CIT CAPTIVEINSURANCETIMES

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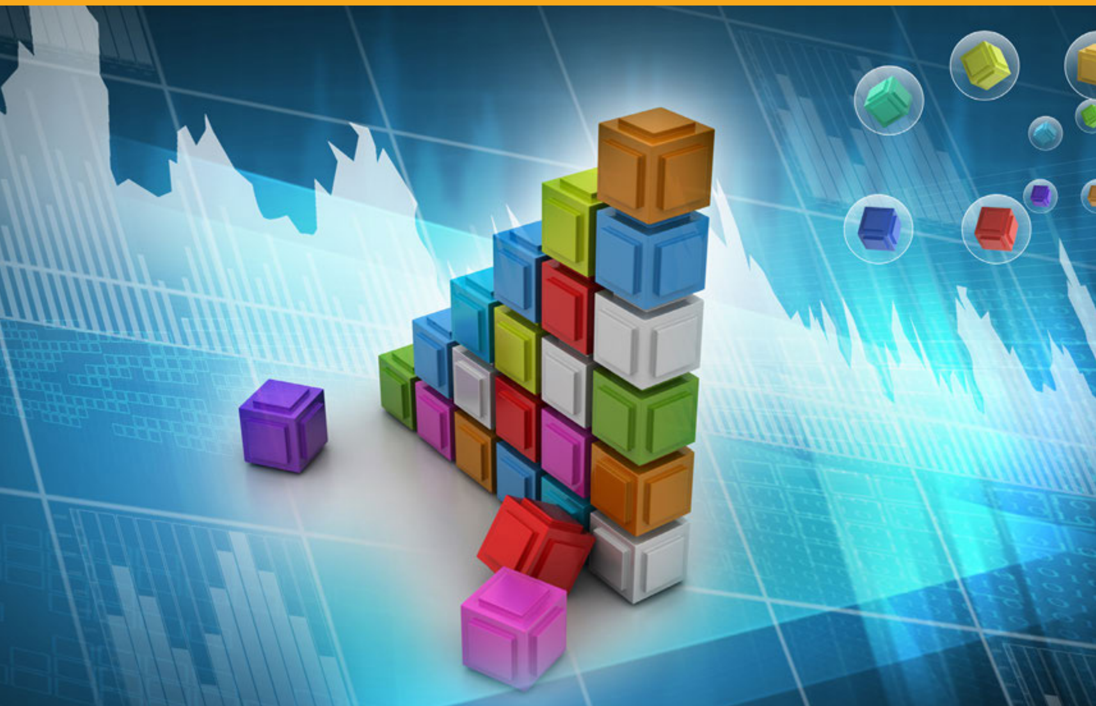

Maersk Group establishes captive to bring down rising insurance costs

The Maersk Group has established its own captive insurance company.

The establishment of Maersk Insurance has led to a decline in the amount, previously $100 million per year, that the Danish conglomerate pays out to insurers.

Earlier this year, Maersk experienced what it called a “stark reminder” of the constant risk it faces after 517 containers were lost overboard and another 250 were damaged during a storm in the Bay of Biscay.

Although the financial cost of the incident is still being assessed, Maersk has stated that it could be as high as $15 million.

In 2010, it was estimated that the group was spending between $300 million and $350 million per year on insuring its assets.

“We have a big balance sheet and can retain a lot of risk ourselves,” said Lars Henneberg, head of risk management for the Maersk Group, on the decision to launch a captive.

“It means we don’t have to pay a premium to the external insurance market.”

Typically, losses below $1 million are taken on by the business unit, while the group will take on losses of up to $50 million.

An ongoing risk assessment programme has been put in place to examine areas of concern for Maersk on a yearly basis.

Feldman Law Firm expands its offering

The Feldman Law Firm LLP is to expand its services into tax controversy work and audit defence of captive insurers managed by third parties.

The firm explained that, although Internal Revenue Service (IRS) audits are infrequent, they are “comprehensive, time consuming, and demand a significant amount of supporting legal and financial documentation”.

Attorney Logan Gremillion commented: “For the last 16 years, we have successfully guided captive insurers administered by [our partner firm] Capstone through IRS audits, IRS Appeals and the US Tax Court.”

readmore p2

Schroeder: so much more to captives

Setting up a captive insurance programme primarily for tax purposes could get owners and managers into serious trouble, according to president of Roundstone Insurance, Michael Schroeder.

These comments follow in the wake of news that, as of fiscal year 2015, Healthcare Services Group (HSG) will transition its workers’ compensation and certain employee health and welfare insurance programmes to HCSG Insurance, its wholly owned captive insurance subsidiary.

The resulting tax benefit of doing so has been claimed by HSG to be its main motivation, in the hopes that it will “favourably impact on cash and marketable securities by approximately $20 million upon full funding of the captive”.

readmore p2

Feldman Law Firm expands its offering

Continued from page 1

"The firm is now offering its services on a case-by-case basis to those who are involved in varying stages of tax controversy with the IRS in the captive insurance area."

The head of Feldman's tax department, Steven Cohen, said: "We have recently represented three Capstone-administered captives in cases docketed in the US Tax Court in which, ultimately, the IRS conceded the tax-payer's position in full, resulting in no change in tax due."

Another programme offered by the firm is a full-scale 'health check up', in which all aspects of planning carried out by third-party captive managers is examined for federal and state tax and domicile compliance.

Schroeder: so much more to captives

Continued from page 1

The captive was originally formed in January 2014 to provide Healthcare Services Group with "greater flexibility and cost efficiency" in meeting its property and casualty and health and welfare needs, including health insurance requirements for individual client facilities mandated by the Affordable Care Act.

Additionally, upon completion of its reorganisation, the group said it expects to accelerate, the deductibility of estimated current and future insurance claims.

Schroeder said: "As opposed to going self-insured completely, with a captive you gain broader access to the reinsurance markets, which for workers' compensation is very important."

