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ISSUE107
28.09.2016 WEDNESDAY
captiveinsurancetimes.com

# The Great Guernsey

## Innovation is key to being a significant market player

## R&Q acquires USA Swimming captive

Randall & Quilter Investment Holdings (R&Q) has acquired the United States Sports Insurance Company (USSIC), a wholly owned captive of USA Swimming.

USSIC, which is in run-off, had a total net asset value of $5.3 million as of 30 June this year. In addition, the company totalled an income of $0.97 million as of year-end 2015.

To acquire USSIC, the total consideration paid by R&Q was $2.1 million, financed by a draw down on the group's revolving credit facility with the Royal Bank of Scotland.

The captive, originally domiciled in Barbados, redomiciled to Washington DC, effective at the end of 2014.

USSIC reinsured a US company, which provided coverage to USA Swimming as well as its local swimming committees and clubs, throughout the US from 1988 to year-end 2013.

The directors of USSIC will be appointed from R&Q existing staff in the US and Bermuda.

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

"This transaction 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 the Caribbean region."

### Verve cell launches with captive focus

Verve Risk Partners has launched as a cell on the Castel Underwriting Agencies platform that will target US professional and management liability risks, focusing on insurance companies and captives.

The cell, Verve, will include errors and omissions and directors and officers coverage for captive insurance companies, risk retention groups, captive managers and various others.

Scott Simmons and Alan Lambert, who are both partners in the business, will lead the cell.

Simmons, partner at Verve, said: "Castel provides us with a comprehensive and robust infrastructure that has enabled us to bring Verve to fruition quickly, and deliver certainty to our capacity providers and wider market stakeholders."

### Vitol Holdings captive receives top ratings from A.M. Best

A.M. Best has affirmed the financial strength ratings of "A (Excellent)" and the long-term issuer credit rating of "a" of Rembrandt Insurance Company, located in Bermuda.

Rembrandt is captive reinsurer and insurer of Vitol Holding, a holding company of a

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## UK government hints at 2017 ILS implementation

The London Market Group (LMG) has confirmed the UK government's plans to implement an insurance-linked securities (ILS) strategy for early 2017.

LMG received a letter from Simon Kirby, the economic secretary to the treasury, in which he laid out timings and the next steps towards the ILS project in London.

The update comes following the Treasury's consultation on the overall approach to the regulation and taxation of ILS special purpose vehicles. The next stage will be to finalise the regulations and implement the new framework.

Kirby said: "The role that London plays as a global hub for specialist insurance and reinsurance is an important part of the UK's financial sector exporting strength."

"Given the increasing importance of alternative risk transfer techniques, the ILS project aims to provide London with the framework it needs to remain a world leader in reinsurance. I am very grateful for the productive contribution that the LMG has made to this project."

Nicolas Aubert, chairman of the LMG, added: "We are heartened to hear that the ILS project remains a priority for the treasury, and we very much look forward to working with them to ensure successful implementation of the UK's new ILS framework as soon as possible in 2017."

group engaged in trading petroleum-related products and commodities.

According to A.M. Best, the ratings reflect Rembrandt's "very strong financial performance and excellent risk-adjusted capitalisation, as well as its importance to the Vitol group as a risk management tool".

The rating agency said: "The company's risk-adjusted capitalisation remains excellent, supported by good internal capital generation, low net underwriting leverage and an outward reinsurance programme that is placed with a panel of financially strong reinsurers."

"A marginally offsetting factor is the captive's concentrated asset base, with a loan facility provided by Rembrandt to the Vitol group, representing 75 percent of total assets at year-end 2015. The investment risk associated with this loan is somewhat mitigated by terms that allow it to be redeemed at short notice."

### Kattan Associates gets Greenlight

Greenlight Reinsurance Ireland, a subsidiary of Greenlight Capital Re, has appointed Kattan Associates Limited to develop business opportunities in the European and Asian markets on its behalf.

Brendan Barry, chief underwriting officer of Greenlight Re, commented: "This is an important step for Greenlight Re Ireland as we continue to expand our global footprint and further diversify our underwriting portfolio."

"We believe that the extensive experience and relationships that Kattan Associates brings to the insurance industry will provide an excellent network for Greenlight Re to access attractive business."

