REGULATION OF CAPTIVES IN THE FACE OF GLOBAL DOMICILES’ COMPETITION: CHALLENGES AND PERSPECTIVES

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I. INTRODUCTION

From Bermuda to China, renewed interest in captives has captivated investors from various industries—and as countries compete to capture the business of international conglomerates—suitable regulation of captives has never been more important. There are a variety of risk management tools, including traditional commercial insurance and alternative mechanisms of covering risks.1 Captive insurance, one of the alternative risk financing mechanisms, has been growing in popularity internationally.2 A captive insurance company (“captive”) is “an insurance company created and wholly owned by one or more non-insurance companies to insure the risks of its owner (or owners).”3 As a type of self-insurance vehicle,4 captives assume the risks exposed by their policyholders/insureds...
Unlike traditional commercial insurance, captives have earned global popularity due to their special benefits such as tax treatment, availability of coverage, affordability of cost, and better efficiency. In the wake of growing demands for captives, captive domiciles, which typically are a state, territory, or country in which the insurance companies are licensed and regulated, accordingly compete for the purpose of building the captive insurance market and further developing the local economy. If domicile selection is compared to picking a long-term business partner, it is easy to understand why domiciles are competing for more captive incorporation.

A notable expansion of domiciles shows a global increase in jurisdictions competing to be captive domiciles, thereby inevitably leading to global competition. Since the first modern captive came into being in Bermuda, captive domiciles have seen a dramatic geographic expansion from originally Bermuda and the Caribbean areas to North America, Europe, and Asia-Pacific Areas. With increasing demands for captives, a global race of constructing captive domiciles is rapidly intensifying. Under the

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7 MATTHEW QUEEN & LIGHT TOWNSEND, *MODERN CAPTIVE INSURANCE: A LEGAL GUIDE TO FORMATION, OPERATION, AND EXIT STRATEGIES* 4 (American Bar Association 2019) (“Domicile is defined by the state or country that licenses an insurance company and has the primary regulatory oversight over that business.”).

8 Insurance is regarded as a fundamental economic activity and even separating law of insurance from the economics of it is considered to be an artificial attempt. See Lloyd R. Cohen & Michelle E. Boardman, *Methodology: Applying Economic to Insurance Law -- An Introduction*, RES. HANDBOOK ON INT’L INS. LAW & REG. 19, 19 (Julian Burling & Kevin Lazarus eds., Edward Elgar 2011).

9 See QUEEN, supra note 7, at 4.


11 See Marsh & McLennan, *The Captive Landscape Report -- 50 Years of Risk Financing Innovation*, 1, 7, https://www.marsh-mbnj.com/en/campaigns/captive-report-2018.html (last visited Feb. 12, 2021) (“Captives have spread geographically into dozens of countries, evolved into multiple forms, and financed a variety of risks... North America and Europe continue to be home to most of the world’s captives, although strong growth is occurring in regions such as Asia-Pacific.”); In addition, according to the data of the Report, 38.1% of total captives worldwide are domiciled in North America, while the Caribbean shares 32.4%, the Europe occupies 25.1%, and 4.2% chooses Asia-Pacific.
circumstances, some core regulatory requirements have been under consideration more seriously, including: capitalization requirements, incorporation expenses, incorporation timelines, lines allowed to underwrite, and tax treatments.\textsuperscript{12}

Competition among domiciles will stimulate regulatory development such as Bermuda’s innovative sandbox and insurance hub.\textsuperscript{13} However, competition among the captive domiciles also comes with challenges which will impede regulation of captive insurance. On the one hand, regulation of captives is still lacking international and domestic collaboration. Typically, captives and the relevant risk locations often are separately situated in different jurisdictions,\textsuperscript{14} which means some captives might conduct cross-border\textsuperscript{15} supply of risk management services.\textsuperscript{16} On the other hand, it also causes some regulatory authorities to ignore potential challenges in strengthening regulatory requirements, by the headlong pursuit of more investors, fee revenue, and local employment.

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\textsuperscript{12} See QUEEN, supra note 7, at 5.

\textsuperscript{13} See Innovation, BERM. MONETARY AUTH., https://www.bma.bm/insurance-innovation (last visited Feb. 12, 2021) (“BMA recognizes the growing importance of innovation in the insurance and wider financial industry and the critical role that innovation plays in promoting efficiency and enhancing competitiveness in the market. It is to this end that the Authority launched two parallel innovation tracks: an Insurance Regulatory Sandbox (‘Sandbox’) and an Innovation Hub, both initially targeted at insurance technology (InsurTech) companies.”).


\textsuperscript{15} “Border” in international trade law originally means border of customs territory. For example, Mainland China and Macao China are separate customs territories.

\textsuperscript{16} According to the General Agreement on Trade in Services (GATS) by World Trade Organization (WTO), “[T]rade in services is defined as the supply of a service: (a) from the territory of one Member into the territory of any other Member; (b) in the territory of one Member to the service consumer of any other Member; (c) by a service supplier of one Member, through commercial presence in the territory of any other Member; (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.” See General Agreement on Trade in Services, art. 1, Apr. 15, 1994, 1869 U.N.T.S. 183. For instance, when a U.S. parent establishes its wholly-owned captive in Barbados to insure the risks from the parent’s business risks in the U.S., which means that the captive provides risk management services from Barbados into the U.S., falling within both mode (a) and mode (c).
This article includes six main parts. Following this introduction, Part II guides an overview of captives, including their origin, development, types, and lines allowed to underwrite. Next, Part III does a comparative research on the captive-related regulatory advantages among the main captive domiciles in the world. Then, Part IV, as one of the core parts of the paper, summarizes and analyzes four main challenges faced by the regulation of captives: (1) There is a lack of effective coordination in the area; (2) The prudential regulation is insufficient to ensure captives’ financial stability; (3) There are regulatory loopholes in controlling abuse of the fronting arrangements by captives; and (4) There is unclear regulation over insurers’ transfer of third-party risks to their captives. After that, Part V, the other core section, generally explains that traditional captive domiciles respond to the global competition with several regulatory innovations while the world insurance market is moving east with rising and developing Asian captive domiciles. In the end, Part VI concludes that the global regulation of captives is challenging and competitive, and effective global cooperation is necessary.

II. OVERVIEW OF CAPTIVES

The first modern captive was formed in the 1950s by Frederic M. Reiss, although captives trace their origins to the mutual insurance companies in the early marine voyages. So far there have been numerous types of captives, including: single-parent captives, group captives, association captives, rent-a-captives, and risk retention groups (RRG). Not only do they issue policies in the traditional lines, but they also provide coverage for the emerging risks.

A. The Origin and Development of Captives

In general, captives are created to satisfy some well-funded enterprises’ needs for risk transfer, and to deal with the upward trend of insurance premium rates and unavailability of commercial insurance in special fields. It is well recognized that the birth of captives could be traced

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17 See Hall, supra note 10.
20 For example, financial institutions, health care, manufacturing, retail/wholesale, transportation, construction, communication, media, technology, and energy share the vast majority of the industry by captives. See Marsh & McLennan, supra note 11, at 9.
from the early marine voyages. In the early 1500s, some London coffeehouses were popular with ship owners, who met there, shared shipping information, and shared risks among different shippers. Their mutual arrangements especially have been regarded as the infancy of captive insurance. As early as 1782, the members of a particular industry started to build mutual insurance companies to provide insurance coverage, which are similar to captives insuring the risks of their owners.

In the wake of increasing insurance premiums, some English and American businesses preferred to form their subsidiaries to insure their risks in order to reduce the cost of insurance. For example, in 1860, an insurance company called Commercial Union was established by a group of London merchants. In the 1800s, when high fire insurance rates were prevailing, a group captive (in the form of a mutual company), which “ultimately evolved into what is now known as the Factory Mutual System,” was established by New England textile manufacturers.

Although the mutual insurance arrangements have developed and expanded for a long time, the first modern captive was formed approximately 70 years ago. Not until the 1950s was the term “captive” created by Frederic M. Reiss. In the early 1960s, there were approximately one hundred captives worldwide. The past 30 years witnessed a significant growth in the

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21 See The Early Days of Captives (through 1984), supra note 18 (describing “Early captives shared risks among shippers on the same voyage and among different owners of different voyages.”).

22 See McAndrew, supra note 19.

23 Id.


25 See id.

26 See id.

27 See McAndrew, supra note 19.

28 Id.; See also CICA, Captives: An Overview, at 7, https://media.cicaworld.com/wp-content/uploads/2020/06/CICA_CaptiveOverview_2018_FINAL.pdf; See also The Early Days of Captives (through 1984), supra note 18.

29 See Hall, supra note 10 (stating “Reiss, known as the father of captive insurance, used the term “captive” to describe an insurance company he helped form to provide insurance coverage solely to the parent . . . In 1960, Bermuda became an offshore financial center and, in 1962, Reiss set up the first modern-day captive there called International Risk Management Ltd.”).

30 See CICA, supra note 28, at 7.
captive market, from roughly 1,000 captives in 1980 to 7,000 captives currently around the globe.\textsuperscript{31}

\textbf{B. Types of Captives}

In order to meet various needs, businesses have created numerous types of captives, mainly including: single-parent captives, group captives, association captives, rent-a-captives, and risk retention groups (RRG). A single-parent captive is the most common form among the captive market,\textsuperscript{32} which refers to "a captive solely and wholly owned by its parent company," and the parent solely provides funding source for it.\textsuperscript{33} According to the data at A.M. Best’s captive center, in January 2020, the share of single-parent captives was still the largest among all captives, amounting to approximately 37%.\textsuperscript{34} In theory, risks insured by single-parent captives initially were only limited to their parents’ risks or their siblings’ risks, while in practice some of them are willing to underwrite non-related parties’ risks or retain minor risks by purchasing reinsurance.\textsuperscript{35}

A group captive, also called multiple-parent captive, means a captive who is established by a group of unrelated entities to insure the risks from each of the entities.\textsuperscript{36} This form of captives can include stock captives as well as mutual captives.\textsuperscript{37} Akin to group captives, some association

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\item See Captive Insurance Companies, supra note 3 (The data originally came from AM Best Captive Center).
\item See Captives and the Management of Risk, (3rd ed.), IRMI (Oct. 2014) https://www.irmi.com/online/bkcaptive/glossary/appndx04.aspx#jd_s (Note: If a single-parent captive only insures its parent’s risks, the captive is referred to as a “pure captive.”).
\item See Glossary of Insurance and Risk Management Terms, supra note 33, at 111.
\item For example, Oil Insurance Limited is a Bermuda-based mutual captive, which “was formed in 1972 by 16 energy companies in response to two large-scale industry accidents that occurred in the late 1960s. The combination of an oil spill in Santa Barbara, California and a refinery explosion in Lake Charles, Louisiana resulted in inadequate coverage and pricing provided by the commercial markets, which triggered the formation of OIL [Oil Insurance Limited],” OIL INS. LTD., OIL HISTORY, https://www.oil.bm/history/ (last visited Feb. 12, 2021). However, it also recognized “mutual insurance company as a self-insurance syndicate,”
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Captives also have more than one owner/parent, however, these owners are typically correlated within a trade or professional association.\textsuperscript{38} For example, in order to avoid expensive commercial insurance costs, a medical malpractice captive in the United States (U.S.) was created by groups of doctors to insure professional risks.\textsuperscript{39}

Rent-a-captive, is a special arrangement based on a licensed captive, which “rents” the facilities relevant to a captive business to an unrelated entity without captive qualification in exchange for a renting fee.\textsuperscript{40}

In addition, the Risk Retention Groups (RRGs) are another specific type of group captives subject to the Risk Retention Act (RRA) of 1986 in the U.S., which authorizes particular group captives to cover all liability exposures except workers compensation exposures.\textsuperscript{41} Notably, the RRGs are created under the federal law which is specifically related to the field, where according to the reverse-preemption rule in the McCarran-Ferguson Act, the business of the RRGs is completely controlled by the RRA unless otherwise specified in a state statute.\textsuperscript{42}

