

# captive insurance times

The primary source of global captive insurance news and analysis

Issue 158 03 October 2018

## ILS INSIGHT

Mark Helyar discusses an innovative new structure

## CAPTIVE INVESTMENTS

Diana Hardy & TJ Strickland talk investment strategy

## ASIA PACIFIC

The region is showing impressive growth but remains a small player

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After its first 10 months, the UK ILS market still  
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# Marsh & McLennan agrees to acquire JLT

Marsh & McLennan Companies (MMC) has agreed to acquire Jardine Lloyd Thompson Group (JLT) in a deal worth \$5.6 billion.

The deal is part of MMC's strategy to become the preeminent global firm in the areas of risk, strategy, and people.

Under the terms of the transaction, which has been approved by the board of directors' of both companies, MMC will acquire all issued, and to be issued, share capital of JLT. Current holders of common shares will receive cash consideration of £19.15 per share.

The total cash consideration equates to \$5.6 billion in fully diluted equity value or an enterprise value of \$6.4 billion. The transaction will be funded by a combination of cash on hand and proceeds from debt financing.

MMC anticipates that annual cost synergies of approximately \$250 million will be realised over the next three years, and expects the realisation of those cost synergies to result in one-time integration costs of approximately \$375 million.

Goldman Sachs acted as financial advisor, while Slaughter and May and Wachtell, Lipton, Rosen & Katz acted as external legal to MMC.

Morgan Chase served as financial advisor, and Clifford Chance Rogers & Wells served as external counsel to JLT.

MMC hopes that JLT's track record of strong organic growth and attractive geographic diversification will enhance its ability to accelerate growth and margin expansion across products and geographies.

Dan Glaser, president and CEO of MMC, said the acquisition creates a compelling value proposition for the firm's clients, colleagues, and shareholders.

Glaser commented: "The complementary fit between our companies creates a platform to deliver exceptional service to clients and opportunities for our colleagues."

"On a personal level, I have come to know, and respect, Dominic Burke and his management team from my time both at MMC and as an underwriter."

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### Region Round-Up

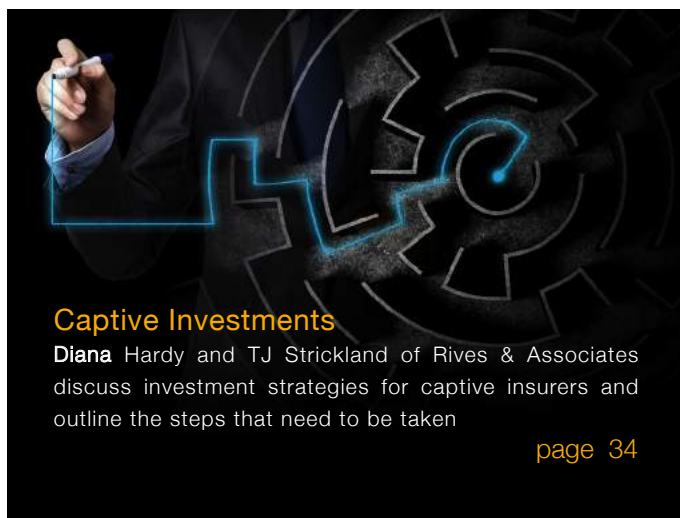
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### Emerging Talent

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## Marsh & McLennan agrees to acquire JLT

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“I am confident that with the addition of the talented colleagues of JLT, Marsh & McLennan will be an even stronger and more dynamic company.”

Following completion of the transaction, Burke, group chief executive of JLT, will join MMC as vice chairman and serve as a member of MMC’s executive committee.

Burke said: “I am enormously proud of what JLT has achieved, founded on our people, our culture and our unwavering commitment to our clients.”

“MMC is, and always has been, one of our most respected competitors and I believe that, combined, we will create a

group that will truly stand as a beacon for our industry.”

In order to satisfy certain fund requirements of the UK Takeover Code, MMC has committed bridge financing from Goldman Sachs to complete the transaction.

MMC has received irrevocable undertakings from JLT’s largest shareholder, Jardine Matheson Holdings, and JLT directors who collectively represent 40.5 percent of the issue and outstanding JLT shares in support of the transaction.

The transaction is expected to close in spring 2019, subject to receipt of required antitrust and regulatory approvals and the approval of JLT shareholders.

## Aegon to make \$1bn from merger of TLIC and annuity captive

Aegon expects to make a one-time benefit to capital generation of approximately \$1 billion by merging its Arizona-based variable annuity captive insurer with another of its subsidiaries, Transamerica Life Insurance Company (TLIC).

The merger of the two legal entities is effective 1 October 2018, subject to customary regulatory approval.

Aegon set up the variable annuity captive in 2015 as there was a need to manage the volatility of the US risk-based capital (RBC) ratio due to misalignment between reserve movements and hedging within the existing variable annuity capital framework.

The National Association of Insurance Commissioners recently proposed improvements to the existing variable annuity capital framework, which reduces the non-economic volatility of the RBC ratio, meaning that the use of a variable annuity captive is no longer required.

Aegon intends to early adopt the proposed changes in the variable annuity captive framework in 2019, which it expects to have no effect on its capital position.

The merger is expected to cause a 50 percent points benefit to the US RBC ratio or approximately \$1 billion one-time capital generation as a result of the release of reserves and diversification benefits.

The move is also predicted to have a beneficial impact on Aegon’s group Solvency II ratio, which will largely offset the impact of US tax reform in the second half of 2018.

Additionally, Aegon expects the merger to have no material impact on its recurring capital generation over the next 10 years given the long-dated nature of the variable annuity business.

Alex Wynaendts, CEO of Aegon, commented: "Merging two of our US entities simplifies our legal structure, increases our capital buffer, and leads to the release of reserves and higher diversification benefits."

"This enables us to further strengthen our capital position in the US and enhance the robustness of our balance sheet."

### **Selfinsurancemarket.com relaunches self-insurance sourcing platform**

Selfinsurancemarket.com (SIM) has relaunched its business inquiry platform and global search facility to aid the promotion and placement of self-insurance programmes.

The platform's new design and features, designed by the site's technology partner iXledger, are aimed at making the sourcing of self-insurance solutions and

partnerships smoother for both insureds and industry professionals.

As part of the relaunch, the site is offering self-insurance service providers a free trial membership.

### **Ravenscroft expands cash management offering with Royal London acquisitions**

Investment services group Ravenscroft has agreed a deal to acquire Royal London Asset Management and Royal London Custody Services to expand its cash management offering.

The acquisition, worth an undisclosed fee, will see all five Royal London Asset employees moving across to Ravenscroft as soon as the sale is completed.

Following completion of the deal, which is subject to approval by Guernsey Financial

Services Commission, the two companies will be rebranded as Ravenscroft.

Mark Bousfield, group managing director of Ravenscroft, said the move was another exciting chapter in the Ravenscroft story.

He commented: "This acquisition rounds out the Ravenscroft service offering: the group now offers fully scalable stockbroking, investment management, fund management, cash management, and gold/precious metals dealing and storage."

The acquisitions mean Ravenscroft's assets under administration will increase to more than £6.5 billion

Bousfield said: "Our assets under administration continue to grow organically as well as through this acquisition, we have more than 100 staff, will be moving into new headquarters in Guernsey in 2019 and

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## Lloyd's Brussels' policy documentation published

A new suite of policy documentation has been published to support the underwriting of risks from the European Economic Area (EEA) by Lloyd's Brussels.

The documents were prepared collaboratively by the Lloyd's Market Association (LMA) wordings team and Lloyd's Brexit and regulatory affairs teams.

Lloyd's has established a new Brussels-based insurance company, Lloyd's Insurance Company SA, in preparation for Brexit.

From 1 January 2019, the Brussels-based company will underwrite non-life insurance and facultative reinsurance risks located in EEA countries.

The new policy documentation for Lloyd's Brussels includes generic

coverholder certificates and open market policies, with country-specific variations where required.

Additionally, it includes ancillary clauses such as service of suit, language declaration clause, data protection/privacy notices, and complaints notices for individual countries.

Alison Colver, head of wordings at the LMA, commented: "We are pleased that, through the collaborative efforts and hard work of the respective teams at LMA and Lloyd's, we have been able to prepare and publish these documents, ahead of January renewals, and of course, Brexit."

All the documents and clauses have been published within the 'Lloyd's Brussels section of the Lloyd's Wordings Repository.

are progressing our plans to expand into other jurisdictions where we understand the financial and regulatory environment and can add value by offering our suite of services."

Piers Hillier, CIO at Royal London Asset Management, stated: "The Royal London Asset Management CI business has seen steady growth under Royal London ownership and Ravenscroft is the ideal local partner for the team to continue their journey with."

Pierre Paul, managing director of Royal London Asset Management, added: "Ravenscroft is an ambitious and rapidly growing Channel Islands' financial services business, with a reputation and philosophy of putting its clients first."

"I believe that the acquisition will have a positive impact on both our staff and clients."

## R&Q agrees to write novation for Barbados-based captive

Randall & Quilter Investment Holdings (R&Q) has agreed to the novation of the commercial general liabilities of a Barbados-based captive, which reinsured the liabilities of its Canadian corporate parent.

The liabilities were novated into R&Q's Bermuda-based segregated account company. Ken Randall, chairman and CEO of R&Q, said the firm was delighted by the transaction.

He explained: "[The transaction] further broadens R&Q's field of activity across North America and the Caribbean."

"We continue to work diligently with a number of captive owners on solutions for partial or full disposal of their liabilities freeing up capital and removing management distractions."

## A.M. Best affirms ratings of UIC

A.M. Best has affirmed the long-term issuer credit rating of "a-" and the financial strength



rating of (A) Excellent of United Insurance Company (UIC) and its Luxembourg-based subsidiary, United Re (Europe).

The outlook of the ratings is stable.

The ratings are reflective of UIC's balance sheet strength, categorised as very strong, as well as its adequate operating performance, neutral business profile and appropriate risk management.

