

The claim load is connected to the risk strategy

Employers' medical stop-loss premiums under the spotlight

Delaware and Nevada

The states' captive leaders on NAIC discussions

Heavy hand

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Companies can get back to business

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CITIBRIEF

AIG and Scott begin partnership

AIG Benefit Solutions and Scott Captive Solutions have entered into a strategic partnership to offer CAPvantage Select, a national group medical stop-loss captive programme.

The programme is designed to meet the growing demand among mid-market employers for self-funded options in the era of healthcare reform and does so by helping companies to control healthcare costs and reduce their risk—as well as managing tax expenses and fees associated with fully insured products.

Pim Jager, vice president at Scott Captive Solutions, commented: “Group captives allow employers to address the volatility, non-transparency and cash flow concerns often associated with the traditional self funded and fully insured market.”

“At the same time these Group Captive programs provide tools and partnerships with best in class vendors to help employers better manage the health risk in their population and drive better financial outcomes in the long term.”

Bob Hosler, national sales director of stop-loss captives at AIG Benefit Solutions, added: “AIG Benefit Solutions prides itself on helping employers provide valuable and affordable protection to their employees.”

“One of the major challenges we see facing mid-market employers today is the rising cost of employee health coverage and determining a cost-effective approach to maintain their employee benefit programs. CAPvantage Select was developed to specifically meet this growing need.”

Rent-A-Center ruling mirrors David versus Goliath

The US IRS’s loss of a huge captive insurance lawsuit has set a precedent for income tax strategies, said Estate Street Partners.

The firm, which helps clients protect assets from divorce and lawsuits, said that certain tax and wealth planning benefits provided by captives have prompted the IRS to increase scrutiny and examinations of these structures, but that the recent Rent-A-Center ruling proves that captives are still viable entities when it comes to certain tax deductions.

In *Rent-A-Center v IRS*, the US Tax Court ruled in January that payments to Rent-a-Center’s wholly owned captive, located in Bermuda, were deductible under section as an insurance expense.

The Tax Court majority found that the Bermuda-based captive insurance company was a genuine insurance company because it was created for significant, non-tax reasons and

that there was no impermissible circular flow of funds.

The opinion of the Tax Court majority next turned to address whether the policies at issue involved insurance risk, concluding that the premium payments made by the taxpayer’s subsidiaries to the captive insurance subsidiary were deductible.

The conclusion relied for a significant portion of its analysis on a similar case that was heard in 1989, involving Humana Inc. The case was among a number of similar lawsuits that aim to define what constitutes an insurance company.

“Captives can benefit individuals from an estate planning and wealth management point of view, but everything must be treated as a business,” said Rocco Beatrice, managing director of Estate Street Partners.

“Individuals must pass an income and revenue check as it relates to the business entity they control; in essence, the company must have annual revenues of at least \$1 million and net income of \$500,000. This is not a matter of individual net worth; it is all about making money from a business enterprise.”

“We can see the financial reasons for Rent-a-Center to form a captive in Bermuda. In a way, the millions of dollars the company spent on litigation against the IRS probably came from the savings realised through years of captive coverage.”

“The Rent-a-Center captive structure is quite complex, but what the IRS seemingly had an issue with were the large payments made by the company to the captive they controlled. The IRS determined that these were not tax deductible for insurance premiums, which are normally deemed as trade or business expenses deductible as per Section 162 of the Internal Revenue Code (6).”

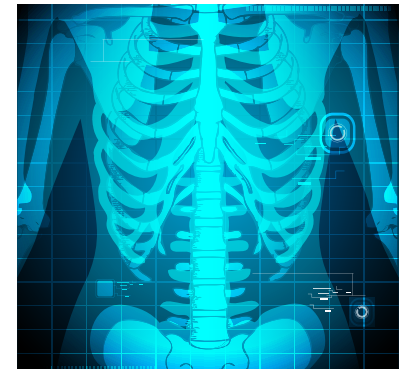
“Rent-a-Center decided to take on the IRS in a case that resembles the David versus Goliath parable, and they have scored a major victory in battle, but there is also a chance that the IRS may appeal.”

Beatrice commented that the Tax Court opinion is important on two levels: the IRS has shown a certain disposition towards examining captive structures as sham entities, which the Tax Court did not see in *Rent-A-Center*; and public opinion of the captive industry is bound to improve as a result of this ruling.

Transmonde in ‘excellent’ health

A.M. Best has affirmed the financial strength rating of “A (Excellent)” and issuer credit rating of “a” of Transmonde Services Insurance Company.

The ratings reflect Transmonde’s historical strong operating performance, excellent risk-adjusted capitalisation and ability to generate



Big interview

It is incumbent on the captive industry to show that it can succeed without the heavy hand of regulation, according to Tom Jones of McDermott Will & Emery

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Intercompany loans

Although the concept of intercompany loans is not new, the issue remains a hot topic for regulators, captive managers and rating agencies alike, says Donald Thorpe of Fitch Ratings

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Malta panel

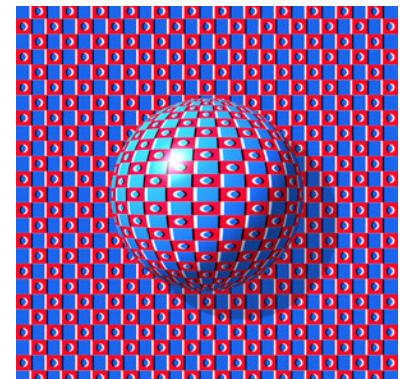
With the implementation date of Solvency II confirmed, captives can get back to business

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Delaware discussion

With a thriving captive industry already established, Delaware’s next challenge is to oppose the newest NAIC proposal

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Nevada insight

The state is watching captive changes at the NAIC closely, says Michael Lynch

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Medical stop-loss

Major organ transplants aren’t cheap, as employers’ medical stop-loss premiums are revealing

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net underwriting income and net income in recent years. These factors have allowed Transmonde to enhance its surplus considerably.

Partially offsetting these positive rating factors are Transmonde's relatively high retentions and concentration in liability lines with significant loss severity potential.

An additional offsetting rating factor is its limited market profile as a single parent captive. Transmonde provides professional, general and pollution liability coverage to members of the International Association of Superintendents, which is a subsidiary of SGS SA—a publicly traded Swiss company.

Transmonde has maintained very conservative underwriting leverage ratios as surplus has consistently grown to support its business volumes. The company has posted low loss and loss adjustment expense ratios, reflecting SGS's effective risk management.

The company's relatively high per occurrence retentions are mitigated by significant deductibles and conservative reserving practices. The ratings recognise the company's balance sheet strength and conservative underwriting leverage measures as well as its role as the captive insurance company of SGS.

While A.M. Best claims that Transmonde is well positioned at its current rating level, factors that may lead to negative rating actions

include unfavourable operating profitability trends, outsized investment losses and a significant decline in its risk-adjusted capital that would not be supportive of its current rating level.

GC paints global renewal picture

The 1 April 2014 renewal was marked by price reductions and more tailored reinsurance coverage, according to Guy Carpenter & Company.

Strong balance sheets, an abundance of capacity and a consolidation of buying led to lower reinsurance pricing across most territories and business segments at the renewal.

James Nash, CEO of Asia Pacific operations at Guy Carpenter, commented: "Despite a spike in insured losses during the first quarter of 2014 after severe storms and floods hit parts of Asia, Europe and the US, excess reinsurance sector capital and rising supply from traditional and alternative sources continued to impact the market and affect pricing in Asia and the US at 1 April renewals."

Japan

Pre-renewal expectations in Japan proved correct as easier market conditions returned on 1 April. The degree of rate decreases was generally greater than expected and Japanese buyers benefitted from price and cost reductions

in most main lines of business, as supply often exceeded demand.

Mergers, corporate restructuring, improved cedent balance sheets and a combination of perils in catastrophe covers all culminated in reduced demand at renewal.

On the supply side, competition was heightened by reinsurers' strong balance sheets, the relatively high starting position of Japanese pricing as compared to historical levels, the foreign exchange depreciation of the Japanese yen, the availability of cheap and broad retrocession cover, and reinsurer growth plans.

South Korea

Property excess of loss programmes in South Korea were significantly affected by three big risk losses in the past year. Adjustments were consequently made to the deductibles of South Korean non-marine treaties. Nevertheless, there was sufficient capacity to place business.

Reinsurers' interest in South Korean casualty excess of loss lines was strong at 1 April renewals due to their strong historical performance. This, however, brought increased competition at renewals, driven by new participants in the space.

India

Although India was hit by a number of natural catastrophes in 2013, including flooding and

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cyclone landfall, the events had a limited impact on the market, with only a few companies picking up losses.

Original property rates remained soft with no signs of correction, despite reinsurers voicing concern and retreating from proportional programmes.

Notwithstanding cedent fears of placement shortfalls at 1 April, programmes did get placed late in the renewal, supported by select reinsurers that put up substantial lines and then leveraged their position to get equal shares on non-proportional programmes.

Although softening market conditions prevailed at renewals, it was not to the extent of the wider market as many Indian programmes started from a lower base technical position.

US

Soft pricing and a specific focus on tailored terms and conditions were again evident at 1 April for US property catastrophe business.

