

THE INTERNATIONAL INSURANCE CENTER: CAN PUERTO RICO BECOME THE NEW VECTOR IN THE INSURANCE INDUSTRY TRIANGLE?

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I. INTRODUCTION

With increased government support, Puerto Rico is poised to position itself as a leader in the international insurance industry in Latin America and elsewhere. There is, however, no easy path to the top. In this Article, I purport to evaluate the Commonwealth of Puerto Rico’s International Insurance Center (henceforth “IIC”) initiative. The Center is a concept that was brought forth in 2004 with Act No. 399,¹ which provides the legislative framework towards creating a bustling insurance and reinsurance trade center by providing advantageous fiscal incentives to the industry. Herein, I address the question of whether Puerto Rico, considering the competitiveness of its IIC law and corresponding regulations, can become a key vector in a market dominated by the State of Vermont, the Cayman Islands and Bermuda; three industry leaders which together constitute an industry-leading “Insurance Triangle.” Furthermore, I examine the feasibility of positioning the Island as a major industry bridge between insurance

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¹ P.R. Laws. Ann. tit. 26, § 4301 (2007).

centers in the United States and Europe and the blossoming Latin American market.

Undeniably, pushing Puerto Rico as a major industry player will not be a painless task and will pose substantial yet surmountable challenges. In Section III of this work, I compare these jurisdictions with Puerto Rico in an attempt to establish a comprehensive blueprint for expediting the development of the international insurance industry in the Island. I attempt to succinctly address current and prospective market conditions and local efforts required towards reshaping said Triangle. The Island's goal of becoming the jurisdiction of choice for specialty insurers and reinsurers of US and non-US risks, as well as for Latin American offshore operations, is carefully examined in Section V, establishing a sensible outlook for said venture.²

Initiatives such as the IIC fit into the vision of positioning Puerto Rico as a thriving financial center, providing a multiplicity of services to international entities. Within said vision, both the International Banking Center³ and the IIC are bound to achieve common objectives and face common obstacles as well. Herein, I propose that the IIC is challenged not particularly by a bureaucratic mesh, but rather by promotional deficiencies that seem to encumber its development. Currently, a small office within the Office of the Commissioner of Insurance (henceforth "Insurance Commissioner"), an agency of the Commonwealth, runs the IIC with limited resources, as I discuss below.⁴

The strengthening of this initiative, and ultimately the International Banking Center, should not compete with, but rather supplement, government strategies embracing the life sciences industry. For instance, several pieces of legislation have been recently approved to support said goal of turning the Island into a biotechnology research and development center.⁵

² See PowerPoint: Ruben Gely and Ralph Rexach, *Puerto Rico Offshore Insurance Center* (October 2007), available at <http://www.rexachpico.com>, under "News".

³ See generally, Emiliano Trigo Fritz, *If You Build It, They Will Come: Creating a Latin American Financial Center in an American Overseas Territory* (July 2010) (unpublished manuscript, on file with author). Under Puerto Rico law, international banking entities can underwrite insurance. P.R. Laws. Ann. tit. 7 § 232j(a)(11) (2008).

⁴ OFICINA DE GERENCIA Y PRESUPUESTO, PRESUPUESTO RECOMENDADO 2010-2011, OFICINA DEL COMISIONADO DE SEGUROS, available at http://www.presupuesto.gobierno.pr/Tomo_II/comisionadoSeguros.htm (Last accessed Nov. 19, 2011). The Office of the Commissioner of Insurance was created by Act No. 263 of Aug. 13, 2008; P.R. Laws Ann. tit. 26 §§ 233-257.

⁵ See Act No. 73 (providing economic incentives for major manufacturers); Act No. 62 (promoting the development of agricultural biotech enterprises); Act No. 101 (providing tax exemption for research scientists within the context of academia); Act No. 214 (creating the Puerto Rico Science, Technology & Research Trust; Act No. 230 (creating and funding the University of Puerto Rico's Comprehensive Cancer Research Center) and several other initiatives promoting bioscience research such as the Molecular Science Complex and the Bioprocess Development & Training Complex.

As I discuss throughout this work, the IIC helps Puerto Rico diversify its economic development growth opportunities and positions the Island to reap a plethora of benefits if adequately supported. Amidst this discussion, we must also keep in mind that the service industry is clearly overcoming manufacturing as the Island's premier economic driver in recent years and is bound to grow as Puerto Rican businesses diversify their products and, more importantly, their markets.

II. PUERTO RICO'S INSURANCE INDUSTRY AND THE CAPTIVE INSURANCE BUSINESS

Puerto Rico has a vibrant insurance industry, directly employing over 9,000 workers in a variety of tasks.⁶ According to the Insurance Commissioner, the sector has been affected by the negative economic climate but the industry as a whole remains "very healthy."⁷ Puerto Rico's domestic market has a sizable presence of international insurers and reinsurers with a long history of doing business in the Island.⁸

Note that 15% of the revenue of the companies featured in Caribbean Business' latest Top 400 Puerto Rico-owned companies came from the insurance industry.⁹ In fact, leading health insurer Triple S is the top-ranked company, with revenue totaling \$1.9 billion.¹⁰ The entire industry, including foreign insurers, wrote \$9.8 billion in premiums in 2009, an increase of half a billion dollars from 2008.¹¹ By the end of 2010, the industry had surpassed the ten billion dollar milestone.¹² There are more than 250 authorized insurers in Puerto Rico.¹³

While throughout this work I attempt to concentrate on the promotional and legal aspects of the Center, it is important to explain the difference between captive insurance and traditional insurance. This is a recurring theme in the IIC scheme and of particular importance in understanding protected cells and other industry concepts. Captive insurance is one of the target businesses for the IIC, and what sets it apart from traditional insurance is that it is an insurer owned by its own insured.¹⁴

⁶ Carlos Antonio Otero, *Comisionado de Seguros defiende confianza en el sector*, EL VOCERO, Nov. 17, 2010, at 21.

⁷ *Id.*

⁸ *Why Puerto Rico?*, US CAPTIVE, April 2006, at 47.

⁹ José Alvarado and José L. Carmona, *Puerto Rico's private business leaders show resolve*, CARIBBEAN BUSINESS, Nov. 11, 2010, at S3.

¹⁰ *Id.* at S5-6. Triple S has said it is considering expanding into the Latin American market, particularly to countries such as Costa Rica, Panama, Colombia, and the Dominican Republic.

¹¹ *Id.*

¹² Joanisabel González, *Alegan solidez en el sector de seguros*, EL NUEVO DÍA, May 27, 2011, at 46.

¹³ *See supra* note 2.

¹⁴ EUGENE WOLLAN, HANDBOOK OF REINSURANCE LAW, § 18 (2003 Supplement).

Many corporations create their own 'captive,' strongly relying on offshore markets to park their subsidiaries. Businesses are lured to creating captive insurers for several reasons. First, they help overcome the frequent unavailability of conventional insurance or situations where the company simply cannot afford the insurance offered.¹⁵ Second, they offer direct access to reinsurers. Other factors include avoidance of state regulation of unlicensed insurers, and of course, tax advantages.¹⁶ Companies may use a captive because traditional insurance does not fulfill their requirements with respect to quality of service, costs and types of risks covered.¹⁷ A pure captive, which cannot insure any risks other than those of its parent, affiliated companies and controlled unaffiliated businesses, is known in the insurance industry as a Class I insurer. This Class system is illustrated in Table II below. An association captive can insure the risks of the parent and affiliated companies or its members, as well as those arising from its business transactions; it is known as a Class II insurer. The first captive under the IIC was finally established in 2009.¹⁸

Note that the IIC's possibilities are intertwined with Puerto Rico's primary tax jurisdiction. This is a unique feature amongst the United States and territories; the Island stands as a Commonwealth that is "foreign in a domestic sense."¹⁹ The industry benefits from this fiscal autonomy, which is an advantage that has long been the cornerstone of economic development initiatives in Puerto Rico. Undoubtedly, it will continue to be of paramount importance in attracting future business to the Center.

III. THE BIRTH OF THE INTERNATIONAL INSURANCE CENTER: THE FRAMEWORK

The IIC initiative was conceived, drafted and legislated under Gov. Sila M. Calderón (2001-2005) in 2004.²⁰ At the core of the IIC is a set of three regulations issued by the Insurance Commissioner. Rule 80 governs the operations of international insurers and reinsurers, setting minimum capital and surplus requirements, and premium ratios, among other standards.²¹

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ JAN DASH AND HERMAN W. LIBURD, FREEDOM IN CAPTIVITY: THE CAPTIVE INSURANCE LEGISLATION OF NEVIS 1-2 (2009).

¹⁸ *Puerto Rico licenses first captive*, CAPTIVE REVIEW, Apr. 3, 2009, available at <http://www.captivereview.com/news/108031/article.shtml>. (Last accessed Nov. 19, 2011).

