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Missouri Profile

The captive industry is expected to be key to growth of the Show Me state

Climate Change

Industry professionals discuss trends around climate change-related risks and how captives can be implemented

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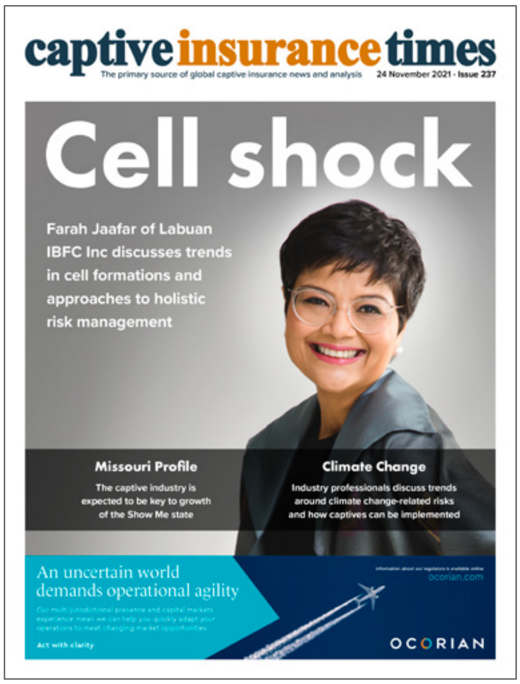

In this issue

IRS granted concessions in Tax Court captive dispute

The concessions of the Internal Revenue Service (IRS) in a legal challenge of a captive insurance company have been accepted by a judge in a US Tax Court before trial. Judge David Gustafson ruled in favour of the IRS' concessions in 'Paul Puglisi and Ann Marie Puglisi, et al v. commissioner of internal revenue' that "eventually determined to concede the amounts of tax at issue (except for about 2 per cent that petitioners conceded) and to concede the penalties".

The petitioners in the case are the owners of Puglisi Egg Farms, a Delaware-based egg farm that formed a captive insurance company, Oxford Risk Management Group, in 2015 to provide coverage against avian influenza when commercial insurance became unavailable. Oxford Risk Management Group served as a reinsurance company rather than writing direct insurance, whereby Puglisi bought insurance from a fronting company, which then entered into a reinsurance agreement with the captive.

Under the reinsurance agreement, Oxford Risk Management Group reinsured 20 per cent of all approved claims of Puglisi Egg Farms, and its quota share of 80 per cent of all proved claims of unrelated entities insured by the fronting company.

The IRS began its audit in 2017 by issuing statutory notices of deficiency for 2015 and 2016, later adding 2018 to total tax deficiencies and penalties of more than US$27 million.

In its issuance, the IRS stated: "It is determined that the purported insurance and/or reinsurance transactions lack economic substance, that the substance of the transactions do not comport with their form, and that the various steps involved in the transactions were engaged in for no purpose other than to avoid or evade taxes."

Puglisi Egg Farms subsequently filed challenging cases. When the case moved to the US Tax Court, the petitioners responded to more than 200 discovery requests and supplied more than 1,000 additional documents. The IRS then conceded the tax deductions following the discovery, but before the case went to trial.

Although Puglisi Egg Farms objected to the motions for entry of decisions, citing "the interests of justice demand that these cases continue towards trial" to meet "a resolution on the merits for petitioners", the decision marks a victory for the wider captive industry.

Oxford Risk Management Group, who was not involved in the audit, noted its congratulations to Puglisi Egg Farms. ■

Marsh: IFRS 17 will pose "drastic changes" to captive reporting

Captives will need to prepare for "drastic changes" in their reporting to ensure compliance with the upcoming requirements of International Financial Reporting Standard (IFRS) 17, according to Marsh. From 1 January 2013, IFRS 17 will enforce material changes to the way in which insurance companies, including captives, value and report on insurance contracts.

Issued by the International Accounting Standards Board, the new standard is designed to harmonise the reporting approach of insurers to promote greater transparency.

Marsh notes that a captive may still be impacted by the requirements if the parent company reports under IFRS, which may require the captive to perform IFRS 17 valuations for consolidation purposes.

IFRS 17 establishes three measurement models to value insurance contracts, two of which will apply to captives.

The general measurement model (GMM) acts as the default measurement model to define how insurance contract assets and liabilities are recognised and subsequently measured at reporting periods, while the premium allocation approach (PAA) is simplified to measure a group of insurance contracts that meet IFRS 17's qualifying criteria.

With the PAA as the preferable model owing to its simplified calculations and reporting requirements, Marsh notes: "The clock is now ticking for insurers to prepare for implementation."

A captive can qualify for the PAA if the insurance contract has a coverage period of one year or less (this is likely to be the case for most captives that issue annual policies with a 12-month boundary) and if it satisfies quantification analysis that the PAA output will not materially differ from that of GMM.

Marsh warns that captives should be aware of four distinct areas that will be affected by the implementation of IFRS 17, beginning with contract boundaries, which will impact the cash flows that are considered in the valuation and the PAA qualification.

Marsh advises captive managers to be mindful of underlying clauses within policy terms and conditions, such as a termination clause or re-underwriting clause which could potentially establish a boundary in the contract that is different to the policy expiration date.

Secondly, IFRS 17 requires insurance entities to estimate the probability-weighted future cash flows of an insurance contract and introduces the concept of discounting for cash flows that are settled more than 12 months after coverage is provided or claims and expenses are incurred.

Therefore, Marsh warns that captives should measure all cash flows that are attributable to insurance contracts, including claims, premiums, expenses, profit commissions and no claims discounts.

In addition, the new standard requires an entity-specific calculation to allow for the compensation required for bearing the uncertainty around the amount and timing of cash flows arising from non-financial risk.

In this instance, Marsh says that captive managers must ensure they align the risk appetite of the captive with the appropriate risk adjustment confidence level.

Finally, Marsh advises that captives be aware of the contractual service margin (CSM). Although only applicable to captives that are valuing under the GMM, CSM represents the expected profit of a contract at the date of inception that is recognised as the insurer provides services under the contract.

Marsh notes that captives should take into account the sensitivity of the modelling of the pattern of service to the underlying terms and conditions of the contract, describing this as "one of the most judgmental areas of IFRS 17".

