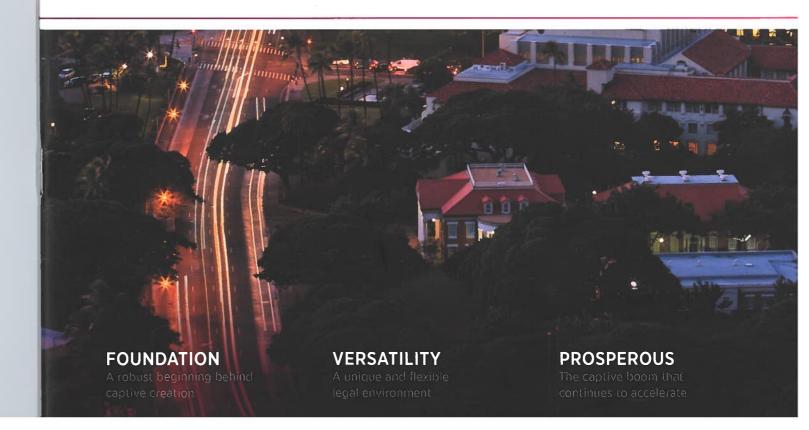


## HAWAII REPORT 2016





Hawaii is the strategic hub of the pacific and a captive insurance paradise.

#### Some of the many reasons to consider Hawaii as a captive domicile:

- Long history as a captive domicile. Hawaii's captive laws were enacted in 1986.
- ▶ Business friendly premium taxes with no minimum tax and a max of \$200,000.
- Strategic location in the middle of the pacific with non-stop flights from 23 major U.S. cities and 27 international destinations.

The state's Captive Insurance Branch offers a dedicated full-time staff focused on the needs of captive insurers and regulation.

For more information about forming a captive in Hawaii, call or visit our website.



### **Captive Branch**

www.captiveinsurancehawaii.gov (808) 586-0981

## A MESSAGE FROM THE GOVERNOR ALOHA!

he state of Hawaii is a unique destination recognized around the world for its culture, natural beauty and Aloha Spirit. Hawaii is also known for its thriving captive insurance industry, which is enhanced by the state's strategic location in the Pacific and stable and efficient regulatory environment. As governor, I invite you to discover Hawaii as a world-class destination for captive insurance.

Hawaii's captive law was first enacted in 1986, and since then, the state has created an effective, business-friendly domicile for captive insurers. Hawaii's captive insurance team, headed by insurance commissioner Gordon Ito and deputy commissioner

Written by **David Ige** 



**Governor David Ige** was sworn in as the eighth governor of the State of Hawaii on 1 December 2014. He became the fourth native-born Governor of Hawaii and first governor in the United States of America of Okinawan decent.

and captive insurance administrator Sanford Saito, has continued to provide and maintain a stable regulatory environment through careful and innovative improvements to our captive laws and regulations. Fostering innovation and economic development is high on my personal list of priorities and I'm proud to support the work done by commissioner Ito and his captive insurance team. Their creation and implementation of a sliding scale for premium tax rates as well as the flexible and balanced regulatory framework are fine examples of the state's commitment to promoting business friendly practices.

As we say with the spirit of aloha, e komo mai, or welcome in, to the business owners and innovators who are considering Hawaii as their captive domicile. You will find that it is a special place to live and work.

## A MESSAGE FROM THE INSURANCE COMMISSIONER

aptives have become and are an essential part of risk management for companies. This recognition has not only contributed to the growth of captives, but also to the number of domiciles.

Hawaii has long been a world-class captive domicile. We are one of the few captive jurisdictions with an experienced and dedicated staff within the Insurance Division specializing in captive insurance regulation and development.

Hawaii's captive service providers and the Hawaii Captive Insurance Council's knowledge, experience and expertise also set Hawaii apart. Hawaii's captive laws are business-friendly. They allow for the writing of all traditional lines of insurance, including casualty, marine and wet Written by Gordon Ito



**Gordon Ito** was reappointed Insurance Commissioner by Hawaii Governor David Ige effective of 1 January 2015. He was previously appointed Insurance Commissioner by Governors Linda Lingle (July 2010) and Neil Abercrombie (January 2011). Prior to his appointment, Ito served as chief deputy insurance commissioner since 2000. Prior to that, he worked as supervising staff attorney of the Insurance Division from 1993 to 2000.

marine transportation, protection and indemnity, property, surety, title, credit life and disability, as well as other lines of insurance that may not currently be available in the commercial market, as

the Commissioner may allow. We avoid double taxing captive premiums that were already taxed elsewhere and have a maximum premium tax of \$200,000. We also continually strive to update our laws and regulations to ensure we are keeping up with the dynamic changes happening in the insurance, financial and regulatory areas, nationally and globally.

Working collaboratively with our captives, their owners and service providers, our main goal is to make sure our captives are successful, while still maintaining prudent and effective regulation.

Thank you for taking the time to read the Hawaii report. I hope you'll consider joining the 197 captive licensees that have chosen Hawaii as their captive domicile as of 2015.

## A MESSAGE FROM THE HCIC PRESIDENT

his year marks the 30th anniversary of the passage of Hawaii's captive law. Hawaii's captive industry has enjoyed steady growth over the last three decades and in particular has some of the most robust locally based dedicated captive resources in the United States.

Hawaii's captive regulatory process and infrastructure has had a chance to evolve over this time period – we've already been through our "growing pains" – to arrive at an environment that adequately balances the needs of the captive owner and the needs of the regulators.

As a captive owner, we have many onshore and offshore captive domiciles to choose from. Being an East Coast based company, others may wonder why we selected a domicile so far away from our home state. As discussed in depth in our

captive case study, 'The Power of Captives', there are many quantitative and qualitative factors leading to our selection of Hawaii.

Hawaii offers a first-class captive owner experience. We never feel like just another number in the Hawaii captive landscape. Hawaii captive industry events are welcoming and inclusive – it's that indefinable aloha spirit that you find in abundance here. We've found unparalleled service across the board from all sectors.

As an active member of the Hawaii Captive Insurance Council, we've witnessed first-hand the level of collaboration between the public and private sector. The production of this Captive Review report is just one such example, with the HCIC, State of Hawaii and other participating HCIC members working together to provide you with the most up-to-date information and techniques on

Written by **Paul Wagner** 



Paul Wagner is vice president of alternative risk techniques at AGL Resources. Wagner utilizes risk financing, integrated structure and aggregate enterprise basket techniques. He earned a BS (Wharton School, University of Pennsylvania) an MBA (Kennesaw University) and CPCU, ARe and ERM certificate. Wagner is active in the Hawaii Captive Insurance Council.

owning and operating your Hawaii captive.

As you peruse the information in this report, the expertise demonstrated by the contributing authors is evident. The majority of contributors are locally based in Hawaii. We trust you will see why Hawaii as a captive domicile is "in a class by itself".





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Christopher Mertes, the CFO and EVP of The Mutual, studies the value of his company's domicile in the state of Hawaii

## THE HAWAIIAN FOUNDING FATHERS

Craig Watanabe, Gerald Yoshida, Peter Lowe and Ward Ching talk to Captive Review about the dramatic evolution of the Hawaiian captive industry

Captive Review (CR): Act 253, Hawaii's Captive Insurance Law, was enacted 30 years ago, how important was the passage of this law? What role did you play in the foundation stages?

Craig Watanabe (CW): Hawaii's initial captive law that was enacted in 1986 and laid the initial foundations for Hawaii's captive industry. Act 253 was codified by local attorney Robin Campaniano who was later appointed the Hawaii Insurance Commissioner; and was the driving force in establishing the short and longer term objectives of the captive market in Hawaii. Implementation and administration of the initial captive law was initially handled by the Insurance Commissioner's key managers, with input from myself and other founding fathers. One of the most significant refinements to the laws was made in 1998 with the creation and dedicated funding of a specialized unit within the Insurance Commissioner's office to handle captives.

### CR: How has the captive landscape evolved in Hawaii in the time you've been serving the industry?

Gerald Yoshida (GY): I was involved in the formation of the first Hawaii captive in 1987, and several thereafter, and I have seen a tremendous evolution in Hawaii as a domicile. As soon as the first four or five captives arrived, everyone was after the big players. Most of the captives were coming out of the West Coast, where the majority of the parents were head-quartered. Subsequently, there has been a lot of interest in Japan, which is a market that has continued to grow and be only beneficial for Hawaii. Now, there is more of a focus on the mid-market and due to the sheer amount of captives as well as domiciles, it has since become a highly competitive industry.

#### CR: What factors have been the most decisive in Hawaii's success as a domicile?

Peter Lowe (PL): One of the premier reasons for Hawaii's success was the formation of the Hawaii Captive Insurance Council and the collaborative effort of everyone involved in developing Hawaii. At the major marketing event for captive insurance companies, RIMS, the Hawaii booth was staffed by all members of the Hawaiian industry with a common goal of promoting Hawaii as a captive domicile. It was agreed by all members of the industry that the success of Hawaii will come by the industry acting as one to promote Hawaii as a domicile.

#### CR: What differentiates Hawaii from less mature domiciles?

Ward Ching: There is a 'can do' attitude across all sectors of the captive business. Regulators are welcoming large, complex and multinational businesses who are looking to domicile one or more captives in Hawaii. The service provider community is ranked amongst the best in the world. The more recent captives are coming from the technology space with a clear eye towards customer satisfaction and new product sales. Captives will be at the center of the insurance disruption now, beginning to take place on a worldwide basis. Many of the captives now domiciled in Hawaii are the most inventive, well capitalized and forward thinking groups in the global marketplace. They are not thinking about how to drive insurance costs down, but to use their underwriting leverage to reach customers and generate new types of customer experiences.

The less mature domiciles are focused on capturing market share for new captives. Hawaii differentiates on regulatory quality, size and complexity of captives being formed, and the redirected focus on using captives as an economic disruptive force.

### CR: What industry trends do you expect will be of the most significance to captives in Hawaii in the next 12 to 18 months?

PL: I would think that the most important trend for Hawaii would be to continue to position itself to be able to provide service for the growing interest in captives in the Asian region.

GY: We can expect to see continued interest in

#### **Craig Watanabe**



**Craig Watanabe** is the Western Regional manager of Strategic Risk Solutions, a leading captive insurance consulting and management company. He has extensive experience in the captive insurance space – both in the private and public/regulatory sectors.

#### **Gerald Yoshida**

**Gerald Yoshida** is a shareholder, director and officer in the Honolulu law firm of Char Hamilton Yoshida & Shimomoto. He is the head of the Firm's Insurance Regulatory Practice Group, which specializes in the formation and representation of captive insurance companies and risk retention groups. He was involved in the licensing of the first captive in Hawaii.

#### **Peter Lowe**



**Peter Lowe** is CEO of Willis Towers Watson New Zealand. He has 26 years' experience in captive management and consulting. He has been involved in the formation of over 100 captives and the development of captive domiciles in the Asia and Pacific region.

