captive insurance times
The primary source of global captive insurance news and analysis
JULY 2022 - Issue 245

Hashing it all out

The potential impacts of implementing smart contracts in the insurance industry

Asia Insight

The growth potential of a competitive captive market

Domicile Selection

Beyond the typical captive and protected cell domicile considerations

Bermuda Focus

A strong captive market bolstered by emerging structures and innovation

Insurtech

The current state of the global insurtech market and lingering technology constraints

VERMONT CAPTIVE INSURANCE
OVER 1,100 CAPTIVES LICENSED

Risk management isn't about choosing better next time.

When you choose to domicile your captive in Vermont, you can be confident you chose correctly. With nearly 40 years of regulatory experience coupled with an unparalleled service provider network and legislative partnership, Vermont offers companies the sensible, secure and supported domicile they need.

Connect with us and see why Vermont sets THE GOLD STANDARD.

VERMONT
www.VermontCaptive.com

captiveinsurancetimes

Issue 245

www.captiveinsurancetimes.com

Published by

Black Knight Media Ltd

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

Follow us on Twitter: @CITimes

Copyright © 2022 Black Knight Media Ltd
All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without permission in writing from the publisher. Company reg: 0719464

In this issue

Blockchain and Smart Contracts

Kyle Owens and Matthew Queen provide an overview of how smart contracts could be implemented in the insurance industry, and the implications for captives

page 16

News Focus

page 6

Asia Insight

The growth potential of the competitive captive market, as well as emerging risks and regulatory regimes

page 22

Domicile Selection

Ian-Edward Stafrace outlines beyond the typical captive and protected cell domicile considerations

page 26

Bermuda Focus

The island's promising captive market bolstered by emerging structures and economic substance requirements

page 32

Insurtech

Implementation of technology solutions in the captive industry and the current state of the global insurtech market

page 38

Industry Appointments

MSL Captive Solutions has appointed Julie Frink as assistant vice president, underwriting lead to provide strategies for customs solutions

page 42

Direct access to the UK and EU market

Capital, time & cost efficient alternative to a standalone insurer or captive

People you can trust

Discover the advantages of our protected cell facilities

Why Atlas?

- A leading Maltese insurer since the 1920s. In 2006 was the first EU insurer to convert to a PCC.
- **Recognised independent EU PCC experts** having assessed and implemented a variety of direct third-party, reinsurance and captive cells, including hosting cells for clients of global management companies and consultancies.
- **Active non-cellular core** - Allows greater flexibility including cells writing third party or compulsory classes.

Why Malta?

- Only full EU member state with PCC legislation.
- Avoid fronting cost through **EU Passporting.**

We offer benefits under Solvency II

- **Less costs** thanks to shared governance, risk management and reporting.
- **Less capital required** as Atlas core capital surplus over SII requirements provides significant support.

Contact us to find out what we can do for your company
t: +356 2343 5411 e: cells@atlaspcc.eu **www.atlaspcc.eu**

Atlas Insurance PCC Limited is a cell company authorised by the Malta Financial Services Authority to carry on general insurance business.

New Vermont law allows captives to enter parametric contracts

Governor Phil Scott has signed House Bill 515 into law to update Vermont's captive insurance statutes and eliminate inconsistencies. The main feature of the new legislation enables captive insurance companies to enter into parametric risk transfer contracts.

Parametric contracts are becoming increasingly common as another form of protection for catastrophic events, whereby the contract pays a sum conditional on certain predefined, quantifiable triggers, rather than the actual losses incurred.

Therefore, parametric risk transfer contracts are seen as more favourable than traditional indemnity insurance as they are not subjected to a lengthy claims adjustment process.

On this note, deputy commissioner David Provost of the Vermont Department of Financial Regulation says: "Although purely parametric contracts are not considered insurance due in large part to that distinction, the contract is a useful risk management tool."

He continues: "Organisations often use captives as a central repository for all types of risk management tools, not just insurance, so it will be helpful for companies to have explicit authority for their captive to enter into parametric contracts."

The new Vermont legislation also addresses sponsored cell captives, in particular, by improving solvency procedures so that other cells are not impacted or limited in their authority in the event of an individual cell becoming insolvent, and by clarifying an inconsistency related to the treatment of affiliated business in sponsored cell companies. The new legislation also simplifies reporting requirements with a more straightforward report for premium tax reconciliation on a fiscal year basis. ■

Labuan IBFC: Captive promotion over next five years

Captive insurance is an emerging niche that will be targeted by the Labuan International Business and Financial Centre (Labuan IBFC) in its strategic roadmap for 2022-2026, designed to support the region's momentum of economic recovery.

The roadmap was detailed in a speech by Malaysia's finance minister, Tengku Zafrul Aziz, who noted that the strategic plan represents an opportunity for the Labuan Financial Services Authority (Labuan FSA) to charter the course for Labuan IBFC's business expansion over the next five years.

With the underlying theme of market sustainability, the strategic roadmap is based on the current strengths of the jurisdiction and expansion of sectors with growth potential.

The first focus is diversification into innovative business solutions by revitalising niche sectors and promoting captive structures. Global corporations from Europe and West Asia looking to expand into East Asian markets will be encouraged to establish captives in Labuan.

Labuan IBFC is currently home to 229 insurers and insurance intermediaries, with total premiums underwritten worth approximately US$2 billion as at year-end 2021. Captives have become the second largest insurance segment, with gross premiums of US$569 million, more than 60 per cent of which came from international markets.

In his speech, Aziz noted that Labuan stands out as a unique domicile owing to its protected cell company (PCC) legislation, which allows for the establishment of PCCs as a cost-effective, 'democratised' alternative to traditional pure captives.

images by rabbit75_fot/stock.adobe.com

COMMITTED
COMPETITIVE
WITHOUT THE RED TAPE

NC DEPARTMENT of INSURANCE
CAPTIVE INSURERS

Discover why North Carolina is the best domicile choice for your captive insurance company. Visit **www.nccaptives.com** or contact **Jackie Obusek** at **919.807.6165** or **Jackie.Obusek@ncdoi.gov** to learn more about the North Carolina captive program.

As well as captive insurance, the strategic roadmap is focused on promoting market facilitation and visibility through intra-Labuan business synergy, and enhancing the IBFC's complementary roles to Malaysia's financial markets through consolidated international ties with Asia.

A.M. Best: Captives need more sufficient cyber data

Despite the hardening market and capacity restrictions driving captives as an attractive risk management option for organisations' cyber risk, sufficient and reliable cyber data for captive insurers remains severely lacking. This is according to a new market segment report by A.M. Best, 'US cyber: the hardest of the property and casualty markets'.

The report finds that the cyber market continues to grow, citing a 75 per cent increase in direct premiums in 2021.

A.M. Best adds that ransomware attacks, aggregation risks and social engineering scams remain critical challenges for the insurance industry, while captives are being utilised as a strategic tool to provide cyber coverage, owing to proximity to the parent company — physically, culturally and enterprise-wide.

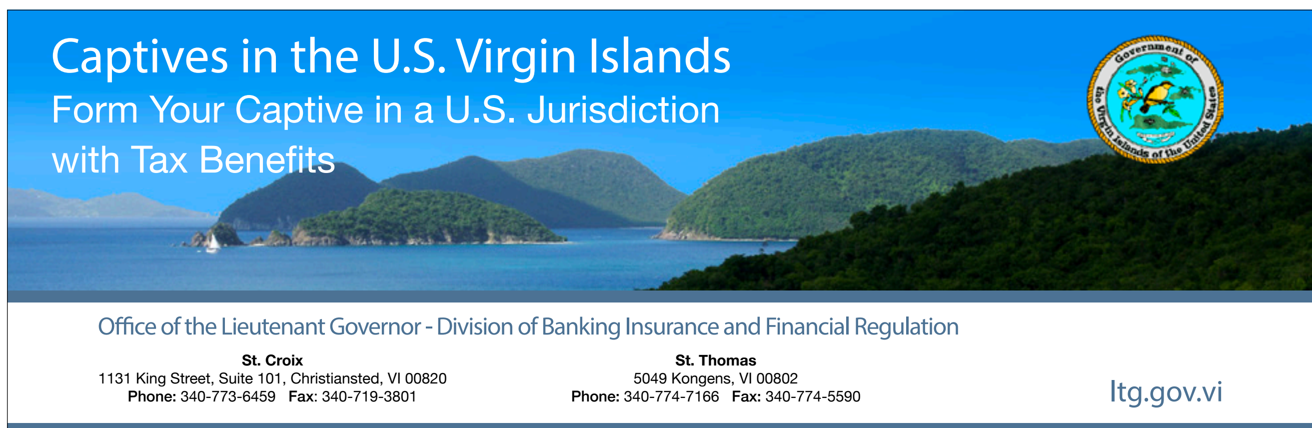
However, with the exception of risk retention groups (RRGs), captive insurers do not generally file with the National Association of Insurance Commissioners (NAIC). Statutory filings required on a jurisdictional basis do not tend to demand specific data for cyber programmes. NAIC data for 2021 found that RRGs wrote around US$19 million in cyber premiums with limited coverage, with some pure captives writing multi-million dollar limits and premiums.

The report identifies that many domiciles have shown interest in having captives provide the same level of detail as the NAIC cybersecurity and identity theft insurance coverage supplement to improve future transparency. In addition, captives are using third-party technology and forensic cyber consultants to help with underwriting, as well as to conduct regular monitoring of the parent's cyber security policies, procedures and testing.

The report notes that, in recent years, cyber managing general agents and managing general underwriters have created their own captive or specialty insurers. In doing so, they retain a share of each risk they underwrite, demonstrating a long-term commitment to underwriting a profitable and sustainable book on a global scale.

Cyber risk modelling is naturally improving as more data becomes available. For example, threat vectors are being modelled with stochastic simulations of frequency and severity scenarios (although these are not close in maturity to more established natural catastrophe models). Although these models have not yet been real-world tested, A.M Best argues there is value in modelling as the process of validating assumptions, parameterisation, discussing results, and comparing events gives insureds and underwriters a better understanding of cyber risks overall.

Looking forward, A.M. Best recommends that, as cyber insurance only grows as a critical element of a company's risk management strategy, insurers will need to develop clear risk appetite guidelines for how much cyber risk to assume, as well as limits on the nature of the risks underwritten according to industry, geography and size of the insured.



Labuan IBFC
International Business and Financial Centre, Malaysia

CONNECTING ASIA'S ECONOMIES

THE LEADING MIDSHORE BUSINESS AND FINANCIAL CENTRE

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.

Labuan IBFC Inc. Sdn. Bhd. **(817593-D)**
Suite 3A-2, Level 2, Block 3A
Plaza Sentral, Jalan Stesen Sentral,
KL Sentral, 50470 Kuala Lumpur, Malaysia
Tel: +603 2773 8977 Fax: +603 2780 2077
Email: info@LIBFC.com

www.LABUANIBFC.com

Samuel Hale forms workers' comp captive

Employer carve-out organisation (ECO) Samuel Hale is set to form a captive to insure its US$50 million workers' compensation risk, fronted by Arch Insurance. Based in California, the ECO protects businesses in the state from excessive and unpredictable employment costs arising from fraud and litigation. The state of California has a very high litigation rate on workers' compensation insurance claims relative to the rest of the US, making it one of the most expensive states for workers' compensation premium. Carve-outs allow approved entities to handle their claim disputes through alternative dispute resolution. These compensation claims are settled quicker, and allow insurers to avoid the immense costs of the slow legal system.

