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# Micro captives listed on IRS dirty dozen list for fifth time in a row

Micro captives have been listed on the Internal Revenue Service (IRS)'s dirty dozen list of "tax scams to avoid" for the fifth consecutive year.

The list is a compilation of alleged scams that the IRS suggests represent "the worst of the worst tax scams" and should be avoided by taxpayers.

Micro captives are taxed under section 831(b) of the tax code and have a premium limit of $2.3 million for the 2018 tax year.

Under section 831(b), captive insurers that qualify as small insurance companies can elect to exclude limited amounts of annual net premiums from income so that the micro captive pays tax only on its investment income.

On the dirty dozen list, the IRS has referred to micro captives as an "abusive tax shelter" and suggested that certain micro captive "structures, promoters, accountants or wealth planners persuade owners of closely-held entities to participate in schemes that lack many of the attributes of insurance".

According to the IRS, the repeated inclusion of micro captives reflects the service's "commitment to curbing abusive arrangements through audits, investigations, and litigation".

The IRS has had a number of tax court successes against micro captives over the past few years.

In the Avrahami case in 2017, the US tax court disallowed the "wholly unreasonable" premium deductions the taxpayer had claimed in a micro captive arrangement and concluded that the arrangement was not insurance under long-established law.

Last year, in the Reserve Mechanical case, the tax court determined that the transactions in another micro captive arrangement were not insurance.

Prior to those two rulings, the IRS issued guidance that micro captive transactions have potential for tax avoidance and evasion in 2016, and established reporting requirements for them via Notice 2016-66.

The 2019 dirty dozen list notes: "The IRS has devoted substantial resources with more than 500 docketed cases in tax court and is conducting numerous income tax examinations of the participants in these arrangements, as well as promoter investigations."

captive insurance times

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## Labuan adds six new captives as premiums total $400.5m in 2018

Labuan licensed six new captive insurance companies last year, as total gross premium grew to $400.5 million, according to figures from the Labuan International Business and Financial Centre (Labuan IBFC).

Labuan IBFC's inaugural Market Report 2018 also revealed that one captive dissolved in 2018, meaning that as of 31 December there were 48 captives in the domicile.

All six of the new captives set up last year were Asian based.

The captive market also saw continued growth in total gross premium, which rose 11 percent to $400.5 million last year.

With 67.4 percent of premiums, foreign business continues to dominate the captive market.

The domicile's insurance sector experienced sustained growth as a whole, with total gross written premiums rising 19.1 percent year-on-year to $1.7 billion.

The Labuan Financial Services Authority (FSA) said that the growth in 2018 "underscores Labuan IBFC's growing prominence as a regional financial hub, facilitating intra-Asian trade, investments, and asset intermediation".

The FSA added: "The results show that despite challenges and changes in global operating environment, investors' trust and confidence in Labuan IBFC remains intact; and moving forward Labuan IBFC is expected to benefit from international regulatory changes introduced to ensure substance and transparency in all cross-border transactions."

### Bermuda among captive domiciles on EU non-cooperative tax jurisdictions blacklist

The EU has released its updated blacklist on non-cooperative tax jurisdictions, featuring a number of captive domiciles, including Bermuda.

The list is part of the EU's strategy to clamp down on tax evasion and avoidance.

Alongside Bermuda on the blacklist is Aruba, Barbados, Guam, Vanuatu, and the US Virgin Islands.

The updated blacklist was based on an intense process of analysis and dialogue steered by the European Commission.

Jurisdictions were assessed based upon three criteria: tax transparency, good governance, and real economic activity, as well as one indicator, the existence of a zero corporate tax rate.

The updated version of the blacklist features 10 new countries, meaning there are now a total of 15 jurisdictions on the list.

Bermuda premier David Burt said the domicile "is compliant" and was confident that within a matter of weeks Bermuda will be removed from this list.

He added: "I wish to assure the people of Bermuda that we do not anticipate any sanctions to be levied against us and this will in no way affect how we travel or otherwise interact with the EU."

The greylist, which indications jurisdictions that will continue to be monitored, has a total of 34 countries.

Thhis list includes nine captive domiciles; Anguilla, Bahamas, the British Virgin Islands, the Cayman Islands, the Cook Islands, Mauritius, Saint Kitts and Nevis, Saint Lucia, and Switzerland.

Erin Brosnihan, chair of the Insurance Managers Association Cayman, said the association was proud of Cayman's record in complying with international regulatory standards.

She commented: "Our international insurance and reinsurance industry by virtue of its systematic growth of the last few years is built upon sound pillars of governance, best practice, and professional infrastructure."

"We remain confident that the Cayman Islands, through its existing platform of insurance managers, regulation, brokers, underwriters, and lawyers continue to build out an industry architecture that will continue to satisfy the evolving demands of stakeholders and outside interests."

Guernsey, Bahrain, Hong Kong, the Isle of Man, Jersey, and Turks and Caicos were among the jurisdictions now cleared and removed from the greylist.

Pierre Moscovici, commissioner for economic and financial affairs, taxation and customs at the European Commission, described the list as a "true European success" and said it "had a resounding effect on tax transparency and fairness worldwide".

Moscovici added: "Thanks to the listing process, dozens of countries have abolished harmful tax regimes and have come into line with international standards on transparency and fair taxation."

"The countries that did not comply have been blacklisted and will have to face the consequences that this brings. We are raising the bar of tax good governance globally and cutting out the opportunities for tax abuse."

### A.M. Best affirms ratings of Energas

A.M. Best has affirmed the financial strength rating of A (Excellent) and the long-term issuer credit rating of "a" of Energas Insurance, the sole captive of Petroliam Nasional Berhad, Malaysia's national oil and gas company.

