



# 180°

A guide to what's hot in the world of captives and ART



Strategic Risk Solutions

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## 2006 Review

In our first newsletter of 2007 we will review the events that occurred in the captive insurance industry in 2006 and the current state of our market.

In March 2006, our President, Brady Young, made several predictions of what would happen in the captive insurance industry. A year later we can grade the accuracy of Brady's predictions.

- *New formations will be flat:* The formation rate was slightly higher than 2005. B
- *Some RRGs will be under pressure:* Pressure, mainly market pressure, is intensifying. B-
- *Employee benefit uses will increase:* There was strong interest and growth. A
- *There will be high interest in using captives for property:* Many captives new and old are writing property. A
- *Many rent-a-captive owners will move to single parent:* Movement was slower than anticipated. B-
- *The fronting market will improve:* It has been more competitive for well structured programs. B
- *Domicile life-cycle will continue:* There have been some signs of growing pains among the newer domiciles. B

Average grade: B+

Overall 2006 was a good year for captive formations and probably exceeded expectations. While captives are a long-term solution, their use is somewhat affected by short-term fluctuations in insurance pricing. The softening commercial market was expected to reduce formation rates. In actuality, formations in the major domiciles where SRS manages captives were marginally higher in 2006 than 2005.

	Vermont	S. Carolina	Arizona	Bermuda	Cayman
2006 Activity	37	29	23	25	56
2005 Activity	37	21	17	22	59
Active captives	563	140	85*	900	740
Premiums	\$13bn	\$4bn	<\$1bn	\$17bn	\$7bn

\* Licenses issued. Number of active captives unknown

The formation rate is down from the high levels seen after September 11, 2001 but it is still considerably higher than the rate seen in the soft insurance market of the late 1990s. Comments by domicile follow.

**Vermont** - in 2006, captive growth was consistent with the prior year in Vermont. The State licensed 37 new captives with 16 dis-solutions for a net increase of 16. This represents a 3.9% increase in active captive numbers for the domicile. Growth was seen in five areas:

- Property: 13 of the new formations are writing property
- Real estate: 7 new captives have parents in the real estate industry
- Life reinsurers: 5 new formations.
- Employee benefits: 5 new formations.
- Medical malpractice: there are now more than 100 healthcare captive programs in Vermont with total gross written premium of \$1.4 billion in premium.

Vermont continues to maintain a leadership position among onshore domiciles. The State is working hard to maintain that position with regional road shows and an educational program. The regulatory environment is stable with no major changes seen in 2006. Only minor regulatory changes are anticipated in 2007. The department has recently endorsed changes allowing captives to securitize their assets. This change will mainly affect life insurance captives in Vermont. Vermont is increasingly attracting service providers and reinsurers to the State to support captives. In 2006, Milliman became the first major actuarial firm to open an office in Vermont.

**South Carolina** - 2006 saw increasing captive growth in South Carolina. There were 29 new captive formations and 5 dis-solutions for a net increase in active captive numbers of 24 or 20.4%. South Carolina is the third leading US captive domicile with 140 active captives, although it is fast gaining on Hawaii which has 160 active captives and is seeing only modest growth. 2006 saw a higher number of risk retention group formations in South Carolina and fewer dis-solutions than 2005.

The growth was experienced despite changes in regulatory personnel. These changes continue with the recent replacement of the Insurance Director in the State.

South Carolina remains an attractive domicile for risk retention groups which account for a higher percentage of total captives (32%) than other domiciles such as Vermont

(14%) and Arizona (26%). South Carolina has also been an attractive domicile for captives with parent organizations located in the South-eastern US. The State may face increased competition from new domiciles such as Alabama and Kentucky for this market in the future.

**Arizona** - 2006 was another strong year for Arizona with 23 new formations. Active captives grew 42% to 74 captives. Arizona has quickly established a critical mass of captives solidifying its position as a leading onshore domicile. Arizona is an attractive domicile for captives with parents on the west coast. These companies account for 54% of Arizona's captives.

By line of coverage, Arizona has a high proportion of liability (40%) and medical malpractice (46%) captives. This is also reflected in the spread of parent company industries with the medical (23%) and construction (11%) industries being the most common.

Arizona continues to face competition from Nevada and Utah, but it appears to be thriving as a domicile. It is one of the few onshore domiciles which doesn't impose a premium tax. Proposed regulatory enhancements for 2007 include:

- Branch captives
- Controlled unaffiliated business allowed for Groups
- Reduction in the Protected Cell statutory capitalization from \$1 million to \$500,000
- Pure captives to be allowed to form as LLCs
- Confidentiality extended to entire captive article—except RRGs

**Bermuda** - There was a 6% increase in active insurers and reinsurers in Bermuda during 2006. A large proportion of the increase was seen among Class 3 reinsurers with the creation of sidecar facilities. The true captive market was more subdued. There were 17 new Class 1 and Class 2 formations bringing the total estimated number of captives in Bermuda to approximately 900.

Bermuda is the most mature captive domicile and remains the world's largest domicile. It has faced increasing competition by new domiciles both onshore and offshore and there has been some trend towards re-domestication of captives onshore. Bermuda has also had to deal with its success as an international reinsurance market with the number of new formations of Class 3 and 4 insurers causing some distraction from the captive market.

However there is a renewed focus on the captive market by Bermuda's regulators and captive community. This includes a streamlined review process for new captives with the BMA in-sourcing more of these activities. This is reducing licensing times for new captives. Bermuda has also launched its own annual captive conference.

