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Healthcare Captives
Grouping together

Terrorism Risk
Accessing TRIA

Labuan gained three new captives in 2015

The Labuan Financial Services Authority (LFSA) licensed three new captive insurers and five protected cells in 2015, taking the domicile's total number of entities to 40.

The LFSA's 2015 report, Connecting Asia's Economies, revealed there was slight growth in gross written premiums for captive insurance business. It increased by 4.3 percent to $354 million, compared to $339.3 million in 2014.

According to the report, Asia has an increasing appitite for captive insurance.

Labuan and Singapore have been joined by Hong Kong in competing for captive business. The latter is now offering a tax incentive for international business underwritten by its captive entities.

Labuan is currently working on diversifying its growth sectors to sustain development. A 'masterplan' is being developed to position the domicile as the preferred centre for captive solutions in Asia.

According to the LFSA's report, if Labuan has the right regulation in place, "captives can augur well as a growth sector for the region as risk owners increasingly prefer to manage risks on their own; albeit in a systematic and professional manner akin to a commercial insurer's".

Lowest Q2 ILS issuance since 2011

Insurance-linked securities (ILS) issuance for Q2 2016 was at its lowest level for the last five years, according to Timetric.

The market experienced a net capital outflow during Q2 2016, as a substantial proportion of Q2 2013 issuance matured.

However, Jay Patel, an insurance analyst at Timetric's Insurance Intelligence Center, suggested that these are just short-term fluctuations in a market, with large scope for expansion.

A recent report by Property Claims Services (PCS) noted that catastrophe bond transactions in 2016 mainly involved repeat sponsors, suggesting that there is potential to increase awareness and use of ILS.

During a Guernsey Finance event in July, a panel claimed that natural disasters in H2 2015 could have a serious impact on the returns generated by ILS and reinsurance-linked investment markets in 2016.

Des Potter, head of GC Securities for Europe, the Middle East and Africa, told the audience that three sizeable events in the first half of this year had created a scenario where further disasters, such as hurricanes, in the latter part of 2016 could lead to losses being incurred by some ILS funds.

Potter went on to say that H1 2016 has been an interesting period for catastrophe losses.

He said: "There's probably been three reasonable-sized events so far; the largest being the wildfires in Canada, and you can probably add to that some of the tornado hail events in the US and the earthquake in Japan. Each of those events is estimated to generate over $3 billion of losses to the insurance industry."

He explained that much of this loss was being borne by the reinsurance market, which in turn had retroceded some of that loss into the ILS market.

Potter added: "The impact in the ILS market is going to be relatively small, though. The losses so far, in the first half of the year, will just be within the expectations of the budgeted loss ratios of these sidecars, although the level of losses in H1 are probably running ahead of plan."

"So, we're probably at an interesting stage of the year when we're looking with interest at the activity in H2."

Russian Re's ratings downgraded

The financial strength rating of Russian Reinsurance Company JSC has been downgraded by A.M. Best from "B+ (Good)" to "B (Fair)".

In addition, Russian Re's issuer credit rating has been downgraded to "bb+" from "bbb-". The outlook remains negative.

A.M. Best explained that the ratings actions reflect a material deterioration in Russian Re's risk-adjusted capitalisation at year-end 2015.

The reduction in capital adequacy stems from the weak underwriting performance of the company during the year, primarily a result of a change in reserving practices enforced by regulation.

During the first half of 2016, Russian Re showed improved underwriting performance and, according to A.M. Best, the company is on track to return to operating profitability by year-end.

A.M. Best suggested that Russian Re will likely continue to face significant challenges in growing profitably, both in its domestic and foreign markets, as a result of increased competition.

Risk managers will have to state value of captive

The base erosion and profit shifting (BEPS) programme could force captive owners to justify

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their insurers to poorly informed third parties, according to the Federation of European Risk Management Associations (FERMA).

Offshore domiciles are under scrutiny from international tax authorities, with the BEPS framework aiming to keep profits in the jurisdictions where they are earned.

In a recent article, FERMA said that the Organisation for Economic Co-operation and Development released recommendations on BEPS in October last year to crack down on so-called profit shifting, prompting a focus on captives. Profit shifting sees profits moved to jurisdictions with lower corporation and other taxes through certain arrangements and structures.

With more than 100 countries and jurisdictions collaborating to implement the 15 BEPS actions, according to FERMA, country-by-country financial and tax disclosure could be made public, giving access to a large amount of highly technical information.

"Tax authorities are competent to perform this analysis because of their expertise and training, but the same does not necessarily apply to members of the public."

"Risks of misunderstanding and misinterpretation will be significant, forcing organisations to defend and justify their financial structures not only to tax authorities, but to less informed third parties."

FERMA president Jo Willaert commented: "For risk managers, captive insurance is not a tax issue but an efficient risk management tool, especially for large corporations."

"With nearly 7,000 captives worldwide, the risk management community is well aware of the reasons and benefits of captive insurance, which is used by non-profits and public organisations as well as corporations."

"These are light structures which perform a genuine (re)insurance activity. They help us to maintain affordable and wide risk coverage, access to reinsurance markets and greater risk insight."

A.M. Best affirms IGI ratings

A.M. Best has affirmed the financial strength rating of "A- (Excellent)" and the issuer credit rating "A-" of International General Insurance Company (IGI) for its Bermuda and UK operations.

A.M. Best said the ratings of IGI "reflect its solid risk-adjusted capitalisation, consistently good technical performance and diversified business profile".

Wasef Jabsheh, CEO of IGI, said: "We are delighted with the rating affirmation. A.M. Best pointed to our prudent risk selection and focus on profitability over top-line growth. We are writing high quality business and the rating recognises the strength of our philosophy and strategy."

"We are continuing to expand geographically whilst diversifying our product range. The business is in robust health and is growing."

R&Q acquires segregated accounts captive company

Randall & Quilter (R&Q) Investment Holdings has purchased Agency Program Insurance Company (APIC), a Bermuda-based segregated accounts captive.

The company, which currently has 28 cells, reinsurers the likes of SPARTA Insurance Company, Discover Reinsurance Company, Nova Casualty Company, Hartford Insurance Company, AmTrust International, Wesco Insurance Company, PMA Companies and Arch Insurance Company.

APIC is in run-off, and has a total net asset value of $2.4 million and reserves of $8.6 million.

Ken Randall, chairman and CEO of R&Q, commented: "We are delighted to complete

the acquisition of APIC. This transaction, which grows R&Q's balance sheet, demonstrates our ongoing commitment to continue to acquire legacy insurance assets and also continues to expand our acquisition activity in the North America, Bermuda and Caribbean region."

Global economic losses highest for years

Preliminary global economic losses reached the highest levels seen since 2011 during the first half of this year, but were slightly below the 10-year average, according to Aon Benfield's Impact Forecasting.

Preliminary global economic losses reached $98 billion and global insured losses $30 billion, Impact Forecasting said in a recap of economic losses from catasthrophes so far this year.

The level of global economic losses covered by public and private insurers in H1 2016 was 30 percent, slightly above the 10-year average of 28 percent, due to a prevalence in the US where insurance penetration is higher.

The US accounted for 47 percent of all global insurance losses sustained by public and private insurance entities during the first half of the year.

Earthquakes were the costliest disaster during the six-month period, standing at $34 billion and comprising 30 percent of the disaster loss total.

Storms were the costliest peril at $12.3 billion, comprising 42 percent of the loss total.

There were at least six individual billion-dollar global insured events during the first half of the year, and at least 22 separate billion-dollar economic loss events.

Steve Bowen, director within Aon Benfield's impact forecasting team, said: "The first half of 2016 ended up as the costliest on an economic and insured loss basis since 2011."

"The year has already been highlighted by a significant earthquake sequence in Japan, the Fort McMurray wildfire in Canada, flooding in Western Europe and a series of extensive hailstorms in the US."

"With the pending transition to La Niña during the second half of the year, there will be a heightened focus on the risk of flooding across parts of Asia and hurricane landfall in the Atlantic Ocean basin. The financial toll of weather disasters during La Niña years has historically been among the costliest on record, and so we will wait to see whether this trend plays out in the coming months."

AIR launches new resilience practice

AIR Worldwide, a catastrophe modelling firm, has formed a global resilience practice to support risk reduction and resilience initiatives.

Daniel Kaniewski, who will serve as vice president of global resilience, will lead the new practice.

Kaniewski commented: "I'm extremely excited to join an innovative company like AIR and take on the challenge of developing the company's public risk strategy."

"I look forward to assisting organisations in applying catastrophe modelling to financing disaster risk and to expanding AIR's already strong collaborations with the United Nations, the World Bank, the US National Flood Insurance Program, insurance regulatory bodies across the globe, and distinguished research groups."

ILS industry creates over 400 jobs

Bermuda's insurance-linked securities (ILS) and convergence industry generated almost 400 jobs last year, the Bermuda Business Development Agency (BDA) has said.

The BDA revealed that 15 ILS funds employed 209 skilled Bermudians and international workers in 2015, while ILS-related jobs within 25 support companies totalled 188.

Bermuda is the most popular jurisdiction in which to establish insurance-linked fund managers, with 38 percent of fund assets managed by firms with head offices in Bermuda, according to the BDA.

In 2015, ILS-related employees represented 9 percent of the total workforce of Bermuda's internationally operating companies, and accounted for over $100 million in payroll.

BDA CEO Ross Webber commented: "We commissioned this research to provide details on the economic impact of the ILS market on Bermuda—both actual jobs created and aggregate fiscal contribution."

"The results of the study are certainly positive, proving the convergence sector has quickly become a pivotal and multiplying contributor to Bermuda's overall economic health."

"The study is not exhaustive, so data gleaned presents a picture of the minimum contribution."

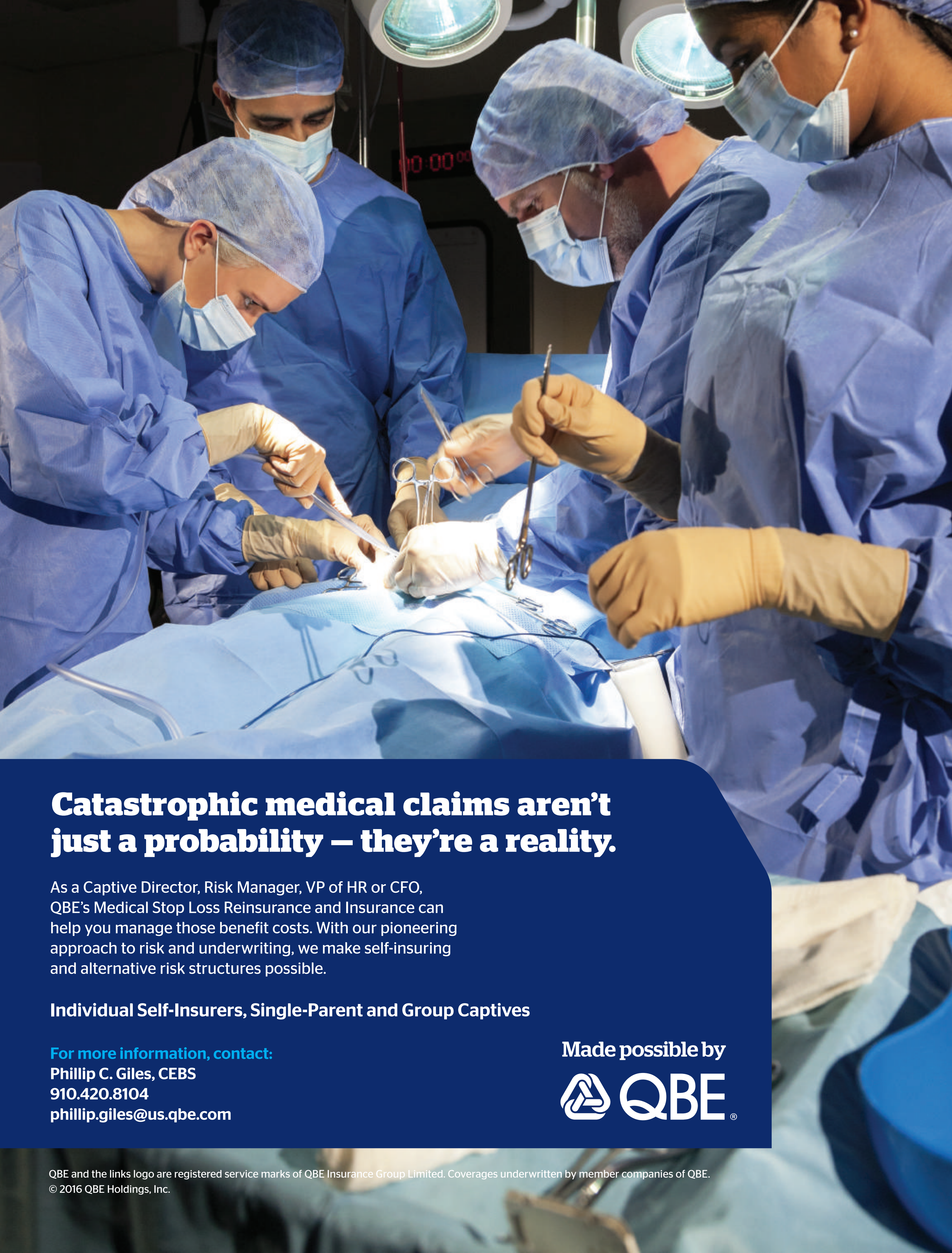
Downgrades for Royal Dutch Shell

A.M. Best has downgraded the ratings of Solen Versicherungen AG (SVAG) and Noble Assurance Company, captives of Royal Dutch Shell (RDS).

The captives' financial strength ratings have been downgraded to "A (Excellent)" from "A+(Superior)" and the issuer credit ratings to "a+" from "aa+".

The downgrade reflects the weakening in the credit profile of RDS, due to continuing low oil prices.

