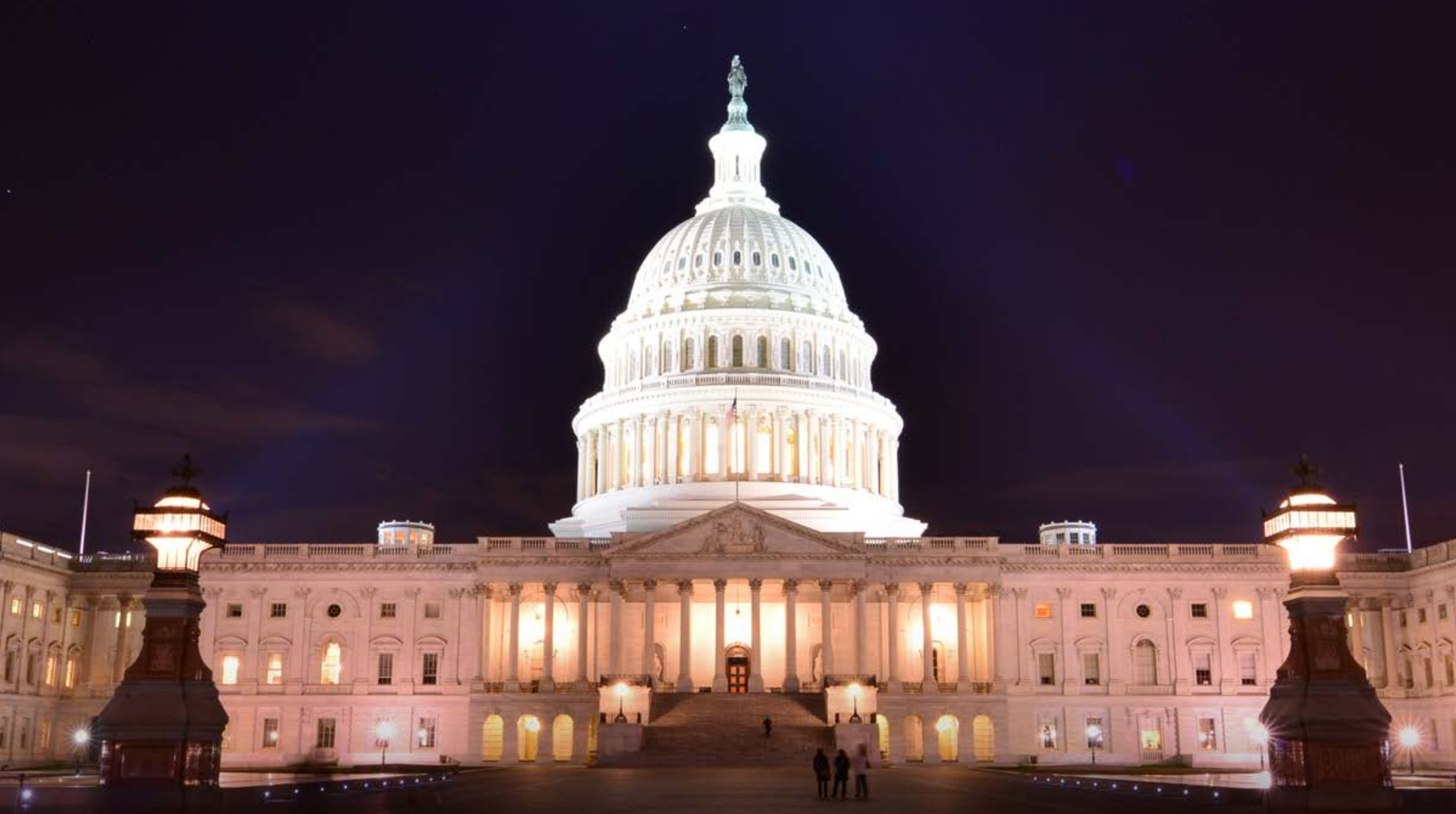
captive insurance times
The primary source of global captive insurance news and analysis
ISSUE126 28 June 2017



New FHLB legislation could see captives return

US legislators have introduced a new bill to allow captive insurance companies that were members of a Federal Home Loan Bank (FHLB) prior to 12 September 2014 to return to the fold.

Randy Hultgren and Gwen Moore introduced the Housing Opportunity Mortgage Expansion (HOME) Act into the House of Representatives on 13 June.

The HOME Act would restore the membership of captives in the FHLB System if they joined before the Federal Housing Finance Agency (FHFA) first proposed its rule barring them from participating and if they can demonstrate a commitment to residential mortgage activities.

The FHFA adopted its final rule in January 2016 that banned real estate investment trusts in particular from using captives to gain access to the FHLB System. FHLB captive insurer members that joined prior to January 2016 were given up to five years to terminate their membership, while those that joined after were given a year.

