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UK presents ILS proposals for second consultation

The UK government has released its second consultation on the implementation of an insurance-linked securities (ILS) regime.

On 1 March, the government published its first consultation, which revealed its approach for an "effective and competitive" framework for insurance special purpose vehicles (IPSVs) in the UK. The UK government asked for feedback on the consultation, which closed earlier this year.

The government received 21 responses from insurers and reinsurers, professional services, investment banks, industry groups and private individuals.

According to the second consultation paper, responses were "supportive of the government's intention to create a competitive framework for ILS and were broadly supportive of the proposals set out to implement a competitive regulatory and tax regime for ILS".

The consultation said: "Responses agreed that a protected cell company corporate structure was appropriate for a new ILS framework; that a bespoke approach to the taxation of ISPVs would be needed; and stressed that a robust but streamlined supervision of ISPVs from the Prudential Regulation Authority and Financial Conduct Authority would be key to the success of the regime."

Continued on p2

Colorado senator shares his doubts about IRS notice

Colorado senator Michael Bennett is the latest figure to criticise Notice 2016-66.

In a letter of concern to the Internal Revenue Service (IRS), which used Notice 2016-66 to formally identify micro captive transactions as "transactions of interest", Bennett stated: "The notice is overbroad and may be burdensome for small businesses to identify transactions involving captive insurance companies over the course of many years."

He said: "While I understand the IRS's need to identify and stop tax avoidance schemes, it is my hope that the service can collect this information in a less burdensome manner or use data it may already have."

Bennett currently serves on the Senate finance committee, which has jurisdiction over tax and captive insurance issues.

Continued on p2

R&Q completes first US-based self-insurer novation

Randall & Quilter Investment Holdings (R&Q) has completed its first US-based self-insurer novation.

The novation, from Maryland Motor Truck Association Workers' Compensation Self-Insurance Group (MMTA WCSIG), was to its wholly-owned US admitted insurer, Accredited Surety and Casualty.

The captive, MMTA WCSIG, was formed in 1994 as a workers' compensation self-insurance group for the members of the Maryland Motor Truck Association. It was then discontinued in 2006.

Accredited Surety has assumed all liabilities from the group for years 1994 to 2006, and has provided full finality for the MMTA WCSIG.

Continued on p4

UK government presents ILS proposals for second consultation

Continued from page 1

The second consultation proposes to create a protected cell company (PCC) regime for multi-arrangement ISPVs.

The paper noted that multi-agreement ISPVs (mISPVs) are permitted under Solvency II, however it said the core requirements of the directive “will apply in respect of each individual contractual arrangement”.

It said: “The proposed UK PCC regime is designed to meet these Solvency II requirements through a strict segregation of risk transfer contracts, therefore providing confidence to cedants and investors that deals will be robustly segregated. It will also provide an administratively efficient means for managing multiple deals from one ISPV.”

According to the government, PCCs introduced under the Risk Transformation Regulations will only be available for use as authorised mISPVs.

Some consultation responses argued that a protected cell regime would “add value” across a range of financial services activities. Respondents also suggested that PCCs should be available as a corporate structure for other regulated activities.

However, the government has said it will keep the potential broader use of PCCs “under review, but will not extend the purpose of PCCs at this stage”.

In terms of taxation, the government proposes to implement a bespoke tax regime. This will involve exempting the insurance risk transformation of ISPVs from corporation tax, a complete withholding tax exemption for foreign investors, and UK investors being taxed as normal according to circumstance.

The government said its aim is to “create a regime that is internationally competitive and in line with the UK’s move towards a territorial tax system”.

The deadline for responses to the second consultation is 18 January 2017.

Malcolm Newman of the London Market Group, which worked extensively on the proposals, welcomed the second consultation. He said: “There will undoubtedly be debate and discussion over some issues but we look forward to a constructive dialogue with government and the regulators to refine the proposals so that ILS business can be conducted onshore in the UK in 2017.”

“Once we have the legislation in place, we can start the vital of work of attracting business. We want to use our strengths and our ability to innovate to create new products and grow the overall reinsurance and insurance market.”

Paul Traynor, international head of pensions and insurance segments at BNY Mellon, added: “We welcome the announcement that the UK government is consulting on a new regulatory and tax framework for ILS.”

“An onshore ILS centre in London would facilitate innovation, particularly in the development of risk transfer products such as pandemic and emerging market natural catastrophe risk. The ability to transfer emerging risks to the capital markets rests on the ability to understand, model and parameterise the peril. If a solution can be found, this will set a precedent for other emerging ILS risks,” Traynor explained.

Colorado senator shares his doubts about IRS notice

Continued from page 1

It is expected that more senators will join Bennett in writing letters of concern to the IRS.

The Self-Insurance Institute of America has already asked the IRS to grant more time to 831(b) captives that need to comply with Notice 2016-66.

Contents

The filing deadline for affected captives is 30 January 2017, just 90 days after the issuance of the notice on 1 November.

R&Q completes first US-based self insurer novation

Continued from page 1

Ken Randall, chairman and CEO of R&Q, said: "This deal reinforces our team's innovation in structuring transactions to provide full finality to an increasing variety of entities with legacy insurance liabilities in the US marketplace."

"The US self-insurer market is very substantial in size and we have several legacy deals of this nature in the pipeline."

