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The primary source of global captive insurance news and analysis

05 February 2020 - Issue 191

Washington State Insurance Commissioner Mike Kreidler discusses the state's proposed captive legislation

WASHINGTON STATE OF MIND

Bermuda Focus

Current market trends, regulation and what to expect this year in Bermuda

Utah Insight

Larger companies are moving to the state, according to Travis Wegkamp

Conference Report

Delegates at the World Captive Forum gathered in Miami to discuss the industry's hot topics

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Published by Black Knight Media Ltd

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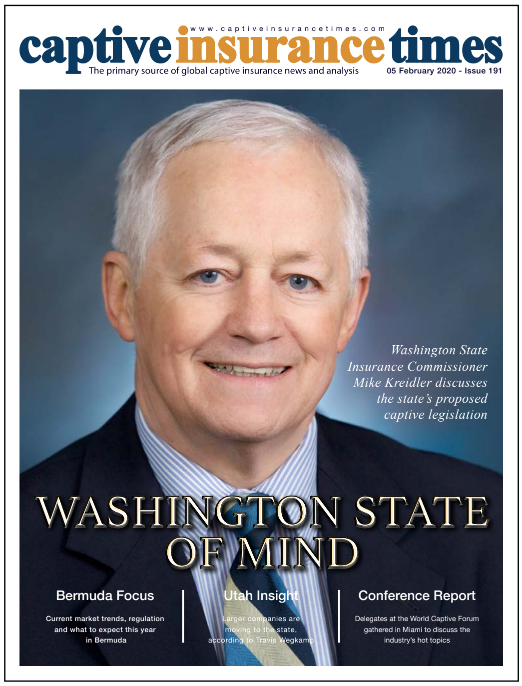
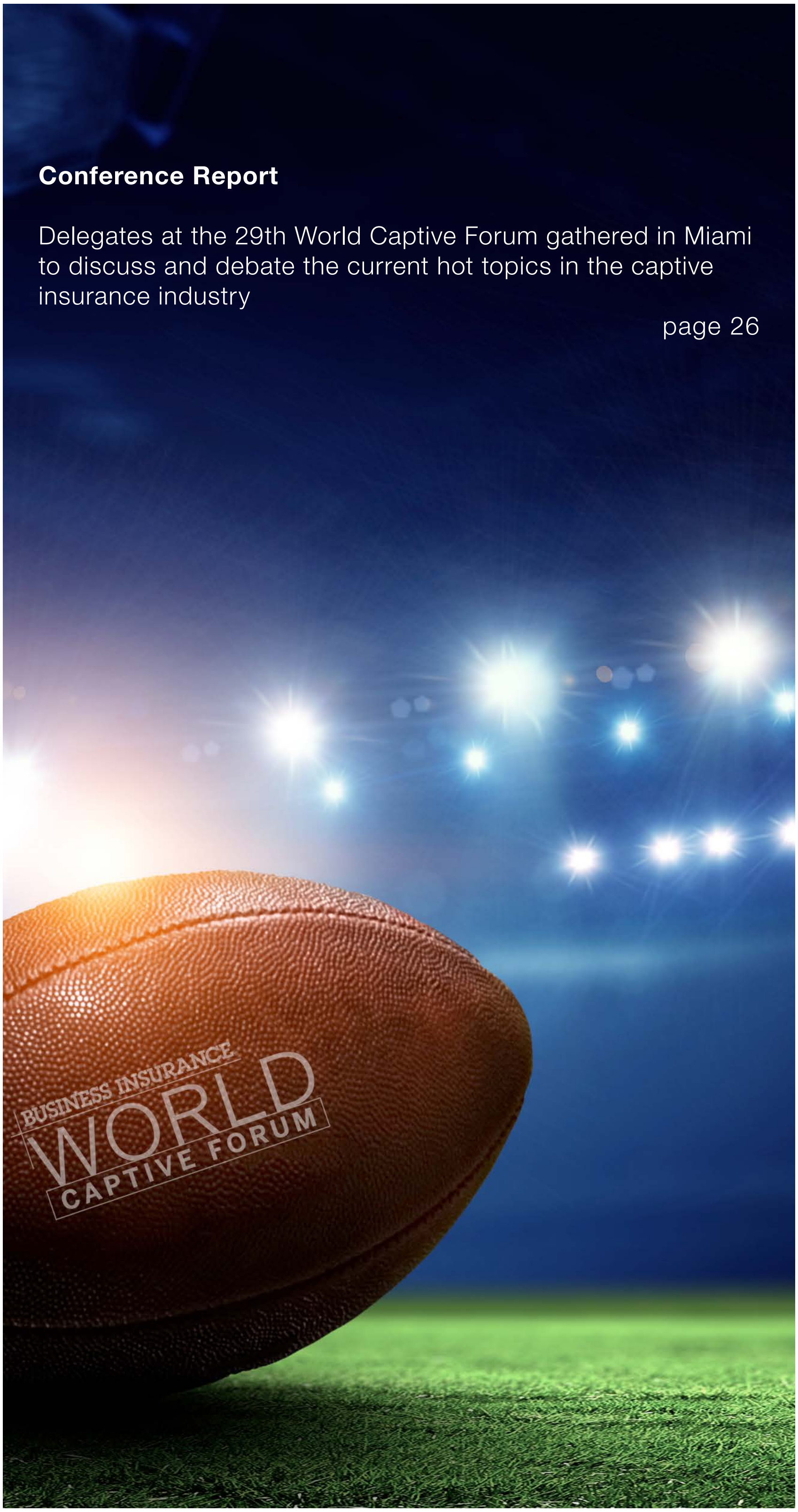
Published by Black Knight Media Ltd
Company reg: 0719464

Cover Image

Mike Kreidler
Credit: The Washington State Office of the Insurance Commissioner




BUSINESS INSURANCE
WORLD
CAPTIVE FORUM

Gemini launches captive to insure crypto custody

Cryptocurrency exchange and custodian Gemini Trust Company (Gemini) has launched Nakamoto, a captive insurance company licensed by the Bermuda Monetary Authority.

Nakamoto, which is believed to be the first captive to insure crypto custody, will allow Gemini Custody to increase its insurance capacity beyond the coverage currently available in the commercial insurance market. The captive will allow the firm to have $200 million in insurance coverage, which according to Gemini, is the largest limit of insurance coverage purchased by any crypto custodian in the world.

Gemini Custody is regulated by the New York State Department of Financial Services and is SOC 2 type one compliant.

Aon has been appointed as the captive manager for Nakamoto while Marsh's digital asset risk transfer team brokered excess insurance from the commercial insurance markets to provide a robust custody insurance solution.

Cameron Winklevoss, president of Gemini, said: "Gemini has created a captive insurance company to address this. Obtaining meaningful insurance in the crypto industry remains a challenge, and our captive will help to increase our insurance capacity and move the industry forward."

Yusuf Hussain, head of risk of Gemini, added: "Gemini recognised this gap and collaborated with two of the world's largest insurance brokers, Aon and Marsh, to solve this." ■

ProSight to offer captive solutions

ProSight Global is set to expand its insurance solutions into the captive insurance market.

The company said this step marks the "natural evolution" of its product offerings and capabilities.

As part of this strategic expansion, ProSight's founder and former CEO Joe Beneducci stepped down from his current role as executive chairman on 1 February 2020 to form an independent agency, Altruis Group.

Altruis Group will become a ProSight distribution partner in new customer niches where the company supports captives, and ProSight will become the agency's first carrier partner.

In addition, ProSight has appointed the current lead director of the board, Steven Carlsen, to the role of chair.

