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Guernsey closes 2014 just short of 800 international insurers

The Guernsey Financial Services Commission (GFSC) licensed 85 new international insurers during 2014.

This includes eight limited companies, three protected cell companies (PCCs), 54 PCC cells, five incorporated cell companies (ICCs) and 15 ICC cells.

The owners of the 85 licensed entities originate from a range of locations, including the UK (35 percent), Cayman Islands (29 percent) and Ireland (13 percent).

Of the business written in the 12 months to 31 December 2014, 45 percent was in insurance-linked securities (ILS), while insurance lines covering property (13 percent), life/health (8 percent), and after-the-event-legal expense (7 percent) were also prominent.

Dominic Wheatley, chief executive of Guernsey Finance, said: “These figures show that last year was very successful for Guernsey as an international insurance centre.”

“We continue to see growth in new entities related to ILS transactions but also a steady stream of more conventional captive insurance vehicles.”

“Much of our business continues to originate from the UK but the figures show the truly international nature of our client base, with a growing number coming from domiciles in Europe and much further afield.”

During 2014, Kelvin Re has become Guernsey’s first rated commercial reinsurer, while Artex Risk Solutions was selected to provide the insurance management services for the BT Pension Scheme’s longevity risk vehicle BTPS Insurance ICC.

Their first transaction involved the Prudential Insurance Company of America completing what was believed to be the largest longevity risk transaction ever, assuming a quarter of the scheme’s longevity exposure, thereby hedging around $16 billion of liabilities.

Similarly, Towers Watson recently announced that it will provide its pension clients with direct access to the reinsurance market through the use of its ICC, Longevity Direct, managed by Willis.

Longevity Direct is aimed at providing cover through the reinsurance market for liabilities between £1 billion and £3 billion.

The Merchant Navy Officers Pension Fund has subsequently become the first scheme to use this facility.

“Pension longevity risk has become a key strength for our insurance sector towards the end of 2014 and we expect that to continue into 2015. Likewise, we understand that a number of other commercial reinsurance companies are in discussions to follow in the footsteps of Kelvin Re, which is extremely pleasing,” commented Wheatley.

Guernsey is hosting the ILS Insight London at the British Museum in London on 28 March. This event will bring together speakers from across the ILS space for dialogue and debate surrounding the key industry issues.

The first panel session will cover structuring innovation and the critical factors enabling and restricting new solutions, while the second will examine the range and depth of Guernsey as an ILS jurisdiction.

Labuan to permit Islamic captives

The Labuan Financial Services Authority (FSA) has resolved to permit captive and reinsurance forms of Islamic insurance.

The Labuan captive ‘takaful’ structure will be licensed under Part VII of the Labuan Islamic Financial Services and Securities Act 2010, which states: “The captive takaful operational business model based on the Shariah contract of tabarru’ is permissible and is concluded amongst the participants only.”

The act also states that, for retakaful arrangements, priority shall be given to operators or retakaful windows of reinsurance companies that have “the capacity to absorb the distributed risks; and financial strength to cater for the requirements of the participants as assessed by the Labuan captive takaful”.

If a Labuan captive takaful is unable to secure retakaful arrangements from retakaful operators or retakaful windows of reinsurance companies, conventional reinsurance may be used.

The Labuan FSA has also commented that this arrangement should be reviewed on a periodic basis as may be determined by the internal shariah advisory board of the Labuan captive takaful.

Solvency II Delegated Acts come into force

The Solvency II Delegated Acts, which contain the rules for the implementation of the incoming directive, entered into force on 18 January.

The European Commission originally adopted the rules on 10 October 2014.

Olav Jones, deputy director general of Insurance Europe, said: “The adoption of the Delegated Acts is an important, and very welcome, step forward in the implementation of Solvency II in 2016.”

CITINBRIEF

"Europe's insurers play a vital role in providing protection and long-term savings products for Europe's citizens and businesses."

"Solvency II can help ensure the European insurance industry remains strong and able to withstand extreme events, as it has over many years."

The rules cover: the valuation of assets and liabilities, including "long-term guarantee measures"; how to set the level of capital for asset classes an insurer may invest in; the eligibility of insurers' own fund items to cover capital requirements; how insurance companies should be managed and governed; equivalence assessments of third-country solvency regimes; the internal model framework; and rules related to insurance groups.

Jones also stressed that it is important that the review processes built into the regulation are used to make a number of refinements and improvements, particularly regarding "unnecessarily high capital charges for long-term investments which are crucial to European economic growth".

Speaking at Moore Stephens' Solvency II Seminar, Omar Ripon, partner in Moore Stephens's insurance industry group, advised firms to take a long-term strategic approach to Solvency II beyond the regulatory "box-ticking mentality".

He said: "Solvency II is finally becoming a reality and there is no time to waste. All insurers, including the smaller firms and niche companies such as captives, have much to gain from understanding the benefits of Solvency II and thereby reducing their compliance costs."

Ripon also said that "smart firms" would already be strategically planning well beyond the next 12 months.

At the same seminar, Ripon stated that Pillar III implementation would be the most strenuous for firms, them to have a long-term strategic vision beyond regulatory compliance mentality.

Moore Stephens said that it expects firms to carry out detailed Pillar II gap analysis in Q1 2015, if they have not already done so, and to have already prepared implementation plans.

Aon brings stochastic modelling to life, health and pensions

Aon Benfield has launched ReMetrica for Life, Health & Pensions in order to evaluate the key risks of long-term products and more accurately influence reinsurance purchases, predict cash flow and analyse financial strategies.

ReMetrica has been developed, Aon Benfield, to provide a fully stochastic framework that allows insurers and their actuaries to answer the challenges being posed by regulations, rating agencies and shareholders.

Rather than looking at individual scenarios, this approach means companies can take into account the frequency and duration of events that could trigger claims—plus explore their variations to allow for uncertainties in the results.

Aon Benfield has also claimed that ReMetrica will improve Solvency II infrastructure, effectively evaluate reinsurance structures in one simulation and produce models within a, particular client's risk appetite.

Irfan Akhtar, head of development for ReMetrica for life, health and pensions, said: "Aon Benfield has undertaken extensive development over the last four years to bring the best of ReMetrica's stochastic modelling to its life, health and pensions clients."

"Unlike most of its peers, the platform has been built as a stochastic tool from inception, rather than simply adding to a deterministic model, and also uses a ground-breaking approach to modelling multi-states."

The multi-state model concept underpins modelling for long-term business within ReMetrica and means that actuaries can now map the journey of policyholders throughout their lives.

Traditionally said, this has been used for health and disability modeling, but ReMetrica can apply this to all lines of business including assurance and annuities.

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Strong Q4 cements ILS record

Property catastrophe bond issuance in the insurance-linked securities (ILS) sector for Q4 stood at $2.1 billion across six separate transactions, contributing to a record annual property catastrophe bond issuance of $8 billion, according to a report by Aon Benfield Securities.

Total catastrophe bonds on-risk stood at $24.3 billion on 31 December 2014, representing another record for the market and an 18 percent increase over the prior year period.

Notable transactions in the report included Everest Re's Kilimanjaro Re Series 2014-2 Class C notes, which provide the firm with $500 million of earthquake coverage for Canada and the US, and represents the largest ever five-year term catastrophe bond transaction.

Aon also noted the California Earthquake Authority's (CEA) return to the catastrophe bond market in Q4, after introducing its new programme, Ursa Re.

The latest transaction for the CEA is the largest yet by $100 million and provides California earthquake indemnity coverage on an annual aggregate basis.

Paul Schultz, CEO of Aon Benfield Securities, said: "The strong finish to 2014 resulted in new records being established in the ILS sector, and while a certain amount of sponsor interest can be attributed to the favourable spreads when compared to traditional reinsurance, the greater range of options that have become available across ILS products was also a significant driving force."

"The increased investor appetite for ILS, coupled with the increasing sophistication of solutions, should ensure a positive outlook for the sector in 2015, and we look forward to working with our clients on new and tailored solutions that meet their risk requirements."

The report has also revealed that, for the 12-month period to 31 December 2014, all Aon Benfield ILS Indices posted gains.

The Aon Benfield All Bond and BB-rated Bond indices posted returns of 4.39 and 2.02 percent respectively, while the Hurricane and US Earthquake Bond Indices returned 7.37 percent and 3.46 percent respectively.

Aon Benfield Securities has forecast another active year for the ILS market in 2015, which it claims will be fuelled by continued growth in alternative capital, and cedants' increasing comfort with the utilisation of ILS in their risk transfer programmes.

With $5.5 billion of catastrophe bonds maturing in H1 2015, it is expected that many existing sponsors will choose to renew their ILS programmes, and that new sponsors will continue to be attracted to the sector given what Aon has termed the "favourable interest spreads and expanding scope of coverage".

Kane confirms quadruple cat bond conquest

Kane has made four new issuances on its independent private catastrophe bond platform, the Kane SAC Limited Note Program. The issuances total $125.84 million.

The Exeter Segregated Account amounts to $54.81million and is due on 15 January 2016, while the Troon Segregated Account totals $27.53 million and is due on 12 January 2016.

The Muirfield Segregated Account amounts to $26.68 million and the smallest of the four, the Hereford Segregated Account, stands at $16.82 million. These are both also due on 12 January 2016.

All of the notes have been listed on the Bermuda Stock Exchange (BSX).

This brings the total number of issuances that have taken place on Kane's catastrophe bond platform to 11 since its launch in August 2013.

Robert Eastham, managing director at Kane (Bermuda), said: "The announcement of four new issuances on the Kane SAC platform serves to demonstrate that the programme is meeting a very clear market demand for the

ability to transact smaller capital market deals in an efficient and cost-effective manner."

"We expect to see strong growth in this area moving forward given the growing influence of the investment community in the insurance arena."

EMEA insurers strongly capitalised, says Fitch

The Europe, Middle East and Africa (EMEA) insurance sector is strongly capitalised, according to a report from Fitch Ratings.

The report was compiled using Fitch's Prism Factor-Based Model (Prism FBM), which was launched in September 2014

Fitch's EMEA insurance portfolio has been characterised as being "strongly capitalised", with 82 percent of entities scoring "Extremely Strong", "Very Strong" or "Strong", typically above or in line with its ratings.

Most ratings are constrained by factors other than capital, such as low profitability, high financial leverage, sovereign constraints, limited scale or lack of business diversification.

Net equity is the largest component of Fitch-calculated Total Available Capital (TAC). However, it accounts for only 47 percent of TAC across the portfolio, as there are several other important components.

Capital buffers, such as, funds for future appropriation, account for 14 percent of TAC, subordinated debt accounts for 15 percent, and value of in-force business accounts for 13 percent.

For life insurers, Target Capital (TC) is dominated by asset risk, which accounts for 65 percent across the life portfolio.

