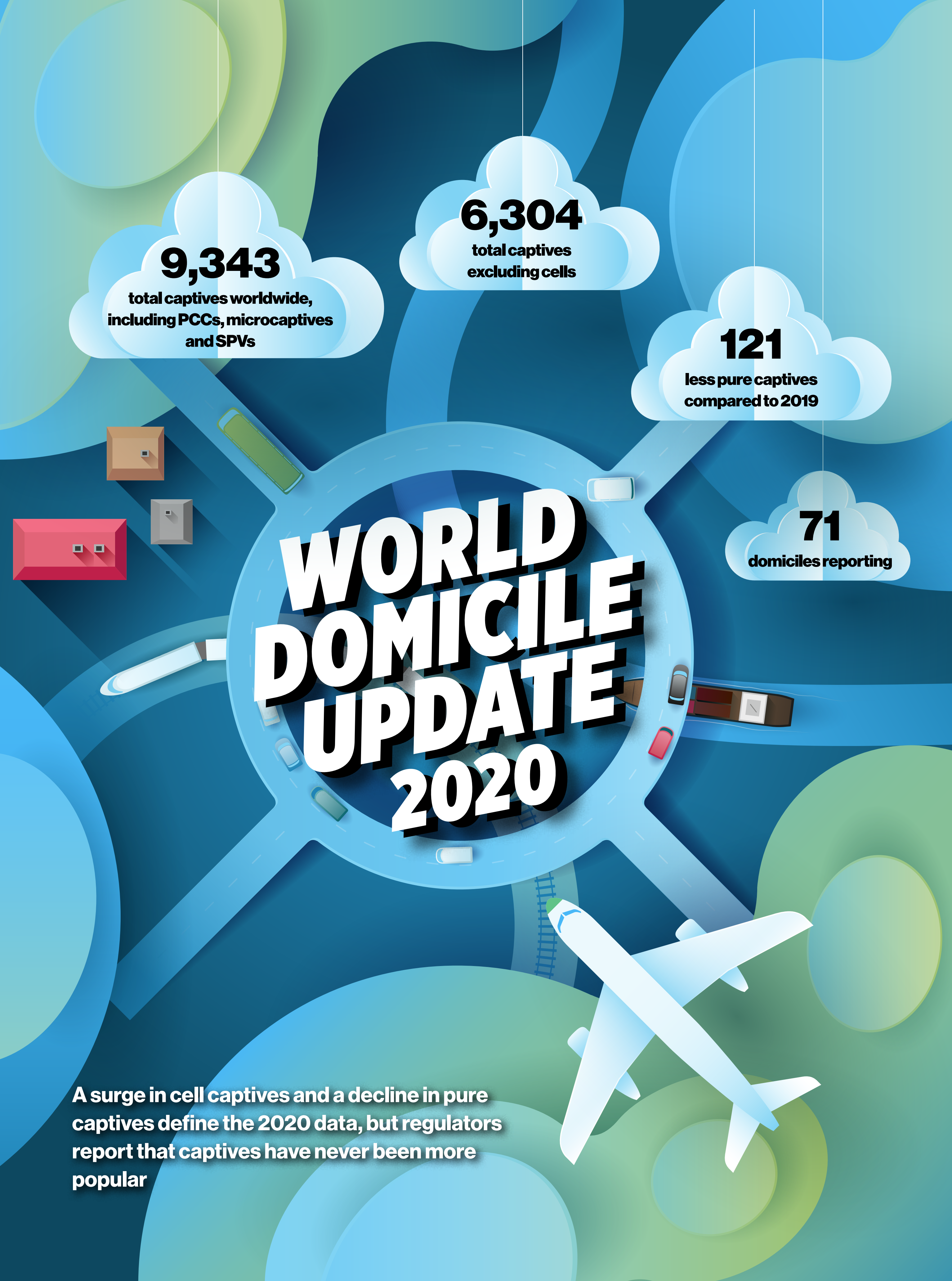
WORLD DOMICILE UPDATE 2020



A surge in cell captives and a decline in pure captives define the 2020 data, but regulators report that captives have never been more popular

The past year has been devastating and record-setting in many ways.

In the captive space, however, there is hope. There has been a spike in interest in captive structures: the Covid-19 pandemic revealed gaps in coverage that organisations didn't realise they had, and rising premium prices in the commercial insurance market has led to risk managers seeking alternative options.