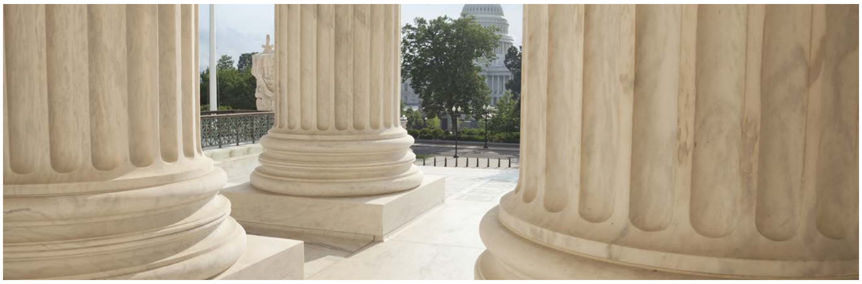
Carlsen has been a member of the firm's board for nine years.

ProSight's CEO Larry Hannon said: "Entering the captive market builds upon the principles that ProSight was founded on a decade ago."

"As our customers seek or require alternative solutions in the current market environment, we will do what we do best—find ways to profitably, cost-effectively, and creatively meet those needs."

Hannon added: "On behalf of everyone at ProSight, I'd like to thank Joe Beneducci for everything he has done over the last decade for our company and our employees. I believe that the energy, dedication, and commitment he demonstrated in founding ProSight will once again result in great success at Altruis."

"It's a privilege to congratulate Steven Carlsen as our new board chair. His deep understanding of our niche-focused strategy will be key to our continued long-term success." ■



CIC Services takes to US Supreme Court to hear lawsuit against IRS

CIC Services has petitioned the Supreme Court of the US to hear its lawsuit against the Internal Revenue Service (IRS) regarding IRS Notice 2016-66.

The Tennessee-based captive manager's first lawsuit against the IRS and US Treasury was in December 2016 in a bid to block Notice 2016-66.

Notice 2016-66 requires reporting by any taxpayer involved in micro captive transactions over a number of past years to which the open statute of limitations applies.

CIC Services, who lost a court case against the IRS in 2017, went onto appeal the decision at US Sixth Circuit Court of Appeals but it was later denied.

Additionally, in August 2019, the Sixth Circuit denied CIC Services' petition for en banc review by a 9 to 7 vote.

Despite being denied, the seven dissenting judges wrote an opinion in CIC Services' favour.

During the hearing, one judge agreed with CIC Services' position as a legal matter but voted with the majority because he suggested the case warranted Supreme Court review.

CIC Services remain confident that the Supreme Court will agree to hear the case.

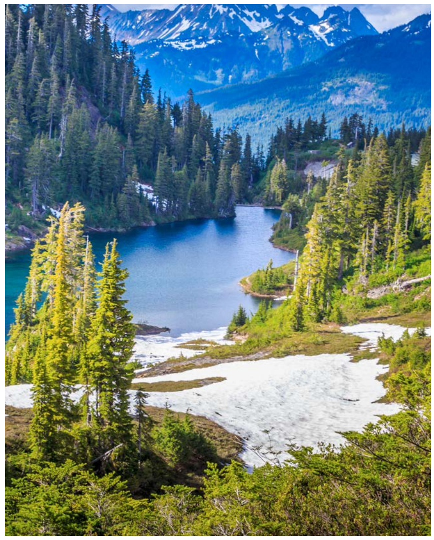
In August, Sean King, general counsel at CIC Services, said the firm's battle to "curtail IRS abuse of law-abiding taxpayers is not over".

King said: "We hope that it will do so and, based on its 9-0 precedent in the Direct Marketing case, we expect to win if it does" reach the Supreme Court.

He explained that "administrative state overreach is a threat to all Americans – not just small and mid-market business owners, and CIC Services is committed to championing the cause".

King previously stated: "The issue at hand—that is, whether or not the IRS can, unlike any other federal agency, continue to systematically enforce obviously illegal regulations just because they are enforced by an illegal 'penalty tax'—is much larger than just captive insurance or just Notice 2016-66."

"Indeed, it involves fundamental issues of liberty, fairness and separation of powers. For those reasons, CIC Services will continue to fight on behalf of taxpayers everywhere." ■



R&Q acquires Montana captive insurer

Randall & Quilter (R&Q) has acquired Vigneron Insurance Company, a Montana captive insurer, from a wholly owned private investment holding company.

R&Q intends to merge Vigneron Insurance Company into R&Q's Vermont captive consolidator insurer, ICDC in Q1 2020, subject to regulatory approval.

The captive underwrites deductible reimbursement policies to cover the obligations under insurance policies taken out by affiliated entities.

Ken Randall, executive chairman of R&Q, said: "We are pleased to have completed the acquisition of Vigneron Insurance Company, our first transaction in Montana, and provided Vigneron Insurance Company's parent company with legal and economic finality for its captive."

Randall also revealed that he "looks forward to closing more transactions in the coming weeks". ■

NiSource captive ratings affirmed

A.M. Best has affirmed the financial strength rating of A (Excellent) and the long-term issuer credit rating of “a” of NiSource Insurance Corporation (NICI).

The ratings reflect NICI’s balance sheet strength, as well as its strong operating performance, neutral business profile and appropriate enterprise risk management.

A.M. Best explained that although risk-adjusted capitalisation is lower than in previous years, NICI’s balance sheet strength is still supportive of the very strong assessment.

NICI is the single-parent captive insurer, wholly owned by NiSource that accepts insurance risks from NiSource and its affiliates, providing all-risk property, workers’ compensation, excess general and automobile liability, medical stop-loss, long-term disability and group life insurance.

A.M. Best suggested that NICI will remain well-capitalised and is positioned to sustain a strong level of operating profits due to its demonstrated risk management expertise and conservative underwriting criteria.

Positive rating action could occur if NICI sustains positive operating results and improves risk-adjusted capitalisation.

However, the rating company said that downward rating pressure could result from a decline in the company’s liquidity levels, an increase in underwriting leverage or an outsized loss event that triggers a sudden decline in risk-adjusted capitalisation. ■

DARAG reveals US reinsurance agreement

DARAG has concluded a loss portfolio transfer between DARAG Insurance Guernsey Limited (DIGL) and a multinational insurance company with subject reserves is in the excess of $100 million.

DIGL is providing economic and operational finality for the counter-party’s US general liability book of business.

TigerRisk served as advisors to both parties in concluding the agreement.

Tom Booth, CEO of DARAG, said: “We continue to expand our geographical footprint, illustrated by the completion of this sizable US transaction underwritten by DIGL.”

He added: “The portfolio will be managed through service agreements between DIGL and our SOBC DARAG operations in the US.”

“I am delighted to be able to announce our continued growth and success in providing attractive legacy solutions to the market.”

Last week, DARAG announced the conclusion a transaction with a Lloyd’s Syndicate to provide reinsurance for a US liability book.

The reinsurance will be provided through DARAG’s Maltese risk carrier, DARAG Malta Insurance and

'Excellent' rating for Sony's captive

A.M. Best has affirmed the financial strength rating of A (Excellent) and the long-term issuer credit rating of "a" of PMG Assurance. The outlook of these credit ratings (ratings) is stable.

Based in Bermuda, A.M. Best categorises PMG's balance sheet strength as very strong, as well as its strong operating performance, limited business profile and appropriate enterprise risk management.

These ratings reflect PMG's strategic position as the captive insurance company for the Sony Group, whose ultimate parent is Sony Corporation.

PMG is a pure captive of Sony, and its role is to provide risk management services to Sony Group members.

The captive's strengths are derived from its underwriting focus, conservative operational strategy and emphasis on risk management controls, which are integrated with those of its parent.

It predominantly writes commercial property and marine coverages for Sony, and employee benefits coverage for Sony employees outside of Japan. PMG's balance sheet strength is assessed as very strong, as evidenced by its strongest level of risk-adjusted capitalisation, excellent liquidity and conservative investment strategy.

