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Captive insurance 'smart' for Del.

Investors like it as diversifying asset, attorney who helped draft legislation says

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For years, banks looking to raise cash have bundled mortgages, auto loans, credit card payments and other debts into securities and sold them to Wall Street. Those securitizations came back to bite investors this summer, when the collapse of the subprime mortgage market sent Wall Street into a tailspin.

Despite recent market troubles, the insurance industry is increasingly looking toward securitization as a way to free up cash and shift risk to the capital markets. And Delaware wants to be first in line.

"This is a natural opportunity for Delaware," Michael Teichman told an audience during the Delaware Captive Insurance Association's annual meeting in Wilmington on Wednesday.

A lawyer at Parkowski, Guerke & Swayze, Teichman helped draft legislation passed this summer that makes Delaware one of the most flexible states in the nation in terms of setting up so-called "special purpose financial captives."

Financial captives have been used by large life insurance companies to securitize excess reserves and issue them as bonds on the capital markets. Regulations require life insurance companies to set aside a certain amount of capital based on the policies they write, but companies say the regulations force them to set aside too much. Securitizing a portion of those reserves can free up capital and help an insurance company grow its business.

Life insurance companies aren't the only type of insurance company that can securitize assets, however.

"This is a growing area," said William P. White, captive insurance program administrator for the Delaware Department of Insurance. "It doesn't have to be life insurance companies. It could be anything ... depending on what you need that financial captive to do, we have those laws and oversight."

Depending on the size of their business, companies that set up financial captives in Delaware could pay the state up to \$200,000 per year in premium taxes, in addition to licensing and other fees, White said.

The insurance industry issued about \$16.7 billion worth of life-insurance securities since the practice began six or seven years ago, said Doug McBeth, managing director of Lehman Brothers' insurance products group.

"Investors have really embraced it as a good diversifying asset," McBeth told the crowd, later adding, "Hedge funds have a big interest in buying these types of assets."

Securitization via financial captives is "potentially just a revolutionary type of structure," said Nicholas F. Potter, a partner at Debevoise & Plimpton LLP, who said Delaware has the opportunity to become a leader now that it has updated its laws. "It opens up Delaware to a new business," he said. "Delaware has done a very smart thing."

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