

# *Captive Insurance* 6<sup>th</sup> annual update seminar

16 December, 2013

# *Opening Remarks*

David Gibbons, PwC

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# ***Agenda***

- 2:00-2:45pm\_\_\_\_\_Market Update  
(including ILS, Canadian & Latin American Update)
- 2:45-3:30pm\_\_\_\_\_Accounting & Regulatory update
- 3:30-3:45pm\_\_\_\_\_Break**
- 3:45-4:10pm\_\_\_\_\_FATCA update
- 4:10-4:30pm\_\_\_\_\_Tax update
- 4:30-4:50pm\_\_\_\_\_AIMS update
- 4:50-5:00pm\_\_\_\_\_Questions
- 5:00-6:00pm\_\_\_\_\_Cocktail reception**

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# *Market Update*

Moderator: David Gibbons, PwC

Panel: Leslie Robinson, BMA  
Stephen Lund, BDA  
Eduardo Fox, Appleby  
Arthur Wightman, PwC  
Colm Homan, PwC

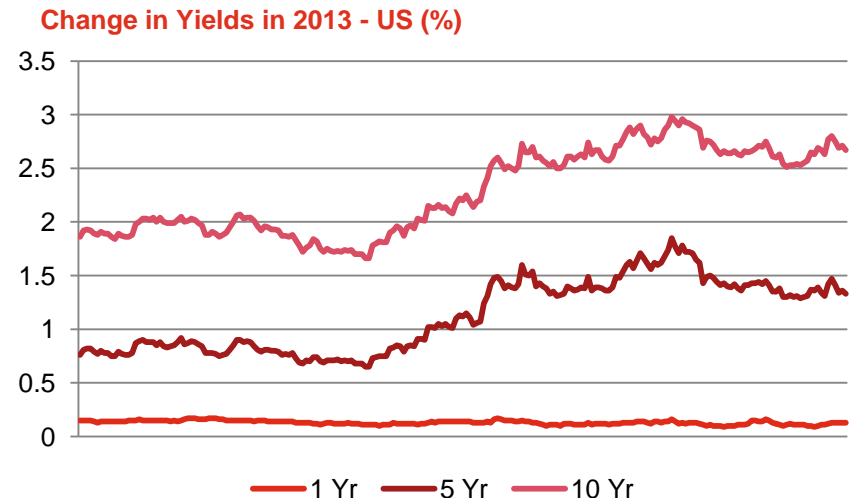
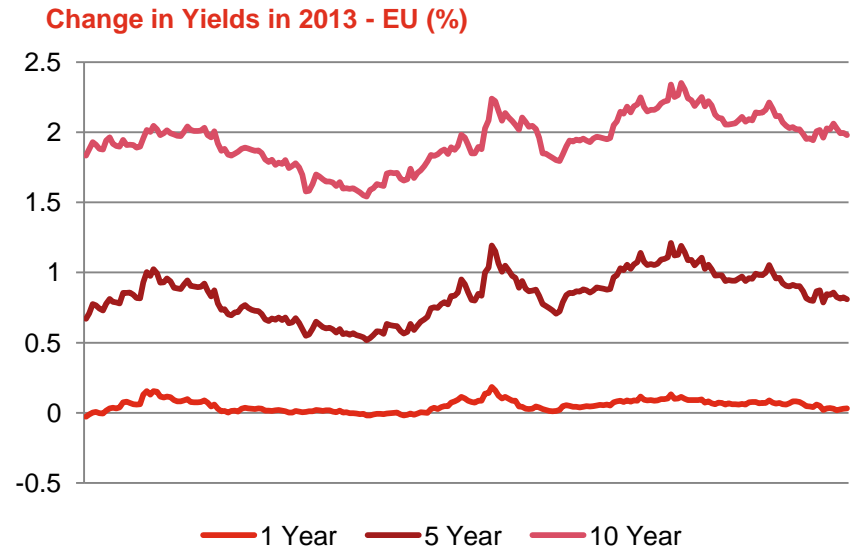
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# *Agenda*

- Global Overview
- State of the Reinsurance Market
- Growth of the ILS Market
- Captive Industry Development
- Latin American Market Update
- Canadian Opportunities Update
- Life Insurance Industry Update

# Global Overview

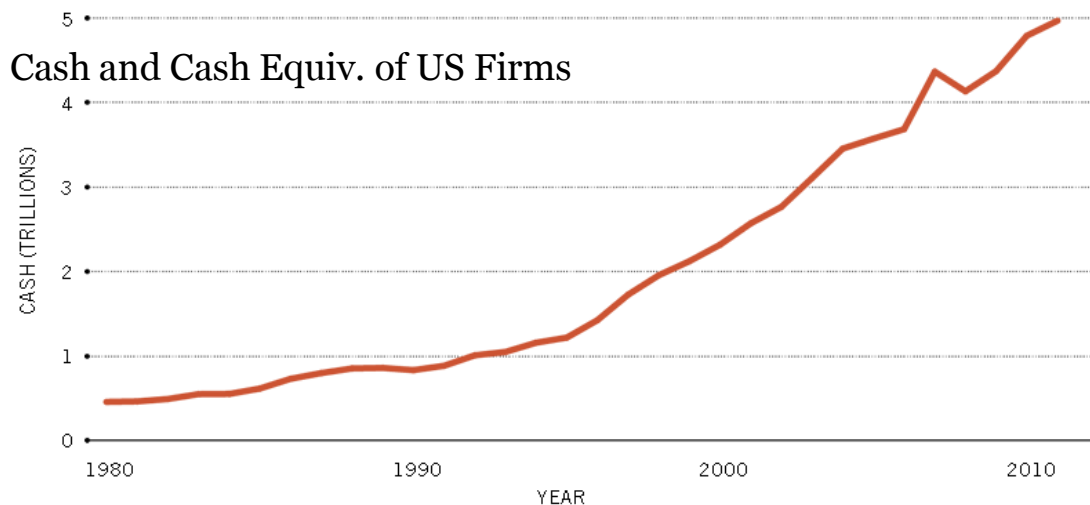
- Uncertainty remains in the direction of world wide interest rates;
- The US Federal Reserve has signaled intent to taper quantitative easing, while the European Central Bank has recently cut prime interest rates in half;
- Uncertainty in the EU has resulted in greater fluctuation and lower yields; and
- US treasury yields have begun to increase in the first 3 quarters of 2013, leading to a fall in the market value of fixed income securities.



# Global Overview

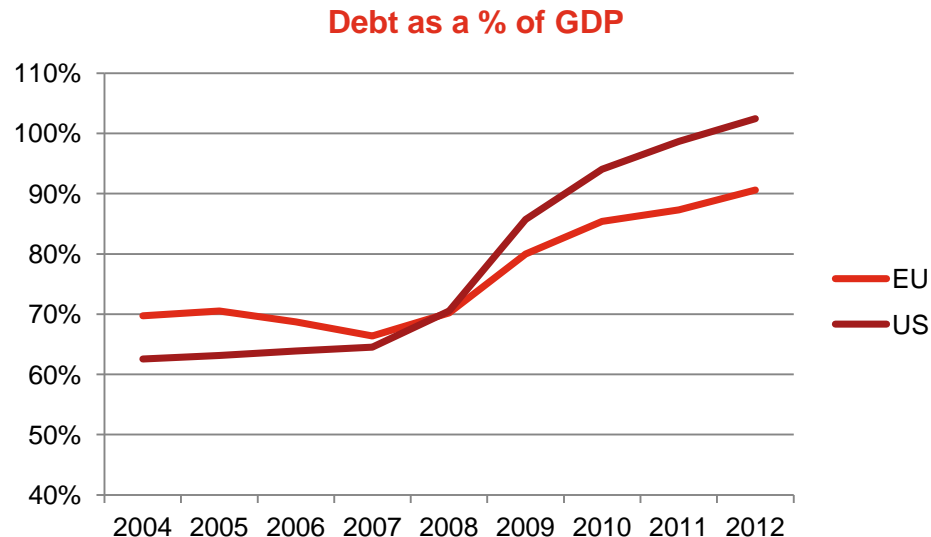
- Mergers of global companies continue to grow year on year (up approx 6% on 2012 and over 40% higher than 2011) with an associated impact on their captives; and
- Companies are holding more cash now than they ever have in the past. A primary driver being uncertainty in the markets. As uncertainty eases, that cash will need to be deployed. This could have impacts both on the capital flows to Bermuda generally, and the appetite to form captives.

