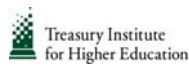


Insurance Trusts Overview Treasury Symposium 2006

February 1, 2006

Jack Fruchtman, Vice President
and Business Manager – Insurance
Trust and Escrow Group

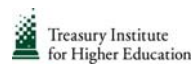
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Agenda

- ◆ Background
- ◆ Purpose of Insurance Trusts
- ◆ Insurance Trust Types
- ◆ Captives Overview
- ◆ Letters of Credit Environment
- ◆ BNY Trust Solution
- ◆ Trust Agreement Requirements
- ◆ Summary



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Background

Dedicated Insurance Group

- ◆ Operating out of Corporate Trust Division
- ◆ Approximately \$65 billion in assets
- ◆ All types of trusts handled
- ◆ Relationships with hundreds of insurers and most major brokers/captive managers
- ◆ 18 professionals on staff (Relationship Managers, Associates and support staff)

Purpose of Insurance Trusts

- ◆ Represent collateral
- ◆ Alternative to Letters of Credit
- ◆ Decreases credit encumbrances
- ◆ Less expensive
- ◆ Meet regulatory requirements

Insurance Trust Types

Traditional Trusts

- ◆ Regulation 114
 - Credit for reinsurance from alien insurers
 - NYS law
 - Stipulates requirements for trusts and investments
- ◆ Regulation 20
 - NYS regulation
 - Allows a single trust for all U.S. liabilities
 - Cumbersome to establish
- ◆ NAIC Surplus Lines – Regulation 41
 - Standard agreement
 - For coverage where frequency and severity of loss are not easily calculated
 - Each state has its own rules as to what may be covered
 - Not for life insurance, workers compensation or accident and health

Insurance Trust Types

Non-Traditional Trusts

- ◆ Deductible Trusts
 - Companies/institutions increase deductibles to lower premiums
 - Insurers require collateral to assure deductibles get paid
 - Typically the coming year's aggregate deductibles plus previous year's unpaid claims
- ◆ Surety Bond Related Trusts
 - Similar concept to deductible trust
 - Surety bonds may be posted in a number of instances such as:
 - Workers compensation
 - EPA requirements
 - Casualty programs
 - Not widely used in current environment
- ◆ EPA Related Trusts
 - Performance guaranty in connection with environmental reclamation
- ◆ Captive Trusts

Captives Overview

Captive Insurance Companies – What are they?

In its simplest form, a captive can be defined as a wholly owned insurance subsidiary of an organization not in the insurance business whose primary function is to insure some or all of the risks of its parent.

Captives Overview

Captive Insurance Companies – Types

Single-parent captives - underwriting only the risks of related group companies.

Association captives - underwrite the risks of members of an industry or trade association. Liability risks such as medical malpractice are frequently insured in this way.

Agency captives – formed by insurance brokers or agents to allow them to participate in the high-quality risks, which they control.

Rent-a-captives – are insurance companies that provide access to captive facilities without the user needing to capitalize his own captive. The user pays a fee for use of captive facilities and will be required to provide some form of collateral so that rent-a-captive is not at risk from any underwriting losses suffered by user.

Special purpose vehicles (SPV's) – are used in risk securitization. They are reinsurance companies that issue reinsurance contracts to their parent and cede the risk to capital markets via a bond issue.

Captives Overview

Key reasons for forming a Captive

- ◆ Lower insurance costs
- ◆ Cash flow
- ◆ Unavailability of coverage
- ◆ Access to the reinsurance market
- ◆ Tax deductibility of premiums

Captives Overview

Counting Captives – 2004

Bermuda	1,150	Turks & Caicos	147
Vermont	700	Hawaii	147
Cayman Island	694	South Carolina	119
Guernsey	410	D.C.	47
BVI	350	Arizona	39
Barbados	257	Nevada	38
Luxembourg	219	New York	27
Dublin	214	Delaware	7
Isle of Man	175		

Letters of Credit Environment

The environment is changing – letters of credit are a problem because:

- ◆ They are expensive
- ◆ They are getting more expensive
- ◆ They reduce ability to borrow for operations
- ◆ They create “contingent liabilities” on balance sheet
- ◆ They create an overall drag on liquidity

BNY Insurance Trust Solution

Why?

- ◆ FAR less expensive
- ◆ Increase available credit / decrease credit encumbrances
- ◆ Reduce “contingent liabilities” on balance sheet

What?

- ◆ Replace L/C's with BNY Insurance Trust
- ◆ Place FINANCIAL assets into BNY Insurance Trust, pledge to insurance carrier/surety provider/other as sole beneficiary
- ◆ What type of assets?
 - Rule of thumb: “A” rated U.S. based debt instruments or better
 - YES: “A” rated bonds or better, treasuries, CP, CD's
 - NO: stocks, below “A” rated debt, real property, receivables, etc.
 - Liquid, safe, predictable in value

BNY Insurance Trust Solution

- ◆ Replace captive L/C's
 - Many captives have cash collateralized L/C's
- ◆ Replace deductible program L/C's
- ◆ Replace L/C's used to back-up surety bonds (limited applications)
- ◆ Replace surety bonds posted to:
 - Insurance carriers
 - Federal or state EPA requirements and superfunds
 - Some state workers compensation programs
 - Others

Cash Collateral L/C? Great Fit!

Why Doesn't Everyone Do This?

- ◆ Biggest reason: client does not have the liquid assets to place into a trust
- ◆ Client has other uses for their "excess" cash
- ◆ If client changes carrier, the "old carrier" may have collateral requirements outstanding; some carriers may not allow for the use of a trust in this situation
 - Not to be confused with old letters of credit that are posted for prior years with their current carrier
- ◆ Carrier acceptance issue: what happens to trust assets in the event of an insolvency?
 - Issue of "perfected security"
 - Most are "satisfied" after the 90-day PREFERENCE PERIOD
- ◆ Caveat:
 - Carriers evaluate each client individually (for financial soundness)
 - This alleviates their concern about the insolvency question

Other Issues

- ◆ Income from the BNY Insurance Trust is usually directed back to depositor, not back into the trust
- ◆ Assets remain on the books of depositor as “restricted cash/other assets”
- ◆ Turn a “contingent liability” (L/C) to a “restricted asset” (BNY Insurance Trust)
- ◆ BNY offers funds managed by depositor’s “credit relationship” banks
 - Allows depositor to enhance their banking relationships by directing “non-credit” business to their credit relationship banks
- ◆ One trust is required per carrier
 - Can usually aggregate all L/C’s into one trust
- ◆ Trust is fairly easy to dissolve
- ◆ Allow for 10 days to set up, but in some situations, it can be done more quickly
- ◆ The BNY Insurance Trust does not need to be renewed or negotiated each year
 - Define the collateral, then simply adjust the trust amount

Key BNY Trust Agreement Requirements

- ◆ BNY and carriers perform due diligence background checks on each new relationship
- ◆ Trustee seeks indemnification from grantor
- ◆ Stipulate required collateral level
- ◆ Trust for sole use and benefit of beneficiary
- ◆ Right of beneficiary to withdraw assets
- ◆ Beneficiary must approve asset substitutions
- ◆ Assets only invested in eligible securities
- ◆ No invasion of corpus for paying Trustee expenses
- ◆ Right of grantor to withdraw income
- ◆ Need beneficiary approval to terminate trust

Summary

Insurance Trusts:

- ◆ Cost less
- ◆ Increase debt capacity
- ◆ Satisfy regulations
- ◆ Grantor keeps investment returns