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SIIA at a loss over Californian legislation

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The Self-Insurance Institute of America (SIIA) has opposed a recent state bill, as it would stifle self-insured health plans.

According to the SIIA, the bill would threaten the employer-sponsored health benefit plans of thousands of California employees and their dependents, particularly among small- to medium-sized businesses.

The proposed bill, SB 161, would restrict employers' use of stop-loss insurance to protect against catastrophic losses and also includes special restrictions on self-insured employers for groups of 50 or less.

SIIA COO Michael Ferguson explained the institute's reasons for opposing the bill in a recent letter to US Senator Ed Hernandez, who is also chairman of the healthcare committee.

Ferguson said: "Given that smaller employers in particular face significant financial challenges in providing quality health benefits for their employees and their dependents, it is more important than ever that they have as many coverage options as possible including self-insured group health plans."

"By restricting the availability of medical stop-loss insurance through minimum attachment point requirements, SB 161 compromises the viability of the self-insured option … why would you want to make it more difficult and expensive for California employers to provide quality health benefits on a voluntary basis?"

He added that if the SB 161 bill is passed, businesses would have no recourse but to buy more expensive traditional healthcare plans on the open market or give up their plans and leave their employees to enter a new

read**more p3**

CITINBRIEF

Market watch
Turkey's 2020 Olympic bid isn't the only exciting event on the economic agenda
p10

Industry people
Laurent Dignat of BNP Paribas reveals how the firm is still helping its clients through the financial crisis of 2008
p12

SIIA insight
Mike Ferguson of the Self-Insurance Institute of America explains why the trade association is so important to the industry
p14

The debate
Industry experts visit the onshore versus offshore question and offer answers for new captive owners
p15

Healthcare captives
Lawyer Peter Strauss talks about his latest book, The Physician's Guide to Captive Insurance Companies
p20

Captive structures
Is collective risk sharing a viable option for self-insurers? Group captives are put under the microscope
p22

Commonwealth Re's ratings under review

A.M. Best has assigned the FSR of "A- (Excellent)" and ICR of "a-" to Commonwealth Annuity and Life Reinsurance Company.

read**more p3**

South Africa puts solvency regime on the backburner

South Africa has postponed the implementation of its new Solvency Assessment and Management (SAM) regime.

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SIIA is at a loss over health-plan law

Continued from page 1

state healthcare insurance exchange under the federal Affordable Care Act.

"Ultimately, taking people from employers' self-insured plans to the state exchanges would have the economic crippling effect of putting millions more people on publicly-assisted health care."

Ferguson concluded that, the legislation, if enacted would likely be in violation of federal law. Specifically, the Employee Retirement Income Security Act preempts state laws that "relate to" self-insured group health plans. Therefore passage of this legislation could invite costly litigation in federal court.

The SIIA is a non-profit trade association that represents the business interests of companies involved in the self-insurance industry.

South Africa puts solvency regime on the backburner

Continued from page 1

According to A.M. Best, the SAM regime will not come into effect until January 2016, coinciding with the expected implementation of Solvency II.

But according to the rating firm, the delay will create some much needed breathing space for niche insurers and in particular captives.

"The country's captive community have made the least progress toward complying with the [SAM] framework. This in part reflects the considerable uncertainty that remains as to the treatment of captives under Solvency II, and the extent to which the sector will be subject to proportionality," said A.M. Best in a recent article.

In a recent report, entitled Africa's Diverse Insurance Markets Offer Growth Opportunities, Untapped Demand, A.M. Best explained that the SAM framework was created during a period of greater economic stability.

"If the framework were applied fully today, it is likely that several South African insurers would be unable to comply with all the requirements."

But despite the logic in delaying implementation, the ratings firm stated that it is "imperative" that the new risk-based framework is rolled out in the next few years.

"It is important that an insurance market on the scale of South Africa adopts a risk-based regime. Solvency II is setting the pace in terms of regulatory development, and the financial services board rightly considers its domestic market as sophisticated enough to adopt the principles of Solvency II, and adapt the principles of the regulation to the South African market."

Commonweath Re's ratings under review

Continued from page 1

The ratings assigned to Commonwealth Re have been placed under review with negative implications by A.M. Best due to its subsidiary, Commonwealth Annuity and Life Insurance Company's acquisition of Aviva USA.

"While the acquisition of Aviva USA is consistent with Commonwealth's growth strategy, A.M. Best views the magnitude of this potential transaction as significant. As a result, there is uncertainty with respect to the impact on its balance sheet and financial metrics," said the rating firm in a recent statement.

Commonwealth Re's ratings reflect its role as an offshore captive reinsurance company for Global Atlantic Financial Group's (the ultimate owner of Commonwealth and Commonwealth Re) life insurance business.

It reinsures approximately 70 percent of Global Atlantic's life insurance business mostly through assumed business from its affiliate, Commonwealth.

"Offsetting rating factors include Commonwealth Re's large percentage of interest-sensitive and separate account liabilities, which may expose it to disintermediation risk and spread compression due to the continuing low interest rate environment."

CCIA captive insurance day

The Connecticut Captive Insurance Association (CCIA) declared 14 May 2013 to be Captive Insurance Day.

The day's events were intended to build awareness regarding the growing captive insurance market in the state and educate members of Connecticut's general assembly about the benefits of captive insurance.

The day commenced with a CCIA member's only breakfast with Connecticut legislators, their staff, and the state's key insurance regulators, including commissioner Thomas Leonardi, deputy commissioner Anne Melissa Dowling and programme manager, John Thomson.

The breakfast was followed by an informational hearing to be conducted before the insurance and real estate committee about captive insurance. The hearing was open to all parties interested in learning about captive insurance in Connecticut.

Tom Hodson, president of the CCIA, said: "Senator Joe Crisco and representative Bob Megna, the co-chairs of the general assembly's insurance and real estate committee, have been tremendous supporters of Connecticut's captive insurance initiative. This special day was Senator Crisco's idea and we are so pleased to be able to showcase Connecticut as the new domicile of choice in the US."

Swiss Re reveals strong Q1 results

Swiss Re has reported "very strong" group net income of $1.4 billion for Q1 2013, a 21 percent increase year-on-year.

A key driver of the successful quarter was strong underwriting performances across Swiss Re's property and casualty reinsurance and corporate solutions businesses.

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Property and casualty reinsurance net income increased 53 percent, from $660 million to 1 billion. In addition to strong underwriting results, reserve releases and lower than expected claims due to the absence of major man-made or natural catastrophes contributed well to the result.

Michel Liès, Swiss Re's group CEO, said: "We are starting our 150th anniversary year with a very strong first quarter result. It demonstrates we have the right strategy and structure in place to reach our 2011-2015 financial targets."

George Quinn, Swiss Re's group CFO, added: "The group portfolio is fundamentally in very good shape but we will continue to focus on areas of underperformance. We will not hesitate to take decisive action to further improve overall returns."

Standard & Poor's revises rating criteria

Standard & Poor's Ratings Services has published its revised criteria for rating insurance companies.

The revisions aim to enhance the transparency of the firm's ratings on insurers by creating an integrated, globally consistent framework that builds on existing criteria.

The rating framework includes business risk and financial risk profiles, as well as new rating factors and sub factors to access the impact of industry and country risks, prospective capital adequacy, and risk position.

"Our aim is to transparently disclose rating factors and clearly specify how we use them to evaluate the creditworthiness of insurance companies and arrive at ratings outcomes."

"Consistent application of these criteria is intended to enhance the forward-looking nature and comparability of our ratings across industry sectors and geographies," said Standard & Poor's in a recent statement.

Captive owners opt for onshore, says Marsh

New captive owners continued to gravitate towards onshore domiciles in the US and EU in 2012, according to Marsh's annual captive benchmarking report—Discovering Opportunity in the Shifting Captive Landscape.

The report, released at the 2013 annual RIMS conference, was based on 886 captive insurance companies managed by Marsh. It found that at the end of 2012, 55 percent of companies had onshore captives versus 45 percent domiciled in offshore locations.

According to Marsh, the onshore movement could be attributed to a number of factors including, travel cost savings, changing insurance regulations and potential premium tax savings.

The report also highlighted that the market is witnessing a decline in existing offshore captives redomesticating to onshore jurisdictions. Of approximately 1220 captives under management at Marsh, only 16 redomesticated to a new jurisdiction in 2012.

"With the proliferation of new captive jurisdictions in the US, the economic downturn, and the passage of the Nonadmitted and Reinsurance Reform Act (NRRA), which provides potential tax savings for companies that stay in their home state, we anticipated that more US-based captive owners would redomesticate their offshore captives to the US. That has not happened," said Arthur Koritzinsky, Marsh's North American captive advisory leader.

The report also found that the majority of new captive owners locating onshore are more likely to be smaller companies.

