ASIAN ACCELERATION

As the market hardens, will Asia see accelerated captive growth?

The Australian-Pacific and Asian region has always been a little forgotten when it comes to captive domiciles. For many years it quietly ticked along.

Now, however, things might be speeding up. In recent years the region has been growing faster, issuing more licences and marketing itself to potential captive owners.

Asian-domiciled captives still only make up 2.4% of the world's 6,754 captive structures. Of that 2.4%, the majority of captives are domiciled in either Singapore, with 74 captives, or Labuan, with 52 captives.

Compared to captive numbers in the world's largest domiciles, such as the 715 captives licensed in Bermuda or the 585 captives licensed in Vermont, these numbers seem small.

One difference in the Asian industry however is that it has been growing overall in the past few years, compared to other domiciles which are shedding captives.

In 2019, captive numbers declined overall compared to 2018 in every region except Asia. For example while the Cayman Islands still remains the second largest captive domicile in the world, it did see 90 licence surrenders in 2019.

Speeding up

While captive interest has spiked in 2020 globally, Asian domiciles have seen accelerated growth. In 2019, Labuan issued five captive insurance licences for the entire year. In the first half of 2020, it had already issued seven.

Datuk Danial Mah Abdullah, director-general of Labuan Financial Services Agency, said that international captive interest in the domicile was increasing, with more expected in the coming year.

"Captive insurance is certainly growing in size as it now attributes 31.4% of total gross premiums underwritten in Labuan IBFC, amounting to $267.9m with 72.8% of the total captive premiums from international markets," Mah said.

"This is in line with the status of Labuan IBFC as a regional wholesale risk intermediating centre. In fact, for the first half of 2020, 64.5% of total gross written premiums of the reinsurance industry originated from international markets.

"We expect this percentage to increase as we develop Labuan even further as a

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centre of risk management and reinsurance through innovation. For instance, Labuan IBFC is the only jurisdiction in Asia that offers protected cell companies (PCC)."

According to the *Captive Review* captive manager survey, 14% of captive managers planned to expand into Asia in the next five years, showing a clear interest in the region.

Why now?

A number of factors are contributing to this interest in Asia, mostly the same things driving the global captive industry. An already hardening market combined with a global pandemic and the economic fallout has led to many organisations realising they have gaps in their risk management. This has been followed by a shrinking of capacity in the market and alternative risk solutions becoming more popular.

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Thomas Keist, global captive solutions leader at SwissRe Corporate Solutions, says that the current market situation is the "perfect storm" for parent companies.

"I think it's absolutely the perfect storm. And the reason being that actually uncertainty, economic turmoil, political turmoil was already here before 2020. So in 2019, for example, things already started," Keist said.

"With the pandemic and Covid-19, it has become one of the worst situations we probably have ever had with respect to not only the economic impact, but also with the insurance market.

"And that's why the concept of self-insurance, certainly while it has developed very strongly over the past 20 to 30 years, is now at the stage where it has the chance to become really mature and established."

Franck Baron, risk manager for International SOS and chairman of Pan-Asia Risk and Insurance Management Association, says that Covid-19 has provided an opportunity for organisations to reassess, which may lead to a growth in captive structures.

"I think at the end of the day, it's creating an opportunity for global organisations," Baron said.

"The first opportunity will be to develop their existing captive tools, or to consider setting a captive up if they don't have it yet in place. So I think for them it's an opportunity to consider their risk financing capability."

Ariel Kou from Marsh in Labuan also believes that this is the "perfect opportunity" for captives.

"I think compared with mature markets like the UK and the US, our perception for risk management is at a very early stage," she said.

"Based on what we're seeing I think this is a perfect opportunity for clients in Asia, for companies in Asia, to realise the true value of self-insurance or captives. To show them 'okay, how can a captive help you in this difficult, uncertain time?'"

Asia has some of the only economies expected to grow this year, amidst a global economic crash. The International Monetary Fund (IMF) has predicted that GDP of the United States would be -4.3%, while China is expected to grow by 1.9% (other Asian domiciles like Malaysia and Singapore are both expected to contract however).

Farah Jaafar-Crossby, CEO of Labuan IBFC, told *Captive Review* that the economic growth in Asia has been strong in recent years.

"When it comes to basic economy growth, except for Latin America, we are the only region that's actually growing," Jaafar said. "And I would say the growth would be 60-70% in East Asia, and then 30-40% in West Asia."

Belt and road

One other potential impact on the growth in Asia is China's Belt and Road Initiative (BRI). The $1trn infrastructure programme has been dubbed a "21st century silk road" with overland and maritime corridors and shipping lanes created to connect China with the rest of the world.

"The size of the BRI means that the dynamics of even traditional insurance products, such as construction, property, energy, liability and marine, will change and clients – along with their brokers and (re)insurers – will need to look at these coverages in a new light," AXA XL says.