The outlook of the credit ratings is stable.

The ratings are reflective of Energas' "very strong" balance sheet, as well as its strong operating performance, neutral business profile and appropriate enterprise risk management (ERM).

They also factor a neutral impact from the company's 100 percent ownership and integration with Petronas.

The ratings agency expects the risk-adjusted capitalisation, which is measured by Best's Capital Adequacy Ratio, to remain at the strongest level over the medium term, supported by its low underwriting leverage and a conservative investment approach.

A factor partially offsetting the balance sheet is Energas' reliance on third-party reinsurance to enable it to underwrite large limit risks and appropriately manage its aggregate exposures.

The captive has a track record of strong operating performance, with a five-year average (2013 to 2017) combined ratio below 60 percent and a return on equity ratio of 11 percent.

Underwriting performance remains subject to volatility dependent on large loss experience and arising from changes in capital expenditure and operational activity at the parent, Petronas, which drives shifts in absolute premium generation at Energas.

The low operating costs and steady stream of reinsurance commission income have contributed to the Energa's overall profitability.

As the captive provides large policy limits compared with its premium income, prospective results are subject to volatility in claims experience, however, this should be moderated partially by the Energas' comprehensive reinsurance programme.

A.M. Best noted that Energas "is well-integrated within the Petronas group's risk management framework and has an active role in overseeing and containing the group's insurance costs" and "has a developed ERM framework, with clear risk appetite and tolerance levels in place".

### Bermuda's inclusion on EU blacklist a 'technical issue', claims premier

Bermuda's inclusion on the EU's updated blacklist on non-cooperative tax jurisdictions is a "technical issue" that will soon be remedied, according to Bermuda's premier, David Burt.

In a ministerial statement, which was published on the government of Bermuda's website, during the passing of a piece of legislation on economic substance, there was a minor technical omission in Bermuda's regulations.

In the statement Burt said: "Essentially, what appeared as a duplication in almost identical language in our drafts was unintentionally omitted."

"Once the omission was discovered it was immediately addressed."

However, Burt explained that this did not appear to have been good enough for the EU.

"Despite the good faith shown over the last year, and our immediate action, the reinsertion of the omitted line appears not to have been good enough for the EU," he stated.

But Burt added that there is "no value in recriminations and attempts to cast blame" and pointed to a section of Bermuda's constitution that states: "The Cabinet shall be collectively responsible to the Legislature for any advice given to the Governor by or under the general authority of the Cabinet and for all things done by or under the authority of any Minister in the execution of his office."

Burt said the "buck stops at my desk".

However, Burt noted that Bermuda's inclusion on the list is only temporary and in eight weeks the domicile would have the opportunity to be removed from the list.

Burt remarked: "I have every expectation that this will be done as our existing laws meet the standard required by the EU. This

is a view shared by Her Majesty's Treasury in London, who have also expressed to the [European] Commission and publicly that they too expect Bermuda to be removed from this list based on our clear compliance with the required standard."

He concluded: "Bermuda remains a jurisdiction of choice for the best of business to operate and this government will do all that is required to preserve that position."

The statement has since been removed from the government website.

Several industry groups have come out in defence of Bermuda's "gold standard" reputation.

Roland Andy Burrows, CEO of the Bermuda Business Development Agency, stated: "Bermuda is a world-respected platform for business that has always adhered to the gold standard."

"We stand firmly behind that reputation, and we commend our government's consultative approach with the EU to date. Our industry stakeholders are committed to working with the government and regulators to ensure Bermuda is recognised as fully complaint."

"We look forward to a positive result as soon as possible."

Representatives from the Association of Bermuda International Companies, the Association of Bermuda Insurers & Reinsurers, the Alternative Investment Management Association, Bermuda International Long Term Insurers & Reinsurers, Bermuda Insurance Management Association and the Society of Trust and Estate Practitioners also gave words of support to the government of Bermuda.

### Gibraltar issues no-deal Brexit guidance

The Gibraltar Financial Services Commission (GFSC) has issued guidance for Gibraltar-based firms on Brexit contingency planning, with particular focus on the event of a no-deal Brexit.

The GFSC has warned firms they should have plans in place to address any risks caused by Brexit and that any necessary changes need to be "executed appropriately and avoid any undue harm to consumers".

The possibility of the UK leaving without a deal is impossible to ignore, despite the fact that parliament voted to rule such a scenario out.

In a statement on the 18 March, the Gibraltar government stated that in the event of a no-deal Brexit, it would be ready to leave the EU with amended legislation "to ensure a fully functioning financial services regime across all sectors".

Gibraltar-based firms will, however, still be expected to have considered the impact of Brexit and what action, if any, is necessary.

The most impactful change will be the loss of EU passporting for firms based in Gibraltar, meaning they can no longer conduct business in other EU states.

The GFSC stated: "Firms regulated in Gibraltar should have plans in place to address any risks arising from Brexit."

"Firms providing services into the EEA should familiarise themselves with the relevant applicable law in all jurisdictions in which they operate."

Nigel Feetham, partner at Hassans International Law Firm, said both UK and Gibraltar insurers should either have implemented, or be in the process of implementing, their Brexit contingency plans.

Feetham broke down several potential Brexit contingency scenarios that insurers may undergo.

The first scenario, a portfolio transfer of EU insurance liabilities to an EU insurer, would enable the UK/Gibraltar insurer to focus on their UK and international business and allow the existing EU policyholder claims to be paid through the EU insurer.

He noted that, due to legal, regulatory, actuarial and other business costs, "portfolio transfers are expensive to execute" and "can take a substantial amount of time to complete".