Aggregate Cash and Equivalents of U.S. Firms



# Global Overview

- We are starting to feel the effects of a world-wide push for greater regulation in the wake of the financial crisis in 2008. Solvency II and Basel III being the main multi-jurisdiction regulations; however, there have also been an increase in country specific regulations, especially in developing markets;
- Governments are coming under increasing pressure to balance their economies. Tightening tax rules around offshore domiciles has been a common talking point.





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# *State of the Reinsurance Market*

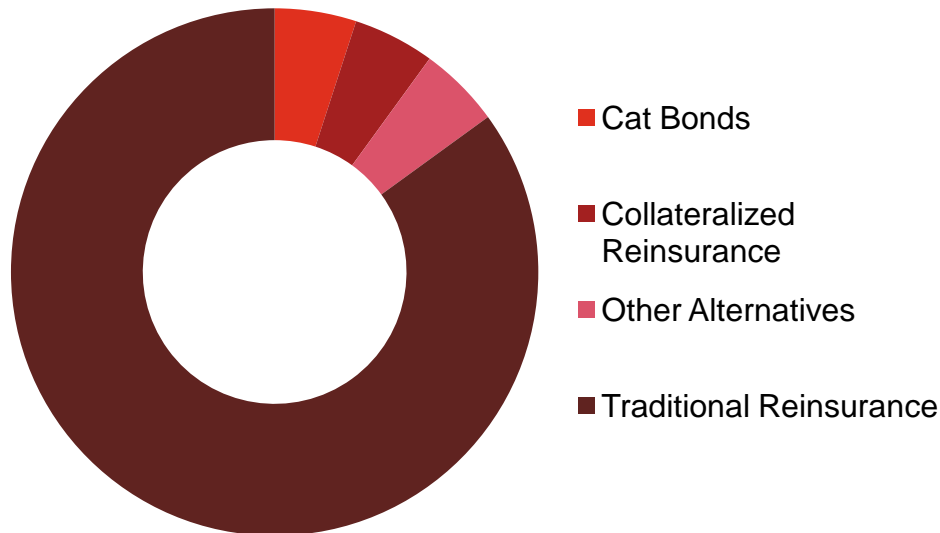
## **In the reinsurance market, current and future challenges:**

- The continued rapid growth of ILS has had, and will continue to have, a significant impact on the traditional reinsurance market: too much capital chasing too few risks;
- Surge of capital into the insurance space (primarily pension funds and money managers seeking improved returns and risk less directly correlated with the market) runs the risk of cannibalising existing capacity and driving down pricing. Soft rates in 2012 (despite large losses in 2011) have continued into 2013;
- These factors, combined with focus on expense ratios and weak investment returns, challenges traditional reinsurers to find new areas for growth; and
- Various options exist, including entering ILS space themselves, increasing retentions, seeking new or more profitable risks and looking to emerging markets such as Latin America (where insurance market penetration remains less than 1/3 that of more advanced economies).

# ***Growth of the ILS Market***

- ILS now accounts for around 15% of the property cat reinsurance market
  - Increased capacity in ILS means that Reinsurers are now looking for new ways to deploy capital, which often means enter layers below those typical for reinsurers.

## **Allocation of capacity**



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## ***Growth of the ILS Market***

- Bermuda continues to be the domicile of choice. Of over \$6.4bn in new ILS deals completed to September 2013 (against \$6.3bn for *whole* of 2012), \$3bn is through Bermuda-domiciled SPIs;
- In 2013, for the first time, total volume of ILS listing on BSX (including catastrophe bonds and reinsurance linked investment funds) surpassed \$7bn;
- Noted trend not only for cat-bond issuing SPIs, but increase in hedge-fund structures holding commercial (3A or 3B) reinsurance company; with increasing use of segregated accounts companies with cells owning SPI/reinsurer and allowing for new cell for each underwriting year; and
- Class 3/SPI/Seg cell.

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# ***Captive Industry Development***

**The most relevant option with a potential impact on captives is traditional reinsurance companies choosing to enter the direct insurance markets**

- Potential knock-on effects being softer market premiums, and the ability to deal directly with players in the reinsurance market, which in turn may reduce the financial benefits of the captive option;
- As such, the indirect and intangible benefits of captives, and communicating these to owners and potential clients, becomes increasingly important:
  - realising value through improved risk management practices and visibility into loss data;
  - even in a soft market, premiums on low loss ratio lines of business may still be well above expected level given company's specific loss history;
  - providing options to address volatility, cover gaps in the insurance programme, or to cover uninsurable risk; and
  - ability to utilise a captive solution to drive revenues as well as reduce expenditure (eg: reinsure products offered to company's customers).

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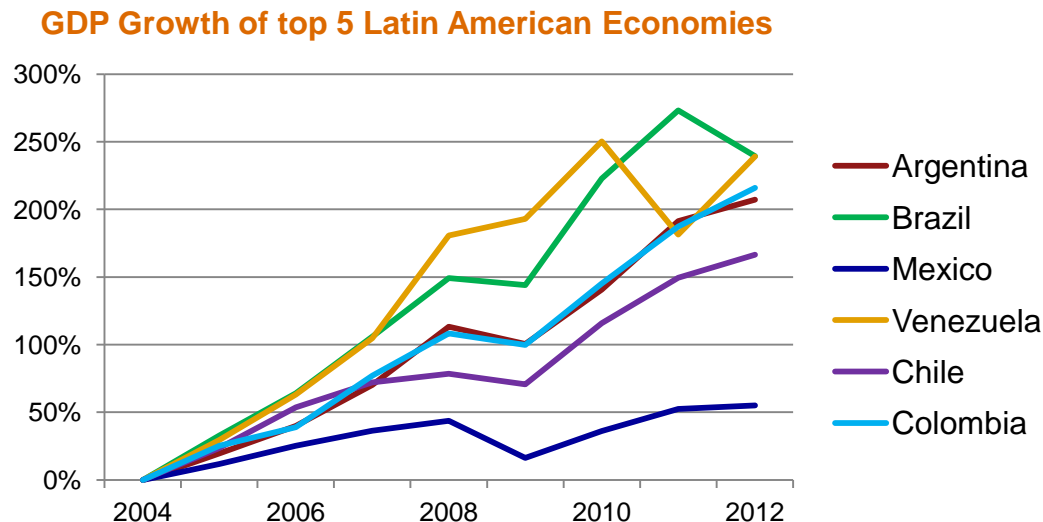
# ***Captive Industry Development***

- The number of insurance company formations by Q3 2013 is up on 2012; with 53 new insurers to September 2013, of which 13 are captives and 29 are SPIs (against 53 new insurers for the *whole* of 2012, of which 12 were captives); and
- Primarily these are from the US market but some success in attracting at least 3 Latin American formations.

