

Module B Unit 3

DOMICILES

Purpose

By the end of this unit the participant should be able to demonstrate an understanding of;

- those domiciles that most commonly host captive insurance vehicles,
- the main advantages and disadvantages of each, and
- Guernsey's position within the worldwide captive environment.

The unit reviews the relevant factors when choosing the domicile of a captive. It begins with consideration of whether the captive should be created onshore or in one of the more established offshore domiciles. After a review of the basic criteria for all captive locations, there is consideration of other general and legal features. It should be stressed that, when discussing domiciles in general,, the legal issues have been summarized to avoid over-complexity. From a legal point of view, the differences between the majority of offshore domiciles are relatively small. They are somewhat more onerous for certain onshore captive jurisdictions such as the EU (but the detail of all the laws applicable in each domicile would turn this unit into an encyclopaedia, quite apart from the fact that changes are occurring all the time and the content of this unit would rapidly be out of date). Thus, the main features are reviewed and if there is interest in a specific territory then one can access the specific law (typically via the regulator's website). There is a review of the main features of those domiciles which generally come into consideration when forming a captive insurance vehicle. Finally a summary of Guernsey's position within the worldwide and European context is evaluated.

Assumed knowledge

Different types of corporate structures applied as captive vehicles – refer to Unit 2

Difference between writing insurance on an admitted and non-admitted basis – refer to Unit 9

Summary of learning outcomes
1. Explain the generic differences between onshore and offshore domiciles
2. From a European perspective, explain why some companies choose to form captives within the EU, whilst others choose domiciles located outside of the EU
3. Be acquainted with the features of the primary jurisdictions that host captive insurance vehicles
4. Describe Guernsey's positioning in the worldwide captive environment

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3.0 ONSHORE VERSUS OFFSHORE

The early captives were all domiciled onshore, i.e. in the country of the parent organization but these were all established before the burgeoning of global business and the development of the offshore financial centres with their fiscal and regulatory advantages.

3.0.1 Definitions

So, what is an onshore domicile? One definition of an onshore captive is “a special purpose insurance company domiciled in the country within which its insured risks are located” (ref International Risk Management Institute, Inc Glossary @ irmi.com). However, this definition becomes less relevant when considering the risks of a multinational company.

It is also not as simple as a question of geography: not all offshore domiciles are islands and vice versa, for instance Gibraltar and Malta were once considered to be ‘offshore’.

Generally speaking, it is easier to define an offshore domicile as one that:

- Has developed captive specific legislation and supporting infrastructure
- Has a comparatively low corporate tax rate
- Has a comparatively small population

Many US states now fulfil the first two criteria, and at the time of writing countries such as the UK and France are considering developing captive specific legislation. For the purposes of this section, we'll run with the above offshore definition, and that of an onshore domicile as being ‘not an offshore domicile’.

3.0.2 Onshore

Today, few captives are created as domestic companies, certainly in Europe. In the USA with over 580 licenced in Vermont, 390 in Utah, 280 in Delaware and hundreds more spread across the other US states it might be thought that the onshore captive model is the most popular but the statistics can be deceptive. Few of the onshore US captives have parents actually resident in the same State; they have been formed in other States to take advantage of particular regulations designed to attract business and compete with the more traditional offshore locations of Bermuda and Cayman. In that sense they could be considered to be more akin to offshore than onshore and indeed a number have redomiciled from offshore jurisdictions. The legal & tax position as well as the business drivers of every company can be quite different and there is no single domicile formula that fits all. It is very much an individual decision which is why it is often suggested that the tax managers of the company be consulted at any early stage and that a variety of domicile options should be included in any feasibility study. One of these options could be a fully licensed onshore company and thus the pros and cons of this are now reviewed.

Advantages

- More Immediate Control

Operating from the same building, possibly, within the main parent head office risk management function, the liaison between the risk manager and his staff and the captive management team could be virtually seamless and instantaneous. However, this closeness can create problems. The captive should be able to show that it is operated at arm's length from the parent which means it will need its own board and demonstrate that it has independent governance, management and control. The close proximity between the captive and the risk manager and his staff could potentially lead to a breakdown of the very essential demarcation of the functions of purchasing and offering insurance, causing a disintegration of the corporate veil between parent and captive and turning the treatment

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of the captive back into that of a self-insurance fund. This might mean the disallowance of premiums as a taxable expense which could create an adverse tax position vis-à-vis traditional insurance.