Feetham added: "some of the smaller insurers may not have the financial resources necessary to undergo a portfolio transfer."

Secondly, an insurer may look to redomicile to another EU state.

He explained: "You can achieve this through a merger (in the case of a UK company), or redomiciling the company (in the case of a Gibraltar company)."

Redomiciling the company involves an insurance licence application to an EEA state regulator, which according to Feetham, can "take a substantial amount of time", "is only suitable for companies that undertake EU business", and "can obviously be disruptive".

The third scenario is the creation of a new licensed insurer in the EU, which Feetham explained requires "separate capitalisation and a portfolio transfer from the UK/Gibraltar insurer of its EU liabilities and is therefore subject to the same limitations as the first two scenarios".

Insurance companies that cannot undergo any of the first three scenarios would then, Feetham suggested, fall under the final scenario, which is related to the European Insurance and Occupational Pensions Authority (EIOPA)'s request for European regulators to implement transition periods for the payment of existing claims in the event of a no-deal Brexit.

EU member states are in the process of announcing these transition periods, mostly ranging between nine and 24 months.

Feetham said: "The question on the 29 March will be, what happens after the end of that transition?"

"UK and Gibraltar insurers with longer tail liabilities will obviously be hoping for further

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## Crumbling foundations captive to run out of funds by May 2020

The non-profit captive insurance company set up to assist Connecticut homeowners affected by the 'crumbling foundations' issue will run out of funds by May next year if it continues at its current rate.

The Connecticut Foundations Solutions Indemnity Company (CFSIC) was set up to administer the Crumbling Foundations Assistance Fund, which was designed to distribute the remediation funds to homeowners across the state impacted by the forming of web-like cracks in their foundations, which can cause irreversible damage.

The captive launched officially on 10 January 2019, receiving 174 applications in the first 55 minutes, and aims to begin the actual process of lifting houses and replacing foundations in April.

Some 30,000 Connecticut homes could be impacted and Michael Maglaras, the superintendent of CFSIC, has previously suggested that if the captive is "to complete its mission paid losses will likely be between $1.2 billion and $2 billion".

Undoubtedly, the captive faces an issue over funding. Its current allotted funding is around $137.5 million, which includes state funding and around $15 million from local commercial insurers.

At the beginning of March, CFSIC had $56 million in incurred claim liabilities, and Maglaras expects to have nearly $90 million by the end of June.

He suggested: "Based on the growth curve of the incurred claims liabilities we will be pretty much stopped by May 2020."

"Without funding, we will essentially be in run-off."

Currently, Maglaras is working with US senators and a number of key congressmen from Connecticut.

He explained: "We are actively engaged with the federal government for additional financial assistance."

Maglaras said he is "reasonably confident" they will be successful in securing more funding because once they run out of funding, they will announce they cannot take any more applications and replace any more foundations, which "will be a deeply political message".

He added: "Like everything else in life the way to get people's attention is through dramatic news, and the dramatic news will be when we go into run-off."

extensions, and in the case of smaller entities who may not have the financial resources for separate capital requirements in each EU territory for these books in run-off, without the need to establish fully licensed branches."

He concluded: "Unless the EU recognises Solvency II 'equivalence' of the UK/Gibraltar regulatory regime and applies proportionality to allow an orderly run-off in full, how else could existing claims be paid and insurers continue to service existing claimants?"

### Ratings of Kroger's captives upgraded

A.M. Best has upgraded the long-term issuer credit rating from "a" to "a+" and affirmed the financial strength rating of A (Excellent) of Queen City Assurance and Vince Court Assurance, the captive insurers of US food retail giant The Kroger Company.

The outlook of the ratings for the captives, which are both domiciled in Vermont, is stable.

The ratings reflect the group's "strongest" balance sheet, its strong operating performance, neutral business profile, and appropriate enterprise risk management (ERM).

The ratings consider the captives' critical role as the captive insurers for Kroger, and their excellent historical operating performance, providing tailored insurance coverage for property and casualty risks.

As each captive writes a broad scope of business for its parent and has significant geographic diversification across the US, the business profiles are assessed as neutral.

According to A.M. Best, ERM is appropriate, due to the impact on its conservative risk culture, defined risk controls, and optimisation of the captives' capital and surplus.

The ratings agency added that it "also recognises the significant capitalisation and financial flexibility afforded the captives by its well-rated parent". **CIT**

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# Stable leadership in the US capital

## The District of Columbia's captive market presents unifying leadership during trying times of US political instability

Ned Holmes reports

It is almost impossible to discuss the District of Columbia (DC) without evoking images of the Whitehouse and its controversial resident. Stability is something that the current president doesn't seem to offer, but the same can not be said about DC's captive market.

With Dana Sheppard, associate commissioner, Risk Finance Bureau of the Department of Insurance, Securities and Banking (DISB), the longest serving captive regulator in the US, at the helm, DC has developed into a domicile that offers an almost oxymoronic combination of stability and flexibility.

### The market

Soft market conditions caused most captive domiciles issues over captive growth last year. DC, however, was not one of those. The domicile saw a remarkable leap in growth year-on-year, adding 17 new captives in 2018, in comparison to 2017 when there were just three new captives licensed.

At the end of last year, there were 154 captives licensed in the domicile representing $1.4 billion in annual premiums. The domicile caters to all types of captives and currently licensed in the district are 39 pure captives and 21 pure captive cells, 37 risk retention groups

(RRGs), 12 rental captives and 23 rental captive cells, 11 association captives and two association captive cells, three agency captives and three agency captive cells, and three branch captives. For pure captives, the minimum capital requirement is set at $250,000, while for most other captive structures it is set at $400,000. There are no set minimum capital requirements for cells in DC, instead cell minimums are established by the insurance commissioner based upon the cells business plan.