¹⁹ *Downes v. Bidwell*, 182 U.S. 244 (1901). As such, Puerto Rico corporations (and individuals) generally do not pay federal taxes.

²⁰ The Government of Puerto Rico retained Dallas-based Locke Lord Bissell & Liddell LLP as counsel during the drafting of the IIC regulations. Locke Lord Bissell & Liddell LLP, About the firm, <http://www.lockelord.com/intlinsreinstransregul/>.

²¹ P.R. REGS. OFFICE OF THE COMMISSIONER OF INSURANCE, REG. 7994 (2011) (henceforth referred to as "RULE 80").

Rule 81 contains protected cell regulations and is discussed in Section VI of this paper.²² Rule 82 governs the operations of international insurer's holding companies, outlining its possible structures.²³ Act No. 400²⁴ incorporates the tax exemptions created by Act No. 399²⁵ (which created Chapter 41 of the Insurance Code) to the Internal Revenue Code of Puerto Rico of 1994.²⁶ This law emphasizes that one of the purposes of the IIC, particularly the tax incentives provided, is to generate well-paid, specialized jobs.²⁷

Gov. Aníbal Acevedo Vilá (2005-2009) succeeded Calderón and reaffirmed his commitment to the Center. In 2005, Acevedo Vilá estimated that the IIC would create roughly 3,000 jobs between 2005 and 2010.²⁸ In 2007, Larry Mirel, former commissioner of the Department of Insurance, Securities, & Banking for the District of Columbia, deemed plans to create the IIC as "excellent."²⁹ Mirel, however, emphasized the importance of a coherent implementation phase as a key driver towards the Center's success.³⁰ He identified three key drivers for Puerto Rico's potential success in its IIC endeavor: lack of federal taxation, use of both English and Spanish languages, and a service-oriented culture.³¹ The first three insurance companies created under the IIC began to operate during Acevedo Vilá's tenure.³² These were: Syndicate Re, Oceanus Re and American International Insurance Co., a Puerto Rico subsidiary of American International Group (AIG).³³ In late 2008,

²² P.R. REGS. OFFICE OF THE COMMISSIONER OF INSURANCE, REG. 6974 (2005) (henceforth referred to as "RULE 81").

²³ P.R. REGS. OFFICE OF THE COMMISSIONER OF INSURANCE, REG. 7508 (2008). (henceforth referred to as "RULE 82").

²⁴ Act No. 400 of Sept. 22, 2004; 2004 P.R. Laws 2050.

²⁵ Act No. 399 of Sept. 22, 2004; 2004 P.R. Laws 2015.

²⁶ P.R. Laws Ann. tit. 13, §§ 8001-9750 (1994).

²⁷ H. REPORT ON H.B. 4723, 7th Sess., (P.R. 2004). Note that the Internal Revenue Code of 1994 was repealed by the legislature. In its place, a tax reform was approved on January 2011, which fundamentally does not alter the IIC's tax structure. *See*, 2011 P.R. Laws No. 1.

²⁸ *Governor seeks to create insurance center in P.R.*, CARIBBEAN BUSINESS, October 20, 2005, at 46.

²⁹ Pedro Valle Javier, *Plans to create International Insurance Center here termed 'excellent'*, CARIBBEAN BUSINESS, October 27, 2005, at 33.

³⁰ *Id.*

³¹ *Id.*

³² Gina M. Hernández, *International Insurance Center taking form...slowly*, CARIBBEAN BUSINESS, June 28, 2007, at 42 (henceforth referred to as "IIC taking form"). Note that during the Acevedo Vilá Administration several changes were made to the Island's Insurance Code to ensure competitiveness. *See*, Gina M. Hernández, *Amendments to the Insurance Code in legislative pipeline*, CARIBBEAN BUSINESS, July 16, 2009, at 27. *See also*, Gina M. Hernández and Frances Ryan, *Puerto Rico Insurance Code undergoing major changes*, CARIBBEAN BUSINESS, September 6, 2007, at 28-29.

³³ *Id.* at 42.

entities operating under the IIC scheme even created their own trade group, the Puerto Rico Offshore Insurers Association (PROINSURA).³⁴

In 2008, the Administration of Gov. Luis Fortuño (2009-) was voted into office. While his platform proposed several changes to the IIC, only in 2011 has the Administration moved to amend the IIC law,³⁵ except for the surtax imposed by Act No. 7 of 2009.³⁶ Currently, nine institutions operate under Act No. 399³⁷ on the Island, with several more in the pipeline.³⁸ Together they generate \$116 million in bank deposits³⁹ and create roughly 250 total jobs.⁴⁰

Today, the insurance industry seems to be holding its own even under the precarious economic climate that has slowed growth to a standstill in the past few years.⁴¹ Almost ten billion dollars in premiums were subscribed during 2009, a \$507 million increase over 2008.⁴² Furthermore, insurance industry net earnings reached \$584 million, a \$130 million increase over 2008.⁴³ Not surprisingly, health insurance continues to lead in the retail

³⁴ *Nueva iniciativa en materia de seguros*, EL NUEVO DÍA, December 9, 2008, <http://www.elnuevodia.com/Xstatic/endi/template/imprimir.aspx?id=502231&t=3>. See also, *Aseguradoras internacionales crean asociación*, BUSINESS NEWS AMERICAS, December 11, 2008, available at http://www.bnamericas.com/news/seguros/Aseguradoras_internacionales_crear_asociacion.

³⁵ 2011 P.R. Laws No. 98, H. BILL 3034, 4th Sess., (P.R. 2010), see also H. REPORT ON H. BILL 3034, 4th Sess., (P.R. 2010). The bill was also filed in the Senate as S. Bill 1899.

³⁶ See *infra* note 161. Rep. Antonio Silva-Delgado presented a fundamentally identical resolution ordering a legislative inquiry into the IIC's progress in both 2005 and 2009. However, after approval, no legislative report on the matter was ever filed. Curiously, both resolutions were assigned to the Treasury Committee that Silva has chaired in the past two legislative assemblies. See, H. RES. 153, 1st Sess., (P.R. 2005) and H. RES. 105, 1st Sess., (P.R. 2009).

³⁷ See *supra* note 25.

³⁸ Interview with Ruben Gely, Director, Puerto Rico International Insurance Center (Nov. 23, 2010). See also, Carlos Antonio Otero, *Espacio de crecimiento para aseguradoras foráneas*, EL VOCERO, August 24, 2010 (henceforth referred to as "*Espacio de crecimiento*") and Angeles Alvarado, *PR en vías de perder Centro Internacional de Seguros*, *Centro de Periodismo Investigativo*, May 3, 2011, available at http://cpipr.org/inicio/index.php?option=com_content&view=article&id=212:pr-en-vias-de-perder-centro-internacional-de-seguros&catid=58:actualidad&Itemid=105.

³⁹ Marian Díaz, *Imán para la inversión internacional en la Isla*, EL NUEVO DÍA (NEGOCIOS), May 29, 2011, at 9. Total assets of these institutions, however, exceeded 2 billion dollars: only a minuscule amount is actually deposited in Puerto Rico. There is, obviously, great potential for Puerto Rico's banking industry to pitch their services to insurers in order to garner a much higher rate of deposits.

⁴⁰ *Id.* Gely disputes this figure and alleges it is much lower, as he estimates the amount of jobs currently directly created by the IIC to be around twenty-five.

⁴¹ *The insurance industry weathers the financial storm*, CARIBBEAN BUSINESS, October 14, 2010, at 38.

⁴² *Id.*

⁴³ *Id.*

insurance category in the Island.⁴⁴ Although local insurers are garnering an ever-higher market share,⁴⁵ consolidation is expected in the next few years due to the overall economic pressure.⁴⁶

IV. TALE OF THE TAPE: PUERTO RICO VS. THE OFFSHORES AND VERMONT

The captive insurance domicile market is highly competitive as there are dozens of international captive domiciles and, in the United States alone, 23 'onshore' domiciles.⁴⁷ Various jurisdictions, however, concentrate the bulk of the insurance and reinsurance captives. These include the State of Vermont, Bermuda and the Cayman Islands. These jurisdictions have led the way by offering the industry a favorable tax environment and a solid business climate. Bermuda is the home of the largest number of captives in the world, followed by the Cayman Islands.⁴⁸ Vermont, the top 'onshore' jurisdiction, clocks in at third place.⁴⁹

Being the largest American captive insurance domicile,⁵⁰ Vermont hosts captives for almost half the companies that make up the Fortune 100 and more than half of the companies that make up the Dow 30.⁵¹ The State authorized its 900th captive in 2010.⁵²

Vermont may be highly relevant in the onshore market, but for the small Atlantic island of Bermuda, the impact of insurance in its much-smaller economy is unparalleled. Bermuda has more captives than anywhere else in the world; in fact, three quarters of the 100 largest U.S. companies have

⁴⁴ *Id.* Ninety percent of the industry's growth was "traced directly to health insurance."

