

# PUERTO RICO

## FINANCIAL SERVICES

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The Puerto Rico International Insurers Association ("PRIIA") was formed in 2015 to bring together the various international insurers registered under Puerto Rico's International Insurance Center. Our intention is to create a single body that can respond to and advise the related parties on insurance issues, and to serve as a single voice in discussions with Puerto Rico's Office of the Commissioner of Insurance, which serves as the main insurance industry regulator. One of the primary focuses of PRIIA is to contribute to the promotion of Puerto Rico as a well-regulated and respected jurisdiction for International Insurers, while also guiding for companies interested in entering the island's International Center.

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The Puerto Rico International Insurers Association (PRIIA) was formed in 2015 to bring together the various international insurance companies registered under Puerto Rico's International Insurance Center, better known as Act 399. PRIIA's efforts focus on the unification of insurers in a single body that can respond to and advise related parties in insurance and regulatory issues.

For the first time, PRIIA joined forces with the Puerto Rico International Banks Association (PRIBA) to produce the 2021 Financial Services Review. This year's edition includes great articles with high-value content covering both international insurance and international banking topics. The joining of forces between PRIIA and PRIBA is not a coincidence or random. On the contrary, it is a byproduct of the continuing experience in Puerto Rico in which investors are discovering a unique environment to develop interface opportunities between the different incentives, including both International Banking and Insurance legal platforms. This is an up-and-coming venue we expect to continue.

Adding to the excitement was the approval of the much-expected Incentive Code of Puerto Rico, better known as Act 60, in 2019. This Legislation consolidates all tax and monetary benefits conferred through several different existing laws into one incentives code. We believe Insurance and Banking preferred Tax Environment was reaffirmed, and accordingly, interested capital deployments will result in due process.

Another significant development was updating the Insurance Code's Rule 80 concerning international reinsurers assuming US risks. As with any other clarification of the regulatory environment, we see this as a positive sign from a potent regulator, the Office of the Commissioner of Insurance of Puerto Rico, and their will to maintain the International Insurance Center platform at the highest standards.

We can report a strong interest from international investors to organize entities within the International Insurance Center of Puerto Rico. This interest is mainly driven by word-of-mouth promotion and the consolidation of Puerto Rico's distinguishing features vis a vis other jurisdictions. A definitive interest from Latin America is evident and expected to continue. Although the areas directly affected by earthquakes that impacted our southern coast in January 2020 and the pandemic crisis which has shaken our economy, Puerto Rico's noble population has demonstrated resiliency and determination. The interest in Puerto Rico's domicile has not diminished. Quite the opposite, more and more individuals and companies seek to expand using Puerto Rico incentive laws. Puerto Rico remains attractive and competitive when compared to other jurisdictions. PRIIA and PRIBA are ready to support international capital as they understand and participate in our banking and insurance platform. A bright future is on the horizon.

Sincerely,




**Ruben A. Gely-Ortiz** is the president of International Insurer's Consulting Group, and vice-president for Puerto Rico's International Insurance Association. He specializes in off shore protected cell business and international reinsurance arrangements.



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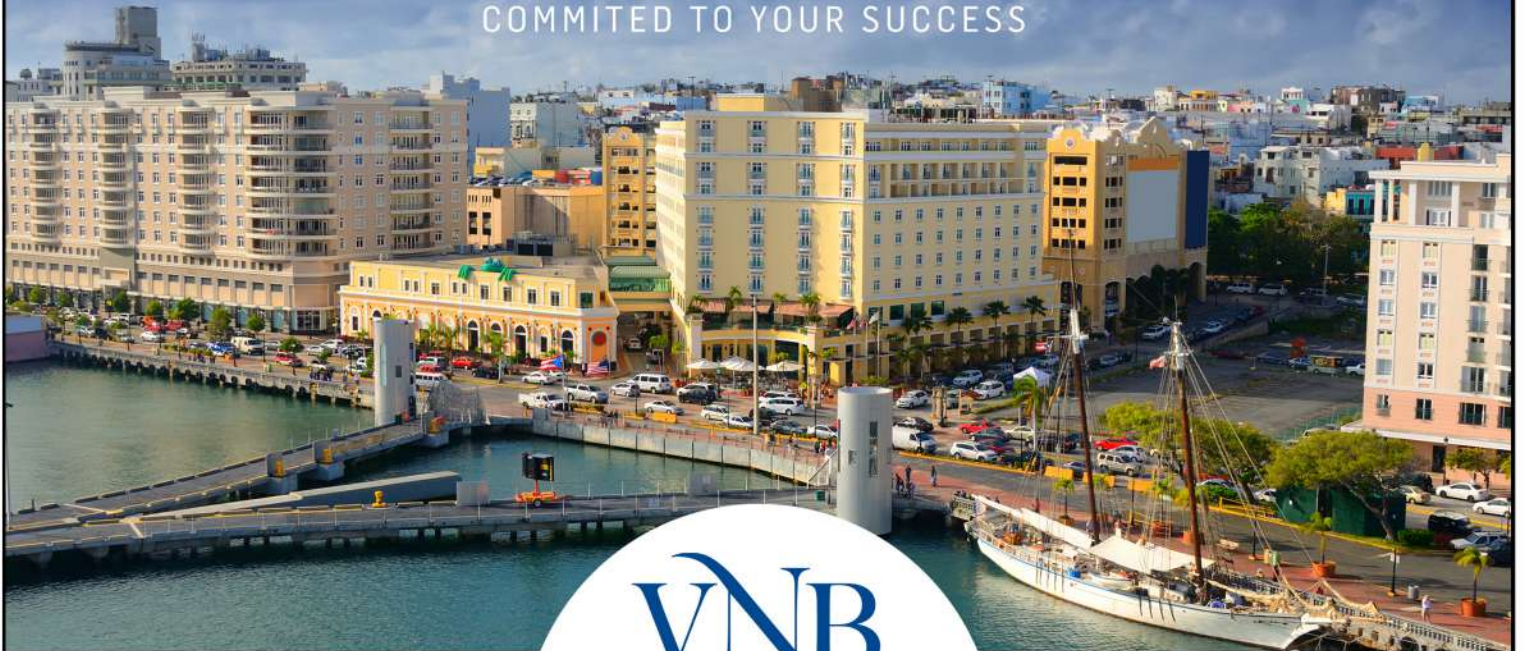
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## A PRIMER ON THE PUERTO RICO TAX INCENTIVES CODE

By: Vidal, Nieves & Bauzá | March 2021

Attorneys Pedro I. Vidal Cordero and Roxana Cruz Rivera of RSM Puerto Rico discuss the changes introduced by the new Incentives Code of Puerto Rico in the tax regime for tax benefits afforded to international insurers and other companies establishing operations in Puerto Rico.



On July 1, 2019, the Puerto Rico government approved its first Tax Incentives Code. After more than a year of public discussions, the then Governor of Puerto Rico signed House Bill No. 1635 into law. The new code is known as the **"Incentive Code of Puerto Rico" or as Act 60-2019 (the "Incentives Code")**. The purpose of the new law was to consolidate all tax and monetary benefits conferred through several separate existing laws, into one Incentives Code and eliminate tax incentives that were either considered obsolete or had not contributed in a real and effective manner to the development of the economy of Puerto Rico.

For example, before the approval of the Incentives Code, approximately seventy-six (76) different laws and economic development programs containing laws adopted between the years 1945 to 2019 for industries as diverse as manufacturing, housing, and international insurers, were comprised into Puerto Rico's economic tax incentives legal framework. The new Incentives Code consolidates useful old and new incentives and tax and monetary benefits in one coherent and effective framework.

Among the tax benefits included in the Incentives Code are those applicable to the exporting of services from Puerto Rico, and providing financial, banking and insurance products and services to persons outside Puerto Rico. These activities were previously covered under Act 20-2012, known as the "Act to Promote the Export of Services", Act 273-2012, known as the "International Banking Center Regulatory Act",

Act 399 of 2004, and known as the "International Insurers and Reinsurers Act of Puerto Rico".

With limited exceptions, the final version of the Incentives Code retained the majority of the tax benefits and incentives contemplated under the existing laws and programs. The Incentives Code introduced certain modifications to existing benefits and, finally, added a number of new tax incentives. Moreover, the Incentives Code incorporated into its provisions Act 21-2019, known as the "Puerto Rico Economic Development and Opportunity Zones Act of 2019". Generally, the Incentives Code offers businesses that decide to establish operations in Puerto Rico within the contemplated industry categories the following:

- A FIXED 4% INCOME TAX RATE.
- A 100% EXEMPTION FROM DIVIDEND DISTRIBUTIONS.
- A 75% EXEMPTION ON PROPERTY TAXES.
- A 50% EXEMPTION FROM MUNICIPAL LICENSE TAXES.

However, certain industries such as businesses engaged in international financial, banking and insurance institutions, for example, are granted different and specific tax benefits within the provisions of the Incentives Code. What follows is a summary of some of the key provisions

found in the Incentives Code.

### **Effective Date of the Incentives Code and Impact on Businesses Holding Tax Incentives' Grants.**

The Incentives Code was effective immediately upon its approval on July 1, 2019. However, those seeking new tax incentive grants were given the option of either filing an application on or before December 31, 2019 under either the Incentives Code or under the individual incentive laws in place prior to their consolidation into the new Incentives Code. Effective January 1, 2020 and thereafter, all applications and requests needed to be filed solely under the provisions of the Incentives Code.

All current tax grants holders (i.e. holders of tax grants under Act 399 of 2004, Act 273 of 2012, Act 73 of 2008 and Act 20 and 22 of 2012, among others) will continue to enjoy the full benefits thereunder, and existing tax grants may be modified or amended under the provisions of the corresponding laws according to which they were originally issued.

### **Significant Changes in Tax Benefits for International Insurers and International Insurer Holding Companies**

#### **FILING LOCATION:**

From the standpoint of international insurers wishing to establish operations under the Puerto Rico International Insurers and Reinsurers



Center created under Act 399-2004, the Incentives Code introduced changes to the general administrative and tax structure which up to now had been only subject to Act No. 399-2004.

The Incentives Code changed the location of the filing for the tax grant. Currently, applications to become authorized as an international insurer or reinsurer and to be issued a fifteen (15) year tax decree or grant contemplated by the law were both processed directly before the Office of the Commissioner of Insurance ("OCS", by its Spanish acronym). The latter notwithstanding, under the provisions of Act No. 399-2004 it was provided that tax grants for international insurers were issued by the OCS in conjunction with the Department of Economic Development and Commerce ("DDEC", by its Spanish acronym).