According to A.M. Best, SVAG's ratings reflect its affiliation with RDS, as it remains an important risk management tool. Therefore, a change in RDS's credit profile could lead to an upgrade or downgrade for SVAG's ratings.


Catastrophic medical claims aren't just a probability — they're a reality.
As a Captive Director, Risk Manager, VP of HR or CFO, QBE's Medical Stop Loss Reinsurance and Insurance can help you manage those benefit costs. With our pioneering approach to risk and underwriting, we make self-insuring and alternative risk structures possible.
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Smaller institutions targeted by cyber attacks, says Beazley

There was a sharp increase in hacking and malware attacks on financial institutions in H1 2016, with the majority aimed at small banks and credit unions, Beazley has found.

The number of hacks in the healthcare, higher education and retail sectors have remained fairly consistent compared to 2015.

But among financial institutions, hacking and malware accounted for 43 percent of breaches handled by Beazley, compared to 27 percent in the same period in 2015.

Of those financial institutions that experienced hacking and malware breaches, 81 percent were banks and credit unions with less than $35 million in annual revenues, compared to 54 percent last year.

During the first half of the year, Beazley managed 955 data breaches on behalf of its clients, compared to only 611 during the same period last year. Out of the total, 139 of those breaches were aimed at financial institutions with revenues below $35 million.

Katherine Keefe, global head of Beazley Breach Response Services, commented: "The persistent high levels of hacking and malware attacks are a reminder that all organisations in all industries need to have plans ready to respond when a breach occurs."

"The large increase we've observed in hacks aimed at financial institutions is noteworthy."

"Smaller banks and credit unions that typically have fewer defences against these breaches are becoming bigger targets and need to be prepared."

XL Catlin launches new African facultative and treaty reinsurance unit

XL Catlin has established a new reinsurance unit focusing on facultative and treaty reinsurance across Africa.

Alex St James will lead the team as head of Africa for XL Catlin's reinsurance. In addition, Matthew Gillies has been named actuarial underwriter. Both St James and Gillies will be based in London.

David Watson, XL Catlin's CEO for reinsurance in Europe, the Middle East and Africa, said: "Africa is a varied and complex collection of frontier and developing markets, generally rich in resources and increasingly home to international companies."

"Traditionally there has been a lack of insurance penetration across the continent, but this is changing and we believe we have a part to play as reinsurance capacity will further drive the development and growth of the primary insurance market."

Ocean Re receives 'excellent' ratings

A.M. Best has affirmed the financial strength rating of "A- (Excellent)" and the issuer credit rating of "a-" of Ocean International Reinsurance Company, located in Barbados.

According to A.M. Best, partially offsetting these positive rating factors is the susceptibility of Ocean Re's captive business to regulatory changes.

A.M. Best suggested that Ocean Re's operating performance is good, with premium sufficiency derived from its captive business.

Ocean Re is a Barbados-based reinsurer, licensed as a qualifying insurance company focused on reinsurance. It offers a diversified product mix in several countries throughout Latin America.

New captive legislation takes effect

The governor of North Carolina, Pat McCrory, has signed the state's new captive legislation into law, meaning the insurance commissioner is now able to set minimum capital requirements for cells, while board meetings can be held outside of the state.

The amendments became effective at the end of June and apply to currently licensed captive insurance companies and pending applications.

There were 44 changes to the North Carolina Captive Insurance Act, with five significant for captive insurers.

The amendments include a captive insurance company exemption from in-state board meetings, if the captive utilises at least two North Carolina-based service providers.

Services include legal, accounting, actuarial, investment advisors and others accepted by the governor.

Another change provides the commissioner with additional discretion to establish the minimum required capital and surplus for a protected cell captive insurance company.

The law previously required a minimum of $250,000, but the amendments now allow the commissioner to set the minimum requirement below $250,000, if that amount is sufficient to support the captive insurer's risk profile.

Other changes include provisional approval for a captive licence for a period of up to 90 days, with amendments allowing for extensions under certain conditions.

Under this amendment, the insurance commissioner also has the ability to limit and rescind the authority of any provisional licence at any time.

Minor technical amendments to rules regarding the formation of captive insurance companies were also tweaked, as were those around conflict of interest, plan of operation, insurance managers and intermediaries, filing annual reports, licence suspension or revocation, and the annual filing requirements for protected cell company applicants.

Wayne Goodwin, North Carolina insurance commissioner, said: "North Carolina has joined the top tier of captive licensing jurisdictions, significantly reduced the regulatory burden on existing captive insurance companies, and made the state more competitive to North Carolina business owners establishing their own captive insurance companies, as well as encouraging non-resident captive insurance companies to re-domicile to North Carolina."

Jesse Coyle, chair of the North Carolina Captive Insurance Association, added: "With over 300 licensed captive insurance companies, generating more than $700 million in annual premium dollars, it's only a matter of time before this is a billion-dollar industry for North Carolina. Captives are creating jobs and having a positive impact on the state's economy."

NC governor signs captive bill into law

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Mauritius to attract African captive insurance business

Mauritius has been positioned as the domicile of choice for African business since the enactment of its Captive Insurance Act in December last year, according to Cim Global Business.

Cim Global Business revealed that African companies are attracted to Mauritius because of its membership of the International Association of Insurance Supervisors (IAIS) and its developed reinsurance market.

The Captive Insurance Act currently only applies to pure captives, which means the business is restricted to the risks of the parent and affiliated corporations.

On 25 April of this year, the Financial Services Commission in Mauritius issued accompanying rules that lay out the requirements for solvency, assets, capital and other regulatory issues for captives domiciled in Mauritius.

One of the requirements includes the pure captive insurer maintaining a minimum capital of $85,000.

Also, a change to the Income Tax Act provides for an attractive tax holiday on income derived by captive insurers for a period not exceeding ten years.

Artex rebrands as it looks to expand

Artex has launched a new logo and brand platform to position the company for growth in the alternative risk markets.

The company has recently expanded into emerging alternative risk fields, including pension longevity and benefit captives, as well as insurance-linked securities.

This follows Artex's general expansion over the last few years, as it has added to its operations in several European locations and improved its presence in the Bermuda and Cayman Islands markets.

David McManus, president and CEO of Artex, commented: "We felt that such rapid growth and attendant change created a perfect point in time to take a really deep dive into understanding exactly what Artex had become."

LMG discusses foreign aid cat bond

The London Market Group (LMG) has launched a whitepaper to discuss the creation of a foreign aid catastrophe bond.

The whitepaper, released at a roundtable in the UK House of Commons, recommends the use of the soon-to-be created UK insurance-linked securities (ILS) regime to address the risk of natural catastrophes in under-insured emerging markets.

The bond would provide a more cost-effective approach to catastrophe relief backed by commercial capital.

Malcolm Newman, CEO of reinsurance company SCOR's London and Paris hub and leader of the LMG workstream, said: "The idea behind the foreign aid catastrophe bond is a joint initiative between the government and LMG to provide a cost effective response to catastrophes currently supported by the UK foreign aid budget."

"We are looking to emulate other government-led forms of insurance which already exist in areas such as Mexico and the Caribbean to cover damage from the major natural perils of windstorm and earthquake.

There are some clear benefits from this proposal, for example the government could provide a more predictable and transparent source of funding for short-term disaster relief and potential longer-term resilience against climate change."

Megalodon introduces new claims management software for insurers

Megalodon Insurance Systems has launched its new client-centred policy and claims management software.

The company introduced the new software at the recent Insurance Accounting & Systems Association Annual Education conference and business show in San Antonio, Texas.

The new software system allows for navigation between policy, claims and billing platforms. Megalodon founder and CEO Bill Montei commented: "Megalodon's mission is to provide captive managers, risk retention groups and small to mid-size insurers with industry leading technology."

"By reducing implementation and customisation costs and using the software-as-a-service model, Megalodon is able to bring an all-in-one system into reach with affordable upfront licensing and maintenance costs along with expert change management to help with a smooth implementation."

Aon Benfield launches new platform

Aon Benfield Impact Forecasting has launched Elements 10, a catastrophe modelling platform designed to enhance strategic business decisions.

According to the Impact Forecasting team, the Elements platform enables them to obtain new insights and manage the catastrophe modelling process from start to finish.

The platform provides users with the flexibility to import various formats, run any implemented model, actively manage accumulations and quantify uncertainty.

It also includes a suite of new and updated flood models for the US, Canada, Malaysia and Poland.

In addition, the European windstorm model has been extended to Austria and the Scandinavian countries.

Stefan Hiemer, natural hazard analyst at Qatar Re, said: "Elements enables us to have full control of model customisation, which gives us the opportunity to adjust the models in regions where we have additional insights and new information through access to the markets."

Flooding in China costs $4 billion

Floods in China during June are expected to have caused a minimum of $4 billion in damages, according to Aon Benfield's Impact Forecasting Global Catastrophe Report.

The report said that monsoon rains led to significant flooding across central and southern China, killing more than 130 people.

The most damaging floods occurred in the Yangtza River basin, totalling over $4.4 billion in damages, according to China's Ministry of Civil Affairs. Low penetration levels are expected to be reflected in relatively low insurance losses.

Meanwhile in the US, Virginia experienced catastrophic flooding, affecting 5,500 homes and 125 businesses. Total economic losses are expected to reach hundreds of millions of dollars, while insured losses are expected to be mitigated by the extensive property coverage provided by the US government's National Flood Insurance Program.

Adam Podlaha, global head of Impact Forecasting at Aon Benfield, said: "With the continued expectation of a transition towards La Niña in the H2 2016, the month of June provided a potential precursor to some of the global impacts typically experienced during such an El Niño–Southern Oscillation phase."

"The enhanced seasonal monsoon rainfall across China and elsewhere in Asia was amplified as flooding caused considerable property and agricultural damage. With catastrophe models becoming more prevalent in Asia-Pacific, the insurance industry is better able to provide a clearer understanding of the financial risks that the flood peril increasingly poses."

Vermont celebrates 35 years

Vermont has marked the 35th anniversary of its captive legislation being signed into law. The legislation was signed into law by the late governor Richard Snelling in 1981.

Current governor of Vermont, Peter Shumlin, said: "We have always tried to improve upon ourselves and have never rested on our laurels."

"We are very proud of Vermont being the top US domicile and look forward to our continued success over the next 35 years and beyond."

To date, Vermont has 1,071 licensed captives with 589 currently active.

Dan Towle, Vermont's director of financial services, commented: "The captive industry infrastructure that's developed in Vermont over the past 35 years—the regulators, managers, accountants, auditors, attorneys, investment professionals, and others, as well as the Vermont Captive Insurance Association—is what has helped make our state the 'gold standard' of domiciles."

PBR has mixed implications

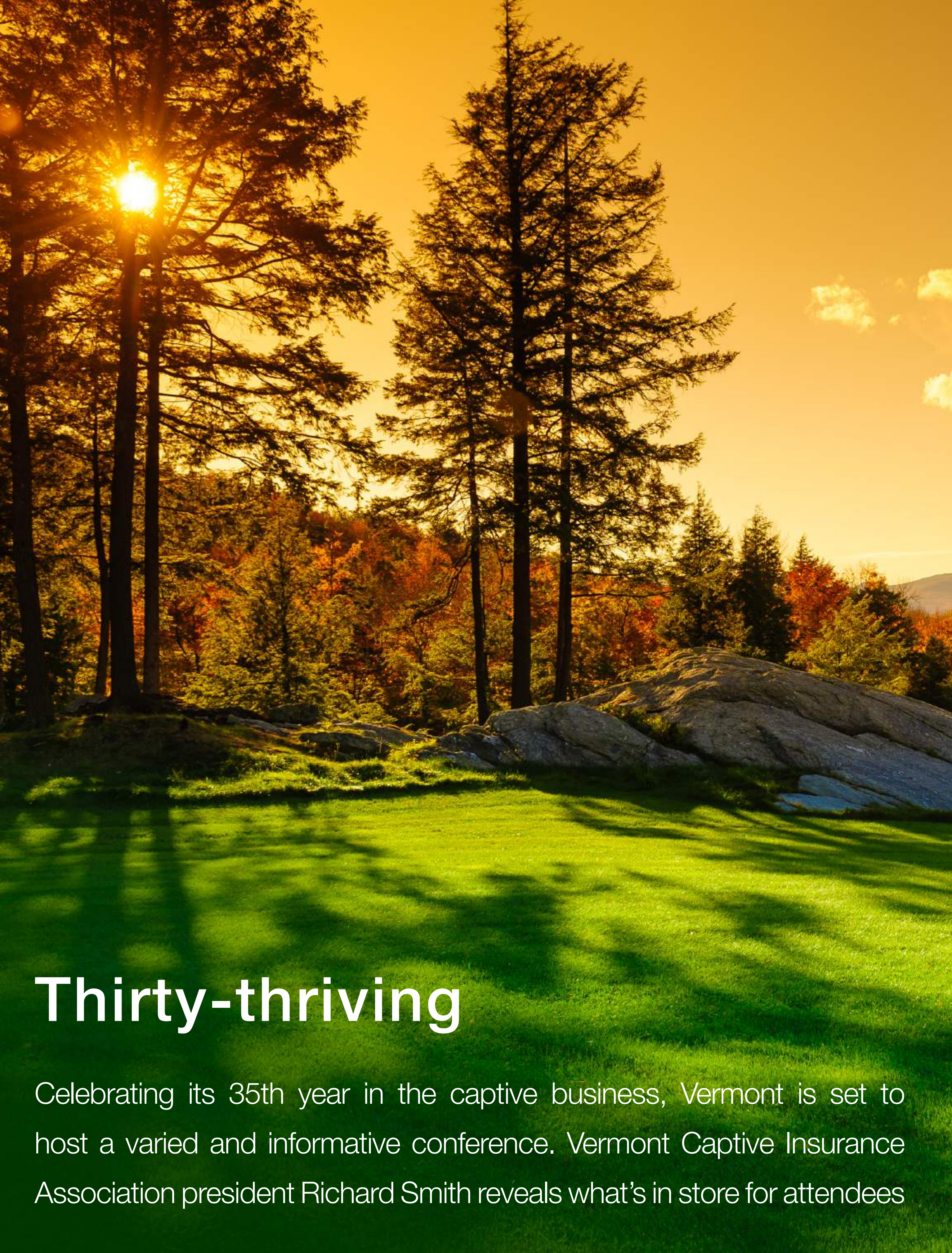
New principles-based statutory reserving (PBR) standards will have mixed implications for US life insurers, according to Fitch.

