



Department of Insurance
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Captive Insurance Division
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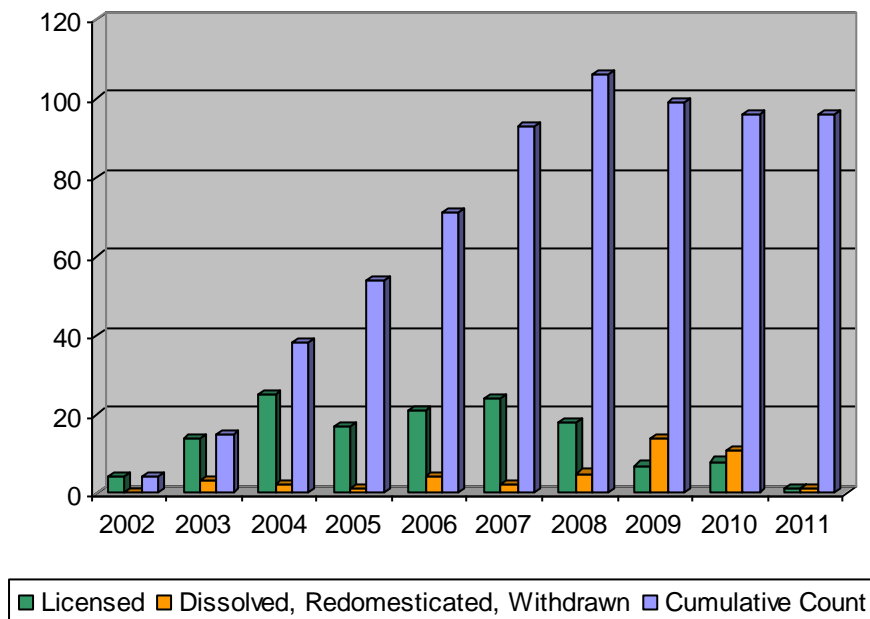
CHRISTINA URIAS
 Director of Insurance

The Arizona Edge

The Arizona captive industry offers competent, talented and reputable regulators and insurance professionals. The business environment is favorable and captives benefit from flat-rate fees and automatic exemption of the audit and actuarial opinion requirements for captives meeting certain small company criteria. We have no premium tax for captives and no statutory examination requirements for pure captives.

Arizona Captive Insurance Division Statistics at March 31, 2011

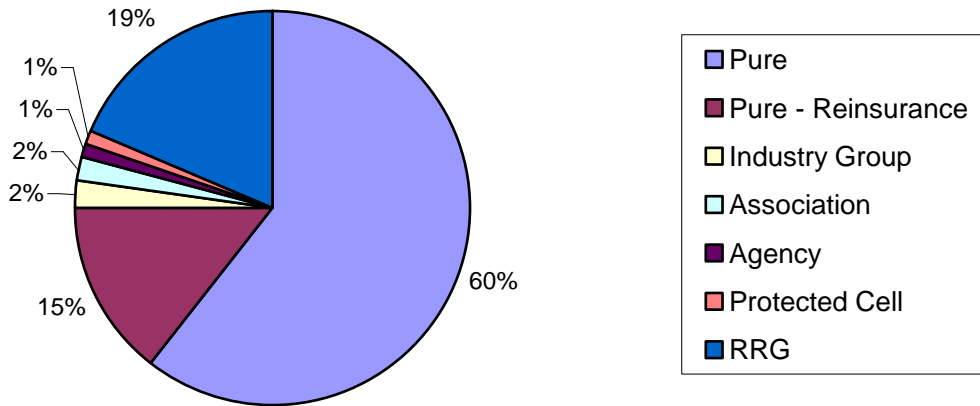
The following chart of cumulative activity reflects dramatic initial growth followed by long-term stability. The attrition that characterized 2009 and 2010 resulted from business plans that reached expected conclusions, smaller or weaker companies exiting the captive industry and possibly the parent company's industry due to the economy, and captives that redomesticated to gain access to laws that were more conducive to their business objectives.



Arizona is now a thriving mid-sized domicile based on the number of captives we regulate. Although not a large domicile based on the number of licensed captives, Arizona's captives collectively wrote \$2.1 billion in premium in 2009. 2010 data was not available at the time of publication. Captive Review published its "Top 10 Leading Captive Domiciles" in March 2011. The polled data did not include Arizona premium volume but this clearly

places us in the top ten captive domiciles worldwide and the top three captive domiciles onshore.

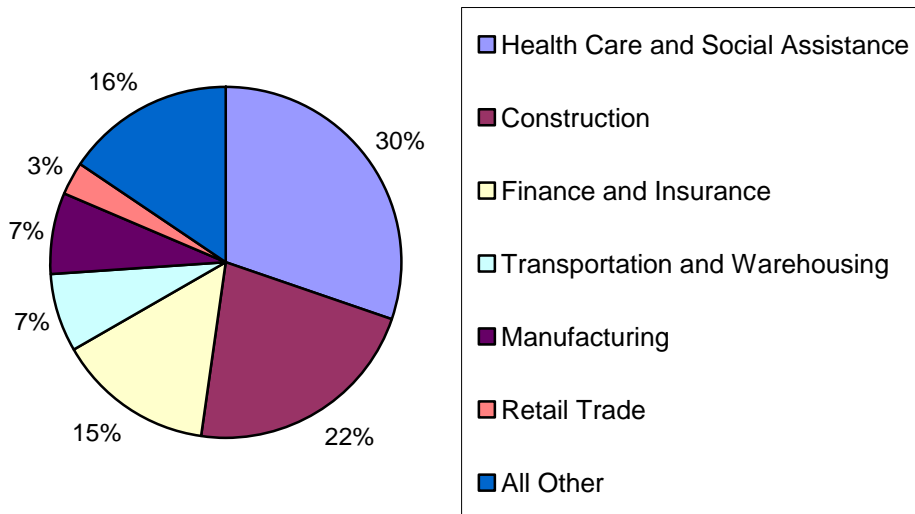
Arizona has become known for licensing pure captives with strong, solid parents and consequently we have noticed a shift towards the pure structure.