For non-life insurers and reinsurers, the largest components of TC are asset, catastrophe, motor, property and liability risk, which Fitch claimed are representative of the business mix in the portfolio.

Asset risk is the largest component, accounting for 24 percent of TC, but it is significantly lower than for life insurers because non-life insurers and reinsurers generally focus on taking insurance risk and tend to minimise asset risk.

Prism FBM also gives credit for diversification between product lines, asset types and types of business.

Diversification benefit across Fitch's EMEA portfolio ranges from 5 percent to 35 percent (as a percentage of TC), with composite insurers having the largest benefit, typically around 25 percent to 30 percent, according to the report.

To assess capital adequacy, Fitch considers Prism scores, regulatory solvency, leverage metrics and insurers' own capital models.

Risk International acquires Bartlett Actuarial

Risk International has acquired independent property and casualty insurance actuarial service Bartlett Actuarial Group.

According to Michael Davis, president and CEO of Risk International, the acquisition of Bartlett Actuarial Group expands the counsel of the outsourced risk management provider to both its Fortune 1000 and middle-market clients, while also enhancing its captive insurance company advisory services.

Risk International offers risk management, insurance claims mitigation, loss prevention, claims recovery and due diligence services, mostly to clients that have a total cost of risk of at least $5 million.

Its 2014 acquisition of Consolidated Risk Management in Cleveland allowed it to expand service capacity to the growing outsourced risk management needs of middle-market companies that earn $100 million or more in revenue and have a total cost of risk of at least $1 million.

"We're anxious to apply Bartlett's good counsel to captive insurance and mutual insurance companies to the growing needs of both our corporate and privately held clients," said David O'Brien, chairman of Risk International.

"Bill and Andrea Bartlett have built a great service reputation, and we're looking forward to teaming with their longtime partner Brian Johnson to grow it into new markets."

Johnson, now managing director of Bartlett Actuarial Group, will lead a staff of 13 who will continue to operate from offices in Charleston, South Carolina and Burlington, Vermont.

Risk International, with a staff of nearly 75, is the largest US firm of its kind. Headquartered in Fairlawn, Ohio, it serves clients from offices in Charlotte, Chicago, Cleveland, Columbus, Wilmington in Delaware, central Michigan, London and Singapore.

Not all doom and gloom for reinsurers, says GC

The reinsurance market is still ahead of historical lows, despite the buying pool decreasing every year for the last 10, according to CEO of Europe, the Middle east and Africa (EMEA) operations for Guy Carpenter, Nick Frankland.

"Since 2009, we have seen an overall reduction of just 25 percent—this in our view is the more meaningful figure, particularly given that 2009 was a profitable period for the industry," said Frankland.

Speaking at a press briefing in London, Frankland claimed that traditional capacity "remains strong in all areas and appetite is, if anything, increasing as reinsurers look to maximise both relationships with clients and class diversification".

At the same event, Guy Carpenter's head of EMEA strategy management, Chris Klein, highlighted the increasing influence of the alternative capital market.

He said: "The collateralised reinsurance market we believe is now providing 50 percent of the established limits for general treaty and property catastrophe covers in the property retro arena—this is a significant figure."

Klein also stated that, from an EMEA perspective, the majority of the new capital is focused on the retro markets and US property catastrophe peak perils.

Klein continued: "If you look at Europe, there is a lot of good quality, well-embedded catastrophe capacity in the region. These perils are more complex, spanning multiple territories and some of these are not very well modelled."

"Insurance-linked securities penetration in EMEA is primarily confined to larger, multi-line, multi-national insurance groups and reinsurance groups operating out of Europe, as well as some industry and public bodies."

The speakers said that Guy Carpenter wants to move towards the consultancy-based model supported by "the transactional power of being a traditional reinsurance broker".

Frankland concluded: "The business generally will need a reset. It needs to work to a lower cost of capital model which will see a period of increased creativity around the use of additional and alternative capital instruments, as well as enhanced return vehicles."

"We are poised on the brink of a fundamental change in this industry and the next 12 months are likely to confirm that."

R&Q completes portfolio transfer

R&Q has successfully completed a portfolio transfer from Aker Insurance AS, a wholly owned captive domiciled in Norway, to R&Q Insurance (Malta) Limited, the group's EU run-off consolidator.

The total consideration of the transfer is NOK 22.3 million ($2.9 million), with transferring current liabilities totalling NOK 14.3 million ($1.8 million).

The policies provide workers' compensation and personal accident cover for the years 2003 to 2009 to Norwegian employees of the parent company Aker Group, which specialises in offshore construction and engineering.

The claims will be managed by R&Q Triton AS in Oslo, the group's local insurance and claims management company.

Paul Corver, head of M&A at R&Q, said: "We are pleased to complete this portfolio transfer; it is an excellent example of our ability to provide finality and a clear exit solution for discontinued lines of business from EU captives."

"This is the first transfer from an EU captive into our Malta platform and demonstrates our ability to execute cross-border EU transfers, along with the advantages this brings."

"It is our understanding that there are further Scandinavian insurers that would benefit from removing legacy liabilities, especially in preparation for Solvency II."

ILS set to reach new heights, says Willis

Following a record-breaking year for insurance-linked securities (ILS) issuance in 2014, 2015 is set to reach new heights as investor interest in insurance catastrophe risk continues to grow, according to the latest ILS report from Willis Capital Markets & Advisory (WCMA).

Non-life catastrophe bond issuance in Q4 of 2014 totalled $2.1 billion, capping the record year that saw over $8 billion of non-life catastrophe bonds issued. The previous record-breaking high was $7.2 billion in 2007.

Tony Ursano, CEO of WCMA, said: "As investors become more sophisticated, any coverage gaps between reinsurance provided by traditional rated reinsurers and that provided by investors is shrinking—72 percent of catastrophe bonds used indemnity triggers in 2014, only 30 percent used [them] in 2007."

"It took over seven years to break 2007's ILS issuance record. In the current climate there are no signs of growth abating and we could very easily see two consecutive record-breaking years. We would not be surprised to see $9 billion of issuance in 2015."

Against the backdrop of a reinsurance market reshaping, the WCMA report notes that although issuance is set to rise, market dynamics in 2015 are less predictable.

Regarding this outlook, William Dubinsky, managing director and head of ILS for WCMA, commented: "For some, predictable may be good but uncertainty creates opportunity for those who are prepared to act."

While 2014 saw the extension of many terms and conditions from the collateralised reinsurance market to the catastrophe bond market, 2015 may see "further extensions, including for indemnity-trigger retrocession deals," according to Dubinsky.

Despite falling spreads and growing assets under management, the report also outlines that the rates of both decline and growth are likely to flatten.

"As a reaction, some investors will reach for yield and accept more risk while others may lean towards more transparent risk transfer with modest expected returns," said Dubinsky.

A final trend for 2015 predicted in the report is large reinsurance buyers challenging the structure of the industry itself, after reaching a plateau under current conditions.

President Obama signs TRIA into law

US President Barack Obama has signed the Terrorism Risk Insurance Act (TRIA) into law just days after it came across his desk.

The president moved swiftly following a Senate vote to reauthorise the act until 31 December 2020.

Senators voted 93 in favour of TRIA, with only four voting against. This vote came after 416 members of the House of Representatives voted for the bill to be renewed, with only five in opposition.

The Financial Services Roundtable (FSR) was among the first to congratulate Congress on the decision to pass TRIA so soon after the Christmas break, which it claimed would reduce the risk to taxpayers by encouraging private insurance coverage following a terrorist attack.

"We applaud a strong collaborative effort by Congress to pass this bipartisan legislation critical to taxpayers and our national economy," said FSR president and CEO Tim Pawlenty.

Insurers such as Marsh & McLennan have also spoken out in support of the passage of TRIA following what it called the "swift reauthorisation of this critically important public-private partnership".

Marsh has stated that the renewal will help to ensure a reliable marketplace for terrorism coverage in the event of attack.

In an official statement, Marsh said: "We are pleased that [the Terrorism Risk Insurance Program Reauthorization Act] directs the Treasury Department to review the protocols for certification which would help to protect the nation's economic security in the event of a terrorist attack."

Thomas Stokes, managing principal and US consulting practice leader of JLT Towner Insurance Management (USA), commented: "After more than a year of dithering, the speed with which this bill was passed and became law is refreshing."

"For the next six years, our clients and other insureds can count on the federal backstop being there for them. This is a huge stabiliser for the US economic system."

TRIA has an eventual $200 million trigger, increasing from its current $100 million limit at 20 percent per year. The nuclear, chemical, biological, radiation trigger remains at $100 million.

This includes a 20 percent copayment, while industry retention will increase $2 billion a year, starting in 2016, from $27.5 billion to $37.5 billion.

Despite efforts from within the insurance industry, the previous incarnation of TRIA was allowed to expire on 31 December 2014.

Assurance gains TCIA membership

Insurance brokerage and risk management consulting firm, Assurance Partners, has become a member of the Tennessee Captive Insurance Association (TCIA).

Jim Wilson, president and CEO of Assurance Partners, said: "Participation in the TCIA provides our firm with the opportunity to serve our clients who choose to domicile their captive company in Tennessee."

"This allows for direct access to a government relations representative, and a powerful voice within the local captive business community."

As a domicile-neutral firm, this membership demonstrates our continuous commitment to provide best-in-class service to our clients, regardless of where they choose to domicile."

USA Risk approved in Texas

USA Risk Group has been approved as an authorised captive manager by the Texas Department of Insurance (TDI) and will be operating under the name Lone Star Captive Management.

The group has stated that it is currently seeing significant interest from domestic Texas companies, which has been attributed to USA Risk's strong commitment to "assisting with the growth and prosperity of this new captive domicile".

The TDI rules and statute require that affiliated companies have significant operations in Texas in order to form or move a captive there.

Captive insurers licensed in the state can only insure operational risks of affiliated companies and controlled unaffiliated business.

Across the pond

While the captive industry is undeniably dominated by US domiciles and their neighbouring offshore competitors, the small island of Guernsey still stands toe-to-toe with the biggest names in the business

STEPHEN DURHAM REPORTS

Much is made of the fact that Guernsey is the lone European representative in many of the 'top 10 captive domicile' lists in recent years, but less is known of the reasons why. What can be argued as chief among these reasons is the island's propensity to embrace new forms of business—namely, the industry's financial instrument du jour, insurance-linked securities (ILS).

"As well as continuing to attract traditional captive companies, a significant proportion of the Island's new business relates to ILS. This business is particularly pleasing as it combines the expertise of the island's insurance managers with those of its legal, banking, and investment sectors," says managing associate at Mourant Ozannes, Helen Wyatt.

Of the business written in the 12 months to 31 December 2014, 45 percent was in ILS, while insurance lines covering property (13 percent), life and health (8 percent), and after-the-event legal expense were (7 percent) also prominent.

