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Enquiry exposes $48 billion in 'shadow insurance' transactions

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A report from the New York State Department of Financial Services has revealed that New York-based insurers are being held accountable for at least $48 billion in hidden 'shadow insurance' transactions through captive and reinsurance entities.

Shadow insurance is a loophole that puts policyholders and taxpayers at greater risk by allowing insurers to make their balance sheets appear artificially healthy and divert policyholder reserves to other purposes, according to the state's financial services department.

New York governor Andrew Cuomo stated that shadow insurance undermines transparency and accountability in the financial and insurance industries, which is critical to the economy.

"It is vital that companies compete based on the quality of their products and services—rather than which ones can best exploit financial loopholes like shadow insurance that put consumers and taxpayers at greater risk."

"Our investigations show that this is a problem all across the nation, so I encourage other state governments—as well as our federal officials—to look into these questionable transactions immediately to protect all consumers."

The report, entitled Shining a Light on Shadow Insurance, states that insurance companies use shadow insurance to shift blocks of insurance policy claims to special entities, such as captive insurance subsidiaries—often in states outside where the companies are based, or else offshore—to take advantage of looser reserve and regulatory requirements.

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CITINBRIEF

Vermont tweaks captive legislation

Amendments to Vermont's captive legislation recently signed into law could strengthen the state's regulatory outlook for insurance companies.

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SA FSB 'increasingly concerned' about third-party cell captives

The South African Financial Services Board has released a discussion paper reviewing third-party cell captive insurance business models.

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Enquiry exposes $48 billion in ‘shadow insurance’ transactions

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Benjamin Lawsky, superintendent of financial services, said that a key lesson of the financial crisis is that regulators have a responsibility to shine a light on questionable practices that shift risk out of sight and into the shadows.

He said: “This is just the tip of the iceberg. There are billions of dollars in the additional shadow insurance risk on the books of other companies that hasn’t been disclosed.”

But Richard Smith, president of the Vermont Captive Insurance Association (VCIA), believes that Lawsky referred to the use of captives by insurance companies for their excess reserve requirements, and not captive insurance in general.

“For these specific captive formations, an insurer actually goes through two regulatory processes: one by the home state regulator of the company ceding the risk and another by the captive domicile receiving the risk.”

“I don’t believe any home state regulator would put at risk the claims from their consumers (as well as the reputation of themselves as regulators) without careful consideration of the captive domicile. And I can say unequivocally, Vermont would not accept these risks without careful consideration of proper reserves and oversight.”

Smith added that the National Association of Insurance Commissioners (NAIC) has set up a subcommittee to review the specific insurance company transfers to captives.

“VCIA understands the review of the use of these specific transfers by the NAIC as they involve large dollar amounts and can be complex. We appreciate the subgroup has allowed VCIA among other interested parties to comment on drafts of the white paper they are preparing on this issue.”

“We are hopeful that once the subgroup sees and understands the process more fully, they will see that the use of captives is a legitimate use for these reserves.”

The Captive Insurance Companies Association (CICA) has acknowledged NAIC president Jim Donelon for his refusal to implement the call for a national moratorium on the captive insurance transactions made by Lawsky.

In his response to the report, Donelon reminded financial services superintendent Lawsky that the NAIC weighs standards before imposing regulations, rather than adopting “a knee-jerk position of issuing a moratorium before the house is on fire”.

Dennis Harwick, CICA president, said: “Having the NAIC remind Lawsky of their [NAIC’s] existing process, while supporting improved transparency, addresses the narrow and unconventional form of reinsurance transaction utilised by banks and life insurance companies referenced in the report without negatively affecting the traditional captive insurance market.”

Harwick also pointed out that CICA was troubled by Lawsky’s comments impugning the regulation of captive insurance companies in states with a long history of credible regulatory oversight.

Vermont tweaks captive legislation

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Governor Peter Shumlin signed new legislation that was passed in the recently concluded session addressing sponsored captives and incorporated cells, association and pure captive account rules, branch and separate purpose financial captives, and captives and risk retention groups organised as reciprocals.

“These improvements in Vermont’s law may seem technical,” said Shumlin. “But taken as a whole they continue to advance Vermont’s standing as the ‘Gold Standard’ for domiciles and will provide greater flexibility and clarity going forward.”

Of sponsored captives and incorporated cells, the change now clarifies that, subject to prior written approval of the sponsored captive and the commissioner of the Vermont Department of Financial Regulation, an incorporated cell is entitled to enter into contracts and undertake obligations in its own name and for its own account.

Previously, Vermont authorised protected cells in a sponsored captive company to be separately incorporated. Users of the programme identified amendments needed to deal with current law requiring the sponsored captive to become a party to the insurance policy/reinsurance agreement, putting its core capital at risk even though the incorporated cell is a legal entity in its own right.

