



Western US Captive Domicile Round-up *2008 and Beyond*

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Southington, CT, October 16, 2008: The year 2008 will no doubt go down as one of the most volatile years in the history of the US financial marketplace. The already-soft insurance market continued to soften, viable investment options were increasingly-difficult to find, the nature of collateralization and securitization evolved -- not necessarily for the better -- and the US Treasury took on an unprecedented role in financial markets by virtue of the TARP legislation passed by Congress in October. Government intervention in the financial services industry continues to engorge, reaching unprecedented levels. Despite all of this, insurance pricing stubbornly refuses to harden.

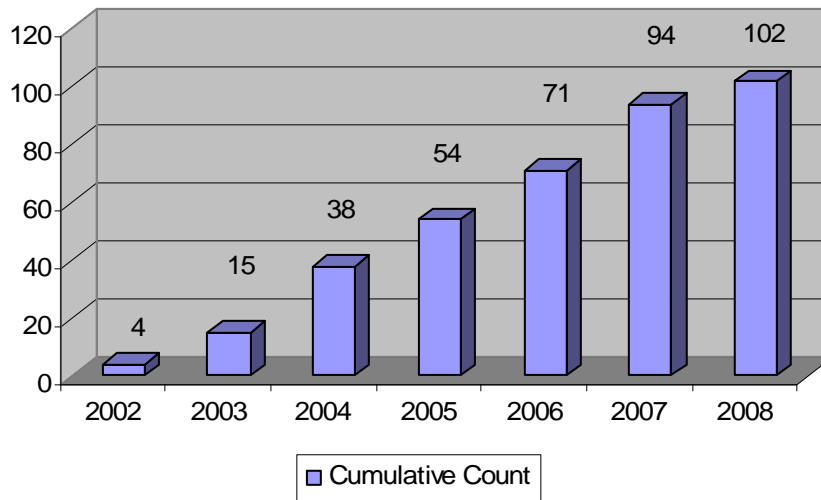
Where will all this activity in Washington take the captive marketplace? Will the result be net positive or negative for the captive industry? What effect will the country's choice of a new president and Congress have on financial markets, and more specifically, on captives? I suppose the answers to these questions are anybody's guess.

The information in this article comes from our asking fairly open-ended questions of those in the know in each domicile's insurance department. We were looking for some specifics too -- a summary of what transpired in each domicile during 2008 from both statistical and legislative perspectives -- but we also prodded the domiciles with questions about what their respective crystal balls might be suggesting for 2009, and how the current financial turmoil might work to the advantage of captives for years to come. Here is the information we were able to glean for each of the western domiciles.

<i>Arizona</i>	
Total Active Captives	102
New 2008 Licenses to date	8

The state of **Arizona** laid the groundwork for a very successful entry into the growing family of western domiciles by licensing and regulating a large number of traditional insurance companies prior to passing the domicile's captive legislation in 2001.

Arizona is proud of the growth and quality of its captives. The Arizona Captive's program has continued to grow since its inception in 2002 and the domicile currently has 102 active captive insurers representing a wide range of industries.



Broken out by type of captive, Arizona licenses 70 pure captives, 5 agency, 2 association, 2 industry group, 1 protected cell, and 22 RRGs.

By OSHA Industry Classification, 34 captives are classified as Health Care and Social Assistance, 25 Construction, 15 Finance and Insurance, 8 Transportation and Warehousing, 7 Manufacturing, 4 Retail Trade, and 9 falling into the "all other" category.

Looking ahead to 2009, it should be noted that Arizona regularly implements changes and improvements to its captive insurance laws to assure that the domicile remains competitive with other captive domiciles. The Arizona captive community has the support of the Department, the Legislature and the Governor to keep Arizona's place as a leader in the U.S. captive insurance market.

"Our goal in 2009 will be to effectively balance resources to continue attracting high quality captive applicants, while successfully managing the financial solvency of our existing captives," said Arizona Insurance Director **Christina Urias**. She added, "Arizona's captive program is thriving and we hope to keep it that way, despite severe budget constraints and a hiring freeze extending into next year. We have increased efficiencies and remain committed to Arizona's captive insurance industry. By working smarter and focusing our resources, we intend to keep our captive program robust, solvent and well-managed. I am committed to an active role in our captive program to help ensure its continued strength and viability."

