STANDING OUT FROM THE CROWD

Tim Faries, partner, Bermuda corporate group head and sector leader for insurance at Appleby, speaks to *Captive Review* about Bermuda's evolving captive market and Appleby's involvement in a recent alternative risk transfer structure addressing African Union member states' response to extreme weather events

Captive Review (CR): Of the captive structures available in Bermuda, which is showing the most growth and why?

Tim Faries (TF): Bermuda captives can be divided into three categories: Class 1 are pure captives, with 100% of the risks underwritten by the captive for the owners of the insurance company and affiliates of the owners; Class 2 allows up to 20% of unrelated business risk to be written; and Class 3 allows as much as 50% of third-party business risk to be taken on.

Over the past few years, there has been a drop off of Class 1 captive formations, although for historic reasons, pure captives retain a strong overall proportion of the captive market. Increasingly, we are seeing greater numbers of Class 2 and 3 captive formations. These classes would also be relevant to multi-owner captives, which points to a trend in smaller companies grouping together to utilise a captive solution.

Written by
Tim Faries

Tim Faries is Appleby's insurance and reinsurance sector leader and Bermuda group head of the corporate and commercial department. He leads a team of lawyers who specialise in all manner of non-contentious corporate insurance work, including life and general insurance and reinsurance, mutual insurance and structured risk financing.

In the past, captives were mainly used by large corporations looking to cede more than $1m of premium annually. We are now seeing mid-sized firms which have just $1m or even less but who want to enter the captive market. Often it will make more sense for them to initially become part of a multi-owner or rent-a-captive structure. This shift in company size entering the captive space seems to be the primary driver behind Class 2 and 3 formations.

CR: Tell us what trends you are seeing in Bermuda's emerging captive markets like Latin America.

TF: We are currently seeing a majority of Class 1 formations emanating from Latin America. Latin America is an emerging market for captives and the market is nowhere near its saturation point for pure structures that has been reached in more established markets.

In terms of emerging risks, there is an increased focus towards addressing cyber security, extreme weather, professional liability and supply chain uncertainty.

CR: Is Appleby using its experience from witnessing the development of North Amer-

ica and Bermuda's captive markets to guide its strategy in Latin America? Will the same market life cycle be repeated?**

TF: From what we have seen in Latin America over the past 10 years, and like in the US some 20 years ago, the large infrastructural and transport companies are discovering captive solutions at the moment. We expect this to filter down into other industries and smaller companies in the next year or so.

CR: Other than Appleby, is the wider Bermuda insurance sector looking to tap into the expanding Latin America market?

TF: For Bermuda generally, Latin America is now a significant source of new captive formations. For example, in 2013, Bermuda Monetary Authority figures showed that approximately 30% of new formations came from Latin America. This is significant but we are still only scratching the surface.

CR: What are the alternative risk transfer (ART) structures that Appleby Bermuda are involved in and how can they help your clients?

TF: The most widely used category of company in the ART space is special purpose insurance (SPI) vehicles and, in the captive context, these are largely used by financial institutions to gain economic efficiencies. For example, a financial institution might put a structure together for a real estate investment trust to help manage financial risk or provide an enhanced product offering to its clients.

CR: How will ART structures fit into the wider Bermuda captive landscape?

TF: The SPI category is the fastest growing category of insurer for Bermuda since 2009. However, it is largely used for commercial re/insurance as opposed to the captive context.

From a captive perspective, we expect to see the SPI, notwithstanding some new innovation, remaining quite narrow in its uses, while being broadly used in the commercial context.

CR: Can you explain Appleby's role in the African Risk Capacity insurance pool?

TF: We acted as Bermuda counsel to African Risk Capacity (ARC), a specialised agency set up by the African Union, which launched the first ever African catastrophe insurance pool.

Specifically, we advised ARC on the incorporation and registration of a Class 2 Bermuda-domiciled specialist hybrid mutual insurance company – ARC Insurance Company Limited (ARC Ltd) – to help African Union

VIDEO | APPLEBY

> "There is an increased focus towards addressing cyber security, extreme weather, professional liability and supply chain uncertainty"
> TIM FARIES - APPLEBY

member states improve their capacities to better plan, prepare and respond to extreme weather events and natural disasters. We worked alongside external partners Stroock Stroock & Lavan LLC, Marsh IAS as insurance manager in Bermuda and Willis Group as reinsurance broker.

Our role is in the legal administration of the entity and its annual requirements for filing and disclosure to the Bermuda regulator.

CR: Which countries and organisations have signed up for this programme, and which African countries are being targeted?

TF: The initial African countries are Kenya, Mauritania, Niger and Senegal. The founding members providing initial capital were Germany and the UK. ARC is initially providing $145m of total coverage to the four African countries, and a further $55m was provided by global reinsurers and weather risk markets in order to cover the risks it is taking on from the participating countries.

CR: What challenges did you face in forming this entity?

TF: The majority of the members are democratically elected governments, which brings the challenge of allowing governmental processes to take place for decision-making. Overall, this added several layers of complexity to the structure, not least because you have to allow for the possibility of a change of leadership every few years, which can slow the decision-making process down.

CR: Is the programme looking to expand its remit for aid in the future?

TF: ARC Ltd continues to seek opportunities such as expanding to offer insurance coverage for Ebola and other epidemics to African nations. And just earlier this year, ARC Ltd announced that it will make its first $25m pay out to three of the African countries.

Before ARC's establishment, the system for responding to natural disasters could be difficult to manage, with farmers having to bear the cost burden of ruined livestock and crops. The ARC pool generally presents a much less reactionary approach, which has been hailed as innovative and forward-thinking.

The fund offers early warnings from satellite-based rainfall data, and promises to trigger quick payouts to governments and communities hardest hit by drought.

Overall, we think the ARC transaction reflects an important step towards the significant role that the global insurance industry can play in using special purpose vehicles to assess and offer solutions to mitigating risks associated with extreme weather events and natural disasters.