient economic substance and foreign companies avoiding a UK taxable presence"

Where any captive underwriting activity is undertaken in the UK, there is a risk that DPT applies under the second scenario. DPT could apply where the captive structures its activity in such a way as to ensure it does not have a UK permanent establishment, for example, by designing its structure to avoid the use of dependent agents that contract on the captive's behalf (dependent agents generally give rise to a permanent establishment).

If it is also reasonable to assume this was to avoid UK corporation tax, DPT would be charged on the profits that would be reasonably allocated to the UK had the business activities been carried on through a permanent establishment. This could result in the allocation of profits arising on non-UK risks insured by the captive.

Freedom of services business

In the example of a European insurer that is based outside of the UK, it is possible for the non-UK insurer to write a UK policy under the EU's freedom of services provision without the need to be UK regulated. However, in these cases it would often be the case that the non-UK insurer engages the support of an affiliated UK entity for certain activities, for example claims handling.

In this case, the non-UK insurer is potentially caught by the second scenario as it could be seen to be avoiding a UK taxable presence. There could be arguments that the activity was not structured in this way to avoid UK corporation tax, particularly as freedom of services is intended to promote business activity and is widely used throughout Europe for commercial reasons.

However, if it were not possible to demonstrate this, then the arrangement could be caught, particularly when the non-UK insurer is located in a low tax jurisdiction (for example, Ireland) where it would likely be left with a tax mismatch because of the Irish tax rate (12.5 percent).

The Irish insurer would need to demonstrate that the transaction has a sufficient degree of substance by documenting that the non-financial benefit of the transaction is greater than the tax benefit associated with the transaction.

This could involve showing the business would not be accessible to the insurer were it not for the transaction.

DPT arises on the profits that it is just and reasonable to assume would have arisen if the activities had been carried on through a UK permanent establishment. The allocation of insurance profits is generally driven by the underwriting activity and assumption of insurance risk, both of which are by the Irish insurer in this case.

Therefore, there should not be any additional profits (over services fees paid to the UK entity) to allocate to the UK had the activities been undertaken by a permanent establishment of the Irish insurer, and DPT may not arise.

Duty to notify

If an entity believes it is potentially within the scope of DPT, it has a duty to notify HMRC (within six months of year-end in the first year; and within three months of year-end in future years). However, notification is not required if:

- It is reasonable to assume that no charge to DPT will arise for the current period;
- It is reasonable to conclude that sufficient information has been supplied to HMRC for it to decide whether to issue a charging notice and HMRC has examined that information;
- An officer of HMRC has confirmed that the company does not have to notify; or
- There is no change in circumstances from the previous period for which notification was or was not given.

Upon notification, HMRC will consider whether a DPT charge arises and issue a preliminary charging notice within two years (or four if there is no notification). Taxpayers have the right to respond to this within 30 days. At this point a final notice will be issued or confirmation of no charge will be provided. A 12-month period follows in which the notice can be reviewed by HMRC (the charge can be increased or decreased). Following this, taxpayers have 30 days in which to contest the DPT charge by appealing to the first-tier tribunal.

The DPT charge includes an interest component calculated for the period from the date notification was due to the date of the notice. Failure to notify by the due date may result in penalties should a DPT charge subsequently arise. DPT is not an allowable expense when calculating corporate tax liabilities.

Practically, if taxpayers wish to obtain a degree of comfort, a dialogue with HMRC is required. The interim guidance notes that UK companies serviced by the large business section of HMRC should engage with their customer relationship managers in the first instance. It is likely that the specialist DPT team will be consulted before any response is received.

The DPT team may issue an opinion on a taxpayer's DPT compliance, but this will not be a formal statutory or non-statutory sign-off. Companies should therefore document their assessment of the application of DPT to their business. **CIT**

Matthew Fountain
Regional tax director, EMEA
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This article cannot be relied upon as advice on the application of DPT. Any particular transaction needs to be considered on its own facts. Any questions should be directed to companies' tax advisors.

Safety by the numbers

Using safety management will pay you more dividends as your programme matures by preventing losses and minimising the impact of losses that do occur, says George Gibson of Charles Taylor Safety Management Services

Various industry groups and insurers have recognised and applied loss control methods to stabilise their losses and add predictability. Some examples of loss control methods among insurers include loss control departments, underwriting guidelines and increasing deductibles and retentions, while among clients, they can include incident investigations, specific personal protective equipment policies, and training. All are aimed at reducing or eliminating claims to stabilise the loss cost.