#### **Ward Ching**

**Ward Ching** is managing director – Western Region, Global Risk Consulting located in San Francisco, California. He is primarily responsible for captive and insurance management services, domicile management, and supports a variety of Aon Management Consulting Services to clients.

penetration through the Far East, in particular Japan. The other factor is that since a lot of the large corporate companies already have a captives, moving to middle and small markets will be of increasing importance to the Hawaii captive industry within the next 12 to 18 months.



### ENVISIONING A GLOBAL CAPTIVE INDUSTRY: WHAT'S AHEAD FOR HAWAII?

Captive branch administrator, Sanford Saito, shares what makes Hawaii a world-class domicile and future plans for captive insurance in Hawaii

oday, Hawaii is attractive to captive owners because of a consistent legal and regulatory approach to licensing, surveillance and the development of the captive industry. Since the inception of captive legislation in the mid-1980s, the State of Hawaii has created a predictable and efficient environment for organisers to implement and refine their captive insurance program.

The captive branch within the Hawaii Insurance Division and its partners routinely work towards maintaining the current captive environment and looking at new ways to innovate and draw in captives and their insureds

#### Captive Review (CR): How does Hawaii differentiate from other domiciles?

Sanford Saito (SS): Hawaii's most attractive feature is our progressively lower premium tax structure, which is lower than other domiciles. We don't have a minimum premium tax and our maximum tax is \$200,000. Hawaii taxes 0.25% on premiums up to \$25m and, after that, a decreasing sliding scale applies. Our large fronted programs and captive risk retention groups appreciate the fact that we do not tax assumed reinsurance premiums or captive premiums that have been taxed elsewhere. The absence of a 'double tax' benefits these programs in particular. We continually review our captive laws and regulations to foster a friendly business environment for captives while maintaining prudent regulatory practices. We have highly experienced personnel and service providers; staff turnover in both the captive branch and service sector is very low.

Hawaii is ideally situated because of our long cultural history and social relationships with owners from around the Pacific Rim. Owners find it is easier to do business and communicate with us in order to achieve their goals. We continue to see significant growth potential in the number of Japanese companies establishing their captive in Hawaii.

#### Other factors that contribute to Hawaii's strong captive environment:

- · 29+ years of continuing and steady support from the Governor's Office and State Legislature for captive owners and the industry
- · Dedicated captive insurance branch within the Insurance Division
- · Well-qualified CIAB staffing some with CPAs and CFEs designations on staff
- · Dedicated resources not relying on the State's general fund
- ·Accredited by the National Association of Insurance Commissioners
- · Follows the International Association of Insurance Supervisors' Insurance Core Principles and Standards
- · Respected domicile regarding reporting and regulatory requirements
- · Consistent legal and regulatory approach to ongoing licensing, financial surveillance and development of captives
- ·Strong infrastructure supported by regulators, captive managers, service providers and the economic stability of the domicile
- · Japanese speaking personnel on staff
- ·Strategic location five hours from the US West Coast and six to eight hours from Japan

#### CR: How is Hawaii promoted as a quality captive domicile on the local, national and international level?

SS: Promotion of the Hawaii captive domicile is multi-faceted and a collaborative effort with the Hawaii Captive Insurance Council. Current promotional activities include:

- · Exhibit at various insurance related convention and conferences such as RIMS, CICA. WCF
- · Present at educational events and forums in Japan, in Hawaii as well as in the US
- ·Co-sponsor an annual educational forum locally here in Hawaii
- · Insurance Commissioner routinely includes captive insurance updates to international regulators in conjunction with his duties with the NAIC's international committee. Insurance Commissioner Ito has met with and discussed captive insurance concepts |

Written by **Sanford Saito** 



Sanford Salto, CFE, was appointed in July 2014 as the deputy insurance commissioner and captive administrator for the State of Hawaii. He is responsible for the licensing and regulation of Hawaii domiciled captive insurance companies, as well as, the prudent development of this important industry for the State.

and the Hawaii regulatory oversite with insurance regulators in Japan, South Korea and Thailand

For many years, Hawaii representatives from both the Insurance Division and the captive insurance industry have met with and discussed the benefits of captive insurance programs with Japanese businesses owners, insurance companies, and captive organisers. Our long-term commitment is now bearing fruit as Japanese businesses and fronting insurers have become more educated and comfortable with the captive insurance concept.

#### CR: What will be the essential ingredients to Hawaii's success?

SS: Hawaii takes pride in offering a stable, reputable and prudent domicile for captives. To continue our domicile success, steady support from the governor and legislature to ensure that we are properly staffed to serve captive owners and working with all stakeholders to keep our laws and regulations up to date in this rapidly changing area. We, in the captive branch (a specialized regulatory unit within the Insurance Division that focuses specifically on the needs of captives and captive regulation) must maintain a knowledgeable and experienced captive staff that stays abreast of changes in the insurance regulatory landscape. These changes may potentially impact captives and their insureds as well as at the cutting edge of captive innovation to support our current and future captive owners that have chosen Hawaii.

# HAWAII CAPTIVE INSURANCE AT A GLANCE

197 active captives, direct economic spend in Hawaii \$20m, annual premium \$5.181bn, combined assets \$18.801bn, combined surplus \$3.916bn

#### Permitted coverages

- · Property / casualty
- · Workers' compensation
- · Securitization of insurance risks
- · Other lines as allowed by commissioner

#### **Organizational structures**

- · Stock
- · Non-profit
- · Mutual
- · Reciprocal
- · Limited Liability Company

#### Filing requirements:

- Captive Application and Business Plan document required for initial licensure and approval
- Changes to Captive Application and Business Plan should be submitted as needed as captive operations change
- After each calendar year: premium tax return and economic impact report
- · After each fiscal year: audited financial statements and actuarial reserve opinion
- NAIC reporting requirements apply to Class 3 Risk Retention Group captives

#### Applicable laws and regulations:

- · Hawaii Revised Statutes, Title 24, Chapter 431, Article 19 (Enacted May 1986)
- Hawaii Administrative Rules, Title 16, Chapter 17 (Enacted May 1991)

License class	Captive class description	Minimum capital requirements *
1	Single owner, reinsurance only	\$100,000
2	Single owner, direct and reinsurance	\$250,000
3	Multi-owner, association or Risk Retention Group	\$500,000
4	Sponsored captive	\$500,000
5	Reinsurance or excess Insurance only	Determined by insurance commissioner

\*Minimum required capital and surplus determined by Insurance Commissioner based on each captive program.

Redomestication of captives from other captive jurisdictions is allowed. Branch of a captive domiciled elsewhere is allowed.

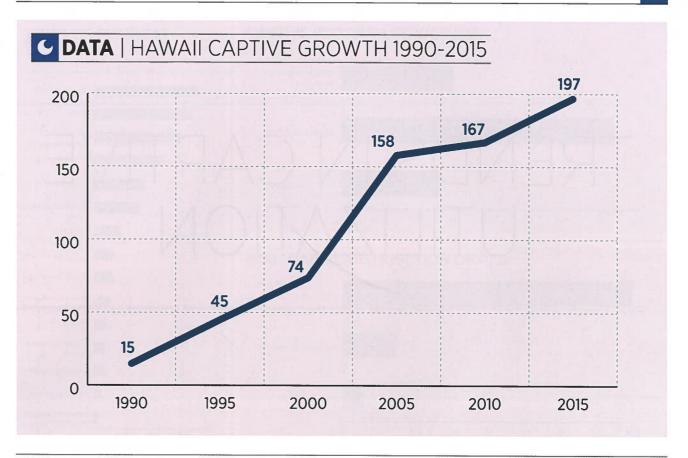
Premium taxes on reinsurance assumed or premiums previously taxed*		Fees
0.00%	\$0 and up No minimum tax	Captive application fee \$1,000
Premium taxes on all other premiums		Initial incorporation fee
	No minimum tax, \$200,000 maximum tax under the following sliding scale:	\$50 Annual business registration fee \$15 Annual captive license fee Class 1 and 2 \$300 Class 3 \$500 Class 4 and 5 \$1,000
0.25%	\$0 to \$25m	
0.15%	\$25m to \$50m	
0.05%	\$50m to \$250m	
0.00%	\$250m and up	

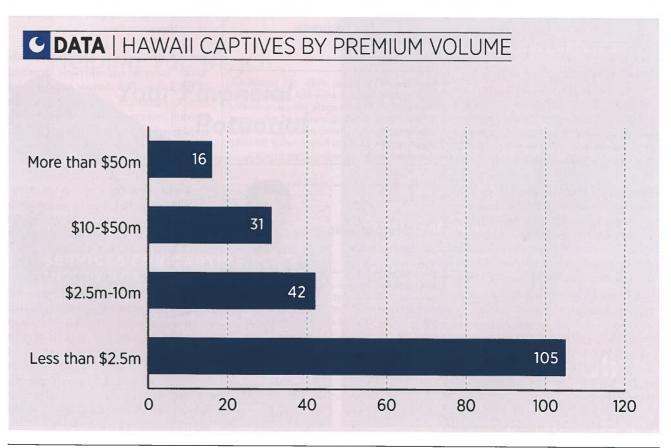
\*No Hawaii premium tax is owed if premiums were previously subjected to tax in jurisdiction where underlying risk is located, or if reinsurance premium assumed by Hawaii captive

#### **CONTACT US**

Sanford Saito, deputy commissioner and captive insurance administrator State of Hawaii | Department of Commerce & Consumer Affairs | Insurance Division | Captive Branch

335 Merchant Street | Room 213 | Honolulu HI 96813 Phone 808.586.0981 | captiveins@dcca.hawaii.gov







## TRENDS IN CAPTIVE UTILIZATION

Fay Okamoto and Sanford Saito explore trends within the captive industry and how best to utilize them

he HCIC surveyed Hawaii captives on how captives are utilized and received responses representing 109 captives. The HCIC and State of Hawaii observe the following trends:

- ·73% of the captives surveyed issue policies directly to their insureds. The most common direct policy is deductible reimbursement, where the captive reimburses the insured for obligations it owes as deductibles under commercially purchased insurance policies
- · Close to 80% of the captives surveyed are for US risks only. This is not surprising considering that 92% of Hawaii captives are owned by US headquartered companies
- ·6% of captives surveyed are for purely non-US risks. These are almost all foreign captive owners from Asia
- ·15% of captives surveyed are for both US and non-US risks. These captives are owned mostly by US-based parent companies, but a few are also non-US parent companies
- The top two lines of coverage are GL and

#### **Fay Okamoto**

Fav Okamoto is division senior vice president captive management at Artex Risk Solutions. Okamoto leads the Hawaii captive management office for Artex and has extensive experience designing, implementing and operating Hawaii captive insurance companies. She is the former chair of the board of the Hawaii Captive Insurance Council (HCIC).

