

# **Bureau of Captive and Financial Insurance Products**

## **Delaware Captive Insurance Association Spring Forum May 15, 2018**

**Steve Kinion**

**Director, Bureau of Captive and Financial Insurance Products  
Delaware Insurance Department**



DELAWARE DEPARTMENT OF INSURANCE  
INSURANCE COMMISSIONER TRINIDAD NAVARRO  
*Bureau of Captive and Financial Insurance Products*  
Delaware is the 3<sup>rd</sup> Largest U.S. Captive Domicile  
and the World's 5<sup>th</sup> Largest Captive Domicile

# Agenda for Meeting



- Delaware's captive status
- Captive bureau marketing
- What's happened since the last DCIA spring forum
- What Delaware's regulators are considering
  - Conditional license
  - Cannabis and captives
- Captive exams
- NAIC update – bond granularity
- Federal Home Loan Banks
- Internal Revenue and captive insurers



# Thank you!



- Thank you for bringing either your captives or the captives that you manage to Delaware.



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INSURANCE COMMISSIONER Trinidad Navarro  
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# Captive Status



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# Delaware Licenses

as of May 8, 2018

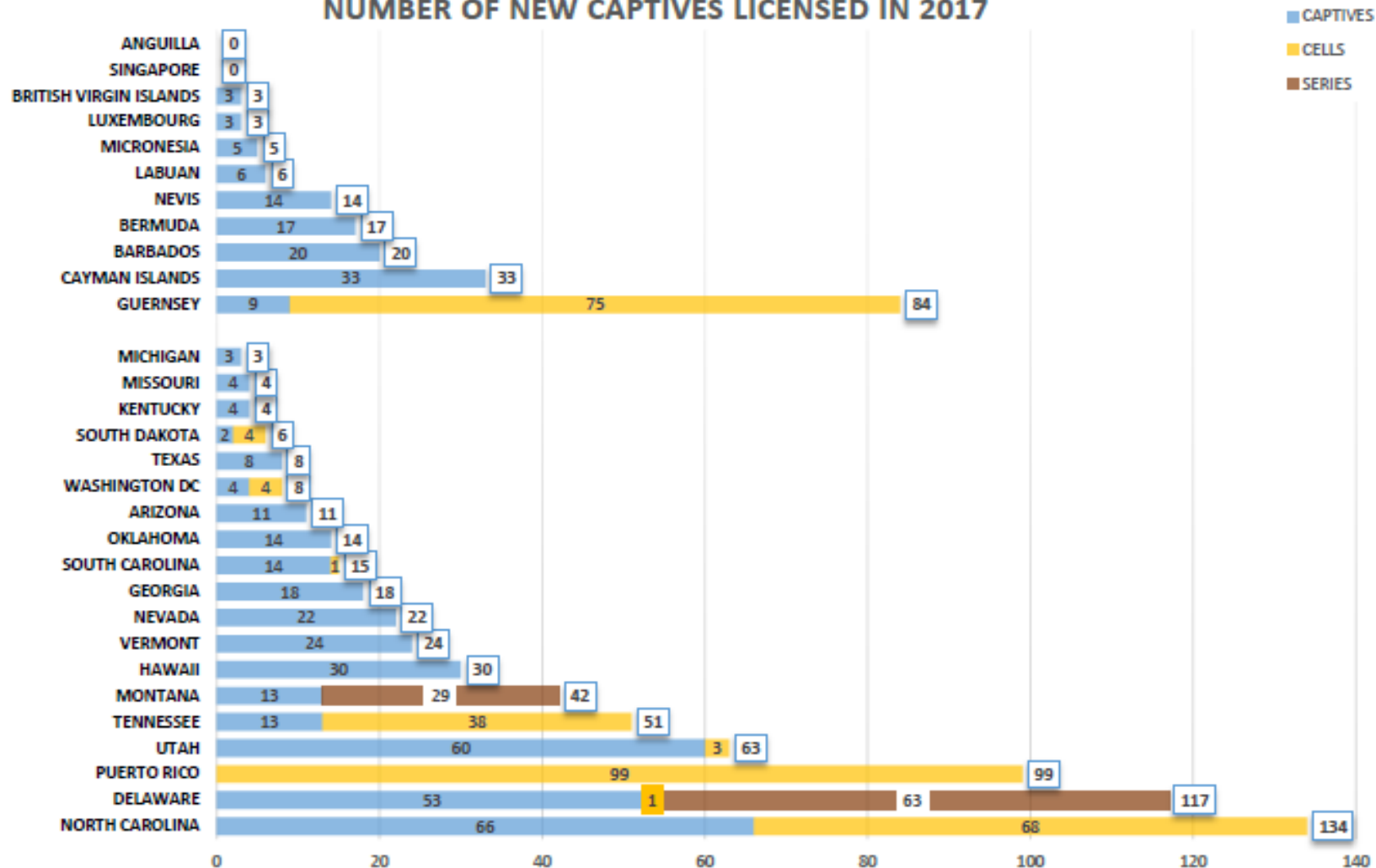


<i>❖ <u>Variety of Captive Types</u></i>	<i><u>Number Licensed</u></i>
Agency	2
Association	3
Cell	11
RRG	3
Industrial	3
Pure	330
Series	616
Special Purpose	41 (35 are for Series Structure)
SPFC	6
Sponsored	2
<b>Total</b>	<b>1,017 (Dormant 48 series, 2 pure)</b>



