RISK MANAGEMENT FORUM

AEAI/RIMS International Conference
October 15-18, 1989
Monte - Carlo

Please respond to

TUESDAY, OCTOBER 17, 1989

SESSION NR 9

ALTERNATIVE RISK FINANCING MARKETS

ANTHONY P.D. LANCASTER

AEAI

Omer Leroy
UNILEVER
Conference Co-Chairman

Risk and Insurance Management Society, Inc.

Hugh Loader
Tetra Pak
Conference Co-Chairman

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

ALTERNATIVE RISK FINANCING MARKETS

BRIEF HISTORY AND OVERVIEW:

DURING THAT DIFFICULT PERIOD - THREE OR FOUR YEARS AGO, ~~~ WHEN CAPACITY FOR LIABILITY EXPOSURES WAS LIMITED, AND PRICES HIGH, ~~~ THERE WAS A FLURRY OF ACTIVITY - WITH COMPANIES ESTABLISHED - TO PROVIDE BOTH IMMEDIATE INSURANCE COVERAGE AND LONGER TERM FACILITIES - FOR HANDLING EXPOSURES - WHICH DEMAND PRICE STABILITY AND PERMANENT AVAILABILITY. ~~~ THE MOST SUCCESSFUL, - ACE AND EXCEL - NOW HAVE AN IMPORTANT PLACE IN THE INSURANCE MARKET, - AND ARE A MONUMENT TO WHAT CAN BE DONE - IN A VERY SHORT TIME.

THESE FACILITIES, - AND THE MANY OTHERS THAT MUSHROOMED AT THE TIME, - WERE ALMOST ENTIRELY DEVOTED TO RESOLVING THE PARTICULARLY DIFFICULT PROBLEM

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

- OF U.S. EXPOSURES. --- ALTHOUGH MANY OF THESE FACILITIES HAVE EUROPEAN COMPANIES AS MEMBERS AND PARTICIPANTS, - ATTEMPTS TO DEVELOP TRULY EUROPEAN FACILITIES WERE LARGELY UNSUCCESSFUL - DUE, I THINK, - TO DIFFERENCES IN APPROACH - BETWEEN AMERICAN AND EUROPEAN COMPANIES - TO JOINT VENTURES OR RISK SHARING.

SPONSORS OF FACILITIES OFFERED TO EUROPEAN COMPANIES WERE UNDER-SUBSCRIBED. ~~~ MANY BUYERS FOUND THAT THEIR DOMESTIC INSURERS - WERE PREPARED TO REMAIN LOYAL AND CONTINUED TO PROVIDE AS MUCH CAPACITY AS POSSIBLE, ~~~ AND MANY OF THE INITIATIVES - TAKEN BY THE BUYING ORGANISATIONS - TOOK SUCH A LONG TIME TO COME TO FRUITION, - THAT BY THE TIME DECISIONS WERE TO BE MADE, - THE "CRISIS" HAD DISAPPEARED.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

THEREFORE, THERE ARE NOT, - WITHIN EUROPE, - THE EQUIVALENTS OF THE STATESIDE INITIATED FACILITIES - SUCH AS ACE, EXCEL, BICL, CODA AND SO ON, ~~~ BUT THIS DOES NOT MEAN - THAT THERE HAS NOT BEEN DEVELOPMENT IN ALTERNATIVE RISK FINANCING STRUCTURES - FOR BOTH INDIVIDUAL CORPORATIONS AND GROUPS.

I WOULD LIKE, - IN MY SHORT PRESENTATION, - TO HIGHLIGHT THREE AREAS OF SIGNIFICANT DEVELOPMENT OVER THE LAST FEW YEARS. ~~~ THESE ARE CAPTIVE INSURANCE COMPANIES, ~~~ ONSHORE PROFESSIONAL INDEMNITY MUTUALS ~~~ AND FINANCIAL INSURANCE - AND REINSURANCE MECHANISMS - INCLUDING - RENT-A-CAPTIVES.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

Captive Insurance Companies:

CAPTIVES HAVE, OF COURSE, - BEEN AROUND FOR A LONG TIME, - AND INDEED IT IS WORTH REMINDING OURSELVES - THAT THE FIRST CAPTIVES WERE ESTABLISHED IN THE VERY EARLY 1920'S - IN NORWAY, - DENMARK AND THE UNITED KINGDOM. ~~~ HOWEVER, - SUBSTANTIAL GROWTH IN CAPTIVES LARGELY OCCURRED IN THE 60'S AND 70'S, - WITH THE GREATEST GROWTH EMANATING FROM THE U.K., - NETHERLANDS AND SWEDEN. ~~~ MORE RECENTLY - THERE HAS BEEN CONSIDERABLE GROWTH IN CAPTIVE FORMATION - BY FRENCH, - ITALIAN, - SPANISH, - AND TO A LESSER EXTENT, GERMAN COMPANIES. ~~~ WE MUST EXPECT THIS TREND TO CONTINUE.

