Securitisation in Vermont

Vermont's legislative season came to an end early June. **Bill Lumley** talks to the state's director of captive insurance Derick White for the low down on what has been achieved

Briefing

Legislation

The cornerstone of this year's legislation as far as Vermont captives are concerned came in the form of an act enabling the securitisation transactions by captive insurance companies.

Senate Bill number 91 was created for the whole department of banking, insurance, securities and healthcare and specifically allows for securitisation rather than having a separate captive bill. It's an act relating to securitisation transactions by captive insurance companies, and it takes effect on 1 July 2007.

Housekeeping

In addition to the securitisation enablement the bill incorporated three 'houskeeping' aspects affecting captives. State director of captive insurance Derick White explains: "We allowed association captives to insure the association and not just its members. Previously our law always said you could only insure the members and we were not sure why it was written in that way."

For example, he says, the global network of community volunteers the Rotary Association has a captive and it insures general liability for all the individual Rotary locations around the US but the law said they could not insure themselves at the national level. "This was an anomaly that the Vermont regulator felt needed to be addressed for the purpose of clarity."

The bill also allowed industrial insured captives, a form of a group captive to insure controlled unaffiliated business. White explains: "We have some hospitals that are organised as industrial insured and in theory as the law stood they were unable to write the non-employed doctors who were just admitting privileges.

"There was a demand for it, so we changed the law to allow them to do just that. We allowed risk retention groups in other kinds of captives to do that and there was really no reason why we should not have allowed that."

Finally, he says the bill clarified the premium tax structure on consolidating companies. Owners of more than one company can consolidate the premium for premium tax purposes because a premium tax is a regressive rate.

"The question arose over what would occur in the event that an organisation owned a pure captive yet was also in a cell in Vermont. We had a couple of just such cases so there we went the extra distance to remove any ambiguity from the tax status," says White.

Triple X deals

The big bulk of the bill was for securitisation to create special purpose

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financial captives (SPFC) which would add provisions to its existing captive insurance law to allow for a securitization transaction involving a special purpose financial captive insurance company. In a typical transaction the ceding insurer would reinsure a specific book of life policies to the SPFC which would then issue securities, or a securitisation, to finance the reserves.

The ceded reserves are secured by the proceeds of the securitisation so the ceding insurer can take credit for the ceded risk, thus relieving pressure on its capital.

It was brought about by a growing number of life insurance companies who wanted to seed their triple X business to the captive. Vermont now has five such companies, only one of which was actually previously securitizing its triple X business.

“The trouble was the law did not specifically spell out that securitisation was allowed,” explains White. “It did not say it was not allowed but some of the big law firms - especially in New York City - felt uncomfortable rendering an opinion that it could be done when the law did not specifically say it could,” he says.

High end deals

This law was therefore passed to set out a variety of rules. The effect is that it makes Vermont more attractive as a domicile, White says. “On these triple X deals we have licenced five in the last year, we're talking to four right now and I think we will get many more.”

Most of them are large insurance companies, including some of the largest in the US, which form the captives then seed off the economic reserves and the triple X reserves to the captive.

The premium coming in is usually just sufficient to equal the economic reserves so somehow they have to come up with the redundant reserves. “They can do that by issuing a separate note to a third party entity off to the side, for instance a special purpose vehicle, which will securitise it,” explains White.

Typically the deals are quite high end, anywhere between $200m and $700m in premium. White says: “I'm told it usually takes about $300m to make it worth going out to the market for a securitisation so it has to be fairly large.

We have already seen the numbers come down a little bit for the other parties that are interested such as the intermediate sized life companies.

Once these things happen of course some of the fees come down as the investment companies find themselves able to shave off a couple of basis points because they have already been through this before,” he says.

“These large companies have approached us. They were following the legislation as it took its course. South Carolina already had an SPFC law in place. A number of people who wanted to come to Vermont for various reasons were holding off until the law was passed. We issued the draft legislation to the whole industry and a significant number of companies provided some good advice that we incorporated into the statute.

They were keenly interested along the way. I think the passing of the act will be the decisive factor in a number of them setting up their captives in the state.

Rising numbers

Over the coming year the number should rise significantly, White suggests. "We've done five over the last 14 months. I told the legislature that we'd get another five this year directly because of that new statute. We always guess low because they want to spend the money in advance but I wouldn't be surprised if we had seven this year and a similar number next year," he says.

He concludes: "Business is still good in Vermont. We have licensed 14 captives this year. Our legislature meets from January to early June so we have a break now until January and we have not put together anything yet for next year."

In addition to three housekeeping changes Senate Bill 91 proposed the following changes to Vermont's captive insurance legislation:

- Expand the underwriting authority for industrial insured group captives to allow an industrial insured group to underwrite the controlled unaffiliated risk of any of the participating industrial insured entities.
- Clarify that an association captive insurance company may insure the risk of the sponsoring association in addition to the risk of members of the association. This clarification confirms what has occurred as a regulatory practice.
- Allows cells of a sponsored captive insurance company to be aggregated – for the purposes of the graduated premium tax – with each other, with the sponsor and with other captives under common ownership and control provided the sole participant on the cell is the sponsor or an affiliate of the sponsor.
- Broaden the allowable sponsors of a sponsored captive insurance company to include any entity "approved by the commissioner in the exercise of his or her discretion, after finding that the approval of a person as a sponsor is not consistent with the purposes of this chapter".