



Argument erupts over 'misleading' excess captive revenue

DELAWARE 03.09.2012

The Delaware Department of Insurance commissioner Karen Weldin Stewart announced the transfer of \$250,000 in excess captive revenue to the city of Wilmington, a statement that has been denounced by a political opponent as misleading to voters.

The department's captive bureau, which was formed in 2009, has seen Delaware experience an 800 percent growth rate in the number of licensed captive insurance entities.

The bureau generated more than \$1.2 million in tax revenue in 2011, more than double what it generated in its first year of existence.

Under state law, the Delaware Department of Insurance's commissioner is able to transfer excess revenue that the captive insurance bureau has earned

from licensing and administering captives to the city of Wilmington through the secretary of state.

Stewart said: "In 2009 when I started the captive bureau, we had 38 captive insurers. At the end of 2011 there were 338 captive risk bearing entities that generated nearly \$1 billion of insurance premium. I attribute this growth to innovative designs in alternative risk transfer that maximise the power of the Delaware's corporate and business entity laws."

But Mitch Crane, a Democratic candidate for the position of Delaware insurance commissioner, said that the surplus is a "budgeting gimmick" that is intended to distract voters from \$1 million in no-bid contracts for her political supporters.

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Farmers Mutual Relief Association gets rated

Financial analysis firm Demotech has assigned Farmers Mutual Relief Association (FMRA) a financial stability rating (FSR) of "A, Exceptional".

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Grayson-Carroll-Wythe is 'A Prime'

Demotech has affirmed the financial stability rating (FSR) of Grayson-Carroll-Wythe Mutual Insurance Company as "A (A Prime)".

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A statement from his campaign said: "During the first three years after the creation of the captive bureau in 2009, Commissioner Stewart awarded no-bid contracts totaling over \$1.7 million to hire three individuals. One of those contracts totaling \$196,080 per year was awarded to Steve Kinion, who donated more than \$2,000 to the commissioner's 2008 political campaign. Kinion was contracted as director of the Delaware captive bureau despite the fact that he lives and maintains a law practice in Springfield, Illinois."

"With the recent non-renewal of two of the three no-bid contracts, over \$370,000 was freed up from the captive bureau. Commissioner Stewart had contracted with Ed Iani for a whopping \$196,000 a year and Mary Jo Lopez for \$174,000 a year, from FY 2009 through FY 2011, but their contracts were not renewed for FY 2012; leading to the alleged surplus."

Crane said: "The current commissioner is engaging in budgetary gimmicks in order to distract voters from her failed record and anti-consumer policies. The fact of the matter is, she has dumped millions of dollars in no-bid contracts into the captive bureau, which only serves the interests of corporations, while allowing constituent complaints to go unanswered due to an understaffed office of constituent services."

Stewart and Krane will face each other on 11 September in the Democratic primary.

Crane added that if he is elected, he will "terminate the exorbitant, six-figure contracts for the current commissioner's political backers".

Grayson-Carroll-Wythe is 'A Prime'

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Grayson-Carroll-Wythe is a progressive mutual insurance company in the US State of Virginia, with a history of service dating back to 1896. It specialises in offering coverage for homes, rental dwellings, farm buildings, churches and small businesses across the state.



GCW Mutual Insurance Company has been awarded the "A (A Prime)" level of FSR because it has maintained positive surplus, liquidity of invested assets, realistic pricing and an acceptable level of financial leverage.

Farmers Mutual Relief Association gets rated

Continued from page 1

FMRA is an assessment mutual insurance company whose products include standard fire, homeowner, farm owner and agri-business policies. It provides insurance and services to its policyholders, who also own the company. They are "fairly priced and comparable services to meet the individual needs of all its members," said FMRA in a statement.

FMRA has been rated as "A, Exceptional" because of its good financial stability. It has maintained positive surplus as well as liquidity of invested assets, acceptable levels of financial leverage, reasonable loss and loss adjustment expense reserves and realistic pricing.

Connecticut receives \$107 Million federal grant for healthcare

The Connecticut Health Insurance Exchange has been awarded a \$107 million grant from the Center for Medicare and Medicaid Services.

Connecticut is the sixth state to receive a Federal Level-Two Establishment Grant for the creation of a state health exchange under the Patient Protection and Affordable Care Act.

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Learn more about what makes South Carolina the ideal domicile for your captive insurance program at www.doi.sc.gov.



Connecticut's governor, Dannel Malloy, said: "The Affordable Care Act, which has unnecessarily become a political punching bag, has one noble, overarching goal: to expand access to more affordable healthcare to nearly every American."

The act makes it possible for states to operate public health exchanges. They act as market-places where US citizens can buy health insurance from participating providers.

The federal grant will fund the implementation of Connecticut Exchange operations, IT systems, and communication and outreach.

"After a year of hard work developing our own state-based exchange, we are one step closer to that goal. This latest grant reaffirms our commitment and readiness to implementing this innovative new way for state residents and small businesses to access affordable health insurance."

In June, the US Supreme Court upheld the 'individual mandate' requirement of the Affordable Care Act as constitutional, after 13 US states challenged its legality.

The court found that the 'individual mandate', which requires US citizens to either buy insurance or face a fine, falls within US Congress's constitutional power to levy taxes.

In a recent blog post, risk management firm Surgical Excellence said that the Affordable Care Act will have significant implications for health insurers.

It said: "Health insurers, faced with shrinking member enrollment and now mandated to spend 80-85 percent of the healthcare dollar on actual clinical care, will be targeting the spending of those dollars on value-based-purchasing: reimbursing care that achieves quality outcomes efficiently."

