



# BERMUDA CAPTIVE 101

Captives, Regulation, Tax

APRIL 2015

# Today's speakers



**Mark Allitt**  
Director  
KPMG Advisory Limited



**Joe DaSilveira**  
Senior Vice President  
Liberty Mutual Management  
(Bermuda) Ltd.



**Leslie Robinson**  
Assistant Director, Corporate  
Authorisations  
Bermuda Monetary Authority



**Oceana Yates**  
Vice President, Captives  
R&Q Quest Management  
Services Limited





# Captive 101

- What is a captive insurance company?
- Structure of a captive insurance company
- Key reasons to set up a captive/how it works
- Understanding insurability
- When to set up a captive

# What is a captive insurance company?

## *Definition and key features*

**A captive insurance company is an insurance company whose primary purpose is the financing of the risks of its owners:**

- Insurance cover is only available to the parent and affiliates of the captive
- Its owners/participants are usually not insurance companies
- It is a licensed insurance company and operates under a different regulatory system than commercial insurers
- Insureds generally require less policyholder protection than the general public



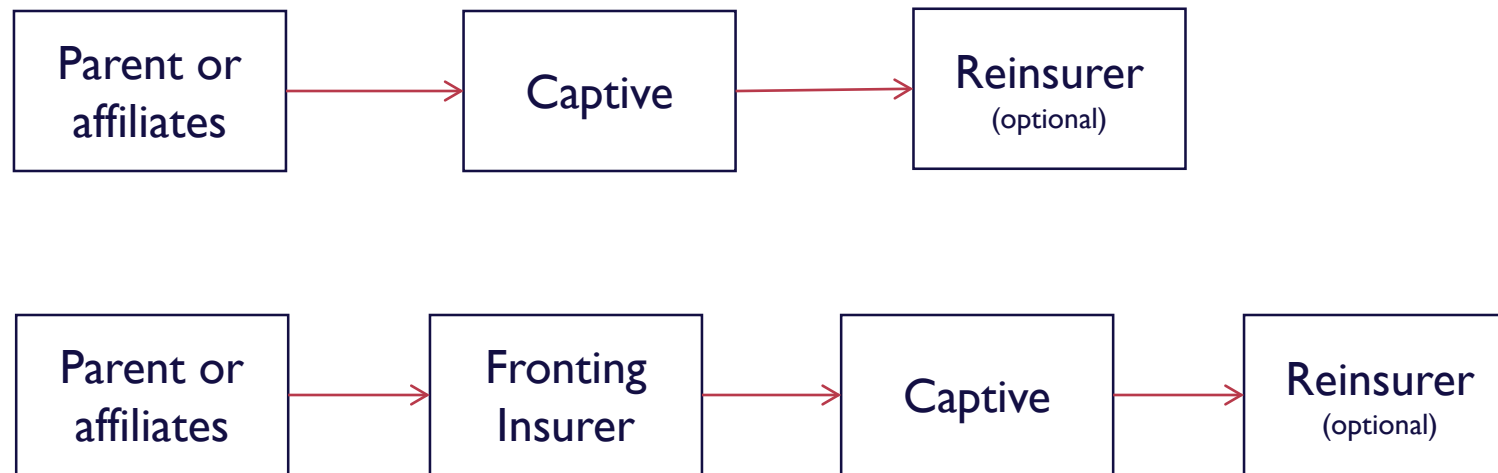


# Structure of a captive insurance company

## *Common captive structures*

### Single-parent captive

- Owned by one parent and insures the risks of its parent or affiliates only (i.e. related business)