C. Lines Underwritten by Captives

A captive is able to underwrite the identical risks as a commercial insurance company,\textsuperscript{43} because it is an insurance company by nature. However, it is established with special purposes. In practice, captives insure various types of risks, including the risks insured in the traditional commercial insurance market and those uncovered by traditional commercial insurers.\textsuperscript{44}
On the one hand, captives are formed to routinely provide coverage in traditional lines. They are especially welcomed in the lines of liability, including: primary general liability, products liability, auto liability, directors and officers liability, professional liability (such as medical malpractice), and excess and umbrella liability.45

On the other hand, as their purposes demonstrate,46 captives are utilized to underwrite some risks either unavailable in commercial market or available but with expensive premiums in the traditional market. Practically, there is a growing popularity to employ captives to deal with more complex emerging exposures, including: “medical stop-loss (MSL) coverage, miscellaneous legal expenses, cyber-liability, difference in conditions (DIC), and employee benefits.”47 In addition, captives are under consideration by construction project owners in some owner-controlled (or contractor-controlled) insurance programs (OCIPS or CCIPs), while some captives are established to provide the warranty programs with the financial supply.48

III. LEGISLATIVE ADVANTAGES IN CAPTIVES REGULATION AMONG DIFFERENT DOMICILES

The global leading captive domiciles mainly include: the traditional offshore domiciles (e.g., Bermuda and the Cayman Islands), the leading U.S. captive domiciles (e.g., Vermont and Utah), and the leading European captive domiciles (e.g., Guernsey and Luxembourg), each of which has the unique legislation to gain more captives. The main legislative advantages of Bermuda and Cayman are their flexible classified regulation and the loose tax regimes for captives. Moreover, the laws of Cayman Islands make it possible for a portfolio insurance company established by a segregated

45 See id.

46 See Captive Formation Consideration Basics; RF Perspectives, IRMI (Vol. 28 No. 1, Jan. 2011), https://www.irmi.com/online/rt/ch0news/11nws281.aspx (last visited Febr. 12, 2021) (stating “When developing the captive program, insureds should look at risks which can be addressed more cost efficiently, or risks for which it is difficult to arrange comprehensive coverage”).

47 Donald Riggin, Captive Insurance Innovations, THE RISK REP. (Vol. XXXIX, No. 8, Apr. 2017), https://www.irmi.com/online/rr/ch001320/captive-insurance-innovations.aspx (For example, “From a captive’s standpoint . . . MSL constitutes third-party insurance business, which may satisfy the Internal Revenue Service (IRS) guidelines for risk distribution necessary to make premiums deductible . . . [and] The goal of placing MSL into a captive is to [save the insurance cost] associated with the first layer of coverage excess of the per-employee self-insured retention.”).

48 See Captive Formation Consideration Basics; RF Perspectives, supra note 46.
portfolio company to operate as an independent captive. In contrast, Vermont and Utah of the U.S. regulate captives with efficient administration, friendly capitalization requirements, and low fees and taxes, according to their respective codified captive laws. For European domiciles, Guernsey has the advanced legislation to support captives to operate as protected cell companies or incorporated cell companies, while Luxembourg’s laws facilitate captives licensed under Luxembourg’s requirements to enter the markets of the other competent E.U. members.

A. Regulation of Captives in the Traditional Offshore Domiciles

There is a belief that captives originated from offshore jurisdictions, because it is well-recognized that captives established in the early times were offshore. Bermuda has become the largest captive domicile in the world since the 1980s. Until 2019, Bermuda, licensing 715 captives, still retained the largest share of captives globally. It was closely followed by the Cayman Islands (Cayman) (ranking at second place with 618 captives in 2019) and then Barbados (at sixth place with 294 captives in 2019).

54 Offshore captives refer to “special purpose insurance [companies] domiciled outside of the country where the insured risk is located.” See Glossary of Insurance and Risk Management Terms-definition of Offshore Captive, supra note 33.


57 See Background on: Captives and Other Risk-financing Options, supra note 53.

58 Id.
Bermuda, Cayman, Barbados, and other jurisdictions with a stable political environment and friendly regulatory climate are usually regarded as preferred captive domiciles.

i. Bermuda Implements the Innovative and Strict Legislation to Regulate Captives

In general, there is innovative and strict regulation of captives in Bermuda. The majority of Bermuda-based captives underwrite risks originating from North America and Europe. Bermuda has been widely recognized to have a “blue-chip reputation,” and the Insurance Act of 1978 (as amended), collaborating with other related regulations such as the Companies Act of 1981 (as amended) and the Insurance Returns and Solvency Regulations of 1980 (as amended), has basically built-up the legal framework for captives regulation.

(a) Proportional Classified Regulation over Captives

There is a classified regulatory insurance regime in Bermuda, contributing to a flexible regulation of captives. Under the multi-license regulatory system, general insurers are categorized into six classes, including: single-parent captives (class 1), multi-owner captives (group captives and association captives) (class 2), commercial insurers or captives.

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59 Id. (demonstrating the third to the fifth places individually stood the U.S. states of Vermont, Utah, Delaware, which would be discussed next section).

60 Of the three traditional domiciles, Bermuda and Cayman have developed the systemic legislation in favor of captives, which will be analyzed in the following subsections. For Barbados, the major legislative advantage is its loose tax policy that zero tax is imposed upon the captives underwriting related risks. See Barbados Repeals Exempted Insurance Act, Captives Maintain Zero Tax, CAPTIVE (Nov. 21, 2018), https://www.captive.com/news/2018/11/26/barbados-repeals-exempted-insurance-act-captives-zero-tax.


62 See BMA Captive Report 2018, supra note 14, at 3 (exhibiting “In 2017, as in the prior year, the majority of risk assumed by Bermuda captives originated in North America and Bermuda – 69% – and Europe – 19%. This is unsurprising considering 75% of captives have a parent in these domiciles. The Authority observed an increase in business written from the United States and a reduction in EU business in 2017 as compared to 2016.”).

63 See Bermuda Captive Market 2017, supra note 56.

64 See Bala Nadarajah et al., Bermuda, IFLR (Jun. 24, 2003), https://www.iflr.com/article/b1ltxvbdp0q4nn/bermuda.


67 See id. at § 4C.
with more capitalization and surplus, excess liability (re)insurers and property catastrophe reinsurers (class 4),\(^{68}\) and the other three types of special commercial insurers and captives (including: class 3, class 3A and class 3B).\(^{69}\) In addition, long-term insurers are classified into five groups,\(^{70}\) and special purpose insurers are regulated as an individual class.\(^{71}\) Under the circumstances, minimum capital and surplus requirements, regulatory fees, solvency margins, and other requirements vary in each class.\(^{72}\) Generally, a lighter regulation is imposed upon the single-parent captives and group or association captives, while regulatory stringency grows with their increasing business capacity.\(^{73}\)

(b) Tax-free Treatment of the Exempted Insurers

The vast majority of captive owners care about friendly tax treatment even though taxation is not the only factor for domicile selection. Bermuda law allows a non-Bermuda business to incorporate a Bermuda-based company in order to conduct business outside of Bermuda, which is called an exempted company.\(^{74}\) Under Bermuda legislation, those exempted are treated tax-free on profits, income, dividends, and capital gains, and duty-free in estate and death, although they are still required to undertake annual fees.\(^{75}\) These taxation exemption rules will likely remain in effect until 2035.\(^{76}\)

(c) International Tax Recognition for Insurance Businesses

In addition to almost zero taxes charged by Bermuda’s government, Bermuda’s international tax treaties increased Bermuda’s competitive position. Bermuda “did its best” to help its insurers to get the similar free tax

\(^{68}\) See id. at § 4E.

\(^{69}\) See id. at §§ 4D, 4DA & 4DB.

\(^{70}\) See id. at §§ 4EB, 4EC, 4ED, 4EE & 4EF.

\(^{71}\) See id. at § 5(2).


\(^{74}\) See Companies Act, 1981 (Berm.), sec. 127.


\(^{76}\) See Non-US Captive Insurance Domicile Comparison Chart, supra note 72.
treatment via many international tax treaties.\textsuperscript{77} For example, in light of the US-Bermuda Tax Treaty of 1986,\textsuperscript{78} a Bermuda-based insurance company would be basically free of the U.S. income tax.\textsuperscript{79} Additionally, the treaty is targeted at tax matters solely in insurance business,\textsuperscript{80} which highlighted parties’ purpose in liberalizing trade and investment in international insurance services. For another example, the Canada-Bermuda Tax Information Exchange Agreement, which promotes the exchange of tax information, actually brought waves of Canadian investment, such as the establishment of captives, into Bermuda “through the repatriation of tax-free dividends to Canada–creating a win-win situation for both countries.”\textsuperscript{81}

ii. The Cayman Islands (“Cayman”) Has the Sophisticated and Unique Legislation for Captives

Likewise, Cayman\textsuperscript{82} has also established a sophisticated and unique legal regime for captive regulation which remains a popular option for health care captives.\textsuperscript{83}

\textsuperscript{77} Yelena Tsvaygenbaum, \textit{A Tax Treaty that Doesn’t Tax - The Unique History of the United States-Bermuda Tax Treaty and the Subsequent Problems Facing the United States Insurance Industry}, 15 CONN. INS. L.J. 267, 267 (2008). International multilateral/bilateral tax agreements/treaties are typically used to avoid double taxation, to attack illegal tax evasion, or to achieve both, through information exchange and international cooperation.


\textsuperscript{79} Id. at art. 4.1 (“The business profits of an enterprise of insurance of a Covered Jurisdiction derived from carrying on the business of insurance (including insubstantial amounts of income incidental to such business) shall not be taxable in the other Covered Jurisdiction unless the enterprise carries on or has carried on business in the other Jurisdiction through a permanent establishment situated therein . . .”).

\textsuperscript{80} See id.; See also Tsvaygenbaum, supra note 77, at 367.


\textsuperscript{82} Cayman is especially competitive in medical malpractice liability, which shared 26% of licenses in Cayman insurance market, and Workers’ Compensation, which shared the second most licenses at 22%. See \textit{International Insurance Company Statistics (In US$) statistics by Primary Class of Business}, CAYMAN IS. MONETARY AUTH. (Mar. 31, 2020), https://www.cima.ky/upimages/commonfiles/InsuranceCompanybyPrimaryClassofBusinessQ12020_1587142167.pdf.

\textsuperscript{83} See James A. Christopherson, \textit{Captive Medical Malpractice Insurance Company Alternative}, 5 ANNALS HEALTH L. 121, 138 (1996) (“The first health care captive-started by Harvard University in the 1970’s-was originally to be domiciled in Bermuda. However, Bermuda regulators resisted the captive’s formation because of a fear of physician malpractice...“).
(a) Classified Regulations over Captives

In order to provide a suitable regulation, the Insurance Law of Cayman 2010 also adopts a multi-license regulation regime for insurers, but it differs from Bermuda law. Cayman classifies insurers granted with licenses into four groups, in which minimal capital requirements, application fees, and annual license fees vary. Whereas the classification is not solely based on the size of business referred to in Bermuda law, instead, it particularly distinguishes domestic captives (Class A), offshore captives (Class B), and special reinsurers (Class C and Class D). Accordingly, the special classification between domestic captives (Class A) and offshore captives (Class B) contributes to a legislative difference, which is much more favorable to offshore captives. For example, there are significantly lower application fees and annual fees for Class B than Class A, which is considerably attractive for the foreign investors eager to reduce application costs. As of September 2020, captives shared 87.4% of the total insurance companies based in Cayman.

(b) Tax Neutrality Systems

Similar to Bermuda law, it is well-known Cayman does not require the payment of income tax, corporation tax, or capital gains. Thereby the only costs for captives are their licensing fees and annual fees. In addition to risk. So the captive was domiciled in the Cayman Islands. Beginning with the Harvard captive, the Cayman Islands has been the domicile of choice for many other health care captives.