Sean O'Donnell, director of financial examination, risk finance bureau, DISB, notes that last year saw the most formations in the domicile since 2015, driven in a large part by activity in the protected cell captive (PCC) space.

"The majority of new formations were either PCCs or cells," says O'Donnell, "which continues a trend over the last four to five years. Of the 17 new risk-bearing entities, 15 were either PCCs or cells. We expect to see PCCs and cells continuing to be popular."

Another recent development in the cell space in DC is the expansion of Aon's White Rock Group. At the beginning of March, Aon announced it would be expanding its protected cell facilities under White Rock into the domicile.

Nancy Gray, regional managing director, captive and insurance management, commercial risk solutions at Aon, noted that the move was a "strategic decision" that recognised the "geographic preference" of Aon's clients.

Melissa Hancock, director of Strategic Risk Solutions, says the district has always had very strong regulation when it comes to cell captives.

She explains: "The rules are laid out already for how cells need to be handled on a day-to-day basis what the regulators need to see for filing. DC has always been super clear about that."

## Strengths

"The DC captive market is quite robust," says Hancock, "last year was one of the best in recent memories and 2019 has started strongly."

"I think the domicile is well positioned to keep growing for a number of reasons."

One of the domicile's key strengths, according to Jon Harkavy, executive vice president and general counsel of Risk Services, is its accessibility. He explains: "It may sound minor, but it is significant—it is not easy to find a domicile with such ready transportation and ease of access. It is very attractive that it is so easy to get a train, drive or fly into a meeting."

Harkavy continues: "What makes it even easier is the fact that DC, unlike most domiciles, permits conference call board meetings if it is in a service providers office. That is very, very useful."

Another of the domicile's strengths is its standing and reputation in the global captive market.

"DC has been in the captive arena for a number of years," says Harkavy, "they are accessible to other regulators and well thought of. While, technically, that shouldn't make a difference the stellar reputation of the district is helpful."

In agreement, Joe Holahan, counsel at Morris Manning & Martin and recently appointed head of the Captive Insurance Council (CIC) of DC, comments: "DC has a well-deserved reputation as a solid platform for captive programmes of all types."

The domicile also boasts a wealth of experienced service providers, however, its defining feature is the balance of flexibility and stability provided by its captive legislation and the DISB that regulate the market.

Its initial captive statute was passed in 2000 and was updated in 2004, and then, in 2014, the Captive Insurance Company Amendment Act of 2014 provided more innovative updates to the domicile, which, according to the CIC DC, has "been credited with having the most advanced US captive enabling laws".

A particularly useful provision of the DC statue is the best practice act. Harkavy breaks down the provision: "The act basically says if you can find, in another legitimate captive domicile, a certain type of structure or a certain law has been reasonably implemented, in that it can be recognised in the regulatory captive community, one can form or take advantage of their best practices through the provision."

He adds: "This provision, which has not been called upon very much gives flexibility in the operation and formation of captives. It is not easily pulled out all the time but it is the ultimate flexibility if called upon. That is very valuable."

## Regulators & relationship

This flexibility within the legislation itself is reflected in the regulators. Sheppard and O'Donnell are extremely experienced captive regulators, and there is a stability amongst the whole of the regulatory team as they are not political appointees.

Hancock describes the team as "knowledgable, accessible and responsible", which she says "makes a big difference".

She notes: "They have stuck to their guns about how they regulate and how they work with companies—they're flexible when they can be."

Holahan adds: "DC's captive regulators are highly experienced and responsive to the needs of the regulated community. Captive applications typically are processed within 30 days. Requests for a change in business plan also are handled quickly and efficiently, and examinations are performed at a reasonable cost."

"One of DC's strong points is the longstanding commitment of the DISB to maintaining the staff and other resources needed to make DC a first-class captive jurisdiction."

Examinations in DC are on a five year cycle, which can be extended or waived upon request after the first examination.

Hancock highlights this as a particular area of strength for DISB: "They really excel at examinations. There are only a few other domiciles that are on par with how examinations are handled, they're very reasonably priced and expertly conducted–it is a really big positive for them."

According to both Hancock and Harkavy, they also maintain a strong and positive relationship with the industry, and of particular importance to Harkavy is that they're very reasonable to deal with.

He explains: "I can approach O'Donnell, and while I certainly won't agree with everything that he does he is there and that is particularly useful. They are reasonable and when we disagree there are no hard feelings."

Additionally, Harkavy emphasises the important role the DC regulators play in advocating captives at the National Association of Insurance Commissioners (NAIC) level.

He says: "DC is one that is very active, along with Vermont they're the strongest in advocating for captives. Having advocacy at the NAIC where particularly RRGs and to a lesser extent captives have issues is very valuable and important."

As with the majority of domiciles, DC is not currently prepared to offer licenses to captives providing coverage for cannabis risk. Harkavy notes: "DC are not prepared to license any captive related to Cannabis without some sort of safe harbor via federal legislation permitting insurance companies to underwrite Cannabis related risk exposures."

He adds that potential captive owners should not look to license a cannabis captive until such safe harbours exist.

## Outlook

The domicile's greatest obstacles in the current climate appears to be competition from the increasingly congested US market, and Harkavy suggests that it is the quality of other US domiciles, not just the quantity that may cause issues for DC.

He says: "Vermont is vibrant and not slowing down and there are a couple of other solid emerging domiciles, which aren't too far away; North Carolina, Alabama, and South Carolina. I would also expect to see something from New Jersey relatively soon, as Bill White, the state's recently appointed assistant commissioner of the Office of Captive Insurance, is in control of the captive programme there. It is less what DC is doing, it is the competition."