ProSight and Artex Risk release warehouse insurance programme

ProSight Specialty Insurance Company and Artex Risk Solutions have launched a new specialty programme for third party logistics that is available to brokers and qualified retail agents across the US.



The warehouse and logistics insurance programme sees Artex partner with ProSight. The new programme will offer coverage for property, general liability, warehouse legal liability, cargo legal liability, automobile liability and umbrella liability coverage.

ProSight has \$1 billion in assets and \$200 million in surplus, and it focuses on niche markets where it has differentiated underwriting and claims expertise. Ratings agency A.M. Best has rated the company as "A (Excellent)".

"Warehouse legal liability coverage requires unique insight into the risks faced by the third party logistics industry," said Michelle Sipple, programme executive at ProSight.

"Typical policies purchased by warehousing customers don't address the unique needs of each customer's operation. ProSight's programme is designed to address this shortfall with a comprehensive product and by limiting distribution to only two partners who have a demonstrated expertise in the business."

Chemical reinsurance captive is A-okay

A.M. Best has affirmed the financial strength and issuer credit ratings of Dorinco Reinsurance Company. Its financial strength rating has been affirmed as "A (Excellent)" and its issuer credit rating has been affirmed as "a". The outlook for both ratings is stable.

Dorinco is the captive reinsurance company for The Dow Chemical Company, an American multinational chemical corporation. Dow chemical is a provider of plastics, chemicals and agricultural products to around 160 countries worldwide.

Incorporated in 1977, Dorinco is a fire and casualty insurance company that is based in the US State of Michigan.

The rating affirmations "reflect Dorinco's historically strong operating performance, balanced risk profile and strong risk-adjusted capitalisation".

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A.M. Best said: "The ratings also consider Dorinco's strategic importance within the Dow organisation and Dorinco's successful mitigation of Dow's worldwide, long-tail and volatile risks through its short-tailed uncorrelated third party reinsurance business."

Partially offsetting these positive rating factors is "Dorinco's limited profile in the reinsurance market, which is a function of its hybrid captive nature. Another offsetting factor is Dorinco's exposure to Dow's risks, many of which are worldwide and either natural catastrophe-exposed or long tail in nature," said A.M. Best.

In spite of these factors, A.M. Best said that Dorinco is well positioned at its current rating level.

FiscalReps expands to meet growth

Global tax compliance business FiscalReps has relocated to larger offices due to growth in its business.

The new office, which is located in Farnborough Business Park, opened for business on 6 August.

Mike Stalley, FiscalReps's chief executive, said: "Our choice of office location was deliberate. The growth in business meant we had simply run out of room at our previous offices. Moving to the new offices at the Farnborough Business Park more than doubles our available space, meaning we can grow the business to meet

continued client demand and expand the team beyond the existing staff of 30 people."

"Moving to Farnborough allows us to keep our head office outside of Central London while ensuring good access to transport hubs, which allows us to easily visit our clients both in London and overseas."

White paper addresses growing insurance collateral challenges

A new white paper from Lockton has sought to address ways of coping with insurance collateral challenges.

Gary Shertenlieb, Lockton's senior vice president in risk finance, discussed the three key problems and alternative solutions in the paper, 'Dulling the Pain of Collateral.'

"The renewed focus on capital preservation has attracted greater internal scrutiny of collateral posted to support insurance programmes," said Shertenlieb.

He stated the first obstacle was some insureds dealing with changes in credit lines and borrowing/letter of credit rates. The second challenge Shertenlieb attributed to insurance carriers underwriting their credit exposure to their insureds more stringently.

Finally, he stated that carriers have been actively monitoring their credit concentrations to the banks and financial institutions that are providing collateral on behalf of their insureds.

"Alternative collateral strategies can make a significant impact on the efficiencies and cost-effectiveness of a complex insurance programme. By understanding that the insurance placement is truly a utilisation of capital, we work with our clients to deliver creative, value-added solutions in challenging economic times," said Shertenlieb.

VICO outlook revised to positive A-

Standard and Poor's (S&P) has revised its outlook of Volkswagen Insurance Co (VICO) to positive from stable as well as affirming its "A-" ratings.

The ratings revision comes after S&P confirmed that, under its criteria, VICO qualifies as a captive insurer of parent company Volkswagen AG (VW).

On 27 August, S&P revised its outlook on VW to positive from stable and affirmed the "A/A-2" ratings, meaning that the ratings of VICO now move into step with those of VW.

S&P has further stated that it may raise its rating of VW over the coming two years if "the group's profit measures remain strong in the face of more challenging macroeconomic conditions and if credit ratios remain at the higher end of the "modest" category despite high capital expenditures."

As VICO now qualifies as a captive insurer, its ratings will reflect those of VW.



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Captive management in the Isle of Man

CIT talks to Ross Dennett of Thomas Miller Risk Management in the Isle of Man about the island's offering, risk management needs and Solvency II

MARK DUGDALE REPORTS

Why do companies go to the Isle of Man for their risk management needs?

