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Court of Appeals rules in favour of RRGs

SAN FRANCISCO 30.04.2013

The US Court of Appeals for the Ninth Circuit has affirmed a district court ruling that under federal law Nevada cannot deny a risk retention group (RRG) the right to do business in the state.

Joesph Deems, executive director of the National Risk Retention Association (NRRA), hailed the decision as "a victory for risk retention groups".

Deems said: "As in other cases where states have attempted to impose requirements on RRGs that violate federal law exempting them from most regulation outside their home state, the Ninth Circuit issued an unqualified opinion upholding the preemption provisions of the Liability Risk Retention Act of 1986 (LRRA)."

In 2010, the Alliance of Non-Profits for Insurance Risk Retention Group (ANI) was ordered by the Nevada commissioner of insurance to cease writing auto liability insurance in the state because it was not an 'authorised insurer' under state law.

The issue went to district court, with ANI winning a summary judgment that the LRRA preempts state regulation over RRGs.

On 8 April, the US Court of Appeals affirmed the district court decision.

In their decision, the judges said: "The LRRA broadly preempts 'any state law, rule, regulation or order to the extent that such law, rule, regulation or order would … make unlawful; or regulate, directly or indirectly the operation of a risk retention group'."

The court also denied the award of attorneys fees to ANI on the grounds that the LRRA's "preemption provision did not unambiguously confer a right to be free from state law" under the US constitution.

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CIT**INBRIEF**

Bermuda announces positive first quarter

Thirteen new insurers have registered in Bermuda during Q1 2013, including five new captives, according to the Bermuda Monetary Authority (BMA).

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US 2014 budget plans incense insurance industry

The Risk and Insurance Management Society (RIMS) has expressed its concerns over an administration proposal to eliminate the tax deduction for reinsurance premiums ceded by domestic insurers to their foreign affiliates.

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Court of Appeals rules in favour of RRGs

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Deems said: "While NRRA, and no doubt others, are disappointed with the court's decision to deny attorneys' fees, it is important to note that attorneys' fees have been granted in the other cases, including Greenfield v National Warranty, an earlier decision by this very court."

In a statement, Scott Kipper, Nevada's commissioner of insurance, said: "We are pleased to finally have a resolution in this case. Now we can continue to focus on maintaining Nevada's reputation as one of the best US domiciles for RRGs."

Commenting on the decision, Thomas Jones, partner at McDermott Will & Emery, said: "Once again, a federal court of appeals has confirmed that a state regulator's singling out an RRG in a discriminatory manner violates the Federal Liability Risk Retention Act. One can only hope that this is the last of judicial contests of this nature."

Bermuda announces positive first quarter

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The results are a marked increase from the seven new insurers registered in Q1 2012.

Shelby Weldon, director of licensing and authorisations at the BMA said that April has also been a busy month for registrations.

"Registrations are trending upwards, 2013 is definitely off to a very good start," said Weldon.

Eight of the new registrations were special purpose insurers (SPIs) with total premiums of more than $93 million. This included three SPIs underwriting more than $1 billion of catastrophe bonds and insurance linked securities.

"The SPIs are covering a diverse range of business activities, from excess of loss coverage, to property catastrophe reinsurance, to proportional reinsurance. The market is continuously finding various ways to utilise these vehicles to complement traditional reinsurance," added Weldon.

US 2014 budget plans incense insurance industry

Continued from page 1

The proposal, a part of President Barack Obama's proposed 2014 budget, "should be disregarded because it creates demonstrable consumer harm and results in a severe economic imbalance," said John Phelps, president of RIMS, in a letter to the US House of Representatives International Tax Reform Working Group.

The economic balance that Phelps describes would cause consumer prices for insurance to increase between $11 and $13 billion each year, while producing only $6.2 billion in new tax revenues over 10 years.

He said: "The impact of these price increases will fall disproportionately on states with cities subject to terrorism risks and those most exposed to large catastrophic risks."

According to Phelps, foreign insurers with domestic subsidiaries are critical to the continued health and vitality of the US and global insurance markets.

"Throughout the recent series of natural catastrophic events, and the terrorist attack on 9/11, foreign reinsurers have filled gaps in coverage where domestic insurers either discontinued or severely curtailed coverage or significantly increased rates."

The Coalition for Competitive Insurance Rates has also written to US members of congress, including Max Baucus, chairman of the Senate's finance committee, expressing its concerns over the budget plans.

The coalition—whose members include the Captive Insurance Companies Association and the Vermont Captive Insurance Association—described the proposed changes as "unthinkable" at a time when the administration is encouraging foreign direct investment to support the Northeast in rebuilding after Hurricane Sandy.

"[The tax] on foreign affiliate reinsurance would only serve to limit US insurance capacity and drive up the cost of insurance, a major threat to homeowners and small business, particularly those in disaster-prone states."

OECD commends Cayman

The Cayman Islands has been recognised for its "robust and transparent" legal and regulatory regime in the OECD's latest global forum peer review report.

The global peer review report was established by the OECD in 2000 as a multilateral framework that investigates transparency and exchange of information of both OECD and non-OECD countries.

The report commended the Cayman Island's financial industry for its clear and efficient system for releasing information and noted the quality of its cooperation and speedy responses to exchange of information requests.

It also noted that Cayman's exchange of information process is well organised, well resourced and adequately staffed with knowledgeable personnel.

Rob Leadbetter, chairman of the Insurance Managers Association of Cayman, said: "Cayman has a solid legal and regulatory framework that is based on a platform of tax transparency and the provision of a stable and responsive business environment."

"I can only hope that the commendations in this report will be heard far and wide and people will start to understand that Cayman is a successful international financial centre because of this high level of compliance and infrastructure."

ACE launches SPV

ACE has established a $95 million special purpose vehicle, Altair Re, to provide additional collateralised capacity for its global reinsurance business.

The capital will be used to support ACE Tempest Re's global property catastrophe reinsurance portfolio.

Willis Capital Markets & Advisory acted as structuring and placement agent on the transaction.

Jacques Bonneau, chairman of ACE Tempest Re Group, said: "Altair Re gives us additional capacity to meet the diversified property catastrophe needs of our insurance and reinsurance company clients."

"Capital markets investors will benefit from ACE Tempest Re's proven track record of conservative underwriting and consistent profitability, while the additional capital will enable us to take advantage of opportunities we see in the global property catastrophe market."

BP captive receives stellar ratings

A.M. Best has assigned the financial strength rating of "A- (Excellent)" and issuer credit rating of "a-" of Saturn Insurance.

Saturn Insurance is a captive of global oil and gas giant, BP.

The ratings reflect Saturn's strong risk-adjusted capitalisation resulting from low risk retention and excellent group reinsurance support.

Saturn also profits from low investment risk as it maintains half of its investments in cash or short-term deposits. The ratings also factor in BP's strength and commitment towards Saturn.

"Saturn benefits from low investment risk and has a very liquid portfolio. Half of its investments are held in cash or short-term deposits, and the other half is loaned back to BP with excellent liquidity conditions," said a statement from A.M. Best.

Downward ratings actions could occur if there was a significant deterioration in Saturn's risk-adjusted capitalisation linked to evidence of no financial support from its parent, BP.

Changes in reinsurance market favour mutual insurers

Mutual insurers are in a prime position to capitalise on changes in the traditional reinsurance market according to Willis Re, the reinsurance broking arm of Willis Group Holdings.

The 1st View April 2013 Renewals Report found that changing distribution models, coupled with a flood of alternative capital, have left many reinsurers concerned over both their existing portfolios and their access to future growth.

This provides mutual insurers with the opportunity to strengthen their existing relationships with traditional reinsurers and to forge new ones.

According to a recent release from Willis Re, mutual insurers have a unique ownership structure where policyholders, not external shareholders, are the ultimate owners. This means that they have less access to other forms of capital, and as a result, mutual insurers are often reliant on reinsurance to provide them with additional capital to deal with catastrophes and large losses.

Robert Swindell, executive vice president at Willis Re, said: "Traditional reinsurers are very aware that while some larger commercial buyers are reducing their use of reinsurance in this phase of the reinsurance cycle, mutual buyers value long-term sustainable relationships throughout the entire cycle."

John Cavanagh, CEO of Willis Re, said: "Seismic changes occurring in the traditional reinsurance market are clearly favourable for mutual insurers."

"Willis Re has always been a strong advocate of the long-term business models characterised by mutual insurers, and will continue to provide analytical and transactional support in this important market."

Volkswagen captive upgrades underwriting platform

Volkswagen Insurance Company (VICO) is upgrading its existing underwriting platform, which is provided by Eurobase Insurance Solutions, to synergy2.

VICO is a wholly owned captive insurer of Volkswagen and subsidiary of Volkswagen Financial Services AG, based in Dublin.

