



WELCOME TO THE
KENTUCKY CAPTIVE ASSOCIATION
2020 VIRTUAL CONFERENCE
STUART FERGUSON



KENTUCKY CAPTIVE ASSOCIATION 2020 VIRTUAL CONFERENCE

THURSDAY, AUGUST 20, 2020

10:00am-10:03am	Welcome, Overview & Logistics	Stuart Ferguson
10:03am-10:10am	Kentucky Regulatory Update	Russ Coy
10:10am-10:20am	Update on CIC v. IRS-Supreme Court Case	Alex Webb
10:20am-10:40am	Current Captive Tax Landscape	Chaz Lavelle
10:40am-11:00am	Employee Benefits Captives	Phil Giles
11:00am-11:15am	Cyber & Ransom Claims	Chris Cannaley
11:15am-11:20am	Short Break & State of the Assoc. Report	Tom Munninghoff
11:20am-11:30am	COVID & Coverage in the Commercial Markets	Bruce Ferguson
11:30am-11:40am	Litigation Arising From COVID-19	Scott Spiegel
11:40am-11:55am	SIIA Captive Advocacy Update	Ryan Work
11:55am-12:00pm	Conclusion	Jon Hickman



PRESENTATION BY RUSS COY

KENTUCKY REGULATORY UPDATE



2020 Kentucky Captive Conference

Market & Domicile Update





Kentucky DOI Changes

New Commissioner—Sharon Clark

New Deputy Commissioner —D.J. Wasson

Director of Financial Division—Rodney Hugle

Early Warning Analyst—Russ Coy

Moved to New Building

Upgrading IT and Website (finally!)

Regulation Re-Certifications and Amendments



2019 Kentucky Year-end

- Kentucky had 0 new formations during 2019.
- We had 7 conversions and dissolutions.
- Net captives currently include 53 licensed and actively writing.
- This includes: 42 pure, 8 group/association, and 3 RRGs.
- Aggregate premium is \$57.8 million (down \$49).
- Total assets under management equal \$119 million (down \$38)



Covid & Ky Captives

- A number of captives quickly modified and issued policies in Jan-Mar.
- Preliminary captive claims up, with “ancillary” coverages the most active:
 - Business interruption & supply chain,
 - Property & Inventory,
 - Difference-in-Conditions/All-Risks
 - Loss of Key Client/Vendor,
 - Environmental & Pollution,
 - Cyber Liability,
 - Event Interruption & Political Risk/Civil Unrest.
- Conservative investment portfolios significantly less impacted by markets
- “Better than a bank-” loans and distributions increased to “bridge” crisis




Special Purpose Reinsurance Captive

- Limited special purpose:
 - May only assume from a fully licensed U.S. insurer maintains an Rating (A-) or better.
- The business that may be reinsured shall be limited to: general and limited warranties; vehicle service contracts, refundable and non-refundable; guaranteed asset protection (GAP) products, road hazard tire, and other similar automotive, equipment, or materials related policies.
- Credit life, health, and disability products shall not be reinsured.
- All reinsurance must be secured by a trust agreement or letter of credit.
- If qualified, lower capitalization, simplified application, abbreviated annual filings.



PRESENTATION BY ALEX WEBB
UPDATE ON CIC V. IRS SUPREME COURT CASE

The background of the slide is a dense field of three-dimensional numbers in various shades of blue and white. The numbers are of different sizes and are scattered across the entire frame, creating a sense of depth and complexity. Some numbers are more prominent than others, while others are partially obscured or in the background.

U.S. CAPTIVE INDUSTRY DEFENSE AGAINST IRS OVER-REACH

W. Y. Alex Webb, J.D., CPA

Webb & Morton, PLLC

for

Kentucky Captive Association 2020 Virtual Conference
August 20, 2020

CIC SERVICES, LLC vs IRS

ISSUE: Whether the AIA bar on suits to restrain assessment or collection of taxes also bars challenges to unlawful agency regulations to collect possible tax information?

COMMON POINTS

- ◆ SCOTUS precedent on APA does NOT bar pre-enforcement challenge to tax-reporting requirements.
- ◆ Punishment of non-compliant tax-reporting with a penalty does not invoke AIA.
- ◆ IRS uses AIA to defend unlawful actions.

CIC SERVICES, LLC vs IRS

ISSUE: Whether the AIA bar on suits to restrain assessment or collection of taxes also bars challenges to unlawful agency regulations to collect possible tax information?