Connecticut announces captive legislative changes

The State of Connecticut Insurance Department has made several amendments to its existing captive insurance legislation. Contained in the lengthy House Bill 5506, the legislative changes include modifications to several definitions. For example, "branch captive insurance company" now includes foreign captives, while "controlled unaffiliated business" includes sponsored captive insurers.

In addition, the bill adds in the definition of "foreign captive insurance company" to be any insurance company formed to write insurance business for its parent and affiliated companies and licensed pursuant to the laws of a foreign jurisdiction that imposes statutory or regulatory standards. The changes also establish a three-year look-back and waiver of penalties on outstanding liabilities for Connecticut insureds that have not paid the non-admitted insurance premium tax, and that establish a branch captive in Connecticut, or redomicile a foreign captive to the state, before 30 June 2023.

Other administrative amendments in the bill now require financial examinations

CENTRALLY LOCATED WITHIN CONTINENTAL US

EXPERIENCE TO SUPPORT MISSOURI'S CAPTIVE INDUSTRY

LAWS AND REGULATION THAT ENCOURAGE CAPTIVE GROWTH

SAM KOMO, MISSOURI CAPTIVE MANAGER, YOUR SINGLE POINT OF CONTACT
573-522-9932 | sam.komo@insurance.mo.gov
insurance.mo.gov/captives

Audit | Taxation | Accounting

Integrity meets trust

we are dedicated to streamlining the needs of your **captive insurance** company

The captive insurance industry is ever-changing and so is the financial and regulatory compliance requirements. Our team stays ahead of the curve to keep you in the know for current and upcoming changes to accounting and taxation rules that could affect you.

Our services:

- GAAP and SSAP Financial Statement audits
- Tax compliance and planning
- Startup and organizational consulting
- Projected financial statements
- Outsourced CFO services
- Internal control review

Strickland Hardee PLLC
Certified Public Accountants
INTEGRITY MEETS TRUST

www.shcpa.cpa
(336) 843-4409
info@shcpa.cpa

at least once every five years rather than every three years, while the renewal period for a certificate of dormancy is now every five years rather than two. In addition, the changes lower the amount of capital and surplus a dormant captive insurer must maintain from $25,000 to $15,000.

Crucially, the legislative changes lower the capital and surplus requirements for the majority of types of captives. Association, industrial and agency captives, as well as sponsored captives licensed as a special purpose insurer, are reduced from $500,000 to $250,000, while pure and branch captives are reduced from $250,000 to $50,000.

However, the bill also gives authority to the commissioner to impose a higher level of capital and surplus if necessary to meet policy obligations.

It also contains technical changes to the commissioner's authority to adopt regulations based on the type, volume and nature of insurance business transacted.

Hong Kong issues second and largest ILS cat bond

The Insurance Authority (IA) has licensed its second and largest issuance of insurance-linked securities (ILS) in Hong Kong, in the form of a 144A catastrophe bond.

Amounting to US$150 million (equivalent to approximately HK$1.18 billion), the catastrophe bond is sponsored by Peak Reinsurance Company via Blak Kite Re, a newly-established special purpose insurer in Hong Kong.

The 144A bond is structured to cover industry losses inflicted by typhoons in Japan. Peak Re has also entered into a retrocession arrangement with Black Kite Re to provide the company with a multi-year protection against typhoon risk in Japan.

The bond is both the largest and the first 144A cat bond issued from Hong Kong. In addition, the transaction is expected to be the first to utilise the Pilot ILS Grant Scheme

BROWN SMITH WALLACE IS BECOMING armanino
Rooted as One
Effective August 1st, 2021, Brown Smith Wallace becomes Armanino. While our name will change, our commitment to the captive insurance industry will remain the same.
Contact Alan Fine, Tax Partner and Captive Insurance Industry Group Leader, Brown Smith Wallace, at 314.983.1200 to learn more.

THE Bahamas CLEAR CHOICE

INNOVATION
EXPERTISE
LOCATION

Like its translucent waters The Bahamas is the Clear Choice for captive insurance. Located just off the coast of Florida, The Bahamas captures everything that captive owners are looking for --- expertise that nurtures innovation to meet market needs and an idyllic environment to meet, live and do business.

Go to **www.bfsb-bahamas.com** to see why our advantage is your business opportunity
or call The Bahamas Financial Services Board for more information **(242) 393.7001**
or email **info@bfsb-bahamas.com**

introduced by the Government of Hong Kong last year.

Commenting on the transaction, Franz Josef Hahn, CEO of Peak Re, says: "We are extremely proud to sponsor and complete the first ever 144A cat bond issued by a Hong Kong special purpose insurer.

"Through continued partnership with global ILS investors, Peak Re can play an important role in developing the ILS market and building resilience in Asia and beyond."

Howden acquires TigerRisk to create combined reinsurance business

Howden Group Holdings is set to acquire TigerRisk Partners, a risk, capital and strategic advisor to the global insurance and reinsurance industry, to create a US$30 billion gross written premium business.

The acquisition is expected to significantly enhance the scale and depth of Howden's reinsurance and capital markets offering to create a fourth global player in the reinsurance market.

The transaction will also consolidate the group's capabilities across its diversified brokerage, managing general agent (MGA), and data and analytics proposition.

Specifically, Howden Re's global distribution network and data-driven reinsurance expertise in international specialty treaty, facultative and the MGA sector will accelerate the growth potential of TigerRisk's US-focused reinsurance, capital markets, technology and analytics offering.

The combined reinsurance business, which will operate under the name Howden Tiger, represents almost US$400 million of combined reinsurance revenues.

Rod Fox, executive chairman and co-founder of TigerRisk, will assume the position of executive chair at Howden Tiger.

Commenting on the acquisition, David Howden, CEO of Howden Group, says: "Not only does the combination create an unrivalled digitally-driven reinsurance and capital markets business underpinned by a complementary product offering and strong cultural fit, it brings full capability to our diversified and differentiated client offering.

"I am so excited about unlocking the potential of the two businesses and I cannot think of a better place for TigerRisk to continue its incredible long-term journey." ■

www.captiveinsurancetimes.com

In Utah, we understand that companies are sophisticated and able to take greater control of their own insurance risks. It is our goal to provide affordable, diverse and flexible solutions that protect against any company's dynamic business environment.

Utah is recognized as an innovative state, fostering and supporting innovative solutions. If you are looking for an on-shore domicile to form a captive insurance company, a Utah domiciled captive is the choice for you, where Risk Management, Cost Control, and Regulation connect.

Utah Captive Insurance,

3110 State Office Building,

Salt Lake City,

UT 84114

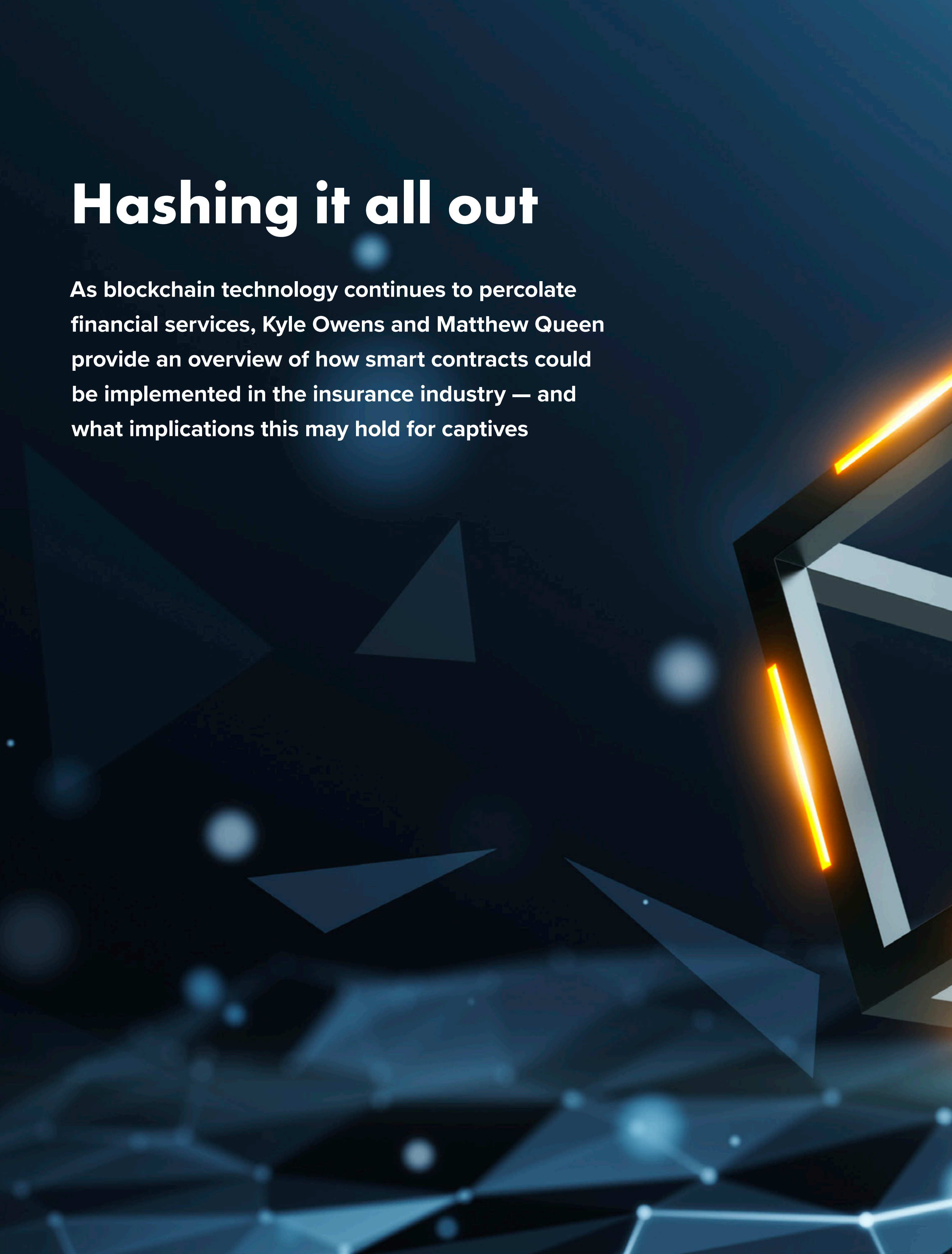
INSURANCE MADE EASY
insurance.utah.gov/captive

SCALE NEW HEIGHTS

Accounting, tax, and audit issues require knowledgeable, responsive, and customized service. RH CPAs delivers an unmatched breadth of tax and audit knowledge that fits your needs. You can count on our team to scale new heights.

CPAs
PLLC

Contact us at (336) 248-8281
for more information
or visit rh-accounting.com



Hashing it all out

As blockchain technology continues to percolate financial services, Kyle Owens and Matthew Queen provide an overview of how smart contracts could be implemented in the insurance industry — and what implications this may hold for captives

It is not an exaggeration to say that, by now, the majority of people are at least somewhat aware of cryptocurrency and the blockchain. Most online news attention is devoted to cryptocurrency centres around the success and failures of speculators making and losing their fortunes overnight.