Hultgren explained that the HOME Act provides a “reliable source of financing that community banks and credit unions in my community rely on for providing access to mortgage credit for families, not to mention its commitment to affordable housing through grant programmes and down-payment assistance”.

He said: “This legislation clarifies that companies with a history and mission of supporting residential housing should be able to continue to serve our communities.”

Moore added: “It is essential that the FHLB has the capacity necessary to continue its mission to make homeownership possible for my constituents in Wisconsin.”

FERMA releases BEPS guidelines for captives

The Federation of European Risk Management Associations (FERMA) has released guidelines for captive insurance and reinsurance arrangements to ensure a consistent implementation of the Organisation for Economic Co-operation and Development's (OECD) recommendations on base erosion and profit shifting (BEPS).

The guidelines have been put in place to support national administrations when transposing BEPS actions into their national laws.

They cover commercial rationale, substance and governance, and transfer pricing—all areas that were questioned by OECD members during the implementation stage of the BEPS actions published in 2015.

The aim of FERMA's guidelines is to allow OECD members to assess the compliance of captive insurance and reinsurance arrangements with the BEPS recommendations.

On commercial rationale, the captive owner should provide an analysis showing how the captive framework can reduce the total cost of risk for its parent group, create a total premium statement, and produce a risk-bearing capacity analysis, as well as other analysis and justifications.

In terms of substance and governance, FERMA recommended that the captive board of directors meet in person within the captive's jurisdiction at least twice a year.

Boards should comprise a minimum of three people, with at least one director to be located within the captive jurisdiction.

FERMA split transfer pricing into three sections, covering captives acting as direct insurers and as reinsurers, and subsidiaries.

For a captive acting as a direct insurer, the association recommended that there should be either a documented and transparent premium-setting process, market quotes from third-party insurance or reinsurance companies, or benchmarking analysis and a model-based technical premium using standard actuarial methodologies.

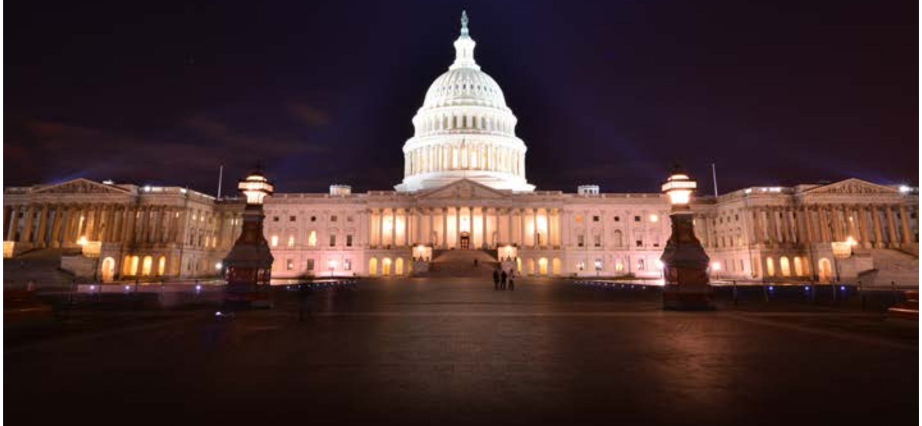
For a captive acting as a reinsurer, FERMA advised providing evidence that reinsurance pricing follows the fronting insurer's pricing, market quotes from third-party insurance or reinsurance companies, and model-based technical premiums.

Finally, FERMA suggested that subsidiaries should have a documented and transparent premium allocation model based on their type of activity, legal environment and exposure measure.

Jo Willaert, president of FERMA, commented: "The objective of such guidelines is mainly to avoid creating a patchwork of diverging national legislations inspired by BEPS. Captives serve an important enterprise risk management role with true business purposes for European businesses and other organisations."

"Although captives are only a very small portion of BEPS, FERMA believes that national authorities should be guided in how to assess captive arrangements according to BEPS recommendations."

Inside captive insurance times



Carl Leeman, FERMA board member and leader of the captive project group, stressed that the document "demonstrates that the main financial ratios of the captive insurance industry are in line with the traditional insurance market".

Leeman added: "The paper, enriched and approved by our 22 national associations, represents a strong consensus within the European risk management community on how captives are supporting the operations of their parent organisations."

SIIA asks US Treasury to look at Notice 2016-66

The Self-Insurance Institute of America (SIIA) has asked the US Treasury to include Notice 2016-66 in the President Donald Trump-ordered review of US tax rules.

Trump issued an executive order in April asking the Treasury to review new tax rules issued on or after 1 January 2016 that "impose an undue financial burden on US taxpayers, add undue complexity to the Federal tax laws, or exceed the statutory authority of the Internal Revenue Service (IRS)".