The captive's operating performance continues to be strong, with favourable net income in four of the past five years driven predominantly by net underwriting income.

According to A.M. Best, PMG is susceptible to volatility in earnings due to the low frequency and high severity losses it insures. However, the captive mitigates its exposures through the use of a comprehensive reinsurance programme. ■

AMICE responds to EIOPA's call for Solvency II review advice

The Association of Mutual Insurers and Insurance Cooperatives in Europe (AMICE) has welcomed the overall success of Solvency II as a regulatory framework, and agrees with European Insurance and Occupational Pensions Authority's (EIOPA) that this review should not result in a revolution, but in the adjustment of certain elements.

In its response to EIOPA's call for advice for the 2020 review of Solvency II, AMICE stated that it is important this is not used as an opportunity to increase the regulatory burden, but as an opportunity to improve the current system in the light of four years' experience since its implementation in 2016.

After coming into effect in January 2016, the European Commission called for the EIOPA to provide technical advice for a comprehensive review of the Solvency II Directive in 2019 as the European captive industry had some issues with the regulations.

AMICE's response follows a request by the European Commission, EIOPA in October 2019 who published an 878-page consultation paper, which includes suggestions to update almost all aspects of Solvency II. The association focuses on three topics from the consultation paper, they look at the review of the long-term guarantee measures; the potential introduction of new regulatory tools in the Solvency II Directive; and revisions to the existing Solvency II framework.

On the long-term measures and equity risk, AMICE has made several proposals to assist in achieving a proper reflection of the net risk profile of the long-term business model and issued two position notes with concrete proposals for easy-to-apply fixes for the volatility adjustment (VA) and long-term equity.

They are particularly concerned that the VA and extrapolation proposals need to be tackled in line with stakeholders' interests.

On macroprudential policies, AMICE suggested that the regulatory tools within the Solvency II system are ensuring a robust insurance sector and providing appropriate protection for policyholders.

Principle of proportionality, which is the main policy that the captive industry has had the most issues with.

AMICE said it supports proposals to increase the thresholds at which Solvency II applies to small insurers, to apply an appropriately calibrated regime for medium-sized insurers, and to ensure that the principle of proportionality works consistently in practice.

AMICE's secretary general, Sarah Goddard, commented: "Historically, AMICE has been deeply involved in the consultation around the development of Solvency II, particularly the implementation of the proportionality principle."

"Proportionality is particularly important for the mutual and co-operative insurance sector, alongside more technical aspects such as long-term equity, the volatility adjustment and interest rate risk."

"We have highlighted these issues in our response to the Solvency II 2020 Review consultation."

She continued: "This review is an important programme in ensuring that the European regulatory system works the way it should do, including fair treatment of all insurers, and AMICE has worked with members across Europe to ensure they are fully represented and their views appropriately reflected in our response."

"We look forward to a positive and ongoing dialogue with EIOPA and other stakeholders on regulatory reform."

In a recent feature in Captive Insurance Times, Florian Wimber, head of European affairs and international insurance, Insurance Ireland, explains that as a next step, it will be "crucial that the industry develops concrete proposals on how Solvency II can be amended during the current review to better reflect the characteristics of captives and apply the principle of proportionality more consistently".

EIOPA aims to release the revision papers later this year. ■

IRS takes next step against ‘abusive’ micro-captives

The Internal Revenue Service (IRS) has revealed that 80 percent of taxpayers who received offer letters elected to accept the settlement terms.

In September last year, the IRS mailed a time-limited settlement offer for certain taxpayers under audit who participated in ‘abusive’ micro captive insurance transactions.

The IRS is also establishing 12 new examination teams comprised of employees from the IRS large business/ self-employed divisions that will be working to address these abusive transactions and open additional exams.

The teams will use all available enforcement tools, including summonses, to obtain necessary information.

The settlement offer followed three US Tax Court decisions confirming that certain micro-captive arrangements are not eligible for federal tax benefits.

The terms of settlement required substantial concession of the income tax benefits claimed by the taxpayer together with appropriate penalties.

IRS Commissioner Chuck Rettig said: “The overwhelming acceptance rate of the private settlement offer is a reflection of the success of the government’s work to stop this abuse.”

“Taxpayers who elected to accept the IRS’ terms have done the right thing by coming into compliance with their federal tax obligations and putting this behind them. Putting an end to abusive schemes is a high priority for the IRS,” he added.

Micro captives have come under scrutiny by the IRS for several years, appearing on the IRS’ ‘Dirty Dozen’ list of tax scams since 2014.

In 2016, the Department of Treasury and IRS issued Notice 2016-66, which identified certain micro-captive transactions as having the potential for tax avoidance and evasion.

The IRS has recently won three court cases against captive companies regarding tax. Following these cases, the IRS has decided to offer settlements to taxpayers currently under exam.

Tax law allows businesses to create captive insurance companies to protect against certain risks.

Under section 831(b) of the Internal Revenue Code, certain small insurance companies can choose to pay tax only on their investment income.

In abusive micro captive structures, promoters, accountants or wealth planners persuade owners of closely-held entities to participate in schemes that lack many of the attributes of genuine insurance. ■

CAPTIVE FORMATIONS

Texas

The Texas Captive Insurance Association revealed it licensed four new captives in 2019, taking the total number of active captives to 45.

The domicile saw steady growth after it formed the same number of new captives the previous year, although this is a decrease from the eight it licensed in 2017 and 13 in 2016.

The association statistics also showed that there was one captive closure last year.

Texas' captive law only allows single-parent captives and precludes companies from outside the state, or without a significant interest or operation in the state, from forming a captive. ■

Bermuda

Bermuda saw 22 new captives were registered during 2019, according to the Bermuda Monetary Authority (BMA), up from the 19 registered the year before.

The domicile now plays host to 715 captives which are writing gross premiums of approximately $40 billion, the association said.

As of 2019, the island's reinsurance market has more than 1,200 (re)insurers holdings totalling assets in excess of $800 billion and writing gross premium of approximately $150 billion.

The strong formation figures come shortly after BMA tapped Craig Swan to become deputy chief executive officer of the authority as of 1 January.

Swan has taken on the newly created role as part of BMA's preparations for when the executive chairman Jeremy Cox departs in 2021, at which point Swan will become CEO.

Commenting on the 2019 captive figures Swan said: "The majority of the 2019 captives originated from the US but five also came from Canada."

"As well as North America, new registrations also came from Asia, Europe and Africa. Seven long-term captives registered during 2019, an increase year-on-year." ■

North Carolina

The North Carolina Department of Insurance (NCDOI) has revealed that at the end of 2019 there were 682 risk-bearing captive insurance entities licensed, including 235 active captive insurers and 447 active cells or series.

Of the 235 captive insurers, 178 were pure captives, 29 were protected cell captives, 20 were special purpose captives and eight were risk retention groups.

In 2019, North Carolina licensed 26 new captives, and 61 new cells, however, the state did see 37 captive closures.

Debbie Walker, senior deputy commissioner of North Carolina Department of Insurance, said: "Although the number of terminations was higher in 2019 than in past years, we are pleased with the number of new 2019 formations."

Walker added: "2020 has started off on a very positive note for the state. To date, we have licensed two captive insurers in 2020 and we have three captive insurer applications under our review."

The state's captive insurance company programme celebrated its sixth anniversary in October 2019 following the 2013 enactment of the North Carolina Captive Insurance Act. ■

Vermont

The Vermont Department of Economic Development has revealed that 22 new captive insurance companies were licensed in 2019.

The data showed that new licenses were made up of 14 pure captives, an increase of two from 2018. The rest included four sponsored captives, two risk retention groups (RRGs), one special purpose financial insurer and one industrial insured captive.