SPECIAL POINTS

- ◇ Coalition: Notice does irreparable harm to captive industry.
- ◇ Coalition: Notice is “arbitrary and capricious”.
- ◇ Center for Taxpayer Rights: Low-income taxpayers also harmed!
- ◇ Smith: Some precedent violates SCOTUS caselaw (need reconciliation).
- ◇ Prosperity Fdn: “Due Process” requires allowing pre-enforcement review.
- ◇ Chamber: Sixth Circuit AIA rule would “shutdown” judicial review of unlawful agency action.
- ◇ ACTC: 8886 penalty is a “regulatory tax”, not a “revenue tax” protected by AIA.

CIC SERVICES, LLC vs IRS

CASE TIMELINE	DATES
Issuance of Notice 2016-66	11/01/2016
Formation of Captive Insurance Defense Coalition	12/01/2016
CIC Services, LLC and Ryan LLC vs. IRS (3:17-cv-00110) filed	03/27/2017
Memorandum Decision filed	11/02/2017
Opinion of U.S. Sixth Circuit Court of Appeals (No. 18-5019) filed	05/29/2019
Petition for <i>en banc</i> rehearing filed	07/08/2019
Order Denying <i>en banc</i> rehearing	08/28/2019
Petition for Writ of Certiorari filed	01/17/2020
Seven Amici Curiae Briefs filed	02/14 – 02/24/2020
Captive Industry Amici Curiae Brief filed (8 th AB)	02/24/2020
Brief of Respondent IRS in opposition filed	03/25/2020
Reply of Petitioner CIC Services filed	04/03/2020
Petition for Certiorari GRANTED	05/04/2020
Brief of Petitioner CIC Services filed	07/15/2020
Nine Amici Curiae Briefs filed	07/14 – 7/28/2020
Captive Industry Amici Curiae Brief filed (10 th AB)	07/22/2020

CIC SERVICES, LLC vs IRS

TIMELINE for NEXT STEPS

- ◆ IRS Reply Brief due 9/8/2020
- ◆ IRS Amici Briefs due 9/15/2020
- ◆ Petitioner's Rebuttal Brief due 10/8/2020
- ◆ Oral Arguments December 2020



CIC SERVICES, LLC vs IRS

What happens if we “win”?

Remand to District Court to hear injunction on the merits.

Question: file another amicus brief?

CIC SERVICES, LLC vs IRS

What if we win an injunction?

Sequestrations of illegally
obtained Forms 8886 and
8918?

Destruction of Forms 8886
and 8918?

Damages?



INTERNAL
REVENUE
SERVICE

CIC SERVICES, LLC vs IRS

What if IRS
withdraws Notice
2016-66 before
injunction ruling?

District Court
proceeding may be
moot.

moot point

????????????????????????????????



CIC SERVICES, LLC vs IRS

What if IRS issues new notice compliant with the *Administrative Procedure Act*?

Rally industry to submit comments and attend hearings.

Lobby Congress



PRESENTATION BY CHAZ LAVELLE

CURRENT CAPTIVE TAX LANDSCAPE

Current Captive Tax Landscape

Kentucky Captive Insurance Association Conference
August 20, 2020

Charles J. (Chaz) Lavelle
Dentons Bingham Greenbaum LLP
Charles.Lavelle@dentons.com

Court Actions Since 2019 Kentucky Captive Association Meeting

- Syzygy – taxpayer lost in Tax Court in April 2019
 - Insured loses deduction and captive pays tax on the same premiums
 - Motion for Reconsideration denied September 2019
- Reserve Mechanical - taxpayer lost in Tax Court
 - On appeal to the 10th Circuit
 - Last brief is due September 11, 2020
 - The industry filed an amicus brief
- Caylor Development tried in the United States Tax Court, awaiting an opinion

Future Court Activity

- The Tax Court
 - Closed its building and held no trials because of the virus
 - In late May, the Tax Court announced that it would have virtual trials – mechanics unclear
- U.S. Supreme Court will hear CIC case
 - Nothing to do with “what is insurance” for tax
 - Challenges IRS promulgation of Notice 2016-66
 - Administrative Procedures Act v Anti-Injunction Act
 - Discussed Elsewhere; Industry amicus brief

IRS Activity

- September 2019 (IR-2019-157)
 - IRS announces a Settlement Program for up to 200 participants
 - Terms are largely a concession but do not tax the captive; penalty can be eliminated with affidavits
 - Any allowed premiums including from closed years are currently taxed in a deemed distribution
- January 2020 (IR-2020-26)
 - 80% accepted the Settlement Program
 - 12 new audit teams
 - Thousands of more audits