FiscalReps unveils new tax database and software

FiscalReps has launched Taxbox2 at the company's Indirect Tax Academy event.

Taxbox2 is designed to simplify the preparation of premium tax and parafiscal returns and comprises of 'investigate', 'calculate' and 'generate' modules.

The conference was attended by more than 90 tax managers from insurers across Europe.

Mike Stalley, CEO and founder of FiscalReps, said: "Building a comprehensive global premium tax database for the insurance industry has been an ambition of FiscalReps for many years and with the recent developments to Taxbox, that ambition can now be realised."

FiscalReps recently appointed Ilka McHugh as client director of technology.

One of McHugh's first tasks was to support the company's client directors in the implementation of the new Taxbox2 modules across Europe.

After her appointment, McHugh said: "I am very excited about being given the opportunity to use my skills in both technology and insurance to provide value to FiscalReps's clients."

"Having had a sneak preview of Taxbox2, I am very excited to be involved in its launch."

Advisers should act now on Notice 2016-66

Advisers should not take a "wait and see" approach to the Internal Revenue Service (IRS) Notice 2016-66, according to Rachel Partain, member of law firm Caplin & Drysdale.

Partain suggested that advisers should begin collecting information and preparing forms in earnest, given the significant penalties.

The IRS's Notice 2016-66, released on 1 November, formally labelled micro captive transactions as "transactions of interest".

The notice requires reporting by any taxpayer involved in micro captive transactions over a number of past years in which the open statutes of limitations applied.

The filing deadline for this is 30 January 2017, 90 days from the date of issuance.

Partain said: "Contacting the IRS with questions regarding how to interpret some unclear aspects of the notice might result in the IRS issuing a clarified notice with a new due date, similar to the reissued basket option contract transaction notices in 2015."

The Self-Insurance Institute of America has already requested more time for 831(b) captives that need to comply with the notice.

Partain said: "An extension of the 30 January 2017 due date would allow captive managers and the certified public accountants for the insureds and business owners sufficient time to coordinate a consistent response and ensure that the necessary disclosures are filed properly and timely, especially given that managers may be focusing on policy renewals and restructuring ownership structures in order to qualify under section 831(b) beginning in 2017."

Marsh supports FERMA's captive insurance education

Marsh has commended Federation of European Risk Management Associations (FERMA) efforts to create a constructive dialogue with the Organisation for Economic Co-operation and Development (OECD) on the role of captives in base erosion and profit shifting (BEPS).

This comes after FERMA launched a campaign to change tax authorities' and other public bodies' misperceptions about captive insurance.

FERMA submitted a position paper to the OECD, urging that the views of European risk managers are considered when discussing the implementation of its BEPS initiative.

Praveen Sharma, global leader of insurance regulatory and tax practice of Marsh, commented: "Ultimately it is about educating the OECD and the various tax authorities on the role that a captive plays in the current uncertain economic climate facing multinational companies."

"It is important to emphasise that captives are not and are no longer being, formed for tax avoidance purposes. They are there for genuine commercial reasons."

Sharma explained that the action plan from the OECD will require captives and their owners to

Tate & Lyle's captive celebrates 10 years in service

Tate & Lyle is celebrating the 10th anniversary of its Gibraltar-domiciled captive insurance company.

The captive was established in 2006 after Aon Global Risk Consulting reviewed Tate & Lyle's global risk management and risk financing requirements and strategy.

According to Tate & Lyle, Gibraltar was the chosen domicile because of its "ability to establish a new captive insurer, swiftly within a well-regulated and recognised captive jurisdiction".

Albert Isola, minister of commerce for Gibraltar, said: "The reasons that Tate & Lyle chose Gibraltar, namely an established insurance domicile with a business-friendly and approachable regulator together with experienced local service providers and easy access for senior management travelling from the UK, remain just as valid today as they were in 2006."

Robert Gibber, chairman of Tate & Lyle Insurance Company Gibraltar and executive vice president and general counsel of Tate & Lyle, added: "Gibraltar continues to provide all the attributes we were seeking from an insurance jurisdiction back in 2006."

change and restructure their current operating models, including corporate governance, control of risks, decision making and insurance contract pricing.

Birte Fehse, senior vice president of Marsh Risk Consulting, said: "It's a good time to start preparing because, whatever happens in terms of legislation, the general trend towards more transparency in tax matters means there will be more scrutiny of captives."

"The advice is to get ready and have the correct documentation in place, even though there are still questions on how exactly BEPS will impact captives."

PARIMA teams up with ANZIIF

The Pan-Asia Risk and Insurance Management Association (PARIMA) has partnered with the Australian and New Zealand Institute of Insurance and Finance (ANZIIF) to provide risk professionals based in the Asia Pacific region with designation and education.

The partnership was formed was this year's PARIMA conference by chairman Franck Baron and ANZIIF CEO Prue Willsford to introduce a new PARIMA ANIZIIF-certified risk professionals (PA-CRP) programme.

PARIMA and ANZIIF suggested that an "established certification" should be in place to show the "professionalism and legitimacy" of the risk professionals in the business world.

Stacey Huang, executive director of PARIMA, commented: "The new education offering will allow risk managers to differentiate themselves as risk professionals."

