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IN WITH A BANG

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Captive Formation
The earlier, the better

Tax Reform
A return to risk

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US AND EU AGREE INSURANCE DEAL

US insurers and reinsurers will now be able to compete in EU markets without having to meet Solvency II requirements, after the completion of a long-mooted covered agreement between the US and the EU.

The US Treasury and the Office of the US Trade Representative (USTR) completed negotiations with the EU on 13 January.

Leigh Ann Pusey, president and CEO of the American Insurance Association, commented: "We believe that [this] is both a win for US insurers and reinsurers competing in the EU and a win for the US state-based system of regulation."

The deal provides a mutual agreement of prudential supervision in the EU and the US, which will eliminate the increasing barriers to US groups operating in Europe.

Pusey added: "In recent months, US insurance groups with operations in Europe have increasingly become subject to discriminatory prudential measures due to the implementation of Solvency II."

National Association of Insurance Commissioners (NAIC) president Ted Nickel described the covered agreement between the US and EU as "disappointing".

Nickel said in reaction to the agreement: "After more than a year of secret meetings, it's disappointing that in the waning days of the [Obama] administration we are finally seeing the details of what purports to be a covered agreement between the US and EU."

Under the agreement, EU supervisors will acknowledge and affirm the US insurance regulatory framework, promising to allow US insurers and reinsurers to compete in their markets without the regulations being imposed on them under Solvency II. In exchange, EU insurers and reinsurers will receive fair reciprocal treatment and be able to compete in US markets.

The agreement covers three areas of prudential insurance oversight, specficially reinsurance, group supervision and the exchange of insurance information between supervisors.

Nickel added: "As most state regulators were not allowed to participate in the process, the NAIC is coordinating a thorough review of the agreement to ensure consumer protections are not compromised through the preemption of state law, and we encourage Congress to do the same."

"Of great concern is the potential to use this agreement as a backdoor to force foreign regulations on US companies."

According to a joint statement from EU and US representatives, insurers operating in the other market will only be subject to worldwide prudential insurance group oversight by the supervisors in their home jurisdiction.

The statement said: "The limitations on the exercise of worldwide group oversight outside of the home jurisdiction include limits on matters involving solvency and capital, reporting, and governance. Supervisors nevertheless preserve the ability to request and obtain information about worldwide activities, which could harm policyholders' interests or financial stability in their territory."

The Federal Insurance Office and the USTR will now consult with and submit the agreement to four congressional committees, in accordance with the Dodd-Frank Act, to gain authority for the covered agreement.

Representative Richard Neal of the House ways and means committee, which will scrutinise the covered agreement, promised to ensure that the deal successfully addresses "EU discrimination against the US insurance and reinsurance industries".

The agreement will then become effective 90 days after that date.

US Treasury secretary Jacob Lew commented: "The covered agreement enhances protections for US insurance consumers and increases opportunities for US insurers and reinsurers. We congratulate all involved for an agreement that serves the best interests of both the US and the EU."

In October 2016, the International Underwriting Association (IUA) warned that improvements in the efficiency of reinsurance regulation were at risk of being undone if a covered agreement between Europe and the US was not reached.

The association suggested that the covered agreement could solve the problem and result in zero collateral on both sides.

In a statement, released in October, Dave Matcham, chief executive of the IUA, said: "A lack of mutual recognition between regulatory regimes on each side of the Atlantic is causing problems and this could be an ideal way of solving them. It could potentially allow the US to be recognised as Solvency II equivalent and speed up the process of reducing US collateral requirements for international companies."

"A covered agreement deal, therefore, has a great deal of appeal. It is vitally important that industry representatives, regulators and federal negotiators in the US and Europe all work together to ensure that global regulation can work as effectively as possible."

Following the covered agreement, Cristina Mihai, head of prudential regulation and international affairs at Insurance Europe, said: "Insurance Europe welcomes the recent conclusion of the bilateral agreement on reinsurance and insurance between the EU and the US, and supports the provisions foreseeing the removal of the discriminatory collateral requirements that EU reinsurers were subject to when placing business in the US."

Mihai added: "Insurance Europe has been very supportive of the EU-US regulatory dialogue and the negotiations of a bilateral agreement on reinsurance and insurance led by the European Commission, and believes the recent conclusion demonstrates the strength of the relationship between the EU and the US."

Compre bags Luxembourg business

Compre has acquired an insurance and reinsurance business in run-off from Swiss Re International in Luxembourg, for an undisclosed sum.

The acquisition is in relation to business underwritten by RW Gibbon Underwriting Agencies and RW Gibbon & Son between 1950 and 1972.

Nick Steer, CEO of Compre, said he was "extremely pleased to announce our second acquisition this year and our first involving a Luxembourg counterparty".

"The transaction further underlines our ability to provide complete finality for complex pool arrangements and we hope to complete further transactions of this type during 2017."

"Demand for portfolio transfer deals in continental Europe is certainly increasing as companies better understand the implications of Solvency II and look to focus on their core businesses and release capital tied up in supporting legacy liabilities."

Compre also agreed to acquire the UK branch of AG Insurance SA, an insurance and reinsurance business in run-off, for an undisclosed figure, earlier in January.

Compre has now acquired 10 companies in run-off.

Gibraltar Finance rocks up in China as its businesses gear up for expansion

Gibraltar could become the home for a number of new Chinese captives, according to a government official.

Albert Isola, Gibraltar's minister for commerce, said the domicile could house the captive operations of Chinese businesses that are expanding overseas.

He said: "As Chinese businesses continue to expand overseas and make acquisitions in Europe and across the world we believe there are opportunities for these businesses to establish captive insurance companies close to their acquired assets and we hope that Gibraltar will become the home for a number of these new captives. We will continue to work to facilitate this process."

Isola made the comments following a Gibraltar Finance meeting with the captive specialised committee of the Insurance Society of China in Beijing on 7 January.

The committee, established to carry out research, build a communication platform and promote Chinese captive business development, invited Gibraltar Finance to discuss the development of captive insurance as a concept in China.

The committee expressed that, although Chinese businesses are still taking baby steps with only a few captives licensed, there is "significant interest" in this form of risk transfer.

Isola added: "We were honoured to have been invited by the permanent directors council of the Insurance Society of China and to speak at this inaugural meeting."

Post-Brexit passporting for financial services could be a reality

UK Prime Minister Theresa May's desire for a "smooth and orderly" departure from the EU could mean some form of reciprocal passporting for captive owners writing insurance in and out of their respective jurisdictions.

In her first major speech on the substance of the UK's negotiating position as it prepares to formally quit the EU in March, kicking off a two-year process, May indicated that she wants a "phased period of implementation" for "our mutual interests", which includes cross-border financial services.

Positive captive growth in Utah

The Utah Captive Insurance Division licensed 68 new captive insurance companies in 2016, as well as 13 cell captives.

Last year's figures bring Utah's captive total to 462 active captive companies and 74 active cells.

In addition to the increase in the number of captives in Utah, the captive division implemented new processes for insurers, including an upgrade to its online applications.

According to the Utah captive division, 2017 will be another "great year" for the domicile.

Travis Wegkamp, captive insurance director for Utah, said: "The 831(b) election resulted in changes that required some adjustment, but ultimately it will provide several improvements and benefits."

He added: "We have also submitted a few changes for legislative consideration. The most notable would be the creation of a specific certificate of authority for captive companies formed as a pool."

Arrangements for the undefined transition period are a "matter for negotiation", but the UK intends to "avoid a disruptive cliff edge", May said.

Ivor Edwards, corporate insurance partner at law firm Clyde & Co, commented: "It's in everyone's interests that financial services can be carried out efficiently across the continent and there has been talk of something equivalent to passporting to aid this."

"It has advantages in that it may be easy to set up and follow, but the risk is that the UK might lose control of rule setting and equivalence of passporting could be withdrawn or quibbled over."

"A dispute resolution process would need to be agreed to deal with this."

Following the UK's 23 June 2016 vote to leave the EU, Marsh Captive Services explained in a brief to captive owners that restrictions to financial services passporting in and out of the EU could have an effect on their businesses.

"'Passporting' refers to the right of UK resident insurers, captives in the UK and Gibraltar, and UK brokers to provide insurance services in EU member states from a single country licence. Since the UK will no longer be part of the EU, that right may be restricted," the brief explained.

"Similarly, an EU resident captive insurer may need an additional licence to conduct insurance business in the UK."

"The EU captive insurer may need to form a UK branch or a new UK entity, particularly if it is insuring compulsory classes such as employers' liability and third-party motor liability risks in the UK."

"Another alternative would be to use a UK insurer to front the risk. For non-compulsory classes of risks, the EU resident captive could cover the UK risks on a non-admitted basis without applying for a separate licence."

But, as Marsh pointed out last year, time is still very much on captives' side.

"The effects of Brexit on captive owners will become more apparent in the months to come, once negotiations start and the terms of the UK's relationship with the EU becomes clearer."

"However, the transitional timeline of two years will allow for proper planning and management of the situation for affected captive owners."

Health insurance data breach affects many in Delaware

A health insurance data breach has affected approximately 19,000 people with employer-paid plans in Delaware, according to the state's department of insurance.

The breach involved Summit Reinsurance Services and BCS Financial Corporation, subcontractors of Highmark Blue Cross Blue Shield of Delaware.

Karen Kane, director of privacy and information management for Highmark Blue Cross Blue Shield of Delaware, revealed that the breach affected 16 current and former Highmark self-insured customers and approximately 19,000 members.