Although the bulk of protection purchased was still placed on a traditional excess of loss basis where capital market sources have less involvement, alternative capacity providers continued to affect the market by offering capacity with flexible terms and conditions at reduced pricing while traditional providers responded to market conditions, protecting their market share.

This competitive environment is expected to continue into the mid-year renewals.

Money managers and mutual funds in ILS surge

Willis Capital Markets and Advisory (WCMA) has seen the insurance-linked securities (ILS) investor base broaden during Q1 2014, according to its quarterly report.

Q1 2014 saw increased participation from money managers and mutual funds investing directly in ILS in particular, while Q2 2014 is on course for strong levels of issuance—with the deal pipeline developing on the back of the successful executions in the first quarter.

According to the report, the bulk of the deals in Q2 are likely to include US hurricane exposure.

The report also found that Q1 2014 saw \$1.2 billion of non-life catastrophe bond capacity issued in six deals, compared to \$1.6 billion marketed in five deals during Q1 2013.

Bill Dubinsky, head of ILS at WCMA, said: “Money managers, mutual funds and ILS specialist investors still see significant value for their investors despite the fall in market clearing spreads. Note that a modest tick upwards in spreads would bring in a significant amount of additional capacity. As a consequence, the risk of running out of capacity seems limited.”

Dubinsky continued: “There are several factors driving the uptick in deals. First, new issuance risk spreads have continued to trend downwards falling from 12.0 percent in Q3 2012 to 6.4 percent in Q1 2014. Second, terms have become more flexible to allow for deals tailored to a sponsor’s needs.”

This flexibility can sometimes increase risk spreads, according to Dubinsky, despite the fact that sponsors have increased options.

Moreover, Dubinsky claims that speed to market is improving—reducing lead times between decisions to proceed and execution. This has, in turn, led sponsors and their brokers to resist overpriced private placements.

Turner cleared of charges

The indictment levelled at Frederick Turner, the founding principal of Active Captive Management (ACM), has been resolved.

The charges, relating to fraudulent insurance acts, have been dropped and the case has been dismissed.

A spokesperson for ACM commented: “Turner has built ACM to have captive management practices and procedures that ensure accessible, transparent and fully cooperative relationships with regulators.”

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"We understand that regulatory misinterpretation can happen even with the best of intentions on the part of the regulators and we appreciate the professionalism of the Kentucky regulators throughout this process."

According to documents filed in the Franklin Circuit Court in Kentucky, Turner was charged with fraudulent insurance acts over \$500.

Turner has been retained by insurance firms including Fidelity Title, Cuna Mutual and American Title and has overseen the formation of more than 600 captive insurance companies.

Temple University introduces risk management degree

Temple University in Philadelphia has continued to expand its risk management and insurance education and research department with the introduction of a Master of Science qualification in risk management and insurance (MS-RMI).

The degree, which begins in September 2014, is a continuation of Temple University's undergraduate programme in risk management and insurance, which has been ranked 5th in the nation.

The new programme is designed to provide budding risk management and insurance professionals the knowledge and professional development needed to advance their careers.

The MS-RMI is a 15-month online programme with two residency requirements. Residencies are designed to provide students an opportunity to interact with faculty, industry experts and colleagues.

A.M. Best downgrades RRL

A.M. Best has downgraded the financial strength rating to "A (Excellent)" from "A+ (Superior)" and the issuer credit ratings (ICR) to "a+" from "aa-" for Risk Reinsurance (RRL).

RRL is the single parent captive of Transpower New Zealand, the state-owned, sole operator of New Zealand's electricity grid.

The rating actions consider the high event retentions relative to RRL's capital target, which could potentially result in significant fluctuation of its risk-adjusted capitalisation. Following a large dividend payment to Transpower in August 2013, RRL's capital target has been set at £25.7 million.

Positive rating factors include RRL's strong balance sheet strength and capital generation ability. The quality of Transpower's risk management has benefitted RRL's underwriting results since its inception and sustained its capital generation ability so far.

Positive rating actions are unlikely at present, though negative rating actions could occur if RRL's capital target is further reduced relative to its event retentions.

Fitch predicts solid Q1 for reinsurers

Global reinsurers are expected to report solid underwriting profitability for the Q1 2014 as catastrophe loss events were limited, according to Fitch Ratings.

Reinsurers' results should to be in line with those reported in 2013, as the industry has not suffered a significant catastrophe loss event since Hurricane Sandy in the Q4 2012.

The largest insured natural catastrophe losses for the period were from severe winter storms in the US and flooding and winter storms in the UK.

Fitch believes that losses from these events will be manageable for the insurance and reinsurance industry, especially as the most exposed firms are typically large, well-diversified operators with the ability to offset losses through other profitable lines and strong capital.

Reinsurers will only have to shoulder a minority of the losses, as these events were not costly enough to trigger insurers' excess of loss property catastrophe reinsurance treaties. Losses for reinsurers will generally be limited to facultative, per risk and pro rata quota share reinsurance treaties.

In the case of the US, this was partly due to increased retentions by primary insurance companies over the last few years, as improved capital positions have allowed insurers to retain more risk.

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The Insurance Information Institute reported that the winter 2014 could rank among the top five in US winter-storm insured losses since 1980.

January losses alone totalled \$1.5 billion as a polar vortex driven by an unusually strong jet stream pushed temperatures below freezing in every state of the country—a rare event.

The significant snowfall and record severe cold resulted in increased claims for both personal and commercial lines insurers. These came from roof collapses, power failures, frozen and burst pipes, auto accidents and business interruption.

Once the insured losses from all the 2014 winter storms are aggregated, it will push the total for the year above the \$2 billion of losses registered from winter events in 2013.

The Association of British Insurers estimated UK flood insured losses will cost the industry £1.1 billion, due to an historic amount of rainfall that was also the result of the abnormal strength of the jet stream.

According to the Met Office, England and Wales recorded the wettest winter since records began in 1766.

As a result, insurers have received a significant amount of flood and storm damage claims for losses to homeowners, businesses

and vehicles, but these are also considered to be manageable.

NAIC focuses on global regulatory network

The National Association of Insurance Commissioners (NAIC) has renewed its support for federal, state and international regulatory cooperation in its 2013 annual report, State-Based Insurance Regulation: The System at Work.

The NAIC remains committed to both educating and learning from insurance supervisors globally. This was underlined when US regulators and NAIC staff participated in technical training and dialogues with regulators from the Association of Latin American Insurance Supervisors (ASSAL), China and Thailand.

In addition, regulator-to-regulator discussions were held throughout 2013 with supervisors from Bermuda, Canada, China, Japan, and Switzerland, laying the foundations for cross-border insurance information sharing, policy coordination and standard-setting.

The EU-US Dialogue Project Steering Committee, which convened a public forum on 14 December, was also highlighted during the paper.

The report also provides a review of 2013's regulatory activity, including government re-

lations international insurance supervision, financial regulation, market regulation, and consumer education.

NAIC CEO Ben Nelson commented: "This past year, state insurance regulators faced myriad challenges on local, national, and international fronts."

"However, NAIC members worked collaboratively to tackle healthcare reform implementation, contribute to international standard-setting, and help consumers recover from natural disasters, to name a few."

Guernsey and Switzerland strengthen ties

The Guernsey Financial Services Commission (GFSC) has signed a memorandum of understanding (MoU) with the Swiss Financial Market Supervisory Authority (FINMA) regarding the distribution of investment funds to retail investors.

The MoU facilitates close cooperation between the two authorities and key elements include the exchange of information and assistance in the enforcement of each jurisdiction's laws.

One of the principal reasons for the MoU is that amendments have been made to the Swiss Collective Investment Schemes Act relating to the distribution of foreign funds to retail investors in or from Switzerland. This requires the existence of a MoU between FINMA and the

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financial services supervisory authority responsible for the foreign funds.

Fiona Le Poidevin, chief executive of Guernsey Finance, the promotional agency for the island's finance industry internationally, said: "The fact that the GFSC has signed this MoU with FINMA means that Guernsey funds can continue to be distributed to retail investors in Switzerland."

"There are already a number of managers with funds, especially open-ended schemes, which are distributed into Switzerland and this MoU means that Guernsey remains an attractive domicile for those seeking to raise capital from the Swiss market."

The MoU with FINMA provides an effective framework between the two authorities for the exchange of information and other supervisory cooperation related to the distribution of investment funds to retail investors.

It will also contribute towards reinforcing investor protection and improving the cross-border distribution of investment funds to retail investors.

Carl Rosumek, director of investment supervision and policy at the GFSC, said: "I am delighted to confirm that the Commission has signed a cooperation agreement with the Swiss Financial Market Supervisory Authority."

"The completion of this agreement is a positive endorsement of the commission and the important work it undertakes on behalf of Guernsey. The commission has a very constructive relationship with FINMA and looks forward to working with them in the cross-border supervision of the funds industry."

Energas captive achieves positive ratings

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and issuer credit rating of "a" of Energas.

The rating affirmations reflect the company's strong risk-adjusted capitalisation, continuing its favourable operating performance and comprehensive reinsurance programme.

The ratings also acknowledge its strategic position as the sole captive insurance company for Petroliam Nasional Berhad, the national oil and gas company of Malaysia, which is wholly owned by the Malaysian government.