# 2017 Domicile Licenses

NUMBER OF NEW CAPTIVES LICENSED IN 2017



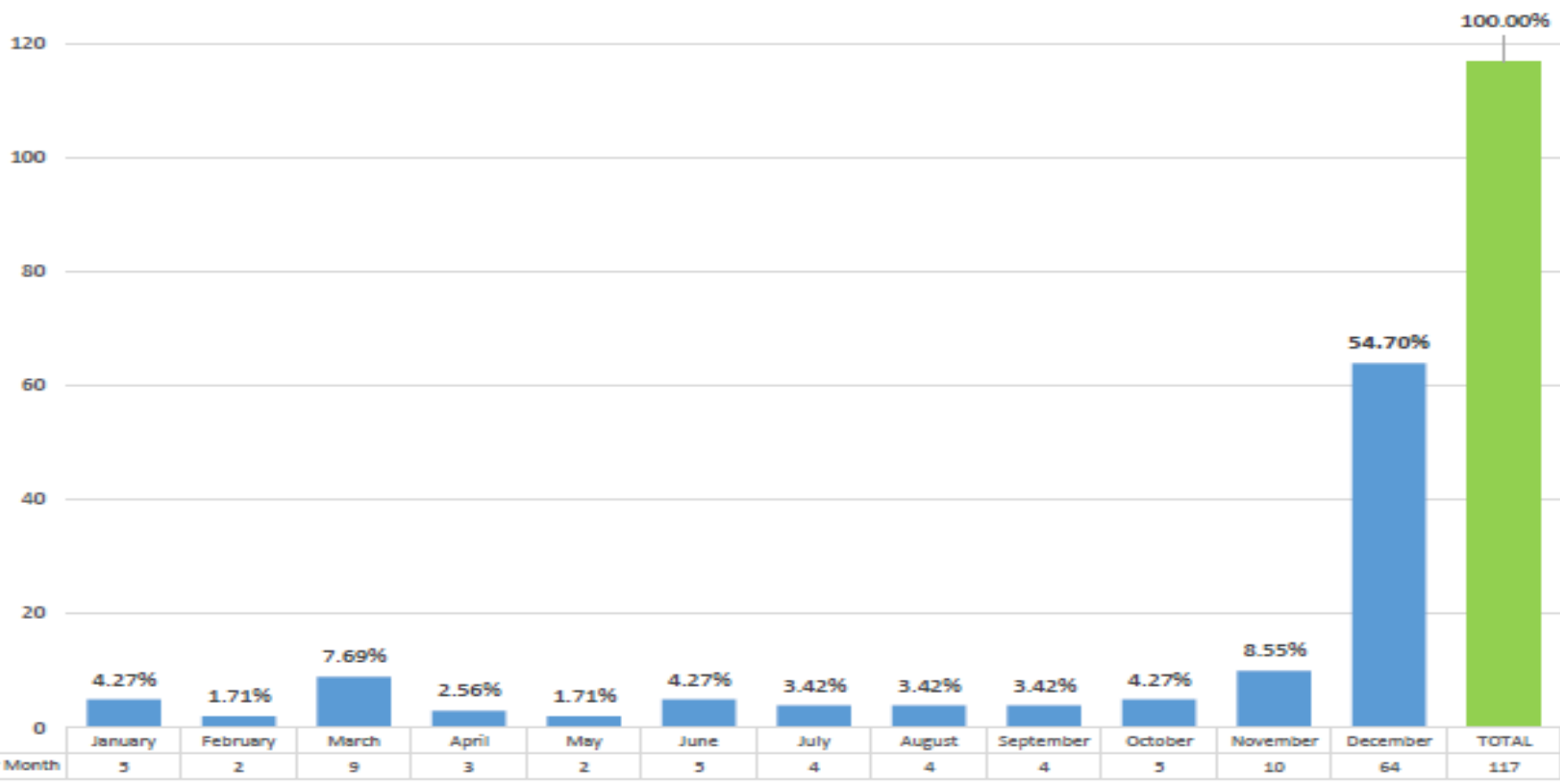
CAPTIVES MEAN PURE, ASSOCIATION, INDUSTRIAL INSURED, ETC.  
 SERIES MEANS A SERIES CAPTIVE INSURANCE COMPANY.  
 CELL MEANS PROTECTED CELL, INCORPORATED CELL, OR SEGREGATED CELL CAPTIVE INSURER.

# Delaware Insurance Department

## BY MONTH DISTRIBUTION OF CAPTIVE INSURANCE APPLICATIONS RECEIVED IN 2017

TOTAL NUMBER OF CAPTIVE INSURANCE APPLICATIONS RECEIVED IN 2017 IS 117

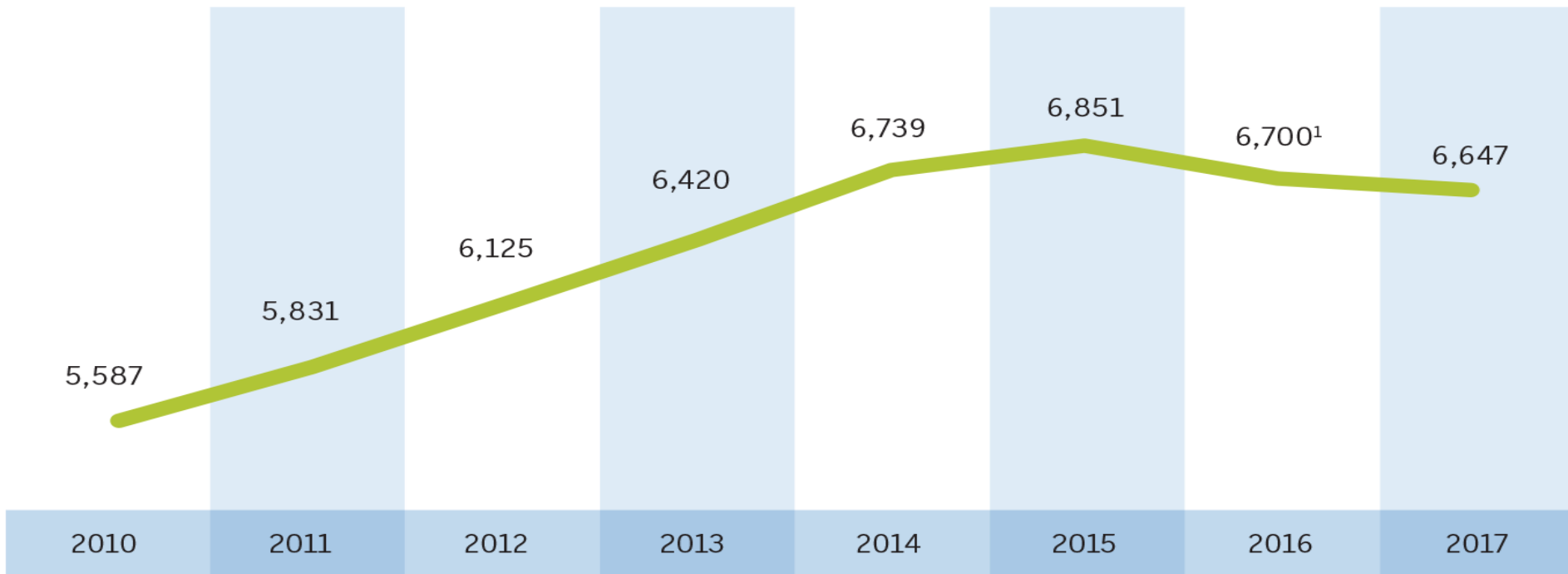
55% OF THE 2017 CAPTIVE INSURANCE APPLICATIONS WERE SUBMITTED IN DECEMBER



# Global Captive Insurance 2010 to 2017



## TOTAL CAPTIVES WORLDWIDE



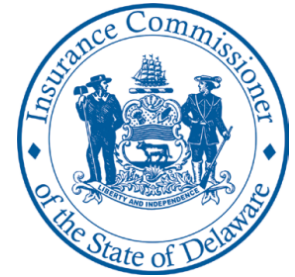
<sup>1</sup> Restated  
Source: BI survey



