captive insurance times

The primary source of global captive insurance news and analysis

ISSUE155 22 August 2018

The Gold Standard

This year's VCIA conference in full

PCC Update
Marsh's Rob Geraghty discusses Mangrove vehicles and more

Market Update
Prolonged soft market conditions for the captive insurance industry

Microsoft Settles
$876,820 changes hands in the Microsoft settlement

Microsoft captive pays $876,820 to settle

Microsoft's captive insurer, Cypress Insurance, will pay $876,820 to the Washington state Insurance Commissioner, Mike Kreidler, as part of a settlement agreement with the state.

The $876,820 sum is made up of $573,905 in unpaid premium taxes and $302,915 in interest and penalties.

In May, the State of Washington Office of the Insurance Commissioner issued a cease and desist order requiring the captive to stop transacting insurance without a licence and to pay tax on its written premiums.

Cypress is domiciled in Arizona but its sole insured, Microsoft and its subsidiaries, is based in Redmond, Washington.

Between 2008 and 2018, the captive collected over $91 million in written premium from its insured.

Insurance companies are required by state law to pay a 2 percent tax based on their written premiums, a revenue which is sent to the state general fund to pay for a variety of programmes.

According to the Office of the Insurance Commissioner, Cypress didn't hold a certificate of authority to transact insurance in Washington State, didn't hold a Washington state surplus line broker's licence to place non-admitted insurance in the state, nor is insurance coverage provided by the captive placed through a surplus line broker licensed in the state.

Prior to 2008, the insurance arrangement between Cypress and Microsoft complied with state insurance laws.

As of 1 July, Cypress obtained new policies through a surplus line broker.

Kreidler said he was pleased with the outcome of the settlement.

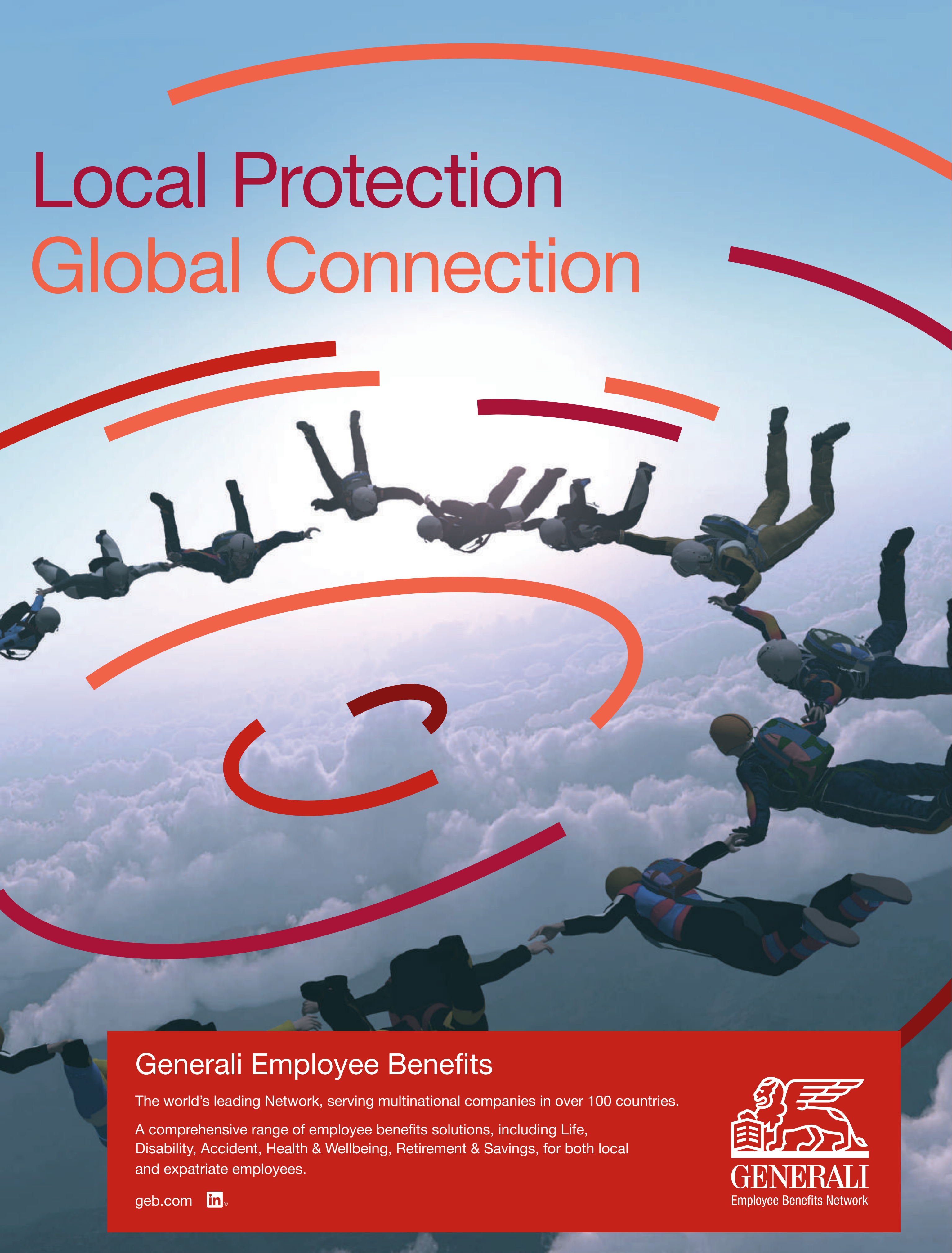
He commented: "Cypress is now complying with Washington state law, and the state will receive some of the money owed."

"Captives are a grey area in state law and this is the first case where we've tested them."

According to Kreidler, his office will now turn their attention to other captives doing business in Washington state.

He said: "I encourage captives insuring risks in Washington–and that want to be proactive in the interest of fairness–to contact my office to start conversations about their portfolios."

"I want to make sure that all insurers pay their fair share as part of doing business here."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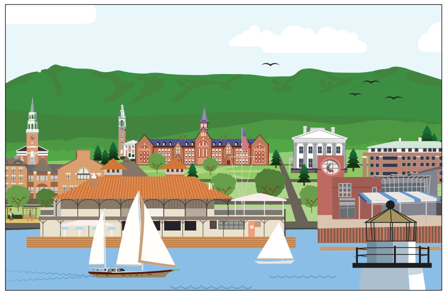

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Microsoft decision to settle reveals 'troubling trend', says Queen

Microsoft's decision to settle with the Washington state Office of the Insurance Commissioner reveals a troubling trend, according to Matthew Queen, general counsel & chief compliance officer at Venture Captive Management.

Microsoft's captive insurer, Cypress Insurance, will pay $876,820—$573,905 in unpaid premium taxes and $302,915 in interest and penalties—to the Washington state Insurance Commissioner, Mike Kreidler, as part of a settlement agreement with the state.

Queen suggested that Microsoft's decision to settle reflects a reality about the American justice system.

He explained: "Justice is available, but it is frequently not worth the time or money."

"Defense costs and plea deals have reduced the speedy right to trial into the exception to the rule rather than the standard operating procedure."

He continued: "The public lacks the facts to assess the legal merits of the case and will never know the full story due to the decision to settle."

"This trend is troubling in light of New Jersey's Johnson & Johnson (J&J) decision, which held that captives are subject to the Non-admitted and Reinsurance Reform Act and home states have the right to assess taxes based on the captive's total gross written premiums—not just the premiums associated with the taxing state."

According to Queen this "radical extension of state power" appears to represent a violation of the 14th Amendment's Due Process Clause.

Queen added: "Some of the state's arguments appear weak."

"In particular, Washington's focus on the captive's lack of a surplus lines broker's license or the existence of a surplus lines broker should be irrelevant as Microsoft has the absolute right to purchase insurance from a non-admitted carrier pursuant to Allgeyer v Louisiana."

"It appears that Washington has taken a similarly aggressive position [to the J&J case] with respect to its premiums taxes and intends to continue litigation on this front until it's stopped by strong defense counsel."

