$5

Business Insurance®

September 5, 2011

www.businessinsurance.com

THE ALTERNATIVE RISKS ISSUE

- Array of strategies for managing risk make their mark

Business Insurance

Online features & highlights
www.businessinsurance.com

video

BUSINESS INSURANCE IN FOCUS: Watch our weekly video, Business Insurance In FOCUS, for insights into the biggest risk management, insurance and benefits stories of the week, as well as interactive information about our in-depth coverage, upcoming events and other features.

MOST POPULAR STORIES
Week of August 29, 2011

1. House panels to consider repeal of health plan 'grandfather' rules
2. Katia is next storm on the way, but path uncertain
3. 'Above average' hurricane activity in next two weeks
4. Top 5 highest-paid public broker executives
5. State comp insurer seeks $50M from staffing firm after verdict
6. Court rules against Wal-Mart in harassment, retaliation case
7. Hurricane Irene insured losses expected to near $3 billion
8. Solvency II will reduce competition: Survey
9. Irene wallops floundering flood insurance program
10. Unfair settlement claim against comp insurer disallowed

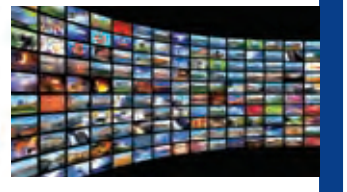
GET ONLINE NEWS EACH DAY
Subscribe to *BI*'s daily newsletter

webinar

BUSINESS CONTINUITY STRATEGIES: A free Sept. 14 *Business Insurance* webcast will feature business continuity experts who will explore issues risk managers and their companies should consider in developing plans. Panelists will include Gary S. Lynch, managing director at Marsh Risk Consulting, and public policy advisor Arietta Chakos. To register for the event, visit www.businessinsurance.com/webinars.

CHANNELS: Visit the Mid-Market Executive channel for risk and benefits information tailored to such firms.

IN-DEPTH COVERAGE on what benefit managers need to do to comply with the health care reform law.



GALLERIES: See the latest photo galleries, and submit your own photos of industry people and events.

Business Insurance (ISSN 0007-6864) Vol. 45, No. 34, is published weekly, except for combined issues the first and second week of July, the fourth and fifth week of August and no issue the last week of December, by Crain Communications Inc., 360 N. Michigan Ave., Chicago, Ill. 60601-3806. Periodicals postage is paid at Chicago and at additional mailing offices. POSTMASTER: Email address change to customerservice@businessinsurance.com or mail to Business Insurance Circulation Department, 1155 Gratiot Ave. Detroit, Mich. 48207-2912. $5 a copy and $125 a year in the U.S. $130 in Canada and Mexico (includes GST). All other countries, $230 a year (includes expedited air delivery). Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 40012850, GST No. 136760444, Canadian return address: 4960-2 Walker Road, Windsor, ON N9A6J3. Printed in U.S.A.

CATASTROPHES

REUTERS

Hurricane Irene battered much of the U.S. East Coast and Northeast last month. The deadly storm came after insurers and reinsurers were hit but a string of other catastrophes earlier in the year. As a result of the losses, interest has increased in industry loss warranties as an alternative to traditional coverage.

Industry loss warranties surge with catastrophes

Alternative coverage viewed as solution for big exposures

By MARK A. HOFMANN

A spate of natural disasters has driven up interest in—and the cost of—industry loss warranties, according to reinsurance experts.

ILWs are a form of capital typically used to complement traditional reinsurance. They are triggered by a predetermined threshold for an industrywide loss in any line of business. ILW contracts can reach up to $100 million in value, market observers say.

"The ILW market is relatively established now, and the ILW market is roughly $5 billion to $6 billion and has been that way for some time now," said Henry Kingham, executive director of Willis Re Specialty in London.

"ILWs are a little different from other forms of insurance-based securities, like sidecars," said Shane de Burca, a partner at New York law firm de Burca P.L.L.C. focusing on corporate transactions, including insurance and reinsurance.

"ILWs respond very quickly because they're a very standardized product," said Mr. de Burca. "They're based on various indices."

The primary trigger in the United States for ILWs is based on the Insurance Services Office Inc.'s Property Claim Services unit's estimate of industry losses from a catastrophe. The most common triggering events for the coverage are hurricanes, earthquakes and Florida wind losses.

> **'ILWs are a little different from other forms of insurance-based securities, like sidecars. ILWs respond very quickly because they're a very standardized product.'**
>
> Shane de Burca, de Burca P.L.L.C.

"The market has opened up; these indices have become more granular," Mr. de Burca said.

"The market has really been growing since 2006," said Patti Guatteri, director-Swiss Re Capital Markets in New York. While interest in ILWs declined in 2009, it has grown since then with more market players and investors interested in the market.

Events such as the Japanese earthquake and tsunami, earthquakes in New Zealand, unusually high U.S. tornado activity during the spring and Hurricane Irene—resulting in billions of dollars of insured losses (see chart, page 18)—have driven interest in ILWs even higher this year.

"This year, in particular, with the large losses occurring early on in the year, you would expect to see an increase in ILWs and other cat bonds," said Matt Wulf, vp-state relations and assistant general counsel for the Washington-based Reinsurance Assn. of America.

"They're really kind of replacement cover." As reinsurers have sustained large losses, "the (catastrophe) bonds, including ILWs, are a quick way for money to enter the market," he said.

"The pricing of ILWs is very much about supply and demand," said Stefano Nicolini, senior vp with BMS Intermediaries Inc. in Westfield, N.J.

"Since the beginning of the year, the price has gone up and up. Now it has reached a plateau," said Mr. Nicolini. "U.S. quake went up 20% literally overnight after the Japanese quake," he said. Frequency of events, the new Risk

See **ILWs** page 18

the ALTERNATIVE RISKS issue

Alternative risk strategies continue to evolve despite the soft commercial insurance market. And the range of organizations using nontraditional coverage options is expanding.

Captives have long been a tool used by risk managers to retain more risk and control liability exposures, but some captive owners are looking to expand the types of risks they cover within their captives, and a growing number of midsize companies are now using captives.

Risk retention groups also are well-established alternative vehicles, and they continue to thrive.

Other nontraditional coverage options such as weather derivatives are not as well-established, but more policyholders are looking for ways to incorporate them into their broader risk management programs.

In this special report on alternative risks, we review the growing array of nontraditional risk transfer options available to risk managers, insurers and reinsurers and take a look out how the markets are likely to develop.

To keep up with breaking news, including the latest on damage estimates from Hurricane Irene and other catastrophes, visit *www.businessinsurance.com*. To have news alerts sent directly to your inbox, sign up for our news alerts and newsletters.

INSIDE this issue

INDEX

RISK MANAGEMENT

Weather derivatives evolve as risk mitigation device

Array of industries use financial tool to protect revenues

By MATT DUNNING

Weather derivatives, originated in the late 1990s by recently deregulated U.S. energy companies looking to mitigate revenue lost to adverse temperatures, have evolved to become a multibillion-dollar worldwide business.

Today, observers and proponents say, the weather derivative market serves numerous business sectors and regions, as well as a host of risks.

Those advances, they note, are the primary reason the number of weather derivative contracts written globally last year reached more than 1.4 million through March, a record for the market, according to the Washington-based Weather Risk Management Assn.

The total value of those contracts rose as high as $45.24 billion in 2006, the year after Hurricane Katrina, and totaled $11.82 billion last year, according to the association (see chart, page 19).

"It was essentially a U.S. business focused on retail energy companies," said Juerg Trueb, a Zurich-based managing director at Swiss Reinsurance Co. "Now, it's a market that's become worldwide and grown to include a lot of varying solutions in a number of different sectors. There's a much broader range of underlying risk that's being contracted, and all kinds of indexes being used to quantify the impact of the weather."

There are two main types of weather derivative contracts.

Standardized, exchange-based contracts are placed by a broker and bought and sold by traders, largely through the Chicago Mercantile Exchange. The buyer's account with the broker is debited or credited based on the fluctuating price of the weather risk covered in the contract.

The second type, over-the-counter contracts, are placed directly with capital providers such as hedge funds or reinsurers and are either warehoused or traded against other nonstandardized products.

OTC contracts offer greater flexibility in specific weather triggers and payment plans, but experts say they carry greater liability to the end user in that they do not mitigate the risk of default of a capital provider.

Where a weather derivative contract differs from a traditional insurance policy—and where it can provide buyers with additional protection—is its coverage of low-severity, high-frequency events like rain, snow and temperature fluctuations, as opposed to one-time catastrophes and natural disasters.

At the market's genesis, energy companies purchased contracts based solely on temperatures, collecting payouts for the number of days the average winter or summer temperature registered above or below a preset threshold.

Proponents attribute the market's growth largely to the addition of bespoke weather risk contracts on rain, snow, wind and other adverse conditions, as well as a cross-commodity products structure basing the payout on the frequency of a weather occurrence combined with the underlying market price or volume of a commodity produced.

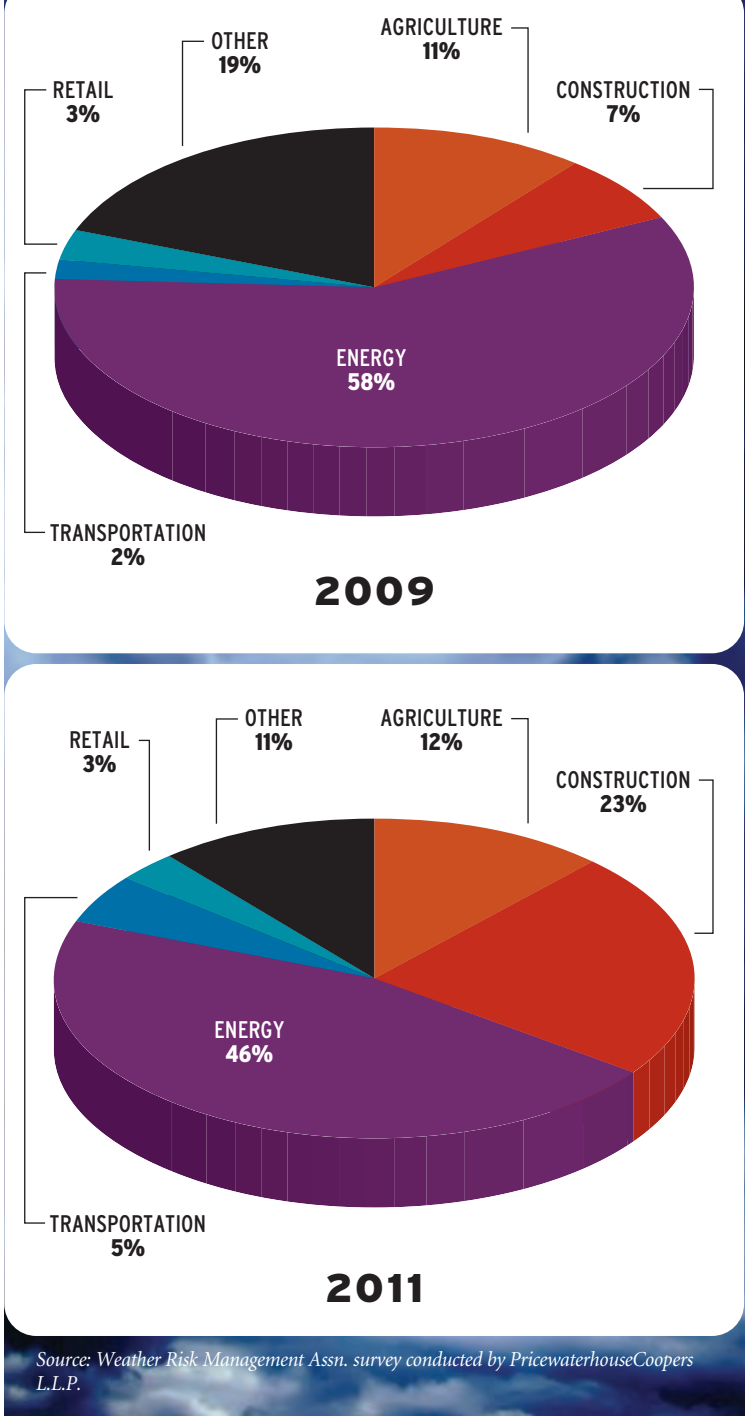
"Over the last decade or so, a lot of companies have looked more closely at their risks and found that an off-the-rack solution like heating and cooling degree day products didn't really fit that well," said Martin Malinow, CEO of the New York-based Galileo Weather Risk Management Advisors L.L.C. and a former WRMA president. "They needed a much more tailored solution that really fit not only the location but also the true nature of the underlying exposure," he said.

The broader range of risks covered has fueled the expanded demographic and geographic diversity of customers using weather derivative products, said Bill Windle, president of WRMA's board of directors and a Woodlands, Texas-based managing director at Renaissance Reinsurance Energy Advisors Ltd. Energy remains the market's dominant participant, but surveys have shown increased interest from the agriculture, construction, transportation and hospitality industries.

See WEATHER page 19

WEATHER DERIVATIVES

Industries interested in weather risk instruments. Percentage of total by industry.



Source: Weather Risk Management Assn. survey conducted by PricewaterhouseCoopers L.L.P.

SECURITIZATION

More catastrophe bonds likely with investor demand strong

After slow start to 2011, active second half predicted

By RODD ZOLKOS

The catastrophe bond market appears set to rebound during the second half of the year despite a slower pace during the first half caused by several factors.

A soft traditional market, the March 11 earthquake and tsunami in Japan, and changes to Risk Management Solutions Inc.'s U.S. hurricane model all contributed to the slow pace of first-half cat bond issuance, market experts say.

However, investor demand for insurance-linked securities remains high and the market has largely worked through the issues that confronted it earlier this year.

"Broadly speaking, we see what we would call probably a very active second half of the year. We've had a couple of transactions already," said Paul Schultz, president of Aon Benfield Securities Inc. in Chicago.

BONDS AND CAPITAL

Catastrophe bond issuance and risk capital outstanding, by year in millions of dollars.

YEAR	ISSUANCE	RISK CAPITAL OUTSTANDING
2004	$1,142.8	$4,040.4
2005	1,991.1	4,904.2
2006	4,693.4	8,541.6
2007	6,996.3	14,024.2
2008	2,729.2	12,043.6
2009	3,391.7	12,508.8
2010	4,600.3	12,185.0
2011*	1,606.8	10,637.1

**First six months*
Source: GC Securities

Mr. Schultz said he sees a good pipeline of transactions likely to come to market, which should carry over into 2012.

According to New York-based GC Securities, an affiliate of Guy Carpenter & Co. L.L.C., nearly $1.61 billion in new catastrophe bonds were during the first six months of 2011, with nearly $10.64 billion in outstanding risk capital in the market at the end of the second quarter (see chart).

That's down from last year, when there was $2.35 billion in new issuance during the first half with total risk capital in the market standing at $11.82 billion. There was more than $12.18 billion in risk capital in the market at the close of 2010, according to GC Securities.

"We definitely have seen an active year this year; particularly we have seen another active third quarter," said Cory Anger, managing director and global head of insurance-linked securities at GC Securities.

"If you kind of look back to the first half of the year, what you've probably seen is that issuance is a little bit slower than for the same period the year before," said Markus Schmutz, head of insurance-linked securities structuring and origination at Swiss Re Capital Markets Corp. in New York.

Mr. Schmutz noted the RMS model change as one factor slowing first-half cat bond issuance. "A lot of people who were thinking about doing issues had some questions about how would the market react to the model change," he said. "They also had some questions about reinsurance renewals at July 1."

"Even today I think investors and issuers are working through some of the changes" to the RMS model, said Aon Benfield's Mr. Schultz. "It still continues to be an issue for the market."

While the earthquake in Japan appeared to slow cat bond issuance, the market's response seems appropriate, the experts say.

It's possible the Japan loss caused a "lag"

See CAT BONDS page 19

*References the 2008 Forbes
Tax Misery & Reform Index

ONE PLACE DIVERSIFYING

Qatar. With every new project comes a new insurance opportunity. Behind it all, the QFC is helping Qatar to become the region's most dynamic economy, and its perfect access point. Benefit from the lowest tax in the world,* 100% ownership, repatriation of all profits and an onshore trading environment. Join us. **www.qfc.com.qa**

BUSINESS ENERGY

qatar
FINANCIAL CENTRE

CAPTIVES

More midsize companies turning to captives

Range of structures offer more options to cover exposures

By JOANNE WOJCIK

Growing sophistication among mid-market executives who want to find a better way to finance the risks their companies face is driving many midsize businesses to turn to captives as an alternative to traditional insurance, experts say.

While group captives often are the entry point to alternative risk transfer for many middle-market organizations because they require less capitalization than single-parent captives, many mid-market executives also are showing interest in what are known as segregated or protected cell captives as well as micro captives, the experts note.

While most mid-market captives are being used to insure or reinsure workers compensation, general liability and auto liability exposures, some recently formed captives finance medical stop-loss insurance for self-funded health benefits programs at mid-market companies (see stories, page 21).

Group captives can be effective for industries that have predictable losses, such as manufacturing, service, wholesale and retail, said Steve Bankes, managing director of group captive solutions at Aon Insurance Managers Ltd. in Chicago. "Their risk profiles and commitment to loss control are very similar. They are committed to keeping their employees safe, protecting the public from harm and don't want to spend too much on insurance."

Such group captive members generally have about $10 million in payroll and about $100 million in annual revenues, but are paying perhaps as much as $500,000 for insurance when they may have only $100,000 to $200,000 in claims in any given year, Mr. Bankes said.

"You will always find companies with good loss experience that want to profit-share with other companies," said Lisa Wall, senior vp of captive consulting at Lockton Cos. L.L.C.

Although group captives require lower startup costs because each member contributes, Ms. Wall and other captive consultants say they also are seeing interest among mid-market executives in single-parent captives and protected cell captives, which basically are a collection of single-parent captives within a captive.

Single-parent and protected cell captives generally require between $250,000 and $1 million in initial capitalization to open, depending on the type of risks financed and the requirements of the selected domicile, captive experts say. However, the captive owner doesn't necessarily have to put all that up in cash. The funds can be borrowed from banks that issue letters of credit to the captive to satisfy capitalization requirements.

Although they require the same capitalization as a single-parent captive, protected cell captives have lower administrative costs, which can be attractive to cost-conscious mid-market executives, said Donna Weber, senior vp at Marsh Inc.'s captive solutions group in Melville, N.Y.

"The dividing line is whether you want to share risks with others or whether you want your risks exclusive to your business in a cell or a single-parent captive," said David McManus, president of ARTEX Risk Solutions Inc., a division of Arthur J. Gallagher & Co. in Hamilton, Bermuda.

"Typically, when you're putting a group captive together, you want to make sure everyone has similar loss control measures in place," said Greg Petrowski, secretary/treasurer at GPW & Associates L.L.C. in Phoenix.

In most cases, mid-market group captives include an assortment of somewhat related businesses, perhaps geographically dispersed, that reinsure insurance policies issued by admitted insurers, referred to as "fronting" insurers. Because these fronting insurers assume credit risk, they usually require collateral from the captive, which often is provided in the form of a letter of credit issued by a financial institution. They also charge fronting fees.

Despite the fees and costs associated with letters of credit, which have become a more expensive option in recent years, such arrangements typically are cheaper than traditional insurance and reinsurance.

In addition to serving as reinsurers, most mid-market captives purchase reinsurance as a backstop, either on a per-claim or aggregate basis. But even though the same reinsurers that serve large captives cater to the mid-market, some are hesitant to provide coverage at the often low attachment points required by smaller captives, which is why some mid-market companies may combine their risks with other similarly situated mid-market companies, either in a group captive or as part of a pool, captive experts said.

For example, in ARTEX's pooling arrangement, mid-market captive owners pay premiums to their captive based on their own experience for the first layer of coverage, also known as the frequency layer because that is usually where the most claims are filed, Mr. McManus said. Then the captive pays premiums into a pool for a second layer of coverage, which pays the less frequent but more severe claims.

"We have very few middle-market companies that…throw their hat in the ring openly with other entities without there being some sort of separate frequency and severity fund," Mr. McManus said.

As reserves grow in their captives, many mid-market executives are eyeing 831(b) captives as a way to preserve those assets for other uses, such as insuring risks for which traditional coverage may not be available, experts said.

"It's a merger of entrepreneurial thinking with risk management," said Rick Stasi, chief operating officer of the alternative risk division at Avizent in Dublin, Ohio. "They come up with things no one in the insurance world would ever think of."

For example, a group captive formed in 2004 to provide auto liability, general liability and workers compensation coverage to a group of about a dozen owners of various national fast-food franchises decided to form a micro captive with the dividends they had received.

"Because they were getting such great dividends, averaging 30% to

See **MID-MARKET** page 21

Private company takes alternative route

By JOANNE WOJCIK

A company doesn't have to be a member of the Fortune 500 to take advantage of captive insurance.

Ask David Bernstein, president of Mid-State Lumber Corp. in Branchburg, N.J., a privately held middle-market building products firm with approximately $100 million in annual sales and 95 employees.

Mid-State Lumber is a member of Grand Cayman, Cayman Islands-based Archway Insurance Ltd., a member-owned group captive that provides workers compensation, general liability and auto liability coverage to 105 midsize companies.

"Ten years ago, I read an article about captives and how they were becoming feasible for midsize businesses like ours," Mr. Bernstein said. "I spoke to our broker at the time and he said if he could get a group together, he would support it, but he struck out."

So Mr. Bernstein did his own research and found two group captives that his company could potentially join. He felt uncomfortable with the first, but a second captive composed of an assortment of construction, service and manufacturing companies that were more geographically dispersed appealed to him.

Mr. Bernstein said what he liked most about Archway was that it included businesses across the United States, none of which were Mid-State Lumber's local competitors or customers.

Ironically, Mr. Bernstein said he was introduced to Archway by Mid-State Lumber's bank, not its insurance broker, though the company today uses Wells Fargo Insurance Services USA Inc. to place several other lines of insurance that include employee theft and umbrella liability, in addition to Archway's coverage.

"We had been shopping insurance forever and the whole process is very grueling; it's not one you enjoy or control," Mr. Bernstein said.

By contrast, participating in a captive has been "a very good experience for us. They help us become a safer environment, which is good for our employees," he said. "I would say we were a pretty safe environment to begin with or we wouldn't have been invited to join Archway."

Archway, managed by Kensington Management Group Ltd. in Georgetown, Grand Cayman, a subsidiary of Captive Resources L.L.C., requires risk assessments prior to inviting a business to join, said Mike Kilbane, president of Schaumburg, Ill.-based Captive Resources.

Moreover, the captive has lowered Mid-State Lumber's risk-financing costs, Mr. Bernstein said.

Since its inception in 1999, Archway has returned $32.5 million to its members in dividends, which are paid in two situations: if a member's loss experience proves better than expected and/or if the group's overall loss experience is favorable, Mr. Kilbane said. In addition, funds deposited into the captive earn

See **FUNDING** page 21

GROUP CAPTIVES can be effective for industries that have predictable losses, such as manufacturing, service, wholesale and retail. Such group captive members generally have about $10 million in payroll and about $100 million in annual revenues, but are paying perhaps as much as $500,000 for insurance when they may have only $100,000 to $200,000 in claims in any given year.

$500K vs. $100K-$200K

INSURANCE CLAIMS

SINGLE-PARENT CAPTIVES AND PROTECTED CELL CAPTIVES, which basically are a collection of single-parent captives within a captive. generally require between $250,000 and $1 million in initial capitalization to open, depending on the type of risks financed and the requirements of the selected domicile.

$250K-$1M

INITIAL CAPITALIZATION

"We make communication work seamlessly across six continents. Zurich does the same with our insurance."

Andrew M. Miller, President & CEO
Polycom, Inc.

Zurich HelpPoint

A single property insurance solution designed to help reduce coverage gaps and overlaps.

Polycom, a global leader in telepresence solutions, needed a financially strong carrier that could make complex insurance coverage easier. Zurich provided a custom solution that's as simple as it is seamless, integrating property with liability coverage all under one policy. It's an example of how Zurich HelpPoint delivers the help businesses need when it matters most. Watch the video to learn more. **www.zurichna.com/stories7**

ZURICH®

Because change happenz®

Opinions

EDITORIAL

Creativity drives market's success

WHAT OFTEN IS called the alternative insurance market, which includes captive insurers and other nontraditional ways to handle business risks, is brimming with creativity.

Today, for example, there are more than 250 risk retention groups, special group captives that can operate nationwide after meeting the licensing requirements of one state. In 1986, just before Congress significantly expanded the kind of coverages RRGs could write, just a handful of RRGs existed.

All types of captives—not just RRGs—have boomed. In the United States alone, there are more than 1,800 captives, compared with just over 100 in 1986.

As captives have grown, attitudes about them have changed. Commercial insurers, once skeptics at best, have become willing partners of the alternative risk financing industry. In many cases, captives could not operate without transferring some of the risks that they assume to traditional reinsurers.

Even state insurance regulators have become more supportive of captives and other alternative risk financing vehicles, though exceptions remain.

The fact that roughly half of U.S. states now have captive licensing laws could not have happened had state regulators opposed those measures.

These are positive developments. In the case of group captives that include RRGs, as we report in this week's issue, policyholders, and especially smaller organizations, are banding together to obtain risk management and loss-control services that they would have found difficult to get on their own.

Not everything is positive on the captive front, though. For example, the outlook for passage of legislation introduced in June to allow RRGs to underwrite property risks and to resolve disputes with state regulators without costly litigation is not encouraging. Rep. John Campbell's bill has just one co-sponsor.

Still, proponents should not give up. If they continue to promote the successes of alternative risk financing vehicles—and how much more they could accomplish with expanded underwriting authority and a better way to resolve disputes—we are confident that Congress one day will embrace and pass the legislation.

LETTERS

Business Insurance welcomes letters to the editor. The section is intended to be a forum for readers' opinions and comments. We reserve the right to edit letters for clarity or space. We will not publish unsigned letters.

Please send your letters to:
Letters to the Editor, Business Insurance,
360 N. Michigan Ave., Chicago, Ill. 60601-3806

Fax: 312-280-3174; email: *gsouter@businessinsurance.com*

SCHILLERSTROM

COMMENTARY

Captives still solving problems

Three hundred years ago, if someone had said they had a captive in the Caribbean, they most certainly would have been a pirate. But today, captives are held by the vast majority of Fortune 500 companies and an increasing number of middle-market firms as an alternative risk financing vehicle.