The very strong assessment of UIC's balance sheet is a result of its very strong level of risk-adjusted capitalisation (according to Best's Capital Adequacy Ratio), healthy liquidity, financial flexibility, quality of capital and reinsurance programme.

UIC's operating performance has been profitable historically, driven by underwriting performance and investment income in most years.

Some volatility in the company's reinsurance underwriting and investment returns has caused results to fluctuate over a five-year period.

Following UIC realigning its investment strategy in 2016, healthy investment income was recorded in 2017 and is projected moving forward.

The company's overall operating performance is assessed as adequate and its business profile was deemed to be neutral.

UIC is one of the longest-tenured alternative risk vehicles by A.M. Best and has an established reputation within the captive insurance market.

The company's risk pooling programmes have been its hallmark business since formation.

Additionally, UIC is currently in the process of expanding its profile by entering the US insurance market.

A.M. Best considers UIC's enterprise risk management to be appropriate for its overall business profile.

## SBLI ratings downgraded

The Savings Bank Mutual Life Insurance Company of Massachusetts (SBLI) has had its long-term issuer credit rating (ICR) downgraded from "a+" to "a" and affirmed its financial strength rating (FSR) of A (Excellent) by A.M. Best.

The outlook of the FSR remains stable and the outlook of the long-term ICR has been revised to stable from negative.

The ratings are reflective of SBLI's "very strong" balance sheet strength, in addition

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### IMAC restarts worldwide brand identity

The Insurance Managers Association of Cayman (IMAC), the nonprofit organisation that represents the Cayman Islands' captive and alternative risk management insurance industry, has reinvented its worldwide brand identity.

The association will use a new name, "Cayman International Insurance", and a new tagline, "The Better Alternative", for external communications and marketing.

Locally, and with reference to the association, it will remain known as IMAC.

The motivation behind the name change is to ensure that Cayman is appropriately promoting its multifaceted insurance industry, which has grown to include

reinsurance and insurance-linked securities in recent years.

Erin Brosnihan, IMAC chair, said it is a "truly exciting time" for both the association and Cayman as a domicile.

She commented: "For 37 years we've delivered the message that Cayman is a leading domicile that is filled with opportunity, and after decades of effecting change for this industry, we've come to realise that we, too, have changed."

"We are no longer an association trying to develop our industry—we have become the face of our industry."

She concluded: "IMAC was built on a rich history of captives, and we look forward to where Cayman International Insurance will steer us in the future."

to its adequate operating performance, neutral business profile and appropriate enterprise risk management.

The downgrade is a result of A.M. Best's view of the modest quality of SBLI's capital and its limited financial flexibility as reinsurance captive solutions are heavily utilised for new business growth.

SBLI's issuance of a surplus note in 2017, which was used to fund its re-mutualisation in conjunction with buying out its private bank shareholders, represented 37.5 percent of the company's ownership and is also placing pressure on the balance sheet.

A.M. Best suggests that the servicing of this surplus note will, in the short run, negatively affect capital relative to prior shareholder dividends paid, however, the ratings agency also believes that the cleaner ownership structure coupled with capping and stabilising future servicing costs to providers of capital are potential positives in the long-run.

Factors that offset these ratings partially include an investment portfolio of good credit quality with modest overall exposure to below investment grade bonds, real estate, schedule BA assets, equities, and mortgage loans relative to capital.

Additionally, A.M. Best notes: "SBLI utilises high quality reinsurance counterparties."

Risk-adjusted capitalisation is projected to decline until SBLI Re is fully written down, but A.M. Best expects SBLI's Best's capital adequacy ratios should remain very strong.

The ratings agency views SBLI's operating performance as adequate as it is supported by good mortality experience, moderate premium growth and favourable persistency.

### Hylant launches group captive

Insurance brokerage Hylant has launched a group captive insurance company, Haven Re, which will provide a cost-saving option for middle-market businesses.

Member firms can use the heterogeneous group captive to insure one, two, or all three primary casualty coverages, including automobile liability and physical damage, general liability including products and completed operations, and workers' compensation and employer's liability.

To support Haven Re, Hylant partnered with The Hartford, a premier "A" rated insurance company, which will handle claims management and loss control for the members of the group captive.

Haven Re, which is domiciled in Tennessee, is designed for middle-market businesses with a strong commitment to safety and loss control, conservative balance sheet and consistent cash flow.

Hylant's senior vice president of captives, Kip Irle, who led the design and structuring of Haven Re, said:

"Focusing on high-performing middle-market businesses and joining them together to realise premium savings with well-designed coverage was core to the success of this captive."

Mike Hylant, CEO of Hylant, added: "Businesses of all sizes are seeking creative options to manage their risk while balancing costs."

"Haven Re was carefully designed to provide the solid protection each client seeks, with added support services not available in standard insurance placements."

### Aon launches Capital Advisory unit to expand reinsurance offer

Aon has launched a Capital Advisory unit within Reinsurance Solutions to provide a holistic approach to capital optimisation for reinsurers, Lloyd's syndicates, and captives.

The aim of Capital Advisory is to aid clients to achieve capital efficiency by accessing alternative or traditional capital or identifying opportunities that make better use of existing capitals while taking into account cost and returns.

Aon has brought together its expertise in reinsurance, analytics, ratings agency advisory, asset management, property and casualty, mergers and acquisitions, life, and capital markets.

The unit will provide bespoke advice to help clients reduce Solvency II capital requirements via reinsurance; improve insurers' investment strategy to drive investment efficiencies, thereby uniting management of both their assets and liabilities; and optimise insurers' capital mix.

Eric Paire, who joined the company from Guy Carpenter in March 2018, will lead

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Capital Advisory, which is currently based in London, with the goal to expand the offering to the US for a global approach.

Paire commented: “There is no single move, no silver bullet, that will restore insurers’ profitability overnight.”

“It is all about fine-tuning and optimising the various components of the profit and loss and the balance sheet for increased operating and financial margins, and an enhanced capital mix, while reducing volatility and allocated capital for a lower cost of capital.”

Nick Frankland, UK CEO of Aon’s Reinsurance Solutions business, stated: “In a low-interest rate economy with pressure on returns, we are committed to working with insurers as their strategic partners to optimise the capital supporting their businesses.”

“We have a head start with our intrinsic knowledge of clients’ operations as their reinsurance intermediary, and can bring an additional focus on profit and loss with our specialist skills from across Aon.”

## Legal & General completes £4.4m buy-in to BA pension scheme

Legal & General has completed a £4.4 billion buy-in to British Airways’ (BA) pension scheme, Airways Pension Scheme (APS), the largest pensioner bulk annuity policy transaction ever in the UK.

The deal includes £1.6 million in pension liabilities that were insured against longevity risk using a captive.

BA set up its own Guernsey-based captive to manage the risk for the APS, which covers nearly 22,000 pensioners, in September last year.

The captive is owned by the trustee but is managed and operated independently.

Under this setup, the trustee transferred longevity risk to the captive company,

which has agreed reinsurance contracts with Partner Re and Canada Life taking on the risk.

The UK pension risk transfer (PRT) market continues to demonstrate a high level of activity with Legal & General actively quoting on more than £20 billion.

Laura Mason, CEO of Legal & General retirement institutional, commented: “This transaction also included the conversion of existing longevity insurance to a bulk annuity, demonstrating Legal & General’s ability to deal with a complex situation and offer innovative solutions drawing on the broad experience and capabilities of the wider Legal & General Group.”

Nigel Wilson, CEO of Legal & General Group, said the second half of 2018 is likely to be a record six months for their PRT business.

Wilson added: “We expect to announce further transactions in the next few months.”

## Insurance Europe advises OECD against special captive guidance

Insurance Europe has advised the Organisation for Economic Co-operation and Development (OECD) to apply existing guidance to captive insurance, rather than introducing special guidance.

As the European insurance and reinsurance federation, Insurance Europe has issued its comment on the OECD’s public discussion draft on ‘Base Erosion and Profit Shifting (BEPS) Actions 8-10 Financial Transactions’, which deals with the relationship between transfer pricing and value creation.

Insurance Europe’s response, which was specifically focused on “Section E–Captive Insurance”, suggested that special guidance should not be introduced because existing chapter one guidance already sets out the principles for the delineation and recognition of transactions.

Insurance Europe added: “In cases where the chapter one analysis leads to the conclusion that the captive insurer’s business is other than that of insurance, chapter one also gives guidance on how to recharacterise the transaction.”

It suggested that if the OECD consider special guidance necessary for captives, then it should begin with a more detailed description of captive insurance and captive insurance transactions to properly differentiate these from other forms of reinsurance between members of a regulated insurance group.

According to Insurance Europe, the whole of section E refers to multinational entities (MNE) and their members, which it argues means the guidance would therefore also end up applying to intragroup reinsurance between members of a regulated insurance group or intra-group retrocession in a regulated reinsurance group—as Insurance Europe understands is the OECD’s intention.

Insurance Europe also disagrees with the statement made in the discussion draft that a captive insurance company does not provide insurance buy rather insurance-type services.

Additionally, it warned the OECD against prohibiting the legitimate use of captives even if the legitimate purpose lies in the future and not in the past.

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CB-67921-05 05/18

# MARSH NEWS

## All the updates on the Marsh & McLennan acquisition of JLT

### Moody's: Marsh & McLennan ratings affirmed, outlook downgraded

Moody's Investors Service has affirmed Marsh & McLennan Companies' (MMC) Baa1 senior unsecured debt and P-2 commercial paper ratings following the group's agreement to acquire insurance broker, Jardine Lloyd Thompson Group (JLT).

MMC's rating outlook has been downgraded from stable to negative based on the expected increase in financial leverage and the execution risk associated with acquiring JLT.

According to Moody's, the acquisition is strategically sound but credit negative based on the expected increase in debt and the execution risk.

