Captive Update

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

November, 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 Special Report: Rating Factors for Organizations Using Life Captive Reinsurers

OLDWICK, N.J. - A.M. Best Co. views as positive the life insurance industry's ongoing discussions related to increased regulatory scrutiny and transparency of captive reinsurers. In general, A.M. Best believes these transactions are reasonable mechanisms for companies to proactively address conservative statutory reserve requirements and achieve some capital and tax efficiency. As a result, A.M. Best adheres to specific analytical processes and rating factors that are relevant for life insurance organizations using captive reinsurers.

For more than a decade, A.M. Best has been monitoring how captive strategies have evolved and been used after the emergence of Regulation XXX (XXX) term life and Actuarial Guideline 38 (AG38 or AXXX) "redundant" reserve requirements. Writers of guaranteed level term or universal life policies with secondary guarantee have continued to resort to internal reinsurance, often through the use of domestic captives or offshore entities—typically in Bermuda—to support XXX and AG38 reserves.

It is important to note that A.M. Best receives proprietary, detailed financial information on all key reinsurance transactions undertaken by its population of rated companies. Captive reinsurance transactions are similar to commercial reinsurance transactions as they must meet the same regulatory requirements for the ceding company to receive credit for reinsurance. However, two regulators—one from the insurance company's state of domicile and the other from the captive's domiciliary state—review each captive transaction. Currently, more than 30 states are captive domiciles.

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 are 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 and/or a reduction in its overall net exposure. However, A.M. Best could downgrade the company's ratings and/or revise the outlook if its Best's Capital Adequacy Ratio (BCAR) declines, operating performance deteriorates and/or insured losses deplete capital.

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 Best's Captive Center.

A.M. Best Affirms Ratings of PMG Assurance Ltd.

A.M. Best Co. has affirmed the financial strength rating of A- (Excellent) and issuer credit rating of "a-" of PMG Assurance Ltd. (PMG) (Bermuda). The outlook for both ratings is negative.

The ratings reflect PMG's excellent capitalization, historically strong operating performance and strategic position as the captive insurance company for the Sony Group, whose ultimate parent is Sony Corporation (Sony) [NYSE: SNE]. PMG's role is to meet certain global insurance requirements of Sony's group members. Beginning in 2010, PMG did not renew nor participate in any non-related third-party treaties in any form. PMG continues its operations, but with a strategic change in underwriting directed fully towards Sony-related business as a "pure" captive.

The company's strengths are derived from its underwriting focus, long-standing customer relationships and conservative operating strategy. PMG writes mostly proportional property and marine reinsurance business and ceased writing life business effective January 16, 2011. However, going forward, PMG expects to add a small amount of employee benefits coverage. The company maintains a large exposure to earthquake-related losses in Japan due to its coverage of Sony's risks.

Due to the nature of the relationship between PMG and Sony, the changes in Sony's credit risk profile have put pressure on PMG's ratings. PMG's success is reliant on Sony's ability to increase its credit risk profile, competitiveness and risk management. The captive continues to be an integral component of Sony's risk management platform. A.M. Best's view of third-party credit ratings, as well as market-based credit risk measures of Sony indicates negative rating pressure on PMG.

Additionally, negative rating pressure might arise if there is any significant downward movement in Sony's risk profile. Any upward rating movement is predicated on improvement in Sony's risk profile coupled with maintenance of PMG's capital strength.

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A.M. Best Affirms the Ratings of Park Assurance Company

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

The ratings of Park reflect its excellent risk-adjusted capitalization, operating performance, liquidity position, sophisticated risk management strategy and practices, conservative investment strategy, its management team's extended experience in the industry and its role as a single parent captive of JPMorgan Chase & Co. [NYSE: JPM], a leading global financial services group.

Partially offsetting these positive rating factors are Park's large gross underwriting exposures as it offers very high insurance limits and insures some properties with substantial insured values. Park is very dependent on reinsurance in order to offer its various property programs and high limits.

