

## THE ANGUS FIRM, PLC CAPTIVE INSURANCE REPORT 2013 – VOL. 1

### INTRODUCTION

Vermont continues to lead in the captive insurance industry. This edition of The Angus Firm, PLC Captive Insurance Report summarizes the Vermont legislative and regulatory changes that occurred during 2013. Where appropriate, we have also highlighted the federal initiatives impacting captives.

### VERMONT DEPARTMENT OF FINANCIAL REGULATION – NEW COMMISSIONER

Vermont Governor Peter Shumlin appointed Deputy Commissioner of Insurance Susan L. Donegan to the position of Commissioner of the Vermont Department of Financial Regulation (the “Department”). She has taken over for Commissioner Stephen W. Kimbell who announced his retirement last November. Commissioner Donegan has broad experience and will be an asset to the Department. She holds a law degree from Vermont Law School, an LL.M. (a master’s degree) in Banking and Financial Services Law from Boston University School of Law and an LL.M. degree in European Union and International Trade Law from Amsterdam Law School at Universiteit van Amsterdam.

### VERMONT LEGISLATION - 2013

The Vermont Captive Insurance Association (“VCIA”) continued to actively pursue the needs of its members by submitting legislative proposals for the 2013 Vermont General Assembly to consider. These proposals, which were signed into law on May 13, 2013, included the following:

- **Sponsored Captives / Incorporated Cells**

Several years ago, Vermont authorized the incorporation of protected cells within a sponsored captive insurance company. Prior to this statutory change, the cells within a sponsored captive maintained their separation by contract. Although members of the captive insurance community were confident that regulatory bodies would respect this separation from the core capital and other cells in the event of insolvency, the industry sought greater certainty in the separation of the cells. Programs that have explored the use of incorporated cells have determined that additional clarification is required with respect to governance, the authority of an incorporated cell to enter into separate agreements or contracts, and the continued role of the sponsor. These areas were addressed by the 2013 legislation.

- **Assessability Threshold for Reciprocals**

Vermont's captive insurance statute has been amended to remove the minimum contingent assessment liability requirement formerly required of reciprocal insurers. Historically, reciprocals were required to issue assessable policies in an amount not less than one nor more than ten times the premium or premium deposit stated in the policy. This minimum assessment provision has been updated to reflect that captives and risk retention groups organized as reciprocals are held to the same capitalization standards as any other form of captive insurer. As such, the amount of an assessment is now governed by the subscribers' agreement for payment of actual losses and expenses incurred while the subscriber's policy was in force. Reciprocals are still permitted to seek Department authorization to issue nonassessable policies.

- **Separate Accounts for Captives**

With the Commissioner's prior approval, captive insurance companies may now establish separate accounts within the company similar to cells in sponsored captive insurance companies. This ability to create separate accounts should enable a captive to segregate risks that impact some, but not all, of its insureds without requiring the company to reorganize as a sponsored captive.

- **Branch Captive Insurance Companies**

The types of coverages that branch captives may insure has been expanded from employee benefits of its parent and affiliated companies to now include all of the coverages that may be insured by other captive insurance companies. Additionally, branch captives are now required to appoint a Vermont resident as its principal representative. This principal representative is the link between the branch captive, the parent company, and the Vermont regulators.

- **Special Purpose Financial Captives**

Special purpose financial captives are now authorized to be consolidated with other captives under common ownership and control for purposes of calculating premium tax due. Additionally, special purpose financial captive are now referred to as special purpose financial insurers.

## 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 last legislative session of Congress, but it failed to pass. Although this bill has not been reintroduced, the risk retention group industry continues to seek amendments to the Liability Risk Retention Act of 1986 to expand the lines of business that risk retention groups can write and to establish a dispute resolution

framework to resolve nondomiciliary state preemptions with respect to the regulation of risk retention groups.

