ATTITUDES TOWARDS CAPTIVE INSURANCE IN ASIA

Survey conducted by *Captive Review* in partnership with Labuan International Business and Financial Centre

CAPTIVE REVIEW

Labuan IBFC

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EXECUTIVE SUMMARY

Asia has long been touted as the next big growth region for captive insurance, but the numbers, in terms of captives formed and domiciled in the region, although growing have yet to back that up. At 31 December, 2016 there were 6,618 active captives globally. Of those, only 148 are domiciled in Asia Pacific jurisdictions. Although there remains a significant number of Asian-owned captives domiciled in other international jurisdictions further afield, the potential for captive growth at home remains vast as economic growth in the region continues unabated.

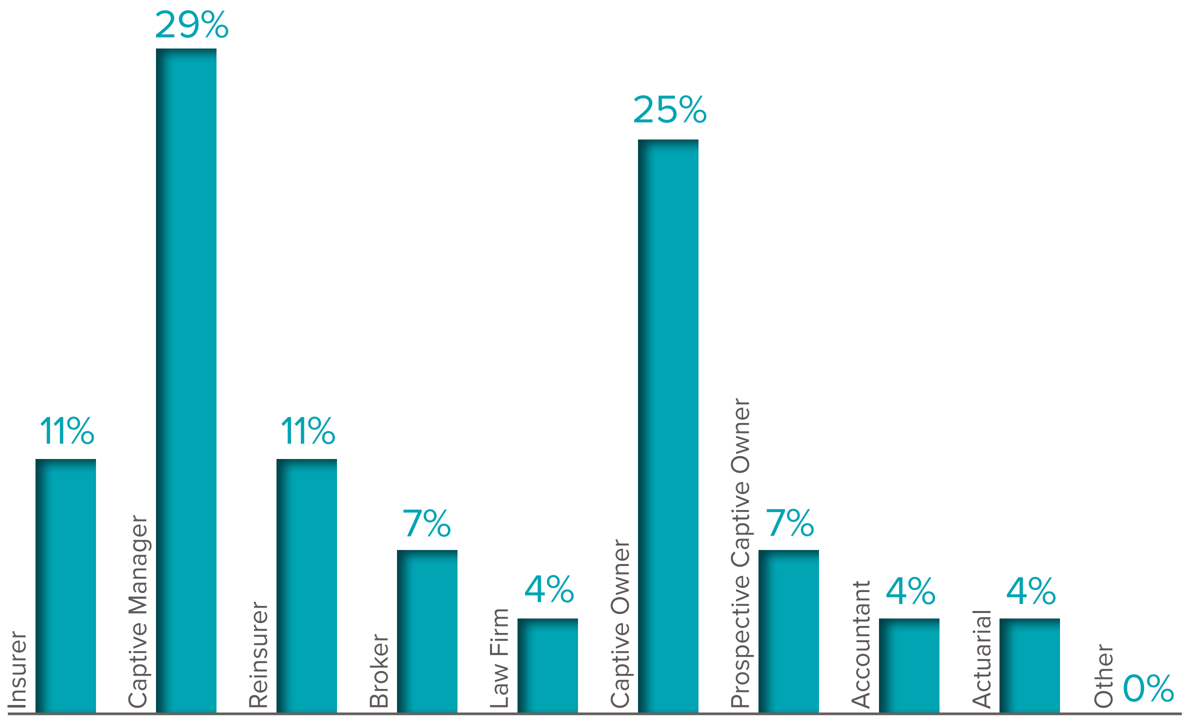
Only eight new captives were formed in the region during 2016, compared to 478 new licences in North America, 108 in Bermuda & the Caribbean and 22 in Europe.

