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Work in progress

Work is underway to boost captive growth in Hong Kong but will updated legislation be enough to draw in new captives?

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CIC Services vs IRS

Sean King of CIC Services discusses the firm's upcoming case against the IRS in the Supreme Court

Emerging Talent

Mike Scott

Assistant vice president

Global Captive Management


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In this issue

Reinsurance Collateral Trusts

The limitations and costs associated with traditional collateral options such as Letters of Credit have dramatically fueled the growth of alternative risk transfer strategies amongst insurers, reinsurers, captives and corporations. Fluid regulatory, financial and risk management environments demand lower-cost collateral solutions – solutions that afford maximum flexibility with minimal effort to set-up and maintain.

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Why choose an Insurance Trust?

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A.M. Best affirms Lion Re ratings

A.M. Best has upgraded the financial strength rating to A (Excellent) from A- (Excellent) and the long-term issuer credit rating to "a" from "a-" of Lion Reinsurance Company Limited (Lion Re), which is based in Bermuda. The outlook of these credit ratings remains stable. Lion Re is a subsidiary of ASSA Compañía Tenedora S.A. (ASSA Tenedora) and is owned ultimately by Grupo ASSA, S.A. (Grupo ASSA), a financial services holding company publicly traded on the Panama Stock Exchange.

A.M. Best stated that these ratings reflect Lion Re's balance sheet strength which is categorised as strong, as well as its adequate operating performance, neutral business profile and appropriate enterprise risk management.The rating firm highlighted that these ratings also reflect Lion Re's continued "adequate operating performance" resulting from its "affiliated insurance companies in the region and from new strategic business alliances, strong risk-adjusted capitalisation", which is measured by Best's Capital Adequacy Ratio (BCAR), and its affiliation to Grupo ASSA, which provides synergies, operating efficiencies and guarantee support.

Lion Re is a Bermuda-based reinsurer assuming risks from ASSA Tenedora and affiliates for property, liability, marine, life, health and miscellaneous businesses. The company provides reinsurance as part of the group's retrocession cover with a geographical exposure to Central America's insurance market.

A.M. Best explained: "The company continues to support ASSA Tenedora's strategy while producing positive bottom-line results amid healthy prospects for growth."

Additionally, it expects Lion Re to continue playing an important role in ASSA Tenedora's strategy, as it consolidates operations in new regions by providing reinsurance capacity while maintaining its capital base expansion.

Lion Re consistently reviews its underwriting guidelines to improve the performance of business segments that are deviating from targets. Investment income, based upon a more conservative strategy, continues to support Lion Re's results; however, the company is not dependent on this revenue to achieve positive bottom-line results, according to the rating company.

A.M Best outlined that factors that could lead to an upgrade of the ratings or positive outlooks for Lion Re included consistently positive bottom-line results that can contribute to further strengthening of its risk-adjusted capitalisation over the next few years while maintaining guarantee support.

However, factors that could lead to negative rating action include a material loss of capital, which leads to a reduced level of risk-adjusted capitalisation that does not support its ratings, and diminished strategic importance. ■

Babel Cover begins testing for digital bicycle insurance

Babel Cover, a technology startup, has started development for its range of digital first inter-connected financial services products, following its announcement for the project in December last year.

As a first phase, it has released a fully digital insurance product with the Maltese insurer Atlas and emerging technology firm Piprate to insure bicycles of competitive cyclists, triathletes and commuters of Malta.

The intention of the pilot is to perform live and controlled product and technology testing laying the framework for release of new products and more countries.

According to Stuart King, founder and CEO of Babel Cover, buyers of insurance will ultimately benefit by having a fully digital product that offers more transparency, ownership and oversight of the insurances they purchase and the investments underpinning the premiums collected.

King also noted that insurance provides an essential social and economic role and the current business model underpinning the deployment of insurance capital to risk is not overly efficient and is subject to an overwhelming amount of non-added value cost.

"Babel Cover's proposed risk financing model as supported by modern technologies will ultimately lead to individualised insurance and cost savings. Babel Cover proposes to return savings to customers in the form of rewards to build greater loyalty and trust between buyers and sellers of insurance," added King. ■

Cayman sees positive Q1

The Cayman Islands Monetary Authority (CIMA) revealed that as of 31 March 2020 there were a total of 660 Class B, C and D insurance companies and 25 insurance managers under the supervision of the Division.

Pure captives and group captives represented the two main categories, with 283 and 125 companies, showing a slight increase in group captives and while pure captives remain stable compared to Q4 2019 figures of 283 and 123, respectively.

The Q1 results showed that 20 percent of the total Class B, C, and D insurance companies were formed as segregated portfolio companies, with over 600 segregated portfolios. There were a total of 780 insurance licensees under the supervision of the Insurance Supervision Division as at 31 March 2020, of which 95 and 685 related to domestic and international insurance markets, respectively. This figure has increased from 764 in Q4 2019.

The Cayman Islands international insurance industry consists mainly of companies insuring risks in North America and remains the leading domicile for healthcare captives, representing almost one-third of all the captives on the island.

As at 31 March 2020, medical malpractice liability (MedMal) continues to be the largest primary line of business with approximately 26 percent companies (re)insuring MedMal, and workers' compensation, the second largest with over 22 percent of companies assuming this risk.

Commenting on the Q1 figures, Adrian Lynch, Insurance Managers Association of Cayman vice-chair, said: "I am encouraged by the consistency of our results in Q1 in Cayman. Obviously everything in life nowadays will have a pre and post-COVID-19 lens. We must remember that Q1 results will often contain the carryover from 2019 efforts, however, they remain a reflection of the hard work and innovative strategies of many of Cayman's managers."

He continued: "I am particularly impressed by the growth in non-healthcare stats again reflective of diversification in our market while remaining true to our roots in healthcare. Longevity growth is also consistent and though not material in terms of license stats it is hugely impressive in terms of premiums written. It would be remiss of me not to consider the potential impact of COVID-19."

"We see many of our clients being impacted from a liquidity and capacity perspective but what is clear is that the captive remains a key strategic ally in their risk financing and risk mitigation conversations. Our risk manager clients are getting far more air time with their C-suite and the captive is being seen as a legitimate capacity creator within programmes seeking support."

"Our pipeline for Cayman is strong and all the portents are very positive in terms of growth opportunities despite the anticipated losses resulting from COVID-19. The knock-on effect here will be a tightening in capacity thus expanding the captive conversation. I expect Q2 will be equally as solid, we may see a dip in Q3 due to the COVID-19 effect and I imagine Q4 will likely be the busiest we have seen in years," he added. ■

Investigation launched into Willis and Aon merger

Bragar Eagel & Squire (BES) has launched an investigation into whether the board members of Willis Towers Watson breached fiduciary duties or violated the federal securities laws in connection with the company's proposed merger with Aon. On 9 March this year, Willis announced it had signed an agreement to be acquired by Aon for approximately $30 billion.

As part of the merger agreement, Willis Towers Watson's stockholders will receive 1.08 shares of Aon common stock for each share of Willis Towers Watson common stock owned. The deal, which is scheduled to close in the first half of 2021, would see the combination of two of the world's largest insurance brokers.

