

ACE at SCCIA Conference

By W. Allen Taft

The momentum of the captive insurance industry in our state after only three years of operation by the South Carolina Captive Insurance Association can be measured by the quality of attendance and speakers at our annual educational conference and membership meeting. The recent conference in Charleston is a case in point.

In an unprecedented showing of support for the South Carolina market, two executives at the pinnacle of the ACE insurance universe participated in the program – Dominic Frederico, CEO of ACE INA Holdings, Inc. as keynote speaker and William Curcio, President of ACE Risk Management, with a strategically compelling view of captive fronting.

The story behind the story is that the ACE executives flew from New York to Charleston and back on a day – last December 5 – of freezing and inclement east coast weather that threatened their plans to return to New York that afternoon for a long-scheduled and highly important business dinner meeting.

“We were watching the weather reports nervously on December 4 and the morning of December 5 when Dominic and Bill were due to speak,” said Dick Goff, the SCCIA board member who served as program chair of the conference. “But they never wavered from their commitment to South Carolina. On a day that they could have been excused because of threatening weather, they delivered for us – and the happy ending is that they got back to New York for their meeting.”

Later, Frederico brushed aside accolades for his arduous travel and put the focus back on SCCIA: “We were proud to have been a sponsor of this year’s SCCIA conference. As a leader in the alternative risk marketplace, ACE remains committed to its viability in the future. We are pleased to support the SCCIA in its industry efforts. Lead by Ernie Csiszar (South Carolina Commissioner of Insurance) and Jim Kinder (President of SCCIA), these efforts have already led to greater economic benefits for the consumer, but also for the insurance industry and for business in general.”

Bill Curcio underscored Frederico’s comments about the leadership of government and industry figures Csiszar and Kinder: “These two individuals, as well as those who support their efforts, are to be commended for their dedication to the further development and viability of the alternative risk transfer marketplace.”

The period since the conference has brought events that make Curcio’s December comments seem prescient. Recently he summarized his views: “We will face many challenges in the captive fronting market going forward. As insurance buyers look toward retaining more and more of their own risk, it is incumbent upon us in the insurance industry to continue to provide valuable alternative risk management solutions. With effective cooperation between brokers, customers, captive reinsurers and carriers, we can grow and help this important product evolve

for the mutual advantage of all parties.”

For those who didn't attend the conference, or who have requested summaries of Frederico's and Curcio's remarks, the following excerpts are provided:

Synopsis of Keynote Address by Dominic Frederico, Chairman and Chief Executive Officer, ACE INA Holdings, at SCCIA Conference, Dec. 5, 2002:

As an industry, our single, greatest challenge right now is our ability to listen, learn and develop collaborative solutions as we co-author our collective future. New solutions are urgently needed and hurdles can seem insurmountable.

In 1986, ACE found itself in a similar predicament. But now, less than 20 years later, ACE has grown from a bold idea into one of the few truly global American insurers, with offices in more than 50 countries and annual premiums in excess of \$10 billion.

EVENT RISK

For those of us in today's insurance industry, the post-Enron, post-9/11 environment has led us to a new reality and one that focuses on "event risk." Clearly the meaning of risk is broadening, encompassing any material exposure to the integrity of our balance sheet from a source that is not known or quantifiable today. This now includes mold, asbestos, terrorism, white collar crime, snipers, earthquakes, tornadoes, increasing credit risks, legislative changes, the impending threat of war, and other unknowns.

NEW RESPONSE ACTIONS

We will need to take new actions in the industry, and embrace a new fiduciary duty to our shareholders, customers, and to our employees. It's about who you want to insure, and who you don't. The right customer for you a year ago may no longer be the right customer for you now. Not only will we need to improve the understanding of the correlation between different risks we underwrite, but we will need to collect employee concentration data, conduct rigorous analytical phases, and revise underwriting and marketing plans. At ACE, we've even taken it a step further by creating an enterprise risk management group and hiring a Chief Risk Officer.