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84 See Insurance Law, 2010 (Law no. 32/2010), § 4(3)(a), (Cayman Is.).
85 See id. at § 4(3)(b).
86 See id. at § 4(3)(c).
87 See id. at § 4(3)(d).
88 Offshore captives are charged for application fee and annual fee from $8,500 through $10,500 while domestic captives are charged with $75,000. See id. at Schedule 2.
89 See id.
90 See Insurance Statistics Overview, CAYMAN IS. MONETARY AUTH., https://www.cima.ky/insurance-statistics (last visited Nov. 8, 2020) (demonstrating “There were a total of 775 insurance licensees under the supervision of the Insurance Supervision Division (the “Division”) as of 30 September 2020, of which 98 and 677 related to domestic and international insurance markets respectively.”).
eliminating double taxation risk, the tax-free environment in Cayman maximizes social welfare by decreasing the cost of operating captives, which accordingly improves efficiency of capital flowing without prejudice to the taxation system of the parent companies’ jurisdictions.

(c) Progressive Legislation on the Segregated Portfolio Companies

For the owners seeking to establish their segregated portfolio companies (SPCs), Cayman is more competitive due to special legislation. SPCs have grown to be the second largest group of Cayman-based insurance companies. To some extent, the legislation plays an incentive role in boosting growth of SPCs. SPCs are also called “Cayman’s version of incorporated cells companies,” which are popular due to “cost savings through the economy of scale that a [portfolio] captive can offer.” In Cayman, a portfolio insurance company (PIC) has been recognized as an independent legal entity registered as an exempted company which is established by SPCs. A PIC, as an entire legal entity, has its own separate account and individual liability, which reduces its business risks associated with other cells under the SPC. In addition, it is able to contract with other PICs/cell insurers, which solves a longstanding limitation for SPCs -- segregated portfolios in the SPC cannot contract with each other.

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94 See Tax Neutrality Benefits, supra note 92.
95 As the statistics of March 2020, Segregated Portfolio Companies shared 20% of licenses in Cayman insurers while the largest one is Pure Captives at 43%. See International Insurance Company Statistics, supra note 82.
96 See Butler, supra note 49, at 3.
98 See Insurance (Portfolio Insurance Companies) Regulations, 2015 (Cayman Is.), reg.3; See also Ogier, Portfolio Insurance Companies in the Cayman Islands (Oct. 2, 2015), https://www.ogier.com/publications/portfolio-insurance-companies-in-the-cayman-islands (describing a structure: “New or existing insurers (other than Class A Insurers) operating as SPCs are now able to incorporate one or more of their segregated portfolios by establishing one or more “portfolio insurance companies” (PICs) underneath the SPC. In essence, a PIC is a Cayman Islands exempted company that is a subsidiary of the SPC under which it is established but is related to a particular cell of such controlling SPC.”).
99 See Butler, supra note 49, at 1.
B. Regulation of Captives in the U.S. Domiciles

As of May 2020, 34 U.S. states, the District of Columbia, Guam, Puerto Rico, and Virgin Islands have formed regulations and legislation concerning captives. Of these, Vermont and Utah are the largest captive domiciles in the U.S.101

i. Vermont’s Codified Captive Law Provides A Transparent and Friendly Regulation of Captives

Enactment of the Special Insurer Act of 1981 made Vermont the first U.S. state to compete for captives against Bermuda and Cayman.102 The law is designed to provide a captive-friendly regulatory climate within the state and to develop a local captive market.103 Since the passage of the Act, a wave of parents settled their captives in “the Green Mountain State,”104 and Vermont rapidly moved into the forefront in captive business both domestically and globally.105 As of the end of 2019, Vermont, with 585 captives operating, has become the largest captive domicile in the U.S. as well as the third largest domicile in the world.106

Similar to traditional offshore captive domiciles, Vermont offers the advantages of efficient administration, cheap fees, and favorable tax


101 See Background on: Captives and Other Risk-financing Options, supra note 53.

102 Note that Vermont is the first state to aim to compete with international offshore captive domiciles, rather than the first state to recognize captives’ formation. “Colorado, which, in 1972, became the first US state to allow captive formations, has seen little growth over the years in the number of licensed captives. Currently, Colorado has seven captives, compared to eight in 2006.” See How the United States Became Home to More Captives Than Any Other Country, IRMI, https://www.captive.com/news/2019/05/29/how-the-us-became-home-more-captives-than-any-other-country (last visited Feb. 12, 2021).


105 See Background on: Captives and Other Risk-financing Options, supra note 53.

106 See id.
Unlike Bermuda and Cayman, which charge no tax, there is a premium tax on the Vermont-based captives. However, the rate is very low.108

In an effort to compete with Bermuda and Cayman, Vermont’s aggressive legislating has kept its captives statutes up-to-date.109 For example, since 1988, Vermont has recognized captives to directly insure excess workers compensation risks.110 In 1993, a bill was enacted to significantly slash captive premium taxes.111 The 2008 bill established a more enabling approval process to facilitate the use of letters of credit for captive capitalization.112 The 2009 Bill created a premium tax credit for new captives born in the second half of the year.113 The new legislation passed in 2017 saw that agency captives began to be recognized as types of captives in Vermont.114

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108 See Vt. Stat. tit.8, § 6014 (West (2020)). In Vermont, generally there are lower tax rates of reinsurance than those of direct insurance for the same amount of premiums, and the rates would drop down as the premiums go to the class with higher amount. For example, for the direct insurance premiums, the rate is 0.38% for the first 20 million dollars while the rate is 0.072% for the part exceeding 60 million dollars. On the other hand, for the part beyond 60 million dollars, the rate for reinsurance premiums is 0.024%, much lower than that of direct insurance premiums.
109 See Morriss, supra note 107, at 60.
110 See Charting Vermont’s Captive Insurance History, BUS. INS., https://www.businessinsurance.com/article/20060806/story/100019430/charting-vermonts-captive-insurance-history (last visited Feb. 12, 2021); See also Vt. Stat. tit.8, §6002 (a)(8) (West (2020)) (demonstrating, “Any captive insurance company may provide excess workers’ compensation insurance to its parent and affiliated companies, unless prohibited by the federal law or laws of the state having jurisdiction over the transaction. Any captive insurance company, unless prohibited by federal law, may reinsure workers’ compensation of a qualified self-insured plan of its parent and affiliated companies.’”).
111 See Advantages of Captive Insurance, supra note 103; See also Vt. Stat. tit.8, § 6004 (c) (West (2020)) (providing, “Capital and surplus may be in the form of cash, marketable securities, a trust approved by the Commissioner and of which the Commissioner is the sole beneficiary, or an irrevocable letter of credit issued by a bank approved by the Commissioner.”).
112 Id.
113 Id.
Moreover, codification of Vermont captive law makes requirements clearer for the captives’ owners, given that codification is clearly articulated and easily accessible to the public.115 Unlike Bermuda, Cayman, and Barbados, in which the captive-related law and regulation are scattered in several acts, Vermont captive insurance law was codified in 2003, and the new amendments have been inserted into the statutes over time.116 Vermont captive law was recodified with the emerging amendments, building it into a cohesive and transparent entire body of law.117

In addition, captives regulation in Vermont also attracted attention of other states such as Connecticut. For example, an act concerning captive insurance companies (Connecticut Senate Bill 281),118 which was signed by the Governor of Connecticut on June 2, 2008, has been recognized as modeled on the captive regulation of Vermont.119

ii. Utah Code Provides a Support to Build a Loose Regulation for Captives

Not far behind Vermont, Utah is the second largest domestic captive domicile and also the fourth largest one globally, with 435 licensed captives in 2019.120 The development of captives in Utah is especially dramatic, as the state adopted its first captive legislation recently in 2003121 and then soon after started licensing captives.122 Likewise, the captive-related legislation has been codified in Utah Code, mainly including: the Captive Insurance Companies Act123 and the Special Purpose Financial Captive Insurance Company Act.124 Similarly, Utah has adopted numerous captive-friendly

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116 See Advantages of Captive Insurance, supra note 103.
117 Id.
120 See Background on: Captives and Other Risk-financing Options, supra note 53.
122 See Cassandra R. Cole & Kathleen A. McCullough, Captive Domiciles: Trends and Recent Changes, 26-4 J. INS. REG. 61, 69 (Summer 2008).
124 See id. at § 31A-37(a)-101.
laws by: removing restrictions on the types of captives and the lines underwritten, eliminating burdens of premium taxes, lowering minimum capital and surplus requirements, and keeping confidential captive records.\textsuperscript{125} Especially in contrast to Vermont, Utah’s annual fees have replaced premium taxes since January 2005.\textsuperscript{126} However, property taxes on the personal and real property of captives still apply in Utah.\textsuperscript{127}

C. Regulation of Captives in the European Domiciles

In Europe, Guernsey is well-known for its innovative legislation that encourages captives to carry on business as the new forms while Luxembourg is preferred due to the “EU-passport for insurers.”\textsuperscript{128}

i. Guernsey’s Ground-breaking Legislation Makes it a Pioneer in Captives Regulation

Guernsey is the largest captive domicile in Europe,\textsuperscript{129} as well as the ninth largest worldwide with 305 captives in 2019.\textsuperscript{130} In addition to the features common to traditional captives jurisdictions, Guernsey has its own selling points on basis of its unique location.

On the one hand, Guernsey, located in the English Chanel, enjoys close proximity to London, which keeps it competitive for the companies seeking to enter into the U.K. market.\textsuperscript{131} On the other hand, since it is situated in Europe but not a member of the European Union (E.U.), Guernsey is particularly suitable for some investors who are eager to expand business to
the European market but are hesitant to comply with the Solvency II of the E.U.\textsuperscript{132}

On the aspect of regulatory legislation, a notable differentiation of Guernsey is its ground-breaking legislation applied to captives, including: first permitting captives to do business as protected cell companies (PCCs)\textsuperscript{133} and introducing the incorporated cell companies (ICCs) legislation concerning captives.\textsuperscript{134} Especially under the ICCs regulatory environment, Guernsey is a pioneer in strongly supporting captives set up as ICCs to participate in the transfer of longevity risks for pension funds.\textsuperscript{135} Guernsey is in the forefront of ICC captives because recently captive-based longevity risk swaps managers prefer establishing Guernsey-domiciled ICCs to deal with the risk transfer.\textsuperscript{136} For example, the BT Pension Scheme\textsuperscript{137} formed a pure captive to access reinsurance from the US-based life insurer Prudential, thus indirectly transferring its longevity risks through its captive to Prudential (reinsurance market).\textsuperscript{138} Still based on the cell structures, on the other hand, Guernsey takes the lead in allowing captives to do insurance-linked security (ILS) business.\textsuperscript{139}

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\textsuperscript{133} See McConvill, supra note 50.
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\textsuperscript{134} Id. at 31.
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\textsuperscript{135} See Longevity Risk Transfer: Peace of Mind for Scheme Sponsors, Trustees and Members, WE ARE GUERNSEY, https://www.weareguernsey.com/media/4966/longevity-risk-transfer.pdf (last visited Feb. 12, 2021) (“The difficulty is that pension funds are not licensed to directly access the reinsurance market . . . [and the solution is] [a] pension trustee can form a captive insurance company, typically a Guernsey-domiciled Incorporated Cell Company . . . which issues an insurance contract to the pension scheme. The captive insurance company then cedes 100% of the risk to the pension trustee’s chosen reinsurer. In this manner, the pension trustee has gained access to the reinsurance market, to which the longevity risk has been transferred.”).
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\textsuperscript{136} Id.
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\textsuperscript{137} BT refers to British Telecom. The BT Pension Scheme is the largest private-sector pension scheme in the U.K. See Geof Stapledon, Termination Benefits for Executives of Australian Companies, 27 SYDNEY L. REV. 683, 694 (2005).
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ii. Luxembourg’s Laws Facilitate Local Captives to Expand Business to Other E.U. Members