#### **Sanford Saito**

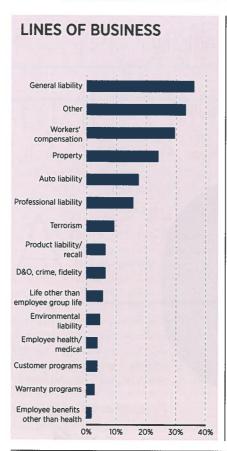


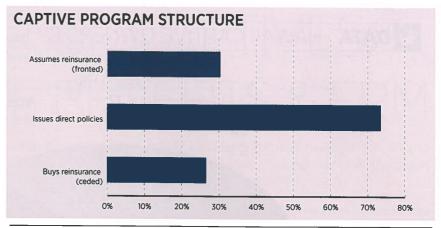
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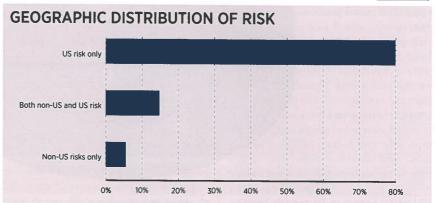
WC. Third is property. These results track with Hawaii's concentration in real estate and construction captives which comprise 31% of Hawaii captives

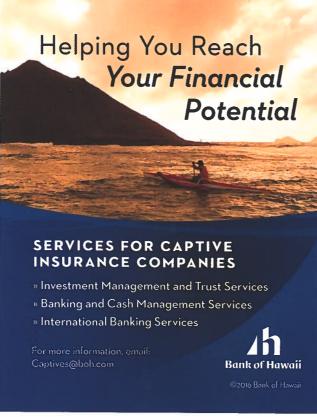
- ·33% of the captives surveyed provide "other" coverage not otherwise identified in the survey. This statistic demonstrates that a significant number of captives provide coverage beyond what might be considered "mainstream". This speaks to Hawaii's experience and willingness to consider unique risks
- · Customer programs, warranty programs, and life programs, while comprising a small percentage of captives, are some of the most significant programs in terms of premium volume
- · If the captive and its parent are financially well-funded with ample assets and surplus, savvy captive owners expand the captive to take on more risk, oftentimes in the more unusual or difficult to place risks. While Insurance Division approval is required for program expansions, such approvals can often be rendered very quickly, enabling the captive to provide immediate risk financing support to the overall insurance program 6





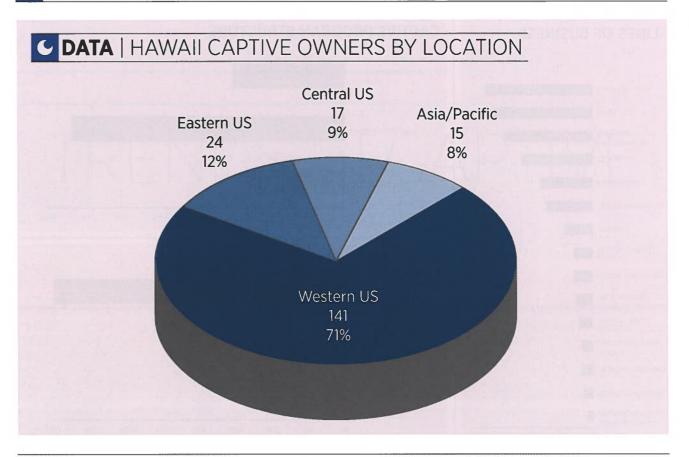


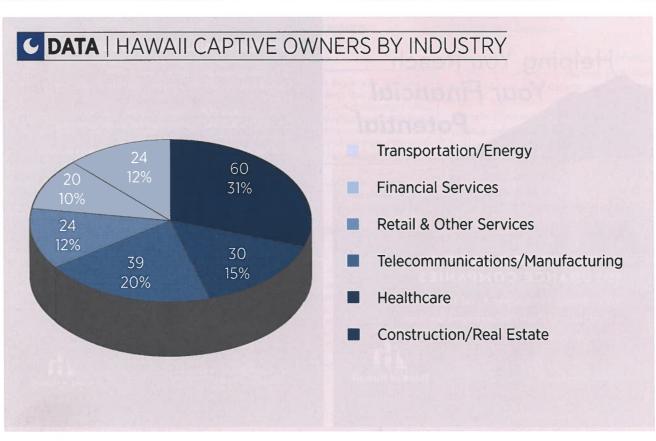




#### CAPTIVE INSURANCE INDUSTRY EXPERIENCE » Actively involved with the captive insurance industry » One of the first to form a captive insurance company in » Active member of the Hawaii Captive Insurance Council (HCIC) and has representation on numerous » Well established working relationships with the captive managers and the State of Hawaii Insurance **GLOBALLY RECOGNIZED** Services, making it one of the highest-rated financial institutions both globally and nationally. » Ranked among the top five U.S. banks in each of the recognized trade publication. Bank of Hawaii

#### ✔ HAWAII | GEOGRAPHY & INDUSTRY





## POWER OF CAPTIVES: EMPLOYEE BENEFITS & ERM

The right strategic partners, program, and captive domicile can help executives from risk management, finance and human resources collaborate and achieve an ERM solution utilizing a captive. Paul Wagner of AGL explores how to cost effectively implement employee benefits and build an ERM template

GL Resources is the largest natural gas-only distribution company in the United States. Its business segments consist of: distribution operations, retail operations, wholesale services and midstream operations. AGL Resources has safely served customers with efficient, reliable natural gas for more than 150 years. The largest segment, distribution operations, operates seven utilities serving residential, commercial and industrial customers in seven states: Georgia, Illinois, Virginia, New Jersey, Florida, Tennessee and Maryland.



Employees: -5,000

Utility customers served: nearly 4.5 million

Retail customers served: 1.1 million

Ticker symbols: GAS (NYSE)

Newspaper listing: AGL Red

#### Overview of GERIC

Global Energy Resource Insurance Corporation's (GERIC's) long-term strategy is to optimize AGL Resources' enterprise risk management with long-term reinsurance relationships and a cost-effective structure. As an essential part of AGL Resources and its advanced risk techniques strategy, GERIC, a pure captive was formed and wrote its first policy in 2001. GERIC is domiciled in Hawaii, and today it writes coverage for property and casualty, employee benefits, weather, cyber and trade credit exposures.

GERIC has structured multi-line insurance agreements that blend property and casualty, and executive risk coverage. GERIC's primary and first excess policies provide two blended layers excess of the self-insured retention in a multi-year structure.

Fully reinsured multi-line policies attach

Written by **Paul Wagner** 



Paul Wagner is vice president of alternative risk techniques at AGL Resources. Wagner utilizes risk financing, integrated structure and aggregate enterprise basket techniques. He earned a BS (Wharton School, University of Pennsylvania) an MBA (Kennesaw University) and CPCU, ARe and ERM certificate. Wagner is active in the Hawaii Captive Insurance Council

above the first excess layer, and thereafter, 100% of the risk is ceded to reinsurers. In addition, GERIC constructs a multi-year stop loss basket with reinsurance support that aggregates its retention exposure from all lines insured and reinsured.



#### Why a Captive?

GERIC's long-term strategy has been centered on three major drivers. Firstly, with a traditional transaction a corporation would purchase insurance coverage through a broker and primary commercial carrier that subsequently cedes a portion of the risk to the reinsurance market. A captive insurance arrangement accesses the reinsurance market directly and eliminates the primary cost of the transaction.

Furthermore, in a traditional setting,

a corporation would purchase individual coverage in silos, including: general liability, property, workers' comp, EPL, D&O, fiduciary and crime. In this typical traditional structure, each silo has a separate large limit. A captive can be structured to blend the separate limits and provide one limit covering all exposures. Further, a captive can use a multi-year arrangement with the same limits rather than the annual repurchasing of separate limits.

Finally, GERIC carves out the layer (buffer zone) above the business unit's retention where the premium to loss ratio is typically the highest.

Other drivers of a captive operation include improving NPV cash flow, generating investment income, promoting market competition and providing coverage where unavailable or overpriced. Enterprise risk management is also enhanced with effective captive governance and knowledge through senior leadership participation across the corporation.

#### Why Employee Benefits?\*

Captives have long been employed to manage the 'brick and mortar' risk of a corporation. While the financial merits are compelling, adding employee benefits to captives has not been as widely embraced as an enterprise risk management tool.

One obstacle in the US is the perception that the Department of Labor (DOL) imposes stringent barriers to access. Actual criteria includes: The fronting company be at least 'A' rated by AM Best and the captive must be domiciled in the US or be an operational US branch of an offshore captive. Benefits offered to the employees need to be an enhancement over what was previously offered.

The Employee Retirement Income Security Act of 1974 (ERISA) plays a part in governing how the DOL will view a

#### C HAWAII | CASE STUDY

company's application to include employee benefits in their captive. Benefits that fall under ERISA guidelines are generally not allowed to be reinsured to a captive unless certain requirements, as mandated by the DOL, are satisfied. Most companies usually apply for individual versus class exemptions – over 20 have obtained this exemption for captive transactions.

An expedited review and approval process (EXPRO) or fast track approval is again available since there are two prior substantially similar exemptions. There is a minimum six month review for new benefits coming into a captive.

Basic and supplemental life, long term disability, active/retiree medical and medical stop loss are coverage that are more commonly reinsured to a captive. Risk assumption is generally in the 80% to 100% range. Individual and aggregate stop loss coverage is also a common component to protect the captive from excessive risk exposure.

Coverage that are less common to a captive structure include AD&D, business travel accident and pension plans. AD&D and BTA are generally low premium high exposure type coverage that can increase the captive's exposure. Pensions have been introduced internationally but not on a domestic level.

From a risk manager's perspective, reinsuring employee benefits to the captive results in greater cost efficiencies through centralized cashflow management and improved program administration. The captive is better equipped to manage risk charges and frictional costs, which results in cost savings. Diversifying risk exposure within the captive, reducing its capital requirement and establishing an aggregate protection on overall risk are additional by products of reinsuring employee benefit risk. The captive can also accelerate deduction of loss reserves through third party risk assumption while enjoying greater flexibility in plan design creation and claim paying processes. Lastly, reinsuring employee benefit risk can produce an increased ROI on reserves.

