BERMUDA 2014

From the publishers of

CAPTIVE REVIEW

REPUTATION
Why Bermuda maintains its position as a leading captive domicile

REGULATION
How the island is meeting international regulatory standards

INNOVATION
Bermuda's captive sector continues to innovate its offerings


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A world-class leader

With a captive insurance sector that's been around for over 50 years and a reputation as an offshore industry pioneer, Bermuda remains a leader in the global captive space. Historically a world-class financial services centre, the island remains the world's largest captive domicile by total number of captives, despite competition from an increasing array of onshore and offshore competitors.

2013 saw the issuance of 91 new insurance licences, of which roughly 25% were for captives, and 2014 is already proving to be a successful year after Bermuda became the first offshore jurisdiction to be granted 'conditional qualified jurisdiction' status by the National Association of Insurance Commissioners (NAIC) in January.

But what is it about Bermuda that ensures its status in the industry? For starters, the island boasts robust regulatory and transparency standards under the Bermuda Monetary Authority (BMA), having successfully sought equivalency to Solvency II. And ease of raising capital, innovative risk solutions, quick incorporation times, no corporate income tax and close ties with the UK and US are just some of the other reasons for the jurisdiction's continued appeal.

As well as maintaining its status as the first choice offshore domicile for captives around the world, Bermuda is also a major force in the rapidly growing cat bond and ILS markets.

Captive Review caught up with a range of captive specialists to find out more and provide an inside view on Bermuda's captive insurance industry in the *Bermuda Report 2014*.

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QUALITY SUPERVISION FOR BERMUDA

Embedding an effective, globally recognised framework

As Bermuda's independent, integrated financial services regulator, the Bermuda Monetary Authority (the Authority or the BMA) plays a pivotal role in maintaining Bermuda's leading reputation as one of the world's premier, international financial centres.

Established under the Bermuda Monetary Authority Act 1969, the Authority supervises, regulates and inspects financial institutions operating in or from within the jurisdiction. We also issue Bermuda's national currency; manage exchange control transactions; assist other authorities in Bermuda with the detection and prevention of financial crime; and advise the Bermuda Government and public bodies on banking and other financial and monetary matters.

The Authority develops risk-based financial regulations that we apply to the supervision of Bermuda's insurance companies, banks, trust companies, investment businesses, investment funds, fund administrators and money service businesses. We also regulate the Bermuda Stock Exchange.

Over time, Bermuda's international business sector has evolved to comprise increasingly sophisticated firms conducting significant volumes of cross-border transactions. According to the latest published figures, Bermuda's financial services industry today consists of a banking sector with total assets of $24.1bn, an investment funds sector with an aggregate net asset value of $187.9bn, and an insurance sector that writes $107.6bn in gross premiums and with total assets of $452.2bn.

Written by
Shelby Weldon

Shelby Weldon, director of licensing and authorisation at the BMA, is responsible for the day-to-day management of the licensing and authorisation team and reports directly to the CEO. The BMA is the financial services agency in Bermuda responsible for the regulation and supervision of banks, trust, investment and insurance companies.

As Bermuda's financial services industry has developed, so too has the Authority's own regulatory framework. For the Authority, this has meant fostering an appropriate regulatory environment with pragmatic regulations that remain workable for our market while also keeping pace with ever-evolving international standards.

Bermuda's effective and practical regulatory environment, our unique access to one of the world's largest reinsurance markets, and a deep and experienced talent pool of captive insurance expertise with a global reputation for innovation and excellence, are just three of the reasons Bermuda remained a domicile of choice for new captives in 2013.

Insurer registrations on the increase

Bermuda registered 91 new insurance companies in 2013 – an over 70% year-on-year increase from the 53 registrations recorded in 2012 and double the number of new captives formed in that year.

The new firms covered both the traditional and fast-growing alternative risk transfer sectors of the insurance market. Achieving this level of business in today's competitive environment reinforces Bermuda's unique ability to service the full spectrum of high-end, global (re)insurance business. It also demonstrates the continued adaptability of Bermuda as a jurisdiction as the market seeks diversification in risk transfer, with alternative products increasingly complementing traditional reinsurance programmes.

New companies registered in 2013 covered all classes of insurer: there were 24 new captives, 16 commercial insurers and a record 51 SPIs. This compares to 12 new captives, 14 commercial insurers and 27 SPIs recorded the previous year.

Several of the 2013 registrations were comprised of significant firms in the traditional reinsurance space, and included a Class 4 reinsurer. We also saw additional core business in the form of two dozen new captives entering the Bermuda market.

Excitingly, a substantial portion (29.1%) of these new captives originated from the Latin American region. We believe that this is a direct result of efforts by our jurisdiction to attract new captives from Latin America. The majority (33.3%) of new captives registering in 2013 hailed from the US.

Bermuda had a total of 831 captives at the end of 2013. This is a substantial number, but just looking at the bare number doesn't tell the whole story. To give it con-

text, you have to look at the volume of business behind it. At the latest count, Bermuda's captive sector wrote $20.3bn in gross premiums, reported total assets of $85.3bn and had capital and surplus of $42.1bn – so clearly, Bermuda has quality captives, writing quality business.

Bermuda's regulatory environment is a definite draw for new captives, however, the Authority is continuously seeking to develop its supervisory toolkit to ensure Bermuda's insurers are being supervised appropriately.

Enhancing our supervisory regime for captives

Moving forward in 2014, the Authority will continue to embed progressive framework enhancements throughout Bermuda's insurance regimes at a pace that is practicable for the firms operating here.

In order to refine the content and process of filing requirements for Bermuda's captive insurers, in 2013 the Authority engaged the industry to participate in an enhanced reporting trial run for limited purpose insurers.

The electronic filing (e-filing) trial run – which concluded on 31 January 2014 – was a success. We received a great deal of constructive feedback which will be considered for incorporation in the final e-filing models that will be used to send the enhanced content back to the Authority. As such, in February we notified all Class 1, Class 2, Class 3, Class A, Class B and dual licence insurers that the Authority had deferred implementation of the enhanced reporting requirement until the 2014 year-end.

In the interim, we will be making further revisions to the e-filing models based on the feedback we received during the trial run and market consultation in respect of the resulting amendments to the Insurance Returns and Solvency Amendment Regulations 1980. The final e-filing models will be published on our website in advance of the 2014 year-end filing deadline.

In addition, based on feedback received from the trial run, we notified the industry that Special Purpose Insurers (SPIs) will not be required to file under the enhanced reporting requirements for limited purpose insurers. We will consult with relevant stakeholders regarding the future filing requirements for SPIs in due course.

International engagement

As we continue to engage on the international front, we will leverage our expanded in-house macroprudential surveillance and policy resources to ensure we proactively identify and monitor regulatory risks and trends, both in Bermuda and overseas. This work, while valuable for supporting our own supervisory efforts, will also inform jurisdictional initiatives with other authorities in Bermuda, including the Bermuda Government.

The Authority has maintained a high level of international co-operation while independently developing regulation for Bermuda which works for the firms which operate here.

Our international interaction, advocacy and supervisory co-operation activities will be primarily focused on the US and UK/Europe. Specifics will include active participation in key committees of international standard setting bodies.

In the US, we will continue to work with the National Association of Insurance Commissioners (NAIC) to complete Bermuda's 'conditional qualified jurisdiction' status. Bermuda's new NAIC status became effective on 1 January 2014 and means that reinsurers licensed and domiciled in Bermuda will be eligible to be certified for reduced reinsurance collateral requirements under the NAIC's Credit for Reinsurance Model Law.

In Europe, we continue our ongoing dialogue with the European Insurance and Occupational Pensions Authority (EIOPA) in relation to Europe's Solvency II Directive. As stated previously, EIOPA's equivalence assessment of Bermuda for Solvency II compliance found our regulatory framework for commercial (re)insurers to be largely equivalent with the Directive. EIOPA's subsequent confirmation that they have the ability to grant 'bifurcated' equivalence also still stands. This means Bermuda's regime for captives can remain out of scope for final equivalence confirmation. Given the nature of our market, this places Bermuda in an ideal position.

Furthermore, the Authority has confirmed that it will not apply any Solvency II-type regime to Bermuda captives. However, we remain committed to the regulatory equivalency process in relation to Solvency II for our commercial insurance sector and are well advanced with our regulatory change programme.

The Authority's unique value proposition

The Authority's approach is based on three constants: a targeted and proportionate approach to regulation; a continued focus on enhanced service levels; as well as effective, open communication and accessibility.

The output of these constants is the Authority's unique value proposition: stability – a stable financial environment where financial services can flourish; predictability – certainty about the Authority's philosophy; reputation – global recognition that Bermudian firms are regulated to an internationally recognised standard; reasonable costs – efficient and effective supervision at a cost proportionate to risk; adaptability – regulations that can be quickly adapted to changes in the local or global financial environment; and pragmatism – knowing what matters for the Bermuda market and delivering it.

ESTABLISHING A CAPTIVE IN BERMUDA

IS THIS STILL AN ATTRACTIVE PROPOSITION?

Angela Taylor of KPMG tells *Captive Review* why companies should domicile their captives in Bermuda

Bermuda has historically benefited from its reputation as a world-class financial services centre, and it has been considered among the top choices of locations for companies who are looking to establish a captive insurance company. The country is home to a vast amount of human capital, those of whom possess the knowledge and immense experience necessary to effectively service those insurance companies choosing to make Bermuda their home. In addition, the ability to form new companies quickly, the relative ease of raising necessary capital, and new innovative risk solutions have made Bermuda one of the three leading insurance markets, along with the United States and Europe.

The existing infrastructure and regulatory framework in Bermuda are robust and yet flexible enough to make the entrance of a new insurance captive relatively pain free. But with an ever-changing economic environment and the ongoing regulatory and legal activities of other jurisdictions who are aiming to gain further captive market share, does the country of Bermuda remain relevant and attractive to the captive insurance market? The answer remains unequivocally yes.

Written by
Angela Taylor

Angela Taylor is a senior manager in KPMG's insurance practice. She has more than 16 years' experience in Canada, the US, Barbados and Bermuda, providing audit services to a wide variety of (re) insurers including SEC registrants, large non-public entities and captive insurance entities.