"A large amount of BRI projects are unprecedented in the BRI countries in terms of scale and complexity. For example, the planned railway between China and Laos will have as many as 75 tunnels – this is a huge construction project requiring large insurance limits and expertise.

"Clients will need to explore more 'niche' products to cover some of the newer risks that will arise from involvement in the BRI countries."

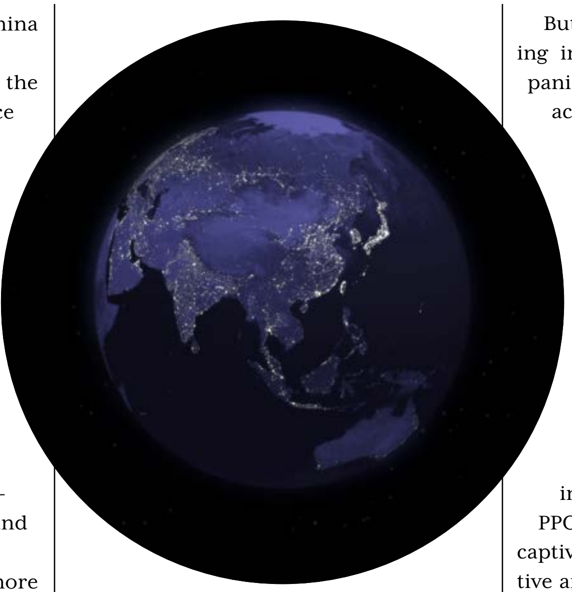
In May 2019 credit ratings agency AM Best released a report on captive growth in the Asia-Pacific also citing the impact of BRI. The report states that while Singapore and Labuan are more established in the region, that China and Hong Kong were "keen to develop captive insurance in their jurisdictions".

"As the capacity in China for new risks related to the Belt and Road also is insufficient, businesses with captives in this region would be well-placed to take advantage of the domiciles' geographical locations and comprehensive insurance ecosystems to connect with foreign insurers and reinsurers and transfer these risks to the international market," Christie Lee, director of analytics at AM Best said.

And it seems to already be moving forward. In August 2020 Hong Kong passed new laws to allow captives to write lines for overseas group businesses. This could prove appealing for multi-national companies that previously may have been put off by Hong Kong as a domicile.

The bill, the Insurance (Amendment) Bill 2020, also introduced a new regulatory regime for insurance-linked securities (ILS), allowing the securities to be domiciled in Hong Kong.

"The proposed legislative amendments will pave the way for Hong Kong to become the preferred domicile for ILS, in particular catastrophe bonds," chairman of the Insurance Authority Dr Moses Cheng said in March 2020.



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In mid-2019 the Hong Kong Financial Services Department Council (FSDC) said they expected to see five to 10 new captive insurance licences per year for the next five years. However at the end of 2019 they had not had any formations in the domicile.

Hong Kong became a captive domicile in 1997. In 2014 a bill was passed that gave captives a 50% reduction on the profits tax on "their insurance business of offshore risks commencing".

As a domicile, China itself has five captives, all of which are state-owned: China National Petroleum Corporation (CNPC), China Railway Corporation, China Petroleum & Chemical Corporation (Sinopec), China General Nuclear Power Group, and China National Offshore Oil Corporation.

Four more China state-owned captives, including China General Nuclear Power Group Insurance Co. and China National Offshore Oil Corporation, are domiciled in Hong Kong.

But other Asian domiciles are also seeing interest from Chinese parent companies for a range of financial services, according to Labuan.

"Out of more than 16,000 companies registered so far in Labuan IBFC, about three quarters or more than 73% of them are from the Asian region," Mah said.

"We are also seeing increasing company incorporation from China, Japan, South Korea and Taiwan."

Moving forward

Looking forward at potential growth in the region, Kou says that she sees PPCs growing in popularity as potential captive owners use them to "try out" a captive and see if it works for their organisation.

"A PCC allows you to test the operation of a captive with a smaller captive," she said. "So if you make some mistakes and you withdraw, the cost is limited compared with the formal captive.

"I think that's a very good option for someone who wants to try the concept of captive or self-insurance."

Captive expert and consultant Malcolm Cutts-Watson has seen issues arise in some domiciles where local markets are sceptical of captives, but he said it's actually a win-win situation.

"In some territories when you start talking about self-insurance and captives, the local market gets nervous because they think they're actually going to lose that premium spend," he explained.

"What the evidence shows is that actually the captive or the self-insurance sits very well with the traditional insurance placement. And in fact, the insurance spend will be the same as in traditional insurance.

"It's just that you'll be able to buy more insurance and also you'll be moving the insurance market away from the volatility of the first losses. So it's actually a win-win."

While the world recovers from the Covid-19 pandemic in coming years it will, experts say, provide many opportunities for risk managers and the captive industry. With the new developments in Asia, it may be the region's time to shine.