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CAPTIVE INSURANCE COMPANY REPORTS

The Midterm Elections—Thoughts from Captive Leaders and Thinkers

January 2019

Editor's Note: This issue of *CICR* asks captive experts about their view on how recent changes in the makeup of the US government might impact captive insurance. Following are a range of viewpoints about the midterm elections and the coming year provided by captive insurance leaders and thinkers.

Captives in View of the Midterm Elections

Editor's Note: From South Carolina, we hear from a notable captive thinker, **Jeff Kehler,** captive program administrator, Captive Division, South Carolina Department of Insurance, who can be reached at jkehler@doi.sc.gov.

In January, the United States will have a divided government. There will be two-party rule in Washington. The impact this will have on the captive community is to suck all of the oxygen out of the room. Democrats will have control of the House, and with that, the power to subpoena and to control the purse strings. This may cause gridlock or at least tie up Congress for extended periods of time that will be focused on politics, not on policy. So, efforts to amend the Nonadmitted and Reinsurance Reform Act (NRRA) or the Liability Risk Retention Act (LRRA) are going to be nonstarters.

Captive formations in virtually all US domiciles are slower than last year. In conversations with many of the captive regulators and captive managers, it appears there are numerous reasons for this. One of them is the result of the reduction in the corporate tax rate. This has released corporate capital to be reallocated to capital projects that had previously gone wanting for funding. So, many executives have plowed funds back into their companies that otherwise may have provided capital to form a captive.

Rumors in the media indicate the Democratic-controlled House may try to rescind some of the tax breaks to reduce the enormous budget deficit. The long-term effect of this may be to increase the formations of new captives, but not in the short term, as current capital surpluses have already been deployed—perhaps in the long term.

Hawaii, South Carolina, and Vermont all held elections for governor. All of the incumbents won. Therefore, it is likely that currently serving insurance commissioners will keep their jobs. This stability in the insurance departments should provide comfort to captive owners and prospective captive owners as uncertainty caused by personnel changes should be at a minimum. Other US domiciles should be pretty stable as well. Nevada had a change of governor, so we will have to watch and see if there is any trickle-down effect.

The one insurance commissioner change that could have a big impact on captives is in California. Democrat **Ricardo Lara** upset Republican incumbent **Steve Poizner.** Mr. Poizner was not very friendly to captives, particularly risk retention groups (RRGs). It will be very interesting to see if the mood and tenor of the California insurance department changes. Fingers crossed.

While there are changes on the political landscape, for most captive domiciles, it is business as usual.

Midterm Politics and Captive Insurance Company Investment Portfolios

Editor's Note: For views on how your investments in captives might change in light of the recent election, we hear from **Carl Terzer**, a major captive investment adviser. He can be reached at carl.terzer@capvisorassociates.com.

As predicted, Democrats took the House. They also picked up seven state governors and increased their representation in many state legislatures. On the other hand, Republicans kept the Senate, increasing their advantage and solidifying a stronger control, which has implications for judicial nominations, appointments, and approvals for any bills that may come out of the Democratic-controlled House.

This mixed outcome does not represent a clear win for either party. In fact, the midterm election results could make Congress even more partisan and divided. While this may diminish the chances for compromise, President **Donald Trump** expressed his desire to work with the Democrats. "Hopefully we can all work together next year to continue delivering for the American people, including on economic growth, infrastructure, trade, lowering the cost of prescription drugs," President Trump said in a news conference. "The Democrats will come to us with a plan for infrastructure, a plan for health care, a plan for whatever they're looking at, and we'll negotiate."

This cooperative tone is no doubt due to the realization that he will now have to contend with higher congressional hurdles to implement policies. However, it would be surprising if we see levels of collaboration great enough to accomplish monumental policy changes.