Beginning on January 1, 2020 applications for authority to act as an international insurer or reinsurer will continue to be filed before the OCS. One important change, however, is that the corresponding tax grant application for an international insurer must now be separately filed with the DDEC.

Tax grants for international insurers will require the OCS's endorsement (following the requirements found in Act No. 399-2004) and be issued in compliance with the provisions of the Incentives Code and the "Incentives Regulations" adopted effective January 20, 2021 by the DDEC.

#### STRUCTURAL CHANGES:

Pursuant to the authority which was granted to the DDEC under the Incentives Code with respect to the tax grants issued to international insurers, the new Incentives Code specifically provides that changes in control, mergers, consolidations or conversions of international insurers operating under Act No. 399-2004 will not result in a repeal of such tax grant if the transaction is approved by the Secretary of the DDEC.

Surprisingly, the Incentives Code does not provide that the OCS's approval is similarly required with respect to any of these corporate transactions and, further, it repeals the existing provisions found in Act No. 399-2004 which up to now had required that changes in control and other extraordinary corporate transactions be approved by the Commissioner of Insurance, --the primary regulator of these entities--, in order for such transactions not to result in a repeal of a tax grant granted under Act No. 399-2004.

On the other hand, international insurer holding companies under Act No. 399-2004 were not required to file each year the special tax return which the Puerto Rico Treasury Department ("PRTD") has developed for international insurers. However, they are required to file an annual certification before the PRTD and the OCS related to their qualification as a tax-exempt entity under Act No. 399-2004. The Incentives Code retained this requirement, but added that the annual certification also be filed before the DDEC in addition to the PRTD and the OCS.



Therefore, an international insurer holding company must file the annual certification before three separate government agencies: PRTD, DDEC and OCS.

#### NEW INCENTIVES FOR INTERNATIONAL INSURERS AND INTERNATIONAL INSURER HOLDING COMPANIES:

International insurers and international insurer holding companies, are now included in the definition of an "accredited investor" found in the Incentives Code. As such, they are able to take certain deductions recognized in the Incentives Code for investments made by accredited investors in certain private equity funds.

The Incentives Code introduced a number of changes to the overall tax regime for tax benefits afforded to international insurers operating under Act No. 399-2004. Generally, an international insurer will continue to be subject to a 4% rate on net income in excess of \$1.2 million. However, the Incentives Code now only grants new applicants a 50% exemption from the payment of municipal license taxes to the Puerto

Rico municipality in which the international insurer has a physical office and from which it generates income related to the business it conducts (under Act No. 399-2004 international insurers were completely exempt from the payment of municipal taxes). Additionally, the new Incentives Code reduced the exemption on the payment of personal and real property taxes to a 75% exemption.

These changes in the tax regime that applies to international insurers under the new Incentives Code are certainly concerning. In particular, municipal license taxes are a type of tax paid by businesses to the municipality in which their principal office is established. It is a tax calculated on gross receipts and the precise amount of the tax varies from municipality to municipality.

Because insurance companies either sell insurance policies in exchange for a premium or reinsure the risks of insurers similarly in exchange for a reinsurance premium, the municipal license taxes international insurers are subject to paying under the Incentives Code may be considerable. Moreover, the decision to





impose this tax on international insurers established in Puerto Rico from a public policy standpoint may be questionable if one considers that domestic insurers operating in Puerto Rico are not subject to the payment of municipal license taxes and, instead, qualify for a 100% exemption from the payment of a tax on the gross premiums charged on policies sold in the market when their operations are conducted from Puerto Rico and meet certain conditions established by law.

#### Other Significant Changes in Tax Incentives

##### MANUFACTURING, GREEN ENERGY AND TOURISM INDUSTRY:

The Incentives Code reduced the tax exemption previously conferred for property taxes and municipal taxes from a 90% exemption to a 75% and from 60% to 50%, respectively. Tourism activities are now 100% exempted from income taxes on dividend distributions. Previously, these distributions were subject to income tax under the PR Code.

##### EXPORT SERVICES (ACT NO. 20 OF 2012):

The Incentives Code explicitly established as new qualifying export service activities the sale of tickets outside of Puerto Rico or the sale of tickets that are purchased by tourists in Puerto Rico, as well as income related to the transmission or sale of rights to a recording of shows, musical productions and events of eSports and Fantasy Leagues held in Puerto Rico for audiences outside of Puerto Rico. Additionally, the tax benefits for municipal license taxes and property taxes for export services were reduced from a 60% and a 90% exemption to a 50% and a 75% exemption, respectively. The tax grants for export services under the Incentives Code have a term of fifteen (15) years, while under Act No. 20 the tax grants have a term of twenty (20) years.

##### INDIVIDUAL RESIDENT INVESTORS (PREVIOUSLY UNDER ACT 22 OF 2012):

Under the Incentives Code, commodities, currencies and any digital asset based on blockchain technology are subject to a special capital gain treatment (previously applicable under Act No. 22-2012, also known as the "Act to Promote the Relocation of Individual Investors to

Puerto Rico"). Furthermore, the Incentives Code requires that Individual Resident Investors donate at least \$10,000 to a not-for-profit organization in Puerto Rico.

New Tax Benefits included in the Incentives Code The Incentives Code recognizes a new tax benefit afforded to new small and medium-size business ("PYMES", by its acronym in Spanish) established in Puerto Rico, as well as for businesses establishing operations in Vieques and Culebra and to so-called "Difficult Recruitment Professionals". PYMES are defined as businesses with an average volume of business of three (3) million or less during the three (3) previous tax years. This tax benefit includes a 2% special income tax rate and a 100% exemption from property and municipal taxes during the first five (5) years of operations. After the initial two (2) years, these businesses will enjoy a 4% income tax rate and a 75% and 50% exemption for property and municipal taxes, respectively. On the other hand, "Difficult Recruitment Professionals" are defined as professionals who are residents of Puerto Rico who have specialized knowledge in the operation of an exempted business under the Incentives Code or under a superseded tax incentives act. These individuals will enjoy a 100% income tax exemption on the first \$100,000.00 of their salary per the calendar year.

#### CONCLUDING THOUGHTS

The Incentives Code is a lengthy, dense, and relatively complex legislation. The DDEC is now the sole central government agency responsible for granting tax incentives to all industries establishing operations in Puerto Rico, including international insurers and other financial entities. This role requires administrative, technological and personnel adjustments to handle the volume of requests managed in the past by other government agencies (for example, the Department of Housing, the Insurance Commissioner's Office, the Industrial Development Company, and others). Further, it should require an effective coordination among the government agencies involved and the DDEC in order that the application process of businesses establishing operations in Puerto Rico under such tax incentive regime are considered in a timely manner. The Government of Puerto Rico has the responsibility of being transparent, effective, efficient and offering a clear-cut tax incentives' framework that decidedly promotes Puerto Rico as a preferred domicile for investors and businesses and, in doing so, contributes to the development of Puerto Rico's economy without undermining its existing and future fiscal responsibilities.

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## PUERTO RICO SHOWCASES AN EXCELLENT ALTERNATIVE FOR CAPTIVE INSURANCE COMPANIES

By: **Francisco Luis, CPA, ESQ** | March 2021

At Kevane Grant Thornton LLP, we have assisted several clients in structuring with captives as part of their business and tax planning. Do not hesitate to contact us if you would like to assess your strategy or plans.

One of the competitive planning opportunities for Puerto Rico is that it is treated as a foreign jurisdiction for United States income tax purposes, but at the same time is protected by the US constitution. Also, is regulated and accredited member of the National Association of Insurance Commissioners (NAIC), the United States Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).

This provides a great scenario to organize an international insurer or reinsurer in the Puerto Rico Center for International Insurance.

Under Puerto Rico's Act 399, international insurers and reinsurers are given attractive tax treatment.

These tax incentives include:  
a total tax exemption on the net income earned up to \$1.2 million and a 4% fixed income tax rate over that threshold;

**100% EXEMPTION ON DIVIDENDS.**

**50% EXEMPTION OF MUNICIPAL LICENSE TAX.**

**75% OF PROPERTY TAX.**

The incentives are secured in a tax decree for an initial term of 15 years, with a renewal option for two additional periods. However, when planning

with the Puerto Rico tax incentives, it is crucial to consider the federal tax implications, mostly when we may have US residents in the ownership structure.

Because of our fiscal autonomy, entities organized and doing business in Puerto Rico are not subject to federal taxation, neither Puerto Rico bona fide residents are taxed on their Puerto Rico source of income. This has been the cornerstone and framework of the Puerto Rico strategy to elaborate on a tax incentives program that, for the past 100 years, has served to promote the economic development of the island.

Preventing the potential abuse with the use of foreign corporations, the federal tax statute has several dispositions that are known to be as anti-deferral rules. The most common and relevant are the concept of Control Foreign Corporations (CFC) and Passive Foreign Investment Company (PFIC).

Without getting to technical, the classification of a foreign corporation such as a CFC or PFIC may end up practically destroying the benefits of foreign tax incentives for the US residents. Moreover, the recent US tax reform brought changes that have resulted in more strict guidelines with respect to the characterization of a foreign corporation as a CFC and PFIC. A CFC is

generally a foreign corporation in which more than 50% of its vote or value is owned by a US Shareholder.

In the captive insurance arena, instead of 50% is 25%. The US tax reform made two major changes in this area. The US Shareholder definition was one that had more than 10% of the voting power of the foreign corporation. Now it adds that it is either voting power or value of the foreign corporation.

The second major change for CFCs is with respect to the number of days during the year that the foreign corporation may meet the criteria to be classified as a CFC. Prior to the US tax reform, the foreign corporation could meet the CFC definition for a period not to exceed 30 days during a year without being classified as a CFC. Now, if the foreign corporation meets the criteria in any day of the year, it is considered a CFC for the entire year.

A foreign corporation is a PFIC if one of two conditions are met. The first condition is based on the income of the corporation. The first condition triggers if at least 75% of the corporation's gross income is considered "passive". Typically, income from investments is considered passive. The second condition is based on the corporation's assets and would be met if more than 50% of the assets are passive.