THE MAJORITY OF CAPTIVES - HAVE BEEN UTILISED TO HANDLE DEDUCTIBLES UNDER PROPERTY AND BUSINESS INTERRUPTION PROGRAMMES, - BUT AS SHAREHOLDERS'

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

FUNDS HAVE INCREASED - AND CONFIDENCE IN CAPTIVE MECHANISMS GROWN, - MANY HAVE MOVED TO PARTICIPATION IN LIABILITY PROGRAMMES. ~~~ DURING THE CAPACITY CRISIS, - A NUMBER OF THE LARGER EUROPEAN CAPTIVES - TOOK SUBSTANTIAL RETENTIONS, - IN SOME CASES UP TO U.S.$10 MILLION - EACH LOSS.

DEVELOPMENT OF CAPTIVES - HAS SEEN AN INCREASE IN THE NUMBER OF EUROPEAN LOCATIONS ENCOURAGING CAPTIVE FORMATION AND THE DEVELOPMENT OF STRONG EFFECTIVE FINANCIAL SERVICES INFRASTRUCTURES. ~~~ THE WELL ESTABLISHED CAPTIVE CENTRE OF GUERNSEY - CONTINUES TO GROW, - BUT HARD ON ITS HEELS IN TERMS OF NUMBERS - ARE LUXEMBOURG AND THE ISLE OF MAN.

GUERNSEY - HAS A LARGELY U.K. OWNED CAPTIVE INDUSTRY, - BUT THERE IS SUPPORT FOR GUERNSEY FROM CONTINENTAL EUROPE, ~~~ WHILST THE ISLE OF MAN -

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

IS PRIMARILY U.K. BASED, - AND LUXEMBOURG IS DOMINATED BY SWEDISH, - AND TO A LESSER EXTENT, - FRENCH CAPTIVE INSURANCE COMPANIES.

THIS JUNCTURE
WILL TALK TO
THE SLIDES

I EXPECT TO SEE CHANGES IN THE GROWTH PATTERNS OF THESE LOCATIONS - AS AWARENESS OF THEIR ADVANTAGES AND DISADVANTAGES GROWS. ~~~ INDEED, - WE ARE BEGINNING TO SEE THIS HAPPEN - AS NEW LOCATIONS DEVELOP - SUCH AS THE FINANCIAL SERVICES CENTRE - IN DUBLIN.

REVISION OF CAPTIVE STRATEGIES - TOWARDS THE FORMATION OF MORE CAPTIVES - WILL REFLECT THE IMPACT OF FREEDOM OF SERVICES - WHICH WILL AFFECT LARGE CORPORATE BUYERS FROM THE MIDDLE OF NEXT YEAR - AND INTRODUCE THE POSSIBILITY TO FORM A CAPTIVE WITHIN THE

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

COMMON MARKET - WHICH CAN WRITE DIRECT BUSINESS - UNFETTERED BY RESTRICTIVE LEGISLATION AND ONEROUS STATUTORY RETURNS. ~~~ THIS COULD TRANSFORM THE WAY - THAT CAPTIVES ARE BEING USED IN EUROPEAN WIDE INSURANCE PROGRAMMES.

TO SOME EXTENT - THE FORMATION OF REINSURANCE, AND NOW DIRECT CAPTIVES - WITHIN THE FINANCIAL SERVICES CENTRE IN DUBLIN - HERALDS - WHAT I FORESEE TO BE A NEW TREND. ~~~ THOSE COMPANIES IN LUXEMBOURG, - WHERE REINSURANCE CAPTIVES ONLY ARE ALLOWED, - MAY FIND A REINSURANCE ONLY VEHICLE - UNNECESSARILY RESTRICTIVE IF THEY WISH TO AVOID FRONTING FACILITIES, - OR CANNOT OBTAIN FRONTING - IN AREAS WHERE THEY WISH TO USE A CAPTIVE TO HANDLE DIFFICULT RISKS - SUCH AS POLLUTION - OR PRODUCT RECALL - ON A DIRECT INSURANCE BASIS.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

CAPTIVE LOCATIONS OUTSIDE OF THE COMMON MARKET, - SUCH AS GUERNSEY AND THE ISLE OF MAN, - MIGHT FIND ATTRACTING EUROPEAN CAPTIVES MORE DIFFICULT, - IF COMPANIES DECIDE TO OPT FOR A DIRECT CAPTIVE WITHIN THE COMMUNITY. ~~~ DUBLIN - COULD WELL BE AN ATTRACTIVE OPTION IN THIS CONTEST.

