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## OF TURQUOISE WATERS AND CAPTIVATING DREAMS: THE COOK ISLANDS AS AN INTERNATIONAL CAPTIVE INSURANCE CENTER

*James A McConvill\**

### ABSTRACT

The Cook Islands is an international offshore financial center which has had ongoing success in the US with its “asset protection trust.” In recent years, the jurisdiction’s financial services sector has been endeavoring to diversify its product offering with the introduction first of the Foundations Act in 2012, followed by the Captive Insurance Act and corresponding Regulations in 2013. The intention behind this recent initiative is to position the Cook Islands to attract business in the emerging markets of China and Latin America, in addition to existing sources of business (particularly North America). The Cook Islands’ Captive Insurance Act and Regulations, of which the present author was the principal drafter, were passed to capitalize on the jurisdiction’s reputation as a private wealth management jurisdiction of choice.

This article explores the key components of the recent Captive Insurance Act and Regulations, highlighting what the author considers to be the most attractive features and also noting what may be considered limitations or potential areas for improvement. It will be argued that an important priority going forward is to enact legislation to enable captive insurance companies to be structured with segregated cells (and ideally incorporated cell companies), along with a variety of reasons why cell company regulation is attractive to captive domicile shoppers.

The author will also argue that while focusing on the growth engines of Asia is important, the traditional market of the United States provides the most potential for developing the Cook Islands as a captive insurance center.

### I. INTRODUCTION

The Cook Islands, an offshore financial center for thirty years,<sup>1</sup> was the pioneering offshore jurisdiction for the so-called “asset protection trust.”<sup>2</sup> The asset protection trust has

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<sup>1</sup> See James McConvill et al., *Cook Islands*, in *PRIVATE FOUNDATIONS WORLD SURVEY 2013* (Johanna Niegel & Richard Pease eds., 2013) (showing New Zealand’s use of the Cook Islands as an offshore source of revenue since the early 1900’s and the etymology and development of the domestic financial policy in the region).

<sup>2</sup> Leslie Wayne, *Cook Islands, A Paradise of Untouchable Assets*, N.Y. TIMES (Dec. 14, 2013), [http://www.nytimes.com/2013/12/15/business/international/paradise-of-untouchable-assets.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2013/12/15/business/international/paradise-of-untouchable-assets.html?pagewanted=all&_r=0); see James McConvill, *A Captivating Development: The Cook Islands and*

long been popular as a risk and wealth management device in North America, in particular among medical practitioners in the United States, along with some appetite for this product in Asia as well.<sup>3</sup>

The Cook Islands is located in the South Pacific Ocean, east of Tahiti and due south of Hawaii. It consists of fifteen islands spread over 2.2 million square kilometers of ocean.<sup>4</sup> Rarotonga is the main island, and is home to over 70% of the country's population with just under 22,000 people, most of whom are Maori-Polynesian.<sup>5</sup> The capital of the Cook Islands is Avarua, located on Rarotonga.<sup>6</sup> The Cook Islands is now a self-governing sovereign state,<sup>7</sup> even though it previously was under the administrative control of New Zealand between 1900 and 1965, following being named a British protectorate in 1888. Since 1965, it has been in a free association with New Zealand.<sup>8</sup> In the Cook Islands, Queen Elizabeth II is the head of state, and there is an elected parliament with twenty-four seats and a Prime Minister.<sup>9</sup> Further, residents of the Cook Islands are considered New Zealand citizens and New Zealand is responsible for the Cook Islands' defense.<sup>10</sup>

Given its close association with New Zealand, the Cook Islands has access to the New Zealand judiciary to draw its judges. This means justice is dispensed in a sophisticated and fair manner – which is important for international corporate entities coming before the jurisdiction's High Court.<sup>11</sup>

Over the years, a large percentage of offshore finance business in the Cook Islands has long been derived from the United States.<sup>12</sup> More recently, the government, Cook Islands Financial Services Department Authority (hereinafter "FSDA") and the financial services industry together have devoted a great deal of time and energy to diversifying the jurisdiction's client base by targeting emerging markets—principally China.<sup>13</sup> This transition

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its *New Captive Insurance Act 2013*, NZ LAW. ONLINE, Aug. 23, 2013, at 24-25 [hereinafter *A Captivating Development*]; see also John G. McFadzien, *Cook Islands Updates the Asset Protection Trust*, 3 TRS. & TRUSTEES 18, 18 (1997) (U.K.). One way to unwind a Cook Islands asset protection trust, since Cook Islands courts do not recognize or give effect to certain foreign judgments in relation to the trust, is for a creditor to show it has used all other appeals and available remedies, and there is fraud beyond a reasonable doubt (along with a strict time limit of two years from when the trust's creation). David R. McNair, *Cook Islands Asset Protection Trust Law*, 3 J. BUS. ENTREPRENEURSHIP & L. 323, 323-25 (2010).

<sup>3</sup> See Wayne, *supra* note 2.

<sup>4</sup> See E. EDWARD SIEMENS, OFFSHORE COMPANY LAW 17 (2009); see also McConvill et al., *supra* note 1, at 203.

<sup>5</sup> See GARY D. BOUMA ET. AL., RELIGIOUS DIVERSITY IN SOUTHEAST ASIA AND THE PACIFIC 127 (2010); see also Jon Tikivanotau M. Jonassen, *Cook Islands*, 23 THE CONTEMP. PAC., Spring 2011, at 209. 22,000 is the estimated population for 2008. *Id.*

<sup>6</sup> See *id.*

<sup>7</sup> See McCONVILL ET AL., *supra* note 1, at 203.

<sup>8</sup> See *id.*; see also *The World Factbook – Cook Islands*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/geos/cw.html> (last visited Feb. 27, 2014); see also BOUMA ET. AL., *supra* note 5, at 127.

<sup>9</sup> BOUMA ET. AL., *supra* note 5, at 127; *The World Factbook – Cook Islands*, *supra* note 8.

<sup>10</sup> See *id.*

<sup>11</sup> *Welcome to the FSDA*, COOK ISLANDS FIN. SERVS. DEV. AUTH., <http://www.cookislandsfinance.com/about-us.php> (last visited Feb. 27, 2014).

<sup>12</sup> Wayne, *supra* note 2.

<sup>13</sup> See Jennifer A. Davis, Michael J. Burns & James McConvill, *Creating a New Foundation*, NZ LAW. ONLINE, Sep. 21, 2012, at 16-17; see also *A Captivating Development*, *supra* note 2, at 24-25.

is due to the recent explosion of economic growth in China, and Asia more generally.<sup>14</sup> In a recent article in *Offshore Investment* magazine, the CEO of the FSDA, Jenner Davis, commented as follows on the potential China provides for the Cook Islands:

The exponential growth of wealth in China presents global opportunity in the areas of wealth management and business planning. Finance centers need to stand ready with the expertise and services to cater for the China market. The Cook Islands is committed to Chinese clients and meeting their needs. Existing legislation and the experience of the service providers allow the jurisdiction to easily provide the sophisticated international planning required by wealth[y] Chinese. As client needs shift, the Cook Islands is able to quickly respond through legislation and service to provide a seamless long-term wealth management and business planning platform for clients.<sup>15</sup>

As the author has noted elsewhere, one of the recent initiatives to attract new business was the enactment of the Cook Islands' Foundations Act 2012 (hereinafter "Foundations Act") (of which the current author was the principal drafter).<sup>16</sup> The appeal of the Foundations Act is that while the Cook Islands has market-leading trusts legislation, the trust concept remains a subject of uncertainty and misunderstanding in China and other emerging civil law jurisdictions.<sup>17</sup> This article considers, where a foundation has separate legal entity status, over time it will become the preferred vehicle for wealth planning and asset protection in these jurisdictions.<sup>18</sup>

Notwithstanding the significance of this new legislation, the Cook Islands has not stopped on its path to becoming a more full-service offshore financial center through the

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<sup>14</sup> Wayne, *supra* note 2; see JOSEPH STIGLITZ, FREEFALL: AMERICA, FREE MARKETS, AND THE SINKING OF THE WORLD ECONOMY 21 (2010).

<sup>15</sup> Cook Islands Financial Services Development Authority, *International Planning for Chinese Clients Using the Cook Islands*, OFFSHORE INV., Nov. 2011.

<sup>16</sup> *Id.*; Cook Islands Foundations Act of 2012 (Cook Is.), available at <http://www.cookislandsfinance.com/legislation-pdf/Foundations-Act-2012.pdf>; Jenner Davis, Michael J. Burns & James McConvill, *The Cook Islands and Emerging Wealth: Laying the Foundation for Future Growth and Prosperity*, OFFSHORE RED, July/Aug. 2012, at 14, available at [http://www.applebyglobal.com/publication-pdf-versions/articles/articles-2012/the-cook-islands-and-emerging-wealth-\(mburns-and-jmconvill\)-september-2012.pdf](http://www.applebyglobal.com/publication-pdf-versions/articles/articles-2012/the-cook-islands-and-emerging-wealth-(mburns-and-jmconvill)-september-2012.pdf) [hereinafter *The Cook Islands and Emerging Wealth*].

<sup>17</sup> *The Cook Islands and Emerging Wealth*, *supra* note 16. In a trust, legal title to trust property passes to the trustee. See *Trust*, THE FREE DICTIONARY, <http://legal-dictionary.thefreedictionary.com/trust> (last visited Dec. 21, 2014).

<sup>18</sup> See generally *The Cook Islands and Emerging Wealth*, *supra* note 16, at 14.

A foundation is formed by a person known as the founder (who may be either an individual or corporate body) who provides (through an "endowment") the assets to be administered by the foundation. The foundation's assets are to be administered [by the foundation] through contractual, rather than proprietary, principles – providing some comfort to those who are from civil law jurisdictions and not familiar with equitable principles. A foundation is a distinct legal entity, unlike a trust. It is managed by a council of members. A foundation can hold assets, enter into agreements with third parties [subject to this being consistent with the foundation's objects] and can sue or be sued in its own name. This would make a foundation similar to a company. However, unlike a company, a foundation does not have any shareholders.

*Id.* "[A]s the world increasingly shifts to the East, demand in the private wealth and business planning area will continue to shift from the trust to the foundation." *Id.* at 15.

Foundations Act.<sup>19</sup> The FSDA, with the guidance and support of the financial services industry on the ground, has continued with the rollout of a wide range of new offshore financial sector laws, including the Captive Insurance Act, which is the primary focus of this article.<sup>20</sup> Moreover, through the initiative of the FSDA, the Cook Islands is also planning to introduce a completely redrafted and modernized International Companies Act and mutual funds legislation in the next few years.<sup>21</sup> This complements other relatively recent offshore commercial legislation enacted in the Cook Islands, including the Limited Liability Companies Act.<sup>22</sup>

The rollout of new legislation began when the Cook Islands Captive Insurance Act took effect in 2013, and was accompanied by the Captive Insurance Regulations 2013, which were introduced in June of that year.<sup>23</sup> The newly-enacted legislation was designed after reviewing the legislation of a suite of captive insurance domiciles both onshore and offshore, and contains the best features of the most successful captive jurisdictions.<sup>24</sup> The objective behind the Captive Insurance Act and Regulations is to position the Cook Islands to be ready to exploit any potential gaps in or new segments of the captive insurance market. It can accomplish this by taking advantage of both its geographic position on the doorstep of an emerging Asia and also its existing reputation in the US.<sup>25</sup>

This article will explore the key features of the new Cook Islands captive insurance legislation by highlighting how the legislation works to place the Cook Islands in a position to become a leading captive insurance domicile.<sup>26</sup> The author will argue that above all else, the determining factors as to whether the Cook Islands will rise as a captive insurance powerhouse or instead become another of many jurisdictions (both onshore and offshore) with captive insurance ticked off the list of laws to pass, but with very few captive entities actually domiciled, are license fees and relative ease of regulation.<sup>27</sup>

According to the author, the Cook Islands now has in place first-class captive legislation, and is well positioned geographically to exploit any growing appetite for captive

<sup>19</sup> See Foundations Act 2012 (Cook Is.), available at <https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/d419dd8deb9aa1057b6033ac7faa6979/Foundations%20Act%202012%20No11.PDF>; see generally *The Cook Islands and Emerging Wealth*, supra note 16.

<sup>20</sup> See Captive Insurance Act 2013 (Cook Is.), available at <https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/d217b3a64385ba649b3a9c0b1cca4af8/Captive%20Insurance%20Act%202013.pdf>; see also *The Cook Islands and Emerging Wealth*, supra note 16, at 14.

<sup>21</sup> See Rachel Reeves, *New 'Foundations Act' Explained*, COOK ISLANDS NEWS (July 10, 2012), <http://www.cookislandsnews.com/national/item/38958-new-lsquo-foundations-act-rsquo-explained>.

<sup>22</sup> See generally Limited Liability Companies Act (2008) (Cook Is.), available at <http://www.cookislandsfinance.com/legislation-pdf/Limited-Liability-Companies-Act.pdf>. The Cook Islands limited liability company or "LLC" is an incorporated legal entity but is treated as a pass-through entity for US tax purposes, meaning that tax is imposed at member level rather than at the level of the LLC, making the LLC similar in that respect to a partnership. *Id.* § 48; COOK IS. FIN. SERV. DEV. AUTH., *Limited Liability Companies*, <http://www.cookislandsfinance.com/lc.php> (last visited Nov. 29, 2014).

