A unit of the world’s largest insurer has begun offering on-island fronting for captive insurance companies with US parents.

Traditionally, the fronting companies are found on the American mainland. But Bermuda captive owners will now be able to take advantage of their annual business trip to the Island to sort out fronting arrangements.

The bold move has come from Lexington Insurance Company, a member company of Chartis. Their US-based Captive/Alternative Risk Transfer (ART) operation has expanded into Bermuda to provide customized fronting arrangements for captives and other ART structures. These solutions will be available in conjunction with other Chartis products or as a stand-alone option.

President of Lexington Insurance Company, David Bresnahan, told Bermuda brokers: “Since coming to Bermuda in the 1940s, AIG has been a committed member of the insurance marketplace and community here. We are very proud that AIG is recovered, profitable and closer to the finish line on the US government involvement.”

“In keeping with that continued commitment, Lexington is pleased to announce that our Bermuda branch is now open to assist captives and insureds with their fronting needs.

“Lisa Lacey has re-located from Boston to Bermuda and is ready to review our capabilities with risk managers as well as brokers and their clients. The Lexington product offering complements Brian McNamara’s local risk management fronting unit and Page Rouse’s Captive Management services group.”

Ms Lacey said, “We currently provide fronting arrangements for US-driven business out of our Boston office. Quite a lot of that business is either reinsured or managed in the Bermuda market.

“We feel that having Lexington staff here is an advantage, because when risk managers come to Bermuda, they would like to have the entire business placed, before they leave. “They can get their reinsurance, talk to their captive managers, law firms and audit partners. They can do all of that right in Bermuda. But there has never been an on-Island facility for them to also obtain their fronting. We see this as a growth area for Lexington.”

Continued on page 6

Captive owners were assured by Bermuda regulators that the new European regulatory directive Solvency II would have no negative impact on how the Island regulates captive insurers.

The assurance was repeated during a highly successful Bermuda Captive Conference after unfounded rumors and unsubstantiated statements suggested that Bermuda captives could be disadvantaged.

Shelby Weldon, the director of insurance, licensing and authorization for the Bermuda Monetary Authority, was quoted as saying, “We are of the opinion that the regulatory regime for captives would already meet the high levels of requirements for Solvency II on a proportional basis. There would be no significant changes for how we treat captives.”

Mr. Weldon added that In the “unlikely event” that Bermuda’s regulations are not deemed to be equal to Solvency II, “it still wouldn’t have any impact on captives.” (See page 2 – Solvency II boost expected).

A record more than 600 delegates attended the BCC at the Fairmont Southampton hotel and many heard a senior official with top auditors PwC express confidence that Bermuda will continue to be a leader in the insurance

Continued on page 7
**Side cars and cat bonds**

Special Purpose Insurers (SPIs) have become the fastest growing type of Bermuda market insurer as demand for catastrophe bonds soars. And Bermuda has quickly seized 20 percent of the global catastrophe bond market. Amid increasing demand, that share appears set to grow.

Leslie Robinson, Assistant Director, Insurance Licensing and Authorisation, at financial regulator the Bermuda Monetary Authority (BMA), revealed that the Island is on track to add even more SPIs this year than the 23 it licensed in 2011.

Speaking at a session entitled ‘SPIs – An Emerging Opportunity’, Ms Robinson told delegates that the Authority had licensed 10 new SPIs so far this year. Five of them were formed in May as sponsoring reinsurers built up capacity for the hurricane season.

The SPI classification was introduced in Bermuda in 2010 and provides a sound legal and regulatory framework for vehicles used for collateralized reinsurance products, including cat bonds, industry loss warranties and sidecars.

SPIs are required to meet several key criteria, allowing the BMA to regulate them less stringently than other insurance entities, the first of which is that they are fully collateralized, meaning that for every dollar of risk, there is a dollar of capital.

Other requirements include that their investors are sophisticated, that the SPI’s purpose is specific, that there is limited recourse, and that it meets the Authority’s standards for transparency and disclosure.

She added that the BMA had almost halved SPI fees from $11,600 to $6,000 last year, to sharpen the Island’s competitiveness in the ILS market.

Fellow panelist Sean McCarty, Managing Director of Aon Benfield Investment Banking, outlined the size of the cat bond market, estimating that there have been $43 billion in placements since 1996 and more than $15 billion worth were active. Bermuda had a 20 percent share of the cat bond market and “most, if not all” of the sidecar issuances, he added.

Jason Carne, Partner, Insurance, KPMG Bermuda, said prior to the enactment of the SPI legislation, the business went elsewhere, but Bermuda now has the edge.

He said Bermuda has unmatched insurance expertise, including auditors and attorneys knowledgeable in the industry.

“Bermuda has the deepest infrastructure,” Mr. Carne said. “When things don’t go according to plan, then you need expertise in place to deal with it.”

Brad Adderley, Partner at international law firm Appleby, also opined that Bermuda was now a superior cat bond jurisdiction to those where deals were taking “months” to go through.

“In Bermuda, the process is smooth and quick,” Mr. Adderley said. “Speed to market is very important.”

Although it might be difficult to win business from sponsors who traditionally placed cat bonds elsewhere, Mr. Adderley felt Bermuda also had the edge because of the Island’s reinsurance market and related expertise.

---

**Solvency II boost expected**

Bermuda’s quest for Solvency II equivalence will bolster the Island’s international business reputation, but will not harm its captive sector, Bermuda Monetary Authority CEO Jeremy Cox said.

Speaking in the opening session of the Bermuda Captive Conference, Mr. Cox dismissed as wishful thinking rival jurisdictions’ claims that equivalence would destroy the Island’s appeal as the world’s leading captive domicile.

“We have some mischief makers out there — some competitor jurisdictions — that wish people to believe that Bermuda is following a path that will destroy its captive sector,” Mr. Cox said.

“The reasons for their [misleading] claims are obvious but certainly, as I mentioned before, we’re not planning on doing that.”

He said it was critical for Bermuda to make very clear the impact of equivalence with the new European insurance rules, so as to communicate “the reality as opposed to the perceptions”.

The Authority has argued its case with the EU that equivalence should not mean captive insurers are subject to the same stringent regulations as commercial re/insurers covering third-party risks.

The Europeans have suggested that they will consider “segmented” equivalence for Bermuda that would allow captives to be regulated less rigidly, commensurate with their lower risk profiles.