Also something of a growth segment for Guernsey in recent times has been a burst of longevity risk transfers. The island's first instance involved the Prudential Insurance Company of America completing what was believed to be the largest longevity risk transaction ever, assuming a quarter of the scheme's longevity exposure, thereby hedging around $16 billion of liabilities.

The transfer of pension longevity risk is where the captive is used to access reinsurance markets. In many cases, life companies are keen to provide reinsurance cover, because the longevity risk is a natural hedge against those insurers' normal life exposure.

Ian Morris, partner and head of insurance services at BWCI, explains: "The longevity structures transfer large amounts of risk but the capital requirements are limited as the risk is primarily reinsured."

"The deals to date have been from the UK so most clients are familiar with Guernsey and its insurance expertise. Clients have looked at a range of jurisdictions but concluded that Guernsey is the most suitable location. I would not expect such business to be written within the EU due to the additional costs and capital likely to be needed to comply with Solvency II."

Another recent transaction saw Willis and Towers Watson working together to establish a facility for the Merchant Naval Officers Pension Fund (MNOPF).

Although the reputation of Guernsey was cited by Willis as being an important consideration, the ability to establish an incorporated cell company (ICC) was a "key differentiator", according to Martin Best, managing director of Willis Guernsey.

Best continues: "The ICC structure provides for more robust segregation between cells, and allows the MNOPF model to be readily replicated for other clients. Longevity risk for pension funds is a growing issue, and the use of a captive to access reinsurance markets is a great solution. Towers Watson and Willis believe that there is a substantial market for this product."

The UK, more specifically London, is Guernsey's core market for captive and ILS business, and it enjoys a strong relationship with the US and Caribbean. Even so, this has not stopped the island's financial services industry from seeking out pastures new. Emerging markets are becoming increasingly aware of the captive concept, according to Wyatt, and Guernsey has already attracted business for captives from parent firms based in Saudi Arabia, South Africa, Colombia and Singapore. China also represents a lucrative market for captive business, despite it developing its own onshore captive domiciles in free trade zones.

However, many believe that the potential smorgasbord of new markets to explore does not necessarily mean guaranteed new business. As well as China's own onshore ambitions, Best says: "It is extremely difficult to export premium from India, so we don't expect to see new business from there. Some South American companies are indeed looking to establish captives, but they are typically looking to the Caribbean."

In addition to this, it can be argued that the level of austerity over the last few years has slowed the volume of new business and available capital, which in turn has meant a limited appetite in parent entities outside Guernsey for new ventures. But, according to Morris, this seems to be changing recently based on the type and number of new entities in Guernsey this year.

Robus CEO Chris Le Conte says: "Austerity impacts us all of course, and has probably impacted on fee levels for managers and general cost-cutting, but equally the whole premise behind captives is to reduce costs through lowering the total cost of risk and so actually periods of belt tightening can be beneficial."

From 2007, Guernsey has seen a steady growth across the levels of gross assets, net

worth and premiums written by its international insurers, according to Wyatt. This can perhaps be attributed to Guernsey's reputation as a safe and transparent jurisdiction in which to do business.

She adds: "There has been some consolidation and an overall reduction in the number of traditional captive companies, but growth has been seen in the number of protected cells and incorporated cells established. Guernsey is well-placed to benefit from the increased appetite for cellular structures and as such there is unrivalled experience and expertise here in cell company structuring."

If Guernsey has to compete for business with domiciles that may be closer geographically to potential clients, it will have to rely on this and its other strengths that differentiate it.

As Guernsey is outside of the EU, it is not directly subject to EU directives on taxation. The domicile was on the original Organisation for Economic Co-operation and Development 'white list' and has since been continually recognised as meeting international standards on tax transparency. To strengthen its reputation in this area, Guernsey has signed 57 agreements on tax information exchange with other countries.

Another strength of Guernsey is what its financial services commission calls a "proportionate" regulatory regime.

The strength of these regulations will be galvanised in the coming year, in order to stay on top of global standards.

Jeremy Quick, the director of banking and insurance supervision at the GFSC, says: "The Guernsey Financial Services Commission has for some time, in alliance with the local insurance industry, been developing plans to meet new international requirements for risk-based supervision. Although not yet finalised, these plans will materialise in 2015."

For solvency, several classes of insurers will be created, including one for captives—characterised as companies that self-insure risks. All categories of insurers will be obliged to apply prescribed and minimum capital requirements.

These calculations run off a spreadsheet supplied by the GFSC that, for instance, sets diversifications parameters. Apart from these quantitative requirements, captives already abide by a corporate governance code and follow the local version of an economic capital assessment.

Quick continues: "It is intended that these requirements will be amended but not in a way that will have a material impact on captives. Also, no additional disclosure requirements are expected for captives."

"These regulatory developments will ensure that Guernsey continues to operate an up-to-date but still proportionate regulatory regime for captives."

It is perhaps this unwillingness to rest on its laurels that has allowed Guernsey to not only compete with, but be considered alongside, the biggest names in the industry. CIT

A regulatory redevelopment

With a revised legislative regime to come early in 2015, the British Virgin Islands is optimistic that its captive numbers will continue to grow, according to Stanley Dawson of the British Virgin Islands Financial Services Commission

STEPHEN DURHAM REPORTS

A major selling point of the BVI is its level of regulation. What has come into effect recently that is benefitting the domicile, or what is in the pipeline?

The current British Virgin Islands (BVI) legislation, the Insurance Act, 2008, Insurance Regulations, 2009, Regulatory Code, 2009 (as amended), and the BVI Business Companies Act, 2004 (as amended), allow for the formation and licensing of BVI business companies to carry on insurance business as any type of captive, from a pure captive to a segregated portfolio company, with independent separation of each of its segregated portfolios or cells. A captive may write either general or long-term business including, reinsurance that is not open market reinsurance business, if it is so licensed by the Financial Services Commission.

There are amendments currently being considered that will enhance and make more user-friendly the existing legislation, including specific legislation relating to pure captives and captives that write some third-party business.

Have the plans to implement a tiered licence fee structure come to fruition yet?

The policy has been agreed in principle and finalisation is now awaiting completion of the amendments to the Insurance Act and Insurance Regulations.

The hope is that this process will be completed within the first quarter of this year, and certainly not later than the second half, and it will most certainly be welcomed by the industry.

Should the structure be approved, it will be based on the annual gross written premiums (GWP) of the captive in the previous financial year. There are approximately five tiers being considered for calculating fees.

The first tier will be applicable to those with GWP of $500,000 or less, moving up to between $500,001 and $999,999 for the second band. The next tier up will be for captives with GWP of between $1 million and $4,999,999.

The penultimate tier will be for captives with GWP of between $5 million and $9,999,999, while the final tier will be reserved for entities with GWP of $10 million and above—the highest fee level. Since the structure has not yet been approved, we cannot at this time indicate specific fees for each level.

What are the BVI's current initiatives to attract new captive managers and reinsurers?

The marketing of the jurisdiction is the function of the International Finance Centre, which has been actively promoting the BVI as a jurisdiction of choice for captive insurer formations and redomiciliations. This includes the formation of BVI business companies to carry on insurance as captive insurance managers, especially when attending conferences, and to carry on reinsurance business.

However, the proposed amendments to the Insurance Act and Insurance Regulations should usher in a more flexible and user-friendly regime for the formation of captive insurance companies, in addition to enabling companies to undertake more than one type of insurance business (if certain conditions are met).

What kind of supporting infrastructure is there on the island for the local insurance industry?

The islands are home to corporate services providers, insurance managers, insurance intermediaries, loss adjustors, auditors, legal advisors and other professionals, as well as a few banks that provide services to the insurance industry.

Have agreements on tax information exchange affected business and do you know of any more planned in the future?

There is no evidence to indicate that tax information exchange agreements (TIEAs) in relation to the captive insurance business have directly affected the insurance industry in the BVI. However, perhaps some of the jurisdictions that are entering into the captive market will be attracted more so to jurisdictions with which they have TIEAs.

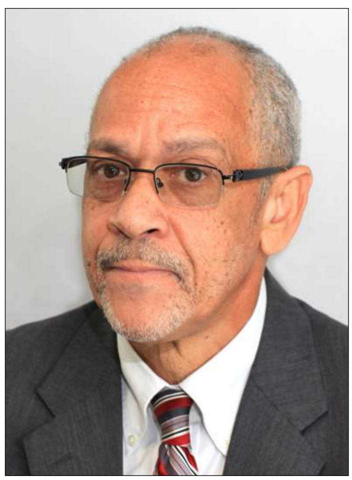
“The proposed amendments to the Insurance Act and Regulations should usher in a more flexible and user-friendlyregime for the formation of captive insurance companies, in addition to enabling companies to undertake more than one type of insurance business”

The BVI currently has more than 27 TIEAs in place with other jurisdictions, while others are considered and agreed to, from time to time.

Does the domicile itself currently have any wider regulatory concerns?

None specifically at present, although admittedly the BVI, like any other financial services jurisdiction, needs to review ongoing international standards initiatives to ensure compliance, with the result of increased cost of regulation and compliance.

With the introduction of a revised insurance legislative regime early in 2015, the BVI is very optimistic that its captive numbers will grow this year and continue into the foreseeable future. CIT



Stanley Dawson
Director of insurance
BVI Financial Services Commission

THE NEW GOLD STANDARD?

The Bahamas sets itself apart from other captive domiciles, as Peter Strauss of The Strauss Law Firm explains

Perhaps the most overlooked and yet increasingly critical decision for captive insurance company owners is domicile selection. What used to begin and end with the simple question of either onshore or offshore now requires a full-scale analysis of dozens of specific factors to determine the appropriate domicile.

These factors include responsible regulatory oversight, a proven track record, capitalisation and investment requirements, legislation that supports the captive owner's objectives, timely application processing, and increasingly so, asset protection. With approximately 70 jurisdictions domestically and internationally to choose from (and expected to increase), how does one navigate the minefield to determine which is appropriate? The answer: let the facts speak for themselves.

While the competitive gap between domestic and offshore captive jurisdictions continues to decrease, offshore domicile are still considered to be more flexible, and typically more accommodating to captives underwriting the risks of small business owners.

As it relates to the regulatory environment, the Insurance Commission of the Bahamas (ICB) has a proven track record of being captive-friendly, having previously established more than 80 cell captives as of 2013. While accommodating a variety of captive structures, the ICB ensures that all captive activity is rooted in a responsible regulatory framework.

Further substantiating the availability of the jurisdiction to accommodate smaller insurance companies, the ICB has passed reasonable minimum capitalisation requirements amounting to the greater of $50,000 or 20 percent of gross written premiums. As an example, in the case of a captive with annual premiums of say $100,000, posting capitalisation in line with Bahamian regulations represents a more effective use of capital compared with the onshore alternatives in which capitalisation averages in the $400,000 range.

