

A COUNTRY'S CAPTIVE CORNERSTONE

Kenneth Kotch of Ryan, LLC, discusses their support for Puerto Rico as its captive insurance “domicile of choice”

Ryan’s captive insurance division provides all of the administrative and operational support required to create and manage a bona-fide captive insurance company. Ryan is authorised to manage captive insurance companies in multiple jurisdictions. Kenneth Kotch has been duly authorised to interact with the Puerto Rico International Insurance Centre on behalf of our clientele since August, 2009, in accordance with the procedures of the Office of the Commissioner of Insurance of Puerto Rico.

The client perspective: why participate in a captive insurance programme?

Creating a captive insurance company has become a popular way for middle market 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.

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. It 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. Specialised management expertise and a credible arm’s-length underwriting process are essential to provide the proper risk analysis and distribution. Structured properly, captives electing code can become valuable profit centres, providing



Kenneth Kotch

Kenneth Kotch is a principal within Ryan, LLC (Ryan) and the national practice leader for Ryan’s captive insurance division. Ryan was founded in 1991 and currently employs more than 2,100 professionals worldwide. Ryan’s global practice includes expertise in every major area of state, local, federal, and international taxation. We maintain the largest indirect and property tax practices in North America and the seventh largest corporate tax practice in the United States.

cost-effective coverage while earning dollars that would have otherwise been paid to a commercial carrier.

Ryan’s relationship with Puerto Rico as a captive insurance domicile

On 9 July, 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.

Advantages of Puerto Rico as a captive domicile for Ryan captive insurance clients

Ryan’s captive insurance division limits its domiciliation of captive facilities to US jurisdictions. This, of course, includes the US territory of Puerto Rico. As an organisation, there

are certain characteristics that we view as essential with respect to our relationship with a regulatory regime:

- A thorough understanding of the underlying regulatory and legal elements that 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 turnaround and efficient application process.

As a United States commonwealth, Puerto Rico’s free market economy is subject to both US 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 US federal and state constitutions, with legal redress venues in US 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 licence classification, which allows for administration of “protected cells” among other captive management options. The flexibility of a regulatory-driven protected cell regime presents a very powerful planning opportunity for many of our clients.



San Juan Puerto Rico Convention Center

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.

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's) long history of regulatory expertise are further enticements for Puerto Rico to be considered 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 US territory to be accredited by the Naic and offers the following benefits to its corporate citizens:

- Puerto Rico is part of US free trade zones and customs system
- Puerto Rico's banking system is regulated under US laws (FDIC)
- Puerto Rico is under the protection of the Homeland Security Act

- Puerto Rico is under the US legal framework and intellectual property protection
- Access to federal programmes and funds

Tax 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 \$1.2m 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.

The elephant in the room

It is no secret that Puerto Rico has been struggling with its mounting debt burden, which can cause anxieties among the captive insurance community. Although this is a development which should not be dismissed, Puerto Rico's Department of Insurance, and more specifically, its International Insurance Centre, which regulates our Puerto Rico domiciled captive insurance companies, continues to provide stable, reliable, and high-quality regulatory oversight. In fact, the International Insurance Centre is widely viewed as an important contributor to Puerto Rico's ongoing economic recovery.

New legislative initiatives, such as the Puerto Rico Oversight, Management, and Economic Stability Act (Promesa Act) are designed to provide the commonwealth resources to address its current economic crisis. Fortunately, such initiatives have preserved the opportunity for Puerto Rico to continue to offer favourable economic incentives for insurers, and ensure stable, reliable, and equitable insurance regulation. ☺

“Ryan’s captive insurance division limits its domiciliation of captive facilities to US jurisdictions”