The Isle of Man is a world-class centre for offshore finance. There are several reasons why the Isle of Man has been a popular captive domicile over the years. Some of the key reasons are:

- The Isle of Man is situated in the heart of the British Isles and is therefore within easy reach of major financial centres in the UK and Europe. It is one of the longest established and best respected offshore financial centres
- It has a highly experienced supervisor in the Insurance and Pensions (IPA) that is approachable and responds swiftly. The IPA is committed to the continued development of an appropriate and up-to-date regulatory framework and was one of the first domiciles to introduce legislation allowing captive insurance companies from other territories to re-domicile to the Isle of Man without being liquidated in the original territory
- The island has been on the OECD white list since assessments were released, and holds an AA+ Standard and Poor's rating, which in the current global context is most certainly a factor
- Isle of Man insurance companies are subject to income tax at a rate of 0 percent.
- The island is politically stable. As a crown dependency, it is not part of the UK, but its foreign relations and defence are the responsibility of the UK government
- It has its own legal system, Manx law, which is based on principles of English common law
- It has competitive capital requirements, which are significantly lower than domiciles that are based within the EU.

Sitting outside of the EU prevents an Isle of Man captive from direct writing within the EU. Some companies view the associated additional fronting costs as a deterrent and choose to either re-domicile or establish another captive within the EU, however on the flipside, capital requirements are significantly lower in the Isle of Man.

Despite soft market conditions and financial market volatility, the island has continued to be successful at attracting new business. Total assets of £55 billion and annual premiums of £10 billion at the end of 2010 represented year-on-year growth of 17 percent and 36 percent respectively.

What sorts of captives do you manage?

Thomas Miller manages all sorts of captives, ranging from privately owned broking businesses

to multinational companies. We currently manage 10 captives, as well as various mutual insurance companies. They are typically domiciled in the Isle of Man, but, subject to appropriate regulatory criteria, we do occasionally manage companies in the Isle of Man that are domiciled elsewhere.

How have the risk management needs of captives in the Isle of Man changed in recent times?

Unsurprisingly, there has been an emphasis and a constraint on companies through costs, cash and capital in recent years. There has also been an increasing focus on risk management and governance, which was the key theme within the recently introduced Corporate Governance Code (CGC). The CGC is a very significant development in the Isle of Man's regulatory framework and is pivotal to our ability to continue to demonstrate compliance with international standards.

Rather than in response to the presence of any perceived systemic risk or governance issues within the Isle of Man, the CGC seeks to apply a standard set of rules across the insurance industry. While the captive sector is generally considered to be at the lower end of that risk spectrum, there are no carve outs for the captive sector and the code is applied across the board. It is obviously in the broader interests of the Isle of Man for companies to demonstrate to the wider world that the sector complies with the code. It is important to note that in many aspects, current practice was already compliant with the code. Typically, managers have undertaken an appropriate gap analysis to flag improvement areas. The positive way in which the local insurance industry has reacted to the CGC demonstrates its maturity and expertise.

How focused are captives on risk diversification as a means of ensuring financial stability?

Nearly all of the captives that we manage limit the business written to their own operations, as opposed to third party business. Selection decisions tend to relate to the extent that the shareholder and the captive board are comfortable retaining greater risk rather than transferring it into the conventional market. Market rates naturally influence that decision-making process.

What is the situation with Solvency II in the Isle of Man and how do you expect it to affect your offering and the captives that you manage?

Unlike other leading captive jurisdictions, the regulator has consistently stated its position on Solvency II. It continues to monitor the development of Solvency II and its implications for the island in conjunction with the Isle of Man government and the insurance market. Their view remains that it would be premature for the island to commit to seeking Solvency II 'equivalence' at this stage.

Regulation in the Isle of Man is closely aligned with the guidance that is provided by the International Association of Insurance Supervisors and its core principles, which is a gold standard for insurance supervision. The IPA has created a regulatory framework for captive insurance that is robust and tailored for the size and complexity of the insurance operations, while maintaining sufficient supervision to protect policyholder interests and the reputation of the island.

Implementation of the EU directive will require considerable enhancement in the regulatory framework of most European insurance regulators and attaining an equivalent position for the island would also entail significant initial and ongoing investment in resources, both for the regulator and the island's insurance market. There are undoubtedly various twists and turns still ahead but the most obvious factor is the cost that is associated with achieving compliance with Solvency II, as well as the capital requirements. Captives are relatively simple business models and we may find that some captive owners feel that applying Solvency II principles and the associated costs are unnecessary and excessive. They could well decide to re-domicile their captives elsewhere. **CIT**



Ross Dennett
Director
Thomas Miller Risk Management Isle of Man

Firm but fair

South Carolina is continuing its reputation as a conservative state with a penchant for healthcare, as CIT finds out

GEORGINA LAVERS REPORTS

After an initial spurt of growth in 2000, the Palmetto State, named after South Carolina's palmetto tree, has settled into its niche of domiciling conservative captives.

The state is the fourth-largest US captive domicile and 12th-largest worldwide, according to recent industry rankings, with a captive insurance law passing in 2000 and risk retention groups (RRGs) governed by the captive act.

"South Carolina passed captive legislation in 2000, and grew very quickly from 2001 through 2005," comments Paul Newton, senior vice president of USA Risk Group (South).

"The captive formations levelled off for the next few years, as the domicile became a bit more conservative and started to focus on certain types of captives."

"While they licensed a fair number of entrepreneurial captives in the early years of the domicile, they tend to steer away from producer driven programmes, and focus on pure captives and other captive forms where the insureds have control over the captive's operations. More recently, South Carolina has shown moderate growth, with a focus on quality."

The state has licensed other captives covering a number of industries including healthcare and elder services, real estate, commercial automobile, construction, banking and financial services, and shipping/transport and logistics.

Coverage includes workers' compensation, general liability and umbrella, medical malpractice and professional liability, business interruption, property, DIC, premises and event liability, terrorism, environmental/pollution clean-up, employment practices, D&O, and fidelity and surety.