<sup>23</sup> See generally Captive Insurance Act 2013 (Cook Is.); see also Captive Insurance Regulations 2013 (Cook Is.), available at <https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/0ea0ea8a7b0745a540222c67860e0600/Captive%20Insurance%20Regulations%202013.PDF>.

<sup>24</sup> See *Cook Islands News*, COOK ISLANDS FIN. SERVS. DEV. AUTH., <http://www.cookislandsfinance.com/news.php> (last visited July 15, 2014); *Limited Liability Companies*, COOK ISLANDS FIN. SERVS. DEV. AUTH., <http://www.cookislandsfinance.com/lc.php> (last visited Nov. 7, 2014).

<sup>25</sup> See Wayne, supra note 2.

<sup>26</sup> See *infra* pts. II, III.

<sup>27</sup> See *infra* pt. III.

insurance vehicles in Asia. Ultimately, it can generate the numbers necessary to make the legislation commercially viable and attract captive players to set up on the ground in the Cook Islands. However, the FSDA and private sector need to focus their efforts principally on the United States since it remains overwhelmingly the main source of captive insurance business globally and the Cook Islands already has a significant presence in the U.S. due to the recognition and successful use of the Cook Islands asset protection trust.<sup>28</sup>

Further, the author argues that targeting the U.S. for the initial batch of captive insurance business needs to be even more focused due to the fact that the main opportunity, initially at least, will be in the somewhat fluid market for so-called “831b captives,” also known as “mini-captives.”<sup>29</sup> The market for mini-captives is a better prospect, than going after large captives, since that is where Bermuda and Cayman, among the offshore centers, still remain the preference.<sup>30</sup> These mini-captives are captives with a collected annual premium below US\$1.2 million, and (as will be discussed in Part II of this article) have numerous U.S. tax advantages to the parent company, including that they are only taxed on investment income and not on the premiums collected.<sup>31</sup> This advantage makes them very attractive if they are set up simply to collect insurance premiums from the parent company and are not involved in investing.<sup>32</sup>

In recent years, as will be discussed, due mainly to the low set up and ongoing registration costs and relatively straight-forward insurance laws, Anguilla has emerged as an offshore jurisdiction of choice for these mini-captives, taking away much of the business of the British Virgin Islands (“BVI”), previously one of the top five captive domiciles in the world.<sup>33</sup>

Under its new Regulations, the ongoing government license fees for captive insurance entities in the Cook Islands will be higher than in Anguilla (at NZ\$3,000, converting to around US\$2,500, compared to US\$1,500-\$2,000).<sup>34</sup> Further, unlike Anguilla, the Cook Islands has yet to enact segregated cell company legislation to enable captives to operate with cells within its structure where the assets and liabilities of one cell are segregated from other cells in the company.<sup>35</sup> In this article, the author will explain that cell companies

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<sup>28</sup> See Wayne, *supra* note 2.

<sup>29</sup> See James McConvill & Michael J. Burns, *BVI Captives Diversifying Beyond the Minis*, CAPTIVE INS. COMPANY REPS., May 2011, at 5-6, available at [http://www.applebyglobal.com/articles-2011/captive-insurance-company-reports-\(james-mcconvill--michael-j-burns\)-\(may-2011\).pdf](http://www.applebyglobal.com/articles-2011/captive-insurance-company-reports-(james-mcconvill--michael-j-burns)-(may-2011).pdf).

<sup>30</sup> See *id.*

<sup>31</sup> See *id.*; see also Beckett G. Cantley, *The Forgotten Taxation Landmine: Application of the Accumulated Earnings Tax to IRC § 831(B) Captive Insurance Companies*, 11 RICH. J. GLOBAL L. & BUS., Spring 2012, at 160-61 [hereinafter *Forgotten Taxation*].

<sup>32</sup> See *Forgotten Taxation*, *supra* note 31, at 160-61; see generally Beckett G. Cantley, *Steering into the Storm: Amplification of Captive Insurance Company Compliance Issues in the Offshore Tax Crackdown*, 12 HOUS. BUS. & TAX L.J. 224, 231-41 (2012) [hereinafter *Steering into the Storm*].

<sup>33</sup> See McConvill & Burns, *supra* note 29 at 1; see MARSH RISK MANAGEMENT RESEARCH, 2013 CAPTIVE BENCHMARKING REPORT: DISCOVERING OPPORTUNITY IN THE SHIFTING CAPTIVE LANDSCAPE 5 (May 2013), available at [http://usa.marsh.com/Portals/9/Documents/GlobalCaptives%20Benchmarking\\_FINAL\\_04174887MA13-12252.pdf](http://usa.marsh.com/Portals/9/Documents/GlobalCaptives%20Benchmarking_FINAL_04174887MA13-12252.pdf) (stating recent statistics on captive insurance domiciles) [hereinafter MARSH].

<sup>34</sup> Insurance Regulations 2008, R.S.A. c. 116 sched. 6 (Anguilla), available at <http://www.fsc.org.ai/PDF/legislation/I016-Insurance%20Regulations.pdf>; see also Captive Insurance Regulations 2013 (Cook Is.).

<sup>35</sup> Captive Insurance Regulations 2013 (Cook Is.).

have a number of practical commercial uses for captive insurance entities themselves, as well as companies wishing to establish a captive.<sup>36</sup>

The author will ultimately contend that whilst it is very important that the Cook Islands (principally through its FSDA) continues its efforts to market into and progressively build its reputation in the “new world” of Asia, along with careful planning and refining of an already attractive captive insurance regulatory package, the Cook Islands has the potential to emerge as a serious rival to the main existing captive insurance domiciles onshore and offshore.<sup>37</sup> A reduction in annual fees, and an introduction of cell company legislation, which is apparently already in the cards, are immediate agenda items that need to be put into action.

## II. BACKGROUND ON CAPTIVE INSURANCE

The term “captive” in the context of insurance refers to an entity owned and controlled by the entities or individuals that it insures.<sup>38</sup> The following definition of a captive insurer provided by the International Association of Insurance Supervisors (hereinafter “IAIS”) in its October 2006 paper, *Issues Paper on the Regulation and Supervision of Captive Insurance Companies*,<sup>39</sup> is helpful in understanding the rationale behind utilizing captive insurance. According to the IAIS, a captive insurer is:

an insurance or reinsurance entity created and owned, [directly or indirectly] by one or several industrial, commercial or financial entities, other than an insurance or reinsurance group entity, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, and only a small part, if any, of its risk exposure is related to providing insurance or reinsurance to other parties.<sup>40</sup>

A captive is also often formed by high income companies, high net-worth individuals, associations, and groups when the conventional insurance market is not sufficiently flexible, stable and/or financially attractive.<sup>41</sup> Moreover, a subsidiary captive

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<sup>36</sup> See generally Barry D. Pressman, Joe Cheddar & Rich Chivaroli, *Alternative Liability Insurance: Are You Ready for a Captive?*, 3 J. AM. C. RADIOLOGY, no. 3, March 2006, at 196, 198; see NIGEL FEETHAM & GRANT JONES, PROTECTED CELL COMPANIES: A GUIDE TO THEIR IMPLEMENTATION AND USE 6-7 (2nd ed., 2010) (discussing the structure and functions of a cell captive).

<sup>37</sup> See *infra* pt. IV.

<sup>38</sup> See PETER J. STRAUSS, THE DEFINITIVE GUIDE TO CAPTIVE INSURANCE COMPANIES 6-7 (2011); see also R. WESLEY SIERK, III, TAKEN CAPTIVE 11 (2008); JAY D. ADKISSON, ADKISSON'S CAPTIVE INSURANCE COMPANIES: AN INTRODUCTION TO CAPTIVES, CLOSELY-HELD INSURANCE COMPANIES, AND RISK RETENTION GROUPS 1-10 (2006).

<sup>39</sup> INT'L ASS'N OF INS. SUPERVISORS, ISSUES PAPER OF THE REGULATION AND SUPERVISIONS OF CAPTIVE INSURANCE COMPANIES 35 (2006), available at [http://www.iaisweb.org/\\_temp/Issues\\_paper\\_on\\_regulation\\_and\\_supervision\\_of\\_captive\\_insurance\\_companies.pdf](http://www.iaisweb.org/_temp/Issues_paper_on_regulation_and_supervision_of_captive_insurance_companies.pdf) [hereinafter ISSUES PAPER].

<sup>40</sup> *Id.*

<sup>41</sup> See Tim Vorhees & Sunny Borens, *Eating and Sleeping Better with a Captive Insurance Company*, 12 J. PRAC. EST. PLAN. 37, 37 (2010); see also Jean-Baptiste Lesourd & Steve Schilizzi, *Captive Insurance Companies and the Management of Non-Conventional Corporate Risk*, 1, 3 (Univ. of W. Austl., Working Paper No. 1105, 2011), available at <http://ageconsearch.umn.edu/bitstream/100886/2/wp110005.pdf>; see also Shanique Hall, *Recent Developments in the Captive Insurance Industry*, CIPR NEWSL. (Ctr. for Ins. Pol'y Res.,

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insurance company may be used by businesses as a risk management technique to finance retained losses in a formal structure.<sup>42</sup>

Captives are also often established to fill gaps in insurance coverage that exist in the conventional insurance market, either because certain coverage is not provided, or where the cost of obtaining coverage is not economically viable.<sup>43</sup> For example, a business with a track record demonstrating it has minimal risk exposure is considered able to most effectively take advantage of the captive structure.<sup>44</sup> Furthermore, with minimal losses, an underwriting surplus can be built up each year, and in time progressively paid back to the parent company through dividends, while retaining a certain level to meet claims rather than depending on reinsurance.<sup>45</sup>

Captive insurance entities have been around since the 1960s, with Bermuda as the original offshore domicile.<sup>46</sup> Many large insurers in the U.S. and other economies actually first started as captives, and then later became “fully-fledged” insurers with premiums from insuring third-party risk greatly exceeding the premium received from its parent company. For example, Allstate was originally a captive insurance entity for Sears.<sup>47</sup>

Recently, captives have become increasingly popular, particularly in the U.S.<sup>48</sup> Additionally, the number of captives, and amount of capital that captives control, has grown considerably. As a result, there are now well over 5,000 captives registered worldwide.<sup>49</sup> Over half of the states in the U.S. have implemented legislation favorable to captive entities, with these states competing against each other to be the domicile of choice for captives.<sup>50</sup> In the U.S. Vermont, Utah, Delaware, Hawaii and the District of Columbia have the largest numbers of captives.<sup>51</sup>

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Kansas City, M.O.), Jan. 2012, at 4-5, available at [http://www.naic.org/cipr\\_newsletter\\_archive/vol2\\_captive.htm](http://www.naic.org/cipr_newsletter_archive/vol2_captive.htm).

<sup>42</sup> See Gary A. Fox & Lynn M. McGuire, *Forming a Captive Insurance Company? Understanding the Business and Tax Implications*, 64 TAX EXEC., Mar.-Apr. 2012, at 149-151; Robert Bertucelli, *The Benefits of Captive Insurance Companies*, 215 J. ACCT. 53, 53 (2013).

<sup>43</sup> *Global Strategic Advisor Develops Joint Venture with HGA-BVI for Alternative Risk Transfer and Captive Insurance Educational Services* (June 1, 2009, 8:10 AM), <http://ca.sys-con.com/node/983427>.

<sup>44</sup> Robert E. Bertucelli, *supra* note 42.

<sup>45</sup> See, e.g., *Insurance Captives' Profitability Soars; Dividends Way Up: A.M. Best*, INSURANCE J. (August 8, 2011), <http://www.insurancejournal.com/news/national/2011/08/08/209840.htm>; see *What's Captive Insurance?*, CAPTIVA INS. MANAGERS, <http://www.captivamanagers.com/upimages/commonpdf/1343974673What-is-captive.pdf>. “The obvious benefit of this is that if you don’t have any losses then you keep all the premium. Captives then often buy their own wholesale insurance or reinsurance to protect themselves,” which costs less than ordinary insurance. *Id.*

<sup>46</sup> See CATHERINE R. DUFFY, *HELD CAPTIVE: A HISTORY OF INTERNATIONAL INSURANCE IN BERMUDA* 38-39 (Roger Howard et al. eds., 2004).

<sup>47</sup> Hall, *supra* note 41.

<sup>48</sup> See *Articles*, BVI ASS’N INS. MANAGERS, <http://www.bviaim.com/articles.html> (last visited Mar. 30, 2014). “The increasing use of captives indicates a trend towards [changes in the structure of many] organisations [sic] and the way they finance their risks.” *Id.* They are an essential part of most risk management programs and “represent a long term strategy that with proper planning and commitment can bring immense benefits.” *Id.* Captive insurance companies have provided significant benefits to thousands of organizations throughout the world by improving their insurance arrangements, smoothing their cash flow and contributing to their profits and balance sheet strength. *E.g., Id.*

<sup>49</sup> See ISSUES PAPER, *supra* note 39, at 4.

<sup>50</sup> MARSH, *supra* note 33, at 2, 7.

<sup>51</sup> *Id.* at 5.



