Captive Update

News of the Alternative Risk Markets From the A.M. Best Company

March, 2013

A. M. Best has been covering the captive sector for several decades. Today we rate approximately 200 captive ventures in over 40 jurisdictions, ranging from Hawaii in the West to Micronesia in the East. Although a rating on a captive is comparable to any other rating issued by AM Best, we recognize that captives serve special purposes and typically have an operating style that differs from the conventional market. A rating can be of benefit to a captive by demonstrating its financial strength and its best practice performance to a variety of stakeholders, such as fronting insurers, reinsurers and a parent not otherwise engaged in insurance.

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A.M. Best Affirms Ratings of ASSA Compania de Seguros, S.A. and Lion Reinsurance Company Limited

A.M. Best Co. has affirmed the financial strength rating (FSR) of A (Excellent) and issuer credit rating (ICR) of "a" of ASSA Compania de Seguros, S.A. (ASSA) (Panama City, Panama).

A.M. Best also has affirmed the FSR of A- (Excellent) and ICR of "a-" of Lion Reinsurance Company Limited (Lion Re) (Bermuda). The outlook for all ratings is stable.

The ratings reflect ASSA's continued excellent operating results, favorable capitalization and strong business profile. ASSA maintains a well-diversified book of business that includes both property/casualty and life/health products. ASSA is ultimately owned by Grupo ASSA, S.A. (Grupo ASSA), a publicly traded financial services holding company on the Panama stock exchange.

ASSA has shown disciplined underwriting in a highly competitive market, while its risk-based capitalization remains fully supportive of its current ratings and outlook. ASSA's underwriting profitability is complemented by consistent levels of investment income, which has enabled it to steadily appreciate surplus while still providing Grupo ASSA with dividend payments. ASSA also benefits from established risk management systems and strong reinsurance programs across most lines of business.

Partially offsetting these positive rating factors is ASSA's risk concentration in a geographically limited insurance market along with operating in a country that A.M. Best considers to have an elevated level of country risk compared to ASSA's ratings. Additionally, the Panamanian insurance market is becoming increasingly competitive as local and large outside insurers continue to compete for market share.

Positive rating actions could occur if ASSA maintains its consistently strong underwriting performance and long-term profitability in conjunction with an upgrading of Panama's country risk tier. Negative rating triggers could include a significant decline in ASSA's risk-based capitalization, sustained adverse operating performance or a downgrading of Panama's country risk tier.

The ratings of Lion Re acknowledge its strong initial capitalization, conservative operating strategy and the explicit parental support. The ratings also consider Lion Re's strategic role as a captive reinsurer of ASSA Compañia Tenedora S.A.

Also inuring to Lion Re's ratings is its sound business plan, upon which the profitability and liquidity measures of these ratings are based. The ratings are supported by an amount of capital that meets A.M. Best's requirements for newly formed companies as measured by Best's Capital Adequacy Ratio (BCAR). Lion Re operates as a Bermuda-based reinsurer focused on writing a combination of property, casualty, health and group life business from affiliated insurers.

These positive rating factors are partially offset by execution risk due to the unproven start-up nature of the company. Drivers that could lead to a positive outlook or rating upgrades for Lion Re are a stable underwriting performance, as well as reduced overall net exposure over the next few years and successful implementation of its business plan. Factors that could lead to a negative outlook or rating downgrades are a material loss of capital from either claims or investments, a reduced level of capital that does not support the ratings or an increase in net retention. Lion Re's ratings are tied to A.M. Best's internal assessment of Grupo ASSA; therefore, an unfavorable operating performance or material loss of capital could result in changes to the captive's ratings.
(Published: BestWire - 01/04/2013).

A.M. Best Affirms Ratings of Bison Insurance Company Limited

A.M. Best Co. has affirmed the financial strength rating of A- (Excellent) and issuer credit rating of "a-" of Bison Insurance Company Limited (Bison) (Charleston, SC). The outlook for both ratings is stable.

The ratings reflect Bison's historically adequate capitalization, generally favorable operating performance, conservative reserve levels and effective enterprise risk management controls. The ratings also recognize Bison's history of maintaining sufficient capital and financial resources to support its ongoing obligations.

Partially offsetting these positive rating factors are Bison's volatile underwriting results due to its low frequency, high severity risk profile, coupled with its high net retained limits relative to its available capital. Additionally, the continually changing risk profile of Bison's primary insureds directly affects its risk profile. This is mitigated by the company's conservative reserving philosophy and the ongoing, demonstrated support from its parent, Duke Energy Corporation (Duke Energy) [NYSE: DUK].

The risk management team of Duke Energy takes a holistic approach to managing its risks and utilizes the captive as an integral part in this process. Bison's long-term growth opportunities primarily depend on the business success of Duke Energy.

Bison's ratings take into account its potential for future earnings volatility. In A.M. Best's opinion, positive rating actions are dependent upon Bison stabilizing its operating performance as well as its risk-adjusted capitalization, materially exceeding A.M. Best's expectations. Positive rating actions also could occur if the credit profile of Duke Energy improves.

The potential for negative rating actions could result if the volatility in Bison's operating performance exceeds A.M. Best's expectations and results in a significant prolonged decline in its risk-adjusted capitalization. In addition, deterioration in the credit profile of the parent could impact Bison's ratings.
(Published: BestWire - 12/14/2012).

A.M. Best Affirms Ratings of Evergreen Reinsurance Company, Ltd.

A.M. Best Co. has affirmed the financial strength rating of A (Excellent) and issuer credit rating of "a" of Evergreen

Reinsurance Company, Ltd. (ERCL) (Bermuda). The outlook for both ratings is stable.

The ratings recognize ERCL's strong risk-adjusted capitalization, historically favorable operating performance and prudent risk controls. The ratings also consider ERCL's role as the pure insurance captive of Evergreen Group (the group), a Taiwan-based international logistics and transportation conglomerate with a core business focus on marine and aviation.

Over the past years, ERCL's operating performance was mainly supported by a favorable underwriting performance as well as interest income earned from deposits and loans to group affiliates. Although it is anticipated that ERCL will continue to maintain favorable operating performance going forward, the overall profitability is expected to be lower than that of its historical level, partly due to the gradual depletion of redundant reserves relating to the third party business. The prevailing low interest rate environment will continue to suppress the company's investment return over the short to medium term.

ERCL plays an integral part within the risk management framework of the group by providing insurance and reinsurance protection as well as risk control services to the operating entities within the group. ERCL consistently maintains a prudent underwriting approach. While ERCL has a large gross underwriting exposure due to its high insurance limits on aviation and marine-related risk, its net retained limits are maintained at a manageable level relative to its capital and surplus.

Partially offsetting these positive rating factors include the potential capital demand from ERCL's affiliated companies within the group and the potential credit risk associated with the large risks on marine and aviation that are ceded to reinsurers. Notwithstanding, the associated credit risk is partially mitigated through the use of financially sound reinsurers.

ERCL's risk-adjusted capitalization, although strong, has exhibited some volatility mainly due to the financial support provided to its affiliated companies in the form of bonds and loans investments, in addition to large dividend payments over the past five years.

While positive rating actions are unlikely in the near term, negative rating actions could occur if ERCL exhibits unfavorable operating performance and/or a significant decline in its risk-adjusted capitalization. In addition, a significantly weakened business and credit profile of the group could negatively impact ERCL's ratings.
(Published: BestWire - 12/19/2012).

