Spotlight on **Captives** 2024

Managing an uncertain global risk landscape

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Captives: Managing an uncertain global risk landscape

How captives can mitigate emerging and future risks

The World Economic Forum's latest *Global Risks Report,* developed in collaboration with Zurich and Marsh McLennan, highlights several areas corporations will have to focus on in the near and longer term. Among them are risks related to climate change, biodiversity loss, societal polarisation, and cyber.

Captives play a crucial role in many of the areas identified by the *Global Risks Report,* particularly in relation to climate-related risks and cyber risks. In this *Spotlight on Captives 2024 – Managing an uncertain global risk landscape* report, we highlight how captives – an established risk management tool used for many years and beyond insurance cycles – support organisations in navigating emerging and future challenges by offering tailored risk management strategies.

Captives not only provide businesses with greater resilience and flexibility, they also allow for centralised risk-related data collection, providing our customers with a more comprehensive view of exposures and claims. This enables more accurate risk assessments, better trend identification, and ultimately more targeted investments. At best, captives can also act as incubators, collecting loss data to help plan and execute risk mitigation and adaptation measures.

As organisations worldwide strive to enhance their ESG posture, this report outlines how the increasing focus on ESG is creating new opportunities for captives within their owner groups.

This report, based on a series of interviews with Zurich specialists, as well as brokers, captive managers, captive consultants, captive specialists from risk management associations, captive owners and risk managers, concludes with an outlook on the future of captives. We predict a continued expansion in both the usage of captives and the establishment of new domiciles.

By Adriana Scherzinger
Head of captives
Zurich Insurance Company

IN THIS REPORT

COMMERCIAL RISK PROJECT TEAM

Tony Dowding, editor, *Global Risk Manager*
tdowding@commercialriskonline.com

Andrew Ryan, head of production
aryan@commercialriskonline.com

Annabel White, head of events, operations
awhite@commercialriskonline.com

Stewart Brown, managing director
sbrown@commercialriskonline.com

ADDRESS

Commercial Risk, Unit 5
Parsonage Farm Business Centre
Ticehurst, East Sussex, TN5 7DL, UK

MEMBER: Beacon International Group, Ltd.

The global risk landscape: Uncertain and volatile

Emerging risks and hard market see captive resurgence

The global risk landscape is one defined by uncertainty and change, and in which environmental risks dominate in the longer term. Businesses are having to deal with unprecedented levels of volatility and at the same time manage new and emerging risks.

The current and future risk landscape is set out each year in the World Economic Forum's (WEF) *Global Risks Report,* and this year's report highlighted a number of near-term (the next two years) risks including misinformation and disinformation, extreme weather, societal polarisation, and cyber risk.

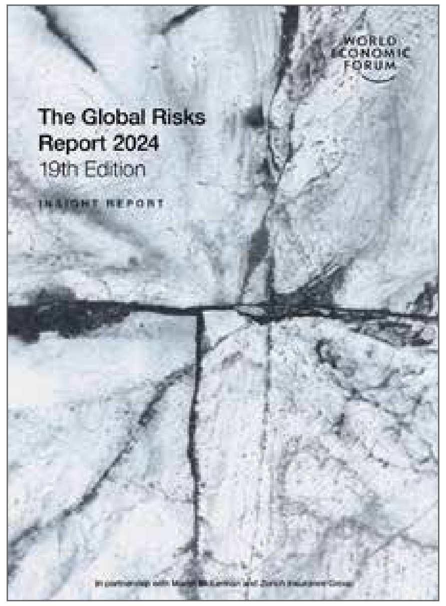
Looking further ahead, environmental risks, such as extreme weather, critical change to Earth systems, biodiversity loss and ecosystem collapse, and natural resource shortage dominate the longer-term risk outlook (next ten years).

The report includes the findings of the Global Risks Perception Survey of 1,490 experts across academia, business, government, the international community and civil society, which examines the evolving global risks landscape. It analyses global risks through three-time frames: current year, two-year and ten-year.

The survey identified four structural forces that will shape the materialisation and management of global risks over the next decade: climate change, demographic bifurcation, technological acceleration, and geostrategic shifts.

Top global risks

The top global risks for 2024 were extreme weather (66%), AI-generated misinformation and disinformation (53%), societal and/or political polarisation (46%), the cost-of-living crisis (42%) and cyberattacks (39%). The top five risks over the next two years were identified as misinformation and disinformation, extreme weather events, societal polarisation, cyber insecurity and interstate armed conflict.



"The risk landscape presented in the WEF report is volatile and evolving, with interconnected risks that impact and exacerbate one and other. Businesses need to take a step back and start planning for the unexpected"

Carolina Klint, risk management leader in continental Europe at Marsh

Over the ten-year time horizon, the top five risks were extreme weather events, critical change to earth systems, biodiversity loss and ecosystem collapse, natural resource shortage and misinformation and disinformation.

John Scott, head of sustainability risk at Zurich Insurance Group, who was heavily involved, as every year, in the WEF report, points out that many of the global risks in the report are sustainability risks, with many characteristics of emerging risks too.

Scott adds: "The report gives us a chance as risk managers to really think through what our organisations should be doing now, in the near-term future, and in ten years' time."

Speaking at the launch of the report, Carolina Klint, risk management leader in continental Europe at Marsh, said: "The risk landscape presented in the WEF report is volatile and evolving, with interconnected risks that impact and exacerbate one and other. Businesses need to take a step back and start planning for the unexpected. The things we worry about are too short term and modest. Taking a long-term and holistic view of risk on the horizon is vital," she said.

That view is supported by Penny Seach, group chief underwriting officer, Zurich Insurance Company, who says the report points to a global risks landscape where economic, geopolitical and societal vulnerabilities will continue to build, and worrying developments emerging today have the potential to become chronic global risks over the next decade.

"The aftermath of the Covid-19 pandemic and ongoing Russia-Ukraine war has exposed cracks in societies that are being further strained by episodic upheaval," says Seach. "Yet the global system has thus far proved surprisingly resilient. A widely anticipated recession failed to materialise last year, and financial turbulence was quickly subdued, but the outlook remains uncertain. Weakened systems only require the smallest shock to edge past the tipping point of resilience."

Insurance markets

All of the risks highlighted in the WEF report are having a significant impact on the insurance market. Climate change and the increase in frequency and severity of weather-related losses is hitting the property market, causing some capacity issues and sharp rate increases for natural catastrophe (nat cat)-exposed property. Supply chains have become increasingly stressed through geopolitical tensions, wars and trade wars, and the impact of extreme weather.

The casualty market is seeing the impact of social inflation and the potential for mass litigation as the EU's collective redress legislation takes shape, while any US-exposed risks are potentially facing the threat of 'nuclear awards'. And cyber losses are continuing to grow despite improvements in cybersecurity.

The result of all this has been a hardening of insurance markets over the last few years, which is only now beginning to moderate in certain lines of coverage. And despite the improved marketplace for buyers, there are still concerns over the state of the reinsurance market and the continuing effect of inflation, social inflation, and growing regulation on claims.

Most observers agree that the hard market is indeed moderating, with increases slowing almost across the board other than nat cat-exposed risks. But it is important to note that in many cases, this is a moderation of increases, rather than decreases.

Swiss Re Institute's latest annual *World Insurance sigma* says the non-life hard insurance market is expected to continue through 2024 and 2025 as inflation and rising claims costs push rating higher, but commercial lines rate increases have decelerated, with some markets starting to soften.

According to Swiss Re, rate increases in commercial lines are easing after years of hard market conditions. It says property rates in the US were up 8% in the first quarter of 2024 (after an 11-17% gain in 2023), and in continental Europe by 5% (after 7% in 2023), while in the UK and Asia Pacific, property rates have already started falling.

Aon's *Q2 2024 Insurance Market Trends* report notes that risk and insurance managers in Europe, Middle East and Africa are beginning to enjoy the benefits of increased competition in many core lines but still face rising rates for catastrophe-exposed risks. "We continue to see rate increases related to elements of natural catastrophe, but at the same time we are seeing reductions across a number of lines, including non-cat exposed property," Aon says.

Marsh's latest *Global Insurance Market Index* points out that primary global insurance rates have flattened during the last three months, after rising every quarter since the beginning of 2017. According to the index, insurance rates in Europe increased 1% in the second quarter of 2024, with casualty rates increasing 4%, while property rates increased 2%, continuing a "long moderation in the pace of increases."

The captive scene

The recent hard market has resulted in a resurgence in the use of captives, both in terms of new captives being established, but perhaps more importantly, a broader use of existing captives. In a hard market, captives tend to play a greater role in the traditional property/casualty lines, but also in incubating emerging and difficult-to-place risks.

Rob Geraghty, senior vice-president, international sales and consulting leader, Marsh Captive Solutions, International, says its managed captives saw gross written premium for property increase from $10bn to $12.5bn last year. Property is the number one risk written by captives, but Geraghty says cyber is certainly trending and other growing areas for captives include crime, which has seen big increases in premium written, D&O, trade credit and political risk.

According to Marsh's 2023 captive benchmarking data, traditional property and casualty coverages represent the single largest type written by Marsh-managed captives. In 2023, captive premiums for property risks increased by 29%. Casualty premiums – which principally come from auto, general liability, workers' compensation/employer's liability, excess liability, product recall, and medical malpractice – increased by 14% in 2023.

"The report gives us a chance as risk managers to really think through what our organisations should be doing now, in the near-term future, and in ten years' time"

John Scott, head of sustainability risk at Zurich Insurance Group

"The global system has thus far proved surprisingly resilient. A widely anticipated recession failed to materialise last year, and financial turbulence was quickly subdued, but the outlook remains uncertain"

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Other lines in captives are also growing quickly. For example, premiums for D&O liability increased by 49% in 2023, commercial life premiums by 25%, and cyber liability by 17%.

Captives tend to operate in areas where pound-swapping with insurers on high-frequency, low-severity risk doesn't make sense, but also where the market is not providing cover or where pricing is too high, or where retentions are significant.

Joshua Nyaberi, head of captive fronting, Commercial Insurance, Zurich Insurance Company, says it is areas with complex, new and not-well-understood risks that face the greatest challenge in securing insurance, and if they do, getting the coverage at affordable cost. He points to cyber, supply chain risks, non-damage business interruption and environmental, social and governance (ESG)-related risks such as transition risks as just some of the common areas where insurance is difficulty to access affordably or is unavailable.

Transition risks, for example, where there are new technologies in the nascent stages of development, often lack loss experience or may have a poor experience, and the risks may not be understood well enough to enable modelling and pricing. Nyaberi says this can bring about a mismatch between insurance demand and supply, leading to insufficient coverage or coverage at a very high cost. He explains that captives can play a role incubating new risks or financing coverage for old risks with constrained capacity in traditional markets.

