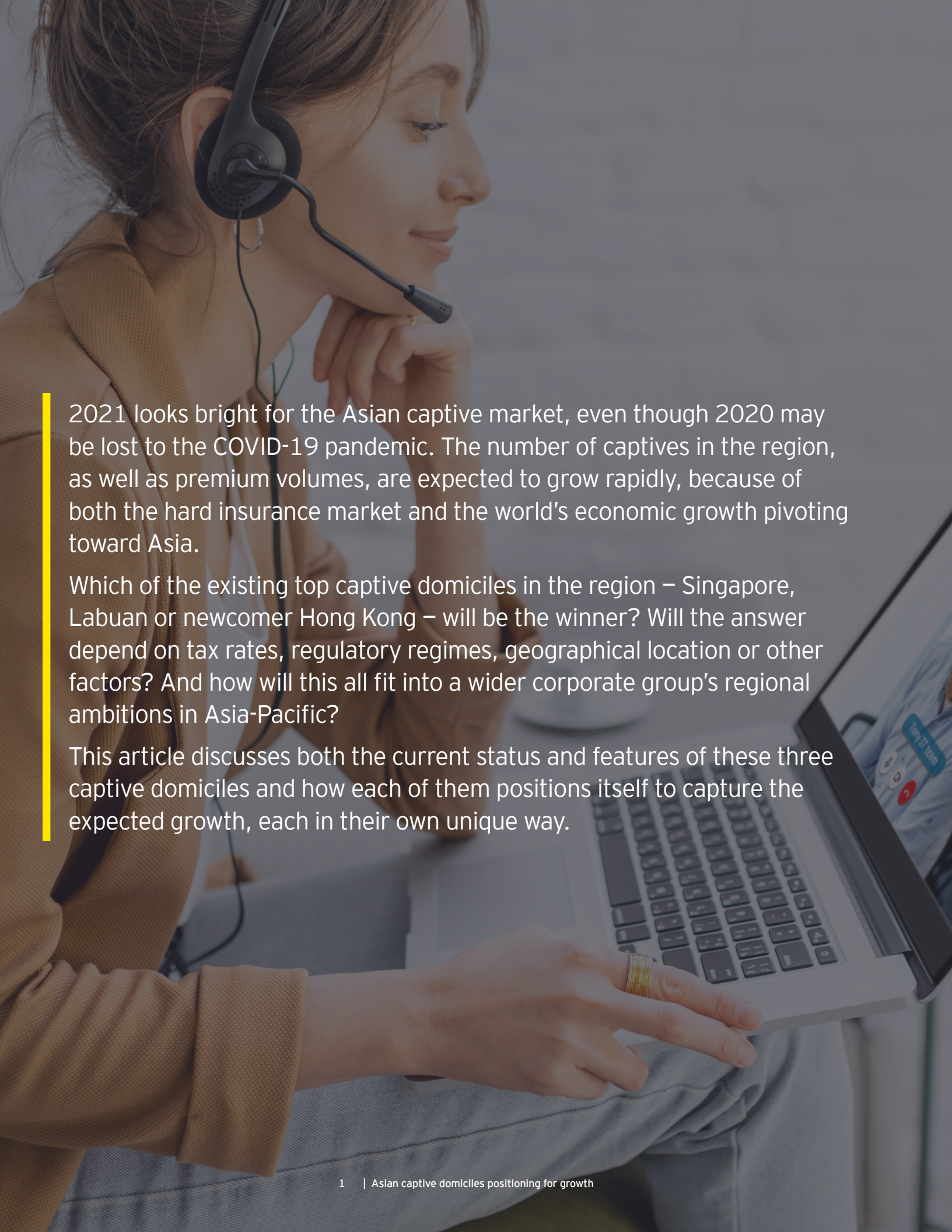


Asian captive
domiciles
positioning
for growth



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A woman with dark hair tied back, wearing a brown blazer and a black headset with a microphone, is looking at a laptop screen. Her hand is resting on her chin, and she has a thoughtful expression. The background is a soft, out-of-focus office setting. The text is overlaid on the left side of the image, with a yellow vertical bar to its left.

2021 looks bright for the Asian captive market, even though 2020 may be lost to the COVID-19 pandemic. The number of captives in the region, as well as premium volumes, are expected to grow rapidly, because of both the hard insurance market and the world's economic growth pivoting toward Asia.

Which of the existing top captive domiciles in the region – Singapore, Labuan or newcomer Hong Kong – will be the winner? Will the answer depend on tax rates, regulatory regimes, geographical location or other factors? And how will this all fit into a wider corporate group's regional ambitions in Asia-Pacific?