Behind Guernsey, Luxembourg is the second largest captives jurisdiction in Europe with 195 captives in 2019, as well as the second largest reinsurance captive domicile, with a regional market share of 24% in Europe. Unlike Guernsey, Luxembourg is an E.U. member, which means Luxembourg is obligated to implement the E.U. law concerning insurance regulation and thus Luxembourg-based captives are indirectly subject to the E.U. regulatory environment. Generally, the captives in Luxembourg are governed by the law of 7 December 2015 on the insurance sector (as modified) and the law of 27 July 1997 on insurance contracts. Both of these laws are responses to EU’s Directive 2009/138/EC of 25 November 2009 (typically called Solvency II). In addition, Luxembourg-domiciled captives received an advantage in 2007 when Luxembourg approved mutual recognition of authorizations and prudential control systems by starting implementing the European Reinsurance Directive 2005/68/EC ("The Directive"). Thus, if a captive is authorized to do reinsurance business by Luxembourg’s regulatory authority according to the local regulatory standards, it is also allowed to carry on its business in the jurisdictions of the other E.U. members which also implement the Directive. Under the circumstances, the Luxembourg-domiciled captive is still only subject to the financial requirements of Luxembourg even if it expanded its business

140 See Background on: Captives and Other Risk-financing Options, supra note 53.
142 See Luxembourg Captive Reinsurance Companies, supra note 52.
145 See Luxembourg Captive Reinsurance Companies, supra note 52.
146 See 2005 O.J. (L. 323) 2, https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex:32005L0068 (last visited on Feb. 12, 2021) ("... The Member State of the branch or of the provision of services may not require a reinsurance undertaking which wishes to carry on reinsurance business in its territory and which has already been authorized in its home Member State to seek fresh authorization ... "); See Luxembourg Captive Reinsurance Companies, supra note 52 (“The [European Reinsurance Directive 2005/68/EC] ensures the mutual recognition of authorizations and prudential control systems, thereby making it possible to grant a single authorization that is valid throughout the European Union, while applying the principle of home country [e.g., Luxembourg] supervision.”).
beyond Luxembourg, because the Directive prohibits the additional financial supervision by non-Domicile states.  

IV. CHALLENGES IN REGULATION OF CAPTIVES

While captives’ flexible types, cheap costs, and friendly tax treatments make captives increasingly popular around the world, these advantages create challenges for regulators. First, there is a lack of effective coordination in regulation of captives, both on the international level and the interstate level of the U.S. Second, the existing prudential regulation is insufficient to safeguard the captives’ financial stability. Third, no special regulatory regime has been formed to prevent abuse of the fronting arrangements by captives. Finally, as the increasing insurers transfer their written risks to their captives, it has been in debate whether the old regulation is still applicable to the new problems in the area, particularly on the transparency issue of life insurance.

A boom in the industry significantly relies on favorable captives’ regulation specially designed for those companies. However, that favorable regulation does not necessarily equal excessively loose regulation, and moreover it should be seriously considered whether the primary objective of the regulation should be facilitating captives-based economy or focusing on consumer protection.  

A. Lack of Effective Coordination in Regulation of Captives

The absence of effective harmonization around the globe as well as in the U.S. puts regulation of captives to an acid test.


It is not necessary to develop identical supervisory and regulatory systems around the world, instead, effective and coordinated rules would properly regulate captives. In general, the Insurance Core Principles (ICPs)

147 See 2005 O.J. supra note 146 (“... Furthermore a reinsurance undertaking which has already been authorized in its home Member State should not be subject to additional supervision or checks related to its financial soundness performed by the competent authorities of an insurance undertaking which is reinsured by that reinsurance undertaking”).

issued by the International Association of Insurance Supervisors (IAIS) are a set of flexible rules to develop a uniform and coordinated supervisory and regulatory system around the globe, however those rules face challenges to implementation.

In 2011, the IAIS formally issued the ICPs, which are a set of benchmarks for insurance supervision. They serve to maintain consistent, highly-efficient supervision over insurers for all the jurisdictions for the purpose of consumer protection and financial stability in the insurance industry. They cover supervision over insurers and reinsurers, over private insurers and government-controlled insurers, and over traditional insurance as well as digitally-conducted insurance. Also, they include general requirements relating to insurance regulation, such as reinsurance, other forms of risk transfer, and enterprise risk management for solvency purposes and capital adequacy. Thus, ICPs are also potentially

152 See id. at 7.
153 See ICPs 13 Reinsurance and Other Forms of Risk Transfer, INT’L ASS’N OF INS. SUPERVISORS, https://www.iaisweb.org/index.cfm?event=icp:getICPList&nodeId=25227&icpAction=listICPs&icp_id=7&showStandard=1 (demonstrating “The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.”); See also id. stand. 13.1 (demonstrating “The supervisor requires ceding insurers to have a reinsurance programme that is appropriate to their business and part of their overall risk and capital management strategies.”); id. stand.13.2 (demonstrating “The supervisor requires ceding insurers to establish effective internal controls over the implementation of their reinsurance programme.”).
155 See ICP 17 Capital Adequacy, INT’L ASS’N OF INS. SUPERVISORS, https://iaisweb.org/index.cfm?event=icp:getICPList&nodeId=25227&icpAction=listICPs&std_id=31&icp_id=1&showStandard=1&showGuidance=1&s=31 (demonstrating, “The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.”).
applicable to captive insurance, even though application ultimately depends on corresponding regulatory legislation in each individual jurisdiction.

The IAIS rules provide flexible references to supervision and regulation of insurance around the globe. First, nothing suggests that IAIS, as well as its ICPs, is created to achieve an identical supervisory and regulatory system globally. As the IAIS’s mission indicates, effective policyholders protection and financial health, which are based on a safe and sound insurance markets, are calling for effective and consistent insurance supervision and regulation. In addition, “proportionality,” which underlies the ICPs, encourages supervisory and regulatory authorities to translate the ICPs’ principle and standards into a suitable framework in an appropriate manner based on the local environment. Notwithstanding the IAIS’s calls on its members to consider observing the ICPs, it still emphasizes the flexibility and the proportionality of application.

To some extent, the original nature of the IAIS caused its implementation problem. Unlike the World Trade Organization (WTO), under which all the members are bound by multilateral agreements like the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS), the IAIS is a voluntary international organization of insurance supervisors and regulators from members. Therefore, absent a binding effect, the IAIS’s high standards only play a persuasive role. The ICPs to the members are more like the National Association of Insurance Commissioners (NAIC) model laws to the states of the U.S. In a sense, the “guidance” nature of the ICPs has to leave the power to implement or not implement them to individual

157 Id.
160 See IAIS Members List, INT’L ASS’N OF INS. SUPERVISORS (last updated May 17, 2020), https://www.iaisweb.org/page/about-the-iais/iais-members (describing that until May 17, 2020, the IAIS has registered 214 members in total, including: 153 members, 7 international members, and 56 NAIC members).
sovereign authorities. In addition, actual implementation levels of ICPs also vary significantly among members as well as particular principles and standards. Thus, it is far less than a uniform and consistent implementation of ICPs around the world.

In addition to the general problem in enforceability, the flexibility of those principles and standards are questioned in the competition among the captives’ domiciles. Notably, proportionality and relaxed standards of the ICPs are beneficial for supervisors and regulators. However, they also come with substantial challenges for global insurance regulation. To some extent, the excessive flexibility if the ICPs makes the sovereign authorities totally free to design their own framework with more discretion to better serve their competitive objective. Moreover, in the face of global competition, particular domiciles may be driven by economic profits from captive-related investments and would therefore set out supervisory and regulatory rules that favor investors without prejudice to the general principles in the ICPs. More flexibility in designing regulatory approaches results in less transparency in implementing those requirements and regulation of business. Although the discretion authorized by the ICPs stimulates regulatory competition among the captive domiciles, it would lead to a new issue of how to balance

164 For example, under Principle 1, “[For] all regions, the observance of ICP 1 ranged between 46% - 75% except for Latin America where all participating Members were rated largely observed . . . All Members from the North America and Western Europe Regions observed Standard 1.2 (definition of objectives, mandate of the supervisor and legal powers), whereas there was an overall observance level at 80%.” See Peer Review of Mandates and Supervisory Powers Relative to the Standards Set Out in Insurance Core Principles 1 and 2, INT’L ASS’N OF INS. SUPERVISORS, at 11 (Nov. 2019), https://www.iaisweb.org/page/supervisory-material/implementation-and-capacity-building/assessments//file/68319/aggregate-report-from-the-expert-team-conducting-the-self-assessment-and-peer-review-of-icps-13-and-24. Under Principle 13, “Overall, observance levels for ICP 13 appear high, but a large number of jurisdictions are Partly Observed . . . [However][.] [t]he Expert Team is aware that a number of supervisors have approached the IAIS with practical questions related to implementation of requirements for reinsurance activities and on-going supervision of reinsurance activities by primary insurers.” See Report from Expert Team Conducting the Self-Assessment and Peer Review of ICPs 13 and 24, INT’L ASS’N OF INS. SUPERVISORS, at 11 (Aug. 2017), https://www.iaisweb.org/page/supervisory-material/implementation-and-capacity-building/assessments//file/68319/aggregate-report-from-the-expert-team-conducting-the-self-assessment-and-peer-review-of-icps-13-and-24.
166 Id.
competitive regulation intended to attract capital and regulation protecting the public interests (e.g., policyholders’ interests). The solution to this issue is not clear yet, on the basis of operation and exploration of the IAIS and its ICPs.

ii. In the U.S.: Lack of Interstate Coordination on Captives Regulation in the Competition for Captives

Although the vast majority of countries adopt a national-level regulation of insurance, the U.S. is an exception by having state-level regulation.\(^{167}\) In the U.S., regulation of insurance has been left to each state since those powers were finalized with the advent of the McCarran-Ferguson Act.\(^{168}\) In practice, as non-traditional insurers, captives have also been subject to state regulation.\(^{169}\) In addition to an increasing number of states updating new legislation concerning captive regulation such as Vermont, Utah, and Nevada,\(^{170}\) those without relevant regulations are considering adding them.\(^{171}\) For example, Connecticut has recently begun updating its captive legislation and building its own captive regulation regime, aimed at capturing captives currently domiciled abroad.\(^{172}\)

States regulation of captives is facing some challenges. First, multiple roles of state regulatory authorities raise an issue of how to: balance multiple interests such as stabilizing financial environment, protecting policyholders, and attracting more investment in the face of fierce interstate and international competition of the captives market. Captives are distinguishable from traditional commercial insurance companies on the basis of their stronger “investment” factor,\(^{173}\) which means more protection

\(^{167}\) See Peter Kochenburger & Patrick Salve, An Introduction to Insurance Regulation, in RESEARCH HANDBOOK ON INTERNATIONAL INSURANCE LAW AND REGULATION 223 (2011).

\(^{168}\) See 15 U.S.C. § 1012(b) (2012) (“No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . ”).


of investment would be considered by state authorities for economic efficiency purposes.\(^{174}\) In traditional insurance regulation, generally the issues concerning protection of policyholders are primarily emphasized, such as premium rate, policy term, and guaranty funds.\(^{175}\) However, adequacy of capitalization and management competence are seen to be competitive advantages for captives regulation.\(^{176}\) Recently, some states have been caring more about the number of captives domiciled and seemingly regarding it as a primary indicator to succeed in captives regulation.\(^{177}\)

Second, national-level coordination in captives regulation is absent in the United States. Little federal legislation specifically relates to regulation of captives so that risks, arising out of discretion, lack guidance and restriction from the national level. In general, there is rare special federal-level legislation of insurance, but with limited exceptions such as the National Insurance Flood Plan (NFIP) and the Terrorism Risk Insurance Act (TRIA).\(^{178}\)

The Federal Reserve System, the U.S. Treasury’s Federal Insurance Office (FIO) and the NAIC, informally known as “Team USA,”\(^{179}\) play a national-level, macro-supervisory roles to monitor the insurance industry, however, with limited substantial effects in practical regulation of captives. Of these, the NAIC faces the most significant challenge concerning regulation of captives. There are a great number of similarities in insurance statutes of the U.S. states, which were largely achieved by coordinating efforts of the NAIC in the form of model laws.\(^{180}\)


\(^{176}\) Id.

