MARSH

Captive Solutions: Creating Security in an Uncertain World

CONTENTS

1 Foreword: The global risk stage.

2 Executive Summary: What did we discover?

6 Captive Vitals: What do you need to know about captives?

- Why form a captive?
- What risk-financing vehicle fits best?
- Does captive size matter?
- Where in the world are captive parents located?
- Where do I domicile my captive? And why?
- Captive redomestication.
- What do I need to know about captive taxation?
- Why do captives insure unrelated risk?
- How are small captives obtaining risk diversification?

16 Industry: What types of organizations are utilizing captives and what are they using them for?

- Top industries utilizing captives.
- Growing industries.

22 Global Risk Stage: What role can captives play in the world today?

- Global uncertainties.
- Gaps in traditional coverage.
- Captive solutions.

24 Global Events: What global risks can captives protect against?

- Terrorism and global terrorism pools.
- Cyber.
- Political and societal risks.
- Environmental/climate change risk.
- Financial risk.
- A changing workforce (workplace disruption).

31 Captive Spotlight: What are specific examples of how captives can flourish?

- Global employee benefits spotlight.
- Captive innovation in defined benefit pension financing arrangements.
- Medical stop-loss and voluntary employee benefits.
- Investment spotlight.

37 Regulatory Developments: How has the legal landscape changed this past year?

- EU – Solvency II.
- UK Diverted Profits Tax (DPT) and Base Erosion and Profit Shifting (BEPS).
- 831(b) captives.
- Federal Home Loan Bank (FHLB) captive access.
- US Self-Procurement Taxes (SPT).
- TRIPRA and the terrorism backstop in the US.

FOREWORD

The world we live in today looks and feels very different than it did only a few years ago. Internationally, the urgency of tackling newly emerging, multifaceted issues that impact our wellbeing has become a priority for many. As a result of these evolving concerns, the insurance market is entering a period of unprecedented change. Our ninth edition of Marsh Captive Solutions' *Captive Benchmarking Report* examines the global challenges facing society and the role that captives can play in meeting these unique challenges across the global risk stage.

The threat of radicalism, terrorism, geopolitical volatility, financial disasters, environmental changes and catastrophes, as well as other uncertainties affect businesses of every size, shape, and geography. The insurance market is being pressured to quickly develop innovative solutions that address new and emerging risks and protect organizations in our changing world. In some cases, however, the market is falling short due to the relentless acceleration of these risks. Captives offer a unique solution for organizations struggling to find adequate insurance solutions, and we have seen a substantial increase in captive utilization for these emerging risks.

This report benchmarks 1,139 captives managed by Marsh worldwide. In this report, we have looked back over multiple years to identify captive utilization trends. We challenge you to question your captive program: Is it helping deliver solutions to the emerging challenges your organization faces?

The operating environment that organizations face is constantly changing, so it is vital that organizations continually re-evaluate their risks. As the leading captive manager, it is our responsibility as a trusted advisor to inform our clients, colleagues, and members of the captive industry of new and innovative ways captives can be used to grow profitably, while also addressing evolving global risks.

Marsh Captive Solutions' *2016 Captive Benchmarking Report* aims to deliver the most comprehensive analysis of the current captive landscape to provide insights for organizations in these uncertain times. We trust you will find value in the exclusive data provided and the conclusions drawn. Above all, please reach out to your Marsh Captive Solutions representative if you require further details.

CHRIS LAY
President, Marsh Captive Solutions

EXECUTIVE SUMMARY

ADDRESSING GLOBAL UNCERTAINTIES ACROSS THE GLOBAL RISK STAGE

As the world continues to change, our clients are looking for innovative ways to address the uncertainties that come with it. This year, Marsh benchmarked 1,139 captives globally, many with new and emerging exposures ranging from cyber and political risk to terrorism. This year, we aim to help current and prospective captive owners and industry experts recognize the gaps that these new and emerging risks create in their risk management programs. We challenge our readers to look toward the future and the changes it may bring. With this in mind, this report aims to provide the tools and insights you need to create more security in an uncertain world; we hope to demonstrate how captives can be used to achieve this.

VALUE-DRIVEN REASONS TO FORM A CAPTIVE

The top reasons cited why organizations are forming captives fall into three broad, value-driver categories:

1. Increased discipline and control purposes (54%).
2. Reinsurance accessibility (38%).
3. Writing unrelated risk (17%).

Approximately 18% of Marsh-managed captives wrote unrelated risk in 2015; 95% of these organizations cited this as the value-driving reason for forming their captives. Writing unrelated risk can also generate additional underwriting profits and assist with overall captive risk diversification.

EMERGING RISKS AND COVERAGES

Each year, Marsh looks at the top five fastest growing non-traditional risks in Marsh-managed captives.

In 2015, multinational benefits represented the fastest growing coverage with growth of 143%. Compared to flat growth in 2014, this surge in interest is astounding, and it represents a growing interest in incorporating employee benefits programs into existing and new captives. Supply chain closely followed with 133% growth in 2015; nearly triple the 2014 growth for this coverage.

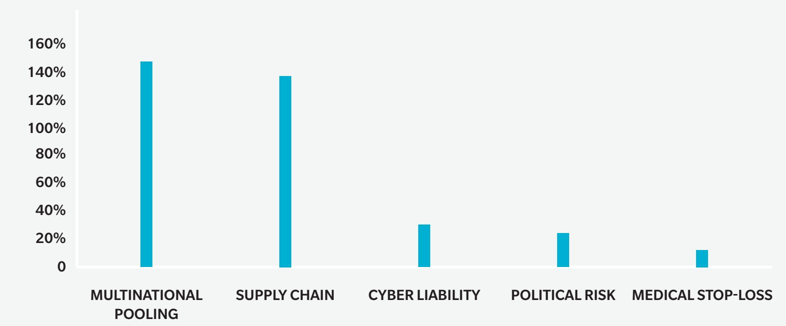
Cyber liability, political risk, and medical stop-loss experienced less explosive growth at 30%, 27%, and 14% respectively. All three coverages, however, experienced consistent and significant growth over the past four years, a trend we expect to continue.

GLOBAL EMPLOYEE BENEFITS

Globalization and the changing workplace are also creating new exposures in the realm of employee benefits. As an organization's workforce grows and spreads across the globe, it becomes more costly to offer employee benefits. Captives can offer innovative solutions that can significantly reduce costs by optimizing the program and risk-financing structure. Multinational employee benefits coverage is one of the fastest-growing coverages over the past year. The number of Marsh-managed captive owners utilizing their captives for multinational employee benefits has increased by 10 in 2015, a 143% increase from the year prior. We expect to see more captive utilization in employee benefit funding arrangements as increasing numbers of organizations seek to improve control and financial efficiencies in benefit arrangements across the globe.

We also took an in-depth look at the uncertainties created by a changing workforce. Some of the most impactful changes include an aging workforce, an increase in the number of remote and contract workers, globalization, and rapid digitalization. As the average age of the workforce continues to increase, interest in adding medical stop-loss programs to captives has increased. From 2014 to 2015, there was a 14% growth in the number of Marsh-managed captives with medical stop-loss programs and, remarkably, a 95% increase over a four-year period. We expect to see continued growth and interest in medical stop-loss programs as medical costs rise.

Top Five Fastest Growing Non-Traditional Risks in 2015



CYBER EVENTS

Cyber liability is one of the most well-known emerging risks; it is a constantly evolving risk that impacts most modern organizations. From 2014 to 2015, the number of Marsh-managed captives using cyber liability programs increased by 30%. Over the past four years, cyber liability programs in our captives, both new and existing, have grown by 160%. There is a need for innovative solutions to create security against emerging cyber risks, and captives are meeting this need for many of our clients.

Over the past year, we have seen new forms of cyber terrorism rise and a sharp increase in cases of cyber extortion, where cyber criminals hold an organization's data for ransom during a cyber-attack. Although cyber liability capacity remains abundant in the commercial market, for clients in some industries, market pricing and appetite has deteriorated. There also remains gaps in traditional coverage for exposures the market will not write. We see significant growth in the number of our captives that are writing cyber risk. Captives are providing access to higher limits and more comprehensive coverage, and they are becoming a more attractive option as this threat continues to grow.

GEOPOLITICAL RISKS

Marsh played a key role in analyzing risks for the World Economic Forum (WEF) that took place in Davos, Switzerland in January 2016. Some of that analysis helped focus portions of the global economic risks WEF chose to highlight in its *Global Risks 2016* report. Given today's geopolitical climate, we expect to see continued growth and interest in captives writing political risk programs. From 2014 to 2015, there was a 27% increase in the number of Marsh-managed captives writing political risk, covering risks in countries like Venezuela and countries in North Africa. This is a notable difference from the flat growth that we saw last year. Over the past four years, we have seen a 58% increase in the number of Marsh-managed captives writing political risk.

While political unrest is not new, the exposures it creates are new to many organizations. In an age of globalization, it is important to recognize the risks political unrest creates for an organization with operations in an affected region. When the political climate seems particularly turbulent in a region, it may become difficult for these organizations to access affordable coverage. New and sudden exposures that come with political unrest can also be difficult to cover. For these reasons, many organizations are looking into adding political risk coverage to their captive programs.

TERRORIST ACTS

Amid political unrest and significant political violence, we saw noticeable growth of Marsh-managed captives accessing the benefits of the Terrorism Risk Insurance Act (TRIA). From 2014 to 2015, the number of Marsh-managed captives accessing TRIA increased from 93 to 109, a 17% increase. In this year's report, we focus not only on excluded perils from property policies but on captives that also write conventional terrorism. In light of recent terrorist acts globally and in the US, we thought it prudent to highlight captives that also write a portion of conventional perils in addition to nuclear, biological, chemical, and radiological (NBCR) risk. Marsh continues to urge all captive owners to think about the financial impact of a catastrophic NBCR terrorism event. This risk is predominantly excluded from commercial terrorism policies;

it can, however, be covered effectively through a captive. Over the past year, global terrorism events have increased, and our goal is to continue to help captive owners explore whether accessing TRIA for these uninsurable perils is beneficial to them.

CAPTIVES GO GLOBAL

Historically, captives were primarily formed by parent companies in two regions, North America and Europe. However, new regions have begun to emerge in the captive market over the last few years. Parent companies around the world are forming captives. In this report, we identify three emerging regions that saw particularly interesting growth over the past four years.

There is positive growth in more emerging regions than ever before. In terms of percentage growth, Latin America, Asia, and the Middle East are experiencing historic growth; however, when looking at the actual number of new captives being formed, North America sets the record with a net increase of 21 captives managed by Marsh over the last year.

LATIN AMERICA

From 2012 to 2015, five new captives, a 44% increase, were formed by parent companies in Latin America, making it the fastest growing international region. Marsh Captive Solutions worked on 42 active captive opportunities and delivered 20 advisory projects for organizations in Latin America. These numbers reflect just how likely it is that this region will continue to embrace captives. With increasing economic activity in the region, the growth of captives will naturally flow as organizations become aware of their benefits. Even more interestingly, our Marsh colleagues in the region reported that 80% of the feasibility-study engagements are coming from organizations without any US risk. Parent companies in Latin America are asking more questions and showing a growing interest in the captive vehicle. We expect growth to continue in the region.

ASIA-PACIFIC

Asia-Pacific has experienced consistent growth over the past four years. Although it did not experience the same growth as Latin America, we cannot ignore the consistency of its progression. Captives have garnered interest from parent companies within the Asia-Pacific region. China, Japan, Singapore, and organizations from several other countries within this geographical sector are forming captives and creating the potential to compete with Latin America in significant and rapid growth. These organizations are forming captives for an array of reasons, including economic stability, proximity, accessing reinsurance markets for much needed additional capacity, and tax efficiencies.

MIDDLE EAST

Although there are not staggering numbers of captives being formed by companies based in Dubai, Abu Dhabi and other financial centers, the fact that Middle Eastern companies are open to discussion and education about captives shows that there is a movement similar to what happened in Asia and Latin America and we project that this region will be the next emerging market on the global risk stage.

CAPTIVES: TAXES AND REGULATORY DEVELOPMENTS

From 2014 to 2015, we saw a 35% growth rate of small captives electing to be taxed under section 831(b) of the Internal Revenue Code in the last year. However, still less than 50 percent of our managed captives take a tax position and obtain income tax efficiencies, proving the fact that there are many business and risk management reasons for owning and operating captives. In Europe, the Organisation for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) Package, which consists of 15 recommendations, is still very new and the proposals are still being reviewed by various countries that may or may not enact legislation that will affect captives and we are finding ways to help clients become 100% compliant.

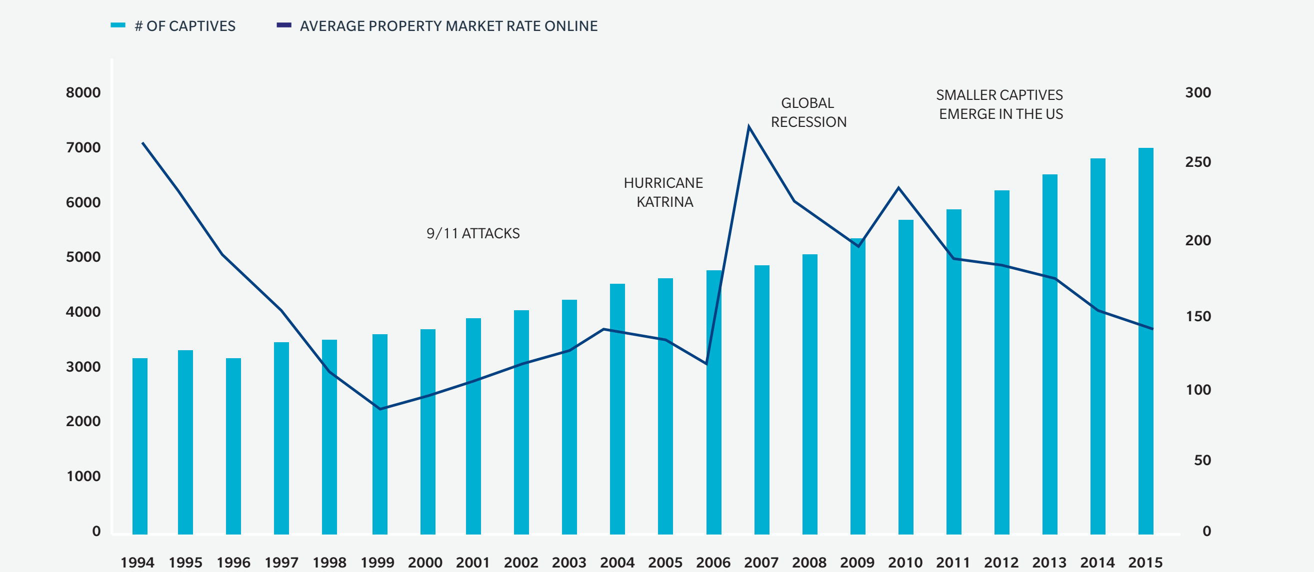
A FIT FOR EVERY INDUSTRY

Captives are known for being heavily utilized in industries, including financial institutions, health care, auto and manufacturing, retail and wholesale, and communications, media, and technology. Marsh manages captives across each of these industries, and we are seeing a growing interest across others. In this year's report, we look at the top five industries and also examine the five industries in which we have seen growing interest — and expect to see rapid captive growth: construction, energy, real estate, education and sports, entertainment, and events.

IMPROVING YOUR CAPTIVE'S INVESTMENT STRATEGY

Our analysis shows that captives continue to maintain very low-risk investment strategies, on average, with the bulk of investment assets held in fixed income and cash. There can, however, be significant differences between captive portfolios, depending on the size of the assets, the domicile, and the industry sector of the captive owner. The risk-adjusted performance of captive investment portfolios over recent years has generally been strong, with monetary policies driving strong returns for fixed-income assets and riskier assets such as equities. Looking forward, the picture is uncertain with cash rates and bond yields projected to remain relatively low for the foreseeable future and economic and geopolitical risks increasing. As such, we recommend that captives review whether their asset strategy remains relevant going forward, and Marsh and Mercer are here to help.

FIGURE 1 **Total Captives Worldwide by Year with Corresponding World Events**
Business Insurance – Special Report, February 29, 2016: 12



CAPTIVE VITALS: WHAT DO YOU NEED TO KNOW ABOUT CAPTIVES?

WHY FORM A CAPTIVE?

