Bureau of Captive and Financial Insurance Products
Delaware Captive Insurance Association
Fall Forum
September 20, 2016

Steve Kinion
Director, Bureau of Captive and Financial Insurance Products
Delaware Insurance Department
Agenda for Meeting

- Proposed bulletins and regulatory issues.
  - Special purpose captive capital reduction.
  - Investments in mutual funds.
  - 831(b) change of ownership.
  - Year end applications.
  - Annual statement forms.
  - Examinations.
- What captive insurance means for Delaware.
- Current captive status including the global and U.S. markets.
- NAIC and federal issues.
  - XXX and AXXX Captives. An opportunity for Delaware.
  - Federal Home Loan Bank.
  - RRGs.
- Conclusion.
Thank you!

- Thank you for bringing either your captives or the captives that you manage to Delaware.
Bulletins and Regulatory Issues
Reduction of Capital Bulletin

Delaware LLC Core Captive Insurer
Reduce Capital from $250,000 to $50,000
Assumes no Premium nor Risk

Series Captive IC 1
Series Captive IC 2
Series Captive IC 3
Non-Series Captive IC 4
Bulletin Allowing Mutual Funds as Minimum Capital and Surplus

- 18 Del. C. §6905(c) states that:

- [m]inimum capital and surplus described in paragraphs (a)(1)-(9) of this section shall be maintained in this State and may be in the form of cash, an irrevocable letter of credit issued by a financial institution chartered by or licensed or otherwise authorized to do banking business in this State, or by any other financial institution approved by the Commissioner, or such other assets as may be approved by the Commissioner.

- Other assets equal mutual funds listed on NAIC Mutual Fund List.
Ownership Change Bulletin
Method 1

Captive Owner 1

Captive Owner 2

Captive Insurer

Captive Insurer

Same Policies

Same Premium

Same Policies

Same Premium
Ownership Change Bulletin
Method 2

Captive Owner

Same Policies  \downarrow  \text{Same Premium}

Non Compliant Captive Insurer Loses C of A

\Rightarrow  \text{Assets & Liabilities}

New Captive Owner

Same Policies  \downarrow  \text{Same Premium}

New Compliant Captive Insurer With New TIN and C of A

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Bureau of Captive and Financial Insurance Products
PATH Act/831(b) Changes Procedure

• Treat as business plan change.

• No cost for ownership change under Method 1.

• For Method 2, if old and new captive mirror each other, then the cost to change ownership is $300 for issuing a new license. No payment of the $3,200 application fee if the same.

• For Method 2, documentation is an affidavit from the captive manager of captive owner that the old and new captives are the same but for the ownership.
PATH Act/831(b) Changes Procedure

- For Method 2, the business plan change must be submitted by December 1. This allows the captive bureau to review the submission.

- Application process will include biographical affidavits of the new owners.

- The target is to issue a license for the new captive effective December 31, 2016.

- Both old and new captive will have to pay the minimum premium tax.
Year End 2016 Application Process

• Year end 2016 applications – what is the cut-off date and time?
  Answer: December 31, 2016 at 11:59:59 P.M. EST.

• Fees and genuine signature portion of biographical affidavits must be received no later than 5:00 P.M. EST on January 12, 2017.

• The Captive Bureau only needs hard copies with pen and ink signature on the application and the biographical affidavits. The remainder of the application is filed electronically.

• File electronically at captive@state.de.us
Year End 2016 Application Process

- If changes must be made to the application, then all changed documents must be dated with the new date clearly noted on the document.

- Policies need to state the risk being covered and the conditions under which a claim occurs.

- All policies must be submitted with the application.

- Asking for a waiver of actuarial and audit reports for December 31 licensees? Please send this request separate from the application.
Year End 2016
Application Process

- Send business plan and pro-forma in both pdf, word processing and spreadsheet, i.e. MS Word and Excel, formats. Only completed applications will be reviewed.

