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08 December 2021 - Issue 238

When all is said and done

A reflection on this year's trends and challenges amid the continued hardening market and COVID-19 pandemic

2021

US Regulatory Focus

Examining regulatory updates and the symbiotic relationship between the regulator and captive companies

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16 Bromley Road, New Beckenham
Beckenham, BR3 5JE

Editorial

Group Editor: Bob Currie
bobcurrie@blackknightmedialtd.com
+44 (0) 208 075 0928

Senior Reporter: Jenna Lomax
jennalomax@blackknightmedialtd.com
+44 (0)208 075 0926

Reporter: Rebecca Delaney
rebeccadelaney@blackknightmedialtd.com

Lead Designer: James Hickman
jameshickman@blackknightmedialtd.com

Marketing and sales

Publisher: Justin Lawson
justinlawson@captiveinsurancetimes.com

Associate Publisher: John Savage
johnsavage@captiveinsurancetimes.com
Tel: +44 (0)208 075 0932

Office Manager: Chelsea Bowles
Tel: +44 (0)208 075 0930

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CICA announces case studies for 2022 essay contest

The Captive Insurance Companies Association (CICA) has revealed the case study topics for its 2022 student essay contest, which is centred around the theme of 'Using captive insurance solutions to address coverage gaps'. Next year's contest is sponsored by Strategic Risk Solutions (SRS). As always, essay contest winners will receive cash prizes, along with the opportunity to present their essays at the CICA International Conference and publication in *Captive Insurance Times*.

The essay contest is open to two-person teams of US college insurance and risk management students. In the contest, teams demonstrate how and why a captive can be utilised as a form of alternative risk financing for emerging risks and loss exposures.

Case studies are designed to focus on developing real-world captive strategies for fictional organisations to provide member value and address coverage gaps for both current and emerging risks.

The first case study for 2022 is centred around the American Cannabis Association (ACA), which is seeking to form a captive to provide the required liability coverage for general, product and automobile liability insurance, as well as cyber risk.

In the scenario, ACA also wishes for the captive solution to help encourage loss control and the sharing of best risk management practices among its members.

The second case study concerns the Craft Breweries Association (CBA), which will determine if and how a captive can be implemented to provide medical stop-loss coverage to participants, as well as to help members control future health insurance costs for both employers and employees.

Furthermore, in the scenario, CBA has a long-term priority to administer a form of voluntary benefit offering to employees to provide a safety net in the event of a serious health issue. ■

ACC: Captive insurance has a "primary focus" in Labuan IBFC's five-year roadmap

Labuan International Business and Financial Centre (Labuan IBFC) saw 18 new captives approved as at Q3 2021, as well as a 28 per cent increase in premiums for its captive business, demonstrating the primary role of captive insurance in Labuan IBFC's five-year strategic roadmap. Farah Jaafar, CEO of Labuan IBFC Inc, noted that this indicates a marked increase from the seven captives incorporated over the same period in 2020.

As a midshore jurisdiction, Labuan IBFC is recognised as the fastest-growing risk and reinsurance intermediation centre in Asia, hosting 232 insurance and insurance-related entities, including 64 captives. Of these captive entities, over 90 per cent have a parent company based in Asia.

In his welcome address at the Asian Captive Conference, Nik Mohamed Din Nik Musa, director general of the Labuan Financial Services Authority (Labuan FSA), explained: "Increasingly, we are seeing a rise in captive's popularity globally, driven not just by the COVID-19 pandemic but also insurance market challenges, as well as natural catastrophes."

The impact of the COVID-19 pandemic and other challenging market conditions on the role of risk management teams within an organisation was discussed in a panel at the conference.

"Proving to be an effective tool in responding to risks and changing market conditions, captive formations have been on a steady rise," Nik Musa added.

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Labuan International Business and Financial Centre (Labuan IBFC), located off the North West coast of Borneo, offers global investors and businesses the benefits of being in a well-regulated midshore jurisdiction that provides fiscal, legal and currency neutrality, in addition to being an ideal location for cost-efficient substance creation.

Labuan IBFC is a wholesale financial, risk and wealth management intermediation centre that also boasts a wide range of business structures including solutions for fintech or digital businesses. It is also home to the world's first sukuk and is acknowledged as an Islamic financial hub.

Well-supported by a robust, internationally recognised yet business-friendly legal framework, Labuan IBFC operates within comprehensive legal provisions and guidelines, enforced by a single regulator, Labuan Financial Services Authority –a statutory body under the Ministry of Finance, Malaysia.

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The Labuan captive business model has seen a particular interest in protected cell companies (PCCs) as a cost-effective alternative to a traditional pure captive. Nik Musa suggested this growth in cell formations is attributable to "a greater appreciation for self-insurance as a component of a dynamic risk management strategy".

Jaafar added the lower entry requirements for cell captives make self-insurance and a holistic risk management strategy more accessible to smaller companies — this trend of 'democratisation', to which the conference lends its name, was discussed at a panel during the event.

The domicile's ongoing commitment to developing a robust risk management and reinsurance 'toolbox' will consolidate Labuan IBFC's leading position in the global captive market, affirmed Jaafar.

Looking forward, Nik Musa identified Labuan FSA's priority over the next five years to be strengthening Labuan IBFC's status as a captive domicile hub by positioning the captive sector as a primary focus in the jurisdiction's five-year strategic roadmap.

This includes reviewing legislation alongside relevant stakeholders and industry participants to ensure the framework is consistent with international standards and best practices, as well as to accommodate the diversification and expansion of niche product and service offerings in Labuan IBFC.