While islands such as Bermuda and Guernsey historically have been the most popular domiciles for captive formations, many of the captives being created today are in such land-locked locations as Vermont, home to more captive insurers than any other U.S. state with nearly 900 licensed captive insurers.

JOANNE
WOJCIK
SENIOR EDITOR

The idea of self-insuring risks in a captive rather than buying commercial insurance is attributed to Frederic M. Reiss, known as the father of captive insurance, who used the term "captive" to describe an insurance company subsidiary he helped form for the Youngstown Sheet & Tube Co. in the 1950s. The company had called the mines whose output was used exclusively by the parent corporation "captive mines."

Because this first wholly owned insurance company subsidiary was created to provide insurance coverage solely to its parent, Mr. Reiss aptly dubbed it a "captive," and the name stuck, although it is something of a misnomer for many of today's captives that provide insurance to third parties as a way to preserve the tax deduction for premiums paid into them.

The captive movement gained momentum during the hard commercial insurance market of the mid- to late 1980s when liability coverage was either unavailable or unaffordable for many buyers. As buyers were forced to raise their deductibles to lower the cost of insurance coverage, they discovered they could squirrel away some of the money they were setting aside to pay claims within those deductibles into captives, where it would earn investment income at a time when interest rates were exceptionally high. Today, more than 5,000 captives exist worldwide.

Something similar is happening today as captives provide a way to address the high cost of employer-sponsored health benefits programs. Some midsize employers that self-fund health benefits are joining group captives to pool a portion of those medical risks, reducing the cost of health benefits by allowing employers to purchase medical stop-loss coverage at higher attachment points.

In another creative use of captives, some mid-market companies are tapping some of the reserves that have built up in their captive subsidiaries to form "microcaptives," permitted under section 831(b) of the federal tax code, to provide reinsurance to their captives rather than purchasing such coverage from traditional reinsurers. Other companies are using captives to provide added financial protection in the event of supply chain disruptions like those that occurred after the recent earthquake and tsunami in Japan.

Like most innovations, captives were created to solve a problem. And they will continue to evolve and proliferate to address the growing need for alternative risk transfer.

Contact: *jwojcik@businessinsurance.com*

PUBLISHED AT 360 N. Michigan Ave., Chicago, Ill. 60601-3806, Fax: 312-280-3174, *biweb@crain.com*. Offices: 711 Third Ave., New York, N.Y. 10017-5806, Fax: 212-210-0704; Suite 814, National Press Building, Washington, D.C. 20045-1801, Fax: 202-638-3155; 6500 Wilshire Blvd., Suite 2300, Los Angeles, Calif. 90048-4947, Fax: 323-655-8157; 967 Bermuda Court, Sunnyvale, Calif. 94086-6750, Fax: 408-774-1155; 21 St. Thomas St., London SE1 9RY, U.K. Fax: +44-(0)20-7457-1440; Fax: 312 280-3174. 77 Franklin St., Suite 809, Boston, Mass. 02110-1510; Fax: 212-210-0704. $5 a copy and $97 a year in the U.S., $130 in Canada and Mexico (includes GST). All other countries, $230 a year (includes expedited air delivery). **FOR SUBSCRIPTION INFORMATION** and delivery concerns please email *customerservice@businessinsurance.com* or call 1-877-812-1587 (in the U.S. and Canada) or 1-313-446-0450 (all other locations.) Send subscription correspondence to Audience Development Department, *Business Insurance*, 360 N. Michigan Ave., Chicago, IL 60601-3806. Microfilm copies available: University Microfilms, 300 Zeeb Road, Ann Arbor, Mich. 48013. Microfiche copies: Bell & Howell, Micro Photo Division, Old Mansfield Road, Wooster, Ohio 44691. Portions of the editorial content of this issue are available for reprint or reproduction in other media. **FOR REPRINTS** or reprint permission, please contact Lauren Melesio/Crain Communications at 212-210-0707 or e-mail *BusinessInsurance@reprints.crain.com*.

Perspectives

SELF-INSURANCE DOES NOT MEAN unlimited liability when it comes to employee benefits, says Craig I. Hasday, president of New York-based employee benefits consultant and broker Frenkel Benefits L.L.C. While stop-loss coverage seldom is used by the largest self-insured employers, it can be an effective strategy for middle-market employers that do not have the financial resources to withstand large claims. Understanding self-insurance and the issues associated with stop-loss coverage can be a powerful tool to take back control of this important expense, he says.

Stop-loss cover provides a tool to take control of benefit costs

By Craig I. Hasday

Self-insuring is a method to fund employee benefits where the employer pays the insurer an administration fee to process claims and use their provider network to access discounts.

However, self-insurance does not mean unlimited liability. To protect against catastrophic losses, the employer can purchase stop-loss insurance to protect against having to pay large claims on any one plan member as well as total claims for the entire group.

While stop-loss coverage is a strategy seldom used by jumbo self-funded employers, it is one that can be effective for midsize employers that do not have the financial wherewithal to withstand large claims.

Stop-loss insurance is a contract between the employer and the insurer to cover costs that exceed those expected at the beginning of the plan year. It is critically important that the terms of the stop-loss agreement be aligned with the underlying employee benefit plans or gaps can result.

There are two types of stop-loss insurance coverage: individual, or "specific" stop-loss, which is designed to protect against the risk that any one plan member's costs will exceed the preselected per-claimant limit; and aggregate stop-loss, which limits a self-funded employer's total claims liability in a plan year to a projected amount plus a margin typically set at 25% of the total expected liability.

A contract can be written on a "prefunding" basis or a "fund-and-refund" basis. A prefunding basis means that once claims exceed the threshold, the insurer begins to pay claims. A fund-and-refund approach to stop-loss coverage requires the employer to first pay the claims and then seek recovery from the insurer.

Stop-loss insurers require information concerning potential high-cost claimants during the initial application period and at renewal. Contracts are rigidly enforced, and insurers can require extensive audits when a claim is presented.

Stop-loss insurers require information concerning potential high-cost claimants during the initial application period and at renewal. Contracts are rigidly enforced, and insurers can require extensive audits when a claim is presented.

In a typical stop-loss relationship with a national insurer, the carrier acts as the claims administrator and reinsurer for large claims. This mitigates potential disputes and provides seamless reimbursement in the event of a large claim.

Stop-loss is purchased on a per-employee basis, regardless of how many dependents are enrolled in the plan, costing between $80 and $100 per employee per month for a midsize group. This compares with

Mr. Hasday

fully insured premiums of $425 for single coverage and $1,000 for family coverage.

Because the Patient Protection and Affordable Care Act has removed maximum lifetime limits and is gradually lifting annual coverage limits over time before they are eliminated in 2014, individual and aggregate stop-loss contract limits also should be unlimited to provide coverage alignment. This year, employers can set annual coverage limits at $750,000. Those limits grow to $1.25 million in 2012 and $2 million in 2013 and are eliminated entirely beginning in 2014.

Aggregate stop-loss

While unlimited individual stop-loss coverage is readily available from insurers, aggregate stop-loss is often quoted with annual limits as low as $1 million, which can cause a significant coverage gap for a self-funded employer.

Another critical issue in purchasing stop-loss coverage is the period during which claims are incurred and the period during which they are paid. There is a lag between the time when services are performed (the incurred date) and the actual payment for these services. This lag typically is two months, but it can be reduced by automatic adjudication initiatives and capitated arrangements, in which medical providers are paid monthly stipends for covering plan members, regardless of the amount and cost of services rendered.

More commonly found contracts terms include:

- 12/12, which covers claims incurred during the 12 policy months and paid during that period;
- 12/15, which covers claims incurred during the 12 policy months and paid up to 15 months later. This also is called "run-out" protection; and
- Paid, which covers claims incurred at any time and paid during the policy year.

In the first year of a contract, individual stop-loss coverage can be written on an immature (12/12) basis; however, aggregate stop-loss usually includes run-out protection (12/15). This will result in lower first-year stop-loss premiums for the employer because there is a lag in paying claims that results in about 10 months of claims being paid in the first year. This lower cost for the employer would be made up in the second policy year, when a full 12 months of claims would be paid.

Significant increases and decreases in employee head counts affect the cost of aggregate stop-loss coverage. Such contracts usually include a provision that sets the overall claims trigger to the monthly claims factor based upon the head count at the beginning of the contract. So when there is a significant decline in the number of people covered, the aggregate attachment point can be much higher than had been expected when the stop-loss contract was signed.

When plan members are added during the year, however, the stop-loss cost usually is not adjusted because claims for these added lives would be considered immature.

In underwriting stop-loss insurance, an insurance company will request a disclosure of large claims prior to the start of the first and subsequent plan years. This disclosure must be completely accurate because inaccurate or incomplete disclosure can result in claim denial.

Perhaps the biggest risk faced is not in the year of transition, but during subsequent years in which a large claim may be identified at the time of underwriting the next year's coverage. Emerging or evolving claims can significantly affect pricing of a stop-loss renewal.

In addition, known claims can be "lasered," which means that a higher stop-loss threshold may be set for that individual or any claims related to that individual could be excluded entirely from stop-loss coverage.

Build a cushion

Self-insurance clearly is not for everyone.

Middle-market companies should consider establishing reserves based on the aggregate stop-loss attachment point plus estimated claims so they can begin to build a cushion against the inevitable bad plan year. Budgeting at the minimum expected cost is a recipe for disaster. Smaller companies have greater volatility and therefore need larger cushions against adverse experience.

Expect monthly variance in claims payments and budget accordingly. Fortunately, some insurers have responded to this volatility for middle-market customers by offering "level-funding" products with a fixed monthly payment and an annual settlement if there is a surplus at the end of the policy year.

Taking the time to understand self-insurance and the potential issues associated with stop-loss coverage can be a powerful tool in taking back control of this important expense. Working with a qualified adviser to help in evaluating this decision is a great first step in determining whether this risk is one the organization wants to and is able to absorb. Stop-loss coverage helps midsize firms cope with liability.

Craig I. Hasday is president of New York-based employee benefits consultant and broker Frenkel Benefits L.L.C., a division of Frenkel & Co. Inc. He can be reached at 212-488-0274 or via email at chasday@frenkel.com.

REUTERS

Some energy reinsurance prices have jumped due to losses related to the catastrophe at the Fukushima nuclear power plant in Japan.

CAPTIVES

Soft market limits attraction of direct access to reinsurance

By SONJA RYST

Captive owners still gain financial advantages from using the alternative risk vehicles to directly access the reinsurance market, but the benefits have diminished.

With a soft market for most lines of coverage, policyholders can obtain attractive rates directly from commercial insurers and don't need to route the risks through a captive to obtain the cheaper rates that historically have been available from reinsurance companies.

And for the few coverage lines where rates are hardening, such as some energy risks, reinsurance costs have risen and capacity has contracted, experts say.

Companies previously obtained significant savings by using captives to tap reinsurance capacity. Reinsurers traditionally provide significant amounts of capacity to insurers so, by accessing that capacity directly, captive owners were able to create efficiencies.

But that benefit is less pronounced, as primary insurers are offering such cheap rates for most forms of property/casualty insurance that accessing reinsurance directly offers little in the way of savings.

"You used to save a lot of money accessing reinsurance (with a captive), but you have such a soft market now that sometimes it's not cheaper," said Gary Osborne, president of the captive manager USA Risk Group Inc. in Montpelier, Vt.

In the end, what a captive will get in tapping the reinsurance market depends on the specific circumstances. "None of our clients are the same," said James Murray, a director of captive and insurance management at Aon Global Risk Consulting in Burlington, Vt., a unit of Chicago-based Aon Corp. "We don't have a cookie-cutter approach."

The benefits of using reinsurance range from a captive's loss experience to the appetite of reinsurers for taking on a risk, he said.

Not all reinsurers are interested in captive business.

"The reinsurance market for captives is smaller than the ones for insurers," said Michael O'Malley, managing director of consulting in Concord, Mass., at the captive management firm Strategic Risk Solutions Inc.

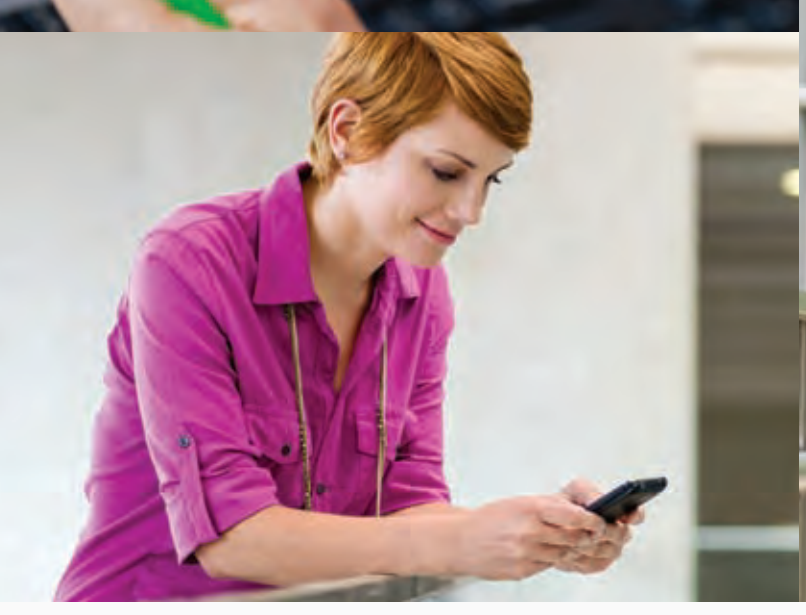
Though, according to Mr. Osborne, "Almost every reinsurer will entertain a captive proposal that's large enough. Few will say point blank that they won't deal with a captive."

In some cases, captive owners continue to find better prices from reinsurers. For example, Mr. Osborne said he put together a captive for a shopping mall operator within the past six months. The company was located in an area that had experienced hurricanes previously, so coverage was not easy for it to find. But the shopping mall operator obtained roughly $150 million of coverage on its windstorm risks from reinsurers for the same price it would have gotten around $100 million from insurers, Mr. Osborne said.

"It's not that it's not worth it to get it; it's just that the insurance market is relatively soft at the moment, so it's relatively easy in most of the general lines (of

See **REINSURANCE** page 22

Smarter is doubling the likelihood your employees will take charge of their health.



Aetna gets your employees more involved in their health and savings. With Aetna, employees are 2x more likely to actively plan for health and consider their options, helping you manage your bottom line without sacrificing quality care.

- Proven record of short-term and sustainable savings.
- Decrease overall medical costs by 7% and prescription costs by 14%.
- Proven savings of more than $400 per member per year.
- 10% fewer non-routine physician visits. 5% less non-urgent ER visits.[1]

See the proof and the savings at smarteris.aetna.com/cdhp, or just scan the code.

[1]Aetna HealthFund® Seventh Annual Study Results, released December 2010.

REINSURANCE

Structured programs avoid pitfalls of finite reinsurance

Multi-year deals include degree of risk sharing

By MICHAEL BRADFORD

Finite reinsurance deals, tarred by scandal and regulatory suspicion, have been replaced by "structured" transactions that put to rest any doubt whether there is a genuine transfer of risk while providing a multiyear alternative to traditional reinsurance.

While finite reinsurance managed loss volatility after it took off in the late 1980s, concerns grew that it was more of a loan, with critics alleging it was being used to hide the true condition of insurers.

A Financial Accounting Standards Board ruling in 1993 that there must be a reasonable chance of a significant loss for a transaction to be accounted for as insurance led the market to develop the "10/10" rule, whereby a transaction was considered insurance if there was at least a 10% chance of a 10% loss.

The image of finite reinsurance was stained in 2008 when investigations by then-New York Attorney General Eliot Spitzer and others into finite deals led to the convictions of several former executives at Stamford, Conn.-based General Reinsurance Corp. and New York-based American International Group Inc.

"Finite came under a lot of pressure in the Spitzer years," said Mike Schnur, Chicago-based partner with TigerRisk Partners L.L.C.

AP PHOTO

The image of finite reinsurance was stained in 2008 when investigations by Eliot Spitzer and others into finite deals led to the convictions of former executives at American International Group Inc. and General Reinsurance Corp. A new trial recently was ordered in the case.

Last month, however, a three-judge panel of the 2nd U.S. Circuit Court of Appeals in New York overturned their convictions in the 2008 case and ordered a new trial, ruling in part that the jury was instructed improperly.

Even if the defendants' names are cleared eventually, the damage to the reputation of finite reinsurance is done, with various forms of structured reinsurance now taking its place.

Even so, there is no firm definition as to what constitutes a structured reinsurance transaction, sources noted.

"My definition is: products where there is a degree of risk-sharing between the parties," said Ed Hochberg, Philadelphia-based executive vp and global product leader of risk transfer products and analytics at Towers Watson & Co. "That is a good way of looking at it, but there are many variations on the theme from there."

"What is meant by structured is structured over time," said Donald A. Paterson, CEO of Paterson[2], a Westlake Village, Calif., firm that develops alternative risk transfer programs. The transactions typically are for longer than a year and involve some sharing of risk among the parties, he said.

Depending on loss activity, return premiums may be paid by reinsurers to insurers under structured reinsurance deals or, if losses are heavy, the insurer could be forced to make additional payments to the reinsurer, Mr. Paterson said.

"I would call it alternative reinsurance," he said of the deals being put together today. "It's reinsurance that's not traditional."

Whatever the name, the rationale for today's deals—and the clear disclosure of risk transfer—differs from that used in developing finite reinsurance products, Mr. Hochberg said.

"What we used to see 10 or 15 years ago," he said, were deals "with an awfully significant element of discounting loss reserves. A lot of that has gone away. That element of the deal is much less significant than it was." The aim of some finite transactions was to "achieve an accounting result, whether it was the movement of a result from one year to another, or whatever the objective was."

Today's deals by comparison are more "capital-oriented," Mr. Hochberg said. "They are designed to truly transfer risk in a way that is comfortable for all parties…When we do a structured deal these days, there's not a question of, 'Where's the risk transfer?' The risk transfer is very obvious."

Finite reinsurance truly began to vanish when a soft insurance market began hardening in 2001, said Dan Malloy, executive managing director at Aon Corp.'s Aon Benfield reinsurance intermediary unit in New York.

See **STRUCTURED** page 22

THIS IS WHERE EXTRAORDINARY THINKING GETS REAL

There is a space between the moment ideas are born, and when they become a reality.

This is where we live, and where we bring our knowledge and insights to bear.

Developing strategies that help clients optimize opportunities, manage their capital needs and risks,

and deliver tangible business results. Never forgetting that our clients' success comes first.

We are Guy Carpenter. **guycarp.com**

MARSH & McLENNAN COMPANIES℠

Partnering for impact™

GUY CARPENTER

Guy Carpenter is one of the Marsh & McLennan Companies, together with Marsh, Mercer, and Oliver Wyman.

RISK RETENTION GROUPS

RRGs still thriving 25 years after law's passage

Alternative vehicles provide affordable, stable coverage

By JERRY GEISEL

WASHINGTON—Passage of the Liability Risk Retention Act 25 years ago unlocked the potential of risk retention groups to provide a highly efficient way for organizations to band together to form group captives.

When Congress passed the LRRA in October 1986, it was the second time lawmakers approved RRG legislation.

Five years earlier, lawmakers approved the Product Liability Risk Retention Act to establish the special group captives that—under a pre-emption provision in the law—can write policies for member-owners nationwide after meeting the licensing requirements of the RRG's domicile.

The pre-emption provision was a major change from prior law in which a captive had to meet the licensing and capitalization requirements of every state in which it wanted to do business.

Some state mandates, such as requiring an insurer to be in business for a certain number of years before it could conduct business in the state, made it virtually impossible for group captives to be set up quickly and do business in multiple states, said Jon Harkavy, vp and general counsel in Washington with RRG and captive manager Risk Services L.L.C.

But the law was a dud. According to a 1986 General Accounting Office report, only one RRG, sponsored by homebuilders, was licensed in the United States under the 1986 law and that RRG soon found itself locked in a legal battle with a state regulator on the group's authority to write coverage.

Settling such regulatory disputes is the focus of the latest RRG legislative efforts, but is one that even backers doubt will win congressional backing (see story, page 15).

The impact of the 1986 law was dramatically different than the 1981 law. Within one year of the passage, 38 RRGs had been established, according to the Risk Retention Reporter, a Pasadena, Calif.-based monthly newsletter that tracks the industry.

Today, more than 250 RRGs are in operation (see chart, page 15), generating nearly $2.5 billion in premium volume, according to the RRR (see chart, page 16). In all, nearly 15% of all U.S. captives are RRGs, according to *Business Insurance* data.

"The law has been an incredible success," said Ed Precourt, senior vp at Marsh Captive Solutions in Burlington, Vt.

The LRRA "has provided numerous industries with stable and affordable coverage when the traditional market could not or would not," said Michael J. Bemi, president in Lisle, Ill., of The National Catholic Risk Retention Group Inc., a Vermont-based RRG.

The reason for the 1986 law's success is simple vs. the 1981 law, which was a delayed congressional response to soaring product liability insurance rates in the 1970s: While the 1981 law limited RRGs' underwriting authority to product liability and completed operations, the 1986 law had no such restriction.

Under the 1986 law, Congress gave RRGs the authority to write all commercial casualty coverage except workers compensation. That opened the door for RRGs to write policies in numerous lines of coverage—most notably medical malpractice and professional liability, where buyers were looking for alternatives to the traditional market's wide swings in rates and available limits.

"We didn't any longer want to ride the market's ups and downs. We wanted stability," said Janice Abraham, president and CEO in Chevy Chase, Md., of Vermont-domiciled United Educators Insurance, a Reciprocal Risk Retention Group, which was licensed about six months after passage of the LRRA.

Industries that have set up RRGs and the lines of coverage written are diverse. Architects, attorneys, builders, chemical manufacturers, engineers, hospitals and nonprofit organizations are just a few of the industry sectors whose members have set up RRGs.

The risks covered by the groups are equally diverse and include

See **RRGs** page 16

Legislation would expand risks covered

By JERRY GEISEL

WASHINGTON—The risk retention group industry is rallying around legislation that would expand the groups' underwriting authority and provide a new way to settle pre-emption disputes with state insurance regulators, but even backers concede that the odds of passage are slim.

The measure, H.R. 2126, introduced in June by Rep. John Campbell, R-Calif., would allow RRGs to provide property coverage to their member-owners. Under current law, RRGs can write all lines of commercial casualty coverage except workers compensation.

In addition, in disputes between the groups and state regulators involving whether the Liability Risk Retention Act pre-empts a state action, RRGs and/or state regulators could ask the director of the Federal Insurance Office to resolve the dispute.

Either party could seek a review of the federal insurance office director's ruling by the U.S. Circuit Court of Appeals for the District of Columbia.

RRG backers welcomed the legislation, especially the dispute mechanism, which could settle disagreements quickly with far less cost than litigation.

"You need some kind of oversight or dispute resolution so you don't fight the same issues over and over again," said Gary Osborne, president of captive and RRG manager USA Risk Group Inc. in Montpelier, Vt.

"There is a ton of industry support for something like this. RRGs are wasting time and money—which could be better used for risk control and claims management—fighting regulators" who are taking incorrect positions, said Michael Bemi, president in Lisle, Ill., of The National Catholic Risk Retention Group Inc., a Vermont-domiciled RRG.

But broad congressional support for the proposal has yet to develop.

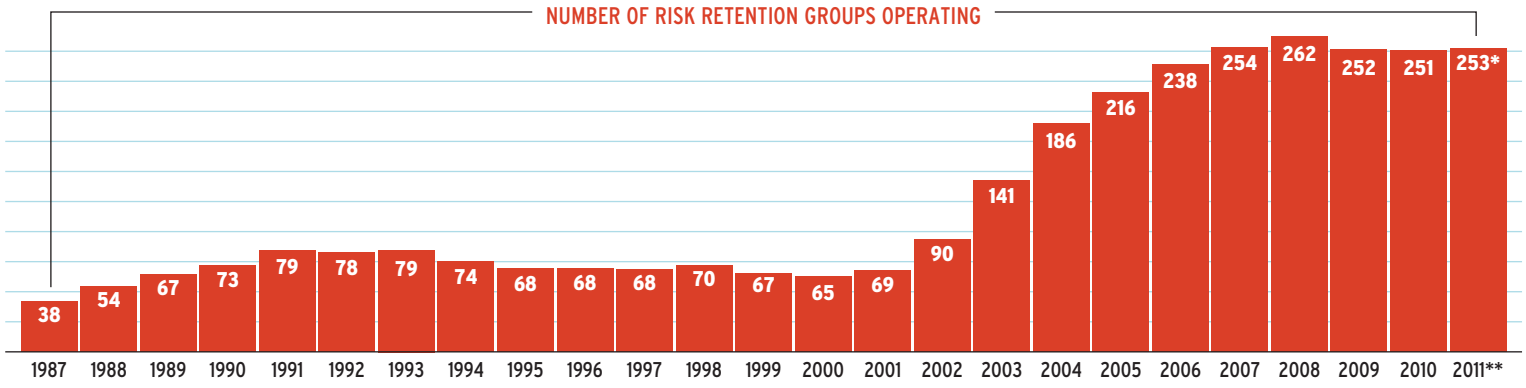
So far, Rep. Campbell's bill has attracted only one co-sponsor, Rep. Peter Welch, D-Vt., while a Senate companion bill to be proposed by Sen. Jon Tester, D-Mont., has yet to be introduced.