This white paper, *Attitude Towards Captive Insurance in Asia*, seeks to unmask some of the factors that lie behind the struggle of the industry to break through and convince business leaders of the long-term benefits of captive insurance. Some key findings of this survey include:

- A "lack of commitment" from internal decision makers was identified as a key factor holding back captive utilisation in Asia by 75% of those surveyed, while the soft insurance market and a "lack of understanding" were also ranked high on this list.
- A strong belief that the captive insurance concept is only well known among the largest companies, suggesting that a high proportion of middle-market prospective captive owners remain unreached. The common misconception that captives are a "pure tax play" is unlikely to be aiding growth across the region either.
- In addition, there was an impression that captives are complicated in nature and may not be worth exploring in the current soft insurance market, clearly indicating that the concept of self-insurance and specifically captives should be better nurtured.
- A positive sign, however, is the belief of 61% of respondents that a "maturing risk management culture" and in-house understanding of captives is driving uptake. This is only ever going to be an upward curve so the more education opportunities provided to risk managers and their superiors, the better.
- Forecasting ahead, while more than 90% of respondents believe that there will be growth in the number of captives in Asia, only 35% believed that the growth would be strong or significant.
- We surveyed a varied cross section of those involved in risk management and insurance in Asia, with more than half of respondents identifying as either captive owners or captive managers. Twenty per cent of respondents worked for (re)insurers.
- Just under half of those surveyed said they were "familiar" with captive insurance, while 29% claimed to be "expert" and a quarter "novice".

I hope you find this white paper valuable and it can help the risk and insurance community understand where their focus needs to be as the concept of captives is promoted across the region.

How would you describe your company?



DEMOGRAPHIC

Captive Review received completed surveys from 112 respondents across the risk and insurance community in Asia. Captive managers and captive owners made up the vast majority of participants, but those working for (re)insurers combined to contribute 20% of respondents.

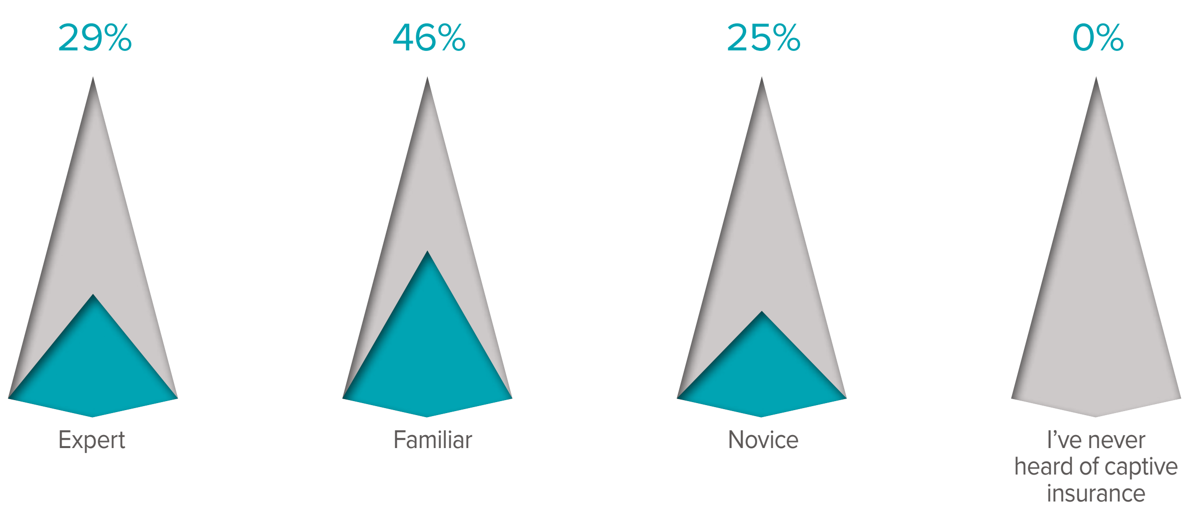
While captive owners and managers are likely to have a strong understanding and interest in promoting captives, a successful captive ecosystem thrives when further support services such as actuaries, accountants, lawyers and brokers have bought into the sector and are committed to help develop it.

With that in mind, 25% of respondents declared themselves as "novice" in their knowledge of captive insurance, which suggests there remains work to be done in spreading the word on captives.

KNOWLEDGE BASE & CAPTIVE DRIVERS

When asked how well known the captive concept is, three quarters of respondents said it was largely restricted to the largest companies. A further 21% said it was very well known, while almost 4% said it was "not known at all".

How would you describe your knowledge of captive insurance?



Malcolm Cutts-Watson, formerly chairman of the Willis global captive practice and now an independent consultant in Guernsey, said this should not be a surprise and follows the same trend as that seen in the United States in the 1970s and Europe in the 1980s.

