

**BUSINESS INSURANCE<sup>®</sup>**

**WORLD**

**CAPTIVE FORUM**

Reinsurance and Fronting

*#WorldCaptiveForum*

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**JANUARY 30 – FEBRUARY 1, 2019**

Michael Woodroffe

President



# Our Panel

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# Agenda

- 2018 Market Overview
- Insurance Linked Securities
- Current Captive Reinsurers
- Case Study – Multi Year Stretch Aggregate Protection
  - Reinsurance Buying Strategies

# 2018 Market Overview

- Global Reinsurance capital fell by 2% since the end of 2017 from \$605 billion to \$595 billion.\*
- Alternative capital is thought to have remained roughly static at \$91 billion.\*\*
- Total insured losses for 2018 = \$80 billion.

\*AON Study

\*\* Artemis

# 2018 Total Cat Losses: \$80 Billion



# Mergers and Acquisitions 2018

- March: AXA buys XL Group for \$15.3 billion
- August: Apollo Global Management buys Aspen Insurance Holdings  
\$2.6 billion
- August: The Hartford buys Navigators for \$2.1 billion
- August: Markel buys Nephila Capital for undisclosed / all cash
- September: China Re buys Chaucer for \$950 million
- October: Renaissance Re buys Tokio Millennium Re for \$1.5 billion

# 2018 Market Overview

Largest natural catastrophes:

- California Wildfires: \$18 billion in insured losses
- Typhoon Jebi (Japan): \$9 billion in insured losses
- Hurricane Michael (Florida): \$10 billion



# 2018 Market Overview

- **Catastrophe covers** – multiple U.S. catastrophes but offset by abundant capacity keeps pricing in line for non-loss hit layers. 5-10% rate increases for layers that have been hit.
- **US Personal Auto** increase in frequency continues – ceding commissions continue to be under pressure from a limited pool of reinsurers that are increasingly non-renewing, bad-performing accounts. Ceding commission down for treaties between 2-3% at 1/1 renewal.
- Ample **excess of loss** capacity for most **casualty lines** in the US. Possible exception, commercial auto, where primary pricing and interest in captives is increasing.
- **Workers' Compensation catastrophe:** moderate price hardening, **working layer** has increased by single digits as reinsurers try and offset primary rate decreases.

# 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 reaches \$13.85 billion

# Insurance Linked Securities

- The Mercury Investible Catastrophe Index was down 8.15 % in 2017 and down 2.29% in 2018.
- The month of November 2018 was negative 7.14%.
- Outstanding cat bonds rose to a record total of \$37.8 billion as at 31 December 2018.