The Investment Outlook

Our economy, and investors, would clearly be better off without policy gridlock or trivial fights when the nation is facing important and difficult problems. However, for the United States, as well as global equity markets, the consensus is that a split Congress is the best possible election outcome. Typically, stocks do well when Congress is divided and the White House is under Republican control. In those instances, the S&P 500 averages an annual return of 12 percent, according to Bank of America Merrill Lynch.

Strong fiscal stimulus, such as large tax cuts coupled with government spending increases, pushed through by President Trump and the Republican House, have propelled the US economy to generate the 3-plus percent gross domestic product growth rates. Along with business-friendly deregulation, these policies also helped propel the US stock market to its recent record highs. However, the market could be negatively impacted on the fiscal front going forward as these policies have also served to deepen the fiscal deficit substantially and might create a debt crisis in the not-too-distant future. Given the growing deficit, it will be hard for a split Congress to continue practices as they have been.

Democrats, due to their control over the House, will likely reject the president's budgets and will now be tasked with steering the country toward a more fiscally conservative position. If they are successful in doing so, this will reduce supportive policy that is fueling stock market gains and could negatively affect corporate profits as well as slow down the economy. If the market weakens due to less stimulus or more gridlock, the investment landscape could change in substantial ways. Most obviously, it could hasten the demise of our country's second-longest stock market rally. However, it is clear that we cannot continue the current path.

What Should Captives Do ... or Not Do?

Markets are nonpartisan and unpredictable. They are often unduly influenced by nonmarket or noneconomic events and are often strongly swayed by sentiment. Investors are better served by paying attention to market dynamics rather than trying to anticipate its direction or time its movements. Political implications will affect the markets, but more time is needed to discern the true impact of the election on the securities markets as political strategies reveal themselves.

Investors should guard against making changes to an investment portfolio solely in response to political developments since we have yet to see how behavioral biases may influence decision-making. Investors would be better served by recognizing their political biases and protecting against poor decision-making that can result from these influences. Thoughtful and well-measured actions should be considered and perhaps taken. Read on.

A Look at Bonds

Bond values fall when interest rates increase. Fed rate increases are believed necessary to fend off pent-up inflationary trends and resume a more normalized interest rate environment. We have had 8 25-basis point increases since the start of the tightening cycle in December 2015. With the Fed firmly on track for more rate increases, the bond market may continue to struggle to produce positive returns. With a 25-basis point raise in rates priced into the bond market for December, the Fed's plan includes 3 more rate increases in 2019 and perhaps 1 in 2020.

President Trump has been critical of the persistence in the Fed's rate policy as rate increases can tend to slow the economy. These increases are the Fed's attempt to achieve a point of "rate neutrality"; a rate believed to neither strengthen nor slow down the economy. However, the rate increases have served to flatten the yield curve, with a declining yield differential between short and long maturity bonds, causing market jitters. Why? Should the Fed "over tighten" the market's liquidity, by raising rates too much too soon, the curve could invert. Normally, the yield curve is upward sloping with long-term rates higher than short-term rates to compensate investors for higher investment risks incurred in tying up capital over longer time periods. An inverted yield curve is downward sloping and has been a strong and accurate predictor of economic recession that typically follows several months after the inversion.

What Does this Mean for Captive Bond Portfolios?

Since "duration" is a measurement of a portfolio's interest rate sensitivity, captive insurers should carefully track their bond portfolio's duration. It would be wise to keep portfolios at shorter durations (less interest rate risk) now than might otherwise be targeted. This tactic can serve to minimize bond portfolio market value losses as rates rise. Shorter maturity and high-quality corporate bonds combined with longer-term taxable municipal can preserve income while shortening average portfolio duration. Shedding tax-exempt municipals and adding some credit risk with high-yield bonds, convertibles, or variable rate instruments should also be considered as the portfolio's risk-adjusted returns will likely benefit from the added diversification.

A Look at Stocks

The stock market's immediate and strongly positive reaction (best midterm uptick since 1982) to the midterm election results might be a sign of continuing positive investor sentiment. While the market's volatility levels will likely remain elevated, this sentiment might also favorably impact private capital markets. Healthy levels of merger and acquisition and initial public offering activity that were seen in 2018 could continue well into 2019: signs of a healthy market.