- Operating using in-house facilities

Within the head office it may be that sufficient capacity can be found for group accountants to prepare the captive's accounting and for members of the insurance department to perform the insurance work associated with the captive, but will they have the necessary expertise? From an accounting point of view, an insurance company has a number of unique features and there will certainly be a learning curve for any accountant. On the insurance side, the head office, staff would not necessarily be skilled in the relevant underwriting and reinsurance aspects required of an insurance company operation. Their skill is as buyers of the product rather than suppliers. Again, however, the biggest problem would be maintaining an arm's length separation of duties as the people concerned would have a conflict and would need to remember that they are serving two masters, i.e. the head office insurance buying function for their primary role and the subsidiary function of direction in relation to the captive work. Which would take priority? It could well become a poor relation to the main head office function and suffer accordingly in administration.

- Reduced travel time and costs

This is certainly true so far as travel cost and time is concerned but this could well be countered by the management time involved in the day-to-day operations, something that would typically be outsourced should an offshore domicile or another US State be chosen.

Disadvantages

- Increased Costs of Administration

Whilst the ability to operate the captive using one's own in-house facilities is shown as an advantage, this can be more expensive if additional resource has to be brought in as there is not the same economy of scale that is available to the management company working for a number of organisations and bringing a variety of skills to bear. The advantages of using a management company are well discussed in Unit 7 and an onshore domicile may bring increased costs of administration by virtue of compliance with more onerous laws and regulatory reporting onshore. Domestic insurance laws are typically designed for the control of the traditional market and protection of the consumer and these requirements could well be disproportionately onerous for a simple captive writing one or two lines of risk of its parent group. The regular information required to be submitted to, for example, the Financial Conduct Authority in the UK is far more detailed than regularly required by most offshore regulators. This is not to say that offshore locations offer 'easy' regulation and have inadequate controls (quite the contrary!), but the laws are designed to reflect the risk profile of captives and not the traditional insurance conglomerates. Even so, an offshore management company would be producing returns to its regulator for a number of clients and therefore would tend to be able to do this rather more efficiently than people dealing with a single company in a somewhat different regulatory environment to what they are used.

- Less Flexibility

Offshore locations certainly have their rules and regulations but they these tend to be interpreted pragmatically, in the main, with rather more flexibility than some rigid bureaucratic procedures of the onshore domicile. Largely, again, because the onshore legislation is designed for a broader range of insurance vehicles and not just captive operations.

- Higher Capital Requirements

For the smaller insurer this could be an issue because some onshore domiciles require a domestic insurance company to maintain a minimum capital of £5million. However, the solvency ratio

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requirements of onshore and offshore domiciles are becoming similar so that a larger captive – and there are many being formed today with capital in excess of £5million – would find little difference in the capital demands either onshore or offshore.

- Delays in Permission to Operate or Change Practice

Most offshore domiciles pride themselves on the speed with which they can licence captive insurance companies and have them up and running. The regulators, the lawyers and the management companies are well prepared for enabling the decisions to create captives (which often tend to be made close to expiry of an insurance programme when speed to get the new captive company operational is of the essence). Two weeks' formation time can be achieved (and it is not unknown for licencing to be completed within 48 hours, although no lawyer or management company would want to commit to such a turnaround). By comparison, the application procedure for an onshore company could be anywhere from six to 12 months. Much the same time scales occur for any change in business plan which, onshore, may require a not dissimilar time scale to creating a new company. Offshore, by comparison, such changes can often be achieved by a short meeting, a telephone call and/or exchange of e-mails

- More regulatory requirements

Onshore, the captive may not be distinguished from other insurance companies and so will have to comply with all of the rules and regulations applicable to the largest company in the jurisdiction insofar as they relate to the classes of business written by the captive. Further, any levies imposed on insurers to finance policyholder protection funds and fees for governmental regulation could well apply to a captive and could be quite onerous.

- Limited skills

Although referred to above, it is worth a separate heading that, operating a captive using the parent's own head office staff, can mean that these people may well not have the necessary skills in underwriting, reinsurance, insurance accounting to offer effective management of an insurance company. There are insurance brokers who, on occasion, have provided onshore management services to captives but they have to have their own limitations purely because of the limited business available. They cannot have the same type of captive management operation which they and others operate offshore with all the appropriate skills tuned to the requirements of the particular domicile.

