# PUERTO RICO INTERNATIONAL INSURERS REVIEW

2019

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The Puerto Rico International Insurers Association ("PRIIA") was formed in 2015 to bring together the various international insurers registered under Puerto Rico's International Insurance Center. Our intention is to create a single body that can respond to and advise the related parties on insurance issues, and to serve as a single voice in discussions with Puerto Rico's Office of the Commissioner of Insurance, which serves as the main insurance industry regulator. One of the primary focuses of PRIIA is to contribute to the promotion of Puerto Rico as a well-regulated and respected jurisdiction for International Insurers, while also guiding for companies interested in entering the island's International Center.

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The Puerto Rico International Insurer's Association (PRiiA) was formed in 2015 to bring together the various international insurance companies registered under Puerto Rico's International Insurance Center (Act 399). Our work is focused on the unification of insurers in a single body that can respond to and advice the related parties in insurance and regulatory issues. PRIIA also serves as one voice indiscussions with Puerto Rico's Office of the Commissioner of Insurance, the government agency responsible for regulating the insurance industry in Puerto Rico. One of the main focuses of PRIIA is to contribute in the promotion of Puerto Rico as an offshore jurisdiction for international insurers and to serve as a trusted guide for companies interested in entering the island's International Insurance Center.

Puerto Rico's captive insurance industry started as one of the various by-products available through the international insurance legislation passed in September 2004. This legislation created a framework for captive insurance structures in a domicile that provides a combination of low political risk, favorable tax legislation and accredited regulatory environment. Puerto Rico's legislation provides for the formation of stand-alone, associated and protected cell captives. There are two main factors that contribute to Puerto Rico's insurance industry steady growth: private and public sector commitment to the island's International Insurance Center, and the generous tax incentives within a US jurisdiction.

Since 2004, we have seen both private entities and government agencies promote the island's insurance laws abroad, which has increased awareness of the opportunity that lies in Puerto Rico. Also, the Office of the Commissioner of Insurance as had an excellent track record in providing expedited support as well as processing applications for captives in an expedited manner.

Another critical factor has been the approval of the tax decree system (Law 98 of 2012) which provides for a contract between the government of Puerto Rico and the international insurer to secure its low income tax regime for no less than 15 years, renewable on two additional terms. This law, in addition to the rest of local statutes to promote the jurisdiction as an international service hub, have been fundamental to attract new companies that are creating jobs and developing a comprehensive insurance industry in Puerto Rico. Since the inception of PRIIA, all international insurer have welcome to join and to bring their local service provider to join the association. Our efforts continue to organize all the existing international insurer and their providers se that we can all benefit and learn from each other while strengthening Puerto Rico as a domicile.

This international insurance report provides a taste of the opportunities in the island for international insurers through various specialized articles by leading experts and companies. For more information about PRIIA, visit us at www.PRIIA.org

Thank you!

Rubén Gely Ortiz

**Ruben A. Gely-Ortiz** is the president of International Insurer's Consulting Group, and vice-president for Puerto Rico's International Insurance Association. He specializes in off shore protected cell business and international reinsurance arrangements.

PRIIA
Puerto Rico International Insurers Association



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# WITH THE WORLD AS ITS STAGE, RYAN'S CAPTIVE INSURANCE CONSULTING PRACTICE CONTINUES TO RELY UPON PUERTO RICO AS ITS CAPTIVE INSURANCE "DOMICILE OF CHOICE"

By: **Kenneth Kotch, Esq.** | March 2019

Kenneth Kotch, Esq. is a Principal within Ryan, LLC, and the National Practice Leader for Ryan's Captive Insurance Consulting Practice. Ryan, LLC ("Ryan") was founded in 1991, and currently employs more than 2400 professionals worldwide.

Ryan's global practice includes expertise in every major area of state, local, federal and international business consultation. We maintain the largest indirect tax practice in North America and the seventh largest corporate tax practice in the United States.

Ryan's Captive Insurance Division pdes all of the administrative and operational support required to create and manage a bona-fide Captive Insurance Company.

Although Ryan is authorized to manage Captive Insurance Companies in multiple jurisdictions, Mr. Kotch has been duly authorized to interact with the Puerto Rico International Insurance Center on behalf of Ryan's Captive Insurance clientele since August, 2009, in accordance with the procedures of the Office of the Commissioner of Insurance of Puerto Rico, and maintains a high level of Captive Insurance licenses within the domicile.

## THE CLIENT PERSPECTIVE; WHY PARTICIPATE IN A CAPTIVE INSURANCE PROGRAM?

Despite the growing number of well-publicized challenges presented in the Captive Insurance industry, creating a captive insurance company ("captive") remains a popular way for business owners to participate in alternative risk management—a form of "risk retention" for risks not efficiently covered by commercial insurance.

With thousands of captives in operation worldwide, the basic tenets of captive administration are well-established. However, in an era of increased operational scrutiny within the captive insurance industry, the importance of strict adherence to operational and structural "best practices" will remain the precept of a viable and effective alternative risk management program.

In general, a captive is not all that dissimilar from other insurance providers. It is a licensed insurance company, created for non-tax purposes, to insure the risks of its owners and affiliates.

The captive issues policies, collects premiums, pays claims and earns profits. To the extent that annual claims do not exceed reserves, the captive may issue dividends, invest profits, or pursue new business ventures at the discretion of the owners. Specialized management expertise and a professional, credible, arms-length underwriting process are essential to provide the proper risk analysis and distribution.

Structured properly, captives can become valuable profit centers, providing cost-effective property and casualty coverage, while earning dollars that would have otherwise been paid to a commercial carrier.

## RYAN'S CAPTIVE INSURANCE CONSULTING PRACTICE AND ITS RELATIONSHIP WITH PUERTO RICO AS A CAPTIVE INSURANCE DOMICILE

**Legislative Background and Real-World Challenges**

On July 9, 2004, the Puerto Rico Legislature unanimously passed legislation that established a comprehensive tax and insurance regulatory structure to encourage and regulate the formation of Puerto Rico International Insurers to write insurance on foreign (non-Puerto Rico) risks. To attract participants, the Act granted broad exemptions and established a regime of flexible, yet prudent, insurance regulation within the Commonwealth.

Given recent amendments to the legislation, the overall regime has been extended to Puerto Rico-based business risks, as well, under certain conditions.

It is no secret that Puerto Rico has been struggling to emerge from the shadows of its mounting debt burden, along with its protracted recovery from the devastating economic and infrastructure-related effects of Hurricane Maria; which can cause anxieties amongst the captive insurance community; from the vantage point of the business owner, risk managers, banking relationships, compliance officers, etc.

The post-Maria commercial insurance market has presented property and casualty rate increases previously unseen in the local Puerto Rican insurance market. Fortunately, the recent legislative expansion of Puerto Rico's International Insurance Act has provided solutions to enable both Puerto Rican and non-Puerto Rican business owners to enjoy favorable economic incentives.

This could be achieved by formalizing elements of their enterprise-level alternative risk management program into a Puerto Rico-based captive arrangement, ensuring stable, reliable, and equitable regulation within the affiliated insurance program. Although the economic and infrastructure-related issues are realities which should not be dismissed, The Office of the Commissioner of Insurance or Puerto Rico (OCI), and more specifically, its International Insurance Center, which regulates Ryan LLC's Captive Insurance Consulting Practice's Puerto-Rico domiciled captive insurance companies, continues to provide stable, reliable, and high-quality regulatory oversight.

The International Insurance Center is widely viewed as an important contributor to Puerto Rico's on-going economic recovery, boasting continuous double-digit growth metrics in recent years, and representing a robust and dynamic profit-center for the Commonwealth.

## THE CHARACTERISTICS OF PUERTO RICO AS A PREFERRED CAPTIVE DOMICILE

Ryan, LLC's Captive Insurance Consulting Practice limits its domiciliation of captive facilities to U.S. jurisdictions. This, of course, includes the U.S. territory of Puerto Rico. As an organization, there are certain characteristics which we view as "essential" with respect to our relationship with a Regulatory regime:

- A thorough understanding of the underlying Regulatory and Legal elements which will dictate the formation and ongoing management of the insurance facility.
- In situations where the law is not readily applied to a particular fact pattern, a collaborative approach to arriving at a balance between client interests and the legal framework giving rise to the applicable policies of the domicile.
- A quick turn-around and efficient application process.

As a United States Commonwealth, Puerto Rico's free market economy is subject to both U.S. Federal and state regulations designed to protect free market-competition; specifically, but not limited to, the insurance and banking industries.

Along with the use of the US dollar, and general allowance of free flow of funds abroad, this regulatory structure guarantees sound credit and investment practices. Legal protection is provided under both U.S.

Federal and state constitutions, with legal redress venues in U.S. Federal or Commonwealth courts. This arrangement allows for both fiscal and tax autonomy with special United States tax distinctions.

Additionally, Puerto Rico offers a particular license classification which allows for administration of "Protected Cells" amongst other Captive Management options.

The flexibility of a regulatory-driven Protected Cell regime presents a very powerful planning opportunity for many of our clients.

Although it is not a solution for all our clients, it is important to have the protected cell option for planning purposes, as we identify the client's short- and long-term alternative risk management needs and expectations.

Generally, the protected cell approach will offer administrative efficiencies, which we can pass along in terms of cost savings to our clients.

## ACCREDITED MEMBERSHIP STATUS TO THE NAIC

Puerto Rico's accredited membership status to the National Association of Insurance Commissioners ("NAIC") and the Office of the Commissioner of Insurance's (OCI) long history of regulatory expertise are further enticements for Puerto Rico to be considered as a viable alternative to transact insurance business.

Accredited insurance departments are required to undergo a comprehensive review by an independent review team every five years, to ensure the departments continue to meet baseline financial solvency oversight standards.

The accreditation standards require state insurance departments to have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, and that they have the necessary resources to carry out that authority.

Puerto Rico is the first U.S. territory to be accredited by the NAIC, and offers the following benefits to its corporate citizens:

- Puerto Rico is part of U.S. free trade zones and customs system

- Puerto Rico's banking system is regulated under U.S. laws (FDIC)

- Puerto Rico is under the protection of the Homeland Security Act

- Puerto Rico is under the U.S. legal framework and intellectual property protection

## FURTHER BUSINESS CONSIDERATIONS OF PUERTO RICO AS A CAPTIVE INSURANCE DOMICILE

Another benefit of choosing Puerto Rico as a Captive Insurance domicile over other Captive Insurance domiciles is that the Captive can be properly administered without the additional friction of local taxation (including premium taxes).

The tax treatment conferred under the International Insurers and Reinsurers Act of Puerto Rico includes:

- Preferred tax regime of 4% on Net Income in excess of $1.2 million to international insurers, secured by a tax decree, with a nature of a contract between the insurer and the Government of Puerto Rico.

The contract decree has an effective period of 15 years, with a renewal option for two additional periods,

- Exemption from income obtained by the International Insurer qualifying International Insurer Holding Companies,

- Exemption on dividends and other profit distributions made by the International Insurer and/or the International Insurer Holding Company,

- Exemption on municipal franchise and real and personal property taxes,

- Exemption to the International Insurer and qualifying International Insurer Holding Company from withholding taxes on payments of dividends and other profit distributions made to third parties, and from filing tax returns with the Puerto Rico Internal Revenue Service.

**"A captive is not all that dissimilar from other insurance providers. It is a licensed insurance company, created for non-tax purposes, to insure the risks of its owners and affiliates."**

- **Kenneth Kotch, Esq.** | Principal within Ryan, LLC

## RYAN LLC'S CAPTIVE INSURANCE CONSULTING PRACTICE'S ONGOING COMMITMENT TO PUERTO RICO AS A DOMICILE

In the captive arena, the Department of Insurance for the state of domiciliation is responsible for the licensing and regulation of captives within its respective jurisdiction. Although captives are not subject to the same level of regulation as commercial insurers, they still have requirements to meet under statutory law.

In Puerto Rico, these requirements include the filing of an annual report, periodic financial examination, and the maintenance of sufficient reserves, among others.

