BUSINESS INSURANCE

WORLD CAPTIVE FORUM

P/C Track:

Finding a Reinsurer and Fronting Company Who Love Captive Business in a Hardening Market

Nicholas Frost
Quest Management Services Limited
MODERATOR

Robert Gagliardi
AIG

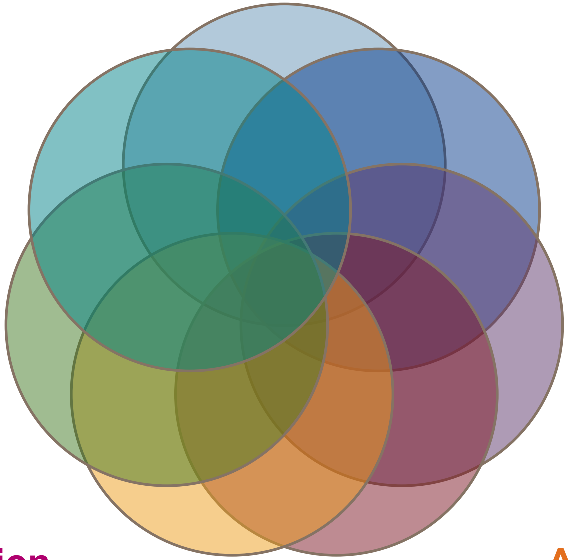
Michael Woodroffe
Kirkway International Ltd

Challenges of Fronting Programs

Underwriting
(often multi-line)

Legal
(R/I agreements
indemnities/
guarantees)

Credit
(transaction and
counterparty
analysis)



Financial
(local solvency,
technical reserves
R/I recovery)

Regulatory
(intercompany
reinsurance)

Administration
(loss billings,
cash flow)

Accounting
(transfer of risk,
claims)

Captive Program Considerations

Timing	• 60 to 90 days prior to inception, depending on program complexity. • Allow sufficient time for discussion of requirements, structuring, client internal communication, multinational program design, and legal contract review, etc.
Critical Information Required	• Policy summary: insured name, coverage, terms, limit structure, reinsurance panel, special wording/endorsements, expiring premium. • Insured (and parent company): general information, organizational structure, exposure (asset value, turnover, headcounts, etc.), audited financial statements, credit rating, etc. • Captive info: audited financials, certificate of incorporation, insurance license, banking/wire instructions (on captive letterhead), business plan (for new captive). • 5 to 10 year loss history. • Understanding of the motivation for fronting.
Program Structure	• Gross line (100% cession to captive) or net line (AIG retains a portion of the risk on net position). • Captive retention (per claim and in the aggregate). • Multinational program? A list of countries/local entity info/policy terms required.
Fronting Premium	• Should be consistent and commensurate with owned risks. • Regulators are paying attention to premium adequacy. • Minimum program gross premium of $500,000 for a captive fronting program to make sense.

Captive Program Considerations

Fronting Fee ***(may be included in premium)***	• Fronting fee is a function of captive's (and parent's) credit quality, ceded limit, exposure, ceded premium, AIG's cost of capital, local policy administration, captive reinsurance related aggregation services, claims management and reporting, global coordination, other specialist services
Collateral Requirement	• Required to secure captive's obligation pursuant to the reinsurance agreement. • For certain countries, statutory collaterals are required to meet regulatory mandate (e.g., U.S. Schedule F, Canada) • Factor in limits, exposure, premium, loss history, parent/captive credit quality. • In the form of letter of credit (LOC), cash/trust account, parental indemnity/ guarantee, or a combination of the above.
Legal Document	• Captive reinsurance agreement. • Parental indemnity/guarantee.
Administration	• AIG assumes claims control on all captive fronting programs. • May offer cash flow guarantee on premium remittance to captive for certain countries.
Multinational Program	• Contract certainty. • Service delivery. • Multinational expertise.

