CAPTIVE DOMICILES – KEY CONSIDERATIONS

Andrea Tucker, of Advantage Insurance, outlines the key considerations to bear in mind when selecting a captive domicile

A key consideration when forming a new captive is the selection of the most appropriate domicile. The local regulatory authority that issues the licence will have primary oversight of the captive. Each domicile has its own unique laws and regulations which the local insurance authorities utilise to regulate the captive insurance industry. With the proliferation of new domiciles, it is important to identify the goals and objectives of the captive insurance programme upfront and assess how these could be affected by the various domiciles under consideration. The Cayman Islands is an extremely attractive captive domicile with an enlightened legislature and a robust system of laws and regulations, all firmly supported by highly experienced insurance industry professionals.

Regulation and laws

Although each domicile has their own legislation in place for the regulation of captives, it is the ability of the insurance regulator to interpret and apply these rules that will impact the effectiveness of a captive. It is important that a regulator be willing and able to understand and support the captive's goals while remaining within the laws and regulations enacted. Experience and a proven track record of supporting the captive industry is important when assessing a regulator as a captive is a long-term commitment and will remain in the domicile for a significant period of time. Domiciles which have short-term goals and are not committed to the industry may become disinterested if immediate expectations are not met. Political instability or a change in government may have negative effects on the environment in which the captive operates. Regulators with a long-standing history of working together with captives and committing resources to quality regulation, full-time staff and experienced analysts are unlikely to lose interest in the industry and leave the captive in unfavourable circumstances. A long-term commitment is required in order to fully redeem the benefits of the captive.

All captives are unique and must therefore consider all aspects of their specific programme and possible risk sharing partners. In a fronted reinsurance relationship, consideration should be given as to which domicile the risk sharing partner would accept contracting with. An attractive prospect to risk sharing partners may include a regulator that is competent and applies quality oversight over licensees.

Andrea Tucker

Andrea Tucker is an account manager for Advantage and has over five years of experience in the financial services sector in the Cayman Islands, having worked in Assurance Services with PwC, Cayman Islands and Patriot Captive Management before joining Advantage. Tucker's experience includes working in banking, hedge funds and reinsurance captives.

Capitalisation and solvency requirements

The initial minimum capitalisation refers to the amount of capital that the owners of a captive need to contribute upfront to qualify for a licence and initiate writing premium. The minimum capital required will vary based on the structure of the captive and the level of related party premiums being written as a percentage of the total amount of net premiums written. Each jurisdiction has its own specific minimum capital and solvency requirements that need to be monitored on a continual basis.

Refer to the table on page 24 for a comparison of minimum capitalisation requirements for a non-exhaustive selection of domiciles.

When it is not desirable for a captive owner to tie up significant levels of cash in the upfront capitalisation of the captive, a letter of credit can sometimes be used in lieu of or in addition to cash for the fulfilment of the capitalisation requirements. Reducing the upfront capital costs creates further opportunities to invest surplus funds and receive a greater return.

Prospective captives must consider the organisational structure that best suits their programme's goals and objectives. Jurisdictions that have onerous upfront minimum capitalisation requirements may inhibit the ability for small- and micro-sized programmes to be licensed and start writing business. An economically viable alternative would be to approach a rental captive facility. This solution provides the market with an option for participants to

MINIMUM CAPITALISATION REQUIREMENTS

Domicile	Cayman Islands	Bermuda	USA - South Carolina	USA - Vermont	Puerto Rico
Capitalisation	Class B(i) $100,000 Class B(ii) $150,000 Class B(iii) $200,000	Class 1 - $120,000 Class 2 - $250,000 Class 3/3A/3B - $1,000,000	Pure - $250,000 Branch Captive - $250,000 Association - $750,000 Sponsored - $1,000,000 RRG – $500,000	Pure - $250,000 Industrial Insured - $500,000 Association - $500,000 Sponsored - $500,000 RRG - $1,000,000	Class 1 - $500,000 Class 2 - $750,000 Class 3 - $1,500,000

pay a participation fee to a licensed captive (hereafter referred to as the "core") to create and attach a protected cell (the "cell"). The core will put up the minimum capitalisation and the participant of the cell will pay a participation fee to the core for the use of the facility. Dependent on the constitutional documents as well as the domicile of the core, all contracts and agreements in relation to the cell will be required to be executed by the core for and on behalf of the cell.

Investment flexibility

Support by the insurance regulator in the captive's domicile with regards to investment flexibility is an important consideration for the long-term success of the captive's operations. A regulator that has the expertise to engage and appropriately assess the request for a change in investment policy is hugely advantageous in achieving greater returns.

The main purpose of a captive is to act as an insurance vehicle and be able to pay claims as they become due, therefore the captive's assets need to be sufficiently liquid and safeguarded. The captive incurs risk on the liability side of its business and should therefore be prudent with regards to the investment of surplus assets. Liquidity and the ability to continuously meet capital requirements is a priority when devising/reviewing the captive's investment policy. Striking the correct balance between safeguarding the assets and receiving a return on assets is key.

The investment policy, portfolio and cash requirements should be continually assessed with reference to the financial health of the captive. The investment profile of a new captive is likely to be more conservative and focused on capital preservation and cash flow stability. A well-established captive in good financial health with a strong sense of its underwriting risk might be able to increase its investment risk tolerance.

> "Experience and a proven track record of supporting the captive industry is important when assessing a regulator"

Availability and quality of support services

Service providers offer valuable support to the ongoing operations of the captive. Quality professionals with the necessary knowledge and experience of the industry and domicile are imperative. Regulators in certain domiciles may require that particular service providers have an office in the domicile. The availability and quality of service providers in a domicile is an important consideration when assessing the captive's outsourcing needs.

A list of service providers that a captive typically engages are:

- Insurance manager
- Auditor
- Legal council
- Banker
- Tax adviser
- Investment manager
- Broker
- Actuary

Selecting the appropriate service providers to assist with day-to-day operations may require comprehensive research into the firm's reputation, qualifications and competencies. The best domiciles will have quality insurance managers vetted by the insurance regulator and supported by professionals who are competent and knowledgeable about the industry. Captives that operate in domiciles which have a multitude of quality professionals to select from, will benefit from competition, i.e. pricing is reasonably well maintained and supported, and the firms operating within the jurisdiction are continuously striving to improve their service offerings.

Consideration should also be given to the disaster recovery plans of selected service providers in the case of a catastrophe. Business continuity is imperative for the captive to remain compliant with applicable laws and regulations. Mitigating actions need to be implemented to minimise the disruption of services and promote the safeguarding of information.

Formation costs

Formation costs and annual fees vary considerably between jurisdictions. The captive structure will influence the annual fees paid to the government and regulators for licensing and registration, audit expenses, actuarial engagements and captive management.

Final thoughts

It is of the utmost importance to select a domicile that aligns well with the captive's goals and objectives. Significant research is required when analysing the various domicile options and emphasis should be focused on the regulatory environment. Captives in well-developed domiciles with a positive reputation will benefit from established laws and regulations and captive focused service provider synergies.

With offices in the United States, Puerto Rico and the Cayman Islands, and over 23 years of experience, Advantage Insurance can assist in the selection of the most appropriate insurance solution that best meets a client's unique objectives and preferences. The Advantage team has deep experience to handle some of the more complex issues that may arise for captive owners in the insurance and financial services industry as well as offer sound advice as to the most appropriate domicile during the captive feasibility stage.