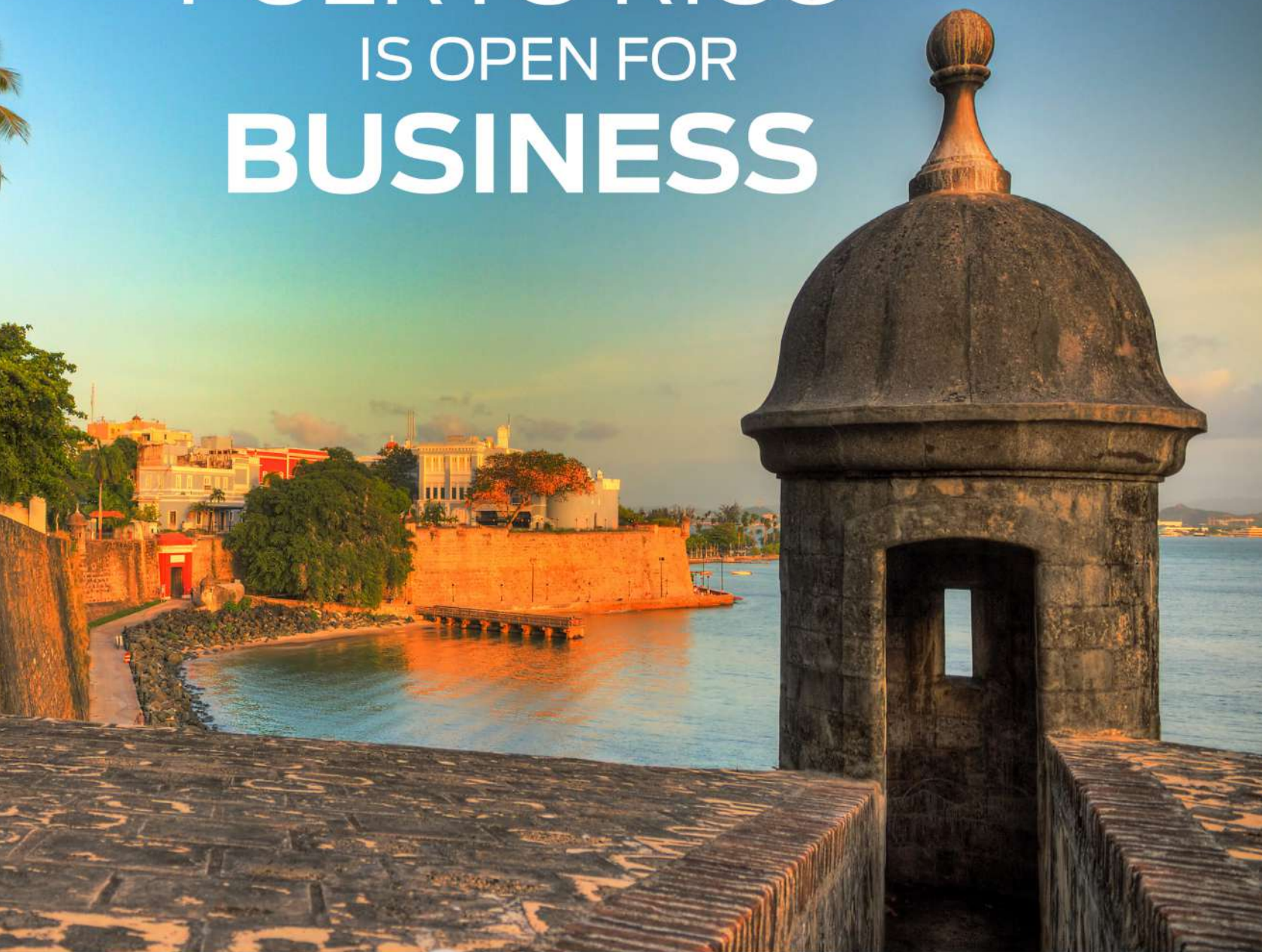
Historically, captives avoided the PFIC classification based on an exception applicable to an active trade or insurance businesses. The truth or the matter is that prior to the US tax reform, there was certain flexibility to use this “insurance exception” as no specific guidance was provided. Recently, proposed regulations were published addressing the requirements that a foreign corporation must satisfy to qualify for the insurance exception.

Now additional tests and metrics need to be complied with to avoid being a PFIC. One of the new tests is that the insurance company needs to have more than 25% of the insurance company's total assets as insurance liabilities reported in the financial statements.

In addition, more than 50% of the corporation's business needs to be from insurance and reinsurance. Although expressed here, these can be sophisticated tests as the proposed regulations are quite technical. The use of captives can result in significant tax savings, and Puerto Rico offers an ideal scenario for this. Notwithstanding, the tax planning needs to consider the new federal tax changes to avoid pitfalls in the future.



# PUERTO RICO IS OPEN FOR BUSINESS



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## IS MY INTERNATIONAL FINANCIAL/BANKING ENTITY ELIGIBLE TO APPLY FOR FDIC INSURANCE, YER OR NO?

By: **Pirillo Law** | March 2021

Pirillo Law is a Puerto Rico medium-size boutique law firm located in San Juan, Puerto Rico. We are empowered to provide clients with legal strategies and real-time solutions that are on-point, actionable and direct. The authors and contributors, Martín Pirillo, Omara Méndez and Natalia Zequeira, all with previous practices in major banking and financial institutions, advise clients of the full spectrum of laws and regulatory compliance matters applicable to financial institutions.

"That is the question..." Welcome to the world of international financial entities and international banking entities, commonly called IFEs. IFEs are entities organized and licensed according to P.R. Act No. 273 of September 25, 2012, as amended ("Act 273") and international banking entities are those organized and licensed under Act No. 52 of August 11, 1989, as amended ("Act 52") (Act 273 and Act 52, collectively the "Organic Acts").

IFE's have encountered the question of Federal Deposit Insurance Corporation ("FDIC") insurance eligibility on countless occasions when working with federal or foreign regulators, payment processors, vendors, and other banking counterparties. This article analyzes the provisions of the U.S. Federal Deposit Insurance Act ("FDI Act") which govern insurance by the FDIC and lays the case in favor of the eligibility of IFEs to request FDIC insurance. In short: are IFEs banking institutions eligible to request FDIC insurance?

### INSURANCE COVERAGE

An analysis of qualification and eligibility for FDIC insurance first requires understanding FDIC insurance coverage.

The FDIC, a U.S. federal agency, insures deposits at eligible depository institutions dollar-for-dollar up to the deposit insurance limit, in the event of failure of a depository institution. Coverage is automatic for the depositor whenever a deposit account is opened at an FDIC-insured depository institution.

A depositor is insured up to the insurance limit of \$250,000 (currently) for each account held by that depositor at different eligible banking institutions, and, if certain requirements are met, for each account held by that depositor in different categories of ownership (for example, joint accounts and trust accounts) even if at the same banking institution. Retirement accounts are also added together (separate from deposit accounts) and insured up to the insurance limit. Thus, a depositor can have more than \$250,000 of deposit insurance coverage at one same institution.

Not all financial products at a banking institution are covered by the FDIC. The FDIC covers the traditional types of bank deposit accounts – including checking and savings accounts, money market deposit accounts (MMDAs), and certificates of deposit (CDs). However, it does not cover non-deposit investment products, such as mutual funds, annuities, life insurance policies, stocks, and bonds.

Summarizing the above, FDIC deposit insurance coverage depends on two main factors: (1) whether the depositor's chosen financial product is a deposit product covered by the FDIC, and (2) whether the depository institution is FDIC-insured.

This article will attempt to address the second question by discussing what is a depository institution insurable by the FDIC. This article does not purport to cover all the legal complexities applicable to the analysis of FDIC eligibility,

as there are additional criteria that depository institutions must comply with to be able to obtain FDIC coverage. If, however, you have gotten this far in reading this article, we invite you to further explore in the future what these additional criteria are and whether your IFE complies with the same. For now, let us focus on the qualification conundrum.

### WHAT IS A DEPOSITORY INSTITUTION?

The FDI Act defines "depository institution" as any bank or savings association. In turn, the term "bank" under the FDI Act includes any national bank and State bank, as well as any Federal branch and insured branch. A "State Bank" is defined as "any bank, banking association, trust company, savings bank, industrial bank (or similar depository institution which the FDIC Board of Directors finds to be operating substantially in the same manner as an industrial bank), or other banking institution which-- (A) is engaged in the business of receiving deposits, other than trust funds ...; and (B) is incorporated under the laws of any State ..." For clarity purposes, Puerto Rico is included in the definition of a "State" under the FDI Act.

### CAN AN IFE BE CONSIDERED A "DEPOSITORY INSTITUTION" UNDER THE FDI ACT?

For this analysis, an IFE would need to demonstrate that it meets each of the prongs of the definition of a "State bank." Assuming that IFEs reading this article are corporations or limited liability companies (LLCs) organized under the



laws of Puerto Rico, the prong of being "incorporated under the laws of any State" is easily met. However, the following two prongs need to be further analyzed: (a) whether the IFE is a "bank" or "banking institution" within the meaning of the FDI Act, (b) engaged in the business of receiving deposits (other than trust funds). The term "banking institution" is not defined under the FDI Act and regulations implemented under it. The question of whether an IFE is a "bank" or "banking institution" within the meaning of the FDI Act does not appear to have been addressed by the FDIC or its staff in the past.

As guidance to financial institution that wish to apply for FDIC deposit insurance, the FDIC published the Deposit Insurance Procedures Manual ("Manual"), which establishes that for an institution to obtain insurance from the FDIC, it must obtain a state or national charter issued by the applicable state or federal chartering authority authorizing the applicant to engage in the proposed banking activities. This requirement may be sufficed with either a national or state bank charter, a state or federal savings bank or association charter, or other types of charter authorizing a depository institution to engage in the business of receiving deposits other than trust funds.

Furthermore, FDIC's and other federal banking agencies' regulations unrelated to FDIC insurance define a "depository institution" as a commercial bank (including a private bank), a savings bank, a trust company, a savings and loan association, chartered under the laws of the United States and having a principal office located in the United States. Federal banking regulations have defined the core "commercial banking" activities in which US-based banks engage in to be deposit-taking, check-payment, and lending. At the local level, Act No. 4 of October 11, 1985, as amended ("Act 4-1985"), the organic act of the Office of the Commissioner of Financial Institutions ("OCFI"), defines "banking business" as the business of buying, selling, paying or collecting bills of exchange or bank drafts, issuing letters of credit or receiving money for their transmittal and transmitting them by bank draft, check or other means, or grant loans, or receive deposits, or engage, in general, through a combination of any of the above functions, in any of the above functions, in any banking transaction that a bank is authorized to perform under the Puerto Rico Banking Act. Local regulation by the OCFI applicable to IFEs also groups deposit-taking, check-payment, lending, and other activities and categorizes them as "commercial banking."