"You can label it a natural evolution pattern and a reflection of sophistication in the risk management community," he said. "Large companies are more likely to have access to international best practice and a large enough balance sheet that self-financing becomes more attractive."

Singapore-based George McGhie, managing director of Willis Towers Watson's global captive practice, said the emphasis on larger companies is likely a result of how Labuan, Singapore and Hong Kong promoted themselves when they first launched as captive domiciles.

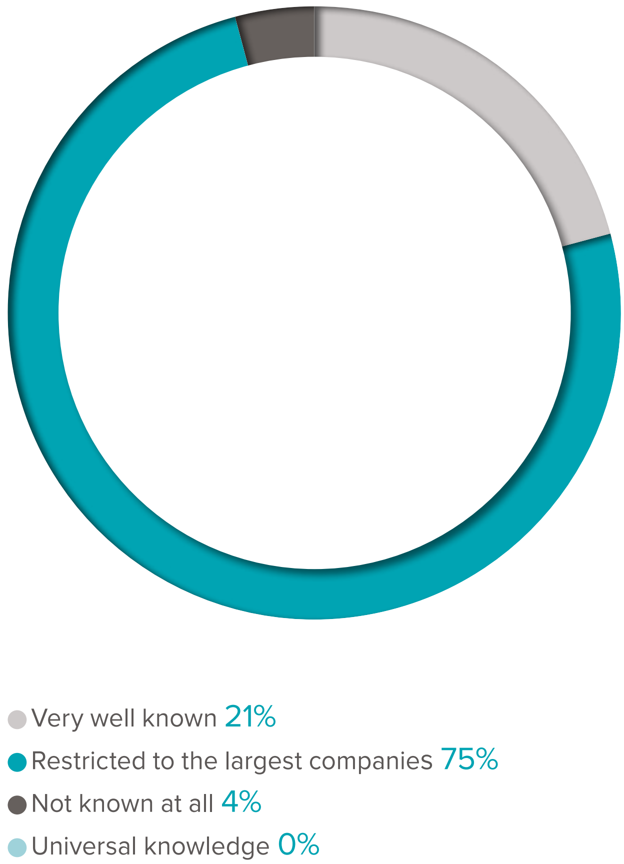
"It was all about attracting the largest multinational companies," he said. "Whereas if you look at Bermuda and Cayman, they have got a broader offering. It is not that captives are only suitable for large companies, but perhaps the messaging around it in the region has focused on them."

McGhie added, however, that the industry should be wary about concluding it to be a "stage of development" and not draw a straight comparison with North America and Europe. "The regions are very different. Many Asian captives are driven by international exposures. The fact that conventional insurance tends to be very cheap in most Asian environments, for small companies with small premium volumes it is hard to justify the cost of a setting up a captive."

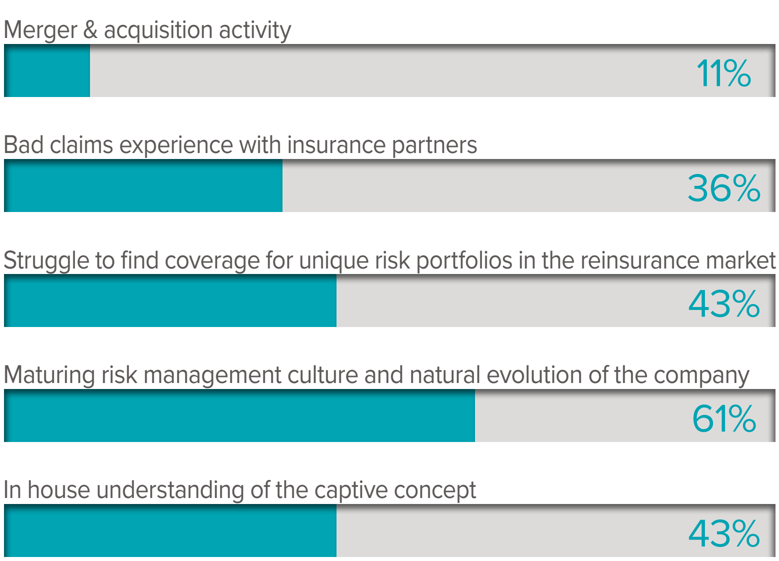
Labuan-based Anthony Egerton, principal officer of Huntington Underwriting Limited, said the knowledge base concerning captives varied across the region.