A.M. Best Affirms Ratings of National Grid Insurance Company (Isle of Man) Limited

A.M. Best Europe – Rating Services Limited has affirmed the financial strength rating of A (Excellent) and issuer credit rating of "a" of National Grid Insurance Company (Isle of Man) Limited (NGIC) (Isle of Man). The outlook for both ratings remains stable.

The ratings of NGIC reflect its strong level of risk-adjusted capitalisation, which is supported by a comprehensive reinsurance programme. The ratings also consider the captive's importance within the risk management framework of its parent, National Grid plc. (NG plc). An offsetting rating factor relates to the volatility of NGIC's operating performance.

A.M. Best expects risk-adjusted capitalisation to remain strong, in spite of NGIC's exposure to Superstorm Sandy during financial year 2013. Gross losses derived from Superstorm Sandy are expected to amount to GBP 186 million. However, this loss was largely mitigated by NGIC's comprehensive reinsurance progamme, which is placed with highly rated reinsurers. NGIC's net loss exposure to Superstorm Sandy is unlikely to exceed GBP 40 million.

NGIC's underwriting results are subject to considerable volatility, owing to the nature of risks it underwrites. Exposure to large loss events in financial year 2013 is expected to result in a combined ratio (loss ratio plus operating expense ratio) in excess of 200%. However, technical earnings continue to be supported by the company's prudent reserving approach. A.M. Best will continue to monitor the underwriting performance of NGIC going forward.

NGIC remains core to NG plc's risk management framework, with the objective of mainly mitigating exposure to business interruption and property damage.

Upward rating movement is unlikely at present.

Negative rating actions could occur if a poor underwriting performance were to become more frequent in the near future, and/or a material deterioration of risk-adjusted capitalization were to occur. In addition, a significant deterioration in NG plc's financial profile would likely lead to a review of NGIC's ratings.

In accordance with Regulation (EC) No. 1060/2009, the following is a link to required disclosures: http://www3.ambest.com/emea/ambersdisclosure.pdf.

A.M. Best Europe – Rating Services Limited is a subsidiary of A.M. Best Company. Founded in 1899, A.M. Best Company is the world's oldest and most authoritative insurance rating and information source.
(Published: BestWire - 02/21/2013).

A.M. Best Affirms Ratings of Nissan Global Reinsurance, Ltd.

A.M. Best Co. has affirmed the financial strength rating of A- (Excellent) and issuer credit rating of "a-" of Nissan Global Reinsurance, Ltd. (NGRe) (Hamilton, Bermuda). The outlook for both ratings is stable.

The ratings reflect NGRe's strong capitalization and conservative operating strategy. The ratings also consider NGRe's critical role and favorable profile as part of the Nissan Motor Co. Ltd. (Nissan) [NASDAQ: NSANY], as well as its excellent operating performance since its inception in 2005.

Partially offsetting these positive rating factors are the significant exposures NGRe has to product liability, property and marine cargo claims. Additionally, the recent deterioration in the financial markets and the decline in the profitability

of automakers has had some impact on premium volumes, although investment results have not been significantly affected. Furthermore, NGRe is expecting a reversal of those trends in the current year.

NGRe is a single parent captive of Nissan, one of the largest automakers in the world. NGRe operates two distinctive lines of business: (1) global property/casualty programs for Nissan, which include global property (United States, Japan, Europe, Mexico and South Africa), U.S. workers' compensation, U.S. and Japan product liability and marine transport and (2) a global platform for extended service contract business. NGRe benefits from the group's extensive risk management and loss control programs.

NGRe operates at conservative underwriting leverage levels; however, it provides coverages with large limits, and as such, its gross exposures per loss occurrence are elevated. Nevertheless, A.M. Best recognizes the quality of the substantial financial resources and support available to the captive.

NGRe's ratings are not expected to be upgraded nor is its outlook expected to be revised within the next 12-24 months, as its operating performance and capital position already have been considered in the ratings process.

A.M. Best could downgrade NGRe's ratings and/or revise its outlook if its Best's Capital Adequacy Ratio (BCAR) score declines, operating performance and risk profile deteriorate, its insured losses deplete capital and/or significant changes and turnover occur in its management team, risk management controls and tolerances.
(Published: BestWire - 11/12/2012).

A.M. Best Affirms Ratings of Noble Assurance Company

A.M. Best Co. has affirmed the financial strength rating of A+ (Superior) and issuer credit rating of "aa-" to Noble Assurance Company (Noble) (Burlington, VT). The outlook assigned to both ratings is stable.

Noble has exhibited strong capital adequacy, stable earnings and consistent surplus growth. The company benefits from intensive risk management processes as a captive insurance company for Royal Dutch Shell plc and its subsidiaries. 100% of the risk taken by Noble is ceded to Solen Versicherungen AG (Solen), a subsidiary of Shell Petroleum N.V. and ultimately Royal Dutch Shell plc. Solen is well capitalized and has demonstrated consistently strong metrics over the past few years. Noble's ultimate parent is Royal Dutch Shell plc.
(Published: BestWire - 12/20/2012).

A.M. Best Affirms Ratings of Prism Assurance, Ltd.

A.M. Best Co. has affirmed the financial strength rating of A- (Excellent) and issuer credit rating of "a-" of Prism Assurance, Ltd. (Prism) (Burlington, VT). The outlook for both ratings is stable.

The ratings reflect Prism's strong capitalization and solid operating performance. Also inuring to the ratings is Prism's strategic role as the captive insurance company of Apogee Enterprises, Inc. (Apogee), and the substantial financial flexibility available to Prism as part of Apogee.

Partially offsetting these positive rating factors is Prism's relatively large retained insurance limits and its limited market profile as a single parent captive. Nonetheless, the ratings recognize the company's balance sheet strength and conservative underwriting leverage measures.

A.M. Best could upgrade Prism's ratings and/or revise its outlook if there is significant improvement in its underwriting performance and capital or a reduction in its overall net exposure. A.M. Best could downgrade the ratings and/or revise the outlook if the company's Best's Capital Adequacy Ratio (BCAR) declines, operating performance deteriorates or if insured losses deplete capital.
(Published: BestWire - 11/16/2012).

A.M. Best Affirms Ratings of Queen City Assurance Inc. and Vine Court Assurance Inc.

A.M. Best Co. has affirmed the financial strength rating of A (Excellent) and the issuer credit ratings of "a" of Queen City Assurance Inc. and Vine Court Assurance Inc. (both domiciled in Burlington, VT). The outlook for both ratings is stable.

The ratings are based on Queen City Assurance Inc. and Vine Court Assurance Inc.'s individual and combined profiles as single parent captives of The Kroger Co. (parent). The ratings also are based on both companies' excellent risk-adjusted capitalization, substantial net income and underwriting profitability, a growing capital base, conservative investments and a strong adherence to the parent company's robust risk controls and its overall risk culture. Additionally, return measures on a group and individual basis are consistently on positive levels reflective of the organization's prudent pricing and deployment of capital.

These significant strengths are partially offset by the companies' risk concentration, which are the result of being single parent captives of the parent company, coupled with a substantial aggregate limit retained by the captives.

Key rating triggers that could result in a downgrading of the ratings include a precipitous decline in the companies' risk-adjusted capital strength. Key rating triggers that could result in an upgrading of the ratings include a consistently profitable operating performance coupled with a substantial increase in risk-adjusted capitalization.

Either a rating enhancement or a deterioration in the capitalization of the parent could result in either an upgrading or a downgrading of the ratings of Queen City Assurance Inc. and Vine Court Assurance Inc.
(Published: BestWire - 02/01/2013).