Based on the foregoing, we, therefore, conclude, that a "banking institution" is an organization that performs banking functions similar to those performed by a bank and is licensed, supervised and examined similarly to a bank. Under their Organic Acts, IFEs are authorized to engage in activities and provide services generally carried out by commercial banks, including: accept deposits, including savings, checking and demand deposit accounts, among others, and to make loans. Furthermore, the Organic Acts authorize IFEs to engage, outside of Puerto Rico,

in any activity that is financial and that a foreign branch or subsidiary of a U.S. commercial bank would otherwise be authorized to engage in according to the applicable federal banking statutes. Accordingly, it is demonstrable that IFEs engaged in such deposit-taking, check-payment, and lending activities are undeniably engaged in "commercial banking." It is further demonstrable that IFEs engaged in commercial banking activities are granted full banking powers, similar to the powers granted to Puerto Rico-chartered banks and perform the same banking functions as Puerto Rico-based or US-based commercial banks, except that they offer these services exclusively to foreign persons. The mere fact that the services are geared towards the international market should not change the characterization of these entities as banks or banking institutions.

Furthermore, IFEs that engage in the business of accepting deposits and offer other products and services classified as distinctive and representative core banking functions under federal and state banking laws must be licensed, supervised and examined by OCFI in the same manner, and to the same extent, as banks authorized to operate in Puerto Rico:

**CHARTERING** – Similar to commercial banks, IFEs are organized through approval of an application and issuance of a permit by the OCFI, the banking regulator in Puerto Rico. In reviewing such application, the OCFI considers the same business concepts applicable to commercial banks (e.g. the financial history and condition of the institution; the adequacy of its capital structure; and the general character and fitness of its management, among other things).

**ORGANIZATION** – The organizational process for IFEs is similar to the process of organizing a commercial bank. Also, IFEs may use the term "bank" in their names.

**REGULATION** – IFEs are subject to state and federal laws and regulations applicable to banking entities and commercial banking products and services, including but not limited to those adopted under the U.S. Gramm-Leach-Bliley Act, U.S. Bank Secrecy Act and the USA Patriot Act, and are subject to banking compliance requirements and risk management controls similar to those applicable to state and national banks.

**SUPERVISION** – The primary regulator of IFEs is the OCFI. The OCFI was created according to Act 4-1985, the OCFI is granted broad powers to regulate and supervise all banks and financial institutions doing business in Puerto Rico. Under Act 4-1985, the OCFI may carry out such acts necessary to successfully achieve its supervisory mandate over financial institutions. The OCFI applies to IFEs supervisory considerations similar to those applied to banks and may impose controls or special conditions such as requiring resolution plans, recovery, and exit plans, in the same or similar way as these may be required of banks.

**EXAMINATION** – IFEs are subject to examination for their safety and soundness, and for which they are assigned composite ratings based on the same rating framework as commercial banks. IFEs are held to safety and soundness standards, capital ratios and legal reserves similar to those applicable to commercial banks. The OCFI follows the federal examiners' manuals, such as the FDIC, for safety and soundness examination purposes and the Federal Financial Institutions Examination Council ("FFIEC") manual for examination purposes regarding compliance, risk and information technology.

**REPORTING** – banking entities are required to submit reports of their capital, asset and liability data using quarterly Report of Condition and Income Reports ("Call Report"). Similarly, IFEs are required to submit the Easy CALL Financial Report, reporting on similar items, as applicable.

By these standards, it is reasonable to argue that an IFE engaged in banking activities is a "banking institution" for purposes of the FDI Act. Therefore, such IFE would be a "State bank" under the definitions of the FDI Act.

## CONCLUSION


FDIC insurance coverage entails qualification at the financial institution level and the financial product level, as well as compliance with certain minimum criteria established by the FDIC. At the financial institution level, a banking institution that is chartered by a State bank regulator and authorized to engage in the business of receiving deposits (other than trust funds) is eligible to request deposit insurance from the FDIC. An IFE licensed by the OCFI and authorized to engage in deposit-taking activities, would, following the reasoning outlined in this Article, be a depository institution under the FDI Act and eligible to request deposit insurance. Having overcome this conundrum, IFEs interested in obtaining FDIC coverage should further explore the financial products and other FDIC eligibility criteria and responsibilities, as well as the benefits to it and its customers of being FDIC-insured.

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At International Insurer's Consulting Group Inc. (IICG), we are passionate about your success in Puerto Rico. Do you know about all of the unique benefits that specialty insurance, captive insurance, and international insurance companies can claim on the Island? Act 399 and Act 98 have opened up unique opportunities which international insurers and reinsurers can take advantage.



Our international insurance consulting firm specializes in the formation process for captives insurance companies, segregated protected cells, private placement life policies, and life & health reinsurers in Puerto Rico's International Insurance Center.

More than just a service provider; we strive to be your Puerto Rican partner.

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## STRATEGIC INSURANCE CONSULTING THAT ADAPTS TO A CONSTANTLY CHANGING WORLD

By: **International Insurance Consulting Group** | March 2021

Rubén N. Gely Ortiz, is the president of International Insurer's Consulting Group, and vice-president for Puerto Rico's International Insurance Association. He specializes in off shore protected cell business and international reinsurance arrangements..

IICG can help you organize and manage your Puerto Rico based Insurance Company! There are many new challenges in the insurance sector, including the growth of oversight, the difficulties of constant returns, and the effects of a hardening insurance market. Companies need to be constantly on the lookout for new ways of managing their risks and investments to provide value to shareholders, policyholders, and stakeholders in general.

International Insurance Consulting Group (IICG) specializes in consulting, administrative and compliance services for domestic insurers and Act-399 international insurers domiciled in Puerto Rico.

Our robust suite of services includes industry-leading solutions, as well as deployment of the latest technology to assist in the administration and performance tracking of your insurance company.

### STRATEGIC CONSULTING

Our insurance consultants create business and technology solutions for small, medium, and large organizations. Our expertise in client and shareholder needs, the competitive environment, and the regulatory structure in Puerto Rico helps us to develop and manage lean operations for insurance companies.

International Insurance Consulting Group is the go-to independent consultant firm for insurance companies in Puerto Rico. Our team is a leader in the insurance sector, with over 30 years of hands-on experience, almost like any other!

We work every day to support the tactical needs of international investors and insurance companies, and we team up with senior executives to protect assets, meet compliance requirements, and achieve performance goals and objectives. Our staff has the technical expertise and business insight to assist international insurers,

captives, private insurance companies, reinsurers, investors, brokers and regulators to solve complex strategic problems. We have a proven track record of efficiently delivering on a wide array of local and international engagements like multi-class international insurer applications, segregated asset plan structures, high-profile claims and disputes, complicated insurer restructuring, and business-wide transformations.

### WHAT WE DO

Our professional consulting team works with domestic and international insurers on matters related to business development, reinsurance placements, operations and compliance. IICG's work goes beyond just consulting; we provide a full portfolio of insurance administration, accounting, and compliance services to domestic insurance companies as well as Act-399 international insurers. Here are some of our more prominent services:



**INTERNATIONAL INSURER LICENSING:** We create and purify business plans and develop complete international insurer applications that reflect professionalism and commitment, helping our clients to complete the international insurer authorization process within established timelines.

**REGISTERED OFFICE IN PUERTO RICO:** Our office in San Juan, Puerto Rico serves as Registered Office and Principal Representative for international insurers and holding companies, complying with regulatory requirements while centralizing services to create operational efficiencies that save time and money for our clients.

**GROUNDBREAKING ANALYTICS:** Our in-house administration software provides unique analytics and management techniques that assist insurance companies and their service providers. This helps our clients gain insight and make better decisions about risk mitigation, risk protection, and management, among other areas.

**INSURANCE MANAGEMENT:** We provide 24/7 administrative support to international insurers and protected cell companies domiciled in Puerto Rico. Our management services include claim handling, full accounting and financial statement preparation, preparation of annual statements for regulatory agencies, and filing of tax returns.

**ACCOUNTING AND TAX:** Our in-house CPA team helps organizations and individuals remain compliant under Puerto Rico law by ensuring timely filing of tax returns and required reporting.

**COMPLIANCE:** We help and support domestic and international insurers' compliance so they can meet the requirements of all the applicable rules, and at the same time grow their bottom and top lines.

#### WHAT MAKES US DIFFERENT?

At the International Insurance Consulting Group, we seek to provide an exceptional experience to all our clients. Whether you're an investor relocating to Puerto Rico, CEO of an international insurer or entrepreneur exploring opportunities, our goal is to become your Puerto Rican partner, not just a service provider. We believe there are many reasons why our consulting service sets us apart from all our competitors.

#### CLIENT-CENTERED

Our priority is always our clients' needs. We are here to serve and make a positive impact on the organization and your success in Puerto Rico. We want to develop lifelong relationships with our customers, helping them on their business paths.

#### FULL ADVICE

We always address the entire financial perspective of a client's organization, from short term and instantaneous requirements to long-term objectives and goals. By providing comprehensive and integrated advice, we can give clients

clarity about their path and confidence about their future prospects. Our team has cutting edge knowledge of international insurance trends that increase performance and profitability. We have similar capabilities as the more prominent systems integrators, but we offer a much more diverse expertise.

#### TEAM APPROACH

We are a team of skilled and dedicated experts in international insurance structures and insurance administration. To expand our services we partner with lawyers, CPAs, and advisory groups, which provide us with groundbreaking insight and infinite external resources. Our interdisciplinary method adds a broader perspective to the work we do and enables us to provide a full suite of services under one roof. We work together to solve a wide range of client needs, and we seamlessly integrate with clients to solve specific issues.

#### MISSION

To be the premier consulting firm for international insurers/reinsurers and captive insurance structures in Puerto Rico. To expand our consulting business globally through new risk management techniques and the use of segregated asset plan structures. To offer insurance administration and claims management services to domestic and international insurers established in Puerto Rico.

#### MEET OUR TEAM >>



**RUBEN N. GELY RODRIGUEZ**  
Chief Executive Officer

Ruben N. Gely started his career in the insurance sector in 1992 as an agent. In 1994, he was appointed Executive Aide to the Commissioner at the Office of the Commissioner of Insurance of Puerto Rico (OCI), and in 2001 became an Examiner's Supervisor in charge of the Financial Analysis Unit at the Office.

He was selected as Director for the International Insurers and Reinsurers Division in 2006 and 2009, and in 2013 was named Deputy Commissioner of Supervision and Compliance. He was appointed in 2010 as a liaison with the Department of Economic Development of Puerto Rico. He has also participated in economic missions from the government of Puerto Rico to China, the United Kingdom, Venezuela, Panama, Colombia, Spain, and the United States.

In addition, he served as a professor of Finance and Insurance at the University of Puerto Rico, and for the University Center of the East, Carolina, Puerto Rico, where he developed an insurance degree curriculum. Ruben Gely has a bachelor's degree in Business Administration

and a Master's Degree in Business Administration, with a concentration in Finance, from the University of Puerto Rico. He received the Chartered Property and Casualty Underwriter (CPCU), the Accredited Adviser in Insurance (AAI), and the Associate in Risk Management (ARM) certifications by the American Institute for CPCU.