Advantages

There are many key advantages for companies who wish to domicile a captive insurance company in Bermuda, among which include quick incorporation times, no corporate income tax and a lower level of regulatory oversight than what exists in the US and Europe. Aside from these regulations and taxation advantages, Bermuda is a politically stable country and enjoys a low debt burden. Bermuda also has a high sovereign financial rating and a stable monetary system. The Bermuda Monetary Authority administers the financial regulatory system for the country, and their work serves to reduce systemic risk, act as a deterrent to fraud and facilitate consumer protection.

> "Bermuda boasts a highly educated and experienced workforce and it has one of the highest ratios of gross domestic product per capita in the world"

Furthermore, Bermuda boasts a highly educated and experienced workforce and it has one of the highest ratios of gross domestic product per capita in the world. The US is very accessible to Bermuda. In addition, Bermuda has close ties to the UK, which is considered to be one of the world's most important insurance markets.

Bermuda's captive insurers are now covering many different lines of insurance, including life insurance and annuities. It has been one of the leading domiciles in the world for captive insurance companies for years and is now second only to the US, which has been experiencing a reduction of its regulatory restrictions around captive formation.

Bermuda is the headquarters for a number of subsidiaries of global reinsurance and insurance companies, such as AIG, Swiss Re, Zurich and Chubb. It continues to be a leader in developing innovative solutions to risk financing problems. Overall, Bermuda is a stable place to incorporate and to operate a captive insurance company, not to mention a fabulous place to live and work.

Regulatory framework

With the ongoing implementation of Solvency II, Bermuda has continued to work with European regulators to ensure that the Bermuda regulatory framework is as robust as possible and that it adheres to current best practices. The Bermuda Monetary Authority continues to

embed progressive framework enhancements at a pace that is appropriate for the firms that operate in Bermuda. Even when Solvency II implementation experienced delays in Europe, Bermuda kept its foot firmly on the gas with respect to implementing new framework initiatives.

The Bermuda Monetary Authority continues to monitor developments in relation to Europe's Solvency II Directive. EIOPA's equivalence assessment of Bermuda in relation to Solvency II found the Bermuda regulatory framework for commercial insurers to be largely equivalent with the Directive. In addition, and more importantly to captive owners, Bermuda's regime for captive insurance companies remains outside of scope for final equivalence confirmation, which translates into lower capital and reporting requirements, and places Bermuda in an ideal position given the nature of the captive market.

In 2013, the Bermuda Monetary Authority was a participant in an expedited assessment for the National Association of Insurance Commissioners' Qualified Jurisdiction process. This process, which had been developed to evaluate the reinsurance supervisory systems of non-US jurisdictions for reinsurance, collateral-reduction purposes, resulted in Bermuda being one of only four jurisdictions to be granted the qualified jurisdiction status at the end of 2013.

Innovation

A great example of Bermuda's continued innovation in the insurance industry can be seen in its involvement in the cat bond and ILS markets, which have been growing and increasing in popularity in recent years. As these alternative risk transfer vehicles become more widely understood by market participants, they are gaining in esteem, and Bermuda has been one of the major players with respect to newly written deals in this space.

While most captives continue to be used for more traditional lines of insurance, there has been a trend recently for captive owners to place non-traditional coverages into the captive as well. Some of the non-traditional lines of business that are gaining momentum in Bermuda have been cyber liability, medical stop-loss, financial and professional coverages.

> "While in Bermuda on business, you can visit your banking and investment managers, account managers, auditors, legal advisers and reinsurers, all in the span of a single day"

New countries are beginning to develop an interest in Bermuda as a jurisdiction of choice. For example, there continues to be growing appeal from Latin American companies who are deciding to form their captives in Bermuda. Many Latin American countries have passed tax or regulatory legislation, the impact of which has been to make the formation of a captive less difficult for Latin American companies. The concept of captives is rising in these countries, and Bermuda has been responsive and well placed to understand the needs and facilitate with the formation of captives from these new markets.

Location and access to the reinsurance market

As mentioned previously, Bermuda's geographical location is ideal as it is a short flight away from major insurance centres, including New York and London. While in Bermuda on business, you can visit your banking and investment managers, account managers, auditors, legal advisers and reinsurers, all in the span of a single day. There are very few jurisdictions in the world that can claim the same fact pattern.

Another one of the key benefits to domiciling a captive insurance company in Bermuda is the easy access to the reinsurance market. This allows a company to access both the Bermuda and the global reinsurance markets, where the available capacity for a particular type of risk, the pricing and various policy terms can often be more favourable than if a company were to attempt to obtain coverage in the direct market.

Domicile of choice

Bermuda has always been, and continues to be, a relevant and appealing place to form a captive insurance company. All insurance industry players in Bermuda continue to work diligently to ensure that it remains the domicile of choice for many more years to come.


Every captive banking relationship cultivated with care.

PULLING IN THE SAME DIRECTION

Tony Bibbings of Artex Risk Solutions describes why Bermuda remains an important captive insurance domicile and how the industry should work together to keep it that way

When the worldwide financial crisis hit in 2008, it looked like Bermuda might survive relatively unscathed. However, as it turns out, the crisis has lasted longer than expected and Bermuda has started to feel the effects.

In recent decades, when others in the world were suffering financially, Bermuda was protected. Bermuda was given a financial boost in the mid to late 1980s when the casualty crisis caused the formation of ACE and XL, and the ongoing interest in captives (*see chart for insurance company formations, page 13*). The savings and loan crisis of 1989 started a US recession. By 1991, when the US opened operation Desert Storm, those Americans that still had jobs stopped international vacation travel. Bermuda's economy, led by tourism and captives, flagged and there were signs the economy was starting to weaken. Then Hurricane Andrew tore apart Homestead Florida on 24 August 1992 and six new property catastrophe companies started operations in Bermuda with attendant cash and employment infusion, not to mention the residential rent increase. The property cat companies were mostly purchased by bigger companies over the course of the 1990s and our economy started to reflect the natural decline.

Written by
Tony Bibbings

Tony Bibbings, country manager for Artex Risk Solutions in Bermuda, has been working in the captive industry since 1987 as a captive manager, broker and underwriter. A chartered accountant from Canada, Tony is also one of the volunteers to work on the captive focus group for BBDC.

By 2001, there was another recession which was in full swing by 9/11, which, of course, set off the largest and quickest insurance company growth in our history.

"9/11 is not only the biggest insured catastrophe ever; it is the most complex," says Gordon Stewart, president of the Insurance Information Institute. The institute estimate of $40.2bn in insured losses includes $11bn in claims for business interruption, $10bn in liability claims, $9.5bn in claims for damage to property, $3.5bn for aviation liability, $2.7bn in life insurance claims and $2bn for workers' compensation claims.

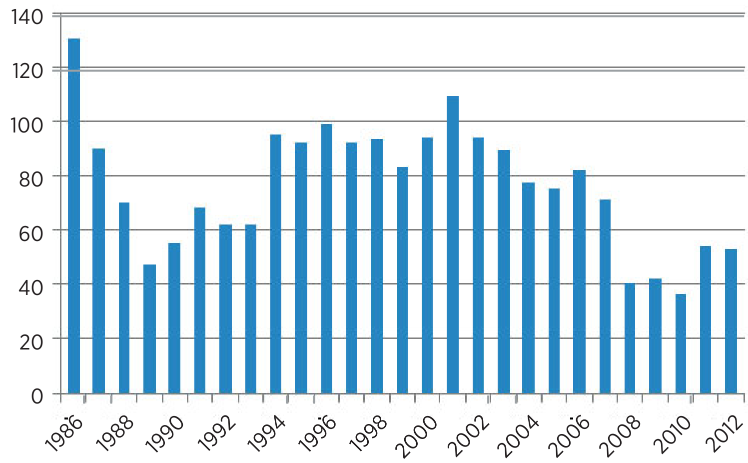
The insurance industry's response to the uncertainty introduced by the size and complexity of this unforeseen event, as well as the erosion of $40bn of surplus in one day, was to increase premiums and reduce cover. More money moved into new and existing insurance companies in Bermuda than had ever happened and, once again, Bermuda's economy was rapidly growing while the US contracted.

The impact of the new demand for services and housing had barely settled when Hurricane Katrina in 2005 resulted in yet more capital, new companies and new employees to the island (note on the company formation chart there was not a spike in number of new insurance companies, but there was a huge spike in capital unique to property cat firms).

Since then, not even the poor investment markets, Australian floods, Hurricane Sandy or faulty accelerators on Toyotas have been enough to turn the market and increase premiums or reduce capacity. As a result, what Bermuda is left with is an outstanding infrastructure but receding demand for our products and services.

These industry events are reflected on the below chart of insurance company incorporations in Bermuda from 1986 through 2012. 1986 shows a boost in the number of captives after the casualty crisis of 1985, 1992 took a couple of years to manifest new captives into 1994 and 2001 shows the most incorporations since 1986. Of course, an increase in the number of commercial insurance companies due to increased premiums, also leads to an increased interest in captives to avoid paying those increased premiums into the commercial market.

DATA | ANNUAL INSURANCE COMPANY INCORPORATIONS IN BERMUDA 1986-2012



The response

Our response is to get all industries pulling in the same direction to keep our business here and to bring in even more.

Until recently, the Insurance Development Council (IDC), supported by industry associations and government funding, has been spearheading our efforts to make Bermuda the domicile of choice for new insurance incorporations through attending industry events, producing newsletters, promotional material, etc. Another government sponsored agency, Business Bermuda, took a slightly different tack to promote Bermuda as a desirable business destination for a broader group of industries. Effective 1 April 2013, these two agencies combined to form the Bermuda Business Development Corporation (BBDC), which advanced the interests of all of the financial services industry. The mandate of BBDC is first to maintain existing jobs within Bermuda, and then get more business here to further job creation.

The BBDC solicited extensive industry input in 2012, which contributed to its mandate and agenda in a big way. There are 10 industry segments that will contribute to the efforts of the BBDC by participating in focus groups dedicated to promoting their segment of industry abroad.

The industries are as follows:

- Accounting
- Asset management & fund administration
- Banking
- Brokers
- Captives & insurance managers (inc. ILS)
- Insurance
- Lawyers
- Reinsurance
- Service providers to financial services (e.g. internet service providers)
- Trusts

What jumps out from this impressive list is the breadth of services available to captives and other companies doing business in Bermuda. Each of these is a mature industry in Bermuda, operating in a competitive environment and serviced by multiple capable professional companies.