Summit Re sent a letter to members, stating that leaked information could include names, social security numbers, health insurance information, names of providers, and/or claim-focused medical records containing diagnosis and clinical information.

Trinidad Navarro, insurance commissioner of Delaware, has ordered an investigation into the reported breach.

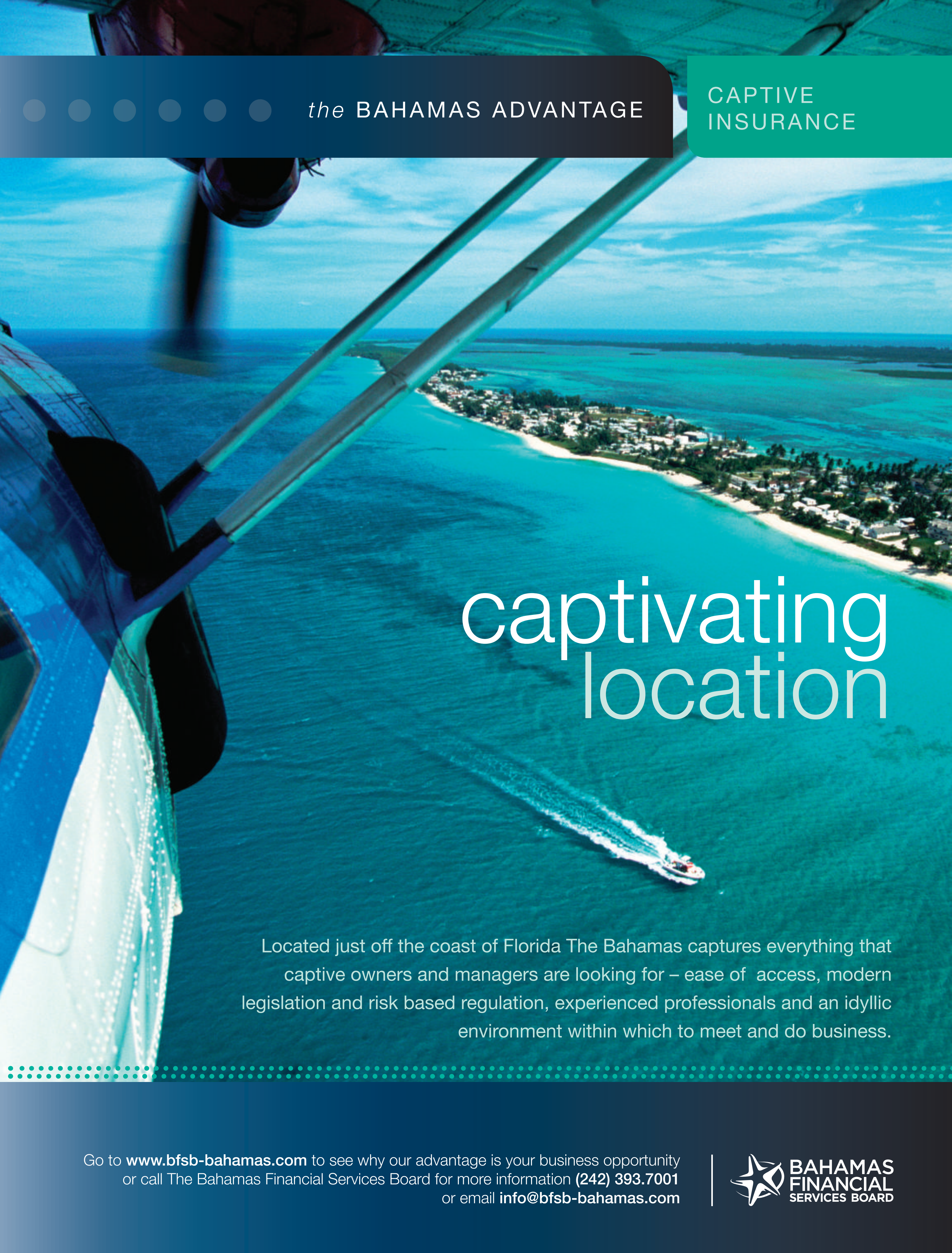
The letter also suggested that, although Summit Re discovered ransomware on 8 August last year, during an "ongoing investigation", the unauthorised access first occurred on 12 March 2016.

However, it noted that: "To date, we have found no direct evidence of actual or attempted misuse of personal information on the affected server as a result of this incident."

In response to the data breach, Navarro reassured members that the department "takes this matter seriously and is currently investigating how this occurred".

Navarro said: "I have directed my staff to closely monitor the situation as it develops. Many Delawareans have received mailed correspondence from Summit Re explaining the breach. Unfortunately, we fear that many may have misinterpreted or inadvertently discarded the letter as some form of a sales ad, due to the fact that they had not purchased any line of insurance from Summit Re."

According to the Delaware Department of Insurance, Highmark Blue Cross Blue Shield of Delaware is cooperating with the Delaware Department of Insurance to resolve the matter.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BAHAMAS FINANCIAL SERVICES BOARD

Missouri licenses five captives and hits the ground running in January

The Missouri Department of Insurance licensed four captives in December 2016, as well as one in January.

All five are pure captives, with four from Missouri-based parents and the other from an Iowa parent company.

At present, Missouri has 58 licensed captives in total and, according to John Talley, captive programme manager at the Missouri Department of Insurance, the domicile "may receive four additional applications this month [January]".

As of 2015, Missouri's captive industry reached $22.5 billion in assets and $3.7 billion in written premium.

In a recent interview, Talley commented: "We have seen captive growth in the financial, transportation, construction, and service industries, both in Missouri and in surrounding states, and [in 2016, we saw], increased interest in captive formation from mid-size commercial and agribusiness entities."

This year Missouri is celebrating 10 years of operation in the captive insurance industry space.

BSX celebrates ILS record

The Bermuda Stock Exchange (BSX) has reported record insurance-linked securities (ILS) listings in 2016.

More than 60 ILS listings, worth $6.16 billion, were floated on the BSX last year.

These included seven new variable rate note programmes and 19 new notes under established programmes.

In total, the number of ILS listed vehicles on the BSX increased from 151 to 175, a 16 percent increase.

The overall value of these securities increased from $19.21 billion to $21.22 billion, a 10 percent increase.

BSX president and CEO Greg Wojciechowski commented: "The accomplishments of the BSX to date and in particular this year's results are directly attributable to the hard work of a dedicated team of world class stock exchange professionals that manage and operate the exchange on a daily basis."

US MGU teams up with Gilsbar

Gilsbar has been selected as a partner by US Managing General Underwriters (MGU) to administer its level-funded healthplan option for small employers.

US MGU specialises in the design, implementation and management of captive insurance companies and self-insured plans.

The level-funded plan is a product that provides smaller employers access to self-funded plan savings, while insulating them from the exposure of a traditional self-funded plan.

Doug Layman, president of Gilsbar Health and Life, revealed he is "excited" to be working with US MGU to deliver a self-funded solution for the small employer.

Randall & Quilter completes Arizona captive novation

Randall & Quilter (R&Q) Investment Holdings has completed the novation of liabilities from PacWest Captive Insurance Company, an Arizona-domiciled entity.

The novation to the R&Q-owned segregated account company in Bermuda, R&Q Quest, included liabilities for policy years 2001 to 2011.

PacWest was formed in 2001 by Leavitt Group Enterprises to provide workers' compensation coverage written by Leavitt-owned agencies.

These policies were fronted by The Hartford and have been in run-off since 30 June 2011.

Reserves for the policy years being novated are estimated to be $4.4 million, as of the end of August last year.

Ken Randall, chairman and CEO of R&Q, said: "We are pleased to complete this novation with PacWest."

"This novation caps off a fantastic year of legacy transactions for R&Q, with prospects for 2017 looking even brighter."

IW&I launches Solvency II solution

Investec Wealth & Investment (IW&I) has launched a fully-automated Solvency II reporting solution for financial mutual and insurance companies, offering clients a "comprehensive" investment proposition.

The solution was developed in response to market demand for cost-effective tools to meet the additional reporting, risk and governance challenges set by Solvency II.

The solution was put together with input from existing clients and industry actuaries.

IW&I suggested that, since the implementation of Solvency II, the directive has "created significant challenges for financial mutuals and insurance companies as it affects their risk and governance, and the frequency and amount of information they are required to report to regulators".

James Bedingfield, senior investment director at IW&I, said: "Our reporting solution has been designed specifically to address the complexities faced by financial mutuals in complying with the myriad requirements of Solvency II, which was primarily designed for much larger insurance firms."

He added: "Given the fact that we already worked with a number of leading financial mutuals for over 20 years, we have an intimate understanding of how to apply Solvency II regulations to their reporting requirements."

SOBC Sandell marks its first transaction

SOBC Sandell, a joint venture between SOBC Corp and Sandell Re, has completed its first transaction, acquiring PIA Captive, a Montana-based company.

Prior to the acquisition, completed on 15 December last year, PIA Captive was a risk retention group in Montana, known as PIA RRG.

Stephanie Mocatta, CEO of SOBC Sandell, said: "We are delighted to have made this first acquisition, and particularly pleased to have worked closely with the Montana commissioner of securities insurance to find a unique solution for the members of the risk retention group who wished to exit the business."

Rick Ecklord, director of Sandell Re, added: "We are pleased to have closed our first acquisition as SOBC Sandell."

"This shows that the combined skills of SOBC and Sandell Re can work together effectively to provide legacy solutions for difficult and challenging run-offs. We look forward to the next challenge."

