

LIMITED
LC/CAR/L.210(Sem.1/3)
3 February 1987
ORIGINAL: ENGLISH

ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
Subregional Headquarters for the Caribbean

UNITED NATIONS DEVELOPMENT PROGRAMME

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Regional Workshop on Trade in Services
St. John's, Antigua and Barbuda
10-12 March 1987



CAPTIVE INSURANCE COMPANIES IN THE CARIBBEAN - AN ANALYSIS

by Greg L. Christie^{*/}

^{*/} The author is a lecturer in law at the University of the West Indies and is Director of the University's LL.M. Insurance Law postgraduate programme at the University's Cave Hill campus in Barbados. He is a member of the Barbados Institute of Insurance.

This document has been prepared without formal editing. The views expressed are those of the Consultant and do not necessarily reflect the opinion of the Organizations.

CONTENTS

(1) AN OVERVIEW OF CAPTIVE INSURANCE COMPANIES

	Page
1.1 THE CAPTIVE DEFINED	1
1.2 THE GROWTH OF THE WORLD CAPTIVE INDUSTRY	2
1.3 TYPES OF CAPTIVES	4
1. The Single Parent Owned Captive	
2. The Group Captive	
3. The Association Captive	
4. The Rent-A-Captive	
5. The Agency Captive	
6. The Direct Writing Captive and the Reinsurance Captive	
7. The Domestic captive and the Offshore Captive	
1.4 REASONS FOR CAPTIVE FORMATION	15
1. Cost Reductions	
2. Enhanced Cash Flow and Investment Income	
3. Access to Reinsurance Markets	
4. Personalized Coverage	
5. Provision of Coverage not Otherwise Available	
6. Freedom of Investment and Movement of Funds	
7. Enhanced Loss Control and Risk Management	
1.5 CRITERIA FOR SELECTING CAPTIVE LOCATION	23
1. Suitable Geography, Air links and Communications	
2. Political and Economic Stability	
3. Acceptable Legal Framework and Insurance Regulatory System	
4. Availability of Management and Ancillary Services	
5. Exemptions from Exchange Controls and Currency Restrictions	
6. Low or Nil Tax Framework	

(2) CASE STUDY: BERMUDA

2.1	GEOGRAPHY, LANGUAGE, POPULATION AND COMMUNICATIONS	36
2.2	STRUCTURE OF GOVERNMENT	37
2.3	POLITICAL AND ECONOMIC STABILITY	38
2.4	LAWS AND LEGAL SYSTEM	40
2.5	TAXATION REGIME	40
2.6	FOREIGN EXCHANGE CONTROLS AND CURRENCY RESTRICTIONS	41
2.7	BANKING AND ANCILLARY PROFESSIONAL FACILITIES	41
2.8	THE CAPTIVE INSURANCE MARKET	42
2.9	INCORPORATION AND REGISTRATION OF CAPTIVES	44
2.10	HIGHLIGHTS OF CAPTIVE INSURANCE REGULATORY LEGISLATION	47

(3) CASE STUDY: THE CAYMAN ISLANDS

3.1	GEOGRAPHY, LANGUAGE, POPULATION AND COMMUNICATIONS	52
3.2	STRUCTURE OF GOVERNMENT	54
3.3	POLITICAL AND ECONOMIC STABILITY	55
3.4	LAWS AND LEGAL SYSTEM	57
3.5	TAXATION REGIME	57
3.6	FOREIGN EXCHANGE CONTROLS AND CURRENCY RESTRICTIONS	58
3.7	BANKING AND ANCILLARY PROFESSIONAL FACILITIES	59
3.8	THE CAPTIVE INSURANCE MARKET	61
3.9	INCORPORATION AND REGISTRATION OF CAPTIVES	64
3.10	HIGHLIGHTS OF CAPTIVE INSURANCE REGULATORY LEGISLATION	67

(4) CASE STUDY: BARBADOS

4.1	GEOGRAPHY, LANGUAGE, POPULATION AND COMMUNICATIONS	71
4.2	STRUCTURE OF GOVERNMENT	72
4.3	POLITICAL AND ECONOMIC STABILITY	74
4.4	LAWS AND LEGAL SYSTEM	77
4.5	TAXATION REGIME	78
4.6	FOREIGN EXCHANGE CONTROLS AND CURRENCY RESTRICTIONS	79
4.7	BANKING AND ANCILLARY PROFESSIONAL FACILITIES	80
4.8	THE CAPTIVE INSURANCE MARKET	82
4.9	INCORPORATION AND REGISTRATION OF CAPTIVES	85
4.10	HIGHLIGHTS OF CAPTIVE INSURANCE REGULATORY LEGISLATION	88

(5) ENCOURAGING CAPTIVE FORMATIONS IN THE COMMONWEALTH CARIBBEAN

5.1	THE PRINCIPAL ECONOMIC ADVANTAGES	94
5.2	EFFECT ON DOMESTIC MARKET AND CONSUMER PRODUCTS	96
5.3	THE DISADVANTAGES	98
5.4	THE FUTURE FOR THE NON-TRADITIONAL CAPTIVE HAVENS	99

TABLES

Table 1	Comparative Analyses of Captive Jurisdictional Features	91
Table 2	Outflow of Captive Non-Fiscal Payments	95

General Note

Any reference herein to "dollars (\$s)" shall mean
"United States dollars".

AN OVERVIEW OF CAPTIVE INSURANCE COMPANIES

1.1 THE CAPTIVE DEFINED

The captive insurance company in its pure or traditional form is an insurance company which is wholly owned and which has as its sole function, the insurance or reinsurance of the whole or part of the risks of its parent and/or its parent's affiliates.

The growth of the captive insurance industry over the past 30 years has however given birth to several distinct structural and underwriting arrangements. Accordingly the purist definition given above can no longer adequately describe the myriad types of captives now in operation.

Captive insurance structures have now come to include for example, insurance companies which are organized by common but unrelated entities for the primary purpose of insuring selected exposures of the entities. Typically, such captives, called "association" captives, are comprised of shareholders having similar risk exposures.

Perhaps the singular characteristic feature which distinguishes today's modern captive from the conventional type insurance company is the restricted nature of its underwriting policy.

As the term "captive" infers, all or a substantial proportion of the risks underwritten or reinsured are comprised of selected exposures of the captive's parent, its shareholders and/or third party risks.

1.2 THE GROWTH OF THE WORLD CAPTIVE INDUSTRY

The concept of captive insurance is by no means a novel one. Organized captive insurance activity can be traced back to the 1920s and 1930s in the United Kingdom and North America, where many of the early captives were incorporated and structured on a mutual basis.

Substantially, these embryonic captives were organized on-shore. That is, they were incorporated and managed in the same country in which the insured risks emanated, very much like the conventional insurer.

The 1950s however marked the beginning of a new era which was characterized by a vibrant surge in the use of captives, mainly by North American parents, as a means of securing improved methods of risk-financing and management.

As the momentum increased there began a significant shift of captive domiciles from on shore to off shore locations, chiefly in a bid to avoid burdensome domestic regulatory legislation and high taxation.

Although accurate figures are unobtainable due to the strict confidentiality laws prevailing in some off shore jurisdictions, the most recent surveys put world captive population between 1700 and 2000, thus indicating a growth of almost 1000 units in the industry during the past 5 years.

It has also been reliably reported that premiums underwritten or reinsured by captives in 1985 were expected to exceed \$12 billion reaching the \$18 billion mark by the end of the decade.

The world's captive insurance industry, which is currently subscribed 70-80% by North American parents (some of which are "Fortune 500" companies), is now substantially concentrated in the offshore jurisdictions of Bermuda, the Cayman Islands, Guernsey, Vanuatu, the Netherlands Antilles, the Bahamas, Barbados and Gibraltar.

Although there is still some element of North American domestic captive activity, this is now generally confined to the States of Colorado, Tennessee, Vermont and Virginia which have all passed statutes specifically designed to attract both domestic and foreign owned captives.

Other favourable but less competitive offshore captive locations, include Antigua and Barbuda, the Turks and Caicos Islands, the British Virgin Islands, Hong Kong, Singapore, The Isle Of Man, Belgium and Cyprus.

Bermuda is currently the leading captive insurance domicile with registrations in excess of 1500. This figure represents between 60-70% of the world total. The Cayman Islands are next in line with a March 1986 listing of 295.

There are over 80 captives in Guernsey and 30 each in Vanuatu and the Netherlands Antilles. Statistics released by the Barbados Supervisor of Insurance indicate that there were 29 captives registered in that country as at October 9, 1986.

There are approximately 30 captives in the Bahamas and 15 in Gibraltar. Colorado, the United States leader, has about 30 captives, Vermont, 25 and Tennessee 10.

1.3 TYPES OF CAPTIVES

As indicated before, one striking feature of recent captive insurance development has been the emergence of novel captive structures bearing significant characteristic differences to the traditional single-parent captive organized to write its parent's own business.

In the main, radical transformations have taken place in capital and stock ownership structures, underwriting and retention policies and ceding and administration arrangements.

Not surprisingly, most of these changes were precipitated by adverse United States legislation and Internal Revenue Service

rulings, chief among them being the U.S. Tax Reduction Act of 1975, the U.S. Internal Revenue Service Ruling 77-316 of September 1977, and the U.S. Tax Court's December 1978 decision in the now celebrated Carnation Co. case. (Carnation Company v. Comm., 71 T.C.400 (1978), Aff'd.640 F.2d 1010 9th Cir. 1981).

1. The Single Parent Owned Captive

This is the captive in its most basic and puristic form. Most of the traditional captives were organized in this fashion underwriting exclusively the risks of its parent and/or its parent's affiliates.

The attitude of the U.S. Revenue Service towards the single-parent owned "pure captive", as it has been towards most affiliated insurance companies, is that the parent company and the insurance subsidiary are both members of the same "economic family".

In consequence, it has contended that no risk shifting or risk distribution can take place in such an environment since those who ultimately bear the pecuniary burden of the loss, namely the parents, are the same ones who suffer from the loss.

As such, the Revenue Service has refused to treat wholly owned captives as genuine insurers, thus denying their parents federal tax deductions in respect of premiums ceded to them.

A like position adopted by the Service in the Carnation proceedings, resulted in the U.S. based Carnation Corporation not being allowed a tax deduction for premiums paid to its Bermuda captive, Three Flowers Assurance.

It is not surprising therefore that U.S. parents are now increasingly liberalizing their captives' restrictive underwriting policies by admitting non-group or third-party risks, so as to qualify as bona-fide insurers in the eyes of the Revenue Service. Although done on a fairly discriminatory basis, some of these single-parent captives are now writing up to 50% in external unrelated risks.

Once unrelated third party risks are accepted, the captive ceases to be a "pure" captive and is then categorized as an "open-market" captive.

A popular open-market underwriting approach involves the reciprocal transfer of risks between two captives or between a captive and a conventional-type insurer, thus enabling each participant with the capacity to minimize its exposure on unprofitable risks.

2. The Group Captive

The group captive, otherwise known as the "multiple" captive, is normally contrasted with the single parent captive which is wholly owned by one entity.

Typically, a group captive is composed either by the parents of large unrelated multinationals or by the captives of the parents themselves, and like the pure captive, it is organized with a view of underwriting or reinsuring certain selected exposures of its shareholders.

One group captive recently incorporated in the Cayman Islands, has as its shareholders, some 33 United States blue chip corporations including U.S. Steel, International Business Machines (I.B.M.), General Electric (GE), Ford Motor Co. and Shell Oil. Another, OIL, is comprised of 31 unrelated oil corporations.

Immense economies of scale arising from an enhanced risk spread and a substantial premium income volume, are easily achieved by this type of captive. Further, given its diversified ownership structure and its relatively wide exposure base, it seems likely that the group thrust will assist the individual multinational shareholder in insulating itself against any move by the Internal Revenue Service in denying premium deductions.

3. The Association Captive

An association captive is a captive which is organized by individual members of professional bodies or trade and industry associations to insure the common risks of its constituent members.

Most association captives are usually operated offshore as reinsurers, assuming business from an unrelated direct insurer called the fronting company. The captive then has the option of retaining all or the greater proportion of the risk assumed from the fronting company or of retroceding a portion to another reinsurer.

This class of captives has been widely used by doctors and hospitals, who began organizing in the mid-70s, the so called "bedpan mutuals", to write medical malpractice insurance at lower premium rates.

They are also utilized by lawyers and a variety of other professionals seeking professional indemnity insurance, and by groups of industry workers and retail organizations seeking workmen's compensation insurance and warranty insurance respectively. Oil companies, shipowners' associations, refineries, utilities and contractors have also been known to have formed association captives.