Approximately 40 percent of the captives that have formed in South Carolina are healthcare related.

Jeff Kehler, programme manager at the South Carolina Department of Insurance, says: "Since 2000, the industry has grown to more than 160 active companies across a widely diverse industry spectrum."

The commissioner of the South Carolina Department of Insurance has regulatory authority over captive insurers. With a dedicated staff of 11 employees and the use of outside examination firms, the department is able to regulate captive insurers from regulatory compliance to on-site examination.

"With 11 employees who are dedicated to the industry on a full time basis, we are well equipped to provide a regulatory environment that is pru-

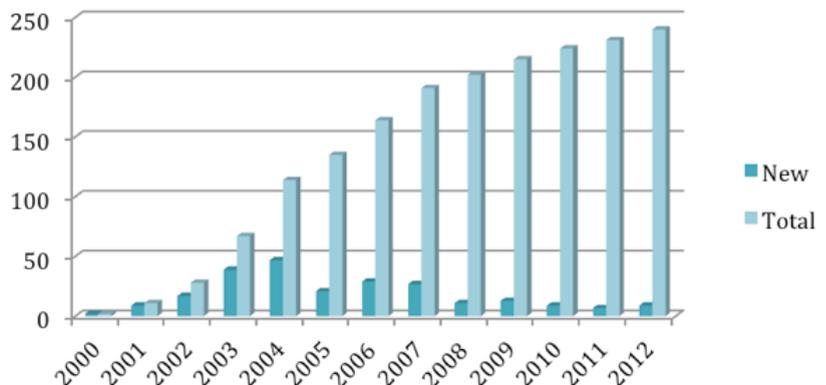
dent but conducive to the growth of the industry in the state," says Kehler.

"South Carolina itself is a beautiful state that has a climate that encourages outdoor activity 12 months out of the year. With a well developed infrastructure, all of the service providers a captive insurance company needs are here in the state. Every discipline has a captive practice."

Specific advantages of basing a captive in the state include the permission of direct insurance, including all commercial lines and excess workers' compensation insurance and reinsurance.

Policy forms are not required to get approval from the insurance department, except for reciprocals and certain designated lines, and there are few investment restrictions for pure captives.

Total Growth as of 29 Aug 2012



As to downsides in setting up shop in the Palmetto State, Kehler jokes: “The only downside to putting up a captive in South Carolina is if the board of directors like to snow ski. We struggle to provide snow skiing as an activity.”

development authority created the South Carolina Insurance Funding Programme, which was aimed at stimulating life captives that are owned by insurers and were considered to be too small to go through traditional securitisation routes.

terested in looking into how they are structured, and if they meet the various tests to qualify for insurance treatment under the tax code.”

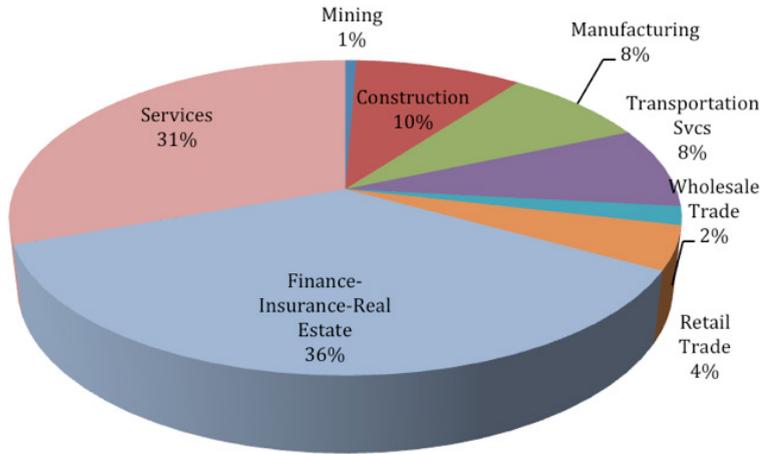
Solvency II is another important issue, as the regulation pertaining to European captives may have a knock-on effect for the US. Kehler agrees that there may be trouble for domiciles seeking equivalency. “There have been conflicting articles on this issue as some have stated little change in capitalisation will be required, others have said additional capitalisation as high as 300 percent will be required for some captives. This high degree of uncertainty has caused some captive owners to redomicile their captives, and not wait around for the answer.”

“General economic conditions can impact captives as well. The slow economic recovery and tight financial markets can produce challenges for the captive industry. For example, letters of credit used for capitalisation may be less attractively priced, or terms may be more restrictive. With interest rates being quite low, it is difficult for captives to generate investment income which could impact some captives that are relying on investment income to a substantial degree. Both of these issues may drive captive owners to rethink their plans of operation and how effectively the captive is utilising its capital.”

Newton adds that alongside tremendous growth in the number of 831(b) (small insurance company) captives in various domiciles, there is bound to be growing scrutiny on risk distribution and types of coverage being insured through these vehicles. “South Carolina has continued to monitor this and prudently regulate what risks are insured through captives they regulate.”

However, Kehler is resolute that overall, the captive industry is doing remarkably well in a challenging time. “New formations are up in almost every domicile around the world,” he concludes. “This demonstrates the resilience of the industry and the value captives provide in risk management and financing.” **CIT**

Active Companies by SIC Code



Doing things differently

“There are generally three questions new captive owners are interested in,” says Kehler. “How long does it take to get a license approved; how quickly can I get a business plan change approved; and how expensive and time consuming are the financial examinations?”

