captive insurance times

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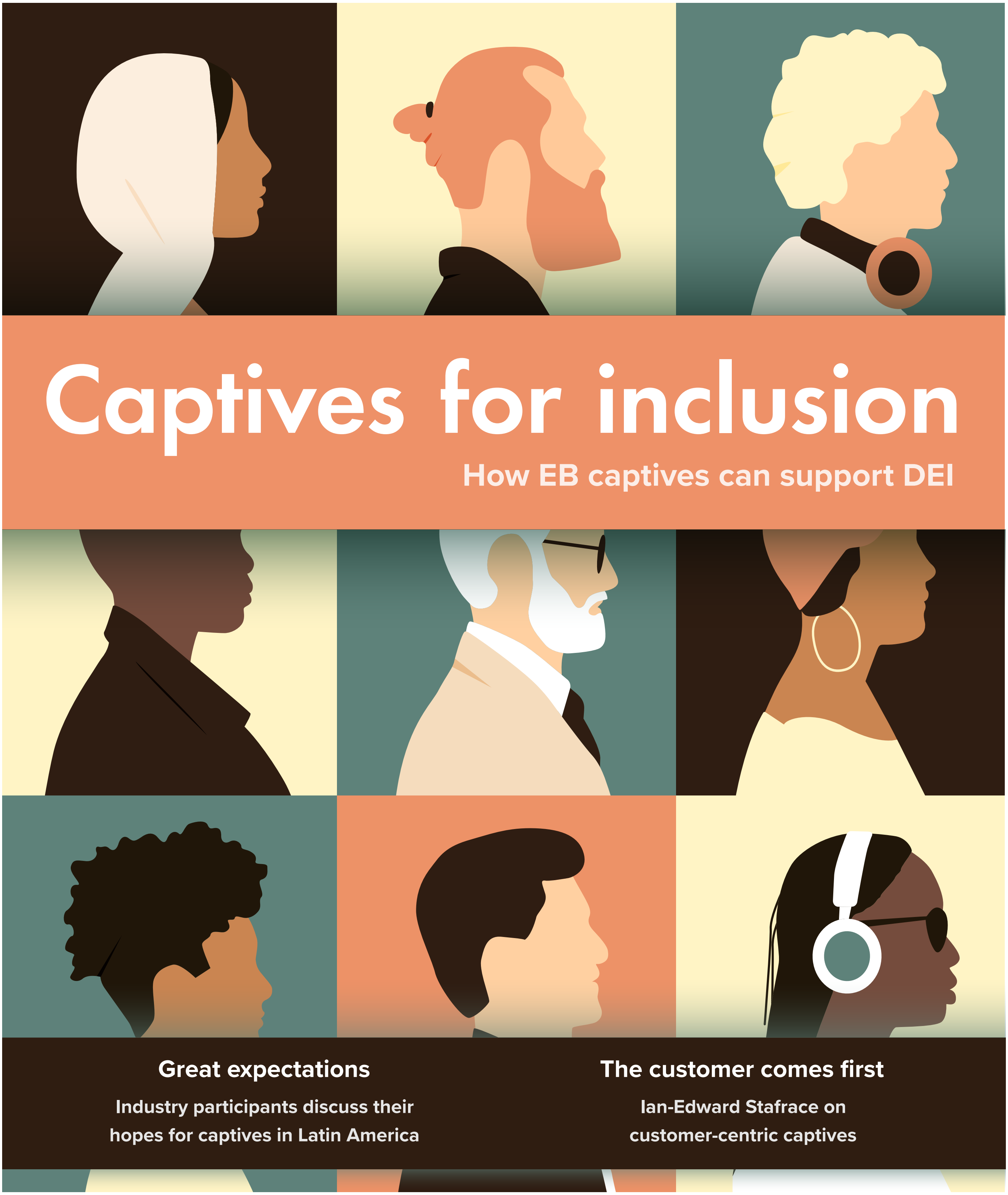

Captives for inclusion

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Great expectations

Industry participants discuss their hopes for captives in Latin America, as well as recent developments and the barriers to captive uptake in the region

Frances Jones reports

“There are great expectations for Latin America (LatAm), with double-digit growth in the number of captives and volume of business negotiated by them,” says Alejandro Santos, managing director of analytics and captive solutions at Marsh Advisory for Latin America and the Caribbean.

LatAm is gaining traction in the captive industry, due to long-anticipated and increasing interest.

Geographically speaking, the region consists of the entire continent of South America, as well as Mexico, Central America and some Caribbean islands. Culturally speaking, this vibrant part of the world is best known for its dancing, varied and flavourful food, and lush tropical landscapes. At this point in time its captive landscape also has much to offer.

“LatAm’s insurance market is a fertile territory for accelerated growth and business model innovations,” says McKinsey & Company in its 2023 Global Insurance Report: Capturing growth in Latin America.’