- **Reinsurance Taxation.** The Obama Administration’s FY 2014 Budget contains a proposal which would deny domestic insurance companies the ability to deduct certain premiums paid to their foreign affiliated reinsurers. This proposal is similar to the legislation that was introduced by Representative Richard Neal and Senator Robert Menendez in the last legislative session of Congress, commonly referred to as the “Neal Bill.” On April 10, 2013, the Coalition of Competitive Insurance Rates<sup>1</sup> submitted a letter to Chairmen Dave Camp and Max Baucus and Ranking Members Sander Levin and Orrin Hatch opposing the proposal. Variations of this proposal have been introduced in the past and have not gained much traction. The concern, however, is that at some point the proposal will be used to fund budget off-sets. The captive industry will, therefore, continue to voice its opposition to the inclusion of such provisions in budgets.
- **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. Questions regarding the NRRA’s application to the captive insurance industry persist despite statements from one of the co-authors of the NRRA that it was never intended to apply to captive insurance. In an effort to resolve this issue, the VCIA has spearheaded the formation of the Coalition for Captive Insurance Clarity (“CCIC”) to advocate for clarification on whether the NRRA was intended to apply to captive insurance. CCIC has pushed for the introduction of clarifying legislation, but it has yet to be introduced. Even so, CCIC’s position has been supported by a letter from outgoing U.S. House Subcommittee Chair, Judy Biggert (R-IL) to the new Chairman and Ranking Member of the Committee on Financial Services, stating that the NRRA “was intended to create certainty in the tax treatment and regulation of the surplus lines and in the reinsurance industry. Despite this very specific purpose, a couple of states are misinterpreting the application of NRRA’s definition of Nonadmitted [insurance].” Further, on January 6, 2013, U.S. Congressman Scott Garret (R-NJ) addressed the Speaker of the U.S. House of Representative stating that “unfortunately, several states have indicated that they plan to interpret the NRRA to also apply to the captive insurance industry. This was not the intent of Congress. In drafting this legislation, it was never contemplated to have the captive industry fall under the NRRA.”
- **Risk Retention Group Victory in the Ninth Circuit.** On April 8, 2013, the Ninth Circuit Court of Appeals affirmed a District Court ruling in favor of a risk retention group. The State of Nevada had ordered the Alliance of Non-Profits for Insurance Risk Retention Group (“ANI”) to cease writing “first dollar” auto liability insurance in Nevada because it was not an “authorized insurer” under Nevada law. Only insurers who possess a “certificate of authority” are authorized to transact business in the state. ANI filed for injunctive relief against the Commissioner and Division of Insurance. The District Court

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<sup>1</sup> The coalition contains a number of reinsurance carriers and trade associations. The VCIA, the National Risk Retention Association, and the Captive Insurance Companies Association are among the members of the coalition.

ruled on summary judgment that the Liability Risk Retention Act (the “LRRA”) preempted Nevada’s statutes and regulations in so far as they prohibit ANI from issuing first dollar automobile liability insurance policies in Nevada. The District Court also awarded attorneys’ fees. The appeals court affirmed the declaratory and injunctive relief, but vacated the award of attorneys’ fees. The Circuit Court stated that the “LRRA broadly preempts ‘any State order to the extent that such order would make unlawful, or regulate, directly or indirectly, the operation of an RRG.’” It is expected that ANI will seek attorneys’ fees on remand under a different theory.

- **Extension of TRIA.** The Terrorism Risk Insurance Act (“TRIA”) is set to expire on December 31, 2014. Originally enacted in 2002, TRIA has been extended twice, most recently in 2007. A third extension, however, is far from certain. Currently, there are three TRIA extension bills that have been introduced in the House of Representatives: (i) Terrorism Risk Insurance Program Reauthorization Act of 2013; (ii) Fostering Resilience to Terrorism Act of 2013; (iii) TRIA Reauthorization Act of 2013. The first two bills would extend TRIA by ten years, while the third bill would extend the program for just five years. Unlike the other two bills, which would extend TRIA without making substantive changes to the program, the Fostering Resilience to Terrorism Act of 2013 designates the U.S. Department of Homeland Security as the lead agency for the certification process instead of the Treasury Department. Despite the introduction of these bills, we do not expect that any serious consideration for extending TRIA will occur in 2013 due to the current political climate.

## THE ANGUS FIRM, PLC CAPTIVE INSURANCE SERVICES

The Angus Firm, PLC provides high quality service to meet the needs of your captive or risk retention group. Attorney David Angus works with your captive managers, auditors, actuaries, and corporate personnel to reach the desired result. David is experienced in the many legal facets facing captives and risk retention groups, including:

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

Additionally, David 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 to develop policy recommendations to present to

the VCIA Board of Directors. David is currently the Vice-Chair of the legislative committee. 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 was selected for recognition in *Chambers USA 2013: America's Leading Lawyers for Business* for his work with captive insurance companies based on *Chamber's* in-depth interviews with clients and peers. He has been continuously recognized by this organization since 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](http://www.angusfirm.com).