SOBC Corp and Sandell Re formed the new joint venture in November last year, with a focus on acquiring and managing legacy insurance and reinsurance liabilities currently in run-off.

In addition, SOBC Sandell will provide consultancy services to insurance and reinsurance entities, as well as regulatory bodies, for distressed blocks of business.

Have a story we should cover?
Let us know via:
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Digital spectre looms large

Business interruption and cyber incidents led the Allianz Risk Barometer for 2017

The threat of terrorism events and the continued rise of technology dominated the sixth Allianz Risk Barometer 2017, revealing business interruption, market developments and cyber incidents as the top three risks to modern businesses.

Allianz's survey, conducted in October and November last year, included responses from risk consultants, underwriters, senior managers and claims experts of Allianz entities globally.

Top of the risk list for 2017 is business interruption. Companies are increasingly worried about the unpredictable business environment where markets are volatile and political perils, such as terrorism, are on the rise.

Some 37 percent of survey participants rated business interruption as one of the three biggest risks that companies face in 2017. Business interruption also featured in the top three risks of those surveyed from France, Canada, the US, Italy, Spain, Australia, Japan and Singapore, making it a global concern.

The nature of business interruption is changing, expanding from damage-driven events such as natural catastrophes, to intangible hazards or formerly uninsurable events (see Figure 1: Which causes of business interruption are feared most?).

Volker Muench, global practice group leader of property underwriting at Allianz Global Corporate & Specialty (AGCS), suggests that business interruption leads the way because of these changes.

He explains: "New triggers for business interruption emerge constantly. These can range from cyber incidents to market developments to the changing political landscape."

"Going forward, we expect there to be more non-damage triggers of business interruption. It is important that our insured customers understand the evolving threats they are facing," Muench adds.

Digital dangers

Survey participants expressed particular concerns about increasing digitalisation and the deployment of new technologies affecting current business models and industry risk profiles (see Figure 2: Digitalisation is significantly impacting business models. Which risk impact of increasing digitalisation do you fear most?).

Solmaz Altin, chief digital officer at Allianz, explains: "Companies that don't want to become a victim of disruption but rather shape their industry, must be able to innovate, change and adapt their business model."

New technologies made an appearance in the barometer's look at global risks for the first time, with 12 percent of responses. Human error, according to Allianz, could increasingly be replaced by technical failure.

Meanwhile, more than half of respondents, 53 percent, across all industries recognised increasing digitalisation and the use of new technologies as the most prominent trend currently transforming their business sector.

According to Georgi Pachov, global practice group leader of cyber at AGCS, technological advances made over the last decade are the main driver of the growing cyber exposure landscape.

Pachov suggests: "There is no industry untouched by the penetration of digitalisation and the vast amount of information exchanged at all stages of the business value chain. This interconnectivity enables growth, cost optimisation and more flexible business models close to the final customer. However, it also poses significant risks related to inability to deliver the product or services."

Ranked in third place with 30 percent of responses was the risk of cyber incidents, which continue to linger high up in global business concerns for 2017.

Figure 1: Which causes of business interruption are feared most?

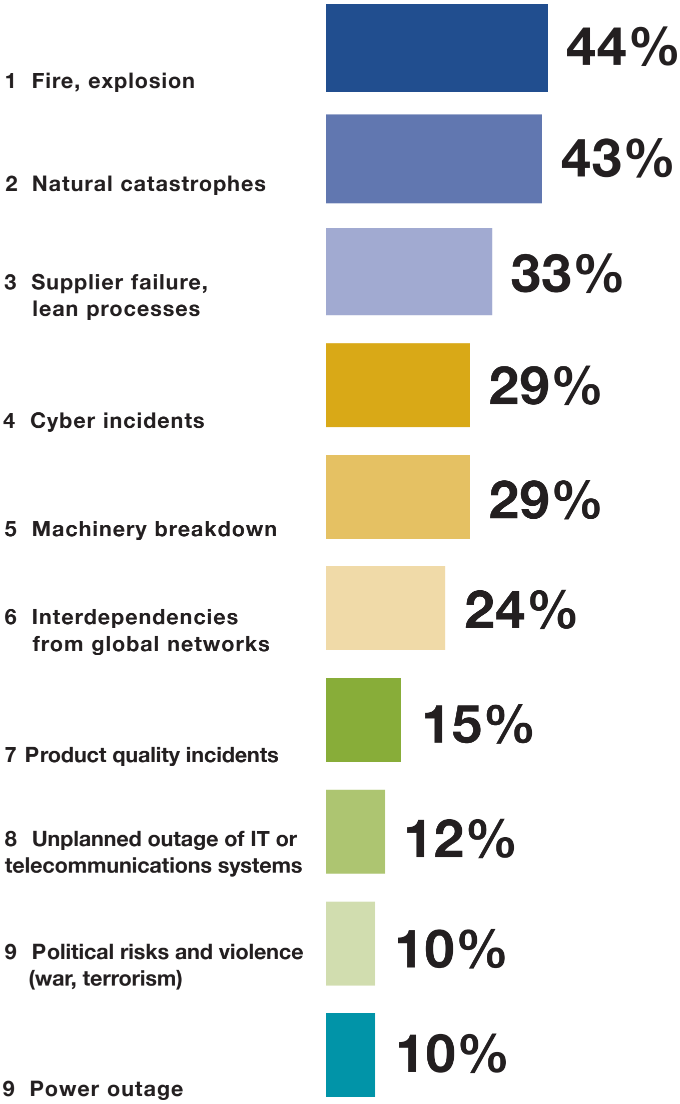

Figure 1: Source: AGCS. Figures represent the percentage of answers of all participants who responded (499). Up to three answers possible.

In 2013, cyber was ranked fifteenth in the top global risks with only 6 percent of responses, but only four years later, it has leapt into the top three, indicating it occupies a significant portion of a company's exposure map.

Breaking it down into countries, cyber risk was ranked the second biggest concern for 2017 in the US, Spain and Austria, from second, third and fifth place in the 2016 survey, respectively. In addition, the impact of cyber incidents emerged as the top concern for businesses in the UK for the second year in a row.

Companies once believed cyber stopped at privacy issues and data breaches, however, the barometer showed that now a single incident can cause reputational damage to a company's profile, business interruption and loss of market share.

Emy Donavan, head of cyber in North America for AGCS, says: "Cyber risk is not going away and people around the world are right to be concerned."

Cyber is still largely an unknown risk, is not isolated to a particular segments and spans different industries and sizes of companies, from an online retailer through to a heavy manufacturer to an oil refinery, according to Allianz (see Figure 3: What are the main causes of cyber incidents?).

Although cyber ranked third overall, a cyber incident could be the root cause or trigger for 50 percent of the risks that feature in the barometer.

Increasing the regulation for data protection is also a contributing factor to cyber being a priority for risk managers, due to penalties for non-compliance.

Although laws in the US are already strict, "a heightened liability focus is also seen elsewhere in the world", according to Allianz.

A significant development is occurring in Europe and the introduction of the General Data Protection Regulation will transform the landscape.

Nigel Pearson, global head of fidelity at AGCS, says time is already running out for businesses to prepare for its implementation in May 2018.

Pearson says: "It will impose significant liabilities and penalties on companies doing business in the EU or with EU citizens."

Figure 2: Digitalisation is significantly affecting business models. Which risk impact of increasing digitalisation do you fear most?

Figure 2: Source: AGCS. Figures represent the percentage of answers of all participants who responded (1,006). Up to three answers possible.

Figure 3: What are the main causes of cyber incidents?

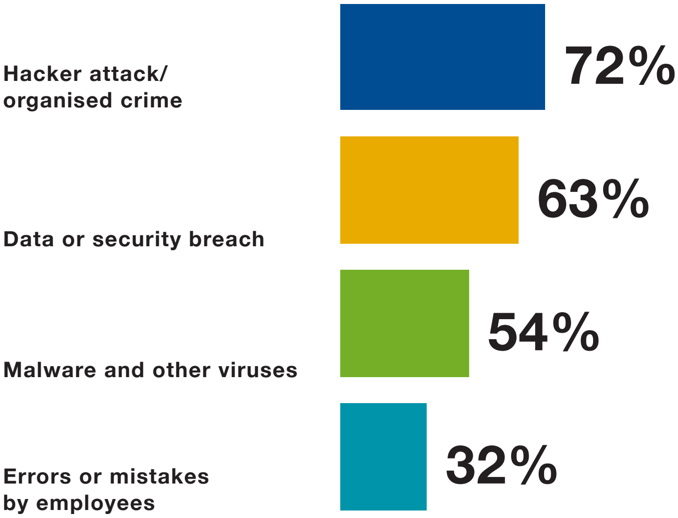

Figure 3: Source: AGCS. Figures represent the percentage of answers of all participants who responded (446). Up to three answers possible.

Pearson adds: "Costs to comply with the legislation will be high, the penalties of not complying could be even higher."

It is the "growing sophistication" of cyber attacks that companies fear most, with 45 percent of respondents saying so, while 42 percent feel that cyber risk is the top long-term peril. However, for small-sized companies, cyber ranked in sixth place.

"Many companies underestimate their exposure and are not prepared for, or are able to respond to, an incident, with a lack of resources to do so a contributing factor," Allianz explained.

Natural catastrophe also featured high on the 2017 barometer.

In 2016, natural catastrophes accounted for $175 billion in economic losses, a four-year high, with insured losses reaching a total of approximately $50 billion.