DARAG and SOBC launch joint US and offshore run-off venture

Legacy acquirer DARAG and US-based run-off specialist SOBC have launched a joint venture, SOBC DARAG, to support expansion into the US and Bermuda/Caribbean run-off markets.

The joint venture, based in Delaware, combines the experience and strong capital access of DARAG with the local expertise and reputation of SOBC.

SOBC DARAG's first acquisition will be Peachtree Casualty Insurance, a Florida-based non-standard auto insurer in run-off.

The acquisition is subject to regulatory approval and is expected to close in the Q3 of 2018.

The launch of SOBC DARAG, and the subsequent acquisition, follow the appointment of Tom Booth as DARAG CEO and the receipt of €260 million in equity funding.

Booth said the company was pleased to be partnering with SOBC and the acquisition of Peachtree as the first of many opportunities to work together in the US and Bermuda/Caribbean market.

He added: "Following our recent announcement of an additional equity commitment of €260 million ($300 million), DARAG is targeting the US and Bermuda/Caribbean markets through the SOBC DARAG."

"The agreement by SOBC DARAG to acquire a US carrier in run-off and the announcement of our joint venture with SOBC are exciting steps in our continued growth."

According to Stephanie Mocatta, CEO of SOBC, working with DARAG and its strong capital backing will help to strengthen SOBC's already strong reputation in the US and Bermuda/Caribbean.

Mocatta commented: "We are extremely pleased to form this joint venture with DARAG."

"We have already worked together on the acquisition of Peachtree and are delighted to announce that we have signed the sale and purchase agreement on this acquisition."

"Together we will be able to provide a variety of run-off solutions to a much broader spectrum of companies seeking well-priced and innovative solutions for their legacy portfolios."

SRS launches new captive insurance scholar programme

Strategic Risk Solutions (SRS) has launched a new programme to provide undergraduate college students with learning opportunities in the captive insurance industry.

The Collegiate Captive Scholar Programme will start off focusing on underwriting the cost of selected students to attend captive conferences, where they will attend educational sessions and meet with captive industry professionals.

The opportunity is open to risk management, insurance, finance and accounting majors.

SRS launched a pilot of the programme at the Vermont Captive Insurance Association (VCIA) Conference and has selected Christian Ferrara of Appalachian State University, Marissa Cesa of Bowling Green State University and Brent Musgrove of Georgia State University to participate in the programme.

Brady Young, CEO of SRS, said: "We are thrilled that we could work this out with VCIA and thank Rich Smith and the association for allowing our initial group of Collegiate Captive Scholars to attend VCIA without any charge."

"We hope to work out similar arrangements with other captive industry associations, both onshore and offshore, so as many qualified and interested students can get exposure to our industry and the great career opportunities it offers."

SRS will be contacting other captive associations in the coming weeks to gain their support for the programme and sending the application forms to various universities across the US to solicit future participation in the programme.

DARAG receives funding to develop platform for US operations

DARAG has revealed an equity funding of up to €260 million to develop an effective platform for the build-out of its US operations.

The funding, which has been provided by Aleph Capital and Crestview, follows a period of significant strategic development for DARAG.

The firm expanded its team with the appointment of Stuart Davies as chairman in June and Tom Booth as CEO in July.

Completion is subject to regulatory approvals, which is expected to be close to the end of the year.

Davies commented: "We have a very clear path to become a leading global legacy insurance business. We have already come a long way in Europe, where we are a market leader, and will now be bringing our expertise to the US and beyond, where we see substantial demand for skilled legacy acquirers such as DARAG."

"Aleph and Crestview's significant investment will support our ambitious expansion targets and their strong track record in the insurance sector makes them an excellent partner."

Hugues Lepic, founder and CEO of Aleph, said: "DARAG is on an exciting trajectory in the rapidly expanding and increasingly important legacy segment of the property and casualty insurance industry. In the coming years we see significant opportunities to drive growth globally and we are very excited to be partnering with Keyhaven and DARAG's management team to support the company in this next important phase of its development."

NEIL ratings affirmed 'excellent'

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and the long-term issuer credit rating of "a+" of Nuclear Electric Insurance Limited (NEIL).

According to A.M. Best, the ratings reflect NEIL's marginal operating performance, favourable business profile and appropriate enterprise risk management.

NEIL provides essentially the entire nuclear utility property insurance coverage in the US.

The rating agency noted that partially offsetting these positive rating factors are the company's primary focus on catastrophe property risks and related business interruption claims, with the subsequent financial stress this could cause in the unlikely event of two full-limit losses.

A.M. Best said: "Despite the recent positive results, the company has reported volatility in underwriting results in recent years due to claims activity, which relates to the fact that the company relies on one market and two principal product lines."

However, it stated that these factors are reflective of a captive insurer focused on a particular niche market supported by its members.

NEIL's risk management programme is designed to manage risks within the company's defined tolerance levels, in addition to a loss prevention programme.

BP captive ratings affirmed as 'excellent'

A.M. Best has affirmed the financial strength rating of "A- (Excellent)" and the long-term issuer credit rating of "a-" of Saturn Insurance, the captive of BP, an integrated global oil and gas company.

The ratings reflect Saturn's balance sheet strength as well as its operating performance, limited business profile and appropriate enterprise risk management.

The ratings also consider rating lift from its reinsurer, Jupiter Insurance, which is the principal captive of the BP group and provides substantial reinsurance support to Saturn.

A.M. Best affirmed Jupiter's rating of "A (Excellent)" and the long-term issuer credit rating of "a", reflecting its strong operating performance, neutral business profile and appropriate enterprise risk management.

According to A.M. Best, Saturn benefits from low investment risk with approximately half of its assets invested in cash and cash equivalents. The remainder is composed of callable loans with a BP affiliate, with excellent liquidity terms.

The rating agency noted that Saturn achieved strong operating results during the period between 2013 and 2016, however, a large workers' compensation claim negatively impacted its performance last year, demonstrating its exposure to volatility.

Saturn's strong performance track record has supported growth in capital and surplus of 43 percent since its incorporation in 2011, with no dividends paid out during this period.

The captive's portfolio consists primarily of terrorism cover, certificate of financial responsibility, workers' compensation insurance and environmental protection agency cover.

In addition, its premiums have been impacted negatively by the soft rate environment over the past three years, with its gross written premiums reducing by approximately 60 percent since 2014.

Cat bond issuance in Q2 shows continued 'robustness' of ILS sector

Catastrophe bond issuance totalled more than $4 billion in Q2 2018, the third largest Q2 total in history, according to a report from Aon Benfield.

Q2 is traditionally the largest in terms of cat bond issuance volume due to the high amounts of US wind-exposed capacity purchased.

Aon's Q2 2018 update on insurance-linked securities (ILS) also revealed that the total outstanding cat bond limit was in excess of $30 billion as of 30 June 2018—a record high for the market.

The report also showed that the quarter had a record volume of maturating bonds, with nearly $3 billion of limit coming off-risk. This capital was, however, entirely

AHPs likely to be prohibited in some states

The formation of association health plans (AHPs) is likely to be prohibited in some states, according to the Self-Insurance Institute of America (SIIA).

Representatives from SIIA attended the National Association of Insurance Commissioners (NAIC) Summer meeting in Boston and included details from the ERISA (B) Working Group's discussion about AHPs in the SIIA state legislative and regulatory update for August.

The discussion was focused on the way in which states will regulate AHPs following the final rule issued by the Department of Labor (DoL) in June, which allows AHPs to be treated as a large group health plan for the purposes of the Affordable Care Act and may allow them to obtain health coverage at a lower cost.

According to SIIA, some states are likely to prohibit the formation of AHPs, while others will require them to meet all state rating and benefit requirements. SIIA added: "Many states are currently in the process of responding to the AHP rule, which they are required to do with the DoL within the next several months."

SIIA predicted AHPs will be a topic of continued discussion at the next NAIC meeting in November.

replaced, and even expanded through $1 billion in new issuance volume.

Cat bond pricing was lower than the levels seen in the 2017 catastrophes, with a weighted average multiple at issuance (issuance spread divided by expected loss) of 2.46 times for this quarter, in comparison to 2.58 in Q2 2017.