Synergy2 is a fully integrated, end-to-end insurance administration platform, configurable to individual business needs, from governance to business process workflow setup.

The new platform will support VICO's global insurance processes across a multitude of classes, ranging from property damage and business interruption through to marine.

Aine McMahon, general manager of VICO, said: "We've worked with Eurobase for a decade now. The insurance solutions team understands the complexities of our business and processes, and we trust the team to deliver a successful implementation for us."

Ian Bishop, client services director of Eurobase Insurance Solutions, said: "An environmental upgrade to the existing Synergy platform is being implemented by VICO. This presents the opportunity for the business to advance to synergy2, with its advanced workflow solution."

"VICO will benefit from the comprehensive functionality of synergy2, including improved control and data quality as well as processing efficiencies."

Tennessee governor signs new PCC legislation

Tennessee governor William Haslam has signed new protected cell captive (PCC) insurance legislation, which was passed unanimously by both houses of the Tennessee General Assembly.

The new law lowers the capital and surplus requirements for a PCC from $500,000 to $250,000. It also enables a person or a business entity to sponsor a PCC and eliminates the requirement for a holding company.

Kevin Doherty, president and chairman of the Tennessee Captive Insurance Association (TCIA), said: "This legislation was a huge priority for the TCIA and I would like to commend our government relations committee, and co-chairs Cynthia Wiel and Norman Chandler in particular for all the effort they put forth during this process."

Full details of the new legislation will be covered in a session at the TCIA's Summer Spotlight in Johnson City, Tennessee on the 25 to 26 June.

NAIC approves American Indian Liaison Committee

The executive committee of the National Association of Insurance Commissioners (NAIC) has approved the formation of an American Indian Liaison Committee.

The new committee will address insurance issues involving the cooperation and relationship between the sovereign states and sovereign tribal nations.

Jim Donelon, NAIC president and Louisiana insurance commissioner, said: "The committee will provide a forum for discussion of insurance issues unique to the American Indian community."

"This decision reflects out commitment to fostering an inclusive and equitable marketplace for the benefit of all insurance commissioners."

John Doak, Oklahoma insurance commissioner, who introduced the proposal, said: "The federal government has formally recognised more than 560 tribes residing in 34 states throughout the US. The fact underscores the need for dialogue in addressing state and tribal cooperation in the insurance industry."

Committee leadership, membership, and charges will be considered in the coming weeks.

Last month, the Delaware Tribe of Indians partnered with Delaware Tribal Financial Services to create a new captive domicile programme.

The Delaware Tribe of Indians domicile enables captive managers to help their clients form corporations in a domestic, low regulation environment with low operating expenses.

Radian ends five-year federal investigation with CFPB

Radian Guaranty (Radian), the mortgage insurance subsidiary of Radian group, has reached a settlement with the Consumer Financial Protection Bureau (CFPB)—to resolve a previously disclosed federal investigation of the company's participation in captive reinsurance arrangements.

As part of the settlement—filed in the US District Court for the Southern District of Florida—Radian has agreed not to enter into new captive arrangements for 10 years and pay a civil penalty of $3.75 million.

Radian has not entered into any new captive reinsurance arrangements since 2007.

"Radian and other private mortgage insurers entered into captive arrangements pursuant to which affiliates of mortgage lenders reinsured a portion of the risk originated by the lenders (and insured by us) in return for a portion of the mortgage insurance premiums that would have been paid to us," said a statement from Radian.

The firm relied on written guidance from the US Department of Housing and Urban Development (HUD) in structuring these captive arrangements. Radian also sought the opinions of reputable actuarial firms to ensure that the terms of their arrangements met HUD's standards.

As of the end of last year Radian had received total cash reinsurance recoveries from these captives arrangements of approximately $750 million.

Since 2008 the HUD has been investigating into the captive arrangements of private mortgage insurers, including Radian, to determine whether these arrangements constituted an unlawful payment under the federal Real Estate Settlement Procedures Act (RESPA). The investigation was transferred to the CFPB in 2011 by the enactment of the Dodd-Frank legislation.

Teresa Bryce Bazemore, president of Radian Guaranty, said: "We are pleased to put this behind us. While we believe our captive arrangements complied with RESPA and caused no harm to consumers, this settlement was an opportunity to eliminate distractions at an acceptable cost so that we can continue our primary focus of writing

new, profitable mortgage insurance and helping low down-payment borrowers realise the dream of homeownership."

Guernsey signs DTA with Hong Kong

Guernsey has signed a double taxation agreement (DTA) with Hong Kong, meaning that Guernsey has now signed full DTAs with seven jurisdictions.

In addition to the DTA with Hong Kong, Guernsey has had a DTA with the UK for many years and has signed DTAs with Malta, in 2012, and earlier this year with the Isle of Man, Jersey, Qatar and Singapore.

The DTA was signed for Guernsey by Peter Harwood, chief minister, who commented that this was an important step in growing the business links between Guernsey and the Far East.

Harwood said: "I am delighted to further strengthen our relationship with Hong Kong. The signing of this DTA, combined with the visit of the Chinese ambassador to the UK to Guernsey this week, recognises the importance attached to Guernsey's business relationship with the Far East."

"The agreement is expected to bring significant commercial benefits to our finance sector, resolving issues relating to potential double taxation, and leading to greater opportunities for new business."

In 2011, Guernsey businesses were approved to list on the Hong Kong stock exchange. Today, a number of Guernsey-based firms have offices in Hong Kong, including law firms Mourant Ozannes and Ogier, fund administrator International Adminstration Group, and fiduciary services providers Louvre, Nerine and Newhaven.

Fiona Le Poidevin, chief executive of Guernsey Finance, said: "The DTA means that individuals or companies with 'home' as one jurisdiction but with interests in the other jurisdiction will have mechanisms in place to prevent then from being taxed by both sets of authorities on the same income."

"This clarity and certainty on matters of taxation makes it more attractive to conduct business between the two jurisdictions, especially in terms of investment funds, fiduciary services and intellectual property."

Rob Gray, Guernsey's director of income tax, said: "As well as creating a mechanism for exchanging requested tax information with Hong Kong, the agreement will assist in resolving issues relating to potential double taxation of both corporate and personal incomes, such as business profits, dividends, interest, royalties, income from employment and pensions."

R&Q on the move

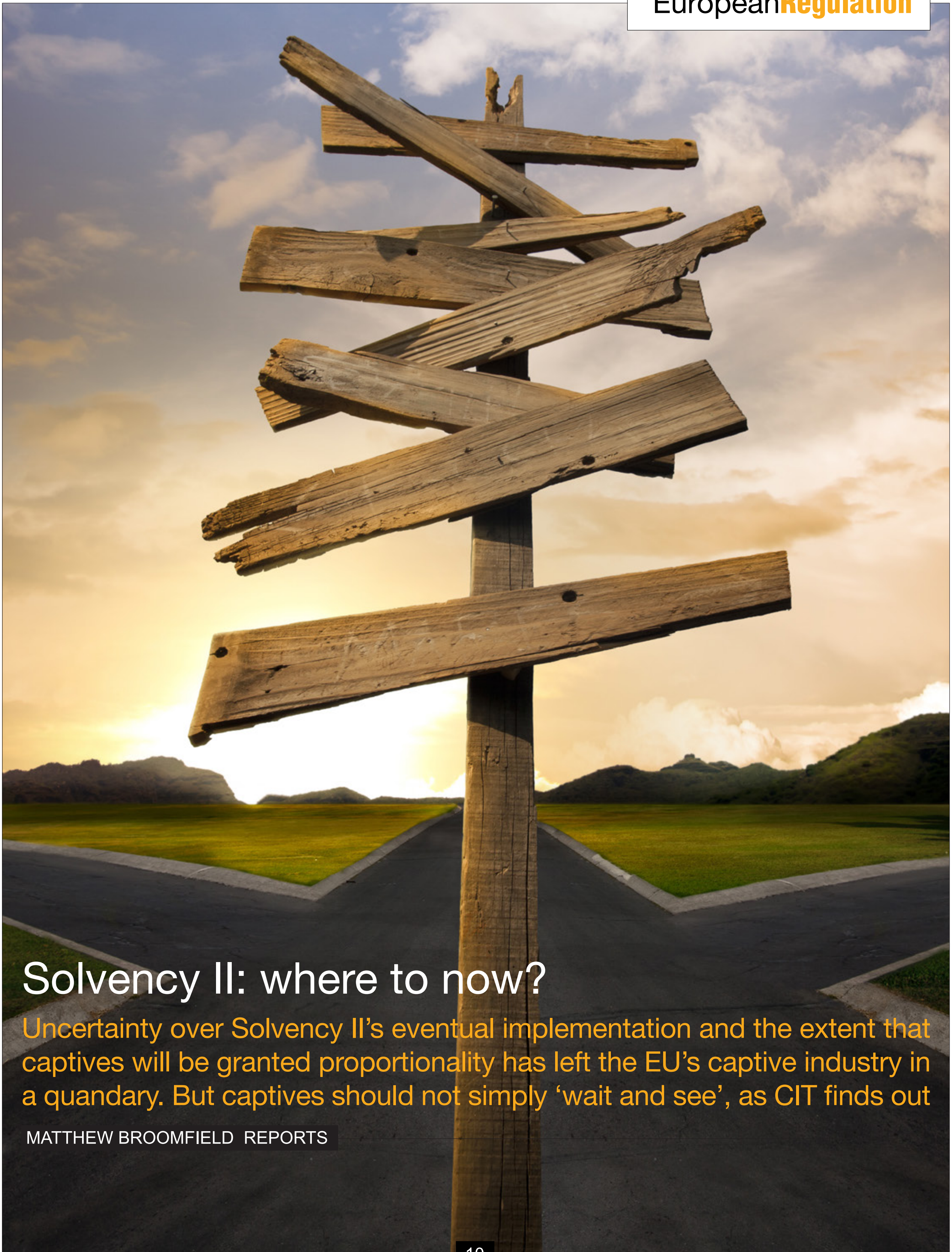
Randall & Quilter has decided to redomicile its holding company from the UK to Bermuda.

