

## Session 065 PD - Comparison Of Captive Regulatory Regimes

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# 2017 SOA Annual Meeting & Exhibit

## *Session 65: Comparison of Captive Regulatory Regimes*

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# Captive Regulatory Regimes Research Project

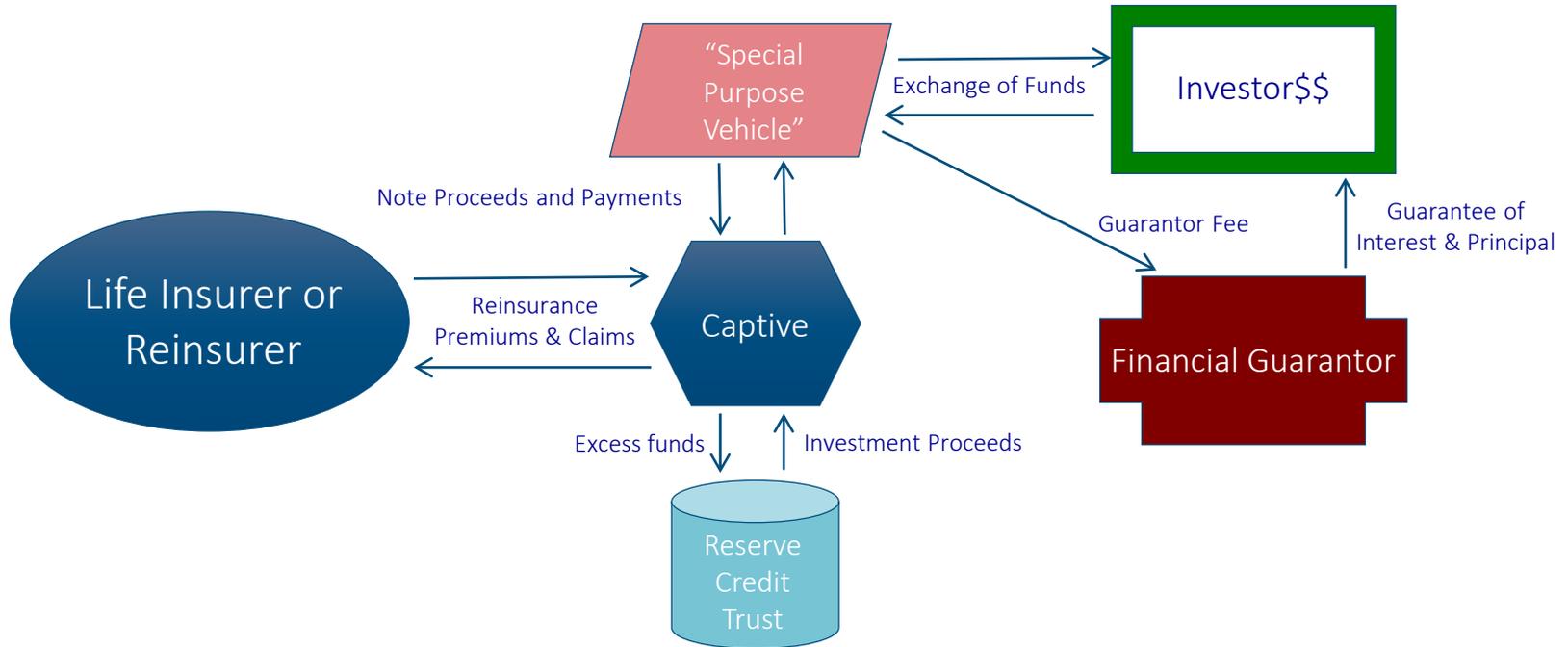


# Captives – something old; something new

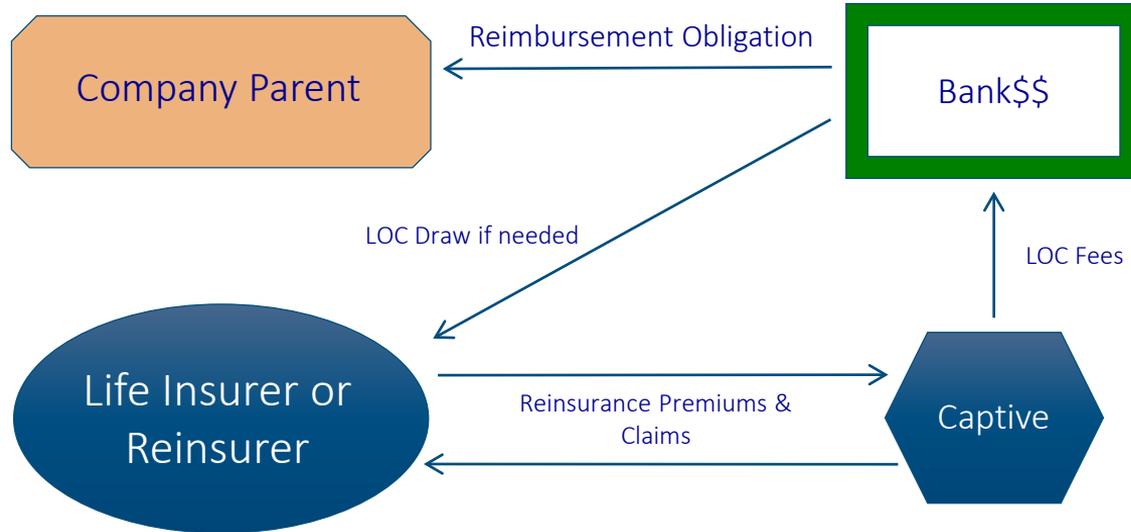
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- Frederic Reiss – Youngstown Sheet & Tube Company
  - “Father of captive insurance; 1950s
- Non-insurance company sponsor
  - Employee benefits
  - Worker’s compensation
- Prolific use in the PC arena
- Life slow to catch on, but...
  - Agent owned reinsurance captives
  - Special purpose
  - XXX/AXXX redundant reserve financing
    - AG48, PBR

# Popular captive structures – capital markets circa 2003



# Popular captive structures – capital markets circa 2010+



# Captive Regulatory Regimes Research Project

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- Insurance companies use captive reinsurers (i.e., subsidiaries insuring the risk of the company's affiliates or controlled unaffiliated business) for a variety of reasons.
- The regulations associated with the use of captives vary by jurisdiction and there may be advantages or disadvantages of establishing a captive in a particular jurisdiction depending on the reason for establishing a captive.
- The purpose of this project is to examine the jurisdictions that allow captives and compare and contrast their regulatory frameworks supporting the development and operation of these entities.
- Additionally, the purpose is to create a resource
  - for life insurers to assist them in their investigation of ways to manage capital; and
  - for insurance policymakers as they consider the use of captive reinsurers and assess its impact to existing insurance industry requirements.

# Captive Regulatory Regimes Research Project

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- Three main sections