"By attaining PA-CRP, they have demonstrated that they have the knowledge and expertise in risk management, and that they are dedicated to upholding high standards of ethical and professional conduct that the profession rightly requires."

Willsford added: "This is a wonderful opportunity for both ANZIIF and PARIMA but, most importantly, it will provide risk professionals with world-class education and training and a long-sought credible risk designation."

Negative outlook for HAI Group

HAI Group has had its financial strength and long-term issuer credit ratings affirmed, however the outlooks for both have been revised down.

A.M. Best affirmed HAI Group's financial strength rating of "A (Excellent)" and long-term issuer credit ratings of "a".

According to A.M. Best, the ratings reflect HAI Group's excellent capitalisation, strong operating results, leading position and proven expertise in the niche public housing authority market.

However, its concentration of risk in the public housing authority sector, which "magnifies the impact of market cycles, public policy and legislative changes", and falls in its underwriting profitability, coupled with the low interest rate environment, mean its outlook is negative.

The rating agency also affirmed the financial strength rating of "A- (Excellent)" and long-term issuer credit rating of "a-" of HAI Group's Housing Specialty Insurance Company (HSIC).

This rating reflects HSIC's strong capital position and the support it receives from HAI Group.

Partially offsetting this is "the start-up nature of the company, which is mitigated by the successful performance and support of HAI Group", according to A.M. Best.

NORCAL purchases PPM RRG

NORCAL Mutual Insurance Company has acquired PPM Services, the holding company for Preferred Physicians Medical Risk Retention Group (PPM).

As part of the transaction PPM Services, located in Overland Park, Kansas, will partner with NORCAL, expanding its presence in the Midwest US.

Steven Sanford, president and CEO of PPM, said: "We are very pleased to be joining such a well-respected company as NORCAL, which shares our commitment to always putting the best interests of physician policyholders first."

"PPM will now be able to leverage the considerable resources of NORCAL to further expand our anaesthesia brand, better respond to changes in the health care environment and deliver additional value to our policyholders."

Scott Diener, president and CEO of NORCAL, added: "This is a great partnership for both companies and an opportunity for NORCAL to continue our national expansion."

Cyber crime concerns at SMEs are increasing, notes Zurich survey

The risks posed by cyber crime are an increasing concern for small and medium-sized enterprises (SMEs), according to Zurich Insurance Group's annual global SME survey.

Just 10 percent of SMEs said that they were too small to be at risk of "falling victim" to cyber crime, compared to 17 percent of those that thought that they were "too insignificant to attract the attention of cyber criminals" in 2015.

Theft of customer data and reputational damage emerged as the biggest potential threats from cyber crime activity, named by 27 percent and 20 percent, respectively.

Only 5 percent of SMEs said they are confident they have sufficient and up-to-date IT measures in place to protect against cyber crime, compared to 8 percent last year.

The survey suggested that attitudes towards cyber crime differ regionally.

European SMEs are in line with global trends, typically fearing theft of data and reputational damage, while US businesses also showed concern about money and savings.

In Latin America, the fastest-growing concern was around the potential risk of third-party lawsuits related to cybercrime, however, 10 percent said they haven't thought about cyber crime, and have no opinion on it.

Zurich surveyed 2,600 C-suite executives and managers at SMEs in 13 countries across Europe, the Americas and Asia Pacific.

Lori Bailey, global head of special lines at Zurich, commented: "With the number of high-profile cyber security breaches in the media over the last year, it is not surprising that the risk awareness amongst SMEs has grown significantly, yet alarming that the vast majority of SMEs do not have the appropriate cybercrime protection measures in place."

Saipem captive given 'excellent' rating

A.M. Best has assigned the financial strength rating of "A- (Excellent)" and the long-term issuer credit rating of "a-" to Sigurd Rück, the captive reinsurer of Saipem, domiciled in Switzerland.

Saipem, an Italian group, provides services to the oil and gas sector, including procurement, construction and installation of pipelines.

The ratings of Sigurd Rück reflect the company's "excellent" capitalisation, "very strong" operating performance and its "importance" as a risk management tool for the Saipem group, according to A.M. Best.

BNY Mellon launches new platform for medical claims

BNY Mellon has launched an automated medical claims payment platform for its property and casualty insurance clients.

The new system, using technology from Jopari Solutions, has been integrated into BNY Mellon's treasury services payment platform and is compatible with the various medical claim processing systems used in the healthcare industry.

Anthony Brady, head of global product management for BNY Mellon's Treasury Services business, said: "Healthcare providers are driving the growth for modern payments systems. They are looking for efficient systems that reduce costs and payment times and are compatible with regulations governing property and casualty and workers' compensation businesses and medical claim payments."

"This fully automated system is now integrated with our global payments platform to deliver standardised property, casualty and workers' compensation payments."

Spirit and Radius ratings affirmed

A.M. Best has affirmed the financial strength ratings of "A (Excellent)" and long-term issuer credit ratings of "a" for Spirit Insurance Company and Radius Insurance Company, captives of Phillips 66.

The Spirit Insurance Company is located in Burlington, Vermont and Radius Insurance Company is based in the Cayman Islands.

The rating affirmations reflect the captives "excellent" capitalisation, risk management practices and "profitable" business writt en from a predecessor captive.

In addition, A.M. Best recognised the level of commitment on the part of Phillips 66, whose management incorporates Spirit and Radius as "core elements" in its overall risk management programme.