Habib Kattan, owner and director of Kattan Associates, added: "I am delighted that Greenlight Re has become a client of Kattan Associates and I look forward to generating profitable underwriting opportunities to expand its client base and underwriting portfolio in Europe and Asia."

### Crosswinds Re sets up shop in the Cayman Islands

Crosswinds Re, a new specialty reinsurance business vehicle established by Crosswinds Holdings, has received approval from the Cayman Islands Monetary Authority as a class B reinsurer.

The new specialty reinsurer will be part of a larger integrated insurance, reinsurance and asset management structure that will mainly focus on the Florida property and casualty insurance market.

The Maples Group, an international law firm, supported the Crosswinds Re domicile in the Cayman Islands. Maples and Calder will act as Cayman Islands counsel, led by partners Abraham Thoppil and Tim Frawley.

Colin King, CEO of Crosswinds Re, commented: "The reputation of the Cayman Islands as the jurisdiction of choice for insurance and reinsurance companies, combined with an established network of high-quality service providers and robust regulatory regime, made this an attractive domicile for Crosswinds Re."

Alasdair Robertson, global managing partner of Maples and Calder and chairman of MaplesFS, commented: "We are pleased to have supported Crosswinds Re in their Cayman Islands domiciliation and look forward to continuing to work together as their business evolves."

### Dow's Dorinco Reinsurance retains 'excellent' rating

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and the long-term issuer credit rating of "a" of the Dorinco Reinsurance Company, with the outlook remaining stable.

Dorinco is the captive reinsurance company of The Dow Chemical Company.

According to A.M. Best, the rating is based on Dorinco's ability to deliver strong combined ratios, as well as its positive net income and strong risk-adjusted capitalisation.

A.M. Best also noted that the captive maintains a conservative investment portfolio, continuing parental support, and a "prudent approach to underwriting".

Partially offsetting the positive rating, however, is Dorinco's "limited profile in the reinsurance market, which is a function of its hybrid captive nature," A.M. Best said.

Factors that could potentially lead to a downgrade include "significant" catastrophe or investment losses, "significant" decline in risk-adjusted capitalisation, and "unfavourable" operational profitability trends.

### Reinsurance demand continues to rise, says Aon

Reinsurance demand has increased over the past 18 months and the trend is expected to continue for the rest of 2016, according to a new Aon report.

The reinsurance market outlook report revealed that Aon expects demand for cyber insurance coverage and products to continue.


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It showed that nearly 90 percent of the market is based in the US, with annual growth running at 30 to 50 percent.

According to the report, international growth will be driven by upcoming EU regulations covering data protection, which will become effective in 2018.

The report also highlighted demand for property catastrophe protection, with Aon expecting demand to remain relatively stable for January 2017 renewals.

It found that while certain regions affected by regulatory changes may look to secure additional capacity, overall demand change is expected to increase by approximately 5 percent across the market.

## PwC: increase in business run-off activity

Exit or restructuring activity is on the up, according to a PwC survey, with 77 percent of respondents saying they expect to engage in it by 2019.

The new survey from PwC, Discontinued Insurance Business in Europe, predicted that sales of legacy liabilities to specialist run-off acquirers and group restructurings through business transfers would be the

## Florida is open for captive business

Florida is back in the business of licensing captive insurance companies, according to Holland & Knight partner Nathan Adams and senior policy officer Beth Vecchioli.

On 11 August 2016, the Florida Office of Insurance Regulation issued a licence to a non-profit Florida corporation to write medical malpractice, other liability and miscellaneous casualty.

This was the first licence issued to a domestic captive insurer since 1988, in accordance to a Florida statute last amended in 2013.

Adams compared Florida to the likes of Vermont, Utah and South Carolina. He suggested Florida is "equally constructive and interested in building a captive industry in the Sunshine State".

He suggested that Florida being open to license captives again would "benefit local companies and stimulate business tourism as a result of the minimum mandatory annual meeting requirement".

Vecchioli suggested that captives are especially attractive in Florida due to its "relatively high" property insurance rates.

She said: "Under the Florida Insurance Code, the only lines captives may not ordinarily insure include workers' compensation and employer's liability, life, health, personal motor vehicle and personal residential property insurance."