- Be patient. On January 1, 2013 the Captive Bureau had 114 applications ready for processing. On January 1, 2014 it had 150 applications. On January 1, 2015 there were 160, and on January 1, 2016 there were 128.

- Reviewing applications takes time.

- Submitting an application is not a guarantee of approval.
2016 Annual Statement Forms

• No changes.
Examinations

- Captives examined by the Department once after their first 3 years and then every 5 years after that unless they have problems.

- The Commissioner has the discretion to examine a captive on a 5 year cycle if the captive has an audit.

- In the very rare case that if a captive does not conduct an audit, then the exam cycle is less than 5 years.
Examinations

Examinations uncover captives are not operating in accordance with their business plan and regulatory requirements even though they have been audited by a CPA firm. Examples are,

- writing business for periods when the captive wasn’t licensed.
- writing lines of business not cited in the business plan.
- payment of dividends not approved by the regulators.

Reminded of cases like the WL Homes (John Laing Homes) 2009 bankruptcy filing involving an Arizona domiciled pure captive.

The captive was formed for the express purpose of paying claims against John Laing Homes arising out of its business activities.
WL Homes pledges $10 million of JLH capital as collateral for line of credit with Wachovia Bank.

WL purchases policy from Zurich for damages and defense costs relating to construction defect claims. JLH Ins. Co. is formed to self-insure the retention/deductible.

Zurich Ins. Co.

Payment of deductible

Homeowners With Defective Homes

JLH Ins. Co. (AZ Pure Captive)
Examinations

• Arizona law allows the Director to examine the affairs of a captive insurer “whenever prudent.”

• Homeowners with defective homes are seeking indemnification.

• Exams are necessary but not perfect.

• Sensitive to the cost of exams – seeking balance.

• Captive managers have suggested changes to exam format.

• Please contact me with exam issues.
What Captive Insurance Means for Delaware
# Delaware Active Licenses
**as of September 14, 2016**

## Variety of Captive Types

<table>
<thead>
<tr>
<th>Type</th>
<th>Number Licensed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency</td>
<td>1</td>
</tr>
<tr>
<td>Association</td>
<td>1</td>
</tr>
<tr>
<td>Cell</td>
<td>13</td>
</tr>
<tr>
<td>Core LLC</td>
<td>40</td>
</tr>
<tr>
<td>Industrial</td>
<td>3</td>
</tr>
<tr>
<td>Pure</td>
<td>297</td>
</tr>
<tr>
<td>Series</td>
<td>681</td>
</tr>
<tr>
<td>Series Trust</td>
<td>1</td>
</tr>
<tr>
<td>Special Purpose</td>
<td>6</td>
</tr>
<tr>
<td>SPFC</td>
<td>5</td>
</tr>
<tr>
<td>Sponsored</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1055</strong></td>
</tr>
</tbody>
</table>
Captive Revenue

- In 2015 the captive bureau generated $6.6 million of gross revenue.
- Costs of operating the captive bureau are closing in on $2 million.
- The $4.6 million of surplus is sent to the state’s general revenue fund after deducting $1 million for the City of Wilmington.
- The captive bureau has generated a surplus since 2011.
Thank you for responding to the CABER team’s survey.

The survey return percentage was 40% which is well above the 25% response rate seen with other economic impact studies.

Delaware’s captive insurance program contributes almost $360 million to the state’s GDP or about 0.6 percent of the GDP.

For every $1,000 spent for the captive program, it generates $276,075 for the state’s GDP.
Supporting Medical Education

• Alaska, Delaware, Idaho, Montana, and Wyoming do not have an in-state medical school.

• These states arrange with other states to allow their students to attend.

• Delaware Institute for Medical Education and Research reserves 25 slots annually for Delaware medical students.

• Delaware Institute for Dental Education and Research reserves 5 slots for Delaware dental students.
Supporting Medical Education

- These programs help reserve seats for Delaware students in medical and dental schools in Pennsylvania so that these students will return to Delaware and practice medicine.

- Delaware like many states has a shortage of physicians.

- Due to budgetary pressures, the state funding for these programs was cut.