The acquisition of JLT will boost the group revenue of MMC, which is the world's largest insurance brokerage and consulting firm by revenue, by about 13 percent and will enhance the group's capabilities in multiple industry specialities including energy, mining, healthcare, construction, marine, and aerospace. Additionally, it will expand the group's presence in reinsurance brokerage.

The ratings agency suggested that these benefits are to help fund the acquisition.

Moody's estimates MMC's debt-to-EBITDA ratio to rise above 4x when the transaction is completed, well above the group's historic leverage of 2.6x to 2.8x, while interest coverage will decline from the high single digits toward the mid-single digits.

Moody's notes that JLT has weaker profit margins than MMC, which the group aims to improve through integration and cost savings.

The negative rating outlook is driven by these elevated risks, however, Moody's predicts that MMC will reduce its financial

leverage toward its historical levels through a combination of debt repayment and EBITDA growth over the 12 to 18 months following the acquisition.

MMC has said such deleveraging will be supported by the slowing of its share repurchases and other acquisitions.

The ratings are reflective of MMC's global market presence; diversification across clients, products and regions; expertise in providing complex risk and human resource to global, national and middle market accounts; and long record of profitable growth.

These strengths are tempered by the group's financial leverage, which has been at the high end of the range for its rating category, its exposure to fluctuating pension obligations, and its potential liabilities arising from errors and omissions in the delivery of professional services.

There are a number of factors identified by Moody's that could lead to a stable rating outlook for MMC, including: smooth integration of JLT and MMC with continued profitable growth, reduction of debt-to-EBITDA ratio below 3.2x following the acquisition, (EBITDA-capex) coverage of interest remaining in the mid-single digits or higher, and net profit margin remaining in the high single digits or higher.

However, the following factors could lead a downgrade in rating: debt-to-EBITDA ratio above 3.2x on a sustained basis, (EBITDA-capex) coverage of interest below 5x, or net profit margin below 8 percent.

Moody's has also assigned provisional ratings to MMC's new shelf registration: senior unsecured shelf at (P)Baa1, and subordinated shelf at (P)Baa2.

## Marsh & McLennan to cut 5 percent of jobs after JLT deal

Marsh and McLennan Group (MMC) expects to cut up to five percent of its workforce following the acquisition of Jardine Lloyd Thompson Group (JLT).

Expected to close in spring 2019, the transaction is subject to receipt of required antitrust and regulatory approvals, and the approval of JLT shareholders.

In a filing to the US Securities and Exchange Commission (SEC), MMC revealed that it had not yet received sufficiently detailed information to make comprehensive plans or intentions regarding the impact of the JLT acquisition, but from preliminary acquisitions, the group predicted a cut to the workforce of up to five percent.

MMC stated: “MMC expects a potential headcount reduction of between two and five percent of the total combined group workforce across all geographies, including in the UK, Continental Europe, Asia, North America, the Middle East, Latin America, and the Pacific, and from a broad range of job categories, including functional support areas such as finance, human resources, IT, operations, legal and administrative support staff.”

A five percent cut of the combined workforce would mean the loss of an estimated 3,750 jobs.

MCC’s preliminary evaluation suggests that it is expected to achieve “synergies of approximately \$250 million within three years of completion of the acquisition, a substantial portion of which could come from headcount reductions in addition to savings in real estate, IT, outside services and other initiatives”.

“The finalisation and implementation of any workforce reductions will be subject to comprehensive planning and appropriate engagement with stakeholders, including affected employees and any appropriate employee representative bodies.”

The SEC filing also showed that MMC expects all non-executive directors at JLT will cease to be directors of JLT and that subject to the workforce reductions described earlier in the article.

MMC said that it “does not intend to make any material changes to the balance of skills and the functions of the employees of JLT.”

## JLT acquisition gives Marsh & McLennan ‘greatest concentration of talent in industry’

Marsh and McLennan Companies’ (MMC) acquisition of Jardine Lloyd Thompson Group (JLT) gives it the “greatest concentration of talent in our industry”, according to Dan Glaser, president and CEO of MMC. Following the announcement of the deal, Glaser said that the acquisition leverages “many complementary strengths of both organisations”.

He stated: “JLT is a premier organisation in our industry. This transaction will further enhance our position as the leading professional services firm, serving clients around the world on the key issues of risk, strategy, and people.”

“The true value in any transaction in our industry is the people. Put simply, the combined MMC and JLT will have the greatest concentration of talent in our industry.”

“We have a shared commitment to excellence, integrity, and a culture of collaboration and what makes both firms unique is our people.”

He added: “Together we will have the broadest and deepest collection of talent in the industry, with a singular focus in serving clients with excellence and distinction. We estimate the addition of JLT will increase MMC revenues to approximately

\$17 billion and they add over 10,000 people to our roughly 65,000 colleagues worldwide.”

According to Glaser, the acquisition adds strength to both organisations.

He explained: “JLT make us stronger in markets such as the UK and Australia and adds to our positions in key growth markets such as Asia and Latin America. They provide further scale and skills to our global reinsurance business and they increase our retirement and benefits presence around the world, especially in the UK.”

“We also see the opportunity to enhance several areas of JLT’s business including accelerating growth in global employee benefits and their developing US footprint.”

Glaser concluded: “We believe the acquisition of JLT provides compelling value for clients and colleagues of both organisations, as well as our respective shareholders.”

“This acquisition is about one word, growth. JLT accelerates our strategy to drive higher revenue and growth by pushing MMC further into faster-growing geographies and market segments while enhancing our capabilities. We are stronger together.”





## Guernsey's track record in substance

### Dominic Wheatley, chief executive of Guernsey Finance, remarks on Guernsey's decades of experience in demonstrating substance in its insurance industry

I moved from London to Guernsey more than 20 years ago when I stepped out of London market underwriting to move into the fast-growing captive industry.

The move was part of a strategy to move captive management business away from an administrative focus to being technically and strategically equipped. It was decided that the operational efficacy of the existing industry had to be matched with real insurance expertise for managers.

It was a model quickly and widely copied because, with Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting (BEPS) Actions not even on the horizon, industry leaders were still forecasting the importance of true expertise to engender substance and technical excellence.

We have been substance-based for a very long time because the UK tax authorities have long demanded that business done in Guernsey was done at arm's length and that the necessary governance to conduct that business would be done on the island.

Areas of concern in the industry today—commercial substance, transfer pricing, governance, and financial ratios—are very familiar to Guernsey captive managers and present no significant challenge. The sector has transformed itself from an administration centre into a full value insurance management industry, providing best-practice strategic and technical advice.

Our maturing insurance sector now has an increasing breadth of experience not only in captives but in the offshoot sectors of reinsurance, insurance-linked securities, and other commercial niche products.

The industry has also embraced modern governance standards, including board and director responsibilities, and benchmarking on key financial metrics.

The Guernsey insurance industry has had a stake in the Guernsey government's response to the ongoing BEPS debate over the past four years. It has publicly supported the BEPS agenda and vowed to demonstrate substance, while indicating that the island's finance sector model and regulatory framework are not particularly conducive to Guernsey being exploited for BEPS.

Our Guernsey Insurance Forum held in London on 11 October addresses the issues underpinning the substance debate from the captive perspective, including how the industry adequately demonstrates engagement with financial, operational, governance, and regulatory issues day-to-day, and the impact of the increasing use of technology on substance.

Among the questions our insurance sector is currently pondering is will the EU's substance requirements offer a new lease of life for captives in picking up emerging risks not being adequately served today by the marketplace.

It looks like the sector could develop in interesting ways.

Meanwhile, our expanding insurance community continues to combine professional skills with decades of experience to deliver real substance alongside the industry's core accounting and administrative expertise.

It services an increasingly demanding clientele with advice on global risk financing strategies and programmes across all major lines of business, in all jurisdictions. From employee benefits to financial classes, property or casualty, and professional indemnity, Guernsey's captive management industry is among the most professional and experienced in the world.

Whatever is required for the captives of our global clients in response to BEPS, they should be very reassured that Guernsey continues to provide a strong substance-based service to meet them. **CIT**

## A promising formula

Nearly 12 months on from the introduction of the UK's insurance-linked securities legislation last December, we investigate how the market has developed

## Ned Holmes reports

Uncertainty surrounding Brexit and the threat of a no-deal scenario has dominated recent headlines in the UK. But while the importance of successful negotiations with the EU cannot be understated, there are other factors in the UK market that are just as deserving of attention.

One of these factors is the insurance-linked securities (ILS) framework, which was signed into law at the end of December last year in a bid to attract ILS business to the UK and allow insurance and reinsurance firms to transfer risk to capital markets meaning businesses and consumers could manage their risk more effectively.

Preparations for the legislation began in early 2015, when the then Chancellor of the Exchequer, George Osborne, announced in the March Budget that the treasury would work with the Prudential Regulation Authority (PRA), Financial Conduct Authority and the London Insurance Market in order to design a new framework to attract ILS business to the UK.

The creation of an ILS taskforce, set up by the London Market Group (LMG), swiftly followed, bringing together representatives from the treasury, insurance and reinsurance firms, law firms, brokers, and specialist ILS fund managers.

Draft ILS regulation was published for consultation in November 2016 and almost a year later, in October 2017, draft legislation was laid before Parliament. The Delegated Legislation Committee approved the Risk Transformation Regulations 2017 and Risk Transformation (Tax) Regulations 2017, which made up the ILS legislation, by a unanimous vote on 29 November of that year and the regulations came into force on 4 December 2017.

### Traffic

The first ten months since the introduction of the legislation has seen two structures formed. First, in January this year, Neon launched NCM Re, a protected cell company (PCC) set up to enhance Neon's global reinsurance offering to its clients.

In June, Atlas Capital UK 2018, became the first catastrophe bond issued using the UK ILS regime. Sponsored by SCOR, the cat bond was created to provide the group with multi-year risk transfer capacity of \$300 million, between June 2018 and May 2022, to protect itself against named storms in the US, earthquakes in the US and Canada, and windstorms in Europe.