From a Human Resources' perspective - there are significant potential cost savings on benefit delivery when benefits are reinsured and managed by the captive. Data availability and analysis from a captive structure is improved; local data warehousing and centralized portfolio

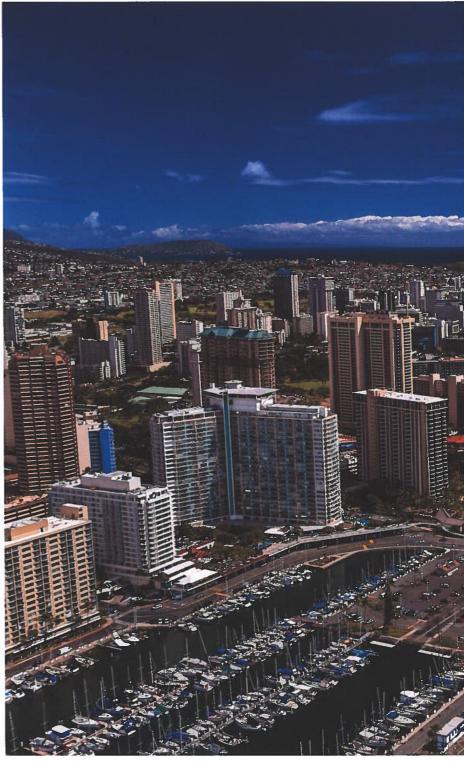
review helps to improve analytics and monitoring. Since benefits are usually centralized with a captive, benefits managers have an increased opportunity for improved oversight.

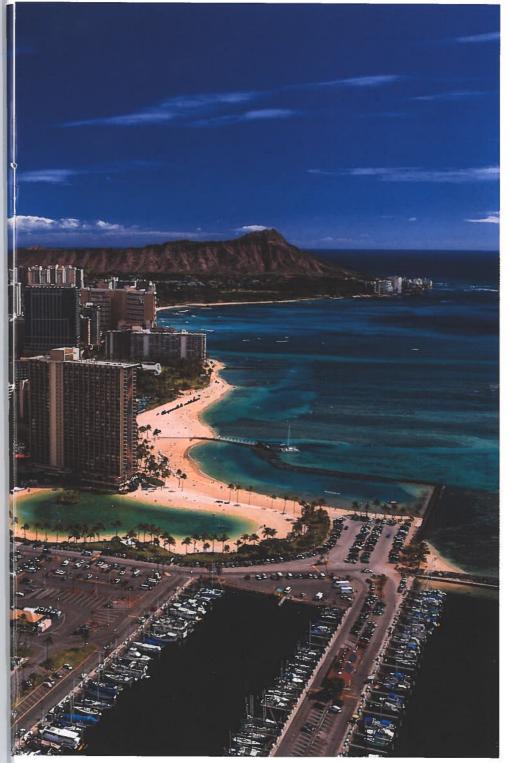
The main driver from both perspectives is control... the more control an

organization has over how benefits are delivered and ways to manage data properly equals greater efficiency and cost savings.

#### Keys to success are:

Communication is the first and foremost point. A captive is often a new paradigm





for human resources. It is therefore imperative for the HR staff at all levels be included in the conversation from the onset, so that they recognize the financial advantages of the captive and understand that benefits can be enhanced and processes streamlined.

Risk management, legal, finance and HR's collaboration is critical for the captive's success integrating life and non-life risk.

Captives that work well in combining life and non-life risks often have a person or team that manages the captive and who accepts accountability for proper roll out.

This person or persons need to be an ongoing advocate of the captive programs.

Captives are recognized as a long-term risk management solution, providing the infrastructure to better manage risks. Larger, more complex and diversified programs are often built up over time. It is recommended that these captive programs bring in coverage incrementally, in manageable portions, to ensure long term success.

### The top 10 reasons why a captive should consider assuming employee benefit risk are:

- 1. Improved claims ratio in partnership with their fronting carrier, captives can establish effective plan designs that are priced accurately to maintain a predictable loss ratio
- 2. Improved data management global data warehousing and easier access to claims data are key elements here
- 3. Since data is consolidated and managed better, captives can more easily structure centralized portfolios which allow for easier access and review by the underwriter and greater transparency
- 4. Tax advantages third-party unrelated risk is a requirement for premium deductibility
- 5. Improved underwriting flexibility since captives take all or a majority of the risk, the benefits and risk managers can often dictate more liberal underwriting practices that are not traditionally available under fully insured programs
- 6. Efficient use of capital net premium rates, no broker commissions, consolidation, greater efficiencies
- 7. Tailored benefit design captives can customize/tailor policies to meet the specific needs of the business
- 8. Improved cash flow captive insurance is a formidable business asset protection strategy
- 9. Improved control of employee benefits with your partner's help, you can draft the coverage and manage the policy
- 10. Reduce overall employee benefits costs

A captive that combines non-life and life risks provides an organization with more flexible risk management and financial efficiency. This overall resiliency provides an organization with more freedom to customize its coverage and employee benefits.

(\*Contributions in this section are credited to James Cortiglia, global benefits sales VP at Zurich global life NA-expatriate and captive programs)

#### Why a Captive & ERM?

To optimize premium/risk, exposure can be categorized in three layers:

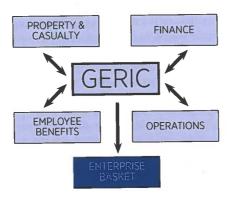
Exposures are known and expected. The working layer should be self-insured by the business unit. Strong loss control measures are an effective tool to contain.

Unexpected losses are known to occur. The buffer zone should be identified and retained by the captive. The parameters of the buffer zone will contain a large premium compared to the loss ratio. The buffer zone is the first layer of insurance and in conjunction with actuarial analysis of the corporation's operations will create the reinsurance base for additional excess of loss premium in the stacking structure.

Mostly unexpected losses not known to occur. The catastrophic layer should be ceded to reinsurance. It contains a small premium as a ratio to losses. There is opportunity to bundle for volume discounts.

Using the aforementioned structure, the captive's buffer zone becomes the enterprise link to aggregate corporation exposure from all sectors as follows:

#### **ENTERPRISE LINK**



Within a captive, a three year stop loss feature (basket) optimizes enterprise expense/risk that includes operational, financial and employee benefits exposures in a pool.

The strategic composition of this pool spreads the risk of unexpected, non-correlated exposures. During the three year period, premiums are pooled and losses are shared. The stop loss retention feature helps manage potential financial volatility. Limits and retention levels for the portfolio are selected to maximize enterprise net premium savings.

#### BIG PICTURE - HOW IT FITS

SLIDE I CAPTIVE Captive Buffer Zone contains **BUFFER ZONE** retention from all coverage lines SLIDE II CAPTIVE Trade credit **BUFFER ZONE** Weather Employee Benefits Property/ Casualty Liability/ Property D&0 **Fiduciary** Crime SLIDE III CAPTIVE BUFFER ZONE Captive retains Group life/ Medical Stop loss

#### Why Hawaii?

Hawaii as a captive insurance domestic domicile is 'in a class by itself'.

Hawaii has many of the features of the top tier domiciles with lower operating costs. Specifically, there is no premium tax for ERISA employee benefits reinsured in a captive program. Since the DOL requires all captive ERISA employee benefits programs to be fronted by an 'A' rated carrier it is a reinsurance transaction.

Furthermore, the DOL requires a domestic domicile for these transactions, making Hawaii, without reinsurance premium tax, an excellent alternative for a captive branch. Cost efficiencies are also extended to the periodic regulatory examination process. Hawaii maintains

an internal staff of examiners.

Hawaii has an exceptionally strong infrastructure of service providers including: management firms and expert legal and audit consultants. Each service has significant depth within their ranks.

Legislation and regulatory oversight forms a solid foundation. Hawaii has been licensing and monitoring captives since 1987. The regulatory group is highly experienced, accessible and dedicated with a proven track record of flexibility and innovation.

Its success factors are further supported by the Hawaiian Captive Insurance Council (HCIC). The HCIC consists of very active and dedicated group of service providers and captive owners that participate in an equal functional structure.

"Fully reinsured multi-line policies attach above the first excess layer, and thereafter, 100% of the risk is ceded to reinsurers"

PAUL WAGNER



## CAPTIVE INVESTING IN HAWAII

Mike Hirai, of Bishop Street Capital Management, examines the detailed laws behind Hawaiian captive investment

First Hawaiian Bank provides insights on the fine art of investing captive assets:

- · Hawaii investment law for captives offers flexibility to invest in bonds, stocks, exchange traded funds, and mutual funds, with some restrictions
- · Initially captive owners may invest conservatively, but as the captive matures and surplus increases, owners are more willing to assume some risk and diversify their portfolios. It is estimated over time that 85% of captives invest in treasuries, agencies, and other types of securities
- · Hawaii law also permits a Strategic Investment Policy (SIP) for non- risk retention

Written by Mike Hirai



Mike Hirai, CFA, is President and Chief Investment Officer for Bishop Street Capital Management. Mike also serves as Senior Vice President and Manager of First Hawaiian Bank's Institutional Wealth Management Division providing investment management services. Mike has over 30 years managing both institutional fixed income and equity portfolios.

captives to maximize flexibility and efficiency with the investment of insurance assets. SIPs are tailored specifically to an owner's objectives and risk tolerance. It establishes guidelines for minimum, maximum, and targeted strategic allocations by type of investment, risk concentration, and duration

- Captive investment guidelines focus upon liquidity, preservation of capital, risk tolerances, and asset and liability matching using suitable investment assets
- · Hawaii investment advisers specializing in captive investing offer in-depth knowledge and proven insurance-related experience in partnering with the captive to develop appropriate solutions - including the creation of a formalized investment policy statement to ensure consistency with the captive or parent corporate guidelines

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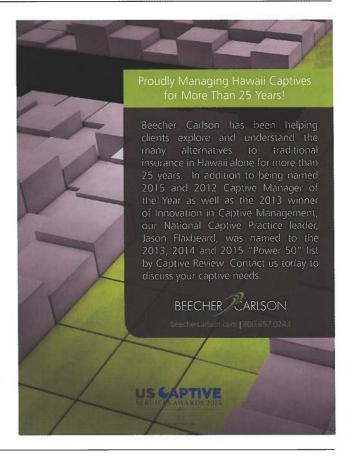
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## CAPTIVES FOR REAL ESTATE CONCERNS



Fay Okamoto of Artex Risk Solutions, explores real estate captives and the vast range of captive uses

eal estate and construction captives comprise one-third of Hawaii captive owners. How can that be, if property coverage – the largest risk area for real estate companies – is generally viewed as not conducive for a captive approach?

#### **Property**

Property is one of the biggest insurance program spends for a real estate owner. Insureds will often voluntarily retain, or be forced to retain, significant amounts of risk in the form of the deductible in order to better manage the cost of insurance.

Property deductible buy-down policies are one of the most common uses for a real estate captive. The real estate company can opt to pass-through some or all of the captive premium as a cost to tenants. Tenants benefit by having full property coverage with no deductibles imposed by the landlord. The landlord benefits by reducing commercial insurance costs and having a loss fund in the captive to pay for actual property deductible losses.