Puerto Rico's approach to captive insurance regulation represents a fair, but strict adherence to NAIC and other Regulatory best practices. A Puerto Rico domiciled captive may have its license suspended or revoked by the OCI for failure to meet any of its requirements under the law, or if it is determined that it is in the best interests of the public or the policyholders of the captive.

As a specialized risk and business management tool, the captive requires highly specialized management expertise, sophisticated risk analysis, and a legal team to determine the potential alternative risk management benefits that may be associated with the program.

Structured properly, and within the appropriate Regulatory environment, the captive insurance company will bring significant financial benefits to the affiliated insured enterprise for many years.

Puerto Rico maintains the Regulatory environment, balancing its unwavering commitment to domicile-level best practices with a reliable, business-centric approach to captive insurance oversight and enforcement.

# THE CASE FOR EXEMPTING PUERTO RICO FROM THE FEDERAL EXCISE TAX ON INSURANCE. The "FET"

By: **Erick G. Negrón** | March 2019

Erick G. Negrón is a Special Counsel in Rexach & Picó, CSP. During his career, Mr. Negrón has amassed considerable experience in the areas of corporate practice, administrative law, taxation and insurance regulation. Since 1981, Rexach & Picó has been specializing in Insurance Regulatory matters.

Puerto Rico, a U.S. jurisdiction whose insurance regulator—the Office of the Commissioner of Insurance—is NAIC-accredited, enacted an "International Insurance Center" legislation in mid-2004 to attract insurers and reinsurers serving world-wide markets, as an alternative to foreign domiciles such as Bermuda or the Caymans. The legislation, which offers a combination of tax incentives with a flexible regulatory framework that follows the pattern of those alternative domiciles, has started to achieve significant success throughout this decade, and especially in the last few years.

Thirty-three "international insurers and reinsurers" are presently licensed, operating 520 "segregated asset plans" (Puerto Rico's version of the "protected cell" concept); written premiums exceeded $1 billion in 2017, and the total assets of those entities exceeded $3.7 billion by the end of that year.

Nevertheless, the overall potential of the International Insurance Center as a platform for revitalizing Puerto Rico's financial sector is affected by the fact that the island's insurers and reinsurers are subject to a special tax—known as the "Federal Excise Tax," or "FET"—generally applicable under Section 4371 of the U.S. Internal Revenue Code ("I.R.C.") to U.S. insurance or reinsurance risks underwritten by foreign insurers. Puerto Rico insurers, in other words, are treated as "foreign insurers" for such purposes; a situation that largely parallels the general treatment of Puerto Rico-domiciled corporations as "foreign corporations" under the I.R.C., but that in the specific context of the FET results in a highly unfair and costly disadvantage for Puerto Rico's economic development objectives, given the fact that many foreign nations have entered into tax treaties with the United States that exempt their insurers and reinsurers from the tax.

Discussions have been under way in Washington regarding the need to remedy the above situation, and last year—for the first time ever—a bill with bipartisan support was filed in the U.S. House of Representatives with the specific objective of eliminating the applicability of the FET to insurers and reinsurers organized in any territory or possession of the United States.

The bill, H.R. 5651, was filed on April 27, 2018 by Congresswoman Jenniffer González (Puerto Rico's Resident Commissioner in the U.S. Congress), Congressman Darren Soto of Florida, Congressman Peter King of New York, and Congressman Robert Brady of Pennsylvania. Although the bill did not get to be approved last year, the proposal to remove Puerto Rico from the applicability of the FET was officially placed on the discussion table, at long last. If such a proposal is finally approved as part of some future legislation, Puerto Rico insurers and reinsurers will essentially be treated similarly to those domiciled in any State of the United States, or in any of the several sovereign nations that have executed tax treaties with the United States that result in exemption from the FET.

## PRESENT LAW: THE FET

Under Section 4371 of the I.R.C., an excise tax (i.e., the FET) is generally imposed on insurance, indemnity bond, annuity, or reinsurance contracts issued by foreign insurers or reinsurers to, for, or in the name of a U.S. person with respect to risks wholly or partly within the United States, or issued to a foreign person engaged in a trade or business within the United States with respect to risks within the United States.

The excise tax, which is applied on the gross premiums paid to the foreign insurer, is levied at a rate of 4% in the case of casualty insurance policies or indemnity bonds; 1% in the case of life, sickness, or accident

insurance policies and annuity contracts (with respect to the life or hazards of U.S. persons), and 1% in the case of reinsurance.

Under Section 4372 of the I.R.C., the term "foreign insurer or reinsurer" means an insurer or reinsurer who is a non-resident alien individual, a foreign partnership, or a foreign corporation (but does not include a foreign government or a municipal or other corporation exercising taxing power). Since Puerto Rico corporations are generally deemed as "foreign" corporations under the I.R.C., the FET has been interpreted to apply to insurance or reinsurance premiums paid on U.S. risks underwritten by Puerto Rico-domiciled insurers or reinsurers.

Specifically, the U.S. Internal Revenue Service ("I.R.S.") reached such conclusion in Rev. Rul. 59-148, 1959-CB 446, and in Rev. Rul. 79-193, 1979-1 CB 359; more recently, the I.R.S. reaffirmed its interpretation in a response letter of March 27, 2015 sent to the Hon. Alejandro J. García Padilla, who was at the time the Governor of Puerto Rico, and who had requested from the I.R.S. the reconsideration of such conclusion.

The Governor's reconsideration request had been primarily based on the fact that Treasury Regulation Sec. 46.4371-2(b)(1) provides that the FET is inapplicable to insurance or reinsurance underwritten by a foreign insurer if "the policy or other instrument is signed or countersigned by an officer or agent of the Insurer in a State, Territory, or the District of Columbia in which such insurer is authorized to do business."

Insofar as Puerto Rico is a U.S. "Territory" from the standpoint of the U.S. Constitution, and is even expressly defined as such in multiple statutes and regulations (including tax statutes and regulations) of the United States, reconsideration of such I.R.S. rulings seemed warranted on the basis of the above-cited regulatory text, aside from the no less important policy considerations that should justify exempting Puerto Rico insurers and reinsurers from the FET.

Yet the I.R.S., in its letter to then Governor García Padilla, reaffirmed its previous position by interpreting that the word "Territory," as used in Treasury Regulation Sec. 46.4371-2(b)(1), had been intended to refer to the territories of Alaska and Hawaii, which had been "incorporated" into the United States for income tax purposes when said regulation was enacted, and not to "unincorporated" territories or possessions such as Puerto Rico.

Unless the I.R.S. were to be willing to change such interpretation, and to thus reconsider its prior revenue rulings, its official position continues to be that the FET applies to premiums paid to a Puerto Rico insurer for underwriting U.S. insurance or reinsurance risks. Under such circumstances, a statutory amendment becomes the necessary alternative for remedying the unfair position in which Puerto Rico is placed.

## REASONS FOR THE PROPOSED STATUTORY AMENDMENT

Not less than 25 income tax treaties entered into by the United States have exempted premiums paid to insurers and reinsurers of the treaty country from application of the FET. This includes treaties with countries such as Cyprus, Finland, France, Germany, Hungary, India, Ireland, Israel, Italy, Mexico, the Netherlands, Spain, Sweden, Switzerland, Romania, and the United Kingdom. The exemption does not apply to the extent that, depending on the treaty, the premiums are reinsured with a person not entitled to the benefits of a similar tax treaty of the United States (i.e., a treaty that provides exemption from the FET).

Consequently, notwithstanding the fact that Puerto Rico is a U.S. jurisdiction, Puerto Rico-domiciled insurers and reinsurers are placed at a disadvantage for underwriting U.S. risks not only when compared to insurers or reinsurers domiciled in States of the United States—which are excluded ab initio from the reach of the FET statute—but also when compared with insurers or reinsurers domiciled in sovereign nations that, unlike Puerto Rico, can enter into tax treaties with the United States.

Significantly, Puerto Rico does not levy a premium tax on the reinsurance of Puerto Rico risks by U.S.-domiciled reinsurers; yet no reciprocal exemption exists from the U.S. taxing side. This is highly important, because due to regulatory and market considerations it is precisely in the realm of reinsurance that a jurisdiction like Puerto Rico has greater potential as an operational venue for companies that have traditionally opted instead for long established non-U.S. domiciles such as Bermuda or the Cayman Islands. In this latter respect, insofar as Puerto Rico financial institutions are federally regulated, exempting Puerto Rico from the FET could become a way to maintain within the U.S. financial system substantial premium amounts that at present flow away from it.

No less importantly, such an exemption could become an invaluable tool for revitalizing the island's financial and professional services platform. Thanks to the flexible but prudent regulatory provisions and the attractive tax incentives provided under the International Insurance Center legislation, which include a flat local income tax rate of 4% that only applies to net income in excess of $1.2 million (income below such amount is fully exempt).

Puerto Rico has been attracting over the last decade a variety of insurers and reinsurers serving worldwide markets and is already becoming recognized as a competitive jurisdiction for such activities. Premiums written by the international insurers and reinsurers were $1,008,420,468 in 2017 (up from $851,605,896 in 2016, and $444,698,297 in 2015), while their total assets were $3,704,375,322 at year-end 2017 (up from $2,496,334,536 at year-end 2016, and $1,634,456,545 at year-end 2015). Although 2018 figures are not yet available, they are expected to reflect a continuation of the upward trend.

That such a sizeable increase in activity took place between 2015 to 2017, despite the ravages of Hurricanes Irma and María in 2017, and the adverse publicity that the island has experienced as a result of its government's fiscal situation and the default in its public debt, is clear evidence of the tremendous opportunity that exists for Puerto Rico as a jurisdiction of choice for specialty insurers and reinsurers, and thus of the importance of redressing the disadvantage that the FET's applicability entails.

## PROPOSED STATUTORY AMENDMENT, AND POSSIBLE IMPACT ON PUERTO RICO'S ECONOMY

H.R. 5651, as drafted, sought to eliminate the applicability of the FET to insurers and reinsurers domiciled in Puerto Rico or in any other territories or possessions of the United States (thus placing all such territories or possessions in equal footing), provided that the exempted premiums were not reinsured with a foreign entity not equally exempted.

Specifically, the proposal was to amend Section 4373 of the U.S. Internal Revenue Code, which lists the exemptions from the applicability of the tax, by adding at the end a new paragraph (3):

"(3) TERRRITORIES AND POSSESSIONS.—Any policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by a partnership or corporation crated or organized under the laws of any territory or possession of the United States, unless any of the hazards, risks, losses, or liabilities covered thereby are covered by a policy of reinsurance issued by a foreign insurer or reinsurer (other than such a partnership or corporation)."

Although this exemption would apply to insurers and reinsurers in all territories and possessions of the United States, its main impact would obviously be in Puerto Rico, and thus the title of the legislation, if passed, would have been the "Puerto Rico Insurance Excise Tax Exemption Act of 2018." Indeed, such an exemption would not only create a tax incentive for fresh capital to flow into new and existing Puerto Rico companies, but would further provide invaluable informational exposure about the island as a potential domicile for insurance and reinsurance activities. This would occur at the precise time when Puerto Rico needs more than ever the adoption of meaningful measures for revitalizing and upgrading its economy.

A sizeable injection of capital by new insurers and reinsurers could make possible an increase in the amount of deposits and in the range of activities undertaken in the island's financial system, with synergies that could change the overall economic panorama of Puerto Rico in the following ways:

- An increase in the amount of aggregate premiums underwritten would trigger an increment in the amount of financial assets held locally. If the scale of Puerto Rico's insurance activity were to become substantial enough, relative to that of long established alternative domiciles, large U.S. or international financial institutions could very well consider setting up operations on the island.

Not only to engage in depository, brokerage or investment banking activities related to the insurance platform, but to also introduce to the island managerial and lending activities (such as trust and letter–of-credit instruments supporting reinsurance obligations) that are part and parcel of the way the reinsurance industry operates. An increase in the lending power of locally established financial institutions would also facilitate access to credit for local entrepreneurs to create and develop new business.

