

What kind of Services do Captive owners expect from international Fronting Insurers in our current market environment?

By Paul WÖHRMANN, CEO of Zurich International Services, Luxembourg*

Today, captive owners need to manage a more complex environment than ever before. Regulation-driven developments and current market characteristics have created new customer service needs and expectations. This needs to be anticipated in time and accustomed for by captive fronting insurers.

In Europe we have observed the following developments in the field of captives and risk financing:

- 1) regulatory implementation of Solvency II for captives in the EU area
- 2) activities relating to the implementation of the OECD framework BEPS
- 3) increasing use of "Non-Life" reinsurance captives also for the "Life" world (mainly with regards to employee benefits insurance)
- 4) increasing assumption of the risk exposure of international insurance programmes within the affiliated group companies by captives by way of reinsurance
- 5) reduction in the number of active captives caused by M&A activity among captive owners
- 6) use of captives as strategic door opener to the reinsurance and ILS market.

Despite these developments the core benefits of a captive remain the same:

- to optimize insurance and reinsurance structures in the Solvency II environment
- to bring two worlds (Life and Non-Life) into one reinsurance captive
- to benefit from arbitrage opportunities in the markets (pricing, coverage and capacity)
- to strengthen the core business of the captive owner
- to develop new solutions for new risks

As captive owners route most of the gross written premiums of underlying insurance programmes back to their captives, fronting insurers can be faced with more complex captive customer service interactions. This is especially true if the fronting insurer is also a member of the captives' retrocession panel. This collaboration also requires proven IT interfaces



between the insurance, reinsurance and retrocession levels. Captive owners should therefore select strategic insurance fronting partners they can work with wherever they have a presence, and which can properly handle the increasingly complex regulatory and tax landscape.

An effective and professional captive fronting partner should be able to:

- simplify insurance policy management across various lines of business
- solve complex insurance as well as reinsurance problems
- access a strong and reliable global network
- ensure insurance premium tax compliance for captive reinsurance agreements
- provide accurate, transparent and timely bordereaux reporting through a single ceding party not limited to Non-Life and the reinsurance level.

In other words: also including employee benefit programmes as well as the retrocession panel

Provided that owners use their captives more actively by approaching the reinsurance and ILS markets, specialized captive consultants, brokers or insurance companies can add value by developing tailor-made services and solutions.

Captive health checks

It is commonly understood that choosing the optimal retention level is a prerequisite for an efficient allocation of scarce capital in order to minimize the total cost of risk. At Zurich, we have seen an increase in the number of captive health checks. These services, which require comprehensive data to be provided by the fronting insurer, benchmark the individual captive retention across the same industry by use of actuarial means.

Managing new risks

The availability of structured financing of new risks, such as cyber, will require professional claims management, pricing and policy wording

capabilities and services. Internationally active Captive owners have the option to choose an integrated international insurance programme with a cession to the captive instead of the traditional solution of local insurance policies.

Cross class balance sheet protection

Insurance is generally purchased, whether directly or in support of a captive, on a line of business-basis. Multi-line programmes are rooted in the idea that insurance can be purchased more efficiently through an integrated risk programme. Generally, the understanding that few risks are closely correlated underpins multi-line captive solutions, as it is very unlikely that multiple events could trigger all the policies.

Risk engineering services

Risk engineering serves to reduce losses through systematic identification, assessment and improvement of risk. Not surprisingly, an increasing number of captive owners are introducing risk management techniques into their day-to-day business culture.

As risk engineering works best in long-term customer relationships, the starting point is to develop a close collaboration between the captive and its risk engineering provider. Thereby, solutions, especially around investment planning for risk improvement, can be tailored according to specific risk appetite and operational requirements.

We also have observed a trend in the European captive market towards integrating Corporate Life risks, such as employee benefits, into existing Non-Life- captives. Consequentially, new risk engineering service propositions have been welcomed by captive owners in an attempt to increase efficiency and improve their operations.

Asset & Liability Management (ALM)

As captive owners seek to maximize wealth creation in the interest of their shareholders, each captive owner manages assets and is therefore highly interested in achieving superior risk-adjusted returns. Since insurance companies already had to align themselves to multiple regulatory, accounting and local statutory frameworks for a long time, their

extensive experience with asset & liability management could be provided to captive owners.

Summary

Despite the "soft" market environment, we have observed in recent years that large captive owners have successively increased the assignment share.

Association leaders have also noticed the trend towards more active use of captives compared to the past⁽¹⁾. This could lead to a new purchasing pattern of captive owners.

The traditional captive fronting insurer is becoming more of a service provider from the customer's point of view.

More active use of a captive as a reinsurer by industrial insurance programmes can also be explained by the diversity of the reinsurance market. This is because apart from the classic reinsurers, new capacity providers like insurance linked securities (ILS) are suitable for captive reinsurance⁽²⁾.