In the extreme, insurers drop a specific line of insurance and/or related industry because the losses are not predictable. Even though they have loss controls in place, the customer base is not consistent with applying them. This has driven some companies in those industries to create their own captive insurance company.

Along with those companies with established controls in place and stable losses, they may choose a captive to retain the underwriting profits (or losses) for insurable risks. These actions have yielded high dividends in the form of cost reduction and exposure reduction.

Then there are some organisations that just buy coverage. They don't think of loss control and don't pay much attention to managing those risks. Then when they can't get insurance or the rates have gone through the roof, it becomes an all-out war against the causes for the poor performance, which can include the insurance company's claims department, the loss is a one-off exception to the rule, or the injured party is to blame.

In the captive insurance world we don't have the luxury of blaming someone else for our results or lack of dividends. We have become the insurance company and the client. As Esperanza Mead, president of Actuarial Factor, puts it: "The key to insurance is to control the losses and the expenses. If you don't mitigate losses, then paid losses, case reserves, and incurred but not reported losses (IBNR) will increase. This translates into underwriting losses and higher/unaffordable premiums."

So how do we get the loss control dividends and what do we do when they stop?

First and foremost, you need to take a lesson from insurance carriers and brokers. They invest heavily in loss control staff and practices. These set the standard for providing a stable environment to underwrite the risk. We can't ignore the fact that insurance companies have solid reasons for not covering certain things. What are you doing to control your exposure?

Looking at your risk and controls are essential to the long-term success of the captive. Some of the coverages are very low frequency of loss, but when losses occur you are the insurance company.

"Adopt loss control methods consistent with your exposures. Determine this by conducting a risk analysis of your exposures, which entails creating a risk register and keeping it up to date." This drives your risk planning and loss control to help reduce both frequency and severity of loss, according to Christopher Moss, director of risk consulting for Charles Taylor.

Creating a risk register seems simple but requires good judgement and deep understanding about the risks you have or may face in the future. The components of a risk register are: description of risk; risk type; likelihood of occurrence; severity of effect; countermeasures; potential additional mitigations; risk owner; and status.

Listing the countermeasures or mitigations assumes that you will follow through and implement them. A very common method is a claims review with your adjuster. What you learn from that review should be brought forward to the loss control (countermeasures) applied. From the captive insurer point of view, the dividends should be: avoiding injury to employees, customers or the public; meeting your risk transfer/insurer requirement; your business operates better; lower costs; less down time; and higher customer satisfaction and retention.

How will I know when the dividends have stopped?

I think it really involves the stability of losses. If they are stable then you can predict with a good confidence level the funding for your captive, which would be the first indication. This also means if nothing changes you will still get those losses. Additionally, if you're not looking at the leading indicators then expect the unexpected.

What's next? Safety management

Safety management is all about forward thinking and looking at the leading indicators and balancing that with lagging indicators such as loss experience.

There is an excellent study by the Campbell Institute benchmarking leading indicators. Its focus is on the environmental, health and safety performance, which can be applied to insurance coverage areas.

When referring to the leading indicators, the Campbell Institute references the following areas:

Operations-based: indicators that are relevant to the functioning of an organisation's infrastructure (for example, machinery and operations), which could be potentially site-specific.

Systems-based: indicators that relate more to the management of an EHS system, which can be rolled up from a facility level to a region/business unit or corporate level.

Behaviour-based: indicators that measure the behaviour or actions of individuals or groups in the workplace, as well as people-to-people interactions related to supervision and management. These are also useful at site-specific level through management level.

How this may apply to a specific risk? Let's take a look at reputational risk from today's headlines, Blue Bell ice cream. This is an established, well-respected 108-year-old brand that was distributed in 23 states, mostly in the Southern US, as well as at least 27 other countries. It offers both institutional and retail products. The company almost went out of business due to a listeria outbreak linked to its products by DNA testing. The following is a select outline of events from the Food and Drug Administration's (FDA) website.

The FDA was notified that the three strains related to the illnesses reported in Kansas and four other rare strains of listeria monocytogenes were found in samples of Blue Bell Creameries single serving Chocolate Chip Country Cookie Sandwich and the Great Divide Bar ice cream products collected by the South Carolina Department of Health and Environmental Control during routine product sampling at a South Carolina distribution centre, on 12 February 2015. These products are manufactured at Blue Bell Creameries's Brenham, Texas facility.

