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Report on Captive Insurance in Singapore and Hong Kong: A Promising Risk Management Solution for Asian Companies

The 20th International Conference on Trade, Business and Economic Law, 8-9 February 2018, Bangkok, Thailand

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CBFL-Rep-1803
March 2018

This report is based on the author's conference paper at the 20th International Conference on Trade, Business and Economic Law (ICTBET) held by the World Academy of Science, Engineering and Technology (WASET). The views expressed in this report reflect the proceedings and the author's presentation, and do not necessarily reflect the policies or views of the conference organizers, presenters, and discussants, and the Centre for Banking & Finance Law.

This report may be cited as: Jin Sheng, "Captive Insurance in Singapore and Hong Kong: A Promising Risk Management Solution for Asian Companies", Centre for Banking & Finance Law, Faculty of Law, National University of Singapore, February 2018, report number CBFL-Rep-1803.

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I. Introduction

Around the world, there are about 7,000 captive insurance companies, which provide risk-mitigation services for their parent corporations. Aside from onshore captive centres in the United States and Europe, there are quite a few offshore captive markets, such as Bermuda, Cayman Islands, Ireland, Luxembourg, the British Virgin Islands, Barbados and Singapore. Each year there are about 200 newly registered captive insurance companies over the past decade.

The Marsh Captive Solutions Benchmarking Report 2016 indicates that the top five fastest growing non-conventional risks were multinational pooling, supply chain, cyber liability, political risk, and medical stop-loss.[1] The bankruptcy of Hanjin Shipping is a recent example of supply chain disruption. On August 31, 2016, the Hanjin Shipping Co., which occupied 3% market share of global container shipping industry and 10% container freight between Asia and Europe as the seventh largest container operator in the world, filed in Korean and American courts for bankruptcy protection; meanwhile, the South Korean government did not plan to bail out this debt-ridden carrier.[2] On September 1, Hanjin Shipping announced that its membership in CKYHE shipping alliance was suspended. The bankruptcy of Hanjin Shipping resulted in chaos in shipping industry, although retail investors expected that the government took measures to ease the supply chain disruptions. Unfortunately, 79 Hanjin's vessels had disrupted operations as of September 4 and 68 Hanjin vessels in its fleet and cargoes were stranded around world; at the same time, anxious retailers had trouble in getting their goods from a cargo crisis arising from the Hanjin collapse.[3]

Another case of supply chain disruption happened in 2000 and a fire triggered by a lightning bolt in a fabrication line in New Mexico resulted in the loss of millions of chips and the Royal Philips Electronics in Albuquerque was forced to interrupt its manufacturing of radio frequency chips for two clients – Nokia and Ericsson. Nokia was lucky in purchasing chips from another of its primary suppliers. Ericsson, on the other hand, suffered an annual loss of more than USD 1.6 billion and ended with a consolidation and merger with Sony.[4] These two cases show the consequence of supply chain interruption and the significance of risk management for Asian companies' sustainability and resilience.

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[1] Marsh & McLennan Companies, "Captive Solutions: Creating Security in an Uncertain World" (May 2016), p. 2, <https://www.marsh.com/us/insights/research/captive-benchmarking-report-2016.html>.
[2] Soo Nam and Costas Paris, "Korean Court Orders Hanjin to Cut Its Fleet" (19 September 2016) *Wall Street Journal*, <https://www.wsj.com/articles/hanjin-unloads-more-cargo-easing-supply-chain-fears-1474259710>.
[3] Kyunghee Park, "Hanjin Shipping Will Seek Asset Stay Orders in 43 Countries" (5 September 2016) *Bloomberg*, <https://www.bloomberg.com/news/articles/2016-09-05/hanjin-shipping-shares-plunge-as-court-accepts-receivership-plan>.
[4] Capstone Associated, "Supply Chain Risks Averted! The Secret to Keeping Your Business Moving" (2015), <https://www.capstoneassociated.com/supply-chain-risks-captive-insurance/>.

