



The Actuarial Profession
making financial sense of the future

GIRO Convention

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Captives – Reserving, Regulation and Innovation in
International Financial Centres

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Introduction – the Captive Market

- Definition of a captive
- Uses of captives
- Size of the captive market
- Captive locations
- Types of captives
- Structure of captives

Definition of a Captive (1)

- **IAIS Definition:**

An insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities, other than an insurance or reinsurance group entity, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities and only a small part if any of its risk exposure is related to providing insurance or reinsurance to other parties

Definition of a Captive (2)

- EU Definition:

A reinsurance undertaking owned either by a financial undertaking other than an insurance or a reinsurance undertaking or a group of insurance or reinsurance undertakings to which Directive 98/78/EC of the European Parliament and of the Council on the supplementary supervision of insurance undertakings in an insurance group applies, or by a non-financial undertaking, the purpose of which is to provide reinsurance cover exclusively for the risks of the undertaking or undertakings to which it belongs or of an undertaking or undertakings of the group of which the captive reinsurance undertaking is a member

Uses of Captives

- Insurance of a company's its own risks
- Access to the reinsurance market
- Reduction of insurance costs
- Insuring specialised risks
- Improvement of risk management
- Provision of employee benefits

Size of the Captive Market

- Over 5,000 captive insurance companies worldwide
- Estimated US\$50bn of premium income

Captive Locations - 2006

<u>America</u>		Sweden 42	
Vermont	533	United Kingdom	30
Hawaii	143	<u>Asia Pacific</u>	
S Carolina	110	Singapore	57
Other	723	<u>North Atlantic & Caribbean</u>	
<u>Europe</u>		Bermuda	1,326
Guernsey	387	Cayman	737
Luxembourg	277	BVI	377
Ireland	199	Barbados	218
Isle of Man	161	Turks & Caicos	95
Switzerland	48	Bahamas	22

(Source IAIS Issues paper on the regulation and supervision of captive insurance companies)

Types of Captives

- Pure captive
- Fronted captive
- Rental captive
- Association captive
- Agency captive
- Risk retention group

Structure of Captives

- Conventional company
- Protected cell company
- Incorporated cell company

Regulation of Captives

- Regulatory approach
- Role of the captive supervisor
- Actuarial involvement
- IAIS Issues and Guidance Papers
- Impact of EU Solvency II regime

Regulatory Approach

- Risk based approach
- Capital requirements
- Contingent capital
- Approved assets
- Reinsurance
- Insurance managers

Role of the Captive Supervisor

- Licensing new captives
- Solvency
- Own capital assessment
- Off-site monitoring
- On-site monitoring
- Changes in business plan

Actuarial Involvement

- Reserve adequacy
- Capital modelling
- Employee benefits
- Other lines of business
- Portfolio transfers
- Premium rating

IAIS Issues and Guidance Papers

- IAIS Captive Issues Paper – October 2006
 - Produced by group of captive supervisors
 - Educational approach
- IAIS Captive Guidance Paper – October 2008
 - Produced by captive and mainstream supervisors
 - Specific guidance for insurance supervisors
 - Application of IAIS Insurance Core Principles
 - Includes corporate governance, risk and the role of insurance managers

Impact of EU Solvency II Regime

- EU domiciled captives
- Non-EU captives using EU fronting insurers
- Development of IAIS solvency standards