With the exception of Transatlantic Re, which entered the market in May with its Bowline 2018-1 offering, issuances came almost exclusively from repeat sponsors.

Despite the volume of repeat sponsor issuance, the report stated that there were a number of "notable issuances and trends observed in the quarter".

The newly-created London ILS regime was made use of for the first time, with the incorporation of the first UK-based vehicle for SCOR's latest Atlas transaction. Another notable trend was the continued usage of the cat bond market from coastal windpools, which had exposure at risk to hurricanes Harvey, Irma, and Maria in 2017.

A sponsor that had been absent from the cat bond market for almost 10 years returned with the issue in Kendall Re for Aspen and an issue, which had ceded losses in previous bonds, successfully came back with Caelus Re V on behalf of Nationwide.

The report appeared positive on the current state of the cat bond market and stated: "Given the 2017 US wind loss events, this strong result evidences the continued utility of cat bonds for sponsors and investors alike, and demonstrates the continued robustness of the ILS sector." CIT

Willis Towers Watson launches financial modelling tool

Willis Towers Watson has launched Captive Quantified, a financial modelling tool for captive owners.

The tool was introduced at the 2018 Vermont Captive Insurance Association's (VCIA) Annual Conference in Burlington, Vermont.

Captive Quantified is designed to automate due diligence and financial analysis to allow organisations to assess the value proposition of forming a captive insurance company compared to traditional insurance or retaining risk on its balance sheet.

It is the latest release in Willis Towers Watson's interconnected quantification models and can be used in concert with these other tools. Sean Rider, managing director, consulting and development, global captive practice at Willis Towers Watson, commented: "Captive Quantified is a real game changer that goes far beyond typical financial analysis used for captive feasibility studies."

"This powerful tool will enable profoundly more sophisticated conversations with finance decision makers as to the value, volatility and efficacy of the captive proposition at both the feasibility stage and throughout the life of the captive. We are proud to present this at VCIA as a further demonstration of Willis Towers Watson's leadership in the market."

NEWS

Captives function best behind risk engineering and legal programmes

Using a captive insurance company as a third line of defence, behind a risk engineering programme and the legal side and contracts, helps drive a company forward, according to Andrew Baillie, programme director of global insurance of the AES Corporation.

Speaking at the 'future-proofing your captive' session at the Vermont Captive Insurance Association (VCIA) 2018 Annual Conference, Baillie used a football goalkeeper analogy to further expand on his point.

He said: "If you're the third choice goalkeeper going to the World Cup, you are going to have a nice time, sitting in the stands and watching all the games but not doing much–that is what I want to do as a captive insurer."

"The first goalkeeper is our risk engineering programme, who is going to do the bulk of the work, if something happens there then we rely on our second goalkeeper, the legal side and our insurance contracts, to ensure we are not accepting risk beyond what we want to."

"If all of that fails, you then you call up the third rate goalkeeper off the bench, the captive, and say it's time for the insurance policies to respond."

"Doing that rather than buying insurance and hoping for the best is really what has helped us to drive what we are doing."

The AES Corporation is a global power organisation that currently operates two Vermont-based captives, AES Global Insurance, which was formed in 2002, and Miami Valley Insurance Company, which was formed in 1986 but was inherited by the company in 2011 as part of an acquisition.

AES Corporation's mission is to improve lives by accelerating a safer and greener energy future, and Baillie explained that many of the challenges in the energy risk market are caused by the shift toward greener energy.

He commented: "Currently there is a lot of social, political and economic lobbying pressure because everyone thinks energy companies are bad."

"There are a lot of lobby groups putting pressure on insurers and a number of insurers have made statements, AXA have said they will no longer insure coal operators and, Swiss Re recently said that companies have to be showing that you are moving away from coal."

"More recently, Munich Re made an announcement that they have set a threshold that unless a company can get below a certain percentage of coal within your fleet they will not insure them."

"The energy industry is in a period of rapid transition and change as we move toward renewable types of energy."

According to Baillie, companies in the energy risk market faced the challenge of finding a balance in meeting their stakeholders' expectations.

"You have to find a balance between being socially responsible with you're doing and meeting the stakeholder requirements to be profitable. The real challenge is balancing the green of the environment with the green of dollars."

Succession planning in captives can be easy

Succession planning in the captive insurance industry can be easy, according to Les Boughner, chairman of Advantage Insurance. Speaking at a session on succession planning at the Vermont Captive Insurance Association 2018 Annual Conference, Boughner suggested there were two main actions that were key to succession planning.

He said: "You look for the best-qualified candidate and one that fits within the culture of the company and don't compromise on either."

"The only time I have failed in succession planning is when I've compromised one of those two."

It is so important to ensure you populate the company with people who are engaged, fun and stimulating.

Bougher also noted that promoting based on potential was a best practice.

He explained: "If you're building an organisation and you have an opening, you're far better off to promote on potential when you have to."

"If you put someone in a responsible position without the experience, it's extraordinary how often they grab it and do a fantastic job."

Association decorates Young and Kusaila

The Vermont Captive Insurance Association (VCIA) rewarded both Dan Kusaila, tax partner at Crowe, and Brady Young, president and CEO of Strategic Risk Solutions, for their achievements in the industry at its 2018 annual conference.

Kusaila received the Captive Crusader Award for demonstrating commitment and dedication to the association through active service.

Rich Smith, president of the VCIA, said Kusaila had "unflagging good humour and positive energy and enthusiasm, in addition to unwavering support of the VCIA".

Smith added: "Dan Kusaila has worked in the captive industry for 20 years becoming a zen master in the mysterious arts of captive taxation in that time."

Young received the Industry Service Award, in recognition of his support of the captive insurance industry and contributions to its vitality and welfare and said he was taken back and humbled by the award.

He added: "I really appreciate the recognition, both from Rich Smith and the VCIA."

"I have a great team around me, not only in Vermont but all over the US and the world. It's a great feeling to know I have a great team looking after the clients and that always have my back. I accept this award on their behalf as well."

Andrew Christie, senior consultant at Aon, was awarded the VCIA Scholarship.

International Center for Captive Insurance Education (ICCIE) Awards were also presented at the conference, with Elizabeth Steinman, managing director of risk finance and captive consulting for the Americas at Aon, receiving the ICCIE Fellow Award.

Paulus Ackah, a student at Georgia State University, received the Harry House full scholarship, while Skye Hall, another student at Georgia State University, received the Harry House partial scholarship.

Worth its weight in GOLD

The 2018 VCIA conference welcomed 1,060 delegates from around the world to Burlington, Vermont, emphasising the importance of the captive industry and discussing how it can continue to grow

Ned Holmes reports

Vermont is by no means a large state. But tucked up in the American northeast, between New Hampshire, New York and Canada, the second smallest US state by population and sixth smallest by area is a behemoth of the captive insurance industry.

The largest US captive domicile, totalling some 556 active captives and $22.1 billion in gross written premium, and the world's largest captive insurance trade association, the Vermont Captive Insurance Association (VCIA), played host to the VCIA 2018 Annual Conference between the 6 and 8 of August.

This year's conference saw 1,060 attendees descend on the Doubletree Hotel in Burlington, illustrating the growth in the industry as a whole since the inaugural conference in 1985, when there were less than a dozen attendees.

VCIA president Rich Smith suggested that the 2018 theme, 'where the captive world comes to meet' highlighted the "tremendous opportunities" available at the event to "learn and collaborate with with the best and brightest in our industry".

The state markets itself as 'the gold standard' and this is a position it appears the association does not take for granted.

Smith assured attendees that as the captive organisation with the largest day-to-day representation in Washington, "the VCIA will continue to work hard to ensure that captives are treated fairly".

Smith added that their success in such endeavours is due to their active and expert members.

"Membership to VCIA keeps the whole industry strong and through that strength we can keep up the fight. Our strength is through you."

Vermont congressman Peter Welch was full of praise for the captive industry, emphasising that this collaboration was one of its great successes, and suggesting that it is a reminder of how others should be operating, particularly in Washington.