It is estimated that more than half of all captive insurance entities are domiciled offshore, with BVI, Cayman [Islands], Guernsey and Bermuda being popular jurisdictions (although Anguilla and Barbados are also growing in popularity)...These offshore jurisdictions directly compete with U.S. states for the registration of these captives, with lower fees and less capitalization costs attracting captives to go outside the US to register.<sup>52</sup>

Over time, a range of different captive types has emerged to cater to different factual scenarios and needs. In its *Issues Paper on the Regulation and Supervision of Captive Insurance Companies*, the IAIS notes the following types of captives:

**Pure captives:** single parent companies, writing only the risks of their owner and/or affiliates;

**Group and/or association captives:** multi-owned insurance companies writing only the risks of their owners and/or affiliates (usually within a specific trade or industry);

**Rental captives:** insurers specifically formed to provide captive facilities to unrelated entities for a fee, where entities prefer not to form their own dedicated captive [also referred to as “rent-a-captives”]

**Diversified captives:** captives writing a limited proportion of unrelated business in addition to the risks of their owner and/or affiliates.<sup>53</sup>

Different businesses will have different motivations and experience different advantages from establishing a captive entity.<sup>54</sup> According to Stephen Malley:

A [c]aptive may serve a number of purposes, for example, to reduce premiums by increased retentions, to provide insurance at predicted costs to avoid otherwise unpredictable and fluctuating premium levels, to control the claims process, and to access reinsurance markets directly. A captive can in addition provide insurance coverage not otherwise available.<sup>55</sup>

Further, the following is a list of benefits for parent companies in owning and operating a captive insurance entity:

**Insurance Coverage** - Ability to write lines of business not immediately available or economically prohibitive to insure in the traditional insurance market.

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<sup>52</sup> James McConvill, *An Island of Captives: The BVI and its Not so Little Secrets*, 6 ORIGINAL L. REV. 40, 44 (2010).

<sup>53</sup> See ISSUES PAPER, *supra* note 39, at 8. See *Guernsey Captive Insurance Industry Growing in Appeal*, ABLV (June 8, 2011), <http://www.ablv.com/en/press/2011-06-08-guernsey-captive-insurance-industry-growing-in-appeal>, for a discussion on diversified captives. “Captive insurance companies are insurance companies established with the specific objective of financing risks emanating from their parent group or groups, but they sometimes also insure risks of the group’s customers as well.” *Id.*

<sup>54</sup> ADKISSON, *supra* note 38.

<sup>55</sup> Stephen A. Malley, *Captive Insurance Companies*, INT’L TAX PLAN. ASS’N, <https://www.itpa.org/?p=6653> (last visited May 22, 2014).

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**Cost** - Reduced premiums and expenses compared to placement of covers in the mainstream insurance marketplace.

**Stability** - Premium stability going forward to avoid traditional pricing fluctuations inherent with conventional insurers with the volatility in underwriting created by the so-called ‘soft and hard market’ cycles.

**Control** - Protection from industry-wide underwriting decisions affecting specific trade sectors.

**Estate Planning and Asset Protection** - Ability to control own investment income subject to regulatory requirements and the retention of profitable underwriting income otherwise passed on to the shareholders of a conventional insurance company.

**Reinsurance** - Allows direct access to the re-insurance market on a more cost efficient basis.<sup>56</sup>

It is estimated that approximately half of all captive insurance entities are domiciled in offshore financial centers. Bermuda, the Cayman Islands, Guernsey, and the BVI are the traditionally popular jurisdictions while in recent years Anguilla and Barbados have been growing in popularity.<sup>57</sup> In particular, Anguilla and the BVI have been attractive for so-called section 831(b)—or “mini”—captives emanating out of the U.S.<sup>58</sup>

Under Section 831(b) of the U.S. Internal Revenue Code, a non-life insurance company (principally insuring property and casualty risks) receiving less than US\$1,200,000 in net annual premium, is not taxed on its underwriting profit.<sup>59</sup> Instead, an 831(b) captive pays income tax only on its investment income (and could avoid tax if investing in tax-free municipal bonds).<sup>60</sup> Accordingly, if a captive insurance company is not involved in investing, then it is not subject to U.S. tax.<sup>61</sup> Further, the payment of the premium is deductible as a business expense for a company establishing the captive, under Section 162 of the Internal Revenue Code.<sup>62</sup> Thus, the parent company has a tax-deductible expense, and the captive does not pay tax on the receipt of premium income, as long as the annual amount remains below US\$1,200,000.<sup>63</sup>

### III. COOK ISLANDS CAPTIVE INSURANCE ACT AND REGULATIONS 2013: RATIONALE AND KEY FEATURES

The main regulatory consequence of the enactment of the new Captive Insurance Act and accompanying Regulations is to “ring-fence” captive insurance companies domiciled in the Cook Islands “from the detailed requirements applying to insurance businesses under

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<sup>56</sup> McConvill, *supra* note 52, at 45.

<sup>57</sup> See MARSH, *supra* note 33, at 6-7; see also McConvill, *supra* note 52, at 44.

<sup>58</sup> McConvill & Burns, *supra* note 29; Press Release, Capstone Associated, Capstone Addresses Anguilla Captive Community (Oct. 29, 2014), available at <http://www.capstoneassociated.com/press/news/capstone-addresses-anguilla-captive-community/>.

<sup>59</sup> IRC § 831(b); See also *Forgotten Taxation*, *supra* note 31, at 159.

<sup>60</sup> See, e.g., *Forgotten Taxation*, *supra* note 31, at 166.

<sup>61</sup> *Id.*

<sup>62</sup> IRC § 831(b); IRC § 162; *Forgotten Taxation*, *supra* note 31, at 159.

<sup>63</sup> *Steering into the Storm*, *supra* note 32, at 238.

the Cook Islands' Insurance Act 2008.”<sup>64</sup> These companies are incorporated under the Cook Islands' Companies Act 1970-71, “solely to underwrite the interests of their local Cook Islands holding companies,” or the International Companies Act 1981-82.<sup>65</sup>

This ring-fencing was seen as necessary due to the recognition that the Insurance Act, along with the Insurance Regulations and Insurance Code, were principally designed to regulate entities conducting insurance business within the Cook Islands, with a significant amount of the business being dealings with local, individual policyholders requiring a heightened level of protection compared to the standard captive insurance entity.<sup>66</sup>

Protection came in the form of a comprehensive suite of compliance requirements imposed under the Insurance Act, Regulations, and Code.<sup>67</sup>

Given that the activities of the standard captive insurance entity is confined to taking on the risk of providing insurance to its holding company, group, or association, many of the requirements in the Insurance Act are inappropriate for captives.<sup>68</sup> Accordingly, based on the author's discussions with representatives of the financial services industry on the ground in the Cook Islands, it was commonly-held that the Insurance Act prevented any possibility of the Cook Islands positioning itself as a leading international captive insurance center.<sup>69</sup>

Moreover, the author drafted

the Captive Insurance Act and Regulations with the existing Cook Islands Insurance Act and Insurance Code as a base...but adjusted by taking out a number of the requirements in the Insurance Act and Code (mainly the adoption of corporate governance and risk management-related policies, and the appointment of an actuary) that do not or should not apply to captive insurers.<sup>70</sup>

Key provisions in the legislation “of the leading captive insurance jurisdictions, both onshore and offshore, were reviewed and, where appropriate, incorporated into the Act and Regulations.”<sup>71</sup> The result is first-class legislation that appropriately and effectively responds to the commercial dynamics of captive insurance businesses, while also ensuring that the Cook Islands can rightly promote itself as having a responsible regulatory environment for

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<sup>64</sup> *A Captivating Development*, *supra* note 2, at 24-25.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*; *see generally* Captive Insurance Act 2013 (Cook Is.); *see also* Captive Insurance Regulations 2013 (Cook Is.).

<sup>71</sup> *A Captivating Development*, *supra* note 2, at 24-25.

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captive insurers in place.<sup>72</sup> Thus, the objective and design of the Captive Insurance Act and Regulations is right-touch, rather than simply light-touch, regulation.<sup>73</sup>

To gain a better picture of how the Act and Regulations are structured and work in practice, what follows is a discussion of the main provisions in both the Act and Regulations.

### A. The Captive Insurance Act

The Act is divided into six parts, and also includes transitional provisions.<sup>74</sup> Schedule 1 provides that a Cook Islands company engaged in captive insurance business that held a license granted under the Insurance Act immediately prior to the introduction of the Captive Insurance Act, is deemed to have been granted a license under the Captive Insurance Act from the date the Captive Insurance Act comes into effect.<sup>75</sup>

Part 1 comprises of Sections 1 to 4, and contains preliminary provisions. It details, *inter alia*, the commencement date, the application of the Captive Insurance Act,<sup>76</sup> and the interpretation of words and expressions. Section 3 defines “captive insurance business” as “the business of a company insuring interests in its holding company or in companies that it is affiliated or associated with or is organised [sic] within a group or agency relationship”.<sup>77</sup> In the Act, “Commission” means the Cook Islands Financial Supervisory Commission.<sup>78</sup>

Part 2 comprises of sections 5 to 17, and contains provisions dealing with the regulation and supervision of captive insurance business. More specifically, Section 6 prohibits a Cook Islands company from carrying on, or holding itself out as carrying on, captive insurance business unless it obtains a license issued by the Commission.<sup>79</sup> Further, Section 7 provides that an application for a license must be made through a Cook Islands trustee company or through an “an approved insurance manager.”<sup>80</sup>

Section 8 sets out the requirements for the Commission to issue a license to an applicant.<sup>81</sup> The criterion is based on, and hence is substantially the same as, the criterion set out in the existing Insurance Act.<sup>82</sup> For example, the Commission needs to be satisfied that the applicant will be in compliance with the insurer’s capital and surplus requirements (specified in the accompanying Regulations), and that the applicant, its directors, and any person having a “significant interest” in the applicant are fit and proper persons.<sup>83</sup>

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<sup>72</sup> *Id.*

<sup>73</sup> *See Id.*

<sup>74</sup> Captive Insurance Act 2013 (Cook Is.).

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* §§ 1-4. The preliminary sections confirm that it covers captive insurance business outside of the Cook Islands by Cook Islands’ international companies, and only covers local companies incorporated under the Companies Act 1970-71 set up exclusively to underwrite the interests of their local holding companies. Any other insurance business will continue to be regulated under the Insurance Act 2008. *Id.*

<sup>77</sup> *Id.* § 3.

<sup>78</sup> *Id.* § 3. *See Cook Islands, FINANCIAL SUPERVISORY COMMISSION*, <http://www.fsc.gov.ck> (last visited Apr. 13, 2014), for more details about the Cook Islands Financial Supervisory Commission.

<sup>79</sup> Captive Insurance Act 2013 § 6 (Cook Is.).

<sup>80</sup> *Id.* § 7.

<sup>81</sup> *Id.* § 8.

<sup>82</sup> *Id.*; *see also* Insurance Act 2008 (Cook Is.).

<sup>83</sup> *Id.* § 8; *see also* Captive Insurance Regulations 2013 (Cook Is.).

Sections 11 to 13 set out the financial resource requirements applicable to licensees.<sup>84</sup> Particularly, Section 11 contains a general requirement for licensees to maintain a financially sound condition by having assets, providing for its liabilities and generally conducting its business to allow it to meet its liabilities at all times.<sup>85</sup>

A licensed captive insurer that forms an opinion that it will not be able to comply with this requirement must forthwith provide written notification to the Commission; an insurer that fails to do so commits an offense.<sup>86</sup> Without in any way limiting the generality of the requirement in Section 11, Section 12 requires that a licensed captive insurer ensure that its capital and surplus are maintained in an amount not less than the amount set out in the accompanying Captive Insurance Regulations (detailed below).<sup>87</sup> A licensed captive insurer who fails to meet the capital and surplus requirement commits an offense, and is liable on conviction to a fine not exceeding \$20,000.<sup>88</sup>

Furthermore, to ensure effective risk management within licensed captive insurers, under Section 13 a licensed insurer must have appropriate arrangements in place for the reinsurance of liabilities regarding risks insured by the licensee.<sup>89</sup>

Sections 14 to 17 deal with the general restrictions on, and obligations of, licensed captive insurers. Section 14 contains a general requirement that licensed captive insurers shall not carry on any business other than captive insurance business and business or activities deemed to be carried on in connection with or for the purposes of the captive insurance business.<sup>90</sup> Further, a licensed captive insurer must carry on its business in accordance with its most recent business plan, which must be submitted to the Commission.<sup>91</sup>

Section 15 deals with the appointment and termination of directors of licensed captive insurers.<sup>92</sup> It requires a licensed captive insurer to have at least two directors, and at least one director must be a natural person residing in the Cook Islands.<sup>93</sup> As such, a licensed captive insurer must not appoint a director without the Commission's prior written approval, and the Commission is not to grant this approval unless it is satisfied that the relevant person is "fit and proper" to be a director.<sup>94</sup> The Commission must receive written confirmation within 14 days of a licensed captive insurer terminating a director's appointment or a director otherwise ceasing to hold office.<sup>95</sup>

Disposal, or acquisition, of a "significant interest" in a licensed captive insurer is regulated by section 16.<sup>96</sup> A "significant interest," in the context of a Cook Islands company, is defined as

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<sup>84</sup> *Id.* §§ 11-13.

