DRIVING CAPTIVE TRANSFORMATION IN ASIA

SURVEY CONDUCTED BY CAPTIVE REVIEW IN PARTNERSHIP WITH LABUAN INTERNATIONAL BUSINESS AND FINANCIAL CENTRE

LabuanIBFC
International Business and Financial Centre, Malaysia

CAPTIVE REVIEW

In recent times, Asia has been tipped as the next growth area for the captive insurance world. While growth has been steady, there is yet to be the 'boom' spoken about by various commentators.

Of the 6,315 captives placed in various jurisdictions globally, only 168 are domiciled in Asia, according to statistics compiled by this publication. This is 20 more than the 148 recorded in 2016. Singapore and Labuan IBFC lead the way in the region with 73 and 48 respectively, with Labuan IBFC leading incorporations in 2018.

Of the 345 new formations in 2018, Asia is home to 10, significantly less than the 77 in Bermuda and the Caribbean and the 242 in North America.

Despite being home to a relatively small share of the global market, a number of

Written by
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Asian multinationals own captives that are domiciled in international jurisdictions. The potential for captive insurance growth in a region that is experiencing rapid economic expansion still remains.

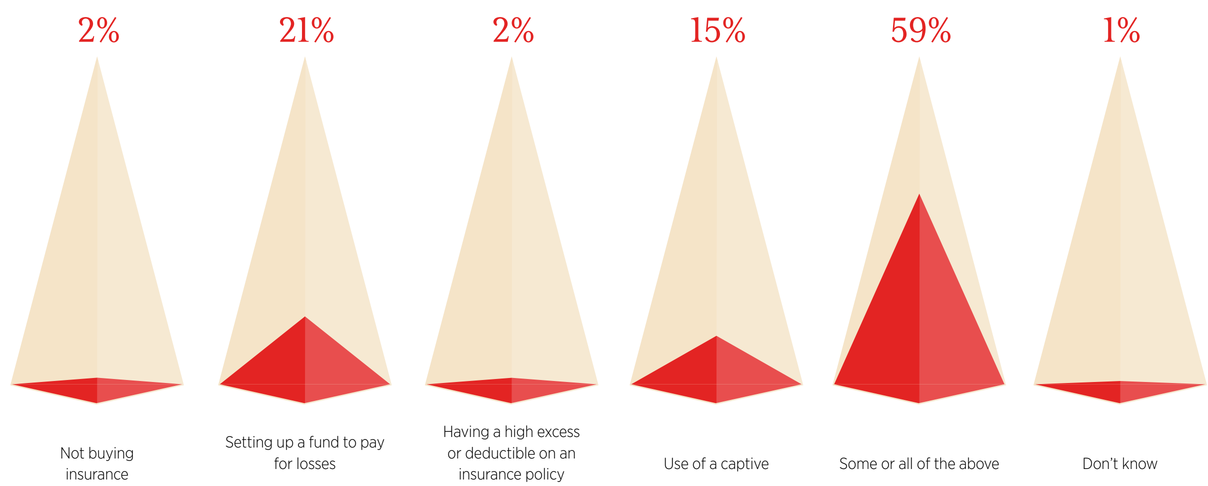
This white paper will reveal some of the factors that are holding the Asian captive insurance industry back, some of the successes the market has experienced and what the future holds for the region.

In 2018, *Captive Review* carried out a survey in partnership with Labuan IBFC.

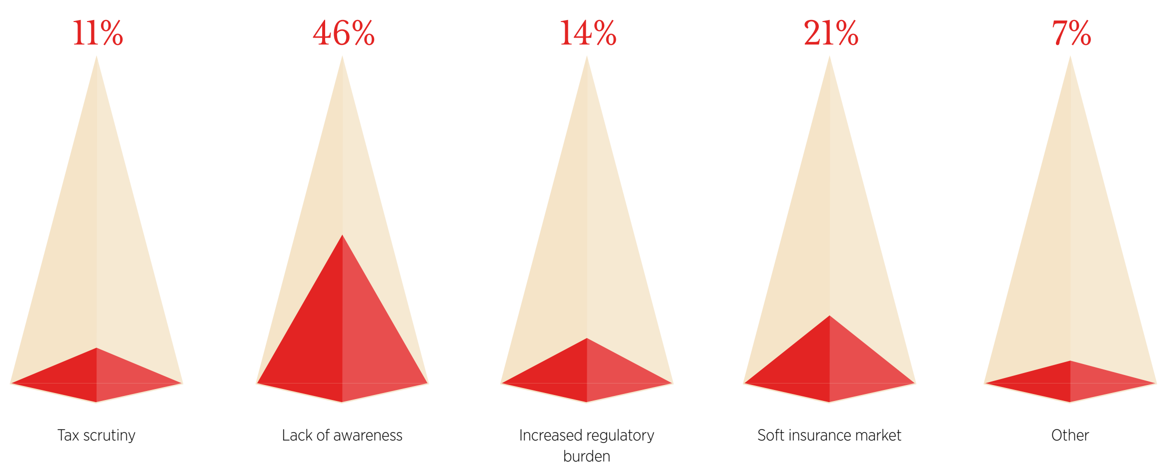
Some of the key findings include:

- A "lack of awareness" was cited by respondents to the survey as the biggest obstacle to new captive formations in the region. Just under half (46%) claimed this was the case, while a soft insurance market and an increasing regulatory burden also fared high up the list.
- When talking about self-insurance, only 15% referred directly to the utilisation of a captive, with most believing it referred to "setting up a fund to pay for losses".
- Regulation was the most important factor for respondents when considering where to set up shop. An overwhelming majority (81%) chose this. Cost followed with 9%.

WHEN WE TALK ABOUT 'SELF-INSURANCE', DO YOU THINK IT REFERS TO…



WHAT DO YOU VIEW AS THE BIGGEST OBSTACLE TO NEW CAPTIVE FORMATIONS IN ASIA?



Demographic

Following on from previous years, some of the questions on the survey attracted more than 100 votes. Over the past 12 months, commentators and industry figures have suggested that Asia must now move forward in its growth as the market sophisticates.

With this in mind, *Captive Review* and Labuan IBFC asked respondents questions on the utilisation of cells, technology, tax transparency and self-insurance.

Knowledge base and drivers

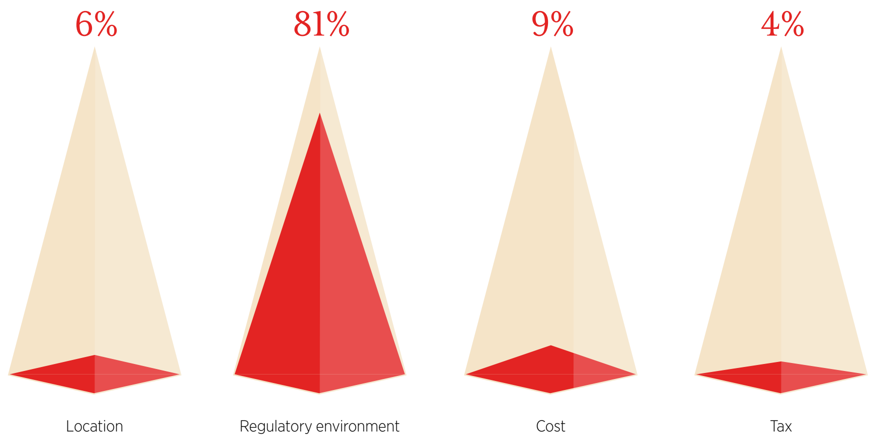
A lack of awareness of the captive insurance industry in Asia is well-known. When asked what 'self-insurance' refers to, 21% believed it referred to 'setting up a fund to pay for losses', 3% claimed it referred to having a high excess or deductible on an insurance policy, 15% chose captives and 59% chose 'some or all of the above'.

Just under half (46%) cited lack of awareness as the main obstacle to forming a captive in Asia.

Industry figures operating in the region concede that the Asian market is "still under development", and that some risk managers are "not as experienced", awareness of the industry is increasing overall, and comparisons cannot be made to the North American and European markets.

"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," said Shiwei Jin, global programme and captive regional director for AXA XL.

WHAT IS THE MOST IMPORTANT FACTOR IN CHOOSING A DOMICILE?



"The actual number of captives formed by parent companies in Asia and the growth rate compared to its economic growth is part of the story."

George McGhie, managing director in Willis Towers Watson's captive practice in Singapore added that awareness of the captive insurance market is growing significantly in the region, but there is a dislocation in geographies. "Awareness is increasing but at varying rates for different countries and industries. It's driven by client needs – if they struggle for competitive traditional capacity, and are not constrained by local regulatory restrictions, their brokers and advisors should be bringing captives to their attention," he said.