- Less Favourable Taxation

With the growth of Controlled Foreign Corporation (CFC) legislation, the tax advantages of an offshore domicile are less than they used to be but the fact remains that there may be still advantages in being offshore. The thought that creating an onshore captive will eliminate any Revenue investigation into the captive's operation can be dismissed. On the contrary the Revenue will pay very close attention into the way the company is operated and, onshore, there are distinct possibilities of overstepping the boundaries of arm's length procedures causing the disallowance of premiums as an expense. Close attention will certainly be paid to how premiums are priced & earned and loss reserves calculated.

3.0.3 Offshore

By far the majority of early captives were formed in offshore locations – bearing in mind that in the early days Dublin and Malta are also regarded as offshore. In the early days of captives this choice may well have been because of the tax advantages available. But with the gradual erosion of these advantages this is no longer the case. The principal advantages of an offshore location is that they have laws and a regulatory environment designed for captive insurance companies and a plethora of excellent insurance company management services. By locating its captive offshore, a parent should not imagine that they are in a domicile where regulation is weak and they can have complete

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freedom in the way they operate the company. This is certainly not so and, in any case, a captive company not operating properly would rapidly create problems with the tax authority in the parent domicile.

Offshore centres have been the subject of scrutiny from international and supranational supervisory bodies for many years. Their favorable tax regimes and the concomitant widely held perception of their being nothing more than tax havens for individuals and corporates to avoid contributing their fair share to the economy have meant that numerous reports have been produced specifically commenting on the quality of the regulatory regimes, general governance standards and AML/CFT controls. It is fair to say that the quality of the environments differs from domicile to domicile, and we shall look more closely at where Guernsey fits into the hierarchy of financial centres later in this Unit.

Many of the advantages and disadvantages of using an offshore domicile can be ascertained by inverting those of the onshore domicile.

Advantages

- Proportionate regulation

By our earlier definition an offshore domicile has regulation specifically tailored to make it a hospitable environment for captive insurance companies. This means that captives are not subject to the same requirements as commercial insurers, rather they are subject to requirements that are proportionate to the size, nature and complexity of their business, and the risks arising therefrom. Since one of a financial services regulator's prime raison d'être is to protect the consumer of financial products, it makes sense that a structure such as a captive where there is a B2B transaction and the consumer (the insured) is the same as, or very closely related to, the shareholder, gives rise to a much lower risk of harm to the consumer than say a retail life product. In practice the application of proportionate regulation leads to the following advantages:

- Faster speed of establishment
 - Lower operational costs
 - Lower capital costs
 - Reduced reporting requirements
 - Increased flexibility for ongoing businesses
- Experienced and skilled professional base

All captive domiciles are home to professional organisations who are dedicated to providing an outsourced captive management service. These companies provide insurance, accounting, company secretarial and compliance services as well as advising on every aspect of the captive life cycle from formation to closure. The concentration of this knowledge and experience in the captive domiciles means that it is easier and more financially efficient to set up a captive offshore.

- Established support services

In addition to the insurance management fraternity, most offshore domiciles are populated by the kind of support services that are essential to the operation of a captive. These are the banks, accountants, auditors, lawyers, actuaries, and investment advisers that many captives employ. Not only are they present in the domicile but they also tend to be experienced in providing these kind of support services specifically to the captive market, and so have tailored their offerings accordingly. This ensures that captives are able to access these services quickly and efficiently.

- Corporate Structures

Over the last 30 years many offshore domiciles have adopted companies' legislation that enables the formation of types of corporate structures that make it easier for a captive insurer, or other type

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of licensed insurer to carry on its business. The most popular and high profile of these is the cell companies, both protected cell companies and incorporated cell companies. These types of corporate vehicles are used widely throughout the offshore world, and more recently within some onshore jurisdictions, by both captive insurers and Insurance Linked Security structures. They further lower the barriers for entry to captive owners and have been developed over the years to specifically support the needs of the offshore insurance industry.

- Tax

Ask any captive manager or consultant about tax and they will invariably say the same thing: tax should never be a prime motivator when it comes to considering forming a captive. This has been a truism now for many years as international initiatives from both supranational bodies such as the OECD's Base Erosion and Profit Shifting framework and national tax authorities have sought to establish a worldwide fair and transparent tax environment.

As a result, most captives do not provide any material fiscal benefit to their parents. Some may provide a slight deferral of the tax payment point, but it is increasingly rare that captive structures are specifically designed with tax benefits in mind.