SIIA claimed in its request to the Treasury that IRS Notice 2016-66 meets "several of the criteria" outlined in the president's definition of regulatory burdens.

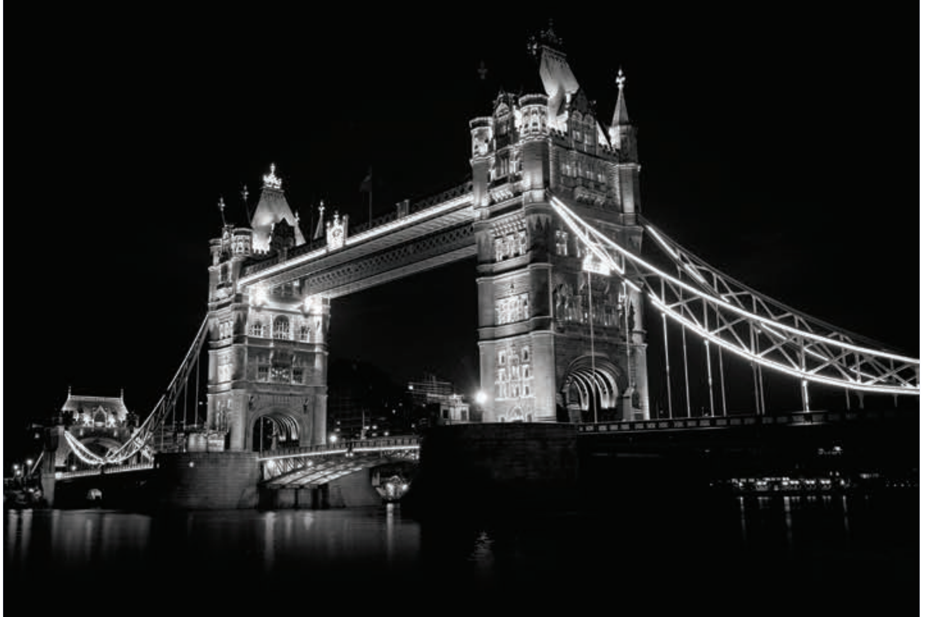
Notice 2016-66 labelled most captives that take the 831(b) election as "transactions of interest" and required them to provide extensive reporting for the past 10 years by 1 May of this year.
SIIA's members argued that the notice placed a significant burden on the captive insurance industry.

The average cost for a captive to complete its notice reporting was $9,257, compared to a typical range of $1,000 to $4,000 to file a federal tax return, according to SIIA.

The overall cost of notice compliance by SIIA members alone totalled more than $22 million.

SIIA said it "continues to believe that more specific and tailored actions could easily be taken to collect the information desired by the IRS in a manner which mitigates the burden imposed by the notice, especially considering a substantial portion of the information is already in the tax return or financials attached to that return".

Trump's order requested an interim report within 60 days of issuance, which means it should be delivered soon, and a final report no later than September identifying actions of the IRS and Treasury that impose financial



UK to implement ILS regime this autumn

London's insurance-linked securities (ILS) regulation is now being finalised by the UK Government ready for implementation this autumn, according to a letter sent from HM Treasury to the London Market Group's Nicolas Aubert.

The introduction of ILS legislation was delayed after UK Prime Minister Theresa May called for the snap general election that was held on 8 June.

Over the past 18 months, the UK treasury has worked with the Prudential Regulation Authority, the Financial Conduct Authority and the London Market Group's ILS Taskforce to develop regulations that will implement a new ILS regime in the UK.

The letter, signed off by Stephen Barclay, economic secretary to the Treasury, stated: "London is the single biggest market for specialist risk in the world and is a global hub for insurance and reinsurance business. But this global business is evolving rapidly and the UK must innovate if London is to retain its uniquely important position in the market."

It continued: "This is why the Treasury responded to calls from the industry to develop a bespoke regime for ILS in the UK—to help ensure that London remains the most competitive insurance and reinsurance hub in the world."

"Alternative risk transfer techniques expand the capacity of the insurance and reinsurance markets, enabling risk to be managed more efficiently and effectively for businesses and consumers. With the right regulatory framework, I believe the UK can make a major contribution to the development and growth of alternative risk transfer. That is good news for the UK and for the global economy."

The letter was also sent to Malcolm Newman, chair of the ILS Taskforce, Chris Beazley, CEO of the London Market Group, Sam Woods, CEO of the Prudential Regulation Authority and Andrew Bailey, CEO of the Financial Conduct Authority.

burdens, undue complexity, or which exceed their authority.

A lawsuit attempting to kill off Notice 2016-66 ahead of the 1 May deadline was dismissed in the Eastern District of Tennessee, with the judge ruling that it was barred by the Anti-Injunction Act, which precludes actions against the government seeking to block the assessment and collection of taxes.