# Latin American Market Update

## Growth and Opportunities

- Over the past 8 to 10 years the annualized GDP growth of Latin American economies has far out-paced that of the G8 economies (14.1% vs 5.9%); and
- Latin America's share of the insurance market has doubled since 2002, with Brazil representing 48% of premiums in the region. The top six countries (Brazil, Mexico, Venezuela, Argentina, Chile, and Colombia) represent 91% of premiums.

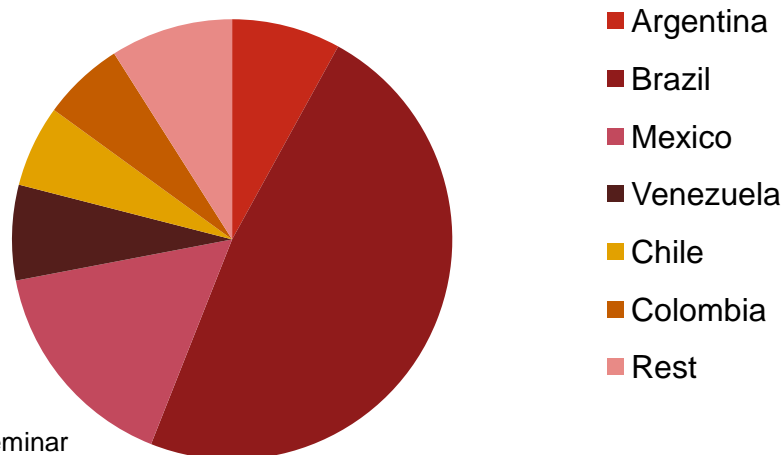


# *Latin American Market Update*

## **...with unique challenges**

- In response to the rapid growth and investment in insurance and reinsurance, Latin American regulators have increasingly focused on protecting and developing local insurance and reinsurance companies; and
- In order to meet the demands of the various regulators, captives from Latin American companies may take on unique structures. In order to be the domicile of choice, we will need to become versed in those structures, understanding their risks and opportunities.

**2011 Premiums written – Latin America**



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# *Canadian Opportunities Update*

- The Canada-Bermuda TIEA has been in place since mid 2011;
- The market for large entities forming captives is generally mature and has a strong foundation in Barbados;
- The main area for growth is in the middle market, who may not have considered or understood the benefits of captives before;
- The TIEA levels the playing field with Barbados. Combined with Bermuda's strong infrastructure, economy, and (re)insurance sector we are in a strong competitive position to grow our Canadian captive presence;
- A recent Bermuda sponsored event saw renewed interest from bigger players mainly in oil and gas with operations in the US; and
- Going back to captive core competencies, beyond tax benefits, are the key to winning Canadian business.



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# *Life Insurance Industry Update*

- We're continuing to see growth in the long-term sector, with 9 new registrations in 2012 and 5 in the 9 months to September 30, 2013;
- Some recent activity in the captive sector, with 3 of the 5 new registrations in 2013 being captives;
- New entrants tend to be either companies supported by private equity companies or hedge funds, looking to enter the fixed annuity market or companies looking to obtain surplus/capital relief through reinsuring liabilities into Bermuda; and
- The BILTIR industry group now comprises 29 insurers and 15 service providers (mgmt companies, audit firms and law firms).

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## ***Conclusion: Seizing opportunities is the key to success***

- The ILS market is growing and they need professionals with captive skill sets;
- Latin America is growing and we are ahead of the game in keeping Bermuda onside on local rules and regulations;
- Canadian interest is growing and we have a strategy to turn opportunities into actual companies on the ground; and

**In all of these areas we need to adapt to remain relevant and attract new business and keep our existing base strong.**

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# *Questions?*

# *Accounting & Regulatory Update*

Moderator: Sean Kelly, PwC

Panel: Leslie Robinson, BMA  
Niall Farrell, BMA  
Colm Homan, PwC  
David Gibbons, PwC

# *Regulatory Update*

# *Accounting Update*

# ***Objectives of the proposed FASB and IASB standards:***

**1**

Improve, simplify and converge the financial reporting requirements for insurance contracts

**2**

Eliminate numerous pieces of current US accounting literature

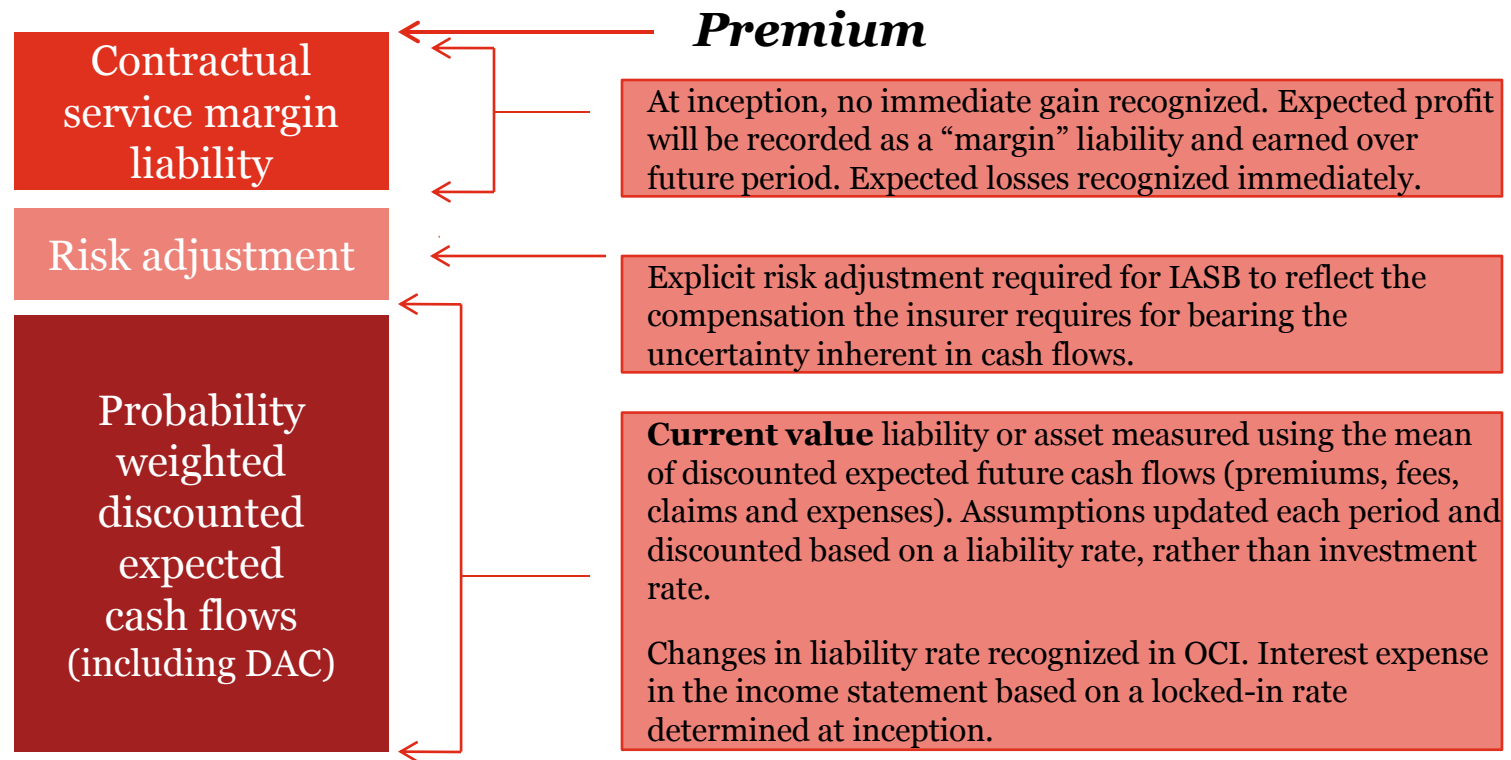
**3**

Provide a comprehensive insurance standard for IFRS reporting

**4**

Provide investors with more decision useful information

# ***Building block approach – long-term business***



Alternative model:  
Premium Allocation Approach (PAA)



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## ***Premium allocation approach – short duration***

- Expected to apply to most property/casualty contracts and annual health contracts; and
- Similar to current unearned premium approach where premium recognized as revenue over coverage period, but with:
  - Discounting of incurred claims if settlement expected to be > 12mths;
  - Revenue pattern based on expected claims not necessarily straight-line;
  - Ceding commission income netted against reinsurance premiums;
  - Exclude deposit component from revenue and claims incurred expense;
  - Net DAC against margin liability; and
  - An additional liability, a “risk adjustment”, recorded reflecting uncertainty in ultimate amount and timing of unpaid claims.