Natural catastrophes and climate change ranked high on the agenda for businesses this year, particularly in Asia. Catastrophes such as storms, floods and earthquakes emerged as the top concern in Japan and Hong Kong, highlighted as a concern by 55 percent and 35 percent, respectively.

Businesses are concerned about the impact of climate change and increasing weather volatility year-on-year, with this reaching fourteenth on the barometer.

According to Axel Theis, board member of Allianz, natural catastrophes and climate change "worry our customers and society at large".

Theis says: "We must assume that global warming above 1.5°C would intensify climate damages, for example from heat waves and rising sea levels, significantly. It is our task as an insurer to develop solutions for these scenarios and establish prevention and insurance protection for, and together with, our customers and public partners."

In addition to the top four risks, businesses are increasingly concerned about the ongoing uncertainty, and potential intangible risks, posed by the changing legal and political landscape around the globe.

Changes in legislation and regulation (fifth), political risks and violence (eighth), and Brexit and eurozone disintegration (sixteenth), ranked higher year-on-year, accounting for more than 40 percent of responses collectively.

Allianz explained: "Fear of protectionism or government intervention in business is perceived to be an increasing threat, leading to worries over access to markets and import and export restrictions; presenting a potential business interruption threat of a different kind."

Terrorism risk is a rising concern, ranking as the number one concern for businesses in the political risk and violence category (see Figure 4: Political risks and violence are an increasing concern for multinational business. Which risks are most worrying?).

Events including the UK's decision to leave the EU and Donald Trump winning the US presidential election were widely unexpected 12 months ago.

Other participants also expect the results of 2017 elections in Europe to exacerbate the current situation.

According to Chris Fischer Hirs, CEO of AGCS, everyone is bracing for a year of uncertainty.

Fischer says: "Unpredictable changes in the legal, geopolitical and market environment around the world are constant items on the agenda of risk managers and the C-suite."

"A range of new risks are emerging beyond the perennial perils of fire and natural catastrophes which require re-thinking of current monitoring and risk management tools." **CIT**

Figure 4: Political risks and violence are an increasing concern for multinational business. Which risks are most worrying?

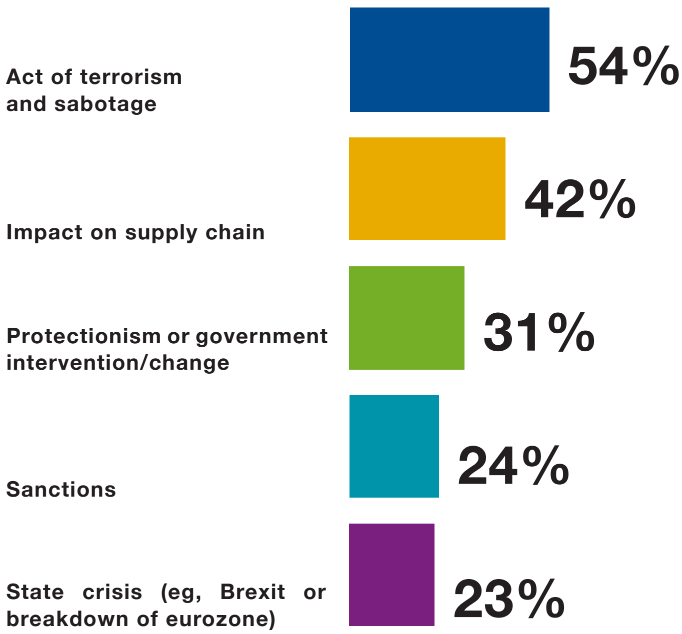

Figure 4: Source: AGCS. Figures represent the percentage of answers of all participants who responded (1,040). Up to three answers possible.

Teaching an old domicile new tricks

After 36 years of captive business, Vermont boasts a culture of legislative change, and still has a few tricks up its sleeve. Dan Towle and David Provost explain

How would you characterise Vermont's 2016, as a domicile?

Dan Towle: Last year marked the 35th anniversary of the implementation of Vermont's landmark 1981 captive insurer statute and we had another solid year of licensing new captives of all different sizes, types, and industries. We enacted new captive insurance legislation to further strengthen our captive law and have continued to see strong interest across all lines of business.

In 2015, Vermont licensed 33 new captive insurance companies, made up of 12 pure captives, seven risk retention groups (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.

In 2016, we licensed 26 new companies, one association captive, one industrial insured and one sponsored, plus three special purpose financial insurers, five RRGs, and 15 pure captives.

From those figures, we licensed eight healthcare captives, five manufacturing, four in the insurance sector, two each for construction, real estate, retailers and 'other', and one in each in finance and in our 'other' category. It is also important to note, that with the eight new captives in healthcare, that the healthcare sector is now Vermont's largest sector, surpassing manufacturing.

What factors contribute to the success of Vermont as a captive domicile?

Towle: Our fully developed infrastructure and firm-but-fair, flexible regulation. Our team of regulators has more than 300 combined years of experience in auditing, captive management and captive regulation. We are accessible and make it a point to respond at the speed of business.

We work with captive owners to develop collaborative approaches for regulation that protect the policyholders while recognising the special purpose for which the captive is formed. We have been independently recognised for our efficient examination process.

Vermont's infrastructure of captive professionals is arguably the most experienced and sophisticated in the world. The Vermont Captive Insurance Association (VCIA) is vital to the success of Vermont. VCIA members are active in keeping our statute current and our voice heard in Washington, at the National Association of Insurance Commissioners, and wherever captives are threatened.

What trends have you seen in the captive insurance space, and do you think these will continue into 2017?

David Provost: As expected, healthcare led the way with eight new captives. That category encompassed liability coverage for healthcare providers and assisted living homes, and medical stop-loss programmes for employer groups. I expect the healthcare market for captives to continue to expand, although this year might just be a wait-and-see period with the new administration in Washington DC.

Manufacturing came in a strong second with five new captives, a bit of a surprise—I hope that continues.

Are there any regulation updates on the cards for Vermont this year? What else can the industry expect to see?

Provost: Making advancements to our captive insurance law is an annual tradition in Vermont. 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. Our 2017 captive bill was introduced to the legislature the week commencing 16 January. This year's bill expands the options for accounting methods used by captives, proposes an additional tax credit for new companies, and allows for the licensing of agency captives in Vermont. The bill also expands the dormancy option to all types of captives and addresses some conflicting language regarding auditor partner rotation for risk retention groups.

This legislation makes Vermont more attractive and sends a strong message to the industry that we are committed to always improving our captive insurance law. **CIT**

Dan Towle
Director of financial services
Vermont Agency of Commerce
and Community Development

David Provost
Deputy commissioner for the
captive insurance division
Vermont Department
of Financial Regulation

US tax reform:
Returning captive focus to risk?

Changes to the US Tax Code should not distract from the fact that the principles of risk financing and the use of captive insurance remain critical to any programme, says Adam Forstot of USA Risk Group

The 831(b) election has been at the forefront of many discussions involving captives and taxes for the better part of two years. The implications for captives for the middle market and those offering non-traditional risks through pools have been well documented. With several court cases nearing conclusion (at least pending any potential appeals), the uncertainty surrounding 831(b) may soon be settled.

With all of the talk surrounding 831(b) and its impact on middle-market captives, there has been very little discussion around the implications of changes to 831(b), or other potential changes to the US Tax Code, for the overall captive industry.

President Donald Trump and many members of the Republican-controlled Congress have made no secret of their intent to make changes to the code tied to Trump's highly publicised objective to keep jobs in America and encourage increasing investment in US operations. Some of the potential changes being mentioned include:

- Reform of Affordable Care Act (ACA) to include elimination of the individual mandate;
- Overall simplification of the Tax Code;
- Reduction in corporate tax rates;
- Reductions to capital gains rates;
- Reduction to the estate tax and/or increase in the exemption threshold; and
- Incentives for US companies to increase investment in US operations, which may include reduction in the corporate tax rate, tax credits and tax holidays on funds repatriated from overseas.

The changes that seem to be most frequently mentioned, aside from repeating the ACA, are reductions to the corporate tax rate and modifications to the capital gains and estate taxes. The corporate tax rate is consistently referenced in decisions by US companies to move operations offshore or go through 'inversion' transactions. With inversion, the legal domicile of the company is moved to a lower tax nation while the primary operations remain in the US. There have been several high-profile inversions in recent years. Some have involved countries generally recognised for their favourable corporate tax rates. Others involved countries perceived as being unattractive from a tax perspective. However, some of these countries offer a favourable tax rate relative to the US.

Accusing these companies of being unpatriotic is not going to be persuasive when they can utilise a perfectly legal technique to reduce their tax obligations. Trump has made no bones about his objective to keep companies in the US. Unless the provisions making inversion and other expatriation of assets and jobs are eliminated (another potential reform), the most attractive option, more than likely, is to reduce the US corporate tax rate.

Without getting into highly detailed economic analysis, the basic assumption would be that reducing the corporate tax rate would not only encourage companies to stay, but also increase corporate profitability while encouraging more investment in the company and/or better returns for shareholders.

What does this have to do with captives? Potentially, quite a bit. It is a well-established principle of captive analysis that captive formation can never be only about tax. Aside from being a red flag for the Internal Revenue Service (IRS), it's simply not a sound reason to get into the insurance business. Forming and operating a captive requires thoughtful analysis of the risk to be insured as well as the company's tolerance for assuming risk. Focusing on tax may distract from these essential elements. As a result, a captive may be formed that may not only fail to properly address a company's risk management needs, it may also expose the company to scrutiny by the IRS.