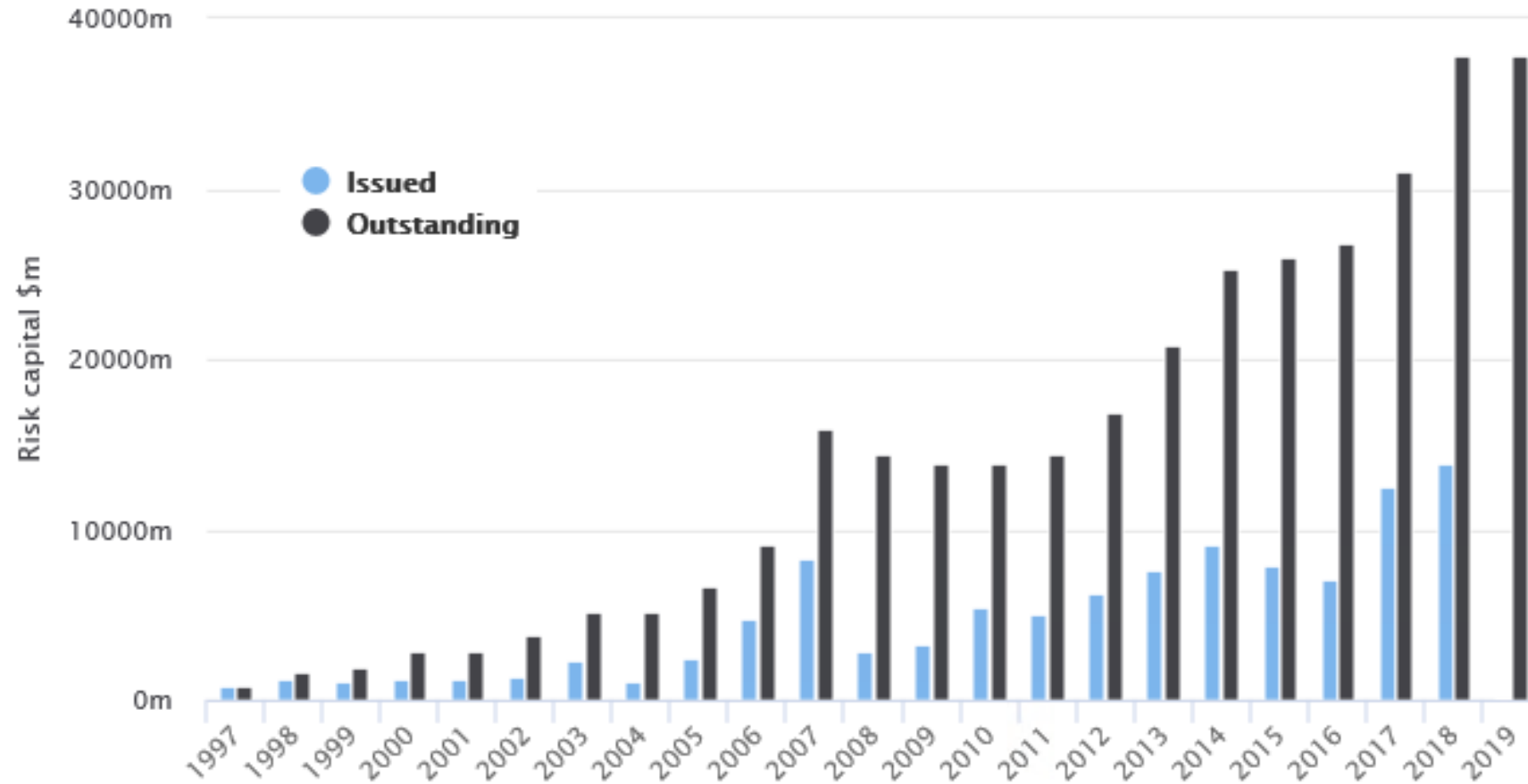
# Insurance Linked Securities

## Non-insurance company buyers of ILS:

- Amtrak bought \$275 million in parametric index per occurrence cover for EQ, storm surge, and wind from named storms to protect the North East and Mid-Atlantic states. The vehicle is PennUnion Re Ltd.
- Pacific Gas and Electric Company (PG&E): Cal Phoenix Re cat bond (\$200 million) was put in place to cover transmission and distribution losses. Currently because of uncertainty as to the size of the wildfire loss and the possibility of PG&E being bankrupt, the bond is trading for as low as 5 cents on the dollar.

# Insurance Linked Securities

Catastrophe bond & ILS risk capital issued & outstanding by year



Source: [www.Artemis.bm](http://www.Artemis.bm) Deal Directory

# Bermuda Specialist Captive Reinsurers

	AM Best Rating (Sep 30 2018)	Policyholder Surplus (Sep 30, 2018)
Allianz	A+	\$68.7 bn
Allied World (Fairfax Group)	A	\$13.7 bn
MS Amlin	A	\$2.65 bn
Arch Capital Group Ltd.	A+	\$8.5 bn
Aspen Insurance	A	\$2.8 bn
BRIT (Fairfax Group)	A	\$13.7 bn
Everest Re	A+	\$5.1 bn
Hiscox	A	\$2.2 bn
Markel	A	\$9.8 bn
Renaissance Re	A+	\$4.9 bn
Third Point Re	A-	\$1.5 bn
Tokio Millennium Re	A+	\$1.2 bn
Trans Re	A+	\$5.17 bn
AXA Group	A+	\$65.96 bn