Vermont is now home to 585 captives, an increase of 558 in 2018, the new figures consist of 559 active and 26 dormant captive insurance companies.

Six of Vermont's 22 new captives were redomestications from other jurisdiction; including three from New York, two from Bermuda and one from Switzerland.

New companies include Massachusetts Mutual Life Insurance Company, KPMG, University of Vermont Health Network, Stamford Health, RELX, and Fortive Corporation.

Ian Davis, director of financial services in Vermont, said: "[The state's] 2019 licensing activity in many ways reflected the changing insurance environment."

He continued: "We licensed nine new captives in Q4 alone and, given the hardening market, we expect the momentum to continue on into 2020."

"Vermont's world-class regulatory framework and service provider network continues to be key determinants in attracting new business to the state," said Rich Smith, president of the Vermont Captive Insurance Association.

He adds: "The stability, knowledge and experience of Vermont's captive industry is simply unmatched."

Vermont has licensed a total of 1,159 captive insurance companies since 1981.

With an active pipeline of prospective new captive insurance companies already underway for 2020, the state expects continued growth in the coming year.

In 2018, Vermont licensed 25 new captives, made up of 12 pure captives, four risk retention groups, three sponsored captives, two industrial insured captives, two special purpose financial insurers, one branch captive and one affiliated reinsurance company. ■

Touchdown in Miami

Delegates at the 29th World Captive Forum gathered in Miami to discuss and debate the current hot topics in the captive insurance industry, from challenges in Washington State to the innovation around employee benefits

Kicking off the first captive conference of 2020 was the World Captive Forum, which took place in Miami, Florida. The domicile-neutral conference celebrated its 29th year at the JW Marriott Turnberry Resort and Spa in the sunshine state, also sharing the hotel facilities with the Kansas City Chiefs, who were in town for the SuperBowl.

The conference, which hosted multiple sessions covering a range of topics and issues affecting the captive insurance sector, welcomed 466 people from 43 US states and 18 countries.

Delegates attended panel sessions covering topics from innovation around the employee benefits sector to the current situation in Washington State.

Hot topics

Washington State's direct placement tax was the main focus on the agenda for the hot topics session at the event.

Washington State and its recent activity with captive insurance companies raised a lot of interest at the conference. To date, 16 captives have self-reported and two captives have paid $2.9 million in unpaid premium taxes and $1.4 million in fines, tax penalties and interest to the Washington State Office of the Insurance Commssioner.

Bruce Wright, partner at Eversheds Sutherland, explained that the state had been in the news a lot recently.

Answering an audience question of how the state identified these captive companies, Wright revealed that some 16 companies handed themselves in during a volunteer programme.

Questions were also raised on how companies were notified—using Starbucks as an example—Wright explained that when Costco settled its fine, the firm only had to "pay tax on Washington State risk, which prompted Starbucks to volunteer under the assumption they were going to get treated the same way". However, Wright noted that the Washington State department said Starbucks "had to pay risk tax not just to Washington state but to the whole country".

With Starbucks — and Alaska Air — being treated differently to Costco, both companies are arguing that the decision was "unfair", according to Wright.

He suggested that this will be something that is "discussed for several years to come".

To try and improve the current situation in Washington, Wright said there is "a group in [the state] who are trying to work out legislation", working with the legislator in Washington "to deal with these issues going forward".

He added that he's sure that the office of the commissioner "is not going to be entirely on the same page as these proposals" from this group but work is in progress.

Digital transformation

With the growing power of the digital world, a panel with Marcus Schmalbach, CEO, RYSKEX; Peter Foley, CEO of LILCHA; Robert Arowood, president, Appalachain Underwriters, addressed digital transformation.

Schmalbach introduced the GIG economy and explained the benefits, challenges, and influences of it. He defined what a GIG economy is, suggesting "it's an online platform, where work can be transacted" while using Uber as an example of this.

Schmalbach said the GIG economy is "growing" but outlined that "it's not just an industry, it's a new form of working".

He outlined that less than one percent of the working-age population participates in the GIG economy today.

The GIG economy can inject $1.3 trillion per year into the global economy as of 2025. Schmalback suggested that there are potential candidates for a captive solution.

Foley noted that the captive industry "is so well-positioned" to capitalise on this evolving economy as it's evolving and changing daily.

He outlines that an alternative risk management industry or risk retention groups (RRG) can allow companies to ensure non-traditional risks in ways that more fully correspond to the level of risk.

Foley looks at an industry paradox as a traditional market committing millions of investments dollars but at the same time, no allocating the corresponding level of resources to developing coverages.

He used a case study example, suggesting that the "insurance industry is failing at developing coverages to deal with some of the challenges" of businesses.

However, he added, at the same time "changes are occurring at such a rapid pace" and the risk is overlooking the positives of being at the "front end of the increasing opportunities".

Employee benefits

Using a captive insurance company for employee benefits is a very popular use, especially in the US where healthcare is the second biggest expenditure for a company after employee wages. One session at the World Captive Forum focused on the innovations around employee benefits.

The panel included Anthony Tropea, strategic benefits leader, global health and wellbeing of GSK; Marc Reinhardt, director Americas of Generali Employee Benefits Network; Paul McNiff, senior consultant of Willis Towers Watson; and Ricardo Almeida, head of business development of Maxis Global Benefits Network.

When asked by NcNiff on what Maxis is hearing from their clients on how they can help them over the next three to five years, Almeida explained that data is a number one priority for Maxis but also how the firm uses digital platforms to analyse the data that they gather to make it more efficient.

In agreement, Reinhardt said “data is key”, but pointed out that asked that once companies get that data, what are they doing with it?

He explained that a lot of work and investment goes into getting the data and making it analysable but there is still a lot of work that needs to be done around this to reach the next level.

Reinhardt suggested that some companies are already working on this. He noted that at Generali, “we still see many clients that have not reached that step. They have the data but what is the next step from here. I think the industry needs to be learning and educating in this area”.

Later in the panel session, McNiff noted that employee benefit costs are significant and are continuing to rise. He stated: “After base paying salary, typically the two biggest components of spend will be post-retirement spend and risk and healthcare benefits.”

He discussed the cost of healthcare around the world but focused on the rising cost of US healthcare and how quickly that cost can add up for a company, especially a larger company with more employees to cover.

Reflecting on the data, Almeida added that Maxis is currently seeing a lot of growth in the market.

Latin America

Latin America also took the spotlight at this year’s World Captive Forum. The region consists of 20 countries with more than half a billion people living there.

According to a panel, the Latin America region is a growing captive market due to growing economies in the multi-Latina countries and the need for insurance products and services.

The panel included Adriana Scherzinger, international programmes at Zurich; Delfin Viloria, risk and analytics leader at Willis Towers Watson; Felipe Chacon, Americas regional distribution manager at Zurich Insurance Company; and Paul Bailie, managing director at Willis Towers Watson.

Scherzinger suggested that over the past three to four years, Latin America has been a “top emerging market for captive business”.

She explained that the region “has seen sustainable growth in the number of captives from the region”.

She explained that education on the captive insurance industry is getting better in Latin America and that service providers are doing training sessions throughout the region, which she noted is mutually beneficial for everyone in the market.

Looking at the next five years of Latin America, the panel also highlighted the benefits that the hardening market will bring such as new formations and expansion of captives that already exist within the region.

Scherzinger said: “We’ll see more formation of captives for Latin American companies and also expand of coverage will be seen in those captives.”

Zurich’s Chacon also highlighted during the panel that employee benefits will be the future for captive within the region.