That stated, the tax implications of forming a captive (or any significant investment) need to be evaluated. For larger companies, the ability to finance risk in a tax-efficient manner is important. In general, premiums paid to the captive can be deducted as a business expense, and at the captive level, reserves can be deducted on an accelerated basis leading to a further benefit. At the current corporate tax rates, this can generate a significant economic benefit. In addition to tax benefits, assuming predictable risk in a captive also lowers the frictional cost by reducing and/or eliminating the carrier overhead attached to that layer of risk (referred to as 'dollar swapping').

> "If the captive suddenly isn't generating the same return as other investment opportunities, does it remain viable? In most cases, the answer is probably 'yes'"

What if the corporate tax rate is reduced to 25 percent, or perhaps to Trump's publicly stated target of 15 percent? What happens if the capital gains rate is lowered at the same time? Will owners be more inclined to accelerate dividends out of concern that the capital gains rate will be increased again?

Most would anticipate that every corporation would conduct thorough analysis of its finances relative to a reduction in the corporate tax rate. This analysis would likely evaluate the internal rate of return on all major capital investments, including the captive. If the captive suddenly isn't generating the same return as other investment opportunities, does it remain viable? In most cases, the answer is probably 'yes', but it will be critical for risk managers and other stakeholders involved with the captive to anticipate these questions and be prepared to demonstrate the value of the captive as a risk management tool outside of a traditional internal rate of return analysis.

A driving principle of captives has been ‘the four Cs’:

- Coverage: Using the captive to offer lines of business unavailable or difficult to obtain in the commercial market.
- Capacity: Using the captive to expand the limits on lines of coverage and/or to access reinsurance to offer the additional capacity.
- Cost: Using the captive to finance risk at a lower cost than with traditional coverage.
- Control: Using the captive to gain more control over key functions such as claims and underwriting.

In many instances, the capital required to support the captive may not generate the same return for a company as opening a new assembly plant. However, the captive is still likely a much better investment than buying first-dollar commercial insurance, which may generate no return. Or, if the company manufactures a complex product for which insurance is difficult to secure and costly, the ability of the captive to provide required coverage probably cannot be measured through typical financial metrics.

Issues surrounding the 831(b) election have dominated the attention on the captive industry over the last couple of years. While many large, corporate entities are far removed from this space, some of the changes to 831(b) may now be relevant. What is likely relevant to a corporate entity is the increase in the threshold from $1.2 million to $2.2 million as of 1 January 2017. Many larger corporate captives are above the previous threshold, yet a number of those captives may be beneath the new threshold, or possible, very close to it.

Companies with captives that have been paying income tax on their underwriting profits, or possibly not taking insurance company treatment for their captives, may suddenly find that the ability to make the 831(b) election and accumulate underwriting profit tax-free makes modifications to their current captive structure a more attractive use of capital.

This may apply to companies writing a variety of longer-tail casualty coverage, but may be especially true for companies with large property portfolios with high retentions for catastrophic perils, such as named storms, tornados and earthquakes. Under traditional insurance company treatment, there is little benefit to running property risk through a captive. There are a few reasons for this, including:

- Captives are generally focused on funding predictable layers of risk. Catastrophic property coverage is highly unpredictable.
- Property claims generally settle very quickly. The captive therefore will have no reserves to use in order to offset underwriting profits in a given year. Since any non-insurance company can deduct casualty losses when paid, the captive offers no cash flow or tax benefit.

These issues generate a number of challenges for companies from a budgeting and cash flow perspective. Since there is no benefit to setting aside funds or having an accrual for potential catastrophic property claims on the corporate books, companies consistently struggle with how to manage this exposure.

While the nature of the risk doesn’t change under 831(b), the way it can be treated does. By utilising 831(b), these companies can now use a captive to fund their property retentions much more efficiently. The company can use the captive to generate a tax deductible premium as a business expense. At the captive level, underwriting profits can be accumulated tax free, which offers companies that previously struggled to manage their catastrophic property risk a much more efficient means for doing so. If losses remain in check, companies can use excess surplus to increase retentions, expand coverage or return a portion of the surplus to the company for other uses.

So, if you combine the potential financial benefits along with the ability to access reinsurance capacity, a property-focused captive may become very attractive where it was previously not economically viable.

Hopefully, as the new administration and Congress settle in, we will receive clarity on their intentions regarding key tax and finance reform sooner than later. Given the actions and results in US politics over the last couple of years, that may be wishful thinking. Companies will continue to have to navigate this ever changing political landscape as it relates to potential changes to the Tax Code and other economic factors.

Despite this uncertainty, companies will need to continue to look for ways to effectively manage their risk. Changes to the Tax Code may change the climate in which this risk management takes place, but these changes should not distract from the fact that the principles of risk financing and the use of captive insurance remain critical to any effective risk management programme.

It would be wise for risk managers to pay attention to potential changes that may affect the captive both positively and negatively. They will need to understand the financial metrics utilised by their companies to evaluate rates of return, the use of capital, and be sure they are able to clearly demonstrate the value of the captive. The risk management team and other stakeholders need to be able to demonstrate the qualitative and quantitative benefits of using the captive to the company decision makers relative to their internal rate of return and other financial metrics to show why the captive is a good investment.

If the captive was formed based on a solid risk management foundation and supported by a detailed feasibility study, the benefit of the captive to the organisation should already be well documented. From there, it will be a matter of articulating the importance of the captive for preserving company assets and ultimately enhancing the bottom line. **CIT**

USA Risk Group does not offer tax advice. The points raised in this article are for discussion purposes only. Anyone interested in how any of these issues may impact their own captive should consult their tax/legal advisors.

Adam Forstot
Vice president
USA Risk Group


The earlier, the better

When deciding whether to form a captive, risk coverage should come first, financial benefits second, according to Steven Lonergan of Capstone Associated Services

Across industries and around the globe, mid-market businesses have been forming captive insurance companies because they serve as a powerful and practical risk mitigation and financing tool. Captive coverages: (i) plug the holes that commercial policies leave behind; (ii) are designed to customise the specific risks of the subject business more closely; (iii) cover deductibles and excess; and (iv) often can, more economically than conventional policies, cover risks otherwise not competitively priced in the marketplace.

Coverages from affiliated captives also eliminate the uncertainty of arbitrary denials of coverages and contentious claims adjustment often seen with commercial property and casualty carriers. The ancillary financial benefits—for example, retaining the ultimate rights and investment income on the capital used to fund losses—are an added bonus.

When implemented as part of a comprehensive risk management programme, alternative risk planning/captive planning improves a business's overall financial strength and integrity. For businesses with a robust risk profile, captives offer significant financial and strategic planning advantages. Given the significant advantages of utilising a captive for risk management, when, from a timing standpoint, should a captive be formed?

First, the obvious. The earlier the captive is formed, the earlier the benefits begin to accrue. While incurred but not reported (IBNR)-type losses can be insured with retroactive provisions or insurance (for example, 'claims made' provisions to the extent that the losses are unknown), nonetheless, as a general proposition, insurance coverage can start no earlier than the licensing of the captive. Also, the captive cannot be licensed until the application, financial pro formas, and business plan are submitted to a government insurance department and then reviewed and approved, followed by the formation and capitalisation of the corporate entity. All in, this is a several-month process.

This article makes the case for forming a captive earlier in the year, preferably in Q1 or Q2, rather than in the traditional end-of-year rush. For insureds and captive owners, timeliness in captive planning will provide a better vehicle for risk mitigation and overall success. There is little doubt that business owners who act earlier in the year may see a fuller realisation of their captive benefits.

More choice in where the captive is domiciled

Domicile selection is a critical component to captive planning. The domicile, or jurisdiction where the captive is incorporated and regulated, should have a positive regulatory track record and offer an appropriate regulatory environment for the particular type of captive being formed. For many businesses, forming a captive offshore makes sense. To be sure, historically, British Caribbean domiciles had a regulatory advantage—both as to expertise in regulating insurers, their legislative framework, strong service provider networks and the resulting large number of captives under formation—over the few US domiciles, especially pre-US Dodd-Frank (that is, pre-2010).

However, to qualify as a Section 501(c)(15) or Section 831(b) captive, forming a captive in the Caribbean calls for the captive electing under Internal Revenue Code Section 953(d) to be a domestic (US) insurer, waiving the benefit of all tax treaties in favour of the captive being treated as a US company for all US tax purposes. In fact, this is the only election that is available to a foreign insurance company, preventing it from being treated as a controlled foreign corporation (CFC).

As part of its revisionist application of its own rules during the Obama administration, the Internal Revenue Service (IRS) in 2014 began applying a new mechanical test under Revenue Procedure 2003-47 that effectively negated the ability of Section 501(c)(15) and 831(b) captives from domesticating in the US other than early in the year using the Section 953(d) election. The IRS began a policy to annualise the captive's income based on the days from the date of formation to the end of the tax year.

This is, if a captive were formed and licensed as of 1 December of a year reflecting $400,000 in premium, the IRS will annualise the captive's income to reflect $4,709,667 (365/31 X $400,000) as premiums for this first year. The captive would be required to have 10 percent of this annualised premium in US assets, which, in many cases with year-end formations, would exceed the captive's total assets. The result is that the captive is disqualified from making the Section 953(d) election.

Previously, for years, the IRS looked to the policy terms and other factors for annualising the income to determine whether the Section 953(d) criteria were met. The net effect of using a daily factor for annualising income is that many captives formed late in the year will be required to have more US assets than their total assets, which is an impossibility. This new ruling policy effectively negates the Section 953(d) election for non-US-domiciled captives formed late in the year. That is, captive owners that wait until later in the year to form a captive are restricted to an onshore jurisdiction, even if an offshore domicile is optimal.