"We are seeing a huge uptick in interest among smaller companies interested in forming captives, especially section 831(b) captives. There is no 'one-size-fits-all' today when it comes to captive formations. The premium spend required to support a captive is attainable by small, midsize, and large organisations," added Koritzinsky.

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Bermuda Business Development Corporation completes merger

The Bermuda Business Development Corporation (BBDC) has completed its merger with Business Bermuda and the Insurance Development Council.

The BDCC completed all legal processes on 19 April when the members of Business Bermuda approved the merger of their organisation with the corporation.

The newly formed BDCC will focus on growing Bermuda's economy, supporting international business and creating jobs. The merger means that all organisations, that have received funding from the government of Bermuda, are now united in the newly formed BBDC.

Caroline Foulger and David Cash have been elected chair and deputy chair of the BDCC board respectively.

"Change is never easy. We recognise that the past few months have been challenging as we have created a new organisation to transform the way Bermuda's international businesses work together and with government to grow the economy," said Foulger in a statement.

"This is a true public-private sector partnership that will chart a new more strategic, targeted and effective course for Bermuda to seize the opportunities and respond to the challenges we now face," she added.

A.M. Best revises SPARTA outlook

A.M. Best has revised the outlook to stable from negative and affirmed the financial strength rating of "A- (Excellent)" and issuer credit rating of "a-" of the members of SPARTA Insurance Group.

The revised outlook reflects the change in SPARTA's management in 2012, as well as certain financial improvements made last year and in 2013, which are projected to be ongoing in the future.

A.M. Best also recognises that SPARTA has undertaken several measures to improve underwriting results. These include focusing on the alternative risk transfer (ART) sector, increasing rate levels across all lines of business and the elimination of unprofitable business.

"The ratings affirmations acknowledge SPARTA's strong risk-adjusted capitalisation and market leadership position. SPARTA provides a broad range of unbundled niche ART and specialty programme business, including commercial auto liability, general liability and workers' compensation, among other lines."

"A.M. Best will continue to monitor SPARTA's performance on a quarterly basis to ensure its ability to sustain its profit generation and build up its surplus in this operating environment," said the ratings firm in a statement.

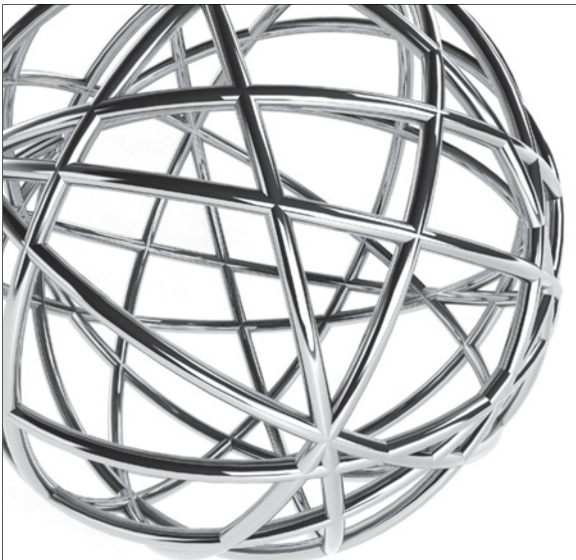
A firm no to Solvency II has been lucrative for Guernsey, says Timetric

Guernsey's decision not to be a part of the EU's Solvency II has strengthened the country's captive insurance sector—making it the largest in Europe today, said a report from Timetric.

In January 2011, the Guernsey government and the Guernsey Financial Services Commission issued a joint statement that it would not be applying for Solvency II equivalency. This, said Timetric, provided a new form of clarity regarding the regulation of insurance business.

The country then saw 72 new insurance providers enter the industry in 2011, and 97 new overseas insurers licensed in 2012, bringing the number of international insurers to 737 at the end of 2012.

According to Timetric, Guernsey has the largest captive insurance industry in Europe and the fourth-largest in the world. Overall, the Guernsey insurance industry grew in terms of written premium value from $7.3 billion in 2008 to $7.7 billion in 2012, at a Compounded Annual Growth Rate (CAGR) of 5.5 percent.



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The industry is projected to grow to value $9.6 billion in 2017, at a CAGR of 4.6 percent, supported by an increasing number of market participants and improving economic growth.

The government of Guernsey applies no tax on corporate income, capital gains and payroll for insurers operating in Guernsey.

"As a consequence, the number of overseas insurers entering the industry is increasing," said Timetric. At the end of 2012, Guernsey had over 737 overseas insurance providers, compared to 687 at the end of December 2011.

"Many of these are captive providers, but also the conventional insurance industry recorded stable growth from 2008-2012, generating revenues from motor, property damage, life insurance, business interruption, transport, employers, public liability and material damage insurance."

Various events in 2011 such as natural disasters—the earthquakes in New Zealand and the tsunami in Japan—and the eurozone crisis, caused a $350-380 billion loss for the industry that year alone.

But Timetric said that these events have had little impact on the Guernsey insurance industry, which is dominated by captive insurance and focus more on the UK than the eurozone.

"However, the Guernsey insurance industry is not free from facing external risk … the ongoing debt crisis in the EU and struggling economic development in the US might influence the growth of the captive insurance industry to 2017."

Marsh to address digital threats

Marsh is holding its Digital Threats 2013 Conference on 22-23 May, to help firms defend their operations against cyber and privacy risk.

"Businesses are increasingly concerned about the potential impact of cyber and privacy risk on their revenues and reputations, in the wake of high-profile security breaches, hacking scandals and more incisive data protection regulation," said Marsh in a recent statement.

Stephen Wares, Marsh's cyber risk practice leader in Europe, the Middle East and Africa, stated that cyber risk is increasingly accepted as a day to day risk that organisations now face, alongside more traditional risks.

"With this acceptance, firms now realise that they need to invest in mitigating cyber risk, which is why over $1 billion is now spent globally on cyber insurance."

"However, insurance alone is not panacea. Delegates to Marsh's conference will learn how to manage cyber and privacy risks more effectively to protect both their tangible and intangible assets."

North Carolina set to become next new domicile

Plans are underway in North Carolina to make it the next US state to allow the formation of captive insurance companies.

The state has also formed the North Carolina Captive Insurance Association (NCCIA) to promote the formation of captives.

"The current primary activity of the North Carolina Captive Insurance Association is helping to pass HB 473, and it's companion bill, SB 476."

"By passing these bills, North Carolina will have a state-of-the-art law permitting the creation of captive insurance companies in North Carolina," said the NCCIA in a recent statement.

The officers of the NCCIA are Alex Webb (chairman), Thomas Adams (president/CEO), Richard Lane Brown (vice president and tax director), Jeffrey Smith (vice president and treasurer), and Jesse Coyle (secretary).

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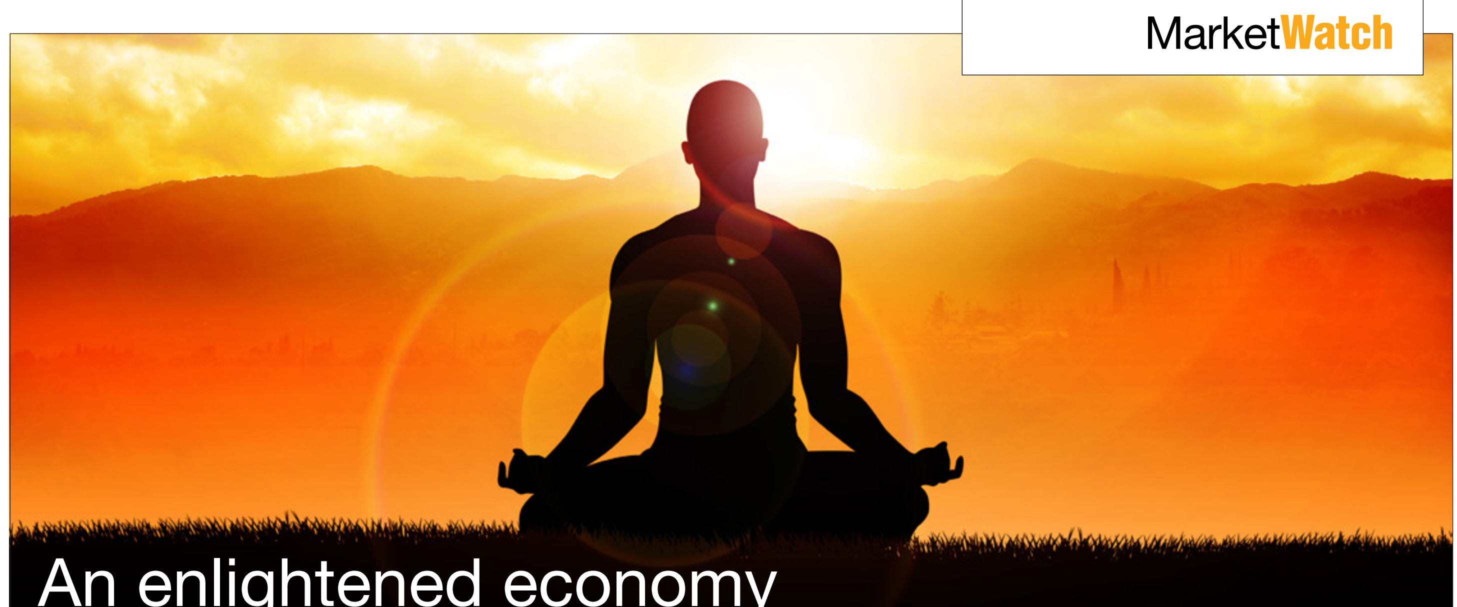

An enlightened economy

While economic woes are still top of the agenda, Turkey's reinsurance market continues to grow. CIT talks to Willis employees to find out more

JENNA JONES REPORTS

With a 2020 Olympic bid in the balance, Turkey has certainly set high hopes for the future of its economy. And while much of Europe is struggling to overcome current economic difficulties, Turkey is enjoying steady growth in the insurance and reinsurance market.