Park provides JPMorgan Chase & Co. with global property coverages, including coverages against terrorism losses, and effective as of July 8, 2011, deductible reimbursement policies covering workers' compensation, auto liability and general liability (pursuant to the Hatherley novation and transfer agreement). As such, these coverages are key components of JPMorgan Chase & Co.'s risk management strategy, and Park benefits from the group's significant financial resources.

JPMorgan Chase & Co. also benefits from the group's extensive risk mitigation and safety programs. As Park reinsures a large portion of its global property program, its exposure to underwriting losses is minimal, barring significant losses from terrorism. It only uses well-rated reinsurers, and its surplus base is more than adequate to support its asset and credit risk exposures. However, as Park offers very high limits, its resulting gross underwriting exposures on its largest properties are also very high. Its dependence on reinsurance is therefore substantial, creating considerable credit risk in the event of exceptionally large losses. In addition, it is dependent on the protection afforded by the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). While the TRIPRA program offers significant protection from terrorism losses, the net impact on Park could still be burdensome, considering the high coverage limits offered. Nevertheless, A.M. Best recognizes the low probability of such extreme events and the support available to Park as part of JPMorgan Chase & Co.

A.M. Best views Park's management and corporate strategy as strengthening the ratings, given the conservative underwriting, operational goals and transparency. A.M. Best views the company's enterprise risk management practices as strong given their impact on conservative risk culture, defined risk controls and optimization ofPark's capital and surplus. Other factors considered in the rating process include, but are not limited to, the diversification in line of business and geography, as well as the company's panel of well-capitalized and highly rated reinsurers. The support and commitment of the parent and the captive's mission have been considered as positive factors.

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

Park's ratings and outlook are not expected to be upgraded 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 Park'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, significant changes and turnover occur in its management team and/or risk management controls and tolerances, or its parent's ratings deteriorate.

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.

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 A.M. Best's 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.

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 Best's Captive Center.

A.M. Best Upgrades Ratings of Coastal Medical Insurance Ltd.

A.M. Best Co. has upgraded the financial strength rating to A (Excellent) from A- (Excellent) and the issuer credit rating to "a" from "a-" of Coastal Medical Insurance, Ltd. (Coastal) (Hamilton, Bermuda).The outlook for both ratings has been revised to stable from positive.

The ratings reflect Coastal's excellent risk-adjusted capitalization and operating performance, strong liquidity position, expanded and sophisticated risk management strategy and practices, conservative investment strategy and its management team's extended experience in the industry.

Partially offsetting these positive rating factors are Coastal's limited market. However, these concerns are mitigated due to the explicit as well as implicit parental support of Meridian Health System (Meridian), the strategic importance of Coastal within the overall risk management program of Meridian and its mission of providing an affordable and stable program of self-insurance.

The company was formed on June 17, 1998 in Bermuda to self-insure the risks of Meridian together with those entities related through common control, affiliation agreements or close working relationships and to access the reinsurance marketplace. Meridian's risk management and insurance department provides important supporting services to the parties indemnified and reinsured by Coastal. Meridian's risk management program for the hospital system establishes risk control policies and procedures, which include safety education, data collection and evaluation, claims management and risk financing.The ratings also take into consideration the role Coastal serves in providing a discipline program of hospital and physician professional and general liability self-insurance to Meridian.

A.M. Best views Coastal's management and corporate strategy as a strength to its ratings, given the conservative risk limits on its underwriting, operational goals and transparency.A.M. Best views the company's risk management practices as excellent given the impact on its conservative risk culture, defined risk controls and capital and surplus. Other rating factors considered include, but are not limited to, the diversification in Coastal's line of business, geography and investments, and its panel of well-capitalized and highly rated reinsurers.Additionally, the support and commitment of Meridian and the captive's mission have been considered as positive rating factors.

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

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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. Best's Credit Rating Methodology can be found at www.ambest.com/ratings/methodology.

AM Best: Captives Continue to Outperform Commercial Insurers

OLDWICK, N.J. - U.S. captives tightened margins as property losses rose in 2012, but still outperformed the overall commercial casualty market, according to A.M. Best.

