

Captive insurance and Gibraltar as a captive domicile

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Why establish a Captive insurance company?

Definition:

A captive is a genuine insurance or reinsurance company, owned either by a non-insurance company, a group of insureds or others wishing to insure or reinsure primarily the risks of the owners or their affiliates.

The Rational.

The move towards self-insurance in general has been precipitated by two main issues;

- i) Conventional insurers no longer want to write certain risks, and
- ii) Insurers are limiting maximum exposures for any one particular risk.

Contingency reserves have always been another option to self insurance and are likely to result in considerably lower costs. I believe, however, it is generally accepted that the setting up of a captive is perceived as a more committed strategy as opposed to self insurance, which may be understood to be more transient especially where particular risks are difficult to cover. Nonetheless, much depends on the creativity of the parent. For example one particular British electrical company has been carrying large reserves of liquid assets for many years. The reserves act as contingency funds, and although many may argue that shareholders would feel their capital was not being used to its full potential, this particular company may use these funds for any purposes i.e. Capital Projects Funds. As these funds are used for alternative aims, the company makes more use of insurance solutions. This company also has its own offshore Captive and a very efficient in house broking company, showing that a combined number of different solutions may be successfully applied.

The Reasons

A parent company who establishes a captive insurance company may do so for a number of reasons, including the following;

Selections of risks: A parent is able to select the specific risks it wishes to insure through a captive, especially those for instance, which have a good claims history. For example, a national transport company with depots countrywide may find that to insure property, fire and damage is far more cost effective through a captive, due to low claims and expensive commercial premiums. However, the motor insurance for all the transport vehicles, due to high administration costs and medium to high claims, is better remaining on the commercial market.

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Lower costs and profitability: Where a parent company no longer has to pay a premium to a commercial insurer, it will be saving the expenses and profit margin of the underwriter - which can be as much as 40%.

The possibility of insuring the uninsurable: Although most risks are insurable on the commercial market, there are a number of areas where commercial insurers have become wary. Even if they do not refuse cover, it is likely that they will limit their maximum exposure. Examples of this are employer's liability, where insurers in the past have been exposed to extremely expensive claims for employees who suffered from the effects of asbestos, especially in the United States. Other common high risks exposures include environmental risks such as pollution and oil spillage

Retained investment income: Obviously where the captive receives premiums as opposed to the insurer, then the captive too will retain the investment income. Depending on which domicile the captive is based, this investment income will also be enhanced by tax benefits.

Autonomy: A further reason to set up a captive, is the facility for the parent to be able to centralise its insurance management. Furthermore, deductibles undertaken will be based on each area of the company, perhaps more responsible for some areas of insurance i.e. motor or medical to access sensible deductibles based on adequate self insurance strategy and not purely to lower the premium cost.

Flexibility: In establishing a captive insurance company, you can in effect establish a tailor made insurance programme for the insured. With such a tailor made option, the insured is likely to avoid gaps or waste caused by overlapping areas. This flexibility allows the parent company to pay the premiums to fit in with its own cash flow forecasts as opposed to insurance company intervals.

GIBRALTAR AS A CAPTIVE LOCATION.

MAIN FEATURES:

As of June 11th this year, Gibraltar has moved into being a particularly unique financial jurisdiction, because of its position within the European Community. The new EEA laws have been implemented on the basis of meeting the requirements of the harmonisation of insurance law, but the existing facility for a tax exempt status of an insurance company has been maintained. Insurance companies based in Gibraltar are now able to take advantage of the freedom of services legislation, and issue insurance direct throughout the Member States.

In the past, if an insurer wanted to set up a branch in, or provide insurance services into, an EEA State, a licensed insurer had to go through that State's separate licensing procedures. The third life and third non-life directives established the "single passport", or the principle of mutual recognition of licensing. This meant that a licence granted to an insurer by, say, France – the "home state" – might be extended to each and every EEA State. For example, if the French insurer wants to set up a branch in Germany – the "host state" – separate licensing in the host state is not required. Instead, in this example, the French company will apply to the French insurance supervisory authorities to open a branch in Germany.