Because association captives, like the group captive, are multi-

owned, they have not only invariably qualified as non-controlled foreign corporations under Subpart F of the U.S. Federal Taxation Code, but the Internal Revenue Service has also recognized on several occasions, that risk shifting and risk distribution is evident in their operations.

For these reasons, not only will deductions be allowed in respect of premiums paid to them, but association captives have also proven to be effective as an excellent structural device for enabling U.S. shareholders of foreign insurance companies to defer payment of taxes on their captives' underwriting profits and investment income.

4. The Rent-A-Captive

The rent-a-captive is conceptually a hybrid captive which is usually organized offshore to provide risk coverage for unrelated companies or associations. The term is therefore applied generally to any arrangement whereby an insured obtains the benefit of captive insurance without actually owning the captive.

In respect of each risk underwritten, the rent-a-captive either opens a new account or issues a block of preferred non-voting shares of a special class with the objective of separating the client's portfolio from that of the existing business of the captive.

As in the case of the association model, the shares purchased may be then redeemed by the captive should the client's programme be terminated. In consequence there is no pooling of business, and each client will thus ultimately bear the pecuniary consequences of his portfolio's performance.

By utilizing a rent-a-captive, an unrelated entity can acquire captive coverage without shouldering the attendant costs involved in captive capitalization and management. The captive on the other hand, benefits by receiving fees for the services rendered and it will also be entitled to share in any investment income earned.

5. The Agency Captive

An extension of the rent-a-captive is the "agency" captive which has surfaced during recent years.

The two types are inherently similar in character except that agency captives are initially owned and organized by groups of insurance brokers for the principal purpose of providing an alternate market facility for their traditional clients.

Rent-a-captives in accepting any new business, sometimes issue a conjoint offer of minimal equity participation.

6. The Direct Writing Captive and The Reinsurance Captive

Any of the foregoing "types" of captives may be broadly classified either as a direct writing captive (DWC) or as a reinsurance captive (RC).

A DWC is a captive which is suitably structured to effect the issuance of primary policies directly to its insureds/shareholders. Exposures underwritten by the captive in this manner will then be reinsured under a secondary (or reinsurance) policy in the conventional reinsurance market.

A RC on the other hand, is a captive which is organized to reinsure chiefly the exposures of its shareholders, these exposures having previously been written under a primary policy by an admitted conventional insurer called a "fronting company".

The RC may then retain all the exposures on its books or choose to retrocede a portion to another reinsurer called a "retrocessionaire". Risks retroceded in this fashion are called "retrocessions".

Prevailing throughout many of the Federal United States and most western countries are insurance legislative frameworks which require direct-writing insurance companies, underwriting domestic exposures, to comply with certain regulations.

Included among these are mandatory registration procedures, minimum capitalization and liquidity margins, and stringent reporting, filing, accounting and administrative requirements.

Though there may be no attendant laws requiring these insurance companies to be domiciled within the jurisdiction, the adverse nature of the predominant regulatory systems invariably renders any DWC operation therein impracticable.

In consequence, most U.S. companies and associations seeking captive coverage of U.S. based risks, have chosen to organize their captives offshore as reinsurers rather than as direct writers.

The underwriting procedure will first involve the U.S. entity assigning its exposures to a licensed or "admitted" domestic insurer (which is authorized by U.S. laws to write directly, U.S. based risks). Up to 90% of the risks taken by the domestic insurer are then in turn ceded to the captive under a reinsurance contract.

For the services supplied, the frontier will levy a fee. Currently this amount ranges between 5-14% of the gross premiums received. Since the frontier is however primarily liable on the policy, it will usually require from the captive or the related insured, some sort of guarantee of the captive's ability to indemnify the frontier in the event of a loss. This the captive or its owner will generally provide in the form of an irrevocable

letter of credit.

By utilizing this fronting mechanism, the RC is able to avoid the U.S. regulatory framework since its operations would not have involved the direct underwriting of U.S. based risks. Further, because it is not also a direct writer or reinsurer of risks originating in its offshore location, the RC will also be exempted from complying with similar domestic regulations.

It is interesting to note further, that the utility of the RC as a uniform risk coverage and management vehicle, is indeed more pronounced in instances where its shareholders are major corporations involved in transnational activities.

The centralized management of captive risks emanating in a variety of countries with varying regulatory constraints can obviously only be effectively accommodated through the use of local fronting facilities backed up by a suitably located offshore RC.

Any other alternative would involve the citing of a DWC in each locality. In such an event, the multinational shareholder would be burdened with substantial and unnecessary capitalization and management costs, the inability to effectively achieve a coordinated risk management plan and the gruesome task of complying with an abundance of differing bureaucratic regulations.

7. The Domestic Captive and The Offshore Captive

A domestic captive is simply one which is located in the same country in which its insured risks originate. An offshore captive is one which is located elsewhere.

Any captive type may assume either form notwithstanding that the overwhelming majority have been organized on an offshore basis.

This trend has been attributable in the main, to adverse considerations, similar to those faced by direct writing captives, prevailing in the domestic environment of the parent.

On the other hand, offshore "havens" have long offered conducive infrastructures for captive insurance activity. These have been characterized primarily by a minimum of regulatory restraints on captive formation, capitalization and management, and also by an absence of constraints on the investment of premium incomes.

Offshore captives are also invariably exempted from the payment of taxes on underwriting profits and investment income. In most locations, they are permitted to conduct their operations with limited disclosures to the state's regulatory agency, with the assurance that the confidentiality of their transactions will be preserved.

On the other hand, if the intended captive's parent is in substance, government owned or heavily dependent upon government

or municipal contracts and/or financing, then political considerations may demand that it be organized locally as a domestic captive.

1.4 REASONS FOR CAPTIVE FORMATION

Although it is widely believed that tax considerations, such as avoidance, reduction or deferral, are the principal reasons for organizing captive insurance companies, this has in fact not been the case.

Captives have been formed predominantly to secure for their owners the following benefits, namely: reduced insurance costs, enhanced cash flows and investment income, access to reinsurance markets, personalized coverage, provision of coverage otherwise unavailable, loss control, centralized risk management, freedom of investment and the ability to freely move funds internationally. Tax benefits arising, if any, are viewed only as an added bonus.

1. Cost Reductions

The most common reason for forming a captive is to minimize one's overall risk management costs.

An analysis of the conventional market's commercial premium structure will disclose that a significant proportion thereof, sometimes as high as 40%, is allocated exclusively to covering

the insurer's overheads.

These will include administrative and advertising costs, commission payments to brokers, underwriting profit and premium taxes. For these reasons, a captive alternative becomes a viable proposition once a corporation's annual premium portfolio begins to exceed \$500,000.

By forming a captive, the corporation should be able to avoid most of these costs as the captive would not require a sales force, agency personnel nor an advertising or promotional programme. Further, expenses that are normally incurred in the areas of administration, adjustment and settlement of claims, premium and other taxes are either significantly reduced or eliminated altogether.

If the conventional insurer has also failed to grant adequate premium credits to a large corporation which has had a good loss ratio experience or which has assumed a relatively large deductible, it may well be to the advantage of the corporation to consider the establishment of a captive.

By so doing, any underwriting profit which would have previously accrued to the conventional market would now be retained within the economic family thus further reducing the corporation's overall insurance costs.

2. Enhanced Cash Flow and Investment Income

Most conventional insurers require premiums to be paid in advance whilst insisting on satisfying claims over a period of time. They thus acquire the ability to generate substantial amounts of investment income not only on any underwriting profit realized but also on unearned premiums and unpaid losses.

The multinational can however enjoy these same benefits by redirecting its exposures to an owned captive. Premiums ceded to the captive are retained within the corporate entity to be utilized in much the same way as before except that the consequent increase in cash flow and the new source of income benefits the owner of the captive rather than the conventional insurer.

By timing premium payments to its captive, the parent can also further enhance its cash flow situation. The same is also true of the captive with respect to its reinsurance arrangements since reinsurance premiums, unlike direct premiums, are in certain circumstances payable on an earned basis.

Investment income can also be further maximized through the tax-free accumulation of premium reserves, unpaid losses and investment income should the captive be sited in an offshore jurisdiction.

The accumulated income would enable the parent, subject to

adequate reserving measures, to offset the operating costs of the captive, finance its domestic activities and expand its operations overseas. In the final analysis, the parent would have succeeded in converting what was once a major cost item into a massive profit centre.

3. Access To Reinsurance Markets

Because the cost of reinsurance is significantly less than direct excess or direct umbrella coverage and because reinsurers can only be accessed through insurance companies, it is therefore possible for a major corporation to realize substantial risk management savings through the utility of an owned captive.

This is easily accomplished by using the captive to insure the parent's policy deductibles whilst ceding the excess to an unrelated reinsurer.

In addition, the parent will be able to obtain risk coverage not otherwise available on the direct market, participate with other captives in the pooling of large risks, and earn ceding commissions and underwriting profits.

4. Personalized Coverage

Conventional insurance contracts are invariably "unilateral" or standardized in nature, seldom constructed to reflect the differing needs and circumstances of insureds. In the same vein,

traditional premium rating structures have remained inflexible in the face of insureds who have striven to maintain a good loss ratio, but who have only been rewarded with smaller deductibles.

The captive however offers the unique opportunity of eliminating these difficulties with its ability to tailor a policy to suit the risk parameters of its owner thus ensuring greater flexibility and reduced costs.

5. Provision Of Coverage Not Otherwise Available

It has been stated previously that the formation of certain captives, principally those owned by U.S. interests, have been precipitated by the inability of buyers to obtain direct market coverage for a variety of exposures. Others have been formed also to provide coverage which has only been obtainable on the direct market, at inordinately high rates of premium.

Examples of some of the risks under consideration include medical malpractice, nuclear hazards, oil and environmental pollution, natural catastrophes, public liability and products liability.

The highly litigious nature of the American society and the tendency of civil juries to grant massive damages awards have contributed substantially to this current scenario of escalating premiums and the relative unavailability of affordable coverage.

To take an example, the average award in medical malpractice

suits for that country, has for the first time surpassed \$1 million. In consequence, an obstetrician practising in Los Angeles, CA., must now pay approximately \$45,000 in annual conventional premiums and a neurosurgeon in Long Island, N.Y., around \$83,000.

With products liability awards now averaging way in excess of \$1.7 million, product manufacturers have also been hard hit. In consequence, there is an increasing reluctance on the part of conventional insurers to accept exposures on both new and potentially hazardous products with the result that manufacturers must either suspend or cease plant operations, seek participation in captive ventures or risk imminent extinction by proceeding without coverage.

Recently, Connaught Laboratories, one of two U.S. producers of a common children's vaccine, halted production for 9 months during which it was unable to secure suitable coverage for its product. Another example was the establishment of a captive by Johnson & Johnson, a leading manufacturer of baby care products, to acquire products liability coverage in respect of its contraceptive pills.

A rapid movement towards further captive formations and developments is therefore expected if the conventional insurance market persists in its failure to meet the reasonable expectations of its traditional clientele.

6. Freedom Of Investment and Movement Of Funds

Captives, especially those that are located offshore, are to a great extent exempted from the regulatory and legislative constraints which are often placed in the way of their conventional counterparts.

Paramount among these are the mandatory regulations which tend to inhibit the freedom of the insurer in targeting areas for the investment or channelling of premium reserves and unpaid losses.

Guided by a conservative investment management policy and subjecting itself to prudent reserving measures, the offshore captive is therefore in a more favourable position to secure a higher return on its investments.

Its flexibility will allow it to channel its funds wherever its owners wish. Investments can be made directly or indirectly through subsidiaries, in the captive's domicile, in the parent's domicile or internationally.

Areas targeted may include property acquisitions, selected long or short-term securities and jointventures. Further, there is always the possibility that it may be permitted to on-lend money to its parent and/or its parent's affiliates.

Large corporations that are engaged in transnational activities will also discover that the offshore captive can be used

effectively to move large sums of money internationally.

The relative freedom that multinationals once enjoyed with respect to the repatriation of their foreign earnings have now almost disappeared as a result of adverse exchange control restrictions, currency fluctuations and a variety of differing foreign government regulations.

However, since no western country has had the internal capacity to provide insurance and reinsurance coverage for all of its domestic risks, domestic carriers worldwide have accordingly enjoyed a relative freedom in being allowed to cede business extra-territorially.