- An increase in the hiring of specialized services in the establishment and licensing phase of insurers and reinsurers, and in their subsequent operations, including a wide variety of managerial and support services—legal, accounting, administrative, brokerage, back-office, and others—both through direct employment or by third-party contractors.

- An increase in the rent and/or purchase of real estate for the commercial operations of the licensed insurers and reinsurers, and for the residential needs of their executives, helping to improve real estate values on the island.

- An increase in other more indirect forms of local hiring and spending, on a range of services that would be required by the licensed insurers and their officers, contractors, investors and clients; such as hotels, restaurants and other hospitality and entertainment services.

> **"Puerto Rico has been attracting over the last decade a variety of insurers and reinsurers serving worldwide markets; and is already becoming recognized as a competitive jurisdiction."**
>
> - **Erick G. Negrón** | Special Counsel at Rexach & Picó

- An increase in local government application and license fees, and in income taxes paid by the insurers and reinsurers pursuant to the applicable 4% Puerto Rico income tax rate.

- Synergistic effects with other areas of the Puerto Rico economy: the exposure and visibility of the island to high level insurance investors would trigger interest in other activities for which it has competitive advantages not sufficiently known in international markets, such as manufacturing and distribution, agri-business and tourism, international banking, or services for export.

## CONCLUSION

To the extent that eliminating the applicability of the FET would trigger a favorable momentum for the island's financial and professional services sector, other areas of the economy could benefit as well. The long perception of economic decline stemming from a recession that has lasted over a decade and that climaxed in the María aftermath would begin to be offset, boosting confidence in the prospects for local industry categories other than insurance and finance. Against the above considerations, no valid counter-argument seems to exist for keeping Puerto Rico insurers and reinsurers subject to the FET. The applicability of such excise tax burdens the island with an unfair disadvantage relative to States of the United States, and to the dozens of countries that have entered tax treaties with the U.S. Passing any legislative initiative through Congress is always a very uphill battle. The case for exempting Puerto Rico from the applicability of the FET, however, is clearly worthy of such effort. Hopefully, the overwhelming merit of this proposition will become increasingly recognized, and in due course the repeal of such applicability will provide an important boost for the island's financial sector and general economy.

## INVESTMENT POSITIONING:

# EXPECT MORE VOLATILITY AHEAD

By: **Glovista Global** | March 2019

Glovista is an investment advisory firm that brings more than just financial expertise to the investment process. We are committed to creating value for our customers, employees and shareholder.

Global markets have welcomed the turn of the year in unmistakably strong terms, with broad price gains across major asset classes. For example, through mid-February, the S&P500 is up 9%, the Euro Stoxx up 7%, Japan's Nikkei +6% and the MSCI EM Emerging Markets Index +9%. Commodity markets have also rebounded strongly, with Oil and Gold up 15% and 2%, respectively. Indeed, global risk markets look quite enticing; however, we remind clients to be watchful of the ongoing global economic activity deceleration, increased risks of an earnings growth recession in the U.S. and still challenged global credit conditions following the sharp credit market repricing of the fourth quarter of 2018.

At the Davos meetings held in late January, the International Monetary Fund (IMF) lowered its global economic growth forecasts for this year and next. The IMF projects the world economy will expand by 3.5% in 2019 and 3.6% in 2020; a downward adjustment of 0.2 and 0.1 percentage points, respectively, from the prior forecasts released last October. Several reasons supporting such downward revisions to world GPD growth include the ongoing weakening of economic growth momentum in Europe, a larger-than-expected slowdown in China's economy, a potential "No Deal" Brexit scenario and continuing trade tensions between the U.S. and China.

Our stance on China is somewhat more constructive, which we address further. Nevertheless, we concur with the IMF's assessment concerning a slowdown in global economic growth during 2019. In addition, we expect mounting downside risks to U.S. corporate earnings which, if validated by the data, would bring about a sustained pick-up in market volatility.

Thus, given such macro dynamics, we advise our clients to embrace prudence in navigating the markets during the remaining of 2019. Specifically, we recommend an emphasis in Quality, Value and an Income-Oriented portfolio approach to portfolio construction for 2019.

Please see the adjoining **"Glovista Investment's Global allocation Map"** table which encapsulates our firm's current views on the major asset classes. Further, we discuss our outlook surrounding asset markets tied to the world's major economic regions.

## U.S.

We hold a cautious outlook towards U.S. equities in 2019. We believe the strong January performance in U.S. equities was led primarily by an outsized decline in equity risk premium levels, propelled by the US Federal Reserve's U-turn in its policy stance from "hawkish" to "dovish", as well as heightened prospects of an impending trade agreement between the US and China. This swift change in policy is welcomed, but we view it as a one-off event.

As we look ahead to the rest of the year, we believe any additional upside to US stock prices will depend on the U.S. Dollar outlook as well as the composition of economic growth in the U.S. and the rest of the world, considering that close to 50 percent of S&P500 index revenues derive from constituent companies' overseas operations.

As we look back at recent economic releases, an assessment of the current state of economic conditions has become impaired by the onset of a deep-freeze in Northern states, as well as the hiatus in the release of economic indicators as a result of the federal government shutdown. Nevertheless, recent indicators have been unambiguously soft, including a decline in CEO sentiment and consumer confidence levels (January), and an ongoing deceleration in US housing market conditions. The consumer sector remains the main driver of economic growth and labor market conditions remain sound, though pockets of weakness have begun to surface – including via weekly jobless claims data, as well as a modest uptick in extended measures of unemployment (e.g. U-6).

As we look ahead to the U.S. corporate earnings outlook, we expect a considerable moderation in the rate of growth owing to several considerations, including: adverse lagged effects from U.S. Dollar strength in 2018, compression in profit margins owing to the extended nature of the U.S. economic expansion, and adverse year-on-year earnings growth effects stemming from the one-off impetus on 2018 U.S. corporate earnings following the application of the largest corporate tax cuts since 1986.

In our view, the future direction of the U.S. Dollar is likely to exert an important role in the direction of global, and U.S., equity prices owing to the reflationary effects associated with periods of U.S. Dollar weakness. In that light, we expect 2019 to bring about a resumption of the U.S. Dollar bear cycle that was initiated early in 2017 and disrupted in 2018 due to the Trump tax cuts and the US FED's continuation of policy rate hikes, both of which have come to pass and will not recur in 2019.

## INTERNATIONAL DEVELOPED (MARKETS??)

We have turned a bit more constructive towards Eurozone equities on valuation considerations. However, we still maintain a neutral/modest underweight allocation owing to clear indications the Eurozone region's interest rate normalization process is likely to be deferred towards the second half of 2019, or the first quarter of 2020. In addition, Europe's cyclical slowdown appears to be accentuated by weaker global trade growth. The German economy, in particular, is suffering the brunt of the rout in global trade growth since its economy is mostly export driven. China's, along with the UK's economies, are among the largest importers of German goods. The combination of a China slowdown and Brexit negotiations have impacted the German economy disproportionately when compared to the rest of the developed world.

Lastly, the Italian economy has just entered into a recessionary phase - with two consecutive quarters of contraction. We foresee an improvement in Europe's economy sometime in the second half of the year, but a neutral stance is prudent at this point.

## EMERGING MARKETS:

Emerging Markets is our strongest conviction call. Our strong view is based on the asset class' attractive valuations, earnings growth momentum, under-ownership status, and the asset class' beneficiary status from a weakening U.S. Dollar cycle. In addition, EM equities are likely to benefit from the ongoing shift in relative economic momentum leadership away from the U.S. that became evident in Q4 of 2018 as well as the increased likelihood of a trade agreement between China and the U.S. during the first quarter of this year. In fact, the Chinese currency, along with other Asian currencies, have strengthened markedly since November 1, 2018. As noted above, we hold a constructive view towards Chinese asset prices and identify a

## GLOVISTA INVESTMENT'S GLOBAL ALLOCATION MAP, FEBRUARY 2019

| Asset Class | Asset Class Investment Strategy Positioning |
|---|---|
| Global Equities | ■ Cautious US Equities on high relative valuations, accompanied by weakening revenue and earnings momentum.<br>■ Favor international developed equities over an intermediate term horizon on valuation considerations. |
| Global Bonds | ■ Avoid exposure to long-term sovereign bonds given full valuation, especially Eurozone government bond paper.<br>■ Favor US Investment grade bonds with intermediate duration as risk mitigators. |
| Commodities | ■ Moderately bullish. Despite global slowdown, supply & demand dynamics remain favorable.<br>■ Favor Gold and selected precious metals over industrial and energy commodities. |
| Emerging Markets | ■ EM is our strongest conviction call on valuation, earnings growth and investor under-ownership considerations.<br>■ EM assets to benefit from the ongoing shift in relative economic momentum leadership away from the US. |

number of potential upside risks to the outlook. For example, over the past several months the Chinese government has announced a series of fiscal and monetary policy stimulus measures, including tax cuts and reserve requirement ratio cuts – with the latest round announced this past January.

Those measures are counter-cyclical in nature, thereby lending support to global investors' economic growth expectations for the balance of the year. In addition, the Chinese government is resorting to fiscal and monetary stimulus measures at a juncture in which the country is seeking an improvement in trade ties with the U.S. which should be taken by the market as a clear sign of Chinese policymakers' intent to stabilize the Chinese Renminbi versus the U.S. Dollar.

Currency stability/strength in the emerging markets space is supportive both of the global economy and markets given the reflationary effects stemming from U.S. Dollar weakness. Within the emerging market space, we favor overweight allocations to value sector-oriented Emerging Market regions, especially Latin America and Eastern Europa.

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2019

# PUERTO RICO INTERNATIONAL INSURERS REVIEW

## SPECIAL REPORT PUERTO RICO

AN EMERGING LEADER IN THE SEGREGATED **ASSET ENVIROMENT**

GATEWAY TO THE LATAM **INSURANCE MARKET**

UNRIVALLED TAX INCENTIVES WITH ALL US LEGAL **PROTECTIONS**

BUSINESS IN PUERTO RICO.COM

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SPECIAL REPORT

# PUERTO RICO: GATEWAY TO THE USA & LATIN AMERICA

**Due to its many advantages, including direct access to the US and other international markets, Puerto Rico is an ideal gateway for insurers and reinsurers wishing to enter the Latin American insurance and financial markets.**

Due to its many advantages, including direct access to US and other international markets, Puerto Rico is a sound gateway for insurers and reinsurers wishing to enter the Latin American insurance and financial market. Since 2005, the International Insurers and Reinsurers Division of the Office of the Commissioner of Insurance of Puerto Rico (OCI) has sought to promote Puerto Rico as an important member of the international insurance arena.

The Government of Puerto Rico adopted this new initiative and incorporated it as part of its economic agenda. The OCI supervises the International Insurers and Reinsurers Division, while the Department of Economic Development and Commerce oversees the promotion of the office's work and the extension of tax decrees, outlined below.

## WHY PUERTO RICO?

Puerto Rico enjoys a privileged geographical location, offering easy access to the United States and Latin America. The advantages of a fully bilingual (Spanish and English) corporate culture have helped the Government of Puerto Rico attract and retain high technology, capital-intensive manufacturing industries. Puerto Rico has dedicated billions of dollars to its local infrastructure, which features state-of-the-art communication and technology systems, as well as modern transportation and shipping facilities. To this effect, Puerto Rico's service sector has become one of its fastest growing industries, accounting for over 25% of Puerto Rico's total workforce.

As a US jurisdiction, Puerto Rico's free market economy is subject to both federal and state regulations designed to protect free market-competition specifically, but not limited to, the insurance and banking industries. Along with the use of US currency and general allowance of free flow of funds abroad, this regulatory structure guarantees sound credit and investment practices.

Legal protection is provided under both federal and state constitutions, with legal redress venues available in federal or state courts.

"Advantage Insurance received its first license in Puerto Rico's International Insurance Center in 2009. Our early experience convinced us that Puerto Rico is an ideal jurisdiction for insurers that require best-in-class regulation and rule of law, with competitive tax incentives. We relocated our corporate headquarters to San Juan in 2016 and have grown to over 25 local employees administering a broad range of companies inside the International Insurance Center. Importantly, Puerto Rico complements our other Captive domiciles, and has helped us to expand our business globally."