Under the redomicile proposal, all existing shares in Randall & Quilter will be exchanged for shares in Randall & Quilter Investment Holdings—the new Bermuda-based holding company for the Randall & Quilter group of companies.

"The introduction of a new Bermuda incorporated UK tax resident company as parent of the [Randall & Quilter group of companies] is being proposed for regulatory, operational and commercial reasons," said the firm in a recent statement.

Randall & Quilter's board of directors believes that by being based in Bermuda, the company will be able to develop an improved regulatory and operational platform to support continued growth and development.

The move has also been marked as an "integral step" of the firm's aim to secure enhanced transparency and certainty on its medium to long-term capital requirements in the face of a series of delays in the implementation of the Solvency II regime for European-based insurance groups.



Solvency II: where to now?

Uncertainty over Solvency II's eventual implementation and the extent that captives will be granted proportionality has left the EU's captive industry in a quandary. But captives should not simply 'wait and see', as CIT finds out

MATTHEW BROOMFIELD REPORTS

Solvency II has been a concern for EU-based captives since its conception back in 2001/2. It was not conceived with captives in mind, and the feeling has always prevailed among the EU industry that it is being accidentally involved in, and adversely affected by, legislation that is not fit for most captives' purposes.

The shadow that Solvency II casts over the EU captive industry was extended late last year with the disclosure that the directive probably would not be implemented in full until 2016 (it had previously been expected to become effective on 1 January 2014).

However, postponement does not mean more time to vacillate. The directive's delay could in fact be positive because it allows captives to gradually and properly adjust their governance structure, and make changes to their programme during the next renewals, before the directive's eventual implementation. "Captives could therefore avoid the potential costs of non-compliance or the extra costs of a fast-paced implementation," says Marc Paasch, head of financial institutions at Marsh Risk Consulting.

"For existing captives, there are no real monetary costs directly attributed to the delay in implementation of the directive—in fact one could argue that the delay saves costs for the period that the new Solvency II regime is delayed," affirms Gerard Connell, vice president at Marsh Management Services in Dublin.

And captives can still partially implement the Solvency II requirements before the official implementation, adds Connell. Any significant monetary costs incurred to date by captives relate to fees paid to service providers for the Pillar I, QIS5 Solvency Capital Requirement (SCR) calculation test conducted in 2010, and initial Pillar II gap analysis and implementation.

Connell says: "For those captives which produced a higher SCR result under Solvency II than under the present Solvency II regime, the delay in implementation gives them more time to raise the additional capital or restructure the business to achieve the required SCR under Pillar I."

More preparation, more uncertainty

Not everyone sees the directive's postponement so positively. Though the delay itself should not necessarily cause additional costs, it could mean that undertakings will have to go through a longer phase of preparation, which could possibly cause additional costs, says Carlos Montalvo, executive director of the European Insurance and Occupational Pensions Authority (EIOPA), one of three European supervisory authorities.

"Under the assumption that preparation is a one-off exercise and it takes more resources than when Solvency II will be operational, this would mean additional costs, though this assumption is not a straight-forward one."

Indeed, Paasch concedes that the situation is complicated for some captives because some domiciles have required captives to perform Solvency II exercises like the Basic Solvency Capital Requirement (BSCR) or SCR calculation. "Captives domiciled in such countries have therefore to comply both with Solvency I and some of Solvency II requirements, which is a double cost," he explains.

Also, the insurance industry should not neglect the reputational cost that the delay may bring to the Solvency II project as a whole, argues Montalvo. "Solvency II makes as much sense today as when we started, if not more, and doubts should never be on the convenience of a risk-based framework. So let's move ahead."

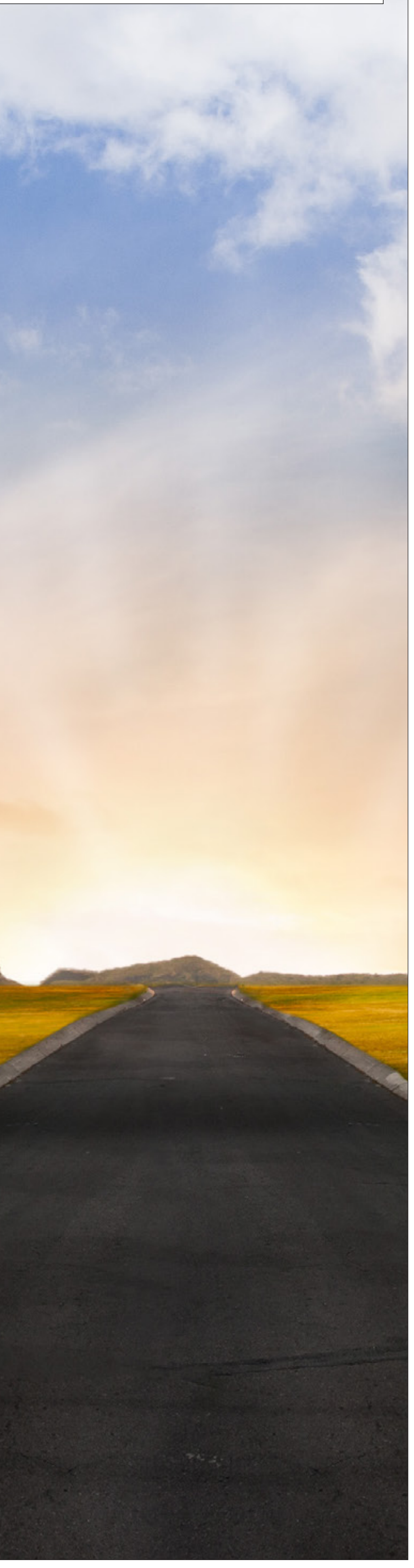
Similarly, Derren Vincent, executive director at Willis Management in Gibraltar, argues that the main cost to captive owners of the directive's delayed implementation is a loss of momentum in terms of ensuring that they are prepared for Solvency II. "One could be forgiven for taking the foot of the gas while certainty over implementation date and clarity over detailed measures is awaited," he says.

And though the directive's delayed implementation provides captives owners with more time to prepare, it extends the uncertainty around the impact of the finalised regulations, says Martin Le Pelley, compliance director at Guernsey-based Heritage Insurance Management. EIOPA is already pushing for the application of Pillar II by national insurance regulators from 1 January 2014, but some regulators are unsure about how to apply Pillar II in isolation, he says. "Furthermore, Pillar II is likely to be more of an issue for captives as the requirements for internal audit and actuarial involvement may be quite onerous for them."

The hazy concept of proportionality is another problem, he says. "Proportionality is little understood by regulators, or else it's open to interpretation, such that there may be disagreement between the licensee, manager and regulator about the risk associated with the various governance aspects for captives."

However, Vincent Barrett, managing director at Aon Global Risk Consulting, argues that EU-based captives will develop greatly in spite of any delays to parts of the directive's implementation. This is because they are subject to regulatory influences aside from Solvency II. "Most captive domiciles have adopted the International Association of Insurance Supervisors' (IAIS) 'Insurance Core Principles' (ICPs) which are broadly similar to the Pillar II requirements of Solvency II," he says.

As a result, improvements in corporate governance and risk management can be seen as a global initiative and so the delays in Solvency II have not had a huge impact on cost for captives per se, adds Barrett. "Furthermore, the recent announcement by EIOPA regarding their planned interim measures for 1 January 2014 mean to a large extent Solvency II will be implemented next year."