Compared with commercial insurance, captive insurance has advantages in coverage, access to reinsurance market and tax benefits. For example, captive insurance covers risks not written by property and casualty insurance. This is very important for industries such as energy industry, logistics, and telecommunications. Also, captive insurance provides access to reinsurance markets, which can lower transactions costs for a captive insurance owner. Additionally, a captive insurance insurer enjoys tax benefits and tax recessions, especially in offshore captive markets. However, in Asia, the development of captive insurance is slow. According to the McKinsey Global Institute, by 2025, Asian insurance market will occupy about 50% of global insurance market. But Asian captive insurance only accounts for a small proportion on the global market.

II. The Landscape of Asian Captive Insurance

Developments of Asian captive insurance were discussed at the international economic law conference dated 8 February 2018. Captive insurance has great potential to develop in infrastructure, energy, agriculture, logistics, catastrophe, and alternative risk transfer (ART), and will materially affect the framework of insurance industry. To date, over 75% Fortune 500 corporations have incorporated their captives as a risk management solution. However, the Asian captive insurance market only takes a small proportion in the global market,[5] although Asian insurance industry should grow by about 8% each year over the next decade and its proportion should reach 40% of the world insurance market by 2020.[6]

Singapore and Hong Kong are both international financial centers with prominent advantages in tax concessions, technology, implementation, professional services, and well-functioning legal systems. Singapore, as the domicile of 71 active captives, has been the largest captive insurance hub in Asia, as well as an established reinsurance hub. Hong Kong is an emerging captive insurance hub with 5 to 10 newly licensed captives each year, according to the Hong Kong Financial Services Development Council. It is estimated that Hong Kong will become a domicile for 50 captive insurers by 2025. Additionally, Labuan is an emerging captive insurance center with about 40 captives. Japan's commercial insurance market amounting to around USD 36 billion ranks No. 3 in the world and has substantial potential for captives. But captive insurance is seldom used in Japan, partly because major insurance companies are large shareholders of industries, and historically Bermuda and Hawaii are popular offshore domiciles for Japanese companies.[7] There are demands for captive insurance in other Asian countries such as ASEAN and South Asia, as well.

[5] According to the 2013 Marsh benchmarking report, 70% of captive owners are domiciled in the Americas, 24% in Europe and only 6% in Asia-Pacific.

[6] IPS Group, "A Rise in Asia Captives – How Singapore Is Preparing", <https://www.ipsgroupasia.com/news/2013/rise-in-asia-captives-how-singapore-is-preparing >.

[7] Becky Butcher, "A.M. Best: Japanese Captives Remain Underutilised" (3 November 2016), <http://www.captiveinsurancetimes.com/captiveinsurancenews/industryarticle.php?article_id=4914>.

Take the example of China. China has substantial needs and great potentials to develop captive insurance, on account of the currency volatility, enterprises' credit risks, and political and operational risks of the Belt and Road initiative. At present, Mainland Chinese enterprises only have four offshore captives incorporated by China National Offshore Oil Corporation (CNOOC), Sinopec, Lenovo and China General Nuclear Power Group (CGN), three onshore captive insurance companies incorporated by China National Petroleum Corporation (CNPC), China Railway, and COSCO Shipping, as well as one industrial captive insurance organization - China Ship-owners Mutual Assurance Association. This captive market grows slowly with one or two captive insurers licensed yearly after September 2011. As an international financial center, Hong Kong has comparative advantages in taxation, professionals, market access and well-established financial infrastructure to develop a functional captive insurance market. For example, Hong Kong's income tax is 16.5% for an insurance company (and 8.25% for a captive insurer); while China's income tax for an insurance company is 25% plus business tax of 5%. Furthermore, restrictions on market entry and operations of China's onshore captives make establishing offshore captives in international or regional captive insurance centers such as Singapore, Hong Kong, and other overseas jurisdictions to become attractive options. Thus there are abundant business opportunities in this area, given that China has over one hundred Fortune 500 corporations.