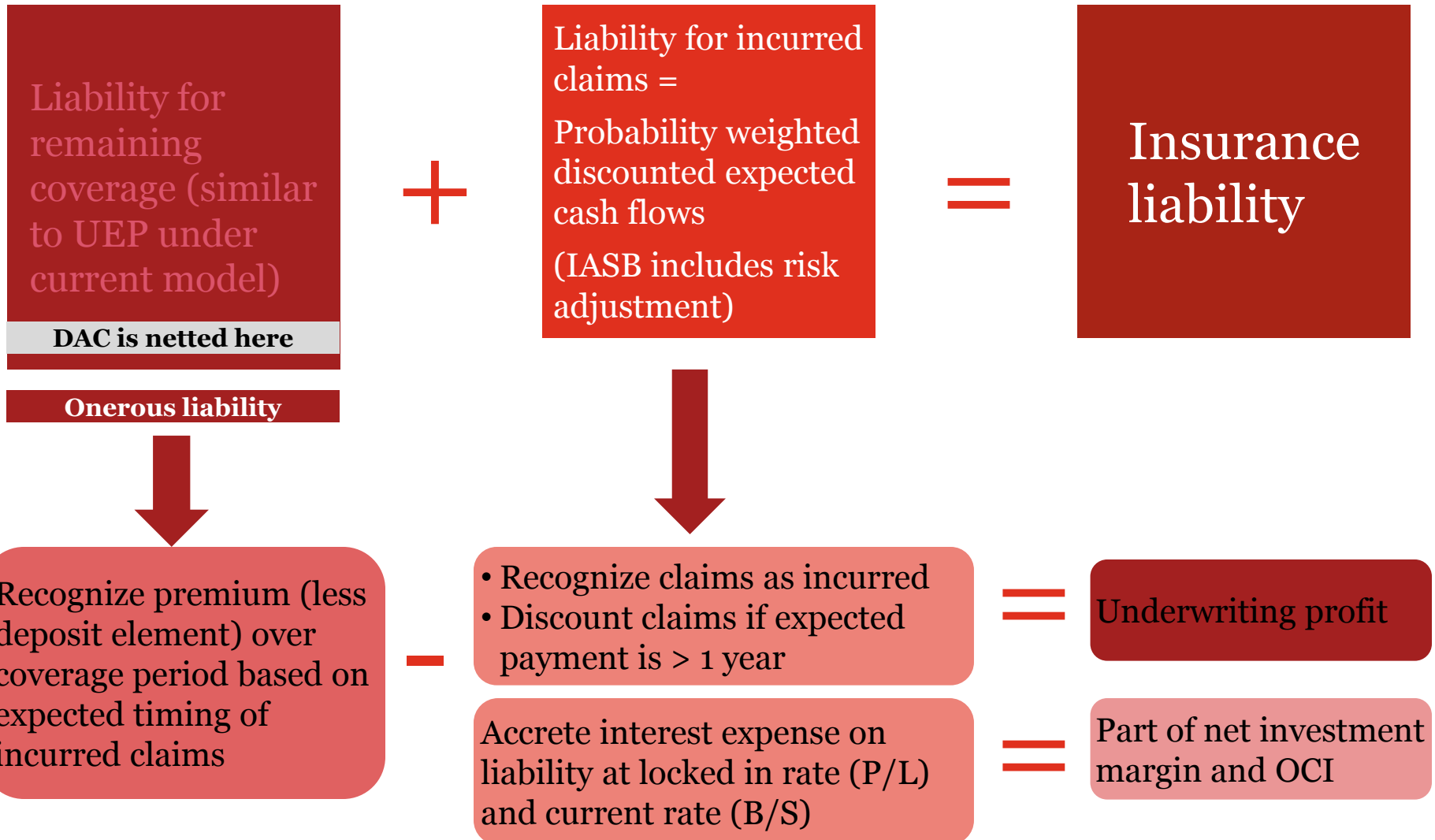
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## ***Definition of insurance contract***

***“A contract under which one party (the issuing entity) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or its designated beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder.”***

- Based on nature of contract, not entity issuing contract;
- Change from current US GAAP, which applies to insurance *entities*;
- Insurance risk = risk other than financial risk; and
- Financial risk = interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable.

# Premium allocation approach (PAA)



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# ***Definition of insurance contract***

Definition of *significant* insurance risk:

Insurance risk is significant:

***“...if, and only if, an insured event exposes an entity to a significant loss. Existence of one scenario in which the present value of the cash flows expected to be paid by entity can significantly exceed the present value of the premiums and other cash inflows will be considered to satisfy the existence of significant insurance risk.”***

- Must be at least one scenario in which insurer can suffer a loss (PV net outflows > PV premiums); and
- *Applies to both insurance and reinsurance contracts.*

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## ***Captive Application***

- Entities that self-insure through a captive insurance company but have no other insurance operations would not apply insurance accounting in their consolidated financial statements;
- However, the captive would apply the provisions of the ED in its stand-alone financial statements. This distinction is due to the fact that at the consolidated level the entity does not have an insurance contract as the insurance contract between the subsidiaries would be eliminated in consolidation; and
- However, if the captive purchased reinsurance, at the consolidated level the entity would have purchased an insurance policy, but in the captive's stand-alone financial statements, the contract would be viewed as reinsurance.

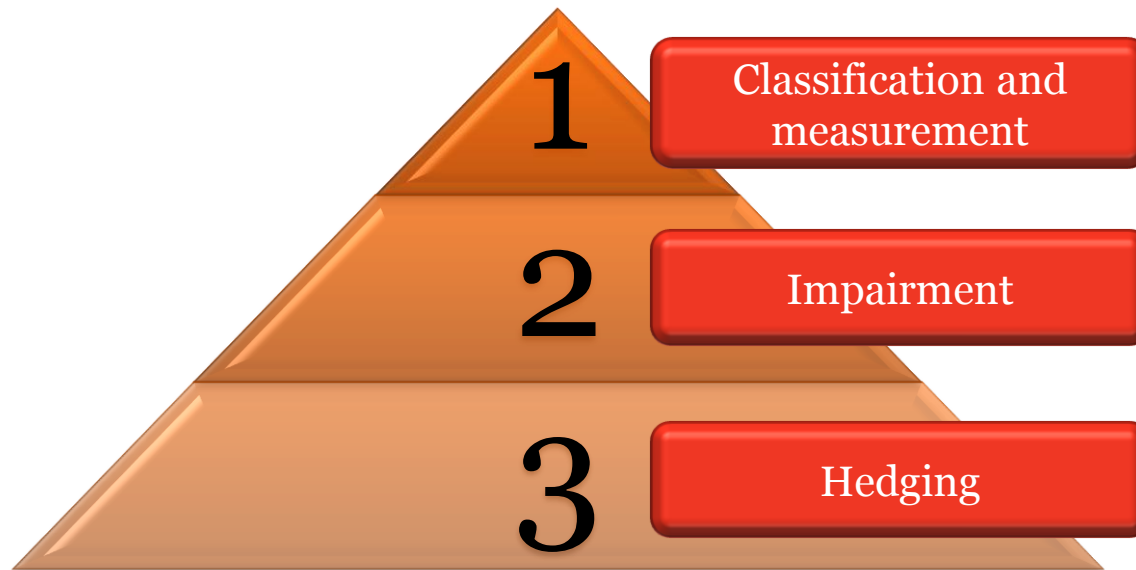
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# *Technical Update - Investments*