A.M. Best Affirms the Ratings of Gateway Rivers Insurance Company

A.M. Best Co. has affirmed the financial strength rating of A-(Excellent) and issuer credit rating of "a-" of Gateway Rivers Insurance Company (Gateway) (Burlington, VT). The outlook to both ratings is stable.

The ratings and outlook reflect Gateway's strong capitalization and conservative operating strategy. The ratings also consider the company's critical role and favorable profile as

part of the AT&T Inc. [NYSE:T] organization, as well as its excellent operating performance during the past five years, providing insurance coverage to subsidiaries of AT&T Inc. for certain property/casualty risks.

Partially offsetting these positive rating factors are Gateway's relatively large limits to its general and product liabilities as well as property lines of business. Nevertheless, A.M. Best recognizes the substantial financial resources of the AT&T Inc. organization.

A.M. Best views Gateway's management and corporate strategy as a major factor that strengthens its ratings, given the company's conservative underwriting, operational goals and transparency. A.M. Best also views Gateway's enterprise risk management practices as strong given their impact on the company's conservative risk culture, defined risk controls as well as providing optimization of its capital and surplus. Other factors A.M. Best considered in the rating process include, but are not limited to, the diversification in Gateway's line of business and geography, as well as the support and commitment of the parent and the captive's mission.

A.M. Best expects Gateway's future operating performance to be stable but strong, and the stable earnings profile should further support the efforts to control its growth and business writings, which are consistent with its capital and surplus position.

Gateway's ratings and outlook are not expected to be upgraded and/or revised within the next 12-24 months as its operating performance and capital position already have been considered in the ratings process. A.M. Best could downgrade Gateway's ratings and/or revise the outlook if its Best's Capital Adequacy Ratio (BCAR) score declines, operating performance and risk profile deteriorate, insured losses deplete capital or significant changes and turnover occur in its management team and/or risk management controls and tolerances, or its parent's ratings deteriorate.
(Published: BestWire - 02/15/2013).

A.M. Best Assigns Ratings to NEWGT Reinsurance Company, Ltd.

A.M. Best Asia-Pacific Limited has assigned a financial strength rating of A- (Excellent) and issuer credit rating of "a-" to NEWGT Reinsurance Company, Ltd. (NEWGT) (Bermuda). The outlook assigned to both ratings is stable.

The ratings reflect NEWGT's stable operating profitability, aided by its retrocession coverage in its general account and the implicit support from the parent company, Itochu Corporation (Itochu). NEWGT was incorporated in October 2005 as a wholly owned subsidiary of Itochu. NEWGT is a Class 3 general business reinsurer and is registered under the Segregated Accounts Company Act 2000 in Bermuda. NEWGT's business is well diversified due to the broad range of trading business activities conducted by Itochu, which is underwritten by the general account. Under the segregated account, some risks have been underwritten, which are well spread through personal accident and residential fire, with the exception of the catastrophe business, which has been in run off since January 2012.

NEWGT reported favorable operating performance in its general account over the past five years, mainly driven by its major line of marine cargo product, which is diversified globally. NEWGT's retrocession coverage against its major product line helped it to stabilize its underwriting results during the past years. As a single parent captive, NEWGT receives support from Itochu to grow in the captive market in the form of capital injections, as well as support from its integrated risk management system.

Partially offsetting these positive rating factors include NEWGT's continuous expansion into the third party business, volatile operating performance in the segregated account and the uncertain outlook of the global economy. NEWGT will participate in Lloyd's Syndicates in 2013, which accounts for a significant proportion of its consolidated net premium income in the forecast periods. Although Itochu will support this new business by injecting capital, the increase in the third party business could increase volatility in NEWGT's operating performance. NEWGT reported a sharp increase in its loss ratio in the segregated account in fiscal year 2010 as it has experienced several large claims from the catastrophe business that has been in run off since 2012. The uncertain economy outlook could impact NEWGT's operating performance, as the sales of marine cargo are susceptible to trading activities.

Downward rating pressure could arise if there is a sharp decline in NEWGT's risk-adjusted capitalization led by a deterioration in its operating performance.

The methodology used in determining these ratings is Best's Credit Rating Methodology, which provides a comprehensive explanation of A.M. Best's rating process and contains the different rating criteria employed in the rating process. Key criteria utilized include: "Alternative Risk Transfer (ART)"; "Understanding Universal BCAR"; "Risk Management and the Rating Process for Insurance Companies"; "Evaluating Country Risk"; and "Catastrophe Analysis in A.M. Best Ratings." Best's Credit Rating Methodology can be found at http://www.ambest.com/ratings/methodology.
(Published: BestWire - 01/11/2013).

A.M. Best Assigns Ratings to Marble Reinsurance Corporation

HONG KONG, FEBRUARY 22, 2013 - A.M. Best Asia-Pacific Limited has assigned a financial strength rating of A- (Excellent) and issuer credit rating of "a-" to Marble Reinsurance Corporation (Marble Re) (Federated State of Micronesia). The outlook assigned to both ratings is stable.

The ratings reflect Marble Re's strong risk-adjusted capitalization, stable operating profitability, strong retrocession coverage and the support from the parent company, Marubeni Corporation.

As a single parent captive of Marubeni Corporation, Marble Re's risk–adjusted capitalization, as measured by Best's Capital Adequacy Ratio, remains strong to support the assigned ratings. Marble Re's absolute capitalization is expected to further increase primarily due to strong profitability and capital injection from the parent company of Marubeni in early 2013. Marble Re reported a combined ratio of an average of

52% in the past five years, with a range from 49.7% to 57.4% as it focuses on marine cargo line risk. The new product portfolio generated from Marubeni Corporation's group of companies, which reported a favorable track record in underwriting results, could support the operating profitability in the future. Marble Re maintains a conservative underwriting guidance with a limited retention and retrocession coverage of an aggregate stop loss cover against marine cargo line.

Partially offsetting rating factors include an implementation risk in Marble Re's expansion plan as well as an uncertain outlook of the economy conditions. Although Marubeni Corporation has a long history in operating captive businesses, the expansion of product lines would cause risk in its implementation. As Marble Re's major product line is marine cargo, of which sales are susceptible to trading activities, weakening trading activities would lead to a sharp drop in premium income, and consequently, could impair its operating performance.

While upward movement on Marble Re's ratings is unlikely, downward pressure could arise if there is a sharp decline in its risk-adjusted capitalization.

The methodology used in determining these ratings is Best's Credit Rating Methodology, which provides a comprehensive explanation of A.M. Best's rating process and contains the different rating criteria employed in the rating process. Key criteria utilized include: "Risk Management and the Rating Process for Insurance Companies"; "Understanding Universal BCAR"; "Rating Members of Insurance Groups"; "Evaluating Country Risk"; "Catastrophe Analysis in A.M. Best Ratings"; and "Rating New Company Formations." Best's Credit Rating Methodology can be found at www.ambest.com/ratings/methodology.

Methodology Sources

A.M. Best remains the leading rating agency of alternative risk transfer entities, with more than 200 such vehicles rated in the United States and throughout the world.

For current Best's Credit Ratings and independent data on the captive and alternative risk transfer insurance market, please visit http://www.ambest.com/captive.