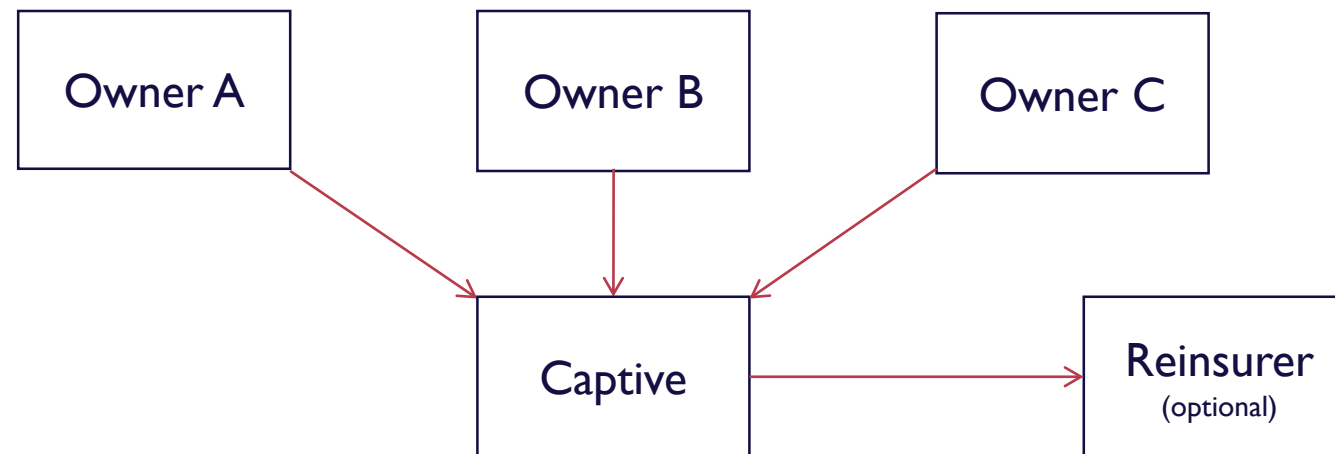


# Structure of a captive insurance company

## *Common captive structures*

### **Multi-owner/group captive**

- Owned by multiple parents and insures the risks of all owners. Owners are typically companies operating in the same industry or trade association and want insurance cover for the same type of risks

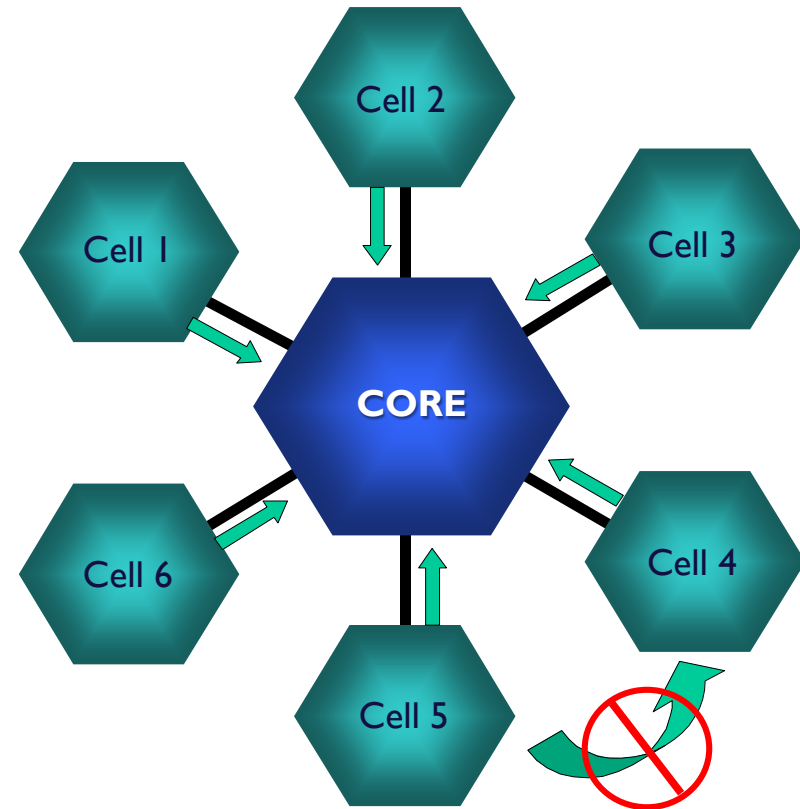


# Structure of a captive insurance company

## *Common captive structures*

### **Segregated account company**

- Each cell insures the risks of its owner and the owner invests assets that are segregated from other cells
- The core does not transact any insurance business but handles the admin functions
- There is no risk-sharing between the cells