In June, the National Association of Insurance Commissioners (NAIC) adopted a recommendation for PBR standards for statutory reporting.

The revised reserving standard will become effective on 1 January 2017, with a three-year transition period.

The new standards will mean reduced reserving requirements for term policies, which, according to Fitch, should benefit companies that do not currently reinsure excess XXX reserves to captive insurers.

Fitch said that for companies using captives to finance term reserves, PBR's impact could be negative due to its effect on tax reserves.



Thirty-thriving

Celebrating its 35th year in the captive business, Vermont is set to host a varied and informative conference. Vermont Captive Insurance Association president Richard Smith reveals what's in store for attendees

Has Vermont's captive insurance market experienced a successful 2016 so far?

The outlook for captives in Vermont this year looks good. Since the beginning of the year, Vermont has licensed seven new captives, three pure, two risk retention groups (RRGs) and two sponsored, with more in the pipeline. However, it's still early to see how the year will go, as many captives are formed at year's end to get them on the books.

Last year, Vermont licensed 33 new captive insurance companies, made up of 12 pure captives, seven RRGs, seven sponsored captives, four special purpose financial insurers, two industrial insured captives, and one association captive, as well as 11 redomestications. That is the largest number of redomestications to ever occur in a single year in Vermont. Growth in 2015 was up significantly from 2014 when 16 companies were licensed.

Seven new RRGs were licensed in Vermont, bringing the active total to 89. Vermont continues to hold a dominant market share with over 60 percent of all RRGs premium volume being written by Vermont companies. Six of the 11 redomestications to Vermont were by RRGs.

New captives were licensed in insurance, healthcare, construction, real estate, professional services, education, transportation, agriculture, retail, and others. The strong diversity of licences was highlighted with seven in the healthcare sector. The new 2015 licensees bring Vermont's overall total licences to 1,062 with 588 active captive insurance companies. Growth is impressive, especially when you consider the prolonged soft market and added competition by other US states. Vermont's focus will always be licensing quality companies and regulating them in an appropriate manner commensurate with their risk.

Why is it important to update captive legislation annually?

It is important to update Vermont's captive legislation annually for two main reasons. First, Vermont wants to lead the captive insurance marketplace in providing the best rules and regulations to keep up with this ever-evolving industry. Captives are by nature flexible and entrepreneurial.

Second, bringing legislation to the state legislature every year allows our policymakers a chance to shape this important industry in Vermont. The legislation makes Vermont more attractive and sends a strong message to the industry that we are committed to always improving our captive insurance law.

What can attendees expect from this year's annual conference?

The Vermont Captive Insurance Association (VCIA) conference, with the theme of 'Lights, Camera, Captives!', will feature leading experts in the captive insurance world. Many panellists are captive owners with unique insights and case studies to share. In total, more than 70 key captive professionals will lead two and a half days of learning in Burlington.

VCIA is set to host nearly 1,100 people. Attendees will have access to any level of learning, from the basic to the advanced. Professional education credits are also offered (CPE, CLE and ICCIE) to those who attend the sessions.

VCIA is equally well known for its high-quality education and its opportunities for people to connect with other captive professionals. Whether you are new to the industry or have many years of experience, there is something for you to learn and someone for you to meet at VCIA.

Many of our panellists are captive owners, allowing you to learn from their first-hand expertise. They represent organisations including Tyco, Global Rescue, Verizon and Agri-Services, to name a few.

Sessions are offered with focus areas for those new to captive insurance, those involved in accounting or finance, operations, and risk management.

Engaging, fun session formats include a game show, a mock trial, a TED talk-style session, sessions with interactive technology, and several sessions using case studies for illustration.

If you are new to the industry the conference is the perfect way to meet and learn from others, and boost your captive education.

What are the main topics that speakers will cover?

David Pogue, author and founder of Yahoo Tech, will be our keynote speaker at lunch on 11 August. He is a world known technology culture expert, and will share his great insight on ‘Disruptive Tech: The Unrecognisable New World of Tech and Culture’.

Wearable tech, the cloud, drones, the quantified self, the ‘internet of things’, self-driving cars, and augmented reality: the tech of our world is changing more and more quickly. But the most fascinating aspect that Pogue will talk about is the effect this is having on the society and culture we once knew.

Charles Davis, CEO of Stone Point Capital, will speak at the general session on 10 August, and will share insight on the broader financial services and insurance marketplace, including the flow of capital, new capital sources, mergers and acquisitions, and how the impact of technology investment is likely to affect the insurance industry.

Stone Point Capital is a financial services-focused private equity firm based in Greenwich, Connecticut, targeting investments in the global financial services industry. Stone Point has been active in the creation of many insurance and reinsurance companies, including being the lead sponsor in the formation of ACE (now Chubb), XL, MidOcean, Harbor Point, Paris Re, AXIS and others.

What sessions are you most looking forward to?

I like to jump around to as many of the sessions as I can get to during the conference. On 9 August, ‘The Original Employee Benefit Captives: Where Are They Now?’ session will be interesting as we re-visit the pioneers of benefit captives and discover their lessons learned and benefits gained. Attendees will learn the interesting history of the past decade of using captives to fund benefits, and see where the industry is today.

On the same day, ‘Captive Re-Feasibility Studies: Remake of a Classic’ will explore the options available to perform a re-feasibility study of your captive; to recognise successful diversification options including unrelated risk in your captive; and to be aware of new ways in which a captive can be used to lower costs of the organisation.

On 10 August, ‘Addressing Cyber Risk with a Captive Solution’ will focus on the trending vulnerabilities and the current state of the cyber market. Our panel includes a risk manager who has implemented cyber coverage into her captive and will share that experience, and an actuary who will discuss pricing mechanisms for these evolving risks.

At the ‘Vermont Captive Quiz Show’ session, attendees will have game-show type experience where they will learn about Vermont’s captive insurance history, usage, management and benefits.

And a mock trial entitled, obviously, ‘Mock Claims Trial: You Be the Jury’ will allow attendees to show captive owners how the claims made within their captive translate into a jury trial and the potential pitfalls of trying a case.

Finally, I always look forward to ‘Hot Topics with David Provost’. Provost is a wealth of knowledge and wit, and will host this dialogue to share with participants news and views on recent developments in captive regulation and practice. I could list a dozen others but I think that gives a good flavour of the topics that will be presented during the conference.

Is there anything new and exciting happening in captive space for Vermont? And are there any plans for the rest of 2016?

This year marks the 35th anniversary of Vermont’s landmark 1981 captive insurer statute. The state continues its longtime status as the largest captive domicile in the US and the third largest in the world.

Although not the first to pass captive insurance legislation, Vermont prides itself on creating a law far more attractive to buyers, with far lower captive capitalisation that did not require prior approval for rates and forms.

VCIA continues to look to increase the number of webinars we do every year, and recently hosted two: ‘How to Ace Your Next Captive Exam’ on 17 March, and ‘Cyber Coverage and Captives’, tentatively, on 27 April. Both had good turnouts and received positive feedback from the surveys.

We have three more we are planning this year: ‘Asset Liability Matching for Captive Structures’ in September, and a tax update in December. In addition to this, Provost and Jim McIntyre have agreed to participate in a roundtable discussion with me on legislative issues facing captives sometime in October, which we will broadcast via webinar or other technology.

VCIA takes the industry lead in monitoring and responding to events emanating from Washington DC and elsewhere. We are continuing our quest to set right the Non-Admitted and Reinsurance Reform Act passed in the US Dodd-Frank Act a few years ago, as well as working with our captive association partners on another of other fronts. CIT

Richard Smith
President
VCIA

Strength in diversity

Attendees can expect a diverse range of topics at this year's North Carolina Captive Conference, according to Jesse Coyle

How has the conference expanded since its first year?

We have seen nothing less than a truly remarkable expansion. Our first education session after enactment of the North Carolina Captive Act had 60 attendees. Then our first conference, held in 2014, had 96 attendees and in 2015 we had 144 attendees. This year we are projecting over 200. This is really remarkable growth for the association. Membership in the association has followed a similar pattern of growth, and this has also held true for sponsors and exhibitors.

In addition, this year, by the end of March, we had sold all of our exhibitor booths and we have now sold all of our sponsorships. Further, between sponsors, exhibitors and speakers alone, we will have approximately 40 companies represented, which is attributable to North Carolina's growing prominence as a premier domicile.

What topics will this year's conference focus on?

Our conference does not have a single specific theme. For 2016, the conference planning committee concentrated on attracting a greater number of nationally recognised speakers from a diversified group. As such, this will be a thoroughly well rounded conference.

However, due to feedback from membership, several of our sessions will provide a focus on 831(b) captives, including a plenary session featuring Tim Tarter, lead taxpayer counsel in the Avrahami case; a plenary session dedicated to discussing changes in federal and state law, including the recent federal legislative changes concerning 831(b) captives; and a general emphasis on practical considerations for 831(b) owners and advisors.

Nevertheless, this year we have really tried our best to move the conference away from a single focus. Last year was highly concentrated, and the year before was too, so our goal this year was to make it more diverse.

One of the things we did was to make a collective effect to reach out to companies we haven't had before, speakers who are nationally known, North Carolina Captive Insurance Association (NCCIA) members, and to otherwise make the conference reach out to people who have not been with us before.

Even though we are trying to avoid a specific focus, we do try to push the need for relevant and up-to-date information, encourage actual experiences, case studies, and discussion regarding current law and legislative changes.

During last year's conference there were some breakout sessions, which only had one speaker. This year, every session, except one, is going to have at least two speakers. The reason for this is that we believe it is more interactive, and means the information presented will be more diversified.

We expect this conference to be strong in attendance, representation, and quality, and that it will help continue to move North Carolina to where it belongs, in the top tier of US captive domiciles.

What sessions are you most looking forward to?

I think the bookends of the conference are going to be very important. On the front end there will be attorney Tim Tarter and the Avrahami case. That's going to be really interesting for his insight on how he is handling the most important captive case in the last year or two.

We also have attorneys Bruce Wright, Chaz Lavelle and Tom Jones, who will be doing a federal and state legislative update, which is always relevant and essential. I think those two bookends are going to be really strong.

On a personal level, I look forward to Adam Forstot of USA Risk talking about redomistications. In North Carolina, we are getting a lot of redomestications and for me that really jumps out of the agenda. I think for the overall audience it will be well rounded, and that these sessions will be well received.

What have NCCIA's priorities been in terms of captives for this year?

We spent a great deal of effort, along with the North Carolina Department of Insurance (NCDOI), crafting and passing legislation to enhance the regulatory climate for captives domiciled here, based on information gathered by our governmental affairs committee from the membership.

We were successful in those efforts and I believe our members and others will see what a strong association can do for its members on the governmental front. That activity adds to the value proposition to our members.

Then, in post-legislative efforts, we'll work to increase other benefits in the communication and promotion areas of the association, thereby increasing the overall membership benefits. We will also have board turnover too, so in the last five months of the year we will be discussing that and getting ready for 2017.

Young domiciles can come and go pretty easily, so for us to be serious participants in the captive industry we have to grow as a state, as a domicile, and as an association. CIT

Jesse Coyle
Chairman
NCCIA

A better place to be

After governor Pat McCrory passed amendments to the state's Captive Insurance Act, North Carolina is looking forward to another successful year, say Debbie Walker and Ray Martinez

How has North Carolina developed since the implementation of its captive law?

Debbie Walker: There have been significant developments since the North Carolina Captive Insurance Act became effective in 2013. We established four initial goals for our programme, the first of which was to accommodate the needs of North Carolina businesses and others in the captive insurance industry that are interested in our programme. We are making great strides towards that goal. One of the ways we are doing this, as we decided from the start of the programme, is to treat our act as a living document where we monitor the act on an ongoing basis and make changes as appropriate to keep it relevant and competitive. As a result, the act that was passed in 2013 has been amended every year since with the full support of the commissioner, the general assembly and the governor. The most recent amendments to the act were enacted in July of this year.

We are seeing growth in the area of captive insurance company service providers operating in North Carolina, and more captive managers and other service providers bringing their clients to the state. We are also seeing further development of these North Carolina-based service providers, which is having a positive impact on our state's economy, a primary reason our act was introduced.

For 2014 and 2015, we believe our economy has been favourably affected to the tune of approximately $18 million dollars as a result of the captive industry, and 50 new jobs have also been created.

Ray Martinez: The most recent amendments to the act include an exemption from the annual in-state board meeting requirement, if the captive insurance company utilises at least two North Carolina-based service providers. These can include legal, accounting, actuarial, investment advisor and captive manager services, and others deemed acceptable to the commissioner.

Another important legislative change provides the commissioner with additional discretion to establish the minimum required capital and surplus for a protected cell captive insurance company. The law initially required a minimum capital and surplus of $250,000, however, the amendment allows the commissioner to set the minimum requirement below the $250,000 floor, as long as that amount is sufficient to support the captive insurer's risk profile.

Other changes include authority for the commissioner to grant provisional approval of a captive insurer's licence application for a period of up to 90 days, unless the commissioner determines that an extension or rescission of that provisional approval is warranted.

There were also minor technical amendments to the law regarding the formation of captive insurance companies; conflict of interest; plan of operation changes; insurance manager and intermediaries; extension for filing the annual reports; licence suspension or revocation; and clarification of the annual filing requirements for protected cell captive insurance companies.

How much growth has North Carolina seen in its captive market so far this year?