Distressed markets

Captive managers stress the value of captives in a market where coverage is restricted or expensive. Peter Carter, head of climate practice and head of captive & insurance management solutions, WTW, says there have been areas of market difficulty, such as D&O side A, cyber, some motor, loss-impacted property where captives have been helpful in accessing additional capacity. Non-damage business interruption coverage is another risk line that he expects to evolve as conventional coverage is harder to secure. And although WTW is seeing cyber pricing start to flatten out, it is still being placed in captives.

Mike Matthews, commercial director – EMEA, Artex, says captive formations thrive in distressed markets where buyers' options are limited or non-existent. "For example, we're seeing captives used to build out long-term capacity in the mining sector, where traditional capacity continues to exit the market. For new energy or new technology risks, we're seeing cell captives used more often in the role of primary carrier (with or without risk retention) to access available reinsurance capacity that is not otherwise available through the more traditional markets."

Lesley Howgego, senior actuarial analyst, Strategic Risk Solutions (SRS), says that in Europe, difficult conditions continue for risks such as P&I, D&O and cyber, leading to greater exploration of how a captive could provide greater flexibility, formalised funding for higher enforced deductibles and the ability to reduce the overall cost of risk.

She adds: "There are also placement challenges for certain industries such as energy, coal, etc. While there is a somewhat evolving stance from some insurers to move away from a total withdrawal of capacity to a more focused approach, several companies in this sector have been left with an inability to obtain insurance capacity or adequate limits. Captives can provide an alternative in terms of both formalised funding, ability to evidence insurance, and access to reinsurance, which provides a broader range of options."

New or emerging risks are clearly an area where captives can play a role. Mark Elliott, CEO of Polo Insurance Managers, notes that when the market doesn't have the relevant technical expertise or loss experience for these new exposures, captives can be used to cover non-traditional risks that are unique to the parent, highlighting solar plants and hydroelectricity entities as good examples.

Skin in the game

Ultimately, as Lars Henneberg, vice-president and head of global risk management, A.P. Moller-Maersk A/S, says: "A lot can be done if you have skin in the game yourself, if you have some of these risks that are expensive because of uncertainty. It helps that the captive participates on the risk to show that you're not just here to offload a risk that you don't understand or that you're uncomfortable with onto someone else, but you actually share the risk and I believe this makes insurers more comfortable."

Gabriella Fraire, president of ANRA (Associazione Nazionale dei Risk Manager e Responsabili Assicurazioni Aziendali), insurance manager at Prysmian, and a member of Ferma captive's committee, highlights the flexibility of the captive model. "The objective of a captive is closely linked to the needs, risks and general characteristics of the undertaking to which it belongs. As a result, captives can provide coverages that are very different in terms of the risks covered, the type of insurance and reinsurance coverages, the peculiarities of the national market, the volume of premiums and assets, and so on," she says.

Fraire, who runs one of the first two Italian captives (Prysmian Re), says that in the European market, the data shows a strong presence of captives in more traditional lines of business such as property

and liability. But there is also a presence in less traditional lines of business such as assistance and legal expenses, which are provided by insurers specialising in these products and are therefore more difficult to access, she says.

Risk prevention

But captives are not just about managing retentions, filling in coverage gaps, making insurers feel more comfortable with risks, or incubating new and emerging risks. There is also an important role in funding loss prevention and risk management measures.

Zurich's Seach highlights the value of a captive in adding capacity for large risks – for example, supply chain, cyber or peak peril nat cat – and notes that covering more of these risks through a captive can release funds for risk management, positively reinforcing gains from such investments.

And her Zurich colleague Nyaberi adds: "Traditionally, successful captives have demonstrated the ability to build up significant financial resources to fund risk management, either through loss prevention initiatives or as funding mechanisms for future insurance coverages through dividends paid to the parent companies. Additionally, captives can help optimise insurance programmes by facilitating reinsurance arbitrage (wording, pricing and capacity) opportunities that deliver more value for insurance spend."

And he adds: "In the digital age, where data is the 'new gold', captives increasingly play a prominent role in risk governance and management by availing data to the risk functions of the parent company. This can drive risk insights that are valuable, especially as companies expand regionally and internationally, and risk management becomes critical/indispensable."

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Lesley Howgego, senior actuarial analyst, Strategic Risk Solutions

If run successfully, a captive:

- Builds up reserves to increase risk-bearing capacity over time, especially for long-term risks, where internal self-funding is difficult
- Reduces price volatility, including pricing for risks that are commercially uninsurable or currently uneconomical
- Retains the group's risks, which incentivises the group to improve its risk profile through long-term risk management strategies
- May reduce costs, specifically in relation to premiums paid and tax-deductible loss reserves, and investment income earned on premium to captive and loss reserves
- Provides direct access to reinsurance markets and can offer broader coverages to the group at tailored wording, particularly for pure frontings
- Improves cashflow as premiums are paid up front and are retained within the captive while claims are settled at a later stage
- Creates a formalised approach to self-insurance and the funding of risks
- Can drive and fund loss prevention activity and capture underwriting profits resulting from such risk improvements.
- Functions as a central risk management tool to collect high-quality risk and loss data to support risk insight analytics, providing a transparent and centralised view of the risks each unit of an international organisation faces.

Source: Zurich Insurance Company

Climate risk and the impact of extreme weather

Captives helping to build resilience and consolidate data

The world is seeing an increase in frequency and severity of nat cat perils and secondary perils, and as a result, insurance markets have increased property rates, tightened terms and conditions, and added exclusions. Climate is also severely impacting supply chains, resulting in major losses on the business interruption side. For risk managers, this means a growing focus on climate risk and looking at ways to mitigate the risk and improve resilience in the face of extreme and changing weather.

Swiss Re Institute's latest annual *World Insurance sigma* notes that annual insured losses of more than $100bn ($108bn in 2023) have become the norm, with increasing frequency of medium-severity disasters such as severe convective storms. Looking ahead, Swiss Re forecasts that global insured losses from natural catastrophes will continue to rise at an average annual rate of 5-7% in real terms.

Climate challenges

"Extreme weather events are very much top of mind for us as insurers," says Zurich's Penny Seach. "The last few years have seen increasingly more frequent and severe natural disasters and extreme weather events. Climate risk has again been a catalyst for market change – losses caused by extreme weather events in recent years have been notable not only for their mix but the quantum of what were once considered to be high-frequency, low-severity perils such as severe convective storm, flood and wildfire. Commercial customers, growing more concerned about not only the raised cost of catastrophe capacity but also its availability, are increasingly seeking to understand and mitigate physical climate-related risks."

Floods, hurricane and wildfire risks are some of the climate risks that present the greatest challenges to companies and insurers. Latest figures from Munich Re show that global insured nat cat losses totalled $62bn for the first half of 2024, with so-called 'non-peak perils' such as thunderstorms, flooding and forest fires the main contributors, accounting for 76% of insured losses.

> **"Captives can enhance risk management within the organisation by improving risk identification and mitigation, and have a positive impact on the cost of those risks and the insurance policies that cover them"**
> **Gabriella Fraire, president of ANRA**

And it is perhaps not surprising that this is leading to sometimes difficult conditions in the insurance market, with difficult-to-insure risks or a complete absence of coverage, or high pricing, as seen in the US, for example, for nat cat-exposed property.

Recent research, jointly published by Howden and the Boston Consulting Group, has forecast that global insurance premiums for climate resilience and nat cat protection are set to reach $200bn-$250bn by 2030, a 50% increase, as a result of increased annual losses caused by climate events, accelerated growth in exposures, climate risk disclosures and governments transferring risk to private markets.

Complex risks

ANRA's Gabriella Frair says climate-related risks are complex risks, and can be covered either by traditional products or by non-traditional products, such as parametric insurance policies. "Captives are not sufficiently structured to provide this complex solution, but they can play an important role in the process. Captives are still part of a non-financial group and therefore have a strong working relationship with enterprise risk management. So captives can enhance risk management within the organisation by improving risk identification and mitigation, and have a positive impact on the cost of those risks and the insurance policies that cover them," she says.

Climate would have been on many companies' risk registers for quite some time, says Ryan Bond, head of insurance innovation for climate and sustainability, Marsh, but it is a category that nearly everyone is thinking about in a greater and more consistent way, driven by the deployment of regulation encouraging corporates to better understand and manage the impacts they have on climate and the subsequent risks they face.

However, Bond says some industries are already facing challenges accessing insurance for new technologies. "Many companies may have a climate strategy or a climate plan but we don't often see businesses looking at how their captives can support the risk management. Captives could play a larger part where the commercial insurance market struggles to provide appropriate products. So there are spaces and opportunities within the captive environment to take the 'early starter/innovator' approach," he says.

Sharing the risk

Captive managers and consultants point to various roles for captives in mitigating climate risks, from sharing those risks with insurers to incubating the risk. Malcolm Cutts-Watson, non-executive chairman, RISCS CWC, for example, says captives can share the risk with forward-thinking markets to show that their parent company is aligned with the insurance industry when it comes to harder-to-insure climate risks, such as new, and in some cases untested, technologies and materials in construction.

Flood of the river Saar, in Saarland, Germany, May 2024

Captives can take on these risks, and begin to nurture or incubate them, says Artex's Mike Matthews: "In time, a buyer could look to fund these emerging risks through more conventional means, having gathered the required granular data and information about the underlying risk profile through the captive's involvement."

Captives also have the ability to tailor policies and coverage to the specific needs of climate-related risk. "Captives offer a nimbleness that is often not found in, or even possible for, traditional insurance structures," says Polo's Mark Elliott. "Captives can create an effective means of managing and financing all, or portions of, an organisation's specific risks associated with climate change."

Building resilience

But a captive can also become central to risk management and loss prevention measures, and to encouraging adaptation and build resilience. The captive can drive some loss prevention programmes, collecting data about the risk, carrying out loss prevention surveys and making recommendations to the business and improving the risk.

"I do believe that playing a role in conducting and funding loss prevention surveys and climate change resilience analysis that can be presented to underwriters is a natural part of a captive's activity," says A.P. Møller-Maersk A/S's Lars Henneberg. "Just to understand the risk, and then drive that risk improvement through differentiated premiums, through bonuses and through contributions to loss prevention initiatives. The captive can do risk assessment, it can do risk analysis, it can price risk."

