TAXATION
The island is a good base of operations with complex IPT developments coming.

CELL STRUCTURES
Malta is the first, and only, EU member state to implement PCC legislation.

LEGISLATION
How Malta's regulator has implemented steps to prepare for the Solvency II Directive.

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At Captive Review, we have long enjoyed a healthy relationship with the captive industry in Malta. As a domicile, Malta has experienced a growth in licensed captives over the years and has had to evolve and adapt to the changing conditions of the industry.

For one, as captives have been deemed as too expensive for some companies, Malta has championed innovative structures such as the Protected Cell Company and the Incorporated Cell Company. A favourable tax domicile, Malta has been able to prove a cost-effective geographic solution for captive owners who also favour Malta’s EU member state status.

But the captive industry in Malta is never one to rest on its laurels, with a pro-active regulator (the Malta Financial Services Authority) and innovative market participants who like to keep their finger on the pulse.

To find out more about the island’s view of 2013 and its captive residents’ perspective on the industry, we gathered insight from a range of industry experts to bring you the Captive Review Malta Report 2013.

Jon Yarker
REPORT EDITOR
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In the future, cash will be king.

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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.

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 PCCs 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
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 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**

<table>
<thead>
<tr>
<th>DOMICILE</th>
<th>No. PCCs</th>
<th>No. individual cells</th>
</tr>
</thead>
<tbody>
<tr>
<td>GIBRALTAR</td>
<td>2010: 5</td>
<td>31</td>
</tr>
<tr>
<td></td>
<td>2012: 3</td>
<td>33</td>
</tr>
<tr>
<td>GUERNSEY</td>
<td>2010: 69*</td>
<td>377*</td>
</tr>
<tr>
<td></td>
<td>2012: 68</td>
<td>395</td>
</tr>
<tr>
<td>ISLE OF MAN</td>
<td>2010: 3</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>2012: 1</td>
<td>0</td>
</tr>
<tr>
<td>JERSEY</td>
<td>2010: 8</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>2012: 1</td>
<td>0</td>
</tr>
<tr>
<td>MALTA</td>
<td>2010: 4</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>2012: 8</td>
<td>18</td>
</tr>
</tbody>
</table>

*ICCs also included

**Note:**

1. PCCs and cells include captive and non captive insurers
2. The statistics are a « snapshot » of the situation as at 31/5 for both years.
3. The creation of Incorporated Cell Company (ICC) legislation in some domiciles may have impacted negatively on the growth of PCCs.
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The changing landscape of European IPT

As change sweeps through European insurance premium tax legislation, Mike Stalley of FiscalReps examines how this issue is evolving in each country.

Malta is the perfect place in which to establish and licence an insurance company in order to benefit from the ability to provide insurance throughout the European Union (EU) under Freedom of Services legislation. However, the opportunity of being able to access this large “single” market without additional regulation comes at a cost, namely, insurance premium tax (IPT) compliance.

Insurers in Malta are required to comply with IPT legislation in each country where they provide insurance, based on the location of risk rules which are defined within the EU non-life directives. Although IPT is not a technically challenging tax to apply, the sheer quantity of EU countries, their differing languages and the complete lack of tax harmonisation makes for a tax which is administratively demanding in order to manage effectively.

In the past, insurers were able to rely on the fact that legislation surrounding IPT was subject to little change, with rates remaining static for many years. Unfortunately, 2012 and 2013 have signalled a reversal of this trend. Many countries are changing their tax legislation, increasing tax rates and introducing new taxes, with the intention of generating additional tax revenue in order to support their ailing economies.

The following summarises recent and upcoming changes to IPT:

**Spain**

Four provinces in northern Spain have made the decision to collect premium taxes directly from taxpayers, rather than via the national tax authority in Madrid. The provinces of Navarra, Álava, Guipúzcoa and Vizcaya have had the power to do so under Spanish law 12/1981, de 13 de Mayo, which gives these Autonomous Communities the right to collect their own taxes, including IPT. Until now, however, this power has never been enforced. It is thought that this decision is a consequence of the ailing economic situation in Spain.

Although this has no impact on the amount of IPT payable, it does add to the administrative burden for taxpayers. This follows a similar stance taken by Italian provinces in relation to IPT on motor vehicle liability premiums, where IPT levels are set independently by each of the 80 Italian provinces.

It is possible that other regions in Spain, such as those in Catalonia, will see this as an opportunity to demand such powers, despite the fact that the current legislation only covers the four provinces mentioned above.

**United Kingdom**

Following the major floods suffered by many parts of the UK in early 2012, HM Treasury has mooted the idea of a flood levy to cover the costs of flood damage. To date, no firm proposals have been made. However, given the more recent flood damage, there is every chance that this may become more of a reality.

**The Netherlands**

On 1 October 2012, the House of Representatives proposed an amendment to the Dutch budget for...
2013. This includes a proposal to more-than-double the rate of IPT from the current 9.7% to 21%, bringing this in line with the VAT rate, which itself increased from 19% to 21% on 1 October 2012.