That lack of broad support contrasts sharply with

See **LEGISLATION** next page

GROWTH SPURTS

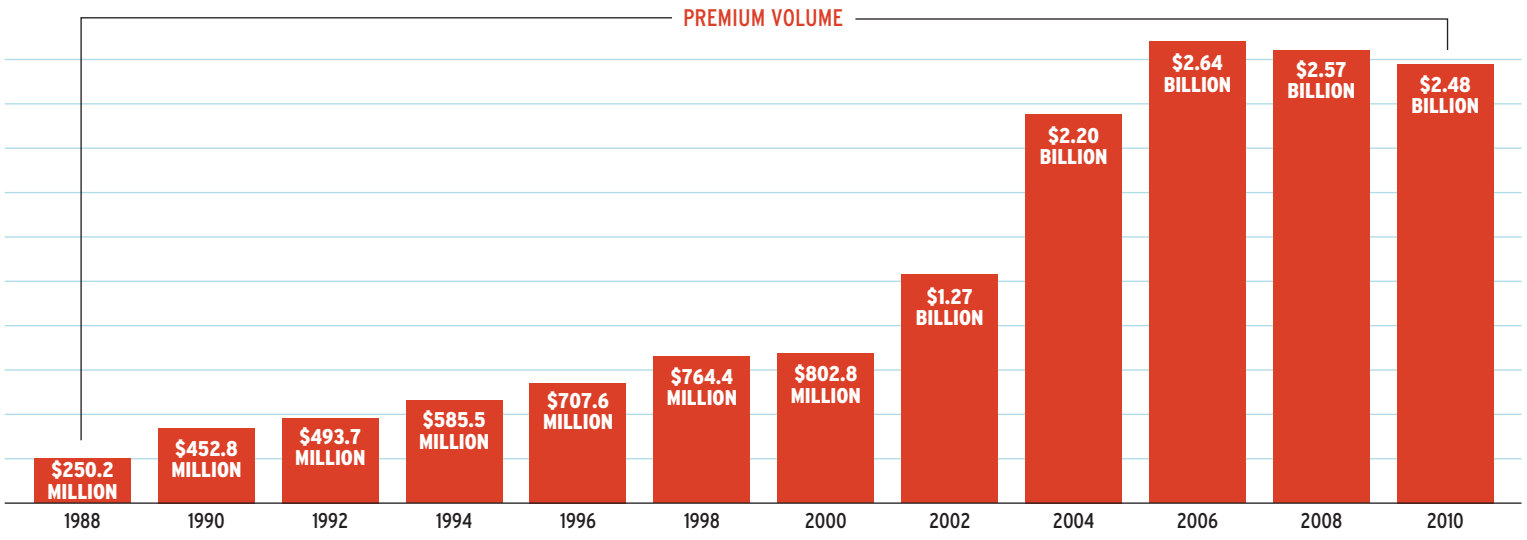
*The number of risk retention groups surged after passage of the Liability Risk Retention Act and during the last hard market.**



* At year-end. **At mid-August
Source: Risk Retention Reporter

A GROWING BUSINESS

Risk retention groups' premium volume has dipped in recent years due to the soft commercial market, but is significantly higher compared with the first few years after the passage of the Liability Risk Retention Act.



Source: Risk Retention Reporter

RRGs: Alternative vehicles still thriving 25 years later

CONTINUED FROM PAGE 14

virtually every casualty line—even medical stop-loss coverage.

While diverse by industry and coverage written, what many RRGs have in common is an underwriting philosophy in which premiums are tied closely to the risk covered and do not leap or plummet depending on competition.

"We have offered 23 years of affordable, stable and high-quality coverage. We have provided stability and predictability of premiums, with no spiking, unlike the traditional market," Mr. Bemi said.

In many cases, RRGs also provide risk management and loss control services that their members, especially smaller firms, could not obtain in the traditional market, said Gary Osborne, president of USA Risk Group Inc., a Montpelier, Vt.-based captive manager.

"We have two attorneys on staff to answer employment-related questions and we also provide unlimited in-person and online driver training as well as a series of about a dozen webinars each year. All of these services, and several others, are completely free for member-insureds," said Pamela Davis, president and CEO of the Vermont-domiciled Alliance of Nonprofits for Insurance, Risk Retention Group in Santa Cruz, Calif.

At the same time, RRG executives say the groups continually try to update coverage to reflect new exposures.

For example, Ms. Davis said ANI has enhanced policies in numerous ways, including adding interns and students in training to the definition of insured for sexual abuse coverage. That is because they are neither employees nor volunteers since they at times are paid a stipend, putting them into a gray area of coverage, she said. Other ANI enhancements include coverage for cyber liability and reimbursement of wages when an employee is put on leave during a professional liability investigation.

The biggest endorsement of how RRGs operate is reflected in their growth.

At the end of its first year in 1987, United Educators, whose policyholders include colleges, universities, independent schools, public school districts, public school insurance pools and museums, generated about $7 million in premium volume with about 100 members. Now the RRG provides coverage to nearly 1,200 policyholders with a premium volume of about $140 million, Ms. Abraham said.

At the same time, some RRGs report annual policyholder retention rates that would be the envy of any insurer. For example, ANI has enjoyed a retention rate of just over 96%, while National Catholic Risk Retention Group has a 99.1% retention rate, Mr. Bemi said.

However, not all RRGs have met with success.

In fact, citing information it obtained from the National Assn. of Insurance Commissioners, the GAO in a 2005 report said 22 RRGs failed between 1987 and 2003, with a somewhat higher failure rate when compared with other property/casualty insurers. Still, a comparison between RRGs and other insurers may not be entirely parallel, the GAO said, because the NAIC analysis did not adjust for size and longevity among other factors.

In all, the GAO said, RRGs have "had a small but important effect" on increasing the availability and affordability of coverage, especially for organizations with limited access to liability insurance.

Legislation: Expansion

CONTINUED FROM PREVIOUS PAGE

the last time lawmakers considered amending the law. In 1986, the Senate Commerce Committee passed a bill, which later became the LRRA, within two weeks of its introduction. Final congressional passage came seven months later amid dramatic rate increases in many casualty lines.

Backers said there is congressional support for the Campbell measure, but it hasn't gained traction due to other, more pressing issues.

"Candidly, Congress is focused on some extremely important issues and, due to that, issues of lesser importance won't get that much attention, no matter how meritorious," said Robert H. Myers Jr., general counsel for the National Risk Retention Assn. and a partner with the law firm Morris, Manning & Martin L.L.P. in Washington.

Battles with state regulators continue, though disputes are fewer in number compared with previous years, some said.

"There have been a lot of disputes, but over the years there has been more acceptance (by state regulators) of RRGs," said Nancy Gray, regional managing director-Americas with Aon Insurance Managers in Burlington, Vt.

The most recent dispute—like many before it—involves how much authority state regulators have over RRGs that are licensed in other states. Nevada regulators last year issued an order to bar Alliance of Nonprofits for Insurance, Risk Retention Group, a large Vermont-domiciled RRG, to stop writing first-dollar auto liability coverage for its Nevada policyholders.

Nevada regulators said such coverage must be written by authorized insurers. To be authorized, an insurer must be a member of state guaranty association. However, RRGs cannot be members of guaranty associations under LRRA.

ANI, which challenged the order, said in a court filing that the LRRA specifically pre-empts any state laws that discriminate against RRGs. But Nevada regulators say there is a special carve-out from the LRRA pre-emption provisions for state-mandated coverage.

In July, a federal judge ruled in favor of ANI, saying that LRRA pre-empted the Nevada requirement. His order requires Nevada to recognize that the term "authorized insurer" includes RRGs, such as ANI.

Nevada insurance regulators, though, are appealing the ruling.

WORKERS COMPENSATION

Firmer workers comp rates may lead to more captives

But costs, benefits must be weighed before formation

By ROBERTO CENICEROS

Anticipating firming insurance prices, experts say more risk managers are considering or adopting alternative risk strategies that include forming a captive insurer.

Putting a company's workers compensation risks into a captive typically is among the top reasons for moving to a captive arrangement—aside from the tax advantages and other benefits a company-owned insurer may provide. However, forming a captive may not be the right strategy for all employers, and the costs can outweigh the benefits.

Workers comp, general liability and auto liability typically are the top three risks covered by a captive. Workers comp is favored because of the line's premium volume, the long-tail nature of its claims and the relative ease in evaluating the exposure statistically, consultants say.

Natural fit

"Workers comp for a lot of organizations is really the big nut in terms of premium volume," said Jim Swanke, director of risk consulting for Towers Watson & Co. in Minneapolis. "If you are going to be doing anything in your captive, you are going to be focusing on the largest-size premiums and the premiums that have the longer tails in terms of payouts. Workers compensation by definition falls into that category."

Sean B. Rider, managing director of sales and consulting for Willis Group Holdings P.L.C.'s global captive practice in New York, agreed.

"For U.S.-based firms, workers compensation is one of first places people go for captive utilization," Mr. Rider said. "Because workers comp in particular is long-tail business, it has a lot of transaction activity; and with enough size and scale, it can be very credible statistically so you can have a lot of rationality around the use of a captive for workers compensation."

While the workers comp insurance market remains competitive, it appears to be transitioning from recent years' soft pricing and is driving discussions on stabilizing costs, said Robert Hessel, senior managing director for large risk casualty in the Atlanta office of Beecher Carlson Holdings Inc.

"The consensus is we are in a market that is trying to change. Comp is getting a bit more difficult and so people are perhaps more sensitive to alternatives today than they were a year or two ago," Mr. Hessel said. "Because the market has been so soft, the tendency has been to lower retentions and purchase more coverage; but to the extent that changes, people will adjust."

Captives are just one option for employers seeking to retain more risk, said Ellyn Casazza, senior vp in Atlanta for Marsh Inc.'s captives solutions group.

But current market conditions are leading employers to weigh increasing their retention and, in doing so, some are evaluating whether a captive may be their best option for assuming additional risk, she said.

Some employers are more concerned about the firming of insurance pricing for risks other than workers comp, Mr. Rider said. Cost increases for product and professional liability insurance may be a greater concern.

But even employers considering putting their professional and product liability risks in a captive likely will want to put their workers comp risks in the facility because the line's statistical reliability provides a "nice stable base" for a captive, Mr. Rider said.

The decision of whether to launch a captive typically should

See COMP next page

ADVERTISER INDEX

Issue of September 5

ILWs: Disasters boost pricing and interest

CONTINUED FROM PAGE 3

Management Solutions Inc. U.S. hurricane model, and supply and demand all served to push up pricing, he said.

Mr. Nicolini said that he did not do any ILW trades as a result of Irene. "If the losses would have been bigger, I think there would have been a lot more activity," he said. Assessments of the extent of losses related to the hurricane are still under way, he said.

"If Irene had made landfall as a Category 2, it would have had more losses and we would have seen a peak in the ILW market" as happened earlier this year, he said.

"There's certainly been a lot of activity" this year, said Guy Hengesbaugh, executive vp with Towers Watson & Co. in Hamilton, Bermuda.

He pointed out two types of deals: One is "cold-spot" earthquake cover, which means non-Japan and non-U.S. earthquake cover. "Several of those deals were sold at the beginning of the year," he said. "Some have been hit by the New Zealand quake."

"The earthquakes in New Zealand and Japan have triggered ILWs," said Willis Re's Mr. Kingham. He pointed out that interest in this cover increased after last year's earthquake in Chile.

"The earthquakes in New Zealand and Japan have caused some of these covers to be impacted," he said. "Pricing has increased significantly in the nonpeak earthquake—in some instances north of 100% for nonpeak earthquake ILWs."

Mr. Hengesbaugh also cited worldwide aggregate structures as an example of ILWs. Those structures cover multiple events on a worldwide basis.

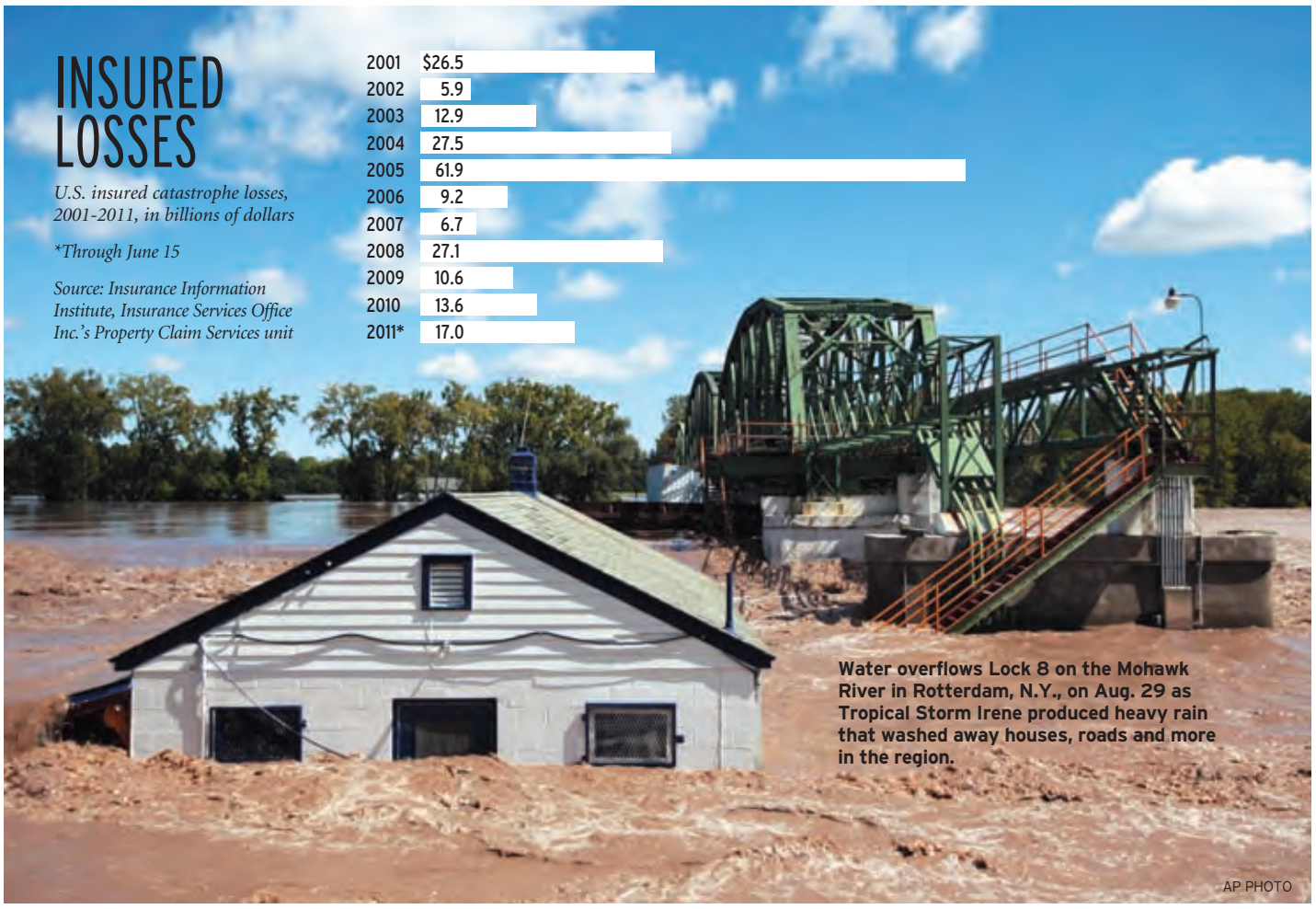
"Typically, you have an overall limit that needs to be hit that's made up of a basket of catastrophes that have to occur," he said. During the first half of the year "we've had multiple worldwide catastrophes, and ultimately those trigger the aggregate ILW covers that were written at the beginning of the year."

Mr. Hengesbaugh said that while the pricing has drastically increased, it's still in the range that attracts buyers.

"The ILW market is a very reactive market, and pricing has most definitely hardened in those territories affected by the recent losses—in some cases up to 100%," Barry Law, head of Guy Carpenter & Co. L.L.C.'s ILW practice in London, said in an email.

"We also saw some peril-related increases in other territories such as earthquake coverages for the U.S. As far as structure is concerned, the losses have affected the relative attachment points of specific trades, and there has been more demand for the loss-affected areas—mainly because the covers had not traded to any great extent before the spate of losses," Mr. Law said.

Associate Editor Sonja Ryst contributed to this report.



Water overflows Lock 8 on the Mohawk River in Rotterdam, N.Y., on Aug. 29 as Tropical Storm Irene produced heavy rain that washed away houses, roads and more in the region.

AP PHOTO

Comp: Long-tail nature well-suited to captives

CONTINUED FROM PREVIOUS PAGE

be based on the size of a company's projected losses rather than its revenue, consultants said.

"We use (projected losses within a year) as a benchmark to determine if a captive is potentially going to add significant tax advantages to outweigh the costs to run the captive," Ms. Casazza said.

That usually means a company must expect about $3 million in retained loss costs per underwriting year, she said.

The decision of how much risk to retain, however, must be decided separately, before determining whether the parent company will pay the retention or whether it will be financed through a captive, Ms. Casazza said.

Loss history, financial capacity to bear risks and commercial insurance market conditions should help determine the amount of risk to retain.

While $3 million in retained losses is an average benchmark for considering a single-parent captive, losses of as little as $250,000 may be appropriate for group or association captives or 831(b) captives, Mr. Ridder said.

An 831(b) captive, established under Internal Revenue Code Section 831(b), allows insurance companies with less than $1.2 million in annual premiums to elect to be taxed by the federal government only on their investment income.

One benefit of operating a captive is that upper management is likely to support safety and risk management department efforts to reduce losses and enhance the financial benefits of a captive insurer, the consultants said.

Companies also form captives, in part, to help them take greater control over their risks and risk costs, Towers Watson's Mr. Swanke added. "Control is right up there as one of the (top) reasons—and to be less reliant on the commercial insurance marketplace and (insurance) cycles."

But the real economic benefit of a captive derives from potential tax advantages, Marsh's Ms. Casazza said.

Under a typical insurance program, income tax deductions for claims are derived over time as claims expenses are paid, the consultants said. Because of the long-tail nature of workers comp claims, deductions might be taken over years while reserves sit in the employer's balance sheet.

But a captive allows its owner to accelerate tax deductions. The entire amount of projected claims costs can be taken immediately as a tax deduction when funding is put into the captive for a claim. Meanwhile, the money placed in the captive to cover future claims expenses can be invested.

Yet companies weighing alternatives of taking on more risks need to be careful because captives can increase costs rather than reduce them, Mr. Hessel said.

"You have to consider administrative costs of the captive and, depending on how you structure the captive, your frictional costs can be higher than under a qualified self-insurance program or a deductible program," he said. "You need to give careful consideration to how you structure the program so you don't increase costs unnecessarily."

Frictional costs to consider can include state premium taxes and assessments, which can be less under a fully insured program.

"If you have a lot of exposure in states that have a difficult tax or assessment regime, it can make a huge difference," Mr. Hessel said.

Apart from tax considerations, operational expenses average about $80,000 to $100,000 per year for captive management fees, regulatory fees, audit services and legal advice, Ms. Casazza said.

Weather: Derivatives evolve to mitigate risks

CONTINUED FROM PAGE 4

"Especially in the last two or three years, the market has shown a much greater diversity in its customer base," Mr. Windle said.

In 2004, 69% of all inquiries about weather derivatives were attributed to the energy sector. Last year, that fell to 46%, while 23% of the interest came from construction companies and 12% from the agriculture industry. Companies in the outdoor entertainment industry—such as amusement parks, concert venues and open-air sports stadiums—also have entered the market in recent years, Mr. Windle said.

Weather derivatives also have enjoyed significant market growth outside the United States, particularly in Europe and Asia. Some 63% of last year's 998,000 OTC contracts were written in Europe compared with just 13% in 2005, according to WRMA.

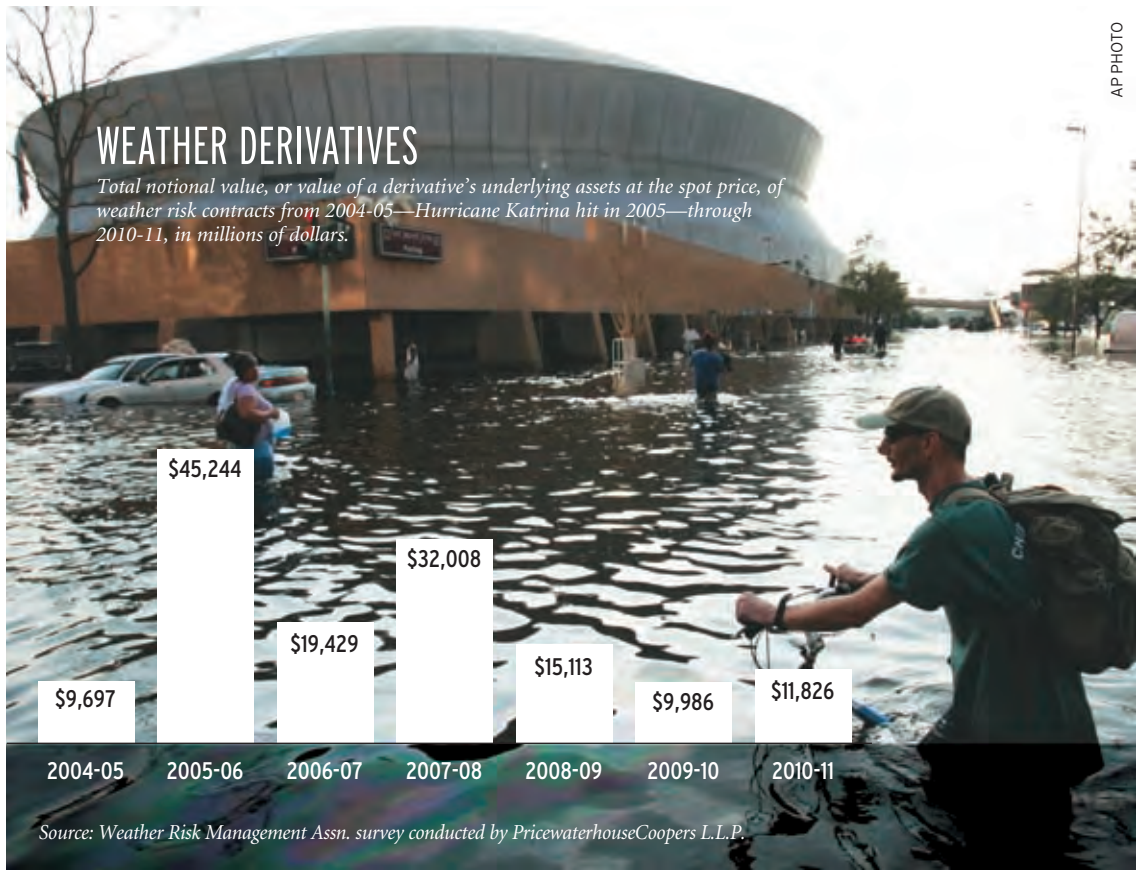
When the CME entered the weather derivatives market in 1999, it had only two product forms for futures and options based on heating and cooling degree days, said Paul Peterson, director of commodity research and product development for CME. Those contracts were solely for energy companies and available in just 10 U.S. cities, he said.

"Today, we're up to 67 different products," Mr. Peterson said. "We're also up to 24 U.S. cities and we have contracts available in 11 other countries, including several European countries, Japan, Canada and Australia."

Looking forward, proponents said there is ample opportunity for growth in the market, primarily in the green energy sector.

Contracts for wind, solar and hydroelectric energy producers are in development, but have yet to be brought to market. Mr. Peterson said the CME is only in the beginning stages of crafting a contract tailored to the green energy sector.

"It's a very complex process, but we're going to keep chipping away at it," Mr. Peterson said. "They're all viable topics, and all very good areas for future work."



AP PHOTO

Cat bonds: Investor demand strong

CONTINUED FROM PAGE 4

in new issuance while the market digested the event and how it played out. But, said Mr. Schultz, "I don't think it changed any of the issuance that was going to come to market."

"What's happened in terms of catastrophic events around the world hasn't really had that much of an impact," he said. "The market does expect to pay losses from time to time."

"Of the outstanding cat bond limit, about $1.5 billion was exposed to Japanese earthquake risk," said GC Securities' Ms. Anger. One issue, Muteki Ltd., paid its full limit of approximately $300 million. That issue provided earthquake coverage to Zenkyoren Ltd., the Japanese National Mutual Insurance Federation of Agricultural Cooperatives, under a deal in which Munich Reinsurance Co. provided reinsurance to the Japanese mutual, then securitized the exposure through the Muteki bonds.

Swiss Re's Mr. Schmutz noted that the Muteki transaction functioned as designed.

"(Investors) took the loss and moved on. We haven't really heard of anyone panicking and leaving the market," he said. "Really it serves as a very nice proof of the product and the concept."

Roger G. Beckwith, vp and secretary of Lane Financial L.L.C. in Chicago, had a similar view of the market's response to the catastrophe in Japan. "Things recovered in a pretty reasonable period of time," he said.

The third factor slowing first-half issuance was the fact that prior to the quake and tsunami in Japan, traditional markets were very aggressive, Mr. Schultz said. "We actually had a couple of bonds that were scheduled to come to market that just went back to the traditional market because it was just more efficient for the clients," he said.

"We still are working through the RMS issue. We think the other ones have been resolved," Mr. Schultz said. "We think we will work through the RMS issue by the end of the year."

'(Investors) took the loss and moved on. We haven't really heard of anyone panicking and leaving the market. Really it serves as a very nice proof of the product and the concept.'

Markus Schmutz,
Swiss Re Capital Markets Corp.

"We started the year with an estimate of $5 billion to $6 billion that was going to come to market. We've sort of revised that to $4 billion to $5 billion," he said.

Investor interest in insurance-linked securities remains strong. "We've seen investor support continue to be robust," Ms. Anger said.

With market proponents regularly citing the uncorrelated nature of cat bonds to other investment instruments, the market might be in a position to benefit from stock market volatility.

"We really have accelerated bringing new investors into the space and it really started after the global financial crisis in 2008," said Mr. Schultz. While most asset classes producing negative returns after the financial crisis, insurance linked-securities produced positive returns, he said.

"The fact that (cat bonds) have shown very little correlation (with other investment risks) makes them an attractive option for many investors," Mr. Schmutz said.

WIth U.S. windstorm risks the most common exposure in the ILS market, there is interest from investors in increasing the diversity of ILS exposures, according to Lane Financial's Mr. Beckwith.

"I think we've seen with recent deals that there's a lot of interest in diversifying ILS," he said. "So things that are non-U.S. wind or non-U.S. are sought after. You've had a pretty good reaction in the market to non-U.S. wind deals."

Recent events could drive the shape of some cat bonds going forward. For example, the frequency and severity of U.S. windstorms and the number of catastrophic events and total losses this year might lead some issuers to look to the cat bond market to cover accumulations of losses.

"(An) area that we're seeing a lot of focus on now from a U.S. perspective is around aggregate structures, which isn't surprising, given that 2011 has been a historically severe year," Ms. Anger said.

Tornado frequency and severity coupled with the Japanese earthquake led to insurance and reinsurance losses, "which aren't negligible," said Mr. Schmutz. That has led some to consider aggregate covers to address the "extraordinary frequency of smaller events," he said.

Ms. Anger noted that supply chain disruptions resulting from the disaster in Japan also have prompted discussions about corporations using the ILS market to address supply chain risks. She cited this year's €150 million ($215.9 million) Pylon II Capital Ltd. European windstorm issue by Paris-based Electricite de France S.A. as a possible model.