“This is where a mature domicile like South Carolina can really respond well to the captive owners. We have worked with the industry to establish time lines and standards so they know what to expect. Our goal is to consistently beat those timelines.”

He adds that the state has continued to refine its policies and procedures to ensure compliance with National Association of Insurance Commissioners (NAIC) accreditation standards; and for those captives that are not NAIC filers, the insurance department has refined its procedures to make it easier for the managers to file the annual reports, while ensuring that it is capturing the right information to fully understand what is going on with the company. “Our financial reviews are rigorous,” he states, “but adapted to the type of captive company.”

Newton agrees that South Carolina has streamlined the examination and business plan change processes. “For examinations, they utilise contract examiners in some cases, and control the time and cost of examinations. For business plan changes, they have an analyst designated to handle all change requests, and monitor the response time. This has provided a vast improvement over the response time from previous years.”

Though it may be conservative in its captive choices, the state has proved unique in its creation of an alternate funding source to attract captive insurers that are finding it tricky to access capital markets for traditional securitisation deals.

In March 2011, a collaboration between the state’s captive insurance market and economic

NAIC road bumps

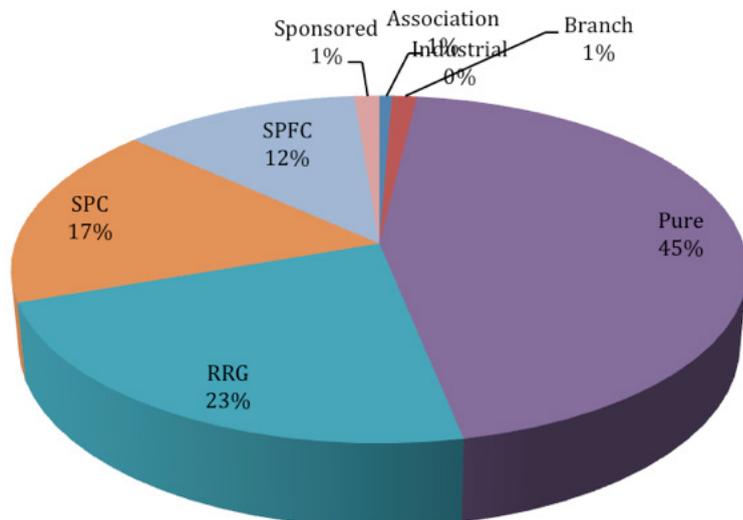
As for the future of captives in South Carolina, Newton and Kehler point to the US Federal Insurance Office, the NAIC, and the growth of 831(b)s as some of the challenges that not only the state will have to address, but the country will too.

“Captives will be challenged on a number of fronts in the future. One area is encroaching regulation,” asserts Kehler.

“The NAIC and the Federal Insurance Office represent two organisations that seem to show a keen interest in regulating captives more rigorously.”

He adds that the IRS may show additional interest in those high net worth individuals who have established micro captives for wealth transfer. “This is not to say these individuals have done anything wrong, it just appears the service is in-

Active Companies by Type



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Risky business

Risk is the keyword of choice in Malta, as the island gets in full swing with its preparations for Solvency II



Karl Micallef

Executive director, Curmi & Partners



Martin Azzopardi

Managing director, Heritage Insurance Management Malta



George Mangion

Partner, PKF Malta

What role do you play in the captive insurance industry in Malta?

George Mangion: As a leading captive insurance adviser, we at PKF Malta have been promoting the island's unique advantages for a number of years at various international conferences. Certainly, the regulatory regime in Malta, which is now a full member of the EU, mirrors fully the directives and these are specific in their determination of the duties and responsibilities of the management of captive vehicles irrespective of size. As part of our service, we continuously advise our clients to make sure their structure is fully documented and kept up-to-date. Quoting Article 41(1) of the Solvency II Directive, it is imperative that information should flow up and down the hierarchy levels and horizontally between different departments or business units.

This can be done either through in-house staff, or subcontracting. At PKF, we offer our services for professional tasks as subcontractors, but we always insist that clients should ensure sufficient segregation of duties to ensure that the people performing tasks are not also responsible for monitoring and controlling the adequacy of their performance. As always, we advise that the cardi-

nal principle of proper segregation (even in SMEs) is upheld, since functions performed by the same person may give rise to conflicts of interest. Our advice to clients is to segregate functions by proper allocation to different persons. Naturally, there are situations concerning SMEs where it is not feasible or is disproportionate to eliminate all potential conflicts of interest. In this case, our suggestion to clients is to apply adequate safeguards in all decision taking or execution of tasks. One safeguard, which is commonly used is staff rotation (or subcontracting), is a temporary measure that helps to mitigate the risk of conflicts of interest.

Karl Micallef: During the first quarter of this year, Curmi & Partners started working alongside Morgan Stanley to explore wealth management opportunities in Malta. Amongst other things, this will allow us to amalgamate our detailed understanding of our client's capital, liquidity and investment needs and combine these with the vast amount of research and analytical work that Morgan Stanley produces at both a macro and micro level.

In Malta, like in all other jurisdictions, insurance companies are regulated and the Maltese regulator has in place capital requirements that must

be met at all times by licensed entities. Typically, insurers need to maintain a substantial capital base in order to write insurance business that could either be left idle earning next to nothing or managed and invested to reduce the weight (in terms of return on equity and other such performance metrics) of such an asset base. Insurance companies have long recognised the need and benefit of investing this capital efficiently, but in an intelligent manner. It is precisely this space that we address. Curmi & Partners fully understands what is needed in this area and is today at the forefront of offering investment solutions for the insurance industry in Malta. Insurers are engaging us for this part of their business—an area that is becoming more complex and technical in nature, yet remains such an important element to the profitability of any insurance player. This way, the management team of the insurer can focus exclusively on the technical side of the profit and loss account—the company's core operations.