The methodology used in determining these ratings is Best's Credit Rating Methodology, which provides a comprehensive explanation of A.M. Best's rating process and contains the different rating criteria employed in the rating process. Key criteria utilized include: "Risk Management and the Rating Process for Insurance Companies"; "Understanding Universal BCAR"; "Catastrophe Analysis in A.M. Best Ratings"; "Rating Members of Insurance Groups"; and "Assessing Country Risk." Best's Credit Rating Methodology can be found at http://www.ambest.com/ratings/methodology

Best's Research

A.M. Best Special Report: Europe's Captives Ride Out Economic Storm, But Regulatory Changes Loom

The European captive industry has weathered the global economic downturn well, although the forthcoming implementation of Solvency II remains among the biggest challenges for the sector, according to a new report from A.M. Best Co.

In the report entitled, "Europe's Captives Ride Out Economic Storm, But Regulatory Changes Loom", A.M. Best describes the impact of the financial downturn on captives, the state of the captive market and the potential impact of Solvency II.

Anandi Nangy-Kotecha, Associate Director, Analytics, said: "Direct captives are likely to be more heavily impacted by the current form of Solvency II than reinsurance captives. Small captives, which lack risk diversification and have high counterparty exposures, are expected to need capital increases to meet regulatory requirements. Given the more onerous regulatory environment and the costs involved, some parents may close dormant captives and run off existing vehicles."

The report considers A.M. Best's views on the potential impact on captives of the three pillars of Solvency II. A.M. Best believes that many captives may find Own Risk and Solvency Assessment (ORSA) compliance particularly difficult under Pillar II as there is no specific ORSA model to follow. Meanwhile, Pillar III's further disclosures, increased transparency and improved benchmarking are generally welcome though difficult for captives.

The report states that while some captives will struggle to comply with the new directive, others will find opportunities. Those that focus on risk and capital management and maintain well-diversified or defensible niche strategies are well-prepared for Solvency II. By maintaining sufficient capital levels, they will be able to take advantage of opportunities to expand their roles, should they arise.

In terms of exposure to sovereign debt, a captive's exposure is generally lower compared with a conventional insurer, although the captive may come under pressure to increase loans back to a parent that has been negatively affected by the financial uncertainty. Yvette Essen, report author and Director of Industry Research, Europe & Emerging Markets, added: "Parent companies continue to have a wide choice of jurisdictions for their captives. Cells are being formed, although the soft market and uncertainties regarding Solvency II's final specifications and implementation date could result in delayed decisions to form captives in onshore jurisdictions."

To access a complimentary copy of this report, please visit http://www3.ambest.com/bestweek/purchase.asp?record_code=209265.
(Published: BestWire - 02/11/2013).

Claims

MTA: Insurance to Cover $1.075 Billion in Hurricane Sandy Damage

The Metropolitan Transportation Authority, which oversees the New York City Transit, the Long Island Rail Road and the Metro-North Rail Road, expects insurance to chip in $1.075 billion to cover its Hurricane Sandy damage.

In a report to its board, the MTA said it estimates losses of $5 billion in connection with the storm, $4.75 billion from infrastructure damage and $268 million from operating losses.

The losses are expected to be covered by federal programs, including FEMA, plus insurance and other resources, the MTA said in its presentation.

The MTA's captive, First Mutual Transportation Assurance Co., had $146.2 million in capital and surplus at year-end 2010, according to an examination by the New York Department of Finance.

According to the examination report, filed in February 2012, First Mutual insures up to $25 million per occurrence for the perils of flood and earthquake, up to an annual $75 million aggregate. The total program limit is $1.075 billion for any one peril, and reinsurance is provided through various carriers.

The captive was launched in 1997 and is domiciled in New York.

Attempts to reach the MTA for comment were unsuccessful.

Sandy made landfall Oct. 29 near Atlantic City, N.J. Sandy's diameter made it the largest Atlantic hurricane recorded in terms of tropical storm wind span ranging 175 miles. The storm impacted Toronto and raised waves in Lake Michigan to 24 feet. Sandy had twice the diameter of Hurricane Katrina, which devastated the Gulf Coast in 2005, and AIR Worldwide said the sheer size of the storm held its power down to a Category 1 hurricane.

Sandy halted activity in New York and other East Coast cities. A record storm surge of nearly 14 feet produced flooding in low-lying areas near the East River and some New Jersey shore towns. The Brooklyn-Battery Tunnel and seven East River subway tunnels were flooded, putting a halt to New York City's commuter rail service (Best's News Service). (Published: BestWire - 12/13/2012).

By Meg Green, senior associate editor, BestWeek: Meg.Green@ambest.com

Domicile News

As China Gets Its First Captive, Equity Analysts See More Prospects Among Energy Companies

China has gained its first locally incorporated captive insurer as an alternative risk financing option, which industry analysts see as a sign the country's businesses are developing more sophisticated risk management strategies.

As many Chinese companies, particularly state-owned leading oil and gas producers and suppliers with high strategic values, are growing big enough to reach the top 500 international firms, the country's insurance regulator has given a green light to the country's largest petroleum company to set up its own property captive insurer.

Beijing-based China National Petroleum Corp. and its subsidiary Petro China Co. Ltd. will jointly develop a captive insurer in western China's Karamay City, in Xinjiang Uyghur Autonomous Region, with registered capital of 5 billion yuan (US$804 million). The companies would have a year to prepare, but development of the captive is expected to be completed in September 2013, according to the China Insurance Regulatory Commission.

Industry analysts say an emerging captive sector in China would need clear and more sophisticated regulations, in addition to tax benefits and flexibility in capital utilization.

"Captive insurance is a new market for China, through which some large companies can set up self-insurance fund," said Wenli Yuan, a Hong Kong-based senior analyst at consultancy Celent. "Compared to managing self-insurance fund, a captive insurance company can manage various risk professionally and effectively."

The oil and gas industry has its own special risks and normal commercial insurance products currently cannot cover all related risks, leaving an opening for captive insurers, said Yuan. "Setting up a captive insurer is an important risk management method for many large multinational companies, which also requires the captive company to have professional risk management skill to spread their own risk," she said.

Some difficulties in forming a captive in China include restrictions under Chinese insurance law and the limited capacity of Chinese enterprises, according to a report from Beijing-based Central University of Finance and Economics.

Chinese insurance law currently requires minimum registered capital for setting up an insurer of 200 million yuan, but the Central University report said not many companies can commit that amount of funding. The report added most Chinese companies are small, and large companies account for only 0.1% of the total.

"Limited capacity results in not only the lack of capital necessary for the establishment of a captive, but also the lack of minimum risk exposures required by the relevant law," noted the university.

Another challenge is there is no regulation related to captive insurance companies in China at present, and the regulator's responsibility is unclear, said Yuan. Although large companies show interest in setting up captive insurers, she expects the CIRC to "approve only a few in the near term, as a pilot."

Global insurance broker Willis Group expects the Chinese captive market in general to grow gradually, as certain issues will need to be addressed. "The law and regulation shall be more sophisticated, otherwise the supervision costs will be huge," said Wise Xu, deputy managing director of Willis in China. "If the captive can't enjoy the tax benefit and flexibility in solvency and capital utilization, it will make no sense to set up a captive in China."

New York, Hong Kong and Shanghai-listed CNPC is the largest Chinese oil and gas producer and supplier, with a presence in nearly 70 countries. It is planning to increase its international exposure.

The company is registering its captive in Xinjiang, which Xu said is "an important oil and gas hub and can offer tax relief for companies." Xinjiang borders Russia, Mongolia, Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan, Pakistan and India. It has abundant oil reserves and is China's largest natural gas-producing region. In 2011, CNPC reported net profit of 133 billion yuan and turnover of 2 trillion yuan.