Energas's role is an integral component in the overall risk management programme of the group.

Energas's capital and surplus has been growing steadily in the past five years due to its favourable underwriting results.

The company's financial strength is further underpinned by its retention of earnings, risk se-

lection and reinsurance programme. In addition, Energas has maintained an investment portfolio of high liquidity.

Energas maintains a comprehensive reinsurance programme with a strong panel of reinsurers, which is expected to continue to protect its capitalisation in the event of large losses.

Partially offsetting these positive rating factors are Energas's potential volatility of underwriting performance and capitalisation due to its captive business nature and higher risk retention since 2013.

Negative rating actions could occur if there is material deterioration in operating performance, resulting in a material decline in its risk-adjusted capitalisation level. Alternatively, negative rating pressure might arise if there is a significant downward movement of Petronas's credit.

Connecticut to update captive laws

Connecticut insurance and business leaders are eagerly watching Senate Bill 188 as it makes its way through the state legislature.

The bill contains provisions updating the state's captive laws, ensuring they remain on par with those of the top domiciles in the country.

Thomas Hodson, who leads JLT Towner Insurance Management, commented: "For over 200 years, Connecticut has been an innovator in insurance, so these proposed updates are a natural extension of that innovation."

"If enacted, these changes will keep Connecticut on par with the top domestic domiciles, providing further proof that it intends to become a domestic captive leader."

Among other provisions, SB 188 offers additional options for companies looking to redomesticate to the state or start a branch captive in Connecticut.

The bill gives the state insurance department flexibility in determining reinsurance credits for companies that redomesticate to the state.

Texas welcomes captives

The Texas Department of Insurance (TDI) has approved the formation of a new captive insurer and the redomestication of two other captive entities under new rules adopted to implement Senate Bill (SB) 734.

The legislation, authored by John Carona and sponsored by John Smithee, has removed the regulatory barriers that previously forced captives to be headquartered outside of the state.

Today, a licence application was approved for Commerce Way Insurance Company to form a new captive operation in Texas.

Redomestication applications were also approved for CART Assurance Company and Prize Indemnity LLC.

"Our state is now open for business for captive insurers seeking to move to Texas or to set up new operations here. The statute has provided for a safe and stable entry of a new type of risk transfer mechanism into the state," said commissioner of insurance Julia Rathgeber.

Carona commented: "This legislation will reduce the cost to businesses relying on out-of-state captive insurance companies. It will also provide incentives for companies to form or redomesticate pure captive insurance companies in Texas."

SB 734 requires that affiliated companies have significant operations in Texas in order to form or move a captive here.

Captives licensed in Texas can only insure operational risks of affiliated companies and controlled unaffiliated business; the statute prohibits captives from accepting insurance policy risks of an insurance affiliate.

New York RRGs get a break

The US Court of Appeals for the Second Circuit has ruled that the federal Liability Risk Retention Act (LRRRA) categorically preempts a New York State statute that allows a direct action lawsuit against a risk retention group.

"The federal Liability Risk Retention Act of 1986 contains sweeping preemption language that sharply limits the authority of states to regulate, directly or indirectly, the operation of risk retention groups chartered in another state," Second Circuit judge Gerard Lynch wrote in his opinion upholding the district court judgement.

Allied Professionals Insurance Company (APIC) attorney Rick Cigel said: "It was the position of APIC that under the Liability Risk Retention Act, a state such as New York cannot apply such a statute to a risk retention group that is not domiciled in New York."

"APIC is domiciled in Arizona but has over 4000 insureds in New York."

The National Risk Retention Association (NRRRA) filed an amicus brief in support of APIC before the district court.

Sanford Elsass, chairman of NRRRA, hailed the Second Circuit court decision, stating: "This decision is a huge win for the industry. It can be used in other cases involving existing state laws, proposed legislation, and regulatory violations."

"This ruling is an unqualified affirmation of the preemption provisions of the LRRRA that allow risk retention groups to do business nationally with only limited regulation by states other than the state in which they are licensed."



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Nothing to fear

It is incumbent on the captive industry to show that it can succeed without the heavy hand of regulation, according to Tom Jones of McDermott Will & Emery

STEPHEN DURHAM REPORTS

What is the current state of the captive insurance industry, from a regulatory point of view?

I think there will be excitement over the next couple of years. This will be, to a lesser extent, on the federal tax side—although there are exceptions that have appeared recently (the taxpayer-favourable Rent-A-Center case, for example) and there will be another one in a month or two, I expect, called the Securitas Holdings & Subs case.

It seems like the real action is going to be on the state regulatory side, regarding the National Association of Insurance Commissioners (NAIC) and how it will treat, not just risk-retention groups, but group captives in particular. There will also be more of an at-

tempt to regulate captives in a more rigorous fashion on a state-wide basis.

Captives have expected, and deserved, lighter regulation than the commercial insurance sector, and I think they have discharged their responsibilities pretty well to avoid trouble such as insolvency. I think it is incumbent on our industry to show that we can succeed without the heavy hand of regulation.

The burden of proof is probably on the captive world to show regulators that there is nothing to fear—we are not a shadow insurance industry that is going to cause some kind of systemic financial failure.

We're entrepreneurial, innovative and practicing a manner of self-help, with the support of the commercial market, to reduce claims loss

mitigation and patient safety in the healthcare world. Captives promote all these positive things and it is up to us to show our benefits.

So is there a possibility that the captive insurance industry's image can change in time?

I don't think there's anything wrong with the image, per se. From the beginning we have been called alternative risk transfer, and the captive sphere has since become large enough that we have almost gone from being alternative to mainstream. The financial meltdown in 2008/2009 stimulated regulators to look at anything that was different in order to determine if it could be dangerous or injurious to the taxpayer. We were just unlucky enough to get caught up in that.

“ We are seeing a lot of consolidation in the captive industry because of what is happening at the parent level in healthcare ”

How are macro-economic events, such as the recent rise in US interest rates, affecting the captive industry?

The captive world continues to grow whether there is a hard market or a soft market, and there is a lot of capital available in the insurance industry—not only conventional insurance, but transformers that essentially change insurance risk into securities risk, so the capital markets can take it.

I do not see captives as being threatened by increasing interest rates in the same way that I do not see them being assisted by rates staying low.

Historically, there have always been jumps. For example, in 1993/1994, interest rates spiked up and the value of portfolios of bonds went way down—captives were technically underwater, but most regulators were patient. The situation reversed the next year and then everything was okay. For this reason, I am not too worried about this most recent economic environment.

Is the trend of new states popping up with captive insurance laws an inexorable one, in your opinion?

There are currently 35 states that have captive facilitating statutes, or at least want captives to form in their state. As a result of this, there is a push and pull at the NAIC—there are the pro-captive states and then there are the not-so-pro-captive states, and this often varies as to whether you are talking to the captive regulator or the regular insurance department.

In the end, it is hard for me to visualise all 50 states having the legislation. It is not impossible, as a majority of states have the law, but probably only two thirds are truly active in it. Many states are dormant in that they have the laws but do not do much with them, such as my home state of Illinois. That, for example, has one captive and no interest of getting any more.

Will this factor lead to states such as Vermont staying on top for the foreseeable future?

States such as Vermont will always be important because they are pioneers. They have the infrastructure, the expertise and all the service providers—whether you are talking about captive management, legal, accounting or actuarial services.

They have an edge and they have an insurance department that understands captives. That gives them a little bit of a leg up, so to speak, but other states can develop the same level of experience over time. Some states that did not seem so likely to be successful, such as South Carolina, have proven many of the doubters wrong.

What macro trends affect your day-to-day environment?

One example is our federal healthcare reform. This has led to a lot of restructuring among hospitals and other healthcare providers—including mergers and acquisitions. This has led to organisations coming together to have two or three captives, so my job is to try and meld the captives, usually by creating one larger entity. We are seeing a lot of consolidation in the captive industry because of what is happening at the parent level in healthcare.

These national trends affect everybody, but those jurisdictions that have a lot of healthcare captives, in particular the Cayman Islands, are especially affected because they have fewer but larger captives.

Construction is another industry that is a heavy captive user. They were doing great until 2008 and then there was the meltdown, which affected the mortgage market, and construction stopped—but now they are doing well again.

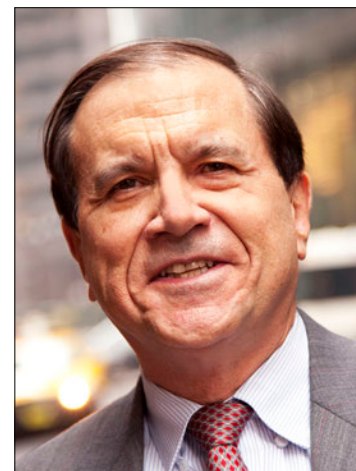
We see more cell captive structures around, too, whether it is in construction, healthcare or any other sector. There are more options

available today. These days you can do a regular captive, a cell captive, a captive that has incorporated cells instead of regular cells, a not-for-profit captive, or limited liability companies. We have a great deal of tools in the toolbox so we work hard to ensure that we pick the right one for the right client.

Despite the strength of the industry, are you still weary of the threat from the IRS?

I would say that, when you set up a captive and look at the structure, you take into account what the tax law is and hopefully you anticipate any ambiguities or vulnerabilities and attempt to minimise them. While you cannot say that our structures are bulletproof, we want them to have a high chance of success, should they be challenged.