# US Specialist Captive Reinsurers

	AM Best Rating (September 30, 2018)	Policyholder Surplus (September 30, 2018)
Arch Re	A+	\$8.5 bn
Axis Re	A+	\$6.15 bn
Berkley Re	A+	\$5.44 bn
Chubb Limited	A++	\$50.93 bn
General Re	A++	\$13.2 bn
Munich Re America	A+	\$30.91 bn
National Indemnity	A++	\$139 bn
Odyssey Re (Fairfax Group)	A	\$13.7 bn
Partner Re	A	\$6.56 bn
Swiss Re America	A+	\$32.78 bn
TOA Re	A	\$1.09 bn
Trans Re	A+	\$5.17 bn

# Healthcare Reinsurers

Aspen (US and UK)

Ascot Bermuda Limited (BDA)

MS Amlin (BDA)

Berkshire Hathaway (US)

Munich Re America

BRIT (BDA)

Renaissance Re (BDA)

Chubb Tempest (US)

Swiss Re (US and Switzerland)

General Re / Genesis (US)

Trans Re (US)

Tokio Millennium Re (BDA)

Lloyd's of London (UK)

AXA XL (BDA)

Markel (BDA and US)



# Auto Reinsurers

Allianz (BDA)

Arch Re / Watford Re (BDA)

Ascot Re (BDA)

Chubb Tempest (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)

Tokio Millennium Re (BDA)

Trans Re (US)

AXA XL (BDA)

# Construction / GL Reinsurers

Allianz (BDA)  
Arch Re (BDA)  
Aspen (BDA & UK)  
Berkley Re (US)  
Berkshire Hathaway (US)  
Chubb Tempest (BDA & US)  
Hannover Re (GER)  
Hiscox (BDA)  
Lloyd's of London (UK)  
MS Amlin (BDA)  
Partner Re (US)  
Swiss Re (US)  
AXA XL (BDA)

# Workers Comp Reinsurers

Arch (US / BDA)

Aspen Insurance (UK)

Axis Re (USA)

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)

Tokio Millennium Re (BDA)

Trans Re (US / BDA)

AXA XL (US / BDA)