Captives are also invaluable tools in hard market cycles. Many of us remember the commercial property market after 9/11 or after the hurricanes of 2004. Established Written by

#### **Fay Okamoto**

Fay Okamoto is division senior vice president – captive management at Artex Risk Solutions. Okamoto leads the Hawaii captive management office for Artex and has extensive experience designing, implementing and operating Hawaii captive insurance companies. She is the former chair of the board of the Hawaii Captive Insurance Council (HCIC).

captives with accumulated earnings were able to help their captive owners to weather those market cycles because the captive could take on higher deductibles, or fill gaps or layers in the insurance program. Captives can also provide direct access to reinsurance markets that might be otherwise unavailable to real estate owners.

When providing property coverage in a captive, or any other similarly unpredictable coverage, consider providing the coverage as part of a portfolio of risks. When pairing property with another more predictable line of coverage, the portfolio provides a stable base of premiums and cash which could be available to pay for the more unpredictable property losses.

#### Terrorism

Real estate owners may also utilize captives to provide terrorism coverage, either excess of commercial terrorism insurance, or as a supplement for nuclear, biological and chemical attacks, which are often excluded from standard insurance. The captive can then access the federal backstop provided by the Federal Terrorism Risk Insurance Program (TRIPRA). Captives should be aware of TRIPRA insurer deductibles, co-insurance and loss triggers to ensure they can adequately bear those risks or obtain appropriate reinsurance.

#### Liability

General liability for injuries occurring at real estate operations, or professional liability for real estate managers who buy, sell or manage real estate on behalf of others is another area where captives could be useful. Raising the deductible under commercially purchased liability policies, then utilizing a captive deductible reimbursement policy can be cost effective. The general liability premium can be recovered from tenants as part of the liability insurance charge.

#### Credit default

Credit default coverage from a captive can be customized to recover lost tenant

income, expenses incurred in pursuit of collection and extra expenses to find and secure a replacement tenant. Captives can also be utilized to fund for deductibles under commercially purchased credit default policies.

#### Construction wrap-ups

Significant construction projects may be insured by owner-controlled (OCIP) or contractor-controlled (CCIP) construction wrap-ups. Such wrap-up programs provide insurance coverage to the entire project, including the owner, general contractors and subcontractors, and may include coverage for damage while construction is in progress (builders' risk), workers' compensation, general liability and pollution liability or contractor default risks. Wrap-ups often carry significant deductibles, where the final cost of losses within the deductible may not be known for many years after project construction.

The Alliance of Schools for Cooperative Insurance Programs (ASCIP), one of the largest joint power authorities for California schools, provides an OCIP program for school construction projects.

Kristinn Olafsson, president and director of ASCIP's Hawaii captive, observes: "ASCIP opted to self-insure some of the OCIP risk via the deductible. Providing

"Captives are also invaluable tools in hard market cycles. Many of us remember the commercial property market after 9/11 or after the hurricanes of 2004"

deductible reimbursement coverage through our Hawaii captive allows ASCIP to provide a fixed and competitive cost to the school construction projects, rather than having the projects themselves absorb the deductible.'

#### Tenant programs

Tenant programs can provide insurance for damage to the tenant's own property, or for the tenant's liability for damage they

may cause to the facility or to other tenants. The ability of captives to facilitate insurance programs to tenants can be an invaluable risk management and tenant relationship tool.

"We are constantly modifying our tenant insurance program to better meet the needs of our tenants," commented Capri Haga, senior vice president of Public Storage. "Since our Hawaii captive supports the fronting carrier, the front allows us the flexibility we need to continuously improve the insurance offered," she added.

In addition, through an unbundled approach, the captive owner can exert maximum control over the program by selecting best-in-class service providers.

Potential uses for a real estate captive go far beyond just property coverage. Hawaii's captive regulators and service providers are very experienced in handling these captives, so real estate captive owners can feel confident there will be a good understanding of their business, risks and concerns.



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## HOME OF THE MIXED PLATE

ixed plate' is a staple of the Hawaiian culinary landscape a popular meal, or 'plate lunch' consisting of large portions of starch, meats, and vegetables. 'Mixed plate' entrees can be a variety of ethnic offerings, and is a metaphor for the ethnic diversity in the islands. These multi-ethnic groups influence our tastes for delicious and exotic foods, cultural traditions and beliefs, and teach us how to live and work together. Giving you a flavor of Hawaii, here is HCIC's 'mixed plate' collection of Hawaii facts:

- · Hawaii is the world's longest archipelago. There are eight main islands and 124 smaller uninhabited ones. The Big Island is twice the size of all the other islands put together
- Our population of 1.4 million people is predominantly located in four main counties within the eight islands. City & County of Honolulu has 992,000, Hawaii County has 194,000, Maui County has 163,000, and Kauai County has 70,000 residents
- ·Race alone by population: 37.5% Asian (all), 25.4% Caucasian, 10.4% Hawaiian or other Pacific Islander, 2.2% Black, 1.0% Other races, 0.2% American Indian/Alaska Native, and 23.3% Multiracial (two or more races)

- · Hawaii is ranked number one among all states in the nation: Mixed population (Hawaii 23.3 v US 3.0), multigenerational households (Hawaii 7.9 v US 3.8), workers using carpools (Hawaii 13.5 v US 9.2)
- ·The median age of Hawaii's population is 38-years-old, with males slightly outnumbering females by 50.5% versus 49.5%
- · Hawaii is home to Kilauea volcano, the world's most active volcano. Kilauea has been continually erupting for the last 30 years
- Snow in Hawaii? You bet, in the winter, at the summits of our three tallest volcanoes, Mauna Loa, Mauna Kea, and Haleakala
- ·Of the 10,000 humpback whales that migrate to the north Pacific from January to April, about two thirds are found in Hawaii, with the greatest numbers in Maui, and Kona on the Big Island a close second
- · Hawaii's state anthem, Hawai'i Pono'î, is in native Hawaiian
- · Many of our street names are also in Hawaiian. This has stumped many a

tourist and navigation system - can you say "Kalanianaole Highway?"

- · Iolani Palace in the heart of downtown Honolulu is the only royal palace in the United States. Electric lights illuminated Iolani Palace four years before the White House had lighting
- ·There are 1,052 flights a week that service 49 cities worldwide. Many are direct flights from major US and international cities
- · Visitors to Hawaii spend per person, per day, \$167 to \$207 depending on what island you visit
- · Many feature films and television series have filmed in Hawaii, such as Jurassic World (2015), Godzilla (2014), and The Descendants (2010), not to mention Hawaii Five-O and Lost. This growing film industry offers yet more diversity to Hawaii's business landscape
- · Honolulu is ranked as the 4th busiest international port of entry for the US
- · Our voyaging canoes, Hokule'a and Hikianalia, are traveling over 60,000 nautical miles around the earth with no compass or sextant, cellphone, watch, or GPS for direction 6



## COLLECTING MULT-INATIONAL RISK

Jason Palmer and Sean Rider, of Willis Tower Watson, examine gathering multinational risk within a Hawaii-domiciled captive program

he island of Oahu in the Hawaiian Islands is known as 'The Gathering Place'. Not only does it serve as home to many experienced captive industry professions, but can also serve as a unique gathering place for multinational corporations with both Asian operations and US operations. Geographically nestled between the Asian and the US insurance marketplaces, Hawaii is the captive domicile of choice for gathering a multinational risk management program.

#### Global profile

Generally speaking the reasons for forming a captive are the same no matter where the exposure lies in the world. For example, one looks to gain greater control over an insurance program, possibly decrease external premium spend, achieve tax benefits not otherwise available and/or collect data to better understand your company's global risk profile.

Utilizing the US captive industry's knowledge base, a Hawaii-domiciled captive program can be the genesis for western risk management approaches, notably, alternative insurance approaches that serve a need to insure Asian business risks. Coupled with companies in Asia demanding alternative solutions to traditional insurance risk transfer, we believe more lines of business emerging from the Asian insurance marketplace will be written through captives.

#### Capitalizing on relationships

Hawaii's well-known relationship with Japan is a case in point. For many years Hawaii captive industry personnel went to Japan with hands full of marketing materials and were met with scepticism from the local commercial insurance market community. Now, those same road blocks are met with introductions, support, and even captive marketing efforts from those same parties. After many years of education, we

believe the Japanese commercial insurance marketplace now realizes an insured interested in its own risk management and understanding its own insurance data is better at managing costs and controlling exposures so that all parties involved derive benefit. Hawaii is to be acknowledged for this revolution which, without persistence and respect for the process, never would have happened.

There has also been an opposite exchange of alternative risk tools. As some of the captive forefathers in Japan are becoming more comfortable with the captive insurance company concept, they are trying to increase their exposure base to include US risk exposures - notably US Workers Compensation.

#### Compensation and benefits

Workers compensation laws and corresponding benefits apply in all 50 states in the US. The overriding scope of the statutory law in each jurisdiction obligates the employer to pay benefits to injured workers, for an occupational injury sustained 'on the job or in the scope of employment'. Further, Workers Compensation Benefits are considered an entitlement for the injured worker, without regard for negligence, therefore creating a no-fault environment. There are four prescribed benefits in every jurisdiction; medical, disability, death and rehabilitation. Benefit levels vary widely by state.

#### An evolving market

The expanding marketplace in alternative risk transfer solutions in both the Asian and US marketplace is yielding opportunities for captives to redeploy capital in support of evolving risk retention strategies. Valuation of these transactions is a complex matter, taking into consideration not just the premiums and transferred reserves. but also the value of redeployment of risk capital into current risk ventures.

Written by **Jason Palmer** 



Jason Palmer is the regional managing director US, responsible for captive management operations in all US domiciles. Jason's primary responsibilities include service in all facets of captive management operations for a variety of risk retention groups, group captives and pure captive programs.

> Written by Sean Rider



Sean Rider is a managing director of consulting & development and a member of the Executive Committee in Willis Towers Watson's Global Captive Practice. He is responsible for leading Willis' captive consulting efforts, and developing strategy, talent, products and propositions to better serve the captive marketplace.

Mature captives, with meaningful portfolios of legacy-retained risk, require capital to support those risk positions. One naturally asks if the redeployment of that capital in support of expanding your captive program delivers greater value to the organization and even compound the positive impact of those original dollars. When viewed in the proper light, these emerging strategies can be very useful, and can be exploited to deliver value to organizational risk strategies.

Gathering your US insurance exposures together with your Asian insurance exposures promotes captive expansion and greater acceptance organization-wide, not to mention the benefit of diversifying the captive's exposure base and likely lowering the associated fixed cost of your captive program. 6

## THE IMPORTANCE OF THE AUDIT

Jill Miura, Jamie Asato and Matthew Takamine, explore what to look for when searching for a captive audit and underline the significance of the process

Captive Review (CR): What makes for a successful audit methodology?

Jamie Asato (JA): A successful audit methodology is dependent on the following ingredients:

- An experienced audit firm that specializes in insurance and, more specifically, captive insurance
- A mature regulatory environment with clearly stated expectations for the audit process and the auditor
- Close coordination among all parties involved in the captive's operation, including the captive owner, captive manager, investment custodian, actuary, claims TPAs, parent company auditors, etc.
- 4. Address critical accounting policies (e.g. loanback treatment, insurance company for tax, loss reserving methodology, etc.) and the impact of insurance program changes well in advance of audit commencement

CR: What should you look for when searching for a captive auditor?