Walker: So far this year we've approved three risk retention groups and one new protected cell captive insurance company for licensure. We have also approved business plans for new protected cells. Several applications are under review at this time. Since the programme's inception, we have approved 99 captive insurance companies, with 98 of those currently active. One captive insurer dissolved because its insured was sold and so it was no longer needed.

We are getting close to that 100 mark, and we are expecting to hit it in the very near future. We expect applications to pick up in the second half of the year, and we have a long list of captive insurer applicants that managers and other service providers have stated they will bring to North Carolina this year. We expect another year of strong growth like we had last year.

Martinez: It is fair to say that right now we are aware of over a dozen hard applications that will be submitted for our approval this year.

What involvement do you have at this year's North Carolina Captive Conference?

Walker: We are involved in four sessions this year. There will be a North Carolina Department of Insurance (NCDOI) session where we will provide a regulatory update, including a discussion about the legislative changes that were enacted this year.

Next, our staff will present a case study of best practices in the submission of a licence application to North Carolina. We also have staff members who are participating in other sessions including those on redomestications, investments and pooling.

What will the NCDOI be working on for the rest of 2016?

Walker: We have a lot of things planned for this year. We are busy participating in local, regional and national meetings and conferences where we have the opportunity to educate and inform others about our captive insurance company programme. We anticipate another strong year for new licence applications, especially as the year-end gets closer.

We have hired a new analyst and the number of dedicated staff for our division has increased to seven, not including the assistance we receive from staff of other areas of the NCDOI.

Martinez: The bottom line from our perspective is that once again we are expecting another great year in 2016 for the North Carolina captive insurance company programme. We expect the number of licensed captive insurers to continue to increase, which will result in an even greater positive economic impact to the state of North Carolina. **CIT**

"We are getting close to that 100 mark, and we are expecting to hit it in the very near future. We expect applications to pick up in the second half of the year"

Debbie Walker, Deputy commissioner, North Carolina Department of Insurance

Becky Butcher reports

SHOWING ITS METAL

Latin America needs more capacity in its insurance industry and consistent regulation if its economies are going to recover

Latin America is slowly but surely coming out of its shell, with the region's risk management needs beginning to look like those of its contemporaries. But the region's 'emerging' status remains steadfast. Non-life premiums in Latin America fell 0.2 percent in 2015, after increasing by 4.8 percent the year before, according to Swiss Re research. This was because Brazil saw a drop in growth from 8.2 percent in 2014 to a 5 percent contraction in 2015. Premiums also declined in Venezuela, falling by more than 25 percent in 2015 due to an economic crisis.

Swiss Re suggested that the declines in Brazil and Venezuela more than offset improvements in Mexico, Argentina and Chile, as well as steady growth in other Latin American economies such as Colombia and Peru.

Although Brazil appears to be holding the region's insurance industries back, where there is growth could be a result of developing natural resources, including mining and oil, or creating manufacturing capacity, all of which require sophisticated insurance industries with sufficient capacity.

"I also think that they are a little more sophisticated and they are leading the way because they are in those positions," says Dennis Silvia, president of Cedar Consulting.

Silvia goes on to suggest that captives are playing a part in these pockets of premium growth in Brazil, because they allow for connections with global reinsurance markets that in turn allow for insurance capacity that might not normally be available in the local economy. He explains: "Insurance is a prime economic engine that creates more growth potential for the economy."

Regulated development

For some parts of Latin America, regulation is having an impact on the level of growth. Insurance companies need to identify markets with regulations that are stable, business-enabling, equitable in their treatment of foreign capital and fostering of market freedom. But in Latin America, this is not always the case.

According to an EY Latin America report, the captive market has not developed to any "significant degree" in the region, partly because of "complex and restrictive" regulations and limited knowledge of captives.

"Many countries in Latin America also impose a withholding tax on cross-border premiums. As regulatory reforms begin to ease, these captive restrictions and new cross-country trade agreements permit their functioning. Several large Latin American corporations that have expressed interest in captive ownership may take this route."

Regulation remains one of the biggest hurdles for captive insurance in Latin America. Magdalena Ramada, a senior economist at Willis Towers Watson, suggests that in several Latin American countries, financial markets regulation, specifically in the insurance industry, reflects Solvency II-type principles, as well as increased control in growing markets such as micro insurance.

Ramada explains that changes in regulation are often not thought through. Insurance companies are then left to comply with new regulations that sometimes the regulators themselves are yet to fully understand.

She says: "Success depends upon the ability of insurance companies to monitor, identify and execute quickly to capitalise on promising markets, and to build relationships in countries in which they can become regulation and market shapers instead of merely spectators."

Although global insurance companies have a presence in Latin America, limited options remain to front captives. This is dependent on the internal policies of each individual company and, in some cases, the local or global relationship with the specific client.

Regulation is not consistent throughout Latin America and in some parts of the region, regulation is preventing further captive growth. Silvia suggests that Brazil is a good example of this.

Silvia explains: "Brazil is meant to be leading the world from the Latin America area, from an economic perspective, but they are very restrictive in allowing insurance business to cede out of the country."

He also reveals that Argentina is having the same problem. Although both countries are high-potential economies, their regulators aren't allowing a lot of outside insurance influence by way of captives and global reinsurers.

Silvia says: "They really are preventing their countries from growing because they have to depend on whatever insurance capacity they have internally and they are not really leveraging the global insurance world against that."

Offshore of itself

Since the rise of captive insurance in Latin America, Bermuda has been a popular domicile for its captives. At the Bermuda Captive Conference, a panel revealed that last year, Bermuda licensed five captives from Latin America.

Jereme Ramsay, business development manager for the Bermuda Business Development Agency (BDA), states that between 2012 and 2015, 14 Latin America captives were registered in Bermuda.

Ramsay suggests that Bermuda has been popular with Latin America because it has been involved in active business development in the region, "particularly with risk forums for financial executives we've organised in several countries to showcase Bermuda's offerings and raise awareness about how captives operate".

A spokesperson for the Bermuda Monetary Authority (BMA) revealed that captives from the Caribbean and Latin America had collectively generated $495 million in gross premiums, with a total capital and surplus of $560 million, as of 31 December 2014.

KEY POINTS

Non-life premiums in Latin America fell by 0.2 percent in 2015 after increasing 4.8 percent the previous year

Natural resource and manufacturing companies in Latin America are looking to captive insurance

25 percent of captives licensed in Bermuda last year came from Latin America

There has also been interest in Europeans domiciles such as Luxembourg and Switzerland

In 2015, 25 percent of captives licensed came from Latin America. According to the spokesperson, this shows that Bermuda is becoming "a domicile of choice for that region".

Eduardo Fox, Appleby's manager for its corporate and trusts groups in Bermuda and Latin America, explains that the majority of Latin

American-owned captives are domiciled in offshore jurisdictions such as Bermuda, the Cayman Islands, Barbados and Puerto Rico.

There has also been some interest in European domiciles such as Luxembourg and Switzerland.

Fox suggests that several Latin American captives have chosen to re-domicile to Bermuda from less viable offshore jurisdictions. This is down to jurisdictions being downgraded by international rating agencies, significant tax system changes, financial and political corruption, or poor due diligence and compliance processes caused by less-than-optimum internal regulatory enforcement.

Bermuda is seen as the ideal offshore alternative by the Latin American market. Nevertheless, according to Fox, the bulk of Latin American captives are still new formations occurring in Bermuda.

Bermuda also has tax information exchange agreements (TIEA) in place with Argentina, Colombia and Mexico, designed to improve tax transparency. Brazil's TIEA with the domicile is currently awaiting ratification, and negotiations are taking place with Chile and Spain. Once Brazil, Chile and Spain have approval from their respective governments, Bermuda will be able to boast a significant tax framework with Latin American countries, giving corporates yet aother reason to choose the domicile for their captives.

Ramsay reveals that, along with Argentina, Colombia and Mexico, Bermuda is also seeing interest and growth from Peru and Chile. He suggests that Latin American audiences are becoming more sophisticated and knowledgeable about captive solutions, and are looking to leverage these structures more and more to better manage their risk management programmes.

Even the most reputable governments in Latin America are now much more transparent and are currently seeking international recognition, says Fox.

Regulation aside, according to Silvia, there is a perception of political instability and economic worry in several Latin American countries, which prevents foreign capital from being invested for development.

The future

Although there is still a long way to go for Latin America, it is no secret that the captive market has gained momentum, with 100 Latin American captive insurance and reinsurance companies around the world.

With this current growth rate and increased sophistication, paired with significant economies in Latin America—Colombia, Mexico, Peru and Chile—and those that could recover from bad luck—Brazil and Argentina—Fox suggests that the market could double in size in the next five to seven years.

Fox predicts that in the next 10 to 15 years, Latin America could see up to 300 captives in total. However, he notes that these may only arise from certain parts of Latin America, not all.

Silvia believes that Latin America has the potential to take on a more prominent position in the world economy, and as that happens, the region will create more opportunities.

But he warns: "Without a growing insurance capacity pool, including captive insurance and other reinsurance capacity coming into those countries, the growth will end up being a fraction of what it could be." CIT

Dip your toe into the risk pool

Karl Huish and TJ Scherer discuss how Artex's pooling mechanism allows middle-market businesses to share their workers' compensation risks

For a business with a large deductible workers' compensation plan, how can a captive be useful?

Karl Huish: In the US, many middle-market and large businesses have a high deductible workers' compensation plan, where the business retains the first $100,000, $250,000 or more of every claim. However, even though workers' compensation risk represents the individual risks of hundreds or even thousands of individual employees, the current view is that this spread of risk by itself is insufficient to meet the necessary risk distribution to have a valid captive. While it is conceivable that the 'risk units' theory of risk distribution could, in the future, broaden to encompass workers' compensation risk, that isn't where the interpretation is today.

So many US businesses, large and small, can have a significant liability on their balance sheets—future workers' compensation claims—and no way to efficiently discharge that liability until the claims are paid. Simply having a captive and transferring the liability to your captive isn't enough for most businesses that don't have several operating subsidiaries—there needs to be a source of third-party risk to meet the risk distribution test.

TJ Scherer: To solve this problem, the company must participate in an insurance pool where there is a sharing of risks between many businesses. Some large brokers, including Marsh and Aon, developed pooling mechanisms for their clients. In these pools, clients could pool their risks together and transfer that pooled risk to each captive, so that the captives would each have unrelated risk, and potentially qualify as an insurance company for US federal tax purposes. This may allow the company to deduct insurance premiums paid to the captive. Large businesses have had this option for many years.

However, until a few years ago, there wasn't a similar solution for small and middle-market businesses, say a business with $400,000 to $7 million or more in annual workers' compensation losses.

What are some of the benefits of pooling?

Huish: For example, if you own some stock in just one company, even if it's a very good company such as Apple, that stock can go up and down quite a bit and have a lot of volatility. However, if you own stock in 10 companies, especially in different industries, they all tend to balance each other out. As the saying goes, don't put all your eggs in one basket.

The alternative risk industry does this by utilising insurance risk pools—accomplishing some basic diversification. Businesses thrive on predictability. They want to be able to predict from month to month and year to year what their revenue and expenses are going to be, and the likes of insurance losses are not very predictable. Participating in a risk pool is a good way of smoothing out those losses to make them more predictable.

Scherer: If you go from a guaranteed cost product to a high deductible there is a lot of benefit taking on that risk yourself. However, one of the drawbacks is that smooth cash flow isn't always there because of the volatility, so joining a risk pool offers the best of both worlds.

Is this where the Artex Exchange solution fits in?

Huish: Yes. A couple of years ago, Artex built a solution for those middle-market businesses called the Artex Exchange (AEX). The solution is a pooling mechanism that allows middle-market businesses to share a layer of their workers' compensation risks. There are several benefits to this. First, pooling risks reduces the variability of losses for any single company—it acts as a risk dampener, which is precisely why companies pool risk.

Second, the pooled risk is an unrelated source of risk, which can help support the captive's position as an insurance company for US federal tax purposes. Some AEX participants already have a captive, and use the AEX to help qualify that captive as an insurance company or diversify their captive's underwriting portfolio. In other cases, the company might want to form a captive, but can't determine how the captive can qualify for insurance company treatment. AEX solves that problem, allowing the company to form a captive and achieve the same type of benefits as larger businesses.

With a captive in place, the company now has a central organising entity for risk management programmes, and an efficient way to create reserves for future losses. Of course, the captive doesn't need to be limited to workers' compensation risks. Many other types of risk can be included in the same captive.

Has the programme been successful so far?

Scherer: We think it has been successful. We started in late 2012, and so our first full year was in 2013. So far we have 10 clients, with $25 million in annualised premium, and we believe the growth is just about to kick off.

There are a lot of clients that we have approached, or prospective clients, who believe the programme sounds really good, and who have shown interest but do not want to be the first to join. However, now that we have been going successfully for four years, we think there will be a lot of businesses interested in joining.

We feel the programme has met everybody's goals including the risk shifting and sharing, and maintaince of the pool. The AEX pool is not meant to be a profitable line of coverage. It is meant to facilitate the captive as a risk management tool. With a captive in place, the business can, over time, expand the uses for the captive and look at general liability, auto liability, property, and other risks unique to the business. For all of our AEX clients, it has met that goal.

Why should companies choose risk pooling?

Huish: Sharing risks in one form or another has been around for hundreds of years, dating back to Lloyd's of London. Risk pooling is used in so many different areas. At Artex we manage different types of risk pools. For example, there might be municipals, cities and towns that will get together and do a risk pool for their general liability risk, property risk or auto risk. Captive insurance companies also use risk pooling for several reasons. The top reasons are to reduce variability of risk and to qualify as an insurance company. To put it in simple terms, businesses really, really want to avoid an extremely large, unanticipated expense, especially something that rises to the level of what is called 'balance sheet risk'.

Scherer: The risk is still there, but now all the risks from many companies are being shared by many captives. The nature of portfolio diversification is that for some years, your own company's losses will be low, but others may be high. The next year, it might be the reverse. The pool has the effect of smoothing out these losses for each participating company.