⁴⁵ See Gina M. Hernández and Carla Lewis, *Insurance industry remains solid; health carrying the weight*, CARIBBEAN BUSINESS, June 3, 2010, at 38 (noting that the increase of local participation in the insurance market increased: they subscribed \$572 million more than in 2008).

⁴⁶ José E. Maldonado, *Insurance industry financially sound despite tough challenges*, Caribbean Business, February 19, 2009, at 15. *But see*, Joanisabel González, *Iniciativa educativa en seguros*, EL NUEVO DÍA, Negocios, at 12 (challenging the notion of Puerto Rico as a saturated market for insurance companies, stating that over 400,000 Puerto Ricans are uninsured and cites recent growth in said statistic, particularly in the context of health services).

⁴⁷ *Why Puerto Rico?*, *supra* note 8.

⁴⁸ INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS, ISSUES PAPER ON THE REGULATION AND SUPERVISION OF CAPTIVE INSURANCE COMPANIES 50 (2006).

⁴⁹ *Id.* 'Onshore' within the context of the financial services and insurance industries mean traditional jurisdictions with no major tax advantages as compared to 'offshore' jurisdictions which are usually small and offer substantially competitive taxation schemes.

⁵⁰ Press Release, Vermont Captive, *Vermont Captive Insurance Surpasses 900 License Mark* (August 10, 2010), <http://www.vermontcaptive.com/press-room/news-releases/vermont-captive-insurance-surpasses-900-license-mark.html>.

⁵¹ *Id.*

⁵² *Id.*

Bermuda captives.⁵³ Among the distinct advantages of Bermuda is the available capacity for catastrophe risks, the large underwriting talent, proximity and access that makes it easier to buy coverage, and a flexible market which strives to stay in the lead.⁵⁴ Its numbers are impressive indeed: the small island hosts more than \$130 billion in insurance capital and \$400 billion in insurance assets.⁵⁵ The market is focused on property and casualty insurance; however, Bermuda captives “write just about every coverage known to man.”⁵⁶ The industry creates 1,700 direct jobs (over 2.6% of the total population) and nearly 10,000 indirect positions in the island.⁵⁷ Thus, this is not exactly a labor-intensive industry, which may be a reason for the Puerto Rico Center being an afterthought in the context of the government’s macroeconomic strategy, ignoring the benefits of luring much-needed new capital to our shores. Said capital can be substantial: note that Bermuda’s 68,265 inhabitants enjoy a Gross Domestic Product (GDP) per capita of \$69,900, one of the highest in the world.⁵⁸

In similar fashion to Bermuda, situated in the Atlantic Ocean, the Cayman Islands are tiny Caribbean islands. Both jurisdictions’ economies, instead of being driven by a large manufacturing base, are buoyed by the financial services industry, particularly the insurance sector. The Cayman Islands have a GDP per capita of \$43,800,⁵⁹ with a population of approximately 48,000, and its geographical area is roughly 1.5 times the size of the District of Columbia.⁶⁰ It is the top foreign jurisdiction for U.S.-held asset-backed securities, with \$119 billion.⁶¹ As a major international financial center, the Caymans attract a considerable volume of financial activity, including captive insurance.⁶² In 2008, the Caymans were home to almost 800 licensed captive insurance companies, with over \$34 billion in total assets and \$7.6 billion in premiums.⁶³ Despite a recently “turbulent and

⁵³ Roger Crombie, *Bermuda In-Depth Series (Part 2): Big and Small Rolled Into One*, RISK & INSURANCE, March 1 2008, available at <http://www.riskandinsurance.com/story.jsp?storyId=76641393>. Bermuda even has an NGO called Bermuda Foundation For Insurance Studies, which provides scholarships to students who want to join the industry. *Insurance is 'driving force of our economy'*, BERMUDA SUN, October 19, 2010, available at <http://bermudasun.bm/main.asp?SectionID=60&SubSectionID=932&ArticleID=48630>.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ C.I.A. WORLD FACTBOOK, Country Comparison: GDP – per capita (PPP), <https://www.cia.gov/library/publications/the-world-factbook/fields/2004.html#bd>.

⁵⁹ *Id.*

⁶⁰ UNITED STATES GOVERNMENT GENERAL ACCOUNTABILITY OFFICE, CAYMAN ISLANDS: BUSINESS AND TAX ADVANTAGES ATTRACT U.S. PERSONS AND ENFORCEMENT CHALLENGES EXIST 7 (2008).

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 9.

uncertain" world market, captive insurance has remained stable in the Caymans.⁶⁴ There have been few liquidations and a consistent number of new captives since the significant growth period in the early 2000's.⁶⁵ The Islands typically attract smaller captive insurance companies because of its lower capital requirements compared to some U.S. states.⁶⁶ Note, however, that the Caymans have been under fire from the U.S. Congress in recent years, as it tries to crack down on offshore tax havens, particularly during the Obama Administration.⁶⁷

In sum, both the Cayman Islands and Bermuda are offshore jurisdictions that have aptly lured enormous amounts of foreign capital to their havens, while the state of Vermont has remained a leader in the onshore sector.

What about Puerto Rico? We must note how the Island fares when compared to these industry giants. Under the IIC, interested international insurance entities have various alternatives to organize and operate within the IIC. These options include an international insurer holding company, an international insurer, or a branch of an international insurer.⁶⁸

As illustrated by Table I, Puerto Rico favorably compares in terms of income taxation with other competing jurisdictions. Tax benefits provided under the IIC law in Puerto Rico are exemptions from income, real, personal property and municipal license taxes, dividend withholdings and branch profit taxes.⁶⁹ Furthermore, no tax returns need to be filed with the Puerto Rico Treasury Department.⁷⁰ Lastly, assets may be kept in foreign currencies.⁷¹

⁶⁴ KPMG, CAPTIVE INSURANCE IN THE CAYMAN ISLANDS: STABILITY IN A WORLD OF UNCERTAINTY (2010).

⁶⁵ *Id.*

⁶⁶ *Id.* at 27.

⁶⁷ See Letter from Anthony Travers, Chairman, Cayman Finance, to Carl Levin, U.S. Sen. (July 27, 2010), available at <http://www.caymanfinances.com/Cayman-Finance-News/an-open-letter-to-sen-carl-levin.html> (denouncing attempts by the U.S. Congress to classify the Cayman Islands as a tax haven; asserting that the Islands comply with money-laundering regulations; and framing the 'offshore' issue as one within the purview of Congress, as creating, closing and modifying tax loopholes is fundamentally a legislative task of the United States and not of the Cayman Islands).

⁶⁸ OFFICE OF THE COMMISSIONER OF INSURANCE, WHAT IS THE INTERNATIONAL INSURANCE CENTER (2009), available at <http://www.ocs.gobierno.pr/ocspr/documents/international/What.pdf> (henceforth referred to as "WHAT IS THE INTERNATIONAL INSURANCE CENTER").

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ See *supra* note 2.

Table I. Tax Burden Comparison⁷²

Jurisdiction	Insurance Company Tax	Withholding Taxes	US Federal Excise Tax	Treaty
Bermuda	No	No	Yes	Yes
Cayman Islands	No	No	Yes	No
Vermont	Federal Tax (35%)	Yes	No	N/A
Puerto Rico ⁷³	No	No	Yes	No

In sum, capitalization requirements are comparable and competitive with the leading jurisdictions referenced herein. The IIC statute provides for five classes of insurers/reinsurers. Table II illustrates the different classes and their required deposits.

Table II. Insurer Classes and Required Deposits⁷⁴

Class	Description	Minimum Capital Surplus	Fees Payable to the IIC⁷⁵
Class I Pure Captive	This company may not insure any risks other than those of its parent, affiliated companies and/or controlled unaffiliated businesses.	\$500,000	\$1,100
Class II Association Captive	Can insure the risks of the parent and/or affiliated companies or its members, as well as those arising from its business transactions.	\$750,000	\$1,350
Class III Property Casualty	Can transact business for traditional insurance or reinsurance foreign risks in property & casualty, except life and disability. Can also underwrite high limit casualty and property catastrophe reinsurance.	\$1,500,000	\$2,850

⁷² WHAT IS THE INTERNATIONAL INSURANCE CENTER, *supra* note 68. *See also*, RULE 80 *supra* note 21.

⁷³ Note that Puerto Rico currently has a special temporary 5% tax. *See infra* note 161.

⁷⁴ WHAT IS THE INTERNATIONAL INSURANCE CENTER, *supra* note 68.

⁷⁵ *Id.* There is a basic application fee of \$750.00. Note that international insurers are also subject to an annual contribution based on their premium level.