The reasons why organizations in all industries and of all sizes form captives are numerous. Two main drivers (highlighted in the value-driver section below) are cost savings and more rigorous discipline, control, and formalization of insurance. Interestingly, over the last 23 years, with the exception of only one year, captives have always grown in number during global disasters and periods of international instability that have significant financial impact on organizations. In this report, we focus on the reason for this phenomenon.

Figure 1 demonstrates a lack of relationship between the commercial market rate online and the number of captive formations. This suggests that captive formations continue to rise regardless of what the insurance market is doing because of the diversity of benefits they provide.

To help readers of this report reflect on their own captive operations, or the reasons driving their interest in implementing a captive program, we have compiled and analyzed a list of the most common reasons to explore a captive option, as cited by our clients. The value driver behind taking the time and energy to set up and incorporate a captive is critical to its long-term success. Organizations should take the opportunity to reflect on why they already operate a captive or why implementing a captive could be beneficial. Figures 2A though 2C

FIGURE 2A Captive Value Drivers - Funding Corporate Retained Risk

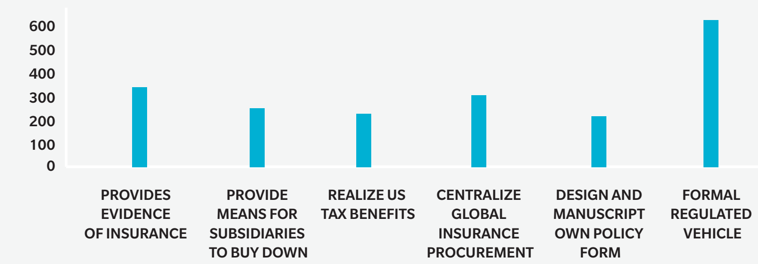
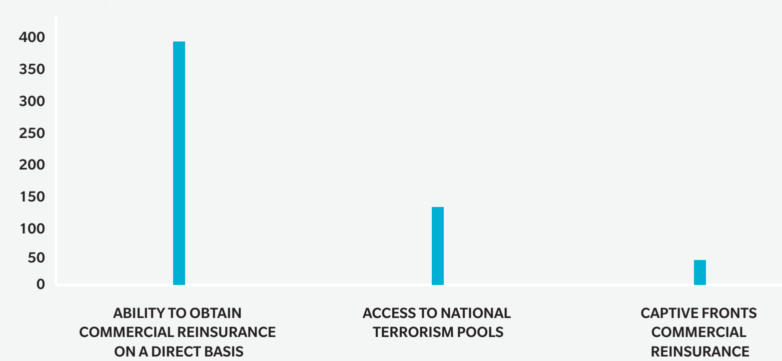


FIGURE 2B Captive Value Drivers - Unrelated Risk

FIGURE 2C Captive Value Drivers - Accessing Reinsurance



articulate the various reasons why captive owners say they originally took the initiative to form a captive.

Learn more about what Marsh Captive Solutions can do for your business:

https://goo.gl/jCMmBc

WHAT RISK-FINANCING VEHICLE FITS BEST?

There is no question as to the most prevalent structure for a captive arrangement. A majority (67%) of captives managed by Marsh Captive Solutions utilize the single parent structure. A single parent captive is its own entity, with 100% control of both decision making and operational management, which allows organizations the flexibility to have full say in matters ranging from an investment policy to engaging the service providers of their choice. Since 2012, there have been 38 additional single parent captives formed; many of these captive formations can be attributed to the rise in captives making the 831(b) tax election and captives accessing the Federal Home Loan Bank. Additionally, the rise of special purpose vehicles (SPVs) and other innovative risk-financing vehicles that have been developed is why this type of risk-financing vehicle is the next largest category after single parent captives. For example, the usage of catastrophic (CAT) bonds, insurance linked securities (ILS), and other non-traditional strategies have allowed organizations to expand their risk management programs in new and innovative ways.

Historically, single parent captives were used to improve the efficiency of an organization's property and casualty programs. Today, risk managers are facing an array of new risks, and the use of SPVs, group captives, and cell facilities are gaining interest. Both traditional SPVs and ILS are primarily owned by financial institutions, which comprise approximately 9% of the captives benchmarked in this study. These vehicles are generally used to protect the organization from financial risk and to control capital and surplus with efficient mechanisms popular among commercial insurers. The most common domiciles for SPVs are shown in Figure 4 below, with Dublin taking the lead for creative financial transactions and Bermuda entities accessing CAT bonds for large scale, longer term durations. In the US, Vermont and South Carolina have significant experience with life insurance entities establishing captives for XXX/AXXX capital relief efficiencies.

Single parent captives are the leading captive structure for all Marsh-managed captives regardless of size. SPVs are more common among extra-large (greater than US$20 million in net premiums) and small (less than US$1.2 million in net premiums) captives than large (between US$5 million and US$20 million in net premium) and average (between US$1.2 million and US$5 million in net premiums) captives that tend to explore alternative risk vehicles such as cell captives, group captives, and risk retention groups (RRGs). Nonetheless, there is a variety of captive structures that can offer a multitude of opportunities for organizations of any size, dispelling the myth that captives are only appropriate for large, Fortune 1000 or FTSE 100 companies.

DOES CAPTIVE SIZE MATTER?

Net premiums are used to determine captive size. Traditionally, the captive domain was dominated by extra-large captives generating more than US$20 million in premium each year. These captives were predominately established by FTSE 100 or Fortune 500 companies. From 2012 to 2013, small captives, formed mainly by mid-market companies, greatly exceeded the number of extra-large captives managed by Marsh. Small captives represent companies whose annual premiums equate to less than US$1.2 million. Currently, close to 35% of the captives benchmarked are categorized as "small." Not all small captives listed elect to take the US Federal tax election under section 831(b). In fact, many of the small captives Marsh manages

FIGURE 3 Type of Risk-Financing Vehicle

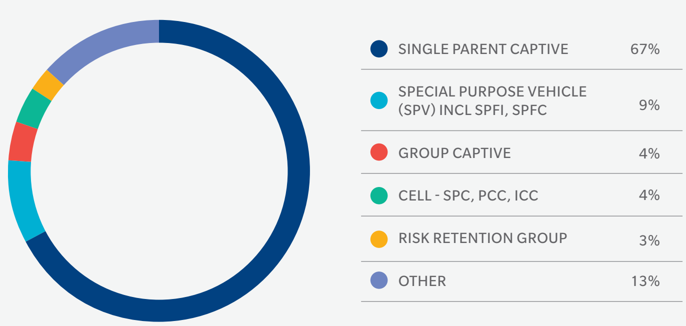
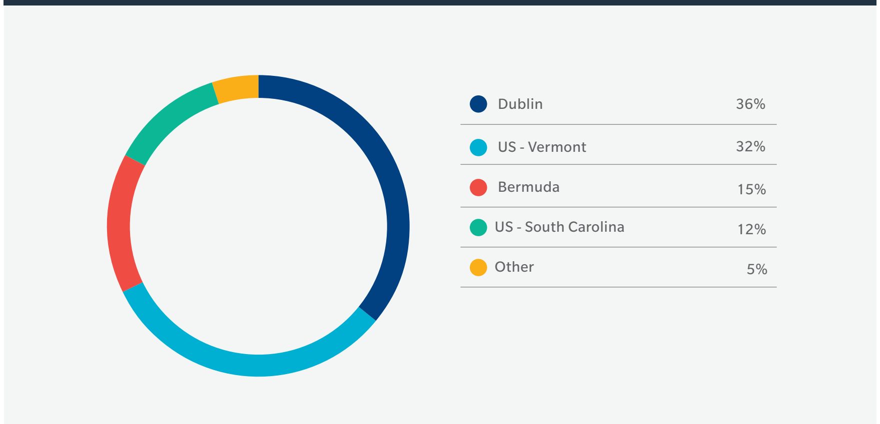


FIGURE 4 Special Purpose Vehicles by Domicile



access reinsurance markets or simply write small levels of premium and do not take a tax election. Small captives offer clients many benefits, including funding for catastrophic losses, insuring risks that are cost prohibitive to transfer, and a "start small" philosophy, with the intention of growing capital and surplus over time. While Figure 5 shows a decrease in small captives, Figure 6 demonstrates the significant rise in small captives taking the 831(b) tax election.

In December 2015, the Senate Finance Committee passed the Omnibus Spending Bill, which included the first significant change to Internal Revenue Code section 831(b) since its inception. The new legislation, effective January 1, 2017, nearly doubles the maximum tax-deductible premium limit to US$2.2 million. This figure will annually appreciate proportional to inflation and coincide with increases in the cost of living. The higher the contribution limit, the more attractive 831(b) captives become to companies interested in forming small captives.

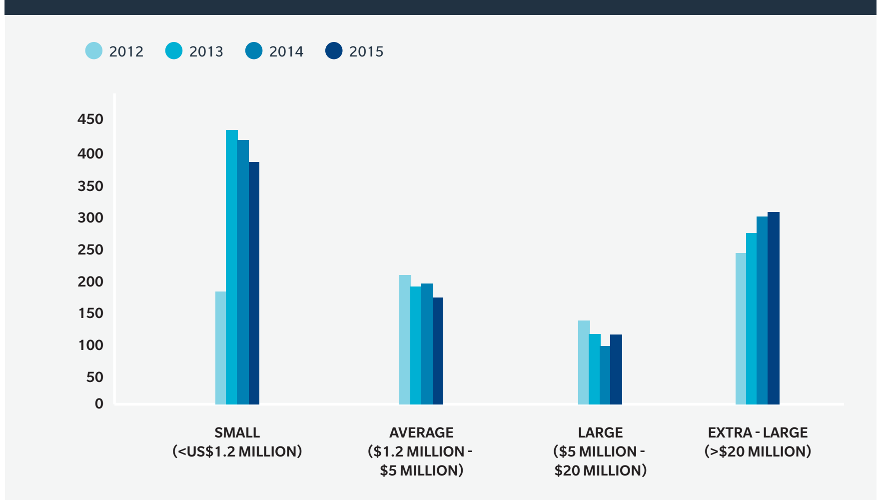
This is welcome news and provides a significant opportunity for public and private organizations across all industries. Many organizations that thought it useful to form and operate a smaller captive insurance company but had premiums well over US$1.2 million can now benefit from a well-established captive that they can grow in future years, while enjoying the benefit of starting up the entity. There are many risks that companies may choose not to purchase insurance for that can now be housed in a captive vehicle. Many of the global events and trends highlighted in this report and in reports from the World Economic Forum, among others, are applicable to small captives and should be analyzed in that way.

Under the new law, to qualify for section 831(b), insurance companies must now comply with one of two entity diversification requirements:

1. No more than 20% of premium can originate from one policyholder, designed for small mutual captives with many owner/insureds; or

2. Ownership of the small captive must also mirror the ownership of the underlying business operations, such that there is not an estate planning and wealth transfer plan that would transfer taxable income away from the business subsidiaries into trusts that benefit heirs. Captive ownership by partners, key employees, or other non-related persons is still permitted, as is pooling of risks within the new law.

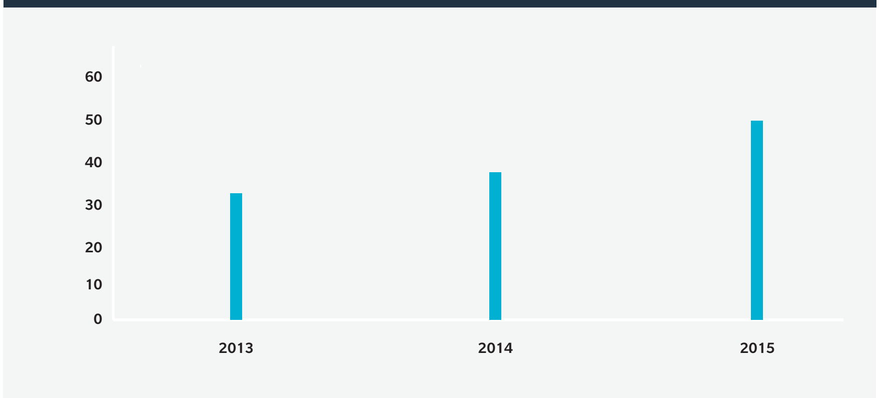
FIGURE 5 Captives by Net Premium Volume



Lastly, under the revamped law, an IRS reporting requirement by the taxpayer to attest that the diversification requirements have been met was incorporated within the legislation and has yet to be defined from an "IRS Tax Form" perspective.

With these legislative changes, we expect continued growth in small captive formations. We strongly recommend looking at this strategy with a reputable firm that can provide all of the necessary and appropriate small captive services, such as brokerage pricing of premiums, captive actuaries on staff, reasonableness tests, and a recommendation that the captive has adequate capital.

FIGURE 6 Marsh-Managed Small Captives Making the 831(b) Tax Election



WHERE IN THE WORLD ARE CAPTIVE PARENTS LOCATED?

Historically, captive ownership has largely been dominated by North American and European organizations; however, slowing growth in these regions and globalization are shifting the geographic makeup of the captive market; in fact, 2014 was a year of decline in both North America and Europe. While we expect to see average growth in these regions pick up again, as shown in 2015, we anticipate greater growth in other regions of the world.

New markets have been catching captive owners' attention as these regions often provide efficiencies that the US cannot. Captive owners are becoming more creative in the construction of their captives, taking advantage of geography-specific opportunities (for example, direct-writing ability across the European Union — something we expect to flourish after the inception of Solvency II), regulatory flexibility, and international tax efficiencies. In Latin America, for example, 80% of feasibility study engagements are from companies without any US risk. Therefore, the mindset in the region is clearly changing, and Latin American organizations are coming to the table with a host of new questions, as many are considering captives for reasons other than potential US tax benefits.

More economic activity is being conducted within the region of Latin America than ever before, so we expect the growth of captives to naturally flow as organizations become aware of their benefits. In the past year alone, Marsh Captive Solutions worked on 42 active captive opportunities in Latin America, mainly in Colombia, Mexico, Peru, and Chile. We also delivered 20 advisory projects, including feasibility studies and other advisory services. From 2012 to 2015, five new captives were formed by parent companies in Latin America, making it the fastest growing international region. Latin America faces challenges with certain regulatory requirements, decreasing currency, exchange restrictions, and regime changes in some of its countries, but nevertheless has established itself as a sophisticated and integrated environment in which to conduct business. In fact, it is because of these unique regional concerns that organizations are becoming more willing to explore new options and alternatives to leverage their total cost of risk. Colombia, Mexico, Chile, and Peru specifically are countries

FIGURE 7A Parent Company Growth Rates by Region
New and Emerging Markets

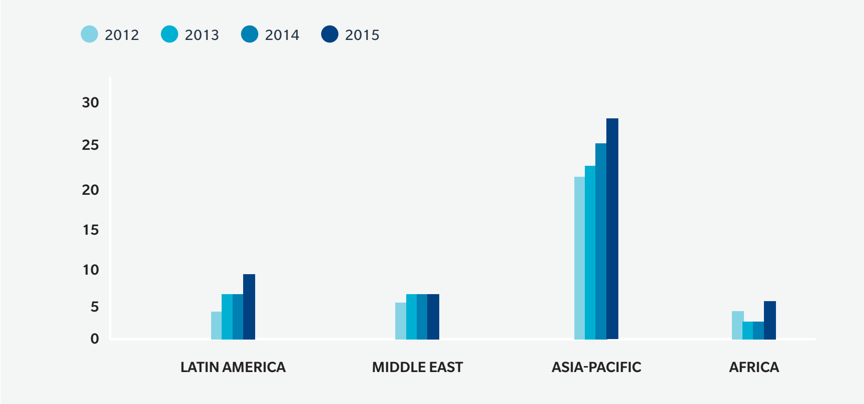
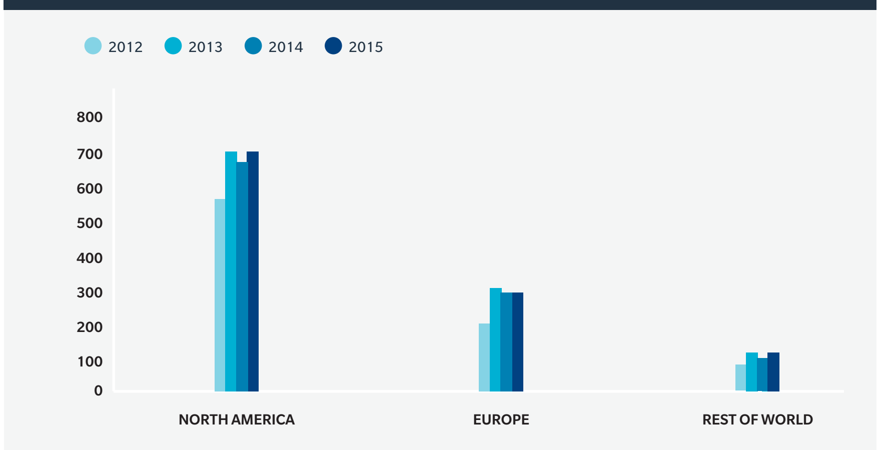


FIGURE 7B Parent Company Growth Rates by Region
Organizations with Captives by Parent Company Region



where Latin American companies will increasingly explore captives in the next few years, and sustainable growth is a trend that is expected to continue.