Bermuda remains the only domicile with global appeal and the only major domicile co-located with a major commercial insurance market.

**Cayman Islands** - 2006 was a relatively flat year for Cayman. New formations were slightly down from 2005 at 56. A large number of dis-solutions resulted in a net increase of 7 active captives. Most of the net growth was seen in segregated portfolio companies.

Cayman is a leading domicile for healthcare captives, which account for 38% of the market. Workers compensation is second with 21% and property third with 10%.

2007 will see a transition in the regulators office with the retirement of the former head of insurance from January 1, 2007. We anticipate this transition to be smooth with the former deputy head assuming the head of insurance role. A new deputy head with regulatory experience in another captive domicile, Guernsey, has been appointed.

**Other Domiciles** - There was a marked difference in the level of activity in offshore domiciles compared to onshore US domiciles. Offshore domiciles saw a significant slowing down in the rate of captive growth during 2006. This was driven by increased competition from the onshore domiciles as well as some closures of smaller captives. The British Virgin Islands reported issuing 57 new licenses during 2006 although net numbers were largely flat. Captive numbers in Turks and Caicos were relatively flat as well, while Barbados saw a decline in active captives.

	Active	Change in 2006
BVI	383	3
Barbados	235	(7)
Turks & Caicos	169	3
Hawaii	161	4
Nevada	96	35
DC	70	11
Utah	30	15

Onshore, growth was strong particularly among some of the newer domiciles. Nevada emerged as a major onshore domicile with the addition of 35 new captives in 2006. It has subsequently passed 100 captives and become the fourth leading onshore domicile behind Vermont, Hawaii and South Carolina. Hawaii saw modest growth in new captives and could soon be under pressure from South Carolina and Nevada to maintain its position as the second leading onshore domicile.

## Outlook for 2007

In keeping with last year, we are also making some predictions of what will happen in the captive insurance industry in 2007.

1. Overall, the captive market will increase slightly.
2. Property utilization will increase with activity in three areas:
  - a. Catastrophe focused group captives
  - b. The use of 831(b) captives to finance property risk
  - c. The use of captives as a tool to access the property reinsurance market.
3. The number of captives writing employee benefits will double.
4. There will be a continued movement to single parent captives from groups and rent-a-captives.
5. Several RRGs will halt operations, voluntarily or involuntarily given soft market conditions.
6. The IRS will be more aggressive, particularly regarding rent-a-captives. Expect a major tax case in 2007 to set precedent.
7. A second-tier domicile will pull back with the governing authorities in that domicile reducing their commitment to the captive insurance industry.

We will review the accuracy of our predictions next year and see if we can improve our grade!

## SRS News

**Client News** - SRS is pleased to welcome the following new captive clients:

- **Hardin Indemnity Ltd**, a single parent captive was licensed in the Cayman Islands in February 2007. The company provides workers compensation insurance to a professional employment organization.
- **Edgewater**, a single parent pure captive was licensed in Vermont in late 2006. Edgewater is owned by American Dental Partners, a Wakefield MA based company.

- **Atlas**, a pure captive was licensed in Vermont in the first quarter. It is owned by Atlas Insurance Brokers an independent NY based insurance broker.
- **Y-Bridge Insurance SPC**, an affiliate of Strategic Risk Solutions, was incorporated as a Segregated Portfolio Company in the Cayman Islands in March 2007. The company will provide SRS clients with an option to use a cell captive program rather create a standalone captive insurance company.

**Our People** - SRS is pleased to announce that **Hans Gmünder** has joined the firm as Vice Chairman and non-executive board member of SRS Bermuda Ltd. He will be responsible for helping the company expand its base of European clients and service capabilities.

Hans is an insurance industry leader with more than 30 years of experience with Winterthur Insurance and later XL Insurance. He was a key contributor in Winterthur's expansion in Europe and globally with multinational clients. He has worked with many clients in designing and operating captives, rent-a-captives and various other alternative risk management solutions for difficult risk problems.

Hans will be based in Zurich, Switzerland. Phone +41 79 430 28 00.

**Events** - SRS will be participating in the following upcoming events:

- **RIMS, April 30 – May 3, 2007.** Brady Young, Michael O'Malley, Wayne Cowan and Ron Sulisz will be attending the RIMS conference in New Orleans. Please contact us at [info@strategicrisks.com](mailto:info@strategicrisks.com) if you are interested in scheduling meetings with any of them at the conference.

**SRS Webinar Series** - SRS hosts periodic webinars on topical issues affecting the captive insurance industry. To ensure you are included on the distribution list for webinar announcements, contact us at [info@strategicrisks.com](mailto:info@strategicrisks.com).

The next scheduled webinar is:

**Actuarial Concepts and Issues for Captives**  
**May 9, 1.00pm EDT.**

**Presenters:** Michael O'Malley, Managing Director, Strategic Risk Solutions and Joel Chansky, Principal & Consulting Actuary, Milliman.

Strategic Risk Solutions (SRS) is an independently owned captive management and consulting firm. The company is an approved manager of captive insurance companies in Arizona, Bermuda, Cayman Islands, D.C., South Carolina & Vermont. SRS is committed to being the premier provider of captive management and advisory services in the territories in which we operate.

For more information on SRS, visit us at [www.strategicrisks.com](http://www.strategicrisks.com).

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