In addition, the ICB has the internal resources available to evaluate a complete application in approximately 30 days. Once approved, the insurance commission has a logical regulatory framework that is free from the more onerous requirements that are typically applied to commercial insurers for the purposes of protecting the uninformed public from buying a product they do not understand.

A sophisticated insured is directly involved in the decision to use alternative risk financing mechanisms such as a captive and has elected to put its own capital at risk to achieve strategic risk financing objectives. In this regard, the captive itself is subjected to a fair but more stringent regulatory requirement that can, and should, be respected by any governing body.

Captive owners are required to undergo annual financial audits, which represent an aggregation of financial statements, and the directors of the captive are legislatively tasked with the responsibility of ensuring the solvency in accordance with the relevant Bahamian insurance statutes.

To that end, captive owners with licensure from the Bahamas enjoy more latitude with the investment capabilities than can traditionally be found onshore, and yet, still maintain credibility based on the existing infrastructure and the accommodating regulatory framework.

The tax treatment of establishing a captive in the Bahamas is also an important consideration. In this regard, two important elections may be filed on behalf of the captive: a 953(d) election and an 831(b) election.

Electing for treatment under section 953(d) of the Internal Revenue Code allows a foreign business to elect to be treated as a US corporation for tax purposes, as opposed to a controlled foreign corporation. Therefore, while a captive may be licensed in the Bahamas and all subsequent business transactions take place in the Bahamas, the company will be treated as a US corporation for tax purposes and will obtain a federal employment identification number (EIN).

Once the EIN is obtained on behalf of the captive, an 831(b) election may be filed. Provided the captive is established in a manner that is considered to be insurance for US income tax purposes, section 831(b) of the Internal Revenue Code stipulates that an insurance company writing no more than $1.2 million of annual gross written premium is able to retain underwriting profits tax-free.

Additionally, because the captive is treated as a US taxpayer and not a foreign insurer, captive owners will not be subject to foreign excise tax.

Furthermore, the Bahamas remains committed to a tax neutral platform, meaning that there are no income or inheritance taxes for all who conduct business in the Bahamas. More specifically, the Bahamas does not charge a tax on premium income written by licensed external insurers.

Political and economic stability should also be a consideration in the selection of an appropriate offshore domicile. The Bahamas has a world-renowned financial infrastructure, maintaining the ongoing status of being the most successful international financial centre in the Caribbean.

Its mature financial services industry, established international banking infrastructure, progressive government and tax neutral environment have yielded an environment that is conducive to wealth management initiatives of ultra high-net worth individuals around the globe.

Politically, the Bahamas has enjoyed more than 280 years of uninterrupted democracy and has been an independent nation since 1973. It is a member of the United Nations, Commonwealth of Nations, and the Organization of American States and Caribbean Community.

Perhaps most impressively, the Bahamas is the highest-ranking nation for civil liberties and political rights as judged by the World Bank, and has been recognised as a sound environment for foreign direct investment with an investment grade government debt rating by both Standard & Poor's and Moody's.

Throw in the close proximity to the US, pristine beaches, world-class resorts, and unrivaled service, and you might just want to move there. **CIT**

Peter Strauss
Managing member
The Strauss Law Firm

Numb3rs game

Early figures from 2014 suggest that interest in single parent captives remains strong, but other alternative risk transfer vehicles are gaining momentum

STEPHEN DURHAM REPORTS

Although the majority of captive insurance domiciles are yet to publish their results for 2014, some of the busiest of the last 12 months have provided a snapshot of which captive vehicles are gaining in popularity.

Utah is an example of a state that has particularly embraced one type of captive, with pure structures making up 84 percent of the domicile's business. One of the strategies that has contributed to Utah's growth in this market is its focus on the small and mid-size captive market.

David Snowball, captive division director at the Utah Insurance Department, said in 2014: "Our conservative and steady approach paid dividends through our ability to attract and retain educated and experienced staff. As our expertise and number of staff has grown we have continued to expand into more complex structures."

Although Vermont's industry is also based around its size and 391 pure captives, its real strength lies in its variety.

Also interviewed in 2014, David Provost, deputy commissioner of captive insurance for Vermont, commented: "We have built an insurance industry that is not reliant on any one business segment, line of insurance or type of captive. I'm very pleased that each year when we look at the licences granted during the past 12 months, that we have a mix of single parent captives, group captives and special purpose insurers of all sizes and sponsored by all sorts of different parent companies."

Vermont licensed 16 new captives in 2014, according to data released by Vermont's captive insurance department on 22 January. The new captives were made up of 10 pure captives, two sponsored, two special purpose financial insurers, one association, and one risk retention group. Two new captives were also redomesticated from Bermuda and Delaware.

Growth in 2014 was down from previous years, primarily to the prolonged soft market and added competition by other US states. Despite fewer formations, gross written premium continued to grow with a projected $29.8 billion, up from $27.5 billion in 2013.

"The quality of Vermont's 2014 licensees continues to be outstanding," said Provost on 22 January.

"Vermont's primary focus is licensing quality companies regardless of market conditions. Much of the activity across other jurisdictions is driven by small 831b companies which is not a core market for Vermont."

Vermont's latest captives were licensed in healthcare, insurance, financing, manufacturing, real estate, technology, religious institutions, and mining.

Dan Towle, Vermont's director of financial services, pinpointed healthcare as representative of the state's diversity. "The continued formation of hospitals and doctor's groups setting up captives in Vermont has been a very positive trend that we expect to continue.

"Hospitals maintain a high interest in forming their captive onshore and in Vermont."

The newly licensed captives in healthcare include Drexel University, Physicians Insurance a Mutual Company, and Emergency Physicians Medical Group PC & AF.

Other notable captives set up 2014 included Union Carbide Corporation, AON Risk Services Companies, Sazerac, Swiss Re Life & Health America Holding Co, and MasterCard International.

Last year's new licensees bring Vermont's overall total licences to 1029, with 581 active captive insurance companies.

The Cayman Islands remains the second largest captive jurisdiction and the leading jurisdiction for healthcare captives. As of 30 September 2014, Cayman had 54 percent pure captives, 18 percent segregated portfolio companies and 17 percent group captives.

Healthcare captives account for 45 percent of the international insurers in the domicile, while the next largest industry segment is financial services at 25 percent, according to Cindy Scotland, managing director of the Cayman Islands Monetary Authority.

By line of business, 34 percent of international insurers were for hospital and medical professional liability, followed by workers' compensation (22 percent), property (12 percent), general liability (10 percent) and professional liability (9 percent).

Speaking at the Cayman Captive Forum in December 2014, Scotland said: "At 90 percent, the risk location of captives continued to be dominated by North America.

The next most important geographical source of captives is the Caribbean and Latin America collectively (3 percent), Europe at 2 percent, and the remaining global market at 5 percent."

In Guernsey, the segregation of assets and liabilities means that parents can establish structures to write different lines of business through each cell, and insurance managers can set up their own protected cell companies (PCCs) or incorporated cell companies (ICCs) to 'rent' cells to different clients.

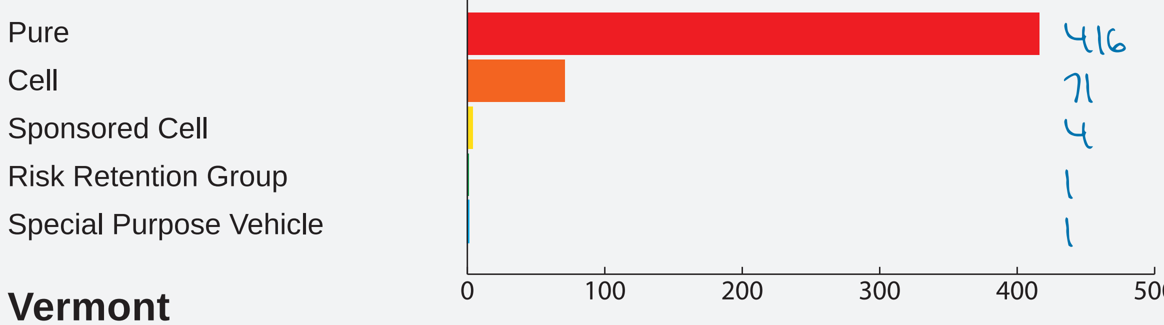
Dominic Wheatley, chief executive of Guernsey Finance, says: "Guernsey pioneered the cell company concept for our captive sector and they have become hugely popular due to their inherent flexibility and the simplicity and cost effective nature of establishing new cells."

"This has helped make captive insurance more cost effective and has meant that the concept has moved from being just the preserve of large multinationals to increasingly viable for small- and medium-sized enterprises.

The segregation of assets and liabilities within captives has also facilitated the use of captives to insure customer risks as product enhancers alongside traditional corporate risks."

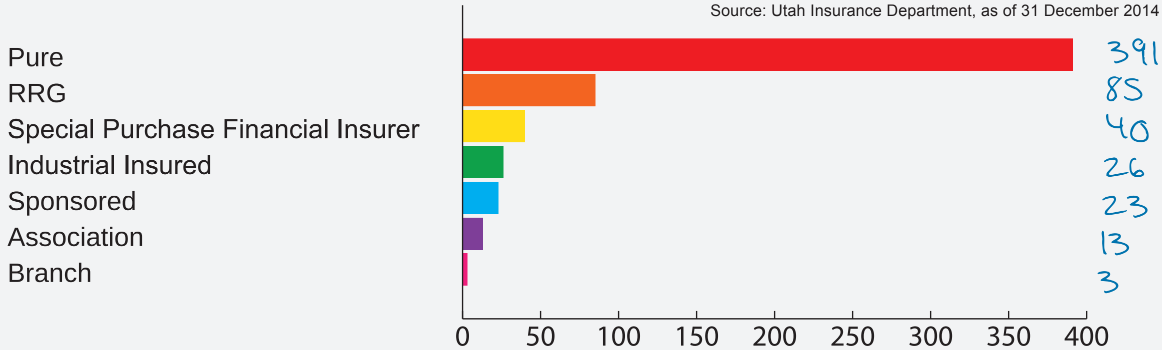
"These characteristics mean that they have been used extensively within the growing insurance-linked securities and pension longevity business, which has comprised much of the growth of new structures being established in the island." **CIT**