The following distinguished rankings of companies that chose to obtain a license for their captive subsidiary in Arizona heralds the success of the Arizona Captive Insurance Division.

	Percent of Total Captives
Fortune 1000	22%
Global 2000	20%
Forbes - Largest Private Companies	5%
Dow 30	2%
S&P 500	15%

The distribution by industry group reflects consistency in historical utilization of captives and the emergence of captive subsidiaries in other industries.



Outlook and Development

Arizona implemented significant changes this year for risk retention group captives (RRGs) as a result of the National Association of Insurance Commissioners (NAIC) adoption of new accreditation requirements effective January 1, 2011. In all, there are eighteen accreditation standards. One standard, Guaranty Funds, does not apply to RRGs. Five standards apply to RRGs with modification. Twelve standards apply to RRGs with little or no modification. Due to the distinctive differences between the regulation of RRGs and pure captives, we developed a separate RRG Reference Guide, which includes regulatory guidance on licensing and ongoing filings requirements for these insurers. Significant standards that are now, or soon will be applicable to RRGs include the applicability of the Arizona Holding Company Systems Act (HCA), new reinsurance ceded standards and new dynamic capital standards.

On December 2, 2010, the Director issued a Regulatory Bulletin regarding compliance by RRGs with the HCA. The HCA may require an RRG to make additional filings with the Department if it is determined to be a member of a holding company system as defined in the HCA. The filings include an annual registration statement that will provide additional detailed information regarding ongoing transactions amongst the RRGs and affiliated entities as well as updated information on the relationships between its parent and affiliates. An important provision of the HCA allows a party that is otherwise presumed to exercise control over the RRG to disclaim the affiliation or control by providing evidence that such control does not exist. If the disclaimer filing is accepted by the Director, the requirements of the HCA would not be applicable.

Effective January 1, 2011, RRGs may take credit for reinsurance if it is approved by the Department and is found to be in compliance with the "Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers". Pursuant to this Guideline passed by the NAIC's RRG Task Force (RRGTF) and the Financial Regulation Standard and Accreditation Committee (FRSAC), credit for reinsurance ceded is allowed for certain unauthorized reinsurers when the reinsurance agreements and the reinsurer meet the requirements of the reinsurance guidelines. A significant element of the Guideline is the relaxation of required reserve collateral security requirements under certain defined conditions.

Accreditation standards require that states have the authority to establish minimum amounts of capital and surplus for RRGs. They must also have the authority to require additional capital and surplus based on the type, volume and nature of business transacted. The standard does not currently require that risk-based capital (RBC) be applicable to RRGs, although they are required to file the RBC Report with their annual statement. This conclusion was arrived at primarily due to concerns about the use of generally accepted accounting principles (GAAP) by RRGs and how that accounting basis would impact the RBC formula. However, the RRGTF generally agreed that there should be a consistent formula to assess the capital levels given the assumed level of risk.

The NAIC Capital Adequacy for RRGs Technical Subgroup, a subgroup of the RRGTF chaired by Steve Ferguson of the Arizona Department of Insurance, considered a standard that is based on the RBC formula. The subgroup debated the circumstances

under which the domestic regulator of an RRG may elect not to take the regulatory action required by the RBC for Insurers Model Act. Under a proposal, regulatory action would not be required when the RBC result fell below the designated threshold if any of the following conditions exist:

- A. The domestic regulator establishes that the RRG's members and/or sponsoring organizations are well-capitalized entities whose financial condition and support for the RRG is adequately documented. The domestic regulator must require the filing of at least three years of historical audited financial statements of the members/sponsor in order to establish the financial ability of the member's/sponsor's support of the RRG. One year of projected financial information should be reviewed if available. The members/sponsor shall have an investment grade rating within established parameters, equity equal to or greater than \$100 million, or equity equal to or greater than ten times the RRG's largest net retained per occurrence limit.
- B. Each policyholder qualifies as an Industrial Insured in their state, or in the state of domicile, whichever has the greater requirements. If the policyholder's home state does not have an industrial insured exemption or equivalent, the policyholder must qualify under the industrial insured requirement of the RRG's domicile.
- C. The RRG was licensed prior to 01/01/2011 and, based on a minimum five-year history of successful operations, is specifically exempted in writing from the requirements for mandatory RBC action by its domestic regulator.

The subgroup reported its recommendation to the RRGTF at the NAIC meeting in Austin, Texas in March 2011. The RRGTF accepted the report without comment from interested parties or its members and voted to expose the report for thirty days. The RRGTF will accept comments, suggestions, criticisms, and concern during that period. Comments will be reviewed and it will be determined if changes need to be made. If there are no further comments, the recommendations are likely to be forwarded to the appropriate NAIC bodies for further action.

The Reference Guide specific to RRGs was released to aid in the comprehension of the new standards which are discussed above. The new Reference Guide dedicated to pure captives is pending release.

The Arizona Department of Insurance is committed to licensing quality captives with sound business plans, adequate pricing, reserving and capital, and good corporate governance standards. Stability, quality and conservative growth are the hallmarks of our success.

For more information, please contact Stephanie Lefkowski at slefkowski@azinsurance.gov or 602-364-3990.