To add some scope to this initiative, there are 30 people currently invited to participate in the captive focus group alone. With 10 focus groups, there is a lot of intellectual capital invested in this. In addition, the search is on for a full time chief executive who will use the body of ideas and business development initiatives produced by the groups to determine actions to be taken. A board of directors with 12 people on it, with diverse backgrounds, will keep driving the process. Of particular note, there is a government representative on the board, which should result in better communication and co-ordination between the two constituencies.

On the captive front in particular, there is reason for optimism:

- The headwinds presented by low commercial premiums for so many years has started to reverse. A recent comment issued by Moody's Investor Service stated: "Rate increases continue across all business lines; for rated companies, net premiums written (NPW) increased 5% in 2012 as a result of cumulative rate increases and exposure growth." When premiums increase, the interest in captives increases, especially from those companies that feel their loss results are better than the industry.
- The clarification of several tax positions the IRS has taken in the US is making it easier to design risk management programmes in captives that do not attract more tax than expected.
- New countries are opening up interest in captives. Many Latin American countries have recently passed tax or regulatory legislation making starting captives easier. A few others are considering it.
- Group captives are making it easier for companies below the Fortune 500 to join others and participate in captives.

In summary, Bermuda is well positioned to take advantage of its superior infrastructure built up over decades. We have rallied all of the various stakeholders to contribute to its promotion and, more than ever before, we are willing to put aside our own self-interest to work together, with the expectation that a rising tide floats all boats. That's why this article isn't just about Artex Risk.

GROWING STRONGER

Andy Baron of Butterfield discusses what we can expect in terms of economic growth for 2014

2013 was a relatively sluggish year in a global economic recovery that has been ongoing since the end of the debilitating "great recession" in 2009. According to the International Monetary Fund (IMF), global GDP is estimated to have grown at roughly 3%, or slightly less, for the year, with the G-7 economies producing a paltry 1.4% growth. Countries that make up the eurozone contracted for the second year running, as a whole, with large important economies like Spain and Italy still contributing heavily to the contraction there.

Despite fears that growth in China might slow, the world's second largest economy managed to produce growth above 7.5% for the second year running and the third largest, Japan, grew more strongly than it has for several years (although only 1.4%). The US, the largest economy in the world, produced a growth rate slightly below 2% for the year; a disappointing figure and crucially, weak enough for the US Federal Reserve to categorise growth at different times as either only "modest" or "moderate". In fact, the average growth rate for all of the other recovery periods from US recessions since 1950, prior to the current recovery, was approximately 4%, while the current recovery has only produced average growth of 2.3%. Consumer spending, government spending and residential investment in the US have all materially underperformed post-war historical recoveries.

Written by
Andrew M. Baron

Andrew M. Baron, CFA, is head of group fixed income at Butterfield Asset Management. He joined Butterfield in September 2006 and is responsible for the portfolio management of the Butterfield US$ Bond Fund and many large discretionary fixed income portfolios, predominantly for captive insurers. He is also head of the Fixed Income Council for Butterfield across the Group Asset Management platform, responsible for producing macroeconomic and interest rate forecasts for the US, UK and eurozone.

While 2014 started somewhat slowly, particularly in the US, forecasts for global GDP are centred in the 3.4% to 3.8% area; a much better outcome than last year and a rate that more closely resembles the world's "trend" growth rate. The outlook is for growth to be supported, to a large extent, by the strengthening of developed markets, advanced economies rather than stronger growth in less developed countries. We see two pillars of support for that argument: better growth in the US and the eurozone emerging from recession.

> **"Despite fears that growth in China might slow, the world's second largest economy managed to produce growth above 7.5% for the second year running and the third largest, Japan, grew more strongly than it has for several years"**

The first supporting pillar for stronger growth in 2014 is our forecast for better growth in the US. We expect growth in the US to be over 2.5% and approaching 3% in 2014, which is in-line with the consensus forecasts of many observers including most private economists, the IMF and the US Federal Reserve. US consumer spending is poised to return to levels more associated with periods of "normal" recovery. After the painful recession, US consumers spent a period of five years actively reducing their use of credit of all kinds, the first time net reductions (or deleveraging) has occurred in post war history. Household debt as a percentage of GDP has improved and is now slightly over 75%, after peaking at nearer 100%, while debt as a percentage of household assets (essentially the consumer's balance sheet) is near its historical average of 15%, a reduction from its peak of nearly 20% of assets. Stock market gains and house price rebounds over the last several years have certainly contributed to this marked improvement in household balance sheets and coupled with a better job market and a bit of confidence, consumers have now begun to increase their use of credit. We feel this recent increase in credit usage is one of the most important indicators of health in the US economy. Prior to the second half of 2013, although banks had been indicating that credit was widely available, there had been little actual net demand for consumer credit; the fact that this phenomenon appears to have run its course is a significant cause for optimism.

US non-residential investment, or "Capex" in corporate parlance, should also increase more substantially in 2014 than last year when it grew at its slowest pace in three years. Our better view for capital expenditures in the US is premised on the fact that there is significant pent-up demand to replace a rapidly ageing stock of fixed assets both in the private sector and government. For example, a 2013 report by the American Society of Civil Engineers, which rated America's infrastructure overall as "poor", estimated that nearly $300bn is needed over the next 20 years to replace and update wastewater systems, that being only one of an exhaustive list of costly deficiencies. Indeed, the average age of private fixed assets, which includes structures and equipment, is 22 years, the highest since 1958! We also believe an abnormally high degree of policy uncertainty has recently existed (sequestration, government shutdown, increased regulation, debt ceiling debate) and most of the uncertainty has now been, if not resolved, at least significantly lessened, allowing for firms to increase their budgets for capital projects and growth.

Lastly, but certainly still of great importance to the forecast for better US growth, is the outlook for government spending. By most measures from private economists and the Congressional Budget Office (CBO), growth in the US in 2013 was reduced by government "fiscal drag" by nearly 1.5% in GDP terms. Said another way, if fiscal consolidation through spending reductions and tax increases combined at the Federal level had not existed, it is estimated that the economy would have grown at a rate closer to 3.5%, rather than 2%. 2013 was also the most restrictive year, from a government perspective, of a string of years that has reduced growth by an average of nearly 0.5% per year over the course of the five years of this recovery. Based on the current budget, the same kind of fiscal headwind will not exist in 2014, therefore boosting ours and most forecasters' estimates for US growth.

The second supporting pillar for better global growth in 2014 is better growth in Europe, both in the eurozone and in the UK. The eurozone is poised to grow for the first year since 2011, albeit at a pace one would not exactly call rapid. The IMF estimates that eurozone GDP will grow at a 1% pace, not dissimilar to the European Central Bank's own forecast of 1.2% growth. It is safe to say that even if those projections are optimistic, the eurozone is likely to be a net contributor of growth to global GDP, rather than a net drag as it has the past two years. It is highly likely that the nature of the growth in the eurozone could be uneven and sporadic and there is significant scope for continued recession in the hardest hit countries; the so-called "periphery" of Europe that includes Greece, Portugal, Ireland and Spain. However, one of the similarities that exists between the more positive growth picture in the US and that of the eurozone is the reversal of fiscal austerity. It is estimated that fiscal austerity will be substantially reduced in the Netherlands, Greece, Italy and Spain and reduced slightly in Germany, France and Portugal. A great deal of deflationary adjustment to the high cost of labour has also occurred within the periphery countries, allowing them to become more competitive versus the likes of their larger neighbours like Germany and France. Much structural adjustment still has to be completed, both within national budgets, as total debt levels are still high, and also through adjustment of the structural stability of the pan-European banking system, but progress is slowly being made. In the UK, growth expectations have been on the rise for some time and the Bank of England projects GDP at 3.4% for 2014. While we and most private economists believe that figure is optimistic, growth in the mid-to-high 2% area is not out of the realm of possibility. Strong UK growth, through trade with the eurozone, has the ability to help drive improvements in the eurozone situation itself, something that has not been a significant contribution in the last few years of below-trend growth and trade.

"If fiscal consolidation through spending reductions and tax increases combined at the Federal level had not existed, it is estimated that the economy would have grown at a rate closer to 3.5%, rather than 2%"

Overall and in conclusion, although we wouldn't be among the most "bullish" forecasters for growth in 2014, we are constructive. We are, in fact, more optimistic for 2014 growth than we have been in several years; years marked by continued pressure from corporate and household deleveraging as well as a decided lack of confidence across the board. Financial markets appear to have rediscovered their storied animal instincts over the last few years and we finally feel like the real economy, in the US particularly, is beginning to grow sustainably stronger.

ONE OF A KIND

Tim Faries of Appleby tells *Captive Review* what makes Bermuda an attractive location for captives and how it meets the industry's standards

Bermuda's reputation as a captive domicile is well-known and respected, having been involved in the industry for over 50 years. The reasons why the island makes for such a successful and attractive jurisdiction are endless. *Captive Review* caught up with Tim Faries to find out why and how Bermuda has become such a success.

Written by
Tim Faries

Tim Faries is a partner and Bermuda group head, corporate and commercial at Appleby. He is also the sector leader for insurance & reinsurance and leads a team of lawyers who specialise in all manner of non-contentious corporate insurance work, including life and general insurance and reinsurance, mutual insurance and structured risk financing. Tim was recently recognised in *Captive Review*'s 2013 Power 50 list.

Captive Review (CR): **How have recent regulations affected managers' decisions to domicile in Bermuda?**

Tim Faries (TF): There are two recent regulatory developments globally that we think will make Bermuda a more attractive domicile for captive owners. First, in January 2014, Bermuda became the first offshore jurisdiction to be granted 'conditional qualified jurisdiction' status by the National Association of Insurance Commissioners (NAIC). The second is the recent tax blacklist promulgated by Colombia which included a number of Bermuda's competitive jurisdictions, but not Bermuda itself. This is a very favourable development which we expect to allow the already plentiful numbers of captives being formed here from Colombia to continue growing in the coming months and years.

CR: **What are some of the benefits of choosing an offshore jurisdiction such as Bermuda?**

TF: We are the largest and have the strongest reputation as a captive domicile and with that comes strength in infrastructure. We have custom legislation and regulations which were designed for captives when they were initially drafted in the late 1970s. They have been refined and modified since and obviously expanded to include the burgeoning reinsurance market and other insurance markets that have developed in Bermuda since the dawn of the captive era.

