The Advantages of Captive Insurance

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There is a trend within many industries towards placing risk within “captive” or “affiliated” insurance companies, but what are affiliated insurance companies and what are the advantages of placing risk with them?

Captive/Affiliated Insurance Companies

All companies will purchase at least some insurance whether because that insurance is compulsory, or because its financiers or business partners insist upon it, or simply because it has made its own risk assessment and decided that it is in the best interests of the company. This means that premium is paid to a third party, whether that is a traditional insurance company or a non-profit making mutual such as a P&I Club, and the risk in question is transferred. However, corporate entities are increasingly looking to an alternative, whereby the risk is placed with a wholly owned subsidiary insurance company. Traditionally known as “captives”, these group insurance companies are referred to, in Malta, as affiliated insurers, and affiliated insurance is defined in Maltese law as:

“The business of an insurance company which is registered in Malta and whose business of insurance is restricted to risks originating with the shareholders or connected undertakings or entities”.

There are several advantages to making use of such an entity, including:

- **The retention of premium within the group of companies.** Rather than passing premium, and any chance of making profit from that premium, to a third party, it can be retained. This is particularly appealing in areas where insurance is habitually or statutorily in place but little or no claims are made against it. It allows the necessary insurance to be in place so that, if a claim does arise, it will be covered but if little or no claims arise, the premium is retained within the group rather than by an unrelated entity.

- **Predictability of insurance cover and price.** By being fully in control of the insurance company, its owners can be certain that they will receive the insurance cover they need at the correct price. This means that, if they do have a year, for example, when claims are unusually high, this need not affect their ability to source or pay for cover the next year. It also gives comfort to the company that the costs associated with sourcing insurance cover are predictable on a long-term basis and genuinely associated with the actual risk involved.

- **Ability to source exactly the cover required.** By controlling the insurer, the company has control over the policy contents, so as to ensure that the cover provided is bespoke to the company’s requirements. The opportunity to access the core of the insurance business allows the company to design policies for specific needs, whatever they may be. It also ensures that
whatever cover is required, it can be provided, whether or not the insurance market as a whole is prepared to offer that particular service.

- **Ability to respond more quickly when new cover requirements are identified.** As soon as it is clear that a particular type of cover is required, the insurer can provide it, without the company having to spend time and money on negotiation with a third party insurer. Such negotiations can engage a great deal of senior personnel time. The use of integrated systems throughout the group of companies will also help to ensure the timely and smooth introduction of new and amended policies.

- **The ability to shift profit centres.** For example, the payment of premium by a German company to a Maltese one would create an expense in Germany and, an income profit in Malta. This could prove advantageous in terms of managing tax liabilities throughout the group as a whole.

- **The ability to “ringfence” a company’s own activities from those of other, unknown entities.** When using a traditional or mutual insurer, the company’s own activities and risk profile are pooled with those of other companies who may or may not have comparable risk profiles. This means that there is little control for the insured over the risks that they may be called upon to underwrite since they have no control over the activities of the other insureds. This can be particularly tricky in the P&I Club market, where there is no limit of liability and additional calls can be made upon Club members at any time, to any level. In the captive context, the company is fully aware of the actual extent of the risk profile and can price its premia accordingly.

- **Full regulatory control.** To create an affiliated insurance company, that company must be approved and supervised by the relevant competent authority. This ensures that the insurance company is in the same position as others vis a vis its robustness. In Malta, the relevant authority is the Malta Financial Services Authority (MFSA), and being authorised here allows the company to write risks throughout the EEA. In addition, the regulatory regime provides comfort to third parties, such as financing banks, that adequate insurance provisions are in place.

- **Enhanced internal risk management.** One generally finds that when a group of companies is carrying its own risk, it becomes increasingly risk aware and better equipped in identifying and managing that risk, thereby reducing the need to make claims. Of course, some risks are entirely unmanageable, such as catastrophic weather conditions, but these can be managed externally, through the purchase of reinsurance for example. The knock on benefit is, of course, the ability to reap the rewards for effective risk management. If no claims are made on the insurance, the profits from the insurance premium stay within the group.