<sup>85</sup> *Id.* § 11.

<sup>86</sup> *Id.* § 11(2)-(3).

<sup>87</sup> *Id.* § 12(1); *see* Captive Insurance Regulations 2013 (Cook Is.).

<sup>88</sup> *Id.* § 12(6).

<sup>89</sup> *Id.* § 13(1).

<sup>90</sup> *Id.* §§ 14-17.

<sup>91</sup> *Id.* § 14(1).

<sup>92</sup> *Id.* § 15.

<sup>93</sup> *Id.* § 15(4).

<sup>94</sup> *Id.* § 15(1)-(2).

<sup>95</sup> *Id.* § 15(3).

<sup>96</sup> *Id.* § 16.

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a holding or interest in the company or in any holding company of the company held or owned by a person, either alone or with any other person and whether legally or equitably, that entitles or enables the person, directly or indirectly -

- (a) to control 10 per cent or more of the voting rights of that company at a meeting of the company, or its members;
- (b) to a share of 10 per cent or more in dividends declared and paid by the licensee;
- (c) to a share of 10 per cent or more in any distribution of the surplus assets of the company; or
- (d) to appoint or remove one or more directors of the company[.]”<sup>97</sup>

A person must not sell, transfer, charge or otherwise dispose of their interest in the insurer, or acquire (directly or indirectly) a significant interest in a licensed captive insurer, unless the prior written approval of the Commission has been obtained.<sup>98</sup> A licensed captive insurer must not (1) cause, permit or acquiesce in the acquisition or disposal of a significant interest in the licensed captive insurer, or (2) engage in a share issue or reorganization that results in a person acquiring a significant interest or a person with an existing significant interest altering the size of that interest.<sup>99</sup>

Despite the extensive list of requirements, the Commission may grant an exemption to a licensed captive insurer whose shares (or the shares of whose holding company) are publicly traded on a stock exchange recognized by the Commission. However, a person who contravenes Section 16 commits an offense and is liable on conviction to a fine not exceeding \$10,000.<sup>100</sup>

Section 17 sets out the requirement for licensed captive insurers to have an “approved insurance manager” at all times.<sup>101</sup> This section provides that an approved insurance manager shall be licensed under the Insurance Act, or an external insurance manager approved by the Commission under this Act.<sup>102</sup>

Part 3 comprises of Sections 18 to 23, and contains the provisions dealing with the regulation of “financial records and audits.”<sup>103</sup> Section 18 contains the general requirements of licensed captive insurers with respect to financial records.<sup>104</sup> A licensed captive insurer is required to keep at an address within or outside the Cook Islands, records which are sufficient to, *inter alia*, enable its financial position to be determined with reasonable accuracy, and enable it to prepare the financial statements and returns as it is required to prepare, make, and have these documents audited.<sup>105</sup> If the records are retained by the licensed captive insurer outside of the Cook Islands the insurer is to provide its trustee company and approved insurance manager with the physical address where the records are located.<sup>106</sup>

<sup>97</sup> *Id.* § 3(1).

<sup>98</sup> *Id.* § 16(1).

<sup>99</sup> *Id.* § 16(3).

<sup>100</sup> *Id.* § 16(5), (7).

<sup>101</sup> *Id.* § 17(1).

<sup>102</sup> *Id.* § 17(2).

<sup>103</sup> *Id.* §§ 18-23.

<sup>104</sup> *Id.* § 18.

<sup>105</sup> *Id.* § 18(1)(b)-(d).

<sup>106</sup> *Id.* § 18(2).

Additionally, a licensed captive insurer is required to appoint an auditor pursuant to Section 19. The role of the auditor is to review financial statements of the insurer.<sup>107</sup> The Commission may not approve an auditor's appointment unless it is satisfied that the auditor (a) has sufficient experience and is competent to audit the financial statements of the licensed captive insurer, and (b) is independent of the licensed captive insurer.<sup>108</sup> Section 20 requires an auditor to carry out a sufficient investigation of a licensed captive insurer to be able to form an opinion on the insurer's statements, and to prepare an audit report for the insurer in compliance with the Captive Insurance Regulations.<sup>109</sup>

Part 4 comprises of Sections 24 to 30, and contains the "general supervisory and enforcement provisions" to be applied by the Commission.<sup>110</sup> Section 24 provides the Commission with the power to inspect the premises and the business of a licensed captive insurer, and a subsidiary or holding company of a licensed captive insurer.<sup>111</sup> Section 25 facilitates a foreign regulatory authority, with the permission of the Commission, taking part in a compliance visit undertaken by the Commission under Section 24.<sup>112</sup> A "foreign regulatory authority" is defined as an authority in a country or territory outside the Cook Islands which exercises: (a) a function corresponding with or similar to a function exercised by the Commission, or (b) a function that, in the opinion of the Commission, relates to the supervision or regulation of any business or activity required to be licensed under the Act.<sup>113</sup> Before the Commission grants permission to the foreign regulatory authority, it must be satisfied that the participation of the foreign regulatory authority is reasonably required: (a) for the effective supervision of the licensed captive insurer, or (b) for the purposes of the regulatory or supervisory functions of the foreign regulatory authority.<sup>114</sup>

Section 26 sets out the circumstances in which the Commission may take enforcement action against a licensed captive insurer.<sup>115</sup> If enforcement action is taken against a licensed captive insurer, the Commission may revoke the insurer's license, issue a directive, appoint an examiner to conduct an investigation, or petition the Court to wind up the insurer pursuant to the Cook Islands' Companies Act or International Companies Act (as applicable).<sup>116</sup>

Section 27 provides the Commission with the power to revoke a licensed captive insurer's license (a) if it is entitled to take enforcement action against the insurer under Section 26, (b) where the insurer has within a reasonable period (usually 12 months, or such period as the Commission may prescribe) failed to commence business or has ceased to carry on the business for which it was licensed, or (c) where the licensee makes a written application to the Commission for its license to be revoked.<sup>117</sup> Where the Commission takes enforcement action, a licensed captive insurer is entitled to submit a written notice to the

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<sup>107</sup> *Id.* § 19(1).

<sup>108</sup> *Id.* § 19(3).

<sup>109</sup> *Id.* § 20(1).

<sup>110</sup> *Id.* §§ 24-30.

<sup>111</sup> *Id.* § 24(1)-(2).

<sup>112</sup> *Id.* § 25(1).

<sup>113</sup> *Id.* § 25(4).

<sup>114</sup> *Id.* § 25(2).

<sup>115</sup> *Id.* § 26(1).

<sup>116</sup> *Id.* § 26(3).

<sup>117</sup> *Id.* § 27(1).

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Commission within 14 days of being notified about the proposed revocation of license setting out why it believes its license should not be revoked.<sup>118</sup>

Section 29 sets out the Commission's power to issue directives. Where the Commission is entitled to take enforcement action against a licensed captive insurer, the Commission may issue a directive to, *inter alia*,

- (a) impose a prohibition, restriction or limitation on the business that may be undertaken by the insurer;
- (b) require that a director be removed and replaced by another person acceptable to the Commission; or
- (c) require the insurer to take such actions as the Commission considers necessary to protect the insurer's obligations, or ensure that the insurer complies with its regulatory obligations.<sup>119</sup>

Part 5 comprises of sections 31 to 36, and contains provisions dealing with liquidation and striking off licensed captive insurers. In particular, Section 34 sets out the circumstances in which the Commission may present to the Court a petition to wind up an unlicensed insurer, or an insurer for which it may take action against.<sup>120</sup> The Section notes that the Court can wind up a company when it is unable to pay its debts, meaning the total value of its assets exceed the total amount of its liabilities.<sup>121</sup> Section 36 confirms that, "unless the Court otherwise orders, carry on the captive insurance business of the insurer with a view to it being transferred as a going concern to another insurer licensed."<sup>122</sup> The liquidator may agree to the variation of any contracts of insurance at the commencement of the winding up, but may not give effect any new contracts of insurance.<sup>123</sup>

Part 6 comprises of sections 37 to 49, and is entitled "Miscellaneous Provisions."<sup>124</sup> Section 39 provides for the Commission to maintain a Register of Licensed Captive Insurance Companies, and such other registers as may be specified in the regulations.<sup>125</sup> Lastly, Section 48 makes it clear that a licensed captive insurer will generally not be subject to any taxes, fees, levies and imposts in the Cook Islands.<sup>126</sup>

## B. The Captive Insurance Regulations

The Captive Insurance Regulations consist of three Parts and add flesh to the bones of the Act's Regulations. Changes were made to shorten and simplify the Regulations between the final draft and the version that the present author drafted, which was ultimately passed by the Cook Islands Parliament in 2013.<sup>127</sup>

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<sup>118</sup> *Id.* § 27(3).

<sup>119</sup> *Id.* § 29(1).

<sup>120</sup> *Id.* § 34(1).

<sup>121</sup> *Id.* § 34(2)-(3).

<sup>122</sup> *Id.* § 36(1).

<sup>123</sup> *Id.* § 36(2).

<sup>124</sup> *Id.* §§ 37-49.

<sup>125</sup> *Id.* § 39(1).

<sup>126</sup> *Id.* § 48.

<sup>127</sup> See *generally* Captive Insurance Regulations 2013 (Cook Is.).



Part I comprises of Regulations 1 to 4, and contains the preliminary provisions, including commencement date and definitions. Further, this part confirms that the Regulations only apply to insurers licensed under the Captive Insurance Act.<sup>128</sup>

Part II is entitled Provisions Applicable to Licensed Captive Insurers. It includes Regulation 5, which provides that the prescribed minimum capital and surplus that a licensed captive insurer must maintain is NZD\$100,000 (one NZD, at the time of this writing, converted to US\$0.83 – thus, NZD\$100,000 equates to US\$83,000).<sup>129</sup> This compares favorably to the capital requirements in some other offshore centers. In the BVI, for example, the capital requirement is US\$200,000 for long-term/life insurance companies and US\$100,000 for other insurance entities. In addition, there is a solvency margin requirement in which the value of the company's assets must exceed its liabilities by a specified amount or "margin" determined as a percentage of the company's net premiums.<sup>130</sup> In Anguilla the figure is US\$100,000 for a Class B "General" Insurance License, or US\$200,000 for a Class B "Unrestricted" License, which also allows long-term insurance.<sup>131</sup> Further, in Vanuatu, the capital requirement is US\$100,000 for general captives, and US\$250,000 for life insurance companies.<sup>132</sup> The US\$100,000 minimum capital requirement also applies in the Federated States of Micronesia.<sup>133</sup>

Under the Regulations "capital" is defined as fully paid-up share capital, whereas "surplus" is the amount by which the company's assets exceed its liabilities.<sup>134</sup> The Regulations also provide that a licensed captive insurer shall maintain adequate systems and controls to monitor and assess the adequacy of its capital resources on an ongoing basis.<sup>135</sup>

Regulation 5 states that in determining the surplus of a licensed captive insurer: (a) only those assets specified in Schedule 1 as "admissible assets" may be taken into account in determining the value of its assets to the extent specified in the Schedule; (b) the insurer's liabilities must be valued in accordance with Regulation 7, and (c) the insurer's assets must be valued in accordance with Regulation 6.<sup>136</sup>

The following assets are admissible assets under Schedule 1: (a) investments in, and advances to, the licensed captive insurer's holding company subject to the insurer earning a market interest rate; (b) cash in hand or on deposit with a financial institution approved by the Commission; (c) an irrevocable letter of credit issued by financial institutions approved by the Commission; (d) bonds and debentures guaranteed by a Government approved by the Commission; (e) securities quoted on a stock exchange approved by the Commission, but not

<sup>128</sup> See *id.* regs 1-4.

<sup>129</sup> See Captive Insurance Regulations 2013, reg 5 (Cook Is.); *Representative Exchange Rates for Selected Currencies for June 2013*, INT'L MONETARY FUND, [http://www.imf.org/external/np/fin/data/rms\\_mth.aspx?SelectDate=2013-06-30&reportType=REP](http://www.imf.org/external/np/fin/data/rms_mth.aspx?SelectDate=2013-06-30&reportType=REP) (last visited Dec. 21, 2014).

<sup>130</sup> See APPLEBY, GUIDE TO INSURANCE LAW IN THE BRITISH VIRGIN ISLANDS 9-10 (2010), available at <http://www.applebyglobal.com/publication-pdf-versions/guides/guide-to-insurance-in-the-british-virgin-islands-%28october-2010%29.pdf> [hereinafter GUIDE TO INSURANCE LAW IN THE BRITISH VIRGIN ISLANDS].

<sup>131</sup> See Insurance Act 2006 § 3 (Anguilla), available at <http://www.fsc.org.ai/PDF/legislation/I016-Insurance%20Act.pdf>.

<sup>132</sup> *Advantage Vanuatu the Captive Solution*, ADVANTAGE VANUATU CAPTIVE INS., <http://insurance.vu/VfscCaptive2.html#Basic> (last visited Dec. 21, 2014).

<sup>133</sup> See Public Law No.18-20, § 1007 (Federated States of Micr.), available at <http://www.fsmcongress.fm/pdf%20documents/18th%20Congress/Public%20Laws/PUBLIC%20LAW%2018-20.pdf>.

<sup>134</sup> Captive Insurance Act 2013 § 3(1).