Class IV Unrestricted Property/ Casualty	Can transact business for traditional insurance and reinsurance foreign risks in property & casualty, including high limits within those categories. Cannot transact life and disability insurance.	\$100,000,000	\$25,350
Class V Unrestricted Life- Disability	Can transact business for traditional insurance and reinsurance foreign risks in life and disability.	\$750,000	\$1,100

Fees range from \$5,000 to \$75,000. For example, an insurer with no more than \$25 million in premiums written would pay \$5,000. The top category, comprised of those insurers with over \$250 million, would pay \$75,000.⁷⁶

V. PUERTO RICO'S NATURAL AND NOT-SO-NATURAL ADVANTAGES

Puerto Rico is blessed with a myriad of elements that support the IIC's business. Some are the result of legislative fiat, but others are out of the Island's control, such as the demise of secrecy. There is no doubt that secrecy, a long-time lure of traditional "offshore" banking entities, is no longer a key driver in making business decisions.⁷⁷ As the IRS and other tax agencies around the world have cracked down on tax evasion, the formerly appealing characteristic of so-called tax havens, idyllically located next to sandy beaches in Grand Turk or in the striking valleys of Switzerland, has been reduced in importance. This has leveled the playing field for jurisdictions such as Puerto Rico, which can offer offshore benefits with the security and stability of an onshore jurisdiction, and an inviting environment. Former tax havens such as Panama are in danger of losing their traditional 'secrecy' edge due to new treaties with the United States.⁷⁸

This demise of secrecy has been exemplified, and triggered in part, by congressional approval in 2010 of the Foreign Account Tax Compliance Act.⁷⁹ Said legislation deters investors from exploiting tax loopholes and using tax

⁷⁶ RULE 80, *supra* note 21, at 6.

⁷⁷ See Ilianexis Vera Rosado, *Necesario convertir la Isla en un paraíso fiscal*, EL VOCERO, Dec. 8, 2010, at 29.

⁷⁸ *Fiscal paradise lost*, THE ECONOMIST, Dec. 7, 2010, <http://www.economist.com/node/21013707>.

⁷⁹ *Foreign Account Tax Compliance Act*, Pub. L. No. 111-147, 124 Stat. 71 (2010).

havens around the world.⁸⁰ It imposes a new 30% withholding tax on certain payments made to foreign financial institutions and non-financial foreign entities that refuse to identify US account holders and investors to the Internal Revenue Service.⁸¹ It does not matter whether the US person invests in US securities or receives the US source income directly.⁸²

Emiliano Trigo best summarizes Puerto Rico's newfound strength in the market of international financial centers:

A former handicap is now an opportunity. As OFCs [offshore financial centers] come under scrutiny Puerto Rico can distinguish itself from shadow banking systems by offering a tax neutral environment within the confines of a U.S. commonwealth. It also serves the United States well that offshore activity be realized within its purview; it strengthens its economic and political interest that offshore assets be stored in bank accounts that are part of the Federal Reserve System.⁸³

Another positive factor is that Puerto Rico has a solid rule-of-law culture and a comparatively efficient government, alongside with its currency being the US dollar. Together, these elements make the Island a safer bet when compared to several other domiciles. While Puerto Ricans may consider corruption a highly problematic aspect that affects our Island, the truth is that safeguards are now in place and the Island is successfully tackling the issue. The respected Transparency International Corruption Perceptions Index (CPI), where Puerto Rico stands competitively, confirms this.⁸⁴

Furthermore, according to the Global Competitiveness Report 2011-2012 issued by the World Economic Forum, the Island's economy remains

⁸⁰ For further discussion on this legislation, see Melissa A. Dizdarevic, *The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 FORDHAM L. REV. 2967 (2011).

⁸¹ Michelle Bontems Graham, *International Estate Planning Strategies Leading Lawyers on Understanding Client Needs, Incorporating Foreign Assets, and Overcoming Tax Issues*, ASPATORE, October 2011, 2011 WL 5038770.

⁸² *Id.*

⁸³ See Trigo, *supra* note 3.

⁸⁴ CORRUPTION PERCEPTIONS INDEX 2010, TRANSPARENCY INTERNATIONAL (2010), available at <http://www.transparency.org/content/download/55725/890310>. Puerto Rico scored a 5.8 in the CPI, measured on a scale from 10 (very clean) to 0 (highly corrupt); this score was good for 33rd place out of 176 ranked countries. In the Americas, Puerto Rico ranked 6th, after Canada, Barbados, the United States, Chile and Uruguay. Note that neither Bermuda nor the Cayman Islands are listed as separate from the United Kingdom for purposes of this survey, and therefore, cannot be directly compared to Puerto Rico.

highly competitive, particularly when evaluated within the context of the Americas, where it ranks as the fourth most competitive country after the United States, Canada, and Chile.⁸⁵ Some of Puerto Rico's strengths, as described by the report, are capacity for innovation, extent of marketing tools, and a dynamic and sophisticated business sector.⁸⁶ The Island ranks 22 and 20 in availability and affordability of financial services, respectively.⁸⁷

However, while the Island moved up six places in the aggregated rankings compared to the previous year,⁸⁸ it is not ranked higher due to various reasons, including excessive government regulation and a burdensome labor law scheme.⁸⁹ However, even factoring for these challenges, Puerto Rico fares competitively due to its solid institutions: democracy, rule of law, and effective administrative oversight, particularly that which is exercised by Federal regulators.

The Island has had a significant measure of self-government since 1952. Since that year, power has peacefully changed hands among major parties seven times. Puerto Rico's relationship with the United States subjects the country's regulations to heightened Federal standards. Puerto Rico has the United States District Court for the District of Puerto Rico; its rulings are appealable to the United States Court of Appeals for the First Circuit and ultimately reviewable by the United States Supreme Court. Federal law enforcement agencies also operate in Puerto Rico, as do regulatory entities such as the Securities and Exchange Commission and the Federal Deposit Insurance Corporation. Furthermore, in terms of insurance expertise, it is pertinent to note that Puerto Rico is a member of the prestigious National Association of Insurance Commissioners ("NAIC"), and the Insurance Commissioner is also a participating member of the Association of Insurance Superintendents of Latin America ("ASSAL").⁹⁰ In sum, the IIC is not established in a seedy, lawless backwater, but on a respected and stable jurisdiction.

As I have described, there are several factors pointing to the strength of Puerto Rico as a solid domicile. Yet, while I do not feel that the current legislation that engendered IIC has failed competitively, the reality is that the current scheme has been underutilized, under promoted, and has not been as effective as it should have been.

⁸⁵ KLAUS SCHWAB, ET AL., THE GLOBAL COMPETITIVENESS REPORT 2011-2012, WORLD ECONOMIC FORUM (2010), available at, http://www.weforum.org/docs/WEF_GlobalCompetitiveness_Report_2011-12.pdf. Again, neither the Cayman Islands nor Bermuda are listed. Puerto Rico is followed closely in the rankings by Panama, Brazil and Costa Rica. *Id.* at 15.

⁸⁶ *Id.* at 300.

⁸⁷ *Id.* at 301.

⁸⁸ *Id.* at 15.

⁸⁹ *Id.* at 300; see Joanisabel González, *Mejor nota global para la isla*, EL NUEVO DÍA, September 10, 2010, at 36.

⁹⁰ WHAT IS THE INTERNATIONAL INSURANCE CENTER, *supra* note 68.

There are several miscellaneous advantages Puerto Rico has over Bermuda and the Cayman Islands. Aside from the bilingual, highly skilled-and-trained workforce we have already mentioned, there is the advantage of having solid air access to the United States, particularly the East Coast, and fair access to European and Latin American markets, easing business travel constraints.⁹¹

The companies working under the IIC have stated a variety of reasons for doing business in Puerto Rico. Syndicate Re, for example, chose the Island for various factors such as its “flexible statute, responsive regulatory environment and widespread availability of support services.”⁹² Oceanus Re, also cites the flexibility of the Puerto Rico statute, and offers a variety of innovative products such as reinsurance programs for auto dealers, which lets them share in the underwriting profit and investment income on extended service contracts and other insurance products sold by them.⁹³ Others have even moved business to Puerto Rico from domiciles such as Bermuda and the Cayman Islands, seeking a safer environment.⁹⁴

VI. THE LATIN AMERICAN MARKET AND THE IIC: PUERTO RICO’S NICHE

IIC management has not been shy: they want to become a “logical portal” for those insurers and reinsurers wishing to enter the Latin American market.⁹⁵ The insurance and reinsurance industries in Latin America reflect low penetration, as discussed below.⁹⁶ Latin America has arguably weathered the financial crisis better than the rest of the world, with renewed growth after 2008.⁹⁷ In fact, the region is on pace to further expand its economy, fueled by Chinese and Indian appetite for raw materials and bolstered by improved economic management in the region.⁹⁸

⁹¹ In April 2011, British Airways resumed twice weekly, one-stop service to London via Antigua. Major competitor Virgin Atlantic successfully started a seasonal route to London in 2009. In the Latin American front, Panama’s Copa Airlines has increased capacity on its twice-daily nonstops between San Juan and Panama City, and is expected to launch service to Bogotá, Colombia. See Frances Ryan, *Economic incentives secure new airlines and cruiselines for Puerto Rico*, CARIBBEAN BUSINESS, Nov. 25, 2010, at 18.

