

THE CHANGING INSURANCE MARKET

Paul Wöhrmann and Helene Westerlind, of Zurich, outline the benefits of having a fronting insurer

Currently the entire insurance and reinsurance market is in a state of great change, and over time could become even more consolidated, because the industry is under rising pressure. This is largely due to the steadily decreasing premium rates leading to lower margins while additional capacity is entering from the financial market.

Interestingly, we have experienced these trends in our current competitive market environment. We are seeing that large European captive owners are using their captives more actively (Wöhrmann/Ruof) in order to:

- optimise insurance and reinsurance structures
- bring two worlds (life and non-life) into one reinsurance captive
- benefit from arbitrage opportunities in the markets (pricing, coverage and capacity)
- strengthen the core business of the captive owner
- develop solutions for new risks

As a consequence, larger internationally operating industrial captive owners need highly experienced insurance companies as fronting partners, to allow them efficient access to the reinsurance market (see *Common Single Parent Reinsurance Captive Structures*, p. 15).

Having a captive on board allows their owners to optimise pricing, coverage and capacity strategies across the insurance cycle.

Large European captive owners have successfully started to follow such a strategic approach under a holistic view (life and non-life/ see further Wöhrmann/Marini).

In the past, the majority of captive reinsurance programmes were reinsured by fronting insurers on a non-proportional basis within primary layers. This is due to

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Paul Wöhrmann



Paul Wöhrmann, head of Captive Services Europe, Middle-East, Africa, Asia Pacific and Latin America, has developed a reputation as one of the world's leading authorities on captive strategy and was ranked the third most influential person in the industry by *Captive Review* in 2016. He has been with Zurich for more than 25 years and leads a team of experts which is located in four countries across the world.

the financial incentive for captive owners to influence future frequency claims through active risk management and the systematic identification, assessment and improvement of risk. As a consequence, the cost of risks can be reduced, and profitability will be protected by introducing appropriate risk control measures, which reduce future claim frequencies and the cost of premiums (Krause/Wöhrmann).

Despite the soft market development, we have observed that within the portfolios of our captive customers, there has been a more active use of reinsurance captives – especially for large captive owners.

On the one hand, captive owners are

now better informed about their risks and keep the captive share on net. These owners ask for cross-class balance sheet protection (see further Wöhrmann/Cunningham) which can include the reinsurance of Employee Benefit programmes.

On the other hand captive owners move from a non-proportional to a proportional reinsurance structure in order to capture the entire arbitrage market potential by accessing the reinsurance, retrocession and ILS market (Amar/Braun/Eling).

Fronting insurers are then faced with complex customer service expectations, especially if the fronting insurer is also acting behind the captive on a retrocession panel. Such risk transfer levels require proven IT interfaces between the retrocession, reinsurance and insurance level.

Therefore, it is vital that captive owners select a well-rated and reliable corporate insurer capable of paying and servicing claims, which are ultimately reinsured to the captive.

Zurich has the experience required to manage such complex captive owner requirements on a global scale and captive owners can expect comprehensive support that is consistent, end-to-end and worldwide (see *Captive Related Services operates across all geographies, underwriting process and Zurich Group*, p. 15).

Zurich can provide their captive customers with so-called “captive health checks” (Webinar) as a separate service. The individual captive retention is benchmarked across the same industry by actuarial methodologies. Zurich's comprehensive data makes such analysis possible and provides added value for captive customers using this service.

Furthermore, captive owners should consider selecting one strategic insurance fronting partner that can operate wherever the customer has a presence, someone who

can cope with the increasingly complex regulatory and tax landscape. An example of such an increase in tax complexity is OECD's Base Erosion and Profit Shifting (Beps) initiative, which may make it necessary for captive owners to review their captive set-up from a tax perspective (see further D. San Millan and D.J. Kusaila).