"Also, by forming a captive you bring some discipline into your claim reserving and claim management functions. Claims, loss control, underwriting, or actually pricing the risk to your operating companies—all of those things come with owning an insurance company and that's what a captive is."

European insurers ready for Solvency II

The insurance sector is, sufficiently capitalised in Solvency II terms, according to EU-wide insurance stress tests conducted by the European Insurance and Occupational Pensions Authority (EIOPA).

The stress test results showed that the insurance sector is more vulnerable to a 'double hit' stress scenario that combines decreases in asset values with a lower risk-free rate.

However, 56 percent of the companies surveyed would have a sufficient level of capital under the most severe 'double hit' stress scenario.

The major vulnerabilities as per the insurance specific stresses were mass lapse, longevity and natural catastrophes.

As a follow up to the stress tests, EIOPA issued a set of recommendations to national supervisory authorities (NSAs) to address the identified vulnerabilities.

Regarding these, NSAs are recommended to engage with companies to ensure that they have a clear understanding of their risk exposures and their vulnerability to given stress scenarios and that they have the capacity to take recovery actions if those vulnerabilities materialise.

Gabriel Bernardino, chairman of EIOPA, said: "EIOPA's stress test 2014 was a truly preventive supervisory tool."

"It gave EU supervisors an updated picture of the undertakings' preparedness to comply with the upcoming Solvency II capital requirements and by applying a set of rigorous and severe

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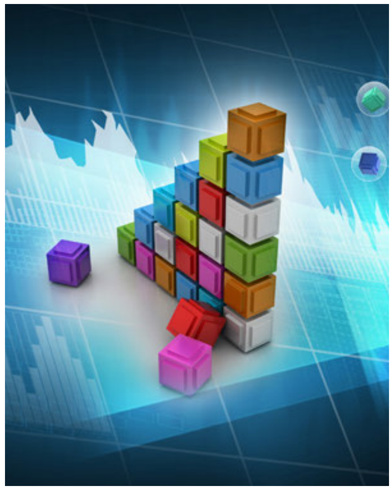


Latest news
Barnett Waddingham launches Siimplify for Solvency II reporting
p4

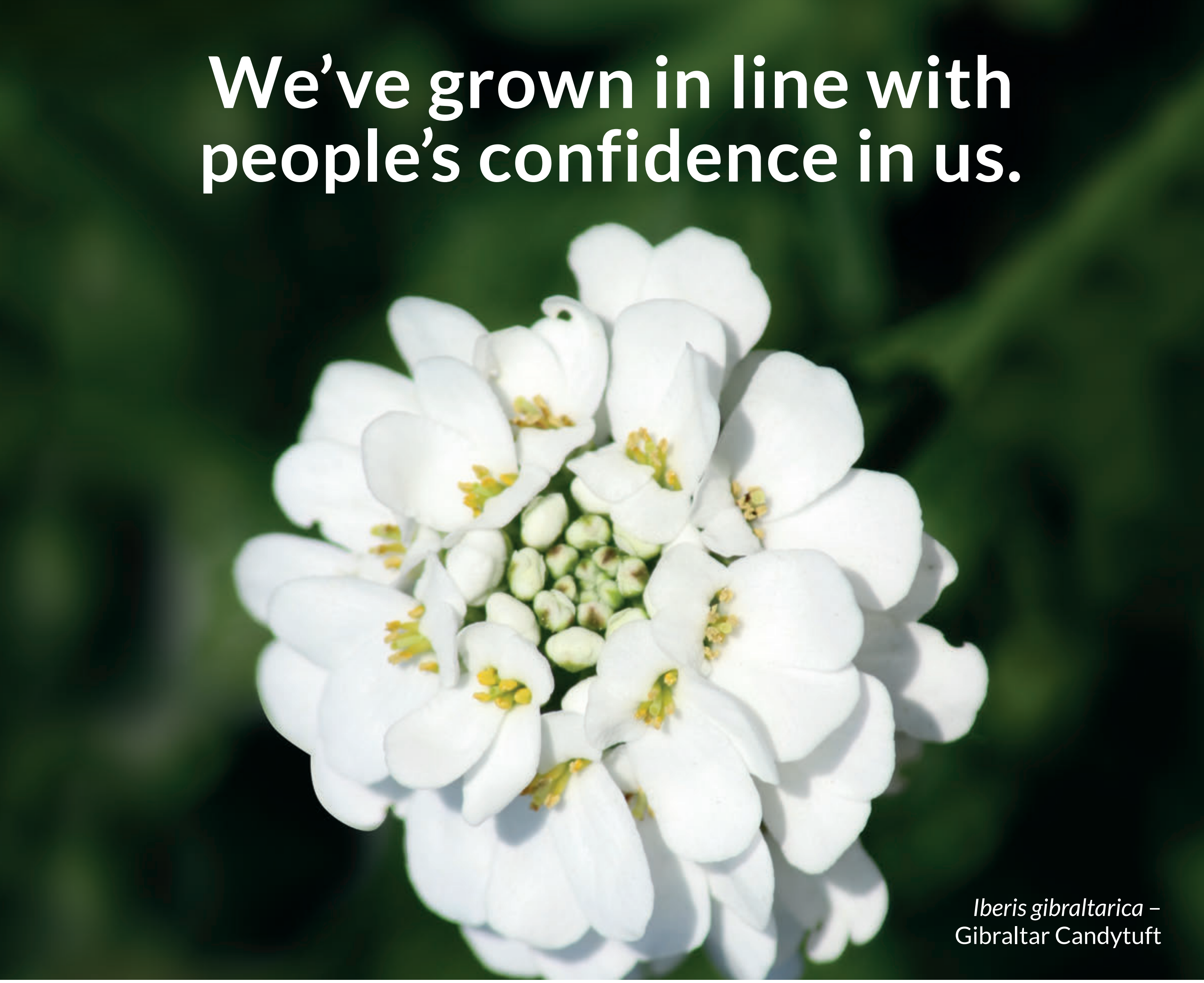
Latest news
SRS celebrates 10 years in Cayman
p6

Latest news
Advantage to join Lloyd's insurance market
p7

Tax recap
Recent cases have proven that captives need jurisdictions with appropriate regulation
p10

Domicile profile
DC's captive insdustry is poised for the next stage in its evolution
p12

People moves
Leonardi to leave Connecticut and moves at AIG, Aon and Heritage
p14



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Gibraltar embraced captive insurance in the 1980's and in 2001 became the first EU jurisdiction to offer Protected Cell Company (PCC) legislation – widely used within insurance company structures writing both general and life insurance business.