Blockchain technology will likely have a lasting impact on finance, accounting and insurance more than the fast-rising popularity and subsequent fall of the hundreds of cryptocurrencies that currently command million- to billion-dollar market capitalisation valuations.

What is the blockchain?

A blockchain is a distributed ledger that is completely open to anyone. It has an interesting property — once some data has been recorded inside the blockchain, it becomes very difficult to change it. Each block contains:

- **Data:** the data that is stored within the block depends on the type of blockchain. For example, Bitcoin blockchain stores the details about a transaction, such as the sender, the receiver, and the amount of coins
- **The "hash" of the block itself:** you can compare a hash to a fingerprint, as it uniquely identifies a block and all of its contents. Once a block is created, its hash is calculated by computers as a string of seemingly random numbers. Blockchains are programmed so that changing something inside the block will cause the hash to change
- **The "hash" of the previous block:** this effectively creates a chain of blocks, and it is this technique which makes a blockchain so secure

But using hashes is not enough to prevent tampering. Current computers are fast and can compute hundreds of thousands of hashes per second. You could tamper with a block and recalculate the hashes of all other blocks to make your blockchain valid again. To mitigate, blockchains have "proof-of-work", along with other methods of verification.

The security of a blockchain comes from its creative use of hashing and the proof-of-work mechanism, but there is one more way blockchains secure themselves: being distributed.

Instead of using a central entity to manage the chain, such as a central bank, blockchains use a peer-to-peer network which everyone is allowed to join. When someone joins this network,

images by phive2015/stock.adobe.com

they get a full copy of the blockchain. Each individual copy of the ledger is a "node". A blockchain node can use this to verify that everything is still in order.

When someone creates a new block, it is sent to everyone on the network. Each node then verifies the block to make sure that it has not been tampered with — if everything checks out, each node adds this block to their blockchain. All the nodes in this network create consensus, and blocks that are tampered with will be rejected by other nodes in the network. To successfully tamper with a blockchain, a bad actor would need to tamper with all the blocks on the chain, redo the verification for each block, and take control of more than 50 per cent of the peer-to-peer network. Only then would the tampered block become accepted by everyone else. It is possible for governments to take a digital offensive and disrupt the chain. A captive insurance company can provide protection by providing insurance over the blockchain.

What are smart contracts?

In simple terms, it is the use of the distributed ledger to store contracts. They are just like contracts in the real world — the only difference is that they are completely digital. In fact, a smart contract is actually a small computer programme that is stored inside of a blockchain.

But why should we trust smart contracts? Stored on a blockchain, tampering with smart contracts becomes almost impossible as they have two key properties:

- **They are immutable:** once a smart contract is created, it can never be changed again. No-one can tamper with the code of the contracts
- **They are distributed:** the output of the contract is validated by everyone on the network. A single person cannot force the contract to release the funds, because other individuals on the network will spot this attempt and mark it as invalid

Smart contracts stand to replace many middlemen historically relied upon to facilitate a transaction. Using any number of cryptocurrencies, the time for transaction finality is reduced. Instead of transactions taking days to process through a bank, transactions are instead finalised nearly immediately.

An infinite number of "wallets" can be created, each within seconds, acting as de facto bank accounts without the inclusion of any third-party. Each wallet can send funds directly to any other wallet. The blockchain itself would include that transaction in one of its "blocks", the transaction would be processed by many computers using proof-of-work, and then the transaction would be settled with no bank accounts and no third-party services.

The implications to traditional banking are enormous. The peer-to-peer nature of cryptocurrency divides it from traditional currencies defined by a sovereign government. Crypto needs no such designation, and a transaction involving crypto can occur without a central bank.

Implications for insurance

The main issue here for insurance is fraud. It is all well and good that contracts could be programmed to gather and release money without a third-party, but don't we need inspectors to take a physical look at the damages and assess whether or not a claim being made is fraudulent? Not for everything. The best use case of this might be life insurance, where there are two possibilities: either an individual is dead or they are alive.

The only problem to solve is determining a mechanism to verify this fact.

Perhaps the contract is programmed to monitor a registry provided by a local government of all deaths and births within a given jurisdiction. Once an individual matching a given set of characteristics (name, age, birthday, and other identifiers) is found by the contract on the registry, the money is automatically released to the insured because everything relating to the contract that needs to happen would be programmed to automatically take place.

In this scenario, no one needs to fill out paperwork or call a representative unless there is an issue, although the better that such contracts become at performing correctly, the less this might happen.

The issue with other kinds of insurance is that damage is a matter of degree, not an either-or proposition. The question is the extent of the damage, not whether there is any damage. This becomes difficult in terms of automating the processes that could solve this problem.

There are various solutions that could in theory mitigate this issue, however. The insurance company could delegate the assessment of the damage to a specific chain or network of auto

body repair shops. If the shop certifies that certain damages have been incurred, the smart contract will pay out different amounts depending on that information.

Alternatively, it could examine rainfall data provided by some third-party for different parts of the country; if rainfall is below a specified amount for an extended period of time in a particular area, individuals owning farming land would collect on that insurance without the need for inspectors to physically view the area. These are just hypotheticals, but the theme is the same: delegate authority to an unbiased smart contract and have it refer to a trustworthy data source in order to determine when and how the funds in question are to be distributed.

When it comes to captive insurance, a similar landscape exists. If smart contracts were created for every single risk that the captive is insuring, and if there was a verifiable method of automatically discerning when the conditions of the contract have been met, large amounts of paperwork and work hours could be reduced to a fraction of their current state. However, as many captive insurers are not highly staffed, the cost savings would likely be less than that of a non-captive insurer.

In a utopian future, governmental entities in charge of setting the rules for the captive insurers, both state and federal, would allow captive insurance companies to be run entirely by smart contracts without the need for any physical participants whatsoever to oversee it.

There would be a standard set of smart contracts deemed reputable by the government which would be available for use by would-be captive insurance companies. The insured entities would still send premiums to the captive insurance company wallet on a given blockchain. This wallet would be separate from the insured, and the insured would not have access to the wallet nor be able to tamper with it in any way. Once certain conditions are determined to have been met by the smart contract, it then releases the funds back to the insured.

But we are far from such a future — or not far at all, depending on who you believe. But consider the fact that we still do not have fully autonomous vehicles in which no driver is required whatsoever. The issue is that there are too many “edge cases”. In autonomous driving, this refers to low-probability occurrences happening on the road that the computer has never had to react to before in that specific context, and then makes an error doing an automated procedure resulting in a crash.

In finance and accounting, it is items that involve subjectivity or judgement, for example, an item’s market value, or interpretation of a certain set of laws. However, it is not hard to see how these things, that are highly numerical in nature, could more easily be given up to smart contracts. For example, market values are easily found or estimated by computer programmes. The key is that enough data exists for the automated process to be accurate in its assessment. As the technological age rolls on, and because more data is collected now more than at any other time in human history, the ability of smart contracts to properly operate will increase.

Example: Kickstarter

The website Kickstarter allows product teams to create a project, set a funding goal, and start collecting money from others who believe in the idea. The developers of the project are only granted access to the funds if a certain amount of predetermined necessary funding is met by pledges from individual supporters who believe in the project.

Kickstarter is a third-party that sits in between product teams and supporters. This means that both of them need to trust Kickstarter to handle their money correctly. If the project is successfully funded, the project team expects Kickstarter to give them their money.

Both the product team and the supporters have to trust Kickstarter who, with smart contracts, can build a similar system that does not require a third-party like Kickstarter.

A hypothetical smart contract would resemble this function that Kickstarter currently serves, as they can be programmed to hold all the received funds until a certain goal is reached.

If the product gets fully funded, the contract automatically passes the money along to the creator of the project. Or, if the project fails to meet these goals, then the money automatically goes back to the supporters. With this technique, no one is in control of the money.

"As the technological age rolls on, and because more data is collected now more than at any other time in human history, the ability of smart contracts to properly operate will increase"

Looking ahead

The main effects that blockchain and its derivatives will have on insurance, and captive insurance specifically, will mainly be to give greater efficiency and thus lower cost to perform certain types of insurance transactions. Certain insurance companies may even produce their own cryptocurrencies as a payment system on their blockchain. With smart contracts, loss adjusting expenses can be significantly reduced.

The effect of this would be to finalise transactions much faster between participants on the network. It would also have some effects not specifically confined to insurance, such as incentivising individuals and organisations to hold and invest in their cryptocurrency by mechanisms such as "burning" tokens. It could also impact firms as they distribute a percentage of fees collected from transactions on the blockchain to entities that hold the token as a sort of annual percentage rate on their holdings, and essentially capture funds this way and keep them within the blockchain owner's ecosystem.

Finally, the cryptocurrency could be utilised as an investment in the hope that as the blockchain itself increases in value, so too will the tokens on that blockchain — but these effects are tangential to actual insurance. ■

Kyle Owens
Audit associate
RH CPAs

Matthew Queen
CEO
Sherbrooke Insurance Program

CAPTIVERESOURCES

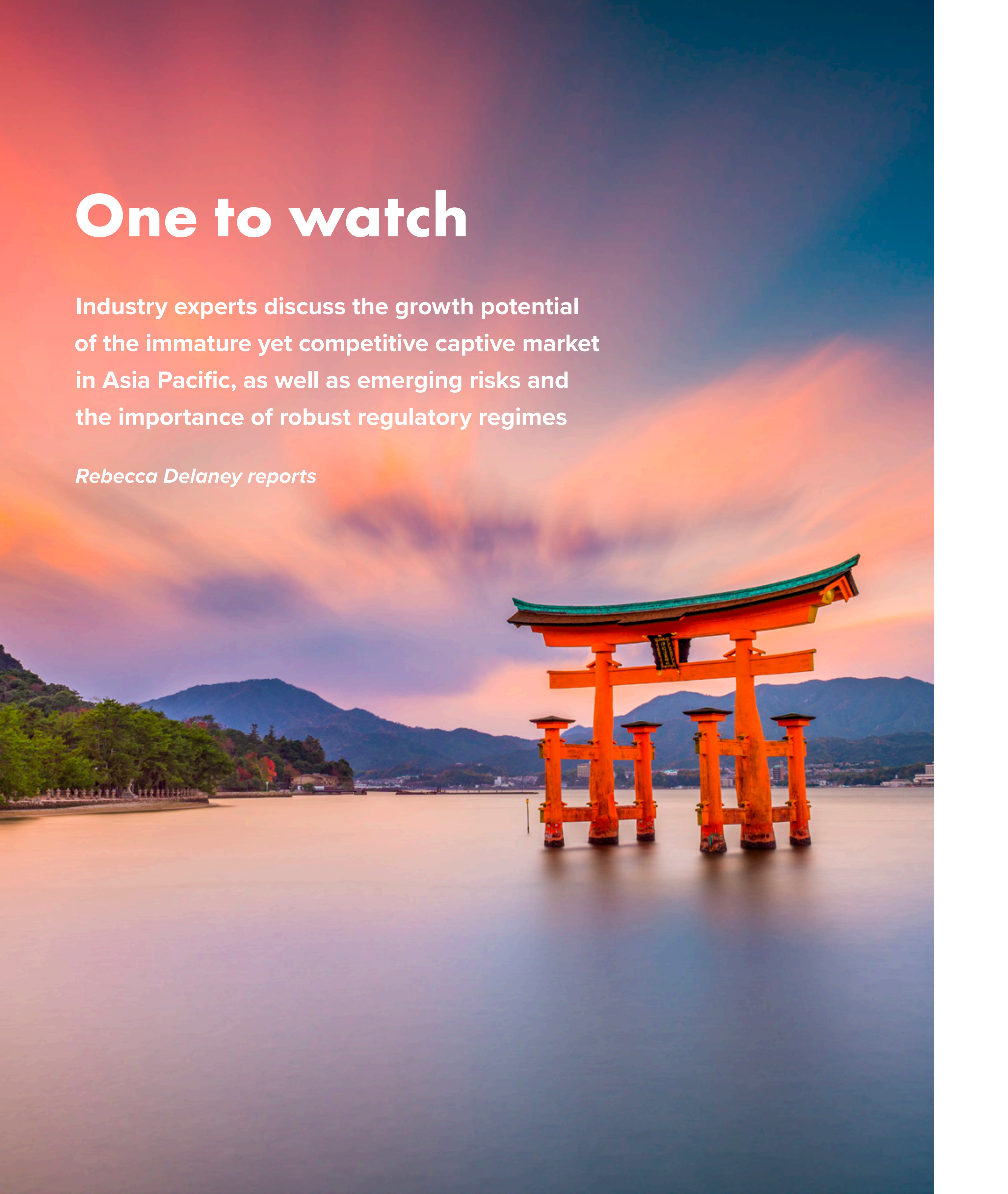
We help best-in-class companies take their risk control from good to great.