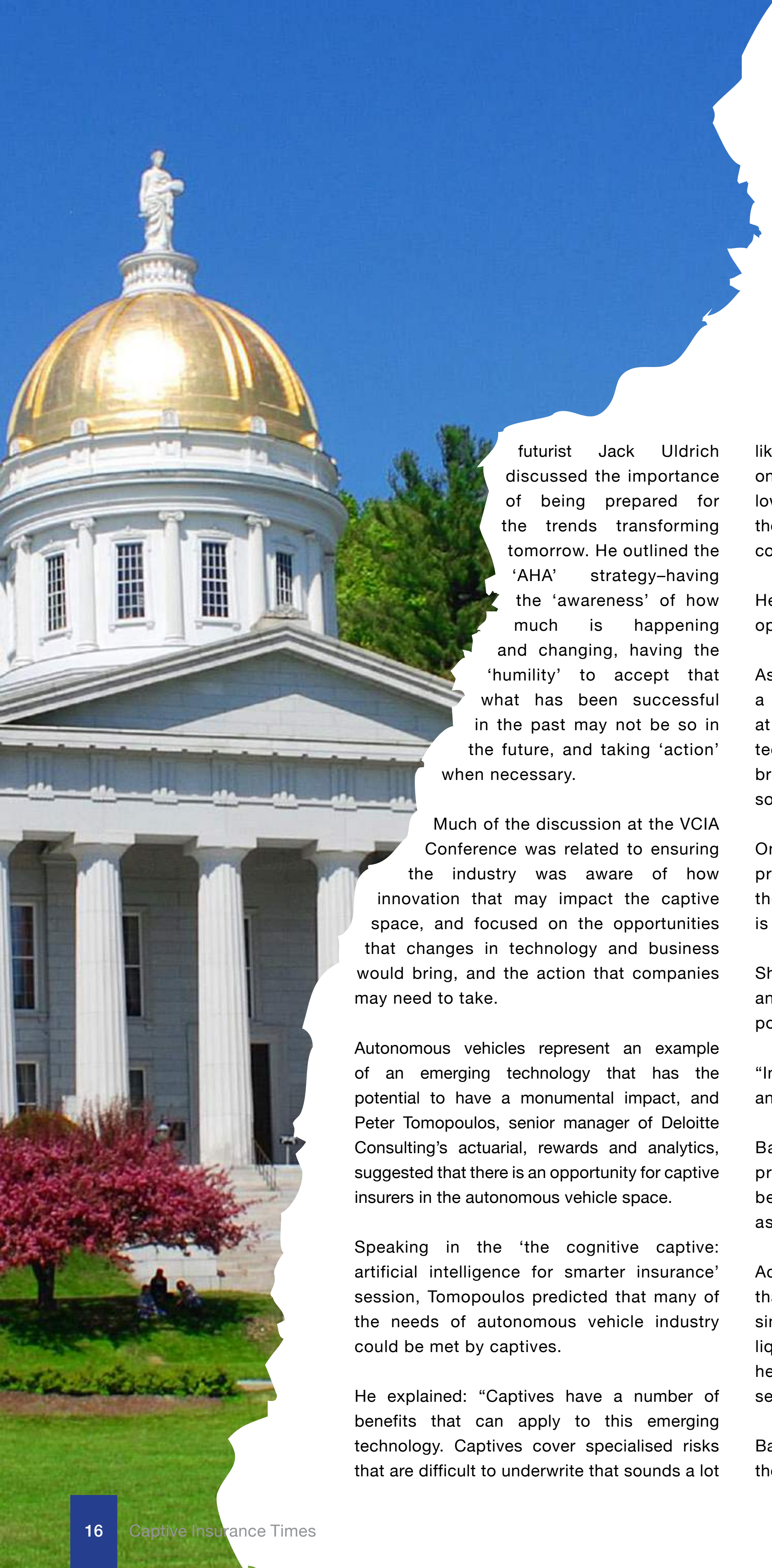
"It shows problems are not unsolvable," said Welch, "what you have managed to do as an industry and the way you have focussed on managing the challenges that you face. Maintaining your focus on client needs, but understanding that it is not your way or the highway and working together with flexible legislative and regulators."

Amongst what is, following a number of state and federal tax cases and in a soft market, a tricky time for captives, the Vermont conference reminded the industry of its strength and importance and emphasised the ways in which it can continue to grow.

Innovation

Like the VCIA conference, Fox cartoon the Simpsons began in the late 1980s. Reflecting this brotherhood was Joel Cohen, one of the show's writers and producers, who spoke at the conference's closing keynote. Cohen spoke at length about the show's success, much of which was based on its positive environment and culture of innovation. Innovation was also at the heart of the event's first keynote speech, as renowned global

Conference Report



futurist Jack Uldrich discussed the importance of being prepared for the trends transforming tomorrow. He outlined the 'AHA' strategy–having the 'awareness' of how much is happening and changing, having the 'humility' to accept that what has been successful in the past may not be so in the future, and taking 'action' when necessary.

Much of the discussion at the VCIA Conference was related to ensuring the industry was aware of how innovation that may impact the captive space, and focused on the opportunities that changes in technology and business would bring, and the action that companies may need to take.

Autonomous vehicles represent an example of an emerging technology that has the potential to have a monumental impact, and Peter Tomopoulos, senior manager of Deloitte Consulting's actuarial, rewards and analytics, suggested that there is an opportunity for captive insurers in the autonomous vehicle space.

Speaking in the 'the cognitive captive: artificial intelligence for smarter insurance' session, Tomopoulos predicted that many of the needs of autonomous vehicle industry could be met by captives.

He explained: "Captives have a number of benefits that can apply to this emerging technology. Captives cover specialised risks that are difficult to underwrite that sounds a lot like what is going to happen, particularly early on, with autonomous vehicles. They can also lower insurance costs and reduce the risk of their parent's balance sheet, as well as filling coverage gaps."

He concluded: "All these new risks will create opportunities for captives."

As seems the norm in 2018, blockchain was a subject of much discussion. The speakers at the 'blockchain and distributed ledger technology' session did an excellent job of breaking down blockchain and debunking some common myths.

One of the session speakers, Carol Barton, president of AIG, suggested it will build on the trust upon which the insurance industry is built.

She said: "As we think about captives, fronting and multinational programmes there is a lot of potential there for blockchain."

"Insurance is an industry that is based on trust, and blockchain is a way to build on that trust."

Barton referred to the first multinational programme delivered via blockchain, between AIG, IBM and Standard Chartered, as a case study.

According to Barton, the case study showed that blockchain had helped with operational simplification, regulatory efficiency, and liquidity and capital. In addition, it had helped reduce counterparty risk, clearing and settlement time and had minimised fraud.

Barton concluded: "I think right now and in the next three to five years as we move into a

> It shows problems are not unsolvable, what you have managed to do as an industry and the way you have focussed on managing the challenges that you face
>
> **Peter Welch**, Vermont Congressman

blockchain digitally-enabled environment the strategic opportunity is about operational efficiency."

Renewable energy is another emerging market that may impact captives, and principal and consulting actuary at Pinnacle Actuarial Resources Robert Walling said there is a "tremendous opportunity" for captives in that space.

Speaking in the 'innovative spotlight: financing unique risk' session, Walling said he had been in conversation with multiple renewable energy programmes that week.

He explained: "One of my players of the week has been energy and I have been on calls with three different renewable energy programmes this week."

"Three completely different programmes with three completely different solutions all facing similar challenges."

"When you're putting solar panels on a hospital, putting them in a residential neighbourhood and creating an energy cooperative, and when you're setting up a power plant that supplements a local facility, the traditional insurance industry doesn't cope well with that. There are lots of different types of warranty programmes, construction defect programmes and financial products that have stepped into renewable energy."

"Whether it is biodiesel or ethanol, solar or wind, there is a tremendous opportunity for the captive industry to step in and help those programmes succeed."

Upkeeping the 'gold standard'

Understandably, Vermont took centre stage for much of the conference in what has been a "good year" for the the 'gold standard' domicile, according to deputy commissioner of the state's Captive Insurance Division, David Provost.

The state has licensed 12 new captive insurance companies this year and has more applications in process.