In 2012, captive insurers achieved total gross premium income of nearly £800m. Three are PCCs managing over 30 cell companiwes. One insurance manager has created 50 cells with its PCC being the largest in the EU providing solutions for cell captives and fronting cells.

Gibraltar's vibrant insurance sector has almost 60 insurance companies currently writing new business and in 2012 wrote over £3.8bn of gross premium income – with Gibraltar motor insurers accounting for 16% of the UK market.

Gibraltar offers bespoke insurance solutions for companies not currently domiciled with the European Union.

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Within the European Union Single Market

stresses indicated to us the areas where undertakings are most vulnerable."

"EIOPA's recommendations will ensure that the vulnerabilities identified are addressed and that follow-up actions by NSAs will be taken in a consistent way."

Participation in the stress test went above EIOPA's target, which was to have at least 50 percent of the insurance market of each country.

The core module exercise was completed by 60 groups and 107 companies, while the low yield module was completed by 225 companies.

Olav Jones, deputy director general at trade body Insurance Europe, said: "As pointed out in the recommendations of this report, there is still work for both the industry and national supervisors to do in preparation."

"To that end, the industry continues to work hard with EIOPA and national supervisors to prepare for Solvency II implementation."

Barnett Waddingham launches Siimplify for Solvency II reporting

Insurance actuarial consultancy Barnett Waddingham has unveiled Siimplify, a new solution that enables insurance firms to calculate Solvency II standard formula capital requirements for their business.

Siimplify has been designed to produce numbers in a standard reporting format, whilst also enabling firms to have less reliance on actuarial resources and more control of their capital management and reporting.

The solution has been developed so that findings can be presented numerically as well as graphically, which is intended to help facilitate strategic decision making.

Siimplify also provides scenarios to help firms with capital optimisation and embedding of risk management.

Kim Durniat, partner at Barnett Waddingham, said: "With Solvency II coming into force on 1 January 2016, firms need to have an efficient year-end regulatory process that has a good structure and meets all the requirements so that the transition from Solvency I to II will be a smooth one."

"Siimplify allows insurance firms to position themselves well to comply with Solvency II requirements and enables them to quickly and easily calculate capital levels and meet reporting requirements with minimal hassle."

"It will also provide a solution to integrate capital management and risk management, enabling the embedding of Solvency II."

Heritage buys 40 percent of Aro's shares

Aro Underwriting Group has completed the sale of 40 percent of its shares to Heritage Group, the Guernsey-based provider of insurance and financial services.

Heritage has acquired shares from an existing shareholder and also invested in new shares in Aro, a UK schemes specialist managing general insurance agent.

Heritage has stated that, in partnership with the Aro management team, it will be investing further in the business over the next three years.

Aro managing director James Bright said: "We have proved, over the past 12 months in particular, that our approach to schemes works well in the UK regional market."

"With Heritage on board, and support from 'A' rated capacity across 10 products, we are set to grow the business into some very exciting new areas in 2015."

Heritage Group chief executive Richard Tee said: "Heritage has an on-going strategy of seeking and investing in specialist businesses that combine well with the expertise within the group."

"We have been really impressed by Bright and the Aro Underwriting team and we're looking forward to the opportunities this investment will bring."

Technology main concern for Canadian insurers

Sixty-five percent of Canadian insurers plan to increase spending on technology in 2015, according to research by Xchanging Insurance Services.

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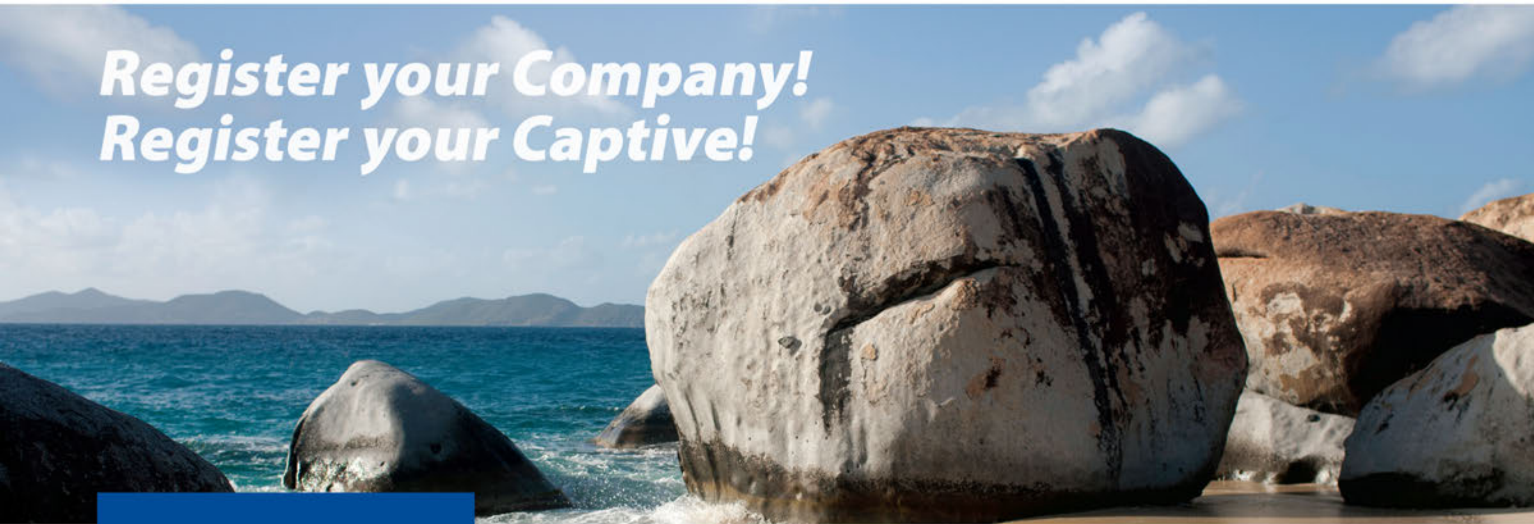
The British Virgin Islands (BVI) is one of the world's leading financial centres for international business including fiduciary services, trust and estate planning, securities and investment, mutual funds establishment and administration, administration and management of captive insurance companies.