The current legislation in Labuan IBFC is observed as market-adaptive compared to other Asian captive markets, as it is the only jurisdiction in Asia to offer a provision for PCCs, both conventional and Islamic.

Nik Musa concluded: "One of the goals is to strengthen Labuan IBFC's complementary roles to Malaysia's economy, which will include the development of the Labuan insurance industry as a whole."

"Labuan IBFC's development over the years has resulted in a diverse pool of financial institutions, including numerous international insurers and reinsurers, establishing a presence in order to capitalise on Asia's rising potential."

A.M. Best: Bermuda, Cayman and Barbados captives continue to surpass US commercial peers

A.M. Best-rated captives in Bermuda, Cayman Islands and Barbados (BCIB) continue to outperform the US commercial casualty composite in terms of underwriting and operating profitability for the fifth year in a row.

BCIB captives make up three of the seven largest global captive domiciles, and although the COVID-19 pandemic slowed growth in new captive formations, others explored new coverages to meet protection requirements as a result of the pandemic.

A.M. Best explains: "The benefits and consistency of local captive management and a captive-friendly regulatory environment have enabled Bermuda, the Cayman Islands, and Barbados to not just maintain, but even expand, their foothold in the captive market."

The rating agency identifies around two thirds of rated BCIB captives as either owned by US-based businesses (in the case of single-parent captives) or aligned with US groups and associations (for group captives).

A.M. Best notes "relatively consistent" year-on-year operating results, similar to those of US commercial insurers but still comparing "very favourably".

Profitability and income generation is driven by new risks from the hardening commercial lines market, steady premium growth, and improved equity markets. Although investment assets remained relatively flat in 2020, there has been a 20 per cent increase since 2016.

In addition, underwriting results improved in 2020 following a high number of large fire losses in 2019, with an aggregate combined ratio of 85.1. BCIB captives paid out almost US$1.8 billion in dividends between 2016 and 2020 while still adding $2.6 billion to their capital and surplus.

In the report, A.M. Best adds: "The BCIB captives have also consistently posted near double-digit returns on equity (ROE), with a five-year average of 10 per cent. Favourable prior-year reserve releases and generally limited exposures to catastrophe events were the two key contributors to solid margins and a strong ROE."

The ratings of BCIB captives remain predominantly in the 'A' to 'A-' range, marking a reflection of the companies' robust balance sheets, integrated risk management practices, management knowledge of the risks insured, and the inherent advantages of being owned by member insureds.

A.M. Best adds: "Ratings on captives recognise the unique nature of these structures and incorporate how these companies fit into an organisation or among their member insureds."

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"For captives, qualitative aspects such as a company's specific purpose, direct access to the business, additional financial flexibility afforded by stakeholders, nature of the business written, and management understanding of the captive's risk management capabilities and risk tolerances are all critical analytical factors."

AMRAE set to launch captive federation

The Association for the Management of Risk and Insurance of Enterprise (AMRAE) has announced the imminent creation of the French Federation of Company Captives.

The federation will be designed to introduce the interests of these companies into public discourse and debate, as well as to facilitate the creation and deployment of captives in France.

AMRAE notes that the combination of a hardening commercial market and emerging exceptional and systemic risks have generated a favourable context to "reaffirm the major interest" in captives as a consolidation of an organisation's overall resilience.

The association says the federation is in response to this recognised demand, having identified more than 50 French companies in 2021 with plans to create captives, several of which request approval from European regulators to place the companies in domiciles outside of France.

In a press release, AMRAE states it "deeply regrets the absence of provisions in favour of these tools in the 2022 Finance Bill", which is determined to be the cause of these companies' proposed redomestication.

AMRAE says it is also continuing its effort to establish a provision for the resilience of French companies, particularly small- and medium-sized organisations.

The association notes that it "remains confident on the favourable outcome" of the federation, anticipating that relevant draft measures will be included within the framework of France's next finance law.

SCOR: European captives show strong solvency ratios

The gross written premium (GWP) of European captives surveyed by reinsurer SCOR in its latest report increased by 4.8 per cent between 2019 and 2020, compared to 3.2 per cent the previous year. The study, 'European captives: analytical review of Solvency II reports', provides a quantitative overview of 187 European captives owned by large industrial and commercial companies that write property and casualty (P&C) risk.

The report offers a statistical analysis of the sample, divided into captive and parent company domicile, premium, assets and reserves by line of business, solvency ratios and capitalisation.

The leading sectors in the sample are energy, mining, power and utilities, food and agriculture, construction and engineering, chemicals and pharmaceuticals, and financial services.

The total assets of the sample captives amount to more than €23 billion, and write more than €4.4 billion in GWP for P&C. Of this, 84 per cent of premium was written in Luxembourg and Ireland, which are identified by SCOR as the two leading European domiciles, with 89 per cent of captives situated in either of these countries.

Luxembourg and Ireland are followed as leading domiciles by Sweden, Malta, Norway, The Netherlands, Germany and Gibraltar.

Parent companies of captives are mainly based in western Europe, including France, Belgium and Germany. Most Luxembourg-domiciled captives have parent companies based in Belgium, Spain and France, while

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Joseph Monaco
Vice President
212-303-1746
joseph.monaco@suntrust.com

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the majority (91 per cent) of US-based organisations locate their European captives in Ireland. 75 per cent of business written by surveyed captives is fronted, as there are no regulatory restrictions regarding the classes in which a captive can provide reinsurance services (providing they have a partnership with a licensed fronting insurance company from which they accept the business).

In addition, 26 per cent (€1.2 billion) of the premium written by the captives is retroceded, predominantly in the marine and property lines, while the main risk is non-life underwriting risk, which makes up 68 per cent of the capital requirement.

