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MICROSOFT: WHAT IT MEANS FOR CAPTIVES

By now, most in the captive insurance industry know about the Cease and Desist Order issued last year by the elected Washington Insurance Commissioner (the “Commissioner”) to Cypress, Microsoft’s Arizona-domiciled captive. The Commissioner ordered Cypress to stop transacting insurance and to pay Washington tax on its premiums, as well as interest and penalties. The dispute settled for \$876,820, and Cypress issues its policies through a surplus lines broker. Since then, the Commissioner established a “Self-Reporting Plan” available to captive insurers who self-report prior to June 30, 2020. Under the Plan, premium tax, interest on premium tax and the tax penalty will be calculated based upon a “look-back period” and objectionable activity outside of the look-back period forgiven. The length of the look-back depends upon the timing of self-reporting. Before December 31, 2019 will include the current year and the previous ten years. January 1, 2020 to June 30, 2020 will include the current year plus the 15 previous policy years, and anything later will include all years since inception of the captive. The Commissioner argues there is no applicable statute of limitations. Starting July 1, 2019, the fine amount and penalty increases every six months a captive program waits to self-report, until reaching a “maximum” on June 30, 2020.

Despite the rhetoric, not every captive insuring risks in Washington would owe premium tax to the state and, in every case, enforcement actions must address constitutional due process considerations. The Supreme Court case *Todd Shipyards* established that simply insuring risks located in another state is not sufficient “minimum contact” to justify a state’s imposition of taxes on the transaction. However, any captive with Washington activity should nonetheless consider the self-reporting regime or its argument for why no tax applies.

Whether other state regulators pursue similar new, aggressive approaches to captive taxation remains to be seen.

PRIMMER FORMS VERMONT’S FIRST AFFILIATED REINSURANCE COMPANY

In late 2018, Vermont licensed its first Affiliated Reinsurance Company (“ARC”), an affiliate of MAPFRE RE, a large global reinsurance company based in Madrid,

Spain. Primmer Attorneys served as advising counsel to MAPFRE RE in establishing the legal entity and obtaining its insurance license.

2018 legislation permitting this new type of captive allows the formation of reinsurance affiliates onshore, and in so doing, avoids application to certain insurance enterprises of the Base Erosion and Anti-Abuse Tax (“BEAT”) that might otherwise apply to offshore reinsurance placements. By building on its experience with traditional captives and special purpose financial insurance companies, Vermont’s new option provides the flexibility of captive regulation with assistance to companies complying with traditional regulatory accreditation standards.

Edward Perez De Lema, CEO of MAPFRE RE was amazed at the collaboration that took place to make this all happen: “We are extremely grateful to Vermont’s captive insurance community, regulators, and legislators for working together in a bipartisan fashion to address a pressing insurance industry need and pass the Affiliated Reinsurance Company Legislation.” He added, “Today is a great day for MAPFRE RE, and I hope it is a great day for Vermont as well.”



NEWS FROM THE VERMONT STATE HOUSE

CAPTIVE LEGISLATION MOVES FORWARD

This year’s session of the Vermont General Assembly is well past its halfway point as lawmakers look to conclude work in mid-May. This was the target for each of the last two legislative sessions as well, but a record number of vetoes by Governor Scott (R) and subsequent stalemates over certain issues led those sessions to run to the end of June. Divided government remains the rule with Gov. Scott facing a Senate and House strongly controlled by Democrats, with only modest cooperation by Progressives or Independents necessary to override a veto.

Around again this year are mandatory paid family leave, a \$15/hour minimum wage, fully taxed and regulated cannabis, a plastic grocery bag ban and additional gun restrictions. Time will tell which battles emerge.

Blessedly far from any political posturing, legislation updating Vermont’s captive insurance laws was readily passed by both houses and just signed into law on April 18. The bill was the latest in what has become an annual “housekeeping” exercise in the Legislature to add new initiatives or simply make some technical amendments that clarify or implement the law.

What is not in the bill is anything to do with cybersecurity and any new mandate for captives or risk retentions groups to operate cybersecurity programs, testing and response plans for breaches. Leadership in the Captive Division continues to signal a move in that direction.

This year’s bill did feature a mix of new and technical amendments, including:

- Clarification that protected cells incorporated as nonprofits can issue dividends to their owners with approval from the Commissioner.
- Revision of the law to permit captives to choose any type of entity permissible under Vermont law. This will negate the future need to update the law for a new type of entity.
- New automatic exemption from bonding for attorneys-in-fact of reciprocals formed as an association captive, an industrial insured captive or an incorporated protected cell of a sponsored captive.