Matthew Takamine: As a captive manager who works regularly to assist clients with selecting auditors, I view auditors as critical business partners in operating a successful captive insurance program. Having spent nine years in public accounting, most recently as a senior audit manager with KPMG prior to joining Beecher Carlson in 2007, I have a strong sense of the qualities we look for, prior to making a recommendation on an audit firm. These include:

 Expertise: The auditor should have expert understanding of the accounting and auditing issues relative to captives and insurance companies. They should also be knowledgeable about the regulatory requirements specific to the Written by

Matthew Takamine



Matthew Takamine, CPA, is the head of Beecher Carlson's Hawaii office and supervises the company's captive operations for the western United States. Matt has over 18 years of experience working with captive insurance companies. Before joining Beecher Carlson, Matt spent nine years in public accounting with KPMG LLP, most recently as a senior audit manager.



Written by

Jill Miura

Jill Miura is a principal with KMH LLP's Assurance & Advisory Services division. She has more than 15 years of experience serving clients, primarily in the captive insurance industry, and has previously served as a captive manager. Jill is a certified public accountant.

Written by

Jamie Asato



Jamie Asato is an Assurance Managing Director at Accuity LLP and has over 15 years of experience serving traditional insurance and captive clients. She received her Bachelor of Arts in Business Administration from Seattle University and is a Certified Public Accountant licensed in Hawaii.

captive's domicile, including minimum capital requirements, investment requirements & restrictions and other domicile-specific requirements that may have a material impact on the captive's business plan. A good captive auditor is also familiar with the broad issues facing the captive insurance industry and can advise their clients accordingly

- Commitment: A good auditor will be committed to meeting agreed-upon engagement milestones and reporting deadlines and will have a track-record of doing so
- Communication: Proactive communication is one of the critical factors to a successful audit it should happen early and often, especially if there are potential issues. Agood auditor will also be there to work with you throughout the year on issues as they arise to as to avoid any problem at year-end
- Fees: Audit fees are also an important consideration – they should be reasonable given the nature and complexity of the captive's particular business plan and competitive with the fees of other firms

CR: In terms of accounting issues, what are the most prevalent in current captive insurance?

Jill Miura (JM): A current hot topic issue for captives involve income taxes, primarily related to qualifications as an insurance company for tax purposes. Such issues have implications on both consolidated and stand-alone captive reporting levels.

There are also significant new disclosure requirements on the horizon for short duration insurance contracts that will be effective for non-public companies for annual periods beginning after 15 December

#### AUDIT ROUNDTABLE | HAWAII C



2016. These disclosures are meant to provide financial statement users with increased transparency about the captive's initial claim estimates, subsequent adjustments to those estimates, methodologies and judgments used to estimate claims and the timing, severity and frequency of claims. We encourage companies to plan ahead and work with their actuaries to ensure they have the appropriate information required for the disclosures.

#### CR: How is an efficient captive audit car-

JM: Planning and communication play key roles in a successful audit. Both translate to efficiency. Auditors should strive for a 'no surprises audit', which is accomplished through effective and timely communication, upfront planning between the insurance company, its service providers and the audit engagement team, as well as active participation in the process by partners and managers. The benefits of a 'no surprises' audit are obvious, but important to summarize:

· It's a proactive versus reactive approach to identifying and resolving issues. A

proactive approach minimizes the possibility of turning issues into problems

- · Management knowing and understanding the issues and related resolutions on a timely basis. Resolution of accounting and/or audit problems before the issue arises is our goal. This facilitates appropriate decision making for our clients as well as allows us to effectively plan the audit
- · Auditors 'getting in and out' as quickly as possible. Our experience has humbly taught us that as much as we enjoy our relationship with our clients, getting the audit done and the audit team out of their office is greatly appreciated by clients
- · Timely reporting of audit results and internal control deficiencies. Internal control deficiencies should be made known to the client as soon as the findings are verified and reviewed

CR:How have captive audits changed over the past five years and how will it change over the next?

JA: The last five years have been relatively calm from an accounting, financial reporting and audit perspective. Most of the

accounting bodies and taxing authorities have focused their efforts in the past five years on the Affordable Care Act implementation. The anxiety from anticipated changes to insurance accounting resulting from IFRS and US GAAP convergence has subsided. However, the FASB has moved forward with its insurance accounting agenda in the US and recently issued ASU 2015-09, which will significantly increase insurance company loss disclosures starting in 2016 for public companies and 2017 for all others. We anticipate that the FASB will continue to be active in updating insurance accounting rules in the near

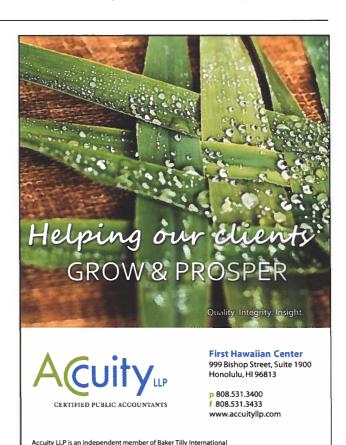
Further, the IRS is scrutinizing captive insurance companies (micro captives in particular) and there are many ongoing court cases, which could change the tax landscape for captive insurance prospectively. We also expect audits to be more technology focused, including increased use of data analytics. While the future is impossible to predict with certainty, we expect the next five years to be more exciting from an accounting, financial reporting and tax perspective. 6



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## IN-HOUSE EXAMS

Sanford Saito, deputy insurance commissioner and captive administrator, and Holly Osumi, chief captive insurance examiner for the State of Hawaii, speak to *Captive Review* about captive examinations in Hawaii and how captive owners can fully utilize them

xamination is a big part of insurance. Hawaii has the resources and the experience to make examinations a useful tool for captive owners. This overview details the captive surveillance cycle in Hawaii and the philosophy and resources behind Hawaii's captive examinations.

### What does Hawaii law require for surveillance of captive insurance companies?

Captive surveillance in Hawaii is a threepart cycle made up of the submission of a business plan or amendments to an accepted plan, financial analysis, and examinations to ensure the captive has required statutory capital and surplus. Requirements are described in Hawaii Revised Statutes §431:19-108, viewable in its entirety at www.capitol.hawaii.gov. The Captive Branch of the Hawaii Insurance Division engages with Hawaii captives throughout this cycle. Examinations are conducted every three years although captive insurance companies may apply for an exemption to extend the examination to a five-year period.

#### What resources does Hawaii have for captive examinations?

In-house staff examiners - Captive Branch is comprised of 15 positions dedicated solely to captive regulation, oversite and development of the Hawaii captive domicile. Examinations and surveillance of captive insurance companies are performed by our staff examiners. This is of significant importance to our captive licensees because examination costs using examiners on staff is considerably lower in comparison to using contracted examiners. For example, an examination of a captive Risk Retention Group may be between \$20,000 to \$45,000 depending on the size, scope and complexity of the program. Full-scope RRG examinations performed by contractors have been known to start in the \$60,000 range or

even higher. In addition, the knowledge and insight gained by Captive Branch staff examiners through field examinations is applied to the ongoing financial analysis and surveillance of our companies."

Contracted examiners – Depending on the complexity of the program, contracted examination specialists such as information technology, actuarial and/ or investment specialists may be required to supplement our on-staff examiners in completing examination.

#### Hawaii's examination procedures and guidance

Captive risk retention groups – Examinations of captive RRGs are required to use the National Association of Insurance Commissioners' (NAICs) Financial Condition Examiner's Handbook to meet the NAIC's Accreditation Standards. The Financial Condition Examiners Handbook requires using the 'risk focused approach' when conducting captive RRG examinations.

The purpose of the risk-focused approach are:

- To detect as early as possible those insurers with potential financial trouble
- 2. To timely identify noncompliance with state statutes and regulations
- 3. To compile the information needed for timely, appropriate regulatory action
- 4. To provide a clearer methodology for assessing residual risk in each activity under review and to explain how that assessment translates into establishing examination procedures
- 5. To allow assessment of risk management processes in addition to those that result in financial statement line item verifications
- 6. To allow for the utilization of examination findings to establish, verify or revise the company's priority score determined through the Insurance

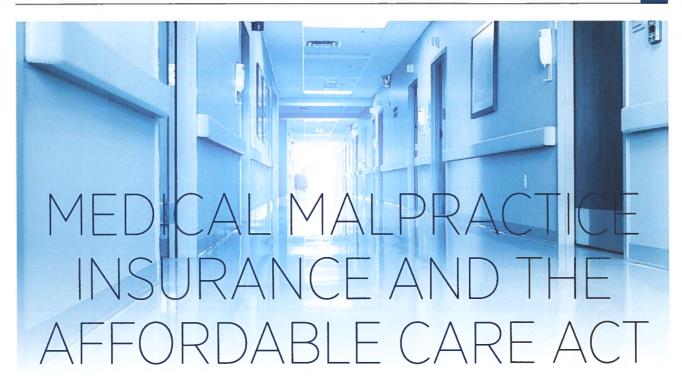
Division's ongoing analysis and utilization of NAIC's analysis tools

These elements allow for examinations that emphasize the analysis of an insurer's current or prospective solvency risk areas as well as the fair presentation of surplus.

Non-captive RRG companies – For non-RRG captive programs, Hawaii examinations require a comprehensive review and evaluation of the examinees financial position, compliance with statutory requirements and its approved business plan. In performing examinations of non-RRG programs, the Captive Branch continues to use a risk-focused approach; however, not to the same magnitude as required by the Examiner Handbook.

Hawaii tailored our state's risk-focused approach to consider not only risks facing the examinee at the examination as of date, but also risks which are anticipated to arise beyond the examination completion date, (i.e. prospective risks). Through a combination of interviews, discussions, questionnaires and review of auditor work papers, the Captive Branch obtains an overall understanding and is able to evaluate the examinee's business processes and controls to assess the financial condition and prospective solvency. Hawaii examiners learn about their captive's key processes such as underwriting, loss reserving, claims handling and investment, and capital management strategies to identify and focus efforts on those moderate to higher risk areas.

Lastly, the quality and reliability of the exams are an important consideration in corporate governance structure and risk management programs. The overall examination surveillance cycle allows the Captive Branch to delve into the mindset of management to ascertain whether the captive program is benefitting the overall holding company system and its insured. It provides necessary feedback as to whether the captive program is effective and serving the owners' needs.