> **"Losses caused by extreme weather events in recent years have been notable not only for their mix but the quantum of what were once considered to be high-frequency, low-severity perils such as severe convective storm, flood and wildfire"**
> **Penny Seach, group chief underwriting officer, Zurich Insurance Company**

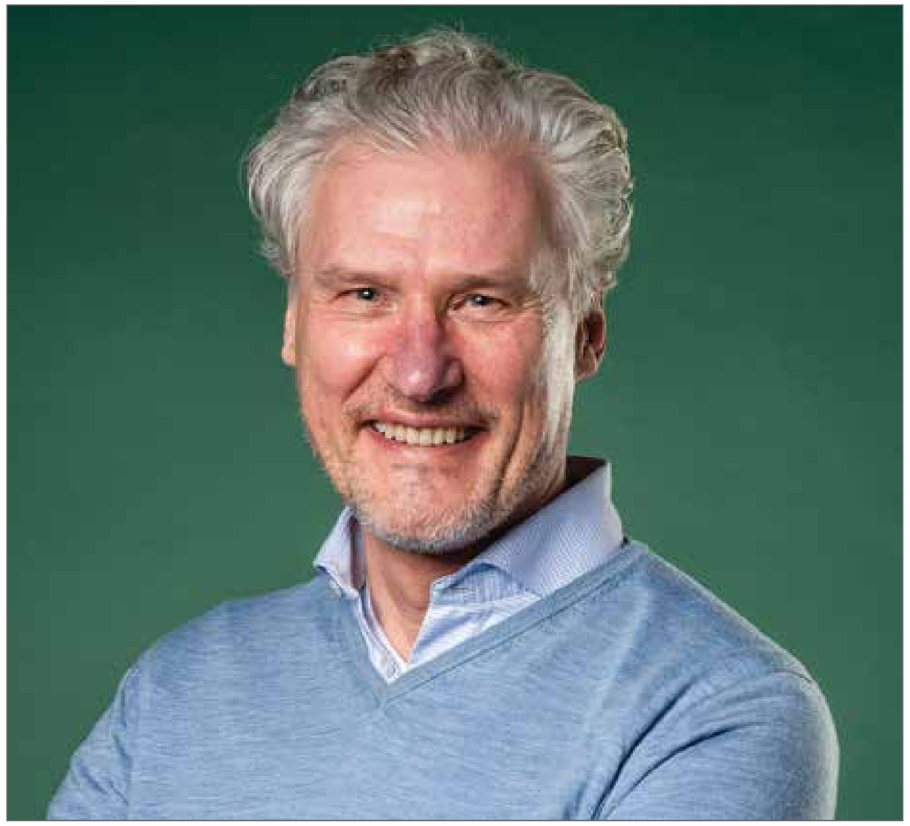
Captives can help pay for projects with consultants to identify and quantify climate physical and transition risks, according to WTW's Peter Carter, and can help with capital expenditure to build better adaptation and resilience, which in turn makes the assets/transition plan easier to insure.

A captive can also help in looking at the multi-year total cost of risk from adaptation and resilience investments. "The recent hard property market is in part due to extensive global losses; the continued increase in the property catastrophe protection gap suggests this is likely to continue to fuel the cycle. Captives can work with parents to invest in protection, which requires upfront capital expenditure. Future insurance savings from the harder phases of property markets can help spread the cost of this capital expenditure, and a more accurate cost benefit for the parent," he says.

Zurich's Joshua Nyaberi agrees: "At the base level, owning and operating a captive automatically means you are retaining risk and have 'skin in the game'. This has an effect on a company's risk philosophy and conscientiousness towards risk taking and risk prevention. The capacity for captives to build up financial resources makes them a potential financing tool for the risk managers or CFOs that makes risk management programmes affordable/manageable without having to draw more than necessary resources from the core mission of the parent."

Data consolidation

Many have suggested there is a data consolidating role for captives with climate risk – that the captive is the perfect centralised



> **"With all the changes we have seen around nat cat and other exposures, alternative risk transfer (ART) is something we should look at to see if we can do better"**
>
> **Kjell van der Vooren, global insurance manager, Heineken**

vehicle for bringing together the various data on climate risk from subsidiaries, to use both for risk mitigation and control, and for providing it to underwriters.

Carter believes there is some potential here: "It requires climate risk to be recognised as something risk managers have tools to manage and that can play a lead/strategic role in helping executives prepare for adaptation and resilience. As more risk managers take the lead in climate risk discussions, I am sure we will see the captive being deployed in incubating risks, collecting data and using that to package and finance risk appropriately."

He adds that captives can encourage risk mitigation/adaptation to improve resilience through the quantification of the financial impacts of climate change to help inform the business case for capital expenditure on adaptation and resilience in terms of pre/post cashflow effects. He says the captive can take a medium-term position to collect data around the climate risk profile and journey of the parent.

"In the future, as and when the wider insurance market changes its appetite considerations on climate and transition, the captive can then reduce retentions," he says. "The marketplace is finding its feet on the durable position on climate and transition, and a captive can help buy the parent time."

Nyaberi says captives can step in to provide cover for climate-related risks, leveraging the fronting and insurance infrastructure of traditional insurers to get the risk to the captive. He says that as a data-consolidating point, captives have a role for new and emerging climate risks where no product exists in the commercial market and no claims history.

One of the big issues with modelling nat cat exposure is that there tend to be proprietary models with proprietary data. However, global insurance companies like Zurich have licensed proprietary models and proprietary data and then combined with their own data to create models to get an in-depth understanding of what is really driving the risk.

Zurich has also tried to encourage, through funding and support, open source data and open source modelling platforms like Oasis, recognising that this open-source approach is also helpful to allow captives to access to this data.

Parametric solutions

The captive can also be the vehicle for the use of parametric solutions for climate risks, especially related to heat or flooding. Parametric and ILS solutions lend themselves well to nat cat risks, says Zurich's Joshua Nyaberi, and captives can play a key role, but he notes that it needs to be evaluated carefully, balancing magnitude of risk/exposure and the captive's ability to actually settle such large exposures when a peril materialises.

Ri3k Consulting's Ken MacDonald believes that captives can play a key role in parametric (re)insurance – not just by acting as a conduit to the marketplace, but also retaining some risk and even taking on part of the basis risk that can be a part of many parametric transactions.

"When it comes to insuring the physical impact of climate change, parametric solutions will play a large role, given that they offer broad coverage and speed of payments," says Marsh's Robert Geraghty. "And those two advantages may lean itself into more captive utilisation going forward as companies look at the risks and how they utilise a parametric outside of the regular indemnity trigger. I think there will be more utilisation of captives going forward, it's just a matter of time now, and understanding and seeing the benefit."

Heineken's global insurance manager Kjell van der Vooren is looking to make more use of ART through the likes of insurance-linked securities or parametric insurance. He told *Commercial Risk's* Risk Frontiers Survey: "Up to now, we have been able to cope through traditional insurance but with all the changes we have seen around nat cat and other exposures, ART is something we should look at to see if we can do better. If you leave it too late to look at these things, to a point where you are forced to do it, then it will not be as successful."

"We all know how difficult it can be to settle BI claims," he said. "There are numerous calculation issues but if you can get around that by agreeing on a basis risk, then it saves on legal costs and gives you the kind of certainty on which you can build your insurance strategy."

Managing the risks of the transition to net zero

Role for captives in incubating the risk

Last year's COP28 saw a commitment to transitioning away from fossil fuels by 2050, following up on the Paris Agreement. The United Nations says transitioning to a net-zero world is one of the greatest challenges mankind has faced. For many companies, this has meant the adoption of net-zero transition plans.

The number of companies disclosing that they have 1.5°C-aligned climate transition plans has jumped 44% in a year, with over 5,906 companies (one in four) reporting having climate transition plans in place last year, according to not-for-profit charity CDP, which runs the world's only independent environmental disclosure system. A further 36% (8,200) disclosed that they expect to create one by 2025.

But large businesses around the world are struggling with their net-zero plans, said a recent survey of more than 400 sustainability leaders carried out by the Carbon Trust's Net Zero Intelligence Unit. The *Breaking business barriers to Net Zero* report highlighted a lack of engagement from senior leaders, concerns that climate change work will be unfairly scrutinised, and issues tackling supply chain emissions.

A lot of companies are beginning to think about the challenges when they start writing their transition plans, says Zurich's John Scott. "What are they going to do in their products or services? What are they going to do to get to net zero? It is very challenging. Everyone is connected to everyone else through a supply chain or a value chain, and it is difficult to change what you do without also requiring other people to change what they do."

He adds: "The opportunity is there for risk managers to play a really important part in the strategic development around transition plans to help create the foundational understanding from a risk perspective of just what are the different risks, the physical risks, the transition risk, the potential litigation risks, that you need to build a transition plan around and address those."

Role of insurance

COP28 was, according to the Insurance Development Forum (IDF), a pivotal moment, a groundbreaking shift in the recognition of the role of insurance in strengthening resilience and adaptation. At the same time, the insurance market is increasingly turning away from high-emitting companies and in particular those without transition plans.

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>
> **John Scott, head of sustainability risk at Zurich Insurance Group**

Significant reductions in greenhouse emissions are required over the next ten years to achieve the outcomes of the Paris agreement, and an acceleration of new technologies is needed to decarbonise the value chain, specifically for clean energy generation, electrification and CO2 removal (carbon capture and storage).

Solar Park Seßlach, Germany

"Our role as an insurer is creating insurance solutions for complex risks, whether the exposures are well known to us or completely new"

Penny Seach, group chief underwriting officer, Zurich Insurance Company

A report from McKinsey (*Capturing the climate opportunity in insurance)* estimates that annual global capital expenditures in the top climate technologies could account for more than $800bn by 2030, corresponding to roughly $10bn to $15bn in insurance premiums on capital expenditures alone.

So the transition to net zero will see many companies relying on new, untested technologies often in nascent stages of development. With these, and the greater use of renewables, there is concern from risk managers that obtaining adequate (or any) insurance coverage at an appropriate price is proving to be difficult.

Zurich's Penny Seach says the insurance sector is uniquely positioned to support the net-zero transition through the provision of products to insure these technologies, as well as risk engineering services to help companies strengthen risk management and build resilience.

But she points out that new risks bring new underwriting considerations: "New technologies can be highly complex and present new risks that are not yet fully understood or quantifiable – submissions may contain exposures never underwritten before. These exposures may not fit neatly into existing products or coverages, requiring innovative new solutions to be developed. And there may also be concerns about the performance and reliability of new technologies, especially in their early stages of adoption."

Supply chains for new technologies and renewable energy production can be complex and global, with potential delays, component failures, and geopolitical factors adding additional considerations. A lack of historical data/claims experience can make it challenging to evaluate and price risks, and the speed of technological development also means that technology comes to market very quickly and certification and standards might not keep up, adding additional risks.

Seach adds: "Our role as an insurer is creating insurance solutions for complex risks, whether the exposures are well known to us or completely new. While there will always be a transitionary period with any new technologies, through working closely with our customers and ensuring broader awareness, we are well positioned to continue to act as a supporter and enabler of the transition through the provision of insurance coverage and risk management services."

Lack of data

The biggest issue with the newer technologies is the lack of data, which is always a concern for underwriters. For green industries, the pace of the technology means there is less historic data for traditional insurance markets to assess risks. SRS's Lesley Howgego gives the example of cover for downtime on a newly designed tidal energy turbine, where the lack of traditional insurance can inhibit the access to finance for such projects. "Captive insurance can play a key role in progressing the use of renewables over fossil fuels," she says.