Utah



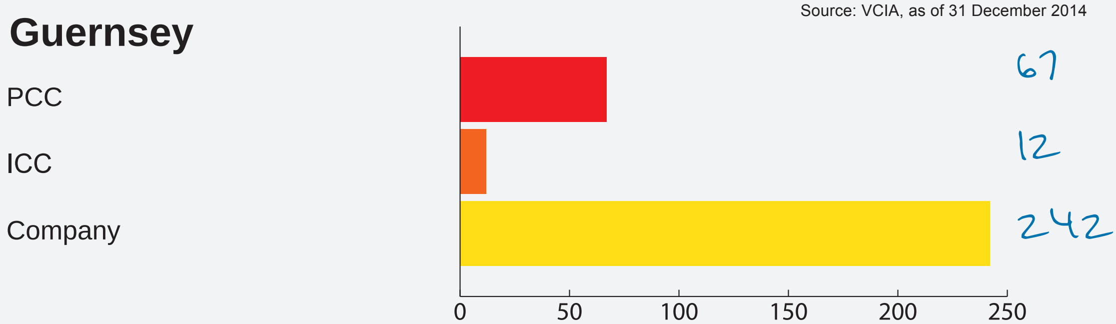
Source: Utah Insurance Department, as of 31 December 2014

Vermont



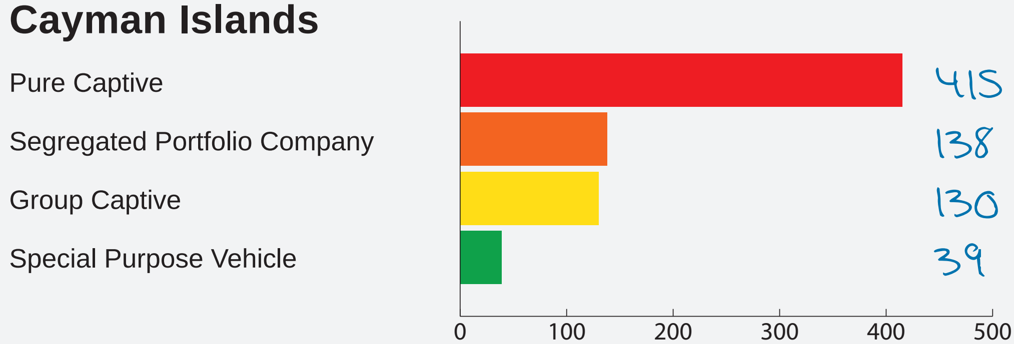
Source: VCIA, as of 31 December 2014

Guernsey



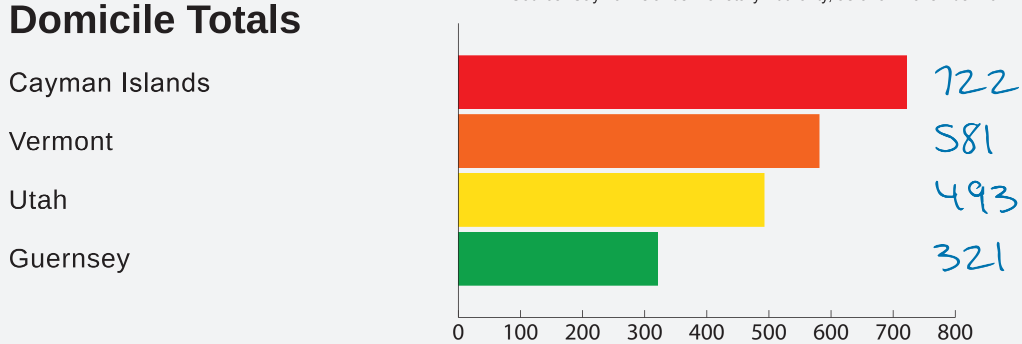
Source: Guernsey Finance, as of 31 December 2014

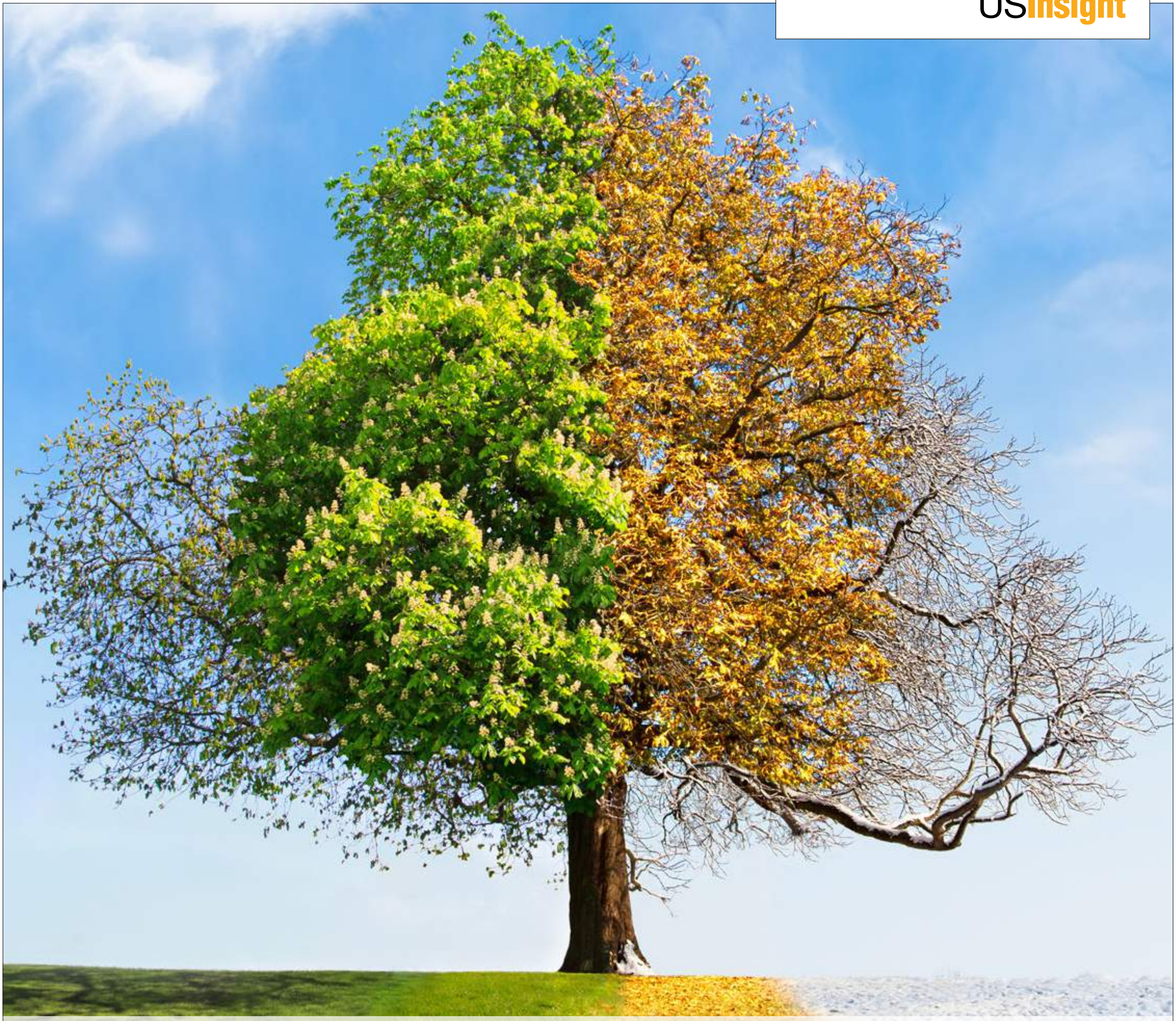
Cayman Islands



Source: Cayman Islands Monetary Authority, as of 31 November 2014

Domicile Totals





The more things change

Washington DC has been the scene of some big moments for captive insurance in the last year, but Skip Myers of Morris, Manning, and Martin says that 2015 could follow a similar pattern

STEPHEN DURHAM REPORTS

Given its timeliness, what is your reaction to the reauthorisation of TRIA?

The initial reaction from my point of view would be that it is great that Congress finally got its act together and the President signed the bill. It was all done pretty quickly, which was nice, and I don't think there was any real surprises—it was a re-endorsement of the Terrorism Risk Insurance Act (TRIA), with somewhat less federal government involvement.

What I mean by this is there was a push by some in Congress, particularly those on the right, to lessen the government's role, while those on the left preferred a bigger government role. The new trigger point limits the amount that the federal government would be on the hook for in the event of a designated terrorist attack, though this doesn't apply to nuclear, biological, chemical and radiological risks. It is an endorsement of the principle that the federal government should provide liquidity to the reinsurance market and reinsurance where there would be very little available if there was no TRIA. This is a good thing for the industry, particularly captives.

Was there any uncertainty from within the industry that this would go through?

There was definitely some real apprehension that it would not get done. That was in part because of the philosophical debate, but more because of the general dysfunction of Congress. As late as right after Christmas, people knew that the new speaker and majority leader had this high on the agenda—but these are just promises. We never really knew. We were fortunate to get it done so quickly in the new Congress.

I think people still assumed that act was going to be reauthorised and never really got to the stage where they were putting substitute programmes in place or not getting the appropriate coverage. It happened quickly enough that it didn't create a great deal of wasted effort.

Are there any similarly concerning regulatory hurdles to clear in 2015?

TRIA was a big item for dealing with Congress, as it lapsed, but there is nothing as pressing on the horizon.

Something like the clarification of the Non-Admitted and Reinsurance Reform Act related to captives would be really great to get done this year, but that will take time.

There are other things that need to be done on more of a defensive basis to prevent federal involvement in insurance business where some people do not like it. An issue such as the federal government placing additional taxation on reinsurance with offshore companies has been a threat for five or six years and that needs to be prevented.

There is talk of the IRS conducting investigations into 'abuses' of captive arrangements. What will be the implications of this?

I think it is pretty common knowledge in the industry that this is going on. From what I understand, the Internal Revenue Service (IRS) is looking at pools that are allegedly being improperly used to provide third party risk to micro, or 831(b), captives.

The IRS thinks that these captives are being 'abused' because there may not be any arm's length pricing or real transfer of risk. Basically, it is a way to postpone taxes and only get taxed on the income from investments, rather than the insurance income as well.

For estate planning purposes, that can be valuable (transferring assets from one generation to another), but there are clearly instances of this not being done correctly. The IRS is trying to get to them by hitting the pooling mechanisms that, in some cases, underwrite risks that are not real insurance risks. Ironically, in these arrangements, the reinsured pays a lot more for this coverage than it is really worth, because it is the insured's insurance company and there is little incentive to pay any claims, anyway. The theory is that the chances of a valid claim are so minimal that they are just going to accumulate cash.