Although China's captive market is at the beginning stage, its growth prospects will be tied to business expansion of the Chinese enterprises and their "increasing willingness to retain more risks due to improved risk management," according to Central University's report.

The university suggested the regulator introduce more offshore captives and reduce the minimum registered capital required to promote the market. The university said it expects captive utilization to grow in China, especially by large state-owned enterprises such as China Petrochemical Corp. (Sinopec), China Ocean Shipping (Group) Co. and China Minmetals Corp.

"As perhaps captive insurance is the most widely accepted form of alternative risk financing, its utilization by certain industries varies markedly," said Jonathan Groves, senior vice president at insurance broker Marsh Inc. in a report. "It is difficult to foresee an environment where captives effectively replace the general insurance market, whether domestic or international, but an increasing role is possible."

Captive insurance companies have been in existence for more than 100 years, said Marsh, which added there are more than 5,000 such companies globally, and more than 70 jurisdictions have some form of captive legislation. The broker said the oil and gas industry is a significant user of captives, while national oil companies that operate captives including Petroleos de Venezuela, Gazprom, Statoil, Petrobras, Petroleum Oil & Gas Corp. of South Africa and CNOOC.

Prior to CNPC's move, another Beijing-based petroleum company — China National Offshore Oil Corp. — was cleared to establish an offshore captive insurance subsidiary — CNOOC Insurance Ltd. — registered in Hong Kong, and commencing operations in 2002. CIL offers insurance covering ships, cargo transportation, fire and natural disaster, property loss, ship liability and general liability.

New York and Hong Kong dual-listed CNOOC concluded an initial private placement of US$210 million for the establishment of CIL in April 2000. The investing institutions included two affiliates of American International Group, Inc. before 2008 — AIG Asia Infrastructure Fund II, L.P. and American International Assurance; and GIC Special Investments Pte. Ltd., the private equity arm of the government of Singapore Investment Corporation, according to CNOOC. The Chinese company reported profit of 112.3 billion yuan and total assets of 718.5 billion yuan in 2011.
(Published: BestWire - 01/22/2013).

By Rebecca Ng, Hong Kong news editor: Rebecca.Ng@ambest.com

Domicile News

Montana Sees Nearly 25% Gain in Captive Insurer Licenses Issued in 2012

Thirty-four new captive insurance company licenses were issued in Montana in 2012, bringing the total number of licensed captives in the domicile to 114, according to the Montana Captive Insurance Association Inc.

The growth "reinforces Montana's position as the leading captive domicile in the Western United States," said Dick Goff, the association's president, in a statement.

The breakdown of licensed captives is as follows: Pure captive insurers: 79; risk retention groups: 16; captive reinsurance companies; 10; protected-cell captives: six; association reciprocal insurers: two; and special purpose captives: one.

The Montana Office of the Commissioner of Securities and Insurance provided the data to the association.

Explaining Montana's growth in captives, "First and foremost, just wonderful regulators" Goff said in an interview in last year. The association's members range from professional organizations, such as lawyers, doctors and hospitals, to mom-and-pop shops, retailers or manufacturers (Best's Review, March 2012).

The Montana association also said it's working to pass legislation this session that would improve the state's captive statute.

Steve Matthews, captive insurance coordinator for Montana, told Best's News Service in the past that Montana was seeing the formation of reinsurance captives (Best's News Service).
(Published: BestWire - 01/17/2013).

By Fran Matso Lysiak, senior associate editor, BestWeek: fran.lysiak@ambest.com

Management

UK's Randall & Quilter Acquires Its First Isle of Man Captive Insurer

Runoff acquisition specialist Randall & Quilter Investment Holdings plc completed its acquisition of the entire issued shares of Hickson Insurance Ltd., an Isle of Man-domiciled captive insurer, for 525,000 pounds (US$845,591).

Hickson Insurance, which has been in run-off since 2002, wrote a mixed book of business from 1988, including public and products liability, property, general liability, marine and motor accidental damage. As of December 2011, there no longer were any insurance reserves due to the maturity of the run-off and claims notifications had ended.

The transaction represents London-based Randall & Quilter's first captive acquisition on the Isle of Man, the company said.

The purchase of Hickson Insurance "further evidences the increasing level of acquisition activity we are seeing as a group," Ken Randall, chairman and chief executive of

Randall & Quilter, said in a statement. "It also continues to demonstrate our ability to provide attractive exit solutions for captive owners who have put their captives in run-off or are contemplating ceasing writing new business."

Randall & Quilter focuses on the global non-life insurance market. The group has up to 400 insurance professionals based in the United Kingdom, United States, Bermuda and continental Europe and a portfolio of 11 insurance companies in run-off. It also provides management services to Lloyd's Syndicate 1897; manages two run-off syndicates and owns and operates three managing general agencies.

In December, Randall & Quilter completed its acquisition of Linpac Insurance Co. Ltd., a Guernsey-domiciled captive insurer, from Linpac Finance Ltd. Randall & Quilter was to pay 450,000 pounds in cash from existing resources (Best's News Service).

Earlier, Randall & Quilter launched Lloyd's Syndicate 1991 through R&Q Managing Agency Ltd., its Lloyd's subsidiary (Best's News Service). The new syndicate will begin underwriting from Jan. 1, 2013, with capacity of 77 million pounds.

Lloyd's currently has a Best's Financial Strength Rating of A (Excellent).
(Published: BestWire - 01/15/2013).

By Fran Matso Lysiak, senior associate editor, BestWeek: fran.lysiak@ambest.com

Management

UK Runoff Specialist Randall & Quilter Acquires Guernsey-Based Captive Insurer

Runoff acquisition specialist Randall & Quilter Investment Holdings plc completed its acquisition of Linpac Insurance Co. Ltd., a Guernsey-domiciled captive insurer, from Linpac Finance Ltd. Randall & Quilter will pay 450,000 pounds (US$727,493) in cash from existing resources.

Linpac Insurance has been in runoff since 2006, according to Randall & Quilter. The insurer wrote business beginning in 1994, including employers' liability, public and products liability, workers' compensation, U.S. and Canada general liability and motor. Reserves totaled 171,000 pounds as of June 30, the date of the latest available management accounts.

"The purchase of LICL further evidences the increasing level of acquisition activity we are seeing as a group," said Ken Randall, chairman and chief executive of Randall & Quilter, in a statement. "It also continues to demonstrate our ability to provide attractive exit solutions for captive owners who have put their captives in runoff or are contemplating ceasing writing new business. This will be our fifth captive acquisition in 2012 and our fourth in Guernsey this year."

Randall & Quilter has a portfolio of 10 insurance companies in runoff in the United Kingdom, United States and continental Europe, with net assets of 85.5 million pounds as at Dec. 31, 2011.

The company provides turnkey management services to Lloyd's Syndicate 1897, manages two runoff syndicates and owns and operates five managing general agencies. The company acquires and manages a portfolio of insurance receivables with a carrying cost of 8.2 million pounds.

Randall & Quilter recently launched Lloyd's Syndicate 1991 through R&Q Managing Agency Ltd., its Lloyd's subsidiary (Best's News Service). The new syndicate will begin underwriting from Jan. 1, 2013, with capacity of 77 million pounds.

Lloyd's currently has a Best's Financial Strength Rating of A (Excellent).
(Published: BestWire - 12/24/2012).

By David Pilla, international editor, BestWeek: David.Pilla@ambest.com

Regulation

ALIA: NAIC Wrong on Assessment of Captives

The National Association of Insurance Commissioners should rethink a subgroup's finding that the regulatory oversight of captives affiliated with a company is inadequate, according to a comment letter the Affordable Life Insurance Alliance filed with the organization.

