The notion of insurance began in the 13th century, with ship owners wanting to protect themselves against catastrophic losses. Fast-forward 800 years and the insurance industry has certainly evolved beyond nautical preservation. Providers of personal or institutional solutions are now viewed as risk managers and trusted advisors.

So what happens when two long-time “insurance guys” get together and talk shop about their corner of the insurance world – collateral? You get some Insights on what challenges they face. Perspectives on what they think clients need. And, a spirited conversation on what it takes to be successful.

Robert Quinn, vice president and business development officer representing the Wilmington Trust Insurance/Reinsurance/ILS Trust product in New York, and Peter Rapciewicz, vice president, Risk Finance Practice, Lockton Companies, sat down recently over a reasonably hot cup of coffee and this is what they had to say.

**Pete, let’s talk about collateral. We’ve both been working in this sector for some time, as the trustee, beneficiary, and as a broker. What are your views on the keys to “collateral success”?**

**PR:** I’ve been in the insurance industry for more than 15 years. The majority of that time spent in the alternative risk/risk financing space. Collateral is a key component of this area. On the market side, I was responsible for the oversight of a large collateral trust portfolio (deductible and reinsurance), as well as various alternative collateral solutions. It was important to ensure the product offerings were flexible for the brokers and clients, while minimizing credit risk for the market. We wanted to provide a suite of value-added products, along with a top-notch service to provide a competitive advantage.

**RQ:** You and I have a similar tenure in this space. Many of my 16 years in the collateral insurance space have been spent working directly with you at either AIG or Lockton. A critical focus for me is always making sure the client is aware of the options. As a collateral specialist, I have traveled the world discussing trusts, letters of credit (LOCs), and the features and benefits of both.

PR: With respect to collateral and the transition to the broker end, I totally agree, it is our job to understand our clients’ needs, keep them informed of the types of collateral that exist, market offerings [what are acceptable types], and the pros and cons associated with each form of collateral. Cost of capital, fees, capacity constraints, and potential returns are all key focus areas.

**RQ:** Similarly, my team at Wilmington Trust gets fairly involved with these aspects as well. I find the clients very forthcoming with information when they believe there is an alternative that might be better for them.

**We have just mentioned two primary collateral options, LOCs and trusts. From the perspective of the beneficiary, what’s your view of the options from a security standpoint?**
**PR:** Pretty plain and simple. If we are looking at a bankruptcy remote product, you'll find that most carriers prefer LOCs followed by trusts.

**RQ:** Yes, I have found that to be the case. However, I have also found that most of the primary casualty carriers, both for captive and deductible programs, are happy to offer the trust as an alternative to LOCs. The carriers with whom I work seem to like offering alternatives to LOCs, which can be somewhat expensive and, in many situations, a lot of work to obtain (LOCs, that is). I want to come back to this point in a moment.

**In discussing LOCs, what would you say, from your broker and beneficiary experience, makes a good service provider?**

**PR:** Obviously this varies. Let’s tackle the letter of credit first. From the market side, there isn’t much interaction with the provider once the LOC has been posted. Prior to posting, you want to ensure that there are timely responses and the willingness to conform to the respective language. Once posted, you want to ensure that the service provider continues to be responsive to any potential requests for addenda. I’ve even seen great service providers offer to do in-person letter of credit swaps.

From the broker perspective, this changes quite a bit. We obviously look to responsiveness but also flexibility on offerings (e.g., collateralized vs. uncollateralized), as well as fee structure and potential returns.

**RQ:** I have noticed that there are a few consistently good LOC providers in the corporate insurance space – specifically the captive space, where certain banks actually specialize in this business. This is also true of reinsurance trustees. In fact, about everything you said regarding LOC providers can be said for trustees.

**Same question, but for trust accounts.**

**PR:** When compared to a LOC, a trust does require a little more interaction with the service provider through the life of the product, so needs will differ. While the perspective is different (market vs. broker), the needs overlap. It’s critical to have a service provider that is responsive, in order to meet deadlines for collateral postings. Key things we look for on the broker side are a quick and transparent onboarding process, timely management of fund inflows and outflows, product offerings (e.g., deposit products, funds, etc.), fees vs. returns, and finally, the experience of the team at the service provider.

**RQ:** I agree that interaction between the parties is increased when a trust is employed. Additionally, when considering the two alternatives, there is one point that is often forgotten and is a critical difference: once the trust is established, there is no need to “renew” it on an annual basis. This, along with the potentially large savings, is one of the greatest benefits of using a trust. LOCs have to be renewed, which means the client has to go through the credit review process each year.

**Pete, you have considerable experience in establishing reinsurance trusts and LOCs. In many situations, the carriers still prefer LOCs. Why do you suppose that is?**

**PR:** As I mentioned previously, I think this is a straightforward answer. There are two common responses: the first is the perception of a LOC being more bankruptcy remote than a trust, and the second being the minimal administration of the LOC (for the insurance carrier) when compared to the alternative.

There are obviously varying opinions on whether or not a LOC is a more bankruptcy remote product than a trust. These can differ by market. However, I think if you have a financially stable company those concerns can be eased through direct conversations with their respective credit officers.

**As a proponent for your clients, do you have any general recommendations that you give them when considering the options?**

**PR:** I can’t say it enough; it is our job to understand our clients’ needs, from the cost associated with each form of collateral to capacity needs or constraints. Once we identify the most efficient and effective product, we then select a service provider who understands those needs and who can provide a solution that works. Collateral requirements are not going away. Clients want a service provider that they can form a long-term partnership with – one with a team that is competitive, efficient, responsive, and experienced.

**RQ:** I would simply implore the client to do the analysis on both. Without understanding the features, benefits of, and limitations of each, there could be a lot of money left on the table.