DENMARK HAS ALSO PROMOTED ITSELF - AS A POTENTIAL CAPTIVE AREA, - BUT LIKE LUXEMBOURG, - FAVOURS CAPTIVE REINSURANCE COMPANIES - AND REMAINS UNSURE AS TO WHETHER OR NOT - IT SHOULD INTRODUCE LEGISLATION TO PROMOTE ITSELF - AS A DIRECT CAPTIVE AREA.

OTHER AREAS - SUCH AS GIBRALTAR AND MALTA ARE AVAILABLE - AND MAY HAVE APPLICATION - IN SOME CASES.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

THERE ARE, - IN THE CAPTIVE AREA, - A WIDE RANGE OF CHOICES, - BOTH IN RESPECT OF UTILISING CAPTIVES WITHIN A SOPHISTICATED APPROACH TO FINANCING BOTH DOMESTIC AND GLOBAL INSURANCE PROGRAMMES - AND CHOOSING A SINGLE, - OR PERHAPS - A COMBINATION OF, LOCATIONS - WHICH FIT THE NEEDS OF BUYERS - TO WRITE - DIRECT INSURANCE, - REINSURANCE, - OR DEVELOP TAX EFFECTIVE FUNDING MECHANISMS.

I FORESEE THE GROWTH OF CAPTIVES CONTINUING, - AND I SEE EXISTING CAPTIVES BEING USED MORE ACTIVELY - IN THE INTERNATIONAL INSURANCE PROGRAMMES OF THEIR PARENTS. ~~~ I SEE MORE CAPTIVES BEING FORMED FROM THOSE COUNTRIES WITHIN EUROPE - WHICH LAG BEHIND - IN THE USE OF THESE SELF INSURANCE MECHANISMS.

AS A WORD OF CAUTION - I BELIEVE - IT IS IMPORTANT - TO REFLECT ON THE IMPLICATIONS OF FORMING A CAPTIVE - AND PARENT COMPANIES SHOULD AT ALL TIMES BEAR IN MIND THE FINANCIAL RESPONSIBILITIES ATTACHED TO THESE RISK TAKING ENTITIES.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

Onshore Professional Indemnity Mutuals:

THE LIABILITY PROBLEMS PARTICULARLY HIT THOSE - WHO BUY PROFESSIONAL INDEMNITY INSURANCE. ~~~ MANY PROFESSIONALS HAVE HAD TO EXAMINE WAYS - OF OVERCOMING THESE DIFFICULTIES, - AND HAVE CONCLUDED - THAT GROUPING TOGETHER WOULD BE THE SOLUTION.

CONSEQUENTLY - RATHER THAN ELECTING FOR CONVENTIONAL GROUP CAPTIVE STRUCTURES, - MANY OF THEM - SET UP MUTUALS BASED ON THE TRADITIONAL, - BUT EFFECTIVE, - P & I CLUB SYSTEMS ~~~ THESE INVOLVE MINIMUM GUARANTEE FUNDS, - ADVANCED PREMIUM CALLS - AND SUPPLEMENTARY CALLS - IN THE EVENT OF LOSSES EXCEEDING PREMIUM INCOME.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

MUTUALS OF THIS TYPE - HAVE BEEN ESTABLISHED FOR ARCHITECTS, - ACCOUNTANTS, - SOLICITORS, - HOUSING ASSOCIATIONS - AND EVEN FOR A SIGNIFICANT NUMBER - OF MEDIUM SIZED INSURANCE BROKERS.

THE MAJORITY OF THESE MUTUALS HAVE BEEN ESTABLISHED WITHIN THE UNITED KINGDOM, - AND WERE GIVEN CONSIDERABLE SUPPORT BY THE U.K. INSURANCE AUTHORITIES, - PARTICULARLY IN RESPECT OF FLEXIBILITY OF THE GUARANTEE FUNDS - AND SPEED IN APPROVING THE SUBMISSIONS.

AN IMPORTANT ELEMENT OF THESE MUTUALS - IS THE EMPHASIS ON MEMBERSHIP SELECTION - AND LOSS CONTROL.

~~~ MANY OF THESE FACILITIES - INCLUDE REGULAR AUDITS - OF THE RISK MANAGEMENT SYSTEMS OPERATING WITHIN THE INDIVIDUAL MEMBERS - BE THEY PARTNERSHIPS OR COMPANIES, - AND DETAILED QUESTIONNAIRES USED TO ESTABLISH AND MONITOR UNDERWRITING CRITERIA - AND CONSEQUENTLY THEY ARE ABLE TO DISSEMINATE INFORMATION - TO THEIR MEMBERS.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE
~~~

PROFESSIONAL INDEMNITY MUTUALS - STRUCTURED IN THIS WAY - CLEARLY HAVE A FUTURE, - AND WITH THE ACCENT ON STABILITY, - IMPROVING LOSS CONTROL AND STRONG CLAIMS HANDLING SERVICES - SHOULD PROVIDE AN EFFECTIVE RISK FINANCING MECHANISM - FOR A LONG TIME TO COME.