A second benefit is that we are the only captive domicile that comes with essentially a robust reinsurance market. We have a one-stop shop approach that you cannot get in any other domicile because they just do not have the reinsurance market that we have here. We have intelligent reinsurers who really understand the captive owner's needs and a choice in the market here that captive owners will not get anywhere else.

A third benefit is the innovation which has been a hallmark of the industry since the early days. The captive concept was arguably born here in the 1960s and that spirit of innova-

> **"We have a one-stop shop approach that you cannot get in any other domicile because they just do not have the reinsurance market that we have here"**

tion and creativity when it comes to finding risk solutions for organisations has remained throughout the five decades since. For example, segregated accounts, which have proliferated throughout the captive industry, were generated in Bermuda in the 1980s.

Fourth, the regulatory environment at present is responsive, proactive and well-regarded globally. It is well-known that Bermuda is seeking Solvency II equivalency for its commercial reinsurance market and has approached it in a way that respects and safeguards the specific interests of captive owners so that they are not unduly burdened by unnecessary regulations. The idea of bifurcated equivalency is one which appears to have been met with favour by the European regulators so we have the best of both worlds in that the captives will have appropriate levels of oversight, supervision and regulation for them and the commercial class will have the enhanced regulation that is in keeping with international standards.

Lastly, we are a tax-efficient jurisdiction, which has some benefits and uses in certain circumstances as well.

CR: How is Bermuda responding to the global push for transparency?

TF: We are a small jurisdiction but we take every opportunity we can with whatever platform we are given to ensure that we have a profile in the international community on issues that matter to us, and transparency is one of those issues. If you look back at the history of Bermuda as an international business domicile, things that are in vogue today in the world of transparency such as know-your-client (KYC), were concepts that we introduced even before it was fashionable to do so. We are leaders in tax transparency and co-chair in a working group within the Financial Action Task Force. The Department of State in the US has classed Bermuda in its lowest risk category for money laundering due to our very robust anti-money laundering regime. We have had all those things in place right from the beginning because we wanted Bermuda to be viewed as a jurisdiction of quality not quantity, which has helped us as the world has moved into this ethos of compliance and transparency.

CR: In what ways does Bermuda provide a robust yet accessible regulatory framework?

TF: It is important in the world of financial regulation, in particular insurance and reinsurance, that regulators are seen to be robust and proactive. What differentiates us from other jurisdictions is the market's accessibility to the regulators and their sensitivity to the needs of the marketplace. We customised our legislation in the Insurance Act 1978 for captive business, and it became a model for other jurisdictions to emulate. To my knowledge, Bermuda is the only domicile to have a regulatory regime which appropriately differentiates the captive insurance and reinsurance regulation from the commercial third-party reinsurance regulation. Over the last several months, as we have been gearing up for an enhanced return for captive classes, a key objective of the regulators was to ensure that it was met with the approval of the industry and was not considered to be an unnecessary burden. It went through an extensive period of consultation to allow the industry to give feedback on the enhanced return regime before it goes live.

CR: How do Appleby's services and solutions benefit captives in Bermuda?

TF: Our captive client base, products and services are very important to us, particularly to our Bermuda practice. On the legal side, we have 12 insurance lawyers which is numerically the largest group focused on the insurance industry and captives are far and above the largest subset within our insurance practice in terms of the types of clients that we provide services for. We provide licensing and regulatory establishment services and advice to guide them through the process and working with the captive manager in the formulation of their business. With prospective clients we help them with their choice of domicile, then once the captive is established we help with things like financing letters of credit, contract issues, potential changes to the business plan and segregated account structures. If there are disputes with captives and other parties such as fronting insurers, we have a strong litigation practice which would respond to that, and we also assist on occasions where captives are being bought and sold. Finally, at the end of the captive's useful life we assist in the dissolution of the entity and closing down the licence. So we provide a cradle to the grave service on the legal side.

Second, we have a service company called Appleby Services (Bermuda) Ltd, which provides corporate administration, directors, secretarial and resident representative services to its clients. Insurance companies, captives in particular, represent a significant proportion of our client base. We work collaboratively with captive managers in providing the administration needs of their captives throughout their lives, including liaising with the regulators, convening the necessary board and shareholder meetings, dealing with banking issues and the general registered office type services that companies and captives need on a regular basis throughout the year.

Lastly, Appleby Management (Bermuda) Ltd is a licensed captive manager which provides some captive management services through that entity and also other financial and accounting services for captives.

> **"We are a small jurisdiction but we take every opportunity we can with whatever platform we are given to ensure that we have a profile in the international community on issues that matter to us, and transparency is one of those issues"**

CR: What are your predictions for the jurisdiction over the next year?

TF: I am really excited about 2014. The recent regulations and changes in the US stand us in good stead to see a decent number of new licences emerge. 2013 was a very good year for the jurisdiction; we had 91 new insurance licences issued, which is not a record but is certainly higher than what we have seen in any year since the financial crisis in 2008. Of those 91, roughly 25% were captives. I'm expecting to see more activity from what would be viewed as non-traditional markets from Latin America and we have got a little bit of interest in Asia that we are hoping to see come to fruition as well. So, as the captive concept spreads globally into new emerging regions, Bermuda, given its 50+ year history as a leading captive domicile, its depth of resources and infrastructure, its reinsurance resources, and its accessible regulatory regime, stands in very good stead to continue to have a leading position in the captive industry in the future.

ONE-STOP SHOP – BUNDLING FINANCIAL SERVICES

Michael Brace of Capital G discusses what new captive insurance companies need to know when first setting up

A new captive insurance company faces many choices. Once the feasibility phase is complete, the owner must choose an appropriate domicile and a qualified captive manager in that domicile to provide management, accounting and administrative services. This manager will also most likely guide the process of choosing financial service provider(s) for the captive. This choice may be one of the more complicated ones as there are a variety of financial services that may be needed, often not immediately but somewhere in the lifecycle of the captive.

While this decision tree represents the normal sequence of events logistically, it behooves the captive owner to consider the financial services component during the planning phase rather than wait until the other decisions have been made. As the preliminary decision on domicile will have an impact on other aspects of managing and operating a captive, it should not be made without factoring in the availability and quality of the other services available in the domicile including the captive manager, bank/custodian, asset manager and reinsurance.

Written by
Michael Brace

Michael Brace joined Capital G Bank Limited in July 2011, bringing with him over 17 years of experience in the financial services industry. Prior to joining Capital G, he spent more than seven years at a private bank, trust and investment house in the United States. Michael earned the CFA (Chartered Financial Analyst) designation in 1998.

Further, the regulatory structure in any given domicile may allow more or less flexibility with respect to permitted investments and potential restrictions on surplus capital. Initial capital requirements, minimum solvency requirements and restrictions on investments could potentially cost more in the long run than the operating costs in any given domicile, even if only in the sense of investment opportunity cost.

> "As the preliminary decision on domicile will have an impact on other aspects of managing and operating a captive, it should not be made without factoring in the availability and quality of the other services available in the domicile"

The choice of domicile alone can seem daunting. The first major decision is whether to incorporate in an onshore or offshore jurisdiction. Depending on the domicile of the parent, offshore may be the only choice. In North America, parent companies currently have options available onshore in the various states in the US or provinces in Canada. That said, Canada may be curtailing the ability of Canadian parent companies running captives. That, however, is another article in itself!

Of course, the regulatory environment, tax implication and capital requirements will likely all play into the choice of domicile. A sometimes overlooked detail in choosing domicile is the availability of service providers, the quality thereof and the potential benefits of having access to all the necessary services in one location. This includes the captive manager, the banks, investment managers and reinsurance providers that may provide services necessary to run a successful captive.

This raises the question for captive owners with respect to choosing financial service providers. Most strong domiciles have local providers though some captives may rather choose a larger global bank though it may not have a presence in the domicile. Regardless, the regulatory structure in the domicile will potentially impact the investment management programme with respect to permitted investments and restrictions on surplus if they exist.

One option is to hire a full service bank to handle the business banking accounts, custody, collateral and investment management under "one roof". The alternative is to shop some, or all, of those services separately to customise them for the specific needs of the captive. Many third party investment managers are capable of providing investment solutions within the constraints of collateral requirements whether or not they are also the custodian of the asset.

The choice of a custodian bank is equally important, especially if letters of credit are involved. Not all custodians are equal. Pricing on the letter of credit can vary quite widely between banks. Custody and investment fees also vary so the captive must consider the all in cost of the full suite of services necessary. Sometimes it is possible to find better pricing using separate service providers though often bringing the whole financial relationship to one institution can result in favourable "package" pricing. This is certainly something that deserves due consideration as even the small costs can add up to something more significant over time.

Collateral considerations may significantly impact the investment options. Some banks have more lenient advance rates on collateral which can make a difference to the long term success of the investment portfolio. It can certainly pay to shop around as more flexible investment mandates can lead to better risk adjusted returns over time.

Depending upon the complexity of the investment portfolio, it may be worthwhile to consider third party asset managers that are not affiliated with the custodian bank. This provides the ability to seek out a specialist asset manager to suit the particular needs of the captive rather than simply adopting the in-house investment manager provided by the custodian. There are certainly pros and cons to this approach.

The disjointed nature of the relationship may create problems with respect to collateral as advance rates can be impacted or the third party manager may not fully consider those constraints. Communication between the asset manager and custodian must be established and must operate smoothly. If this is indeed not the case there may be significant "headaches" to come. This is especially noticeable during the annual audit if there are any information discrepancies between the two parties. As such, accurate and co-ordinated reporting is paramount.

If a captive is choosing an independent investment manager, it will be imperative that the manager not only understand the collateral constraints but is willing to actively manage around those to maximise risk/return within the construct of acceptable advance rates. Excellent returns are beneficial, however, if the strategy does not work in conjunction with the collateral constraints it may become problematic.

"Whether financial services are bundled under one roof or parsed out to a number of providers, the decisions made today may impact the variety of options available tomorrow"

Beyond collateral issues, the regulatory structure of the domicile will impose minimum capital requirements and may place restrictions on permitted investments. Additionally, there may be further restrictions on the use of surplus. This brings us back to the choice of domicile and how that may impact decisions in other areas of operating the captive.