"For them, the original catalyst for putting it in place was the loss of income and business interruption from European windstorms," as it could provide property protection, she said. "When we see very significant events that have had an impact on corporations, we do see increased focus on alternative solutions."

CAPTIVES

Supply chain risks pose challenges

Funding through captives seen as an option by some, but benefits seem limited

By MIKE TSIKOUDAKIS

REUTERS

Car manufacturers were confronted with supply chain issues after the earthquake and tsunami in Japan earlier this year. Some companies are considering using captives to cover the risks, but the short-tail nature of supply chain risks limits the appeal of using captives.

Some risk managers and organizations seeking to address their supply chain risks, highlighted by the disaster in Japan, have weighed covering their suppliers through their captive insurer, but few, if any, have taken that approach, experts say.

Competitive pricing for business interruption coverage and a general caution about adding external supplier risks to the company-owned captive have limited the approach's appeal among buyers, they say.

Companies often require outside suppliers to obtain a certificate of insurance with specific limits per the negotiated contract. If the supplier cannot put up the amount of insurance the company wants, the company often buys an excess layer covering the supplier and passes the costs on to the outside provider, observers say.

The recent earthquake and tsunami in Japan and other natural disasters have highlighted this specific exposure that companies face. One way to handle the exposure is placing it in a captive, which brokers say could carry tax advantages as a third-party risk and assist a company's risk management efforts.

"We do bring it up," said Gary Osborne, president of USA Risk Group Inc. in Montpelier, Vt., when company boards inquire about innovative ways to cover suppliers.

"We haven't seen many people using the captive (approach). We've actually had three or four clients buy a policy," said Mr. Osborne, who works mostly with Fortune 2000 to 5000 companies with $1 billion in sales and premiums of $5 million to $8 million.

When the issue is brought up to clients, "quite a few of them have found that the coverages are priced where they didn't want it or they aren't willing to take the risk in the captive," he said.

Many captive managers are finding competitive pricing in the commercial insurance markets for business interruption and supply chain risks, Mr. Osborne said. "They're finding the products (in the commercial market), and they're not particularly comfortable writing it in the captive," he said.

Les Boughner, executive vp and managing director of Willis Group Holdings P.L.C.'s North American captive practice in Burlington, Vt., said companies with captives are more focused on protecting their internal risks.

"The discussions we've had with our clients are much more directed on 'how do we use a captive to protect us from the exposure' than it has been to 'how do we build a business out of it,'" Mr. Boughner said. "If we had an entrepreneurial captive that was really interested in starting to sell this coverage, they'd probably find the rates are so low they weren't interested in it."

Nancy Gray, regional managing director-Americas at Aon Insurance Managers Ltd. in Burlington, said some captives cover a company's internal supply chain risks, but so far there has been mainly discussion of expanding to cover outside suppliers, among other third-party risks such as customer risk and employee benefit programs.

Amid a soft-market insurance cycle, companies during the past five years have been forced to cut captive expenses as much as possible, Ms. Gray said. "Utilizing the captive to become a profit center becomes another source of revenue to companies while also keeping their costs down," she said.

Since the early 1980s, many captive owners have "moved away from writing third-party exposure and focus just on writing their own exposure," Ms. Gray said.

But if captive owners have a good understanding of the exposures related to their suppliers and are confident in underwriting those risks through the captive, they can look "at their captive as a profit center instead of just a cost center," she said.

If a company writes enough third-party business, it qualifies as an insurance company for federal income tax purposes and receives the tax benefits of deducting loss reserves, Ms. Gray said.

"If you're not an insurance company, you only get the tax deduction when the losses are actually paid. So this is an accelerated tax deduction if you can write enough third-party risk in your captive," Ms. Gray said.

Companies also can team with standard insurers to underwrite supply chain risks through their captive, said Steven R. Bauman, senior vp and head of captive services at Zurich Global Corporate, North America, in New York.

The captive would underwrite the risk using Zurich's form and take a retention in their captive or quota share risk with Zurich, or they can take the underlying deductible amount in their captive and Zurich would take the excess layer, Mr. Bauman said.

The customized coverage can cover suppliers several links down the chain, Mr. Bauman said. "We are talking to several people now on the possibilities."

"It gives the assurance to the client that the coverages that are provided to those suppliers or those contractors are to the standards that the client dictates through their captive," Mr. Bauman said.

Risk management strategies often prevail as the preferred approach in dealing with outside suppliers, experts say.

"I'm not sure captives will be a large solution for, in terms of numbers, captives that will be used for the supply chain risk of the suppliers," Aon's Ms. Gray said. "I think there are more opportunities for captives looking at a company's own risk profile. They need to understand the risk themselves."

Supply chain risks are short-tail exposures, said USA Risk Group's Mr. Osborne.

A company affected by the March earthquake and tsunami in Japan likely already has worked its way around the blockage and knows its ultimate loss, Mr. Osborne said. "It's not going to take you six years to figure out what was my actual loss from that supply chain incident. There's not a whole lot of sitting on money for a tax deduction."

Instead, companies are looking at ways to deal with supply chain problems, such as rerouting the supply chain, diversifying their suppliers and moving away from the tight margins that come with just-in-time strategies, Mr. Osborne said.

"I've seen much more standard risk management techniques rather than financing it," Mr. Osborne said. "This is one of those (situations) where, even with my love of captives, I'm not sure the captive brings much to the table," he said.

'This is one of those (situations) where, even with my love of captives, I'm not sure the captive brings much to the table.'

Gary Osborne, president of USA Risk Group Inc.

Business Insurance

Publisher/General Manager, Strategic Business Media: Mark Stach (*Chicago*)

Associate Publisher/ Online General Manager/Event Director: Paul D. Winston (*Chicago*)

Editor: Gavin Souter (*Chicago*)
Editor-at-Large: Jerry Geisel (*Washington*)
Managing Editor: Matt Scroggins (*Chicago*)
Assistant Managing Editors: Charmain Benton (*Chicago*); John D. Thomas (*Chicago*)
Art Editor: William Murphy (*Chicago*)
Senior Editors: Michael Bradford (*Dallas*); Roberto Ceniceros (*Boise*); Judy Greenwald (*San Jose*); Mark A. Hofmann (*Washington*); Sarah Veysey (*London*); Joanne Wojcik (*Denver*); Rodd Zolkos (*Chicago*)
Associate Editors: Matt Dunning (*New York*); Sonja Ryst (*New York*); Mike Tsikoudakis (*Chicago*)
Copy Desk Chief: Katherine Downing (*Chicago*)
Copy Editor: Ann Reus (*Chicago*)
Editorial Assistant: Mallory Gillikin (*Chicago*)
Research Director: Kevin P. Edison (*Chicago*)
Research Editor: Karen Brown Tucker (*Chicago*)
Editorial Cartoonist: Roger Schillerstrom (*Chicago*)

Advertising Sales Director: Susan Stilwill (*Chicago*)
Regional Sales Managers: Ron Kolgraf (*Boston*); Robert B. Murray (*New York*); Mary Pemberton (*Denver*)
Southeast & Classified Advertising Manager: Monique Murray (*New York*)
Production Manager: J. Thomas Janka (*Chicago*)
Assistant to the Publisher: Justine Karl (*Chicago*)

Marketing Manager: Kathy L. Barnes (*Chicago*)
Audience Marketing Director: Michelle O'Malley (*Chicago*)
Events Manager: Rebecca Briggs (*New York*)
Digital Product Manager: Christina Kneitz (*Chicago*)

EDITORIAL: Boise: 208-286-1425; Chicago: 312-649-5200; Dallas: 972-691-7960; Denver: 303-278-7444; London: 44-207-457-1400; New York: 212-210-0100; San Jose: 408-774-1500; Washington: 202-662-7200
ADVERTISING: Boston: 617-292-4856; Chicago: 312-649-5224; Denver 303-898-4043; New York: 212-210-0136
SUBSCRIPTIONS & SINGLE COPY SALES: 1-877-812-1587 (U.S. & Canada) 1-313-446-0450 (All other locations)

Business Insurance is published by Crain Communications Inc.
Chairman: Keith E. Crain
President: Rance Crain
Secretary: Merrilee Crain
Treasurer: Mary Kay Crain
Executive Vice President/Operations: William A. Morrow
Senior Vice President: Gloria Scoby
Vice President/Group Publisher: Christopher Crain
Group Vice President/Technology, Circulation, Manufacturing: Robert C. Adams
Vice President/Production & Manufacturing: Dave Kamis
Chief Information Officer: Paul Dalpiaz
G.D. Crain Jr. Founder (1885-1973)
Mrs. G.D. Crain Jr. Chairman (1911-1996)
S.R. Bernstein Chairman-executive committee (1907-1993)

BPA WORLDWIDE | AMERICAN BUSINESS MEDIA The Association of Business Media Companies

Group captives help firms tackle health benefits funding issues

By JOANNE WOJCIK

Mid-market companies are discovering that group captives can make self-funding employee health benefits a bit less daunting, experts say.

Captives can provide a primary layer of medical stop-loss coverage that would be tapped before traditional stop-loss insurance. Because medical stop-loss coverage purchased at higher attachment points generally is less expensive than that with lower attachment points, it could save the employer money while also providing protection from high-cost claims.

Self-funded employers that use a group captive for primary stop-loss coverage also can avoid "lasering," a practice in which insurers set higher attachment points for certain plan members with costly pre-existing conditions.

"Small employers tend to find that self-funding is more of a risk because of the lasers," said Kenneth R. Olson, president of Horton Benefit Solutions in Chicago. "They can be absolutely devastating for businesses' financial statements. So we've tried to craft the captive concept to provide reinsurance net of stop-loss."

For example, if 10 companies each with 50 to 500 employees form a group captive to provide stop-loss coverage at attachment points up to $500,000, they most likely never will feel the impact of a laser, Mr. Olson said.

"Most lasers come in about $100,000 to $200,000. We almost never hear of a laser above $500,000," he said.

To protect the captive from being hit with a sizable claim that would otherwise be subject to a laser, the captive can purchase disease-specific coverage, said Mr. Olson.

"We require all our members to buy first-dollar transplant coverage," he said. "It is relatively inexpensive. For a group with 100 lives, you might spend less than $10,000 a year."

But the peace of mind it provides to all employers participating in the captive is priceless, Mr. Olson said.

"If you have one transplant in your group, you're looking at several hundred thousand dollars. If this person is put on a transplant waiting list, there is an automatic laser. But with the transplant cover, there is no laser," he said.

"If you take a look at the market, many midsize employers chose not to self-insure because they were concerned about large swings in cost," said Sam Fleet, president of Charlotte, N.C.-based AmWINS Group Inc. "For them to go self-insured, it takes a huge leap of faith. They don't get any data from their carriers," so they don't know how much risk they may be taking on.

But for group captives funding medical stop-loss coverage, "it's a brave new world. It's becoming one of the more popular ways to self-fund health benefits," Mr. Fleet said.

The high cost of health care combined with the federal health care reform law is driving interest among mid-market companies in using captives for health benefits self-funding, said Rick Stasi, chief operating officer of the alternative risk division at Avizent in Dublin, Ohio.

"They say, 'You've done a good job controlling our property/casualty costs, but we're getting clobbered on health insurance,'" he said.

On a related front, some protected cell captives that Avizent manages have been providing stop-loss coverage for about two years, he said. In fact, Avizent itself is a participant, using a captive to fund stop-loss coverage of its self-funded benefits program for less than 1,000 employees, Mr. Stasi said.

> **'Most lasers come in about $100,000 to $200,000. We almost never hear of a laser above $500,000.'**
>
> Kenneth R. Olson, Horton Benefit Solutions

"The captive takes anywhere from $25,000 to $250,000," depending on where the participating employer wants its stop-loss attachment point to be, and New York-based Chartis Inc. picks up any claims above that amount, Mr. Stasi said.

Like group captives that self-insure liability risks, virtually all of these new benefits captives require participating employers to engage in certain loss-control activities, such as health risk assessments and population health management, experts said.

For example, the captive the Horton Group is assembling, which will be managed by Berkley Accident & Health L.L.C., a unit of Greenwich, Conn.-based W.R. Berkley Corp., is requiring that 80% of the employees of participating employers complete a health risk assessment as a condition of remaining in the captive.

Because many participating employers previously did not have an incentive to offer wellness programs because their insurers did not give them credit against their premiums for engaging employees, "it's exciting for us to do population health management for the first time for many of these employers/ groups," Mr. Olson said. "We expect a culture shift."

"The benefit of the captive is not necessarily risk sharing, but health risk management," said Mr. Fleet. "The objective is to become a zero-trend company. You can do that when you have a group of employers together that have the same goal and objectives."

Mid-market: More firms turn to captive insurers

CONTINUED FROM PAGE 6

40% of premiums, after three or four years they decided to set up an 831(b) behind the group captive to provide reinsurance," Mr. Stasi said.

Because many middle-market companies are privately held, some owners are using 831(b) captives for "wealth transfer" and estate planning, said Doug O'Brien, managing director and national casualty and alternative risk practice leader at Wells Fargo Insurance Services USA Inc. in New York.

"The surplus builds up on a tax-beneficial perspective over the years. Then the dividends or capital gains are given to an heir at a more favorable tax rate," he said. "I probably get five calls a week regarding interest in these types of captives."

In the wake of this year's earthquake and tsunami in Japan, Les Boughner, executive vp and managing director of Willis Global Captive Practice in Burlington, Vt., says he is seeing interest among mid-market companies to use captives for supply chain management.

"A captive is nothing more than a financial tool," he said. "I don't know how any company of substance—and that would include most midsize companies—can say they have a full array of financial tools if they don't have a captive."

Funding: Private company takes alternative route

CONTINUED FROM PAGE 6

investment income, he added.

The insurance program financed by Archway actually is reinsurance. The participating members all receive standard $1 million insurance policies from The Hartford Financial Services Group Inc., which then cedes the primary $350,000 layer of each policyholder's coverage to the captive.

The way the excess $650,000 layer is financed depends on reinsurance market conditions, Mr. Kilbane said.

"Either the carrier takes the excess-of-loss layer or we go to the reinsurance market if the Hartford is not interested and see what the reinsurance market quotes for that layer," he said. "Or the Hartford and a reinsurance carrier will do a quota share, which is what Archway is doing now. The excess-of-loss layer is shared 50-50 with ACE Ltd. and the Hartford."

All captive members still pay premiums, which are calculated based on prior loss experience as well as a one-time $36,000 start-up fee, which is used to buy one share of captive ownership. Because captive members are, in effect, shareholders, they don't have insurance contracts per se. But they do have a legal commitment for a minimum of one year and become eligible for dividend payments after three years.

Because Archway is a group captive, most of the risks it finances are unrelated to an individual parent or member company, making premium payments tax-deductible for each company under Internal Revenue Service rules.

Meanwhile, all funds held by the captive are managed by another Captive Resources division: the Captive Investors Fund.

Claims administration and loss-control services for captive members are provided by Gallagher Bassett Services Inc., a unit of Itasca, Ill.-based broker Arthur J. Gallagher & Co., which is paid out of premiums.

Captive Resources also employs loss-control engineers and claims advocates to oversee the third-party administrator.

Mr. Bernstein said he believes if more mid-market business executives were educated about captives, they would want to use them, especially because they can help to smooth the cost of risk financing regardless of insurance market conditions.

"The group has to do well, of course," he said. "But we're insulated from the impact of natural disasters and investment losses on an insurer's financial portfolio. We stand on our own merits."

Structured: New coverage avoids finite's pitfalls

CONTINUED FROM PAGE 12

"People were underreserved" after the soft market years, Mr. Malloy said, "and deals were done to create better results. People opted to buy less expensive finite deals, and some of those ended up going very badly for reinsurers. As the market hardened in 2002 and 2003, buying shifted to deals with more risk transfer with higher margins because the market could support it."

Structured reinsurance arrangements are useful for workers compensation, property/casualty and some property catastrophe exposures "where you aren't transferring the 100-year risk," Mr. Malloy said. "It might be at the bottom of your property catastrophe program."

"Typically, you want good actuarial or modeled data" on risks that have a fairly comfortable range of potential outcomes, he said.

"The motivation of the client is typically something other than the transfer of risk for a price" in a structured reinsurance arrangement, said Mr. Malloy. "They want to retain the economics of the business in some fashion" and the risk- and reward-sharing features let them to do that, he said.

The multiyear aspect of structured reinsurance products also can make them useful for risks that are not as easily modeled, Mr. Paterson said.

The Y2K risk—widely held fears that computers would crash at the turn of the last century—is an example of an exposure with consequences that could have developed over time that would have been suitable for a multiyear risk-sharing arrangement in a structured reinsurance program, Mr. Paterson said.

Sources said structured reinsurance is well-suited as an aggregate stop-loss product. "You take all the risk of a company and put it in one basket," Mr. Paterson said.

Not all markets will write such whole-account coverage, though, because it tends to cannibalize their traditional business, Mr. Paterson said. "There are not many markets doing that."

Because opinions vary on what constitutes a structured reinsurance deal, experts say it is hard to know how much of the coverage is written.

"One man's structured reinsurance deal might be another man's traditional deal with some bells and whistles," said Mr. Malloy.

Before it fell out of favor, finite reinsurance was around 5% to 6% of the reinsurance market, experts said. Structured reinsurance is "certainly no more than that," said Mr. Schnur, and likely far less, other sources said.

Reinsurance: Soft rates limit captives' advantages

CONTINUED FROM PAGE 10

business) for our clients to find the insurance they need," said Jill Husbands, head of office and managing director at Marsh IAS Management Services (Bermuda) Ltd. in Hamilton, which is a unit of the New York-based Marsh Inc.

She said in specialty lines of insurance where the market has hardened a little, some clients need to find capacity from reinsurers. For example, her team has seen "a number of instances" of captives in the energy sector wanting to access the reinsurance market themselves out of the need for additional capacity, she said.

But accessing reinsurance is not always straightforward.

Andrew Baillie, property risk manager for AES Corp. in Arlington, Va., is finding that options are limited for the power company, which faces risks that range from tropical storm damage to gas explosions at its plants.

The company established AES Global Insurance Co. in Burlington, Vt., to insure its assets on a consolidated basis. The captive now carries the first $30 million of AES' risk. To cover its risks beyond that amount, the captive also buys up to $1 billion dollars of additional coverage.

But prices for some energy exposures have increased significantly as a result of losses related to damage to the Fukushima nuclear plant in Japan in March and the BP P.L.C. oil spill in 2010.

"We're finding that there's a limited supply of the coverage we need because we're in a fairly difficult market," Mr. Baillie said. He said the captive provides a wider choice of underwriters from which AES can buy coverage. "Sometimes the opportunities are cheaper, and sometimes they're not, but if you need (coverage) then you're the victim of whatever the pricing will be," he added.

Mr. Baillie said AES is exploring other options for its April renewal.

"The most sophisticated risk management buyers will be continually looking at the market to see what the correct solution is for them," Mr. Baillie said. In some cases, the solution might be to carry more risk in the captive; and in others, the answer might be to move the risk into other places or to use new structures.

"You have to continually look at how (the market) is evolving," Mr. Baillie said.

News In Brief

Cat modelers estimate Hurricane Irene losses

Insured losses from Hurricane Irene, which hit the U.S. East Coast and caused damage from the Caribbean to New England, could be as high as $7.1 billion, AIR Worldwide Corp. said. Meanwhile, EQECAT Inc. put the total at $3.4 billion. Risk Management Solutions Inc. had not announced its estimate late last week.

Marsh to buy broker unit of Alexander Forbes

Marsh & McLennan Cos. Inc.'s Marsh Inc. unit has reached an agreement to acquire the brokerage business of Johannesburg-based Alexander Forbes Ltd. MMC reported brokerage revenue of $10.6 billion in 2010, which made it the world's second-largest brokerage in the *Business Insurance* 2011 ranking. Alexander Forbes reported brokerage revenue of 3.65 billion South African rand ($510.3 million) in 2010. According to Marsh, the business comprises Alexander Forbes Risk Services and certain local and correspondent operations serviced across sub-Saharan Africa, including Botswana and Namibia.

Combined ratios worsen for U.S. reinsurers

U.S. property/casualty reinsurers combined ratio continued to deteriorate, worsening to 116.2% during the six months ended June 30 from 98.7% during the same period in 2010, according to a survey of 19 U.S. reinsurers released by the Reinsurance Assn. of America. The results are "due to the extraordinary number of catastrophes in 2011, such as the Japanese earthquake and tsunami, tornadoes in southern and northeastern U.S., and floods," said a spokeswoman for the RAA.

Gilman, McNenney file libel suits against Spitzer

Former Marsh Inc. Managing Director William Gilman is seeking $60 million in damages in a libel suit filed against former New York Gov. Eliot Spitzer last month. In his suit, Mr. Gilman said Mr. Spitzer implied that he was guilty of crimes, including ones of which he was never accused, in a column on Slate.com. Mr. Gilman and fellow former Marsh Managing Director Edward McNenney were indicted in 2005 on 37 charges regarding alleged bid-rigging, but each was convicted of only a single count of restraint of trade and competition, and a judge tossed those convictions last year. Mr. McNenney has filed a separate libel suit against Mr. Spitzer, seeking $30 million.

Tenn. licenses first captive under revised law

Tennessee has licensed its first new captive insurance company since the state revised its captive law this year. Julie McPeak, commissioner of the Tennessee Department of Commerce and Insurance, signed the license for Park View Insurance Co., a pure captive formed by Nashville, Tenn.-based hospital and health system operator HCA Inc. The revisions updated the existing captive law and permitted the formation of protected cell captives, branch captives and special-purpose financial captives in Tennessee.

House panels to consider 'grandfather' rule repeal

House Republican leaders said several House committees will develop legislation to repeal the health care reform law's grandfather plan rules. House Majority Leader Eric Cantor, R-Wis., said in a memorandum sent to House Republicans that employers losing grandfathered status for their health care plans will face higher costs, "negatively affecting wages and job growth." Last year, the Senate defeated a proposal by Sen. Mike Enzi, R-Wyo., that would have effectively nullified the grandfather rules.

Bermuda insurer registrations surge

Thirty-one insurance companies registered in Bermuda during the first half of the year, according to the Bermuda Monetary Authority. That compares with 36 companies for all of 2010, the BMA said. More special-purpose insurers were formed during the first half of 2011 than all of 2010, BMA CEO Jeremy Cox said in a statement announcing the activity.

Commercial property rates rising: Marsh

Property insurance rates have begun to rise, according to a benchmarking trends newsletter posted on Marsh Inc.'s website. But rates for other lines of commercial coverage continued to decline during the third quarter, most notably for publicly traded companies' directors and officers liability insurance, according to Marsh. Catastrophes in the United States and elsewhere led insurers to push for increased or flat rates for property coverage, particularly for accounts with "significant catastrophe exposures and/or poor loss histories," Marsh said.

P/C industry's first-half cat losses $27B: Best

The U.S. property/casualty insurance industry suffered $27 billion in catastrophe-related losses during the first half of 2011, A.M. Best Co. Inc. said in an analysis. That represented a 127% increase over the $11.9 billion in catastrophe losses sustained during the same period of 2010, the rating agency said. Losses for commercial lines of insurance rose to $8.3 billion in the first half, from $4.1 billion in the same period in 2010. During the first six months of this year, U.S. reinsurers saw $3.6 billion in catastrophe-related losses as opposed to $800 million sustained during the same period in 2010.

P/C reserves deteriorate, still adequate: Fitch

U.S. property/casualty insurers' loss reserves have deteriorated moderately, but they remain adequate for now, Fitch Ratings Ltd. said in an analysis. The industry continues to benefit from reserve strength built up in prior years, the rating agency said. Insurers' total reserve development was $10.2 billion in 2010, down slightly from $10.3 billion in 2009, Fitch said.

Gras Savoye reorganizes, names new CEO

French brokerage Gras Savoye & Cie. has reorganized its top management structure and appointed a new CEO. The brokerage has split the roles of chairman and CEO, previously both held by Patrick Lucas, and appointed Patrick Werner as CEO. Mr. Lucas, 72, will remain chairman of the company.

Liberty Mutual's comp appeal rejected

A federal appeals court dealt another blow to Liberty Mutual Group Inc.'s years-old legal battle against American International Group Inc. in a case involving the alleged underreporting of workers compensation premiums. In the ruling, the 7th U.S. Circuit Court of Appeals in Chicago denied Liberty Mutual's request for permission to appeal a federal judge's decision to grant preliminary approval of AIG's offer to settle litigation with a class of plaintiffs composed of hundreds of rival insurers. The appeals court also denied Liberty Mutual's request to block the mailing of settlement notices to potential members of a class of insurers that would be eligible to share the $450 million.

N.Y. agents, brokers appeal disclosure rule

Two New York insurance agent and broker groups appealed a judge's decision upholding a state regulation that requires producers to disclose incentive compensation they receive. The Independent Insurance Agents & Brokers of New York and the Council of Insurance Brokers of Greater New York filed the appeal with the New York State Supreme Court Appellate Division, Third Department in Albany. They seek to overturn New York State Supreme Court Judge Richard M. Platkin's November decision that upheld the state insurance department's authority to promulgate New York Insurance Regulation 194. The regulation, which took effect Jan. 1, requires producers to disclose the incentive commissions they receive from insurers and other third parties.

WHEN CONFRONTING DISASTER, HAVING ALL YOUR EGGS IN ONE BASKET SHOULD MAKE YOU FEEL

An insurer willing to take on all of your commercial property risk is rare. So rare, in fact, that only FM Global does it. How do we provide coverage no one else can? By assessing risk in a way no one else does. We base our underwriting on engineers' assessments. It's an approach that reduces risk, preventing losses before they happen.

We feel our clients are better protected when we assume all the risk ourselves. Understanding risk and how to minimize it allows us to do just that. So, even when our clients have losses, they tend to be smaller and less frequent. **Underwriting through loss prevention engineering. That's insurance evolved.**

Insurance Evolved FM Global®

» To learn more, visit **fmglobal.com/insuranceevolved/safe**

D&O insurance solutions from Chartis.