A.M. Best: European captives remain resilient and adaptive

A.M. Best-rated European captives have generally been resilient to the effects of the COVID-19 pandemic and have maintained stable ratings fundamentals throughout 2021, according to the credit rating agency in a new market segment report. A.M. Best's new report, 'Europe's Captive Sector Thrives Amidst Hardening Market', investigates the increasing use and importance of captives as a result of commercial insurance rate increases and the continued hard market.

These market conditions have demonstrated the role of captives as a risk management tool that provides bespoke risk solutions to parent organisations in lines of business where commercial capacity has declined and rates have increased.

In these current conditions, it is now important for companies to have the flexibility throughout the insurance cycle and the access to reinsurance market capacity that is afforded by captives.

A.M. Best identifies that price increases in the reinsurance market began as early as 2018 in some segments, and has continued to harden since — particularly in casualty lines as insurers respond to the impact on loss experience of social inflation. The top three captive domiciles in Europe by the number of licensed captives are Guernsey, Luxembourg and the Isle of Man.

The rating agency also notes in its report that tougher renewal discussions in Europe have led to an uptick in the use of existing captives in order to optimise risk transfer solutions. For example, increasing retentions or limits on existing cover, or else expanding into new lines of business.

A.M. Best-rated European captives generally have strong capital buffers that provide resilience against significant market shocks, such as the market volatility, global economic slowdown and increased claims activity caused by the COVID-19 pandemic.

The report notes that, in the future, a captive could offer business interruption capacity to its parent company only to control the limit provided for pandemic-related coverage, but this is recognised to have pricing challenges.

From a regulatory perspective, A.M. Best says the ongoing review of Solvency II continues to occupy the minds of EU-domiciled captive owners and managers. On 22 September, the European Commission (EC) adopted its review package for Solvency II rules for insurers and reinsurers domiciled in the EU.

Moving forward with the review, the European Parliament and member states of the council must negotiate the final legislative texts based on the EC's proposals.

The review is particularly relevant to captives concerning the application of proportionality, which is designed to "ensure that the practices and powers of supervisory authorities are proportionate to the nature, scale and complexity of risk inherent in the business of the insurer or reinsurer".

A.M. Best highlights that this is important for captives in ensuring that regulatory requirements do not become too onerous.

The report recognises that innovation is increasingly important to the long-term success of all insurers, as it provides sustainable competitive advantages and allows insurers to be responsive to external challenges, such as low investment yields, stagnant growth and declining expense ratios.

A.M. Best notes that, while captives themselves are an example of innovation in the insurance industry, captive innovation initiatives are often driven by the needs of the parent company.

This is also true of a captive's ESG approach, which tends to be very closely linked to that of the parent organisation as a growing number of captive owners begin to integrate ESG factors into their operations, particularly concerning corporate governance and investments.

The rating agency notes that this change in a captive owner's operations to give greater emphasis to ESG considerations is usually part of a parent organisation's wider risk management strategy to manage transition risk, especially in the oil and gas sector.

In addition to more commercial reinsurers formally integrating ESG factors into their strategy, new emerging risks will require captives to adapt to ensure they still fully meet the requirements of the parent company.

Such emerging risks include environmental liability and cyber risk, with the latter requiring social engineering and data security to ensure the captive still provides adequate coverage while considering ESG factors in its operations.

Genesis Legacy Solutions completes first LPT through Vermont cell

Genesis Legacy Solutions (GLS) has issued its first loss portfolio transfer agreement (LPT) through its Vermont cell to an affiliate of Cypress Property and Casualty Insurance Company. The LPT agreement reinsures Cypress' commercial general liability portfolio written in the states of Florida and Texas from 2008 to 2020.

Formed in December 2020 as part of Maiden Holdings, a Bermuda-based holding company, GLS provides a full range of legacy services to US insurance entities, specialising in offering solutions for legacy books and poor-performing portfolios, as well as claims, reinsurance, structural and operational issues.

Brian Johnston, CEO of GLS, comments: "We are delighted to have issued this first LPT from our newly-formed Vermont captive cell. We worked closely with both the Cypress management team and the Vermont Department of Financial Regulation's captive insurance division and now have a template for future transactions under the Vermont captive legislation. GLS worked closely with the Maiden team on this transaction, and we look forward to executing many more. Our pipeline continues to be strong, and we are currently evaluating many opportunities from a variety of sources."

PwC: insurers and reinsurers rate industry risks

Reinsurers rank climate change as the top risk facing the global insurance industry, according to PwC's latest survey.

Produced in collaboration with the Centre for the Study of Financial Innovation, the survey investigates the risks facing the insurance industry in the second half of 2021.

This was completed by more than 600 insurance industry leaders in 47 territories. The top risk of concern for reinsurers is climate change, reflecting the global focus as part of a wider ESG agenda. PwC describes this as a "step-change" for the insurance industry as governments and regulators continue to intensify reporting requirements for companies to explain and demonstrate how they are quantifying and managing ESG-related risks.

The rise in catastrophic events has also elevated climate risk in the view of reinsurers to an immediate threat rather than a longer-term issue.

Arthur Wightman, PwC Bermuda leader and insurance leader, explains: "It is clear from our biennial survey that the impact of climate change is now seen as a far nearer-term risk to insurers and reinsurers than previously considered."

"The industry is also gravely concerned that the wider implications of climate change are difficult or impossible to predict."

"COP26 discussions presented an opportunity for the insurance industry to highlight the unique and critical role it can play in bringing its expertise and resources to help address the formidable challenge of climate change and help the world go faster to net zero," he adds.

Overall, life, non-life, reinsurance and composite insurers rank cybercrime as the top risk facing the global insurance industry over the next two to three years, as remote working during the COVID-19 pandemic has highlighted the vulnerability of firms.

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TRUIST

PwC notes that the evolving type, volume and success of cyber threats has heightened cyber to both an operating and underwriting risk, as it can cause losses from subsequent business interruption.

In addition, cybercrime is a mounting risk for insurers because of the associated operational issues, including the loss or corruption of data, damage to reputation, and credit losses.

Matt Britten, risk assurance partner, PwC Bermuda, comments: "As organisations introduce cloud-computing and new digital solutions with the increase in virtual working, the challenge for insurers has become more complex than ever."

"The rise in the risk posed by cybercrime reflects concern about both the vulnerability of insurers' systems to cyber attacks and the costs of underwriting cyber insurance."

He adds: "Of significant concern is that insurers may be underestimating the potential costs of cybercrime when writing policies."

