

Labuan: A Leading Domicile for Captive Insurance

Captive insurance, while dating back to the 1950s, has enjoyed increasing popularity in recent decades. Basically, a captive insurance is wholly owned and controlled by those it insures. Its primary purpose is to insure the risks of its owners.

Because the owners are also the insureds, they are able to exert much greater control, especially in regard to the types of risks insured and the decision process surrounding underwriting, as well as loss control, operations, and management.

In its simplest form, a captive is a wholly owned subsidiary created to provide insurance to its non-insurance parent company (or companies). Captives are essentially a form of self-insurance whereby the insurer is owned wholly by the insured.

The Labuan Domicile

Labuan is a home to several important captive insurers. Petronas' captive Energas has strong ratings.¹ AirAsia also gone to the captive route by setting up a Labuan captive.²

In setting up the captive, AirAsia announced the rationale and motive of doing so, which reflects the common benefits and purposes of captive insurance:

"The Labuan captive unit will directly insure AirAsia's international aviation, maritime and liability risks. AirAsia will pay its insurance premiums to the captive unit instead of paying through local insurers. With the setup of its own captive business, AirAsia said it will have a choice of which risks and how much risk the company intends to retain within the group, thus giving greater flexibility in managing its risks. The Labuan captive business will have inherent tax and investment advantages, and it offers AirAsia an opportunity to set up a profit center within the group."³



Photo source: <https://www.theborneopost.com/newsimages/2022/08/Labuan-port.png>

In a 2021 Report, EY reported that currently Asian domiciles account for 3 per cent of captives globally, with 168 out of a total of 6,315. Significant growth was recorded at 30 per cent from 2015 to 2018 with Labuan and Singapore as leading domiciles.⁴

Labuan is now home to 232 insurance and insurance-related entities including 64 captives, with AirAsia contributing nearly 92 per cent of total captives and the remaining 8 per cent being based in the US and Europe.⁵ The Labuan captive sector has experienced exponential growth with premiums growing at 7.9 per cent per year.⁶

An Award-Winning Captive Hub

Labuan International Business and Financial Centre (Labuan IBFC) clinched the Top International Captive Domicile of 2021 Award at the European Captive Review Awards.⁷ The Awards is organised by the global trade publication *Captive Review* and this was the second consecutive year that Labuan had been shortlisted. Labuan IBFC was the only jurisdiction from Asia to be shortlisted in this category, alongside other leading global domiciles, cementing Labuan IBFC's growing recognition as a captive domicile in Europe.

Labuan IBFC also recently won the Best Asian Domicile for three years running at the Asian Captive Review Awards. The jurisdiction was also recognised as Captive Insurance Jurisdiction of the Year at the China Offshore Awards in 2018 and 2019, as well as shortlisted for the non-EU jurisdiction category in the European & UK Captive Review Awards 2018.

Its CEO Farah Jaafar highlighted that Labuan IBFC is Asia and MENA's fastest-growing risk and reinsurance wholesale intermediation market, boasting more than 220 licence holders, and makes for not only a wide but deep marketplace for captives to thrive. Labuan IBFC is also the only jurisdiction in Asia that provides for the protected cell company (PCC) structure, with more than 10 PCCs licensed to date.⁸ 2020 was a boon year for Labuan captive business with eight new captives formed, totalling 55 captives formed in both Asia and MENA in 2020. This growth has continued unabated, and in the first half of 2021, eight new captives were approved.

Types of Captives

Labuan offers multiple forms of captive structures, including pure/single owner captive, group, association, master and subsidiary rent-a-captive, cell and multi-owner captive, as well as PCCs.⁹

A Rental Captive is a captive insurance company that can be used or "rented" by unrelated insureds. It allows insureds to gain the benefits of a captive insurance arrangement without actually participating in the captive insurance company's ownership or management. The sponsor contributes the captive's statutory capital (sometimes called "core capital"). Generally, the sponsors that own a rental captive do not take on much risk. They are only charging a fee for the use of their capital and for organising and operating the captive.¹⁰



Photo source: https://www.labuanibfc.com/clients/asset_52E835CC-1342-4701-B6FA-E2CD03AD74B4/contentms/img/media-kit/Labuan_Malaysia_Financial-Park-Complex-01.jpg

Rental captives can be structured to allow risk sharing among the participants or with no risk sharing at all. Where there is no risk sharing, participation in a rental captive facility can be similar to purchasing insurance from a commercial insurer. PCCs are essentially rental captives with a special provision that legally separates the assets and liabilities in each insured's account or "cell" from those of every other participant's "cell".