"However, there is no single 'Asia market' and many Asian countries retain restrictive regulation of local insurance markets, hampering progress. At the same time conglomerates in many Asian countries include insurance companies which, while commercial in nature, are used to fill some 'captive' needs."

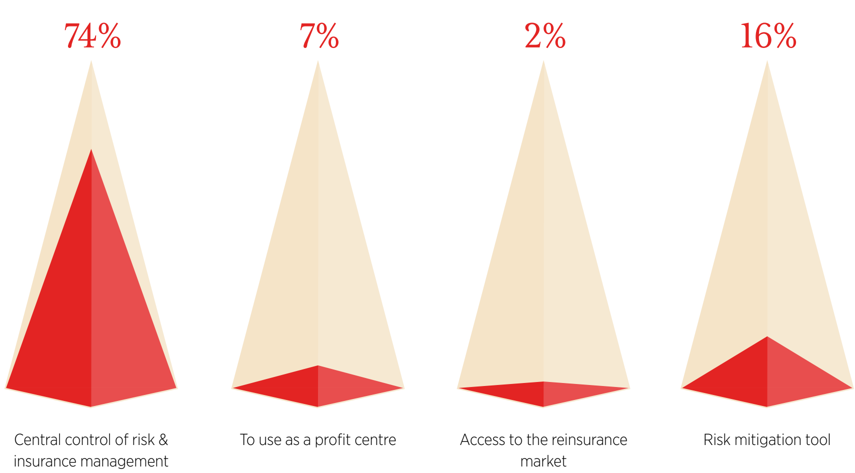
Sebastian Schuez, head of customer, distribution and market development for Zurich in Singapore agreed, claiming that large multinationals are now taking note.

"There is an increasing awareness with large multinational companies," he said. "Human resources departments have recognised that a reinsurance captive can support the development of a tailor-made insurance coverage for the benefit of employees. Without having a captive available, corporates which insure their employees have to follow the traditional market standards."

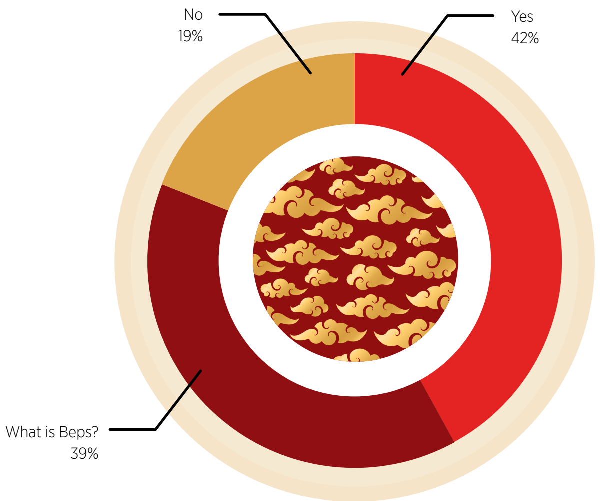
Awareness of the industry continues to increase steadily, suggesting that in time the market will become more sophisticated and captives will become a leading risk-management tool for multinationals. With the exploration of different possibilities in structures and domiciles or even risks coverage, captive formations are likely to accelerate.

However, convincing the C-suite that setting up a captive is the right decision can often prove a challenge for risk managers in the exploratory stage.

WHAT IS THE MOST APPEALING ASPECT OF OWNING A CAPTIVE?



DO YOU UNDERSTAND THE RELEVANCE OF BEPS FOR CAPTIVES?



An overwhelming majority (74%) of respondents to the survey claimed that central control of risk and insurance management was the most appealing aspect of owning a captive, which should prove encouraging. This was followed by 16% who said it was most appealing because of its dynamic function as a risk management tool. Use as a profit centre and access to the reinsurance market trailed on 7% and 2%, respectively.

Regulatory attitudes

Just under half (42%) of the respondents understood what Organisation for Economic Co-operation and Development (OECD)'s Base Erosion and Profit Shifting (Beps) was and its implications on the global captive insurance market. This was followed by 39% who did not know what Beps was, while 19% didn't understand its relevance.