According to the rating agency, the captive's loss experience has remained "favourable", partly due to no material catastrophe events and the "strong" loss control programmes at the parent.

Spirit provides terrorism coverage to its parent and, while terrorism risk exposure remains relatively high on a gross basis, A.M. Best suggested that concerns are mitigated by reinsurance protection afforded by the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA).

However, due to the "temporary nature" of TRIPRA, A.M. Best said it will continue to monitor the company's gross terrorism risk exposure over time as it relates to the company's risk management practices and overall capacity.

Do you have a story we should cover?

Let us know via:

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ICING ON THE CAKE

In captive insurance, tax is no longer the cake itself, but the cherry on top. Birte Fehse and Praveen Sharma of Marsh explain

Becky Butcher reports

What challenges do captives face around the Organisation for Economic Co-operation and Development's (OECD) base erosion and profit sharing (BEPS) action plan?

Birte Fehse: The main challenges are around a captive's operating model. This includes the ability to prove the captive has a good business case and that the activity, the people and the captives are commensurate with money that goes into the captive. Transfer pricing is the second challenge. For captives, proving that the transfer pricing they have in place is comparable to the commercial market and that it is a genuine commercial transaction is important.

Praveen Sharma: The issue is that the G20 has tasked the OECD to come up with proposals to reduce, if not eliminate, tax evasion transactions. Consequently, captives have been captured under the OECD project and have been deemed by the OECD to be a tax avoidance mechanism. That means captives and their owners will have to review their current operating models.

Multinational companies will have to rethink why they have a captive at all, what value the captive brings to their overall risk management strategy, and how the captive should operate going forward. Once the substance and value of the captive has been determined and established, the next consideration is the premium that the captive should receive for the risk it is assuming. Although these new requirements seem quite challenging, as they will require a shift in the operating model, they are not insurmountable.

What is the likely impact of BEPS on the captive insurance industry?

Sharma: It will mean that captives and captive owners will have to rethink how the captive is involved in the overall risk management strategy, how the contract of insurance is structured, who makes the decisions regarding the contract of insurance, the risks the captive insurer is taking, how it is assessing those risks, and whether it has any decision-making powers at the captive board level to reject or question the validity of the contract of insurance.

What can the industry do to respond to these challenges?

Sharma: At the moment, the industry is unable to do much until the BEPS proposals have been implemented in the legislation of the OECD members. For the moment, companies should start looking at country-by-country reporting. Having said that, many countries already have transfer pricing and controlled foreign companies legislation. Consequently, it would be appropriate for captive owners to commence a review of the current captive involvement and structure to determine possible changes to the operating model.

Fehse: Now is a good time to start preparing because whatever happens in terms of legislation, the general trend towards more transparency and tax matters means there will be more scrutiny on captives in the future.

The advice, even though it has not been defined 100 percent, on how BEPS will affect captives is to get ready to have the correct documentation in place. Marsh is looking to work with the Federation of European Risk Management Associations (FERMA) on how we can build a constructive dialogue about the role of captives. We plan to engage in a dialogue to educate and work with the OECD on the genuine commercial role that captives have to play as risk and insurance vehicles.

Sharma: It has already been announced that FERMA has opened a dialogue with the OECD, and that FERMA has issued a position paper on the topic. Ultimately it is about educating the OECD on captives and emphasising that captives are no longer being formed for tax avoidance purposes, rather, they play a significant role in managing the total cost of risk of the multinational group.

As captives are now well regulated by the respective supervisory authorities, they are being structured and applied on a genuine commercial basis, and tax is not the main driver.

The tax is the icing on the cake, but not the cake itself. The commercial aspect represents a large slice, so if the tax savings are

> Ultimately it is about educating the OECD on captives and emphasising that captives are no longer being formed for tax avoidance purposes

Praveen Sharma, Global practice leader of insurance regulation and tax, Marsh not there then the commercial portion is still quite big. Many years ago, tax was the cake and the commercial reasoning was the icing, but now the balance has shifted.

Multinational companies are under tremendous pressure for capital as well as for managing group costs. The OECD needs to understand the modus operandi of why companies form or utilise a captive and why is it structured the way it is.

Multinational companies therefore assess the viability of utilising a captive after taking into account all relevant commercial issues including capital, costs, value and risks. Tax is no longer a critical issue for multinational companies.

Fehse: If you run your captive professionally then BEPS should not be such a big challenge. It is helping to further professionalise captives.

Sharma: Captives have been around for many years, and in that time there have been challenges to the industry that it has overcome.

We have adapted and modified captive insurance, so we should see this as just another challenge that we will have to overcome and adapt to accordingly. If we have to restructure the insurance arrangement, we will have to restructure the organisation, the corporate governance, the decision-making process and the board member structure.

Fehse: Captives should work with their organisations' tax departments to make sure they are in line with each other, because BEPS is all around the role of the captive as a wider part of the organisation.

Together they need to have a clear business case, so companies need to be able to articulate why they have chosen to have a captive in place, working with the tax department to get clarity on how intercompany transactions are set, and to document that.

Also, having good reporting and management information in place is essential. In addition, companies need to make sure cash flows in and out of the captive are well documented, well explained, and transparent.

