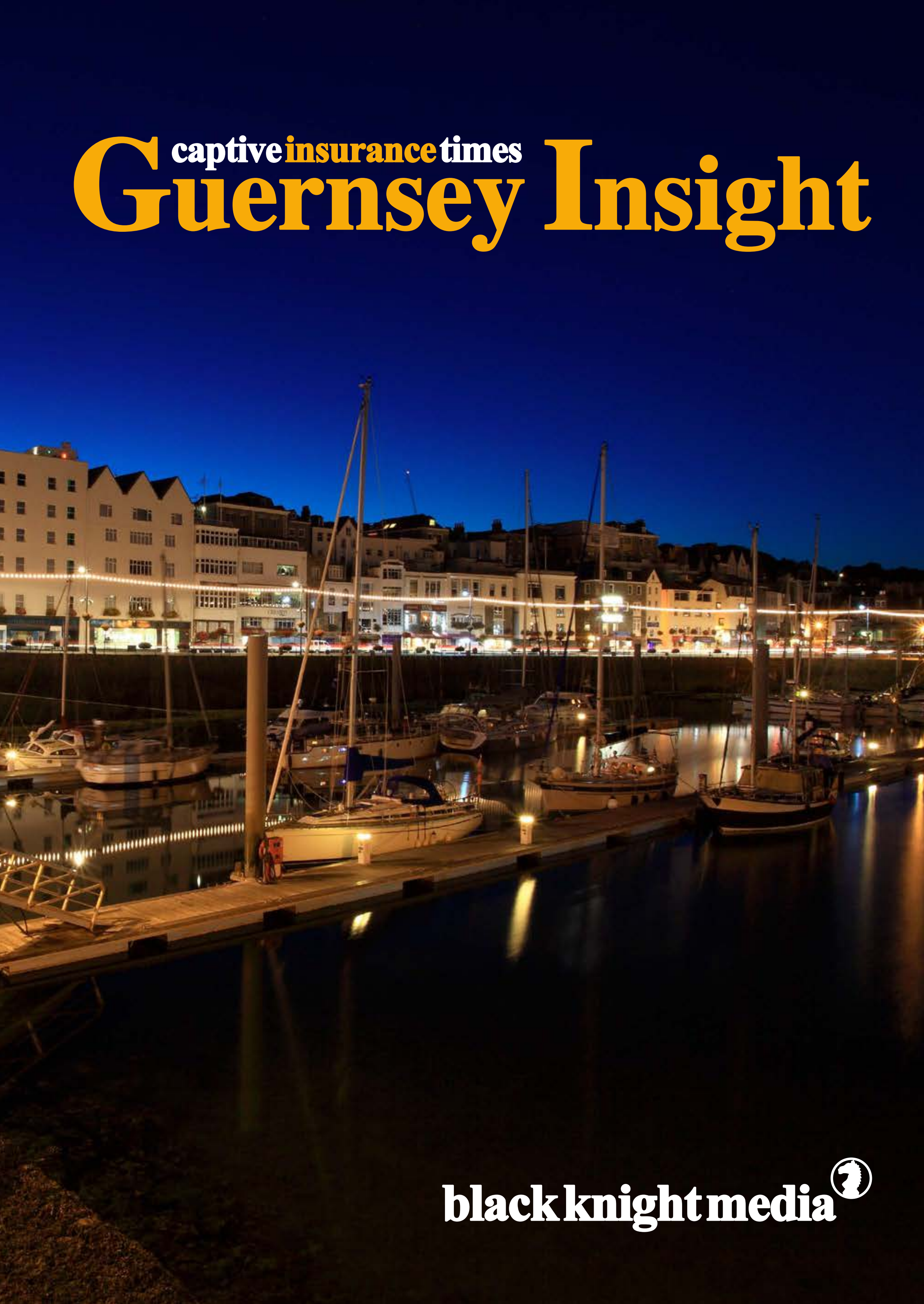
captive insurance times

Guernsey Insight



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Editor's Note

Good things in small packages

The traditional captive insurance market has peaked with large corporations already owning one or more of their own insurers, however, small- and medium-sized entities are enjoying something of a boom.

This is true in Guernsey, where six new captives were created last year, of which four were protected cell companies, while 76 new cells were created. In total, Guernsey is now home to 837 captive insurance entities.

Dominic Wheatley, CEO of Guernsey Finance, maintains that captives are still the bedrock of the insurance industry on the island.

Wheatley explains: "I don't subscribe to the theory that captives require a hard market in which to flourish because surely constructing a business plan on a set of market circumstances over which you have no control is not an optimal approach."

"So, even if a captive is established in a hard market cycle, it is unlikely to be abandoned when the market softens, because the real benefits of the structure lie in its governance, management, control and proper pricing of retained risk."

Where there is significant potential for growth in Guernsey is in reinsurance, with insurance-linked securities and pension longevity swaps proving particularly popular.

In this Guernsey-focused issue from Captive Insurance Times, you will find detailed insight into the island's insurance industry, providing an update on topics such as BEPS, Brexit, Solvency II, ILS, pension longevity, cell structures, Guernsey's agreement with China, and investment opportunities for captives.

Becky Butcher
Supplement Editor

Guernsey by numbers

Guernsey's latest insurance sector statistics, as of 31 December 2016.
For more information, visit: www.gfsc.gg

Last 12 months

Type	31 Dec 2015	Additions	Surrenders	Net Change	31 Dec 2016
Companies	242	6	6	0	242
PCCs	64	4	3	1	65
PCC Cells	444	79	53	26	470
ICCs	13	1	0	1	14
ICC Cells	41	4	1	3	44
Totals	804	94	63	31	835

Authorised managers

	31 Dec 2015	Additions	Surrenders	Net Change	31 Dec 2016
Total	19	0	0	0	19

International insurers gross assets, net worth and premiums written

	Gross Assets (£bn)		Net Worth (£bn)		Premiums (£bn)	
Date	Nominal	Inflation Adjusted	Nominal	Inflation Adjusted	Original	Inflation Adjusted
2015	23.86	23.86	11.48	11.48	5.54	5.54
2014	23.66	23.66	11.57	11.57	4.94	4.94
2013	22.87	23.43	10.14	10.39	4.83	4.95
2012	22.35	23.60	9.32	9.84	4.63	4.89
2011	21.76	23.71	8.97	9.77	4.62	5.03
2010	21.40	24.55	8.46	9.71	4.05	4.65