Additionally, “it’s already the fastest-growing regional insurance markets globally — in both the life and non-life segments — and it’s amongst the most profitable markets for insurers globally,” adds McKinsey & Company.

Rapidly expanding economies, an emerging middle class and increasing awareness of the value of financial protection have led to LAtam’s thriving insurance market.

According to the MAPFRE Economic Research, ‘The Latin American Insurance Market in 2022’, LatAm witnessed increased profitability in its insurance industry by US$9.909 billion, compared to 2021.

The research also found that the “two biggest markets in the region continue to be Brazil and Mexico, followed by Puerto Rico.”

This is a noteworthy development, considering it has the smallest population of the 19 countries analysed in the study.

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A slow start in the captive race

When comparing the size of the region against the rate of captive adoption, LatAm's insurance industry has somewhat understandably lagged far behind the US and Europe.

Despite the size of multinational companies in the LatAm region (known as 'MultiLatina' companies), "there are still very few that are exploring and capitalising on the opportunities that captives can provide for both risk and HR managers," says Maxis Global Benefits in an article entitled 'Employee benefits in Latin America'.

A 2021 Captive Insurance Times article, 'Forecasting opportunity', highlighted that LatAm's relatively slow captive growth rate is due to the fact that the region has struggled with a lack of knowledge and education on its benefits.

The McKinsey report identifies several structural challenges, such as a fragmented market and some socioeconomic factors, such as financial inequality and low technology penetration.

However, the hard commercial market has increased captive utilisation in LatAm, and subsequently captive uptake rates are increasing in the region.

Isabel Mettetal, director of SRS Cayman, says: "As market capacity diminishes, premium rates soar and terms and conditions become more stringent. With additional exclusions, companies are actively seeking alternative methods to effectively manage their risks. This growing interest in captives has prompted an uptick of captive feasibility studies in LatAm."

Marsh's Santos adds: "Contributing variables to the increase of captive formations [in LatAm] are hard market conditions — this has been the case for a few years now. Other variables include development in risk management knowledge and sophistication from our clients [at Marsh]."

New developments

Insurance companies have been quick to spot and respond to the potential for captives in the area, with key players expanding into the region. For example, SRS appointed Luis Delgado as regional director for LatAm in July.

Delgado moved from Bermuda to Colombia to establish a physical presence for SRS in the region. "Conducting face-to-face meetings instils confidence in prospective clients and expedites the progress of captive projects," says SRS' Mettetal.

Delgado comments: "Over the past few years, we [at SRS] have seen record levels of captive formations, feasibility studies and general interest and enquiries from prospects across LatAm, so it makes sense to be closer to where our clients and prospects are located."

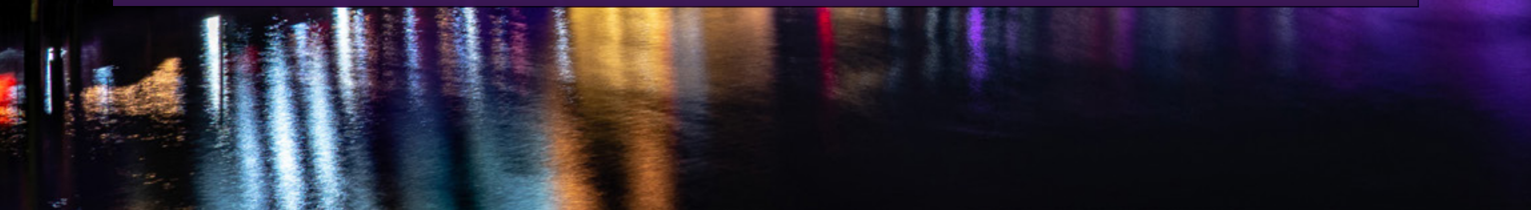
Affirming this sentiment, the CEO of SRS, Brady Young says: "Latin America represents an important region for SRS. We believe there are opportunities for LatAm parent organisations to make greater use of captive insurance."

SRS is seeing pure captive and cell structures owned by large corporate parents continue to dominate the region. "However, we are seeing interest in small commercial reinsurers and agency captives," notes SRS's Mettetal.

Tom Morante, attorney at law at Carlton Fields, says: "New coverages, such as employee benefits captives, have become attractive in the current macro environment. In addition, while single-parent captives have historically seen the most growth, there is a gradual interest in cell captives, which are proving particularly attractive as a captive entry-level strategy."

Marsh LatAm has also seen strong interest in the captive concept in the last few years, with many companies looking for alternatives for their more difficult placements.

Marsh's Santos agrees with Morante that this interest includes the segregated cell concept for non-traditional lines, such as cyber and D&O. However the single-parent captives still dominate, as well as traditional lines such as property.



Challenges and barriers

Carlton Fields' Morante notes: "Captive adoption in LatAm faces many of the same challenges as in other regions, particularly in the areas of underwriting, pricing and fronting structures."