Captive customers remain an attractive customer segment among industrial insurers due to their special risk management affinity. Captives could increasingly become strategically important asset for the captive owner as a door opener to other risk financing markets, especially under a holistic view.

Corporate Insurers committed to the fronting captive businesses have to invest in this service proposition in order to meet the increased expectations of the captive owners.

1) Alexander Malmke, in: Versicherungswirtschaft no. 9, 2015, p. 10
2) S.B.Amar/A.Braun/M.Eling. Alternative Risk Transfer and Insurance-Linked Securities: Trends, Challenges and New Market opportunities, Institute of Insurance Economics I.VW-HSG, University of St. Gallen (2015)

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The article represents the personal views of the author and not necessarily the view of Zurich.

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The handbook of reference for PLI professionals in Europe

A broader content, new and updated market analysis and fresh case studies based on the most recent developments within the European insurance regulatory environment are the main ingredients of this second edition.

After the success of the first edition, printed in one thousand copies and distributed in more than ten Countries throughout Europe, FARAD International, a major player in private life insurance (PLI) in Luxembourg, is delighted to launch the second edition of the publication coordinated with the support of PwC Luxembourg and the law firm Philippe & Partners.

Marco Caldana, Chairman FARAD International, initiator and coordinator of the project, confides that «In the ever-evolving scenario of PLI, given the enthusiasm that this publication aroused among insurance experts, and in order to follow up with the evolution of the regulatory landscape and the consequent products innovations, it was a must for us to publish a new edition.»

The book is the result of the collaboration of 26 international experts. It aims to capture market trends and evolutions through three main sections: regulatory, market analysis and case studies among which stands out a deep analysis of the regulatory framework especially with regard to the Insurance Distribution Directive, that came into force in most EU Member States on October 1st, GDPR and the implications of Sustainability within the insurance sector.

«Although efforts are made at the European Union's level to harmonise legislation, especially recently within the financial services and insurance sectors, we

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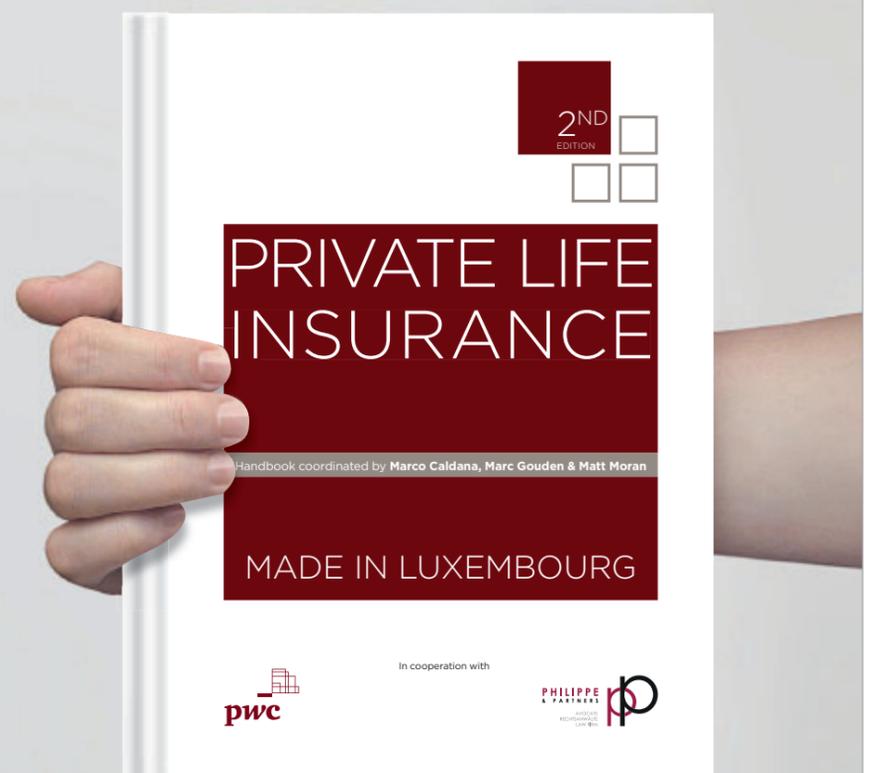
Within their analysis, the authors favored an approach focused on a detailed exploration of different European markets as well as tax and regulatory issues specific to each jurisdiction. The handbook concludes with a selection of case studies on the latest topics in the field of private life insurance.

«I am sure that market participants across the EU and further afield will benefit from the input of so many respected contributors. The case studies provided, together with the expert assessment of key sector themes, should prove invaluable to insurers, private bankers and wealth managers alike.» concludes Matt Moran, Partner of PwC Luxembourg and one of the coordinators of the project.

The book is now available at a price of 65 € for an online purchase on the website of FARAD International (www.farad.lu), as well as in specialized Luxembourg bookshops such as Librairie Française (2,4 Rue Beck) and Librairie Promoculture (14 Rue André Duchscher).

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