# ***Investments***

## **Status of convergence of IFRS and US GAAP**

- The project plan consists of 3 main phases –Phases 1 to 3 is ongoing.
- In December 2011, the Board amended IFRS 9 to require application for annual periods beginning on or after 1 January 2015.



# *Investments – Measurement*

## **IFRS 9**

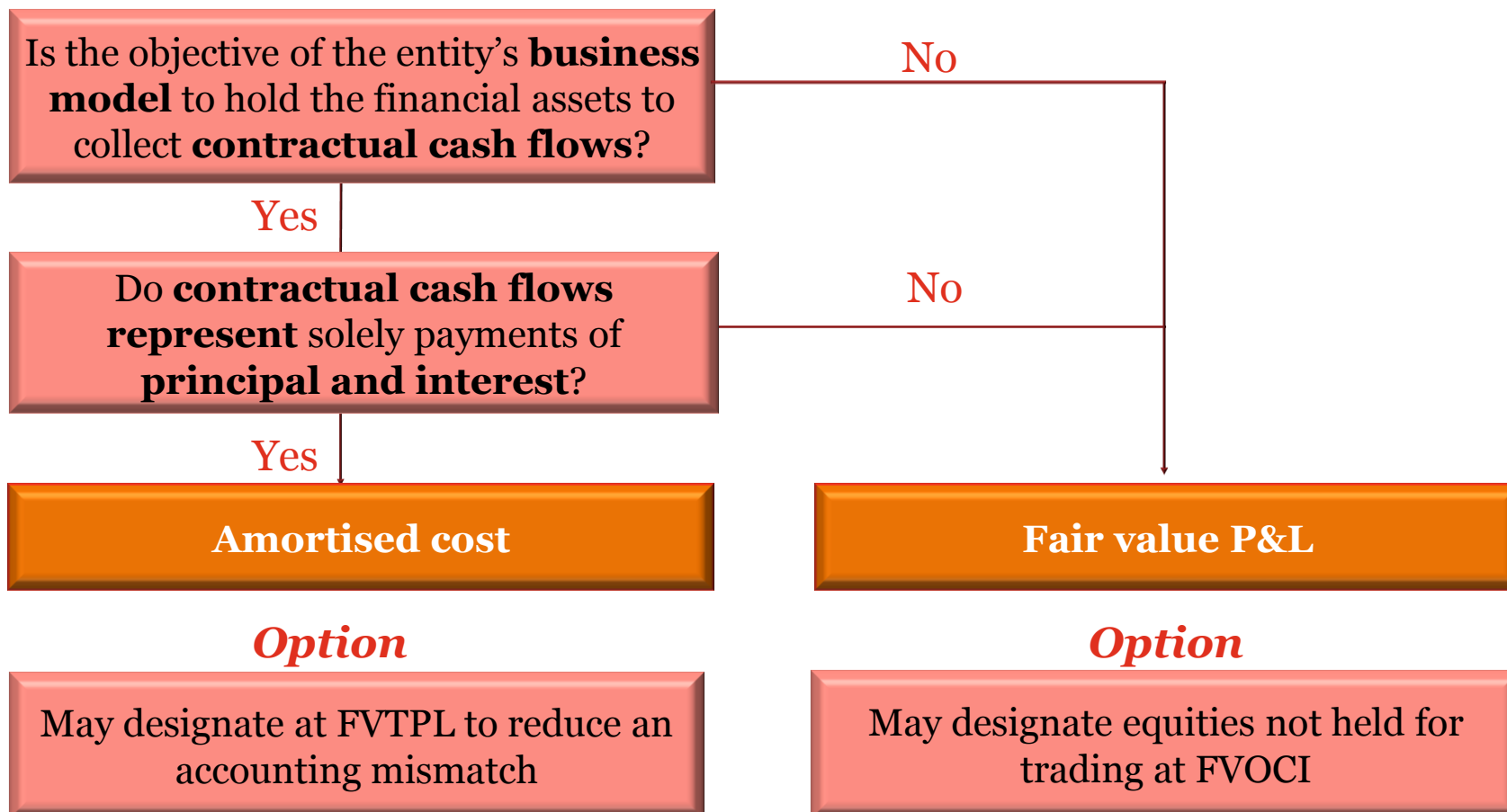
- IFRS 9 replaces the multiple classification and measurement models in IAS 39 with a single model that has only 2 classification categories:
  1. Amortized cost
  2. Fair value
- There is no change to initial recognition (i.e. fair value);
- Subsequent measurement of **financial assets** should be at either amortized cost or fair value after considering:
  1. The business model of the entity for managing the financial asset
  2. The contractual cash flow characteristics of the financial asset
- Subsequent measurement of **financial liabilities** should be at amortized cost; and

**This standard applies for annual periods beginning on or after Jan 1, 2015 with early application permitted**



# *Investments – Measurement (cont'd)*

## **IFRS 9 measurement**



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## ***Investments – Status of convergence project (Ph 1)***

- FASB responses: Many felt that the cash flow characteristics test inappropriately limited the number of debt investments that would be eligible for amortized cost or fair value through other comprehensive income measurement. While respondents tended to agree with a business model assessment, a majority felt that the restrictions on sales out of the amortized cost category would inappropriately limit companies' ability to manage their credit risk exposures; and
- IASB responses: A majority of respondents supported adding a fair value through other comprehensive income category to the amortized cost and fair value through net income categories for debt investments.

**Joint redeliberations were conducted last September 2013 of the February 2013 Exposure Draft on Accounting for Financial Instruments- Classification and Measurement.**

## ***Investments – Status of convergence project (Ph 2)***

- By a 3-to-1 margin, financial statement users supported the FASB's model, expressing a preference for a model that recognizes all expected credit losses over a model that retains a threshold or requires the recognition of only some expected credit losses;
- Preparers generally did not support the FASB's model, and expressed a preference for a model that only requires the recognition of some expected credit losses, and/or establishes a threshold to be reached prior to recognition of all expected credit losses; and
- A majority of the respondents to the IASB's proposal, including the majority of users and preparers, were supportive of the IASB's model, which recognizes credit losses based on deterioration in credit risk. However, respondents did express the need to refine various aspects of the proposal, as well as provide implementation guidance to ensure consistent application.

**Joint redeliberations were conducted last September 2013. Both Boards participated in the discussions, but each Board only made decisions on their respective papers.**

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# ***Investments – Presentation and disclosure***

- **IFRS 13 FV measurement and disclosure requirements**

Provides a single source of guidance on how to measure fair value where its use is already required or permitted by other IFRS and enhances disclosure requirements for information about fair value measurements.