Captive Review has been producing the World Domicile Update for quite a while now, but 2020 was a year like no other. Because of this, and due to the growing

Written by
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interest in the captive insurance market, we decided to expand the size and scope of our usual World Domicile Update feature. We have data from 71 captive domiciles, the most ever, with all major captive hubs reporting their 2020 totals.

This year we have also asked regulators for even more detail about their captive numbers and are producing even more analysis about what the figures mean for the captive industry. Regulators provided figures not only of new formations, licence surrenders and total captives, but also a breakdown of the types of captives in each category.

We always want to present transparent, detailed data and analysis. Our total captive numbers include pure captives, group captives, association captives, cell structures and risk retention groups, with cell captives counted separately. As domiciles count these captives differently depending on local regulations, *Captive Review* felt the fairest way to present the data was separate from other

382
new captives licenced in 2020

474
captive licences surrendered in 2020

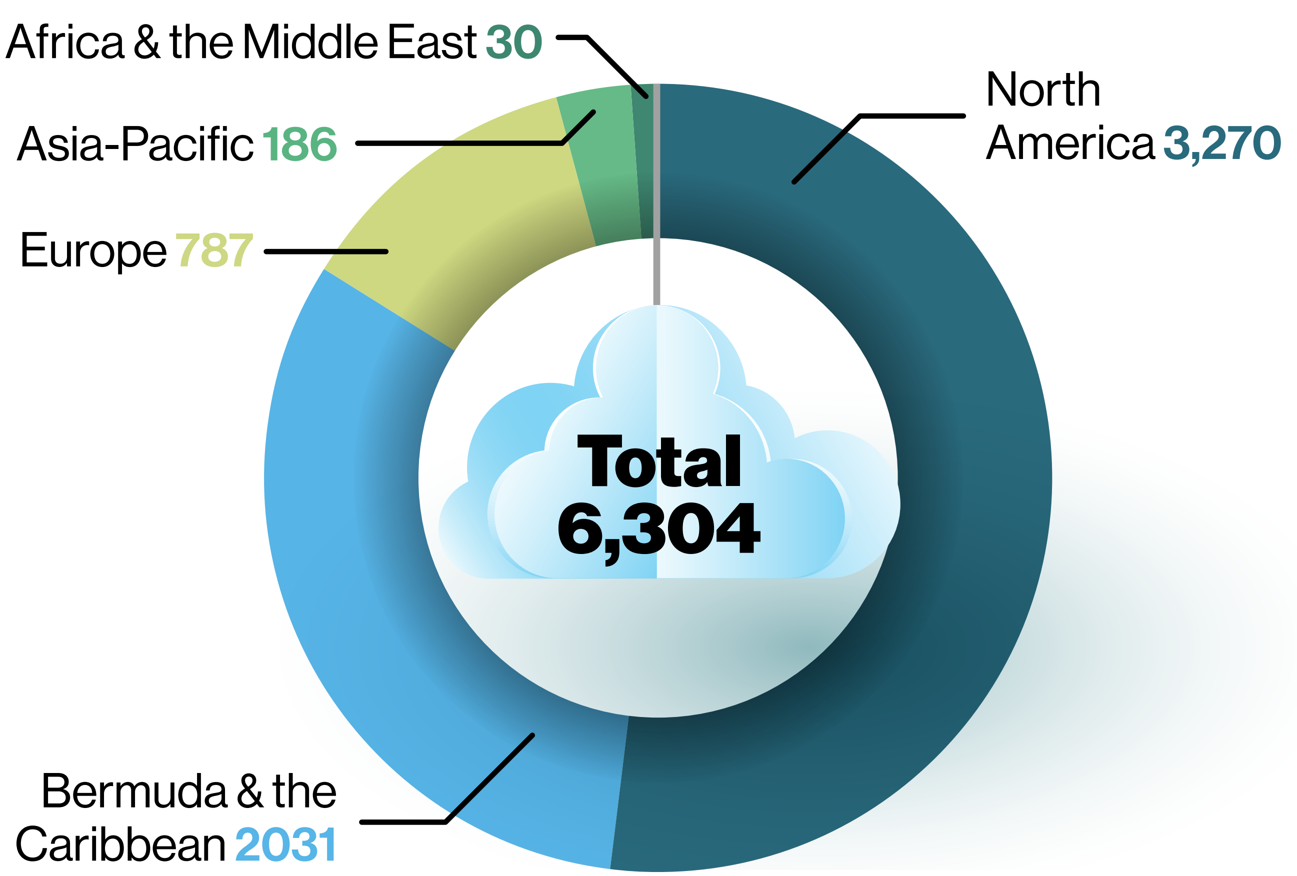
-93
net loss of captives in 2020

6,304
total captives as of 31 December 2020

3,039
total cell captives as of 31 December 2020

9,343
total captives (including cells)

Total captives (2020)



The numbers

At the end of 2020 there were no less than 6,304 captives worldwide, located in 71 different domiciles. From the Cayman Islands to Kazakhstan, *Captive Review* has been able to publish the most accurate, up-to-date and comprehensive count of all captive structures globally. Compared to end-of-year figures from 2019, overall there were 45 less captives in total at the end of 2020.