Of the new captives licensed, nine were pure captives, two were risk retention groups (RRGs), one was a group captive and one was a sponsored entity.

Provost said: "We are having a good year, we have licensed a dozen captives already which normally at this time of year means more are on the way. There are opportunities in the captive market across the board right now. We aren't focused on one area."

This year has been relatively quiet in terms of legislative changes in Vermont, with the largest change being the new affiliated reinsurance company (arc) legislation which was signed into law in May.

The legislation provides an opportunity for companies affected by the recent imposition of the Base Erosion Anti-Abuse Tax on reinsurance ceded to offshore affiliates with an onshore alternative. No arcs have yet been formed, but Smith explained that the strength of Vermont's regulators may help formations grow.

He said: "The fact that it is the captive division that will be regulating them could be huge because people know the regulator in Vermont can do the job."

"They take on these exogenous type of insurance vehicles and are able to regulate them and regulate them well."

The grassroots generation

Another topic which dominated discussion in Burlington was the next generation of captive insurance professionals.

The industry talent crisis was a talking point, with statistics in a conference session suggesting that nearly 400,000 people are expected to retire from the insurance workforce in the next three to five years and approximately 25 percent of the current workforce by the end of 2018.

Speaking at VCIA Anne Marie Towle, captive practice leader at JLT Insurance Management, said that the industry needs to be more active in inspiring the next generation of insurance professionals and said work needed to be done at the "grassroots level".

She said: "Insurance is not something that you hear about much at high schools, more conversation needs happen at this level."

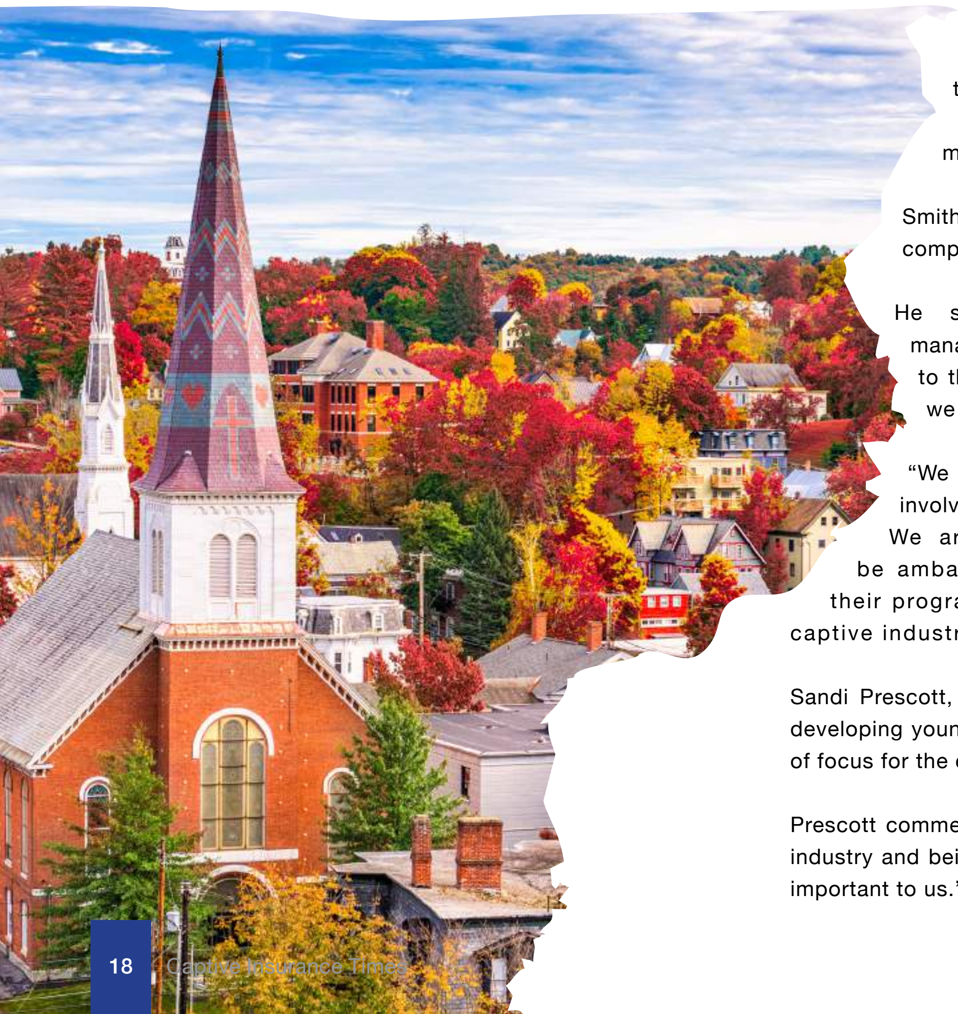
"All of us in the industry need to be more active and help educate at the grassroots level by speaking at high schools."

Another of the panellists, Colin Donovan, president of the risk retention group STICO Mutual Insurance, suggested that attracting more young people to the industry also needed to be done at a college level.

Donovan said: "The path for young professionals has to be there at the college level. If there is no risk management programmes then you're going to have to find people that accidentally fall into insurance jobs, there has to be a programme if there is going to be a true path laid out."

The VCIA has recognised the importance of exposing students to captive insurance and is looking to expand the number of risk management students that attend the conference over the next few years.

The conference's emphasis on the importance of young captive professionals was highlighted by the professional development sessions provided, including unique sessions such as 'presenting to boards and management'.



At this year's conference, Strategic Risk Solutions (SRS) sent a number of students from across the country to the conference, allowing them to attend educational sessions and network with members of the industry.

Smith explained that he hoped to help more companies to follow suit in the future.

He said: "SRS brought students from risk management programmes from across the country to the conference this year and that is something we are looking to expand over the next few years."

"We are hoping to get other captive managers involved in hosting students at future conferences. We are hoping that these young people will be ambassadors for the industry and go back to their programmes to make more people aware of the captive industry."

Sandi Prescott, head of client service at Performa, said that developing young captive professionals was an important area of focus for the conference.

Prescott commented: "Getting younger people involved in the industry and being able to provide the educational sessions is important to us." CIT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A numbers game

With prolonged soft market conditions, changes in US tax law and headwinds of low-interest rates, how is the captive insurance market coping?

Becky Butcher reports

After a prolonged period of soft market conditions, captive insurers remain nimble and steady, despite facing headwinds of low-interest rates and changes in US tax law.

A recent A.M. Best report, which reviews the rated captive market, suggested that all these factors demonstrate how well companies are identifying emerging risks, as well as their ability to take advantage of reinsurance pricing when opportunities arise.

Every year, A.M. Best releases a report focusing on the rated captive industry. This year's report found that the captive market remains "exceptionally strong and continues to outperform its counterparts in the commercial casualty segment".

The rating agency noted that the biggest challenge was "to find a new or interesting way to describe the persistently good news".

The report showed that the discussion on the investment environment and its adverse impact on companies has been a topic for conversation since the 2008 financial crisis.

It also revealed that there are an estimated 5,600 captive insurers operating throughout the world, with approximately 3,090 of those domiciled in the US.

The report found that changes in captive laws are also contributing to the increase in formations.

Although Bermuda, the Cayman Islands and Barbados have historically been popular captive domiciles, the report showed that more recently new captives have been formed in the US, with Vermont, Utah and Delaware now ranking in the top five domiciles in the world.

Last year, North Carolina had the largest increase in the net number of captive for a second year, followed by Hawaii, Georgia and South Carolina.

Seeing the largest decreases in captives were Utah, Montana, Kentucky and Vermont. A Strategic Risk Solutions (SRS) report found that the main reason for captive closures were redomestication, mostly from offshore to onshore, parent consolidations or acquisition and soft market conditions affecting some group captives are risk retention groups (RRGs).

A.M. Best noted that North Carolina has been aggressive in implementing laws favourable to captives and is now the

Figure 1 — Number of Captives, 2017

	US	International	Global
Total Active Captives	3,090	2,461	5,551
New Captive Formation	355	86	441
Captive Closures	335	136	471
YoY Change (%)	0.7	-2.0	-0.5

Source: SRS Webinar: 2018 - The State of the Captive Insurance Market, March 1, 2018 fifth-largest domicile by total number of captives—six off of Hawaii.