\(^{177}\) See Haley M. Heath, Samuel C. Baber, Arkansas Insurance Department Eager for Creation or Re-Domicile of Captive Insurance Programs, 54-SPG ARK. LAW. 24, 24 (2019) (“It has been two years since Governor Hutchinson signed Act 370, which improved the regulatory environment for captive insurance companies domiciled in Arkansas, into law. However, as of January 2019, only six captive insurance companies are domiciled in Arkansas. In the 2019 session, the Legislature further expanded the state’s insurance captive law to make the state’s regulatory environment even friendlier to insurance captives.”).

\(^{178}\) See Kochenburger & Salve, supra note 167, at 226.

\(^{179}\) See Statement by Thomas Sullivan Associate Director Board of Governors of the Federal Reserve System before the Committee on Banking, Housing, and Urban Affairs U.S. Senate, 116th Cong. 1-6, (2019) (testimony by Thomas Sullivan on insurance regulation).

\(^{180}\) See James Smethurst et al., Conduct of Business Regulation: A Survey of the UK Regime and A Comparison with the US, German and Hong Kong Approach, RES. HANDBOOK ON INT’L INS. LAW & REG. 355, 355 (Julian Burling & Kevin Lazarus ed., Edward Elgar 2011)
largely depends on the differences in legislation and regulation. For example, the vast majority of captives operate as reinsurers in the domiciles with friendly regulatory climate but enter another insurance market via fronting plans. However, based on the premise of consumer protection, the NAIC is considering creating model acts to eliminate those differences favorable to captives. In other words, the nature of captives operation is to some extent opposite to the objective of the NAIC.

According to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), “the Federal Reserve is responsible for the consolidated supervision of insurance holding companies that own an insured bank or thrift, as well as insurance holding companies designated for Federal Reserve supervision by the FSOC,”181 while the FIO generally monitors the insurance industry nationally as a whole, assisting in administering the TRIA program, developing federal policy on international insurance matters including representing the U.S. in the IAIS, and negotiating covered agreements with non-U.S. jurisdictions.182 In general, due to the macro-supervisory feature, there are limited effects on coordinating supervision and regulation of captives from the national level.

B. Insufficient Prudential Regulation to Ensure Captives’ Financial Stability

The development of captives is also challenging prudential regulation in the industry. A forefront issue is that the existing prudential regulation is insufficient to ensure that captives are financially capable of paying their claims. Prudential regulation is aimed at contributing to the stability and soundness of a financial institution (micro-prudential regulation) as well as the safety and health of the whole financial system (macro-prudential regulation).183 Generally, this type of financial regulation sets out

(“The NAIC has drafted model statutes that apply to numerous areas of insurance regulation. Almost all of these model statutes have been enacted into law by states, albeit with many minor and a few major changes.”).


requirements on capital and liquidity.\textsuperscript{184} Naturally, one of the goals for insurance regulation is to ensure insurance companies have the ability to pay their policyholders’ claims when coverage is triggered,\textsuperscript{185} which is closely related to solvency regulation.\textsuperscript{186} As a part of prudential regulation,\textsuperscript{187} disclosure requires that the significant data or information concerning the financial firms’ financial health should be available to insurance regulators.\textsuperscript{188} Under the circumstances, insurance companies are obligated to disclose their financial conditions to regulators in a complete and accurate manner.

In regulation of insurance including regulation of captives, there is a global knowledge that the amount of liquidity held by an insurance company should be in proportion to the risks it assumes. Not only the widely recognized Solvency II of the E.U.,\textsuperscript{189} but also the Risk-Based Capital system of the U.S.\textsuperscript{190} emphasizes that minimum amount of capital should be appropriate to insurers’ fundamental operation (i.e., the amount of the undertaken risks, including the risks insured by insurers plus the internal

\textsuperscript{186} See Louise Steinberg, International Organisations: Their Role and Interconnectivity in Insurance Regulation, RES. HANDBOOK ON INT’L INS. LAW & REG. 276, 276 (Julian Burling & Kevin Lazarus ed., Edward Elgar 2011); See also Kochenburger & Salve, supra note 167, at 230.
\textsuperscript{187} See Delimatsis, supra note 184, at 1311.
\textsuperscript{188} See Labonte, supra note 183, at 5.
\textsuperscript{190} RBC Regime was created by the NAIC and was adopted in the early 1990s. “[I]t is a method of measuring the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile.” See Risk-Based Capital, NAT’L ASS’N OF INS. COMM’R (last updated Jun. 24, 2020), https://content.naic.org/cipr_topics/topic_risk_based_capital.htm.
business risks). However, in a typical captive arrangement, a parent company may attempt to inject less capital than is appropriate to the amount of risks its captives would insure.

Particular insurance regulators would also set out a lower minimum capital and surplus level for captives than that for traditional commercial insurers in order to satisfy the parent companies. It appears especially noticeable in some onshore domiciles which provide separate sets of regulatory legislation for traditional insurers and captives. For instance, in Vermont, a stock insurer is required to possess $2,000,000 as the minimum capital for licensing and then to maintain $3,000,000 as the minimum surplus, while a captive is only required to maintain $250,000 through $500,000 as their lowest capital as well as their minimum surplus. Insurers underwrite the same or similar amount of risks in the same line (e.g. In general, the captives based in Vermont are authorized to carry on the same business in life insurance, health insurance, and certain types of casualty insurance, as the commercial insurers are). However, prudential regulation provides no justification for having lower minimum capital and surplus requirements for captives than for traditional insurers. Under current legislation, captives possess less liquidity than traditional insurance

191 For example, E.U.’s Solvency II generally sets out, “Supervision shall be based on a prospective and risk-based approach.” See EUR. COMM’N., Solvency II, art. 29 (2009). For another example, U.S.’s RBC basically consists of two core sub-approaches, including: “the risk-based capital formula . . . [and] a risk-based capital model law.” See id.
194 See VT. STAT., tit. 8 §6004 (West, Westlaw through acts 1–102 of the Adjourned Sess. of the 2019-2020 Vt. Gen. Assembly (2020)) (“No captive insurance company shall be issued a license unless it shall possess and thereafter maintain unimpaired paid-in capital and surplus of: (1) . . . a pure captive insurance company, not less than $250,000.00; (2) . . . an association captive insurance company, not less than $500,000.00; (3) . . . an industrial insured captive insurance company, not less than $500,000.00; (4) . . . an agency captive insurance company, not less than $500,000.00 . . . (6) . . . a sponsored captive insurance company, not less than $250,000.00.” ((5) Risk-retention Groups omitted)).
195 See VT. STAT., tit. 8 §6002 (West, Westlaw through Acts 1-159, 161-169, 171-179, M-1-M-12 of the Adjourned Sess. of the 2019-2020 Vt. Gen. Assembly (2020)) (“[a]ny captive insurance company . . . may apply to the Commissioner for a license to do any and all insurance comprised in subdivisions 3301(a)(1), (2), (3)(A)--(C), (E)--(Q), and (4)--(9) of this title and may grant annuity contracts as defined in section 3717 of this title”); See also VT. STAT., tit. 8 §3301 (West, Westlaw through Acts 1-159, 161-169, 171-179, M-1-M-12 of the Adjourned Sess. of the 2019-2020 Vt. Gen. Assembly (2020)) (Providing that insurance subdivisions referred in VT. STAT., tit. 8 §6002 include life insurance, health insurance, certain casualty insurance.).
companies, making them less capable to indemnify huge losses and thereby more vulnerable to insolvency where the same amount of risks are materialized. As mentioned before, captives are not limited to pure captives, rather there are various types of captives, which write numerous risks from non-related policyholders. It is an issue that local legislation does not ensure captives’ financial capacity to cover their payments and protect their policyholders.

C. Regulatory Loopholes to Control Abuse of the Fronting Arrangements by Captives

With few regulatory legislations, there is a rising concern that the fronting arrangements by captives disturb local insurance regulation and provide the fronting companies with excessive power to issue policies.

Captives, which usually domicile in a jurisdiction with favorable capital and tax treatments, typically seek fronting arrangements as a path to access another insurance market, without restriction from local regulation. It is relatively common that captives participate in fronting arrangements. Purportedly above half of fronting arrangements involve captives. 196 Although legality of fronting arrangements is questioned, states rarely prohibit them expressly. 197 Fronting arrangements are special reinsurance arrangements for the purpose of assisting an insurance company unlicensed or unauthorized in a jurisdiction that it is conducting business in. 198 A commercial insurer licensed in a jurisdiction issues policies, then it cedes all or substantially all of the risks and premiums to a captive unlicensed therein on the basis of a fronting agreement, and thus original risks ultimately reside with the captive. 199 Typically, a ceding company, known as a fronting company, only plays a policy-issuing role in the front of insurance transaction. 200 They usually provide licensing services in exchange for a

portion of original premiums (i.e. so-called “fronting fee”).

This type of fronting arrangement is similar to how captives “rent” licenses to maximize capacity in a given jurisdiction. When a captive operates in a fronting transaction as a reinsurer, it develops its insurance business at a lower cost due to savings such as domestic tax deduction and international tax avoidance. However, in practice, fronting arrangements appear more

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quoting the Glossary of Insurance and Risk Management Terms at 41, (5th ed., International Risk Management Institute, Inc. 1991)).

201 See U.S. GEN. ACCT OFF., supra note 198 at 8.

202 See McCollum v. Continental Ins. Co., No. L-92-141, 1993 WL 382455, at *3 (Ct. App. Ohio Apr. 9, 1993) (describing “Essentially, a [']fronting agreement ['] . . . is an insurance term indicating that an entity is renting an insurance company’s licensing and filing capabilities in a particular state or states”). In reality, an insurer well licensed in jurisdiction A satisfies the local capital and surplus requirements. An unlicensed insurer seeks to carry on insurance business in jurisdiction A, however, is unable or unwilling to meet local license requirements. The unlicensed insurer negotiates and makes a fronting arrangement with a well-licensed insurer (“fronting company”). Under the plan, the fronting company issues insurance policies in domicile A based on its license. Then, due to the plan, all risks or substantially all risks are ceded to the unlicensed insurer so that the fronting company finally retains few risks and the unlicensed insurer actually insures all risks. The unlicensed insurer indirectly carries on business in jurisdiction A with the fronting company’s license. The fronting insurer usually obtains some payments from the unlicensed insurer. To some extent, those payments are considered as “renting fees” for an insurance license in jurisdiction A. Therefore, it is compared to a process that an unlicensed insurer “rents” a license from a local well-licensed insurer and indirectly undertakes insurance business in the jurisdiction.

203 For example, “[In Europe, t]o cooperate as fronting insurer in a 100% reinsurance contract, whereas there exist no economic or financial reasons, in case the reinsurance contract was concluded with a reinsurer situated in a country with an obviously better tax regime.” See Hugo Keulers., Belgium, IFLR (Mar. 1, 2002), https://www.iflr.com/article/b11txqmzcb3xr/belgium. In the U.S., there is only federal exercise tax at 1% of premiums upon reinsurance transaction while 4% for direct insurance. See 26 U.S.C. § 4371 (2018); See also Christopherson, supra note 83, at 139. In Canada, “[t]he Canadian excise tax does not apply, at the present time, to a contract of re-insurance and this is frequently one reason for using a fronting company.” Julian T. W. Kenney, British Columbia Captive Insurance Companies: The New Kid on the Insurance Block, 46 ADVOCATE (VANCOUVER) 351, 361 (1988).