Malcolm Newman, chairman of LMG's ILS taskforce and managing director of SCOR's Europe, the Middle East and Africa

hub, says the issuance of two structures on the UK ILS regime within the first year is "good news".

He explains: "We didn't expect that many, due to the short time available between the legislation being passed in December and the 1 January deadline. In reality, we have always viewed 1 January 2019 as the target date for UK ILS issues, so the fact that we've had two already is good news."

"There are at least half a dozen firms currently talking to the PRA, so I think there could be a little rush of approvals before the end of the year. It is encouraging though that there are a number of ILS conversations underway at the moment."

Rhodri Lane, head of international capital markets at Aon Securities, agrees with Newman.

"It is still early days with the UK ILS market," says Lane, "but the fact that we have seen Neon sponsor a sidecar and SCOR sponsor a cat bond from the new regime is very positive."

William Hogarth and Garrett Moore, partners at Clyde & Co, suggested that the first 10 months had fallen short of the expectations of some people within the industry.

Hogarth and Moore explain: "The level of activity of the new UK ILS regime has not been as high as some had hoped for initially but we are aware of a number of projects in the pipeline and there are strong signs that the flow of transactions being placed through London will grow."

After its maiden 10 months, there appears to be a great deal of optimism surrounding the UK ILS framework and market but it is far from the finished article. Brendan Roche, global leader of ILS and special purpose vehicles centre of excellence, Marsh Captive Solutions, describes the legislation as "a good starting point for the development of an ILS industry in the UK" and says that the market "continues to evolve".

Lane predicts that this evolution will come as the market continues to grow and as the UK's framework sees more use. He states: "For now the initial framework of the market simply needs to be used more and, thus, tested."

### Impact of Brexit

Brexit remains an unavoidable subject where the UK is concerned, especially as Theresa May's government continues to struggle to find common ground with its EU counterparts. Despite Brexit being a polarising issue that is dominating the attention of both the government and regulators, Hogarth and Moore remain confident that it will not have a negative effect on the UK ILS market.

They say: “We are confident that all interested parties in London and the rest of the UK will work to ensure the continued resilience and growth of the UK insurance market as a whole, as well as the fledgling London ILS market.”

Newman also expects that its impact on the UK ILS market will be minimal. “The ILS is effectively a reinsurance vehicle,” he explains, “and reinsurance can be done across borders.”

“We’ve seen with the SCOR cat bond issue that Europeans are not concerned about having an ILS within the UK even if a hard Brexit occurs—and the UK ILS legal form will continue, unaffected. We don’t see Brexit really having any negative impact on UK ILS.”

According to Roche, European cedents could see an impact from Brexit. He states: “As a Solvency II regulated market, the UK is attractive to European cedents looking for certainty of regulatory capital equivalence. Post-Brexit it will depend on whether the UK retains Solvency II equivalence as to how this will impact European cedents.”

Roche also believes that leaving the EU may provide the Prudential Regulation Authority with more flexibility surrounding its authorisation and supervision of insurance special purpose vehicles (ISPV).

“They therefore may be better placed to provide options to ISPV structures and better utilisation of the PCC to aid speed to market for transactions.”

## PCCs

The UK ILS framework legislation, the Risk Transformation Regulations, also introduced PCCs as a legal structure, a first for the UK, and something that Roche suggests could open up opportunities for other sectors of the finance industry to consider options in UK ILS.

Roche explains that the structure could also “facilitate the development of collateralised reinsurance in the UK. This form of ILS allows for speed of execution as the PCC will be authorised for a range of underwriting scenarios and will use standardised documentation to allow a faster route to market for all parties”.

Lane added: “I would expect to see some of the major PCC platforms establish vehicles in the UK to allow their clients to deploy capital for various ILS structures via a UK vehicle.”

## Looking ahead

The general consensus is that the first 10 months of the UK ILS framework and market have provided a good starting point,

something to build on moving forward. Newman says that the aspiration has to be the UK becoming a location which is considered amongst the top ILS marketplaces in the world. That, he says, is not something that can be achieved by “just competing for US property cat bonds”.

“It has go to do something different,” says Newman. “Europe is certainly one focus as not many Europeans have gone into ILS in the same way Americans have. I’m hopeful that something will come out of Lloyd’s, where there’s some creativity around capital sources and usages. I’m hoping that Lloyd’s will look at ILS and come up with some creative ways to get third-party capital in. If this happens then this will be truly different to what we’ve seen before.”

According to Newman, ILS also continues to have the full backing of the UK Government. He states: “The ILS task force is still active and we had a meeting with the PRA and various other parties recently to ensure that we continue to learn and progress. The treasury also attended, showing that there is still strong government support to make this work. I think the Government is still 100 percent behind us.”

Roche predicts that the UK market will see a more varied scope of perils being covered as more activity and continues to develop, and the PRA become more comfortable with ILS structures, we will see a more varied scope of perils being covered.

He says: “To date, ILS has been predominately used for natural catastrophe risk, but opportunities for other low frequency, high impact events should be considered, including some of the speciality Lloyd’s markets, marine, and then looking longer tail to casualty and life.”

“ILS could be used to fund some of the short-tail risk in these markets as investors look at ways to lock in funds for longer terms with potential for better rates.”

Hogarth and Moore echo Roche’s prediction on the diversification of the perils covered by the London ILS market in the future.

“There is a great deal of optimism that London’s position as a global investment centre,” say Hogarth and Moore. “Coupled with the London insurance market’s expertise and ability to innovate, will see growing opportunities for ILS to cover new and more diverse risk and access more capital.”

“While the new UK ILS regime is not seen as a replacement for Bermuda as an ILS centre, there is consensus that London, with its direct access to capital markets and the London insurance market, could grow to complement Bermuda and other ILS centres by making ILS capacity more available, and providing the talent and environment for ILS innovation.” **CIT**



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## Insurance-linked innovation

Mark Helyar discusses the new ILS structure under development in Guernsey, its motivation and why Guernsey is the ideal location for ILS

### Ned Holmes reports

An innovative new structure is under development in Guernsey, which would allow both the fund and insurance element of insurance-linked securities (ILS) within a single structure. Leading the development is Mark Helyar, a Guernsey-based lawyer.

Captive Insurance Times spoke to Helyar about the new structure, its development, and why Guernsey is the ideal location for it.

### Can you describe the new ILS structure you are developing?

This is a structure which utilises a limited partnership, similar to private equity fund structure, where the general partner company is licensed to conduct insurance business (typically in Guernsey this would be collateralised reinsurance).

The investor subscribes to commit capital to an ILS programme by the limited partnership and the general partner company conducts the insurance transformation on its behalf, within the same single structure. The limited partnership is not liable for the actions of the general partner (limited partnership liability is limited). The structure is tax transparent (the investor pays tax where they are resident).

The investor does not have to consolidate the limited partnership/general partner vehicle into its own accounts and the limited partnership would generally be an unregulated, private vehicle.

### What is the motivation behind its development?

Access to ILS investment in this sector is typically driven by the acquisition of shares in a regulated collective investment scheme or fund. The fund must then use separate and separately regulated structures (often in another jurisdiction) to transform insurance risk into capital market risk, usually by accepting risk ceded from an insurer or reinsurer. The risk is usually completely collateralised—a \$25 million risk is covered by \$25 million of capital, held in an independent trust account for the benefit of the reinsured during the period of cover (usually a single year).

The current market structure is costly (double regulation, double audit, double governance structures, double administrators), inefficient, and lacks governance and cost transparency.

It is far more efficient and cost effective, as with this new structure, to conduct the investment and ILS transformation in a single entity based in the same jurisdiction, with a single set of administrators, auditors and directors.

### When will it be launched?

There is no requirement to alter existing regulations in order to accommodate this activity—the existing law and regulations in Guernsey already provide discretions for its approval, and we have a substantial investment fund market and insurance management market to provide the professional support.

Clients are already in the later stages of formation. I anticipate we will see some form of guidance from the regulator in due course but this doesn't require new legislation, it's a new idea using existing, tried and tested structures. The limited partnership is well known in the funds industry, less so in the insurance sector.

### What impact do you predict it will have on the market?

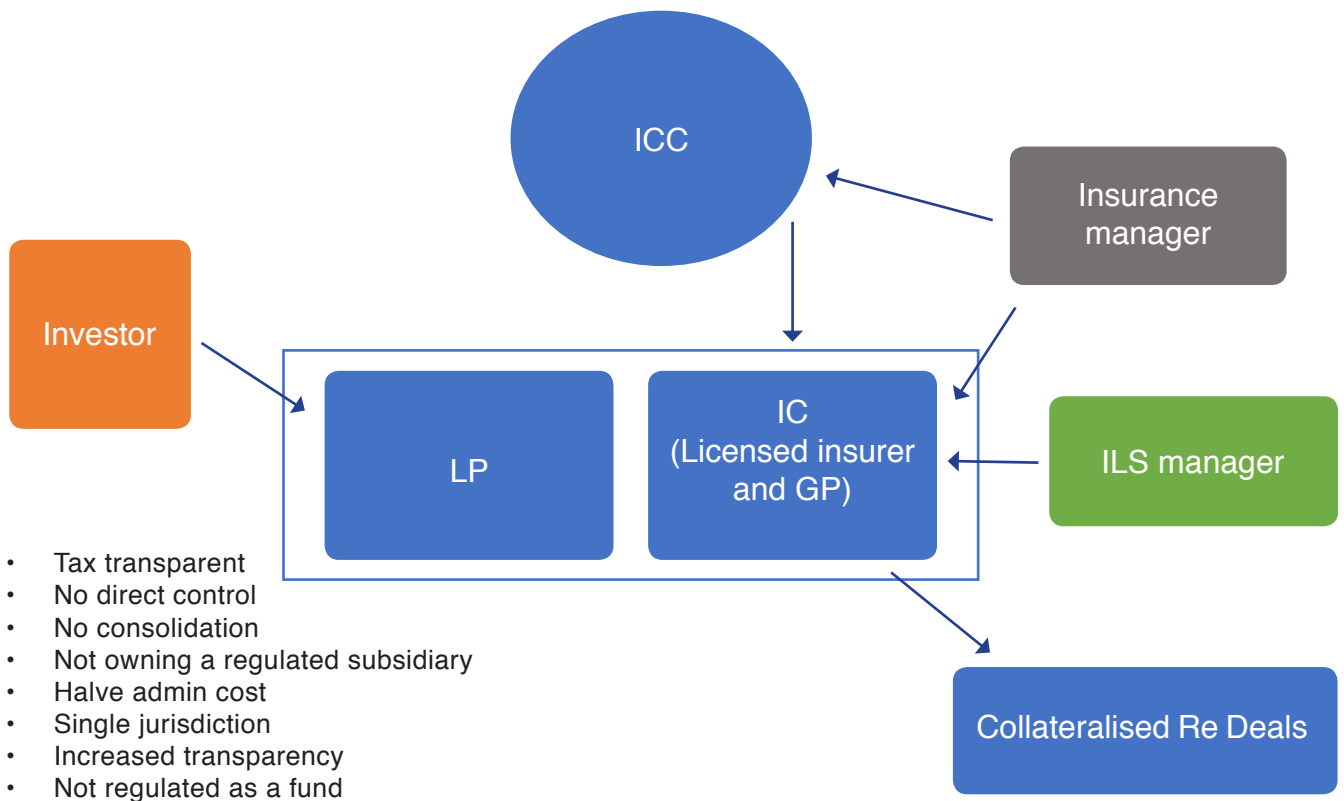
Large investors seek investment in pure, non-market correlated risk. They also typically do not want to invest passively via a large investment fund. This structure is therefore a game-changer for most substantial ILS investors.

