Captive Worldwide: Which Country Offers the Best Domicile for Captives?

Richard W. Wright
Willis HRH Captive Consulting Practice
SIIA Conference
September 22, 2009

AGENDA

- It's All About the Trip?
- Onshore versus Offshore – From the U.S. Perspective
- Onshore versus Offshore – From the European Perspective
- Major Domiciles
- Weighted Scorecard Criteria
  1. Strategic
  2. Financial
  3. Operational
- Examples of Real/Perceived Domicile Issues/Benefits
- Questions and Answers
IT'S ALL ABOUT THE TRIP?

Do you want to: Then go to:

- Ski? Vermont
- Play Golf? Bermuda
- Scuba Dive? Cayman Islands

We DON’T do it this way anymore!

UNDERSTANDING THE DOMICILE T-R-I-P

Taxes
- Income Taxes
- Withholding Taxes
- Premium, Branch Profit, and Excise Taxes

Regulations
- Ownership Options
- Coverage Options
- Capitalization Options

Infrastructure
- Operating Efficiency
- Operating Cost
- Operational Experience

Perception
- External: e.g. Tax Haven Issues
- Internal: Corporate Culture
- Gatekeeper Influence

Source: The Risk Report, March 2008
Kathryn A. Westover
Innovative Captive Strategies
OFFSHORE VS. ONSHORE FROM THE U.S. PERSPECTIVE

- Onshore – any state with captive legislation (there are about 30 of them now!), plus the District of Columbia (D.C.)


OFFSHORE VS. ONSHORE FROM THE EUROPEAN PERSPECTIVE

- Onshore – any member of the European Union (E.U.) or the European Economic Area (EEA). Common onshore domiciles: Ireland, Luxembourg, Sweden, Malta

- Offshore – everywhere else. Common offshore domiciles: Guernsey, Isle of Man, Bermuda
OTHER NOTABLE “GLOBAL” DOMICILES

- Singapore
- Gulf Region Domiciles – Bahrain, Dubai, Qatar

BENEFITS OF AN ONSHORE DOMICILE

- Avoidance of FET (same as offshore if 953(d) is elected)
- Loan backs allowed to financially secure parents
- Onshore image more acceptable to public companies
- Captive paper more acceptable to vendors and other 3rd parties
- Access to US government terrorism backstop (TRIA)
- Alignment of parent and captive legal systems
- Ability to write employee benefits (ERISA)
- Domestic domiciles a must for risk retention groups (RRGs)
BENEFITS OF AN OFFSHORE DOMICILE

- Typically lower capital requirements
- Less compliance, risk based regulation
- Regulation weighted towards compliance by captive manager
- No premium taxes in domicile
- Parent group tax/finance planning opportunities
- Direct access to strong insurance/reinsurance market (Bermuda)

MAJOR DOMICILES

<table>
<thead>
<tr>
<th>Non – U.S.</th>
<th>Number of Captives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bermuda</td>
<td>960</td>
</tr>
<tr>
<td>Cayman Islands</td>
<td>787</td>
</tr>
<tr>
<td>Guernsey</td>
<td>372</td>
</tr>
<tr>
<td>British Virgin Islands</td>
<td>319</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>261</td>
</tr>
<tr>
<td>Anguilla</td>
<td>178</td>
</tr>
<tr>
<td>Turks &amp; Caicos</td>
<td>173</td>
</tr>
<tr>
<td>Barbados</td>
<td>164</td>
</tr>
<tr>
<td>Ireland</td>
<td>131</td>
</tr>
<tr>
<td>Isle of Man</td>
<td>116</td>
</tr>
<tr>
<td>Nevis</td>
<td>64</td>
</tr>
<tr>
<td>Singapore</td>
<td>62</td>
</tr>
<tr>
<td>Sweden</td>
<td>50</td>
</tr>
<tr>
<td>Switzerland</td>
<td>50</td>
</tr>
<tr>
<td>Malta</td>
<td>34</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>U.S.</th>
<th>Number of Captives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vermont</td>
<td>553</td>
</tr>
<tr>
<td>Hawaii</td>
<td>162</td>
</tr>
<tr>
<td>South Carolina</td>
<td>156</td>
</tr>
<tr>
<td>Nevada</td>
<td>124</td>
</tr>
<tr>
<td>Utah</td>
<td>122</td>
</tr>
<tr>
<td>Arizona</td>
<td>104</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>89</td>
</tr>
<tr>
<td>Kentucky</td>
<td>76</td>
</tr>
<tr>
<td>New York</td>
<td>50</td>
</tr>
<tr>
<td>Delaware</td>
<td>40</td>
</tr>
<tr>
<td>Montana</td>
<td>35</td>
</tr>
</tbody>
</table>

Source: Risk Management Magazine – July/August, 2009
SAMPLE WEIGHTED SCORECARD CRITERIA

Willis expands on the T-R-I-P concept with the following:

- Strategic
- Financial
- Operational

Sample Weighted Scorecard Criteria

STRATEGIC

- Domicile Infrastructure
- Ease of Communication/Access
- Economic Environment
- Regulatory Environment/Flexibility
- Domicile Reputation
- Political/Sovereignty Risk of Domicile
- Compliance with International Best Practices
- Ease of Exit from Domicile
- Membership in European Union
- Confidentiality Practice of Domicile
Sample Weighted Scorecard Criteria

FINANCIAL

- Security of Funds in Domicile
- Double Tax Treaties
- Capital/Solvency Requirements
- Operating Costs
- Regulatory Costs
- Loan Back/Treasury Rules Flexibility
- Fiscal Optimization/Consideration
- Recognizing Credit for Reinsurance Purchased