<i>Colorado</i>	
Total Active Captives	6
New 2008 Licenses to date	0

Colorado became the first domicile in the US to authorize the formation of captives with the passage of the Colorado Captive Insurance Company Act in 1972. Captive insurance companies in Colorado are regulated by the Department of Regulatory Agencies (DORA), Division of Insurance where **Marcy Morrison** has served as Commissioner of the Division of Insurance since January, 2007.

Colorado has six licensed captives. The domicile has been largely inactive for the last several years, with licensed captives dropping from 8 in 2006 to 6 currently. One of the six captives licensed by Colorado is a risk retention group.

According to DORA's 2007 Statistical Report, readily available from their website, Colorado captives wrote \$38.7 million in earned premium in 2007 and had \$160.8 million in capital and surplus. Approximately one-third of the total earned premium is generated from the risk retention group which writes residential warranties. The report is unclear as to the status of WesCap Insurance Company. Non-government sources tell us that this captive has been in run-off for some 20 years; yet, the report appears to suggest that the captive was newly-licensed in 2008. We have been unable to reach any authoritative party affiliated with DORA, but should we receive clarification on this issue in the future, we will post it to captive.com.

Unfortunately, Colorado does not currently have an active captive association, although earlier in the domicile's history, the Colorado Association of Captive Entities (CACE), filled that role. Time will tell whether Colorado will once again become a force in the industry.

<i>Hawaii</i>	
Total Active Captives	163
New 2008 Licenses to date	4

So far in 2008, **Hawaii** has licensed 4 new captives and had 4 captives surrender their licenses, leaving the number of active captive licensees at 163. The four new captives are all single owner captives whose owners operate in the real estate, credit card processing, and photo/imaging technology sectors.

For 2007, Hawaii's captives wrote approximately US\$1.4 billion in premiums and maintained US\$6.8 billion in combined total assets.

In light of the current economic conditions, Hawaii continues to focus its efforts on prudently refining its regulatory environment to meet the needs of captive organizers and their constituents. Some of the issues include a refined risk-focused exam approach that must be used by state insurance department exams of risk retention captives, and the potential application of International Financial Reporting Standards for captives.

On June 18, 2008, the legislature passed Act 190, refining Hawaii's captive laws in two ways:

- First, although Hawaii's existing captive legislation did allow securitization transactions, Act 190 served to clarify the state's laws in this area.
- Second, Act 190 renamed Hawaii's Class 4 captives to be called "sponsored" captives. By way of background, Hawaii amended its law in 2001 to allow for the sponsoring of a captive that could also segregate cells. This took place at or near the same time that Vermont's sponsored captive legislation was passed. At that time, Hawaii called this type of captive a "Class 4 Lease Capital Facility" while Vermont settled on the term "Sponsored captive." Other domiciles followed Vermont's terminology lead and passed legislation allowing for "sponsored captives," resulting in the term becoming more prevalent. Although the HI and VT laws essentially contain the same requirements, Hawaii passed this year's Act to make the terminology consistent with what is being used in other domiciles.

Act 190 became effective on July 1, 2008.

While the downturn in certain sectors of the economy has forced Hawaii to enhance its surveillance of some captives, these conditions have surfaced opportunities for other organizers who have sound business models that include strong risk financing strategies that can withstand these adverse economic conditions. These organizations typically do not need to rely on the domestic credit markets for financing of ongoing operations and maintain relatively conservative investment policies.

Hawaii anticipates licensing a few more captives by year end, and if the economic conditions improve, it is likely that the domicile will add a few special purpose financial and segregated cell captives in 2009. Although Hawaii's captive laws were amended earlier this year for these types of captives, demand for these programs declined with the economic conditions in the U.S. From our own research, this is not at all unique to Hawaii, but is happening almost universally.