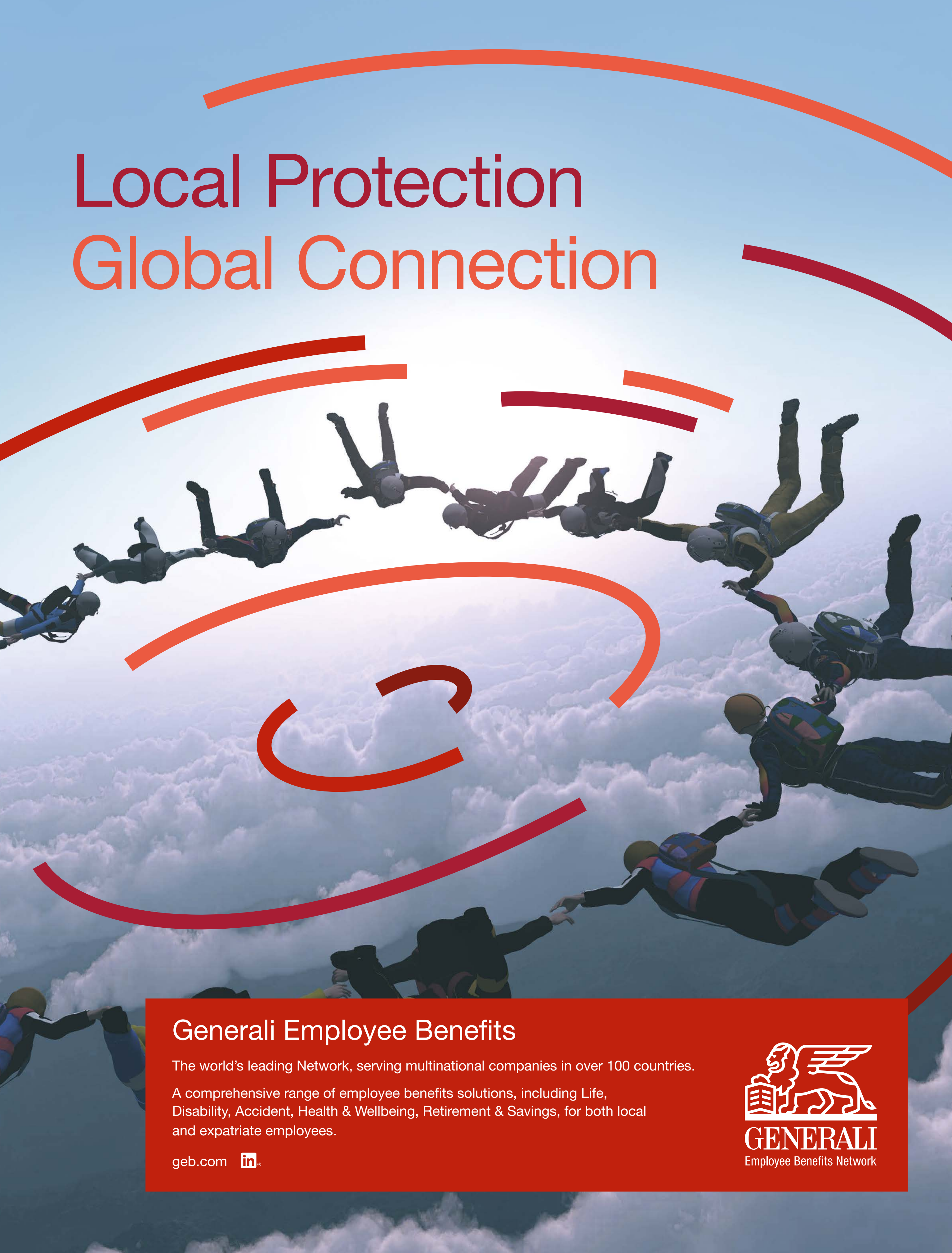
He predicted a big trend in taking over “a risk engineer approach towards employee benefits”, adding that there is a lot of interest going into wellness programmes.

Elsewhere, WTW’s Bailie described the shift that he has seen over the years and how discussions around captives have changed in Latin America.

He said that 15 years ago it “would have been much focussed on tax issues” and “prospects would have been private companies”.

But recently, Bailie has seen “more involvement by professional risk managers and a more corporatised approach” in the region.

He suggested that this is the development that they are seeing as with a more of a corporate approach that the portfolio management becomes bigger and “a captive vehicle is a way to do that”.■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WASHINGTON STATE OF MIND

In September 2019, the Washington State Insurance Commissioner (OIC) Mike Kreidler made captive insurance a legislative priority for 2020.

At the time, Washington State law provided no statutory framework to allow the formation of captive insurance companies within the state.

During 2019, the OIC began investigating Washington state-based companies who had formed their own captive insurance companies. These companies have been cooperating in the investigations by the OIC and worked with the OIC on legislation for 2020.

In January, the OIC introduced its draft legislation on captive insurance. The proposed legislation on captive insurance, which was introduced to the Washington House of Representatives on 13 January, concerns independently procured insurance and the application of the state's insurance premium tax for both in-state and out-of-state risk.

The legislation will create a statutory framework for how captive insurance companies can be formed by Washington state companies, who can form them and what taxes will be paid by them to Washington state.

In January this year, Kreidler ordered unauthorised insurers Olympic Casualty Insurance and ASA Assurance to stop insuring risk in Washington state for their parent companies Starbucks and Alaska Air Group.

In December 2019, Kriedler ordered Olympic Casualty Insurance, a captive insurer for Starbucks, to pay $22.8 million in unpaid premium taxes, interest, and penalties and a $1.1 million fine.

To date, 16 captives have self-reported and two captives have paid $2.9 million in unpaid premium taxes and $1.4 million in fines, tax penalties and interest to Washington state.

Kreidler reached a settlement of $876,820 with Cypress, a captive insurer for Microsoft Corporation in August 2018.

In addition, the insurance commissioner reached a settlement of $3.6 million with NW Re Limited, a captive insurer for Costco Wholesale Corporation in March 2019.

Maria Ward-Brennan speaks to the Washington State Insurance Commissioner Mike Kreidler to discuss the legislation and his opinions on captive insurance.

What are your thoughts on the US captive insurance market?

The captive insurance market in the US has seen exponential growth. The OIC bill would create a legal framework, through independent procurement, that would allow large and fiscally solid companies to procure property and casualty insurance from insurers, not in the admitted market.

This could also be done through the creation of their own captive insurance companies if they choose.

How will the new captive insurance legislation work and what will the legislation include?

OIC's bills were filed prior to the beginning of the current legislative session and the hearings were on the 30 January.

The bills create a framework to allow independent procurement of insurance from insurers not in the admitted market, including captives. It would have such insurance purchases be registered with the OIC with a 2 percent premium tax applied.

How will implementing captive insurance legislation benefit the state?

The legislation would create a legal framework to allow large companies to form and use captives. That framework currently does not exist in Washington.

It would also increase revenue to the state general fund by applying the 2 percent premium tax.

In addition, the legislation would ensure a level playing field and continue Washington's consistent application of the 2 percent premium tax across all types of insurance. The legislation is in line with other states.

Do you have an update on the latest captive insurance legislative hearing that took place on 30 January?