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key tools to unlocking value for owners in run-off business.

According to PwC, the past year has been “extremely busy” for the European run-off market, and it expects activity to continue at its current pace.

The survey also revealed that 81 percent of respondents predict that Europe will see more than 10 disposals of legacy business portfolios over the next two years.

It found that the number one objective for companies using a strategic run-off plan was to release capital.

Board engagement was named as the main challenge for continental European reinsurers and insurers with run-off business.

PwC estimated that the overall size of the European non-life discontinued business market remains flat at just under €250 billion.

The survey, carried out in July 2016, noted no immediate impact following the UK’s decision to leave the EU. However, depending on amendments to the passporting rules, the report suggested that some companies may restructure as they re-evaluate the best location for their business.

Andrew Ward, director of PwC’s solutions for discontinued insurance business team, commented: “Europe’s run-off market has had an exceptionally busy year and the transaction environment continues to thrive. Board level engagement on legacy business is still a challenge for continental European insurers in particular, but the volume of deals we have seen in the UK and to some extent on the continent shows that legacy is in the spotlight for many reinsurers and insurers.”

“Solvency II has really focused attention on the most effective use of capital and is increasingly generating opportunities for acquirers of run-off. Insurers with legacy business are beginning to make decisions around the capital benefits associated with disposing of discontinued books. We expect to see this trend continue for some time as Solvency II becomes embedded within middle tier and more niche reinsurers and insurers.”

## Willis Re upgrades cyber insurance management tool

Willis Re has launched an update of its cyber risk portfolio-modelling tool, PRISM-Re at the annual Monte Carlo Rendez-Vous.

PRISM-Re, which was first released in 2015, helps clients to manage their cyber portfolios and estimates downward risk arising from privacy breaches.

The 2016 update includes access to the modelling of cyber losses from out of network outages.

Mark Synnott, executive vice-president of Willis Re, said: “We are extremely proud of the unique work we have been doing with clients to help them better understand and manage their cyber exposures since the launch of PRISM-Re.”

“The 2016 update further enhances our capabilities in the rapidly evolving cyber arena and we look forward to introducing it to our clients over the coming months as we roll it out across our global network via our client advocates.”

## Aon sees decrease in catastrophe bond transactions

A total of 24 catastrophe bond transactions closed during a 12-month period, ending 30 June this year, with a limit of $5.2 billion, a decrease of $7 billion on the previous period, according to Aon Securities.

Aon’s report, Alternative Markets Find Growth Through Innovation, revealed that

## UK treasury committee launch Solvency II inquiry

The UK's treasury committee has raised concerns about the EU's Solvency II Directive.

Following the UK's vote to leave the EU, the treasury has agreed terms of reference to launch an inquiry into the regulation.

The inquiry will explore the impacts of the directive, and the options now available to the UK, in more detail.

Andrew Tyrie, member of parliament and chairman of the Treasury committee, said: "Brexit provides an opportunity for the UK to assume greater control of insurance regulation."

"The Solvency II Directive came into force in January, only after a heap of concerns had been expressed about it."

"Among its manifest shortcomings was the failure to secure value for money over its implementation."

"The treasury committee will now take a look at the Brexit inheritance on insurance to see what improvements can be made in the interests of the consumer."

the decrease was largely due to "significantly lower" issuance volumes during H1 2016, as issuance volumes during H2 2015 were "relatively flat" on a year-over-year basis.

It also found that US exposures continued to dominate the catastrophe bond market, with 18 of the 24 transactions comprising US risk in some capacity.

On a notional basis, this represented 83 percent of the period's issuance, compared to 86 percent in the prior year period, according to the report.

The report identified that three catastrophe bonds closed covering property risks in Europe, and three insurers required coverage for Japan risks with catastrophe bonds, securing a $720 million total limit.

In addition, one extreme mortality bond was brought to market, covering Australia, Canada and UK risks.

In addition, five quota share sidecars were launched during the 12 months, with a capacity totalling $1.1 billion for the four sidecars that disclosed their sizes.

Paul Schultz, CEO of Aon Securities, said: "During the 12-month period under review we saw a continued increase in alternative capital in the reinsurance sector."

