



180°

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



Issue 8, Q1 2006

Inside This Issue
2005 Beyond the Numbers
SRS News

2005 Beyond the Numbers

In this newsletter Brady Young will summarize the developments and results in the various major captive domiciles where SRS is actively forming and managing client insurance companies, including Arizona, Bermuda, Cayman, South Carolina, and Vermont.

Overall, 2005 was a strong year for captive formation and usage. Not quite as strong as 2003 and 2004 results but still very solid by historic standards. Hurricanes, insurance market changes, new IRS revenue rulings, uncertainty over TRIA's extension and other forces were largely background noise to the continued broadening and expansion in the use of captives. Captives are now part of the solution for a myriad of risk financing issues that affect companies and entities from almost every sector and industry. The evidence of this growth is obvious by looking at developments in each of the domiciles.

Arizona

As the numbers below indicate, Arizona continued to make steady progress towards its goal of becoming a credible and more convenient alternative to Hawaii for captive owners on the west coast. While it cannot compete with the beaches of Hawaii or the offshore domiciles, AZ's accessibility, onshore status, climate, accessible Regulator and flat fee (no percentage premium tax) were attractive to many new captive owners as well as to a few of the larger existing captive owners who decided to re-domicile to Arizona.

2005 AZ Formations	2005 AZ Licenses Surrendered/Revoked	2005 Total Active AZ Captives
17	1	60

The majority of the owners of AZ captives originate from the West, Southwest and Midwest with a sprinkling from other regions of the country. The most significant development that occurred in AZ in 2005 was the change in law allowing AZ captive owners to now use qualified service providers (auditors, actuaries, etc) located outside AZ. As managers, we welcome this change, which provides our clients more choices and access to a larger pool of experienced service providers to support their captives.

Bermuda

Following a record year for natural catastrophe losses, Bermuda was in the news as another flock of Class IV insurers and reinsurers were launched to fill the anticipated void in the property natural catastrophe market. Bermuda continued to attract its fair share of Class I, II and III companies that are mostly operating as captives – insuring the direct or related risks of its owner(s).

As the numbers below show, there was a great deal of activity in both new formations and surrendered licenses.

2005 Bermuda Formations	2005 Bermuda Licenses Surrendered/Revoked	2005 Total Active Bermuda Companies (Class I-IV)
75	38 Class I & II	1,225*

However, Bermuda also saw another year where the number of licenses surrendered (38) for Class I and II exceeded the number of new formations (32) for these same classes. This is mainly due to the effort by the Bermuda Monetary Authority (BMA) to update its roster of active companies and reflects Bermuda's status as the largest and most mature domicile where captives that were formed in the 70s, 80s, or 90s are no longer active or needed.

There were no major regulatory changes in Bermuda in 2005 but the BMA continued its efforts to get the message out that Bermuda is not just the domicile of choice for large commercial insurance start-ups, but also desires to be a leading player in the captive arena. To that end, the BMA recently decided that Class I applications will be reviewed internally-- materially reducing the time needed to process new applications. It will make Bermuda a more attractive option for captive owners when timing is a principal consideration. Bermuda continues to be unique in the use of its "formula" approach to determining minimum capitalization requirements, however, it has been receptive to making exceptions on a case-by-case basis.

Finally, the continued expansion of the commercial insurance market in Bermuda is a positive factor for many cap-

(Continued on page 2)

tive owners, especially larger entities that already travel to Bermuda each year for renewal discussions with underwriters who can now address their captive needs as well.

Cayman

Cayman continues its emergence as the “quiet giant” among captive domiciles. While it does not generate the attention (positive or negative) of other domiciles, Cayman continues to generate an impressive number of new captives each year. In addition, fewer owners are surrendering their licenses--suggesting that these Cayman captives are continuing to play an important role in their owners’ risk financing strategies.

2005 Cayman Formations	2005 Cayman Licenses Surrendered/Revoked	2005 Total Cayman Active Captives
59	19	733

The number of existing and new captives owned by healthcare providers continues to represent a significant percentage of the active captives in Cayman. This is not surprising as Cayman filled the void in the market in the 1970s and has a great deal of momentum, expertise and support from influential players in the healthcare industry. What is somewhat surprising is how many other industries, including construction, transportation, financial service, have selected Cayman as their domicile of choice.

It’s hard to exactly pinpoint why Cayman continues to have so much success but it does follow a successful formula which includes having:

- a knowledgeable and stable regulatory environment
- accessibility for board and other necessary meetings
- professional and reasonably priced service providers

Given the growth of captives in all domiciles and the increasing demands placed on captive managers and other service providers from auditors, Sarbanes Oxley and other factors, attracting and retaining enough experienced accountants is a big and ongoing challenge. Finally, Cayman’s vulnerability to an increasing number of hurricanes as seen in past years and the ongoing rise in the local cost of living (mainly due to housing prices) make it somewhat challenging to retain and attract expatriates, the historic source of the much of the talent needed to support the needs of captive owners. Only time will tell how well Cayman handles these challenges and what effect it will have over the long run on captive business.

South Carolina

Last year was a year of transition for South Carolina as a new team has replaced most of the regulatory staff that put this domicile on the map. It is still too early to judge-- but there does not appear to be any less interest or support in making SC a viable alternative to Vermont among US domiciles.

As the numbers reflect, SC had a solid year but not the kind of net growth they have experienced in the past year. This is probably a good thing as they have been focusing on existing captives that set up in prior years and appear to be trying to attract more single owner captives and less group captive or RRGs, which are more challenging to regulate especially in a softening insurance market.