Sharma: Documentation is critical, so between now and whenever the BEPS proposals are fully implemented into the respective national tax laws, companies should start looking at their process, people and structure, and then think about their transfer pricing and the methodology being adopted.

This should all be documented so that, by the time BEPS does get implemented, companies are prepared to defend their positions.

In the UK, we already have the diverted profits tax, which is very much a part of the BEPS proposals. Companies have the justification for why a captive exists, whether it is for tax or commercial reasons, and for how the pricing is calculated.

Many countries already have transfer pricing regulation, but now companies have to look at the value chain. That analysis should start happening today. CIT

“Captives should work with their organisations' tax departments to make sure they are in line with each other, because BEPS is all around the role of the captive as a wider part of the organisation”

Birte Fehse
Senior vice president
Marsh Risk Consulting

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The case against the cell

Stewart Feldman suggests it may be time to examine your LLC, PCC, series or cell planning, and consider returning to a traditional captive arrangement

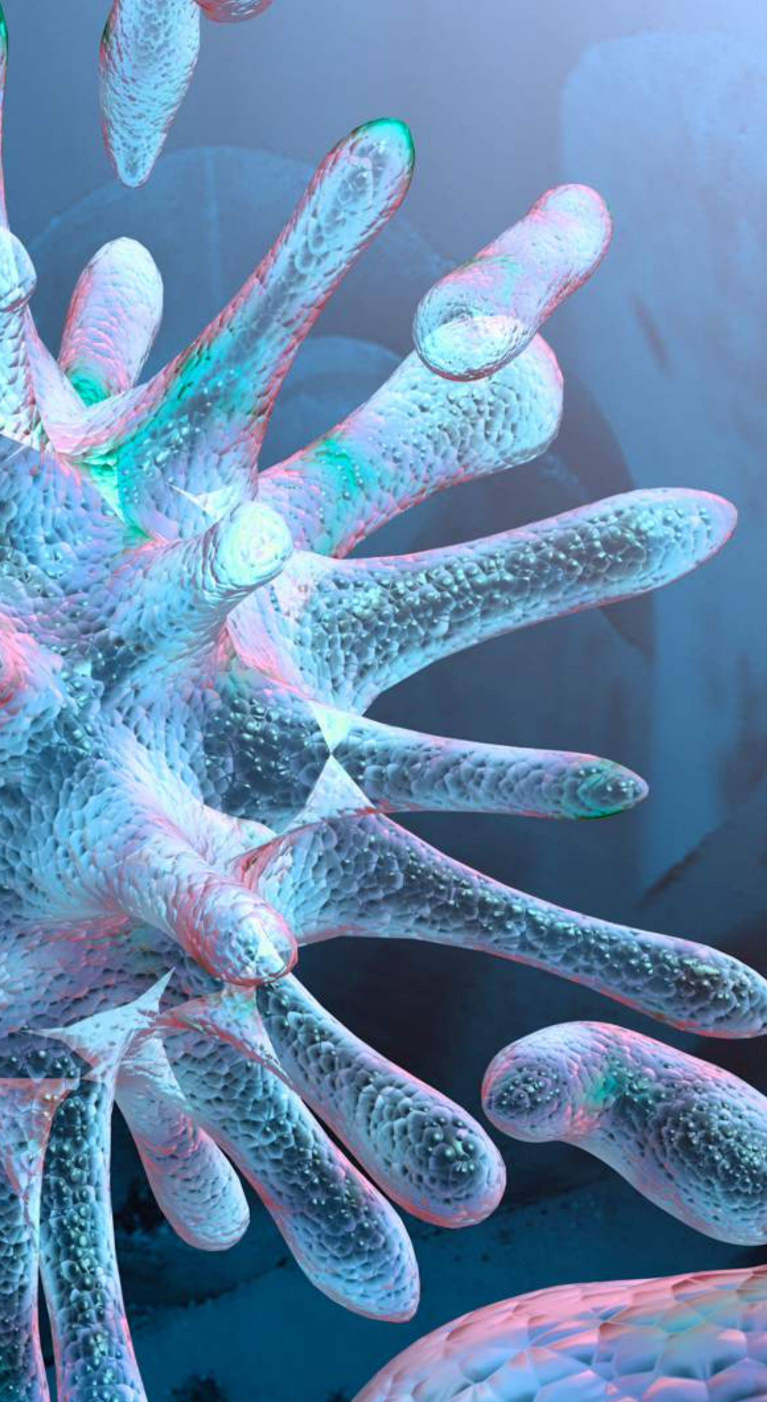
I am both a tax and corporate lawyer, and I am asked to resolve problems daily. Lately, what seems to be crossing my desk with frequency are protected cell companies (PCCs), segregated cells, series limited liability companies (LLCs) or other cell arrangements that are 'held together with bubble gum'.

While known by various names, the arrangements are generally the same: a promoter, who is typically not a professional, forms a core company offering clients easy access to a captive insurance arrangement.

The promoter is usually a wealth adviser, financial planner, a property and casualty insurer or a life agent or, even worse, a lawyer or certified public accountant (CPA) who is not your adviser or your fiduciary, but who works for the captive sponsor. In some ways, it is akin to the old rent-a-captive arrangement in which the client, in effect, rents a hotel room.

The common characteristic of these arrangements is that they frequently fail from both federal income tax and insurance standpoints. Captive insurance is complicated. It involves many moving parts and a variety of service providers.