On 13 March 2015, Blue Bell Creameries reported that it had removed the affected ice cream products from the market by picking then up directly from the retailers and hospital settings it serves. The company also shut down the production line where the products were made.

The Center for Disease Control reported that as of 20 April 2015, a total of 10 patients infected with several strains of listeria monocytogenes were reported from four states: Arizona (one), Kansas (five), Oklahoma (one), and Texas (three). Illness onset dates ranged from January 2010 through January 2015. All 10 patients were hospitalized. Three deaths were reported from Kansas.

Blue Bell Creameries announced that on 27 April it would carry out an intensive cleaning and training programme at all of its production facilities. On 14 May, Blue Bell Creameries announced that it had entered into voluntary agreements with the Texas Department of State Health Services and the Oklahoma Department of Agriculture, Food, and Forestry outlining a series of steps and actions it would take as part of its efforts to bring its products back to market.

According to Blue Bell Creameries: "The actions include rigorous facility cleaning and sanitising, revised testing protocols, revised production policies and procedures designed to prevent future contamination, and upgraded employee training initiatives."

The firm also stated that the agreements include provisions specific to addressing listeria, including: conducting root cause analyses to identify its potential or actual sources; retaining an independent microbiology expert to establish and review controls to prevent the future introduction of listeria; notifying the Texas and Oklahoma health agencies promptly of any presumptive positive test result for listeria monocytogenes found in ingredients or finished product samples, and providing the state agencies full access to all testing; ensuring that the company's pathogen monitoring programme for listeria in the plant environment outlines how the company will respond to presumptive positive tests for listeria species; and, instituting a 'test and hold' programme to assure that products are safe before they are shipped or sold.

An established firm such as Blue Bell Creameries has loss control programmes in place and has successfully served its customers for 108 years. It knows the right procedures and is an expert at making ice cream. Unfortunately, its loss control programme stopped paying dividends.

Looking at the lagging indicators of claims/losses did not predict the failures in the manufacturing process. Reading regulatory inspection reports prior to its crisis didn't tell the management they had a problem.

Some items that stood out from the FDA facility inspection reports during the course of this listeria outbreak include: paint deteriorated above food processing equipment; ingredient hoppers not kept clean; employees not wearing appropriate clothing; dripping water from pipes over production lines; and an inadequate sampling programme.

Behaviour, systems and operational indicators would have revealed the company's issues and facilitated resolution with a proactive safety management approach.

An example is a safety management dashboard that indicates key metrics on a weekly and monthly basis.

This may include: senior management visits; incident occurrence and resolution (near loss investigations included); conversations with associates; tracking the number of outstanding maintenance issues; and vendor reviews.

Safety management cultures

With good reason, we focus on the monetary impacts of risks. Managing those losses with a focus on the claimant and individual cases makes sense, but that may put proactive management approaches in a reduced role. Let's compare the two approaches:

Culture

- Management actions indicate a focus on prevention/elimination of hazards to customers and employees
- Accountability of management
- Resources equal for loss control
- Visibility

Monetary

- No engagement of senior management
- Focus on the claimant
- Company resources assigned limited to cost reduction
- Regulatory fines drive programme focus

Culture is focused on managing the risk by consistently monitoring the environment and demonstrating commitment to the various systems and risk/safety initiatives.

The monetary approach is more of a delegate and report system. It could be thought of as a 'no news is good news' approach.

How should you incorporate safety management into your captive?

Safety management's purpose is to have a system in place that does not wait to act. This is very much like the quality revolution.

Instead of waiting for customer complaints to trigger a change in production, we continuously conduct monitoring of our operations and make changes as variances are identified.

The company leadership needs to determine their level of commitment. Start by completing a risk register.

This will chart your path to the exposures, controls available, lagging and leading indicators to monitor, and highlight the resources needed.

Then engage the executive leadership to determine the overall approach and content. Service providers, both internal and external, such as brokers, third-party agents, legal, human resources and so on can provide valuable input to this process.

An example of a typical captive programme's safety/risk control structure for a similar industry with multiple employers may entail a pre-membership and membership track of loss controls and safety management initiatives. For example:

Pre-membership: review of safety plans; assistance in plan development; onsite visit; underwriter risk information; expert advice on risk control.

Membership: risk control committee; safety resources; executive training; loss-specific abatement programmes; incident investigation; and monitoring 'at risk' members.

Review and monitoring of the results and changes in exposure should be part of the overall process.