Michael Woodroffe

President

Kirkway International Limited

Agenda

- 2019 Market Overview
- Insurance Linked Securities
- Current Captive Reinsurers
- Case Study – Parametric Trigger
- Case Study – Multi Year Stretch Aggregate Position
- Reinsurance Buying Strategies

2019 Market Overview

- Global Reinsurance has hit its highest level of $610 billion capital mainly driven by increases in traditional reinsurance providers.

- Alternative capital is thought to have remained roughly static at $93 billion.

- Total insured losses for 2019 = $56 billion, which is significantly lower than the $93 billion figure for 2018.

2019 Total Cat Losses:
$56 Billion

2019 Largest Natural Catastrophes

- Hurricane Dorian: $4.5 billion in insured losses
- Typhoon Faxai (greater Tokyo region): $7 billion in insured losses
- Typhoon Hagibis (greater Tokyo region): $8 billion in insured losses

2019 Market Overview

- **Catastrophe covers** – multiple smaller U.S. catastrophes and a generally stable capacity has driven non-hit layers to range from flat to 5% rate increase and programs that have been hit have increased by 10-20%.
- **US Personal Auto –** primary carriers continue to push rate increases to offset rising loss trends for the 5th year running. Continuing downward pressure on ceding commissions from a limited pool of reinsurers interested in the class.
- **Excess of loss –** hardening market but with major client differentiation. Treaties with historical London support seeing capacity constraints, especially in treaties with a history of losses to reinsurers.
- **Workers' Compensation:** The **catastrophe layer** price increases with reinsurers not bending on rates. The **working layer** has increased again by single digits as reinsurers try and offset primary rate decreases and modest loss severity rise.

London Syndicate Departures

Syndicates	2019 Capacity (£mm)	Captive Support	Comment
Acappella (2014)	138	slight	Entering run-off in 2020
AmTrust (1861)	500	yes	Merged into Syndicate 4444
China Re (132)	132	yes	Merged into Syndicate 1084
Hamilton (120)	120	yes	Merged into Syndicate 4000
Neon (2468)	385	yes	Entering run-off in 2020
Pioneer (1980)	94	yes	Entering run-off in 2020
Skuld (1897)	59	no	Entered run-off in mid 2019
Vibe (5678)	112	yes	Entering run-off in 2020

Lloyd's

- Between merged and run-off syndicates, approximately $1.04 billion has left the market.

- MS Amlin, a major reinsurer of captives, has reduced stamp capacity by $325 million and has exited 9 lines of business.

2019 Mergers and Acquisitions

- Chaucer Syndicate merged with China Re Syndicate.
- Hamilton Re Syndicate acquired Pembroke Managing Agency Ltd.
- AmTrust Syndicate merged with Canopius.

Insurance Linked Securities

- Cat bonds allow insurers to get reinsurance protection from a new pool of capital separate from traditional reinsurers – such as money managers, hedge funds and pension funds.

- Investors' capital stays in segregated collateral accounts – if event occurs funds are available to make a payment, thereby virtually eliminating credit risk inherent in traditional reinsurance.

- 2019: insurance-linked securities issuance drops from $13.85 billion to $11.09 billion

Insurance Linked Securities

- US Hurricane Bond Index (Bloomberg) ended June 2019 up to 2.74% return versus total 2018 at -1.13%.

- In the years 2017 and 2018, 25 ILS contracts have now had major losses due to natural catastrophes. The market has come to maturity.

- Outstanding cat bonds rose to a record total of $40 billion as at 31 December 2019.