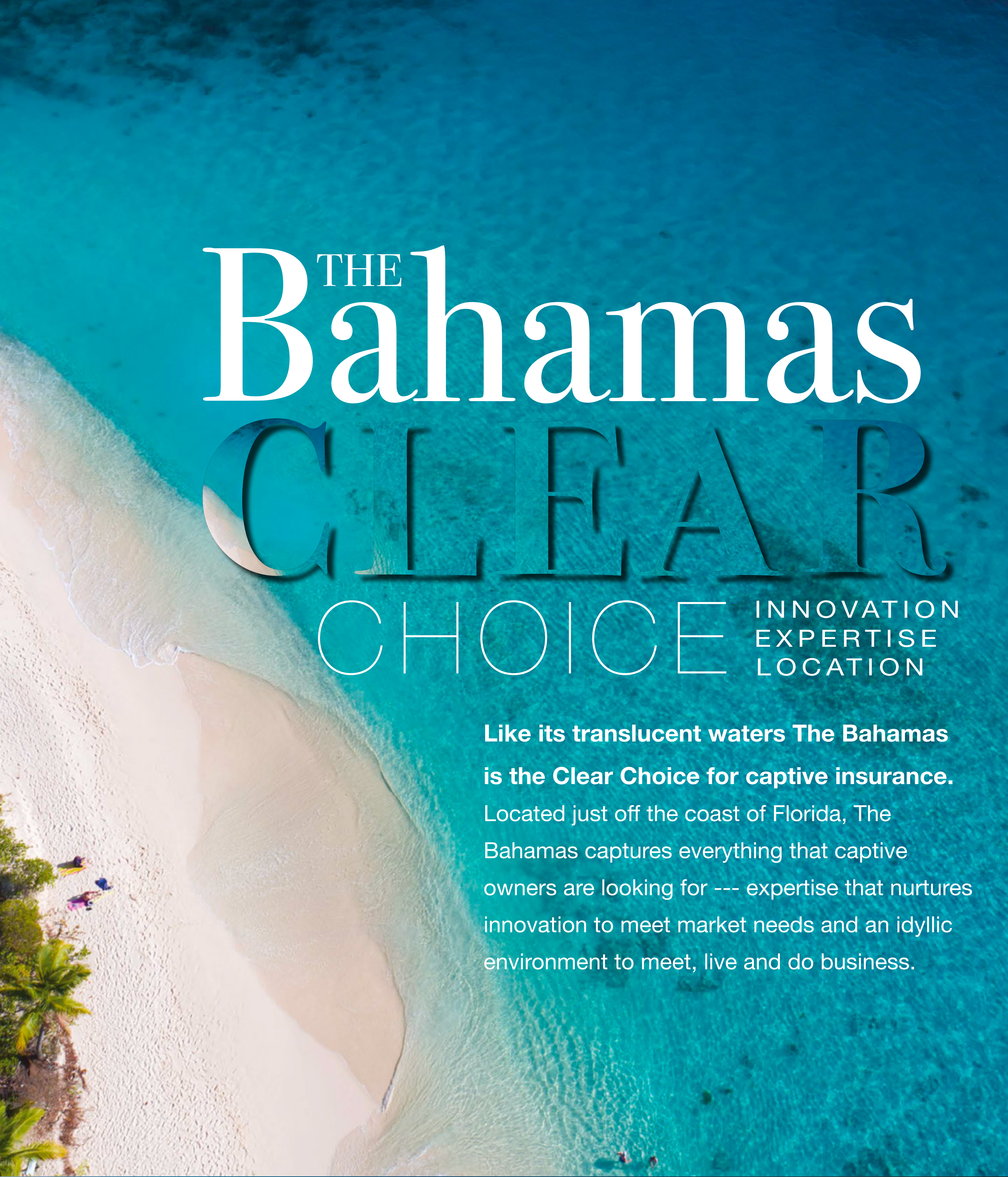
Cybercrime was followed in the overall rankings by regulatory risk (as insurers say regulation has become excessive, bureaucratic, and increasingly an impediment to business operations) and technology (there is concern around the ability of the insurance industry to stay at the forefront of technological modernisation, as well as the operational risks associated with managing the transition to digitised services).

Other named concerns include interest rates, human talent, change management, competition, investment performance and macronomy, while reinsurers also name capital availability and political risk as notable areas of concern.

PwC identifies that COVID-19 does not appear as overwhelmingly significant in its 2021 report — although the pandemic featured in responses as an operating and underwriting risk, overall respondents did not expect it to have a profound or lasting impact on the insurance industry.

Survey participants were also asked to rate how well-prepared they perceive the insurance industry to be in its ability to handle the identified risks.

On a scale of 1 ("poorly") to 5 ("well"), the average response was 3.22, marking a slight increase from 3.11 in the 2019 report. ■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Cell shock

Farah Jaafar, CEO of Labuan IBFC Inc, discusses trends in cell formations and approaches to holistic risk management in the domicile of Labuan IBFC ahead of the 2021 Asian Captive Conference

Rebecca Delaney reports

With the overarching theme of ‘Democratisation of self-insurance’, the fourth annual Asian Captive Conference is gearing up to promote self-insurance vehicles and leverage the position of Labuan International Business and Financial Centre (Labuan IBFC) as a domicile.

The latter is particularly crucial owing to what Labuan IBFC Inc describes as the “unrealised potential growth” in Asia. The region hosts only 6 per cent of parent captives in the global alternative risk transfer market, despite making up more than 50 per cent of the world’s gross domestic product and 40 per cent of all Fortune 500 companies, according to the World Bank.

Labuan IBFC Inc adds that, overall, Asian domiciles have less than 200 captives, with Labuan IBFC as the fastest growing domicile for captives in Asia, the Middle East and North Africa, having licensed one-quarter of all captives in these regions.

Eight of these formations were in the first half of 2021 (the same amount as in all of 2020), demonstrating a progressive upwards trend.

Furthermore, more than one-third of all premiums written in Labuan IBFC in 2020 were from captives, with expected growth for 2021. “We believe that the growth seen in the jurisdiction is merely the beginning of a coming-of-age for Asian self-insurance vehicles,” says Labuan IBFC Inc.

Hosted by Labuan IBFC Inc and the Labuan International Insurance Association as a virtual event, this year’s Asian Captive Conference will particularly examine how companies can reap the benefits of cell captives in the existing challenging insurance market. Taking place on 2 December, sessions include investigating the ways in which self-insurance is well suited to meet the evolving needs of risk management in a post-pandemic world amid an ever-hardening reinsurance market, and how the minimum global tax rate under the base erosion and profit shifting framework is likely to affect captives and the wider international tax landscape.