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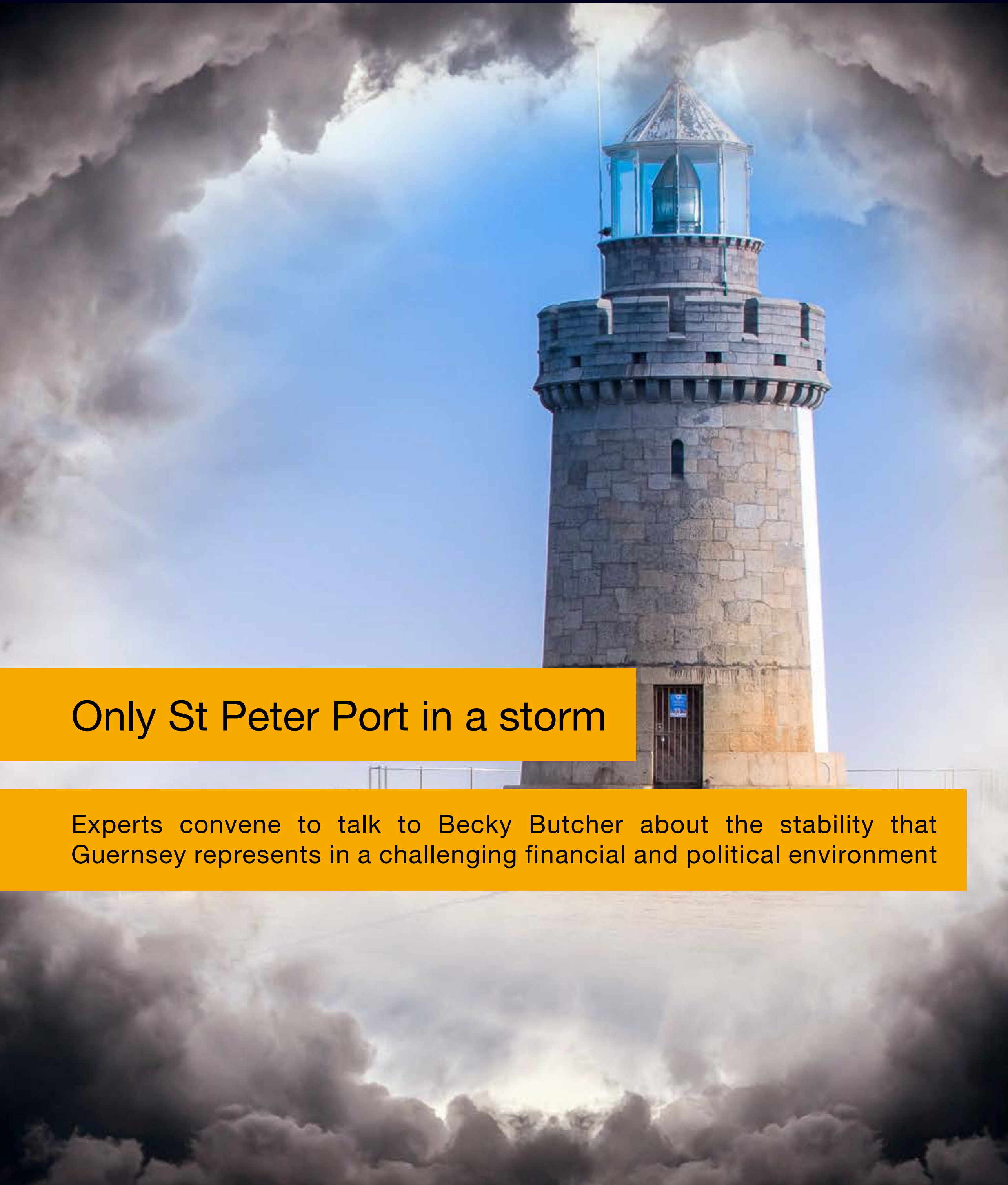


Only St Peter Port in a storm

Experts convene to talk to Becky Butcher about the stability that Guernsey represents in a challenging financial and political environment

Persistent soft market conditions and frequent catastrophic events should spell uncertainty for captive insurers, but they are proving far more resilient than many expected.

It's widely held that the traditional captive insurance market has peaked, with most Fortune 500 companies already owning one or more of their own insurers. Yet small and medium-sized entities are enjoying something of a boom. This is true in Guernsey, where six new captives were created last year, of which four were protected cell companies, while 76 new cells were created. In total, Guernsey is now home to 837 captive insurance entities.

Even though captive growth as a whole has become "static" in Guernsey, Dominic Wheatley, CEO of Guernsey Finance, maintains that captives are still the bedrock of the insurance industry on the island.

Wheatley explains: "I don't subscribe to the theory that captives require a hard market in which to flourish because surely constructing a business plan on a set of market circumstances over which you have no control is not an optimal approach."

"So, even if a captive is established in a hard market cycle, it is unlikely to be abandoned when the market softens, because the real benefits of the structure lie in its governance, management, control and proper pricing of retained risk."

"Therefore, when there has been a sustained softness in the conventional markets you can only assume that people have captives for permanent or long-term strategic reasons, not short-term tactical reasons," Wheatley adds.

Richard Searle, partner at BDO, suggests that there is confidence in Guernsey, alongside a healthy amount of caution.

Amid unquantifiable variables such as Brexit, Searle points out that Guernsey has traditionally been good at is managing its own destiny. He says: "As long as we don't just sit back and leave our destiny in the hands of others, but take control of it and manage it, I think we will be okay."

According to Jeremy Quick, director of the banking and insurance supervision and policy division at the Guernsey Financial Services Commission (GFSC), the captive industry is faring "reasonably well". He revealed that year-end premium in 2015 stood at £5.46 billion, compared to £4.94 billion in 2014, while licence numbers were in the 830s in 2016 compared to the early 800s in 2015.

Quick comments: "The global economy is back on track and Guernsey, as an international finance centre, should benefit from that in the long term."

The GFSC has noticed an uptick in activity in a number of sectors. Insurance-linked securities (ILS) and pension longevity swaps have been two of the biggest. Quick suggests that the pension longevity swaps sector will continue to grow, given the challenges that pension funds face with life expectancy increasing.

Although the reinsurance industry has seen a surge in figures, Guernsey remains a big captive domicile, which is an area that is stable in net terms.

Quick reveals that Guernsey has seen companies both leave the island due to mergers and acquisitions and enter the market anew, suggesting there is still a commercial appeal to the captive, despite strains on traditional business such as low insurance rates, increasing insurance premium tax in the UK and the crackdown on base erosion and profit shifting (BEPS).