OPERATIONAL

- Set-up Timetable/Meeting Timeline
- Risk of License Failure
- Availability of PCC & Redomiciliation Legislation
- Burden of Local Corporate Governance Requirements
- Local Management Resources
- Disaster Recovery Resources
- Availability of Qualified Local Directors
- Underwriting Flexibility
- Ability to Outsource Functions
- Regulatory Reporting Requirements
### WEIGHTED CAPTIVE DOMICILE MATRIX

#### Strategic criteria

<table>
<thead>
<tr>
<th>Domicile</th>
<th>Guernsey</th>
<th>Bermuda</th>
<th>Vermont</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domicile infrastructure</td>
<td>8</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>Domicile resource in the areas of legal, accounting and audit, actuarial, corporate governance, captive management companies, banks, non executive directors etc.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ease of communication / access</td>
<td>5</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Duration and frequency of flights and due regard to time zones. Infrastructural development of electronic communication.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory environment / flexibility</td>
<td>7</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Regulatory accountability and agility to be commensurate with premiums. Lack of unnecessary red tape and bureaucracy.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Confidentiality of domicile</td>
<td>8</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Confidential data protection of information in secure servers.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Financial criteria

<table>
<thead>
<tr>
<th>Domicile</th>
<th>Guernsey</th>
<th>Bermuda</th>
<th>Vermont</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to build up retained earnings / CFC</td>
<td>8</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>Local taxes depleting retained earnings. Parent domicile CFC requirements that have the effect of potentially repatriating profits annually . Ease of dividending if required.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan back / Treasury rules flexibility</td>
<td>8</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Ease of ability to use surplus funds (subject to local C&amp;S) in Group Treasury or loan backs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiscal optimization / consideration</td>
<td>9</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>Local taxes and potential CFC issues</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recognizing credit for reinsurance purchased</td>
<td>8</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>Ability to take credit for reinsurance placed in domicile (dictated by Regulator).</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Operational criteria

<table>
<thead>
<tr>
<th>Domicile</th>
<th>Guernsey</th>
<th>Bermuda</th>
<th>Vermont</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to and strength of local reinsurance markets</td>
<td>5</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Excess insurance and reinsurance market strength</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Underwriting flexibility</td>
<td>8</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Ability to operate in flexible environment regarding underwriting strategy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory reporting requirements</td>
<td>8</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Frequency, timeliness and form of local regulatory reporting. 0 = heavy demand, 10 = low demand.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Total

<table>
<thead>
<tr>
<th>Domicile</th>
<th>Guernsey</th>
<th>Bermuda</th>
<th>Vermont</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-total</td>
<td>484</td>
<td>531</td>
<td>528</td>
</tr>
<tr>
<td>Financial criteria</td>
<td>509</td>
<td>556</td>
<td>488</td>
</tr>
<tr>
<td>Strategic criteria</td>
<td>1,492</td>
<td>1,583</td>
<td>1,441</td>
</tr>
</tbody>
</table>

### RECENT ENTRANTS BUSINESS MODEL

**Cheaper, Better, and/or Different!!**

- Lower Cost of Doing Business
- Niche Offerings
- Closer to Business Source
- Innovation

*Prediction: Most new captive domiciles will fail to achieve critical mass.*
EXAMPLES OF REAL/PERCEIVED DOMICILE BENEFITS/ISSUES

BARBADOS

- Attractive to Canadian parents due to favorable tax treatment
- Popular with large Canadian banks writing customer risks
- Bank captives often swap risks to generate 3rd party business
LUXEMBOURG

- Part of European Union (EU) – captives can write direct (i.e. no front)
- Renowned as a captive reinsurance center, but is becoming attractive to captive reinsurers who want to create a direct writer too
- Mainly used by European parents

MALTA

- Also part of EU
- Has Protected Cell Legislation (PCC)
- Lower cost structure and less “gold plating rules” than Ireland
- Double Tax Treaty with USA is about to be signed
CAYMAN ISLANDS

- Deep and mature financial services industry
- Regulatory and taxation conditions are extremely favorable for captive formation
- Healthcare captives dominate – nearly 36% of all captive are healthcare captives

BERMUDA

- Arguably, the world’s premier domicile; oldest, largest, most mature domicile
- Strategically located within a few hours flight of cities on East Coast and most European capitals
- Strong infrastructure including large insurance and reinsurance community
VERMONT

- Largest and most mature domestic (U.S.) domicile; 3rd largest domicile overall
- Nearly 80% of VT captives are pure captives, but 14% are risk retention groups (RRGs)
- Domestic domiciles are required for RRGs, writing ERISA benefits and to gain access to TRIA

SOUTH CAROLINA

- Popular with doctors groups forming risk retention groups (RRGs)
- “Special purpose legislation” allowed formation of “XXX” securitizations for life insurance company captives
- Fast growing U.S. domicile – strategically located, great weather
DISTRICT OF COLUMBIA (DC)

- Protected cell captive (PCC) legislation
- Lower capital requirements than many other domestic domiciles
- No problem with TRIA-only structures

A PREDICTION FROM MALCOM CUTTS-WATSON*

A Convergence of:

- Insurance regulation (IAIS core principles and Solvency 2)
- Accounting Standards (US GAAP moving to IAS)
- Tax Harmonization (removal of arbitrage opportunities, transfer pricing rules, non deferral of captive profits)
- Making the choice of captive domicile a soft decision again (back to skiing, golf, etc.) as the business cases of most domiciles are similar!

* Chairman, Willis International Captive Practice
“What A Long, Strange T-R-I-P It’s Been”

– Jerry Garcia