Fellow panelist Leila Madeiros, Deputy Director of the Association of Bermuda Insurers and Reinsurers (ABIR), said the regulatory credibility gained from the process of seeking equivalence would pay dividends.

“I think it’s so significant that Bermuda was selected to be reviewed and assessed in the first wave with Switzerland and Japan,” Ms Madeiros said. “There is an opportunity in the captive market for equivalence. Not if, but when Bermuda is deemed equivalent, we may see increased interest in captives from Europe because then they can base themselves in Bermuda without a penalty.”

Lawrence Bird, President of the Bermuda Insurance Management Association (BIMA), said the decision not to pursue equivalence could come back to haunt other jurisdictions. He said that there were noisy “mischief makers”, including those from competing jurisdictions, who have denigrated Bermuda and criticized the jurisdiction for embracing Solvency II.

Continued on page 8
Taking your investment plan to the next level

Carl Terzer
Founder & Principal
CapVisor Associates, LLC

Prospective captive insurance owners learned the ABCs of managing the assets of a captive during a Bermuda Captive Conference session on investment strategy.

The focus of the presentation was on strategic asset allocation and optimizing asset results for captives. Strategic asset allocation is responsible for 90 percent of investment results and is the biggest contributor to return. Different asset allocation strategies will be associated with different risk and reward results.

It is important for captives to find the right balance. The panel agreed that having several investment managers with conflicting strategies can create over diversification and diminishing returns.

Moderated by Carl Terzer, Founder and Principal of CapVisor Associates, LLC, the speakers included Howe and Rusling President Craig Cairns and Chief Investment Officer for PRP Performa David Kilborn.

They examined the role of analytic systems as tools for deciding on strategic asset classes for an investment portfolio.

Asset allocation will be impacted by the risk tolerance profile of the shareholders and the purpose and maturity stage of the captive.

For a newly formed captive or a small captive, the risk should be low and assets should be highly liquid, especially for start-ups with no claims history. Further, new captives are generally focused on building surplus and preserving capital.

During the formation stage, a more reserved investment allocation strategy would be appropriate. As the captive reaches the advanced or mature stage, more risk can be tolerated.

During the development stage, captive should have a more liquid growth allocation strategy and a durable growth strategy would be recommended for the maturity stage.

The presenters discussed the difference between strategic vs. tactical asset allocation. Strategic would have a longer time horizon – three to five years – and would not be adjusted frequently.

The allocation would be based on projections and would take a broader approach. It would include assets types such as cash, US Bonds, TIPS, high yields, hedge funds and equities. The tactical allocation would have a three to 18-month time frame and be focused on current results. It would include Treasuries, Corporates, MBS, CMBS, ABS and would be detailed on a more granular basis.

The panel also discussed the asset allocation process – taking client inputs, constructing the portfolio and creating a dynamic asset allocation. Each captive should have a clearly defined investment strategy and should know what they want out of their investments.

Client inputs are defined as risk tolerance levels, liquidity and surplus needs, restrictions and life cycle stage.

Customized software tools are available on the market to help captives with strategic asset allocation. The three main model types are: the asset only method; the actuarially based method; and, Dynamic Financial Analysis.

The first method will only take into consideration the investments on the balance sheet in order to produce an asset allocation. The second method is based on actuarial projections and computer models designed to run various economic scenarios. The output is projected balance sheets and income statements based on the different scenarios and asset allocations.

The third model is the most comprehensive and is most suitable for very large captives. This model creates thousands of probability distributions using various asset allocations.

The panel weighed-in on when captives should think about revising their strategic asset allocation.

Generally, unless a major change in the captive occurs such as a merger or changes in underwriting lines of business, the strategic asset allocation should not be revised before three to five years.

The tactical allocation should be revised to capture new market opportunities or changes in the markets as they occur.

Continued on page 15 ▶

Capital strategy employs new model

Don Kramer
Founder
ILS Capital Management Ltd.

Lingering low interest rates have changed the economics of reinsurance and led to a boom in insurance-linked securities (ILS), reinsurance industry legend Don Kramer told delegates at the Bermuda Captive Conference.

Investment income has plunged as a result of low yields on the conservative assets traditionally held by property and casualty re/insurers and reinsurance rates have not risen sufficiently to make up for the shortfall, Mr. Kramer said in a keynote address.

This has led to lower return on equity and stock valuations well below book value for many reinsurers. Capital coming into the industry recently has tended to be in the form of catastrophe bonds and sidecars, as opposed to new company formations, Mr. Kramer said.

“Nobody’s starting new companies to be in the catastrophe business at 80 percent of book value,” Mr. Kramer said. “It should bring about a rise in prices, but instead it’s created a new industry – insurance-linked securities.”

Mr. Kramer, who has started up five reinsurance companies including Ariel Re during a stellar career, last year founded ILS Capital Management Ltd., which aims to attract new capital into this increasingly popular space.

When Mr. Kramer launched Tempest Re in Bermuda in 1993 after Hurricane Andrew, at a time when seven other reinsurance companies also started up in business on the Island, he said the economics were much more favorable than those faced by reinsurers today.

“The people at Lloyd’s said the first blow and we’d be out of business,” Mr. Kramer said. “They were wrong, of course. Now, Bermuda dominates the catastrophe business.

“In those days, you could expect to make 17 or 18 percent return on equity, and trade at 120 percent of book.

“If you were writing long-tail business, you could have a combined ratio of 100 or 103 percent and you’d still be making money because interest rates were high and you were getting an investment return of five to seven percent.

“In the catastrophe business, you had to make money from

Continued on page 15 ▶
A Bermuda advantage for Canadian risks

A session moderated by Trevor Mapplebeck, Managing Director, Alternative Risk Solutions of Marsh Canada and accompanied by Mark Allitt, Senior Manager of KPMG Advisory Limited and Kevin McCredie, President of Sylvite Financial Services Inc. discussed the changing landscape for Canadian captive owners and provided first-hand insights into an innovative use of a segregated account company to meet the needs of Sylvite.

Sylvite Financial Services manages some of the largest agriculture risk management programs in Canada and acts as insurance consultant to the largest Insurance Purchasing Group called the Risk Management Alliance (RMA).