# Key reasons for a captive





# Key reasons for a captive

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## COST REDUCTION

- Reduces overall costs of the parent's insurance/risk management programme
- Any underwriting gains and investment income are retained by the parent
- Parent benefits from its own loss experience: does not pay a premium based on industry-wide losses or perceptions



# Key reasons for a captive

## 2

### COVERAGE: ACCESS TO REINSURANCE

- The parent can tailor the insurance policies for its specific needs and risks, providing greater flexibility and control
- Established to provide access to the reinsurance market
- Access to preferential pricing from reinsurance market
- Potential to earn ceding commission from reinsurers



# Key reasons for a captive

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**CASHFLOW:  
INVESTMENT  
INCOME**

## **Investment income is retained by the parent**

- Benefit from the lag between paying premiums and payout of losses, earn investment income and possibly reduce or deferred tax



# Key reasons for a captive

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**CONTROL:  
ADMINISTRATIVE  
TOOL**

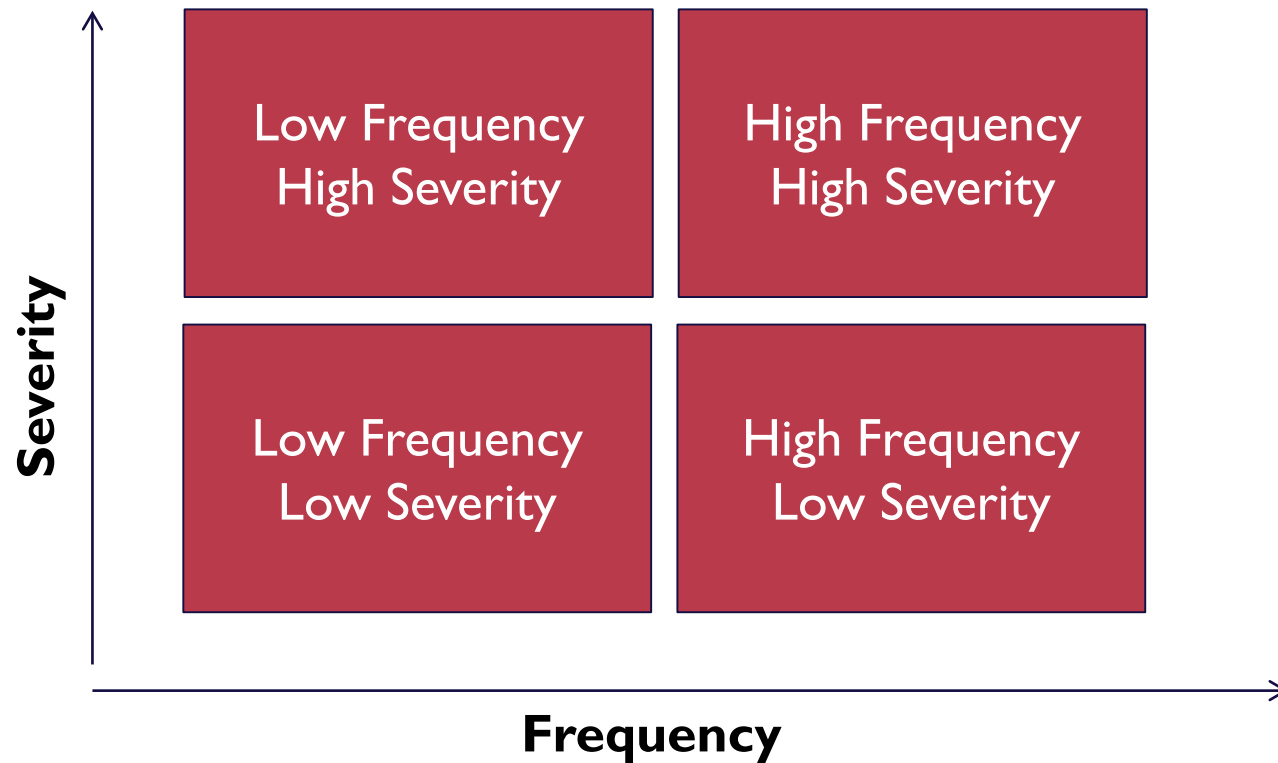
- The parent can tailor the insurance policies for its specific needs and risks, providing greater flexibility and control
- Can help bring a focus to losses and loss prevention within the parent's overall culture
- Successful captives become an integral part of the Enterprise Risk Management programme