How to proportion proportionality?

A continuing point of contention for EU-based captives regarding Solvency II is around the issue of 'proportionality', the extent that it will be applied to captives, and what it would actually mean in practice. Although there have been few useful formal concessions for captives, the impact of Solvency II on captives will depend on how each jurisdiction translates its requirements into national law, and how its insurance regulator then applies those requirements to captives, says Mike Poulding, director at The Poulding Consultancy.

This lack of clarity over how regulators might apply proportionality to captives could lead to regulatory arbitrage, says Connell. "The general lack of any clear guidance from regulators on the matter could lead to the risk of divergent application of the principle in the different EU domiciles, thereby perhaps undermining the harmonised regulatory framework that Solvency II is meant to be."

But Connell says he is optimistic that proportionality will be applied for captives to elements of the capital costs under Pillar I, reducing the initial capital requirements for low-risk captives. Based on the principle of proportionality, some simplifications have already been allowed for the calculation of specific sub-modules or risk modules of the standard formula. Paasch gives the example that small captives can use simplifications for the calculation of the best estimate for unearned premium provisions. "If inter-company loans represent a high proportion of their investments, some captives could also reduce their capital requirement for concentration risk by implementing a specific contract with the parent company, subject to their regulator's approval," he explains.

No specific simplifications have been granted regarding Pillar II or III of the directive. For reporting, the guidelines issued by EIOPA give little flexibility to captives for implementing a simpler approach, says Paasch. However, the directive's governance requirements have not defined a precise structure or process that should be implemented, so captives can propose to the regulator their own views of a proportional governance system, he adds.

For Montalvo, the application of proportionality to captives comes down to common sense, meaning in some cases it will apply, but not in others. "The regulator acknowledges the need of implementing the very same Solvency II principles and requirements in a different way. This should allow, for example, for a simplified treatment of captives, and also specific simplifications in the Standard Formula only for captives."

Montalvo adds that captives are still insurers and so need to follow the same corporate governance and risk management standards as all the other insurers under Solvency II. "This concept is nothing more and nothing less than bringing common sense to the implementation debate," he says.

Short and long-term challenges

One of the short-term challenges is the need to put an effective actuarial function in place, says Poulding. "It looks likely that this will be required by 1 January 2014." The recent EIOPA consultation document on the guidelines on preparing for Solvency II outlines a number of issues that will need to be tackled shortly. These include corporate governance, forward-looking risk assessment (previously Own Risk and Solvency Assessment), submission of information to the supervisor and pre-application for internal models, notes Poulding. "Over the medium term, ie, by 2016, captives will also have to be in a position to calculate and meet the new Solvency II capital requirements," he adds.

Paasch, however, says that the most pressing short-term challenge for captive owners is the shift of focus in the matter of captive management. "Solvency II asks the directors to manage their undertakings with a strategic multi-year approach that takes all risks into account. This paradigm underlies the directive and is formalised through the ORSA process," he explains. Captive owners are therefore required to have defined a mid-term strategy. But this is a challenge because captives are a risk management tool for their parent companies and follow their evolution, so they have not always pre-defined a risk appetite or a multiyear business plan, Paasch says.

Implementing a compliant governance structure and improving data management (regarding confidentiality, integrity and traceability) are also two important challenges, though they should be achieved in the next two years, Paasch claims. "Pillar II and III require essentially a one-time effort; maintaining the new governance and reporting system will not be a significant challenge over the next years." However, he says that in the longer-term some captive owners may be concerned about their ability to keep meeting the capital requirements in an ongoing economic crisis.

Time to act

Despite the uncertainties surrounding the nature of Solvency II, its implementation, let alone its final impact, captive owners should not passively wait and see how the regulation unfolds. Paasch says that captive managers can assist captive owners in adjusting and completing their governance framework, for example, by providing their expertise in internal processes, data management and compliance. Captives can also rely on them for assuming some new tasks or functions required by the directive. But Paasch adds: "Strategic decisions and the shift of approach still have to be made by the captive owners; defining a risk appetite and a mid-term business plan, in a multiyear approach, is under the responsibility of the board of directors."

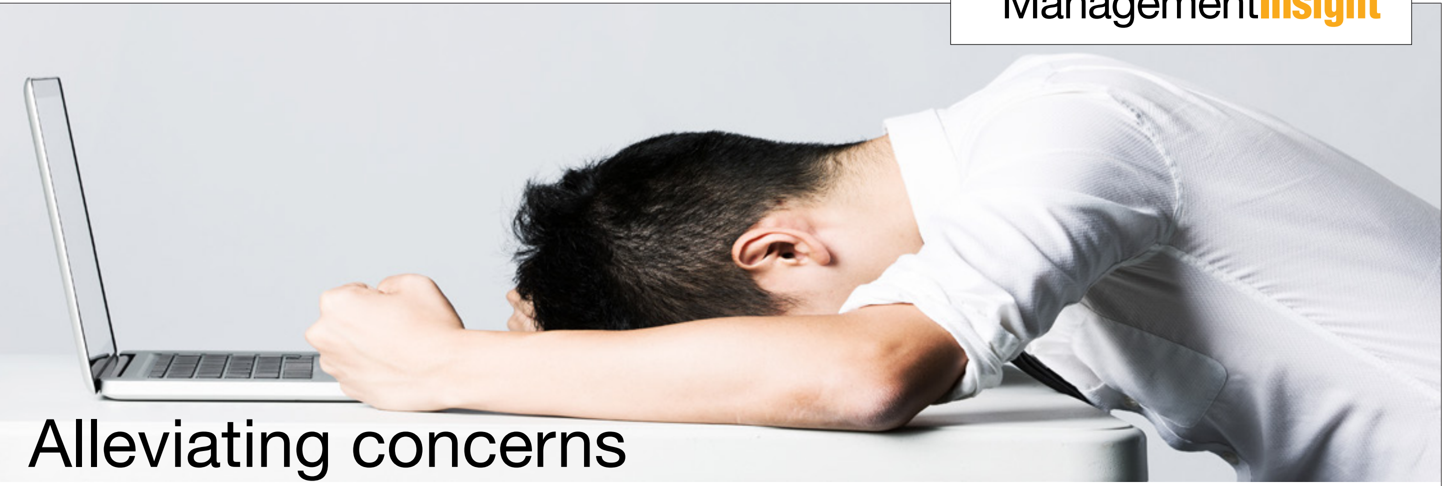
Regulators can provide captive owners with feedback regarding what their captive has achieved, for example, in terms of SCR calculation, governance structure or ORSA process. But Le Pelley says that captive owners should be asking regulators how they will be applying the proportionality principle to minimise the risk of over-regulating a low-risk captive. "They should be asking how and when the Level II implementation measures are being written into the jurisdiction's law. There is a risk that if a jurisdiction leaves it too late to enact the Solvency II implementation measures they may poorly draft key aspects of the legislation, or else not cater adequately for their market."

Montalvo affirms this point. He says: "The most obvious question to ask is, 'How do the national authorities intend to apply the proportionality principles for captives?'"

But maybe it is wrong to ask how the proportionality principle will be applied. Captive owners could instead propose their own approaches and initiate a dialogue with regulators, suggests Paasch. "The first ideas proposed to authorities could become the model for the next year's." CIT

Solvency II's tripod

- Pillar I consists of the quantitative requirements (for example, the amount of capital an insurer should hold);
- Pillar II sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers; and
- Pillar III focuses on disclosure and transparency requirements.



Alleviating concerns

CIT speaks with Ronan Ryan of Allied Risk Management about the Irish market, what to expect from your captive manager and the appropriate level of service

JENNA JONES REPORTS

How would you describe the current state of the Dublin market and has there been much of an inflow of captive business being written?

While I believe in the strength of Dublin as a captive domicile going forward, I fear for our ability to retain a certain level of the business. On updating our own list of captives recently for an annual publication, I noticed that I put a line through five companies. Four of which have been or are going through the liquidation process and one as part of a cross border merger to Malta. For the majority, these were profitable companies. What's the main reason? Is it really Solvency II? I don't know. If we look at Solvency II, what does it mean for the average captive? It means as follows:

- Same minimum capital requirement as Solvency I, but for the majority it is hard not to see a significant level of increased in solvency capital requirement (SCR)
- Production of your Own Risk and Solvency Assessment (ORSA)
- Sixty reporting spreadsheets instead of current (circa 10) reporting requirements
- Build/buy your own standard model from the standard formula instead of it being issued to you by the central bank.

With the exception of the first point above, the burden of the work will be with the captive managers to administer and manage for the captives and that will increase costs, time and resources. However, while I have no doubt that strongly capitalised captives will survive and flourish under the new regime, I'm not so sure about the rest.