"The clarification of the Non-Admitted and Reinsurance Reform Act related to captives would be really great to get done this year, but that will take time"

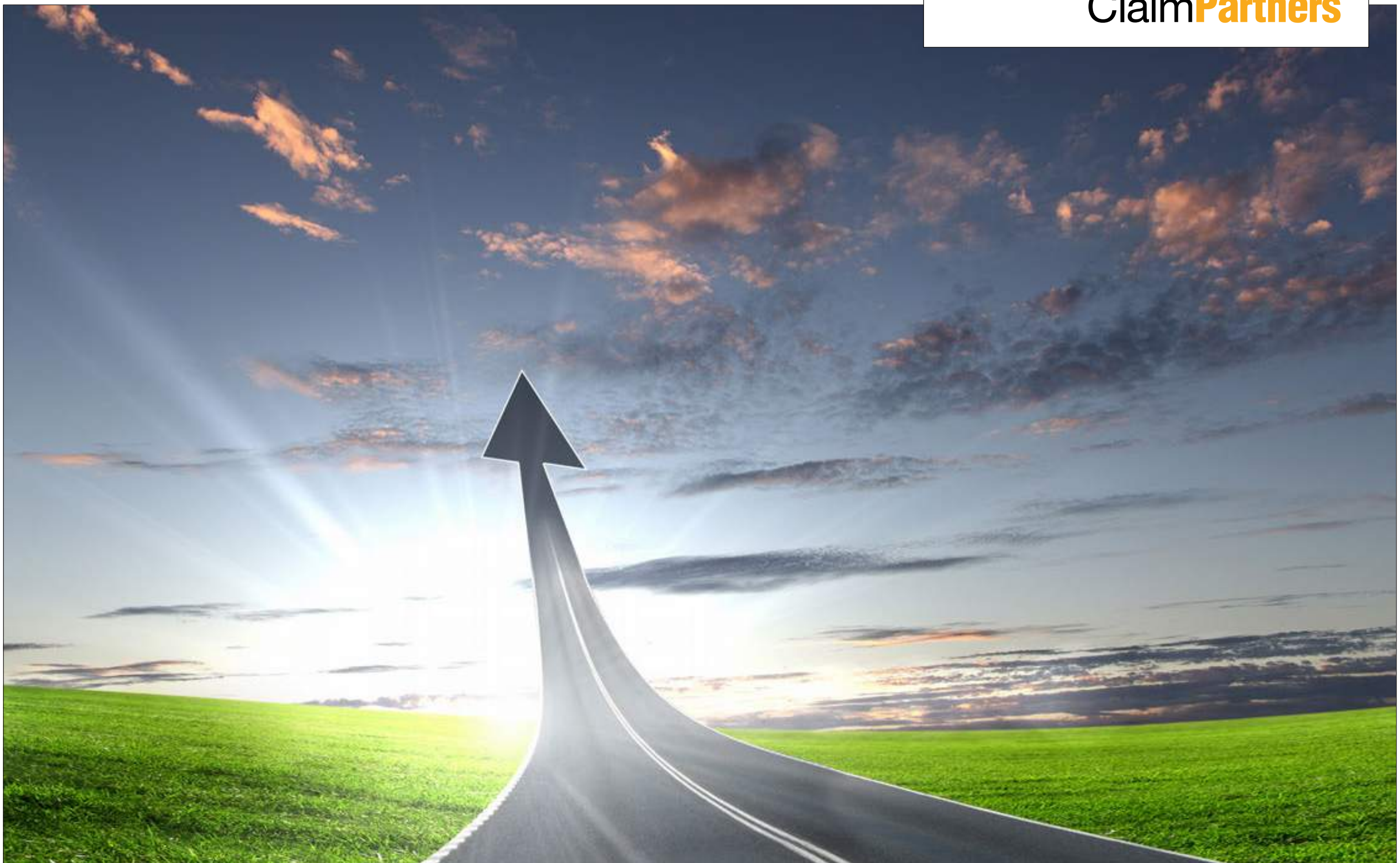
CICA says that you should do captives right or not at all, and I agree with that. In other words, you have got to adhere to the rules on underwriting, third party risk and arm's length arrangements, and it is an abuse of the system if you don't do that. The IRS examination was predictable and we don't know how it will turn out, other than the faulty arrangements will go out of business. It will be a message to micro captives that these types of arrangements had better be done right, or they are going to have problems in the audit.

Aside from regulations, do you see any potential shifts in the US captive industry in 2015?

I don't see anything right now that is going to alter the captive industry itself. There have been a number of significant new domiciles emerging in recent times, such as Texas and Connecticut, which has created more competition for the same business.

We have also still not seen the end of the soft market, though if we had, then I believe that would have had a major effect on business. I think that this market, and the concurrent lack of demand, means that we will not see as many risk retention groups being formed in 2015. However, I think it is important to remember that both the soft market and the proliferation of new domiciles were both trends in 2014, so are nothing new. CIT

Skip Myers
Co-chair of the insurance and reinsurance practice
Morris, Manning, and Martin



Claims and captives: getting it right matters

Claims are at the very core of a captive programme, so having the right claim partner is essential to success. Donna Kreitman of AIG explains the important factors to consider when choosing one

A large part of a captive's expenses will be claims related, so committing the time to find the right partner is certainly a good investment. The greater the ability of that partner to meet a programme's business needs with regard to claims, the more successful that partnership will be.

Before beginning a search, it is a good idea to have a clear and thorough list of those needs to share with potential providers. You might have noticed that I did not use the word "complete" to describe that list, and with good reason. A high-quality claim provider will work closely with clients to gain a more in-depth understanding of their business objectives with regard to claims and in the course of doing so, is likely to surface needs and opportunities that had not previously been considered. Having been down this road before, experienced providers know where the rough spots are and can easily navigate around them to ensure that claims operate smoothly and efficiently.

There are many factors to consider when determining the claim capabilities needed to ensure a programme's success. These include:

The complexity of the programme:

- How many lines of business will be covered?
- Will coverage be provided by a single insurer in one country or multiple insurers in several countries?
- In how many jurisdictions is coverage provided?
- Is a controlled master programme involved?

The parties involved in the claim handling process:

- Who is going to handle claims—the insurer, a third-party administrator, or a combination?
- Does the programme require designated outside vendors, such as forensic accountants, medical consultants or reconstruction experts?
- How does the insurer's claim organisation need to interface with these other parties?

Service standards:

- What are the service standards expected to be met by the claim provider and the other parties involved with claims?

Choosing the right claim partner

Once the list is finalised, it is time to begin evaluating claim providers. There are many factors to be considered. The first is whether the provider takes the time to truly understand the client's needs and demonstrates its expertise by refining and expanding the client's list to ensure that it is both complete and well-matched to all of the claim-related business objectives of the captive programme.

Next, consider whether the provider has the capacity to offer an efficient, proven, and co-ordinated programme of claim and loss reporting procedures, as well as cash flow services. Also, look for a solid claim partner that focuses on mitigating damages, employs a robust fraud detection process, controls expenses during the life of the claim, and has the resources to evaluate recovery after conclusion of the loss.

People, processes and technology play a critical role in the quality of service a business can deliver to its clients. Let us focus on these factors in terms of claim providers.

Claims specialists

Having a team of highly qualified and technical claim professionals who are subject matter experts in each line of business is an invaluable asset to a captive programme. Consider whether claims will be handled by experienced specialists in local jurisdictions, who deal with losses in a specific line of business and are supported by global subject matter claim professionals when warranted. When intricate global claim issues requiring immediate attention come up, it is important to know that claim professionals with in-depth expertise are ready to address them.

Best practices

The right claim partner will make claim service a priority. It will deliver exceptional service, typically via clear, detailed and documented protocols and procedures for loss reporting, reserving, and settlements. One way to accomplish this is through the use of best practices.

Written best practices provide operational controls that are shared and implemented throughout an insurer's global claim network. Using best practices to address claim management, claim controls, and core operational issues facilitates managing any programme. It is particularly important for complex global programmes, which typically have large claim volumes and intricate claim issues across several jurisdictions.

Special claim handling instructions

Special claim handling instructions are also an option. A strategic partner should be skilled at drafting these instructions and efficiently distributing them to its global claim network. These instructions can include reporting requirements and detailed guidelines that ensure consistency, no matter where in the world a claim is being handled.

For example, a client may request that the claim handler include instructions such as: loss notification when reserves and/or settlements reach a certain threshold amount, frequency and format of reports, the use of a specific loss adjuster, attorney or other expert, and/or a list of dedicated claim contacts.

Special handling instructions are an addition and do not take the place of other agreements or policy language. But, they are a key element for ensuring that the claim provider meets the client's expectations regarding claims handling requirements. At every renewal, these instructions should be reassessed in order to determine if there are opportunities for improvements.

Technology

While the core function of claim management has not changed, operations have advanced, especially with the availability of new technology to manage data. Having a claim provider with access to state-of-the-art claims systems is yet another important factor when choosing a partner. Claim data may be obtained through the use of external systems that can provide detailed and up-to-date claim information that is critical to managing business.

Clients and their insurance carriers should be able to easily view consolidated claim information worldwide, monitor all activity, run various loss reports and access financial information in various currencies. At AIG, our IntelliRisk system allows clients 24/7 access to up-to-date claims information and trends.

IntelliRisk provides clients with tools to proactively monitor their claim activity and run ad hoc reports. Such systems allow for efficient claims handling and streamline loss processes throughout the globe.

Cash management

When it comes to cash management, efficiency depends on a strong collaboration with the claim provider. Managing the funds in an escrow or similar funding structure against claim payments requires a dedicated, experienced team and an efficient end-to-end process.

This matter becomes more complex in global programmes where cash calls require reimbursement for a loss. Working with a claim partner to review loss payments and other financials can benefit a client in sorting through cash flow issues and reimbursement requests.

Streamlined processes

Claims need to be identified as early as possible in the loss notification process. Once these claims are identified globally, the right claim partner will be able to streamline loss reporting.

A centralised multinational claim department optimises procedures, deliverables, roles and responsibilities to simplify and streamline loss processes throughout the globe.

A collaborative relationship should exist where the provider's multinational claims department can readily access specialised assistance from the provider's team of global fronting experts and claim professionals that have an in-depth knowledge about the structures and unique features of captive programmes. This team can be an invaluable resource, as it will be highly skilled at facilitating the resolution of any claim issues that might arise.

Claim service agreements

If the services of a third-party administrator or other outside claim partner are required, the insurance carrier should vet these vendors so that everyone is satisfied that the programme is in compliance with all applicable regulatory requirements. When the partnership between the captive and an outside claim team is being documented, an agreement should include the goals, expectations and objectives to be met during the claim service, as well as outline any applicable specific measurable results.

Other controls

Other controls that the right claim partner will employ include, but are not limited to, in-house and panel counsel with a proven track record and insurance professionals that specialise in litigation management. Effective litigation management will help to keep legal costs in check. During the claim handling process, the claim professional should identify if any subrogation exists and determine whether pursuing that avenue is cost effective. If successful, any monies recouped inure to the captive's benefit.