More earned premiums to fund losses

Among the financial benefits of forming a captive to finance future losses (as opposed to reserving monies on the insureds' balance sheets to fund losses) is that premiums paid to a bona fide captive are tax deductible. In addition, on an operating basis, Section 831(b) captive owners pay income tax only on their investment income. Section 501(c) (15) captives, although subject to more severe restrictions overall, are wholly tax exempt on all income, both investment and underwriting.

Whether the property and casualty insurer is formed under Section 831(a), 831(b), or 501(c) (15), excess admissible assets can be invested in a wide variety of domicile-approved investments, as can the insurer's admissible assets, including (depending on the jurisdiction) secured corporate lending (for example, bonds and mortgages) under commercially reasonable terms. Still, these financial incentives should always come second to the insurance needs of the business. And as part of good insurance practice, the captive should meet the long-established criteria for being recognised as an insurer:

- The law of large numbers;
- Significant risk transfer; and
- The risks insureds should meet the commonly accepted notions of insurance.

In furtherance of the above, a captive usually underwrites many individual risks, which, practically speaking, means having a large number of non-correlated or negatively correlated risks. Arguments exist as well to have multiple policies covering different risks of multiple parties, although this analysis has little basis in insurance practice.

Despite the long-standing requirement for significant risk transfer and adequate distribution of risk, some 'captive managers' promote captive ownership as a tax-driven strategy while having no tax law or tax courting qualifications. Worse, some captive managers implicitly promote this strategy while taking no responsibility for the intricate and ongoing tax and legal structure of the captive. For them, the financial benefits act as a pure marketing tool to drum up business and expand their portfolio. This situation has fuelled the environment by which the IRS has increased its scrutiny of Section 831(b) and 501(c)(15) filers.

That said, when formed for the right reasons and operated properly, the financial benefits of a captive insurance company are first-rate. To this end, the benefits are more easily realised and more flexibly implemented early in the year.

In general, forming a captive insurance company requires reasonable risk transfer, distribution of risk, and solvency (capital supported by annual profits balanced against the net risk exposures). Operating captives earn premium throughout the exposure year. The earlier in the year the captive is established and funded, the more earned premium dollars exist to cover unexpected early losses.

Better strategic planning

For the captive insurance industry, October through December is very busy. Everyone involved in the planning process is hyper-focused on making sure captives are properly structured and funded before year's end.

There's certainly reason for there to be an uptick in captive activity when the autumn season begins. Typically, after the Q3 results are in, the annual budget gets fine-tuned. Business owners coordinate with their advisers to finalise year-end planning.

From an insurance, business and tax perspective, it's better to allow enough time for the captive to be properly structured and fully vetted rather than to do a rush job. Providing enough time for everyone involved to do their part makes for better strategic planning and execution. Of course, it is possible to form a captive in Q4, but there is no doubt that having more time to plan and execute helps ensure a positive outcome.

Turnkey captive insurance planning

Forming a captive, like any corporate formation, calls for a well-thought out plan and a team in place, preferably with an early-in-the-year start. It calls for partnering with a professional team led by tax or corporate lawyers well versed in the intricacies of captives, with the expertise to oversee the project. Captive management is the insurance and administrative part of the planning, which, while important, is only part of the equation.

Most captive insurance managers disclaim all legal and tax consequences of the planning, which leaves little chance of the captive 'getting it right' and 'covering the required bases'. The IRS has recognised this and has directed its attention to administrative and clerical, and insurance broker-type managers because their work has been found to have serious deficiencies not seen in lawyer or administered captives. For a successful implementation and operation, it is critical to have tax, corporate, regulatory and other legal representation that has substantive captive experience to avoid the many pitfalls of the planning. To be sure, the planning calls for a multidisciplinary team that also includes lawyers with assorted expertise, accountants, risk managers, underwriters, claims personnel, and actuaries.

In collaboration with The Feldman Law Firm, Capstone Associated Services administers property and casualty captive insurance companies, providing alternative risk financing services throughout the US. Now in its nineteenth year, Capstone provides captive services to mid-market organisations on a turnkey basis. We encourage beginning the discussion early in the year, focusing on the right reasons for forming a captive: risk coverage first, financial benefits second, followed by other benefits. **CIT**

Steven Lonergan
Director of business development in the Midwest
Capstone Associated Services


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In an ever-changing, and oft-surprising, environment it can be difficult to predict what's around the corner. Beecher Carlson's Jason Flaxbeard takes a tentative look at what the captive world can expect from 2017

If asked at the end of 2015 what to expect in 2016, I would likely not have taken the long odds offered on Brexit, a Donald Trump presidency and the Dow Jones approaching 20,000. But that's the point. Things change so quickly in this digital age that a reactionary vehicle such as a captive may struggle to keep up. So what do each of the items above mean for captives? Ask me again in 2018. The standard deviation is too great for predictive purposes.

That said, with a slant to my own brand of myopic foresight and understanding that none of what follows should sway any betting decision, here's what my visible horizon looks like in 2017.

Captives will continue to explore cyber risk

This exploration will yield little by way of a resolution around the risk itself, but will provide companies with the security of a financing option that offers some modicum of sleep insurance. But it will be a restless sleep.

What I see some companies looking into, in a cyber market that evolves quicker than most, is the development of prescriptive wording for coverage in a captive, written as a best-in-class policy to cover as many aspects of the risk as possible.

Companies can take this policy to the market and look for reinsurance behind the captive. Terms and conditions are very important in a changing market, and owning the primary risk taker—the captive—may allow some flexibility in following the daily/weekly/monthly trends within the online world. One item that no doubt will be addressed in 2017, and captives may have an angle here, is the assessment of the controllable nature of cyber risk. What I mean by this is that cyber risk has many facets and one aspect often neglected is the human element.

Behavioural reviews of human interaction with the internet can be financed through captives and may yield positive results. As always, humans can be a morally weak link in the cyber chain and will remain

so until something is done so that all employees understand that not every winking cat video viewed on a company device is as benign as its visible content.

Captives will delve deeper into the alternative market

Capital is king and return is its queen. Always was and always will be. Although captive income statements will be bolstered by rising interest rates, captives can still look to insert themselves into the capital food chain in a very real way. Assuming all risk into the captive and purchasing reinsurance behind the captive potentially reduces frictional costs (captive premium tax can be lower than admitted insurance costs, for instance). Captives offer wording benefits as alluded to in the cyber paragraph above, and they open up an access point to capital markets.

Currently, the capital markets operate within offshore reinsurance vehicles, but we've seen that they have started to play a greater role in the insurance industry as a whole in 2016, and 2017 shows no signs of this back-end capital letting up. Good risk will always find capital, and companies with good risk profiles and healthy retentions can find support from reinsurers on a multi-line, multi-year basis.

This structure allows budget certainty for companies in a financially uncertain world; an efficient tracking and reporting mechanism through the captive's financials; and the ability to assume more risk in the retained layers. Companies will look to their captives, or will form captives, to position themselves for capital market access and a potential hardening market over the coming years.

The IRS's review of captives will continue

The Internal Revenue Service's (IRS) review of captives will continue apace in 2017, but that's best dealt with in other articles. That said, risk management-focused captives with the appropriate structure will reap the benefits of the elevation in qualifying premium from $1.2 million to $2.2 million.

From a regulatory perspective, I expect Bermuda to pass incorporated cell legislation. Although this may have been under consideration for some time and might stray into 2018, I expect Bermuda to develop a law that competes with the Cayman Islands and the onshore domiciles. Solvency II will continue to drive European regulation and companies, but hopefully regulators will place captives into the correct regulatory bucket, allowing for their continued usage and floridity within their owners' risk financing plan.

Along those lines, companies will look for regulatory stability. Migration back to home state domiciles, although slow at present, will continue as home state regulators have another year of experience under their belts.

With the market relatively soft, I see companies looking to lay off legacy liabilities. Some Solvency II regulatory pressure on capital could also encourage captive owners to explore loss portfolio transfers, commutations, novation or captive sale. The aged liabilities may be in the form of an specific book of business, a dormant captive in run-off, or merely individual claims that can be extracted from the book for sale to a third party. The reason that this is attractive currently is the focus of the reinsurers on premium volume in order to utilise their capital in an efficient manner.

The thing companies 'cleaning' their balance sheets receive from the transaction is certainty. They release reserves and cash and, in return, no longer need to manage claims. They also insulate themselves from any adverse claim development and free up risk managers' time to manage risk prevention rather than risk development.

As companies focus on budget control, more entities will look to medical stop-loss within their captive, taking a corridor of risk and ceding the excess (up to the statutory level) to a reinsurance partner.

From an industry perspective

I am confident that the board of Captive Insurance Companies Association (CICA) will appoint a new president who can be a uniting force within the industry. CICA exists among many other captive associations but retains an independent, domicile-neutral voice. That voice often offers reactionary support to issues and other associations. I believe the new president will take on the challenges of a changing captive environment, provide a conference with educational material that supports the industry as a whole as well as the next generation of captive professionals, for whom the industry will appear markedly different.

In short, much of the industry will stay the course in 2017. There are nascent opportunities available to those whose approach to risk management allows for a long-term view and an extensive use of their captives.

The insurance markets seem to be running close to a 100 percent combined ratio and, with investment income only now starting to return, the market may well start placing some rate pressure on renewals.