"In developed markets like Japan, knowledge of captives in much broader and extends well beyond the largest companies," he said. "And then you have China, where you have a lot of interest as an investor play and interest from the state-owned enterprises."

How well known is the captive concept among the risk management community in Asia?



What are the two most common factors driving Asian companies to consider forming a captive?



The majority of respondents cited the "maturing risk management culture and natural evolution of the company" as the most common factor driving Asian companies to consider forming a captive. This result further reinforces attitudes regarding the "largest companies".

The high number citing the "struggle to find coverage for unique risk portfolios" should be encouraging, since this remains one of the key reasons for forming captives all over the world.

Beijing-based Ludan Wang, assistant general manager within Willis Towers Watson's global captive practice, said in mainland China primary drivers were captives being viewed as an innovative approach for the financial sector and to deal with overseas risk.

"In China the companies have huge balance sheet power to cover their risk so they don't think about insurance," he said. "But for those companies with business overseas, they are thinking about meeting local regulation, using a captive to help with cash flow and achieve tax benefits."

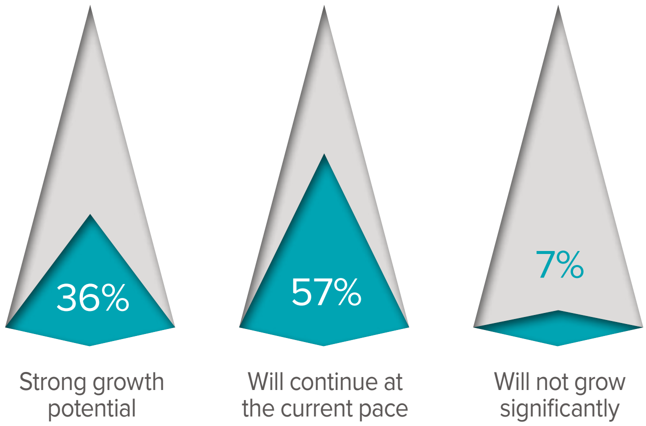
GROWTH POTENTIAL & MISCONCEPTIONS

While 57% of respondents said captive growth in Asia would "continue at the current pace", 36% said they believed the region had "strong growth potential". Only 7% said it "will not grow significantly".

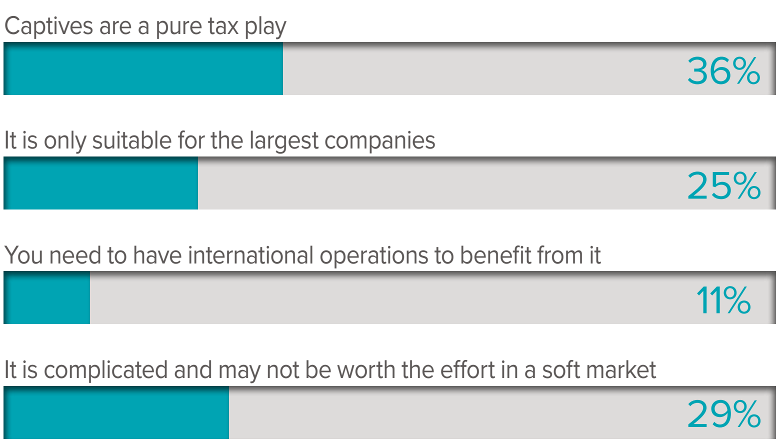
The current rate of growth in the region, by captive formation numbers alone, is not impressive when considering only eight new captives were established in Asia Pacific domiciles during 2016. However, George McGhie said there are other areas of growth that statistics do not recognise.

"We know there are a lot of captives that are not well used or in the wrong place," he said. "Another area of growth is helping companies assess their existing captive and make sure it is providing full value to the parent. That is, and will be, an area of growth, but we will not see it in the raw statistics."

What do you think of the future growth potential for captives in Asia?



What is the most common misconception about captives in Asia?



McGhie added he has also seen interest in the Asian domiciles from American and European corporations as a result of increased business interest in the region and from frustration with Solvency II in Europe.