He added: "However, continuing a recent trend, the capital is being increasingly deployed in the collateralised reinsurance space rather than in the form of catastrophe bonds, whose overall lower issuance volumes were driven by a number of factors."

"[These include] competition from traditional markets and longer coverage periods, both of which result in some cedents renewing capacity less frequently, and certain cedents increasing their risk retentions."

### EID receives 'excellent' ratings

A.M. Best has affirmed the financial strength rating of "A (Excellent)" and the long-term issuer credit rating of "a" of Eni Insurance Designated Activity Company (EID).

EID is a sole captive insurer of Eni, an Italian multinational gas and oil company.

The ratings reflect EID's "strong" underwriting profitability and "excellent" risk-adjusted capitalisation, according to A.M. Best.

The ratings also consider the captive's importance to the Eni Group as a risk management tool.

EID's risk-adjusted capitalisation, meanwhile, is "expected to remain excellent".

A.M. Best suggested available capital is "likely to increase" in 2016 due to a non-recurring return premium payment of €17.5 million to EID from a reinsurance company.

### R&Q buys UK-based insurance company in run-off

Randall & Quilter Investment Holdings has acquired the Royal London General Insurance Company (RLGI), a UK non-life insurance company in run-off.

R&Q purchased the insurance company from the Royal London Mutual Insurance Society for £11.9 million, representing a small discount to RLGI's net assets of £13.5 million at year-end 2015.

Once the transaction has received regulatory approval, RLGI will transfer to R&Q Insurance Malta. R&Q aims to complete this by the end of 2017.

Ken Randall, chairman and CEO of R&Q, said: "We are delighted to have reached agreement to acquire RLGI and this continues to demonstrate the ability of R&Q to provide exit solutions to owners of insurance companies in run-off."

"This will be the second transaction where R&Q has provided non-life legacy solutions to the life and pensions sector. We remain excited about our legacy acquisition pipeline."

In R&Q's H1 2016 results, the company revealed that it would step up its acquisitions of various insurance companies, including captives insurers.

The report said that the transactions would range from UK insurance companies to US novations, loss portfolio transfers and the purchase of onshore and offshore US and UK captives.

### Insurance industry facing 'perfect storm', says PwC

The industry is facing a "perfect storm" of soft rates, low investment yields and new regulation, as well as feeling the impact of new technology, shifting customer expectations and the threat of losing margins to "nimble" insurtech entrants, according to a new report from PwC.

The annual PwC report, released at the Monte Carlo Reinsurance Rendez-Vous, challenged the insurance and reinsurance industry to take brave steps in their cost reduction strategies.

It found that 70 percent of insurance business leaders plan to implement a cost reduction initiative over the coming year. However, PwC argued that squeezing a few percentage point savings is no longer enough in such a competitive and disrupted marketplace.

According to PwC, investment in technologies that sharpen the precision of risk selection and pricing but also improve the overall operations efficiency and effectiveness, will be "crucial" for companies looking to differentiate themselves.

The report said: "Those who take up the challenge will see significant cost savings and a game-changing boost in customer relationships."

Stephen O'Hearn, global insurance leader at PwC, commented: "Many insurance executives have had bruising prior experiences with cost initiatives failing to deliver long-term gains or culture change within the organisation. But the time to confront the challenge is now."

## Global reinsurance capital up by 4 percent, finds Aon

Aon Benfield estimates that total global reinsurance capital increased by 4 percent to a record $585 billion over H1 2016.

The figure, which comprises capital from both traditional and alternative markets, shows that traditional capital rose by 3 percent to $510 billion and alternative, a 5 percent rise to $75 billion.

The report revealed that total premiums written by the Aon Benfield Aggregate increased by 5 percent to $130 billion, with the main driver being consolidation activity.

It also showed that total investment returns benefited from significant capital gains linked to declines in interest rates.

The assumption of higher levels of asset risk stabilised the annualised ordinary investment yield at 2.6 percent, but the figure remains 40 percent below the level seen prior to the financial crisis, according the report.

Mike Van Slooten, co-head of Aon Benfield's market analysis team, said: "The combined effects of lower-for-longer interest rates and underwriting margin compression were evident in this period."