Other European domiciles have been established—how competitive is the European marketplace for captive business?

I do not think it is that competitive for pure captive business. Each EU domicile has its own characteristics but essentially they are all governed by the same EU insurance and reinsurance regulations.

How important is the feasibility study when clients are establishing new captives?

It is very important. The study would be comprehensive in nature and should address the following key areas as a minimum:

- Review of the purpose and benefits of establishing a captive insurance company. The report will typically review all classes of insurance purchased and determine if participation by a captive is feasible and financially viable. This will address issues such as:
    - Policy issuance, fronting arrangements and related costs;
    - Claims management procedures;
    - Board structure and corporate governance issues;
    - Management reporting; and
    - Financial reporting.
- Consideration of capital requirements and share structure for the captive.
- Consideration of choice of domicile for a captive.
- Three-year financial projections for the captive for all viable classes of insurance, including details of all establishment and ongoing operational costs.
- Accounting and tax issues relating to:
    - Ownership structure;
    - Control; and
    - Dividend policy.
- Review of the role and responsibilities of the appointed manager of a captive.
- Critical path setting out the steps, actions and costs required to move from the design stage to the establishment of a captive.

Ireland has double taxation treaties with approximately 60 other countries—how important are they for prospective captives?

They are another piece of the jigsaw for the risk manager and group finance function on deciding on an appropriate domicile.

What is the typical time frame for establishing a direct writing captive in Dublin and how does this compare to other domiciles?

The typical time frame is four to six months depending on the quality of the submission. I would think that this is not too dissimilar to most of the other EU domiciles.

How can owners and directors of captives check if they are getting an appropriate level of service?

It is appropriate that owners and directors of captives should ask themselves if they are getting an appropriate level of service and to ensure that complacency has not crept into the relationship with their appointed captive managers.

There are a number of areas that captives should consider when reviewing the services they are receiving from their management companies:

- Resource and stability—there needs to be a team with appropriate professional skills in the required disciplines: underwriting and claims; finance and accounting; regulatory and compliance; and company secretarial and administration. Each discipline requires a special skill set that needs to be coordinated and appropriately focused on the day-to-day operation of the company. There can be a temptation for management to leave service teams to their own devices in favour of focusing on new business projects. Ensure that your service does not suffer as a consequence and remind the team manager of your service expectations from time to time. Captive managers seek to bring economies of scale by having one team responsible for the management of many client accounts.

  The service team is a key part of staffing so staff turnover or stall changes are to be avoided because this can sometimes have an adverse effect of the quality of service delivered, unless business development demands a change of skill base.

- Service delivery—failure to deliver to prior agreed service requirements will often be an indication of a service team that is over stretched poorly managed or that its focus has been otherwise distracted from servicing your company. Examples of such areas will be:
  - Failure to provide management accounts to the parent's finance department on the due date
  - Failure to submit regulatory, tax and company returns on time
  - Failure to issue premium invoices or prepare policy documentation within the terms of the service agreement
  - Failure to produce a high quality, informative, complete and accurate board papers to the directors within the agreed delivery date prior to the board meeting
  - Failure to provide draft minutes of board meetings within the agreed period following the meeting
  - Failure to address, in the agreed timeframe, matters arising at the board meeting that may require action by the managers.
- Communication—how can there be excellence in service without regular communication? Some individuals are better communicators than others, but it is important to distinguish between nice-to-have and essential. Communication on some aspects of the business is essential to ensure the efficient operation of the company.
- Awareness—your service team will be much more effective when team members are aware of all aspects of your company activities. This may manifest itself in a number of ways. For example:
  - Does your service team sit together and do they work together on several clients? This promotes cohesion within the team and an awareness of each other's strengths and weaknesses. A good team will draw on each other's strengths and compensate for weaknesses through collective responsibility.
  - Does the team work on other businesses that are likely to write similar lines of coverage to those that you need to place in your company? Practical experience of handling those classes of business in other captives can be very valuable to you.
- Proactivity in planning—it is imperative that you are satisfied that your captive manager is keeping abreast of all regulatory, compliance and corporate governance issues, for example, Solvency II, to ensure the company is in a position to fully implement these on a timely basis. Are these agenda items at all board meetings?
- Loyalty and support—at times, these qualities are called upon from your manager to address and resolve unexpected challenges that may occasionally arise. Acceptance of responsibility and commitment to your company must be expected to face these challenges to ensure full compliance to the highest standards of regulation and corporate governance.

How do you see the remainder of 2013 shaping up for the captive market in Europe?

The market will be getting ready for Solvency II's Pillar II reporting requirements, which are expected sometime in 2014. CIT

Ronan Ryan
Director
Allied Risk Management

Tools of attraction

CIT's captive experts offer differing viewpoints on how best to market European domiciles in the face of severe US and Caribbean competition

How can European domiciles market themselves better to attract more captive business?

Ian-Edward Stafrace
Risk analyst and international business development
Atlas Insurance PCC

While marketing helps raise awareness, it is the domicile's regulatory environment that is really the key to attracting captive business. The domicile can have great websites, social media, articles and advertising in technical publications, organise conferences, exhibit at global events, organise travel delegations and so on, but it will not translate into captive business if the regulatory environment is not itself attractive for captives and attuned to their needs

A good example is Malta and the fact that it is the first, and to date, only full EU member state to have adopted protected cell company (PCC) legislation.

PCCs are essentially segregated business structures. Third parties are allowed to enter the PCC as cell owners with their business segregated (ring fenced) and accounted individually in what is referred to as a 'cell'. Each cell's assets and liabilities accrue solely to the shareholders of that cell. Such cells could be used for multiple purposes such as captive risk financing tools or writing third party risks for added revenue and profit.

Being domiciled within the EU the PCC—on behalf of its cells—is allowed to direct write into Europe and this eliminates the requirement of European fronting insurers.

One of the most important features of Maltese PCC regulation is that the regulations presuppose that the individual cells will have recourse to the PCC core capital. While absolutely protected from liabilities from the core or other cells, a cell will not have to be capitalised to the minimum EU directive requirements for standalone insurers so long as such requirements are met by the PCC as a whole.

Maltese regulations establish that once the cell has exhausted all of its assets in meeting its liabilities, such a cell will have perfect access (secondary recourse) to the PCC core capital. Non-recourse provisions are allowable under regulations but solely for pure captive (affiliated) or reinsurance cells.

As an EU member state, Malta implements EU legislation and directives including conforming to, and contributing to the development of, European Solvency II regulation. The Maltese PCC provides benefits on all Solvency II pillars, causing substantial cost burden sharing and reduced own funds requirements:

- Under the quantitative capital requirements of Pillar I, the core puts up the minimum capital requirement. A cell will typically only put up own funds equivalent to the calculation of the cell's notional solvency capital requirement, which with small undertaking often falls far below the €2.3 million/€3.5 million minimum capital requirement absolute floor. A PCC may lend its surplus core capital to cells to meet their notional solvency capital requirement where in deficit and the cell will therefore always be backed by the core capital.
- A fully operational PCC will have all risk management, internal control, own risk solvency assessment process and other systems of governance requirements of Pillar II catered for under its regulated licence with cost sharing significantly benefiting cells. The same applies to Pillar III's reporting and disclosure requirements where all procedural structures and resources will be in place to meet the new extensive quarterly and annual reporting requirements as one single legal entity.

Small mono line insurers and captives struggling with Solvency II requirements could very well consider converting to cells as an alternative to consolidation or closure.

Protected cells are therefore a cost-effective, extremely flexible and secure alternative to owning a standalone insurer, reinsurer or captive. Such structures can result in significant cost and capital savings for cell owners, even more so in the EU once Solvency II is implemented.