Over the last several years, organizations in the Asia-Pacific region have contributed to its status as the region with the most consistent growth globally. Historically, organizations in the region were more likely to transfer their risk to insurance companies within the commercial marketplace and follow a more traditional approach to risk management. However, China, Japan, Singapore, and organizations from several other countries within this region are competing with the Latin American region in terms of significant captive interest. Organizations are forming captives for an array of reasons, including economic stability, proximity, and tax efficiencies. Japan, for example, has expressed tax-driven reasoning for forming captives in domiciles like the Federated State of Micronesia. Parent companies in China are also increasingly interested in captives, yet must still overcome regulatory restraints before more formal arrangements can be implemented. It will be interesting to watch this region continue to emerge and expand its captive activity in the near future.

From 2012 to 2015, the growth of captives formed by organizations in Africa looks staggering; however, there was only a net gain of one captive in the region. While this may not seem noteworthy, it nonetheless suggests the potential for renewed interest by organizations in Africa and other areas internationally. We will continue to assist these emerging regions as they discover the benefits of captive insurance.

WHERE DO I DOMICILE MY CAPTIVE? AND WHY?

While, Bermuda, Vermont, and Cayman remain the front-runner domiciles for captives in 2015; formations in these domiciles have slowed. Nonetheless, Bermuda- and Cayman-domiciled captives still comprise nearly 33% of the total premium volume benchmarked in our report. The flexibility, years of experience, and developed infrastructure offered by these domiciles continue to make them a secure choice for captives, even as new domiciles emerge.

Vermont retains its position as top US onshore domicile in terms of premium volume, as it alone accounts for 35% of the total premium received by Marsh benchmarked captives. Since Vermont entered the market in the 1980s, it has continued to set itself apart with competitive laws, quick response to owners' need for change, and committed regulation. There were no new US domiciles in 2015, keeping the total US domicile count at approximately 35. Even states with current captive legislation, but with dated non-competitive provisions are looking to update the law to attract more captives and become more competitive with more favorable legislative states.

The number of captives domiciled onshore increased by 3% in 2015, essentially reversing the slight decline we saw in 2014. This echoes the trend we have observed in redomestications, where organizations are beginning to assess and realign their captive strategies based on shifting business needs. For example, domiciles in the EU are gaining increased attention with the implementation of Solvency II. EU domiciles are also ideal for companies seeking to insure third parties. Third-party benefits such as car rental coverage, extended warranty, errors and omissions, and property for customers, vendors, and independent contractors are just some of the avenues EU-domiciled captives are exploring. While we have seen only steady growth, Malta remains an attractive domicile in the EU because of its progressive regulation, tax system, and location.

CAPTIVE REDOMESTICATION

There were 13 redomestications in 2015, which represents roughly 1% of Marsh benchmarked captives globally. There are various reasons for captive redomestication as organizations address their risk management challenges. However, there has been no material movement in the overall numbers "to and from" any particular region. In recent years, we have seen very little change in terms of increases or decreases in redomestications; they have ranged from 8 to 16 as shown in Figure 11.

FIGURE 8 Captives by Domicile and Gross Premium

DOMICILE	NUMBER OF CAPTIVES	PREMIUMS
BERMUDA	255	10,400,916,645
US - VERMONT	187	14,635,222,052
CAYMAN	102	4,999,034,404
DUBLIN	92	437,811,873
LUXEMBOURG	66	840,594,087
US - HAWAII	53	2,427,008,762
US - SOUTH CAROLINA	48	1,750,050,685
GUERNSEY	43	(6,405,787)
BARBADOS	38	234,630,584
US - NEW YORK	31	2,238,798,719
SINGAPORE	30	355,851,711
ISLE OF MAN	27	382,249,827
MALTA	25	436,403,618
SWEDEN	24	59,556,745
US - UTAH	18	31,379,247
US - MISSOURI	16	180,492,640
US - TENNESSEE	13	775,000
US - ARIZONA	10	340,488,196
US - DELAWARE	8	1,271,213,751
SWITZERLAND	7	53,225,914
US - NEW JERSEY	7	374,022,830
US - MICHIGAN	7	13,321,126
LABUAN	6	88,494,097
US - TEXAS	5	35,545,745
FEDERATED STATES OF MICRONESIA	4	17,956,859
AUSTRALIA	4	Not disclosed.
US - CONNECTICUT	3	14,282,752
US - NEVADA	2	12,390,857
US - DISTRICT OF COLUMBIA	2	2,195,350
CA - BRITISH COLUMBIA	2	17,528,957
ARUBA	1	3,586,707
US - KENTUCKY	1	1,497,385
US - LOUISIANA	1	49,722,236
US - MONTANA	1	493,896,539
GRAND TOTAL	**1,139**	**42,193,740,113**

FIGURE 9 Global Captive Onshore and Offshore Domicile Comparison (Captives and Branch Captives) 2015

	CAPTIVES BY DOMICILE	CAPTIVES BY DOMICILE %	PREMIUMS	PREMIUMS %
ONSHORE*	636	56%	25,619,344,201	61%
OFFSHORE	503	44%	16,574,395,912	39%
TOTAL	**1,139**	**100.00%**	**42,193,740,113**	**100.00%**

*Onshore domiciles are defined as Australia, Dublin, Luxembourg, Malta, Singapore, Sweden, and the US. Offshore domiciles are defined as all other for the purposes of Figures 9 and 10.

FIGURE 10 Global Captive Onshore and Offshore Domicile Comparison (Captives and Branch Captives) Last Five Years

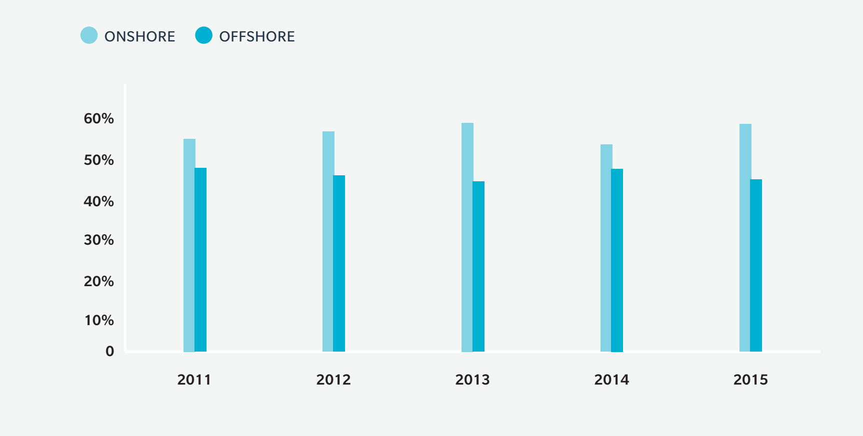


FIGURE 11 Number of Redomestications Over Five Years

2011	2012	2013	2014	2015
16	11	8	13	13

FIGURE 12 2015 Redomestications

REDOMESTICATED FROM	REDOMESTICATED TO	NUMBER OF REDOMESTICATIONS
BERMUDA	LUXEMBOURG	2
BERMUDA	US - VERMONT	1
BARBADOS	US - DISTRICT OF COLUMBIA	1
MALTA	BERMUDA	2
US - MONTANA	US - TENNESSEE	1
ISLE OF MAN	LUXEMBOURG	1
US - SOUTH CAROLINA	US - OTHER	1
US - UTAH	US - TEXAS	1
US - VERMONT	US - MISSOURI	1
US - HAWAII	US - UTAH	1
US - ARIZONA	US - TEXAS	1
GRAND TOTAL		13

The larger domiciles of Bermuda, Vermont, and Cayman are likely to frequently appear on the redomestication list, simply due to the amount of captives located there. However, a level of one to three redomestications per year should be considered normal, as these domiciles represent nearly 48% of Marsh-managed captives globally.

WHAT DO I NEED TO KNOW ABOUT CAPTIVE TAXATION?

The two most significant developments globally from a tax perspective are:

1. The US Treasury Department's Internal Revenue Service's focus on small captives making the Section 831(b) election and tax deductibility of premiums pursuant to Section 831(a).
    - Essentially, the focus of the newly enacted small captive law is to eliminate estate tax planning techniques with captives. However, the entire captive industry has a great opportunity to redefine and restructure small captives and rebuild them with greater business purpose — non-estate tax-focused entities with a greater focus on enterprise risk management and funding for catastrophic events, with appropriate capital to support the business plan.
2. Base Erosion Profit Shifting (BEPS) across Europe.
    - Organisation for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) Package, which consists of 15 recommendations, could affect some captives operating

FIGURE 13 US For-Profit Captive Owners That Treat Their Captive As An Insurance Company For Tax Purposes

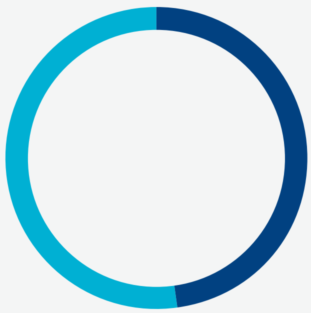


FIGURE 14 US Captive Owners: Approach Used to Quality As An Insurance Company For Tax Purposes

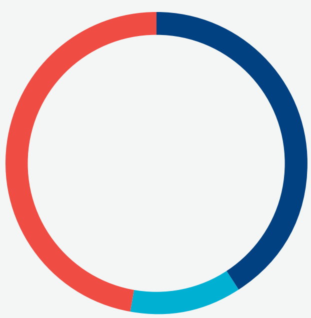
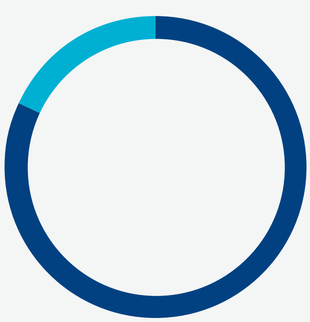


FIGURE 15 Captives That Write Some Amount of Unrelated Risk



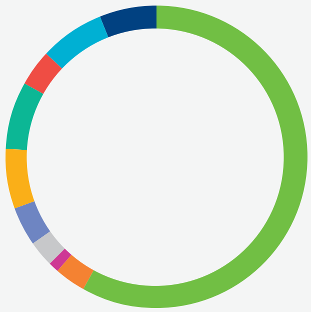
across Europe. However, this is very new and the proposals are still being reviewed by various countries that may or may not enact legislation that will affect captives. As is the case with any regulatory or tax law change, appropriately established and run captives will prevail and will be in compliance with new initiatives; Solvency II is an excellent example of this. Marsh Captive Solutions along with other Marsh & McLennan Companies are in a unique position to address, analyze, and make recommendations for complying with BEPS, and continue as business as usual with a captive.

In 2015, we reported that 48% of US, for-profit companies took a tax position with their captive. Case law from 2014 (*Rent-A-Center* and *Securitas*) reminds us that organizations should continue to review their facts, circumstances, and risk distribution elements to determine if their captive could qualify as an insurance company for federal income tax purposes. The 1% increase this past year is evidence of this, along with the growth of small captives in the US and other larger captives realizing some of the tax efficiencies surrounding captive ownership in light of these new precedents.

WHY DO CAPTIVES INSURE UNRELATED RISK?

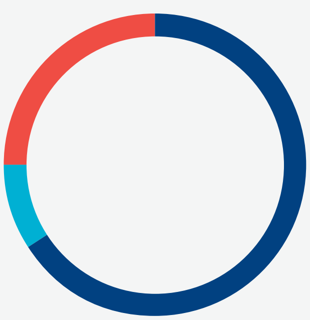
Figure 15 shows that 18% (down from 19% in 2014) of captives write some degree of unrelated risk/premium. Reasons to write unrelated risk business include capturing underwriting profits and risk diversification. Examples of unrelated risk could be risk pool premium, customer risk such as extended warranty, agency captive business, and

FIGURE 16 Percentage of Unrelated Risk Premium



1% - 10%	6%
11% - 20%	7%
21% - 30%	4%
31% - 40%	7%
41% - 50%	6%
51% - 60%	4%
61% - 70%	3%
71% - 80%	1%
81% - 90%	4%
91% - 100%	58%

FIGURE 17 Approach to Achieve Insurance Tax Status for All Small Captives

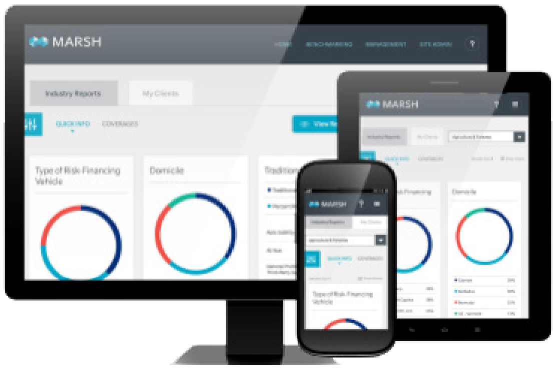


BROTHER/SISTER APPROACH	66%
HYBRID BROTHER/SISTER APPROACH AND UNRELATED RISK	9%
UNRELATED RISK	25%

vendor or contractor risk. Nearly 5% of the captives benchmarked reported accessing a risk pool. Both large risk pools like Marsh's Green Island Reinsurance Treaty (GIRT, currently writing $650 million in premium) and small captive risk pools, which are lower in premium and higher in severity, remained flat from 2014 to 2015.

HOW ARE SMALL CAPTIVES OBTAINING RISK DIVERSIFICATION?

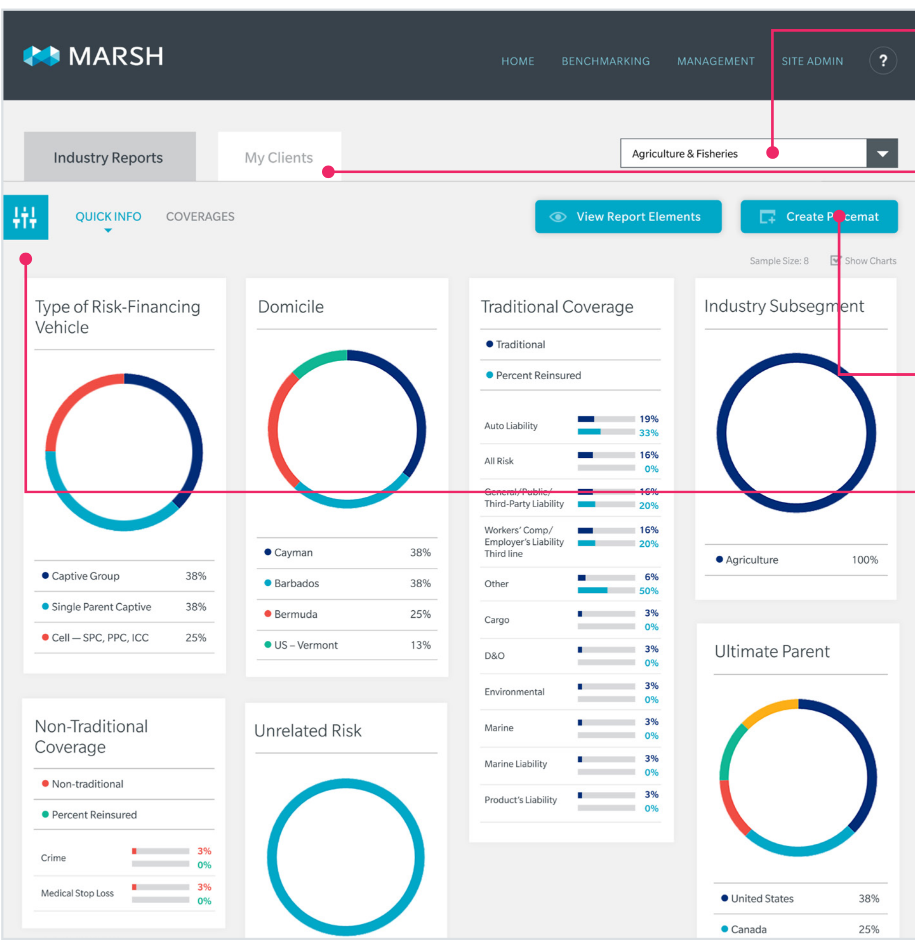
Figure 17 is important because with the strong growth of small captives in the US there is evidence that a majority of companies rely on their organizational structure to support efficient tax status. However, because so many middle market and small organizations are structured as Limited Liability Companies (LLCs) or Subchapter S corporations, both of which are considered "flow through" or "disregarded entities" for federal income tax purposes, there is a need for a strong and stable risk pool to meet the tax requirements. Therefore, you will notice a significant number of captives relying on unrelated risk (25%) in the form of a well-developed and prudent risk pool.