⁹² Press Release, International Insurance Center of Puerto Rico, Office of the Commissioner of Insurance, Syndicate RE, A.I. New Insurance Underwriting Venture – Authorized in Puerto Rico (May 30, 2007) available at <http://www.ritcsm.com/newsfiles/syndicaterepre ssrelease.pdf>.

⁹³ Donna Harris, *Reinsurance plan offers dealers tax advantages*, AUTOMOTIVE NEWS, April 8, 2007.

⁹⁴ Interview with Rubén Gely, *supra* note 33. Gely was referring to U.S. Commonwealth and Flagstone Re, respectively.

⁹⁵ WHAT IS THE INTERNATIONAL INSURANCE CENTER, *supra* note 68.

⁹⁶ *Why Puerto Rico?*, *supra* note 8.

⁹⁷ *Nobody’s backyard*, THE ECONOMIST, Sept. 9, 2010, at 13.

⁹⁸ *Id.*

The reality is that the global nature of the insurance and reinsurance markets generates a constant flow of investment ventures and general business development between countries and markets. If the past twenty years were defined by investments in “Lloyd’s [of London] and Bermuda,” there is no doubt that the next two decades will be about the emerging markets.⁹⁹ Experts are certain the Latin American markets are ripe with opportunity:

Insurance penetration in Latin America, despite its recent growth, lags the trends of more developed markets of Europe or the US. It is a relatively small market taking into consideration its geographical size as compared to other markets, but demonstrates strong growth potential. It is also important to remember that regulation differs from market to market and most Latin American countries are still trying to develop stronger regulatory frameworks and regulators. So far, insurance regulators have not evolved as much as banking regulators but some countries have further to go than others.¹⁰⁰

There is great room for growth in the region. For example, Costa Rica and Brazil have just dismantled state monopolies for insurance and reinsurance, respectively.¹⁰¹ A recent Fitch Ratings report states that penetration rates for the insurance industry in Brazil will increase in the medium and longer term.¹⁰² Brazil’s notoriously low participation of the insurance industry in its economy -- less than 4% of GDP -- is poised to grow despite the economic downturn.¹⁰³ While relatively small, the Brazilian insurance market is still the largest in Latin America.¹⁰⁴

A key Puerto Rican advantage is hosting an industry that understands its stateside counterparts, yet has access to a trained and educated workforce that possesses prized bilingual skills. However, our bilingual workforce will not, by itself, enable us to understand the Latin American insurance industry. The IIC should join forces with PROINSURA in order to study, support and execute strategic involvement in the Latin American market. In the end, the

⁹⁹ CLYDE & CO., GOING GLOBAL 2010 | DEVELOPMENTS IN THE INSURANCE MARKETS AROUND THE WORLD 2 (2010).

¹⁰⁰ *Id.* at 8.

¹⁰¹ *Id.*

¹⁰² *Fitch: Brazilian Insurance Sector Poised for Further Growth in 2011*, BUSINESSWIRE, Dec. 6, 2010, available at <http://www.businesswire.com/news/home/20101206006437/en/Fitch-Brazilian-Insurance-Sector-Poised-Growth-2011>.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

question of whether Puerto Rico can become a key player on it must be answered by our own domestic insurers and by the several international entities under the IIC that are making inroads in said market. The framework is already built.

There are encouraging signs towards developing business ventures in Latin America leveraging the IIC's potential. For example, Panama-owned Barents Re, announced plans to enter the IIC during 2011, further bolstering Puerto Rico's outreach to Latin America.¹⁰⁵ Fortunately, local insurers have started to expand into the Latin American market such as Cooperativa de Seguros Múltiples' venture into Uruguay.¹⁰⁶ Even Triple S has commented on their interest in entering the Latin American market, mentioning Panama and Costa Rica, among others, as the likely candidates for new operations.¹⁰⁷

Finally, an encouraging sign is that entities doing business under the IIC are already working to adapt their products for the Latin American market, offering myriad specialized policies such as personal accident insurance as well as kidnap and ransom policies.¹⁰⁸

VII. THE BENEFITS OF A COMPETITIVE IIC SCHEME: STRENGTHS AND CHALLENGES

The New Progressive Party won the 2008 elections with a platform that included several proposals to shore up the IIC, but action has only been taken in 2011. The Insurance Commissioner is organized under the Governor's Office and does not belong to any constitutional department.¹⁰⁹ Today, the office oversees the entire insurance industry in Puerto Rico with 113 employees and an annual budget of roughly \$10 million.¹¹⁰ According to the director of the Center, the actual IIC office consists only of himself and another employee.¹¹¹ No specific budget other than their salaries is apportioned for the IIC.¹¹² Below, I discuss the need for increased allotment of government resources towards promoting the Center.

In addressing the competitiveness of Puerto Rico's legislation, IIC officers do not believe that capitalization requirements should be lowered to

¹⁰⁵ *Report: Panama's Barents Re eyeing PR market*, CARIBBEAN BUSINESS, Oct. 21, 2010, http://cbonlinepr.com/news03.php?nt_id=49730&ct_id=1&ct_name=1. Barents expects to obtain a reinsurance license in Puerto Rico soon and start operations in 2011. The company only does business in the Latin American region, focusing on mass-market insurance products, surety bonds and fiscal risks. The company was drawn by the size and potential of Puerto Rico's economy.

¹⁰⁶ *See Insurance industry financially sound despite tough challenges*, *supra* note 46.

¹⁰⁷ Brenda Vázquez Colón, *Reportan crecimiento*, EL VOCERO, Mar. 13, 2011, at 35.

¹⁰⁸ Gina M. Hernández, *AIU Holdings rebranded as Chartis Insurance*, CARIBBEAN BUSINESS, October 22, 2009, at 34.

¹⁰⁹ OFICINA DEL COMISIONADO DE SEGUROS, *supra* note 4.

¹¹⁰ *Id.*

¹¹¹ Interview with Rubén Gely, *supra* note 38.

¹¹² *Id.*

compete with jurisdictions such as Grand Cayman and Bermuda.¹¹³ Officers understand that increased capitalization standards transmit a sense of seriousness in the IIC's business that is appreciated by industry leaders and serves to "guard the door", thus avoiding troublemaking entities that can tarnish the Center's repute.¹¹⁴ That is, lower capitalization may result in busted captives, thus diminishing Puerto Rico's stature as a credible place to engage in the insurance trade.

Our current scheme already offers a variety of advantages that have not been reaped by entities. For example, the tax exemptions legislated in Act No. 399 includes property taxes, mostly imposed by municipalities.¹¹⁵ Therefore, international insurers may exploit this exemption in order to generate increased revenues by engaging in the real estate business in Puerto Rico, subject to other applicable regulations.

Another issue where entities can reap benefits under the IIC framework is the establishment of protected cell companies, regulated in Puerto Rico by Rule 81.¹¹⁶ These are a variation of the traditional rent-a-captive scheme.¹¹⁷ The protected cell captive offers more security to policyholders because it isolates each participant's assets and liabilities as if they were separate companies doing business with the core company.¹¹⁸ They are one of the most versatile ways for companies to manage their risks.¹¹⁹ Under the protected cell scheme, a holding company opens an international insurer, which in turn divides its business into several protected cells. Protected cell legislation is a relatively recent creation in offshore jurisdictions such as Gibraltar, Bermuda, the Cayman Islands, and Guernsey.¹²⁰ Some 'onshores' have also adopted it.¹²¹ While there are eleven entities in the IIC, three of these operate roughly forty protected cells.¹²²

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ See *supra* note 1, Art. 61.240 (13).

¹¹⁶ RULE 81, *supra* note 22. All classes of insurers except Class 1 can use protected cells.

¹¹⁷ Rent-a-captives are defined as a form of captive serving businesses that are unable to capitalize a captive but are willing to assume a portion of their own risk and share in the underwriting profits and investment income; it is generally sponsored by insurers or reinsurers, which essentially "rent out" their capital for a fee. HANDBOOK OF INTERNATIONAL INSURANCE: BETWEEN GLOBAL DYNAMICS AND LOCAL CONTINGENCIES 952 (J. David Cummins and Bertrand Venard, eds., 2007).

¹¹⁸ *Id.* at 935.

¹¹⁹ Interview with Rubén Gely, *supra* note 38.

¹²⁰ NIGEL FEETHAM AND GRANT JONES, PROTECTED CELL COMPANIES: A GUIDE TO THEIR IMPLEMENTATION AND USE 3 (2008).

¹²¹ *Id.*

¹²² Interview with Rubén Gely, *supra* note 38. See also, *Imán para la inversión internacional en la Isla*, *supra* note 39.