Since the president cannot count on Congress, or the Fed, for more easing by increasing federal debt levels or slowing the rising interest rate policy respectively, he will need to do everything in his power to keep the economy rolling to improve his reelection chances. Pressure may build for him to seek ways of more quickly ending the damaging trade war and turning it into winning deals for the US economy.

Investors should also expect President Trump's business-friendly policies to continue. This, along with improved trade relations, would be supportive of equity markets and continued economic expansion. Of course, at some point, the good times will end, as they always do.

What Does this Mean for Captive Equity Portfolios?

Even with our robust economic performance, institutional investors are concerned with the US equity market. The October correction may have provided some breathing room for a seemingly overheated stock market, but headwinds are foreseen in several indicators. The first concern just simply has to do with the extraordinary length of this equity bull market. The phrase "in the late innings" has been used for some time now to describe this bull market's length, and the expectation is that a major correction is overdue and might be near. If the recent correction has forestalled a crash, it has not changed the fact that other factors indicate a slowdown in the economy. Real estate activity and business investment have fallen off. Corporate profitability is expected to decline from current year-over-year rates. Inflationary pressures are beginning to rise.

Captive equity portfolios could be de-risked a bit as a hedge against concerns of a sharp downturn. A shift that overweights the portfolio to more defensive sectors, like utilities or consumer staples, would be a good start. Another minor tweak could be to shift toward high dividend stocks where the income can offset some possible market value loss. Alternatively, more substantial protection can be achieved by considering covered call writing programs or engineered stock portfolios, both of which are popular considerations. With a little more complexity and expense, put/call writing and structured products may also be worth exploring. Each of these strategies is designed to produce returns that lag the market's returns when stocks are up but will limit the downside losses in the event of a downturn, a concept known as up/down market capture. In times that threaten equity market values, an asymmetrical relationship to market returns might be desired whereby your portfolio might, for example, experience 80–90 percent of the market's upside but only 40–60 percent of any downturn.

"Passive" versus "Active" Management Strategies

Many retail investors, disillusioned with active managers/brokers or mutual funds that are expensive and fail to beat benchmark indexes, have turned to "passive" strategies, namely electronically traded funds (ETFs). These low-cost, exchanged-traded, and unmanaged baskets of securities certainly have a place in many, if not all, captive portfolios as well. However, using them properly is the key. Since they are designed to perform like the index (e.g., the S&P 500) that they are engineered to parallel, they participate in 100 percent of the index's upside or gains (less fees) as well as 100 percent of the losses (plus fees). With a 9-year bull market in stocks, investors have yet to experience the dark side of these otherwise appealing strategies. Skilled "active" managers, those that pick and manage individual stock or bond portfolios rather than these passive fixed basket portfolios, might afford investors the benefits of good risk controls that can protect captive portfolio values in a down market. Of course, passive strategies might also be beneficial in down markets. They might be used to provide added portfolio diversification, in low or uncorrelated asset classes, and in increments that might be too small to be worthwhile for engaging an active manager.

The best advice that captives should embrace is that they should be more attentive to their portfolios no matter the political, economic, or market environments—circumstances will always be changing, externally or internally, requiring reevaluation of the investment program for long-term success.

Important Things To Note

Editor's Note: And from our itinerant Scot, **Gary Osborne,** vice president at Alternative Risk Programs for Risk Partners, Inc., we get another view. He can be reached at gosborne@riskpartners.com.

The midterm elections did not prove decisive for either party with the swing against the sitting president falling in the usual range from prior history. Important things to note for the captive industry include the following.