The financial services questions should not be an afterthought but rather an integral component in the decision process even in the early stages. The choice of domicile can impact investment, custody and collateral decisions. It is important to consider these factors during the start-up phase to avoid unintended consequences later. Whether financial services are bundled under one roof or parsed out to a number of providers, the decisions made today may impact the variety of options available tomorrow. The captive owner should always be cognisant of the totality of the operation and bear in mind that the parts all need to fit together seamlessly over time.

BERMUDA: ADAPTING TO CHANGE

Terence Power and Grainne Richmond speak to *Captive Review* about the healthcare captive industry in Bermuda

Clients at Dyna Management Services Ltd., include a broad spectrum, from single parent captives to large group and association captives, as well as commercial reinsurance clients. Total premium volume of clients under management as it relates to captive entities exceeds $300m, while total assets for that client grouping exceeds $2.3bn.

President of Dyna Management Services Ltd., Terence Power, has more than 35 years of experience in reinsurance and captive management in Bermuda and has worked with a number of his healthcare clients for the majority of the 35 years. Grainne Richmond, vice president of Dyna, has worked in accounting and insurance since 1996 and has extensive experience on a wide range of international clients with unique and complex ownership and programme structures.

In this article Mr Power and Ms Richmond address some questions posed by *Captive Review* on the healthcare captive industry and Bermuda.

Captive Review (CR): Firstly, most people talk about Cayman as the leading domicile for healthcare captives – is this true?

In our view, without comparable statistics being available from all domiciles and an agreed upon industry metric for measurement it is difficult to say if this statement is true or not. What we do know is that historically Cayman was perceived as the more popular domicile for the healthcare industry.

That being said Bermuda has always had a significant position in this market segment which continues to grow. Based on Dyna's own client base and experience we know that

Written by
Terence J. Power

Terence Power has over 35 years of experience and expertise in insurance and captive management. He held the position of executive vice president and independent consultant with International Advisory Services Ltd., from 1981 to 2010. In November 2010 he determined to re-establish Dyna Management Services Ltd. as a full service Independent Management Company.

Written by
Grainne Richmond

Grainne Richmond, joined Dyna in May 2011 having previously worked in Bermuda in the area of captive insurance management and fund administration for International Advisory Services Ltd. and Artex Risk Solutions (Bermuda) Ltd. between 2002 and 2011.

Bermuda has a large number of healthcare captives. These entities integrate as one of the core elements in the risk financing and risk management functions for some of the largest healthcare institutions in the US. One of Dyna's clients in this market segment has been based in Bermuda for over 30 years while others have been established here for over 20 years. All of these entities and their stakeholders are continuing to look at ways to maximise the benefits associated with their captives and efficiently manage their capital to support their continuing growth. Bermuda and its regulatory environment offers a very favourable domicile in catering to fulfilling those goals.

CR: In Dyna's experience have the US hospital programmes used just one domicile or a multiple of domiciles?

Each programme will have its own unique needs, and each domicile may, in particular circumstances, have its own unique attractions over the other for prospective captive entities. At Dyna, we work with single parent and group captive structures in Bermuda, Cayman and Barbados. We also see clients that have protected cell companies domiciled in Bermuda and in the US, as well as risk retention structures. Generally, most programmes that utilise the RRG structure will have a related group captive established in Bermuda or another domicile outside the US. In most instances the Bermuda entity has been the vehicle which has been used to gain access to the commercial reinsurance markets, the majority of whom are represented in Bermuda. We often find our clients arranging their captive board meetings in Bermuda and also visiting with the reinsurance markets at the same time. The ability to do so is certainly one advantageous aspect of Bermuda as a domicile.

CR: How have feasibility studies helped determine captive structures from Dyna's point of view?

In considering the establishment of any captive, the feasibility study is a key component to help ensure that all stakeholders, including the board and trustees at the parent entity, are making the most informed decision, and are fully versed with the risk profile as well as the benefits that may result from their decision. All feasibility studies will address many common areas, such as those associated with the proposed lines of business, actuarial consid-

erations, insurance structure and retentions, reinsurance support, capital funding, investment guidelines etc., but it should always also address the following:

- Domicile review
- Rationale for establishment of the entity
- Cost/benefit analysis
- Other qualitative benefits that may accompany the establishment of the entity
- Mission statement
- Corporate governance

The answers to a number of these questions posed in the study will provide guidance as to the optimal structure and domicile that best suits the individual needs of the group and the programme.

In our view the 'feasibility study' process should not stop once the captive is established. It is important to continuously challenge the continuing operations, and to look to new opportunities that may arise as the landscape and risk profile of the parent entity or group evolves. Over the past few years we have seen our clients undertake continuing feasibility reviews to study the cost/benefit of adding additional coverage lines as dislocations occur in the commercial market, or where their operations highlight emerging areas of exposure that might benefit from a captive solution.

CR: How have you seen the role of the captive change in recent years?

One of the biggest changes we have seen is the changing role of the captive from merely being the funding source for claims payments, to being the vehicle that is the focus for leading recommendations of initiatives associated with best practice, quality of care, and patient safety at the owner institutions.

The change has been one of maturing from being an entity that largely reported historic events and loss trends, to becoming a vehicle that is at the forefront of the focus in improving standards and quality of care and reducing the occurrence of future adverse outcomes.

CR: What risks does cyber present for hospitals? How have you seen your clients respond to some of these risks?

Over the last couple of years we have seen a heightened awareness among our clients of the potential liability and negative impacts from information breaches, and unauthorised access to private information and data, both electronic and paper records.

> **"The risks in the healthcare setting are obviously not merely confined to the potential loss of financial and personal related data gathered and maintained as it pertains to patients"**

The continuing introduction of new technology in areas such as electronic medical records, and a number of high profile instances of data breaches have helped to draw attention in this area. In addition the changing landscape in the healthcare environment that results in more satellite locations, increased digital communications, and the integration of physician practice groups increases the challenges of maintaining data security and integrity.

The risks in the healthcare setting are obviously not merely confined to the potential loss of financial and personal related data gathered and maintained as it pertains to patients. The potential unauthorised release of, or illegal access to, patient health information can be equally devastating to the individual whose data has been compromised. In these circumstances the added risk, at both the institutional or patient level, of possible extortion by those who may have accessed such information illegally cannot be overlooked.

Many of the commercial markets who are active in this line of coverage provide extensive added value services such as assistance and resources to their clients including assistance with systems and controls reviews, and enhancing protocols designed to minimise the potential for internal breaches. Many of our clients have taken advantage of these resources. In addition at the client institutional level we have seen the increasing use of biometric security being applied to further reduce the potential for internal data breaches.

BERMUDA: THE GUIDE

KPMG's guide to Bermuda's insurance regulations provides all the answers to establishing a captive on the island

Bermuda continues to be the premier domicile for the captive sector with over 25% of the global market. This guide provides summary information on the Bermuda insurance market, the regulatory system, incorporation process and annual filing requirements.

Bermuda's progressive regulatory system is risk-based with a supervisory process, which involves a high degree of co-operation between insurance company and regulator. Regulation is conducted under a multi-licence system, whereby every insurer must obtain a certain class of licence dependent on its size and the lines of business it will write. The objective of the class system is to provide proportionate regulation reflective of the nature and complexity of the insurance company. This proportionate approach has allowed the regulation of Bermuda's captive insurance companies to be largely unaffected by the Bermuda Monetary Authority's (BMA) development of its regulatory framework for commercial insurers.

Insurance legislation and regulation

The insurance legislation in Bermuda is comprised of a series of Acts of Parliament addressing company formation and solvency, prudential standards, and filing requirements, which together combine to form the regulations. At the core of this legislation is "The Insurance Act 1978 (as amended)" which applies to general and non-life insurance companies and "The Life Insurance Act 1978" that applies to long-term insurance companies. The respective life and property casualty regulations apply to all persons carrying on insurance business in or from Bermuda.

Recent international developments in regulation and growth in the Bermuda market have resulted in the BMA enhancing its regulatory regime to protect both public interest and the reputation of Bermuda as an insurance centre. The BMA has adopted a risk-based approach to regulation, incorporating the revised International Association of Insurance Supervisors (IAIS) core principles, allowing for greater oversight of companies with riskier profiles. Regulation now comprises a risk-based capital measure and a transparent financial reporting requirement for companies with significant third-party exposures and a 'Code of Conduct' setting out governance and risk management principles for all insurance companies licensed by the BMA.

Multi-licence system

The Bermuda multi-licence system creates distinct categories for all companies writing general and non-life insurance. Non-life operations are divided into six classes (1, 2, 3, 3A, 3B, 4) depending on the type of business written and the relationship between owners and policyholders. Insurers and captives insuring or reinsuring life, annuity and long-term accident and health insurance must obtain a long-term licence. Long-term licences are also divided into five classes (A,B,C,D,E) reflecting the different size and complexity of life insurers in the jurisdiction.

The BMA designed and implemented Special Purpose Insurer (SPI) legislation to facilitate, among other things, the convergence of the capital and insurance markets.

The insurance regulations set minimum levels of statutory capital and minimum solvency margins depending on the class of the insurer and the type of business that the insurer undertakes.

While the BMA framework has undergone significant change for the commercial sector over the past few years, it should be noted that there is no intent to change capital requirements for captives (classes 1, 2 or 3 for non-life and A or B for life) which remain a function of either premium or technical reserves, as described below.

Non-life insurers

• Class 1

Applies to single parent captive insurance companies owned by one or more affiliates of a group and underwriting only the risks of the owners of the insurance company and affiliates of the owners.

Class 1 insurers must maintain a minimum capital and a surplus that is the greater of: (a) \$120,000, (b) 20% of the first \$6m of net premiums written (NPW) plus 10% of the excess of \$6m of NPW, or (c) 10% of loss reserves.

• Class 2

For multi-owner captives; defined as insurance companies owned by two or more unrelated persons, provided the captive underwrites only the risks of the owners and their affiliates and/or risks related to, or arising out of, the business or operations of the owners and affiliates.

A Class 2 licence also applies to single parent and multi-owner captives writing no more than 20% of unrelated risks.

Class 2 insurers must maintain minimum capital and a surplus that is the greater of: (a) $250,000, (b) 20% of the first $6m of NPW plus 10% of the excess of $6m of NPW, or (c) 10% of loss reserves.