Germany
In May 2012, the German Ministry of Finance introduced a number of proposals to amend the IPT legislation currently in place. The main objectives of these proposals are not only to widen the scope of IPT collection, but also to reduce the administrative burden for both taxpayers and tax authorities in order to streamline the tax compliance process.

Although no firm proposals have been made, it is likely that the authorities will propose an increase in the limits used to determine whether filings can be made quarterly, instead of monthly.

Denmark
On 12 June 2012, the Danish Parliament approved the introduction of a premium tax on non-life insurance premiums, which will replace the existing stamp duty. The new tax will be introduced on 1 January 2013, at the rate of 1.1% of non-life insurance premiums. Exemptions apply to specified insurance classes, such as maritime, transport and aviation policies. The tax does not apply to the Faroe Islands and Greenland. From the same date, the Stamp Duty Act will be repealed.

All insurers liable to pay the tax must register and account for the tax at monthly intervals. The Minister of Taxation may provide more detailed rules in this regard, including rules for digital tax returns. Certain insurers, such as those insurers established outside the EU, will be required to appoint a Danish tax representative; however, it will no longer be a legal requirement for an EU insurer operating on a Freedom of Services basis to appoint a fiscal representative in Denmark.

Finland
The Finnish Government has proposed an increase in the standard rate of IPT from 23% to 24%, with a planned effective date of 1 January 2013. This follows on from an increase from 22% to 23% in 2011.

Greece
The operation of the Motor Guarantee Fund (MGF) in Greece is about to undergo major changes. For a number of years, the MGF has struggled with serious financial problems, which are also being impacted by the deterioration of the economic situation in Greece.

First, an increase in the rate of levy from 5% to 6% has been proposed, together with a widening of the scope of the taxable base to include both net premium and policy fees.

Secondly, all FOS participants in the MGF will be required to pay a one-off membership fee of €50,000 and guarantee a minimum annual contribution to the MGF of €10,000 per annum. For all but the largest insurers, writing motor business in Greece could become un-commercial as a result of these significant increases in the MGF levy.

Czech Republic
Based on information released by the Czech authorities, it would appear that the new IPT regime will not be implemented until parliament has approved the IPT legislation. This will most likely be in 2014. In accordance with Decree Nr. 361 from 23 May 2012, the Czech Government instructed the Ministry of Finance to present the draft IPT legislation to parliament for its approval by 31 December 2013.

Hungary
The Hungarian Government has approved the introduction of a new premium tax, which will come into force on 1 January 2013. The new tax applies to gross premiums at the rate of 15% on comprehensive ‘casco’ policies (EU classes three to six) and 10% ‘accident and property’ classes. The wide definition that appears to be given to ‘accident and property’ could mean that the tax applies to many more insurance classes than it does at present. It is understood that the new tax replaces the Fire Brigade Tax, but that it does not replace the 30% tax on compulsory motor third-party insurance, which remains in force.

Despite the relative technical simplicity of applying IPT, the increasing pace of tax changes across the EU is making it increasingly administratively challenging. It is therefore a matter of urgency for insurance businesses to tighten up their tax compliance, and to be adaptive to future change - or risk the potentially punitive consequences of non-compliance.
“ART” SOLUTIONS AND SERVICE THAT SIMPLY ADD UP

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The banking side of Maltese captives

Kathryn Cordiner of HSBC Bank Malta PLC talks to Captive Review about captive insurers’ banking requirements

When a captive is established, it needs to ensure it has the right service providers involved in its business infrastructure. While this may be a concern for many, when a captive is established within a domicile in Malta, the captive’s manager will be comforted with the choice of well-established and reliable service providers they have available to them. This is especially true of the banking implications of a captive and to find out more, Captive Review talks to Kathryn Cordiner of HSBC Malta about the services available on the island.

Captive Review (CR): Can you give us a brief background on the Financial Institutions team and how it fits into the HSBC proposition?

Kathryn Cordiner (KC): The Financial Institutions teams across HSBC comprises of experienced senior bankers and product specialists, each chosen for their sector-specific expertise and knowledge of global financial markets. We have over 400 bankers around the world who work closely with our clients to understand their needs, and deliver integrated and customised banking propositions. As relationship managers within global banking and markets, we provide a wide range of products and services to financial institutions globally, including the insurance sector.

CR: What changes are you seeing in the services captives require from their banking providers?

KC: Captives by nature are generally conservative in their investment policies. Over the past couple of years, here at HSBC Malta we have seen an increase in cash deposits and captives, as well as other insurance companies, have moved from higher risk investments to conservative investments. Furthermore, with the introduction of Solvency II and the new risk management rules, counterparty rating is becoming a prerequisite for insurance companies to place funds with a financial institution. As the only bank to be rated AA by all three ratings agencies, HSBC is well positioned to assist in this ‘flight to quality’, supporting it through our balance sheet strength.