  - Macro perspective
  - Micro perspective
  - Spreadsheet analysis
- More than just mechanical review of regulations
- Posted report:
  - <https://www.soa.org/research-reports/2017/2017-comparison-captive-insurer/>

# Spreadsheet analysis

Column #	Item	Column#	Item
(1)	Market Size (from 2016 where available)	(8)	Examinations and Other Regulatory Requirements
(2)	Premium Volume (from 2016 where available)	(9)	Captive Restrictions
(3)	Top Products	(10)	Requirements for Establishment
(4)	Initial/Ongoing Capital Requirements	(11)	Initial/Ongoing Governance Framework Requirements
(5)	Financial Reporting Requirements	(12)	Credit for Reinsurance
(6)	Dissolving/Exiting Requirements	(13)	Incorporation Time
(7)	Affiliate Agreement Requirements	(14)	Websites
		(15)	Miscellaneous

Jurisdictions	
Arizona	Anguilla
Delaware	Barbados
Hawaii	Bermuda
Iowa	British Virgin Islands
Missouri	Cayman Islands
Montana	Guernsey
Nevada	Ireland
North Carolina	Isle of Man
South Carolina	Jersey
Tennessee	Gibraltar
Utah	Malta
Vermont	Singapore
	Hong Kong
	Bahamas
	Nevis
	Luxembourg

# Research Project Sponsors and POG Members

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Sponsors	
Reinsurance Section	Committee on Life Insurance Research
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# Captives 101



# What are Captives

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- An insurance or reinsurance company
- Specifically established to insure or reinsure the risks of its parent or associated third parties
- A common risk financing vehicle used by companies to:
  - Obtain coverage terms and pricing that may otherwise not be available in the commercial markets
  - Recoup insurance carrier profit and insulate from changes in the commercial markets
  - Align and control full spectrum of company and people risks
  - Give small organizations the ability to gain access to large company solutions

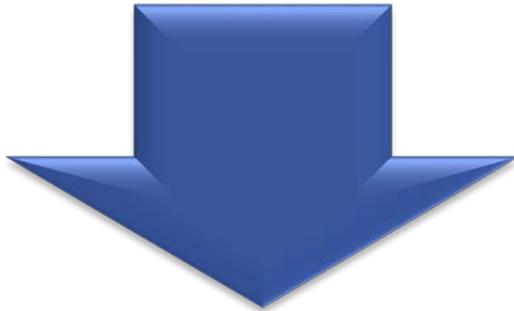
# Who uses captives?