**Effective for years beginning on or after January 1, 2013, early adoption permitted with prospective application**

- **ASU 2011-04 Topic 820 FV measurement and disclosure requirements**

Amended to converge requirements for how to measure fair value and for disclosing information about fair value measurements in US GAAP with IFRS.

**Effective for years beginning after December 15, 2011 (non-public entities)**

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# ***Investments – Presentation and Disclosure***

## **Convergence of IFRS 13 and ASC 820**

- Definition of fair value.
- Categorization of fair value measurements into three-level hierarchy, based on the type of inputs to the valuation techniques used - Level 1, 2, and 3
- Initial recognition of investments is based on its fair value at acquisition date.
- Disclosure requirements apply to all assets and liabilities measured at fair value, not just financial ones:
  - Information about the hierarchy level into which fair value measurements fall;
  - Transfers between Level 1 and 2; and
  - Methods and inputs to the fair value measurements and changes in valuation techniques.
  - Additional disclosures for Level 3 investments except for...

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# ***Investments – Presentation and Disclosure***

## **Differences between IFRS 13 and ASC 820**

- Disclosure requirements: IFRS requires quantitative sensitivity analysis for Level 3 investments (formerly IFRS 7 requirement).
- Accounting treatment:
  - IFRS does not have accounting requirements specific to investment companies. The Boards are reviewing the accounting for investment companies as part of a separate project.
  - Fair value measurement of deposit liability.

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# ***Investments – Presentation and Disclosure***

## **ASU 2013-03 Topic 825 Financial Instruments – Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities**

- The requirement to disclose the level of the fair value hierarchy categorization does not apply to non-public entities for items that are not measured at fair value in the statement of financial position but for which fair value is disclosed.
  - An example is debt security measured at amortized cost in the statement of financial position whose fair value need to be disclosed in the notes to the financial statements.

**Effective on or after February 3, 2013.**

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# ***Investments – Presentation and Disclosure***

## **Convergence of IAS 32 and IFRS 7 amendments and ASU 2013-01**

The balance sheet offsetting disclosures require the presentation of gross and net information about transactions that are:

- (1) offset in the financial statements or
- (2) subject to an enforceable master netting arrangement or similar agreement, regardless of whether the transactions are actually offset in the statement of financial position.

**IFRS 7 changes is effective for years beginning on or after January 1, 2013 and IAS 32 changes is effective for years beginning on or after January 1, 2014. Early adoption permitted with prospective application to both standards.**

**ASU 2013- 01 is effective for years beginning on or after January 1, 2013 with required disclosures retrospectively for all comparative periods presented.**



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# *Accumulated Other Comprehensive Income*

## **ASU 2013-0 Topic 220 Comprehensive Income** – Reporting on Amounts Reclassified Out of Accumulated Other Comprehensive Income (“AOCI”)

- An entity is required to present either parenthetically on the face of the financial statements or in the notes, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification.
- An entity would not need to show the income statement line item affected for certain components that are not required to be reclassified in their entirety to net income, such as amounts amortized into net periodic pension cost.

**Effective for years beginning after December 15, 2012 for public entities; a year later for non-public entities.**

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# *Questions?*

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# *Coffee and Refreshment Break*

Seminar will resume in 15 minutes

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# ***FATCA Update***

**Moderator:** Paul Eldridge, PwC

**Panel:** Wayne Brown, Bermuda Government  
David Gibbons, PwC  
Scott Slater, PwC

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# *Agenda*

Introduction

Recent changes to the FATCA rules & How it may affect your company

Bermuda / United States FATCA Intergovernmental Agreement

Bermuda / UK FATCA Intergovernmental Agreement

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# ***What is FATCA?***

- The Foreign Account Tax Compliance Act (“FATCA”) is a set of laws enacted to prevent and detect offshore tax evasion and improve taxpayer compliance.
- **FATCA** was enacted in March 2010 as part of the “HIRE” act. It is a broad sweeping set of laws that will affect many foreign entities.
- The **FATCA** rules & regulations establish different sets of obligations depending on whether an entity is (a) U.S. or non-U. S. entity and (b) a financial entity, or a non-financial entity.
- Domestic entities are not directly affected by **FATCA**.
- Foreign entities that are financial institutions are considered *Foreign Financial Institutions* (“FFIs”).
- Foreign entities that are not financial institutions are *Non-Financial Foreign Entities* (“NFFEs”).
- Each group will have their own set of obligations to satisfy in order to avoid 30% withholding on withholdable payments made to or by them.

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## ***Foreign Insurance Companies with 953(d) elections***

- Under existing U.S. tax law, a foreign insurance company that makes the permissible election under IRC section 953(d) is considered a U.S insurance company for U.S. tax purposes.
- However under the final **FATCA** regulations as originally issued, 953(d) insurance companies were still excluded from the definition of “U.S. persons” in applying the **FATCA** rules (unless such company took the additional step of becoming licensed to do business in a particular U.S. state.) This meant that foreign insurance companies were tasked with assessing whether they were FFIs or NFFE, and complying with the specific **FATCA** compliance tasks required by their status as an FFI or NFFE.

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## ***Foreign Insurance Companies with 953(d) elections – The Good News***

- On October 29, 2013, the IRS and U.S. Treasury Department released Notice 2013-69. The Notice stated that the IRS intends to include 953(d) companies in the definition of “U.S. persons” for **FATCA** purposes.
- This would be a very favorable modification to the existing **FATCA** regulations because as a U.S. person, it would not have to comply with either set of obligations **FATCA** imposes on foreign entities.



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## ***Foreign Insurance Companies with 953(d) elections – The Bad News***

- Even though the proposed change set out in IRS Notice 2013-69 is very helpful since it treats 953(d) companies as “U.S. persons,” this does not necessarily mean the insurance company can forget about **FATCA** entirely. Although 953(d) companies would be relieved of the **FATCA** obligations since they are not foreign entities under U.S. tax law, it also will mean that they will be considered potential *U.S. withholding agents*, which imposes a new and separate set of obligations if they make **FATCA** withholdable payments to foreign entities.

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## ***U.S. Withholding Agent Obligations – In Brief***

- There are five principal obligations a U.S. withholding agent must perform to comply with **FATCA** (not all will apply to foreign insurance companies).  
Withholding agents must:
  1. Review and enhance due diligence procedures to be able to document the **FATCA** status of each new policy holder;
  2. Perform due diligence procedures on policy holder accounts existing on June 30, 2014 to document and classify each policy holder into its appropriate **FATCA** category no later than July 1, 2016;
  3. Begin Form 1042-S reporting on U.S. source FDAP income and insurance or reinsurance premiums paid in calendar year 2014 by March 15, 2015;
  4. Begin Form 8966 reporting with respect to U.S. owned foreign entities for calendar year 2014 by March 31, 2015; and
  5. Begin **FATCA** withholding on U.S. source FDAP income and other withholdable payments in required circumstances beginning on July 1, 2014 and on gross proceeds of U.S. securities sales and foreign pass thru payments on January 1, 2017.

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## ***Examples of typical withholdable payments for 953(d) companies***

- Dividends to shareholders
- Reinsurance premiums (i.e., to Green Island)
- Claims payments to subsidiaries and other insureds
- Service fees
- Related party loans
- Cash pooling / investment subsidiaries

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## ***Private Bermuda Reinsurance Companies (without 953(d) elections) & FATCA***

- Without a 953(d) election, Bermuda private reinsurance companies will need to determine whether they are FFIs or NFFEs.
- Unless you issue cash value insurance contracts with a value greater than \$50,000, or annuities, or assumption reinsurance you will be an NFFE.
- NFFEs have differing **FATCA** obligations depending on whether they are considered “Active,” or “Passive.”