Despite this, 81% claimed that regulatory environment was the most important factor in choosing a domicile. The second highest response was cost, with only 9%.

Regulatory uncertainty driven by the Beps project may have "slowed the momentum" in Asia said Angela Marks, deal manager at Zurich Financial Services Australia. However, regulators and associations across the region are taking a proactive approach to conversations with tax authorities, which should help with clarity, she added.

McGhie claimed that while Beps did impact the region, focus has "largely shifted away" from compliance with it and moved towards ensuring appropriate levels of substance and sustainable levels of planning and funding.

This is reinforced by the statistics, which showed that more than two thirds (69%) of respondents believed substance and governance requirements were their biggest regulatory concerns.

Scrutiny around transfer pricing and reputational damage trailed with 24% and 3% respectively, while "I don't know" accounted for 4% of answers.

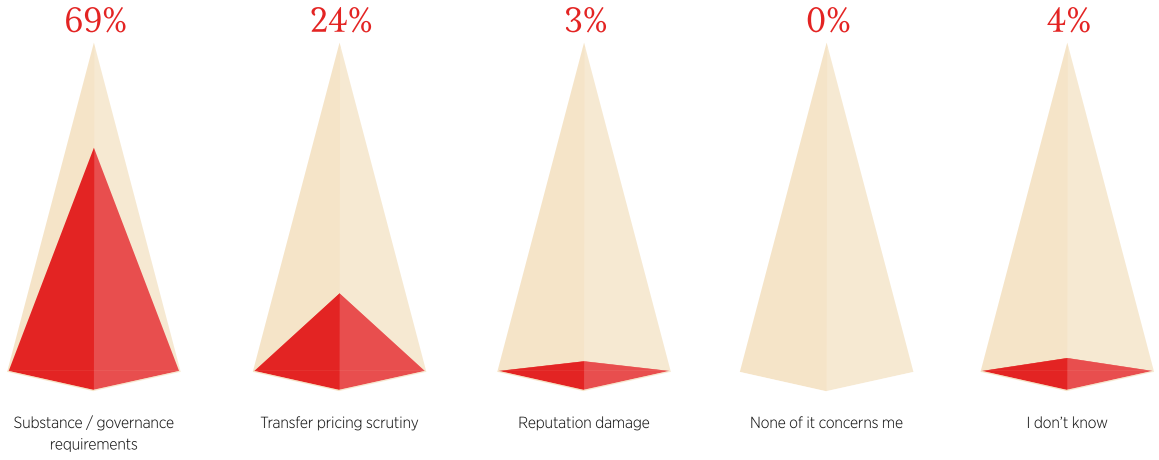
With an increased focus on substance requirements and an increasingly established regulatory framework, the Asian market should "open up", said Oliver Schofield, head of captive and alternative risk transfer at Principal Re.

"From the regulatory perspective, more international recognition is manifesting outside of the Asian region," he said.

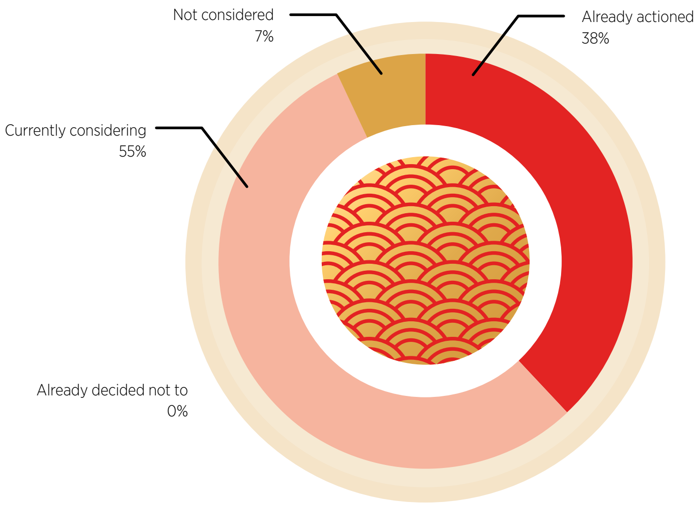
"Labuan IBFC and Singapore have the growing infrastructure, they have regulators that are well versed in international business and are now set up as an exciting place for captives.

"There are many Asian companies that have captives, but not all of them are in Asia. Some are in Bermuda, some in Guernsey. Why is there not the reverse flow? This is something we're pushing."