In addition, even before entering into the insurance business, companies will carry out full risk assessments of their businesses in order to ascertain whether this is the right course for them to take. This will indicate those areas where the company has a good track record and, perhaps, those where it is not so good. Owning an affiliated insurance company will allow the group to cherry pick those aspects of its risk that it is happy to insure for itself and those where it would prefer somebody else to take the risk.

- **Access to the reinsurance market.** An affiliated insurance company, unlike its non-insurer group companies, can manage its own risk profile through the purchase of reinsurance. Since
this is purchased between professionals, reinsurance is generally obtained on more favourable terms than traditional insurance, thereby providing the same level of cover but for a lesser cost. It is entirely at the group’s discretion whether to hedge their risks through the purchase of reinsurance and to what extent. There is an advantage for the captive over a traditional third party insurer in relation to reinsurance because the captive has a more complete understanding of the risks that it is carrying and can carry that knowledge over to its decision making in relation to the purchase of reinsurance.

Practical Issues

It is advisable at the earliest stage to approach an insurance management company to ask them to provide initial feasibility studies to help the company fully understand its own risk profile and whether the affiliate model really can benefit them in the long term.

Becoming and remaining an authorised insurance company is not without its financial implications, but companies are increasingly seeing that the outlay is more than made up for by the benefits. In addition to the costs associated with any business start-up, typical costs for a new insurance company in Malta would include Malta Financial Services Authority application fees, and fees for assistance in making the license application to MFSA. This assistance is usually provided either by a specialist lawyer or an insurance manager. All insurance companies also have to meet minimum capitalisation requirements. These are variable and depend on the nature of the business being written as well as on the volume of business written.

Malta allows an alternative potential vehicle, the Protected Cell Company, which can reduce the regulatory and financial burden and this is discussed in further detail below.

Alternatively, companies may wish to build their insurance businesses over time and begin by placing, say 10% of their risk with the affiliate for the first year and maintaining their current providers for the remaining 90%. Over time, as the profits of the affiliated insurer grow, the company can place greater amounts of risk with the affiliate.

Companies that do not have the necessary expertise to run their own insurer can make use of insurance managers to handle the day to day operation of the business. Malta hosts most of the major international insurance management companies who can provide this service at a relatively low cost.

Profits that are realised in Malta, by an affiliated insurance company with overseas ownership, are treated favourably under the Maltese tax regime. Whilst a flat rate of 35% is applied across the board, there are innovative incentives available for financial services companies that effectively reduce that rate to 5%.

Maltese resident affiliated insurers are also able to benefit from Malta’s double tax relief provisions and its extensive double taxation network without falling foul of Inland Revenue legislation in their parent’s domicile.

The regulation in Malta allows affiliated insurers to provide services not only to their group companies, but also to members of trade, industry or professional associations insuring risks related to the group’s own business. This means that a Maltese affiliated insurer has the potential to provide specialist insurance to competitor companies and to become a generator of profits in its own right.
In addition, since Malta is a member of the European Union, insurance companies that are authorised in Malta are able to take advantage of the EU “passporting” provisions, which allow such companies to write insurance into all other EU and EEA countries.

Protected Cell Companies

Maltese regulation allows for insurance business to be carried out through Protected Cell Companies (PCCs). No other business sector has this advantage and Malta is one of only a small number of EU domiciles that allows this business vehicle. The law allows for:

- A single corporate body to form multiple, distinct cells whose assets and liabilities can be ring-fenced from one another and from the core assets of the PCC;
- The creation and issue of cell shares so that their owners may receive the profits of the cell;
- Transfer of cellular assets to other persons and the extension of the protected cell assets concept to the transferee;
- Use of non-cellular assets within the PCC as a secondary asset base where cellular assets are exhausted.

The ability to purchase a cell within a PCC and write risk from that cell provides advantages to companies that might not consider the creation of a stand-alone insurance company. It allows the start-up and ongoing regulatory burden to be spread throughout the owners of the PCC without putting any individual cell owners’ assets at risk from the others.

Ganado & Associates

G&A has extensive expertise in the insurance field and is well placed to provide services in this area. If you require further information, please contact Dr Matthew Bianchi via:

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