204 See Jerome B. Libin & Leonard B. Terr, Tax Ramifications of International Insurance Transactions: An Overview, 19 FORUM 284, 303 (1983) (“Since the IRS in practice has not sought to collect the excise tax (although in principle the tax applies) in the case of foreign-to-foreign transactions, 74 at least where neither party to the transactions is otherwise subject to U.S. tax jurisdiction (e.g., by reason of not being engaged in a U.S. trade or business), no excise tax exposure effectively may exist with respect to the reinsurance premiums paid by the United Kingdom fronting company to the tax haven reinsurer.”).
complex because a captive might be involved in a multi-level risk transfer including retrocession.\textsuperscript{205}

First, fronting arrangements disturb local insurance regulation to some extent. By utilizing fronting insurers to enter the insurance market, captive reinsurers circumvent the local insurance regulation such as minimum capital requirements and minimum surplus requirements.\textsuperscript{206} For instance, typically minimum capital requirements are calculated accurately to reflect the risks an entity would face so that regulatory authorities are able to monitor and correct the business in time.\textsuperscript{207} Under a fronting insurance transaction, it is difficult for the regulatory authority in the jurisdiction where direct insurance business is conducted to access the financial information of the captive reinsurer in another jurisdiction unless special agreements between two domiciles provided otherwise.

Second, it is relatively challenging to ensure a fronting company underwrites on the basis of the number of risks for the benefit of its reinsurer, rather than abuses its issuing power. In general, fronting companies are less concerned with loss exposures and have less of an economic incentive to issue policies\textsuperscript{208} because approximately all the risks and premiums ultimately go to the captive reinsurance company. In other words, there are few substantial duties put on the fronting company except “to record an ‘in and out’ entry in its books.”\textsuperscript{209}

Third, in the U.S., while case law made some achievements curbing an abuse of fronting arrangements, there has been no significant progress in regulatory legislation. In many cases, a payment to its captive insurer will not be regarded as a tax deductible premium payment if the Internal Revenue Service (IRS) and the courts find that there was an insufficient actual transfer of risk outside the “corporate family” group.\textsuperscript{210} By contrast, legislative efforts

\textsuperscript{205} For example, after an offshore-domiciled captive reinsures a portion of risks from a U.S.-domiciled insurer, and then recedes all or part of risks to another reinsurer, which is called “retrocession.” See Regulation of Reinsurance Fronting Practices, supra note 200, at 211.

\textsuperscript{206} Id. at 196.


\textsuperscript{208} See Regulation of Reinsurance Fronting Practices, supra note 200, at 196 (arguing that fronting companies have a different measurement of risk).

\textsuperscript{209} J. Alan Lips, Consumer Credit Insurance--A Need for Regulation in Kentucky, 56 KY. L.J. 668, 679 (1967).

\textsuperscript{210} For example, in Gulf Oil Corp. v. Commissioner of Internal Revenue, Gulf Oil Corporation (Gulf) created a Bermuda-based wholly-owned captive Insco, Ltd. (Insco) and Marsh & McLennan, Inc. agreed to provide Insco with issuing and related services. Under their arrangement, Gulf and its affiliates directly purchased insurance from the third-parties’ commercial carriers and accordingly the major exposures of the carriers were ceded to Insco.
regulating fronting arrangements have brought few notable effects. In 1993, the NAIC adopted the “Fronting Disclosure and Regulation Model Act,” however, such attempts have drawn fierce objections from the industry as well as some policyholders who want to freely manage their risks via fronting transactions.\footnote{See Carranza-Kopper, supra note 196, at 243-44; Howard W. Greene & Jon Harkavy, \textit{Fronting is a Consumer Right}, RISK MGMT. 24, 29 (1991), Vincent J. Vitkowsky & John L. Ingersoll, \textit{Survey of 1992 Developments in the Public Regulation of Insurance}, 28 TORT & INS. L.J. 408, 417 (1993).} Moreover, regulators from states unanimously believed that existing insurance legislation was sufficient to deal with fronting issues so that the model standards have not been incorporated by any state statute until now.\footnote{See \textit{Regulatory View of Fronting}, IRMI, https://www.irmi.com/online/rt/ch004/11041000/al04f010-regulatory-view-of-fronting.aspx (last visited Jan. 22, 2021).}

The Fronting arrangements by the captives causes regulatory problems, including: the captives’ circumvention of local regulation through the arrangements and the difficulties to ensure the fronting companies to issue policies reasonably. However, there is no special regulatory legislation for the issue.

Later, the Commissioner questioned whether the premiums “representing the amounts of insurance premium payments made by Gulf and its domestic affiliates to primary insurers that the insurers subsequently ceded to Inesco” should be tax-deductible. The Third Circuit did not agree that the payments should be deductible from Gulf’s gross income because they were not premiums for insurance. Gulf Oil Corp. v. Comm’r of Internal Revenue, 914 F.2d 396, 409-12 (3d Cir. 1990). In addition, there are similar holdings on the point among other federal circuits. See Clougherty Packing Co. v. Comm’r of Internal Revenue, 811 F.2d 1297, 1307 (9th Cir. 1987) (stating “Premiums paid by the parent to the captive, whether directly or through an unrelated insurer, may not be deducted by the parent as insurance premiums . . . they may not be deducted as necessary business expenses under 26 U.S.C. § 162(a).”); \textit{Malone & Hyde, Inc. v. Comm’r of Internal Revenue, 62 F.3d 835, 840 (6th Cir. 1995) (holding that “the payments to such a captive that are designated as insurance premiums do not constitute bona fide business expenses, entitling the taxpayer to a deduction under § 162(a).”); \textit{Syzygy Insurance Co. v. Comm’r of Internal Revenue, 117 T.C.M. (CCH) 1165, T.C. Memo. 2019-34, 36 (stating “that U.S. Risk [a fronting company] and Newport Re [another fronting company] were not bona fide insurance companies, which in turn means that they did not issue insurance policies . . . This means Syzygy’s [microcaptive] reinsurace of those policies did not distribute risk; therefore, Syzygy did not accomplish sufficient risk distribution for Federal income tax purposes through the fronting carriers.”).}}
D. Lacking Regulation Over Insurers’ Transferring Third-Party Risks to Their Captives

In addition to traditional regulatory challenges, an emerging issue—some insurers’ attempts to transfer their written risks to their own captives—is also challenging the current insurance regulation regime. Initially, the vast majority of captives were created by non-insurance companies, in order to deal with a different variety of self-insured risks. Thereby regulation of captives mainly focused on protection of single sophisticated policyholders such as the captives’ parent companies and their sibling companies. Over time, insurance companies have realized that forming their own captives makes more profits, and the market effects of this realization are growing year by year. For example, according to The Captive Landscape Report of 2019 published by Marsh, 22% of Marsh-managed captives profited with premiums of 18.7 billion USD by providing third-party coverage in various forms in 2018. The growth rate of captives insuring third-parties’ risks over the last 5 years is 62%.

The regulation of captives writing third-party risks remains unclear and vague now. Generally, because there is little regulation specially related to this area, regulators question whether the old solutions should be directly applied to new problems. Until now, the majority of the domiciles in the U.S. provide little prohibition on captives’ business in writing third-party risks as well as little special regulation.

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213 In the instance, captives issue policies to protect their parents or siblings against liabilities from unrelated persons, which is generally called insuring “third-party risks” or “unrelated-party risks” See Glossary of Insurance and Risk Management Terms-definition of Offshore Captive, supra note 33.

214 See Hall, supra note 10, at 6.


217 See Marsh & McLennan, supra note 10, at 4.

218 Id.

219 See Hall, supra note 10, at 7.

220 According to domicile comparison report published on Cayman International Insurance website in 2016, only very few states expressly prohibited captives from entering
Especially in the life insurance area, a lack of regulation over captives writing third-party risks has caused concerns and debates on the transparency requirements. Commercial life insurance companies have shown more interests in transferring a portion of risks to their captives, especially by forming captive reinsurance companies and by trading insurance securitizations. Those life insurance companies are interested in establishing their own captives to assume the risks from their direct insurance. The life insurance companies also utilize captives “to finance the reserve ‘redundancies’ associated with requirements for universal life products with secondary guarantees features and term life insurance.” Under the circumstances, a concern has also been raised about whether the traditional regulation for self-insured-based captives is suitable and sufficient to address the coming issues “regarding transparency and consistency when applied to individual policyholder risks backed by life insurance companies.” NAIC Subgroup members also dispute whether the levels of transparency and confidentiality for commercial insurers should be identically imposed upon the captives providing third-party coverage. Some members assert the confidentiality requirements and question whether transparency is necessary when there is no contractual connection between those captives and the original policyholders. They also raised concerns about whether the same levels of transparency would be harmful to the ceding/reinsuring transaction between the captives and their parents or siblings because the disclosed information for the purpose of regulation is also available to their business competitors. By contrast, other Subgroup members, who aligned with transparency requirements and thus challenged

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222 Typically, the arrangements that insurance companies form their own captive reinsurance companies work as the fronting arrangements discussed above.

223 See Financial Stability Hearing, supra note 221; see also Captive Insurance Companies, ACLI, https://www.acli.com/Public-Policy/Captive-Insurance-Companies.

224 Regulatory Standard Hearing, supra note 215.

225 Id.


227 See id. at 14-15.
complete confidentiality, believe at least a reasonable amount of information should be disclosed to the public just like the annual financial statement. Instead of being concerned about the harm from competitors, those members focused their attention on improving financial strength through disclosure to the public.\footnote{See id. at 15.}

Therefore, as an increasing number of captives are involved in underwriting the third-party risks from their parent insurers, the lack of regulation in the field raises questions on whether traditional solutions are applicable to the new problems, particularly on the transparency issues of life insurance.

V. PERSPECTIVES

In order to maintain competitive edges, some traditional captive domiciles, such as Bermuda, Cayman, and Guernsey, have aggressively taken several innovations to reform the local regulatory system and enhanced international cooperation for more foreign businesses. Meanwhile, the pivot of the global insurance market is moving east, with the development of Asian captive domiciles in which there are huge insurance markets. For the challenging and competitive regulation of captives, an effective international cooperation is needed.

A. Traditional Captive Domiciles Respond to Competition with Regulatory Innovations

In the wake of increasingly intense global competition among captive domiciles, traditional captive jurisdictions have been responsive by creating innovative regulatory mechanisms to adjust to new demands for risk management as well as to ensure effective supervision over the industry.

i. Bermuda’s Regulatory Regime Is Evolving to Meet Global Competition

As a leading captive domicile for more than half a century, Bermuda has been evolving and keeping pace in insurance regulation in order to compete with the global insurance market.\footnote{See Bermuda Captive Market 2017, supra note 56.} U.S. taxation reforms are a
looming threat to Bermuda’s captives market. A large portion of Bermuda-based captives have U.S. parents and thereby it would be possible for the U.S. to attract the captives back again by amending the tax laws.

Bermuda has been adjusting its regulations in order to boost steady development in insurance markets and achieve effective regulations and transparency. For example, in 2009, Bermuda created Special Purpose Insurers (SPIs), which are designed to conduct some special insurance transactions such as insurance-linked securities. Later, some initiatives were adopted by the Bermuda Monetary Authority (BMA) to remove a portion of annual fees for the SPIs in 2012, which contributed to a more thriving market on the islands. Also, the SPIs have earned praise due to their successes in taking risks to the capital market at an affordable cost.

Aware of growing international competition, BMA initiated two separate innovative solutions focused on insurance technology (InsurTech) companies: an insurance regulatory box (“sandbox”) and an innovation

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232 According to BMA Captive Report of 2018, 69% of the risk insured by captives based in Bermuda arose out of North America and Bermuda and most captives had their parents coming from the jurisdictions. See BMA Captive Report 2018, supra note 14, at 3.