The five-year combined ratio for about 175 captives in A.M. Best's captive composite was 92.3 at year-end 2012, compared to the commercial casualty composite's five-year combined ratio of 103.3, A.M. Best Assistant Vice President Steven Chirico said during the "State of the Captive Insurance Market" webinar.

"Captives outperform the commercial industry," Chirico said.

Over the past decade, Chirico said he's seen dramatic changes in the captive industry.

The captive community used to respond to changes in the commercial market, he said. For instance, during hard market cycles, more captives would form and existing captives would write more business. In soft markets, those captive trends would reverse, he said, and captives would be less popular and write less business.

"In the captive space now, the value of captives to their policyholder/owner is more than just finances," Chirico said. "We visit company after company that has tailored policies and specific loss control and engineering and ways to help their parent company prevent risk. It's not just financing the risk anymore."

Parent companies are working to maximize the use of their captives, he said.

"They are retaining more, writing more and providing other coverages that may or may not be considered strict insurance," Chirico said.

Risk retention groups have also outperformed the commercial insurance industry, and in fact, outperform other types of captives, said Fred Eslami, senior financial analyst for A.M. Best.

RRGs had five-year combined ratios after policyholder dividends of 85.1 compared to the commercial composite ratio of 103.3. Like other types of captives, RRGs work hard on risk management. "It's a galvanization of interest in preventing losses in the first place," Chirico said.

RRGs, which are licensed in a single state but under federal law, are allowed to operate in all states, write liability insurance only. About 41% of the 257 RRGs write medical professional liability and 59% write other forms of liability, Eslami said.

Since 2010, Congress has considered bills that would allow RRGs to expand into property, Eslami said.

A number of states have recently adopted captive-enabling legislation, which has led to robust competition among domiciles.

"Competition is good…it keeps people honest and motivated," Chirico said. However, he said domiciles can either take all comers, then try to weed out the ones they don't want, or be tough on licensing captives up front, which would allow slow growth.

New domiciles "can be successful," Chirico said. "They can also be a horror show if it's going the wrong way."

A.M. Best Affirms Ratings of Dorinco Reinsurance Company

A.M. Best Co. has affirmed the financial strength rating of A (Excellent) and the issuer credit rating of "a" of Dorinco Reinsurance Company (Dorinco) (Midland, MI), which is the captive reinsurance company of The Dow Chemical Company (Dow). The outlook for both ratings is stable.

The rating affirmations reflect Dorinco's continued strong operating performance, balanced risk profile and excellent risk-adjusted capitalization. The ratings also consider Dorinco's strategic importance within the Dow organization and Dorinco's successful mitigation of Dow's worldwide, long-tail and volatile risks through its short-tailed uncorrelated non-standard auto reinsurance business.

Partially offsetting these positive rating factors is Dorinco's limited profile in the reinsurance market, which is a function of its hybrid captive nature. Another offsetting factor is Dorinco's exposure to Dow risks, many of which are worldwide and long tail in nature.

A.M. Best believes that Dorinco is well positioned at its current rating level. Key drivers that could lead to a downgrading of the ratings or a revision in the outlook to negative include a decline in Dorinco's risk-adjusted capitalization, unfavorable operating profitability trends or an outsized catastrophe loss. Alternatively, factors that could lead to rating upgrades include continued favorable operating profitability trends coupled with improved risk-adjusted capital levels.

A.M. Best Affirms Ratings of Eni Insurance Limited

A.M. Best Europe – Rating Services Limited has affirmed the financial strength rating of A (Excellent) and issuer credit rating of "a" of Eni Insurance Limited (EIL) (Dublin, Ireland). The outlook for both ratings remains stable.

EIL is the sole captive of Eni S.p.A. (Eni) (Italy), an Italian multinational gas and oil company with operations in more than 80 countries.

The rating affirmations of EIL reflect its strong risk-adjusted capitalisation, its comprehensive reinsurance programme as well as its good, albeit relatively volatile, financial performance. An offsetting rating factor remains EIL's consistently high fixed income exposure to peripheral European sovereign bonds.