Anyone who thinks otherwise is doing their clients and themselves a disservice. Anyone who has gone through an Internal Revenue Service (IRS) tax controversy on captive issues knows better than to brush aside the complexity of alternative risk planning.



The scant attention given to tax compliance by some cell promoters is disconcerting. Even worse is their inability to support or survive an IRS examination, let alone to mount a US Tax Court challenge. The cell structure unfortunately provides a veneer of unwarranted comfort to the cell or series owner.

In many cases, the client's money is exposed to serious unknown financial risks from the insureds of other cells. We have been retained for projects where the client's sole objective was to extract himself, his insureds and his cell from the tentacles of the series captive structure and the poor protections afforded to cell owners.

Like many planning ideas, cell captive arrangements, in theory, might work. The core supports the cell, often allowing for easier and less expensive entry into the planning. The cell's capital might be supported by that of the core. In practice, with many promoters, this strategy often takes the form of a classic bait and switch arrangement where the client is lured away from a standalone captive into a cell or series arrangement.

Theoretically, the cell structure should have the benefit of walls separating the cells or series LLCs. Often in practice, the sloppy corporate and legal oversight, the incomplete legal documentation, the dearth of corporate law supporting the cell arrangements, the commingling of funds, and the commonality of the core all lead to porous walls. Using the high-rise condominium as an example, if you are in one unit, a water leak from above, or fire and smoke damage from another unit on the same floor, will usually wreak havoc on all of the buildings' occupants. Thinking otherwise is naive.

Common problems

In a recent project reviewed by our team, a cell arrangement was domiciled in a 'questionable' offshore domicile where the sponsor's cell arrangements constitute 80 percent of all of the captives in that island nation. The domicile was not a British territory benefitting from British regulation, but a notorious independent offshore domicile better known for crime and financial impropriety. The regulation was scant and ineffective.

There was no requirement for audited statements, and none were produced. Reports to the domicile were misleadingly based on the consolidation of the core and cell arrangement, not each client's individual cell. The client had no right to receive and was unable to obtain financial information on the other cells or their insureds. The core provided most of the capital, but the cell's capital didn't support the individual cell's losses. The cell granted broad-based powers of attorney to the core to execute policies and other contracts on behalf of each cell. The cell actually granted the core signature authority over its bank and brokerage accounts.

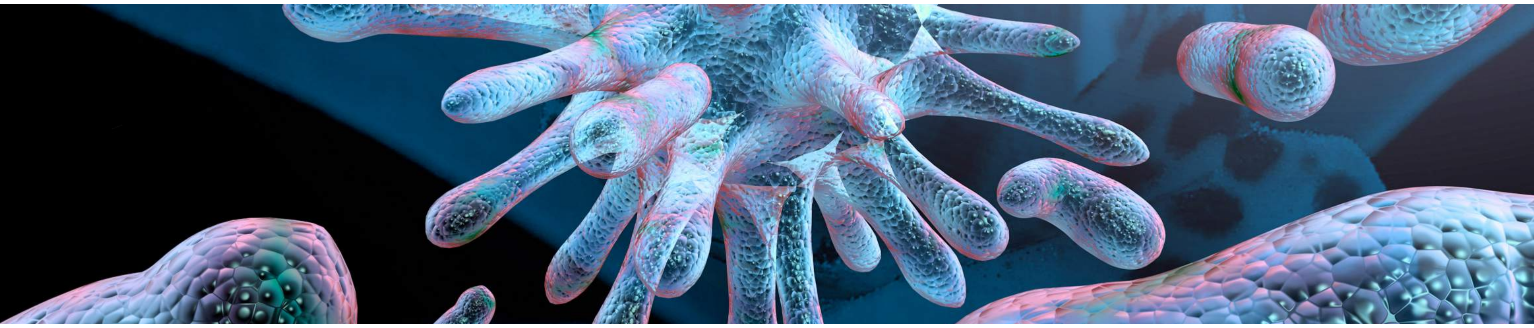
The $5 million of client money in the cell was outside of the client's practical control. The core's capital, intended to support its cells, wasn't there, even though the client's capital was inadequate to support the cell's level of insurance activities. When the client wanted out of the cell arrangement, the core refused to sign the documents.

Meanwhile, the core's sponsor disclaimed all legal and tax responsibility for the planning. There was no fiduciary obligation owed by the core or the sponsor to the cells because the captive sponsor, although a lawyer, inserted in the documents that he was the lawyer for the plan sponsor and captive manager—essentially, he was the opposing lawyer.

Buried deep in the captive documents, the client had ceded to the core's manager the role typically taken on by the officers and directors and owners of the captive. Under the documents presented by the core's manager and executed by the client, the core manager, being the captive sponsor, had the right to control the cells. The captive cell owner granted co-control over the bank account to the core's manager, leaving the client with little authority. The client stood helpless, losing control of the entity in which he had invested millions.

Traditionally, captives are regulated by the domicile, however, regulation of a captive as an insurance company is a characteristic cited by the US Tax Court as one of the key factors in establishing treatment as an insurance company for federal tax purposes. The captive must function as a bonafide insurer for it to benefit from the tax status as a property and casualty insurer. There was scant evidence of this throughout the promoter's documentation. In general, at some point both the IRS and the domicile's regulatory examiners will likely audit a cell captive. This is when its core manager will likely do the 'Texas two-step' and disappear.