233 See Fox, supra note 231; Tax Reforms, supra note 231.


235 See id.

236 See id.

237 See id.

238 See Innovation in Insurance, BERM. MONETARY AUTH., https://www.bma.bm/insurance-innovation, (last visited Feb. 12, 2021). For example, participating companies of sandboxes includes: AkinovA, which is working on “[a]n electronic marketplace to transfer and trade insurance risks, enabling cedants and intermediaries acting on their behalf to transfer insurance risk to investors” and Nayms Ecosystems Limited, which is working on “[a] smart contract powered platform that allows insurance entities to create fully-collateralised, fully digital, transparent, trustless and tradable reinsurance contracts.”
Both of them apply to traditional insurance as well as captives and insurance linked securities. The sandbox is a testing mechanism for innovative InsurTech products and services in a specified period of time. Ultimately BMA would adjust its regulatory requirements on the basis of feedback from the participating parties as well as the objection of policyholder protection. The insurance hub provides a platform for BMA to communicate with the start-ups about innovative InsurTech products and services. In all, those innovation tracks have been expected to provide BMA more regulatory experience consistent with innovative InsurTech and further to contribute to more attractive and appropriate regulatory rules for insurance companies including captives.

ii. Cayman Develops International Cooperation and Regulatory Innovations to Strengthen Its Competitiveness

Recognizing the accelerating globalization of the insurance market, Cayman has been increasing the competitiveness through international collaboration and innovative regulation. First, Cayman attempted to compete by enhancing collaboration with the NAIC of the U.S. on regulatory issues. Similar to Bermuda, the risks assumed by 90% of Cayman-based captives originated North America according to the Cayman Islands Monetary Authority (CIMA)’s statistics of the first quarter in 2020. Likewise, the local captive market is also sensitive to legislation in the U.S.

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239 See id. For example, ChainThat Limited is operating a project named RiCap BERMUDA, which is “a blockchain-driven electronic platform allowing brokers, insurance companies and reinsurers to do business in a single platform to improve business efficiency and cut frictional cost (phase 1), as well as build a private business network to access third party capital (phase 2 and 3).”

240 For example, “A global company partners with a technology start-up in developing a blockchain application that it seeks to sell to companies that use captive companies to manage risks. The product aims to streamline and simplify the global nature of the captive operations, which usually covers multiple jurisdictions, making a strong case for a distributed ledger solution. The Sandbox will allow the company to test the product on a limited basis to its own affiliates, and the feedback received during the Sandbox tenure will ensure viability for external use for other players.” See Guidance Note: Insurance Regulatory Sandbox and Innovation Hub, BERMUDA, MONETARY AUTH. 17-18 (Published on Sep. 2018), https://cdn.bma.bm/documents/2019-03-28-05-10-19-BMA-Insurance-Regulatory-Sandbox-Innovation-Hub-Guidance-Note.pdf.

241 See id. at 3.

242 See id.

243 See id.

244 See id. at 4.


246 See Insurance Company by Risk Location, supra note 14.
For example, as the leading healthcare captive domicile, Cayman has witnessed a drop in the number of healthcare captives, as a result of healthcare insurers mergers caused by the U.S. Patient Protection and Affordable Care Act of 2010. In order to coordinate in regulation and to provide mutual assistance and information exchange, Cayman signed a memorandum of understanding with the NAIC in August 2018.

Second, Cayman supports innovative uses of captives. For example, as discussed in Cayman’s enabling legislation, introduction of the PICs, which operate under the SPCs, as well as their accompanying regulation has been regarded as a special response to global competition. Since the first enactment of the Cayman Insurance (Amendment) Law 2013, Cayman has seen prosperity in the SPCs captive market, with a number of 135 companies by March 31, 2020. Besides, there has been an innovative expansion in risks underwritten, including “employee medical stop loss, equipment maintenance, and writing of unrelated party risks.” Finally, Cayman is also attempting to develop the captive regulation regarding InsurTech. Similar to BMA, CIMA has realized the dominant role of InsurTech in the emerging issues such as cyber risks. Although CIMA appears to be behind BMA in

247 See Owen Faulkner, Healthcare and Beyond in Cayman, CAPTIVE INT’L (Nov. 28, 2018), https://www.captiveinternational.com/article/healthcare-and-beyond (“[T]he Cayman Islands has long been hailed as the leading jurisdiction for captives in the healthcare sector.”).
250 See Cayman Enacts PIC Regulations, BUS. WIRE, (Jan. 30, 2015), https://www.businesswire.com/news/home/20150130005900/en/Cayman-Enacts-PIC-Regulations (Chairman of the Insurance Managers Association of Cayman (IMAC), Kieran O’Mahony, [commented], “[T]he PIC legislation and accompanying regulations both exemplifi[ed] and reinforces Cayman’s leading position over other jurisdictions in terms of sensible and proportionate regulation, innovative legislation (based upon a trustworthy and reliable legal system) and the high level of governance and compliance afforded to it.”).
251 See Insurance Law (Amendment) 2013 (Cayman Is.), Insertion of Part 4A - portfolio insurance companies; See also Ernst & Young Global Ltd., Portfolio Insurance Companies -- A Versatile Fool, https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/financial-services/ey-portfolio-insurance-companies-pics.pdf (last visited Feb. 12, 2021) (“[T]hey are easy to establish and further enhance risk management if you are already part of an SPC or looking to become part of one as an alternative to a traditional pure captive. PICs continue to make up a significant portion of the new captives created in Cayman since the legislation was enacted.”).
developing InsurTech rules because it has not formally declared any innovative initiatives, it continues to research and explore.\\(^{253}\)\\n
iii. Guernsey Enhances International Business Cooperation and Regulatory Transparency to Respond to Competition

Guernsey remains competitive by developing further cooperation with international captive owners and introducing a more transparent regulatory platform. First, without the obligation of implementing the E.U. solvency regulation, Guernsey has been aggressively cooperating with more international captive owners. While the impacts of the E.U. Solvency II on global insurance markets remain to be seen, Guernsey provided a prompt response, making clear that it currently has no plan to follow the E.U. rules on the ground that it is not a member of the E.U.\\(^{254}\) Since then, the clear standpoint has been a strong selling point for Guernsey, which is regarded to unburden Guernsey-based captives from additional costs.\\(^{255}\)

Second, a distinctive strategy for Guernsey is its close cooperation with Chinese captive owners on the basis of its advantageous location – physically close to the U.K. and the E.U. member countries.\\(^{256}\) Guernsey Financial Services Commission (GFSC) has signed a set of Memorandums of Understanding with all the Chinese financial services regulatory authorities,\\(^{257}\) at least indicating that Chinese insurance regulatory authorities and China-based business have positive attitudes towards insurance-related

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253 See Scotland, supra note 245.

254 See Solvency II Position Statement, GUERNSEY FIN. SERV. COMM’N., (Jan. 25, 2011), https://www.gfsc.gg/news/article/solvency-ii-position-statement (stating “1. The authorities in Guernsey have no plans to seek equivalence under Solvency II . . . [Although] [t]he States of Guernsey and the GFSC will be focused on amending Guernsey’s regulatory regime to take account of these international developments[,] [o]bviously any changes to that regime will need to take account of the nature of, and be appropriate to, Guernsey’s insurance industry.”). And note: No opposite position statement has been published on the official website of GFSC.


investment in Guernsey. Accordingly, Guernsey’s insurance market would be entirely receptive to Chinese businesses. In particular, a joint venture established between Guernsey-based independent insurance manager Alternative Risk Management and Beijing Airport Captive Management Consulting, which was designed to form a captive structure in China and to provide captive-related consulting services, has been recognized as a remarkable achievement by the Memorandum of Understanding between GFSC and Beijing Airport Economic Core Zone. In 2017, Guernsey welcomed at least three Chinese delegation visits to negotiate establishing captives owned by China-based corporations.

Besides, in order to serve the prospective “clients” better, GFSC has also introduced a regime called the Innovation Soundbox (Soundbox), close to a combination of Bermuda’s Sandbox and Innovation Hub. Likewise, the Soundbox is also designed to improve effective communication between GFSC and businesses in order to promote registrations of financial services businesses.

B. World Insurance Markets Are Moving East to Foster Asian Emerging Captive Domiciles

In general, Asia is seeing a huge potential in building captive domiciles, although they are not currently at a relatively large scale. Compared with those mature jurisdictions such as Bermuda, the Caribbean,

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259 See Beijing and Guernsey in Captive Insurance Joint Venture, WE ARE GUERNSEY (Nov. 29, 2017), https://www.weareguernsey.com/news/2017/beijing-and-guernsey-in-captive-insurance-joint-venture/ (last visited Feb. 11, 2021) (In addition to citation, it is purported “BACM is the only captive insurance consulting group in China and is backed by the Beijing Airport Economic Core Zone (BAECZ) - a key hub for China’s business, industrial and creative sectors.”).


261 See The Innovation SoundBox, GUERNSEY FIN. SERV. COMM’N, https://www.gfsc.gg/commission/innovations/innovation-soundbox (last visited Feb. 12, 2021) (stating the Innovation Soundbox provides, “the Innovation SoundBox provide: Access to regulators and Commission policy makers; Transparency on the Bailiwick’s regulatory requirements; A steer on potential regulatory difficulties and challenges an innovative proposition could face; Openness on our suitability & eligibility criteria; and Explanation of our requirements and how to submit an application for authorisation.” However, no relevant statistics about implementation of the Innovation Soundbox have been found in the GFSC’s website.).
North America, and Europe, obviously Asian captive domiciles are still standing on a developing stage, however, with a robust growth. According to a Sigma Research Report in 2019 by Swiss Reinsurance Company Ltd., the pivot of global insurance market is forecasted to move east.

i. Asian Traditional Captive Domiciles Are Achieving Visible Development

Due to keen competition within Asia, the established international financial centers (i.e., Singapore, Labuan (Malaysia), Federated States of Micronesia and Hong Kong (China)) have made some progress in constructing their own captive regulatory systems, which has contributed to a flourishing captive market and promoted general development in Asian captive markets. The Asia-Pacific area has had a 24% increase in the number of captives over the past five years while the number of captives in Europe, the Middle East, and Africa dropped by 8% during the same term.

Of the financial hubs, Singapore has recently been the leading Asian captive domicile. By the end of 2019, Singapore ranked as the top Asian domicile as well as at the twentieth most competitive domicile globally. Its main competitor, Hong Kong, also evidenced an increase from only 1 captive

262 See Claire Wilkinson, Captive Experts Eye Asia-Pacific as Next Region for Growth, BUS. INS. (May 14, 2019), https://www.businessinsurance.com/article/20190514/NEWS06/912328427/Captive-experts-eye-Asia-Pacific-as-next-region-for-growth (“The captive insurance sector in Asia-Pacific is relatively small but has potential for significant growth, as businesses in the region increasingly consider the self-insurance vehicles part of their risk management strategies, experts say. As companies in the region become more exposed to captives and insurance rates firm, captive growth is likely to accelerate, they say. Ratings agency A.M. Best & Co. Inc. said it expects to see ‘significant growth’ in the Asia-Pacific domiciles as businesses seek ‘new and more sophisticated ways of risk management and control,’ in a report published Tuesday.”).


266 See Background on: Captives and Other Risk-financing Options, supra note 53.
in 2011\textsuperscript{267} to 4 captives at the end of 2019.\textsuperscript{268} Although those areas have recently developed, unique competitive advantages for them are still absent in comparison with those of worldwide advanced captive domiciles.

ii. Mainland China is a New Choice of Captive Domicile for Asia as Well as for the World

In the near future, particular areas in Mainland China are expected to grow to be internationally competitive captive domiciles on the basis of the improving captives regulation and the huge insurance markets of Mainland China. On the one hand, China has been exploring and testing new insurance regulatory regimes particularly in the pilot free trade zones\textsuperscript{269} and in specially-established areas for captive registration, with increasing awareness and understanding of international trade rules in insurance services and international investment rules. On the other hand, the growing demands for alternative risk management are creating an increasingly huge domestic insurance market.