Questions and Discussion

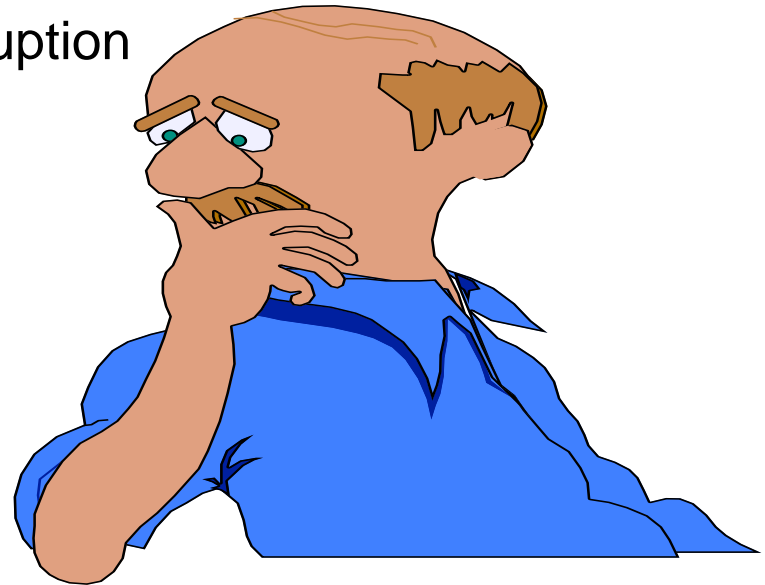
- Supervisory Issues

Actuaries and Captives

- Business lines
- Reserving approaches
- Other Issues

Key business lines

- Employers Liability
- Public Liability
- Motor (fleet)
- Property Damage/ Business Interruption
- Mortgage Indemnity Guarantee
- Professional Indemnity
- Employee Benefits



Employer's Liability

- Standard cover
- Risks vary substantially
- Industrial disease affects certain companies
- US parents may cover workers compensation
- Much discussed elsewhere so will not consider in depth here

Public Liability

- Standard cover
- Risks vary substantially according to the nature of the business
- Need to understand parent's business
- Substantial variations between companies in experience and development

Motor (fleet)

- Standard cover
- Risks vary substantially
- Need to understand parent's business
- May cover overseas risks so may need to consider non UK markets
- Nature of fleets vary substantially

Property Damage/ Business Interruption

- Standard cover
- Short tail
- Reserving not usually complex
- Some care needed where periods of unexpired risk remain

Mortgage Indemnity Guarantee

- Subject of past papers
- Exposure dependant on lending strategy...
- .. as illustrated by Northern Rock
- Standard approach of earnings pattern may need to be reviewed for 2008

Professional Indemnity

- Costs have increased rapidly so more use of captives
- Including by actuarial firms
- Claims made
- Dependant on claim assessments
- Susceptible to impact of large claims (in relatively small accounts)

Employee benefits

- Not necessarily relevant to GIRO but captives do take on some risks
- Need to be prepared to consider
- May be fronted for reinsurer
- Or retained for major entity
- More discussed than implemented
- US is probably more active in this area – possibly due to tax considerations

Reserving themes

- Small accounts (generally) and susceptible to volatility
- Monoline covers (e.g. MIG)
- Data can be problematic not enough or poor quality (but most captive managers now much more aware of actuarial needs)
- Need to consider parent as well as trends generally for the class of business
- Parent exposure may be an issue as well as the captive retention – need to clarify scope of review

Reserving methods

- Due to modest size of companies approach is normally relatively simple and deterministic
- Due to volatility of claims development Bornhuetter Ferguson type methods may be appropriate
- As always – useful to consider a range of approaches
- More sophisticated stochastic methods may “trickle down” as used more frequently for larger insurers

Premium Rating

- Captives usually work to an annual renewal
- May be asked to comment on appropriate premium
- Need to reflect changes in parent's business as well as standard factors for class of risk

Best Practice - Reserving

- Issues already under review by profession
- GRIT – GIROC
- Uncertainty
- Underwriting cycle
- Data quality
- Reserving methodologies

Best practice - Premium Rating

- Under review by profession
- GRIP
- Uncertainty
- Impact of underwriting cycle
- Technical issues e.g. latent claims, price optimisation, expense allocation etc

PCCs and ICCs

- More complex structures
- Need to understand whether you are reviewing a cell or the company
- Scope of review should be defined
- Who is the client?

Capital Assessment

- Guernsey has introduced an “Own Solvency Capital Assessment” effective 30 September 2008
- Other captives jurisdictions may follow
- Solvency II will impact on Dublin, Luxembourg and Malta
- Opportunity for further work for actuaries
- However, if costs rise too high alternative approaches to managing risk may be sought

Questions and Discussion

- Actuarial Issues