For large energy companies, their transition away from oil and gas to renewables is key to net-zero targets, and Howgego points out that many traditional oil and gas companies have big divestment plans in fossil fuels, with counteracting investments in renewables. She notes that the traditional markets have moved away from supporting the fossil fuel industry, leaving cover gaps that are being supported by the captive industry.

"People want to deploy renewable energy, especially offshore, but there just isn't really the claims history to accurately price on," says Zurich's John Scott. "Similarly, with things like battery storage, especially large-scale battery storage using lithium ion batteries that we know are fire prone if they haven't got suitable fire protection. Those kind of risks, where the insurance industry finds it more difficult to underwrite, and at an acceptable price, I think it would be natural to put into a captive and provide some diversification for the captive owner."

Captive role

A captive is the ideal vehicle to help their parent companies' mitigation efforts, for example in incubating new risks from the adoption of new technologies where the insurance market is hesitant, both in terms of providing coverage and collecting data.

Zurich's Joshua Nyaberi says: "Captives have an important role to play in their parent companies' risk management, particularly in de-risking new investments and incubating new risks that could stem from the adoption of new and often untested technologies required to remain successful in the net-zero transition."

He explains that in the transition phase, new technologies in their nascent stages of development either have poor loss experience or the risks may not be understood well enough to enable modelling and pricing by traditional markets. "This inevitably leads to lack of coverage, and coverage being insufficient and at a very high cost. A captive can provide a formal structure for setting aside resources through premiums to fund a risk that might be uninsurable in the traditional market.

And he notes that captives that broaden their mandate beyond the traditional focus on cost efficiency, "can deliver foundational business protection that enhances resilience to evolving risks. By measuring and monitoring the impact of emerging risks, the captives can collect data for tracking, target setting and informed decision-making. This can create transparency for regulatory or voluntary disclosures too."

Industrial companies are most affected by the net-zero transition and are therefore the first to look for solutions, says ANRA's Gabriella Fraire. "Captives are hybrid companies because they are (re)insurers but part of a non-financial group, and as such they are more sensitive to the issue and ready to address the needs of the group," she says, adding that captives can help develop new coverages or extensions to traditional policies that fill the gap between insurance supply and demand, smoothing out critical issues due to the transition.

Captive leverage

Laurent Nihoul, board member of Ferma, chair of Ferma captive committee, and general manager, corporate risk & insurance, ArcelorMittal, says there are a number of factors that can make it challenging to obtain insurance for new technologies. These include the lack of historical data, rapid technological changes, complex risk profiles, regulatory uncertainties, high costs, limited market availability, and the need for specialised expertise.

"We see captives acting as an incubator for a number of these net-zero challenges, especially where the captive can then access the ART markets to smooth the impact of claims in the early years of incubation"

Malcolm Cutts-Watson, non-executive chairman, RISCS CWC

Organisations must therefore overcome these hurdles to secure adequate and affordable insurance protection, and Nihoul believes captives undoubtedly have a role to play in supporting this process. However, he notes that it is important to recognise captives are not a simple panacea.

"In my view, there are two key areas in which captives can be leveraged effectively. First, they can facilitate improved risk management practices by operating as a central unit, leveraging detailed data analytics to understand and mitigate the risks that underpin the net-zero transition more effectively. Such structures can enable more effective coordination of risk data and exposure analysis, risk management and prevention measures, and financing requirements," he says.

"Second, the captive provides a means of addressing specific gaps in the availability of standard insurance cover. Considered use of such vehicles can enable owners to structure difference in conditions/difference in limits (DIC/DIL) clauses by combining coverage available in the insurance market with bespoke, insurance sub-covers or exclusion buy-back solutions," Nihoul adds.

Risk incubator

Any new industry struggles without a track record or data, says RISCS CWC's Malcolm Cutts-Watson. "We see captives acting as an incubator for a number of these net-zero challenges, especially where the captive can then access the ART markets to smooth the impact of claims in the early years of incubation. Fundamentally, the commercial market swerves emerging risk until it is able to model and price risk, hence a captive can be used as an incubator of these risks until they are fully understood and can be properly priced."

Zurich's Scott agrees, noting that with the novel nature of technologies that will drive the transition to a low-carbon economy, captives are an obvious place to learn about what the risks are and to price them appropriately, with a clear loss history, and a clear understanding of what risks these new technologies bring.

One company that has embraced new technology in its moves to net zero is A.P. Møller-Maersk A/S. Its head of global risk management Lars Henneberg says it is all about getting insurers to understand the risk: "What we see is that in areas of new technology, particularly in relation to the energy transition, we need to manage insurers closely to make sure they understand the risk so that if you change to a different kind of fuel, for instance, on the vessels, you need to take them through the particular risk associated with that new design of the vessels to make them comfortable."

He adds: "I've been positively surprised that even though it is new technology, even though you could argue that there is an enhanced risk, it hasn't had an impact on pricing and it has not been difficult for us to get the level of insurance that we want."

Paldiski wind park, Estonia

Mitigating the impact of biodiversity loss and nature risk

Growing need for data for biodiversity risk disclosures

"Humanity has become a weapon of mass extinction," said UN Secretary-General António Guterres in 2022, referring to nature and biodiversity loss, which is now beginning to be recognised as a major issue globally. The World Economic Forum's latest *Global Risks Report,* developed in collaboration with Zurich and Marsh McLennan, states that biodiversity loss and ecosystem collapse has "severe consequences for the environment, humankind and economic activity due to destruction of natural capital stemming from a result of species extinction or reduction, spanning both terrestrial and marine ecosystems".

In the WEF's *Global Risks Perception Survey,* biodiversity loss and ecosystem collapse ranked number 20 in terms of global risks in the two-year time frame but third in the ten-year timeframe. There are moves to halt and reverse biodiversity loss, such as the Global Biodiversity Framework, but the issue is some way behind climate in terms of awareness and action.

The WEF has noted that as of 2023, 66% of the world's 500 largest companies have set carbon-emissions targets, but progress on setting biodiversity targets has been significantly slower, with only 1.6% of US S&P 500 companies committing to biodiversity no net loss or net positive targets.

Nature risk

Biodiversity and nature risks are difficult to grasp for businesses, both in terms of assessment and disclosure, and in the restoration of natural ecosystems. Part of the issue is a lack of data, which can lead to some reservations on the part of the insurance industry to fully take on such risks.

New guidance such as the recommendations issued by the Taskforce on Nature-related Financial Disclosures (TFND) mean that businesses are expected to make biodiversity risk disclosures, and companies must strive to avoid natural resource and biodiversity loss.

The TNFD said the recommendations "are a key milestone in the relationship between nature, business and financial capital, positioning nature risk alongside financial, operational and climate risk and helping to shift capital flows to nature-positive outcomes". Under the TNFD, businesses must identify, assess, act and report on nature-related dependencies, impacts, risks and opportunities.

At the same time, there is the threat of biodiversity litigation against corporates, which some see as the potential next frontier of environmental litigation. Indeed, many believe nature risk is set to be the new climate risk. The risks include supply chain and operations disruption, reduced productivity, increased litigation risk, increased costs of regulatory compliance, stranded asset risk, loss of customers or challenges accessing capital.

Natural capital

In a panel session at the *Commercial Risk/ESG Risk Review* ESG Insight and Intelligence 2024 conference, which was part of London Climate Week, Geoff Summerhayes from global climate and nature investment and advisory firm Pollination noted: "Over the last two decades, world economic prosperity, measured by GDP, has doubled yet natural capital has reduced by 40%. We have operated on a paradigm where we extract from nature, and we haven't valued nature, and we've assumed that nature was abundant and endless, and it's not."

He said sectors like food and agriculture, as well as construction and the built environment, are heavily dependent on nature, as well as supply chains and transport and virtually every other sector of the economy. "Every sector of the economy, if not primarily, is actually in some way dependent on nature. We're only just waking up to the significance of nature. We've tended to treat climate and nature as somewhat separate, but nature will follow the climate playbook on fast forward," he said.

Zurich's John Scott agrees: "I think it's a really big challenge. It's been tough enough dealing with and understanding climate change risk, whether it's the physical risks or the transition risk. But what is very clear from the work of the TFND is that nature and climate are intimately interlinked. The biosphere, whether it's in the air or the land, in the water, freshwater or sea water, is intimately linked with climate change."

For society, biodiversity loss has emerged as a parallel challenge to the common climate-related risks such as flood risk, crop failure and physical damage to assets, says Zurich's Joshua Nyaberi, and he notes that this is magnified if, for example, major insurable assets are located in biodiversity-sensitive areas. "Efforts to restore natural ecosystems face risks of failure of the chosen interventions, such as failure of afforestation efforts, and the loss of financial investments into such interventions," he says.

"Every sector of the economy, if not primarily, is actually in some way dependent on nature. We're only just waking up to the significance of nature"

Geoff Summerhayes, Pollination

"For example, companies have increasingly turned to carbon offsets and removal certificates in their decarbonisation efforts. Such carbon credit risks remain valid or adequate as long as the investments to sequester carbon are not adversely impacted. There are not many broadly available insurance solutions for the protection of such investments, and companies have to rely on self-insurance where traditional products are not available in the market," says Nyaberi.

Need for data

It can be very complex to understand how an individual company is impacted by nature because of the lack of data, especially when it comes to the supply chain of companies. It is hard to see where the impact is throughout the value chain. But at the same time, more data is clearly required to inform models underwriting biodiversity risks.

"Capital may be available in the insurance sector for these risks, but lack of data makes modelling and pricing difficult," says WTW's Peter Carter. "There are efforts underway within environmental impairment liability to better account for biodiversity loss. As clients disclose under TNFD, clients may be compelled to better manage and financially protect themselves. A captive could provide the right level of innovation and ambition for the parent in this regard," he says.

Others in the captive market agree that there is a role for captives in collating the data on risks required for biodiversity risk disclosures. RISCS CWC's Malcolm Cutts-Watson points to carbon capture as an often-cited example. "Some of the risks in this area are not always going to be able to be placed in the direct insurance market due to lack of data, evolving science and technologies, and nascent knowledge in the insurance market."

"Nature and climate are intimately interlinked. The biosphere, whether it's in the air or the land, in the water, freshwater or sea water, is intimately linked with climate change"

John Scott, head of sustainability risk at Zurich Insurance Group

He adds: "This is not a criticism of the market: they have to balance their risk appetite with delivering value to their shareholders, so prudent underwriting will be expected. Captives are a fantastic tool for data collection and analysis – data that can then be shared and jointly interpreted with insurance markets."

Strengthening the supply chain through microinsurance

Parametric covers to improve supply chain resilience

Communities with low-income populations that traditionally have had little or no access to insurance are increasingly benefiting from the availability of micro-insurance – a form of coverage for small risks that is written at affordable costs.