Can pooling provide any relief for existing liabilities?

Scherer: Yes. By forming or having an insurance company, the insured can transfer its existing risk to the captive through a reserve transfer, sometimes called a loss portfolio transfer. This provides the insured with a cleaner balance sheet, less in reserves, and a tax deduction for the premium payments. Since many companies would not have the ability to do this without a pooling mechanism, AEX can provide the solution.

Does pooling change the current programme at all?

Huish: Risk pooling doesn't change the existing programme for the business, however, sometimes companies put off risk pooling because they think it involves change, when really it doesn't. Risk pooling is just an overlay—it fits right on top of the existing programme. With AEX, the company keeps its large deductible programme in place, including the broker and excess carrier.

Do you think some have been put off by the potential changes?

Huish: I think businesses need more explanation and education on captives. Some businesses are willing to go through that process of learning and others think it will be too complicated. Many good solutions take a little bit of education to get there. But once the business understands it, watch out. They get very excited about the benefits that a captive can bring.

A lot of businesses learn about one type of captive and then believe the same rules apply to all captives when in fact there are many types of captives. We have to re-educate risk managers about alternative risk and what a captive really means, and that takes some patience on their part. This especially occurs when you have a new programme such as AEX. Now that our programme has been around for a couple of years, risk managers are more willing to engage and I can see it having good growth in the future.

Has there been an increase in movement to pooling from other alternative risk solutions?

Scherer: Companies using a large deductible are using a type of alternative risk. A large deductible is a great start, but if the company is willing to take the risks of that deductible, there's more that can be done. One answer, we feel, is to join a workers' compensation pool and utilise a captive. Companies are always looking to move on to the next level. So, many clients that are on a high deductible are looking at other options, and forming a captive is one of those.

Huish: A large deductible is only one type of alternative risk but clients see a lot of benefits from it. One benefit to the company is purchasing less insurance, and saving money on all of the overheads associated with commercial insurance. Businesses are forming their own captive insurance companies so they can have their own risk manager vehicles and be able to pay those premiums up front into their captives.

Imagine a middle-market business, with workers' compensation losses that will be $5 million or so. However, it cannot take a tax deduction for those until it actually pays the claims, so the business ends up having a large liability stuck on its balance sheet.

One way to fix this problem is to create your own captive insurance company and transfer that liability to your captive. But to have a legitimate captive insurance company in the US you have to have a sufficient amount of unrelated risk and that's where the pool comes in and provides that.

What about additional benefits?

Huish: Most large deductible programmes require a letter of credit (LOC) or other collateral. AEX may permit the business to reposition the collateral to the captive, thereby freeing up substantial after-tax cash for business use or shareholder distribution. Also, some carriers will also accept a 'Reg. 114 Trust', which can be a cheaper and easier alternative to an LOC, and can generally only be entered into by insurance companies, including captives.

Scherer: Further, with AEX providing unrelated premiums to the captive, the business may be able to transfer additional direct premiums to the captive, outside of AEX, for other retained risks, such as general liability, auto, property deductibles, prior years' comp retentions or other self-insured risks. This can result in a significant financial and risk management benefit. CIT

TJ Scherer
Account executive
Artex Risk Solutions

Karl Huish
President of captive division
Artex Risk Solutions

True to TRIA

Groups and cells are among the best options for gaining access to the Terrorism Risk Insurance Act, according to Thomas Stokes of JLT Towner

Why has there been an increase in group and cell captives accessing TRIA?

Group and cell captives in general are experiencing an unprecedented period of growth within the captive industry. Small and middle-market businesses are the engines driving this growth, as the threshold for participation in cell and group captives is lower than other captive options.

Cell captive entities operate in much the same manner as single parent and group entities. Structured properly, these entities function to retain a portion of exposure emanating from the parent company with the goal of accessing underwriting profitability, among other benefits.

It is well established that captives have access to the federal terrorism backstop. The increase seen in accessing the Terrorism Risk Insurance Act (TRIA) as an exposure within a captive's portfolio of risks is a function of an increase in the utilisation of cell and group captives in general.

What are the necessary steps a risk manager has to take to ensure they are fully covered by TRIA?

The US has been fortunate that, following the terrible events of 9/11, while there are still acts of terrorism affecting both the US and its allies, none have replicated the devastation necessary to trigger the federal backstop covered by TRIA. We hope the federal backstop is never triggered and that all acts of terrorism cease altogether. That being said, because of its limited use, there is little precedent that would detail the process in practice as it pertains directly to captives.

The current legislation details three eligibility requirements. Insurers must: be a recipient of direct earned premiums for any type of commercial property and casualty insurance company; be licensed (or admitted) to provide insurance in any state; and meet any other criteria that the secretary may reasonably prescribe. These last criteria should be settled, again, once industry responses are received and the treasury prescribes additional clarification.

As a result, risk managers must assess their businesses and overall exposure to, and risk of loss from, any potential terrorist event. Because not all terrorism events would qualify as a trigger for the backstop, it is always best for risk managers to work with a broker and an alternative risk consultant familiar with the operation of the provisions of the backstop. This way they can determine first what coverage is available in the marketplace, and at what price, before augmenting coverage through a captive insurance company.

The US Treasury has proposed rules around TRIA and self-insurance arrangements. What is it looking at?

The US Treasury has posed several questions to understand the role of self-insurance arrangements and captive insurers prior to implementing rules designed to affect those industries. The resulting rules will take these comments, as received by the industry, into consideration. While changes are posed to exclude captives from the definition of a small insurer, no posed rules pertaining to the exclusion of captives as entities qualifying for the programme have been detailed. Highlighting this fact is the Treasury's inclusion of a section within the legislation reserved for further regulations concerning the participation of captive insurers in the programme.

In my opinion, once responses are received from the industry, captives will continue to qualify. The questions are an attempt to understand the various permutations and create rules tailored specifically for the captive industry. Captives are now widely recognised as insurance vehicles by the insurance industry in general and also, more importantly, by the courts. When structured and operated properly, captives serve as qualified insurance entities, and acting otherwise would be contrary to the Treasury's own stated position.

In addition to qualifying, insurers as well as captives will be subject to data collection protocols designed to monitor the effectiveness of the programme. It has been stated that the captives will have separate protocols following responses to the proposed industry questions. With national elections occurring later this year, however, it is not expected that legislation will be received for several months.

What differentiates JLT's sponsored cell captive facility, Isosceles Insurance Company, from the competition, particularly when it comes to TRIA?

Sponsored cell captive facilities benefit captive owners by offering lower startup costs, lower exit costs, less lead time for establishment, lower operating costs and less administrative burden as compared with single parent captive or risk retention groups.

JLT has a broad variety of cell captive options that can accommodate almost any desired insurance transaction globally. Our cell facilities in Bermuda, Barbados, Guernsey and Connecticut are each designed to meet specific needs.

Our Connecticut cell facility can be used, pursuant to a properly structured programme, to access the TRIA backstop, to provide for US-based employee benefits and to provide easy and economical access to the benefits of captive insurance. In particular, our Connecticut structure allows participants to incorporate their cells as either the shareholder owner or as a rental of a JLT-owned cell, to further accommodate the structuring needs of our clients. CIT

Thomas Stokes
Practice leader
JLT Towner US Consulting

Beyond the bottom line

Captive insurance models in healthcare can help to drive quality and safety improvements, says Eric Dethlefs of Cassatt Insured Group

Studies have suggested that the medical liability system costs the US billions of dollars annually. Components of the costs of the medical liability system include indemnity payments, administrative expenses and defensive medicine costs. The indemnity payments and administrative costs are tangible, although not comprehensive.

How medicine is practiced and the costs associated with defensive medicine are exceptionally difficult to estimate. Most insurance professionals would likely argue that controlling indemnity payments and administrative expenses is their top priority.

Hospitals and healthcare systems, physicians and physician practice groups, midwives and other health care providers can access the medical professional liability marketplace in various ways. Common access points are through an admitted commercial insurance company, a surplus lines insurance company, or, more commonly over the course of the last decade or so, through a captive insurance company.

Over the past 25 years, the number of captives worldwide has steadily increased as more and more hospitals and other healthcare organisations are seeing the benefits outweigh the costs of purchasing malpractice insurance in the commercial marketplace. Captive insurance companies can offer more flexible coverage terms and more competitive premiums than those that are available in the standard commercial market.

In essence, a properly structured captive, with laser-like focus on patient safety and quality, will change the way care is delivered beyond the bottom line.

The financial incentive for most captives is not about generating a profit or surplus wealth accumulation.

Premiums represent the captive's best estimate of expected indemnity costs and allocated loss adjustment expenses, plus an additional amount to cover administrative expenses such as, among other things, risk management and patient safety initiatives.

All insurance companies, whether in the commercial market or a captive, charge premiums, invest those premiums, and manage the indemnity and expense payments.

In the context of a captive that works well for hospitals and health systems, when initiatives are in place to promote a safer patient experience, medical malpractice insurance premiums are likely to be less. Those premiums will still be invested and the losses managed well, but the cost of risk is lower.

When hospitals and healthcare organisations form their own captives, they share both the risks and rewards of participation. A commitment to quality improvements naturally results in fewer medical errors and other untoward events, and therefore, an overall reduction in malpractice cases. With that comes meaningful cost savings for all members of the captive.

It is this inherent commitment among the captive participants to ensure the best possible outcomes for their patients that makes this type of coverage model unique and appealing. For the best possible results, it is in the best interest of all members of the captive to be working in close collaboration with one another to share insights, data and best practices, so they can work toward delivering the highest possible quality and safety standards in their organisations.

Through such close collaboration, these organisations are not only working to improve outcomes in their own hospitals or healthcare organisations, but throughout all other institutions that participate in the captive. In this way, a captive becomes an even more meaningful risk management and quality improvement tool by working to increase the quality of care for patients across an entire region or group of healthcare institutions.

Through their connection in a captive group, hospital and healthcare executives open up an invaluable pathway of communication. This constant communication between its members allows for the sharing of best practices that would otherwise not occur. The opportunity to collaborate with similar minds to improve their organisations is a special benefit that a group captive offers.

This is an opportunity that can distinguish captive insurance groups from traditional commercial insurance solutions, which tend to be focused exclusively on claims. The members of a group captive can participate in collective and cooperative efforts, sharing best practices and identifying emerging trends and issues in order to have a true learning organisation.

Ultimately, the captive's ability to thrive will depend on the engagement of each of the members in its activities. A member that is not prepared to participate in management of the captive and in the programmes offered by the captive will not be able to maximise the benefit of involvement in, and may not contribute positively to, the captive's overall results.

This is a risk that is inherent in group captives, but one that can be easily avoided by the obvious consequences of failing to actively collaborate and participate.

Ensuring at the outset that each member has the same goals and expectations as the rest of the group, and is willing to make the investment of time and resources, should go a long way toward eliminating this concern.

One important way to achieve open and meaningful information exchange and dialogue between the captive's various members or owners is by forming a patient safety organisation (PSO). A PSO is a group, institution or association that improves medical care by reducing medical errors.

Its purpose is to create a collaborative and confidential environment of learning and knowledge exchange among its members, substantially enhancing their efforts to improve patient safety and quality of healthcare throughout their hospitals.

Information and experience shared by members serves as the backbone of a successful PSO.

This organisation will collect and analyse the data and information that is shared by its members, and in doing this, it will identify any trends or common issues occurring in the field.

A hospital acting alone would not be able to detect such things, showing the true value of creating such an organisation.

Through the PSO, hospital staff and insured physicians closely collaborate to discuss the liability issues and methods for identifying and managing risk exposures in the hospital and office practice settings.

This may be accomplished through several methods, including:

- Collecting, analysing and sharing patient safety-related information;
- Collaborating on improvement strategies;
- Exchanging information in a protected environment;
- Supporting patient safety initiatives and encouraging a culture of safety;
- Providing caregiver support for providers involved in a serious event or claim;
- Confidential, closed-group discussion forums;
- Deposition guidebooks for physicians, nurses and staff members;
- Patient safety culture surveys; and
- Regular educational programmes, seminars and events dedicated to the sharing of outcomes and best practices.

Another important feature of captives is that they give their members ownership and control. By having the members own and control the group, there is increased accountability and commitment to follow through with the group's vision and goals.

Members will have the ability to direct the insurance programme and network with other shareholders to enhance patient safety and risk management initiatives.

Group captives will also employ a dedicated staff force, which will be held accountable for results.

What makes captives work particularly well is that their models are reverse-engineered, whereby improving patient outcomes is the first and foremost priority versus economic gains, unlike in the traditional insurance market.

And in doing it this way, everyone reaps the rewards—from the insured members and owners to their patients. CIT

"The members of a group captive can participate in collective and cooperative efforts, sharing best practices and identifying emerging trends and issues in order to have a true learning organisation"

Eric Dethlefs, President and CEO, Cassatt Insured Group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Risk in regulation

Although captives are adapting to the ongoing soft market, regulation continues to be a problem. Jason Flaxbeard of Beecher Carlson explains more

How is the insurance market changing? Are captives struggling to adapt?

Captives, as they have always done, are adapting to a softening market. Soft market strategies include the review of old reserves held either on the parent or the captive's balance sheet. With the growth of the investment-backed reinsurance vehicles in Bermuda, access to premium has become very important.

Companies may be able to reinsure or novate these reserves to a partner willing to offer favourable terms. Similarly, some captives are using the soft market to negotiate commutation terms with their fronting carriers.

The soft market offers other strategies too—there are risk managers who use these times, and the profit created in the captive, to invest in safety programmes and procedural improvements to risk management techniques, in order to prepare for a hard market, whenever that might be.

Also, although theory dictates that a captive should shrink in a soft market, its operational efficiencies remain valuable to companies. It can also offer companies the ability to assume risks from affiliated third parties, something that has become very important over the past five years.

What kind of challenges are captives facing, and how are they overcoming these?