WHAT CONCERNS YOU MOST ABOUT THE BEPS PROJECT?



TO WHAT EXTENT HAVE YOU CONSIDERED IMPLEMENTING, OR TESTING, NEW TECHNOLOGY?



Technology

Technology is an increasingly important aspect of risk management for Asian companies. According to the statistics, 55% of survey respondents are currently considering implementing new technology in their business, with 38% already actioned and only 7% not considering it.

The adoption of technology will help to create new markets for regional captives, and will largely be used to boost operational efficiencies, claimed McGhie.

Big data was cited by respondents as the technology that they were most familiar with. More than half (53%) chose it, with interface accounting for 19%, artificial intelligence for 14%, blockchain 11% and API – connectivity and data 4%.

Respondents said they expected artificial intelligence to cause the biggest disruption to Asia's insurance industry. Just under half (49%) chose this. Blockchain came in second place, accounting for 16%, while 15% chose API – connectivity and data, 12% chose big data, 3% chose interface and 4% chose "none of the above".

Despite this, blockchain technology is already making its mark on the captive insurance world, said Jin, citing Insurwave, a newly launched insurtech business.

She said: "Streamlining communication and transactions helps improve industry processes significantly and provides better insurance services to customers. This is a powerful example of how technology can change risk management and benefit our clients. I would encourage captives to actively engage in new technology discussion and development through industry communities such as PARIMA and Insurtech Asia Association and insurance carriers and participate in suitable pilots to jointly drive innovation in insurance."

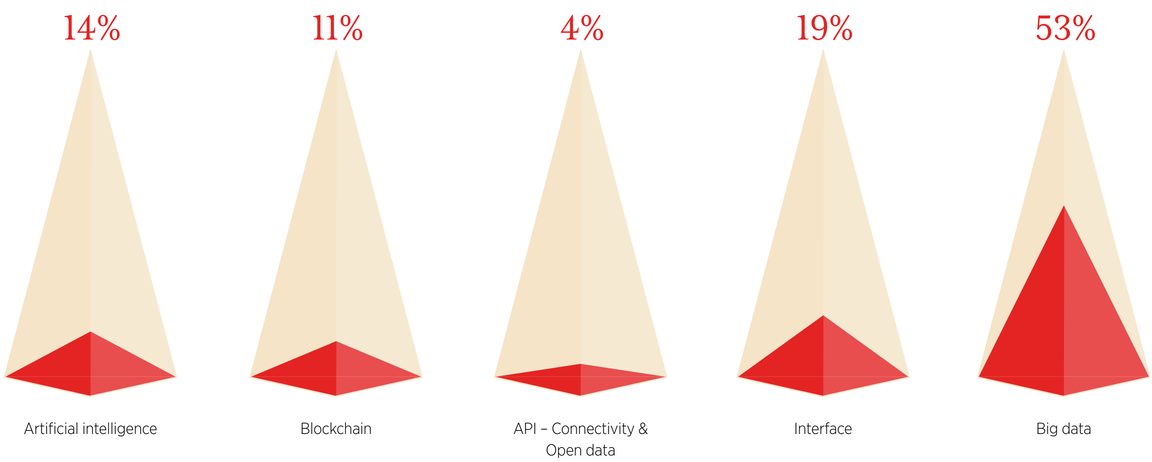
Sean Welsch, an independent captive manager operating in the region said that the result of technology will take hold once multinationals agree to share data in an end-to-end solution.

"Looking at Asia overall, technology is a big topic," he said. "When it comes to captives, it's still not as used as it should be. An end-to-end solution for captives as such is what we're trying to work on, but it's going to take a while."