**RUBEN A. GELY ORTIZ**  
President

Ruben A. Gely Ortiz is the founder and president of the International Insurer's Consulting Group, Inc. (IICG). He is recognized as an international insurance advocate and pioneer in Puerto Rico captive insurance structures. In addition to serving as president of IICG, he is the vice president of Puerto Rico's International Insurers Association (PRIIA), a non-profit organization created to protect the interests of international insurers domiciled in Puerto Rico.

He received the Associate in Risk Management (ARM) and Associate in General Insurance (AINS) certifications from the American Institute for CPCU. In addition, he is a licensed reinsurance intermediary in Puerto Rico. Ruben Gely Ortiz is an expert in captive insurance structures for Latin America based companies, segregated asset plans, private placement life insurance policies, and Act 20/22 applications. He has a special interest in the aviation and aerospace industry, and currently holds an FAA issued multi engine private pilot license with instrument rating.



**ORLANDO FIGUEROA DIAZ**  
Chief Financial Officer

Orlando Figueroa Diaz is the chief financial officer of the International Insurer's Consulting Group, Inc. His primary role is to assist international insurers with financial advice and captive insurance management under Puerto Rico's commercial law.

He is highly experienced in the management of captive insurers and protected cells – at present he handles the accounting for over eighty captive insurers in Puerto Rico. Figueroa Diaz joined the company after serving as lead audit senior for some of the largest clients in Puerto Rico. He is a key member of the Youth CPA committee of the Puerto Rico Certified Public Accountant Board.





He has a bachelor's degree in Business Administration with concentrations in both Accounting and Finance from the University of Puerto Rico. He was honored by the Puerto Rico Certified Public Accountant Board for having the highest average score in the Certified Public Accountant (CPA) examination in 2016.



**FERNANDO FORNARIS**  
Marketing & Media Manager

Fernando Fornaris is a professional in the area of communications, specializing in marketing and advertising. He focuses his efforts on the planning, development, and implementation of innovative advertising strategies in digital media.



**EDWIN MONTAÑEZ**  
Client Services Manager

Edwin O. Montañez-Concepción is the client service manager of International Insurance Consulting Group, Inc. His primary role is to assist clients with their financial advice and captive insurance management under Puerto Rico's International Insurance Center.

Montañez-Concepción joined the company after leading the audit and assurance team of retail & distribution companies and financial institutions, specializing in broker-dealers. Additionally, as a Certified Public Accountant, he is highly experienced in managing and administrating businesses in Puerto Rico, with over five years in the field. In addition, he worked as an intern for both the Internal Revenue Service (IRS) and the Treasury Department of Puerto Rico.

He has a bachelor's degree in business administration with concentrations in both Accounting and Finance from the University of Puerto Rico. He is also a member of the Puerto Rico Certified Public Accountants Association.

He obtained his undergraduate degree from the Polytechnic University of Puerto Rico, and a Master's degree from the University of the Sacred Heart in Santurce, Puerto Rico. Fornaris was part of the VMLY & R Puerto Rico team, where he strengthened his knowledge in the advertising industry. Later, he started his own social media & digital marketing firm Alphastar Media, where he contributed ideas to brands such as Biaggi & Faure Fine Arts, San Juan Bautista Cathedral's 500th anniversary, Crest, and Black Cow Cheese, among other clients.

ICG, Inc is an independently owned insurance consulting and management firm headquartered in San Juan, Puerto Rico. Dedicated to providing step-by-step support during initial formation stages as well as ongoing management and compliance services to international insurers and reinsurers organized in Puerto Rico.

We strive to be more than just a one-time consulting resource. Instead, we support and join you as a partner in the process of establishing and maintaining operations in Puerto Rico.

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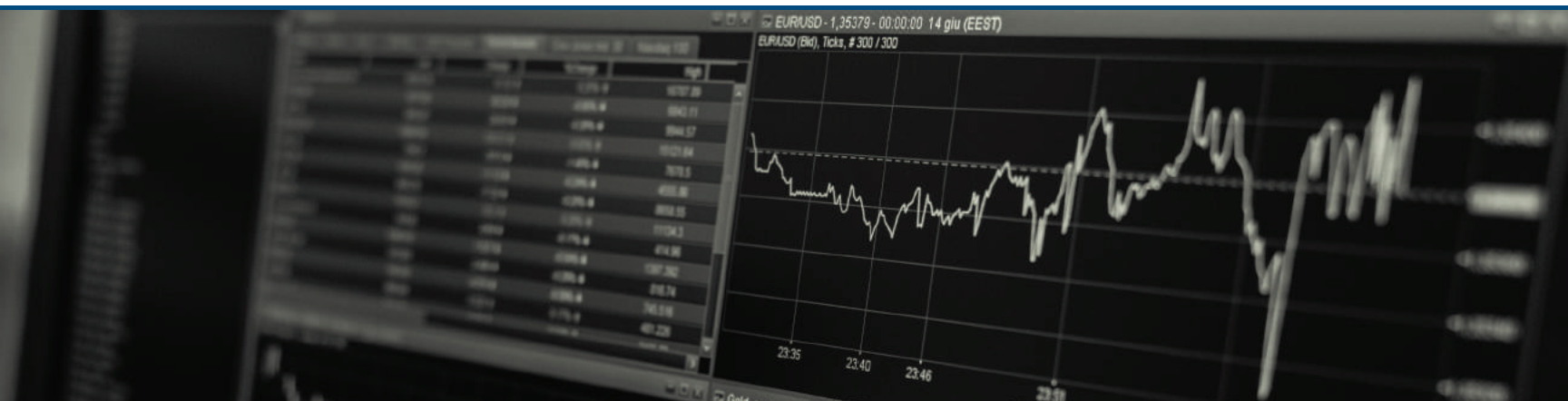
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# INTERNATIONAL PRIVATE WEALTH MANAGEMENT PLANNING USING PRIVATE PLACEMENT VARIABLE ANNUITIES AND LIFE INSURANCE POLICIES ISSUED BY A PUERTO RICO INTERNATIONAL INSURER

By: **James A. Walker, Jr.** | March 2021

"Jay" Walker is the founding partner and CEO of Bulldog Expert Solutions & Technologies, Inc., a law firm specializing in international insurance, re-insurance, and finance matters.



## I. STRUCTURE AND BENEFITS OF A VARIABLE INTERNATIONAL ANNUITY OR INSURANCE POLICY.

The four major benefits offered by a variable annuity or life insurance policy issued by a non-U.S. life insurance company are:

- **Cost**
- **Flexibility**
- **Asset Protection**
- **Estate Planning Family Wealth Confidentiality**

The basic architecture of any variable annuity or variable life insurance policy is as follows:

Premium Paid - Sales Charge - Administration Charges - Mortality Charges - Investment Charges + Investment Return - Surrender Charge = **Year Ending Cash Value**

In general, the major differences between an annuity and a life insurance policy from an internal cost perspective are the increased Mortality Charge and Administration Charges brought about by the substantially increased risk retained or reinsured by the insurance company and the substantial additional actuarial and administrative expense involved in administering an insurance policy.

In this equation, the critical factors from a client's perspective are, (1) reduce the variable policy costs; (2) to access custom policy designs and solutions not otherwise available from a "one

size fits all" traditional retail life insurance company; (3) to access best of breed independent investment managers and custom insurance dedicated funds, as the single most important factor in the financial success of a variable annuity or life insurance policy is the long-term investment return generated by the segregated account policy variable reserves; and (4) to obtain the asset protection and estate planning advantages of a segregated account protected variable life insurance or variable annuity policy. The value proposition of Private Placement Life Insurance ("PPLI") lies in the ability to provide bespoke insurance policies to high-wealth clients that maximizes the insurance, tax, asset protection and estate planning benefits of life insurance, while minimizing the cost and inflexibility of traditional life insurance.

## II. PUERTO RICO AS AN INTERNATIONAL INSURANCE JURISDICTION.

Act No. 399 of September 22, 2004, known as the Puerto Rico International Insurers and Reinsurers Act, established the main legal framework for the development of Puerto Rico as an International Insurance Center, oriented towards the export of insurance and reinsurance services to international markets. Puerto Rico created the International Insurers and Reinsurers Division of the Office of the Commissioner of Insurance of Puerto Rico (OCI), with a specific focus and goal of developing Puerto Rico into an important member of the international insurance arena. The Government of Puerto Rico expressly adopt-

ed this new initiative and incorporated it as part of economic agenda for the 21st Century. The International Insurers and Reinsurers Division is under the Supervision of the OCI. The Department of Economic Development and Commerce oversees the promotion of this facility and the extension of applicable tax decrees that are an important part of the international insurance initiative.

Similar to the 50 US States, the Puerto Rico OIC is an accredited member of the National Association of Insurance Commissioners ("NAIC"), making it unique as an international insurance jurisdiction. In addition, the OCI is also participating member of the Association of Insurance Superintendents of Latin America ("ASSAL"). The OCI regulates 50 domestic insurers and 358 foreign insurers with a premium volume that reached \$10.5 billion for 2013. This level of US and Latin American experience and expertise is a major attraction of Puerto Rico as an International Insurance Center, as is the English / Spanish dual fluency, the regionally convenient location, the low cost of doing business in Puerto Rico, and the high quality of professional service providers in Puerto Rico (the major US accounting firms and insurance specialty providers have significant presence in Puerto Rico, as do many banks and investment providers).

## III. PPLI ISSUED BY A PUERTO RICO INTERNATIONAL INSURER.

A variable annuity or variable life insurance policy issued by a Puerto Rico international



insurer can provide significant advantages:

#### A. Low-cost.

Puerto Rico's international insurance companies can provide a wealthy and sophisticated investor access to reasonably priced variable annuities and life insurance policies. These companies are not subject to the massive overheads typically associated with U.S. domestic life insurance companies, such as a large distribution system, sales commissions, and multiple layers of government regulation. Puerto Rico provides exceptional tax efficiency to a Puerto Rico international insurer, which is taxed on its operational net income in excess of \$1,200,000 at 4% tax rate. This is a tremendous operational cost and thus pricing advantage when compared to a similar insurance company licensed in any of the 50 US States.

#### B. Investment Flexibility.

Provided the investments meet with certain diversification requirements and the Policyowner does not exercise prohibited "investor control" over the selection of the securities comprising the Separate Account, there is no limitation on the type of investments that can be held in the Separate Account. As part of the Annuity Policy Application process the Investment Manager(s) of the Separate Account are selected and the investment arrangements and fees are finalized. Accordingly, a Policyowner can take advantage of the investment expertise of a specialized investment manager instead of having to settle for the investment options offered by a traditional highly regulated insurance company.