- WALTER KEENAN, CEO, ADVANTAGE INSURANCE INC.

AdvantageInsurance

"Captive Alternatives has established three International Insurers since 2015, and now manages more than 160 captives in Puerto Rico. The Puerto Rico model has been instrumental in expanding our capabilities and significantly boosting our growth, leading to a position on the Inc 5000 as a nationally ranked high growth company. We have great experience of working with multiple domiciles, and congratulate the Puerto Rico Department of Insurance on running a very professional department that is highly responsive to both our clients and our administrative needs.

The International Insurer laws are a model for a reputable regulatory environment with due regard for the speed of modern business needs. With top level professional experts and a significant domestic insurance market, Puerto Rico has proved to be an emerging domicile that should be taken very seriously. We are extremely pleased with our relationship and look forward to providing additional alternative risk solutions to the USA's mid-size businesses, as well as more international business."

- MARK SIMS, VP OF BUSINESS DEVELOPMENT, CAPTIVE ALTERNATIVES

CAPALT
INNOVATIVE RISK SOLUTIONS

## INSURANCE ARENA

The Puerto Rico Office of the Commissioner of Insurance (OCI) long history of regulatory expertise is further reason for Puerto Rico to be considered a viable alternative when considering where to transact insurance business. The OCI regulates 49 domestic insurers and 312 foreign reinsurers and reinsurers writing $12.3 billion of premium for 2018. Puerto Rico is the fourth largest insurance market in Latin America in written premium basis and the first in per capita basis. The OCI is an accredited member of the National Association of Insurance Commissioners (NAIC). The OCI is also a participating member of the Association of insurance Superintendents of Latin America (ASSAL). The regulatory basis of the center calls for prudent but expedient regulation.

## INTERNATIONAL INSURERS ARE LICENSED ON A CLASS BASIS WITH THE FOLLOWING DEFINITIONS, CAPITAL AND SURPLUS REQUIREMENTS

| TYPE OF LICENSE | DESCRIPTION OF AUTHORITY | CAPITAL REQUIREMENTS | FEES & CHARGES |
|---|---|---|---|
| **CLASS 1 AUTHORITY** "Pure captives" | ■ Authority to transact insurance and reinsurance related to risks from the sole owner of the international insurer, any affiliated owner or other affiliate of the international insurer; 51% of Third Party risks permitted to comply with regulations of domicile where the risks are assumed. | ■ $500,000.00 capital and surplus<br>■ 5:1 premium to surplus ratio | ■ $350.00 general application fee<br>■ $750.00 authorization fee |
| **CLASS 2 AUTHORITY** "Association captives" | ■ Authority to transact insurance and reinsurance related to risks of the owners, whether or not said owners are affiliates of the international insurer or of any of their respective affiliates and risks that arise from the business transactions of said owners of affiliates, as may be determined by the Commissioner, or<br>■ Any other risk that does not exceed the total of 20% of the net premiums written by the international insurer. | ■ $750,000.00 capital and surplus of which $500,000.00 must be paid in capital<br>■ 5:1 premium to surplus ratio;<br>■ 3:1 regarding third party risks | ■ $350.00 general application fee<br>■ $1,000.00 Authorization fee |
| **CLASS 3 AUTHORITY** "Property casualty" | ■ Authority to transact Property & Casualty insurance and reinsurance, excluding High Limits Casualty and Property Insurance.<br>■ Assumption of domestic risk permitted under regulation. | ■ $1,500,000.00 capital and surplus of which $500,000.00 must be paid in capital<br>■ 3:1 regarding third party risks | ■ $350.00 general application fee<br>■ $2,500.00 Authorization fee |
| **CLASS 4 AUTHORITY** "Unrestricted property & casualty" | ■ Authority to transact Property & Casualty insurance and reinsurance, including High Limits Casualty and Property Insurance<br>■ Assumption of domestic risk permitted under regulation. | ■ $100,000,000.00 capital and surplus of which $2,000,000.00 must be paid in capital<br>■ 2:1 premium to surplus ratio | ■ $350.00 general application fee<br>■ $25,000.00 Authorization fee |
| **CLASS 5 AUTHORITY** "Unrestricted life & disabilty" | ■ Authority to transact Life & Disability insurance and reinsurance<br>■ Assumption of domestic risk permitted under regulation. | ■ $750,000.00 capital and surplus of which $750,000.00 must be paid in capital<br>■ According to approved Business Plan by the Office of the Commissioner | ■ $350.00 general application fee<br>■ $750.00 Authorization fee |
| **CLASS 6 AUTHORITY** "Unrestricted life & disabilty" | ■ Unrestricted L & H or P & C<br>■ Securitization Programs | ■ NO CAPITAL REQUIREMENT | ■ $350.00 general application fee<br>■ $25,000.00 Authorization fee |

"THE KEY FOR THE SUCCESS OF CAPTIVES IN PR IS THE SEGREGATED ASSET ENVIRONMENT PROVIDED BY CHAPTER 61"

## LEGAL BACKGROUND

Act No. 399 and Act No. 400 in Chapter 61 of the Puerto Rico Insurance Code were adopted in order to establish the basis for the International Insurance Center (IIC), which provides a competitive environment for reinsurers to cover risks in and out of Puerto Rico under a secure and flexible regulatory system, with attractive tax benefits.

In June 2011, Act. No. 98 was passed to provide long-term tax status that will guarantee the tax treatment for an initial period of 15 years, renewable for two additional 15-year periods.

International insurance entities have various alternative ways to organize and operate within the IIC. These options include operating as an international insurance holding company, as an international insurer or a branch of an International insurer, and protected cell arrangements.

## INTERNATIONAL INSURANCE HOLDING COMPANY:

- A holding company that must hold interests (shares and other securities) in an international insurer or international insurance holding company organized under Chapter 61 of the Insurance Code of Puerto Rico.
- May control international insurers or other international insurance holding companies, or businesses that are incidental and that provide services exclusively to international insurers with which they maintain a relationship as subsidiaries or affiliates.
- Maintain its cash, equivalents and other investments in a proportion of no more of 1:1 with other insurance related assets, including interest in the international insurer.

## INTERNATIONAL INSURER:

- An entity organized to conduct insurance business outside Puerto Rico.
- Includes reinsurers, captives, and associated captive company structures.

## BRANCH OF FOREIGN INSURER:

- Maintains main office in Puerto Rico.
- Segregates assets under a trust constituted pursuant to the laws of the Government of Puerto Rico.
- The deed of trust and all its amendments made according to the manner established by the Commissioner of Insurance.
- Has assets in trust in an amount at least equal to 150% of the capital and surplus required, or in the case of a Class 4 insurer, 110%. International insurers are licensed on a class basis depending on the type of risk and each class has different capital and surplus requirements.

## SEGREGATED ASSET ENVIRONMENT

Key for the success of Captives in PR is the Segregated Asset Environment provided by Chapter 61. Under this regime Segregated Asset Plans, which are non-juridical entities enjoy a strong separation of assets and liabilities, secured by statute, rule and a specific plan of operation approved by the Regulator. Some aspects of the environment are:

- With prior approval from the Commissioner, an international insurer may establish and operate one or more Segregate Assets Plan of Operations.
- Assets of a Segregated Assets Plan approved by the Commissioner are available solely for the payment of the obligations of said segregated asset plan and are not available for the obligations of other segregated assets plans or of the general account of the insurer.
- No segregated assets pans shall be considered as an entity with a jurisdictional personality separate from that of the international insurer. This environment has proven to deliver flexibility and comfort enough to attract not only captives but other platforms as well in the broad spectrum of insurance business plans.

## REGULATOR RESPONSIVENESS

Captives are of course under the oversight of the OCI, an Accredited Member of the NAIC, as well as a member of the Association of Latin America Insurance Superintendents (ASSAL). The OCI-PR has dedicated a Division to handle captives and other International Insurer initiatives.

Although Chapter 61 of the Code provides a statutory period of 60 days for a complete application to be processed, there are reports of applications completed in 30, 15, and even 5 days. The Division is recognized for providing prompt response to inquiries pre-application.

> A “Segregated Assets Plan” (“SAP”) is a set of assets identified and managed by an international insurer separately from any other assets, and that supports a specified set of liabilities similarly separated from the rest of the liabilities of the insurer. Thus, the assets of one SAP cannot be used for paying liabilities of another SAP, or for paying general liabilities of the insurer.
>
> Such “separateness” is not only for accounting purposes, but reaches all the way to the scenario of an insolvency. Although the SAPs are not independent legal persons, an insolvent SAP may be placed in receivership and be liquidated without affecting the assets and liabilities other SAPs, or the general assets and liabilities of the insurer itself.

- By Eric G. Negron, Special Counsel, Rexach & Pico

REXACH & PICÓ
ATTORNEYS AT LAW

"As a United States Commonwealth, Puerto Rico's free market economy is subject to both U.S. Federal and state regulations designed to protect free market-competition; specifically, but not limited to, the insurance and banking industries.

Along with the use of the US dollar, and general allowance of free flow of funds abroad, this regulatory structure guarantees sound credit and investment practices. Legal protection is provided under both U.S. Federal and state constitutions, with legal redress venues in U.S. Federal or Commonwealth courts. This arrangement allows for both fiscal and tax autonomy with special United States tax distinctions. Additionally, Puerto Rico offers a particular license classification which allows for administration of (Protected Cells) amongst other Captive Management options. The flexibility of a regulatory-driven Protected Cell regime presents a very powerful planning opportunity for many of our clients.

Although it is not a solution for all of our clients, it is important to have the option for planning purposes, as we identify the client's short- and long-term alternative risk management needs and expectations. Generally, the protected cell approach will offer administrative efficiencies, which we can pass along in terms of cost savings to our clients."

- Kenneth Kotch, Principal, Ryan LLC

Ryan

## TAX TREATMENT

Tax exemptions conferred under the International Insurers and Reinsurers Act of Puerto Rico include:

- $1.2 million tax exemption on net income. Exemption applicable at the individual cell level for protected cell company arrangements and at the company level. Preferred 4% tax rate on net income, guaranteed by a decree effective over a renewable period of 15 years.
- Exemption from premium taxes.
- Exemption on dividends and other profit distributions made by the International Insurer and International Insurer Holding Company. Exemption on municipal franchise, real and personal property taxes.
- Exemption to the International Insurer and qualifying International Insurance Company from withholding taxes on payments of dividends and other profit distributions made to third parties, and from filing tax returns with the Puerto Rico Internal Revenue Service.
- Isolation of the proceeds and benefits paid by international insurers from state and donation taxation procedures.

## OTHER TAX INCENTIVES

**Export Services**

The Act to Promote the Exportation of Services (Act No. 20 of 2012) will without a doubt turn Puerto Rico into an international services center. Some of the highlights of the Law include: (i) a 4% income tax rate that can be reduced to 3%, (ii) 0% income tax rate on distributions, (iii) 90% exemption of real and property taxes, (iv) 60% exemption on municipal license taxes and (v) 20 year exemption period that may be extended by an additional 10 years.

Among the qualifying export services are: research and development, advertisement and public relations, consulting, investment banking, asset management and other financial services, and professional services such as legal, accounting, architectural and engineering services.

**International Financial Entities (IFE's)**

The International Financial Center Regulatory (Act No. 273 of 2012) provides tax exemptions to businesses engaged in eligible financial activities in Puerto Rico. Some of the highlights of the Law include: (i) a 4% income tax rate; (ii) 100% exclusion of interest, financing charges or participation in partnerships benefits; (iii) 100% tax exemption on all real and personal property belonging to an IFE; and (iv) 100% tax exemption on the payment of municipal license taxes. The decree will be effective during a period of 15 years. Two extensions of 15 years each may be available.