Captives dominate British Virgin Islands insurance sector

Captives in the British Virgin Islands (BVI) are dominating the insurance sector in number and revenues generated, according to a new government-commissioned report.

Of the 176 insurance licences active on 31 December 2016, 137 were for captive insurers, while the remaining 39 were domestic.

In 2016, the BVI insurance sector employed 106 people, and contributed $16 million in gross value added, as well as $2 million in taxes.

The majority of clients of insurance service providers in the BVI hail from the US and Canada.

BVI legislation allows for US 831(b) captives and 953(d) captives to be licensed in the domicile. 831(b) captives can write up to $1.2 million in annual premium, while 953(d) captives must write more than $1.2 million in annual premium.

The majority of BVI captives are on the smaller scale, with an average underlying value of $500,000.

Captives need to be ready to demonsrate they are BEPS compliant

Multinational companies with large captives need to be prepared to demonstrate their alignment to base erosion and profit shifting (BEPS) principles or face potential reputational damage and financial penalties, according to Nick Gale of Marsh Captive Solutions.

The UK implemented the diverted profits tax regulation to incorporate many of the BEPS recommendations into local rules in 2015. Other countries are set to adopt similar changes.

Gale has urged multinational companies to act now by documenting the financial and non-financial benefits of their captives.

They also need to show how their captives add value to local entities and the group, and document why the captive was established in its current domicile.

Captive owners must check whether they are using the most appropriate transfer pricing methodology and prepare an analysis to support captive premium.

Gale said: “In addition to the above, you can consider seeking risk expertise in order to perform a ‘health check’ on your captive, in regards to the recent changes.”

The Organisation for Economic Co-operation and Development’s (OCED) proposed changes to international laws for the BEPS project aim to tackle aggressive tax planning, which could affect the way captives approach tax and transparency.

BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations.

The OECD has specifically named captives as a potential vehicle for tax avoidance, meaning that they are likely to be subject to increased scrutiny.

OECD ranks Barbados as ‘largely compliant’ domicile

Barbados was “largely compliant” with international tax standards during 2016, according to the Organisation for Economic Co-operation and Development (OCED).

A.M. Best: SFCR analysis shows strong solvency ratios for captives

The solvency and financial condition reports (SFCR) of A.M. Best's rated European captives showed that their solvency ratios are "very strong", according to the rating agency.

A.M. Best's analysis comes after single entity risk carriers in Europe were required to publicly disclose a SFCR as part of the Solvency II regime by 20 May. The report provides insight into their financial conditions as at 31 December 2016.

Solvency II ratios for the reviewed sample of captives range from approximately 160 percent to 240 percent.
This finding is "in line with expectations" as the captives A.M. Best rates tend to be well capitalised.

The rating agency suggested that the disclosure of own funds and the composition of solvency capital requirements show that own funds for each analysed captive is composed exclusively of unrestricted Tier 1 capital.

Konstantin Langowski, financial analyst at A.M. Best, suggested that the rating agency observed "notable differences" in the style and quality of the narrative part of the disclosures among its sampled captives, in particular in the description of governance and risk structure.

Langowski added: "Most A.M. Best-rated captives are able to articulate and illustrate their risk management framework and capabilities as part of the interactive rating process. However, in A.M. Best's view, the disclosures fail to do justice to the risk management and governance practices of the captives, as well as to demonstrate the importance of these functions to captives and their parents."

A.M. Best also suggested that some captives have doubt around the regulatory objectives to improve market discipline and policyholder protection by means of public disclosures in light of captives' business models.

However, A.M. Best pointed out that most captive managers appreciate that the overall implementation of Solvency II has improved their general risk management capabilities and enabled them to manage their capital requirements better on a risk-adjusted basis.

Pillar III of Solvency II aims to harmonise and improve the transparency of financial disclosures to the market, as well as enhance consumer protection.

The purpose of the reporting requirements is to impose greater market discipline and confidence, as well as the overall objectives of the Solvency II regime of creating a stronger and more uniform regulatory environment for capital adequacy and risk management.

The OECD rewarded Barbados with the ranking for being a "transparent and highly cooperative jurisdiction".

Other domiciles received the same recognition, including Austria, Germany, Hong Kong, the Netherlands, the UK and the US.

In addition, Barbados recorded a net addition of 11 captive insurance entities for the fiscal year ending March 2017, raising its total from 235 captives in 2015/16 to 246 captives in 2016/17.

Of the 246 captives domiciled in Barbados, approximately 81 percent originate from either Canada or the US.

Senator Darcy Boyce, minister in the office of the prime minister with responsibility for energy, immigration, telecommunication and Invest Barbados, said: "As evidenced by the steady growth in new captive insurance registrations, it is clear that Barbados retains its status as a preferred jurisdiction in which to conduct international business."