Captive Resources empowers companies to take control of their insurance programs, develop safer workplaces, and ultimately lower their cost of risk through the creation and oversight of member-owned group captives.

Our risk-reward-based group captive model attracts entrepreneurial companies and shows them how to ***reimagine insurance.***

Visit our website to learn more

www.captiveresources.com



One to watch

Industry experts discuss the growth potential of the immature yet competitive captive market in Asia Pacific, as well as emerging risks and the importance of robust regulatory regimes

Rebecca Delaney reports

images by seanpavonephoto/stock.adobe.com

The volatility experienced over the last two years has undoubtedly highlighted the interconnectivity of risk and placed risk management as increasingly critical within any organisation.

As the focus of many risk management teams shifts from event-based to impact-based assessments, as well as earlier and more detailed mapping of current and emerging risks against an organisation's risk appetite, future-proofing is particularly important as markets reopen and recover amid ongoing uncertainty.

This is particularly critical in Asia Pacific (APAC), where the diversity of the region's geopolitics and the disparity in levels of economic development poses difficulties in the generalisation of risks, especially with the proliferation of long-tail risks.

This is according to Aon's 2022 Asia Market Review (subtitled 'Managing risk in connected Asia'), which notes that as traditional industry borders dissolve, ecosystems and the digital platforms that enable them will become increasingly influential forces in the future of business and financial services.

The market review adds that digital transformation in APAC is accelerating at a faster pace than any other region, which presents unique opportunities to maximise growth. For example, in the renewable energy industry, climate change and a widening appetite for newer technologies and solutions in Asia (such as offshore wind, floating solar power and battery energy storage systems) corroborates increasingly prevalent ESG agendas.

Other emerging risks in the region, as a result of digital transformation, include business interruption, intellectual property and cyber risk. Business interruption is particularly exacerbated by geopolitical and supply chain disruptions, while intellectual. property considerations are particularly important in an innovation-driven economy. And, of course, cyber risk requires underwriting confidence as ransomware preparedness, response and recovery capabilities improve.

"There is significant potential for captive growth in Asia Pacific," affirms Lawrence Bird, director of captive and insurance management operations, APAC, WTW. "Growth has been steady in recent years and we are now seeing an increase in enquiries as the external market has hardened and continues to be challenging on price and capacity in some sectors."

Bird explains that this has led to an increase in new captive formations and the number of commissioned feasibility studies, as well as growth in existing captives in the form of increasing captive retention levels.

As with the rest of the global captive industry, Shiwei Jin, global programme and captive regional director, APAC, AXA XL, notes the hardening commercial market has motivated captives to fill coverage gaps, or in some cases take on all risk, for professional indemnity (PI) and directors' and officers' liability (D&O) lines. She adds that this is particularly seen in financial institutions in Australia, and to a lesser degree in Asia over the last two and a half years.

"We definitely see more eagerness and actual take-up from companies to either expand their use of captives or formulate captives for traditional property and casualty lines, as well as less traditional lines. Some captives see this situation as a long-term solution while others see it as a short-term fix. The new lines of business are PI, D&O, cyber, environmental and employee benefits globally, and to some degree in our APAC region as well," Jin explains.

Alastair Nicoll, regional director, captive management, Aon, adds that although most captive domiciles are receiving new enquiries and licence applications, data on how many enquiries result in new captives is not readily available. He notes that as the conference circuit opens up post-pandemic, this will boost the marketing agendas of domiciles.

A competitive market

And there is certainly no shortage of domiciles in the APAC region, each with their own unique selling points, as Nicoll points out. Singapore has emerged as a significant reinsurance centre and a global capital for Asian risk transfer, with annual statistics demonstrating that Singapore retains a slight lead over other domiciles in Asia.

WTW's Bird adds: "The majority of captive domiciles in the region, especially long-established domiciles like Singapore, are well placed to attract the increased demand for captives in Asia Pacific."

For example, in early 2020, the Singapore Government extended the Insurance Business Development captive insurance umbrella scheme until 31 December 2025. The scheme is designed to support Singapore's value proposition as an Asian insurance and reinsurance hub by granting a concessionary tax rate of 10 per cent for five years on qualifying income derived from onshore

> *"Regulatory changes to captive legislation have a critical role in shaping the future of captives in Asia Pacific"*

reinsurance by approved insurers. Captives that do not apply for this scheme are then taxed at the standard corporate tax rate of 17 per cent.

In addition, the Monetary Authority of Singapore's ILS Grant Scheme funds up to 100 per cent of upfront ILS bond issuance costs in Singapore. The first catastrophe bond issued under the ILS regulatory regime in March 2019 was sponsored by Insurance Australia Group (IAG), and structured and placed by GC Securities, to provide IAG with AUD$75 million of annual aggregate catastrophe protection for three years.

This marked an important milestone for alternative risk transfer and financing in the APAC region, which has unique disaster protection needs. Bird notes that increased interest under the umbrella of climate, catastrophe and ESG-related risks means that Singapore-listed companies are now required to include climate disclosures in their sustainability reports.

With the grant incentive extended until 31 December 2022, the wider Asian ILS market seems on track to continue to accelerate as Asian ILS products (such as collateralised reinsurance, sidecars, protected cells, and industry loss warranties) position themselves to offer an attractive diversification away from traditional US natural catastrophe risk.

Another jurisdiction in APAC that stands out as an attractive hub for international risk management and insurance is Hong Kong, with Nicoll saying: "Hong Kong authorities continue to market its benefits as a domicile."

For example, in March 2021 the Insurance Authority (IA) expanded the scope of insurable risks by Hong Kong-based captive insurers. This was designed to further consolidate the role of captive insurers as an intra-group risk management centre, as well as to reinforce Hong Kong's position as a preferred captive domicile by state-owned enterprises from Mainland China.

In addition, the Hong Kong Specialty Risks Consortium helps to match supply and demand in speciality risks, while complementing the IA's captive initiatives.

The consortium pools risk owners with exposure to specialty risks in their overseas projects with services providers (such as insurers, reinsurers, and brokers) that offer risk management, insurance and reinsurance solutions.

As well as captive insurance, Hong Kong is beginning to develop its ILS market, having issued its first ILS catastrophe bond in October 2021. Hong Kong is in a strong position to become a preferred ILS domicile owing to its status as an international financial centre with free flow of capital, while the IA recently revealed its five-year plan to leverage Hong Kong's position as a captive domicile and reinsurance hub and to solidify the strategic position as a risk management centre for mainland business.

The third important domicile for alternative risk transfer in APAC is the Labuan International Business and Financial Centre (Labuan IBFC). With protected cell legislation unique to the APAC region, the jurisdiction hosts a significant number of cell captives as a quick and convenient solution for coverage.

In addition, Labuan IBFC recently published its strategic roadmap for the next five years, which includes captive insurance as a significant pillar, by promoting captive structures to encourage economic recovery, resiliency, and market sustainability.

AXA XL's Jin summarises: "Established captive domiciles such as Singapore, Labuan and Hong Kong have been renewing or expanding their legislation for captives. This provides certainty and attraction for new captives in the region and APAC parent companies to move its captives back home."

On the importance of a robust regulatory framework, Jin adds: "Regulatory changes to captive legislation have a critical role in shaping the future of captives in APAC." This includes new regulatory regimes to create new captive domiciles and captive markets with significant growth potential.

For example, Jin outlines that India's Gujarat International Finance Tec-City (GIFT) is beginning to position itself as a captive domicile after years of the industry pushing for captive legislation in India. "GIFT's captive legislation will allow Indian-headquartered companies to form pure captives to write risk for a company's Indian-based exposures only," Jin explains. "Indian clients have been taking tangible steps to explore captives and benefit from such legislation change."

Aon's Nicoll affirms: "The regulatory environment drives a professional captive community. The well-known jurisdictions need to balance their marketing efforts with their regulatory responsibilities. Less mature domiciles spend more time marketing and the more established ones spend more time regulating."

He adds that positioning a domicile as attractive is a collaborative effort between regulatory bodies, captive managers, legal firms, and other service providers. "The tax regimes are a factor as is political stability and related captive infrastructures. Furthermore, a large part is played by the captive owners themselves, which demonstrates the reality of an effective environment in which to operate," Nicoll says.

Moving forward

Turning to the future landscape of the Asian captive industry, Nicoll highlights the importance of regulators ensuring that licenses are issued to responsible organisations that operate ethically and transparently to foster a strong captive market in the region. He notes that some regulators are now devoting more attention to captive applications with higher exposures to ESG risk.

"With increasing focus on ESG, there is a growing need for environmental risk to align with the ESG aspirations of multinational parent companies," he notes.

WTW's Bird adds that many clients are expressing heightened interest around ESG-related risks and the associated reputational implications for their company. As well as the aforementioned climate disclosures in Singapore, he outlines that the Malaysian Stock Exchange has introduced governance and diversity requirements, while China has introduced new environmental disclosure rules.

"Companies will need to extend their enterprise risk management processes to cater for ESG-related challenges, and captives will likely facilitate the financing of such exposures," Bird anticipates.

As well as ESG considerations, the future of the captive industry, both in APAC and globally, will be increasingly informed by tax schemes and systems.

Nicoll says that global adoption of the Organisation for Economic Cooperation and Development's base erosion and profit-shifting (BEPS) guidelines has induced domiciles in the APAC region to clarify their tax incentive schemes and corporate tax systems. This includes the adoption of substance and transfer pricing regulations, as well as the upcoming minimum effective tax rate under the new BEPS framework.

Bird adds that the approaching IFRS 17 for insurance companies is likely to significantly impact captives in many domiciles when the standard is introduced on 1 January 2023.

