



# 180°

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



Strategic Risk Solutions

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## TRIA and Captives, The Next Chapter

On December 26, 2007, President Bush signed a seven-year extension of the Terrorism Risk Insurance Act (TRIA). First introduced in 2002, TRIA has provided a Federal backstop to commercial insurers and captives. In our first newsletter of the year, we take a look at the evolution of TRIA and what the extension means for captive insurers. This newsletter draws on information presented by Joe Holahan and Skip Myers from Morris, Manning & Martin in our November 2007 webinar.

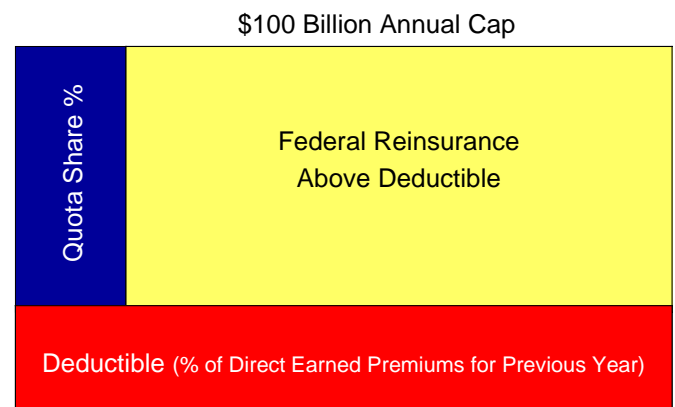
**A (Very) Short History of TRIA** - TRIA was initially enacted in November 2002. The initial Act established a three-year program with reduced federal participation each year. Its goals were to address the short-term market disruption following September 11. Federal participation was intended to stabilize the insurance market and allow the private sector time to build capacity and long-term solutions for terrorism risk insurance. Federal involvement was designed to be temporary without usurping the role of the States in regulating insurance.

The initial Act was extended for a two year period with a further reduction in federal participation. During these five years there was no terrorism act triggering coverage under the Act. This and the presence of TRIA itself has helped stabilized the terrorism insurance market, although few viable private alternatives have been developed. As a result there was extensive lobbying by the insurance industry for a more permanent extension of TRIA. This resulted in the current seven-year extension. While it is a more permanent solution, the Act which was signed by the President was a far more limited extension than proposed by the House of Representatives. The House Bill had called for a 15 year extension with coverage extended to include Nuclear, Biological, Chemical and Radiological (NBCR) terrorism and group life insurance.

**Major Components of TRIA** - TRIA is structured to provide federal reinsurance for losses resulting from a "certified" act of terrorism. To date, this has generally been limited to acts of foreign terrorists in the U.S. The most recent extension expands the definition to include acts of domestic terrorism. Aggregate insured losses must equal or exceed a threshold (currently \$5 million) for an act to be certified by Secretary of the Treasury. However federal compensation does not become available until aggregate insured losses exceed a much higher trigger (currently \$100 million). Once the trigger is met, all certified losses are eligible for federal compensation, not just those in excess of trigger.

Insurers must pay deductible and co-insurance amounts. Deductibles are specified as a percentage of direct earned premiums for the previous year. Co-insurance is a percentage of any terrorism loss covered under the Act. Insurers must "make available" coverage for certified acts of terrorism in commercial P&C policies on the same terms as other coverage.

### Exhibit 1: TRIA Deductible & Co-insurance, 2003-2007



TRIA is funded post-loss. Up to 3% annual premium surcharge could be levied on all policyholders of insurers covered by the Act. (In some cases, the Secretary of the Treasury may have authority to require an even higher surcharge.) The surcharge would apply regardless of whether the insured elected to buy the coverage.

**Current Changes** - Exhibit 2 shows an evolution of the major components of TRIA. Federal participation had been decreasing over the initial five years of TRIA through higher deductibles, higher triggers and larger co-insurance percentages. The latest extension however maintains the participation points at the 2007 levels. There are no plans to change participation levels through the seven-years. These fixed levels and the length of the extension provide the most certainty to insurers underwriting terrorism insurance at any point under TRIA.

Rather than decrease federal participation, the major change in the current extension is to include domestic terrorism. There is no requirement for insurers to offer NBCR coverage, but NBCR coverage will be the subject of a study by the Government Accountability Office.