"The reasons for such growth are clear. Barbados has long been recognised for its network of double taxation agreements, transparency, strong regulatory environment, forward thinking legislation, world-class infrastructure, a well-educated labour force and its ability to foster international trade."

FCC Services captive reports 'financially solid' 2016

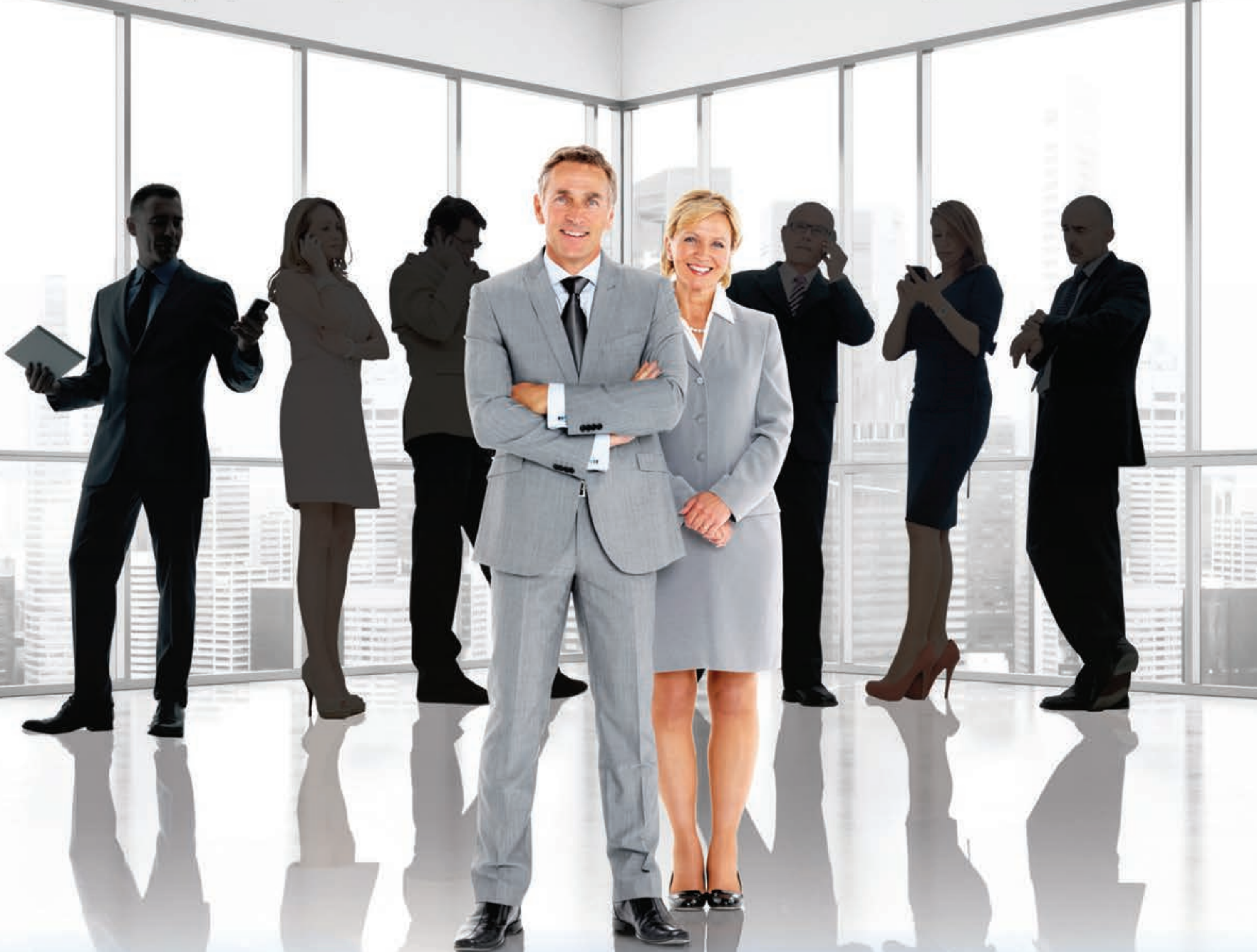
The Farm Credit System Captive Insurance Company, the captive insurer of FCC Services, has reported a net income of $10.3 million in 2016, an increase of 7.8 percent compared to the previous year.

The captive's 2016 results highlighted a "healthy investment income" and expanded coverage to protect Farm Credit organisations in a time of change in the financial services and agriculture sectors.

One of the new coverages protects against fraud claims stemming from email scams, while another is medical stop-loss, which covers the self-insurance medical trusts of the system against high-dollar claims.

However, the results did show that premiums earned by the captive, and paid by the member organisations, decreased by 3.26 percent compared to the prior year, totalling $16.2 million.