Mr. Mapplebeck opened the session by providing an overview of the trends in the Canadian captive market and shared the results of Marsh’s 2012 Captive Benchmarking Report. He noted that as the world’s largest captive domicile, Bermuda has more than half of all offshore captives and he believes this is a trend that will continue, especially as a result of the opportunities arising from Canada.

Mr. Mapplebeck went on to discuss the profile of a typical Canadian captive owner, explaining that most key Canadian industries use captives, although to a much lesser extent than the US. But he believes the number of Canadian captives will grow significantly, and those domiciled in Barbados will re-evaluate their domicile selection as a result of the Canada/Bermuda Tax Information Exchange Agreement (TIEA).

There have already been a number of high profile re-domestications from Barbados to Bermuda and the captive industry anticipates that Bermuda has become the preferred domicile for future incorporations.

Mr. Allitt agreed that the TIEA opened the opportunity for Canadian companies to use offshore captives. In addition, he added that the opportunity is not limited to captives and can provide significant benefits to non-insurance applications where Canadian companies have foreign operations or assets.

Mr. Allitt did however importantly note that while the TIEA provides significant tax planning opportunities for Canadian companies it is important to remember that tax should not drive the decision as to whether a captive is the correct risk management strategy.

When the decision is made to form a captive, Bermuda will be at the front of Canadian’s minds as a result of its many differentiators. They include the tax opportunity, the Island’s highly regarded regulatory regime, access to reinsurance markets and proximity to Canada – the combination of which makes Bermuda the front-runner as the leading domicile for future Canadian captives.

Mr. Allitt guided the audience through a number of the key tax considerations for Canadian captives explaining that the most significant benefits derive from Canadian companies foreign risks. The premium paid from the foreign group entity, together with investment income generated from the captives required capital, is re-characterized in the captive as ‘active business income’ which under the TIEA is treated as exempt surplus and can be repatriated to Canada without incurring any Canadian tax.

Canadian risks are likely to fall within Foreign Accrual Property Income (FAPI) rules, which mean that the income is taxed in Canada as it is earned. However, he explained that there are a number of potential benefits of a captive for Canadian risks, including a tax deferral in respect of loss reserves held by the captive plus a host of other non-tax benefits, such as the ability to ‘insure the uninsurable’ and access the reinsurance markets.

Mr. McCredie then provided an overview of Sylvite’s activities with captives and how they use Risk Management Alliance (RMA), an organization that provides segregated cell solutions to meet the needs of numerous Canadian companies in the agriculture sector.

The insightful discussion shared RMA’s objectives and experiences in serving their members risk management and risk transfer needs by providing them with an integrated solutions platform. Mr. McCredie explained this is achieved by grouping agricultural companies with ‘best in class’ risk management practices and offering them access into the captive solution – when individually they may not have had sufficient critical mass.

The benefits enjoyed by RMA members is placement of their risks in a cell in which is fully insulated from other participants, while at the same time benefiting from increased buying power through buying reinsurance as a group.

RMA offers sophisticated analysis of the participants’ risks providing tailored risk analysis tools and an RMA knowledge center. This enables creative program structures to be designed to meet the participants’ needs together with achieving the benefits offered by captives, including tax planning opportunities.

Mr. McCredie explained that Sylvite is currently expanding into the US and anticipates replicating this SAC solution in Bermuda to serve their US business.

BIMA’s ACI Scholarship presented

The President of the Bermuda Insurance Management Association (BIMA), Lawrence Bird (left), congratulates accounts associate at Dyna Management Services Ltd., Desirae Simons, for winning BIMA’s ACI Scholarship.

Ms Simons received the monetary award during the Bermuda Captive Conference. The money will be used to pay for courses and books for the International Center for Captive Insurance Education (ICCIE). She will work online toward an Associate in Captive Insurance (ACI).

Also pictured (right) is ICCIE Executive Director Mitch Cantor.
### The face of global economic change

How the European Union deals with the sovereign debt crisis will be the biggest single factor in the performance of financial markets in the second half of 2012, according to investment expert Henk Potts, Director of Global Investment Strategy at Barclays Wealth. Mr. Potts told an audience at the Bermuda Captive Conference that efforts to contain the crisis would likely lead to moves toward fiscal integration in Europe, a eurozone deposit guarantee scheme and more austerity.

“The pace of progress in Europe has been picking up, but it’s not been fast enough for the markets,” said Mr. Potts in a session on the ‘Global Market Outlook’.

German opposition and countries having to give up some sovereignty were potential obstacles to further integration, he added. “The number one problem is that what makes good political sense in the short term often does not make good economic sense in the long term.”

Both Mr. Potts and fellow speaker Ryan Wang, US Economist, HSBC Securities, expected to see the EU economy shrink this year by less than one percent, but return to growth next year with an estimated expansion of less than one percent.

Both experts also expect to see the US economy continue on a path of slow, sub-three-percent growth this year and in 2013. And they also expect to see China’s GDP continuing to expand at a clip of between eight and nine percent for the next two years.

The emergence from poverty of tens of millions more Chinese people would help to fuel growth in the coming years, Mr. Potts said. The Chinese middle class made up 55 percent of the population and that figure was expected to rise to 75 percent by 2025.

“Today we see China as a manufacturing powerhouse, but increasingly we will see China as a consumption powerhouse,” Mr. Potts said.

This would be a major driver of commodity prices. Barclays is bullish for the long term prospects of oil – it forecasts that Brent crude will be at $185 a barrel by 2020 – as well as copper, platinum and corn.

Mr. Wang told delegates that he believed the chances of more quantitative easing in the US were about 50-50 and that the economy would have to weaken further for the Federal Reserve to pump more money into the system.

He added that European governments were not alone in going through a period of austerity – the US had been going through something similar since 2009, he said.

“At the federal level, government debt has been rising rapidly as a percentage of GDP,” Mr. Wang said. “But at the state and local government level, debt as a percentage of GDP has actually been falling.”

Stricter budgetary limits at local level had resulted in public-sector layoffs, as well as cut-backs in public construction projects, he added.

Among the emerging economies, Mr. Potts saw great prospects for Africa’s “lion economies”, many of which had grown at an annualized rate of more than six percent over the past ten years.

While Africa still had problems, he said some of its notable problems of the past were easing. For example, inflation in Africa had averaged eight percent over the last decade, a far cry from the hyper-inflation that some associate with the continent. Meanwhile, over the same period African countries had cut their foreign debts by 25 percent.