**Captives and TRIA** - Onshore captives are "insurers" subject to the Act. As such onshore captives will be required to charge a

premium surcharge to their policyholders to recoup funds paid under TRIA, even if no coverage is provided.

## Exhibit 2: Evolution of TRIA

	2002 Act	2005 Extension	2007 Extension
Period	3 Years	2 Years	7 Years
Coverages	P&C - some exceptions, e.g. prof. liability	P&C – additional exceptions incl. commercial auto	P&C. Group life proposal rejected.
Terrorist Acts	Foreign	Foreign	Foreign and domestic
NBCR required	No	No	No (study by GAO)
Threshold	\$5 M	\$5 M	\$5 M
Trigger	\$50 M	2006: \$50 M 2007: \$100 M	\$100 M
P&C deductible	2003: 7%; 2004: 10%; 2005: 15%	2006: 17.5%; 2007: 20%	20%
Co-insurance	10%	2006: 10% 2007: 15%	15%
Industry Retention	\$15 bn	2006: \$25 bn 2007: \$27.5 bn	\$27.5 bn

As TRIA deductibles are based on an insurer's premium volume, captives as smaller insurers may have advantages in accessing TRIA at a lower level than commercial insurers. However, the Treasury may deny a claim if it is deemed to be "designed to circumvent the purposes of [TRIA]." The Treasury is aware of the deductible discrepancy and cautions entities against forming a captive insurer for stand-alone, single-risk terrorism insurance in order to avoid TRIA's deductible requirements. Care also needs to be taken when structuring TRIA coverage in captives relative to pricing and capital adequacy. Obvious gaming strategies are out:

- Charging minimal premium for high levels of TRIA coverage
- Maintaining two captives—one onshore for TRIA risk and another offshore for all other perils

The Treasury has the authority to issue regulations setting conditions on captive participation in federal backstop, but so far has declined to do so.

A high percentage of onshore captives are writing TRIA coverages. This is primarily to fill gaps where the commercial market can't respond, premiums are too high or limits are insufficient. This is particularly true where coverage extensions are needed for indirect time element or NCBR risks.

**NCBR** - Although the latest extension did not include NCBR, TRIA could still provide coverage for NCBR risks insured by the captive. TRIA requires that insurers covered by the Act offer terrorism insurance to their insureds. There is no requirement to offer NCBR coverage. So long as Nuclear Biological Chemical & Radiological (NBCR) is excluded from the entire policy, an insurer may exclude NCBR risks from terrorism coverage. If provided by the captive, NCBR losses could be covered by TRIA, subject to

commercially reasonable standards, although demonstrating commercially reasonable standards may be difficult as there is very limited market capacity for NCBR, especially nuclear and radiological.

**Guidelines For Captive TRIA Programs** - With the on-going commitment of the Federal government to the backstop, TRIA programs will remain viable for captives in the coming years, if structured appropriately. The following guidelines should be followed although there are no hard and fast rules on what is acceptable to the Treasury.

- Strive for mix of TRIA and non-TRIA risk.
- Maintain sufficient surplus and reinsurance to pay claims if the trigger is not met and to pay deductible and co-insurance amounts.
- Charge a commercially reasonable rate for coverage of certified acts of terrorism.
- Avoid unusual arrangements that could be characterized as gaming.

The need for terrorism coverage is often driven by lenders. Using a captive insurer, even if backed by TRIA, may fall outside the lenders requirements for rating and licensing. To avoid later problems, if lenders are involved, get them on board early in the process.

## Domicile News

### South Carolina Proposes Captive Manager Standards

In December, the South Carolina Department of Insurance proposed a Bulletin establishing specific standards for captive management companies in the State. The Bulletin includes clear requirements for character, reputation, financial responsibility and insurance experience. The proposed Bulletin has been distributed to all managers in South Carolina including SRS and is currently in a comment period.

We welcome and fully support the introduction of these standards. They are important to build the right regulatory environment in South Carolina. The standards are in line with our current operating practices and we will look to confirm our compliance with the new standards at the earliest opportunity after they are formally introduced.