III Highlights for Singapore Captive Insurance

To date, both conventional risks and unconventional risks, such as political and social unrest, and various business disruptions, become more frequently than before. Captive owners seek solutions to be more resilient and mitigate risk within their operations. Compared with other jurisdictions such as Bermuda, which is the largest offshore captive center for more than 1,200 captive insurance companies (797 active captive as of December 31, 2016), and Vermont, which is the largest onshore captive center with over 1,100 licensed captives, Singapore is an attractive option for Asian companies. Singapore's tax rates for offshore captive business, offshore specialized risks business and marine hull and liability insurers are 0%. Singapore's tax on Headquarter services is 10% and tax for offshore insurance business (OIB) is 10%.[8] In order to implement the OECD's guidelines of minimum base erosion and profit shifting (BEPS) standards, however, the Monetary Authority of Singapore has announced to withdraw captive tax exemption on March 30, 2018.[9]

[8] As Asia-Pacific leading captives' hub, Singapore provides tax incentives schemes for various insurers. For example, the tax for offshore insurance business is 10%; while the corporate income tax rate is 17%. Refer to PWC, "Insurance Tax Highlights – Asia Pacific: Singapore" (March 2014), <https://www.pwc.com/sg/en/asia-pacific-insurance-tax-highlights/assets/insurance-tax-highlights-sg-201403.pdf>.

[9] Aon Risk Solutions, "Asia Market Review 2017" (2017), p. 7, <http://images.comms.aon.com/Web/AON/%7B7c771da5-63d2-43a4-b8a0-d7448477422f%7D_Asia_Market_Review_2017_Final.pdf?elq_mid=44593&elq_cid=6579974>.

The Asian captive industry faces a bottleneck stage. Singapore's strong banking system, reinsurance markets, and sound legal system will support a vigorous growth in this sector and keep developing the premier Asian offshore captive market. Using China's example again, China's continuingly growing industrialization, international trade transactions, and mega infrastructure projects demand greatly for upgraded insurance services. In particular, the Chinese government may stop "endorsing" corporate bonds. On the other hand, China's insurance regulator utilizes high threshold in admission criteria for captive insurers and it takes much more time in its approval procedure with a long waiting list; and the high tax rates and other charges have added transaction costs of captive insurers. As a result, its captive market grows slowly with one or two captive insurers licensed yearly after 2013. In March 2017, the China Insurance Regulatory Commission (CIRC) signed a Memorandum of Understanding (MoU) with the Guernsey Financial Services Commission (GFSC) on a framework for mutual assistance and exchange of information between the two regulators.[10] It indicates the regulatory authority's efforts in seeking offshore captive markets to satisfy insurance needs from emerging private sector companies and the increasing privatization of state-owned enterprises. The China Captive Alliance is boosting to develop captive opportunities for China-based businesses, too.

IV Conclusion

Captive insurance is a promising area of insurance sector to develop in Asia. After ten years of the global financial crisis (GFC), various risks are accumulating. Globally, debt burdens of governments, households and nonfinancial firms are at an all-time high, having risen globally from 200% of GDP in 2002 to 225% in 2015. In the Chinese context, the debt grows so quickly after the GFC that the debt to GDP ratio reached nearly 300% last year.[11] Therefore, there are substantial needs for Asian corporations to develop captive insurance so as to deal with increasing risks in the future. In particular, new coverages such as supply chain, cyber liability, business interruption, terrorism, agriculture, catastrophe, Director's and Officer's duties, and employment liability should be developed.

Developing captives will enhance competitiveness of Singapore as an international financial hub. In the Asia-Pacific region, the captive industry has experienced consistent growth since 2011. It will be prosperous in the near future, driven by the "One Belt One Road" Initiative and the increasing demand for risk management. In the long run, the great growth of captive insurance companies may have an impact on the business of commercial insurance companies, since the former will take a substantial market share in the primary insurance market and commercial insurers will have to face competition from captive insurers.

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[10] GFSC, "Commission Signs MoU with China's Insurance Regulator" (14 March 2017), <https://www.gfsc.gg/news/article/commission-signs-mou-china%E2%80%99s-insurance-regulator>.

[11] Guy Manno, "China's Debt Bubble Threatens Global Growth as Debt to GDP Nears 300%" (7 November 2016), <http://www.valuewalk.com/2016/11/china-debt-bubble-threatens-global-world/>.