BES stated that they are concerned that WTW's board of directors "oversaw an unfair process and ultimately agreed to an inadequate deal price".

The stockholder rights law firm said they are investigating all relevant aspects of the deal and "are committed to securing the best result possible for WTW's stockholders".

In light of the current COVID-19 pandemic, Aon's CEO Greg Case sent a letter to employees addressing how the pandemic has affected the firm.

Case outlined in his letter that the combination with Willis Towers Watson "will be a positive catalyst that enables us to accelerate innovation on behalf of clients. This all-stock combination requires no financing and our intent to complete it creates no incremental financial burden".

Willis Towers Watson declined to comment, while Aon is yet to respond to a request for comment. ■

PARIMA calls on insurance market to work together in response to COVID-19

The Pan-Asia Risk and Insurance Management Association (PARIMA) has requested for the insurers and brokers across the Asia Pacific region to come together with flexibility and partnership for businesses in the region to survive as a result of the COVID-19 pandemic.

In its message, PARIMA stated: "In an unprecedented crisis, many companies are under great pressure and for some, it may be a question of survival."

PARIMA suggested insurers and intermediaries should endeavour to treat customers fairly and grant flexibility to business customers, as well as individual consumers when reasonable and practical across both the timing and extent of premium payments and claims negotiations.

"The support of the insurance industry is going to be critical for businesses, and it is paramount that businesses have continued access to insurance and are kept well informed as we navigate these uncertain times," the association added.

PARIMA recognised that insurers are also under stress, and highlighted that they are not in favour of regulators imposing retroactive coverage of claims that were not envisaged within contracts as this could create material solvency risks for insurers.

"Regulators enforcing retrospective changes would jeopardise contract certainty and erode the trust needed to build a long term and collaborative relationship, a relationship that will be essential for business in recovering from the pandemic," PARIMA explained.

The board is also "strongly advocating for the creation of national/regional insurance pools for future pandemic risks".

PARIMA noted that national/regional pools have been previously useful in responding to other severe and widespread risks, such as terrorism, and could prove to be equally relevant in dealing with a global pandemic exposure.

The association said it is prepared to provide an expert view from risk and insurance managers to support this cause. ■

Airmic calls for change in approach to insurers' pandemic response

Airmic has urged the insurance market to choose a more responsible position on the COVID-19 pandemic or the sector will risk long-term damage to trust and reputation and the loss of customers.

The UK association explained that as many corporates are facing the "existential" outcomes from global governments' lockdown measures and "recession likely to follow", it expects brokers and insurers to demonstrate fairness and flexibility with regards to claims and renewals.

Airmic said: "The harsh market is already straining relations with many corporate clients, and insurers' rigid interpretation of wording regarding the pandemic could accelerate this deterioration."

However, Airmic stated that insurers have a choice, "they can either interpret ambiguous contract wordings with their balance sheet in mind, or they can act as partners to long-standing customers who seek business protection."

"All parties will benefit from a partnership approach to the current crisis".

It also called for the avoidance of last-minute and poorly communicated changes in underwriting policy, including coverage limits and exclusions; constructive dialogue in wording disputes and a willingness to look favourably on grey are claims; flexibility in cover and rebates for reduced risk exposure relevant to current trading conditions and business operations; and recognition of the cumulative impact of the harsh market and pandemic on renewals.

Additionally, the association asked for a commitment to avoid COVID-19 exclusions on directors and officers policies; business interruption covers that are fit for modern business risk profiles, which may include the increased use of parametric tools to protect cash flows; and greater collaboration and communication between businesses, insurers and brokers to allow innovation and opportunity to emerge from the crisis.

Similar to PARIMA's call to the insurance market, Airmic is also looking beyond the COVID-19 pandemic as the association supports the creation of national catastrophic pooling and reinsurance mechanisms, such as the existing UK pools for terrorism and flood.

The association highlighted that they must be embedded in broader national and international risk strategies and should themselves be pooled to ensure the efficient use of capital.

A collaborative approach, such as joining up the public, private and academic sectors may be the only long-term option, according to Airmic.

The association noted that it is currently working with industry and government bodies to explore how to turn this into a reality.

Airmic CEO John Ludlow commented: "The insurance industry is at a critical juncture. Member surveys suggest the hardening market is already forcing businesses to look at alternative transfer options, and an ill-judged response to the pandemic could prove the trigger."

"We understand insurers are under stress but it is in the interests of all parties that we work together openly, constructively and collaboratively. For years, insurers have said they want to be business partners with our members. Now is the chance to put words into practice," he concluded. ■

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FERMA launches taskforce to tackle business interruption risks

The Federation of European Risk Management Associations (FERMA) has created a taskforce to create proposals to address the issue of business interruption coverage for catastrophic risks. The aim of the taskforce is to support the creation of economies that are resilient in the face of systemic and catastrophe risks, explained Dirk Wegener, president of FERMA.

The task force, made up of senior risk managers from FERMA members, plans to publish its initial results by the end of May.

FERMA and the member associations want to open a dialogue with all relevant stakeholders, including EU institutions, insurers and brokers, and government bodies.

Additionally, it was noted that FERMA has called for a discussion among these stakeholders to create a holistic solution that provides cover for non-damage business interruption for all types of catastrophe risks, not just pandemic.

"We intend to draw on that expertise to make concrete proposals to form the basis of discussions with stakeholders," Wegener said.

Meanwhile, FERMA also argued that the impact of catastrophe events, like the current pandemic, are beyond the resources of the private insurance industry and enterprise risk management alone.

The absence of business interruption cover without a requirement for physical damage, or non-damage business interruption, is a critical issue, FERMA explained. It affects all sizes of business, but especially small and medium enterprises.

FERMA identified that several European countries have existing public-private partnerships to cover extraordinary risks.

The landscape is diverse and, inevitably, each has strengths and weaknesses. The taskforce suggested it will be essential to avoid easy solutions.

Wegener added: "Any catastrophe mechanism for business interruption must be able to respond to various types of disaster, address the complexities of catastrophes and avoid the pitfalls of existing schemes." ■

Nissan's captive issued 'excellent' ratings by A.M. Best

A.M. Best has affirmed the financial strength rating of A (Excellent) and the long-term issuer credit rating of "a" of Nissan Global Reinsurance (NGRe), based in Hamilton, Bermuda. The outlook of these credit ratings remains stable.

A.M. Best stated that the ratings reflect NGRe's balance sheet strength, which they categorised as very strong, as well as its adequate operating performance, neutral business profile and appropriate enterprise risk management.

NGRe is a single-parent captive of Nissan Motor Company. In its role as a single-parent captive, NGRe provides Nissan with a host of insurance coverages in the US and abroad, including extending service contracts, product liability and inland marine.

As a member of the Nissan family of companies, NGRe benefits from the group's proprietary data warehouse, extensive risk management practices and loss control programmes.

The rating affirmations reflect NGRe's steady growth in surplus driven by consistent premium growth and favourable profitability over the past 10 years.