Peter Miller, executive director at EY, also suggests that the captive industry remains "relatively safe" because insurance is always needed. Miller adds: "The only risk in Guernsey is that it becomes futile to have a captive because you can get it cheaper elsewhere."

Although as a whole Guernsey's captive figures are somewhat static, the same does not apply for Artex, which has seen success in bringing on new business, according to Peter Child, managing director for Artex's Guernsey office.

Child explains that currently in Guernsey there is more of a focus on reinsurance and if Guernsey wants to grow as a whole then it has to focus in that area.

He comments: "For Artex as a business, this year there is still a lot of strength out there and you never know when the market changes, it might not

Guernsey Update

be as dramatic as the way it has changed in the past, but there will be change and there will always be little areas where there will be a disconnect between what underwriters are willing to write risks at and what the insureds think their risks are worth, and when that happens we can provide some kind of value."

"There are always challenges but Guernsey's advantage is that we can move and navigate challenges to the benefit of our clients"

- Paul Sykes, Aon

Paul Sykes, managing director at Aon Guernsey, suggests that Guernsey is "nimble and innovative" and can move quickly as and when it is hit with fresh challenges.

Sykes says: "There are always challenges but Guernsey's advantage is that we can move and navigate challenges to the benefit of our clients."

"We have a very close relationship with the regulator and the local government, and if the business environment isn't quite right we can move quickly to ensure it is optimally fit for purpose."

Brexit

With 70 percent of Guernsey's financial services business coming from or via London, Wheatley says Brexit will affect the island "profoundly".

According to Wheatley, London's position as a major centre for insurance and financial services makes it vitally important to the island. Unfortunately, uncertainty has reigned in London.

The UK officially pulled the trigger on Article 50 of the Treaty of Lisbon in March and commenced the two-year negotiation process that will end in its exit from the EU.

The activation of Article 50 allowed EU legislators to convene to decide what positions they will take on a range of issues, from the rights of EU citizens in the UK to financial services passporting.

Official negotiations between the European Commission and the UK's Brexit team were expected to commence on 29 April, however, they were put on hold when UK Prime Minister Theresa May called a snap general election to take place on 8 June.

To the shock of almost everyone, the election resulted in a hung parliament after the Conservative Party fell short of a majority, but May has vowed to carry on as prime minister and has since secured the necessary votes to continue in government.

Her position, however, is far more precarious than anyone expected before 8 June and although Brexit negotiations have kicked off in Brussels, there is yet to be any certainty or clarity around how they will play out.

Wheatley suggests that London's position as the centre of insurance will not change a great deal, despite moves from giants such as Lloyds of London, which announced the launch of its new EU insurance company in Brussels so that it can continue to be able to write risks from all 27 EU member states and three European economic area states after the UK has left the EU.

Wheatley comments: "There's no reason to think that Brexit will affect London's position in the insurance world, while it presents further opportunity for Guernsey which sees itself as a natural extension or support to City services."

"We have the relationships, expertise, geographic and legal closeness that positions us as 'London offshore'—we don't see ourselves in competition with the city."

According to Wheatley, Guernsey will have to take a 'wait and see' approach, but for now is getting on with business as usual, very much offering an island of certainty amid the political upheaval elsewhere.

Wheatley explains: "Our island's political stability and economic security throws it into sharp contrast with a number of international finance centres which are being tossed about by the waves of change on both sides of the Atlantic. We invite you to explore the Guernsey advantage."

Solvency II

The Solvency II directive came into full effect on 1 January 2016 with requirements for EU insurers to comply with its three pillars on capital and solvency, governance and supervision, and disclosure and transparency of information.

Guernsey took an early stance in 2011 not to seek equivalence under Solvency II because the directive does not distinguish between different types of insurer and the levels of capital they have to hold, and would therefore place an "inappropriately large capital burden on captives", which constitute the major part of Guernsey's insurance industry.

It was also suggested that the regime would be unsuitable for the large numbers of special purpose insurers in Guernsey in the alternative risk transfer space, including issuers of ILS.

Guernsey instead committed to complying with the insurance core principles of the International Association of Insurance Supervisors in the areas of solvency, corporate governance and public disclosure.

The introduction of a new solvency regime under the Insurance Business (Solvency) Rules 2015 set this compliance in law.

The general rule is that a Guernsey-licensed insurer and reinsurer must hold capital resources in accordance with three levels: the minimum capital requirement, the prescribed capital requirement and the capital floor.

These rules have recently been updated by the GFSC to include a new class of insurer and scrap the requirement of special purpose insurers to maintain minimum or prescribed capital requirements.

Although a decision was made in 2011, the island is again considering whether it is appropriate to pursue equivalence with Solvency II.

Stakeholders are currently discussing the cost and implications of equivalence to figure out how realistic it would be to achieve.

Once the decision has been made, dialogue with the Guernsey regulator and government would need to be started. It is understood they would support the industry consensus.

"We are living in a period of unprecedented turmoil and disruption so the stability and predictability of a financial jurisdiction like Guernsey does present as a reassuring option to many"

- Dominic Wheatley, Guernsey Finance

Potential advantages for Guernsey being put forward include simplified access to a wider range of reinsurance buyers and increased attractiveness as a home for reinsurance capital.

Bermuda is an example of a jurisdiction that has achieved equivalence with Solvency II.

When implementing the directive, Bermuda decided on a bifurcated approach to Solvency II, whereby only commercial insurers would qualify as Solvency II-equivalent, leaving captives out of its scope.

John Rowson, CEO at Kelvin Re, suggests that equivalence should be given “deep consideration”.

Rowson says: “I think a major advantage for Guernsey is that Bermuda has invested a lot of time and money implementing Solvency II equivalence.”

“Reinsurance is Bermuda’s principal industry, whereas for Guernsey it is a major industry, simply because we have a very diversified financial services sector.”

He adds: “The diversification in our financial sector is a strength to the island and supports the insurance and reinsurance offering for major banks and consulting firms with large local offices.”

Bermuda could be a useful test case for Guernsey. Rowson says: “This allows a detailed assessment as to whether it is going to add value or not.”

Rowson added: “I am very open minded to it and I am very pleased with the work that is being done and will support it, whatever the outcome.”

According to Richard Searle, partner at BDO, there are certain cases in which Solvency II equivalence could be useful, particularly when looking at business trading with Europe.

However, he also notes that Guernsey has a lot of business for which Solvency II would be “over the top and completely irrelevant”.

Searle explains: “Any approach that Guernsey takes should follow the approach the island’s regulators have taken in the past—to work with industry to identify where would it be relevant and implement a two-track system.”