2005 SC Formations	2005 SC Licenses Surrendered/Revoked	2005 Total SC Active Captives
21	7	121

South Carolina is an attractive option for clients based in the Southeast who enjoy coming to Charleston or other locales in the state at least once a year for company board meetings. Like AZ and Vermont, SC’s onshore status enables captive owners to underwrite ERISA benefits and TRIA coverages. While there have been no major changes on the legislative front, the operating requirements and enforcement of the existing captive law seems to be going through somewhat of a transition. This is normal for an evolving domicile like SC and may reflect an attempt to tighten some of the rules/operating requirements.

There are a significant number of management firms operating in SC but most have three or fewer captives under management. Those that have a critical mass of clients, are struggling to attract and retain experienced accounting staff, a common problem in all domiciles but particularly acute when a domicile is still in its formative stages. The combination of these factors led to a significant percentage of existing captive owners having difficulty meeting state mandated deadlines for statutory reporting. This is unacceptable and should improve as the management companies hire additional staff and gain more experience.

Vermont

Vermont reinforced its rock solid position last year as the leading onshore domicile. Not only does Vermont have more licensed captives than all the other domiciles combined, the state has the most stable operating environment of any of the onshore captive domiciles. This is a bold statement but deserved given the:

- unwavering political support,
- continuity and depth of expertise that exists in the 25 person unit headed by Len Crouse that is dedicated solely to captive approval/oversight
- well developed local infrastructure and service provider community

As shown on the table on page 3, the number of new formations was down somewhat from recent years and the number of licenses surrendered was up. This is not necessarily surprising given the maturity of Vermont as a domicile. Interestingly, Vermont has quietly become the leading

(Continued on page 3)

domicile for RRGs and a leading domicile for health care entities forming or re-domiciling their captives.

2005 VT Formations	VT 2005 Licenses Surrendered/Revoked	2005 Total VT Active Captives
37	19	542

While Vermont is responsive to new applicants and continues its efforts to reach out to prospective captive owners, Len and his team have resisted the pressure from new competitors and have remained conservative on the type of captive structures and owners they are willing to license in Vermont. Again, this reluctance is not surprising given their status as the leader and one of the reasons Vermont is viewed differently than some other domiciles by the NAIC, fronts/reinsurers, and other outside parties that work with or are involved with captive operations.

The only storm cloud on the horizon in Vermont in the short term is the availability and cost of experienced accounting staff. Necessary hiring by existing and new management firms, auditors, and the state has created an imbalance in supply and demand. This will ultimately increase operating costs for all Vermont based captives. Whether this puts Vermont at a material, competitive disadvantage remains to be seen.

SRS Expands Offshore Team

In the closing months of 2005, SRS hired four individuals in its Cayman and Bermuda offices to support the clients that have been added in those domiciles and to provide additional capacity to support planned expansion efforts. The four individuals include:

Wayne Cowan, (Director/Vice Chairman Cayman) Wayne is responsible for new business development and relationship management. Wayne was the former Managing Director of JLT Cayman. Prior to leading JLT's Cayman operations, Wayne was the Managing Director of Johnson and Higgins and Marsh's operations in Cayman. He has served as an active member of the Private Sector Consultative Committee (an advisory body to Government on all major legislation) and was a member of the executive committees of both the Cayman Island Society of Professional Accountants (CISPA) and the Cayman Insurance Managers Association. Wayne is the Treasurer of the Cayman Islands Chamber of Commerce and is a Fellow of the Institute of Chartered Accountants in England and Wales.

Ron Sulisz, (Director – Cayman) - Ron, a Chartered Accountant is responsible for the management and supervision of client accounts, including financial and regulatory reporting and special assignments related to captive management programs. Ron is the former Chief Executive Officer of the Cayman Islands National Insurance Company

Ltd ("CINICO"). Prior to being the CEO of CINICO, Ron worked in Bermuda, Luxembourg and the Cayman Islands managing captive insurance companies for Marsh and HSBC.

Joel Czember, (Account Manager – Bermuda) - Joel joined the Bermuda office after spending many years with Marsh in both their Cayman and Bermuda office. At SRS, Joel will be serving as account manager for Bermuda clients and providing some support to selected Cayman clients. Joel is a Chartered Accountant and a Chartered Financial Analyst.

Romalyn Lamano, (Staff Accountant-Cayman) who is a certified public accountant joined the Cayman office as a staff accountant from the Philippines where she provided accounting support for a variety of multinational companies.

These four individuals along with the other SRS staff in Bermuda and Cayman provide our existing and new clients with a tremendous wealth of additional depth and breadth of captive management experience.

Events—Upcoming SRS events include:

- Brady Young is speaking at CICA on Domicile Selection
- SRS is hosting a Captives 101 Session in Kansas City preceding the Vermont Captive Insurance Association Event on March 30th. Contact Beth Lutz 603-488-1569 or Beth.Lutz@strategicrisks.com for more details
- 2006 Cayman Healthcare Captives Web seminar on March 29th at 1pm EDT, . More information is available on our web-site at www.strategicrisks.com.

Client News—

- Mentor Network, a social network provider formed a captive in Vermont to underwrite liability and other risks to support its overall corporate risk financing program.
- A privately held insurance broker selected SRS to form and manage a Cayman captive being used to underwrite liability and other uninsured risks of its parents and affiliates.
- Synernet Re, owned by a group of Maine based health-care providers., selected SRS to assist it in re-domiciling from Barbados to Vermont.
- Transit Re was formed in Vermont by its owners to address a portion of the liability risk of its state transit authority owners.
- A privately held assisted living company formed a South Carolina captive to underwrite the primary layer of professional and general liability program.
- SRS was selected to manage a Vermont captive for a large general contractor based in the mid-west that will initially focus on ensuring availability and reducing the cost of insurance for its various subcontractors.

For more information on SRS, visit us at www.strategicrisks.com

Contact: info@strategicrisks.com Tel: 781 487 9800