#### C. Separate Account Protection.

Separate account legislation in the jurisdiction where the insurance company is domiciled should provide that the policy assets in the separate account formed by the insurance company to fund the annuity or insurance policy are not subject to the claims of creditors or other Policyowners of the insurance company, and are available only to satisfy the company's obligation to the Policyowner

This protection from unrelated creditors' claims is granted by Puerto Rico law and activated by the Commissioner's approval of the Segregated Assets Plan. Article 61.160 of the Insurance Code provides that "[w]ith prior approval from the Commissioner, an International Insurer may establish and operate one or more segregated assets plans." P.R. Laws Ann. tit. 26, §4316(1). It further provides that:

*The assets of a Segregated Assets Plan approved by the Commissioner shall be available solely for the payment of obligations specifically identified in the corresponding Operational Plan and shall not be available for the payment of the obligations of other segregated assets plans or of the general obligations of the International Insurer. Art. 61.160(4) of the Code, P.R. Laws Ann. tit. 26, §4316(4).*

This protection holds even if the international insurer becomes insolvent:



*In the case of the liquidation or rehabilitation of an International Insurer under the provisions set forth in Chapter 40 of this Code, the Segregated Assets Plan shall not be available for the payment of the general obligations of the insurer. Art. 61.160(6) of the Code, P.R. Laws Ann. tit. 26, §4316(6).*

In addition, Rule No. 81, Art. 7, §2, establishes that recourse with respect to an obligation arising from or related to a Segregated Account is limited to that Segregated Account's assets, and does not extend to the assets of any other Segregated Account or the International Insurer's general account. Similarly, recourse with respect to an obligation arising from or related solely to the company's general account is limited to the assets of the general account. See Rule No. 81, Art. 7, §3. Rule No. 81, Art. 4, §2.

In sum, the Commissioner's approval of the Segregated Assets Plan not only allows a Puerto Rico International Insurer to establish and operate a separate account for each variable life insurance and/or annuity contract that the Puerto Rico international insurer issues or

assumes, but it also grants the assets and income in each such separate account legal protection against claims arising from or related to obligations to creditors other than the creditors of the separate account itself.

#### D. POLICY OWNER AND BENEFICIARY ASSET PROTECTION.

For private placement life insurance and annuity policies issued by a Puerto Rico international insurer, Puerto Rico law expressly limits the rights of creditors of the policy owner or policy beneficiary as against the policy, as follows:

**"ARTICLE 61.240. – Benefits Exempt from Seizure**

*(1) Except as provided under paragraph (3), any benefits (including any cash value or proceeds) to be provided to an insured or beneficiary under a life insurance or annuity contract issued by an International Insurer:*

*(a) shall inure exclusively to the benefit of the person for whose use and benefit the*



*insurance or annuity is designated in the contract; and*

*(b) shall be fully exempt from:*

*(i) garnishment, attachment, execution, or other seizure;*

*(ii) appropriation or application by any legal or equitable process or by operation of law to pay a debt or other liability of an insured or of a beneficiary, either before or after the benefits are provided; and*

*(iii) a demand in a bankruptcy proceeding of the insured or beneficiary.*

*(2) The exemptions provided under paragraph (1) apply regardless of whether:*

*(a) the power to change the beneficiary is reserved to the insured; or*

*(b) the insured or the insured's estate is a contingent beneficiary.*

*(3) The exemptions provided under paragraph (1) do not apply to:*

*(a) a premium payment made in fraud of a creditor, subject to the applicable statute of limitations for recovering the payment;*

*(b) a debt of the insured or beneficiary secured by a pledge of the insurance policy or the proceeds of the policy; or*

*(c) a child support lien or levy established pursuant to applicable law.*

*(4) This article does not prevent an insured, owner, or annuitant from assigning, in accordance with the terms of the life insurance or annuity contract:*

*(a) any benefits to be provided under the life insurance policy or annuity contract; or*

*(b) any other rights under the policy or contract.*

*(5) If a life insurance or annuity contract issued by an International Insurer prohibits a beneficiary from assigning or commuting benefits to be provided or other rights under the contract, any assignment or commutation or attempted assignment or commutation of the benefits or rights by the beneficiary is void.*

This broad statutory asset protection is especially attractive given Puerto Rico's status as a Territory of the United States, with full participation in the US federal legal system, the same as any of the 50 US States.

#### IV. INTERNATIONAL INSURER POLICY DESIGN FLEXIBILITY.

The flexibility afforded to a Puerto Rico international insurer issuing private placement life insurance and annuity policy to high wealth "accredited investors" is substantial, in strong

contrast to the very restricted offerings allowed by a US State regulated carrier or a Puerto Rico domestic licensed insurer, or by a European or major Latin American jurisdiction regulated insurer. Custom policies and policy Riders to address client / insured specific facts and planning are easily viable for a Puerto Rico international insurer, allowing the insurer to address a wide variety of policy requirements, including but not limited to: 7702 guideline premium / corridor test Mec & non-Mec policies; 7702(g) restricted policies; 7702 CVA test cash value and death benefit only policies; Canadian exempt text policies; and the full spectrum of custom global life policies and policy Riders.

#### A. Full Cash Value PPLI.

The first place to start is a US traditional style Full Cash Value variable life insurance policy. Since the early 1980's, to qualify for lifetime tax deferral on increasing annual cash values, the policy must either satisfy the (a) cash value corridor test; or (2) the guideline premium and cash value corridor test. For full cash value variable policies, the US path is the guideline premium / cash corridor tests, with the important distinction of Mec or Non-Mec depending on the premium funding pattern (a non-Mec must pass the "seven pay test" which in a simple explanation requires the premium funding to be spread over five years (e.g a \$1Mill single premium is a MEC, whereas the same policy funded \$200K per year for five years is a non-MEC).

The result of these US tax requirements is that traditional policies with a lifetime growing cash value require very large initial and ongoing mortality risk coverage, which can bring cost and capacity issues to a large PPLI policy.

Additionally, the PPLI policy must also be compliant with the diversification requirements of IRC 817(h), and also must not violate investor control restrictions. Within the IRC §817(h) approach is the concept of insurance dedicated funds, which allow for collective investment management of segregated account variable insurance policies that pass the diversification testing, because the segregated account is allowed to "look through" the insurance dedicated fund to diversified underlying investments of the fund.

It is here that Puerto Rico yet again presents a significant advantage for PPLI policies with a US connection, as the Treasury Regulations specifically allow a Puerto Rico insurer to invest in an insurance dedicated fund in the same manner as insurers domiciled in the 50 States. The final Regulations expressly provide that for purposes of 1.817-5(f)(3)(vi), which is the requirement that the account be segregated pursuant to State law or regulation, Puerto Rico receives the same treatment as the 50 States. No other international jurisdiction has been granted this unique and important treatment for variable insurance policies.

#### B. Restricted Cash Value PPLI

The second life policy core design is a Restricted

Cash Value policy, which limits lifetime cash value / access to premiums paid less prior surrenders (basis). This is the most commonly used policy design for high-wealth international clients as it is much more tax conservative in substance, allows for tax-free access in the future to premiums paid if needed, and it provides an ultimate death benefit that is tax free not only internationally but also to a US beneficiary (IRC 7702(g) and 101(a)(1).

As this design is not typically domestically available due not to the Internal Revenue Code but rather US State insurance regulation (non-forfeiture laws) and US taxable insurance company accounting rules that do not apply to an international insurer in Puerto Rico.

This custom policy design is often ideal for ultra high-wealth international clients, as it provides very solid insurance substance, the lifetime ability to receive return of premium distributions tax-free from the policy, and the long-term death benefit that is usually tax-free under their home country tax laws, and can even be designed to be tax-free under the Internal Revenue Code to a US taxpayer beneficiary of the policy.

This policy provides tremendous insurance substance and custom flexibility, and it is very commonly used as the investment vehicle for a foreign non-grantor trust established by a non-US person for the benefit of his or her family that includes both non-US and US beneficiaries.

#### C. Death Benefit Only Policy.

Finally, the third policy design is the most restrictive and tax conservative as a Death Benefit Only policy, providing no cash value or policy loan or other lifetime access. This design is used for very wealthy clients that want to minimize current value for things like estate transfer planning or wealth tax planning. This policy design can be used pass the US IRC 7702 Cash Value Accumulation test, making it an ideal platform for multi-jurisdictional tax efficiency.

This is the most conservative policy structure, as it is solely a wealth accumulation and transfer long-term life insurance tool, with \$0 lifetime cash value. For the ultra-high wealth client seeking the maximum projected life insurance death benefit at life expectancy, family asset protection, and compliant estate planning confidentiality, this is a unique solutional PPLI platform.

#### V. EXAMPLE - INTERNATIONAL CLIENT INVESTING IN THE UNITED STATES.

As compared to the extensive and very technical United States tax definitions and requirements for an annuity or life insurance policy, it is important to understand that these rules are only applicable where US tax compliance is relevant. Examples of that would commonly be:

(a) high-wealth US client purchasing international policy for long-term tax and estate planning and investment diversification reasons;





(b) high-wealth non-US person moving, temporarily or permanently, to the U.S. and thus in need of “pre-immigration” tax and estate planning; and

(c) high-wealth non-US persons with US intend(ed) beneficiaries.

Thus, absent a US taxpayer connection, US 7702 life insurance tax compliance is not applicable. An example would be a high-wealth non-US family seeking to hold and invest funds in an international PPLI policy for long-term family estate planning. In such a situation, the key is that the policy be structured to comply with the tax rules and requirements of the client’s home tax domicile, which usually requires a much lower mortality risk shift corridor as compared to a full cash value PPLI owned by a US taxpayer.

Specific to private placement life insurance issued by a Puerto Rico international insurer, Puerto Rico law expressly provides that “amounts received by a non-resident individual or by a foreign corporation or partnership as benefits or interest of any kind under a life insurance or annuity contract issued by an International Insurer will also not be considered gross income” subject to any local Puerto Rico tax or withholding. The result is that a custom PPLI policy issued by a Puerto Rico international insurer to a non-US policy owner is exceptionally income tax efficient.

That said, the US tax issue that often arises for

the wealthy non-US family is the US estate tax if the non-US investor owns US investment, including US stocks and bonds. For a US taxpayer, the US federal estate tax applies a 40% tax to the decedent’s worldwide wealth above a statutory exemption threshold (for 2021 that exemption is \$11,700,000).

