EFFICIENCY AND PROFITABILITY

Paul Woehrmann and Todd Cunningham of Zurich discuss Solvency II and the benefits of integrated multi-line programmes in addressing captive needs

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Multi-line programmes are rooted in the idea insurance can be purchased more efficiently through an integrated risk programme. At Zurich, we can provide these programmes for corporations or in support of captives as a retrocession protection.

The understanding that many risks are not or not closely correlated is the underpinning of Zurich's multi-line captive solutions. If you think about the way insurance is purchased, whether directly or in support of a captive, it is generally on a mono-line basis. This means you are spending premium dollars for each line of business with potentially significant limits of insurance for the property, casualty or management lines, for example. The likelihood of having multiple events that are going to trigger all of these policies is often very low. So the notion that you can purchase coverage on an integrated basis is one that has been around for more than two decades. The market has ebbed and flowed, but Zurich has been one of the very few consistent and reliable players that has continued to offer these programmes to our corporate clients. The current market is flowing, in the sense there are a number of large, global carriers, which have recognised the differentiation these types of programmes can offer, in terms of competitive advantages and the benefits to their customers.

Two key trends can be observed: additional capacity and considerable interest on the part of insurance and reinsurance buyers. The latter are realising these types of programmes can deliver real economic value. As a result, we are seeing renewed interest in these types of programmes, both directly and for captives.

Risk management judgements

Perhaps one of the greatest shortcomings for the captive area, in this respect, is that companies are at risk of making poor judgement calls, simply as a result of limited data. Since their risk is limited to that of the parent company, they run the risk of missing loss trends and emerging risks a larger reinsurer can identify. Managing these risks is critical to the sustainability of the captive so a captive manager would be wise to work with retrocessional partners that can offer insight and risk transfer products. Multi-year, multi-line programmes are one way of gaining these benefits.

Many captives will retrocede, or reinsure, a portion of their risk. How much they reinsure depends on their view of the volatility of the risks in the captive, the pricing available in the market place and other similar factors. But again, this is based on limited data. For a captive, trying to establish a total cost of risk can be a challenge.

When faced with this kind of uncertainty, captives may be tempted towards risk transfer in order to limit their net exposure across various lines of businesses. Should the captive owner decide to protect the balance sheet on an annual basis, introducing an integrated multi-line and multi-year capacity behind the reinsurance captive as a retrocession solution helps to minimise uncertainty.

Solvency II

A lot of companies running a captive in Europe have been doing enormous amounts of work to prepare themselves for January, 2016, and the impending application of the Solvency II regulation. It is our estimation that, under this regulation, the operational costs of running a captive will increase. This has resulted in a lot of questions from our clients. These questions primarily ask us to suggest ways to increase a captive's profitability or to get more underwriting profits out of the captive. In addition, clients often ask for advice on how to capture the purchasing power of the parent company and all of its subsidiaries. We have made recommendations to our large customers running reinsurance captives to bring in their employee benefit portfolio, which are normally decentralised and not put into an international programme for employee benefit risk. Under Solvency II, employee benefit risk is considered non-correlated to non-life exposures. So companies running reinsurance captives covering non-life risk can benefit from bringing life risk and employee benefit into the captive. They can generate capital credit in their balance sheet as the risk across their captive portfolio is more diversified.

Since we began making these recommendations, we have seen good results across various countries. An increasing number of captive owners across Europe are exploring the opportunity to bring in employee benefit programmes into their captive. But these companies need to consider what lines of business they are able to take across in captive. In other words, how much capital they need under Solvency II and where they need specific protection.

Protection is a critical topic. For each line of business, a company with a captive can buy stop-loss protection or they can think about bringing together a 'basket' of lines of businesses. This means finding a carrier behind the captive, which will provide a retrocession agreement and the capabilities to protect the captive for one year or on a multi-year basis.

At Zurich, we feel it is in the interest of European risk managers running a captive to get information about tailor-made solutions behind a captive, which would allow them to capture various lines of business in one package and for several years.

> "Our multi-year programmes allow our insureds to spread a single block of reinsurance capacity across multiple lines of business"

Tailor-made solutions for large companies running a captive

We see interest from a wide range of corporate insureds, including manufacturing, retail, energy, contractors and transportation. In a sense, it is less of an industry segmentation than it is a buying behaviour. It is a more sophisticated way of purchasing insurance and we find that our customers are among the top risk managers around.

Our multi-year programmes allow our insureds to spread a single block of reinsurance capacity across multiple lines of business. This may result in pricing efficiencies that come about as a result of limits compression, an aggregate stop-loss or merely looking at the customer's risk portfolio on a 'whole account' basis. These programmes can deliver real administrative cost savings as the programme renewal process is pushed back from each year to every three years. Furthermore, our programmes are guaranteed for three years, meaning the rate is fixed and the insured has stable capacity at a known rate. This gives customers the ability to budget for their insurance programme over a longer horizon.

A key area for integrated risks is in contract certainty. Imagine you buy your insurance programme from 10 different carriers and suffer a loss event. This event could result in liability to third parties and could result in damage to your own property. If you have different carriers involved, there may be a dispute over cause of the loss or the resulting damages. With an integrated risk programme, you have a single carrier across multiple lines, which can help reduce coverage disputes and more timely claims settlements.

Zurich's strategy

Across all global corporate regions, Zurich follows a customer centric approach. Our risk management looks at risk and exposure in a more holistic way. We have identified two strategic factors at play in each large company running a captive. On one hand, you have risk managers taking care of the non-life risks and on the other side, you have HR managers taking responsibility for the employee benefits and life side. Running a captive provides an opportunity for large customers to bring both sides together for the benefit of risk financing management. At Zurich, we are able to help them because our colleagues from global life and non-life areas work as one team serving the customer, which provides comprehensive expertise to address these complex needs.

We help our clients to optimise the insurance, reinsurance and retrocession levels:

- Large international customers can rely on our professional insurance infrastructure and network across non-life and life lines of businesses, providing certainty about locally required compliance standards.
- European customers with global insurance programmes get served their customer needs from one source of captive experts, supported by a central clearing-house. All fronted lines of businesses are ceded to the reinsurance captive thanks to integrated IT-systems, which provide consistent content of Captive Bordereaux. More than 350 captive reinsurance programmes of European captive owners get served providing per quarter claim and premium information which can be traced back to the local insurance level.
- Finally, Zurich can provide access to its capacity-facilities and expert teams running across its global network to follow the customer's needs, which could be addressed as a gross reinsurance cession rather than a net cession.