The slight reduction in captive numbers may be a surprise for many in the industry. The first year of the decade saw an increasingly distressed commercial insurance market, caused by a myriad of factors — some that had been building for years, some that were unexpected and sudden.

Captive managers, consultants, accountants, and lawyers have been flooded with enquires about starting a captive in the past year, with rising premium prices and reduced capacity in the insurance market causing organisations to look for alternatives. Regulators too have spoken of how busy they have been in the last year with more applications and enquiries than have been seen in many years.

This has caused a surge in the captive industry, with 382 new captives and 336 new cells formed in 2020 alone.

However as the larger economy reacted to the pandemic many companies began to struggle. Many governments introduced financial support for both organisations and individuals, particularly for businesses forced to close because of Covid-19 lockdown restrictions.

A report by PriceWaterhouseCoopers (PWC) found this had caused a substantial rise in mergers and acquisitions in 2020, particularly in the second half of the year.

"In the fourth quarter of 2020, deal volumes and values were up by 2% and 18%, respectively, compared with the same quarter the prior year," the report said. "Across Asia-Pacific, EMEA and the Americas, M&A activity increased by between 17% and 20% during the second half of 2020 compared to the first half of the year."

Despite government support in some countries, this did of course have a flow-on effect to captives.

Regulators, particularly those in North America, Bermuda and the Caribbean, have reported that the economic environment has led to more mergers, acquisitions and closures of captives than previous years. The Bermuda Monetary Authority (BMA), for example, has credited the domicile's net loss of 23 captives to "amalgamations and deregistrations of dormant captive insurers."

This puts the reduction of captive numbers into context: there is obviously no use for a captive if the parent company is closing down.

While there was a reduction in the overall number of captives, when analysing market trends it is important to look at the breakdown of captive types. The data shows that it is only pure captives that reduced in numbers last year. At the end of 2019 there were 5,238 pure captives, dropping by 121 in 2020 to 5,117. All other captive types increased in numbers, except for group captives, where the numbers stayed the same.

Captive Review can reveal that there are at least 3,390 cell captives in the world, but this is a conservative number given the differences in licencing between domiciles. When reporting on cell data, we are counting protected cell companies (PCCs), 831(b) captives, and some special purpose insurance vehicles.

The spike in cells, in comparison to other types of captive structures, makes perfect sense when you consider the lead time to form a cell captive is much, much shorter than other captive structures. Cell captives can be a quick solution for an organisation needing to cover a risk urgently, without the lead time or capitalisation requirements of a pure captive.

North Carolina, for example, licensed 126 new individual cells in 2020. Debbie Walker, senior deputy commissioner at the North Carolina Department of Insurance (NCDOI), said that they have seen a large range of organisations utilising cells. "The growth of cells and series in protected cell and series captives continued [in 2020]," Walker said.

"Many business owners have opted to obtain their captive insurance through a cell or series rather than forming standalone captive insurance companies. During 2020 we saw these cells and series used by all sizes and types of companies with varying risk management needs."

Global individual cell figures

2,992
Individual cells 2019

336
New cells

289
Licences surrendered

47
Net difference cells

3,039
Individual cells 2020

Cell captives

See more data on cell captives, as well as detailed analysis and comments from experts, in our Captive Cell Guide. The guide, which will be published in May, will include a breakdown of individual cell captive numbers by domicile.

Asia-Pacific and Mena

17 new captive formations

5 captive licences surrendered

12 net difference for 2020

216 total captives as of 31 December 2020

While only 3.5% of captives worldwide domiciled in Asia-Pacific, Middle East and Africa, the region has been growing quickly in the past few years. Data provided by regulators shows that the Asia-Pacific region grew captive formations by 6.3%, and the Mena region 3.4% in 2020.

Singapore is still the largest domicile in the region, with 81 total captives at the end of 2020. However Labuan had strong growth in 2020, increasing their total captives by 15.4% and now licencing a quarter of all captives in the Asia-Pacific and Mena.