Years ago, the IRS attacked the captive world with its proposed federal treasury regulations and, to make a long story short, the captive constituency responded quite actively—convincing the IRS to withdraw the regulation. The current scenario is a more NAIC or state regulatory threat. In the next year or two, all facets of the captive world will need to push back against any unnecessary regulations. **CIT**



Tom Jones
Partner
McDermott Will & Emery



The parent/captive trap

Although the concept of intercompany loans is not new, the issue remains a hot topic for regulators, captive managers and rating agencies alike, according to Donald Thorpe of Fitch Ratings

STEPHEN DURHAM REPORTS

To loan inter-company, or not to loan inter-company? That is the question. While there are undeniably benefits to this practice, they can often also act to the detriment of a captive's overall financial strength rating.

In recent months, regulators in particular have expressed a significant interest in intercompany loans, because it is them that must give their approval. This has led them to seek the guidance of agencies such as Fitch Ratings, to better understand the context surrounding intercompany loans and obtain an outside perspective on their risks.

In short, intercompany loans can be thought of simply as internal loans made to a sponsor from the captive. It is also salient to point out that these loans generally apply to pure captives—or an entity with one parent as sponsor, one customer as sponsor, and one significant asset that, in this case, is the intercompany loan itself.

Donald Thorpe, head of Fitch's captive analytical efforts in North America, explains: "Although there is a chance that these loans will have no effect on a company, there is always the potential that they could significantly reduce liquidity."

"Generally speaking, the captive would be rated the same as the sponsor because everything is linked to the sponsor—it's the only customer and the only owner. However, the issue is that the intercompany loan limits the liquidity of a captive and hinders its ability to pay claims. This then causes Fitch to work more to understand its nature and possibly lower its rating."

The crux of the argument resides in the everyday practicalities of operating a captive, namely—the fact that captives must retain a certain amount of available cash in order to pay any claims that arise. In other words, the company needs to figure out how to convert the loan back into cash at a moment's notice.

Although this might not be as much of a problem with relatively predictable claims such as liability—the fact remains that more unusual 'stress' scenarios, such as property and catastrophe, are so sudden that they need more liquidity to cope with a sudden spike in claims.

Thorpe continues: "Some intercompany loans are very large, around 90 to 95 percent of a company's investment portfolio, and thus have all their cash concentrated in a single asset. The important thing is that the captive should have a sense of what to do if claims spike."

"This contingency plan can be as simple as going back to parent and asking them to pay the note—but this introduces parent's liquidity factor. Alternatively, in a situation where the parent company is also the insurer, the claims could be offset against the note."

As well as the parent acting as a source of cash, there are other ways to rescue a captive that has fallen foul of intercompany loans—financially, as well as in the eyes of organisations like Fitch.

In many instances, captives possess letters of credit due to the terms of their business—at the behest of a fronting carrier, for example. This

letter can act as a potential source of liquidity, to the extent that the captive has reinsurance.

According to Thorpe, many insurance policies also have what is known as a cash call, with which the reinsurer can provide cash to the primary insurer to pay claims.

Although these are indeed potential sources of cash and, therefore, should be considered in Fitch's analyses, letters of credit and reinsurers are considered more as tertiary sources of assistance, while the captive and its sponsor are thought of as being primary sources.

Despite the fact that these methods can save the perpetrator of an intercompany loan, Thorpe hastens to add that these examples are idiosyncratic at best and, as a result, may not be an option in every situation.

The fact remains that the presence of intercompany loans adds a potential liquidity risk, and this risk must be mitigated for it not to be reflected in the ratings.

While there is currently no specific initiative to educate captive managers about the issues surrounding intercompany loans, some research papers, such as the one recently published by Fitch, have been found to help.

Thorpe adds that no reform in the regulations is imminent, even though regulators are intensifying their interest in them. At this point at least, it appears that regulators will continue to trust captives to make their own mistakes. **CIT**

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Malta on the forefront

With Solvency II going ahead in 2016, captives can get back to business



Growth has been strong over the past five years, but now I think that the industry has stabilised quite a bit. Whether or not we will see further growth in the industry depends on developments in other jurisdictions



Andrew Zammit, managing partner, CSB Advocates



What is the current size and scale of captives in Malta, and are PCCs still by far the most popular structure?

Andrew Zammit: A number of vehicles have been set up and several large captive managers such as Marsh and Aon have established themselves here. We have attracted some very interesting names to come over here and establish captive vehicles.

Protected cell companies (PCCs) seem to be one of the primary approaches that captive managers are taking, though when companies such as Marsh moved to Malta seven or eight years ago, they chose not to venture down that path. However, I believe that PCCs remain the most cost-effective solution for the establishment of a captive—at least before that captive achieves critical mass enough to justify a stand-alone structure.

Joseph Ghio: The use of cells under a PCC structure has been gaining popularity over captive companies over the past few years as evidenced by the steeper increase in the number of protected cells. The implementation of Solvency II will probably be another driver for captive promoters preferring cell solutions to address higher minimum capital conditions.

Matthew Bianchi: Since its inception in 2004, Malta's PCC legislation has generated significant interest in the industry. Sixteen PCCs are now established in Malta, with a total of 25 cells. Malta's PCC legislation provides captives with various advantages, namely the benefits of share capital and the possibility of segregating high-risk lines of business from less risky ones.

Malcolm Falzon: The popularity of a structure is a result of its proven effectiveness in achieving the targets it is presented as being capable of delivering.

This, I believe, is where the existing success and immense growth potential of the PCC structure lies. Cells being able to rely on the core structure to satisfy statutory minimum capital requirement under Solvency II; the possibility of Solvency II provisions on systems of governance, including inter alia the forward looking assessment of the risks of the undertaking (the ORSA), being carried out across the PCC as a single legal entity rather than by each individual cell; reductions in costs in relation to most of the Pillar III reporting requirements—as the industry

aligns itself further to Solvency II requirements. Such attributes render PCCs a viable and attractive alternative for many.

Do you think the captive industry in Malta will continue to grow in the coming years and, if so, why?

Bianchi: Malta has experienced significant growth in the captive market since accession to the EU in 2004. The jurisdiction is expecting to further increase its numbers now that a clear implementation date for the Solvency II directive has been decided. The regulator is also actively pursuing new legislative measures. During 2013, Malta enacted legislation on reinsurance special purpose vehicles (RSPVs) that enables the structuring of catastrophe bonds, sidecars and other insurance risk securitisations in Malta.

Falzon: Growth over the course of 2013 was, by any standard, mild (one PCC and an additional four protected cells), albeit an improvement upon the previous couple of years. Clarity as to the implementation of Solvency II, now scheduled to come into force on 1 January 2016 following a series of delays, will, however, no doubt serve as the catalyst for significant growth.

The past uncertainty surrounding the finalisation and timing of the most important legislative development in the insurance sector in recent years has stultified growth. The time to take the plunge and concretise plans that have been parked during this protracted transitory period has come.

Preparatory measures adopted by the Malta Financial Services Authority (MFSA) with a view to ensuring that the market is suitably prepared for implementation, and the proactive approach taken by market players in laying the foundations for what is to come, spurred by a heightened awareness of the intrinsic importance of risk spreading, are expected to result in an increase in applications in 2014, as the benefits associated with these structures become more of a must-have than a nice-to-have.

The recent introduction of legislation on RSPVs is also expected to have a significant effect on the market, providing an unprecedented regulatory framework for the authorisation and supervision of RSPVs consistent with the requirements of the Reinsurance Directive and Solvency II, which will allow for the creation of

alternative risk transfer solutions, insurance-linked securities (ILS), catastrophe bonds and the provision of additional reinsurance capacity.

Zammit: Growth has been strong over the past five years, but now I think that the industry has stabilised quite a bit. Whether or not we will see further growth in the industry depends on developments in other jurisdictions.

I think people appreciate the regulatory framework and tax advantages available in Malta, but there are clearly other sensitivities, especially for listed companies, due to ongoing debates on what is acceptable tax structuring. We are still watching the space with some interest but, in the next five years, I doubt that we are going to see growth comparable with the past five years.

Ghio: As the coming into force of the Solvency II directive has finally been set for 1 January 2016, local players are confident that captive and cell set-ups will accelerate as promoters decide to implement plans that have been postponed on a number of occasions, because of a lack of clarity on how the Solvency II regime was going to effect the captive space and when this was going to come live.

What elevates Malta above its competitors, such as Luxembourg, Dublin and Gibraltar?

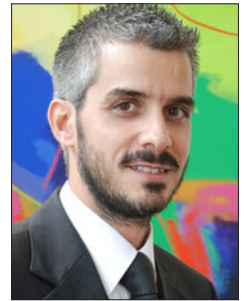
Falzon: Among the key distinguishing features associated with Malta are its innovative and comprehensive regulatory framework and the positive reputation commanded by what is generally considered to be a firm yet flexible and highly approachable regulator. It displays a pragmatic approach towards prospective applicants and in the conduct of its supervisory functions.

Malta was the first, and to date remains the only, full EU member state to implement PCC and In-corporate cell company legislation.