Letter 6336

- Offers made to certain others on same terms as the September settlement program
- March 20, 2020 – Letter 6336
 - Issued to EVERY (?) person who filed a Form 8886?
 - Tens of thousands of letters?
 - Response due May 4, 2020
 - Delayed to June 4, 2020 per IRS email
 - The Letter reminds taxpayers
 - 2019 filing season is underway
 - The IRS has won several tax cases [3 cases]

Letter 6336, *cont.*

- If the Taxpayer wishes to withdraw
 - Do not take a 2019 deduction
 - Amend returns for prior open years
 - File at a specific place in Philadelphia
 - Mark “Micro-captive” on top of the amended return
 - Qualified Amended Return (no penalty?)
- Statement (Under Penalty of Perjury)
 - Year of last deduction or tax benefit
 - Date ceased participating in the transaction
- No response – audit with maximum tax and penalties (?)

Future IRS Activity

- Due date for response to Letter 6336 has passed
- Status of the 12 new audit teams
- March 20 – Letters 6336 issued to tens of thousands of taxpayers
- March 25 – People First Initiative (IR-200-59)
 - Extraordinary steps to help the people of our country
 - Immediate relief to help people facing tax uncertainty
 - Generally not start a new audit
- April 14 – letter from LB&I re: priorities during pandemic
 - Work should continue on Micro Captive campaign

Future IRS Activity

- United States sued the Delaware Department of Insurance to enforce a summons
 - Sought documents relating to 191 captive insurance companies
 - Related to tax shelter promoter investigation of Artex
 - Delaware provided 20,000 pages:
 - Documents related to 16 captives that authorized Delaware to provide the IRS their information
 - Documents responsive to the summons, but not specific to any captive
- “Micro-captives” are not on the 2020 “Dirty Dozen” list, but will get a separate IRS press release