Nicholas Bacon
Director of international markets
Nelson Levine de Luca & Hamilton

The financial factors that influence selecting a captive domicile are well chronicled. However, in many cases they produce only a short list of suitable candidates rather than a clear winner. Consequently, I encourage European domiciles to take the steps below to effectively market themselves and attract more captive business:

- Allocate sufficient marketing resources to the softer and less prescriptive factors that play an important role in determining the winning domicile, eg, an appropriate infrastructure, an experienced workforce, a dedicated and approachable regulator, and an interested and responsive legislative body.
- Develop a strategy to ensure both captive owners and brokers understand the domicile's value proposition. While the captive owner makes the ultimate decision, they almost always rely on a broker's guidance. In view the major brokers have the lion's share of the market, I recommend the domicile develops a formal communication strategy with them to ensure a full understanding of the overall captive 'experience' on offer.
- Monitor developments in the marketplace and broader risk landscape and also consider whether a competitive advantage can be gained from creating innovative solutions that allow captives to more effectively respond to capacity-constrained coverage. For example, as cyber attack becomes an increasingly common and potentially catastrophic risk that, unlike natural catastrophes, is forever changing and becoming more difficult to underwrite, could the use of captives grow to accommodate shortfalls in the commercial market.
- Understand your competitor's strengths and weaknesses and develop marketing material to respond. This becomes ever more important with the number of captive domiciles increasing each year as more US states adopt captive legislation.
- M&A is part of normal business life and, consequently, situations arise continually where either, a company that has a captive buys another company with a captive or a company with no captive acquires a company with a captive. Both scenarios create an opportunity for the captive domiciles involved but the one with the most efficient re-domiciliation legislation will be best positioned to take advantage. Ensuring that a fast track service for such scenarios exists and is supported by a clear marketing strategy will yield benefits.
- Develop client-friendly marketing materials that explain Solvency II and address inevitable questions. Although the ultimate outcome of Solvency II is uncertain it does not change the fact that it is a relevant consideration for new and existing captive owners as they develop their five-year strategy. Projecting a clear and informed view is a marketing opportunity for any EU domicile.
- Lastly, explore the feasibility of hosting industry events on matters of general market interest that will attract captive owners, prospective owners, brokers, and underwriters to spend time in your domicile, meet the regulators and develop an informed understanding of your value proposition.

In short, there is much that European domiciles can do to market themselves to attract more captive business.

Lesley Harding
CEO of global captive practice
Willis

Captive owners typically seek a European domicile with a fair yet robust governance regime, a welcoming, approachable regulator and a good selection of captive management professionals

and non-executive director candidates from which to draw a management and supervisory team.

The establishment of a captive is a strategic play for most corporate entities, not entered into lightly, but after a considerable amount of risk portfolio modelling and financial analysis has been undertaken, fiscal and legal considerations have been addressed, investment strategies identified and risk factors assessed.

After the commitment to invest has been made, and the structure determined, the parent will seek a domicile that will nurture the embryonic vehicle and support it throughout its development. A domicile demonstrating strong leadership in the area of corporate governance yet flexibility in approach when dealing with individual clients will surely win the majority of new start up vehicles. Successful operations are built on understanding and the more enlightened regulator will seek to establish a deep relationship with the captive owner and manager.

By developing a sound understanding of the parent's business and both corporate and captive drivers, the regulator can play a truly important role in the development of the vehicle once established, helping to build the capital base, develop the underwriting portfolio and support sustainable growth.

Captive managers using balance scorecards to determine the appropriateness of domicile will highly value factors such as flexibility on loaning back funds to parents and allowance of callable share in lieu of fully paid up capital, but of equal importance to the captive owner is the ability to secure quality advice and management from a number of alternative sources.

A European domicile that offers attractive financial benefits and an open supportive regulatory environment to clients soon develops a healthy labour market as more service providers flood in to provide insurance, actuarial, accounting, legal and tax support.

In summary, a regulator with vision, which is prepared to work in partnership with prospects, clients and captive managers to develop a relationship based on understanding and trust, will surely find a ready and willing reception for its domicile.

In addition to flexibility, innovation is an important factor for domicile selection. For example, domiciles that have embraced the cell structure or re-domiciliation legislation have seen their portfolios grow. Cell business remains the fastest growing segment of the captive market and domiciles that continue to exclude cell structures are missing out on a large piece of the new business pie.

While the ability for a captive to redomicile may appear a double-edged sword—captives may be lost to other domiciles as well as encourage immigration of captives—in reality any domicile demonstrating such a proven exit strategy will have a competitive advantage. The next area of innovation is related to insurance linked securitisation and other transformer type transactions and structures. This business is predicted to double in value by 2017 and the domicile that sets out to capture this business by means of conducive regulation and partners with the financiers and managers to create a low cost, responsive proposition will surely gain first mover advantage and establish a wining lead.

Dr Matthew Bianchi
Secretary general
Malta Insurance Management Association

The attraction of business is a fundamental objective of many domiciles and their governments. The influx of new business results in the creation of jobs, the increase in tax revenue and in foreign investment and could also lead to the enhancement of a particular domiciles' reputation and good-standing in the eyes of the 'outside' world. Malta is no exception to this, as it is the Maltese government's goal to attract further business to Malta, including the business of insurance and captives.

The key to attracting any type of business (including that of captives) relies on the reputation and stability of a particular domicile. This may be achieved by having a flexible—yet stable—economic, political, social, legal and regulatory framework in place. This provides a certain amount of comfort to any persons interested in setting-up shop in a particular domicile. Being a EU member, Malta does offer such assurances, since its legislation is harmonised with the rest of the EU. However, Malta also goes a step further and offers captive owners and other reinsurance undertakings innovative legislation such as legislation dealing specifically with captives as well as protected cell company and incorporated cell company legislation. Cost-efficiency is also another major factor that helps domiciles attract further business. In this respect Malta provides captives with top professional services as most of the top international insurance managers have all been established in Malta for some time, and Malta also offers international legal and accounting expertise.

Domiciles should also promote and market the advantages and benefits of establishing a captive in Malta. This should include the organisation (and attendance) of international seminars, conferences, workshops and talks. Domiciles should take an active role on the international stage by being the key players at any of these seminars, conferences, etc. This can either be done by domiciles organising such events themselves or by sharing their knowledge regarding the insurance and captive industry by setting-up promotional stands and delivering speeches and hosting talks at these events. Throughout recent years Malta has been at the forefront in this respect and thanks to the work of the Malta Financial Services Authority, Finance Malta, the Malta Insurance Management Association, the Association of Insurance Brokers and other local service providers such as law-firms—Malta has managed to promote and market itself as an attractive and feasible domicile for captives.

The dissemination and distribution of up-to-date and accurate information is a major tool for any domicile wishing to market and promote itself on the international arena. The dissemination of information should include information regarding a domicile's key features and characteristics, its primary benefits and its legal and regulatory framework. Throughout the years Malta has continuously been active in this respect. In fact market players, associations and local law-firms have constantly been providing the market, both locally and internationally, with regulatory, legal and market updates, whilst also sharing their ideas, thoughts and predictions for the future. This goes a long way in evidencing that the Maltese market is conscious and responsive to the changes that are happening in the insurance industry, and this sends a clear message to the outside world that Malta is an accomplished jurisdiction that is equipped for the future developments that are to take place in the insurance and captive industry.

Fiona Le Poidevin
Chief executive
Guernsey Finance

As the number one captive domicile in Europe and the fourth largest globally, Guernsey has to be very aware of how it promotes itself in an ever increasingly competitive marketplace. The variety of methods and tools available to jurisdictions to promote themselves has increased markedly in recent years but what has not changed is the need for domiciles to ensure they have a clear and concise message that they can put across to attract potential captive business.

This is what stood Guernsey in particularly good stead when as a jurisdiction in 2011 we announced that we had no plans to seek equivalence under Solvency II and that any changes made to the island's regulatory regime would only be made if they were appropriate to Guernsey's specialised insurance industry.

Clients appreciate certainty and clarity and I believe that is what we gave them with our early declaration in relation to Solvency II. It certainly helped us when it came to marketing Guernsey as a European domicile for captive business. Indeed, independent economic and business research firm Timetric recently attributed our Solvency II stance as a key reason behind our continued presence as the number one captive insurance domicile in Europe and why Guernsey boasted 737 international insurance providers at the end of 2012, compared to 687 at the end of December 2011. These figures have increased again this year and currently stand at 752 at the end of March 2013.

European domiciles can also position themselves in a favourable light by proving an ability to come up with new and innovative captive products that aid business. Guernsey has always ensured it has been at the cutting edge of innovation in financial services and that has been no different in the captive market. Guernsey pioneered the cell company concept back in 1997 with the introduction of the protected cell company (PPC) for use in the captive insurance sector. The subsequent success of this innovation is illustrated by the fact that the cell company is now used across the financial services world as an alternative application for the structuring of many different types of products. It has also allowed the captive model to become more accessible for small to medium-sized businesses that can enjoy a more cost-effective and less restrictive operating model for their risk management.

What the PCC has given Guernsey is a great marketing message that it can use to attract new business, particularly in less mature markets where they want to see that you have pedigree and are innovative in what you do. This means that as these markets develop they are already aware of Guernsey and recognise it as an established and leading captive domicile. This is particularly important as looking further afield—rather than just in the vicinity of Europe—captive business will be a key battleground going forward. CIT

Legally fond

CIT catches up with Crosby Sherman of the New Jersey Department of Banking and Insurance to talk about new laws, cell formation and poaching captives

MARK DUGDALE REPORTS

Why did New Jersey decide to enact a captive law, which became effective in May 2011?