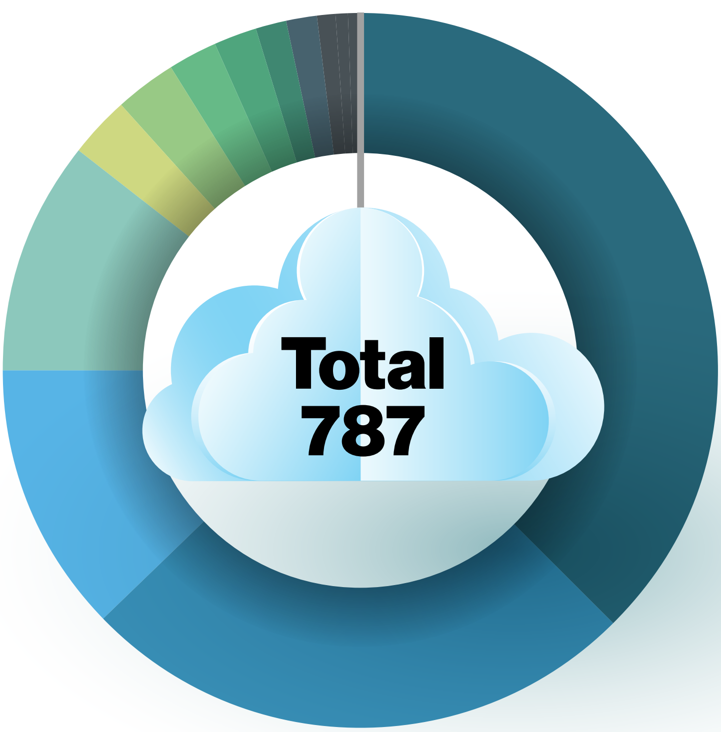
One trend in the region is the increase of Japanese-owned captives. Hawaii has traditionally been a hub for Japanese captives, but an increasing amount are looking to domiciles like Singapore, Labuan and Micronesia. Japan's commercial insurance market is valued at $36bn annually, and with the hardening market forcing premium prices up there is a significant opportunity for the captive industry.

> **"I think at the end of the day, it's creating an opportunity for global organisations"**
> **Franck Baron**

Micronesia became a captive domicile in 2006, and from the beginning focused on licensing Japanese-owned captives, stating its aim was to "become the premier Japanese captive domicile." The Federated States of Micronesia Insurance Board (FSM) says they want Japanese captives to be at "home" in the country, and that their captive regulations "are specifically designed to be strong, stable and yet flexible enough to adapt and capitalise on the industry needs, especially for Japanese captives."

Last year Datuk Danial Mah Abdullah, director-general of Labuan Financial Services Agency, told *Captive Review* that Labuan was seeing more and more Asian

Total Captives
Regional Breakdown



Singapore 81 / Labuan 55 / Micronesia 26 / South Africa 23 / New Zealand 6 / Vanuatu 6 / China 5 / Hong Kong 4 / Cook Islands 3 / Dubai 3 / Mauritius 2 / Bahrain 1 / Kazakhstan 1

Bahrain

Total 2019	1
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	1

China

Total 2019	5
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	5

Cook Islands

Total 2019	3
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	3

Dubai

Total 2019	2
New formations	1
Licences surrendered	0
Net loss/gain	1
Total 2020	3

companies redomesticating. "We are seeing increasing company incorporation from the Far East region i.e. from China, Japan, South Korea and Taiwan," Mah said.

One of the only regions to experience growth, with a net increase of 12 captives compared to 2019, captive experts say that they expect more formations as the past year changed attitudes to risk management. Risk manager for International SOS and chairman of Pan-Asia Risk and Insurance Management Association (PARIMA) Franck Baron said that while the pandemic has had a big economic impact, it has also allowed companies to reassess their risk management. This has, he said, led to a growth of captive interest as organisations realise the benefits captives can provide.

"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."

Captive loan requests

Another unforeseen trend reported by regulators in 2020 was an increase in requests from captives for loan requests. Due to the economic impact of the pandemic and many companies experiencing cash flow problems, many of those with captives opted to use excess capital in their captives to help.

Debbie Walker told *Captive Review* that the NCDOI is one of the domiciles that received loan request applications. "The increase appears to have been primarily driven by the negative impact of the pandemic on the businesses of the captive owners and their affiliates," she said.