EIL's risk-adjusted capitalisation is expected to remain strong in 2013, despite the introduction of large dividend payments to Eni in 2012. Future variable dividend payments, expected to be at the high end of after-tax earnings, will most likely prevent a significant improvement of EIL shareholders' funds in the medium term. However, continuous reductions in the capital requirements relating to EIL's credit and reserve risk exposures are expected to absorb the stagnation of shareholders' funds. The credit exposure is expected to decline due to the run-off of a book of business that is linked to a reinsurance panel of lower quality, and it is anticipated that the reserve risk will decrease as a result of expected continuous reserve releases. In addition, EIL maintains a comprehensive reinsurance programme with a strong panel of reinsurers, which is expected to continue to provide good protection to its balance sheet in the event of large losses. Nevertheless, a weakness to EIL's balance sheet strength remains the high exposure to fixed income assets invested in peripheral European sovereign bonds.

EIL's underwriting performance remained at a stable level in 2012 with a combined ratio of 73.2%, despite large single losses in its property lines during the year. Going forward,

A.M. Best expects overall earnings to remain good, but they are likely to remain subject to volatility, due to the impact of large underwriting losses and the potential strong movements in unrealized capital gains stemming from EIL's fixed income exposure to peripheral European sovereign bonds.

Positive rating actions are unlikely at this time.

Negative rating actions could occur if EIL's underwriting profitability were to trend negatively going forward and/or a significant deterioration of its risk-adjusted capitalisation were to occur linked to no evidence of support from Eni to boost the latter. In addition, if the captive's importance as a risk management tool were to be reduced within the group then negative rating pressure would arise.

Methodology Sources

A.M. Best remains the leading rating agency of alternative risk transfer entities, with more than 200 such vehicles rated in many domiciles.

For current Best's Credit Ratings and independent data on the captive and alternative insurance market, please visit 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 BCAR for Property/Casualty Insurers"; "The Treatment of Terrorism Risk in the Rating Evaluation"; Evaluating Non-Insurance Ultimate Parents"; and "Alternative Risk Transfer (ART)." Best's Credit Rating Methodology can be found at http://www.ambest.com/ratings/methodology.

In accordance with Regulation (EC) 1060/2009, the following is a link to required disclosures: http://www3.ambest.com/emea/ambersdisclosure.pdf.

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Domiciles

Captive Regulators a Hot Commodity as More States Pass Domicile Legislation

WASHINGTON - The recent surge in states seeking to become captive insurance domiciles has put a premium on regulators with experience working with the industry.

States across the country are working to differentiate themselves as they try to convince captives to set up shop within their borders. Industry experts said the reputation of a state's regulators can be a deciding factor.

Texas and North Carolina became the most recent states to pass captive domiciliary legislation this summer, and both are working to hire captive regulators. In August, one of the largest captive domiciles in the country saw its top captive regulator abruptly resign. The Hawaii Insurance Division announced that Sanford Saito would serve as interim deputy commissioner and captive insurance administrator, succeeding George Sumner III (Best's News Service, Aug. 28, 2013).

Dennis Harwick, president of the Captive Insurance Companies Association, said the transition from Sumner to Saito in Hawaii was made easier because the state has a deep bench of captive regulators who can step in quickly to fill a vacancy. But Harwick said states that are new to the captive marketplace may not be so lucky.

"Time and again, what I hear from captive managers is that the regulators are one of the most important things to consider when you're looking for a place to set up a captive," Harwick said. "It's a perennial challenge to get regulators who are familiar with captives."

Because captives are owned by, and tailored for, the company that sets them up, they have a different model than traditional insurance companies. Tom Sullivan, a former Connecticut insurance commissioner, said that model requires a different regulatory mindset than what is needed for traditional insurance regulation. Due to the way single-parent captives are structured, regulators don't receive phone calls from angry consumers or have to deal with the same rate and filing issues.

Sullivan, who is now with PricewaterhouseCoopers, said when he was hiring captive regulators in Connecticut, he looked for a "hybrid of a financial examiner and someone who's product knowledgeable" about how captives are set up.