- Obamacare is not going anywhere so the growth in the use of captives for self-insured medical exposures among employers with 50–500 employees should continue to expand. The one hinderance to this would be the change in governors in several states over to the Democratic party, which has traditionally been the party to restrict the availability of stop-loss insurance to smaller employers. The Self-Insurance Institute of America, Inc. (SIIA), and others have regularly fought back against New York and other blue states that have used the ability to regulate stop-loss insurance as a way to limit its availability to smaller employers.

- In the leading states for captive formations, there is no obvious party or leader changes that could spell a change in the captive marketplace. In fact, it is believed that the new Tennessee governor had been involved with group captives prior to his political career, and it should be a good thing for a state leader to understand the benefits of captives on a personal level rather than as a "pitch."

- The hurricanes and wildfires could finally have an impact on the pricing of reinsurance. Whether that would be restricted to property-type covers or on a more broad scope is to be seen. It is also unclear what impact Brexit will have on the London market and whether it may actually drive London to look for more US business rather than European.

- The Marsh/JLT merger will be interesting down at the little alternative market level. JLT had managed to carve out a niche as a somewhat independent captive manager as it did not have a substantial US presence. That status is unlikely to remain with the Lockton, USI, and Brown and Brown-type brokers when they are integrated into Marsh. Captives were certainly not a major consideration in the merger, but the impact could be interesting on the already-diminished captive management marketplace.

- The fallout from the 831(b) cases has been limited so far, but with several other decisions due in 2019, the swing back to the more traditional risk management purpose is likely to pick up swing. I am still seeing interest in using the 831(b) election, but it is more as a catastrophe funding tool than an estate planning tool.

Tax Changes or Not?

Editor's Note: Our notable tax advisers **P. Bruce Wright** and **Saren Goldner**, partners in the tax department of Eversheds Sutherland (US) LLP situated in the New York office, step up with a few thoughts following the election. They can be reached at brucewright@eversheds-sutherland.com and sarengoldner@eversheds-sutherland.com.

We are likely going to get decisions on three additional Tax Court cases involving IRC § 831(b) companies: *Wilson, Caylor, Syzygy* and perhaps *Pryor Packers.* If these cases are decided in a manner similar to *Avrahami v. Comm'r* and *Feedback Ins. Co., Ltd. v. Comm'r,* 149 T.C. 7 (2017), and *Reserve Mech. Corp. v. Commissioner,* 2018 Tax Ct. Memo LEXIS 87, (T.C. June 18, 2018), we may see a drop-off in the number of existing IRC § 831(b) companies, new IRC § 831(b) companies as well as other structures insuring similar risks as in the *Avrahami* and *Reserve Mechanical* cases, or other atypical coverages. Also, if these cases follow the pattern of holding against the taxpayers, the Internal Revenue Service (IRS) likely may be even less willing to make concessions to settle cases.

We are likely to see in late 2018 proposed regulations addressing the provisions of the Tax Reform Act of 2017 affecting captives. We have already seen proposed regulations on loss discounting but will likely see something on (1) the base erosion and anti-abuse tax (BEAT), which hopefully will address, among other items, the BEAT anti-abuse provisions, and (2) the new insurance exception to passive foreign investment company (PFIC) status. Captives may be affected by the "qualified insurance company" requirement to the new exception.

If the Illinois statute amending its captive law, which was vetoed by the current governor, is not signed into law by year-end 2018, the law will have to be approved again by the legislature before going to the new governor for signature.

We may see new actions brought by the Washington State insurance commissioner with respect to entities domiciled in Washington State that have captives elsewhere. If this happens, there may be little or no publicity if cases are settled.

No Significant Impact

Editor's Note: Delaware's resident captive legal pundit, **Jeffrey Simpson**, of Gordon Fournaris and Mammarella, PA, tells us his views. He can be reached at JSimpson@gfmlaw.com.

I don't see a significant impact on captives from the midterm elections. At the federal level, the midterms are not going to result in any material change in tax policy as to captives and probably no personnel changes at Treasury or the IRS among the people driving the current campaign against micro-captives. So, I expect status quo regarding captives at the federal level.