Captives face many regulatory problems. Happily, all captives are different. What stands before each of them, however, is regulation. Base erosion and profit sharing (BEPS) regulation is becoming an issue, as is some of the US states' approaches to self-procurement taxes.

There are still captives re-domesticating, creating home-state branches and setting up new vehicles in new states. That trend seems sure to continue as the number of states with captive laws who integrate their insurance and treasury functions continues to rise.

BEPS itself will require more disclosures from companies owning captives, and more oversight. Transfer pricing will be scrutinised further and individual transactions reviewed for efficiency and appropriate disclosure. There will be more regulatory burden on companies as a result.

How can domiciles combat the rise of the Non-admitted and Reinsurance Reform Act? What options are there?

There are a number of steps a captive can take, including actually paying the tax. That's what many captives are doing while they lobby for an amendment that will exempt them from having to pay the self-procurement tax to their home state in the first place.

The next obvious step is to redomesticate back to the parent's home state. This has happened in states such as Texas and Georgia recently, largely because it made sense to bring risk management into the same domicile, and because the home state offers a cheaper independently procured tax rate.

Other options exist, such as using a fronting carrier, but these can come with catches that might not always be fiscally attractive.

Is the soft market allowing companies to explore run off markets, and why?

Capital is king. Insurance is essentially access to someone else's balance sheet. If an insurer's balance sheet has access to cheaper capital than your own, buy insurance. If your cost of capital is less than an insurer's, retain the risk.

Captives, as a financing tool, are seeing that capital at the parent level is becoming more available, but this is also true in the insurance and reinsurance markets, so much so that the cost of capital in reinsurance has provided companies with an opportunity to transfer risk at favourable rates.

The main options that companies are using include selling the captive to clean the corporate balance sheet and start again; novating the policy to a reinsurance market or commuting back to the front; or reinsuring the policy with a reinsurance carrier that offers surplus relief as well as some profit share on the portfolio (this may also be investment income).

Each one of these options, should capital be cheaper at the carrier level, will allow a company to transfer risk, clean the corporate balance sheet and free up collateralised funds that support the liabilities.

Are captives adapting to emerging risks? How are they doing this?

Yes they are. Cyber, for instance, is a coverage that has emerged as a risk, but a not entirely quantifiable one. Companies are insuring the portion of the risk that is quantifiable in the captive, notification and regulatory risk, and looking to transfer to the market the unknown, indemnity risk. CIT

Jason Flaxbeard
Senior managing director
Beecher Carlson

Open and shut: the US and EU cases for captives

Regulatory permissions are partly the reason for an expansion in the US captive market, while the opposite is true in the EU, says Paul H Phillips III of Ernst & Young

Regulatory **Perspective**

What are you currently seeing in the US captive markets compared to in the EU?

Within the US, the captive market continues to expand at an accelerated pace while in the EU the market has been flat or contracting. One of the accelerators is clearly the favourable US Tax Court decisions that have added more clarity to the key criteria of risk shifting, risk distribution and what qualifies as an insurable business risk.

Additionally, it is important to note that within the US, the regulatory framework that governs insurance companies, including captives, resides at the state level. In this regard, while Vermont may be celebrating its 35th anniversary of having captive laws in its books, other states have recently been entering the market or modifying their insurance laws to further accommodate the captive industry. Accordingly, now 40 US states are competing for captive business. Thus, in the US, the expansion of the captive market is in part due to regulatory permissions.

This is in contrast to the EU captive market. Within the EU, we first started to see contraction due to the requirements of Solvency II, with various organisations re-examining the benefits of captive structures given internal hurdle rates, or the cost of capital and the increased capital requirements. Solvency II also introduced a fair amount of uncertainty into the environment, as the market seemed fairly confused regarding the actual applicability of the rules.

The confusion, and the contraction, within the EU has been compounded by the Organisation of Economic Co-operation and Development's (OECD) base erosion and profit shifting (BEPS) project, as the market has reacted to statements and concerns raised regarding captives.

I should also highlight that while we have seen most organisations within the EU that own captives re-evaluate their use of this corporate risk management tool, many have decided to enhance the substance of their captive and increase the documentation of the corporate rationale for why their captive is appropriate. Accordingly, in both the EU and US captive markets, the volume of consultancy services is increasing, but for clearly different reasons in each market.

Beyond the regulatory environment, are you seeing any specific trends in insurance products?

Starting with the US market—we are seeing growth across the board and it's difficult to pinpoint one particular line of business or even industry segment that is having a true break-out performance. However, I do see a few slight leaders in the pack.

With regards to lines of business, still focusing on the US market, we have seen a rise in product liability and product recall. Obviously, given the tort environment in the US, this is a natural product for companies that believe they have better experience than the overall industry, or who feel as if they are unfairly penalised in pricing due to the adverse development of claims of others, to explore placing this line into a captive.

We have also seen that in certain industry sectors product liability and recall coverage is not available to consumers, so a captive is a viable risk management alternative.

Perhaps most notably within the US, and expanding internationally, is the number of companies that we see examining different types of business risks and exploring whether such risk could be better managed in a centralised structure such as a captive insurance arrangement. I believe this is due, in part, to the residual value insurance (RVI) case and the clarification by the US tax courts on what may qualify as insurance. The other aspect that facilitates this is that many companies now have quite a bit of knowledge and data regarding their business risks.

This may have been captured as a result of enterprise risk management efforts, stress testing, succession planning or any of the other risk-based modelling initiatives an organisation may have executed.

This data may allow a company to analyse its experience and structure the transfer of such risk as pursuant to an insurance contract into a captive that is regulated as an insurance company. Accordingly, when big data is aligned to the RVI case, there are various opportunities in creating risk management, captive insurance and alternative risk transfer programmes.

Also, within the US we have seen an uptick in companies seeking to offer insurance to their customers for customer-based risks, such as extended warranty programmes. I can't specifically call out the driver for this uptick, but I would suspect that it could be related to the increase in the premium threshold for electing small insurance companies to be taxed on investment income only under Internal Revenue Code Section 831(b).

This was modified late in 2015 to limit, or eliminate, the benefits of the election in certain situations where estate taxes may be at issue. However, in addition to the elimination of the perceived estate tax planning abuse, the premium ceiling for electing companies was raised from $1.2 million to $2.2 million, starting in 2017.

As this election was once popular in the producer-owned reinsurance space—dealer-owned extended warranty companies—I believe that that area of the market has re-emerged. Of course, the mere increase in the premium limit has many organisations re-evaluating programmes for otherwise self-insured risk.

Likewise, we do see some companies restructuring or taking other appropriate steps, including winding down, in reaction to the possible elimination of the benefits of the election.

I would be remise if I didn't mention that within the US we also still see interest in employee benefits as possible placements within a captive, and lately this has included a focus on medical stop-loss programmes. Given the recent favourable rulings and the potential benefits of these programmes, they are often discussed.

In looking exclusively at the EU, I honestly cannot identify any real trends in products or specific sectors. Lately, the real efforts have been in assisting companies with substance or documentation concerns, such as transfer pricing considerations. However, historically, EU captives that I have been exposed to have EU pension risk transfers or other employee benefit type arrangements.

You mentioned risk distribution as a key criterion for qualification. How do you currently evaluate the matter?

The academic debate that we often have is: how many subsidiaries are needed in order to have risk distribution? This is due to the captive safe harbour rulings in 2002 (Revenue Rulings 2002-89, 2002-90 and 2002-91) that described the need for 12 or more subsidiaries, whereas no one subsidiary had more than 15 percent or less than 5 percent of the total premium or risk going into the captive.

The safe harbour ruling was also later clarified by the Internal Revenue Service (IRS) in Revenue Ruling 2005-40, where it articulated its position that the risk of an entity that is disregarded for tax purposes is the risk of its owner, and in the facts as presented, all risks transferred to an owner of 12 disregarded entities. As a result, distribution was deemed to not exist.

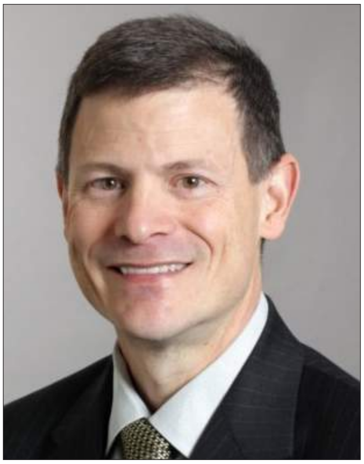
First, I would stress that all facts matter in evaluating qualification. But, if we are limiting such analysis to only risk distribution and assuming all other facts are good, my belief is that if the facts line up to the risk being shifted across the organisational structure, as opposed to coming down from a parent, than the number of subsidiaries is factually irrelevant to the actual risk distribution analysis. This is due to the US Tax Court statements in Rent-A-Center and Securitas, which emphasised risk distribution as being the analysis of statistically independent loss events.

Accordingly, technically one subsidiary, other than the captive, may be good enough for the risk being transferred from the subsidiary. Regardless of the technical or actuarially-based argument that the court has embraced, the IRS has not withdrawn or modified its prior revenue rulings.

Such guidance remains as authoritative pronouncements that must be evaluated, or weighed, against all relevant authorities in forming an opinion on a specific set of facts and circumstances. My view is that to be at a more-likely-than-not level of comfort, a taxpayer would need clean facts in all aspects and need at least two other subsidiaries, with no one subsidiary representing 90 percent or more of the total risk or allocable premiums going into the captive. **CIT**

“If the facts line up to the risk being shifted across the organisational structure, as opposed to coming down from a parent, than the number of subsidiaries is factually irrelevant to the actual risk distribution analysis”

Paul H Phillips III, Tax partner, Ernst & Young



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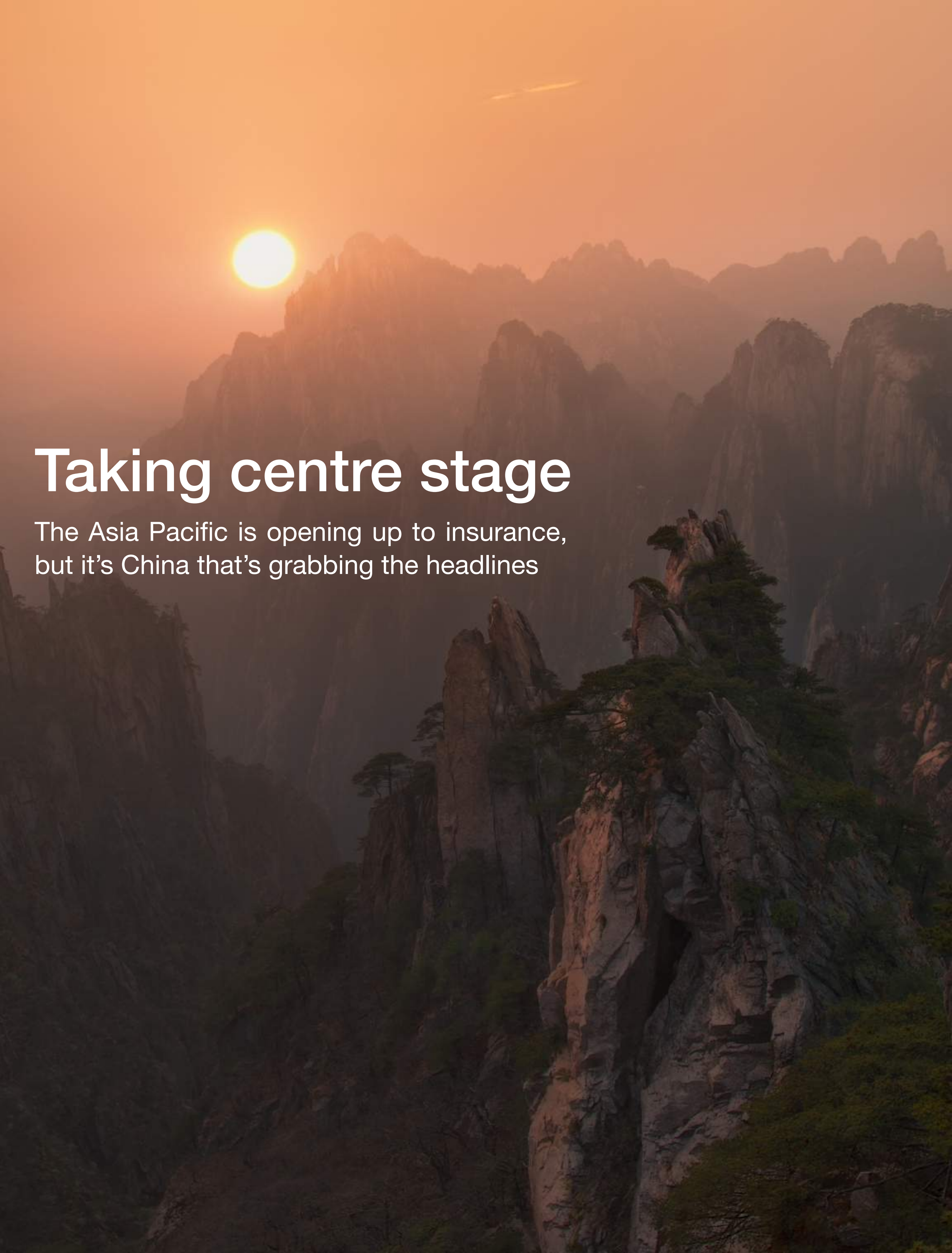
Taking centre stage

The Asia Pacific is opening up to insurance, but it's China that's grabbing the headlines



The expansion currently underway in the Asia Pacific captive market is down in large part to China, where insurance is taking hold at a healthy pace.

One contributing factor is the overall trend of not only the large state-owned enterprises but also the small- and medium-sized enterprises starting to develop their risk management and retention strategies and ultimately looking to captive solutions.

Problems exist, though. Rob Geraghty, vice president and business development leader at Marsh, claims that in China, a captive is still regarded as a regular insurance company, suggesting that this is "inflexible" compared to other captive environments.