SCOR calculates solvency ratio as the eligible own funds amount divided by the solvency capital requirement.

Captives in the sample have a strong average solvency ratio of 277 per cent, while the median ratio is around 175 per cent. The reinsurer notes that 43 per cent are capitalised at more than double the regulatory requirement.

The report was compiled by Jacky Mochel, chief technical officer of alternative solutions, and Mathieu Pasqual, deputy chief underwriting officer of speciality insurance, alternative solutions at SCOR P&C.

IFSCA receives committee recommendations for captive development

The International Financial Services Centres Authority (IFSCA) of India has received an insurance committee report recommending the development of the international finance services centre (IFSC) in Gujarat into a global insurance and reinsurance hub. The committee was formed to identify key areas for the development of insurance and reinsurance business in IFSC to ensure ease of operations, limited compliance burdens, competitive costs, ease and

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scope of innovation, and international cooperation with other established financial hubs. The recommendations presented to IFSCA specifically mention the captive insurance model as a cost-efficient form of alternative risk management, adding "there is increasing momentum of owning captives". The committee outlines that the advantages of self-risk management with customised coverage will also allow IFSC to offer flexibility in risk retention and risk transfer, as well as recapture of underwriting profits and lower administrative costs. The committee notes that IFSCA may develop a framework to enable captives to operate in the jurisdiction, adding that leading global financial centres have favourable regulatory regimes to facilitate captive operations.

"The captive model can play a vital role as a development catalyst for the insurance sector in IFSC. It will propel many corporates and reinsurers to enter the sector," the committee says. In addition, the committee recognises that IFSCA has enabled a framework for global in-house centres, which can be implemented by reinsurers to provide complimentary insurance services.

Other recommendations include the redesign of investment structures to provide insurers with additional products to mobilise funds with greater flexibility and higher returns.

The committee adds that premium financing may be introduced in IFSC as it is a "significant driver" for niche areas of insurance business, as well as the development of alternative risk transfer solutions for the global market, including insurance-linked securities, catastrophe bonds and parametric risk transfers.

The insurance committee is chaired by G. N. Bajpai, who previously served as chairman of both the Securities and Exchange Board of India (SEBI) and Life Insurance Corporation of India (LIC).

Members of the committee are: R. Kumar, chairman of LIC; Atul Sahai, chief managing director of New India Assurance; T. L. Alamelu, member of the Insurance Regulatory and Development Authority; Manoj Kumar, executive director of IFSCA; Devesh Srivastava, chief managing director of General Insurance Corporation of India; Shankar Garigiparthy, CEO and country manager at Lloyd's India; Ieva Segura Cobos, head of regulatory risk management, Asia at Swiss Re; and Sakate Khaitan, managing partner of Khaitan Legal Associates. ■

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ACC: Cell formations show democratisation

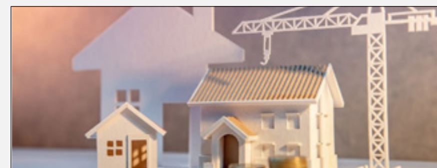
New cell formations demonstrate that the captive industry and its ecosystem is becoming more accessible to a growing number of companies considering alternative risk financing, says a panel at the Asian Captive Conference. The session, 'Democratisation of self-insurance' (to which the conference lends its sub-name), was moderated by Farah Jaafar, CEO of Labuan IBFC Inc.

Read the full article online

EY warns of tax pitfalls in captive formation

There are several tax pitfalls prospective parent companies must be aware of when setting up a captive insurance company, according to a new guide by Ernst & Young. The guide, 'Captive formation and tax pitfalls', outlines five key tax misconceptions and perils to consider when setting up a captive insurance company and choosing a suitable domicile.

Read the full article online



HUB launches renters' insurance captive

Global insurance broker Hub International Limited has formed HUB Tenant Liability Captive Insurance company to retain insurance premiums and mitigate risks for residential rental real estate clients. Multi-family, student housing and single-family residential rentals require residents to carry renters' insurance, which is traditionally offered by a third-party provider.

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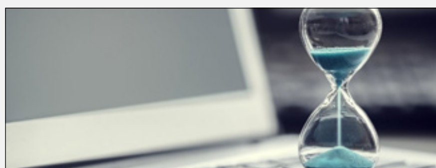
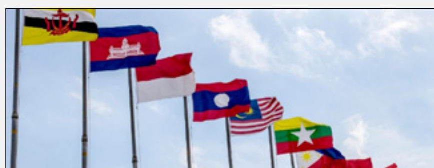


CCF: mature group captives face several potential issues

Mature group captives face a myriad of potential challenges ranging from member exits, adjustments to captive retentions, complex claims and more, according to a session at the 2021 Cayman Captive Forum.

Read the full article online



ACC: Pandemic has shown value of risk management teams

The COVID-19 pandemic has shifted the role of insurance and risk professionals by highlighting the importance of integrating and embedding risk management teams into an organisation, according to a panel at the Asian Captive Conference.

Read the full article online

Gallagher acquires WTW treaty reinsurance brokerage

Arthur J. Gallagher has completed the acquisition of Willis Towers Watson's treaty reinsurance brokerage operations, the combined business of which will trade as as Gallagher Re, the reinsurance segment of the global insurance brokerage, risk management and consulting services firm.

Read the full article online

The golden rules

Ben Whitehouse of Butler Snow and Kevin Walters of the Tennessee Department of Commerce and Insurance discuss regulatory updates and the importance of having a symbiotic relationship between the regulator and captive companies

Rebecca Delaney reports

As the captive landscape evolves to accommodate the burgeoning interest in alternative risk financing, whether in terms of new captive formations, expanding existing captives or redomestication, it is of paramount importance for parent companies to select a domicile with a strong regulatory framework based on communication and cooperation.