CR: How can HSBC assist captives who are looking for a conservative investment approach?

KC: HSBC Global Asset Management is the core global investments solutions provider of the HSBC Group. With over 20 years’ experience advising on, executing and managing liquidity investment strategies, HSBC Global Asset Management offers a full range of AAA-rated liquidity strategies in multiple currencies as well as a dedicated liquidity investment team focused on active management with extensive credit research capabilities. Locally, HSBC Global Asset Management (Malta) manages investment portfolios that are tailored for insurance companies who require cautious capital management.

CR: Can you expand on this managed service for insurance companies and how this fits with an insurance company’s overall investment objective?

KC: This managed service is specifically aimed at earning a higher rate of return with the same or lower level of risk. HSBC Global Asset Management (Malta) provides its customers with an investment management process that aims to maximise regulatory efficient, risk-adjusted returns, which ultimately minimise capital movements, liquidity risk, interest rate risk and credit risk. This type of discretionary portfolio management coupled with other HSBC liquidity management solutions enables captives to maximise their interest income and minimise their interest cost.

CR: What other solutions does HSBC provide to captives?

“IT IS IMPERATIVE THAT A CAPTIVE CHOOSES A BANKING PROVIDER WITH BALANCE SHEET STRENGTH AND A STRONG CAPITAL BASE”
KC: In order to assist captives in their liquidity management and further to the discretionary portfolio management and liquidity funds offered by HSBC Global Asset Management, we provide account and payment services, Forex and interest rate hedging, letters of credit (LoC) as well as credit facilities and electronic platforms to manage multiple positions in various countries.

CR: You mention electronic solutions, can you expand on this?
KC: Given the current market conditions, it is important for a captive to consider their selected banking provider’s ongoing ability to invest in the cash management business. Global transaction banking is a key business line for the HSBC Group and we are committed to this business on a long-term basis and have a number of global initiatives under way in order to ensure we are a leading player in this market for many years to come. We have invested in electronic solutions to ensure that captives can manage their payments and cash management, securities, trade and Forex deposits via a single log-in. The two electronic solutions we offer to our clients are HSBCnet and HSBC Connect.

While HSBCnet is our global internet banking platform, HSBC Connect is our flexible and secure host-to-host solution, developed to address our client’s recurring need to simplify the processes for originating payments and making collections. Its overall aim is to achieve greater efficiency and reduce costs.

HSBC Connect provides secure, direct integration between a company's internal systems and the bank. Using either a PC or mainframe to connect to HSBC, a corporate customer can deliver and receive electronic files of transaction instructions and account information. This allows for the transmission of large volumes of transactions and information in different formats without the need for an Internet browser or additional software.

HSBC Connect is often used in conjunction with HSBCnet. This allows users easy access to information and transaction initiation via the internet, while benefiting from the ability to integrate banking information with information held in internal systems.

The complete payment process flow – from the generation of an instruction by a company’s ERP to the automatic reconciliation of account payables using bank statement – is fully automated and seamless. Insurance companies will benefit from payment monitoring, automated exception reporting and reprocessing options.

CR: You mentioned that HSBC has invested in electronic solutions, what is the latest development in this regard?
KC: HSBCnet mobile is a new and convenient method of securely accessing a number of HSBCnet services anywhere and at any time in more than 60 countries through your mobile device. As HSBCnet mobile uses your mobile device’s web browser, no applications or downloads are required. HSBCnet mobile allows you to check account balances and statements, authorise payment instructions and receive notifications of payments requiring your authorisation. It provides global visibility and control on the go.

CR: Why might a captive require letters of credit?
KC: LoC can be key in helping a captive insurance company to meet capital or security requirements. In order to do this, it is imperative that a captive chooses a banking provider with balance sheet strength and a strong capital base. HSBC as one of the world’s largest banking and financial services organisations, with around 6,900 offices in both established and faster-growing markets, is perfectly positioned in this regard.

CR: How else can HSBC assist insurance companies in setting up in Malta?
KC: Any insurance company embarking on the licensing procedure will need to establish the operational set-up, including an investment committee to oversee the efficient management of monies available for investment. This is where HSBC Global Asset Management (Malta) can assist by advising companies of the drafting of an investment management mandate.

CR: Finally, as a domicile, do you think Malta is gaining traction in attracting insurance companies?
KC: The jurisdiction has gained more momentum and Malta is currently well represented by both large insurance managers as well as ‘big name’ insurance companies. HSBC’s financial standing, product offering and global reach make it best-placed to service this industry.

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The European cell company

Mark Camilleri of Atlas Group examines the benefits of using a Protected Cell Company structure in light of Solvency II developments that are shaking the insurance industry.

As a full member state of the EU, Malta is obliged to implement EU legislation and directives. Malta acceded to the EU as a full member state in 2004. Malta must conform to European solvency regulation. Malta, therefore, must also embrace Solvency II.