In addition, panels will discuss the role of cell captives in the democratisation of captives, and the key risk themes in the current and future developments of captives and reinsurance within Southeast Asia.

Cell captives have emerged as a particularly popular structure in the region owing to their implementation as a “stop-gap measure” to provide quick and cost-efficient access to reinsurance for risks that are difficult or too expensive to place in the commercial market.

Ahead of the panel discussion at this year’s Asian Captive Conference, Farah Jaafar, CEO of Labuan IBFC Inc, discusses the current trends around cell formations in the domicile and how the structures compare to pure captives.

What are the most significant factors driving the growth of Labuan IBFC as a captive domicile?

Labuan IBFC offers Asia's widest range of insurance, reinsurance and self-insurance structures — in fact, we have the most comprehensive toolbox of self-insurance structures and solutions in the region, both in terms of the conventional and shariah-compliant versions. To date, Labuan IBFC is still the only jurisdiction in Asia that offers a protected cell company (PCC) as part of a risk management solution.

A little less-known fact is that we also have the largest and deepest insurance and risk management ecosystem in Asia, with more than 220 licence holders supported by professional corporate service providers and international banks.

Holistically, Labuan IBFC offers an ideal location for captive set-up. Our leadership in captives has been entrenched by our approach in developing the jurisdiction's self-insurance sector, which is founded on generating awareness with the regional risk management community and working closely with industry groups.

Having great intermediaries has been beneficial, and fostering a close working relationship with the Labuan International Insurance Association has been key. The hardening market, greater awareness, COVID-19 and the characteristics of the jurisdiction have created the perfect storm for our growth. Additionally, one cannot overlook that Labuan IBFC provides a cost-efficient operating base to create economic substance such as administration and operational expenses.

"We are seeing a trend in corporations starting to explore captives"

What trends have you observed around the formation of cell captives in Labuan IBFC?

While cell captives are typically set up by corporations with exposures to specific risks, especially those difficult to get traditional commercial cover, there are also corporations that are aiming to consolidate risk exposures for a holistic view of risks and transparency of risk costs and returns via a pure captive.

We envisage cells as "training wheels" for pure captives, as it gives corporations a taste of the benefit of self-insurance. Having said this, like everything else in wholesale financial and risk intermediation, there is no one-size-fits-all solution. Cells, though, do provide quick cover options, especially as we no longer require approval for the setting up of cells, merely a notification to the regulator within 14 days.

We are seeing a trend in medium-sized corporations starting to explore and consider captives as part of their risk management solution, more so now as it is more cost-efficient in setting up via a cell. With the current hardening market and the COVID-19 pandemic, this has undoubtedly accelerated the setting up of cell captives for specialised risks, which would have otherwise been traditionally uninsurable — for example, we have seen a lot of cyber risk, directors and officers liability, and travel cover being placed in cells.

What are some of the key factors to consider in order to set up a cell with confidence? Do these factors differ when setting up a traditional captive?

Whatever the circumstances or situation may be, the choice of service provider is key. That said provider must be competent and familiar with the management of cells as well as the wider landscape of the insurance industry. This requirement applies to either the core provider for the protected cell company or the master rent-a-captive, depending on the option chosen.

Other factors worth considering include paid-up capital, professionalism and servicing elements. The relationship with the core is key, as the core will have to agree with the level and scope of risk being placed in the cell. There is, to a certain degree, an underwriting element in the operations of the core vis-à-vis the cells.

Do you think cells are seen as a short-term solution by new market entrants? Is this feasible or sensible? And what about solvency?

In Labuan IBFC, it generally takes two weeks to set up a cell operationally. Depending on the risks within the cell (whether long-tail or short-term) and if the risks have expired their term, then closing down a cell can be done almost immediately. Whilst cells as a corporate structure are easy to set up, the reinsurance contract inputted into the cell still requires a run-off like all other insurance contracts.

However, it is worth noting that there is no limit on the cover that can be taken at the cell, which is relatively similar to a pure captive.

This ultimately depends on the appetite of the core overall and the solvency of each cell individually. Hence, the solvency ratio is managed at the core regarding the reporting to the regulator. In Labuan IBFC, the solvency statement of the core is required to be reported to the Labuan Financial Services Authority twice a year.

Is it a reasonable base assumption to consider a cell as a 'trainer' facility before moving to a pure captive solution? How feasible is this conversion?

It is possible for a cell to convert into a pure captive the moment it achieves economies of scale to set one up.

It could also be due to the changes of the corporate's risk profiles over time, which would then require a more holistic review of its risk management strategy. For a more holistic approach to strategic risk management, there is no real alternative to a pure single owner captive.

Alternatively, we have seen instances where only a couple of new lines or risk areas necessitate cover, as some users prefer to set up only a new cell or two. At the end of the day, it all largely depends on the strategic risk management practices within the organisation.

In Labuan IBFC, the conversion from a cell to a pure captive is considered a new application. This is because a pure captive is a new legal set-up (whereas a cell is not), so proper due diligence is required. That said, the process may be relatively simple as the cell already has a track record in the jurisdiction. In such cases, the approval process will normally take a month. ■

Gateway to the West

Sam Komo of the Missouri Department of Commerce and Insurance, Alan Fine of Armanino, and John Talley of TAL Consulting discuss current market conditions for the captive industry in the state of Missouri, as well as the regulatory environment and emerging risks

Rebecca Delaney reports

images by seanpavonephoto/stock.adobe.com

With rolling plains extending into the Ozark Mountains at one periphery, and stretching above the Missouri River into the Pony Express route of the Old American West at the other, Missouri boasts the picturesque postcard landscape of the Midwest.

As the largest captive domicile in the Midwest, Missouri is part of the 'Western Region' alongside Arizona and Utah. The three domiciles jointly host the annual Western Region Captive Insurance Conference, while the National Association of Insurance Commissioners (NAIC) has its headquarters in Kansas City.

According to the Missouri Department of Commerce and Insurance (DCI), the state has issued 78 captive licenses, 52 of which were active as of 1 July 2021 — over half of which are owned by Eastern-based companies.

"Missouri understands the complexity of the captive market. That is why we look at multiple indicators to assess current conditions in Missouri and around the world," explains Sam Komo, captive manager at Missouri's DCI.