It is no longer a choice for insurers to appoint an investment manager—it is a must. Placing cash in bank deposits is no longer acceptable from both a risk and return point of view. Increased



competition within the industry as well as the current interest rate scenario will not allow for this option. Insurance companies have to invest their assets more effectively and efficiently in a professional manner for a number of reasons: technical profit margins are decreasing, regulatory costs are increasing, investment parameters are becoming more stringent and capital hungry, and attractive risk-adjusted investment returns are becoming harder to find.

Over the past decade, Curmi & Partners has been successfully managing a number of investment portfolios for insurance companies with both discretionary and advisory investment mandates. The success that we enjoy today is not the result of yesterday's decisions, but the outcome of a well thought-out investment strategy that is structured around the specific willingness and (more importantly) ability of our clients to take on risk.

Martin Azzopardi: Heritage Insurance Management is a leading independent insurance manager in the European time zone. We are a part of the Heritage Group, which is an independent management-owned specialist financial services organisation that is based in Guernsey. The Heritage Group has other specialist financial services companies, all providing services to corporate and private clients around the world. We employ more than 200 members of staff throughout offices in Guernsey, London, Malta and Gibraltar. Heritage established in Malta in 2007 and today manages direct writers, including a protected cell company (PCC) as well as captive companies/cells.

How are you helping captive insurance companies in Malta to optimise their businesses so that they can manage their risks better and even make a profit?

Azzopardi: The conventional insurance market can at times be a cumbersome and inflexible risk management tool. The traditional risk transfer mechanism is often susceptible to conflicts of interest between the needs of the policyholder wanting to derive value from its insurance and the needs of the insurance company to deliver value to its shareholders. Creating a captive insurance company provides a bona fide self-insurance mechanism, which can offer a superior alternative to traditional insurance products. Captive insurance can either be achieved by the creation of a wholly owned insurance subsidiary or by using a cell within a PCC protected-cell company, which offers similar self-insurance facilities. These vehicles are normally managed by independent insurance managers.

Being independent allows our clients to have absolute faith and confidence in the impartiality of our advice and services—a highly prized

quality in the world of corporate finance. Some of the benefits to clients include:

- Cost-effective risk transfer—where the traditional market is applying high rates, restricted cover, increased deductibles or limited capacity
- Opportunities to retain underwriting profit—due to better than average loss performance or niche and profitable portfolios of insurance business
- Insulation from the unpredictable swings of the insurance market cycle—often a key driver in forming a captive for our clients, many of whom have experienced this negative impact first hand
- Additional benefits—such as: direct access to the reinsurance market, positive cash flow, capital leverage, investment income, bespoke cover and low cost base.

Micallef: Today, risk management is at the top of any board of directors' agenda—more so within the insurance industry whose business is all about pricing and managing risk. Traditionally, the non-technical side of an insurer was completely segregated and managed independently from the core operational side. Such an approach could lead to an undesirable level of positive correlation between the two, which could leave a very nasty effect on an insurer's financial performance when reality turns out to be different to original projections. Nowadays, Curmi & Partners is introduced to an insurer's operations at a much higher level in order to structure a set of investment parameters appropriate to that specific company. This has instilled a greater level of liaison between us and the risk manager of an insurer in order to achieve the desired equilibrium level between operational risk and investment risk.

Managing the investment portfolio of an insurer is very different to almost any other scenario—this is mainly due to the liabilities an insurer is exposed to. The exercise of asset-liability matching is an extremely important function. This is because any relative change in value between the insurer's assets and liabilities can have a significant impact on the capital reserves and shareholder's equity of the insurer.

In addition, insurance companies need to have a multi-tier investment approach. A one-size-fits-all set of investment parameters for policyholder funds, own funds and surplus funds may have served the respective investment committee's well to date, but this is set to change in the future. Moving along the risk spectrum, surplus funds should not be managed the same way policyholder funds are managed. Using the investment parameters of the policyholder funds across the entire investment portfolio is ineffi-

cient, while using the investment parameters of surplus funds across the entire investment portfolio is irresponsible.

Mangion: At PKF, we realise that captive insurance companies are facing a heavy burden with the implementation of the Solvency II rules. In this context, we have offered our professional services in a number of key functions, particularly to start-ups and SMEs. One of the functions that we offer is that of internal audit. Examples of critical or important functions or activities that we provide include regular or constant compliance, internal audit, accounting and limited risk management. When we are commissioned to establish an internal control system, we assist the client with setting policies and procedures that instill a strong system and encourage a high level of integrity.

As always, it is up to management to make sure that staff members are fully aware of the internal control system and should understand their role within it such that the system is embedded in the overall culture of the undertaking.

We assist clients to improve their performance in four important aspects: control environment and activities, communication and monitoring. Ideally, even in the case of SMEs, the internal control system itself should be monitored continuously to ensure that any necessary improvements are implemented as this plays an important role within the Solvency II directive.

How is preparation for the implementation of Solvency II affecting what you and your clients are doing in Malta?