\footnotesize{\textsuperscript{267} See Ron Kozlowski & Johnny Ho, supra note 6.  
\textsuperscript{269} Until May 25, 2020, a total of 18 FTZs have been established in Mainland China. See Six More FTZs Joining Chinese FTZ Families, STATE COUNCIL OF CHINA (Updated on Aug. 26, 2019), http://english.www.gov.cn/policies/latestreleases/201908/26/content_WS5d63c4a2c6d0c6695ff7f4e4.html. Note that unlike the U.S., in which each state has its own jurisdiction, Mainland China is a jurisdiction as a whole and all of the Chinese FTZs build a team but with different tasks, who is designed to exploring innovative rules in boosting economy, to provide experience for broad non-FTZ areas in Mainland, and ultimately to put advanced regulatory rules in place around Mainland. See Chart: Add 6 more! Pilot Free Trade Zones Build a New Layout for Opening Up, STATE COUNCIL OF CHINA (Aug. 26, 2019), http://www.gov.cn/xinwen/2019-08/26/content_5424774.htm. See Newsletter Shanghai Forum: Global Governance and Asia, 12 FUDAN J. OF HUMANITIES AND SOCIAL SCIENCE No.2, at 25 (Sep. 2019), https://fddi.fudan.edu.cn/_upload/article/files/39/68/866fd0ab4e9a881eb705de57eff779cd629cc-68fc-4da4-8ba8-43e3a1c7bfa5.pdf.}
(a) Innovations in Regulation of Captive-Related Insurance and Corresponding Progress in Mainland China

Particular Free Trade Zones (FTZs) in Mainland China are considering establishing an “offshore international financial center” to attract foreign and domestic banking and insurance businesses. Of these Chinese FTZs, China Shanghai FTZ (“Shanghai FTZ”), especially aims to be an international insurance (reinsurance) center on the basis of its advantages in international trade and international marine shipping. In 2015, the People’s Bank of China (the Central Bank of China), collaborating with the Ministry of Commerce of China, China Banking Regulatory Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, State Administration of Foreign Exchange and Government of Shanghai issued a scheme for building an international financial center in Shanghai, which expressly announced that the reinsurance industrial chain should be established and supported the establishment of Chinese-owned or foreign-owned reinsurance businesses including: captive insurance companies, mutual insurance companies and other non-traditional insurance companies. With these innovative guidelines, the Shanghai FTZ has seen notable achievements in regulation concerning captives. For instance, on February 8, 2017, COSCO Shipping Captive Insurance Co. Ltd., whose single parent is China COSCO Shipping Co. Ltd., was created as the first captive registered in Shanghai FTZ.

270 See CHINA (SHANGHAI) PILOT FREE TRADE ZONE ADMIN.《牢牢把握自贸试验区战略机遇努力打造上海保险业改革新高地树立保险业开放新标杆--<实施意见>自贸试验区保险市场建设解读》 (Dec. 9, 2014), http://www.china-shftz.gov.cn/NewsDetail.aspx?NID=5e4bdfb2-2bb1-4468-baa1-150b0ea05ad2&CID=f672f518-99a3-4789-8964-1335104906b4&MenuType=1&navType=0.
271 CBRC and CIRC has merged into CBIRC since April 2018.
272 CBRC and CIRC has merged into CBIRC since April 2018.
273 “Foreign” here specially refers to “Non-Chinese.”
274 See STATE COUNCIL OF CHINA,《关于印发《进一步推进中国（上海）自由贸易试验区金融开放创新试点 加快上海国际金融中心建设方案》的通知》(Oct. 29, 2015), http://www.gov.cn/zhengce/2015-10/29/content_5055131.htm (“（二十）完善再保险产业链。支持在自贸试验区设立中外资再保险机构，设立自保公司、相互制保险公司等新型保险组织，以及设立为保险业发展提供配套服务的保险经纪、保险代理、风险评估、损失理算、法律咨询等专业性保险服务机构。”).
275 See COSCO SHIPPING CAPTIVE INS. CO. LTD., About Us, http://captive.coscoshipping.com/col/col13420/index.html (last visited Feb. 12, 2021); See also
Another member of the Chinese FTZs – China (Guangdong) Pilot Free Trade Zone – also aggressively explores insurance regulatory regimes. As an area of China (Guangdong) Pilot Free Trade Zone (Guangdong FTZ), Qianhai, Shenzhen\(^{276}\) specially focuses on the cross-border trade in insurance services and insurance-linked investment. One geographic advantage for Qianhai is that it is just a one-hour drive away from Hong Kong, which strategically attracts Hong Kong-based businesses.\(^{277}\) Similar to Shanghai FTZ, Shenzhen also publicly announces its guideline relating to captive-related insurance innovations, including: encouraging captive insurance companies and other emerging insurance service providers to conduct business in the Qianhai area of Guangdong FTZ.\(^{278}\) By contrast, Qianhai initiated a head start in participating in global cooperation of financial services regulation before Shanghai FTZ and other Chinese FTZs.\(^{279}\) It has been standing as an observer as well as the only Mainland participant in the

\(^{276}\) Shenzhen City of Guangdong Province, with the title of “Window of Mainland China,” was also established for the purpose of China’s Reform and Opening-up policy.


\(^{278}\) See Gov’t of Shenzhen, *深圳市人民政府关于加快现代保险服务业创新发展的实施意见* (13 May 2020), http://www.sz.gov.cn/zfgb/2015/gb920/content/post_4981953.html (“二...（三）加强保险市场体系建设。大力发展保险总部经济，吸引保险法人机构落户，鼓励保险总公司来深设立专业子公司、基金管理公司、项目公司、区域总部、研发中心、运营中心。加快保险机构组织形式创新，支持设立自保、相互制保险等新型保险机构和航运保险、责任保险、健康保险、养老保险等专业保险机构。支持设立互联网保险公司和新型保险要素交易平台。”).

\(^{279}\) Until May 26, 2020, Qianhai has been the only one participant in the GFIN, from Mainland China. See Our Members, GLOB. FIN. INNOVATION NETWORK, https://www.thegfin.com/members (last visited Feb. 12, 2021).
Global Financial Innovation Network,280 which is a cross-border financial innovation testing mechanism to promote communication between financial regulators and businesses on the basis of international collaboration.281

Besides, Kashgar282 and Karamay283, which are economic development areas in Xinjiang,284 have adopted favorable regulation specially supporting captives, in order to keep pace with Chinese captives development.

(b) The Potential Domestic Insurance Markets in Mainland China

Generally, increasing demands for alternative risk management in Mainland China and its geographic location would contribute to its huge captive insurance markets in the coming years. First, Mainland China has recently seen a robust growth in the domestic commercial insurance market.285 As a whole, “China’s share of the global insurance market went from 0% in 1980286 to 11% in 2018, and [was] forecast to reach 20% in 10 years’ time.”287 Most recently, according to the data by China Banking and Insurance Regulatory Commission, the monthly nationwide gross premium has almost doubled its growth from 850 billion Renminbi (approximately 119 billion USD) in January 2019288 to 1.670 trillion Renminbi (approximately

280 See id.
282 Kashgar announces that registered financial and insurance businesses would obtain a lump-sum award at 1% of amount of capitalization up to 5,000,000 Renminbi (approximately 700,869 USD) as well as special tax awards under specified circumstances. See Chinacaptive.org,《喀什专属自保地介绍》(May 23, 2017), http://www.chinacaptive.org/practice/addressinfo/100.
283 Karamay is the first captive domicile in Mainland China. CNPC Captive Insurance Company Limited, which is the first captive of Mainland China, was registered in Karamay, Xinjiang. See China Nat’l Petroleum Corp.,《专属财产保险股份有限公司：中国境内首家自保公司》(Aug. 24, 2015), http://www.cnpc.com.cn/cnpc/ztjqyj/201508/b1e487eac70b4520b07525dcfde79cbc.shtml (Note: The captive was formed on December, 2013 although the reference paper was published on 2015).
284 Xinjiang refers to a Chinese autonomous region, located in Northwest of China.
285 See Wu, supra note 260.
286 Since 1978, Mainland China has been implementing Reform and Opening-up Policy, significantly contributing to Chinese economic boom.
288 See CHINA BANKING & INS. REG. COMM’N,《2019年1月全国各地各保险保费收入情况表》(Mar. 8, 2019),
The flourishing direct insurance market indicates the development of enterprise risk management practices. Also, a positive prospect for captive insurance can be forecast because both of direct insurance and captive insurance are typical risk management solutions and both can be utilized to satisfy the increasing needs for risk management, regardless of whether those solutions are direct or alternative. In addition, the current Mainland market also provides lots of opportunities for captive insurance even though it is still a new player in captive insurance.

Finally, as another element to broaden local captive insurance markets, Mainland China’s geographic location would also lead to more establishments of captives. Close proximity and convenient traffic would always be important to captive owners. When selecting a captive domicile, an investor would keep his/her eyes on the proximity between the domicile and the risk location based on consideration for costs and efficiency. As noted above, the majority of captives domiciled in Bermuda assume the risks from North America, and Chinese businesses prefer Guernsey as a springboard to enter into insurance market of the U.K. and the E.U. Likewise, Australia businesses prefer to establish captives in Singapore while Japanese businesses choose Hawaii. On this point, Mainland China is likely to be a destination for enterprises that seek a captive solution to assume the risks originating from China as well as China’s neighbors (i.e. South Korea, Japan, Thailand, India and etc.).

C. International Cooperation is Key to Improving Global Captives Regulation

One of the best solutions to improve global regulation of captives is effective international cooperation in the area. The challenges in the captives
regulation need effective collaboration among the worldwide domiciles via the bilateral,\(^\text{294}\) regional,\(^\text{295}\) or multilateral\(^\text{296}\) approaches. For the issue out of the prudential regulation, it would be helpful to ensure the captives’ financial stability and give the appropriate discretion to each authority if these domiciles reach an agreement on the concrete range of minimum capital and surplus requirements for captives. Next, for the purpose of restricting abuse of the fronting arrangements by captives, it is necessary for the domiciles to form a regime to provide the mutual assistance on financial information verification when a jurisdiction in which a fronting is located makes a request to another domicile of the related captive. Financial information exchanges between or among authorities is an effective way to deal with regulatory loopholes. For example, in this way, the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes has made significant progresses in closing down the loophole of global tax system (i.e., offshore tax evasion).\(^\text{297}\) Finally, with a lack of regulation on emerging issues, such as captives writing third-party risks, deeper international coordination should be developed to explore the new solutions and provide regulatory guidelines. To some extent, they could work like the ICPs by the IAIS, which “serve as a basic reference.”\(^\text{298}\)

VI. CONCLUSION

Global competition of captives regulation is distinctive due to its purpose and objectives (i.e., sound financial system and sufficient policyholder protection). Under the circumstances, the regulation of captives faces challenges in international collaboration (domestic coordination of regulations for the U.S.), prudential and solvency regulations, fronting arrangements regulations, and regulations over third-party coverage.

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\(^{294}\) Bilateral agreements typically refer to the agreements between two parties (e.g., the U.S.-Australia Free Trade Agreement & The U.S.-Korea Free Trade Agreement).

\(^{295}\) Regional arrangements usually refer to the arrangements among the parties in a specified area, with an aim of furthering regional integration (e.g., The Dominican Republic-Central America Free Trade Agreement).

\(^{296}\) Multilateral cooperation refers to the international cooperation involving more than two parties (e.g., The General Agreement on Trade in Services of World Trade Organization is a multilateral trade agreement.).

\(^{297}\) See OECD SECRETARY-GENERAL REPORT TO G20 LEADERS, OECD, at 8 (Jul. 2017), http://www.oecd.org/ctp/oecd-secretary-general-tax-report-g20-leaders-july-2017.pdf (“[As of July 2017,] 500 000 people having disclosed offshore assets, and around 85 billion euros in additional tax revenue identified as a result of voluntary compliance mechanisms and offshore investigations.”).

arrangements. Recently, economic development in Asia has stimulated significant growth in demands for diverse risk management solutions including captive insurance, which provides a huge risk management market, although accompanying regulation remains to be explored and developed. In the face of the competitive and challenging regulation of captives, effective international cooperation is necessary, and a domicile can rarely solve these regulatory challenges independently. Ultimately, only practice and time will show the best way to achieve the effective regulation over captives.