The majority of established state domiciles in the US have active associations that collaborate with their respective regulators. It is fundamental that regulators have a comprehensive knowledge of captives as a niche sector of a jurisdiction's wider insurance industry.

It is also important to have an ongoing communication between regulators and captive stakeholders — although this may be hindered slightly as captive owners are generally not insurance professionals, with captive managers, auditors and actuaries instead providing the required information to ensure the captive is operating under its business plan.

In discussing the nature of the relationship between regulators and captive companies, Ben Whitehouse, senior counsel at Butler Snow, identifies that as captive domiciles mature, regulators request increasingly detailed information.

"Five years ago, the conventional wisdom suggested that certain US domiciles were 'easier' or asked fewer probing questions than others. These distinctions are now largely gone — I do not see this as a negative sign, it is simply that regulators across domiciles have learned from their experiences and know more of what questions they need to ask," he explains.

Kevin Walters of the Tennessee Department of Commerce and Insurance affirms the importance of a state department's captive insurance section in providing the necessary information, answers and regulatory support to the domicile's captive industry.

"We believe a knowledgeable regulatory team working closely with industry stakeholders is crucial to a successful captive insurance company," Walters adds.

The states of play

Regulation is not stagnant, and legislation must be periodically updated to reflect the current captive landscape.

The Biden administration's tax proposals set out at the beginning of the year advocated increasing the long-term capital gains and qualified dividend tax rate to 39.6 per cent for taxpayers with over US$1 million in adjusted gross income. This means a deduction by paying a premium to a captive is more valuable, as planning for declaring and paying dividends to captive owners where they have an income lower than the threshold amount can generate substantial savings.

In addition, the administration proposed to increase the corporate tax rate to 28 per cent (it currently stands at 21 per cent, a marked decrease from the pre-2018 rate of 35 per cent). This would have a significant impact on captives as it would increase the amount of tax paid on the same amount of investment income.

It would also affect deferred tax calculations, either having a positive impact on the surplus or net worth of captives with a deferred tax asset at the time of tax rate adjustment, or a negative impact for those with a deferred tax liability.

Also at the beginning of the 2021 legislative session, many US captive domiciles introduced new and updated captive bills to their state legislative process.

For example, in April the Alabama House chamber sent captive bill amendments to governor Kay Ivey to include three new alternative risk entities (agency captives, reinsurance captives, and special purpose financial captives) and establish a new formal redomestication process.

Utah introduced House Bill 54 to reduce the minimum capitalisation requirements for sponsor captives as a response to the growing number of small- and medium-sized companies looking for alternative insurance solutions, while Delaware's Senate Bill 36 in July allowed for captives to be classified as registered series, as well as allowing a captive to enter dormancy after 12 consecutive months, rather than a calendar year, of inactivity.

Walters notes that Tennessee's latest modernisations include allowing parametric insurance coverage, incentivising redomestication from offshore domiciles through a premium tax credit, and reducing the statutory capital required by protected cell companies (PCCs) to begin operations from $250,000 to $100,000.

In response to this increased interest around cell captives, Vermont governor Phil Scott signed Senate Bill 88 into law in May to update the domicile's captive insurance law to clarify the ability of a cell to convert to a different type of cell or a standalone captive, as well as simplify redomestication processes and required documentation for licensure.

Regarding tax, Senate Bill 37 introduced in North Carolina in March proposed changes to the amount of premium tax paid by captive insurers in the state, including a provision for special purpose captives with a cell or series structure to pay the same tax imposed on PCCs.

Most notably, the state of Washington introduced a new captive insurance law to allow for the creation of a framework to register eligible captive insurers in the state — crucially and somewhat controversially, the legislation also established a 2 per cent premium tax on risks allocable to Washington-based risks.

Despite the results of an advisory ballot against the premium tax, the state's Office of the Insurance Commissioner formally adopted the regulations last month, to be effective from 21 December.

These regulatory developments over the past year aim, on the whole, to ease the process of setting up and operating a captive in the respective domiciles while adhering to the necessary administrative specifications.

Compliance is key

As with any form of regulatory requirements, there exists potential compliance issues despite the diligence of personnel in respective state departments.

Whitehouse states that any issues in compliance faced by the captive industry are practical rather than that of personnel: "As our industry grows, both regulators and captive

service providers need to attract and retain staff. Most every regulator I know either is currently advertising for open positions or have had an open position recently."

He explains that this is partly owing to the expanding opportunities available within the captive industry, which has seen more regulators shift to non-government positions.

"Captive owners and managers should be concerned that their regulator has adequate captive-focused analytical resources available. The 'captive-focused' part is most important since the alternative — traditional regulators pressed into service to cover captives or contract regulators — can have unpleasant consequences," Whitehouse warns.

In addition, Walters emphasises the importance of engagement and communication between industry stakeholders, such as actuaries, attorneys and accountants.

"Regulators rely heavily on the captive manager to ensure all aspects of the captive are properly maintained and monitored to ensure all regulatory requirements are met. This includes areas such as timely and accurate annual filings, prompt responses to regulatory inquiries, and proper engagement of key stakeholders," he explains.

However, Walters notes that such collaboration requires 'two-way street' communication from the captive industry and the domicile's regulator, where the latter must be readily available to provide the necessary standard of expertise and customer service.