- This year about $2 million of captive insurance revenue monies were used to fund these programs.
Captive Status
### Global Captive Insurance Growth 2010 to 2015

<table>
<thead>
<tr>
<th>Year</th>
<th>Captives</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>6,939</td>
</tr>
<tr>
<td>2014</td>
<td>6,839</td>
</tr>
<tr>
<td>2013</td>
<td>6,420</td>
</tr>
<tr>
<td>2012</td>
<td>6,325</td>
</tr>
<tr>
<td>2011</td>
<td>5,831</td>
</tr>
<tr>
<td>2010</td>
<td>5,587</td>
</tr>
</tbody>
</table>

Source: Business Insurance
ONSHORE/ OFFSHORE
BY THE NUMBERS

There were 6,939 captives worldwide in 2015, a 1.5% increase over 2014. For the first time, the United States surpassed North American offshore domiciles to become the No. 1 region in number of captive domiciles.

Percentage of total captives per region

Slide Courtesy of Business Insurance

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Top 5 American Offshore Captive Domiciles in 2015

- Bermuda  797 captives
- Cayman Islands  708 captives
- Anguilla captives  319 captives
- Nevis  268 captives
- Barbados  236 captives

Source: Business Insurance
Top 5 European Captive Domiciles in 2015

- Guernsey 319 captives
- Luxembourg 217 captives
- Isle of Man 115 captives
- Ireland 84 captives
- Sweden 44 captives

Source: Business Insurance
Top 5 Asia Pacific Captive Domiciles in 2015

- Singapore  68 captives
- Labuan  40 captives
- Micronesia  16 captives
- Vanuatu  8 captives
- New Zealand  7 captives

Source: Business Insurance
Native American Captive Domiciles

• More than 40 captives now domiciled with the Delaware Tribe.
• Most focused on automobile F&I or finance and insurance market.
• Operates out of Caney, Kansas.
Top 10 U.S. Captive Domiciles as of December 31, 2015

1. Hawaii
2. Montana
3. Delaware
4. Nevada
5. Florida
6. Texas
7. South Carolina
8. Virginia
9. Iowa
10. Alaska

Source: Business Insurance

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Bureau of Captive and Financial Insurance Products
Top 5 U.S. State Captive Domiciles in 2015

- Vermont 596 captives
- Utah 450 captives
- Delaware 323 captives
- Nevada 202 captives
- Hawaii 197 captives

Source: Business Insurance
# Captive Insurance

## Annual Premium

### 2014
1. Vermont $25.4 billion  
2. Arizona $7.4 billion  
3. Nebraska $5.5 billion  
4. Delaware $5.4 billion  
5. Missouri $5.07 billion  
6. Hawaii $5.06 billion  
7. Nevada $4.1 billion  
8. South Carolina $3.2 billion  
9. New York $1.1 billion  
10. Utah $833 million  

### 2015
1. Vermont $25.5 billion  
2. Arizona $6.3 billion  
3. Delaware $4.9 billion  
4. Hawaii $4.2 billion  
5. Missouri $3.6 billion  
6. South Carolina $2.3 billion  
7. New York $1.3 billion  
8. Montana $1 billion  
9. Utah $745 million  
10. Oregon $692 million  

Source: NAIC
States Without Captive Laws
Shown in lavender

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Bureau of Captive and Financial Insurance Products
XXX and AXXX Captives: A Second Captive and Structured Financing Opportunity for Delaware
Taxes and Life Reinsurance Captives

• Under life insurance contracts companies are obligated to pay, in the future, benefits to policyholders. Companies establish reserves in order to reflect their (unaccrued) liability to pay those benefits.

• Reserves are set aside for future liabilities are a tax deduction.

• Principle-Based Reserve (PBR) effective on January 1, 2017. Allows 3 year phase-in.