# Understanding insurability

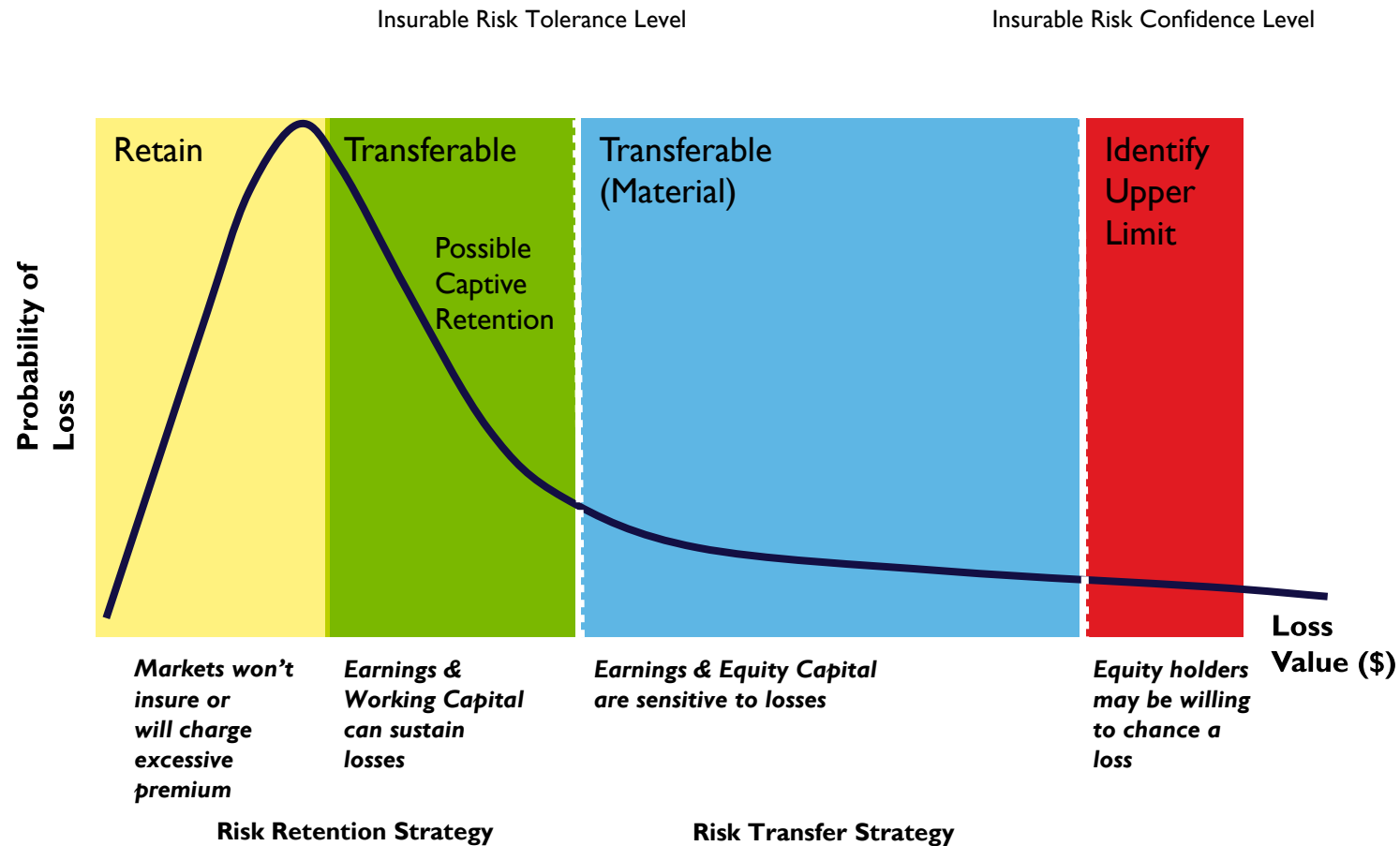
## *Frequency and severity*

**Risks usually fall into one of the following categories:**



# Understanding insurability

## *Risk transfer and financing*





# When to set up a captive insurance company

## *When does a captive make sense?*

- Insurance programmes are significant premium size
- The company has high deductible limits
- Good loss experience and degree of loss-control capability
- Significant lag between loss occurrence and settlement
- The company has risks outside of Canada
- Desire for greater flexibility in programme design
- Anticipates hard market or currently experiencing hard market
- Desire to obtain coverage for non-traditional exposures for which commercial insurance is expensive/not available





# Captive Regulation

- Overview of the Bermuda Monetary Authority (BMA or Authority)
- Captive legislation
- Captive regulation
- Licensing service standards
- Statistics
- International information exchange

# Bermuda Monetary Authority overview

- The Bermuda Monetary Authority is the integrated regulator of the financial services sector in Bermuda
- Established in 1969 by an Act of Parliament
- Functions independently from Government, but often advises the Ministry of Finance in matters pertaining to financial services



# Bermuda's captive legislation

- Companies Act 1981
- Insurance Act 1978
- Insurance Accounts Regulations 1980
- Insurance Returns and Solvency Regulations 1980
- Segregated Accounts Companies Act 2000
- Guidance Notes
- Code of Conduct
- Also see: [www.bermudalaws.bm](http://www.bermudalaws.bm)



# Insurer class structure

- General Business Insurers
  - Class 1, 2, 3 – Captive Classes
  - Class 3A, 3B, 4 – Commercial Classes