Whitehouse adds: "With an increase in the turnover in captive regulators at all levels and in many domiciles, it is further incumbent upon captives to keep the lines of dialogue open. Making sure a new regulator is familiar with a complex or unusual business plan is important, especially before an issue arises."

Issues of compliance have not been as explosive in 2021 as in the past, although micro captives were reinstated on the 'Dirty Dozen' list of tax scams and abusive arrangements by the Internal Revenue Service (IRS) back in July.

Having escaped the 2020 list for the first time in five years, financial institutions were once again cautioned by the IRS that micro captives "lack the attributes of insurance" by failing to pay tax on underwriting income under section 831(b) of the US Tax Code. However, in May the US Supreme Court made a significant unanimous ruling in favour of CIC Services in the micro captive manager's ongoing litigation with the IRS, ruling that the Anti-Injunction Act does not prohibit federal courts from blocking the IRS' enforcement of regulations with affirmative reporting requirements.

Last month, a US Tax Court accepted the concessions of the IRS before trial in a case against a Delaware-based captive owner, conceding all but two per cent of the more than $27 million tax deficiencies and penalties at issue. Does this indicate a shifting paradigm in the federal regulation of captives, or merely two victories of coincidence? Only time will tell.

Looking forward, Whitehouse anticipates that the regulatory landscape will evolve to include more innovative insurance solutions from insurtech entrepreneurs, even if the programmes do not fit neatly into the box of true self-insurance, because of the captive industry's reputation for innovation.

"Captive owners and managers should be concerned that their regulator has adequate captive-focused analytical resources available. The 'captive-focused' part is most important since the alternative can have unpleasant consequences"

He adds: "If the captive industry is going to continue to be the home for insurance innovation, we will need to have concessions and accommodations with traditional insurance regulators, including those who have not been known as 'captive-friendly'."

"The continued hard market will encourage more businesses to explore alternative risk financing options, like captive insurance. We continue to see more formations and business plan changes involving companies tailoring their captive programmes to offer unique solutions to manage their risks," Walter concludes. ■

When all is said and done

Industry professionals reflect on this year's trends and challenges as the continued hardening market and abiding impact of the COVID-19 pandemic drove captive formation and expansion

Rebecca Delaney reports

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As a year measured in incremental phases by lockdown announcements, travel tier lists, vaccine rollouts and government roadmaps draws to a close, the captive industry continues to thrive amid difficulty and slowdown around the world. While posing immense challenges to governments, industries and people alike, the COVID-19 pandemic was instrumental in promoting alternative risk management and insurance as an attractive resolution to the problems present in the commercial market.

These issues are indicative of the conditions of a continued hardening insurance market, which consists of diminished capacity, high premiums, stricter underwriting standards and widespread volatility and uncertainty. This, alongside the lingering impact of the COVID-19 pandemic, generated a favourable environment for the captive industry as a provider of coverage that is too expensive or simply unavailable in the traditional insurance market.

The Marsh Global Market Index reveals that commercial prices increased by 15 per cent in Q3 2021. “While increases are moderating somewhat and new capacity is entering certain markets, such as directors and officers (D&O), this is the sixteenth consecutive quarter of global price increases,” explains Lorraine Stack, managing director of Marsh Captive Solutions.

This is affirmed by Peter Kranz, captive practice leader at Beecher Carlson. He says: “While there was some tempering of the traditional insurance market pricing, albeit from triple-digit increases to high double-digit increases, there were increases in exclusions and decreases in capacity, continuing to push more organisations into risk retention and captives.”

> *“The ongoing hard market conditions have provided a backdrop for captive development and expansion, both in terms of new formations as well as optimisation and greater utilisation of existing captives”*

With many insureds experiencing a fourth year of tough renewals, Stack notes that the further increases in fronting and collateral costs has caused insurers to reconsider exposures and restrict terms for some large, complex risks, particularly those in the auto, chemical and waste industries.

She adds that these hard market conditions and subsequent volatility are “likely to remain in the near future” owing to uncertainties in the commercial market over the impact of natural catastrophe events, increasing climate-related losses and supply chain interruptions following extended periods of national lockdown.

Captive growth is traditionally driven by such challenging insurance conditions. As anticipated, this market activity, combined with greater focus on captives, has caused an increase in formation activity in 2021 compared with 2020, a trend which is affirmed across numerous domiciles, adds Kranz.

“The ongoing hard market conditions have provided a backdrop for captive development and expansion, both in terms of new formations as well as optimisation and greater utilisation of existing captives,” says Mark Elliott, CEO of Humboldt Re and chairman of the Guernsey International Insurance Association (GIIA).

“Rate increases by the global commercial marketplace carried over into 2021, both on the insurance and reinsurance side. These last two years of market challenges led to the explosion of new single-parent captives, group captives, risk retention groups, and especially protected cell companies (PCCs) and cell captives,” adds Michael Serricchio, managing director at Marsh Captive Solutions.

Stack notes that Marsh is set to implement around 100 new captive formations, on top of a similar number in 2020.

“We are seeing increases in the premium written by the existing captives we manage. Fifteen of our domiciles saw premium growth of more than 20 per cent in 2020, including some of the most mature domiciles such as Bermuda, Cayman, Singapore and Guernsey,” she adds.

“We are also seeing significant acceleration in the number of cell formations globally, suggesting that the challenging market conditions are impacting the types and sizes of companies that were not traditionally users of captives.”

Marsh’s annual benchmarking Captive Landscape Report indicates a 53 per cent increase in new cell formations, attributed to the simplicity, cost and ease of set-up. However, the report noted that cells still only make up less than 10 per cent of total captives managed by Marsh, with single-parent captives remaining the most popular structure despite a slower 6 per cent increase in new formations.