The rating company suggested that NGRe maintains a large portion of investments in asset-backed securities (ABS), which produce significant monthly income that contributes to strong operating cash flows.

"Despite the substantial proportional size of the underlying loans, these ABS instruments are considered to be of high credit quality and have performed in accordance with expectations," A.M. Best added. ■

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A mature island

Justin Cole of DGM Financial Group discusses the current captive climate in Barbados, new regulation, and what the industry can expect to see over the next 12 months

What does the captive market look like in Barbados?

Barbados is a mature captive market that has been in existence since the early 1980s.

As a well-known domicile, it continues to experience steady annual growth with a net gain of 18 new insurance companies in 2019, bringing the total number of insurance companies to 294 at the end of 2019. This type of growth has been very consistent and we expect it to continue into the future.

What are the biggest challenges/ opportunities for the captive insurance industry in Barbados?

The Organisation for Economic Co-operation and Development (OECD) inclusive framework on base erosion and profit shifting (BEPS) brought about numerous challenges as the country had to take a fresh look at its insurance legislation to ensure that all ring-fencing was removed and Barbados remained compliant. Barbados was able to completely revamp legislation to ensure compliance while remaining an attractive captive domicile. These OECD efforts, specifically as they relate to economic substance, have also been greeted as a great opportunity for Barbados when compared to competing domiciles. Barbados has always been a jurisdiction of substance and has a highly educated local workforce within the insurance sector. The country relies far less on foreign professionals than other competing jurisdictions. With these new requirements levelling the playing field across all jurisdictions, Barbados believes that this has created a real opportunity and competitive advantage.

Is there any planned legislation for captives in Barbados?

Barbados' new Insurance (Amendment) Act now features two classes of insurance licence: Class 1 for companies insuring related-party risk which are taxed at 0 percent and pay a licence fee of USD 12,500; and Class 2 for companies that insure and/or reinsure third party risk which is taxed at a rate of 2 percent on taxable income and a licence fee. Barbados legislation also allows for separate account structures, segregated cell companies and incorporated cell companies.

Do you currently see any new business coming to Barbados from Latin America or any other countries that are in the DTA?

Yes, Latin America is a rapidly growing segment of the Barbados captive industry and Barbados' efforts to develop a double taxation agreement (DTA) with Mexico in this regard has paid off, coupled with our marketing initiatives to make inroads into the Latin American marketplace. Barbados also has DTAs with Panama, Venezuela and Cuba, and is actively working to expand our treaty network in order to create additional opportunities worldwide.

What changes do you see for Barbados' captive market over the next 12 months?

Early signs indicate that Barbados' captive market will continue to grow over the next 12 months as there continues to be a lot of interest in establishing captives, likely due to the hardening insurance market which always drives interest in captives. The decision to establish a captive is usually the result of long-term planning, rather than a short-term reaction, therefore, I don't think that the COVID-19 pandemic will have a major impact on the captive sector in Barbados. The Financial Services Commission, which is Barbados' insurance regulator, has seamlessly transitioned to working remotely and continues to function effectively. Likewise, the various captive management teams have done the same allowing business to continue uninterrupted. ■

"Early signs indicate that Barbados' captive market will continue to grow over the next 12 months as there continues to be a lot of interest in establishing captives, likely due to the hardening insurance market"

Justin Cole
Vice president, management services
DGM Financial Group

Hong Kong Outlook - By Maria Ward-Brennan

Work in progress

Work is underway to boost captive insurance market growth in Hong Kong but will China's Belt and Road Initiative and new legislative changes be enough to draw in new captives to the region?

Hong Kong, officially the Hong Kong Special Administrative Region of the People's Republic of China (HKSAR), is a metropolitan area and special administrative region of China in the eastern Pearl River Delta by the South China Sea. With a population of over seven million people, Hong Kong is among the most densely populated areas of the world. It is also a major international financial centre and its currency, the Hong Kong dollar, is the eighth most traded in the world. Hong Kong's captive insurance market is still making slow and steady progress.

In 2019, total gross written premiums for its four domiciled captives was HK$1,355 million and total underwriting profit was HK$396 million.

The four captives include CGN Captive; CNOOC Insurance, Shanghai Electric Insurance; and Sinopec Insurance. Although there is slow progress, work is being done to try and accelerate the speed of growth within the Hong Kong captive market.

James Rayner, global relationship leader at Crawford & Company, says: "Hong Kong has ambitions to be the domicile of choice for Chinese captives, with the Hong Kong Financial Services Department Council targeting 50 licensed captives by 2025."

Rayner explains that Hong Kong has recently expanded its captive law to make itself more accessible to infrastructure companies in its 'China's Belt and Road Initiative' (BRI). However, he notes that Hong Kong is still at the stage of building its reputation as a captive domicile and growing awareness of the captive insurance concept among Chinese corporations.

China's special region

China has been pushing for Hong Kong to become a viable captive domicile for the region. The BRI, which was adopted by the Chinese government in 2013, is a multibillion-dollar

images by weerasak_saeku/shutterstock.com initiative that involves infrastructure development and investments in 71 countries and international organisations.

Edward Wu, head of captive and mutual practice in China at Willis Towers Watson, explains that the initiative aims to improve transnational connections along the old silk road and the maritime trade route connecting China and Europe.

Wu adds: "This boosts the insurance sector and generates the demand of centrally managing the large enterprise's global insurance programme using captive."

As China's state-owned enterprises expand overseas, Wu explains that they are showing interest in achieving the best risk management practice, including consolidated insurance buying through captive insurance programmes.

"However, in mainland China, high market admission thresholds and regulatory standards that are similar with general commercial insurance companies limit the candidate of captive applicants to super-large central enterprises, state-owned enterprises and very few private enterprises," Wu states.

Hong Kong has relatively lower capital requirements, which encourages some enterprises that are not large, to set up their captives in Hong Kong.

Wu highlights: "To actively respond to the country's 'going-out' strategy, many Chinese enterprises are using Hong Kong as a platform for global market expansion."

"Hong Kong's insurance regulator is trying to build a risk management centre under BRI and a popular captive domicile to help mainland companies better manage their offshore business and risks," he adds.

Time to compete

Like all captives domiciles around the world, competition is a key challenge for them all and as Rayner highlights this is no different for Hong Kong. Rayner notes that Hong Kong faces stiff regional competition for captive business, as well as from very established captive domiciles like Bermuda and Guernsey.

Wu also highlights that Hong Kong is facing fierce competition among other Asia captive domiciles, such as Singapore, which is the top Asian domicile with the biggest number of captives licensed by the end of 2019, while Labuan is also taking a very proactive approach to promoting itself as a favourable captive domicile in Asia.

Rayner notes: "Each has a more developed captive service ecosystem than Hong Kong's, and they continue to dedicate resources to building relationships and recognition in the Chinese market."

He states that in uncertain times, these domiciles' deeper experience may be attractive to companies forming their first captives. Hong Kong's political and economic ties to the mainland should, in theory, stand it in good stead to capitalise from an uptick in Chinese captive formations.