They will have better transparency and lower costs, and therefore will see enhanced returns when compared to the current fund and ILS transformer model.

### Who is the structure aimed at?

This is not a retail investor structure, it will be used by large pension funds who are already familiar with the market and perhaps by ultra-high net-worth individuals family offices who invest in ILS to provide portfolio diversification.

ILS is typically a small part of a much larger and wider portfolio. The regulator will wish to ensure that there are sensible



safeguards so that investment cannot be offered to retail investors (typically by requiring a high minimum investment limit). This is entirely sensible—widows and orphans shouldn't be betting on hurricanes.

### Other than yourself who is developing the structure?

I have heard of other people talking about it in recent months (for example at the Asian ILS conference), but I have been mooting the structure now for some time and banging the drum for Guernsey as the ideal place to conduct this activity.

In recent months investor concerns over transparency, costs, and margins, as well as wishing to retain active rather than passive investment control, have caught up and the structure is now being implemented.

Guernsey is the ideal jurisdiction in which to conduct this activity, as unlike other leading offshore insurance or ILS jurisdictions, we also have a very large and diverse investment fund industry. This means that the Guernsey regulator and the administration industry is familiar with both insurance and investment sectors and their structures. We have found the Guernsey regulator's innovation unit to be very responsive and adaptable—development requires two regulatory units (investment and insurance), which in many jurisdictions are contained in entirely separate silos, to communicate and cooperate. [CIT](#)



Mark Helyar is a lawyer based in Guernsey. He specialises in advice and structuring in the ILS, insurance and reinsurance markets.

He has won a number of awards and nominations for novel structures in the ILS market, including he worlds first listed private CAT bond and the first Takaful securitisation.

# A game changing toolkit

Richard Magrann-Wells from Adjoint explains the benefits of blockchain, what it can offer the captive industry and the opportunities that the captive industry presents to blockchain companies

Ned Holmes reports

### What is blockchain?

Blockchain is a new way to share data. It is an honest 'distributed ledger'. A way for authorised users to share and see the data that is relevant just to them. The technology is different from existing communal spreadsheets or data platforms. With blockchain all the parties can be sure that the data is trustworthy.

When a user can be certain that data is reliable, and tamper-proof, it is truly a game-changer. You no longer have to wait for

confirmations and validation—with blockchain that is already baked-in. Trustworthy data can be used to drive business decisions with confidence.

### How could blockchain benefit the captive industry?

Captive insurance requires interaction between insureds, captive management companies, reinsurers, fronting insurers, and regulators. If all parties shared a common trustworthy pool of data, in real-time, it would save vast amounts of time and resources that are spent on collecting and validating information. Captive management could post information, the reinsurer could underwrite based on that unchangeable information



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and the regulator could use that same real-time information to supervise the insurance company. The other benefit is tracking the payments that flow through the value chain—premiums from local subs to frontiers, to captive managers, etc.

We will start to see the first impact in the first quarter of 2019. Our first product is already being tested in a production environment Q4 2018.

### Can you explain smart contracts and how they are related to blockchain and captives?

‘Smart contracts’ refers to self-executing programmes. When you have reliable data you can use smart contracts to execute the next step in the process without waiting for human input or validation. With a few lines of code, a payment or a notice can go out automatically because the smart contract is activated by trustworthy data provided by the blockchain. The captive insurance industry requires careful adherence to process and procedure. Smart contracts can eliminate the potential for errors and delays by programming that process map directly into the ledger known as blockchain.

Some people presume that implementing a blockchain solution requires uprooting legacy systems that have driven the industry for years. That is not the case. The only potential obstacle that blockchain faces is the hype that preceded the technology.

“

Where captives are concerned, we cannot yet disclose the parties involved, we can reveal that by early 2019 one of the larger corporate captives will be run using Adjoint’s open-source blockchain platform ‘Uplink’

”

Richard Magrann-Wells, US sales lead, Adjoint



### Do you foresee a large impact long term?

Blockchains are just a better toolkit. They won’t cure cancer, but just as email and spreadsheets have transformed the way we communicate and calculate, blockchain will forever change the way we share information over the internet.

The captive industry is proving a terrific starting point for this technology. The participants tend to be sophisticated. They are methodically regulated. The business is extremely process intensive. All of this provides opportunity for improvements leading to significant cost savings and a improved client experience—with the implementation of distributed ledgers and smart contracts.

### Is Adjoint working on anything in the captive insurance/blockchain space?

Yes. We already have a few applications in the insurance industry in production today. Where captives are concerned, we cannot yet disclose the parties involved, we can reveal that by early 2019 one of the larger corporate captives will be run using Adjoint’s open-source blockchain platform ‘Uplink’. We are working with brokers, insurers, and corporate captive owners—all of whom will benefit from the efficiencies that the Adjoint platform, combined with proprietary embedded smart contracts, will deliver. **CIT**

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# *Emerging Talent*

**Showcasing the new generation of captive professionals  
TJ Strickland, senior audit manager, Rives & Associates**

### **Personal bio**

I grew up in a small town in eastern North Carolina, called Roanoke Rapids. I was lucky to find a passion in growing our insurance services niche so early in my career.

My beautiful wife and two kids are happy to call Lexington our home. Our free time is spent mainly entertaining our four and one year old, but we enjoy craft breweries and wineries, weekends at the lake, and volunteering at our church.

### **Professional profile**

After graduating from East Carolina University, I started my career with Rives & Associates in Lexington, North Carolina. At Rives I specialise in providing assurance, advisory, accounting, consulting and taxation services.

I have played an instrumental role in leading internal training and have expertise in internal control evaluation and technology implementation, improving processes for this clients by recommending internal control enhancements and implementation of policy and claim management information systems.

I was recently named as a 2018 “Top 30 Under 30” recipient with the Insurance Accounting Systems Association.

### What is your impression of the industry?

The industry is influenced by economics and regulation. Significant changes can affect the strategic direction of the captive industry. As we have witnessed in recent events, court decisions or recession can certainly affect how a captive is formed and funded.

As with any industry, there are companies out there that can give the industry a bad reputation. Over the next few years, as more tax court decisions come out, I think you will see some of the 'bad eggs' in the industry jump ship or evolve their operations to gain compliance.

I enjoy being on the forefront of regulation changes and determining best practices to ensure compliance across the board. Some call this job security—I just call it fun!

### What are your aspirations for your career in the captive industry?

I like solving problems. When a captive is struggling with regulatory issues or evolving their operations, it gives me an opportunity to step in and help.

Serving as a partner to work through complex structure issues, complicated accounting treatments, or regulatory issues is what I strive to be an expert in.

Though cliché, I aspire to be a thought leader and influence the direction of the captive industry.

### What advice do you have for someone considering a role in the industry?

Take it! There is plenty of work to go around and we have fun in the process. I see a wave of professionals moving to shore (retirement) that is not being followed with enough talent to fill their shoes.

Especially with the continued growth of captives across domiciles, there are great opportunities for young professionals. **CIT**

“

Over the last several years, TJ Strickland has been responsible for auditing many of Atlas's client captive insurance companies.

Working with TJ is a pleasure. He is professional, knowledgeable and responsive and, as he has gained experience in the captive field over the years, he has grown in confidence and become a credible, trustworthy representative of his firm at conferences and in meetings with clients and our account management teams.

”

Martin Eveleigh, chairman, Atlas Insurance Management

TJ

Strickland

# Asia Pacific: Eclectic, complex, and diverse

As interest for captives in the Asia Pacific region grows, the diverse countries that are straddling the captive stratosphere must consider whether to enter the top layer of captive insurance or risk plummeting back to Earth

### Ned Holmes reports

Interest for captives in the Asia Pacific region continues to rise, but while the area is showing impressive recent growth, it continues to represent a very small share of the global captive market.

Marsh Captive Solutions' report, 'The Captive Landscape', showed that the Asia Pacific region has the most consistent recent growth. From 2016 to 2017, there was a growth of 24 percent in Marsh-managed captives driven by parents in the region—a huge feat when you consider the Caribbean was the only other region with positive growth (6 percent).

Despite this continued growth, the region remains a small player in the global captive market, commanding just 6 percent of captives by parent company region, 4.2 percent by domicile, and producing \$547 million in premium by parent company region, with \$445 million by domicile.