At the state level, I guess it's possible that a new governor could appoint a new insurance commissioner, or in the few states that elect their insurance commissioners, a new commissioner could have been elected who will have a different disposition than predecessors. That different disposition could make the state a more or less attractive domicile than it had previously been. But I haven't heard any chatter along those lines, and I haven't had a chance myself yet to run down those state-level results and inquire about the potential for change.

So, while the midterms may have been generally significant, I don't think there will be a huge impact on the captive insurance industry in particular.

The 2018-Midterms: What Does It Mean for Captive Insurance?

Editor's Note: The SIIA extraordinary legal adviser, **Ryan C. Work**, vice president of Government Affairs, tells us the view from his thorough analysis. He can be reached at rwork@siia.org.

Now that the news cycle has subsided, and the 2018 midterm election is behind us, many are asking what the results mean for the captive insurance industry. While short-term uncertainty remains, the legislative and regulatory environment is teed up for a clearer path forward. Politically, many policymakers are already turning their eye toward the 2020 election, meaning it will be important for industry participants to educate policymakers and candidates alike about captive insurance in the role it plays.

Historically, the 2018 midterm election was just as expected—the party controlling the White House lost. In fact, outside of a blip post-9/11, you would have to go back to President **Harry Truman** to find a midterm in which the president's party won seats in Congress. With the administration remaining the same for the next 2 years, it now faces a different legislative environment with what will become a contentious split-party Congress. While election results were perhaps not surprising, several factors were indeed surprising—suburban turnout and a green wave. Suburban voters turned out in record numbers, as we saw with key Democratic pick-ups in suburban districts in New Jersey, Pennsylvania, Virginia, and California. Combined with other congressional districts that saw a clear anti-Trump candidate, these suburban and growing rural districts largely turned control of the House.

Turnout aside, voters generally became more partisan, with Democrats and Republicans self-identifying more than ever, and away from a marginalized independent voting bloc. Second, a green wave of money was poured into elections like never before. Grassroots fundraising, national issue focus, and partisan conflict all led to a record amount of campaign contributions. The Texas Senate race pitting incumbent Senator **Ted Cruz** and Congressman **Beto O'Rourke** is a perfect example. Though ultimately defeated, Representative O'Rourke raised a record $38.1 million in the third quarter alone, an astronomical fundraising figure. The bottom line is that money in politics played a major role across the country, ousting incumbents and making safe incumbents spend more to be comfortable.

For the captive industry, the 2018 midterm may very well have some long-lasting impacts. In Congress, key committee leaders with jurisdiction over captive insurance tax and policy issues are changing. While the Senate remains controlled by Republicans, long-time Senate Finance Chairman **Orrin Hatch** (R-UT) is retiring, with Senator **Charles Grassley** (R-IA) expecting to take the committee reins after most recently serving as Judiciary chairman. Senator Grassley has served on the Finance Committee for some time and is taking the gavel with a vast array of knowledge and a reputation for fighting for consumers and taxpayers. Important to note, he played an instrumental role in the revisions to IRC 831(b) passed by Congress in 2015, which increased the premium threshold pegged to inflation, while putting in place a number of curbs to potentially abusive behavior in the enterprise risk captive space.

In the House, the soon to be majority Democrats will take over key committee posts and change the policy and oversight agenda. On Ways and Means, Representative **Richard Neal** (D-MA) will take over the influential tax panel, likely taking a hard look at recent tax reforms as well as the health insurance marketplace. House Financial Services will be chaired by Representative **Maxine Waters** (D-CA). Her focus will be on consumer protection and oversight, though with a strong understanding and background on insurance issues in general. Other committees like Oversight, being chaired by Representative **Elijah Cummings** (D-MD), will review administrative actions. Overall, look for common policy themes from a Democratic House—health insurance, oversight of administrative policies, and likely debates on overarching issues like immigration and infrastructure.