Henry To, chairman Hong Kong, China Guy Carpenter, explains that at the beginning in mid-2017, captive development in Hong Kong slowed when the chairman of the China Insurance Regulatory Commission (CIRC) stepped down.

Applications to establish captives in Hong Kong from China enterprises have "practically come to a halt". However, discussions regarding captives were re-activated beginning in mid-2018 when the China Banking-Insurance Regulatory Commission (CBIRC) was established following the merger of the CIRC and the China Banking Regulatory Commission, according to To.

Relations between people in Hong Kong and mainland China have been relatively tense since the early 2000s. Hong Kong made world headlines for months across 2019 as many Hongkongers took to the streets and protested.

Rayner highlights that these upticks remain to be seen whether these anti-mainland protests will reignite and if this will dent Hong Kong's standing with Chinese firms.

Also weighing in, Wu explains that the recent unstable political environment in Hong Kong society also raises Mainland enterprises' concern about workplace safety and business continuity.

Creating the legal tools

As one of Asia's growing captive domiciles, Hong Kong provides favourable regulations to captives, such as lower minimum capital requirements, lower solvency requirements, the permission of outsourcing, tax concession and other policies differentiated with general commercial insurance companies.

Wu says: "It lowers the total cost of running a captive. The friendly captive regime and incentive policies are considerable attractions for mainland enterprises."

Addressing any planned legislation for Hong Kong, Mike Campbell-Pitt, chief technical officer, Asia, Crawford & Company, said: "In March, the Hong Kong Insurance Authority (IA) amended its captive laws through the Insurance (Amendment) Bill 2020, which expands the scope of coverage which can be written by captives in Hong Kong.

The bill aims to provide a new regulatory regime for the ILS business and expand the scope of insurable risks of captive insurers set up in Hong Kong. According to the current Insurance Ordinance (Chapter 41), a captive is restricted to write the insurance and reinsurance of risks of below companies:

i. a company (first company) which belongs to the relevant company's group of companies

ii. a company (second company) in respect of which the relevant company or the first company holds, or is entitled to control the exercise of, not less than 20 percent but not more than 50 percent of the voting power at any general meeting of the second company

iii. a company (third company) where the third company is a subsidiary of the second company

"The key objective was to ensure Hong Kong is positioned to capitalise on captive business that may flow from China's huge BRI. Large companies that are expanding globally will need to find a home for a range of speciality risks that may be difficult to insure in China, such as credit, surety and political risks," Campbell-Pitt divulges.

Simon Lam, executive director (general business) at Hong Kong IA, outlines the steps they are taking "to promote the ecosystem that is congenial to the setting up and operation of captive insurers."

He explains that the reduced corporate tax rate of 8.25 percent has recently been extended to onshore risks underwritten by captive insurers since 2018/19.

An amendment bill seeking to expand the scope of insurable risks for captive insurers to cover, for example, the underwriting of risks of bodies corporate within the group, and the underwriting of risks in proportion to the controls over the relevant body corporate by the group, is also awaiting scrutiny by Legislative Council of Hong Kong, according to Lam.

He suggests by expanding the scope of insurable risks by captive insurers, multinationals will be able to implement their global risk management strategy more effectively to cover their projects.

The IA has also put forward an amendment bill to cut by half the profits tax rate for insurers underwriting marine and speciality (e.g. catastrophe, political, terrorism, war and credit) risks. The tax concession is also applicable to insurance broker companies placing such risks to (re)insurers in Hong Kong.

The IA will be seeking to build up the insurance-linked securities (ILS) market in Hong Kong to enable the transfer of catastrophic risks to the capital market.

"In this respect, an amendment bill was gazetted in March 2020 for the authorisation of special purpose insurers (SPI) as a platform for the issuance of ILS that caters specifically for underlying risks in BRI and the Greater Bay Area," Lam adds.

Will the captive dream remain in isolation?

Campbell-Pitt reflects that over the next 12 months the hardening market that the insurance sector is currently experiencing "should sharpen Chinese companies' attention on captives as an alternative form of risk transfer, which may lead to formations in Hong Kong".

He continues: "Large corporate clients were already seeing a hardening of the market, in terms of premiums and reduced capacity for certain risks, business types or geographical regions with higher loss exposures. This should bring increased activity in the captive sector."

But with a lot of the world currently in lockdown due to the COVID-19 pandemic, will this put on hold the work being done to boost the captive market in Hong Kong?

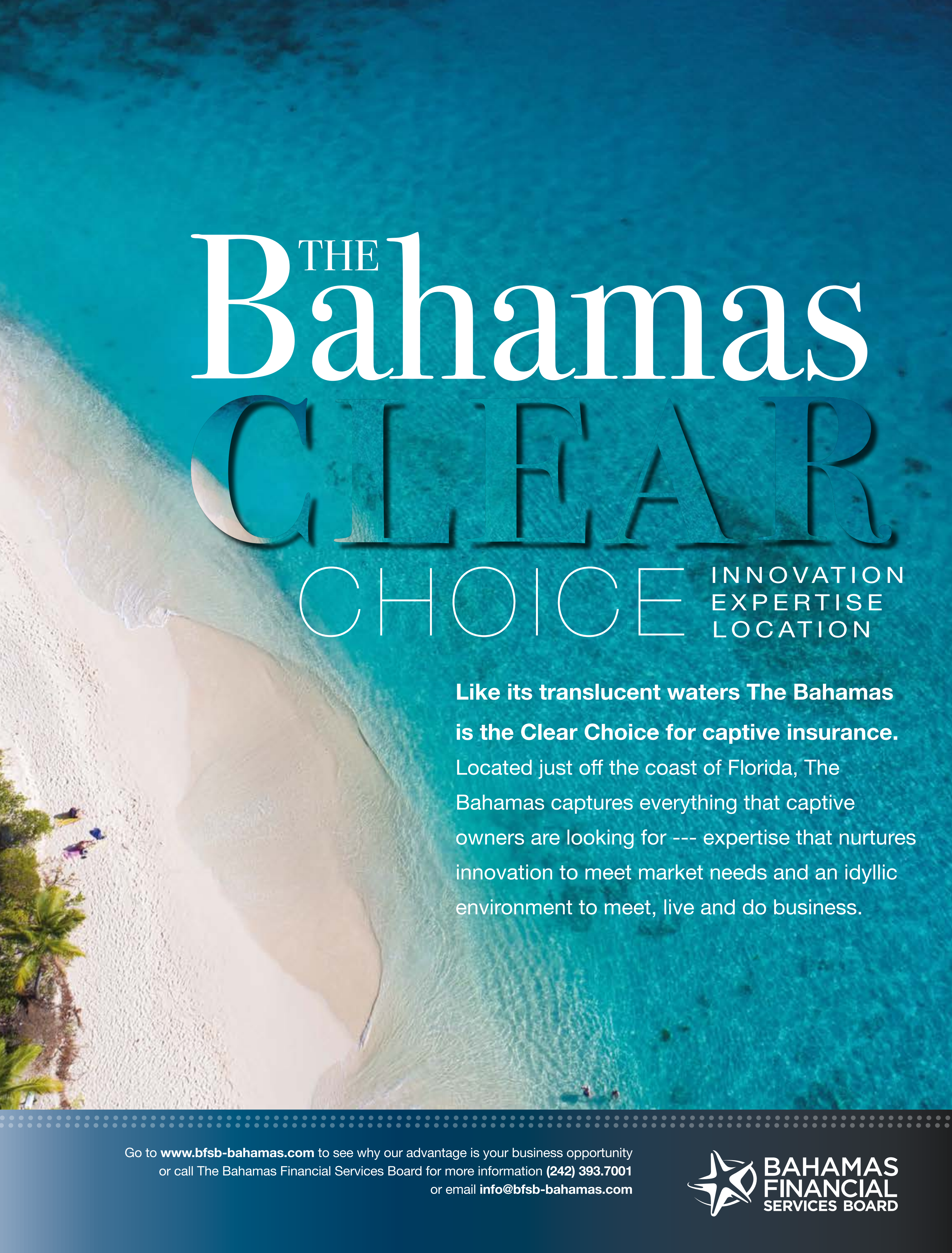
Lam suggests that COVID-19 highlights the importance of risk management, sufficient capacity and ability to absorb the potentially massive losses that a pandemic can threaten. "This will instil stronger belief in risk management solutions to cope with the change in the risk landscape for multinationals," he adds.