However, China is looking to change its attitude towards captive insurance companies. Geraghty says: "China has a positive philosophy in encouraging Chinese companies to look at the captive environment and potentially set up a captive in China."

Those setting up captives are coming from a wide variety of sectors. Tracy Stopford, senior vice president and managing director of the Willis Hong Kong captive practice, suggests that China has seen interest from the energy and transportation sectors, and from other industries with significant risks and operational assets.

There has also been interest in insurance-linked securities and catastrophe bonds from some organisations—interest that has only increased after China Property and Casualty Reinsurance launched its $50 million catastrophe bond Panda Re, last year.

Stopford says this transaction could open up the market for asset managers looking to diversify risk in China.

China has also attracted foreign interest, particularly from the Guernsey International Insurance Association (GIIA). The association recently signed an agreement with both the China Captive Alliance and the Kashgar government, committing to further development of China's captive insurance market.

The agreement means that the parties will cooperate on captive insurance market development, on financial innovation, to promote the viability of the Chinese captive market, and on developing more communication between China and the international captive industry.

Charles Scott, managing director of independent insurance manager Alternative Risk Management, signed the agreement on behalf of the GIIA, alongside Yongjie Liu, general manager of the China Captive Alliance.

Scott says: "[The agreement] establishes a very important framework for the cooperation and development of our two jurisdictions in the area of insurance, specifically captives."

"It also means that Guernsey is now well positioned to benefit from captive opportunities in the international arena that emerge from Chinese corporates."

Fenglin Xu, deputy director of the Kashgar Trade Development Zone, adds: "The signing of the [agreement] between ourselves and Guernsey is an important step to enhance the captive insurance market in China."

Private captive enterprise is positioning itself for an influx of Chinese business, too. Marsh recently appointed Ariel Kou to its Beijing office, to focus on developing and implementing captive insurance programmes for its clients in China.

Geraghty explains: "We are investing in Chinese captive solutions, and now that Ariel Kou in based in China we have got someone on the ground that is the main point of contact for Chinese captives."

Although the Chinese captive insurance market has made significant progress, regulation is still cited as an issue that's holding it back from further development.

Chinese regulators have adopted a risk-based solvency system similar to Europe's Solvency II and, according to Geraghty, the country still maintains a strict approval process for captive insurance.

"China implemented its own risk-based capital regulation at the beginning of 2016, the China Risk Oriented Solvency System, which requires Chinese insurance companies to be transparent in their recording and reporting of risk. For companies to meet the requirements, it is essential for them to define and measure the risk, in order to report in a logical and meaningful way."

China implemented its own risk-based capital regulation at the beginning of 2016, the China Risk Oriented Solvency System (C-ROSS), which requires Chinese insurance companies to be transparent in their recording and reporting of risk.

According to Stopford, for companies to meet the requirements of C-ROSS, it is essential for them to define and measure the risk, in order to report in a logical and meaningful way.

By adopting robust risk management standards and practices, Chinese multinationals are at the same time implementing the necessary practices to report solvency to the regulators, in line with global best practice.

Outside of China, there has been little movement from the rest of Asia on the captives front. Stopford adds: “While we are not necessarily seeing innovative movement for captives, we have seen in Hong Kong the complete overhaul of the insurance regime.”

She suggests that the existing regulatory set-up in Hong Kong was not considered to be in line with the requirements of the International Association of Insurance Supervisors (IAIS), including the requirement that insurance regulators should be financially and operationally independent of the government and the industry.

In July 2015, the legislative council passed the ordinance that would align Hong Kong’s insurance standards with the rest of the world. Stopford claims that this was seen as the “most important” regulatory reform in the insurance sector since the original ordinance first passed in 1983.

She says: “It is unclear how the new Independent Insurance Authority will affect current captive legislation, but we are paying close attention to the implementation as it progresses.”

“[Elsewhere] the established domicile of Singapore, a favourite of Australian organisations, has remained fairly static.”

Geraghty expects the mainstay of Asian companies using captives to continue to be Japanese, Malaysian and Korean. However, he suggests that in the future, this could potentially expand to companies in the like of the Philippines and Thailand.

He explains that some of the larger companies in these areas have sophisticated risk management processes that compare to their international peers.

Looking ahead, Geraghty expects that once specific captive legislation is implemented in China, the captive market will continue to develop.

While currently there is a set criteria to follow when setting up a captive, for example, firms need to be a certain size, Geraghty suggests that as China develops those regulations, it could see an increase in the use of captives.

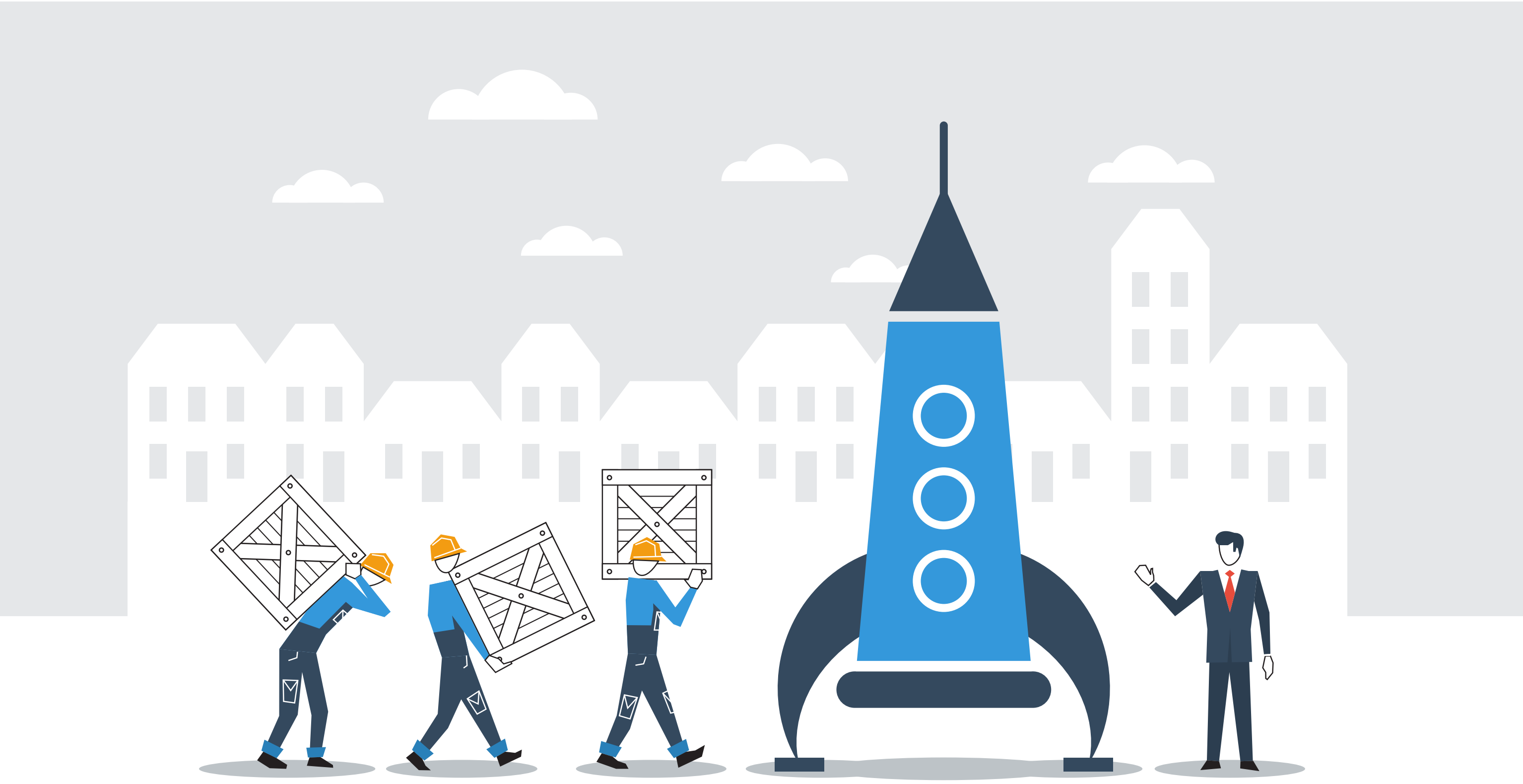
He notes that further improvements are being created to put appropriate regulation in place, and to allow Chinese entities to set up captives, adding that, typically, the Asia Pacific captive market mirrors the Latin American market.

“We have seen an increase in Latin America in recent years, especially in Bermuda, where entities have been set up by Latin American companies. We have also seen companies from Chile, Peru, Mexico and Columbia look at, and establish, captives,” says Geraghty.

“It’s about education and understanding of qualitative and quantitative benefits, the desire to retain risk in a captive, and then finding the right domicile to do that.”

With the Chinese captive insurance market closely following the Latin American route, Geraghty concludes that as more companies talk about it, and make decisions around it, the more the market will continue to grow.

He says: “The only way is up. Once the market gains momentum, it will start with traditional risks, in the same way as a lot of captives have started, such as regular property and casualty risks.” **CIT**



Hamilton bound

Economic changes in Canada have companies considering captives in warmer climes for their insurance coverage. Kim Willey explains of ASW Law explains

How have macroeconomic factors affected Canadian businesses? Have you seen any new lines for captives?

Canada has seen tremendous change in the last year and a half. These factors have made Canadian companies more alive to risk generally and more specifically to their insurance coverage and the prices they are paying for such coverage.

With falling oil and gas prices, Bermuda has seen an uptick of interest in captives for oil and gas companies. This may be because these companies are now more aware of reducing costs as a way to maximise their bottom line, and they see captives as a solution.

High-profile cyber breaches have also created an interest in setting up captives to self-insure against cyber risks, which are often very difficult to price appropriately for specific businesses in the commercial market. Also, Bermuda has seen more interest in the use of captives for employee benefits, as Canadian companies become more aware that this is a way to reduce costs and increase organisational discipline for these types of risks.

Has the current landscape meant an increase in captive activity?

Interest in Bermuda captives from Canadian companies has been steadily increasing since the introduction of the Tax Information Exchange Agreement (TIEA) between Canada and Bermuda in 2011.

The TIEA levelled the playing field with Barbados, which has had a double-tax treaty with Canada for some time. This resulted in a number of captives of large publically listed Canadian companies re-locating to Bermuda.

The TIEA allows profits from captives that insure non-Canadian risk to be repatriated to Canada at a reduced tax rate. It is very important to note that this is meant to encourage Canadian companies to invest in international operations and bring profits back to Canada. There is no tax advantage for captives that insure Canadian risk. Therefore, the reason for using a captive continues to be that it is an efficient business structure.

For Canadian multi-national companies with international risk, TIEA permits the tax-free repatriation of certain profits, related to such international risk, back to the Canadian parent. Although tax savings may be a reason for setting up a captive for international risk, the primary motivation continues to be business efficiency.

Why are Canada-based companies heading to Bermuda? What does Bermuda have that Canada lacks?

Canadian companies are setting up captive structures in Bermuda because captives are an efficient business structure. Captives allow companies to better control their insurance costs and claims and to manage risk within their organisation. Captives can also access the reinsurance market directly.

The capital placed in a captive may also be invested, allowing the company to earn investment income.

Canada does have a 'home-grown' option for captives, in British Columbia. However, in our experience, British Columbia does not offer the advantages of Bermuda, particularly as captive regulation is a very small part of British Columbia's regulatory ambit.

Canadian companies are selecting Bermuda because it is a well-respected leading jurisdiction for captive formation, management and regulation. Bermuda has a knowledgeable and efficient regulator, the Bermuda Monetary Authority (BMA), which specialises in captive regulation.

Bermuda is also a highly collaborative jurisdiction. Industry, government and regulators work closely together to facilitate speed to market and innovative, expeditious resolution of client issues.

In addition, Bermuda has a strong history of innovation when it comes to new lines of insurance business and a well-established reinsurance market. Bermuda also has a wealth of dedicated insurance service professionals and an established infrastructure.

Are there any regulation restrictions in Canada?

Canadian companies should consult with their Canadian advisors as part of the feasibility study process for specific advice. However, there are no Canadian legal restrictions on a Canadian company setting up a Bermuda captive.

If the Canadian company is looking to insure Canadian risk through the captive, it should again consult with its Canadian advisors for any fronting arrangements required in Canada.

Have the Panama Papers had an impact on the number of Canadian companies choosing to domicile in Bermuda?

The Panama Papers and some other recent notable tax fraud cases in Canada have certainly increased the scrutiny of offshore jurisdictions. However, Canadian companies are continuing to recognise the value of the Bermuda captive structure.

The first point to make is that despite all the negative press, offshore investments are not illegal. The Canada Revenue Agency has stated on its website: "Investments outside the country are not illegal. Canadians who invest outside the country are in compliance with Canada's tax laws as long as they report all of the income earned outside Canada." The second point to make is that for Canadian risk, as stated above, there is no tax play for Canadian companies. The TIEA only grants favourable tax treatment on the repatriation of profits on active business sourced outside of Canada.

Therefore, Canadian companies who use the captive structure for risks associated with a business in Canada pay tax in Canada in just the same way as any other Canadian business. The reason for a setting up a captive is that it is an efficient business structure.

The third point is that not all offshore jurisdictions are the same. Bermuda is globally respected for its leadership and proven record on compliance and transparency.

In particular, the EU awarded Bermuda full equivalence with Europe's Solvency II insurance regulatory regime in 2016, and Bermuda was the first offshore jurisdiction to be granted qualified jurisdiction status by the US National Association of Insurance Commissioners, effective 1 January 2015.

Solvency II equivalence was a huge vote of confidence in Bermuda's entire regulatory structure by the EU.

However, as the enhanced capital requirements are not relevant to the captive structure, Solvency II equivalence is only directly applicable to Bermuda's commercial insurers, not captives.

How can a company reassure its management that an offshore captive structure is safe?