Where there’s a risk, there’s a way

In 2021, companies were encouraged to assume greater control of their risk financing structures to incorporate captives and even consider insurance-linked securities (ILS) markets to a greater degree.

“All of this is indicative of a fundamental change in the risk financing landscape which, absent an incredibly sudden soft market, may continue for several years,” Kranz comments.

As well as changes to the structural landscape of the captive industry, 2021 saw notable developments in the type of coverage offered by captives as a response to market conditions and new emerging risks.

Serricchio explains that as the commercial market changed, hardened and challenged, “the captive market responded to their owners’ needs by allowing them to take large global retentions or deductibles, and having the captive fill in on that layer, both directly written and reinsurance from fronting carriers where needed”.

Aon’s 2021 Global Risk Management Survey, published in October, noted that the pandemic highlighted the increasing importance of firms’ ability to manage long-tail risks, including cyber and business interruption, as they shift their focus from event-based to impact-based risk assessments. Elliott observes an overall restructuring of programmes, including a trend of increased retentions in traditional

lines such as property and casualty, as well as captive involvement in structured reinsurance solutions. Notably, he points to a "significant uptick" in captives writing coverage for cyber and D&O liability, as these are lines where market capacity has declined and premiums have increased considerably.

D&O in particular has been identified as a significant emerging risk being written more into captives, which Serricchio highlights is another example of captives being effectively utilised to respond to the problems in the commercial market.

"Captives are fulfilling that need with all of those different types of deductibles, excess quota shares, and even these new emerging risks that are finding their way into the captives," he says.

Stack adds: "Over the last 18 months we have seen increased use of cell captives, including PCCs and segregated account companies, to secure Side A D&O coverage. We have formed Side A D&O cells in Bermuda, Guernsey and Washington DC, with an application underway in Malta."

Beecher Carlson's Kranz indicates that, owing to recent claim activity, cyber risk has seen an increase in exclusions, most notably for ransomware. This, in combination with forced increased retentions and reduced excess capacity, has made captives a more viable solution for providing coverage for cyber risk, particularly during the pandemic where remote working models exposed the vulnerabilities in companies' systems.

Cyber risk was particularly emphasised at this year's Airmic conference — one of the first to return to an in-person event after the pandemic — and in the association's annual survey reports, which identified that the commercial insurance market is vastly ill-equipped to meet the needs of organisations regarding scope of cover and capacity as premium rates rise to as high as 400 per cent.

The Airmic survey also noted that cyber risks are the most likely new risks to be financed by captives. This will target a range of common gaps in cyber coverage, including a lack of proper asset inventory, poor identity and access management, lack of segmentation, and an emphasis on security at the expense of resiliency.

"In 2021, cyber has become increasingly problematic for insurers and insureds alike, largely due to recent high-profile ransomware claims. Premiums are rising, and insurers are seeking to limit coverage, indicating a marked reduction in appetite for cyber risk in the commercial insurance market," Stack affirms.

Serricchio notes that, although an emerging product rather than an emerging risk, the rising use of parametric insurance and alternative structured risk has seen captives participate in more creative and strategic methods of purchasing insurance, particularly to finance catastrophe risks such as earthquakes, wind and flood.

The pandemic encouraged the use of captives for business interruption by exposing coverage gaps and causing companies to reconsider their risk management programmes to ensure they adequately addressed business interruption issues.

GIIA's Elliott affirms that the optimisation of business development opportunities to capitalise on the favourable market conditions was prominent in many firms' development agenda in 2021.

"Over the last 18 months we have seen increased use of cell captives, including PCCs and segregated account companies, to secure Side A D&O coverage"

Captive managers had to ensure they had the resources available to efficiently and effectively manage the heightened demand for captive consulting services, such as feasibility studies and strategic reviews. Stack highlights that this was a priority for Marsh, as well as consolidating local resources in domiciles to deal with the higher number of formations. Elliott also points to talent recruitment as a significant priority in 2021. In the context of the ongoing talent crisis in the captive industry, the lack of sufficient education and awareness surrounding captives as a niche sector of the already misinterpreted insurance industry has created challenges in talent acquisition and retention.

Serricchio adds that although it is inevitable that organisations have some natural attrition of staff, it is fundamental to find and retain talent that understands the industry and is able to process and handle new captive formations from a service provider, actuarial, audit, legal and regulatory perspective.

Through internships, mentor programmes, skills training and networking opportunities, the industry has made strides to address this dubbed 'crisis' in recent years, and 2021 was no exception. Although the pandemic exacerbated the practical issues associated with conducting training and networking online, the majority of in-person events looks set to resume in 2022, fuelling the skills, knowledge and networks of the next generation of captive professionals.

Regulatory developments

While the focus this year was predominantly on the alternative risk solutions being developed in the markets, there have also been some interesting updates in US states concerning the direct procurement tax.

Kranz highlights Washington as the key example, where a captive insurance law passed in May (similar to procurement tax changes passed in Minnesota in 2020) allowed for the creation of a framework to register eligible captive insurers in the state and imposed a 2 per cent tax on the insurance premiums provided to the captive's parent company or affiliate in the state. Although the Washington electorate voted in a ballot measure to repeal the premium tax, this was a non-binding advisory vote and the Washington Office of the Insurance Commissioner formally adopted the captive regulations last month.

The bill attracted criticism from senior figures in the captive industry in its draft stages as a potentially detrimental precedent surrounding the regulatory oversight of state commissioners and the status of US states as captive domiciles.

"We have seen other states make clear they are not going to pursue such taxes, but it is an added complexity to the evaluation of domiciles based on where the captive parent and risk is located," Kranz comments.