Campbell-Pitt suggests COVID-19 losses are likely to cause capacity to dry up and prices to rise in affected lines, presenting opportunities for the captive industry to prove its value. He explains: "It is unlikely, however, a company would form a captive specifically to insure pandemic risks due to the difficulty modelling these risks and the potentially very high cost of claims."

Finally, To states that the commitment to promote Hong Kong as a captive centre will likely not be affected by the COVID-19 pandemic.

To says: "However, the pandemic will likely cause delays in captive development and establishment in the next 12 months. We expect new captives to be established in Hong Kong, but again, COVID-19 will delay the process."

At this moment, there is an emphasis on maintaining a healthy and stable insurance market in Hong Kong, To concludes. ■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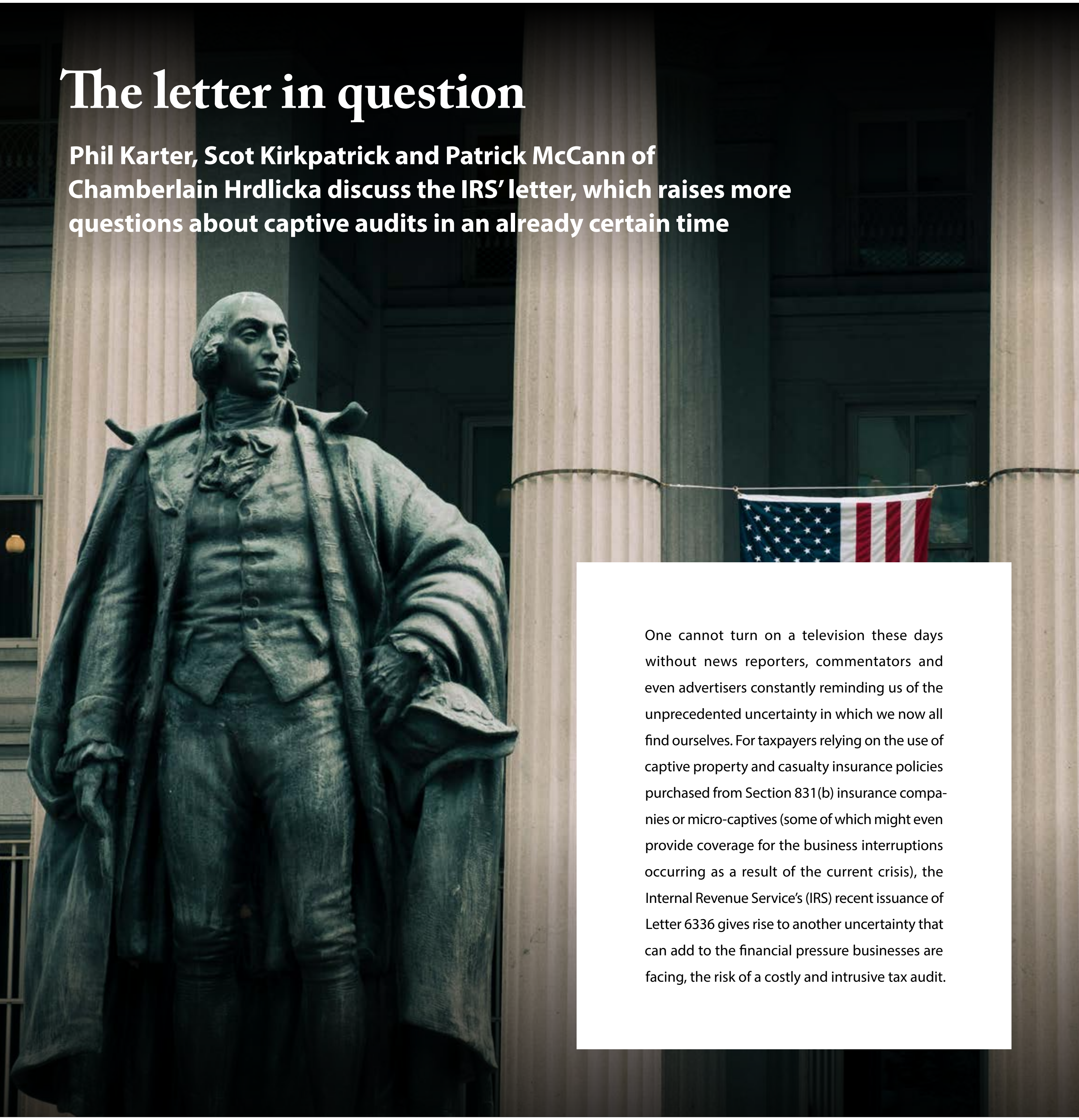
The letter in question

Phil Karter, Scot Kirkpatrick and Patrick McCann of Chamberlain Hrdlicka discuss the IRS' letter, which raises more questions about captive audits in an already certain time



One cannot turn on a television these days without news reporters, commentators and even advertisers constantly reminding us of the unprecedented uncertainty in which we now all find ourselves. For taxpayers relying on the use of captive property and casualty insurance policies purchased from Section 831(b) insurance companies or micro-captives (some of which might even provide coverage for the business interruptions occurring as a result of the current crisis), the Internal Revenue Service's (IRS) recent issuance of Letter 6336 gives rise to another uncertainty that can add to the financial pressure businesses are facing, the risk of a costly and intrusive tax audit.

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Phil Karter
Shareholder
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On 20 March 2020, only one week after US President Trump issued his proclamation on declaring a national emergency concerning the COVID-19 outbreak, the IRS issued letters to tens of thousands of taxpayers seeking information about their participation in micro-captive insurance transactions. The irony is that the recipients of the letter were identified only as a result of their previous compliance with Notice 2016-66 and their filing of reportable transaction disclosure statements (Forms 8886), with the letter stating, “We have information that you’ve taken a deduction or other tax benefit related to micro-captive insurance on a prior year tax return and disclosed pursuant to Notice 2016-66 and Notice 2017-08”.