- Long-Term Business Insurers (annuity, life, some accident & health)
  - Class A, B – Captive Classes
  - Class C, D, E – Commercial Classes
- SPIs (insurer fully funds liabilities through a debt issuance or some other approved financing mechanism)



# Minimum solvency margins

## *General business*

Class of Insurer	<b>CLASS 1</b> 100% Related	<b>CLASS 2</b> <20% Unrelated or Multi-owned	<b>CLASS 3</b> 20% to <50% Unrelated
Minimum Solvency Tests: The Greater of:			
a) Minimum Statutory Capital & Surplus	\$120,000	\$250,000	\$1 million
b) Premium Test: First \$6 million of Net Premium Written	20%	20%	20%
Net Premiums Written in excess of \$6 million	10%	10%	15%
c) Loss Reserve Test: Loss and Loss Expense Reserve	10%	10%	15%





# Minimum solvency margins

## *Long-term business*

Class of Insurer	<b>CLASS A</b> 100% Related	<b>CLASS B</b> <20% Unrelated or Multi-owned
Minimum Solvency Tests: The Greater of:		
a) Minimum Statutory Capital & Surplus	\$120,000	\$250,000
b) Asset Test: Total Assets	0.5%	1.5%



# Bermuda captive regulation

- Captive vs. Commercial
- Risk-Based Approach
- Role of Principal Representative and Insurance Manager
- Pragmatic approach to regulation
- Practical, business-savvy approach
  - Creative
  - Responsive to business needs



# Licensing process – service standards

- Application to incorporate company:
  - Can have same day response
- Application for insurance license:
  - Can be done simultaneously with incorporation.
  - Completed applications received by 5 p.m. Monday, are reviewed and responded to by 5 p.m. Friday

## **Final registration and issuance of license:**

- Upon approval of application and receipt of all registration documentation, issuance of license can take up to three business days