ALIA executive director Scott Harrison sent the letter to the NAIC to weigh in on the life insurance implications of the Captive and Special Purpose Vehicle Use Subgroup's white paper studying those insurance entities.

The subgroup began looking into captives and SPVs after some regulators described use of captives and the potential concern that a shadow insurance industry is emerging, with less regulation and more potential exposure than policyholders may be aware of as compared to commercial insurers. At the NAIC's summer meeting, subgroup members debated whether captives and SPVs are used to circumvent the reserving requirements of U.S. statutory accounting.

The NAIC subgroup added that "this potential concern becomes amplified when academics claim the shadow banking system was believed to have contributed to the recent financial crisis, thereby putting significant pressure on state insurance regulators and the NAIC to assess the merits of the aforementioned claims" (Best's News Service).

The white paper said the subcommittee had uncovered little evidence that companies were intentionally using their affiliated captives and SPVs to skirt reserve requirement. But they did say changes may be needed to keep that problem from arising.

The recommendations included studying how transparent affiliated captives and SPVs should be, ensuring that they do not become major competitors in the reinsurance market and updating the NAIC's Special Purpose Reinsurance Vehicle Model Act. The paper also said the use of captives should generally follow the international views contained within a recent International Association of Insurance Supervisors guidance paper.

Comments letters on the white paper were due by Nov. 16.

"ALIA strongly supports the use of captives by life insurers," Harrison said. "Companies need to have the flexibility

to adapt their risk management strategies to changes in the marketplace. In the current environment, companies need more options, not fewer, and U.S.-based captives that are subject to state regulation are a safe and effective risk management tool."

However, Harrison took issue with the NAIC over the idea of reassessing the regulations placed on captives and SVPs.

"We respectfully disagree with any suggestions that the current regulatory framework or oversight regarding the use of affiliated captives is somehow inadequate, or that companies have engaged in these transactions for reason other than effective risk management," Harrison said in a statement. "We fully support a constructive dialogue with the NAIC designed to address the questions and concerns that regulators have raised and to address as well the question of what enhancements to existing standards and requirements may be appropriate."

Other life trade organizations are also submitting comments on the captive but their comments haven't been posted online yet.
(Published: BestWire - 11/20/2012).

By Jeff Jeffrey, Washington Bureau Manager: jeff.jeffrey@ambest.com

Regulation

Bermuda Captives Spared From Solvency II-Style Commercial Requirements

The Bermuda Monetary Authority will not impose Solvency II-style commercial requirements on its captive industry. The announcement was made Jan. 29 at BMA's Annual Meeting as BMA presented its 2013 business plan setting regulatory priorities and goals.

Attempts to gain immediate comment from BMA were unsuccessful.

BMA Chief Executive Officer Jeremy Cox highlighted two key areas in the plan impacting captives and other parts of the insurance sector.

Bermuda will not have a captive regime along the lines of Solvency II, he said in a written statement. "We will introduce a risk return as part of our consolidated annual filing for captives that they will submit electronically, which will create efficiencies in the process for the market and the Authority," he said in the statement. Requiring the risk return allows regulators to get key risk information, although the industry is already volunteering much of what it will require. "It's good for Bermuda and the market that we can make this decision based on the proven appropriateness of our regime for captives," Cox said.

BMA remains committed to international discussions on solvency, while implementing what he calls "fit-for-purpose regulations" for Bermuda. Bermuda would continue participation in international talks, Cox said, but needs to have its own view of what should be done in its insurance market in part because so many companies there have a global footprint.

The European Union is still crafting the final details for Solvency II. Regulators in Bermuda had been pushing to meet those requirements before the original Jan. 1, 2014 deadline. Bermuda is among the nations that have been trying to have its insurance regulations deemed equivalent to Solvency II requirements so Bermuda insurers can operate more freely in the European market.

Shelby Weldon, BMA's director of insurance, licensing and authorization, said last summer that while the commercial regulatory regime will continue to work to meet Solvency II requirements, captives likely would continue to operate as usual because they mostly meet them (Best's News Service).

Skepticism remains that the EU can implement Solvency II by January 2014 and speculation increased after the EU delayed for the third time a vote on Omnibus II, which must pass before Solvency II can be considered. While the European Insurance and Occupational Pensions Authority still sees January 2014 as an implementation target, it issued a late December paper that suggested a gradual approach to account for differences among nations (Best's News Service).
(Published: BestWire - 01/30/2013).

By Thomas Harman, associate editor, BestWeek

Regulation

Captive Advocates Create Coalition to Clarify NRRA in Response to 'Amazing Amount of Confusion'

The captive insurance industry has formed a new coalition to push Congress to clarify that the Nonadmitted and Reinsurance Reform Act was never meant to apply to captives.

"There's still an amazing amount of confusion and trepidation within the captive industry because of the ambiguity in the law, and we finally said we need to move ahead and get a federal legislative fix to get it right," said Richard Smith, president of the Vermont Captive Insurance Association. The NRRA was intended to encourage states to simplify and standardize surplus lines regulations.

Without legislative language clarifying the NRRA, the captive industry is worried captives could face additional taxation under the law. Some in the industry are so concerned they have decided to delay plans to put new business in their existing captives, Smith said.

"They aren't willing to expand what they already have in their captive for fear they are exposed to taxation that makes it not economical," he said. "They could be taxed at a much higher rate, as opposed to a captive premium tax based on where the captive is domiciled."

The newly formed Coalition for Captive Insurance Clarity said it welcomes industry members to join in the effort to amend the law to provide clear and definitive language in the NRRA and will work with members of Congress to get the necessary changes.

The VCIA, which is leading the charge on the issue, has hired the firm of FaegreBD Consulting to help seek a legislative change. FaegreBD was one of the architects of the NRRA and will be working in partnership with VCIA's

longtime lobbying firm McIntyre & Lemon PLLC to seek a legislative remedy.

Smith said the VCIA has had "tremendous interest from other domiciles and leading consultants in the captive industry to join CCIC and we expect to have many members sign on to the coalition."

He said those other members are expected to be announced later the week of Dec. 3.

VCIA said it's the largest trade association in the world for captive insurance. Established in 1985, the association has grown to provide programs that support the captive insurance industry on both the state and federal levels for its 450-plus member companies.

One of Congress' goals in passing the NRRA was to encourage states to standardize the web of state regulations that govern surplus lines, said Richard Bouhan, retired executive director of the National Association of Professional Surplus Lines Offices.

In July, he said at least 44 states have passed legislation related to the implementation of the NRRA, including confirming the state has oversight and sole taxing authority of surplus lines policies when it is the home state of the insured (Best's News Service).

But complicating the pictures are two interstate tax-sharing compacts — the Surplus Lines Insurance Multi-State Compliance Compact and Non-Admitted Insurance Multi-State Agreement — that together with NRRA, could mean three different tax schemes for surplus lines insurers.
(Published: BestWire - 12/04/2012).

By Meg Green, senior associate editor, BestWeek: Meg.Green@ambest.com

Regulation

Director Weldon: Bermuda Moving Toward EU Equivalency Standard Despite Solvency II Questions

Despite some emerging concerns regarding implementation of European Union Solvency II requirements, the Bermuda Monetary Authority will continue efforts to meet an EU equivalency standard that is part of the directive, said Shelby Weldon, BMA director of insurance, licensing and authorization.