Microinsurance knocks down price barriers for small businesses, farmers and others who need insurance to cover climate-related risks and other threats to their livelihoods. Often, low-income populations aren't able to buy traditional coverage because of the price or lack of a distribution network that makes insurance accessible.

The growth of microinsurance has been impressive.

The Microinsurance Network said in a report, *The Landscape of Microinsurance 2023*, that in 2022 up to 330 million people were covered by microinsurance, written by 294 insurers in 36 countries.

The report notes that $5.8bn in premiums was collected in 2022, around 15% of the market estimated to be $41.4bn. Microinsurance can be standalone coverage or, more commonly, bundled as part of an offering such as credit, savings or agricultural products.

Corporates and microinsurance

The growth of microinsurance is partly fuelled by involvement from large companies that are concerned with improving the social plight of disadvantaged populations while meeting commitments to ESG principles, sustainability strategies and protecting supply chains.

"Companies are supporting programmes that ultimately lead to a stable living wage for their suppliers, which is a basic human need," said Jaime de Piniés, CEO of Blue Marble, a microinsurance consortium. "In the case of climate adaptation, they are seen as investing in activities that lead to strengthening the climate resilience of their suppliers."

Companies are also supporting microinsurance as a way to help satisfy regulatory requirements around the sustainability of their operations.

Supply chain resilience

Companies see microinsurance as a way to strengthen supply chain resilience. In cases where companies source commodities, whether hard or soft, from suppliers that are underserved financially, microinsurance is a particularly effective arrangement.

"From a climate adaptation standpoint, because we focus primarily on insurance against climate shocks, we are helping strengthen the farmers' climate resilience"

Jaime de Piniés, CEO, Blue Marble

The growth of microinsurance is partly fuelled by large companies that are concerned with improving the social plight of disadvantaged populations while meeting commitments to ESG principles, sustainability strategies and protecting supply chains

Companies tend to have long-term objectives as part of their sustainability strategy related to climate adaptation or human rights, for example. Microinsurance protects the end suppliers, whether they are farmers that supply food and beverage companies or garment workers in factories of textile industry companies, with coverage that provides income stability.

Helping a farmer have a stable living income speaks to the idea of meeting basic human needs, says de Piniés. "And from a climate adaptation standpoint, because we focus primarily on insurance against climate shocks – droughts, hurricanes or cyclones, for example – we are helping strengthen the farmers' climate resilience."

The coverage also helps create a more resilient supply chain. If a farmer is hit by a flood that significantly damages his crops, an insurance payout allows him to restore production, and recover so he can deliver the quality and quantity of the commodity that the company expects the next season.

"Making sure that the supplier is strong and resilient and has coping mechanisms is actually good for business – it keeps the supply chain able to better withstand those shocks," says de Piniés. And where suppliers are offered these benefits, it can create greater loyalty to the firm, he adds.

Blue Marble develops parametric coverage because customers tend to be in remote areas that are difficult to access by loss assessors that would be necessary if indemnity coverage was provided. Because there is a lack of good historical yield data for farmers, for example, it would be difficult to price an indemnity product, which could make it very expensive.

According to the *Microinsurance Network* report, insurance is gaining increased visibility among governments and multilateral players as a mechanism to support smallholder farmer resilience and agriculture value chains. It notes that climate risk is the threat most frequently addressed by agricultural microinsurance products, with 79% of the products addressing this risk.

The report adds that in 2022, 116 million people were covered through 89 products that included coverage for climate risks, with the majority being agriculture products (68), although climate coverage was also included in property, business interruption and life products.

Captives and microinsurance

In some cases, a company's captive insurer is used to provide capacity for microinsurance schemes.

Blue Marble works with a Latin American coffee producer, using a local insurer to make sure that the product is approved by the local regulator and offered by a licenced and locally branded insurer. Blue Marble then brings in international reinsurers or, in some case, captives.

"It's a synergetic relationship because many captives also have sustainability targets of their own but many times struggle to see how they can contribute to the overall targets of the parent company," says de Piniés. "The captive provides a conduit to participate in reaching those targets, often by serving as a place within the company where the programme can be centralised."

The collaboration with the coffee producer has yielded positive results. Adverse climate conditions in 2022 resulted in a difficult year for coffee

Microinsurance protects the end suppliers, whether they are farmers that supply food and beverage companies or garment workers in factories of textile industry companies, with coverage that provides income stability

Textile factory workers, Chattogram, Bangladesh

"Captives can adapt insurance to the needs of low-income markets more flexibly than traditional insurers and can facilitate partnerships with insurance companies and non-governmental organisations to access more resources and expertise"
Peter Carter, head of climate practice & head of captive & insurance management solutions, WTW

growers, but the programme delivered a country record of $3.0m in payouts for smallholder coffee farmers.

Blue Marble described it as a "moment of truth", proving that microinsurance gives the coffee farmers the financial help they need, when they need it.

Developmental context

Captives and other risk-funding vehicles are also useful in a developmental context. Earlier this year, ten multilateral development banks (MDB's) announced plans to work together on catastrophe insurance around the world.

Captives, association captives, and segregated cell companies are potential vehicles for MDBs to capitalise. Microinsurance is a product class that can be offered from these vehicles at better-than commercial rates. The Caribbean Catastrophe Risk Insurance offering livelihood protection coverage to small fishing operations is an example.

Peter Carter, head of climate practice and head of captive and insurance management solutions at WTW, says captives could be used by microfinance institutions to manage risks more efficiently in terms of better loss control and product development.

"Captives can adapt insurance to the needs of low-income markets more flexibly than traditional insurers and can facilitate partnerships with insurance companies and non-governmental organisations to access more resources and expertise," says Carter.

Awareness and trust

A challenge remains in building awareness around how parametric insurance works. Training is needed to ensure that underwriting teams are comfortable with the risk, how it's priced and underlying assumptions.

"It is certainly a challenge but it's also a great way to build trust," says de Piniés. "And the stronger that trust is, the more potential there is to grow the schemes. We work with Zurich teams and they have a lot of experience working with captives. Working with them is obviously a great way to build that trust."

Coffee farmers in Colombia

Cyber becoming a mainstay risk for captives

Concern over growth in ransomware and changing regulations

Cybersecurity continues to be a major issue for corporates, with the increase in ransomware attacks a major concern, and the recent CrowdStrike outage a stark reminder of the threat even from non-malicious acts. At the same time, cyber regulations around the globe are constantly changing and adapting. Cyber risks consistently top the rankings of risk managers' concerns.

The number of data breaches doubled in 2023, according to technology firm Verizon Business's 2024 *Data Breach Investigations Report,* reaching a record-high of 10,626 across 94 countries. Ransomware and extortion accounted for 32% of all breaches last year. Third-party breaches accounted for 15% of the total, up 68% and driven by a threefold increase in vulnerability exploitation attacks.

Although North America accounted for more than half of security incidents analysed, the majority of confirmed data breaches were in the Europe, Middle East and Africa (EMEA) EMEA region. It accounted for 6,000 of more than the 10,000 recorded. Moreover, half of breaches in the EMEA region were internal.

The cyber market

Cyber is no longer an emerging risk but cyber insurance is now a well-established cover. The cyber insurance market went through a hardening phase from 2019 as losses mounted, notably from ransomware attacks. Last year saw the market in Europe settle down in terms of pricing amid more emphasis on cyber protection and mitigation.

Indeed, the market is moderating considerably, with Marsh's *Global Insurance Market Index Q2 2024* reporting that European cyber insurance rates decreased 7%, with the downward movement in rates observed mainly in excess layers, and larger accounts generally experiencing savings at the primary and first excess layers. Aon's *Q2 2024 Insurance Market Trends* confirmed that buyer-friendly market conditions continued in the second quarter despite claims frequency trends, with increased capacity and competition leading to price reductions, particularly in high excess layers.

The market is seeing a fierce competition in the excess and mid-market businesses, which will continue to change the cyber market landscape in 2024. However, Andreas Ruof, head of proposition development, senior captive service specialist, Zurich Insurance Company, says this depends on several early indicators that the insurer is keeping an eye on:

- Will the increase of ransomware incident frequency from 2022 to 2023 continue to spike significantly in 2024?
- Will claims severity from supply chain attacks increase as well?
- Change Healthcare event and CrowdStrike event contribute most likely around 10% loss ratio points to the global cyber market in 2024.

"The key question is whether or not this will lead to a sharpened underwriting discipline, and more sustainable terms & conditions, including a significant reduction of 'unquantifiable exposures in insurance portfolios' by systemically excluding such exposures instead of gaining competitive advantages in the absence of appropriate exclusions, such as war and critical infrastructure failure," says Ruof.

Aon's *Q2 2024 Insurance Market Trends* confirmed that buyer-friendly market conditions continued in Q2 despite claims frequency trends, with increased capacity and competition leading to price reductions, particularly in high excess layers

Ransomware is still the biggest threat and this is expected to continue in the foreseeable future. According to the June 2024 edition of *Ransomware Tracker* by TheRecord.media, the number of attacks claimed by ransomware groups in May 2024 spiked to the highest level (450 victims) in nearly a year. And there are other rapidly developing problems, such as the impact of artificial intelligence (AI) in hacking, and the evolving ecosystem of service providers supporting a growing cybercrime industry (so-called 'ransomware-as-a-service') around the world.

Insufficient limits

One of the problems for large multinationals is that the limits in the market are just not sufficient, though they have greatly improved from a few years back. A.P. Møller-Maersk A/S's Lars Henneberg says that the limits the cyber market provides is probably not relevant for big corporates. "We're not concerned about the $150m loss, we are concerned about the billion-dollar loss," he says.

"Our captive writes cyber insurance but it's a very small programme. It is basically there because some of our customers ask us to have cyber insurance up to a certain level and this programme is designed to deliver that comfort to our customers. We realised having bought cyber for a number of years that the price for this transfer was too high compared to our own modelling and our own perception of the risk, and we found that the premium would be better spent by investing it in additional cybersecurity and we would get better risk mitigation," says Henneberg.

The global average cost of a data breach has surged by 10% in the last year to reach an all-time high of $4.88m, driven by more disruptive cyberattacks

"As cyberattacks become more sophisticated and pervasive, traditional insurers can struggle to keep pace with the dynamic risk landscape, which can often result in higher premiums and more restrictive coverage terms"

Laurent Nihoul, general manager, corporate risk & insurance, ArcelorMittal,

and an increase in lost business, and the rising expense of third-party response services, according to a IBM's *Cost of a Data Breach Report 2024*.

The combination of insufficient limits and the continuing threat of cyberattacks and breaches, not to mention the growing regulation in this area, is seeing captives take more of an interest in the risk, and captives are increasingly writing more cyber insurance due to the escalating frequency and severity of cyber threats.