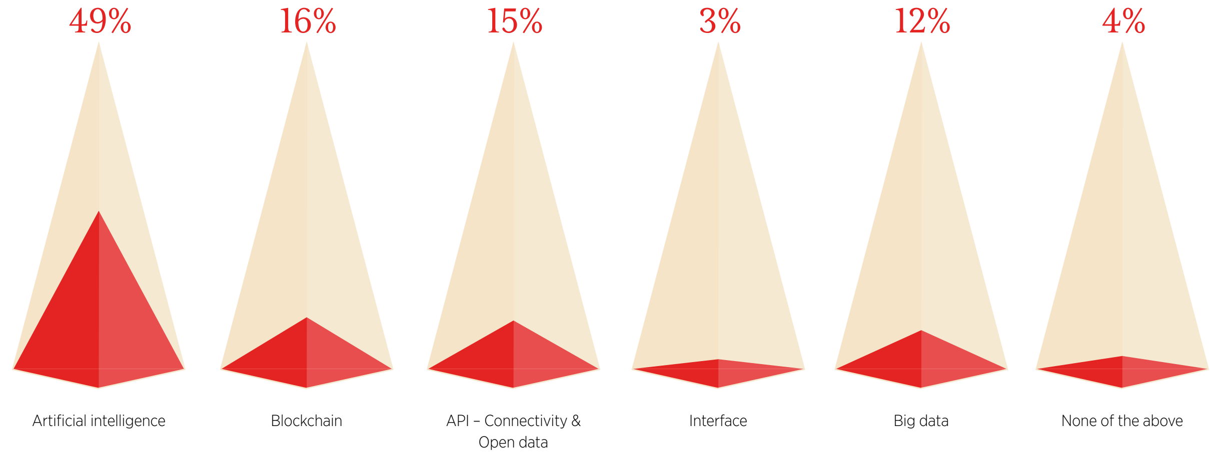
A look ahead

With steady year-on-year growth, the captive insurance market in Asia is continuing to mature and sophisticate. This is shown in the statistics, which make clear that 52% of respondents have heard of protected cell companies, while 20% have experience of working with them.

WHICH TECHNOLOGY ARE YOU MOST FAMILIAR WITH?



WHICH TECHNOLOGY DO YOU THINK WILL CAUSE THE BIGGEST DISRUPTION TO ASIA'S INSURANCE INDUSTRY?



More notably, 76% of respondents said that cell companies could be a suitable solution for Asian risk. Only 17% said they didn't know and 6% opted for 'no'. Growth in the number of cells formed will come in the region's most established domiciles, claimed Schofield. "Regionally, places like Labuan IBFC recognise that there should be an uptick in the number of captive cells in the coming years and have geared themselves accordingly," he explained.

Opportunities are also posed by China's Belt and Road Initiative (BRI), respondents believe. According to the statistics, 48% said that the BRI will have a "big impact" on the Asian insurance market over the next five years. Equally 48% said it will have "some impact" and 5% said it will have no impact.

More than two thirds (71%) said captives will have a role to play. The remainder said captives will have no role.

Alongside this, a hardening Australian market and an increasing sophistication of the industry will also drive Asia's growth.

"High interest countries are Australia, Japan, Singapore, Malaysia, China and Hong Kong," said Franck Baron, group deputy director, risk management and insurance at International SOS Pte. Ltd. and chairman of the Pan-Asia Risk & Insurance Management Association in Singapore

Mergers and acquisitions by companies in Asia-Pacific also drive growth, said Simon Burtwell, global captive network lead and partner, FS insurance at EY in London.

"We are seeing an increasingly acquisitive Asia-Pacific region investing in European and American businesses and suddenly finding within the mix of those, they've got captives," Burtwell added.

Marks said: "We also expect the rapidly evolving risk landscape to prompt momentum in non-traditional classes of business. One area in particular where we expect to see movement is in the domain of employee benefits, with employers increasingly turning to captive arrangements to fund employee cover for accidental death, life insurance, and long-term disability."

Jin also expects an increase in sophistication, predicting that captive owners will start moving away from insuring solely traditional risk. "We see clients are showing greater interest in using captives as part of a risk management strategy to fund and insure corporate retained risk or to obtain commercial reinsurance on a direct basis.

"We are having more and more discussions on captive programmes that go beyond traditional property and casualty risk to include cyber risk, terrorism, crime and other non-traditional risk," she concluded.

YEAR-ON-YEAR CAPTIVE GROWTH IN ASIA

	NUMBER OF CAPTIVES			
DOMICILE	**YEAR-END 2018**	**YEAR-END 2017**	**YEAR-END 2016**	**YEAR-END 2015**
China	5	4	2	2
Cook Islands	3	3	3	N/A
Hong Kong	3	3	3	3
Labuan	48	43	39	25
Micronesia	24	23	19	18
New Zealand	6	6	5	5
Singapore	73	70	71	68
Vanuatu	6	6	6	8
Total	**168**	**158**	**148**	**129**