The company explained that this was due to significant rate decreases in the casualty lines and declines in scheduled values in the Lenders' Single Interest programme.



Larry Lawson, president of the captive and executive vice president of risk management and insurance services at FCC Services, said the 2016 results show that "financially, the captive had another good year and remains financially solid". Lawson added: "It continues to return value to the Farm Credit System by providing superior insurance coverage at reduced costs."

He explained that by buying insurance through the captive and as a group, "the system saved in excess of $20 million in 2016".

In 2016, the captive handled 1,029 claims, of which 845 were opened during the year. The report revealed that the risk management and insurance services team closed 837 of those claims, with 192 still open at the end of the year.

According to Lawson, total claims payment totalled nearly $8 million.

In addition, FCC Services, along with the captive's board of directors, has appointed new team members to expand the captive's expertise and strength.

Lawson said: "We've taken steps in the last two years to strengthen our staff and provide solid continuity for management in the years to come. We've positioned the team well to address the emerging and continuing insurance and risk management needs of the captive and the Farm Credit System."

Texas governor signs off captive bill

Texas governor Greg Abbott has signed the state's new captive bill into law.

A Texas captive insurance company can now be formed as a reciprocal insurance exchange, and take credit for reinsurance ceded to a non-affiliated reinsurer when specific requirements are met.

Captives are also able to insure life insurance benefits for employee benefits subject to the Employee Retirement Income Security Act, and hold capital and surplus in the form of Texas county or municipal bonds.

In addition, the new captive bill authorises the insurance commissioner to waive the requirement to provide an actuarial report with the captive's annual filing if certain conditions met, and eliminates the requirement that the captive must have a licensed claims adjuster if the claims are limited to first-party claims of the parent and/or affiliates of the captive.

The Texas Captive Insurance Association worked closely with the legislature, the Texas Department of Insurance and other parties to update the state's captive legislation for the second time since 2013.

Breakwater provides growth capital to Hamilton Captive Management

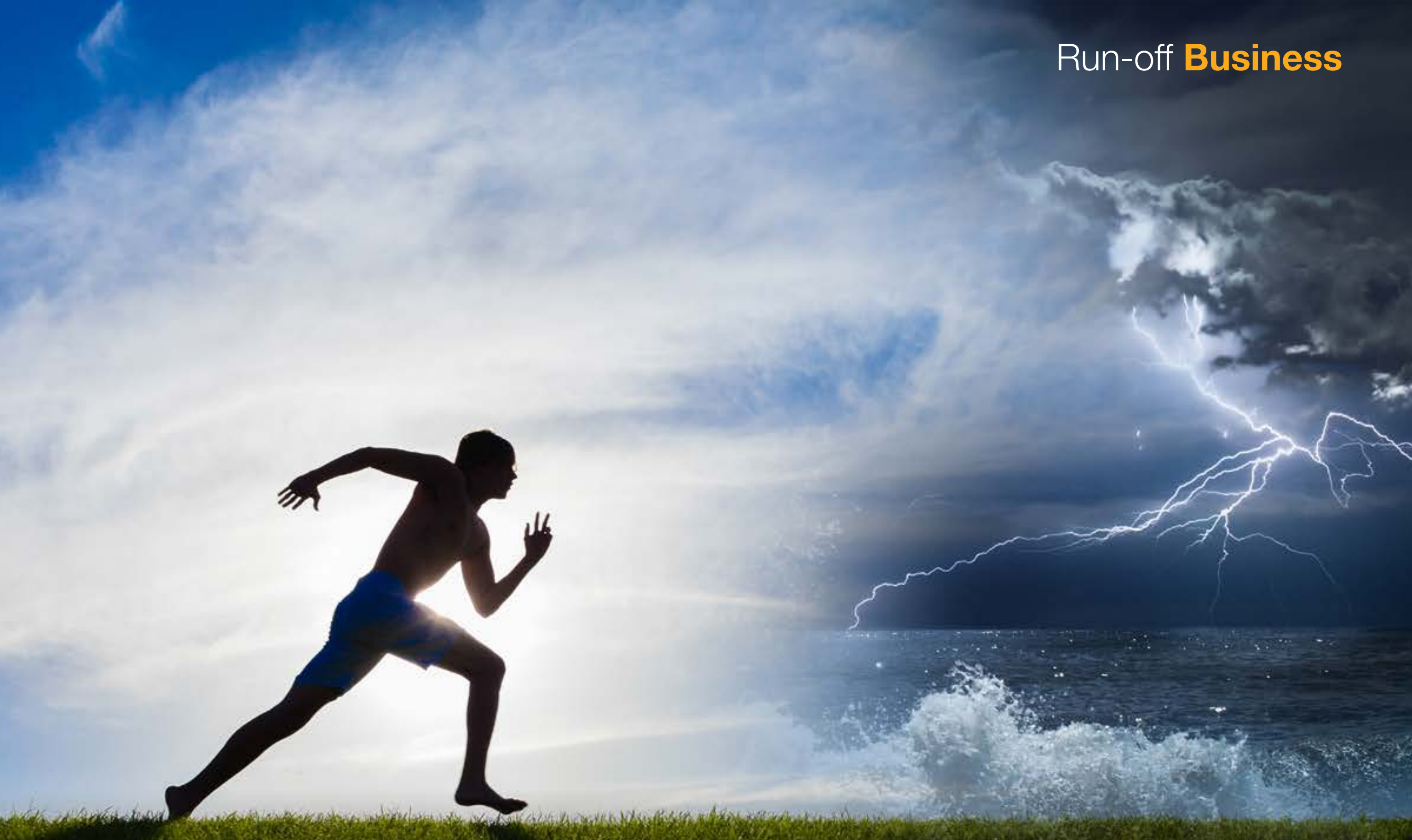
Breakwater Investment Management, a private investment firm, has provided a senior secured term loan to support the continued growth of Hamilton Captive Management.