# Is there an alternative to wasting money on excess insurance?



# Multi-Year Excess of Loss

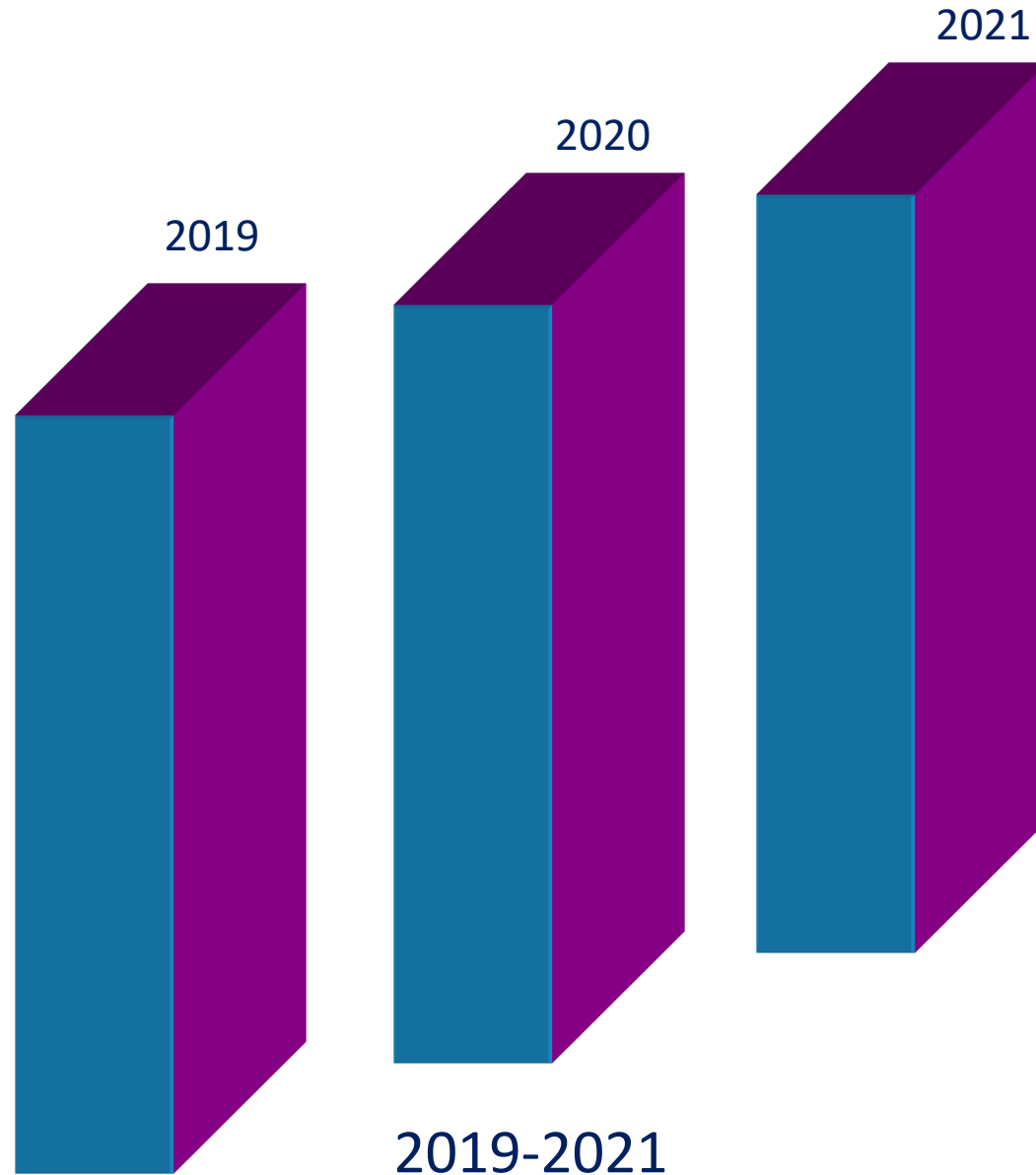
- Client buys \$10m xs \$1m Umbrella from Standard markets every year.
- Premium is \$1.5m per annum.
- Limited frequency; one loss every five years.
- 3 years on, client has bought \$30m worth of excess insurance with little chance of full utilization. Premium is “Dead Money”.