Debbie Walker, senior deputy commissioner, North Carolina Department of Insurance, said: "Businesses in the healthcare, financial, construction, manufacturing, and information technology industries have contributed to over 65 percent of the captive insurer formations in North Carolina."

"As the industry in our state continues to mature, we anticipate some insurer closures due to changes in the business operations of the insureds, consolidations and acquisitions; however, overall we expect growth to continue as more businesses, especially the smaller to medium-sized businesses, learn about the benefits of managing their risks through the use of a captive insurance company."

North Carolina isn't alone, other states are also enacting captive-friendly legislation to increase the chances of being selected as a captive domicile. Increasing the number of captives produces much needed revenue, which the report reveals is one of the leading factors for the rise in the number of captives in recent years.

The report also said that changes to the Internal Revenue Service's (IRS) Section 831(b) should accelerate the growth in new formations in the US. Section 831(b) of the Internal Revenue Code allows small property and casualty captive insurance companies to make a tax election meaning the premium they take in is not taxed as income.

In January 2017, the IRS increased the maximum allowable premium an insurer can write from $1.2 million to $2.2 million and they can still qualify for favourable tax treatment under Section 831(b). In January this year, the IRS also announced its first inflation adjustment to premium limits.

The adjustment was a result of the provisions put in place as part of the Protecting Americans from Tax Hikes (PATH) Act of 2015, which amended section 831(b) of the US tax code.

A.M. Best said: "We believe that these changes will give rise to more small and medium-sized companies (SMEs) forming new micro captives in 2018 and beyond."

SRS's report showed that the number of US captives was flat in 2017, but new formations have outpaced closings by 20.

Although the industry thought the new premium limit would encourage captive insurance companies to take the 831(b) election, there was a worry that the Avrahami decision would have the opposite affect.

On 21 August last year, the long-awaited ruling confirmed a win for the IRS after payments made to the Avrahamis by their micro captive, Feedback, fell outside of the scope of certain tax elections, including 831(b) for investment income up to $1.2 million.

After the ruling, industry participants had various opinions on what this meant for the micro captive industry. One market player encouraged participants and prospective micro captive owners, "if there is a legitimate, non-tax business reason for utilising the captive, and the captive is properly run, there is no reason to change direction".

Thomas Adams, president and CEO of the North Carolina Captive Insurance Association, says: "While it is true that some domiciles declined last year in terms of growth, several like North Carolina, actually saw significant growth. We expected that in the wake of the Avrahami decision there would be slowing in the micro captive sector. We did see that, however, we also saw growth in pure captives."

Adams adds: "Going forward we have to acknowledge that the captive industry is maturing. Growth will come at different rates and at different times. The type of information contained in the A.M. Best report will be more useful over a longer period of time."

Figure 2 - A.M. Best's rated captives by domicile

Domicile	%
Vermont	12.2%
Bermuda	9.6%
California	8.1%
Cayman Islands	5.1%
Texas	4.6%
Illinois	4.1%
Other US	42.6%
Other International	13.7%

Source: A.M. Best data and research

A.M. Best revealed that its captive insurance composite ended last in "strong form", with a pretax profit of $1.3 billion. Although this figure was down almost 18 percent from the $1.58 billion reported in 2016, the US captive market continues to "fulfil its mission".

Despite the decline, the composite posted a combined ratio (after dividends) of 91.4 percent and a net underwriting profit of $390 million.

The report noted that Hurricane Harvey likely played a material role in the drop, given the substantially weaker-than-average underwriting results reported in commercial multi-peril and in Texas—the state accounted for 10 percent of all direct premiums written last year and ranked as the third-largest state among US captives.

In the report, A.M. Best said: "This captives segment still generates exceptional underwriting results year over year—hence, our favourable view of the segment regardless of market cycles."

It added: "The strong results are a testament to the segment's close alignment of interests with stakeholders and deeply ingrained risk management culture. Our favourable view also reflects the composite companies' exceptionally conservative reserve philosophies and their close proximity to insureds, which allows for the ability to quickly identify and manage risk as it emerges."

The report also suggested that a lack of competition in the insurance industry is a major advantage for the captive market. The captive insurance segment has little in the way of competition from the commercial market, with renewal rates well over 90 percent for the rated group captives and RRGs.

Richard Smith, president of the Vermont Captive Insurance Association says he "is not suprised" by the finding of the A.M. Best report.

Smith commented: "Over many years, the captive insurance marketplace has outperformed the traditional insurance industry for what I believe is the main driver for captive formations: when you own your risk through a captive you will have the data and internal expertise to control those risks more effectively."

"This is why year-over-year, we have seen steady captive formations in Vermont and other domiciles, even in a soft insurance marketplace."

Although competition isn't a problem, the report found that investment challenges continue. It suggested that captive insurers must contend with the same investment market challenges as standard market insurers, and thus have also seen their investment yields decline owing to low returns. **CIT**

Figure 3 - A.M Best's rated global captives by type

Source: A.M. Best data and research as of June 2018

Domicile	%
US Single Parent Captives	11.2%
RRGs	21.8%
International SPCs	15.7%
Other Domestic Captives	38.6%
Other International Captives	12.7%


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Emerging Talent

Showcasing the new generation of captive professionals

Karen Hsi, programme manager, captive programmes, UC Office of the President

Personal bio

I was born and raised in Fremont, California. I've studied ballet, jazz, modern, and hip hop dance for 25 years. Throughout high school and college, I've had some very unique opportunities to travel the world dancing for government officials, backup dancing for famous celebrities, and cheering for college sports teams as part of their dance squad.

Currently, I spend my spare time focusing on my health and fitness, taking dance classes, circuit training, or kickboxing. On the weekends, I enjoy spending time with my family and volunteering with youth ministry at my church.

Professional profile

I double majored in psychology and education at University of California, Berkeley. I started out pursuing higher education business administration. I was fortunate enough to land a position at the Office of the President as an intern with risk services while I was still an undergrad at Berkeley. Interning for two years provided me with the opportunity to learn about the unversity's insurance programmes in more depth and I was hired upon graduation as a liability programmes analyst, where I was in charge of building and managing the travel insurance programme system-wide for departments such as education abroad and other insurance programmes for students, faculty, and staff across the system. With the knowledge I had acquired of insurance and the university system, I eventually had the opportunity to help run the university's captive insurance programmes and end up in the role I currently hold today.

How did you end up in the captive industry?

My internship in risk services at the Office of the President helped to familiarise me with the University's systemwide risk management and insurance programmes. My analyst position allowed me to really manage and grow two specific liability programmes that were run out of University of California Office of the President.

When the university's captive, Fiat Lux, was formed in 2012, I had the privilege to participate in one of the first workgroups, a student initiatives workgroup, focused on student utilisations of the captive and how the captive could potentially bring value and generate savings in that space. Up until then the captive hadn't been very active, it was just doing basic deductible buy back policies.

When they finally hired an executive director to run the captive in 2015, Fiat Lux started writing over 25 lines of coverage and really took off as an innovative space to help the university look for alternative financing mechanisms for its unique risks. When they decided to hire the second position of programme manager for Fiat Lux, I knew I had to apply. It was the perfect position for someone curious, creative, and constantly seeking challenges and problem solving opportunities.

What is your impression of the industry?

Exciting, compelling, innovative, entrepreneurial, adaptable, dynamic, and intellectual.

I am excited to see how the industry will continue to embrace and respond to changing technology and the unique coverages that will stem from new and emerging risks.

What are your aspirations for your career in the captive industry?

I aspire to acquire greater responsibility to run and manage an entire captive operation.

I hope that in doing so, I will be able to drive captive innovation in institutions that are just beginning to explore captives as an alternative financing mechanism or to further develop novel strategies and efficiencies that will help enhance existing programmes.

What advice do you have for someone considering a role in the industry?