**Individual Resident Investors**

The Act to Promote the Relocation of Individual Investors (Act 22 of 2012) offers attractive tax benefits to individual investors who relocate to Puerto Rico (must be present in Puerto Rico at least 183 days amongst other resident requirements). In order to qualify, the new resident investor must not have been a resident of Puerto Rico during the past 15 years.
Highlights of this Act include: (i) 100% exemption of income taxes (including alternative minimum tax) on interest and dividends received, and (ii) 100% tax exemption on capital gains that occurred while a resident of Puerto Rico and which are realized after 10 years of becoming resident of Puerto Rico.

# PUERTO RICO

## AN IDEAL JURISDICTION FOR INTERNATIONAL PRIVATE PLACEMENT LIFE INSURANCE AND OTHER PLANNING OPPORTUNITES

By: **James A. Walker, Jr.** | March 2019

"Jay" Walker is the founding partner and CEO of J.A. Walker Associates, Inc., a law firm specializing in international insurance, re-insurance, and finance matters.

This article will summarize the significant advantages that Puerto Rico provides for private placement insurance companies and their international clients.

### SPECIAL CONNECTION WITH THE UNITED STATES OF AMERICA

Puerto Rico is an "unincorporated territory" of the United States. Constitutionally, Puerto Rico is subject to the Congress' plenary powers under the territorial clause of Article IV, Sec. 3, of the U.S. Constitution. U.S. federal law applies to Puerto Rico. Under the establishment of the Federal Relations Act of 1950, all federal laws that are "not locally inapplicable" are automatically the law of the land in Puerto Rico. Judges appointed to the Puerto Rico federal district court were appointed under the Article III of the Constitution of the United States.

Puerto Rico's economic, commercial, and banking systems are integrated to those of the United States. President George H. W. Bush issued a November 30, 1992 memorandum to heads of executive departments and agencies establishing the current administrative relationship between the federal government and the Commonwealth of Puerto Rico. This memorandum directs all federal departments, agencies, and officials to treat Puerto Rico administratively as if it were a state, insofar as doing so would not disrupt federal programs or operations.

### TAXATION IN PUERTO RICO

Taxation in Puerto Rico takes the form of both US and Puerto Rico taxes.

The U.S. Government classifies Puerto Rico as an independent taxation authority by Federal Law. Puerto Rico has independent tax-levying authority by provisions of 48 U.S.C. § 734 of the United States Code.

Although the Puerto Rico government has its own tax laws, Puerto Ricans are also required to pay many US federal taxes, with the major exception being that most residents and businesses do not have to pay US federal income tax.

Specifically, a Puerto Rico international insurer does not pay US federal income tax unless it is engaged in a US trade or business, or it has made the irrevocable IRC 953(d) tax election. The Puerto Rico international insurer instead files and pays taxes in Puerto Rico.

### PUERTO RICO AS AN INTERNATIONAL INSURANCE JURISDICTION

Act No. 399 of September 22, 2004, known as the Puerto Rico International Insurers and Reinsurers Act, established the main legal framework for the development of Puerto Rico as an International Insurance Center, oriented towards the export of insurance and reinsurance services to international markets. Puerto Rico created the International Insurers and Reinsurers Division of the Office of the Commissioner of Insurance of Puerto Rico (OCI), with a specific focus and goal of developing Puerto Rico into an important member of the international insurance arena. The Government of Puerto Rico expressly adopted this new initiative and incorporated it as part of its economic agenda for the 21st Century.

The International Insurers and Reinsurers Division is under the Supervision of the OCI. The Department of Economic Development and Commerce oversees the promotion of this facility and the extension of applicable tax decrees that are an important part of the international insurance initiative.

Similar to the 50 US States, the Puerto Rico OIC is an accredited member of the National

Association of Insurance Commissioners ("NAIC"), making it unique as an international insurance jurisdiction. In addition, the OCI is also a participating member of the Association of Insurance Superintendents of Latin America ("ASSAL"). The OCI regulates 50 domestic insurers and 323 foreign insurers with a premium volume that reached $12.8 billion in 2017. This level of US and Latin American experience and expertise is a major asset of Puerto Rico as an International Insurance Center, as is its English / Spanish dual fluency, the regionally convenient location, the low cost of doing business, and the high quality of professional service providers in Puerto Rico.

## THE PUERTO RICO INTERNATIONAL INSURANCE CENTER

Laws No. 399 and 400 of September 22, 2004, in Chapter 61 of the Puerto Rico Insurance Code were adopted jointly with Rules 80, 81 and 82 of the Regulation of the Insurance Code, in order to establish the legal framework for the Puerto Rico International Insurance Center (IIC). This legislation provides a competitive environment within which insurance companies and reinsurers could cover risks outside of Puerto Rico, under a secure and flexible regulatory scheme, which includes attractive tax benefits.

Law No. 98 of June 20, 2011 was passed to provide long term tax status that will guarantee the tax treatment for an initial period of 15 years, renewable for two additional 15 years periods.

Rule 100 of September 23, 2013 established guidelines and additional requirements that are applicable to international insurers who intend to assume or accept reinsurance on risks resident, located or to be executed in Puerto Rico.

Under this regime, an International Insurer is a licensed and regulated Puerto Rico insurer that is organized to conduct insurance business outside Puerto Rico. This includes reinsurers, captives, and associates captive company structures. For a private placement life insurance company, this means that its clients cannot be tax resident in Puerto Rico.

## PUERTO RICO INTERNATIONAL INSURER TAX TREATMENT

Puerto Rico International Insurers are subject to a preferred tax regime of 4% of Net Income, with exclusion of $1.2 million. Exemptions are provided in the law for Premium taxes, withholding taxes, Personal-Property taxes and dividend distributions. Although the 4% tax treatment is observed at the segregated asset plan level, the segregated assets plan of a Class 5 International Insurer, issuers of PPLI products, are specifically excluded.

## PUERTO RICO SEPARATE ACCOUNT LEGISLATION

Puerto Rico International Insurer segregated assets plans are governed by Article 61.160 of the Insurance Code. For an international insurer issuing variable private placement annuity and life insurance policies, the Segregated Assets Plan requires that the insurer establish and maintain a separate account for each variable life insurance and annuity contract that it issues or assumes.

The assets related to each separate account will be segregated from the assets related to every other separate account and from the insurer's general account assets. Each separate account will include among its assets the premiums paid with respect to the variable life insurance and annuity contract for which it was established, and all interest, earnings, and other assets derived from those premiums.

The Segregated Assets Plan further provides that the assets of each separate account will only be available to satisfy liabilities arising from the variable life insurance and/or annuity contract for which the separate account was established, or which relate specifically to the operation of that separate account. The separate accounts will not be charged with any liabilities arising from any other business of the issuing insurer.

This Segregated Assets Plan regulation follows similar law and methodology in the 50 US States. Insurance policy protected segregated accounts isolate and protect each policy's reserve assets which belong to a specific insurance policy, such that each segregated account policy account has no exposure to any claims or other obligations of the issuing insurance company or of other policy owners or policy beneficiaries. Even if the issuing insurer were to go bankrupt, a policy's separate account reserves would be safe and apart from any liability of or claims against the issuing insurer, with such funds being payable only to the policy owner (or beneficiaries in the event of the death of the insured).

The Puerto Rico regime is bolstered by substantial US legal precedent that is applicable to a Puerto Rico insurer, and in turn insures that a US federal or state court would be obligated to honor and uphold this Puerto Rico legislation.

## STATUTORY INCOME TAX CERTAINTY TO THE NON-PUERTO RICO POLICY OWNER OR POLICY BENEFICIARY

Specific to PPLI, Puerto Rico law expressly provides that "amounts received by a non-resident individual or by a foreign corporation or partnership as benefits or interest of any kind under a life insurance or annuity contract issued by an International Insurer will also not be considered gross income" subject to any local Puerto Rico tax or withholding.

If an international client purchases a US issued cash value life insurance or annuity policy and later receives annuity payments or policy surrender proceeds from a policy with investment gain, the US imposes a 30% withholding tax. The same policy issued from a Puerto Rico International Insurer, however, is completely exempt from any taxation to the international policy owner client.

## STATUTORY ESTATE TAX CERTAINTY TO THE NON-PUERTO RICO POLICY OWNER OR POLICY BENEFICIARY

Specific to PPLI, Puerto Rico law also expressly provides a complete exemption from any Puerto Rico estate taxation as follows: "the value of any amount payable by an International Insurer by reason of a life insurance or annuity contract to a non-resident of Puerto Rico shall be considered property outside of Puerto Rico and shall be exempt from the estate tax…"

Complementing the complete income tax exemption noted above, Puerto Rico also provides a complete estate tax exemption for life and annuity policies issued by a Puerto Rico international insurer.

## STATUTORY "ASSET PROTECTION" CERTAINTY TO THE NON-PUERTO RICO POLICY OWNER OR POLICY BENEFICIARY

Puerto Rico law expressly limits the rights of creditors of the policy owner or policy beneficiary as against a life insurance or annuity policy issued by a Puerto Rico International Insurer, as follows:

"ARTICLE 61.240 – BENEFITS EXEMPT FROM SEIZURE

- (1) Except as provided under paragraph (3), any benefits (including any cash value or proceeds) to be provided to an insured or beneficiary under a life insurance or annuity contract issued by an International Insurer:
  - (a) shall inure exclusively to the benefit of the person for whose use and benefit the insurance or annuity is designated in the contract; and
  - (b) shall be fully exempt from:
    - (i) garnishment, attachment, execution, or other seizure;
    - (ii) appropriation or application by any legal or equitable process or by operation of law to pay a debt or other liability of an insured or of a beneficiary, either before or after the benefits are provided; and
    - (iii) a demand in a bankruptcy proceeding of the insured or beneficiary.

- (2) The exemptions provided under paragraph (1) apply regardless of whether:
  - (a) the power to change the beneficiary is reserved to the insured; or
  - (b) the insured or the insured's estate is a contingent beneficiary.

- (3) The exemptions provided under paragraph (1) do not apply to:
  - (a) a premium payment made in fraud of a creditor, subject to the applicable statute of limitations for recovering the payment;
  - (b) a debt of the insured or beneficiary secured by a pledge of the insurance policor the proceeds of the policy; or
  - (c) a child support lien or levy established pursuant to applicable law.

- (4) This article does not prevent an insured, owner, or annuitant from assigning, in accordance with the terms of the life insurance or annuity contract:
  - (a) any benefits to be provided under the life insurance policy or annuity contract; or
  - (b) any other rights under the policy or contract.

- (5) If a life insurance or annuity contract issued by an International Insurer prohibits a beneficiary from assigning or commuting benefits to be provided or other rights under the contract, any assignment or commutation or attempted assignment or commutation of the benefits or rights by the beneficiary is void.

As noted earlier, U.S. State Courts must honor Puerto Rico's Laws and enforce Puerto Rico judgments as Puerto Rico is a US Territory. U.S. Federal Courts (including Bankruptcy Courts) must honor Puerto Rico Laws. Specifically, Puerto Rico laws governing Puerto Rico life insurance and annuity policies issued by a Puerto Rico insurer must be honored by U.S. State and Federal Courts. This means that a Puerto Rico issued variable life or annuity policy owned by a resident of California or that has a Florida resident beneficiary, for example, enjoys the statutory protections of Puerto Rico law if a creditor claim seeking to levy against the policy is brought in California or Florida. This is a critical advantage for US connected policy owners or policy beneficiaries as compared to an international jurisdiction that is not a US Territory.

## INTERNATIONAL INSURER POLICY DESIGN FLEXIBILITY

The flexibility afforded to a Puerto Rico international insurer issuing private placement life insurance and annuity policy to high wealth "accredited investors" is substantial, in strong contrast to the very restricted offerings allowed by a US State regulated carrier or a Puerto Rico domestic licensed insurer, or in my experience, by an EU or major Latin American jurisdiction regulated insurer. Custom policies and policy riders to address client / insured specific facts and planning are easily

viable for a Puerto Rico international insurer, allowing the insurer to address a wide variety of policy requirements, including but not limited to: 7702 Guideline Premium / Corridor Test MEC & non-MEC policies; 7702(g) restricted policies; 7702 CVA test cash value and death benefit only policies; Canadian exempt text policies; and the full spectrum of custom global life policies and policy riders.