"As cyberattacks become more sophisticated and pervasive, traditional insurers can struggle to keep pace with the dynamic risk landscape, which can often result in higher premiums and more restrictive coverage terms," says Ferma's Laurent Nihoul. "Captives, on the other hand, offer a flexible and cost-effective alternative. This is undoubtedly an area where we should see the use of captives continuing to grow steadily in the future."

The key starting point for captives writing cyber is the level of market capacity available and at what risk attachment point, and the value for money of the risk transfer product. "If the product is deemed expensive or the attachment point is considered too high then a re-negotiation to introduce the captive writing a layer of risk on the programme is the natural next step for captive owners," says WTW's Peter Carter. He adds that WTW has seen captives placing cyber risks into the captive even though this year capacity seems to have increased and premium reduced.

Mainstay risk

Robert Geraghty, senior vice-president, international sales and consulting leader, Marsh Captive Solutions, International, says cyber is certainly trending and is inside the top ten risks being written by captives – Marsh manages up to 102 captives writing cyber globally, with $155m in premium.

"What I've seen in the development of cyber is a few years ago it used to be the add-on," says Geraghty. "It used to be that you would have a property programme and a liability programme, and if you had surplus you may look to add in cyber. Now companies are setting up captives or cells with the starting risk being cyber. It was one of those smaller risks that now has become a mainstay risk."

Most commercial carriers want to take a certain element of cyber, so the captive can fit in many different ways through the programme, he says. "The captive may fill in at the bottom on the primary layer, but also take any of the gaps in between in getting the top capacity. I have seen companies take the primary layer and the top excess layer to fill the capacity on the cyber programme, if capacity has dropped in the market for that particular client."

SRS's Lesley Howgego says the captive's role in cyber risk is slowly developing, although out of sync with traditional captive convention. "We see captives typically sit high in excess placements, usually where commercial capacity is exhausted or the pricing is outside of appetite for corporates. Alternatively, we may see some cyber programmes structured as deductible buydown," she says.

Ruof says that over the course of 2023 and continuing in 2024, Zurich has observed an ever-increasing interest in financing cyber risk through captives or cell captives, and this is particularly true for captives owned by multinational companies in EMEA, where cyber insurance capacity has been restricted and premium rates rose due to the increasing frequency of cyberattacks and reported losses. In 2023, Zurich saw growth of its fronted cyber portfolio of more than 50% as a result of growing demand in EMEA.

"A new generation of risk managers has realised that captives can be effectively used as a very powerful strategic risk management tool, especially when it comes to managing emerging or rapidly evolving risks such as cyber risk. Captives are risk management vehicles to facilitate self-financing risk and particularly challenging policy coverages, as well as accessing capacity in the reinsurance markets," he says.

But it also goes beyond that, says Ruof: "Captives are being used to centralise global cyber risk data for meaningful analysis to properly quantify exposures and to produce actionable cyber risk insights that drive effective cyber risk mitigation activities. In doing so, captives benefit from improved underwriting profitability on the cyber risk they assume."

Click here for further information.

Insuring cyber risk

Despite the growth in ransomware attacks, and perhaps due to the competition in the cyber insurance market, fronting for captives does not seem to be a problem. However, captive managers highlight a number of areas when it comes to captives writing cyber risks that require attention, not least the need to properly understand the underlying risk.

Artex's Mike Matthews says that before considering writing cyber in a captive, buyers should implement a cyber risk management framework to ensure the organisation's IT ecosystem is secured and there is continuous monitoring in place to reduce the potential for loss (in the captive).

"Cyber captives are primarily being used to fund deductible buybacks and/or to replace opportunistic pricing in the upper layers of larger cyber towers. We're also seeing cyber MGAs forming captives to participate in their cyber portfolios to generate additional revenues (share in the underwriting profits), developing bespoke contractual liability insurance policies or cyber coverages and/or adding additional capacity," he says.

Nihoul notes that captives are facing the same challenges as traditional insurers in writing cyber risks, including: the complex and rapidly evolving nature; a lack of extensive historical data making it difficult to accurately assess and price policies; management of risk aggregation given the potential for cyber incidents to affect multiple parts of an organisation simultaneously; hurdles relating to effective risk analysis processes and collaboration with IT functions; and the difficulties of accurately assessing risk exposures and developing loss scenarios.

According to Ruof, there are two main challenges for captives that write or are considering writing cyber risk. The first challenge is to fully understand and reliably quantify the cyber risk you introduce to your captive portfolio, he says. The second challenge is then to ensure that your cyber captive programme is sustainable over time.

As a result, captives writing cyber risk will need to frequently re-assess and re-quantify their cyber risk exposures, while also supporting or initiating cyber risk mitigation activities that most efficiently address the rapidly evolving vulnerabilities to cybercrime.

Ruof adds: "As a cyber fronting partner, it is important to provide easy access to an ecosystem of cyber risk experts, tools and insurtech partners to support captive owners in all the areas of concern where exposures to attacks and data breaches have been identified. A very close collaboration of corporate risk management and their chief information security officer's (CISO) office with the captive is of critical importance as you set up and continuously improve cybersecurity risk and ensure a resilient captive cyber risk programme."

"A new generation of risk managers has realised captives can be effectively used as a very powerful strategic risk management tool, especially when it comes to managing emerging or rapidly evolving risks such as cyber risk"

Andreas Ruof, head of proposition development, senior captive service specialist, Zurich Insurance Company

Changing workplace transforming employee benefits

Integration of staff benefits into captives requires collaboration

With economic uncertainty predicted over the next few years, and society becoming more polarised, employees are demanding more support from their organisations, and employee benefits are becoming an important tool in talent attraction and retention. The workplace is changing rapidly, with flexibility becoming a key requirement.

A recent study, *2024 Global Benefits Forecast,* by global pensions and employee benefits consulting firm MBWL International found that healthcare and flexible/hybrid working are the most valuable benefits for multinational companies' employee value propositions, while ESG and diversity, equity and inclusion (DE&I) continue to be important considerations for benefits strategies.

However, the report noted that global benefits management and governance has become less effective and more challenging, with cost and employee communication continuing to be significant issues. It said multinationals should review their approach to global benefits management and strategy, to optimise return on investment and maximise their limited time and resources.

Changing workplace

Employee benefits are undergoing a significant transformation to meet the demands of a changing talent market. According to a recent global survey from the World Employment Confederation, *The Work We Want*, flexibility has become a non-negotiable in the world of work. Among other findings, 83% say that employees now value flexibility around where and when they work as much as other factors such as compensation.

It is pretty clear that the workplace is changing and with it the need to have flexible benefits for employees. As Reto Heini, distribution manager, Zurich Global Employee Benefits Solutions, Zurich Insurance Company, explains: "Given the increasingly diverse preferences among different generations, it is natural that the flexibility of employee benefits must evolve accordingly. A more adaptable corporate benefits package consistently delivers greater value compared to conventional one-size-fits-all solutions."

According to a recent report from Zurich Integrated Benefits, *What is human-first approach to employee benefits,* the expectations of employees will change dramatically as we approach 2030 – they will increasingly demand benefits that are meaningful and tailored to fit their goals, not their roles. The report finds that just 21% of today's employees feel that their benefits align closely with what is important to them, so corporations will need to rethink the

"Benefit gaps are more prevalent than commonly assumed and are not solely determined by the presence or absence of coverage but also by the exclusions and limitations that may apply"

Reto Heini, distribution manager, Zurich Global Employee Benefits Solutions

employee experience and expand their offering, says Heini.

Captives and employee benefits

Captives and employee benefits have been talked about for many, many years. Captives have begun to get more involved in employee benefits, with benefits both for employees, the employer and for the captive itself in terms of diversification, and while there are still a relatively small number of captives writing employee benefits, compared to say property, the captives that write employee benefits are doing it at a very big scale.

For example, Marsh-managed captives write about $14bn of gross written premium in employee benefits. Its 2023 captive benchmarking data notes that employee benefits is a growing area for captives, accounting for about 20% of Marsh's global captive portfolio. Marsh says it is seeing numerous captives funding medical stop loss and international employee benefit programmes.

Demand for employee benefits cessions to captives has surged significantly. Zurich's employee benefits captive customers have grown from a handful in 2011 to approximately 40 today, with premium volumes exceeding $500m. Globally, there are currently around 200 captives reinsuring employee benefits risks out of roughly 1,500 active captives, highlighting the substantial growth potential.

Captive owners are increasingly recognising the benefits of integrating employee benefits insurances into their existing non-life captives. Including employee benefits life programmes reduces a captives' expense ratios by generating underwriting profits, enhancing financing efficiency, and lowering operational expenses.

Heini believes this comprehensive approach leads to holistic captive balance sheet protection and potentially lower local frictional costs. Additionally, the European Solvency II framework incentivises captive owners to incorporate employee benefits exposures, especially when a non-life captive is already in place.

According to Heini, integrating life into an existing non-life reinsurance captive allows companies to maximise capital efficiency and help drive risk-prevention initiatives and HR-driven diversity and inclusion agendas by facilitating the inclusion of covers and benefits that might not otherwise be available in the commercial insurance market. And captives have the flexibility to selectively manage employee benefits, focusing on specific countries or particular coverage areas.

Global disparities

An important benefit for multinationals is that captives can help address disparities in benefits across geographies. Heini says this can be done by obtaining detailed information from local fronting insurers and ensuring compliance with global minimum standards. "Benefit gaps are more prevalent than commonly assumed and are not solely determined by the presence or absence of coverage but also by the exclusions and limitations that may apply," says Heini. "Many companies have decentralised approaches to employee benefits, resulting in head offices often being unaware of the levels and breadth of local coverages. This increases the risk of unequal treatment of employees based on their country of residence."

Unlike non-life insurance programmes, employee benefits programmes are implemented using a bottom-up, country-specific approach because these programmes must be coordinated with each country's social security system and are influenced by local tax laws, labour laws, and interest groups. As a result, says Heini, employee benefits vary significantly from one country to another, allowing captives to address them in a highly selective manner.

"The initial fact find on the capability of using the existing captive has to be fully explored and if not feasible then a company should look at the merits of a standalone employee benefits captive in the same location or elsewhere"

Peter Carter, head of climate practice and head of captive & insurance management solutions, WTW

WTW's Peter Carter says the captive can be used to offer coverages in countries where it is not the norm to find that sort of coverage, but it can be offered by the group. In this way, captives can be used as a differentiator as part of employee experience and overall package.

But he notes that in some domiciles, the licensing of an existing captive may be restrictive in terms of accepting long-term business such as disability benefits. "Therefore, the initial fact find on the capability of using the existing captive has to be fully explored and if not feasible then a company should look at the merits of a standalone employee benefits captive in the same location or elsewhere," says Carter.