• Class 3

In 2008, the BMA reassessed the scope of this group, in line with its risk-based approach to regulation and reclassified the firms within this category to include two additional classes: Class 3A and Class 3B.

Class 3 – any company that does not qualify as Class 1, Class 2, Class 3A, Class 3B, Class 4 or SPI. Class 3 insurers must maintain a minimum capital and surplus that is the greater of: (a) $1,000,000, (b) 20% of the first $6m of NPW plus 15% of the excess of $6m of NPW, or (c) 15% of loss reserves.

Class 3A – commercial insurers whose percentage of unrelated business exceeds or is expected to exceed 50% of net premiums written and/or net loss and loss expense provisions; and where the unrelated business net premiums do not exceed or are not projected to exceed $50m. Class 3A insurers are required to maintain a minimum capital and surplus that is the greater of (a) Enhanced Capital Requirement ("ECR"), (b) $1,000,000, (c) 20% of the first $6m of NPW plus 15% of the excess of $6m of NPW, or (d) 15% of loss reserves. A 20% loading is applied to the outcome to attain a Target Capital Level ("TCL"), this serves as an early-warning level at which may trigger additional reporting requirements or other enhanced requirements.

To calculate the ECR the Class 3A insurer uses the Bermuda Solvency and Capital Requirement – Small and Medium Capital Requirements (BSCR-SME) method. This involves calculating capital and solvency using a risk-based formula prescribed by the BMA. In addition to the BSCR-SME, Class 3As will also be required to assess the maturity of their risk management framework through the completion of the Commercial Insurance Risk Assessment (CIRA) and perform an own capital self assessment process called the Commercial Insurers Solvency Self Assessment (CISSA). The CIRA framework assesses the quality of the insurer's risk management function surrounding its operational risk exposures. The total scores for each component within the CIRA framework are aggregated to produce the Operational Risk Charge (ORC) percentage.

The relevant ORC percentage is applied to the 'BSCR (After Covariance Adjustment)' subtotal in the BSCR-SME Model, and can range from 1% to 10%.

The BMA recognised that the revised solvency framework was a significant change from the previous framework and thus phased in the capital requirements over a three-year period from 2011 as the requirements became effective. In practice this means that as the new requirements are applied, Class 3A insurers will calculate 50% of the BSCR-SME in the first year, 75% in the second year and 100% in the third year and onwards. Class 3B – commercial insurers whose percentage of unrelated business exceeds or is expected to exceed 50% of net premiums written and/or net loss and loss expense provisions; and where the unrelated business net premiums exceed or are projected to exceed $50m.

• Class 3B

Class 3B insurers are required to maintain a minimum capital and surplus that is the greater of (a) ECR, (b) $1m, (c) 20% of the first $6m of NPW plus 15% of the excess of $6m of NPW, or (d) 15% of loss reserves. A 20% loading is applied to the outcome to attain a Target Capital Level (TCL), which serves as an early-warning level at which additional reporting requirements or other enhanced requirements may be triggered.

To calculate the ECR the Class 3B insurer uses the Bermuda Solvency and Capital Requirement (BSCR) method including completion of the CIRA to produce the ORC. This is generally consistent with the requirements for 3As set out above with the exception that the BSCR is a more comprehensive standard model than the BSCR-SME.

• Class 4

Insurers and reinsurers underwriting direct excess liability insurance and/or property catastrophe reinsurance risks. Class 4 insurers must maintain a minimum capital and surplus that is the greater of (a) ECR, (b) $100m, (c) 50% of NPW (with a maximum deduction for reinsurance of 25% of gross premiums written) and (d) 15% of loss reserves.

Each company holding either a Class 1, 2, 3, 3A, 3B or 4 licence must also meet liquidity ratio requirements.

Long-term

A long-term licence applies to insurers and reinsurers writing life, annuity and long-term health and accident insurance and/or reinsurance contracts that are expected to be in effect for a period of no fewer than five years.

The BMA has proposed the following Minimum Solvency margins (MSM) for Bermuda's Life companies:

Class	Minimum Margin of Solvency
A	Greater of $120,000 or 0.5% of assets*
B	Greater of $250,000 or 1.0% of assets*
C	Greater of $500,000 or 1.5% of assets*
D	Greater of $4m or (2.0% of first $250m of assets* plus 1.5% on excess)
E	Greater of $8m or (2.0% of first $500m of assets* plus 1.5% on excess)

*where assets equal total assets held on the balance sheet for the long-term business fund, less amounts in long-term segregated accounts.

Special Purpose Insurer

In 2008 the BMA introduced the Special Purpose Insurer (SPI) to the insurance class system.

The purpose of the SPI amendment was to enhance the BMA's regulatory framework for the prudent development of side-cars, catastrophe bonds and other similar insurance-linked special purpose

Transactions are given the increasing convergence of the capital and insurance markets. In order for a company to receive consideration for registration as an SPI, it would have to meet the following criteria:

• The insurer is carrying on insurance securitisation or transformer type business; the insurer is established to enter into a single transaction or a single set of transactions; the insurer's obligations are fully-collateralised, and; transactions are carried out with a limited number of sophisticated participants.

The regulatory framework for SPIs is less intrusive, based on the fundamental principle that the SPI is a fully funded vehicle used for a transaction between two (or more) knowledgeable and sophisticated counterparties, each of whom understand the risks associated with the transaction. The SPIs are subject to an expedited regulatory approval process – due to the fully funded nature of the entity, they are only required to have capital of $1. They also benefit from an exemption to file an annual Loss Reserve Specialist opinion and can also apply for relief from filing audited financial statements. Since its implementation, the SPI legislation has been used for numerous securitisations and cat bond issuances. It is a very fast and efficient way to facilitate these types of transactions.

Use of Internal Capital Models (ICM)

The BMA plans to begin accepting ICM applications in Q3 2013. If the ICM is approved by the BMA it may be used by commercial insurers as an alternative to the BSCR in calculating the ECR requirement.

Solvency standards and the group supervision framework

The BMA has established a set of rules to apply its enhanced solvency regime and risk management standards to Bermuda's insurance groups. This includes applying the BSCR, corporate governance requirements and eligible capital rules to groups for which the Authority is appointed Group Wide Supervisor. In addition, supervisory colleges are held between the BMA and other regulators of insurance groups as an important component of group aide supervision.

The Insurance (Group Supervision) Rules 2011 (the Group Rules) establish corporate governance and risk management requirements for insurance groups with an effective date of 1 January 2013. The Rules have been drafted to appropriately reflect the regulatory requirements for insurance groups based on the nature, size, scale and complexity of the Bermuda groups for which the Authority serves, or expects to serve as Group Supervisor. They will be expected to demonstrate compliance with the Group Rules through establishing, maintaining and documenting governance systems and processes, with related communications and reporting structures. The groups must also establish and maintain effective key functions (i.e. internal audit, compliance, risk management and actuarial).

"The Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Rules 2011" set out the process for determining the ECR for all such insurance groups, and any other statutory filing requirements related to solvency which they are required to file annually with the Authority. The group ECR requirement will come into effect for 2013 year-end and will be phased in over five years. The group ECR will be calculated either through the use of an internal capital model which has been approved by the BMA or a group BSCR. The BMA has indicated that it will continue to revisit the group BSCR model based on market consultation.

Segregated Account Companies

• Amendment Act 2004

Bermuda companies have for some time had the legal ability to segregate assets and liabilities within the corporate structure by means of a Private Act of Parliament. On 1 November 2000, "The Segregated Accounts Act 2000" came into force and was subsequently amended by the Segregated Accounts Companies Amendment Act 2002 and 2004 – collectively The Segregated Accounts Companies Act (SAC).

These Acts of Parliament provide for any company regulated under the Companies Act 1981 to apply to operate segregated accounts. The effect of this segregation is to protect the assets of one account from the liabilities of other accounts.

The statutory divisions between accounts are not intended to create separate corporate bodies, but rather realise within a single company what would otherwise be achieved by incorporating subsidiaries or by a company creating a floating charge over certain assets in favour of its obligations to clients.

• Incorporation and licensing

The company may take some time to decide to establish a captive. However, once the decision is made, the incorporation process in Bermuda is relatively straightforward and may be accomplished within weeks.

• Service providers

With many of the captive's day-to-day operations being outsourced, a key decision to be made is the selection of service providers. These typically include insurance managers, lawyers, bankers and auditors. Each company must also appoint a principal representative, an approved auditor, and a loss reserve specialist (with the exception of Class 1 companies).

Long-term insurers must also appoint an actuary. The principal representative, the loss reserve specialist, the auditor and the actuary must be approved by the BMA

• Company name and announcement

The first step in the incorporation process is to reserve the intended name of the company with the Registrar of Companies (ROC). The company's legal counsel will advertise, in a Bermuda newspaper, the intention to incorporate the company, stating the name of the company and a summary of its objects.

Application for new incorporation

The next stage in the incorporation and licensing process is to submit the application package to the BMA which will provide copies to its Assessment and Licensing Committee (ALC). The following should be included: pre-incorporation form, ownership details and supporting documents, business plan, application for consent to be registered and memorandum of association.

• Pre-incorporation form

This form provides details of ownership, capitalisation, lines of business, reinsurance arrangements and service providers.

Ownership details and supporting documents

The BMA performs due diligence procedures related to the applicant's intended owners. For a corporate shareholder directly or indirectly owning more than 5% of the Bermuda entity, audited financial statements must be provided as part of the application package. Public company shareholders should provide their most recent audited annual report and Securities and Exchange Commission (SEC) 10K filing.

For each individual shareholder who will own more than 5% of the Bermuda entity, a personal declaration form must be completed.

• Business plan

Notwithstanding the sound business practice of developing and modelling a business plan and financial projections, the written business plan will provide most of the information required on the pre-incorporation form. The business plan provides the ALC with sufficient detail to make an informed decision when considering an application. A comprehensive business plan should expedite the incorporation process.

• Application for consent to be registered and memorandum of association

The applicant will prepare a formal application for consent to be registered and a memorandum of association of a company limited by shares. The memorandum is the charter of the company and is subscribed to by three persons resident in Bermuda, who act as the nominees for the company.