Craig Watanabe, the Deputy Insurance Commissioner & Captive Insurance Administrator, made his expertise available to us, for which we are most grateful. Craig has been friendly and helpful for all the years we have known him, and it's good to know that some things don't change, even in volatile times. Aloha is alive and well in Hawaii. Craig summed things up nicely, stating that "Despite some of the current challenges facing the domestic (U.S.) captive insurance market, Hawaii continues to attract captive organizers from the U.S. and Japan in 2008."

<i>Montana</i>	
Total Active Captives	32
New 2008 Licenses to date	8

Montana is a relatively new captive domicile, having passed its initial captive enabling legislation in 2001.

The domicile continued its strong and steady growth in 2008 by adding 8 new captive/RRG licenses since the 2007 report, bringing it's current active captive licenses to 32 (15 pure captives, 11 RRGs, 3 association captives, 2 reinsurance captives and 1 protected cell captive).

The Montana Insurance Department hired **Steve Mack** as its new captive insurance examiner to work alongside **Tal Redpath**, Captive Examiner, and **Steve Matthews**, Captive Coordinator and Chief Financial Examiner. Montana's ART expertise, flexibility, and responsiveness differentiate it from other western domiciles. To maintain that edge, the MTDOI garnered legislative budget approval to add to staff as its captive ranks continue to steadily grow.

This year MTDOI entertained numerous discussions regarding new captive/RRG formations, speculating that the soft market and suspected capital funding challenges are slowing actual applications. Despite this, Montana expects 4 new licenses to be issued by year-end.

The prospects for 2009 are optimistic yet cautious, depending on what happens with the US economy. The recent turmoil in financial markets initially produced some trepidation regarding Montana-domiciled insurer investments which have since been allayed in reviewing the conservative investment portfolios for Montana's captives, RRGs and other domestic insurers. MTDOI staff speculates that recent events may further underscore insurers' desire for diversification and capital preservation while pure captives may take a more aggressive approach and purchase undervalued stocks.

New captive and RRG programs are expected to increase in number as hard market forces begin to take hold. One casualty of recent financial events is the MTDOI's decision to modify its legislative proposal regarding RRG investment flexibility to be more conservative than originally planned. The Montana Captive Insurance Association and the MTDOI are coordinating the pursuit of other initiatives for the 2009 legislative session beginning in January to include

- an expansion of surety and inland marine to allowable lines
- the addition of special purpose captive legislation
- strengthening existing confidentiality provisions
- allowing the commissioner to waive filings under certain conditions, and
- prorating the \$5,000 minimum premium tax for a captive's first year of operation, along with other general housekeeping provisions.

Montana's captive legislation has historically received overwhelming legislative support and the MCIA is confident that its lobbying efforts and support by the MTDOI will continue that trend. 2009 will also see a new Insurance Commissioner in Helena, with John Morrison ending his tenure after his 2 term limit. The candidates running for the position are Monica Lindeen (D-Billings) and Duane Grimes (R-Helena), both of whom are strongly supportive of Montana's captive insurance industry and have attended the MCIA's 2008 conferences held in Billings and Whitefish. The 2008 conferences were attended by over 125 attendees according to Brenda M. Olson, MCIA Chair and principal of ORG Captive Management. The stars are perfectly aligned in Big Sky Country to accommodate strong captive/RRG growth in Montana for a very long time.

<i>Nevada</i>	
Total Active Captives	122
New 2008 Licenses to date	13

Nevada joined the ranks of captive domiciles with the passage of its enabling captive legislation in 1999. The domicile enjoys the benefits of an active association – the Nevada Captive Insurance Association (NCIA), which was formally organized in 2004. The association's annual conference took place at the MGM Grand Hotel in Las Vegas from October 23-25.

The Nevada DOI hosts one of the most impressively easy-to-navigate websites in the industry. A rare find indeed!

A total of 122 captives have been licensed as of this writing, with 13 captives having been added to date in 2008, following a very active 2007 which added 21 captives. Another 6 applications are currently in the pipeline.