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- Companies: Public, Private, Tax-exempt
- Associations or Groups of individuals or small organizations
- Wealthy individuals
- Insurance agents or brokers
- Life Insurance carriers

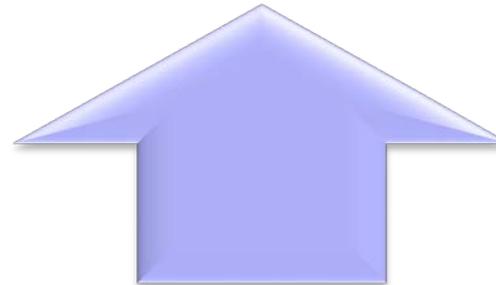
# Typical risks for an employer to consider

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- Professional Errors & Omissions Liability
- Products Liability
- WC/Employers Liability
- Property Damage/Business Interruption
- General Liability
- Auto Physical Damage/Liability
- TRIA/TRIEA
- Certain or Limited Liability Employee Benefits
- Pollution/Environmental
- Extended Warranty
- Other Uninsurable Risks

- Group Term Life
- Active and Retiree Medical/Dental
- Medical Stop Loss
- Disability
- Deferred Compensation Funding
- Supplemental Executive Retirement Plans
- Pensions
- Retiree Medical
- Voluntary Benefits

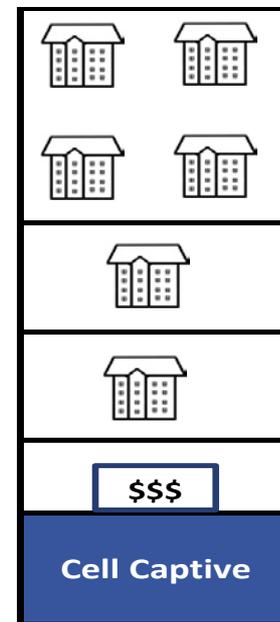
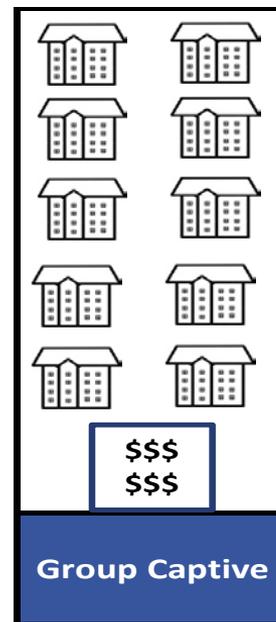
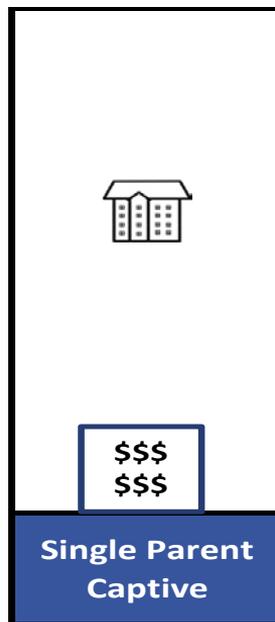
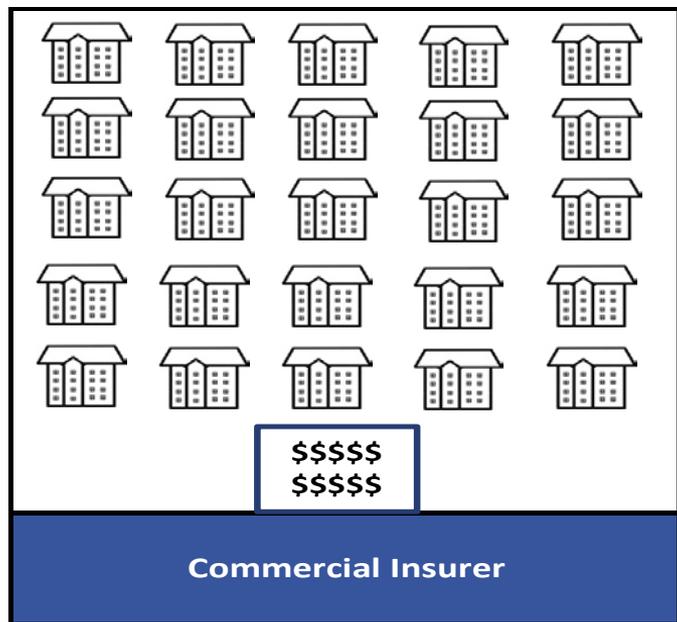