<sup>135</sup> Captive Insurance Regulations 2013, reg 8 (Cook Is.).

<sup>136</sup> Captive Insurance Regulations 2013, reg 5(2) (Cook Is.).

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exceeding seventy percent of the quoted market value; (f) premiums receivable; (g) reinsurance balances receivable; (h) accounts receivable net of provision for bad or doubtful debts.<sup>137</sup>

Regulation 6 deals with the valuation of assets and states:

- (1) [A] licensed captive insurer must ensure that the value of its assets is determined on the basis required by the accounting standards in accordance with which the insurer's financial statements are prepared.
- (2) Under no circumstances shall any asset of a licensed captive insurer be valued in an amount higher than the market value of that asset.<sup>138</sup>

Regulation 7 deals with the calculation of a licensed captive insurer's liabilities. A licensed captive insurer must ensure that its liabilities are: "(a) calculated and valued on the basis required by the accounting standards in accordance with which the insurer's financial statements are prepared and include all contingent and prospective liabilities; and (b) monitored and calculated on a continuous basis."<sup>139</sup>

Regulation 8 relates to corporate governance. It sets out a licensed captive insurer's risk management requirements as follows:

- (1) A licensed insurer shall establish and maintain—
  - (a) a clearly defined strategy, and if the board considers it appropriate, policies, for the effective management of all significant risks that the insurer is or may be exposed to; and
  - (b) systems and controls that are sufficient to ensure that the risk management strategy and policies are effectively implemented.<sup>140</sup>

Regulation 8 also provides that the board of a licensed captive insurer is responsible for:

- (a) ensuring that they understand all the risks to which the insurer is exposed in its business;
- (b) assessing the resources required for an appropriate risk management system, including accurate and reliable management information and reporting systems, and for ensuring that the required resources are available; and
- (c) overseeing the implementation of the licensed captive insurer's risk management strategy, policies, systems and controls.<sup>141</sup>

Part III of the Regulations contains a number of miscellaneous provisions. Specifically, Regulation 9 sets out the form an application for a license under the Captive Insurance Act must take, including that the application must include a current business plan of

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<sup>137</sup> Captive Insurance Regulations 2013, sched. 1 (Cook Is.).

<sup>138</sup> Captive Insurance Regulations 2013, reg 6 (Cook Is.).

<sup>139</sup> *Id.* reg 7.

<sup>140</sup> *Id.* reg 8(1).

<sup>141</sup> *Id.* reg 8(4).

the insurer.<sup>142</sup> Regulation 10 then deals with fees for licensed captive insurers. The fees are contained in Schedule II to the Regulations. Currently, the fees for licensed captive insurers are NZD\$1,000 to apply for a license, then NZD\$3,000 for a license, and the annual renewal fee is \$3,000.<sup>143</sup> On the other hand, the fees for an external licensed manager licensed under the Captive Insurance Act are much less with an application fee of NZD\$300, license fee of \$300, and the annual renewal fee the same.<sup>144</sup>

#### **IV. COOK ISLANDS AS A CAPTIVE INSURANCE CENTRE: KEY OPPORTUNITIES AND AREAS FOR CONSIDERATION AND POTENTIAL IMPROVEMENT**

As previously mentioned, the Captive Insurance Act and the Regulations were drafted after a detailed review of the key features of the main captive domiciles both offshore and onshore.<sup>145</sup> A number of the attractive provisions in the legislation of these jurisdictions were incorporated into the Cook Islands Act and Regulations during the drafting process, providing the Cook Islands with attractive, first-class captive insurance legislation.<sup>146</sup>

As has also been indicated in this article, the Cook Islands is well-positioned geographically and from the perspective of its recent marketing efforts (through the FSDA) to exploit a gradual upward direction in understanding of, and resulting demand for, captive insurance structures in Asia.<sup>147</sup>

The Cook Islands must not, however, simply rest on its laurels. The Cook Islands will not become a leading offshore captive insurance center just by adding a Captive Insurance Act to its status books and waiting for a tick over in registrations of captive insurance companies. In this section, the author will point out three actions that the Cook Islands may take to assist the jurisdiction in hopefully speeding up the realization of its objective to become the new hot offshore domicile for captives. These three actions are:

- (i) Principally focus on the US, not Asia, for captive insurance business;
- (ii) Reduce license fees in the Cook Islands to attract Section 831(b) captive registrations;
- (iii) Enable cell company structures to be established in the jurisdiction.

##### **A. Principally Focus on the US, not Asia, for Captive Insurance Business**

Asia is where a large percentage of the world's population is located, and has been the region which has seen the greatest amount of economic growth over the last few years, and particularly since the global recession. China in particular has experienced a massive

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<sup>142</sup> *Id.* reg 9.

<sup>143</sup> *Id.* sched. 2.

<sup>144</sup> *Id.*

<sup>145</sup> *A Captivating Development*, *supra* note 2, at 24-25.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

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increase in growth and prosperity, and has clearly positioned itself to be one of the two great superpowers. For 2013, China's economy was projected to have grown by 7.6%.<sup>148</sup>

Many offshore financial centers have accordingly focused their attention on, and developed new products and services to appeal to the Asian market – and especially the growth engine of China. In this regard, the Cook Islands is certainly no exception.<sup>149</sup> As the CEO of the Cook Islands Financial Services Development Authority, Jenner Davis, wrote in a 2011 article in the trade journal *Offshore Investment*:

The exponential growth of wealth in China presents global opportunity in the areas of wealth management and business planning. Finance centers need to stand ready with the expertise and services to cater for the China market. The Cook Islands is committed to Chinese clients and meeting their needs. Existing legislation and the experience of the service providers allow the jurisdiction to easily provide the sophisticated international planning required by wealth Chinese.<sup>150</sup>

It is anticipated that over time, the growth of the Chinese economy and the economies of other emerging Asian jurisdictions will lead to a natural growth in demand for captive insurance in Asia and that with new, first-class captive insurance legislation and its location in the Pacific Ocean, the Cook Islands will be perfectly located to take advantage of this growth.<sup>151</sup> The author also anticipates that in more mature markets in the Asian region, like Australia and New Zealand, there will be a greater appreciation of the benefits of setting up captive insurance structures to manage risk, and that the Cook Islands will be a major benefactor of this growing appetite.

There has been recent commentary that in the last few years, in Asia there has been growing interest in captives. This has mainly been due to the increasing premiums for conventional insurance in the region, resulting in companies bringing their insurance needs in-house.<sup>152</sup> Australia, New Zealand, Japan and Thailand corporations have witnessed a significant increase in premiums since 2011 due to natural catastrophes (earthquakes, floods) there. Increasingly tight regulation of insurance companies in Asia as regulators move to a risk-based approach has also led to an increased level of concentration within the insurance industry, meaning higher barriers to entry and thus the ability of the main players to attract higher premiums.<sup>153</sup>

Further, as corporations in Asia grow and become multinational with sophisticated methods of risk management, there is also a natural increase in demand for alternative risk financing solutions.<sup>154</sup> Dylan Bryant noted recently that: “The captive income market is well-known for having started slowly in Asia. However, interest in captives appears to be growing

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<sup>148</sup> William Kazer, *China Forecasts 7.6% Growth in 2013*, WALL ST. J. (Dec. 26, 2013, 3:53 PM), <http://online.wsj.com/news/articles/SB10001424052702304753504579281760062940986>.

<sup>149</sup> Cook Islands Financial Services Development Authority, *supra* note 15.

<sup>150</sup> *Id.*

<sup>151</sup> Daniel Koepfer, *Transforming Asia*, in CAPTIVE ASIA PAC. REPORT 8, 8 (2013), available at <http://archipelagopcc.com/wp-content/uploads/2013/07/CRAAsiaPac2013.pdf>.

<sup>152</sup> *Id.* at 8-9.

<sup>153</sup> *Id.* at 8.

<sup>154</sup> *Id.*

as state organisations [sic] and private companies begin to realise [sic] the benefits they can provide such as effective risk management and reduced costs.”<sup>155</sup>

Accordingly, in the present author’s view, the recent efforts by the Cook Islands (mainly being the establishment of the Cook Islands Financial Services Development Authority) to promote the jurisdiction as a domicile of choice for captives in Asia does make sense, and should certainly continue. There is, however, the risk that such efforts mean that the jurisdiction has too many eggs in the Asian basket during its development phase as a captive insurance center, and that too much emphasis on future possibilities in an emerging Asia will come at the expense of immediate, concrete opportunities in the region where the appreciation of (and demand for) captives is already very strong—the United States.

The statistics speak for themselves in this regard. According to Marsh, in 2013 all of Asia accounted for approximately 6% of global captive business, compared to approximately 70% in the United States alone, and 24% in Europe.<sup>156</sup> The market for captive insurance in the United States is not only mature, but highly sophisticated and still experiencing high growth. Thirty-seven out of the fifty states, plus the District of Columbia, have captive insurance legislation.<sup>157</sup> Bermuda and the Cayman Islands are also popular domiciles for captive vehicles of large corporations, in addition to “golden captive” U.S. states including Vermont and South Carolina.<sup>158</sup> In the same Marsh Global Captives Benchmarking report regarding the North American market, it is noted:

Companies based in the Americas tend to be more comfortable with taking significant risk for pricing casualty coverages (workers’ compensation, general and products liability and automobile liability). In addition, tax-accounting regulations allow for tax deductions on property and casualty reserves...thereby providing additional economic advantages for companies, compared with self-insurance.<sup>159</sup>

In addition, only 4-5% of captives worldwide in 2013 were domiciled in an Asian jurisdiction (with Singapore being the leading jurisdiction with 63 captives, followed by Labuan with 39).<sup>160</sup>

It is very important that those promoting the Cook Islands as a captive domicile do not disregard or underestimate the U.S. market. As has been raised in this article, the Cook Islands already has brand awareness and respect in the United States among high net-worth individuals, corporations and their advisers because of the successful asset protection trust

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<sup>155</sup> Dylan Bryant, *Asia – Coming to Grips with Captives*, in CAPTIVE ASIA PAC. REP. 10, 10 (2013), available at <http://archipelagopcc.com/wp-content/uploads/2013/07/CRAAsiaPac2013.pdf>.

<sup>156</sup> MARSH, *supra* note 33, at 4.

<sup>157</sup> *Id.* at 7; see also Jay Adkisson & Dana Hentges Sheridan, *Choice of Domicile in Captive Insurance Planning*, BUS. L. TODAY (ABA, Chi., Ill.) Feb. 2014, at 3, available at <http://www.americanbar.org/content/dam/aba/publications/blt/2014/02/choice-domicile-201402.authcheckdam.pdf>; see also Christine Hall, *Why Companies Are Opting for Captive Insurance Arrangements*, FORBES (Jan. 28, 2013, 10:25 AM), <http://www.forbes.com/sites/bmoharrisbank/2013/01/28/why-companies-are-opting-for-captive-insurance-arrangements/> [hereinafter *Why Companies Are Opting for Captive Insurance Arrangements*]; DC Captive Domicile Information, DC.GOV, <http://disb.dc.gov/page/dc-captive-domicile-information> (last visited Dec. 7, 2014).

<sup>158</sup> MARSH, *supra* note 33, at 5; see Bertucelli, *supra* note 42, at 52.

<sup>159</sup> MARSH, *supra* note 33, at 4.

<sup>160</sup> Koepfer, *supra* note 151, at 9.

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legislation.<sup>161</sup> The United States is overwhelmingly the main source of business for the financial services sector in the Cook Islands, and there is no reason why this is going to change any time soon.<sup>162</sup>

While there is obviously potential in Asia due to the enormous population and the recent growth trends among the major emerging economies within the Asian region, the U.S. market is not in decline.<sup>163</sup> Due to rising insurance premiums for a variety of reasons (including a spate of terrorist acts and natural catastrophes), along with the recent return to economic growth following the financial crisis in 2008-09, which left the U.S. economy anemic for a number of years, there has been a resurgence in demand for captive insurance vehicles among US corporations both large and small.<sup>164</sup>

As will be explored further below, placing the United States as the number one jurisdiction to market itself into, does not mean that the Cook Islands will need to aggressively compete with the main offshore players of Bermuda and the Cayman Islands for the high-end, highly lucrative business of large and medium-sized U.S. corporations that are already heavily utilizing captive insurance structures to manage risk.<sup>165</sup>

It is the author's position that due to its distance from the United States, its time zone, along with the lack of sophisticated insurance-specific infrastructure and insurance professionals on the ground in the Cook Islands, such an objective would be unrealistic and futile, distracting the Cook Islands from the more immediate, and potentially even more lucrative prize.

Rather than displacing Bermuda and the Cayman Islands from the top of the captive domicile tree, the Cook Islands can potentially rapidly emerge as a recognized captive insurance center by focusing on the market for s831b 'mini-caps,' and in doing so displace the other islands in the Caribbean—Anguilla and the BVI.<sup>166</sup> The size of these captives themselves may be relatively small, however, as will be shown, the market for these captives is substantial.<sup>167</sup>

## B. Reducing license fee to attract Section 831b captives to the Cook Islands

Part II of the article explained that US corporations set up so-called "mini-caps" to take advantage of the tax advantages under Section 831(b) of the US Internal Revenue Code.

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<sup>161</sup> See Wayne, *supra* note 2.