PRESENTATION BY PHIL GILES

EMPLOYEE BENEFITS CAPTIVES



Medical Stop Loss Captives Market Overview

Kentucky Captive Insurance Conference

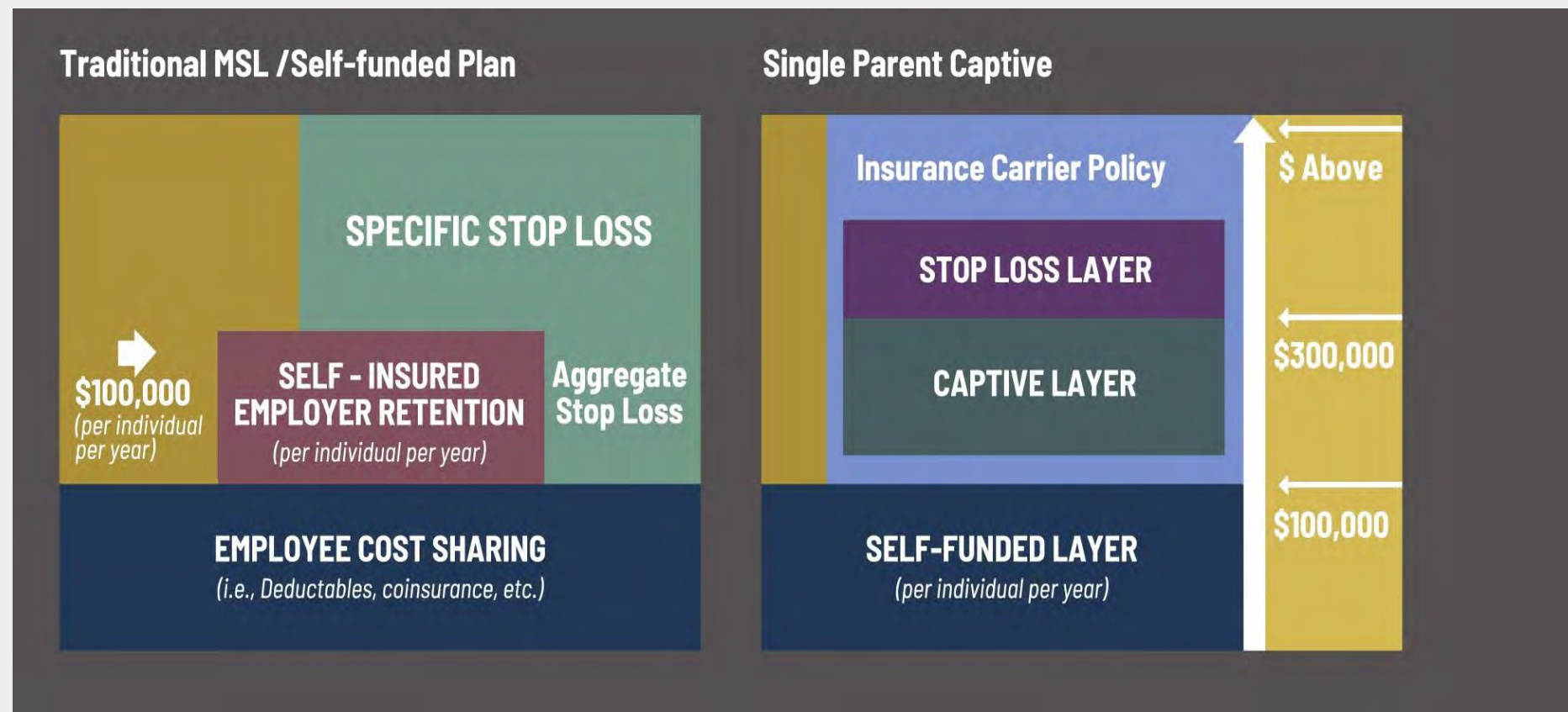


MSL Captives – Market Overview

Medical stop loss captives have been among the most significant growth segments in the insurance industry for the past decade:

- Coincides with accelerated interest in self-funding since ACA in 2010
- From 48% of all U.S. employers (2010) to more than 60% currently self-funding
- Most growth with employers having <500 employees (Boon to Group Captive industry)
- MSL market has expanded from \$7b to \$25b (unparalleled growth)
- MSL Captive market estimated (conservatively) to be about \$2b(+) and growing.

Single-Parent MSL Captives





Single-Parent Profile



- **MSL premiums typically don't generate enough premium for a stand-alone single parent**
- **Larger individual self-funded employers that have an existing single-parent captive for other lines of business and would like to expand its use to include medical stop loss**
- **Minimum MSL premium for an assumed reinsurance structure: \$1M (+/-), 1000 (+/-) lives**



Advantages: single-parent MSL captive



- **Expand utility of an existing captive**
- **Recognize and deploy surplus more efficiently**
- **Enhanced cash flow management**
- **Establish/build loss reserves**
- **Highly-efficient structure**
- **Enhanced ability for risk control**
- **Data collection and usage**

A photograph showing several hands pointing at and writing on documents with charts and graphs, suggesting a business meeting or analysis.

Group Captives



Heterogeneous
...and Open Market

Homogeneous

High-Performance



Group Captive Types



Heterogeneous:

- Varied industry composition.
- Generally need to be larger than homogeneous groups
- Typically caters to employers < 250 lives

Homogeneous:

- Industry specific
- Tightly controlled, more engagement among members
- Generally larger average employer size 250 – 500(+) lives