"Earnings have clearly become more sensitive to catastrophe losses and prior year reserve development. However, the return on equity remains attractive relative to other sectors and should be viewed in the context of a continuing decline in the cost of capital."

## Munich Re invests in new data platform

Munich Re, together with its partners, has installed the SAS Analytics and Hortonworks data platform for its big data initiative.

With the new data platform, Munich Re intends to increase its clients' resilience against economic, political and cyber risks.

The platform enables departments to explore new ideas, develop new business fields and further enhance customer service.

Marc Wewers, lead IT architect for big data and analytics at Munich Re, commented: "As a reinsurer with worldwide operations, we have vast data resources at our disposal. We now want to leverage them fully to advance our business and realise pioneering business models."

Wolfgang Hauner, chief data officer at Munich Re, added: "A platform like this can only work if the users are happy with it. The rapidly rising numbers of users and the large number of analytics projects clearly show that our approach is spot on."

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# Innovation and opportunity

Attendees at this year's Guernsey Insurance Forum heard how Guernsey is positioning itself as a 'significant player' in the international insurance community

After taking a break from hosting its annual insurance event, Guernsey Finance came back to the marketplace in style, hosting a fast-moving and informative event in London.

The event, moderated by ITV presenter Alistair Stewart, consisted of two panel discussions focusing on the latest market trends, developments and growth potentials in the captive insurance and captive reinsurance market in Guernsey.

In his opening speech, Dominic Wheatley, CEO of Guernsey Finance, spoke of "innovation" and "two new phenomena" that have started gathering momentum in Guernsey's captive market.

Wheatley revealed the new trends that come from the roots of the reinsurance market, are insurance-linked securities (ILS) and collateralised reinsurance.

"To see all areas of our industry in such robust form demonstrates not only its quality and substance, but also emphasises that Guernsey is a player of significance in the international insurance community," Wheatley said.

## Market trends and developments

Steve Britton, managing director of Aon's global ILS management and panellist at the forum, revealed that the worldwide ILS market doubled between 2010 and 2015, growing at a rate of 25 to 35 percent each year. He noted, however that, as of June this year, the rate of growth did dip to 10 percent.

Britton referred to a Goldman Sachs article from 2013, The 8 Extraordinary Technologies Forcing Businesses To Adapt Or Die, which noted that collateralised reinsurance was listed as the fourth largest growing trend.

Now in 2016, Britton described the ILS market as a "big baby" and emphasises the fact that the market is only going to get bigger. He noted that in the next five years the ILS market could represent $1 in every $5.


He said: "Growth will be driven by demand. There is already plenty of supply, there is just not enough demand for it yet. If there is demand, investors will put money into this market."

The slow market is because of the current soft market, according to Britton. He suggested when a 'big event' happens, more money from investors will appear in the market.

He reassured attendees that although this year saw a dip in ILS growth, by next year rates should increase back to 15 to 20 percent.

Stewart asked panellists what is driving that demand in the industry, questioning whether the industry was reacting to growing demand or whether it was the industry creating demand.

To this, Britton suggested that the answer is both. He said: "If you talk to the bankers, who structure these transactions, they suggest there is still not enough demand. Collateralised reinsurance is just another form of offsetting capacity."

According to Britton, considering the largest economic losses occurring in the world, there are still countries not purchasing insurance.

John Rowson, CEO of Kelvin Re, added that, while capacity is available, the industry should be making sure that insurance is being purchased in countries that currently do not buy it.

After Wheatley referred to Guernsey's "innovation" in his opening speech, Mark Helyar, counsel of Bedell Cristin, revealed that Guernsey has drafted a set of rules to provide "extensive guidance" for its special purpose insurers (SPIs), set to go live before the end of 2016.

The panel discussed Guernsey building an SPI structure. Helyar, who helped to draft the new rules, explained that the draft has now been completed and is with the Guernsey Financial Services Commission (GFSC) for a final review.

He explained that the rules are "pretty much signed off" and "are expected to be in place by the end of the year".

Before the new rules go live, a consultation paper will be sent out to the marketplace for comment.

Guernsey was also named as the domicile for other insurance captives, longevity swap transactions and various other reinsurance vehicles and arrangements.

These SPI rules already exist in Bermuda, making it possible for somebody looking from the outside to understand the jurisdiction's approach to SPIs in terms of solvency and capitalisation.