Disadvantages

- Reputation

Offshore centres are often taken as a whole and tarred with the same brush in the mainstream media and by some activist group. The 'tax haven' description is one that still finds currency even though many offshore jurisdictions, Guernsey included, have fulfilled every requirement of various supranational bodies seeking to drive transparency and best practice through the international tax landscape. Episodes like those of the Panama Papers in 2016 have served to reinforce the perception of some commentators that all offshore domiciles are involved in 'shady dealing' of some kind. Justified or not, this kind of perception can stick, and some corporates looking to set up a captive might not want to be associated with the reputational risk of an offshore structure.

- Tax

As noted above tax is at best a peripheral advantage of establishing a captive offshore. Nevertheless, captives continue to be subject to scrutiny from tax authorities, particularly the majority of the captives that employ an outsourced operating model, and so have a low headcount and less able to demonstrate substance. Such scrutiny can include reviews of specific captives by tax authorities. These reviews can be detailed and time consuming costing the captive owner in terms of management time and increased fees from its service providers.

- Control

By establishing the captive offshore and employing a third party to manage the captive, the shareholder is necessarily ceding control of the vehicle to a certain extent and relying on the performance of others to ensure that its vehicle works in the way that it was designed. This is not a comfortable place for some owners.

- Distance

Captive boards require management input from the shareholder. Especially where captives are housed in stand-alone corporate structures rather than cells, shareholder representatives that sit on the board will be required to visit the offshore domicile regularly to ensure that the key decisions made, and core activities undertaken, by the company are taken in the jurisdiction where it is regulated to carry on insurance business. This is even more important following the introduction of Economic Substance legislation in most offshore domiciles in or around 2019.

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This is an additional expense in terms of both time and money that would not be incurred to such an extent should the captive be established onshore.

3.1 EUROPEAN UNION CAPTIVE DOMICILES

Companies with risks primarily located in the EU may look to establish a captive within an EU domicile in order to take advantage of the passporting rights enabling them to write direct insurance into every other country within the EU. In so doing they could avoid having to employ a fronting insurer, saving costs and gaining increasing control over the insurance provided.

There were a number of EU domiciles which had specific laws and fiscal attractions designed to make them attractive to captives. These are Dublin, Luxembourg and Malta. However, with the introduction of the Solvency II directive, all EU territories operate under the same regulatory framework. That is not to say that all territories are equally attractive to locate your EU captive. The domiciles mentioned above remain popular as they have endeavored to interpret the directive in as sympathetic a manner as possible. Territories still retain control over setting of their fiscal regime (such as deductions for equalization reserves or tax rebates on dividend payments to international shareholders) albeit there is increasing pressure to enact a minimum corporate tax regime globally.

Luxembourg has built up a reputation as the EU domicile to house reinsurance captives. Dublin is popular with US corporates to establish a direct writing captive

The questions to be asked relative to creating in an EU domicile are:

- Is your EU spread worth it?

Is there sufficient spread of business throughout the countries of the EU and is it of a sufficient size to make it worthwhile the cost and effort of establishing and operating a captive writing direct. If the parent limits its activities to the EU this may well be appropriate but if its EU operations are merely part of a very large multi-national spread, then is it worth going through the additional regulation of an EU domicile for only a part of the business' risks?

- Is it economic and feasible to write direct?

Will the captive have knowledge of the local general good requirements such as insurance rating and the policy form in each country of the EU in which it operates? Will it have the ability to produce policies in the local languages, pay local insurance premium taxes and will they be able to provide underwriting and claims services to the local subsidiary? Even if the local subsidiary employs an insurance broker, will that broker be happy to work with say an unrated Dublin captive company operating possibly in a language with which they are not familiar. Even when policies can be produced in the various local languages, this is still going to be a more expensive and time consuming operation than issuing in a single language.

- Is fronting a worthwhile expense?

The cost of operating directly, as described in the above paragraph, has to be compared with the cost of using a fronting carrier charging, say, and 7.5% of premium. If the parent has operations in different parts of the world, the same arguments applies as to whether, with maybe the majority of the group's risks insured on a fronted basis, it is viable for a captive to write direct at all. The simplicity and convenience of entering into one world-wide fronted programme may well have attractions. Compared to the administration costs of running a direct company, paying a fronting fee may be economically worthwhile.

- What will the capital costs be?