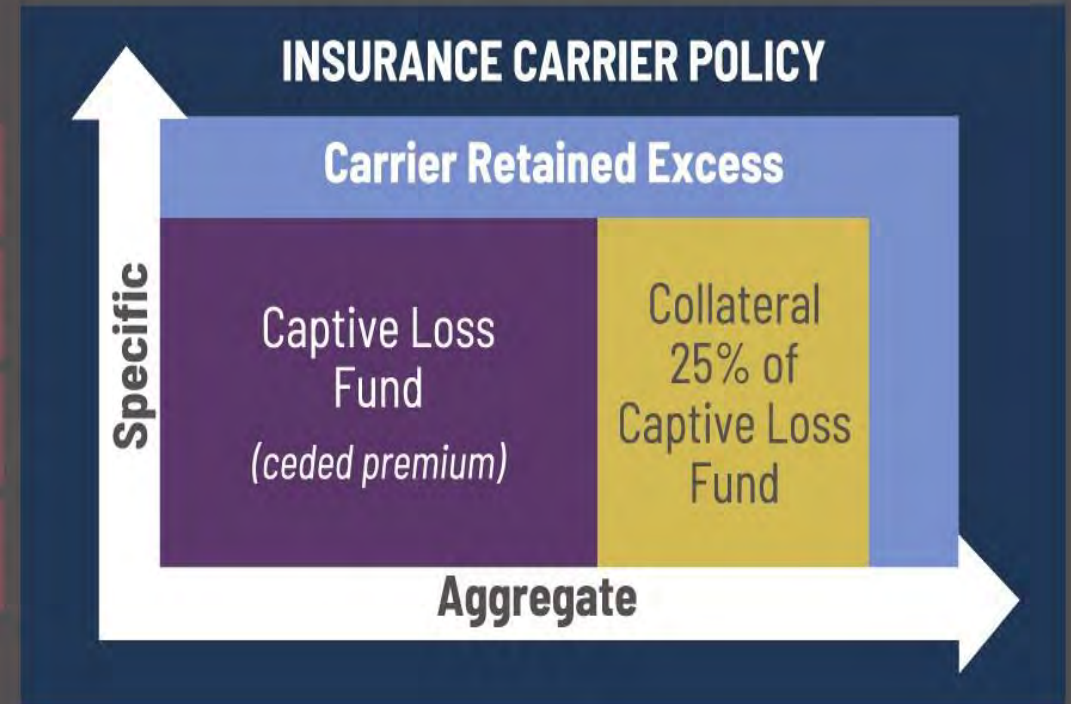
High Performance

- Existing self-insurers
- Strong track record

Group Captive Structure



Group Captive Structure





The power of collaboration

Advantages of a group captive



- Promotes long-term rate stability for members:
- Increased underwriting credibility – Collective predictability
- Increased spread of risk and application of pooling principals
- Leveraging collective size for purchasing of service components
- Increased effectiveness of risk management programs
- Information sharing and trend identification



MSL Captive Solutions, Inc.



Questions?

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PRESENTATION BY CHRIS CANNALEY
CYBER & RANSOM CLAIMS



Cyber Risk and Ransomware Claims

KY Captive Conference – August 20th, 2020

Chris Cannaley

Chris Cannaley is an Account Executive with Travelers Private and Non-Profit Bond and Specialty Insurance unit. With more than 20 years' experience in banking and insurance, Chris brings a unique perspective to the world of executive liability insurance. Chris holds a BS in Accounting from Indiana Wesleyan University, and an MBA from Ball State University. His community service experience includes leadership positions with Young Professionals of Central Indiana, and many years as a volunteer with Special Olympics of Hamilton County and Habitat for Humanity. He is an Indianapolis native, where he currently resides with his wife and two children.



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Conference Goals

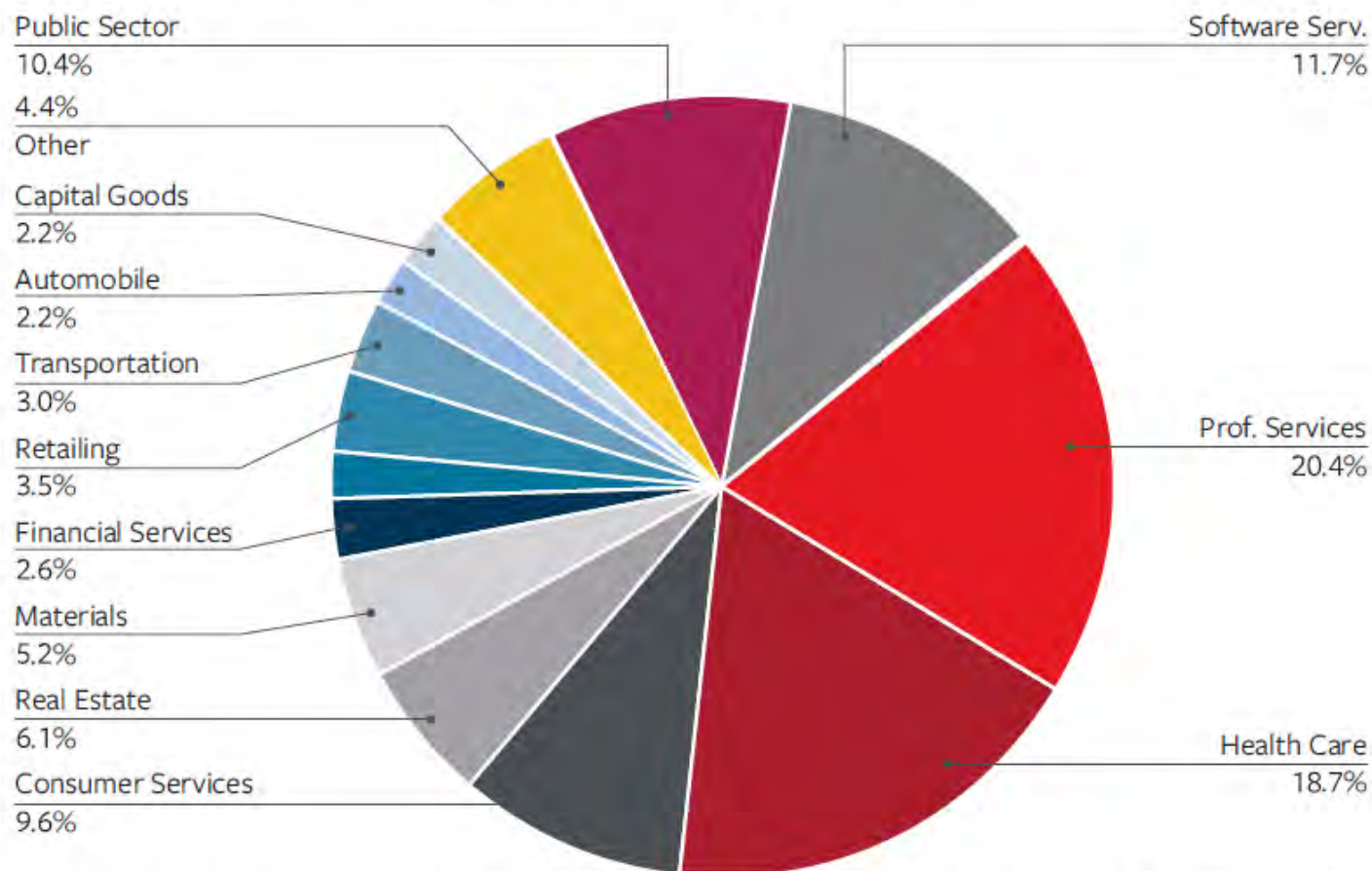
- Discuss the Rise of Ransomware
- What Businesses are at Risk?
- To Pay or Not to Pay
- Examine regional claim examples
- Simple steps to reduce Ransomware Risk