This article discusses both the current status and features of these three captive domiciles and how each of them positions itself to capture the expected growth, each in their own unique way.



Captive insurance in Asia

Asia currently accounts for about 3% of captives globally, with approximately 168 of the total 6,315 domiciled in Asian jurisdictions. Asia, however, has seen a significant growth in recent years, increasing by about 30% from 129 in 2015 to 168 in 2018. Singapore and Labuan lead the number of captives in the Asian region. At the time of writing, Singapore is home to estimated 78 captives, while Labuan boasts estimated 56 captives domiciled there. Comparatively, Hong Kong (HK) is a relatively recent market entrant, with only four captives¹.

Global commercial insurance premiums have been rising for three consecutive years, and this trend is not expected to reverse any time soon (COVID-19 claims, economic recovery fueled by expansive monetary policies driving demand, etc.). Risk managers of large and-midsize multinationals may have previously shied away from captives because of the increasing regulatory and fiscal compliance burden, such as the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project and the upcoming IFRS 17 implementation. Now, however, they are taking a fresh look at captive structures, primarily because of a captive's value in proactively managing the group's risks, but also because of the difficulty obtaining coverage in the open market for their changing risk profiles. As industries digitalize, multinationals typically hold significantly more intangible assets than tangible ones. For some of these bespoke risks, a captive and direct access to the reinsurance market may be the only solution.

As the risk profile of global groups shifts toward Asia, and as more Asian conglomerates expand globally, both existing and up-and-coming Asian jurisdictions are revisiting their captive regimes to capture the expected growth. At the same time, revisions are being considered to their tax regimes to conform to OECD requirements, specifically concerning minimum substance under BEPS.

¹ Captive manager analysis and insurance statistics market reports

Singapore

Singapore is the established Asian captive market leader. The country's political stability, highly skilled and multilingual work force, trusted legal system and stable currency all provide an attractive environment for long-term risk management. It is Asia's non-life insurance and reinsurance center, making it a natural fit for captives seeking to manage large and complex risks, requiring a developed service industry and direct access to the reinsurance market. A key driver for this is Singapore's regulator, the Monetary Authority of Singapore (MAS). MAS is well respected by regulators in insurance hubs around the world. It pursues an active policy to strengthen and develop Singapore as an Asian (re)insurance center, including attracting captive solutions.

A large proportion of groups currently owning captives are from Australia. Apart from the factors above, both the geographical proximity and the fact that many Australian groups have a regional head office or treasury function in Singapore have made it a logical choice. Recently, interest from Japanese groups has increased as well.

Singapore has always sought to offer attractive tax incentives to captives. Periodically, these are updated, most recently this May. In the Singapore Budget 2020 statement, it was announced that the Insurance Business Development-Captive Insurance (IBD-CI) scheme would be extended until December 31, 2025.

Under the current IBD-CI scheme, approved captives are granted a concessionary tax rate of 10% for five years on qualifying underwriting and investment income. The scheme is available for both direct insurance and reinsurance, and it applies to both onshore and offshore risks. Certain classes of risk that are considered commoditized (direct stand-alone fire, motor, work injury compensation, personal accident and health insurance policies) do not qualify for the incentive.

While the above scope of qualifying income and benefits under the IBD-CI scheme has not changed significantly since the revisions announced in 2017 (abolishing the limitation of the incentive scheme to offshore risks), additional conditions have been introduced for both new and renewal IBD-CI applications in the May 2020 MAS circular. IBD-CI applicants are required to have a minimum of two professionals who are engaged substantially in the qualifying activity. To qualify, the professionals must have a minimum diploma or equivalent qualification. The introduction of this qualitative and quantitative substance requirement was necessary to meet the evolving OECD BEPS minimum standards.

It was also announced in 2019 that captives whose incentive awards were approved before June 1, 2017, and expire after June 30, 2021, will continue to enjoy the benefits under their existing awards, such as a tax exemption for offshore risks. However, for BEPS compliance reasons, these captives will become subject to the abovementioned scope of qualifying income (which would apply equally to new IBD-CI applicants) as of July 1, 2021.

Singapore's overall value proposition as a captive domicile remains sound and will be strengthened in the long run. Geopolitical tensions, especially the US-China trade disagreement, will make many owners look for long-term stability in Singapore. The tax concession remains attractive and demonstrates the government's commitment to adopt practices that are aligned with OECD's BEPS action plans. Those captives that currently do not have the economies of scale to support the required headcount will rethink their options, either by increasing their premium volume through adding new lines of business and increasing their retentions or by enjoying the still favorable general tax rate of 17%. It should be noted that 17% is higher than the expected threshold for the application of the BEPS 2.0 minimum tax rate, so it should remain beneficial, even after the eventual adoption of the new OECD measures.