CUSTOMER DIFFERENTIATION

During 2002, new underwriting initiatives created opportunities for customers to differentiate themselves. With customers actually taking a proactive and positive approach, ACE has witnessed numerous commercial businesses – current as well as prospective customers – take the time to ensure that all levels of our company understand just what makes them different. Instead of resisting change, the reaction has been surprisingly different. Customers are embracing and traveling the road of change.

EMERGING CONCERNS FOR THE FUTURE

Embarking upon this new reality of event risk, you can expect to see four major emerging issues: natural catastrophes and our ability to proactively anticipate them; ensuring capacity should the number of European insurers and reinsurers withdrawing from the US market continue to accelerate; commitment to receivables, despite the occurrence of recent major downgrades and major reserve inadequacies being reported across the P&C industry; and crucial communications efforts that focus on all stakeholders in our business.

As we pursue the challenge of finding solutions for the many faces of event risk, we will find ourselves testing our collaborative skills as never before.

“Fronting For Your Captive – A Changing Marketplace,” synopsis of address by William N. Curcio, President, ACE Risk Management, at SCCIA Conference, December 5, 2002:

In order to sustain a viable Alternative Risk Transfer (ART) market that can be brought into the future, a new paradigm must emerge. The entire fronting community needs to learn from its mistakes and return to a healthy state for the captive fronting market. Otherwise, its value may be compromised, and even under threat from regulators.

With the recent downfall of several large, long-standing carriers, along with the effective withdrawal of other competitors, a void has been left in the ART sector. As a result, players in this market have been stripped of choice as well as long-term value that remains available to single parent insureds and other buyers of captive products.

The solution cannot be left solely to the self-correcting market influences of the laws of supply and demand. With further insolvencies, we can anticipate greater shrinkage in the number of available providers while inviting more regulation.

Today, 10 years after a bill that defined fronting was passed by the National Association of Insurance Commissioners (NAIC), no state has adopted it. The purpose of the bill was not only to define fronting but also to protect buyers from abuses that can occur, particularly in light of concerns regarding insolvency. Unless the industry is able to better address its own irresponsible behavior, it is more than possible that regulators will renew their efforts.

A new covenant needs to emerge in the fronting arena, bringing with it a change in attitude, behavior and practices from across all sectors of market participants, resulting in a reasonable and responsible balance. The fronting community, in this case a trinity of the carrier, the reinsurer and the buyer, should embrace cooperative ways to manage their risk. With such a covenant, all parties - including brokers – will support the future viability of our marketplace. This must be done through sound, independent decisions that are less oriented to the cheapest price and minimal carrier involvement and more toward sustaining an important product.

The fronting community, however, does share the responsibility to prevent a front company from becoming a “potted plant.” The front carrier should not and cannot ignore the immense financial risk that exists well beyond the policy period in most third-party contracts. Customers and brokers need accept a more active role by selecting fronting carriers that have the financial strength, the expertise and can

provide quality claims and engineering service.

The most significant exposure for a fronting company is credit risk. When the reinsurer fails financially or will not honor its financial obligations, it becomes a significant concern. The fronting carrier must require collateral commensurate with the risk and pricing.

The captive fronting arena represents a time-honored tradition of creative, alternative risk solutions. It must remain vibrant and available to all those who seek to purchase these products. Our unwavering commitment to this important marketplace, however, must be supported by an equivalent dedication by all parties involved. This will be the only way to preserve the undeniable benefits and value over time of fronting products. Support for the ART marketplace through informed and sound business decisions, will facilitate our ability to afford these products well into the future, in spite of the toughest challenges we may face.

The dynamic participation of Frederico and Curcio at the SCCIA conference reflects the organization's strategic view, according to program chairman Goff: "We know that to succeed as an organization and to attract people to our conference, we must offer the very best in speakers and professional education opportunities. Participation by our ACE friends is a prime example of that strategy."

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