According to a recent blog post by Namik Gulsun, executive director at Faber Global, a trading division of Willis Group Holdings, figures from the Turkish Contractors Association (TCA) in 2010 and 2011 show that Turkey's gross domestic product grew 9.2 percent and 8.5 percent respectively.

He says: "Despite its growth slowing in recent years, Turkey's current rate of economic development suggests a bright future ahead for the country."

Gulsun explains that domestic insurers in Turkey must take advantage of this growth by promoting the use of more specific insurance covers for the new assets it is creating.

"While they cruise slowly but surely towards increasing insurance penetration in the country, Turkish insurers must also adapt and become more responsive to new types of risk that they consider 'unusual' in terms of sophistication or size," says Gulsun.

One of the main reasons for Turkey's economic growth is the country's expanding construction industry. TCA figures show that during 2010 and 2011, the construction industry in Turkey grew 18.3 percent and 11.3 percent respectively.

Gulsun says: "This is being driven by a combination of significant government investment and regional projects in the Middle East, North Africa, Russia and Commonwealth of Independent States countries."

"To put this into perspective, Turkish contractors are now second only to Chinese contractors in terms of number projects won globally."

Gulsun adds that new finance techniques such as project finance—in which the private sector provides finance to construction projects, runs them to gain a return, and then hands them back to the government at an agreed point—are also boosting the Turkish economic structure.

Gulsun says: "While the construction industry continues to broaden its geographical footprint abroad, the Turkish government's use of project financing means that projects that once would have been in the realm of fantasy are now becoming a reality."

"Project financing [is] creating access to capital, and the calm and solid political environment continues to attract foreign investors," he adds.

Options such as project finance have provided the Turkish government with access to an abundance of capital, which has in turn led to high value and specialised projects ranging from $500 million to $1 billion.

"This has left Turkey's insurers playing a game of catch up. While the industry is astute at covering traditional risks, it has not yet become attuned to covering more specific complex risks that the country's recent economic boom is creating."

"This is where reinsurers with global expertise can offer assistance and support in creating appropriate programmes to cover more complicated risks."

Gulsun highlights that PPP (public private partnership) hospital projects, which are health campuses of unparalleled size in Turkey, are just one example of the expensive project work that is taking place in the country.

He adds that other types of general and public liability covers are also stemming from these new projects, including, political risks, surety bonds, comprehensive machinery covers and financial covers for complex contract articles.

And as economic growth continues and diversified risks mount up, Malcolm Cutts-Watson, chairman of the Willis global captive practice, believes that the introduction of captive insurance could solve many of the country's risky problems.

"Any forward looking government, such as Turkey's, might welcome captive technology for the benefits it can bring. These include inward investment, development of local infrastructure and the improved competitiveness of local companies," says Cutts-Watson.

According to Cutts-Watson, captives can deliver these benefits by acting as risk aggregators, enabling economies of scale to be achieved on risk transfer purchases, the spread of risk and an enlarged asset portfolio.

Cutts-Watson believes that captives can also act as a focal point for the mutualisation of group risk and foster improved collaborative risk management and loss control behaviours, driven by business units having a financial stake in the success of the insurance programme.

He adds: "Captives can play a role in managing traditional risks but also can participate in emerging risks such as cyber liability and risks that are unattractive to the market, such as environmental."

"Risk retention in a captive can also be a temporary play until the market can model the risk and price accordingly or can be a long term strategy to a robust risk financing solution." CIT

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Removing the capital cap

CIT catches up with Laurent Dignat of BNP Paribas to find out how the firm is assisting its captive clients through post-financial crisis problems

JENNA JONES REPORTS

How does your role at BNP Paribas help the captive market?

At BNP Paribas's risk and capital management solutions, we focus on insurance and reinsurance and that also includes the captive market. The way we tend to operate is to adopt a solution driven approach—meaning that we don't actually sell investment products but we try to develop the appropriate solution to address an existing issue. 'Ask a better question, get a better answer, develop a better solution', this is our credo. This can apply to investment topics as well as risk management or capital management issues in the insurance world.

I joined BNP Paribas a couple of weeks before the Lehman Brothers crisis, with a reinsurance background. In the reinsurance world, the business model is very much of the opinion, 'I take risks on the liability side because my core business is underwriting risks and this is where I make my money, but as far as the asset side of the balance sheet is concerned I simply do not take risk, so therefore I have an extremely conservative investment strategy'. This approach is absolutely fine as long as you can get a yield of 4 percent out of your portfolio of non-risky investment. Things have changed since the Lehman Brothers crisis. Five years ago short term cash was yielding at 5 percent and nowadays it is only yielding around 50 basis points, or 10 times less. This is a major issue especially if a significant if not the majority of your investment portfolio is trapped either in trust funds or pledged as collateral for letter of credit (LoC) which is the case for the reinsurance captive markets.

Addressing the issue of reinsurance captives squeezed between extremely poor yield on their cash and higher cost of guarantees such as LoC is the way we approached this specific market, which has become a new market for us that complements the 'traditional' reinsurance market. Our solution works in both worlds.

What is the issue with posting collateral?

In the aftermath of the credit crisis, maintaining financial strength remains a critical concern for the insurance industry. The pressure on reinsurance recoverable credit risk in fronting insurers balance sheets is extremely strong, but unlike traditional reinsurers, most captives do not have a specific financial rating.

So for reinsurance captives it is of utmost importance to be able to credit enhance their liability. Otherwise they may not be able to deal (as posting collateral is imposed by regulators) and may have to pay a much higher fronting fee to compensate for a higher capital charge in the fronting insurer balance sheet.

The issue with all those credit enhancement solutions is that they require assets to be posted as collateral. The constraints in terms of eligibility of those assets are such that as a company, unless you opt for low-risk assets with limited returns like short term cash, then a punitive haircut will be applied, making the operation inefficient. These can be 60 percent for equities. For instance, posting $1 of equity as collateral will only give you 40 cents of guarantee.

We also know the reinsurance business and the cash flows associated with it. One very important point to understand is that generally when captives do post collateral to a fronting insurer (LoC or trust), it is very rarely to effectively pay claims. The role of collateral for captives is simply to credit enhance the reinsurance recoverable credit risk that sits in a fronting insurer's balance sheet sometimes for several years. The fronting insurer will require collateral to be posted in order to minimise the capital charge on its reinsurance recoverable.

How can BNP Paribas help companies to see the types of returns they witnessed before the financial crisis?

By nature, the reinsurance business is a long-term business where contracts are renewed from one year to another. This means that whatever asset is trapped and used as collateral it will very likely serve as collateral for a longer (than one year) period of time. One may have some LoC that will be in place for more than five or 10 years. Today, you have no other choice than collateralising such a LoC with a three-month cash deposit, which poses a considerable challenge.

We have therefore developed a series of new assets that are eligible as collateral and that can provide exposure to yielding assets with an investment horizon of three to five or seven years. The most important point is those assets provide capital protection at maturity and they also provide additional protection against the downside risk associated with the yielding assets at any point of time. The level of protection—generally 95 percent or 90 percent—can be used to support the LoC as if the collateral was cash. Our solutions are developed around strong risk management at the asset level without impeding the liquidity.

If the investment performs as anticipated, you get the upside as if you were 100 percent invested in the yielding asset, but as the downside risk is protected up to a certain level, you enjoy a much lower haircut.

With these solutions we are able to provide either a much lower haircut for a given target yield (in other words for a given expected yield you get more capital for $1 of collateral), or for a given level of haircut, you get a much higher expected yield out of your collateral.

You have at one end of the spectrum cash, which offers almost no return but has no haircut. At the other end you have equity, for instance, where you may have a targeted 6 percent return (YTD is 10 percent) but with a 60 percent haircut applied.

Our goal is not to generate the highest possible yield but to optimise the haircut/return of the portfolio. We target a 4 percent to 5 percent yield for a 5 percent to 10 percent haircut. Our solution is about enhancing yield and/or getting more capital for one dollar of collateral.