Kyle Hales of Perr&Knight discusses the implications and benefits for doctors and hospitals related to medical malpractice insurance as a result of the introduction of the Affordable Care Act

Kyle Hales (KH): Since the introduction of the Affordable Care Act (ACA) in 2010, we have been witnessing a number of changes involving the medical malpractice insurance needs of doctors and hospitals. For example, we witnessed a significant shift in the relationship between doctors and hospitals, resulting from a change in relationship between doctors and patients. The ACA has resulted in a change to the way patients interact with doctors. Patients are now less likely to be seen by a single doctor, but rather be seen by a series of doctors who are part of an Accountable Care Organization (ACO).

#### Captive Review (CR): How has the introduction of the Affordable Care Act (ACA) changed doctors' relationships with hospitals?

**KH:** The hospitals are purchasing ACOs and bringing teams of doctors on-board in employed positions, whereas previously the doctors worked in a capacity similar to that of an independent contractor. The Affordable Care Act is creating a more concrete and consistent position for US doctors as hospitals begin to put them on the payroll.

CR: What does the ACA mean in regards to medical malpractice liability insurance?

## Kyle Hales, ACAS, MAAA Principal & Consulting Actuary – Perr & Knight

Kyle Hales is a principal and consulting actuary with Perr&Knight. He has extensive experience providing property & casualty actuarial services to insurance companies, captive insurers and self-insured entities. Hales leads a team of actuaries and oversees a team of consultants who engage in performing various risk management services for self-insured clients such as captives, risk retention groups, and certified self-insured entities.

KH: Previously, when doctors and hospitals were working independently, they would each have their own medical malpractice liability coverage. Often, when an incident was reported, the claimant would name the hospital, the doctor, the nurse, etc. In defending their named insured, it was not uncommon for each insurance carrier to incriminate the other defendants. Often, one defendant was making the plaintiff's case against the other defendants. Now that more doctors are employed physicians, the hospitals are either purchasing coverage directly for the doctors or otherwise influencing the doctors' insurance requirements.

As a result, the insurance carriers for the doctors and hospitals have united to work as one team, jointly defending these claims.

#### CR: What benefits has the ACA had on self-insured groups?

KH: Alongside the changes in medical malpractice and the relationship between doctors and hospitals, is the joining of doctors to self-insured groups. Medical malpractice for doctor groups is being amalgamated with the hospital self-insured program. As a result, these self-insured groups are becoming larger. This typically results in a financial benefit as most self-insured's fixed expenses are relatively constant. Additionally, the self-insureds are saving money on claim defense costs. For example, instead of having two attorneys researching an incident, defending the claim, etc., they are now defending the incident as a single claim thus saving on defense costs.

#### CR: Are there any future implications you envisage the ACA contributing to?

KH: It is too early to determine what kind of overall implication the introduction of the ACA will have on medical malpractice insurance requirements. Although, in what we have noticed so far, it appears to have been a win-win situation for both groups.

#### 6

## PURSUING PROSPECTS IN THE JAPANESE MARKETPLACE

Captive branch administrator, Sanford Saito, discusses the ever-evolving relationship between Hawaii and Japanese captives

number of domiciles, both established and niche, are beginning to pursue an emerging interest among Japanese corporations and their risk managers in captive insurance. Hawaii's approach to the Japanese marketplace is a joint effort highlighting the state's many strategic and regulatory benefits for Japanese captive owners.

Hawaii's captive insurance administrator, Sanford Saito, observed: "Over the past 12 months, we have seen a tremendous growth in Japanese captive formations. We attribute this to our commitment to educating and informing Japanese prospects through presentations and meetings, as well as state and industry efforts in fronting insurance companies, regulators and captive managers to lay the foundation for captive insurance programs."

#### A Japanese-Hawaiian background

At the close of 2015, Hawaii was home to around 200 captives (197 at 31 December 2015). Numbering among those 200 are 24 captives owned by Japanese corporations, with only half of them writing any US risk. This suggests Hawaii is seen as a

Written by Sanford Saito



Sanford Saito, CFE, was appointed in July 2014 as the deputy insurance commissioner and captive administrator for the State of Hawaii. He is responsible for the licensing and regulation of Hawaii domiciled captive insurance companies, as well as, the prudent development of this important industry for the State.

good option not just by those benefiting from the convenience of having a captive domiciled within a US jurisdiction.

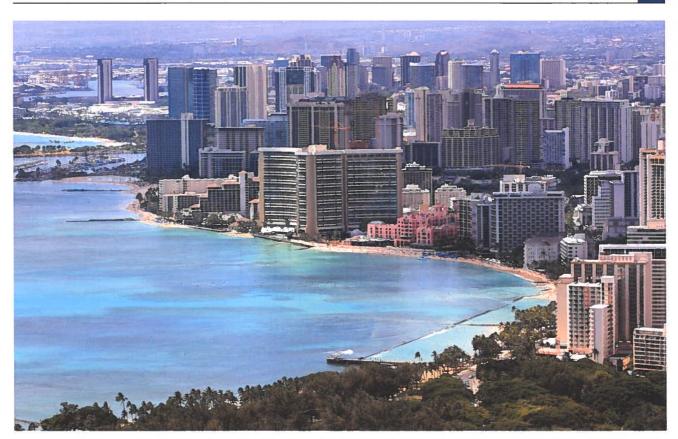
As a US jurisdiction, Hawaii offers many advantages for Japanese captive owners as a domicile of choice. Japanese captives domiciled in Hawaii have access to top line US investment managers and reinsurance markets while maintaining geographical proximity to Japan. Direct air access to Honolulu from many points in Japan is seen as a key benefit. Japanese captive owners have noted that Hawaii is strategically located such that their Hawaii captives can conduct business in many parts of the world in the same business day.

Japanese owners have also noted the lack of language or cultural barriers to doing business in or visiting Hawaii. Hawaii is an attractive place to visit, and is home to highly experienced regulators and professional service providers within the Hawaii captive industry who are fluent in Japanese.

Additionally, Hawaii has been licensing captives since the mid-1980s and has developed a reputation as a strong, stable and reliable domicile for captive insurance. As a mature domicile, regulators can leverage over 30 years of experience with a wide range of captive programs and insurance coverages to help captive owners, both Japanese and non-Japanese owners alike, in exploring how to utilize their captive efficiently.

Operationally, Hawaii also does not tax reinsurance premiums assumed, which is a significant cost advantage. This is particularly beneficial to all captive programs that act as reinsurers.

Lastly, Hawaii has allowed captive owners to transact their insurance business in their own functional currency, for Japanese-owned captives, yen as their functional currency, thereby avoiding



financial volatility due to foreign currency exchange rates.

#### Japan entering the Hawaiian market

A recent example of a Japanese company entering into captive insurance is the licensing of DCM Reinsurance Company, whose owners are the largest mobile telecommunications service provider in Japan. The decision to domicile DCM Reinsurance Company in Hawaii was helped by many factors including Hawaii's captive regulatory and premium tax structure and the fact that Hawaii's captive insurance service providers read, write and speak Japanese. These service providers include attorneys, audit firms, captive insurance managers and banks.

Some specific examples include:

- · Hawaii attorneys were able to communicate directly with the company's legal department to draft, review and execute key legal documents
- The company's Japanese accounting firm was able to resolve key accounting, compliance and tax issues with their Hawaii-based accounting firm affiliate
- The Hawaii-based banks communicated directly with the captive setup team in

Japanese to provide support and guidance in cash management matters.

"Over the past 12 months we have seen a tremendous growth in Japanese captive formations"

These organizational and operational issues were discussed in Japanese and ultimately led to board approval to form DCM Reinsurance Company.

The Hawaii domicile offers very important and attractive benefits with respect to premium taxation and regulatory environment. First, Hawaii's premium tax rates only apply to premium written directly that is not taxed elsewhere. Second, we do not tax reinsurance assumed premiums. This is of keen interest to a Japanese captive, or any Hawaii captive for that matter, as Hawaii does not apply a premium tax on reinsurance premiums assumed by the captive.

#### A match made in heaven?

Hawaii's flexible captive regulatory environment also played a key role in recent decisions by Japanese companies to form captives. Discussions with these companies allowed for the holding of the Captives' capital and operational accounts in yen, allowing for the elimination of most of the foreign exchange gain/losses that could occur if assets were held in US dollars. In addition, Hawaii regulators allow Japanese captives to report financial results in yen, the captive's functional currency, making consolidation of the financial statements significantly easier.

Hawaii has always had a long-term commitment and vision in establishing the state as the captive insurance domicile of choice for the Asia-Pacific region. In this region, Japan is a particular emerging captive market worth noting. The Hawaii Captive Branch, along with many local captive management firms and the Hawaii Captive Insurance Council, are working in concert with brokerage affiliates in Japan to educate businesses on the benefits and suitability of captives.

## HOW TREASURED IS YOUR COMPANY'S DOMICII F?



Christopher Mertes, the CFO and EVP of The Mutual Risk Retention Group, discusses the value of his company's domicile in the state of Hawaii

he Mutual Risk Retention Group, Inc. (The Mutual) is a risk retention group providing medical professional liability coverage in the acute care continuum (emergency room, hospitalists, intensivists, and anaesthesia). The company provides insurance for its insureds in 11 states and is the leading writer of the acute care continuum in the state of California. The Mutual enjoys a collaborative partnership with its founding and sponsoring organization, CEPAmerica.

The Mutual was formed as a mutual risk retention group in 1992 and began underwriting medical professional liability insurance as a Hawaii-licensed risk retention group. Since January 1998, The Mutual

Written by **Christopher Mertes** 

Christopher Mertes has more than 30 years of finance and management experience, including 25 years in medical professional liability insurance. He has been at The Mutual since 2003. Mertes was formerly on the board of directors of Hawaii Captive Insurance Council (HCIC).

has annually reported a net profit and an increase to its policyholder surplus. Since 2002, The Mutual's surplus increased over 600% to \$40.6m at year end 2014.

The Mutual's board of directors and man-

agement have worked diligently throughout the years to develop and implement a cohesive strategic plan that ensures financial stability while delivering the best insurance services to its insureds. As a result of the ongoing strategic plan, the company has developed many innovative programs.

One of the key developments to solidify the surplus base of the company was implementing a capital contribution requirement that is linked to equalized voting for all insured members. This program allows for ongoing capitalization of the company as it grows through new members while at the same time it also equalizes voting to ensure a direct and equal vote for all insured members.

#### THE MUTUAL RISK RETENTION GROUP | HAWAII



Another part of the strategic plan is the company's investment and support of an innovative risk management program that revolves around patient safety. The company developed a variety of patient safety services for its insureds including annual on-site seminars utilizing physician educators, topical newsletters, site assessments, litigation stress seminars, promotion of medical software, online education and most recently the formation of a new position of chief medical officer. The company's chief medical officer is an experienced acute care continuum physician who adds clinical expertise in the claims and patient safety areas, as well as serving as an officer on the executive management

To assist the company's management in the delivery of all facets of the strategic plan, the company has partnered with nationally and internationally recognized experts for actuarial, investment, reinsurance brokerage, tax consulting, legal and audit services. The company also has a strong reinsurance platform that utilizes domestic, London and international reinsurers that diversifies the company's risk.