Marsh has online benchmarking capabilities for all industries that can focus on industry and both traditional and non-traditional coverages.

CAPTIVE BENCHMARKING PORTAL

With our new benchmarking portal, Marsh Captive Solutions colleagues now have the ability to provide you with:



View benchmarking data from a variety of industries.

See how your company's benchmarking information compares to others within the same industry.

Print "placemat" reports that can be shared with management.

Filter key benchmarking metrics for your captive and compare captive performance to industry peers.

INDUSTRY: WHAT TYPES OF ORGANIZATIONS ARE UTILIZING CAPTIVES AND WHAT ARE THEY USING THEM FOR?

Captives are traditionally the most prevalent for large organizations within the financial institutions, health care, auto and manufacturing, retail/wholesale, and communications, media and technology (CMT) industries (Figure 18). Each year, we examine the leading industries, which typically comprise large, diverse, and global organizations. However, an analysis of only the top industries is not enough to make a true assessment of the changing captive landscape or how captives can continue to add value to all industries.

Figure 20 shows captive utilization across the full spectrum of industries. We have seen an increase in captive utilization in five new industries: construction, energy, real estate, education, and sports, entertainment, and events.

TOP INDUSTRIES UTILIZING CAPTIVES

FINANCIAL INSTITUTIONS

There is a longstanding trend of financial institutions dominating the captive industry. There has been a steady increase in financial institutions' focus on, and resources devoted to, risk management. This can be attributed to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and other regulatory changes both in the US and other nations. Nearly 25% of captives managed by Marsh are established within the finance industry. As in previous years, property lines, professional liability, directors and

FIGURE 18 Top Five Industries Utilizing Captives

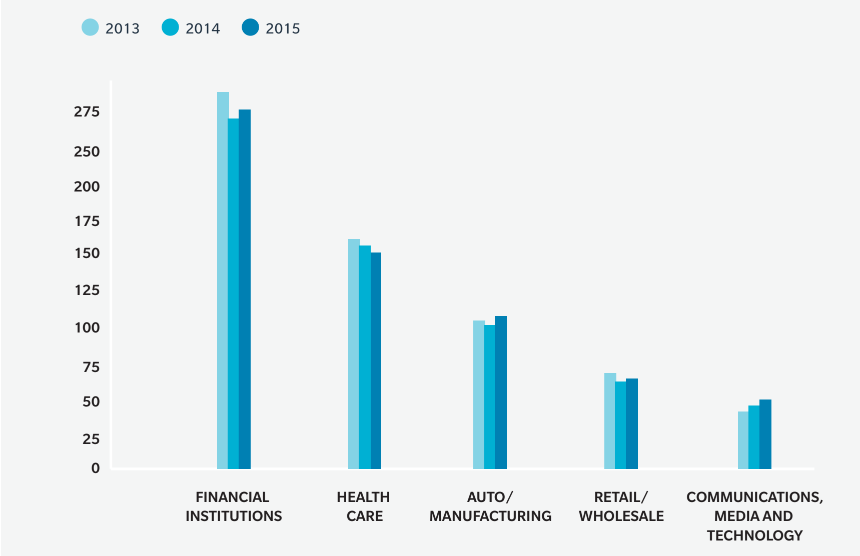
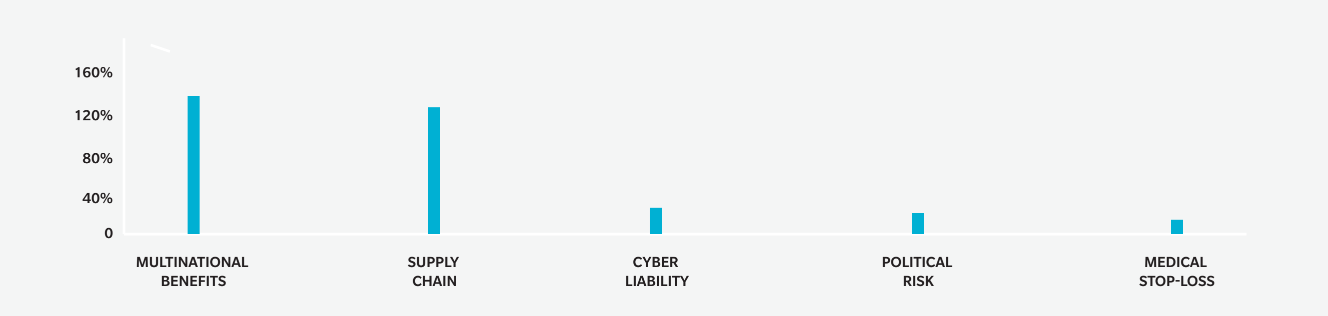


FIGURE 19 Top Five Fastest Growing Non-Traditional Risks in Captives



officers (D&O) liability, and errors and omissions (E&O) liability are the most popular lines utilized. We observed a slight increase in workers' compensation (WC)/employers liability in this year's benchmarking statistics, as well as growing interest in a wide variety of non-traditional employee benefit coverages. SPVs have contributed to a great deal of the success in the growth of captives and continue to be viable risk-financing tools such as the XXX/AXXX structures, ILS and CAT bonds, as highlighted earlier.

HEALTH CARE

The health care industry remains the second largest utilizer of captives. In recent years, the number of health care captives has declined, but this is not due to a lack of interest in or lack of success with captives in the industry. The primary cause of the decline is the numerous mergers and acquisitions within the industry. In recent years, we have seen an increase in the demand for health care captives and a growing desire to expand upon existing captive programs. Many health care captives are considering non-traditional coverages such as TRIA and employee benefits. Furthermore, we believe that all health care organizations, especially those with hospitals, should consider how their general liability risk could be affected as a result of a terrorist act involving the excluded NBCR perils. Health care organizations should have a renewed focus in exploring single parent standalone captives in the US, and not just the opportunity for a branch of a foreign captive.

AUTO/MANUFACTURING

The auto/manufacturing industry has a long history of establishing captive insurance companies to enhance their insurance program structures, as they are the third largest industry within the captive world. Manufacturers have significant property values, plants, machinery, equipment, and large workforces. Consequently, the top coverages written within the industry are property, general liability, third party liability, workers' compensation, and employers liability lines.

RETAIL/WHOLESALE

As a consumer-driven industry, retail/wholesale captives write very predictable lines to accommodate the need to retain customers. Almost 47% write property coverage, 40% write general liability lines, and close to 30% write workers' compensation/employers liability. However, retail/wholesale companies can look to alternative and non-traditional lines to accommodate some of their modern-day concerns. For example, the pervasive use of online shopping signals a potential growth in cargo liability and shipping concerns. Additionally, retailers have recently fallen victim to vicious cyber-attacks where sensitive customer and employee information has been compromised. Consequently, cyber, crime, and many other non-traditional lines are being explored and implemented by retail/wholesale captives.

COMMUNICATIONS, MEDIA, AND TECHNOLOGY (CMT)

Large public companies comprise the majority of CMT captives. Over the past few years, some of the largest economic advantages identified were for our clients in the CMT industry. These companies have found savings in writing their own property, general liability, workers' compensation, and employers liability lines.

The technology industry is home to many start-up organizations that are poised to shape the economy in many ways. The risks that these organizations face are as unique as the industry itself and, as such, the commercial market is unsure how to respond, often leaving the organization with little to no insurance solution. Top non-traditional coverages written by CMT captives include employment practices liability insurance (EPLI), cyber risk, political risk, crime, and intellectual property (IP).

Within the past year, the number of CMT companies writing excess liability has surged from 7% to 19%, and a large number of captives within the CMT

industry are taking advantage of the US government terrorism program. By writing TRIA coverage into their captives, they are able to indemnify NBCR risks that are typically not insurable in the commercial market. Thirty-two percent of CMT captives are now accessing the federal backstop to protect themselves from “worst-case scenarios” that seem inevitable to occur in the world we live in today. Captive utilization for unrelated risk continues to be prevalent for CMT captives.

GROWING INDUSTRIES

CONSTRUCTION

Marsh manages 50 captives in the construction industry. Although construction captives saw a slight

FIGURE 20 Captive Utilization by Parent Company Industry

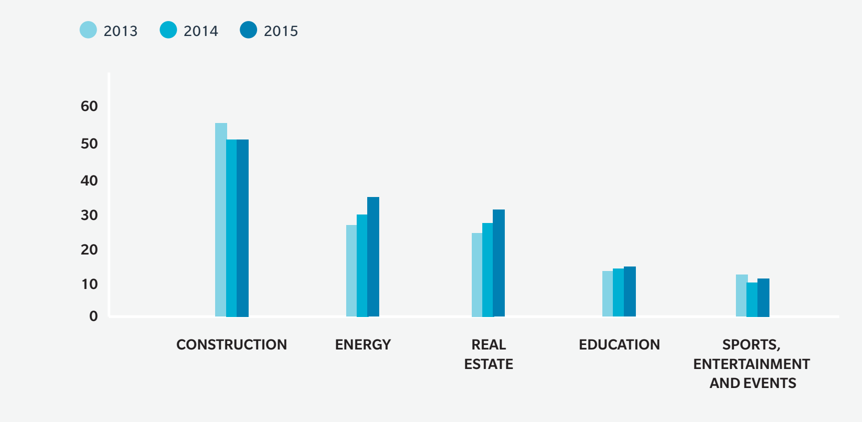
CAPTIVES (%)	CAPTIVES	INDUSTRY	PREMIUMS (%)	PREMIUMS
24.06%	274	FINANCIAL INSTITUTIONS	50.52%	21,315,407,419
13.08%	149	HEALTH CARE	6.02%	2,539,679,258
7.55%	86	MANUFACTURING	3.53%	1,488,356,676
5.62%	64	RETAIL/WHOLESALE	8.74%	3,689,672,801
4.65%	53	COMMUNICATIONS, MEDIA AND TECHNOLOGY	11.61%	4,900,099,427
4.39%	50	CONSTRUCTION	0.65%	275,057,754
4.39%	50	TRANSPORTATION	2.32%	968,791,315
3.86%	44	OTHER SERVICES	1.12%	473,074,569
3.69%	42	POWER AND UTILITY	2.09%	881,683,094
3.16%	36	CHEMICAL	0.62%	262,749,596
2.90%	33	ENERGY	0.86%	363,092,379
2.81%	32	REAL ESTATE	0.15%	65,116,639
2.28%	26	AUTOMOTIVE	0.27%	114,253,769
2.19%	25	MISC. OTHER	0.26%	109,668,379
2.19%	25	MINING, METALS AND MINERALS	1.90%	801,886,222
2.02%	23	FOOD & BEVERAGES	1.64%	692,374,149
1.84%	21	LIFE SCIENCES	3.20%	1,348,302,116
1.76%	20	MARINE	1.79%	754,506,393
1.40%	16	EDUCATION	0.14%	58,256,054
1.40%	16	AVIATION, AEROSPACE AND SPACE	1.51%	635,612,893
1.05%	12	SPORTS, ENTERTAINMENT AND EVENTS	0.37%	155,444,146
0.97%	11	AGRICULTURE AND FISHERIES	0.33%	140,258,209
0.79%	9	PUBLIC ENTITY AND NOT FOR PROFIT	0.08%	34,142,311
0.79%	9	PROFESSIONAL SERVICES	0.13%	55,500,910
0.61%	7	FORESTRY AND INTEGRATED WOOD PRODUCTS	0.09%	38,982,551
0.53%	6	HOSPITALITY AND GAMING	0.05%	21,771,086
100%	**1,139**		**100%**	**42,193,740,113**

decline in recent years, the potential for growth in the construction industry is significant. New construction captive programs typically write general liability, workers' compensation, and/or property lines of coverage. Existing captive programs are expanding by adding unrelated risks. From 2014 to 2015, the number of construction captives writing unrelated risk doubled. Today, 16% of Marsh-managed construction captives write some form of unrelated risk, such as contractor controlled insurance programs (CCIP) and owner controlled insurance programs (OCIP), which are typically comprised of general liability and workers' compensation programs. Construction captives also have the tendency to implement medical stop-loss policies.

ENERGY

The energy industry, not to be confused with the closely related power and utilities industry, is a prime example of an emerging captive market. In 2014, the number of Marsh-managed energy captives grew by 11%. This growth was topped in 2015 with a 13% increase. A majority of energy captives (64%) write property lines of coverage. General liability and excess liability lines of coverage trail behind at 33% and 30%, respectively. As the international demand for cleaner energy sources increases and collides with growing global energy needs, we believe energy companies will continue to implement and utilize captives.

FIGURE 21 **Growing Industries Using Captives**
Unique and Emerging Industries



REAL ESTATE

Real estate is an industry not typically discussed in detail within our benchmarking report, but one that has shown continued growth. In fact, there has been a 25% increase in real estate captives since 2013. Historically, real estate developers turned to captives for efficient insurance solutions; however, they have recently become a popular mechanism used by Real Estate Investment Trusts (REITs) and other organizations in the real estate financing sector of the industry.

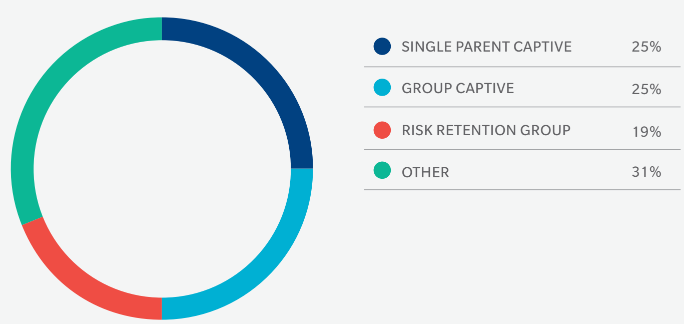
These organizations have been forming captives in order to access funding from the Federal Home Loan Bank. This is the most plausible explanation for the large increase in captive formations over the past two years. Because REITS and real estate financing institutions often have very few to no employees, we find that D&O liability is the most popular coverage written by real estate captives, with more than 30% writing this line, including some form of D&O liability. Other lines of coverage are mortgage impairment, TRIA, and E&O. Often these organizations seeking advances from the FHLB elect to buy down their large D&O/E&O deductibles to ensure they have the resources readily available should a claim arise.

Property coverage comes in as a close second to D&O, with about 25% of real estate captives using these entities to address issues with their current property policies or risks they are self-insuring. Real estate companies also utilize captives to insure third parties as well as access to TRIA. An explanation of the entire concept of TRIA and how it affects captives can be found in the Global Events section.

EDUCATION

In the education industry, most captives are formed as not-for-profit entities created to satisfy specific risk management needs. As a result, it is the only industry in which single parent captives are not the most utilized risk-financing vehicle (Figure 22). The top coverage written by captives in the education industry is general liability, with 63% of captives writing this coverage. Auto liability follows closely with 56%. We expect to see more education captives writing cyber liability to fill gaps in coverage, access higher limits, and access the global reinsurance market. Educator's legal liability, staff medical stop-loss, student health, student travel accident, equipment maintenance, student renters' insurance, and TRIA are other unique and applicable coverages such entities should consider.