One of the ways the domicile may counteract this is by looking to innovate. In February, the district established a Financial Services Regulatory Sandbox and Innovation Council, which aims to analyse and report on the viability of implementing a financial services regulatory sandbox in DC, and to develop a blockchain and innovation regulatory framework to promote financial services innovation in the district.

The council will be comprised of professionals from a range of financial services industries, including captive insurance. DC has kept up its fast pace through the start of 2019. According to Holahan, the year is off to a strong start and there have been several captive formations already.

He adds: "DC saw in increase in applications and new formations in 2018 over previous years. We expect this trend to continue. The soft market has slowed captive formations in every jurisdiction. DC is no different in this respect, although we are continuing to see good growth even with this countervailing factor."

The cell captive space is likely to be an area of continued growth, due partially to the strength of the domicile's regulation on cell captives, but also because it is one of the largest growing segments in the captive market in general.

Hancock notes: "DC has a ton of experience in that space and I think that will continue to be strong for the domicile."

Amidst the huge growth last year, there was a decline in RRG formations. Only one was licensed, which is the lowest increase since 2010. O'Donnell says DISB expects to see RRG formations remain flat compared to recent years.

Hancock suggests that RRGs have always been an area of strength for DC, adding "they really know what they're doing around handling those. As long as RRGs are going to be formed I think DC is definitely on the list."

Harkavy highlights insurance sponsored RRGs as a potential area for growth.

"They have a number already," he says, "I think the most successful is MedPro RRG, which is sponsored by Berkshire Hathway. I see a number of traditional insurers looking to replicate that type of relationship with their own RRGs. I see that as a potential source of growth in the district."

There is a consensus among almost anyone you speak to about the DC captive industry that it will continue to grow. As opposed to other important bodies in the capital, in Sheppard, O'Donnell and their team, the industry is in good hands. **CIT**

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# Ex marks the spot

**With discussions abound on the future forms blockchain solutions will take and the effects they will have, we take a closer look at the Bermuda Insurance Exchange, a blockchain-enabled risk and capital exchange set to launch in July**

**Ned Holmes reports**

Discussions around blockchain and the potential 'disruption' that it could cause the captive market in the future have been a mainstay of captive conferences for so long that it is sometimes easy to forget that blockchain-based solutions for the market are more than just future plans and projections.

Real life, ready to go solutions are beginning to pop up across the captive market.

One such solution is the Bermuda Insurance Exchange, a distributed ledger technology (DLT)-enabled risk and capital exchange that is set to launch in Bermuda later this year.

DLT is a database that is consensually shared and syncronised between multiple sites, institutions or geographies, which has no central administrator and works on a peer-to-peer network. It ensures that every party's copy of the information is in exactly the same state and that every change is recorded and traceable, meaning data can always be trusted and verified.

## The Bermuda Insurance Exchange

The Bermuda Insurance Exchange will allow broker, reinsurance, and insurance companies access to the capital markets using blockchain and allow the transfer of risk and capital between direct insureds, brokers, cedants and captive insurers, and insurance, reinsurance, industry loss warranties and insurance-linked securities (ILS).

It's creators, London-based startup ChainThat, suggest that it could provide a "technology-driven insurance ecosystem" that utilises DLT and smart contracts for placing, accounting, settlement and claims, ensures regulatory and tax compliance, and can be governed directly by its participants.

The nature of the platform and its base in DLT technology means that data is 100 percent secure and accurate, with each counterpart retaining full and entire ownership of their own data.

According to ChainThat, the exchange will also greatly reduce the administrative costs of conducting business. The startup estimates it could reduce "frictional administration costs by up to 30 percent for every party in the distribution chain".

ChainThat adds that it expects "this will dramatically improve expense ratios because the efficiency is realised in insurers own administration costs but also in distributors where such costs form part of the brokerage and distribution charges".

David Edwards, CEO of ChainThat, explains that the reduction of expense ratios is an early target for the new platform.

"It is very much initially focused on the expense ratios," he explains, "driving those down so that we can reduce the insurance gap that is out there at the moment."

He continues: "The idea of the exchange is to match risk to capital. What we don't want to do is dictate the business model. We don't want to say here's how the future is going to look and here is how your business has to change."

"What we wanted to do was give them the platform to support the current processes the way that insurance, reinsurance and ILS are done, and the administration behind those. So, it is like a trading platform that supports all of the back office processes."

According to Edwards, blockchain, DLT and smart contracts are the only technologies that fit the business model of insurance today

He says: "Previously, we've always been trying to make technology fit into the business model of insurance and, fundamentally, it hasn't worked because we always put ownership in a central service–usually, someone owns the service and other people don't. DLT is, in effect, a peer to peer solution. It is just those parties involved that own it."

## Origins

ChainThat was formed in 2015 with the aim of building new technology enabled insurance industry.

One that would have improved market access, speed, innovation and data quality, matched with reduced cost. They began by building a DLT platform, which they believed could revolutionise the London Market.

"I thought we'd solved London's problem," explains Edwards, whose background is primarily in designing systems for the London insurance markets. We had built a decentralised placement platform that could revolutionise the London market, but they just weren't interested at the time.

"I always thought London would have been a great place to start, but the rate of change there means it is exceptionally slow at adopting new technologies."

So the company decided to continue to explore other avenues of creating value across the insurance value chain. It developed proof of concepts for a number of large organisations and took a multi million investment from global insurance consulting, managed services, and insurtech company Xceedance in 2017.