Turning to the administration, a number of key political posts overseeing captive insurance at the federal level remain vacant, particularly at Treasury. At the same time, other important positions have more recently been filled, notably the confirmation of **Charles Rettig,** as the new commissioner of the IRS, a position that had been vacant for over a year. The interim commissioner, **David Kautter,** is now returning to his formal position as assistant secretary for tax policy at the US Treasury. Both Treasury and the IRS remain the primary regulators of captive insurance on the federal level, being active on items such as Notice 2016-66, as well as being the driving force behind a number of court cases (i.e., *Avrahami* and *Reserve Mechanical*).

Lastly, the role of states in insurance regulation also means looking at the impact that state elections, particularly in various captive domicile states where changes occurred in the governor's office or at the state insurance commissioner level. Overall, nine states saw the governor's political party switch, while a number of others saw new insurance commissioners elected. These new positions mean new insurance commissioners, or in some instances governors, having a different stance on general captive insurance policy. Even if the new governor is from the same political party as the previous one, the governor may choose a new insurance commissioner—or the insurance commissioner may resign to pursue political office or seek private sector employment.

Overall captive policy is likely to see a continued evolution, and potential growth, over the course of the next election cycle. With the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) changes behind the enterprise risk captive (ERC) space, Congress is not likely to weigh in again any time soon on captive insurance tax policy. At the same time, regulators on the federal and state level will continue to carefully look at captive risk management practices, including types of risk, risk distribution, and ownership structures. Regulators will also continue to pay close attention to ongoing federal Tax Court cases, which will no doubt shape the future of ERCs. While these cases may mean short-term uncertainty, decisions from the court and subsequent regulatory action will hopefully set clear guidance and certainty in the long term. For overseas captives doing business in the United States, tax reform issues, such as BEAT and PFICs for non-controlled foreign corporations (NCFCs), continue to complicate structures and will need clear Treasury and IRS guidance, and perhaps congressional clarification, to give the industry a clear path forward.

Predictions Come True

Editor's Note: Vermont's vocal captive spokesman gives us food for thought. **Rich Smith**, president of the Vermont Captive Insurance Association (VCIA), can be reached at smith@vcia.org.

Unlike 2016 when all the polls were wrong, the 2018 midterms turned out mostly as predicted—the House of Representatives flipped to Democratic control, and the Senate remained in Republican hands, with the Republicans expanding their majority. Though it is too soon to tell exactly what the divided Congress will mean on every issue and for every committee, with the help of VCIA's Washington advisers, Capitol Counsel, here are some thoughts on how this all impacts the captive insurance industry.

Though the House has flipped, as of this writing, the Congress returns next week for its lame duck session under current control. There is little time between now and January, so Congress will likely focus on bills that are must-pass, where there is a statutory deadline. However, with Democrats having won control of the House, there may be some deals on issues where both parties see a benefit in "clearing the decks" for the next Congress. In addition, Senate Majority Leader **Mitch McConnell** (R-KY) will continue to move as many nominations as possible through the Senate.

November will be dominated by party leadership elections and policy negotiations behind closed doors on outstanding issues. The most pressing order of business for the lame duck is appropriations. The continuing resolution (CR) funding for many government functions is set to expire on December 7, 2018. After leadership elections, negotiations on government funding should continue; however, these negotiations will be contentious since President Trump has said he will not sign an appropriations bill without funding for "the wall," and Democrats have adamantly opposed significant wall funding. Congress may also consider an emergency spending measure to meet needs in hurricane-ravaged areas, and such a bill could carry other spending priorities if they are complete. It is possible that Congress could pass a CR through early 2019. However, it is also possible that Congress passes regular appropriations bills during the lame duck session—Democrats will have new leverage in the House but may want to clear the decks for next Congress so they can focus on nonfunding-related priorities. Several authorizations are set to expire during the lame duck session and require action from Congress. Given the flip of House control, clean, short-term extensions might be the most likely path as the new House Democratic majority might choose to fight on more favorable ground next year.