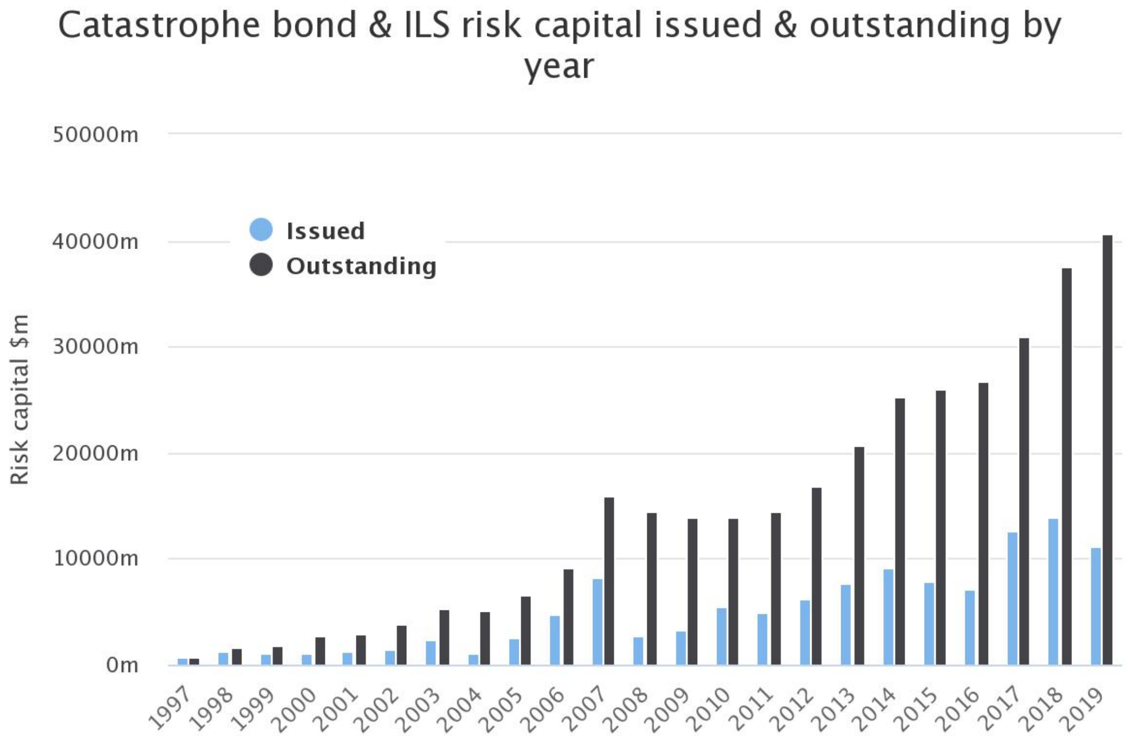
Insurance Linked Securities

Non-insurance company buyers of ILS:

- Sempra Energy (SD Re Ltd) Cat bond ($125 million) 3 year indemnity deal was put in place to cover losses from CA Wildfires.

- CA State Compensation Fund has put in place Golden State Re II Ltd. which covers WC policies triggered by a large earthquake. The limit is currently $210 mm.

Insurance Linked Securities



Source: www.Artemis.bm Deal Directory

Bermuda Specialist Captive Reinsurers

Carriers	AM Best Rating (Sep 30 2019)	Policyholder Surplus (Sep 30, 2019)
Allianz	A+	$78.02 bn
Allied World (Fairfax Group)	A	$13.75 bn
MS Amlin	A	$1.83 bn
Arch Capital Group Ltd.	A+	$12.01 bn
Aspen Insurance	A	$2.7 bn
BRIT (Fairfax Group)	A	$13.75 bn
Everest Re	A+	$8.98 bn
Markel	A	$10.63 bn
Renaissance Re	A+	$5.95 bn
Third Point Re	A-	$1.38 bn
Trans Re	A+	$8.69n
Convex Re	A-	$1.8 bn
AXA Group	A+	$66.72 bn
AmTrust	A-	$3.4 bn

US Specialist Captive Reinsurers

Carriers	AM Best Rating (Sep 30 2019)	Policyholder Surplus (Sep 30, 2019)
Arch Re	A+	$12.01 bn
Axis Re	A+	$5.59 bn
Berkley Re	A+	$6.06 bn
Chubb Limited	A++	$54.57 bn
General Re	A++	$14.12 bn
Munich Re America	A+	$31.58 bn
National Indemnity	A++	$146.79 bn
Odyssey Re (Fairfax Group)	A	$13.7 bn
Partner Re	A+	$6.56 bn
Swiss Re America	A+	$27.93 bn
TOA Re	A	$417.96 mm
Trans Re	A+	$8.69 bn