Micallef: Curmi & Partners has always regarded the Solvency II Directive as an opportunity rather than a threat. Solvency II is not a direct result of today's crisis, or even that of 2008. It was an acceptance that the increase in risk, which is generic in today's world, needed to be matched by similarly robust insurance regulation (and banking regulation for that matter) in order to better assess the financial and operational soundness of industry players within this new reality and risk dimension.

From an investment management angle, we are past preparing for implementation. At Curmi & Partners, we are operating as though the directive is already in full force. Furthermore, we are aware of the weaknesses of Solvency II, and have adopted an investment style that not only follows the directive word-for-word, but also achieves the spirit that the directive set out to achieve. As we all know, the directive has been in



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Curmi & Partners provides a wide range of services that present solid investment opportunities that demonstrate consistent investment results across differing markets and market conditions.

In risk capital terms, we fully understand the delicate relationship between the core operations and the investment portfolio of the insurer. This sensitivity allows us to achieve the pre-set investment objectives without jeopardising the overall regulatory, capital risk requirements.

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the making since 2004. The structure being proposed to measure and address investment risk is one that is based on yesterday's risk profile.

We can already see Solvency II being updated to align itself with the realities of today's investment world. Our approach has been not to wait for this to happen, but to guide our insurance clients to be proactive and to go beyond what the directive is calling for. Risk measurement can no longer be entirely associated to the traditional metrics; it is not enough to look at duration, ratings, asset class and currency. Portfolio management needs to go beyond that. Investment managers need to look at the underlying security of the invested instruments and ensure that the target investment return is adequate to justify the regulatory capital that is tied up for that investment. Curmi & Partners is equipped to measure the capital haircut of an investment portfolio on a daily basis, at the touch of a button. That is true added value for any risk manager. You cannot manage risk unless it is measured.

Azzopardi: Work on Solvency II has been going on for a number of years. Until last year, compa-

nies were focused on one particular area, predominantly quantitative Pillar 1 issues. Together with our clients' boards, we have dedicated resources working solely on Solvency II, though actuarial expertise is felt to be the primary missing resource. We have worked closely with clients when compiling the various questionnaires that have been issued by the Malta Financial Services Authority (MFSA), even more so when we carried out the gap analysis exercises as part of the preparatory and implementation process for Pillar 2.

Solvency II is a fundamental review of capital adequacy with a view to establishing harmonised capital requirements and risk management standards within the EU. It is planned to instil the concept of sound and prudent management in the mind of directors. Ensuring compliance with Solvency II has been on the board's agenda and active steps are being taken to ensure as smooth a transition into the new regime. Unfortunately, there is an ongoing uncertainty surrounding the implementation date, currently January 2014.

Due to its non-captive specific structure, many captive insurers are very concerned with this legislation. This concern can also be found among the smaller direct writer companies. There is a perceived risk of incurring additional layers of cost given the requirement of insurance companies, irrespective of size and nature, to adopt written policies and procedures as well as create internal structures to tackle such areas as internal audit, risk management and outsourcing. There is the perception that the board's attention is being diverted away from the core business of an insurance company.

It has been argued that a potential solution could be the establishment of a cell within a PCC. In this scenario, the owners of the portfolio of business retain their ownership of their underwriting book. Of importance is that overall governance of the core and the cells is the responsibility of the PCC board that may in turn delegate the administration of the cells to committees. This will probably require that the directors sitting on the board of a PCC must have sufficient skills to meet the possibility of a higher level of scrutiny,

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not only to ensure compliance with Solvency II, but also given the possible diversification in the underlying portfolio of business.

Mangion: On the whole, operators in Malta are well prepared for the Solvency II Directive, whenever it comes into force. A lot of preparation has been coordinated with the insurance section within the MFSA and good progress has been made.

It is true that regulation comes at a cost, and the markets at these times are not favourable, but in the long run the achievement of a higher standard of quality will yield rich dividends to insurers within the single market. A lot of preparation has been going on to make sure that undertakings identify such critical or important functions as may be challenged by the supervisory authority in the determination or non-determination of Solvency II directives. Naturally, the effect on costs and resources to carry out such reforms will vary according to the size of the undertaking. As an undertaking chooses to develop an internal model (rather than use the standard

formula), the actuarial function is an important, albeit expensive, factor as it contributes towards the design of the internal model. It does this by providing an actuarial opinion as to the scope of the internal model, ie, which risks should be covered by the internal model, and how dependencies between risks should be derived.

What is there about Solvency II that you would like to be clarified?

Mangion: One of the perplexing questions that is frequently asked by clients is the topic of proportionality as applied under Solvency II.

Many consider that better clarification is necessary on how proportionality principles are applied, as this will be critical for the attractiveness of EU captive centres. There is a need for better guidelines by the EU on how proportionality can be applied by individual regulators in a way that makes the majority of EU-based captives more viable under Solvency II. If properly used, the principle of proportionality may relieve SMEs

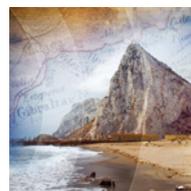
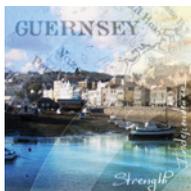
of certain regulatory burdens that may cripple them. At the extreme end, without its proper use it may encourage smaller operators to migrate out of the EU family. However, for small captives with limited financial strength and expertise, the common view is that the new compliance requirements are likely to prove burdensome.

What is on the horizon for you and your captive insurance clients before the end of 2012?