Today's directors and officers face more risk than ever, due to a growing breadth of regulations and heightened enforcement. Having the right coverage is critical. At Chartis, we offer cutting-edge insurance solutions built to meet the challenges of D&O risk today—and will keep innovating to meet the challenges of tomorrow. Learn more at **www.chartisinsurance.com/D&O**

CHARTIS®
Your world, insured

$5

Business Insurance®

September 5, 2011

www.businessinsurance.com

THE ALTERNATIVE RISKS ISSUE

- Array of strategies for managing risk make their mark

Business Insurance

Online features & highlights
www.businessinsurance.com

video

BUSINESS INSURANCE IN FOCUS: Watch our weekly video, Business Insurance In FOCUS, for insights into the biggest risk management, insurance and benefits stories of the week, as well as interactive information about our in-depth coverage, upcoming events and other features.

MOST POPULAR STORIES
Week of August 29, 2011

1. House panels to consider repeal of health plan 'grandfather' rules
2. Katia is next storm on the way, but path uncertain
3. 'Above average' hurricane activity in next two weeks
4. Top 5 highest-paid public broker executives
5. State comp insurer seeks $50M from staffing firm after verdict
6. Court rules against Wal-Mart in harassment, retaliation case
7. Hurricane Irene insured losses expected to near $3 billion
8. Solvency II will reduce competition: Survey
9. Irene wallops floundering flood insurance program
10. Unfair settlement claim against comp insurer disallowed

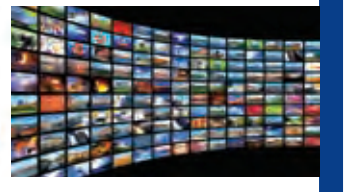
GET ONLINE NEWS EACH DAY
Subscribe to *BI*'s daily newsletter

webinar

BUSINESS CONTINUITY STRATEGIES: A free Sept. 14 *Business Insurance* webcast will feature business continuity experts who will explore issues risk managers and their companies should consider in developing plans. Panelists will include Gary S. Lynch, managing director at Marsh Risk Consulting, and public policy advisor Arietta Chakos. To register for the event, visit www.businessinsurance.com/webinars.

CHANNELS: Visit the Mid-Market Executive channel for risk and benefits information tailored to such firms.

IN-DEPTH COVERAGE on what benefit managers need to do to comply with the health care reform law.



GALLERIES: See the latest photo galleries, and submit your own photos of industry people and events.

Business Insurance (ISSN 0007-6864) Vol. 45, No. 34, is published weekly, except for combined issues the first and second week of July, the fourth and fifth week of August and no issue the last week of December, by Crain Communications Inc., 360 N. Michigan Ave., Chicago, Ill. 60601-3806. Periodicals postage is paid at Chicago and at additional mailing offices. POSTMASTER: Email address change to customerservice@businessinsurance.com or mail to Business Insurance Circulation Department, 1155 Gratiot Ave. Detroit, Mich. 48207-2912. $5 a copy and $125 a year in the U.S. $130 in Canada and Mexico (includes GST). All other countries, $230 a year (includes expedited air delivery). Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 40012850, GST No. 136760444, Canadian return address: 4960-2 Walker Road, Windsor, ON N9A6J3. Printed in U.S.A.

CATASTROPHES

REUTERS

Hurricane Irene battered much of the U.S. East Coast and Northeast last month. The deadly storm came after insurers and reinsurers were hit but a string of other catastrophes earlier in the year. As a result of the losses, interest has increased in industry loss warranties as an alternative to traditional coverage.

Industry loss warranties surge with catastrophes

Alternative coverage viewed as solution for big exposures

By MARK A. HOFMANN

A spate of natural disasters has driven up interest in—and the cost of—industry loss warranties, according to reinsurance experts.

ILWs are a form of capital typically used to complement traditional reinsurance. They are triggered by a predetermined threshold for an industrywide loss in any line of business. ILW contracts can reach up to $100 million in value, market observers say.

"The ILW market is relatively established now, and the ILW market is roughly $5 billion to $6 billion and has been that way for some time now," said Henry Kingham, executive director of Willis Re Specialty in London.

"ILWs are a little different from other forms of insurance-based securities, like sidecars," said Shane de Burca, a partner at New York law firm de Burca P.L.L.C. focusing on corporate transactions, including insurance and reinsurance.

"ILWs respond very quickly because they're a very standardized product," said Mr. de Burca. "They're based on various indices."

The primary trigger in the United States for ILWs is based on the Insurance Services Office Inc.'s Property Claim Services unit's estimate of industry losses from a catastrophe. The most common triggering events for the coverage are hurricanes, earthquakes and Florida wind losses.

> **'ILWs are a little different from other forms of insurance-based securities, like sidecars. ILWs respond very quickly because they're a very standardized product.'**
>
> Shane de Burca, de Burca P.L.L.C.

"The market has opened up; these indices have become more granular," Mr. de Burca said.

"The market has really been growing since 2006," said Patti Guatteri, director-Swiss Re Capital Markets in New York. While interest in ILWs declined in 2009, it has grown since then with more market players and investors interested in the market.

Events such as the Japanese earthquake and tsunami, earthquakes in New Zealand, unusually high U.S. tornado activity during the spring and Hurricane Irene—resulting in billions of dollars of insured losses (see chart, page 18)—have driven interest in ILWs even higher this year.

"This year, in particular, with the large losses occurring early on in the year, you would expect to see an increase in ILWs and other cat bonds," said Matt Wulf, vp-state relations and assistant general counsel for the Washington-based Reinsurance Assn. of America.

"They're really kind of replacement cover." As reinsurers have sustained large losses, "the (catastrophe) bonds, including ILWs, are a quick way for money to enter the market," he said.

"The pricing of ILWs is very much about supply and demand," said Stefano Nicolini, senior vp with BMS Intermediaries Inc. in Westfield, N.J.

"Since the beginning of the year, the price has gone up and up. Now it has reached a plateau," said Mr. Nicolini. "U.S. quake went up 20% literally overnight after the Japanese quake," he said. Frequency of events, the new Risk

See **ILWs** page 18

the ALTERNATIVE RISKS issue

Alternative risk strategies continue to evolve despite the soft commercial insurance market. And the range of organizations using nontraditional coverage options is expanding.

Captives have long been a tool used by risk managers to retain more risk and control liability exposures, but some captive owners are looking to expand the types of risks they cover within their captives, and a growing number of midsize companies are now using captives.

Risk retention groups also are well-established alternative vehicles, and they continue to thrive.

Other nontraditional coverage options such as weather derivatives are not as well-established, but more policyholders are looking for ways to incorporate them into their broader risk management programs.

In this special report on alternative risks, we review the growing array of nontraditional risk transfer options available to risk managers, insurers and reinsurers and take a look out how the markets are likely to develop.

To keep up with breaking news, including the latest on damage estimates from Hurricane Irene and other catastrophes, visit *www.businessinsurance.com*. To have news alerts sent directly to your inbox, sign up for our news alerts and newsletters.

INSIDE this issue

INDEX

RISK MANAGEMENT

Weather derivatives evolve as risk mitigation device

Array of industries use financial tool to protect revenues

By MATT DUNNING

Weather derivatives, originated in the late 1990s by recently deregulated U.S. energy companies looking to mitigate revenue lost to adverse temperatures, have evolved to become a multibillion-dollar worldwide business.

Today, observers and proponents say, the weather derivative market serves numerous business sectors and regions, as well as a host of risks.

Those advances, they note, are the primary reason the number of weather derivative contracts written globally last year reached more than 1.4 million through March, a record for the market, according to the Washington-based Weather Risk Management Assn.

The total value of those contracts rose as high as $45.24 billion in 2006, the year after Hurricane Katrina, and totaled $11.82 billion last year, according to the association (see chart, page 19).

"It was essentially a U.S. business focused on retail energy companies," said Juerg Trueb, a Zurich-based managing director at Swiss Reinsurance Co. "Now, it's a market that's become worldwide and grown to include a lot of varying solutions in a number of different sectors. There's a much broader range of underlying risk that's being contracted, and all kinds of indexes being used to quantify the impact of the weather."

There are two main types of weather derivative contracts.

Standardized, exchange-based contracts are placed by a broker and bought and sold by traders, largely through the Chicago Mercantile Exchange. The buyer's account with the broker is debited or credited based on the fluctuating price of the weather risk covered in the contract.

The second type, over-the-counter contracts, are placed directly with capital providers such as hedge funds or reinsurers and are either warehoused or traded against other nonstandardized products.

OTC contracts offer greater flexibility in specific weather triggers and payment plans, but experts say they carry greater liability to the end user in that they do not mitigate the risk of default of a capital provider.

Where a weather derivative contract differs from a traditional insurance policy—and where it can provide buyers with additional protection—is its coverage of low-severity, high-frequency events like rain, snow and temperature fluctuations, as opposed to one-time catastrophes and natural disasters.

At the market's genesis, energy companies purchased contracts based solely on temperatures, collecting payouts for the number of days the average winter or summer temperature registered above or below a preset threshold.

Proponents attribute the market's growth largely to the addition of bespoke weather risk contracts on rain, snow, wind and other adverse conditions, as well as a cross-commodity products structure basing the payout on the frequency of a weather occurrence combined with the underlying market price or volume of a commodity produced.

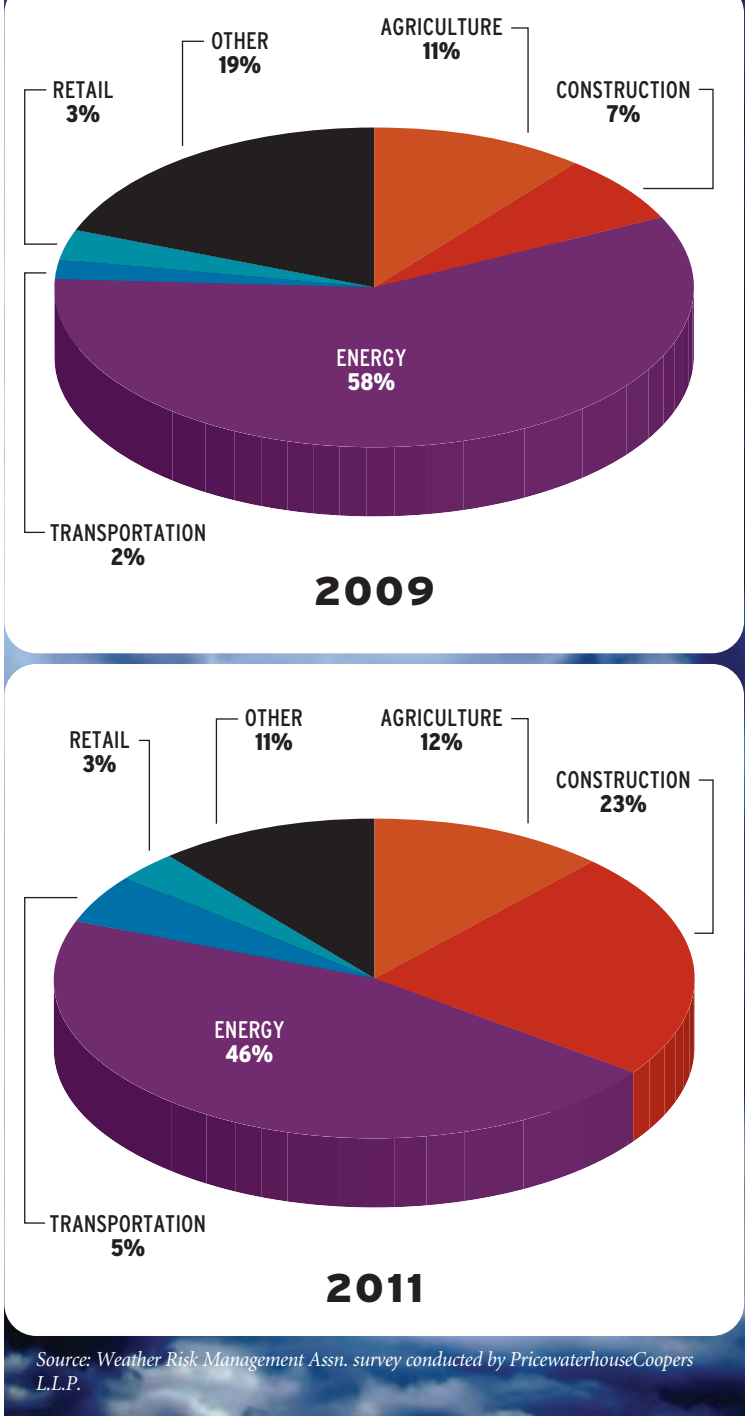
"Over the last decade or so, a lot of companies have looked more closely at their risks and found that an off-the-rack solution like heating and cooling degree day products didn't really fit that well," said Martin Malinow, CEO of the New York-based Galileo Weather Risk Management Advisors L.L.C. and a former WRMA president. "They needed a much more tailored solution that really fit not only the location but also the true nature of the underlying exposure," he said.

The broader range of risks covered has fueled the expanded demographic and geographic diversity of customers using weather derivative products, said Bill Windle, president of WRMA's board of directors and a Woodlands, Texas-based managing director at Renaissance Reinsurance Energy Advisors Ltd. Energy remains the market's dominant participant, but surveys have shown increased interest from the agriculture, construction, transportation and hospitality industries.

See WEATHER page 19

WEATHER DERIVATIVES

Industries interested in weather risk instruments. Percentage of total by industry.



Source: Weather Risk Management Assn. survey conducted by PricewaterhouseCoopers L.L.P.

SECURITIZATION

More catastrophe bonds likely with investor demand strong

After slow start to 2011, active second half predicted

By RODD ZOLKOS

The catastrophe bond market appears set to rebound during the second half of the year despite a slower pace during the first half caused by several factors.

A soft traditional market, the March 11 earthquake and tsunami in Japan, and changes to Risk Management Solutions Inc.'s U.S. hurricane model all contributed to the slow pace of first-half cat bond issuance, market experts say.

However, investor demand for insurance-linked securities remains high and the market has largely worked through the issues that confronted it earlier this year.

"Broadly speaking, we see what we would call probably a very active second half of the year. We've had a couple of transactions already," said Paul Schultz, president of Aon Benfield Securities Inc. in Chicago.

BONDS AND CAPITAL

Catastrophe bond issuance and risk capital outstanding, by year in millions of dollars.

YEAR	ISSUANCE	RISK CAPITAL OUTSTANDING
2004	$1,142.8	$4,040.4
2005	1,991.1	4,904.2
2006	4,693.4	8,541.6
2007	6,996.3	14,024.2
2008	2,729.2	12,043.6
2009	3,391.7	12,508.8
2010	4,600.3	12,185.0
2011*	1,606.8	10,637.1

**First six months*
Source: GC Securities

Mr. Schultz said he sees a good pipeline of transactions likely to come to market, which should carry over into 2012.

According to New York-based GC Securities, an affiliate of Guy Carpenter & Co. L.L.C., nearly $1.61 billion in new catastrophe bonds were during the first six months of 2011, with nearly $10.64 billion in outstanding risk capital in the market at the end of the second quarter (see chart).

That's down from last year, when there was $2.35 billion in new issuance during the first half with total risk capital in the market standing at $11.82 billion. There was more than $12.18 billion in risk capital in the market at the close of 2010, according to GC Securities.

"We definitely have seen an active year this year; particularly we have seen another active third quarter," said Cory Anger, managing director and global head of insurance-linked securities at GC Securities.

"If you kind of look back to the first half of the year, what you've probably seen is that issuance is a little bit slower than for the same period the year before," said Markus Schmutz, head of insurance-linked securities structuring and origination at Swiss Re Capital Markets Corp. in New York.

Mr. Schmutz noted the RMS model change as one factor slowing first-half cat bond issuance. "A lot of people who were thinking about doing issues had some questions about how would the market react to the model change," he said. "They also had some questions about reinsurance renewals at July 1."

"Even today I think investors and issuers are working through some of the changes" to the RMS model, said Aon Benfield's Mr. Schultz. "It still continues to be an issue for the market."

While the earthquake in Japan appeared to slow cat bond issuance, the market's response seems appropriate, the experts say.

It's possible the Japan loss caused a "lag"

See CAT BONDS page 19

*References the 2008 Forbes
Tax Misery & Reform Index

ONE PLACE DIVERSIFYING

Qatar. With every new project comes a new insurance opportunity. Behind it all, the QFC is helping Qatar to become the region's most dynamic economy, and its perfect access point. Benefit from the lowest tax in the world,* 100% ownership, repatriation of all profits and an onshore trading environment. Join us. **www.qfc.com.qa**

BUSINESS ENERGY

qatar
FINANCIAL CENTRE

CAPTIVES

More midsize companies turning to captives

Range of structures offer more options to cover exposures

By JOANNE WOJCIK

Growing sophistication among mid-market executives who want to find a better way to finance the risks their companies face is driving many midsize businesses to turn to captives as an alternative to traditional insurance, experts say.

While group captives often are the entry point to alternative risk transfer for many middle-market organizations because they require less capitalization than single-parent captives, many mid-market executives also are showing interest in what are known as segregated or protected cell captives as well as micro captives, the experts note.

While most mid-market captives are being used to insure or reinsure workers compensation, general liability and auto liability exposures, some recently formed captives finance medical stop-loss insurance for self-funded health benefits programs at mid-market companies (see stories, page 21).

Group captives can be effective for industries that have predictable losses, such as manufacturing, service, wholesale and retail, said Steve Bankes, managing director of group captive solutions at Aon Insurance Managers Ltd. in Chicago. "Their risk profiles and commitment to loss control are very similar. They are committed to keeping their employees safe, protecting the public from harm and don't want to spend too much on insurance."

Such group captive members generally have about $10 million in payroll and about $100 million in annual revenues, but are paying perhaps as much as $500,000 for insurance when they may have only $100,000 to $200,000 in claims in any given year, Mr. Bankes said.

"You will always find companies with good loss experience that want to profit-share with other companies," said Lisa Wall, senior vp of captive consulting at Lockton Cos. L.L.C.

Although group captives require lower startup costs because each member contributes, Ms. Wall and other captive consultants say they also are seeing interest among mid-market executives in single-parent captives and protected cell captives, which basically are a collection of single-parent captives within a captive.

Single-parent and protected cell captives generally require between $250,000 and $1 million in initial capitalization to open, depending on the type of risks financed and the requirements of the selected domicile, captive experts say. However, the captive owner doesn't necessarily have to put all that up in cash. The funds can be borrowed from banks that issue letters of credit to the captive to satisfy capitalization requirements.

Although they require the same capitalization as a single-parent captive, protected cell captives have lower administrative costs, which can be attractive to cost-conscious mid-market executives, said Donna Weber, senior vp at Marsh Inc.'s captive solutions group in Melville, N.Y.

"The dividing line is whether you want to share risks with others or whether you want your risks exclusive to your business in a cell or a single-parent captive," said David McManus, president of ARTEX Risk Solutions Inc., a division of Arthur J. Gallagher & Co. in Hamilton, Bermuda.

"Typically, when you're putting a group captive together, you want to make sure everyone has similar loss control measures in place," said Greg Petrowski, secretary/treasurer at GPW & Associates L.L.C. in Phoenix.

In most cases, mid-market group captives include an assortment of somewhat related businesses, perhaps geographically dispersed, that reinsure insurance policies issued by admitted insurers, referred to as "fronting" insurers. Because these fronting insurers assume credit risk, they usually require collateral from the captive, which often is provided in the form of a letter of credit issued by a financial institution. They also charge fronting fees.

Despite the fees and costs associated with letters of credit, which have become a more expensive option in recent years, such arrangements typically are cheaper than traditional insurance and reinsurance.

In addition to serving as reinsurers, most mid-market captives purchase reinsurance as a backstop, either on a per-claim or aggregate basis. But even though the same reinsurers that serve large captives cater to the mid-market, some are hesitant to provide coverage at the often low attachment points required by smaller captives, which is why some mid-market companies may combine their risks with other similarly situated mid-market companies, either in a group captive or as part of a pool, captive experts said.

For example, in ARTEX's pooling arrangement, mid-market captive owners pay premiums to their captive based on their own experience for the first layer of coverage, also known as the frequency layer because that is usually where the most claims are filed, Mr. McManus said. Then the captive pays premiums into a pool for a second layer of coverage, which pays the less frequent but more severe claims.

"We have very few middle-market companies that…throw their hat in the ring openly with other entities without there being some sort of separate frequency and severity fund," Mr. McManus said.

As reserves grow in their captives, many mid-market executives are eyeing 831(b) captives as a way to preserve those assets for other uses, such as insuring risks for which traditional coverage may not be available, experts said.

"It's a merger of entrepreneurial thinking with risk management," said Rick Stasi, chief operating officer of the alternative risk division at Avizent in Dublin, Ohio. "They come up with things no one in the insurance world would ever think of."

For example, a group captive formed in 2004 to provide auto liability, general liability and workers compensation coverage to a group of about a dozen owners of various national fast-food franchises decided to form a micro captive with the dividends they had received.

"Because they were getting such great dividends, averaging 30% to

See **MID-MARKET** page 21

Private company takes alternative route

By JOANNE WOJCIK

A company doesn't have to be a member of the Fortune 500 to take advantage of captive insurance.

Ask David Bernstein, president of Mid-State Lumber Corp. in Branchburg, N.J., a privately held middle-market building products firm with approximately $100 million in annual sales and 95 employees.

Mid-State Lumber is a member of Grand Cayman, Cayman Islands-based Archway Insurance Ltd., a member-owned group captive that provides workers compensation, general liability and auto liability coverage to 105 midsize companies.

"Ten years ago, I read an article about captives and how they were becoming feasible for midsize businesses like ours," Mr. Bernstein said. "I spoke to our broker at the time and he said if he could get a group together, he would support it, but he struck out."

So Mr. Bernstein did his own research and found two group captives that his company could potentially join. He felt uncomfortable with the first, but a second captive composed of an assortment of construction, service and manufacturing companies that were more geographically dispersed appealed to him.

Mr. Bernstein said what he liked most about Archway was that it included businesses across the United States, none of which were Mid-State Lumber's local competitors or customers.

Ironically, Mr. Bernstein said he was introduced to Archway by Mid-State Lumber's bank, not its insurance broker, though the company today uses Wells Fargo Insurance Services USA Inc. to place several other lines of insurance that include employee theft and umbrella liability, in addition to Archway's coverage.

"We had been shopping insurance forever and the whole process is very grueling; it's not one you enjoy or control," Mr. Bernstein said.

By contrast, participating in a captive has been "a very good experience for us. They help us become a safer environment, which is good for our employees," he said. "I would say we were a pretty safe environment to begin with or we wouldn't have been invited to join Archway."

Archway, managed by Kensington Management Group Ltd. in Georgetown, Grand Cayman, a subsidiary of Captive Resources L.L.C., requires risk assessments prior to inviting a business to join, said Mike Kilbane, president of Schaumburg, Ill.-based Captive Resources.

Moreover, the captive has lowered Mid-State Lumber's risk-financing costs, Mr. Bernstein said.

Since its inception in 1999, Archway has returned $32.5 million to its members in dividends, which are paid in two situations: if a member's loss experience proves better than expected and/or if the group's overall loss experience is favorable, Mr. Kilbane said. In addition, funds deposited into the captive earn

See **FUNDING** page 21

GROUP CAPTIVES can be effective for industries that have predictable losses, such as manufacturing, service, wholesale and retail. Such group captive members generally have about $10 million in payroll and about $100 million in annual revenues, but are paying perhaps as much as $500,000 for insurance when they may have only $100,000 to $200,000 in claims in any given year.

$500K vs. $100K-$200K

INSURANCE CLAIMS

SINGLE-PARENT CAPTIVES AND PROTECTED CELL CAPTIVES, which basically are a collection of single-parent captives within a captive. generally require between $250,000 and $1 million in initial capitalization to open, depending on the type of risks financed and the requirements of the selected domicile.

$250K-$1M

INITIAL CAPITALIZATION

"We make communication work seamlessly across six continents. Zurich does the same with our insurance."

Andrew M. Miller, President & CEO
Polycom, Inc.

Zurich HelpPoint

A single property insurance solution designed to help reduce coverage gaps and overlaps.

Polycom, a global leader in telepresence solutions, needed a financially strong carrier that could make complex insurance coverage easier. Zurich provided a custom solution that's as simple as it is seamless, integrating property with liability coverage all under one policy. It's an example of how Zurich HelpPoint delivers the help businesses need when it matters most. Watch the video to learn more. **www.zurichna.com/stories7**

ZURICH®

Because change happenz®

Opinions

EDITORIAL

Creativity drives market's success

WHAT OFTEN IS called the alternative insurance market, which includes captive insurers and other nontraditional ways to handle business risks, is brimming with creativity.

Today, for example, there are more than 250 risk retention groups, special group captives that can operate nationwide after meeting the licensing requirements of one state. In 1986, just before Congress significantly expanded the kind of coverages RRGs could write, just a handful of RRGs existed.

All types of captives—not just RRGs—have boomed. In the United States alone, there are more than 1,800 captives, compared with just over 100 in 1986.

As captives have grown, attitudes about them have changed. Commercial insurers, once skeptics at best, have become willing partners of the alternative risk financing industry. In many cases, captives could not operate without transferring some of the risks that they assume to traditional reinsurers.

Even state insurance regulators have become more supportive of captives and other alternative risk financing vehicles, though exceptions remain.

The fact that roughly half of U.S. states now have captive licensing laws could not have happened had state regulators opposed those measures.

These are positive developments. In the case of group captives that include RRGs, as we report in this week's issue, policyholders, and especially smaller organizations, are banding together to obtain risk management and loss-control services that they would have found difficult to get on their own.

Not everything is positive on the captive front, though. For example, the outlook for passage of legislation introduced in June to allow RRGs to underwrite property risks and to resolve disputes with state regulators without costly litigation is not encouraging. Rep. John Campbell's bill has just one co-sponsor.

Still, proponents should not give up. If they continue to promote the successes of alternative risk financing vehicles—and how much more they could accomplish with expanded underwriting authority and a better way to resolve disputes—we are confident that Congress one day will embrace and pass the legislation.

LETTERS

Business Insurance welcomes letters to the editor. The section is intended to be a forum for readers' opinions and comments. We reserve the right to edit letters for clarity or space. We will not publish unsigned letters.

Please send your letters to:
Letters to the Editor, Business Insurance,
360 N. Michigan Ave., Chicago, Ill. 60601-3806

Fax: 312-280-3174; email: *gsouter@businessinsurance.com*

SCHILLERSTROM

COMMENTARY

Captives still solving problems

Three hundred years ago, if someone had said they had a captive in the Caribbean, they most certainly would have been a pirate. But today, captives are held by the vast majority of Fortune 500 companies and an increasing number of middle-market firms as an alternative risk financing vehicle.