Labuan, Malaysia

Labuan was established in 1990 as an international offshore financial center and grew to be one of the few preferred offshore financial centers in Asia due to its political stability, strong economic foundation, competitive and favorable tax regime, and attractive regulatory framework for both conventional and Islamic captive insurance. Labuan also is the only Asian captive domicile offering protected cell companies (PCCs). PCCs allow a sharing of captive common costs among the cell owners, making them cost-effective. Hence, it is no surprise to see Labuan being recognized as one of the preferred and fastest-growing risk management centers in Asia.

Same as Singapore, and consistent with global changes introduced by OECD's BEPS action plans, Malaysia is committed to address tax evasion and harmful tax practices, including the elevation of substance requirements in Labuan. Labuan captive insurers are now required to have a minimum of three full-time employees and incur a minimum of RM200,000 (about USD 47,500) annual operating expenditure in Labuan in order to enjoy the preferential tax rate of 3% of their net audited accounting profits effective from 2019.

Initially, these changes took the Labuan market by surprise, but the network of 50+ captive insurers welcomed such initiatives to endorse international best practices recommended by OECD. BEPS-compliant standards of regulation (both qualitative and quantitative), together with a matured environment, provide confidence to the regulators to continue promoting Labuan as a well-established captive domicile.

Additionally, there is an emerging market position that the substance requirement can be met in mainland Malaysia rather than in Labuan itself, making it a more practical option for multinationals with existing substance in Kuala Lumpur. The fact that labor costs in Labuan and mainland Malaysia are significantly below those in Singapore and Hong Kong help to mitigate the additional cost of complying with the new substance requirements.



Hong Kong

In comparison with the established Asian domiciles, HK's existing captive market is small. Since 2012, Mainland China has encouraged Chinese companies to establish captives in HK, although with limited success. As of July 31, 2020, there are four HK captives, all owned by Mainland China state-owned enterprises. They are used primarily to ensure the risks of their HK group entities, as well as some Mainland China risks. It enjoys a regulatory advantage in this, since HK reinsurers have equivalence with Mainland reinsurers for Chinese regulatory credit risk charge purposes.

In light of China's national policy initiatives, such as the Greater Bay Area initiative and the broader Belt and Road Initiative, HK has a larger role to play as a risk management hub and captive location. Accordingly, HK's Government started to promote the insurance sector in recent years.

Under the Insurance (Amendment) Bill 2020, passed in late July, HK captives are now permitted to write overseas group business, not just HK domestic business. The previous limitation of being able to ensure only HK incorporated and registered companies severely limited the usefulness of HK captives for multinational groups.

HK has also recently updated its tax concession for authorized captive insurers in HK by dropping the limitation of the 50% reduction in the corporate income tax rate in HK to offshore risks. Commencing from the year of assessment, 2018/2019, such tax concession is extended to onshore risks. In other words, captive insurers in HK can now enjoy an effective profits tax rate of 8.25% on their insurance business of both offshore and onshore risks.

It's worth noting that there is no time limit on the concessions. As a result, unless there is a change in the fundamental domestic tax legislations of HK, captive insurers are eligible for the tax concession indefinitely on the basis that the relevant requirements are met. There are also threshold requirements for the level of activities in HK (i.e., number of employees with sufficient qualification(s), amount of operating expenditure incurred in HK) to qualify for the tax concession, which is in line with BEPS requirements. However, the details of the threshold requirements for this concession are yet to be released by the HK tax authority.

Outlook

Looking into the future, all three jurisdictions now have tax incentive schemes compliant with BEPS substance requirements and are looking to seize additional market share. Each domicile has its own target segment: Singapore is the location of choice for Australian multinationals and increasingly attracts Japanese and non-Asian groups with diversified Asian investments, HK targets the Chinese market, and Labuan has its existing niche.

We would expect tax to play less and less of a role as a factor to distinguish between captive jurisdictions. The current BEPS 2.0 initiative is expected to establish global minimum tax rules under its Pillar Two, effectively negating any tax benefit beyond a certain point. Both Singapore and HK have attractive regular tax rates, even without the incentive schemes, and the main attractiveness of their captive regime comes, as it should, from nontax factors.

With that, the 2020s may well become the decade of the Asian captive.

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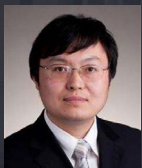
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