

Insurers increasingly are utilizing capital markets approaches such as securitization to address regulatory and other issues. Against a backdrop of existing “Delaware advantages” that are routinely valued by the capital markets, the Delaware Revised Captive Insurance Company Act and Delaware’s business entity laws combine to provide insurance securitization opportunities unavailable in any other jurisdiction. These statutes offer flexibility and choice in an environment of responsive and sensible regulation. Parties interested in the benefits offered by XXX and other insurance securitizations can look with confidence to Delaware as the domicile in which to locate their captive insurance companies, form their SPEs, and find solutions to their evolving needs in a dynamic marketplace.

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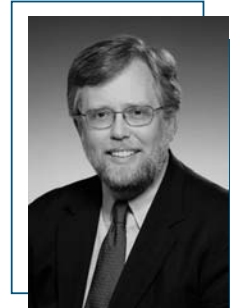
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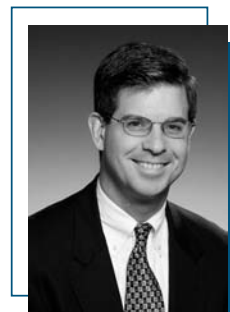
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## INTRODUCTION

Delaware is widely recognized as the leading domestic jurisdiction for a broad range of traditional securitization transactions. The flexibility and clarity of Delaware’s laws governing business entities, the expertise and reputation of its courts that interpret those laws, and the responsiveness of its governmental leaders to the needs of securitization participants have won the confidence of the capital markets and the business and legal professionals who service them. These advantages, especially when combined with Delaware’s updated captive insurance company law, make Delaware an appealing, dynamic choice for the emerging class of transactions referred to as “insurance securitizations.”

## REGULATION XXX AND OTHER INSURANCE SECURITIZATIONS

The National Association of Insurance Commissioners promulgated the Valuation of Life Insurance Policies Model Regulation, or “Regulation XXX,” in 2000. The widespread adoption of Regulation XXX by the states has played an important role in the growing volume of insurance securitizations. Regulation XXX mandates the level of reserves that must be maintained by an insurer with respect to certain term life insurance policies. This required level of reserves significantly exceeds the amount of reserves traditionally maintained for such policies. The increased reserves necessitated by Regulation XXX are commonly called “redundant” reserves. Such reserves tie up more of an insurer’s capital and limit its financial flexibility, possibly for decades.

With increasing frequency, life insurers are turning to the capital markets for relief from the redundant reserve requirements imposed by Regulation XXX. The so-called “XXX securitization” has emerged as a means to achieve Regulation XXX reserve relief. XXX securitizations have been accomplished through several different, though essentially similar, approaches. These generally have been characterized by an insurer ceding certain risks to a captive insurance company and such captive reinsurer, directly or through a separate special purpose entity, raising capital from investors in amounts sufficient to fund the redundant reserve requirements.

Beyond the “XXX securitizations” devised in response to Regulation XXX are the similarly motivated “AXXX securitizations,” which provide relief from redundant reserve requirements related to certain universal life insurance policies. Further, insurers in both the life and property and casualty insurance markets, seeking to make better overall use of their capital, are looking more often to the capital markets for solutions. For example, “embedded value securitizations” tap the capital markets in order to extract the expected revenue from a closed book of insurance business. Meanwhile, catastrophe bonds, which involve shifting insurance risk to the capital markets, have been used in both life insurance and property and casualty insurance contexts. Similarly, “sidecars,” used exclusively in the property and casualty area, enable reinsurers to increase capacity by essentially sharing a percentage of their risk with the capital markets. Each of these evolving financing structures represents a further instance of the increasing convergence of insurance and capital markets financing.