Captives can also play a pivotal role in advancing DE&I initiatives by facilitating employee benefits coverage that might otherwise be unavailable. For instance, captives can ask their fronting insurers to compare current covers with the company's goals and provide suggestions for adequate cover where possible.

"This could include extending benefits entitlements for common law or same-sex partners, and ensuring policy wording is gender neutral or gender inclusive. Even in countries where coverage for same-sex partners is typically unavailable, creative policy wordings, agreed upon by both the local insurer and the captive, may facilitate such coverage," says Heini.

Captives can also leverage their relationships with global employee benefits networks to provide suggestions on policy wordings and pricings in countries where such benefits are not provided and lack of data limits local risk appetite, he adds.

Collaboration with HR

One of the age-old issues when it comes to captives and employee benefits is the relationship between the risk management and human resources (HR) departments. The two tend to be siloed, with the employee benefit programme sitting with HR and the rest of the organisation's risks, and the captive sitting with the risk manager.

However, as Marsh's Robert Geraghty points out, the numbers are so big for employee benefits that it is now front and centre for all the c-suite, who are looking at whether there is a better way to manage this.

Ken MacDonald, Ri3k Consulting, agrees, noting that prior roadblocks included lack of visibility of the data for global employee benefits programmes and a disconnect between risk and insurance departments and the HR area. "As these internal walls have broken down, the risk finance benefits can be unlocked. Typically, employee benefits spend will dwarf non-life/P&C spend, hence the prize can be substantial and the captive can profitably play a key role and even enhance the proposition to employees," he says.

Employee benefits has become the largest risk that A.P. Møller-Maersk A/S takes in its captive. Lars Henneberg says: "It is not easy, but that is partly to do with how a company is organised. This is normally something that is dealt with in a very fragmented way in the local countries. If you manage to bring human resources and risk management together and get them to cooperate on a central approach to this, the captive is a fantastic tool because you get a lot of operational efficiencies, and it allows the human resources department to have a centralised strategy on employee benefits."

This means you can have a centralised and consistently executed strategy on employee benefits that is basically set by the HR department and executed through the risk management department, he explains, noting that a captive has a lower expense ratio and does not have the same requirements for profit making as insurers have. A.P. Møller-Maersk A/S captive's expense ratio is 5% while the market benchmark is 20%.

Focal point

Captive managers say that captives can be used as a focal point and a differentiator. Employee benefits captives are finally beginning to come into their own as more organisations unite the funding of risk across their businesses, resulting in closer cooperation between risk and HR managers.

Employee benefits is generally led by the insurer and reinsured back to the captive. The programme is created then it is insured, often through multinational pooling, and then reinsured into the captive vehicle.

Artex's Mike Matthews says that by positioning a captive behind a multinational pool, sponsors can typically capture 10-15% in additional revenue. "The captive becomes the focal point for the funding of global benefits, resulting in consistent benefit levels across the sponsor's organisation," he says. "We're seeing use beyond the core life, disability and medical covers to include wellbeing and wellness initiatives – either as an incubator model to gather data to support future discussions with traditional markets or as a way to recycle captive surplus to fund new local and corporate benefit initiatives."

"The captive becomes the focal point for the funding of global benefits, resulting in consistent benefit levels across the sponsor's organisation"

Mike Matthews, commercial director – EMEA, Artex

One of the aims of using captives to write employee benefits is to eliminate the frictional costs associated with writing employee benefits cover in the commercial market. "Captives can improve claims reporting, usually providing quarterly reports, compared to the current annualised reporting," notes Polo's Mark Elliott. "As the market experiences medical inflation, increased workforces, and a higher incidence of chronic diseases, captives can provide stability for employee benefits cover."

Group captives – a US success story and a way forward for Europe?

Potential in Europe but not yet established

Group captives are a well-established solution in the US but are much less common in Europe. However, the risk-sharing capabilities of group captives have many benefits and may provide an important solution for smaller and mid-sized companies in the same industry/sector, or sharing particular risks or a common interest that may lack the scale and resources to form single-parent captives

A group captive is an insurance vehicle established to insure the risks of its members. It is open to companies that can be related by industry sector (homogenous group captives) or companies from different industry groups but with commonality in policy needs (heterogenous group captives).

Risk sharing

According to a report last year by the Insurance Information Institute (III) and Captive Resources, *Group Captives: An Opportunity to Lower Cost of Risk,* group captives are an option for mid-size companies that are committed to risk management and safety and have a desire for greater transparency into their insurance programmes. "They can provide a viable way to protect companies across several lines of casualty insurance. Their prominence is likely to grow as economic and litigation trends continue to increase costs, prompting companies to continue to seek effective risk-financing programs offering superior cost control," the report states.

"This calls for a unique approach to premium development where each member's premium is individually determined to allow them to fund for most of their ultimate losses while allowing for risk sharing and risk shifting amongst the entire membership"

Joshua Nyaberi, head of captive fronting, Zurich Insurance Company

Group captives involve risk sharing among members who are not necessarily of the same size, and in some cases not even from same industry. "This therefore calls for a unique approach to premium development where each member's premium is individually determined through the use of an actuarially determined loss forecast to allow each member to fund for most of their ultimate losses while allowing for risk sharing and risk shifting among the entire membership, primarily for shock losses," says Zurich's Joshua Nyaberi.

Benefits

The benefits of group captives are broadly similar to those of single-parent captives, such as optimising insurance spend and managing cost of insurance through cycles, but they also traditionally request significant investments in loss prevention as a condition of membership. Given the loss-sharing, there is a collective commitment to funding loss prevention initiatives, and assessment of individual member performance, and overall this helps improve the quality of risks the members retain.

Indeed, the III/Captive Resources report showed that organisations participating in group captives on average suffer 48% fewer fatalities, 39% fewer lost-time claims and, overall, 22% fewer workers' compensation claims.

The validation of this investment is in the high level of dividends that the established group captives have paid back to the owners – "a testament to good risk prevention", according to Nyaberi. In fact, a Captive Resources study of 15 mature group captives across 233 closed accident years found that group captive members paid $5.6bn into their loss funds to pay out claims costs. However, with group captives returning underwriting profit to their member/owner insureds, the captive members earned $1.3bn in dividends, representing 23% of loss funds.

US group captives

Group captives are a well-established solution in the US, which has been significantly ahead of the rest of the world on use of captives. Group captives have thrived in the US, according to Nyaberi, "partly due to the incredible work of captive consultants, who are instrumental in their creation and nurturing their development but more importantly the risk philosophy of the companies using captives".

The majority of group captives tend to cover workers comp, auto physical damage (fleets) and general liability, although lately there has been notable growth in captives covering medicare costs, whereby most members are owners of existing property & casualty (P&C) captives.

A recent example of group captives being set up to tackle particular issues is the creation earlier this year of Edgware Re, a group captive insurance company for organisations seeking more control and stability in their cyber insurance programmes, established in Bermuda by Marsh. Participating members of the cyber-only group captive can purchase up to $10m in insurance or reinsurance from Edgware Re, with limits expected to grow as participation increases.

Europe potential

However, the concept of group captives has not been fully established in Europe. Nyaberi says group captive consultants are critical to their formation and there are not many that have set up shop in Europe, although he believes that is slowly changing as some of the established US captive consultants open branches across Europe. He says there is significant educational investment required to sensitise potential captive users (particularly mid-sized companies) of the ways a group captive could benefit them by working with industry peers on risk management.

Captive managers say group captives haven't really taken off in Europe, though they say there is no particular reason why they shouldn't work on the continent, with the suggestion that the main challenge is scale. It is perceived to work in the US due to the average size of premium spend by US SMEs (small and medium-sized enterprises) compared to their European equivalents.

The closest form to group captives that has been seen is a 'mutual' established in Belgium at the end of 2022 to provide cyber coverage for its members. MIRIS (Mutual Insurance and Reinsurance for Information Systems) was incorporated in Belgium, with founding members including BASF, Airbus, Michelin and Solvay. Captive managers say they are seeing more interest from like-minded organisations in mutualisation of risk in response to ongoing market challenges, like the cyber mutual in Belgium, and they expect to see more of these industry and/or class-specific solutions coming onstream in the coming years.

The closest to group captives seen in Europe is a 'mutual' established in Brussels at the end of 2022 to provide cyber coverage for its members, with founding members including BASF, Airbus, Michelin and Solvay

Brussels Airlines Airbus A319 airplane at Brussels airport

The future is bright for captives

New domiciles, new captives and new opportunities

The volatility of the underwriting cycle has been a driving factor for captives in the past, and the recent hard market was no exception. While there was some debate as to whether the cycle still exists after such a long soft market, in 2019 the hard market came back, causing risk managers to turn to their captives once again.

So how is the captive market looking today and what does the future hold for the sector? It certainly looks bright: The number of domiciles continues to expand, European onshore captives look set to thrive in the next few years, while pressures in traditional insurance market seem set to continue, at least in some lines. At the same time, the growing focus on sustainability and ESG is opening up opportunities for captives to play an even bigger role.

Zurich has observed strong demand for captives in Europe, as evidenced by the volume of new business enquiries. "Captive creation and use will remain strong," says Zurich's Joshua Nyaberi. "In a world increasingly faced with new/emerging risks that are either difficult to insure or uninsurable, the captives' value increases both for companies who already operate one and for those who have an interest and therefore can create their own."

Captive expansion

Captives has been on the increase over the last few years, and most domiciles around the globe have seen new formations on the up. The number of captives has been rising for the last four years, and there are now 6,181 captives (2023), not including microcaptives, series captives or individual cells of cell members in protected cell companies, from 5,879 in 2020, to 6,074 in 2021, to 6,093 in 2022, according to *Business Insurance's Captive Managers and Domiciles Rankings + Directory 2024*.

Of the 6,181 captives, over half (54.4%) were onshore in the US, and 30.6% were North American offshore. Europe accounted for 10.9%, with Asia taking 3.3% of the captive market.

Much of the recent growth has involved US parented captives, and most of that has been onshore in the US. Indeed, states have been falling over themselves in the last decade or so to pass captive laws. And for the first time ever, last year saw Vermont overtake Bermuda and the Cayman Islands, to become the world's largest captive domicile, according to the *Business Insurance* ranking.

In Europe, Guernsey retained its top spot, followed by Luxembourg and the Isle of Man and Dublin. But onshoring is beginning to take off in Europe, with France leading the way, bringing in new rules that make it more attractive to create captives in the country.

Meanwhile, in the UK, Lloyd's recently announced its first captive for many years, and the UK government is being urged to make it even more attractive to host onshore captives in the UK. At the same time, Italy is also being urged to attract captives, and there is pressure growing in Spain and Germany to add the territories to the existing domiciles such as Ireland, Sweden and Switzerland.