Another change is to separate accounts. An association or pure captive is now allowed to establish one or more separate accounts within the captive—similar to what is currently authorised for life insurance companies in the state, said a release from the Vermont commerce and community development agency.

The new law also authorises branch captives to insure the same risks as other captives, and requires the appointment of a Vermont principal representative as the designated link between the branch captive, the parent, and Vermont regulators.

Special purpose financial will now be treated similarly to other captives by authorising them to be consolidated under common ownership and control for purposes of calculating premium taxes. Their name has been changed to special purpose financial insurers.

Finally, captives and risk retention groups currently organised as reciprocals are held to the same capitalisation standards as any other form of captive insurer. As such, the limitations on a subscriber’s contingent assessment liability—specifically, the minimum contingent assessment liability—provided for was deemed unnecessary and has been eliminated.

SA FSB 'increasingly concerned' about third-party cell captives

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In the paper, the board explained that it has become "increasingly concerned" that some aspects of third-party cell captive insurance business create unnecessary risks for insurers and policyholders.

In a number of jurisdictions, such as Guernsey, Jersey and the Cayman Islands, protected cell company (PCC) legislation successfully governs cell captive business. In those domiciles, a PCC is a separate legal entity—a trait that it shares with a traditional insurance company.

"However, unlike a traditional insurance company the structure of a PCC is subdivided into the core, which contains the capital for the whole of the entity, and individual cells, which have the option to be capitalised individually and separate from the core or use the core funds to meet its capitalisation requirements."

"The assets of each individual cell are statutorily segregated to ensure that a claim against one cell cannot be covered by the assets of another cell."

But in South Africa, cell captive arrangements are governed by contractual arrangements with cell owners. They provide for the separation of funds and limitation on cross-subsidisation between cells.

"Despite these contractual arrangements, there is no legal ring-fencing of funds in the case of liquidation, as the current insurance legislative framework regards all the assets and liabilities of third-party cells as part of the assets and liabilities of the insurer," according to the discussion paper.

To combat these issues, the board proposed that cell captive business be conducted under a dedicated insurance licence that is not combined with other forms of insurance business.

It also called for enhanced regulatory requirements to be out in place for third-party cell captive insurers alongside prior approval from the registrar for all cell arrangements entered into with affinity schemes.

Comments on the discussion paper must be submitted in electronic format to the registrar of long- and short-term insurance by 31 July 2013.

South Carolina's legislation is progressing nicely

Legislation in South Carolina that will update protected cell law and allow captive insurance companies to become dormant has passed the House of Representatives 87-0, and is now in the hands of the Senate Banking and Insurance Committee.

According to Derek Martisus, head of US insurance solutions at Performa, H3797 aims to make the state both friendlier to captive owners and also more desirable to cell captives.

"In an effort to make South Carolina a more captive-friendly domicile, the new legislation will allow captives to become dormant for a period of time and lower costs for captive owners during that period. Clearly, this aims to retain captives that may otherwise dissolve, in hopes that a use will be discovered for the captive in the future."

"What some feel to be the most important aspect of the legislation pertains to cell captives. The legislation would permit cells to be either incorporated or unincorporated. While perhaps a little uninteresting to those not involved in cell captives, it will immediately put South Carolina in the mix for protected cell captive formations."

Jeff Kehler, programme manager at the South Carolina Department of Insurance, said that the sweeping revisions to the state's protected cell legislation would give South Carolina "the best protected cell legislation available".

Success all around for Radius Insurance Company

A.M. Best has awarded the financial strength rating of "A (Excellent)" and issuer credit rating of "a" to Radius Insurance Company, based in the Cayman Islands.

Radius's ratings are based on its excellent capitalisation, history of profitable business written from a predecessor captive, as well as the position it holds as the captive insurer for its ultimate parent, Phillips 66.

"Partially offsetting these positive rating factors are Radius' exposure to large losses due to the limits offered on its policies as well as its significant dependence on reinsurance protection," said A.M. Best.

Key rating triggers that could result in positive rating actions would be Radius generating consistent net income, limited losses and meeting and/or exceeding its business plan over the long term.

Triggers that could result in negative rating actions would be Radius generating consistent net losses, numerous large claims and/or not executing its business plan over the long term.

Guernsey's chief minister talks tax with Cameron pre-G8

Prime Minister David Cameron invited Guernsey's chief minister, deputy Peter Harwood, to attend the pre-G8 'open for growth' meeting at Lancaster House on 15 June to discuss tax, trade and transparency with governments from around the world.

The meeting—which is part of the UK's G8 tax, trade and transparency agenda—was also attended by Deputy Harwood's counterparts from Jersey and the Isle of Man, as well as representatives form the G8 members from African and Latin American nations, and from the UK's overseas territories.

