STATE OF THE STATE

VCIA SPECIAL SECTION

Many things determine the success of the captive insurance marketplace. The regulatory climate is one that will have a major effect on the captive marketplace. For a captive domicile to succeed, it requires a capable regulator, as well as thoughtful regulations. Over the past 12 months, the captive insurance community has seen a number of regulatory changes, both onshore and offshore. Key changes in the regulators have occurred at both the Cayman Islands and the British Virgin Islands. In addition, Bermuda has recently named a new head to the Bermuda Monetary Authority. Domestically, changes in regulators have also occurred in Arizona and Nevada. And they have also occurred in Vermont, where Len Crouse retired from the deputy insurance commissioner's post on June 1, 2008.

Obviously, this type of thing occurs periodically, but Vermont moved quickly to assure the continuity that was needed. The appointment of David Provost to succeed Crouse as deputy commissioner (see "New Sheriff in Town," page 52 for further information about Provost) provided this needed continuity. It was important to fill the position with a qualified candidate as quickly as possible.

Moving on

Molly Lambert, president of the Vermont Captive Insurance Association (VCIA), notes that this has been "a year of unexpected change and unexpected challenges." And she points out that as Provost has taken over as deputy commissioner, "Vermont has made an orderly transition to new leadership." Dan Towle, director of financial services for the Vermont Department of Economic Development, points out that after Provost came to the Department, "He hit the ground running." Additionally, "Provost had six months to transition into his job," says Towle.

And as Towle adds, "Vermont has been in the business of captive insurance for 28 years, and the state provides incredible support to the captive effort." Further, he says, "While there has been turnover of the governor, legislature and the insurance commissioner during these 28 years, we have always been able to maintain an incredible amount of stability within the captive insurance division and the captive industry in Vermont."

Molly Lambert says that Len's legacy is the talent he surrounded himself with, and David is a perfect example of this." As she points out, "It's the hallmark of every good leader."

However, as Lambert notes, it was not just the change of personnel that provided unexpected challenges. Last year's proposed IRS regulations also caused concern throughout the entire U.S. captive industry. But thanks to a coordinated response that was provided in a timely manner by the major players within the domestic captive industry, the IRS decided to shelve its proposed regulation. Lambert says that by marshaling the forces of VCIA as well as the Captive Insurance Company Association (CICA), and forming the Coalition for Fairness to Captive Insurers, "We were able to get the best people to represent our interest." In fact, "We got the best of the best, and the results speak for themselves."

Soft market concerns

The overall captive market is bracing for the adverse effects of the current soft insurance market. Typically, captive formations lag during these times, and frequently some owners choose to wind down their captives, while some group captives and risk retention groups have difficulty retaining members. However, Lambert notes, "Even in a soft market, Vermont has shown steady growth." Towle says that while historically "the overall interest level in captives may slow down during a soft market, the formations in Vermont don't take a huge dip."

While the captive activity in Vermont is currently down, Towle points out that the first half of the year is always slow. "Most of our activity is in the second half of the year," he says. In fact, he points out, "There have been a lot of years we booked half of our business during the fourth quarter." And at this point, Vermont, "still has quite a few applications in the pipeline."

It also helps that captives have become a more significant component in the overall risk financing movement. Lambert says, "Captives are being used much more today as strategic elements to a company's risk management programs." And she thinks this is a good sign of a more mature market. As a corporation becomes more sophisticated "they find that captives are a more reliable risk management tool," she says. "Most have an eye on how they can use their captives more effectively."

One obvious outcome, Towle says, is that "existing captives begin to add other lines of coverage." Lambert adds, "Existing captives will continue to develop more expansive uses for their captives." Clear evidence of this has been the increased amount of premium that is going through the state. Vermont has reported that gross written premium for 2007 was $15.26 billion. This represents a 32.1% increase over 2006, and confirms that existing captives are beginning to take on more risks.

This expanding usage can be seen in a number of areas. However, one area that often is discussed is employee benefits, and Towle confirms that "many of our current captive owners continue to have conversation with us about this." And he says, "Several are in the process of moving toward that goal." Does that mean that the "flood gates" are about to open? "Not likely," says Towle. However, he does think there should be a continual flow of companies that will incorporate employee benefits into their captives. He also points out that the idea of health insurance RRGs appears to draw a great deal of interest.

By the numbers

The year 2007 was an "average" year for captive formations in Vermont. Overall, they issued 32 new licenses during the year. For the most part, industry segments ran the full range—from pure captives for a transportation company to a risk retention group for the health care industry, and everything in between. Other industries represented include real estate, manufacturing, construction and banking.

The health care RRG is notable because Vermont has not always been the domicile of choice for health care organizations. However this view of Vermont is quickly changing, notes Towle. Today, nearly 100 health care-related captives call Vermont their home. And from all indications this is a trend that should continue.

Another area that has seen rapid growth recently has been captives for the insurance industry. The majority of these have been licensed as special-purpose captives that are established for either "triple X" or "A triple X" securitizations. Towle says that Vermont is still getting significant interest from life insurers regarding securitizations and, as a result, is still going strong. Further he says, Vermont is continuing to have dialogue with a number of prospects. Towle believes that securitizations "will remain one of the major growth areas for Vermont in the short term."

Conclusion

By any measure, it has been an eventful 12 months in Vermont's captive insurance community. Challenges have arrived from everything including proposed IRS regulations that would have effectively closed the door on single-parent captives in the United States to changes within the leadership at the Department. However, through it all, Vermont has remained committed to its captive owners and prospects. And despite all the challenges, it appears that Vermont is well positioned to take advantage of whatever the insurance market gives. *

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