The protected cell scheme provides for segregated accounting and separate insolvency provisions.¹²³ Another advantage of protected cells is that they may be securitized.¹²⁴ Protected cells can be combined with each other for investment purposes, without actually being integrated for accounting purposes.¹²⁵ Furthermore, the liabilities of each investor are kept separate and costs are reduced because there is no need for several boards or authorized representatives.¹²⁶

A particular benefit of the protected cell scheme is that it provides a vehicle for a relatively small company that could find the \$500,000 capitalization requirement for a Class 1 insurer rather onerous.¹²⁷ With the alternative of protected cells, these types of businesses can then maintain a cell under another insurer, perhaps a Class 3, until said cell can evolve and grow over time until finally complying with the requirements of a Class 1, thus maturing into an independent insurer.¹²⁸

In Puerto Rico, only property and contingency risk may be insured through protected cells, as opposed to other jurisdictions that currently allow, for example, life and annuity risks.¹²⁹ As such, it is important to examine the feasibility of expanding the regulations in order to provide the benefits of this advantageous scheme to other types of risk.

In November 2010, the Fortuño Administration filed House Bill 3034, which proposed various amendments to Chapter 61 of the Insurance Code and corresponding sections of the Internal Revenue Code.¹³⁰ The Bill was approved by the legislature and signed by the Governor on June 20, 2011.¹³¹ The new law amends Article 61.260 of the Insurance Code, which outlines the powers of the Insurance Commissioner, so that the Commissioner's authority is expanded to combine and create other categories and designations aside from the five traditional classes of insurers, thus creating a more flexible framework.¹³²

Furthermore, the new law amends several provisions related to estate taxes and embargo procedures affecting benefits and monetary amounts received by International Insurers.¹³³ The purpose of these technical amendments is to effectively isolate said benefits received by an

¹²³ See *Puerto Rico Offshore Insurance Center*, *supra* note 2 at 30.

¹²⁴ *Id.* at 31. See RULE 81, *supra* note 22, Art. 5.

¹²⁵ RULE 81, *supra* note 22, Art. 8.

¹²⁶ Interview with Rubén Gely, *supra* note 38.

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ See 2011 P.R. Laws No. 98, *supra* note 35. The bill was also filed in the Senate as S. Bill 1899.

¹³¹ *Id.*

¹³² *Id.*

¹³³ Interview with Rubén Gely, *supra* note 38.

International Insurer from the local tax structure.¹³⁴ The IIC management team understands that premiums paid to International Insurers come from wealth generated from outside the Island; thus, applying Puerto Rico's taxes to them is detrimental to the business the Center strives to attract.¹³⁵ These amendments are the product of the Center's recent experience with insurer US Commonwealth. Said insurer is linked to a similar operation in the Cayman Island, where it enjoys a more competitive environment in this respect.¹³⁶ This entity had issues with current Puerto Rico laws. During the formation of the IIC legal framework, estate taxes and embargo procedures of amounts paid by non-residents were not correctly exempted.¹³⁷ However, perhaps the most important provision in the law is the establishment of tax-exemption decrees beginning in January 1, 2012, when the 5% special tax applied by Act No. 7 expires. I discuss this proposal in Section IX of this work.¹³⁸

Aside from local legislative action, another plausible alternative that would put Puerto Rico in a privileged position to favorably compete with Bermuda and Grand Cayman would be lobbying Congress to amend the Internal Revenue Code in order to exempt entities under the IIC from the United States excise tax, particularly from the 1% tax on reinsurance premiums.¹³⁹ The amendment would simply establish Puerto Rico as a domestic domicile for purposes of the excise tax. Congress should be persuaded using the argument that it is better to bring all of these insurers and reinsurers onshore instead of abroad. As previously discussed, with the demise of secrecy as a factor for maintaining international financial and insurance centers, the main reason why insurers remain offshore is markedly

¹³⁴ *Id.* See also, José L. Carmona & Carlos Márquez, *Legislature revives Puerto Rico's International Insurance Center*, CARIBBEAN BUSINESS, May 19, 2011, at 2.

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ Currently, the Internal Revenue Code, section 4371 establishes the following:

"There is hereby imposed, on each policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer, a tax at the following rates:

(1) Casualty insurance and indemnity bonds 4 cents on each dollar, or fractional part thereof, of the premium paid on the policy of casualty insurance or the indemnity bond, if issued to or for, or in the name of, an insured as defined in section 4372 (d);

(2) Life insurance, sickness, and accident policies, and annuity contracts 1 cent on each dollar, or fractional part thereof, of the premium paid on the policy of life, sickness, or accident insurance, or annuity contract; and

(3) Reinsurance 1 cent on each dollar, or fractional part thereof, of the premium paid on the policy of reinsurance covering any of the contracts taxable under paragraph (1) or (2)." 26 U.S.C. 4371 (2011).

generous tax treatment. By exempting Puerto Rico, Congress would help bring those captives onshore, where Federal agencies can better monitor and regulate them, while at the same time providing a huge shot in the arm for Puerto Rico's financial and insurance industries. However, I must warn the Island should push for this amendment with a coordinated lobbying effort, which is certain to be costly, particularly considering that offshore jurisdictions that may be affected will certainly also push to preserve the status quo.

The windfall from a potential exemption of Puerto Rico from the federal excise tax could be sizable because the Island would then have a superior tax structure, particularly for the reinsurance business. Even attracting a modest fraction of the billions of dollars deposited in other jurisdictions could have a considerable impact on our financial system. The Island has the potential to become not just a regional but also a world leader in this sector if the amendment is approved. We must remember Puerto Rico has a much larger and sophisticated financial infrastructure than jurisdictions such as Bermuda, elements which can be leveraged if a successful lobbying efforts result in excise tax exemption.

Another opportunity offered by the IIC which is of particular interest to local insurance companies is that it allows said companies to use the advantageous framework to create insurance outlets offering rent-a-captives.¹⁴⁰ As discussed elsewhere in this work, this helps companies lower costs in cases coverage would be too expensive or even unavailable elsewhere.

The IIC also presents a myriad of opportunities for asset managers, who can use it to provide alternative investment solutions to insurance companies. For example, they can help insurance companies receive regulatory approval, locate strategic joint venture partnerships, recommend reinsurance transactions, and assist in insurance executive searches.¹⁴¹ Mutual funds can benefit too. They may use an international insurer as an investment vehicle for portfolio diversification by region or by business sector, or they can enter into investment transactions in the securitization market.¹⁴²

In sum, I feel the current framework has been only mildly effective in luring industry players to Puerto Rico. However, I also feel that the statute, while competitive, is underpublicized. Puerto Rico must not be sated and satisfied. We have not failed, but both marketing elements and overarching market and industry factors have been hard-to-overcome hurdles for the IIC. The one-on-one marketing efforts carried forth by IIC officials have borne

¹⁴⁰ See Interview with Rubén Gely, *supra* note 38. Rent-a-captive outlets run the operation of multiple captives out of a centralized local operation.

¹⁴¹ WHAT IS THE INTERNATIONAL INSURANCE CENTER, *supra* note 68.

¹⁴² *Id.*

fruit, but not enough for the Center to assume a true industry-leading position, as I discuss below. The reality is that we offer a superb mix of both onshore and offshore domiciles, but we have to get our act together and speak with a single voice towards the industry, both local and foreign, ready to act and react to maintain our competitiveness.

VIII. THE CASE FOR INCREASED PROMOTIONAL EFFORTS WITH THE D.E.D.C.

There is no denying that Puerto Rico has, as discussed above, several characteristics that make it an ideal place to park a sizable international insurance business. However, while our legal framework, particularly taxation, competes favorably with other jurisdictions, the fact is that promotional efforts have been deficient. These efforts are key to creating market awareness in the appropriate sectors of the various strengths of the local IIC. The market largely ignores Puerto Rico's possibilities.¹⁴³ Even many local companies are not aware of them.¹⁴⁴ This visibility problem must be solved.

The NPP party platform for the 2008 election devotes roughly a page to the IIC.¹⁴⁵ The platform proposes, *inter alia*, transferring the promotional aspect of the IIC away from the regulator, the Insurance Commissioner ("Oficina del Comisionado de Seguros") to the Department of Economic Development and Commerce ("DEDC"). These proposals seek to avoid conflicts of interests derived from having the regulator handle promotional tasks for the IIC.¹⁴⁶ I understand this is a worthy idea. However, the mere transferring of promotional responsibility to the DEDC will not, *ipso facto*, ensure the building of an adequate apparatus for the IIC's success.¹⁴⁷

Insurance, particularly international reinsurance and captives, is a highly technical industry managed by experts in very narrow topics.

¹⁴³ See *Espacio de crecimiento*, *supra* note 38.