Bermuda is one of several nations seeking to meet the equivalency standard for commercial entities under Solvency II, an update of an earlier suite of rules designed to help reduce the risk of insolvency. The equivalency standard states that any non-EU company operating in the Union should come from a domicile whose rules are recognized by EU members as equivalent to those in Solvency II.

European regulators and observers have been seriously questioning whether the EU can implement Solvency II on Jan. 1, 2014 as scheduled. The U.K.'s Financial Services Authority shows signs of "recognition" that "they don't really know when this is going to happen now," said Chris Finney, a partner with London-based law firm Edwards Wildman Palmer UK LLP, who suggested that Solvency II could be issued in a gradual fashion after the start date. Germany's Federal Financial Supervisory Authority has been thinking about the probability of further delays to Solvency II. BaFin's quarterly newsletter for the fourth quarter of 2012 quoted Kurt-Georg Hummel, a department head at the agency, as saying "we expect that Solvency II will not enter into force until 2016, rather than 2014" (Best's News Service).

But Weldon said Bermuda is not deterred by the apparent uncertainty and will push ahead toward improving its rules and meeting EU equivalency. He said the idea of EU equivalency is not the driving force behind Bermuda's regulatory regime, but in doing what's best for its market and ensuring that policyholders are adequately protected. While seeking equivalency with EU standards in supervising commercial classes, Weldon said Bermuda does not seek duplication of those standards. Still, he said U.S. companies should have a higher comfort level that companies located in Bermuda are regulated and supervised according to international standards.

The efforts toward equivalency will not apply to captive insurers in Bermuda, one of the world's largest captive domiciles. The BMA announced on Jan. 29 that it would not make captives meet Solvency II-style requirements, but instead will have captives file risk-return plans as part of a consolidated filing, Weldon said.

When the BMA decided to seek equivalency, it never intended for captives to meet Solvency II requirements, Weldon said. Instead, BMA is closely watching a working group formed by the International Association of Insurance Supervisors regarding appropriative supervision for captives, Weldon said.

Bermuda is not changing its regulatory approach toward captives, Weldon said. But it is embarking on a data collection consolidation program that will help make sure captives get appropriately licensed and regulated, he said. The effort is designed to provide statistical information about what happens in the captive space and the lines of business being conducted within captives. Ultimately, Weldon said, the information would be used to improve Bermuda's understanding of captive risk and whether companies should be licensed under Solvency II.

Weldon recommended that U.S. state regulators follow what's happening at IAIS and its own Solvency Modernization Initiative. He said U.S. companies would do well to concentrate on what happens at an international level, compared to the more focused regional EU rules that seek equivalency. He said U.S. regulators should review and develop an understanding of their insurance markets and put together regimes based on that information.

In September, the National Association of Insurance Commissioners passed the Own Risk Solvency Assessment model rule as a guide for how states should approach questions about insurer solvency. If adopted by states, the rule would require insurance companies that have annual premiums of more than $500 million and insurance groups with $1 billion to submit a report to their state regulator outlining their enterprise risk management processes. The confidential report would include information about the

risks the company or group could face going forward and the sufficiency of their capital resources to address those risks (Best's News Service). Some in the insurance industry have viewed ORSA as the U.S. answer to the European Union's Solvency II standards.
(Published: BestWire - 02/15/2013).

By Thomas Harman, associate editor, BestWeek

Regulation

Outgoing US Rep. Biggert: Dodd-Frank Act Shouldn't Apply to Captives

The Dodd-Frank financial reform act passed in 2010 was never intended to be applied to the captive insurance industry, wrote former U.S. Rep. Judy Biggert, R-Ill., the outgoing chairman of the House Subcommittee on Insurance, in a recent letter to the subcommittee's new leaders.

Biggert's Dec. 18 letter, which was just recently made public, was addressed to incoming chairman Rep. Jeb Hensarling, R-Texas, and ranking member Maxine Waters. In it, Biggert wrote that several states have misinterpreted the Nonadmitted and Reinsurance Reform Act, which is part of the Dodd-Frank Act, and have created confusion among captives about new tax requirements.

"As a supporter of NRRA and an advocate for its inclusion and passage as part of Dodd-Frank, I can tell you unequivocally that the NRRA was never intended to include the captive insurance industry," Biggert wrote. "[NRRA] was intended to create certainty in the tax treatment and regulation of the surplus lines and in the reinsurance industry. Despite this very specific purpose, a couple of states are misinterpreting the application of NRRA's definition of 'non-admitted.'"

Biggert told Hensarling and Waters the NRRA portion of the Dodd-Frank Act may need a technical amendment to provide more clarity to states on how it should be applied.

"Captive insurance companies serve a vital role in the financial services industry and it is important that their industry not be negatively impacted by an incorrect interpretation of congressional record," Biggert said.

Without legislative language clarifying the NRRA, the captive industry is worried captives could face additional taxation under the law. Some in the industry are so concerned they have decided to delay plans to put new business in their existing captives, said Richard Smith, president of the Vermont Captive Insurance Association.

Efforts to reach spokesmen for Hensarling and Waters for comment were not immediately successful.

Biggert's letter has garnered support from captive insurance industry supporters, many of whom said state regulators needed more clarity about how the NRRA should be applied.

In Vermont, the nation's captive insurance capital, the Vermont Captive Insurance Association has formed a coalition, dubbed the Coalition for Captive Insurance, to push for increased clarity on how the Dodd-Frank Act should affect captives, if at all (Best's News Service).

"This letter from Rep. Biggert is a clear indication of Congress' intent not to include the captive insurance industry in NRRA," Smith said.

The coalition has received support in its effort to clarify the NRRA from Daniel Towle, director of financial services at Vermont's Department of Economic Development. "A few domiciliary states and opportunistic service providers are clearly exploiting the present situation, which is not in the best interest of their clients or the industry as a whole," Towle said in a statement.
(Published: BestWire - 01/07/2013).

By Jeff Jeffrey, Washington Bureau Manager: j eff.jeffrey@ambest.com

Strategy

Businesses May Turn Increasingly to Captives for Medical Stop Loss Insurance

Businesses may increasingly turn to self-insurance, and their use of captives for medical stop-loss insurance may grow as a result of the U.S. health care reform law, some industry experts predict.

Bill Boone, national alternative health care solutions leader at Marsh Inc., said reform removed the lifetime limit and annual per insured limits in 2014 that previously prevailed in the market. "This has brought stop-loss insurers to the table to provide high excess limits that are now especially critical," Boone said. "One really bad case, and it could be $2 million bucks."

More clients are placing medical stop loss into their existing captives and "investigating the creation of new captives to do the same," said Boone. Many of the larger medical institutions have already implemented a captive for professional liability and general liability and physician medical liability for their employed physicians and sometimes for non-employed staff physicians, Boone said.

Matthew Buettgens, senior research associate at The Urban Institute, told Best's News Service if states don't change the current regulations, it's likely there will be more self-insurance, and more medical stop-loss captives.

According to an issue brief by The Commonwealth Fund in November 2012, authored by Buettgens and Linda Blumberg, the Patient Protection and Affordable Care Act changes the small-group insurance market substantially starting in 2014, but most changes don't apply to self-insured plans. This exemption provides an opening for small employers with healthier workers to avoid broader sharing of health care risk, isolating higher-cost groups in the fully insured private market, they wrote.

Small businesses that offer fully insured plans with favorable demographics or claims experience fear they will see steep premium jumps upon implementation of the ACA when buying through the insurance exchanges that come online in 2014, said Ryan Siemers, a principal at Aegis Risk.