"That's often not easy to find because as you narrow the focus of candidates, there are just fewer of them than if you were looking for a generalist," Sullivan said.

Sullivan said he looked for candidates for captive regulator positions both in the private market and among the ranks of traditional regulators. "You're looking for someone who's used to looking at inter-company agreements, reinsurance contracts, etc., since you'd be looking at them anyway with a primary company," Sullivan said. "Pulling someone from within your department and using them in your captive unit can be a good potential way to find people. But their learning curve might be higher, since they're not used to dealing with captives, specifically."

Regulators in states like Delaware, Hawaii, South Carolina, Utah, and the nation's largest domicile Vermont, are known for their knowledge of the industry. Harwick said that makes it easier to attract captives than in states that are less known for being captive domiciles.

Harwick said Arizona has seen several top regulators leave the department for the private sector in recent years, which has hurt the state's ability to attract captives. "It is an ongoing challenge for states to get both the financial and political will to set aside staff to only do captives," Harwick said. "Arizona simply hasn't put enough resources into captive insurance regulation, and that has had an effect."

Meanwhile, other states have garnered headlines for hiring high-profile captive insurance regulators.

Missouri hired Maria Sheffield, a former Georgia insurance regulator and attorney, in July to serve as captive program manager (Best's News Service, July 23, 2013).

In June, Crosby Sherman stepped down as chief of captive insurance regulation in New Jersey to become deputy commissioner of the Insurance Division in the Vermont Department of Financial Regulation (Best's News Service, June 24, 2013).

Right now, Harwick said Texas is being watched closely as it creates a regulatory infrastructure for captives because the state's resilient economy and low taxes could attract a lot of interest from captive managers.

"Everyone is holding their breath to see what happens with Texas because it has the potential to be a big player," Harwick said. "They passed the legislation and they have a group on the industry side looking to move ahead. But no one has been hired yet." Despite the competition among states to attract captives, regulators overseeing the industry are known for sharing information about how to avoid common pitfalls.

David Provost, who heads Vermont's Captive Insurance Division, said he has had conversations with regulators in Texas about issues to consider while setting up their captive insurance infrastructure. "We've developed a good system over the past 30 years in Vermont, after having our stumbles early on. We tell them things to look out for and how to avoid those stumbles," Provost said. "But you have to have someone who wants to take that job on, whether as a side-job or as a full-time position."

Provost said he is often approached with job offers from other states.

"They may say, 'Do you want the job?'" Provost said. "But what they're typically looking for is to say, 'The legislature just passed the law. What do we do now?'"

Provost said he expects that eventually all 50 states will become captive domiciles, but some may never go furhter than passing a law allowing for the formation of captives. For its part, Vermont approved its 1,000th captive this week, Provost said.

Nancy Gray, regional managing director for the Americas for Aon Global Risk Consulting, said while important, a state's regulators are just one factor captives consider when deciding where to locate.

She said costs and taxes play a big part in the decision. "There are some states that are cheaper than other states when it comes to the premium taxes that are charged," Gray said. "But many times, it's also geographic location that comes into play. If you're an East Coast company, odds are you want to have your captive also be on the East Coast."

That said, Gray added, "No one wants to see a domicile that doesn't have a good reputation for regulation. The regulatory experience and how responsive the regulators are is critical to the industry."

Connecticut Approves Third Captive Insurer

HARTFORD, Conn. - Connecticut has approved Red Apple Risk Insurance Co. to operate as a captive, making it the third captive insurer to be licensed by the state.

The Red Apple Group is a New York-based grocery store chain that is owned by John Catsimatidis, a Republican who recently led an unsuccessful campaign to become mayor of New York City.

Efforts to reach a Red Apple Group spokesman were not immediately successful.

Thomas Hodson, president of the Connecticut Captive Insurance Association, said in a statement the decision to grant the company's application was "significant in so many ways."

Hodson said the approval signaled a "gaining momentum" in Connecticut's captive insurance initiative.