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The host state (German) authorities will be consulted but it is only the home state (French) authorities which have the power to prevent the company opening the branch, or providing the services. ①

In June, the UK Government reached the conclusion, following a thorough review of the supervisory activities of the Gibraltar Financial Services Commission, that the local supervisory regime for insurance, matches the exemplary standards of supervision in the UK. This joint commitment to high standards between the UK and Gibraltar has opened the way for Gibraltar insurers to take advantage of this “single insurance passport”, enabling Corporations to set up direct writing captive insurance companies on the Rock. ①

WHAT TO LOOK FOR

When choosing a domicile for a captive insurance company, a company is looking at a number of areas;-

- ◆ What tax benefits are there for the parent company, does it fit in with the overall corporate requirements and structure?
- ◆ What type of captive can be written? Is there the opportunity of setting up a captive insurance company to cover all my European risks directly? Can I also set up a reinsurance captive? Is there a facility to operate a rent-a-captive?
- ◆ Is there a recognised regulatory body overseeing the relevant matters, and are the pertinent professionals duly licensed?
- ◆ Local relevant infrastructure of professionals and financial institutions i.e. solicitors accountants, banks etc.
- ◆ What are the costs going to be like and how easy is it to get to Gibraltar?

Taking each of these concerns in turn, Gibraltar has the following to offer;-

With regards to taxation possibilities of captive insurance companies, there is one option to establish an exempt company that pays a nil rate of tax. A captive insurance company, therefore, established as a Tax Exempt insurance company in Gibraltar has the advantage of being able to earn its underwriting income and accumulate investment income, free of any local taxes simply by paying an annual exempt fee of £225 per annum; or

There is also a second option: a Gibraltar incorporated company or a registered branch of an overseas company may apply for registration under the Income tax (Qualifying Companies) Rules 1983. Qualifying companies are chargeable to tax on their profits at such rates as may be prescribed from 0% to not more than 35%. This is of significant value to those countries with CFC legislation. For example, a UK owned captive in Gibraltar may establish a qualifying company, subject to a rate of tax of 23.25% (i.e. a UK owned foreign company declaring three quarters of corporation tax in Gibraltar, in theory, falls outside CFC legislation). This is likely to be preferable to most UK companies, to pay a rate of 23.25%, rather than a full corporation tax rate of 31% (as at 1st April 1997).

Gibraltar has no regulatory restrictions on the type of insurance the captive is involved in and therefore can write direct, reinsurance and rent-a-captives.

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There is a well established supervisory body , the Gibraltar Financial Services Commission (FSC), where licence applications are submitted in line with the relevant EEA directives. The Commissioner has a number of supervisors overseeing banking and investment, insurance and controlled activities.

It is also worth taking note that as Captive insurance is an emerging market for Gibraltar overall costs are competitive, compared to other domiciles.

Gibraltar has a well established infrastructure, there are numerous banks including the main British clearing banks. Five of the six top accountancy firms are represented in Gibraltar and all other companies involved in financial dealings are regulated by the FSC. For example, captive managers, insurance brokers and agents, company management operations and investment houses.

Access to the Rock is relatively easy and there are several flights daily from the main British airports.

RE-DOMICILIATION.

In addition to the above, a parent company may choose to re-domicile their captive in Gibraltar to take advantage of the benefits Gibraltar offers. This legislation was brought in as of 1st March 1996 and states “ A company domiciled outside Gibraltar and domiciled in a relevant State may, if permitted to do so by its constitution and by the applicable law in the jurisdiction of its incorporation and, if the company is domiciled in a jurisdiction other than that in which it is incorporated, apply to establish its domicile in Gibraltar. Relevant States for the purposes of this legislation includes

- All the EEA States,
- Bermuda, Cayman Islands, Hong Kong, Turks and Caicos and the British Virgin Islands
- States which are members of the British Commonwealth
- Singapore and Switzerland

This allows those European companies who may have historically chosen further away centres, such as Bermuda, to move closer to their European activities. **Furthermore a captive from one of the above named countries re-domiciling in Gibraltar, will be licensed and deemed as being incorporated in Gibraltar. The same captive will then be permitted to apply to be a Gibraltar Insurer, allowing it to write direct into the EEA.** It is also likely that reinsurance companies would benefit from the flexible tax regime through re-domiciliation.