Heylar explained: "The work is already happening, the business is already being conducted in Guernsey, there was just no where to go to see what the rules were."

"These new rules will be codifying digressions that the commission are passing different types of applications and it will be extensive guidance on the types of collateral available."

With Guernsey also introducing the new rules, Helyar suggested that this would bring them "on to a level playing field" with Bermuda and other ILS domiciles.

Mark Cook, director at Willis Towers Watson, also drew attention back to innovation in Guernsey, discussing the rise of captives with employee benefit risk.

Cook noted that there are now approximately 100 captives funding employee benefit risk, with most of those launching over the last five years.

He said: “It is not just traditional risk products and health products we are talking about, stop-loss products, medical programmes and so on.”

Cook revealed that another trend he is seeing in the industry is a rise in longevity swaps. He used the British Telecom Pensions Scheme (BTPS) as an example.

BTPS was a £16 billion transaction, completed in July 2014, to transfer a quarter of its longevity risk to the Prudential Insurance Company of America.

BT established its own captive insurer, a Guernsey-based incorporated cell company (ICC), allowing it to access the reinsurance market directly without paying a bank or insurer to act as an intermediary.

“The reinsurance market is providing companies with a good deal compared to the traditional ones that banks are offering,” said Cook.

### Brexit

Stewart also questioned the panel on whether they thought Brexit was an opportunity, challenge or deadweight on the captive industry.

Oliver Schofield, executive director of RKH Reinsurance, described Brexit as an “opportunity”.

He said: “I don’t think it is something that we, as an industry, should be overly scared about.”

Schofield showed confidence that Brexit will not affect the captive marketplace, he said: “The insurance and reinsurance industry around the world has reacted well to times of uncertainty.”

When it was decided in June this year that the UK would leave the EU, there were concerns around passporting for captives. Schofield suggested that the industry should not be concerned about passporting issues in the captive market, but rather for other industries, as “there might be all kinds of issues”.

Schofield said: “For the captive industry, I see it as a great opportunity for people who are current owners or potential owners of captives to be able to take a long look at the playing field that there is and decide what is going to be the best approach for them.”

“I don’t believe that there will end up a regime that will strangle the benefits of captives to their corporate sponsors.”

### Solvency II

With the uncertainty around Brexit, there are still a lot of questions around the UK and the Solvency II regime. Although legally the UK will not have to abide by the Solvency II initiative anymore, if it still wants to trade within the EU it will have to stick to the Solvency II legislation.

Schofield explained: “We also know that most insurers and reinsurers around the world, regardless of whether they are European headquartered or trading into Europe, regard Solvency II being the benchmark for superior finance management and I don’t see that as being a threat, I see that as an opportunity.”


On the flip side, Solvency II has the potential to push businesses away from the EU if they are against complying with Solvency II regulation.

Cook explained that one of Willis Towers Watson's pension captive clients, based in the EU, is against complying with Solvency II for pension reserving. Because of this, the client is looking to move outside of the EU. Cook noted that this has been within the last six months.

### IAIS insurance core principles

Stewart addressed Caroline Bradley, deputy director of the Guernsey Insurance Division and member of the International Association of Insurance Supervisors (IAIS) task force, to ask about any developments and how Guernsey stood within the latest IAIS meeting.

Bradley said that, from the first meeting, she recognised that the current IAIS insurance core principles (ICPs) need to be updated.

She explained that the current ICPs, relating to the supervision of reinsurance and reinsurers, would need to be updated because they reflect issues that were around at the time the standards were written.

Bradley recently attended a meeting, held in Bermuda with the newly set up IAIS task force, which was designed to review the ICPs.

She said: "We feel that it is important for Guernsey to be involved in those types of forums with that kind of company so that we can then ensure that the regulations, as they develop, take account of jurisdictions like Guernsey in terms of entities and the types of regulatory framework that we have."

Bradley noted that the ICPs currently deal with things such as contract certainty, finite reinsurance and issues that were hot topics with regulators a number of years ago but that are not such an issue now.


She said: “I think we are well-placed in Guernsey within regulatory framework to both influence the standards that have been developed but also to meet those standards because in Guernsey we have always regulated reinsurers, whereas other jurisdictions haven’t so they are catching up with that.”