More often than not, the captive manager disclaims all tax and legal responsibility and the client is left to piece together the planning and



handle the audit or tax controversy on his own. Realistically, this is a nearly impossible task.

Captive planning has many moving pieces. It is subject to regulation and oversight by its domicile, by the insured's home state, and by the IRS. A client must 'thread the needle' of all these regulators and do so with the recognition that it operates on limited premium and a constrained administrative budget.

Can you imagine needing a new car but instead choosing to buy the individual component parts and assemble it yourself? As the purchaser, you are then left to assemble the pieces. This is a recipe for certain disaster.

Too often even sophisticated clients hire a captive manager and then find that the actuary is located in one state, the corporate lawyer—if one exists—is in another states, the tax lawyer in another, the auditors still somewhere else. At best, each is taking responsibility for only their piece of the puzzle and disclaiming broader responsibility. Even if that car makes it out of the driveway it is destined to be abandoned by the side of the road, with each of the component suppliers blaming another. No one warrants or stands behind the project as a whole.

So why are there a plethora of cell arrangements in the marketplace? Often a cell structure allows for a promoter with little to no captive experience to sell a sophisticated financial product with a tax and legal overlay, but with none of the costs, responsibility, or care. Imagine a sponsor able to present the client with form contracts, fill in some blanks and then collect a $75,000 annual fee and offer a captive for only $25,000 in capital.

Sometimes this is bolstered by a fill in the blank feasibility study, but rarely based on an on-site, professional evaluation. The manager types the client's name into an LLC agreement and the captive is in place. Even the domicile cooperates upon payment of its formation fee.

Questions to ask

Who are the tax and legal professionals that designed the captive planning? Speak to them and have them explain their roles. Who stands behind the planning? Get it in writing and have the legal and professional team acknowledge that they represent you.

Visit the sponsor's offices and meet your captive planning team. Many 'captive managers' operate virtual offices with the 'team' holding full-time jobs or working from home. The question is whether there is a team of professionals in place that can support and carry out the planning. This is often not the case.

Don't expect your company's consumer protection association or lawyer to know very much about captive and alternative risk planning. In the same way, you wouldn't expect your ophthalmologist to be able to provide an appropriate treatment for your arthritis. You may get an answer, but don't rely on it.

Will you control your own company? Is there a company manager who supersedes your role as the owner, director or officer? Examine the documents. Make sure that you will be receiving annual, audited statements of your own cell.

Require access to the other cells and to the core's financials, and take precautions to ensure that your cell isn't exposed to the acts of other cells or the core. Better yet, don't choose a cell or a series arrangement—opt instead for a standalone captive.

Who is the captain of the ship? Captive planning is complicated. Who is taking overall responsibility? Get it in writing.

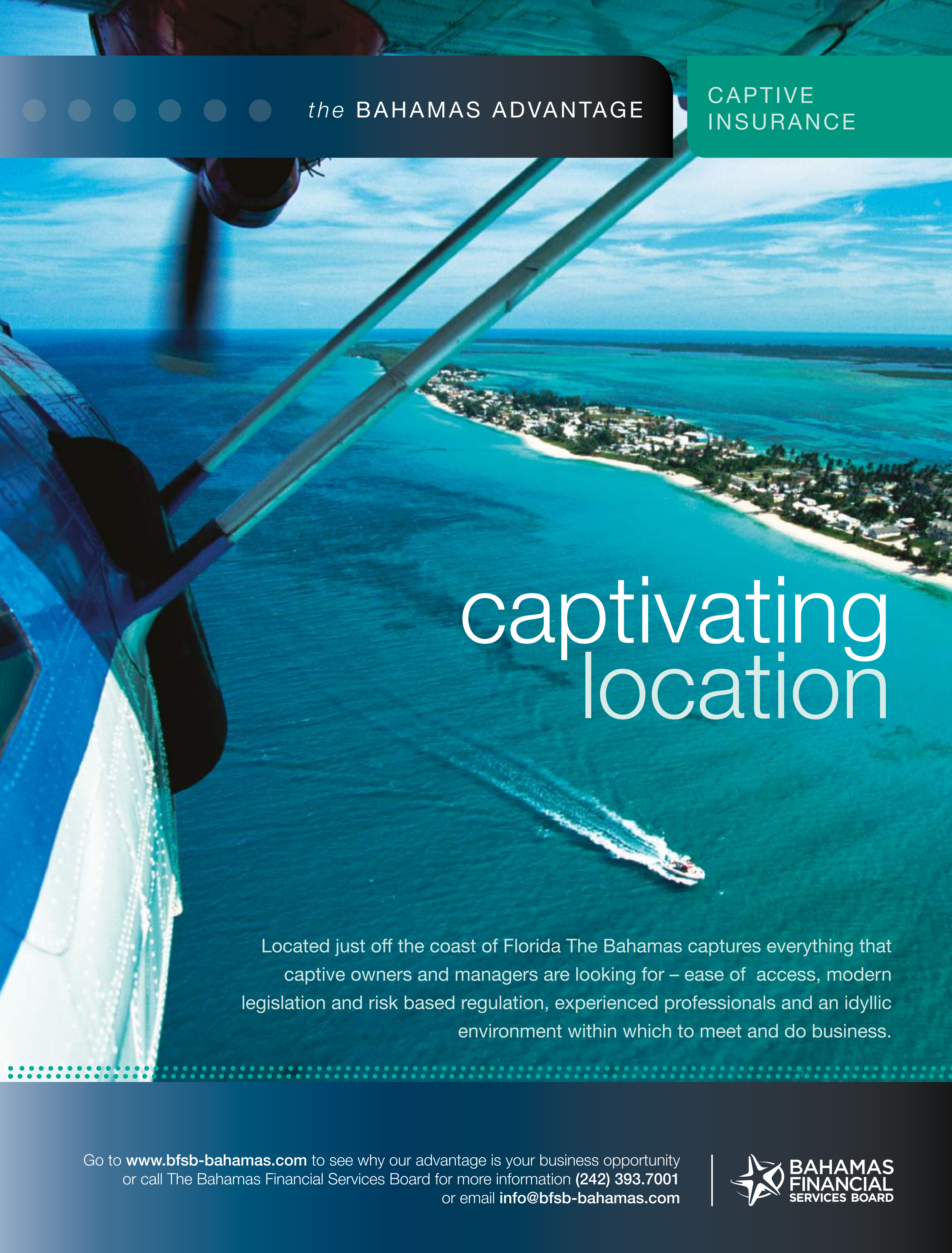
Who is responsible for evolving the planning as the tax law changes as it did in 2004, 2008 and again in 2015. Who is paying for the redesign of the captive when—not if—new legislation is enacted?

