

Captives and the middle market – two years on

As the middle market sector of the captive insurance industry continues to grow, **Ron Clark** of **Abacus Risk Management** examines the drivers behind this trend and the impacts it is having



RON CLARK is a director of Abacus Risk Management Services PCC Ltd, Malta. Prior to joining Abacus, Clark was with the Zurich Financial Services Group for 13 years serving as CEO of the Belgian, Luxembourg and Dutch operations and has occupied several underwriting managerial and CEO positions elsewhere in Europe and the US.

Two years ago I wrote an article for the *Captive Review Malta 2010 Insurance Report* entitled *Captives and the middle market*. In this I commented on the relatively poor take-up rate of captives by middle market entities in Europe compared to the situation in the US where ‘mini’ or ‘micro’ captives were and still are, flourishing. I suggested that the main reasons for this imbalance were the introduction in the US of 831(b) captive insurance companies legislation with its appealing tax breaks which encouraged the creation of such vehicles. A major stumbling block in Europe was the inertia of the independent broker to venture out of his comfort zone despite the availability of favourable legislation particularly that relating to Protected Cell Companies (PCCs) in certain domiciles in Europe, which is ideally suited to the needs of the middle market.

Now, two years on, it is interesting to take the temperature of captive creation by the middle market in Europe. A good indicator of any increased interest in captives by this segment can be obtained by comparing the development of PCC’s and protected cells in the main European domiciles with PCC legislation. The *Captive Review’s Cell Company Guides* from 2010 and 2012 provide a basis of comparison and the table on page 7 created from the data contained therein compares the development of PCCs and individual cells in

Gibraltar, Guernsey, Isle of Man, Jersey and Malta (the latter still being the only full EU member state to have introduced PCC and also Incorporated Cell Company legislation).

This data paints a mixed picture of PCC and cell development. Clearly, Guernsey with its many years of PCC experience is the leader both in terms of numbers of PCCs and cells. However, Malta is making good headway in second place having doubled the number of PCCs and increased the number of cells by 40%. Little progress seems to have been made in the other domiciles over the period.

The middle market - still hugely untapped by the captive industry

The modest growth shown in the table suggests that there is still a huge untapped market as regards to captive ownership to be exploited by the enterprising independent broker who is still generally recognised as being best positioned to service this segment in most countries. However, the question for the captive industry is how to best tap into this potential and provide the catalyst to those brokers willing to seize the opportunity to differentiate themselves from the herd and embrace alternative risk transfer (Art) solutions.

The independent broker wishing to prove his worth to selected clients would be best advised not to simply ‘tweak’ traditional policy wordings and/or find a cheaper (and perhaps less secure) market to match a competing offer, but rather to create a more efficient and cost-effective solution comprising, e.g. a captive cell and traditional market solutions. This would underline his added value and depending upon the ultimate solution, provide his client with:

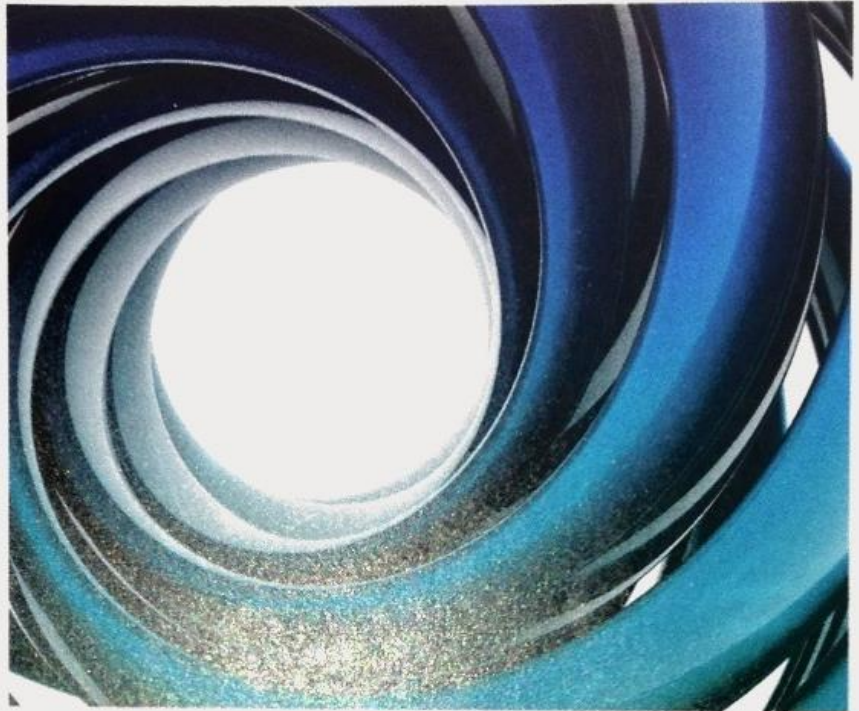
- deductibility of premiums paid to the captive cell in the same way as premiums paid to traditional insurers
- the opportunity to create tax deductible reserves in the cell
- a reduction in premium costs to the traditional market by accepting a larger deductible on those coverages where the claims frequency and severity are predictable and by insuring the larger deductible in the cell.
- coverage in the cell for those exposures which are difficult or impossible to place at acceptable premium rates