“I do think it is important for Guernsey to be in the forum so we can influence those standards as they develop.”

Wheatley expressed his enthusiasm towards Bradley’s work with the IAIS around global regulatory standards, and the possible creation of a level playing field.

In his closing remarks, Wheatley explained that although the collateralised reinsurance sector has seen growth, he can see the market growth “accelerating”.

According to Wheatley, there have long been rumours about the bottoming of the soft insurance market.

He said: “I think ever since 2002, people have been telling me that it’s going to bottom out any minute now.”

“I take the suggestion that we might be seeing the bottoming of the market with a massive pinch of salt.”

Wheatley suggested that, as a captive domicile, Guernsey remains at an advantage of being outside the EU and by being in an environment of “real substance” having not only a regulator by an industry of “true excellence” that all of those people who come to Guernsey for their captive business “appreciate greatly”.

“The Guernsey Insurance Forum has demonstrated how the global insurance market is changing, through evolution in some areas and transformation in others, and how the Guernsey industry is responding to these demands and opportunities with intelligence and energy and playing a key role in the innovation required,” added Wheatley. **CIT**

# Compliance considerations

Alan Fine of Brown Smith Wallace explains three key options to maintain compliance with changes to Section 831(b)

The Protecting Americans from Tax Hikes Act of 2015 created changes for 831(b), a section of the Internal Revenue Code that had not been amended in 29 years. As originally written and enacted, Section 831(b) provided “small” property and casualty insurance companies with premiums less than $1.2 million, an annual option to elect to be taxed solely on their investment income (rather than the sum of their underwriting and investment income).

As a result of the changes in the act, captive owners are asking what their options are in order to bring their captive into compliance with the new law.

**One of two diversification tests must be met**

The act’s changes take effect on 1 January 2017. These changes are geared toward curtailing the use of the micro captive insurance structure as a means of distributing wealth to heirs without being subject to either estate or gift taxes, which US Congress deemed to be abusive. It is important to note that this does not mean that structures taking advantage of this benefit prior to 1 January 2017 will be deemed to be abusive or overturned due to the estate planning benefit taken.

In addition to increasing the premium limitation to $2.2 million per year, the amended law also provided two “diversification” tests, at least one of which must be met in order for the company to be eligible to make the Section 831(b) election.

The first diversification test provides that no single policyholder may account for more than 20 percent of the insurer’s net written premiums (or, if greater, direct written premiums). Importantly, this threshold is measured on a controlled group basis, meaning that all companies with more than 50 percent common ownership are treated as a single policyholder for these purposes.

The alternate diversification test provides that in situations where a spouse or lineal descendant of a business owner has ownership of the insurance company, their ownership in the operating business must be within 2 percentage points of the insurance company. This test in particular is designed to eliminate the potential estate planning benefit associated with having a captive owned by one's heirs.

**Options to ensure your captive complies with the new law**

One of the diversification tests must be met for years beginning on or after 1 January 2017, in order to be eligible for the 831(b) election.

**Change ownership:** one option is to actually change the ownership of the existing captive so that it conforms to the requirements of the new law. If, for example, the children of the business owner own 100 percent of the captive but none of the operating businesses, they could sell their interest back to their parent. It is important to recognise that this will create a gain on which the children will have to pay income tax. Should this strategy be preferred, it is critically important that the sale be structured on an arms' length basis in order to avoid challenges by the IRS for a bargain sale. Accordingly, a valuation of the captive should be performed by a reputable service provider with experience in this area.

It may be determined that the needs which led to the creation of the captive no longer exist. In that case, the captive could surrender its license and liquidate. It is important to note that this liquidation may lead to two levels of tax: one at the corporate level, to the extent that the captive is holding appreciated assets, and a second by the owner of the captive. Therefore, it is vitally important to make sure that an appropriate valuation is performed of both the captive itself as well as the assets it owns.

**Freeze current captive:** the second option available would be to 'freeze' the current captive—discontinue paying premiums to this entity and surrender the insurance licence. The benefits of implementing this strategy include deferring the tax that would be imposed by implementing the first option and keeping the amounts out of the parent's estate. The former captive, with its existing capital, could be used to create or buy a new business or to lend funds to the operating businesses as needed.