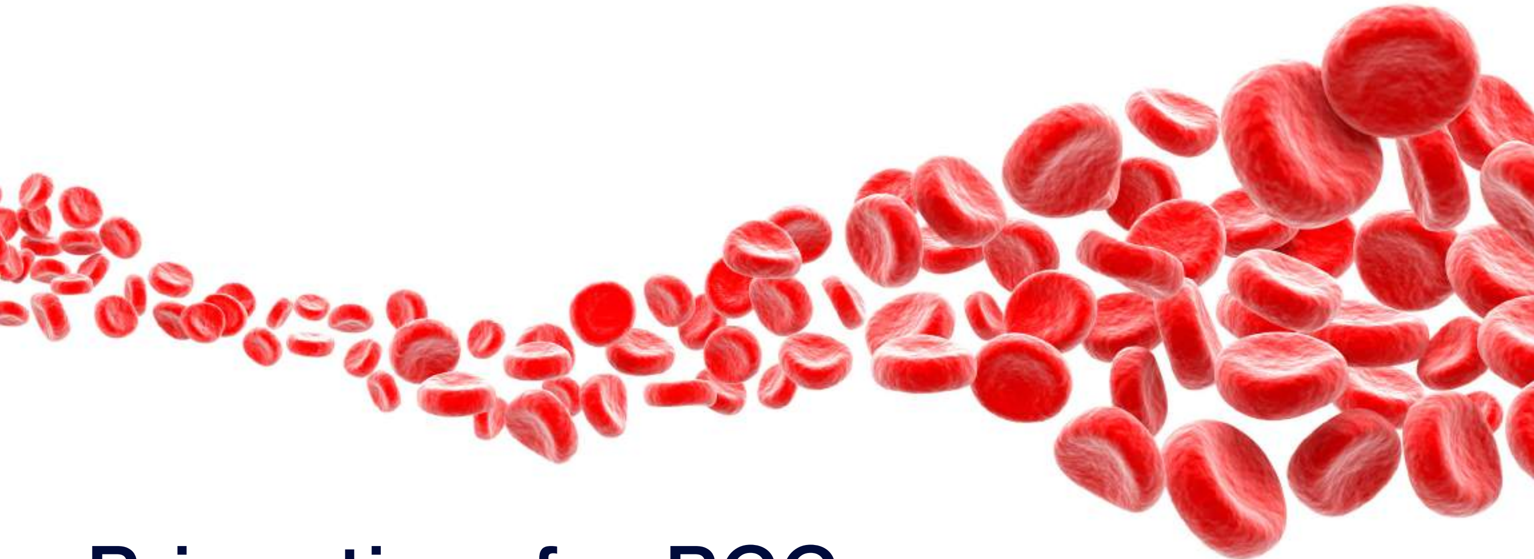
You can learn so much if you are willing to put yourself out there and ask questions. People in the industry are very willing to help pass on the knowledge and grow the next generation of professionals.

For anyone that is interested in moving into a fast paced, ever-changing space, filled with creative problem solving and relationship building, I wouldn't discount looking into a role within this industry. CIT

“Karen Hsi is the principal architect of three new captive risk financing arrangements in our captive platform that in the aggregate, will exceed $50 million of premium annually. Karen has accomplished all of this while still in her 20's and in her first two years in the captive industry. I highly recommend her.”

Courtney W. Claflin
Executive director – captive programmes
University of California

Karen Hsi



Prime time for PCCs

With an uptick in PCC formations, Rob Geraghty of Marsh reveals that its Mangrove vehicles are set to have their strongest growth year ever

Becky Butcher reports

Who should consider using a Protected Cell Company (PCC)? And what do they offer?

Firms ranging from medium-sized companies upwards, that are potentially looking to retain risk, whether in a captive or any sort of risk retention vehicle, should consider using a PCC. It should also be considered as an option by those looking to segregate risk, assets, and liabilities—this can be done within the cell itself. We have also seen a number of firms utilising a cell to front risk on a non-admitted basis to access reinsurance markets.

There's a great deal of interest in protected cells, with greater uptake than we have ever seen before across the European region. PCCs are suitable for any firm seeking to front their risks into Europe via a cell for European business; they have many of the same benefits as captive, solutions, but with different advantages such as potential time costs and capital savings.

The interest though is truly global, with many recent enquiries coming in for our vehicles in Washington DC, and the Isle of Man.

What current trends are you seeing around PCCs in Europe?

Marsh Captive Solutions has created a new cell feasibility study run by the advisory team in London, which complements our existing captives suite of products, to assess the potential advantages of new cell establishments.

Some organisations are looking to establish cells and start with the cell feasibility study, therefore, a lot of ongoing feasibility studies are currently underway, and there have been some new establishments across the region, in terms of the Mangrove PCCs in Malta, the Isle of Man, and Washington, DC, that we own, and some of the other third-party PCCs that we operate in Guernsey, for example.

Why do you think that there is such a keen interest in PCCs all of a sudden?

PCCs offer many of the advantages that a captive offers. However, clients are increasingly looking towards saving more on the timing, costs, and potential capital reduction as well. There is a growing emphasis on these elements; the client does not have to give up so much time, as the cell does not have its own board of directors. Furthermore, PCCs do not have that high-level cost element that is usually associated with captives and do not have to be capitalised to the level of a captive.

Do you see people moving from protected cells onto single-parent captives eventually or do a lot of people stay within PCCs?

Some firms use PCCs as a way to test the water when starting out, rather than diving in with a fully-fledged legal entity such as the captive vehicle. Increasingly, we are seeing more companies looking to do this.

At the moment, new companies will probably stay within a cell for a certain amount of time, and then as they develop and expand the cell operation, they may put many more lines of business in.

As the cell becomes bigger, they may potentially head towards the captive route.

Are you seeing any particular domiciles stand out in terms of PCCs uptake?

We are seeing a lot of growth in the Isle of Man. Mangrove Insurance Solutions PCC was established in 2009. This year it is set to have its highest growth year ever and we anticipate strong growth, moving forward.

In February this year, we launched our new vehicle in Malta, Mangrove Insurance Europe PCC. More firms are seeking to write direct business in Europe, but don't necessarily have the capital to run at Solvency II level. Our vehicle in Malta offers a cost-effective and capital-efficient way of writing European business. Consequently, we have had a lot of success in Malta this year.

In Washington, DC, Mangrove Insurance Solutions PCC has also had a very good year with numerous new cell formations. We believe that a significant portion of the growth in the US PCCs will come from mid-size firms as we tailor products to provide solutions in this client segment.

With the launch of Mangrove Insurance Europe in February this year, how have the first few months been? How much interest have you received?

We have had a great start to the year in Malta, with success there in terms of established cells and many Mangrove feasibility studies, which are ongoing at the moment.

The key in Malta is the potential for direct writing across the EU from that multi-vehicle and the potential for having lower capital requirement because the minimum guarantee funds under the Solvency II regulation has been provided by Marsh in setting this up. Therefore, companies that potentially couldn't get to direct write into Europe and satisfy at Solvency II levels potentially can use Mangrove in Malta instead.

Over the group, it is about time and cost saving, which companies seem to be putting a lot more emphasis on. They are looking to implement a captive but potentially can get all they want from a cell and get more benefit from it.

Why was Malta the domicile for the Mangrove PCC?

We invested a lot of time and capital in Mangrove PCC as we started out, so we gave careful consideration as to where we would locate it. We wanted to put it somewhere where it could direct write in Europe, to satisfy the market demand.

We already had our Mangrove operation in the Isle of Man and additionally, we manage a third-party in Guernsey but we couldn't write direct European business from either of those domiciles so then we looked towards the established domiciles in Europe.

As an established domicile where Marsh already has the largest market share and a very experienced team, coupled with a proactive regulator and both strong and appropriate captive legislation, Malta offered us and our clients what we wanted. From a Marsh point of view, it has been one of our highest growing onshore domiciles for captives. For all of these reasons, we saw that as a perfect fit for Mangrove.

How do you see interest in PCCs developing over the next five years?