These provide important options to insurers, particularly the smaller players in the market which would benefit from relying on an existing core structure, not least in light of the possibility of sharing the weight of governance, capital, risk management and reporting requirements inherent in Solvency II.

Apart from being highly and effectively regulated and providing captives with the ability

“ The days of the ‘wait and see’ approach adopted previously are now long gone and the local captive industry is working with the MFSA to facilitate the transition to the Solvency II regulatory landscape ”



Joseph Ghio, partner, Fenech and Fenech Advocates

to passport within the EU and write business directly in other EU member states without incurring fronting costs, as a captive jurisdiction Malta is also cost effective.

Indeed, other advantageous elements associated with the jurisdiction include: the comparatively low advisory cost-base and regulatory fees; an efficient and Organisation for Economic Co-operation and Development-recognised tax system that comprises, inter alia, an extensive double taxation treaty network; and exemption from payment of duty on documents on the insurance of risks situated outside Malta.

The attractiveness of Malta as a jurisdiction of choice is further augmented by a multilingual, highly skilled and specialised workforce, its geographical position and high standard of living, its sophisticated telecoms network, and high speed connectivity with the rest of Europe.

The above combined are often viewed as particularly important drivers for making the move to Malta, as has occurred in the case of top international insurance managers relocating over the past decade and leading blue chip companies selecting Malta as the base for their captive.

Ghio: Although the size of the Maltese captive industry remains small when compared to longer established jurisdictions such as Luxembourg or Ireland, Malta remains the only EU member state that has introduced legislation allowing the setting up and licensing of ICC and PCC structures.

The proactive attitude of the MFSA remains widely cited as an important factor in the island’s growing reputation as a business-friendly jurisdiction across all areas of financial services, including captives. The Maltese culture of doing business, including the firm yet flexible regulatory approach taken by the MFSA, gives Malta an edge over more established jurisdictions where

access to the regulator can best be described as remote at times.

Being a small country, the local regulator is nimble and dynamic responding quickly to international developments and challenges. Other factors that have contributed to Malta’s success are the country’s extensive network of more than 60 double taxation treaties, the prevalent use of English as a business language, the availability of professional human resources, a convenient time-zone, and an attractive cost base.

International groups such as car manufacturer BMW, reinsurer Munich Re, and telecoms giant Vodafone are some of the world-class names that have chosen to move their captive operations from older established jurisdictions such as Ireland and Guernsey to Malta on account of the island’s comprehensive value proposition.

Bianchi: Key aspects that make Malta an attractive captive domicile above its competitors include its resilience during the global recession and its extensive double taxation treaty network with more than 70 jurisdictions. Malta also offers structuring flexibility, with the possibility to structure captives as standalones, PCCs or ICCs.

Indeed, the jurisdiction is still the only EU member state with fully fledged PCC and ICC legislation. Malta also has RSPV legislation that is expected to attract further business to the jurisdiction.

Zammit: I think the principle fact is the pro-business approach—both from the private sector and the regulators. They are both keen to see this business continue to grow, with reputable names coming to Malta all the time.

Cost is also something which we feel does convince potential clients—we are very cost conscious and competitive within the EU.

Things are moving slowly in domiciles such as Luxembourg at the moment so we are focusing on trying to make the most of this by offering fast and efficient service.

Will regulations play a large part in 2014?

Ghio: Now that a date for the implementation of Solvency II has been set, we are seeing that 2014 will most likely be characterised by how captives and cells will implement the necessary changes to ensure compliance with Solvency II. The days of the ‘wait and see’ approach adopted previously are now long gone and the local captive industry is working with the MFSA to facilitate the transition to the Solvency II regulatory landscape.

This year will hopefully also see the first roll-out of RSPVs under new rules introduced by the MFSA and further reliance on the use of ILS structures are a testament to Malta’s innovative mind-set.

Zammit: The regulatory framework we have is definitely ready to take on new business, and I don’t see any gaping holes in our regulations that require any immediate attention. We are going to have to stay abreast with all of the regulatory developments happening Europe, but I don’t see any material elements to convince me that a change in regulations would attract more business to Malta.

The reality is that Solvency II does bring its own problems, but there is nothing we can do in Malta to make ourselves more attractive to operators that are looking at options outside of the EU.

Bianchi: The use of RSPVs and ILS is now a fundamental part of the international risk transfer market. Malta recognised this opportunity by enacting RSPV legislation in 2013. The Maltese government intends to continue on this path by



“ The jurisdiction is still the only EU member state with fully fledged PCC and ICC legislation. Malta also has RSPV legislation that is expected to attract further business to the jurisdiction ”

Matthew Bianchi, partner, Ganado Associates

“

Timeframes for authorisation would be agreed in advance with applicants. Sensitivity to applicants' timing concerns is also manifested in the fast-track nature of the authorisation process applicable to captives set up in Malta

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Malcolm Falzon, partner, Camilleri Preziosi



enacting further legislation to consolidate Malta's reputation as a domicile of choice among insurers and reinsurers worldwide.

Malta will also continue to take active steps to ensure that the transposition of the Solvency II directive into national regulation takes place by 31 March 2015.

In fact, as the competent authority, the MFSA has already started working with the insurance industry on the implementation of the interim measures of Solvency II.

Falzon: The most recent initiative towards further growth in the sector was the promulgation of the RSPV regulations. At present, these require that the RSPV be set up as a limited liability company in Malta.

The MFSA is currently assessing the possibility of such securitisation vehicles being set up as a PCC or as an ICC.

The introduction of such regulation allowing for ILS transactions through the use of cell structure would, again, be a first for any European jurisdiction.

Following the establishment of the implementation of Solvency II, it is anticipated that the focus of the MFSA would be that of taking a forward-looking approach to prepare licensees for the coming into force of Solvency II.

As has occurred in the past, various consultations and information sessions on the subject

are expected to be held, with a view to facilitating a smooth transition into the new regime.

What is Malta doing to attract new captives to the island?

Bianchi: With Solvency II preparations in hand, Malta is well placed to continue attracting captive business to the jurisdiction.

The PCC structure is an advantageous alternative that could help captives mitigate the costs of the new Solvency II regime.

The PCC offers captives the opportunity to continue writing business through the establishment of a cell at decreased set-up and ongoing costs, and also allows them to share in the capital base of the PCC. RSPV legislation in Malta provides another possible alternative as this new vehicle could result in a certain level of capital relief for both insurers as well as captives.

Zammit: We maintain our presence at international conferences as well as organising some in Malta. This allows people to come here and see what is going on for themselves, in terms of what our physical and regulatory infrastructures have to offer.

There is an ongoing effort by Finance Malta, the financial services interest group, which attends many of the international conferences in captive insurance, asset management, and so on. These efforts also continue to be supported by the private sector and Maltese profession-

als themselves at conferences and events. Between them they can spread the word in terms of where Malta's attractiveness lies.

Falzon: Maintaining a pragmatic approach to regulation adopted over time, particularly in so far as PCC and ICC—and more recently RSPVs—are concerned, remains a core driving force for growth of the captive sector in Malta.

With respect to the latter, in December 2013 the MFSA indicated that applications for the authorisation of RSPVs would be fast-tracked, provided that accurate and complete information be provided throughout the structuring and documentation process.

Importantly, timeframes for authorisation would be agreed in advance with applicants. Sensitivity to applicants' timing concerns is also manifested in the fast-track nature of the authorisation process applicable to captives set up in Malta.

The commitment shown by the Maltese government towards the drive to consolidate the achievements of the past and create opportunities for further growth in this sector, amongst others, is clear.

Raising further awareness of the advantages associated with setting up or re-domiciling in Malta remains key—the MFSA, supported by practitioners, are busier than ever before delivering the message. Now that the air of uncertainty surrounding Solvency II's due date has cleared, the market is ready to listen.

Ghio: The uncertainties surrounding Solvency II have meant that new captive and cell launches have been somewhat flat, not only in Malta but also in places such as Dublin and Luxembourg. As the January 2016 deadline looms closer, new launch activity will also pick up with promoters considering their options on where is the best, onshore, jurisdiction to set up. It is in times of change such as this that Malta will continue being ranked among the most attractive and cost-efficient options.

The country will continue to attract business by keeping true to the characteristics that have made it successful so far and giving priority to the quality rather than the numbers of the new set-ups that locate in Malta. From this perspective there is no doubt that the MFSA will continue to be the best guarantor of our world-class reputation. **CIT**

Hi, I'm in Delaware

With a thriving captive industry already established, Delaware's next challenge is to oppose the newest NAIC proposal, says Steve Kinion

STEPHEN DURHAM REPORTS

Could you give an overview of the state of Delaware's captive industry, and also an idea of what your most popular type of captive is?

Delaware is the third largest captive domicile in the US and the sixth largest worldwide. The types of captive that we have vary: from those that create a small annual premium volume of around \$500,000 to, at the other end of the spectrum, captives that create hundreds of millions of dollars—so there is quite a large difference between the two.

I still think the most popular form of captive in Delaware are those that create less than \$1.2 million in annual premiums, which are commonly referred to as falling under the 831(b) election.

Over the next 18 months, I believe that our industry will grow at a pace of around 10 to 15 percent, though we are conscious that this growth will have to be managed accordingly.

What are series business units?