Red Apple Risk Insurance Co. is the first captive to be approved since Connecticut Insurance Commissioner Thomas Leonardi created a division within the department specifically focused on captives. In October 2012, Leonardi tapped John Thomson to manage Connecticut's captive insurance rulemaking unit (Best's News Service, Oct. 5, 2012).

Connecticut has had laws in place to allow captives to form there since 2008. But the state only began funding and staffing a captive insurance division within the state Insurance Department in 2012.

Recently, a number of states have been making moves to become captive insurance domiciles, wading into what is already a competitive marketplace.

An Ohio Senate panel is meeting Oct. 15 to consider legislation that would make the state a domicile (Best's News Service, Oct. 11, 2013).

In June, Texas became the 31st state to become a captive domicile. Like Ohio, Texas had insurers who had captives in other states. Texas officials said this created more cost for Texas companies, because other states that allow captives impose obligations on insurers participating from outside their borders, according to the bill's statement of intent (Best's News Service, May 31, 2013).

Captive Development Remains Constant in Asia

SINGAPORE - Asia-Pacific companies' use of captives has remained constant at about 5% to 6% of total captives worldwide over the past five years, according to a new Marsh captive report.

In Asia, "there aren't particularly new issues, but we're seeing a continued development within the region on a broader desire to implement more risk management-based changes as opposed to insurance simply being seen as a

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cheap commodity," said Stuart Herbert, head of Marsh Captive Solutions of Asia.

Although development of risk-management expertise has improved, there is "still the challenge of companies moving from a purchaser of insurance as a commodity to one that looks more comprehensively at issues around total cost of risk," said Herbert.

Asia-Pacific companies, with the exception of those in Australia and Japan, are still lagging behind in terms of captive formation compared to the Americas and Europe, Middle East and Africa regions. Herbert said "Asia companies tend to be more risk adverse, and they generally have lower retentions and deductibles and prefer to purchase insurance in the commercial market." Highly competitive domestic insurance markets enable companies to enjoy cheap insurance.

India limits or prevents the ceding of risk to a captive. Admitted or locally issued insurance is mandatory in many countries like Taiwan, South Korea, Philippines, Indonesia and China. "As such, the issues around requirement for admitted insurance policies would require a local fronting insurer, which adds frictional cost to the structure," said Herbert. Also, it may be difficult to find an appropriate fronting partner, particularly in China.

Nevertheless, Herbert said "we've seen considerable amount of interest in captives from China." At the moment, Hong Kong appears to be the first port of interest for establishment, given its proximity to China.

In the 2013-14 budget, the Hong Kong government made 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 (Best's News Service, March 5, 2013). Currently, Hong Kong has one captive insurer, which belongs to a Chinese company and mainly underwrites property business. Premium income of the captive insurer amounted HK$1.33 billion (US$172 million) in 2011, according to Office of Commissioner of Insurance.

In China, the largest petroleum company, China National Petroleum Corp., set up a property captive insurer as the first locally incorporated captive. The captive insurer is located in western China's Karamay City in Xinjiang Uyghur Autonomous Region, with registered capital of 5 billion yuan (US$817 million) (Best's News Service, Jan. 23, 2013).

Singapore has 66 captive licenses as the largest domicile in Asia-Pacific and it currently has 62 captive insurers. Captive insurers reported total gross premiums of S$1.14 billion (US$898 million) in 2012, accounting for 17% of total offshore insurance fund. Property was the biggest business line for offshore insurance fund's general captive insurers with gross premium of S$786 million in 2012, according to Monetary Authority of Singapore.

Availability of offshore insurance business incentive and a tax exemption for captive insurers, along with existing infrastructure, management and operation systems for captives, are among attractions of Singapore as a captive hub. Strategically, Herbert said it is located "to serve Asia-Pacific and offers investors unparalleled access to the global market." Also, captive-specific legislation is in place with a clear definition of in-house and non-in-house risks, as well as the treatment of non-in-house risks. Singapore's conducive regulatory environment, political and economic stability, transparency of business conduct and availability of insurance expertise are also attractions.