"Nationally, we found an ongoing increase in licensing, but a greater increase in inactive captives over the last three years. While Missouri has experienced a similar trend, it has not been to the extent we have seen nationally. For that reason, Missouri is on solid ground as it works to promote the programme," he affirms.

Komo adds that the Missouri Economic Research and Information Center has estimated that all industries will see an increase of 4.5 per cent through to 2028, while agencies, brokerages and insurance-related activities have the potential to grow by as much as 11.4 per cent — "we believe the captive industry will be a dominant part of this growth," Komo notes.

These market conditions are affirmed by John Talley, president of TAL Consulting, who says: "The market conditions for Missouri are at a high level. As with the rest of the US, rising prices for materials and inventory has caused businesses to reassess the cost of insurance — many are looking at a captive as a risk finance mechanism to keep insurance cost manageable and have greater control over claims procedures with their risk management programme."

Market conditions for the captive industry in Missouri, and indeed internationally, continue to reflect the impacts of the COVID-19 pandemic.

Komo says: "Our world continues to evolve and so does the risk within it, thereby the captive industry will remain an option to address those challenges. Even as the COVID-19 pandemic proves to be one of the biggest challenges in generations, our society and the economy has continued to move forward. This same spirit is what drives people to look for solutions in uncharted territories, and makes the captive industry thrive in Missouri and the world."

The pandemic is partially correlated with the "significant increase in interest" around alternative risk financing over the past 18 to 24 months, notes Alan Fine, tax partner at Armanino.

He explains: "Most commercial insurance policies contain exclusions for damages caused by communicable diseases. There are, however, many instances where business owners who had previously implemented a captive insurance strategy were able to submit successful claims payments, thereby providing their businesses with desperately-needed funds."

Talley adds that the combination of the COVID-19 pandemic and the hardening market has caused Missouri businesses to explore captives for solutions that can provide them with much-needed financial stability and protection.

Described by Talley as "excellent for new captive formations", the landscape of the captive industry in Missouri is as diverse as the state's overall economy, according to Komo, encompassing insurance, financial services, health, banking and construction to name but a few.

He adds: "Missouri's ability to think outside the box to support this diverse community is why the state is positioned for future growth in the industry. We look at every new captive as an opportunity to be innovative while moving the programme forward."

Komo notes that to be successful in the current landscape, captive companies must be responsive to the needs of the customer and have the experience to find innovative solutions.

They must also provide opportunities that are financially sound and have flexibility within their laws to operate quickly and efficiently.

The captive industry in Missouri is facilitated by the Missouri Captive Insurance Association (MOCIA), which was formed in 2010 by experienced captive professionals in the domicile. MOCIA partnered with the Missouri captive department following the passage of domestication legislation to promote and support the new state law.

Fine notes that, in the future, MOCIA will explore suggested modifications to the state's statutes to ensure sustained competitiveness as a domicile, noting that "we have tried to model ourselves after those jurisdictions which came before us and maintain the flexibility to serve the needs of the business constituents in our state".

The Show Me state

The Missouri DCI regulates more than 2,000 insurance companies, the wide scope of which means the department has a great deal of experience and flexibility in administering insurance and reinsurance programmes. Captive structures available include pure, association, industrial insured, branch, sponsored, and special purpose life insurance captives.

These companies are regulated under the provisions of Missouri's 2007 captive legislation, which was instrumental in allowing Missouri to become the largest captive domicile in the Midwest. The legislation determined that pure captives are not permitted to insure risks other than those of the parent or affiliated companies, while no captive is allowed to provide personal auto or home insurance coverage.

Furthermore, the law states that no captive is allowed to accept or cede reinsurance — however, they may reinsure workers' compensation of a qualified self-insurance plan of its parent and affiliated companies.

"The stage was set in the beginning when we passed our first captive legislation in 2007, and expanded that legislation in 2013. Each stage in this process allowed the agency the needed flexibility to ensure we could view every application on its own uniqueness and merit, while still maintaining our commitment to regulatory requirements," Komo explains.

"Some may ask why Missouri has not moved forward on new legislation in the past eight years. I would respond by saying the state already has the tools needed to develop groundbreaking advancements in the captive realm today."

Komo adds that this does not mean that Missouri is not considering any future legislative updates. Rather, the domicile seeks to be proactive, rather than reactive, to the captive industry. In addition, DCI rules relating to insurance solvency and company regulation dictate that all captive companies must have an annual audit by an independent certified public accountant.

Fine says: "Missouri's DCI, through the managers of the captive programme, has been very supportive not only of new formations but also redomestications to Missouri. The regulatory environment in Missouri compares favourably with other jurisdictions, as the regulators appropriately oversee the formation of captives and their ongoing activities without being overzealous in their oversight."

"Missouri believes in regulation, but not overregulation, within the captive industry," Komo summarises. He outlines the "simplistic approach" undertaken by the department in terms of fees, explaining that the US$7,500 licensing and $7,500 annual renewal fee are 100 per cent deductible from any premium tax, marking the domicile from its competitors.

With premium tax rates at less than 0.4 per cent (which cannot exceed $200,000), pure captives must directly write more than $2 million in premium to pay any taxes. In addition, examination costs are low as the DCI uses in-house examiners in a modified examination approach for pure captives.

"These factors are what bring service providers to Missouri and the reason this programme continues to grow. Data shows the captive industry in Missouri has the potential for growth, while the ongoing challenges around the world would suggest even greater opportunity for the captive industry moving forward," Komo says.

Looking ahead

With this forward-thinking perspective in mind, Komo expects future health risk to be significant following the COVID-19 pandemic, particularly as this coverage represents 11 per cent of Missouri's base financial risk (20 per cent when combined with banking and financial services). Other key emerging risks for the captive industry in general are cyber and environmental risk. The former is especially relevant following the pandemic, as Talley notes that the decentralisation of employers' work locations has made organisations more vulnerable to computer networks and system cyber risks.

"Cyber liability can be more effectively tailored to meet the needs of the insured with a captive policy that is typically the case in the commercial marketplace — this is particularly important given the incredible pace of change in our technologies."

Talley affirms: "Captive insurance companies have shown the ability to move quickly to provide the particular type of cyber risk coverage a business needs."

"Data shows the captive industry in Missouri has the potential for growth, while the ongoing challenges around the world would suggest even greater opportunity for the captive industry moving forward"

Looking at Missouri specifically, Komo notes that the state "is always looking at emerging industries with unidentified risk and our pool of existing captives as we evaluate developing risk".