SRS' Mettetal elaborates: "In many LatAm countries, a double-fronting arrangement is mandatory when the captive is not licensed in the country where the risk is located. Typically, fronting companies must meet certain rating criteria, and the collateral requirements can become quite onerous. Finding a suitable partner willing to front for the desired coverages has proven challenging for many companies."

The geographical scattering of LatAm countries, and the corresponding differences in legislation, can pose regulatory barriers to those interested in forming a captive. These challenges are starting to be addressed in higher-performing countries, such as Mexico and Brazil. As regulatory changes continue to address these challenges, the use of captives in other LatAm countries will increase.

Marsh's Santos says: "Insurance regulation is one of the key challenges we face in the region. Although some countries are relaxing their reinsurance regulations, we still have to deal with complex structures.

"We currently have restrictive regulations in many countries such as tax reforms that become a hurdle on the use of captives. Furthermore, most countries are facing economic turmoil with high inflation rates that cause restrictions on retentions, as well as volatile currencies."

Mexican and Colombian corporations are employing captives with greater frequency, where the regulation is more conducive to captive formations.

Captive growth in Latam will need to be encouraged and supported by legislation to smooth regional differences. This will likely be enabled and aided by collaboration between regulators and parent companies, and sharing knowledge between the different countries.

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>
> **Isabel Mettetal, SRS**

Carlton Fields's Morante goes on to say: "The complexity of the regulatory environment governing captive formation and the absence of accommodating captive legislation, has hindered captive formation in the region. Although a desire to reduce premium expenses motivates larger LatAm corporates to seek risk transfer vehicles, such as captives, as legislatures in the region come to recognise the value of designing legislation to enable captive formation at home, educational campaigns will evolve."

Laying down roots

LatAm companies embrace 'offshore' captive domiciles, which goes some way to mitigating the limitations a country's regulation has on its captives. 'Offshore' captive domiciles such as Bermuda and Cayman Islands, have "well-designed and efficient regulatory frameworks for captive formation," says Carlton Fields' Morante.

SRS' Mettetal comments: "We find LatAm captives domiciled in Bermuda, Barbados and in the Cayman Islands.

"More recently, there has been some interest from Mexico in onshore domiciles like Vermont and North Carolina. Mexico and Colombia stand out as the two primary drivers of growth in the region."

She adds that there is an opportunity for domiciles in the US to encourage LatAm captives to form there.

In March 2023, the State of Vermont and The Vermont Captive Insurance Association (VCIA) sent a delegation of industry representatives to lead a captive insurance education forum in Mexico City.

It raised awareness about Vermont as a captive insurance domicile.

Vermont had 66 companies licensed with foreign ownership from 23 different countries outside of the US, as of February 2023.

In February, Kevin Mead of the VCIA, said: "While awareness of captive insurance has been increasing, there is great opportunity in Latin America, in particular.

"We are happy to start this type of intentional education and collaboration, the first of its kind in the region."

Santos says: "Bermuda has been the preferred domicile for Marsh captives", noting that Barbados and Vermont are gaining popularity.

The uptick in strategic reviews and feasibility studies in LatAm, as observed by Marsh, SRS and law firm Carlton Fields, suggests that LatAm's captive benefits are starting to be seen.

Although it is more than likely that this progress is inconsistent amongst the 19 countries, larger multinational companies are showing more interest and knowledge of captive insurance companies compared to midsize and small companies.

An opportune moment

Industry participants agree that there is a vast opportunity for companies in LatAm to make greater use of captives. They recommend educating key decision-makers about the benefits of captives, understanding the regulatory landscape in each country and performing a feasibility study which should include an analysis of suitable domiciles.

Commenting on SRS' recent move into the region, Mettetal says: "SRS is undergoing geographical expansion, with a strategic focus on the emerging market in Latin America.

"The region lacks independent captive managers, and SRS recognises the importance of establishing a local presence. SRS firmly believes that having a seasoned team in the region significantly impacts business operations, which has been warmly received and highly valued by our existing clients and potential partners."

MAPFRE's 2022 Economic Research report estimated LatAm's insurance protection gap to be US$267.2 billion.

When estimating this amount, the MAPFRE calculated the difference between insurance coverage that's economically necessary and beneficial for society, and that which is actually required. This estimate allowed MAPFRE to approximate the potential insurance market in the region at US$440.9 billion — a figure that demonstrates how profitable the industry could be for insurers and captive insurers alike.

The McKinsey & Company report notes that LatAm has a "persistent but diminishing [insurance] protection gap", which highlights the "immense room for growth and development in the region."

SRS's Mettetal concludes: "There remains an untapped market amongst midsize and small corporations that are not yet aware of the advantages offered by captive solutions and [SRS] aims to increase the awareness of this group in the region."

It seems now is the time to tap into the captive market in LatAm, and we wait with great expectation. ■