The BVI boasts a number of advantages for captives:



...one of the world's premier domiciles for

captive insurance

- Maintaining strong regulatory standards and has signed tax information exchange agreements in recent years that place the domicile on the OECD's white list of favourable global domiciles. The legislation and regulation is also flexible in its application, and compares favourably to competing jurisdictions.
- A competitive pricing scheme in comparison to its major competitors. It is therefore relatively easy to obtain affordable structures.
- No requirement to hold board meetings in the BVI. This can save an entity significant cost, time and effort.
- No requirement to capitalise a captive in the territory with a BVI bank.
- The BVI is very popular for 831(b) elections and we have the capacity of 953(d)s. The domicile is more global in terms of captive formation which strengthen BVI's offering internationally.
- International memberships with Organisation of Economic Cooperation and Development (OECD), International Association of Insurance Supervisors (IAIS), Group of International Insurance Centers Supervisors (GIICS) and Caribbean Association of Insurance Regulations (CAIR) confirm the client's confidence in our reputation as a trusted and reliable jurisdiction.

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When asked about specific technology categories that would receive more investment in 2015, 31 percent cited quoting/underwriting portals as the top priority, followed by big data/analytics (28 percent) and mobile applications (20 percent).

When asked about their companies' most valued claims-related technologies, more than half (54 percent) cited predictive modelling/analytics.

Only 14 percent of respondents pointed to cyber security solutions as the most valued technology.

When asked about the top three challenges of 2015, modernisation of core technology infrastructure (23 percent), increased competition (23 percent), and developing innovative products and services (20 percent) were cited most.

Increasing market share (41 percent) and reaching customers in new ways and through multiple platforms (23 percent) were cited as the top two business goals, affirming the value placed on technologies like mobile applications.

Surprisingly, breaking into new insurance markets was ranked as the least important goal with less than one percent choosing it as the top business goal.

"With approximately $46 billion in direct premiums written, it's clear that the Canadian market is growing exponentially," said Sean Allen, vice president of sales for Xchanging Insurance Services, North America.

"It's encouraging to see the market making a concerted and dedicated effort toward investing in modernising its technological infrastructure to better serve its growing customer base, capitalise on growth opportunities and ward off rising competition."

The survey, undertaken in partnership with Insurance-Canada.ca, was conducted in October and November via the website's newsletter subscriber base and relevant Canadian insurance LinkedIn groups.

Eighty-three percent of respondents were from property and casualty, with the remainder working in life and annuity, reinsurance and multi-line.

SRS celebrates 10 years in Cayman

Captive management and consulting firm Strategic Risk Solutions (SRS) has celebrated its 10-year anniversary at the Cayman Captive Forum.

The company's Cayman based subsidiary, SRS (Cayman) was formed and licensed in November 2004.

Since its formation, the company has grown to be the fourth largest captive manager in the Cayman Islands with 75 under management.

"It has been exciting to see the company grow to its current position in Cayman and fill the need for a high quality independent captive manager," said Wayne Cowan, vice chairman of SRS (Cayman).

"Having worked in the Cayman captive industry for several years, I always believed that the SRS model of quality service and value added consulting would be successful."

Cowan started at the company in 2005 and was joined by co-managing directors Ron Sulisz and Seamus Tivenan.

The three have led SRS Cayman through most of its history.

The company has recently added a fourth managing director in Dan MacLean who joined from Aon Insurance Management in September 2014.

Brady Young, president of SRS, said: "I want to thank and congratulate Sulisz, Tivenan and Cowan for their hard work, dedication and professionalism in establishing SRS as one of the leading captive management firms in the Cayman Islands."

"Our success has been driven by putting seasoned captive insurance professionals in a position where they can focus on the needs of their clients."

Osborne lands prestigious TCIA award

USA Risk Group president Gary Osborne was awarded the James Hinton Captive Insurance Volunteer Award by the Tennessee Captive Insurance Association (TCIA) at its recent annual conference.

The award is presented annually to an individual who demonstrates "outstanding leadership" within captive insurance.

Osborne has worked in the captive industry for more than 30 years, is a frequent presenter at industry events, a former faculty member of the International Center for Captive Insurance Education, and serves on several industry associations and committees.

Osborne was instrumental in revitalising the captive legislation in Tennessee and serves as treasurer for TCIA.

USA Risk Group's vice president of insurance, Adam Forstot, accepted the award on Osborne's behalf.

"I am deeply honoured to have been presented with this award," commented Osborne.

"Tennessee has made great strides in the past few years with their legislation and infrastructure and I am grateful to have been a part of that."

The award's namesake, James Hinton, was a founding member of the TCIA.

Advantage to join Lloyd's insurance market

Advantage Property & Casualty Company is due to launch a new reinsurance underwriting business to participate in the Lloyd's insurance market.

As a corporate member of Lloyd's, Advantage will participate in syndicates insuring property, casualty, marine, motor, aviation and energy risks worldwide.

Simon Kilpatrick, head of Advantage's business insurance division, said: "We are excited to begin trading as a corporate member of Lloyd's and look forward to the unparalleled market access that Lloyd's offers."

"By underwriting at Lloyd's, Advantage and its affiliated captive insurance entities can participate in highly diversified portfolios of insured risks to complement their existing, more concentrated exposures."