The BNP Paribas Solvency II Capital Requirement solution launched late last year. How has it progressed?

Assuming that Solvency II will be implemented in due course, I think there are two main positive factors about this. The first factor is that it is a risk-based capital model, which means that when you manage risk you manage capital and vice versa. It means you have to look at ways to manage risk on both side of the balance sheet including the asset sides in order to reduce the capital charge apply on investments. The second factor is probably the counterparty credit risk, which will have some direct consequences for the captives business.

At the moment a number of captives return the reinsurance premium they received back to their parent company. The cash is therefore pooled with the rest of the company's cash and managed as one. Going forward, this cash pooling mechanism will raise an important counterparty credit risk issue for captives. With only one counterparty, no diversification, and a credit rating of the parent company probably in the BBB or below range, captives may have to hold more capital to cope with their Solvency II requirements.

As a consequence, the situation for parent companies will be for them to accept an increase in the capital of their captive, which can reveal costly, or to establish ways to diversify the credit risk and look at developing a specific investment strategy for their captives. This second alternative is what BNP Paribas tends to do in a risk controlled framework. It is very binary for companies—if they want to keep the cash they will have to increase the capital within the captive and if they don't want to bear this additional cost they will have to define their own investment strategy. Through the BNP Paribas Collateral Enhancer platform we can certainly provide them with a competitive advantage. CIT

Laurent Dignat
Managing director, head of risk and capital management solutions
BNP Paribas

A self-preservation society

CIT talks to Mike Ferguson of the Self-Insurance Institute of America to see what the trade association is up to, and how its initiatives are progressing

JENNA JONES REPORTS

When was the SIIA formed and what were the reasons behind it?

The association was incorporated in 1981 to represent the business interest of companies involved in the nascent self-insurance industry, prompted by the passage of the US Employee Retirement Income Security Act (ERISA) in 1974. At that point in time, it was clear that the industry had significant growth opportunity and having a trade association would help facilitate this growth by bringing companies together and pushing back against harmful legislative/regulatory developments.

What are the most important focuses for the SIIA?

Generally speaking, the SIIA is focused on defending against legislative/regulatory threats at both the federal and state that would make it more difficult for employers to utilise self-insurance programmes, including captive insurance. We also play an important role in educating the general business community about self-insurance solutions that are available in the marketplace. Other areas of focus include delivering high quality educational content and informational resources to those already involved in the self-insurance/alternative transfer marketplace and providing unique networking opportunities.

How does the SIIA's grassroots initiative work?

We proactively connect our association members with members of Congress in Washington DC and/or in their districts. SIIA coordinates the meeting logistics and provides talking points. This initiative has supported the association's broader government relations programme by reminding policy-makers that they have real constituents who are involved in the self-insurance/alternative risk transfer marketplace. To my knowledge, this effort is not replicated anywhere else within our industry.

What kind of relationship does the SIIA have with officials such as the NAIC? Are they supportive of ideas and progression?

In most cases, the National Association of Insurance Commissioners (NAIC) promotes regulatory approaches that would make it more difficult for employers to utilise self-insurance solutions so their agenda mostly conflicts with that of SIIA. In this regard, we do our best to help to funnel to concerns of members as part of formal and informal communications to NAIC officials.

The alternative risk transfer committee recently launched a stop-loss captive campaign. How has it been received?

We are still in the early stages, but I believe the industry will find it useful to have a central point of education and information about these innovative alternative risk transfer programmes.

Those in the captive world have clearly started to recognise that the healthcare marketplace in the US dwarfs the property and casualty marketplace, so there is an obvious interest to getting involved in the space and stop-loss captive programmes provide such opportunity. And since self-insured group health plans are the building blocks for such programmes, SIIA is the perfect industry resource.

Our lobbying activities related to stop-loss insurance regulations compliments the educational value proposition, because if employers are not able to access stop-loss insurance, this business model simply does not work.

The SIIA's board of directors has prioritised preserving the current employer-based healthcare system. How has legislation progressed?

This is really more of an ongoing focus as this is not legislation currently pending that would end the employment-based healthcare system, but there are powerful interest groups that would like to see the current employment-based healthcare system dismantled—either in favour of an individual-based system or single-payer system. If the healthcare insurance markets start to implode as the US Affordable Care Act is fully implemented, these pressures could increase.

What does the SIIA have planned for the future?

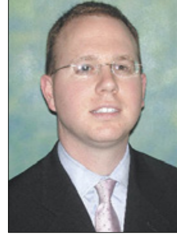
We plan to expand our government relations team further, with a specific focus on developing more robust advocacy capabilities at the state level. The association also intends to become more of a financial political player in Washington DC through the continued growth of its political action committee. We'll be announcing these and other initiatives at its upcoming National Conference & Expo, scheduled for October 21-23 2013. Details can be accessed online at www.sii.org. CIT

Mike Ferguson
COO
Self-Insurance Institute of America

Home preference

CIT's experts reveal their thoughts on the current onshore versus offshore debate

It has been reported that the majority of new captive owners are gravitating towards onshore destinations. Do you find this to be the case and why?



Michael Serricchio
Senior vice president, captive advisory group
Marsh

Bermuda and the Cayman Islands continue to be the world's largest offshore captive domiciles, and Vermont continues to be the largest onshore domicile for captive owners, representing approximately 36 percent of all captives.

However, according to Marsh's 2013 Captive Benchmarking Report, which analyses data from its more than 1200 captive clients around the world, there continues to be a slight, yet evident, trend for companies choosing to establish their captives onshore, particularly in the US.

Fifty-two percent of all captives are domiciled onshore—either in the US or EU versus 45 percent located offshore.

Although we have not seen any large scale movement from offshore to onshore domiciles, nor has the US seen any significant re-domestications, various reasons exist, including captive owners looking to re-domicile their offshore captives, or shopping for a domicile for a new captive and opting for onshore domiciles. This trend cannot be attributed to one single factor, yet when taken as a whole, the captive industry can see a pattern.

As a strict requirement exists relating to the use of captive insurance companies to write policies under the Terrorism Risk Insurance Act (TRIA), this is one of the clearest reasons for onshore domiciling of US captives: the captive (or a branch of a foreign captive) must be domiciled in a US territory. The federal government backstop programme is an invaluable opportunity for organisations using a captive to insure terrorism and nuclear, biological, chemical, and radiological risks, which are largely excluded from commercial property insurance policies. Legislation that extends TRIA until 2019 has been introduced, however, it is thought that any extension measures would change the terms, deductible, excess share, and potentially limit certain current TRIA provisions.

Though used less frequently by captives than TRIA, writing ERISA benefits with a captive also requires the captive to be located in the US. At the end of 2012, 29 captives had taken advantage of the Department of Labor's expedited approval process—which has since been suspended. While it is expected that the number of companies using a captive to write Employee Retirement Income Security Act benefits will continue to grow, the suspension of the expedited approval process could potentially have an effect on such predictions.

As the US regulatory environment continues to evolve, much uncertainty remains in the EU's regulatory changes relating to Solvency II, which is unlikely to be fully implemented before 2015. This uncertainty has likely contributed to slow growth in EU domiciles, while aiding to the appeal of US captives for US parent companies forming new captives or re-domesticating their EU captives. It should be noted that closing or attempting to re-domesticate EU captives is costly and time consuming, which contributes

to the phenomenon that many EU captives still continue to be located in a member state, even if they are in run-off.

A less discussed, yet more likely, contributor to the onshore trend results from the Non-Admitted and Reinsurance Reform Act (NRRA) in the Dodd-Frank Act of 2010. As a result of the NRRA, Self Procurement Taxes (SPT) have been put into the lime light and have become debated. While there have been discussions in the industry—even declarations by members of the US Congress—that the NRRA does not apply to captives, many captive owners are considering the effect of SPT on their choice to create captives outside their home state.

Over the past few years, a number of states—New Jersey, Connecticut, and Oregon, among others—have established new captive legislation. New Jersey has already established five new captives since 2011, and Connecticut established its first two captives in 2012. Meanwhile, states such as Maryland and Texas are in various stages of considering, developing, and establishing captive legislation. States such as Florida, Maine, Oklahoma, and Tennessee have also been working on their captive legislation and developing more favourable laws in an attempt to bring captive business within their jurisdiction.

The final reason for US onshore growth is one of the strongest—yet smallest—factors. Micro captives, or 831(b) captives, established under Section 831(b) of the Internal Revenue Code, have been increasing in popularity over the past few years, particularly in domiciles such as Utah and Kentucky. By definition, a captive that writes less than $1.2 million in premiums, underwriting income is not subject to federal income tax, and captives only pay income tax on investment income. These captives continue to be popular with companies of all sizes, and likely will continue to grow.

Bermuda and the Cayman Islands continue to be the largest players in the captive domicile market, but as captive owners become aware of and begin using the advantages available onshore, growing US states are making their names known and creating a respectable competition.

Derek Lloyd
Director and insurance manager
AMS Insurance

As an offshore insurance manager, I may have a slightly different perspective to the likes of Aon and Marsh, which have both come out recently in the press to comment on the apparent trend of new captive owners gravitating towards onshore jurisdictions. That may well be true as an overall judgment and certainly for US owners of captives, I would agree that there is significantly more choice these days as more and more states roll out their own captive insurance legislation and seek to generate additional revenue for the depleted state coffers. Indeed, it may well be that certain proposed US captive owners have elected to keep their entity onshore within the US or redomicile the entity back to their home state that may not have been a captive domicile at the time of formation.

Certainly for our part, for the last four years, we have seen consistent growth in the overall captive numbers under our management within the various offshore jurisdictions in which we provide management services. This has included a mix of US parent companies and non-US parents. We have just had an unprecedented 2013 in terms of both actual new licence approvals and also formal engagements to proceed with ongoing captive licence applications through the second quarter and beyond.

The conclusion that I would draw from that is that new captive formations generally are buoyant around the globe at the present time with most jurisdictions, onshore or offshore, seeing some level of growth in their overall numbers.

Jeff Kehler
Programme manager
South Carolina Department of Insurance

I think this has been an ongoing process for the last five years or so. There are several reasons that help to explain this phenomenon. First, much of the tax reform efforts over the last 20 years have minimised the benefits of an offshore domicile. What little tax benefit is left is often offset by the high cost of travel, time, and

the hassle of getting to a location that is neither easy nor efficient.

Secondly, there is still a certain unattractive stigma often associated with an offshore domicile. It isn't fair, but it exists in the background, nonetheless. This is particularly true for non-profit organisations, hospital systems, and other institutions that are generally felt to involve the public trust.

Third is the explosion of domestic domiciles. With a couple more states set to join the captive space, the US has nearly 40 states with captive enabling legislation. This provides lots of options for US companies as well as foreign companies seeking to address their US exposures. Additionally, the competition among US domiciles is increasing. In order for those newcomers to gain some traction in a relatively short time period, they are looking for ways to offer benefits not present in the more established, mature domiciles. These benefits often take the form of reduced fees, taxes, and expenses; shorter turnaround times; and, depending on the type of captive, a regulatory regimen that is less costly and time consuming. Finally, the newcomers are playing the home state card. That is, 'why go out of state for your captive needs when you can do it right here where your business is located?' The home state advantage can be very attractive for a parent company looking for the captive advantages at the lowest possible cost.

Lastly, the two largest offshore domiciles have tended to become more narrowly focused in their business appetites. Bermuda seems to lean more towards insurance linked securitisations and large reinsurance deals. The Cayman Islands seems to be focused on healthcare related captives and group captives serving middle-to lower-middle sized companies.

Notwithstanding the above comments, the offshore market is not going to wither and die away. There will always be companies that need very specialised coverages, limits, and terms and conditions that are not available stateside or they are seeking arrangements that are best suited to an offshore domicile. Also, the offshore regulatory environment is different than it is in the US. These differences will keep the offshore marketplace thriving in spite of the increase in US domestications.

Gary Osborne
President
USA Risk Group

I can understand the thought that there is a trend to onshore formation over offshore, but it is being driven largely by fear more than utility. The uncertainty over Foreign Account Tax Compliance Act, the lack of clarity over the Nonadmitted Reinsurance Reform Act on surplus lines tax and the continued 'tax avoidance' bashing by beltway types regarding offshore formation, as well as the proliferation of choice of onshore domiciles, has seen a considerable number of captives formed in the US. However, many of these are 831(b) micro captives that have to be taxed as a US insurance company anyway and these have pumped up the numbers in favour of domestic domiciles. There are quite a few reasons to consider offshore, especially for private companies not subject to the shareholder pressure on public companies regarding 'hiding' funds offshore:

- Offshore captives do not have to pay for state examinations
- Offshore jurisdictions tend to charge a license fee instead of a premium tax
- Annual meetings in the jurisdiction are not mandatory
- Capital requirements are usually more flexible including treatment of collateral
- There are fewer limitations on ownership of captives.

Domicile selection can now hinge on how a prospect regards several questions:

- Would being in an offshore jurisdiction be problematic?
- Could we face a significant self-procurement tax problem depending on location of risk/parent?
- Is the contemplated ownership complex?
- Is capital/collateral a challenge?

Offshore remains an important and vital choice for captive formation. The abundance of choices domestically can only be beneficial to our industry, as the biggest issues facing it today remain the national and state level pressures from traditional regulation, and regulators who do not understand the appropriateness of light touch regulation for alternative risk vehicles. In fact, the National Association of Insurance Commissioners interference could drive formation back to the offshore

jurisdictions as they continue to push states to add unnecessary rules, regulations and reviews for captives. USA Risk was involved in 33 new captives/cell formations in 2012 and would note that of this total, 20 were formed offshore, reinforcing that it remains an important factor in the continued growth in alternative risk.

David Provost
Deputy commissioner of captive insurance
Vermont Department of Financial Regulation

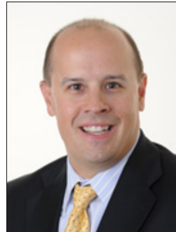
I'm sure the statistics can speak for themselves, and trust that is the case that the majority of formations are onshore. I suspect a chief reason is simply that there are many more onshore choices now than in the past, no matter where onshore might be in a particular case. So many jurisdictions have seen the benefits reaped by successful captive domiciles such as Bermuda, the Cayman Islands, Hawaii and Vermont that it's only natural to try to emulate that success. The end result is that it's much more likely that you have a local choice than before, and many find a benefit to keeping their business closer to home.

Simon Kilpatrick
Executive vice president
Advantage Insurance Management

We have not seen this to be the case in our business. I would be cautious to draw too firm a conclusion from these reports as they tend to raise other unanswered questions. For example, is this increase due to the offshore domiciles falling out of favor in some way or is it simply a function of the increased number of US states that have become captive domiciles in the past few years?

What we are seeing is that the onshore versus offshore decision is not as obvious as it used to be. While there are still arguably some asset protection benefits and broader investment options when going offshore the tax advantages have all but disappeared. It is also becoming a much more level playing field in terms of legal frameworks.

Most captive domiciles onshore and off revisit their legislation regularly and are quick to adopt the best practices of their competitors. The top onshore and offshore domiciles are also becoming increasingly similar in terms of the resources and experience of their regulators and of their service providers. Despite all this, parity differences still exist in the way regulators interpret their respective laws and in their ability or willingness to operate with flexibility and creativity. A regulator that is fully supportive of the captive's business plan is a key factor in choosing a domicile.



Paul Arbo
Partner
BDO Cayman

We have certainly seen the recent report which, on first read, was not very surprising to me, given the level of political posturing that always accompanies a US election campaign as well as certain protectionist/nationalistic policies that have cropped up in the US and Europe as the financial crisis continues to stretch out into years.

However, once I read deeper into the report, it was clear that the growth in numbers onshore from almost a decade ago can be at least partly attributed to the fact that there are many more states which have enacted captive legislation over this period. Also, it was highlighted in the report that the majority of new captive owners locating onshore are smaller companies looking for more cost-efficient solutions such as section 831(b) captives, which the Cayman Islands has consciously not marketed aggressively.

Finally, the report noted that the number of existing offshore captives which are redomiciling to onshore jurisdictions appears to actually be declining over the period covered in the study.

I can say from personal experience that the flow of new captives into the Cayman Islands continues to be healthy over the past number of quarters. Two thousand and twelve was a year of impressive growth for the Cayman Islands, with more than 50 new insurance licences granted, the highest number of captive applications since 2004. This year continues to show growth, with nine licences granted during Q1 2013, compared to the eight licences granted during Q1 2012.

To some extent, this recent success is due to general factors which will benefit all domiciles, such as the overall hardening of traditional insurance markets and the increased acceptance of the captive insurance model among medium-sized businesses which, in past years, may have felt that they were not large enough of a player to experience the benefits which captive structures provide.

More specific to the Cayman Islands's captive industry, the recent popularity of employee benefits plan captives bodes well due to our positioning as the historical leading jurisdiction for healthcare captives. I am also encouraged to see the recent advertising campaigns from the Insurance Managers Association of Cayman and other efforts by local regulators and professional bodies which have aimed, specifically, to dispel some of the misconceptions which have been built up against the Cayman Islands over the years.

The very real and legitimate themes of the Cayman Islands industry credentials when it comes to transparency, integrity, innovation and the collective intelligence and experience by local professionals are now being pushed out there for public consumption like never before.

The Cayman Islands continues to stand on its own merits as a top domicile with a track record of success and innovation and a sound regulatory environment with modern legislation that is on par with any other jurisdiction, offshore or onshore.

Steve Chirico
Assistant vice president
A.M. Best

My response is largely based on the 250 captives that A.M. Best rates globally. It is apparent that the choice of domicile ebbs and flows over time. Over the last few years there has been some 'on-shoring' occurring where a corporation will supplement a well-established offshore domiciled captive with an onshore option. This option takes the form of an additional captive domiciled in one of the established onshore domiciles. There is often reinsurance between captives since this is an easy solution for capitalisation compared to physically moving capital between domiciles.

The preponderance of recently formed onshore captive domiciles has made competition for captives intense with more than half the US states and the District of Columbia throwing their hat in the ring. However, we can remember two decades ago when there was the opposite flow of increased registrations by high quality offshore domiciles. One can suppose that the recent onshore captive registration activity is due to the increased regulatory environment for financial services firms that have been implemented since the 2008 financial crisis, especially Dodd Frank, which compounds the increased regulatory environment that resulted from the Enron failure and resulting Sarbanes-Oxley compliance requirements.

If you look further back, the 'on-shoring' trend really started in the 2003-2005 timeframe and was interrupted briefly by the IRS with its chal-

lenges of single parent captives that culminated in 2007. Since a vast majority of the offshore US sponsored single parent captives rated by A.M. Best select the 953(d) election to be taxed as a US taxpayer, it is apparent that the tax advantages of an offshore domicile are liquidated to a large extent.

A.M. Best consistently hears from their rated captive population that the number one consideration of which domicile they choose for their captive is the ease of doing business. Efficient consideration of business plan changes, timely return of phone calls, people in the domicile that have a deep understanding of alternative risk, in short, expertise and basic old fashion customer service seem to be the key drivers of domiciliary choice. Other key considerations are the availability of competent service providers, registration and other domiciliary costs.

It should be noted that the choice of domicile between offshore and onshore for a rated captive has a minimal impact on the rating of a captive.

A.M. Best is much more concerned with the regulatory effectiveness of any domicile whether it is onshore or offshore. There are offshore and onshore captive domiciles that we view as better than others regarding their operation with robust regulation and an environment that fosters policyholder security. The rating process for a captive considers the domicile of the captive as a qualitative factor. CIT

Experts will debate the below question in the next issue of CIT:

What attributes would your ideal captive regulator have, and how are the regulators in the jurisdictions in which you work measuring up?

Have something to say?

Send responses to jennajones@captiveinsurancetimes.com

Medicine without borders

Author and lawyer Peter Strauss details the hardships faced by US medical professionals and exposes insurance's dirty little secret

Life is filled with risks. Every day, you take risks in your business. Some of these risks are calculated on your part; after all, you must take on these risks in order to make a profit in your business. Other risks may not be so well known to you, or they may not be at the forefront of your mind on a regular basis. As much as you may carry insurance on the truck used to make deliveries in your business, you may not carry similar insurance on the computer used to track your deliveries. There may even be some risks that you know about but are simply too expensive for you to insure.

Unfortunately, unless you pay an insurance company a premium to insure your business against all of these risks, there is no tax benefit to self-insurance. Most businesses, whether it be a medical practice, surgery centre, advertising firm, or any number of other companies unknowingly self-insure a great part of their risks from daily business activities. Self-insurance, whether funded out of company reserves or personal after-tax savings, is not tax-deductible. To compound the issue, smaller deductibles are expensive, can contain complicated qualifiers, and are not tax-beneficial. The solution for many is a captive insurance company. Properly structured, self-insurance through the use of a captive insurance company can create substantial tax deductions, resulting in tremendous tax savings.

Captive insurance produces material tax savings that help you to save real dollars in your business. Furthermore, captive insurance helps businesses to combat inadequate insurance and excessively high premiums. Yet, most business owners have no idea what captive insurance is, much less how to use it to their advantage.

Captive insurance is a strategy whereby your business purchases insurance coverage from an insurance company that you own and control, ie, a "captive" insurance company. The premiums paid by your business are tax deductible. Meanwhile, the premiums that your captive collects are tax-free. You read that correctly: The premiums collected by your captive insurance company are tax-free.

Every year, throughout the US, medical professionals suffer losses in their businesses that are not covered by insurance. An interruption in business due to an outside cause such as a hurricane or significant regulatory change can inflict costly damage to your practice. Just as well, you may stand to lose substantial revenue due to malfunctioning equipment or an action taken by a government agency against your practice. Doctors everywhere have to worry about the ever-increasing costs of litigation defence arising from the explosion of tort litigation and runaway juries handing out verdicts in malpractice cases as if money grows on trees.

Fortunately, there is insurance available to cover most of these cases. Unfortunately, the cost of insurance can be very expensive or practically unattainable for doctors in many states. Even those who can afford the insurance often find that it does not protect them or their business from many common forms of business losses.

Some doctors choose to combat the high cost of liability insurance by reducing coverage or 'going bare' and not purchasing any insurance at all. By doing so, these physicians are knowingly taking on increased risk to their financial wellbeing. Perhaps they believe that they will not be sued, and that they are very good at managing their liabilities.

Surprisingly enough, a growing trend amongst physicians is to simply choose not to insure themselves. As absurd as that may seem to some of us, there is some method to this madness. Insurance statistics prove this out: approximately 80 percent of all insurance claims are made by fewer than 20 percent of all insureds. In other words, most doctors never have a claim, but they are paying for the claims of others by purchasing insurance.

Those doctors who are not buying insurance have, in many cases, simply figured out the dirty little secret of insurance. If everything goes well, and there is no claim at the end of the year, the entire premium paid to the insurance company for that year becomes pure profit for the insurance company. Of course, the insurance company will incur a number of losses from other doctors, but the insurance company is not in this game to provide a public service; it is here to make a profit.

By offering liability insurance to doctors, the insurance company is publicly advertising that it thinks it can make a profit on such insurance. This is because, on the whole, the majority of doctors will not have any claims, and the insurance company actuaries have figured this out.

When you buy liability insurance from the insurance company, the insurance company is making an investment in you. The insurance company is betting its own money that you will not have a claim, and that those valuable premium dollars you paid to buy the policy will become pure profit for the insurance company.

In order to capture these profits for yourself, you should best understand how likely it is that you will incur a loss in your own business. Are you the type of physician who carefully manages his risk exposure and liabilities? If you can answer yes to this question, then captive insurance may allow you to capture those insurance company profits for yourself.

Captive insurance is a simple concept. Working with a lawyer experienced in captive insurance and a captive management services provider, you incorporate your very own insurance company. We refer to this insurance company as a captive because it is owned and controlled by you. Also, unlike insurance companies that sell insurance to the general public, your captive only sells insurance to you and businesses that are affiliated with you.

Your business pays premiums to your captive in return for insurance covering the potential liabilities and risks of your business. If all goes well, and there are no claims at the end of the year, your captive gets to recognise those premiums as pure profit.

I've recently authored the book, The Physician's Guide to Captive Insurance Companies, to reflect the fact that a growing number of doctors throughout the US are implementing captive insurance as an integral part of their business and estate plans. As more and more doctors are getting burned by the high cost of liability insurance, and are seeing premium dollars wasted when no claims are made, an increasing percentage of these same doctors are choosing to instead insure themselves through their own captives, keeping those profits for themselves.

Your business pays premiums to your captive in return for insurance covering the potential liabilities and risks of your business. If all goes well, and there are no claims at the end of the year, your captive gets to recognise those premiums as pure profit

The focus of the book is on the benefits to your business from captive insurance. The benefits gleaned from captive insurance begin and end with the availability of completely customised insurance coverage for your business. However, in addition to learning how your very own captive insurance company enables you to capture insurance premium dollars as profits, the book also walks you through the many ways your own captive insurance company can help you to better protect your business from an asset protection standpoint. Every year, thousands of doctors are named as defendants in litigation, ranging from professional liability and malpractice claims to personal tort lawsuits, divorce proceedings, and business disputes.

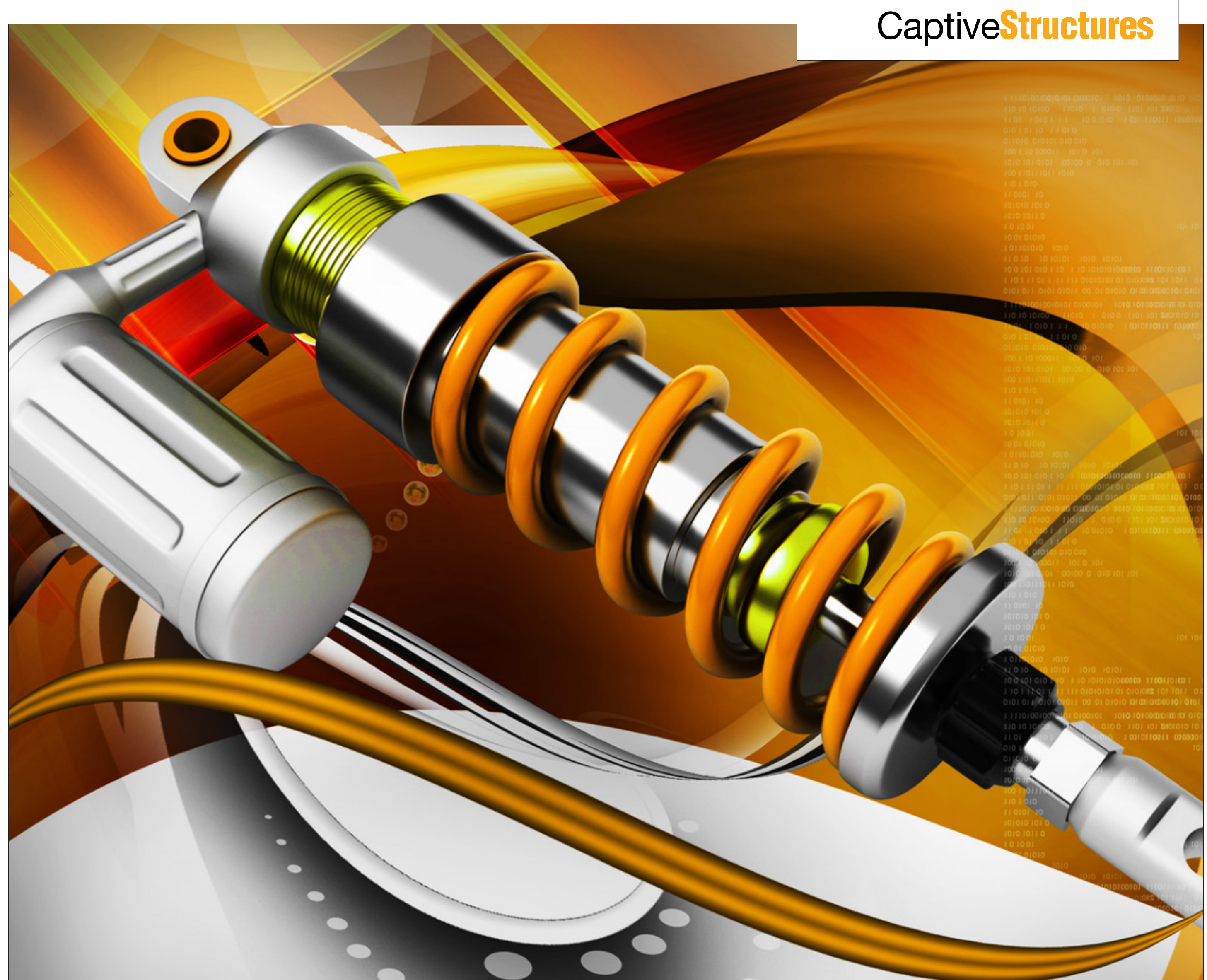
If you are like most doctors or business owners for that matter, the money you earn in your business goes into a bank or brokerage account titled in your own name, or in the name of a conventional trust set up by a neighborhood estate planning lawyer. Unfortunately, as many doctors can painfully attest, that money is unprotected and can be taken from you by plaintiffs' lawyers. If your money instead flows into a captive insurance company, you stand a better chance of protecting your wealth.

It is extremely important to note that the insurance we are discussing is real insurance. Moreover, the type of company that we refer to as a captive insurance company is, in fact, a licensed insurance company owned by you. Your captive is licensed, regulated, managed, and maintained just like any other insurance company out there. Probably the only difference between your captive and every other insurance company out there is this: since you are the shareholder, you profit from the captive's performance.

There are also important financial and tax aspects of captive insurance. Tax benefits do not, in and of themselves, justify the use of captive insurance. Nevertheless, a properly structured and valid captive insurance arrangement offers some useful tax benefits, including the ability to exempt up to $1.2 million of business income from federal income tax every year.

Captive insurance, however, is not a tax panacea. The tax benefits must be weighed against the tax cost of liquidating the captive or taking out periodic dividends. Depending on your time horizon, a captive insurance plan may not offer tax benefits. However, with careful planning, one can accumulate significant tax-mitigated wealth through the use of a captive insurance company. CIT

Peter Strauss
Managing member
The Strauss Law Firm



Shock absorbent

CIT takes a look at the group captive structure to see if collectively sharing risk is a viable option for captives, and finds that size really does matter

JENNA JONES REPORTS

A group or association captive is a structure in which multiple businesses join forces to create an insurance company that collectively covers liability and risks.

According to Duke Niedringhaus, vice president of JW Terrill, the genesis of the group captive industry was the Raffles Insurance captive, with most group captive structures formed post Raffles using the same successful model.

Based in the Cayman Islands, Raffles was formed by nine companies in 1984 to enable businesses to acquire adequate coverage at affordable rates. The famous group captive has now grown to over 300 members.

A statement from the Raffles Insurance website claims that "by bonding together to create true sharing of risk, shareholders can control their insurance costs rather than being subject to the volatility of the general insurance industry."

Michael Gibbs, president of the Kensington Management Group, explains that group captives were initially linked to specific industry associations and that in the mid-1980s the first groupings of unrelated and diverse industries were formed.

"The founders of these groups wanted to offer the benefits of a captive to smaller middle-market well run companies, on the basis that bringing together a number of companies in diverse industries and in diverse geographical areas, would achieve a diversity of risk profile similar to that of a traditional insurance company, and the buying power of a Fortune 500 company."

Gibbs explains that a 'traditional' group captive comprises of unrelated companies, whether in common or diverse industries that are financially sound and prepared to shares some risk with their fellow captive shareholders.

"While single parent captives will have the same high standard of risk control and safety culture, there is no risk sharing in that structure. Additionally, group captives will normally be looking for new like-focussed 'members' to join, so as to increase buying power and minimise the impact of risk sharing."

Fitting the bill

As with any alternative risk vehicle, group captives aren't suitable for every company looking to insure its own risks for various reasons, be it size, lines of cover or capital.

JJ Purdy, president of Garnet Captive Services, explains that the structure is aimed at companies that are sophisticated enough to know they need to assume risk in order to control the long-term cost of insurance but are not large enough to either withstand the volatility of traditional forms of risk, or to garner enough interest for a quote from a traditional insurer.

Gibbs feels that any well-run company with an established and effective safety culture and a favourable loss history would be good candidates to start or join a group captive structure.

"As regards lines of coverage, regular casualty lines of workers compensation, auto, auto physical damage, and general liability are the most common [for group captives], but property and medical insurance stop loss are also becoming popular."

Purdy believes that many different coverages can be fit for a group captive structure. But that the attributes that typically make the structure work are exposures that have a component of controllability and predictability.

In terms of actual requirements, Niedringhaus explains that they are fairly minimal. "There is a small capitalisation of about $35,000 plus collateral (cash or letter of credit) to secure the potential risks of the participating member of the captive."

While coverage lines and requirements are important factors, according to Niedringhaus, one of the mains reasons and great advantages of group captives is the minimum casualty premium of only $150,000—making the captive alternative that large corporations relish available for many mid-size companies.

And if a company is suited to the group captive route by meeting the above requirements, the final hurdle is to decide whether a heterogeneous or a homogenous captive is more preferable.

Gibbs says that an "industry specific or 'homogenous' captive will comprise of member companies drawn from one industry with a similar risk profile, eg, trucking, or construction. Heterogeneous captives are those with member companies drawn from a blend of diverse, unrelated companies within certain risk parameters."

According to Purdy, Garnet Captive Services has experience with both heterogeneous and homogeneous groups, witnessing positives and negatives in both types.

He says: "A homogeneous group can provide consistency in exposure, which can help in underwriting and pricing. It can also allow for specialisation and leverage to loss mitigation efforts."

"However this homogeneity can also subject the entire group to the risk of failure due to an institutional risk; an occurrence or trend that affects all companies across that specific industry (whether it be insurance related or simply economic)."

Niedringhaus states that homogeneous captives can certainly tailor their loss control programmes to specific member exposures and provide industry specific networking. However, he feels that the group captive industry has proven that diverse companies utilising a heterogeneous captive can achieve success.

"Targeting different industries to grow a captive can generate substantial growth and thus reduced fixed costs and spread of risk for severity losses. Several of the premier group captive facilities are heterogeneous."

Reaping the rewards

Purdy explains that for well run companies it is far more cost effective in the long run to assume risk rather than transfer it in a traditional marketplace.

"The main benefit of a group captive is that it enables its members to assume risk where that risk assumption otherwise would have been intolerable or unavailable."

Another added benefit that Purdy highlights is the ability in most structures for the unbundling of service providers. "Where in most traditional insurance transactions the insurance company controls and dictates service, many group captives provide the ability to chose the highest quality claims, loss control, and other vendors, many of which can lead to even lower ultimate costs of insurance."

According to Niedringhaus, the main benefit of joining or forming a group captive is the control that a member obtains over its insurance programme.

The benefits of group member control include, cost savings due to a well-run captive, claims management, and the opportunity to receive all underwriting profits and investment income, which can then be deferred to a family trust.

Niedringhaus adds that group captive members also greatly benefit from regular active communication between members.

He says: "The group captive model requires active engagement by the members including two board meetings and two risk control workshops. If there is one reason for success of the group captives, it would be active member engagement. Members all join a committee to manage the captive such as underwriting, risk control or investments. Members are active in recruiting new captive members to fuel growth and thus reduce fixed costs."

Embracing the pitfalls

As with any risk management option, there will always be flaws to the structure. Purdy pinpoints the potential downsides, narrowing them down to, the size of the group and the potential insurance risk/credit risk from other members of the group.

With regards to group size, Purdy explains that since the group risk sharing component of the structure provides a "shock absorber" of sorts for volatility to any one member, it is important that the group is of sufficient size.

And while a group is at risk if it is too small, there are also potential pitfalls to structures that are too large. As Purdy explains, its not just Goldilocks that requires things to be 'just right'.

"The ideal size is one that is large enough to withstand the volatility that comes with large claims, but small enough such that all members can sit in a room together and make decisions about their programme."

The issue of credit, according to Purdy, should be a simple task of delegation between members. He says that each member should be responsible for a distinct, limited amount of exposure.

"It is important that the programme manager structure the group such that every member is providing security to the group that ensures their ability/willingness to meet their responsibilities, even in the worst case scenario."

Niedringhaus explains that the group captive industry continually faces the challenge of obtaining final closure on an underwriting year, which poses a time consuming problem for all members involved.

"Workers compensation and liability are fairly long tail exposures and adverse losses can generate assessments that continue for several years … Some managers have developed solutions for closing an underwriting year but there are limited options for a loss portfolio transfer when products liability is written in the captive. We have brokered the transfer of the open liabilities for one large complex captive and found the process to be a very arduous nine month process."

But despite some unappealing downsides, Niedringhaus claims that companies rarely return to the traditional insurance market after using a group captive.

"Group captives have seen amazing growth recently through various market conditions. We estimate it is a $1.5 billion market in the US and 70 percent of that premium has been added in the last decade. [Last year] added about $200 million in premium and the first quarter of 2013 has already added $75-$100 million."

"Once engaged in the group captive for workers compensation, auto and liability exposures, business owners are looking to expand their captive use to other health insurance group captives and 831(b) micro captives for their uninsured business risks." CIT

2013

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Captives and Corporate Insurance Strategies Summit

Location: Toronto
Date: 22-23 May 2013
www.captivesinsurance.com

This summit is the only forum dedicated to providing Canadian risk managers and captive owners with the business intelligence they need to maximise the effectiveness of their corporate and captive insurance programmes.

Bermuda Captive Conference 2013

Location: Bermuda
Date: 9-12 June
www.bermudacaptive.bm

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Airmic Conference 2013

Location: Brighton
Date: 10-12 June 2013
www.airmicconference2013.com

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Western Region Captive Insurance Conference

Location: Arizona
Date: 10-12 June 2013
www.westerncaptiveconference.org

The Western Region Captive Insurance Conference is the perfect source to gain understanding by interactions with the regulators from Arizona, Missouri and Utah, experts from all segments of the captive industry and owners and managers of captives and RRGs. The conference caters to those who are both new and old to the captive industry detailing what works and what is important to the industry. Join us as an attendee, session speaker or exhibitor!

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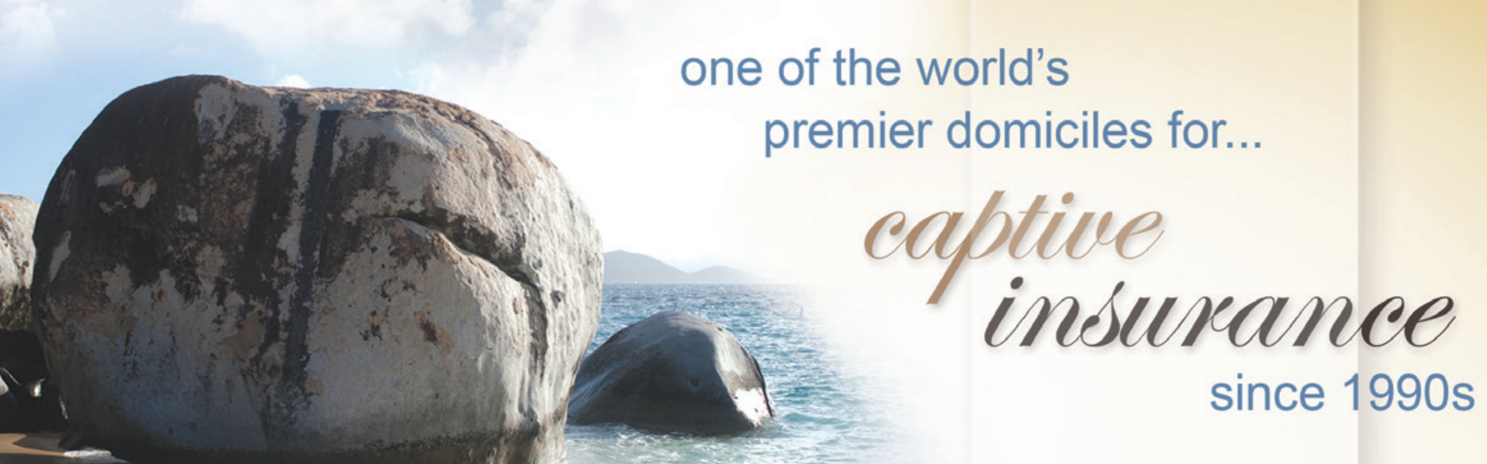

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Industry appointments

Validus Holdings has appointed former CEO of the National Association of Insurance Commissioners (NAIC), **Therese Vaughan**, to the company's board of directors.

The new appointment will expand Validus's board to 12 members.

Prior to her role at the NAIC, Vaughan served as the Iowa insurance commissioner and is a past NAIC president.

Ed Noonan, Validus chairman and CEO, said: "We are pleased to welcome Vaughan to the Validus board. Vaughan brings significant experience in insurance and financial regulation and deep industry knowledge to the position. I am confident that she will be an asset to our board and management team."

Vaughan added: "I am delighted to join Validus's board and look forward to working closely with the other directors and Validus's talented management team to build on the company's success as it continues to grow the business."

American International Group (AIG) has made three executive appointments in its property casualty business division.

Robert Schimek has been named president and CEO of AIG Property Casualty's America's region. Schimek will relocate to New York from London, where he has been serving as president and CEO of the Europe, Middle East, and Africa (EMEA) region.

Schimek will continue to report to Peter Hancock, president and CEO of AIG Property Casualty.

Nicholas Walsh will take over Schimek as president and CEO of the EMEA region on an interim basis as AIG seek a permanent successor. He will also report to Hancock.

Finally, **Alexander Baugh** will assume responsibility for AIG's global casualty business. He will report to John Doyle, CEO of global commercial insurance within AIG Property Casualty.

Baugh previously held the role of chief risk officer and head of strategy for AIG Property Casualty.

Commenting on the new appointments, Hancock said: "Schimek, Walsh and Baugh represent what is most powerful about AIG: a strong bench of seasoned property casualty experts with deep product and global expertise who work closely and tenaciously to help clients and brokers embrace opportunities and face challenges all over the world."

Guy Carpenter & Company has appointed **Stephen Mathews** as managing director of GC Securities. He will be based in New York and report to Chris Ezbiansky, head of M&A advisory for the Americas.

Prior to joining GC Securities, Mathews was a senior member of Willis Capital Markets & Advisory.

Kane has appointed **John Uprichard** as managing director of Kane LPI Solutions.

The new company, incorporated in Bermuda, is licensed by the Bermuda Monetary Authority under the investment funds act 2006 as a fund administrator and will operate as the head office for the firm's life, pension and investment administration activities.

Uprichard was formerly head of businesses for LPI (life, pension and investment) at Kane and will report directly to Simon Hinshelwood, group CEO of Kane.

York Risk Services Group has appointed **Jim Ossner** as vice president of sales for York Alternative Risk Solutions (York ARS).

Ossner previously held the role of assistant vice president of strategic alliance business development at Chubb Specialty Insurance.

York ARS's services include captive management, programme administration for captive programmes and self insured groups, claims administration, loss control and premium audit services.

York Risk Services Group provides services to alternative risk transfer programmes encompassing a range of risk financing structures including self insured groups, group captives, agency captives and risk retention groups.

Xchanging has announced a number of promotions and appointments to its claim services business, Xchanging Claims Services (XCS).

Mark Sullivan has been appointed chief adjuster for reinsurance and will combine this with his existing position as head of delegated lead.

Andy Campbell will be joining the firm to support Sullivan as his deputy. He currently holds the role of head of quality for XCS.

Steve Woolford has been promoted to the role of technical head 1st party. **CIT**

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