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## ***NFFEs – Active vs. Passive***

- Most private Bermuda reinsurance companies will be considered Passive NFFEs under the FATCA definitions.
- Active NFFEs are entities where less than 50% of its gross income and 50% of its assets are held for the production of passive income (i.e., dividends, interest, rents and royalties).
- The benefit to being an Active NFFE is that you are an “Excepted NFFE” under the **FATCA** rules.
- If you are an Excepted NFFE, a withholding agent is not required to withhold under **FATCA** on a withholdable payments (or portion thereof) made to you.
- The other main category of Excepted NFFEs is publicly traded corporations
  - i.e., a corporation the stock of which is regularly traded on an established securities market.
  - In addition, any corporation that is owned (80% or more) by such publicly traded corporation will also be considered an Excepted NFFE.

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## ***Private Bermuda Reinsurance Companies – The Bad News***

- As Passive NFFEs, Bermuda reinsurance companies are charged with the task of identifying substantial U.S. owners and reporting information on such owners to the IRS. If the NFFE fails to do this, a U.S. withholding agent will be obligated to withhold 30% on all withholdable payments made to such NFFE.
- In addition, the NFFE would have to fill out and submit the IRS Form W-8BEN to U.S. withholding agents (or W-8 BEN-E when the final form becomes available).

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## ***Private Bermuda Reinsurance Companies – The Good News***

- Thanks to the Bermuda government's negotiating efforts with the IRS, private reinsurance companies in Bermuda will have two additional options to achieve **FATCA** compliance:
- The first option is to register with the IRS via the **FATCA** online registration system ("FATCA Portal"). Entities who successfully register through the **FATCA** Portal will be issued a Global Intermediary Identification Number ("GIIN"). Normally the **FATCA** Portal is only intended for FFIs.
- The second option is to become a "sponsored" entity. This essentially means that FATCA compliance would be delegated upwards to a parent entity with control of the NFFE although it could be another entity which is willing to assume the obligations of taking care of **FATCA** compliance..

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## ***Under U.S. Bermuda IGA Are Holding Companies Reporting Financial Institutions (FFIs) or NFFE?***

- Final FATCA regulations say yes to holding companies and treasury centers as FFIs
- IGA's don't specially list them as a separate category of FFI (Financial Institution)
- U.K. says reporting financial institution includes certain holding companies resident in U.K.
- Section 2.29 of HMRC guidance notes says a holding company of an insurance company is not itself, "specified insurance company," unless the holding company issues or is obligated to make payments with respect to cash value insurance of annuities



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## ***Panel Discussion***

- Update on Bermuda / United States Intergovernmental Agreement
- Update on Bermuda / UK Intergovernmental Agreement

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# *Questions?*

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# ***Tax Update***

Speaker: Scott Slater, PwC

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## ***TAX - Discussion Points***

- Legislative Outlook
- 2013-2014 Priority Guidance Plan
- Judicial Update
- Current Trends
- FATCA

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## ***Legislative Outlook: Bermuda Market Impact***

- Corporate Tax Reform – possible reduction in corporate tax rate to 25%
- Related party reinsurance (ie, the ‘Neal bill’)
- Changes to CFC regime
- Territorial Tax System
- Base Erosion and Profit Shifting (BEPS)
- Expiring tax rates and credits
  - Individual tax rates (see next slide)
  - Estate tax rate from 35% to 55%
  - Lifetime transfer limitations from \$5.0m to \$1.2m

## ***2013 top individual tax rates for incomes above \$400k single / \$450k joint***

	<b>Wage income</b>	<b>Interest income</b>	<b>Dividends</b>	<b>Capital gains</b>
2013 top rate	39.6%	39.6%	20.0%	20.0%
Base HI payroll tax (employee share)	+1.45%*	--	--	--
2013 phase-out of itemized deductions (“Pease”)	+1.2%	+1.2%	+1.2%**	+1.2%**
2013 HI surtax	+0.9%	+3.8%	+3.8%	+3.8%
<b>2013 combined top rate</b>	<b>43.15%</b>	<b>44.6%</b>	<b>25.0%</b>	<b>25.0%</b>

\* Additional 1.45% applies for self-employed.

\*\* Assumes taxpayer has ordinary income that exceeds itemized deductions.

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## ***Department of the Treasury 2013-2014 Priority Guidance Plan***

- The Treasury Department's Office of Tax Policy and the IRS use the Guidance Priority List each year to prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance;
- 2013-2014 Plan reports various items related to insurance companies and products; including:
  - Issuing 'final regulations regarding Series LLCs and cell companies'.
    - Implication – Clarity / finality to 'cell regs'
    - Ability to follow in proposed form?
  - A 'revenue ruling under Section 801 addressing the application of Revenue Ruling 2005-40 or Revenue Ruling 92-93 to health insurance arrangements that are sponsored by a single employer.'
    - Implication - IRS is considering whether single employer Medical Stop Loss policies are considered 'unrelated risk' for "risk shifting" / "risk distribution" purposes.

# Judicial update- “Concentration” Cases

- U.S. Tax Court

- *Rent-a-Center, Inc. & affiliated subs. (Dkt. Nos. 021627-10, 006909-10) (11/14/11)*
- *Securitas Holdings, Inc. & subs. (Dkt. No. 021206-10) (12/12/11)*
- *Batan Ins. Co. SPC, Ltd. (Dkt. No. 003841-10) (2/6/12)*
  - *Darco Insurance Company, Inc. (Dkt. No. 021725-10) (2/13/12); Dielco Crane Service (Dkt. No. 16972-10)*
  - *Vincent Enterprises, Inc. & subs. (Dkt. No. 002759-10) (continued)*
  - *Pilgrim’s Pride (Dkt. No. 16972-10) (Dispositive motions due 12/15/11)*
  - *YRC Worldwide & subs. (Dkt. No. 6714-10) (Jt. Status due 9/15/11)*
  - *S&J Supply Co., Inc. (Dkt. No. 003502-11)*

- Court of Federal Claims

- *Proliance Surgeons (Dkt. No. 09-680T) (fact discovery deadline 11/14/11; Jt. Status due 7/20/12)*



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## ***Judicial update***

- U.S. District Court (N.D. Texas)
  - *Salty Brine, Inc.* (Dkt. No. 5:10-CV-00108-C); consolidated cases including *K&T Farm, Ltd.*, *Wasson Solid Waste Disposal System, Ltd.*, *Five Star Consolidated Co., Ltd.*, *Thomas & Kidd Oil Production, Ltd.*, *Delta Oil & Gas, Ltd.*, *Del-Tex Hydrocarbons, Ltd.*
    - **Found in favor of the Government**
- U.S. District Court (Washington DC)
  - *Validus Reinsurance Ltd.* - Federal Excise Tax (Case No. 1:13-cv-00109)

Argument: No clear evidence that Congress intended to tax wholly extra-territorial transactions; i.e., Congress did not intend to tax transactions between two foreign entities with no US touchpoints. When statute is not specific as to extra-territorial application, it has none.