Deputy Harwood said: "We had a frank conversation with the prime minister, and I asked him to acknowledge the strong track record Guernsey has on tax transparency, on information exchange and on beneficial ownership—the latter demonstrated by Guernsey being one of the few jurisdictions in the world, including G8 members, to actually regulate trust and corporate service providers."

"Guernsey welcomed the G8 and this meeting as opportunities to set out our leadership on tax and transparency. It was certainly useful to meet other participants in the tax session and to ask them to look beyond political rhetoric and judge Guernsey on the actions for tax transparency and against tax evasion that it has taken."

The UK also used the meeting to set out its commitment to the Multilateral Convention on Mutual Assistance in Tax Matters. In addition, the UK announced its intention for all of the G8 members to publish 'national action plans' on beneficial ownership on 18 June.

Deputy Harwood said: "I welcome the UK's commitment to improve the supervision and enforcement of company formation agents in the UK and other jurisdictions, and which will bring those jurisdictions up to the standards that have been in place in Guernsey since the year 2000."

"However we also recognise that Guernsey has an obligation to maintain its position among those jurisdictions who show leadership on the recording of details on beneficial ownership. For that reason we will also set out an action plan of steps that will further strengthen the procedures we already have in place to prevent the misuse of companies and legal arrangements in Guernsey."

Texas forms TCIA to support captives

To support the signing of SB 734 into law, the Texas Captive Insurance Association (TCIA) has been formed to serve the captive insurance market in the state.

The newly formed TCIA will be open to all interested parties that want to see a strong, vibrant captive insurance industry in Texas.

Michael Mead, past chair of the Captive Insurance Companies Association, is one of the founding members of the board of directors and a senior advisor to the TCIA.

Burnie Burner, a leading insurance attorney in Texas who helped to negotiate the language in the bill, said: "The state benefits from increased premium tax revenue, and jobs are created in Texas as opposed to other states."

"As with any new law there is a lot of work to do including rulemaking at the Texas Department of Insurance, and the [TCIA] will be a strong advocate for the industry as the state moves forward in implementing the law."

Governor Rick Perry signed the bill into law on 3 June, allowing the formation of pure captive insurance companies. Texas now joins the majority of US states that allow the formation of captive insurance companies

Cook Islands pass captive insurance laws

The parliament of the Cook Islands has passed the Captive Insurance Act 2013, following the introduction of foundations for the industry in June 2012.

Minister Mark Brown emphasised the importance of the industry to the country's economy and indicated that there has been strong interest in captive insurance from overseas insurance firms.

Brown said: "The government has made a commitment to diversifying our economy by encouraging, strengthening and promoting our financial services sector. The passing of the captive insurance act will increase business opportunities and is an important step in the growth of this key industry to our economy."

With only two other finance centres in the Asia Pacific region offering captive legislation, the Cook Islands hopes to tap into the underserved regional market.

Jenner Davis, CEO of the Cook Islands Financial Services Development Authority, said: "Our first focus will be on New Zealand and Australia corporations from which we have already had interest."

"The legislation was designed to provide advantages over current options for the region through flexibility and 'right touch' regulation. We also offer cost stability, relevant expertise, and a convenient location."

The legislation is the first in the industry to also allow domestic companies to avail themselves of the service by forming a captive through a Cook Islands company.

Guy Carpenter secures patent for MetaRisk Reserve

Guy Carpenter & Company has been awarded a patent for MetaRisk Reserve by the US Patent and Trademark Office for creating a unique and predictive model for the analysis of reserve risk.

"MetaRisk Reserve's methodology provides insurance companies with a clearer picture of their reserve risk—the largest risk on their balance sheets. This leading-edge product reveals otherwise hidden inflationary trends in historical losses, and allows clients to determine what an inflation increase will do to reserves," said Guy Carpenter in a recent release.

"MetaRisk Reserve also provides insurers the ability to more precisely assess the impact of reserve deterioration on profits and capital, and become more compliant with rating agency and upcoming ORSA requirements."

Don Mango, vice chairman and head of enterprise analytics for Guy Carpenter, said: "The MetaRisk Reserve patent was the result of a two-year effort and demonstrates the outstanding and exclusive capabilities of this product."

Marsh CEO gives advice on volatile risk landscape

Peter Zaffino, chairman and CEO of Marsh, provided insight into managing change in the global marketplace at the 2013 Bermuda Captive Conference.

Zaffino said: "Today's emerging trends can compound existing risk in this industry … and the market is picking up a lot more risk, and much more diverse risk, over time."

He went on to cite several key trends that are affecting the market, including: population densities continuing to drive insured values along

coastal regions worldwide; increasing economic risk and volatility, particularly in mature economies; and even greater convergence between capital adequacy and risk management.