Although Canadian boards and management are rightly wary of offshore structures, once a company has completed its feasibility analysis it will find that the captive structure is a very efficient method of managing risk.

Bermuda as a jurisdiction for the captive is a natural choice for all the reasons mentioned above. Bermuda has a long history of forming, managing and regulating captive structures.

Bermuda's regulatory structure is robust and ensures that the captive is properly capitalised to meet its ongoing risk management objectives.

Bermuda also has a wealth of world-class service providers, many with experience in the Canadian market. We would recommend that key decision-makers visit Bermuda and meet with the professional service providers and the regulator on the island as part of their due diligence process. CIT

"Canadian companies are selecting Bermuda because it is a well-respected leading jurisdiction for captive formation, management and regulation"

Kim Willey, Senior counsel, ASW Law

SILVER LININGS

Although the Panama Papers brought focus to the appropriate use of a captive, Mike Stalley of FiscalReps suggests the leak could benefit the industry

Since the release of the Panama Papers, has the scrutiny of captives increased internally, externally, or both?

The awareness of the use of complex offshore financial structures in general has certainly increased, although not necessarily direct scrutiny of captives.

With greater transparency demanded by many stakeholders, and with increased scrutiny from the media, it's probably inevitable that the appropriate use of captives, as part of an overall risk management strategy, will be considered by multinational corporations that wish to be more transparent in their operations and structure.

Conversely, the additional scrutiny could benefit the captive industry as it presents an opportunity to sell the use of a captive structure as a transparent, non-aggressive risk transfer mechanism.

The majority of captives are formed for risk management reasons, rather than for tax purposes, so providers of captive solutions can demonstrate the value of captives to the wider business world.

What concerns, if any, have the Panama Papers raised among your clients?

Most public companies that own captives are already required to make significant disclosures about all their holdings, this is so the ability to 'hide' assets offshore is already significantly reduced.

What bearing does this leak have on captives' tax planning? What are you recommending?

These leaks have certainly brought the subject of aggressive tax planning more into the spotlight. At FiscalReps, we do not promote aggressive tax planning, we focus on achieving and maintaining tax compliance for clients. Tax is a consequence of doing business—it should always be considered in any commercial arrangements, but making arrangements primarily for tax reasons is, in my opinion, never a wise approach.

Interestingly, topics such as base erosion and profit shifting (BEPS) regulation and increasing activity from many tax authorities are already focusing the minds of many multinational organisations on tax compliance. The release of the Panama Papers is really another push in that direction.

From a transfer pricing perspective, the simplest argument for a tax authority to assert is that the premium being charged by the captive to its insured party is not at arm's length, by reference to premiums paid for similar risks in the open market.

That, in essence, is the transfer pricing argument—is the premium being charged artificially inflated or deflated, either in order to shift profits to a lower tax jurisdiction or to shift costs to a higher tax jurisdiction?

In my opinion, the strongest defence is for a captive to demonstrate that the risks it is insuring are non-typical by their nature, with equivalent coverages unavailable in the open market.

Placing a vanilla property damage, business interruption or general liability policy through the captive may not meet that test adequately.

Secondly, designing a risk transfer programme that encourages the right risk behaviours from participating insureds, with an insurance policy being an element of the wider programme, will create a contract of insurance that is not comparable with those available on the open market.

The greater the differential between the bespoke captive insurance policy and the equivalent vanilla open market policy, the easier it is to demonstrate that the captive premium is fair for the risk being insured, and not artificially set based on equivalent open market coverages.

We have a number of clients who are very creative in their use of captives and the insurance coverages they write, with the key benefits being better risk management, lower costs to the business, and the alignment of corporate behaviours across the business.

Looking to the future, how will corporates weigh their reputations and contentious tax issues?

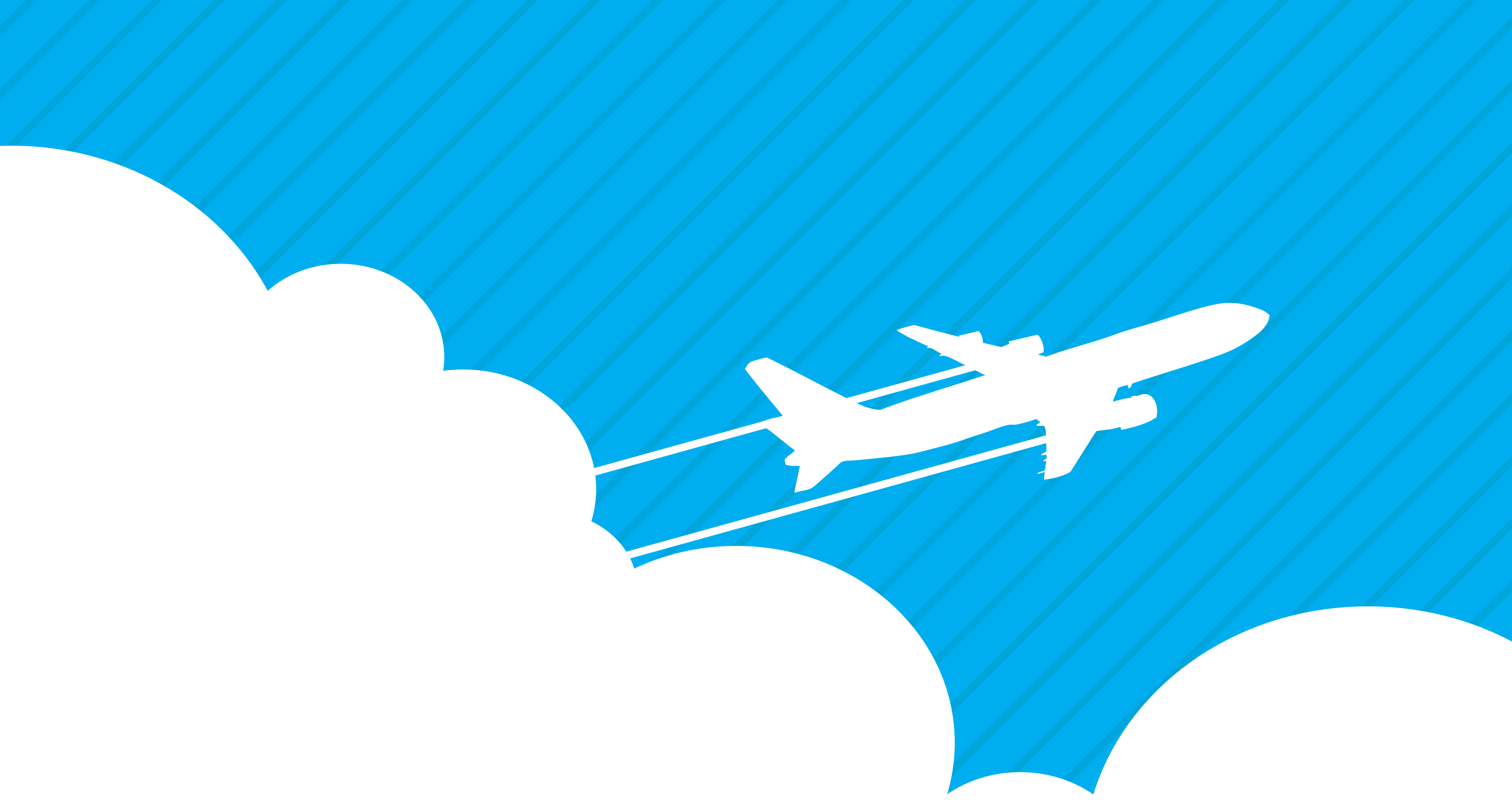
The reputational value of a business is very hard to assess, but it's easy to lose quickly with the wrong headline regarding a corporate's tax affairs.

Within our client base we have seen a real desire to become fully compliant and transparent when it comes to taxes—a drive to be that good corporate citizen and pay the right amounts of tax to the right tax authorities.

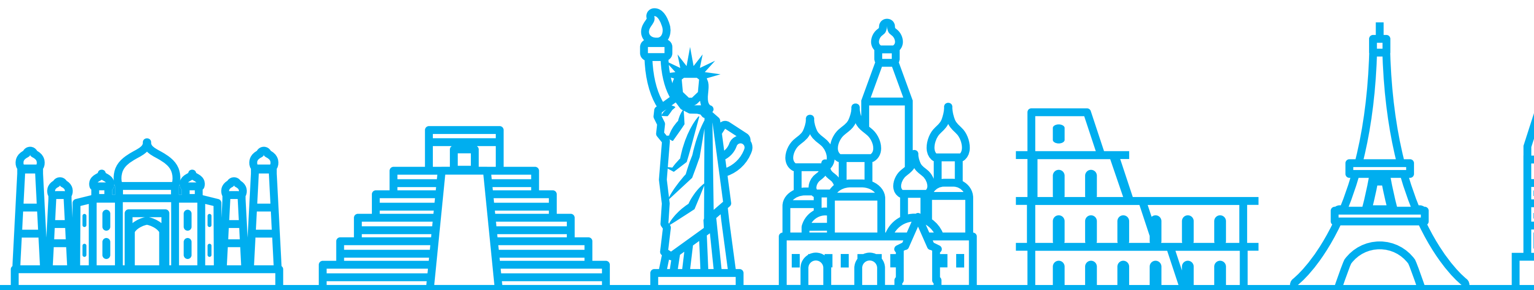
Making decisions and implementing aggressive tax planning strategies, I believe, will be subject to increasing internal scrutiny before final decisions are made, with the need to manage reputational risk being one of the key factors to consider. CIT

> "The strongest defence is for a captive to demonstrate that the risks it is insuring are non-typical by their nature, with equivalent coverages unavailable in the open market"

Mike Stalley, CEO, FiscalReps



Industry Events



VCIA Annual Conference

9-11 August
Vermont
www.vcia.com

Register now for the VCIA Annual Conference. This stellar event is a great choice for any level of industry professional. Known for its high quality educational content, the VCIA conference is held in beautiful Burlington, Vermont, each August.

NC Captive Insurance Association Annual Conference

22-24 August
Charlotte
www.nccia.org

The NC Captive Insurance Association Annual Conference has grown considerably for 2016 both in terms of the strength of its educational programme and its first ever exhibit hall featuring 16 exhibitors from around the country.

SIIA National Educational Conference & Expo

25-27 September
Austin, Texas
www.siia.org

The SIIA National Conference & Expo is the world's largest event focused exclusively on the self-insurance and alternative risk transfer marketplace. It typically attracts more than 1,700 attendees from around the US and a increasing number of countries around the world.

GEB Forum

21-23 November
Brussels
www.geb.com

During this three-day event, top experts and professionals will discuss emerging trends and share innovative practices from across the globe. The programme will include inspirational lectures, seminars, workshops and networking sessions.

Comings and goings at DIMA, Marsh and more

Sarah Goddard has stepped down from her position as CEO of the Dublin International Insurance and Management Association (DIMA).

Goddard will be joining the Association of Mutual Insurers and Insurance Cooperative in Europe (AMICE), serving as secretary general.

Taking over from Goddard as interim CEO will be Eddy Van Cutsem. In this role, Van Cutsem will work with the DIMA board to develop its future strategy.

In addition, David Stafford has been named the new chairman of the association, succeeding Marco Nuvoloni.

Goddard said: "I've been really privileged to have spent the past 12 years working with DIMA, a time when so much has happened within the industry and within the country."

"It's been a time of immense and intense change in so many ways, but—as is always the case with this industry—it is the fantastic people I have met and worked with during this time which has given me the greatest pleasure. I will really miss working with them and with DIMA, but at the same time I'm really excited about the new challenge ahead of me."

Stafford commented: "We really value the depth of experience Eddy Van Cutsem brings to DIMA, and his knowledge of the requirements of our members from being a DIMA board member in the past will be invaluable."

Montana insurance commissioner Monica Lindeen will step down from her role at the end of this year after coming to the end of her eight-year term.

Lindeen was originally elected as insurance commissioner in 2008. She was re-elected to a second term in November 2012.

Lindeen said in her foreword for the Montana Captive Insurance Association's latest Domicile Report: "This is my last year as Montana's insurance commissioner. I'm proud of how our captive programme has grown over these last seven years, and I'm honoured to have worked with so many great professionals involved in the captive industry."

Marsh has named Martin South as the new president of its US and Canada division, based in the firm's New York office, effective 1 September.

South, who previously served as CEO of Marsh in the Asia Pacific region, will report to John Doyle, president of Marsh.

South will oversee Marsh's US brokerage business in Canada, and its portfolio of US businesses including industries and practices.

He will succeed Rob Bentley, who has moved roles to work on strategic initiatives across the Marsh & McLennan Companies risk and insurance services segment.

Doyle commented: "I look forward to working closely with Martin South to deliver superior value to our clients in the US and Canada at this important time in our industry." CIT

CIT CaptiveInsuranceTimes

Editor: Mark Dugdale
markdugdale@captiveinsurancetimes.com
+44 (0)203 750 6022

Deputy Editor: Stephanie Palmer
stephaniepalmer@blackknightmedialtd.com
+44 (0)203 750 6019

Reporter: Becky Butcher
beckybutcher@blackknightmedialtd.com
+44 (0)203 750 6018

Contributors: Drew Nicol

Business Development and Design: John Savage
johnsavage@captiveinsurancetimes.com
+44 (0)203 750 6021

Publisher: Justin Lawson
justinlawson@captiveinsurancetimes.com
+44 (0)203 750 6028

Designer: Steven Lafferty
design@securitieslendingtimes.com
+44 (0)203 750 6021

Recruitment Manager: Chris Lafferty
chris@assetservicingtimes.com
+44 (0)203 750 6024

Office Manager: Chelsea Bowles
accounts@securitieslendingtimes.com
+44 (0)203 750 6020

Office fax: +44 (0)20 8711 5985

Published by Black Knight Media Ltd

Black Knight Media Ltd
Provident House
6-20 Burrell Row
Beckenham
BR3 1AT, UK

Company reg: 0719464

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