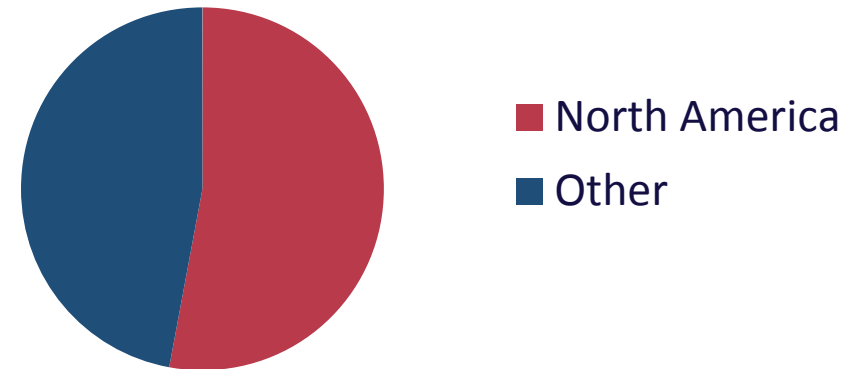
# Bermuda captives: By the numbers

- 800 active captives as of 31st December 2014

- New captive registrations in 2014:

Class 1	Class 2	Class 3	Class A
6	7	3	1

## 2014 captive registrations by region



# International information exchange

- BMA has 25 Memoranda of Understanding (MOU) in place with other jurisdictions / organisations
- The BMA signed an MOU with the Office of the Superintendent of Financial Institutions (OSFI) in August 2008, formalising a basis for consultation and cooperation between the BMA and OSFI
- Bermuda has a total of 41 Tax Information Exchange Agreements (TIEAs). TIEA regulation is not within the remit of the BMA, however, the BMA provides information to Government on request





# Tax

- Overview of key considerations of a tax effective offshore captive



# Overview of key considerations of a tax effective offshore captive

## Key requirements from a tax perspective:

- Deductibility of premiums by foreign operating companies without (significant) taxation on income inclusion to captive
- Effective use of Canada's extensive network of tax treaties and TIEAs
  - *TIEAs have opened the door to more jurisdictions, including Bermuda (effective since July 1, 2011)*
- Repatriation of profits from captive without tax
- Ongoing monitoring of various maintenance and tax technical requirements