I think Delaware may even be the only state that does them. Series business units (SBUs) are something like cells, in a different format, which exist as a result of the state's insurance laws. Delaware's general business laws, upon which our captives operate, allow for the creation of the series.

Where you find cells operating only in an insurance context, SBUs (or the equivalent) are used in multiple other areas of business such as mutual funds, for example.

In this case, series level one may contain the international bond funds, series two could contain European stock funds, series three may have the US funds—but the key to this is that the mutual fund managers are able to segregate and encapsulate the assets and liabilities of each fund, as they reside in a different series.

This is the beauty of the Delaware Limited Liability Company (LLC) Act, as it allows for the formation of these types of series.

Each captive sitting in a series is ringfenced from the others that may be under the same LLC in terms of the chain. Even so, they do not have to be separate. Under Delaware's freedom of contract, they can decide whether they wish to share assets and liabilities with the others in

the series, and it is this contractual flexibility that makes the SBUs very popular.

We have between 580 and 600 SBUs at the moment and most, but not all, of these make the 831(b) election.

It has become an easy, low-cost and efficient way for a captive prospector to enter the industry. After a period of time, some owners may even decide to graduate these entities into full, standalone captives.

A cornerstone of Delaware's insurance industry is what is known as the Three Legged Stool, or the interaction between regulator, statute and industry. What is the key to this relationship?

Collaboration. We work very closely with our captive insurance association and we will consistently meet with captive managers once or twice a year, at least. I, personally, like to speak with captive managers as much as possible. We want to find out what the State of Delaware can do to better serve managers and their clients, and what they see in the industry that we do not.

The feedback is very cyclical, as we can inform captive managers what we are seeing from our end. In 2009, Delaware was not even under consideration as a captive domicile for most people, but today we are one of the most popular, so the relationship has clearly worked well for all concerned.

Delaware has experienced a great deal of regulatory change in the last decade—are there any new developments in the pipeline?

Yes. As a matter of fact, we are currently negotiating a bill with the Delaware Captive Insurance Association (DCIA) and ideally this will be clarified and become law.

The DCIA will, hopefully, make the law explicit that captive insurance companies can become members of the Federal Home Loan Banks System.

This is important, as we are seeing a new trend in the last six months of real estate investment trusts (REITs) seeking to form captive insurance companies of their own. While this is beneficial for them for insurance reasons, it would also allow them a portal into FHLBanks, which

would, in turn, allow them to access capital at very attractive price.

However, while this is a very significant step for the REIT industry, for us this is just one of many new regulations that we see—it should not affect our industry to a great extent.

Does Delaware suffer the same interference from the National Association of Insurance Commissioners as other states, or is the industry simply too big?

It does affect us and there is a proposal within the National Association of Insurance Commissioners (NAIC) at the moment that would change the definition of a multi-state insurer for NAIC accreditation purposes.

If this definition, as written, is adopted, then I believe it could have a detrimental effect on captive insurance.

If this new definition becomes NAIC policy then certain types of captives, such as group or association captives, run the risk of being treated as commercial property and catastrophe companies, and having to abide by all of their similar standards. It's a disturbing development.

Delaware has been very forthright in opposing these laws and we have been for a long time. There is more momentum building from others so we are hopeful that we can affect a change in mentality. We have to submit our comments to the NAIC by 19 May. On 12 and 13 May at the DCIA conference, I will also be addressing this problem. With any luck, we will be able to persevere and come out of the other side stronger than ever. **CIT**



Steve Kinion
Director in the bureau of captive and financial insurance products
Delaware Insurance Department



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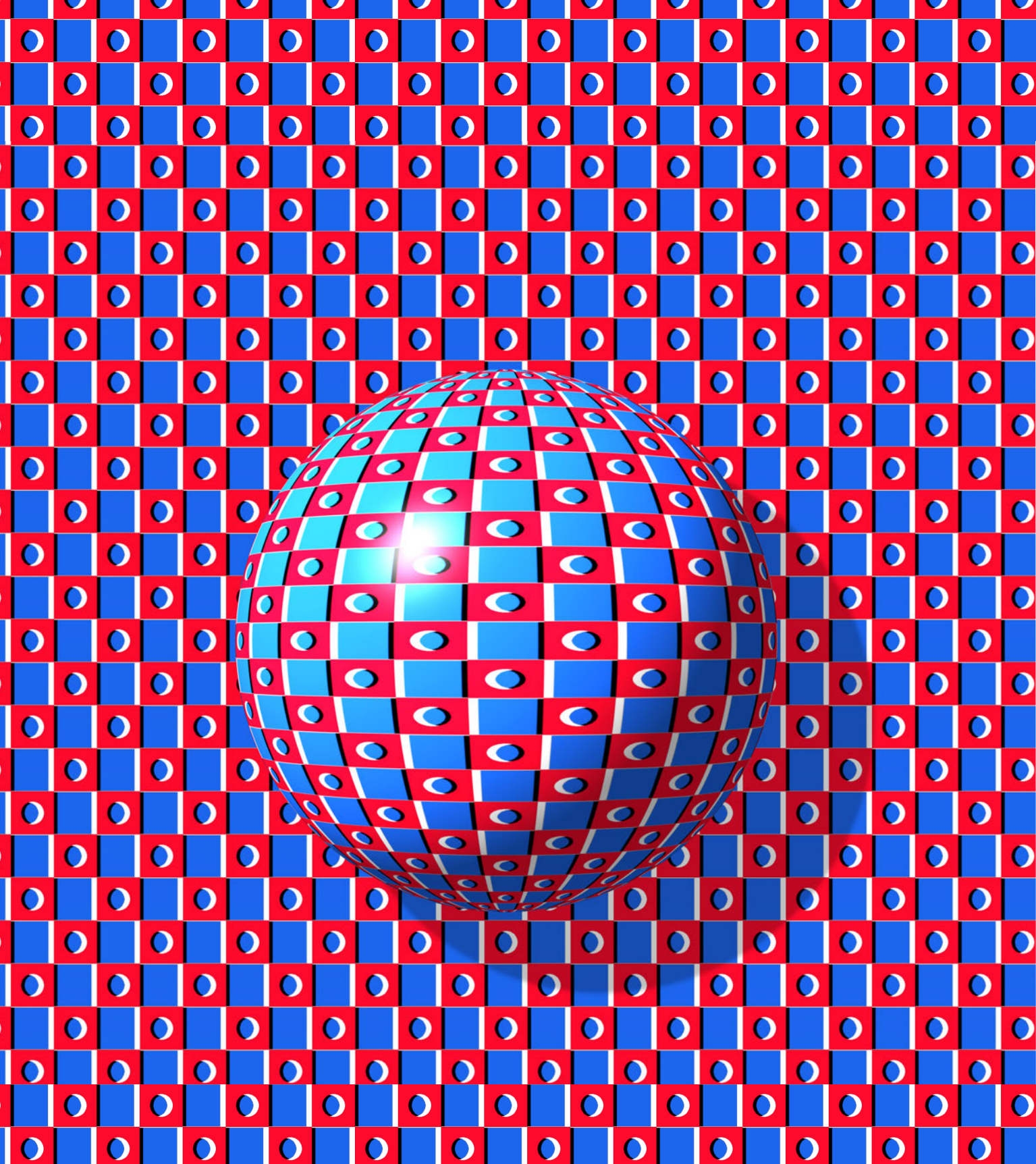
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Keep your eye on the ball

Nevada is watching captive changes at the NAIC closely, says Michael Lynch

STEPHEN DURHAM REPORTS

How has Nevada's captive insurance industry developed over the years, and where does it stand now?

Nevada has been doing captives since 1999, so we are one of the older US domiciles. We also, thankfully, have quite a progressive corporate statute on our side.

In the US, each domicile has its own secretary of state who deals with the business matters. In Nevada, we have a very pro-business system that allows corporations to form in a single day.

The synergy between the secretary of state's office and our own has been a great benefit to forming new companies in an efficient way.

Nevada initially, during the early 2000s, focused on pure captives, though we introduced a couple of agency captives and then eventually risk retention groups. We are the currently the biggest RRG domicile outside of Vermont.

In 2005, Nevada attached the series limited liability company (LLC) structure to the language of our state statutes. This bred a renaissance for captives. Whether it was pure captives or segregated cell programmes being formed, they could now pair with the series LLC formation.

This gave a lot of diversity and flexibility in the structure and allowed them to meet a lot of needs. Since then it really has been quite a boom, and it is still these types of formations that are our biggest growth sector.

We still do pure captives, too. In December 2013, we closed out the year with 30 new captives—with 18 closed in September alone. The majority of these new entities were either pure captives or sponsored cell programmes.

Is it the speed of Nevada's captive formation that is its greatest advantage?

We can do pure captives in a day, and this undoubtedly sets us apart from other domiciles.

On the other hand, I think our biggest selling point is the staff that we have available. We have a fully accredited property and catastrophe actuary, financial experts, and we have experts who can help with investment questions.

This means that, in the formation stage when they are doing their feasibility analysis, prospective clients can bounce ideas off of our reinsurance experts and us as well.

We can provide information and coaching as to what might be the best possible solution for a client.

I believe our state is probably the most progressive in terms of making these experts

available. There is no charge—the managers and clients can call us every day and they do, if only to go through ideas and brainstorm.