Healthcare Reinsurers

- Aspen (US and UK)
- Ascot Bermuda Limited (BDA)
- AXA XL (BDA)
- Berkshire Hathaway (US)
- BRIT (BDA)
- Chubb Tempest (US)
- Convex Re (BDA)
- Coverys (US)
- General Re / Genesis (US)
- Lloyd's of London (UK)
- Liberty Specialty (BDA)
- MS Amlin (BDA)
- Markel (BDA and US)
- Munich Re America (US)
- Odyssey Re (US)
- Renaissance Re (BDA)
- Trans Re (US)

Auto Reinsurers

- Allianz (BDA)
- Arch Re / Watford Re (BDA)
- Ascot Re (BDA)
- AXA XL (BDA)
- Chubb Tempest (US)
- Corinthian (US)
- Dorinco (US)
- Greenlight Re (Cayman)
- Hamilton Re (BDA)
- IAT Re (US)
- JRG Re (BDA)
- Mainstreet Group (US)
- MS Amlin (BDA)
- MultiStrat Re (BDA)
- Odyssey Re (US)
- Partner Re (US)
- Qatar Re (BDA)
- Sompo (US)
- Third Point Re (BDA)
- Topsail Re (Cayman)
- Trans Re (US)
- United (Cayman)

Workers Comp Reinsurers

- Arch (US / BDA)
- Aspen Insurance (UK)
- Axis Re (USA)
- AXA XL (US / BDA)
- Bermuda Catastrophe Reinsurers (BDA)
- BRIT (BDA)
- Chubb Tempest (US)
- Greenlight Re (Cayman)
- Hamilton Re (BDA)
- Hannover Re (GER)
- JRG Re (BDA)
- Lloyd's of London (UK)
- Markel (BDA)
- Midland Management (US)
- Midwest Employers (US)
- MS Amlin (BDA)
- National Union (US)
- Safety National (US)
- Trans Re (US / BDA)

Fronting Carriers

GLOBAL

- AXA XL
- Lloyd's of London
- Zurich Financial Group
- AIG

USA

- AIG
- AF Group
- Zurich
- Arch Insurance
- Old Republic Group
- State National
- REd Point
- Clear Blue
- Homestate
- Old American
- Hallmark Insurance Co.
- Accredited Insurance Co.

Protecting Your Captive With Parametric Triger Coverage

- Example: Group of 50 hotels with over 30 locations in coastal Florida and coastal Texas. They already own a captive that helps insure their primary workers' compensation, general liability, and auto liability. They buy their property coverage, including windstorm, from the regular domestic market.
- Problem: At their 1st of January 2020 renewal, the market informs them that the rates are going up dramatically and their windstorm deductible is increasing to 5% per location.
- Windstorm Exposed TIV = $900,000,000 hence 5% is $45,000,000 total risk exposed.
- Problem 2: Conventional treaty reinsurance market not interested in quoting such a small book at normal treaty terms.
- Problem 3: Regular buy-back market looking for huge rate online.