Anthony Egerton, principal officer of Huntington Underwriting, says these figures are a "slight disappointment".

He explains: "These figures should be looked at within the context of the region, providing roughly 35 percent of global GDP. If you look at the International Monetary Fund and World Economic Forum projections, the region of the world that is growing the fastest is the Asia Pacific."

"So, there is a disappointment in the captive industry that things have not advanced as far as they might have."

### Obstacles

Across the region there are a number of factors stunting the growth of the captive market. The first of these is the business conglomerates that dominate many of the emerging economies, such as Indonesia, Malaysia, and Thailand.

Many of these large conglomerates have insurance companies within their ownership which are licensed and regulated onshore and write coverage for both their group and third party business.

Egerton says these insurers are active in the local insurance industries, therefore not fitting under the "Western definition of a captive".



He adds: “This model in Asia, where there is a wholly owned insurance company that is licensed and regulated onshore that also writes third party business, is part of the answer why the captive industry has not evolved as much as the global GDP figures and the other parameters suggest it should have.”

As is often the case in emerging regions, there is a gap in captive education which negatively impacts the growth of the Asia Pacific captive market.

Egerton explains: “Even in the developed markets like Japan, there is an education gap and a learning curve needed to go through with many organisations.”

There are a number of organisations, such as Guernsey Finance and the Labuan International Business and Financial Centre, that conduct roadshows that provide captive education throughout the region, however, more work is needed to close the education gap.

Egerton comments: “There is still the requirement of education, training, and recognising the role that the captive structure can play in the risk management strategy.”

Another challenge facing captives and their parent companies in the region is the Organisation for Economic Co-operation and Development’s (OECD) base erosion and profit shifting (BEPS) initiative.

The initiative brings together more than 115 countries, and jurisdictions, and it is aimed at harmonising tax regulations internationally and counteracting the exploitation of gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.

Vic Pannuzzo, CEO of Artex in Singapore, says the impact of BEPS is being felt by regulators and captive owners globally, and that is no different in the Asia Pacific region.

He remarks: “The need to review governance and substance in the captives’ domicile has developed into an important consideration for captive owners as regulators around the world respond to OECD requirements to counter BEPS or harmful tax practices.”

“We have seen some large captive owners move their insurance and risk office to Singapore to fortify management and governance processes within the domicile.”

## Trends

According to Pannuzzo, the Asia Pacific market is similar to most other regions at the moment. He explains: “While there is evidence of new captives being formed in the region, some have also closed as a result of merger and acquisition activity.”

“It is difficult to talk about trends as we really do not have the volume that would allow us to plot particular trends but anecdotally we are seeing opportunities from multinationals that are growing in the region and others that have issues accessing capacity restrictions on natural catastrophe exposures or climate change directives. Captives are being explored as vehicles that can help create capacity by partnering with traditional or alternative risk capital providers.”

## ILS

In recent years, there has been a distinct shift toward insurance-linked securities (ILS) in the region. At the start of the year, the Monetary Authority of Singapore (MAS) launched the ILS grant scheme in a bid to catalyse the development of Singapore’s ILS market.

The grant, which will apply to ILS bonds covering all forms of risks, removes all of the issuer’s upfront set up costs which it is hoped will draw ILS business to the country.

Pannuzzo says the region is seeing “increasing momentum” toward ILS deals being done in the near future.

He adds: “Singapore is very keen to become an ILS hub and has formalised an incentive programme that will absorb the set up and issuance costs that can run into the millions.

It has a special purpose reinsurance vehicle framework and is looking to adapt its variable account capital company structure to accommodate protected cell company regulations.”

Singapore’s rise toward becoming a major reinsurance hub was kickstarted with the establishment of the Lloyd’s Asia platform, and Egerton, who worked for Lloyd’s in Asia Pacific between 2003 and 2008, suggests the ILS scheme is a natural step.

Egerton says: “I see the Singaporean authorities efforts in agreeing to sponsor the cost of some early ILS as really the next stage in positioning Singapore as that centre of excellence.”

According to Egerton, Hong Kong continues to remain an important financial centre in the region and within the last month has announced a series of different measures in an attempt to attract global and regional players back.

“They have established a talent list that they wish to attract, they have identified certain sectors of the industry that they want to promote and attract, so there is quite an interesting dynamic between those two historical centres”, he says.

Attention must also be paid to the developments of the “elephant and tiger in the room”, India and China. Special economic zones for financial services, including insurance and reinsurance, have been created in the Chinese Guangdong province, and similar steps have been taken in Gujarat in India.

Egerton notes efforts from Singapore “to promote the city as a centre for ILS issuance as part of that broader industry development.”

## Predictions

Asia Pacific may still hold a small slice of the global captive market, but Egerton sees it as a market that is continuing to mature, a view which is supported by the increasing numbers at the Asian Captive Conference and the growth figures.

“I don’t see there being a huge surge of captive formations,” he explains, “but there is definitely a pipeline of prospects that will lead to a steady increase in numbers of captives being formed.”

There is an argument that the captive numbers have been slowed by the very cheap cost of traditional insurance and reinsurance, caused by current over-capitalisation and underpricing, but Egerton is not of this view.

“I’m not sure I buy into that a great deal”, he observes, “I think the other key benefits of a captive still remain irrespective of ultimately the cost of the risk transfer because that is only part of, and at the end of the day a relatively small part of, the motivation for establishing a captive.”

## A diverse region

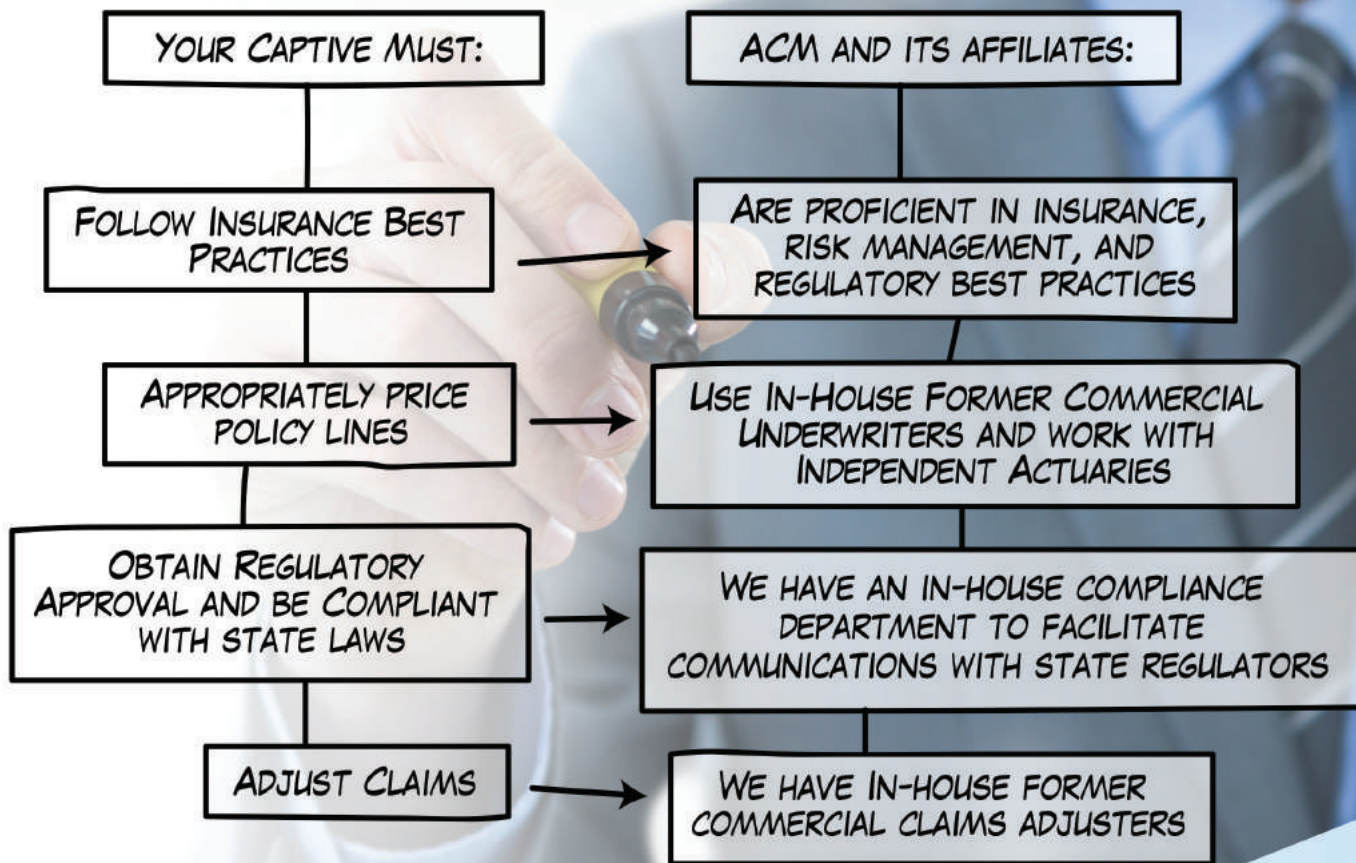
What must not be forgotten in discussing the Asia Pacific market is its diversity. Pannuzzo describes the region as “an eclectic mix of cultures, customs, and regulation”.

He adds: “There is no uniformity of insurance regulations between countries and each market will be approached differently. The biggest markets for captive business continue to be Australia, China/Hong Kong, Japan and Malaysia.”