## DELAWARE: AT THE INTERSECTION OF INSURANCE AND FINANCE

In the various insurance securitization structures and other non-traditional financing transactions involving insurers, a common feature is the utilization of a captive reinsurer, thereby requiring the selection of a domicile in which to license that captive. At this intersection of insurance and finance there are certain considerations that figure prominently. Among them are certainty and predictability regarding applicable law, regulatory stability and responsiveness, and flexibility. These are defining characteristics of the “Delaware advantage” that has established Delaware’s reputation as a leading jurisdiction for traditional securitization transactions, with a clear preference in the capital markets and among rating agencies for Delaware special purpose entities (“SPEs”). The general

preference for Delaware as a securitization jurisdiction, combined with Delaware's updated captive insurance company statute, the expertise of the dedicated captive insurance group within the Delaware Department of Insurance, and the ongoing legislative support for the state's captive insurance program, make Delaware an attractive choice for XXX securitizations as well as for other insurance-based capital markets transactions.

### **THE "DELAWARE ADVANTAGE" FOR INSURANCE SECURITIZATIONS**

Delaware enjoys a reputation as the foremost United States jurisdiction for organizing a business. The state provides modern and flexible business laws, a sophisticated judiciary with a reputation for excellence and fairness, and a business-friendly government. The capital markets have long recognized Delaware as a leader in providing SPEs for asset-backed financing transactions, including existing XXX securitizations. These traditional "Delaware advantages," along with others, offer meaningful benefits to an insurer planning to undertake a XXX securitization or other financing.

A chief component of the Delaware advantage in regard to insurance securitizations is the Delaware Revised Captive Insurance Company Act, enacted in July 2005. This statute: (1) builds on Delaware's stellar reputation for *responsiveness* to business needs; (2) provides for the regulation of captive insurance companies in a rigorous but *sensible* fashion, consistently with their nature and purpose, and ensures that such regulation is carried out by a dedicated captive insurance company group within the Delaware Department of Insurance; and (3) offers *flexibility* and *opportunity* to captive insurance companies and those who can benefit from utilizing them. One such opportunity is forming and licensing a Delaware captive reinsurer to participate in a Regulation XXX securitization.

Another element of the Delaware advantage is the state's business entity laws. The benefits available under the state's corporation law are well known and have been utilized for more than a century by many of the country's largest public and private businesses, including those in the insurance industry. In the past decade, however, Delaware alternative business entities, particularly Delaware limited liability companies and statutory trusts, have experienced an unprecedented surge in popularity and use. For many legal and business professionals, Delaware's alternative business entities are the SPEs of choice for structured financings because they offer unparalleled contractual flexibility in important areas such as ownership, management and finance. They also possess a variety of statutory features that in a traditional asset securitization help separate and isolate the SPE from other parties, a desirable result from the perspective of rating agencies and other capital markets participants and an equally important consideration for insurance securitizations.

Coupled with other factors such as knowledgeable and responsive regulators and administrators in the Delaware Insurance Commissioner's and Secretary of State's offices, its captive insurance company and alternative business entity laws make Delaware a very attractive jurisdiction for organizing and operating a captive insurance company, as well as any SPE, that participates in a XXX securitization or other insurance-based capital markets financing.

### **HIGHLIGHTS OF DELAWARE'S CAPTIVE INSURANCE AND ALTERNATIVE BUSINESS ENTITY STATUTES**

The advantages of utilizing a Delaware captive insurance company and Delaware SPEs in an insurance securitization, including a XXX securitization, include:

#### ***Flat, capped premium taxes and other cost advantages***

Premium taxes under Delaware's captive insurance company statute compare quite favorably overall to those applicable in other leading onshore captive domiciles. Unlike the reverse-graduated premium tax scales applied in other jurisdictions, Delaware's law adopts a flat rate premium tax structure. For a Delaware captive reinsurer participating in a XXX securitization, the premium tax rate would be 0.1% on assumed reinsurance premiums, with an annual premium tax cap of \$75,000 on those premiums. This flat rate, capped approach can offer premium tax savings over competing jurisdictions, thereby reducing the overall cost of a XXX securitization. In addition, Delaware's captive insurance company statute compares favorably to the laws of other leading domestic jurisdictions in terms of application, licensing and examination charges. The statute also offers opportunities for further savings by treating two or more captive insurance companies under "common ownership and control" as a single captive insurance company for purposes of the premium tax, application fee and annual license fee.