# Types of captives

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- Single Parent / Pure Captives
- Group / Industrial Insured Captives
- Risk Retention Groups
- Association Captives
- Sponsored Captives, a.k.a Rental Captives
- Special Purpose Captives
- Reciprocals

# Types of captives



Can be in conjunction with Special Purpose Entities (SPEs)

## Breakdown by type

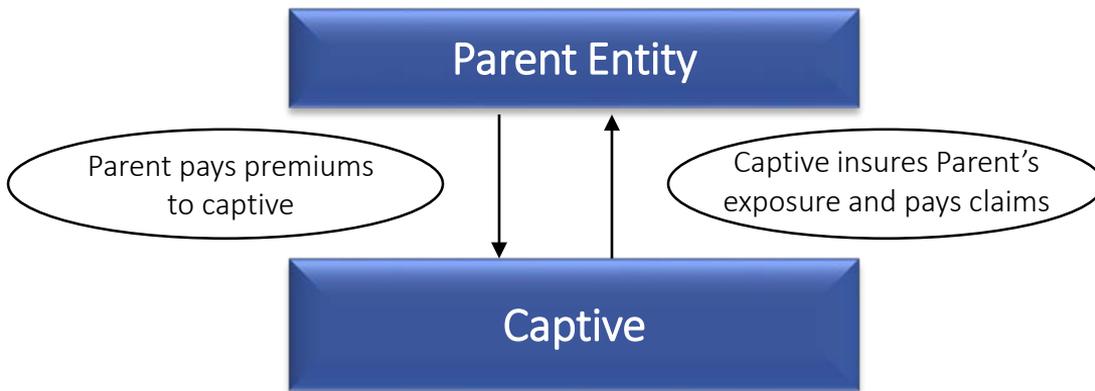
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- Single Parent: 4,892 (77%)
- Group/Association: 518 (8%)
- Cell Company: 471 (7%)
- RRG: 239 (4%)
- Other: 211 (3%)

# Structure of a traditional captive

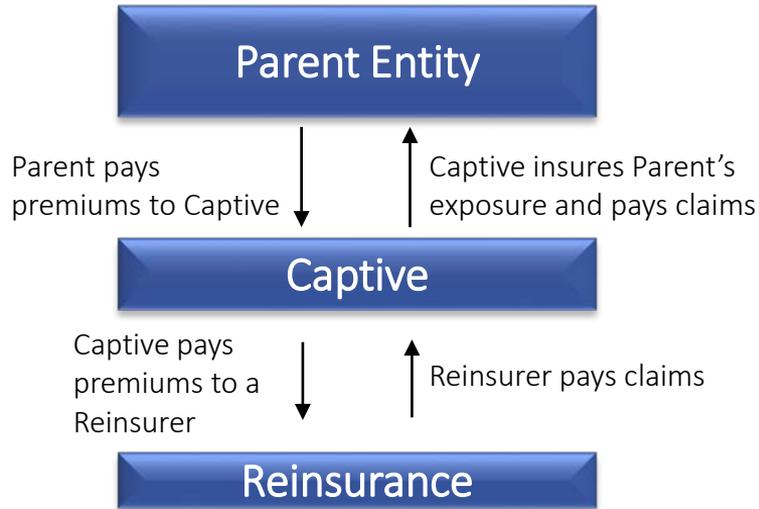
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- An insurance or reinsurance company
  - Owned by an individual parent corporation
  - Organized as a subsidiary of the parent corporation
  - Insures the owner's risks or risks of a third party