FIGURE 22 **Type of Risk-Financing Vehicle for Education Industry Captives**

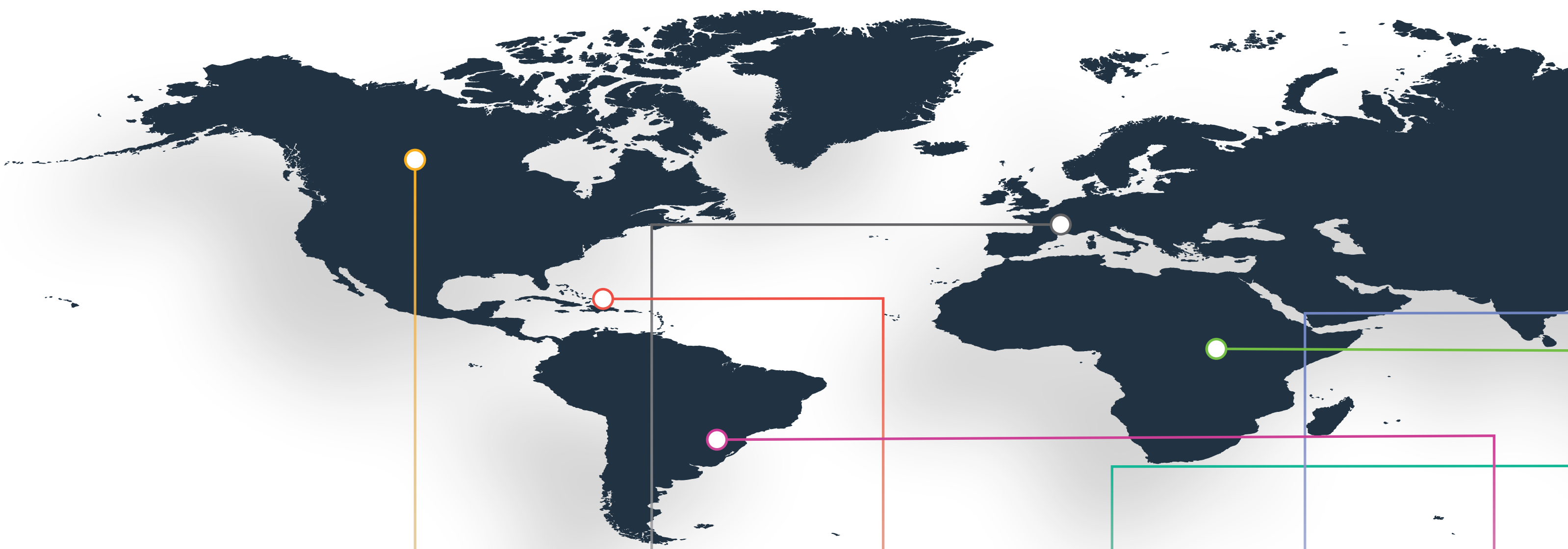


SPORTS, ENTERTAINMENT AND EVENTS

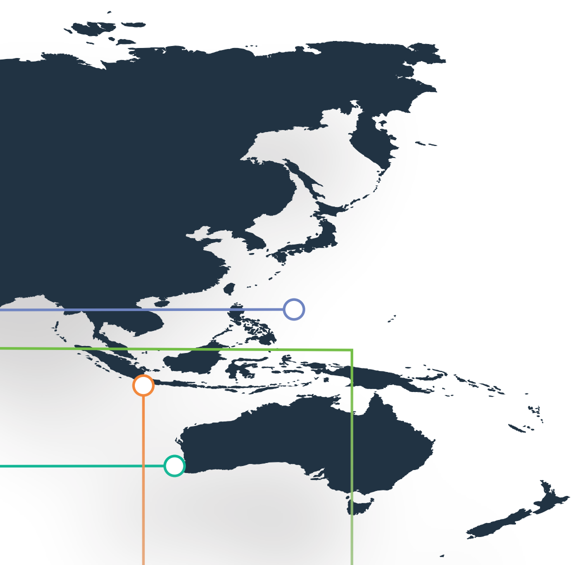
Sports, entertainment and events companies are prime captive candidates. Many companies in this industry have significant exposures to emerging risks such as terrorism and cyber risks, and the exposures associated with these risks may be difficult to insure in the commercial market. A good example of this is the rise of concussion insurance. In 2015, the National Football League reported a 58% rise in the number of concussions from the prior year. Some commercial insurers offer concussion insurance to mitigate this risk, but it is by no means widely available. Captives can potentially increase access to these industry-specific coverages.

Value drivers for the sports, entertainment and events industry to form and operate captives are team or group pooling purchasing, better control of defense on sensitive and emerging risks (like cumulative trauma workers' compensation savings), and access to higher capacity through the reinsurance markets.

Figure 23 Global Risk Stage: What Role Can Captives Play in the World Today?



	NORTH AMERICA	EUROPE	CARIBBEAN	AUSTRAILIA	ASIA-PACIFIC	LATI
MARSH-MANAGED CAPTIVES DOMICILED IN THE REGION	415	284	396	4	40	
GROSS PREMIUM PAID TO CAPTIVES	23,889,832,829	2,203,436,276	15,638,168,341	–	462,302,668	
CAPTIVES OWNED BY COMPANIES FROM THE REGION	704	305	52	30	28	
GROSS PREMIUM PAID BY PARENT COMPANIES	33,630,782,610	6,122,326,442	1,552,187,976	215,817,489	378,394,000	26,



N AMERICA	MIDDLE EAST	AFRICA
-	-	-
-	-	-
9	6	5
363,216	231,803,332	36,065,048

GLOBAL UNCERTAINTIES	GAPS IN TRADITIONAL COVERAGE	CAPTIVE SOLUTIONS
• Emerging cyber risks. • Cyber breach. • Cyber extortion. • Cyber terrorism.	• Terms/exclusions. • Limits/capacity. • Narrow solutions in commercial market. • Property damage as a result of cyber breach. • Injury as a result of cyber breach. • Remediation.	• Ability to tailor policies to meet needs. • Ability to access global reinsurance market for more comprehensive coverage. • Ability to access higher limits with global reinsurance markets.
• Nuclear perils. • Biological perils. • Chemical perils. • Radiological perils. • More frequent terrorism attacks. • More widespread terrorism attacks.	• Excluded nuclear, biological, chemical, and radiological (NBCR) perils. • High retentions. • Greater exposures from globalization.	• Ability to access government backstop programs in US, Europe, and many other countries. • TRIA trigger coverage for protection if Trigger is not met.
• Floods. • Earthquakes. • Hurricanes. • Droughts. • Increased frequency of natural catastrophes. • New exposures due to climate change. • Pandemics.	• Growing exposures due to climate change. • More frequent natural catastrophes.	• As natural catastrophes become more frequent and spread to unprepared locations, the environmental market may begin to harden. Having a captive allows access to less expensive coverage and prepares for a real "worst-case scenario." • Formal funding. • CAT bond access. • Flood, earthquake, and wind. • Insurance linked securities (ILS).
• Sudden economic downturns. • Fiscal asset bubbles bursting. • Declining oil prices. • Foreign currency devaluation. • Economic duress.	• Unaffordable or unobtainable coverage (risk of a hardening market). • Globalization increases exposures every day.	• Access to less expensive and more comprehensive coverage. • Access to global reinsurance market. • Better investment philosophy/fewer restrictions (Mercer investment solutions).
• Political unrest. • Social unrest. • Involuntary migration. • Territorial disputes. • Political violence. • Collapse of State/Country Government.	• Unaffordable or unobtainable coverage (risk of a hardening market). • New and sudden exposures which are difficult to predict due to changing political climate.	• Ability to reinsure a global fronting carrier to retain profits. • Access to cheaper and more comprehensive coverage. • Access to global reinsurance market.
• Aging workforce. • Rapid digitalization. • Artificial intelligence. • Increase in contract and remote workers.	• New and emerging exposures are becoming more frequent. • An aging workforce is creating significant changes to existing exposures. • Artificial intelligence eliminating the need for existing coverages while creating the need for new ones that are difficult to access (cyber). • Wage and hour claims.	• Access to a dynamic insurance vehicle that can proactively address emerging risks instead of reactively responding to them (commercial market). • Captives can offer access to data which is necessary to assess changing risks and exposures within your workforce. • Adding employee benefits to the captive to create financial security and stability: - ERISA. - Multinational pooling. - Medical stop-loss. - Voluntary benefits.

CMT companies writing excess liability has surged from 7 TO 19%.

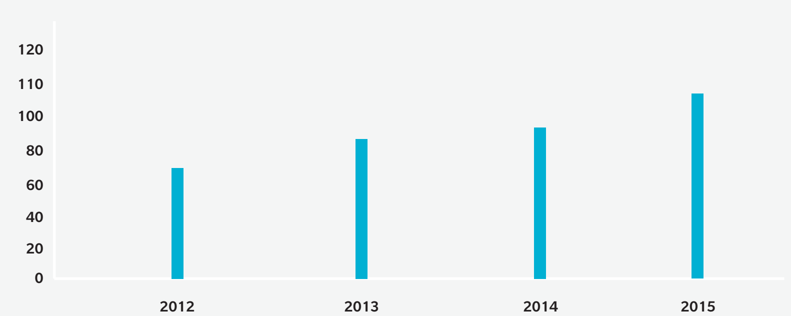
GLOBAL EVENTS: WHAT GLOBAL RISKS CAN CAPTIVES PROTECT AGAINST?

The world we live in today faces worrying and rapidly developing challenges it has never seen before. Countries historically viewed as safe or stable must now prepare for the possibility that they will be affected by a multitude of imminent global risks. As the world's leading captive manager, we aim to protect our clients by adequately preparing them for the "worst-case scenario" and educating them on the newest and most innovative ways to combat potential catastrophes. With the proper insurance strategies implemented within their risk program, it is possible for multinational commercial enterprises to thrive and maintain security in an uncertain world.

Keeping in mind that political upheaval, economic duress, social unrest, and other large-scale calamities can quickly unfold in any part of the world, we encourage our captive owners to think outside of the box and consider writing non-traditional risks. A captive is a nimble tool that can quickly respond in the event of a catastrophic loss, helping to lower cash flow volatility and provide budget stability.

This section of the *2016 Captive Benchmarking Report* identifies several growing global concerns discussed in depth in the World Economic Forum's (WEF) *Global Risks 2016* report and explains how they will inevitably affect the insurance market and captives for both domestic and international companies. You will find that each of these risks have come full circle and are completely intertwined: Cyber-attacks are equivalent to modern day terrorism; extremist terrorism facilitates geopolitical instability globally; political turmoil leads to economic duress; the evolution of the traditional workforce and climate change facilitate financial crises, and so on.

FIGURE 24 US/Branch Captive Writing TRIA Coverage



Businesses need guidance on how to obtain adequate coverage to protect themselves as these changes are reflected in the global insurance market. As these risks become more prevalent, it is likely that gaps in insurance coverage will multiply, retentions will increase, and premiums will skyrocket, creating an unavoidable hardening market. One solution is a captive. Our objective is to provide our existing captive clients and prospective captive owners with captive solutions that address these pressing insurance issues confronting the world. We hope to facilitate awareness and demonstrate to captive owners that economic, social, and political differences can be mitigated both effectively and efficiently. Captives may not be able to secure a stable society, but they can aid in the effort to provide some level of immunity to the financial risks businesses face.

TERRORISM AND GLOBAL TERRORISM POOLS

One of the pervasive fears of individuals and businesses alike is the changing international security landscape. Large-scale terrorist attacks burden the minds of society and create a general feeling of insecurity. Violent attacks by groups with political or religious goals have become an unfortunate part of everyday life. The world today has been referred to as a globalized battlefield with countries of every size, shape, and structure engaging in the fight against terrorism.

Global organizations are able to use a captive in a cost-effective and efficient manner in countries like the UK (Pool Re), France (GAREAT), Australia (ARPC), Spain (CCS), and many other jurisdictions to access government-sponsored terrorism facilities. To be able to form and operate a captive anywhere in the world is a powerful business driver. Companies with captives domiciled in the US can access the US government's terrorism program, formally known as the Terrorism Risk Insurance Act (TRIA), which has 109 US captives already subscribing to it (see Figure 24). Re-established by the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA), captives may write either conventional terrorism coverage for property damage or issue policies specific to perils typically excluded from conventional terrorism policies, such as the NBCR perils or cyber terrorism, which are largely unobtainable in the commercial marketplace. TRIA is essentially a "free" form of subsidized terrorism

FIGURE 25 Captives by Industry Writing TRIA Coverage

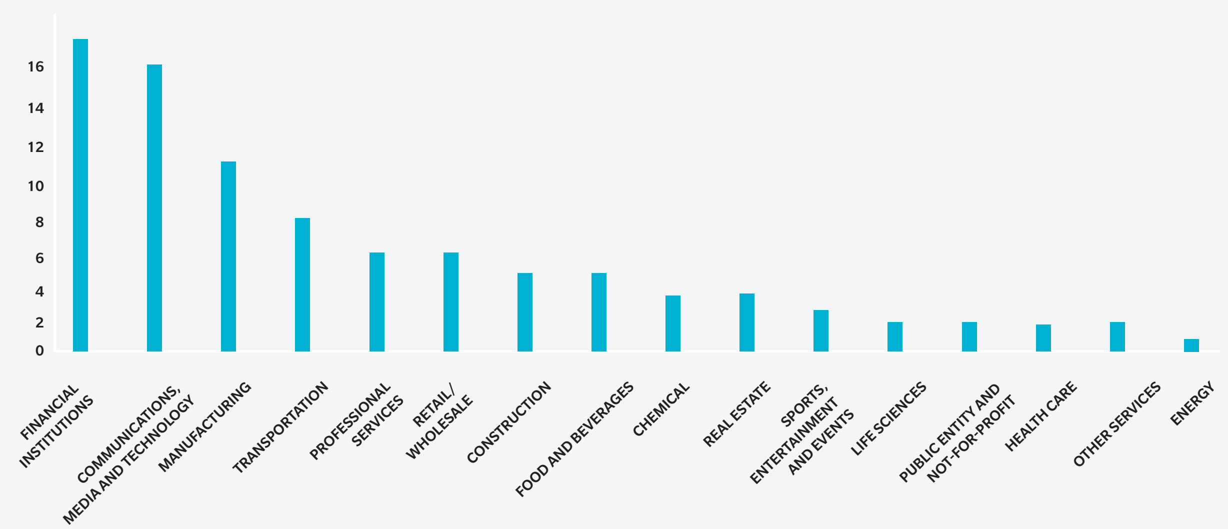
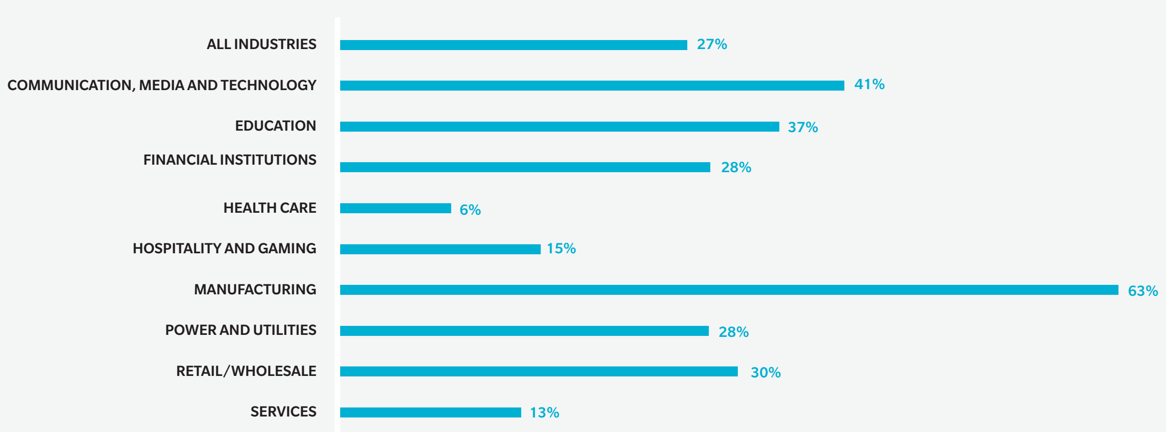


FIGURE 26 2015 Cyber Insurance Growth Rates by Industry (Marsh Clients)
Source: Marsh Global Analytics



protection (although there is a recoupment provision within the TRIA law) that undisputedly provides economic value, addresses currently self-insured perils, and adds overall protection to organizations should a devastating terrorism event take place. Adding TRIA and NBCR coverage to an organization's captive could potentially absorb the financial impact on an organization in the event of a catastrophic terrorist attack, thus freeing an organization of detrimental consequences that these extremist groups are seeking to achieve. Surprisingly, many captives that could access a terrorism program actually do not. Marsh recommends that all captive owners consider implementing a form of terrorism coverage; it's a relatively simple and low-cost addition that could save millions of dollars.