Using safety management will pay you more dividends as your programme matures by preventing losses and minimising the impact of losses that do occur. CIT

"The company leadership needs to determine their level of commitment. Start by completing a risk register. This will chart your path to the exposures, controls available, lagging and leading indicators to monitor, and highlight the resources needed"

George Gibson
Vice president
Charles Taylor Safety Management Services

Industry Events

35th Annual National Educational Conference & Expo

Location: Washington DC
Date: 18-20 October 2015
www.siia.org

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.

HCIC Annual Forum

Location: Kauai, Hawaii
Date: 27-30 October 2015
www.hawaiicaptives.com/hcic-annual-forum/

We invite you to join us for the HCIC Annual Educational Forum at the Grand Hyatt Kauai Resort and Spa! Forum sessions will focus on the most relevant topics and key issues facing the captive industry. Don't miss this excellent opportunity for learning and networking with captive insurance company owners, industry service providers and others.

Industry appointments

Allied World Global Markets has added two executives to its casualty team.

James Emerton has joined as vice president and **Martin Fisher** has arrived as assistant vice president. They will be responsible for building out the UK and international corporate business Allied World and will be based in London.

Fisher most recently spent three years working as a senior casualty underwriter responsible for underwriting a large renewal portfolio comprised of domestic, multinational, multi-line and captive insurance programmes.

Emerton was previously at Zurich where he spent nine years working as a senior underwriter within the global corporate casualty and product recall teams.

Denis Burniston, senior vice president of general casualty at Allied World, commented: “Emerton and Fisher are great additions to our current casualty team and will allow us to continue expanding in London and Europe more broadly. They both have extensive experience in the industry and a wealth of knowledge that will be valuable to our growth going forward.”

Beazley has appointed **Tim Allen** to head its transaction liability business from March 2016.

Allen previously served as a transaction liability underwriter at Beazley and returns at a time when the market is experiencing increased demand for mergers and acquisitions-related insurance.

Neal Wilkinson, Beazley’s management liability focus group leader, said: “I am delighted that Allen will be returning to Beazley. He has many years’ experience in transaction liability and is greatly respected in the market.”

“Transaction liability insurance is an important growth market for Beazley. We have been writing this class of business since 2010 and will continue to invest in growing the team.”

The OIL Group of companies has appointed **Bertil Olsson** to succeed **Robert Stauffer** as president and CEO.

Olsson joins from Marsh & McLennan Companies, where he was managing director and head of South Central Region, Marsh USA.

He brings over 25 years of energy insurance experience. His career began in Europe with Marsh in the Stockholm office, where he worked on programmes for integrated oil companies.

He then moved to the firm’s Houston office and continued working as a marketing specialist concentrating on energy industry programmes.

Olsson will succeed Stauffer upon his retirement in January 2016.

Gerard Naisse, chairman of Oil Insurance and Oil Casualty Insurance, commented: “We are pleased to have Olsson at the helm of our operations going forward and expect a smooth transition between now and Stauffer retirement in early January 2016.”

“He is a well-known and highly respected energy insurance professional and brings with him a wealth of energy insurance experience and knowledge. We are confident that he will provide effective leadership within the executive team to continue to grow our respective businesses.”

Michael Halsband has joined Drinker Biddle & Reath as a member of the firm’s insurance transactional and regulatory team. He will be based in the New York City office.

Halsband brings 25 years of leadership experience in the insurance and reinsurance industry to the firm. His transactional work is focused on complex structured reinsurance transactions, products and entities.

He also advises clients on corporate and regulatory matters.

Prior to his new role, he was the founding senior executive and president of the capital markets and insurance-linked securities convergence initiative at Sirius Group.

Neil Haimm, chair of the corporate and securities practice group, commented: “As an insurance-focused deal lawyer, Halsband broadens the capabilities of our insurance transactional and regulatory team.”

“He brings significant knowledge and experience to help our clients capitalise on the influx of institutional capital into the insurance and reinsurance industries.”

The British Virgin Islands Finance marketing manager **Alicia Green** has been appointed to the executive board of the International Center of Captive Insurance Education (ICCIE).

Green becomes the first ICCIE alumna to be appointed to the board in the organisation’s history.

She received her associates of captive insurance (ACI) from the institution in 2013, bringing the total number of ACI alumni fellows from the BVI Islands to five.

Green stated: “I am delighted to have the opportunity to work with leaders in the industry to promote the captive business and the BVI’s international offer. I look forward to working with the existing board and utilising my marketing expertise to further grow the organisation.” **CIT**

Got a hire, promotion or new office to shout about? Let us know:

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