Should this occur, many captive owners will look to their captives for larger retentions and to other sources of capital in the reinsurance market. Hard market or soft market, there are opportunities for captives.

I hope that you've read this article quickly, as the speed at which captives innovate may well mean that it is out of date come the CICA International Conference in March. **CIT**

Jason Flaxbeard

Executive managing director

Beecher Carlson


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Finance with benefits

HR departments must have an oversight—and an understanding—of what's going on in the employee benefits captive, says Ciaran Healy of Willis Towers Watson

One of the most notable trends in the captive industry in recent years has been the increasing role of captives in employee benefit financing.

Corporations have been using captives to retain and manage non-life/property and casualty risks for decades, but until relatively recently, life/employee benefit risk has not been considered for captive inclusion to the same extent.

Although the idea of using a captive to fund benefits risks has been around for a number of years, the percentage of the total global captive population to adopt this approach remains relatively small, however, the numbers are very much on the rise. Given the current levels of interest in the topic, the expectation is that there will be spike in the numbers over the comings years.

This heightened level of interest is exemplified by the fact that the topic of 'employee benefits and captives' is now one of the leading agenda items of the numerous captive conferences on the annual circuit.

So why is employee benefits getting so much attention?

Quite simply, when implemented correctly, employee benefits in a captive can bring a range of significant advantages. Successful inclusion of employees in a traditional captive arrangement can result in very compelling cost savings but can also facilitate enhanced coverage and improved management of the risk.

By using a captive to fund insured benefits, companies can make significant savings on insurer profits and broking commissions. There is also the advantage of improved cash flow and the associated ability to collect investment returns. Financial efficiencies of moving from a decentralised structure to pooling are generally accepted to be in the region of 10 to 15 percent, but there are also incremental savings to be made from using a captive. Our work with clients suggests that the cumulative savings of using a pool and a captive, compared to buying locally, can reach 25 percent. Considering that for many organisations, employee benefits coverage costs are greater than property/casualty coverage costs, this percentage saving represents a significant prize. This also suggests that looking at employee benefits and property/casualty holistically could strengthen the business case for medium-sized companies to establish a captive for the first time.

These headline cost savings are obviously very attractive, and are resulting in many organisations commissioning employee benefits captive feasibility studies (we currently have an unprecedented level of enquires from clients). However, these premium and commission savings are not the only quantitative advantages that are available.

Diversification benefits available through the consolidation of life and non-life risks in a single captive portfolio can result in significant improvement on the captive's return-on-equity measures. This is particularly true of captives domiciled in the EU, which are subject to tougher solvency and risk management rules under Solvency II, implemented in January 2016.

Solvency II is increasing compliance and governance costs for captives based in the EU, and companies have been looking at ways to reduce cost and get more from their captives. One way in which captives can increase premiums and broaden their risk profiles is to add employee benefits. Solvency II provides capital credit for non-correlated risks, giving captives diversification benefits when adding life risks to a property/casualty portfolio.

The advantages listed will likely appeal strongly to the risk manager and CFO of an organisation, but what about the HR director, who will generally be closest to the current employee benefits programme?

A common concern of HR professionals, who may not have had much prior exposure to captive insurance, revolves around the quality of benefits and the misconception that a group-owned insurance vehicle would not be able to offer the same quality of coverage as the current employee benefits insurance partners. However, using a captive can enhance coverage rather than dilute, and can give HR departments more control over employee benefits cover, as well as ensuring that cover is more consistent across various jurisdictions. The captive can be used to offer benefits cover that is not widely available in the local market, ensuring that employees across the group receive the same quality of coverage irrespective of which location they work in. Organisations can provide the benefits cover they want, not what insurers want to provide. Increased control of cover is particularly useful when looking to attract and retain talent. In an age when talent retention ranks high on the risk registers of organisations of all industry sectors, the flexibility that a captive approach can facilitate will likely be very appealing to HR stakeholders within the organisation.

In addition to the considerable advantages noted above, organisations that use captives to finance insured employee benefits risk can also achieve better management and transparency of data.

One of the more significant challenges associated with the centralisation of benefits is transparency. Information on employee benefits spend is generally difficult to access adequately, given its decentralised nature and the local authority over its purchase. As well as this, networks typically only provide data six months after the end of the underwriting year, making it difficult to achieve true visibility of the data. However, captives need to pay claims quarterly or monthly, so data from fronting insurers flows faster to support the cash-flow arrangement. Quarterly reporting means more transparency of financial performance and the ability to improve claims and cost management. This control of the data allows for improvement initiatives to be identified and also provides the central HR function with enhanced oversight of the benefits purchasing behaviour of subsidiaries.

For many organisations, these outlined advantages are compelling. So a legitimate question is: why are the numbers of employee benefits captives still relatively low?

Most insured employee benefits are relatively straightforward to include in a captive. The profile of employee benefits risks are usually high-frequency, low-severity risks that are relatively simple to forecast and therefore well suited to a captive approach.

However, this approach will not suit every organisation and there are significant challenges to successful implementation.

Firstly, companies require a critical mass of employees (usually at least 5,000) with a good geographical spread if they are to use a captive to fund benefits risk via a multinational pooling arrangement. Employee spread is important because companies will not want to add high accumulations of risks, such as concentrations of employees, in single high-risk locations, such as major cities or catastrophe-exposed zones. There are also important internal operational considerations, notably around the structure of HR and how it is connected to other parts of the business. In particular, there needs to be a degree of centralisation and cooperation between HR and the risk management function, which is not typical.

Effective communication and collaboration between the risk management and HR departments is an essential prerequisite for a successful employee benefits captive, and this can take some work to achieve in most cases.

Typically, risk management is a centralised function to drive non-life insurance programmes and HR is decentralised. So companies will likely need an additional layer to organise and centralise benefits, which will take time to establish. Moving to a captive-based approach could mean changes to carriers, and HR will want to know that insurers are able to deliver the required benefits locally.

The importance of engaging with HR and understanding its needs cannot be underestimated.

Another consideration for risk managers is the relative immaturity of the employee benefits captive concept and the ability of insurers to provide expertise, service and product.

Although the ability of insurers and networks to facilitate benefits funding by captives has improved, with a number of networks investing in developing employee benefits pooling systems that captives can access, still further improvements are required to bring the offering on par with non-life equivalents.

Another explanation as to why the numbers of employee benefits captives are relatively small is the lead time to transition from a decentralised approach to a centralised multinational pooling arrangement, which can take several years to correctly implement.

With many organisations already progressed on this journey, the numbers of employee benefits captives coming on stream over the next few years could effectively double the population of employee benefits captives, and as familiarity grows and the concept continues to mature, the uptake is likely to further accelerate.

So, in conclusion, although the concept has taken some time to gain traction and the uptake numbers are relatively small, the potential it represents, together with the momentum it is generating, will ensure that the financing of employee benefits through a captive will continue to trend strongly for some time to come. **CIT**

Ciaran Healy
Director of consulting for the global captive practice
Willis Towers Watson

Plotting a course

With a dedicated captive plan in place, the Lone Star State is on the rise, says Josh Magden of the Texas Captive Insurance Association

Was 2016 a positive year for Texas as a captive domicile?

The 2016 calendar year was a very positive one for Texas as a captive domicile. By the end of the year, the state reached the 30 captive mark. Over the last 12 months, Texas-based captives have written over $2 billion in premium. That's huge. Of course, it's indicative of the business risks and revenue streams generated by many of the Fortune 1000 companies based in Texas—100 of the Fortune 1000 list and 50 of the Fortune 500 companies in 2016.

It's important for readers and captive market participants to bear in mind the evolution of Texas as a domicile. The captive statute allows only pure captives, and the initial law passed in 2013 was fairly narrowly constructed—only risk pooling internal to the parent corporation's economic family was allowed. This, inaccurately, gave rise to a perception that the Texas law was intended to serve only large corporate captives. As a matter of fact, the very first captive that redomesticated to Texas was a small captive. Since then, the 30 that domicile in Texas today run the gamut from global household corporate names to 831(b) captives.

All in all, the success comes from consistent application of a plan. Our Texas Captive Insurance Association (TxCIA) board is a great group of people, all of whom strive to make Texas as strong a domicile as possible. It's fun volunteering alongside them.

With TxCIA to hold its 4th annual conference in February, how has the domicile expanded?

Awareness and acceptance of Texas as a domicile help growth, of course. It is fair to say that, on average, the larger Texas companies have the ability to meet the more stringent thresholds that the original 2013 law established, such as the risk distribution among 12 subsidiary entities or risk from 50 percent of 'controlled unaffiliated' business. However, there are many master limited partnerships (MLPs) from Houston to the Permian, and real estate investment trusts (REITs) from Austin to Dallas that are smaller but had the sufficient number of subsidiaries back in 2013 to set up shop in, or relocate to, Texas if they wanted to do so. The real challenge is reaching those entities with concise and digestible information on what can be done in a Texas captive. So, initially, it probably was the Fortune 1000 companies that analysed redomesticating to Texas. Those big companies have sophisticated risk management teams and well-informed consultants and attorneys and will make their decisions based on perceived political risk and/or the financial implications of moving back home versus staying put.

The 2015 changes in SB667 that TxCIA helped to pass in the 2015 legislature aided both the functionality of the Texas statute and, I think, the perception of the domicile as one that understands the importance of sensible updates. TxCIA worked closely with the Texas Department of Insurance on that 2015 legislative package, and as much as anything, I think a knowledgeable and supportive regulatory team is key to growth. The fact that SB667 allowed risk pooling and credit for risk reinsured to an affiliate enabled a broad swatch of pure captives to accomplish what they needed to in a Texas captive. A second bill, HB2557, adds some additional dimensions around what county hospital districts can do in terms of establishing captives in Texas. While TxCIA did not draft or originate this second piece of legislation, we did support it. That said, it applies to a smaller subset of Texas non-profit hospitals supported by county tax revenues, and to my knowledge, has not yet been utilised as yet.