He advises that a captive can best position itself to address emerging risks by "always [being] ready to identify conditions in the captive market in order to properly prepare your agency for unknown factors".

Domiciles which are able to quickly engage with evolving market conditions will be best placed to explore opportunities to serve these emerging sectors — "and Missouri will be ready," Komo concludes. ■

A heated topic

Industry professionals discuss trends around climate change-related risks and how captives can be implemented to help address these risks as they evolve in frequency and severity

Rebecca Delaney reports

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Described by the World Economic Forum in its 2021 Global Risks Report as an “existential threat to humanity”, climate change consistently ranks conspicuously high as a risk of concern within the insurance industry, in terms of both likelihood and impact.

The report, produced in partnership with Marsh McLennan, SK Group and Zurich Insurance Group, identifies the top three highest risks of the next decade, according to likelihood, to be extreme weather, climate action failure and human-led environmental damage, respectively. Other named environmental risks include major natural disasters, water crises, and failure of climate change mitigation and adaptation.

In particular, climate action failure is named the most impactful risk and the second most likely long-term risk in the report’s Global Risks Perception Survey — meaning that the global transition to a greener economy cannot be delayed until after the effects of the COVID-19 pandemic abate.

The frequency and severity of climate change is the ‘new normal’ in meteorological, hydrological and geophysical terms, with corresponding issues ranging greenhouse gas emissions, atmospheric carbon dioxide concentration, global surface temperatures, global mean sea level, and the frequency of extreme weather events.

With climate change comes two main economic risks: physical risks and transition risks. Physical risks are caused by event-driven or long-term shifts in climate patterns, which have the ability to cause both direct damage to tangible assets and indirect damage to production and supply chain through business interruption. Transition risks are associated with the shift to a low-

"There is a divergence between total economic losses and insured losses; a gap which is growing and causing less resilience in the financial world in general"

carbon economy, whereby investments could lose value and cause a macroeconomic supply shock.

The themed report, 'Working together to tackle climate risks: risk professionals and the insurance industry', released by the Association of Insurance and Risk Managers in Industry and Commerce (Airmic) and KPMG, highlights that transition risks are beginning to attract a higher level of attention.

Furthermore, in the association's annual survey, Airmic identifies the number one issue of concern for risk professionals to be regulatory compliance in the context of ESG principles, with climate change as a key area for insurers and buyers to work more collaboratively.

The annual survey also reveals that 43.8 per cent of risk professionals believe that climate change will have a material impact on their organisations within one or two years, particularly in the energy, utilities, food, beverage, banking and finance sectors.

Extreme events in recent years that demonstrate the already tangible impact of anthropogenic climate change include heatwaves in Western North America, extreme rainfall in Western Japan and Central Europe, bushfires in Australia, and Hurricanes Harvey and Maria in North America.

Despite these palpable examples, a recent report by S&P Global Ratings finds that reinsurers may be underestimating their exposure to natural catastrophe risk by as much as 50 per cent. An empirical stress scenario based on 30 years of insured loss experience finds that 70 per cent of events in the last 20 years have been made worse or more likely by climate change.

S&P also determines that 2021 marked the second-largest amount of insured catastrophe losses on record, while secondary perils have contributed a record-high amount to total insured losses.

Alex Pui, head of natural catastrophe and sustainability, Asia Pacific (APAC), Swiss Re, explains: "In insurance industry parlance, 'secondary perils' actually has two meanings; it refers to non-peak perils (such as earthquakes or tropical cyclones) as well as typically more frequent losses, such as floods, flash floods, hailstorms, convective storms and wildfires."

A separate report by Aon recapping global catastrophes in the first half of 2021 estimates total economic losses from natural disasters at around US$93 billion, while insured losses stand at around $42 billion, marking a 2 per cent increase from the 10-year average.

"We are seeing an increasing burden in these losses that actually rivals some of the losses from the peak perils themselves," Pui notes.

"This is definitely a very obvious trend that we have seen, which is also consistent with the increasing frequency of these particular events. There is a divergence between total economic losses and insured losses; a gap which is growing and causing less resilience in the financial world in general."

Pui highlights that this is particularly true of the APAC region for two reasons. As a high economic growth region with increasing economic density, this increases loss potential. Secondly, climate risk strikes disproportionately in the region, with rising sea levels causing typhoon activity in the Philippines and in the Pearl River Delta region in Hong Kong.

Under the weather? Consider a captive

With the increasing frequency and severity of extreme climate-related events and environmental impairment liability, it is of paramount importance for companies to consider their risk management frameworks and how the alternative risk transfer market can be of benefit. In particular, firms must be more nuanced in their understanding of how climate change can and will impact their businesses, and how to manage this risk.

"With more intense, severe weather events, it is clear that our climate situation is rapidly evolving at a pace that necessitates accounting in risk pricing today," explains Sean Rider, chief revenue officer at One Concern.

"As a result, we are finally seeing different financial services and insurance firms realising that they are not prepared to price risk with today's models. As rising climate-related losses threaten insurers, the industry is looking to partner more with artificial intelligence companies like One Concern to understand their climate risks at the property level, which previously was not possible."

The flexibility of a captive means it is well suited to facilitate such understanding and provide coverage solutions for emerging or evolving risks that are unquantified, difficult to price and lack risk data — or else simply lack adequate coverage in the commercial insurance market.

"In this context, captives are typically used to warehouse acute climate perils that are often deemed too difficult or too expensive to place in the traditional insurance market. If an individual business unit were to go out and procure insurance by itself, this would not be an efficient way to obtain capital," Pui explains.

Rider adds that captives are able to better absorb new and innovative analytics techniques that directly link climate change to current and future risks compared to traditional insurance structures.

"Captives are freer to pilot and test newer technologies and innovations that enable them to quickly and accurately address their climate-related risks. As a result, they are more resilient and better equipped to withstand and bounce back from climate impacts," he says.

Many captives already insure risks relating to traditional property weather perils, or a form of standalone weather-sensitive coverage, particularly in the agriculture and transportation industries.

Captive coverage should include contingent business interruption, as this forms an essential part of the exposure to first-party physical and non-physical damage business interruption losses.

Another advantage of captives, according to Pui, is the ability to establish a track record: "Although these risks are very difficult to place today, if a captive is managed well and is able to demonstrate a track record of loss history, it could then be positioned to eventually actually transfer some more of that risk into the open market."