Protected Cell Companies (PCCs) started in 1997 in Guernsey when the principles of insurance rent-a-captives were adapted into regulation, through which cells are created within one single legal entity. The main principles are that cells are ring fenced from each other and from the non-cellular (core) capital. Each cell operates as a separate insurance undertaking, with all assets and liabilities accruing solely to the shareholder(s) of that cell.

Since then, many jurisdictions have adopted PCC regulations with improvements to such regulation through experience. The PCC insurance vehicle causes efficiencies in allowing for small to medium sized corporations and/or direct writing prospects to benefit from the PCC’s capital and corporate structures in writing their own business and bringing home their own business plan.

Malta is the first and, to date, only EU member state to have adopted PCC legislation. This legislation is regulated under the Maltese Companies Act. The Companies Act (Cell Companies Carrying on Business of Insurance) Regulations recognises the legal entity referred to as a “Protected Cell Company” (PCC) and defines it as being “a company formed or constituted as such or converted into a cell company and creating within itself one or more cells for the purposes of segregating and protecting the cellular assets of the company in accordance with the provisions of these regulations”.

The regulations go on to define cells to be “a cell created by a cell company for the purpose of segregating and protecting the cellular assets of the company in the manner provided by these regulations and includes a reference to segregated accounts, compartments or units within a company having multiple accounts, compartments or units”.

Article 9 of the regulations establishes that the assets of a cell company shall be either cellular assets or non-cellular assets, and further lays down obligations upon the PCC directors who must keep cellular assets separate and separately identifiable from core assets. They must keep cellular assets attributable to each cell separate and separately identifiable from cellular assets attributable to other cells. And finally, they must keep separate records, accounts, statements and other documents as may be necessary to evidence the assets and liabilities of each cell as distinct and separate from the assets and liabilities of other cells in the same company.

But the most important feature of Maltese PCC regulation is that the regulations presuppose that the individual cells will have recourse to the core capital. The strength of this part of the law is that a cell will not have to be capitalised to the extent of the Minimum Guarantee Fund (MGF) as established by the EU Directive. The PCC’s core capital will afford to the cell a capital base equal to the MGF requirements, and the cell will be allowed to capitalise its structure up to its own solvency capital requirement, no matter how reduced this may be.

By way of example, under existing European solvency regulation, an insurance undertaking operating a book of premium of €1m would be required to apply the MGF. On the other hand, a cell operating a similar book of premium income would require as little as €180,000 depending on classes written and any buffer requirements established by the regulator. Reinsurance outwards from the cell could potentially reduce the capital requirement even further by up to 50%. This is simply because the minimum own funds of MGF rule at €2.5/€3.7m are fronted and carried by the core capital for the cell.

The regulations establish that once the cell has exhausted all its assets in meeting its liabilities, such cell will have perfect access (secondary recourse) to the core’s capital.

Solvency II Concerns

There is much speculation on when Solvency II will be applied within the EU. While news quoting European Insurance and Occupational Pensions...
Authority (EIOPA) as postponing the regime start date to the 1 January 2015, possibly further on to the 1 January 2016, national regulators tend to shy off confirmation of this implementation date. In reality, one can understand that their motive is to keep up the pace for development of compliance in their realm. The following is a summary of how Solvency II compliance works. This is built on three pillars.

- **Pillar I** – This is known as the quantitative modelling process in calculating the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR). A series of Quantitative Impact Studies (the latest QIS 5) being carried out by the European regulator have failed a substantial number of relatively important direct writing and captive European insurance operations who have found that their existing own funds do not meet the SCR or MCR requirements. Of major concern to the insurance industry is this process which may very well require existing operations to inject fresh capital.

- **Pillar II** – This area of regulation will require governance processes to be in place. Clearly the emphasis here would be on good corporate governance. Very laborious internal controls, which include a risk management function, transparent board of directors and board committees to be set up (including an internal audit function), will follow this. And ultimately the Own Risk Solvency Assessment, which contemplates measures in giving comfort that the model used in calculating the SCR of the company, is appropriate to the risk profiles of that company. These are all very costly operations, which may be prohibitive for some.

- **Pillar III** – This is where the insurance undertaking reports to the regulator and publishes results on its solvency positions. Yet again, it is expected that this procedure will be very detailed and complex, resulting in substantial cost. And as if this was not enough, expensive actuarial input is necessary under all three pillars.

**That European PCC**

The Maltese PCC ticks all boxes for all three pillars, causing substantial cost burden sharing and reduced own funds requirements.

- **Pillar I** – The core capital puts up the MCR equivalent of what is known as the MGF under the existing Solvency I regime. This means the cell will only have to put up an own funds equivalent to the calculation of the cell’s SCR. With small cellular insurance undertakings in many cases this SCR result would fall far below the MCR absolute floor (currently set at €2.3m/€3.5m). Furthermore, the cell may also benefit from diversification with an active core, only once this is demonstrated to the regulator.