By utilizing a fronting arrangement in each foreign locality, backed up with a suitably placed offshore captive to which the greater percentage of all risks will be ceded, the multinational can therefore avail itself of this seemingly unconventional method for remitting funds.

Once secured in the hands of the captive, the funds may be moved freely to whichever country its owners may direct.

7. Enhanced Loss Control and Risk Management

For the multinational owners of captives, the captive serves as a central risk management base co-ordinating the entire portfolios of its owners. As a result, parents will enjoy optimum risk

management, enhanced loss control, greater uniformity in risk coverage, standardized claims settlement procedures and ultimately, a substantial reduction in overall insurance costs.

1.5 CRITERIA FOR SELECTING CAPTIVE LOCATION

If on the basis of an analysis of the foregoing considerations, a decision is taken to form a captive, the next step would be to determine its site or location.

To that end, the first and foremost question concerns the choice of a domestic location where this is permitted, as against an offshore location. For reasons which have already been explained, the general tendency in terms of resolving this issue has been to favour the latter alternative over the former.

As to the criteria which will however determine the choice of one offshore location as against the other, the following have ranked high amongst the factors which are normally taken into account by the majority of corporations seeking to establish captives in offshore localities:

- Suitable geographical location, air links network and international communications facilities;
- Political and economic stability;
- Acceptable legal framework and non-adverse insurance regulatory machinery;
- Availability of competent management, professional and other

complimentary services;

- Exemptions from foreign exchange controls and currency restrictions; and
- Low or nil tax framework.

Axiomatically, Bermuda and the Cayman Islands have established themselves as the world leaders among offshore captive havens primarily because of their efforts in developing and maintaining jurisdictional infrastructures which have been characterized in the main by these features.

Their experience and that of other captive havens, underlies the proposition that foreign governments who are desirous of attracting captives to their shores must, as a mandatory and minimum prerequisite, and to the extent that it is possible, implement suitable political, economic and legislative measures to ensure that these incentives are in place.

Each of the factors will now be considered separately.

1. Suitable Geography, Air Links and Communications

The geographical location of the captive is a major consideration since it is obviously desirable for the parent to be as close as possible to the scene of the captive's operations. It is partly for this reason therefore that most U.S. corporations have preferred to establish their captives in Caribbean jurisdictions rather than in Far Eastern or European havens.

Variables, such as differences in time (which can seriously impede the normal execution of business transactions), travel costs, communications costs and management time exposures are all directly linked to this one single factor.

It is also essential that the locality be adequately served by international airlines which at best, should provide daily and direct scheduled services to and from the seat of the parent's operations and other major cities.

A locality which does not have in place a modern and reliable international telecommunications network will also encounter substantial difficulties in attracting captives to its shores.

Since the conduct of international insurance transactions demands strict compliance with deadlines and time scales, it is vital that the captive, its owners/clients, its management (where located elsewhere) and its reinsurers possess the means by which they can cross-communicate quickly, easily and cheaply.

Further, if the captive is involved in the underwriting or reinsurance of multiple transnational risks, the need to have access to adequate international communications facilities will become even more pronounced.

To this end, a suitable locality should at the very least, provide international direct dialling, courier and telex facilities. The ability to provide access to more advanced and

sophisticated facilities such as telefax, teleconferencing and transmission of computerized data through telephone or satellite networks would be an added advantage.

2. Political and Economic Stability

The question of political stability, though a prominent factor, is sometimes difficult to assess.

Very little significance if any at all, should be attached to a current climate of stability if historically a nation's profile has been characterized by turmoil or civil unrest.

Consideration should be given to the political history of the country, the various political groupings that there are, the political and economic philosophies which they have espoused, the degree of support which they command and the possibility of certain adverse circumstances arising should there be a change in government.

Perhaps some of the key indicators of political stability are peaceful and democratic transitions in government, consistent and widespread support for government's economic and political policies, governments characterized by integrity, honesty, fair treatment and efficiency, an even distribution of wealth and steady economic growth.

On this matter of economic growth it hardly needs to be said that no business concern can be maintained as a viable proposition in a floundering economy. It is therefore necessary to assess the stated economic policies of government with a view to determining the future economic prospects of the locality chosen.

In any event, guarantees should be sought against the imposition of future taxes and against the possibility of an expropriation or nationalization of assets. A contingency plan for the speedy relocation of the captive should also be structured to avoid the possible risk of sequestration of funds or the adverse consequences brought on by a sudden deterioration in the economy.

3. Acceptable Legal Framework and Insurance Regulatory System

An offshore locality which possesses a modern legal system, an independent judiciary and laws which mandate the preservation of the due process of law should be sought.

Experience has shown that localities which were formerly under British occupation and those which still are have attracted literally all U.S. owned offshore captives. Bermuda, the Cayman Islands, the Bahamas, the Turks and Caicos Islands, the British Virgin Islands and Barbados being the principal ones.

One significant observation which springs from this correlation is the fact that all the legal systems involved, including that of the United States, are patterned off the British common law

system.

The captive owner therefore reaps the benefits to be derived in such instances where the laws and the systems of judicial process prevailing in the domicile of the captive are fundamentally similar to those prevailing in the domicile of the parent.

Further, the British common law system which is over nine centuries old, has served as the foundation of the legal systems of the majority of the free world, barring those of Continental Europe and its former Latin American colonies. The system has been well tested, tried and developed, and today stands aloft as the corner stone of the world's most democratic countries.

A more decisive factor however, in the decision-making process, concerns the laws of the locality which govern the formation and operations of captive insurance companies. Naturally the less stringent and the more flexible these laws are, the more attractive the locality will be as a captive haven.

An indepth and comparative analysis of the laws of each locality must therefore be undertaken whilst bearing in mind the proposed objectives of the captive.

Of paramount importance are the following questions:

- What types of captives are permitted - whether direct writing or reinsurance or both - whether pure only or pure and other types?
- Whether there are any limitations on the classes or lines of business which it is intended to write?
- Whether the company will be able to engage in business other than insurance?
- The length of time it takes to form and licence the captive and the government authority which is vested with this responsibility;
- The costs to be incurred including legal expenses, registration fees, licence fees and levies if any.
- The detailed registration and licensing procedures to be complied with;
- The nature of the information which is to be supplied concerning ownership;
- The minimum capitalization margin, if any;
- Whether there are any minimum solvency requirements and if so, what are the relevant amounts?
- Whether there is any requirement for the payment of a security deposit?
- The nature of the returns which are required to be made to the authorities;
- Whether confidentiality is guaranteed?
- What records are required to be maintained?

- Whether investments are restricted to certain specified classes?
- The precise nature of government supervision over the underwriting policies of the captive.
- Whether the laws inhibit the free form and content of the insurance contract?
- Whether there are any annual fees or other taxes payable to the authorities and if so, the amounts?
- Whether the captive is restricted to local management and if so, the costs to be incurred?

4. Availability of Management and Ancilliary Services

Perhaps one of the key factors involved in choosing a captive location is the need to ensure that competent management resources are available locally.

Effective management of an offshore captive requires a substantial degree of professional expertise. The management unit selected will be required to oversee the captive's risk management, reinsurance management, claims management and funds management portfolios. These in turn will involve the following:

- The evaluation of exposures;
- Premium ratings;
- The determination of retention levels;
- The implementation of a loss prevention programme;
- Fronting and reinsurance negotiations and arrangements;

- The evaluation, adjustment and settlement of claims;
- Reserving;
- The investment of surplus funds.

In addition, the management unit will also be responsible for seeing to the day to day administration of the captive by handling documentation and correspondence, filing the required statutory returns and making arrangements for the provision of accounting and legal services.

The selection of capable management is therefore a decisive factor and although the cost implications must be studied, care should be taken to ensure that competent management is not sacrificed in favour of lower costs.

Once the preceding survey is carried out, it will also become necessary to determine whether competent complimentary professional services are available.

In this regard, a suitable locality would be expected to provide reputable banking and trust services, specialist lawyers who are fully conversant with local and other applicable laws, established accounting firms and stock brokers with connections through to the major international markets.

5. Exemptions From Exchange Controls and Currency Restrictions

The locality chosen should either have a total absence of exchange controls and currency restrictions or be prepared to grant sufficient exemptions in the event that such controls are in force.

In any other case the captive will be inhibited in its ability to maintain foreign exchange accounts in respect of its reserves, unpaid losses, underwriting profit and investment income or to invest freely outside the locality and remit profits to its parent.

Such conditions would most obviously retard the operations of the captive whilst inflicting a serious blow on its profitability.

6. Low or Nil Tax Framework

As stated previously, very little significance should be attached to taxation considerations during the decision-making process which has to do with whether or not a captive should be established. However, as a location factor, tax considerations are of paramount importance.

To begin with, if the locality in question imposes little or no taxes on premiums, underwriting profit or investment income, the captive's ability to expand its reserves and to maximize its earnings is thereby substantially enhanced. Further, additional

tax advantages will accrue to both the captive and its owners if there is also an absence of capital gains and income taxes.

Secondly, if the particular locality has entered into a bilateral double taxation treaty with the domicile of the captive's owners, certain fiscal benefits may be forthcoming.

To take an example, U.S. owned captives located in Barbados are exempted by treaty from paying a federal excise tax on all premiums which are remitted from the United States. The current excise tax rates are 1% on life, accident and sickness insurance premiums, 1% on all reinsurance premiums and 4% on property, casualty and indemnity bond premiums.

In addition, under U.S. federal tax laws, a foreign insurance company may be liable to direct taxation at the rate of 46% on any U.S. related income should the company be considered to be engaged in a "U.S. trade or business".

Apart from U.S. double taxation treaties, which have defined the phrase to mean any activity carried on through a "permanent establishment" located in the U.S., no unequivocal and conclusive definition has yet been forthcoming.

Accordingly, captives that are established in a locality which is a party to such a treaty can avoid the tax by simply structuring their operations to suit. On the other hand, captives located elsewhere must run the risk of incurring the penalty.

On the question of enabling tax deductions in respect of premiums paid to its foreign captive, a U.S. company should however be aware that this has absolutely nothing to do with the particular locality chosen.

The Internal Revenue Service will instead be guided by its appraisal of the captive's ownership structure and its underwriting policies in its quest to determine whether there has been a bonafide shifting of risks from the owner to the captive.

Generally, deductions have been refused in the case of pure single parent captives for want of this criterion. On the other hand it is unlikely that group, association or rent-a-captives will be viewed in a similar light principally because of their multi-ownership structures and their relatively open-market type underwriting policies.

Further, where the owner of the captive is domiciled in the United States, its tax liability on profits earned by the captive is also not affected by the particular locality chosen.

The maximum benefit which may accrue in this regard is the ability to defer the payment of taxes until such time that the profits are repatriated. However, even this benefit may be denied should the captive be classified as a "controlled foreign corporation" for the purposes of Subpart F of the federal taxation code.

Canadian owners of Barbados domiciled captives are on the other hand exempt from the payment of income taxes on profits repatriated to Canada so long as the risks to which they relate are non-Canadian based. This has been as a result of a double taxation treaty entered into between those two countries. Unlike their U.S. counterparts therefore, Canadian owned transnationals stand to benefit in this particular regard by location shopping.

CASE STUDY: BERMUDA

2.1 GEOGRAPHY, LANGUAGE, POPULATION AND COMMUNICATIONS

The atlantic archipelago of the British Crown Colony of Bermuda is comprised of seven major islands and innumerable islets all totalling no more than 20.5 square miles in area. The larger islands including the "mainland" on which the capital, Hamilton, is located, are all interconnected by bridges. Current population is estimated at about 56,000 and the language spoken is English.

Bermuda is situated in the western Atlantic ocean some 600 miles east-south-east of Cape Hatteras, North Carolina, and about 1000 miles north of the West Indies. Separated from the United States by the Gulf Stream, it enjoys enviable year round temperatures which range between 55 degrees in the winter and 87 degrees in the summer.

Bermuda offers excellent international communications facilities by way of mail, cable, telex, direct dialling telephone, courier, airline and shipping services. These are enabled in part by its close geographic proximity to the United States and its ideal mid- Atlantic location.

Major international airlines offer direct flights to Miami, New York, Boston, Philadelphia, Baltimore, Washington, London,

Montreal, Toronto, Halifax, Barbados, Nassau and Jamaica. Flying time to London is 6.5 hours and to New York, just 1.5 hours.

2.2 STRUCTURE OF GOVERNMENT

Although it was discovered in 1503 by the Spanish, it was not until 1611 that Bermuda assumed the status of a British Crown Colony. In 1620 it was granted the right to elect its own government and since 1684 its Governors have been appointed by the British Crown.