The continent’s population was expected to double to two billion over the next 40 years. The population was becoming increasingly well connected, thanks largely to 650 million cell phones, ten percent of them with access to the Internet.

“Some of the experts believe that Africa is now at the point of economic take-off where China was ten years ago,” Mr. Potts said.

### Effective uses of segregated account companies (SACs)

In a session moderated by Dennis Silvia, Vice President of Cedar Management, three segregated account company (SAC) owners discussed creative ways in which SAC structures can be used to meet a firm’s strategic goals.

Joseph Joyce, Executive Vice President of Keystone Insurers Group explained that his organization operates a franchise of insurance agencies throughout the US, which ranks as the fifth largest independent insurance agency in the US.

They set up Keystone Advantage Limited, a Bermuda SAC, to enable them to “help their insurance clients and partner agents take advantage of the most sophisticated insurance products and alternative risk transfer techniques offered in the market.”

The Keystone SAC is exclusively used for their franchises and offers an alternative market for their clients – a strategy that Joyce has found provides their agents with a competitive edge.

Chris Murray then provided an overview of the way in which Midwest Insurance Coalition PG utilizes their SAC, MICRPG Insurance Group, Ltd.

The SAC is principally designed to enable their members to assume their own risks and Mr. Murray provided the audience with examples that included a Nursing Home Professional and General Liability Account and a Physicians Medical Malpractice Account.

The sophisticated yet simple nature of the segregated account legislation in Bermuda has enabled MICRPG to capitalize on alternative risk transfer for their members, which may otherwise have proved cost prohibitive.

Tony Weller, President of Citadel International Reinsurance Company Limited, explained that their group, which includes a SAC, provides a wide range of creative solutions for their clients across both the live and run-off markets.

Weller explained that a SAC cell is a cheaper option for owning an insurance company and as a result Citadel’s clients have often used SAC cells as an introduction to the insurance industry prior to moving forward with a stand-alone captive.

*Continued on page 9 ©*
Captive cited in Canada-wide plan

The success of a Canadian not-for-profit organization’s Bermuda captive has been cited as one of the reasons they have been asked to take on new, significant responsibilities in critical hospital care.

It emerged during the Bermuda Captive Conference that the organization, Canadian Blood Services (CBS) – the organization that manages Canada’s blood supply – has been asked to design a new, Canada-wide system for organ and tissue donation and transplantation.

CBS Vice-President, General Counsel and Corporate Secretary, Watson Gale, later confirmed, “The success of the captive program has assisted in that success.”

Organ and tissue transplantation in Canada is provincially based and somewhat fragmented. Provincial Ministers of Health have asked CBS to design a new system that would provide for a national program for organ and tissue transplantation and donation.

Mr. Gale told Bermuda Insurance Update: “One of the things that interested the Ministers was that we have a structure of risk financing that provides a sense of security and support to such a national program (blood services) that currently doesn’t exist in the country for transplantation.

“It was by no means the major reason why we are able to go ahead with the organ and tissue transplantation program, but it is an important piece of the foundation. It’s the whole system of risk management they saw, and the captive is an important part of that system of risk management.”

During the Conference, Mr. Gale was on a panel discussing a good governance framework for captives, including the need and role of independent directors and adherence to a Code of Conduct.

Ms Robinson stated that while there are no specific guidelines, it was up to insurers to use their best judgment. For example, if it was determined that your captive has a complex reinsurance program in place and for this reason an underwriting committee was established to oversee this perceived risk, then the Code requires you to document the reason for determining what you did.

She also confirmed, if something has been working to date, the Code does not require you to change it. If decisions have historically been made using board resolutions and this has been working in the past, there was no need to change this process by having multiple board meetings during the year.

Ultimately, Ms Robinson stated, the requirements of the Code have probably always been followed and that the biggest change is to now evidence this fact through documentation.

A signed Statutory Declaration confirming compliance with the Code is required to be filed for each year-end and, going forward, a new electronic filing format will allow this to be done as part of one sign-off for the entire statutory filing.

Mr. Gale said that from his organization’s experience, the Code of Conduct was very easy to comply with as the requirements of the Code had always been in place.

The board of the captive oversees and contributes to a variety of activities that have a direct impact on the parent such as litigation preparedness, records management and reputational matters.

The success of the captive program has led to CBS being asked to design the new national system for organ and tissue donation and transplantation.

US fronting in Bermuda

New Lexington literature states that the Bermuda office is building on a proven record of success: a client retention rate in excess of 95 percent; enduring client relationships, some over 25 years; and, 50 percent growth in clientele in the past four years alone.

The Bermuda operation provides tailor-made, flexible fronting solutions to help achieve each client’s unique goals, using custom-crafted policy wording.

For unusual risks, Lexington will tailor policy forms to fit individual needs and exposures. This consists of: General Liability, including Products Liability; Professional Liability for a wide range of industries, including architects and engineers, churches, physicians, and more; Commercial and Inland Marine Property Insurance; and, Retained (self-insured) limits funding.

The brochure further states: “It’s not just our forms that are flexible, our approach is too. We provide fronting arrangements on both captives we manage and captives managed by others and, in the absence of a captive, we may use an indemnification agreement. Our office in Bermuda allows clients to tap into a blend of broad skill levels and underwriting expertise all in one place. We can also collaborate with our clients’ choice of service providers.”
Canada-Bermuda pact is “game-changer”

Bermuda has numerous advantages as a captive domicile for Canadian corporations and Barbados is no longer the default choice.

That was the clear message from an expert panel heard by a room packed with delegates at the Bermuda Captive Conference.

The Tax Information Exchange Agreement (TIEA) between Canada and Bermuda, which came into effect last year, effectively leveled the playing field on taxation.

This has allowed the Island’s other advantages, such as proximity to Canada, service provider expertise and the presence of globally significant insurance and reinsurance markets, to come to the fore.

Toronto-based David Downie, a Partner, Canadian & International Tax, at KPMG, said the TIEA had been a “game changer” for Bermuda. Through the agreement, Bermuda had earned “Designated Treaty Country” (DTC) status and with it, many of the benefits of Canada’s full tax treaty partners like Barbados.

This means that the dividends of foreign affiliates that are resident in Bermuda, paid to their Canadian parent companies out of the active business income earned in Bermuda will be exempt from Canadian taxation.