The Rise of Ransomware

- Last year, over 187 million ransomware attacks were detected—by one security firm alone.
- Most ransomware attacks will fail, but the ones that succeed are increasingly vicious.
- Cyber criminals are no longer content to demand modest ransoms once a network is compromised; instead, they are demanding six, seven, or even eight-figure ransoms.
- According to Travelers claim data, the number of registered ransomware claims, and the severity of those losses, has increased four-fold from 2017 to 2019.
- To compel businesses to pay outrageous sums, ransomware attackers have become more and more aggressive.
 - They dig deeper into victim networks in order to gain access to critical systems and data.
 - They delete backups, and in some cases, they threaten to disclose sensitive or confidential data.
 - As a consequence, it is becoming much harder for businesses to recover from an attack.
- From the third quarter to the fourth quarter of 2019, the average downtime caused by ransomware increased from 12.1 days to 16.2 days.
- Nowadays, a business caught unprepared for ransomware can be crippled, or even forced to close its doors.

What Businesses are at Risk?

Common Industries Targeted by Ransomware in Q4 2019



Coveware, "Ransomware Costs Double in Q4 as Ryuk, Sodinokibi Proliferate."

To Pay or Not to Pay

- When a business suffers a ransomware attack, it may have to decide whether to pay the ransom demand. This can be a difficult decision—not all businesses, and not all ransomware attacks, are the same. The decision should be made with the guidance of competent professionals who have expertise responding to ransomware events, such as legal counsel or digital forensics experts.
- Important considerations can include:
 - Can the business recover its systems and data without paying the ransom?
 - Would payment of the ransom reduce the overall cost of recovery?
 - If the ransom is paid, will the criminals provide the keys to decrypt the data?
- Not all ransomware attackers will provide decryption keys after a ransom payment; some will demand additional payments, and some will simply refuse.
- A digital forensics expert that facilitates ransomware responses on a frequent basis can help the business evaluate whether payment of the ransom will be worth the cost, or be just an opportunity for the attacker to victimize the business again.

Claim Example #1

Loss Summary: The Insured is a law firm that has several practice areas, including litigation, business, real estate and collections. This matter was reported as a ransomware attack involving the Phobos variant of Mamba ransomware. It is believed the virus was introduced into the Insured's system through an account with a weak password (p@\$w0rd), created by the Insured's outsourced IT consultant.

Current Status: The Insured retained a breach coach and forensics provider. To date Travelers has funded ransom and transaction fees totaling \$7,650.00 and paid \$126,679.00 in forensic fees, legal expenses, and data restoration costs. Travelers has recently been provided with third-party IT provider invoices totaling \$127,345.82. The forensics provider identified forty-four files that may have been accessed by the threat actor, but after manual review, it appears that the identity information of only one person required notification.

Travelers is advised that the Insured is preparing a Business Interruption claim. The law firm's computer system was encrypted from the morning of September 9, 2019 until the evening of September 19, 2019. The computer system returned to function one practice area at a time and was not fully functioning until September 23, 2019. At this time we are estimating it to be approximately \$250,000.00.