¹⁴⁴ *Id.*

¹⁴⁵ PARTIDO NUEVO PROGRESISTA, PROGRAMA DE CAMBIO Y RECUPERACIÓN ECONÓMICA 57 (2008). The NPP platform proposed: recruiting first-class personnel for the IIC; revising the statutes to ensure competitiveness; allowing Class 1, Class 2 and Class 3 captives to underwrite domestic risk; reduce capitalization requirements in order to match competitive jurisdictions such as Bermuda and Vermont; and finally, create a support infrastructure to assist entities operating under the IIC and extending the benefits of the Industrial Incentives Act of 2008 to them. Note that the IIC initiative has bipartisan support, certainly a boon in a politically balkanized environment such as Puerto Rico. The original law was unanimously approved and enacted during the Calderón Administration (affiliated with the Popular Democratic Party) and, as discussed, the 2008 NPP platform, strives to support and strengthen the Center. Bipartisanship virtually ensures that the initiative will have government support regardless of the party in power after the 2012 elections and the years to come.

¹⁴⁶ *Id.*

¹⁴⁷ *IIC taking form*, *supra* note 32.

Promotional efforts for a venture such as the IIC are far more complex than placing a billboard at an airport or a couple of full-color advertisements in the New York Times. On a favorable note, however, there have been renewed joint marketing efforts featuring the IIC office and the DEDC since May 2010.¹⁴⁸ Positive signs in this area have recently emerged: the DEDC Secretary recently traveled to London alongside the Executive Director of the IIC in order to pitch the advantages of the local scheme to insurers and reinsurers based in the United Kingdom.¹⁴⁹ This is an encouraging event and signals the DEDC's commitment to the insurance initiative. Hopefully, these joint ventures will continue in the future.

Nonetheless, these positive efforts are hindered by the lack of a marketing budget: the IIC office has no apportioned moneys for this purpose.¹⁵⁰ The IIC relies mostly on one-on-one marketing efforts. The DEDC should contract with experienced purveyors of these services and engage in intensified efforts in order to spell out our Center's attributes to industry power brokers worldwide, while emphasizing Latin America, its natural niche market.¹⁵¹

IX. THE IIC AND POSITIVE EXTERNALITIES

Puerto Rico already has a sophisticated banking and financial service infrastructure. By having extensive back office functions already in place, entities doing business under the IIC can leverage their position in the Island by using high-quality local purveyors of various services such as accounting, underwriting, claims management, and information technology/technical support.

Currently, IIC entities can set up shop anywhere in the Island. A good idea would be encouraging IIC entities to locate in the same area. This idea

¹⁴⁸ Interview with Rubén Gely, *supra* note 33. The establishment of a joint IIC-DEDC marketing office was one of the issues "requiring immediate attention", according to the Transition Report issued by the outgoing Commissioner in 2008. *See* Oficina del Comisionado de Seguros, Resumen Ejecutivo, Transición 2008, at 5. *See also*, Espacio de crecimiento, *supra* note 38.

¹⁴⁹ Joanisabel González, *La Isla busca negocios en Londres*, El Nuevo Día, February 11, 2011, at 39 (chronicling a visit to London by DEDC Secretary José Pérez-Riera and IIC Executive Director Rubén Gely, where the Secretary stated their meetings were generally geared towards continuing negotiations with a major British insurer whose investment in the Puerto Rico IIC would be around \$400 million).

¹⁵⁰ *Id.*

¹⁵¹ The OCI has recognized the importance of the DEDC in marketing efforts for the IIC; it has also recommended the appointment of a commission including representatives of the Puerto Rico financial and insurance sectors tasked with promoting the IIC where the OCI and the DEDC "lack access." Statement of Dorelisse Juarbe Jiménez, Insurance Commissioner before the P.R. House of Representatives, May 19, 2005, discussing H. Res. 153, 1st Sess., (P.R. 2005).

has been discussed in the grander scheme of the International Banking Center.¹⁵²

While entities under the IIC do not have to celebrate an annual meeting in Puerto Rico, joint marketing efforts can be undertaken with the help of the Puerto Rico Tourism Company in order to attract conventions and industry symposia. Furthermore, the IIC can encourage executives of holding companies to celebrate meetings in Puerto Rico and bring forth valuable room-nights and expenses for ancillary services.

But all of the above are surpassed by the potential impact of the IIC's synergies with the Puerto Rico financial services industry. Perhaps as a sign of the times, the major players therein have been lukewarm at best towards promoting their business to IIC-registered entities.¹⁵³ It must be kept in mind that the IIC requires a level of minimum capital, which must be kept in Puerto Rico in various forms, not specifically bank deposits. Experts seem to agree that Puerto Rico's home-grown recession had its root in the local banks' accounting woes, which eventually resulted in huge losses that left the banks lacking capitalization and local investors perplexed as billions of dollars were lost in stocks and other securities tied to their performance.¹⁵⁴ Banking consolidation is expected to strengthen the financial services industry in the long term. However, the length of this term is still uncertain.¹⁵⁵

Given the bumpy road facing local banks, any measure that encourages recapitalizing and replenishing the local banking industry's

¹⁵² See Trigo, *supra* note 3.

¹⁵³ Interview with Rubén Gely, *supra* note 38. Gely notes the exception of UBS Financial Services, which has been actively and successfully pitching its products to IIC insurers and reinsurers. See also, *Why Puerto Rico?*, *supra* note 8 (featuring remarks from Miguel Ferrer, chief executive officer for UBS Financial Services in Puerto Rico, emphasizing the investment bank's commitment to the IIC and the belief that the center would have a positive impact on the entire financial local market "principally because of the increase in the liquidity standards of the local capital market and in the number of participants").

¹⁵⁴ Matthias Rieker, *Puerto Rican Hopes Ride on Bank Auction*, WALL ST. J., April 30, 2010, <http://online.wsj.com/article/SB10001424052748703572504575214633956847088.html>. The recession in Puerto Rico, which officially started in early 2006, was abetted by a banking crisis a year earlier. Loan sales between banks unraveled after auditors discovered massive accounting discrepancies related to the structure and valuation of complicated mortgage derivatives. Those derivatives racked many banks, which responded by curbing lending.

¹⁵⁵ CENTER FOR THE NEW ECONOMY, FISCAL SITUATION UPDATE, FISCAL YEAR 2010-2011 BUDGET, Vol. IV, No. 1, 4-5 (May 2010). In 2010, the Puerto Rico Commissioner of Financial Institutions closed three local banks: Eurobank, R-G Premier, and Westernbank. The Commissioner appointed the FDIC as receiver for the closed institutions. The FDIC, in turn, entered into separate "purchase and assumption" agreements with Oriental Bank, Scotiabank, and Banco Popular to acquire both assets and deposits, respectively, of each of the closed banks. Over \$17 billion in assets and roughly \$15 billion in deposits changed hands in this well-publicized transaction.

coffers will have a highly positive effect.¹⁵⁶ Local and foreign investors lost billions of dollars in equity during the banking crisis in the Island.¹⁵⁷ As Puerto Rican banks find themselves with fresh liquidity, they will again feel comfortable to turn around and open the floodgates to finance new construction projects and re-inject capital to businesses. This process is a *sine qua non* condition for jumpstarting the Island's troubled economy. However, this requires engaging in promotional maneuvers in order to sell their products to investors and lure them into placing their capital into brokered deposits or other instruments purveyed by Puerto Rican banks. In short, a marked increase in deposits in our banks will help restart the Island's languishing economic engine. Of course, the IIC shall not solve the problem of deposits by itself, but will undoubtedly help, constituting a sorely needed 'shore up' for the banking sector in the Island.

Insurance is not foreign parlance for Puerto Rico's banks. Since Congress passed the Gramm-Leach-Bliley Act¹⁵⁸ in 1999, banks were allowed to enter the insurance business. Banco Popular was the first in Puerto Rico to establish a subsidiary, Popular Insurance, which has successfully operated for the past ten years, experiencing continuous growth during said period.¹⁵⁹ While international insurance and reinsurance is different and more sophisticated than retail brokerage, reality beckons our financial sector to leverage its resources in order to nurture the vast opportunities that Act No. 399 offers and that have been left largely untapped, much to the chagrin of our Center (and our economy).

X. CHARTING A COURSE FOR THE IIC: GOALS, EXPECTATIONS AND A WARNING

Puerto Rico must establish clear targets for the IIC's development in order to pressure the DEDC for optimized marketing efforts. In this area, it is imperative to call for a results-based government approach. IIC management should be specific on how many captives it wants to attract, how many jobs (direct and indirect) it wants to create and how large a part of Puerto Rico's financial and general services industry it wants international insurance to become. IIC officers believe the Island can easily reach 50-60 entities, excluding protected cells.¹⁶⁰

¹⁵⁶ *Id.* at 4. The ratio of assets to capital for commercial banks in Puerto Rico declined from 15.45 to 12.9 in 2009. They also reported aggregate losses of \$567.4 million during 2009.

¹⁵⁷ John Marino, *Economy and government functioning*, CARIBBEAN BUSINESS, March 4, 2010, at 16. Puerto Rico stocks lost roughly \$19 billion in value in the years preceding 2009.

¹⁵⁸ Also known as the Financial Services Modernization Act of 1999, Pub. L. 106-102, 113 Stat. 1338 (1999).