Our staff take great pleasure in helping people to get from the ideas stage to a certificate of authority.

What is of concern for Nevada's captive industry in terms of upcoming regulatory changes?

The only things that are coming up for us are the same National Association of Insurance Commissioners (NAIC) accreditation standards that happen every year, in every US domicile.

We are certainly watching the developments of the definition of a multi-state insurer being expanded to include a great deal of other things beyond what, I think, was the original intent of the proposed language.

Nevada, with all the other captive domiciles, is watching the situation very closely. At present, we are simply preparing our written comments to present to the NAIC.

It is hard to say which way this decision will go, but I can tell you that we are not contemplating any changes to our statutes and I do not see any major changes coming up in the next year.

To be honest, I do not even think people are forming up on the sides of pro and con. Ideas have been put out there and part of the reason for this was to address the problem of captive reinsurers that were affiliated with the big, traditional life insurance companies—whether they were based in the US or offshore.

We also regulate traditional insurers, and I think that most other domiciles will agree with us that there needs to be a little more guidance and transparency to the financial reporting of the AXXX and XXX reinsurers.

What that situation has done is open the door for the more anti-captive states to try and put things in the legislation that will, in effect, over-regulate the captives themselves.

Nevada is supportive of its captive industry, but we also support responsible regulation. I cannot really say whether we are for or against the changes, but I can say that we feel very strongly about, what we feel, will be the best course of action.

So would you say that your department has a good working relationship with the NAIC?

I would definitely say it's a good working relationship. The NAIC, in a lot of ways, works for us—they help provide resources and education for a start.

They have to deal with a lot of different issues and captives are just a small part of that.

From 2012 to now, the main focus of almost all the insurance commissioners and the NAIC is the implementation Patient Protection and Affordable Care Act (PPACA). As a result of this overarching issue, I think many of the other captive-related issues could be taking a back seat.

Are the wider US regulations, such as the Dodd-Frank reforms, of concern for Nevada?

While there was a little bit of concern, due to some of the definitions coming out of US Dodd-Frank Act being misconstrued, I think all of those issues have now been put to bed.

We are not seeing any other state, federal or insurance offices coming out and trying to expand that rule, so I think things look pretty good now in that respect.

In terms of the next 18 months, what are Nevada's projections for captive industry growth?

Last year was one of our biggest for a while and I think that is because there are so many more states now that are promoting these types of captive programmes.

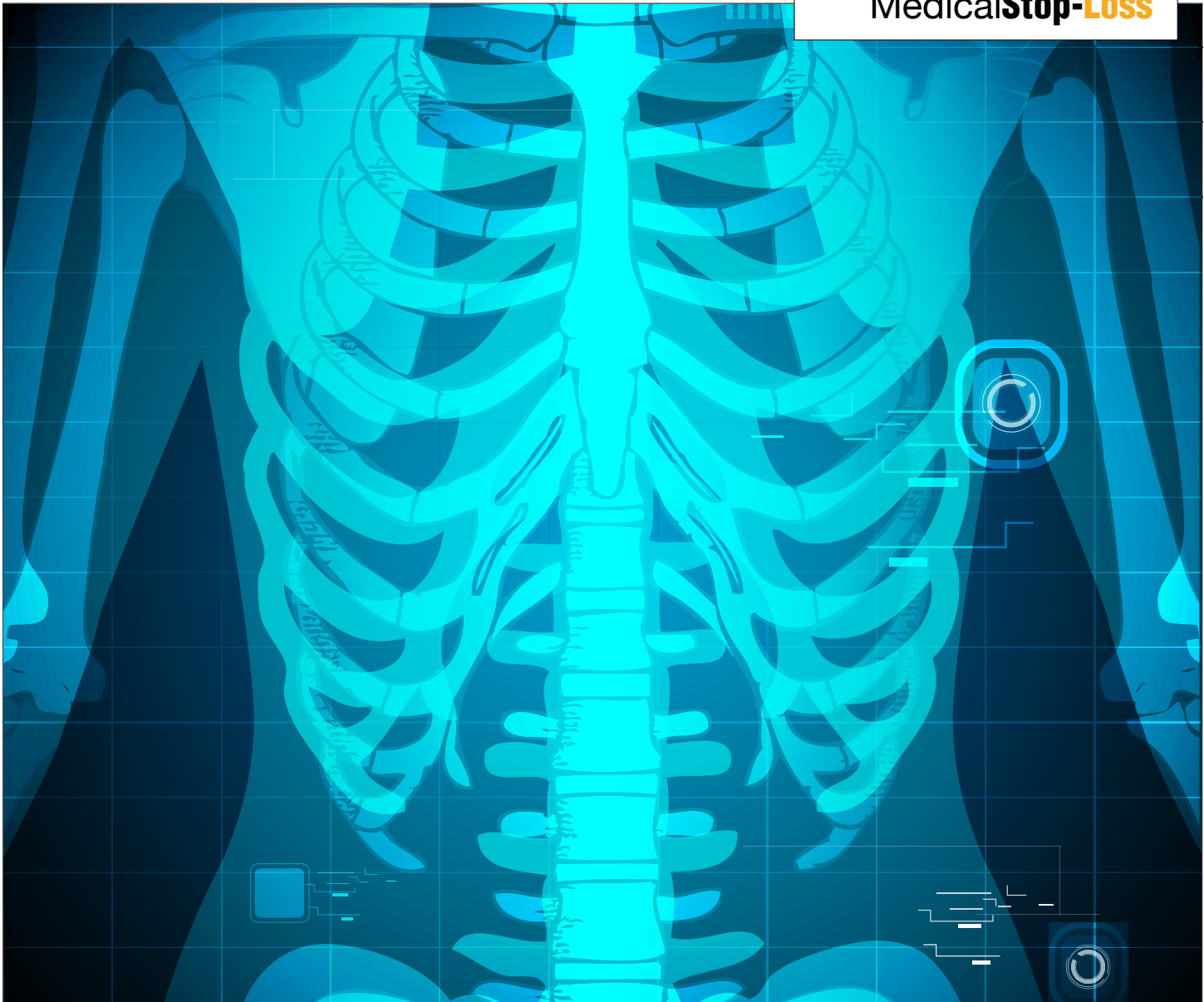
In other words, because the general awareness about captives has increased on a national level, the frequency of those interested has increased, too.

We are receiving a lot more calls and seeing more insurance providers come to Nevada that want to get approved, and this tends to lead to more applications.

I firmly believe that the tide is rising for all the captive domiciles, and the State of Nevada is no exception. **CIT**



Michael Lynch
Deputy commissioner, captive and corporate and financial sections
Nevada Division of Insurance



The claim load is connected to the risk strategy Major organ transplants aren't cheap, as premiums are revealing

MARK DUGDALE REPORTS

The placement of medical stop-loss insurance in captives is gaining traction, as ageing workforces continue to put pressure on employers that must shoulder claims made through healthcare plans.

"We have been working with clients on alternative risk financing strategies for their employee medical coverage for over 10 years and we are experiencing increased interest in the use of medical stop-loss captives, both for self-funded employers and risk bearing providers," comments Beecher Carlson senior vice president Peter Kranz.

He says that employers want a more favourable means of funding and expensing expected claims, and to obtain saving benefits—both

claims and risk management—while managing income tax liabilities.

But that divisive piece of legislation, usually referred to as 'Obamacare' after the current US president who was its champion, has given employers another reason to look at captives for medical stop-loss insurance.

Kranz says: "While we have been working on alternative strategies for over a decade as the ballooning cost of healthcare hasn't been a new concept, since the Patient Protection and Affordable Care Act (PPACA) was passed there has been increased activity in this space, in part due to the spotlight shone, by virtue of the legislation, brightly on the increasing costs but also due to the

concerns about the impact of PPACA on future costs—private industry's response to PPACA has been an expectation of continued cost increases."

The 2013 Aegis Risk Medical Stop Loss Premium Survey, which represents 224 employers covering approximately 450,000 employees with more than \$145 million in annual stop loss premiums, revealed that the average premium in the US ranges from \$97.43 per employee per month for a \$100,000 individual deductible to \$12.19 for a \$500,000 individual deductible in the same context.

Just over half of the survey's respondents reported at least one claimant in excess of \$500,000 paid in the last two policy years,

while 14 percent reported a claimant in excess of \$1 million.

On top of this, the PPACA required the removal of any individual lifetime maximums on underlying health plans, increasing the liability covered by medical stop-loss.

In response, 97 percent the respondents to the Aegis survey reported an unlimited lifetime maximum, an increase from 13 percent in 2010, before the healthcare reform requirements came into effect.

The captive insurance market has reacted to this increased interest with new products and services, to both capture their fair share and attract those employers that may not be capable of setting up their own pure captives.

“The primary barrier that exists in a company setting up a captive for medical stop-loss is critical mass, cutting two ways—predictability of experience weighting and amortisation base for the retained loss and risk management expense” says Kranz.

“As a general rule, a medical stop-loss captive for fewer than 750 employees (or 1800 members) tends to be more challenging. The availability and structure of aggregate captive reinsurance, as well as the availability of captive surplus to support the programme, can present challenges.”