The idea of borrowing from the former captive is similar to that of creating the captive, in that there is more flexibility in structuring the terms of the loan agreement (as long as they remain on an arm's' length basis). The business owners could then create a new captive that does meet the new ownership requirements of Section 831(b).

**Forgo 831(b) election:** finally, in some situations it may make sense for the captive to forgo the 831(b) election. This doesn't mean that the premiums paid to the captive would not be deductible. Instead, the captive would pay tax on all of its taxable income, not just its investment income. This may make particular sense for those captives, which incur significant/frequent losses, as these losses would now be deductible (which is not the case for an insurer making the election to be taxed solely on investment income).

This has the added benefit of not having to restructure the ownership of the captive. It may also not require a change in business plan or approval of the department of insurance, depending on the captive's domicile. It is strongly suggested to consult with your advisor before concluding no communication is necessary with the department of insurance.

The changes to Section 831(b) provide an enhanced opportunity for those choosing to utilise a captive insurance strategy. Each captive owner should consult with someone experienced in this area in order to understand whether they are in compliance with the new law, and what the best alternative is for those situations where the new requirements are not met. CIT

"The 2015 changes to Section 831(b) provide an enhanced opportunity for those choosing to utilise a captive insurance strategy"

**Alan Fine,**
**Partner in charge of captive insurance advisory services,**
Brown Smith Wallace

# Industry Events

## FERMA Seminar 2016

**03-04 October 2016**
**Malta**
www.ferma.eu

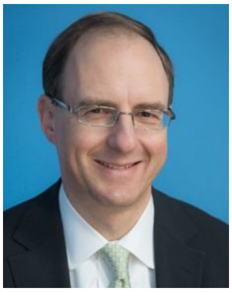
The 2016 FERMA Seminar will bring together risk management and insurance professionals from across Europe to discuss the latest developments in risk management and the insurance market. The event is dedicated to risk and insurance managers with the themes: education, communication and leadership.

## GEB Forum

**21-23 Novmember 2016**
**Brussels**
www.gebforum.com

The 2016 Generali Employee Benefits (GEB) Forum will take place in Brussels, where global headquarters is based, and celebrate the 50th anniversary of the GEB Network.

## Rewire Securities, the Delaware Insurance Department and Hanover Stone Partners all see personnel changes



**Markus Schmutz has joined Rewire Securities as partner.**

Previously, Schmutz served as head of insurance-linked securities (ILS) market at Swiss Re Capital Markets in New York, where he was responsible for ILS transactions.

Stefano Sola, co-founder and CEO of Rewire, said: "Markus Schmutz will be instrumental in further developing Rewire's underwriting analytics and related ILS products with a key focus on further integrating rewireconnect, our insurance risk transfer technology platform."

**Karen Weldin Stewart will stand down as insurance commissioner for Delaware, after losing her vote in the primary contest.**

Stewart was first elected to the post in 2008 and was re-elected in 2012. In the primary contest on 13 September she lost the vote to democratic party candidate Trinidad Navarro, who will run for the insurance commissioner role in 2017.

Navarro, who received 54 percent of the vote, will now face Jeffery Cragg, the republican party candidate, in November's general election.

Cragg beat rival republican candidate George Parish in the primary contest, winning 51 percent of the vote.

**Hanover Stone Partners (HSP) has named Katherine Dedrick, William Goddard and David Seibert as senior risk advisors, expanding the company's risk management services.**

Dedrick, who will be based in Chicago, has more than 30 years of experience in insurance, risk management and corporate governance issues.

Goddard has previous experience with risk management, medical benefits, insurance brokerage and claims management. He will be based in St Louis.

Seibert, who brings experience in risk management, finance and information system management, will be based in St Paul.

John Kelly, founder and CEO, HSP, commented: "As clients in numerous industry sectors throughout the US rely on our firm for strategic risk advisory services and proven expertise in risk management programme development and implementation, we are continuing to expand our capabilities with the industry's leading risk and insurance professionals."

"We're pleased to welcome to our team Katherine Dedrick, William Goddard and David Seibert and look forward to our work together on behalf of our clients." CIT

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