Swiss Developments in Alternative Risk Financing Models

All-round preventative measures and tailor-made insurance solutions can help companies overcome a whole range of unforeseen events. Alternative risk financing solutions offer even greater possibilities - the corporate customer participates to a greater extent in a good claims experience, they can deal with previously uninsurable risks and receive a group-wide control instrument for their risk management needs.

From the Client to the Partner

In the past, companies have sought insurance cover primarily in order to transfer their risks to an insurer against payment of a premium. But traditional insurance solutions can only cover part of the spectrum of corporate risk. Furthermore, they can only offer corporate clients limited opportunities to share in any gain arising from the insurance business. Today, companies have far greater scope for optmising their risk portfolio.

Above all, the primary aim is to exploit the opportunities arising from the whole gamut of risk refinement and risk financing measures - they are the keys to optimisation of corporate risk management.

Positioning Alternative Risk Financing Models

Like traditional solutions, alternative risk financing models provide cover for all kinds of exposure, but they differ in the type of financing and goals they pursue. They also offer the possibility of ongoing stabilisation of earnings and loss ratios, which impact on the annual results.

Corporate customers can carry risk at the primary insurance level and also through reinsurance. Swiss experience up to now indicates that alternative risk transfer solutions are, for the most part, confined to the reinsurance sphere.

The following factors frequently lead corporate clients to explore the possibilities of alternative risk financing:

Good Claims Experience

Understandably, corporates with good claims experience show little inclination to pay insurance premiums, behaviour that is analogous to the law of large numbers. The individual implementation of an active risk manage-ment policy gives rise to a reasonable demand for individual rewards for good claims experience in relation to corporate risk.

Improved Coverage

Many insurance clients deal with risk exposures for which they receive no primary insurance coverage. Foremost among these are limited cover capacity and uninsurable risks such as political uncertainties, price volatility, loss obligations, patent infringements and other business risks.

The instruments of alternative risk financing offer companies the chance to meet such challenges head-on.

Performance-Related Management Instrument

Corporate customers provide risk managers with an instrument that provides group-wide risk transparency. The structured evaluation of claims and the search for risk sources make it possible to influence claims frequency. Systematic risk management allows differentiated, individual remuneration on the level of the local group company.

The Captive Concept

A captive is an insurance company established in the form of a stock corporation as a subsidiary of a non-insurer. The main purpose of such "captive” insurance companies is to assume the insurance risks of companies within their own group. Captives can be licensed as primary insurers or reinsurers. In Switzerland, the operating environment for the establishment of reinsurance captives has been deregulated, so that companies can take advantage of attractive local conditions.