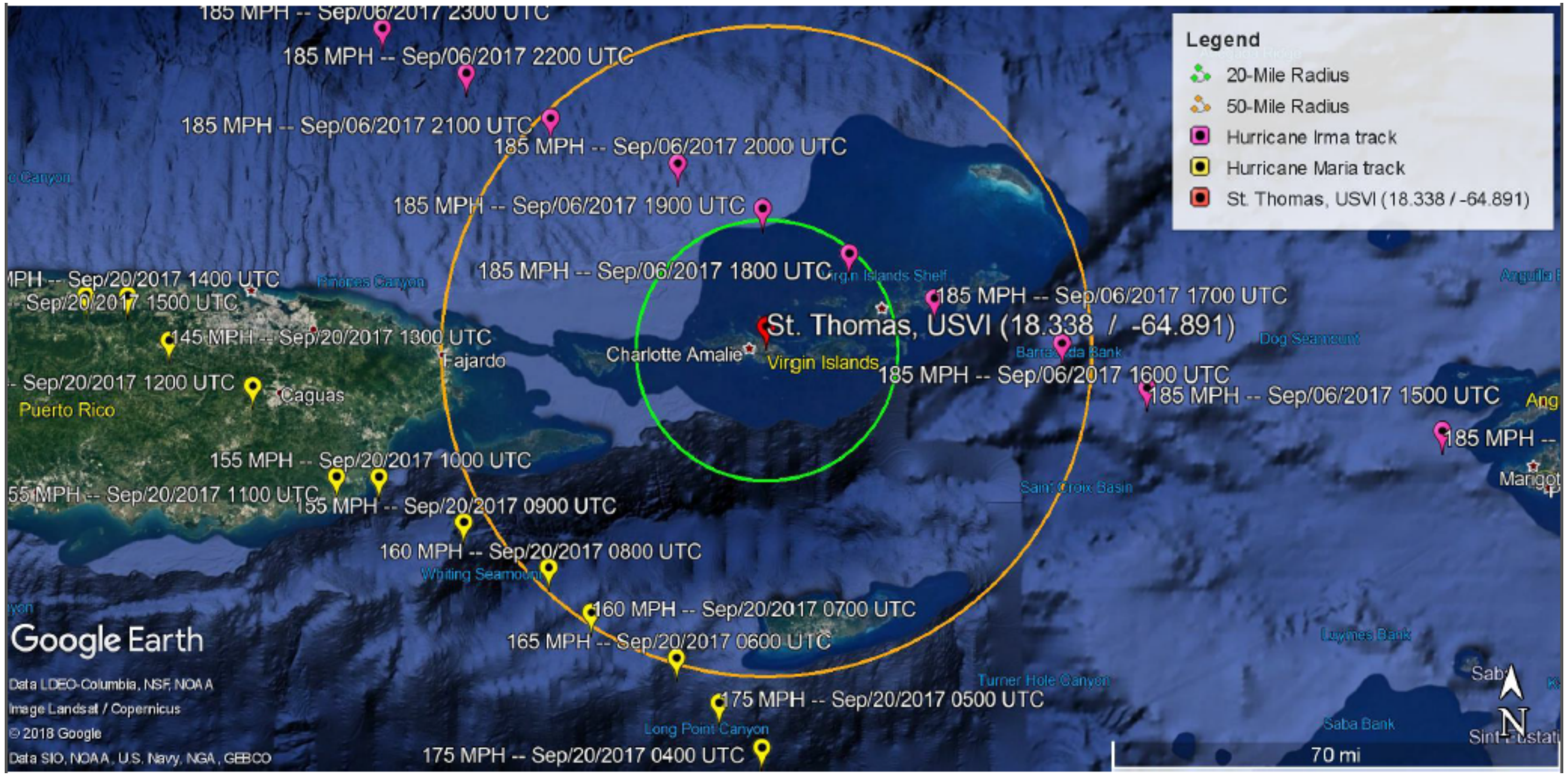
Protecting Your Captive With Parametric Trigger Coverage

- Solution: Captive owners decide that they are happy being exposed to $10,000,000 of windstorm loss.
- Captive owners are confident that construction of all properties is high quality and well-maintained with good risk management program.
- Decide to buy $20,000,000 of parametric trigger coverage triggered by winds within 20 miles of each location in Florida and Texas, being in excess of 75 mph.
- Second trigger also excess of $10,000,000 of otherwise recoverable losses retained by the captive, in respect of 5% deductible.

Protecting Your Captive With Parametric Trigger Coverage

- Resulting rate online dramatically decreases from conventional reinsurance buying.
- Instant cash available to captive to pay for all deductible claims not limited by conventional coverage, such as landscaping and business interruption.
- A+ rated insurance paper using ILS funds and state of the art anemometers spread throughout coast of Florida and Gulf.