While leadership elections will take place throughout November, we do know there are positions where more than one senator or representative has indicated interest. In the House, there has been a great deal of speculation about whether Democratic Leader Nancy Pelosi (D-CA) can retain her position given opposition from a number of new members and calls within the Democratic party for "new blood." However, to date, there have been no viable alternatives proposed for speaker.

In the Senate, though the Republicans retain the majority, there will be new members on the Senate Banking Committee as well as potentially new leadership on the Republican side. Senator **Mike Crapo** (R-ID) may remain chair of the Banking Committee, or he may become chairman of the Senate Finance Committee; the next most senior Republican on the Banking Committee who can be chairman is Senator **Pat Toomey** (R-PA). While Senators Toomey and Crapo are both conservatives, Senator Toomey may prove more willing to move forward with legislation that he cannot get agreement on with the ranking member, Senator **Sherrod Brown** (D-OH). Under the leadership of either Senator Toomey or Senator Crapo, the Senate Banking Committee is expected to continue to work on sanctions issues, flood insurance reform, and, potentially, housing finance reform. The loss of Senator **Dean Heller** (R-NV) will impact how the committee addresses certain issues, as Senator Heller has been a leader on insurance issues, including international insurance capital standards and private sector flood insurance competition.

Senator **Elizabeth Warren** (D-MA) will likely remain on the committee and will remain a voice on the left on all issues of financial services. She will likely continue to push for greater regulation on large banks, for potentially breaking up large banks, and both ranking member Senator Brown and Senator Warren have criticized regulators for reducing capital standards and other regulations on large institutions. Though they may not be able to pass any bills on these issues in a Republican-controlled Senate, we expect their messages to be echoed by future-Chair of the Financial Services Committee Representative Waters (D-CA) in the House, meaning a continued spotlight on these issues.

It is expected that Representative Waters will take the helm of the House Financial Services Committee, where most insurance bills would go through. Although Representative Waters does not have a stated position on the captive insurance industry one way or the other, it is most likely she will defer to the National Association of Insurance Commissioners on most issues that impact insurance. She is the polar opposite of the current chairman, Representative **Jeb Hensarling** (R-TX). She is active on financial consumer issues and has been highly critical of the Consumer Financial Protection Bureau (CFPB) under the Trump administration for rolling back consumer protection. However, she is also seen as a dealmaker, and so it is unclear if she will govern the committee to the left or if she will moderate and move to the center as chairman.

There are a number of insurance-related issues that may see action next Congress. The National Flood Insurance Program expired on November 30, 2018, and needs to be extended. Congress has passed a series of short-term extensions to the program, which will extend it until December 21, 2018. However, there has been some movement on a reform bill; the House already passed a comprehensive reform bill that includes updates to flood mapping, mitigation, affordability, and private sector competition. The Senate has yet to move a bill through committee, and there has been some opposition to leveling the playing field to allow consumers to choose private insurance if it is more affordable. Representative Waters will likely seek to cap rates and rate increases, seek to continue additional subsidies, and may be less friendly to private sector alternatives.

The Terrorism Risk Insurance Act (TRIA), the federal program designed to ensure that there is insurance for acts of terrorism passed after 9/11, expires at the end of 2020. This means that Congress will have to begin work on an extension/reform bill sometime next Congress. Though TRIA was created in 2002 as a temporary program to share terrorism losses between the private and public sectors, the program has been extended three times and will likely be extended again. Each reauthorization has made some changes, and there may be a push to have more risk assumed in the private sector by private insurers and reinsurers. Unlike Chairman Hensarling, new Chairman Waters is supportive of an extension of TRIA, which could pass the House more easily in the 116th Congress.