BEPS

In October 2015, the Organisation for Economic Co-operation and Development (OECD) released its BEPS action plan to renovate international taxation rules and combat tax strategies aimed at artificially shifting profits to low- or zero-tax jurisdictions.

It is also designed to promote fair and equitable tax treatments on an international basis.

The BEPS package aims to achieve this by taxing profits where value is added, improving substance arrangements, and improving tax strategy transparency globally.

In February this year, Guernsey said the island is “continuing to take steps to build on its position as a BEPS-compliant jurisdiction”.

According to Wheatley, BEPS is “significant”, but less of an issue for Guernsey than some other jurisdictions.

Wheatley says: “Our insurance industry is substantial. We have qualified, experienced professionals undertaking all significant insurance activities and decisions in Guernsey, under the direction of highly experienced directors and the supervision of one of the leading international insurance regulatory bodies.”

“Given this, we see no reason for BEPS concerns for owners of Guernsey captives.”

In 2016, Guernsey established a BEPS working party to assess the OECD’s action plan, as well as scrutinise the European Commission’s ‘BEPS directive’.

The working party is chaired by Guernsey’s chief minister, deputy Gavin St Pier, and includes Guernsey Finance chairman Lyndon Trott as well as tax professionals and representatives of the Guernsey Institute of Directors and the Guernsey Society of Certified and Chartered Accountants.

According to Guernsey Finance, discussions between the working party and local business bodies have demonstrated that Guernsey is already largely compatible with the BEPS actions.

Guernsey Finance revealed that the island has taken five significant steps following discussions over BEPS.

These include taking up membership of the BEPS Inclusive Framework and accepting an invitation from the OECD to join the Ad Hoc Group on the Multilateral Instrument (Action 15), where the government committed in June to signing the BEPS Multilateral Instrument.

The island has also signed up to the Multilateral Competent Authority Agreement to assist with the sharing of relevant information in relation to country-by-country reporting (CbCR) (Action 13), as well as broadly adopting the OECD’s CbCR implementation package, to facilitate its implementation of this BEPS minimum standard.

Finally, it has put in place the relevant implementing regulations for CbCR.

Commenting on BEPS in February, St Pier said: “Guernsey is already in a leadership position on tax transparency, and we are also now very well-placed on the evolving BEPS international standards.”

“Over the past 12 months we have taken significant steps to demonstrate our commitment to this agenda, and we will continue to do so.”

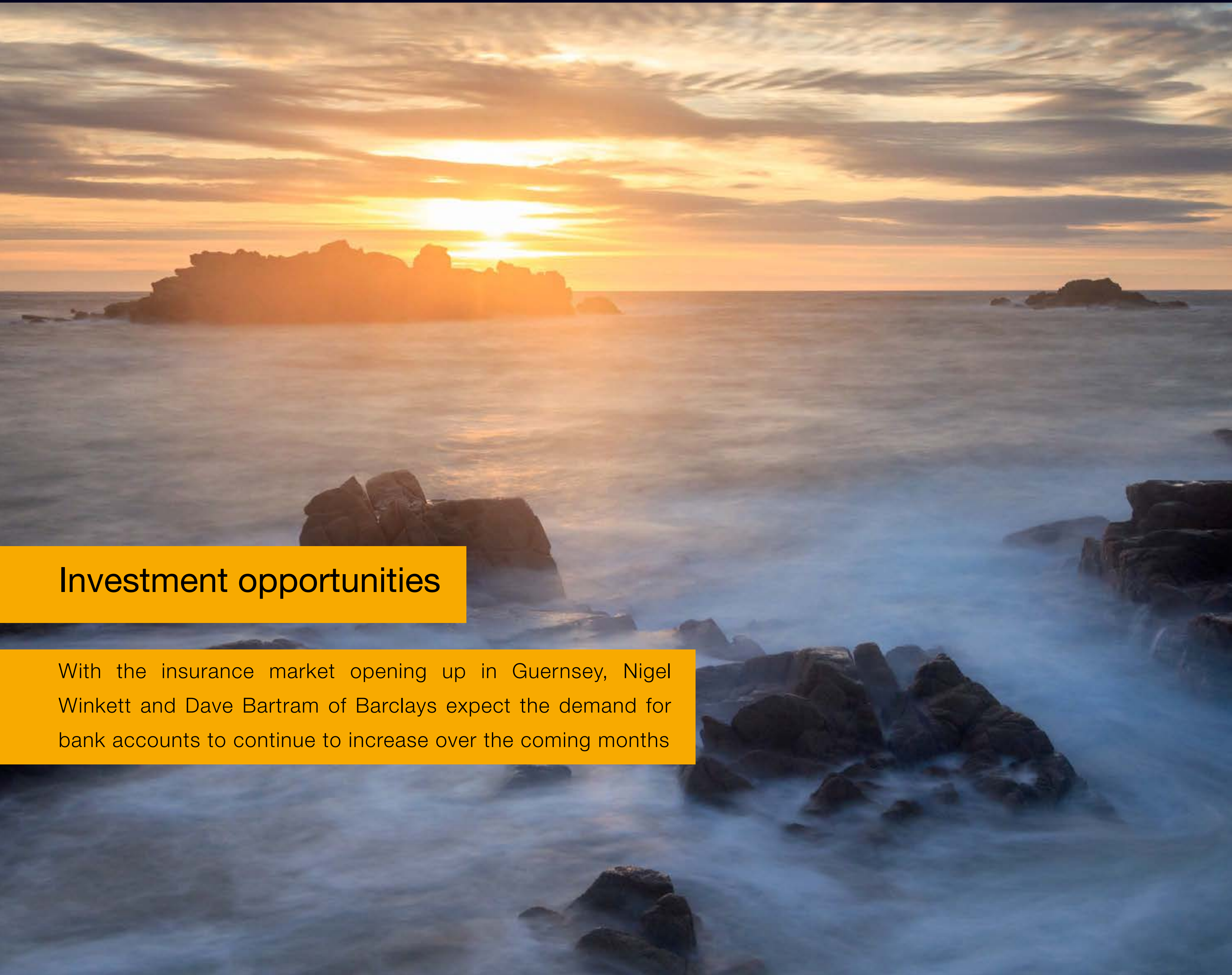
“Our position as a ‘BEPS-compliant’ jurisdiction is important for the global tax transparency agenda and provides stability, competitiveness and opportunities for our finance sector.”

Although the foreseeable challenges in the industry are technical, including common reporting standards and Brexit, both present opportunity as much as challenge for Guernsey.

Wheatley says: “We are living in a period of unprecedented turmoil and disruption, so the stability and predictability of a financial jurisdiction like Guernsey does present as a reassuring option to many.”