In summary.

Gibraltar is at the threshold of a new era of growth in this area. Just in the last few months, there has been a surge in enquiries regarding setting up captive insurance companies in Gibraltar.

With the constant development of international commerce, whether you are a risk manager, legal representative, financial controller or (re)insurance broker, direct captives should be under serious consideration, and Gibraltar as a captive insurance location.

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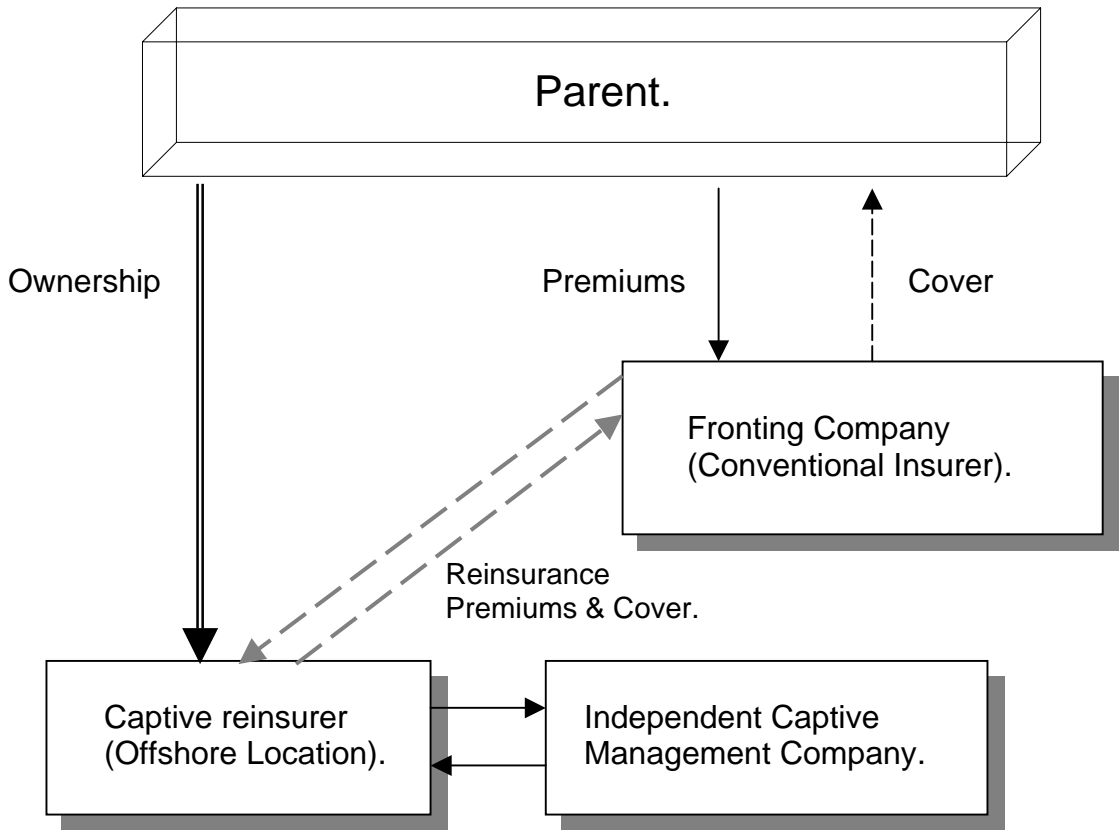
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① Source: Gibraltar Financial Services Commission Insurance Guidance Note No.10. The “Single Passport”.

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Flow Diagrams on next page.

Captive Reinsurance.



Direct Captive Insurance.