The principal captive type in Singapore is single parent. It is owned and controlled by one company and it is formed to insure or reinsure the risk of parent and related companies. "Singapore has not kept pace with other domiciles in the development of protected cell legislation," noted Herbert.

In Singapore, main risks covered by captive insurers are property damage, business interruption and general liabilities. Captive insurers "generally fall into two camps, those that write full risk and purchase reinsurance and those that either accept deductible buy-down or act as reinsurers to a thirty-party insurer and only take a portion of the risk," said Herbert. Singapore is seeing more interest in professional lines as a number of larger financial institutions have captives in the market.

There is increasing captive interest from corporations in Singapore, Taiwan, South Korea, Philippines, Indonesia and China. "These companies want to know more about captives as an alternative risk-financing arrangement as opposed to traditional insurance or balance sheet funding type of arrangement," said Herbert. There would be some captive formation from companies based in these regions, but this may not be as fast or steady as those in the Americas and Europe.

As with captives globally, Herbert said "employee health and benefits is becoming a more common discussion point in Asia and this may well have the benefit of driving captive growth in certain markets as it appears to be able to generate reasonable results under a captive pooling structure."

For a mature market like Australia, Herbert noted "there is still some growth potential for captive utilization in certain industries such as financial institutions." There is also "a broadening of appetite in the upper middle-market clients to a potential captive solution."

Globally, Bermuda, Cayman Islands and Vermont are the top three domiciles, accounting for 36% of all captives. The highest captive-use industry is financial institutions (18.6%), followed by health care (17.2%) and retail and consumer products (9.1%), according to Marsh's 2013 report. For Asia-Pacific-based companies, Marsh said "the Federated States of Micronesia is growing and now has nine total captives."

For Asia and global markets, Marsh noted driving forces for captive growth include desire to control group risk and to consolidate management practice across the group, flexibility in program design and funding for uninsurable, difficult placed risks or those deemed to be overpriced by market, access to market such as reinsurance and local pool arrangement and quarantine premiums within the captive especially from those programs with good claims history.

Hawaii's Top Captive Insurance Regulator Resigns

HONOLULU - Hawaii's top captive insurance regulator has resigned, citing policy differences within the insurance division.

George W. Sumner III, formerly Hawaii's captive insurance administrator and deputy commissioner, said he has resigned over the differences, but declined to give specific details.

Sumner, who has held the post since October 2009, told Best's News Service he hopes to remain active in the captive insurance industry.

"During my tenure [with Hawaii], we have created a very strong domicile. During tough economic times and increased competition, we licensed 40 new captives, grew premiums from $1.2 billion to $2.6 billion, and assets from $6.4 billion to $14 billion."

"I love the captive insurance industry. My future plans are to remain in the industry on the regulatory side. I understand how the private and public sector need to work together to get good results. I'm looking at domiciles in the U.S. and internationally, and am considering the Pacific Rim," Sumner said.

Before signing on as a regulator, Sumner was a vice president of the Bank of Hawaii, where he led the bank's captive insurance team. The team increased the bank's captive accounts from 36 accounts with $136 million in assets and deposits in 2000, to 90 captives with $830 million in assets and deposits in 2009.

Sumner has also previously been active in the industry, working as chairman and president of the Hawaii Captive Insurance Council.

Last week at the Vermont Captive Insurance Conference in Burlington, Vt., Sumner said the Pacific Rim "is so underserved, compared to the saturation of the United States and plus all the 40 states that are now licensed... I think that's really where the growth is" (Best's News Service, August 13, 2013).

A.M. Best Europe—Rating Services Limited
6th Floor, 12 Arthur Street
London, EC4R 9AB
+44 (0) 207-626-6264

A. M. Best Asia-Pacific Limited
Unit 4004 Central Plaza,
18 Harbour Road ,Wanchai, Hong Kong
+852-2827-3400

For comments or questions on Best's rating of Captive Insurers, please contact
Mr Clive Thursby, Senior Director, **A. M. Best Europe — Rating Services Ltd.**
Telephone: +44 (0) 207-397-0279
or Email: Clive.Thursby@ambest.com