He adds: “Challenges such as increasing insurance premium tax rates are an unfortunate policy choice as they are proven disincentive to the governance of retained risk by incorporations, but there is not much we can do about that.” CIT

Guernsey Update



Investment opportunities

With the insurance market opening up in Guernsey, Nigel Winkett and Dave Bartram of Barclays expect the demand for bank accounts to continue to increase over the coming months

What trends are you seeing from the banking side of the captive insurance industry?

Dave Bartram: With captive figures remaining static in Guernsey, we are not seeing clients open new banks accounts. Instead, we are seeing more letters of credit and further investment.

However, with markets such as insurance-linked securities, pension longevity schemes, and the recent agreement between Guernsey and China, there will be new bank accounts needed. We have seen an increase in the number of bank accounts opened over the last 18 months and we are hoping to see those figures continue.

What will the deal with China do for Guernsey?

Bartram: At Barclays, we have private bankers who work in China, and with China being new to the captive insurance industry, our job back in Guernsey is to educate those bankers on the captive concept.

Once the education process is complete, we will work with clients to see if a captive is something that is suitable, if they have considered a captive.

And if they are not aware of the captive concept, we will provide them with information on what a captive is. We are all working together to wave the Guernsey flag, and hope to be rewarded with new business from China.

What challenges are your clients currently facing in Guernsey?

Nigel Winkett: One of the issues we hear about is our clients holding large volumes of cash, which is down to the appetite around returns on those balances. Are boards prepared to look at alternative ways of making that money work harder? There are challenges around education and around the alternatives because it is not just about holding cash, it is about looking at investment strategies that the board are comfortable with.

Bartram: If you look back to a few years ago when the base rate was high, the money a captive would earn covered all the captive fees, which meant that the treasurer sitting at the parent level had no cost coming from the captive. However, now we are seeing the treasurer having to add money to the captive to

Dave Bartram
Relationship manager of captives
Barclays

cover fees, which are also rising, making a captive less viable than it once was.

As a result of this, companies are asking how the captive can make better use of the surplus cash, and that's where Barclays comes in. Captives should not sit on cash, they should look at ways they can invest that money.

We have seen that companies in Bermuda are far more willing to put money into non-cash investments, whereas in Guernsey, companies tend to be a lot more risk averse.

Does Barclays have anything new in the pipeline for captive clients?

Winkett: One of the products we offer is a security trust arrangement. At present, Barclays is the only bank that provides that type of product in Guernsey. Barclays partly owns a trust company on the island, as well as in other jurisdictions, and so we devised a security trust arrangement as an alternative to the standard letter of credit. This is a non-credit solution, which requires none of the parent organisation's credit capacity, unlike letters of credit. It is a flexible solution that allows collateral to be tweaked easily and quickly.

> "Captives should not sit on cash, they should look at ways they can invest that money"

> "One of the products we offer is a security trust arrangement. At present, Barclays is the only bank that provides that type of product in Guernsey"

Bartram: We've also seen that captives and online payments do not work well together and, over the years, banks have struggled to find a solution to this. The issue was a user's ability to sign off on considerable payments without checks.

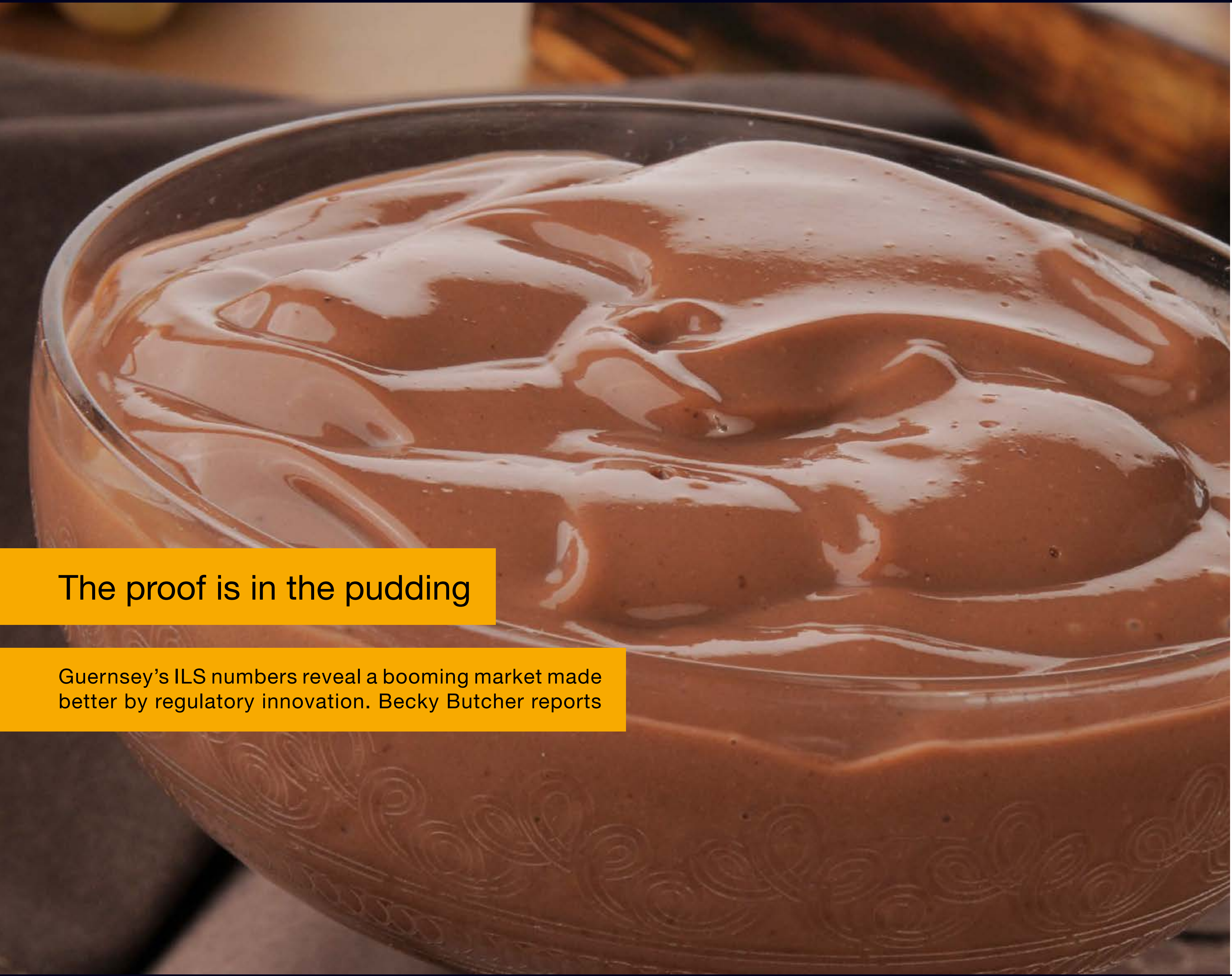
At Barclays, we have created a platform that has nine levels of signatures. Barclays.Net will enable online payments to be made in line with the captive's mandate.