Claim providers should have an end-to-end process to ensure compliance with Medicare. Failure to comply with this US federally mandated requirement can result in fines and penalties being levied. Lastly, while it is critical to align with an insurer that focuses on providing prompt claim service, it is equally important that the insurer has a robust fraud detection process, so that only legitimate claims are paid.

Summary

Claim management is important to a captive account's success, and choosing the right partner is critical to achieving that success. A globally integrated provider with experienced, skilled claim professionals and the ability to offer a globally coordinated, efficient programme of claim and loss reporting procedures, as well as cash flow services, benefit both captives and their parents.

Such a strategic relationship also allows for accurate and timely communication that is critical when providing claim and payment information and loss data. Choosing an insurer with the right claim organisation not only matters, but can have a direct impact on a captive account's bottom line. CIT

Donna Kreitman
Senior vice president and head of global risk solutions and multinational claims
AIG

Tom Stokes of JLT Towner Insurance Management (USA) offers predictions for the captive insurance industry in 2015

Last year brought new developments in the captive insurance industry, combined with a healthy dose of the same-old-same-old. Some of the events were predictable, while others caught many by surprise. This year, with the proliferation of new domiciles, seemingly pro-captive court rulings and some aggressive planning opportunities, the stage is set for significant advances in captive insurance and, perhaps, a few battle scars, too.

TRIA reauthorisation spurs organisations to think about alternative ways to cover some of their terrorism exposures.

A comedy act could probably scripted based only on the Terrorism Risk Insurance Act (TRIA) soap opera, ending with its swift passage by the new Congress in January. As we predicted last year, President Barack Obama did not hesitate to sign the legislation. The extension, which doubles the federal backstop trigger to $200 million for qualified traditional terrorism events and increases the copayment from 15 to 20 percent, wasn't ideal, but a reasonable compromise. More importantly, the new law is not due to sunset again until the end of 2020, giving insureds more certainty than they had last year.

Now entities exposed to these risks can better evaluate captives as a way to insure for both traditional and nuclear, biological, chemical and radiological (NBCR) events, which commercial markets are not yet equipped to cover.

Two recent tax rulings against the IRS change the landscape for captives

Last year, captives for Rent-a-Center and Securitas were on the winning side of tax court rulings, in which the Internal Revenue Service (IRS) contended neither captive was truly an insurance company. They were so judged, according to the separate rulings.

There are a number of reasons why this bodes well for organisations looking toward new captive solutions, but the courts basically said that if a captive is operated on an arm's length basis with the proper intent to insure risk, the IRS should not challenge based on technicalities.

> "There is one caveat: the Rent-a-Center case saw significant dissent, meaning that the IRS may not be done challenging captives on these grounds"

There is one caveat: the Rent-a-Center case saw significant dissent, meaning that the IRS may not be done challenging captives on these grounds. However, the landscape has changed enough for organisations seeking alternative insurance solutions can look toward captives with more confidence.

Overall, soft market conditions will continue through 2015

This condition will not matter to those organisations seeking captive-centric benefits. We have always counselled our clients to look beyond the lowest premiums.

At some point, today's soft market will become tomorrow's capacity problem, leaving those organisations looking, perhaps hurriedly, at other solutions. Compare this to rushing out and buying a gas-guzzler now that gasoline hovers around $2 per gallon. Who knows what the price will be 18 months from now. Short sighted thinking is becoming a thing of the past.

We recommend that organisations examine the many other benefits of a captive-centric approach. Such an approach can improve loss control, resulting in fewer incidents and lower severity of claims. By enjoying the same tax status afforded commercial insurers, captives further build on their ability to accumulate capital to protect against loss.

The best thing to do is to take a fresh look. Understand the advantages and disadvantages. Whether the decision is to start a captive or transfer more risk to one, a greater comprehension of the many benefits of captive insurance will come.

More domestic companies will move their offshore captives onshore

There are a number of reasons why captive owners will consider either moving onshore or choosing to establish a new captive domicile in the US.

Firstly, the differences between offshore and onshore have all but disappeared. While there remain very attractive offshore domiciles, the advantages have narrowed and costs are usually less expensive onshore. Secondly, as more states introduce captive legislation, there is greater access to localised regulation and oversight.

Choosing a new captive domicile depends on each entity's unique risk transfer needs, but should come after a comprehensive feasibility study. Understand that with so many domiciles from which to choose, a comprehensive analysis by decision makers is paramount to choosing the right location.

The attack on the Dodd-Frank Act will continue

Last year saw Congress poke significant holes in this contentious law, which has become a poster child for complex legislation. The Republican-dominated Congress has promised to remove some provisions and water down or delay others, but the act doesn't appear to be going anywhere.

Captive owners are focusing their interest on one area of the now five-year-old act, the Non-Admitted and Reinsurance Reform Act (NRRA). While this part of the legislation may have simplified some of the complexities of individual-state regulation, the confusion over taxing surplus and excess lines continues.

Clarification of whether NRRA empowers states to impose premium taxes on insurance transactions outside of their jurisdiction was requested three years ago. If so, will states be able to coordinate their collection and redistribution? The answers to these questions are as elusive as ever.

There is hope that Congress will finally tackle this part of the Dodd-Frank conundrum to provide clarity, but the best guess is that this particular aspect of the bill will not be addressed this year. Captive owners that may be in the process of evaluating whether to redomicile their captives should stay tuned.

Group captives will find a broader audience

For years, captive insurance managers have predicted a trend where the middle market would comprise a growing percentage of the overall captive insurance market. We believe this year we will see a strengthening of that trend, especially in the group captive area.

More small-to-medium-sized companies are expressing an interest in this type of captive. They are looking at like-minded companies of similar size with similar exposures and exploring how captives can help them manage both costs and risk. There is no reason why only the biggest companies should enjoy the benefits of captive participation.

One reason for the increased interest is the continued confusion around the requirements of Obamacare and how it affects smaller employers. Group captives were tailor-made for smaller companies that wish to enjoy the same advantages.

The IRS will continue to focus on 831(b) captives

Small captives, organised under IRC Section 831(b), are the fastest growing segment of the captive industry. As a refresher, these small captives can write no more than $1.2 million in annual net premiums and can elect to pay tax on investment income only, exempting them from tax on underwriting profits. The one caveat causing trouble for many, however, is that the entity must qualify as an insurance company, thus having the necessary attributes such as risk transfer and risk distribution.

During 2015, the IRS expressed some concern about these vehicles being used as tax and estate planning vehicles. A dozen or so captive managers have been contacted by the IRS to participate in an investigation into possible abuses (JLT Towner is not among them). We believe this scrutiny will intensify.

For existing small captives, there is little worry as long as it was formed and operates for solid insurance purposes. Captive managers can help to stay current with developments as they occur.

In fact, this is good advice for any captive. Institute an annual programme review to ensure that a captive is operating at peak efficiency. Explore whether the reason the captive was formed is still valid and whether te captive might entertain new risk transfer opportunities. Research the new opportunities to manage risk through captive-centric risk management practices. The more prepared a captive is, the better it can weather any environment. CIT

Tom Stokes
Managing principal and US consulting practice leader
JLT Towner Insurance Management (USA)

More than just a bond du jour

Jason Loffredo of Comerica Securities outlines what captives should consider when choosing a financial consultant

Most asset owners aren't looking for the 'bond du jour' for their investment portfolios.

They prefer a partner to work with as a financial consultant to discuss and review the portfolio, and provide the necessary products and services to achieve their financial goals.

Whether managing a bank portfolio or a captive investment portfolio, investors are faced with a complex financial marketplace and most recognise the need for specialised guidance to help them determine which investment options are best suited for them.

Working with a brokerage firm and an individual financial consultant can offer several benefits. The captive (be that the investment portfolio, the manager or a combination of both) and the financial consultant work closely together to design an investment strategy that is custom-tailored to match each individual captive's goals and objectives.

The financial consultant has access to a wide breadth of market resources to build a portfolio specifically aligned to specific collateral guidelines. For example, if the investments secure a letter of credit (LOC) or reinsurance trusts, it is crucial to adhere to the restrictions placed by the LOC provider or the fronting insurance company that is the beneficiary of the trust.

An investment policy statement

In order to structure an investment portfolio, having an investment policy statement (IPS) is an essential tool. The IPS will outline general rules for the captive's portfolio. It provides the investment goals and objectives for a captive and describes the strategies that the financial consultant will abide by to meet those objectives. If an IPS is absent, the financial consultant can help to construct and implement an appropriate IPS.

An IPS should have specific information on matters such as asset allocation, risk tolerance, and liquidity requirements. As the IPS is developed, the financial consultant can provide a captive with choices, advice and strategies to help reduce risk and maximise return with a range of products and services.

On the product side, the IPS may typically allow the following: commercial paper, high grade and high yield corporate bonds, equities, preferred stocks, structured products, government agency bonds and mortgage-backed securities, institutional money market mutual funds, municipal securities, US treasury securities, brokered certificates of deposit (CD) and placement programmes. In general, captives will have funds in safe investments in order to pay claims. Safety, liquidity, and yield, in that order, are typically the most important objectives.

Plan into practice

Once an IPS is in place, the captive and financial consultant can implement the specific investment strategy.

A useful strategy in this current low interest rate environment is a bond ladder. Building a bond ladder is an excellent tool that can help reduce (although not eliminate) interest rate risk and re-investment risk, while maintaining steady cash flows.

So, as interest rates begin to rise, as one bond matures the funds can be reinvested to the end of the ladder into longer higher-yielding bonds. For example, a three-year brokered CD laddered portfolio could have investments that mature every six months. When the first CD comes due in six months, the captive will have the opportunity to buy the current three-year CD rate.

By using this strategy, the portfolio is building liquidity every six months, essentially playing defence against an increase interest rates. Building a laddered bond portfolio is just one way that a financial consultant can service a captive's investment needs.

The financial consultant can also use portfolio analytical tools to simulate how a portfolio may behave under certain market conditions by shocking the portfolio. This portfolio analysis allows the captive to shock the market with a change in interest rates or a market crash to see the resulting impact on the portfolio. For example, using a parallel shift in the interest rate curve allows the captive to bump the interest rate curve by a constant spread (+ or -), which corresponds to upward or downward shifts of the interest rate curve, respectively.

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Once completed, the captive will be able to revalue the portfolio under each scenario, and calculate the difference between the original and scenario fair value.

Once a shock test is performed, the financial consultant can discuss the possibility of adjusting the duration of the portfolio and take action. One action is to do a bond swap. An investor might consider swapping longer-term bond holdings for shorter-term bonds in order to lower the potential impact on their overall bond portfolio value.

Another strategy is to implement a swap to increase the portfolio yield. Instead of a buy and hold investment strategy, investors will often swap a shorter-term bond for a longer-term, since longer-term bonds typically offer a higher yield.