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All EU domiciles are now subject to the Solvency II regime. Solvency II came into force in 2016, and was motivated by the desire to ensure that the commercial insurance sector in the EU was sufficiently robust to survive any reasonably foreseeable shocks. As a result its capital requirements are significantly greater than many offshore jurisdictions. Its minimum capital requirements are EUR1.2m for reinsurers and EUR 3.7m for direct insurers, with no reduction applied for captive insurers. In practice EU regulators often add a risk based buffer to these capital floors, pushing the capital requirement up to a level that means an EU captive may become out of the reach of all but the larger corporates.

- What will the regulatory costs be?

Solvency II not only has capital requirements in Pillar 1 but has two further pillars focusing on risk management and reporting. The regulatory burden imposed by Solvency II as a whole drives up the general cost of regulatory compliance when compared to non-EU domiciles.

What is more, even though there is freedom of services within the EU for those companies set up in another EU territory, the company still has to go through the process of registration and approval in each territory in which they wish to do business. There is a notification and approval process to go through which may incur time and cost.

- Limited location choice

As we outline in the preamble to this section, essentially the choice is primarily between Dublin, Malta or Luxembourg. However, some Nordic companies have established captives in their home countries. Recently other EU territories have indicated an interest in attracting captives but need to invest in an ecosystem that will foster captive growth.

- What is wanted? Captive or conventional insurer?

Creating a pure captive in say Dublin or Malta, solely to write direct within the EU, should be assessed from an economic and regulatory viewpoint. Choosing another non-EU domicile and operating on a fronted basis could well be as financially attractive. On the other hand, if the aim is to form an insurance company to write large volumes of customer business such as a leasing company insuring leased property or a bank writing customer loan protection business, then the profitability could well be such that the costs and additional administration necessary to write within the EU on a direct basis are well justified.

3.2 FEATURES OF THE MOST POPULAR CAPTIVE DOMICILES

3.2.1 Captive Domiciles

There are many locations around the world claiming to be ideal domiciles for captive insurance companies. Estimates of the number of domiciles differ, but as at 31 December 2020, Captive Review stated that 71 domiciles has contributed to its annual World Domicile update, listing a total of 6,304 captives and 3,039 cells. These were split broadly 50% onshore US, and 50% RoW.

The top twenty domiciles by number of captives were:

Position	Domicile	Number of Captives
1	Bermuda	692
2	Cayman Islands	652
3	Vermont	589
4	Utah	349

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5	Delaware	296
6	Guernsey	287
7	Barbados	278
8	North Carolina	250
9	Hawaii	242
10=	Tennessee	199
10=	Luxembourg	199
12	Nevis	182
13	Georgia	179
14	Nevada	166
15	South Carolina	156
16	Montana	135
17	Arizona	131
18	District of Columbia	106
19	Anguilla	99
20	Isle of Man	96

3.2.2 Attributes of Captive Domiciles

These domiciles' particular attributes vary. Some are domiciles of long standing and others are relative newcomers either attracted by a share of a very large market or to take advantage of new sources of business. Their particular advantages and disadvantages will equally vary according to the parent company's business drivers and location. Ultimately the choice of captive domicile is very much an individual one but it is suggested that the following criteria should be relevance.

- Stable economic and political environment

What is the history of the location? Has it been economically sound for a long time? Is there an active political opposition and if so, would a change of Government dramatically alter the economic situation and the policy of the Government on offshore business?

- Simple but effective insurance legislation

A clear set of sensible rules is better than inadequate regulation; the latter can lead to all sorts of anomalies and can create uncertainty at the parent company where company lawyers and advisers look for understandable ground rules. The legislation should be proportionate, effective and not be full of bureaucratic hurdles. What is the application procedure and the ongoing regulatory control? It has to be stressed that one should not necessarily be looking for the most relaxed and easy going regime. What is wanted is a regulator who knows and understands the law and will apply it fairly but with reasonable pragmatic discretion. The maintenance of regulatory high standards, such as was evidenced in the Isle of Man and the Channel Islands by the Andrew Edwards Report, is in the interests of all stakeholders.

- Availability of high-class management services

The captive company needs to be managed and in the absence of the captive employing a raft of staff, there needs to be a selection of management companies available with all of the attributes described in Unit 7. Healthy competition between management companies (whether they be a branch of a global franchise or a local independent provider) will ensure maintenance of service standards and keen pricing.