In consequence, Bermuda is now the oldest self-governing British colony and it prides itself as having the oldest bicameral legislature in the entire British Commonwealth second only to the British parliament.

Seeking greater autonomy in local government, Bermuda secured the entry into force of a new constitution in 1968. Provision is now made for a bicameral legislature comprised of a 40 seat House of Assembly whose members are elected in local elections and a senate whose 7 members are appointed.

The executive authority of the Colony is vested in the Crown of England and exercised through the resident Governor who holds office at the Crown's pleasure.

The Governor appoints as Premier, the member of the House who commands the majority support therein and he in turn forms a

cabinet of government ministers drawn from the House.

The Governor is obliged to seek the advise of the cabinet on all matters of government excepting such matters which relate to the internal security and external affairs of the Colony, over which he has an exclusive authority.

The constitution makes adequate provision for the guarantee of individual fundamental rights and freedoms and upholds the due process of law.

2.3 POLITICAL AND ECONOMIC STABILITY

Except for two periods of civil unrest in 1973 and 1977 and the economic downturn which followed on the heels of a 1981 general strike, Bermuda has had a remarkable history of relative political tranquility, peace and economic prosperity.

The tourism and the offshore sectors are the principal foreign income earners generating in excess of \$600 million annually. Unemployment is minimal and an exceptionally high standard of living is enjoyed by most Bermudians given the near \$18,000 per capita income.

Although Bermuda receives no aid or subsidies from Britain, and despite a small national debt and a high import bill, its attraction as a major tourist destination and the world's leading captive insurance haven has enabled it to enjoy an overall

current account surplus.

With the distinct possibility of its being granted independence in the near future, there is however some scepticism among Bermudians as to the adverse effects this could have on the vibrancy of the offshore sector.

Bermuda's reputation as a long standing and stable tax haven has been painstakingly nurtured and carefully guarded over the years by its respective governments, whose policy has been to open the doors only to reputable and "clean" concerns.

As evidence of its commitment to the continued growth of the offshore sector, the government enacted in 1966, the Exempted Undertakings Tax Protection Act, which vests in the Governor the power to grant to any exempted entity, a guarantee against the imposition of any taxes on income, capital or capital gains up to the year 2006. It has not been the practice to refuse applications emanating from eligible and admitted entities.

Bermuda has two major political parties, the Progressive Labour Party and the United Bermuda Party. The latter has for the past 18 years maintained a literal stranglehold on the seat of government. The opposition Progressive Labour Party has stated its full support for the captive insurance industry.

2.4 LAWS AND LEGAL SYSTEM

As a self governing British Colony, the supreme laws of Bermuda are those embodied in its constitution. Local acts of parliament take precedence over, and are supplemented by the English common law, the English doctrines of Equity and English acts of general application which were in force in England in 1611. English law is therefore the predominant law.

Bermuda's independent judiciary is comprised of a magistrate's court, a supreme court and an appellate court. The Privy Council which sits physically in England, serves as the final appellate court.

2.5 TAXATION REGIME

Bermuda is classified as a traditional nil tax haven and accordingly there are no prevailing income, corporation, profits or dividends taxes. Neither are there any taxes levied on interest, gifts, capital gains or inheritances. The country has no tax treaties.

Government revenue is principally derived from customs duties, land taxes, registration fees and annual taxes levied on exempted insurance, finance and shipping companies, a payroll tax, a hotel tax and a variety of stamp duties.

2.6 FOREIGN EXCHANGE CONTROLS AND CURRENCY RESTRICTIONS

The local unit of currency is the Bermuda dollar which has the same gold parity as the United States dollar.

Generally Bermudian residents are prohibited from maintaining banking accounts in currencies other than Bermudian currency and they are required to seek approval for the purchase of foreign exchange.

Non-residents including exempt companies may however maintain foreign currency accounts and deal freely in non-Bermudian currency. Control free repatriation of funds by these entities is also allowed.

2.7 BANKING AND ANCILLARY PROFESSIONAL FACILITIES

Unlike most major tax havens, Bermuda neither encourages nor facilitates offshore banking. There are only three domestic banks, the Bank of Bermuda which was established in 1889, the Bank of N.T. Butterfield & Son, established in 1858 and the Bermuda Provident Bank.

All three offer a complete range of international and domestic banking services including trust, investment and financial management services.

In addition, they provide direct access to the Euro-dollar market whilst maintaining excellent connections with leading financial institutions worldwide and satisfying the diverse needs of the offshore community. Two of the three banks have current assets in excess of \$2 billion.

By virtue of the 1969 Banks Act, all three banks are locally controlled with a minimum of 50% of their total voting rights being vested in residents.

Full legal, accounting and auditing services are provided by the colony's 14 law firms some of which have staff compliments exceeding 100, together with its accounting firms.

Bermuda has hundreds of insurance specialists and over 160 management companies staffed with experienced professionals offering excellent managerial services to captives and other exempt companies. A local college which was recently established, offers advanced courses in the disciplines of insurance, banking and finance.

2.8 THE CAPTIVE INSURANCE MARKET

Bermuda is now firmly entrenched as the world's leading captive insurance and reinsurance centre. Its offshore registry now boasts a listing of over 6,000 exempt companies, more than a quarter of which are captive insurance companies; the others being shipping, finance, trading and holding companies.

Its captives, which comprise about 70% of the world total, are estimated to have earned in 1985, premium incomes in the vicinity of \$8 billion.

Bermuda's dominance of the international captive insurance market from as early as the late 1960s in direct opposition to its current Caribbean competitors, the Bahamas and the British Crown Colony of the Cayman Islands, can perhaps be explained by the fact that it was then the only self-governing British colony other than the Bahamas, which was proximately located to the United States and which had in place the appropriate tax haven infrastructure.

At that time, the Cayman Islands were virtually unrecognized as a tax haven and further, they did not acquire full self-governing status until August 1962 when they ceased to be a dependency of Jamaica.

The early development of the Bermuda captive market was also aided by the attempted enactment in 1967, of stiff legislation in the Bahamas intended to regulate Bahamian captives. This unpopular development together with the imposition of a 1% Government tax on gross insurance premiums, resulted in the migration of literally all Bahamian captives to Bermuda and the Cayman Islands.

Today, Bermuda captives include single parent captives, association and industry captives, captive pools and open market

captives. They are all strongly complemented by a comprehensive domestic network of long standing insurers, reinsures and brokers.

2.9 INCORPORATION AND REGISTRATION OF CAPTIVES

A Bermuda domiciled captive is prohibited from engaging in the conduct of offshore insurance business unless it is an incorporated body and has been registered as an insurer under the 1973 Bermuda Insurance Act.

Although foreign incorporated companies may apply to the Minister of Finance for a special permit to be registered as a foreign incorporated body, it has nonetheless been the policy of the Government that all offshore or exempted companies should be locally incorporated.

The incorporation procedure is two-pronged and involves in the first instance, an application to the Minister for a licence to incorporate and secondly, the filing of the company's memorandum of association with the Registrar of companies pursuant to the 1981 Bermuda Companies Act.

Prior to the filing of the initial application, an advertisement containing the name and objects of the company, is required to be placed in a local newspaper.

The application to the Minister on the other hand, is required to

be supported by the company's memorandum of association signed by at least 3 subscribers and in which must be stated, the name of the company, its objects and its authorized share capital.

S.7 of the Insurance Act specifies certain minimum capitalization margins to be met by all insurers. In the case of a property and casualty captive, it is \$120,000, in the case of a life insurance captive, it is \$250,000 and in the case of a captive writing combined business, \$370,000.

Upon receipt of the Minister's permit, an applicant must file within one month, its memorandum of association with the Registrar's office.

After this procedure is completed, the company may then adopt its by-laws, elect its board and issue its shares. Shares may have a no-par value and may also be issued as redeemable shares.

A captive company must have at least 2 directors and may hold its board meetings outside the country as long as two alternate directors reside therein. The annual meeting of the shareholders may also be convened extra-territorially.

Although a Bermuda captive is required to maintain a members' register, full disclosure of its beneficial shareholders can be avoided by the issue of shares to nominees.

Bermudian captives are required to pay a government incorporation

fee which ranges between \$500 and \$5,000. If capitalized at the minimum legal margin, a general company would pay \$750, a life company \$1,250 and a company writing combined business, \$1,250.

All Bermuda domiciled captives are required to be registered under the 1978 Bermuda Insurance Act. The power to grant registration is vested by the Act in the Minister of Finance.

In considering whether to register an insurer, the Minister is required to have regard to whether the insurer appears to him to be a fit and proper body to be engaged in the business of insurance.

He is also required to consider whether the applicant has adequate knowledge and expertise and whether any person concerned in the management of the business is a fit and proper person to be so concerned.

S.6 further prohibits the Minister from registering the applicant if he is not satisfied that the value of its assets exceeds its liabilities by the statutory amount. A company may not also be registered if the stated minimum share capital requirements have not been met.

An applicant is required to furnish information on its intended underwriting policies, its estimated premium income volumes and its capital and surplus levels for the first two years of operation.

At the time of registration under the Insurance Act, it is also required to inform the Registrar of Companies, of the location of its principal office and of the prescribed particulars of its principal representative.

Particulars pertaining to its insurance manager (in the event of its intention to be managed by one), its approved auditor and any other prescribed person to be engaged in or to be employed in its business, must also be furnished.

If the Minister is satisfied with the circumstances of the applicant, the Registrar of Companies will be directed accordingly and a certificate of registration will in due course be issued.

The certificate will bear the name and business address of the company, the date of its registration and the conditions if any, attaching to the grant of the certificate.

An initial registration fee of \$2,250 is payable upon application and thereafter, an annual fee of \$1,550 becomes payable.

2.10 HIGHLIGHTS OF CAPTIVE INSURANCE REGULATORY LEGISLATION

The Insurance Act of 1978 and the Regulations made thereunder constitute the regulatory machinery which currently governs the registration and operations of all Bermuda domiciled insurance companies.

Although the Act received Royal assent in July 1978, it was not until February 1980 that it was brought into force. Since then, it has been amended on three occasions, namely in March 1981, May 1983 and March 1985.

The power to administer the provisions of the Act are vested in the Minister of Finance and are exercisable by him, subject to the advice of an Insurance Advisory Committee. The Registrar of Companies is however expressly authorized to act on the Minister's behalf in respect of certain matters falling under the jurisdiction of the Act.

Every insurer is required by the Act to maintain a principal office in Bermuda and to appoint and maintain within Bermuda, a principal representative who is either a registered management company or some other person approved by the Minister, as that insurer's principal representative.

On pain of criminal prosecution, a principal representative is required to inform the Minister if he is of the opinion that the insurer on whose behalf he acts, is insolvent or is about to become insolvent.

Other events which are reportable include the insurer's involvement in any criminal proceedings and any failure on its part to comply with the prescribed solvency margins and liquidity ratios.

In addition to the minimum capitalization margins, the Act requires a general insurer to maintain a minimum level of capital and surplus amounting to 20% of the net retained annual premiums for the first \$6 million of premiums and 10% of net retained annual premium for amounts in excess of \$6 million.

General insurers are also required to maintain "relevant" or liquid assets equal to at least 75% of their liabilities. The Act excludes from the definition of relevant assets, investments in and advances to affiliates, real estate and unquoted securities.

Long term insurers on the other hand, are required to segregate their long term business into separate accounts and to maintain the said accounts in such fashion so that the assets and liabilities of its long term business can be readily and easily identifiable.

Long term companies are also prohibited by S.24 (5), from paying a dividend to any person other than a policyholder, if the value of its assets does not exceed its liabilities by the required amount as certified by an approved actuary. In any case, aggregate dividends declared or made payable, may not exceed the certified surplus.

All captives are required by Sections 15 through 17, to prepare annual audited "statutory financial statements", which are to be kept at the principal office of the insurer for a period of at least five years from the ending of the year to which they

relate. The Registrar of Companies may requisition the statements at any time during this period.

The information to be included in the statements should be such that an "early warning" would be given of the company's failure or potential inability to observe the solvency requirements of the Act.

Insurers are also required to submit an annual "statutory financial return" in the prescribed form. This should include an auditor's certificate attesting to the company's compliance with the financial provisions of the Act and a certificate of solvency signed by the company's principal representative.

Any insurer which is engaged in any business other than insurance is required to maintain separate accounts with respect thereto and to segregate the assets and liabilities of its insurance business from those of its other businesses.