## Community spirit

Work began on the platform for the current project, the Bermuda Insurance Exchange, six months ago. Edwards visited Bermuda midway through 2018 to meet with brokers, insurers, reinsurers, and captives to try to understand how the domicile worked. These meetings persuaded him that it was the right place to launch the platform.

"They gave us the idea that our platform could work in a marketplace like Bermuda," he says. "We don't want to create a global solution in which we have to take into account every country's regulations. By creating a marketplace within a domicile like Bermuda, you can then make sure that you get regulation and compliance built in from the ground up rather than trying to tackle everything in one go."

One of the things that sold Bermuda to Edwards and ChainThat was the way the community there functions. He expands: "The fact that it is an island has a huge impact on the way the community functions. We know we have to collaborate to compete, which is a hard thing to do, but the way the island is set up they have a very close knit community which seems to work better together."

Important too are the regulators and the government, who Edwards notes are "very friendly".

He adds: "The regulators seem to be very helpful with their initiatives as well, you've got the Bermuda Monetary Authority, the innovation hub and the sandbox, and it is also very forward thinking in terms of digital asset regulations."

## What does this mean for captives?

But what does this new DLT-based risk platform mean for captive insurance? Well, in the 'Beyond Ideas' brochure, which provides information on the exchange, ChainThat suggest there will be a range of benefits for the captive market. Firstly, the DLT technology will eliminate manual administration costs that are duplicated across the insurance chain, as the exchange provides a common record for all parties. This should reduce frictional costs, meaning captives could expect lower premiums, in comparison to insuring through any other market.

Additionally, it may lead to new specialist captive products. According to ChainThat, the more risk put through a captive by a parent company, the more it can reduce its total cost of insurance, and the more its captive can become a profit generating entity. Therefore, as the Bermuda Insurance Exchange facilitates easier and faster trading it will accelerate the development of new

products that will enable captives to access previously unavailable classes of business".

Edwards notes that there are further benefits, he says: "We are looking at how we can work with the regulators to make the registration more efficient. To make it a lot more straightforward to actually register new captives."

He adds that it will offer a more efficient way to manage captives, including premiums and claims.

"It doesn't matter whether they are using a captive manager or are doing it themselves," says Edwards, "this will give them access to different capital to try and find, based on their company profile, what type of capital is going to be best for them, open up those options and try and remove that barrier for captives."

"It is not going to cost captives a lot to do this and it is going to be a much more efficient way to find the right sort of capital. It will also manage the claims process, which can be quite labourious in some cases, providing claims process capability for the captive."

## The production trial

The current plan is for the Bermuda Insurance Exchange to go live on a production trial in July this year, beginning at first with a focus on reinsurance.

Edwards explains: "The idea is that we are starting with reinsurance, because of the market in Bermuda, and will then open it up further and bring on new modules. Initially our targets will be cedants, brokers and reinsurers, but we will then be opening it up to special purpose vehicles, ILS fronts, capital markets, and captive insurers."

The target for the production trial is to run for six months at low cost, beginning with a group of between five and 20 participants, to allow for each participant to build its internal business cases.

Interest has been "very positive" so far, according to Edwards, who was in Bermuda recently to give a live demonstration of the platform to around 60 people, including insurers, reinsurers, brokers, capital providers, regulators, and the Bermuda premier and finance minister. He says that the live demonstration proved that "this is not just another idea that is out there".

"This is real and ready to go."

The focus for ChainThat over the next six to eight months is Bermuda and getting the exchange to work in the way the market wants it to work. Edwards is optimistic about a potential domino effect in the jurisdiction.

"There is a limited number of participants in Bermuda," he says, "but I think as soon as a couple of them use it and get the efficiency it will make it very easy to integrate and get on board with this platform and everyone can start to come on board and form that marketplace."

## Hubs

Further expansion is planned in terms of services, including the addition of modelling and sanction checking services. Following success in Bermuda, Edwards indicates that the plan is for geographic expansion and potentially the creation of other exchanges.

He explains: "We will definitely be looking at how we expand it further, perhaps into the North American market. Looking at how we can make it more efficient for the managing general agents and the retail brokers out in Florida to access. Try and make it easier for this marketplace to be accessed globally, so, people can come into it."

"Singapore is probably the next most likely place we'd go to, though we are still yet to confirm that. We see marketplaces evolving as hubs, so we might have a hub in London, in Bermuda, in Singapore, in Dubai, and then we can figure out how to transfer risk between those hubs in a legal and compliant way going forward."

"The long term vision is to take it to a place where, in 10 to 20 years time, we have risk profiles and capital profiles, and this platform gives a way to match the risk to the right kind of capital in the most efficient way."

## A real solution

ChainThat believes a byproduct of the increased efficiency and value that the exchange will offer the market is that it will make it more conducive to innovation.

Edwards says: "People want to bring new products to the market at the moment, but when you have a 30 percent expense ratio it is quite hard to get these new products and make them profitable."

"If we drive that expense ratio down we can start to bring new products into the market, which will hopefully help to speed up that innovation cycle."

Edwards is confident that the exchange has all the characteristics to succeed, more than anything because in an insurance market full of projections about blockchain solutions, ChainThat are offering something real and tangible.

"It has received a great response because it is real," he notes, "we have always built first before we talk about a solution to someone. Build it first and then take it out to them."

"Obviously there are more iterations when we get feedback, but when they actually see it they understand that it is real and see how quickly these processes can be done." **CIT**

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# Raleigh-ing the troops

## The crack team behind North Carolina's Department of Insurance

Introduction by Barry Smith, assistant director of public affairs at the North Carolina Department of Insurance

People keep asking why captive insurance companies are domiciling in North Carolina and there are many reasons.