- Availability of good banking, legal & financial services and non-executive directors

All these business support services combine with a healthy insurance manager's environment to create a viable business ecosystem and gives the domicile international credibility. The captive may

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well be dealing in multiple currencies and material cash flow so a robust and efficient banking system is necessary for day-to-day operations allied with other financial, legal and investment services. With increasing focus on governance, it is of value that a domicile can offer a panel of experienced candidates to act as directors of the captive.

- No exchange control problems

There is obviously a need for cash to flow freely around the world and so any domicile due diligence should assess whether a current freedom of exchange control likely to continue into the future and what governmental commitments have been given.

- Good accessibility

One of the advantages of an onshore captive is the reduction of travel time for parent company representatives to attend management and board meetings. If an offshore domicile is chosen, it may not make sense to widen the travel time gap too much. If it takes a day's travel with several hours' adjusted difference, a two hour board meeting could well take up three days or more of actual time. It often makes sense to choose a domicile convenient from a travel point of view.

- Good communications

In these days of electronic and satellite communication there would be few domiciles which cannot meet acceptable criteria in this regard but it is something to check over.

- Acceptability as an insurance centre

The captive will most likely be dealing with insurers and reinsurers which are going to be assessing the standing of the captive. They are obviously going to have more comfort with a properly capitalised captive, set up in one of the leading, well-regulated and acceptable locations than they are for an undercapitalized captive in a less established regime.

- A neutral tax environment

As has been stated already, any tax benefits arising from the site of a captive tend to be negligible. However, it is important to ensure that the choice of domicile does not produce additional tax costs for the captive owner.

3.2.3 Legal environment of Captive Domiciles

Onshore or offshore, a captive will have to comply with applicable laws and regulations. Fortunately, in the main, these are very similar in substance around the world and differ only in the detail. Nevertheless, a complete review of the applicable laws in any one location would be a major undertaking. Accordingly, comment is limited to a summary of the main features. Of course, the company lawyers will require copies of the relevant laws in the chosen domicile and anybody working in a location will need to be au fait with the detail of any laws in that jurisdiction, which might directly or indirectly impact upon captives. In general, the following will be encountered:

Company law

There will be the basic company law applicable to all companies regardless of activity. It will likely include the ability to use different types of corporate structure such as the cell structures referred to elsewhere. The services of local lawyers will typically be required for company formation and they will provide a summary of the essential features and how these may differ from the parent company. These will include:

- The minimum number of shareholders required. Usually this is one but can be more.

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- The minimum number of directors and whether any must be resident in the domicile under local law.
- The position of alternate directors can vary. Sometimes they are required to be approved and/or appointed by the board and in other cases they are the appointees of the principal director for whom they act and who remains responsible for them.
- The minimum number and form of general meetings of shareholders will be stated. Historically one annual general meeting was required in each calendar year, not more than 15 months from the previous one. More modern regulation makes the holding of general meeting optional.
- The form of annual return to the local registrar of companies (as opposed to the return to the insurance regulator) will be specified. Usually this lists shareholders and directors and their addresses and key data such as the capital and how it is provided.
- The Memorandum and Articles of Association or Incorporation are the bye laws of the company and will set out in detail what it can do and how it will operate. Clauses will specify the procedures for activities such as the appointment of directors and whether their appointment is continuous or subject to periodic re-election, procedures at directors' meetings or general meetings, the quorum, how and when extraordinary general meetings can or must be called, how the articles can be changed and the like. A standard set of these will normally be provided by the lawyers forming the captive. Usually, they are acceptable in standard form but occasionally parents require some of their own particular foibles incorporated.

Insurance law

This will set out the regulations insofar as companies transacting insurance business are concerned. It does not change the basic company law but is additional to it. In most offshore locations seeking to attract and retain captives, these laws tend to be modern, concise and easy to read and understand. Onshore domiciles may have older laws built up over many years and designed to cope with the traditional insurance conglomerate and as a result can be complex. However, summaries of the principal requirements will usually be provided by the managers and often the regulatory body in the domicile will publish a comprehensive guide to the regulations including other applicable laws and useful local information. The features will usually include:

- Registration and licensing procedures with copies of application forms and personal information questionnaires for directors.
- Minimum capital and how this can be held, i.e. cash or whether letters of credit are acceptable.
- Solvency requirements. Depending on domicile, this will differ for general business and long-term (life) business, whether the company is a pure captive or writes unrelated business or whether it is a single owner or multi-owner captive.
- Allowable investments, insofar as their treatment in solvency calculations, will be listed. These differ marginally by location but all tend to recognise loans back to the parent group.
- The form and frequency of annual returns and what these must contain, including the form of accounts and claims information and whether individual technical (underwriting) accounts are required. Usually, these returns are required to be made annually, within three to six months after a financial year-end but there can be a requirement for quarterly returns in the early years of a captive.