<sup>162</sup> See *id.*

<sup>163</sup> Caroline McDonald, *Steady As She Goes: 2014 Captive Domicile Review*, RISK MANAGEMENT (Aug. 1, 2014, 6:02 AM), <http://www.rmmagazine.com/2014/08/01/steady-as-she-goes-2014-captive-domicile-review/>.

<sup>164</sup> See *id.*; see also MARSH, *supra* note 33, at 16.

<sup>165</sup> See Bertucelli, *supra* note 42.

<sup>166</sup> Jenna Jones, *Domiciling in the British Virgin Islands Could be the Answer to many Parent Companies' Problems in the US – Just Don't Expect a Direct Flight to Your Destination*, 26 CAPTIVE INS. TIMES 12 (2013); *Insurance and Reinsurance in the British Virgin Islands: Overview*, PRACTICAL LAW, <http://us.practicallaw.com/1-501-3313> (last visited Nov. 11, 2014) [hereinafter *Insurance and Reinsurance in the British Virgin Islands*].

<sup>167</sup> See *Why Companies Are Opting for Captive Insurance Arrangements*, *supra* note 157; see also *Middle Market Spurs Overall Growth in Captive Insurers*, BUSINESS WIRE (Mar. 5, 2012, 11:12 AM), <http://www.businesswire.com/news/home/20120305006128/en/Middle-Market-Spurs-Growth-Captive-Insurers>.

If the total amount of premiums paid to the captive is less than US\$1.2 million per year, and the captive simply operates as a shell with no investment income, then it will not be taxed.<sup>168</sup>

Thus, the payment of the US\$1.2 million by the parent company to its mini-cap can delay or, if the money remains in the captive, eliminate any tax liability for these funds. Section 831(b) captives are not only a risk transfer mechanism, but also a mechanism to effectively reduce or avoid tax in the US.<sup>169</sup>

Because these captives are relatively small given the annual premium limit of US\$1.2 million, and are structured for the principal purpose of exploiting the tax benefits under the Internal Revenue Code, the management and administration of the captive typically remains in the United States, and parent companies are very sensitive about the cost and ease of running the captive.<sup>170</sup> The more it ultimately costs to set up and run the section 831(b) mini-cap, the more is taken away from original reason purpose of the captive : to save the company money.<sup>171</sup>

Due to this desire to keep costs down as much as possible, and because Section 831(b) captives generally do not have any real physical presence in the jurisdiction in which it is domiciled (unless it is domiciled in one of the U.S. states facilitating captives), in the present author's experience, Section 831(b) captive managers typically have very little loyalty to whichever jurisdiction the captive is domiciled at any particular time.<sup>172</sup> As a result, what has been seen over the last decade is a flight of Section 831(b) captives from one jurisdiction to another, based on which one can offer the best package in terms of price and ease of regulatory requirements at the time.<sup>173</sup>

These mini-caps actually comprise a significant component of the captive insurance market. According to Marsh's Global Captive Benchmarking Report, in 2012 approximately 21% of captives were "small captive companies"—meaning they had annual premiums of less than US\$1.2 million.<sup>174</sup>

Section 831(b) captives originally chose one of the U.S. captive domiciles, however a flight to the BVI occurred when the BVI offered lower set up and annual license fees. Then, over the last five years or so there has been a very noticeable flight away from the BVI to Anguilla, with a significant drop-off in the BVI's insurance industry as a result.<sup>175</sup> The Federated States of Micronesia (also located in the Pacific Ocean), has also enacted captive insurance legislation principally to target the Japanese market, as a result of a series of natural

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<sup>168</sup> Captive Ins. Co. Ass'n, CICA STATEMENT ON 831(B) CAPTIVES (final Mar. 9, 2014).

<sup>169</sup> See *Forgotten Taxation*, *supra* note 31, at 166; see generally *Steering into the Storm*, *supra* note 32, at 231-36; STEWART, *supra* note 14, at 60-62.

<sup>170</sup> See *Forgotten Taxation*, *supra* note 31, at 160.

<sup>171</sup> *Advantages of Captive Insurance*, DEPARTMENT OF FIN. REGS., <http://www.dfr.vermont.gov/captives/advantages-captive-insurance> (last visited Nov. 11, 2014).

<sup>172</sup> See Jones, *supra* note 166, at 12; Martin Cooke, *The Foundations are Firmly in Place to Maintain the BVI's Longstanding Position as One of the Leading Captive Jurisdictions*, says Martin Cooke of Hyperion Insurance Management, 47 CAPTIVE INS. TIMES 16 (2014).

<sup>173</sup> See Cooke, *supra* note 172, at 16.

<sup>174</sup> MARSH, *supra* note 33, at 16.

<sup>175</sup> Gavin Bradshaw, *With Captives Forming a Mainstay of its Insurance Sector, BVI is Seeking Other Options to Avoid Over-Reliance on 831(b)s*, DOMICILE UPDATE (Captive Review, London, England), Feb. 2011, at 25-26.

catastrophes there, including the earthquakes in 2011,<sup>176</sup> and in the present author's view, is another a potential up-and-coming rival to Anguilla.

License fees, both the initial and the annual renewal fee charged to captives by the jurisdiction, are the principal factor in determining whether a Section 831(b) captive will stay or go. Accordingly, because of this emphasis on price, as well as there being little or no need for a section 831(b) captive to have a physical footprint in the jurisdiction in which it is domiciled, there is a lot of potential for the Cook Islands to gain a significant share of this market.<sup>177</sup>

In order to hit the ground running, however, the Cook Islands will need to go back and review the fees it charges captives under the Captive Insurance Regulations. There was a revision upwards in the initial and annual fees charged to captives,<sup>178</sup> which the author believes should be unwound. While Anguilla is the main reference point with regard to fees given it has become the market leader among offshore centers as a domicile for section 831(b)s, the recent entry of The Federated States of Micronesia into the captive market cannot be ignored. While it does not have the reputation or the track record that the Cook Islands can promote, it is certainly now the cheapest offshore jurisdiction to park a section 831(b) captive. It is also located in the Pacific like the Cook Islands.<sup>179</sup>

When the drafting process for the Captive Insurance Act and Regulations was underway in 2011, it was suggested that an application fee of NZD\$1,000 (approx. US\$830) and an annual license fee of NZD\$1,500 (approx. US\$1,250) would apply to Cook Islands' captives. By the time the Captive Insurance Regulations were enacted in 2013, however, the annual license fee had increased to NZD\$3,000 (approx. US\$2,500), while the application fee remained at NZD\$1,000.<sup>180</sup>

An annual license fee of US\$2,500 is in the mid-range of fees when looking at a number of the leading captive domiciles offshore,<sup>181</sup> but if we are to accept that at least in the short-to-mid-term the Cook Islands needs to position itself as an attractive jurisdiction for section 831(b) captives, the current fee is too high and needs to be revised down. As

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<sup>176</sup> Vicky Beckett, *Asia Pacific: Domicile Update*, in CAPTIVE: ASIA PAC. REP. 13, 13-14 (2013), available at <http://archipelagopcc.com/wp-content/uploads/2013/07/CRAAsiaPac2013.pdf>. Micronesia's legislation has also been designed to benefit Japanese clients with respect to Japan's controlled foreign company ("CFC") legislation. See *id.* at 14.

<sup>177</sup> *Cook Islands A Progressive Offshore Jurisdiction*, ATRIUM INCORPORATION SERVICES, <http://www.atrium-incorporators.com/cook-islands-general-features/> (last visited Nov. 29, 2014).

<sup>178</sup> Captive Insurance Regulations 2013 (Cook Is.); Captive Insurance Amendment Regulations 2014, sched. 2 (Cook Is.).

<sup>179</sup> *The World Factbook – Micronesia, Federated States of*, CENT. INTELLIGENCE AGENCY, available at <https://www.cia.gov/library/publications/the-world-factbook/geos/fm.html> (last visited Dec. 21, 2014) [hereinafter *The World Factbook – Micronesia*].

<sup>180</sup> Captive Insurance Regulations 2013 (Cook Is.).

<sup>181</sup> The annual fee is US\$2,000 in Vanuatu; US\$10,000 in Barbados; US\$5,000 in Singapore (a "mid-shore" jurisdiction); and 10,000 Malaysian Ringgit (approximately US\$3,000) in Labuan. See *Advantage Vanuatu the Captive Solution*, *supra* note 132; see also *Captive Insurance*, BCF BUSINESS LAW, <http://www.bcf.ca/en/barbados/captive-insurance> (last visited Dec. 22, 2014); Insurance (General Provisions) Regulations 2004 (Sing.) available at [http://www.mas.gov.sg/~media/resource/legislation\\_guidelines/insurance/sub\\_legislation/Insurance\\_SL/INSURANCE%20GENERAL%20PROVISIONS%20REGULATION\\_S.pdf](http://www.mas.gov.sg/~media/resource/legislation_guidelines/insurance/sub_legislation/Insurance_SL/INSURANCE%20GENERAL%20PROVISIONS%20REGULATION_S.pdf); Ins. Bd. Federated States of Micr., Certificate of Authority Application for Licence – Labuan Insurance and Insurance-Related Activities 3 (2014), available at <http://www.lfsa.gov.my/documents/10156/54d99e04-3ba1-456d-a5bf-60dfa8b5f442>.



mentioned earlier, the BVI and Anguilla are useful precedents for the Cook Islands when revisiting its license fee for captives.

Among the offshore jurisdictions the BVI was, for a number of years, the jurisdiction of choice for section 831(b) captives.<sup>182</sup> The BVI was well-known as the leading centre for international business companies, and had the advantage of being geographically close to the US. But it was clearly the low fees and flexible regulatory environment which were most attractive to the section 831(b)s.<sup>183</sup>

Under the BVI's previous Insurance Regulations 1995, the application fee was US\$500 and the annual license fee was set at US\$2,000.<sup>184</sup> These fees remained for a period after the enactment of the new Insurance Act 2008 and Insurance Regulations in February 2010, though it was necessary to set in place a new fee structure due to different categories of insurance licenses (from category "A" to category "D") that were introduced under the new Insurance Act.<sup>185</sup>

New fees were eventually introduced through the Financial Services Commission (Fees) (Amendment) Regulations 2010, in December 2010.<sup>186</sup> For a standard captive insurance entity insuring the risk of its parent company or an associated company (a so-called "category C" insurance company), the new annual fee became US\$3,500 (US\$7,500 if structured as a segregated portfolio (i.e. cell) company).<sup>187</sup> For a "category D" insurance company (which also entitles the license holder to cover "open market re-insurance business," where the insurer is not connected with the insured), the fee is US\$7,500.<sup>188</sup>

As a result of the anticipation of the new BVI Insurance Act being introduced, with new categories of licenses, and other changes to corporate governance requirements of insurers etc., its eventual enactment, and the new fee structure applying to captives holding a license under the new Insurance Act, there was a consistent and notable decline in the number of captives registered in the BVI since 2007.<sup>189</sup> According to the BVI Financial Services Commission's regular Statistical Bulletin, at the end of fourth quarter of 2007, there were 376 captives domiciled in the BVI.<sup>190</sup> By the end of 2008, this was down to 319, then 219 by the fourth quarter of 2010 as the new fee structure was introduced, with numbers continuing to fall at the end of 2011 (174 captives), 2012 (157 captives), and then just 147 by the end of the third quarter of 2013.<sup>191</sup> There was not a single new captive registered in the BVI in the third

<sup>182</sup> *Insurance and Reinsurance in the British Virgin Islands*, *supra* note 166.

<sup>183</sup> Michael J. Burns, *Commercial Law Developments in the British Virgin Islands*, IFC REVIEW (January 12, 2011), <http://ifcreview.com/restricted.aspx?articleId=3830&areaId=10#>.

<sup>184</sup> Martin Eveleigh, *British Virgin Islands: Captive Insurance in the British Virgin Islands*, MONDAQ, <http://mondaq.com/x/7480/Insurance/Captive+Insurance+in+the+British+Virgin+Islands> (last updated Mar. 9, 2000).

<sup>185</sup> GUIDE TO INSURANCE LAW IN THE BRITISH VIRGIN ISLANDS, *supra* note 130, at 5-6.

<sup>186</sup> Press Release, British Virgin Islands Financial Services Comm'n, New Fees In Effect from 1 January, 2011 (December 17, 2010), *available at* <http://www.bvifsc.vg/News/tabid/160/articleType/ArticleView/articleId/150/language/en-GB/New-Fees-in-effect-from-1-January-2011.aspx>.

<sup>187</sup> Virgin Islands Financial Services Commission Act (No. 12 of 2001), Financial Services Commission Regulations 2010 (listed under Schedule (b) Regulatory Legislation Fees, Item No. (iii) Insurance Act of 2008).

<sup>188</sup> Financial Services Commission Regulations, 2010 (Virgin Is.).

<sup>189</sup> Jenna Jones, *The Flighty Type*, CAPTIVE INS. TIMES, October 7, 2013, at 13.