On 31 January 2020, in IR-2020-26, the IRS announced the establishment of 12 new examination teams to assist in the audits of what it described as abusive small captive insurance transactions. The information release reported that “[e]xaminations impacting micro-captive insurance transactions of several thousand taxpayers will be opened by these teams in the coming months. Potential civil outcomes can include full disallowance of claimed captive insurance deductions, the inclusion of income by the captive entity and imposition of all applicable penalties.” Letter 6336 appears to be the first step to opening those examinations as a tool to help the IRS identify and prioritise its targets for examination. The letter requires a statement made under penalties of perjury regarding the last year the taxpayer claimed deductions or other tax benefits related to small captive insurance transactions.

Letter 6336 stipulated an initial response date of 4 May 2020, which was extended an additional 30 days in response to the ongoing pandemic caused by COVID-19. It does not require a response or impose a penalty for failing to respond. However, the letter notes that the IRS will “take [the taxpayer’s] actions in response to [Letter 6336] into account when considering future compliance activity related to [the taxpayer’s] micro-captive insurance arrangement.” The practical implication of that statement is left to the reader’s imagination.

Letter 6336 has left many recipient taxpayers and their professional advisors struggling to determine how to best respond or even whether to respond at all. The decision will likely depend on the answer to a number of questions, such as: (i) Do the taxpayers continue to rely on captive property and casualty insurance policies as a component of their risk management strategy? (ii) If not, when did the taxpayers last participate in a captive insurance transaction? (iii) How structurally and operationally sound is (or was) the captive insurance programme utilised by the taxpayers? Finally, (iv) do the taxpayers plan to file qualified amended returns disclaiming any tax benefits related to the captive insurance transactions?

Omitted from a discussion of these considerations are taxpayers that have already been audited or are under audit for their participation

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in a micro-captive transaction, including those whose cases have gone to IRS Appeals or even the US Tax Court. Although Letter 6336 was sent indiscriminately to both unaudited and audited micro-captive taxpayers, there is little to for audited taxpayers to contemplate. Whether you respond or not should have no bearing on your situation, although a gentle reminder that "I'm already under audit" might mitigate further intrusiveness and preserve arguments that you have fully complied in good faith with all IRS requests related to your captive insurance audit. For taxpayers yet to be audited, Letter 6336 requests that if "you're no longer claiming deductions or other tax benefits for any micro-captive insurance transactions covered under Notice 2016-66 on your Federal income tax returns, please notify us by sending a letter to the address shown above." Read literally, it does not appear that a response is required for any taxpayers who continue to purchase captive property and casualty insurance policies as part of their risk management programme. The letter states that "[i]f you continue to participate in a micro-captive insurance transaction covered under Notice 2016-66, you must continue to disclose your participation in the transaction." The disclosure requirement is nothing new, as it is not imposed by Letter 6336, but rather by an ongoing obligation to report under Notice 2016-66. Therefore, any taxpayers who continue to rely on captive insurance as an alternative risk management strategy must continue to disclose that participation on Form 8886 – Reportable Transaction Disclosure Statement filed with their Federal income tax returns.

What then was the objective of Letter 6336, given that a vast proportion of the recipients are already audited or are maintaining their captives currently and told they need not respond? The answer seems to be that the letter is intended to prioritise the universe of unaudited micro-captive taxpayers as targets for future examination. So let's review the considerations that might bear on your response, or whether you should respond.

For those taxpayers who last participated in the transaction and filed their tax returns on or before 15 April 2016, the statute of limitations has expired and there is no threat of any captive related adjustments for those years. (Note that there may be a limited exception that the government tries to argue for captive insurance companies domiciled in foreign jurisdictions and failed to file an protective filings related to their status as a foreign company.) Still, responding to Letter 6336 may prevent the government from initiating an audit for later years that could contain some other non-captive insurance related issues.

Taxpayers on an extension to file their 2016 tax return or who last participated in 2017 should think more carefully about whether or not to respond. The statute of limitations remains open for those years and the government is free to initiate an audit and assert adjustments related to their captive insurance transactions. However, absent an immediate extension of the statute of limitations, the government will have only a limited opportunity to complete an audit and may prioritise taxpayers for whom more time remains before the expiration of the statute of limitations. By responding to Letter 6336, taxpayers in those circumstances may unwittingly make themselves a target for audit by sticking out from the crowd and presenting a greater sense of urgency to investigate, particularly if the claimed premium deductions were large. The phrase "discretion is the better part of valour" comes to mind for such taxpayers hoping that the statute of limitations will run its course.

The taxpayers facing the greatest uncertainty are those who last participated in captive insurance transactions in 2018 or 2019. For them, there is sufficient time remaining on the applicable statute of limitations for the government to initiate an audit and assert adjustments within the limitation period. Responding to the inquiry could be viewed by the IRS as a good faith effort to cooperate, but whether that is likely to translate into more lenient treatment if an audit is commenced is unknowable. Although a response to Letter 6336 may buy some goodwill with an auditor, for an issue being tightly controlled by IRS personnel above the audit level, one should not assume that compliance will have any bearing on the IRS' decision whether to assert the 20

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percent or 40 percent penalty in a micro-captive insurance audit.

For those with significant time remaining on the statute of limitations, a separate question is whether to file qualified amended returns for open years foregoing the captive insurance premium deductions claimed on their original returns. By filing QARs, those taxpayers can eliminate the risk of any accuracy-related penalties that might accompany an audit determination.

In the course of a QAR analysis, taxpayers no longer operating their captive should strongly consider whether their former captive insurance structure will withstand an IRS challenge and potential judicial review. Even those with strong captive insurance programmes but who claimed only small premium deductions should consider a cost-benefit analysis that takes into account the cost of a potential audit defense of a captive insurance arrangement.

There is no point in winning the battle and losing the war if the cost to defend outweighs the benefits derived from the deduction originally claimed.

Thus, in confronting what to do about Letter 6336 and the possibility of filing QARs, taxpayers may benefit from an independent third-party review of their captive insurance arrangements to evaluate how well they might stand up to scrutiny and, assuming they do, whether that battle is worth fighting. On the other hand, if your captive is still operating and continues to serve a bona-fide risk mitigation purpose integral to your business, that is a battle likely to be well worth fighting.

IRS coercion efforts notwithstanding, where the arrangement is motivated by business rather than tax considerations, taxpayers who are audited should not be reluctant to stand their ground. ■

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> "My background had been in auditing government and public sector entities when I was with PwC in Scotland, so the learning curve was steep"

Personal bio: I'm originally from Edinburgh, Scotland, and enjoying my second spell living and working in the Cayman Islands. I like to spend my spare time reading, playing Gaelic Football, working out at F45 and visiting the islands' restaurants and beaches with my partner, baby son, and friends.