Across the pond, a slightly more optimistic view: the Guernsey Financial Services Commission's pre-authorisation pilot scheme for cell captives was successfully implemented by Robus Group's PCC for a client's professional indemnity programme.

Elliott explains: "[This gives] insurance managers the ability to respond quickly to put in place captive insurance solutions towards the end of challenging insurance programme renewals."

More broadly, EU-domiciled captives continue to await the final results of the European Commission's ongoing review of Solvency II — in particular the proportionality principle, which is designed to ensure the requirements and powers of supervisory bodies are proportionate to the nature, scale and complexity of risk inherent in the business of the insurer or reinsurer.

This is particularly important for captives as it will ensure that regulatory requirements do not become too onerous. In the review's next steps, the European Parliament and member states of the European Council will negotiate final legislative language based on the commission's proposals.

In terms of international regulations, while not taking effect until 1 January 2023, captives are recommended by Marsh to begin preparing for the implementation of International Financial Reporting Standard (IFRS) 17.

Comparative reporting under IFRS 17 will enforce material changes to the way in which captives value and report on insurance contracts, with Marsh recommending captive managers to be mindful of contract boundaries, underlying clauses, probability-weighted future cash flows, risk appetite and contractual service margins.

In addition, 2021 saw the Organisation for Economic Cooperation and Development (OECD) finalise its anti-base erosion and profit-shifting framework, which determined that multinational enterprises will be subjected to a minimum global tax rate of 15 per cent from 2023.

The two-pillar plan to ensure a fairer distribution of profits and control competition over corporate income tax was endorsed by leading captive domiciles, including but not limited to Bermuda, Cayman Islands, Guernsey, Hong Kong and Luxembourg.

Marsh's Stack comments: "The potential impact of the minimum tax rate on major captive domiciles remains to be seen as the proposed programme to reform international taxation has not yet been finalised. The proposed legislation has the support of more than 130 countries, including the G20 and much of the OECD, and most of the world is monitoring how it will proceed."

She adds that 2021 has seen an emerging trend of regulators requesting certain ESG disclosure as the wider insurance industry

adopts and integrates ESG principles into its agenda and strategy.

Airmic's annual survey named regulatory compliance in the context of ESG as the number one 'hot topic' of insurers, with climate change specifically being a fundamental area where insurance buyers and insurers must work more collaboratively in the future.

"Indeed, Guernsey launched an ESG framework in 2021 setting out requirements for the insurance industry there in terms of governance and disclosures," Stack notes.

Other disclosures include the Task Force on Climate-related Financial Disclosures (TFCD). Almost 40 per cent of risk professionals in Airmic's annual survey stated that their organisations are ready for TFCD reporting, with a significant number of respondents viewing regulations and reporting requirements as an opportunity to hone their focus on ESG issues and improve their organisation's resilience and profit margins.

"While we expect much in the ESG space will be influenced by the captive parents' approach, there will still certainly need to be due consideration at captive board level. We fully expect to see more activity in this area in 2022."

Challenges

Although the captive industry has undoubtedly reaped the associated benefits of the hardening market and pandemic, this does not mean the year was without its challenges.

Kranz explains that over the past several years, the reaction of the traditional insurance market "has been an impetus to more creative solutions being developed, partly out of necessity and partly out of opportunity".

He observes a slight shift in reinsurance markets offering large limits on integrated aggregate programmes, explaining: "On other such programmes, it means we might need two to four markets to fill out a US$50 million to $75 million panel. The markets are looking to diversify where their capacity is deployed, which makes such structures more feasible for more companies that are not of this scale."

Litigation between captives and the Internal Revenue Service (IRS) continued throughout 2021. In May, the ongoing case between CIC Services and the IRS saw a landmark unanimous ruling by the Supreme Court in favour of the captive manager, which determined that the Anti-Injunction Act does not prevent federal courts from enjoining the IRS' enforcement of regulations that establish affirmative reporting requirements.

More recently in the case, a federal judge issued a ruling temporarily forbidding the IRS from enforcing Notice 2016-66 against CIC Services, pending final resolution of the case.

Elsewhere, in November, the concessions of the IRS were accepted in a US Tax Court in a legal challenge against a captive owner. Following issuances of statutory notices of deficiency for three tax years of more than US$27 million, the IRS conceded the amounts of tax and penalties at issue. Whether this marks the beginning of a precedent remains to be seen in 2022.

Elliott adds that, from an association perspective, the most significant challenge in 2021 was resourcing to handle the increased demand for captives and alternative risk financing, as well as ensuring business continuity in a remote working and restricted travel environment.

"The key challenges right now for us all are to manage growth, and to drive innovation in creating new products to enhance the role of the captive in the risk financing ecosystem"

Ensuring the mental and physical wellbeing of employees to keep staff engaged, happy and healthy was one of the biggest challenges of 2021, Serricchio adds. He notes that organisations strove to use their technology to their best advantage to maintain smart, simple and efficient processes in the remote working model.

As the world cautiously but optimistically returns to normal — or at least a state of 'new normal' — the captive industry remains confident in sustained future growth, with Stack affirming that "the captive industry is in a great space in 2021, with demand at a high".

"The key challenges right now for us all are to manage growth, and to drive innovation in creating new products to enhance the role of the captive in the risk financing ecosystem. For the longer-term, attracting new and diverse talent and succession planning will be key to the continued health and success of the industry," she concludes. ■

The Tennessee Department of Commerce and Insurance (TDCI) has named Jonathan Habart as director of its captive insurance section.