The other part of that equation is the Barclays iPortal, which is an online letter-of-credit facility. Barclays give the captive a letter of credit limit, which will be documented in an offer letter and then it's up to the captive manager to do what they want with that limit. All of our letters of credit are secured against cash in Guernsey, whereas in the US they are secured against investments.

Barclays.Net for captive managers is being released in Q4 this year, and is currently undergoing testing with our London-based insurance team. CIT

Nigel Winkett
Head of fiduciaries, fund and captives
Barclays

ILS Insight



The proof is in the pudding

Guernsey's ILS numbers reveal a booming market made better by regulatory innovation. Becky Butcher reports

There were 14 global insurance-linked securities (ILS) transactions with $2.76 billion of risk capital issued in Guernsey's Q1 2017, approximately $1.4 billion above the 10-year average.

The results, which were published ahead of Guernsey's fourth annual ILS masterclass in Zurich on 6 July, found that the outstanding market size of $27.19 billion is almost $377 million higher than at the end of 2016.

At the same time, the number of insurance entities in Guernsey increased from 804 to 835 during 2016, a year-on-year increase that has been attributed to growth in the ILS market.

Dominic Wheatley, CEO of Guernsey Finance, explained upon the release of the results: "As international fragility and uncertainty increases, the ILS market blossoms and Guernsey, with its 50 years of international insurance experience, has always taken an industry thought leadership role in this asset class."

Wheatley went on to explain that the ILS business in Guernsey is taking the next step in its evolution by working out ways of dealing with emerging risks that are otherwise difficult to categorise or ringfence.

He says: "There has been some recent innovation in the industry and captives can play a significant role in those arrangements."

The Guernsey Financial Services Commission (GFSC) is also innovating in the ILS space, with the implementation of a new set of rules to clarify the regulatory treatment of collateralised reinsurance.

The updates allow an applicant seeking a licence for a new special purpose insurer (SPI) to be granted a single consent for the formation of further SPIs without the need for further applications.

A streamlined application process allows new insurers to be established within one business day.

The Insurance Business (Solvency) Rules 2015 were also amended to include the new SPI class of insurer. Under the new rules, an SPI is not required to maintain the minimum or prescribed capital requirements, or to conduct its own risk or solvency assessments.

This approach reflects the risks associated with SPIs, where typically 100 percent of the possible loss associated with underwriting a reinsurance contract is held in a trust account independent of the SPI vehicle.

Typically, cash assets will be applied against liabilities. However, under the changes, the GFSC recognises that the commercial interests of the counterparties may be satisfied using insurance and reinsurance, letters of credit or partly paid shares.

These changes demonstrate Guernsey's equivalence approach to Bermuda, cementing it as an alternative jurisdiction for ILS business within the European timezones.

Paul Sykes, managing director at Aon Guernsey, says the changes "reinforce its success, but Guernsey is also building on what was already there".

Stewart McLaughlin, executive director at Aon Guernsey, notes that the updates put Guernsey on a "level playing field" with other ILS jurisdictions, including Bermuda.

Bermuda and other jurisdictions had the advantage of SPV legislation, particularly tailored towards ILS business, but by making these changes, McLaughlin believes that Guernsey is now at the forefront of the ILS industry.

The new rules now make it easier for new business to enter the industry.

McLaughlin says: "For additional ILS managers coming into the market, the rules make the process a lot more streamlined, so for new entries to the market, it is good news."

Of course, the market for ILS is about to become more competitive, with the UK's plans for London hailed as a potential game changer by the city's local insurers.

The UK government has released two consultations on implementation of ILS-friendly rules, suggesting that the regime could be in place as early as this year.

Stephen Barclay, economic secretary to the Treasury, echoed many of the sentiments behind London's ILS regime in a recent letter.

He wrote: "London is the single biggest market for specialist risk in the world and is a global hub for insurance and reinsurance business."

"But this global business is evolving rapidly and the UK must innovate if London is to retain its uniquely important position in the market."

Guernsey should take the UK 'seriously' as it sets up an ILS regime in London, according to McLaughlin.

He suggests that one of the reasons for concern is that the UK's initial plans have been "comprehensive" and the London Market Group's ILS taskforce has a "very strong" panel of members with a wealth of experience.

He does add: "I understand some of the roadblocks include how the UK will provide a tax-neutral environment, expedite regulatory approval and implement protected cell company legislation—three major hurdles that have to be overcome."

"When London states it is seeking to be the centre for the future development of this business, Guernsey needs to take them seriously."

"Guernsey is mindful of the competitive forces and continues to innovate and introduce improvements to its ILS environment, such as the SPI regime improvements that the GFSC issued in September, to stay out in front."

Justin Wallen, head of ILS at Artex Guernsey, suggests that the new ILS regime will "not necessarily be a problem" for Guernsey.

Wallen says "the proof will be in the pudding" as to whether or not London can achieve the same level of efficiency, cost and service that ILS funds in Guernsey are already receiving, as well as those in Bermuda and Cayman.

"Our clients have confidence about the product and service they are going to get in Guernsey and they know that the transaction can be turned around quickly and cost-effectively," Wallen explains.