“Before 2011, the surplus was taxable. Now, it is exempt surplus,” Mr. Downie said. “That means it can be returned to Canada tax-free, instead of paying 25 percent withholding tax. That’s a huge, huge advantage Bermuda has. Barbados is no longer the number one place to go.”

Also on the panel for the session entitled ‘Bermuda as a Domicile for Canadian Captives’ was Paul Leighton, an Analyst, Captive Advisory Services, with CPG Strategy. Mr. Leighton said that from a Canadian standpoint, Bermuda had numerous advantages.

They included geography – Bermuda is just a couple of hours away from Toronto – as well as effective legislation, stability and deep insurance industry experience.

He also disputed the notion that Bermuda was a more expensive jurisdiction than Barbados. “What really drives up expenses are the hidden or frictional costs that happen when things don’t go smoothly,” Mr. Leighton said.

“In Bermuda, you have an industry that’s set up to respond much faster – that’s what I mean when I say it’s cheaper to do business in Bermuda than Barbados.”

Fellow panelist Kara Ann Selby, a Toronto-based Partner, International Tax Services, with PricewaterhouseCoopers, said captives seeking to take advantage of the DTC tax benefits needed to meet a “mind and management” standard, which requires key decisions to be made in the captive domicile.

In practice, she said this would mean a majority of directors should be Bermuda residents, that board meetings should be held in Bermuda, records should be kept on the Island and that major decisions should be made in a board meeting in Bermuda.

Asked in a question-and-answer session what was now the default captive domicile for Canadians, Mr. Leighton said it used to be Barbados. “The default answer now is that everybody’s on a level playing field,” Mr. Leighton said. “But from an expertise point of view, the default answer has always been Bermuda.”

No new changes imposed on captives

Continued from page 1

world, and in the captive industry specifically, for the foreseeable future.

Arthur Wightman, Insurance Leader, PwC Bermuda was speaking during a beach-side terrace reception hosted by PwC.

He said, "We believe in the fundamental strength of Bermuda as the world’s leading captive domicile."

“We believe that the traditionally high level of collaboration and innovation amongst key industry players – whether captive owners, the government, regulators, or service providers – and our collective ability to stay out in front of the latest changes, trends, issues and opportunities in the marketplace, will position Bermuda to continue its leading position long into the future.”

Also at the BCC, a standing room only crowd heard how legislative changes that created a new class of insurer in 2009 have gained traction and established an emerging opportunity for Bermuda as a significant jurisdiction for much-needed and highly-specialized insurance structures. (See Side cars and cat bonds – Page 2.)

The informative review of the Insurance Linked Securities market showed the Island has become a favored destination for the Special Purpose Insurers (SPIs) with the deepest pool of professionals to handle the specialized business.

While visiting risk managers and captive professionals agreed that the BCC was an extremely informative event, they also remarked at the quality of networking opportunities.

BCC President Peter Willitts commented: “We’ve never seen the Bermuda Captive Conference in terms of numbers. While the 2012 attendance is a milestone, we have always been more focused on building the most useful event for the exchange of captive insurance knowledge.

“Our goal is to be the most useful resource for everyone – from the most experienced captive owners to those at the beginning of the process, just trying to understand how captive insurance can help their company.”

And from what we have heard from a large number of clients this week, we are on the right track.”

Bermuda Insurance Management Association President Lawrence Bird congratulated the BCC organizing committee and noted: “We will continue to plan carefully to manage future growth. Some of our sessions this year were so over-subscribed, there was standing room only. We have heard very complimentary comments about the session content.”
Latin interest in Bermuda domicile

Bermuda is an ideal domicile for Latin American captives and is likely to see more business from the fast-developing continent, especially from the oil and gas sector.

This opinion came from a man who should know, Tommaso Mascarucci, President of Black Gold Re Ltd, the six-year-old Bermuda-based captive of Colombian oil giant Ecopetrol – the country's largest company.

Mr. Mascarucci told delegates at the Bermuda Captive Conference that Black Gold Re had been set up after an exhaustive feasibility study and the crucial choice of Bermuda as the domicile.

Speaking in a session on Bermuda as a location for Latin American captives, Mr. Mascarucci said Bermuda had been one of 11 potential domiciles examined by Ecopetrol.

“We looked at the legal and regulatory framework, the quality and availability of service providers, and access to the reinsurance market,” Mr. Mascarucci said. “This created a lot of discussions on the board.

“One key focus for us was reputation. A good domicile will have a good legal framework, so the rules you have to follow are clear. So we ended up in Bermuda.”

Why did Ecopetrol opt for Bermuda? Mr. Mascarucci said there were several key criteria, not the least of which was the Island’s good standing in the eyes of the OECD (the Organization for Economic Co-operation and Development).

Other factors included the jurisdiction’s transparency and regulatory stability, the presence of a reinsurance market and world-class service providers, and, the fact that it is the largest captive domicile in the world with around 17 percent of the world’s captive insurers.

The presence of other energy sector captives also helped to persuade the Ecopetrol board of Bermuda’s suitability. And others from the industry in Latin America may follow suit, he added.

“Oil and gas is a high-risk industry that needs a lot of insurance and a lot of capacity,” he said. “Captives are a useful tool to fit into their risk management strategies.”

Federico Candiolo, Attridge-Stirling & Woloniecki Counsel, explained the regulatory requirements for captives when incorporating and operating in Bermuda. Fellow panelist Eduardo Fox, a senior manager with Appleby, told delegates at the packed session how the Tax Information Exchange Agreement (TIEA) between Bermuda and Mexico had effectively lowered the tax rate applied by Mexico to Bermuda entities.

Before the TIEA took effect in 2011, Bermuda was considered a “preferential tax regime”, which Mr. Fox said was a Mexico government term used to denote a “tax haven”. The Central American country then levied withholding tax at a rate of 40 percent.

With the ratification of the TIEA came an upgrade in tax status for Bermuda, and standard rates of Mexican income tax now apply.

From his own experience, Mr. Mascarucci spelled out the keys to captive success. The most important factor was to have a strong business plan, so it was known from the start exactly what the captive was intended to do, he said.

The right domicile, a management control system, high-quality service providers and visits to the captive domicile by parent company management, complete with feedback, were also crucial factors, he added.