North Carolina has long been considered a business-friendly state and is often recognised by business and trade publications. The state also has an active trade group, the North Carolina Captive Insurance Association, that monitors captive trends and policy and works to keep improving that environment.

Perhaps the primary reason captive insurance companies are moving to North Carolina is the 2013 North Carolina Captive Insurance Act. This legislation abstained from drafting a one-size-fits-all regulatory environment and, instead, provided the insurance commissioner and regulators with flexibility to meet the varying needs of individual captive insurance companies.

This legislation is highlighted by the experienced and credentialed professionals who comprise the North Carolina Department of Insurance (NCDOI)'s captive team. This 13-member team is led by senior deputy commissioner Debbie Walker, under the guidance of insurance commissioner Mike Causey and chief deputy commissioner Michelle Osborne, and is charged with faithfully implementing the act with appropriate regulation and outstanding customer service.

**Insurance commissioner Mike Causey** is a native of Guilford County, North Carolina. He has more than 25 years in the insurance industry as an agent, manager, supervisor, and agency owner. After taking office in January 2017, Causey's goal as commissioner has been to fight for more competition in the industry, combat insurance fraud, and make the department more consumer-friendly.

**Dr Michelle Osborne** serves as the chief deputy commissioner. Osborne has worked in the insurance industry since 1990 and started two successful insurance agencies from the ground up. She also served 16 years as a sales manager for a fortune 500 company.

**Debbie Walker** is a CPA and has earned the fellow, life management institute designation. She is the senior deputy commissioner of the Captive Insurance Companies Division and is responsible for the oversight of the licensing and ongoing regulation of all North Carolina captive insurance companies. Walker has more than 25 years of insurance regulatory experience and has been responsible for the establishment and management of the NCDOI's captive insurance company regulatory operations. Prior to the 2013 enactment, she held the position of chief financial analyst for more than seven years.

**Leane Rafalko** is a certified financial examiner and is the team's chief captive analyst. Rafalko directly assists the senior deputy commissioner in the activities related to licensing and regulation of North Carolina domestic captive insurance companies. In addition, she supports Walker in educating the public about the North Carolina captive insurance programme and explains the benefits of domiciling in the state. Rafalko has more than 17 years experience at the NCDOI, including several examiner positions and the position of senior captive insurance specialist.

**Matt Mascia** is a CPA and the team's captive financial analyst. He is responsible for supervising the ongoing financial analysis of licensed companies as well as handling other leadership duties in the division. Before joining the NCDOI in 2016, Mascia worked in the traditional insurance industry for more than 25 years, holding various officer positions.

**Kathy Hart**, one of the original members of the captive insurance team, is the captive insurance administrator–a role she has held since the programme's inception in 2013. Hart is responsible for the issuance of captive insurer licenses and the planning and budgeting of events and conferences. Additionally, she serves as a liaison between the division and the North Carolina Secretary of State's Office. Hart also maintains all licensed captive insurer corporate and licensing records and is assistant to the division senior deputy commissioner.

**Kait Chase** is the division's risk retention group (RRG) analysis manager, overseeing RRG licensing and ongoing financial analysis responsibilities, and manages two financial analysts who assist with RRGs. Chase was recently promoted into the position, having previously served as the department's senior financial examiner.

**Michael Arcangel** was recently promoted from senior financial analyst to supervising analyst. Arcangel, one of the industry's 'emerging talent', is responsible for the direct and supervisory level review of the applications, annual filings, and special requests submitted by captive insurers or their designated representatives. He is currently pursuing his associate in captive insurance designation.

**Eileen Culliney** is a CPA and supervising analyst, and is responsible for the direct and supervisory level review of the applications, annual filings, and special requests submitted by captive insurers or their designated representatives. Culliney is also responsible for ongoing financial regulation of her assigned captive insurers. Prior to this, she held the positions of senior examiner and supervising examiner.

**Stephanie Bacik** is a CPA and senior financial analyst. She is responsible for the financial review of applications, review of new business plans and ongoing financial analysis of licensed captive insurers. Bacik also teaches as an adjunct accounting instructor.

**Radhika Sankaran** is a senior financial analyst. Sankaran is responsible for financial review of applications, review of new business plans, and ongoing financial analysis of licensed captive insurers. Sankaran has obtained the National Association of Insurance Commissioners certifications of associate professional in insurance regulation and professional in insurance regulation. Prior to accepting this position, Sankaran held several other financial analyst positions within the department.

**Spencer Caldwell** is a CPA and financial analyst. Caldwell is responsible for the financial analysis of licensed captive insurers, including the evaluation of annual financial filings, dividend/loan requests, dissolution requests and other special filings, as well as the analysis of new captive insurance license applications. Caldwell recently obtained his CPA designation and now is working on the certified fraud examiner designation.

**Cecilia Guan**, the most recent addition to the captive insurance regulatory team is a CPA and RRG financial analyst. Guan transferred from the NCDOI's financial examination team, and is now responsible for the financial analysis of RRGs and other captive insurers, including the evaluation of annual financial filings, business plan amendments, reinsurance transactions, and other special filings. Guan is also responsible for analysis of new RRGs and other captive insurer license applications.

**Rick Kohan**, an associate property and casualty actuary, is not a part of the Captive Insurance Company Division, but is an essential team member in the regulation of captive insurers. With more than 30 years of actuarial experience, Kohan works in the actuarial services division of the NCDOI under the direction of the chief actuary Kevin Conley and is responsible for the regulation of property and casualty actuarial issues of North Carolina captive insurance companies.

**David Yetter** also works in the actuarial services division as a life actuary under the direction of Conley. Yetter's role sees him responsible for the regulation of life and health actuarial issues of North Carolina captive insurance companies.