While islands such as Bermuda and Guernsey historically have been the most popular domiciles for captive formations, many of the captives being created today are in such land-locked locations as Vermont, home to more captive insurers than any other U.S. state with nearly 900 licensed captive insurers.

JOANNE
WOJCIK
SENIOR EDITOR

The idea of self-insuring risks in a captive rather than buying commercial insurance is attributed to Frederic M. Reiss, known as the father of captive insurance, who used the term "captive" to describe an insurance company subsidiary he helped form for the Youngstown Sheet & Tube Co. in the 1950s. The company had called the mines whose output was used exclusively by the parent corporation "captive mines."

Because this first wholly owned insurance company subsidiary was created to provide insurance coverage solely to its parent, Mr. Reiss aptly dubbed it a "captive," and the name stuck, although it is something of a misnomer for many of today's captives that provide insurance to third parties as a way to preserve the tax deduction for premiums paid into them.

The captive movement gained momentum during the hard commercial insurance market of the mid- to late 1980s when liability coverage was either unavailable or unaffordable for many buyers. As buyers were forced to raise their deductibles to lower the cost of insurance coverage, they discovered they could squirrel away some of the money they were setting aside to pay claims within those deductibles into captives, where it would earn investment income at a time when interest rates were exceptionally high. Today, more than 5,000 captives exist worldwide.

Something similar is happening today as captives provide a way to address the high cost of employer-sponsored health benefits programs. Some midsize employers that self-fund health benefits are joining group captives to pool a portion of those medical risks, reducing the cost of health benefits by allowing employers to purchase medical stop-loss coverage at higher attachment points.

In another creative use of captives, some mid-market companies are tapping some of the reserves that have built up in their captive subsidiaries to form "microcaptives," permitted under section 831(b) of the federal tax code, to provide reinsurance to their captives rather than purchasing such coverage from traditional reinsurers. Other companies are using captives to provide added financial protection in the event of supply chain disruptions like those that occurred after the recent earthquake and tsunami in Japan.

Like most innovations, captives were created to solve a problem. And they will continue to evolve and proliferate to address the growing need for alternative risk transfer.

Contact: *jwojcik@businessinsurance.com*

PUBLISHED AT 360 N. Michigan Ave., Chicago, Ill. 60601-3806, Fax: 312-280-3174, *biweb@crain.com*. Offices: 711 Third Ave., New York, N.Y. 10017-5806, Fax: 212-210-0704; Suite 814, National Press Building, Washington, D.C. 20045-1801, Fax: 202-638-3155; 6500 Wilshire Blvd., Suite 2300, Los Angeles, Calif. 90048-4947, Fax: 323-655-8157; 967 Bermuda Court, Sunnyvale, Calif. 94086-6750, Fax: 408-774-1155; 21 St. Thomas St., London SE1 9RY, U.K. Fax: +44-(0)20-7457-1440; Fax: 312 280-3174. 77 Franklin St., Suite 809, Boston, Mass. 02110-1510; Fax: 212-210-0704. $5 a copy and $97 a year in the U.S., $130 in Canada and Mexico (includes GST). All other countries, $230 a year (includes expedited air delivery). **FOR SUBSCRIPTION INFORMATION** and delivery concerns please email *customerservice@businessinsurance.com* or call 1-877-812-1587 (in the U.S. and Canada) or 1-313-446-0450 (all other locations.) Send subscription correspondence to Audience Development Department, *Business Insurance*, 360 N. Michigan Ave., Chicago, IL 60601-3806. Microfilm copies available: University Microfilms, 300 Zeeb Road, Ann Arbor, Mich. 48013. Microfiche copies: Bell & Howell, Micro Photo Division, Old Mansfield Road, Wooster, Ohio 44691. Portions of the editorial content of this issue are available for reprint or reproduction in other media. **FOR REPRINTS** or reprint permission, please contact Lauren Melesio/Crain Communications at 212-210-0707 or e-mail *BusinessInsurance@reprints.crain.com*.

Perspectives

SELF-INSURANCE DOES NOT MEAN unlimited liability when it comes to employee benefits, says Craig I. Hasday, president of New York-based employee benefits consultant and broker Frenkel Benefits L.L.C. While stop-loss coverage seldom is used by the largest self-insured employers, it can be an effective strategy for middle-market employers that do not have the financial resources to withstand large claims. Understanding self-insurance and the issues associated with stop-loss coverage can be a powerful tool to take back control of this important expense, he says.

Stop-loss cover provides a tool to take control of benefit costs

By Craig I. Hasday

Self-insuring is a method to fund employee benefits where the employer pays the insurer an administration fee to process claims and use their provider network to access discounts.

However, self-insurance does not mean unlimited liability. To protect against catastrophic losses, the employer can purchase stop-loss insurance to protect against having to pay large claims on any one plan member as well as total claims for the entire group.

While stop-loss coverage is a strategy seldom used by jumbo self-funded employers, it is one that can be effective for midsize employers that do not have the financial wherewithal to withstand large claims.

Stop-loss insurance is a contract between the employer and the insurer to cover costs that exceed those expected at the beginning of the plan year. It is critically important that the terms of the stop-loss agreement be aligned with the underlying employee benefit plans or gaps can result.

There are two types of stop-loss insurance coverage: individual, or "specific" stop-loss, which is designed to protect against the risk that any one plan member's costs will exceed the preselected per-claimant limit; and aggregate stop-loss, which limits a self-funded employer's total claims liability in a plan year to a projected amount plus a margin typically set at 25% of the total expected liability.

A contract can be written on a "prefunding" basis or a "fund-and-refund" basis. A prefunding basis means that once claims exceed the threshold, the insurer begins to pay claims. A fund-and-refund approach to stop-loss coverage requires the employer to first pay the claims and then seek recovery from the insurer.

Stop-loss insurers require information concerning potential high-cost claimants during the initial application period and at renewal. Contracts are rigidly enforced, and insurers can require extensive audits when a claim is presented.

Stop-loss insurers require information concerning potential high-cost claimants during the initial application period and at renewal. Contracts are rigidly enforced, and insurers can require extensive audits when a claim is presented.

In a typical stop-loss relationship with a national insurer, the carrier acts as the claims administrator and reinsurer for large claims. This mitigates potential disputes and provides seamless reimbursement in the event of a large claim.

Stop-loss is purchased on a per-employee basis, regardless of how many dependents are enrolled in the plan, costing between $80 and $100 per employee per month for a midsize group. This compares with

Mr. Hasday

fully insured premiums of $425 for single coverage and $1,000 for family coverage.

Because the Patient Protection and Affordable Care Act has removed maximum lifetime limits and is gradually lifting annual coverage limits over time before they are eliminated in 2014, individual and aggregate stop-loss contract limits also should be unlimited to provide coverage alignment. This year, employers can set annual coverage limits at $750,000. Those limits grow to $1.25 million in 2012 and $2 million in 2013 and are eliminated entirely beginning in 2014.

Aggregate stop-loss

While unlimited individual stop-loss coverage is readily available from insurers, aggregate stop-loss is often quoted with annual limits as low as $1 million, which can cause a significant coverage gap for a self-funded employer.

Another critical issue in purchasing stop-loss coverage is the period during which claims are incurred and the period during which they are paid. There is a lag between the time when services are performed (the incurred date) and the actual payment for these services. This lag typically is two months, but it can be reduced by automatic adjudication initiatives and capitated arrangements, in which medical providers are paid monthly stipends for covering plan members, regardless of the amount and cost of services rendered.

More commonly found contracts terms include:

- 12/12, which covers claims incurred during the 12 policy months and paid during that period;
- 12/15, which covers claims incurred during the 12 policy months and paid up to 15 months later. This also is called "run-out" protection; and
- Paid, which covers claims incurred at any time and paid during the policy year.

In the first year of a contract, individual stop-loss coverage can be written on an immature (12/12) basis; however, aggregate stop-loss usually includes run-out protection (12/15). This will result in lower first-year stop-loss premiums for the employer because there is a lag in paying claims that results in about 10 months of claims being paid in the first year. This lower cost for the employer would be made up in the second policy year, when a full 12 months of claims would be paid.

Significant increases and decreases in employee head counts affect the cost of aggregate stop-loss coverage. Such contracts usually include a provision that sets the overall claims trigger to the monthly claims factor based upon the head count at the beginning of the contract. So when there is a significant decline in the number of people covered, the aggregate attachment point can be much higher than had been expected when the stop-loss contract was signed.

When plan members are added during the year, however, the stop-loss cost usually is not adjusted because claims for these added lives would be considered immature.

In underwriting stop-loss insurance, an insurance company will request a disclosure of large claims prior to the start of the first and subsequent plan years. This disclosure must be completely accurate because inaccurate or incomplete disclosure can result in claim denial.

Perhaps the biggest risk faced is not in the year of transition, but during subsequent years in which a large claim may be identified at the time of underwriting the next year's coverage. Emerging or evolving claims can significantly affect pricing of a stop-loss renewal.

In addition, known claims can be "lasered," which means that a higher stop-loss threshold may be set for that individual or any claims related to that individual could be excluded entirely from stop-loss coverage.

Build a cushion

Self-insurance clearly is not for everyone.

Middle-market companies should consider establishing reserves based on the aggregate stop-loss attachment point plus estimated claims so they can begin to build a cushion against the inevitable bad plan year. Budgeting at the minimum expected cost is a recipe for disaster. Smaller companies have greater volatility and therefore need larger cushions against adverse experience.

Expect monthly variance in claims payments and budget accordingly. Fortunately, some insurers have responded to this volatility for middle-market customers by offering "level-funding" products with a fixed monthly payment and an annual settlement if there is a surplus at the end of the policy year.

Taking the time to understand self-insurance and the potential issues associated with stop-loss coverage can be a powerful tool in taking back control of this important expense. Working with a qualified adviser to help in evaluating this decision is a great first step in determining whether this risk is one the organization wants to and is able to absorb. Stop-loss coverage helps midsize firms cope with liability.

Craig I. Hasday is president of New York-based employee benefits consultant and broker Frenkel Benefits L.L.C., a division of Frenkel & Co. Inc. He can be reached at 212-488-0274 or via email at chasday@frenkel.com.

REUTERS

Some energy reinsurance prices have jumped due to losses related to the catastrophe at the Fukushima nuclear power plant in Japan.

CAPTIVES

Soft market limits attraction of direct access to reinsurance

By SONJA RYST

Captive owners still gain financial advantages from using the alternative risk vehicles to directly access the reinsurance market, but the benefits have diminished.

With a soft market for most lines of coverage, policyholders can obtain attractive rates directly from commercial insurers and don't need to route the risks through a captive to obtain the cheaper rates that historically have been available from reinsurance companies.

And for the few coverage lines where rates are hardening, such as some energy risks, reinsurance costs have risen and capacity has contracted, experts say.

Companies previously obtained significant savings by using captives to tap reinsurance capacity. Reinsurers traditionally provide significant amounts of capacity to insurers so, by accessing that capacity directly, captive owners were able to create efficiencies.

But that benefit is less pronounced, as primary insurers are offering such cheap rates for most forms of property/casualty insurance that accessing reinsurance directly offers little in the way of savings.

"You used to save a lot of money accessing reinsurance (with a captive), but you have such a soft market now that sometimes it's not cheaper," said Gary Osborne, president of the captive manager USA Risk Group Inc. in Montpelier, Vt.

In the end, what a captive will get in tapping the reinsurance market depends on the specific circumstances. "None of our clients are the same," said James Murray, a director of captive and insurance management at Aon Global Risk Consulting in Burlington, Vt., a unit of Chicago-based Aon Corp. "We don't have a cookie-cutter approach."

The benefits of using reinsurance range from a captive's loss experience to the appetite of reinsurers for taking on a risk, he said.

Not all reinsurers are interested in captive business.

"The reinsurance market for captives is smaller than the ones for insurers," said Michael O'Malley, managing director of consulting in Concord, Mass., at the captive management firm Strategic Risk Solutions Inc.

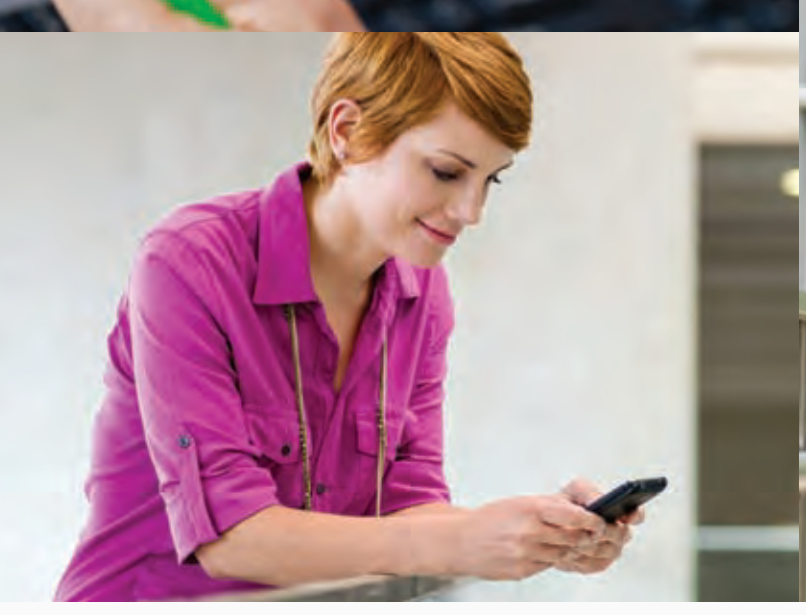
Though, according to Mr. Osborne, "Almost every reinsurer will entertain a captive proposal that's large enough. Few will say point blank that they won't deal with a captive."

In some cases, captive owners continue to find better prices from reinsurers. For example, Mr. Osborne said he put together a captive for a shopping mall operator within the past six months. The company was located in an area that had experienced hurricanes previously, so coverage was not easy for it to find. But the shopping mall operator obtained roughly $150 million of coverage on its windstorm risks from reinsurers for the same price it would have gotten around $100 million from insurers, Mr. Osborne said.

"It's not that it's not worth it to get it; it's just that the insurance market is relatively soft at the moment, so it's relatively easy in most of the general lines (of

See **REINSURANCE** page 22

Smarter is doubling the likelihood your employees will take charge of their health.



Aetna gets your employees more involved in their health and savings. With Aetna, employees are 2x more likely to actively plan for health and consider their options, helping you manage your bottom line without sacrificing quality care.

- Proven record of short-term and sustainable savings.
- Decrease overall medical costs by 7% and prescription costs by 14%.
- Proven savings of more than $400 per member per year.
- 10% fewer non-routine physician visits. 5% less non-urgent ER visits.[1]

See the proof and the savings at smarteris.aetna.com/cdhp, or just scan the code.

[1]Aetna HealthFund® Seventh Annual Study Results, released December 2010.

REINSURANCE

Structured programs avoid pitfalls of finite reinsurance

Multi-year deals include degree of risk sharing

By MICHAEL BRADFORD

Finite reinsurance deals, tarred by scandal and regulatory suspicion, have been replaced by "structured" transactions that put to rest any doubt whether there is a genuine transfer of risk while providing a multiyear alternative to traditional reinsurance.

While finite reinsurance managed loss volatility after it took off in the late 1980s, concerns grew that it was more of a loan, with critics alleging it was being used to hide the true condition of insurers.

A Financial Accounting Standards Board ruling in 1993 that there must be a reasonable chance of a significant loss for a transaction to be accounted for as insurance led the market to develop the "10/10" rule, whereby a transaction was considered insurance if there was at least a 10% chance of a 10% loss.

The image of finite reinsurance was stained in 2008 when investigations by then-New York Attorney General Eliot Spitzer and others into finite deals led to the convictions of several former executives at Stamford, Conn.-based General Reinsurance Corp. and New York-based American International Group Inc.

"Finite came under a lot of pressure in the Spitzer years," said Mike Schnur, Chicago-based partner with TigerRisk Partners L.L.C.

AP PHOTO

The image of finite reinsurance was stained in 2008 when investigations by Eliot Spitzer and others into finite deals led to the convictions of former executives at American International Group Inc. and General Reinsurance Corp. A new trial recently was ordered in the case.

Last month, however, a three-judge panel of the 2nd U.S. Circuit Court of Appeals in New York overturned their convictions in the 2008 case and ordered a new trial, ruling in part that the jury was instructed improperly.

Even if the defendants' names are cleared eventually, the damage to the reputation of finite reinsurance is done, with various forms of structured reinsurance now taking its place.

Even so, there is no firm definition as to what constitutes a structured reinsurance transaction, sources noted.

"My definition is: products where there is a degree of risk-sharing between the parties," said Ed Hochberg, Philadelphia-based executive vp and global product leader of risk transfer products and analytics at Towers Watson & Co. "That is a good way of looking at it, but there are many variations on the theme from there."

"What is meant by structured is structured over time," said Donald A. Paterson, CEO of Paterson[2], a Westlake Village, Calif., firm that develops alternative risk transfer programs. The transactions typically are for longer than a year and involve some sharing of risk among the parties, he said.

Depending on loss activity, return premiums may be paid by reinsurers to insurers under structured reinsurance deals or, if losses are heavy, the insurer could be forced to make additional payments to the reinsurer, Mr. Paterson said.

"I would call it alternative reinsurance," he said of the deals being put together today. "It's reinsurance that's not traditional."

Whatever the name, the rationale for today's deals—and the clear disclosure of risk transfer—differs from that used in developing finite reinsurance products, Mr. Hochberg said.

"What we used to see 10 or 15 years ago," he said, were deals "with an awfully significant element of discounting loss reserves. A lot of that has gone away. That element of the deal is much less significant than it was." The aim of some finite transactions was to "achieve an accounting result, whether it was the movement of a result from one year to another, or whatever the objective was."

Today's deals by comparison are more "capital-oriented," Mr. Hochberg said. "They are designed to truly transfer risk in a way that is comfortable for all parties…When we do a structured deal these days, there's not a question of, 'Where's the risk transfer?' The risk transfer is very obvious."

Finite reinsurance truly began to vanish when a soft insurance market began hardening in 2001, said Dan Malloy, executive managing director at Aon Corp.'s Aon Benfield reinsurance intermediary unit in New York.

See **STRUCTURED** page 22

THIS IS WHERE EXTRAORDINARY THINKING GETS REAL

There is a space between the moment ideas are born, and when they become a reality.

This is where we live, and where we bring our knowledge and insights to bear.

Developing strategies that help clients optimize opportunities, manage their capital needs and risks,

and deliver tangible business results. Never forgetting that our clients' success comes first.

We are Guy Carpenter. **guycarp.com**

MARSH & McLENNAN COMPANIES℠

Partnering for impact™

GUY CARPENTER

Guy Carpenter is one of the Marsh & McLennan Companies, together with Marsh, Mercer, and Oliver Wyman.

RISK RETENTION GROUPS

RRGs still thriving 25 years after law's passage

Alternative vehicles provide affordable, stable coverage

By JERRY GEISEL

WASHINGTON—Passage of the Liability Risk Retention Act 25 years ago unlocked the potential of risk retention groups to provide a highly efficient way for organizations to band together to form group captives.

When Congress passed the LRRA in October 1986, it was the second time lawmakers approved RRG legislation.

Five years earlier, lawmakers approved the Product Liability Risk Retention Act to establish the special group captives that—under a pre-emption provision in the law—can write policies for member-owners nationwide after meeting the licensing requirements of the RRG's domicile.

The pre-emption provision was a major change from prior law in which a captive had to meet the licensing and capitalization requirements of every state in which it wanted to do business.

Some state mandates, such as requiring an insurer to be in business for a certain number of years before it could conduct business in the state, made it virtually impossible for group captives to be set up quickly and do business in multiple states, said Jon Harkavy, vp and general counsel in Washington with RRG and captive manager Risk Services L.L.C.

But the law was a dud. According to a 1986 General Accounting Office report, only one RRG, sponsored by homebuilders, was licensed in the United States under the 1986 law and that RRG soon found itself locked in a legal battle with a state regulator on the group's authority to write coverage.

Settling such regulatory disputes is the focus of the latest RRG legislative efforts, but is one that even backers doubt will win congressional backing (see story, page 15).

The impact of the 1986 law was dramatically different than the 1981 law. Within one year of the passage, 38 RRGs had been established, according to the Risk Retention Reporter, a Pasadena, Calif.-based monthly newsletter that tracks the industry.

Today, more than 250 RRGs are in operation (see chart, page 15), generating nearly $2.5 billion in premium volume, according to the RRR (see chart, page 16). In all, nearly 15% of all U.S. captives are RRGs, according to *Business Insurance* data.

"The law has been an incredible success," said Ed Precourt, senior vp at Marsh Captive Solutions in Burlington, Vt.

The LRRA "has provided numerous industries with stable and affordable coverage when the traditional market could not or would not," said Michael J. Bemi, president in Lisle, Ill., of The National Catholic Risk Retention Group Inc., a Vermont-based RRG.

The reason for the 1986 law's success is simple vs. the 1981 law, which was a delayed congressional response to soaring product liability insurance rates in the 1970s: While the 1981 law limited RRGs' underwriting authority to product liability and completed operations, the 1986 law had no such restriction.

Under the 1986 law, Congress gave RRGs the authority to write all commercial casualty coverage except workers compensation. That opened the door for RRGs to write policies in numerous lines of coverage—most notably medical malpractice and professional liability, where buyers were looking for alternatives to the traditional market's wide swings in rates and available limits.

"We didn't any longer want to ride the market's ups and downs. We wanted stability," said Janice Abraham, president and CEO in Chevy Chase, Md., of Vermont-domiciled United Educators Insurance, a Reciprocal Risk Retention Group, which was licensed about six months after passage of the LRRA.

Industries that have set up RRGs and the lines of coverage written are diverse. Architects, attorneys, builders, chemical manufacturers, engineers, hospitals and nonprofit organizations are just a few of the industry sectors whose members have set up RRGs.

The risks covered by the groups are equally diverse and include

See **RRGs** page 16

Legislation would expand risks covered

By JERRY GEISEL

WASHINGTON—The risk retention group industry is rallying around legislation that would expand the groups' underwriting authority and provide a new way to settle pre-emption disputes with state insurance regulators, but even backers concede that the odds of passage are slim.

The measure, H.R. 2126, introduced in June by Rep. John Campbell, R-Calif., would allow RRGs to provide property coverage to their member-owners. Under current law, RRGs can write all lines of commercial casualty coverage except workers compensation.

In addition, in disputes between the groups and state regulators involving whether the Liability Risk Retention Act pre-empts a state action, RRGs and/or state regulators could ask the director of the Federal Insurance Office to resolve the dispute.

Either party could seek a review of the federal insurance office director's ruling by the U.S. Circuit Court of Appeals for the District of Columbia.

RRG backers welcomed the legislation, especially the dispute mechanism, which could settle disagreements quickly with far less cost than litigation.

"You need some kind of oversight or dispute resolution so you don't fight the same issues over and over again," said Gary Osborne, president of captive and RRG manager USA Risk Group Inc. in Montpelier, Vt.

"There is a ton of industry support for something like this. RRGs are wasting time and money—which could be better used for risk control and claims management—fighting regulators" who are taking incorrect positions, said Michael Bemi, president in Lisle, Ill., of The National Catholic Risk Retention Group Inc., a Vermont-domiciled RRG.

But broad congressional support for the proposal has yet to develop.

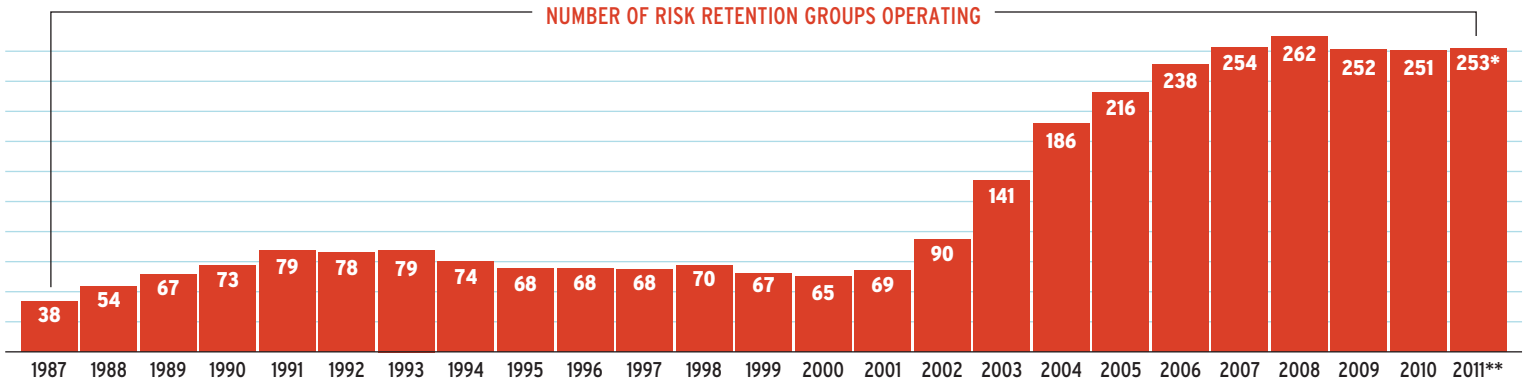
So far, Rep. Campbell's bill has attracted only one co-sponsor, Rep. Peter Welch, D-Vt., while a Senate companion bill to be proposed by Sen. Jon Tester, D-Mont., has yet to be introduced.