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- Audit and any actuarial requirements.
- Registration of managers and requirements for any local statutory representative.
- Winding up requirements and procedures.
- An attached regulation will set out annual registration and application fees.

Tax law

This will outline the formation and/or annual registration procedure and any applicable fee in lieu of taxation, procedures which will be carried out by the managers as a matter of course.

The parent group tax managers may review the tax position of a domicile in rather more detail to ensure it does not produce negative tax consequences or ascertain whether there are aspects which can be advantageous.

Most domiciles now have economic substance laws that set out criteria for companies to be assessed as being resident in that jurisdiction for tax purposes. These focus on local establishment, requiring that core income generating activities are carried out and evidenced as being carried out in domicile.

- Anti-Money Laundering and Countering the Financing of Terrorism Laws (AML/CFT)

In 1989, the OECD created FATF, the Financial Action Task Force to oversee the implementation of Money Laundry / Terrorist Financing regulation on membered countries. FATF was mandated to evaluate and rank membered countries in an effort to combat ML and TF. As a result, AML/CFT legislation has been introduced in every jurisdiction over the recent past. It primarily affects the financial services industry and other industries that are party to material financial transactions. The key concept is that of Know Your Customer as explained more fully in Unit 15.

- Data Protection Laws

The EU introduced its General Data Protection Regulation in 2016. Most domiciles now have adopted some kind of equivalent guidance. It's complex legislation, affecting all industries. The same fundamentals are in play across all jurisdictions rooted in the individual's right to ensure that their personal data is only held for lawful reasons, and in a fair and transparent manner.

This means that every recipient of personal data has to go through a process that determines:

- The type of data – is it personal sensitive information
- The lawful reason for holding the data
- Whether the data can be minimised
- The accuracy of the data
- Security of the data retention method
- Where they forward data

It's a complex task that requires continual monitoring.

In some, but not all jurisdictions, certain insurance companies are exempt from some of the DP requirements.

- Redomiciliation Laws

Captives have become increasingly mobile in recent years, as a result of changes in activity or parent group expansion or restructuring. To accommodate this, some locations have enacted laws providing for the cross-border migration of captives. These allow a captive located in, say, Bermuda or Isle of

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Man to relocate to Guernsey or vice- versa, without the need for liquidation in one country and creation of a new company in another.

- Other Laws

Other laws may impact to a lesser extent, according to activity. For instance, some locations will have Third Parties (Rights against Insurers) Laws allowing claimants to claim against insurers directly in the event the person against whom they have a claim, is bankrupt. This could apply where a captive writes product liability or employers' liability insurance and the parent (the insured) is liquidated.

3.3 GUERNSEY AS A CAPTIVE DOMICILE

3.3.1 History

Guernsey has been a domicile for captives since the first captive registration in 1922. However, it did not truly begin to develop as an offshore captive domicile until the 1960s. Its expansion was bolstered by the introduction of its first dedicated insurance law in 1986 that was drafted in part with the requirements of the captive industry in mind. The industry continued to thrive through the 1990s and early 2000s, with the number of captives increasing year on year.

The advent of the ILS sector in the early 2000s contributed to continued growth as the number of captives plateaued. In more recent years commercial reinsurance and insurance have seen further diversification, and pension longevity transactions have just added to that theme.

In a report commissioned by the States and GIIA and published in 2021, the current state of the insurance market was summarised as follows. See link below to the report.

<https://www.gov.gg/CHttpHandler.ashx?id=151400&p=0>

3.3.2 Reputation

Guernsey has always placed itself at the forefront of good practice, and so has built up a strong reputation for sound regulation as a captive domicile. It was a founding member of the International Association of Insurance Supervisors, which is the international standards setting body for the insurance sector, and represents the Offshore Region of Insurance Supervisors on the Executive Committee.

It has been subject of various reviews by international and national bodies over the years. In 1998 the UK Government commissioned a report by Mr. Andrew Edwards to review the financial regulation of the Crown dependencies namely Guernsey, Jersey and the Isle of Man. This is generally referred to as the Edwards Report. The report was very complimentary of the systems, laws and regulatory procedures in Guernsey, Jersey and the Isle of Man. The following are extracts from his report:

"They have developed reputations for stability, integrity, professionalism, competence and good regulation.