- **Pillar II** – A fully operational PCC will have an expert board of directors already in place, with all risk management, internal control and other systems of governance requirements here catered for under its regulated licence.

- **Pillar III** – All procedural structures and resources will be in place to report and publish results as one single legal entity.

**In conclusion**

Small mono line insurers and captives struggling with Solvency II requirements could consider converting to cells as an alternative to consolidation or closure. Being domiciled within the EU the PCC, on behalf of its cells, will allow for direct writing into Europe and this very fact eliminates the requirement of European fronting insurers.

European cells are not only for captives. In fact most cells in Atlas Insurance PCC in Malta have been created to take advantage of EU passporting rights and successfully sell insurance directly to third-parties in the European economic area. Protected cells are a cost-effective, extremely flexible and secure alternative to owning a standalone insurer, reinsurer or captive. Such structures can result in significant cost and capital savings for cell owners, even more so in the EU once Solvency II is implemented.

At all times a PCC may lend its core capital to cells, which cells may require further capital for the cell to meet their own regulated capital requirement. This is perceived to be a further strength afforded to a cell within the PCC, in that the cell will always be backed by the core capital.

Malta is the first, and to date, only EU member state to have adopted PCC legislation.
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HighDome PCC is an insurance company (a protected cell company) located in Malta, that helps you build your own captive solutions.

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Atlas Insurance PCC Limited is a cell company authorised by the Malta Financial Services Authority to carry on general insurance business.
Risk management in the limelight

With the area of risk management gaining more attention – especially in the context of the Solvency II Directive debate – Dr Malcolm Falzon, of Camilleri Preziosi, comments on the approach towards implementation of Pillar II requirements.

There can be little doubt that risk management has emerged as the question of leading importance in the discussion regarded the impact of the Solvency II Directive on captive insurance companies and the insurance industry as a whole. Of the three pillars of the Directive, Pillar II is arguably the most significant and complex to implement given the inherent need for companies to prioritise the management of risk within their operational business models.

Last year saw the Malta Financial Services Authority (MFSA) issue a guidance paper on risk management, and this on the back of a guidance paper on the system of governance requirements under the Solvency II regime in which the MFSA indicated that it would be separately addressing what it describes as the important key function of risk management, the necessity for which underpins much of the proposed Solvency II regime. Throughout the years, the MFSA has been recognised as a firm yet flexible regulator, cognisant of the need to reach out to the market with a view to ensuring that the implementation of Solvency II will result in the fulfilment of its underlying aims without however inhibiting the continued growth of the market, including the captive segment.

The purpose of the MFSA’s guidance paper is set out as providing insurance and reinsurance undertakings with the regulator’s views on the requirements of the Risk Management System (RMS) to be implemented, or rather, augmented, in view of Solvency II requirements. The Directive’s requirements cannot as yet be considered definite, and the MFSA’s position in the guidance paper ought to be viewed in that light and remains susceptible to change. However, the ability to understand and to some extent anticipate the regulator’s expectations in respect of this set of requirements is considered a welcome approach within the context of the uncertainty intrinsic in a framework with as yet no final set parameters or conclusive implementation date.

Governance requirements
Solvency II will require insurers to develop, demonstrate and be seen to demonstrate an adequate system of governance, including appropriate internal organisation and key functions, an effective risk management system, and prospective risk identification through, inter alia, own risk and solvency assessment (Orsa). The main governance requirements for insurance undertakings under Pillar II can be said to relate to the following:

1. the creation of effective systems of governance which provide for sound and prudent management of the business, subject to constant review, taking into account that the administrative, management or supervisory body of the (re)insurance undertaking has the ultimate responsibility for the undertaking’s compliance with the laws, regulations and administrative provisions adopted pursuant to the Directive, particularly in so far as Pillar II is concerned. The MFSA guidance paper specifies that directors are expected to have a clear understanding of the risks involved and use such knowledge in their decision-making process;

2. implementing a risk management strategy which comprises details of the undertaking’s objectives, its key risk management principles and its general risk appetite, and places it in a better position to identify and assign risk management responsibilities;

3. implementing a well-documented risk management policy, which defines and categorises an undertaking’s material risks and risk limits by type, and which will be applied on a day-to-day basis;

4. the fulfilment of fit and proper tests for persons performing risk management functions;

5. integrating, with the organisation’s decision-making processes, an effective risk management system providing processes and procedures, which will enable the undertaking to identify, measure, monitor, manage and report risks which the organisation is or could be exposed to;
6. having an effective internal control system in place, which includes administrative and accounting procedures, an internal control framework and appropriate internal reporting procedures, which generate the necessary information regarding risks and permit the proper monitoring of such information;

7. having a compliance function responsible for advising management on compliance with laws and regulations including the identification of compliance risk and the assessment of the potential impact of changes in the legal environment;