That lack of broad support contrasts sharply with

See **LEGISLATION** next page

GROWTH SPURTS

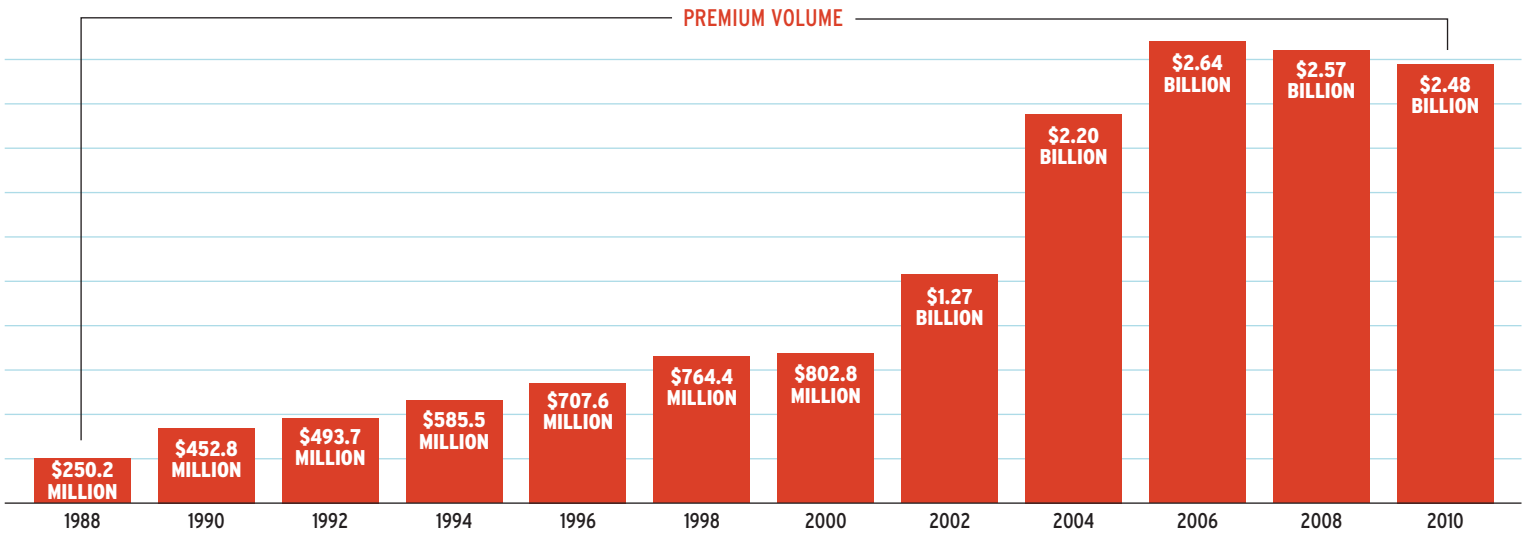
*The number of risk retention groups surged after passage of the Liability Risk Retention Act and during the last hard market.**



* At year-end. **At mid-August
Source: Risk Retention Reporter

A GROWING BUSINESS

Risk retention groups' premium volume has dipped in recent years due to the soft commercial market, but is significantly higher compared with the first few years after the passage of the Liability Risk Retention Act.



Source: Risk Retention Reporter

RRGs: Alternative vehicles still thriving 25 years later

CONTINUED FROM PAGE 14

virtually every casualty line—even medical stop-loss coverage.

While diverse by industry and coverage written, what many RRGs have in common is an underwriting philosophy in which premiums are tied closely to the risk covered and do not leap or plummet depending on competition.

"We have offered 23 years of affordable, stable and high-quality coverage. We have provided stability and predictability of premiums, with no spiking, unlike the traditional market," Mr. Bemi said.

In many cases, RRGs also provide risk management and loss control services that their members, especially smaller firms, could not obtain in the traditional market, said Gary Osborne, president of USA Risk Group Inc., a Montpelier, Vt.-based captive manager.

"We have two attorneys on staff to answer employment-related questions and we also provide unlimited in-person and online driver training as well as a series of about a dozen webinars each year. All of these services, and several others, are completely free for member-insureds," said Pamela Davis, president and CEO of the Vermont-domiciled Alliance of Nonprofits for Insurance, Risk Retention Group in Santa Cruz, Calif.

At the same time, RRG executives say the groups continually try to update coverage to reflect new exposures.

For example, Ms. Davis said ANI has enhanced policies in numerous ways, including adding interns and students in training to the definition of insured for sexual abuse coverage. That is because they are neither employees nor volunteers since they at times are paid a stipend, putting them into a gray area of coverage, she said. Other ANI enhancements include coverage for cyber liability and reimbursement of wages when an employee is put on leave during a professional liability investigation.

The biggest endorsement of how RRGs operate is reflected in their growth.

At the end of its first year in 1987, United Educators, whose policyholders include colleges, universities, independent schools, public school districts, public school insurance pools and museums, generated about $7 million in premium volume with about 100 members. Now the RRG provides coverage to nearly 1,200 policyholders with a premium volume of about $140 million, Ms. Abraham said.

At the same time, some RRGs report annual policyholder retention rates that would be the envy of any insurer. For example, ANI has enjoyed a retention rate of just over 96%, while National Catholic Risk Retention Group has a 99.1% retention rate, Mr. Bemi said.

However, not all RRGs have met with success.

In fact, citing information it obtained from the National Assn. of Insurance Commissioners, the GAO in a 2005 report said 22 RRGs failed between 1987 and 2003, with a somewhat higher failure rate when compared with other property/casualty insurers. Still, a comparison between RRGs and other insurers may not be entirely parallel, the GAO said, because the NAIC analysis did not adjust for size and longevity among other factors.

In all, the GAO said, RRGs have "had a small but important effect" on increasing the availability and affordability of coverage, especially for organizations with limited access to liability insurance.

Legislation: Expansion

CONTINUED FROM PREVIOUS PAGE

the last time lawmakers considered amending the law. In 1986, the Senate Commerce Committee passed a bill, which later became the LRRA, within two weeks of its introduction. Final congressional passage came seven months later amid dramatic rate increases in many casualty lines.

Backers said there is congressional support for the Campbell measure, but it hasn't gained traction due to other, more pressing issues.

"Candidly, Congress is focused on some extremely important issues and, due to that, issues of lesser importance won't get that much attention, no matter how meritorious," said Robert H. Myers Jr., general counsel for the National Risk Retention Assn. and a partner with the law firm Morris, Manning & Martin L.L.P. in Washington.

Battles with state regulators continue, though disputes are fewer in number compared with previous years, some said.

"There have been a lot of disputes, but over the years there has been more acceptance (by state regulators) of RRGs," said Nancy Gray, regional managing director-Americas with Aon Insurance Managers in Burlington, Vt.

The most recent dispute—like many before it—involves how much authority state regulators have over RRGs that are licensed in other states. Nevada regulators last year issued an order to bar Alliance of Nonprofits for Insurance, Risk Retention Group, a large Vermont-domiciled RRG, to stop writing first-dollar auto liability coverage for its Nevada policyholders.

Nevada regulators said such coverage must be written by authorized insurers. To be authorized, an insurer must be a member of state guaranty association. However, RRGs cannot be members of guaranty associations under LRRA.

ANI, which challenged the order, said in a court filing that the LRRA specifically pre-empts any state laws that discriminate against RRGs. But Nevada regulators say there is a special carve-out from the LRRA pre-emption provisions for state-mandated coverage.

In July, a federal judge ruled in favor of ANI, saying that LRRA pre-empted the Nevada requirement. His order requires Nevada to recognize that the term "authorized insurer" includes RRGs, such as ANI.

Nevada insurance regulators, though, are appealing the ruling.

WORKERS COMPENSATION

Firmer workers comp rates may lead to more captives

But costs, benefits must be weighed before formation

By ROBERTO CENICEROS

Anticipating firming insurance prices, experts say more risk managers are considering or adopting alternative risk strategies that include forming a captive insurer.

Putting a company's workers compensation risks into a captive typically is among the top reasons for moving to a captive arrangement—aside from the tax advantages and other benefits a company-owned insurer may provide. However, forming a captive may not be the right strategy for all employers, and the costs can outweigh the benefits.

Workers comp, general liability and auto liability typically are the top three risks covered by a captive. Workers comp is favored because of the line's premium volume, the long-tail nature of its claims and the relative ease in evaluating the exposure statistically, consultants say.

Natural fit

"Workers comp for a lot of organizations is really the big nut in terms of premium volume," said Jim Swanke, director of risk consulting for Towers Watson & Co. in Minneapolis. "If you are going to be doing anything in your captive, you are going to be focusing on the largest-size premiums and the premiums that have the longer tails in terms of payouts. Workers compensation by definition falls into that category."

Sean B. Rider, managing director of sales and consulting for Willis Group Holdings P.L.C.'s global captive practice in New York, agreed.

"For U.S.-based firms, workers compensation is one of first places people go for captive utilization," Mr. Rider said. "Because workers comp in particular is long-tail business, it has a lot of transaction activity; and with enough size and scale, it can be very credible statistically so you can have a lot of rationality around the use of a captive for workers compensation."

While the workers comp insurance market remains competitive, it appears to be transitioning from recent years' soft pricing and is driving discussions on stabilizing costs, said Robert Hessel, senior managing director for large risk casualty in the Atlanta office of Beecher Carlson Holdings Inc.

"The consensus is we are in a market that is trying to change. Comp is getting a bit more difficult and so people are perhaps more sensitive to alternatives today than they were a year or two ago," Mr. Hessel said. "Because the market has been so soft, the tendency has been to lower retentions and purchase more coverage; but to the extent that changes, people will adjust."

Captives are just one option for employers seeking to retain more risk, said Ellyn Casazza, senior vp in Atlanta for Marsh Inc.'s captives solutions group.

But current market conditions are leading employers to weigh increasing their retention and, in doing so, some are evaluating whether a captive may be their best option for assuming additional risk, she said.

Some employers are more concerned about the firming of insurance pricing for risks other than workers comp, Mr. Rider said. Cost increases for product and professional liability insurance may be a greater concern.

But even employers considering putting their professional and product liability risks in a captive likely will want to put their workers comp risks in the facility because the line's statistical reliability provides a "nice stable base" for a captive, Mr. Rider said.

The decision of whether to launch a captive typically should

See COMP next page

ADVERTISER INDEX

Issue of September 5

ILWs: Disasters boost pricing and interest

CONTINUED FROM PAGE 3

Management Solutions Inc. U.S. hurricane model, and supply and demand all served to push up pricing, he said.

Mr. Nicolini said that he did not do any ILW trades as a result of Irene. "If the losses would have been bigger, I think there would have been a lot more activity," he said. Assessments of the extent of losses related to the hurricane are still under way, he said.

"If Irene had made landfall as a Category 2, it would have had more losses and we would have seen a peak in the ILW market" as happened earlier this year, he said.

"There's certainly been a lot of activity" this year, said Guy Hengesbaugh, executive vp with Towers Watson & Co. in Hamilton, Bermuda.

He pointed out two types of deals: One is "cold-spot" earthquake cover, which means non-Japan and non-U.S. earthquake cover. "Several of those deals were sold at the beginning of the year," he said. "Some have been hit by the New Zealand quake."

"The earthquakes in New Zealand and Japan have triggered ILWs," said Willis Re's Mr. Kingham. He pointed out that interest in this cover increased after last year's earthquake in Chile.

"The earthquakes in New Zealand and Japan have caused some of these covers to be impacted," he said. "Pricing has increased significantly in the nonpeak earthquake—in some instances north of 100% for nonpeak earthquake ILWs."

Mr. Hengesbaugh also cited worldwide aggregate structures as an example of ILWs. Those structures cover multiple events on a worldwide basis.

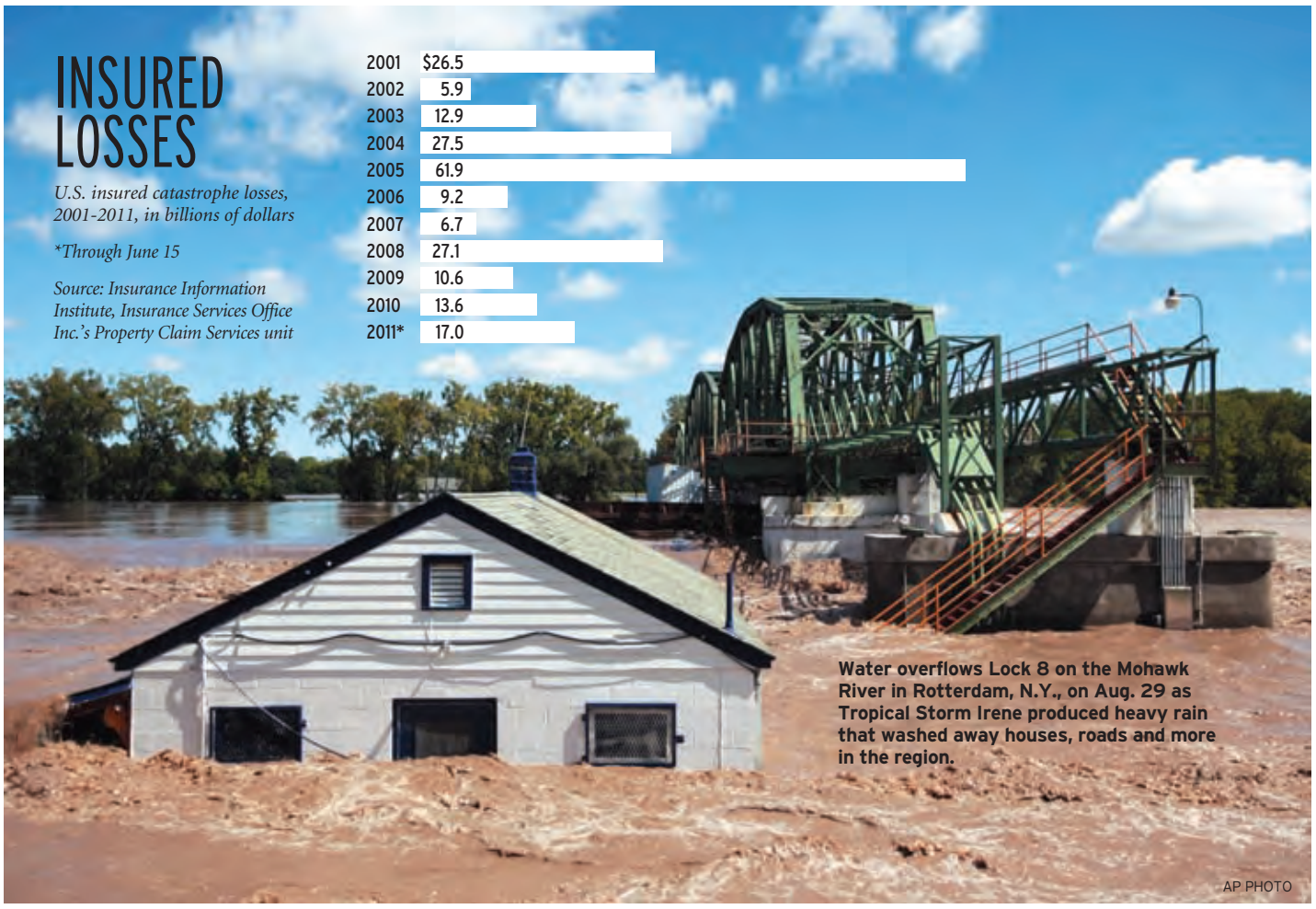
"Typically, you have an overall limit that needs to be hit that's made up of a basket of catastrophes that have to occur," he said. During the first half of the year "we've had multiple worldwide catastrophes, and ultimately those trigger the aggregate ILW covers that were written at the beginning of the year."

Mr. Hengesbaugh said that while the pricing has drastically increased, it's still in the range that attracts buyers.

"The ILW market is a very reactive market, and pricing has most definitely hardened in those territories affected by the recent losses—in some cases up to 100%," Barry Law, head of Guy Carpenter & Co. L.L.C.'s ILW practice in London, said in an email.

"We also saw some peril-related increases in other territories such as earthquake coverages for the U.S. As far as structure is concerned, the losses have affected the relative attachment points of specific trades, and there has been more demand for the loss-affected areas—mainly because the covers had not traded to any great extent before the spate of losses," Mr. Law said.

Associate Editor Sonja Ryst contributed to this report.



Water overflows Lock 8 on the Mohawk River in Rotterdam, N.Y., on Aug. 29 as Tropical Storm Irene produced heavy rain that washed away houses, roads and more in the region.

AP PHOTO

Comp: Long-tail nature well-suited to captives

CONTINUED FROM PREVIOUS PAGE

be based on the size of a company's projected losses rather than its revenue, consultants said.

"We use (projected losses within a year) as a benchmark to determine if a captive is potentially going to add significant tax advantages to outweigh the costs to run the captive," Ms. Casazza said.

That usually means a company must expect about $3 million in retained loss costs per underwriting year, she said.

The decision of how much risk to retain, however, must be decided separately, before determining whether the parent company will pay the retention or whether it will be financed through a captive, Ms. Casazza said.

Loss history, financial capacity to bear risks and commercial insurance market conditions should help determine the amount of risk to retain.

While $3 million in retained losses is an average benchmark for considering a single-parent captive, losses of as little as $250,000 may be appropriate for group or association captives or 831(b) captives, Mr. Ridder said.

An 831(b) captive, established under Internal Revenue Code Section 831(b), allows insurance companies with less than $1.2 million in annual premiums to elect to be taxed by the federal government only on their investment income.

One benefit of operating a captive is that upper management is likely to support safety and risk management department efforts to reduce losses and enhance the financial benefits of a captive insurer, the consultants said.

Companies also form captives, in part, to help them take greater control over their risks and risk costs, Towers Watson's Mr. Swanke added. "Control is right up there as one of the (top) reasons—and to be less reliant on the commercial insurance marketplace and (insurance) cycles."

But the real economic benefit of a captive derives from potential tax advantages, Marsh's Ms. Casazza said.

Under a typical insurance program, income tax deductions for claims are derived over time as claims expenses are paid, the consultants said. Because of the long-tail nature of workers comp claims, deductions might be taken over years while reserves sit in the employer's balance sheet.

But a captive allows its owner to accelerate tax deductions. The entire amount of projected claims costs can be taken immediately as a tax deduction when funding is put into the captive for a claim. Meanwhile, the money placed in the captive to cover future claims expenses can be invested.

Yet companies weighing alternatives of taking on more risks need to be careful because captives can increase costs rather than reduce them, Mr. Hessel said.

"You have to consider administrative costs of the captive and, depending on how you structure the captive, your frictional costs can be higher than under a qualified self-insurance program or a deductible program," he said. "You need to give careful consideration to how you structure the program so you don't increase costs unnecessarily."

Frictional costs to consider can include state premium taxes and assessments, which can be less under a fully insured program.

"If you have a lot of exposure in states that have a difficult tax or assessment regime, it can make a huge difference," Mr. Hessel said.

Apart from tax considerations, operational expenses average about $80,000 to $100,000 per year for captive management fees, regulatory fees, audit services and legal advice, Ms. Casazza said.

Weather: Derivatives evolve to mitigate risks

CONTINUED FROM PAGE 4

"Especially in the last two or three years, the market has shown a much greater diversity in its customer base," Mr. Windle said.

In 2004, 69% of all inquiries about weather derivatives were attributed to the energy sector. Last year, that fell to 46%, while 23% of the interest came from construction companies and 12% from the agriculture industry. Companies in the outdoor entertainment industry—such as amusement parks, concert venues and open-air sports stadiums—also have entered the market in recent years, Mr. Windle said.

Weather derivatives also have enjoyed significant market growth outside the United States, particularly in Europe and Asia. Some 63% of last year's 998,000 OTC contracts were written in Europe compared with just 13% in 2005, according to WRMA.

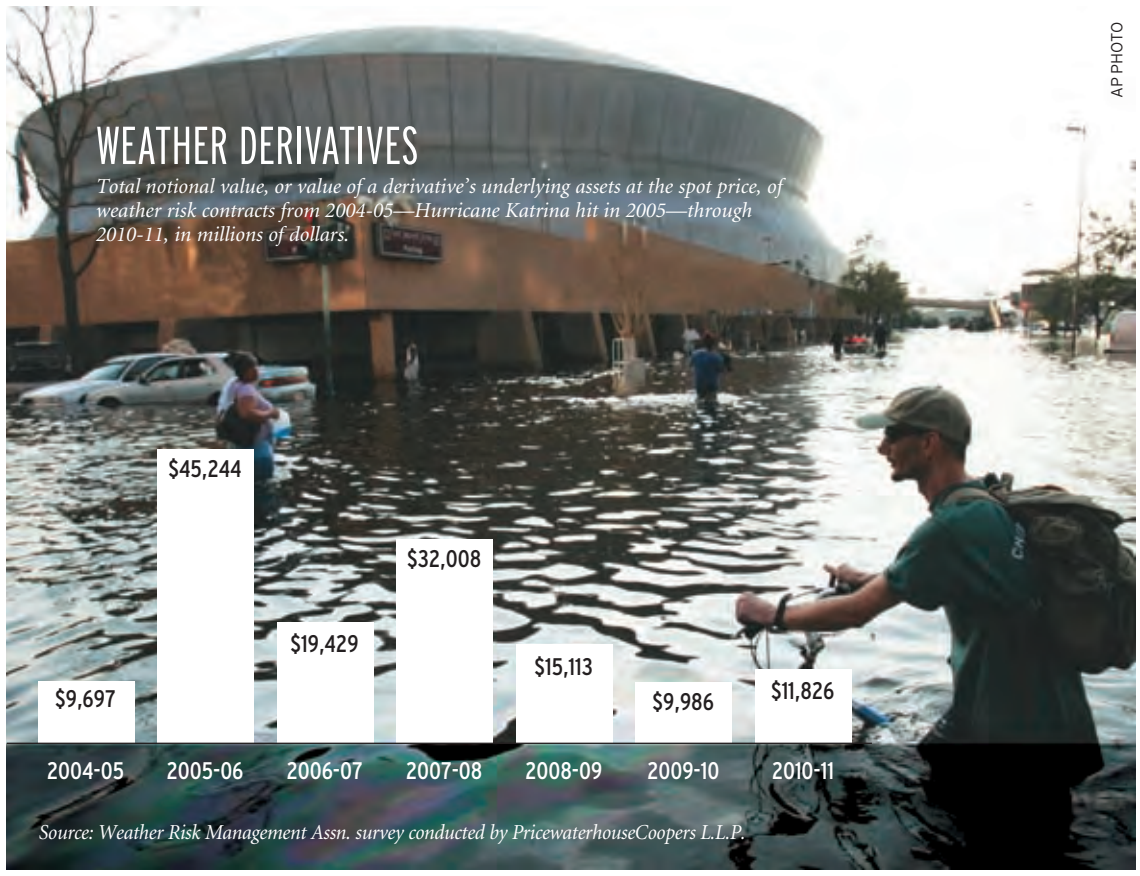
When the CME entered the weather derivatives market in 1999, it had only two product forms for futures and options based on heating and cooling degree days, said Paul Peterson, director of commodity research and product development for CME. Those contracts were solely for energy companies and available in just 10 U.S. cities, he said.

"Today, we're up to 67 different products," Mr. Peterson said. "We're also up to 24 U.S. cities and we have contracts available in 11 other countries, including several European countries, Japan, Canada and Australia."

Looking forward, proponents said there is ample opportunity for growth in the market, primarily in the green energy sector.

Contracts for wind, solar and hydroelectric energy producers are in development, but have yet to be brought to market. Mr. Peterson said the CME is only in the beginning stages of crafting a contract tailored to the green energy sector.

"It's a very complex process, but we're going to keep chipping away at it," Mr. Peterson said. "They're all viable topics, and all very good areas for future work."



AP PHOTO

Cat bonds: Investor demand strong

CONTINUED FROM PAGE 4

in new issuance while the market digested the event and how it played out. But, said Mr. Schultz, "I don't think it changed any of the issuance that was going to come to market."

"What's happened in terms of catastrophic events around the world hasn't really had that much of an impact," he said. "The market does expect to pay losses from time to time."

"Of the outstanding cat bond limit, about $1.5 billion was exposed to Japanese earthquake risk," said GC Securities' Ms. Anger. One issue, Muteki Ltd., paid its full limit of approximately $300 million. That issue provided earthquake coverage to Zenkyoren Ltd., the Japanese National Mutual Insurance Federation of Agricultural Cooperatives, under a deal in which Munich Reinsurance Co. provided reinsurance to the Japanese mutual, then securitized the exposure through the Muteki bonds.

Swiss Re's Mr. Schmutz noted that the Muteki transaction functioned as designed.

"(Investors) took the loss and moved on. We haven't really heard of anyone panicking and leaving the market," he said. "Really it serves as a very nice proof of the product and the concept."

Roger G. Beckwith, vp and secretary of Lane Financial L.L.C. in Chicago, had a similar view of the market's response to the catastrophe in Japan. "Things recovered in a pretty reasonable period of time," he said.

The third factor slowing first-half issuance was the fact that prior to the quake and tsunami in Japan, traditional markets were very aggressive, Mr. Schultz said. "We actually had a couple of bonds that were scheduled to come to market that just went back to the traditional market because it was just more efficient for the clients," he said.

"We still are working through the RMS issue. We think the other ones have been resolved," Mr. Schultz said. "We think we will work through the RMS issue by the end of the year."

'(Investors) took the loss and moved on. We haven't really heard of anyone panicking and leaving the market. Really it serves as a very nice proof of the product and the concept.'

Markus Schmutz,
Swiss Re Capital Markets Corp.

"We started the year with an estimate of $5 billion to $6 billion that was going to come to market. We've sort of revised that to $4 billion to $5 billion," he said.

Investor interest in insurance-linked securities remains strong. "We've seen investor support continue to be robust," Ms. Anger said.

With market proponents regularly citing the uncorrelated nature of cat bonds to other investment instruments, the market might be in a position to benefit from stock market volatility.

"We really have accelerated bringing new investors into the space and it really started after the global financial crisis in 2008," said Mr. Schultz. While most asset classes producing negative returns after the financial crisis, insurance linked-securities produced positive returns, he said.

"The fact that (cat bonds) have shown very little correlation (with other investment risks) makes them an attractive option for many investors," Mr. Schmutz said.

WIth U.S. windstorm risks the most common exposure in the ILS market, there is interest from investors in increasing the diversity of ILS exposures, according to Lane Financial's Mr. Beckwith.

"I think we've seen with recent deals that there's a lot of interest in diversifying ILS," he said. "So things that are non-U.S. wind or non-U.S. are sought after. You've had a pretty good reaction in the market to non-U.S. wind deals."

Recent events could drive the shape of some cat bonds going forward. For example, the frequency and severity of U.S. windstorms and the number of catastrophic events and total losses this year might lead some issuers to look to the cat bond market to cover accumulations of losses.

"(An) area that we're seeing a lot of focus on now from a U.S. perspective is around aggregate structures, which isn't surprising, given that 2011 has been a historically severe year," Ms. Anger said.

Tornado frequency and severity coupled with the Japanese earthquake led to insurance and reinsurance losses, "which aren't negligible," said Mr. Schmutz. That has led some to consider aggregate covers to address the "extraordinary frequency of smaller events," he said.

Ms. Anger noted that supply chain disruptions resulting from the disaster in Japan also have prompted discussions about corporations using the ILS market to address supply chain risks. She cited this year's €150 million ($215.9 million) Pylon II Capital Ltd. European windstorm issue by Paris-based Electricite de France S.A. as a possible model.