S.30 of the Act vests in the Minister, the power to investigate the affairs of any insurer if he is satisfied that such an investigation is required in the interests of policy holders.

The Minister is also given wide powers under S.32 of the Act in any instance in which it appears to him that an insurer is about to become insolvent.

Included amongst his powers are the power to restrict an insurer

from issuing any further policies or from making any further investments of a specified class, the power to demand the company to realize an existing investment and the power to instruct the company to maintain within Bermuda, specified assets of a certain description.

S.52 of the Act safeguards the confidentiality of the business of registered insurers by restricting the disclosure of any information received by a public officer in the performance of his duties under the Act.

All exempt captives are eligible for the grant of a government guarantee of exemption from all income, capital gains and profits taxes up to the year 2006.

CASE STUDY: THE CAYMAN ISLANDS

3.1 GEOGRAPHY, LANGUAGE, POPULATION AND COMMUNICATIONS

About 150 miles south of Cuba, 178 miles west-northwest of Jamaica, and approximately 475 miles south of Miami, Fla., in the warm waters of the Caribbean, lies the fast developing offshore sanctuary of the Cayman Islands.

Geographically, this British Crown Colony is comprised of three islands, all low lying and surrounded by shallow white sand beaches. No rivers flow through any of the islands.

Grand Cayman, the largest of the three and the site of the Colony's offshore centre and capital, Georgetown, is 75 square miles in area. Cayman Brac and Little Cayman, which lie a few miles to the north-east, are only 14 and 10 square miles respectively in size.

Cayman, as it is often called, is a renowned tourists' paradise and enjoys excellent temperatures with the annual mean varying between 74 to 86 degrees.

The last official census which was taken in October 1979, disclosed the then overall resident population to be 16,677. Estimates for the year 1985 have indicated a figure of

approximately 20,000, 90% of which live on Grand Cayman. The official language of the Cayman Islands is English.

Cayman offers a superb domestic and international communications facility which ranks second to none amongst commonwealth caribbean offshore centres.

At the end of 1985 there were 12,906 telephones in use by 7,343 subscribers. A domestic standard B satellite earth station and a telecommunications submarine cable link-up with Jamaica, enables instant direct dialling to some 98 countries around the world.

Its sophisticated 24 hour telex system which has more lines per capita than any other nation, provides direct connections with the United States, the United Kingdom, Europe, the Caribbean and Central and Southern America.

A Reuters service introduced in 1985, provides access to international financial databases whereas access to general computerized databases in Europe and the United States are available through a packet switched network. Facsimile and courier services are provided to major world destinations.

Direct daily scheduled jet services operated by Air Jamaica, Cayman Airways and Republic Airways, link the islands through the new Owen Roberts International Airport in Grand Cayman, with Miami, Houston and Kingston. Confirmed onward connections to major cities around the world are guaranteed by a local high

speed airline reservation datalink.

3.2 STRUCTURE OF GOVERNMENT

The Cayman Islands were discovered on May 10, 1503 by the Spanish explorer, Christopher Columbus and were ceded by Spain to Britain in 1670, by the Treaty of Madrid.

From thence until 1962, the government of the Caymans was administered by Jamaica. When Jamaica secured its independence in August 1962, the Cayman Islands opted to remain subsumed as a British Crown Colony, a status which to this day is fiercely guarded by its people.

Under the current 1972 constitution, the Islands' third, provision is made for a parliament/government composed of an Executive Council and a Legislative Assembly with supreme executive authority being vested in the British Crown and exercised locally by a Crown appointed Governor. The current Governor is his Excellency, Mr. Peter LLOYD.

The Council, which advises the Governor, is comprised of four elected members drawn from the Legislative Assembly and three "Official Members" who hold office as the Chief Secretary, the Attorney General and The Financial Secretary.

The Legislative Assembly, which is the primary law making body, is composed of 12 members elected during general elections. The

last Assembly elections were held in November, 1984. There are no official political parties in the Cayman Islands.

The Governor who serves at the pleasure of Her Majesty, presides over both bodies and is obliged to act on the advice of the Council except in matters relating to external affairs, internal security, the police and the civil service. The day to day government of the colony is handled by the Executive Council, with each of its members being responsible for a specified portfolio.

3.3 POLITICAL AND ECONOMIC STABILITY

The Cayman Islands have perhaps uncovered one of the ideal recipes for political and economic stability. Its absence of political parties and trade unions unequivocally reflects the economic prosperity of its people, their general livelihood, their satisfaction with the government's handling of the country's affairs and their obvious desire to have their country remain a colony.

There are no volatile minority groups in existence, there is virtually nil unemployment, and a very high standard of living is enjoyed by the majority of its populace.

The Cayman Islands' economy thrives principally on the offshore and tourism sectors.

As at December 1985, there were 17,486 companies registered in the Islands, 9,819 of which were classified as offshore or exempt companies. Of this lot, banks and trust companies accounted for 481, captives 296 and shipping, trading and holding companies, 9,042.

In 1985, the offshore banks alone injected some \$54 million into the economy by way of salaries, utility payments and capital expenditures whereas tourist arrivals over the same period surpassed the 400,000 mark.

Both industries provide full employment opportunities and a spur for local construction activity. Two new luxury hotels, the Hyatt Regency and the Treasure Island Resort, are due for completion in late 1986, whereupon a further 530 rooms will be added to the already attractive and competitive tourist infrastructure.

Although government revenue for 1985 amounted to \$63 million producing a small deficit of \$4.2 million, the colony has however in recent years enjoyed annual budget surpluses. As at December 1985, the public debt stood at \$15.6. This was comprised of British Exchequer loans, British aid loans, E.E.C. loans, C.D.B. loans and amounts outstanding to local commercial banks.

From all indications however, a bright economic future appears to be in store for the Caymans. Officials have predicted a surge in tourist arrivals for the coming year and the government is committed towards the development of the Islands as a reputable

offshore banking and captive insurance domicile.

3.4 LAWS AND LEGAL SYSTEM

Like all other British Colonies, the laws of the Caymans are structured upon English law. There are four principal sources of law which rank in priority as follows: the local constitution, local acts of parliament, acts of general application which were in force in England at the date the Islands were settled, the English doctrines of equity and the English common law.

The laws of the Caymans are administered through an independent judicial hierarchy comprised of a summary court, the grand court and a court of appeal. Prior to the establishment of a local court of appeal in 1984, appeals were heard before the Jamaica court of appeal. Final jurisdiction over all matters rests with the Judicial Committee of the Privy Council, which resides in London.

3.5 TAXATION REGIME

The Cayman Islands are classified as a traditional or nil tax haven and consequently none of the following taxes are levied and neither is there any likelihood that any of them will be introduced in the foreseeable future. They are income tax, corporation tax, capital gains tax, gross insurance premiums tax, inheritance tax, estate duty, undistributed profits tax, dividends tax, withholding tax, business tax, sales tax, gift

tax, payroll tax and turnover tax.

The principal sources of government revenue are import duties, stamp duties, property transfer taxes and licence fees.

Import duties are levied right across the board on virtually all imported goods at a maximum rate of 27.5% c.i.f.. In 1985 these accounted for 35% of government revenue or \$23.3 million. Transfers of real property attract a 7.5% value tax and a 1% tax on any amount secured by a legal or equitable mortgage is also levied.

Licence fees payable by offshore banks during the same period amounted to \$5.6 million whereas offshore captives contributed in excess of \$1.3 million. Other fees collected by government in 1985 exceeded \$13 million. The total revenue for fiscal year 1985 was \$66.4 million.

The Cayman Islands have no tax treaties with other countries.

3.6 FOREIGN EXCHANGE CONTROLS AND CURRENCY RESTRICTIONS

The Cayman Islands introduced their own currency in 1972, replacing the Jamaican currency which up until then was regarded as legal tender. The local unit of currency is now the Cayman dollar, the parity of which is fixed at CI\$1 = US\$1.2.

Due to the vibrancy of the Cayman economy in recent years and its

sustained favourable balance of payments position, all forms of exchange controls were abolished in March 1980.

Today, there are no prohibitions on the use of U.S. currency in the Islands and all hard currency and financial transactions are completely free of restrictions.

3.7 BANKING AND ANCILLARY PROFESSIONAL FACILITIES

The Cayman Islands boasts one of the most extensive and comprehensive banking and trust networks offered by any offshore locality.

As at December 1985, there were 481 banks and trust companies licensed in the islands, the majority of which are U.S. owned. Licences are granted by the Governor and strict scrutiny of all applications is maintained so as to ensure the non-registration of disreputable or financially unsound concerns.

Banks are licensed in one of three categories or classes. A category "A" licence authorizes the conduct of both domestic and offshore business whereas a category "B" licence permits offshore business only. "B" licences are either "restricted" or "unrestricted". In the case of the former, the holder is limited to dealing with a small number of clients whose names must be filed with the authorities.

Represented amongst the estimated 35 class "A" licensees, are

some of the world's leading banks including Bank of America, Chase Manhattan, Royal Bank of Canada, Barclays Bank plc, Bank of Nova Scotia and Canadian Imperial Bank of Commerce.

The class "A" banks and trust companies provide a complete range of banking, trusteeship, financial, investment and management services which are further enhanced by the comprehensive connections which they maintain world wide with their parents, affiliates and other financial institutions. Clearing functions are conducted by six banks.

More than 14 firms provide accounting and auditing services. Among these are the noted international firms of Coopers & Lybrand, Peat, Marwick, Mitchell & Co., Price Waterhouse & co., Pannell Fitzpatrick & Co. and Touche Ross & co.

Superior captive management services are provided by the Islands' 29 licensed Underwriting Managers and a wide range of non-captive offshore management services are also provided by the Islands' trust companies, law firms, and accounting firms.

Nineteen law firms were licensed to engage in practice in 1986 and their estimated 45 members are suitably qualified and experienced to handle the legal requirements of the domestic and offshore sectors. The colony in September 1982, established its own Law School and its first batch of lawyers are to be graduated this year.

3.8 THE CAPTIVE INSURANCE MARKET

The Cayman Islands are now widely acknowledged as one of the leading captive insurance centres in the world, surpassed only by Bermuda in terms of gross captive registrations.

As at March 10, 1986, there were 323 insurance companies licensed under the 1979 Cayman Islands' Insurance Law, of which 295 were captives.

All Caymanian insurance companies are licensed in one of four categories or classes, namely: Approved A, Ordinary A, Unrestricted B or Restricted B.

A class "A" licences permits a local (i.e. an insurer other than an exempted insurer incorporated or constituted in, and having its head office in the Cayman Islands) or an external insurer (i.e. an insurer who is neither a local nor an exempted insurer) to carry on insurance business generally in or from within the Cayman Islands.

Where an external insurer has its principal or registered office outside the Islands, the Governor may grant an "A" licences of the "Approved" type if he is satisfied that the foreign legislation for the regulation of such an insurer is acceptable. In any other case, an "A" licences of the "Ordinary" type will be issued.

"B" licences on the other hand, are only granted to exempt insurers who are required to engage exclusively in the conduct of external or offshore business from within the Islands.

The holder of a "Restricted B" licences is permitted only to accept insurance business from its shareholders or such other persons as the Governor may permit. Accordingly, all parent-owned, association and group type captives will normally be registered under this category. In any other case, an "Unrestricted B" licences will be granted.

Of the 323 insurance companies which were licensed as at March 1986, 26 were holders of Approved "A" licences, 2 of Ordinary "A", 52 of Restricted "B" and 243 of the Unrestricted "B" type.

An analysis of these statistics indicates that the majority of the 295 captives are of the reinsurance type, with just about 22% being parent, association and industry owned.

A wide range of insurance business is written by these captives, the principal ones being medical malpractice, products liability, life insurance, credit life, credit health, credit accident, workers' compensation, motor, comprehensive, property, public liability and general liability.

29 "Underwriting Managers" or captive management companies are currently licensed under the 1979 Act. However, only 24 of these are presently active, managing the affairs of 253 of the 295

locally domiciled captives. The resident staff complements of these companies are in some cases nil, whilst in other instances they range between 2 and 31.

Eight are independent management companies managing 1 or in some cases, up to 18 captives, whereas the majority of the others are members of large or medium-sized multinational groups.

The largest captive management portfolio is held by Johnson & Higgins (Cayman Islands) Ltd., a Member of the international firm of Johnson & Higgins. This group maintains a management presence in at least 5 offshore jurisdictions, including Bermuda, Vermont and the U.S. Virgin Islands.

