CAPTIVES AND MALTA: FULL SPEED AHEAD

Edmond Zammit Laferla of Mamo TCV highlights the draws and benefits of Malta

For nearly three decades, Malta has been skilfully and diligently developing its financial services sector. The result is that, today, Malta has firmly established itself as a renowned and stable financial services domicile where a growing number of global players have set up shop. Prior to joining the EU in 2004, Malta already had in place a strong legal and regulatory infrastructure that was fully compliant with EU standards. Nevertheless, it was Malta's entry into the EU which triggered a substantial influx of international players establishing themselves in Malta. Gaining access to the EU single market and to 500 million people proved to be instrumental for Malta with the banking, investment services and insurance sectors experiencing a gradual but steady growth.

Focusing on the insurance sector...

Following a number of recent developments in the international arena, among which the entry of Solvency II and the Brexit result, it is being proposed that the Maltese insurance sector may well be set to propel itself to an exponential increase in terms of players, gross written premium, lines of business and product diversity. This may not be far away from truth but one must exercise great caution. Admittedly, the Maltese insurance market has grown and the outlook remains positive. Indeed, a cursory glance over the latest market statistics would support such a claim. Thus, for example, it results that by 2016, Malta has managed to increase the number of authorised (re)insurance undertakings to 59 (from eight in 2004), seven of which are captive insurers and 12 are protected cell companies carrying 32 cells in all. The majority of the (re)insurance undertakings write non-life risks which are located outside Malta, mainly in the EU/EEA area. The total gross premium (life and non-life risks located outside Malta) has grown considerably and is now poised to reach the €3bn mark during 2017. With the proper fundamentals in place and delivering positive results in terms of growth and sustainability, Malta can aspire for an even brighter future.

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The 'captive' factor

Undoubtedly, the captive industry continues to attract considerable attention. Many words have been spent on the advantages of setting up a captive. Groups of companies have considered in detail this alternative risk transfer (ART) tool with risk managers going through great pains to demonstrate the said advantages and assisting their board of directors to choose the ideal jurisdiction where to set up their captive. There are many compelling reasons why a corporate group should consider a captive – all involving cost savings and maximising a group risk management strategy. And why not? The benefits include the retention within the Group of the premium spent; the reduction of insurance administrative costs; availability of flexibility on premium payments; dictation of policy terms; increased claims control; recapturing underwriting profits; accepting greater deductibles; direct access to the reinsurance markets; underwriting exposed risks; and the creation of an independent profit centre.

Traditionally, only the large groups of companies have looked and tapped into the captive market. However, the 21st century captive market looks to be heading toward a major shift as an increasing number of SMEs are manifesting their intention to "join the fray" albeit in a cautious manner. It is submitted that as an ART, the captive can help SMEs to meet with the ever changing plethora of risks which they face in today's world. For example, experts argue that 'modern' risks such as cybercrime pose a very serious threat to SMEs, possibly more than the 'traditional' employment liability risk. Purchasing insurance cover for these 'modern' risks may be difficult and, if available, the premium to be charged would be very costly. The captive may prove to be the cost-effective solution for SMEs, which constitute the backbone of the economy of every country. The EU is well aware of the importance of SMEs – a number of initiatives at EU level have been introduced to promote and assist SMEs, which continue to constitute a growing category of the business sector. This is a niche market which Malta is vying with extreme interest.

The Malta factor

Along the years, Malta has made significant efforts to position itself as a 'captive-friendly' domicile. It has managed to attract substantial interest from international players who have decided to set up their own captive in Malta. These include renowned household names hailing from the telecommunication, food retail and automotive industries. However, Malta requires to move on.

Up until recently, captives could only be set up in Malta as standalone companies either as a new set-up or else via a re-domiciliation or continuation mechanism, where this is possible. The post-financial crisis' emphasis on cost-cutting together with the rising costs related to Solvency II compliance, have prompted yet another shift in the local captive market. Arguably, the entry into the captive market may be deemed costly – setting up, capitalisation and management costs could prove to be prohibitive for large groups of companies. And let alone for SMEs! Admittedly, this could be the anti-climax for the captive market. Nevertheless, Malta has acted with foresight and with the introduction of the cell company structure, it has provided present and future captive owners with a valid alternative cost-effective solution thereby rendering the captive an attractive ART tool once again. In fact, Malta is the only EU member state to have cell company legislation and this places the country at the forefront of 'captive-friendly' jurisdictions. This innovative corporate structure permits the taking up of a cell to be used for captive business while benefitting from the sharing of common costs, administrative functions and regulatory reporting; reduction in capitalisation costs; the segregation of the assets and liabilities of each cell from those of other cells; and the provision of tailor-made product solutions. Under Maltese law, a cell company can take the form of a protected cell company (PCC) or an incorporated cell company (ICC). The main (and substantial) difference between a PCC and an ICC is that the PCC is deemed to constitute one single legal entity (including its cells) while under the ICC umbrella, each cell has a distinct legal personality

separate from that of the core. This distinction has a direct impact on the capital required for the PCC and ICC. Whereas in the case of a PCC, the solvency requirements apply at the level of the core (and notionally for each cell), the ICC structure would require to ensure that the core and each cell meet their MCR and SCR requirements at all times. Obviously, each type of cell company has its particular usages but it is submitted that both structures provide a cost-effective and sustainable solution to large corporations and SMEs. Interestingly to note is the fact that a number of foreign entities have already grasped the opportunity and set up cells (under local PCCs) which carry on captive business.

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Going forward…

As outlined above, Malta needs to move on. As a jurisdiction, it has gained significant traction but the spadework requires to continue because the domicile must remain competitive at all levels. The upgrade of the country's long-term sovereign credit rating to "A-" by Standard & Poor's provides additional support to the projected stable economic outlook with the financial services industry being accredited as one of the most important economic drivers. In addition, the Brexit aftermath could also bring new business opportunities to Malta especially in the insurance sector. Naturally, cognisance must be taken of the challenges being faced by the 21st century captive market among which one can highlight the increased costs related to Solvency II compliance and the future implementation of the Beps recommendations.

Being at the forefront is not easy. But Malta continues to be keen to explore new frontiers. The recent introduction of legislation providing for the setting up of reinsurance special purpose vehicles (RSPV) both as standalone companies or as a cell under a securitisation cell company (SCC) is yet another new opportunity to tap further into the international insurance sector, specifically the insurance-linked security market (ILS). The economic and political stability, EU membership and access to the single market, the English language, a central location, a strong regulatory framework and the accessibility and expertise of the local regulators are but a few of the most important attractive factors which will continue to prompt business promoters to consider Malta as their onshore "jurisdiction of choice".