Egerton too, concludes that the Asia Pacific region is a “complex region”, with major economies like Japan and Australia mixed with smaller but highly healthy cities and countries like Hong Kong and Singapore. **CIT**



# Captives Are For Risk Management

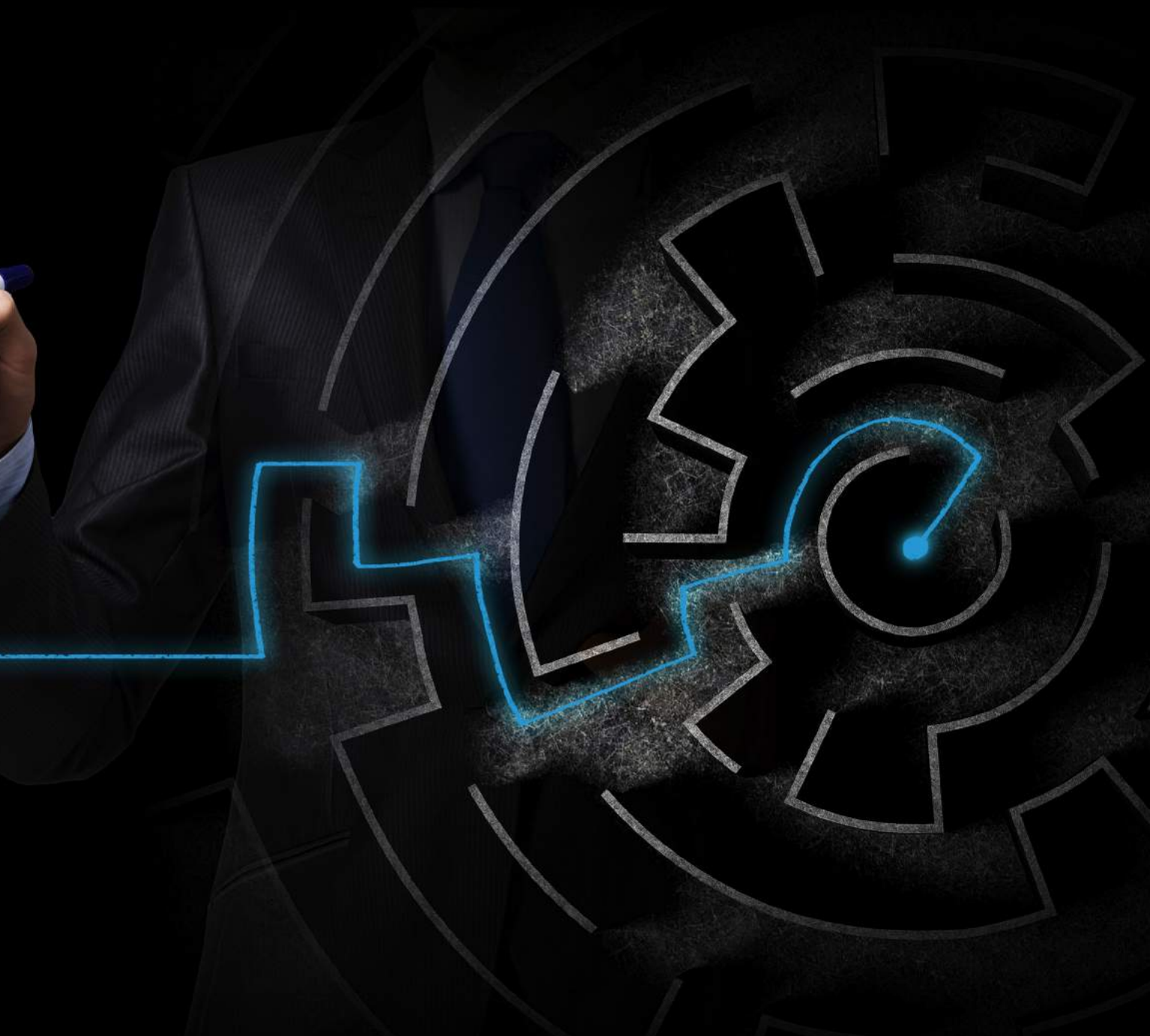


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## A step-by-step process

Diana Hardy and TJ Strickland of Rives & Associates discuss investment strategies for captive insurers and outline the steps that need to be taken

It happens more than you think, you receive a financial statement from a captive manager at the start of an audit and see “investment in limited liability company (LLC)” on the balance sheet. The first thoughts as an auditor are “great, more required procedures and more costs ... wish we could have been involved in the initiation”. Alternative investments within a captive insurance company can entail many different forms: investments in LLCs, loans, real estate, life insurance policies, and many more. Before auditing alternative investments, there are many steps a captive owner should take.

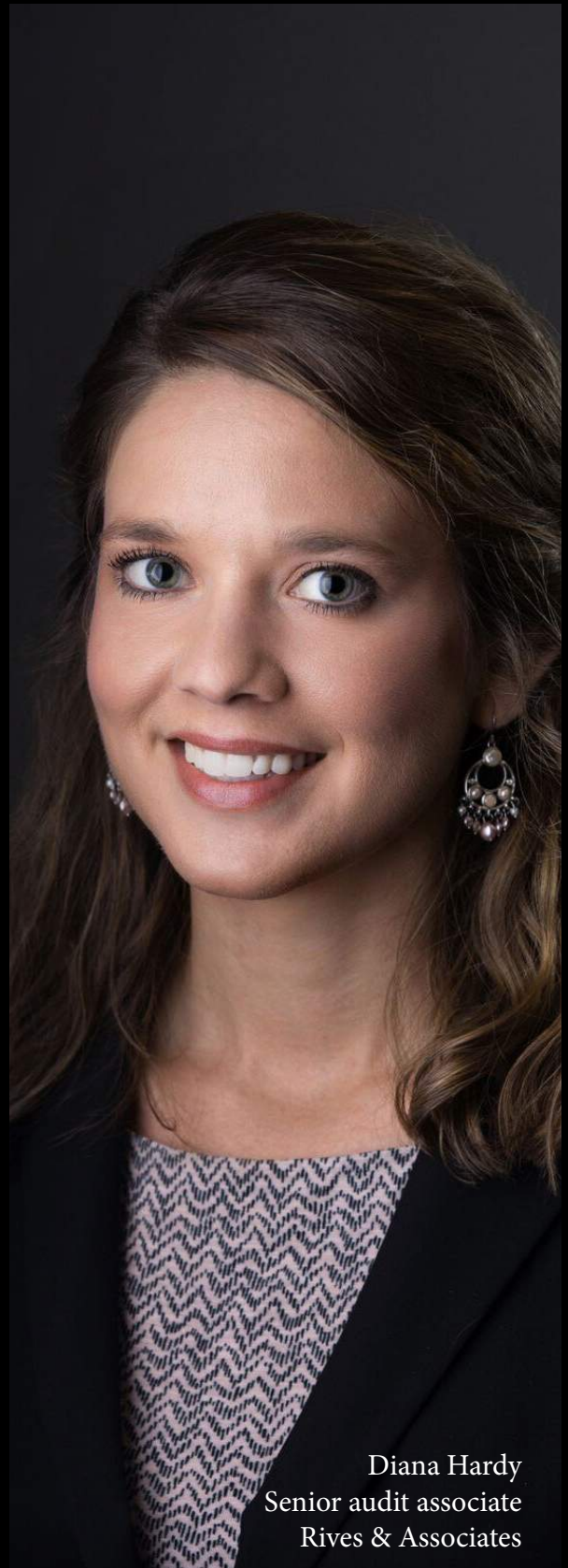
As a captive owner, alternative investments can serve as a means to providing a strategic direction in building the investment portfolio and hedging against loss experience. The first step as a captive owner is to discuss the alternative investment with the captive manager. The captive manager will be able to assist in determining if the investment meets the Investment Policy Statement (IPS) based on risks managed by the captive. Furthermore, the captive manager will assist in determining compliance with regulatory requirements. This is the point at which the captive manager should be reaching out to both the regulator and independent auditor. At least, it's the point we wish they would reach out. Having input at the initiation of an alternative investment allows the independent auditor to evaluate what type of audit evidence will be required for the valuation of the alternative investment. Valuation is key from an audit perspective. Having input from the start with the auditor assists the captive manager in maintaining the proper documentation needed in completing the audit. Such communication can also help reduce audit costs, which are ultimately passed to the captive owner.

You may be asking, what is the captive manager going to need to maintain to support the valuation of an alternative investment? The answer: it depends.

## Investment options

One of the most common transactions we see captive owners attempting is having a captive issue a loan back to the insured/owner. Many domiciles allow this transaction to occur as long as the captive is adequately capitalised and able to meet its policyholder and state obligations. When engaging in an affiliated loan transaction, consider doing the following:

- Update the company's IPS and obtain approval of amendment of IPS from regulators
- Acknowledge and approve transaction in the company's board minutes
- Execute the transaction via a promissory note with clearly stated terms (principle, interest rate, payment terms, etc.)
- Maintain an amortisation schedule for accurate financial reporting



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Real estate is also a viable option for captives to invest excess funds, however, one should tread cautiously. In many domiciles, there is nothing keeping a captive from seeking out real estate to be held as an investment. The biggest hindrance is liquidity. An insurance company of any type should have access to funds to meet its short and long-term obligations.

In the event of a claim, an insurer should be able to quickly liquidate any assets to meet its policyholder obligations. Real estate is illiquid in the sense that it could take months or years to recoup your investment. Many captives will not have excess capital to invest in real estate until many years after formation. In the event that real estate is your choice investment, it is important to maintain deeds and up-to-date appraisals of the property.

Life insurance policies are frequently seen by captive insurance companies as investment tools. In the same manner a captive invests in equity or debt securities, life insurance policies provide a return on investment and shouldn't be conceived otherwise. As discussed above, liquidity should always be one of the focuses of the investor when considering how to invest within a captive.

For life insurance policies, consider a life insurance company with an A+ rating from A.M. Best or another rating agency and a guarantee of the proceeds of the cash surrender value on demand upon surrender of the policy.

Our first scenario, investments in LLCs is an ambiguous term that could mean a plethora of possibilities to the reader of financial statements. Essentially, a captive insurance company can set up a subsidiary LLC to place investment vehicles. This can be harmless but some captive investors attempt to conceal aggressive or unapproved investment transaction because, in their eyes, the investment is no longer in the captive's control but of the subsidiaries.