- *The Islands are in the top division of offshore centres.*
- *The Islands have a firm and continuing objective to be the best governed, best regulated and most responsible of offshore centres – as well as the most successful.*
- *The Islands score highly on political stability.*
- *The Islands' judicial systems have shown themselves well able to deal with international business.*
- *The Islands have well developed rules to combat corruption and conflicts of interest.*

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- *Islands' parliaments have accepted high standards of regulation as obligatory and in the Islands' best interests.*
- *"The Island authorities are committed to well-regulated insurance sectors attuned to offshore needs."*

More recently its regulatory environment has been the subject of reviews by the IAIS. In 2019 The IAIS commented:

"...Guernsey has actively worked to maintain high supervisory standards but also to avoid unnecessary regulatory cost... Guernsey has a high level of observance of current international standards...In overview..., supervisory programmes appear to be well organized, well managed and effective in dealing with policyholder risk given the nature, scale, and complexity of the market."

Guernsey's observance of the core principles of the IAIS is among the highest in the world, not just among fellow offshore captive domiciles.

Guernsey is also on the EU tax white list, and in 2019 the OECD concluded that Guernsey's tax regime is not harmful.

Guernsey also has a strong reputation for the quality of servicing and personnel available on island, and has been the recipient of the best non-EU domicile award at the UK and European Captive Awards ever since the award's inception.

3.3.3 Markets

Guernsey's primary market for captive clients is the UK. Guernsey's close ties to the UK, a similar legal system, geographical proximity, and the fact that it is possible to write many UK risks on a non-admitted basis all contribute to this position.

Almost 40% of the UK FTSE 100 have captives in Guernsey.

The GFSC recently stopped publishing statistics relating to the domicile of its licensed insurers' shareholders, so we do not have industry wide data to share. However, other sources include:

- Australia
- Rest of Europe
- South Africa
- Middle East
- China

3.3.4 Competition

Guernsey's competition in the captive space is primarily European (the days of European captive owners flying out to Bermuda 2 or 3 times a year are all but over). Within the EU that typically means Luxembourg, Dublin and Malta, whilst outside of the EU is the Isle of Man. As has been explained already, there is little direct competition between the EU domiciles and those outside of the EU. The choice of whether to site a captive within the EU can be based on a fairly straight forward calculation of a fronted v. a direct writing structure. If a fronted structure is chosen, it will almost always be more efficient to locate the captive outside of the EU.

However political considerations, and historic affiliations can come into play, with French captives tending to be based in Luxembourg, and German captives in either Switzerland or Malta.

On the whole though, when it comes to choosing a European captive domicile, the answer is often Guernsey. Guernsey primary advantages are often seen as being:

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- Reputation
- Captive specific legislation
- Competitive operating costs
- Speed of establishment
- Flexible capital requirements

However, the Isle of Man also shares these attributes. There is little to separate the two islands' legislation. Guernsey, though, has an industry at least 3 times the size of the Isle of Man's, and considerably more infrastructure to support captive servicing. It has a stronger brand and more visible marketing – see the Guernsey Finance website at www.weareguernsey.com, and is the default option when it comes to answering the question “where shall I establish my non-EU European captive?”.

When it comes to other insurance segments, most notably commercial reinsurance, and ILS business, Guernsey's primary competition is Bermuda. Bermuda dominates the worlds of offshore reinsurance and ILS, and though Guernsey has been innovative in trying to secure a share of this business, it has found making meaningful inroads to be difficult.

Guernsey has been the world leader in facilitating pension longevity transactions, though the numbers of transactions, albeit high value, remain comparatively small. Bermuda is again the main competition for this kind of business, although Guernsey is holding its own at present.

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Self-test questions

Answering these questions will remind the participant as to what has been learnt. Once completed, please check your answers against the relevant text.

1. What are three advantages and disadvantages of an onshore captive domicile?
2. Does taxation have any influence when choosing a captive domicile?
3. What is the main benefit of establishing a captive in an EU domicile?
4. What are considered the five primary advantages of Guernsey as a captive domicile?

Summary of learning outcomes

1. Explain the generic differences between onshore and offshore domiciles
2. From a European perspective, explain why some companies choose to form captives within the EU, whilst others choose domiciles located outside of the EU
3. Be acquainted with the features of the primary jurisdictions that host captive insurance vehicles
4. Describe Guernsey's positioning in the worldwide captive environment