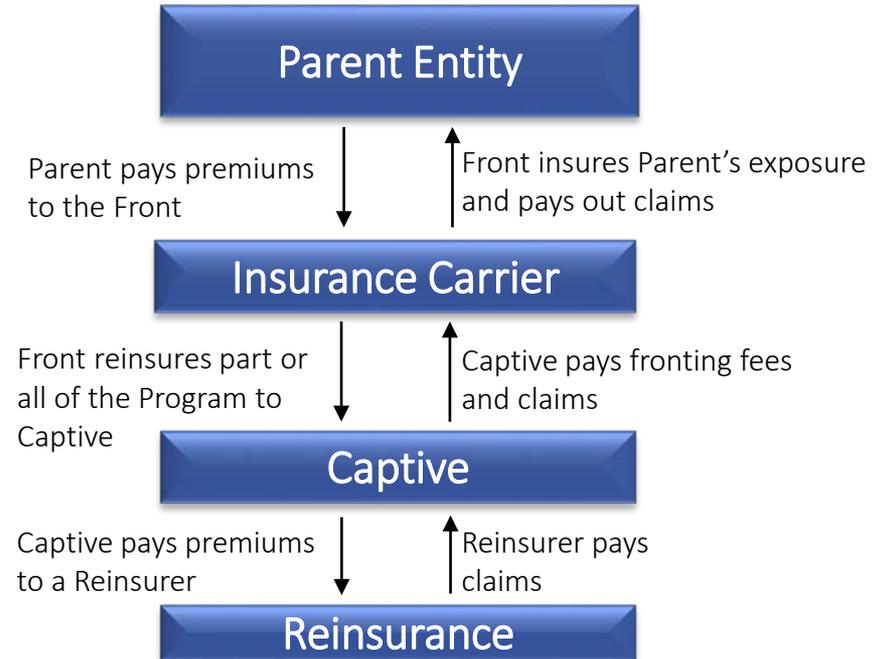


# Captives are generally established to insure or reinsure risk

## Direct Insurance



## Reinsurance / Fronted



# Captive program design life cycle

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- Analysis of current insurance program
- Pre-feasibility study (goal identification and service partner selection)
- Initial testing of reinsurance and fronting markets
- Feasibility study (actuarial/accounting/tax review)
- **Domicile analysis**
  - Onshore vs Offshore decision
  - Europe and Asia
- Go/No Go decision
- Corporate risk management restructuring
- **Captive application and formation**
- Captive begins insurance operation

**Needs an Actuary**

# Captives: Macro Perspective



# Global captive insurance markets

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## ■ Risk Transfer

- Broadening of definition of captive insurance
  - Cell Companies, Portfolio Insurance Companies, Special Purpose Vehicles, Insurance Linked Securities
  - Increased Emphasis on Non Related Party Risk
  - Has resulted in expansion of:
    - Types of companies
    - Classes of risk
    - Size and types of transactions
    - Risk Structuring Arrangements
      - > Licensed and Regulated as Captives

# Global captive insurance markets

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## ■ Risk Transfer

- Preeminent captive insurance jurisdictions including:
  - Vermont, Delaware
  - Bermuda, Cayman Islands, Guernsey
- Licensing captives in the life sector under broadened definition
- Important for a Sponsor Contemplating a Captive
  - Contemplate risk management objectives
  - Be aware of various captive jurisdictions
  - Licensing Requirements, Reporting Requirements, Regulator Expertise
  - Types of risk transfer vehicles and frameworks available

# Global captive insurance markets

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- Measurement of Life Captives
  - There can be challenges in securing viable & useful information regarding the size of the life captive sector
  - Primary challenges are due to:
    - Jurisdictions license, measure and categorize life insurance risk transfer differently
    - Definition of captive insurance
      - Continues to evolve
      - Is different in various jurisdictions
    - Domiciles are not consistent in measuring captive licensing activity
    - Appropriate metric to use as measurement may vary by type of transaction
  - Understanding key differences is an important consideration

# Global captive insurance markets

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- Opportunities
  - Captive Insurance Markets Provide Opportunities for Innovation in Risk Transfer
    - Structuring and transfer of defined benefit pension risk
    - Use of portfolio insurance companies to transfer risk among captive insurance companies
    - Increased use of cell companies
    - Continued development of risk linked securities to transfer insurance risk to the capital markets
    - Increased use of SPVs
    - Interest in using captive insurance companies for risk structuring activity
    - Emerging Risks
  - Captive jurisdictions have demonstrated a willingness to accommodate innovation in risk transfer