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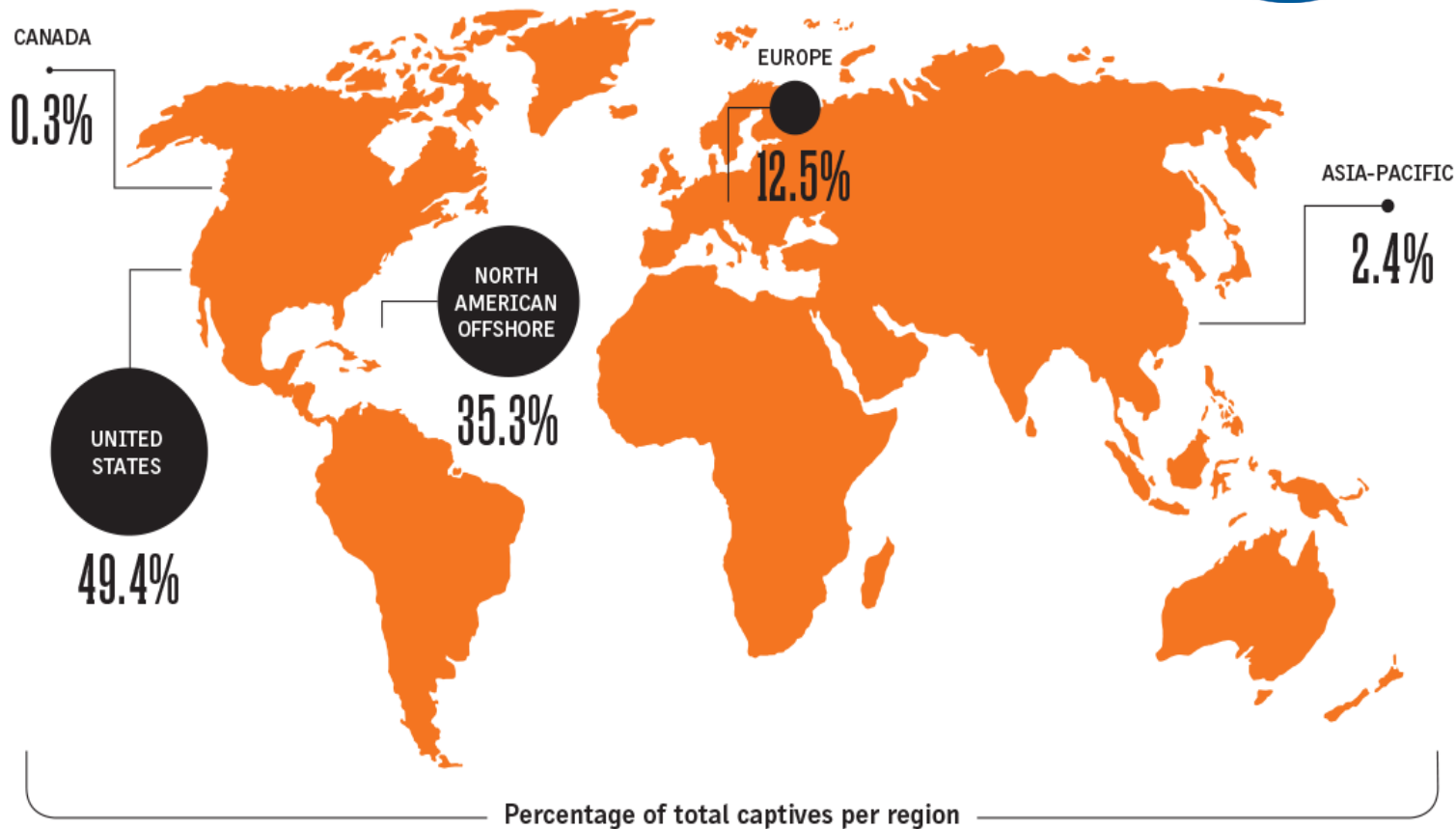
# Global Captive Distribution



## ONSHORE/ OFFSHORE BY THE NUMBERS

There were 6,647 captives in 2017, not including microcaptives, series captives or individual cells or cell members in protected cell companies.

Source: *BI* survey



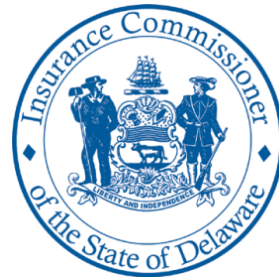
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# Captive Bureau Marketing



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# Captive Bureau Marketing

- **More global focus.**
- **Increased presence at conferences like the World Captive Forum, CICA, Captive Review, SIA (both domestic and international), European Captive Forum, and American Conference Institute.**
- **Sponsorships at conferences.**
- **Continuous presence in Best's Review, Captive Review, and The Self-Insurer.**
- **Advertisement on A.M. BestTV.**



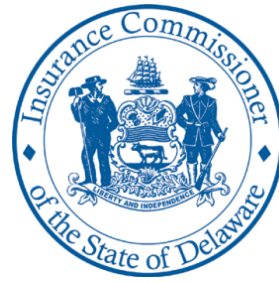


# What's Happened Since the Last DCIA Spring Forum



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# Since the Last Conference



- **ICCIE Trained Organization.**
- **Dormant captives. Governor Carney signed HB 87 on August 30, 2017. Developing a form for submission to obtain dormant status.**
- **Captive Bulletin No. 8 regarding short duration contracts and ASU 2015-09.**
- **Captive Bulletin No. 9 extending the annual report and premium tax filings from March 1 to April 15. HB 289 has passed both chambers of Delaware GA and is awaiting Governor's signature.**
- **HB 334 regarding conditional license. Passed the House.**





# What the Delaware Regulators are Considering



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# Conditional License - HB 334



