

STANDING COMMITTEE REPORT NO. 16-49

RE: C.B. NO. 16-48/R&D

SUBJECT: CHANGES TO TITLE 37, CAPTIVE INSURANCE LAW

DECEMBER 4, 2009

The Honorable Isaac V. Figir  
Speaker, Sixteenth Congress  
Federated States of Micronesia  
Second Special Session, 2009

Dear Mr. Speaker:

Your Committee on Resources and Development (R&D), to which was referred C.B. No. 16-48, entitled:

"A BILL FOR AN ACT TO FURTHER AMEND TITLE 37 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA BY INCLUDING A DEFINITION OF A NEW CLASS 3 MULTIPLE CORPORATE CAPTIVE INSURANCE COMPANIES AND PROVIDING FOR THE ISSUANCE OF CAPTIVE INSURANCE MANAGING LICENSES, AND FOR OTHER PURPOSES.",

begs leave to report as follows:

The intent and purpose of the bill are expressed in its title.

The subject bill, C.B. No. 16-48, proposes several amendments to title 37 of the FSM Code, which is the law establishes the Corporate Captive Insurance for the Federated States of Micronesia ("MCC"). Listed below are the proposed amendments:

***Amendment to Section 1001 of title 37***

The first proposed amendment is to amend Section 1001 of title 37 of the FSM Code by defining class 3 Multiple Corporation Captive Insurance Companies ("MCC").

***Amendment to Section 1002 of title 37***

The second proposed amendment is to amend Section 1002 of title 37 of the FSM Code for the purpose of determining what constitutes a class 3 captive insurance company.

***Amendment to Section 1003 of title 37***

The third proposed amendment is to amend Section 1003 of title 37 of the FSM Code by requiring the Insurance Commissioner or Insurance Board to issue a captive insurance manager's licensing.

***Amendment to Section 1007 of title 37***

The fourth proposed amendment is to amend Section 1007 of title 37 of the FSM Code to clarify the minimum paid in capital and surplus for the core captive ("Mother") and the member captive

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("Baby") of class 3 captive insurance companies.

***Amendment to Section 1010 of title 37***

The fifth proposed amendment is to amend Section 1010 of title 37 of the FSM code to extend the time in which captive insurance companies is required to submit reports and statements to the Commissioner and Insurance Board. Another amendment to this section is that for Multiple Corporate Captive Insurance Companies only the core captive of the MCC Insurance Companies is required to submit report and statements to the Commissioner or Insurance Board pursuant to subsections 2(a), (b), (c) and (d) of Section 1010 of title 37 of the FSM Code.

Your Committee held a series of public hearings on the bill during the Second Special Session of the 16<sup>th</sup> FSM Congress. Witnesses at each hearing consist of representatives from the Micronesian Registry Advisors (MRA), Mrs. Wakaba N. Taitano, Steve Baker and Garrison Irons, Lawyer for the MRA Kembo Mida Jr., Assistant Attorney General Jun Bacalando Jr. and the Banking Commissioner Wilson Waguk.

On December 1, 2009 during one of the hearings on the bill, Mrs. Taitano testified that because of customers' demand C.B. No. 16-48 is being proposed. Mr. Steve Baker informed the Committee that MRA has already communicated with 24 captive insurance prospects, four of them have shown interest to relocate to the FSM within six months, but only if the FSM offers a similar class or structure. Accordingly, the Multiple Corporate Captives or "MCC" concept was developed.

The MCC concept is similar to Protected Cell Captive or "PCC", which are baby cells of larger captives. A PCC allows a generally smaller company to become a part of a larger captive (to "own" a cell within that captive), where the overall captive is controlled by a larger company with a larger amount of capital committed. The most significant difference between a PCC and a MCC is that in the latter there will be more than one licensed captive and corporate entity. The primary reason for this is to enable the tax benefit for Japanese companies.

