REALITIES OF BREXIT ON MALTESE CAPTIVES

Dr Matthew Bianchi of FinanceMalta considers the implications of Brexit and the Covid-19 pandemic on the jurisdiction

Naturally, Brexit has had far-reaching effects both in the UK and the EU, be it in relation to free trade, human mobility and tourism – the financial services industry and insurance sector are no exceptions. The loss of the right for UK firms to passport throughout the EU has had a major impact on all those UK insurers and captives that wrote insurance business throughout the EU. As a result, UK insurers had to draw-up and implement contingency plans to ensure that policyholders were not negatively affected by Brexit, as well as to ensure continuity and regularity in the performance of the insurer's activities.

Those captives that decided to continue writing business throughout the EU have had to set-up shop anew within an EU jurisdiction – otherwise their activities would have to be limited to the mere run-off of any existing policies. This has presented an opportunity for a growing EU jurisdiction like Malta to attract such captives – through its innovative legislation in the financial services industry, particularly the Protected Cell Company (PCC) legislation and its state-of-the-art ICT infrastructure. The PCC structure in particular offers several benefits which would accommodate the particular needs of a captive.

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Captive Review (CR): What challenges has Covid-19 created and how has Malta adapted?

Matthew Bianchi (MB): The Covid-19 pandemic has changed the way most industries function and the insurance industry has not been spared. The manner in which businesses interact with their clients, staff and counter-parties has changed drastically, with the reliance on ICT becoming crucial in their daily activities. Fortunately, Malta, and the insurance industry in particular, was well prepared for such a drastic change and the transition was seamless, considering the circumstances.

Notwithstanding the challenges that

were common throughout the world, the market in Malta has continued to function effectively with modern technology playing a big part, both with regard to the local business and in the international sphere. Consequently, Malta has not witnessed much of a slow-down in the financial activity in the insurance market. As can be expected, there have been captives whose lines of business were directly impacted by increased claims or by a reduction of income due to Covid-19, and different measures were taken by these captives to react to the new reality and address any shortfall, possibly through diversification by adding new business lines that are not sensitive to Covid or spreading to new jurisdictions. The key concern was the impact on liquidity and in some instances this resulted in divestments. Efforts were also made to identify further cost-cutting measures in addition to the benefit of lower or no travelling and entertainment expenses. Overall, the market has remained strong and functional notwithstanding the challenges posed by Covid-19.

CR: What are the longer term impacts of both Covid-19 and Brexit?

MB: The severity and extent of the long-term impacts of Covid-19 will very much depend on how long it will take for the world to revert to a sense of normality – what is clear is that going forward the way business is carried out will change drastically. Throughout the course of this new reality, lessons have been learnt (both positive and negative) and this will really shape business strategies in numerous industries. Here, one can expect that difficulties may arise in relation to the lack of liquidity in the market due to reduced revenue for insurers which may have an impact on any possible credit terms within the distribution chain and the investment strategy of insurers. In addition, the insurance market has already seen changes to policy wordings introduced as a result of Covid-19.

With regards to Brexit, other than the loss of passport rights, a lasting impact will be felt in relation to the regulatory environment of the UK and its interaction with that of the EU. Now that the UK has left the EU, it is no longer subject to EU directives and regulation, including Solvency II. The UK is implementing its own equivalent regimes – however the possibility for regulatory divergence is likely in the longer term. Although at the point of withdrawal the UK had indicated it will not be looking to make major changes to its regulatory landscape, the possibility remains that insurers operating in the UK and EU could be subject to two distinct regulatory regimes, leading to an asymmetry in the compliance requirements. One would hope that in the future the UK will be assessed to be an equivalent jurisdiction for the purposes of Solvency II, which will reduce the compliance burden on captive groups having to satisfy both regimes.

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CR: How will Malta continue to foster innovation and provide a choice destination for emerging tech and captives moving forward?

MB: Malta has always been at the forefront of legislative innovation within the financial services industry – this originated with the introduction of the PCC structure in the insurance industry (with a similar structure being introduced in the collective investment scheme sphere) and has developed further with additional innovation in the form of incorporated cell companies and securitisation cell companies which can be used in the context of insurance-linked securities. In addition, the Malta Financial Services Authority has shown an increased risk appetite in relation to captive structures and is considering changes to existing legislation to render Malta a more attractive jurisdiction to the captive industry.

Another major current development in Malta is the drive and effort with which the MFSA, as a proactive financial services regulator, is promoting the idea of Malta becoming a global fintech hub. The MFSA has launched a standalone Fintech Strategy aimed to provide legal and regulatory certainty, ensure market integrity and financial soundness while safeguarding investor rights in the fintech sphere. The strategy also features a regulatory sandbox which enables financial service providers to test the viability of their products within the regulatory framework, while keeping in direct contact with the regulators.

CR: What are the unique advantages of Malta for those looking to set up a captive?

MB: By having PCC legislation in place for over 15 years, Malta has something that makes it stand-out in the EU captive market. Being the only EU member state with PCC legislation, Malta has grown into an EU captive domicile that offers captive promoters the opportunity to set up their captive cell within a PCC. Cells in PCCs are an attractive option for prospective owners of small or medium captives – they offer a convenient way of acquiring a dedicated space on an already active insurance platform. The PCC structure offers economies of scale and significant cost burden sharing since it allows cells access to the common pool of knowledge/expertise within the common management system at the core of the PCC. In addition, the PCC allows for the speed of set-up and speed of exit, and is cost effective, both in set-up and in management.

Considering the challenges that the insurance market faces in the medium and long-term future, the PCC structure can truly emerge as the viable alternative for the captive industry.

CR: What are your expectations for captives in 2021?

MB: The reinsurance market is currently showing hard market conditions and these are expected to continue in 2021. Consequently, this has a knock-on effect on the insurance market with potential hikes in rating structures and lower limits of cover and higher deductibles. One example is the professional indemnity insurance sector which has shown steep increases in premium over the last renewal season. This may result in businesses considering the establishment of a captive for their insurance needs, to be an effective solution to be able to correctly rate the risks based on their experience.