The loan has been provided through Breakwater Investment's Credit Opportunities Fund.

Peter Strauss, founder and CEO of Hamilton, commented: "Breakwater was a thoughtful and flexible partner in this financing, and we look forward to benefiting from the team's knowledge as Hamilton executes on its various growth initiatives."

Eric Beckman, managing partner at Breakwater, added: "Peter Strauss has led Hamilton to become a leading captive insurance manager with a highly scalable business model and industry-leading client retention rates. Breakwater is excited to partner with Strauss to help drive Hamilton's continued expansion."

Hamilton Captive Management, founded in 2013, focuses on providing strategic solutions to individuals, families and business owners.



Running into trouble

As Solvency II continues to become embedded across Europe, Nick Steer of Compre predicts an increase in legacy business as owners seek to optimise the use of their own capital

How big is the current run-off market in Europe? And do you expect to see the market to increase?

Every year PwC release a survey, Discontinued Business in Europe, on the size of the non-life run-off market, in terms of liabilities. The latest report estimates the market currently stands at €247 billion. Although that is a large market, it is not all fully addressable by a legacy acquirer such as Compre. This is because some owners of run-off will deal with it themselves, but even if only 10 percent of that figure is addressable, it still creates a sizeable market—€25 billion is a large amount of liabilities to be available.

Whether that market grows in total, very much depends on how quickly the market deals with closing down the old liabilities and the size of any new liabilities. The overall size may remain very constant, but in my opinion, as Solvency II continues to become embedded across Europe, we could see an increase in legacy business for purchasers, such as ourselves, as the owners seek to optimise the use of their own capital.

Will demand for run-off services increase?

Run-off has grown over the years from being a fringe area to becoming an integral part of the whole insurance market. It is increasingly seen as a method whereby insurance and reinsurance companies and captives can manage their capital in an optimal way. At Compre, we are essentially a capital relief mechanism for active businesses.

Soft market conditions coupled with challenging investment returns, as well as Solvency II, which is highlighting the amount of capital supporting old business, means that owners of legacy business should be considering if that is the best use of their capital.

Whether companies chose to divest or not is entirely up to them, but at the very least they should be considering what to do about it. For anybody who owns legacy business, in my opinion, it is more prudent to utilise capital for future business, rather than supporting business from the past. It is more valuable to use the resources they have got, not least the people that they have got, to be focusing on future business instead of legacy business. We have got a very long track record in providing vendors optimal solutions for their older business. I think the market will grow and I think Compre is extremely well-placed to take advantage of that market.

After making 11 company acquisitions, what made Compre choose to acquire the Dublin-based captive insurer?

Our longer-term vision for the business is to be the leading European non-life legacy business consolidator, while our shorter-term aim to grow the net-tangible asset value of this business.

We aim to achieve our shorter-term goals by acquiring run-off business portfolios and creating value from those acquisitions.

Equinox CA Europe is our eleventh acquisition, and our first in Ireland, however, we have previously acquired 10 companies from other jurisdictions such as Finland, Germany, Sweden, Switzerland and the UK.

In addition to that, we have completed 13 business transfers, covering 24 individual insurance portfolios across Europe, most of them in Belgium, Denmark, France, Finland, Germany, Luxembourg, Norway, Sweden and the UK, so there is quite a breadth of markets that we deal in.

We acquire business from large well-respected counterparties including Allianz, Swiss Re, QBE, HSBC, Sampo Group and now SNC-Lavalin.

We acquired the Dublin-based captive as part of a competitive process that we were invited to participate in and we were successful in winning it.

The function of Equinox CA Europe was to insure SNC-Lavalin's French business. SNC-Lavalin's French operation was sold in December last year, so there was no longer a need to have a captive.