Parametric Trigger



Parametric Trigger

Premium Indication

Limit	Rate	Premium	Irma Recovery	Maria Recovery
$4,000,000	6.98%	$279,058	$4,000,000	$2,000,000
$5,000,000	6.98%	$348,822	$5,000,000	$2,500,000
$6,000,000	6.98%	$418,586	$6,000,000	$3,000,000
$10,000,000	6.98%	$697,644	$10,000,000	$5,000,000

Hurricane Intensity	20-Mile Radius	50-Mile Radius
Category 1	10% Payout	0% Payout
Category 2	25% Payout	0% Payout
Category 3	50% Payout	0% Payout
Category 4	75% Payout	25% Payout
Category 5	100% Payout	50% Payout

STRUCTURE: CAT-IN-A-CIRCLE

CAT-IN-A-CIRCLE QUALIFYING EVENT: Coverage is Triggered if an Event Track Point falls on or within the boundaries of the Circle, or intersects the Circle, as reported by the National Hurricane Center's Public Advisory Reports.

QUALIFYING EVENT MAXIMUM PAYOUT: The higher Payout of either circle within the same Named Storm, however, the payouts can be added over multiple Named Storms, not to exceed the Limit during the Contract Period.

HURRICANE IRMA PAYOUT: CAT-IN-A-CIRCLE = 20-MILE CIRCLE, CATEGORY 5 = 100% PAYOUT

HURRICANE MARIA PAYOUT: CAT-IN-A-CIRLCE = 50-MILE CIRCLE, CATEGORY 5 = 50% PAYOUT

Is there an alternative to wasting money on excess insurance?

Multi-Year Excess of Loss

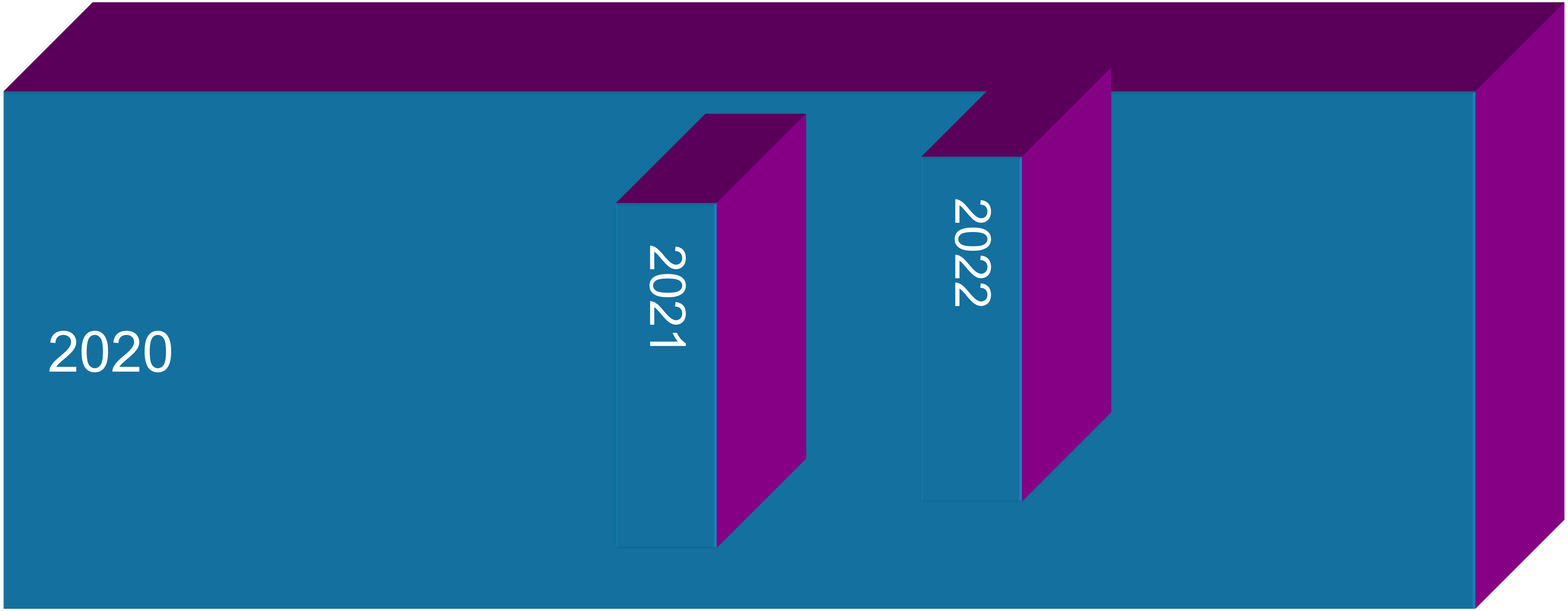
- Client buys $10m xs $1m Umbrella from Standard markets every year.
- Premium is $1.5m per annum.
- Limited frequency; one loss every five years.
- 3 years on, client has bought $30m worth of excess insurance with little chance of full utilization. Premium is “Dead Money”.