FINANCIAL INSURANCE & REINSURANCE:

THE LAST FEW YEARS HAVE SEEN THE ESTABLISHMENT, - MAINLY IN BERMUDA, - OF A NUMBER OF SPECIALIST INSURANCE COMPANIES - PROVIDING FINANCIAL MECHANISMS - DEVELOPED TO ASSIST CORPORATE BUYERS, - AND INSURANCE AND REINSURANCE COMPANIES - TO OVERCOME LOSS RESERVING, - OR BALANCE SHEET AND RISK FUNDING PROBLEMS. ~~~ MOST OF THESE COMPANIES ARE EUROPEAN OWNED.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

FOR THE CORPORATE BUYER - THESE FACILITIES CAN BE UTILISED - TO FUND EXPOSURES SUCH AS ENVIRONMENTAL CLEAN-UP, - PRODUCT RECALL, - PRODUCT TAMPER, - AND HIGH RISK PRODUCTS LIABILITY EXPOSURES - WHERE THE CONVENTIONAL INSURANCE MARKET - IS EITHER UNWILLING TO PROVIDE COVERAGE - OR WILL ONLY DO SO - AT UNACCEPTABLE TERMS.

THE STRUCTURES OFFERED BY THESE COMPANIES ARE NUMEROUS, - AND INCLUDE:

- PROSPECTIVE AGGREGATE COVERS,
- OFF BALANCE SHEET FUNDING FOR LOSS PROVISIONS,

AND REINSURANCE FUNDING FACILITIES FOR CAPTIVES.

IN ADDITION, - OTHER OFFSHORE FACILITIES, - WHICH HAVE BEEN ESTABLISHED FOR A LONGER TIME, - PROVIDE RENT-A-CAPTIVE OR EXTERNAL RISK FUNDING MECHANISMS - WHICH CAN BE AN ATTRACTIVE ALTERNATIVE - TO A CAPTIVE INSURANCE COMPANY, - PARTICULARLY WHERE THE PARENT IS UNWILLING TO PUT UP CAPITAL FOR ITS OWN

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

INSURANCE COMPANY, - OR - THE PREMIUM VOLUME IS LOW, - AND PARTICULARLY IF OR THERE ARE EXCHANGE CONTROL OR TAX DIFFICULTIES - WHICH MAKE THE CAPTIVE CONCEPT MORE PROBLEMATICAL ~~~ THE USE OF THESE FINANCIAL INSURANCE VEHICLES IS INCREASING, - AND THEY HAVE APPLICATION IN A WHOLE RANGE OF AREAS - WHERE CONVENTIONAL INSURANCE IS NOT THE SOLUTION. ~~~ WE HAVE SEEN THEM USED IN RECENT TIMES - TO PROVIDE STOP LOSS PROTECTION FOR LLOYD'S UNDERWRITING MEMBERS, - TO FUND FOR POLLUTION EXPOSURES - USING LONG TERM POLICIES - WHERE THE PREMIUM PAYMENTS WILL, - WITH INVESTMENT INCOME, - PROVIDE FOR THE POLICY LIMITS AND TO RELEASE BALANCE SHEET PROVISIONS - FOR AREAS SUCH AS WORKERS COMPENSATION.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

SUMMARY

A NUMBER OF RISK FINANCIAL ALTERNATIVES HAVE BEEN DEVELOPED WITHIN EUROPE OVER THE LAST DECADE, - AND THE PACE OF GROWTH AND INNOVATION IN THIS AREA - IS INCREASING.

CAPTIVES REMAIN - THE FOREMOST ALTERNATIVE - AND CONTINUE TO GROW AS THE CONCEPT SPREADS THROUGHOUT WESTERN EUROPE. IN ADDITION, - DIFFICULT INSURANCE MARKET CONDITIONS OF RECENT YEARS - HAVE RESULTED IN THE CREATION OF A NUMBER OF MUTUALS - ESTABLISHED FOR PROFESSIONAL INDEMNITY EXPOSURES - AND THE USE OF OFFSHORE - FINANCIAL INSURANCE COMPANIES - TO ASSIST WITH THE FUNDING OF DIFFICULT EXPOSURES.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

THE INCREASING AWARENESS OF THE BUYERS' NEEDS - IS BEING REFLECTED IN THE DEVELOPMENT OF OUR INSURANCE INDUSTRIES' CO-OPERATION WITH THESE NEW WAYS OF FINANCING RISK. ~~~ WE CAN EXPECT, - OVER THE NEXT FEW YEARS, - NEW SOLUTIONS AND GREATER CHOICE OF FACILITIES - AS THE INDUSTRY CONTINUES TO RESPOND POSITIVELY AND CONSTRUCTIVELY - TO THE REQUIREMENTS OF THEIR CUSTOMERS.

****

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE