



## CIT IN BRIEF

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## States could face litigation over NRRA

MONTPELIER 05.03.2013

Law firm Anderson, Kill & Olick (AKO) is throwing its weight behind declarations that the Non-admitted and Re-insurance Reform Act (NRRA) does not apply to captives.

The firm has published a white paper stating that the ambiguity in the NRRA's wording, if not clarified, could result in unnecessary litigation, inconsistent rulings, and waste of both private and public resources.

In a statement, Phil England, head of the alternative risk and captive insurance services practice group at AKO, said: "A strong case can be made that the NRRA does not apply to captive insurance and an even stronger case can be made that the NRRA was not intended to apply."

"Bottom line, captives should not have to move from a domicile because of the NRRA. Congress should amend the law to make clear that the NRAA does

not apply to captive insurance companies. In the meantime, the prudent course is to wait for further clarification and not re-domesticate from one state to another solely based on this statute."

England explained that legislative intent is very significant in interpreting how a law should be implemented, and that it is also an important factor in how courts will rule when litigation occurs.

"The clarifying statements by two primary architects of the NRRA—former subcommittee chair, Judy Biggett and congressman Scott Garrett of New Jersey—are significant in this regard. Those statements clearly indicate that it goes against the intent of the NRRA to levy self-procurement taxes on 100 percent of the premiums paid to a captive by a 'home-state' policyholder that has material risks located outside of that state."

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### Solvency II delays will cause disappointment

The European Parliament plenary meeting to consider the Omnibus 2 amendments to the Solvency II directive has been pushed back from 10 June to 22 October 2013.

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### Hong Kong captive is A-OK

A.M. Best has affirmed the financial strength rating of "A- (Excellent)" and issuer credit rating of "a-" to Marble Reinsurance Corporation, which is based in the Federated State of Micronesia.

[readmore p3](#)



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A vintage map of Southeast Asia, showing islands like Sumatra, Java, and Borneo. A blue rectangular overlay is positioned in the upper half of the image, containing the text 'EXPERTISE makes all the difference.' in white. The map is detailed with various island names and geographical features.

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**States could face litigation over NRRRA**

Continued from page 1

England concluded that the passage of the NRRRA could not have been meant to eradicate years of existing tax treatment or US Supreme Court rulings regarding state taxation of captive insurance companies.

“Congress, in its haste to insert a minor provision aimed at surplus lines insurance into the already unwieldy Dodd-Frank Act, inadvertently upended one of the organising principles of the captive insurance world—regulation and state taxation by the captive’s domicile.”

“States that try to apply the NRRRA to captive insurance companies are likely to face litigation.”

In response to the NRRRA, the Vermont Captive Insurance Association (VCIA) formed the Coalition for Captive Insurance Clarity (CCIC), in November last year.

The CCIC welcomes industry members to join in the effort to amend the law, and will work with members of US Congress to make the necessary changes.

The Tennessee Captive Insurance Association joined the CCIC in February.

**Solvency II delays will cause disappointment**

Continued from page 1

Omnibus 2 will amend certain provisions of the Solvency II directive, including the implementation date.

The delay will allow for the results of the current study on the impact of Solvency II on products with long-term guarantees to be considered and, where applicable, resulting amendments to the legislation to be drafted.

The study was launched in January 2013, with the European Insurance and Occupational Pensions Authority due to provide its findings by 14 June.

In a statement, Peter Ott, European head of Solvency II at KPMG, said: “Whilst we have been expecting for some time that a delay would be inevitable, it is disappointing that the opportunity has not been taken to provide a clear timetable for the remaining process to make Solvency II a reality.”

“European insurers are ostensibly fatigued by the many delays that have happened throughout the last decade and the discussions whether the directive will ever become a reality in its cur-

rent form are becoming more intense. A clear timetable is needed on the remaining steps to industry compliance.”

**Hong Kong captive is A-OK**

Continued from page 1

The ratings reflect Marble Re’s strong risk adjusted capitalisation, stable operating performance, strong retrocession coverage and the support from its parent, Marubeni Corporation.

Marble Re’s absolute capitalisation is expected to further increase primarily due to strong profitability and capital injection from the parent company of Marubeni in early 2013.

“Partially offsetting rating factors include an implementation risk in Marble Re’s expansion plan as well as an uncertain outlook of the economy conditions. Although Marubeni Corporation has a long history in operating captive businesses, the expansion of product lines would cause risk in its implementation.”

“As Marble Re’s major product line is marine cargo, of which sales are susceptible to trading activities, weakening trading activities would lead to a sharp drop in premium income, and consequently, could impair its operating performance,” said a statement from the ratings firm.

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## Guy Carpenter's MetaRisk promises to aid sensitivity

Guy Carpenter & Company has released MetaRisk 7.1, the latest version of the firm's premiere risk and capital management decision making tool. The platform promises to enable the development of more accurate and efficient risk and capital models.

"This newest installment of the MetaRisk platform delivers access to new business-critical intelligence that was not available before and illustrates our commitment to continue to invest in developing leading-edge products and services for our clients," said Don Mango, head of Enterprise Analytics for Guy Carpenter.

"With this upgrade, users will be able to quickly identify the drivers of adverse risk scenarios, run sensitivity analysis and dynamically evaluate alternatives to mitigate risk and find opportunities to grow their business profitably."

MetaRisk 7.1 will feature new capabilities and enhancements including access to catastrophe models, reserve runoff scenarios and modelling reinsurer default—MetaRisk's new Credit Risk functionality includes tables of reinsurer ratings and downgrade thresholds,

allowing users to have the ability to model individual or classes of reinsurers and the impact of default on ceded loss amounts and company financials.

Additional enhancements have been made throughout the upgraded platform, including additions to policy profiles, frequency and severity libraries, reinsurance contract clause libraries, options for modelling correlation and report offerings. The platform's other improvements include enhanced simulation performance, improvements to MetaRisk Fit and MetaRisk Reports, increased memory efficiency and multi-user support being made available for servers.

"With sustained global market and economic challenges ahead, the ability to clearly see the evolving landscape and accurately evaluate risk will be as crucial as ever," said Steve White, chief actuary of Guy Carpenter.

"Unlike many of the black box solutions in the marketplace, MetaRisk is designed to eliminate blind spots and allow users to make informed, proactive risk and capital management decisions with eyes wide-open."

ing of "a" of National Grid Insurance Company (NGIC), based in the Isle of Man.

NGIC's ratings reflect its strong level of risk-adjusted capitalisation, which is supported by a comprehensive reinsurance programme.

The ratings also consider the captive's importance within the risk management framework of its parent, energy company, National Grid.

The volatility of NGIC's operating performance could offset the positive ratings. The captives underwriting results are also subject to considerable volatility, owing to the nature of the risks it underwrites.

"Negative rating actions could occur if a poor underwriting performance were to become more frequent in the near future, and/or a material deterioration of risk-adjusted capitalisation were to occur. In addition, a significant deterioration in National Grid's financial profile would likely lead to a review of NGIC's ratings," said a statement from the ratings firm.

## Isle of Man captive gets A ratings JLT Re supports wind-only takeout

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

JLT Reinsurance has teamed up with Florida-based Weston Insurance Company to help de-

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We are open to new ideas that enable this industry to thrive and we promote quality and innovation over quantity. Besides our business-friendly environment, we are on the forefront of captive insurance regulation in this country and have brought practicality to many of the regulatory standards for the captive insurance industry. And, as a dedicated partner, we work with you and the greater captive industry, to recommend laws that promote responsible development and growth.

Learn more about what makes South Carolina the ideal domicile for your captive insurance program at [www.doi.sc.gov](http://www.doi.sc.gov).



populate Citizens Property Insurance Company through the removal of wind-only policies.

Citizens is a not-for-profit alternative insurer that provides insurance to property owners who cannot find coverage in the private insurance market.

The Citizens board of governors approved the wind-only takeout, which will lead to a nearly 15 percent reduction in exposure in Citizens' coastal account, on 11 February following the Office of Insurance Regulation's approval of the agreement on 31 January.

JLT Re (North America) as reinsurance broker, and JLT Advisory as strategic capital and analytics advisors, have worked with the JLT analytics practice to support the depopulation.

The depopulation will see Weston remove approximately 31,000 personal residential, commercial residential and commercial non-residential wind-only policies totalling \$30 billion in exposure from Citizens's coastal account.

It is the first takeout of its kind, although Weston will also take on personal and commercial residential policies as part of the depopulation.

Alastair Speare-Cole, head of JLT Re's global operations, said: "We are proud to be able to help create more capacity to help Citizens reduce their exposures."

"Craig Darling of our North American operation and Kevin Timmons of our advisory team, along with their colleagues have worked hard to bring this project to a successful launch. JLT Re's involvement in this deal underlines our on-going commitment in building a US platform."

In a statement, Barry Gilway, president and CEO of Citizens, said: "[The company] is very excited about this first ever depopulation and commercial wind-only policies from our coastal account."

"In listening to our policyholders, we've learned that one of their main concerns in evaluating a takeout offer is the worry that their rates will increase dramatically or their policies will be cancelled at renewal. The price and renewal provisions of the Weston takeout agreement give policyholders the certainty needed to accept the benefits of private-market coverage secure in the knowledge that they will have continuity of coverage and rates."

**AT&T captive is 'stable and strong'**

A.M. Best has affirmed the financial strength rating of "A- (Excellent)" and issuer credit rating of "a-" of Gateway Rivers Insurance Company in Vermont, a captive for telecoms company AT&T.

The ratings and outlook reflect Gateway's strong capitalisation and conservative oper-

ating strategy. The ratings also consider the company's critical role and favourable profile as part of the AT&T organisation, as well as its excellent operating performance during the past five years, providing insurance coverage to subsidiaries of AT&T for certain property/casualty risks.

Partially offsetting these positive rating factors are Gateway's relatively large limits to its general and product liabilities as well as property lines of business. Nevertheless, A.M. Best said that it recognised the substantial financial resources of the AT&T organisation.

A.M. Best views Gateway's management and corporate strategy as a major factor that strengthens its ratings, given the company's conservative underwriting, operational goals and transparency. A.M. Best also views Gateway's enterprise risk management practices as strong given their impact on the company's conservative risk culture, defined risk controls as well as providing optimisation of its capital and surplus.

Other factors that A.M. Best considered in the rating process include the diversification in Gateway's line of business and geography, as well as the support and commitment of the parent and the captive's mission.

A.M. Best expects Gateway's future operating performance to be stable but strong, and the



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stable earnings profile should further support the efforts to control its growth and business writings, which are consistent with its capital and surplus position.

**ICCIE announces best year yet**

The International Center for Captive Insurance Education (ICCIE) enjoyed its best ever year in 2012.

ICCIE is a comprehensive captive insurance education programme in North America, offering courses that are relevant to any domicile around the world. A faculty of instructors recognised for their various captive insurance specialties runs the courses.

The Vermont Captive Insurance Association created ICCIE in 2001 to ensure that the growth and quality of the captive insurance industry was sustained through a pool of qualified industry professionals.

Its 2012 highlights include welcoming new students from around the world and nearing 1000 total enrollments. The center is also continuing to strengthen its partnership with industry organisations and webcasting seminars live from captive conferences.

The ICCIE has also made additions to its board of directors, including Chaz Lavelle from Bingham Greenebaum Doll in Kentucky and Carolyn Rice from Johnson Lambert in Vermont.

Keith Jones of Primmer Piper Eggleston and Cramer will also be joining the faculty as one of the instructors of the core course, which covers forming and operating a captive.

**Housing authority risk vehicles as safe as houses**

A.M. Best Co. has affirmed the financial strength rating of "A (Excellent)" and the issuer credit ratings of "a" of Housing Authority Property Insurance, which is made up of a mutual company and housing authority risk retention group, and subsidiary Housing Enterprise Insurance Company.

Excellent capitalisation, very strong operating results, a market leading position and proven expertise in the niche public housing authority market are the reasons for the strong ratings.

"Partially offsetting these positive rating factors is the group's concentration of risk in the public housing authority sector, which magnifies the

impact of market cycles and public policy and legislative changes," added a statement from the ratings firm.

The Housing Authority Insurance Group provides property and liability coverages to public housing authorities and their affiliated operations throughout the US.

A.M. Best pointed out the group's "solid operating performance", which sees it maintain a market share of about 40 percent, adding that it has "progressively built up its surplus through retained earnings as its underwriting leverage is very low".

"The group's underwriting results remain strong due to its focused and disciplined underwriting approach and conservative reserving. Over the years, it has increased rates when appropriate and withdrawn from problematic accounts and lines of business, such as workers' compensation."

"In addition, Housing Authority Insurance Group's operating performance benefits significantly from effective enterprise risk management, its tax efficient structure and strong client relationships, which are supported by a number of customised programmes and services."



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# Pick of the mix

As 2012 licensing figures roll in, CIT looks at what some of the big guns are offering and what the new kids on the block are bringing to the industry

JENNA JONES REPORTS

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With the US, Caribbean and Europe offering more than 50 domiciles between them, captive owners, as well as companies contemplating the idea, are certainly spoilt for choice. This is without mentioning the likes of Asia, Australia and Canada, where self insurance is taking off.

For US states, 2012 was an exciting year for the industry. In July, the State of Oregon opened its doors to captives, allowing pure, association, branch and captive reinsurers to set up shop. In the same month, Florida attempted to lure potential captives with a new law that lowered capital requirements.

This created more competition in the US, with domiciles looking to attract new business and lure captives from rival domiciles. Last year, Vermont lost SBD Insurance and Lumerica Insurance Company to Connecticut and New Jersey, respectively.

"The captive insurance industry is becoming a competitive environment and domiciles are competing with each other for captives," says Steve Chirico, assistant vice president at ratings agency A.M. Best.

Regulatory strain—from Non-admitted and Reinsurance Reform Act confusion to Solvency II implementation—has affected new formations and performance over the last 12 months.

Malcolm Cutts-Watson, chairman of the Willis global captive practice, says: "There is an interesting dynamic between the new kids on the block, eager to attract new business, and the more established domiciles keen to retain reputation and market share. All are demonstrating creativity in responding to regulatory challenge and the need to innovate."

The stability of the insurance cycle has also affected domiciles, with the soft state of the market continuing to thwart the captive insurance industry, according to Chirico.

He says: "We have seen some slow down of rate decreases and some minor rate increases depending on the line of business. Workers' compensation in the US has had a slight improvement as well as property catastrophe reinsurance rates, but by and large we are still in a fairly soft market."

## Candy reign

Despite Vermont losing two captives in the past six months, the state is still home to the most in the US. Captive Insurance Companies Association (CICA) domicile listings show that in 2011 Vermont was home to 590 active captives, more than twice as many as second place Utah with 239.

In 2011, Vermont licensed 41 new captives, but in 2012, the figure dropped to 32. David Provost, deputy commissioner of the captive insur-

ance division in the Vermont Department of Financial Regulation, explains that the drop is not a concern to the state.

He says: "41 new captives was considered an extraordinary year, and 32 is pretty close to our long-term average. Other than 2002 and 2003, which saw 70 and 77 captives formed post-9/11, and 2008 at the depth of the recession, the 2000s have seen formations of between 30 and 40 new companies each year."

With a steady stream of captives being licensed in Vermont year-on-year, Provost has witnessed a number of popular lines of business and continued trends.

The state has seen a continued growth in the use of captives by healthcare professionals for professional liability, as well as a growth in small captives and interest from the construction industry. It has also seen a spattering of captives being formed for cyber liability alongside existing captives adding the line to their plans.

"But one of our longest running trends is the lack of a trend. In other words, we regularly have a wide variety of business organisations form captives each year—we are not reliant on a particular source," says Provost.

When it comes to competition, Provost is clear that Vermont will not try to predict the state's future success.

"[Last year] was a very good year, and I expect 2013 to be very good as well. Six new captives or 60 is irrelevant—we welcome any good programme that fits our statute and environment."

"We do not set projections or targets for new licences. As a regulator, that would be imprudent. Our entire focus is on quality, not quantity," explains Provost.

As the third largest domicile in the US, Hawaii is clearly a popular destination, but it is facing challenges from competing jurisdictions, with Delaware's impressive 2012 figures seeing it close in on its rival.

Despite the current competitive nature of the industry, George Sumner III, captive insurance administrator and deputy commissioner of the Hawaii Insurance Division, is happy with the states 2012 licensing figures.

Sumner says: "Hawaii licensed 12 captives in 2012 with no cells during the year. We [also] added approximately \$2 billion in assets so the captives in Hawaii are quite substantial and the parents are well known."

"We were once again pleased with our results, however, we can always do better. Hawaii is working with the private sector to make prudent changes to improve what we have to offer the existing captives as well as the captives considering Hawaii."

Sumner also stresses that Hawaii is selective when it comes to the managers and captives that it brings into the state, and also that a location's success should be attributed to much more than just figures. "[Hawaii] is not interested in just the numbers of captives. We stress quality over quantity, looking at the asset growth is a better measure of the success of a domicile."

While last year's figures are scrutinised and compared, Sumner believes that Hawaii is ready for the year ahead. "Hawaii has a good reputation of being a prudent domicile that has an open mind and works well with the industry to make good common sense choices."

"The captives and managers that domicile their captives in Hawaii are properly screened to protect the reputation of the domicile. This benefits both the managers and captives."

New licences in South Carolina also grew substantially in 2012.

Jeff Kehler, programme manager of the South Carolina Department of Insurance, says: "[We] had a good year last year in number of new licences and we look forward to an even better year in 2013. We will continue our promotional efforts and actively reach out to the industry to grow our captive business."

US domiciles' high growth figures are down to a progression within the jurisdiction as to why companies use and need a captive, according to Chirico.

He says: "I think that we've moved beyond having an appetite for captives that's just based on risk financing. There's a lot more qualitative aspects now of why companies are forming captives."

"Captives are continuing to grow in our view because it's not just a financial transaction anymore, it's a qualitative enterprise risk management situation and the captive fits very nicely into that."

Chirico feels that the migration of certain captives from offshore to onshore also helps to explain the US's significant growth in captive formations.

"What a lot of companies are doing is keeping their offshore captive and having an additional onshore captive. For very large global corporations, having an offshore and an onshore captive gives a lot of flexibility as far as the products they are able to offer their parent companies."

## Tropical tastes

The Cayman Islands and Bermuda are Caribbean alternatives that manage to stand up to the US. According to CICA's 2011 domicile listings, Bermuda has 300 more captives than Vermont and 600 more than Utah.

Peter MacKay, chairman and CEO of Global Captive Management in the Cayman Is-

lands, says: “[In 2012] the major US domiciles have shown healthy growth too which shows that captives are of interest again. Cayman has always been able to compete with the onshore domiciles, and Bermuda, and continues to attract well capitalised, quality captives.”

“Because of our niche in healthcare and with the changes going on in healthcare in the US, we believe that captives will continue to grow and more healthcare organisations will utilise captives to reduce costs.”

The importance of healthcare captives to Cayman is not to be underestimated, according to MacKay. They represent 45 percent of all the entities that are domiciled on the islands.

Cayman is also seeing more captive structures popping up, with the formation of group captives and segregated portfolio companies emerging to pool their risks.

According to MacKay, 2012 saw the Cayman Islands exceed its expectations, licensing 52 new captives with another 14 applications to be approved this year, marking a significant increase from 2011, and also the most applications since the hard market in 2004.

But MacKay struggles to imagine captives continuing to form at the pace of last year, despite the heightened interest in them. He does see room for significant growth figures if rates begin to firm up in the commercial market as potential interest comes to fruition through the formation of new captives.

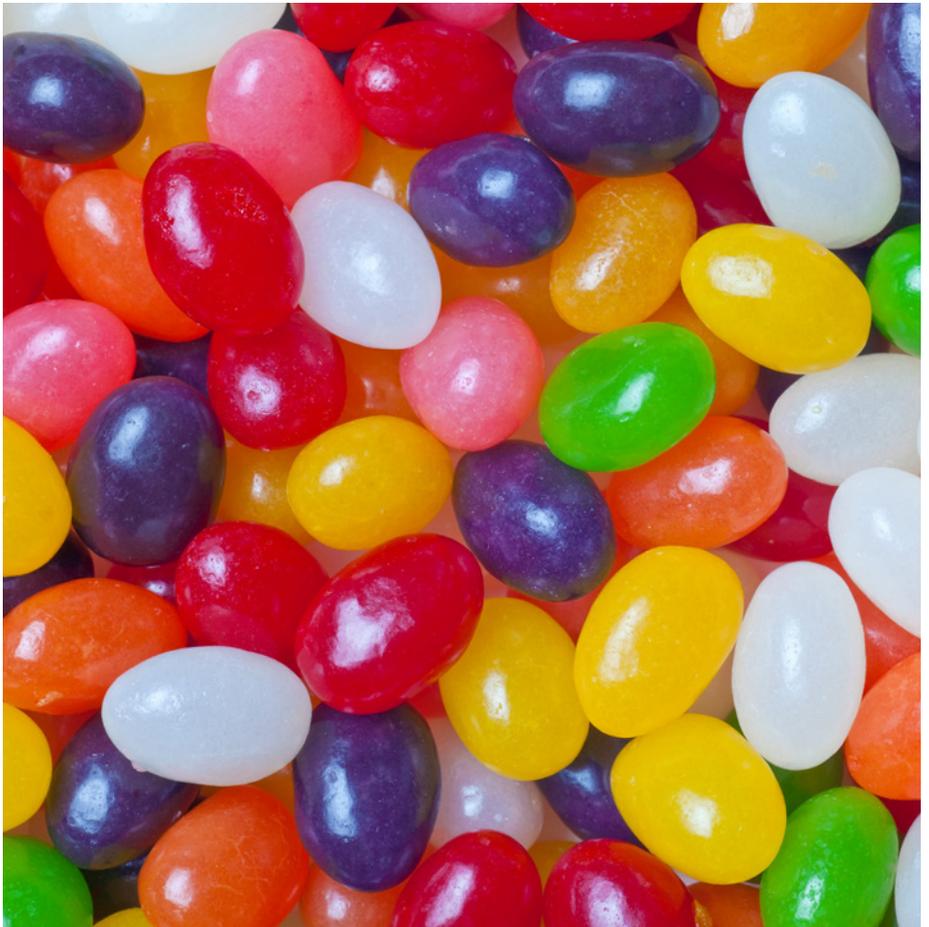
## Home sweet home

Although US and Caribbean locations dominate the top 10 in CICA's domicile listings, the small island of Guernsey is flying the flag for the European market, taking fourth place behind Bermuda, Cayman and Vermont.

Last year, Guernsey licensed 97 new international insurers with a net growth of 50 entities, bringing its total number of international insurers up to 737. This number was made up of 242 limited companies, 68 protected cell companies (PCC), 404 PCC cells, five incorporated cell companies and 18 ICC cells.

Despite the growth, Fiona Le Poidevin, chief executive of Guernsey Finance, feels that the island is suffering due to poor market conditions, but perhaps not as much as other established players.

“The general economic downturn might usually have meant that organisations would look for more effective risk management solutions, but the continuing soft market conditions mean that in fact many are not predisposed to looking beyond the conventional insurance market for alternatives, such as captive insurance.”



“Figures show that the formation of new captives globally is not particularly strong and that, taking into account surrenders, the number of active captives is relatively stable. In addition, other jurisdictions have not seen such levels of new business as Guernsey. For example, Cayman has been celebrating the approval of 52 new licences last year, which is around half of the number of international insurers licensed in Guernsey during 2012.”

But South Carolina's Kehler thinks that the EU's struggling economy may well affect captive growth in Europe.

He says: “The US is the largest captive domicile in the world and that is not likely to change. The EU economy is struggling currently and that may put a damper on captive growth in the European domiciles. Bermuda seems intent to focus on insurance linked securities and cat bond arrangements. Cayman will continue its emphasis on healthcare and group captives. I expect we will see moderate to above average growth in all of the non-European domiciles.”

Guernsey is an old hand at captive insurance and Poidevin says that the island's experience continues to weigh heavily in companies' decisions to domicile there.

She says: “Organisations continue to view Guernsey as an attractive captive domicile because of our considerable experience in the field. Over time, we have been able to refine our legislation, hone our proportional regulation and build up a significant pool of captive managers, ranging from some of the most well known names in the industry to local, independent firms.”

“Our strong heritage in captive insurance also means that these providers have accumulated significant expertise in being able to service clients of varying scale and size from all different parts of the globe.”

## Asian delight

Outside of the prominent captive regions, Asia is ready to stand up and be counted. Described by Chirico as Asia's Vermont, Singapore is by far the most established domicile in the area. And despite four new captives that it licensed in 2012 being offset by four de-registrations, Singapore's captive count of 61 is a testament to an up-and-coming jurisdiction.

Cutts-Watson of Willis says that he is quietly confident about Asia's growth prospects in 2013 despite the soft market.

He says: "The challenges of a protracted soft insurance market and relatively low awareness on alternative risk transfer mechanisms such as captives have continued to be the main obstacles for growth in the region. While there were new captives set up in 2012, the continuing outflow of Japanese-owned captives has offset the net growth in the market."

"Asia demonstrates great potential given the emergence of major global organisations from the area that are keen to adopt international best practice with regard to risk financing and captive usage."

The continued outflow of Japanese-owned captives and new captives predominantly from Singapore and the Asia region, says Cutts-Watson, can only help the region to progress, which is a trend that Chirico has also witnessed.

Chirico says: "[A.M. Best] is fairly impressed that some Japanese industrial companies are looking at Asian options—as opposed to expensive locations where they've traditionally had captives such as Hawaii—as alternative captive domiciles that are closer to them and offer a lower cost operating platform."

Chirico also highlights other up-and-coming Asian destinations such as Labuan, Vanuatu and Micronesia that are beginning to make themselves known in the industry.

"We've been engaged to rate a captive in Micronesia which we had never heard of as a captive domicile before. There is an island called Yap in

Micronesia, which has eight or 10 captives now so it's definitely somewhere to watch," says Chirico.

Although Asia is going in the right direction to becoming a potentially competitive jurisdiction, Cutts-Watson feels that direct comparison so early on in Asia's risk management and financing evolution is unfair.

He says: "The insurance markets in US and Europe have had a long period of time to become familiar and comfortable with captive participation ... a longer term review, say in five years, will provide a more meaningful comparison and identify any regional trends."

Kehler also agrees jurisdictions such as Asia, the Pacific Rim and South America—which all represent opportunities for substantial growth—need time to evolve accordingly.

He says: "The development of the captive industry in these areas will take time as culture and social changes will have to keep pace with the speed of technological change. That is not something that happens overnight."

Poidevin feels that Asian captives could benefit from the experience of more established domiciles, rather than opting to stay at home. "Guernsey has been building relationships in Asia and, while captive insurance is a very new concept for the region, it is hoped that our considerable experience and expertise will mean that we might attract this business in the future."

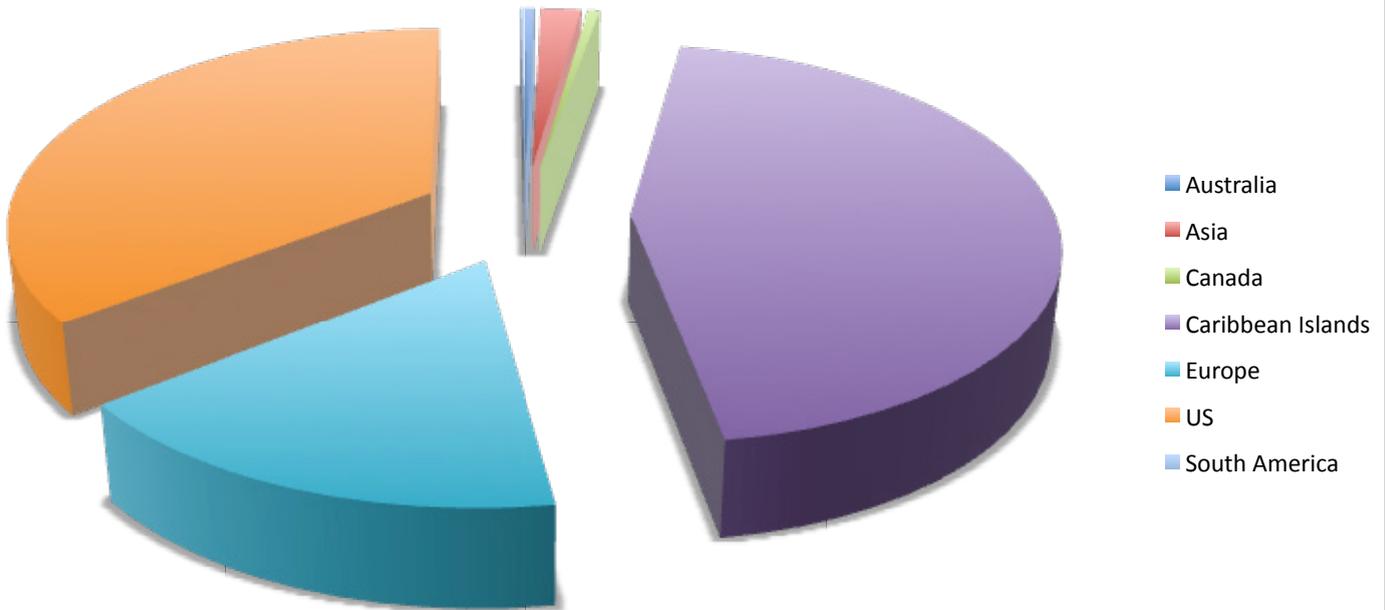
Asia may not be contending for US business any time soon, but Provost is sure that it will work for Asian businesses and multinational organisations with need for an Eastern presence.

**Our strong heritage in captive insurance also means that these providers have accumulated significant expertise in being able to service clients of varying scale and size**

He says: "Each domicile has its advantages, whether you're talking about any of the more than 30 US domiciles, Bermuda, the Caribbean, or Europe. Each company forming a captive has to evaluate all domiciles and select the right domicile for its particular needs."

"The US is seeing tremendous growth in the number of captives, in part due to the expansion of the captive concept to smaller companies. I expect that trend to continue, but it's not limited to US domiciles." **CIT**

## CICA domicile figures as of the end of 2011



## Feeling the pull

CICA president Dennis Harwick tells CIT why his glass is half full, how the market is growing stronger, and what to look out for at the association's upcoming international conference

### JENNA JONES REPORTS

#### Was 2012 a positive year for captives?

I think it was—I'm an optimist. Captives are supposed to struggle in a soft market and a bad economy, and I'd say that 2012 was an uncertain economic year, but despite that uncertainty, almost every domicile added net numbers of captives. Captives, which used to be considered somewhat exotic, have clearly achieved critical mass.

When the market finally hardens, I think you are going to be delighted with the number of organisations and businesses that will move forward with a captive. In light of everything, 2012 was a positive year for captives.

#### What is the captive market doing for companies that it hasn't done before?

The beauty of a captive is that it can, within reason, be creative in covering and shifting risk. An organisation or a company can call on a captive to cover risks that the commercial market doesn't want to address.

The big thing right now in the US market is healthcare. Healthcare reform is here—it is the law of the land. And there are a lot of people asking how a captive will fit into this landscape.

#### The CICA international conference is almost upon us—what will be the hot topics? Is there a particular panel discussion that attendees should look out for?

We have a couple of sessions on the impact of the Affordable Healthcare Act. When we started to work on this year's conference, I

asked the programme committee what keeps them awake at night. The members of the committee almost uniformly said that it was the changes that were just over the horizon—things like healthcare reform and regulatory uncertainties. That was the genesis of our theme, New Horizons.

It's why we engaged a demographer as the keynote speaker. He can talk about demographic trends that are going to affect the industry. We're also having the keynote speaker followed by an economist who will talk about economic and insurance market trends in 2013.

A session that I'm really excited about is called The Changing Regulatory Environment. It features very interesting speakers from both the US Federal Insurance Office and the Bermuda Monetary Authority.

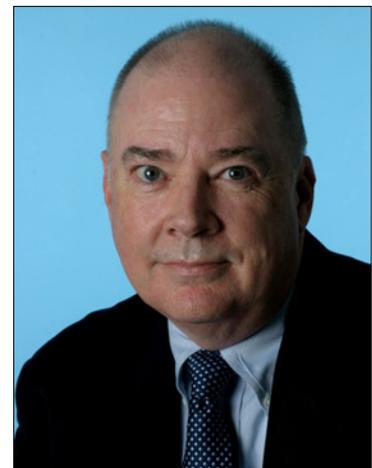
#### Good regulatory news has arrived in the form of declarations from prominent US politicians that the NRRRA does not apply to captives—what are your thoughts on this?

There are almost always unintended consequences when you have legislation. In this case, the Non-admitted and Reinsurance Reform Act (NRRRA) was trying to address a problem with surplus lines insurance, but some state taxing authorities have used the act's language to try to tax captive insurance. Having two or three of the primary authors of the legislation come out and declare unequivocally that NRRRA does not apply to captives will help resolve this troubling issue.

#### How do you think the captive insurance industry will fare in 2013? Are there any prospective challenges facing the industry?

I think it's going to be another momentum building year for captives. I don't know that the market is going to harden this year—at least significantly—but there's going to continue to be more and more people who will understand the strategic reasons for forming a captive, and that momentum will carry the captive industry forward.

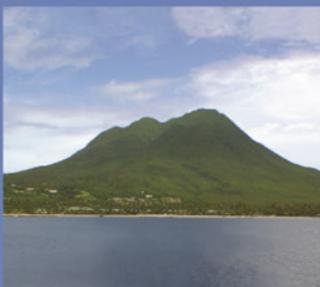
When the market does harden, I think the industry is going to see an explosion in the number of captives, particularly in the US markets. People will find a way to use captives in the healthcare arena and even though the federal government has slowed down the application process for utilising captives to fund employee benefits, that arena remains a huge opportunity for growth. **CIT**



**Dennis Harwick**  
President  
Captive Insurance Companies Association

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## Cell to let

CIT talks rent-a-captives with Simon Kilpatrick of Advantage Insurance Management to see what the facility offers the industry

## What is the history behind rent-a-captives? And why were they created?

Rent-a-captives have been around for more than 25 years and started initially as risk sharing pools or programmes where small- to mid-sized businesses that could not afford to fully self-insure could join forces with similar business to finance their risk. Initially, the participants in these arrangements shared risks with the other participants to varying degrees.

The evolution of rent-a-captives began to accelerate after Guernsey introduced the concept of protected cells in 1997. Protected cells allowed for the true segregation of assets and liabilities, which allowed participants a greater degree of comfort and control. The concept of segregated cells has taken off with most captive domiciles having some form of cell legislation in place. The latest changes in the industry include the capability for segregated cells to incorporate themselves, which allows for them to take tax specific elections and further strengthens the segregation of risks and asset protection between the various cells.

## How does Advantage's rent-a-captive facility work?

We have two rent-a-captive facilities so that we can provide both an onshore and offshore option. Chesapeake Bay Insurance Company is a Washington DC-based agency protected cell company. Customers can purchase certain insurance directly from Chesapeake or they can form a cell within it to offer the coverage.

In the Cayman Islands, Advantage Property and Casualty SPC can create protected cells that can direct write or act as reinsurers depending on the client's needs. For both companies, we provide all of the back-office administrative support including policy design, accounting, corporate activities and regulatory reporting. Clients can provide their own capital to their cells or rent capital from us.

## How might this structure benefit companies?

Rent-a-captives offer companies many of the same benefits of traditional captives including the ability to participate in their underwriting profitability and in the investment income generated by the premium dollars. Additionally, captive owners have the ability to custom design coverage and have more say in the claims handling process. The fact that they are now self-financing their risk often leads to lower claims and losses as a result of improved safety practice. Lower losses can mean a lower overall cost of risk financing for the business.

## What requirements does a company need to set up a rent-a-captive? Do these differ across domiciles?

The requirements differ if one is creating a cell or joining an existing pool. Joining a pool is very easy as no additional licences are required. Once the underwriting and due diligence requirements are met, the policy can be issued.

Creating a new segregated cell is more involved as the cell typically seeks to get its own certificate of authority or licence. This requires an application to the regulators that is substantially similar to that of a standard pure captive. The requirements for licensing differ slightly between the domiciles, but we are seeing that these standards are becoming more similar all the time.

## If the company was looking to solve a short-term problem by self-insuring, then a rent a captive avoids the long-term commitment

All regulators want to see evidence that the cell's business plan has been clearly thought out and designed to last in the long run. Financial pro-formas should indicate that the cell has a likelihood of financial success and these may often need to be supported by an actuarial study that projects the expected losses under expected and adverse scenarios.

## Why would a company opt for a rent-a-captive over a pure one?

The primary reason for joining a rent-a-captive is economies of scale. Companies that are not large enough to form their own captives can rent the services provided by the captive manager, auditors, actuaries, etc, at an incremental cost.

Additionally, if the company was looking to solve a short-term problem by self-insuring, then a rent a captive avoids the long-term commitment required to create a pure captive. A rent-a-captive also provides a good stepping-stone or incubator where the company can test the waters before taking the plunge into the creation of a standalone captive.

## Do rent-a-captives cover the same risks as pure ones?

Rent-a-captives provide a high degree of flexibility. If something can be done with

a standalone captive, it could most likely also be done through a rent-a-captive or segregated cell. However, the rent-a-captive model may not always be the optimal method. Just as with pure captives, certain statutory risks would require the captive to utilise a rated and admitted front company. Captives don't typically write risks such as property and personal lines.

## What are the downsides to the structure?

Pure captives are completely autonomous and control every aspect of their operations, whereas rent-a-captives typically limit the ability of their cells to make these decisions. Participants in a rent-a-captive typically cannot choose as freely who their service providers are. They are often forced to use the auditors and actuaries that are hired by the owners of the rent-a-captive facility. There may be limitations imposed by the rent-a-captive on the type of investments the cell can make and there may be less flexibility on the types of coverage that can be written.

## How do regulators view rent-a-captives compared to traditional captives?

The majority of the major domiciles have updated, or are currently in the process of updating, their segregated cell laws. The trend is to allow some form of incorporated cell and to more clearly define how cells can interact with one another.

These changes seem to indicate that the rent-a-captive and segregated cell captives are still looked on as favourable captive structures by the regulators. That said all captives, including rent-a-captives, are judged on their financial health and stability as well as how they operate and conduct themselves in the marketplace. As rent-a-captive participants leave a lot of those details up to their owners and operators, it is very important for companies to conduct a thorough initial review to ensure that the rent-a-captive is in good standing in its home domicile. **CIT**



**Simon Kilpatrick**  
Executive vice president  
Advantage Insurance Management



# Risky with a chance of meatballs

CIT delves into reputational risk to see how insurers are helping companies to keep their reps in check

## JENNA JONES REPORTS

Reputational risk is a major concern to companies that are currently caught up in the horse-meat scandal. Findus, Birdseye and Burger King are just a few of the household names facing a backlash from customers, clients and the world's media.

In the middle of January, Ireland's food safety authority claimed that horse DNA had been found in beef burgers being sold in UK and Irish supermarkets. By the beginning of February, many of the UK's biggest supermarkets had been drawn into the scandal, allegedly selling a variety of contaminated beef burger, lasagna and meatball products.

Oil company BP is still facing the repercussions of the 2010 Deepwater Horizon oil spill, with a trial underway in New Orleans to settle civil claims relating to the fatal oil rig fire that cost 11 lives and triggered the largest spill in US history.

The disaster could cost the company billions—indeed, the US Department of Justice reportedly offered BP \$16 billion deal to settle the civil claims being litigated in New Orleans—and that is forgetting the irreversible damage that has been done to the company's reputation.

Companies' reputations are under constant threat, and these examples show the many different forms that those threats can take.

Martin Eveleigh, chairman of Atlas Insurance Management, says that when a reputation is damaged or under threat from being so, all affected companies are faced, at the very least, with the public relations expense of responding to the crisis.

He says: "How your customer sees you is vitally important whether you are a supermarket, a doctor, a car manufacturer or a defence contractor."

"Reputational risk is seen as a much more serious issue now than it was just a few years ago, because of the vastly increased channels for dissemination of information."

Eveleigh fears that it is not just the number of ways of disseminating information that is the problem, but also the velocity at which stories are able to spread around the world.

Andrew Barile, principal of the Andrew Barile Consulting Corporation, feels that as reputational risk is judged on the basis of exposure of an individual corporation, all businesses "need to explore the purchase of reputational risk coverage".

At the end of 2011, Chartis (now AIG) partnered with communications firms Burson-Marsteller and Porter Novelli to create ReputationGuard, a commercially available insurance product providing innovative coverage to help policyholders cope with reputational threats.

Developed by Chartis's executive liability division, ReputationGuard offers clients access to reputation and crisis communications professionals as well as coverage for costs that are associated with avoiding or minimising the potential effects of negative publicity.

"Threats to reputation and brand image are more common and wide reaching today than ever before—and can impact on a company's bottom line. Events such as executive scandal, questions about product safety, data breaches, litigation and other negative publicity can become front page news and quickly impact reputation or brands," said a statement from Chartis.

Tracie Grella, president of Chartis's professional liability unit, explained in a statement at the time that the public's perception of the response to an event could have a lasting impact on an organisation's reputation, with one person's negative opinion becoming adverse publicity on a global scale.

In January, Atlas Insurance Management—in partnership with Anne Klein Communications Group (AKCG), a national crisis communications firm—launched a new service to aid captives participating in its risk pool.

Eveleigh explains: "The Atlas Reinsurance Exchange is a risk pool which enables captives to

spread risk by sharing it with other captives. The participants are captives writing predominantly enterprise risks, for which the commercial market does not adequately cater."

Eveleigh explains that most of the captives participating in Atlas's risk pool issue policies covering reputational risk, so the firm enlisted AKCG to construct a risk management programme that provides crisis response services to captives and their insureds.

He says: "The team will be available to help captives and their insureds react in the event of a crisis by ensuring effective, positive and timely communication of the insured's message."

While the Atlas Reinsurance Exchange is one way for corporations to manage their reputational risks through captives, Barile explains that there are a number of other options.

"The captive may write a direct procurement reputational risk insurance policy directly to the corporation. Another approach would be for the corporation to buy the reputational risk policy from the traditional commercial market, and then have the captive reinsure the 'front' carrier," says Barile.

Barile adds that coverage that is written in the captive insurance company can ultimately benefit a corporation, as the potential for increased underwriting profits and investment income could potentially lead to a dividend/loan being paid back to the parent corporation.

But on the contrary, Barile explains, captives could have a reputational risk loss, as it is the captive insurance company that is taking on the underwriting risk when writing coverage.

Companies need to understand the need for reputational risk in today's digitally connected world, where facts and opinions—true or false—can become skewed and taken at face-value. It is important that they understand that reputation is more than just a PR exercise, and come to grips with the options that are available to them. **CIT**



## A Caribbean getaway

Close ties with Canada and varied tax agreements are what the Caribbean island of Barbados are really about, as CIT finds out

### JENNA JONES REPORTS

Barbados is home to some 270 active captives, according to industry statistics. But with its idyllic year-round climate, good infrastructure and low offshore tax rates, it's a wonder that the Caribbean islands captive count isn't higher.

The island has been a player in the international insurance industry since it introduced the Barbados Exempt Insurance Act in 1983.

The act defines exempt insurance as the business of insuring risks outside of Barbados by a company that is not owned by persons resident in CARICOM, an association of Caribbean countries.

For a company to qualify under the act, it must be incorporated in Barbados with a minimum capital of \$125,000 and at least one resident Barbadian citizen as a director, and also only carry out exempt insurance business.

Barbados was late to join the international insurance market in comparison to other Caribbean destinations, with no real activity seen until 1984, when the Barbados-US tax treaty was signed.

Since then, Scott Stollmeyer, operations manager at Amphora Captive Insurance Managers, feels that while numbers have remained positive, the road has not always been smooth.

He says: "Growth had been steady leading up to around 2004, but since then the growth has slowed off significantly. We have never lost any captives from a numbers standpoint but the growth experienced in the 80s, 90s and early 2000s clearly slowed."

On top of exempt insurance companies, qualifying insurance companies can also be established in Barbados, says Emeline Taitt, acting CEO of Invest Barbados.

"The business conducted by these entities falls into two broad categories—general insurance and life insurance. In the general insurance category, the main lines written include property, property and casualty, motor, warranties, bonds, employee benefits, workers' compensation, em-

ployer liability, public liability, malpractice, credit risk and environmental liability."

Barbados has long been thought of as the leading domicile of choice for Canadian captives, because of a strong, mutual business relationship that has been in place for many years.

Taitt states that approximately 51 percent of active companies that are domiciled in Barbados originate from Canada and 40 percent are US-owned. The remaining percentages derive from Europe, Latin America and the Caribbean.

The Barbados-Canada double taxation agreement (DTA) was signed in 1980 to ensure that Canada would avoid double taxation—a situation where profits are taxed twice, in foreign country and then again when they are forwarded to the parent company's country of residence.

According to the Barbados Financial Services Commission, dividends that are paid out of income earned from captive insurance business in Barbados to a Canadian company are considered 'exempt surplus' and are not subject to Canadian taxes, providing the risks are non-Canadian.

Barbados and Canada's relationship has a history that spans decades, though Stollmeyer believes the bond evolved much earlier.

He says: "Barbados has had a long standing relationship with Canada from the 1800s. In fact there was a Royal Bank of Canada branch in Barbados before there was one in Toronto."

While the Canadian DTA is the most profitable tax agreement that Barbados has concluded, the island also boasts numerous others with the likes of the UK, China, Luxembourg and Sweden.

Offshore domiciles such as Barbados are still working to shake off the 'tax haven' label that many commentators continue to attach to them.

But Taitt says that Barbados is known by governments, regulators and business people to be a leading, low tax jurisdiction that fully sup-

ports government-to-government transparency. But due to its international prominence, it can be mistakenly included in public discussions regarding tax havens.

"Taxes are levied on international companies. The benefits of using Barbados come in the low tax rates payable and the avoidance of double taxation on repatriation of profits. Barbados has also had a tradition of sharing information for more than three decades with tax authorities in instances where deemed necessary. The country is moving to phase two of the global forum peer review, another testament to its transparency and compliance with regulatory requirements. The domicile has and continues therefore to show that it is not a tax haven."

Stollmeyer says that the island's regulatory framework is flexible in regards to both reserve requirements and applicable accounting principles, and that there is no indication of the island adopting Solvency II equivalency.

Taitt adds that the cost of living in Barbados—which is typically lower than that of its main competitors—attracts captives to the island.

"Barbados also stands out from other jurisdictions because of the high availability of indigenous human capital. Barbados has a large pool of highly educated and qualified professionals able to meet the employment needs of captives and captive management. This aids in cost competitiveness as the need for higher paid foreign employees is lessened," says Taitt.

American Overseas Group was a testament to this last year when it decided to re-domesticate its operating subsidiary, American Overseas Reinsurance Company (AORE), from Bermuda to Barbados.

Speaking at the time, American Overseas Group CEO David Steel said: "Our strategy is to enhance shareholder value by writing short-tail, P&C [property and casualty] reinsurance business complementing our long-tail financial guaranty portfolio run-off. AORE's re-domestication is integral to our business plan." **CIT**



## The lay of the land

CIT's experts discuss the potential for a hard market, covering emerging risks and whether recent NRRRA clarifications put an end to confusion



**Jeff Kehler**  
**Programme manager**  
 South Carolina Department of Insurance



**Carlos Oliveras**  
**Managing director**  
 Kane (USA)



**Gary Osborne**  
**President**  
 USA Risk Group



**Thomas Hodson**  
**President**  
 Connecticut Captive Insurance Association



**Alan Kandel**  
**Business development manager**  
 A.M. Best



**Nick Dranchak**  
**Senior financial analyst**  
 A.M. Best



**Steve Kinion**  
**Director**  
 Delaware Bureau of Captive and  
 Financial Insurance Products



**Mark Dugdale**  
**Editor**  
 Captive Insurance Times

**In 2012, the talk was of the market hardening in the US—has this been the case?**

**Thomas Hodson:** Yes, the market is definitely hardening. My sources in the market tell me that most companies are reporting rate increases, even double digit increases in some specific lines of business—workers' compensation and commercial auto. This is a bit of an unusual market right now. Historically, rate increases have been primarily driven by capacity. In today's hardening market, however, there is plenty of capacity. So what is driving rates upwards? I think it is a combination of things. First, is underperforming investment returns. While the stock market is improving, it is still not where it needs to be. Therefore, to be competitive, insurance companies have significantly cut expenses over the last few years. With little opportunity to further reduce expenses, they must focus on increasing revenue.

Secondly, I see catastrophic exposures and claim experience associated with hurricanes, tornados, winter storms, over the last few years having a negative impact on the amounts and returns on operating capital—and presenting significant exposure to losses in the future. Companies need to maintain profitability to meet shareholder expectations, so rates have to increase and risk exposures need to be managed.

**Jeff Kehler:** It is a mixed bag. The majority of lines of coverage have seen little to no increase. However, I suppose a flattening of decreases represents some form of increase. The lines receiving the increases are those where there have been major losses or the potential is there. Otherwise, they have been pretty flat.

**Gary Osborne:** There are some symptoms of hardening out there, but it is certainly not the case on a general basis. Certain risks—such as errors and omissions and coastal property—are no longer declining and are in some instances pushing for increases, but we can still see bloodthirsty competition for quality risks.

**Carlos Oliveras:** There have been some rate increases in specific target markets, but we have not seen a broad rate increase across the whole industry. More specifically, workers' compensation capacity and underwriting appetite have hardened significantly in California, New York, Illinois, and several other states. Liability coverage remains soft, while re-drawn weather maps and models have resulted in reduced capacity and increased rates across much of the East Coast and South. Commercial trucking rates have hardened in economic growth areas such as Texas and the new 'Energy Belt'. In terms of the professional liability market, this has perhaps reached a floor, although continued consolidation in all industries may skew the data.

**Steve Kinion:** I expect that commercial insurance rates will continue to firm in 2013 in many, but not all, lines of coverage.

**What sort of business environment has this created for US captives?**

**Kehler:** It is business as usual. Those companies that see the risk management and financing benefits of captives are continuing to form captives despite the still soft market pricing and low interest rates. Captives are great tools for managing risk regardless of the pricing environment.

**Oliveras:** Many US companies have experienced steady rate increases during 2011 and 2012 in conjunction with decreased availability in cover/limits. The soft market cycle has provided cheap insurance for the US market for many years, and as this slowly reverses to a hard market, the rate increases will drive more captive formations.

Growth in certain sectors is strong due to improved corporate balance sheets and a desire to protect assets as efficiently as possible. Due to a near zero interest environment, two factors have emerged. Firstly, real underwriting losses will be recognised more quickly and will result in faster rate modifications. Companies should be prepared for rapid change, and some are forming captives or joining group captives as

a defensive move before any swing. Secondly, a huge amount of capital is seeking steady returns, and it is being (selectively) deployed against emerging and catastrophic risks. Captives are being utilised to bring this risk capital to bear quickly and efficiently.

**Hodson:** As the market hardens, I am seeing significantly more interest in captive solutions. In addition to rate increases, we are also seeing the traditional market shrink coverages, or eliminate them altogether. This combination of events has always driven companies to seek alternatives for their risk management needs. One emerging impact is the lack of innovation within the traditional insurance market, where the corporate risk needs are not being met.

Interestingly, even during the depths of the soft market, when rates were lower and coverages were more available, interest in captives remained strong. Captives now represent somewhere between 30 and 40 percent of the commercial insurance market, so they are a much more accepted, more widely used risk management tool. Add to this a hardening market and emerging risks, there is going to be significantly more interest in captives.

I am intrigued and excited as I see businesses developing captive programmes to help them in strategic risk management—using the captive entity to align and focus on strategy implementation and execution.

**Osborne:** A major component of the recent US captive growth has been micro captives—it is slow going for other formations, especially groups as raising capital is difficult (although USA Risk did have two new group programmes in late 2012 so it is not totally dead). The interest is out there, but the low interest environment is also problematic as tying up substantial capital and collateral in a captive is not compelling for many when the funds will barely make any kind of return.

**Some US captive insurance departments reported growth in the number of licensed entities in 2012—are more companies turning to alternative risk transfer vehicles, and why?**

**Nick Dranchak:** A large percentage of Fortune 500 companies already have captives. The growth has been accelerating in smaller mid-market companies that are forming micro captives utilising IRS code 831(b) with premiums of less than \$1.2 million. With that being said, there was still growth in larger captives (mainly single parent) along with risk retention groups (RRGs). Companies are forming captives in order to lower their insurance costs and gain control over claims and claims settlement. Captive insurance is not only a risk financing tool, but also an overall enterprise risk management tool when used correctly.

**Osborne:** Outside of the State of Vermont, the growth is heavily driven by the marketing of mi-



cro captives. This is positive in that it is spreading the use of captives down to smaller private companies, but the question remains whether these formations are long-term captives, as if a tax election is changed, is their *raison d'être* gone? The other driver in many states is a push to 'home state' regulation to minimise the possibility of states applying self-procurement taxes.

**Hodson:**  
Captives now represent somewhere between 30 and 40 percent of the commercial insurance market

**Hodson:** I believe that you need to look behind these reported numbers and assess the behaviours and motivations for establishing a captive. As companies face double-digit rate increases from their tra-

ditional insurance carrier, naturally they are going to seek alternatives for transferring risk. That said, I get the sense that some of the reported growth in numbers of new captives established in certain domiciles is associated with micro captives where the primary motivation is wealth transfer or tax savings, rather than risk transfer. This is a segment of the market that is not being driven by the hardening or softening of insurance pricing. So, what we think of as the true driver of interest in captives, ie, companies seeking an alternative to the traditional insurance market, may not necessarily explain the reported numbers of new captive entities.

That being said, as interest increases in these micro captives, so will the regulatory scrutiny. If a captive, regardless of the size, does not transfer sufficient risk, for an actuarially justified premium, it is not a true insurance entity.

**Oliveras:** Many US companies are using a captive to leverage negotiations for better pricing and coverage. Companies are also seeing the beginning of the hard market and are investigating the alternatives so they will be ready. The uncertainty of taxes and the economy in the US is also driving some to look at captives as an alternative.

New group captive formations have remained slow, but activity and interest is picking up in this sector. Also, large organisations will look to their captives to fund for and cover ever more com-



plex enterprise risk. Lastly, 2012 saw significant growth in micro captives with US domiciles such as Delaware and Utah.

## Kehler: Many of the newer exposures such as cyber risk or nano-technology are great risks for a captive company

**Kehler:** There has been steady growth in the global captive industry since the 1950s. With creativity and innovation, what was once the province of the Fortune 500 is now within the reach of the medium and small companies. Captive growth will continue as more ways are developed to build on the fundamental structure of the traditional captive company, and to make it available to smaller companies and high net-worth individuals.

**Kinion:** More companies are turning to alternative risk transfer vehicles. One reason is that a

vehicle allows a company to fill gaps in existing insurance coverage. What I often find is that business owners notice the exclusions in their insurance policies. When the business owner identifies the exclusions, it must make a decision of whether to address the exclusion, or do nothing. If the owner decides to address the exclusion, it can try to find a different insurer in the admitted market or seek coverage via a surplus lines company. The owner can also look to alternative risk transfer in the form of a captive insurer in the non-admitted market. When properly used, a captive insurance company can help the owner fill the gaps created by exclusions, maximise the risk management, and control claims, as well as accumulate surplus to cover unforeseen risks.

## How are emerging risks, such as cyber, driving growth?

**Kehler:** Many of the newer exposures such as cyber risk or nano-technology are great risks for a captive company. Traditional insurers are not comfortable with some of the exposures and using a captive to fund a layer of risk or to access the reinsurance market can make managing the risk affordable.

**Oliveras:** We have not yet experienced significant growth due to cyber risk or emerging risks. Some captive owners are expanding the insurance portfolio to cover cyber risk and other

emerging risks, but overall, it has not driven significant growth industry-wide. A recent AIG survey revealed that more than 70 percent of C-Suite participants cited cyber risk as a major threat to their business' survival. We expect a move toward funding for this risk through captive vehicles and programmes.

**Alan Kandel:** An area of growth for captives is employee benefits. This area of coverage for captives is proven more difficult since employee benefits are controlled by the human resources department of companies. In addition, in the US, the Department of Labor must grant approval to include employee benefits and is subject to Employee Retirement Income Security Act guidelines.

With the Patient Protection and Affordable Care Act (PPACA) taking effect, companies will be forced to look for healthcare care options, which may include adding this coverage to the captive. One example is that hospitals have been hiring doctors, who were previously self-employed, to work as employees, which adds additional liability risks going forward. Many healthcare captives or RRGs already include medical malpractice, but the sheer number of new physicians will increase the risk level, administrative support and risk management requirements.

Cyber risk has become more common with identity theft alone estimated to cost consumers roughly \$5 billion and companies about \$50 billion each year. Captives must work to understand their exposure to these risks and evaluate their approaches to mitigate the risk within the framework of their enterprise risk management programmes.

**Hodson:** This question gets back to my earlier point on lack of innovation within the traditional insurance market. One of the most exciting trends I'm seeing in the captive insurance market is in the area of emerging risks. First, understand that every company faces risk that cannot affordably be written by the traditional insurance market. Captives can be an ideal vehicle for covering such risks.

For example, the standard business interruption policy will respond only if there is actual damage to the policyholder's property, which causes the interruption of business. After Hurricane Sandy, I heard many complaints from companies along the Connecticut coast that their interruption policy did not respond to their loss of business because there was no physical damage, but they were without power for a week, which caused a loss of business. Companies are turning to captives to creatively cover real risk that they cannot cover, or cannot affordably cover, in the traditional insurance market.

More excitingly, however, is how companies are using emerging risk to help justify the cost of a captive for their other, more traditional insurance needs. For example, the premium many companies pay for work comp, general liability and property insurance may not be enough to justify the cost of a captive. But, when you add the premium for cyber liability or broader busi-

ness interruption coverage, captives become an affordable alternative to the traditional insurance market.

**Kinion:** Emerging risks are significantly driving growth. What I am finding is that captive owners favour using a captive insurance company to insure emerging risks because a captive allows the owner the flexibility to tailor insurance coverage. Imagine yourself as a business owner facing the following challenges in regard to emerging risk. First, many of these risks are deemed to be potentially significant, but are not fully understood. Second, the consequences of these risks cannot be fully defined. Third, because they are emerging risks, projecting their relative frequencies, their probability distributions, and severity is difficult. Finally, often these risks are outside of the business owner's control, such as economically systemic risk.

The internet-based business world offers tremendous advantages—many remaining to be seen in future years. On the other hand, this world creates risks few considered a mere decade or two ago. Today, we have to consider risks involving the theft or exploitation of private information such as health records. There are computer viruses that damage and destroy data, as well as the risk of computer fraud. The occurrence of these risks can result in significantly disrupting the operations of a business.

## Kinion: When discussing captives, these companies seek the economic advantages of reducing insurance cost while improving cash flow

**Osborne:** Cyber risk is rarely the driving programme behind a captive formation. If a captive makes sense in the overall risk management strategy, then cyber risk is almost certainly a line that will be considered. Other emerging risks are regulatory action (US SEC, medical privacy, etc), supply chain, and medical stop loss.

The uncertain environment surrounding PPACA is driving interest in any viable alternative to the exchanges, penalties and mandatory state coverages companies may be faced with.

## What are US companies—of all sizes—saying about captive insurance when they discuss it with potential managers and other service providers?

**Hodson:** Companies of all sizes can use risk management and captive insurance vehicles to

implement strategies and manage their destiny in the complex business environment and erratic insurance market place. A good example is employer initiatives responding to the impacts of PPACA, or 'ObamaCare'. One of the most frequent questions I get from employers is whether a captive can be utilised to manage the financial effects and compliance obligations under the new law. The answer is yes. I'm currently working with a number of companies that are interested in satisfying their PPACA obligations through a combination of self-insurance and stop-loss coverage. In fact, we have a turnkey solution in development that we expect to be a perfect solution for middle market companies wishing to offer to healthcare coverage to their employees and satisfy their obligations under PPACA.

**Osborne:** The proliferation of micro captives has been both a blessing and a curse. There is a certain knowledge of captives in a much broader swath of the market, but also perhaps a distrust of the 'over-selling' of them as tax vehicles. Prospects want to know the tax consequences, but there are also a lot of questions concerning capital and collateral and the costs involved, and how can the benefit of a captive be measured. The self-procurement issue comes up much more frequently, as does how to maximise the return on the parked assets in a captive.

**Oliveras:** Captives provide an alternative to the traditional market. Risk managers are increasingly aware of the opportunities that a captive can provide in leveraging renewal negotiations and expanding coverage. Also, companies that are exploring a captive understand the need to control their financial/operational/enterprise risks, costs and how these are managed.

Companies will also look to fill the coming gaps in health insurance and other benefits. Group captive stop-loss programmes may be an effective fix to the exploding cost of medical insurance. Self-insurance alternatives including captives may help companies cope with expanding regulations and the potentially devastating cost of non-compliance.

**Kinion:** When discussing captives, these companies seek the economic advantages of reducing insurance cost while improving cash flow, minimising the volatility of cycles in the insurance market, controlling risk through better claims management, having flexibility in underwriting, and having access to the reinsurance market. They also consider the tax advantages of owning a captive insurer.

## The NRRA has been clarified to a certain extent—how would a complete clarification affect US captives?

**Kehler:** A complete clarification removes any uncertainty and concern from the marketplace. It allays any concerns over having to pay additional costs for surplus lines taxes or self-procurement taxes and lends comfort to the captive owner that it can leave its captive in the domicile of its choosing.

**Dranchak:** The good news is there have been comments and opinions in print by several former government officials that the Non-admitted Reinsurance Reform Act (NRRA) does not apply to captives. The bad news is there is still no clear official statement as to whether the tax would apply to captives that are not in the parent companies' home domiciles. Some companies are being proactive by either forming captives or re-domesticating to their parents 'home state' where they may only be taxed once. For captives that don't want to move from their existing domicile, they are taking the same risk using reinsurance sold to a fronting captive that is domiciled in their 'home state'.

## Dranchak: The bad news is there is still no clear official statement as to whether the tax would apply to captives that are not in the parent companies' home domiciles

**Kinion:** The ambiguity surrounding the NRRA's application to captive insurance creates uncertainty. Business owners do not like uncertainty because it creates factors such as doubt, skepticism, and a lack of confidence. When a US company can better and more efficiently utilise its capital by using a captive insurer, then that is good for the US economy. By clarifying the NRRA, we can help grow the economy.

**Oliveras:** When the NRRA first came up it placed a lot of uncertainty in some peoples' minds about the captive industry and where to domicile their captive. Complete clarification would provide some level of certainty to captive owners about self-procurement tax issues so they can make the decision about where best to domicile based on factors other than cost. There are 35 states with captive laws, but only a small number that have made a serious commitment to regulation and staffing.

During 2012, some captive owners re-domesticated to the state where their parent operates in order to reduce cost and provide certainty about liability for self-procurement tax. Notwithstanding the cost of re-domestication, some captive owners have now relocated to jurisdictions with less robust regulatory regimes.

**Hodson:** I'm not sure we can say that it has been clarified to any extent. The former Chair

of the Congressional Sub-committee that developed the NRRRA, Judy Biggert, and Congressman Scott Garrett of New Jersey, have indicated that the law was never intended to apply to captives. While these statements are a very important step toward clarifying that the NRRRA does not apply to captive programmes, they do not carry the weight of law. The ambiguity in the law will only be settled by either an amendment to the NRRRA, or judicial action. Certainly, Biggert's and Garrett's comments will carry great weight in the final disposition of this issue.

Connecticut, as a captive domicile, has seen significant interest from local companies considering re-domesticating their captives to the state. One of the reasons given, obviously, is the risk that the NRRRA will be applied to captives. However, as I understand it, this issue is not a top driver of their interest in Connecticut.

All that said, clarifying whether or not the NRRRA applies to captives is very important. Therefore, the Connecticut Captive Insurance Association announced in early January that it was joining the Coalition for Captive Insurance Clarity, which was formed recently under the leadership of the Vermont Captive Insurance Association to seek clarification on this issue.

**Osborne:** As much as I would like to say that the comments on the NRRRA change anything, they do not. The issue of self-procurement taxes is still out there and all the noise about the NRRRA ignores the fact this issue was always there and the NRRRA just brought it back to states' attention that captives may be subject to some other taxes than just their domiciliary states.

### What other regulations or initiatives are US captives looking at in 2013?

**Oliveras:** PPACA is prompting captive owners to look at all possible alternatives for their medical insurance and other employee benefit plans. Also, hospitals and health plans will use their captives to support alternative care organisation's and physician group acquisitions. Group medical stop-loss for mid-market companies with self-insured plans are also emerging.

PPACA is also prompting healthcare providers and service providers to the healthcare industry to look to alternative risk vehicles for professional liability coverage. As these structures emerge they will also require services that mitigate medical negligence claims and address patient safety, which is an element of healthcare delivery that is intensifying in the country. We have business partners that help us deliver these services to our clients.

**Kehler:** Securitisation captives in the US are being scrutinised by the National Association of Insurance Commissioners (NAIC), RRGs are having to deal with risk-based capital standards, and I'm sure the Federal Insurance Office will want to look at captive insurance companies

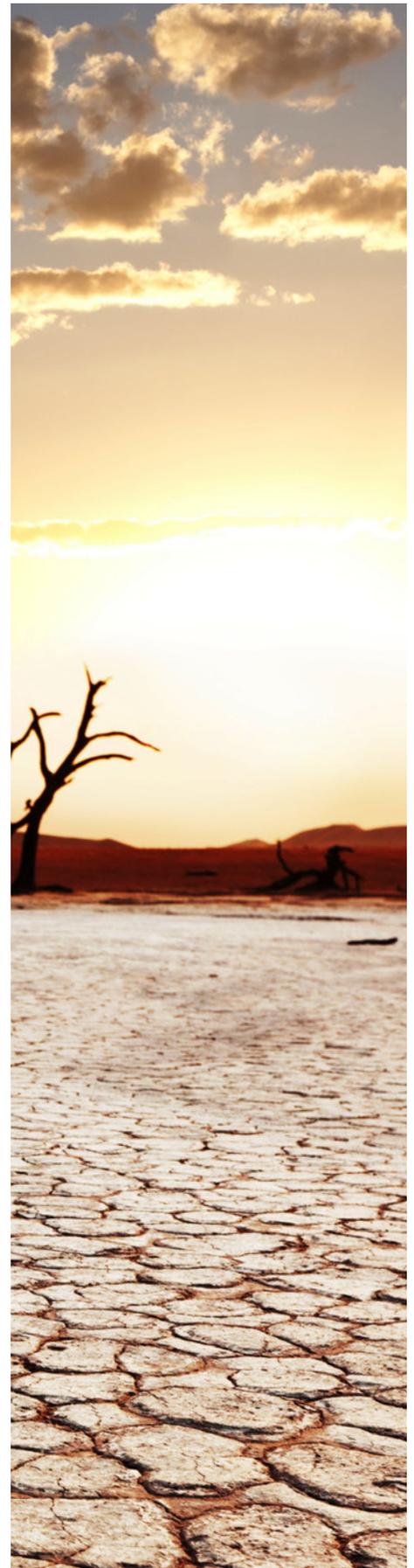
somehow. Regulatory creep is a major concern going forward. Captive owners need to be vigilant and work with their regulators and the various regulatory bodies to ensure reasonableness is not left out of the regulatory environment.

## Oliveras: When the NRRRA first came up it placed a lot of uncertainty in some peoples' minds about the captive industry and where to domicile their captive

**Kinion:** The captive industry should monitor the activities of the NAIC Captives and Special Purpose Vehicles Subgroup. This sub-group is studying how insurers use captives and special purpose vehicles to transfer insurance risk. It may recommend new regulatory requirements to address concerns that are identified in this study. The new regulatory requirements may involve modifications to existing NAIC model laws and/or generation of a new NAIC model law, which may ultimately become the laws and regulations implemented in a number of states.

**Hodson:** In the wake of Hurricanes Sandy and Irene, as well as the October snowstorm of 2011, many in Connecticut's state government are concerned about the increasing cost of catastrophes and their impact on businesses around the state. The Connecticut Captive Insurance Association has been working with John Thomson, program manager for captives at the Connecticut Insurance Department, to develop captive solutions in the state that will allow companies to affordably bear more of the risk of loss from a catastrophe.

**Osborne:** The NAIC looking at 'triple X' captives is a concern because the law of unintended consequences could apply if the NAIC starts creating rules on captives. There is still more movement on the laws on cell captives, but I am not convinced that tying a pretty bow on cells and calling them something else is anything new. There is also anecdotal evidence that the IRS is looking hard at some of the micro captives, especially where they are 'investing' in life insurance. This review could be a damper on the spread of these programmes. **CIT**



## Industry appointments

Barclays Wealth and Investment Management division in Guernsey has hired **Colleen McHugh** as a captive investment manager.

McHugh has moved to Guernsey from Bermuda where she worked as a private banker within the captive, insurance and reinsurance markets.

Commenting on her appointment, McHugh said: "I'm looking forward to meeting new clients; developing trusting relationships and helping them find the right investment solutions. Over the years I have learned that listening to my clients and truly understanding their business is key."

"Captives have unique investment requirements and it's important that companies talk to advisors with relevant experience in the sector so that appropriate solutions are found for their clients."

Ken Bradley, director at Barclays Wealth and Investment Management in Guernsey said: "I'm pleased to welcome McHugh to our team here in Guernsey. Her experience within the captive insurance market will be a key enhancement of Barclays offering and will ensure that we continue to meet the specific needs of our clients in this sector."

In November 2012, Barclays named **Simon Phillips** as head of captive insurance, based in Jersey.

SPARTA Insurance Holdings has appointed **Ralph Jones III** as CEO and **Brian First** as president and COO.

Jones joined SPARTA as president in September 2012. Prior to joining SPARTA he worked for various firms in the insurance industry, including Chubb and Arch Insurance.

First was a member of the initial management team responsible for launching SPARTA in 2007 and previously held the roles of executive vice president and chief underwriting officer.

George Estes III, who will continue to serve as SPARTA's executive chairman, said: "I am pleased to be able to pass the torch to these two highly talented executives. We have an experienced team in place dedicated to the programme and alternative risk insurance market, and I look forward to working closely with Jones and First as we continue to build enterprise value."

Marsh has appointed **Greg Larson** as head of its Dallas office. Larson succeeds **Kristine Meuse**, who has been appointed Marsh's central zone risk management leader. He will report to Stephen Skeeter, Marsh's south central partnership leader.

Larson—who joined Marsh in 1993—previously held the role of south central partnership risk management leader at Marsh where he worked with some of the firm's largest clients in Texas, Louisiana and Oklahoma.

Skeeter said: "Larson's consistent track record as a strong client advocate, including his experience in delivering effective risk management solutions to our clients in the Dallas-Fort Worth area, make him an ideal candidate to lead our Dallas office."



Commenting on his appointment, Larson said: "Marsh's Dallas office has a strong history of assisting clients in developing robust risk and insurance programmes to support their strategic objectives."

"The ability to better define risk, design effective solutions to mitigate risk, and deliver exceptional results on those strategies is the cornerstone of our mission to help clients, and I'm delighted to be leading the Dallas office in this effort."

JLT Reinsurance in North America has hired **Mark Maxson** as executive vice president to grow its West Coast operation.

Alastair Speare-Cole, head of JLT Re's global operation, said: "Maxson will expand JLT Re's reinsurance treaty business in the western region of North America and will be based in our recently launched San Francisco office."

"As we continue to build out our North American platform, this appointment demonstrates our commitment to clients in the region and our continued growth strategy from a treaty and programme perspective."

Prior to JLT Re, Maxson worked for Willis Re in the production and servicing of property and casualty reinsurance, including workers' compensation, medical malpractice and risk retention groups.

Craig Darling, president and CEO of JLT Re in North America, said: "Maxson brings a wealth of experience in the medical and workers compensation reinsurance business that strengthens our capabilities for our clientele. We are excited by his arrival and look forward to working with him in expanding our Western Region footprint."

It has been reported that **Raymond Farmer** has been confirmed by the South Carolina Senate as director of the department of insurance.

South Carolina governor Nikki Haley appointed Farmer to the role on 13 November 2012.

Farmer served as the deputy insurance commissioner of the enforcement division for the Georgia Department of Insurance and more recently as the vice president for the American Insurance Association. **CIT**

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