Underwriting activity in the Lloyd's market will be conducted by Advantage DCP, a newly formed subsidiary of Advantage Property & Casualty Company.

Hampden Agencies Limited will provide Lloyd's advisory services to Advantage DCP, with corporate administration services provided by Nomina.

Hampden Agencies and Nomina are members of The Hampden Group, a provider of specialty insurance services to corporate participants in the Lloyd's insurance market.

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Ratings round-up

Marble Reinsurance, PMG Assurance and MetLife under the spotlight

A.M. Best has affirmed the financial strength rating of "A- (Excellent)" and the issuer credit rating of "a-" of Marble Reinsurance Corporation, with a stable outlook for both ratings.

The ratings reflect what A.M. Best called Marble Re's solid risk-adjusted capitalisation and conservative operating strategy.

Marble Re has reported strong profitability since commencing this captive operation in Micronesia, largely owing to the favourable underwriting results led by its marine cargo line.

In 2013, Marble Re started expanding its product portfolio into non-marine cargo lines thanks to its strong relationship with Marubeni's group companies.

Most of the premium from the new portfolio will be ceded to third-party reinsurers, enabling Marble Re to secure stable income by earning ceding commissions.

Partially offsetting factors include its parent company's credit risk profile.

Due to its position as a single-parent captive of Marubeni, Marble Re has received a wide range of support in terms of capitalisation, management expertise and risk management strategy.

As a result, Marble Re's business relies on Marubeni's credit risk profile and competitiveness.

While Marble Re has been deemed well-positioned for its current ratings by A.M. Best, downward pressure could arise if there is "material deterioration" in Marble Re's risk-adjusted capitalisation due to significant operating losses or an adverse change in its capital management plan, in addition to significant downward movement in Marubeni's credit risk profile.

A.M. Best has also affirmed the financial strength rating of "A- (Excellent)" and the issuer credit rating of "a-" of PMG Assurance, though the outlook for both ratings has been classified as "negative".

The ratings reflect PMG's excellent capitalisation, historically strong operating performance and strategic position as the captive insurance company for the Sony Group, whose ultimate parent is Sony Corporation.

PMG's role is to meet certain global insurance requirements of Sony Group members.

PMG did not renew or participate in any form of non-related, third-party treaties from 2010 onwards.

PMG continues its operations, but with a strategic change in underwriting directed fully toward Sony-related business as a pure captive.

A.M. Best has stated that the company's strengths are derived from its underwriting focus, long-standing customer relationships and conservative operating strategy.

PMG writes mostly proportional property and marine reinsurance business after ceasing to write life business on 16 January 2011.

Going forward, PMG has said that it expects to add a small amount of employee benefits coverage.

The company maintains a large exposure to earthquake-related losses in Japan due to its coverage of Sony's risks.

Due to the nature of the relationship between PMG and Sony, the changes in Sony's credit risk profile have put pressure on PMG's ratings. PMG's success is reliant on Sony's ability to support its credit risk profile, competitiveness and risk management.

A.M. Best said: "The captive continues to be an integral component of Sony's risk management platform. [Our] view of third-party credit ratings and market-based credit risk measures of Sony indicates negative rating pressure on PMG."

Additionally, negative rating pressure might arise if there is any significant downward movement in Sony's risk profile.

A.M. Best has claimed that any upward rating movement is predicated on improvement in Sony's risk profile coupled with maintenance of PMG's capital strength.

Finally, A.M. Best has affirmed the financial strength rating of "A+ (Superior)" and the issuer credit ratings of "aa-" of the primary life/health insurance subsidiaries of MetLife.

Additionally, A.M. Best has affirmed the financial strength rating of "A (Excellent)" and issuer credit ratings of "a+" of MetLife's property/casualty companies, consisting of Metropolitan Property and Casualty Insurance Company, seven fully reinsured subsidiaries and a separately rated subsidiary, Metropolitan Group Property and Casualty Insurance Company.

The rating affirmations reflect what A.M. Best termed as MetLife's "diverse business mix, favourable operating results, strong franchise, considerable scale and prominent market positions across several product lines".

MetLife continues to generate consistent revenue and cash flows, reporting growth in operating earnings across all segments.

A.M. Best noted the organisation's strong, global risk management capabilities, which incorporate extensive use of sensitivity analysis and hedging activities to reduce economic risk related to volatility in equity markets, foreign currencies and interest rates.

Friends of the court

Recent cases have proven that it is critical that captives are organised in jurisdictions where there is an appropriate level of regulation, according to Alan Fine of Brown Smith Wallace

In January 2014, the US Tax Court handed down a pro-taxpayer case related to the federal income tax deductibility of insurance premiums paid to a commonly controlled captive insurance company. This case, Rent-A-Center v Commissioner, provided insight into several issues that have long been sources of contention between the Internal Revenue Service (IRS) and taxpayers.

A recent tax court memorandum case, Securitas Holdings v Commissioner, further supports the conclusions reached in the Rent-A-Center case, and expands options available to taxpayers when structuring their captive insurance programme. It also reinforces some of the basic principles that all captive owners would be wise to follow in their dealings with captives.

Securitas AB is the Swedish parent of Securitas Holdings (SHI), which owns a number of affiliated corporations in the US that provide security services, including uniformed security officers, alarm system installation and various cash handling services. During the years in question, SHI had no employees or vehicles and did not provide security services of its own. From 1999 to 2001, SHI acquired a number of additional security businesses. The acquired companies collectively employed approximately 123,000 people, bringing the total number of employees to more than 200,000 during 2003 and 2004.

In response to the dramatic rise in insurance costs in the early 2000s, Securitas implemented a captive insurance programme to control its risks and obtain more favourable insurance rates. The captive also enabled Securitas to centralise risks and for the subsidiaries to know in advance their costs of risk.

As part of this programme, SHI acquired Protectors Insurance of Vermont in 2000. Between 1996 and 2002, Protectors wrote no new or renewal business and its operations were confined to the runoff of previously written policies. Protectors maintained its own books and records, maintained a separate bank account for its operations, prepared financial statements and held annual board of directors meetings.