"IFRS 17 appears excessive for captives, but they will need to adopt the standards in the domiciles in the region, which is a tall order," Bird says. "Captives will need to appoint experts in this field or work with their captive managers to guide them through this process and ensure that the captive continues to give its wider group the benefits that captives bring overall."

The importance of intra-company collaboration and cooperation is affirmed by Jin, as she explains that since the COVID-19 pandemic, the risk management function is developing more robust connections with the core functions of an enterprise to improve overall resilience.

She says: "The long-term strategic view and early planning is critical for the APAC captive industry. Companies in APAC, especially multinationals, are fostering a more holistic risk management mindset."

For captives specifically, the feasibility process allows an organisation to assess and manage its risks from a more strategic perspective. This then enables data collection which can be used as a foundation to cultivate more detailed risk knowledge.

"As a result, the organisations can understand and quantify risks they face more effectively. They can also better define their risk appetite and risk financing strategy. Even if the immediate decision is not to set up a captive, the changing market conditions have opened the potential for exploring captives as a long-term strategic risk management tool," Jin concludes. ■

Hidden gems

Ian-Edward Stafrace of Atlas Insurance PCC outlines what to consider beyond the typical captive and protected cell domicile comparisons

When comparing captive and cell domiciles, the academia, guides and articles often only scratch the surface of relevant features and characteristics. Although these can help shortlist options in the face of a wide choice, some crucial aspects are often missed in the initial shortlisting and considerations.

This article covers aspects and needs that can emerge in the set-up journey, or even years later. These aspects include the need for substance in the domicile, potential to write risks directly, flexibility to change and adapt, accounting standards and ease of group consolidation, and the changing expectations of stakeholders.

New pain points will inevitably emerge over time, driven by changes in stakeholder expectations, mergers and acquisitions, or the organisation's strategy, direction or risk financing needs.

Protected cell companies (PCCs) should be considered as more than capital and cost-efficient solutions for organisations not large enough to have a standalone captive. Companies, even large corporations with established captives, should delve deeper into the solutions some cell hosts can offer to address the above needs and pain points.

It is important to move beyond legislation and regulation to determine whether the domicile hosts PCCs that:

- Have significant substance with premises and people in the domicile
- Can cover risks directly in the territories in which the organisation is or may be active in future
- Cover risks inside rather than just outside the captive domicile
- Are long-established contributors to the domicile's local economy
- Are not restricted to hosting fully funded cells and take an underwriting approach to assess the cells they host
- Have experience with cells writing direct third-party consumer insurance products
- Have non-cellular cores well capitalised beyond regulatory requirements
- Can rapidly incubate or front risks through their non-cellular core
- Are independent of international brokers

images by mizar_21984/stock.adobe.com

"With an increased focus on broader sustainability and ESG considerations, captives and cells should be helping the parent company enhance its reputation"

More traditional considerations typical in domicile comparisons include capital requirements, regulatory fees, application timelines, legislation, reserving, supervision, reporting requirements and taxation.

Although these traditional considerations are undoubtedly relevant, focusing on these alone can cause organisations to miss out on the more financially and strategically impactful domicile features and service providers. The following considerations are equally as important when selecting a domicile for a captive or protected cell.

Changing stakeholder expectations

The choice of domicile, particularly onshore versus offshore, often depends on stakeholders' expectations, whether regulators, tax authorities, investors, customers or employees.

With an increased focus on broader sustainability and ESG considerations, captives and cells should be helping the parent company enhance its reputation rather than cast doubts on its values and motivations.

Ireland, Luxembourg and Malta are key EU member states that have tailored themselves to improve understanding and proportionally facilitate captives while adhering to EU minimum standards and requirements, including Solvency II and the Insurance Distribution Directive. In addition, Malta is also the only EU member with protected cell legislation — cells can be capital efficient, with Solvency II recognising cells as ring-fenced funds.

Reinsurance cells do not need to be domiciled in the EU to cover EU risks. Offshore jurisdictions can offer lower capital and cost-base. However, growing stakeholder pressure has increased the interest in establishing reinsurance cells within the EU, including for organisations headquartered outside the EU, such as Switzerland.

Malta adopts the latest International Financial Reporting Standards (IFRS), including the new IFRS 17. While implementation may be challenging for standalone insurers and captives, PCCs help facilitate compliance as they implement it for their other cells, and in Atlas' case, for its active core. Compliance with IFRS 17 can help owners consolidate the cells in their groups with increased transparency to stakeholders.

Need for substance in the domicile

Stakeholders are raising the bar for captive substance. With shared economies of scale, Maltese PCCs give confidence in being onshore in the EU, yet without the complexities, costs and time associated with a standalone company — potentially saving capital, too.

Insurers are increasingly expected to have adequate on-the-ground staff and employed key function holders. PCCs can help address substance requirements as cells form part of a broader single entity that provides shared board, governance and key functions in Malta.

Some PCCs also actively write business through their core. For example, Atlas's core is a long-established contributor to the local economy as a traditional non-life domestic insurer with multiple branches and offices in Malta, naturally providing ample substance to the PCC. PCCs that actively cover risks in their domicile also address arbitrage objections from stakeholders on insurance companies that only cover risks outside their domicile.

Potential to write risks directly

As aforementioned, Malta is the only EU member state with cell legislation, meaning Maltese PCCs can provide cells with direct access to the European Economic Area single market. Following Brexit, some PCCs continue to provide access to the UK market. Atlas was one of the first PCCs to submit a branch application to the UK Prudential Regulation Authority. While the application is processed, new UK business continues to be written under the UK Temporary Permissions Regime.

Searching for a Trusted Captive Manager?

Retaining your own risk does not mean you need to take a chance on your captive manager.

Captive insurance allows you to form your own regulated insurance company turning an expense into a profit center for your business. In the simplest of terms, you finance your risk in a new and different way.

If you're looking to own your own insurance outcomes, look no further than Global Captive Management Ltd. Since 1982, our clients have trusted our experience, knowledge, and expertise ensuring success of their captive insurance programs.

For more information, reach out to us through our website at **www.global.ky**.

Together, we will find the right solutions for your captive.

Own Your Outcomes

Fronting partners can provide added value and simplify compliance requirements. However, they can be increasingly selective. Fronters also add costs to the programme, affecting feasibility, especially when premiums are below their rising minimums.

EU direct writing cells are slightly more costly than pure reinsurance cells. However, the saving of fronting fees can make them more cost-effective, notably where local compliance and outsourcing needs in the country of risk are limited or are handled by intermediary subsidiaries of the cell owner.

Maltese PCCs with an active core can also rapidly front and incubate risks, giving more time to assess and set up a cell. When licensing a cell before renewal, Atlas is able to underwrite the renewal through its core, providing it is already passported to all the countries where the risks are situated for the required classes of insurance.

Flexibility to change and adapt

Many offshore domiciles are well suited for reinsurance captives and cells, with typically lighter regulatory environments, lower taxation, and more rapid application and set-up timelines. Some have introduced fast-track schemes promoting the pre-authorisation of captive insurance cells to be licensed within 48 hours. For many organisations, this fits their present needs very well.

Other jurisdictions provide a more rounded and robust environment catering for the possibility of consumer distribution or potential third-party protection. Solvency II and equivalent jurisdictions also help reduce the capital cost for insurers fronting unrated captives, which can help fee, collateral and capacity negotiations.

Most PCCs are owned by intermediaries or investors who restrict the cells they host to fully funded programmes with no theoretical risk gap or potential secondary recourse to the non-cellular core. The cores of these PCCs tend to cover the absolute minimum capital needed for a core without any insurance activity.

There are then the exceptional PCCs with a broader appetite, experienced with writing consumer and third-party business across several countries. Their cores are inherently exposed to risk, so the extent of their resources and surplus capital beyond regulatory requirements becomes an essential factor to consider.

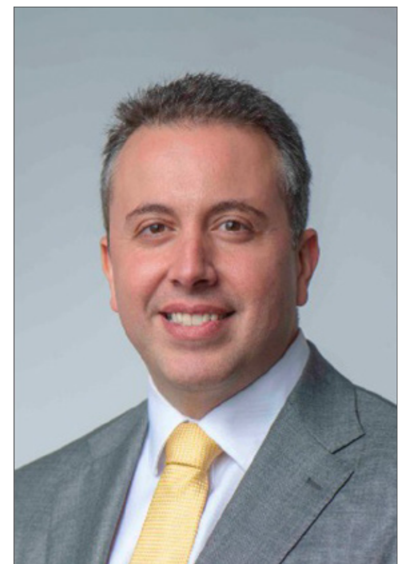
These PCCs with active cores could be used to initially set up a reinsurance cell with the option to extend the cell's licence to write third-party business eventually.

With the pace of change continuously increasing, organisations appreciate the ability to adopt an agile, iterative approach to setting up their insurance vehicles with real options to scale and evolve.

For example, Atlas hosts multiple insurtechs. Occasionally, startups with promising models do not have sufficient data or capital to set up a cell. They may have reinsurance lined up or they may wish to run a contained pilot to help them attract investors and better estimate projections.

Through its core, Atlas has assisted insurtech ventures in micro-testing parametric and other business models, for example, using blockchain smart contracts to automate underwriting and claims processes. The non-cellular core can provide a sandbox facility that improves time-to-market and the gaining of actual market data. Business plans and projections can then be revised based on experience. With these considerations, it should be clear that the organisation's strategy and domicile choice can significantly be shaped not by the domiciles but by providers in those domiciles, particularly the well-resourced and experienced PCCs that foster sustainable innovation, delivering new solutions to emerging challenges. ■

Ian-Edward Stafrace
Chief strategy officer
Atlas Insurance PCC Ltd



2022 Alabama Captive Insurance Association Annual Conference

SAVE THE DATE!
July 27-28, 2022

At the Grand Bohemian Hotel
Mountain Brook, AL

ACIA Annual Conference will provide attendees with:

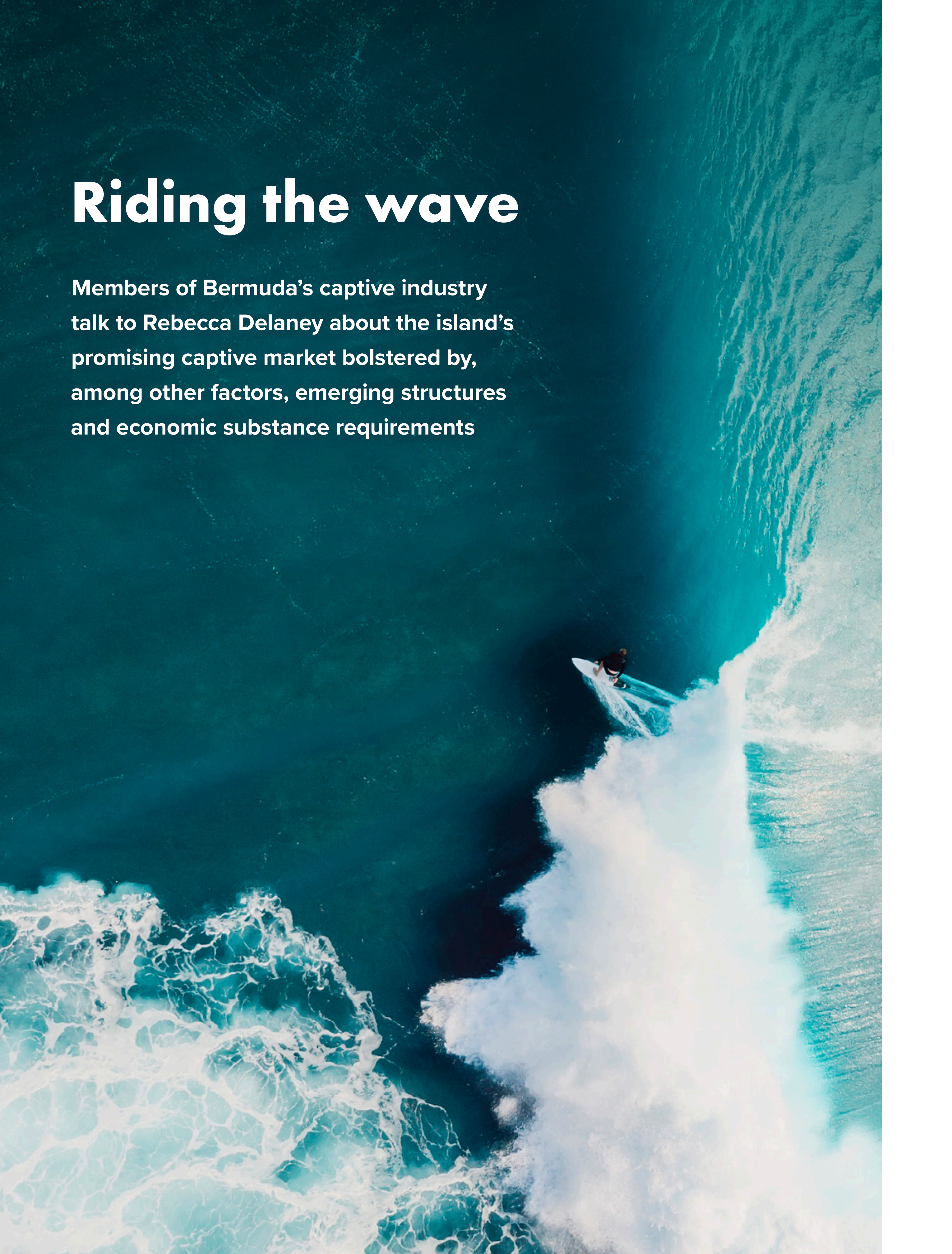
Student recruitment opportunities

Continuing education sessions

Industry networking and updates

Register at WWW.ALCAPTIVES.ORG

ALABAMA CAPTIVE
INSURANCE ASSOCIATION



Riding the wave

Members of Bermuda's captive industry talk to Rebecca Delaney about the island's promising captive market bolstered by, among other factors, emerging structures and economic substance requirements

As the global insurance market observes an increase in captive formations owing to rising commercial rates, the archipelago of Bermuda — a cluster of islands connected by bridges to form one land mass — is no exception. From having formed the first modern captive in 1962, Bermuda shows no signs of slowing down as a leading captive domicile.

Annual licensing statistics from the Bermuda Monetary Authority (BMA) report that the jurisdiction registered 78 new insurance entities in 2021, 17 of which were newly-licensed captives, while 27 of the entities were special purpose insurers (SPIs). Six of the newly-licensed SPIs were registered through the BMA's new three-day licensing and registration process, demonstrating that Bermuda's insurance sector continues to update and enhance regulatory practices.

In addition, the BMA admitted more companies offering innovative products or operating under innovative, non-traditional structures to its insurtech regulatory regime in 2021. Four organisations were admitted to the Authority's innovative hub, while a further four were registered under its insurance regulatory sandbox.

Matthew Carr, partner at Appleby Bermuda, points out that while these licensing statistics are an important bellwether for the island's captive market conditions, it is also important to recognise the activity and growth within existing captive structures.

"Based on these two metrics, current captive market conditions are favourable — captive owners are finding additional uses for existing captives, harnessing economies of scale and generating greater efficiency, while new captive formations are steady, but not booming," he says.

The BMA notes in its licensing analysis that the majority of Bermuda captive owners have a parent company based in North America. This is affirmed by David Gibbons, partner at PwC Bermuda, who observes: "We have seen growth and faster crystallisation of interest to formation over the last 18 months in Bermuda, both from traditional markets like North America, and other markets globally."

Kim Willey, partner at ASW Law, notes that the firm has recently set up captives for Canadian and Asian clients, as well as traditional liability coverage by US corporate entities and associations. She adds that interest in captives is increasingly derived from a range of locations and industries, with interest in coverage for novel areas of risk, such as weather, cyber and cannabis.

For the latter line of business, there is a trend of Bermuda captives taking on directors' and officers' (D&O) coverage for cannabis companies in jurisdictions where production of the substance is federally legal. Willey notes that this began with D&O indemnity coverage, and has since expanded to include property and product liability risk coverage.

Gibbons explains: "As the nature of business continues to evolve so does the risk. This means that organisations are looking at more bespoke covers — and one of the ways to get cover for bespoke risks is through a captive.

"This positions the Bermuda captive industry as primed for growth."

Echoing this optimism, Carr says: "Fortunately Bermuda has retained its attractiveness to captive owner clients who, after closely evaluating multiple jurisdictions, are satisfied that Bermuda has the most complete offering coupled with jurisdictional pedigree."

Regulatory environment

Such jurisdictional pedigree is by virtue of the BMA, which Gibbons describes as a "well-established and respected global regulator of all insurance companies, including captives." He highlights that the BMA's regime is both recognised by the National Association of Insurance Commissioners and Solvency II-equivalent. This is very important for an offshore domicile because people forming captives want to work in a well-established and reputable location," Gibbons explains. "Having an equivalence to Solvency II allows captive owners the option to apply if this is required. If Solvency II is not required, the captive owner can apply for a Class 1, 2 or 3 licence."

This carving out of captive classes of insurers and reinsurers from the commercial prudential regime following Solvency II-equivalence is a demonstration of the BMA's sensitivity to the needs of captive owners, according to Carr, as compliance would have otherwise been expensive and onerous.

Carr adds: "Bermuda, like many other highly-regulated jurisdictions, must attempt to strike the right balance between responsible and modern regulation, and operating efficiency for those under the remit of that regulation. For the most part, it seems this balance has been reasonably achieved. Bermuda's captive industry groups have an open channel of communication with the BMA."

images by artifirsov/stock.adobe.com

> **“When a new captive owner presents a case to form a captive, our regulators are easily available to discuss it, which is really important and sets Bermuda apart”**

The variety of insurance and reinsurance entities in Bermuda as a risk domicile of choice means that the regulatory framework must be routinely modernised to keep pace with the dynamic risk landscape.

Gibbons adds: “Bermuda is the largest captive domicile — an achievement that has been built up over decades. That knowledge is intrinsic in the regulatory environment. When a new captive owner presents a case to form a captive, our regulators are easily available to discuss it, which is really important and sets Bermuda apart.”

This interpersonal element is echoed by Carr, who notes the proximity within the city of Hamilton between the regulator, service providers, capacity providers, and other industry professionals, allows for ease of operations and business.

“As such, by and large, captive owners and those overseeing the captive business want to be on the ground in Bermuda routinely. For the most part, this makes economic substance requirements relatively easy to satisfy,” he adds.

Economic substance requirements are designed to protect the reputation of offshore jurisdictions by ensuring that revenue streams from business activities are based on actual local activity, in order to substantiate the use of low-tax jurisdictions. Discussing the necessity of economic substance regulations, Gibbons says: “As global regulation increases, the rationale behind substance requirements makes sense. It is important to have the people making decisions in the territories where the companies are based.

“In the insurance industry, it is usually easier to meet those requirements because underwriting decisions can be made by one underwriter, actuarial decisions can be made by one actuary, and so on. This allows organisations to drive fit-for-purpose, legitimate business while also understanding the requirements and being compliant.”

Captives must adhere to a deeming provision in Bermuda’s 2018 Economic Substance Regulations, according to which they must maintain a principal office in Bermuda and appoint a principal representative based in Bermuda, approved by the BMA.

Willey explains: “All Bermuda companies engaged in insurance activities, including captives, are required to comply with the economic substance requirements, which necessitate demonstrating that core income-generating activities are carried out in Bermuda.”

She adds that core income-generating activities for an insurance entity include prediction and calculation of risk, insuring and reinsuring of risk, providing client services, and preparing regulatory reports.

For an economic substance declaration, these activities include details of expenditures in Bermuda, full-time employee equivalents in Bermuda, and Bermuda-based board members and meetings.

Captives with more intensive administration, such as group captives with multiple policyholders, or captives writing third-party business, are more likely by nature to have palpable substance evidenced by dedicated employees and premises.

Willey affirms: “In practice, we do not find that it is particularly difficult for Bermuda captives to demonstrate compliance with economic substance requirements. Captives generally have a Bermuda-based insurance manager tasked with carrying out insurance activities, and a representative of such insurance manager on the captive board.”

Looking forward

Just as Bermuda reflects the promising risk landscape, it is not immune to the challenges of the industry. A significant concern felt throughout the global captive industry is around education and talent retention.

World Class
CAPTIVE
Know-How

South Carolina has long been one of the nation's premier captive domiciles. In partnership with the captive business community, our Captive Division continues to set the standard for excellence among America's captive domiciles. What sets our domicile apart from all the others?

FIND OUT.

Visit us at captives.sc.gov

The Pursuit of Captive Excellence

BOTANY BAY PLANTATION
CHARLESTON, SOUTH CAROLINA

State of South Carolina
Department of Insurance
Captive Division

CAPITOL CENTER
1201 MAIN STREET, SUITE 1000 | COLUMBIA, SOUTH CAROLINA 29201
CAPTIVES.SC.GOV

Gibbons notes that the transition of talent between industries as workers seek different challenges and opportunities, dubbed the Great Resignation, is potentially critical to the captive industry. As a bespoke sector, it risks losing a significant amount of intrinsic knowledge.

He says: “It is incumbent on the industry itself, both in Bermuda or globally, to recognise, invest in, and develop talent. It is important that the overall base of talent being developed is far greater than it was historically — and it is not just a talent base, it is a knowledge base to be utilised if key individuals exit the industry.”

Educating the market on the benefits of the captive model and supporting the business case for establishing a captive is crucial. Willey says: “Despite captive structures, which originated in Bermuda in the 1960s, being around for more than 50 years, captives remain an underutilised risk mitigation tool. With the risks to businesses ever-growing and the perpetually increasing cost of commercial insurance, captives continue to be a cost-effective risk mitigation strategy for many businesses.”

The evolving risks faced by organisations is outlined by Gibbons, particularly in the context of increasingly prevalent ESG agendas. For example, he highlights, on the environmental side, new insured lines of business include solar panels, wind farms and electric cards, while on the social side, company directors are responsible for more stringent diversity and inclusion (D&I) action and reporting.

As a hot topic on any conference agenda right now, the extensive reporting associated with ESG brings increased focus on insurers and, in turn, increasing dissection of claims risk. “It is important for companies to execute sustainability and inclusivity initiatives correctly, and to also understand the risks if they get them wrong,” Gibbons says.

“It is vital to understand the nature of the risks that are changing, as well as the evolution in what you are insuring, over time. Placing the right business into a captive is key because you want to keep the right level of capital.”