The captive law was enacted as a part of governor Chris Christie's initiative to grow business opportunities within New Jersey and to provide the opportunity for businesses already headquartered in New Jersey to form or relocate their captive without having to leave the state. With the concentration of Fortune 500 companies and a sophisticated financial services infrastructure in New Jersey, I like to say we have a 'captive audience' here, so why not take advantage.

What are the specifics of the law and how does it ensure both a sustainable and prosperous environment for captives?

Those familiar with captive insurance will find the New Jersey law quite familiar as the core provisions were modelled after Vermont's successful law. Capitalisation requirements and premium taxes are virtually identical.

What has interest in establishing a captive in New Jersey been like?

Interest has been strong and continues to grow. The word has gotten out and it seems the inquiries increase weekly.

New Jersey welcomed Lumerica Insurance Company from Vermont earlier in the year—how much of a coup was this for the state?

Lumerica was our second re-domestication of a captive insurer to New Jersey, the first being Ports Insurance Company from New York. Ports America Holdings, parent to Ports, and BASF, Lumerica's parent, are companies with significant presence in New Jersey. We were excited they had the confidence in the state, the department and its processes to move their captives to New Jersey.

The state also approved its first cell captive recently—how important are these types of captives to the state? What makes New Jersey a good place for them to set up?

Cell captives appear to be a trend within the captive world that allow middle market companies to realise the benefits of a captive due to cost savings, etc. For the same reasons discussed above and below, New Jersey should be considered when thinking about a cell captive.

How has New Jersey's insurance department worked to develop the state as a viable US captive domicile?

The department has staff dedicated solely to the regulation of captives. The commissioner recognised early on the need to have this staff in place if New Jersey was to be a contender. John Talley, the assistant chief, and I are approachable, aim to be responsive and are willing to listen. We have developed a reach-out programme to help our service providers educate prospective captive owners on the particulars of captive insurance in New Jersey.

What does the department make of NRRA clarifications and the chance of these being acted on at the federal level?

The Non-admitted and Reinsurance Reform Act (NRRA) has raised awareness in the captive world of issues involving state self-procurement taxes, but there's some disagreement about whether a clarification at the federal level, if one could be gotten, would accomplish what folks are looking for. Some are concerned that specifically excluding captives from the NRRA could actually have negative consequences for the captive industry. This is an area that might benefit from more deliberation.

Federal intervention in state insurance law is often criticised—what are your thoughts on this?

State insurance regulation has proven to be very effective and continues to improve as the globe grows smaller and state regulators get smarter and work ever more closely together. Working through the NAIC, state regulators will continue to engage with federal and international regulators alike to ensure insurance regulation appropriately protects the public while remaining fair and balanced. CIT

Crosby Sherman
Chief of captive insurance
New Jersey Department of Banking and Insurance

Pump up the volume

Despite recent staffing woes at its insurance department, Arizona's tax regimes are among the primary attractions for new business. CIT finds out

JENNA JONES REPORTS

Nicknamed 'the Grand Canyon state' and best know for its desert landscape and erratic climate, it is apparent from the get-go that the State of Arizona has a lot more to offer than just insurance services.

With more than 30 states offering captive insurance services, the US is not the easiest of places to stand out in the market. But with a cumulative count of 101 captives at the end of 2012, according to the Arizona Department of Insurance, the state is steadily moving up the ranks.

Arizona did not pass its captive insurance laws until 2002. Starting with four new captives, growth jumped to double digits annually through to 2008.

Peter Kranz, managing director at Beecher Carlson, explains that while growth has been quite steady "in recent years, in part due to the economic downturn and M&A activity, that growth has slowed".

Currently, more than 75 percent of captives in Arizona are pure captives, with nearly 70 percent of those in the healthcare, construction or financial services industries, explains Kranz.

"Arizona captives can write all of the standard commercial property and casualty and liability lines of business—over a quarter of captives in Arizona write or reinsure workers' compensation, general liability and medical professional liability."

"Arizona typically attracts sophisticated risk financiers and has a significant presence in the healthcare, construction and financial services sectors."

But for Kranz, the most tangible benefit to domiciling a captive in Arizona is that there is no premium tax, which is particularly attractive to larger captives that would be pushing up against a $150,000 to $200,000 cost in other domiciles.

The regulatory bulletin from the Arizona Department of Insurance for its captive insurance programme states: "Arizona captive insurers are not required to pay state premium taxes … this omission is crucial because comparison to captive insurance laws in other domiciles, US and alien, plainly shows that when captive insurance premiums are taxed it is according to a schedule specific to that form or insurance rather than that at the rates applicable to ordinary commercial insurance business."

"As evidenced by the legislative history, the Arizona legislature made a deliberate decision to enact a statutory scheme that would not impose premium taxes on these specialised insurers."

Kranz also adds that the state is well positioned geographically for companies whose primary operations are located on the West Coast.

While Arizona may not be the most obvious choice when selecting a US domicile Kranz believes that the lack of premium tax charges is certainly a "huge plus" for the state.

"A few other domiciles have tried to replicate this benefit, but interestingly the growth of those domiciles hasn't been with the large captives or parent organisations."

"In attracting large, sophisticated organisations, Arizona has developed a business friendly environment that is committed to the captive insurance industry."

With experienced Caribbean domiciles such as the Cayman Islands, Bermuda and Anguilla within close proximity of the US, it is understandable for American firms to venture offshore. But according to Kranz, the allure of offshore has depleted in recent years.

"For captives of US-based parent companies, in particular, the benefits of going offshore have really dissipated over the last decade or so … [and] when you look back to 2008 and the global recession, the perception of going to an exotic location really took a hit."

"At least temporarily, that mindset hasn't changed with US companies—current economic policies in the US are leaving open significant questions about a continued recovery so finances will stay under close scrutiny. Further, over the past decade in particular, more jurisdictions have joined the captive world and more captive infrastructures (regulatory and service provider) have greatly matured—the appeal of some offshore domiciles is that they 'know insurance' but that is just not the playing field anymore as the industry in whole domestically has grown as mature and possibly more dynamic."

But though US parents are currently more likely to opt for onshore, the current turnover of staff in the regulatory regime in Arizona could well discourage potential firms from choosing the state as it "[raises] questions about the consistency of how captives will be regulated and handled," says Kranz.

In July last year, Christina Urias resigned as the director of Arizona Department of Insurance. Also in 2012, Stephanie Lefkowski resigned as chief analyst of the insurance department's captive division.

But Kranz is hopeful that the recent confirmation of Gerrie Marks as the new director and Vince Gosz as chief analyst could turn the state around.

"Vincent Gosz is committed to the captive industry succeeding in Arizona and has demonstrated that commitment in his dealing with existing captives during his short time onboard."

"I can tell you firsthand that Gosz seems like the guy who can change [the] perception [the state] and bring some stability and strong leadership in Arizona." CIT

Access (not) denied

Douglas Powell and Burke Coleman of Demotech review the recent US Court of Appeals decision on Nevada and report on the current status of risk retention groups

The latest financial reports and recent legal developments have risk retention groups (RRGs) well positioned for the future. Year-end results for 2012 present continued positive financial performance for RRGs and a recent decision from the US Court of Appeals for the Ninth Circuit should promote a more competitive and well-defined marketplace going forward for RRGs.

Legal analysis

One of the most significant legal issues facing RRGs is their regulatory treatment by non-domiciliary states. The Liability Risk Retention Act of 1986 (LRRA) exempts RRGs from much state regulation and prohibits states from discriminating against RRGs. Still, some states have ignored these provisions and imposed overreaching regulations on RRGs.

The Ninth Circuit recently issued an important decision for RRGs, upholding the protections afforded to them by the LRRA. The court found that a state cannot deny an RRG's right to provide insurance in the state.

In Alliance of Nonprofits for Insurance, Risk Retention Group v Kipper, the court determined that an order from the Nevada's insurance commissioner preventing an RRG chartered in Vermont from providing first dollar auto liability coverage for its members in Nevada was a discriminatory act in violation of the LRRA. Nevada argued that its state law requires minimum auto liability insurance to be provided by an insurer with a certificate of authority from the state. Nevada also argued that because the foreign RRG lacked a certificate of authority, it was unauthorised to provide such coverage.

Applying the plain language of the LRRA and an earlier Ninth Circuit decision, the court upheld a district court ruling that the LRRA preempts Nevada law and held that a state action discriminates against an RRG if it "differentiates between insurance providers without an acceptable justification". In this case, Nevada's commissioner offered no acceptable justification for denying the RRG's right to conduct business in the state.

The court also dismissed the commissioner's suggestion that the RRG could have complied with Nevada law by entering into a fronting arrangement with an authorised insurer. The court stated that "one of the main purposes of the LRRA's enactment was the elimination of state-law hurdles to interstate operation".

