

A year for captives

The financial crisis has pushed alternative risk transfer back up the agenda. Kane CEO **Stephen May** and Practice Leader of Insurance Management, **Shaun Brook** explain why the Middle East is set to become an important market for captive insurance.



Mr Stephen May

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Captive insurance has historically had a low penetration in the Middle East. However, the region's financial centres are paving the way to producing a lively captive hub in the Gulf. It was natural that Bahrain would be the first to welcome captive insurance due to its long history as an international insurance outpost and, indeed, it was home to the region's first captive. But the pace of growth only began to change when Dubai and Qatar introduced their own captive legislation.

Of the 5,000 captives which exist around the world today, just five of them are in the Middle East (see Table 1). The first was Tabreed Captive Insurance, set up to provide insurance for Abu Dhabi-based cooling company Tabreed. It received a licence from the Bahrain Monetary Authority (now the Central Bank of Bahrain) in 2004. Qatar Petroleum has a captive insurer, Al Koot Insurance Company, and while Dubai has no pure captives at present, there is one protected cell company (PCC) that is 100% owned by Dubai Holding and another owned by Mubadala Development Company. Saudi Remix established Masheed Insurance Company, Bahrain's second captive insurer last year.

Impact of the financial crisis

We have witnessed a steady growth in interest in self-insurance solutions. However, the financial crisis led some to postpone decisions as they waited to see how the downturn would play out. Now, with the global economy picking up, we are seeing a number of organisations – both in the region and beyond – taking action on their desire to self-insure. While it is still early days, there is a huge potential for the development of a captive insurance market in the Middle East, and it is our belief that 2010 through to 2011 is set to be a

pivotal year in its development.

As we enter a post-energy era in the Gulf, financial services is becoming an important growth area. Bahrain, the UAE and Qatar are making insurance management a priority and as part of that involves developing environments conducive for captive growth. Recent headlines suggest that Qatar is set to announce the licensing of its first captive insurance manager and it predicts that up to 15 captives will be set up in the region over the next few years.

The financial crisis itself is likely to prompt many insurance buyers to rethink their risk transfer solutions. While primarily a banking crisis, the downturn highlighted some very real concerns over counterparty credit risk. Some

Table 1 Captives located in the GCC

Parent	Location	Industry	Captive	Location
Tabreed	Abu Dhabi	District Cooling	Tabreed Captive Insurance Company B.S.C	Bahrain
Saudi Remix	Saudi Arabia	Concrete	Masheed Captive Insurance Company B.S.C	Bahrain
Dubai Holding	Dubai	Group	Dubai Holding Insurance Services PCC Ltd	DIFC
Mubadala Development Company	Dubai	Group	MDC (Re) Insurance Ltd	DIFC
Qatar Petroleum	Qatar	Oil & Gas	Al Koot Insurance and Reinsurance	Qatar

Table 2: GCC companies with captives located outside the GCC

Parent	Location	Industry	Captive	Location
Saudi Aramco	Saudi Arabia	Oil, gas, utilities	Stellar Insurance Ltd	Bermuda
Saudi Basic Industries Corporation (SABIC)	Saudi Arabia	Petrochemical & industrial	SABCAP	Guernsey

organisations discovered that the companies they thought they had been insuring their risks with had in fact been passing a large proportion to other insurers and reinsurers. Some of these companies experienced major investment write-downs along with rating agency downgrades or even government bailouts.

As a result, buyers are showing more interest in their insurance purchasing, and questioning why they need to go to the commercial insurance market when they can insure their own risks at less premium for a greater breadth of cover. Of course, the captive proposition is not just about price, but it is a good place to start.

Benefits of captive insurance

Captives offer a much greater predictability of cash flow. Because these structures are not subject to the same peaks and troughs as the wider insurance market they offer better budgetary control and the ability to limit insurance spend. Organisations that have a better than average loss record and solid balance sheet will discover they have a lot to gain from a more tailored product. There is an opportunity to start from scratch and to build something that is bespoke to their risk profile.

Captives make the most sense for modern organisations that are profitable and measure and control their risks within a risk management framework. As the Gulf economies continue to evolve, more and more organisations will fit this description.

By purchasing their insurance from the commercial insurance market some organisations are currently paying above the odds for their cover and subsidising the losses of companies that lack their track record. Captive insurance offers these buyers a price that better reflects their risks and in some cases can offer a better return on their capital than they are currently gaining from the parent company's normal business activities.

Another important dynamic is the growth in publicly held companies. This progression is apparent in the local stock markets, which are experiencing a growing number of listings and public offerings. In addition, there has been the gradual transfer of ownership of government assets to public private partnerships. Shareholder scrutiny drives better corporate governance, including a greater focus on risk management.

To glean some insight into the types of organisation and industries that can benefit from captive insurance, one needs only look as far as the more established captive domiciles in other parts of the world. From Bermuda to Guernsey and Cayman Islands to the Isle of Man, it is clear there is a very wide spectrum of companies benefiting

from self-insurance. In the Middle East, Kane is focusing its efforts on a broad range of industry sectors including telecoms, power, energy, utilities, transport, healthcare, financial services and manufacturing.

Room for more captives from Middle East

So what does the Middle East have to offer from a captive standpoint? As the axis of the global economy moves ever eastwards, the region is ideally placed as a central and efficient meeting point. Multinational organisations with bases in the US, Europe and the Asia Pacific will increasingly see the value in consolidating their risk transfer arrangement through the Gulf. It offers a central time zone, rapidly developing infrastructure and favourable business and regulatory environment.

Moreover, a growing proportion of the shareholders of global blue-chip enterprises come from the Middle East. Companies are now starting to see the value in retaining or channelling their organisations' risk through a market with a culture they know and understand. We are witnessing increasing demand for local risk transfer solutions, including those with takaful structures, both in countries that have already developed captive legislation and those that have not yet done so.

In Saudi Arabia, the first two companies to set up captives chose domiciles outside the GCC (see table 2). We believe it is significant that the third Saudi company to set up a captive – concrete firm Saudi Remix – chose Bahrain as a base for its captive, Masheed Captive Insurance Company (Table 1). While Saudi Arabia has not yet developed captive legislation, this may be available in the future. In the meantime, buyers may find it more convenient, as Saudi Remix has done, to maintain their captive within the same territory.

With so many well-established captive markets around the world, the centres of the Middle East have the opportunity to learn from other domiciles. By looking at what has been tried and tested elsewhere, the region has the ability to strike the right balance between a firm yet fair approach to supervision.

Potential for Middle East captive domiciles

Reports in the media often focus on the perceived competition between the territory's financial centres, asking which one will win the race to become the pre-eminent hub. But we think the idea that there will be winners and losers is an irrelevant issue. Different enterprises have different criteria and priorities, and if there is already room for 60 captive domiciles around the world, then there is ample room for three to four captive centres within the Middle East.

As the year unfolds, the region will see a slow but steady growth in captive insurance. We know of a number of captive structures which are already in the pipeline. One advantage the region has over many offshore regimes is the ability to test the waters locally. Nobody likes to be the first to enter a new market, but all it will take is a small number of pioneers to demonstrate the market's attributes before there is a snowball effect and other captives take hold.■