Professional profile: I obtained an MA in English Literature and History from the University of Glasgow in 2008, and partially completed a one-year MSc in Information Technology before leaving the course early to take up full-time employment in 2009 – graduate jobs were hard to come by during the financial crisis. I qualified as a Chartered Accountant with PwC in Edinburgh in 2012, shortly before relocating to Cayman for the first time and then spent time working in the not-for-profit and banking sectors back in Edinburgh before returning to Cayman in 2016 to join Global Captive Management.

How did you end up in the captive industry?

Upon joining PwC Cayman, I was assigned to their insurance department and began working on a portfolio of captive insurance companies, performing the audits of their financial statements.

My background had been in auditing government and public sector entities when I was with PwC in Scotland, so the learning curve was steep, but I found myself working in a great team of smart, dedicated people, and the training provided was excellent. I learned a lot about the captive industry in the two years that I worked there, which stood me in good stead when I was looking to return to Cayman a few years later, and the opportunity to join GCM arose.

What has been your highlight in the captive industry so far?

Having the opportunity to travel widely for client and industry meetings with GCM. I've been fortunate enough to visit Mexico, Italy, Canada and Aruba, as well as various places in the US, in the course of my work. It's always great to visit and explore new places, and the trips have given me an opportunity to spend some time with my clients in person and better understand how I can help them.

What/who have been your influences in the captive industry?

Damian Pentney and his management team at PwC Cayman were responsible for bringing me into the industry in the first place and equipping me with the knowledge I needed to succeed early on. Since then, there are genuinely too many people to name – I deal with and learn from, a variety of people from across the industry day in, day out, including my clients, actuaries, attorneys, tax advisors, regulators and my peers at other firms, through our local industry association. The management team here at GCM are really supportive and are, collectively, an invaluable resource to me.

What is your impression of the industry?

The industry is well-established and growing here in Cayman and elsewhere for good reason – firms are having to manage their risks ever more closely and, increasingly, it's making sense for them to utilise captives, particularly in the current hard market. That said, the pace of regulatory change is quick and requires captive owners to be engaged and invested in their operation – the captive is a business in itself, after all.

The clients of mine who are most committed to the running of their captives have reaped the greatest rewards, retaining millions of dollars that would otherwise have been spent on commercial coverage. Working with committed people, pulling together in a fast-paced, ever-changing environment makes the industry a great place to work.

What are your aspirations for your career in the captive industry?

I feel that I've progressed well in my first five years in the industry, and I'm looking forward to many more. GCM was recently acquired by Holmes Murphy & Associates and we're already enjoying the benefits and opportunities that that relationship brings. I'm active within the local industry association here in Cayman and, more recently, have taken on responsibility for regulatory compliance arrangements in our office, so I feel that I have a lot of opportunities to continue to learn, progress and provide the best possible service and advice to my clients.

> "The industry is a brilliant place to work for people who are naturally inquisitive and are committed to providing great client service"

What advice do you have for someone considering a role in the industry?

The industry is a brilliant place to work for people who are naturally inquisitive and are committed to providing great client service. It takes a whole team of service providers to successfully run a captive; you'll need to understand your role and then be diligent and organised in fulfilling it in order for you – and your clients – to get the most out of it. ■

> "Mike Scott has excelled during the short time he has worked for GCM.
>
> Not only has he become technically proficient in insurance accounting, but he has also developed strong relationships with his clients building a solid foundation of trust which is key to our role in the industry.
>
> Furthermore, his willingness to adapt to the industry and take an active role in compliance shows he has a bright future ahead."

Alanna Trundle, vice president, Global Captive Management

Standing on the shoulders of giants

Sean King of CIC Services discusses the firm's upcoming case against the IRS in the Supreme Court, what a win would mean for the industry, and the support they are receiving from the captive insurance industry throughout this legal process

What will your main points be for the Supreme Court case against the IRS?

Our main point is that our legal challenge to the regulatory mandate illegally imposed upon taxpayers by Notice 2016-66 (in contravention of the Administrative Procedures Act) is not an attempt to restrain the assessment or collection of a tax. Consequently, we are asking the Supreme Court to affirm that federal courts may enjoin enforcement of the illegal notice without running afoul of the Anti-Injunction Act. To be more specific, we contend that the information gathering and recordkeeping requirements imposed upon material advisors like CIC Services by Notice 2016-66 are so removed from the assessment and collection phases of the federal tax enforcement process that enjoining those requirements does not enjoin the assessment or collection of taxes.

Are you receiving support from the captive sector as you continue to defend your case against the IRS?

We have been encouraged and humbled by the outpouring of support we have received both inside and outside of the captive insurance industry. We would not be here without the support of high-caliber attorneys who took up the mantle to advance our case, the Antonin Scalia Supreme Court Legal Clinic of the George Mason Law School, and many captive insurance regulators who have supported us in the case.

We have received a phalanx of industry support from Self-Insurance Institute of America (SIIA), the North Carolina Captive Insurance Association, the Tennessee Captive Insurance Association, the Kentucky Captive Insurance Association, the Missouri Captive Insurance Association, and the Oklahoma Captive Insurance Association. Many of our supporters in the captive industry also submitted "friend of the court" briefs as well.

We are also truly grateful for the outpouring of support we have received outside of the captive industry which highlights the importance of our cause well beyond the captive industry. In this case, we are "standing on the shoulders of giants" with Amicus Briefs submitted by the United States Chamber of Commerce, the CATO Institute, Professor Kristin E. Hickman of the University of Minnesota School Of Law, and the Tax Clinic at the Legal Services Center of Harvard Law School.

If you win, do you see a push back from the IRS on 'micro-captives' for the entire industry?

If we win at the Supreme Court the case will likely be sent back to the federal district court for further consideration and a decision regarding whether or not an injunction should be issued. We are confident that we meet the standard for an injunction and that Notice 2016-66 would ultimately be enjoined by the district court. What the IRS does from there is anyone's guess, but the IRS would at a minimum be precluded from enforcing the notice and may also be precluded from making use of any data collected as a result of the illegal notice. That would be a big victory.

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The IRS could attempt to reinstate the notice by writing a new rule with substantially similar provisions, but that new rule would at least have to be created in accordance with the process prescribed by the Administrative Procedures Act. In other words, the service would have to give notice of a new proposed rule, give sufficient time for the public to comment on the notice, accept public comments, and incorporate the public feedback into any final rule that it might issue. Had this process been followed from the beginning, the IRS would have had the industry's support and could have collected much more targeted and useful data more quickly.

What is your ultimate aim/goal, win or lose?

Our goal is to force the IRS from this point forward to comply with the requirements of the Administrative Procedures Act when imposing substantive obligations on taxpayers (like filing and record keeping requirements) that are not directly related to the assessment or collection of taxes. If we win, that will be the new law of the land. If we lose, then we'll have to turn to Congress for a remedy. Regardless, the IRS simply cannot be permitted to continue acting as a law unto itself with freedom to issue even obviously-illegal rules and to enforce those illegal rules against taxpayers with impunity while evading judicial scrutiny.

Many from the industry, including yourselves have been critical of the IRS' letter sent out to businesses early into the pandemic - do you think the US Congress will help the industry out as requested by many via letters?