Habart previously served as the captive insurance section's assistant director since October 2020, and has been interim director since August 2021 following Belinda Fortman's departure. Other previous roles in the department include staff examiner and captive insurance specialist, before which Habart held various roles in the Tennessee Department of Finance and Administration.

Commenting on the appointment, Commissioner Carter Lawrence says: "Jonathan proved to be the strongest candidate for the position because of his proven leadership, institutional and regulatory knowledge and his close working relationships with Tennessee's numerous captive companies and the Tennessee Captive Insurance Association."

"With Jonathan firmly in the director's role, I am confident that Tennessee will continue to build on our reputation as a first-choice domicile for captive insurance companies both domestically and internationally."

Recent modernisations to Tennessee's captive statute include the authorisation of parametric insurance coverage, as well as reducing the statutory capital required from protected cell captive insurers from US$250,000 to $100,000.

The department notes that Tennessee is currently ranked tenth worldwide for captive domiciles, and is the sixth largest domicile in the US, with 150 active licensed companies and 336 cells with annual gross written premium of more than $1.72 billion. ■

Marsh has appointed Pat Donnelly as president of Marsh US and Canada, effective 1 January 2022.

Donnelly currently serves as head of Marsh Speciality for Marsh US and Canada.

In his new role, Donnelly will report to Martin South, whom he also succeeds, as South will assume the roles of president and CEO of Marsh and vice chair of Marsh McLennan.

Donnelly will be responsible for overseeing Marsh's insurance brokerage and risk advisory businesses across the jurisdictions. He will also join the executive committee. He previously served as CEO of JLT Specialty US before the insurance broker was acquired by Marsh McLennan in 2019.

South says: "Marsh US and Canada has a talented team, and the region has consistently stepped up to help our clients through a challenging risk landscape over the last 18 months."

"Pat's experience and leadership will help Marsh US and Canada continue to achieve its business goals, meet clients' challenges in the years ahead, and offer enhanced opportunities for our colleagues."

Donnelly adds: "Organisations across the US and Canada are faced with unprecedented challenges to their business operations and their resilience plans have been tested to the limit. I look forward to working with the colleagues across the region to develop the solutions that will enable firms to face the future with greater confidence, contributing to their success."

Marsh McLennan also named Dean Klisura as president and CEO of Guy Carpenter, effective

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1 January 2022. He, along with South, will report to group president and chief operating officer John Doyle, who will in turn report to president and CEO, Dan Glaser.

Business, banking and insurance law firm Paul Frank + Collins (PF+C) has appointed David Angus as counsel, bringing his captive insurance and transactional practice from The Angus Firm to PF+C's captive insurance team.

The captive insurance team offers captive insurance representation and tax advice to incorporated cell captives, group captives and risk retention groups domiciled in Vermont, South Carolina, Arizona, Texas, Missouri and New York.

In his new role, Angus will be responsible for providing experienced legal services to captive insurance businesses and individuals, ranging structure and formation to corporate governance and compliance.

He will also provide assistance in contract drafting and negotiation, such as reinsurance agreements, retrocession agreement and insurance policies, as well as business law, including entity selection, mergers and acquisitions, business succession planning, and dissolution.

Stephanie Mapes, head of PF+C's captive insurance team, comments: "The Vermont captive industry is booming, and the PF+C captive team continues to grow. Dave has been a part of the Vermont captive legal community for many years now, and we are so fortunate that he has joined us."

"Dave comes to us already experienced, rounding out our capacity to serve captive insurers and risk retention groups, so that they can serve the objectives and higher purposes of their owners."

Peter McDougall, president and member of the captive insurance team, adds: "Dave is well known and well respected in the captive insurance community and our community at large, and adds further strength and depth to our captive insurance team."

Lockton New Zealand has appointed Peter Lowe as CEO.

Launched in September, the brokerage's New Zealand operations will benefit from Lowe's background in alternative risk financing and reinsurance, having designed, placed and managed risk financing programmes for a portfolio of global insurance accounts.

He previously served as CEO and director of Willis Towers Watson New Zealand, before which he was chairman of the firm's Australasian alternative risk transfer and captive practice, where he was responsible for the management of all captive insurance companies in Australia, New Zealand and the Pacific.

Lowe currently serves as president of the New Zealand Captive Insurance Association.

Lockton New Zealand also recently appointed Myra Fernando as captive accountant. Since 2019, she has helped to form and manage captive insurance companies for businesses in New Zealand and Australia.

Fernando previously held the position of captive accountant at Willis Towers Watson and insurance and consumer specialist at Marsh, respectively.

MAXIS Global Benefits Network has appointed Paul Lewis as global head of business development, reporting to CEO Mattieu Rouot.

He succeeds Ricardo Almeida, who joins Mercer Marsh Benefits to lead the Latin American and Caribbean employee benefits business.

In his new role, Lewis will be responsible for overseeing the four business development regions of MAXIS GBN, a joint employee benefits venture by MetLife and AXA. He will also sit on the executive committee.

The business development function has seen year-on-year double-digit growth in premium volume over the last five years with a portfolio of more than €1 billion. MAXIS GBN works with around 50 per cent of multinationals in the employee benefits captive space.

Lewis previously served as director of business development for the Americas, before which he was business development manager for the US East region. Before MAXIS GBN, he held the position of regional sales manager for expatriate benefits at MetLife.

Commenting on his appointment, Lewis says: "I am delighted to be taking on this new position and look forward to working closely with our highly talented teams around the world to continue growing MAXIS GBN's business globally."

"My ambition is to build on the success we have seen in all regions since the launch of the joint venture in 2016 and continue to be the easiest global benefits network to work with." ■

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