**To find out more about North Carolina's Department of Insurance, go to www.ncdoi.com**

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# Appointments at Artex Risk Solutions and CICA

**Peter Mullen has re-joined Artex Risk Solutions as CEO, with David McManus shifting into the new role of chairman.**

Mullen officially returns to the company he helped found in 1997 after eight years as CEO of Aon Captive & Insurance Management.

He joins the company a year after the move was originally announced in March 2018.

After helping to found Artex alongside McManus and North America president Jennifer Gallagher in 1997, Mullen spent almost 20 years at the company, most recently serving as executive vice president.

He also held the role of vice president at AIG between 1986 and 1992.

McManus said he is "thrilled" to welcome Mullen back to Artex and is "excited for what the future holds under his leadership".

He added: "Innovation is at the core of his talents and is the foundation of our company."

"I'm confident that this innovation, together with Peter Mullen's fresh perspective and energy, will drive Artex to even greater success in the years to come."

**The Captive Insurance Companies Association (CICA) has made a number of changes to its board of directors, including the election of Steve McElhiney as chair.**

An industry veteran with more than two decades of experience, McElhiney, who is president of Tall Pines Insurance Company and CEO and chairman of EWI Re, served as vice chair of the CICA board last year.

He joined EWI Re in 2004 and has also previously held roles at Fireman's Fund, TIG, Overseas Partners US Reinsurance Company, and Argo.

McElhiney has also served as a past president and chairman of the International Chartered Property Casualty Underwriter Society and as a past chairman of the board of the Vermont Captive Insurance Association.

Additionally, the board elected Lance Abbott, president of BevCap Management and director of BevCap Captive Group, as vice chair, and Renea Louie, vice president, Pro Group Captive Management Services, as secretary/treasurer.

Colin Donovan, president of STICO Mutual Insurance, and Deyna Feng, captive manager for Cummins Risk International, were both elected to the board on three-year terms.

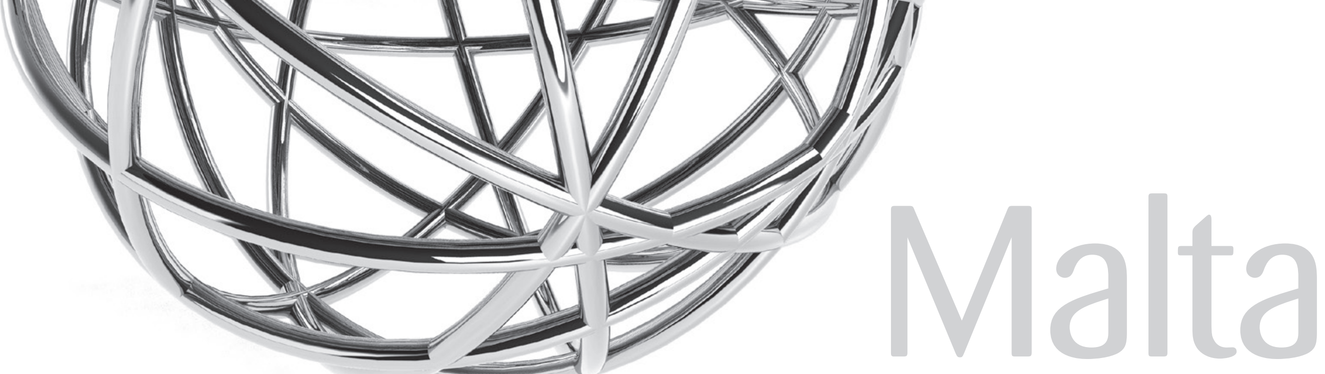
Outgoing board chair Joel Chansky, consulting actuary at Milliman, is a returning CICA board member, alongside; Courtney Claflin, executive director of captive programmes, University of California, Office of the President; Carol Frey, vice president marketing and business development, Great American Insurance Company; Fredrik Finnman, group risk manager, Sandvik Group, located in Sweden; Robert Myers, partner, Morris, Manning & Martin; Michael Scott, attorney, Law Office of Allison & Mosby-Scott; and Michael Zuckerman, assistant professor, Temple University.

McElhiney said he looked forward to building the momentum CICA has created.

He commented: "We want to continue fostering relationships that connect the industry and strengthen our collective voice, elevate the emphasis on best practices and engage top talent."

Dan Towle, president of CICA, said the association was excited to have Donovan and Abbott join.

He added: "Their expertise is a strong fit for CICA's strategic priorities and our commitment to developing the next generation of captive professionals." CIT



# Malta

## flawless Structure
## Seamless Opportunities

Malta is host to a myriad of captive re/insurance companies, protected cell companies and cells that have come to enjoy the domicile's stable regulatory environment and EU membership benefits. Malta offers re/insurers and cells:

**European Union Membership** - Malta's status as an EU member allows companies and cells the ability to passport their services throughout the European Union and EEA states. Maltese insurance law and regulation implements all relevant EU directives.

**Redomiciliation Legislation** - Companies established in other countries can seamlessly transfer to Malta without any break in their corporate existence.

**Protected Cell Legislation** - Protected Cell Companies can be incorporated in Malta, enabling cell promoters to write insurance through a cell. The law ensures proper protection and insulation of cell assets and liabilities from those of other protected cells and the core of the protected cell company.

**A Stable Regulatory Framework** - The Malta Financial Services Authority (MFSA) is reputed to be "firm but flexible" - encouraging discussion with promoters at all stages of an application process and also on an ongoing basis.

**Extensive Double Taxation Treaty Network** - Malta has around 70 tax treaties with various EU and non EU countries.

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FinanceMalta is the public-private initiative set up to promote Malta as an International Financial Centre.