8. having an effective and objective internal audit function, responsible for evaluating the effectiveness and adequacy of the internal control system and other areas of governance, acting independently from any other key functions and operational processes, and reporting to management, which shall in turn be responsible to determine what actions are to be taken in light of those findings and to ensure that in effect those actions are carried out;

9. internal assessment of the insurer’s own overall solvency needs through Orsa, an important tool for an undertaking to assess the risks within its business and the level of solvency required to mitigate those risks, and a significant means of assisting strategic decision-making;

10. having an effective actuarial function to be carried out by persons with the appropriate levels of experience and skill, which as part of the Orsa contributes to the assessment of compliance with the requirements regarding the technical provisions and assessment of whether the undertaking’s risk profile deviates from the assumptions underlying the calculation of the Solvency Capital Requirement (SCR) with the standard formula or with its partial or full internal model.

The above governance requirements are in large part addressed in the MFSA’s guidance paper, which provides a platform for consultation with the regulator in navigating the requirements being advocated by the Directive. The guidance paper also provides a platform for establishing the process, drawing up the policies, measuring the additional costs, formalising governance procedures, and developing the systems that are crucial for a timely attainment of Pillar II compliance.

Proportionality and the importance of adaptability

The risk management system to be adopted by an insurance undertaking must be proportionate to the nature, scale and complexity of the risks particular to its business, as indicated in Article 41(2) of the Solvency II Directive. The proper application of the principle of proportionality should mean that the ways by which the legislative aims of Solvency II are achieved will differ from one insurance undertaking to another, depending on their respective risk profiles. Recognising that the risk structures of any one insurer are not equivalent to those of every other insurer (and that the risk structures of captives are not equivalent to those of commercial insurers having a multitude of policyholders) is essential, as is the need for legislators to adapt the objectives of the Directive to the impact that regulation emanating from there could ultimately have on insurers.

This must be done without detracting from the need to safeguard the objectives of the Directive, principal among which the protection of policyholders against the failure of insurance undertakings, the creation of a level regulatory playing field and contributing to the overall stabilisation of the entire financial system. However, in recognition of the fact that the realities and specifics of one insurer are materially different from those of another, the aforementioned proper application of the principle of proportionality is of paramount importance.

Similarly, when recognising the inherent differences between the risk profile of a captive and that of a typical commercial insurance undertaking, there again comes to the fore the recurring concern as to whether the legislative framework, as currently proposed, is excessively burdensome on captives. Indeed, it is suggested that the regulator is endowed with the responsibility of ensuring that regulations drawn up within the context of the continuing build-up to Solvency II implementation, and more importantly, the application of such regulations, duly take into account the particular nature and peculiarities of the industry and its constituents.

It is questionable as to whether the compendium of proposed corporate governance requirements applicable to insurance companies in general is appropriate for captives, taking into account the expected cost and complexity of fulfilling such requirements. One could go so far as to suggest that Solvency II is ultimately an imperfect model for regulating captives and, even more so, Protected Cell Companies (PCCs), and that accordingly there is a real need for the MFSA to adopt a flexible (yet pragmatic) approach in adapting regulatory requirements to captives’ characteristics.

Adaptability and a responsible dose of flexibility at the regulatory level will be key to ensuring that the Solvency II Directive will not be perceived as having reduced reliance on captive solutions as a risk management tool to an impractical or non-viable option. The recognition within Solvency II itself of the value of captive insurance companies as an appropriate and effective means of managing risk, and the positive approach taken by the Maltese regulator so far, augur well in this respect for MFSA-registered captives and PCCs.
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From pillar to post

With the forthcoming establishment of the ‘three pillar’ system under Solvency II, Dr Beppe Sammut of Ganado & Associates discusses the advantages of utilising a PCC structure.

The imminent (or not so imminent) implementation of the Solvency II regime will mark a radical overhaul to the regulatory landscape for insurance and reinsurance undertakings, with the establishment of the ‘three pillar’ system, which adopts a risk based approach and ensures that insurance undertakings are adequately capitalised and that risks are sufficiently measured.

A natural consequence of the enhanced three pillar system is the increased costs and regulatory requirements that insurance undertakings are facing in their preparation for Solvency II implementation. While the majority of the larger players in the market have the necessary financial and structural resources to comply with the Solvency II requirements, pure captives and the smaller insurance undertakings will find that the costs of complying with Solvency II are rather burdensome, particularly in relation to Pillar II. Those pure captives and small insurers that do not have the financial, organisational or operational resources to conform to the Solvency II requirements may search and opt for alternative structures that better suit their needs.

The PCC has emerged as a structure offering smaller captives and smaller insurers with the opportunity to continue to write business while benefitting from the efficiencies of the PCC structure, and while sharing in the capital base of the PCC. Malta is the only full EU member state that has legislation in place regulating the PCC structure, which allows insurers to create separate and segregated cells within a PCC while allowing them to write business directly throughout the EU by means of the single passport, and allowing them to reap the benefits of their business as if they were a separate legal entity. The choice of utilising the PCC allows captives and insurers writing business through a cell to benefit from the decreased set-up and ongoing costs as well as shared capital requirements.