## UNITED STATES STATUTORY VARIABLE INSURANCE TAX RECOGNITION OF PUERTO RICO

Variable life insurance and annuity policies are required to meet specific diversification requirements under U.S. tax requirements. Section 817(h) of the Internal Revenue Code provides that the investments of each separate account underlying a variable annuity policy or variable life insurance contract must be "adequately diversified" in accordance with Treasury regulations for the Policy to qualify as an annuity or life insurance policy. The Treasury Department has issued regulations prescribing the diversification requirements in connection with variable policies. See Treas. Reg. 1.817 5.

The regulations generally require that at the end of the first policy year and thereafter on the last day of each quarter of a calendar year no more than 55% of the value of a Separate Account's assets be represented by any one investment, no more than 70% be represented by any two investments, no more than 80% by any three investments, and no more than 90% by any four investments.

Critical to the Code $817(h) approach is the concept of insurance dedicated funds, which allow for collective investment management of segregated account variable insurance policies that pass the diversification testing, because the segregated account is allowed to "look through" the insurance dedicated fund to diversified underlying investments of the fund. It is here that Puerto Rico yet again presents a significant advantage for PPLI policies with a US connection, as the Treasury Regulations specifically allow a Puerto Rico insurer to invest in an insurance dedicated fund in the same manner as insurers domiciled in the 50 States.

The final Regulations expressly provide that for purposes of 1.817-5(f)(3)(vi), which is the requirement that the account be segregated pursuant to State law or regulation, Puerto Rico receives the same treatment as the 50 States. No other international jurisdiction has been granted this unique and important treatment for variable insurance policies.

## UNITED STATES FBAR REPORTING

Under the "FBAR" rules (F90-22.1) Report of Foreign Bank and Financial Account, each U.S. person having a financial interest in, or signatory authority over, any foreign financial accounts with an aggregate value exceeding $10,000.00 at any time must file the FBAR by June 30th of the following year. Financial accounts include insurance policies with a cash value. However, Puerto Rico is defined as being in the United States for the FBAR rules, such that there is no FBAR filing obligation for a Puerto Rico bank account or securities account or cash value insurance policy.

## UNITED STATES FATCA REPORTING

The Foreign Account Tax Compliance Act (FATCA) is a 2010 United States federal law to enforce the requirement for United States persons including those living outside the U.S. to file yearly reports on their non-U.S. financial accounts to the Financial Crimes Enforcement Network (FINCEN).

It requires all non-U.S. (foreign) financial institutions (FFIs) to search their records for indicia indicating U.S. person-status and to report the assets and identities of such persons to the U.S. Department of the Treasury

Since Puerto Rico is a U.S. Territory, the FACTA rules and requirements by express statute language do not treat Puerto Rico banks or insurance companies as a FFI that must endure the expense and complications of FATCA reporting by a foreign financial institution.

## INTERNATIONAL COMMON REPORTING STANDARDS

The Common Reporting Standard (CRS), developed in response to the G20 request and approved by the OECD Council on July 15, 2014, calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. It sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions.

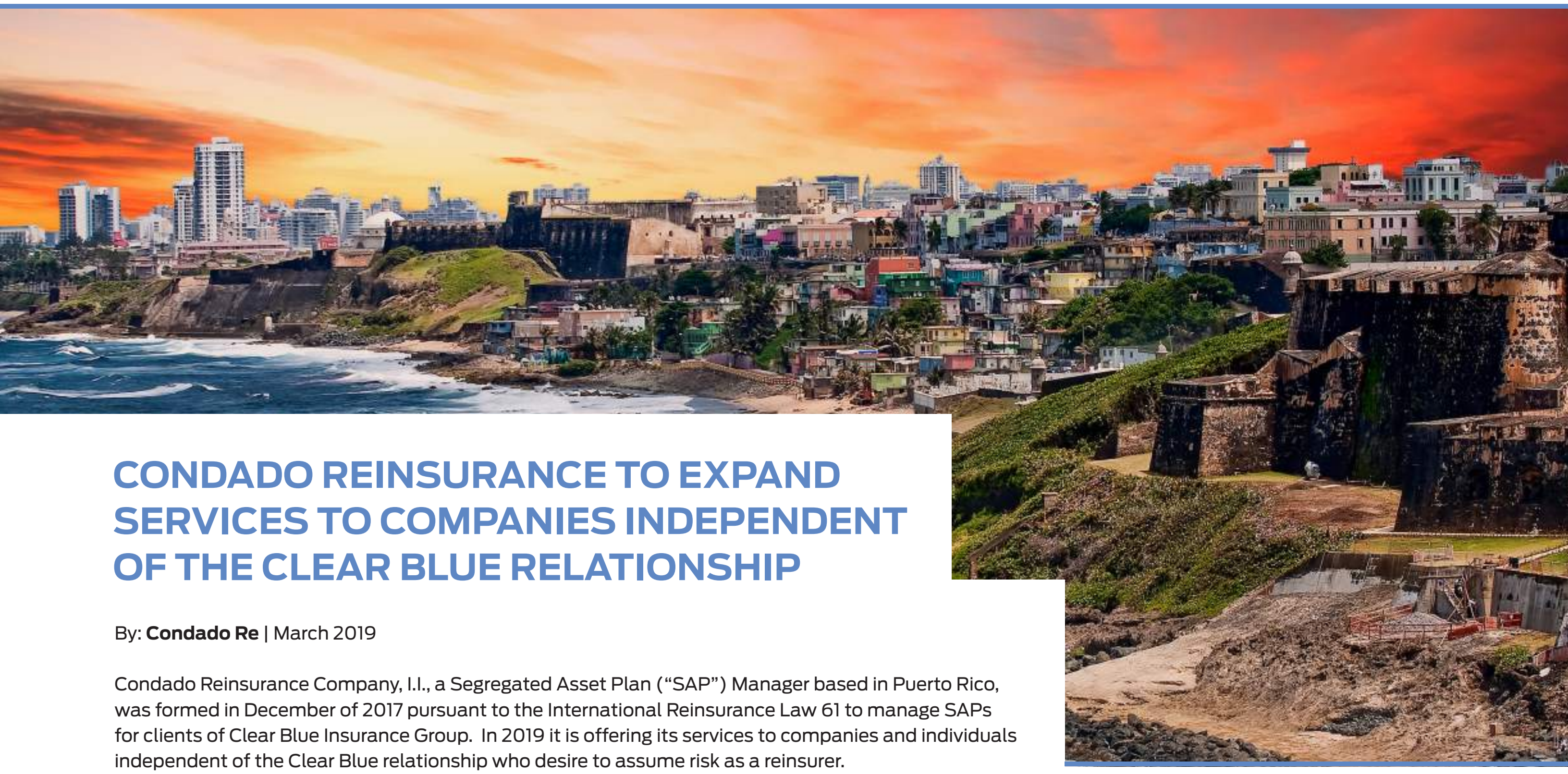
The scope and breadth of CRS is significant. For purposes of Puerto Rico, however, it is a non-event, as the United States has not elected to participate in CRS, and Puerto Rico as a US Territory accordingly is not part of CRS or any CRS reporting. This again provides significant cost and operation efficiencies and savings for a Puerto Rico international insurer.

> **"THE U.S. GOVERNMENT CLASSIFIES PUERTO RICO AS AN INDEPENDENT TAXATION AUTHORITY BY FEDERAL LAW. P. R. HAS INDEPENDENT TAX-LEVYING AUTHORITY."**
>
> \- **James A. Walker, Jr.** | J.A. Walker & Associates

J.A. Walker & Associates is strategically located in Puerto Rico to provide international insurance, legal and financial consulting services to international insurers, financial groups, and family offices. The International Insurance Center of Puerto Rico

Puerto Rico provides a unique international insurance domicile with many compelling advantages. Under the US flag, Puerto Rico's free market economy is subject to both federal and state regulations designed to protect free market competition specifically within, but not limited to, the insurance and banking industries. Along with the use of US currency, the dollar, and general allowance of free flow of funds abroad, this regulatory structure guarantees sound credit and investment practices. Legal protection is provided under both federal and state constitutions, with legal redress available in federal or State courts. For more information visit The Office of the Commissioner of Insurance of Puerto Rico (OCI) at http://ocs.gobierno.pr/enocspr/index.php/aseguradores-internacionales.

Puerto Rico provides attractive incentives and resources for international businesses and individuals moving to Puerto Rico. For information from The Department of Economic Development & Commerce, please see www.ddec.pr.gov/en/invest. Of specific note are Act 20 that provides incentives for businesses that export services from Puerto Rico, and Act 22 that offers tax exemptions to certain individuals who become new residents of Puerto Rico and apply for the exemption.



# CONDADO REINSURANCE TO EXPAND SERVICES TO COMPANIES INDEPENDENT OF THE CLEAR BLUE RELATIONSHIP

By: **Condado Re** | March 2019

Condado Reinsurance Company, I.I., a Segregated Asset Plan ("SAP") Manager based in Puerto Rico, was formed in December of 2017 pursuant to the International Reinsurance Law 61 to manage SAPs for clients of Clear Blue Insurance Group. In 2019 it is offering its services to companies and individuals independent of the Clear Blue relationship who desire to assume risk as a reinsurer.

SAPs operate similarly to Segregated Cells, in that they establish legally segregated asset plans (cells) or underwriting accounts that act as reinsurers of insurance risk, ensuring that assets in one underwriting account may not be used to satisfy liabilities in another underwriting account, nor the general (non-SAP) liabilities of the Reinsurer. Non-SAP assets are not available to satisfy SAP liabilities.

Condado Re was initially established by Clear Blue's Management to provide SAP services to Clear Blue clients. Clear Blue is a leading specialty provider of property and casualty insurance; operating in the Program Insurance niche market across the mainland United States. Clear Blue leverages its "A-" (Excellent) Size VIII A.M. Best rating, expansive licenses and reputation to provide access to the U.S. property and casualty insurance market through its three US domiciled Carriers: Clear Blue Insurance Company (IL), Clear Blue Specialty Insurance Company (NC) and Rock Ridge Insurance Company (IN). In the industry, this is commonly referred to as "fronting." Clear Blue writes a wide variety of insurance products, including general liability insurance, commercial liability insurance, commercial multi-peril insurance, property insurance and other niche insurance lines. The Clear Blue Carriers had $470 million of GWP in 2018. The Clear Blue Insurance Companies do not retain insurance risk, rather it cedes 100% of the gross written premium to the largest and highest rated Reinsurers globally.

Its Managing General Agency (MGA) clients provide the underwriting and distribution of the niche insurance products. Clear Blue provides the program management services to the Reinsurers.

diligently as it would if Clear Blue retained the risk itself. It is these services that substantially separates Clear Blue from its competitors. As Clear Blue's business evolved, it discovered its MGA clients either wished to or were required by Clear Blue's Reinsurers to take a small portion of the insurance risk as a Reinsurer itself. Because of the program management services provided by Clear Blue, logically, it made sense for Clear Blue to be involved with the management of the risk retained by the MGA client.

Clear Blue's Management has a long history of niche program management, thus ensuring for the Reinsurers that the insurance risk ceded to them is managed as carefully and

Thus, Condado Re was formed. Condado Re is licensed to underwrite non-catastrophe property and all casualty lines except workers compensation. Clear Blue's Management chose to domicile Condado Re in Puerto Rico due to the tax advantages provided in the Puerto Rican code and the fact that Puerto Rico is a National Association of Insurance Commissioners (NAIC) jurisdiction. In other words, Puerto Rico can match the low tax environment of other world-wide jurisdictions while subject to the US Regulatory regime, thus, Puerto Rico has become a significant competitive domicile in which to conduct segregated cell business for US-based insurance risks.