"Asset classes are showing more convergence, and the market is experiencing large losses on depressed portfolio valuations, while also seeing downward pressure from low interest rates on return on equity."

"There's also what can be seen as a corresponding increasing use of alternative capital to drive business as investors hunt for yield in an otherwise low return environment."

Zaffino also stressed the importance of effective data and analytics to further enhance relationships between a business and its partners.

"Companies must invest in data effectively and use it to help make insightful business decisions that go beyond quantification of retained risk."

"The emphasis should be on proactive objective setting from effective interpretation of the data, using it for both tactical and strategic business actions, to drive resource allocation and leverage competitive advantage."

Sunset Brands acquires IVEST

Sunset Brands has finalised its acquisition of IVEST, a privately held financial services company with an emphasis on investment banking with products ranging from wealth advisory services to captive formation and management.

Adam Smith, IVEST president, said: "The new relationship with Sunset Brands (dba Sunset Capital Assets) will facilitate the creation of a regional investment banking entity focused on the Southeast US. It will allow us to market to an under served region outside of Atlanta in the southeast."

"As our financial landscape continues to change, Ivest will maintain forward-thinking plans and management to provide our clients with the full scope of products necessary to consider and implement all available options."

Philmont Insurance stands in good stead

A.M. Best has assigned the financial strength rating of "B++ (Good)" and an issuer credit rating of "bbb+" to Philmont Insurance Company.

The ratings reflect Philmont's strong captialisation and conservative operating strategy. The ratings also consider Philmont's critical role and favourable profile as part of the Toll Brothers organisation.

"Partially offsetting these positive rating factors are Philmont's relatively large reserves and its incurred but not reported reserves. Nevertheless, A.M. Best recognises the strong liquidity position of Philmont and the substantial financial resources of the Toll Brothers organisation," said the rating firm in a statement.

A.M. Best expects Philmont's future operating performance to be stable but strong, and the stable earnings profile should further support its growth and business writing, which is consistent with its capital and surplus position.

Cyber is still a misunderstood risk

European organisations are failing to understand the risk of cyber threats and implement strategies to deal with it effectively, according to a new survey from Marsh.

The 2013 Cyber Risk Survey was conducted at Marsh's annual Digital Threat's conference, which 85 risk managers from UK industries attended.

It showed risk managers' concerns about cyber risk have increased in the last 12 months, with 71 percent of respondents indicating this to be the case, while 54 percent have recently seen a cyber attack mounted against their organisations.

Only 17 percent of risk managers accepted that the cost of a cyber attack could potentially amount to more than $5 million. Slightly for than a fifth said their organisations had not conducted dedicated cyber risk financial impact assessments.

On their organisations' perceived existing cyber risk maturity level, 23 percent believed that management of cyber risk is fully embedded and optimised within their firms.

"The spectre of a cyber attack evidently looms large among the risks that risk managers believe could threaten the continued success of their organisations," said Stephen Wares, cyber risk leader for Europe, the Middle East and Africa at Marsh. "Despite this, it would seem that in the majority of firms, cyber risk is still largely misunderstood and many struggle to implement a clear strategy to tackle it effectively."

The
British Virgin Islands

The British Virgin Islands' (BVI) legislation provides for the formation and regulation of captive insurers. The application process is seamless; once the established criteria for the issue of a licence has been met a licence to carry on insurance business from within the BVI is issued. Local Insurance Managers provide the necessary expertise.

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Lets get innovative

Celebrating 50 years in risk management, attendees of the Airmic conference were treated to all things insurance. CIT reports from the ground

JENNA JONES REPORTS

The (not so) sunny seaside resort of Brighton was the backdrop for the 2013 Airmic conference. While the weather may not have been something to shout about, the association's 50th anniversary certainly was.

Airmic is the result of a meeting between 22 risk managers back in 1963. Since then, the association has helped to support those responsible for risk management and insurance in their own firms by providing research, training and networking.

The Airmic Forum, chaired by Anthony Hilton, financial editor of the Evening Standard, was a well-attended panel during the three-day event as industry experts discussed current issues in today's insurance market.

The panel was made up of John Doyle of AIG Property Casualty; Steve Hearn of Willis Group; Thomas Hürlimann of Zurich; Stephen McGill of Aon Risk Solutions; and Vincent Vandendael of Lloyd's.

Hilton kicked off the debate with a discussion on current market structure rates. For a reinsurance perspective, he asked Hürlimann if rates were being moved up or if Zurich were struggling for business.

Hürlimann explained that looking back after 9/11, rates have gone up strongly all over the world, and that since Q4 2008, Zurich has never had a quarter with a negative rate. From this evidence Hürlimann feels that, after years of chopping and changing between hard and soft markets, "suddenly the market has more or less stabilised".