Solvency II boost expected

Continued from page 2

Solvency II. They have suggested that Bermuda is less attractive as a captive domicile for seeking equivalency. But Mr. Bird believes that their position will eventually backfire on them.

There were real benefits to building up credibility and trust in the international community, Mr. Cox said.

“Those regulators that may be out there who think that they can hide under the radar – those days are gone,” Mr. Cox warned. “And, in my view, it’s far better to put yourself in a position where you are trusted or credible and can be relied on because remember, equivalence means a lot.

“I think that we are on a path that really will put this country in a tremendous position, not only from an insurance perspective, but also from some of these other industries like the fund sector.”

Earlier, Business Development and Tourism Minister Wayne Furbert had opened the conference by reminding delegates that Bermuda was a world leader with its 862 captives.

Mr. Furbert reflected on the value of effective cooperation between the public and private sectors in producing a robust and globally competitive insurance industry.

“The Government of Bermuda recognizes that policy issues are most effectively addressed with the involvement of relevant stakeholders on an equal footing,” Mr. Furbert said.

“In that regard, it is noted that each component of the insurance sector, through the auspices of the Insurance Advisory Committee, is authorized in law to provide advice to the Government on any matter relating to the development and promotion of the insurance industry in Bermuda.

“This partnership has resulted in an unhindered flow of data and information between the Government and the insurance sector which is essential for business, trade, investors and the people of Bermuda. From its inception, the members of the insurance sector have risen to the occasion by providing the Government with invaluable advice.”
As an example of the diverse uses of SACs, Weller explained that Citadel has set up cells for clients wishing to quarantine problematic classes of business, including US workers compensation. They have also housed run-off acquisitions or partitioned run-off books within their cells.

SAC providers usually require that each cell is fully funded, i.e. collateralized to the full limits, which for certain classes of business can be uneconomical for clients. However, Weller explained that with the use of their AM Best A-rated reinsurer, Citadel Re, they designed programs that enable their clients to participate in their risks while at the same time mitigate the exposure with a reinsurance product.

The session sparked many positive comments from the audience who were inquisitive about the diverse applications of SAC cells, and the flexibility and adaptability of the specialized corporate vehicles.

Top right: The record attendance at the Bermuda Captive Conference this year, led to some packed sessions. Planning is already underway for the 2013 Conference. Bottom left: BCC delegates enjoyed the opportunity to meet regulators such as Leslie Robinson, (center) the Assistant Director, Insurance Licensing & Authorisation of the Bermuda Monetary Authority. She was one of several BMA staff who spent a lot of time at the Bermuda Captive Conference taking meetings. Bottom Right: BCC Chairman Peter Willitts (l) confers with BCC Coordinator Rhona Emmerson and Founding BCC Chairman Roger Gillett.

Effective uses of segregated account companies (SACs)

Continued from page 5

Tony Weller, President, Citadel International Reinsurance Company Limited

Chris Murray, Midwest Insurance Coalition PG
Delegates found the common rooms and exhibit halls a great opportunity for formal and informal client meetings and networking; there was a demand for the ubiquitous Bermuda tote bag; continuing educational credits were available; Scott Gemmell (l) of Deloitte chats with Lawrence Bird and Ken Rand of Marsh; PwC Bermuda Insurance Leader Arthur Wightman is flanked by Aon Bermuda’s Peter Mullen and Kathleen Bibbings. They are joined by Aon Vermont’s Nancy Gray; The BCC’s annual beach-side opening reception was sponsored by PwC.
Photos: (top left) President of the Bermuda Captive Owners Association William Montanez; (top right) Director of Bermuda law firm Conyers Dill & Pearman Chris Garrod, together with Aon Insurance Managers (Bermuda) Ltd. EVP Robert Paton and Bermuda Monetary Authority Director, International Affairs, Shanna Lespere; (right) Director, Insurance Licensing & Authorisation of the BMA, Shelby Weldon sits down with one of his many client and industry meetings in the exhibit hall; (below) Conference networking opportunities included an early morning nature walk sponsored by the Bermuda Captive Owners Association and the annual golf tournament at the majestic Port Royal Golf Course, home of the PGA Grand Slam of Golf – the most difficult pro golf event for which to qualify.
Connecting with people and making them like us is at the heart of successful business, according to brand visionary Ken Schmidt.

In an entertaining speech over lunch at the Bermuda Captive Conference, Mr. Schmidt, the former Head of Communications for Harley-Davidson, suggested that it’s naive to believe that quality of product is what sells.

“We invest in people,” Mr. Schmidt said. “People getting out and having influence on the people we do business with by getting them excited, passionate and enthusiastic. It’s very simple. All we want to do is get people to like us. Period.”

Mr. Schmidt drew on his experience at the American motorcycle maker, which his ideas helped to turn around from the brink of bankruptcy in the 1980s.

Mr. Schmidt said the key to Harley’s dramatic rebound was something every business should be doing – asking what people want and then providing it to them. While many businesses purported to do this, too many failed to walk the walk and talk the talk, he said.

Whether it’s insurance or motorcycles you are selling, the principle is the same, he argued – differentiating yourself from your competition is about getting people to like you so much that they will tell the world about you.

No one liked being sold to, Mr. Schmidt said. He said messages of product quality, commitment to excellence and heritage did nothing to create demand, adding that firms should not think in terms of customers, but rather of “disciples”.

“It’s not a religious term, it’s a human word,” he said. “A disciple is someone who feels so good about something that, without being prompted, they tell other people about what makes them happy, what they enjoy and why it’s different.”

Unconventional though Mr. Schmidt’s message was, he received an enthusiastic reception from an amused audience of insurance professionals.

The longtime motorcycle enthusiast’s formal association with Harley-Davidson began in 1985. As a specialist in corporate positioning and media relations, he was asked to work with the then-struggling Harley-Davidson to help restore the company’s image and create demand for its motorcycles.

Within a few short years, Harley-Davidson became one of the most visible and frequently reported-on companies in the world, while sales of its motorcycles rocketed upward.

In 1990, Schmidt became director of Harley-Davidson’s corporate and financial communications, and served as its primary spokesperson to the media and the financial communities.

He appeared numerous times on network news programs and was frequently called upon by business media to share his insights on non-traditional communications and customer relations. Speaking engagements around the world soon followed.