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# ***Current Trends***

- IRS continues to challenge captive insurance companies via raising a variety of issues, including:
  - What is insurance?
    - Is ‘harm’ a requirement?
    - Is ‘fortuity’ a requirement?
      - Rev Rul 2007-47 – remediation risk
      - TAM 201149021 – residual value insurance (“RVI”)
  - Risk concentration (e.g., risk distribution) where >50% of the risk is concentrated in a single insured
    - See previous slide
  - Loss reserves
    - Redundancy / fringe reserves
  - Use of IRC Section 831(b) companies
    - Notice 2002-70 defined structures as a ‘tax shelter’; however, later revoked
  - ‘Trickle down’ of FET exams

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# ***FATCA***

## **Foreign Account Tax Compliance Act (“FATCA”)**

- Requires certain Foreign Financial Institutions (FFIs) to report information to the IRS with respect to financial accounts held by U.S. taxpayers
- Addressing concern that U.S. taxpayers are evading taxes by hiding money offshore
- 30% withholding tax applies if FFI does not comply (effective 7/1/2014)
- Currently IRC Section 953(d)-electing companies are NOT exempt from FATCA
  - Per Notice 2013-69, the Treasury Department and the IRS intend to modify the definition of U.S. person in the Chapter 4 regulations to include a foreign insurance company that is not a specified insurance company and that elects pursuant to section 953(d) to be subject to U.S. income tax as if it were a U.S. insurance company.

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# *Questions?*

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# *AIMS Update*

Speaker: Michael Mielzynski, PwC

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## ***Reserve accuracy poll***

At December 31, 2012, what percentage of US P&C insurance companies' reserves from December 31, 2009 were within 10% of their originally recorded value?

- a) 87% – isn't it called actuarial "science?"
- b) 71% – there is a lot of judgment
- c) 59% – well, more than I thought
- d) 38% – who needs actuaries anyway?

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# ***Percentage of companies with December 31, 2012 reserves within X% of initial recorded reserves***

## **U.S. Companies with initial recorded reserves in excess of \$500M**

Calendar Year End	Degree of Precision		
	Within +/- 5%	Within +/-10%	Within +/- 25%
2003	17%	36%	71%
2004	27%	45%	77%
2005	21%	47%	85%
2006	19%	40%	84%
2007	18%	39%	85%
2008	26%	52%	85%
2009	28%	59%	90%
2010	46%	73%	94%
2011	70%	90%	99%

*Source: SNL, Individual Company Statutory Statements, 2012.*



# ***Percentage of companies with December 31, 2012 reserves within 10% of initial recorded reserves***

**U.S. Companies with initial recorded reserves in excess of \$500M – by coverage**

Calendar Year End	Degree of Precision - Within +/-10%					
	All	General & Excess Liab	Medical Malpractice	Commercial Multi Peril	Workers Comp	Personal Auto Liab
2003	36%	6%	38%	21%	5%	50%
2004	45%	22%	23%	27%	38%	64%
2005	47%	35%	7%	19%	53%	64%
2006	40%	29%	7%	33%	54%	48%
2007	39%	22%	6%	33%	64%	52%
2008	52%	23%	7%	38%	76%	46%
2009	59%	42%	24%	53%	90%	54%
2010	73%	71%	53%	69%	95%	71%
2011	90%	90%	71%	100%	100%	88%

Source: SNL, Individual Company Statutory Statements, 2012.

- Reserve accuracy varies by coverage; commercial lines tend to be more difficult to estimate.

# U.S. Industry Aggregate

Calendar year (**redundancy**)/**deficiency** as a % of initial reserves

Calendar Year End	All	General & Excess Liab	Medical Malpractice	Commercial Multi Peril	Workers Comp	Personal Auto Liab
2003	15%	44%	-7%	6%	31%	-2%
2004	5%	21%	-16%	-3%	13%	-5%
2005	-1%	6%	-22%	-5%	3%	-7%
2006	-4%	0%	-26%	-11%	0%	-6%
2007	-5%	-3%	-26%	-12%	0%	-5%
2008	-8%	-1%	-23%	-10%	0%	-6%
2009	-5%	-1%	-19%	-6%	0%	-6%
2010	-4%	-2%	-12%	-3%	0%	-5%
2011	-2%	0%	-6%	-1%	0%	-3%

Source: SNL, Individual Company Statutory Statements, 2012.

- Reserve development for the U.S. Industry Aggregate in total also shows that reserve accuracy varies by coverage.

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# ***Bermuda captive market comparison***

## **Using a sample of PwC Bermuda audit clients**

- **Compiling captive reserve data much more difficult**
  - Different evaluation dates – we had to “round” to year-end 2012, 2011, etc.;
  - Policy periods generally do not correspond to calendar years – reserves we labeled as “2009” often include losses from 2008 or 2010;
  - Accrued reserves were sometimes not provided by line of business – we had to judgmentally allocate a total reserve figure; and
  - Excluded captives in runoff.
  
- **Our sample population was comprised of the following:**
  - Approximately 30 captives, roughly evenly split between Class 1, 2 and 3;
  - Approximately \$235 million in aggregate reserves; and
  - 15+ captives each provided AL, GL and WC.

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# ***Bermuda captive market comparison***

## **Overall reserve development**

- **Favorable reserve development observed during 2012**
  - “Year-end 2011” reserves = \$237.3 million
  - Favorable development of \$14.7 million observed during the next twelve months
  - $(\$14.7 \text{ million}) / \$237.3 \text{ million} = (6.2\%)$
- **Favorable reserve development also observed during 2011 and 2010**
  - 2011:  $(\$19.8 \text{ million}) / \$237.1 \text{ million} = (8.4\%)$
  - 2010:  $(\$15.2 \text{ million}) / \$229.5 \text{ million} = (6.6\%)$
- **Stronger favorable development observed compared to US industry data**

# ***Bermuda captive market comparison***

## **Line of business**

- Approximate reserve balances by line of business
  - WC ~ \$79 million
  - GL ~ \$75 million
  - AL ~ \$25 million
- Reserve development observed during 2010 – 2012

Calendar Year End	All	General Liability	Workers Comp	Auto Liability
2010	-6.6%	-3.0%	-2.7%	-9.0%
2011	-8.4%	-12.3%	-6.6%	-25.4%
2012	-6.2%	-12.2%	-3.2%	-28.9%

- WC & GL showing stronger favorable development than US industry data
- AL indications affected by one statutory-only filer with sizeable redundancies

# ***Bermuda captive market comparison***

## **Class**

- Approximate reserve balances by class
  - Class 1 ~ \$73 million
  - Class 2 ~ \$94 million
  - Class 3 ~ \$68 million
- Reserve development observed during 2012, 2011 and 2010

Calendar Year				
End	All	Class 1	Class 2	Class 3
2010	-6.6%	-6.8%	-13.0%	2.7%
2011	-8.4%	-14.3%	-3.9%	-7.7%
2012	-6.2%	-11.4%	-9.7%	4.0%

- Classes 1 and 2 showing similar levels of conservatism in reserves, Class 3 closer to “correct” in hindsight

# ***Bermuda captive market comparison***

## **Type of financial statements**

- Approximate reserve balances by type of financial statements filed
  - Statutory only ~ \$85 million
  - GAAP only ~ \$51 million
  - Both ~ \$100 million
- Reserve development observed during 2012, 2011 and 2010

Calendar Year	Bermuda			
End	All	Statutory	GAAP	Both
2010	-6.6%	-0.4%	-16.1%	-6.7%
2011	-8.4%	-12.1%	-20.3%	1.3%
2012	-6.2%	-8.3%	-16.1%	-1.3%

- Captives who only file statutory financial statements show larger favorable development than those who file both statutory and GAAP statements
- Indications for GAAP-only filers are affected by our small sample size and significant favorable development observed in PL line for one company

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# ***Bermuda captive market comparison***

## **Potential future enhancements**

- Track reserve development over multiple years to observe statistics of reserves established vs. ultimate settlements
- Augment data available for analysis – more companies, coverages, and years
- Track captive reserve development in a different jurisdiction; i.e., Cayman



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# *Questions?*

# *Cocktail Reception*

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# *Thank you*

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