Hilton went on to highlight the amount of excess capital currently in the market, with estimates at of up to $60 to 70 billion.

Vandendael said: "Fortunately, there is a lot of [new] capital around and there is more capital coming in, combined with low interest rates, so therefore low investment income. [Also] governments keep printing money to keep the interest rates low in order to boost the economy."

Hilton then steered the conversation towards the types of new alternative sources of capital that are infiltrating the market, asking McGill if they could potentially lead to a hardening of the market.

McGill questioned whether the industry would ever witness a hard market like that of the past, as the peaks and troughs of the markets have largely evened out. If a hard market does emerge it tends to be very short lived.

McGill also highlighted a very interesting "trend of convergence" that he sees emerging in the industry as third-party capital enters the reinsurance industry in a way that he believes could be "quite profound".

He said: "[The] third-party capital is measured in trillions not billions, and it comes amongst other things from pension funds. It is going to be interesting to see what that capital does."

Hilton moved on to the subject of market innovation, explaining that clients' business models are currently changing fundamentally due to a number of factors, including different supply chains, the use of technology, and the emphasis that is being put on brands and reputation.

"Big companies can now insure much less of their risk map than they have ever been able to in the past, because they have moved on and the insurance industry has perhaps not fully kept pace with them," said Hilton.

Hilton then questioned whether the different parts of the industry are doing enough to keep up with the changes in the world, asking Hearn whether insurance brokers are driving the innovation process as hard as they should be.

Hearn admitted that brokers, and in fact all other stakeholders involved in innovation aren't "collectively doing enough to drive an agenda".

"Innovation works best [when] you have a client, carrier, broker, and a regulatory framework that enables innovation to happen and I think that one of the challenges that we've had in recent years is the increasingly complex regulatory world."

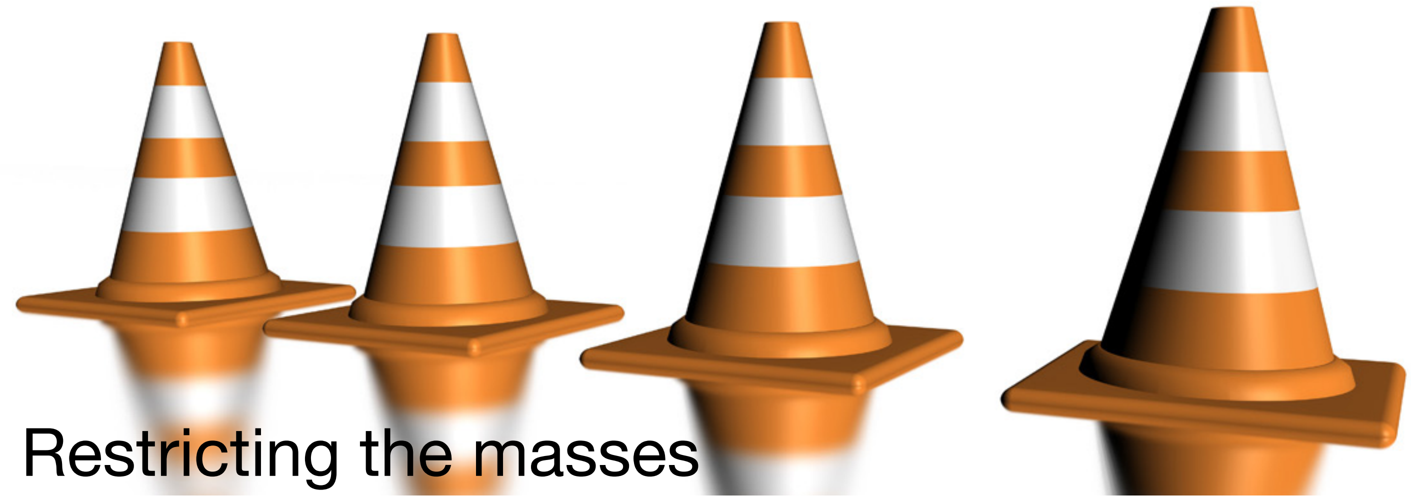
McGill added that the industry is not keeping up with the pace of innovation or the pace of change.

He said: "It's difficult to bring an innovation culture into an organisation that can drive results. When you think about big data, the data mining that is going on today is so profound that keeping pace with it is challenging."

"But if [firms] can keep pace with it and actually mine it effectively, I think it presents huge competitive advantages for clients, for brokers, and for underwriters."

Hearn concluded by again highlighting the current regulatory framework, which he believes makes innovation and the possibility of any kind of breakthrough very difficult.

