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SETTING THE FOUNDATIONS

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China is looking to stretch the boundaries of captive insurance strategies, according to Dominic Wheatley of Guernsey Finance.

There has been much comment recently about the development of insurance and risk financing in China, and particularly about the growing interest in the use of captive insurance companies amongst Chinese corporations.

Of course, the readership of this publication is aware that captives are well established strategic tools among the world's top companies with the vast majority of them using captives for a variety of purposes and across the full range of corporate risks. However, to date, their use has been limited amongst major Chinese corporation.

The reasons for this are not hard to see. As most assets and corporations have been publicly owned in China, risk has simply been assumed by the government and losses met out of current government revenues. Not surprisingly insurance has not been seen as necessary by managers or their public sector shareholders. However, the move towards a more mixed economy and a more international outlook has come two significant trends: the emergence of private sector corporations; and the increasing privatisation of government owned companies.

These changes in ownership and governance, and the exposure to international management practices, have increased recognition of the economic efficiency of insurance in a general sense (personal lines insurance is also fast growing alongside the emergence of an affluent middle class in China), and the financial efficiency of formal risk management, risk transfer and risk financing models. As ever in China the rate of progress and adoption of sophisticated techniques is faster than outsiders expect and is set to accelerate over the coming years.

The first tentative steps to explore captives have involved non-Chinese assets and taken place in traditional captive centres. However, the attention is now switching to domestic risks and establishing a captive centre in mainland China. The assimilation of the technology involved is rapid and is matched by development in their chosen internal captive centre, Kashgar, in the Xinjiang region of north western China, and the establishment of the China Captive Alliance ("CCA") as the trade association for their fledgling captive industry.

The inaugural Asia-Europe Captive Summit in Kashgar this June marked important steps towards linking up the domestic captives with their overseas sister-captives writing international risks and coordinating and consolidating global insurance programmes. These included a technical support agreement between the CCA and the Guernsey International Insurance Association, and a captive promotional agreement between the Kashgar Trade Development Zone and Guernsey Finance.

All of this progress is being encouraged and facilitated by the China Insurance Regulatory Commission ("CIRC") and China's other financial regulatory bodies, and is enthusiastically endorsed by the People's Bank of China. Discussions are already underway towards a memorandum of understanding between the CIRC and the Guernsey Financial Services Commission which should enable operational and financial efficiencies, and provide enhanced transparency and joined up regulatory oversight. This will bring the operational and strategic benefits of captives and holistic risk management to bear on Chinese corporations on a global basis.

These developing arrangements are a major step forward towards China's goal of developing its own domestic international insurance expertise and a mature insurance industry, as well as increasing its international insurance relationships. For Guernsey they represent a significant broadening of Guernsey's growing business relationship with China, which stretched back to 2007 when we appointed our first Chinese representative, Wendy Weng, in Shanghai. Wendy has been highly instrumental in encouraging the development of captive technology in China and broking the various relationships that are now helping shape China's captive future.

They also further enhance Guernsey's reputation as the leading centre for the management, governance and regulation of global captive insurance programs.

What will this achieve?

In general terms, three benefits will accrue to China and Chinese corporations out of these developments.

Firstly, China will gain access to the substantial accumulated expertise and experience of Guernsey's long-established captive industry. This includes the intellectual property involved in administering captive insurance companies, including the innovation for which Guernsey is known, and its world class captive regulatory environment. Also included are its knowledge and experience of delivering programmes into diverse regulatory environments around the world, and the optimal use of captives for maximum strategic effect. Finally, China will benefit from Guernsey's network of counterparties in London, Zurich and elsewhere. Through working with Guernsey's industry China will in time be able to assimilate this knowledge and network to the enhancement of its own captive industry.

Secondly, Chinese companies will be able to develop global programs based around Guernsey captives utilising all of the accumulated experience and expertise of Guernsey's insurance industry, and with ready access to that of the London market as well as to its considerable reinsurance capacity. These arrangements will coordinate their program delivery and consolidate their global risks, and could ultimately be on-shored back into their domestic captive in Kashgar, providing significant capital efficiencies and streamlining their governance and reporting lines.

Thirdly, Chinese captive owners will be able to make use of their access to expertise in other classes as they look to extend their initial property programmes, including taking advantage of soft-market multi-line capacity in the London wholesale markets, employee benefits, casualty and emerging risks such as cyber risk.

Guernsey can also advise on non-conventional programme designs, risk transfer pricing and detailed terms and conditions. Its robust governance, regulation and the considerable substance of its insurance community will ensure captive arrangements are respected by international regulatory and tax authorities, and work in harmony with the non-captive elements of insurance programs.

For its part, Guernsey will benefit not only in terms of new captive business, but in terms of developing our understanding of Chinese business and corporations, their risk environment and attitudes to risk and risk financing, and the strengthening of our trading links with China.

Of course, multi-domicile captive strategies are not new but they did take decades to develop elsewhere. It is a measure of China's ability to adopt technology quickly that just a few years after establishing its first captives it is already looking to stretch the boundaries of captive strategies. The future for captives in China is secure and is coming quicker than you may think.

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