Others include Marsh & McLennan, Pinehurst (part of the Emmett Chandler Group), Westwinds (part of the U.S. based Alexander & Alexander Group), Samuel Montagu & Co. and Transnational Risk Management Ltd. (part of the Reiss Organization).

Johnson & Higgins has a current portfolio of 55, Samuel Montagu 45 and Transnational Risk, 42.

There are currently 43 insurance agents, 7 sub-agents and 8 insurance brokers licensed under the 1979 Insurance Law.

The selective approach which has long been adopted by the Cayman authorities with respect to the grant of licences, is clearly reflected in the statistical discrepancies between the number of

applications received and the number of licences which so far have been granted.

Between June 17, 1980 and March 10, 1986, 37 applications were received for "A" licences and all but 9 were approved. However, of the 521 applications which were made for captive "B" licences, only 295 or 57% were granted.

3.9 INCORPORATION AND REGISTRATION OF CAPTIVES

Generally speaking, the Cayman Islands Companies Law (1961) provides for three types of corporate structures, through which captives operating from within the Cayman Islands may conduct offshore business.

Primarily, there is the ordinary non-resident company and the exempted company, both of which may be incorporated locally. Provision is made thirdly for the foreign incorporated company which need only be registered under the Companies Law.

The greater majority of locally incorporated captives are of the exempt company type, a company whose basic structure is similar to that of the English joint stock company except that unlike the ordinary company (whether resident or non-resident), it is exempted from certain provisions of the Companies Law.

Ordinary companies and exempt companies limited by shares, may be incorporated by filing with the companies registrar, the

company's memorandum of association and its articles of association.

The memorandum will contain the name of the company, the situation of its registered office, its objects, its authorized share capital and a statement to the effect that the liability of its members is limited. The articles will contain the by-laws of the company.

The exempt company however has a number of advantages over the ordinary company.

It may be constituted by one member and there is no requirement that a register of the company's members should be maintained. It may also issue no-par shares as well as bearer shares except that the latter may only be issued against fully paid up capital. If it is so desired, it is permitted to dispense with the word "limited" in the company name.

At least one meeting of the directors must be held annually in the Islands and for this purpose, local alternate directors may be retained. An exempt company may also obtain an exemption from the imposition of future Caymanian taxes for a specified period up to 30 years.

The formation of an exempt company involves a relatively simple procedure which is usually effected within 3 days. The minimum government registration or incorporation fee payable by an exempt

company, given an authorized share capital of not more than \$900,360, is \$915.

Once this process has been completed an application in the prescribed form must then be made for the grant of a class "B" insurer's licences. If it is so desired, a provisional application may be made prior to incorporation.

In either case, an application in the form of "Form 2" of the Cayman Islands Insurance (Forms) Regulations (1980) must be completed and submitted.

Amongst the particulars which should be included in the application are, the name and the registered office address of the applicant, particulars concerning its directors, managers, officers, shareholders, auditors and management company (where it is to be managed by one), and the person resident in the Islands, who is authorized to accept service of process on the applicant's behalf.

The application is also required to be supported by evidence of the applicant's incorporation, its memorandum and articles of association (in the event that it has already been incorporated), a business plan and three references, including one from an insurer or a reinsurer and one from a bank. Criminal records of the applicant's shareholders, directors, managers and officers must also be provided.

The annual government licences fee for both types of "B" licences is currently \$5,400. Initially, the fee is payable upon application and thereafter in January of every year. If an application is refused, the fee will be returned.

Apart from the government incorporation fee and the said licence fee, no other amounts, whether in the form of taxes or otherwise, are payable by a captive to the government.

S.4(2) of the Insurance Law vests in the Governor of the Islands, a discretionary power to grant licences and it is also provided that the negative exercise of such power shall not be challengeable in any court of law.

3.10 HIGHLIGHTS OF CAPTIVE INSURANCE REGULATORY LEGISLATION

The 1979 Cayman Islands Insurance Law is the principal legislative mechanism which governs the registration and operations of all insurance companies, domestic or offshore, which conduct business from or within the Cayman Islands.

First enacted in October 1979, the Law has since been amended on no less than 5 occasions. Once in December 1979, twice in 1980, once in 1983 and again in December 1985.

Under this last amendment, all licences fees payable by insurers, agents and underwriting managers, were increased. In the case of class "A" licences, the fee payable was increased by as much as

\$4,200 whereas that payable by class "B" insurers was increased from \$3600 to \$5,400.

Although the inherent power to administer the provisions of the Act is by law vested in the Governor of the Islands, S.5 however makes provision for the mandatory appointment by the Governor, of a Superintendent of Insurance, "for the general administration of the Law".

The current Superintendent is Mr. Peter Bates, a former excess of loss aviation underwriter for LLOYD's Syndicate 168. Mr Bates was installed in office in July 1984.

The key objective of the Act is regulation. As Mr. Bates puts it, the Act was intended to "encourage licence applications only from companies wishing to operate on sound and secure insurance principles, to operate within a predetermined business plan, to maintain minimum solvency margins and willing to submit audited accounts for scrutiny".

Minimum net worth requirements as prescribed by the Act, are \$120,000 in the case of property and casualty captives, \$240,000 in the case of life insurance captives and in the case of a captive writing combined business, \$360,000. Although these margins are required to be maintained at all times, the Act makes no provision as to premium to net asset ratios.

Class "B" insurers are required to appoint a principal

representative in the Islands and maintain permanently at a designated office, normally to be within the Islands, full and proper records of its business activities.

Where a captive engages in other business besides insurance, it is required to maintain separate accounts in respect of its insurance business and such other business. The assets and liabilities in respect of each must also be segregated.

S.6(C) of the Act, bestows upon the Governor, the discretionary power to prescribe that investments of a specified class be subject to the prior approval of the Superintendent and that any investments of such class already made, be realized within a specified period. Captives holding a Restricted type "B" licences are exempted from this provision.

Every class "B" licensee is also required to furnish to the Governor, within 6 months of the ending of each financial year, an approved auditor's certificate attesting that annual accounts have been prepared in accordance with generally accepted accounting principles.

In addition, an auditor's certificate of the captive's compliance with its intended business plan as stated in its original application, must also be submitted annually.

A captive which is involved in the conduct of life insurance business is further required to prepare annually, a certified

actuarial valuation of its assets and liabilities so as to satisfy the Governor of its solvency.

Finally, S. 11(1) of the Act prohibits the disclosure of any information relating to the application, affairs or a policy holder of a licensee, by the Superintendent or any person acting under his authority.

CASE STUDY: BARBADOS

4.1 GEOGRAPHY, LANGUAGE, POPULATION AND COMMUNICATIONS

The sovereign state of Barbados is the most easterly of all Caribbean islands and lies in the mid Atlantic at the south-eastern tip of the Lesser Antilles island chain, just 280 miles off the northern coast of Venezuela. The island has an area of 166 square miles, is riverless and is washed on its western shores by the Caribbean Sea.

The seat of government and the island's capital is Bridgetown, which is situated at the south-western corner of the island. Barbados enjoys a typical tropical climate with temperatures rising to the 80s in the summer months.

Its population is currently 253,000 thus making it the 7th most densely populated country in the world after Monaco, Gibraltar, Hong Kong, Singapore, The Vatican City, and Malta. About 40% of the island's populace reside in the city of Bridgetown.

The official language of Barbados is English and the adult literacy rate is an impressive 97%.

The island is served by at least 10 international air carriers including Pan American, Eastern, British Airways, Air Canada,

British West Indian Airways and Cruzeiro Bo Sul S.A..

Daily direct flights which originate from the modern Grantley Adams International Airport situated just 10 miles from Bridgetown, link the island with major cities in the United States, Canada, Europe, England, the Caribbean and the South American Continent. Flying time to Miami is 3.5 hours, to New York - 4.5 hours, to Toronto - 5 hours and to London, 8.5 hours.

The Bridgetown harbour which was recently extended at a cost of over \$16 million, provides excellent container handling and berthing facilities for the countless freight vessels and cruise liners which call at the island's port each year.

Barbados boasts a modern and efficient domestic telephone network which at the end of 1984, comprised over 80,000 telephone units. A sophisticated satellite communications network enables automatic international direct dialling and telex transmissions to countries world wide.

The local postal distribution system is unmatched by any other in the English-speaking Caribbean.

4.2 STRUCTURE OF GOVERNMENT

Discovered in 1536 by the Portuguese explorer, Pedro a Campus, Barbados was ignored by the colonial powers until it was claimed and settled by the English in 1627. In 1639 it was granted the

right to elect its own government but nonetheless remained a British Crown Colony until 1966, when it became an independent and sovereign state.

The Westminster styled constitution of Barbados, enacted in 1966, makes provision for three independent organs of State. The Legislature, the Executive and the Judiciary. The Executive Authority of the State is vested by convention in Her Majesty, and exercised locally by the Governor General.

The Senate which is the Upper House of the Legislature, consists of 21 members. 12 are appointed by the Governor General on the advice of the prime minister, two on the advice of the leader of the opposition and the remaining 7, at the sole discretion of the Governor General.

The House of Assembly or the Lower House is comprised of 27 members. The members are elected during national elections and hold office for a maximum period of five years in each instance. The last general elections were held earlier this year.

On the question of the composition of the Executive, the Governor General is obliged to appoint as prime minister, that member of the House of Assembly who commands the majority support therein. the prime minister in turn, assembles the Executive by nominating as government ministers, members drawn from both Houses of Parliament.

4.3 POLITICAL AND ECONOMIC STABILITY

Although its legendary stability is often substantiated by reference to the fact that it is the only Caribbean island which never belonged to more than one foreign power in its long colonial history, there are indeed more convincing factors which today unquestionably establishes Barbados as one of the most stable of all independent Caribbean States.

Since attaining independence in 1966, the island's seat of government has been successively shared by its two major political parties, the Democratic Labour Party and the Barbados Labour Party.

The former, which succeeded the latter earlier this year as the ruling party, is headed by Prime Minister The Rt. Hon. Errol W. Barrow, Q.C., M.P., who is also credited with leading the country into independence on November 30, 1966.

Whilst in government and with the fruitful co-operation of the private sector, both parties have implemented policies by which they have steadfastly pursued the planned, orderly and progressive development of the island's economy.

Although sugar has been the mainstay of the island's economy for over 3 centuries, in recent times great emphasis has been placed upon the development and expansion of the island's tourism and manufacturing sectors. During the past decade, careful

attention has also been given to promoting the island as a competitive and stable offshore financial sector.

In 1984, the Barbados economy experienced a 3.5% tourism led growth but suffered a severe setback in the following year, when it registered a G.N.P. of just 0.3%.

This was reflected in a reduction of export earnings in the sugar industry from \$33 to \$30 million. Tourist arrivals for the same period also registered a decline of 3% over 1984 figures. Arrivals for 1985 totalled 359,000 producing foreign earnings of \$288 million.

The export manufacturing sector, which for the past five years was sustained principally by electronics assembly plants, also suffered output reductions of 9.3% as a result of a slump in the U.S. computer industry. Exports of garments and furniture also registered significant reductions due to the imposition of trade restrictions in Caribbean export markets.

In spite of the foregoing, Barbados was nonetheless able to record a surplus on the current account of its balance of payments and an overall surplus of \$46 million.

Its inflation rate for 1985 was down 0.7% over the previous year's 4.6% and the current unemployment rate is 18.3%— the same as the year before. The total national debt at the end of 1985

stood at \$404.7 million.

Barbadians now enjoy a real per capita income of \$4,240 and is classified by most international agencies as a middle-income country.

Since the enactment of the International Business Companies (Exemption From Income Tax) Act in 1965, successive Barbadian governments have steadfastly promoted Barbados as a "low-tax" offshore financial centre.

The common policy has not been to promote Barbados as a "tax haven", but as a country which offers "quality offshore financial services to quality clients on competitive terms". Emphasis has been placed on integrity and sound management rather than on size.

The major pecuniary attractions which the industry offers are exemptions from exchange control and fiscal impositions, a network of double taxation treaties and guarantees against the imposition of future taxes.

The incentive infrastructure provided by the I.B.C. legislation was supplemented in 1979 by the Offshore Banking Act, in 1982 by the Shipping Incentives Act and again in 1983, by the Exempt Insurance Act.

In addition, the island has secured the ratification of double taxation treaties with the U.K., Canada, Northern Ireland,

Norway, Sweden, Switzerland and a number of Caricom states. A new treaty with the United States was ratified this year and took effect retroactively from January 1, 1986.