In the latest Allianz Trend Watch report analysing growth in the global insurance market, it finds that Asia currently has a "three-speed insurance market", with gross written premium in Asia now accounting for 32% of total global premium (life and non-life). China and Japan combined account for two-thirds of this premium spend, but Japan is "bottom of the league" in terms of premium growth.

Malaysia, Singapore, South Korea, Taiwan, Hong Kong and the Philippines are mid-table. China leads a top tier made up of India, Indonesia, Laos, Pakistan, Sri Lanka, Thailand and Vietnam.

Malcolm Cutts-Watson said he believed growth in Asian captives will really kick in when markets in the region become less protectionist and as premium levels continue to rise.

"It remains quite a closed market in Asia, but if the markets open up and you get more free trade agreements then that might be the way to move the captive market forward," he said. "The premium drive from China will also influence the rest of Asia."

Misconceptions about captives exist in all markets and we see the idea they are only suitable for the "largest companies" is cited again. A further 29% highlight the belief that forming a captive "is complicated and may not be worth the effort in a soft market" as another prominent misconception.

But it is the theory that "captive are a pure tax play" that seemingly still dominates negative perceptions of captives in Asia.

"The fact it is only 36% demonstrates the knowledge that captives are a risk management tool, rather than a tax play," Anthony Egerton said.

"Those perceptions still exist, but it looks as though the message is getting through. I don't think that the perception is peculiar to Asia either – the whole world is still waking up to the fact that these entities have a far greater role to play than creating a more efficient tax position."

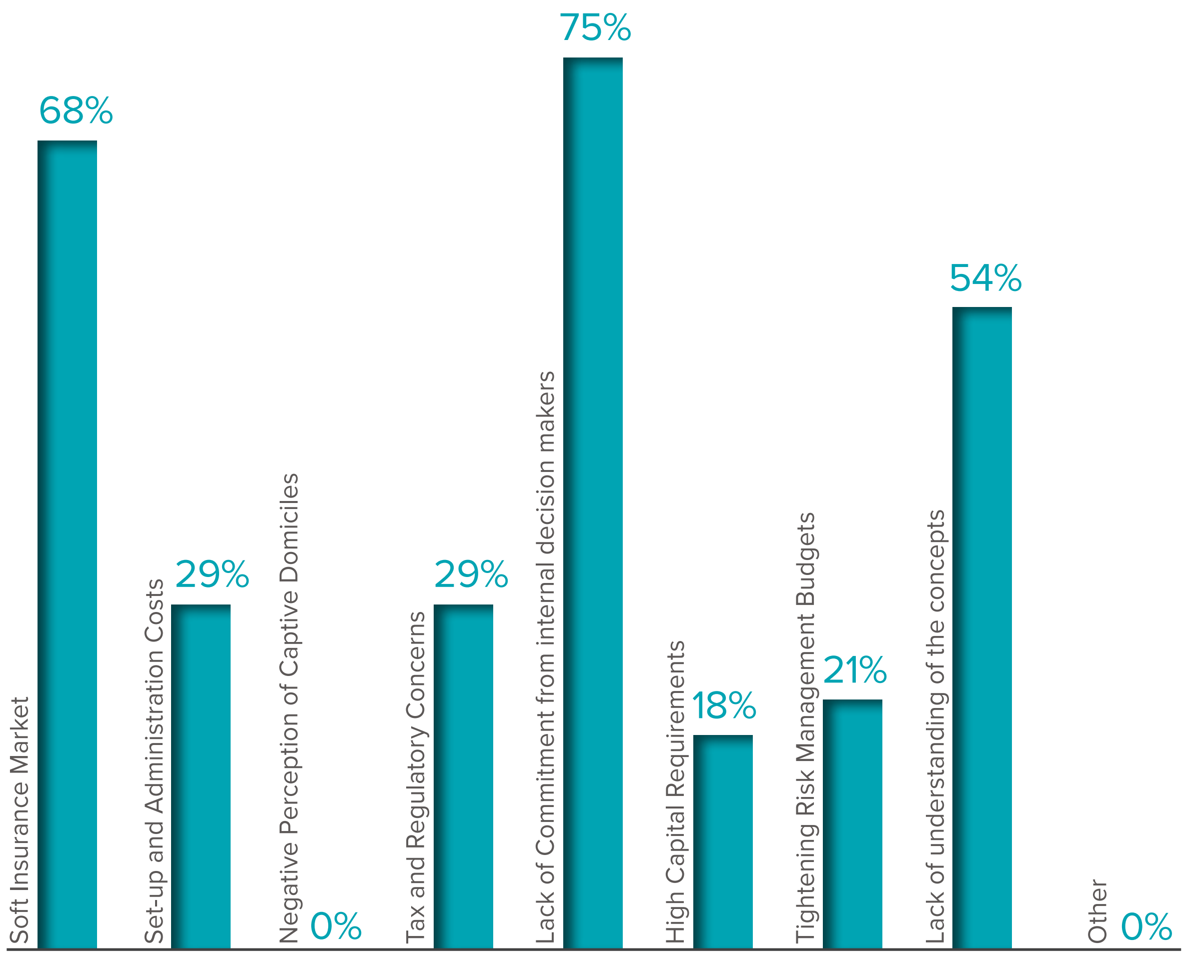
McGhie agreed that the tax motivation remained a "common misconception" and he continues to make the point to prospects and other advisors that tax is not what captives are about.