Mangion: One of the irritating issues is the continuous delay in the implementation of the Solvency II system. This delay has come at a price for insurers and quite a few are concerned about the additional costs as a result of delays. Certainly, as the implementation will be delayed beyond this year, our prognosis for 2012 is that the smaller insurers in Malta will have been burdened by extra preparation costs, while without doubt larger non-life insurers have incurred bigger hits than their life company counterparts. **CIT**



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2012

09 September

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Cayman Captive Forum 2012

Western Region Captive Insurance Conference

Location: Indianapolis
Date: 1-3 October 2012
www.siaa.org

Location: Waikiki
Date: 22-24 October 2012
www.hawaiiicaptives.com

Location: Grand Cayman
Date: 27-29 November 2012
www.caymancaptive.ky

Location: Arizona
Date: 14 May 2013
www.westerncaptiveconference.org

The SIIA National Conference & Expo is the world's largest event focused exclusively on the self-insurance/alternative risk transfer marketplace and typically attracts more than 1,600 attendees from around the US and from a growing number of countries around the world.

The HCIC 2012 Forum will delve into opportunities to enhance your captive and risk management strategies despite the stagnant economy. This conference will provide a wide range of educational seminars and speakers that will offer tremendous learning and networking opportunities. Sponsorship forms and session submission forms may be found at www.hawaiiicaptives.com

Plans are underway to provide an informative series of panelists and speakers and quality educational content for the captive owner and those who are seeking information on captive formations in the Cayman Islands. There will be memorable social events that will allow attendees to enjoy a taste of Grand Cayman.

The next conference for the Western Regional Captive Association will be held in Arizona in May of 2013. The exact dates and locations will be determined in the near future. Please mark you calendar in pencil for this event. There will be no conference in 2012 due to scheduling of other captive conferences and the date of the 2011 WRCIC late in the year. Missouri will host the conference in 2014.

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Industry appointments

Bermuda-based Montpelier Reinsurance has named **Christopher Downey** as head of Global Casualty and Specialty Treaty Reinsurance.

Downey is responsible for leading the full portfolio of casualty and specialty treaty business written through Montpelier Re and will report directly to Christopher Schaper, President of Montpelier Re.

Prior to the appointment, Downey was senior vice president of specialty & casualty at Al-terra Bermuda.

Schaper said: "I am very pleased to have an individual with Chris' capabilities, background and knowledge join and lead our team. I look forward to working closely with him."

In July of this year, Montpelier Reinsurance named **Dr Gero Michel** as head of risk analytics, who also reports directly to Christopher Schaper.

The new position at the company involved enhancing Montpelier's risk analysis efforts for natural catastrophe exposed businesses including research, development, portfolio optimization and other underwriting initiatives.

XL Group's reinsurance operation in Bermuda has promoted **Tim Fisher** to senior vice president and Canadian branch manager.

Prior to this appointment, Fisher was senior vice president and underwriter in XL's Bermuda division. During his 12 years in Bermuda, Fisher helped to grow the reinsurance book of business, which includes US and international property catastrophe and specialty risks.

He will be responsible for leading XL's Toronto-based reinsurance underwriting team, reporting to Christopher Buse, managing director and head of casualty reinsurance in North America.

In June of this year, XL Group began accepting collateral trusts in lieu of Letters of Credit (LOCs) used as collateral for corporate deductible and captive insurance programmes in the UK.

A statement from the company said that LOCs were often expensive to maintain, with James Martin, client and distribution leader for the Group commenting at the time:

"We are delighted to be working with Wells Fargo to offer this additional service to our customers. In today's economic climate, LOCs are proving more costly to businesses both in management fees and as they tie up otherwise useful capital. Offering the collateral trust solution to our clients provides a valuable alternative."

Jason Richardson will be the COO of Lockton's Southeast operations, with responsibility for offices in Atlanta, Greater Miami, and Charlotte, North Carolina.



Richardson will be responsible for the overall operations of Lockton Southeast including leading service teams in risk management and employee benefits consulting services in the three offices.

"Lockton has built a significant foundation of risk management and employee benefits expertise in this region, and we see tremendous opportunities for growth ahead," said Doug Hutcherson, president of Lockton's Southeast operations.

"We are counting on Jason's experience as a builder of teams to add to the blueprint that's propelled Lockton's remarkable growth around the globe."

Richardson will return to his roots in Atlanta, having begun his insurance brokerage career there with Hobbs Group, which was later acquired by HRH. Most recently, Richardson was a regional partner with insurance broker Willis in Northern California and in Colorado where he was in charge of insurance and brokerage operations.

His expertise includes sales development, insurance operations, executive risks, property and casualty insurance, construction risks, and captive insurance programs.

Michael Lubben is the new head of risk management at Marvin Windows and Doors. Lubben's new role will involve safety, security, and enterprise risk management.

Marvin Windows and Doors uses its Vermont-based captive to cover the company's large product liability.

Prior to his appointment, Lubben was vice president of risk management at Ryder System.

UK-based company FiscalReps has appointed **Peter Hewitt** as a client director. Hewitt will team up with consultant Peter Hore to establish a new VAT practice.

Hewitt and Hore launch a VAT practice specialising in delivering high quality, specialist VAT advice to the insurance industry.

Hewitt was previously based in London, working for accountancy firm Ernst & Young as a senior manager for its financial services indirect tax team.

In a statement, FiscalReps said: "We are delighted to have attracted someone of Hewitt's calibre to FiscalReps. Hewitt is one of the leading VAT and IPT specialists in the London insurance market and this hire enables us to build a VAT practice to complement our existing IPT business." **CIT**

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Published by Black Knight Media Ltd
Provident House, 6-20 Burrell Row
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Company reg: 0719464
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