Barbados has succeeded in establishing itself as the Caribbean's fastest developing and independent non-traditional offshore centre and today boasts competitive offshore banking, trust, captive insurance, ship registration and trading company facilities. The continued growth of the sector is expected to give a substantial boost to the island's economy.

4.4 LAWS AND LEGAL SYSTEM

The supreme laws of Barbados are those embodied in its constitution. Local acts of parliament take precedence over, and are supplemented by English acts of general application which were in force in England in 1627, the English doctrines of equity and the English common law.

The constitution guarantees the universally accepted fundamental rights and freedoms of the individual and mandates the preservation of the due process of law. The established principles of natural justice are also recognized by the country's laws.

Barbados' independent judicial hierarchy is comprised of 5 summary magisterial courts, a supreme court and an appellate court. Final appellate jurisdiction over all matters rests with

the Judicial Committee of the Privy Council, which resides in London.

4.5 TAXATION REGIME

Unlike Bermuda and the Cayman Islands, Barbados has always imposed a systematic and comprehensive network of direct and indirect taxes.

The principal taxes which are levied include a corporation tax of 45% (on corporate profits), an income tax (on individual incomes), customs and excise duties, consumption taxes, stamp duties, a hotel and restaurant sales tax, a land tax (levied annually on the assessed value of real estate), property transfer taxes, national insurance and social security contributions, a percentage tax on gross insurance premiums, a tax on life insurance companies' investment income, a tax on bank assets, and a travel tax.

Of government's overall revenue of \$311 million in fiscal year 1985, taxes accounted for 91.5% or \$284.5 million. Of this figure, income, corporate, property and other direct taxes amounted to \$121 million whereas consumption taxes, import duties, stamp duties, sales taxes and other indirect taxes amounted to \$163.5 million.

As a stimulus to the offshore sector however, non-resident companies are exempted from the majority of these impositions. In

addition, foreign companies based in Barbados stand to gain significant and additional tax benefits since the country has entered into a number of double taxation treaties with other countries.

A comprehensive network of fiscal incentives intended to attract both local and foreign investors and to expand the tourism and manufacturing sectors, is also in place.

This is further supplemented by the preferential tariff treatment given to exports entering the European Common Market under the Lome II Convention and likewise, that given to Barbadian goods entering the United States under the Caribbean Basin Initiative Plan.

Barbados is part of the "North American Region" for United States tax deductibility of business meetings.

No capital gains or inheritance taxes are levied in Barbados.

4.6 FOREIGN EXCHANGE CONTROLS AND CURRENCY RESTRICTIONS

The local unit of currency is the Barbados dollar, which since 1975 has been linked to the U.S. dollar at a fixed parity of U.S.\$1.00 = BDS.\$2.00.

Although by law, the Minister of Finance is vested with complete exchange control authority, much of his functions have been

delegated to, and is now exercised by, the country's central bank.

Residents are prohibited from holding foreign currency accounts and are generally restricted from maintaining external accounts. Importations which involve the outflow of foreign exchange require prior approval and an import licence.

On the other hand, non-residents are normally permitted to hold external accounts denominated in Barbados dollars. The sanction of the exchange control department must however be sought if such funds are to be converted into foreign currencies. Likewise, a non-resident is required to seek permission in order to maintain a foreign currency account.

Offshore banks and captive insurance companies are exempted from all currency and foreign exchange restrictions. Special exemptions are also provided for captive management companies and the expatriate employees of exempt companies.

4.7 BANKING AND ANCILLARY PROFESSIONAL FACILITIES

The island's domestic banking system offers an excellent range of commercial banking, investment banking and trust services. Barbados also facilitates the registration of offshore banks which are licensed to engage in extra-territorial financial transactions and to hold accounts on behalf of locally licensed captives.

Represented amongst the domestic banks are some of the world's leading finance oriented transnationals. These include the Chase Manhattan Bank, City Bank, Barclays Bank, the Royal Bank of Canada, the Bank of Nova Scotia and the Canadian Imperial Bank of Commerce.

The Barbados National Bank, which is government owned, also offers a wide range of commercial banking facilities. The state owned Barbados Development Bank on the other hand, provides capital financing for the tourism, agricultural and manufacturing sectors.

There are over 10 firms of chartered accountants in Barbados. Among them are the international firms of Coopers & Lybrand, Pannell Kerr Forster, Peat Marwick Mitchell & Co., Price Waterhouse and Touche Ross & Co..

A formal tuition facility was established on the island in 1982 to provide professional accountancy training leading to the award of the A.C.C.A. professional qualification.

The University of the West Indies at its St. Augustine Campus in Trinidad, also conducts a postgraduate programme leading to the award of the M.Sc. Degree in Accounting.

Barbados boasts over 200 licensed attorneys at law, the majority of which are English trained. It is noteworthy also that the Faculty of Law of the University of The West Indies, is based at

the Cave Hill campus, which overlooks the island's western coast.

Since its inception in 1970, the Faculty has conducted full-time graduate programmes leading to the award of the LL.B Degree, the LL.M Degree by Thesis and the Ph.D. Degree in Law.

More recently, two other graduate programmes have been offered. The LL.M. in Legislative Drafting and the LL.M. by Coursework and Thesis. A seminar-based Insurance Law course was first introduced by the author, in September 1981, as an option on the latter programme.

Insurance expertise and manpower resources are abundant in Barbados with over 700 professionals currently engaged in the domestic industry. The Barbados Insurance Institute offers formal tuition services to its members and several persons employed in the industry possess the C.L.U., A.C.I.I., F.C.I.I. and the F.L.M.I. professional insurance qualifications.

As at October 9, 1986, 19 captive management companies had been issued with Letters of Authority by the Barbados Supervisor of Insurance.

4.8 THE CAPTIVE INSURANCE MARKET

The Barbados captive insurance market is a relatively new one, having substantially emerged upon the passage through the Barbados Parliament, of the Exempt Insurance Act and the

Insurance (Forms and Fees) Regulations, in March, 1983.

These enactments were intended to constitute the final component in an already existing legislative framework for offshore financial services, the other components being, the International Business Companies (Exemption from Income Tax) Act of 1965, the Offshore Banking Act of 1979 and the Shipping Incentives Act of 1982.

Notwithstanding its tender age, the Barbados captive market, with its attractive and competitive facilities, has already begun to show signs of usurping the stranglehold which Bermuda and the Caymans have since long held on world captives.

As a result of a U.S. double taxation treaty which came into force on January 1, 1986, Barbados is now in a position to offer U.S. owned offshore captives, total relief from a 4% and 1% federal excise tax, which in other circumstances, would be levied respectively on all outgoing direct and reinsurance premiums.

No other offshore captive domicile offers this facility and already, Bermuda has commenced negotiations aimed at obtaining similar concessions on the basis of a defence agreement which it currently has with the United States.

Prior to the ratification of the U.S. tax treaty, captive registrations in Barbados progressed at a very slow pace. In 1984 only 2 licences were granted as against 5 in 1985. 1986 however

witnessed a massive surge in captive applications and so far, an additional 22 licences have been granted.

Currently, there are 29 licenced captives in Barbados but no information with regard to their composition has been forthcoming.

As at October 9, 1986, 19 management companies had been issued with Letters of Authority. It is suspected however, that only 8 of these are in active operation.

Included amongst them, are one of the world's leading captive management companies, Johnson and Higgins. This company currently offers management services in the Cayman Islands, Bermuda, the U.S. Virgin Islands and Vermont. Represented also, are Marsh and McLennan, Reed Stenhouse/Alexander & Alexander, the Fred Reiss Organization and the American International Group.

As a result of an April 1986 amendment to the Exempt Insurance Act, all management companies are now required to seek formal registration with the Department of the Supervisor of Insurance. An annual registration fee of \$2500 has also become payable.

Although notices were recently sent out to the 19 companies which already hold Letters of Authority, inviting applications for registration, it is not yet known just how many have responded.

4.9 INCORPORATION AND REGISTRATION OF CAPTIVES

All captives are required to be incorporated locally under the 1982 Companies Act either as a company limited by shares or as a mutual company and to obtain a licence under the Exempt Insurance Act, before engaging in any business.

Incorporation is achieved by filing with the Company's Registrar, articles of association in duplicate, a statutory declaration that no incorporator is less than 18 years old, is of unsound mind or bankrupt, the names and addresses of the intended directors, and the situation of the registered office.

The articles should also clearly state that the intended objectives and activities of the company are to be the transaction of exempt insurance business. The proposed name of the company should not be misleading and at least one of the nominated directors should be a resident citizen of Barbados.

A captive may be incorporated with one or more shareholders but no shareholder must be a resident of Barbados or of the Caribbean Community.

The minimum capitalization margin in the case of a non-mutual captive is \$125,000 and in the case of a mutual captive, contributed reserves of not less than \$125,000. Capitalization requirements may however be satisfied by valid letters of credit drawn upon a domestic bank or upon a locally licensed offshore

bank. No stamp duty is payable on capital.

The maximum number of shares that the company will issue, the classes into which they are to be divided and any restrictions attaching thereto, must all be set out in the articles. Shares have no par or nominal value but the company will be required to maintain a separate capital account for each class and series of shares. Shares are redeemable subject to a solvency test whereas the issue of bearer shares is prohibited.

A captive cannot be incorporated without the consent of the Minister of Finance. Once this has been obtained, the issuance of the certificate of incorporation by the Companies Registrar, will be conclusive proof of the incorporation and the existence of the company.

An application in the prescribed form and signed by at least 2 directors of the applicant company, together with an application fee of \$250, must then be forwarded to the Supervisor of Insurance.

The application must include the following: particulars of the type of exempt business it is intended to engage in, estimated first year premium income, reinsurance programme particulars, particulars as to the company's intended bankers, auditors, actuary and management company (where it is to be managed by one), and particulars concerning the company's directors and shareholders.

The application must be accompanied by a certified copy of the articles of the company and a copy of the certificate of incorporation.

If the Supervisor is satisfied of the circumstances of the company and finds its articles acceptable, he may issue a licence in which may be specified certain conditions, including the class or classes of business which may be engaged in.

Upon the issuance of a licence, an annual government fee of \$2,500, becomes payable. If the licence is refused, the application fee will be refunded.

In practice, it is advisable that a tentative application be made to the Supervisor prior to the incorporation of the captive. In any such event, all the foregoing information should be submitted together with a draft of the company's articles.

When the Supervisor advises that the tentative application is acceptable, the company may be incorporated and a final application submitted along with a certified copy of the articles of incorporation. Licences are normally obtainable within 3 weeks of the submission of the tentative application.

4.10 HIGHLIGHTS OF CAPTIVE INSURANCE REGULATORY LEGISLATION

The Exempt Insurance Act constitutes the regulatory machinery which governs inter alia, the operations of Barbados domiciled captives. The inherent power to administer its provisions is vested in the Minister of Finance, although most of his functions have since been delegated to the Supervisor of Insurance under S.16.

The Office of the Supervisor of Insurance has been in existence for over 14 years and has been headed by the current Supervisor, Mr. Ivan Bradshaw, B.Sc., since 1979.

The Act offers numerous attractions and incentives to locally domiciled captives as well as to the management companies which provide them with management services.

Of major significance, is the fact that licensees are permitted to become operational at their own convenience. Accordingly, shelf operations are permissible thus facilitating ease of movement from other jurisdictions.

Except in instances where a captive is self-managed, no person other than a "management company" is permitted to offer or provide management services to a licensed captive.

A management company is required to register under the Act, but it need not be incorporated in Barbados. An annual registration

fee of \$2,500 is payable but there are no residency or nationality restrictions with respect to ownership.

No income tax, capital gains or other direct tax is payable on the gains or profits of a licensee or management company or on the transfer of any security or asset from any one such company to another. Both are also specifically exempted from withholding taxes and exchange control restrictions.

A licensee may also be granted, under S.32, a 15 year guarantee against the withdrawal of any benefit or exemption which is now provided under the Act. Both may freely place fixed-term deposits and hold current accounts with any locally licensed offshore bank.

Specially qualified staff otherwise unavailable locally and which are hired by either, may with the permission of the Minister, obtain income tax concessions on a part of their salaries and benefit by having a part of their salaries paid in a foreign currency.

S.35 of the Act safeguards the confidentiality of a licensee's business by allowing disclosure only of its name, the location of its registered office and the names of its shareholders as they appear on the register of shareholders. A person who violates this provision is liable upon summary conviction, to a maximum fine of \$1,000 and/or 12 months imprisonment.