# Captives: Micro Perspective US Jurisdictions



# Captive breakdown by region

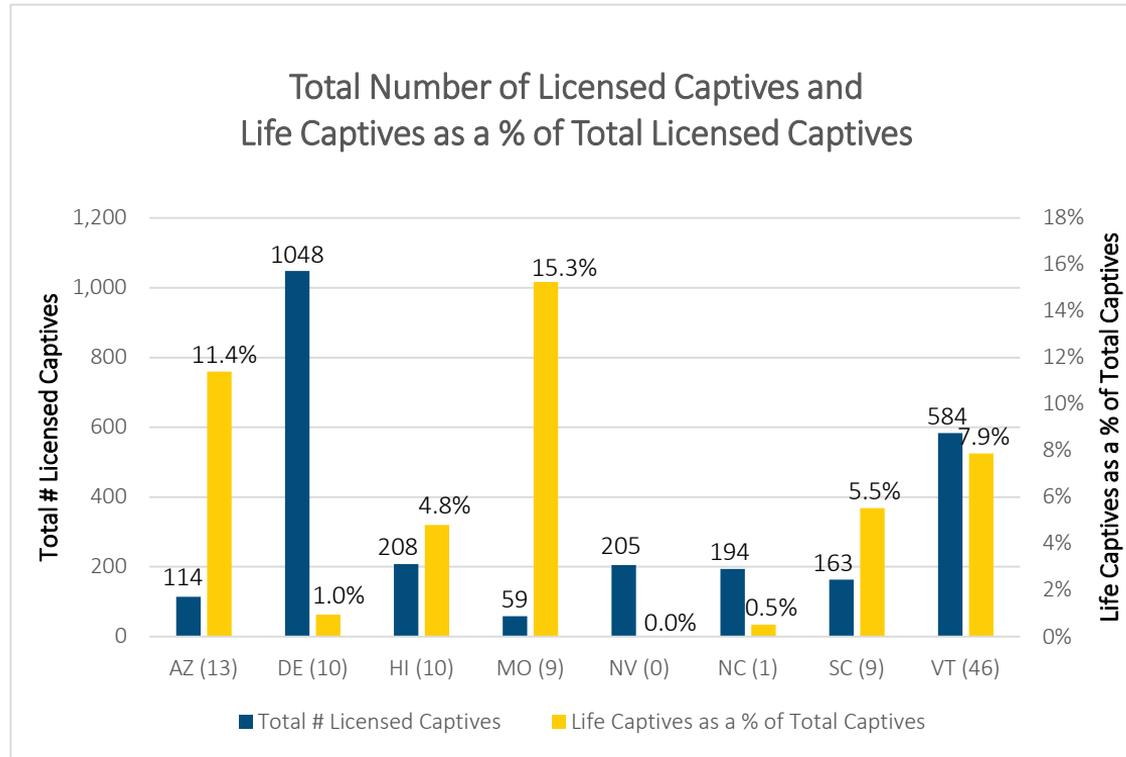
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- 6,618 Captives globally as of 12/31/2016
  - 3,212 in North America (United States & British Columbia) (49%)
  - 2,417 in Bermuda/Caribbean (37%)
  - 841 in Europe (13%)
  - 142 in Asia Pacific (2%)
- 616 New Captives licensed in 2016
  - 78% in the US
- Growth in US was driven by efficient regulation and 831(b) tax election

## U.S. domicile – life captives

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- Initially 13 jurisdictions selected based on publicly available information, and RRC and POG industry knowledge
- Final list covers 8 jurisdictions with five eliminated where it was determined there was little or no life captive activity: IA, MT, TN, UT and DC
- For the remaining jurisdictions, data was determined through a combination of publicly available sources and direct communication with domiciles: AZ, DE, HI, MO, NV, NC, SC and VT



*Note:* Delaware count includes Series captives; Hawaii life count set at 10 for purposes of the exhibit.

# Market size

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- VT's 46 life captives wrote \$12.6B of premium in 2014
  - Approximately half of VT's total 2015 captive premium of \$25.5B
- DE's 10 life captives wrote over \$5B in 2016
- MO's 9 life captives write \$2.2B and SC's 9 life captives wrote \$1.2B
- No other domiciles' life captives write in excess of \$1B

# Products

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- Primary products written by life captives are Term Life, Universal Life with Secondary Guarantees and Variable Annuities
  - To relieve capital strain
  - Also for VA's, economic accounting is more in alignment with hedging strategies than statutory accounting
- Some Long Term Care to relieve surplus strain
- Some with traditional whole life used to release trapped capital associated with closed blocks of dividend paying business subsequent to demutualizations

# Captive regulatory environment

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- Much of the regulatory framework is based on the long history of property/casualty captive insurance with very little if any mention of life insurance business
- As a result some captive domiciles steer away life captive filings
- As a result a significant factor in choice of domicile is the reputation and experience of the domicile
- Life captives are most often SPCs and some states have developed additional statutory rules to handle SPCs

# Critical considerations

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- Industry Knowledge
- Consistency of Process
- Ability to shepherd the filing
- Ability to close the transaction quickly

These are more important than jurisdictions actual regulatory requirements around minimum capital, financial reporting and governance

# Capital requirements

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- Typical regulatory minimum capital for a pure captive is \$250K
- May be as high as \$1M for a risk retention group or sponsored captive
- Many jurisdictions allow the capital requirement to be met by a letter of credit (LOC)