### Vermont - Len Crouse Announces Retirement

On January 17, 2008 Len Crouse, Vermont Deputy Commissioner of Captive Insurance announced plans to retire effective June 1, 2008. Len has been a prominent figure in the captive insurance industry and has been a key figure in establishing Vermont as a leading domicile worldwide. He has served as Deputy Commissioner of Captive Insurance in Vermont since May of 2003. Prior to his appointment, he was Vermont's Director of Captive Insurance since May of 1990.

We have worked closely with Len over the years and have tremendous respect for the work he has done to advance the field

of captive insurance and Vermont as a domicile. We wish him the best in his retirement.

A search is currently underway for Len's successor and we will keep you apprised of the appointment in future issues.

### Cayman Captive Forum

Ron Sulisz from SRS Cayman, co-chaired the annual Cayman Captive Forum held November 27 through November 29 at The Ritz Carlton, Grand Cayman. The forum was very successful with 856 registrants, the highest level of registrants for this annual event.

We are pleased to announce that Ron has agreed to chair the conference committee for the 2008 Forum which will also be held at The Ritz Carlton, Grand Cayman from December 2 through to December 4.

### Arizona: Rod Morris Returns departs ADOI

In January, the Arizona Department of Insurance (ADOI) announced that Rod Morris, the Captive Administrator, will be leaving the Department. He will be returning to his former executive position at OPIC.

The ADOI is conducting a search for a new Captive Administrator. In the meantime, Christine Urias, the ADOI Director, will manage captive regulations in Arizona and continue to move Arizona forward as a captive domicile.

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## SRS News

**SRS Experiences Steady Growth in 2007** - 2007 was strong year for SRS across all our domiciles. We experienced steady growth with the addition of twenty two new captive clients. Growth continued to be strongest in our Cayman office, although all domiciles showed growth during the year.

We expanded our local presence with the establishment of offices in Arizona and South Carolina and made several key hires. Ann Wick joined the firm in August and Derick White will join effective February 1, 2008. These senior hires have been supported by additional hires in all of our domicile offices. We feel we are well staffed and positioned going into 2008 and that the state of the captive insurance industry is strong. We will continue to look for steady growth, but with a strong emphasis on maintaining a high level of customer service and quality in our operations.

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

- **Ormaryd Insurance Company Ltd** - SRS was appointed manager of this Cayman domiciled captive effective February 1, 2008. The company provides insurance for commercial general liability, foreign general liability, automobile liability and worker's compensation coverages.
- **Gaylord Risk Solutions Limited** - SRS has been appointed manager of this recently licensed Cayman single parent captive. The company provides hospital professional liability, general liability and aggregated umbrella coverages.
- **Red Clay Risk Retention Group, Inc** – SRS was appointed manager of this recently licensed South Carolina Risk Retention Group. The company provides healthcare professional liability coverage to its physician owners.
- **Live Oak Insurance Company** – SRS was appointed manager of this recently licensed Special Purpose Captive domiciled in South Carolina. The company provides windstorm and property coverage.

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

- **March 5-7: CICA International Conference.** Ann Wick and Michael O'Malley will be presenting at the conference to be held at the Westin Kierland Resort, Scottsdale. Wayne Cowan and Derick White will also be attending..
- **March 13: VCIA Seminar, Cincinnati.** SRS will be sponsoring this event to be held at The Cincinnati Hotel. Derick White will be presenting at the seminar.
- **April 9, VCIA Seminar, Charlotte, NC.** Kathryn Marsh will be attending the seminar.

Please contact us at [info@strategicrisks.com](mailto:info@strategicrisks.com) to arrange meetings with our team at any of these industry events.

**SRS Webinar Series** - SRS hosts periodic webinars on topical issues affecting the captive insurance industry. Our provisional schedule of upcoming webinars includes:

- February 27: Captives 101
- March 26: Domicile Unrest: Growing Pains or Change in Direction
- April 24: Captives for Non-Profit Organizations
- May 14: RRGs: Opportunities and Challenges

To ensure you are included on the distribution list for webinar announcements, contact us at [info@strategicrisks.com](mailto:info@strategicrisks.com).

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Strategic Risk Solutions (SRS) is an independently owned captive management and consulting firm. The company is an approved manager of captive insurance companies in most leading onshore and offshore domiciles. SRS is committed to being the premier provider of captive management and advisory services in the territories in which we operate.

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