Smaller companies need to pool their risks with other entities via group captives or other similar types of aggregating facilities, according to Kranz. “As you scale up the size spectrum utilisation of a pure captive becomes more predictable and easier to structure with third party stop-loss protecting against significantly adverse volatility while retaining the upside of better claims management and experience.”

“In addition, moving to a self-funded plan, whether utilising a captive or not, the ability to negotiate favourable provider payment contracts can play an important role—with a preference for fixed payment (also known as capitation) over fee for service models.”

Indeed, the group captive model is a solution that providers believe is well-suited to the job.

AIG Benefit Solutions and Scot Captive teamed up recently to launch CAPvantage Select, a national group medical stop-loss captive programme.

“Group captives allow employers to address the volatility, non-transparency and cash flow concerns often associated with the traditional self-funded and fully insured market,” commented Pim Jager, vice president at Scott Captive Solutions.

“At the same time these group captive programmes provide tools and partnerships with

best in class vendors to help employers better manage the health risk in their population and drive better financial outcomes in the long term.”

Bob Hosler, national sales director of stop-loss captives at AIG Benefit Solutions, added: “One of the major challenges we see facing mid-market employers today is the rising cost of employee health coverage and determining a cost-effective approach to maintain their employee benefit programmes. CAPvantage Select was developed to specifically meet this growing need.”

“The group captive structure is proving to be popular with smaller entities seeking to self-insure medical stop-loss,” says Kranz.

“Group captives, or other types of aggregating facilities, allow these smaller companies to obtain the benefits of scale and risk sharing, which mitigate the challenges posed by not having critical mass on their own. A medical stop-loss programme with only 500 covered members could ‘blow up’ with just one bad claim, whereas a pool of 5000 is far less susceptible to such adverse experience.”

Another solution of the group ilk to recently hit the market is BevCap Health, a heterogeneous group captive and the first cell of Hawaii-domiciled BevCap Sponsored Captive Insurance

Originally founded in February 2013 with a standard sales company out of Odessa, Texas, BevCap Health is now comprised of five additional participants: Krey Distributing in St. Peters, Missouri, L&F Distributors in McAllen, Texas, Jordano’s in Santa Barbara, California, Andrews Distributing in Dallas, Texas, and TriEagle Sales in Tallahassee, Florida. It now covers more than 3000 employees.

Jason Dixon, a senior consultant at US programme manager BevCap Management, says: “[BevCap Health’s] benefit strategy allows fully-insured members to achieve the transition to individual employer self-funded health plans, and current self-funded clients the ability to optimise data-driven, innovative ideas through peer exchange. The standard market simply does not provide for this high value strategy.”

“BevCap Health combines the advantage of economies of scale and leverage. Leverage enables our clients to procure national health plan administration service partners at a reduced cost versus buying health insurance one-by-one from the standard market.”

“‘Unbundling’ of the service providers, choosing only the best in class, yields a transparent and accountable service model allowing our distributors the ability to directly monitor cost and obtain critical data to measure and improve healthcare plan performances and reduce expenses.”

Despite the attraction of using captives for medical-stop loss insurance, regulators are weary of employers of small workforces taking them on.

The District of Columbia Department of Insurance, Securities & Banking’s Dana Sheppard has gone on record to say that his state is not in their favour, following passage of the PPACA.

The associate commissioner said: “Regarding medical stop-loss captives, Washington DC is not in favour of allowing small employers located in DC to self-insure their healthcare risks, including the establishment of medical stop-loss captives, if their motivation for doing so would result in removing young and healthy persons out of the [district’s PPACA healthcare exchange], and leaving older less healthy employees in the exchange. We believe this will turn the district’s exchange into a high risk pool, a result the district would obviously wish to avoid.”

“Regulators are concerned that large scale use of self-funding will remove better risks from the federal and state risk pools and result in adverse selection and higher premium rates for members of those pools,” says Kranz.

State regulators are also worried that the critical public policy benefit that is health insurance will be largely unregulated.

“ERISA (Employee Retirement Income Security Act of 1974) pre-empts state regulation. While there is some legitimacy to the concerns, they may be more politically motivated,” says Kranz.

“State regulators have longed for ways to defeat the ERISA pre-emption. High priced coverage in state insurance pools undercuts the [US President Barack] Obama administration’s promise of low cost coverage.”

But Kranz remains unconvinced: “We believe the use of a medical stop-loss captive provides a private market solution that is properly regulated through PPACA, domicile insurance regulation, reinsurer regulation, and state benefit and payment laws.”

Determining whether a captive is the right fit for an organisation is more of a control question than cost, according to Dixon.

“Our clients want to understand what is driving the year over year cost increase, and have the ability to make change to help ‘bend the trend’. The financial stability of the organisation does need to be taken into account to determine if a captive is the best solution. However, the size of an organisation does not determine their financial stability, knowledge of the insurance landscape, or their desire to take back control of their rising cost of health insurance. BevCap members get to own the healthcare process (risks and costs) from beginning to end.” **CIT**

Industry appointments

Jardine Lloyd Thompson has promoted **Steve Arrowsmith** and **Killian Whelan** in its insurance management group.

Arrowsmith has been appointed executive chairman, and Whelan becomes CEO of the global group. They will lead insurance management's global operations.

Whelan and Arrowsmith formerly served as CEO and chairman of the Bermuda operations.

Mike Methley, who oversees JLT's business operations in Latin America and Canada, will be their contact.

JLT is undertaking a period of growth. It has added multiple offices in the US and Barbados, through its insurance management business

Bill Fleury has joined Athena International Management's team of independent directors in the Cayman Islands.

Fleury has worked for PricewaterhouseCoopers in Toronto and the Cayman Islands, Fidelity Investments in Canada, UBS, and Butterfield Fund Services.

He also has a chartered financial analyst designation, a well as a chartered accountant qualification in Canada.

Fleury previously served as general manager and COO of the Cayman Islands Chamber Pension Plan, one of the jurisdiction's largest multi-employer pension providers.

Commenting on his new appointment, Fleury said: "Athena International Management has a reputation of offering quality corporate governance and with my breadth of fund operational and governance experience, I can help the organisation and our clients grow and prosper."

Allison Nolan, managing director, also discussed Fleury's new role: "[He] is highly experienced and client-service oriented. We feel that Fleury will be the ideal person to carry this corporate culture of distinction forward."

Miller Insurance Services LLP has hired a specialist for its Hong Kong team. It has appointed **Joe Ng** to a reinsurance business production role.

Ng joins the treaty reinsurance team in Hong Kong to focus on Miller's work across Asia, particularly Taiwan, China and South Korea.

He will be working with Jennifer Lin, head of Hong Kong, and Miller's treaty specialists throughout Asia and in London.

Ng formerly served as deputy general manager at China Taiping Group. He worked at Taiping for the 43 years. He was also a member of the

underwriting management board at Taiping Reinsurance Co.

Simon Weaver, head of Asia has commented on Ng joining the firm: "[He] has been a highly influential Asia insurance market figure for more than 40 years, having someone of his calibre on board will help us implement our growth plans."

Willis Group Holdings has hired a new head to run its international division of its reinsurance business, Willis Re.

Greg Solomon has been appointed regional director and head of life and health in the Asia Pacific, Middle East, Turkey and Africa (APMETA).

He will be based in Hong Kong and will begin leading the APMETA life and health team in May.

Solomon previously worked for reinsurance company Swiss Re. He managed its global reinsurance capital management team out of London, and most recently served as the head of life and health clients in Hong Kong, Taiwan and south-east Asia.

Solomon's experience of the Asian market offers "significant value in the quantification of risk along with the design and placement of appropriate solutions", he commented.

Maurice Williams, managing director of Willis Re APMETA, said: "We are delighted to have someone of Solomon's calibre join our life and health team and are excited about the opportunities to work with existing and new clients across the APMETA region."

SUNZ Insurance Company has hired **Brian Fischer** to serve as in-house legal counsel for the Sarasota-based company.

SUNZ COO Glen Distefano said: "[Fischer]'s claims and premium expertise in the area of workers' compensation particularly in the professional employer organisation and staffing industries is a tremendous addition to SUNZ and will help us enhance our quality assurance, operations and the future growth of our company."

Prior to SUNZ, Fischer focused on private practice in the area of workers' compensation law for over 27 years. For the last 10 years, Fischer represented professional employer organisations, staffing companies and other corporations, handling various aspects of large deductible and insurance captive workers' compensation insurance programmes.

In addition, he negotiated programme communications as well as disputes with insurance companies and disputes arising out of insurance company receivership proceedings; involving collateral, paid loss reimbursements, as well as premium and audit disputes

At SUNZ, Fischer's duties will include the oversight and management of the claims handling process for its professional employer organisation and staffing company insureds as well as assisting with matters of reinsurance and regulatory compliance.

Mortgage risk consulting firm zIngenuity has hired **Bradley Young** as vice president of business development and will work with zIngenuity's existing sales team to continue driving growth for the firm's servicing quality control and mortgage risk consulting service offerings.

Young arrives at zIngenuity after leaving SN Servicing Corporation, where he led efforts to expand and grow mortgage-servicing rights as executive vice president of business development.

Steve Mageras, managing director and principal of zIngenuity, commented: "[Young] has experience across a wide range of mortgage banking and servicing companies, extensive contacts across the industry, and a real commitment to quality."

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Conference Finale &
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