# Multi-Year Excess of Loss

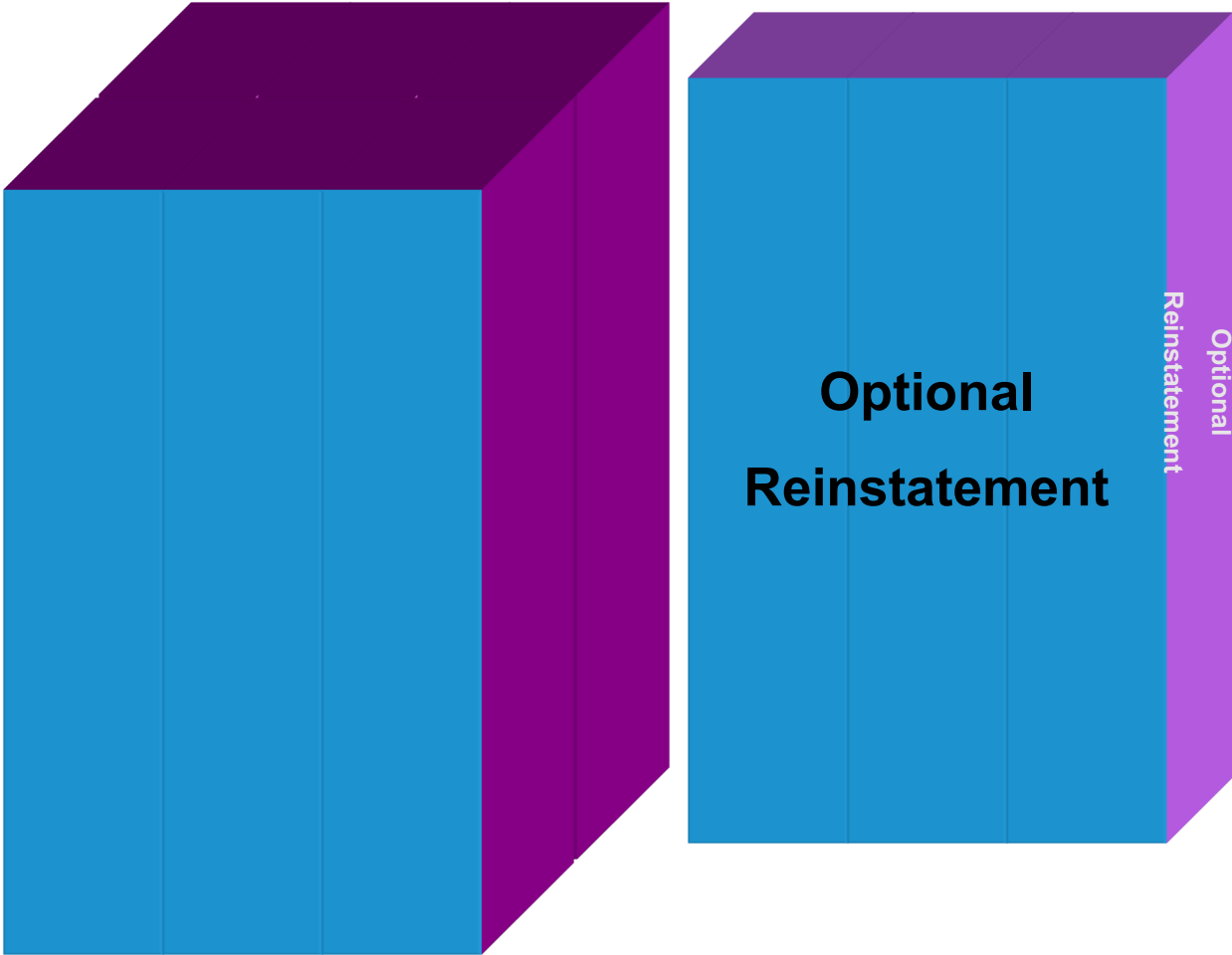
## Answer:

- 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





# Making reinsurance affordable for small and start up captives



# Reinsurance Strategies for Small Captives

- Make little into big. Multi year contracts or first year policy 15 months period.
- Assist cash flow – stagger deposit premiums (10%, 20%, 30% and 40%) and be conservative about estimated premium income.
- Have mid year premium adjustments if uncertain about target price.
- Pay as you go reinstatements – only pay for cover if you need it.
- Sub limit non-essential coverages.
- Cap sideways exposures to reduce costs.