"It is more about long term strategic risk management benefits," he added. "You are not setting this up to achieve tax benefits and it surprises me sometimes the seniority of the people in the industry that make that assumption."

OBSTACLES TO GROWTH

When asked to name three factors believed to be holding captive utilisation back in

Choose three factors you think are holding captive utilisation back in Asia?



Asia, the soft insurance market (68%) and "lack of commitment from internal decision makers" (75%) led the way.

Commentators on this report agreed with these findings, even if there remains frustration that the soft insurance market remains a factor in the decision making process of forming a captive.

"We all know that if you look at the statistics on captive incorporation activity, it doesn't match the state of the insurance market," George McGhie said. "It is feared that corporates are looking at captives as an alternative to commercial insurance, whereas captives fill a different role to commercial carriers. Captives are used in addition, and as a complement, to the traditional markets."

Anthony Egerton said he was not surprised by the prominence of blame laid upon the soft insurance market. "The longer the soft market goes on and technology advances and new forms of capital becomes available, the question will be is this actually a soft market or is it just the insurance industry becoming more efficient?"

A lack of commitment from internal decision makers is well understood, however, and there is an appreciation that this will take time to rectify. Often it is a result of complex internal processes at Asian businesses and an inability of captive promoters to gain access the right person.

"I understand the 75% because if you are working for a prospective captive owner or advising them, clearly one of the biggest hurdles to get a captive launched is to get an internal decision maker to say yes," Egerton added.

"I am disappointed that 54% highlighted a lack of understanding as a factor because I think a lot of good work on education has been done by the industry and Labuan IBFC. Maybe I am too optimistic about the extent of understanding."

McGhie added that internal decision makers were his biggest issue when proposing a captive solution to clients.

"It is more to do with the decision-making process," he said. "Some of the larger companies we deal with have very complex internal processes. It is very difficult to find the one decision maker who can push the captive formation all the way through to completion. It involves lots of departments and we have to explain it all over again."

Ludan Wang said a lack of understanding and maturity of risk management were both influential factors in China, while the decision making process within Chinese enterprises can be very bureaucratic. "The drivers and obstacles in China are different for the privately owned companies and the state-owned enterprises," he added.

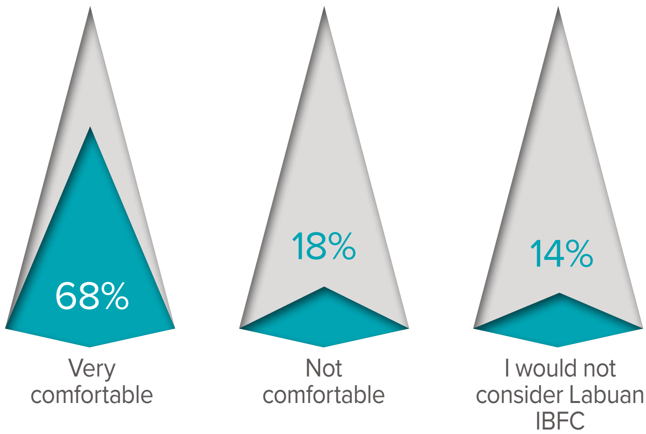
REGULATORY ATTITUDES

Accessing the regulator (61%) and expert local infrastructure (57%) were picked as the most prominent factors for respondents when considering a captive domicile. A low tax environment (36%) was the third most commonly chosen factor.