In recognition of its successful underwriting, effective claims philosophy and proactive patient safety programs, combined with its excellent operating profitability and supportive capitalization, The Mutual was upgraded to a financial strength rating of 'A' with a stable outlook by A.M. Best in June 2015.

Captive Review (CR): How does Hawaii as a state of domicile differentiate from other popular domiciles?

Chris Mertes (CM): Hawaii is well respected as a state of domicile in its regulation of RRGs as well as being convenient to the west coast, with many non-stop flights into Honolulu. In addition, the weather is good all year long, so it is an easy trip in the winter. Hawaii is also the right balance of ease of conducting business and necessary regulation. Hawaii's stable regulatory approach means that we don't need to waste time and energy on the regulatory side of things. This enables The Mutual to concentrate on servicing its insured members.

CR: Can you tell us about the Hawaii DOI and its relationship with service providers and the captives/RRGs in Hawaii?

CM: I think the relationship between the

Hawaii DOI, the service providers, captives and RRGs is excellent. The lines of communication are open, and while the DOI are regulators, it is a collaborative relationship. If there are issues or questions, the people at the DOI who handle the RRGs and captives, are always willing to meet in person or by conference call.

CR: Can you elaborate on Hawaii rules, national rules and operations and how restrictive they appear in comparison to other domiciles?

CM: Hawaii has always been a conservative domicile as far as provisions gov-

"One of the key developments to solidify the surplus base of the company was implementing a capital contribution requirement that is linked to equalized voting for all insured members"

erning RRGs, however, we view that as a good thing. That being said, with the NAIC accreditation program, most if not all states that are captive domiciles for RRGs formed as captives, have adopted the same types of laws applicable to RRGs under the NAIC accreditation program. We don't view the Hawaii statutes and regulations as overly restrictive, and we have been able to work within that framework in building our policvholder surplus and achieve an 'A' rating from A.M. Best.

CR: What is the reputation of Hawaii as a state of domicile and how does this affect the captive industry on the island?

CM: I think Hawaii has a good reputation as a captive domicile. As one of the 'older' or original domiciles, the State has developed experienced staff within the DOI, and the service provider sector has a significant breadth of experience and depth. Due to this positive reputation, there are large national and multi-national companies that have large captives that are domiciled in Hawaii

#### CR: What kind of support is offered to captives and RRGs in Hawaii?

CM: I think there is great support for captives and RRGs in Hawaii. The support comes from the DOI, the service providers, as well as from the Hawaii Captive Insurance Council (HCIC). The DOI holds periodic meetings with the industry to discuss various topics, including prospective legis-

lation and regulations that will or might affect the industry. In addition to its annual conference, the HCIC also hosts periodic webinars and other educational sessions.

#### CR: How does Hawaii rank in terms of regulatory costs for RRGs?

CM: Regulatory costs break down into three main areas: license fees, premium taxes and regulatory examination charges. Hawaii's license fee for RRGs is competitive at \$500 a year and the state also does not double-tax premiums, since The Mutual pays premium taxes to the states in which risks are written, we do not pay any premium tax again in Hawaii. This can be a significant savings over other captive domiciles who either impose higher annual license fees or premium taxes.

Last for regulatory exams, as long as the exams are conducted by in-house Insurance Division personnel, the exam costs are reasonable and comparable to other domiciles. We understand that many captive domiciles outsource the examination function, and in our experience have found outsourced exams to be significantly less efficient and more costly.

CR: What industry trends do you expect will be of the most significance to Hawaii as a state of domicile in the next 12 months?

CM: It will be interesting to see if the initiative pending in Congress to amend the Liability Risk Retention Act will advance. From a Hawaii standpoint, Hawaii's entry in to the Far East, in particular, Japan, appears to be advancing, so that while Hawaii will continue to attract formations from sources in the US, there will likely be increasing formations from Japan.



#### ACCUITY LLP

Jamie Asato, 808.531.3442, jamie.asato@accuityllp.com, 999 Bishop Street, Suite 1900 | Honolulu, Hawaii 96813-4427 Accuity LLP is one of Hawaii's largest CPA firms, serving Hawaii's insurance industry through a dedicated insurance group comprised of highly trained audit, tax and consulting professionals. Accuity is ranked 7th in the nation according to A.M. Best's 2015 Amount of Statutory Premiums Audited and performs NAIC financial condition examinations of Hawaii domiciled insurers on behalf of the Hawaii Insurance Division. Accuity and is the only locally owned PCAOB registered firm in Hawaii and the exclusive Hawaii member of Baker Tilly International – the eighth largest international network of independent CPA firms in the world.



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Fay Okamoto; 808.426.5906; fay\_okamoto@artexrisk.com; 1357 Kapiolani Boulevard, Suite 1430, Honolulu HI 96814 Artex Risk Solutions provides a gateway to creative programs, competitive capacity and collaborative expertise. We're experienced in the full spectrum of risk management alternatives. From guaranteed cost to captive, a risk transfer solution is available or can be designed to fit a client's specific risk management and financial objectives. Operating in over 22 domiciles and with a staff of 300+ specialists in 15 global offices. Artex has the proven capacity to supply a needed alternative to the traditional insurance market.



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Founded in 1897, Bank of Hawaii is a leading financial institution offering full service banking in the state of Hawaii with locations on each of the major Hawaiian Islands. Bank of Hawaii has strongly supported the captive insurance industry here in Hawaii since its inception. Bank of Hawaii has been consistently recognized globally, nationally and locally as one of the strongest banks in the industry. As the Bank of Hawaii, our commitment to the community is not just the right thing to do, it is part of all that we do.



#### **BEECHER CARLSON**

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Beecher Carlson has been helping clients explore and understand the many alternatives to traditional insurance in Hawaii alone for more than 25 years. In addition to being named 2015 and 2012 Captive Manager of the Year as well as the 2013 winner of Innovation in Captive Management, our National Captive Practice leader, Jason Flaxbeard, was named to the 2013, 2014 and 2015 "Power 50" list by Captive Review. Contact us today to discuss your captive needs at 800.657.0243 or visit us at beechercarlson.com.



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First Hawaiian Bank's investment management team offers in-depth knowledge and proven experience with captives in Hawaii for over 25 years. We partner with your captive to provide appropriate solutions relative to Hawaii captive law and customer objectives. Our asset allocation strategies can be customized to fit your objectives.



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#### STATE OF HAWA

Department of Commerce & Consumer Affairs | Insurance Division | Captive Branch, Sanford A. Saito, Deputy Commissioner and Captive Insurance Administrator, 808.586.0981 | captiveins@dcca.hawaii.gov, 335 Merchant Street | Room 213 | Honolulu HI 96813

Experience, Reliability, Accessibility - Hawaii is one of the world's premier domiciles for captive insurance. With more than 25 years experience, Hawaii's Captive Insurance Branch leads the way with specialized insurance regulatory expertise and reliable professional services. We believe in prudent, but flexible regulation of captive insurance companies in this rapidly changing environment.



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## COR-NER-STONE:

#### AN IMPORTANT QUALITY OR FEATURE ON WHICH A PARTICULAR THING DEPENDS OR IS BASED

Members the Hawaii Captive Insurance Council, Matthew Takamine and Paul Wagner, provide expert background information on the council and its role in the Hawaiian captive industry

uch as a strong building requires a solid foundation, so does a successful captive domicile. In the case of a building, cornerstones support the structure above it, enabling the building to reach great heights. For a successful captive domicile, such cornerstones are also needed - in the form of strong regulatory approach, government support of the captive program, quality captive owners, and an active network of service providers.

Owners and service providers come together in the Hawaii Captive Insurance Council (HCIC) to promote, develop, and maintain a quality captive insurance industry in the State of Hawaii.

Service providers serve as the backbone of HCIC operations. Hawaii is blessed with an abundance of experienced service provider talent, many of whom have worked in the industry since its infancy. HCIC has no paid employees, running its operations through a combination of outsourced contractors and volunteers from the industry.

"As much as we (service providers) are all competitors in our day jobs, there is a definite sense of team when we work on HCIC initiatives," states Matt Takamine, HCIC Chair.

In addition to an active service provider membership, Hawaii's captive owners are vocal and active in the association. Paul Wagner, HCIC President and a captive owner observes: "The level of captive owner involvement in HCIC is, I think, unique to Hawaii. You don't see the same level of interaction and solicitation of captive owner input in other captive domiciles."

Last, but certainly not least, is HCIC's partnership with State of Hawaii captive regulators. By working in concert, both public and private sectors vet legislative and regulatory changes before they are implemented. Such collaboration minimises the chance of unintended consequences,

Written by Paul Wagner

Paul Wagner is vice president of alternative risk techniques at AGL Resources. Wagner utilizes risk financing, integrated structure and aggregate enterprise basket techniques. He earned a BS (Wharton School. University of Pennsylvania) an MBA (Kennesaw Uni-

versity) and CPCU, ARe and ERM certificate. Wagner

is active in the Hawaii Captive Insurance Council.

Written by **Matthew Takamine** 

Matthew Takamine, CPA, is the head of Beecher Carlson's Hawaii office and supervises the company's captive operations for the western United States. Matt has over 18 years of experience working with captive insurance companies. Before joining Beecher Carlson, Matt spent nine years in public accounting with KPMG LLP, most recently as a senior audit manager.

"Hawaii is blessed with an abundance of experienced service provider talent, many of whom have worked in the industry since its infancy"

confusion, and potentially harmful policy decisions, leading to greater stability for the

Fulfilling its role as a cornerstone of Hawaii's captive industry, promoting a

strong and vibrant environment for Hawaii captive owners, is what HCIC is all about.

#### Hawaii Captive Insurance Council

The council was formed in 1991 and has 80+ current members.

Captive owners are:

- · 60%+ of HCIC membership
- · Represent 30% of active Hawaii captives

#### Our mission

Guided by the Aloha spirit, the HCIC unifies and supports captive owners, regulators, legislators and captive service providers. The HCIC advocates on issues and initiatives, educates on current and future issues and communicates this information to its members and prospective members to maintain Hawaii as a world-class captive domicile.

#### Our projects

- ·Organise annual educational forum and other educational events
- · Present marketing seminars in Japan and
- · Speak at other captive industry events
- · Promote Hawaii as a captive domicile on the local, national and international
- · Advocate for Hawaii captive industry through all levels of government
- · Educate captive business producers through our scholarship program
- · Liaise with other captive organizations

#### Our alliances

- · Captive Insurance Companies Association (CICA)
- · National Risk Retention Association (NRRA)
- · International Centre for Captive Insurance Education (ICCIE)
- · The risk management society (RIMS)
- · Chartered Property & Casualty Underwriters (CPCU)
- · Hawaii Chamber of Commerce 6



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