INNOVATION IN MALTA

Matthew Bianchi and Beppe Sammut of Ganado Advocates give an overview of cell companies as an innovative insurance structure available in Malta

Innovation has long played centre stage in Malta's financial services industry. This is particularly true in the insurance sector which has carved out a reputation for itself as being on the forefront of legal and regulatory development in the European Union. Malta is an acclaimed insurance jurisdiction that offers flexible, innovative structures to cater for the needs of insurers, captives and intermediaries alike. Innovation in the Maltese insurance sector can be traced back to the introduction of the protected cell company (PCC) model in the 2000s – a model that offers a convenient way of acquiring a dedicated space on an already active insurance platform; this being an attractive option to prospective owners of small or medium captives and small insurers.

The PCC model has been a resounding success for Malta, with a high number of cells being established and utilised for numerous business models. While the PCC model was originally seen as an ideal vehicle for captives and fronting arrangements, the scope for the use of the PCC has continued to develop and now extends to (re)insurance-linked security models, direct insurance business, as well as to insurance intermediaries. In fact, Malta's cell legislation allows for cells for direct and captive insurance, reinsurance, brokers and managers.

The PCC model also paved the way for further innovation by serving as the basis for other innovative structures, such as incorporated cell companies and securitisation cell companies, which may serve as reinsurance special purpose vehicles.

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The PCC structure

The main benefit of a PCC results from its legal nature. It is a single legal entity that allows for the creation of one or more cells all having separate patrimonies which are segregated from the assets and liabilities of each other cell and the 'core'.

While each cell has its own distinct patrimony, the PCC (including all cells and the core) is treated as one legal entity, meaning that the cells do not have a separate legal personality. This results in attractive benefits in terms of regulatory capital requirements, system of governance and regulatory reporting. Seeing how each cell only needs to satisfy its own notional capital requirement, this may lead to certain undertakings being required to maintain capital which is lower than that required to be maintained by standalone insurers.

In addition, the PCC structure offers economies of scale and significant cost burden sharing as well as grants cells access to a common pool of knowledge and expertise within the common management system at the core of the PCC. Similarly, all transparency and reporting requirements are carried out through the directors of the PCC, resulting in a cost-effective structure which diminishes the burden on individual insurers writing business through a cell. Considering that Malta is the only EEA member state that caters for the PCC model – which effectively allows PCCs to enjoy the freedom to provide services throughout the EEA – it is no surprise that interest in this structure has grown over the years.

Captives and fronting arrangements

The benefits of substantial cost burden-sharing and reduced capital requirements of the PCC have attracted the smaller 'monoline' insurers and captives that were facing closure, and provided them with an alternative model that would allow them to continue underwriting their business accordingly. The fact that a PCC is allowed to underwrite business directly throughout the EEA via passporting has led to the decrease of fronting arrangements, which leads to large savings in costs. In fact, Malta has continued to witness interest in the use of the PCC structure to replace the traditional fronting arrangement for the purposes of reducing EU fronting costs.

Insurance intermediaries

The use of the PCC has not been limited to the more traditional captive and fronting arrangements and, following Brexit, many UK insurance brokers and managing general agents (MGAs) took advantage of the PCC model in order to write business in the EEA. Here, UK brokers and MGAs have the option of either setting up a 'broker' cell and continuing to intermediate their EU business in line with their original model, or alternatively may establish an 'insurance' cell to effectively access the underwriting profit of their insurance book – in both cases benefitting from the cost burden sharing and reduced capital requirements. In the latter case, seeing how the daunting governance costs and capital requirements for brokers and MGAs are alleviated by the PCC structure, one can expect further growth as these intermediaries make the leap to participate and profit in their own insurance book.

Directors' and officers' cover

The hardening and challenging directors' and officers' (D&O) liability insurance market has resulted in the search for alternative insurance models to the placing of D&O programmes with traditional insurers. The issues surrounding ring-fencing of assets (particularly in the case of an insolvency), circularity of funding (where a company is legally prohibited from indemnifying its directors) and independence of claims handling (where directors and officers would not want their 'employer' deciding on whether a claim should be settled) has resulted in difficulties for D&O cover to fall under a captive model.

Here the PCC is emerging as an alternative model for captive insurance arrangements for the following reasons:

1. the cell may be seen to be under the control of a third party considering how the cell does not have separate legal personality from the PCC itself, the cell owner does not have any voting rights and the directors are not appointed by the cell owner, but by the third-party owners of the PCC
2. the PCC offers independence and objectivity in the management of the cell business, in particular in relation to claims
3. orphaned trust or similar structures may be utilised to further distance and divorce the ownership of the particular cell from the ownership of the company of the directors and officers in question – this provides comfort in relation to the circularity of funding and ring-fencing of assets.

Insurtech

Technological developments will continue to play a crucial role in driving innovation in numerous industries and sectors. The insurance sector has also experienced the exciting changes brought about by technology, as evidenced by the dawn of 'insurtech'. Insurtech relates to technological innovations aimed at 'disrupting' the insurance market – these technological innovations are created and then implemented for the purposes of improving the efficiency of the insurance market (whether it relates to the creation, distribution or admin of insurance products).

As new insurtech products are developed, it is expected that stakeholders will be on the lookout for models and structures best suited to cater for these products. Malta's legislative framework (in particular the PCC model) offers insurtech players the necessary flexibility and innovation that should allow them to launch, test and develop their products, while benefiting from lower governance costs and capital requirements.

The use of the PCC model can be twofold: either the establishment of a cell in order to write direct business by utilising the insurtech's technology by more accurately pricing its insurance product and better estimating potential claims, while providing its customers with a user-friendly innovative technology on their smart devices; or creating its own PCC structure and marketing the use of its platform and the sale of its insurtech products through the establishment of individual cells for captives and other insurers that wish to utilise the technological-driven products crafted by the insurtech entity.

Securitisation cell companies

The legislative framework for securitisation cell companies (SCC) continues to build on Malta's experience in legislating for PCCs, funds (umbrella or multi-fund structures), private client and the not-for-profit sectors, and draws on the successful features of Malta's various pieces of cell legislation in these sectors, while introducing some important innovations that provide securitisation structures with the flexibility and utility of cell entities.

One of the main attractions of SCCs is their potential for use as platform structures for insurance-linked securities transactions such as collateralised reinsurance, private catastrophe bonds and bespoke longevity solutions – in that the SCC may be authorised as a reinsurance special purpose vehicle which can assume risks in accordance with the relevant provisions of the Solvency II directive.

The SCC structure incorporates the principles of single legal entity with multiple patrimonies, as well as that of segregation of patrimonies with no cross-contamination. Each cell established by the SCC may enter into one or more insurance-linked securitisation transactions provided that the insurance risks assumed always originate from the same insurance undertaking or same insurance group. However, different cells may enter into transactions with different originators thus enabling SCCs to be used as platform structures. Furthermore, the fully funded capital requirement that applies to securitisation special purpose vehicles established will apply on a cell-by-cell basis.

The future of the insurance landscape

Innovation and technological developments in the insurance sector will remain at the forefront for years to come. Traditional insurance business models are being challenged by new risks, challenges, ways of thinking, newcomers to the market and different consumer needs. Malta has a proven track record which evidences its willingness to embrace change and innovation, by offering alternative structures that provide solutions to market players and which may vary depending on the market needs and current realities. Malta's flexible, robust and innovative legislative framework surrounding cell companies ensures that it will continue to be well-placed to best service the changing needs of the insurance market.