The advantages of the PCC structure become clearer once its legal nature is understood: a PCC is a single legal entity comprising within itself separate cells that are ring-fenced from each other. Creditors of a cell normally have a right of secondary recourse to the non-cellular assets (core) of the PCC, once all cellular assets of the cell to which the liability is attributable have been fully exhausted.

On this basis, we are of the view that under Pillar I the PCC as a whole should meet the statutory Minimum Capital Requirement (MCR), while each individual cell should meet the solvency capital requirement, provided each cell has secondary recourse to the core assets of the PCC. This is already the case under current solvency legislation, and it would be counter-intuitive were the PCC to be required to meet an MCR more than once.

Pillar II seeks to introduce an enhanced system of governance and insurance undertakings have been asked to identify the ‘critical’ functions within the company and are required to carry out an Own Risk and Solvency Assessment. Notwithstanding that these requirements are essential for the carrying on of business insurance in a more prudent and sound manner, they will create a more burdensome regime for the smaller captives and smaller insurers.

The PCC structure offers economies of scale and significant cost burden sharing, and grants the cells access to a common pool of knowledge and expertise within the common management system at the core of the PCC. Even though corporate procedures relating to each cell may not necessarily be identical, a common approach may be adopted by the board of the PCC, which permeates the structure as a whole. Furthermore, all transparency and reporting requirements under Pillar III may be carried out through board of the PCC, resulting in a cost effective structure which diminishes the burden on individual captives or insurers writing business through a cell.

Malta’s legislative and regulatory set-up caters for the establishment of PCCs, whether through incorporation, conversion or redomiciliation, as well as through the creation of cells and the transfer of cellular assets from and to other PCCs. The PCC is being put forward as an advantageous alternative, offering a cost effective solution to the increased costs incurred as a result of the implementation of Solvency II, without sacrificing all the benefits of enhanced corporate governance and a more risk based approach under Solvency II.

“Malta is the only full EU member state that has legislation in place regulating the PCC structure”
Business or pleasure? How about both...

With a plethora of hotels to choose from on the island, Captive Review talked to Julian Diacono of the Hilton Malta about what makes the Hilton the obvious choice.

M alta, a popular offshore destination for the wider financial services industry as well as the captive insurance subset, receives hundreds of thousands of travellers on business every year. With this growth in popularity, the selection of hotels found on the island has grown as well. But of all these hotels, which one can offer the best environment for a corporate trip? Julian Diacono, director of business development at Hilton Malta, explains what is it about the Hilton Malta that raises it above the competition.

Captive Review (CR): Malta plays host to a range of hotels; how does the Hilton Malta stand out?
Julian Diacono (JD): The Hilton Malta is located right next to the main entertainment and shopping areas of the island. It is located within a development called ‘Portomaso’, a very exclusive address in Malta. It is an award-winning development, which Hilton Malta forms a part of (including our own private road which leads right up to the hotel). Guests have the luxury of being able to stay in a tranquil venue overlooking an exclusive yacht marina and a selection of restaurants. The Portomaso complex also includes a conference centre, a casino, nightclub, eateries, water sport facilities, scuba diving; which makes the Hilton Malta a great destination for both business and pleasure. Generally speaking, leisure is approximately 54% of our business, with the rest being to do with corporate and business travel.

CR: Malta is a common destination for business trips – how can the Hilton Malta facilitate guests visiting on business?
JD: Hilton Malta offers a variety of facilities, which means that while a stay at the Hilton Malta is bound to be comfortable and relaxing, it is also a place that can support the frenetic lifestyle of anyone that is travelling to the islands on business. We offer an executive business lounge and an executive leisure lounge, a full conference centre (which can seat up to 1,330 delegates) and nine other meeting rooms, a business centre which has eight different meeting rooms, and the Portomaso Banquet Hall. Furthermore, Wi-Fi is accessible throughout the hotel and we offer a number of restaurants for entertaining business associates. Our guest relations manager is on duty every day in order to assist guests with any needs, and we also offer a full concierge service to cater for those special requests of our guests. This all makes the Hilton Malta a convenient business area, and we see the fruits of our labour, as a lot of our guests frequently come back to stay with us. Word of our quality spreads easily and it is widely regarded that the Hilton Malta is the place to stay when visiting the island (a reputation also supported by numerous awards in the hospitality industry).

CR: If a guest wanted to entertain a business client, how could the Hilton Malta satisfy this?
JD: All year round, we offer three types of cuisine from our three restaurants; these include the Oceana Restaurant, Bottega del Vino and the more exclusive Blue Elephant. During the summer months, two other restaurants open outdoors: The Gazebo,
which is a very relaxed, *al fresco* venue, and the Merkanti Beach Club Restaurant. Two bars are also open throughout the year: the Vista Lobby Lounge is a place to enjoy a freshly brewed coffee and tea, while the Quarterdeck Bar is a cocktail bar overlooking the Marina.