This year's (2015 data) benchmarking focused on captives writing TRIA for both conventional and NBCR perils. The number of captives writing TRIA increased by 17% since last year and by nearly 60% since 2012. TRIA is something that all organizations, from hospital systems and health care entities, to real estate owners and REITS, to financial instuitutions, should consider for both conventional and NBCR risks.

Virtually all major US domiciles regulate captives that write some form of TRIA (whether it be conventional terrorism or the excluded NBCR perils), with Vermont and New York being the top two. TRIA must apply within a domestic domcile or be a US domestic branch of an offshore captive.

In 2016, The TRIA program is subject to a Trigger amount ($120 million in 2016 and increasing to $200 million in 2020) which means that unless a loss event reached $120 million amongst all participants, the TRIA program will not respond. Because it is possible that a captive could have a net retention for a loss to an organization's property, there is a TRIA Trigger protection reinsurance product available and Marsh is assisting captives with reducing their liability to a loss that would be under the Trigger amount.

FIGURE 27 Cyber Liability Total Limits Purchased (All Size Revenues/Marsh Clients)
Source: Marsh Global Analytics

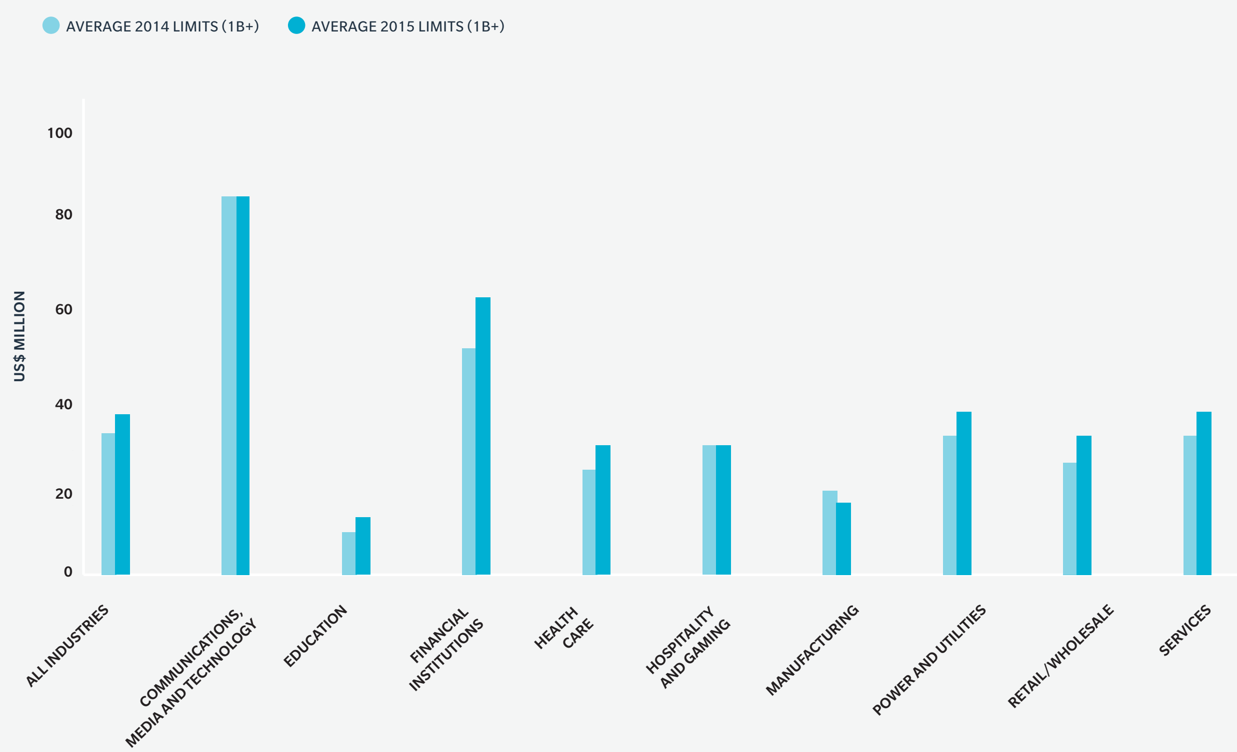
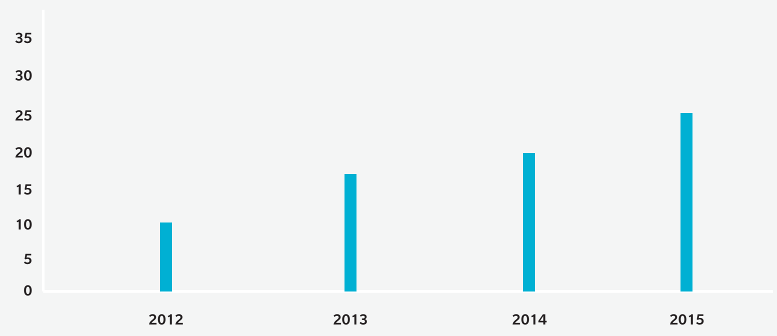


FIGURE 28 Captives Writing Cyber Insurance



CYBER

A global risk that will undoubtedly continue to threaten all businesses is cyber. Organizations have a significant obligation to protect the privacy and personal data of their employees and customers. They must also be prudent in guarding confidential operational documents, records, and archives. Cyber terrorism is the single most likely attack and most impactful risk for organizations globally. A cyber-attack to an organization of any size can be tremendously devastating to its reputation and financial position. While virtual risk and cyber activism is a relatively new concept, it is increasingly being used as a non-violent tactic to protest and/or attack businesses and will inevitably increase as technology develops. Businesses must view cyber risk as an enterprise-wide concern.

Captives are one of the most effective ways to properly manage cyber risk. Cyber programs initiated by captive owners grew by 30% in 2015 and, in the past four years, the amount of captives writing cyber has increased by 160%.

Based on Marsh Global Analytics research, Figures 26 and 27 show that we are finding organizations in the CMT, manufacturing, and universities/educational institutions industries are the most prevalent types of businesses purchasing cyber insurance due to their data breach exposures. Consequently, these firms may be the best candidates to build a comprehensive cyber program into their captives.

Business enterprises often spend hefty amounts to protect their most valuable data, yet there is an increasing chance that their security will still be breached. This demonstrates the need for business owners to find less expensive strategies to deal with this looming threat. Some industries that have been purchasing cyber insurance are being forced to pay increased premium amounts, take on larger retentions, and buy much larger limits — at times doubling their expiring limits. Pricing, in general, has greatly increased, particularly for organizations in industries that have been hard hit by cyber losses. Recent well-publicized events involving large companies are fueling this trend. In addition, over the past year there has been a larger number of claims involving cyber extortion/ransom.

Cyber ransom and extortion occurs when a cyber attacker either holds certain files or an entire system ransom until an organization pays a certain sum to gain back control of their data.

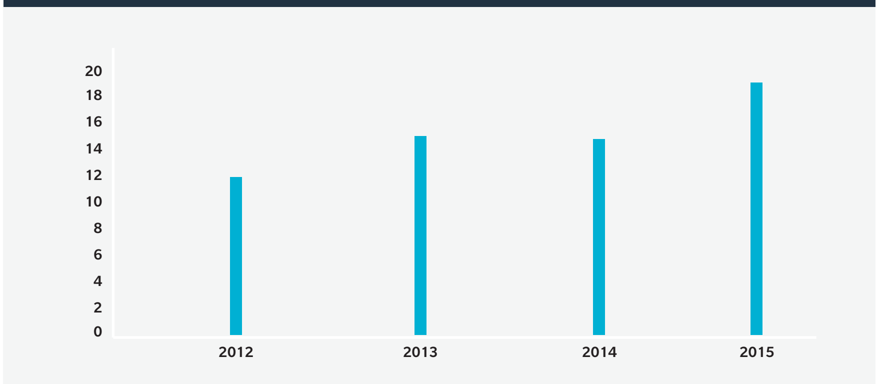
Within the cyber spectrum, organizations often want to use captives to access the reinsurance market in order to retain higher limits and lower premiums as gaps in this coverage continue to emerge. Currently, commercial insurers will only cover approximately US$200 million to US$300 million limits. Organizations are finding a useful strategy in obtaining higher limits is to retain the US$200 million to US$300 million within their captives and then access the reinsurance market for the remaining US$700 to US$800 million to obtain commonly desired limits of US$1 billion. A captive is the optimal alternative vehicle to accomplish this and address many other cyber liability concerns, making it a compelling option that we expect more organizations to gravitate toward.

By using captives as a mechanism to insure the gaps in traditional coverage, they subsequently will reduce their risk for extreme financial harm, have the ability to mitigate reputational damage, and cover costs associated with class-action lawsuits should a cyber-attack occur.

POLITICAL AND SOCIETAL RISKS

Another universal condition causing significant concern for multinational business enterprises is the multitude of geopolitical and societal risks posed by the world we live in today, as discussed at the WEF. Political risk exposures for international corporations are on the rise, as we see companies doing more business in the Middle East (Dubai and Abu Dhabi), North Africa, and Latin America.

FIGURE 29 Captives Writing Political Risk Coverage



Increased social unrest and political instability have been hindering parent companies' abilities to conduct business. Detailed in the WEF *Global Risks 2016* report, State collapses due to internal violence, weak rule of law, corruption, and political deadlock are becoming widespread and have both regional and international consequences.

The *Global Risks 2016* report highlights Latin American countries which are enduring dramatic regime collapses, election tampering, political rebellion, the rise of organized criminal groups, and the flow of a steady stream of drugs that surface in developed countries. Other more developed countries are experiencing a rising number of displaced people fleeing from unstable dangerous governments. This large-scale involuntary migration, induced by conflict, violence and extreme economic hardship, has triggered a debilitating refugee crisis for many governments across the world.

Territorial disputes in the East China seas are major concerns in Asia, along with the development of weapons of mass destruction that have the potential for significant destruction should they fall into the wrong hands. Global inequality gives rise to stratification and further advances have impoverished and marginalized communities. Malnutrition, trauma, global disease outbreak (such as the Ebola and Zika viruses), among other factors, are paralyzing organizations and their ability to conduct business throughout the world.

One way to battle these undeniable global risks is to use cleverly constructed insurance programs to help efficiently manage business operations. There has been steady growth over the past four years in organizations that export or have operations in foreign countries incorporating political risk coverage into their captives, as seen in Figure 29. By writing this line, businesses have the ability to gain protection against the unpredictability and threats resulting from interaction with international emerging markets. Captives can write multiyear contracts, with customized terms and conditions, and obtain reinsurance protection above a certain threshold from a carrier as a means to feeling secure in turbulent times. Political risk can be a useful complimentary coverage to TRIA for organizations with US captives engaging in business globally.

With this coverage, a captive can write a parent risk without needing to engage in business transactions in each local country, thereby eliminating the admitted and non-admitted rules in each country.

When there is no guarantee of peace and civility, a captive can help retain capital to protect against political and societal uncertainties. We urge organizations to prepare and "expect the unexpected." If an organization does not consider political violence and political risk a large exposure, it should at least consider self-funding this risk in a captive — and then take steps to analyze the exposure, factors, and triggers that could give rise to a loss.

The use of analytics is a vital tool in this process, as there is great importance in quantifying a risk as the first step before simply placing it in a captive. Working with Marsh Global Analytics, colleagues are able to identify and quantify adverse loss scenarios and determine an organization's ability to retain risk with "risk-bearing capacity" analytics can drive an organization's use of a captive, while establishing discipline and re-evaluating capital needs. A captive is a natural fit to "take on" retained risk that is identified as part of analytics work, such as risk finance optimization (RFO), to provide the most efficient and cost effective program for an organization.

ENVIRONMENTAL/ CLIMATE CHANGE RISK

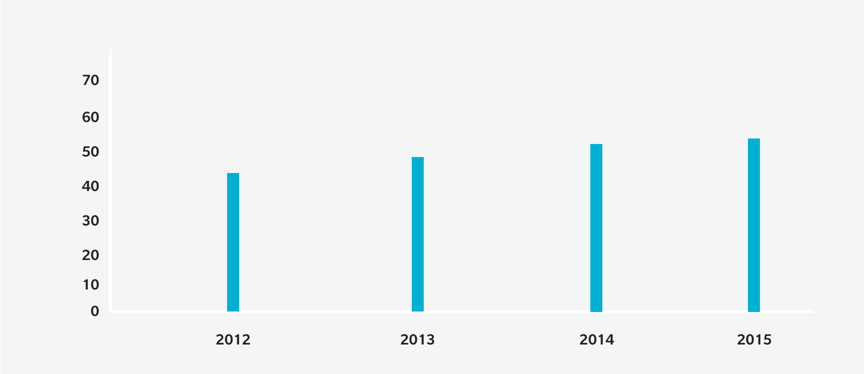
Climate change and environmental neglect/exploitation are creating irreversible consequences leading to global concern and the realization that governments must be vigilant in their efforts to enforce measures to mitigate long-term effects.

Climate change has affected weather patterns and has enhanced storms, giving rise to extreme weather events such as hurricanes, tornados, blizzards, flooding, earthquakes, landslides, wildfires, geomagnetic storms, and tsunamis. All of these risks have been and will continue to be insured by captives, since a captive can play such a strategic role in these uncertain risk factors. The past year was recorded as the hottest year on earth. There has been an undeniable increase in the frequency and intensity of water shortages — so much so that by 2050, the OECD Environmental Outlook estimates that four billion people will be living in water-scarce areas. This has led to an international food crisis as countries struggle to adapt agriculturally. It has become more difficult to retain climate resiliency, which is significantly impacting the cost of business operations.

Captives offer security for this extremely uncertain environmental landscape by offering customizable coverage such as buying down earthquake and wind deductibles, and providing a vehicle to access reinsurance for wind and transmission and distribution (T&D) for power and utility companies. Captives recently have shown a large uptake rate for supply chain risk (which increased 133% from 2014 to 2015); considered non-property-damage business interruption which could result from global weather events and could, ultimately, affect a business halfway around the world. Examples include the Thailand floods in 2011, the Japan earthquakes and tsunami of 2011, and Superstorm Sandy in 2012. All of these extreme weather events shared common elements in that they were examples of how a captive that was well established, capitalized, and operated could provide security to its owners.

The *Global Risks 2016* report cites man-made environmental catastrophes caused by pollution, oil spills, fracking, radioactive contamination, and greenhouse gas emissions as having real and permanent effects to the global economy. Depleted resources result in increased demand for raw materials despite the reduction of their existence, thus inhibiting businesses in these industries from properly functioning. We believe there are major strategic advantages to starting to address and quantify these risk factors and by forcing organizations to consider traditional risk transfer and captive use along with reinsurance, where appropriate.

FIGURE 30 Captives Writing Environmental Coverage



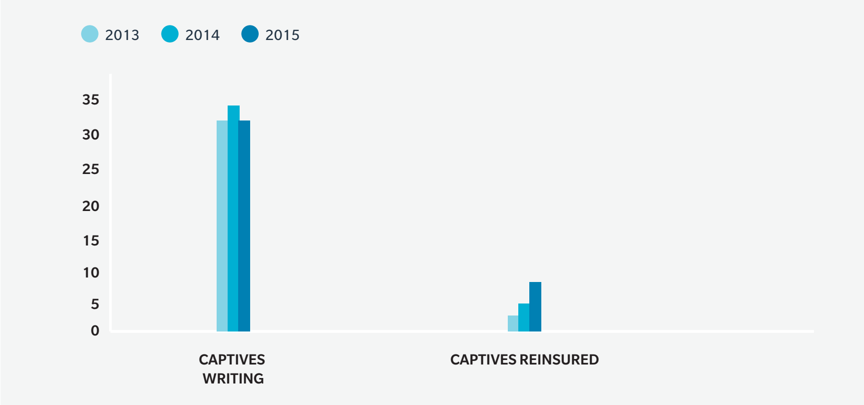
Despite the annual World Environmental Forum and the United Nations Climate Change Conference initiating efforts such as the annual Paris Agreement, and an array of new regulations controlling oil, pollution, and other elements, the environmental concerns and damages currently facing international businesses have not been immediately addressed. As an example of a contingent business interruption (CBI) loss insurable in a captive, the hazardous smog blanketing a number of China's cities has caused metropolitan areas like Beijing to close down businesses for days until the haze has dissipated. Business interruption coverage for non-property damage is a non-traditional line that captives are beginning to cover, closely aligning with emerging and future environmental risks.