Reassessment of the dynamics of property catastrophe supply and demand has placed greater importance on reinsurance markets — to which captives offer access — particularly in terms of pricing adequacy, risk profiles, and risk selection.

As well as using captives as part of an organisation's overall risk management strategy to mitigate the financial impact of extreme weather events, parametric insurance can be used to pay out an aggregate amount in the event of a specific trigger.

For example, in August parametric insurance provider Arbol launched a solution for climate change risk management, Captive+Parametric, which allows companies to take immediate action in their risk management by transferring climate risks into captives through a parametric structure. The participating companies have access to Arbol's climate data, intelligence platform, and online structuring and pricing tools.

In addition, Howden Group collaborated with Replexus and the Danish Red Cross to implement a Guernsey-based insurance-linked securities (ILS) structure to create a world-first humanitarian catastrophe bond covering pure volcanic eruption.

"Captives are freer to pilot and test newer technologies and innovations that enable them to more quickly and accurately address their climate-related risks"

No time for a rain check

This article has noted that it is critical for a company to integrate climate risk into its broader risk management framework for emerging risks — but how can an organisation best position itself to do so?

Airmic and KPMG's climate risk report emphasises the need for collaboration between corporate risk managers and reinsurers during the transition to net-zero. Reinsurers are expected to assume a greater role in mitigating the effects of climate change, building resilience to its impacts, and supporting the transition to a low-carbon economy as they can augment their existing knowledge of physical risk to adopt an enterprise-wide approach.

This is particularly important as climate risk is strongly linked to enterprise risk. Consequently, companies must develop climate risk scenarios, stress test exposed assets and develop a climate strategy for liabilities.

Pui comments: "For any organisation, there should be a realisation that climate risk is an inherently complex topic rather than a tick box exercise. With that acknowledgement comes significant investment in terms of building up capability internally, to be in a position to understand what climate service providers and consultants are actually feeding them with."

In its survey, S&P finds that reinsurers have increased their efforts to integrate climate change considerations into their decision-making processes, especially concerning risk management, exposure management and pricing. However, although 71 per cent of survey respondents indicate they consider climate change in their pricing assumptions, only 35 per cent say they include a specific allocation of price for climate change.

A physical climate risk assessment is a complex operation that nevertheless must be undertaken for a company to understand the limitations and quantifying uncertainties of climate models, according to Pui, who describes global climate models as "the latest crystal balls that enable a view into the future".

Therefore, a firm must incorporate this model uncertainty into a holistic view of climate risk that considers beyond modelled outputs, encompassing literature, catastrophe modelling and interdependencies between events.

Climate and catastrophe models can help to project future risk profiles, as the results can be used for asset value estimation, stakeholder management, strategy reevaluation, and to meet regulatory disclosure requirements.

"By incorporating climate change scenarios into analytics, organisations can do a better job at benchmarking mitigation actions," adds Rider. He notes that the ever-changing nature of technologies and innovations enables highly strategic resilience investments that are informed by data-supported insights.

"With the aid of new technologies and capabilities, such as One Concern's digital twin platform, organisations can run stress and reverse-stress testing scenarios to identify previously overlooked vulnerabilities that have not posed a direct threat until recently," Rider continues.

"The key component here is disclosure. The more companies disclose about their climate-related risks, the more insight is added to the reservoir of knowledge that will price climate risks more accurately while supporting a green economy."

There is a distinct opinion among respondents in Airmic's annual survey that they view regulations and reporting requirements, such as the Task Force on Climate-Related Financial Disclosures (TCFD), as an opportunity to enhance their focus on ESG issues relevant to the resiliency of their business. From this regulatory perspective, for reporting periods beginning on or after 1 January 2021, the UK Financial Conduct Authority mandates all premium-listed companies to state in their annual financial reports whether their climate-related financial disclosures are in-line with the recommendations of TCFD.

39.9 per cent of respondents in the Airmic-KPMG survey state they are ready for such disclosure, while 33.6 per cent say they are actively working to be ready.

However, as many as 17 per cent of respondents cite they have not yet taken quantification and management actions on climate — these are more likely to be in the public and non-for-profit sectors.

Pui adds: "With respect to TCFD and regulation, this is important, but only if set up in the right way to incentivise more disclosure from companies by levelling the playing field. At this point in time, TCFD is still voluntary but remains the closest to an international best practice or standard that we currently have."

"However, the landscape is fast changing, with individual regulators already signalling that they will start to make climate reporting mandatory. It is best to be in a position to be ready for that change, and to make sure that good change management is in place," he adds.

It never rains but it pours

As a unique risk that, unlike most other types of risk, cannot be controlled or financed when necessary, there are challenges associated with the use of captives to insure against climate risk.

From a data and analytical perspective, non-traditional weather risks pose issues as many companies do not keep internal records of specific weather risks, or their impact on revenue or tangible assets. Without this information, it is difficult to establish a preliminary trigger in coverage.

Rider adds: "Since captives tend to be much more related to the business that created them, they may overlook aspects of how climate change affects society on a larger scale, which can have meaningful downstream impacts. With this, factors related to energy, for example, might be overrepresented in one group, whereas a traditional reinsurer will look more broadly across hazard risks."

Furthermore, as climate risk management becomes more and more complex, companies face greater ambiguity and uncertainty over the appropriate investment balance between loss prevention and loss mitigation.

Pui notes: "It sounds obvious, but ultimately the captive itself is effectively still self-insuring climate risk, so it is not able to transfer it out anywhere else. This becomes a unique issue with respect to climate risk, because a lot of these large companies have operations in different parts of the world and are therefore vulnerable to the supply chain problem."

He adds that effective diversification may be difficult if the base rate rises in too many different regions: "If the intention is to use the captive to place risk in the ILS markets, then the pricing and market education will also be key challenges."

"Coverage will not be cheap just because you have a captive — although you will have greater access to different risk pools, this does not mean that those different potential risk transfer partners will react any differently to traditional insurance markets," Pui continues.

In addition, challenges arise as companies with frameworks that rely on historical data to construct output assumptions may struggle to implement catastrophe models. Therefore, it is crucial for firms to invest in new dynamic technologies.

However, there are still significant uncertainties in climate models, as they are first and foremost designed to examine how the global climate system would react to the conditions and consequences of climate change, rather than to assess physical risk. It is also important to note that such models should be used to inform, as opposed to dictate, decision-making processes.

"From the perspective of addressing climate change, the most significant challenge in using captives is that they might not have the full range of capabilities to carry out the type and degree of analysis that best suits their needs," Rider states.