With respect to recovery, we are not optimistic about identifying the responsible parties.

Claim Example #2

Loss Summary: On March 30, 2020, the Insured, a school district with 3,500 students, 578 employees, and nine school locations, discovered a ransomware attack impacting its computer systems. The attack encrypted all the Insured's twenty-five servers, most of which do not have viable backups. It has been determined that nearly every Windows device that was powered on and connected to the Insured's network was infected. The threat actor utilized the NetWalker ransomware variant. On Friday, April 3, 2020 a ransom demand of \$2,000,000.00 was delivered to the Insured. This demand is much higher than what we have previously seen with NetWalker, leading us to believe a different threat actor is utilizing this ransomware variant.

Current Status: The Insured engaged a Breach Coach and a ransom negotiator, as well as a computer forensics expert to assist with the incident response and investigation. The Insured also has engaged its local IT vendor to assist with remediation and restoration efforts. Proposed budget of approximately \$115,000.00 for forensic and on-site services. Legal expenses are currently budgeted at \$20,000.00. A future reserve increase will be necessary to fund restoration expenses, as well as a negotiated ransom payment in the event a ransom is ultimately paid.

As the identity and whereabouts of the attacker are unknown, we are not optimistic about recovering from the responsible parties.

Simple Steps to Reduce Ransomware Risk

Train your employees - Ransomware attacks are often launched through email, so training employees to recognize and report suspicious emails can help prevent a ransomware event.

Disable Microsoft Office macros - If an employee does click on a malicious email attachment, it can cause a Microsoft Office “macro” to execute that will attempt to install ransomware. Although macros are often disabled by default, users can “opt in” and allow a macro to run.

Block Remote Desktop Protocol (RDP) - Ransomware attacks can also be initiated via Remote Desktop Protocol (RDP). Businesses that do not require RDP should block RDP externally and, if possible, internally. This can be easily accomplished with a simple reconfiguration of the business’s firewalls.

Strengthen controls over privileged access - After initially compromising a network, attackers will often try to obtain administrative privileges in order to gain access to a business’s most critical assets. Requiring multifactor authentication for privileged access is an even better way to limit the impact of a ransomware attack.

Review and test backup and recovery capabilities - It is no longer sufficient just to have data backups. Businesses need to make sure that they are also backing up critical network resources. Backups need to be stored in a secure location, so that ransomware attackers cannot encrypt or delete them. Finally, it is critically important for businesses to test their backup and recovery capabilities at least once a year, to be sure that the backups will be available when needed the most.

What questions do you have?

Thank you!



PRESENTATION BY BRUCE FERGUSON
COVID & COVERAGE IN THE COMMERCIAL MARKETS



THE HARDENING MARKET CONTINUES AND IT IS NOT JUST PRICING...

- Large property rates +20% in first half of 2020. Capacity severely limited due to large losses across the board.
- Mgmt Lia now 11 quarters of increases (EPLI & D&O worst hit)
- Auto lia 36 quarters of increases. Trend to uw out the frequency w/ No comp/coll and high ded's
- GL being hit from all sides up into the XS



HOW CARRIERS ARE RESPONDING.....

- ▶ Property ded's
 - ▶ Wind/Hail - \$100,000 or 10%
 - ▶ Water damage - \$250,000+
 - ▶ EQ 10%
- ▶ Mgmt Lia: Class action EPLI Ded's commonly \$250,000+
- ▶ Auto Lia:
 - ▶ Carriers asking clients to self insure phys dam.
 - ▶ Lia ded's \$5,000+ common



HOW CARRIERS ARE RESPONDING.....

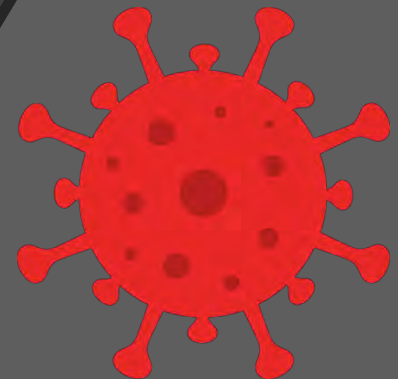
- ▶ GL & XS
 - ▶ Third party litigation financing, nuclear verdicts, social inflation have EXTREMELY scared the market.
 - ▶ Capacity is at an all time low especially on admitted side
 - ▶ \$5,000+ ded's common to uw out frequency
 - ▶ Communicable disease exclusions – cover a sublimit



PRESENTATION BY SCOTT SPIEGEL
LITIGATION ARISING FROM COVID-19

LITIGATION ARISING FROM COVID-19

August 20, 2020



EMPLOYMENT LAWSUITS

- WHO IS FILING?
 - Employees who come into the office and get sick.
 - Former employees who were terminated after complaining about lack of safeguards.
- ISSUES:
 - Failure to provide a safe & healthy workplace.
 - Failure to follow state-imposed mandates.
 - Dealing with employee(s) who refuse to return to work.