Starting in 2014, the law mandates that employers with 50 or more employees that don't offer coverage to their employees pay $2,000 annually for each full-time employee

over the first 30, as long as one of their employees receives a tax credit.

Siemers maintains the captive industry has been promoting placement of stop loss into captive arrangements for a while but stop loss is subject to high payouts that could be detrimental to a captive. Life or disability insurance, which are more consistent and less "sporadic," could be a better fit.

Private stop loss or reinsurance plans can mediate the risk of self-insurance for small employers, facilitating the decision to self insure, Buettgens and Blumburg wrote. "We simulate small-employer coverage decisions under the law and find that low-risk stop-loss policies lead to higher premiums in the fully insured small-group market," they wrote. "Average single premiums would be up to 25% higher, if stop-loss insurance with no additional risk to employers than fully insuring is allowed — an option available in most states absent further government action."

Captives for medical stop loss also could increase because stop-loss coverage at deductibles some smaller businesses would want would be too expensive, Siemers said. As an alternative, they may seek membership in a larger captive to put their catastrophic risk into at "potentially" a lower cost than market stop-loss premiums, Siemers said.

Generally, employers must have specific/individual stop-loss policies, designed for the claims of one covered individual in a group.

Consumer advocates contend very small employers will try to self-insure and use medical stop loss with low deductibles to avoid compliance with the law (Best's News Service).

With employer-sponsored health benefits, fully insured and self-insured group plans are governed by the federal Employee Retirement Income Security Act of 1974, said Carmen Balber, director of the Washington D.C. office of Consumer Watchdog. However, self-insured plans don't have to comply with some of the law's key consumer protection provisions, including the requirements for minimum essential health benefits, she said. A big concern is that small businesses will be using the exchanges, and self-insurance is being encouraged for businesses with the healthiest employees, Balber previously said, noting it's a way to "cherry pick the healthiest in the risk pool" (Best's News Service).

About 25 states regulate medical stop loss in some way, and only three states have adopted the National Association of Insurance Commissioners' Stop Loss Insurance Model Act, said Mike Ferguson, chief operating officer of the Self Insurance Institute of America. Under the model act, the deductible is currently at $25,000 for specific policies, Ferguson said. The NAIC is looking at revising the model act to raise the attachment points on both specific and aggregate policies.

An actuarial subgroup of the NAIC has recommended that stop-loss deductibles — also known as "attachment points" — be set at a minium of $60,000 per insured individual, according to the Commonwealth Fund issue brief. The suggested parameters would expose small employers to significant financial risks if self-insuring and would dissuade the vast majority from doing so. "As a result...average premiums in the fully insured small group market would be lower than under a scenario with looser stop-loss regulations or none at all," Buettgens and Blumberg wrote.

With the latest proposed revision, brokers, captives or others may say they can offer an alternative lower than $60,000, for example, so some small businesses may put their catastrophic risk into a captive, potentially at a lower cost than the higher stop-loss premium, Siemers said. Currently, many medical stop-loss carriers aren't eager to write coverage at deductibles lower than $50,000, Siemers said.

If the NAIC and regulators don't stipulate a minimum stop-loss deductible limit, captive arrangements may flourish because small employers will observe the steep cost of stop-loss premium at low deductibles and seek alternative, potentially lower cost funding arrangements, Siemers said. Medical stop-loss captives are "a promising market growth opportunity for the self-insurance marketplace," Ferguson said.

Health reform could potentially make it more attractive for smaller businesses to band together in a captive and get lower risk than a traditional stop-loss policy, said Buettgens, noting there could be "a disproportionate growth" in captives depending how states view a captive versus a traditional stop-loss policy.

Some brokers say medical stop-loss captives are spurring interest from all size businesses. If health reform drives up costs, companies, regardless of size and with good loss experience, will want to self- insure, said Les Boughner, executive vice president and managing director of the captive practice at Willis. However, several group captives have already been formed for medical stop loss, and ERISA benefits must use a U.S. captive, Boughner said. These risks can be located anywhere in the United States but because it is a group captive, it would "probably be domiciled offshore," Boughner said.

According to America's Health Insurance Plans, starting in 2014, health reform requires health plans pay a sales tax on policies sold to individuals, families, small businesses and seniors. The tax begins at $8 billion in 2014 and rises to $14.3 billion in 2018. The Congressional Budget Office has said this tax will be passed along to individuals and small businesses via higher health insurance premiums (Best's News Service).
(Published: BestWire - 02/20/2013).

By Fran Matso Lysiak, senior associate editor, BestWeek: fran.lysiak@ambest.com

Strategy

Hong Kong Seeks to Energize Captive Insurance Market With Tax Cut

HONG KONG - Hong Kong's government plans to offer a tax cut on captive insurers' profit in a bid to attract more offshore funds, particularly in what it sees as untapped captive insurance business from China's big corporations, according to the financial secretary's proposed budget for 2013-14.

A.M. BEST

The new policy aims to strengthen Hong Kong's position as an international asset management center, said Financial Secretary John Tsang in his proposed budget presentation. The government will reduce the profit tax on captive insurers' offshore insurance business so that they will enjoy the same tax concessions as those currently applied to reinsurance companies.

The 50% profit tax reduction for captive insurance companies is a favorable move for insurance industry in Hong Kong, given the city's proximity to China, where many big corporations are seeking alternative risk management options such as captive insurance, said Peter Tam, chief executive of the Hong Kong Federation of Insurers.

Singapore has been attracting captive insurance and reinsurance business over the past decade. Tam said Hong Kong has lagged behind Singapore in attracting such potential insurance business. He sees the tax incentive as a breakthrough for Hong Kong's effort to develop into a more comprehensive insurance sector.

Singapore is the largest captive insurance market in Asia with more than 60 captive insurers. Malaysia's offshore financial services center, Labuan International Business and Financial Center, has more than 30 captive insurers. Hong Kong only had two captive insurers with total premiums of HK$704.8 million (US$90.9 million) in 2010, according to the Office of the Commissioner of Insurance (Best's News Service, Aug. 9, 2011).

The minium capital requirement for a captive insurer in Hong Kong is HK$2 million, compared with HK$10 million for a general insurance company. Hong Kong "is strategically positioned to serve the insurance needs" of China's huge and fast-growing market, said the OCI.

The China Insurance Regulatory Commission recently cleared the country's largest petroleum company, China National Petroleum Corp., to set up a property captive insurer as the first locally incorporated captive. Beijing-based CNPC and its subsidiary Petro China Co. Ltd. will jointly set up the captive insurer in western China's Karamay City in Xinjiang Uyghur Autonomous Region, with registered capital of 5 billion yuan (US$795 million) (Best's News Service, Jan. 23, 2013).

Captives are an emerging insurance market in Asia, as the region's aviation, energy and construction businesses boom, according to insurance broker Willis Group. This is particularly true in China, where major oil companies are ready to set up captive insurers. The risk management needs of companies are becoming more sophisticated and they are starting to seek alternative insurance mechanisms, said Willis (Best's News Service, Nov. 8, 2011).

In China, captive insurance is a new market and some large companies can set up self-insurance funds, said Wenli Yuan, senior analyst at consultancy Celent. The oil and gas industry has its own special risks and normal commercial insurance products currently cannot cover all related risks, leaving an opening for captive insures, noted Yuan. The growth prospect of China's captive insurance business will be tied to Chinese enterprises' expansion and their decision to retain more risks due to improved risk management.

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