Hürlimann agreed with Hearn, explaining that regulators aren't helping the current situation and could be accused of making it more difficult for clients, firms and brokers alike. **CIT**



Restricting the masses

Did New Zealand pass up the opportunity to become the most successful domicile in the Asia Pacific region? CIT digs deeper

JENNA JONES REPORTS

A decade ago, the NZCIA (the New Zealand Captive Insurance Association) was formed to promote the country as a potential captive domicile for New Zealand and Australian companies.

According to Peter Lowe, CEO of Willis New Zealand and president of the NZCIA, the development was very successful, with all captives formed under the Insurance Companies Deposits Act.

But in 2010 New Zealand passed a new insurance law called the Insurance Prudential Supervision Act 2010. It was considerably more restrictive towards captive insurers than the previous legislation, explains Lowe.

“The NZCIA negotiated a number of exemptions for New Zealand-owned captives. The government did not want to become a captive domicile and restricted captives to New Zealand-owned companies and operated with the majority of policies issued to New Zealand policy holders.”

The change in legislation therefore meant that companies that may have been interested in setting up shop in New Zealand—from nearby locations such as Australia, Japan and Singapore—were denied access.

Lowe highlights the example of Australian companies, which sought out New Zealand as a potential domicile, as the insurance environment in their home country is “very restrictive”.

James Wong, managing principal at Aon Global Risk Consulting, explains that the older captives in New Zealand were established around 20 years ago with growth taking place at a gradual pace.

“The number of captives peaked at around 20 prior to the current regulatory framework that came in to place … currently there are 15 captives in New Zealand. However, a small number of these may be in runoff.”

Wong says that New Zealand is currently home to pure captives and that generally captives are New Zealand-based, or they at least have a significant presence there.

“Whilst the overall regulatory framework is fairly rigid, the Reserve Bank of New Zealand is approachable and willing to listen and collaborate on specific issues.”

“By virtue of being an onshore domicile, New Zealand is conducive of captives being fully or partially self-managed. Historically this has been an advantage in terms of operating efficiency.”

The Reserve Bank of New Zealand strives to take a risk-based approach, says Wong.

He adds: “Given the regime is relatively new, it is a sophisticated framework that also aims to reduce unnecessary compliance costs where possible.”

In a recent speech to the Law and Economics Association of New Zealand, the Reserve Bank of New Zealand’s head of prudential supervision, Toby Fiennes, said: “Our approach places significant emphasis on self discipline and with regulatory requirements we have tried to minimise complexity while ensuring strong capital and liquidity buffers.”

“This approach works well for us in New Zealand. We have a relatively simple financial system, for which a straightforward, conservative approach is well-suited.”

Despite the Reserve Bank of New Zealand’s “well-suited” conservative approach, Lowe feels that the country may have taken the wrong path. He says: “Australia [has a] very restrictive insurance environment and New Zealand has used the Australian model as its base documents for insurance regulations. The major captive domiciles, [such as] Singapore, Hawaii, Bermuda, and Guernsey, now have superior captive legislation.”

Wong feels that its is New Zealand’s very restrictive landscape that is ultimately stopping companies from domiciling there and consequently making residing captive owners reassess their options.

“Despite considerable efforts in developing captive-related regulations, a number of captive-owners are reconsidering whether to continue operations in New Zealand.”

“Whilst the compliance costs and governance time required are around the same or moderately higher than comparable captives in other domiciles, they reflect a significant increase compared to prior years.”

But despite the regulatory restrictions, Wong is optimistic about the future of New Zealand’s captive insurance market.

“The New Zealand captive market will continue to evolve along with the New Zealand insurance market. Whilst some of the existing captives may close due to increased operating costs and governance requirements, new entries may arise from the increased sophistication around risk financing concepts for New Zealand-based companies.”

The possibility of bow-outs being replaced with new entrants seems slim to some—including Lowe. In his words: “New Zealand missed a great opportunity to become the captive domicile of the Asia Pacific region.” CIT

Portfolio of success

Derek Martisus of Performa tells CIT why investment funds are a viable solution for small- to mid-sized captive companies

JENNA JONES REPORTS

What do you think are the biggest challenges for the small to mid-sized captive market with respect to their investment portfolios?

This segment of the captive market struggles to obtain service from quality institutional investment firms. Captives with sizeable investment portfolios will attract the attention of the large insurance asset managers that cater to traditional insurance companies. These firms, however, do not play in the smaller space. This leaves firms with retail investment platforms to provide service. By this I mean those firms that are suited to invest assets on behalf of high net worth individuals.

The largest issue, as we see it, is the attempt of small captives to purchase individual bonds. In order to achieve proper diversification within their bond portfolios, these companies need to buy sufficiently small amounts of individual bonds. In this scenario, pricing is significantly affected on the purchase side with the increased cost flowing directly through to the captive's portfolio performance. Perhaps a more troubling scenario is the need to liquidate these small holdings in a hurry. Should there be a market event that necessitates the need to liquidate a small bond holding or a captive specific cash need, the potential buyers of the captive's holdings will sense the urgency and require pricing appropriately. This scenario is one that few captives think of in advance and many investment advisors do not explain as a possibility.