As a legacy specialist, what is your role and what are your objectives when acquiring a business in run-off?

From the vendor's point of view, we give them full economic, operational and legal finality, while from the policyholder's point of view, we will always pay valid claims, which we aim to settle more by negotiation rather than litigation.

From our own point of view, aside from the obvious profit incentive, it is important that we have a fair, but firm, claims handling policy that treats policyholders with respect.

As a result that enhances our reputation with the vendors, the policyholders, the regulators and also with the market in general.

For what reasons would a company put its captive into run-off?

The reasons business is put into run-off are quite common, and apply equally to insurance and reinsurance companies as captives.

A company can look at releasing capital to drive new business opportunities, it removes a certain drag that is caused by non-core legacy business, as well as any volatility and it provides companies with finality.

Longer-term claims can be difficult to understand, predict and manage. The captive or the owner may have operational challenges and that plus the added pressure of Solvency II on capital and operations, not least the increased reporting that companies now have to do under the directive, can create a compulsion to divest.

Do you know your next move in the market?

Watch this space—there is something in the pipeline. Compre is clearly open for business and if captives are looking to do anything with their legacy business please pick up the phone and give us a call. CIT

“Compre is clearly open for business and if captives are looking to do anything with their legacy business please pick up the phone and give us a call”

Nick Steer
CEO
Compre

Industry Events

ILS Insight 2017

Zurich
06 July 2017
www.weareguernsey.com

The event, which takes place at Park Hyatt Zurich during the afternoon of Thursday 6 July, will feature two panel debates among leading figures from the ILS industry and a keynote speech from Christoph Buerer.

The event is expected to attract more than 100 professionals from across the world of insurance-linked securities.

VCIA Conference

Burlington, VT
08-10 August 2017
www.vcia.com/Events/

Now in its 32nd year running, the VCIA Annual Conference proudly hosts 1100 people from all over the world for two and a half days of the finest captive education available.

Attendees have access to any level of learning – from basic sessions to the most advanced. Professional education credits are offered to those who attend the sessions.

Thomson departs HAI Group, while BDA appoints new board member

John Thomson has stepped down from his role as president and CEO at HAI Group, the public housing insurance agency.

Thomson departed the company on 16 June after serving in the role since January 2016.

HAI Group has appointed Edmund Malaspina as interim CEO and president.

Malaspina joined HAI Group in 1991 and was most recently the chief marketing officer, responsible for business development, enterprise strategy, as well as industry initiatives and market intelligence.

In a statement, Malaspina said: "I have seen this company take ideas and turn them into reality, and have been fortunate to be a part of the process."

He added: "The demand for affordable housing will not be dissipating anytime soon; so I look forward to leading the talented team at HAI Group in the creation of innovative ideas to better serve our members so they in turn can serve their community. I thank the Board of Directors for this opportunity and am confident about the future of HAI Group."

Christine Hart, chair of the HAI Group board of directors, added: "[The board] provides their full support to both Malaspina and all of the employees at HAI Group. Together through hard work and dedication, the future for HAI Group is bright."

The Bermuda Business Development Agency (BDA) has appointed Greg Wojciechowski to its board of directors.

Wojciechowski currently serves as president and CEO of the Bermuda Stock Exchange (BSX).

Since beginning his role at BSX, he has driven the development of Bermuda's domestic capital market and attracted global capital market support, particularly in the insurance-linked securities and cat bond sectors.

He has additional roles including as chairman of Bermuda's Financial Intelligence Agency and ILS Bermuda, and sits on the board of directors of the World Federation of Exchanges.

Welcoming Wojciechowski to the board, Kiernan Bell, chair of the BDA, said: "Wojciechowski has impeccable credentials and highly relevant experience and knowledge as CEO of the BSX, and is one of the jurisdiction's finest ambassadors. We could not be more pleased to have him join us in our work to empower Bermuda's economy, encourage inward investment, and promote Bermuda's reputation globally."

Wojciechowski added: "I'm delighted to join the board of the BDA and work with my fellow directors to drive forward the agency's goals. Hopefully my business-development experience at the BSX will add a beneficial perspective."

"The BDA plays an essential role in our jurisdiction's outreach to attract more business to the country, a mission that impacts all of us. I'm proud to help engage other corporate stakeholders to support the critical work BDA is doing for our domestic economy." **CIT**

captive insurance times

Editor: Mark Dugdale
markdugdale@captiveinsurancetimes.com
+44 (0)203 750 6017

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

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

Associate Publisher/Designer: John Savage
johnsavage@captiveinsurancetimes.com
+44 (0)203 750 6021

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

Marketing Director: Steve Lafferty
design@securitieslendingtimes.com
+44 (0)203 750 6021

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