While a new commissioner is not yet in place, according to **Gary Cooper**, the Deputy Commissioner of Captive Programs in Nevada, "Legislation-wise, nothing new is anticipated."

It was noteworthy that Deputy Commissioner was directly and quickly accessible to us. Accessibility and helpfulness is certainly an important consideration when contemplating a domicile for one's captive.

<i>Utah</i>	
Total Active Captives	105
New 2008 Licenses to date	13

Utah entered the rapidly-expanding arena of western captive domiciles in 2003 when the state passed its first captive legislation. The legislation was subsequently enhanced in 2004, by the elimination of premium taxes.

The most recent amendment to Utah’s captive legislation -- Substitute Captive Insurance Company Amendments -- was approved by the Legislature with no opposition. The bill was signed into law on March 18, 2008 by **Governor Jon M. Huntsman**, and became effective on May 5, 2008. As of this writing, Utah had already licensed its first SPFC. This bill amends the Captive Insurance Companies Act, Title 31A, Chapter 37 and adds a new Chapter 37a that creates a new type of captive insurance company and enacts the regulations that apply to these risk management structures. It also adds a new chapter to the Captive Insurance Companies Act that provides for the organization and operation of a special purpose financial captive insurance company (SPFC).

According to **Don Spann**, the Captive Insurance Director of the Utah Insurance Department, “All captives domiciled in Utah are pure captives except one RRG and one Special Purpose Financial Captive (SPFC).” When asked to explain the growth over the last two years, Spann continued, “The Utah Department of Insurance saw a healthy year in 2007 with an increase of 62 new captive insurance companies. During 2008 we have had steady growth of 13 new pure captives for a total of 105.

“I anticipate a significant workload of captive insurance company applications to be received in November and December.”

In conclusion, Spann was particularly pleased with the success of the Utah Captive Association’s Second Annual Captive Conference in September at the Zermatt Resort in Midway, Utah. The domicile looks forward to a very active year in 2009.

MANCINI’S MUSINGS:

Given the slow but steady growth in captives in each of the western domiciles during 2008, here are a few thoughts and conclusions:

- Political and economic uncertainty in most cases results in a “wait and see” attitude on the part of corporations and groups considering captives. More often than not, they appear to be delaying the initiative of actually pulling the trigger on forming their captives. Numerous captive managers have made it clear that interest in captives is robust, but actual formations are sluggish, with caution being the watch word. As the market hardens, assuming that regulatory pressures do not negatively impact our industry, we expect to see more robust growth in captive formations, not just in the western domiciles, but throughout the captive industry.
- Globally, insurance and reinsurance company ratings are being slashed. This reality will, no doubt, affect captives in a variety of ways.

- Financial market turmoil could portend well for the captive industry in an environment where failures of institutions once thought to be impregnable make the thought of taking control of one's own risks considerably more attractive.
- Many insurance departments are freezing or cutting budgets, and are therefore reluctant to add staff to handle captive growth. We are seeing this dilemma at all levels from Commissioner down to staff. When insurance department personnel are stretched too thin, they are forced to wear multiple hats and are just as likely to get grumpy as helpful, potentially resulting in a once-vibrant domicile being perceived as a flash in the pan. This problem is not confined to western domiciles – we are seeing it everywhere.
- The industry has more domicile choices than ever. New domiciles such as Kentucky are licensing large numbers of captives -- for good reason, according to our sources. The industry is likely to take captives to the location offering the best combination of regulatory knowledge, efficiency, adequate staff, and a proven track record of regulating insurance entities over the years – captive or more traditional. Viable, well-positioned new domiciles will inevitably “spread the wealth” of new captive formation, predictably slowing the growth of older domiciles who, at one time, seemed like the only logical choice.

We all look forward to learning how industry challenges will play out in 2009. Captive.com will do everything possible to keep our visitors “in the know” in the coming year. I always welcome the comments and insight of industry professionals, and look forward to incorporating your thoughts into future articles.

Captive.com extends thanks to the captive association representatives and domicile contacts who graciously gave of their time to give us the accurate information we needed to update the industry on these important issues.

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