He continues that this can be addressed by captives partnering with the broader vendor community that possesses the tools, technology and experience necessary in order to better understand the exposure to climate change risks faced by a company and wider society.

Into the eye of the storm

Such partnerships between captives and emerging companies are likely to be explored in more detail in the future, Rider anticipates, adding that the industry is still in the phase of trying to model risk more effectively and understand how climate change is driving risks at a granular level.

Looking forward to the evolution of climate change coverage, Pui expects "cautious attempts" to test new solutions for property and catastrophe, since this remains the largest and more direct market for climate risk. New solutions include coverage such as parametric hail, flood or wildfire.

"While insurance can be seen as the only panacea to climate risk, it must be mitigated by actions on the ground, such as whole infrastructure protective assets"

He identifies another key emerging area of note as carbon offset insurance. This is an example of "enabling insurance solutions rather than mitigating" (enabling meaning it will insure renewables or the construction of more renewable energy sources). Another example includes directors and officers liability, as the impact of anthropogenic climate change becomes increasingly clear.

"In the next 12 months, I do not think there will be any large movements in the climate risk space, as it has to be incremental. While insurance can be seen as the only panacea to climate risk, it must be mitigated by actions on the ground, such as whole infrastructure protective assets," Pui concludes. ■

Somers Risk Consulting has appointed Eva Conley as senior manager of captive consulting services.

The boutique firm offers captive consulting and management services via customised programmes throughout the captive lifecycle, from feasibility and implementation to supporting the company's wider risk management framework. Conley previously served as both supervising and senior financial analyst for captive insurance at the South Carolina Department of Insurance, before which she was a vaccine manager and grant administrator at the Department of Health and Environmental Control.

Conley holds a license from the National Association of Insurance Commissioners as a professional in insurance regulation, as well as a certified insurance service representative qualification from the National Alliance for Insurance Education and Research. ■

Acrisure Re, the reinsurance division of global insurance broker and fintech platform Acrisure, has appointed Ian Wicks as executive vice president and Simon Arnott as senior vice president, effective immediately.

The reinsurance division offers customised advisory, portfolio and reinsurance solutions, while the broker also provides employee benefits and captive advisory services to middle-market and larger companies.

Based in the division's London office and reporting to partner Nigel Dane, Wicks will focus on the casualty side of Acrisure Re's business with a wider strategic role in the reinsurance division.

Wicks previously served as chairman of the non-marine reinsurance division at Ed Broking, before which he held various senior roles at Harman, Wicks & Swayne, Willis Re, and JLT Re.

In his new role, Arnott will be responsible for sourcing new business and expanding Acrisure Re's property catastrophe and retrocession solutions, as well as consolidating current accounts and market relationships.

Arnott will be based in the division's Bermuda office, reporting to president of Acrisure Re Bermuda, Clark Hontz.

He previously held the position of head of business development for the non-life division at Securis ILS Management, before which he served as executive vice president and head of catastrophe lines at Tokio Millennium Re in Bermuda.

Dane comments: "I am so pleased to welcome Ian to our casualty team in

London and look forward to working with him as we expand our footprint in third-party lines. His knowledge and breadth of contacts will be invaluable."

Hontz adds: "I am delighted to welcome Simon to the Bermuda team. His vast experience in structuring and pricing programmes, extensive knowledge of the insurance-linked securities market and broad network of global market relationships will significantly enhance our production capabilities and market insights."

Vesttoo has appointed Robert Hauff as portfolio manager for the alternative reinsurance and investment platform's insurance-linked programme (ILP).

The platform is a marketplace for life, property and casualty insurance-based risk transfer and investments based on proprietary artificial intelligence-based technology.

This facilitates risk transfer between insurance companies and institutional investors to provide asset managers with insurance-linked investments.

In his new role, Hauff will be responsible for creating the investment strategy for Vesttoo's ILP, which allows asset managers and pension schemes to earn long-term, sustainable alpha by pledging existing assets to support short- and mid-term life, property and casualty alternative risk transfer transactions.

He will also manage day-to-day operations of the programme and lead research into insurance-linked opportunities.

Hauff previously held the position of managing director of fixed income research at Wells Fargo Securities, where he was responsible for collaborating with investors, sales and trading to drive revenue through multiple business units and act as the firm's insurance industry expert.

Commenting on the appointment, Yaniv Bertele, CEO and founder of Vesttoo, says: "We are thrilled to add Robert and his deep understanding of fixed income and capital markets. As a highly accomplished leader within the financial services industry, and an expert in leading growth initiatives, Robert will help Vesttoo bridge the reinsurance funding gap with our ILP programme."

Hauff adds: "Vesttoo is the perfect opportunity for me — combining advanced technology with sound alternative investments. This is the future of the industry."

"Vesttoo has been extremely successful at bringing together insurers and investors and expanding the alternative reinsurance market. I am excited to join their global team and help deliver results for our clients and industry partners."

The Geneva Association has appointed Christian Mumenthaler, CEO of Swiss Re, as chairman, succeeding outgoing chairman Charles Brindamour, who will remain on the association's board.

Mumenthaler previously served as vice chairman since November 2019. His old role has been assumed by Lee Yuan Siong, CEO and president of AIA.

Amanda Blanc, CEO of Aviva, was also elected as a new board member at the association's statutory assembly.

The Geneva Association is an amalgamation of insurance and reinsurance companies that investigates key risk areas within the global insurance industry through collaborative research with its members, academic institutions and multilateral organisations.

Commenting on his appointment, Mumenthaler says: "I feel privileged to take on this role at such a crucial time for both our industry and society more broadly, as reinsurers mobilise to confront immense challenges, namely climate change and the after-effects of COVID-19."

"Through its rich portfolio of research and dialogue activities, the organisation makes an essential contribution to the debate on strengthening the world's resilience to global risks. I look forward to further increasing the impact we have for all our stakeholders."

Siong adds: "The enormous positive difference that insurance can bring to the lives of our communities has never been more relevant than it is today. I look forward to collaborating closely with Christian and members of the board as we work together to address the global strategic and risk management issues facing our industry, while playing our part in the transition to a better, more sustainable future."

Jad Ariss, managing director of The Geneva Association, adds: "Together with the rest of the board, we will ensure The Geneva Association – through its programme of research, discussions and outreach – continues to provide meaningful support to the insurance sector in its mission to make the world a more sustainable, equitable and resilient place." ■