"Although the issuance of a loan, dividend or distribution is not an unusual transaction for a captive insurer, in 2020 and into 2021, it seems more captive owners are benefiting from not only the insurance coverage they have obtained from their captive insurer, but also through the use of excess capital in their captive insurers."

Captive Review's 2020 Captive Manager Survey revealed that 14% of captive managers plan to open a new office in the Asia-Pacific in five years, a further example of growing interest in the region.

The Mena region remains the smallest when it comes to captive numbers, with only 30 captives licensed in four domiciles: Bahrain, Dubai, Kazakhstan and Mauritius. The region seems fairly stable when it comes to captive numbers, with Dubai the only domicile to report any new formations and none reporting captive licence surrenders.

Hong Kong

Total 2019	4
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	4

Kazakhstan

Total 2019	1
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	1

Labuan

Total 2019	52
New formations	8
Licences surrendered	5
Net loss/gain	3
Total 2020	55

Mauritius

Total 2019	2
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	2

Micronesia

Total 2019	25
New formations	1
Licences surrendered	0
Net loss/gain	1
Total 2020	26

New Zealand

Total 2019	6
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	6

Singapore

Total 2019	74
New formations	7
Licences surrendered	0
Net loss/gain	7
Total 2020	81

South Africa

Total 2019	23
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	23

Vanuatu

Total 2019	6
New formations	0
Licences surrendered	0
Net loss/gain	0
Total 2020	6

Total

Total 2019	204
New formations	17
Licences surrendered	5
Net loss/gain	12
Total 2020	216

Total Asia-Pacific

Total 2019	175
New formations	16
Licences surrendered	5
Net loss/gain	11
Total 2020	186

Total Mena

Total 2019	29
New formations	1
Licences surrendered	0
Net loss/gain	1
Total 2020	30

Summary

As we reflect on the year that was 2020, it's hard to properly put into words the impact it will have on our future in an immeasurable amount of ways. One of the phrases heard the most last year in the industry – after the "new normal", "lockdown" and "zoom" – was most definitely the hard market.

The topic seems inescapable, but it has been a driving force behind almost all current industry trends. A survey by UK-based association Airmic in February 2021 found that 94% of risk managers had seen higher premiums in the previous quarter, leading to more investigating captive options. More then 23% of risk managers said they were now considering captives, an increase of 3% from the previous survey.

> **"The hard market that finally emerged has been a reminder to all the people that formed captives in the past that there's a reason we formed captives"**

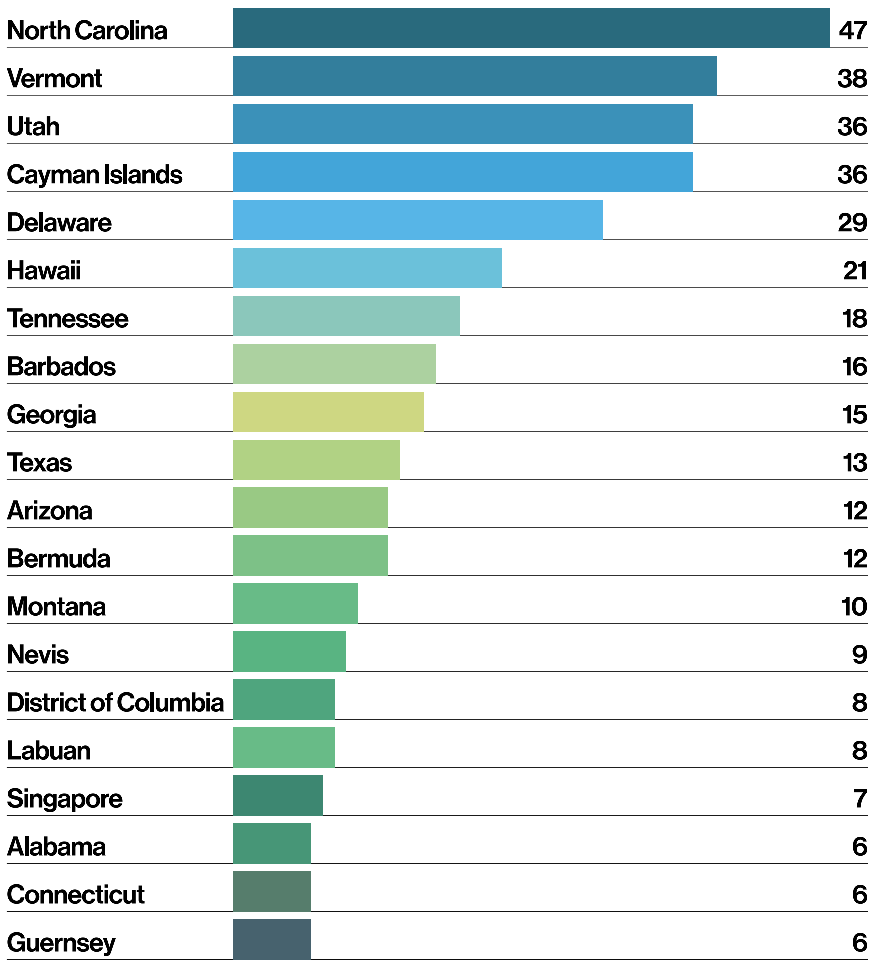
While the hard market has obvious negative consequences for a number of organisations, Dave Provost said that it does help captives show how useful they are during difficult periods.