• Submission

The applicant will submit the pre-incorporation form and business plan, together with copies of the application, for consent and the memorandum of association to the BMA for review by the ALC, which meets each week.

• Approvals

Upon approval from the owners, the BMA provides the ROC with its consent, in the form of a "no objection" notice, for the captive to be incorporated as an exempt company with the approved memorandum of association. The ROC then produces a memorandum of association for the new company. Legal counsel submit the approved memorandum of association to the BMA, on receipt of which the supervisor issues a form certifying the deposit of memorandum of association and ROC consent along with a certificate of incorporation.

• Tax exemption

Under Bermuda law, insurance companies are not required to pay taxes in Bermuda on either income or capital gains. They can apply for, and automatically receive, an undertaking from the Bermuda government that states that in the event of income or capital gains taxes being imposed, the company will be exempt from such taxes until the year 2035.

Organisation of the newly incorporated company

The first meeting of the company's provisional directors can be held on the day the approved memorandum of association is filed with the BMA. The provisional directors act until the main board of directors is appointed. They allot the minimum share capital of the company and convene the statutory meeting of shareholders. At the statutory meeting of shareholders, the board is elected, following which the first meeting of directors is held. Additional resolutions passed at the first meeting of the director include approval and adoption of the company's by-laws and appointment of the approved auditors, insurance managers, approved actuary and any other service providers.

Insurance registration

On payment of the capital of the company, two of the captive's directors and its principal representative sign the insurance application (Form 1B) which the applicant submits to the BMA, requesting registration. On its receipt and review, the BMA issues a certificate of registration and the company can then begin writing business.

Enhanced Reporting requirements

The BMA are implementing enhanced reporting requirements for the captive sector, in the form of a risk return, to be filed electronically. The risk return will be a self-assessment that firms conduct on an annual basis, appropriately modified given the limited purpose and lower risk profile of captives. This will ensure firms remain appropriately classified and supervised within the BMA's risk-based framework. As a result of the enhanced requirements, there are no changes to capital or solvency requirements, and the risk returns will not be disclosed publicly. The risk return will include the audited statutory financial statements (as currently required); supplemental unaudited financial data including investment, underwriting, reserving and collateral; a qualitative risk assessment, and a confirmation of compliance with other aspects of the license, including changes to controllers and the ability to continue to operate at current capital levels.

Statutory filing requirements

The Insurance Act 1978 requires every insurer to prepare annual statutory financial statements and a statutory financial return for filing with the BMA (Class 1 insurers only need to file the statutory financial return). The deadline for submission of the statutory financial statements and statutory financial return is six months after the company's financial year-end for Class 1, 2, 3, A and B insurers (up to nine months upon application) and four months after the company's year-end for Class 3A, 3B, 4 and insurers (up to seven months upon application).

Statutory financial statements

The form of these statements is prescribed in the regulations. Included in the statutory financial statements is a statutory balance sheet, income statement, a statement of capital and surplus, and notes to the statutory financial statements. These statements are prepared in accordance with the Act and will therefore be distinct from financial statements prepared under generally accepted accounting principles (GAAP) for presentation to the shareholders. Primary differences are the treatment of certain assets as 'non-admitted' for the purposes of determining statutory capital and surplus. The statutory financial statements and the statutory financial returns are not public documents.

Statutory financial return

The Act requires every insurer to file an audited annual statutory financial return with the BMA. Every general business insurer must file a general business solvency certificate. In addition Class 3, 3A, 3B and 4 companies are required to file an actuarial certification of loss reserves annually. All Class 2 companies need only provide an actuarial certificate for the loss reserves every three years while every long-term insurer must file a long-term business solvency certificate and a certificate from the approved actuary.

• Statutory ratios

The regulations require that the statutory financial return contains three ratios:

- Premium to statutory capital and surplus ratio: the proportion of net premiums written during the year to statutory capital and surplus at the end of that year.

- Five-year operating ratio: calculated as the sum of the loss ratio and the expense ratio less the investment income ratio. Each of these ratios is calculated on a five-year cumulative basis.

- Change in statutory capital and surplus ratio: the proportionate increase or decrease in statutory capital since the end of the previous financial year.

Minimum liquidity margin

A company must also pass a liquidity test. An insurer carrying on general business is required to maintain the value of its 'relevant assets' at no less than 75% of the amount of its 'relevant liabilities'.

Unquoted equities, investments in and advances to affiliates, real estate and collateral loans are not 'relevant' for calculation of the liquidity ratio.

Principal representative and principal office

The Insurance Act 1978 requires every insurer to maintain a principal office in Bermuda. Every insurer must also appoint a principal representative in Bermuda. A principal representative is a corporation or resident in Bermuda who has the ability to represent the company, and has been approved by the BMA.

Government fees

Any insurance company, that is an exempted company, is required to pay an annual government fee based on its assessed capital. For companies with share capital, the assessable capital is the aggregate of its authorised share capital and share premium account. The assessable capital of a mutual company is the amount of the company's reserve fund. Companies are required to provide the ROC with a declaration at the time of payment of the annual government fee. This declaration states the type of business carried out by the company, the amount of its assessable capital and how the assessable capital has been calculated. Companies are also required to pay an annual registration fee that is based upon the class of licence(s) held.

A CENTRE OF EXCELLENCE

Greg Wojciechowski tells *Captive Review* why Bermuda has become such a success in the ILS space and how the Bermuda Stock Exchange has helped to contribute

Bermuda has seen year-on-year growth in the insurance-linked securities (ILS) market, which includes vehicles such as catastrophe bonds, side cars and industry loss warranties. There has also been a deepening interest in these vehicles from investors and issuers, significant growth in the number of vehicles being incorporated in Bermuda and a spike in the listing of ILS structures on the BSX.

The Bermuda Monetary Authority, which regulates financial services on the island, reported that the new registrations of special purpose insurers (SPI) in 2013 rose to 51 – almost double the number registered in 2012. This trend indicates that Bermuda has grown its share of the ILS market and accounts to US$9.2bn or around 41% of the near $21bn of outstanding ILS and catastrophe bond market.

The BSX had another record-breaking year in 2013 with the value of listed ILS vehicles growing 67% during the year, passing the $9bn mark at the end of 2013.

The BSX started 2013 with $5.81bn of listings, increasing that to $7.06bn in May. It rose again to $8.4bn by mid-October, then reached $9.161bn by 19 December before finishing the year at the new high of $9.713bn.

During 2013, 42 new ILS were listed on the Exchange with a capitalisation of $4.617bn. The number of ILS on the Exchange has grown by 103% from 38 at the end of 2012 to 77 at the end of 2013 and less than a month into 2014, two new securities have already been listed.

The world risk capital

Bermuda's longevity and reputation in the insurance and reinsurance markets has

Written by
Greg Wojciechowski

Greg Wojciechowski is president and CEO of the Bermuda Stock Exchange (BSX). Prior to this, he was the Exchange's COO. He was responsible for developing the Exchange's regulatory and operational infrastructure and for its day-to-day operations. He is also chairman of Bermuda's Financial Intelligence Agency.

resulted in it becoming known as 'the world risk capital'. The jurisdiction's regulatory and operating infrastructure is understood and respected globally. For years, Bermuda's insurance market has responded to market needs and trends and through an innovative and proactive approach has been able to adapt to create products and support as the market evolves. There is no better example of this than the work undertaken in Bermuda both commercially and from a regulatory perspective to create a centre of excellence for both ILS and alternative risk transfer (ART).

Realising a developing trend in the evolution of the capital formation process of traditional insurers, Bermuda was quick to respond by implementing a commercially sensible approach to the creation and listing of ILS products. Through a collaborative effort, changes were made to Bermuda's regulatory framework which clarified and commercialised the incorporation process of ILS structures. The BSX did the same by focusing attention on creating a listing regime that met the specific needs of issuers of insurance related securities and their investors while leveraging the BSX exchange platform for trading and operational support.

Bermuda has critical mass and a long-positioned and well-tested infrastructure that underpins the insurance and reinsurance industry. As a result, Bermuda has become the logical home for the formation and development of ILS and ART products. If you like, a cottage industry has developed here around ILS and ART. This cottage industry includes support and expertise in relation to all components of the structure, including the regulator and the investment community.

The Bermuda Monetary Authority, using a risk-based approach to oversight, has been commercially sensible when designing the framework for creation and regulation of these sophisticated vehicles. Other infrastructure service providers, such as fund administrators, lawyers and accounting firms, have

> "The BSX had another record-breaking year in 2013 with the value of listed ILS vehicles growing 67% during the year, passing the $9bn mark at the end of 2013"

honed their support services for the ILS asset class. Longevity in the business, some of the world's largest ILS investors, specialised and well respected support services for the ILS asset class and an internationally recognised stock exchange with a specialisation in the ILS asset class have combined to make Bermuda a centre of excellence for ILS and ART.

The leader of offshore exchanges

The BSX has been in existence since 1971 and is a leader among offshore stock exchanges. As the only offshore exchange that is a full member of the World Federation of Stock Exchanges (since 1999), we have been focused on not only driving the development of Bermuda's domestic capital market, but also placing Bermuda within the global framework of recognised stock exchange platforms.

The BSX has been operating a fully electronic trading, clearing and settlement platform since the late 1990s and actively supports all aspects of stock exchange activity for domestic and international issuers. Our regulatory framework has been designed and operates predicated on accepted international standards which seek to strike the appropriate balance between providing issuers with access to the market while providing investors with certain safeguards and with sufficient and timely information for the purpose of enabling them to make an informed decision as to the value and merits of listed securities.

Our state-of-the-art electronic trading platform, based upon a central limit order book model, provides equal and fair access to all approved and BSX regulated trading members. To ensure operational efficiency, the BSX acts as the central counterparty for transactions executed on the BSX platform.

The BSX launched its NASDAQ OMX's X-stream trading platform in April 2013, providing the Exchange with world-class trading technology and strengthening its commitment to the development of Bermuda's domestic market while underscoring its ability to provide global capital market support in and from Bermuda. NASDAQ OMX technology is used by over 70 marketplaces in 50 countries. Operating with X-stream technology, the BSX is the most powerful trading venue in the Caribbean and offshore markets as defined by performance, latency and throughput.

While other offshore exchanges are talking about implementing the system, we've already implemented it and we've already upgraded to the next generation of more robust trading technologies.