- Setting the default period for exams at five years (the Commissioner may examine more often).
- Revision of the investment standards for risk retention groups, association captives, and agency captives to allow those entities to either comply with the current investment requirements or submit their own investment policy to the Commissioner for approval.
- Requiring the use of NAIC statutory accounting as the standard for ARCs.
- Revision of provisions around determining who is an “independent director” of a risk retention group.
- Extension to risk retention groups of the own risk and solvency assessment (ORSA) provisions of traditional insurers. The threshold triggering ORSA applies to insurers that write more than \$500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than \$1 billion of annual direct written and assumed premium.

There are a few other bills making their way through the legislative process which may have some impact on certain captives or risk retention groups insuring Vermont risks. These include a bill related to strict and joint liability for releases of a toxic substance from a large facility. The Governor vetoed similar legislation last year, with a primary concern the availability and affordability of insurance.

Another bill proposes to repeal the statute of limitations for civil actions based on childhood sexual abuse, and permit such actions to be brought at any time, including those previously barred by the statute of limitations. The bill also provides that damages may be awarded against an entity that employed, supervised, or had responsibility for the person allegedly committing the sexual abuse if the entity acted negligently. This is an issue a number of states across the country are considering and several have adopted.

And finally, the Vermont Department of Financial Regulation (“DFR”) is backing a bill primarily related to traditional insurers. The bill has passed the Senate and is now before the House where action is expected. S.131 creates an insurance regulatory sandbox with authority of the Commissioner to grant an applicant innovation waiver from insurance law, regulation or bulletin subject to certain findings by the Commissioner. Other provisions in the bill include updates to existing law related to surplus lines companies by authorizing the formation of domestic surplus lines companies and updates to the tax treatment in general, and repeal of the never-used surplus lines multi-state compact which came about as a response to Dodd-Frank but never gained critical mass to become effective.

We will further report on these and other captive insurance legislative and regulatory matters in future issues.

VERMONT CAPTIVE INDUSTRY UPDATE

Vermont posted strong growth numbers in 2018. Twenty-five new captives were licensed in 2018, according to data released by the Vermont Department of Financial Regulation. These were twelve pure captives, four risk retention groups, three sponsored captives, two industrial insured captives, two special purpose financial insurers, one branch captive, and one affiliated reinsurance company.

The new captives are in the healthcare, insurance, retail, manufacturing, professional services, real estate, entertainment and energy industries. Vermont continues to see strong growth from the healthcare industry, with six new healthcare captives licensed in 2018 — including captives owned by American Academic Health System LLC, Vertex Pharmaceuticals Inc., Non-Acuity Physicians & Physician Groups, Long-Term Care Facilities, The Crestwood Group and CARE Professional Liability Association, LLC.

Other notable captives formed in 2018 include: Twenty-First Century Fox, Inc., ACE Hardware Corporation and MAPFRE Re. As discussed in more detail above, MAPFRE Re is an affiliated reinsurance company

(“ARC”), the first of its kind, and comes less than a year after Vermont passed legislation creating this new type of captive structure. The legislation establishes Vermont as a viable, domestic alternative for U.S. companies that are currently reinsuring offshore and may now be subject to the Base Erosion and Anti-Abuse Tax (“BEAT”), which was enacted as part of the Tax Cuts and Jobs Act of 2017. Under the new law, an ARC is permitted to reinsure the risks of a ceding insurer that is its parent or affiliate as well as cede those assumed risks to another reinsurer(s).

The new captives licensed in 2018 bring Vermont’s overall total licenses to 1,137, with 558 active captive insurance companies. Vermont — the largest U.S. domicile in terms of annual gross written premium (\$22 billion in 2018 based on preliminary figures from DFR) and third largest in the world – has an active pipeline of prospective new captives and expects continued, consistent growth for the coming year.

PRIMMER NAMED “BEST TAX LAW FIRM” BY VERMONT BUSINESS MAGAZINE

Vermont Business Magazine has for the third consecutive year designated Primmer Piper Eggleston & Cramer PC the “Best Tax Law Firm.” Our taxation practice works frequently with our captive team to address tax issues in the formation and operation of captives and to solve complex federal and state tax challenges as they arise, including ERISA matters. If the recent tax law changes or other circumstances leave you with tax questions, please give us a call.

E-MAIL OPTION AND ARCHIVE

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