A Look at the Captive Business in Latin America

A Question & Answer Session with Simon Beynon

Simon Beynon

is Senior Vice President and currently leads AIG's Global Risk Solutions (GRS) business for Latin America and the Caribbean. GRS provides innovative and market-leading solutions for: Global Fronting, Alternative Solutions, Breakthrough Innovation, Captive Management, and Assumed Reinsurance.

Simon Beynon answers important questions about the increased interest in fronting programs among companies in Latam.

As a result of Latin America's economic expansion in recent years, the region's captive insurance sector is experiencing considerable interest. Simon Beynon discusses the reasons for the region's increased interest in captives and the important facts to consider when setting up a captive.

Question: Why is there so much focus on captives in Latam at the moment?

Answer: Over the last few years, we have seen a trend resulting in Latin America being one of the top emerging markets for captive business. I believe there are three key drivers behind this momentum:

1. A growing economy has stimulated an increased demand for insurance products and services, thereby exposing many companies to the need for a more sophisticated risk management strategy. More and more, captives are being considered as part of that strategy.
2. Risk managers are increasingly interested in exploring fronting solutions to address some of their new, unique and growing multinational exposures. A captive can be an integral part of the solution and assist in the creation of a flexible compliant insurance program that addresses many of the insurance needs of these companies.
3. Finally, insurance service providers looking to expand in Latam are doing a better job of raising awareness of the potential benefits of retaining risk through captive programs. Providers are also facilitating training and education programs throughout the region to raise awareness of the potential benefits of captive programs.

Question: When does it make sense to think about a captive?

Answer: When a company is considering establishing a captive program, there are important factors to consider, many of which may be unfamiliar to the company. I would advise these companies to hire an expert that will provide advice and help them understand the pros and cons of the various options. A number of firms can conduct a feasibility study and help create a business plan to determine if starting a captive would make sense. These captive management firms can also provide advice on domicile considerations and capital requirements. It would also be advisable for companies to speak with tax and legal experts if such services are not provided by the captive management firm. With insurance regulations, tax codes changing often and difficulties exporting currency in some countries in the region, it is imperative for companies to be fully briefed before deciding if a captive program can meet their needs and objectives.

Question: What fronting costs are involved with a captive program?

Answer: If a captive is not licensed to write direct business, it will need to retain a fronting company to issue the policy and administer the program so that a compliant insurance program is put in place. Fronting companies will charge for these services. In general, fronting fees include:

1. Program coordination and administration fees
2. A charge for the cost of capital and credit, operational and legal risk assumed
3. Claims handling fees
4. Reinsurance services such as cash flow management and reporting fees.

For fronting companies that do not have their own licensed reinsurance companies, an additional reinsurance fronting policy from a licensed third party reinsurance company will be required which will attract additional fees.

Question: What fronting services are provided?

Answer: A good fronting company will be able to provide a broad range of advice regarding the creation and implementation of a compliant captive insurance program. The fronting company should also be able to issue on a timely basis the required policies to ensure contract certainty and efficiently manage cash flows for premiums and losses to and from the captive. Some fronting companies are willing to enter into service level agreements to document the full range of services they will provide. Such an agreement may be helpful to manage expectations and deliverables for companies new to fronting programs.

Question: Why do fronting companies require collateral and what types of collateral are required?

Answer: Fronting companies require collateral to mitigate the credit risk and offset the cost of capital incurred when providing the fronting program. The amount and type of collateral required will vary depending on the fronting company's counterparty credit risk and the types of coverage written—first party or long tail liability, and the credit rating of the captive and parent. Commonly preferred collateral instruments include letters of credit, a trust or a parental guarantee.

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Question: For what types of insurance coverages do companies use captives?

Answer: At AIG, we have been approached by clients to front for a wide variety of business risks which illustrates the creativity and flexibility captive programs allow. These risks range from traditional property or casualty risks where the client is looking to retain risk at lower attachment points to better manage the overall cost of risk, to other risks that are not adequately addressed by the traditional insurance market such as for pollution, pandemics, reputation risk or the cost of regulatory investigations. We are also seeing more interest from clients looking to better manage their exposures as they expand business into North America where they may face new exposures and increased litigation costs.

Question: What are the tax considerations when owning a captive?

Answer: Tax regulations could have a number of consequences on the captive and its parent. To ensure compliance with all applicable tax laws, tax advice should be obtained prior to forming the captive and throughout its use. As various countries consider changes to their tax code which could have an impact on captive insurance programs, captive owners should consult with their tax advisors on the impact of these changes upon their captive use.

Question: What types of companies are looking at captive solutions?

Answer: We are engaged in discussions with clients of all sizes across a broad range of industries including energy, manufacturing, mining, engineering, food and beverage and entertainment industries. The key characteristics of the clients we are working with include companies looking to:

- Benefit from positive loss experience by retaining significant elements of risk
- Solve a specific problem for which there is no clear risk transfer solution
- Resolve a situation where current market conditions or shifting underwriting capacity are limiting availability of risk transfer
- Improve the efficiencies of multinational programs/operations
- Realize potential tax efficiencies
- Reflect improving loss control efforts that have not yet materialized in historic data
- Bridge the gap between client retentions and attachment points that are increasing due to poor loss experience or market conditions
- Achieve flexibility regarding the type of exposure, class of risk, and/or coverage issued

Question: What criteria should companies use to evaluate a fronting company?

Answer: To be able to answer this fully, we would need to understand the type of issues the company needs to address:

- Does it need policies issued in multiple countries?
- What lines of business does it require covered?
- Is it comfortable using a fronting company that doesn't own the reinsurance company? This is important as direct and reinsurance fronting is required in most countries in Latin America, and some fronting companies do not own a reinsurance company.
- Does it require local claims or engineering expertise?
- How concerned is it about efficient cash flow management and access to premium and loss reporting on a real time basis?
- Are risk transfer limits required in addition to the fronting policy?
- Is it an unusual or complex risk that requires a fronting company with more sophisticated structuring skills?

Essentially, companies need to understand what services they require and engage with the fronting carrier that can best provide them. In addition to providing the basic services, companies should consider the global capabilities, knowledge of local markets, and expertise of a fronting company. For example, AIG serves customers in more than 130 countries; we are able to write multiple lines of business in these countries. We are knowledgeable about local regulations and taxes due to our local presence and have over 50 years experience in fronting captive insurance programs. Importantly, AIG is committed to growing our existing business in the region, and we are excited to work with clients to help them develop unique captive insurance solutions as part of their overall risk management strategy.

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