"The first few transactions in London will be closely watched as to whether or not they can achieve what we're already achieving." CIT

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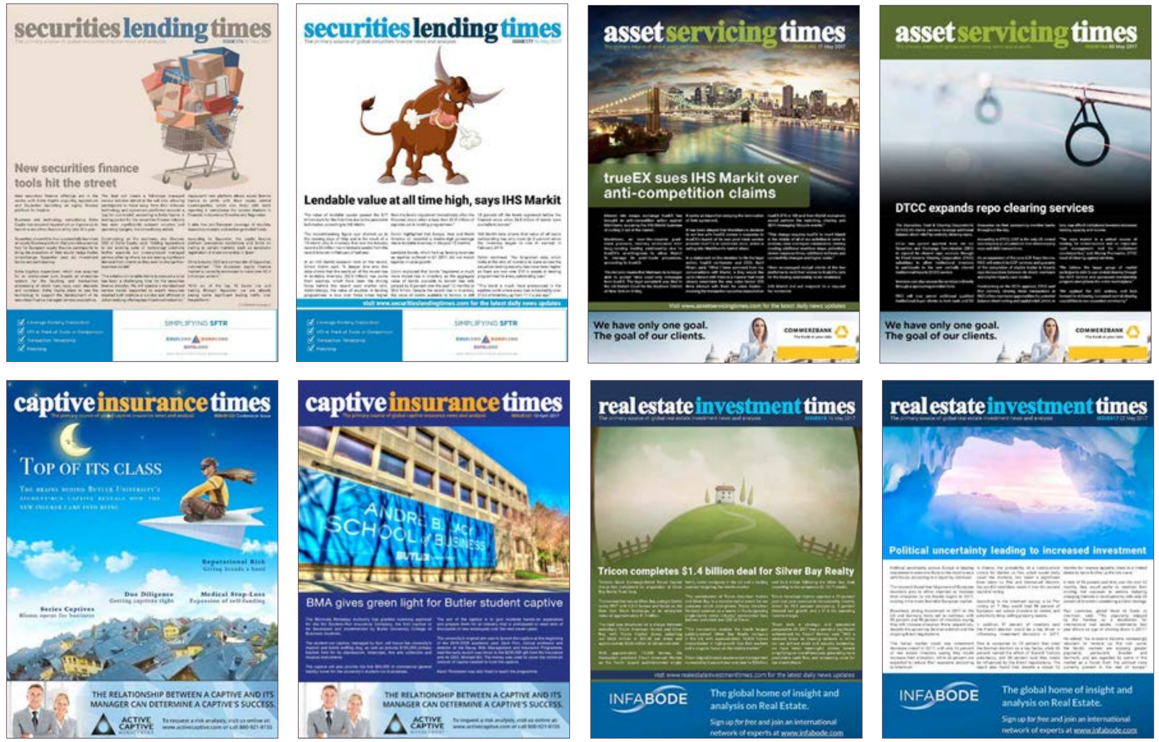

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IC the way forward

Guernsey has seen significant growth in the use of incorporated cells for pension longevity, as Christopher Anderson of Carey Olsen explains

What movement has Carey Olsen seen in longevity risk transfer in Guernsey?

Carey Olsen was involved in the £16 billion BT Pension Scheme longevity risk transfer in 2014, which was a significant deal for Guernsey. We also act as the legal adviser to the Merchant Navy Officers Pension Fund. In addition, there are two more transactions in the pipeline for a large UK pension fund–similar in size to the BT deal. We are also working on two other longevity deals.

Why has there been so much interest in longevity risk transfer?

Pension funds with defined benefit (DB) liabilities are looking for options. The pensions industry is concerned about the demographic time bomb and the poor performance of traditional investments in the low-interest rate environment. Both of these trends are making it harder for pension funds to match up their assets and liabilities. A longevity risk transfer is one solution to this issue.

One of the reasons that longevity risk transfer is so interesting is the difference between the needs of pension funds and life insurers and reinsurers. On the one hand, increased life expectancy creates difficulties for DB pension funds because they are obliged to make payments to pensioners over a longer period. On the other hand, increased life expectancy means that life insurers' and reinsurers' liabilities to make payments on death are deferred.

This creates opportunities, especially for a reinsurer with a large book of life business. A longevity risk transfer becomes the perfect hedge for that reinsurer because it can offset the longevity risk against its life business. However, a reinsurer is not licensed to write insurance of a pension fund's risks. That is where the Guernsey cell comes in, as an intermediary between the pension fund and the reinsurer. At Carey Olsen, we have seen quite an appetite for this business.

Where do incorporate cell captives fit into this?

The incorporated cell of an incorporated cell company (ICC) insures the liabilities of the pension fund and then reinsures its liabilities with the reinsurer. The incorporated cell doesn't retain any net risk. There are significant credit risks in relation to each counterparty, for example, if the reinsurer goes bankrupt, the incorporated cell doesn't get paid. Therefore, an important part of the process is ensuring that there is security and collateral provided, so that in the event of a counterparty failure there is enough capital to unwind everything.

How did the introduction of cell structures in Guernsey change the market?

By the 1990s, a lot of UK companies that could make use of a captive already had one. The protected cell company (PCC) was introduced in Guernsey in 1997 to enable smaller captive cells to be operated at lower cost. With the introduction of such cell structures, captive insurance became economically viable for a large number of smaller companies.

Why were incorporated cells needed?

As the name suggests, longevity contracts are designed to ensure over a long period of time. The liabilities of the pension fund can extend for a period in excess of 60 years. A lot can change in that time and so it is important for the parties to have options to migrate, collapse or adjust the structure if necessary. Unlike a protected cell of a PCC, an incorporated cell is a separate company, which makes it much easier to move around, migrate to another jurisdiction or move it to another ICC in Guernsey.

There is also a slightly stronger argument about the segregation of the assets and liabilities of a corporate cell, because an incorporated cell is a separate company and a protected cell isn't. However, PCCs are still more popular in the insurance industry generally, as they are cheaper, easier to manage and more flexible.

Do you think the number of ICCs will catch up with PCCs?

I think we will continue to see significant growth in the use of Guernsey cell companies in longevity risk transfer transactions. But, I would be surprised if we had as many ICCs as PCCs in five years.

For larger pension funds, it is economically viable for them to set up their own ICC so they can utilise different cells for transactions and reinsurers. However, a number of service providers, such as Willis Towers Watson, Mercer and Artex, have set up their own ICCs which can offer smaller pension funds individual incorporated cells, replicating the PCC structure for captives as described above. This type of setup offers the same solution but at a slightly lower cost. CIT

Cell it to me

Protected cells continue to be the vehicle of choice for securitisations. Stewart McLaughlin of Aon reveals how flexibility has been a key factor in their success

It was the 20th anniversary of the protected cell company this year. Has the structure changed much in that time?

There has been little change to the legislation over the last 20 years, which is testament to Steve Butterworth, director of insurance at the Guernsey Financial Services Commission from 1988 to 2003, who was widely credited for developing Guernsey's protected cell company (PCC) concept, as well as Nick Van Leuven, who wrote the legislation.

Since it was first enacted, Guernsey's legislation has been used as the benchmark for the PCC concept by more than 40 jurisdictions globally. In my opinion, other jurisdictions have used the Guernsey legislation as a blueprint and have made only minor changes, most notably to the terminology, in an attempt to differentiate their offering.