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

- simplify management across lines of business
- solve complex insurance problems
- access a strong and reliable global network
- address insurance premium tax compliance for captive programmes
- provide accurate, transparent and timely bordereaux reporting through a single ceding party

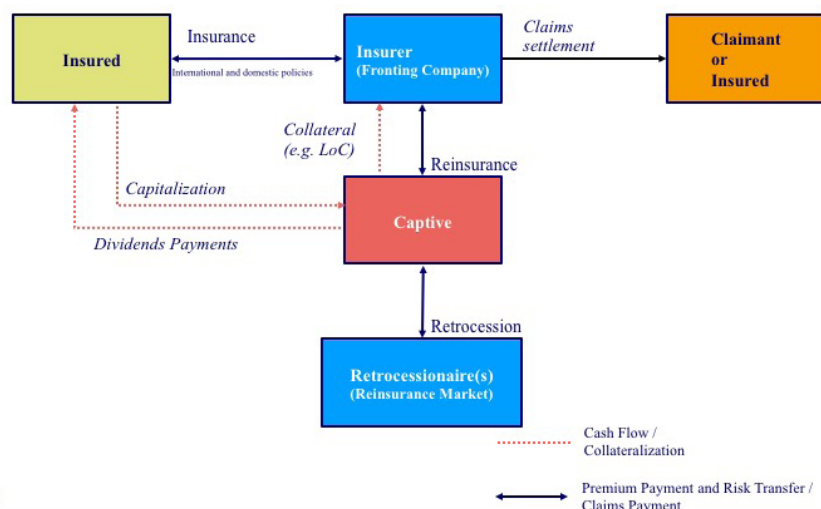
Customers who consider a change in their buying behaviour for arbitrage requirements, need an insurance partner with a specific proposition to meet their needs. This partner should be able to deal with the new and growing demand by reinsurance captives to leverage tangible benefits of portfolio diversification and to ensure that capital requirements are met. At Zurich, we see arbitrage in three different categories where captive owners can capture tangible benefits.

Firstly, pricing arbitrage especially for medium and high excess layers between the insurance, reinsurance and ILS market.

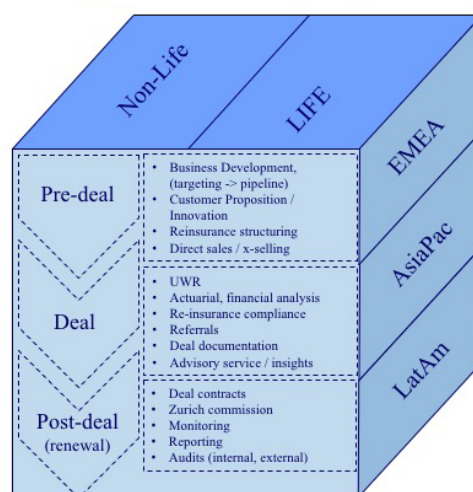
Secondly, coverage and wording arbitrage in order to issue tailor-made insurance programmes, for example on cyber risk with wordings that meet the captive owner's expectations. Captives would accept insurance policy exclusions. Hence, the wording of the insurance coverage could be much broader than that of the retrocession level behind the captive. In other words, the captive would cover any deviation.

Finally, capacity arbitrage. Capacity arbitrage has been experienced in the banking and mining industry. Such a solution generally requires substantial captive risk retention and attention for counterparty credit risk matters.

Common Single Parent Reinsurance Captive Structure



Captive Related Services operates across all geographies, underwriting process and Zurich Group



Conclusion

The current market environment provides attractive and comprehensive risk self-financing and risk transfer solutions, which could create persistent business opportunities for various market participants. Corporate insurers which operate globally might find they are increasingly asked by captive owners to keep their net-

work infrastructure available, for a fee, for more lines of business. Since the retrocession level, in addition to the insurance programmes, is often an integral part of a captive's involvement, insurers who can serve in a customised manner, with transparent premiums and claims information, will be prioritised as future partners of captive owners.

Quotes: S.B. Amar/A. Braun/M. Eling, Alternative Risk Transfer and Insurance-Linked Securities: Trends, Challenges and New Market Opportunities, Institute of Insurance Economics IVW-HSG, University of St. Gallen (2015)

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