Solvency margins are easily calculated. In the case of a property and casualty captive, a 5:1 premium net worth is required up to an annual premium income of \$5 million and a 10:1 ratio for a premium volume exceeding \$5 million. A life captive is deemed insolvent in any case where the value of its assets does not exceed its liabilities.

Before engaging in any business whatsoever, a licensee is required to deposit with the Supervisor, a certificate setting out the local address of its registered office along with the name and address of a person resident in Barbados, on whom documents relating to the business of the licensee may be served.

S.15 further stipulates that a licensee must maintain in Barbados, such registers of its policies, claims registers, books and other business records as the Supervisor may direct.

Barbados domiciled captives are also subjected to certain reporting requirements under S.18. At the ending of each financial year, they are required to submit to the Supervisor, certified and audited copies of their revenue accounts, profit and loss accounts and balance sheets.

An auditor's certificate attesting to the solvency of a licensee, the value of its assets and its compliance with the provisions of the Act must also be rendered.

Table 1

COMPARATIVE ANALYSES OF CAPTIVE JURISDICTIONAL FEATURES

	BERMUDA	CAYMAN ISLANDS	BARBADOS
SOVEREIGN STATE/ COLONY	British Colony	British Colony	Sovereign State
GEOGRAPHICAL LOCATION	Western Atlantic. 600 mls. off east coast of USA	Caribbean. 475 mls. south of Miami	Mid-Atlantic/ Caribbean. 280 mls. off north coast of Venezuela
COMMUNICATIONS			
- Air Links	Good	Good	Excellent
- Telephone	Good	Excellent	Excellent
- Telex	Good	Excellent	Good
LAWS/ LEGAL SYSTEM	British	British	British
OFFSHORE BANKING FACILITIES	No	Yes	Yes
DOUBLE TAXATION TREATIES	No	No	Yes With USA, UK, Canada, Northern Ireland, Norway, Sweden, Switzerland and Caricom States
CAPTIVE POPULATION	In excess of 1500	295 (March 1986 listing)	29 (October 1986 listing)
CAPTIVE ENABLING LEGISLATION	1978 Insurance Act. Entry into force- Feb. 1980. Ammended 1981, 1983 & 1985	1979 Insurance Law. Ammended 1979, 1980, 1983 & 1985	1983 Exempt Insurance Act. Ammended 1986.
REGULATORY AUTHORITY	Minister of Finance/Insur- ance Advisory Committee/ Registrar of Companies	Governor/ Superintendent of Insurance	Minister of Finance/ Supervisor of Insurance

	BERMUDA	CAYMAN ISLANDS	BARBADOS
REQUIREMENT FOR LOCAL INCORPORATION	Not legally reqd. although reqd. by Govt. policy	No- but if foreign company, local registration reqd.	Yes
PERMITTED LINES OF BUSINESS	All	All	All
MINIMUM CAPITALIZATION	Property & Casualty: \$120,000. Long Term: \$250,000. Combined: \$370,000	Net worth: P&C: \$120,000 LT : \$240,000 Combined: \$360,000	Non-Mutual Captive: \$125,000 Mutual Captive: contributed reserves of \$125,000. Letters of credit acceptd.
GOVERNMENT INCORPORATION AND LICENSING COSTS	Incorp. fee ranges between \$500 & \$5000- plus \$2,250 licence fee	Minimum-\$915 on authorised capital not exceeding \$900,360 plus \$5400 licence fee	\$375 incorp. fee. \$250 licence application fee. \$2500 licence fee
TOTAL ANNUAL TAXATION	\$1550	\$5400 plus \$460 (minimum) on authorised capital not exceeding \$900,360	\$2500
CONSTRAINTS ON UNDERWRITING POLICY	Must furnish information on intended underwriting policy, esti- mated a.p.i, capital and surplus levels for first 2 years	General business plan to be furnished upon initial application	Must furnish information on gross p.i. and net p.i. for first year - plus reinsurance plan
CONSTRAINTS ON INVESTMENT	P&C Captives to maintain "relevant" assets equal to 75% of liabilities	None for Parent- Owned Captives. In other cases- certain investments may be subject to prior approval	None

	BERMUDA	CAYMAN ISLANDS	BARBADOS
MINIMUM SOLVENCY REQUIREMENTS	As in minimum capitalization margins	As in minimum capitalization margins	P&C Captive: 5:1 premium net worth for a.p.i. up to \$5M. 10:1 premium net worth for a.p.i. exceeding \$5M. LT Captive: Assets to exceed liabilities
ANNUAL RETURNS AND REPORTING	"Statutory financial report" certified by auditor. Must include certificate of compliance and solvency	Auditor's certificate attesting to preparation of annual accounts and certificate of compliance with intended business plan. LT Captives- additional certified actuarial valuation of assets and liabilities	Certified and audited revenue, profit and loss accounts and balance sheets. Plus- auditor's certificate of compliance
CONSTRAINTS ON CAPTIVE MANAGEMENT	Restricted to local management co. or other resident and approved person	Self, local or foreign management permitted. Local representative required.	Locally registered management co. except in cases where captive is self-managed
TREATY BENEFITS ACCRUING TO CAPTIVES	None	None	Exemption from US. Federal excise premium taxes. Tax free repatriation of profits to Canada in respect of non Canadian insured risks
UNCONDITIONAL FOREIGN EXCHANGE EXEMPTION	Yes	Yes	Yes
STATUTORY GUARANTEE OF CONFIDENTIALITY	Yes	Yes	Yes
GUARANTEE AGAINST FUTURE TAXATION	Yes- Up to year 2006	No	Yes- 15 year guarantee

ENCOURAGING CAPTIVE FORMATIONS IN THE COMMONWEALTH CARIBBEAN

5.1 THE PRINCIPAL ECONOMIC ADVANTAGES

Commonwealth Caribbean States stand to derive a number of economic benefits by facilitating the operations of captive insurance companies from within their jurisdictional confines.

The most direct benefit which will accrue to such States will be the foreign revenues generated exclusively from captive incorporation levies, annual licensing fees and stamp duties. Fiscal impositions on annual premium incomes and/or on investment incomes should at all costs be avoided.

In this respect, it should be noted that it was an attempt by the Bahamian Government in the 60s in levying a 1% tax on gross captive insurance premiums which precipitated the total collapse of that country's captive insurance industry.

Currently, the Barbados Government earns \$3125 in respect of each captive's first year operations and for each subsequent year, \$2500. Similar quotations for the Cayman Islands and Bermuda are \$6315 and \$5860 (minimum) and \$2750 and \$1550 (minimum), respectively.

Total direct revenues earned by the Cayman Government from local captive operations in fiscal year 1985, amounted to approximately \$1.7M whereas that earned by the Bermudian Government during the same period, was estimated to be in the region of \$2.4M.

A further direct economic benefit to be derived from a captive insurance presence in any Caribbean State will be represented in the form of foreign currency payments for professional and other services rendered locally.

Table 2

OUTFLOW OF CAPTIVE NON-FISCAL PAYMENTS (SETTING UP AND OPERATING COSTS)

	BARBADOS	BERMUDA
	\$	\$
Legal Expenses	3000	5000
Annual Management Fees	8000-15000	25000
Audit Expenses	3000	5000
Banking Expenses	3000	3000
Director's Expenses	1000	5000
Hotel/Meeting Expenses (Association Captives)	20000	30000
Total	45,000	73,000

Compiled By The Barbados Central Bank - March 1986

Included amongst these will be legal, accounting, banking, management, hotel and directors' services. The costs of leasing or in instances where it is permitted, purchasing business and residential premises, together with those costs to be incurred in

the hiring of clerical staff will also necessitate further recurrent expenditures.

5.2 EFFECT ON DOMESTIC MARKET AND CONSUMER PRODUCTS

As indicated earlier in this paper, offshore and onshore captive developments have arisen primarily out of a need on the part of North American insurance purchasers to reduce risk financing costs and the inability of the conventional insurance markets to respond favourably to the reasonable expectations of certain segments of the consumer markets of western developed countries.

The surge towards the captive trend by many large multi-nationals and consumer groups has in turn brought favourable responses from insurers and brokers alike, chiefly in the form of an adaptation of enhanced captive risk management and risk-financing techniques.

Accordingly, it is not unlikely that conventional companies in the industrialized countries will for example, in the near future, develop a willingness to write the entire portfolio of clients' businesses and not just particular lines, provide excess coverage for self-insurance programmes, separate risk financing services from technical services, the latter perhaps been offered free of cost, and offer quotations net of brokerage commissions in which case brokers would be remunerated on a fee basis thus enabling the client to pay reduced premiums directly to the insurer.

However, the benefits that captives have bestowed upon their owners and the changes that they have precipitated and are expected to force in the conventional markets of the owners' domiciles, have so far had very little impact, if any at all, in the domestic markets of Caribbean Captive States.

This should come as no surprise since Caribbean based offshore captives are not owned by domestic entities, do not compete with Caribbean domestic insurers and by virtue of their very character, are not direct writers or reinsurers of risks originating in their offshore locations. In fact, captives are currently prohibited by law in all Commonwealth Caribbean captive havens, from underwriting or reinsuring domestic based risks.

Accordingly, a captive presence in any Caribbean State will not bring about an automatic and immediate improvement in the insurance programmes of, or the products offered by, domestic carriers nor an improvement in the risk management or risk financing techniques employed by local purchasers.

Possibilities do however exist, in the long term, for the limited transfer of technical skills to the domestic market via the restricted participation of local insurance personnel in the management activities of captive insurance companies.

5.3 THE DISADVANTAGES

Generally speaking, there are no substantial disadvantages to be suffered by a Caribbean State which chooses to accommodate a reasonably well regulated offshore captive formation facility within its jurisdictional confines.

The operations of offshore captives in any well regulated locality do not as some believe, disrupt or even interfere with, the conduct of business on the domestic insurance market nor does it produce a net outflow of scarce foreign exchange.

Efforts of the local authorities should be directed principally towards establishing and maintaining a reputable facility. Apart from developing the required infrastructure, this would require a sensible approach towards the internal regulation of the industry.

Regulatory legislation should neither be too burdensome nor too lax. There should be adequate provisions for the screening of applicants so that companies whose objectives appear not to be viable and whose officers are of questionable professional repute, will be denied admission. Asset bases and liquidity levels, especially those of group, association and rent-a-captives, should be ascertained so as to ensure that admitted captives possess the capability to settle claims as they fall due.

Minimum capitalization, solvency and reserve margins should be imposed and a fault free mechanism developed to ensure that the latter are periodically assessed. Steps should also be implemented to ensure that satisfactory certified accounting and underwriting returns are submitted to a professionally staffed Government regulatory authority on an annual basis or as the need arises.

5.4 THE FUTURE FOR THE NON-TRADITIONAL CAPTIVE HAVENS

Although there are several Commonwealth Caribbean States which for years have provided legislative facilities for the registration of offshore captive insurance companies, literally all have failed miserably in their quest to achieve the status of competitive captive localities.

The facts speak for themselves as it has become painfully evident that viable captive insurance havens do not emerge overnight merely in consequence of the implementation of basic captive enabling legislation.

The key considerations previously explored constitute the determinant standards which must be met and perhaps this can also explain why two of the Commonwealth Caribbean's traditional captive havens, namely Bermuda and the Cayman Islands, have progressed substantially over the past 18 years, whilst the other, the Bahamas, has fallen significantly behind.

The trials and tribulations which attended Barbados' long sought after entry into the circle of leading Caribbean captive havens can also be rationalized on this basis. Naturally, as a new contender, it was also burdened with the additional task of establishing itself in a market which for years had been dominated by traditional nil-tax havens offering comprehensive and well established offshore facilities and characterized by a long standing reputation for economic and political stability.

Like many of its Caribbean counterparts, Barbados had since the 60s, maintained on its statute books, wholesale offshore legislation in the form of a standard International Business Companies Act. However, it was not until it embarked upon a systematic and comprehensive programme of legislative reform and promotional campaigns, whilst maintaining a stable economic and political climate, that its potential to make an impact on the Caribbean captive market was realized.

Yet despite most of these efforts, only 7 captives were attracted to its shores in the period prior to its ratification of a unique double-taxation treaty with the United States in January 1986.

The inescapable conclusion to be drawn is therefore unequivocally clear. Incoming Caribbean States will be severely hard pressed in generating any appreciable level of captive activity unless they are in a position to establish relatively comprehensive and competitive captive jurisdictional infrastructures, characterized

in part by some unique, substantial and novel offering.

For some of these States, adverse political and socio-economic considerations may render any such probability an impossibility. In other instances, substantial internal adjustments will become necessary.