Climate change has an immediate effect on global business operations by causing massive property loss and business interruption risks. Many captive parents and prospective captive owners should consider the benefits of writing property, wind, flood, and business interruption into their captives in order to protect against environmental threats. Liabilities for potential manmade environmental catastrophes, such as earthquakes caused by fracking, and droughts caused by overutilization of water supplies, should also be considered for certain industries.

FINANCIAL RISK

After the market crash of 2008, businesses have become hyperaware of financial risk; however, they may not always utilize a captive to further secure their fiscal concerns. We are still witnessing global systematic financial crises on a daily basis driven by global inequality, fiscal crisis asset bubbles, structural unemployment, and energy price shocks. Businesses continue to

FIGURE 31 Captives Writing Trade Credit Insurance and Reinsuring Trade Credit



experience great vulnerability in the interconnected global economy.

The *Global Risks 2016* report specifies factors such as corporate and public debts built up by emerging markets, low interest rate environments, corporate over-borrowing, the rise of unsustainably overpriced assets (such as commodities, housing, and equities/asset bubbles), and the decrease in certain international currencies as relevant concerns that effect daily business operations for companies of all sizes. Uncertainties around Bitcoin, the digital-only currency not backed by any central bank, could significantly impact the economy and multinational businesses.

Parent companies have several different options to use their captives in conjunction with the preservation of global trade receivables. A strategic way to ensure an enterprise's fiscal stability is to implement trade credit coverage within the captive. Trade credit coverage can allow an organization to think more strategically as to where it can enter a market, thereby providing more security in the knowledge that its outstanding accounts receivables will be paid or, if not, then covered by real insurance. Simply put, a captive can support a more pre-emptive sales culture and is the only mechanism through which the commercial insurance market can be accessed, or enable higher retentions whereby commercial coverage can attach in the excess. In addition, captives can use surety/bond programs to guarantee performance in the face of a substantial risk.

A CHANGING WORKFORCE (WORKPLACE DISRUPTION)

The last large global risk that specifically constrains the productivity of international business is that of a changing workforce. Various elements, including widening income inequality, rising cyber dependence, an aging work force (retiring baby boomers), and higher than normal unemployment rates all contribute to the apprehensions organizations may have when evaluating their operations.

As described in the financial risk portion of this report, the energy crisis has had a severe financial impact on organizations within the industry. This also reflects a distressed employment atmosphere reflecting challenging employment patterns seen in many other industries. Oil and gas companies have cut permanent and contract staff, totaling more than 250,000 jobs worldwide, according to joint Mercer and Oliver Wyman research and client experience.

The ways in which organizations are conducting business is fundamentally transforming as advances in technology are made. Often referred to as the fourth industrial revolution, the rapid digitization of the workplace is having some adverse consequences. Organizations are rapidly eliminating jobs based on the efficiencies technology provides. Now, computers can complete tasks once reserved for humans; entire industries are being eradicated based on concepts like artificial intelligence.

In addition, there are considerable changes that organizations face in terms of health care and employee benefits as a result of an aging workforce and regulatory changes such as "Obamacare." It is important for organizations to incorporate non-traditional coverages that will aid in situations that disrupt the workplace such as business interruption and cyber. It is also prudent to consider ways to incorporate employee benefits (medical stop-loss or voluntary benefits) into a captive, which can help a business with the strains of a changing workforce.

CAPTIVE SPOTLIGHT: WHAT ARE SPECIFIC EXAMPLES OF HOW CAPTIVES CAN FLOURISH?

GLOBAL EMPLOYEE BENEFITS SPOTLIGHT

Long considered a potentially significant growth area for captives, strong momentum is now gathering in the number of captives writing employee benefits, in particular, multinational risk benefits, which has seen 143% growth between 2014 and 2015.

Some organizations have implemented captive structures within individual benefits programs to facilitate risk retention and improve cash-flow efficiencies. However, a more common path to a captive for those with sufficient critical mass (estimated to be headcount of more than 10,000 across at least five countries) starts with the consolidation of contracts through one of the eight networks of insurance companies around the world that have formed to provide multinational pools. Multinational pools facilitate aggregated experience rating, which leverages a multinational's buying power.

While multinational pooling enables cost reduction and a certain degree of harmonization, cash and data still remains with network providers along with risk. Risk transfer is an important means of balance sheet protection for property and casualty risks which have catastrophic potential but is less important for employee benefit risks which tend to follow high frequency low severity loss patterns, which are less volatile and easier to forecast. In addition, waiting periods for surplus if income exceeds outgo (known as a pooling dividend) can be significant and underlying data flow, which also follows the experience calculation is stale by the time it is delivered. Captives are being used as a mechanism to overcome these inefficiencies and achieve more advanced risk management objectives such as:

1. Retaining risk in line with group risk appetite.
2. Getting cash-flow back in the business and preventing unnecessary profit leakage.
3. Getting access to actionable data to support strategic benefits management objectives.

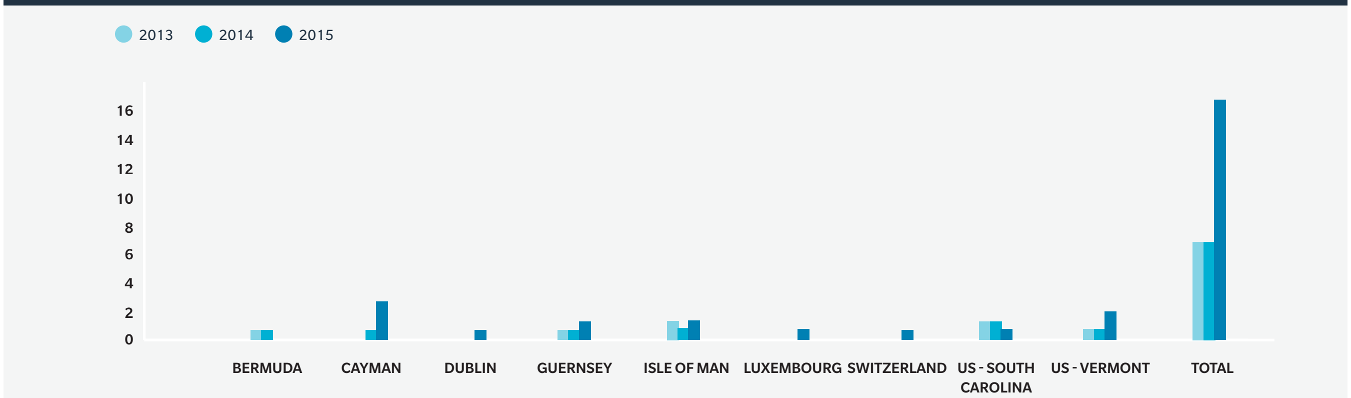
Adding a captive as a reinsurer behind a benefit network makes it possible to retain risk and premium at a group level while still maintaining a robust local employee benefit administrative structure through a fronting company.

In essence, the captive is invisible to local employees and benefit administrators and simply acts as a mechanism to direct cash-flow, risk, and data back to the organization.

There are numerous potential advantages of using captives for employee benefits:

- Control over rates, terms, and conditions.

FIGURE 32 Captives Writing Multinational Pool Benefits by Domicile



- Reduction of insurer profits and brokerage expenses.
- Flexibility of plan design and wording.
- Increase in frequency of reporting.
- Cash-flow advantages as premium paid at the beginning of the year, claims paid as they occur.
- Harmonized governance across multiple geographies.
- Data warehousing and management with access to real-time financial data.

Importantly, adding employee benefits to an existing property and casualty captive can bring stability to the captive balance sheet and diversification for solvency requirements.

CAPTIVE INNOVATION IN DEFINED BENEFIT PENSION FINANCING ARRANGEMENTS

Although most defined benefit pension plans are closed, significant challenges remain in management of legacy obligations. A number of recent innovative transactions involving captives are proving to be financially and operationally beneficial for

FIGURE 33 Structure of Buy-in/Buy-Out Involving a Captive

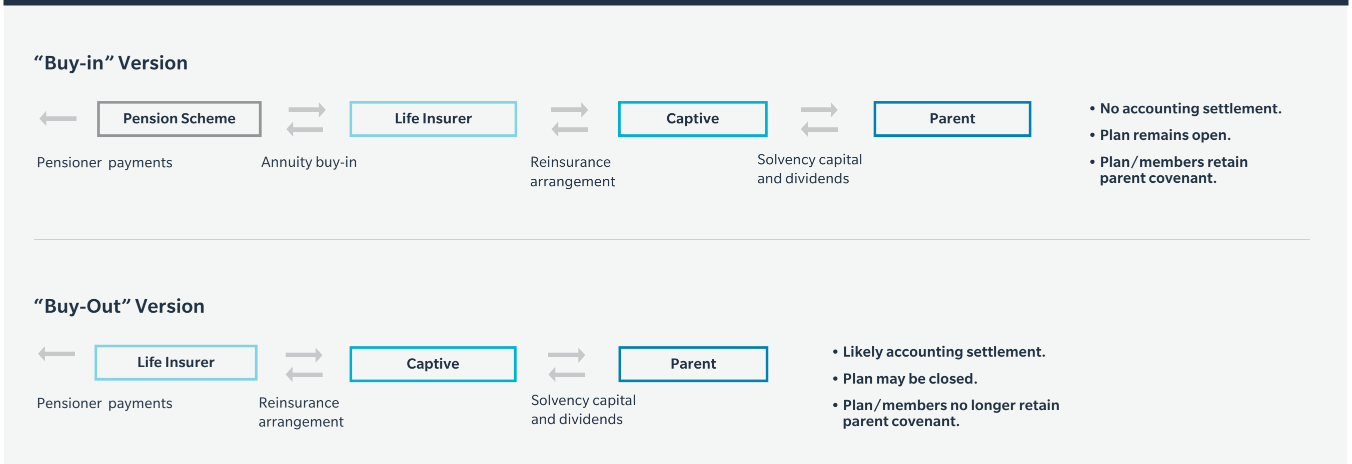


FIGURE 34 Longevity Swaps Involving a Captive

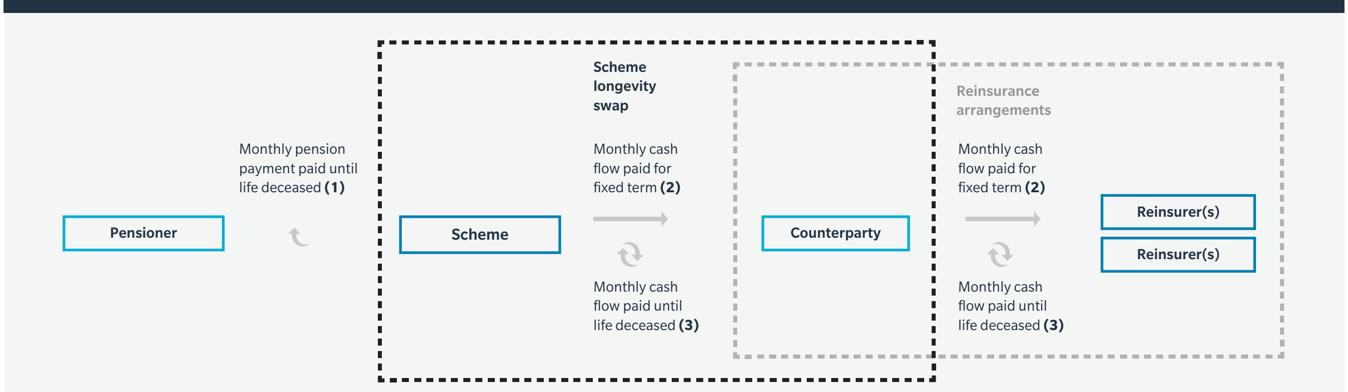
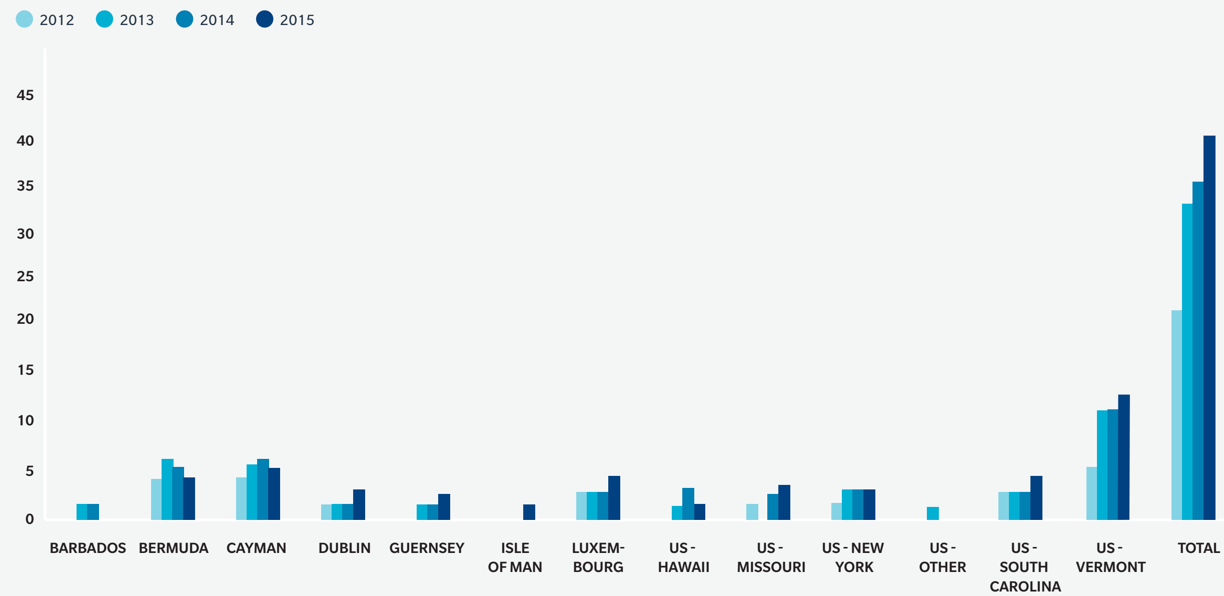


FIGURE 35 Captives Writing Medical Stop-Loss Coverage by Domicile



sponsors and trustees. Pension captive transactions to date fall within two objective groupings; first, where the corporate sponsor structures a buy-in involving a captive to gain control over assets and harmonize governance, and second, where a captive is used as a synthetic fronting structure to reduce costs in a longevity swap arrangement.

The cost of transferring externally via a buy-out is generally prohibitive so the buy-in structure has been the chosen structure so far. Simply put, this involves the transfer of investment assets and management functions to a captive via an insurance contract routed through a fronting insurer.

The arrangement is likely to require a sizeable financial outlay, but for those with the resources and will, the rewards can be significant, including operational efficiencies from centralization of activities and governance, and financial advantages in the ability to access and manage funds previously held outside of group control. Also, potential surplus can be repatriated via dividend from the captive. Fiduciaries can also benefit from this arrangement as concerns around the strength of employer covenant and the management of investments are alleviated with the financial security of a highly rated insurer.

Longevity risk, which involves the risk that beneficiaries live longer than expected, is a significant exposure faced by defined benefit pension schemes that have not put hedging arrangements in place. One way of managing the risk is through a longevity swap, where the scheme maintains control of its investment strategy but hedges its longevity risk.

In a traditional longevity swap, the counterparty is typically an investment bank or life insurance company that fully reinsures the risk, but where a captive can be substituted as the counterparty to provide the following benefits:

- Lower costs for larger transactions.
- Greater flexibility in eventually moving to full-risk transfer.
- Addition of potential greater flexibility in collateralization arrangements.
- Help avoiding transaction size limits driven by front's credit and concentration constraints.
- Increase in price transparency.

Marsh Captive Solutions can assist clients in introducing employee benefits to captive arrangements in domiciles across the world. We anticipate that the number of captives writing employee benefits will continue to grow at a steady pace over the coming years.

MEDICAL STOP-LOSS AND VOLUNTARY EMPLOYEE BENEFITS

Medical stop-loss insurance programs within captives have grown significantly in the last four years as seen in Figure 35. Additionally, voluntary employee benefits (VEB) are becoming an excellent source of profitability and diversity for larger employers to reinsure with their captives. VEB can also allow for unrelated risk in the captive as we have discussed in the taxation section.