- **Voluntary license that's "one and done" which means no renewal. A conditional license is issued at the time of application submission.**
- **Fee for a conditional license is \$100. This is in addition to current application fee.**
- **By regulation, standards will be developed to determine who may qualify for this privilege.**
- **Either build organic an electronic payment platform or use NAIC State Based System.**
- **Transaction fees. Credit card fee, electronic check fee, or SBS has a \$5.95 per transaction fee.**

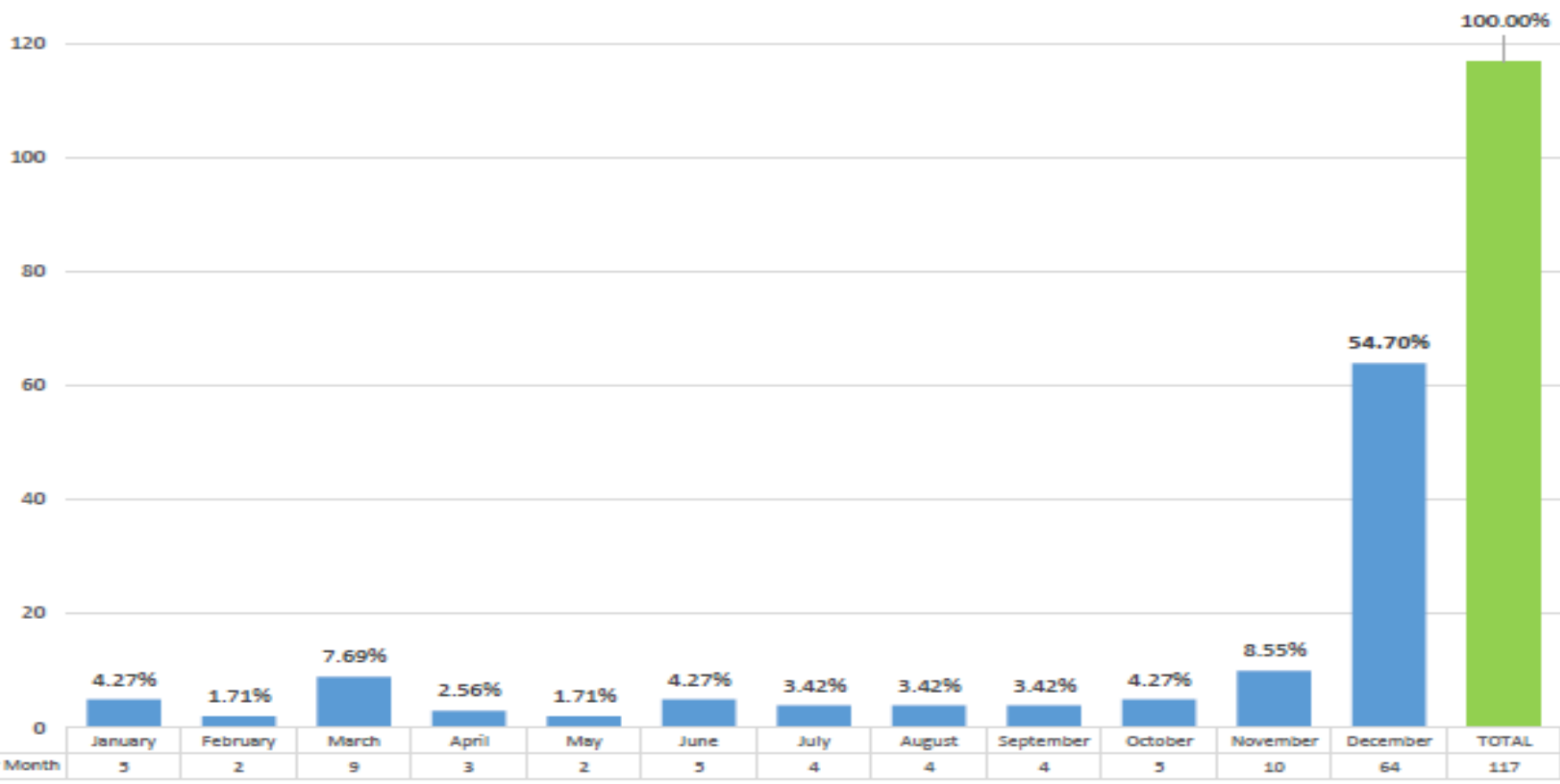


# Delaware Insurance Department

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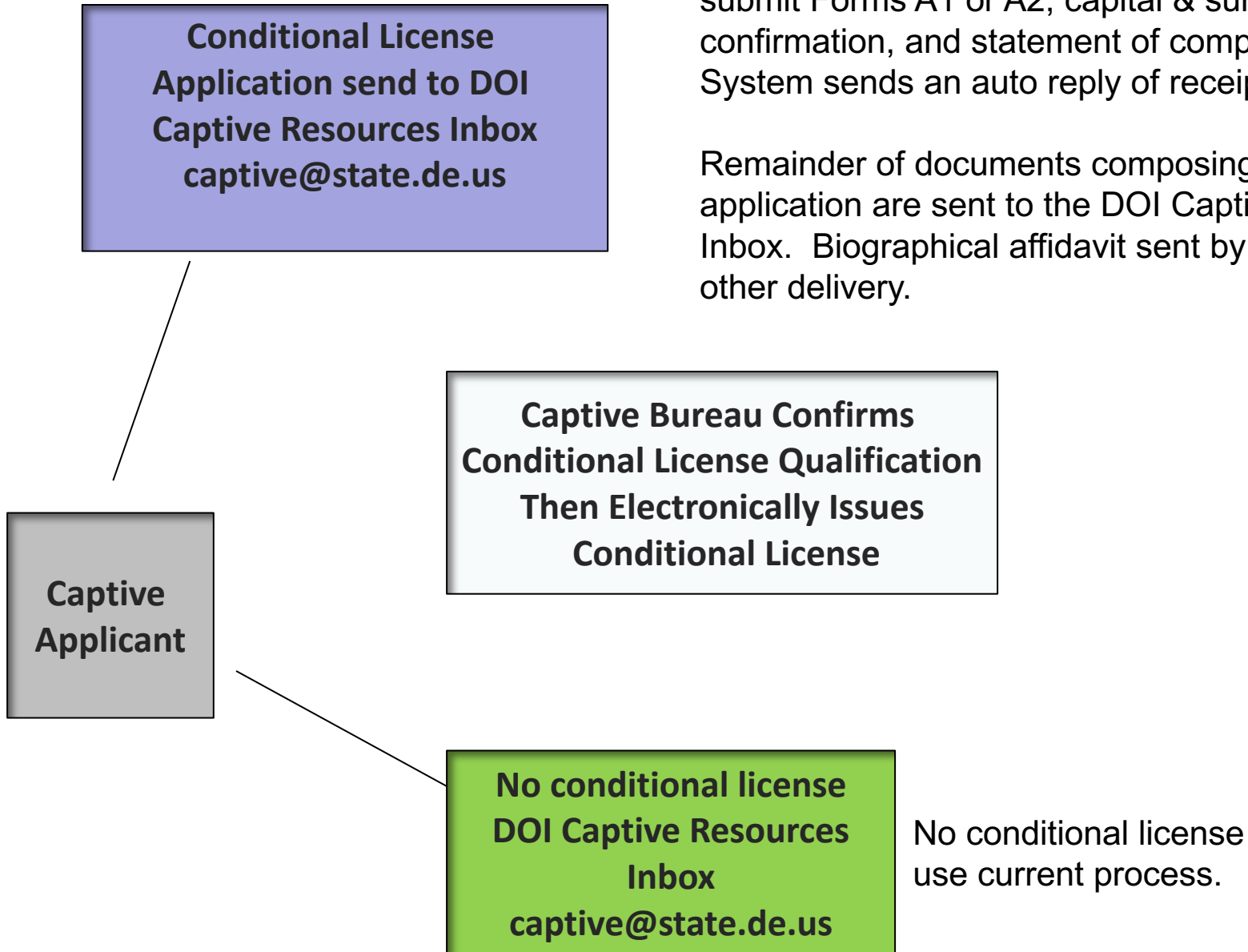
55% OF THE 2017 CAPTIVE INSURANCE APPLICATIONS WERE SUBMITTED IN DECEMBER