Unfortunately, this generous exemption is not available for a decedent that is not domiciled in the US (a US citizen or green card holder or domiciled resident in the US). Instead, a non-US decedent pays the US estate tax on US situated assets owned by him or her at death, with an exemption of only \$60,000. US situated assets include US real estate, US tangible personal property, and securities of US companies.

Happily, a Puerto Rico issued PPLI solves this problem, as the PPLI policy provides the critically needed tool to compliantly avoid the US federal estate tax, as the PPLI policy is not a US situated asset, and life insurance owned by non-US decedent is exempt from the US estate tax. I

For example, if a non-US taxpayer directly owns \$10 Million of US stocks and bonds, he or she is only granted a meager \$60,000 exemption from the US estate tax. At a current rate of 40%, the US estate tax would claim approximately \$4 Million of his portfolio, leaving \$6 Million for his family. If instead that same non-US taxpayer invested the \$10 Million in a Puerto Rico issued international private placement life insurance policy, with the investment management of the

policy’s variable separate account reserves holding the same US stocks and bonds, at the insured’s death there is no US estate tax, saving the international family \$4 Million in this simple example.

Importantly, this elegant solution does not create any Puerto Rico estate tax exposure for the international policy owner. Puerto Rico law expressly provides a complete exemption from any Puerto Rico estate taxation as follows: “the value of any amount payable by an International Insurer by reason of a life insurance or annuity contract to a non-resident of Puerto Rico shall be considered property outside of Puerto Rico and shall be exempt from the estate tax...”

The end-result is that the Puerto Rico issued PPLI policy solves the US estate tax problem while not creating any Puerto Rico taxation. Given that the traditional use of an offshore / tax haven corporation as the investment platform for a non-US client with US investments now creates substantial tax, global reporting, and economic substance costs and concerns, the use of PPLI is a simple and elegant solution for non-US clients seeking to invest in the US.

Puerto Rico’s advanced international insurance laws and unique advantages as a US Territory combine to make a Puerto Rico international insurer the ideal provider of PPLI for an international client with intended underlying US securities portfolio investments.





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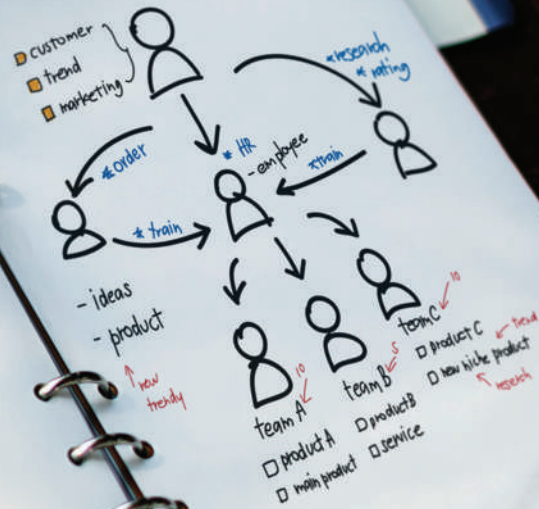
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# PLANNING



## A PUERTO RICO INTERNATIONAL INSURER CLASS 5

# LIFE REINSURER

By: **Converge RE II** | March 2021

Converge RE II is domiciled in Puerto Rico as a Class 5 reinsurer in good standing through the International Insurance Center (IIC) that structures financial solutions for insurers. Puerto Rico is a member of the National Association of Insurance Commissioners (NAIC) and is a US territory, subject to US laws and courts..

### THE EVOLUTION OF LIFE REINSURERS

Primary insurers require reinsurers with demonstrated experience in structured solutions to deliver necessary returns and appropriate capital relief. The reinsurance of asset-intensive life and annuity liabilities requires a specialized skill set and is therefore accessible only by a limited number of specific parties that possess the following characteristics:

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### WHY CONVERGE RE II AS A LIFE REINSURANCE PARTNER

We are a licensed Puerto Rico Class 5 reinsurer

formed in 2017 focusing on the U.S. asset-intensive life and fixed annuity market. Converge RE II is sponsored by Lightstone Enterprises Ltd. Converge RE II will provide capital relief and earnings enhancements for its primary insurers, via access to the multi-disciplinary asset management capability of Converge Asset Management. Converge RE II (as reinsurer) and Converge Asset Management (as asset manager) will combine efforts to manage the Converge RE investment portfolio and work with primary insurers to formulate an effective reinsurance and investment strategy. Converge RE II has implemented effective, integrated ALM processes where liability and asset professionals work together cohesively.

Converge RE II is uniquely positioned to generate favorable reinsurance transactions through its: Specialized, deal-oriented reinsurance structuring team capable of addressing bespoke needs of primary insurers Willingness to negotiate major deal terms in order to facilitate a transaction. The efficiency of a Puerto Rico reinsurance platform.

### WHY THE PUERTO RICO INTERNATIONAL INSURANCE CENTER AS A VENUE FOR A LIFE REINSURER


The Puerto Rico International Insurance Center is under the supervision of the Office of the

Commissioner of Insurance and was formed in 2005. Life Reinsurers assume risks outside of Puerto Rico under a secure and flexible regulatory scheme. The regulatory framework of the International Insurance Center is based on prudential parameters of the Office of the Commissioner of Insurance that has a long history of regulatory expertise. The OCI is an accredited member of the National Association of Insurance Commissioners. Puerto Rico functions under U.S. law and the U.S. court system.

Puerto Rico is one of the largest markets in Latin America, with a fully bilingual (Spanish and English) corporate culture that is important in attracting and retaining high performers in the Finance, Information, and Professional Service sectors. Puerto Rico has a robust domestic insurance sector that allows for the availability of local insurance expertise and experience. The Puerto Rico International Insurance Association (PRIIA) is established as the insurance industry liaison with the Office of the Commissioner of Insurance.

Puerto Rico can be reached by air in one business day from multiple airports worldwide. The Puerto Rico International Insurance Center has a solid business culture, set in a beautiful venue with wonderful hotels and transportation, and last but not least lots of SUN!





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## WHY EVERY BUSINESS OWNER SHOULD CONSIDER A PRIVATE INSURANCE STRATEGY IN PUERTO RICO

By: CapAlt | March 2021

David Kirkup, COO/ CFO manages all operations and oversees the financial performance for Captive Alternatives Group. With more than 20 years in the insurance industry Kirkup is using his expertise to help make Captive Alternatives the premier risk management consulting and captive management enterprise.

Amid speculation that the US insurance market is “hardening” in many areas, business owners are likely to find affordable insurance coverage options more limited shortly. With adverse renewal conditions, risk managers would be wise to explore alternative risk financing options, such as captive insurance. However, as smaller US and foreign-domiciled captives face uncertainty from several sources, many business owners will find a Private Insurance strategy in Puerto Rico to be an increasingly attractive option.

### UNIQUE STRUCTURE IN PUERTO RICO

Puerto Rico is a well-established international insurance destination with more than 450 reinsurance companies currently in existence. It is also the third-largest domicile for insurance in Latin America with annual premiums over \$11 billion. Puerto Rico is a unique jurisdiction with many distinctive advantages.

Puerto Rico is a territory of the United States and is a regulated and accredited member of the National Association of Insurance Commissioners (NAIC) and the United States Federal Reserve and, in some cases, the Federal Deposit Insurance Corporation (FDIC), protect Puerto Rican banks. Puerto Rico is considered “dual sovereignty” where some matters are governed by the law of the United States while Puerto Rican law takes precedence in others, such as corporate and insurance laws, as well as a separate and distinct tax code.

Because of Puerto Rico’s unique advantages, as well as the regulatory scrutiny with traditional 831 (b) tax elected captives, Captive Alternatives chose to move all existing and future private insurance operations to the Island. Puerto Rico is so unique that CapAlt’s structure isn’t even considered a captive: each business owner creates what is called a Segregated Asset Plan held within a Private Insurance structure.

A private insurance structure works as a participant in the sharing of risk, which is the cornerstone of any effective risk management program. One point of difference between a private insurance structure and a traditional captive arrangement is that the private insurance structure does not issue direct insurance coverage to the insured. Rather the insured obtains their selected risk coverages from an independent insurance carrier or fronting carrier. The private insurance structure participates in the insured’s selected risk coverages with the issuing carrier, by providing reinsurance to the fronting carrier.

In this article, we will cover the two types of risk Private Insurance structures are used to insure. Private Insurance for Enterprise Risk Coverages A private insurance strategy protects against financial losses by funding for unpredictable risks specific to a business owner and their affiliated companies. These risks are typically



those that have a relatively low probability of occurring but could be financially devastating to a business (such as a cyber breach, regulatory change or loss of key customer or supplier). A private insurance strategy provides a means of clearly identifying these, often hidden, risks and developing a tax-efficient financing plan in the event they transpire.