In June 2003, Protectors received permission from the Vermont Department of Insurance to lend all but $1 million of its capital to SHI. The regulators then allowed Protectors to issue an insurance policy in 2004 without requiring SHI to contribute additional capital.

In 2002, Securitas formed a new captive reinsurance company, SGRL, in Ireland. At no point in 2003 or 2004 did any of the US operating subsidiaries own any interest in SGRL.

As with Protectors, SGRL maintained separate books and records, maintained a separate bank account for its operations, prepared financial statements, and held meetings of its board of directors. SGRL then reinsured the workers' compensation, automobile, employment practice, general liability and fidelity liability risks issued by Protectors as well as some of the policies insured in the commercial market.

During the years in question, the premiums were paid by two of the SHI subsidiaries on behalf of the other subsidiaries. Journal entries were used to record liabilities on the books and records of the insureds, as was the practice by Rent-A-Center. These premiums were reviewed by outside actuaries and determined to be reasonable.

Upon examination, the IRS disallowed portions of the federal income tax deductions for insurance premiums paid to the captive in 2003 and 2004.

Determining if an arrangement qualifies as insurance

In reaching its decision to uphold the deductibility of the premium payments, the court reviewed the framework utilised for determining whether an arrangement qualifies as insurance for federal income tax purposes.

Did the risk shift from insured to insurer?

The court reviewed the balance sheet and net worth analyses used in the context of brother-sister captive insurance arrangements to determine whether the insured had moved the risk of loss with respect to a covered claim to the insurer. The IRS argued that a guarantee from SHI to Protectors prevented the risk of loss from shifting to the insurer. The Tax Court, citing its opinion in Rent-A-Center, distinguished this case because the parental guarantee here did not involve an undercapitalised captive, nor was the underlying insurer insolvent.

The court further distinguished the current situation by focusing on the fact that the guarantee was provided only to provide the tax-exempt status of a related captive and, perhaps most importantly, no amount was paid out on the guarantee.

The court further focused on the fact that Protectors was adequately capitalised, and its net premium to surplus ratio was well below the industry standard. It also stressed that this determination was to be made after considering the impact of reinsurance.

The court also reviewed the system of allocating premiums and addressing the claims submitted to Protectors. It had no problem with the utilisation of accounting entries for addressing premium and claims obligations. The court cited the Rent-A-Center opinion: "It is unrealistic to expect members of a consolidated group to cut checks to each other and using journal entries to keep track of the flow of funds is commonplace."

This is particularly noteworthy given that the IRS frequently takes issues with such arrangements, and it eases the burden on taxpayers. It is still critical that the premiums be determined on an arms-length basis and confirmed with an outside actuary wherever possible.

Was there adequate risk distribution?

The court examined whether the arrangement met the requirement of risk distribution. In this case, in 2003 and 2004 one of the insureds accounted for 37 percent and 88 percent of the risks insured with Protectors. The IRS argued that this concentration of risk violated the concept of adequate risk distribution.

Historically, the examination of risk distribution has focused on the number of insureds, particularly within the brother-sister captive arrangements. Revenue Ruling 2002-90, for example, provided a safe harbour for those situations where there are 12 entities under common control being insured by a captive. In that case, as long as none of the insured accounts for more than 15 percent of the risk or less than 5 percent of the risk, the risks will be deemed to be sufficiently distributed. There are a number of cases that have utilised a similar framework, as well as IRS rulings that focus on the 15 percent upper standard.

The tax court rulings in Securitas and Rent-A-Center take a different focus, specifying that the concept of risk distribution is viewed from the insurer's perspective. The court focused on the significant number of employees (in excess of 123,000), offices, vehicles and services being insured, and that this constituted a large pool of "statistically independent risk exposures". This large number of independent risk exposures is not changed merely because "multiple companies merged into one".

The risks associated with those companies did not vanish once they all fell under the same umbrella. It is the pooling of exposures that brings about risk distribution—who owns the exposures is not crucial. Accordingly, the court found the arrangement to have sufficient risk distribution.

Did the captive arrangement constitute insurance?

The court then analysed whether the captive arrangement constituted insurance in the commonly accepted sense. Factors previously considered in this analysis include whether: (i) the insurer was organised, operated and regulated as an insurance company; (ii) the insurer was adequately capitalised; (iii) the insurance policies were valid and binding; (iv) the premiums were reasonable; and (v) the premiums were paid and the losses were satisfied.

The court found that both insurance companies were properly organised, operated and regulated. Critically important in this analysis was the fact that each company maintained its own books and records, prepared financial statements and held meetings of their respective boards of directors. They also found the companies to be adequately capitalised, the policies to be valid and binding, the premiums reasonable, and losses satisfied.

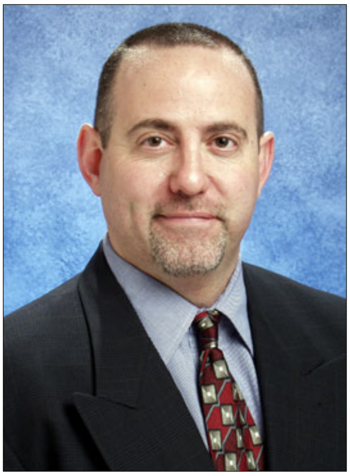
Tax Court upholds deductibility of premiums

The court upheld the deductibility of the premiums paid in this case. Securitas Holdings v Commissioner, read in conjunction with Rent-A-Center, offers clear support for examining the number of independent risks being insured rather than the number of entities (especially given that, in 2004, 88 percent of the risks were paid for by a single entity).

Still left unanswered are questions related to parental or other guarantees. Unexercised guarantees in Rent-A-Center and Securitas were found to not disturb the presence of risk shifting. It is unclear whether any exercise of a parental guarantee will automatically invalidate risk shifting, or if a partial exercise may leave risk shifting unaltered.

