

The Grand Canyon of captives

Arizona Captive Insurance Association president Rae Brown says the state's captive service providers are not only seeing an increase in captive formations but also inquiries to determine the use of captives as a strategic tool in risk management programmes



What trends have you seen in the Arizona captive market?

After years of a flat or falling insurance market, Q1 2019 saw an increase in premium rates in nearly all commercial markets except workers compensation. Hardening markets are being attributed to sustained low investment rates of return and higher than expected losses not to mention pandemic losses for high severity/low-frequency coverages. The result for Arizona is an increased interest in alternative risk transfer

options. Arizona captive service providers are not only seeing an increase in captive formations but also inquiries to determine the use of captives as a strategic tool in risk management programmes.

Along with new formations, existing Arizona captives have sought to expand the capacity of their existing lines of coverage and add new lines to their captive. Arizona has historically seen a steady year-over-year increase in the numbers of captive insurance company formations and I expect the trend to continue.

What has the AzCIA been working on over the past few months?

The Arizona Captive Insurance Association (AzCIA) has been very busy over the last couple of years. In 2020, as a domicile association member of the Western Regional Captive Insurance Conference (WRCIC), we made the decision to postpone our annual regional conference until May 2021. However, we are committed to continuing to educate and engage our local captive

community and will be announcing a summer series of webinars available to the WRCIC community. We also kicked off a monthly WRCIC virtual happy hour recently with guests from all over the country.

Early in 2019, AzCIA participated in drafting and submitting the amicus brief to the 10th Circuit Court of Appeals in support of the Reserve Mechanical v. IRS appeal. AzCIA was pleased to join a total of 11 captive industry associations and the Self-Insurance Institute of America (SIIA) in those efforts.

AzCIA also drafted a response to the recent IRS letter 6336 targeting small captive insurance companies. The response was sent to each of the Arizona congressional delegates expressing our discontent with the requirements and timing of the letter's content.

Most recently, we pledged our support to join a coalition of captive insurance associations and advocates to support the Supreme Court appeal efforts of CIC Services.

Have you seen an uptick in interest around captive insurance since the COVID-19 pandemic?

I believe the uptick in activity related to the COVID-19 pandemic will occur as an after effect. For practical purposes, losses are still occurring. It may not become abundantly clear which captive coverages are the most applicable until thoroughly vetting captive policy language. I have experienced increased inquiries, but I believe that when parent company operations begin to return back to normal there will be a call for a refresh of risk management strategies and that is when we will see the true uptick of interest in the solutions the captive industry has to offer.

How is the state's insurance department helping the captive industry during the pandemic?

The Arizona Department of Insurance, Captive Division (DOI) has always maintained an open-door policy and is available and responsive to the local community. The captive division team has many years of tenure with the DOI and are a telephone call or email away to help when needed. Specifically, during the isolation period of the pandemic, they have remained open for business and are working remotely without much disruption to captive owners and service providers.

In response to the pandemic, the DOI has communicated that they are as flexible and accommodative as they can regarding captive filings and are offering extensions on a case by case basis.

Also, based upon the CDC's recommendations related to the risk of air travel and the need for social distancing the requirement that a captive insurer's board of directors meet at least once each year in Arizona can be accomplished by means of a telephonic meeting presided over by the Arizona resident Director.

Does the Arizona Captive Insurance Association work close with the insurance department? How important is this?

The AzCIA has always maintained a close relationship with the DOI. We are the conduit between the captive owners and the DOI and are invested in fostering the relationships between the two.

The captive owners and service provider members of the AzCIA are the eyes and ears of the industry for the DOI. Its membership and allies

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are involved in many different domiciles helping to drive industry stability both domestically and offshore. The interdependent relationship between the AzCIA and the DOI is essential for keeping the DOI apprised of industry trends and statute changes that give them a platform to determine what is best for the Arizona domicile.

Currently, the Governor of Arizona has started interviewing candidates for the director's position after Keith Schraad's departure in early 2020. When the appointment is finalized, the AzCIA will actively work to educate the new director on the benefits of the Arizona captive industry and the importance of the DOI captive division. We understand the intricacies and benefits of captive insurance and will promote them to the new Director for the benefit of our clients and colleagues.

“At this point in 2020, the biggest challenge for the captive industry as a whole is two-fold: COVID-19 fall-out and IRS scrutiny”

What are the biggest challenges for the captive industry right now?

At this point in 2020, the biggest challenge for the captive industry as a whole is two-fold: COVID-19 fall-out and IRS scrutiny.

There will be much to learn from the pandemic for captives and it will take time to sift through the details to learn the lessons and plan for our future. Just a few of the questions that we are asking: What captive coverages are applicable to the pandemic; what commercial coverage restrictions will the already hardening marketplace place on future captive coverages; will a Pandemic Risk Insurance Act (PRIA) become available as a federal backstop? The answers to these questions and countless others will be the drivers in the near future of the captive industry.

The other continued challenge for the industry is the outreach of the IRS to place captive insurance under intense scrutiny. The amicus brief submitted on behalf of Reserve Mechanical and the captive association coalition forming to respond to the CIC Services 10th Circuit Supreme Court appeal are excellent examples of our efforts to show support and put forth efforts to respond to the unreasonable demands placed upon captive insurance companies for the last few years.

How do you expect the Arizona captive market to change over the next 12 months, what do you expect to see?

As I have mentioned, I foresee a shift in the types of companies that want to participate in alternative risk transfer programmes such as a captive insurance company. The pandemic will undoubtedly expose risks that companies are unwilling to continue to self-insure but are also unavailable in

the commercial market. It is only logical to forecast an increase in captive formations, for both mid-size and large corporations. I would also expect to see established captives with more traditional lines of business adding enterprise risk coverages.

Arizona has a reputation as a solid domicile, and with no premium tax or statutory exam for pure captives, I would expect to see a higher year-over-year increase in 2020 captive formations. Prior to the dramatic change, COVID-19 brought with it the state was already experiencing an uptick related to the hardening market from both new formations and expanded lines in existing captives.

What will AzCIA be working until the end of the year?

Given the current global circumstances related to COVID-19, AzCIA will spend the remainder of 2020 engaging our local captive community. Our challenge is to creatively adjust how we engage the community and an upcoming summer webinar series is only the first step in serving our membership and allies. Our talented board members are working through ideas that provide value in formats which do not require in-person contact. We also continue to work with the DOI in their efforts to market Arizona as an attractive captive domicile. We have collaborated on their increased marketing exposure and we look forward to continuing those efforts.

Lastly, we will continue to be actively involved in the lobbying efforts with our fellow captive associations on behalf of the industry. We feel that coming together as a collective voice in support of the captive insurance industry is one of our most important missions. ■