\$3,600 license fee paid by credit card, which incurs a transaction fee, or electronic check. Also submit Forms A1 or A2, capital & surplus confirmation, and statement of compliance. System sends an auto reply of receipt.

Remainder of documents composing the complete application are sent to the DOI Captive Resources Inbox. Biographical affidavit sent by U.S. Mail or other delivery.



# NAIC OPTins Online Tax Filing



Submit the Forms & Fees Electronically



Create your Filing in OPTins



State Receives & Processes Filing Electronically



Quick, Electronic Review and Approval

## The OPTins Filing Process

Fees and forms are submitted to the states simultaneously and securely.

All forms and information are easily accessible, in one location, and interactive.

Unlike a paper check, payment is secure.

Filings are never lost or misrouted.

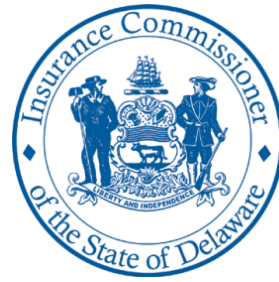
All correspondence between state and industry is electronic.

Quicker Process = Less Man Hours = Improved Bottom Line



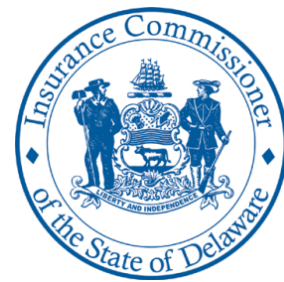
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# NAIC OPTins Online Tax Filing



- **Online payment of premium tax, surplus lines tax, assessments, and other state specific filings.**
- **Mandated in Delaware for non-captive/commercial/traditional insurers.**
- **Captive must provide its name, FEIN, and banking information. Does this conflict with section 6920?**
- **\$10 transaction fee.**





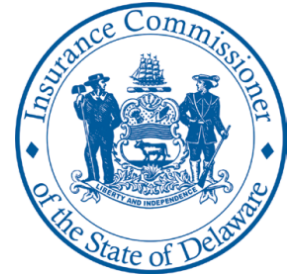
# Cannabis Risks in a Captive

## Banking and Regulatory Considerations.

- Delaware House Concurrent Resolution No. 52 “Creating the Adult Use Cannabis Task Force.”
- 40 banks provide services in Delaware.
- 13 of the 40 are state chartered banks.
- 20 credit unions provide services in Delaware.
- Banks file Suspicious Activity Reports (SAR) but state regulators do not.
- Consideration of more robust examination system for these captives to examine for prohibited activities.
- Limiting loans and dividends and monitoring claim payments.
- Quarterly reporting.



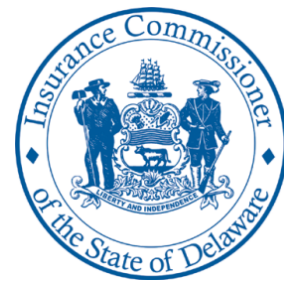
# Marijuana Captive Case Study Challenges Faced



Due to IRC 280e Premium **Not**  
Treated as Tax Deductible Expense



- **Controlled Substances Act (CSA) – Marijuana is a Schedule I Drug.**
- **Schedule I are drugs with no currently accepted medical use and a high potential for abuse. Examples are: heroin, LSD, ecstasy, and peyote.**
- **Illegal to use, distribute, or sell marijuana under CSA.**
- **Disallowed coverage for federal crop insurance.**
- **If an insurer owns a bank it is subject to Federal Reserve.**
- **Money laundering?**



# Cannabis Risks in a Captive

**Medical and Recreational marijuana risks.**

- **crop insurance**
- **product liability**
- **food safety for edible products**
- **dispensaries are responsible to track and validate medical marijuana cards**
- **premises liability and theft risk because marijuana is a small portable product and mostly cash basis**
- **medical conditions are protected health information**
- **cyber coverage for data breach or theft for mishandling patient information**
- **environmental damage**



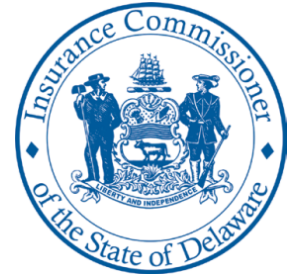


# Captive Exams



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# Exam Process Changes

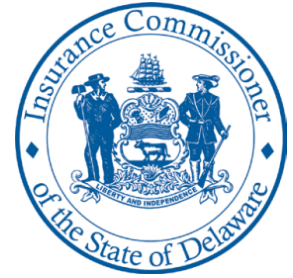


**18 Del. C. § 6908 “Examinations and investigations” requires that every captive insurer be examined at least once every 3 years with the time period being extended to 5 years if the Captive Insurer has a comprehensive annual audit during such period of a scope satisfactory to the Commissioner by independent auditors approved by the Commissioner. The first examination will occur 3 or 4 years after licensing and cover the first 3 or 4 years of existence. Provided there are no solvency concerns or serious compliance issues and the Captive Insurer has an annual audit, subsequent examinations will occur every 5 years thereafter and cover the five-year period since the prior examination.**