In 1997, Schmidt left Harley-Davidson to take an ownership position with a highly successful Chicago-based marketing firm, VSA Partners. In addition to Harley-Davidson, VSA serves many other of the world’s best-known brands, including General Motors, Coca-Cola, IBM, and Campbell’s Soup.

In July 1999, he sold his portion of VSA to start his own business, Ken Schmidt Company, and slow down the pace of his life.

Now, Schmidt is a frequent speaker to business groups and academic communities throughout the world. Few speakers generate more positive word-of-mouth and referrals. “I love to startle people by exposing them to proven ideas and concepts they’ve never imagined,” he said.

“Whether I’m talking about how perfectly average people can do extraordinary things – which is now an everyday occurrence at Harley-Davidson – or how to build an entirely new corporate culture, rekindle relationships with customers, or reach out to new ones in completely untraditional ways, I’m teaching people to throw conventional approaches out the window. I see opening hearts and minds as my life’s work.”

Today, Schmidt shares his expertise with many of America’s leading brands, but happily states that he is “semi-retired,” which allows him to pursue his other passions. He calls working with the grandson of one of Harley-Davidson’s founders to create the book, 100 Years of Harley-Davidson, one of the greatest highs in his lifetime.

After all he has accomplished, his philosophy of life and business hasn’t changed: “Never do what’s expected, make yourself as noticeably different as possible, and have a lot more fun than you’re supposed to.” ☺
A Bermuda insurance executive has been named the 2012 Woman of the Year by the US-based Association of Professional Insurance Women (APIW).

Executive Vice President, Corporate Business Development for Bermuda-based Argo Group, Barbara C. Bufkin, was presented with the prestigious award at a ceremony in her honor at the New York Marriott Marquis Hotel June 19.

President and CEO of Argo Group Mark E. Watson III, has noted how proud his entire organization is of Ms Bufkin.

He commented: “As both a professional and a mother in a male dominated industry, Barbara blazed a trail for women entering today’s world of insurance. I convinced her to join our company shortly after I took the helm and she’s been one of my most valued team members ever since. Her professional achievements, leadership ability and the example she sets for others have greatly contributed to our team’s success over the past decade.”

The APIW Insurance Woman of the Year award, presented annually since 1976, recognizes an exceptional woman who has achieved prominence in the insurance industry. Ms. Bufkin was chosen as this year’s award recipient in recognition of her outstanding achievements and leadership within the industry, as well as her commitment to the advancement of women.

Barbara C. Bufkin had previously been Senior Vice President, Business Development of Argo Group International Holdings, Ltd. since August 2007. She began working with Argonaut Group as a reinsurance consultant in 2001 and formally joined the company as Vice President, Corporate Business Development in September, 2002.

In 2007, after the merger with PXRE, Ms. Bufkin agreed to relocate to Bermuda and assumed responsibility for new business strategies and development as well as ceded reinsurance for Argo Group. Ms. Bufkin has spent her entire career in reinsurance and insurance.

A powerful leader within her organization and industry, Ms. Bufkin serves as an exemplary role model for women. She has spent considerable time and effort as an advocate for women in the workplace. Ms. Bufkin has encouraged the development of human resource policies that are more attractive to women candidates and, during her tenure, the number of female vice presidents at Argo Group has more than doubled.

Ms. Bufkin is a mentor to professional women inside and outside of the insurance industry. She participates in women’s industry groups in Bermuda, London and the US, together with other networking, which provides her with the opportunity to help others.

Ms. Bufkin serves as a director and on the membership committee for the Bermuda Centre on Philanthropy and has been a director for the Association of Bermuda International Companies since 2008. She has been an independent director of Behringer Harvard Opportunity REIT I since its launch in 2005, where she has chaired its nominating committee and served as a member of the audit committee. In addition, she served as a director of Southwestern Insurance Information Service from 1986-1993.

Ms. Bufkin has been recognized by numerous industry groups and publications, including Who’s Who in Insurance and Risk Management, Business Insurance Women to Watch 2006, Reactions Magazine Rising Star 2006 and the Top 20 Women to Watch – The Glass Ceiling, Reinsurance Magazine, August 2009.

In announcing this year’s award, APIW President Carol Ann O’Dea said: “APIW is proud to bestow this honor on Barbara Bufkin. She serves as an outstanding role model. Her mentoring, flexibility and accommodation of personal situations extend equally to all colleagues regardless of gender. Her leadership and accomplishments, as well as her commitment to supporting and advancing women, are exceptional examples of all of the qualities that APIW looks for in the recipient of this highly prestigious honor.

“She has portrayed exemplary professionalism in all her activities and is highly respected both within her organization and within our industry.”

Founded in 1976, APIW is the leading organization dedicated to advancement of professional insurance women and to the recognition of their contributions to the industry. APIW sponsors programs that encourage professional development and provide opportunities for members to hone leadership skills. ☻
Another major insurance conference held in Bermuda in June was the 6th Annual Insurance Day Summit Bermuda, with a theme of “Rethinking Reform, Risk and Regulation”.

More than 50 chief executive and senior management speakers imparted their industry wisdom over two days.

Discussions included the US federal advisory committee on insurance, the Eurozone crisis, enterprise risk management and a number of other topics.

These notes detail a few of the stories emerging from the event.

The next industry venture for Bermuda insurance industry icon, Brian O’Hara, could bring a significant new line of business to the Bermuda market.

Through a firm called Front Street Advisors Ltd, he has partnered with a group that is creating a form of insurance that would allow banks to count intellectual property and other intangible assets of their borrowers as collateral, and in so doing, ease their capital requirements.

The former XL Capital CEO said that Bermuda was the place with the concentration of talent and capital necessary to realize the idea.

He said, “There is nowhere else that you can get a variety of companies with that kind of capital and that kind of expertise and the collaborative DNA that could get their minds around the complexity and challenges of investing in something new like this.”

Mr. O’Hara said that it would help banks faced with a very high cost of capital.

He said, “There is nowhere else in the world that you can walk around in one square mile and talk to billions of dollars of capacity and develop something of this nature and size.”

He is also interested in a new model for run-off of discontinued lines of business, with a new legal approach.

“To make it work,” he said, “a special purpose vehicle would be ideal to post collateral to give comfort to the run-off company that it would work, and with reinsurance behind it, if it doesn’t work.”