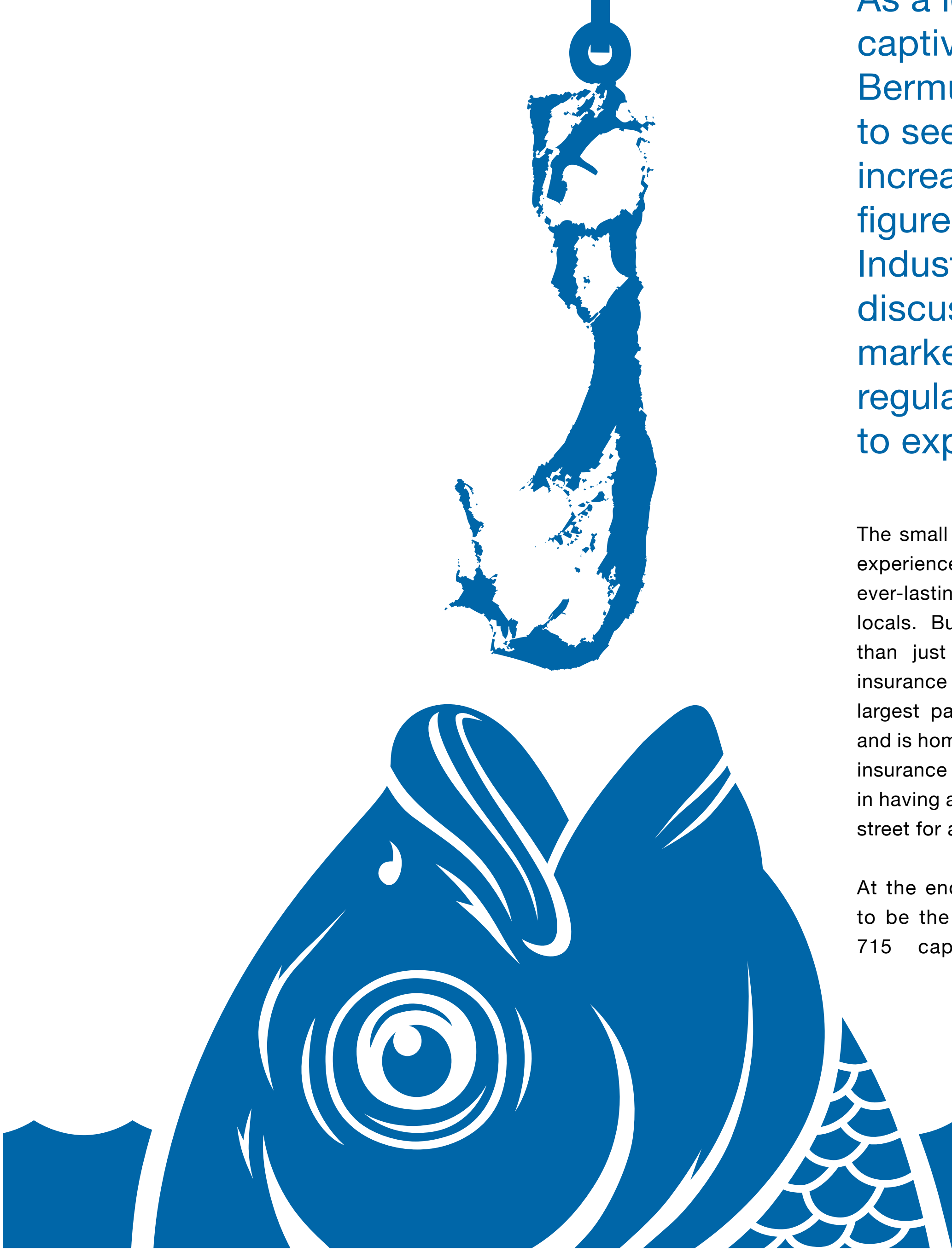
We presented our views about a fair and reasonable approach to allow businesses to establish and use captive insurers in our state and pay the 2 percent premium tax due from authorised insurance operations.

It should also be noted that we made our legislative proposal at the request of the businesses that want to establish captives in our state.

Do you think Washington will find it challenging to attract captives after banning orders were issued within the state?

OIC's legislation would not ban captives. Instead, it would create a legal framework to allow their use. However, the bill would not make Washington a captive domicile state. Washington is not a captive domicile state, so captive insurers cannot be set up in this state. Parent companies in this state can form captive companies and have them domiciled in other states. These parent companies may then use a surplus line broker to procure insurance from their insurance companies and pay their taxes. ■

Hooked on Bermuda



As a leader in the captive industry, Bermuda continued to see a year-on-year increase to its captive figures in 2019. Industry experts discuss current market trends, regulation and what to expect for this year

The small island of Bermuda is a treat to experience with its colourful buildings, ever-lasting ocean views and charming locals. But Bermuda offers a lot more than just physical beauty, the island's insurance and reinsurance sector form the largest part of its international business and is home to the largest offshore captive insurance domicile. The island prides itself in having a unique selling point with a high street for all your insurance needs.

At the end of 2019, Bermuda continues to be the leading captive domicile with 715 captives, which approximately generated $40 billion in premiums. The Bermuda Monetary Authority (BMA) regulates Bermuda's financial services sector and has a reputation of having an 'open door policy'.

Plain sailing

On the current captive insurance market in Bermuda, Jereme Ramsay—at the time of writing, was business development manager of the Bermuda Business Development Agency (BDA) but has since joined KPMG Bermuda—said: "We see significant growth across long-term captives such as the UK pension schemes and employee benefits (EB) placing their risks into a captive structure".

He adds: "Property and casualty (P&C) captives continue to flow, we've seen an uptake of interest across EB. We're optimistic about this year, especially from three lines of business; auto; property; and cannabis."

Industry participants are suggesting that Bermuda is currently experiencing a 'steady market'.

Brian Quinn, managing director, founding director of Granite Management, says that due to heavy competition around the world, "the island is not expanding greatly".

He explains: "The market in [Bermuda] is very steady and where people want a more integrated solution, integrated with the insurance market or new innovations – those kinds of captive clients come to Bermuda".

Also weighing in, David Gibbons, partner, captive insurance leader, PwC, illustrates that Bermuda has a very US-focused market as a lot of captives located on the island are from the US.

However, he notes that of the new formations of 2019 in Bermuda, a quarter came from Canada. He outlines that the interest from Canada continues to grow and that Latin America continues to be an interest, particularly Colombia.

Gibbons adds: "The BDA is working with industry to increase Bermuda's exposure in Asia."

Bermuda has been visiting both Latin America and Canada for a number of years to promote itself as a 'world-leading' captive insurance domicile, but as many industry participants have noted in the past, companies have to get comfortable with change and establishing relationships can take time.

Discussing Canada, Gibbons says: "The Bermuda market expected a larger influx of Canadian companies when the Tax Information Exchange Agreement was signed in 2011. We are beginning to see that influx now as Bermuda's reputation grows in Canada, and Canadian companies look to utilise not only Bermuda's captive market but also the reinsurers that reside there."

Echoing the trend in both Canada and Latin America, Leslie Robinson, senior vice president, Willis Towers Watson (WTW), says: "We continue to see formations out of the US but we're also seeing formations out of Latin America."

"Bermuda, through the work of the Bermuda BDA, has been working for some years in marketing the captive concept to Latin America, and our own shop is now getting quite involved with Latin America, and as a result, we are seeing some growth in captive formations from this region."

"Also, Canada is another area where our peers are seeing some growth in captive formations, and this is again due to the work of the Bermuda Business Development Agency in the marketing of captives and the Bermuda jurisdiction to Canadian firms," she adds.

Wave of trends

As the use of technology continues to grow, the risk of cyber breaches heightens, and although traditional insurance faces difficulty when dealing with cyber risks, captives continue to thrive as a useful coverage tool. This trend can also be seen in Bermuda, Ramsay explains that "insurers are utilising their captive structure to fund their cyber risk programmes and having direct access to carriers that actually provide that line of business from a reinsurance side".

He adds: "Cyber risk is extremely hard to scratch the surface in terms of cover and prices are too expensive, so funding their captive structure has been ideal and allow them to put that capital aside for a rainy day for when it does come. But also, giving them direct access to another layer with another insurance market."