The future

From a product development perspective we see the ILS sector as one with growth potential which continues to drive the convergence of the capital markets and the insurance industry. Bermuda is the intuitive and logical place for convergence to occur. Given the depth of insurance industry expertise and critical mass of key players located here coupled with the growing importance of the BSX, our regulatory framework and global acceptance and reputation, all of the key ingredients are present to make Bermuda the centre of excellence for ILS.

At the BSX, we are joining our insurance colleagues in reaching out to our global clients to ensure that they are aware of our commitment to make Bermuda the centre of excellence in the ILS/ART space and to do our part in the development of the asset class. In this regard, ILS (Bermuda) Ltd. hosted the inaugural 'Convergence 2013', business facilitation and networking event. Convergence 2013 brought together 300 industry leaders from around the globe to Bermuda for a day and half of educational sessions and networking. By all accounts, the event was a great success and was a platform for serious discussions for future transactions.

Bermuda Convergence 2014 will be held again and an announcement in respect of event dates and specifics will be made in the very near future.

With a record number of ILS vehicles listed, the BSX is assisting Bermuda to firmly establish itself as a centre of excellence for the creation, listing and servicing of the ILS asset class. At the Exchange we are looking forward to our work in 2014 in the ILS space and in helping Bermuda become the jurisdiction of choice for the formation and listing of ILS.

The island's longevity in the insurance and reinsurance markets and ILS makes Bermuda an intuitive location: a cottage industry, with critical mass, experience and depth. Bermuda will continue to strive to be a centre of excellence in this space – and the BSX will be there to help.

AN OASIS OF TRANQUILITY

Marina Mello of The Royal Gazette takes a look at the Rosedon, one of the premier hotels in Bermuda, to find out more about why the island is home to more than just captives and service providers

Charming Rosedon is one of the most sought-after business hotels in Bermuda, thanks to exceptional service from the staff, beautiful colonial-style rooms and a lush tropical garden setting.

The 39-room boutique hotel is just steps from Bermuda's high-powered financial centre. But as soon as you walk through the doors of the old English manor home with its hallmark blue shutters, you step into an oasis of tranquility.

Atop a hill opposite the grand Fairmont Hamilton Princess, Rosedon is a place to escape the impersonal touch of a large resort hotel.

For busy executives, it's like a home away from home. Delicious full-course breakfasts are brought each morning to your room, patio, poolside or on the main house front porch.

Written by
Marino Mello

Marino Mello is business editor for The Royal Gazette, has worked as a journalist for 20 years in Bermuda, UK and the US. Prior to this, Marina worked for the Atlanta Business Chronicle, Bloomberg News and CNN.

Traditional English tea is served in the afternoons on the front terrace.

And the general manager, Muriel Richardson hosts a rum swizzle party every Tuesday night. You may even help yourself to Rosedon's well-stocked 'honour-system' bar and pantry.

Most of the hotel's spacious, attractively decorated rooms are set in two-story buildings overlooking Rosedon's lovingly tended gardens and sparkling swimming pool, which is heated during the winter months. There are only three rooms in the historic, antiques-filled main house, dating back to 1906.

Rosedon was, in fact, built as the private home of Mr. E. J. Thompson and named after his son, Robert Rosedon Thompson. The home's designer back then knew what he was doing. The walls were built double with thickness and furred to prevent any dampness seeping through. And the woods were all imported: pine, oak, cherry, mahogany and even California redwood went into the decor, with each room designed to suit a particular wood. The elegant pillars in the entrance hall were specially carved and imported from Chicago.

There was no electricity in those days and Rosedon was the only house in Bermuda to be

“Rosedon enjoys numerous industry recognitions and awards, including the Trip Advisor Travelers’ Choice of 2012, and Conde Nast Johansens Award under longtime general manager Muriel Richardson”

lit by gas, which was piped from a bakery just a few blocks away – considered quite a luxury as other homes were lit by kerosene lamps.

Today, Rosedon’s rooms are all equipped with modern private bathrooms, flat screen televisions, cable TV, iPod docks, air-conditioning, business phones with voicemail, complimentary wireless internet, as well as hair dryers, wall safes, and coffee makers. A wonderful convenience, all rooms have their own mini refrigerators.

The Royal rooms, which are a step up, have whirlpool baths, DVD players, trouser press, in-room snacks, and a thoughtful basket of Bermuda-made gifts for purchase, should you run out of time for shopping.

Rooms are all tastefully decorated with fine European fabrics, hardwood furnishings, including four-poster beds in some rooms, pillow top mattresses, and high quality bed linens and towels. Most rooms have wood floors and all have their own garden-view patios. Other business services offered by the hotel, include a fax machine, daily newspapers, a guest computer in the lobby area, breakfast meetings on the front porch, catered cocktail parties, and same-day laundry service.

The hotel has no restaurant but light meals, including homemade soups, salads, deli-style sandwiches, and picnic lunches are available upon request. There are also many great restaurants well within walking distance of the hotel. However, Rosedon’s breakfast is included in the room rate and served upon request each morning.

Perfect to have a meeting over or recharge after a busy day, afternoon tea is complimentary and served promptly at 4pm on the front verandah, with an assortment of freshly made sandwiches, breads, cakes, and pastries.

Guests also have access to the well-stocked Beau’s Honour Bar in the main house, named after one of the long-serving employees. And for a late night snack or a quick sandwich, Clarabelle’s Pantry is always open, and also on an honour system. Another perk guests love about Rosedon is the complimentary taxi service to one of the island’s famed South Shore pink beaches.

With its prime location, the property is just minutes from Hamilton Harbour, and the souvenir shops, designer boutiques and department stores of Front Street, and it is in the midst of the island’s (re)insurance and business hub.

Many offices of major Bermuda-based international companies are within walking distance of the hotel, as are banks, business services, restaurants, delis and coffee shops. The bus and ferry stops are also close by.

While a preferred business hotel, Rosedon offers many packages year-round including Wedding, Honeymoon, Romance, Spa, Anniversary, Holiday and Golf packages.

Rosedon has a high rate of return guests, who praise the Bermudian warmth and hospitality at this hotel, including complimentary champagne and wine for repeat guests, honeymooners, and anniversary celebrations.

For that, Rosedon enjoys numerous industry recognitions and awards, including the Trip Advisor Travelers’ Choice of 2012, and Conde Nast Johansens Award in recognition of continued standards of excellence under longtime general manager Muriel Richardson. The Travelers’ Choice Award is based on the reviews and opinions of millions of travelers. The hotel is ranked number two out of 29 hotels in Bermuda reviewed on TripAdvisor.com and number one in the city of Hamilton.

VALIDUS V. US: CASCADING EXCISE TAX

Asher Harris of FiscalReps looks at what the rejection of the excise tax theory in the US means for offshore reinsurers

In a major victory for the international reinsurance industry, a Federal District Court in the US rejected the cascading excise tax theory in Validus v. United States. This decision is particularly significant for international groups that include reinsurers located in offshore financial centres such as Bermuda.

The US imposes an excise tax on reinsurance premiums paid to non-US reinsurers at a rate of 1% of the premiums paid. Over the course of the 1990s, the Internal Revenue Service adopted the position that the tax was due whenever a US risk was transferred, even if the transfer was through a retrocession between two non-US entities of a risk previously reinsured out of the US. Even more importantly, it took the position that a retrocession of US risk was subject to the tax even if the original reinsurance transaction had been taxed. This could result in the same underlying insurance risk triggering multiple layers of US federal excise tax. In 2008, the position was formally issued by the IRS in Revenue Ruling 2008-15.

Because many tax treaties include exemptions from insurance excise tax, the impact of the cascading excise tax theory fell disproportionately on groups that included reinsurers domiciled outside the scope of the US tax treaty network, such as in Bermuda. For these, the spectre of the need to comply with complex and uncertain requirements of US tax law loomed as an impediment to insurance transactions that made good business sense.

Written by
Asher Harris

Asher Harris is a US consultant at FiscalReps. Asher conducts a boutique law practice, limited to the practice of tax law. Asher's core practice is in the representation of insurance companies, reinsurers and those forming a captive insurance company.

In Validus, the Federal District Court rejected the arguments put forward by the US Government in support of the cascading excise tax. Although the tax was challenged on several theories, the court concluded that the statute, as written, only applies to reinsurance transactions and was never intended to apply to retrocessions. Despite the fact that the court decision was based on the technical language of the statute, stronger arguments were put forward that emphasised the fundamental unfairness of the tax, its violation of international norms of insurance taxation and its incompatibility with the basic principles of tax policy. The court chose not to address these more abstract issues and reached a decision in favour of Validus on narrower grounds.

> "The impact of the cascading excise tax theory fell disproportionately on groups that included reinsurers domiciled outside the scope of the US tax treaty network, such as in Bermuda"

As of the date of this writing, the US has not yet indicated whether it intends to appeal the decision. If it does appeal, the validity of the cascading excise tax may remain unresolved for an extended period of time. The US Government would be well advised to abandon its right to appeal and acquiesce in the decision of the Federal District Court. The cascading excise tax theory was widely perceived as illogical and unfair and the attempts of the IRS to enforce the tax against non-US reinsurers were arbitrary by their very nature. Like Fatca, the tax was viewed as an exercise of the US taxing authority on an extra-territorial basis and an attempt to strong-arm non-US companies to pay tax to the US. Unlike Fatca, which is at least an attempt to address perceived abuses of the international system, the cascading excise tax simply taxes transactions between non-US businesses.

The IRS' right of appeal means that the court's decision is by no means the final word. But the adverse finding is a clear indication that an impartial judiciary is sceptical of the argument that international reinsurers dealing among themselves were the intended target of the excise tax. The government would be best served by acquiescing in the Validus decision; withdrawing Revenue Ruling 2008-15 and allowing the cascading excise tax doctrine a well-deserved demise.

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The Wells Fargo Insurance Trust is the ideal alternative to LOCs used as collateral for captive, reinsurance, ILS, and corporate deductible programs. It will cost 80%-95% less than LOCs, it will free up your credit lines, and the income generated from your trust accounts belongs to you (the depositor). Wells Fargo's reputation for service and responsiveness is enhanced by its deposit products that generate a better rate of return than other options while not creating "tax events" for non-US entities. Our expert Relationship Managers will take you through the entire process without additional legal costs.