What can attendees expect from the TxCIA conference? And what will be the main focus?

Texas has such a substantive cross-section of industry leaders and innovators that it somewhat defies broad labels, except perhaps as a state where entrepreneurs and hard-chargers with the vision to see the path and a bit of luck can turn a business idea into a million- or often billion-dollar revenue business. It's the wildcatter ethos, maybe.

With that spirit in mind, we are excited to offer a full but diverse slate of sessions from experts on a range of topics, from the benefits and challenges of obtaining a credit rating to some of the structures, technology and tools offered by the confluence market. If one wants to characterise the focus of this year's TxCIA conference, the most apt description is probably helping a captive find appropriate tools as it becomes a more sophisticated operation.

What sessions are you most looking forward to?

The dais at this 4th Annual TxCIA Conference will host as interesting a group of speakers as we've had. The subject matter is intentionally more diversified. Given our pure captive statute and the narrower subset of the captive universe to which we will naturally appeal, our goal is to provide captive owners and corporate risk management teams the chance to hear from experts who can add a new dimensions to their captive knowledge. We want captive owners to say to themselves at least once during the conference: 'I hadn't really thought of that.'

Having known many of the speakers for some time, I'm looking forward to simply hearing their counsel to our attendees and seeing many of them here in Austin again. Lisa Havens of Baylor Scott & White will be our keynote speaker. As a veteran of the captive world and a respected leader within her complex and well-regarded institution, I do think that her perspective is deeply informative for those who want to understand the true dexterity a captive can have as it supports the parent entity's objectives. As importantly, how that risk is measured, managed and costed needs to be shared with executive management and oversight boards, and Lisa Havens will discuss how she does that, as well.

We will have several sessions that are distinct from prior conference topics, including one on the strategic value and economic benefit that captive credit ratings can yield. JLT Strategic Advisory and Kroll Ratings will bring our audience insight on how this is becoming more of an issue for captives of all sorts, but perhaps particularly for those that support multinational operations, especially when issues of regulatory harmonisation and equivalence press in on captive users.

Another important session will see Nephila Advisors outlining the options that confluence markets are bringing to bear on the insurance market. It's not just reinsurance pricing that insurance-linked securities tools affect. The geography of Texas is so diverse, the weather at times so extreme, and the coastal exposure so significant, that needs for bespoke excess of loss cover or aggregated attritional loss portfolios might very well find a better mousetrap. The intrinsic nature of custom-crafted risk vehicles that confluence markets offer is, to me, the DNA of why captives exist and help their parent companies thrive.

While I certainly have a strong bias, any Texas company with a captive or contemplating one would be well advised to sign up. The Texas Department of Insurance will once again have several members of its captive team available to act as resources or meet with captives or prospective captive owners and their advisors. Attendees can accomplish quite a lot in a very short timeframe.

Can we expect to see anything new from Texas in 2017? Will there be any legislation updates?

There are always improvements to be made en route to being a relevant and well-positioned domicile. Texas has many great insurance success stories, but in this particular subset of the insurance industry, we haven't really accumulated enough laurels to rest on yet.

The biennial legislature meets here in Austin in odd-numbered years for a six-month session—it is a fast-paced experience for legislators, constituents and any with bills in the queue. TxCIA will have a bill that contemplates non-affiliated reinsurance, reciprocal (in the same economic family) captive structures, as well as some minor housekeeping and clean-up items. The first two items will affect energy companies and many companies whose insurance risks tend to be unique to their industry or geography, as well as those whose non-profit or diversified limited liability company/limited partnership ownership structure does not fit the letter of the statute's pure captive intent, although it certainly fits the full spirit in which it was conceived.

Like any new association, TxCIA lives and breathes based on the intellectual capital and support of our members. We want more specific perspectives, and need that support to articulate the benefit of certain legislative changes. **CIT**

Josh Magden
Board president
TxCIA

Comings and goings at Willis Towers Watson, IMAC, Crawford & Company, Kroll, and more

Tracy Stopford, previously senior vice president and managing director at Willis Towers Watson (WTW) Captive Management Hong Kong, has taken on the new role of senior vice president and operations director of WTW North America.

Stopford, who had served in her previous role since May 2015, was responsible for setting up Willis's captive management practice in Hong Kong and consulting to Chinese and Hong Kong-domiciled captive insurance companies.

In her new role, she will be based in the company's Hunt Valley office in Baltimore, Maryland.

She will be responsible for the operational delivery of client services, developing and improving service standards and ensuring a compliance culture is evident throughout the global captive practice.

Kroll Bond Rating Agency (KBRA) has named Tina Bukow as senior director of business development for the insurance ratings initiative.

Bukow joins from A.M. Best, where she worked for 12 years, most recently as head of business development for insurance.

In her previous role, she was responsible for ratings growth in the US, Canada, the Caribbean and parts of the Latin American region, with a strategic focus on the alternative risk transfer market.

In addition, Bukow has been an active member of the Vermont Captive Insurance Association and International Center for Captive Insurance Education.

James Nadler, president and COO of KBRA, said: "The addition of Tina Bukow to our firm further solidifies our commitment to provide a dependable rating alternative to the insurance industry."

Linda Haddleton is set to start her new role as chair of the Insurance Managers Association of Cayman (IMAC) at its annual general meeting.

Haddleton takes over from Kieran O'Mahony, senior vice president and client services leader for Marsh Management Services Cayman. In 2016, Haddleton served as vice chair and legislative and regulatory committee chair for IMAC.

She is also managing director in the Cayman office for Artex International. In this role, she leads the Cayman office staff and operations, consisting of insurance-linked securities, structured transactions and captives.

Crawford & Company has named Geoff Piggot as the new CEO of its global technical services.

Piggot joins from Gen Re and replaces Mike Reeves, who is retiring after 40 years at the company.

In his new role, Piggot will be based in Crawford's London office and will report to Ian Muress, CEO of Crawford International Operations.

Muress said: "Geoff Piggot joins Crawford at a time when we are making unparalleled investment in our consulting business to ensure the company continues to lead the claims industry."

"As our new CEO joins the business, I would like to thank Mike Reeves for his Crawford service."

Crawford also recently appointed Andrew Robinson as the company's new global COO.

Robinson will be responsible for the company's four business units—Broadspire, US Services, International Operations and Garden City Group—as well as for its information technology on a global basis.

Previously, Robinson worked at The Hanover Insurance Group, where he served as president of specialty insurance, executive vice president of corporate development and chief risk officer.

Harsha Agadi, president and CEO of Crawford, said he is "thrilled" Robinson has joined the Crawford team.

Andy Bord, previously CEO at Capita Insurance Services, has been named as interim CEO of Flood Re.

Bord will join Flood Re on 23 January and will take over from current CEO Brendan McCafferty on 10 February.

Flood Re is a reinsurance programme designed to help provide better access to affordable flood insurance cover. It went live on 4 April last year.

Mark Hoban, chairman of Flood Re, said: “Andy Bord has a strong knowledge of the insurance sector and he has worked as both a permanent and an interim CEO.”

“His strong consumer background and experience of working in complex regulated environments will be particularly helpful as we continue our efforts to ensure that as many people as possible benefit from the scheme.”

A permanent replacement for the CEO position is yet to be confirmed.

James Durkin, currently president of Arthur J Gallagher’s (AJG) employee benefits division, has been appointed to the newly created role of chairman.

Durkin will be responsible for developing the next generation of leadership at the company and supporting the division’s business priorities.

In the new role, he will report to William Ziebell, who is currently a regional leader in the benefits division, but will take on Durkin’s management role for the employee benefit consulting and brokerage business across the US and internationally.

Patrick Gallagher Jr, chairman, president and CEO of AJG, said: “By promoting these two outstanding leaders, we are well-positioned for exceeding client expectations and maximising opportunities that will continue to fuel our growth.”

CNA Healthcare has named Chris Heckman as its new vice president of hospitals and captives.

Heckman will be responsible for bringing together the company’s hospital and captive strategies as well as leading the department.

He will report Glen Curley, senior vice president of healthcare at CNA Specialty.

Curley said: “Chris Heckman has been instrumental in shaping and executing CNA’s short- and long-term strategy for hospitals.”

He added: “Heckman is recognised and respected both internally and externally as a deep technical expert in the hospitals industry, allowing us to deliver solutions to the needs of our healthcare producers and CNA’s customers.”

Heckman, who joined CNA in 2012 as an underwriting consulting director, most recently served as assistant vice president and industry leader for hospitals.

FiscalReps has appointed Nazaret Gonzalez to the role of client director in its insurance department.

Gonzalez, who joined the company in 2011, has served as a specialist and senior manager over the last six years.

Bringing experience in tax to the position, she will be responsible for supporting the company, including in the implementation of TaxBox2, a new product by FiscalReps.

Mike Stalley, CEO of FiscalReps, said: “Over the years, Nazaret Gonzalez has successfully nurtured her client base whilst developing close relationships with the Spanish tax and regulatory authorities through her regular face to face meetings.”

Have an appointment we should cover? Let us know via: beckybutcher@blackknightmedialtd.com

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, Barney Dixon

Associate Publisher: 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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