"The hard market that finally emerged has been a reminder to all the people that formed captives in the past that there is a reason we formed captives, and part of it is to help us through these hard markets," Provost told *Captive Review*.

"I think it's going to be good for the future of captive insurance everywhere to have this reminder that captives play an important part in in the business world. I think they're definitely here to stay, and I think they're going to be growing for quite a while."

When it comes to the specific lines that are being significantly impacted by the hard market, the answer is the same as it has been for the last year: directors and officers (D&O) is the standout.

Highest new formations
2020



How do we count captives?

Total captive numbers reported here include:

- pure captives
- group captives
- association captives
- cell structures
- risk retention groups

When this feature refers to captives with no preface, it is referring to numbers that include all the above captive types amalgamated. Individual cell captives are counted separately, and will always be referred to as cells.

Williams said that while there are many other lines impacted by the hard market, D&O seems to be the one that parent companies have the most urgency around. "I think D&O gets a lot of the press around this, rightfully so," he explained. "But any area where the market is particularly distressed or there is dislocation between market appetite and buyer's expectations and the capacity they can get.

"Clearly that's heightened in D&O, and PI as well, you can imagine. It's across the market, but D&O and PI are the real focus points where we've really seen some clients saying 'I need to do this and I kind of need to do this now for my renewal.'"

"You can't just look at the totals, you have to look at it domicile by domicile to understand what's going on – everybody needs to accept or understand the fact that risk financing is changing" Owen Williams

Overall, the World Domicile Update data tells a compelling story about the global captive market, but it also about how much is still unknown.

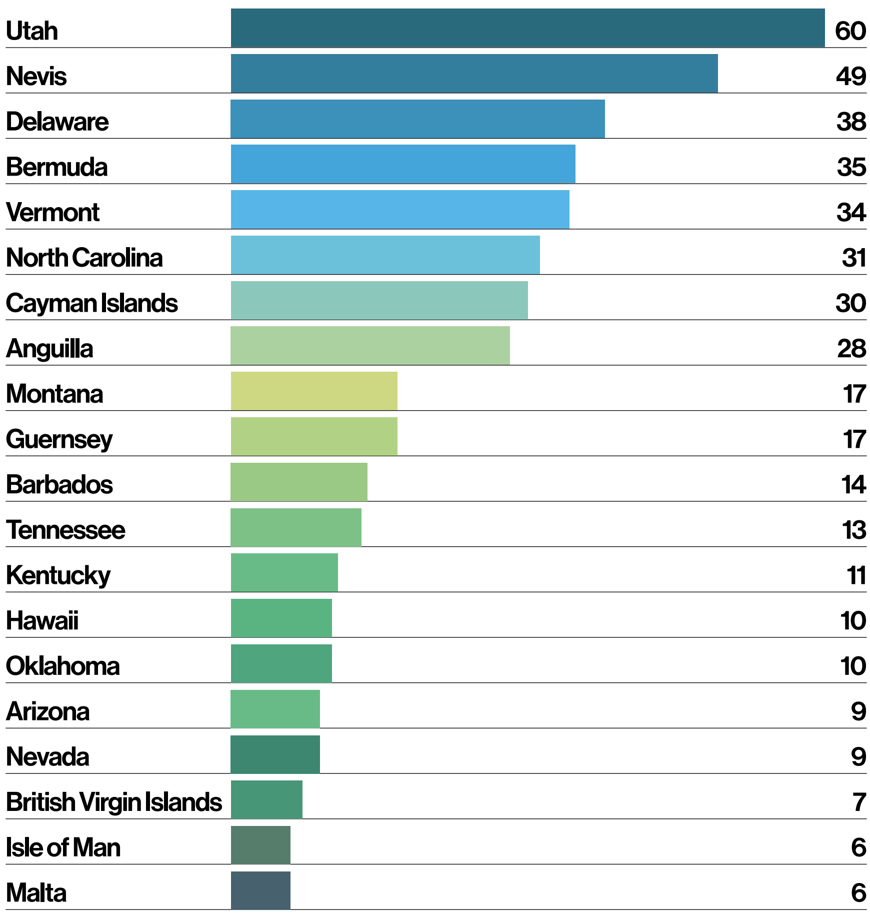
At a glance the figures seem to point to a slowly declining industry, but on closer inspection show burgeoning interest and increasing opportunities.

