

THE ANGUS FIRM, PLC CAPTIVE INSURANCE REPORT 2012 – VOL. 1

INTRODUCTION

The captive insurance industry continues to be a dynamic industry. This edition of The Angus Firm, PLC Captive Insurance Report summarizes the Vermont legislative and regulatory changes that occurred during 2012. Where appropriate, we have also highlighted the federal initiatives impacting captives.

VERMONT GUBERNATORIAL RACE

2012 is an election year for the Vermont Governor. Incumbent Governor Peter Shumlin remains the frontrunner in this year's race. Regardless of whether or not Governor Shumlin wins reelection, we are confident that the person serving as the governor of Vermont will continue to support the industry. Although it is a politically appointed position, we do not anticipate any changes to the office of the Deputy Commissioner of Captive Insurance.

THE DEPARTMENT REBRANDS ITSELF

In an effort to account for how health care will be regulated in the future, and to more accurately reflect the services provided by the Vermont Department of Banking, Insurance, Securities & Health Care Administration, the Department has rebranded itself the Department of Financial Regulation (the "DFR"). This change will not impact the regulation of captive insurance companies by Deputy Commissioner of Captive Insurance Dave Provost and his team.

NEW CAPTIVES LICENSES

Vermont continues to build on its past success with respect to Vermont captive formations. During the first quarter of 2012, Vermont issued eight new captive licenses, putting this year on pace to meet the 41 captives licensed in 2011. This is the strongest first quarter growth since 2005 and the sixth time that captive formations surpassed the 40 new captives licensed benchmark. The breakdown of the types of companies formed is as follows: 30 single parent captives, six risk retention groups, three sponsored captives, one industrial insured, and one association captive.

VERMONT LEGISLATION - 2012

As has been the case for many years, Vermont has updated its captive legislation to address the needs of the industry. The amendments this year were minor in nature and included the following:

- Mutual companies and nonprofit corporations with one or more members are now permitted to incorporate into a protected cell.
- Captives may utilize a trust to satisfy Vermont's minimum capital and surplus requirements.
- Association captives acting as reinsurance companies are no longer required to report in the Yellow Book due to the fact that they are fronted.
- Vermont risk retention groups are permitted to reinsure with Vermont-sponsored captives in addition to foreign or alien cell programs.

In addition to the amendments to the Vermont Captive statutes, the following regulations have been proposed:

- **Annual Financial Reporting Regulation For Risk Retention Groups Chartered In Vermont.** Regulation C-2012-1 is designed to establish guidelines for annual financial reporting for risk retention groups chartered in Vermont. This regulation provides guidance for the risk retention group and its auditor when preparing and filing the annual audited financial statements of the group. For qualifying groups, the regulation also requires the establishment of an audit committee and prescribes certain actions and duties of the committee. The DFR developed this regulation in cooperation with the NAIC.
- **Risk Retention Group Holding Company Systems.** The purpose of Regulation C-2012-2 is to establish reporting requirements for risk retention groups chartered in Vermont that are members of a holding company system. This regulation identifies risk retention groups that may be part of a holding company system and sets annual registration and reporting requirements. The underlying purpose of holding company regulation is to assist the regulator in assessing the solvency of both the members of the group and the group taken as a whole. The regulation was developed in cooperation with the NAIC. The DFR developed this regulation in cooperation with the NAIC.
- **Captive Insurance Financial Regulation.** It is proposed to amend and restate Regulation 81-2 to establish guidelines for credit for reinsurance for risk retention groups chartered in Vermont. This regulation provides guidance for the risk retention group when placing reinsurance outside the traditional bounds. The guidelines were developed in cooperation with a NAIC working group as part of the response to the 2005 GAO report on risk retention groups. The proposal also incorporates editorial and ministerial changes to the existing regulation, bringing it up to date with current actuarial and auditing practices.

The Vermont Captive Insurance Association (the "VCIA") submitted comments for each of these proposed regulations during the comment period, which expired on May 7, 2012.

FEDERAL UPDATE

Activity on the Federal level continues to be of interest to the Vermont captive industry.

- **Liability Risk Retention Act Amendments.** The Risk Retention Modernization Act of 2011 (HR 2126) was introduced in the House, but it is not expected to pass. This amendment to the Liability Risk Retention Act of 1986 would accomplish the following: (i) expand permitted lines of business that risk retention groups can write to include commercial property insurance; (ii) establish corporate governance and financial responsibility standards for risk retention groups; and (iii) establish a dispute resolution framework to resolve nondomiciliary state preemptions with respect to the regulation of risk retention groups.
- **Reinsurance Taxation.** Commonly referred to as the “Neal Bill,” Representative Richard Neal and Senator Robert Menendez introduced in their respective houses legislation which would deny domestic insurance companies the ability to deduct premiums paid to their foreign affiliated reinsurers. These companion bills have been referred to committee and no further action is expected to be taken. The risk remains, however, that these bills will be revived to fund budget off-sets.
- **The Nonadmitted and Reinsurance Reform Act of 2010 (the “NRRA”).** In July of 2010, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the NRRA came into effect. Many questions surrounded the impact and application of the NRRA to captives. The VCIA has posted on its website a white paper entitled “The Nonadmitted and Reinsurance Reform Act of 2010 and Its Potential Application to Captive Insurance,” which analyzes this issue in detail. The paper can be found at www.vcia.com. Since this issue has not been definitively resolved, discussion continues regarding whether or not legislation should be introduced to amend the NRRA to clarify that it does not apply to captive insurance companies.
- **GAO Report – Risk Retention Groups: Clarifications Could Facilitate States’ Implementation of the Liability Risk Retention Act.** The U.S. Government Accountability Office (the “GAO”) recently released a report on the implementation of the Liability Risk Retention Act of 1986 (the “LRRRA”). The Report noted different interpretations of the LRRRA have led to varying state regulatory practices and requirements in nondomiciliary states. These differences have led to litigation and have resulted in courts applying the LRRRA in an inconsistent manner. To address this issue, the GAO recommended Congress clarify certain LRRRA provisions regarding registration requirements, fees, and coverage.

THE ANGUS FIRM, PLC CAPTIVE INSURANCE SERVICES

The Angus Firm, PLC will provide high quality service to meet the needs of your captive or risk retention group. Attorney David Angus will work with your captive managers, auditors,

actuaries, and corporate personnel to reach the desired result. David Angus is experienced in the many legal facets facing captives and risk retention groups, including:

- Formations
- Vermont Compliance
- Corporate Governance
- Fronting Arrangements
- Deductible Reimbursement Policies
- Reinsurance Negotiations
- Redomestications
- Mergers
- Dissolutions
- Tax-Exempt Status Filings
- Risk Transfer and Risk Distribution Analysis
- Pure Captives
- Risk Retention Groups
- Reciprocals
- Sponsored Captives

Additionally, David Angus is active with the Vermont Captive Insurance Association. Since 2007, he has served on the VCIA's legislative committee helping to assess federal and state regulation and issues impacting the VCIA's membership and develop policy recommendations to present to the VCIA Board of Directors. In the past, he has also served on the VCIA's annual conference planning committee, a high-profile industry meeting drawing captive insurance owners and service providers from across the country for educational seminars and networking opportunities. David Angus was selected for recognition in *Chambers USA 2012: America's Leading Lawyers for Business* for his work with captive insurance companies based on the organization's in-depth interviews with clients and peers. David Angus was first recognized by this organization in 2011.

CONTACT THE ANGUS FIRM, PLC

Please contact David Angus at (802) 399-2260 to discuss how The Angus Firm, PLC may assist you with your captive insurance needs or visit us on the web at www.angusfirm.com.