<sup>190</sup> *Insurance*, 13 BVI FIN. SERVS. COMM'N STAT. BULL. Dec. 2008, at 4, *available at* <http://www.bvifsc.vg/Portals/2/Statistical%20Bulletin%20No.%2013%20-%20December%202008.pdf>

<sup>191</sup> *Id.*; *Insurance*, 21 BVI FIN. SERVS. COMM'N STAT. BULL. Dec. 2010, at 6, *available at* [http://www.bvifsc.vg/Portals/2/Q4%202010%20Statistical%20Bulletin%20\(11%20April%202011\)%20Final%](http://www.bvifsc.vg/Portals/2/Q4%202010%20Statistical%20Bulletin%20(11%20April%202011)%20Final%20)

quarter of 2013. The BVI went from being among the top five captive domiciles in the world, to thirteenth place in 2013.<sup>192</sup>

While the annual license fee in the Cook Islands is set lower than the BVI rate, it is higher than Anguilla which has surpassed the BVI as the section 831(b) domicile of choice.<sup>193</sup> Accordingly, the Cook Islands is likely to be automatically disregarded by section 831(b) captives contemplating a flight from Anguilla. Under Schedule 6 of the Insurance Regulations, the annual fee in Anguilla for a “Class B” captive insurance is US\$1,500 (or US\$2,000 for an unrestricted licence, enabling the captive to insure risks of entities for which it is not associated) and there is no indication this is going to change any time soon, particularly given that the offshore captive industry has become overwhelming the main source of revenue for Anguilla’s Financial Services Commission, and the Islands’ financial services sector.<sup>194</sup> The initial application fee is US\$500.<sup>195</sup>

As captive registration numbers consistently dropped in the BVI between 2007 and 2013, the numbers consistently rose in Anguilla. According to the Anguilla Financial Services Commission Annual Report in 2011, there were approximately 130 captives in 2007, 209 by 2009, 252 in 2010,<sup>196</sup> with this number increasing to 268 in 2011, and 291 in 2012. In 2013, Anguilla had risen to fifth place in the list of the top captive domiciles in the world.<sup>197</sup>

Accordingly, in approaching a review of captive license fees in the Cook Islands with a view to gaining a sizeable percentage of the section 831(b) market, it would seem that all that would need to be done is drop its annual fee slightly below that of Anguilla. It may be the case that dropping the annual fee to, say, US\$1,500<sup>198</sup> would result in a flight of section 831(b)s from Anguilla (and indeed from the BVI) to the Cook Islands, however it may not be as full a flight as the Cook Island thinks it may experience.

The Cook Islands not only needs to knock Anguilla out of the water to win a share of the section 831(b) market that is worth the effort, but it also needs to knock out of the water (or prevent from getting into the water in any serious way) up-and-coming threats. As was noted above, The Federated States of Micronesia is a potential threat in the section 831(b) market.<sup>199</sup> While it only has approximately ten captives under its belt at the time of this

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20(1).pdf; *Insurance*, 25 BVI FIN. SERVS. COMM’N STAT. BULL. Dec. 2011, at 71, available at <http://www.bvifsc.vg/Portals/2/2011%20Stats%20Bulletin%20Qtr%204.pdf>; *Insurance*, 29 BVI FIN. SERVS. COMM’N STAT. BULL. Dec. 2012, at 7, available at <http://www.bvifsc.vg/Portals/2/2012%20Stats%20Bulletin%20Qtr%204%20Final.pdf>; *Insurance*, 33 BVI FIN. SERVS. COMM’N STAT. BULL. 6 Dec. 2013, at 6, available at <http://www.bvifsc.vg/Portals/2/2013%20Stats%20Bulletin%20Qtr%204%20Final.pdf>

<sup>192</sup> See MARSH, *supra* note 33, at 5.

<sup>193</sup> Insurance Amendment Regulations 2014 (Cook Is.); see also *Insurance*, BRITISH VIRGIN IS. FIN. SERVS. COMM’N, <http://www.bvifsc.vg/en-us/divisions/insurance/faqs.aspx> (last visited Dec. 22, 2014).

<sup>194</sup> See generally RICHARD HANDS, ANGUILLA FIN. SERV. COMM’N, ANNUAL REPORT AND ACCOUNTS 9 (2011), available at <http://www.fsc.org.ai/PDF/Director's%20Report.pdf> (noting “[t]he dominance of the offshore, captive insurance sector remains clear and demonstrates Anguilla’s position as the fifth largest jurisdiction by number of companies in the captive insurance market.”).

<sup>195</sup> Insurance Act 2008 sched. 6 (Anguilla), available at <http://www.fsc.org.ai/PDF/legislation/I016-Insurance%20Act.pdf>.

<sup>196</sup> *Id.*; BUSINESS INSURANCE, EXPANDED DIRECTORY REPORT 2011– CAPTIVE DOMICILES, 4 (2011), available at [http://www.mra.fm/jpn/news/pdf/nr\\_20110312-2011\\_directory.pdf](http://www.mra.fm/jpn/news/pdf/nr_20110312-2011_directory.pdf).

<sup>197</sup> MARSH, *supra* note 33, at 5.

<sup>198</sup> The author believes that any revision of the Insurance Regulations should also change the dollars applicable from NZD to USD, particularly given that the Cook Islands’ business is mainly to come from the United States.

<sup>199</sup> See *The World Factbook – Micronesia*, *supra* note 179.

writing, and is apparently focusing on Japan as its principal source of business for captive registrations, Micronesia is located relatively close to the Cook Islands in the Pacific Ocean and has the lowest annual fee for captives that the author has come across so far.<sup>200</sup>

According to the Federated States of Micronesia Insurance Board, both the application fee and annual license fee for captives is US\$500.<sup>201</sup> To further entice international corporations to move their captives to Micronesia, the jurisdiction also introduced so-called Multiple Corporate Captive legislation in 2012<sup>202</sup> resembling the cell company legislation that has now been adopted by almost all of the main captive insurance jurisdictions.<sup>203</sup>

The author recommends that to achieve the real inroads into the captive insurance market (and more specifically the section 831(b) market) to meet the aspirations of those in the Cook Islands government and private sector, the Cook Islands needs to at least match Micronesia's US\$500 annual fee, with perhaps a waiver of the fee for the initial year or two for which the captive is domiciled in the Cook Islands. While this may mean that the Cook Islands is not getting as much in fees per captive registered, it will hopefully result in the jurisdiction getting far more captives to choose the Cook Islands as its domicile, and thus more than make up the difference.

### C. Enable Cell Company Structures to be Established in the Jurisdiction

Complementing the need to focus on the U.S. market for captive insurance, as well as reduce the annual license fee charged to captives, it is crucial that the Cook Islands follows the recent initiative among captive domiciles offshore and in the United States by introducing cell company legislation.<sup>204</sup> Regulations that facilitate captive entities being able to be structured with separate and distinct cells (with these cells themselves possibly being incorporated, depending on the relevant captive domicile), with each cell performing a separate and distinct role, is considered to be a must if a jurisdiction is to be taken seriously as a captive insurance center and attract a healthy number of regulations in the jurisdiction.<sup>205</sup>

There have already been some reports that the Cook Islands is open to introducing cell company legislation, and may in fact do so soon as part of the recent drafting process within the Cook Islands FSDA to modernize and diversify Cook Islands' offshore commercial legislation.<sup>206</sup> This article argues that this might be through amending the Cook Islands' International Companies Act, rather than introducing separate protected cell company legislation.

A protected cell company is also commonly known as a segregated accounts company or segregated portfolio company, among other names. For example, in Bermuda the entity is known as a segregated accounts company or ("SAC"), whereas in the BVI and

<sup>200</sup> See generally, *Members of the FSM Captive Insurance Council*, MICR. CAPTIVE INS. COUNCIL, <http://www.fsmcaptiveins.com/Members.htm> (last visited Dec. 21, 2014).

<sup>201</sup> INS. BD. FEDERATED STATES OF MICR., CERTIFICATE OF AUTHORITY APPLICATION PACKAGE FOR CAPTIVE INSURANCE COMPANY 3 (2014), available at [http://www.fsminsuranceboard.com/docs/applications/App\\_Captive%20Insurance\\_Co.pdf](http://www.fsminsuranceboard.com/docs/applications/App_Captive%20Insurance_Co.pdf).

<sup>202</sup> See Koepfer, *supra* note 151, at 9.

<sup>203</sup> See e.g., NAT'L ASS'N OF INS. COMM'RS, PROTECTED CELL COMPANY MODEL ACT (2002).

<sup>204</sup> *Id.*

<sup>205</sup> See Bertucelli, *supra* note 42.

<sup>206</sup> Reeves, *supra* note 21.

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Cayman it is known as a segregated portfolio company (or “SPC”).<sup>207</sup> International offshore law firm Appleby provides this neat summary below of the nature and rationale of a protected cell company (referring to it as an SPC):

The SPC is a single legal entity, which may establish internal portfolios. Each portfolio’s assets and liabilities are legally separated from the assets and liabilities of the company’s ordinary account (called its “general assets”) and are also separate from assets and liabilities attributed to the SPC’s other segregated portfolios (if any).

A creditor entering into contractual dealings with a particular segregated account will have restricted recourse; it will only be entitled to make its recovery against assets attributed and credited to the specific segregated portfolio to which the contract is also attributed. The creditor will not be legally entitled to make recovery against assets attributed and credited to other segregated portfolios of the SPC, or (save to the extent otherwise provided in any relevant contract) against the general assets of the company.

The value of an SPC structure is immediately apparent: the SPC may be used in many circumstances where previously a group structure of various companies would have been required.<sup>208</sup>

Another international offshore law firm, Conyers Dill & Pearman, has noted that structuring an insurance company as a protected cell company can provide the following benefits, particularly for captives where each cell within the captive can insure different risks (or indeed take on the risks of other companies that want to trial a captive before setting up their own, or simply are too small to justify the cost of setting up and managing their own captive):

SACs are also useful in the insurance industry, being a sensitive vehicle for “rent-a-captives”, being insurance companies established and licensed by a sponsor who then “rents” the capital, the insurance licence [sic] and the company’s capacity to operate various participants. Insurance companies also find SACs useful for legally segregating reserves among different insurance products, particularly long-term business such as life and disability programs.<sup>209</sup>

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<sup>207</sup> See CHRISTOPHER BICKLEY, *BERMUDA, BRITISH VIRGIN ISLANDS AND CAYMAN ISLANDS COMPANY LAW* 29 (3d ed. 2004); Graham Lockington, *A Numbers Game: Can the Segregated Portfolio Company Play a Role in Europe*, 26 INT’L FIN. L. REV. 28 (2007); see also James McConvill and Michael J Burns, *The Emergence of the Offshore ‘Incorporated Cell Company’ and its Use in the Insurance Sector*, 19 INS., FIN. & INVESTMENT, Apr. 15 2013, at 3 [hereinafter *The Emergence of the Offshore ‘Incorporated Cell Company’ and its Use in the Insurance Sector*]; see Bermuda Segregated Accounts Companies Act 2000 (Virgin Is.); see Segregated Portfolio Companies Regulation 2005 (Virgin Is.).

<sup>208</sup> APPLEBY, *GUIDE TO SEGREGATED PORTFOLIO COMPANIES IN THE CAYMAN ISLANDS* 3 (2013), available at [http://www.applebyglobal.com/publication-pdf-versions/guides/guide-to-spcs-in-the-cayman-islands-\(november-2013\).pdf](http://www.applebyglobal.com/publication-pdf-versions/guides/guide-to-spcs-in-the-cayman-islands-(november-2013).pdf); see also *The Emergence of the Offshore ‘Incorporated Cell Company’ and its Use in the Insurance Sector*, *supra* note 207.

<sup>209</sup> CONYERS DILL & PEARMAN, *BERMUDA SEGREGATED ACCOUNTS COMPANIES* 5 (2013), available at [http://www.conyersdill.com/publication-files/Pub\\_BDA\\_Bermuda\\_Segregated\\_Accounts\\_Companies.pdf](http://www.conyersdill.com/publication-files/Pub_BDA_Bermuda_Segregated_Accounts_Companies.pdf).

In a recent co-authored article in the journal *Insurance, Finance & Investment*,<sup>210</sup> the present author went into some more detail in discussing the benefits of a captive setting up in a cell company structure (referred to as “PCCs” (the article focuses on incorporated cell companies (“ICCs”), which the current article will look at further below), noting:

The wide variety of insurance purposes for which SCCs have already been embraced include rent-a-captives, life and annuity companies and transformer vehicles.

*(a) Rent-a-captives*

A “rent-a-captive” is a risk financing solution whereby the sponsor (e.g. a captive insurance manager) sets up and licenses a captive insurance company and then “rents” the core capital, license and corporate capacity of the vehicle to participants in the captive. This gives participants access to the many benefits of captive risk financing without the large capital costs involved in setting up a pure captive. Accordingly, among other things, the “rent-a-captive” opens up the captive solution to smaller companies for whom a pure captive would be too expensive.

If a rent-a-captive structure does not offer legal segregation of accounts (through a SCC/ICC structure), participants need to agree among themselves to keep the gains and losses of each program within the rent-a-captive separate and distinct from the others. Without such a contractual agreement, the participants would potentially be liable for claims against other programs in the rent-a-captive, even if the understanding was that the programs were independent of each other.

Both the SCC and ICC structure address this fundamental weakness with the conventional rent-a-captive by ensuring that each program within the rent-a-captive is established as a separate cell, and accordingly the separation of assets and liabilities as between cells is unassailable in the event of liquidation. This cell structure of the rent-a-captive implements “fire walls” between program participants which should withstand the claims of third party creditors of other participants . . . .