But it is not just about new captives. Perhaps more importantly, companies are putting more and more business through their captives. Indeed, global captive premiums grew again in 2023, driven by both existing and new captives. Gross written premium written by Marsh captive clients, for example, reached $73bn in 2023, up from $70bn in 2022, $68bn in 2021 and $61bn in 2020.

Marsh's latest benchmarking report shows that the bulk of international (non-US) captive premium growth was in the UK (Guernsey) and Europe, where premiums increased by an average of 15%

EUROPEAN CAPTIVE DOMICILES

Ranked by number of captive licenses at year-end 2023

	Domicile	2023	2022
1.	Guernsey	199	203 (restated)
2.	Luxembourg	195	195
3.	Isle of Man	98	99 (restated)
4.	Dublin	63	66
5.	Sweden	28	29
6.	Switzerland	24	24
7.	France	14	10e
8.	Malta	11e	11
9.	Gibraltar	10	10
10.	Germany	9	9
11.	Liechtenstein	7	8
12.	Denmark	6	7
13.	Norway	6	6
14.	Italy	2e	0e
15.	Jersey	2e	2e

Source: Business Insurance survey

in 2023. Marsh notes that much of the growth is driven by an increased interest in protected cell companies, and proportionality developing in EU regulation.

Hard/soft market

As we've seen, a hard market generally leads to greater captive use. One of the reasons for optimism over the future growth of the captive sector is that while the hard market may be moderating, or even softening in places, captives have shown themselves to be invaluable tools regardless of the state of the traditional

"History and statistics tells us that captives do not reduce in total numbers in a soft market, or even a prolonged soft market. This is testament to the totality of the benefits that captives deliver"

Ken MacDonald, Ri3k Consulting

insurance market, and captive experts see a role for captives whatever the state of the insurance market at any given time.

Captive consultant Oliver Schofield from RISCS CWC believes captives have become much more of a strategic risk management tool: "Having said that, I have always maintained that captives are not just for the hard market – they bring benefits to owners at every stage of the market cycle."

He adds: "Looking at the previous four insurance market cycles, while tough market conditions force insurance buyers into captive participation as there is no commercial option, we have seen corporates take a longer-term strategy view when soft market conditions return. Boards have a long memory and don't want to be in a bind when the next hard market comes, hence they use their captives to build capacity even when market conditions are benign so as to be able to better manage risk in the next hard market."

And Ken MacDonald, Ri3k Consulting, says: "History and statistics tells us that captives do not reduce in total numbers in a soft market, or even a prolonged soft market. This is testament to the totality of the benefits that captives deliver. These are long-term investments, and most owners appreciate this when setting up their captive."

The hard market certainly triggered significant growth in captives and cell formations as self-retentions increased, but their value continues long after the cycles moderates. "Across cycles, captives remain a strategic risk management tool even for the more recent users as their value is validated over time," says Zurich's Joshua Nyaberi. "Under hard market conditions, controlling total cost of risk becomes a major focus and captives have proved their ability to keep the cost of risk management stable. Profitably managed captives build significant reserves and financial resources, making it possible to fund future risk management initiatives from captive dividends."

Marsh says it has formed 500 new captives globally in the last four years and 125 brand new ones last year. Marsh's Robert Geraghty notes that the broker was setting up brand new captives in the soft market as well. "It is not just about quantitative benefit, it is not just about cost savings. A captive provides capacity and coverage advantages, and there are the claims and control aspects of a captive, and the compliance aspect. Captives are being set up for many other qualitative benefits – it is not just about pricing," he says.

Marsh sees growth continuing, not in terms of brand new captives but in terms of premium, lines of business and utilisation growth, with existing captives taking on more lines of business, higher retentions, and taking on more risk overall as well as brand new captives. "We see companies looking at how the captive can be utilised further to write more business," says Geraghty. "Companies are a lot braver now, taking decisions faster and looking at the market and utilising the captive further with stronger risk appetites and taking on more risk overall."

Captive owners upbeat

For those that already own captives, it is a vehicle that has its uses in all markets, but perhaps works harder in the hard market. Above all, it is a vehicle to reduce the volatility caused by the underwriting cycle, and it is a well-established principle that a captive can mitigate market fluctuations. Some captives follow the market, and if the market is high, they take more risk, while other

Carl Leeman, chief risk officer at logistics firm Katoen Natie, speaking as part of this year's *Commercial Risk* Risk Frontiers Europe survey, said his company is using its captive more intensively and it now covers ten lines of business

captives, as A.P. Møller-Maersk's Lars Henneberg explains, have taken control of the pricing.

"So we price it based on the risk and not based on the market," he says. "The market is supply and demand driven, whereas we take a view on the risk and say 'what level of premium do we need in order to cover the losses, our expenses, reinsurance costs and a small profit on top for transfer pricing'. That provides a very stable risk transfer price for the business and we are not subject to these market fluctuations."

A.P. Møller-Maersk did a benchmarking exercise this year to see what it would cost to place certain risks in the market. "It shows that we are actually pricing it around 25% below the market at the moment – some a little bit higher but most on average around 20-25% lower. Because we have a lower expense ratio, we have lower expectations in terms of profit and we have a better understanding of the risk."

It is fairly clear that once premium and risk retentions start flowing into a captive, such flows tend not to switch back to the insurance market when it begins to soften, though of course this depends on their risk profile, risk appetite and desire to manage insurance costs.

"We price it based on the risk and not based on the market. That provides a very stable risk transfer price for the business and we are not subject to these market fluctuations"

Lars Henneberg, vice-president and head of global risk management, A.P. Moller-Maersk A/S

And now that the underwriting cycle is back (and in fact never went away), Ferma's Laurent Nihoul points out: "Sudden changes in the insurance market will likely happen in the future given the cyclical nature of the sector. Captives will therefore continue to be an efficient means of buffering the impacts of a hardening market, such as shortage of capacity, increase in premiums and restrictions in terms and conditions."

Carl Leeman, chief risk officer at Belgium-based international logistics firm Katoen Natie, speaking as part of this year's *Commercial Risk* Risk Frontiers Europe survey, said his company is using its captive more intensively and it now covers ten lines of business, while Matthias Beck, head of the group insurance department and risk management at the Würth Group, said that captives are definitely a useful tool during tough times.

"We have a well-established captive already for more than 20 years, and use it more and more for business-specific risks and risks that are from our point of view not adequately evaluated by the insurance market. Cyber is one of those, as well as credit and certain liability risks. The main benefit I see is the flexibility of developing tailor-made solutions for our individual risks and, to a certain degree, the independency from the insurance market, especially to react anti-cyclical," said Beck.

Sustainability and ESG – a role for captives?

This report has focused on some of the risks highlighted by the WEF *Global Risk Report*. And many of these risks are

"Captives can insure projects and initiatives that support sustainability goals, helping organisations manage the risks associated with their green investments"

Gabriella Fraire, president of ANRA

related to sustainability. It is clear from this report that captives will play a crucial and growing role in their organisations when it comes to sustainability and ESG, whether that be in relation to climate risk, net-zero transition or employee benefits and wellbeing. Risk managers undoubtedly see the captive as a means to support ESG and sustainability.

"The transition agenda and journey carries with it great risks and the need to do it fairly and justly. Captives can aid a just transition and with that they take on a much bigger role than providing traditional insurance solutions," says Zurich's Joshua Nyaberi.

Captives are increasingly being recognised as an important component in supporting their parent organisation's ESG and sustainability initiatives, according to Ferma's Nihoul: "As businesses prioritise sustainable practices, captives offer multiple strategic benefits, such as providing customised insurance solutions for ESG-related risks that traditional insurers might overlook or not underwrite adequately. These might include environmental liabilities, climate change impacts, and social responsibility issues."

He believes captives can also play a role in incentivising sustainability practices – for instance, a captive might offer premium discounts for reduced carbon emissions, adoption of renewable energy, or the implementation of eco-friendly practices. He notes that captives can insure renewable energy projects that may struggle to obtain coverage from the traditional market, and facilitate the growth of sustainable energy initiatives and contribute to broader environmental goals. And he points to the potential use of captives to fund ESG initiatives with premiums paid to captives invested in sustainable projects, creating a pool of capital that supports ESG endeavours.

The growing focus on sustainability and ESG will certainly create opportunities for captives. As ANRA's Gabriella Fraire explains: "Captives can insure projects and initiatives that support sustainability goals, helping organisations manage the risks associated with their green investments. In addition, premiums collected by captives can be reinvested in ESG investments, aligning the captive's activities with the ESG goals of the parent company," she says.

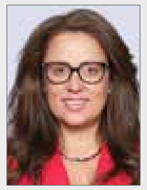
Comprehensive coverage

Looking at the separate components of ESG, Henneberg notes that on the environmental side, energy transition comes with new technology, where insurers are reluctant to participate and captives can definitely help bring comfort to insurers, bridging that gap in capacity. "On the social areas, you can imagine that there was some employee practises that are not picked up by the normal employment practices liability (EPL) policies, and in the governance area there could be lack of procedures or lack of governance in place, that has caused emissions or that cause a cyberattack. In all these augmented ESG areas, are the existing commercial market policies fit to cover the augmentation? The captive can provide a wrap to ensure that insurance coverage is comprehensive," he says.

And finally, he notes that on climate change adaptation, "we have the tools in the captive to do risk analysis, risk qualification, and we have the risk engineering capabilities to go out and do site assessments and then come up with associated improvements for resilience, see where investments could be made to improve resilience, and see what procedures could be introduced to improve resilience".

Zurich's John Scott concludes that when it comes to sustainability: "I think it's an opportunity for risk managers to work closely with their insurers and with their brokers to really find innovative ways to deal with risk. The commercial insurance sector has a real value in providing insights into risk management, and what kind of risk management might be most effective, and what kind of financial risk transfer mechanisms are the most effective. And with managing risk, it's not just transferring it to somebody else, but it's also about finding ways to manage the risk in a better way. And I think it's that kind of innovation that really will create enormous opportunity, and captives can be a part of that."

Zurich Captives Contact Information



Executives
Adriana Scherzinger
Head of captives
Zurich Commercial Insurance
Zurich Insurance Company
Email: Adriana.Scherzinger@zurich.com

Non-life Opportunities
Joshua Nyaberi
Head of captive fronting
Zurich Commercial Insurance
Zurich Insurance Company
Email: joshua.nyaberi@zurich.com

Proposition Opportunties
Andreas Ruof
Head of proposition development
Senior captive services specialist
Zurich Commercial Insurance
Zurich Insurance Company
Email: andreas.ruof@zurich.com

Life Opportunities
Reto Heini
Distribution manager
Zurich Global Employee Benefits Solutions
Zurich Insurance Company
Email: reto.heini@zurich.com

Websites

Zurich Captive Services

Zurich Commercial Insurance

Zurich Integrated Benefits

Zurich Commercial Insurance LinkedIn

Office Address
Zurich Commercial Insurance
Mythenquai 2
8002 Zurich,
Switzerland

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