"For them, the original catalyst for putting it in place was the loss of income and business interruption from European windstorms," as it could provide property protection, she said. "When we see very significant events that have had an impact on corporations, we do see increased focus on alternative solutions."

CAPTIVES

Supply chain risks pose challenges

Funding through captives seen as an option by some, but benefits seem limited

By MIKE TSIKOUDAKIS

REUTERS

Car manufacturers were confronted with supply chain issues after the earthquake and tsunami in Japan earlier this year. Some companies are considering using captives to cover the risks, but the short-tail nature of supply chain risks limits the appeal of using captives.

Some risk managers and organizations seeking to address their supply chain risks, highlighted by the disaster in Japan, have weighed covering their suppliers through their captive insurer, but few, if any, have taken that approach, experts say.

Competitive pricing for business interruption coverage and a general caution about adding external supplier risks to the company-owned captive have limited the approach's appeal among buyers, they say.

Companies often require outside suppliers to obtain a certificate of insurance with specific limits per the negotiated contract. If the supplier cannot put up the amount of insurance the company wants, the company often buys an excess layer covering the supplier and passes the costs on to the outside provider, observers say.

The recent earthquake and tsunami in Japan and other natural disasters have highlighted this specific exposure that companies face. One way to handle the exposure is placing it in a captive, which brokers say could carry tax advantages as a third-party risk and assist a company's risk management efforts.

"We do bring it up," said Gary Osborne, president of USA Risk Group Inc. in Montpelier, Vt., when company boards inquire about innovative ways to cover suppliers.

"We haven't seen many people using the captive (approach). We've actually had three or four clients buy a policy," said Mr. Osborne, who works mostly with Fortune 2000 to 5000 companies with $1 billion in sales and premiums of $5 million to $8 million.

When the issue is brought up to clients, "quite a few of them have found that the coverages are priced where they didn't want it or they aren't willing to take the risk in the captive," he said.

Many captive managers are finding competitive pricing in the commercial insurance markets for business interruption and supply chain risks, Mr. Osborne said. "They're finding the products (in the commercial market), and they're not particularly comfortable writing it in the captive," he said.

Les Boughner, executive vp and managing director of Willis Group Holdings P.L.C.'s North American captive practice in Burlington, Vt., said companies with captives are more focused on protecting their internal risks.

"The discussions we've had with our clients are much more directed on 'how do we use a captive to protect us from the exposure' than it has been to 'how do we build a business out of it,'" Mr. Boughner said. "If we had an entrepreneurial captive that was really interested in starting to sell this coverage, they'd probably find the rates are so low they weren't interested in it."

Nancy Gray, regional managing director-Americas at Aon Insurance Managers Ltd. in Burlington, said some captives cover a company's internal supply chain risks, but so far there has been mainly discussion of expanding to cover outside suppliers, among other third-party risks such as customer risk and employee benefit programs.

Amid a soft-market insurance cycle, companies during the past five years have been forced to cut captive expenses as much as possible, Ms. Gray said. "Utilizing the captive to become a profit center becomes another source of revenue to companies while also keeping their costs down," she said.

Since the early 1980s, many captive owners have "moved away from writing third-party exposure and focus just on writing their own exposure," Ms. Gray said.

But if captive owners have a good understanding of the exposures related to their suppliers and are confident in underwriting those risks through the captive, they can look "at their captive as a profit center instead of just a cost center," she said.

If a company writes enough third-party business, it qualifies as an insurance company for federal income tax purposes and receives the tax benefits of deducting loss reserves, Ms. Gray said.

"If you're not an insurance company, you only get the tax deduction when the losses are actually paid. So this is an accelerated tax deduction if you can write enough third-party risk in your captive," Ms. Gray said.

Companies also can team with standard insurers to underwrite supply chain risks through their captive, said Steven R. Bauman, senior vp and head of captive services at Zurich Global Corporate, North America, in New York.

The captive would underwrite the risk using Zurich's form and take a retention in their captive or quota share risk with Zurich, or they can take the underlying deductible amount in their captive and Zurich would take the excess layer, Mr. Bauman said.

The customized coverage can cover suppliers several links down the chain, Mr. Bauman said. "We are talking to several people now on the possibilities."

"It gives the assurance to the client that the coverages that are provided to those suppliers or those contractors are to the standards that the client dictates through their captive," Mr. Bauman said.

Risk management strategies often prevail as the preferred approach in dealing with outside suppliers, experts say.

"I'm not sure captives will be a large solution for, in terms of numbers, captives that will be used for the supply chain risk of the suppliers," Aon's Ms. Gray said. "I think there are more opportunities for captives looking at a company's own risk profile. They need to understand the risk themselves."

Supply chain risks are short-tail exposures, said USA Risk Group's Mr. Osborne.

A company affected by the March earthquake and tsunami in Japan likely already has worked its way around the blockage and knows its ultimate loss, Mr. Osborne said. "It's not going to take you six years to figure out what was my actual loss from that supply chain incident. There's not a whole lot of sitting on money for a tax deduction."

Instead, companies are looking at ways to deal with supply chain problems, such as rerouting the supply chain, diversifying their suppliers and moving away from the tight margins that come with just-in-time strategies, Mr. Osborne said.

"I've seen much more standard risk management techniques rather than financing it," Mr. Osborne said. "This is one of those (situations) where, even with my love of captives, I'm not sure the captive brings much to the table," he said.

'This is one of those (situations) where, even with my love of captives, I'm not sure the captive brings much to the table.'

Gary Osborne, president of USA Risk Group Inc.

Business Insurance

Publisher/General Manager, Strategic Business Media: Mark Stach (*Chicago*)

Associate Publisher/ Online General Manager/Event Director: Paul D. Winston (*Chicago*)

Editor: Gavin Souter (*Chicago*)
Editor-at-Large: Jerry Geisel (*Washington*)
Managing Editor: Matt Scroggins (*Chicago*)
Assistant Managing Editors: Charmain Benton (*Chicago*); John D. Thomas (*Chicago*)
Art Editor: William Murphy (*Chicago*)
Senior Editors: Michael Bradford (*Dallas*); Roberto Ceniceros (*Boise*); Judy Greenwald (*San Jose*); Mark A. Hofmann (*Washington*); Sarah Veysey (*London*); Joanne Wojcik (*Denver*); Rodd Zolkos (*Chicago*)
Associate Editors: Matt Dunning (*New York*); Sonja Ryst (*New York*); Mike Tsikoudakis (*Chicago*)
Copy Desk Chief: Katherine Downing (*Chicago*)
Copy Editor: Ann Reus (*Chicago*)
Editorial Assistant: Mallory Gillikin (*Chicago*)
Research Director: Kevin P. Edison (*Chicago*)
Research Editor: Karen Brown Tucker (*Chicago*)
Editorial Cartoonist: Roger Schillerstrom (*Chicago*)

Advertising Sales Director: Susan Stilwill (*Chicago*)
Regional Sales Managers: Ron Kolgraf (*Boston*); Robert B. Murray (*New York*); Mary Pemberton (*Denver*)
Southeast & Classified Advertising Manager: Monique Murray (*New York*)
Production Manager: J. Thomas Janka (*Chicago*)
Assistant to the Publisher: Justine Karl (*Chicago*)

Marketing Manager: Kathy L. Barnes (*Chicago*)
Audience Marketing Director: Michelle O'Malley (*Chicago*)
Events Manager: Rebecca Briggs (*New York*)
Digital Product Manager: Christina Kneitz (*Chicago*)

EDITORIAL: Boise: 208-286-1425; Chicago: 312-649-5200; Dallas: 972-691-7960; Denver: 303-278-7444; London: 44-207-457-1400; New York: 212-210-0100; San Jose: 408-774-1500; Washington: 202-662-7200
ADVERTISING: Boston: 617-292-4856; Chicago: 312-649-5224; Denver 303-898-4043; New York: 212-210-0136
SUBSCRIPTIONS & SINGLE COPY SALES: 1-877-812-1587 (U.S. & Canada) 1-313-446-0450 (All other locations)

Business Insurance is published by Crain Communications Inc.
Chairman: Keith E. Crain
President: Rance Crain
Secretary: Merrilee Crain
Treasurer: Mary Kay Crain
Executive Vice President/Operations: William A. Morrow
Senior Vice President: Gloria Scoby
Vice President/Group Publisher: Christopher Crain
Group Vice President/Technology, Circulation, Manufacturing: Robert C. Adams
Vice President/Production & Manufacturing: Dave Kamis
Chief Information Officer: Paul Dalpiaz
G.D. Crain Jr. Founder (1885-1973)
Mrs. G.D. Crain Jr. Chairman (1911-1996)
S.R. Bernstein Chairman-executive committee (1907-1993)

BPA WORLDWIDE | AMERICAN BUSINESS MEDIA The Association of Business Media Companies

Group captives help firms tackle health benefits funding issues

By JOANNE WOJCIK

Mid-market companies are discovering that group captives can make self-funding employee health benefits a bit less daunting, experts say.

Captives can provide a primary layer of medical stop-loss coverage that would be tapped before traditional stop-loss insurance. Because medical stop-loss coverage purchased at higher attachment points generally is less expensive than that with lower attachment points, it could save the employer money while also providing protection from high-cost claims.

Self-funded employers that use a group captive for primary stop-loss coverage also can avoid "lasering," a practice in which insurers set higher attachment points for certain plan members with costly pre-existing conditions.

"Small employers tend to find that self-funding is more of a risk because of the lasers," said Kenneth R. Olson, president of Horton Benefit Solutions in Chicago. "They can be absolutely devastating for businesses' financial statements. So we've tried to craft the captive concept to provide reinsurance net of stop-loss."

For example, if 10 companies each with 50 to 500 employees form a group captive to provide stop-loss coverage at attachment points up to $500,000, they most likely never will feel the impact of a laser, Mr. Olson said.

"Most lasers come in about $100,000 to $200,000. We almost never hear of a laser above $500,000," he said.

To protect the captive from being hit with a sizable claim that would otherwise be subject to a laser, the captive can purchase disease-specific coverage, said Mr. Olson.

"We require all our members to buy first-dollar transplant coverage," he said. "It is relatively inexpensive. For a group with 100 lives, you might spend less than $10,000 a year."

But the peace of mind it provides to all employers participating in the captive is priceless, Mr. Olson said.

"If you have one transplant in your group, you're looking at several hundred thousand dollars. If this person is put on a transplant waiting list, there is an automatic laser. But with the transplant cover, there is no laser," he said.

"If you take a look at the market, many midsize employers chose not to self-insure because they were concerned about large swings in cost," said Sam Fleet, president of Charlotte, N.C.-based AmWINS Group Inc. "For them to go self-insured, it takes a huge leap of faith. They don't get any data from their carriers," so they don't know how much risk they may be taking on.

But for group captives funding medical stop-loss coverage, "it's a brave new world. It's becoming one of the more popular ways to self-fund health benefits," Mr. Fleet said.

The high cost of health care combined with the federal health care reform law is driving interest among mid-market companies in using captives for health benefits self-funding, said Rick Stasi, chief operating officer of the alternative risk division at Avizent in Dublin, Ohio.

"They say, 'You've done a good job controlling our property/casualty costs, but we're getting clobbered on health insurance,'" he said.

On a related front, some protected cell captives that Avizent manages have been providing stop-loss coverage for about two years, he said. In fact, Avizent itself is a participant, using a captive to fund stop-loss coverage of its self-funded benefits program for less than 1,000 employees, Mr. Stasi said.

> **'Most lasers come in about $100,000 to $200,000. We almost never hear of a laser above $500,000.'**
>
> Kenneth R. Olson, Horton Benefit Solutions

"The captive takes anywhere from $25,000 to $250,000," depending on where the participating employer wants its stop-loss attachment point to be, and New York-based Chartis Inc. picks up any claims above that amount, Mr. Stasi said.

Like group captives that self-insure liability risks, virtually all of these new benefits captives require participating employers to engage in certain loss-control activities, such as health risk assessments and population health management, experts said.

For example, the captive the Horton Group is assembling, which will be managed by Berkley Accident & Health L.L.C., a unit of Greenwich, Conn.-based W.R. Berkley Corp., is requiring that 80% of the employees of participating employers complete a health risk assessment as a condition of remaining in the captive.

Because many participating employers previously did not have an incentive to offer wellness programs because their insurers did not give them credit against their premiums for engaging employees, "it's exciting for us to do population health management for the first time for many of these employers/ groups," Mr. Olson said. "We expect a culture shift."

"The benefit of the captive is not necessarily risk sharing, but health risk management," said Mr. Fleet. "The objective is to become a zero-trend company. You can do that when you have a group of employers together that have the same goal and objectives."

Mid-market: More firms turn to captive insurers

CONTINUED FROM PAGE 6

40% of premiums, after three or four years they decided to set up an 831(b) behind the group captive to provide reinsurance," Mr. Stasi said.

Because many middle-market companies are privately held, some owners are using 831(b) captives for "wealth transfer" and estate planning, said Doug O'Brien, managing director and national casualty and alternative risk practice leader at Wells Fargo Insurance Services USA Inc. in New York.

"The surplus builds up on a tax-beneficial perspective over the years. Then the dividends or capital gains are given to an heir at a more favorable tax rate," he said. "I probably get five calls a week regarding interest in these types of captives."

In the wake of this year's earthquake and tsunami in Japan, Les Boughner, executive vp and managing director of Willis Global Captive Practice in Burlington, Vt., says he is seeing interest among mid-market companies to use captives for supply chain management.

"A captive is nothing more than a financial tool," he said. "I don't know how any company of substance—and that would include most midsize companies—can say they have a full array of financial tools if they don't have a captive."

Funding: Private company takes alternative route

CONTINUED FROM PAGE 6

investment income, he added.

The insurance program financed by Archway actually is reinsurance. The participating members all receive standard $1 million insurance policies from The Hartford Financial Services Group Inc., which then cedes the primary $350,000 layer of each policyholder's coverage to the captive.

The way the excess $650,000 layer is financed depends on reinsurance market conditions, Mr. Kilbane said.

"Either the carrier takes the excess-of-loss layer or we go to the reinsurance market if the Hartford is not interested and see what the reinsurance market quotes for that layer," he said. "Or the Hartford and a reinsurance carrier will do a quota share, which is what Archway is doing now. The excess-of-loss layer is shared 50-50 with ACE Ltd. and the Hartford."

All captive members still pay premiums, which are calculated based on prior loss experience as well as a one-time $36,000 start-up fee, which is used to buy one share of captive ownership. Because captive members are, in effect, shareholders, they don't have insurance contracts per se. But they do have a legal commitment for a minimum of one year and become eligible for dividend payments after three years.

Because Archway is a group captive, most of the risks it finances are unrelated to an individual parent or member company, making premium payments tax-deductible for each company under Internal Revenue Service rules.

Meanwhile, all funds held by the captive are managed by another Captive Resources division: the Captive Investors Fund.

Claims administration and loss-control services for captive members are provided by Gallagher Bassett Services Inc., a unit of Itasca, Ill.-based broker Arthur J. Gallagher & Co., which is paid out of premiums.

Captive Resources also employs loss-control engineers and claims advocates to oversee the third-party administrator.

Mr. Bernstein said he believes if more mid-market business executives were educated about captives, they would want to use them, especially because they can help to smooth the cost of risk financing regardless of insurance market conditions.

"The group has to do well, of course," he said. "But we're insulated from the impact of natural disasters and investment losses on an insurer's financial portfolio. We stand on our own merits."

Structured: New coverage avoids finite's pitfalls

CONTINUED FROM PAGE 12

"People were underreserved" after the soft market years, Mr. Malloy said, "and deals were done to create better results. People opted to buy less expensive finite deals, and some of those ended up going very badly for reinsurers. As the market hardened in 2002 and 2003, buying shifted to deals with more risk transfer with higher margins because the market could support it."

Structured reinsurance arrangements are useful for workers compensation, property/casualty and some property catastrophe exposures "where you aren't transferring the 100-year risk," Mr. Malloy said. "It might be at the bottom of your property catastrophe program."

"Typically, you want good actuarial or modeled data" on risks that have a fairly comfortable range of potential outcomes, he said.

"The motivation of the client is typically something other than the transfer of risk for a price" in a structured reinsurance arrangement, said Mr. Malloy. "They want to retain the economics of the business in some fashion" and the risk- and reward-sharing features let them to do that, he said.

The multiyear aspect of structured reinsurance products also can make them useful for risks that are not as easily modeled, Mr. Paterson said.

The Y2K risk—widely held fears that computers would crash at the turn of the last century—is an example of an exposure with consequences that could have developed over time that would have been suitable for a multiyear risk-sharing arrangement in a structured reinsurance program, Mr. Paterson said.

Sources said structured reinsurance is well-suited as an aggregate stop-loss product. "You take all the risk of a company and put it in one basket," Mr. Paterson said.

Not all markets will write such whole-account coverage, though, because it tends to cannibalize their traditional business, Mr. Paterson said. "There are not many markets doing that."

Because opinions vary on what constitutes a structured reinsurance deal, experts say it is hard to know how much of the coverage is written.

"One man's structured reinsurance deal might be another man's traditional deal with some bells and whistles," said Mr. Malloy.

Before it fell out of favor, finite reinsurance was around 5% to 6% of the reinsurance market, experts said. Structured reinsurance is "certainly no more than that," said Mr. Schnur, and likely far less, other sources said.

Reinsurance: Soft rates limit captives' advantages

CONTINUED FROM PAGE 10

business) for our clients to find the insurance they need," said Jill Husbands, head of office and managing director at Marsh IAS Management Services (Bermuda) Ltd. in Hamilton, which is a unit of the New York-based Marsh Inc.

She said in specialty lines of insurance where the market has hardened a little, some clients need to find capacity from reinsurers. For example, her team has seen "a number of instances" of captives in the energy sector wanting to access the reinsurance market themselves out of the need for additional capacity, she said.

But accessing reinsurance is not always straightforward.

Andrew Baillie, property risk manager for AES Corp. in Arlington, Va., is finding that options are limited for the power company, which faces risks that range from tropical storm damage to gas explosions at its plants.

The company established AES Global Insurance Co. in Burlington, Vt., to insure its assets on a consolidated basis. The captive now carries the first $30 million of AES' risk. To cover its risks beyond that amount, the captive also buys up to $1 billion dollars of additional coverage.

But prices for some energy exposures have increased significantly as a result of losses related to damage to the Fukushima nuclear plant in Japan in March and the BP P.L.C. oil spill in 2010.

"We're finding that there's a limited supply of the coverage we need because we're in a fairly difficult market," Mr. Baillie said. He said the captive provides a wider choice of underwriters from which AES can buy coverage. "Sometimes the opportunities are cheaper, and sometimes they're not, but if you need (coverage) then you're the victim of whatever the pricing will be," he added.

Mr. Baillie said AES is exploring other options for its April renewal.

"The most sophisticated risk management buyers will be continually looking at the market to see what the correct solution is for them," Mr. Baillie said. In some cases, the solution might be to carry more risk in the captive; and in others, the answer might be to move the risk into other places or to use new structures.

"You have to continually look at how (the market) is evolving," Mr. Baillie said.

News In Brief

Cat modelers estimate Hurricane Irene losses

Insured losses from Hurricane Irene, which hit the U.S. East Coast and caused damage from the Caribbean to New England, could be as high as $7.1 billion, AIR Worldwide Corp. said. Meanwhile, EQECAT Inc. put the total at $3.4 billion. Risk Management Solutions Inc. had not announced its estimate late last week.

Marsh to buy broker unit of Alexander Forbes

Marsh & McLennan Cos. Inc.'s Marsh Inc. unit has reached an agreement to acquire the brokerage business of Johannesburg-based Alexander Forbes Ltd. MMC reported brokerage revenue of $10.6 billion in 2010, which made it the world's second-largest brokerage in the *Business Insurance* 2011 ranking. Alexander Forbes reported brokerage revenue of 3.65 billion South African rand ($510.3 million) in 2010. According to Marsh, the business comprises Alexander Forbes Risk Services and certain local and correspondent operations serviced across sub-Saharan Africa, including Botswana and Namibia.

Combined ratios worsen for U.S. reinsurers

U.S. property/casualty reinsurers combined ratio continued to deteriorate, worsening to 116.2% during the six months ended June 30 from 98.7% during the same period in 2010, according to a survey of 19 U.S. reinsurers released by the Reinsurance Assn. of America. The results are "due to the extraordinary number of catastrophes in 2011, such as the Japanese earthquake and tsunami, tornadoes in southern and northeastern U.S., and floods," said a spokeswoman for the RAA.

Gilman, McNenney file libel suits against Spitzer

Former Marsh Inc. Managing Director William Gilman is seeking $60 million in damages in a libel suit filed against former New York Gov. Eliot Spitzer last month. In his suit, Mr. Gilman said Mr. Spitzer implied that he was guilty of crimes, including ones of which he was never accused, in a column on Slate.com. Mr. Gilman and fellow former Marsh Managing Director Edward McNenney were indicted in 2005 on 37 charges regarding alleged bid-rigging, but each was convicted of only a single count of restraint of trade and competition, and a judge tossed those convictions last year. Mr. McNenney has filed a separate libel suit against Mr. Spitzer, seeking $30 million.

Tenn. licenses first captive under revised law

Tennessee has licensed its first new captive insurance company since the state revised its captive law this year. Julie McPeak, commissioner of the Tennessee Department of Commerce and Insurance, signed the license for Park View Insurance Co., a pure captive formed by Nashville, Tenn.-based hospital and health system operator HCA Inc. The revisions updated the existing captive law and permitted the formation of protected cell captives, branch captives and special-purpose financial captives in Tennessee.

House panels to consider 'grandfather' rule repeal

House Republican leaders said several House committees will develop legislation to repeal the health care reform law's grandfather plan rules. House Majority Leader Eric Cantor, R-Wis., said in a memorandum sent to House Republicans that employers losing grandfathered status for their health care plans will face higher costs, "negatively affecting wages and job growth." Last year, the Senate defeated a proposal by Sen. Mike Enzi, R-Wyo., that would have effectively nullified the grandfather rules.

Bermuda insurer registrations surge

Thirty-one insurance companies registered in Bermuda during the first half of the year, according to the Bermuda Monetary Authority. That compares with 36 companies for all of 2010, the BMA said. More special-purpose insurers were formed during the first half of 2011 than all of 2010, BMA CEO Jeremy Cox said in a statement announcing the activity.

Commercial property rates rising: Marsh

Property insurance rates have begun to rise, according to a benchmarking trends newsletter posted on Marsh Inc.'s website. But rates for other lines of commercial coverage continued to decline during the third quarter, most notably for publicly traded companies' directors and officers liability insurance, according to Marsh. Catastrophes in the United States and elsewhere led insurers to push for increased or flat rates for property coverage, particularly for accounts with "significant catastrophe exposures and/or poor loss histories," Marsh said.

P/C industry's first-half cat losses $27B: Best

The U.S. property/casualty insurance industry suffered $27 billion in catastrophe-related losses during the first half of 2011, A.M. Best Co. Inc. said in an analysis. That represented a 127% increase over the $11.9 billion in catastrophe losses sustained during the same period of 2010, the rating agency said. Losses for commercial lines of insurance rose to $8.3 billion in the first half, from $4.1 billion in the same period in 2010. During the first six months of this year, U.S. reinsurers saw $3.6 billion in catastrophe-related losses as opposed to $800 million sustained during the same period in 2010.

P/C reserves deteriorate, still adequate: Fitch

U.S. property/casualty insurers' loss reserves have deteriorated moderately, but they remain adequate for now, Fitch Ratings Ltd. said in an analysis. The industry continues to benefit from reserve strength built up in prior years, the rating agency said. Insurers' total reserve development was $10.2 billion in 2010, down slightly from $10.3 billion in 2009, Fitch said.

Gras Savoye reorganizes, names new CEO

French brokerage Gras Savoye & Cie. has reorganized its top management structure and appointed a new CEO. The brokerage has split the roles of chairman and CEO, previously both held by Patrick Lucas, and appointed Patrick Werner as CEO. Mr. Lucas, 72, will remain chairman of the company.

Liberty Mutual's comp appeal rejected

A federal appeals court dealt another blow to Liberty Mutual Group Inc.'s years-old legal battle against American International Group Inc. in a case involving the alleged underreporting of workers compensation premiums. In the ruling, the 7th U.S. Circuit Court of Appeals in Chicago denied Liberty Mutual's request for permission to appeal a federal judge's decision to grant preliminary approval of AIG's offer to settle litigation with a class of plaintiffs composed of hundreds of rival insurers. The appeals court also denied Liberty Mutual's request to block the mailing of settlement notices to potential members of a class of insurers that would be eligible to share the $450 million.

N.Y. agents, brokers appeal disclosure rule

Two New York insurance agent and broker groups appealed a judge's decision upholding a state regulation that requires producers to disclose incentive compensation they receive. The Independent Insurance Agents & Brokers of New York and the Council of Insurance Brokers of Greater New York filed the appeal with the New York State Supreme Court Appellate Division, Third Department in Albany. They seek to overturn New York State Supreme Court Judge Richard M. Platkin's November decision that upheld the state insurance department's authority to promulgate New York Insurance Regulation 194. The regulation, which took effect Jan. 1, requires producers to disclose the incentive commissions they receive from insurers and other third parties.

WHEN CONFRONTING DISASTER, HAVING ALL YOUR EGGS IN ONE BASKET SHOULD MAKE YOU FEEL

An insurer willing to take on all of your commercial property risk is rare. So rare, in fact, that only FM Global does it. How do we provide coverage no one else can? By assessing risk in a way no one else does. We base our underwriting on engineers' assessments. It's an approach that reduces risk, preventing losses before they happen.

We feel our clients are better protected when we assume all the risk ourselves. Understanding risk and how to minimize it allows us to do just that. So, even when our clients have losses, they tend to be smaller and less frequent. **Underwriting through loss prevention engineering. That's insurance evolved.**

Insurance Evolved FM Global®

» To learn more, visit **fmglobal.com/insuranceevolved/safe**

D&O insurance solutions from Chartis.

Today's directors and officers face more risk than ever, due to a growing breadth of regulations and heightened enforcement. Having the right coverage is critical. At Chartis, we offer cutting-edge insurance solutions built to meet the challenges of D&O risk today—and will keep innovating to meet the challenges of tomorrow. Learn more at **www.chartisinsurance.com/D&O**

CHARTIS®
Your world, insured