These cases demonstrate that courts will emphasise observing the common notions of insurance. For captive arrangements to be respected, it is critical that captives are organised in jurisdictions where there is an appropriate level of regulation.

Observing the corporate formalities of the captive is also important, including maintaining individual books and records, issuing financial statements and conducting board of director meetings. Although this won't prevent IRS scrutiny, it will significantly increase the captive's chances in court, should a case go that far. **CIT**



Alan Fine
Tax partner, insurance advisory services
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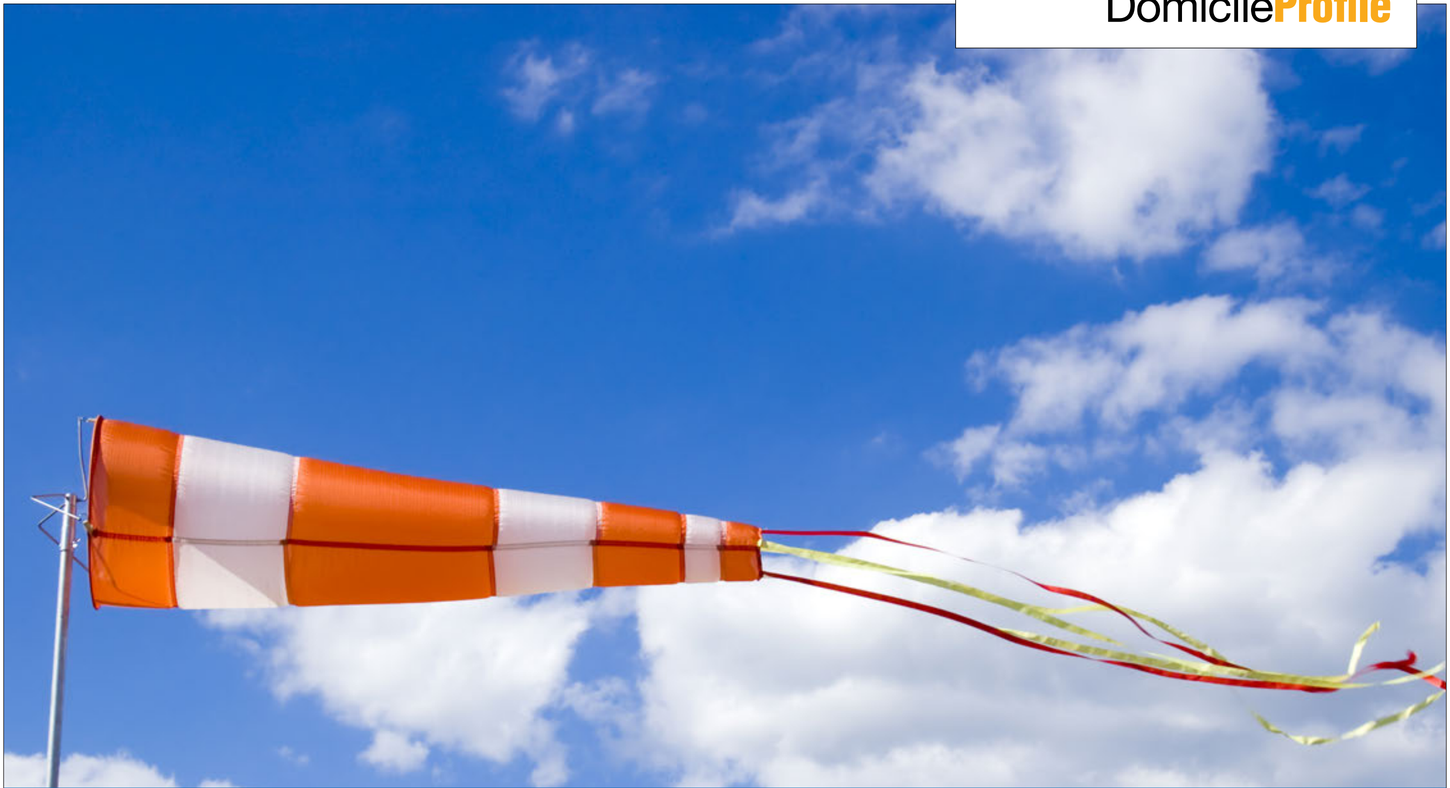

Second wind

With a reinvigorated team and solid regulatory tradition, the District of Columbia's captive industry is poised for the next stage in its evolution

STEPHEN DURHAM REPORTS

Since it became the capital of the US in 1791, the District of Columbia has been the site of some of history's most momentous events. It is perhaps this weight of responsibility and expectation that has imbued the state's numerous associations with a sense of commitment to doing things the right way.

When the District of Columbia's captive insurance legislation was first enacted, at the turn of the millennium, the market was sparsely populated. Today, domicile competition is much fiercer, but the District of Columbia appears determined to stick its guns, particularly when it comes to its robust and reliable regulatory structure.

Associate commissioner of the risk finance bureau at the District of Columbia Department of Insurance, Securities and Banking (DISB), Dana Sheppard, is thought to be the longest-serving individual in such a position. This has become a symbol of the regulatory stability that the District of Columbia, along with the wider industry, considers to be one of its greatest strengths.

Put simply, the state's priority is to ensure that insurance companies being formed in the District of Columbia are, according to director of the Saslow Lufkin & Buggy insurance practice group, Glenn Saslow, "real insurance companies with real risks". The way in which the DISB strives for solidarity in growth has also tied in with the recent reintroduction of founding members of the state's captive industry.

Saslow says: "What has been favourable of late is the domicile bringing back the

Capital costs

Minimum capital and surplus requirements in the District of Columbia

Captive Form	Paid-in-capital	Surplus	Total
Pure captive	$100,000	$150,000	$250,000
Association captive (mutual)	$100,000	$500,000	$600,000
Agency or rental captive	$100,000	$300,000	$400,000

individuals who were part of its formation in order to determine what was successful and reintroduce those same principles to continue growth. We have meetings every quarter to ensure that we are doing all the right things."