And for a captive that may have surplus funds over and above what is needed for collateral, or a more mature captive with a larger net worth, a more aggressive approach can be considered. For example, an investor might consider accepting lower credit quality in order to gain a greater return. Bonds with lower credit ratings typically compensate investors for the greater risk with higher yields.

Other analytical tools available from the financial consultant to the captive include credit quality, sector and maturity analyses. With that said, a captive and financial consultant should review the portfolio on a timely basis.

In the same fashion as when we go see the doctor to make sure our health is in good working order, regular consultations with a financial consultant ensures that a portfolio is properly aligned to the captive's needs and goals.

Have any of the corporate bonds in the portfolio experienced a downgrade? Or, are any on negative watch? Do the captive's investments match the tail on their loss reserve liabilities?

These are all questions the financial consultant can review with a captive in order to maintain a good bill of financial health.

In this day and age, the financial marketplace continues to see a growing number of financial portals. The portal is marketed as a self-service trading tool to buy and sell securities. As mentioned above, today's financial marketplace is a complex environment.

For example, a simple bond search—via a portal—for a government agency bond can produce hundreds of bond offerings to choose from. Each one of those bonds is likely to be structured differently based on certain call provisions or coupon structure.

With that said, having a financial consultant is a valuable resource to take the helm and navigate through this ocean of bonds.

A dedicated investment professional can help select a bond and most importantly discuss the investment and all the terms and conditions, as opposed to just hitting the 'search' button.

Bond du jour

At the end of the day, whether involved in the beginning stages of forming a captive, or in a mature captive, a financial consultant is a valuable resource to have available.

A financial consultant can help to design and implement a proactive investment approach rather than letting the market take charge.

Prospective captive clients should hear about all of the different products and services discussed above, but there is one quality that is truly the most important piece to a client investment relationship: integrity.

A financial consultant has all tools and skills necessary to help manage a portfolio, but if they do not have integrity, then their client's financial goals will fall prey to the 'bond du jour'. Rather than settling for the bond du jour, find a financial consultant who has this quality, and leverage all that it has to offer. **CIT**

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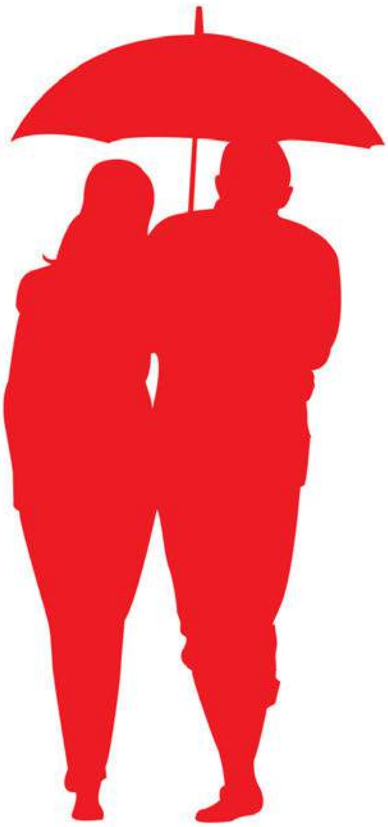

Industry appointments

Susan Donegan has been reappointed as the commissioner of the Vermont Department of Financial Regulation (DFR) for a period of two years.

Donegan worked at the DFR from 1985 to 1990 and was the department's first director of securities regulation. She was later counsel to the commissioner and hearing officer at the Massachusetts Division of Insurance from 2008 to 2011.

In 2011, she returned to Vermont as deputy commissioner of the insurance division at the DFR. She was appointed commissioner in January 2013.

Donegan also represents the state Vermont at the National Association of Insurance Commissioners (NAIC) at the International Association of Insurance Supervisors (IAIS) as vice-chair of the governance working group.

"I remain steadfast in my commitment to maintain Vermont's exceptional stature in the captive community and to help Vermont welcome new companies that have proven they deserve to be included in the list of 'gold standard' captives here," said Donegan.

"I plan to continue my committee work with the NAIC, particularly relating to principal-based reserves and other issues that impact the captive world. And I am always happy to help our sister states learn best practices from us since we have proven experience in regulatory issues."

Marsh has promoted **Lou Ann Layton** to leader of its Pacific north partnership.

The new role will include covering Marsh's office in Denver, Honolulu, Salt Lake City, San Francisco, San Jose, Seattle and Portland.

Layton has relocated to San Francisco for her new role.

She previously led Marsh's US financial and professional liability practice (FINPRO) and has also chaired FINPRO's global advisory board, led Marsh's claims advocacy and financial institution practices, as well as the western regional FINPRO practice.

Devin Beresheim will take over from Layton. He previously served as the US east zone leader for FINPRO at Marsh.

His responsibilities will include fiduciary, employment, cyber/privacy, and related insurance coverage, serving Marsh's global risk management clients.

Martin Eveleigh has been elected chairman of the North Carolina Captive Insurance Association (NCCIA).

Eveleigh, who is president of Atlas Insurance Management, has been a member of the NCCIA board of directors since 2013, and served as chairman of the annual conference committee in 2014.

He began his career as a broker in the Lloyd's of London market. He designs alternative risk transfer programmes, particularly risk pools and captive structures.

He has chaired the legislative committee of the Bahamas International Insurance Association and drafted legislation and regulatory guidance for Anguilla and Nevis.

Thomas Adams, president and CEO of the NCCIA, said: "Eveleigh is one of the best known individuals in captive insurance"

"His election provides not only continuity but the strong leadership skills that will be necessary to continue North Carolina's rise to becoming one of the top domiciles for captive insurance companies."

Lane Brown was re-elected as vice chairman and **Jesse Coyle** was elected as secretary of the trade association.

Jeremy Colombik and **Dan Reppet**, two new members, were elected to two-year terms on the board.

The Cooperative of American Physicians (CAP) has appointed **Sarah Pacini** as its new CEO, which will become effective 1 February.

Pacini previously served for Advocate Health Care, the largest health system in Illinois.

As CEO of both CAP and the Mutual Protection Trust (MPT), she succeeds James Weidner, who is retiring after serving as CEO since 1995.

She will work to enhance and extend CAP's core businesses, MPT and CAP Assurance Risk Purchasing Group, which provides access to medical professional liability protection, patient safety education, and risk management services.

Pacini brings to CAP extensive experience in healthcare, law, patient safety, captive insurance, claims and risk management, and medical professional liability.

Juan Cobo, chair of the MPT board of trustees, commented: "Throughout her career, she has worked hard to protect all stakeholders in the healthcare system."

"Most recently she was responsible for forming a risk purchasing group to support and protect physicians in Illinois."

RIMS has named **Rick Roberts** as president for the 2015 term.

Roberts is the director of risk management and employee benefits for ensign-Bickford Industries. He has been a member of RIMS for 25 years and on its board of directors for seven.

He previously served as the society's vice president and board liaison to the external affairs committee.

Roberts commented: "No two days as a risk professional are ever the same."

"Current events, new technologies and global initiatives continue to keep risk professionals searching for the latest industry information and best practices." CIT

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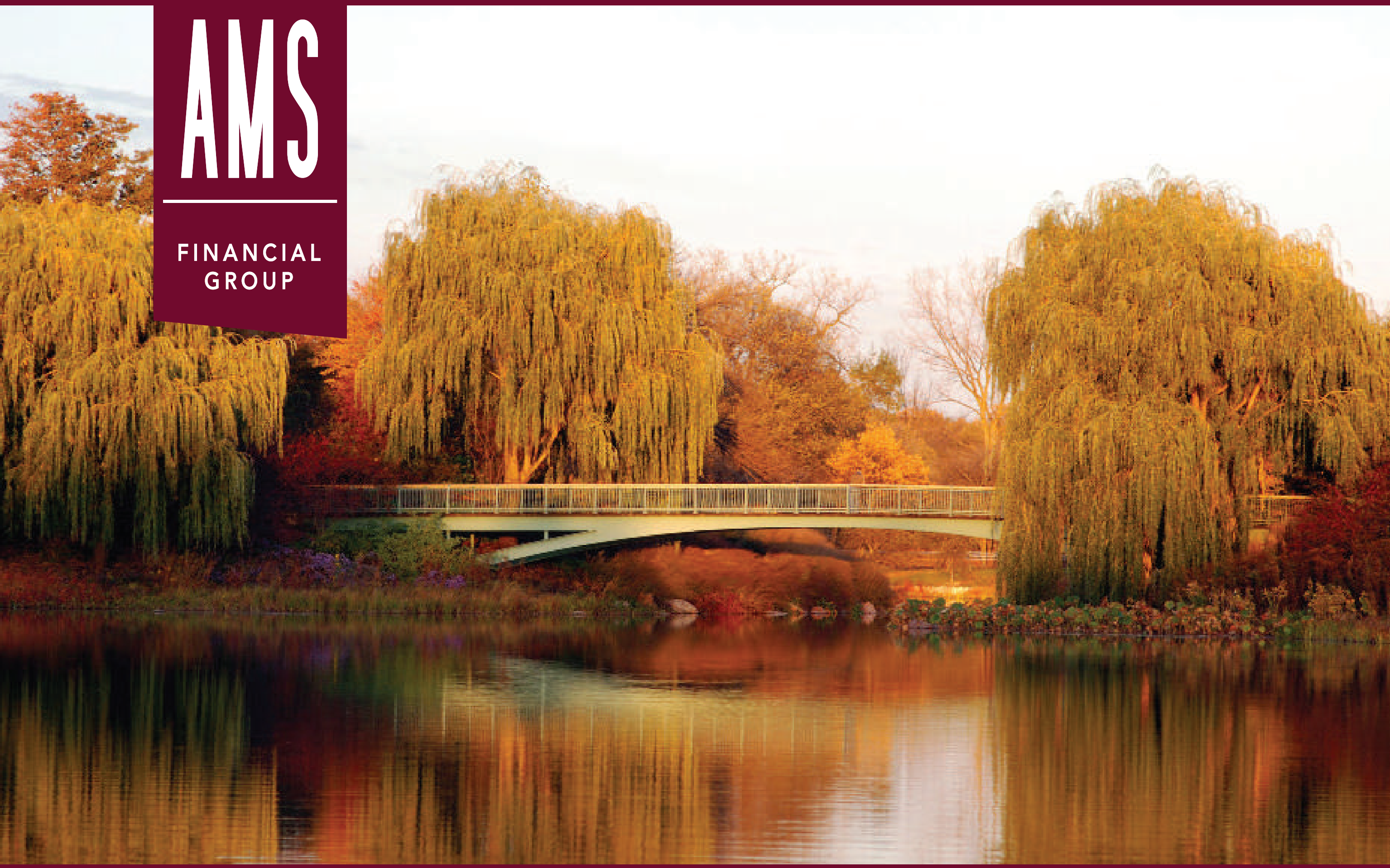


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