**In practice, life captives hold economic capital determined in the actuarial feasibility study**

# Financial reporting requirements

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- Most jurisdictions require GAAP
- Statutory requirements are not uniform and include:
  - Modified Stat – e.g. Stat with GAAP or UFRS reserves or with a variation on reserve formulas
  - Risk Retention Groups (“RRGs) require Stat
  - Domicile may have discretions to allow Stat or other reporting
  - Stat required for all

# Other requirements

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- May or may not require arms-length transactions with affiliates
- Examination required every 3 to 5 years
- Line of business restrictions, re Life captives:
  - NC may not write life or annuities
  - NV has not licensed any XXX of AXXX reinsurance captives
  - Some jurisdictions do not allow LTC in captives
- Some governance requirements such as board meeting frequency and loss reserve certification
- Most states allow captives to assume reinsurance and take credit for reinsurance ceded as long as in compliance with that particular state

## Other requirements (continued)

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- Application fees generally small
- Stated target time for incorporation is usually 30 days
  - Depends on quality and completeness of application
  - Due to complexities of life captive transactions the actual time is often longer

# Captives: Micro Perspective Global Jurisdictions



# Captive insurance operates in global market

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- Four major global sections
  - United States
  - Europe
  - Asia
  - Offshore

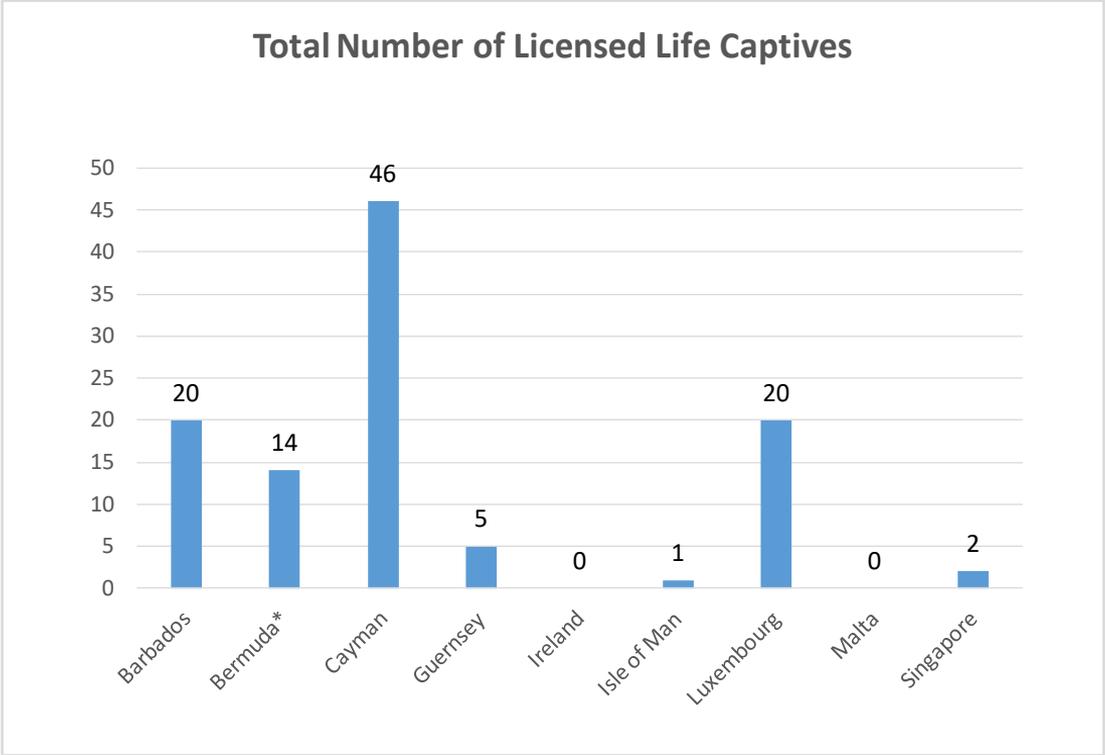
## Nuances of jurisdictions

- Licensing/ongoing administration
- Acceptable types of risk transfer
- SPV's
- Allowable classes of companies
- Acceptable lines of business
- Governance

# Captive insurance operates in global market

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- Very limited to no activity in several jurisdictions
  - Malta, Singapore, Isle of Man, Jersey, Hong Kong
  - Ireland, Isle of Man
    - Any life activity ancillary to employee benefits
    - Isle of Man one captive reinsuring VA benefits, in run-off
- Luxembourg
  - Approx. 200 captives
    - No “pure” life reinsurance captives
    - 5 reinsure life business of a bank plus other non-life benefits
    - 20-25 cover employee benefits but no longevity component



\* Bermuda count does not include Special Purpose Insurers.