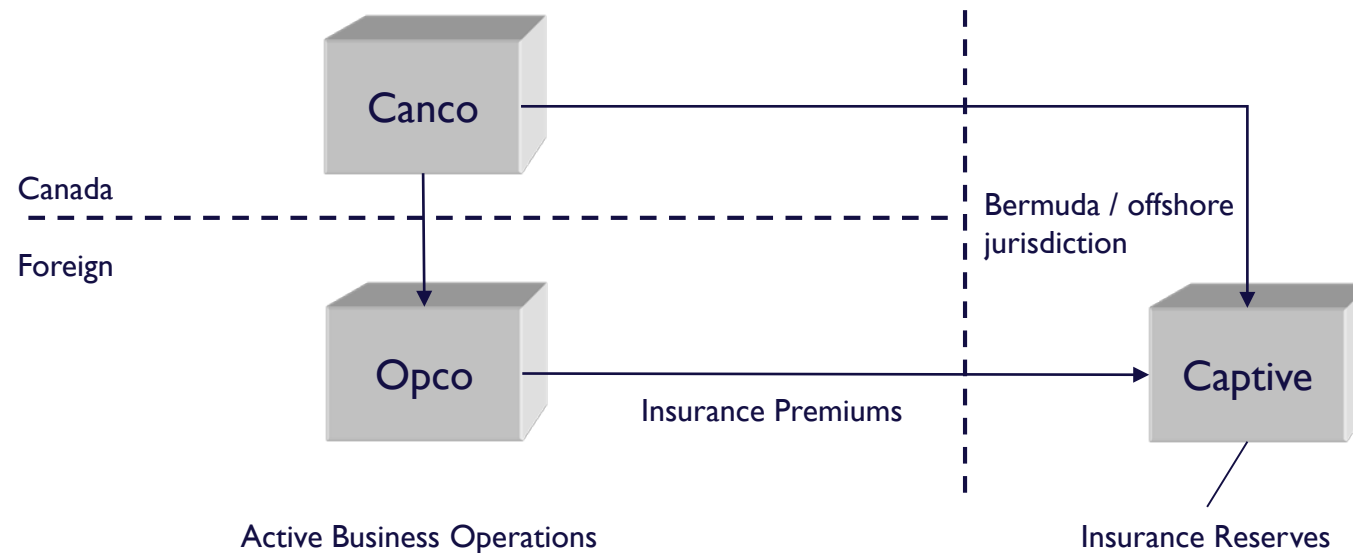


# Overview of key considerations of a tax effective offshore captive

## Benefits of insuring the risk into a captive:

### Tax

- Deductibility of premiums by offshore operating companies without (significant) taxation on (i) income inclusion to captive; or (ii) repatriation of captive profits to Canada



# Principal Canadian income tax considerations

- **Location of central management and control (i.e., mind and management)**
- **Characterization of income earned by captive**
- **Repatriation of profits via dividends from captive**



# Principal Canadian income tax considerations

## **Tax is based on ownership of the captive:**

- Controlled foreign affiliate ( 50% or more Canadian owned)
- Non Controlled foreign affiliate (less than 50%, but more than 10% Canadian owned)
- Portfolio interest (less than 10% Canadian ownership)

## **A Canadian owned captive can earn 3 types of income:**

- FAPI (Foreign Accrual Property Income) which is taxed in Canada as it is earned. This will most likely apply to Canadian risks insured into the captive
- Taxable surplus – Repatriated funds are taxed in Canada when paid as a dividend
- Exempt surplus – Not subject to any Canadian taxation



# Insuring foreign risk into your captive

## Principal Canadian Tax Considerations:

### ▪ **Insurance Premiums: (95(2)(a)(ii)(B))**

- Premiums paid by Opco to Captive deemed to be active business income, provided:
  - Canco has a “qualifying interest” in BOTH Captive and Opco throughout the year, and
  - The premiums are deductible in computing Opco’s (non-Cdn) active business earnings
- If the above requirements are met the profits of Captive should be considered exempt surplus provided that BOTH Captive and Opco are residents of a “designated treaty country”

### ▪ **Investment Income Earned on Insurance Reserves**

- Investment income earned by Captive on insurance reserves likely considered active business income to the extent that assets are required for the insurance business

### ▪ **Repatriation of Profits from Captive**

- Dividends paid by Captive to Canco are received free of Canadian tax to extent that they are considered to be paid out of Captive’s exempt surplus pool



# Insuring foreign risk into your captive

## **Principal Foreign Tax Considerations**

- **Deductibility of premiums by Opco**
- **Jurisdiction selection**
- **Offshore costs**



# Insuring Canadian risk into your captive

## **Principal Canadian Tax Considerations:**

- **Immediate premium deduction in Canada subject to certain limitations**
  - Watch prepaid expense disallowance
  - Transfer pricing considerations
  - Sufficient risk transfer and distribution (i.e., true shifting of risk)
- **FAPI rules will generally be applicable**
  - FAPI is on net profit, after deducting certain reserves
- **Time value of deferral due to claiming of reserves**
  - Costs include: potential premium tax, excise tax, fronting fees, annual running costs



Email [rsvp@bda.bm](mailto:rsvp@bda.bm) for more information



**Tuesday, May 5, 2015**

8:30 am – 11:30 am

Trump International Tower & Hotel  
325 Bay Street



**Wednesday, May 6, 2015**

8:30 am – 11:30 am

The Bow, 54<sup>th</sup> Floor  
500 Centre Street SE



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# QUESTIONS?



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Email: [info@bda.bm](mailto:info@bda.bm)

Post questions in webinar chat