While it is called a segregated accounts company in Bermuda or a segregated portfolio company in Cayman, the legislation, in my view, is based on the original Guernsey PCC.

Guernsey has also introduced the incorporated cell company (ICC), taking the PCC concept one step further by having cells that are individual legal entities in their own right.

What does an ICC offer over a PCC?

We have seen increasing use of ICCs, especially for longevity transactions where pension funds are accessing the reinsurance market through their own captive facility.

This is a more appealing structure for the pension trustee who is seeking assurance on robust ring fencing, given the size and duration of these transactions. The transactions are in the billions and the estimated duration can be as much as 40 years.

Who is using PCCs in Guernsey?

The rent-a-captive concept was around before PCCs were invented, where clients separated their business activities by contract. Rent-a-captives were most often used by small and medium-sized enterprises (SMEs), which could not devote the management time or didn't find it cost effective enough to establish their own captive insurance company.

PCCs were essentially established to strengthen the rent-a-captive arrangement and bring it on to the statute books.

This is still the case today with the modern PCC, but the insurance industry has continued to find new and innovative uses for PCCs. The insurance-linked security or collateralised reinsurance industry continues to grow, for example.

It is difficult to generalise about the use of PCCs. There are many cells that are sizable enough to be standalone captives but, for various reasons, the PCC is the preferred vehicle. Protected cells also continue to be the vehicle of choice for securitisations. Ultimately, their flexibility of use has been a key factor in their success.

With four new PCCs created in Guernsey last year, do you expect to see continued growth in the sector?

Yes, but it's not exponential. The traditional captive market is flat, according to the statistics. Some 90 percent of the Fortune 500, for example, already have a captive. One would expect that the remaining 10 percent have decided against it. There is always scope for growth and perhaps with emerging risks such as cyber we will see increasing demand and the captive industry will continue to innovate.

So far this year we have seen one insurance-linked securities manager coming to market, which is fantastic news for White Rock PCC and Aon as a whole. This is a unique business, so new managers are rare. With the continued convergence of insurance and capital markets we are hoping that we can place insurance risk on the agenda for a wider group of investors. CIT

Stewart McLaughlin
Executive director
Aon Insurance Managers

China Deal

Year of the captive

Guernsey's hard work is paying off as China looks to stretch the boundaries of its captive strategies. Becky Butcher reports

The relationship between Guernsey and China, going strong since 2007, took a giant leap forward last June when the Guernsey International Insurance Association and both the China Captive Alliance and Kashgar Government came together in a bid to further develop China's captive insurance market.

Since then, a further two memoranda of understanding (MoU) have been signed with China, vindicating the island's continuous representation in the country over the last ten years.

The first MoU was an agreement to facilitate business through an arrangement between the Guernsey and China insurance industry regulators.

This firstly set out the guidelines for cooperation, which include the requirement for both supervisory bodies to have a specific point of contact for communication between the organisations; the types and timing of requests for information; and the respect for a public-interest test.

The second agreement, with the Beijing Airport Economic Core Zone, encourages cooperation in the areas of captive insurance market development, financial innovation, and international information exchange, in order to promote the viability of the Chinese captive market and wider communication between China and the global captive industry.

According to Dominic Wheatley, CEO of Guernsey Finance, China opening up its insurance market has been a "slow burn but ultimately an exciting outcome".

Wheatley explains that Guernsey Finance has always maintained the value of being in the region, and will continue to do so.

He says: "We've put in the hard yards, quietly maintaining a footprint in China for the last decade, so these signs of the imminent maturing of that relationship through the internationalisation of Chinese corporates is very positive."

Although captives are well-established tools used by companies all over the world, their use has historically been limited among major Chinese corporations. The reasons behind this are not difficult to see, notes Wheatley.

He explains: "As most assets and corporations have been publicly owned in China, the government has simply assumed risk and losses have been met out of current revenues."

"Not surprisingly, insurance was not recognised as necessary by managers or their public sector shareholders. However, the move toward a more mixed economy and a greater international outlook has seen two significant trends: the emergence of private sector corporations; and the increasing privatisation of government-owned companies."

China has technology on its side. The rate of its progression and adoption of sophisticated techniques is faster than outsiders expected and, according to Wheatley, is set to accelerate even more over the coming years.

Wheatley suggests that this innovation is being encouraged and facilitated by the China Insurance Regulatory Commission (CIRC) and China's other financial regulatory bodies, and is enthusiastically endorsed by the People's Bank of China.

Discussions are already underway around a potential agreement between the CIRC and the Guernsey regulator, which should enable further operational and financial efficiencies and provide enhanced transparency and joined up regulatory oversight.

"These developing arrangements are a major step forward toward China's goal of developing its own domestic international insurance expertise and a mature insurance industry, as well as increasing its international insurance relationships," Wheatley says.

Guernsey started broadening its presence in Asia with Guernsey Finance's 2007 appointment of Wendy Weng as its first Chinese representative in Shanghai.

Wheatley notes that Weng has been "highly instrumental" in encouraging the development of captive technology in China.

Most recently she has overseen the delivery of a series of educational seminars introducing local practitioners to the pending Common Reporting Standard requirements.

On the back of her success, Guernsey Finance has extended its presence in the region further, appointing Christopher Chan as its first Hong Kong representative earlier this year.

Chan is leading Guernsey's promotional efforts across the wider Southeast Asia region, particularly introducing family offices and fund managers to the vehicles and structures most commonly developed in Guernsey.

But it's the island's captive insurance expertise—it is the home of the protected cell company—from which Guernsey Finance believes China will benefit most.

Chinese companies will able to develop global programmes based around Guernsey captives, and Chinese captive owners will able to make use of their access to expertise in other classes, taking advantage of soft-market multi-line capacity in the London wholesale markets, employee benefits, casualty, and emerging risks such as cyber.

According to Wheatley, Guernsey can offer China and Chinese corporations advice on non-conventional programme designs, risk transfer pricing, and detailed terms and conditions.

Guernsey Finance maintains that the island's robust governance, its regulation and the substance of its insurance community "will ensure captive arrangements are respected by international regulatory and tax authorities, and work in harmony with the non-captive elements of insurance programmes".

Guernsey will benefit not only in terms of new captive business, but also in terms of developing its understanding of Chinese business and corporations, and their risk environment and attitudes to risk and risk financing.

Wheatley says: "Of course, multi-domicile captive strategies are not new but they did take decades to develop elsewhere. It is a measure of China's ability to adopt technology quickly that just a few years after establishing its first captives it is already looking to stretch the boundaries of captive strategies."

He adds: "The future for captives in China is secure and is coming quicker than you may think." CIT

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