#### ***Sensible, efficient regulation***

The Delaware captive insurance company statute vests in the Delaware Insurance Commissioner regulatory authority designed to balance the need for responsible governmental supervision and oversight with the unique requirements and purposes of captive insurance companies. A Delaware-licensed captive insurance company is required to provide to the Insurance Commissioner prompt notice of a material change in its financial condition or management, and advance notice of material transactions such as dissolution, sale of (or granting a security interest in) substantially all assets, incurrence of material indebtedness, or merger. A Delaware captive reinsurer's plans for funding necessary reserves in a XXX or other insurance securitization, including any indebtedness to be incurred in connection with that transaction, normally would be addressed in the initial licensing process. In this regard the Commissioner is provided with considerable regulatory flexibility under Delaware's captive insurance company statute to evaluate and approve a captive structure as flexible or circumscribed as the parties deem appropriate for their business needs.

#### ***Expanded entity choices***

Delaware provides significant flexibility with respect to the legal form of organization that a captive insurance company may take. Depending on the particular type of captive insurance company involved, just about any domestic, foreign or alien corporation, limited liability company, partnership, limited partnership, statutory trust, reciprocal insurer or other entity can apply for a certificate of authority to act as a Delaware captive insurance company. This flexibility regarding choice of entity offers expanded planning opportunities in regard to management, operations, and other important matters. It also permits parties to establish a Delaware corporation, statutory trust or limited liability company to serve as the captive reinsurer in a XXX or other insurance-based securitization, and thereby take advantage of the many benefits to be enjoyed under Delaware's business entity laws.

#### ***Focus on licensing***

Delaware's captive insurance company law is designed to serve only as a licensing statute, not as a business entity organization statute. The captive insurance laws of many other jurisdictions tend to blur the line between business organization matters and captive insurance licensing, and can create uncertainty insofar as they overlap with applicable entity laws (e.g., the corporation statute) that govern the formation and internal affairs of the organization seeking a captive insurance company license. For example, some captive insurance company laws require a certain number of incorporators or otherwise impose requirements that are typically addressed in the relevant business entity statute. The potential for this sort of confusion is minimized under Delaware's captive insurance company law. Further, the clear demarcation between licensing and business organization issues in Delaware facilitates its offering the broad range of entity choices discussed above.

#### ***Capital markets' familiarity with Delaware SPEs***

As mentioned above, Delaware's alternative business entities, chiefly the Delaware limited liability company and statutory trust, are the capital markets' SPEs of choice for traditional structured financing transactions. In fact, the Delaware statutory trust has been used repeatedly as an SPE in a number of XXX securitizations. Insurers and other decision-makers are finding that many of the reasons for using a Delaware statutory trust or limited liability company as the SPE in a standard asset-backed securitization are equally applicable in a XXX or other insurance-based securitization. Chief among these reasons are contractual flexibility, predictability and certainty.

#### ***Contractual flexibility, transactional certainty***

The Delaware Statutory Trust Act and the Delaware Limited Liability Company Act are enabling statutes that provide parties with considerable latitude in drafting their governing agreement and furnish default provisions when that agreement is silent. This discretion extends to virtually all meaningful issues relating to the entity or its constituents—formation, ownership, management, finance, operations, and termination. In addition, the stated policy of each statute is to "give maximum effect to the principle of freedom of contract and to the enforceability" of the governing agreement. This policy has enabled participants in a broad range of sophisticated financings to utilize a Delaware statutory trust or a Delaware limited liability company as their SPE and structure it in a way that maximizes the success of their transaction. The widespread use of Delaware SPEs in asset securitizations means that rating agencies and capital markets participants have repeatedly demonstrated confidence in these business entities and in the expertise, experience and responsiveness of Delaware's lawmakers, courts, government officials, bankers, lawyers and other professionals. Delaware's alternative business entities are yet another example of Delaware's ongoing leadership in helping businesses take advantage of today's market opportunities.