In addition, the segregation of assets and liabilities of each program within the rent-a-captive means there are individual books of business for each program (each with its own internal financial statements and records) making each program more attractive to potential acquirers.

*(b) Life and Annuity Companies*

It has also been recognised that the legal separation of cells has application for insurance outside of the realm of captive insurance. Insurers that engage in the underwriting of different kinds of long-term risks (for

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<sup>210</sup> See generally *The Emergence of the Offshore ‘Incorporated Cell Company’ and its Use in the Insurance Sector*, *supra* note 207, at 3-5.

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example, life, disability, pension plan or annuity programs) can utilize cells to legally segregate the reserves attributable to the different programs and products.

*(c) Transformer Companies*

A “transformer company” is a company set up for the purpose of transforming insurance risk into capital markets products (and, indeed, vice-versa). If a company is to engage in a multitude of these arrangements to manage risk and generate profits, it would be advantageous to do so through the creation of cells to segregate each individual arrangement within the structure.<sup>211</sup>

As a result of these recognized, tangible benefits of utilizing the cell company structure for a captive, the overwhelming majority of the world’s top twenty captive domiciles now has protected cell company legislation in place.<sup>212</sup> This attracts new captive business, and also maintains the business of existing captive entities recognized in the jurisdiction that wish to transfer to a cell company structure. In the Asia-Pacific region, where the Cook Islands is located, all of the other notable offshore captive jurisdictions (Vanuatu, Labuan, the Federated States of Micronesia) have protected cell company legislation of some form or another,<sup>213</sup> whereas Singapore (mid-shore) and Australia and New Zealand (onshore) do not.

Further, protected cell companies are forming a greater percentage of the total number of captives registered in a jurisdiction, and hence it can legitimately be said that it is a disservice to a jurisdiction promoting itself as a captive domicile, not to have cell company legislation in place.<sup>214</sup>

The Cayman Islands is a clear example. Cayman introduced protected cell company legislation applicable to captives in 1998.<sup>215</sup> According to the Cayman Islands Monetary Authority, of the 750 captives that were domiciled in Cayman in the middle of 2013, 134 were structured as segregated portfolio companies (so close to 20%). Moreover, nine out of the twenty-four (approximately a third) new captives registered in Cayman in 2013 were SPCs.<sup>216</sup>

In Guernsey (the first offshore jurisdiction to implement protected cell legislation applicable to captives), there were 72 captives structured as cell companies out of a total 343 domiciled in the jurisdiction.<sup>217</sup> By the end of 2011, of the 772 captives domiciled in

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<sup>211</sup> *Id.* at 4-5.

<sup>212</sup> See, e.g., *Domiciles*, CAPTIVE REVIEW, <http://www.captivereview.com/data-centre/cell-company-guide/> (last visited Mar. 11, 2014).

<sup>213</sup> See Koepfer, *supra* note 151, at 8-9.

<sup>214</sup> See e.g., JOHN ROWSON, CHANGING TRENDS IN CAPTIVE AND CELL FORMATS (Aon Ins. Managers Ltd. 2013), available at [http://www.aon.com/guernsey/attachments/18.7.13\\_whitepaper\\_celldevelopments.pdf](http://www.aon.com/guernsey/attachments/18.7.13_whitepaper_celldevelopments.pdf).

<sup>215</sup> *Segregated Portfolio Companies in the Cayman Islands*, OGIER, [http://www.ogier.com/Publications/library/Pages/Segregated\\_Portfolio\\_Companies\\_in\\_the\\_Cayman\\_Islands.aspx](http://www.ogier.com/Publications/library/Pages/Segregated_Portfolio_Companies_in_the_Cayman_Islands.aspx) (last visited Dec. 20, 2014).

<sup>216</sup> *Cell Innovations*, CAPTIVE INT’L, (Nov. 28, 2013), [http://www.captiveinternational.com/article/cell-innovations\\_](http://www.captiveinternational.com/article/cell-innovations_)

<sup>217</sup> *Licensed Insurers*, GUERNSEY FIN. SERVS. COMM’N, <http://www.gfsc.gg/Insurance/Type-of-Insurance-Entity/Pages/Licensed-Insurer.aspx> (last updated June 9, 2010); *Guernsey Still Top European Domicile with*

Bermuda, 50 were registered as segregated accounts companies.<sup>218</sup> According to Marsh, across the main captive domiciles in the world, in 2012 approximately 3% of captives were structured as protected cell companies, though this percentage is sure to rise over the next few years.<sup>219</sup>

One of the things that has been holding back the rise of protected cell companies in the insurance sector, and indeed in other regulated sectors (notably funds), is that in the conventional cell company structure, each cell does not in fact have incorporated status.<sup>220</sup> Thus, while the legislation of the relevant jurisdiction might state that the assets and liabilities of a cell are separate and distinct from those of other cells in the protected cell company (and of the protected cell company itself), there have been doubts as to whether this ring-fencing would be upheld outside of the relevant jurisdiction where the captive entity is domiciled.<sup>221</sup> Accordingly, if litigation is commenced in London or New York against a captive cell domiciled in the BVI, for example, a point of contention has been whether the foreign court would recognize the ring-fencing provided for under BVI law, when the conventional understanding is that for an entity's assets and liabilities to be segregated, it needs to be a separate legal entity and thus incorporated. This is of particular concern when the onshore jurisdiction where the litigation is run (because assets or liabilities of the captive is attributable to that jurisdiction) does not itself have some form of protected cell company legislation.<sup>222</sup>

As a result of the risk that a foreign court may disregard the statutory ring-fencing of assets and liabilities, it has been advised that cell companies retain their assets in the relevant offshore jurisdiction where it is domiciled, rather than in a foreign jurisdiction where proceedings may take place.<sup>223</sup> This has been one downside to insurers utilizing protected cell companies to structure their business. Another downside that has been commented upon is that as a cell within a conventional protected cell company is not an incorporated legal entity, it has no power to enter into contracts and the protected cell company itself has to contract on behalf of the cell. As a cell within a protected cell company cannot typically contract with other cells, or with the protected cell company itself, it restricts the ability of different cellular insurance strategies being introduced within the one protected cell company.<sup>224</sup>

Due to these limitations with the conventional protected cell company, some captive jurisdictions have passed laws to allow individual cell companies ("ICCs") to be incorporated.<sup>225</sup> This followed on from initial incorporated cell company developments in the District of Columbia in 2004 with respect to its captive insurance laws (and similarly even

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50% *Captive Rise*, Post, <http://www.postonline.co.uk/post/news/2312738/guernsey-still-top-european-domicile-with-50-captive-rise> (last visited Dec. 22, 2014).

<sup>218</sup> See BERMUDA MONETARY AUTHORITY, 2012 ANNUAL REPORT 61, 64 (2012), available at <http://www.bma.bm/publications/ANNUAL%20REPORTS/Annual%20Report%202012.pdf>.

<sup>219</sup> MARSH, *supra* note 33, at 2, 4.

<sup>220</sup> See *Protected Cell Companies*, WILLIS GLOBAL CAPTIVE PRACTICE, May 2008, at 1, available at [http://www.willis.com/documents/publications/Services/captives/Protected\\_Cell\\_Companies\\_\(PCCs\)\\_-\\_The\\_present\\_and\\_Future.pdf](http://www.willis.com/documents/publications/Services/captives/Protected_Cell_Companies_(PCCs)_-_The_present_and_Future.pdf).

<sup>221</sup> *Id.*

<sup>222</sup> *The Emergence of the Offshore 'Incorporated Cell Company' and its Use in the Insurance Sector*, *supra* note 207, at 4-5.

<sup>223</sup> *Id.*

<sup>224</sup> *Id.*

<sup>225</sup> *Id.*; For a detailed, practical account of the reasons for utilizing incorporated cell companies in the captive arena see Koepfer, *supra* note 151, at 4-5.

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earlier in Delaware in 1996 with its “Series LLC” law -although the LLC is not an unincorporated entity).<sup>226</sup> Following the District of Columbia amending its captive insurance law in 2004 to allow individual cells to be incorporated, Jersey and Guernsey were the first of the offshore jurisdictions to introduce ICC legislation (in February and May 2006, respectively). In both Jersey and Guernsey, ICCs could be created for most purposes, and each incorporated cell could have different directors from the ICC itself.<sup>227</sup>

Some smaller offshore jurisdictions, such as St. Lucia (in November 2006), and Vanuatu (in October 2009) also introduced laws to enable the incorporation of ICCs. In both of these jurisdictions, the availability of ICCs is limited to insurance companies.<sup>228</sup> More recently two significant European offshore jurisdictions, Malta and the Isle of Man (in February and June 2011, respectively), introduced ICC laws, with ICCs being available for both insurance and funds in Malta and for insurance only in the Isle of Man. In Malta, an incorporated cell can be established simply by way of a resolution of directors of the ICC.<sup>229</sup>

In March 2013, Cayman Islands passed amendments to its Insurance Law 2010 to allow SPCs to register subsidiary companies known as “Portfolio Insurance Companies” (“PICs”) with the Cayman Islands Monetary Authority (“CIMA”).<sup>230</sup> The PICs will not need to obtain a separate insurance license from the CIMA (so long as the scope of the PIC’s insurance business is within the scope of the license granted to the SCC), and can contract with other cells in the SCC.<sup>231</sup>

Accordingly, the Cook Islands should embrace these developments and not only take a step forward by introduced protected cell company legislation (which it is already contemplating), but also give its new captive insurance market a boost by also enabling captives to register as incorporated cell companies. Vanuatu is the only captive domicile in the Pacific to date that has enacted legislation to facilitate incorporated cell companies.

According to the present author, in order to better market the Cook Islands as a captive insurance jurisdiction within the US, it would be better if protected cell company (and indeed incorporated cell company) provisions are incorporated into the existing Captive Insurance Act (or the Captive Insurance Regulations), rather than existing outside of the Captive Insurance Act. Given that there is potential for the Cook Islands to win a potentially sizeable share of the \$831b “min-cap” market, even if the Cook Islands over time ticks the box by introducing mutual funds legislation as well, it is submitted that cell company structures are more likely to be utilized by captives rather than by any mutual funds registered in the Cook Islands. Hence, it make sense to sell the Captive Insurance Act and Regulations as a self-encompassing regulatory package which clearly facilitates captives domiciled in the Cook Islands to set up cells.

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<sup>226</sup> James McConvill & Michael J. Burns, *The Emergence of the Offshore “Incorporated Cell Company” and its Use in the Insurance Sector*, INS., FIN. & INV., Apr. 15, 2013, 3, 4-5.

<sup>227</sup> *Id.* at 3-4.

<sup>228</sup> *Id.*

<sup>229</sup> *Id.* 4-5.

<sup>230</sup> *Id.*

<sup>231</sup> *Id.*; see also Wendy Lee, *Cayman Islands: Cayman Introduces Portfolio Insurance Companies*, MONDAQ (Apr. 19, 2013), <http://www.mondaq.com/x/234234/Insurance/Cayman+Introduces+Portfolio+Insurance+Companies>.



## V. CONCLUSION

As the Cook Islands is already well-known and respected in the US as an offshore financial center given its flagship asset protection trust regime and LLC legislation, there is now an opportunity for the Cook Islands to gain a share of the lucrative US-originated captive market. The so-called “s831b’s”, or min-caps, represent approximately 20% of this market, and the Cook Islands has the reputation and first-class captive insurance legislation in place to be one of the leading domiciles in this space.

As a result of its existing marketing efforts and geographic position in the Pacific, the Cook Islands also stands to benefit over time from the slowly growing demand for captive insurance in Asia (including the developed economies of Australia and New Zealand, where there is already an appreciation among corporations of the benefits utilizing captives). Singapore, Labuan, Vanuatu and Micronesia already have runs on the board as Asia-Pacific offshore captive domiciles, however the author has outlined in this article how the Cook Islands can tweak its already first-class product offering (including though facilitating cell captives, appealing to some of the medium-sized captives) to overtake some or all these players.

The author has discussed in the article that a revision downwards of the annual license fee for captives registered in the Cook Islands, as well as the enactment of legislation to facilitate the use of cell company structures by Cook Islands’ captives, are reforms that are urgently needed to help the Cook Islands obtain the captive registration numbers that it needs to make its captive initiative worthwhile. The Cook Islands does not want to be another jurisdiction that can count the number of captives registered on one hand.

It was explained that the likely result of these reforms would be that the Cook Islands would see the US as the main source of business for captive registrations, rather than Asia—at least for the immediate future. While there has been a lot of talk in the last few years about America’s decline and the rise of emerging economies (principally China) in Asia, this does not naturally apply to the captive insurance market and the Cook Islands government and private sector should not be under the mistaken impression that it does.

There is certainly the risk that too much time and money could be essentially wasted by the Cook Islands continually pushing to be a benefactor of the Asian dream, when there is a ready market with an already well-trodden path by Cook Islands industry participants in the US.

The Cook Islands has solid, world-class captive legislation in place, and by implementing the reforms suggested by the author in this article, replicating the success that the Cook Islands has already enjoyed with its asset protection trust could be more than a captivating dream. It could be a lucrative reality for which the jurisdiction’s financial services participants need to be wide awake to exploit.