As many other experts have said, Pete Krantz gives fantastic advice to anyone analysing figures in the World Domicile Update: be holistic. "I think the first thing with the numbers is you can't just look at the totals, you have to look at it domicile by domicile to understand what's going on," he explained.

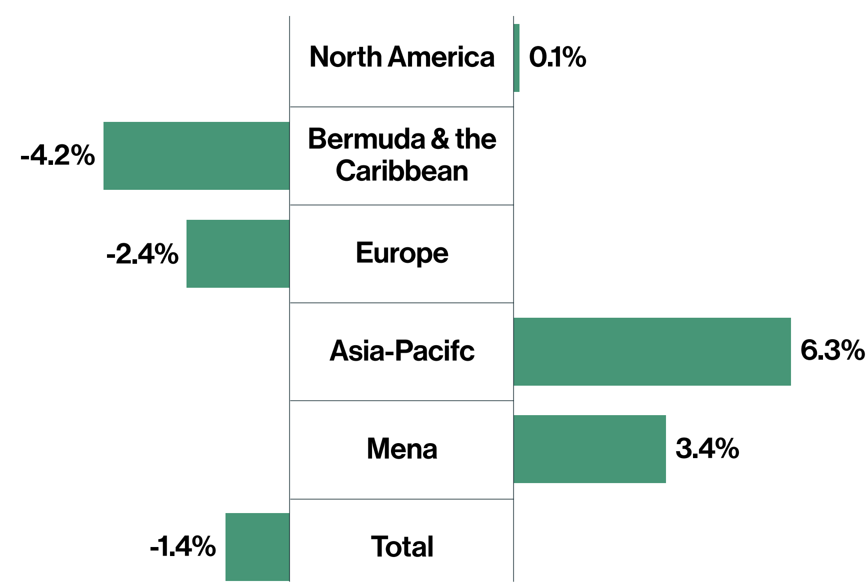
"As far as what's going on, everybody needs to accept or understand the fact that risk financing is changing. We need to get away from thinking about insurance line by line, saying I'm going to retain X amount on this line and this could cost me Y.

"The holistic way to think about it is the total cost of risk, and how do you mitigate it? The regulators need to adapt to that too and understand because that's going to affect the structures that we bring to them. They need to understand those structures, that risk is being financed differently."

Licences cancelled/ surrendered
2020



Growth
By region



LABUAN'S RISE TO PROMINENCE

Labuan IBFC chart the development of Labuan as a thriving captive insurance jurisdiction in the Asia and Pacific region

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.

Captive Review (CR): **How has Labuan's captive market changed since its launch?**

Labuan IBFC (LIBFC): Labuan IBFC's recognition as a captive jurisdiction is relatively nascent, having only offered captive solutions since the passing of the Offshore Insurance Act 1990.

Historically, Labuan was predominantly a Malaysian-centric international financial centre and as such the majority of the captives were Malaysian. The first Labuan captive was established in 1998 and is still operational today. Labuan IBFC now have 55 captives. Originally in 2010, 75% of the premiums were Malaysian-based, and presently, the ratio is 65% foreign. The shift between domestic-based captives and foreign captives in Labuan is in line with the jurisdiction's main aim of being a regional reinsurance and risk management domicile. Today, Labuan IBFC is home to more than 220 insurance-related licensed entities, representing the largest group of licences in the jurisdiction.

The centre is home to Asia's only rated captive, Energas, and to the world's first Islamic captive as of 2014, which is owned by a Sri Lankan entity. Our range of self-insurance vehicles is also wide, ranging from single parent captives to association captives, and we are the only jurisdiction in Asia with protected cell company (PCC) legislation.