# Exam Process Changes



- A list of the captive insurers due for financial examination is prepared in or around March of each year.
- This year Delaware will conduct about 160 exams for years ending in 2017. This compares with 200 exams for years ending in 2016.
- Examinations are performed continuously throughout the year with the examination cycle beginning approximately July 1st and ending approximately June 30th of the following year. For example, our financial examiners will work on examinations for years ending in 2016 beginning in July, 2017 thru June, 2018.
- Exams will not start until after the CPA reports are filed.



# Exam Process Changes



- **First Day Letters (FDL) are sent to the captive manager in April or May. For 2018, the FDLs have been mailed to captive managers with the names of the captives to be examined in 2018.**
- **Upon receiving the FDL captive managers need to upload the information into the shared drive.**
- **After the FDL is sent, an examiner will contact the captive manager via telephone to discuss the examination.**
- **A notice of examination is sent to the captive insurer's Lead Contact giving 30 day notice of the examination's start.**



# Exam Process Changes



- **Examiner will have one to two weeks to conduct exam and issue draft exam to the department.**
- **If the requested information and materials have not been provided when the examiner is ready to start, no additional time will be allocated and the examination will not be rescheduled. The examiner will perform the examination using the information that the captive manager has prepared. The examiner will document the lack of preparation by the captive manager and discuss the impact of the lack of preparation on the examination including exceptions, issues or missing documentation in the report on examination. Insufficient preparation by the captive manager may result in negative conclusions regarding the captive's operations.**



# Exam Process Changes



- The Department's goal is to perform the examinations of captives making the IRC section 831(b) election for approximately \$5,500. This should be doable under the new process assuming that:
- Actuarial work is not required.
- All of the information requested is provided prior to the 30 day notice.
- There aren't any material findings as a result of the examination.



# Exam Process Changes



## Cooperation is essential:

- Captive managers are responsible for collection, preparation and uploading of all the materials requested and listed in the FDL prior to receiving the 30 day notice.
- Captive managers are responsible for contacting the respective auditors, facilitating the necessary releases or approvals, coordinating the necessary documentation, and ensuring the CPA audit work papers are available and uploaded to the ShareFile prior to the commencement of the examination.
- It is essential that the captive manager complete the above steps prior to receiving the 30 day notice from the examiner.



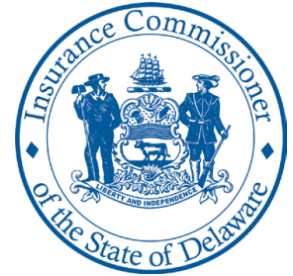


# NAIC Update -Bond Granularity



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# NAIC Bond Granularity



- Increases the granularity from six NAIC designations to 20 designations to 20 RBC categories.
- Current designations are NAIC 1 to 6.
- Maintain current six NAIC designations for statutory accounting and state investment laws.
- 20 RBC categories included in new Schedule D electronic only column.
- RBC category based on NRSRO rating or information provided by NAIC Investment Analysis Office .



# NAIC Bond Granularity

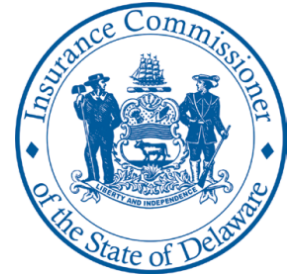


- **Why be more granular?**
- **Larger range within NAIC designation could be incentive to invest in lower quality bonds within the same NAIC designation.**
- **Lower quality bonds get the same RBC charge as higher quality bonds in NAIC designation.**
- **More granularity will reduce the incentive to invest lower quality bonds.**





# NAIC Bond Granularity



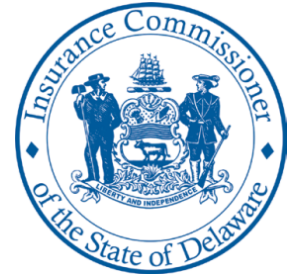
## A.M. Best Company – Bond, Long-Term Debt, and Preferred Ratings

	No. Ratings
• NAIC 1 contains bonds rated aaa, aa+, aa, aa-, a+, a, a-	7
• NAIC 2 contains bonds rated bbb+, bbb, bbb-	3
• NAIC 3 contains bonds rated bb+, bb, bb-	3
• NAIC 4 contains bonds rated b+, b, b-	3
• NAIC 5 contains bonds rated ccc+, ccc, ccc-	3
• NAIC 6 contains bonds rated cc, c, d	<u>3</u>
	21

**\*Granularity proposal condenses NAIC 6 into one rating plus NR for not rated making 20 RBC factors.**



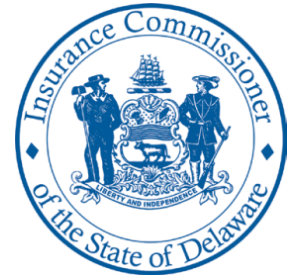
# NAIC Bond Granularity P&C



- **Currently for bonds, P&C has six RBC factors.**
- **NAIC 1 is 0.30%**
- **NAIC 2 is 1.00%**
- **NAIC 3 is 2.00%**
- **NAIC 4 is 4.50%**
- **NAIC 5 is 10.00%**
- **NAIC 6 is 30.00%**
- **In 2019 or 2020 the six factors will expand to 20 factors.**



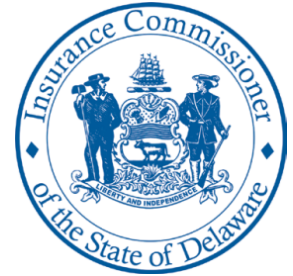
# NAIC Bond Granularity Life



## Example: Proposed Bond Factors

Bond Rating	Current Category	Proposed Category	Current Factor	Proposed Factor
Aaa	NAIC 1	Proposed 1	0.40%	0.28%
Aa1	NAIC 1	Proposed 2	0.40%	0.43%
Aa2	NAIC 1	Proposed 3	0.40%	0.63%
Aa3	NAIC 1	Proposed 4	0.40%	0.79%
A1	NAIC 1	Proposed 5	0.40%	0.96%
A2	NAIC 1	Proposed 6	0.40%	1.13%
A3	NAIC 1	Proposed 7	0.40%	1.30%

# NAIC Bond Granularity



- Impacts Risk Retention Groups registered in more than one state.
- Impacts larger insurers less because they hold a larger portfolio of corporate bonds so the change is spread over a larger population of bonds.
- Impacts smaller insurers more because they hold a smaller portfolio of corporate bonds so the change is spread over a smaller population of bonds.
- Smaller insurers may migrate to exchange traded funds to get large variety of underlying asset diversification, but ETFs are valued at fair value not amortized cost like Schedule D bonds.