Condado Re currently operates three SAPs. Each is attached to a Clear Blue program underwritten by a Clear Blue MGA client. As stated, assets in each of these SAPs cannot be used to pay the liabilities of the others, nor can the assets of these SAPs be used to pay the liabilities of the General Reinsurer, Condado Re, I.I. As the name suggests, each of these separate insurance risks are completely segregated from the other.

Clear Blue Insurance Services Puerto Rico (CBISPR), the insurance services company within the Clear Blue Insurance Group that provides operating services to the three Clear Blue Carriers, also provides operating services to Condado Re and the Condado Re SAPs. CBISPR and Condado Re have the same Management Team. Management has made the strategic decision to create a business line within CBISPR dedicated to providing SAP services to clients outside of the Clear Blue Insurance Group.

Companies and Individuals that have or want to take niche insurance risk in a low-tax NAIC environment should contact us directly at the information provided below. Additionally, CBISPR is recruiting additional staff to assist in providing these services. Interested individuals should also use the contact information below.

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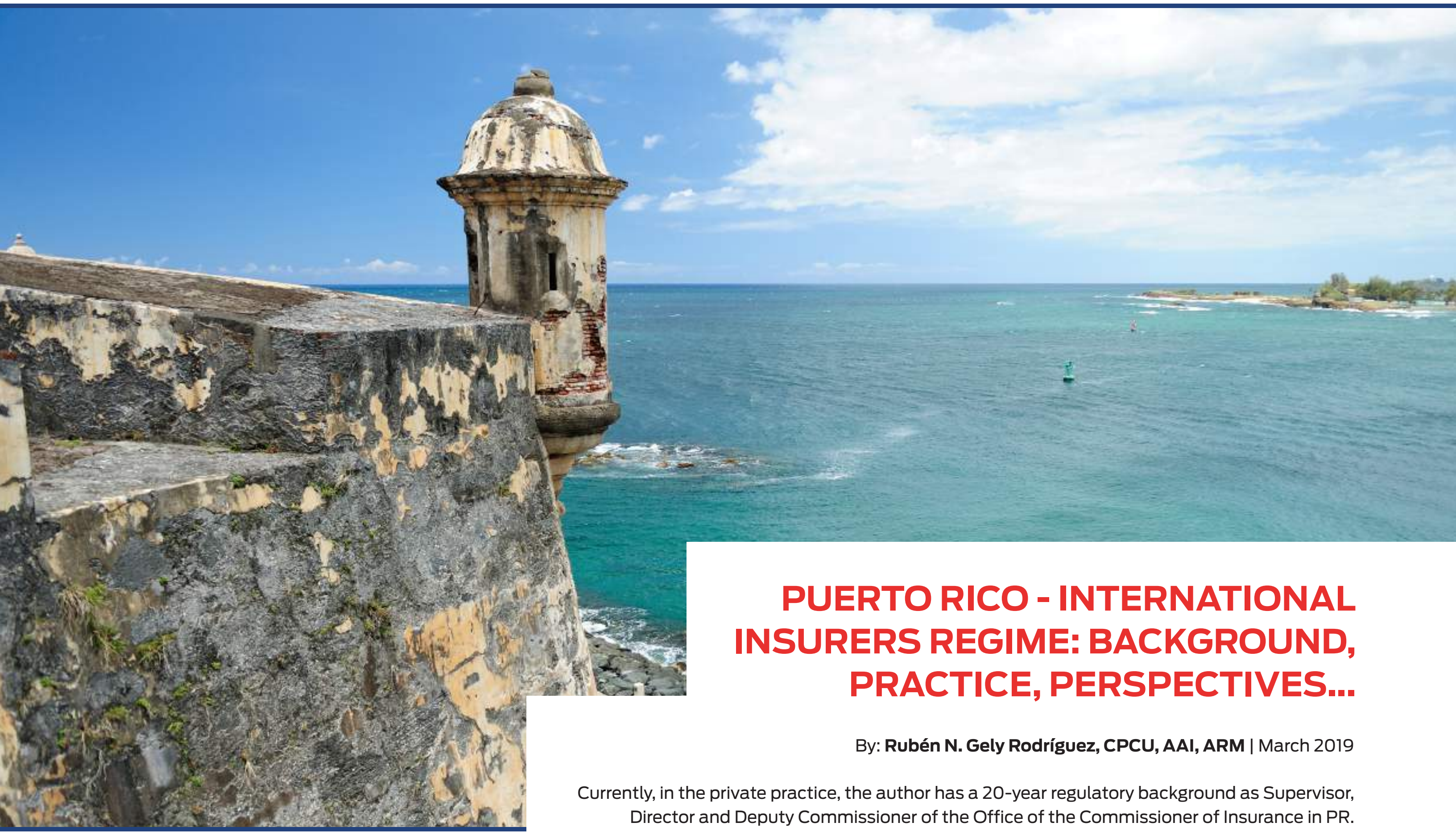


# PUERTO RICO - INTERNATIONAL INSURERS REGIME: BACKGROUND, PRACTICE, PERSPECTIVES...

By: **Rubén N. Gely Rodríguez, CPCU, AAI, ARM** | March 2019

Currently, in the private practice, the author has a 20-year regulatory background as Supervisor, Director and Deputy Commissioner of the Office of the Commissioner of Insurance in PR.

Starting in 2004 and developing throughout the years, Puerto Rico established a world class international insurer regime, yet to be discovered by many. The International Insurers and Reinsurers Act of Puerto Rico, aka Act 399 or the International Insurance Center (IIC), set the "smallest of the largest Caribbean Islands", as a need-to-know site for those deciding the domicile for an international insurance market platform.

## BACKGROUND

The IIC Regime is a derivate of a recognized domestic market regulator, The Office of the Commissioner of Insurance of Puerto Rico (OCI-PR) looking offshore, with the goal of contributing to the island's economy from the financial services sector. A previous success story of a similar legislation, applicable to international banking, fueled the initiative.
PR domestic insurance practices mirrors US insurance standards in most respects. It is supplemented by years of local court decisions in areas such as corporate governance, consumer protection, and insolvency. PR domestic market is the fourth market in Latin America as measured by written premium, yet the first in a per capita basis.

From this experienced regulator and regulated market, an international insurance regime was created, putting together successful ideas implemented throughout the world. The IIC regime provides for Captives, Association Captives, Property & Casualty platforms, Life & Health platforms, Insurance Linked Security programs, Segregated Asset Plans and Holding Companies.

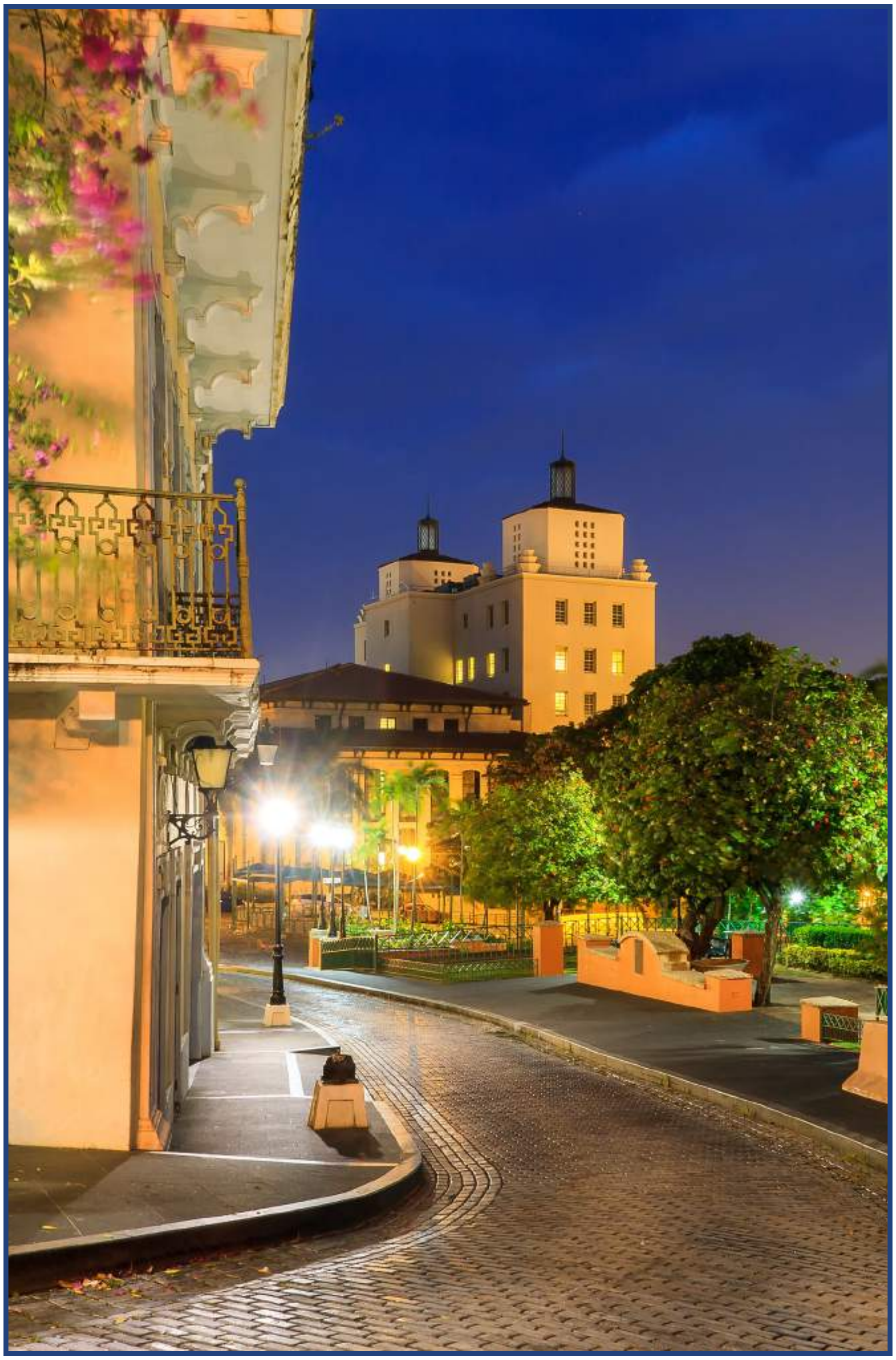
In 2011, OCI-PR added substantial value to itself and to its licensees, by becoming a National Association of Insurance Commissioners (NAIC) accredited jurisdiction. This moved the domicile to the highest standard in the hemisphere. In terms of regulatory recognition, this is a definitory criteria for sensitive plans of operation, such as Captives.

It also represented a crucial differentiation feature with respect to other outshore jurisdictions. With the US jurisdiction status subject to a separate tax system, PR is in a dimension by itself, out of the common comparative matrix analysis of jurisdictions.

## PRACTICE

The entrance to the IIC regime is expedited by statute, yet not pro forma by any means. The OCI-PR requires a full application where the plan of operation, credentials of owners and organizers, economic substance/feasibility, management agreement, and providers relationship are revised. Since the beginning, the regime wisely inserted capital requirements above most jurisdictions, both in the manner of initial, and of ongoing basis requirements.

Ongoing compliance includes audit statement /actuarial certification of reserves and observance of financial ratios of solvency and liquidity. L & H platforms solvency ratio is determined by the business plan on record. Compliance is reviewed, at least on a yearly basis, in the renewal exercise. Full compliance examinations are conducted within a 5-year cycle. Corporate transactions, such as amendment to the business plans, mergers and change in ownership, among others, must be reported and approved by the OCI-PR. A resident principal representative has legal duties of representation and reporting to the OCI-PR on compliance or insolvency issues.



The international insurer in PR is entitled to a tax decree or contract with the Government of Puerto Rico, issued by the OCI-PR and the Puerto Rico Department of Economic Development and Commerce.

The main purpose of the document is to secure the tax treatment for a renewable 15-year period. Said document will include conditions negotiated with the decree holder.

The conditions, flexible and according to the insurer's business plan, have the purpose to guide and motivate the economic contribution of the entity to Puerto Rico's economy.

After 14 years of duty, the International Insurers and Reinsurers Division of the OCI-PR in charge of the regime, has developed considerable insight into international insurance plans of operation. The Division has also sharpened focus in areas of compliance interest.