Multi-Year Excess of Loss

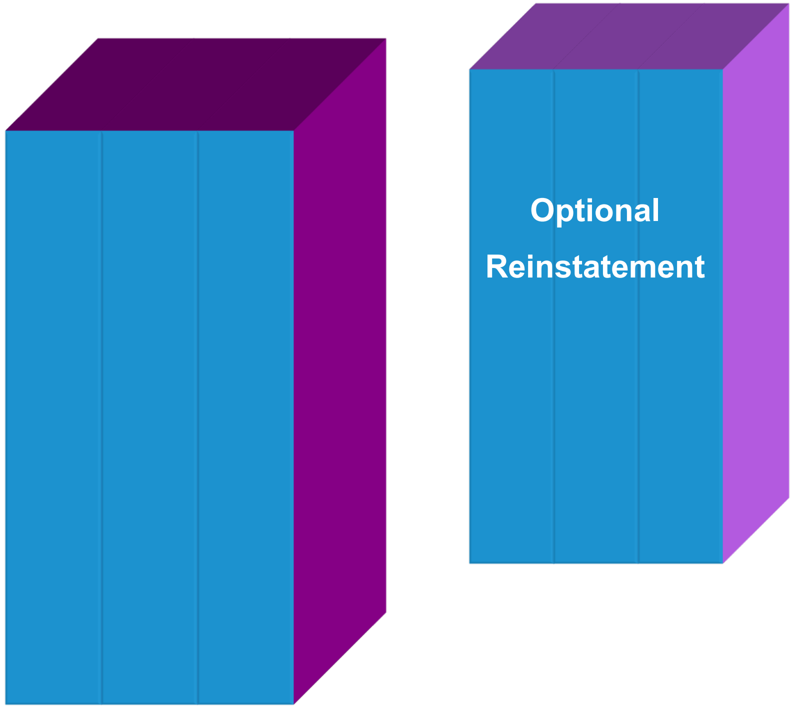
Answer:

- Provide client with 36 month policy with one limit of $10m xs $1m stretched over 3 years.
- Cost approx. $1m per annum with profit commission of 30-40% upon commutation at year 5.
- Use of "Trigger" additional premiums to improve policy holder cash flow.
- Provide reinstatement of limit at clearly defined pre-agreed costs.
- Client saves money with no losses, saves money with average losses and has survivability and continuity at no extra cost in the event of catastrophic loss.
- No cap in hand return to excess insurer.

Single Aggregate – Multi-Year Limit



Depth of Coverage



Reinsurance Strategies

- **Buy Long**
  - Multi Year contracts wherever possible, with built-in reinstatements to avoid renegotiating mid crisis.
- **Lock in aggregate protection**
  - Protect against adverse developments from rising loss ratios across all lines.
- **Avoid swing rated deals**
  - Stick to for flat rated contracts to avoid 'double whammy' of deteriorating losses whilst being hit with huge additional Reinsurance premium.
- **Insist on buying Reinsurance separately**: divide & conquer

Reinsurance Strategies

<u>Scrutinize Security</u>

- **Fronting Carrier**
  Review security carefully.

- **Reinsurance Security**
  Avoid weak balance sheets, legacy issues and companies with no long term capital commitment.

- **Stick with trusted Reinsurers**
  Especially if you have built a “bank” of premium with them.

Q & A

Michael Woodroffe

President

Kirkway International Limited

mw@kirkwayintl.com 441.296.5829