• PBR will result in decreased reserves which means decreased deduction. Life insurers may opt to phase-in over three years in order continue using non-PRB reserves.
Life Reinsurance Captive Taxation

Life Insurance Company

Taxable Premium

Life Captive Insurer for XXX or AXXX Business

Life Insurance Tax Deductible Insurance Reserve
Comparing Pre & Post PBR

Pre-PBR

Total Statutory Reserve

Term Life Insurance Reserve

Post-PBR

Total Statutory Reserve

PBR Term Life Insurance Reserve

The definition of economic reserves has historically been a negotiated deal term that for XXX/AXXX financing deals has often been determined with best estimate assumptions. The graph shows how XXX economic and excess reserves can vary over time. Under AG48 an insurer must add extra assets to satisfy the primary security shortfall.
Comparing Pre-AG48 to AG48

Pre-AG48

- Total Statutory Reserve
  - Economic Reserve
  - Other Security
    - Financed Portion of Reserve
      - Funded with Traditional NAIC-eligible securities

AG48

- Other Security
  - Total Statutory Reserve
    - Additional Reserve Up to AM Reserve
  - Economic Reserve
    - Funded with Primary Security

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Structured Financing for Other Security

SPV

Transaction Agreement
Surplus Note
Credit Derivative

Life Reinsurance Captive

Reinsurance Agreement

Life Insurance Co.

Highly Rated Third Party Risk Takers

Put Option Agreement
Surplus Note
Cash for Surplus Note
Structured Financing Specifics

- Credit derivative usually mature in 20 to 30 years to avoid the cost of refinancing.

- Credit derivative must be rated by KBRS, S&P, Fitch, Moody’s or other NRSRO.

- The credit derivative is subject to draw conditions such as a level of Company Action Level Risk Based Capital.
Hedging Growth

- Low interest rates impact investment return.
- Hedge against low interest rates continuing over a 30 year horizon.
- Counterparty is hedging rates will rise. If they do, then counterparty makes money.
- If rates remain the same, then captive makes money.
- To offset cost of hedging, if interest rates rise super captive makes money on income received by investing the reserve.
- Using interest rate swaps as the instruments to hedge.
Hedging Structure

Holding Co.

Life Insurance Company

Life Reinsurance Captive

Ring Fenced Hedging Account

Payment of hedging profits
How Much Risk is There for Life Reinsurance Captives?

Exhibit 1
Product Risk Scale

Lower Risk
- Current Assumption UL
- Group Life
- Credit Ins.
- Suppl Health Products
- Term Life
- Whole Life
- Variable Life
- Final Exp/Pre-Need
- Term UL

Medium Risk
- No-Lapse UL
- Dental
- Stop Loss
- Medicare Supp/Advantage
- Indv/Small Group Medical
- Long Term Care

Higher Risk
- Fixed Indexed Annuities
- Immediate Annuities
- Large Group Medical
- Structured Settlements
- Fixed Deferred Annuities
- Disability Income
- VAs w’ Living Benefits

Source: A.M. Best data and research
Federal Home Loan Bank
Federal Housing Finance Agency

- Excludes captive insurers from membership and prevents entities not eligible for membership from gaining access to Federal Home Loan Bank membership through a captive insurer.
- Membership of existing captive insurers will be “sunset” in five years if the captives were members before proposed rule was published.
- Consequence for Delaware is that fewer captive insurers will be formed.
- Principal place of business effects all insurers captive & otherwise.
NAIC Accreditation and RRGs

- Captive Risk Retention Groups. The F Committee adopted a referral from the Risk Retention Group (E) Task Force for the Review Team Guidelines to include RRGs organized under a state’s P/C statutes within the Part B1: Financial Analysis section regarding the appropriate depth of an analysis review. The guidelines previously included were specific to captive RRGs.
Questions & Answers

Steve Kinion, Director, Bureau of Captive and Financial Insurance Products
Delaware Department of Insurance
302-674-7300 Dover Office
302-577-5280 Wilmington Office
302-222-7181 Cell
steve.kinion@state.de.us

Please copy our office manager, Jamie Bafundo, jamie.bafundo@state.de.us on all correspondence