After years of discussion about the convergence of the insurance and capital markets, real examples of it were seen in sidecars and catastrophe bonds. The new classification of “Special Purpose Insurer” was created in Bermuda a few years ago, but he sees a wider use for it than just cat bonds and sidecars.

“There’s a new arm developing in the Bermuda market that we call ‘Hedge Re’,” Mr. O’Hara said, “where you have a merger of the capital investment market and the underwriting market. It’s something we’ve talked about for decades but it’s taking place right in front of our eyes now, big time.

“That’s where the action is taking place. It’s unlikely we’re going to see another class like 2001 or 2005, because there is ample capacity of underwriting platform and talent embedded in Bermuda already. It’s all about capital.

“Even after last year with the huge losses in the market, it didn’t hit the capital. We have plenty of capital for the normal challenges but to meet the peak risk challenges, we need capital that can come and go. And that’s what the beauty of the sidecar is.”

A top Bermuda insurance executive told the Summit that one key to the future of the Bermuda insurance market is maintaining the pool of industry talent for which the Island is renowned.

As panelists discussed the importance of industry talent in the leading Bermuda insurance market, XL Insurance Bermuda Ltd President, Patrick Tannock, made the point that the ability to acquire the best talent was just as important as access to capital, especially with the rate of change in today’s world.

He said there is a paradigm shift in the rate of change – evident in the ever-growing computing power and emerging risks.

CEO of Hiscox Bermuda, Charles Dupplin, said his company continued to seek the best talent possible in Bermuda and around the world.

Chairman of Aon Benfield’s Bermuda operations Paul Markey believes the future will see more Bermudians working in the industry around the world, taking advantage of a world of insurance knowledge in other countries.

A deluge of collateralized capital has been flooding the Bermuda insurance market in anticipation of huge returns.

But Bermuda’s top insurance brass say that the continuing influx of capital is changing the market dynamic. Some of the money may end up being trapped in the insurance industry, tied up with ongoing liabilities. That, together with a low interest rate environment may leave some investors eager, but unable to get out.

The money is capital that has not been able to find a home in the financial community and is looking for diversified opportunities.

The panel warned that surplus capital can be too much of a good thing, as excess capacity to write business artificially depresses rates.

Bermuda is on track for achieving equivalency with Solvency II, according to The Deputy Governor of the Central Bank of Ireland, Matthew Elderfield.

Speaking at the Summit, Mr. Elderfield, the former CEO of the Bermuda Monetary Authority, said the first assessment of Bermuda by the European Insurance and Occupational Pensions Authority (EIOPA) had been largely very positive.

Bermuda, Japan and Switzerland are three countries in the first wave of those non-EU countries seeking recognition from the European Union that their regulatory regimes meet key standards.

Mr. Elderfield said, “By being in the first wave of the equivalence assessment process, and by hopefully gaining a favorable outcome, Bermuda will be in the enviable position of having definitively cleared the EU process before many other competitor jurisdictions are able to do likewise.

“That provides absolute certainty to the Bermuda market as to the treatment they will receive under the EU rule book, and it means that, unlike some other countries, the risk of adverse regulatory developments will not be hanging in the background.”
Capital strategy employs new model

Continued from page 3

underwriting. There were periods of enormous loss, and then there were payback periods in hard markets. Today, that’s changed. Last year was the second-worst year in the history of the catastrophe business, but rates, which should be going up, have leveled.

While the margins on underwriting had not changed, interest rates had plunged, he added. The yield on a 10-year US Treasury bond was now below 1.6 percent as he spoke, rather than the five percent it had been 20 years ago. Stock market valuations for catastrophe reinsurers were, in many cases, at 70 or 80 percent of book value.

However, the industry was still managing to attract new capital, he said, increasingly through ILS, as investors, including large pension funds, looked for alternative ways to boost yield amid volatile markets and anemic global growth.

“Insurance Linked Securities are attractive, because they are not correlated with the markets, with interest rates nor with the economy,” Mr. Kramer added. ILS Capital Management aims to offer investors a diversified portfolio of risks to smooth out volatility and deliver consistent returns over the years. It uses portfolio analytics to achieve this.

Bermuda has become a leading ILS jurisdiction over the past two-and-a-half years, with more than $4.25 billion of such securities having been listed on the Bermuda Stock Exchange within that time.

Mr. Kramer referred to one of them, Everglades Re Ltd., the vehicle for the largest ever single-peril catastrophe bond deal, providing hurricane cover for Florida Citizens Property Insurance.

“They were trying to sell $250 million and they ended up selling $750 million,” he said. “That was better than the Facebook IPO!”

THE BERMUDA INSURANCE MARKET CONFERENCE SCHEDULE

2012 Events

Vermont Captive Insurance Association Conference  Aug. 7-9
Burlington Sheraton Hotel & Conference Center
Burlington, VT
www.vcia.org

RIMS Canada Conference  Sep. 9-12
Saskatoon, Saskatchewan, Canada
http://www.rimscanda.ca

Captive Live USA  Sep. 10-11
Fairmont Chicago
Millennium Park
Chicago, Illinois
www.captiveliveusa.com

American Society for Healthcare Risk Management (ASHRM)  Oct. 7-10
Gaylord National Resort & Convention Center
National Harbor, Maryland
www.ashrm.org

The National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO)  Oct. 8-11
Atlanta, GA
http://www.napslo.org/

Bermuda Captive Seminar Series  Oct. 9
Presenting by request across North America, this is the latest captive seminar on strategic captive uses for risk managers and the gamut of captive professionals.
Detroit, Michigan
rochelle.simons@logic.bm

Property Casualty Insurers Association of America (PCI)  Oct. 28-31
St. Regis Monarch Beach
Dana Point, CA
www.pciaa.net

Professional Liability Underwriting Society (PLUS) International Conference  Nov. 7-9
Sheraton Chicago Hotel & Towers
Chicago, IL
www.plusweb.org

European Captive Forum (ECF) 2012  Nov. 13-14
Luxembourg Congres
Luxembourg
http://europeancaptiveforum.com

2013 Events

World Captive Forum  Jan. 28-30
Turnberry Isle Miami
Aventura, Florida
http://worldcaptiveforum.com

Bermuda Captive Conference  June 10-12
Fairmont Southampton Hotel
Southampton, Bermuda
www.bermudacaptive.bm

Colin Freeman (l) from Barclays Wealth chats with Cedar Management colleagues Chris Russin and Tom McMahon (r).