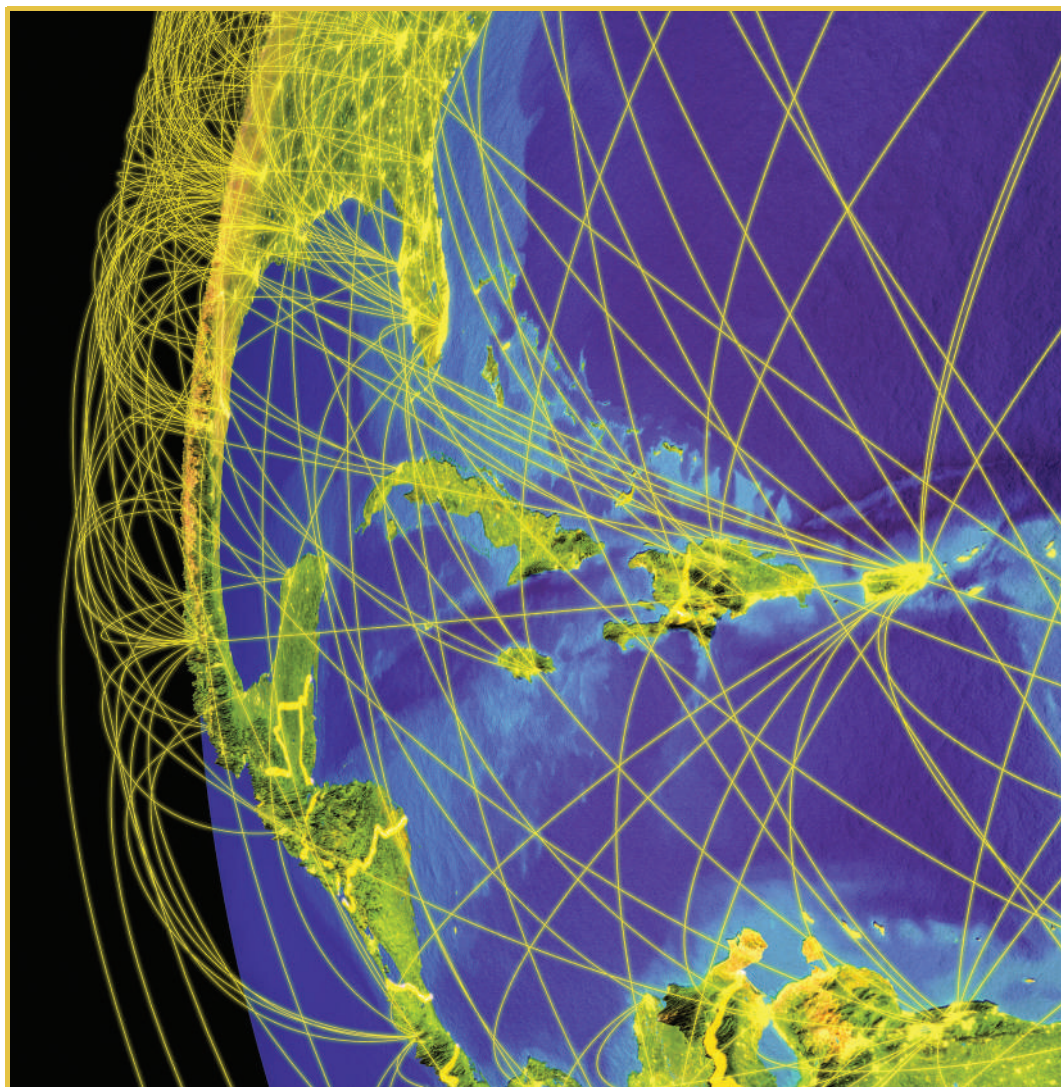
In addition to funding unpredictable losses, participating in a private insurance structure may enable a business owner to accumulate equity, generate underwriting profit and increase transparency and control over their risk management efforts. As insurance reserves build, business owners can further support their Enterprise Risk Management objectives. Most business owners understand the major risks they face, and they know how to manage these risks to minimize the likelihood of claims. By shifting certain lines of insurance coverage into a private insurance structure, business owners stand to profit from a low claims experience but can rest assured knowing potentially catastrophic risks are funded.

**New Opportunities for Commercial Coverage**  
Obtaining commercial coverage in the traditional marketplace is universally frustrating for business owners. Unless losses occur, and claims are made – something stakeholders work hard to avoid – commercial insurance is a sunk cost. Further, businesses with effective risk management processes in place often pay the same expensive premiums as those with poor risk management controls. This often means that the premiums of the many, subsidize the losses of the few irresponsibly or poorly run businesses. This is a great proposition for insurance companies: an estimated 40% of commercial premium dollars go to insurer expenses and profits.

A private insurance structure, on the other hand, allows businesses to capture unused premiums as profit and have more say in the claims process. For many business owners, the idea that you can share in both the risk and reward involved in insurance is a true paradigm shift. Effectively, small and mid-size businesses can now do what the largest corporations in the world have been doing for years: turn a sunk cost into an asset and another profit center.

Historically, smaller private reinsurance companies have faced difficulty covering the more commercial risks of business as larger insurance companies had limited interest in issuing admitted policies and then ceding their profits to a nonrated, non-admitted reinsurer. However, a new industry-first initiative is making the ability to reinsure commercial coverages accessible to small and middle-market businesses.

Captive Alternatives is excited to have partnered with a London-based insurer to provide a comprehensive yet simple way for small and medium-sized enterprises to reinsure up to 18 different lines of commercial P&C insurance into a Private Insurance structure. This program allows business owners to retain up to 50% of their premiums as underwriting profit.



The process is simple: business owners purchase the same coverage, at the same price. If desired, they are even able to use their existing insurance broker. They then take on a finite, manageable amount of exposure based on historical loss ratios and risk tolerance. The level of exposure along with risk type and historical losses dictates how much of the initial premium will be allocated to a Private Insurance structure as a reinsurance premium. The Private Insurance structure participates in the risk and the reward of the insurance, giving business owners an incentive to run a safer enterprise. Whatever is not paid out in claims is considered an insured surplus, and that can be invested for growth in a tax-advantaged structure.

#### CONCLUSION

A private insurance structure creates a profit center out of an ordinary business expense: the cost of insurance. Fortune 500 and other large companies have used alternative risk financing vehicles for many years to improve cash flow, receive certain tax advantages and create significant equity. For smaller business owners the pri-

vate insurance structure is a rewarding alternative to simply “buying insurance”. Regardless of your company’s size, Captive Alternatives can help you set up a fully compliant Private Insurance structure to develop a top tier risk management program, reduce your risk, and build equity to protect your business.

#### ABOUT CAPTIVE ALTERNATIVES

Captive Alternatives is a risk management and insurance consulting firm that helps business owners develop effective risk management programs. CapAlt’s pioneering business strategy, Private Insurance, enables businesses and organizations to self-insure select business risks and participate in the underwriting profit arising from effective risk management.

As a result, CapAlt clients build wealth and help protect and assure their corporate future. CapAlt manages the operations of more than 140 Segregated Asset Plans from their offices in Puerto Rico and Atlanta.



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## DE-RISKING DAMAGE TO REGIONAL TRADE AND ECONOMIES

By: **ItalBank International** | March 2021

By Rogelio Cardozo is the Managing Director of ItalBank International, a leading international bank based in Puerto Rico with operations throughout Latin America as well as in the United States.

The world relies on a vast array of intricately interrelated networks to deliver crucial goods and services to the marketplace. Yet, while this is evident, a concerning trend initiated more than a decade ago still is developing among global financial institutions. This phenomenon is known as de-risking, a process by which large global banks that serve as correspondent banks to local financial institutions, are increasingly limiting if not terminating their correspondent banking relationships with local and/or regional banks.

As an international bank based in Puerto Rico, we have witnessed this practice firsthand and its substantial impact on small to medium enterprises (SMEs) as well as trade-in Latin America and the Caribbean.

Given our SMEs client base and our geographic footprint that extends from Mexico to Argentina, we can attest firsthand that de-risking poses significant challenges to developing economies

in the region. The implications are serious as corresponding banking allows SMEs and individuals to safely move money across borders and around the world but, most importantly, because it supports and encourages global trade.

The lack of correspondent banking services has a wide-reaching impact on an economy in terms of trade and remittances. Without an established correspondent banking relationship (CBR), trade is inhibited, and often the flow of goods restricted slowing if not severely impeding economic growth.

Additionally, remittances always get impacted with fewer participants and higher cost, which limits important sources of income for families. As the Covid-19 crisis has shown, for Central America and the Caribbean is clear that remittances are an important support for their economies and regional stability. In Latin America

and the Caribbean, over the last decade, we have witnessed the negative impact of de-risking on banking and, subsequently, regional trade.

According to the UN's Economic Commission on the Caribbean and Latin America, 12 Caribbean countries have had their CBRs of at least one of their local banks terminated or "de-risked". Among the Caribbean nations already cut off: Antigua and Barbuda, The Bahamas, Belize, British Virgin Islands, Cayman Islands, Dominica, Guyana, Jamaica, Montserrat, Saint Kitts and Nevis, Suriname, and Trinidad and Tobago.

In Latin America, according to the International Finance Corporation's recent survey of institutions, over ¼ of banks, report CBR reductions in the region. This phenomenon even impact a U.S Commonwealth as Puerto Rico that has the same regulations and standards of all States but been perceived higher risk within the U.S financial system larger institutions like the Reserve Bank



of Bankers and card brands in some cases restrict the services provided, thus increasing cost and limitations on the services International Financial Entities can provide, impacting not only the regional economies but also Puerto Rico.

Trade has long been recognized as a key driver of development with a clear connection to a country's overall economic performance. For instance, in Belize, we came across a case that demonstrated how de-risking could impact regional trade. In this case, the U.S. restaurant industry along the Gulf Coast was directly affected by its inability to pay shrimp exporters in Belize when their bank could not process the wire as the shrimp exporter's bank did not have a U.S. correspondent to receive it.

In this instance, they had to suddenly locate other suppliers who had a direct impact on US Gulf Coast restaurants. A "fix" in these cases is always found, as these economies do not lack creativity, but usually, it comes at a higher cost. These so-called solutions are at the expense of the regulated financial industry in both countries, which impedes commerce, such as the Belize example clearly points out.

As a response to continuing constraints, Alternatives Payment Methods (APM) are increasingly becoming commonplace in Latin America. Although this is a good trend in some cases, trade finance instruments are premised on an existing credit relationship between counterparty banks and their ability to mitigate those risks.

Fewer options increase not only the cost but also overall credit risk in these markets. Banks mitigate and spread risk across the correspondent relationship business model, allowing smaller exporters or importers to get access to global markets. Without these relationships, the critical flow of goods and services is stalled. From our own experience of operating within the region for 13 years, we know that all banks are facing complex challenges in serving clients, but much of the stress is on smaller local banks and their economies as regional and/or global banks have far more options to deal with de-risking but higher standards to cater to local SMEs and international trade necessities.

De-risking has challenged other fundamental services such as humanitarian operations within the region that also is reliant on CBRs. International NGOs face the same restraints as local banks. It has been reported that 2/3 NPOs (Non-profit) organizations have experienced issues of financial access; 15 percent have ongoing issues.

These include delays in wire transfers, fees, and other operating costs that have obstructed humanitarian work by having a real and harmful effect on beneficiaries; those who need it most. Due to the serious implication of de-risking, it is important to identify solutions as an industry and within the region to address this alarming trend. As a U.S. bank based in Puerto Rico, we understand that smaller, "niche" U.S. financial institutions with closer connections and knowledge of Latin American and Caribbean markets

are needed for greater granularity, and that's why we understand that the International Banking industry is key to provide solutions based in our unique position of being compliant with U.S. federal regulations and having personnel with a cultural closeness to this regions that allow bridging both sides having a positive impact in local economies while keeping the U.S. economy engaged in the region.

This provides more options while spreading the overall risks as banks partner with local financial institutions and fintech's to tackle the risk that traditional U.S. banks have been turning down. With this greater proximity approach and risks better understood, therefore better managed, opening new income avenues for all while adopting a "local-root" business mentality, can positively impact local economies at both ends of the trade relationship while knocking barriers in the process.

Additionally, the role of multilateral institutions is critical as they can create and provide tailored offerings to support CBRs. Finally, for all of this to happen, what is necessary are forward-thinking

regulators that support a regulatory framework that would allow U.S. smaller institutions such as ours to develop and enter in these relationships. It would enable us to foster our local community and contribute to the economic development of the region. Being proud members of the Puerto Rican banking community, we greatly understand how this is a win for all economies involved.

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