Typical investments placed in a subsidiary LLC include rental properties, affiliated debt, and hedge funds, amongst others. In most cases, the subsidiary LLC has to be consolidated with the captive as if the companies are one in the same. For the purposes of the financial statements, there is no concealment of investments held in a subsidiary LLC.

Before considering any alternative investment, it is always best to first visit your IPS and talk with your captive manager. Furthermore, determine if the desired investment requires regulatory approval and that the captive would remain liquid to meet obligations.

Then ultimately, inform your auditor so all parties can work to provide the necessary paper trail and valuation methods. Always remember, the most common answer when approaching an alternative investment will be: it depends! **CIT**



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## Health insurer trends: the shift from payer to partner

Eric Butler of Generali Employee Benefits comments on the changing landscape for medical insurance and remarks on how the rise in 'lifestyle diseases' is causing healthcare costs to skyrocket

Gone are the days when a health insurer would operate on a pure indemnity model, just processing and paying medical claims and then passing on the inevitable medical trend every year in the form of increased premiums. Annual double-digit medical trend increases are not financially sustainable for captives, which cannot pass on the increases to local businesses as easily.

Today, health insurers and healthcare captives are far more engaged in the health (and health delivery) of their covered populations. They are more proactive. This is a shift from payer to partner. For healthcare captives the focus of this partnership is increasingly about addressing changes in the burden of illness for a population, which means trying to have a positive impact on the current and future health of all individuals insured.

### What's driving costs?

Medical trend should never be confused with medical inflation. Inflation reflects year-over-year changes in unit costs, and while medical treatments and services can certainly experience inflation, the bigger drivers of medical trend are things like new medical technology, new drugs, aging populations, patient demand and changes in physician treatment patterns. Medical trend has also been particularly impacted by changes in burden of illness, especially by the rise in non-communicable diseases (NCDs), or what are more commonly known as 'lifestyle diseases'.

Modern life is such that people are moving less, with upwards of 40 percent of individuals in many countries failing to do even moderate activity, defined as just 150 minutes per week. This is a big problem, as the negative impacts of a so-called 'sedentary lifestyle' and being overweight are well known, but the prevalence in many countries of individuals with a BMI of more than 25 has reached 40 to 60 percent, or higher. Add to this a rise in binge drinking, persistent smoking rates, pervasive stress, and more time spent in direct sunlight and you can see a significant upward trend of NCDs.

The impact on health outcomes is serious. In 2017, over 70 percent of deaths were related to NCDs, with a shocking 38 percent of these deaths classified as premature, meaning involving individuals between 30 and 69 years of age. Of those premature deaths, 80 percent were related to four disease groups: cardiovascular disease, cancers, respiratory illnesses, and diabetes.

The physical and psychological effects of these illnesses on people and businesses are far-reaching and somewhat impossible to quantify, but the direct impact on insurance claims costs is significant.

### Changing the curve of medical trend

The estimates can vary dramatically from country to country, but most surveys conducted by brokers/consultants such as Aon, Mercer-Marsh and Willis Towers Watson have placed

global medical trend at just under 10 percent. This is more than three times general inflation, which means that healthcare costs are growing disproportionately to other costs of multinational companies. The math is sobering. A company with global medical insurance costs of \$90 million today could conceivably expect to pay \$238 million ten years from now, absent any intervention.

If healthcare captives are to make any real headway with regards to medical cost containment, there needs to be a concerted effort to understand true underlying cost drivers within their health plans. This has to begin with data analysis.

Though data seems to be plentiful, both data quality and correct application of the data are what matter most. The real challenge is in turning data into meaningful insight.

While most health insurers around the globe can supply clients with summary claims data, too many report only top 10 diagnoses or general benefit utilisation. The risk is that simplistic reporting can be incomplete, one dimensional, and even distorted.

Health insurers that can slice claims data in multiple ways can provide a better perspective, as can reports with drill-down capabilities to discover, for example, which populations are driving which benefits, or which diagnostic groups are driving benefit categories.

Even better are health insurers with reports that can further indicate if year over year changes within each category are related to more patients, more services per patient, or a higher unit cost per service. This type of insightful data provides an effective roadmap for interventions and programmes to mitigate trends and cost drivers.

### Turning data into meaningful solutions

Beyond data assessment, however, in order for employers to make a real impact on employee health, it is essential to overlay claims data with observations and insights on local population health trends, programme design, provider network structure, and any impact on plan costs from the public health sector and the regulatory environment. An understanding of all of these factors is essential to help convert data into meaningful solutions for employers and those insured.

Through this approach of leveraging information to develop insight and meaningful recommendations, the best health insurers act as partners to healthcare captives—providing illuminating reports, informed and market-specific insight into cost drivers and their causes, comparative benchmark information, and targeted recommendations on how to address the findings. Sometimes, due to limited scope of cover locally, or the local interplay with a public health system, the cost drivers within the local private

medical cover are not at all related to things we would expect (like NCDs). A good analysis can identify that, to ensure that we do not over-engineer a programme that isn't driving medical claims.

Whatever the cost drivers identified, recommendations can include modifications to plan design, provider networks, pre-authorization requirements, as well as the introduction of targeted wellbeing programmes. At Generali Employee Benefits (GEB), we focus on wellbeing programmes that support members at every stage of the health continuum, including programmes that help members stay healthy or return to health, as well as programmes to help members prevent and manage chronic illnesses. In this way, we approach programme design holistically at the local and global level.

### Making a tangible impact on employee health

GEB routinely carries out this kind of analysis for captive clients. So how does all this play out in practice? As an example, the reports for one large client revealed an unusually high amount of respiratory claims in one Asian country (more than 38 percent of total spend) compared to other clients in the same market. This spend, however, was not related to NCDs but rather it was overwhelmingly related to simple colds and flus, and this was due to an extremely high incidence rather than due to severe cases. That is to say, nearly everyone covered had a cold/flu claim but the number of claims per person were few and relatively inexpensive.

We identified that local HR policy was a big driver of these statistics in that a doctor's note was required for even one day's absence, even for simple conditions such as the common cold, despite the fact that there is little a doctor can do to treat a cold. As it was, an HR policy to control sick days had the unexpected result of driving up claims for conditions where general practitioner visits have little to no impact. We recommended an HR policy change, along with other initiatives to reduce the need for such sick days, and improve respiratory health overall. These ideas included:

- Education materials on how to avoid catching or passing on a cold
- Implementation of targeted anti-cold and flu campaigns
- An assessment of in-office air quality, proper changing of air filters, and improved sterilisation procedures for all office surfaces
- Implementation of an anti-smoking campaign
- Implementation of on-site medical kiosks and a telemedicine service to reduce demand for outpatient consultations.

As part of this exercise, we worked closely with our network partner to ensure that our recommendations were feasible locally, addressing intricacies of the local environment and the interplay between public and private healthcare systems.

### The future of health and wellbeing

With NCDs often representing the leading cause of deaths around the world, and sometimes the leading cause of claims, this is the opportune moment for all players in the benefits ecosystem to intervene, collaborate and help improve quality of life and sustainability of insurance programmes. This is where digital solutions can also play a part, particularly since functionality has gone up in recent years and implementation costs have come down.

Multinational employers, particularly those who are self-insured through a captive, are increasingly focused on changing the health of all employees and their dependants. This shift requires health insurers who can move from being just a payer, to being a true partner.

Successful healthcare captives are strengthening their partnerships with their local health insurers, or even better through their global network providers such as GEB, using data analysis, insights and recommendations to focus on managing behaviours and costs of healthcare providers. It's a classic win-win. [CIT](#)

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**Eric Butler, director, global health and wellness, Generali Employee Benefits**







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# Comings and goings at Hiscox, Artex and Walkers

### **Dolphin makes a splash at Hiscox.**

Global reinsurer Hiscox has appointed Andrew Dolphin as COO of Hiscox Re, the group's reinsurance operation.

Dolphin will begin his new role and join the Hiscox Re and Insurance Linked-Strategies (ILS) executive board immediately.

Having joined Hiscox in 2000, Dolphin's analytical and commercial skills saw him move from a technical role in the group reinsurance purchase team to leading the whole of the Hiscox Re International teams across London, Paris, and Bermuda.

He has played an important role in growing the business capability across multiple fronts, from analytics and underwriting to our underwriting platform development and ensuring pricing rigour across multiple lines.

In January 2017, Hiscox rebranded its insurance-linked securities team under Hiscox Re ILS to reflect the expanded range of insurance-linked securities products it offers.

Dolphin will continue to be based in London and will report to Mike Krefta, CEO of Hiscox Re and ILS. Krefta stated: "Andrew Dolphin's proven track record of success and strong reputation made him a stand out candidate for this position."

### **Artex has appointed Paul Cole as its Gibraltar managing director.**

In his new role, Cole will be responsible for the day-to-day management of administrative and insurance operations, including supervision of 26 staff in Gibraltar.

Cole joined Quest in 2007 and was at the company when it was acquired by Artex in 2016 and became Artex Risk Solutions.

Prior to his role at Artex, he held several roles in the investment banking division of HSBC Bank. Cole will report to Steve Quinn, managing director and head of mainland Europe for Artex.

### **International law firm Walkers has appointed Kate Storey as partner in its Guernsey practice.**

Storey will lead its Guernsey insurance team and will also be responsible for continuing her complementary finance, corporate and investment fund practices. Previously, Storey spent almost five years as partner at Appleby's Guernsey practice. Storey will be discussing substance in the insurance industry at the Guernsey Insurance Forum, which is being held in London on 11 October.

Louise Hall, Walkers Guernsey managing partner, said the firm was delighted about the addition of Storey.

Hall commented: "Kate Storey brings with her a great deal of experience in a number of specialist areas which complement the existing practice areas of the department."

"In addition, her recognised expertise in Guernsey insurance law and regulation will also enable us to meet client demands in an area which continues to be incredibly buoyant for Guernsey as an international finance jurisdiction."

Storey stated: "I chose to join Walkers because it is expanding heavily in the Channel Islands and is already the biggest global offshore law firm." **CIT**

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