# Captives: Micro Perspective Bermuda, Cayman, Guernsey



# International: Bermuda, Cayman Islands & Guernsey

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- Commonalties
  - Preeminent off shore captive insurance jurisdictions
  - Long term successful track record(s) in captive insurance
  - Active in life captive sector
  - Accessibility to regulators
  - Initiatives to develop and maintain required knowledge
  - Willingness to accommodate innovation in risk transfer
  - Active in international regulatory community

# International: Bermuda

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## ■ Overview

- Largest captive domicile (Approximately 800)
- Multi-tiered licensing structure for captives
  - General Insurance (6 tiers)
  - Long Term Insurance (5 tiers)
  - Special Purpose Insurer (ILS Securitizations)
  - Requirements are Reflective of Increased, Size & Complexity
- Regulatory Status / Recognition
  - NAIC Conditional Qualified (Conditional) Reinsurance Jurisdiction
  - Solvency II Equivalence Status
  - May Enhance Credibility in International Insurance Markets

# International: Bermuda

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- Requirements for Licensees:
  - Maintain a principal office in Bermuda and appoint a principal representative
  - Prepare and file annual audited financial statements and Statutory Financial Return
  - Must appoint an approved actuary
  - Meet the minimum capital and solvency margins required by their class of license
  - Maintain Enhanced Capital Requirement
    - Bermuda Solvency Capital Requirement for the long-term insurers' model
    - Approved internal capital model.

# International: Cayman Islands

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## ■ Overview

- Over 700 licensed captives
- Active in life captive sector (50 life captives)
- Recent growth in life captive and international reinsurance sectors
- Multi-tiered licensing structure for captives
  - General Insurance (Includes Term Life & Credit Life)
  - Long Term Insurance
  - ILS Securitizations
  - Requirements are Reflective of Increased, Size & Complexity
- Regulatory Status / Recognition
  - Currently not pursuing Solvency II equivalence
  - Portfolio Insurance Companies (PIC) allow risk transfer between cells

# International: Cayman Islands

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- Requirements for Licensees:
  - Maintain a principal office in the Cayman Islands and appoint a principal representative.
  - Prepare and file annual audited financial statements and Statutory Financial Return.
  - Actuarial valuation certified by an approved actuary
  - Meet the minimum capital requirements by class of license
    - Minimum Capital Requirements
    - Prescribed Capital Requirements
  - No prescribed mandatory financial reporting platform
    - US GAAP, US Stat, IFRS, UK GAAP, Canadian GAAP

# International: Guernsey

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## ■ Overview

- 200+ licensed captive insurance companies
- Approximately 500 Cell Companies
- Two Types of Cell Companies
  - Protected Cell Companies (PCC)
  - Incorporated Cell Companies (ICC)
    - Cell is separately incorporated making them distinct legal entities
    - Enables risk transfer between different cells within the same ICC.
- Increase in interest in reinsurance for longevity risk
  - Cell companies provide low cost transaction and segregation of assets
- Regulatory Status / Recognition
  - Not Solvency II Equivalent
  - Risk Based Approach – ORSA Requirements for Large Complex Licensees

# International: Guernsey

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- Requirements for Licensees:
  - Maintain a principal office in Guernsey and appoint a principal representative.
  - Prepare and file annual financial statements and Statutory Financial Return
  - complete margin of solvency and approved asset calculation
  - valuation report prepared by the actuary
  - Capital Based on Proportionality Approach Three Tiers
    - Capital floor of £250,000
    - Minimum Capital Requirements
    - Prescribed Capital Requirements (confidence level)
    - Reduced capital for PCCs and ICCs
  - Financial Statements are GAAP basis (Follow GAAP of sponsor)

# International: Bermuda, Cayman Islands & Guernsey

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## ■ Summary

- Tiered Regulatory Approach Reflects:
  - Evolution in Captive Insurance Markets
  - Increased Risk, Size and Complexity in Captive Insurance Risk Transfer
  - Emphasis on Risk Based Regulation (Proportionality)
- Long term successful track record in captive insurance
  - Low Failure Rates
- Function as Insurance Laboratories
  - New Risk Transfer Mechanisms (Cell Companies)
  - Increased Emphasis on Capital Market Transactions (ILS, Pensions)

# Our contact info

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