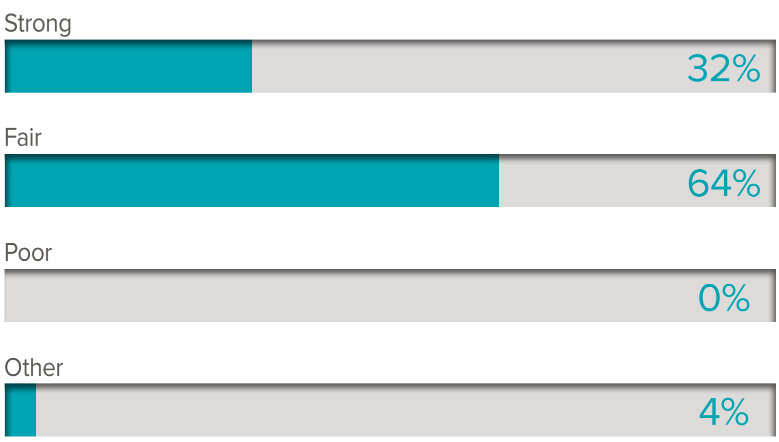
"Captive infrastructure is essential, particularly given the increasing emphasis on the substance requirements that are fundamental to compliance with the OECD's Beps initiative," Anthony Egerton said. "In Labuan the regulator is good to work with, but there are also experienced captive managers, lawyers and accountants that understand not just the regulatory requirements, but also the international risk management environment.

"A good infrastructure will be absolutely essential for all domiciles going forward."

How comfortable would you feel owning a captive or working with a captive domiciled in Labuan IBFC?



How do you perceive Labuan IBFC as a captive domicile specifically and risk management domicile generally?

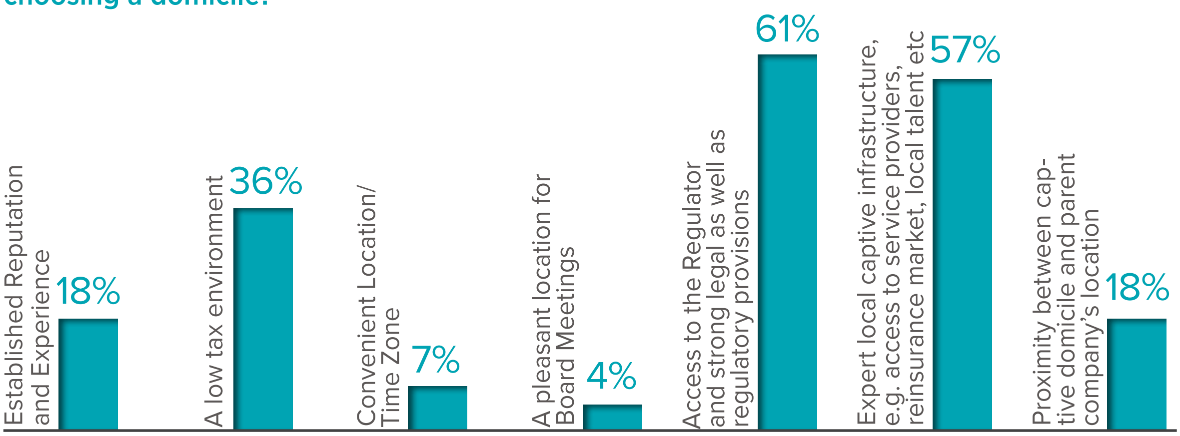


So called 'soft factors' did not make much of an impression on respondents with "convenient location" and "pleasant location" only chosen by 7% and 3% respectively.

The "proximity between captive domicile and parent company" was recognised as important by 18% of respondents, while "established reputation and experience" was chosen by the same proportion.

Labuan IBFC received favourable responses from those surveyed with 68% stating they would feel "very comfortable" owning or working with a captive in the jurisdiction. In a separate question, 64% of respondents said they considered the domicile to have a "fair" reputation, while 32% considered it "strong".

Choose the two factors you think captive owners feel are most important when choosing a domicile?



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