“ THE MODEST GROWTH SHOWN SUGGESTS THAT THERE IS STILL A HUGE UNTAPPED MARKET AS REGARDS TO CAPTIVE OWNERSHIP TO BE EXPLOITED ”

Some independent brokers mistakenly consider that to propose an Art solution is to potentially discard the traditional insurance placement. However, in practice an Art solution is rarely an 'all or nothing' approach but rather a component of a hybrid solution running concurrently with a traditional placement in the commercial insurance market.

As an independent insurance manager located in Malta with executive directors working out of Brussels, Abacus has targeted specific independent brokers in Continental Europe to brief them on the Art opportunities available to specific types of clients most likely to be interested in our solutions. As a result, several enquiries in the past year have been received regarding the creation of PCCs and captive cells. This confirms that there is indeed a budding interest in Art solutions in this broking community but that it is necessary to take the initiative in seeking out the real opportunities.

In the UK, independent brokers are also becoming more aware of the opportunities in Art



“ I AM MORE CONFIDENT THAN AT ANY TIME IN THE PAST THAT IN EUROPE WE IN THE CAPTIVE INDUSTRY HAVE A REAL OPPORTUNITY OF BREAKING INTO THE MIDDLE MARKET”

solutions. This is in part thanks to the efforts of the British Insurance Brokers Association and some other broker associations in widening the perspective of their independent broker members through Art content in their seminars and conferences.

Broker cells and PCCs

For larger independent brokers or groups of smaller brokers willing to join forces, there are also considerable competitive advantages to be had through the creation of their own PCCs or cells in Malta in which to place the business of those customers without the available capital to create their own insurance vehicles. This could be business which the traditional insurance markets are unable to provide or provide at a price considered to be unacceptable. Equally, some enterprising brokers may consider it appropriate to remove all or part of some highly profitable portfolios from the traditional markets and to place these in their own PCCs or cells. Successful examples of this latter category can be found in Malta.

Clearly, such appealing opportunities require careful study to ensure that the necessary capital to meet minimum guarantee funds and/or solvency requirements is wisely applied to such ventures and that adequate reinsurance or other safeguards are available.

I am more confident than at any time in the past that in Europe we in the captive industry have a real opportunity of breaking into the Middle Market thanks in great part to PCC legislation and a greater understanding of how to engage the independent broker in Art solutions to enable him to better satisfy the needs of his middle market clients. ☺

PCC AND CELL DEVELOPMENT - A MIXED PICTURE

DOMICILE	No. PCCs	No. individual cells
GIBRALTAR	2010: 5	31
	2012: 3	33
GUERNSEY	2010: 69*	377*
	2012: 68	395
ISLE OF MAN	2010: 3	1
	2010: 3	1
JERSEY	2010: 8	0
	2012: 1	0
MALTA	2010: 4	13
	2012: 8	18

*ICCs also included

Note

- i. PCCs and cells include captive and non captive insurers
- ii. The statistics are a « snapshot » of the situation as at 31/5 for both years.
- iii. The creation of Incorporated Cell Company (ICC) legislation in some domiciles may have impacted negatively on the growth of PCCs.