I have never had so many enquiries about PCCs than I have had this year and it's not just enquiries, many companies are following through with formations. Our Mangrove vehicles are set to have their strongest growth year ever. It is definitely a prime time for companies to look towards these solutions and the overall market of PCCs to grow. **CIT**

> I have never had so many enquiries about PCCs than I have had this year and it's not just enquiries, many companies are following through with formations

Rob Geraghty, senior vice president and international sales leader, Marsh Captive Solutions

Captive industry dates for your diary

NRRA Conference Chicago	Guernsey Insurance Forum Guernsey
October 03-05 riskretention.org	October 11 weareguernsey.com
Hawaii Captive Insurance Council Annual Forum Hawaii	**Captive Insurance Council of DC Annual Conference** Washington, DC
October 15-18 Hawaiicaptives.com	October 24-25 dccaptives.org

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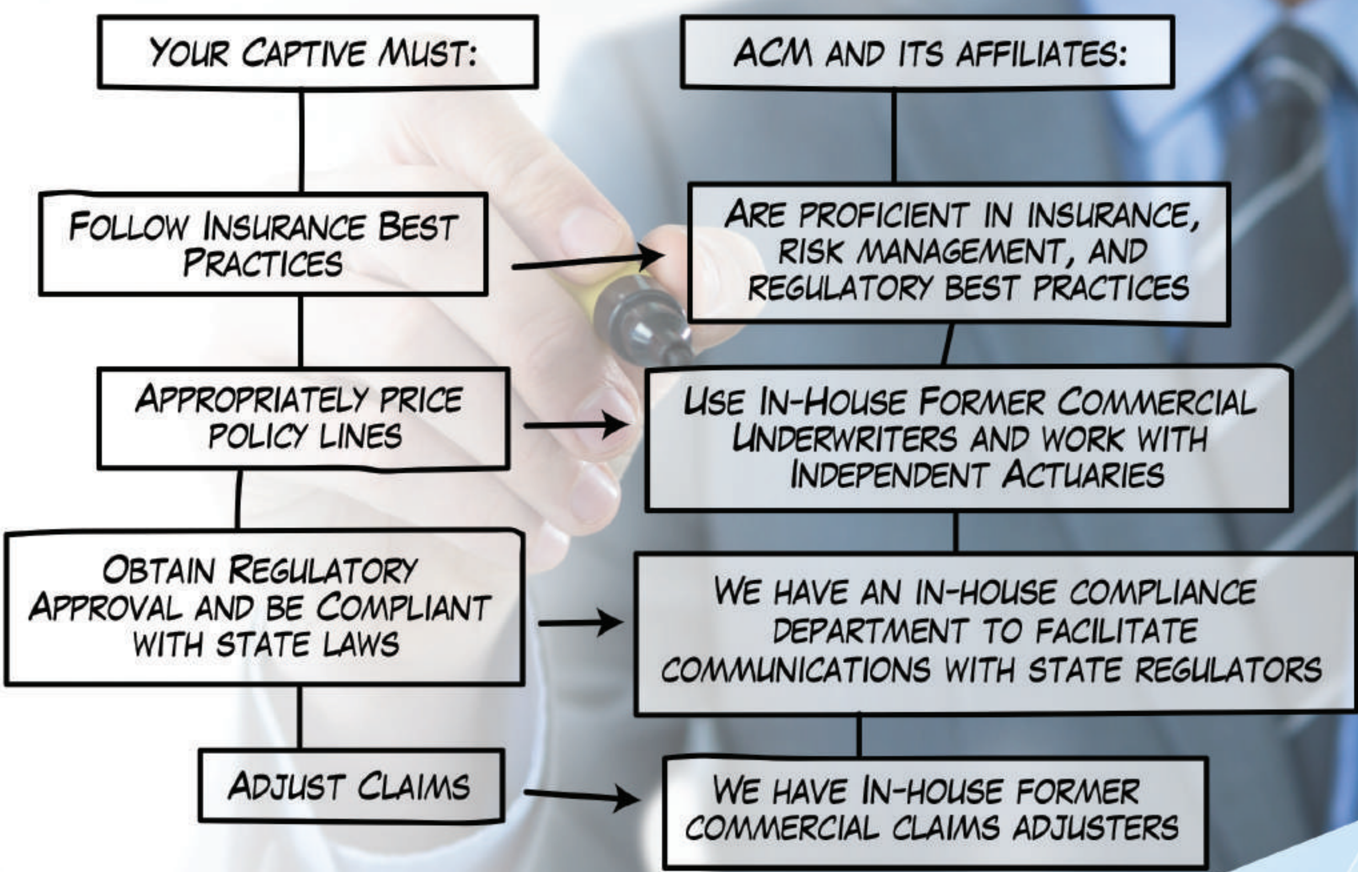

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ACTIVE CAPTIVE MANAGEMENT

Comings and goings at Marsh, Stern Risk, and more

Insurance broker and risk management solutions provider Marsh has appointed two existing employees to newly created roles.

Giampaolo Scarso has been appointed as international client advisory services (CAS) leader, a role which will see him focus on global risk consulting, captive management and claims advocacy support.

Scarso has been with Marsh for eleven years in various leadership capacities. He will be based in Milan and will report to Michael Poulos, global head of client advisory services.

Commenting on the move, Scarso said: "I'm thrilled to lead CAS across Marsh's International division."

"As the global risk landscape becomes increasingly volatile, it is critical that we provide clients with strategic advice that is underpinned by powerful data, analytics, and technology. This will enable them to make better-informed decisions and safeguard their futures with confidence."

Charlie Netherton, who has been at Marsh for two years, has been appointed as the head of client advisory services for the UK and Ireland, as well as a member of the UK and Ireland executive committee. He will report to Scarso and CEO Chris Lay.

Netherton commented: "I look forward to working with Giampaolo Scarso and our CAS colleagues across the UK and Ireland to develop and deliver market-leading solutions that clients expect from Marsh, and that contribute to their success."

Poulos added: "Client advisory services are a critical part of Marsh's value proposition. Globally, clients expect us to be able to advise them on the most complex and challenging risks they face. Scarso and Charlie Netherton are both talented individuals who will provide clients with access to the full range of Marsh's solutions and risk expertise."

Stern Risk Partners has appointed Stephen Stern as executive vice president.

Stern brings with him expertise in brokerage placements and captives in the real estate industry.

He will lead the Atlanta office for Stern Risk Partners and will use his account expertise to service new and existing clients.

Previously, Stern served as senior vice president for Beecher Carlson, where he placed insurance programmes for large real estate clients.

Commenting on his appointment, Stern said: "I am thrilled to be part of the Stern Risk Partners team."

"My background mirrors the consultative and analytically driven approach that Stern Risk has been delivering to their clients and our industry expertise aligns perfectly."

Michael Stern, CEO of Stern Risk Partners, added: "We are very excited to welcome Stephen Stern to our team. His experience, knowledge and relationships in the real estate industry and large, complex risks further bolsters our ability to service our clients with 'best in class' solutions and resources."

AIG has appointed Thomas Lillelund as CEO of its European business, AIG Europe, which is headquartered in Luxembourg.

AIG Europe, a new legal entity for AIG's business in the European Economic Area and Switzerland, has been established to provide business for AIG's European operations after the UK leaves the EU.

Lillelund will report to Chris Townsend, CEO of International General Insurance. He will be responsible for Continental Europe and Ireland.

As part of Lillelund's appointment, Anthony Baldwin, current CEO of AIG Europe Limited, will become CEO of AIG's new UK entity, AIG UK, and will continue to report to Townsend.

Lillelund joins from Aspen Re, where he served as CEO. He has also worked as AIG's Regional vice president in Southeast Asia and worked for various companies in Hong Kong, South Africa, and the US.

Townsend said: "I'm delighted to welcome Thomas Lillelund back to AIG as CEO of our European business. Lillelund is a well-respected international insurance executive who is a strategic leader with experience growing and building teams."

AIG has established two new entities, one in the UK and one in Luxembourg, to enable uninterrupted client service regardless of the future relationship between the UK and the EU.

AIG will transfer existing business to the new UK and European entities and merge its existing carrier, AIG Europe, into the new European company.

The two new companies will begin writing business from 1 December this year. **CIT**

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