Vermont CAPTIVE INSURANCE ASSOCIATION

VERMONT: STATE OF THE STATE

By Michael J. Moody, MBA, ARM

The success of the captive insurance marketplace is influenced by many factors. One is the regulatory climate. 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 challenges, both onshore and offshore.

Key changes in the regulators have occurred both in 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, deputy commissioner of the state's Captive Insurance Division, retired on June 1, 2008.

Vermont moved quickly to assure the necessary continuity with the appointment of David Provost. (See "New Sheriff in Town," July 2008 issue of *Rough Notes* for further information about Provost.)

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." It was not just the change of personnel that provided unexpected these challenges. Last year's proposed IRS regulations also caused concern through 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 marshalling the forces of VCIA as well as the Captive Insurance Companies Association (CICA), and forming a coalition, "we were able to get the best people we could to represent our interests. Fortunately, we got the best of the best, and the results speak for themselves."

Dan Towle, director of financial services for the Vermont Department of Economic Development, points out that when Provost came into the department "he hit the ground running." Additionally, "Provost had six months to transition into his job," says Towle, who points out, "Vermont has been in the business of captive insurance for 28 years, and the state provides incredible support to the

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captive effort.” Further, “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.”

Lambert puts it best, “Len’s legacy is the talent he surrounded himself with, and David is a perfect example of this. It’s the hallmark of every good leader. As a result, we are having an orderly transition of leadership.”

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 during the soft markets. However, Lambert notes, “Even in a soft market, Vermont has shown steady growth.”

While the captive activity in Vermont is currently down, Towle emphasizes that the first half of the year is always slow. “Most of our activity is in the second half of the year…[In fact,] “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,” he confirms.

It also helps that captives have become a more significant component in the overall risk financing movement. Lambert notes, “Captives are being used much more today as strategic elements to 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,” and, she says, “Most have an eye on how they can use their captives more effectively.”

One obvious outcome, Towle and Lambert say, is that existing captives expand the lines of coverage that they offer. 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 resulted in 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. One area that typically is discussed is employee benefits. Towle says, “Many of our current captive owners continue to have conversation with us about this.” And he says, “Several are in the process of moving towards 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 be attracting a great deal of interest.

By the numbers

2007 was an “average” year for captive formations in Vermont. Overall, they issued 32 new licenses. For the most part, industry segments ran the full range—everything 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 since Vermont has not always been the domicile of choice for health care organizations. However, this view of Vermont is quickly changing, Towle notes. 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, they are still going strong. Further, he says, they are continuing to have dialog 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 arisen from everywhere, including proposed IRS regulations that would effectively close 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 of the challenges, it appears that Vermont is well positioned to take advantage of whatever the insurance market gives. ■