The decision is not surprising, given the plain language of the LRRA and the court's previous ruling on the issue. Nevertheless, the holding is important for RRGs, affirming that the LRRA preempts state law and that states cannot deny an RRG's right to do business in the state. The LRRA provides important protections for RRGs where non-domiciliary states overreach with discriminatory regulations. RRGs should be encouraged by the Ninth Circuit's application of the law.

Balance sheet analysis

RRGs collectively reported financially stable results as measured both by liquidity and leverage.

Liquidity, as measured by liabilities to cash and invested assets, at year-end 2012 was approximately 65.3 percent. A value less than 100 percent is considered favourable. This indicates an improvement for RRGs collectively, as liquidity was reported at 69.4 percent at year-end 2011. Moreover, this ratio has improved steadily each of the last five years.

Leverage, as measured by total liabilities to policyholders' surplus, for year-end 2012 was 123.3 percent. This indicates an improvement for RRGs collectively, as leverage was reported at 138.3 percent at year-end 2011.

Over the five-year period from 2008 through 2012, RRGs as a whole have increased policyholders' surplus by 69 percent. This increase represents the addition of more than $1.4 billion to policyholders' surplus. During this same time period, liabilities have increased only 11.7 percent, a little more than $440 million.

Income statement analysis

RRGs reported an aggregate underwriting gain for 2012 of nearly $188 million, an increase of 19.4 over the prior year. Further exhibiting these favourable underwriting results is the combined ratio reported by RRGs collectively. The combined ratio, loss plus expense, for year-end 2012 was 83.5 percent. This indicates an improvement, as the combined ratio was reported at 88.5 percent at year-end 2011.

RRGs collectively reported net income of over $322 million, an increase of 5.7 percent over the prior year. For a historical perspective, RRGs have reported an underwriting gain since 2004 and positive net income at year-end since 1996. The financial ratios calculated based on year-end results of RRGs appear to be reasonable and positive. It is important to note that while RRGs have reported net underwriting gains and net profits, they have also continued to maintain adequate levels of policyholders' surplus while increasing DPW period over period. These reported results indicate that RRGs collectively are adequately capitalised and able to remain solvent if faced with adverse economic conditions or increased losses. CIT

Douglas Powell
Senior financial analyst
Demotech

Burke Coleman
Legal counsel and compliance manager
Demotech

2013

05 May

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European Insurance Forum 2013

Location: Dublin
Date: 9-10 May
www.europeaninsuranceforum.com

DIMA's annual conference, the European Insurance Forum, will gather some of the leading minds and voices in the European re/insurance industry to examine the important-and relevance-of the industry both within the largest trading bloc in the world, and in a global context.

Captives and Corporate Insurance Strategies Summit

Location: Toronto
Date: 22-23 May 2013
www.captivesinsurance.com

This summit is the only forum dedicated to providing Canadian risk managers and captive owners with the business intelligence they need to maximise the effectiveness of their corporate and captive insurance programmes.

Airmic Conference 2013

Location: Brighton
Date: 10-12 June 2013
www.airmicconference2013.com

The Airmic Conference 2013 will open its doors to over 800 UK industry buyers and sellers of the insurance market seeking to keep up-to-date with trends, discover new service providers, learn and network with their peers, and be inspired by our keynote speakers.

Western Region Captive Insurance Conference

Location: Arizona
Date: 10-12 June 2013
www.westerncaptiveconference.org

The Western Region Captive Insurance Conference is the perfect source to gain understanding by interactions with the regulators from Arizona, Missouri and Utah, experts from all segments of the captive industry and owners and managers of captives and RRGs. The conference caters to those who are both new and old to the captive industry detailing what works and what is important to the industry. Join us as an attendee, session speaker or exhibitor!

Industry appointments

The Bermuda Monetary Authority (BMA) has named **Craig Swan** as managing director of supervision, a new executive post to lead all of its supervisory functions.

Swan has been appointed to the role with immediate effect and will report directly to Jeremy Cox, CEO at the BMA. He previously held the role of director of insurance supervision at the authority.

The new post has strategic responsibility for all the BMA's supervisory activities, including the supervision of banks, trust companies and investment businesses, as well as insurance supervision.

In a recent statement, Cox explained that the new position reflects the next phase of strategic evolution for the BMA.

"We are very pleased that an existing member of our leadership team will take on the challenge of this new role. Swan brings strong technical skills to this position, and his experience in building a very effective infrastructure for enhancing Bermuda's insurance framework will be of great benefit moving forward," said Cox.

Commenting on his new role, Swan said: "I am looking forward to contributing to the authority in this capacity. Bermuda's financial sectors are very innovative and remain focused on maintaining leadership in challenging conditions. The BMA also has a key role to play in enhancing Bermuda's reputation overall as a leading financial centre."

Global reinsurer PartnerRe's global property and casualty business unit is going to be split into two teams to meet the needs of the company's clients in mature and high-growth markets.

Both new teams will report to Emmanuel Clarke, CEO of PartnerRe Global.

To facilitate the changes PartnerRe has made a number of promotions and new appointments.

Christopher Renia, head of credit and surety, global specialty lines, has been promoted to head of mature markets, property and casualty.

Salvatore Orlando, head of property and casualty in Mediterranean Europe, Middle East, Africa and Latin America, has been promoted to head of high growth markets.

Chief underwriting officer for property and casualty global, **Scott Alstadt**, has been promoted to chief underwriting officer for all global business units.

Patrick Chevrel, head of specialty property lines, has been promoted to head the newly formed global accounts team, which will focus on providing reinsurance solutions to PartnerRe's worldwide clients.

Chevrel will co-report to Clarke and Tad Walker, CEO of PartnerRe North America.

Finally, **Alain Flandrin**, head of property and casualty, will relocate to Singapore to lead PartnerRe's growing Asia Pacific platform.

Clarke said: "These organisational changes reflect our focus on providing efficient solutions to meet the evolving needs and reinsurance buying preferences of our clients. I congratulate Renia, Orlando, Alstadt, Chevrel and Flandrin on their appointments and I am confident that they will provide excellent leadership in their respective new roles."

KPMG has appointed its former head of Solvency II, **Phil Smart**, to the new role of UK head of insurance.

As head of Solvency II for KPMG, Smart assisted the firm's clients with all aspects of implementing the new regime.

Smart joined KPMG in 1991, and has been a partner for the past 10 years. During his duration at the firm, he has been client lead partner for a range of international and financial services groups.

Smart said: "The insurance industry continues to face a range of challenges, including increased regulation, capital constraints and operational inefficiencies, all in the context of high levels of market competition. I look forward to building on KPMG's existing strong track record of delivery and industry expertise in assisting clients in dealing with these issues."

Bill Michael, EMA head of financial services at KPMG, said: "Smart brings energy, enthusiasm and tremendous market profile to the role. After a number of recent successes in the marketplace, he is perfectly positioned to further develop our insurance practice."

Matt McCabe has joined Marsh's growing network security and privacy practice as a senior vice president. He will be based in New York and report to Bob Parisi, Marsh's network security and privacy practice leader.

In his new role, McCabe will be responsible for advising clients on emerging cyber security trends and ways in which they can address their data and privacy needs.

McCabe most recently served as senior counsel to the US House of Representatives committee on homeland security, where he advised congressional representatives on federal, state and local policy involving cyber security, data protection and privacy law.

Parisi said: "I am pleased to welcome McCabe to Marsh. His experience and knowledge of today's most pressing cyber security issues will help provide our clients with invaluable insights and identify new challenges before they become problematic."

According to a recent Marsh benchmarking report, more companies are turning to cyber insurance to protect their firms from the financial consequences of a cyber attack. The number of US Marsh clients purchasing cyber insurance increased 33 percent in 2012 over 2011.

York Risk Services Group has appointed **Jim Ossner** as vice president of sales for York Alternative Risk Solutions (York ARS).

Ossner previously held the role of assistant vice president of strategic alliance business development at Chubb Specialty Insurance.

Rick Stasi, president of York ARS, said: "Ossner has 24 years of industry experience and will be a great asset to our alternative risk solutions team."

The services of York ARS include captive management, administration for captive programmes and self insured groups, claims administration, loss control, and premium audit services.

The company provides services to alternative risk transfer programmes encompassing a range of risk financing structures including self insured groups, group captives, agency captives and risk retention groups. **CIT**

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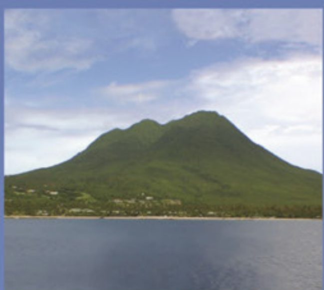

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