Rather than pool its insureds' risks, a rental captive may keep a separate underwriting account for each insured participation. In some domiciles, these accounts are legally separated or protected, and the term "cell captive" or "protected call company (PCC)" is used, indicating that each insured's assets are kept in its own walled-off cell. The assets in one participant's account may not be used to pay liabilities in another unless the respective participants have entered into an agreement to do so.¹¹

The Executive Chairman of Labuan IBFC, Datuk Iskandar Mohd Nuli, said at the Asian Captive Conference 2022 in Kuala Lumpur:

"New risk categories are expected to be included in the captive segment, such as cyber cover and other more esoteric risks, which are viewed as timely and viable segments to invest in, while capitalising on having access to Labuan's large regional reinsurance market."¹²

Regulatory Requirements

To set up a captive in Labuan, an applicant must be a Labuan company (including protected cell companies) incorporated or registered under the Labuan Companies Act of 1990, or a special purpose vehicle (SPV). They must also be a member of the Labuan International Insurance Association.¹³

Every Labuan captive insurer must have an operational management office in Labuan, managed by a team that has adequate knowledge and expertise in the insurance business, including the captive insurance business. Otherwise, they need to appoint a licensed Labuan underwriting manager.¹⁴

Control persons, directors and principal officers need to be approved by Labuan Financial Services Authority, the statutory regulator of Labuan IBFC, set up via the enactment of the Labuan Financial Services Authority Act 1996, reporting directly to the Minister of Finance, Malaysia.¹⁵

A Labuan captive insurer needs to maintain a minimum paid-up capital or working funds amounting to a specified sum with a bank in Labuan. In addition, the captive insurer needs to monitor the level of its solvency regularly. Higher capital requirements may be imposed commensurate with the Labuan captive insurer's business activities and risk exposures.¹⁶

Labuan Captive Insurers are required to have a minimum of three full time employees and incur a minimum of RM200,000 annual operating expenditure in Labuan in order to enjoy the preferential tax rate of 3 per cent of their net audited accounting profits effective from 2019. These changes initially took the Labuan market by surprise, but the captive industry has welcomed the initiatives to endorse international best practices recommended by OECD/BEPS compliant standards of regulation,¹⁷ reflecting a matured environment and also promoting Labuan as a well-established captive domicile.¹⁸

¹ Maria Ward-Brennan, 'Petronas' captive received 'excellent' ratings', (Captive Insurance Times, 7 April 2020), <https://www.captiveinsurancetimes.com/captive-insurance-news/industryarticle.php?article_id=681&navigationaction=industrynews&newssection=industry>

² Iris Lai, 'Malaysia's AirAsia Cleared to Launch Captive Insurer in Labuan', (Insurance Newsnet, 29 April 2010), <<https://insurancenewsnet.com/oarticle/Malaysia-AirAsia-Cleared-to-Launch-Captive-Insurer-in-Labuan-a-185221>>

³ *Ibid.*

⁴ EY, 'Asian Captive Domiciles Positioning for Growth', (EY, n.d.), <https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/financial-services/ey-asian-captive-domiciles-article-vfinal-5-digital.pdf>

⁵ Bernama, 'Labuan transformed into regional business and financial centre', (Daily Express, 9 October 2021), <<https://www.dailyexpress.com.my/news/179373/labuan-transformed-into-regional-business-and-financial-centre/>>

⁶ The Malaysian Reserve, 'Labuan IBFC's captive sector sees exponential growth', (The Malaysian Reserve, 19 August 2022), <<https://themalaysianreserve.com/2022/08/19/labuan-ibfcs-captive-sector-sees-exponential-growth/#:~:text=He%20also%20described%20that%202021,premiums%20against%20market%2Dhardening%20effects>>

⁷ Jailani Hasan, 'Labuan IBFC clinches global accolade for Top International Captive Domicile 2021', (Bernama, 10 November 2021), <<https://bernama.com/en/business/news.php?id=2021621>>

⁸ See: <https://en.pnasia.com/releases/apac/labuan-ibfc-shortlisted-for-international-captive-domicile-2021-for-second-consecutive-year-336301.shtml>

⁹ Guidelines issued pursuant to section 4A of Labuan Financial Services Authority Act 1996

¹⁰ For Rental Captives and Protected Cell Captives see: <https://www.captive.com/articles/what-is-a-protected-or-segregated-cell-captive>

¹¹ *Supra* note 8.

¹² *Supra* note 5.

¹³ *Ibid.*

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ Guidelines issued pursuant to section 4A of Labuan Financial Services Authority Act 1996, note 4 *supra*.

¹⁷ See: <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm>

¹⁸ EY Report *supra* note 6.



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