CLASS ACTION LAWSUITS

- WHO IS FILING?
 - Employees who claim to have been subjected to health & safety risks or lack of proper safety equipment.
- ISSUES:
 - Can source be identified?
 - State-imposed mandates.



INSURANCE LAWSUITS

- WHO IS FILING?
 - Companies claiming that their insurer wrongfully denied them coverage.
- ISSUES:
 - Does a business' commercial general liability insurance policy provide coverage for Covid-19 related claims?
 - Does the definition of bodily injury cover a Covid-19 related claim?
 - Do policy exclusions give an insurer a basis to deny a Covid-19 related claim?
 - Communicable Disease Exclusion
 - Bacteria Exclusion

UNIVERSITY/EDUCATION LAWSUITS

- WHO IS FILING?
 - Students denied refunds for cancelled in-person classes.
 - Students who attend class and become ill.



ELECTION LAWSUITS

- WHO IS FILING?
 - Candidates challenging restrictive voting procedures.
- ISSUES:
 - Safety.
 - Constitutional rights.

BREACH OF CONTRACT LAWSUITS



- WHO IS FILING?
 - Companies/Individuals.
- TYPES OF CLAIMS:
 - Breach of contract claims due to inability to meet supply requirements.
 - Defenses: force majeure, impossibility due to state closures.
- PROPOSED SOLUTIONS:
 - Legislature to stay lawsuits

NUCLEAR VERDICTS IN TRUCKING CASES

- Accidents involving trucking industry.
- Verdicts have increased dramatically.
- One source said increase was over 483% from 2017 to 2018.
- Insurance rates going up due to large verdicts.



PRESENTATION BY RYAN WORK
SIIA CAPTIVE ADVOCACY UPDATE



Captive Advocacy Update

**Ryan Work, Vice President, Government Relations
Self-Insurance Institute of America (SIIA)**

**Kentucky Captive Association
2020 Educational Conference**



SIIA Captive Priorities/ Activities

Industry Engagement & Responsibility

- Education
- Captive Manager Code of Conduct
- Strengthen Voice/ Unified Message

Policymaker Education & Advocacy

- Build Congressional & Industry Support/ Relationships
- PATH Act / Clarifications
- IRS/ Tax Reform
- Regulatory Burdens

Regulatory Dialogue

- Education & Relationships
- Notice Burden/ Narrowing
- Viable Alternatives
- Court Briefs



Industry Advocacy: The Road Ahead

- COVID/ Hardening Market
- “Micro-captive” transactions off IRS ‘Dirty Dozen’
- Court Cases – CIC, Reserve...
- Treasury Dialogue
- Congressional Education
- Owner Engagement



Proactive Industry Actions: SIIA Captive Manager Code of Conduct



Principles:

- Integrity, conflict of interest, confidentiality, advertising and practice management.

Goals:

- Anticipating industry challenges
- Easily understandable for clients, policymakers and regulators;
- Professional differentiator for SIIA members and managers; and
- Needed level of uniform professionalism to the industry.

Feedback/ Actions:

- SIIA Signatories
- TN Now Requiring Sign-Off from Captive Managers



Identifying and Building Champions & Influencers

Champions: Member offices for ongoing and engaged advocacy, building long-term relationships:

- Domicile State Members
- Key committees:
 - House: Ways & Means, Oversight
 - Senate Finance

Requests:

- Defending, requesting information, setting out concerns, and inquiring as to the time/ resources committed to captive oversight.
- Potential IRS Reform

Continued SIIA Member Engagement:

SIIA members partner with congressional staff and state regulators to strengthen relationships and create communication flow on the ground.



Captive Owner Narrative

- **Leverage Local Captive Owner Relationships**
- **Town Halls with Senate/ House Members**
- **Individual Congressional Meetings**
- **District Contacts**



Takeaways



Owner Engagement



Policymaker Education



Guidance & Focus



SIIA/ Domicile Membership & Activity



Contact: rwork@siia.org





CONFERENCE CONCLUSION

JON HICKMAN