Among the main types of captives that can be formed in the District of Columbia include pure, association, agency, branch and rental captives. Segregated accounts companies can also be formed in the state, where each segregated account is capitalised separately, and the assets in the segregated accounts are legally separate from the assets in the other segregated accounts.

In particular, one of the most active areas for the state in recent times has been in the formation of risk retention groups (RRGs). As Saslow puts it: "The District of Columbia is one of the few domiciles in the US that understands how an RRG operates and how is best to regulate them. If you want to form an RRG in the US right now, you are pretty much limited to Vermont, the District of Columbia and possibly South Carolina. Many of the others have not regulated these entities properly and, as a result, decided not to accept them anymore."

This has allowed the District of Columbia an opportunity to capitalise on the reluctance of its competitors and sweep up RRG business, which many in the industry feel is a definite positive for the state.

Skip Myers, managing partner at the Washington DC office of Morris, Manning & Martin LLP, comments: "It became one of the first incorporated cell states and remains one of the best laws. The regulatory environment is good, thorough and relatively prompt and transparent. It is telling that it is also considered so by other domiciles."

The fact that the District of Columbia also houses the nation's capital does present some difficulties for the industry, namely the sheer volume of political decisions being made within Washington DC and the potential knock-on effect they have on the DISB and its affiliates.

A recent example of such a decision was the introduction of the Affordable Care Act (ACA). This has forced the DISB, and concordantly the Captive Insurance Council of the District of Columbia (CIC-DC), to be careful on what they will and will not allow. In particular, the state does not allow medical stop-loss for certain types of structures. This is because it did not want to allow any kind of stop-loss captive that could purportedly bypass certain requirements of the ACA.

Myers comments: "The problem that the state has, in terms of stop-loss captives, is multiple employer welfare associations—which are multiple trusts with a single stop-loss captive. Those are problematic and have been demonstrated to be so as a number of them have gone bust."

Despite not allowing the establishment of these 'riskier' vehicles, the District of Columbia is open to accepting certain kinds of stop-loss business. Saslow, also a director on the board of the CIC-DC, explains: "If you take a large, multinational, Fortune 500 stop-loss captive for example, and this captive did not circumvent the ACA in any way, then the state would be more than happy to take a look at it."

As well as the politically-conscious mindset the DISB has been required to adopt, it also has to deal with little monetary support—again as the result of a busy government that is occasionally spread thin.

As a response to these kinds of challenges, the District of Columbia has succeeded in bringing another supportive force in acting commissioner of the DISB, Chester McPhearson.

Despite being only eight months in the position, McPhearson has already made a strong commitment to the captive space. Saslow says: "His focus is extremely positive on the industry and I think that is going to pay huge dividends for it." CIT

Industry appointments

Connecticut Insurance Commissioner **Thomas Leonardi** is set to join Evercore, a New York-based global investment banking advisory firm, as a senior advisor focusing on insurance.

"Thanks to the diligence of Leonardi's work in my administration, Connecticut has reclaimed its reputation as the insurance capital of the world, and our international influence has never been higher," commented Connecticut governor Dannel Malloy.

"I have no doubt that Leonardi's global reputation as a recognised expert on a variety of regulatory issues, along with the outstanding relationships he has built with consumer and industry trade associations, played a crucial role."

"I thank Leonardi for all he has done as a member of this administration and wish him all the best in his next endeavour."

Leonardi was appointed by Malloy in February 2011 to lead the Connecticut Insurance Department.

For 22 years prior to the appointment, he was CEO of Northington Partners, a Connecticut-based investment banking, venture capital, and private equity boutique that specialised in the insurance industry.

"I want to thank Malloy for entrusting me with the responsibility to head the Connecticut Insurance Department over these past four years," said Leonardi.

"We could not have achieved so much on such a global scale without the governor's extraordinary vision and unprecedented support for me and my department."

Leonardi will leave the agency on 11 December, with the Malloy due to announce subsequent personnel in the coming weeks.

AIG Europe has appointed **Riccardo Gavazza** in the role of global fronting underwriter, to be based in Milan, Italy.

Gavazza will join the global risk solutions team in order to deal with global fronting programmes incorporating varying levels of risk retention and/or risk transfer, captives, and rent-a-captives.

He will also be involved in alternative solutions combining structuring and risk transfer to address what AIG terms as "complex, unusual, or difficult to insure risks".

Gavazza joined AIG a decade ago as a property and energy senior underwriter. From 2009 he has specialised in energy underwriting.

He has 18 years of experience in the insurance industry and has worked for RSA and Zurich managing large domestic and multinational accounts.

Aon Insurance Managers (Cayman) has hired **Gillian Owen** to become its new director.

Owen's responsibilities will range from relationship management and business development through to operational excellence.

Before joining Aon Cayman, Owen was vice president with USA Risk Group (Cayman) where she was responsible for regulatory compliance, relationship management and business development initiatives.

Prior to this, Owen was at JLT Risk Solutions (Cayman), where she managed an extensive portfolio of captive insurance companies.

Owen previously worked at Marsh Management Services and PricewaterhouseCoopers in Cayman.

"Owen is a welcome and valuable addition to the Aon Cayman management team and brings a range and depth of captive management and client service experience to the table," said Adrian Lynch, managing director at Aon Cayman.

"[She] has always been popular with colleagues and clients alike and we look forward to introducing her to our clients."

Heritage Insurance Solutions Limited (HISL) has appointed **David Jewell** as chairman of its board.

Jewell's new role is part of the firm's strategic plan to grow its position in the London insurance market.

He has more than 50 years experience in the London insurance market.

Previous roles include active underwriter at Lloyd's, divisional director at Capita and director of various insurance companies and Lloyd's Agencies.

Heritage Insurance managing director, Karl Bradley, commented: "Jewell is a highly regarded and experienced insurance specialist and his appointment as chairman to the HISL board serves to further enhance our senior team providing comprehensive broking services."

Markel International has made two appointments in its professional and financial risks division. **CIT**

Got a hire, promotion or new office to shout about? Let us know:

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