One of the most common trends industry professionals are seeing is the hardening of the market. The captive insurance industry has been at the behest of a soft market for a considerable amount of time, it had been a perfect storm of a comparatively low level of catastrophic losses and the desire of new capital to find investments that have provided a decent return over the last few years and present risks that are uncorrelated with more traditional asset classes.

Although the soft market had a greater impact on the commercial market than the captive insurance industry, companies were experiencing growth at a much slower rate than previous.

Now, the industry is seeing a hardening market, and the interest around the captive market creeping back to a more steady rate.

Mike Parrish, head of client services at Marsh Management Services (Bermuda), suggested that challenges in the commercial market for certain casualty and professional liability lines are having an impact on the trends they are seeing.

Parrish says: "We're seeing an increase in captives taking larger retentions and using the captive more to try to reduce the external costs of insurance, in areas they may not have previously been involved with."

Additionally, Robinson believes the hardening market will help push captive formations and new business in existing captives.

She explains: "What I also find is that clients are using their captives as leverage to try and help with some of this increased pricing."

She continues: "For example, in some cases, the captive is used to buy down increased deductibles that are being required with the commercial insurers in order to mitigate some of the increase in premium. In other instances, captive owners may never expand the use of the captive, but hold the captive as an option to help with pricing negotiations with the commercial market underwriters."

Regulation and reputation

A domicile heavily relies on a good reputation in order to draw in businesses to set up their captives. So that Bermuda's commercial insurers and reinsurers and insurance groups will not be disadvantaged when competing for and writing business in the EU, Bermuda implemented a regulatory framework to become Solvency II equivalent.

Solvency II is a harmonised framework aimed at ensuring there is a single market, utilising a single set of rules for insurance services

Bermuda was granted full equivalence by the European Commission in 2015 to comply with the Solvency II directive meaning European companies can operate in Bermuda. While also having 953(d) election, meaning even if the captive is based in Bermuda, the owner will still be a US taxpayer.

Quinn says: "The BMA has a great reputation and very stringent regulations in terms of how they manage the insurance industry in Bermuda. In my opinion, a far superior regulatory regime than other domiciles in the world, in that respect."

Gibbons believes having good regulations is key to a good domicile. He says: "Bermuda enjoys the only bifurcated regulation of a Solvency II equivalent regime for the commercial space and the risk-based local regime for captives. Having both allows captives to elect to be Solvency II compliant by moving into a commercial classification if they are writing business in Europe."

He continues: "This along with the recognition by the NAIC of Bermuda as a qualified jurisdiction shows how experienced and respected the BMA is and gives captive owners increased comfort."

Robinson believes the main challenge is that as Bermuda is a leading jurisdiction, all international eyes are on them.

She explains: "Particularly when it comes to regulatory standard setting bodies, as they are always looking at Bermuda. As a result, it has caused us to undergo continuous assessments of our actual market and this has led to

Reinsurance Collateral Trusts

The limitations and costs associated with traditional collateral options such as Letters of Credit have dramatically fueled the growth of alternative risk transfer strategies amongst insurers, reinsurers, captives and corporations. Fluid regulatory, financial and risk management environments demand lower-cost collateral solutions – solutions that afford maximum flexibility with minimal effort to set-up and maintain.

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To find out more about how SunTrust can support and enhance your reinsurance business, please contact:

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SunTrust®

increased legislation and regulation in all segments of our financial services market, including captives.”

Parrish states that the increased regulatory and compliance environment will negatively impact operational costs. This will be a challenge, he said, for the captive sector as managers try to keep the cost of doing business at a manageable level.

He explains: “All service providers now have an increased administrative workload to maintain compliance with regulations around AML/KYC and Economic Substance and we accept that this is not going to change and is a necessary part of maintaining Bermuda’s reputation and integrity.”

However, he adds: “Clearly if the cost of doing business in a place like Bermuda becomes prohibitive then some companies may question the value of having a subsidiary domiciled here and explore alternatives.”

Island in the stream

As we start a new decade, what does 2020 have in store for Bermuda?

Ramsay says he is “optimistic” based on conversations he has had around the growth that’s going to happen in the first two quarters of 2020. He explains that this is based on the level of interest and the amount of new prospective clients that Bermuda is working with.

Parrish believes that 2020 has the potential to be an interesting year for its captive sector in Bermuda.

He reflects back to the challenging pricing outlook in the commercial market and views this as a trigger for more companies retaining risk and either forming captives or expanding the uses of the captives that they have.

He adds: “I expect 2020 to be a busy year in the captive industry, I think we’ll see some new formations from companies struggling to find cover, along with expanded uses of our existing captives.”

Quinn thinks “captives will grow” becauce of the increased interest in employee benefits.

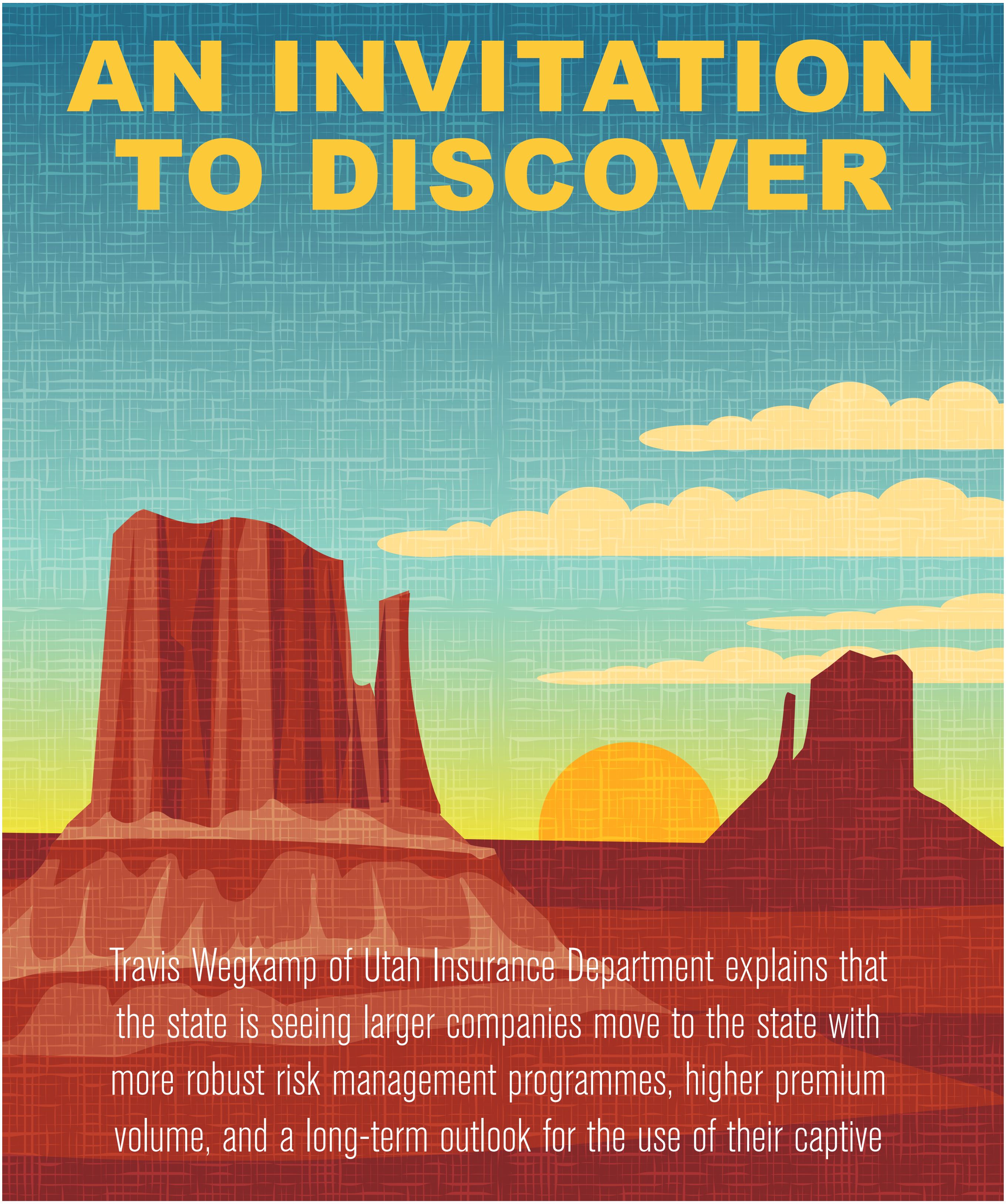
He adds: “There are around 120/150 employee benefits captives at the moment in the world, out of 5,000 or so captives. It’s quite a small number but there are hundreds looking at bringing employee benefits into their captives.”