The captive insurance industry is hopeful that Congress will ultimately pass the Captive Insurers Clarification Act, originally introduced by Senator **Patrick Leahy** (D-VT) and Senator **Lindsay Graham** (R-SC) to amend the NRRA, which was intended to streamline the regulation and taxation of surplus lines insurance. Some of the definitions in the Act are so broad that questions have been raised about its effect on captive insurance. If captive insurance is considered "nonadmitted insurance" under the NRRA, captive insureds may be required to pay a premium tax to their home state in addition to their captives paying domiciliary state premium taxes and be partially regulated by the insured's "home state."

On tax matters, instead of Republican-only efforts to refine and build on the 2017 tax reform law and to substantially modify the Affordable Care Act and its associated tax provisions through the expedited reconciliation process, for example, we now expect Democrats to play a much more active role in defining Washington's tax legislative agenda. While today's highly partisan tax environment may well continue—or even intensify—in the 116th Congress, stymying consensus-building on many tax issues, there is some real potential for Democrats to find common ground with President Trump and Senate Republicans in certain areas.

Substantive or technical modifications to the new tax reform law could be discussed more seriously, including entirely new items that may only emerge once anticipated regulatory guidance on the BEAT, for example, is released, potentially over the next few weeks. Under divided government and with an effective 60-vote requirement for action in the Senate, Democrats will have considerably more leverage in shaping any modifications to the law than they had during its original enactment. The 116th Congress could revisit proposed policy changes and technical fixes that do not make it over the finish line during this year's lame duck session, and any number of "new starters" may find their way onto the legislative agenda as well, including some that may emerge as responses to new regulatory guidance.

As Congress comes back to town, it is clear that there will be significant action in both the lame duck and in the next Congress on many areas of importance to the captive insurance industry. Even with divided government, there are issues that must be addressed such as government funding and expiring authorizations, and there are areas where there could be bipartisan agreement.

So, while much has changed as a result of the election, the work of Congress and the administration will continue. As we have learned over the past 2 years, Washington, DC, is full of surprises. There will likely be issues that arise that we could not predict, and how President Trump positions himself and the administration in the next 2 years will be important. If the president chooses to work with House Democrats on areas of interest, following the populist tone he has sometimes taken, we could see more compromise and agreement than expected.

A Few Thoughts on the Midterm Elections

Editor's Note: Finally, we hear from DC's inimitable **Robert "Skip" Myers**, general counsel to the National Risk Retention Association. He can be reached at rmyers@mmmlaw.com.

CICR comment: Skip always has a few strong words for his fellow DC inhabitants.

The following are a few thoughts.

Now that the elections are over, we are in a position to mull over the results. The Democrats succeeded in flipping the House, while the Republicans maintained control of the Senate. Past history shows that control of both the legislative and executive branches by one party does not generally last very long. The American people seem to like "checks and balances," which can become particularly important when the nation is so clearly divided.

The split in control between the House and the Senate leads to the reasonable conclusion that only the most important things (e.g., the national budget) will be attended to in the legislative process. The rest of the time will be spent arguing, grandstanding, and otherwise catering to the insatiable appetite of the media.

Captive insurance will not be on any politician's priority list. On the other hand, the change in the control of the House could help, at least marginally, the proposed legislation by the Coalition for Captive Insurance Clarity to exclude "captives" from the NRRA. It could also help the "Nonprofit Property Protection Act" (which would allow a very few RRGs to offer property coverage to charities). As a generalization, Republicans tend to oppose any federal action that would affect state insurance regulation, while Democrats are more open to federally imposed change. Nonetheless, even if either of these two bills should pass the House, they will be ignored by the Senate.

The change in the control of the House Financial Services Committee from Representative Hensarling to Representative Waters could result in some interesting investigations and hearings. Representative Waters is no fan of banks and insurance companies.

The only issue that I can envision affecting captives (and insurers in general) will be cyber security. There has been talk of federal preemption of state regulation of financial institutions regarding cyber security. A major hacking or disclosure of private information could push Congress toward legislation.

In sum, captives are not a big fish in Congress's pond. Captives are not even visible to the big fish in the pond.