

The modern world

A new Insurance Act has created a modern corporate governance landscape for BVI captives

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The British Virgin Islands (BVI) has for some time been among the top five offshore jurisdictions in the world for the domiciliation of captive insurance vehicles. The regulation of captives, and other insurers domiciled in the BVI, underwent a major revamp in February 2010 with the introduction of a new Insurance Act, and accompanying regulations. A new Regulatory Code came into effect at the same time.

This article focuses on the corporate governance requirements for BVI captives and seeks to highlight the fact that the BVI has implemented a responsible regulatory framework for insurers, which has sufficient flexibility to enable captives to structure their corporate governance arrangements to reflect their needs and risk profile.

Captive insurance in the BVI

The overwhelming majority of insurance businesses operating in or from within the BVI are captives. According to the *Statistical Bulletin* from the BVI Financial Services Commission, at the

end of the second quarter of 2010, there were 207 captive insurers out of a total of 246 insurers domiciled in the BVI (the remainder being credit life and domestic insurers). The BVI is perhaps best known among captive insurance market participants for establishing a niche for itself in registering 831(b) 'mini captives' (although this is changing, with larger captives from the US and elsewhere now choosing to domicile in the BVI).

Corporate governance

The BVI's Insurance Act 2008 and Insurance Regulations 2009 took effect on 1 February 2010. This new legislation was accompanied by the Regulatory Code 2009, also taking effect on 1 February 2010. The Regulatory Code applies to a range of financial service licensees in the BVI, including insurers, and is designed to supplement the primary financial services legislation, including the Insurance Act.

Part II of the Regulatory Code applies to financial services licensees generally and includes, inter alia, a number of corporate governance requirements.

Part IV of the code specifically applies to insurance licensees and includes further corporate governance requirements specifically for insurers.

The Insurance Act introduced a new licensing system for insurers. There are four licence categories under the Act: A, B, C and D. While the Insurance Act and Regulations do not specifically mention captives, the explanatory notes in the Regulatory Code state that a captive insurer will need to apply for either a category C or category D licence.

A category C licence may only be issued to a BVI company and entitles the holder to carry on insurance business that is not local domestic business, including reinsurance business that is not 'open market reinsurance business' (defined in the Act as reinsurance business where the insurer is not connected with the reinsurer). A category D licence may only be issued to a BVI company and can permit the licensee to engage in open market reinsurance business.

While the Act deals briefly with corporate governance for insurers, it is the Regulatory Code that covers the field in terms of setting out the corporate governance requirements for insurers. There are some corporate governance requirements in the Regulatory Code which are prescriptive, and therefore need to be followed to the letter by captives (as well as fully-fledged insurers).

For example, insurers must have at least two directors and these must be individuals. If the insurer is a diversified captive taking on third-party risk, it would require a category D licence and must therefore have at least one non-executive director. A category D licensee must also appoint an independent person to perform an internal audit function.

“An unnecessarily burdensome corporate governance framework would hinder the efficient operation of captive insurers”

Insurers must also, inter alia, establish a remuneration policy and ensure it is appropriately reviewed; establish an underwriting and pricing strategy and policies, along with systems and controls to ensure the strategy and policies are implemented effectively; and establish policies, systems and controls to enable the monitoring and management of the insurer's asset/liability position to ensure its investment activities and asset position are appropriate given its risk profile.