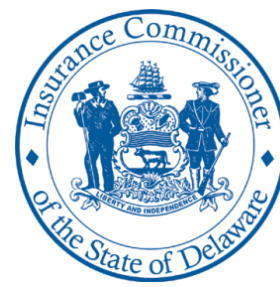
# NAIC Bond Granularity



- **RBC impact is an insurer by insurer matter based on the investment holdings.**
- **Should impact P&C insurers less. Estimate is a loss of 5 to 10 points for RBC.**
- **Will impact life insurers more. Estimate could be a loss of 50 to 70 points for RBC.**



# NAIC Update



## RBC Statistics

	2016	2015	2014	2013
No Action	4,012	4,019	4,021	4,093
Company – Trend Test	52	43	43	47
Company	34	30	30	30
Regulatory	20	18	14	12
Authorized	11	11	15	14
Mandatory	26	38	34	21
Total	4,103	4,116	4,114	4,170
% No Action	97.8%	97.6%	97.7%	98.2%

\*Fraternal companies are not included in this table

\*\* % of No Action does not include those Company's that trigger the Trend Test



# Federal Legislation



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# Federal Housing Finance Agency Regulation

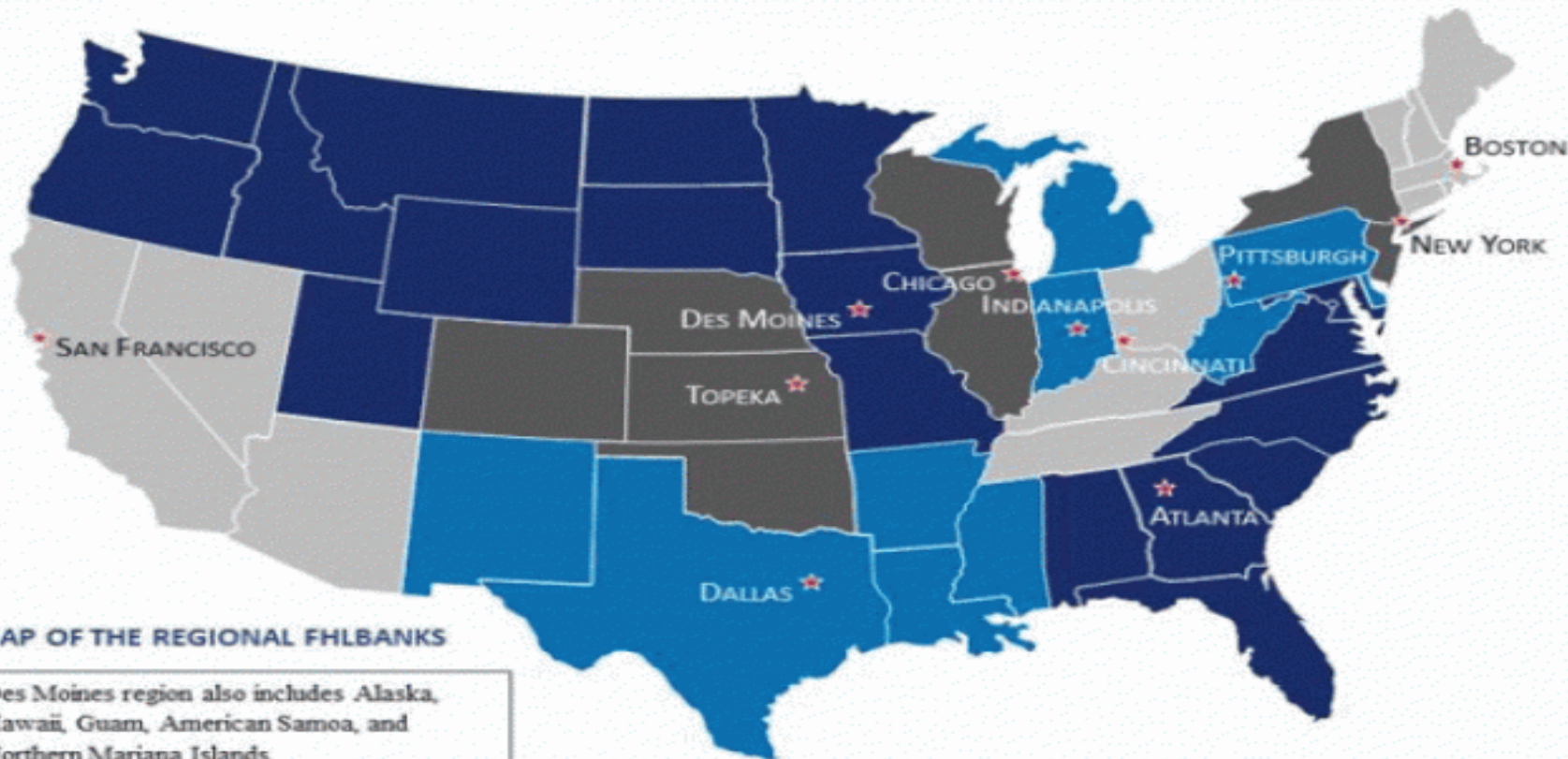
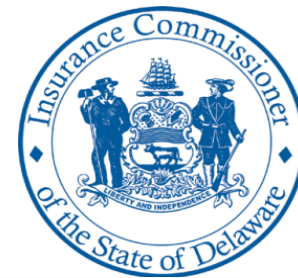


- Regulation excludes captive insurers from membership and prevents entities not eligible for membership from gaining access to Federal Home Loan Bank membership through a captive insurer.
- Membership of existing captive insurers will be “sunset” in 2021.
- FHFA rule negative consequences for Delaware are that fewer captive insurers will be formed which translates into affordable housing grants for Delaware.