**CR:** The Hilton Malta is right in the middle of the Mediterranean – does the menu reflect this?

**JD:** The executive chef is Joe Vella, a Malta native who is an award-winning chef and is something of a celebrity, having published two cookbooks and hosted his own TV programmes. He is considered to be one of the island’s top chefs. In fact, the Hilton Malta is a venue of choice for many events on the island simply because they want Joe’s cooking skills. Joe always ensures that the freshest local produce is used and you will have no difficulty enjoying Mediterranean fare while staying here. However, our menus are international and obviously at Blue Elephant you can enjoy the flavours and ambience of Thailand.

**CR:** Business trips can be very stressful times for those involved in the captive industry. How can the Hilton Malta help guests relax?

**JD:** When you say relax, the first thing that springs to mind is the Five Senses Myoka Spa within the Living Well Health Club, offering 11 different treatment rooms and a full range of treatments. Within the club, there is also a fully equipped gym, which is open all day from early in the morning to late in the evenings, and we find this is a popular choice for business visitors either preparing before or unwinding after a day of meetings. The Living Well Health Club also offers two squash courts, a tennis court, the services of a personal trainer, a hairdressing salon, four different outdoor pools, an indoor pool, sauna, steam baths and jacuzzi – so the guest is really spoilt for choice.

The location of the hotel is a benefit, close to all one’s requirements and pleasures. The Hilton Malta opened in 2000 but you wouldn’t think it when you walk in the front door. We are constantly investing and invigorating the decor. When we first opened we had 294 rooms, which we added to with 110 executive rooms in 2008. A few months after that, we added six studio apartments as well – all of these rooms are very well received by guests as they range from classical Mediterranean in style to a more contemporary design.

> **THE HILTON MALTA OPENED IN 2000 BUT YOU WOULDN’T THINK IT WHEN YOU WALK IN THE FRONT DOOR. WE ARE CONSTANTLY INVESTING AND INVIGORATING THE DECOR**
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Abacus Risk Management Services PCC Ltd. an insurance manager incorporated in January 2009 as a PCC and regulated by the Malta Financial Services Authority (MFSA), is an associate company of GasanMamo Insurance Limited, one of Malta’s leading general insurance companies with over 190 committed staff members and insurance roots going back to 1947. Abacus offers risk management and insurance management as well as the possibility for entities or individuals to take a cell in Abacus and thus operate under the Abacus umbrella licence.

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One of Malta’s leading insurers since the 1920s, Atlas converted to PCC in 2006, a first for Malta and EU. Atlas gives promoters the opportunity to own their own EU insurance vehicle with less capital and cost avoiding fronting requirements. Cells in Atlas can also write third-party risks our substantial active core provides added flexibility. We are independent, allowing promoters to subcontract cell management to authorised insurance managers.

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FinanceMalta, is a non-profit public-private initiative, set up to promote Malta’s international Financial Centre. The organisation brings together, and harnesses, the resources of the industry and government, to ensure that Malta maintains a modern and effective legal, regulatory and fiscal framework in which the financial services sector can continue to grow and prosper.

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Ganado & Associates, Advocates is a leading business law firm based in Malta. Consistently ranked by clients, peers and independent directories alike as a top-tier law firm in all our core sectors, we aim to provide our clients with sound, yet practical, legal advice based on our unparalleled experience and industry insight. The core industry sectors which we advise include insurance and reinsurance, banking and asset management and as well as non-financial services sectors such as shipping, aviation and energy. As a full service business law firm, our practice area offering is built around the needs of our clients supporting them from inception and throughout the stages of their projects.

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BEE Insurance Management Ltd (C-23610) is entered under the Insurance Intermediaries Act, 2006 and regulated by the Malta Financial Services Authority to act as an Insurance Manager.
Malta is host to a myriad of captive re/insurance companies, protected cell companies and cells that have come to enjoy the domicile's stable regulatory environment and EU membership benefits. Malta offers re/insurers and cells:

**European Union Membership** - Malta’s status as an EU member allows companies and cells the ability to passport their services throughout the European Union and EEA states. Maltese insurance law and regulation implements all relevant EU directives.

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**Protected Cell Legislation** - Protected Cell Companies can be incorporated in Malta, enabling cell promoters to write insurance through a cell. The law ensures proper protection and insulation of cell assets and liabilities from those of other protected cells and the core of the protected cell company.

**A Stable Regulatory Framework** - The Malta Financial Services Authority (MFSA) is reputed to be “firm but flexible” - encouraging discussion with promoters at all stages of an application process and also on an ongoing basis.

**Extensive Double Taxation Treaty Network** - Malta has over 45 tax treaties with various EU and non EU countries.

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