Carr adds that, as with many industries, there is a growing emphasis on efficiency of capital — as a small collection of islands, Bermuda must be conscious of the cost of transacting business. However, he notes that changes to work models from the COVID-19 pandemic and remote working options may provide efficiencies for captive operations going forward.

And what will Bermuda’s captive development agenda look like for the remainder of 2022? Willey states that the post-COVID landscape will focus on emerging structures and risks, citing Bermuda’s digital asset business regulation, adopted in 2018, as an area with considerable interest and a potential for a developing market.

She adds that Bermuda has also adopted incorporated segregated account company (ISAC) legislation, which builds on existing segregated account company legislation to allow a parent entity to incorporate multiple incorporated segregated accounts (ISAs).

“We have been involved in one of the first ISAC structures in Bermuda, which involved licensing a non-commercial insurer and each of its ISAs as a separate legal entity with its own insurance license. The ISAC model may be useful for non-commercial insurers looking to segregate areas of emerging risk from their traditional coverage,” Willey explains.

Another important element in the future of Bermuda’s captive landscape is the recent creation of the Bermuda Captive Network (BCN), a combination of the Bermuda Captive Owners Association, the Bermuda Insurance Management Association, and the Bermuda Captive Conference. Gibbons explains that BCN provides a one-stop-shop for service providers, owners and managers in the Bermuda captive industry.

Speaking optimistically of the impact the Network will have on the island, Carr says: “The newly-created BCN fuses an array of industry knowledge, information and expertise into a unified body which will have a very positive impact on the Bermuda captive market going forward.”

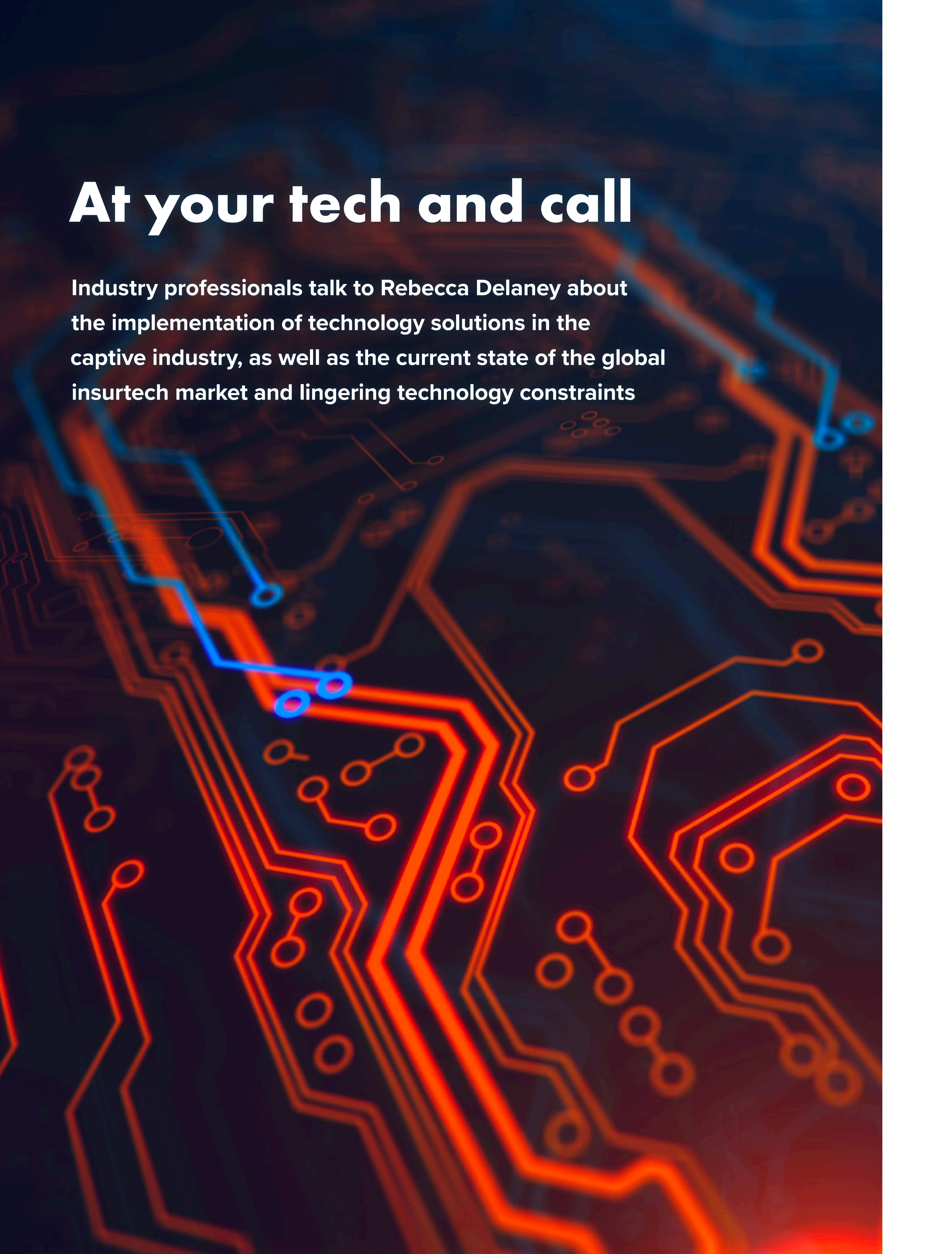
Both Carr and Gibbons emphasise the importance of the upcoming conference this September, which this year will involve more captive owners to drive the agenda and communicate with service companies. Gibbons adds that the conference will be instrumental in developing talent to address the industry-wide talent crisis outlined above.

“As an inexperienced captive professional, the ability to understand risk across an insurance company, rather than looking at individual pieces within a large insurance or reinsurance company, is great experience and can rapidly advance your career prospects. This is a solid foundation for a career in insurance beyond captives, and developing that talent will consolidate Bermuda’s existing strengths as a captive domicile,” he concludes. ■

WE KNOW CAPTIVE INSURANCE.

IT TAKES VISION

For more than 70 years, no firm has had a more complete understanding of the captive and self-insured market than Milliman. With our global reach, we routinely advise multinationals on cross-border transactions and how to meet each domicile's unique requirements—key in today's captive environment.



At your tech and call

Industry professionals talk to Rebecca Delaney about the implementation of technology solutions in the captive industry, as well as the current state of the global insurtech market and lingering technology constraints

With buzz phrases like "digital transformation" and "catalyst for change" puncturing the insurance industry, it was only a matter of time before fintech deviated into insurtech to create an entire new subsector of the industry.

Transformative technologies such as artificial intelligence (AI), machine learning and distributed ledger technology (DLT) — the most well-known example of which is the blockchain — are garnering increasing attention and investment from insurers. But is interest enough to translate into actual implementation and progress?

An underlying conclusion of the 2022 Big Data and AI Executive Survey by New Vantage Partners is that although investment in data and AI initiatives continues to grow (such as appointing chief data and analytics officers as the roles evolve within a company), achieving data-driven leadership remains a distant target for most organisations.

Essentially, despite the progression of large enterprise data, analytics and AI initiatives, as well as the accelerated take-up of these technologies, the actual implementation of AI into widespread production remains low following initial tentative steps in the captive industry.

Marcus Schmalbach, CEO of RYSKEX, describes the first implementations in the blockchain area as unimpressive and having no real impact on the captive industry. However, he continues that the developments of Web3 and the use of smart contracts "will have a disruptive impact on the industry."

These promising conditions are demonstrated in the inaugural Global Insurtech Report by Gallagher Re for the first quarter of 2022, which notes that global investment in the insurtech sector throughout 2021 reached a record-high of US$15.8 billion — higher than recorded investment in 2020 and 2019 combined.

In the report, Gallagher Re cites that since 2012, around $41.65 billion has been invested globally into insurtechs across 2,249 deals in 63 countries. 52 per cent of investment deployed in this period went into only 4.4 per cent of all insurtech deals.

The first quarter of 2022 saw just five mega-rounds; Gallagher Re explains that this lower number of mega-rounds, along with higher participation in early-stage investment, is indicative that capital invested is becoming more democratised — essentially, a more equally distributed spread of total capital is being invested.

The report anticipates: "The vast majority of new insurance projects, ventures and businesses will be heavily supported by tech. Technology will be the platform, enabler and product that continues to keep our industry relevant and cost-efficient."

The plethora of advantages afforded to the insurance industry by DLT and the blockchain are applicable to larger captives. This includes simplified policy amendments, premium transfers, claims reporting, and claims payments.

Dogan Kaleli, CEO and founder of Stere, a one-stop-shop capacity platform for insurance programmes, outlines an example to demonstrate the benefits for captives. He explains: "A multinational corporation that self-insures with a captive could use DLT to make it easier for its stakeholders in different countries to access coverage and pay premiums to the captive."

In this example, Kaleli notes that since some jurisdictions require locally-issued admitted policies, this presents a potential problem in reconciliation between the captive and fronted local policies.

DLT addresses this issue as when a change is made to a policy, it is immediately reflected throughout the entire blockchain to create a single, consistent source of information.

This is particularly advantageous to group captives, Kaleli outlines, where multiple owners require access to policy terms and claims information, as well as the ability to share data between group members and service providers. He says: "A private blockchain, with the necessary permissions, can provide secure access to consistent data for all captive participants."

Schmalbach adds that the claims handling process is another key area addressed by DLT and smart contracts. He explains: "The use of smart contracts, paired with parametric solutions, will be the future of enterprise risk protection, a completely new approach defined as "parametric risk transfer" and already passed into law by the State of Vermont."

This is affirmed by Kaleli, who notes that DLT can accelerate the filing and settlement of claims as smart contracts can automate claims payments when specific triggers are met.

"Automating claims through DLT can eliminate the need for, and expense of, manual claims adjusting processes for many types of straightforward claims," he says. "Complex claims may still require human expertise and in-person adjusting services, no matter what kind of entity is providing the risk transfer."

images by lev/stock.adobe.com

"With the advent of cloud, opportunities to automate and scale claims, underwriting, policy issuance and money management are all now available at a lower cost to captives and RRGs"

He notes that as digital technologies continue to evolve, there is a general adoption in the insurance industry to better identify and analyse risks — and captives are certainly part of this trend.

"Writing third-party risks can be an attractive way for captives to generate surplus, diversify their underwriting portfolios, and increase profits. Using blockchain, apps and other technologies can enable captives to write third-party business more easily and profitably," Kaleli says.

Schmalbach adds that he expects a second wave of insurtechs particularly focused on the use of oracles and smart contracts, noting that there already exists collaboration between captives and insurtechs in early stages.

Logging on

So, with the advantages laid out, how can insurtech be practically implemented in the captive industry specifically? Cameron MacArthur, founder and CEO of AI Insurance, notes that captives were historically excluded from conversations around technology because legacy systems were not scalable.

He explains: "Systems used to cost upwards of $1 million, which is completely out of the realm of possibility for a captive insurer.

With the advent of cloud, opportunities to automate and scale claims, underwriting, policy issuance and money management are all now available at a lower cost to captives and risk retention groups."

"With the improved accessibility of technology, MacArthur observes captives focusing their technology investment on automating the underwriting and application processes: "The practical examples here are about scaling your existing team. If you can automate some of the simple applications, and just flag and escalate ones that require review, you can scale your existing underwriting team to handle an order of magnitude more applications."