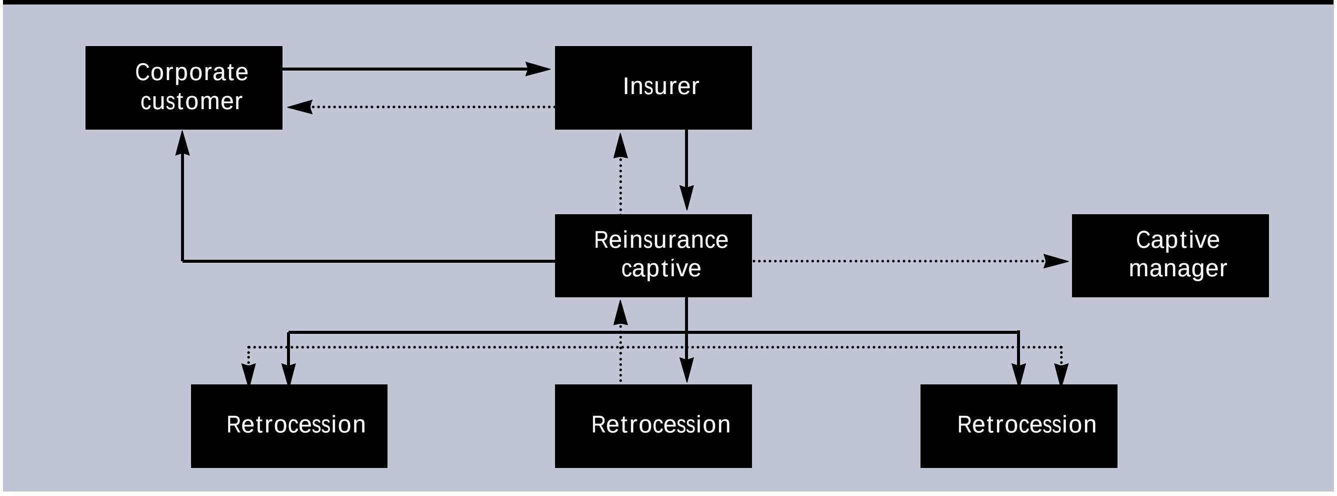
Rent-a-captive concept

For corporate clients who do not have their own captive, there is the possibility of a "rent-a-captive” arrange-ment. The customer defines a risk element which they want to cover themselves. This risk is then ceded through a reinsurance solution to the reinsurer, which may also be a subsidiary of "Zurich”, and assigned to the rent-a-captive account of the client. Premiums for the assumed risk are then credited and any claim settlements charged to the rent-a-captive account. Therefore, by means of reinsurance, the customer can participate directly in the good claims experience of its own risks.

Finite risk solution

Finite risk solutions are financing concepts with insurance risk transfer, in which the insurance company finances a substantial degree of the risk exposure itself. These are tailor-made solutions for national and international corporate clients. They are frequently used for difficult or uninsurable risks and are not limited to particular insurance segments.

Figure 1: Structure of Captive Reinsurance Programme with Retrocession



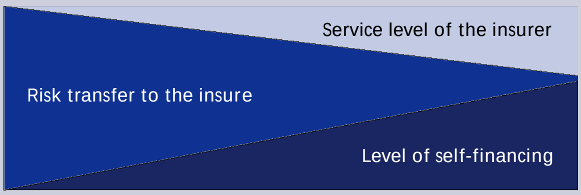
Finite risk treaties are written over a period of several years. The risk compensation is thus evaluated on an individual basis over a period of time.

Depending on the volume of risk transferred and the level of self-financing and service, the approach will be through banking or insurance-type techniques. Finite risk concepts can be used as a replacement for existing insurance, a complement to traditional insurance, or as a risk transfer for previously uninsurable risks. One of the appeals of finite risk solutions is that they are suitable for the requirements of direct insurance, reinsurance and for retrocessionary business.

Besides the classic insurance risks, other risks which affect the balance sheet or capital of a company can be covered, for example, models for the protection of the insured party from unforeseeable events or other traditionally uninsurable entrepreneurial risks. This may be the case in retrospective (loss portfolio) transfer and prospective (anticipation of future loss) programmes.

In finite-risk contracts, a fixed ratio of premium to risk-protection is arranged. The latter can be made up of an event-related limit and an annual limit or a treaty sum for a contract term of several years. Even in the case of a poor risk experience, the amount insured at the start of the contract is guaranteed. Generally the client participates in pofit sharing to a substantial degree, determined when the contract reaches full term and then paid out to the client. The profit quota share is calculated on the basis of the periodic premium plus the interest earnings, less any claim payouts and proportionate costs.

Figur e



Insurance solutions with low level of customer self-financing

Insurance solutions with high level of customer self-financing

Conclusion

If companies have an established alternative infrastructure, for example in the form of captive business, finite risk concepts can also be implemented as part of a retrocession programme. This allows the captive to provide the expected cover vis-à-vis the ceding company (usually a primary insurer).

Active risk management which incorporates the possibilities described above introduces a new quality into the relationship between corporate and insurance customers. By implementing self-insurance solutions in the form outlined above, the purchaser of security is elevated to the status of an insurance partner and benefits directly from sharing in the technical result.

Both sides are working towards, and realising, synergetic effects. The possibility of offering cross-functional, tai-lormade solutions in alternative risk financing from primary insurance, via reinsurance through to retrocession, evinces a client-centred philosophy.

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For further information, please contact:

Dr Paul Wöhrmann
Head of Financial Services
Zurich Switzerland
Corporate Customers

Tel: +41 (0)1 628 82 82
Fax: +41 (0)1 628 87 70
http://www.zurichbusiness.ch/art

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