Direct cost of service is another issue. Managing the assets of small institutional investors is time consuming. Advisors address this by either employing a buy and hold strategy or charging very high fees or both.

How can these captives work around these challenges?

We believe that bond funds provide an excellent solution to the above challenges. Funds can be managed in a large pool granting diversification and liquidity, all while enabling the cost to be controlled as individual clients pay fees as though they were a much larger investor. Should a credit event occur with a particular bond holding, a position in a fund can be liquidated much more easily and cost effectively than a smaller holding.

Are there downsides to fund solutions?

Once a captive reaches a certain size, a fund solution may actually be more costly than a separate account solution. This will usually occur between $25 and $50 million. We frequently run into captive clients that really want to directly own bonds as opposed to owning shares of a fund. There is also a loss of customisation as funds require that your investment guidelines match those of the funds being utilised. The analogy I use when explaining how funds can work in this scenario involves crayons. A big 64-pack gives you many options of colours and you can choose the exact colour you like. However, if you buy a standard eight pack, you can create all of these colours by combining several crayons and experience significant cost savings.

What do you currently see in the portfolios of small- to mid-sized captives?

The short answer is everything! If I were to generalise, I would say that there are two primary types of portfolios that we see where significant improvements could be made. The most prevalent portfolio type we see is the cash or cash-like portfolio. Captives are sitting on millions of dollars in checking accounts, money market funds or cds. The explanations that we get are pretty consistent. These captives aren't quite ready for a managed investment portfolio and feel secure knowing that their assets are liquid. In this case, I would lobby for the captive's managers to add a line to the income statement that says 'opportunity cost'. This stance has cost captive owners potential investment returns and will continue to do so.

We also see captives invest heavily in treasuries to the exclusion of other asset classes. Rather than opportunity cost, we see many captives that are not fully informed of the risks involved in such a portfolio. Extending beyond cash, captives believed that treasuries should be the next logical move as credit risk is limited. While we aren't concerned with credit risk, investors need to be concerned with interest rate risk. As interest rates rise, the value of these treasury securities will fall. This is simple bond maths, but it is not on the radar of many investors.

Do you believe the financial crisis had an impact on the investment portfolios or investment habits of captives?

Most certainly an impact was felt. My answer to the last question is often a result of the captive's fear of another meltdown. We see many captives clinging to cash despite opportunity cost and we see others avoid asset classes such as structured product due to residual fear. Proper diversification is the key to any portfolio's performance and eliminating asset classes for investment will impede a captive's potential return and increase risk.

According to a recent Marsh benchmarking report, more than half of the investments made by captive insurance corporations consist of loans to their parent companies. Do you believe this to be the case and why?

I'm an actuary by training and have spent a good deal of time studying statistics. One must always look at a poll and resulting statistics with a skeptical eye. I have no doubt that Marsh's study is accurate. However, we must remember that it is looking at their pool of captives.

As the largest captive manager in the world with clients that are captives of large financially strong parents, their experience will differ from a small independent captive manager. I expect that the study overstates this percentage a bit for all captives worldwide, but the point is valid. From our perspective, these loan-backs remove assets from our prospect base and push back to the treasury department of the parent organisation. We think that while not fast moving, the trend will be for this loan percentage to drop over time due to market movements.

If you look at the opportunity in the captive space, it resides with the middle-market 831(b) captives in the US. These captives would be wise to do little to have the IRS question their tax status as an insurance company. Loan-backs could be viewed as a transaction that is not arms length. We think that while loan-backs will continue, these small captive formations will lean towards a conservative stance on the loan-back front. As they make up an increasingly larger percentage of active captives, the industry-wide statistics will move accordingly.

What does an investment advisor need to know about a captive that differs from other client types?

Captives are insurance companies. The investment advisors need to understand the business of the captive and the liabilities that they incur. Collateral solutions and their impacts on investment portfolios are critical to captive success. Advisors must also understand how captives operate on a day-to-day basis. The captive manager is the quarterback of the entire operation and it is critical that an advisor understands this. Communication can be challenging in a captive relationship with captive owner, manager, auditor and regulator all having a say in the investment portfolio of the captive. A good investment advisor will be nimble in navigating this landscape. CIT

Derek Martisus
Head of US insurance solutions
Performa Limited (US)

VCIA's 28th Annual Conference

Location: Vermont
Date: 13-15 August 2013
www.vcia.com

The event will feature nearly 60 panelists, many of whom are captive owners, sharing case studies and personal experience. There will be lots of education and great opportunities to mix and mingle with all the key players in Burlington, Vermont.