Kaleli adds: "Captives are increasingly investing in data and analytics, not only to better manage the risks they assume for their owners, but also because reinsurers and other capacity providers are requiring it to commit capital."

Practical examples of the implementation of insurtech in the captive and reinsurance space include:

Allianz and Swiss Re recently placed the world's first legally-binding catastrophe excess of loss reinsurance contract on DLT, covering one of Allianz's core catastrophe reinsurance contracts. Since reinsurance contracts are not generally regulated by an overarching statutory law, owing to the transnational nature of reinsurance business, the adoption of DLT can instead be based on internal technical and compliance requirements.

Gradient AI and True Captive Insurance partnered to reduce group healthcare insurance costs through the former's SAIL medical underwriting solution, which leverages a large medical data set and machine learning to evaluate health risk at a more detailed level to improve True Captive's loss ratios and profitability by predicting underwriting and claim risks with greater accuracy.

AI Insurance is an insurance platform for captives encompassing policy management, insured management, claims, and business analytics. With fast-track end-to-end claims processing, advanced access to data, and automated loss runs and audits, captives, risk retention groups and speciality carriers can benefit from intelligent business rules supporting many coverage types.

Time to reboot

With a gradual uptake of technology solutions in the captive industry, Schmalbach highlights the importance of having a legitimate motivation behind implementation in the first place.

He explains: "The previous blockchain solutions were not creative enough to be considered must-haves. It is not worthwhile to implement a blockchain as an end in itself; accordingly, the boom will be triggered as soon as smart contracts are able to help cover hard-to-place and hard-to-cover risks, which is now technologically possible."

Although these technology constraints are beginning to be eroded, challenges about administrative complexity remain for implementation in the insurance industry. MacArthur outlines finance and money management as the most significant challenges.

He says: "There are incredible technology solutions available when it comes to invoicing and payment, but they are not effective if your team is still handling physical cheques. Consumers and businesses buying insurance are ready to make the switch, but if captives want to move into the future, they will need to get more comfortable setting boundaries and offering payment by automated clearing houses."

This is affirmed by Kaleli, who notes that many insurance organisations still processing investments of older technology and systems do not have the flexibility to integrate new tools and technologies.

"As smaller risk-bearing organisations, most captives do not have the resources of large primary insurers and reinsurers, so captives look to technologies that can provide cost-effective ways to improve risk management within existing resources," he says.

"But that often comes with two additional challenges: finding owner financial support for additional technology projects; and technology providers that may view captives as too small for solutions designed to serve larger insurance entities."

Radical changes to established industry processes will inevitably cause disruption — although smaller captives currently lack the resources to ensure their technology and systems are the most up-to-date, the future landscape of insurtech in the captive industry appears optimistic that technology solutions will become more accessible.

"Captives look to technologies that can provide cost-effective ways to improve risk management within existing resources"

Schmalbach adds that the range of important issues and risks where the traditional market is currently struggling — climate change, cyber, pandemic, energy crisis, ESG — will fuel the future of insurtechs.

He says: "Many insurtech solutions were not designed for the captive market — this will change now. Solutions for these risks, coupled with technologies of the future like blockchain and AI, can be the potential of a decacorn valuation for traditional providers, but also insurtechs."

Continuing this encouraging sentiment, Kaleli adds: "We are excited to see continuing growth in insurtech companies and opportunities for them to serve captives. Over the next 18 months, Stere believes we will see many more opportunities to connect more captives with capacity providers that have a shared interest in using analytics and other tools."

Increased captive ownership over their data and information in the future is highlighted by MacArthur, as he notes that the array of vendors in the process will have to adapt to work closer together on the same system.

"Unification of data in one single source of truth is a core component to success for any company trying to innovate. Because of this, we are focusing a lot of our roadmap on how to add value to anyone in the ecosystem, whether it is the investment manager, claims manager, managing general agent, or captive manager," he concludes.

"I am excited about joining MSL Captive Solutions and working in the managing general underwriter environment again"

Julie Frink joins MSL Captive Solutions

MSL Captive Solutions has appointed Julie Frink as assistant vice president, underwriting lead to provide strategies for customs solutions based on the needs of clients.

In her new role, Frink will offer expertise on risk evaluation, underwriting and consultative collaboration with programme managers and brokers for both new and existing captive programmes.

As a company specialising in the development, structure and underwriting of medical stop-loss captives, Frink brings a wealth of relevant experience. Most recently, she served as assistant vice president of medical stop-loss programmes at Liberty Mutual.

Before this, Frink was lead underwriter in the captives division of Berkley Accident and Health, beginning her career as stop-loss underwriter at Star Line Group, where she served for more than 12 years.

Commenting on the appointment, Phillip Giles, managing director of MSL Captive Solutions, says: "We are very excited to have Julie join our rapidly growing team. Julie's block underwriting background and deep experience with both single-parent and group captives really enhances the technical depth of our underwriting team."

Frink adds: "I am excited about joining MSL Captive Solutions and working in the managing general underwriter environment again. Captives are a fast-growing sector of the market and I enjoy the creativity and opportunity of underwriting captive programmes, both single-parent and group captives." ■

Aon has appointed Howard Byrne as managing director for both Aon Insurance Managers (Cayman) and Aon Risk Services (Cayman).

He replaces Melissa Thomas, who is departing the firm.

In his new role, Byrne will assume leadership responsibility for all Aon Cayman group operations. He currently holds the position of director and chief commercial officer at Aon Cayman, in addition to being a member of the executive leadership team. Over the last 10 years at Aon Cayman, Byrne has overseen the creation of around 50 insurance captives and reinsurers in the domicile.

Byrne first joined Aon Cayman in 2002, where he also served as vice president of business development and insurance operations. Before this, he was senior underwriter at United Insurance Company, based in the Cayman Islands.

Commenting on his new position, Byrne says: "Having just completed 20 years with Aon Cayman, I am extremely pleased and honoured to take on this new role. Following another year of record growth and client engagement, we are looking forward to continuing to help our clients make better decisions. I would like to take this opportunity to thank our great clients, our colleagues further afield, our numerous provider and industry partners and our friends at CIMA for all their support and collaboration over the years."

John English, CEO, captive and insurance management, Aon, adds: "Howard has been an integral member of the executive leadership team in Cayman for many years and his leadership abilities will ensure that we build on the tremendous momentum we have in our Cayman operations. I look forward to working with him in his new role."

FEEL
EXTRAORDINARY

Choose employee benefits, services and solutions
that win hearts and minds.
Start your journey at geb.com

WE SPEAK YOUR LANGUAGE

"I am very appreciative that our membership and board believe in my ability to serve in this capacity for the organisation"

HCIC names Paul Shimomoto as president

The Hawaii Captive Insurance Council (HCIC) has appointed Paul Shimomoto as president for 2022.

The council is responsible for the promotion, development and maintenance of the captive insurance industry in Hawaii.

HCIC collaborates with the State of Hawaii Insurance Division to produce information and educational material on the current issues impacting captives, and the benefits of Hawaii as a captive domicile.

Shimomoto previously served as director of the HCIC, as well as chair of the marketing committee. He is also the council's government and industry liaison.

In these previous roles, Shimomoto has been a regular speaker at HCIC's annual educational forum and other roadshow events, particularly educational seminars in Japan.

Shimomoto is also a partner at Goodsill Anderson Quinn & Stifel, a Hawaii-based law firm, where he practices corporate and insurance regulatory law with an emphasis in captive insurance.

Commenting on his appointment, Shimomoto says: "I am honoured to serve in this role for HCIC. I am very appreciative that our membership and board believe in my ability to serve in this capacity for the organisation.

"I look forward to furthering the organisation's efforts to improve the domicile and enhance the benefits we offer our members." ■

Risk Strategies has appointed Jason Ellison as employee benefits leader for the brokerage's national healthcare practice.

In his new role, Ellison will coordinate the firm's specialised resources and expertise across the two key practices of employee benefits and healthcare, while developing processes to expand this model to other business segments. With experience across the healthcare industry, Ellison has previously worked with for-profit and non-profit hospital systems and multi-specialty organisations across employee benefits and reward strategies, including compliance, network optimisation, and direct-to-employer strategies.

Ellison most recently held the position of area senior vice president of Gallagher's health and welfare consulting business, where he also served on both the firm's national healthcare practice leadership team and national innovation advisory group. Before this, Ellison was principal and senior consultant at Mercer, and held various leadership roles at UnitedHealthcare.

Commenting on the appointment, Bob Dubraski, chief growth officer and national healthcare practice leader, says: "We are thrilled to have Jason join the Risk Strategies family. His leadership and expertise in this national role for employee benefits, focusing on the healthcare industry and other areas of the benefits business, will allow us to grow our existing team and the business."

Ellison adds: "It is really exciting to join a true specialty broker like Risk Strategies in such a pivotal role. I am eager to apply my wide range of experience in employee benefits programme consulting in a way that drives collaboration between practices to better serve clients while growing the firm's overall business nationwide." ■

VCIA

www.vcia.com

Boost your career by collaborating in America's largest captive conference this summer

- Network with hundreds of industry professionals
- Learn the latest on emerging risks and diverse topics like cyber & InsurTech as they relate to captive insurance
- Gain a large amount of credits: CPE/ VT CLE/ CRE/ ICCIE

VCIA 2022

August 8-11, 2022
Burlington, Vermont

Where the Captive World Comes to Meet

"There's no better place to gather actionable ideas that you can immediately put to use in all areas of the insurance marketplace" - *John Alberici, President, NC3, Inc.*

Collateral Trust Services

Our advantage

Truist Corporate Trust & Escrow Services has a long history of trust, escrow, and risk management excellence with both domestic and international coverage.

If you're choosing a cost-effective and convenient collateral trust as part of your captive and reinsurance solution, we have a broad range of specialties that can help mitigate risk in your insurance business:

- Collateralized Reinsurance
- Regulation 114 Trusts
- Captives
- Surety Bonds
- Insurance-Linked Securities
- Deductible Trusts

Our experience is only one aspect of what differentiates our reinsurance trust business from other firms. Additionally, we excel because of:

- Single point of contact
- Comprehensive servicing
- Rapid response times
- Team of reinsurance specialists
- Extensive carrier relationships

To learn more about how Truist can efficiently and comprehensively support your escrow transaction, please contact:

Donny Tong
Senior Vice President
212-590-0976
donny.tong@truist.com

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

Barbara Aubry
Senior Vice President
212-303-4164
barbara.aubry@truist.com

Truist.com

Truist Wealth is a name used by Truist Financial Corporation and affiliates. Banking products and services, including loans, deposit accounts, trust and investment management services provided by Truist Bank, Member FDIC. Securities, brokerage accounts, insurance/annuities offered by Truist Investment Services, Inc. member FINRA, SIPC, and a licensed insurance agency where applicable. Life insurance products offered by referral to Truist Insurance Holdings, Inc. and affiliates. Investment advisory services offered by Truist Advisory Services, Inc., Sterling Capital Management, LLC, and affiliated SEC registered investment advisers. Sterling Capital Funds advised by Sterling Capital Management, LLC.

©2021 Truist Financial Corporation. Truist, Truist Purple, and the Truist logo are service marks of Truist Financial Corporation.