Gibbons outlines that 2020 will be the first year that captives have to submit economic substance filings describing the level of activity that is performed in Bermuda.

He explains: “These filings will require owners and risk managers to review the governance and operating processes around their captive. The companies that have gone through this so far have realised that their captives are underutilised and are using this as the time to expand the level of activity in the captive.”

Finally, if the hardening market continues, like it’s suspected, Gibbons believes companies will look at their captives again to supplement market cover. He explains that “it’s almost a back to basics approach” as this was the original reason captives were formed. ■

AN INVITATION TO DISCOVER



Travis Wegkamp of Utah Insurance Department explains that the state is seeing larger companies move to the state with more robust risk management programmes, higher premium volume, and a long-term outlook for the use of their captive

How did 2019 playout for Utah in terms of captive insurance?

It was another strong year for the captive insurance industry in Utah. We had a total of 42 new formations, 11 of which were cell captives, bringing our total number of risk-bearing entities to 435.

While this is a net decrease of six for the year compared to the previous year-end total, the captives that are replacing the closures are larger companies with more robust risk management programmes, higher premium volume, and a long-term outlook for the use of their captive. This is a trend we're very pleased with.

What trends are you currently seeing in the Utah captive insurance market?

Workers' compensation remains popular; while Utah captives cannot write direct workers' compensation we do allow them to provide deductible reinsurance coverage and/or reinsure a layer of an affiliate's self-insured retention (SIR). Tenet liability coverages for property management companies have seen an uptick here, as well as continued interest in cyber liability and voluntary employee benefit programmes. It would also seem there is a recent revival in the interest of cannabis-related captives.

Utah does allow for medical use in the state, and if presented with a well-designed programme I would be open to considering it and discussing it's viability here with the commissioner.

Are there any plans to update captive legislation this year?

We are introducing one change for the current 2020 legislative session that I believe will have a strong impact on Utah's attractiveness as a captive domicile. The change is a single additional line of language that will allow our captives to reinsure pure third-party risk with prior approval of the commissioner. This has the two-pronged effect of also allowing our pooling captives to share and reinsure risk without the need to meet the controlled unaffiliated business (CUB) test. For a captive to insure directly though, the insured would still need to meet the parent, affiliate or CUB requirement.

What are the biggest challenges for US captives right now?

Continued interest and scrutiny from the Internal Revenue Service (IRS) means captives need to take the necessary care to operate primarily as an insurance company and to formulate programmes with adequate risk distribution. The unfortunate challenge and difficulty with this is the IRS' lack of guidance on what constitutes adequate risk distribution.

What are your predictions for the market this year?

It would appear the traditional insurance market is showing signs of hardening, as such, I think the interest in captives will grow and remain strong for 2020, and I fully expect Utah to continue to be a player and a beneficiary of this interest.

Utah has a strong, stable, and diverse economy with a business-friendly attitude of cooperation and collaboration that our captives industry partners value and appreciate. We invite all others to discover this unique state and it's many opportunities as well. ■

"We are introducing one change for the current 2020 legislative session that I believe will have a strong impact on Utah's attractiveness as a captive domicile

Travis Wegkamp
Captive insurance director
Utah Insurance Department

Industry Events 2020

Don't miss your copy of Captive Insurance Times

CICA International Conference California	WSIA Insurtech Conference New Orleans	GLOBAL INSURTECH SUMMIT Istanbul, Turkey
March 08-10	March 15-18	April 21-22

The latest moves in the captive industry

Former Coca-Cola captive creator Laurie Solomon has joined LineSlip Solutions, a US cloud-hosted software firm, as a strategic advisor.

According to LineSlip, Solomon will use her more than 25 years of industry expertise, to help bridge the gap between brokers, carriers, insurers and the up-and-coming insurtech company.

Alongside her new role, Solomon will continue to oversee the running of ELT Risk Solutions, an insurance and risk management advisory firm based in Atlanta, which she founded in 2016.

Solomon also brings experience from a 21-year stint with The Coca-Cola Company, between 1995 and 2016, where she served as a risk manager and director, global risk management.

Whilst there she managed the consumer giant's captives as well as designing cost-effective risk financing and risk transfer strategies for captives.

Commenting on her new role, Solomon said: "I am excited to work with insureds and the greater risk management community to help solve some of the problems in our industry. We have so much opportunity to leverage technology and data to make smarter decisions, but adoption has been slow because insurtech typically lacks the insider's view into the realities of day-to-day processes."

"I am looking forward to introducing the industry to LineSlip and ushering in a new way of leveraging data that doesn't involve change management or retooling," she adds. ■

Mike Palmer, senior consultant at Citadel Risk, has taken up an additional role as London representative for a Bermuda captive reinsurance firm, Fergus Re.

Palmer said that he has taken on the new role "with a view to building a broker network for them to increase the portfolio and create a London based profile to grow the business."

He noted that Citadel has been working with Fergus over the past 18 months and has been using Fergus as a 'retro' style market.

Palmer said: "Fergus now has further deployed capital (and much more to come) so want to develop their own profile and brand. In the short term, Citadel and Fergus will write similar risks on the same slip/basis," Palmer said.

"This is a great opportunity for Fergus to develop in the London and European market using existing Citadel and new contacts etc. I am very excited to take on this role for Fergus and the board of directors," he adds. ■

HYPERION INSURANCE GROUP

Hyperion Insurance Group has hired three principals including a captive specialist for Hyperion X Analytics.

The three new appointments include Mark Shumway, serving as head of advisory, Iain Davie, as head of catastrophe modelling, and Michelle To, who will work as head of business intelligence.

Shumway will specialise in (re) insurance capital management, rating agency advisory, shareholder value, captive strategy, regulatory capital, and fundraising. Shumway has led advisory teams at multiple firms and worked at A.M. Best as a lead insurance credit analyst.

Davie brings over 20 years of underwriting, exposure modelling, and technology consulting experience to the team.

Davie joins from Quantemplate, an insurance technology company, where he was head of solution architecture. To brings strategic consulting, advisory, and analytical expertise to the group. She has experience in the use of enterprise data in helping clients to execute strategic growth plans in the (re)insurance market.

She joins from Aon Consulting, Bermuda, where she advised clients on growth, portfolio optimisation, and value creation.

David Flandro, managing director of Hyperion X Analytics, said: “With Mark Shumway, Iain Davie, and Michelle To now on board, and with the formation of our advisory, catastrophe modelling, business intelligence, and actuarial pillars, Hyperion X Analytics has established itself as the premier alternative in an increasingly narrow broking analytics market.”

Elliot Richardson, chairman of RKH reinsurance brokers, added: “High-level analytics capabilities obviously complement our 70-strong reinsurance broking team, especially the recent additions to our treaty area.”

“In addition, our combined capabilities allow us to bring more powerful insights with support being made available to all Hyperion clients.” ■