Being domiciled in Labuan IBFC means

being a part of a much larger ecosystem, providing a comprehensive landscape from which operationalising a captive is possible with ease. Our banking industry with more than 50 banks also assists towards this aim, as do our insurance managers. Another point to note about Labuan as a captive domicile is the wide range of structures offered. The jurisdiction has a single point regulator, Labuan Financial Services Authority (Labuan FSA) which has a proportional approach to regulation. All of these pull factors add to the attractiveness of Labuan IBFC as a wholesale financial and risk intermediation centre.

CR: What market trends are you seeing in the Labuan captive insurance sector?

LIBFC: With the Covid-19 pandemic, it is difficult to predict market trends. Many companies are looking to set up self-insurance to a certain degree but whether this is in the immediate future remains to be seen, as setting up an effective captive vehicle requires a fair amount of time.

That said, there is still some growth in the captive numbers for 2020. This could be due to the current challenges surrounding the pandemic and the general economic uncertainty coupled with the hardening market; these factors have resulted in an environment in which the acceptability and adoption of captives can grow.

With self-insurance being relatively new in the Asia and Pacific region and with many organisations adopting a more prudent approach during these harsh economic times, a PCC provides greater flexibility with the ability to set up a smaller self-insurance entity in a shorter time frame and at a lower cost.

For Labuan IBFC, this trend and the acceptability of PCCs, especially during this hard market and challenging business environment, seems to hold true with the heightened interest in PCCs.

In 2020, the jurisdiction welcomed six new PCCs from all over Asia, and we expect this growth to continue in 2021 as understanding and acceptability of this structure is further driven by harder reinsurance markets and an expected prolonged pandemic-affected economic outlook. In general, thanks to the PCC, there is a greater appreciation that captives can provide cheaper access to markets when there are cells involved.

CR: How did captive business perform in 2020 and what are the jurisdiction's plans?

LIBFC: Labuan IBFC had eight new captives and a total of 55 captives registered in the jurisdiction last year which has further reinforced its regional prominence in the captive market.

In terms of gross written premiums, Labuan's captive insurance business accounts for 31.2% of the total gross premiums underwritten in Labuan IBFC, amounting to $497.4m and with 65.4% of the total premiums originating from international markets.

"Being domiciled in Labuan IBFC means being a part of a much larger ecosystem, providing a comprehensive landscape from which operationalising a captive is possible with ease"

Even as Labuan IBFC continues to enjoy growth in its reinsurance and risk management sector, we remain open to business innovations and opportunities. This is evident with the influx of digital financial services such as insurtech, revolutionising the conventional forms of financial offerings in the Centre, including the possibility of setting up purely digital captives operating on distributed ledger technology.

To ensure its continued growth and leadership in the Asian captive market, Labuan IBFC is working on finalising its Captives Master Plan, which will chart the path for the development of the domicile as a self-insurance centre over the next five years. In addition, Labuan IBFC continues to actively participate in international events as well as curate captive-focused programmes (such as the highly successful Asian Captive Conference) that feature internationally renowned industry speakers and subject matter experts.

CR: What are the biggest challenges for the captive market in the region?

LIBFC: One of the biggest challenges is the lack of awareness of the captive insurance industry in Asia. The penetration of captives on the continent is relatively low compared with regions such as the US and Europe, where captives have been a fixture of clients' risk management strategies for many years.

Awareness of the industry continues to increase steadily, though, suggesting that in time the market will become more sophisticated and captives will become a leading risk management tool for multinationals and larger corporations in Asia. With the exploration of different possibilities in flexible structures covering areas of risk which are harder to cover, coupled with the ever harder reinsurance market, we expect captive formations to accelerate.

However, the decision to set up a captive is not made easily by boards, and it can be challenging on a multitude of fronts for risk managers – and this is why Labuan IBFC's open approach in engaging with risk managers at the very onset of their captive journey is a key benefit for our licence holders and potential licence holders, where discussions with the regulator facilitated by the market development arm, Labuan IBFC Inc, can be initiated at the very beginning of internal discussions surrounding the setting up of a self-insurance vehicle. Being a wholesale risk management intermediation centre allows Labuan IBFC this bespoke approach, as does the benefit of having a one-stop, business-friendly regulator, the Labuan Financial Services Authority.

In recent years, Labuan IBFC has worked on generating awareness of self-insurance and engaging with risk managers in Asia, as well as providing an offering beyond pure captives such as PCCs and association captives. The jurisdiction has also ensured that the regulatory processes in Labuan have some degree of flexibility during the pandemic.

Labuan FSA has and continues to provide regulatory relief to cushion the impact and disruption to business operations caused by the coronavirus pandemic. Again, this is only possible due to the business-friendly approach that is available in a wholesale financial services environment.