The IRS made no friends in the industry or congress by sending that letter when and how it did. I'm confident that, despite the rhetoric, most enforcement activity against captives will ultimately be suspended until taxpayers are able to comply. It's simply unreasonable to expect taxpayers to comply with IRS demands during a time when those taxpayers are forbidden by lockdown orders from legally accessing the necessary records, obtaining the required legal or tax advice or are otherwise struggling just to stay in business.

Do you believe this pandemic will highlight the importance of captives, especially for small- to medium-sized businesses in the US?

Small businesses are critical to our country's economy. They employ nearly half of private sector workers and account for most of the job growth over the last ten years. And yet compared to Fortune 1000 companies that have more diversified business models and the ability to raise additional cash quickly in the capital markets, small businesses are uniquely fragile.

Few Fortune 1000 companies will go out of business due to this pandemic, but there's little doubt now that we're going to see millions of small businesses do so. The impact on the job market is going to be dreadful. It already has been. But those small businesses that had the foresight and the intestinal fortitude to insure against business interruption risks via a captive insurance arrangements even despite the IRS's hostility are unquestionably better off today than those who didn't. The former are far more likely to survive than the latter. We've seen several examples already of captive insurance arrangements saving the bacon of small business owners, allowing them to stay open and preserve jobs despite lockdowns and the like.

In short, anyone caring about the ability of small businesses and their employees to support our economy must favour expanding the appeal and accessibility of captive insurance.

The pandemic has also exposed many of the IRS's traditional criticisms of certain captive insurance arrangements as unfounded. For instance, some risk pools that may have gone a few years without claims, a source of consternation to the IRS, will now have many massive ones. Policies that once many have appeared overpriced in the IRS's eyes suddenly appear cheap. Businesses with policies protecting against COVID-19 related risks like business interruption may have paid an arm and a leg for it at the time, but the fact is that now such coverage generally can't be obtained by businesses that lack it at any price.

It seems that the IRS was not smarter than the actuaries after all and that comprehensive business interruption insurance has been, if anything, long underpriced. ■

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Sean King
General counsel
CIC Services

Paul Owens is set to join Strategic Risk Solutions' (SRS) board of directors, serving as an independent director as well as a strategic advisor.

Based in the UK, Owens will initially focus his strategic advisory role on the expansion of SRS's operations in Europe and other new regions, while also providing advice on governance, operations and the overall direction of the business.

Most recently Owens served as CEO of Willis Towers Watson (WTW) global captive practice and has over 30 years' experience in the global insurance sector and recently in the captive industry in Europe, North America and Asia Pacific.

Owens retired from his CEO role at WTW earlier this year.

Brady Young, president and CEO of SRS, commented: "We have known Paul Owens for a long time and have tremendous respect for his knowledge of the captive market especially outside North America which is important to us given our expansion plans in Europe and beyond."

Commenting on his new role, Owens said: "It was a privilege to lead the WTW global captive practice. Having retired and moved on from that role, I am keen to put some of the experience I have gained to use." ■

Lesley Thompson, who recently joined Willis Towers Watson (WTW), has agreed to take on the leadership of the Cayman office, subject to the requisite regulatory approvals.

Thompson has over 20 years insurance management experience that she brings to the team after serving in multiple jurisdictions both on and offshore. Her experience includes single parent, association, group, agency, not-for-profit, private placement life and annuity, rent-a-captive, segregated portfolio companies, insurance-linked securities, side-cars and special purpose vehicles.

Thompson joined WTW after five years with Aon in Bermuda, she moved to the Cayman Islands in 2005 where she has worked with multi-jurisdictional independent captive managers and for the past four years has led the insurance management services of the Maples Group. She is also a faculty member, director and the current president of the International Center for Captive Insurance Education (ICCIE). In the announcement, WTW said: "We look forward to Lesley Thompson driving our continued delivery of industry-leading client service."

Additionally, WTW has hired Gareth van den Bergh as a senior account manager at Willis Towers Watson (WTW), also based in the firm's Cayman office. In his new role, Van den Bergh will be reporting to Thompson. He will be responsible for the day-to-day management, providing regulatory guidance and managing key client relationships of a diverse portfolio of captive structures.

Van den Bergh trained and qualified as a chartered accountant while working for Grant Thornton in South Africa. He transferred to Grant Thornton, based in the Cayman Islands in 2014, where he specialised in the audit of captive insurance entities. In 2016, he moved to Captiva Managers (Cayman), where he was initially appointed as an account manager responsible for a book of captives writing a variety of business. He was promoted in 2018 to senior account manager and became responsible for leading the insurance management team in Captiva's Cayman, British Virgin Islands (BVI) and Anguilla offices. He was then appointed to the board of directors of Captiva Managers (BVI) in 2019.

Commenting on Van den Bergh's appointment, Thompson said: "[Gareth] van den Bergh has a solid foundation of technical skills and qualifications which combine well with his detailed knowledge of the Cayman Islands insurance market and regulatory regime, all of which he brings to the Cayman team of WTW at a very important time." ■

Strategic Risk Solutions (SRS) has hired Derek Bridgeman, who joined the firm's European operations on 18 May as managing director.

In his new role, Bridgeman will develop and lead the risk consulting practice in Europe. Prior to joining SRS, and since 2017, he has led the international captive advisory practice at Marsh. In addition to his risk finance advisory experience, he spent over 10 years in Marsh's captive management practice where he served a range of multinational captive owners and special purpose reinsurance entities. He also led Marsh's EU Solvency II and base erosion and profit shifting initiatives.

Bridgeman will join the board of SRS Europe which includes its pan-European branch offices.

Additionally, Neil Campbell has also joined the European consulting team as part of the expansion of SRS Europe's consulting operations and will focus primarily on the firm's structured reinsurance consulting capabilities.

Campbell began his career with ICI's insurance team in London. He was risk manager for Zeneca and AstraZeneca for 12 years, subsequently joining JLT as leader of the firm's global life science practice before setting up his consulting firm in 2014.

At SRS, Campbell will support the firm's European risk consulting around captive strategies and complex reinsurance options.

Commenting on his new role, Bridgeman said: "I worked with some great people and really enjoyed my time with Marsh however I am delighted to have been presented with the opportunity to join SRS."

"The proven track record and independent nature of SRS were highly appealing to me and I look forward to building on the solid foundation developed in Europe to date. Recent industry changes and economic pressures arising from COVID-19 mean that now, more than ever, clients will be challenged to seek opportunities to optimise their overall insurance spend."

"I look forward to working with clients and prospects to challenge the status quo and consider alternative risk transfer options," he stated.

Brady Young president and CEO of SRS, said: "With the European operational infrastructure now firmly established and represented in major European Union domiciles, the firm is gaining traction with clients and plans to continue to hire great talent to drive the business forward."

"With broker owned management firm mergers continuing we are the only credible option for captive owners if they want international, independent and unbiased advice underpinned by solid management services," he added.

Last month, SRS announced the appointment of Andy Hulme as part of an expansion in underwriting capabilities and services.

Based in the UK, Hulme provides underwriting support to SRS clients globally.