# Federal Housing Finance Agency – Federal Home Loan Bank Districts



MAP OF THE REGIONAL FHLBANKS

Des Moines region also includes Alaska, Hawaii, Guam, American Samoa, and Northern Mariana Islands

New York region also includes Puerto Rico and Virgin Islands

# Federal Housing Finance Agency



- **H.R. 2890**
- **Amends the Federal Home Loan Bank Act to permit captive insurance companies that were members of a Federal Home Loan Bank prior to September 12, 2014, to continue to be eligible to be members of such a Bank. Grandfathers Federal Home Loan Bank (FHLB) memberships of approximately 20 captive insurance companies.**
- **S. 2361**
- **Amends the Federal Home Loan Bank Act to allow a captive insurance company that was a member of a Federal Home Loan Bank before January 19, 2016, to continue or restore the membership of the captive insurance company in the Federal Home Loan Bank.**



# Federal Housing Finance Agency



## Top Four Affordable Housing Agencies to Receive FHLB Affordable Housing Grants Since 1990

- **Sussex County Habitat for Humanity** **\$4,354,192**
- **Cornerstone West** **\$2,071,512**
- **Central Delaware Habitat for Humanity** **\$1,100,000**
- **Milford Housing Development** **\$991,300**

Since 1990 the FHLB of Pittsburgh has provided \$17,212,466 in Delaware affordable housing grants supporting a total development cost of \$188,936,749.54 .





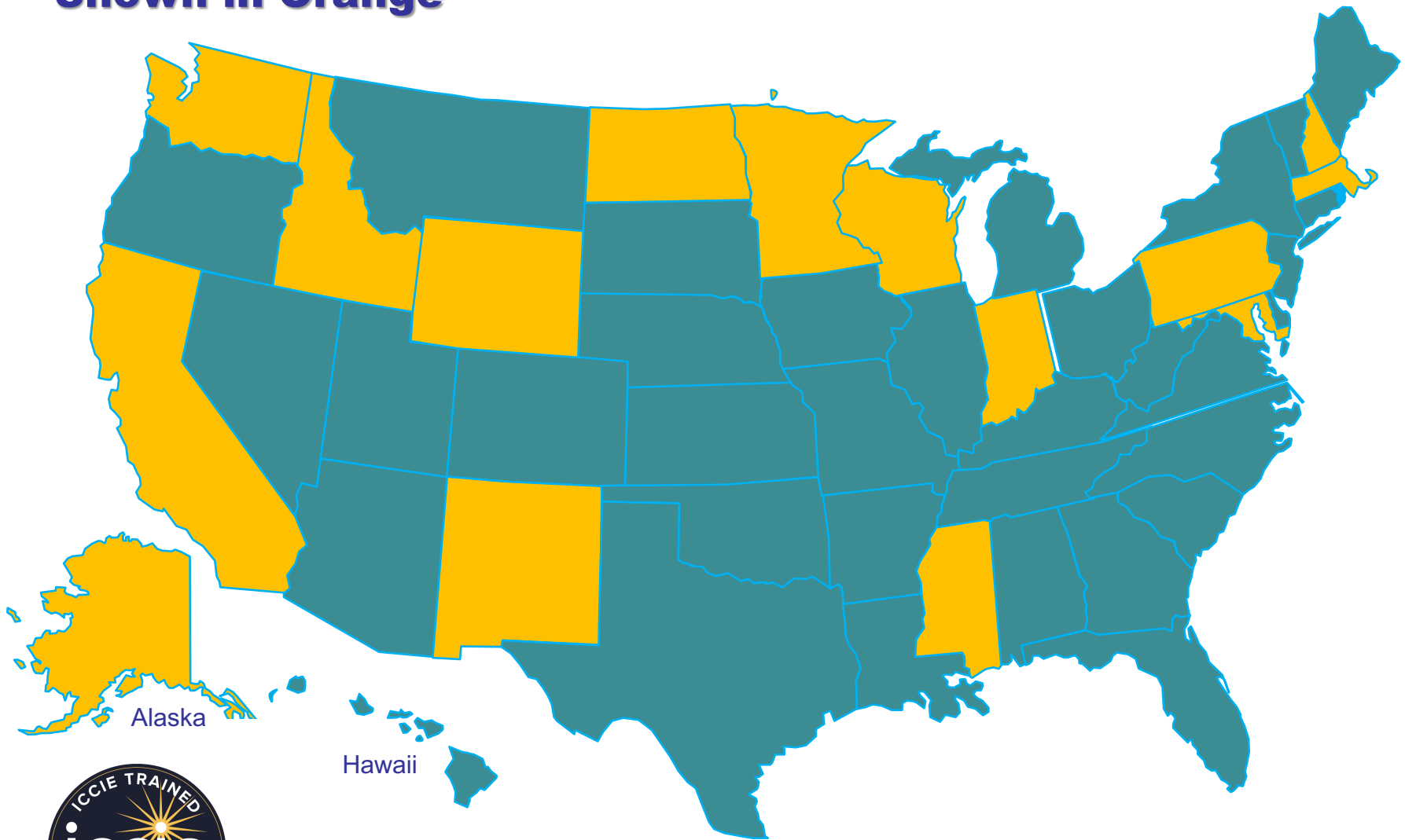
# Internal Revenue and Captive Insurers



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# States Without Captive Laws

Shown in Orange



Alaska

Hawaii



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# IRS and Captives

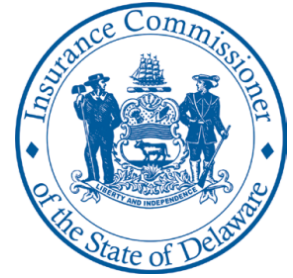


## How can state regulators help?

- More standardization in financial statements such as a standard annual statement used by all states.
- More standardization for examinations.
- Are you ready for captive manager/"promoter" regulation?
  - Should captive managers be licensed as insurance producers?
  - Have you read Rob Walling's article in May's *Captive Review*?
- Do you want NAIC involvement?



# Delaware Annual Report Comparison to 2016-66



## Information sought to IRS Notice 2016-66 on the Delaware Annual Report

- Name of captive domicile.
- Name of the captive manager.
- Types of insurance coverage.
- Description of paid claims.
- The captive's assets.
- $\leq 70\%$  loss ratio.
- Related party loans.



# Questions & Answers

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