Ferma Risk Management Forum 2013

Location: The Netherlands
Date: 29 Sep - 2 Oct 2013
www.ferma.eu

The FERMA Forum is the only event that brings together risk managers from across the whole of Europe. Its theme this year is to inspire, educate and influence in a riskier world. The event will be attended by 1500 European risk professionals.

SIIA 2013 Educational Conference & Expo

Location: Illinois
Date: 21-23 Oct 2013
www.siia.org

The SIIA National Conference & Expo is the world's largest event focused exclusively on the self-insurance/alternative risk transfer marketplace, typically attracting more than 1700 attendees from throughout the US and from a growing number of countries around the world.

ASHRM Annual Conference & Exhibition

Location: Texas
Date: 27-30 Oct 2013
www.ashrm.org

Year after year, the American Society for Healthcare Risk Management's Annual Conference & Exhibition continues to be the optimal learning, networking and career-building experience. This year's theme, 'Everyone is a Risk Manager', emphasises the role that all healthcare workers hold as guardians of patient safety. Attend ASHRM 2013 and experience this theme first-hand.

Industry appointments

Strategic Risk Solutions (SRS) has named **Jeff Kenneson** as senior vice president of client development. He will coordinate the firm's business development efforts with a particular focus on expanding SRS's presence in the small captive market.

Kenneson will also serve as president of Y-Bridge Insurance SPC—a Cayman Island protected cell company.

Y-Bridge owns SRS's interests in various cell captive facilities, including Enterprise Risk Exchange, a Delaware-based serial LLC and risk pooling facility, as well as Green Mountain Sponsored Insurance Company, which is domiciled in Vermont.

He joins SRS with more than 20 years of experience forming and managing captive insurance companies, including the last nine years at USA Risk Group.

Brady Young, president of SRS, said: "Kenneson has a proven track record of developing and managing captive insurance business. We believe his expertise will help our expansion in the underserved small captive insurance market as well as improving the management of our expanding business partner network."

Guy Carpenter & Company has recruited **Jason Hurley** as managing director of UK life reinsurance, effective 2 September.

Hurley will be responsible for building the firm's life reinsurance presence in the UK and Ireland. He will be based in London and report to Franck Pinette, CEO of European life reinsurance at Guy Carpenter.

Prior to joining Guy Carpenter, Hurley was senior vice president of business development for RGA UK Services. He led the delivery of reinsurance solutions across a range of products and services.

Commenting on the appointment, Pinette said: "In recent years, Guy Carpenter has achieved strong growth in the life reinsurance arena in continental Europe. Our ability to advise, structure and execute transactions for our clients has enabled us to build a strong presence in a market which has not traditionally relied upon brokers."

"We are now looking to expand our position in the UK and Ireland, and I am delighted that Hurley has joined our team to head up this endeavor. His extensive industry experience and excellent reputation in the market make him the ideal person for this role."

Hiscox has appointed **Jeremy Pinchin** to the role of CEO for Hiscox Re, as it looks to merge its reinsurance functions in London, Paris and Bermuda into a single business unit.

Pinchin joined Hiscox in 2005 as group claims director and became CEO of Hiscox Bermuda in August 2012. He will retain these roles.

Bronek Masojada, Hiscox's chief executive, said: "Under Pinchin's leadership Hiscox Re will have clear strategic direction, leveraging the combined expertise of our underwriters in London, Paris and Bermuda."

Hiscox Re will be fully operational for the January 2014 renewal season, according to the company, which has also recruited a new European COO from AXA.

Florence Tondu-Melique will be based in Paris and will oversee Hiscox's operations in its 10 European locations across France, Germany, Spain, Portugal, the Netherlands and Belgium.

Michael Gould, group COO at Hiscox, said: "Tondu-Melique's tremendous energy, experience and commercial acumen make her a natural fit for Hiscox and her appointment will really strengthen the existing team."

Pierre-Olivier Desaulle, managing director of Hiscox Europe, added: "She has an instrumental part to play; not only in driving the growth of our European business but also in ensuring we continue to deliver a first class customer experience that looks and feels the same across geographies."

AXIS Re has appointed **Ben Rubin** as executive vice president of capital markets, effective 8 July. Rubin will be based in Bermuda and will report to Jay Nichols, CEO of AXIS Re.

In the newly created position, Rubin will be responsible for managing and developing relationships with third-party capital providers in support of AXIS Capital's global specialist underwriting operations.

Rubin joins AXIS Re from Bank of America Merrill Lynch, where he was most recently a director in the investment banking unit based New York.

Commenting on the appointment, Nichols said: "I have worked closely with Rubin on a number of ventures over the years that brought innovative alternative reinsurance structures to the market." **CIT**

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