# 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

## Scrutinize Security

### ➤ **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.

# Agenda

- Fronting Market
- Strategies and Considerations in Choosing a Front
- Collateral Considerations
- Optimizing Reinsurance Options

# Fronting and Reinsurance Strategy

- Marsh 2014 captive fronting study:
  - Only 30% of Captives are Fronted
  - Only 33% of Captives purchase reinsurance
- Fronting is required for
  - Auto Liability and Workers' Compensation
  - 3<sup>rd</sup> Party Business
  - Employee Benefits,
  - Some countries requiring it for absolutely everything
- Fronting not required: single parent captive 1<sup>st</sup> party brother-sister business

# Pure Fronting

- For **programs** (MGA/MGU/Group Captives)
- **Unbundled** option:
  - Cost: as little as a 5% (or \$100,000)
  - Claims and choice of TPA
  - Reinsurance design options
  - Disadvantage: may not be cheaper: two margins
- **Full service** fronting
  - Manage claims
  - Provide reinsurance
- State National: a pure fronting company

# Start Ups: Potential Competition

- Accredited Surety and Casualty, Trisura, Clear Blue, Greyhawk, Spinnaker, Equity and Redpoint
- Why? Flexibility, lower cost
- Hybrid model (keep some of the risk) by James River's Fall Lakes subsidiary and Benchmark
- Disadvantage: A- rating



# More Services

- What services?
- Specialized services for traditional lines
- Excess insurance
  - Example: Workers' Compensation with Statutory Limits
- Cost advantage to bundling fronting services and reinsurance
- How to cost it out?
- Caveat: class restrictions

# Multinational Fronting

- Local compliance requirements in all countries. Examples.
- Reinsurance to Captives to reduce total cost
- Why not write direct? Too complicated and costly
- Insurers with global networks – everywhere?
  - AIG
  - AXA/XL
  - Chubb
  - Swiss Re
  - Zurich

# Collateral

- Collateral : the number one issue
- Costs sometimes **larger than fronting costs**
  - LOC costs persist for many years
  - Collateral build up: difficult to change fronting companies
  - Why insurance Carriers have less freedom to offer lower collateral to captives than to other self-insurance mechanisms
- Why **LOCs the preferred option**:
  - Fronting Perspective: Simplicity, Automatic Renewal, Most Bankruptcy Remote
  - Captives' Perspective: Some investment Flexibility,
  - Easier for Group Captives

# Other Collateral Options:

## Pledged Assets/Trusts—

Low cost

More restrictions

Trust agreements are complicated!

## Cash or Funds Withheld: Why sometimes preferred?

- How much? *Sometimes more than estimated losses!*
  - Explore Surety Bonds, Excess of Loss Credit Insurance Policies
- Better: high deductible programs for casualty with captive deductible reimbursement policy

# Claims Considerations

- Carrier, TPA or self-management? Who decides, who appoints?
- Expertise: who has it , how can you tell?
- Key issues:

Claims cooperation

Dispute Resolution

Arbitration and Mediation

Cooperation with **your** claims systems

# Reinsurance Structures

- 3 Main Structures
  - Proportional
  - Excess of Loss
  - Aggregate Excess

- Layer issues:

Captive writes only a layer or

Captive writes whole program and reinsures

# Annual Aggregate Stop Loss

- **News!** Captive annual aggregate Stop Loss programs once again available!
- What's on offer, what lines.
- **Advantages:**
  - Covers bad scenarios for the captive as a whole
  - Can eliminate the need for a capital call
  - Can avoid having loss situations in a tax-free jurisdiction
  - Can run more lines of business through the captive
  - Use the premium savings to pay for the aggregate stop loss cover
  - Stoploss premiums are modest!
- Potentially the lowest Economic Cost of Risk (ECoR) Strategy.

# Structured Reinsurance

- Multi Year programs
  - Reduce Multi Year volatility
- Funds withheld structures
  - Possible cash infusions from the reinsurer, paid back with future premiums
  - Eliminate cash call from parent
  - More stability for illiquid investment strategies
  - Lower cash outlays than other structured programs
- Loss Portfolio Transfers and Adverse Development
  - Can lessen risk and collateral costs
- Solvency II jurisdictions may require even more aggressive structures
  - Capped Quotashares are often used for surplus relief
  - Can combine forward looking and LPT/ADC's to avoid capital infusions



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