A timely filing of an annual statement is one of those focus areas, as it is the support for a recommendation of renewal. Another area of interest is the adherence of the licensee to prudent insurance management practice.

Following the success of the IIC regime as a Segregated Asset Plan domicile, the regulator has been exposed to a diversity of applications of this model. The OCI-PR maintains a detailed registration of P & C Segregated Asset Plans on an individual basis. The regulator is empowered to insert special conditions for authorization on a case by case basis. Furthermore, the regulator is empowered to establish authorization categories, upon compliance of tailored made conditions for specific markets.

This offers an opportunity for market innovators in their goal of official recognition.

## PERSPECTIVE

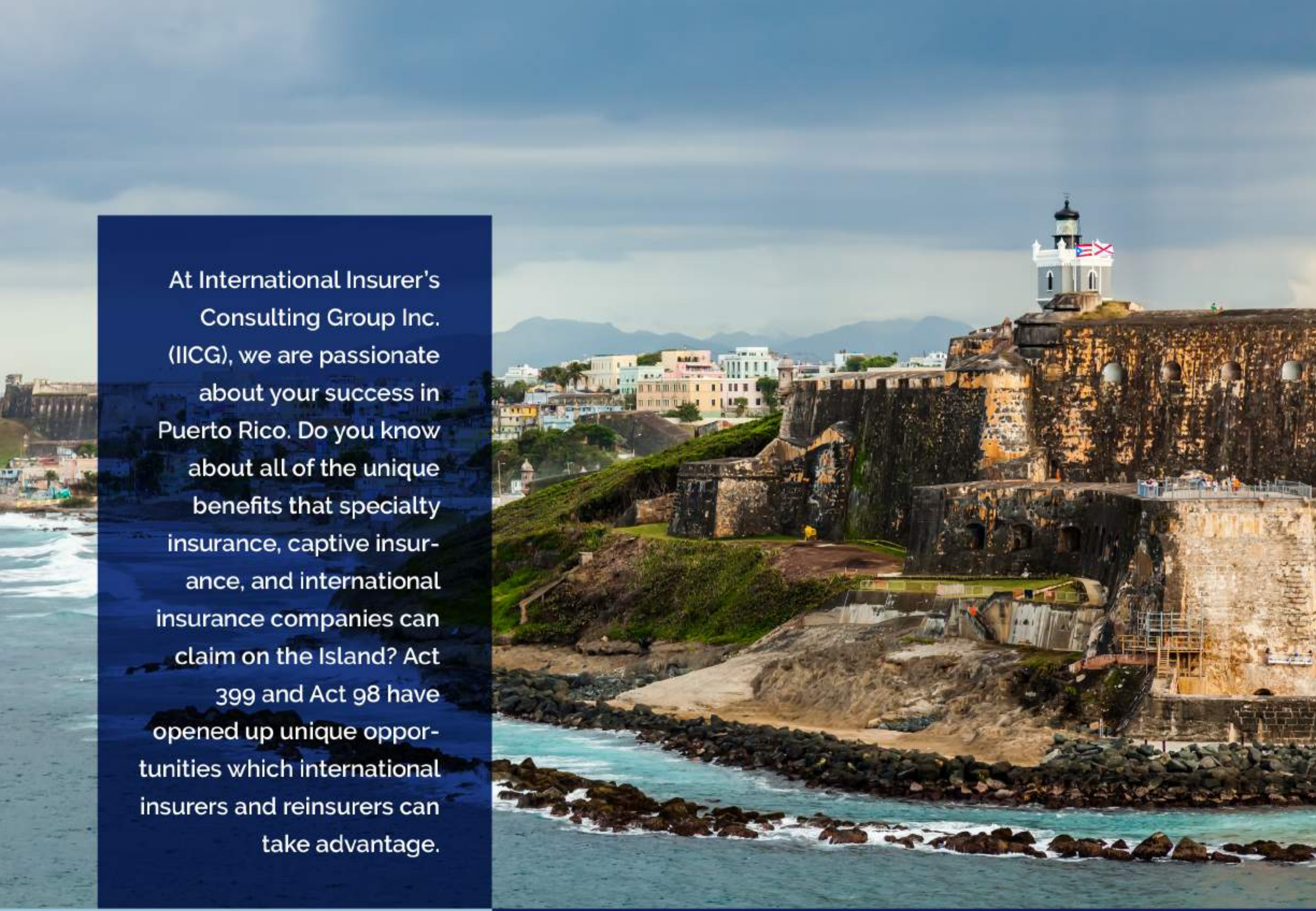
Moving forward, IIC regime users should expect a regulator in close monitoring of the compliance with the business plan filed. The regulator will of course enforce solvency status, at the entity, and at the Segregated Asset Plan levels. To keep itself at the pace of the market, the OCI-PR should monitor and implement best regulatory practices. With the tax decree conditions mentioned before as the support, the OCI-PR should be focusing in securing the economic contribution of the sector.

This could take several fashions, one of them being the utilization of domestic resources, as available. The availability of a local provider, already established in the accounting, legal and banking side, will be increasing as insurance providers will be attracted by other incentives programs.

Puerto Rico's IIC is a natural niche market site. Accordingly, its development will primarily be a function of the site awareness among qualified users and bona fide promoters.

Without excluding other emerging opportunities, we see the IIC most probable developments as a hub for LATAM reinsurance, US reinsurance for L & H legacy business, private placements life insurance platforms, and specialty market platforms.

For additional information feel free to contact Mr. Rubén A. Gely at (787) 308-6297 or email your inquiry to: r.gely@iicgpr.com



# REINVENTING THE CAPTIVE WITH A PUERTO RICO PRIVATE INSURANCE COMPANY

By: **David Kirkup, COO/CFO** | March 2019

David Kirkup is the COO/CFO for Captive Alternatives is a risk management and insurance consulting firm that helps business owners develop effective risk management programs.

CapAlt's pioneering business model, the Private Insurance Company, enables businesses and organizations to self-insure business risks, and participate in the underwriting profit arising from effective risk management. As a result, CapAlt clients build wealth to help protect and assure their corporate future. CapAlt manages the operations of more than 175 Private Insurance Companies from their offices in Puerto Rico and Atlanta.

## PUERTO RICO: THE "IDEAL DOMICILE"

Captive Alternatives has experience working in many insurance domiciles, both US-based and international. However, after vetting Puerto Rico as an international insurance destination in 2015, it quickly became our "domicile of choice".

Puerto Rico is a US territory with more than 3.5 million US citizen residents, an ideal geographic location, and a bilingual business culture. What sets Puerto Rico apart as a domicile is the abundance of oversight and regulation from both the US and Puerto Rican governments. In addition to internationally-recognized insurance sanctioning bodies, Puerto Rico is subject to US federal laws and the FDIC. The Office of the Commissioner of Insurance of Puerto Rico (OCI) is an accredited member of the National Association of Insurance Commissioners (NAIC).

In 2005, the Office of the Commissioner of Insurance of Puerto Rico established the International Insurance Center in order to create a competitive environment for international insurance companies and reinsurers domiciled on the island. Based on best-in-class practices from the world's most effective captive regulations, the IIC has propelled Puerto Rico to prominence as an important member of the international insurance arena, created jobs, and brought new capital and investment to the island.

As part of the creation of the IIC, Puerto Rico has established a unique tax code in order to encourage its growth as a captive and reinsurance domicile. Puerto Rico's tax incentives under Act 399 add to the attraction for captive owners. Puerto Rico would not be able to maintain its position as a leading captive domicile without a high level of due diligence required of captive managers, prospective captive owners, and their advisors.

Puerto Rico is also one of the only domiciles that requires every participant of a Protected Cell company - not just the core owners - to maintain a 3:1 surplus to premium ratio. This requirement, stringent to some, is a core feature that demonstrates the OCI's approach to strong, fair and transparent regulation.

Although Puerto Rico suffered immense damage from Hurricane Maria in late 2017, the island has not stood still. New and refurbished hotels are opening monthly, and visitor numbers are increasing. Billions of dollars in federal help and new investment are flowing in, helping Puerto Rico upgrade vital infrastructure and make the island far more sustainable in the future.

Confident in having found the foremost domicile, CapAlt moved all existing captives to

Puerto Rico in 2015 and has been using the domicile exclusively since.

## THE PRIVATE INSURANCE COMPANY

Captive Alternatives has operated a true insurance model since its inception in 2000 and Puerto Rico has proven to be a sophisticated international insurance destination for our pioneering Private Insurance Company model.

The Private Insurance Company operates under a segregated asset plan structure enabling the quick creation of legally separate cells. This structure allows CapAlt to offer clients a fully compliant Private Insurance Structure that compares very favorably with the 831(b) model, while avoiding most of the concerns and problems of that tax election.

The Private Insurance Company now makes comprehensive enterprise risk management accessible to those outside the Fortune 500 list. CapAlt's Private Insurance structure helps business owners identify and fund "hidden" risks that can compromise or even bring down their business, as well as taking on high deductible insurance from their commercial coverages.

Captive Alternative's comprehensive approach to risk analysis and assessment uncovers these hidden risks and finds innovative, cost-effective ways to protect against them. Working with CapAlt can help business owners end their unintended self-insurance and help assure business continuity.

## SAFE HARBOR COMPLIANT STRUCTURE IS PARAMOUNT

Just as with traditional commercial insurance, premiums are determined by underwriting and actuarial analysis based on industry and company specific data, as well as certain algorithms and metrics. This ensures that insurance premiums are deductible to the business corporation. A reinsurer, Madison Re, I.I. (MadRe), then assumes risk from more than 170 individual insured businesses, and then reinsures this risk to the Private Insurance Companies it controls. MadRe operates a Funds Withheld Risk Reserve (FWRR) in order to provide each Private Insurance Company with at least 50 percent unrelated risk, which is a requirement of the Risk Sharing/ Risk Distribution Safe Harbor Rules.

## NEW INITIATIVES

**Commercial Coverages** - Most smaller captive insurance companies have difficulty covering the more commercial risks of a business. This is because large insurance companies have little interest in issuing admitted policies and then ceding their profits to a captive. In an industry first, CapAlt has partnered with International Re, a London MGA, to provide a comprehensive and simple way for SME companies to re-insure their

commercial coverages such as WC, AL, GL and Property into a Private Insurance Company. This new initiative will be of interest to mid-size insurance agencies who can create a controlled Private Insurance portfolio to help stabilize their client base and increase retention.

**831(b) Problems** – The IRS approach to regulation of 831(b) captives has been uncompromising, treating all 831(b)s as bad captives irrespective of the facts. Industry tax experts see little possibility that the audit treatment of 831(b) captives will improve any time soon. CapAlt has pro-actively developed a simple process for owners to close their 831(b) with a tax-free transfer mechanism, and then move forward with a more robust Private Insurance company model for the future.

## CONCLUSION

US-domiciled captives face uncertainty from several sources. These include unresolved issues related to the PATH Act and its changes to 831(b), ongoing activity in the US Tax Court targeting 831(b) captives, evolving definitions of risk distribution and pooled reinsurance, to name a few. On the other hand, traditional offshore domiciles like Bermuda and Cayman are facing new issues with a raft of alternative minimum taxes like GILTI, PFIC, BEAT and more, black and grey lists targeting money laundering, and increased regulatory requirements emanating from the EU.

With the level of legislative, judicial and regulatory uncertainty captives are currently facing in the US, many business owners will find Puerto Rico to be an increasingly attractive option and the Private Insurance Company to be the ideal risk management vehicle.


***Ryan Has the Answers.***

As Captive Insurance Companies become more commonplace, regulation and scrutiny are likely to increase and become more sophisticated.

In such an environment, experience is essential.

Leveraging nearly three decades of experience, Ryan helps clients navigate the regulatory, tax, and enterprise risk management complexities of Captive structuring to meet their alternative risk management needs.

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**Serving Puerto Rico for over 4 decades**


# Solutions

**for our thousands of clients, as our response to their claims**

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