¹⁵⁹ José L. Carmona, *Popular Insurance celebrates first decade in business*, CARIBBEAN BUSINESS, July 1, 2010, at 8.

¹⁶⁰ Interview with Rubén Gely, *supra* note 38.

The underlying objective of the Center is to foster the export of Puerto Rico's strong, developed insurance sector's products to Latin America. However, this has not been the case in the first few years of the Center, as the vast majority of the entities working under Act No. 399 are foreign. The IIC strives to help local insurers bundle their expertise to pitch solid insurance and reinsurance products elsewhere. Logically, homegrown insurers are more likely to have their assets and create jobs in Puerto Rico than foreign firms, not to mention much less likely to leave the Island. With such a crowded market in Puerto Rico, an expansion into new jurisdictions is a logical step. Marketing the Center towards Latin America will certainly require an injection of cash by the government, but it is an investment that can pay off if carefully executed. While Latin America is known for its protectionist policies in terms of insurance, there is immense potential for reinsurance products in said market, as discussed above. Puerto Rico has the tools to bridge gaps and carve itself a niche market by looking south, where other jurisdictions may be at a disadvantage.

Finally, while the IIC has had its up and downs, it is important to mention the low blow suffered when controversial Act No. 7 of March 9, 2009 taxed otherwise exempt entities operating under Act No. 399.¹⁶¹ IIC insurers strongly opposed this tax, with PROINSURA leader Rafael Padial denouncing the measure as sending out "signals" of an "unstable" business environment.¹⁶² Act No. 7 amended the Puerto Rico Insurance Code to establish a special 5% tax on the net income of every International Insurer or International Insurer Holding Company.¹⁶³ The income subject to taxation is that derived from December 31, 2008 and before January 1, 2012.¹⁶⁴ The irony is that said tax barely collected \$3.5 million in FY 2010,¹⁶⁵ while badly damaging Puerto Rico's credibility in the international insurance industry. For a comparatively low figure, the government put the IIC's goodwill and credibility in question.

House Bill 3034, enacted into law as Act No. 98 of 2011, strives to contractually guarantee the tax regime that shall apply to international insurers operating under the IIC.¹⁶⁶ The law is an attempt to restore the

¹⁶¹ Article 29A of Act No. 7 amended the Puerto Rico Insurance Code to establish the new tax. See 2009 P.R. Laws No. 7; see also JOINT REPORT ON H. BILL 1236, 1st Sess., (P.R. 2009).

¹⁶² Carlos Antonio Otero, *Impuesto 5% asusta aseguradoras foráneas*, EL VOCERO, Mar. 26, 2009, at 44. See also, *Impuesto podría alejar a las aseguradoras internacionales*, EL NUEVO DÍA, Mar. 26, 2009, available at <http://www.elnuevodia.com/Xstatic/endi/template/imprimir.aspx?id=549546&t=3>. Note that, at the time of these reports, PROINSURA stated the deposits brought to the Island's banking industry were over \$115 million.

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ Yanira Hernández Cabiya, *Pocos cesanteados por la Ley 7 se beneficiaron de ayudas disponibles*, EL NUEVO DÍA, Aug. 15, 2011, at 10.

¹⁶⁶ 2011 P.R. Laws No. 98, *supra* note 35.

Center's credibility in terms of taxation after Act No. 7's blow.¹⁶⁷ Its statement of motives predicates that without the stability provided by such a guarantee it would be very difficult to realize the investment potential that these entities can generate under the IIC.¹⁶⁸ As such, the Fortuño Administration has implicitly acknowledged the mistake of the bait-and-switch policy enacted in 2009.

The new law provides for tax-exemption decrees in the form of a contract that would last fifteen years and would be granted alongside the certificate of authority typically required for these entities to operate under the IIC (current entities would be grandfathered in and automatically provided a decree).¹⁶⁹ It also empowers the Insurance Commissioner and the DEDC Secretary to require additional conditions to the international insurer, such as creating a fixed amount of employment or economic activity.¹⁷⁰

In order to establish this guarantee, the law permanently taxes international at a rate of 4% on the amount of net income exceeding \$1.2 million after December 31, 2011.¹⁷¹ Furthermore, the law enacts a 4% tax for protected cells (except those licensed under Class 5 insurers) after December 31, 2011. The current 5% tax expires on said date.¹⁷² The law's objective is to lower the tax imposed by Act No. 7, and still remain competitive, according to IIC management.¹⁷³ The regulators also note that the competitiveness of both Class 1 insurers and protected cells is preserved by way of the \$1.2 million exemption.¹⁷⁴ Protected cells are taxed under the law to avoid having them become a haven within the IIC with no tax burden whatsoever.¹⁷⁵ The decrees provided by this new law will not exempt any entities under the IIC from this permanent tax.¹⁷⁶

It is unclear how these new onerous taxes will affect the application and approval process for new insurers under the IIC scheme in the next few months.¹⁷⁷ Notwithstanding this arguably mild effort to rectify this issue and abjure its erred tax policy, the government still violated the age-old adage of standing by its taxation commitment and created negative buzz among

¹⁶⁷ Joanisabel González, *Trato preferencial para la aseguradora internacional*, EL NUEVO DÍA, June 24, 2011, at 42.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* See also, *Trato preferencial para la aseguradora internacional*, *supra* note 167.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ Interview with Rubén Gely, *supra* note 38.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ Joanisabel González, *Optimismo y ajustes en la industria de seguros y la banca*, EL NUEVO DÍA (REVISTA DE NEGOCIOS), Jan. 30, 2011, at 11.

industry insiders, and even those within the regulatory agency.¹⁷⁸ I feel Puerto Rico's "gentleman's word" on tax treatment should not be tarnished: it only helps project the Island as an unstable place to do business, as these companies make business decisions and projections based on planned tax burden for upcoming years that should be reliable and not subject to arbitrary changes. A bait-and-switch policy is poisonous to our economic development strategy. The government should keep its word and refrain from tampering with the IIC in order to restore credibility to this venture.

XI. CONCLUSION

A complex initiative such as an IIC is undoubtedly bound to require concerted effort in order for it to become an effective wealth creator. The multiplicity of positive externalities that this initiative can create outweighs the favorable tax treatments that these insurance entities get from Puerto Rico. The Center has the potential for employing thousands of Puerto Ricans while attracting veteran international industry professionals who can then, over time, engender a new cadre of Puerto Rican insurance experts in a variety of related fields, such as actuarial science. The reality is that, without comprehensive tax incentives, these companies would probably never set foot in Puerto Rico. The present IIC scheme requires legislative work but, fundamentally, calls for a dedicated administrative staff supported by a strong, professional marketing drive. This is a highly technical industry that calls for a very tailored, particular approach to selling our IIC.

Moreover, Puerto Rico must rise above the deeply political discourse that has plagued administrations of both major parties and undertake a comprehensive, results-based approach to government regulation and fiscal policy, with an emphasis on correctly using its taxing power and its support apparatus to nurture industry and expertise in sophisticated business sectors such as international insurance and reinsurance operations. Bipartisan support lends credibility and conveys a sense of security and stability that has distinguished leading jurisdictions in this industry. So far, the Fortuño Administration has shown mixed signals towards the Center's development, with increased promotional efforts but diminished competitive advantages due to onerous new taxes applying to IIC entities. Stability on taxation is a quintessentially sacred element that should only be tinkered with in close consultation with affected entities. That stability, plus a push towards striking the US excise tax on IIC entities would certainly bolster its competitiveness and thrust Puerto Rico into the forefront of the international insurance industry.

¹⁷⁸ *Id.* See also, H. REPORT ON H.B. 1640, 1st Sess., (P.R. 2009).

The Center is not intended to be, nor will be a panacea for bolstering Puerto Rico's economic growth. However, it has the unequivocal potential of creating well-paid, long-term employment while exposing the Island to industry professionals as a welcoming center of business. Moreover, its ultimate goal, enticing and guiding local insurers to transform their operations into sophisticated international entities, is bound to help diversify the island's economy while creating wealth. The potential positive effect of the IIC lies in fostering homegrown capital while at the same time attracting foreign insurance expertise to the island to create a true 'melting-pot' that results in a world-class industry, one that is but a newborn today.

Furthermore, the Center and the international insurance industry in general present an opportunity to quickly generate growth in the Island. Because of the very nature of the business, there is no heavy machinery or costly technical investments to be made. Investment and deposits can trickle in a relatively short period of time – a highly valuable consideration given our current economic malaise.

Finally, while Puerto Rico can compete with Bermuda, Grand Cayman, Vermont and similar jurisdictions, the Island should focus its efforts on carving a niche market in Latin America for itself and converting itself into an industry axis. Indeed, a jurisdiction that learns to speak the language of South and North America as well as Europe would be unique. The IIC requires both the government and the private sector to pull their weight in order to make international insurance a driver for Puerto Rico's economy. The opportunity to redraw the insurance triangle and become a major player is in our hands.