Is there a third-party component, for example, a pool, as part of the planning? Who has designed this and has it been tested? Understand the insurance and tax risks associated with the pool or risk sharing arrangement, and find out if it is audited and who controls it.

If you're the type that wants to assemble a high-performance car on your own then a cell arrangement may be right for you. However, given that you're about to embark on a long trip, you might want to pray that all of the components are working together.

For the rest of the business community that would rather have a turnkey approach, it may be time to examine or re-examine your LLC, PCC, series or cell planning and to consider returning to a traditional, standalone captive arrangement. CIT

Stewart Feldman
CEO and general counsel
Capstone Associated Services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Industry Events

World Captive Forum

29 - 31 January 2017
Florida
www.conferences.businessinsurance.com

Celebrating its 26th year, the 2017 World Captive Forum will address new and emerging risks facing companies and organisations worldwide, demonstrating how captives can offer solutions that may not be available in the traditional insurance marketplace. A domicile-neutral conference, the World Captive Forum provides in-depth, high-calibre educational content to risk managers, benefit managers and financial executives whose organisations have risks insured by a captive or who are exploring the formation of one.

CICA International Conference

12 - 14 March 2017
California
www.cicaworld.com

This year's CICA International Conference offers a deeper understanding of the causes of disruptions and strategies for harnessing these changes to optimise your captive's performance. Learn about disruptive technology and cyber risk, employee benefits and healthcare, the sharing economy, regulatory and tax challenges, and strategies to address the new risks they bring.

Comings and goings at Hanover Stone Partners, Hiscox and more

Jeremy Pinchin is stepping down from his Bermuda leadership roles at Hiscox.

Pinchin, who is CEO of Hiscox Re and ILS and Hiscox Bermuda, will return to London next year, continuing in his role as Hiscox Group claims director and as a member of the executive committee. He will also join the board of Hiscox Special Risks.

Michael Krefta will take over the Bermuda-based roles on 1 August 2017. Krefta currently serves as chief underwriting officer of Hiscox Re. In his new role, he will be based in Bermuda and will report to group CEO Bronek Masojada.

Krefta will also join the executive committee.

Masojada commented: “Jeremy Pinchin has had a huge influence on the evolution of our Bermudian operation. It is under his leadership that Hiscox Re was not only created but has since successfully navigated a turbulent reinsurance market.”

“He also initiated the creation of Kiskadee Investment Managers, our ILS fund manager, and evolved our approach to product innovation, with repeated success.”

“In returning to London, I am confident our group claims function will continue to benefit hugely from his leadership.”

Masojada added: “Throughout the recent transformation of our reinsurance business, Michael Krefta has expertly guided the underwriting integrity that is so attractive to our third party supporters, while instituting a more commercial approach in our underwriting.”

“I look forward to working closely with Michael as he leads the business through its next phase of growth, particularly as our ILS business grows in significance with now more than $1 billion in assets under management.”

Hanover Stone Partners has appointed Paul Petrylak as senior risk adviser of financial product advisory, based in New York.

Petrylak brings more than 20 years of risk management, insurance and reinsurance experience to the company.

Prior to his new role, he was president of CIT Insurance Services, where he was responsible for deploying diverse risk management strategies, including captives, residual value, trade credit and credit risk, to address inherent banking business risks.

Pool Re has appointed Stephen Burr as head of actuarial services, with immediate effect.

Burr will report to Steve Coates, chief underwriting officer at Pool Re.

Prior to his new role, Burr was senior pricing actuary at RenaissanceRe Syndicate 1458.

Julian Enoizi, CEO of Pool Re, said: “Stephen Burr is the ideal candidate to manage our actuarial function.”

“He joins with an exceptional track record and I am certain that our members will quickly benefit from his expertise.” CIT

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