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P/C Track:
Are All Cells
Created Equal?



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Are All Cells created Equal

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Are All Cells created Equal

- Rent-a-Captive
- Protected Cell Company (PCC)
- Incorporated Cell Company (ICC)
- Series LLC



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Rent - A - Captive

- Assets and Liabilities “Technically” Comingled
- Stop – Loss Protection purchased for each account.
- Designed to be a Matched Portfolio



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Protected Cell Captive Insurance Companies

- Concept started in Guernsey as Segregated Portfolio Companies
- Most Leading Domiciles now have a version
- Can be unincorporated or incorporated
- Assets and liabilities belong to respective individual cells



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Incorporated Cell Legislation

- Expanded PCC Legislation.
- ICC – Legally Recognized Entity.
 - Distinct and Separate.
- Insurance Regulator will require the ICC to meet the standard requirements of a standalone Captive.



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Series LLC

- Delaware 1996 – Series LLC.
- First Captive Licensed in Delaware in 2010.
- Delaware Law updated in 2015.
 - Series Captive Insurance Company
- Operational Cost efficiencies.
 - Premium taxes.
 - Audits.
 - Actuarial Reviews.



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Incorporated Cell (“IC”) versus unincorporated Protected Cell (“PC”) **Differences**

- Corporate Structure:
 - IC – separate legal entity – corporation, LLC; non-profit; group captive
 - PC – no separate legal entity (segregated account of Protected Cell Captive - “PCC” or “Core”)
- Regulation:
 - IC - defined as “captive insurer” in cell law - provisions applicable to “captives” apply to IC (annual meeting requirement)
 - PC – separate account of PCC (“Core”)



Incorporated Cell (“IC”) versus unincorporated Protected Cell (“PC”) **Differences (cont.)**

- Board of Directors and Officers:
 - IC – may have separate BOD, Officers and registered office
 - PC – same as Core
- Corporate Documents:
 - IC – articles and bylaws (or operating agreement for LLC)
 - PC – no corporate documents



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Incorporated Cell (“IC”) versus unincorporated Protected Cell (“PC”) **Differences (cont.)**

- Premium Tax:
 - IC – Separately taxed same as a pure captive, subject to \$7,500 minimum and \$100,000 maximum. Must file separate premium tax return.
 - PC – Not separately taxed. Premiums of all PCs are “rolled up” to Core. One premium tax return filed with total combined premiums. Subject to \$7,500 minimum and \$100,000 maximum.



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Incorporated Cell (“IC”) versus unincorporated Protected Cell (“PC”)

Similarities

- Minimum capital and surplus – established by the Commissioner (no statutory minimum)
- Certificate of Authority – both ICs and PCs receive a COA
- Financial Reporting requirements – same
- Business Plan change requirements – same
- Operations similar – both operate similar to pure captive; both can contract with Core and other cells; both enter into participation agreements; assets and liabilities of both segregated under cell law; both can obtain separate FEIN



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Example Uses for Cells

- Alternative to stand-alone pure captive – cheaper to operate; licensing may be quicker; fewer internal approvals (PC)
- Assume reinsurance from traditional carrier to retain portion of risk
- Access reinsurance market (generally 100% pass through, no retained risk)
- Pooling of risk to gain risk distribution or reinsurance leverage
- Public entities that cannot own a pure captive (public entity is the participant insured but does not have to be the owner)
- Segregate risk (conventional terrorism versus NBCR)



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Segregation of Assets and Liabilities

- By statute, assets and liabilities of cells and core are segregated
- But will courts and arbitration panels always respect the statutory segregation?



Cases Addressing Segregation of Cells and Core

- Bermuda cases
 - Tensor Endowment Ltd. v. New Stream Capital Fund Ltd. (Sept. 23, 2010)
 - Insolvent hedge fund
 - Segregation of accounts not main issue but upheld
 - In the Matter of CAI Master Allocation Fund, Ltd (Sept. 26, 2011)
 - Segregation is “not merely a corporate veil but a statutory ‘Iron Curtain’....”
 - “Compelling equitable grounds” such as fraud might be reason to depart from segregation
- Ambac Segregated Account
- Pac Re
 - Unincorporated cell
 - Beneficial owners of cell also owned core
 - Court respected segregation but arbitration panel did not
 - U.S Dist. Ct. S.D.N.Y. refused to set aside arbitration decision



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Topics to be covered:

- Pac Re Cell – Structure & Expectation
- Fall out from the Pac Re Case
- Montana's 2019 Legislation
- Series LLC/SBUs vs. PCC/Cells



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Pac Re Cell: Structure & Expectation

- Structure
 - Core and Cell had common ownership.
 - Traditional carrier issued direct policies.
 - Cell reinsured the traditional carrier.
- Expectation
 - Regulator's expectation was that Cell's risk was limited with no exposure to Core.
- Reality
 - Arbitration resulted in unintended consequences for the Core.



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Fall out from the Pac Re Cell Case:

- Not the Final Word
 - Litigation / Arbitration / Settlement
- Direct Policyholder Impact
 - None
- Considerations for Core Owners / Sponsors
 - What does this mean?
 - Require IC's or not?
 - Why expose the Core more than necessary?



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Montana's Reaction to Pac Re? 2019 Legislation

- PCC must be IC
- Why? ----- Why Not?
- Opening Bank and Brokerage Accounts
 - Much easier if an IC – Banks accept an IC's legal entity status



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Series LLC / SBUs vs. PCC / Cells

- Montana offers both structures
- Notable difference? – Direct Writing
- In Montana, an SBU can be plain vanilla SBU, Corp, or an LLC.
- Similar Question – How would segregation of assets/liabilities hold up in court if SBUs are not incorporated?



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Best Practices to Maintain Segregation of Assets and Liabilities

- Follow the statute! For example, use “IC” designation religiously
- Document segregation in Participation Agreement and Articles and Bylaws
- Maintain separate accounts and accounting for core and each cell
- Observe corporate formalities strictly and document them in writing
- Contracts
 - Make it clear when core is contracting on behalf of unincorporated cell and which cell
 - Incorporated cell must contract on its own behalf by authorized officer
 - Parties should acknowledge and agree to segregation
 - All contracts should designate law of domicile as governing law
 - May want to avoid bind arbitration (see *Pac Re*)
 - If forum for resolution of disputes is court, require suits to be maintained in domicile
- Maintain nexus with domicile
 - Maintain assets in domicile
 - To greatest extent practicable, conduct all business in domicile



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