Further clarification on the MCC concept is that there would be a "Mother" captive, which would arrange for a single captive manager (like Aon or Marsh) to manage the Mother captive as well as to manage all of the "Baby" captives. The Mother Captive would own at least 5% stake in the Baby captives and would hold at least one director seat in each Baby captive. The Mother captive would be required to have initial paid in capital of

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\$1,000,000.00 (and to maintain that amount, unlike class 1 or 2 captives, where the FSM law allows them to let that capital drop to \$100,000.00) and the Baby captives would only have to have initial paid in capital of \$100,000.00. The Mother captive would benefit from some fees that the Babies would pay to the Mother, and the Babies would benefit by having a captive, which they might otherwise not be able to afford or know how to manage. As Babies grow, they might eventually start their own Class 1 captive, and leave the MCC.

There are many jurisdictions (including Bermuda, Hawaii, and Cayman Islands), which provide for PCC, and the sponsor has to have \$1,000,000.00 in capital, whereas the minimum capital for the cell captives is only \$100,000.00.

During one of the hearings on the bill, Assistant Attorney General Mr. Bacalando indicated that the bill was proposed by MRA, and in a nutshell the purpose is to create another class of captive insurance company call "MCC". He indicated that there is a need to amend section 313 of title 54 of the FSM Code, and a bill is already drafted. The proposed bill to amend section 313 of title 54 is to impose taxes on all captive insurance companies licensed in the FSM regardless of capitalization. For instance, if the core captive is required to put up a paid in capital of \$1,000,000.00 and the member captive is required to put up \$100,000.00, taxes will be imposed on them regardless of capitalization.

Mr. Bacalando raised a concern, what will happen if the Mother ("core captive") divests of its 5% stake in one of the baby captives. The baby captive must immediately increase its capital in excess of \$1,000,000.00 and apply to the FSM Banking and Insurance Board to become licensed as a Class 1 (pure captive) or Class 2 (captive). The baby captive can no longer be considered as a MCC "member captive" if it does not have a Mother.

Another concern is what happens if the Mother captive dies (presumably meaning it liquidates or relinquishes its license)? If the Mother captive dies or liquidates or relinquishes its license, then ALL of its baby captives must either apply to the FSM Banking and Insurance Board to become attached to a different (adopted) Mother, or they must ALL immediately increase their capital in excess of \$1,000,000.00 and individually apply to the FSM Banking and Insurance Board to become licensed as a Class 1 or Class 2 captives. They can no longer be considered MCC "member captives" if they do not have a Mother.

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The Banking Commissioner Mr. Wilson Waguk commented that the five-year duration in subsection 9 of section 3 of the bill and extension from three (3) months to six (6) months in subsection 2 of section 1010 of the bill are issues worth considering. If something goes wrong within the five years, the Banking Commissioner cannot solve the problem. He must wait for the five year to lapse before doing anything. The Committee commented that as long as there is monitoring of activities, the timeframe of three or five year is not a problem.

Furthermore, the Banking Commissioner indicated that three month reporting is the time frame that applies to banks. According to MRA, six months is the period that virtually every one of the other 82 domiciles allow for captives licensed in their jurisdictions, to submit their audited financial statements, so the FSM is the most uncompetitive domicile in this regard. The existing captive in the FSM has complained about the time requirement in very strong terms. In the major countries of the world, banks are usually the first companies to report earnings every quarter and at the end of their financial year, because preparing financials is a much simpler task for them. Insurance companies including captive insurance companies require more time to prepare their audited financials because they must first have a qualified actuary complete a reserve valuation. This usually takes about two to three months. So with the extra step involved, it is inappropriate to require captive insurance companies to submit audited financials to regulatory authorities in the same time frame as banks.

It is anticipated that a significant amount of revenues will be generated by this MCC scheme, if this bill becomes law.

Your Committee on Resources and Development is in accord with the intent and purpose of C.B. No. 16-48 and recommends its passage on First Reading, and that it be placed on the calendar for Second and Final reading in the form attached hereto as C.B. No. 16-48.