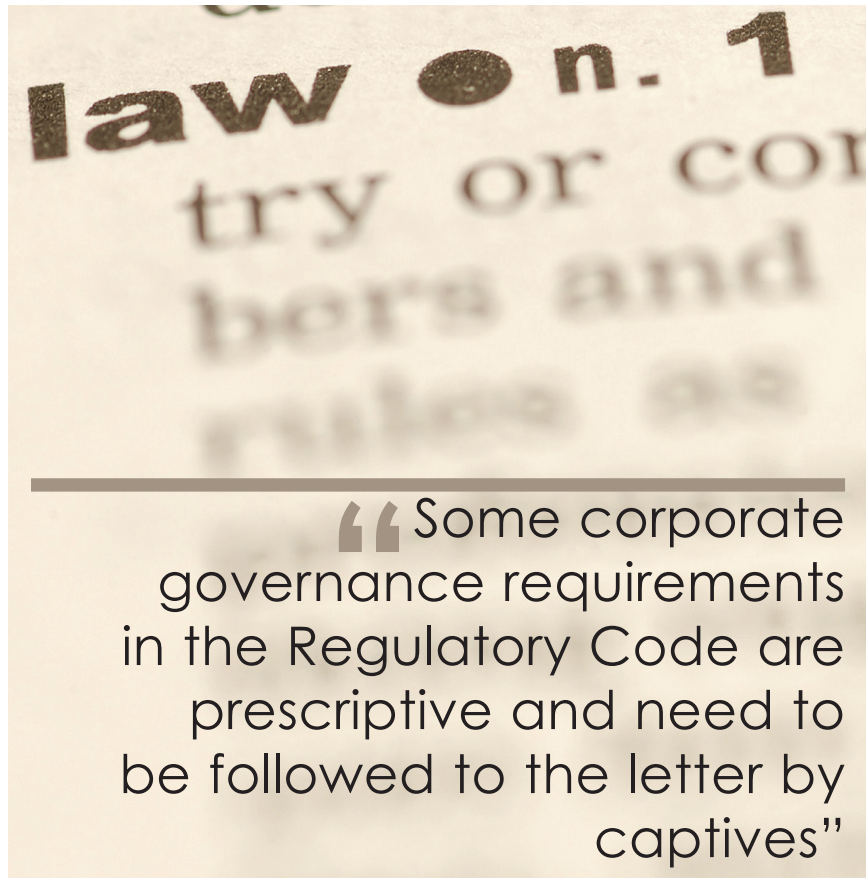
The bulk of the corporate governance provisions in the Regulatory Code are, however, non-prescriptive. These provisions are expressed to be subject to the "size, nature, complexity, structure and diversity", along with the risk profile, of the licensee. According to the commission, this represents a 'principles-based' or 'risk-based' approach to corporate governance regulation, and provides licensees with enormous discretion to structure their corporate governance framework to suit their needs.

This approach is especially important for captives, given that they are typically smaller than fully-fledged insurers, and have a much lower risk profile (unless they are diversified rather than pure captives and assume third-party risk). The commission is certainly aware of this, making it clear in the Regulatory Code that it will have different expectations for captives when it comes to corporate governance.

In the explanatory notes to the Regulatory Code, the commission states: "There are no exemptions from the code with respect to captive insurers, but where the code is not prescriptive in its requirements, the commission accepts that the risks faced by a captive insurer should be taken into account when applying the requirements of the Code."

The commission goes further in stating: "The commission recognises that an unnecessarily burdensome corporate governance framework would hinder the efficient operation of captive insurers. The principles-based nature of the code enables the directors of a captive insurer to establish a corporate governance framework that is appropriate for the business undertaken by the insurer and the risks that it takes."

Among the rules in the Regulatory Code that are expressed as being subject to the "size, nature, complexity, structure and diversity" of the insurer include the requirement to implement a risk management strategy and policies; to establish strategies, policies, systems and controls as appropriate; to establish a business continuity policy and put business continuity arrangements in place; to establish and maintain an adequate



system of internal controls; and the requirement to establish and maintain an investment strategy and policies and have systems and controls to ensure that this strategy and policies are effectively implemented.

The Regulatory Code also provides some useful additional guidance on issues specific to BVI captives to be considered when developing their corporate governance framework:

- a) the need to avoid undue influence by the captive insurer's owner, the insurance manager or other interested parties;
- b) the need to identify and effectively manage potential conflicts of interest;
- c) the need to ensure that the board is able to manage outsourced operations effectively, including the functions outsourced to the insurance manager; and
- d) the need to take full account of interests of possible claimants on the parent policyholder where they rely on the fact that the captive is covering a particular liability.

Importantly, the commission also recognises that for captives it will generally be the insurance manager rather than directors or senior managers who will carry

out key corporate governance functions. The commission notes in the Regulatory Code, however, that despite the fact that the insurance manager is an important part of the corporate governance framework for captives, it does not take the place of the board of directors who retain ultimate responsibility for corporate governance.

International standards

The recently enacted suite of regulation affecting captives domiciled in the BVI is designed to make sure that the BVI adheres to international best practice standards of insurance supervision and maintains its reputation as a responsible, international offshore financial centre. The recent initiatives certainly achieve this. It is equally true that with these regulatory initiatives, the BVI can offer also flexibility and efficiency for insurers, and especially captives.

The 'principles-based' approach towards corporate governance adopted in the Regulatory Code provides for an effective regulatory landscape in the BVI, which is important in positioning the jurisdiction as a domicile of choice for a diverse range of captives from all parts of the world. ☺