Typical VEB includes:

- Critical illness.
- Spousal and child life insurance.
- Hospital indemnity.
- Identity theft and legal plan access.
- Pet insurance.
- Home, umbrella, and automobile insurance.

INVESTMENT SPOTLIGHT

"Will my cash be trapped?" is perhaps one of the most commonly asked questions by prospective captive owners, so having an efficient captive investment strategy is critically important to captive owners.

Figure 36A shows the average asset allocation being adopted by captives in the survey.

INTERCOMPANY LOANS

Intercompany loans continue to constitute a material proportion of the overall assets for captives. This continues to reflect the very low levels of yield available on cash and fixed-income investments, resulting in a higher opportunity cost of holding funds in the captive rather than investing in the core business activities.

Over the past few years we have seen various stimuli for reducing the amount held in intercompany loans, including direct regulatory influences (with regulators restricting the size of these loans for some captives) and indirect influences (for example, with Solvency II in some cases the intercompany loans may attract a relatively higher capital charge). In any case, the proportion of assets held in intercompany loans has fallen slightly since the last survey (see Figure 36B).

NON-INTERCOMPANY INVESTMENTS

On a weighted basis, the asset allocation for captives is principally invested in fixed income, with smaller amounts held in cash, equities, and alternative assets. However, this comparison can be distorted by the larger captives, so the following serves to provide a more in-depth analysis .

BY SIZE

The amount of investment risk that a captive takes appears to be linked to the size of the captive (see Figure 36C). This suggests that larger captives are much more likely to be investing in equities and alternative assets, with the smallest captives largely investing in cash.

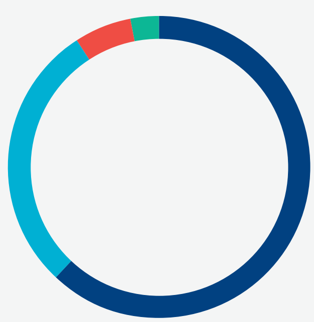
BY REGION

From Figures 36D and 36E, the allocation for European captives does differ from US captives and those from the rest of the world. In general, a higher proportion of the assets are held in cash, and less in the riskier investments of equities and alternative assets.

The change in the regulatory environment to Solvency II for most European captives appears to have made little difference to the matching approach for the liabilities. Under Solvency II, the least risk asset is a government bond of a similar maturity to that of the liabilities, but for European captives the majority of the low-risk investments remain in cash rather than fixed income (indeed, US captives and those from the rest of the world, on average, have a relatively higher allocation to fixed income).

Mercer is currently working with a number of European captives to look at

FIGURE 36A Captive Investment Portfolios
Average Asset Allocation (Non-Weighted, Excluding Intercompany Loans)



CASH	62%
FIXED INCOME	29%
EQUITIES	6%
ALTERNATIVES	3%

FIGURE 36B Captive Investment Portfolios
Weighted Asset Allocation Including Intercompany Loans

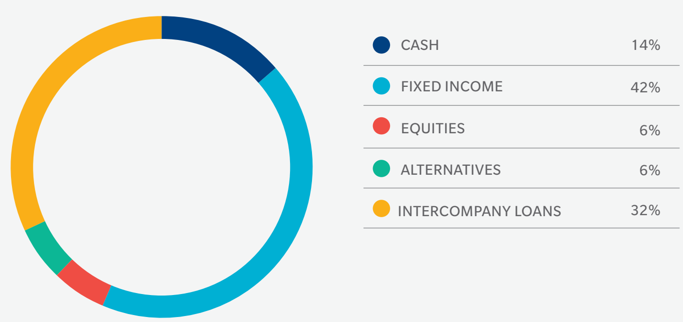


FIGURE 36C Captive Investment Portfolios
Average Asset Allocation vs. Total Investments

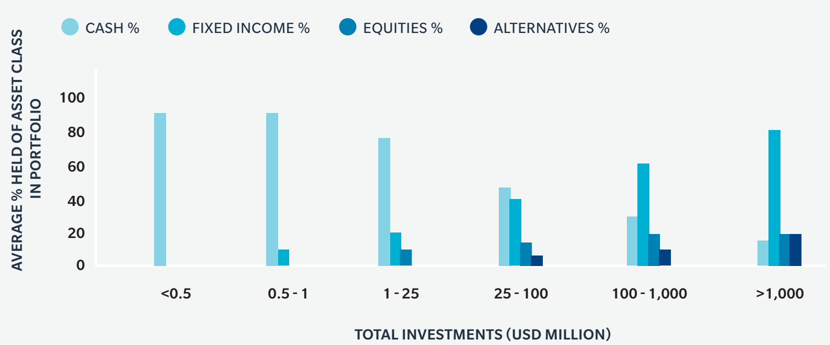
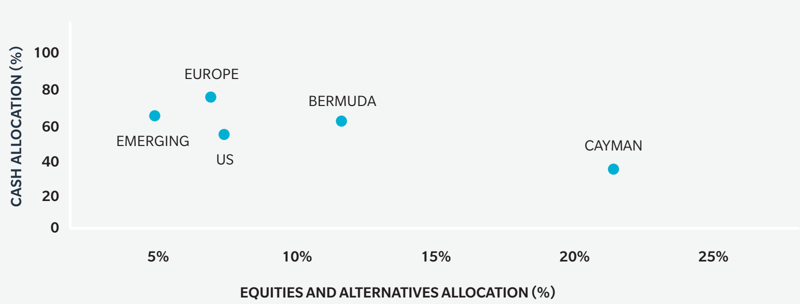


FIGURE 36D Average Asset Allocation - Regional Differences
Asset Allocation by Region



Mercer's Captive Solutions Team works in partnership with many captive insurers, and provides the following benefits:

PROVEN EXPERTISE:

The Mercer team advises insurers including captives on investment, risk and capital related issues, ranging across life, non-life, and health businesses of different sizes and jurisdictions. Over 2015, Mercer worked with 32 insurers with assets totaling approximately $230 billion.

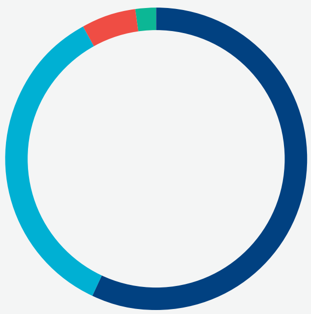
INDUSTRY LEADING IDEAS

The Mercer team's experience of working with insurers puts it in a unique position to bring to captives industry-leading ideas and to benchmark their circumstances against peers and best practice.

CUSTOMISED DELIVERY

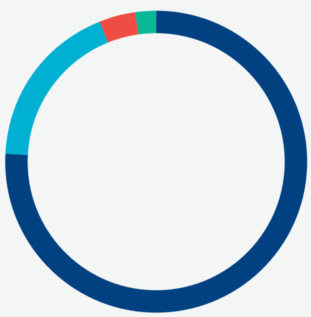
The Mercer team works collaboratively with insurers with various sized internal teams and provides complementary and tailored solutions.

FIGURE 36E Average Asset Allocation - Regional Differences



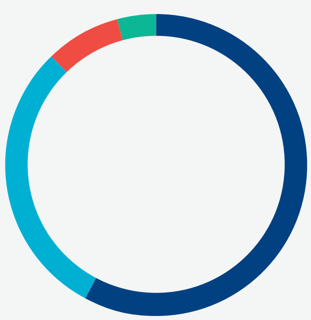
UNITED STATES

CASH	57%
FIXED INCOME	35%
EQUITIES	6%
ALTERNATIVES	2%



EUROPE

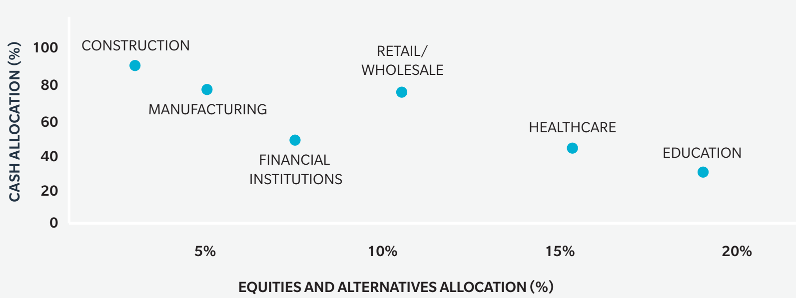
CASH	76%
FIXED INCOME	18%
EQUITIES	4%
ALTERNATIVES	2%



REST OF WORLD

CASH	58%
FIXED INCOME	30%
EQUITIES	8%
ALTERNATIVES	4%

FIGURE 36F Asset Allocation - By Industry



ways of improving the capital efficiency of the investment portfolio, subject to the captives' liquidity constraints and investment beliefs.

In general, captives based in the Cayman Islands take materially more investment risk with their assets, with an average allocation to equities and alternatives of more than 20% (Figure 36D).

BY INDUSTRY

Figure 36F shows the varying asset allocation of captives from different sectors, ranging from construction where, on average, close to 90% is allocated cash, to health care where, on average, nearly 60% is allocated to fixed income and alternatives.

REGULATORY DEVELOPMENTS: HOW HAS THE LEGAL LANDSCAPE CHANGED THIS PAST YEAR?

EU — SOLVENCY II

Solvency II finally arrived on January 1, 2016, without causing much of a ripple given that implementation measures had been in place for some time. In the coming year, much attention will be focused on local approach to implementation by the national regulators and the extent to which principles of proportionality will be applied by individual states. There are still areas where greater guidance and clarity is required before the full impact of certain aspects of the new regime can be assessed. Examples of this are the treatment of deferred tax assets, the regulatory response to new investment and capital forms not expressly considered in the legislation as adopted, and the precise approach to equivalency or non-equivalency in key jurisdictions outside the EU. Marsh Captive Solutions invested in IT solutions to make the capital calculations and reporting straightforward for our clients and prospects so that their transition to Solvency II was as smooth and effortless as possible. Every day, we are working with our European based captives on making the transition easy and continuing the good path that has been laid to compliance with Solvency II.

Given that implementation has been in place for some time, EU captive owners are fully familiar with the new regime, and through the Own Risk and Solvency Assessment (ORSA) process have adopted a more sophisticated approach to capital utilization and investment return. EU captive owners are also likely to explore alternative forms of capital (Tier 2/3 Capital) in order to strengthen their capital base and the use of letters of credit, parental guarantees, subordinated debt, and unpaid share capital are options likely to be explored.

With the increase in sophistication, Marsh is also seeing a broader integration of captives into the risk management and enterprise risk techniques of captive owners' parent groups, and a desire to diversify into non-traditional lines of coverage such as employee benefits, cyber, and trade credit. We anticipate that the growth rate in the number of captives in EU domiciles will increase and that the EU will become one of the more sophisticated captive markets over time.

UNITED KINGDOM DIVERTED PROFITS TAX AND BASE EROSION AND PROFIT SHIFTING (BEPS)

The UK introduced the Diverted Profits Tax (DPT) with effect from April 1, 2015, which has potential impact for UK captive owners and UK subsidiaries of overseas organizations that pay premium to a captive (re)insurance vehicle. DPT is aligned to the Organisation for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) Package, which consists of 15 recommendations. The BEPS Package, if adopted by other G20 countries, has the potential to have a significant impact on some captives and their owners. However, it remains to be seen how other G20 countries will interpret and incorporate the BEPS recommendations into their local laws. Marsh Captive Solutions and our sister companies have been assisting clients with compliance to BEPS without any disruption or issues.

831(B) CAPTIVES

A significant tax law change to small captives was passed in December 2015. The new legislation nearly doubles the maximum tax-deductible premium limit to US$2.2 million. This figure will annually appreciate proportional to inflation and coincide with increases in the cost of living. The higher the contribution limit, the more attractive 831(b) captives become to organizations interested in forming small captives.

Additionally, to qualify for section 831(b), insurance companies must now comply with a new diversification requirement in one of two ways. Either no more than 20% of premium can originate from one policyholder, or the ownership of the captive must mirror the ownership of the businesses, subject to a 2% de Minimis rule. Lastly, a reporting requirement by the taxpayer to attest that the diversification requirements have been met was incorporated within the legislation.

FEDERAL HOME LOAN BANK (FHLB) CAPTIVE ACCESS

In January 2016, the Federal Housing Finance Agency (FHFA) released a final rule amending its regulation on Federal Home Loan Bank (FHLB) membership in order to finalize a proposed rule originally issued in 2014. The objective of the FHFA is to prevent entities that do not otherwise meet the statutory requirements from becoming bank members by establishing captives as outlets to circumvent the membership eligibility requirements and gain access to low-cost FHLB funding. The rule redefines "insurance company" to exclude "captive insurers" and, therefore, prevents non-eligible entities from gaining de facto FHLB membership through a captive insurer. The rule allows current FHLB captive insurer members who joined prior to FHFA's proposed rule up to five years to terminate their membership. Those that joined after issuance of the proposed rule in 2014 have only up to one year to wind down their operations.

US SELF-PROCUREMENT TAXES (SPT)

Effective January 2015, Illinois enacted legislation to impose a self-procurement tax on the purchaser of insurance from a non-admitted insurance company, including a captive. The rate of tax in Illinois is 3.5% of premium plus a 1% Fire Marshall Tax on property risks. There was much political controversy surrounding this tax and it was expected that the tax may be repealed but that did not occur in 2015. There have been recent developments in Illinois to revamp its captive laws, as there are only two Illinois captives currently. Based on discussions with regulators in Illinois, the outlook appears favorable and we encourage Illinois companies to work with us on this new development.

Moreover, in April 2015, Tennessee also enacted a self-procurement tax at a rate of 5% potentially to attract captives from other states to redomesticate and prevent Tennessee companies from looking too far from home to establish captives.

TRIPRA AND THE TERRORISM BACKSTOP IN THE US

As expected, TRIPRA was extended by Congress in January 2015, paving the way for the insurance industry to continue to offer terrorism insurance to its policyholders. Captives also followed this trend, offering terrorism cover to its affiliated groups. TRIA, which was originally enacted in 2002 after the events of 9/11, is now extended until 2020. There are significant changes to TRIPRA over the next four years and captive owners should be aware of the government participation percentage along with the Trigger amounts, which increase from US$120 million in 2016 to US$200 million in 2020. Marsh has a cost effective TRIA Trigger protection offering to captive clients in the form of a reinsurance program. Lastly, there will be certain reporting and disclosure information that the US Treasury will mandate for 2015 (optional disclosure in 2016) and beyond.

About Marsh

Marsh is a global leader in insurance broking and risk management. Marsh helps clients succeed by defining, designing, and delivering innovative industry-specific solutions that help them effectively manage risk. Marsh's approximately 30,000 colleagues work together to serve clients in more than 130 countries. Marsh is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), a global professional services firm offering clients advice and solutions in the areas of risk, strategy, and people. With annual revenue of US$13 billion and approximately 60,000 colleagues worldwide, Marsh & McLennan Companies is also the parent company of Guy Carpenter, a leader in providing risk and reinsurance intermediary services; Mercer, a leader in talent, health, retirement, and investment consulting; and Oliver Wyman, a leader in management consulting. Follow Marsh on Twitter, @MarshGlobal; LinkedIn; Facebook; and YouTube. For more information, visit www.marsh.com.

About Marsh Captive Solutions

Marsh Captive Solutions includes the Captive Advisory Group, Captive Management Services, and the Captive Solutions Actuarial Group. We have more than 430 colleagues managing more than 1,250 captives globally. In the industry for nearly 50 years, we have management offices in 18 countries and advisory expertise in retail brokerage offices worldwide. Captive Advisory is the consulting arm of Captive Solutions.

A designated team of expert captive advisors works closely with captive champions in the geographies to deliver best-in-class advice and service from feasibility studies to structuring and implementation of captives. This group is also responsible for training and developing colleagues throughout Marsh to be captive champions and practitioners. Captive Management is an industry leader in designing, implementing, and managing new captives. Once a client has decided to develop a captive, Captive Management can provide the necessary financial, accounting, treasury, and insurance services, from choosing the appropriate location to conducting regulatory filings. Our established relationships with key service providers such as auditors, lawyers, and actuaries helps ensure that each captive runs smoothly, cost effectively, and with the strategic and financial benefits most appropriate for our clients' businesses. Our Captive Solutions Actuarial Group comprises credentialed actuaries and supporting actuarial analysts. Our actuaries consult exclusively with captive and self-insurance programs in numerous global domiciles.

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