

The potential of the cell captive structure for sub-Saharan Africa

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Executive summary

Globally, cell captive insurance is a relatively new concept. It grew out of the captive insurance concept, where a corporate entity self-insures its own assets by setting up its own licensed insurance subsidiary.

In a cell captive structure one central licensed insurer (referred to as the “sponsor” or “promoter”) forms ring-fenced cells issued to other organisations (referred to as the “cell owners”) for the insurance of the cell owner’s own assets or the insurable risks of its client or membership base. Depending on the statutory or contractual conditions in place, the cell owner can draw dividends on the proceeds of the cell, obtain underwriting from the cell captive insurer and benefit from other insurance-related support functions. The cell captive insurer is accountable for all regulatory compliance and holds the insurance licence that covers the business of all the cells.

The cell captive structure emerged as a way for a corporate entity to access the benefits of captive insurance without setting up its own captive insurance company. However, such first-party business is not the only application for the cell captive model. The cell captive structure can also be used to cover the risks of the clients or members of the cell owner. Such structures are referred to as third-party cell captives.

The cell captive mechanism has the potential to help address some of the structural constraints faced by many insurance markets in sub-Saharan Africa, including a fragmented local industry facing constraints in the provision of specialised risk cover to the corporate sector, and, in the retail market, a lack of market innovation. In Mauritius, the cell captive structure is successfully leveraged for first-party insurance. In South Africa (the global pioneer of third-party cell captives) cell captives have demonstrated their ability to drive retail innovation and provide an entry path into the insurance market. Other countries, such as Namibia and the Seychelles, have also developed preliminary regulation, while others are exploring potential use cases for the cell captive structure in their jurisdictions.

This study aims to inform regulators who are considering the introduction of cell captives to their market. Based on desktop research and in-depth consultations with market and regulatory stakeholders, it outlines existing cell captive models, identifies the potential roles to be fulfilled by cell captives and highlights key regulatory considerations. It asks two main questions:

- **Use cases:** What key insurance market constraints are cell captive arrangements able to address and how?
- **Regulatory design:** What are the steps and considerations to design a cell captive regulatory framework to meet the desired use case(s) in a particular country context?

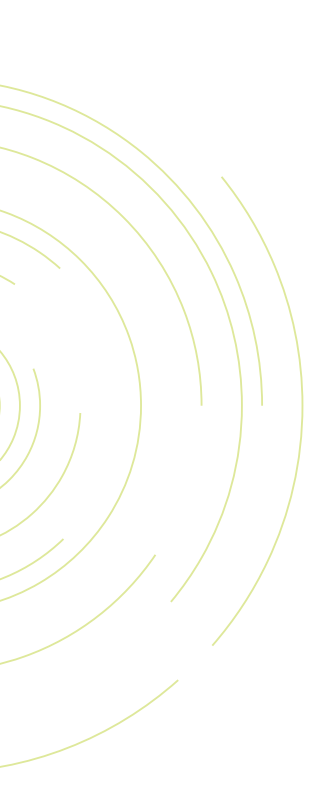
We find that cell captive structures do, indeed, have scope to support the development of insurance markets in emerging economies. They could serve at least four use cases:

- **Specialised risk management.** Cell captives are well suited to bridge the protection gap where local insurance markets cannot meet specialised risk management needs and, in doing so, can help to build local skills. The adoption of a cell captive regime enables corporates to own an insurance cell through which to insure their first-party business. This arrangement enables them to use their own capital to capitalise the

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Cell captives have been one of the most important steps in the evolution of the captive insurance space and have become an integral component of the self-insurance market in many of the established captive domiciles.

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cell and, in return, reap the profits from their own insurance business and tailor the insurance cover to their specific needs. The cell captive insurer centralises the reinsurance component and provides compliance and other services.

- **Retail innovation.** The South African experience illustrates that the third-party cell captive structure creates the incentive for cell owners to innovate to meet the needs and realities of their client/membership base. It does this by allowing them to share in the benefits of insurance, exercise autonomy and operate outside of the legacy systems of insurers, without having to become an insurer in their own right. As such, it is increasingly a vehicle of choice for insurtech ventures.
- **Insurance market participation.** In cases where insurance capacity is constrained or regulators want to avoid further fragmenting the local insurance market by issuing additional licences, cell captive structures can provide an alternative operating space for prospective players as cell owners. Alternatively, it can provide a pathway into the insurance market for prospective new insurance licensees while they build up capital, skills and experience. In this way, it encourages broad-based market participation and can serve formalisation objectives.
- **Offshore financial centre development.** For emerging offshore domiciles, the introduction of cell captive arrangements can be a potential driver of local insurance industry growth. A cell captive regulatory framework can be used to attract multi-national companies (MNCs) or global cell captives/brokers that serve MNCs. In this way, offshore domiciles can generate additional revenue streams for the local economy. Doing so, however, requires a sophisticated regulatory framework that is able to compete with other offshore centres.

Realising the true value of the cell captive structure requires a clear regulatory framework to support its adoption and implementation in a way that is appropriate to the specific local context. Key considerations for regulatory authorities that are considering introducing a cell captive framework include:

- **Use case/policy objectives:** What would be the use case(s) for cell captives given the particular market realities and policy objectives of the country in question? That is: for which market development outcomes is the cell captive considered an appropriate solution?
- **Permitted underwriting functions:** What is the scope of the underwriting functions that cell captives will be permitted to perform – first and/or third party?
- **Regulatory framework elements:** What should the regulatory and supervisory framework cover to ensure the effective introduction, operation and oversight of cell captive structures? A key consideration is what legal structure is needed to ensure appropriate ring-fencing between cells. Further considerations relate to capital requirements, governance structures and elements of supervisory oversight.

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While the cell captive structure is not a panacea, it holds much promise as a vehicle to realise increased inclusion and growth within insurance markets in SSA.

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1 Introduction

This study explores the potential role of cell captives in the development of insurance markets in sub-Saharan Africa (SSA).

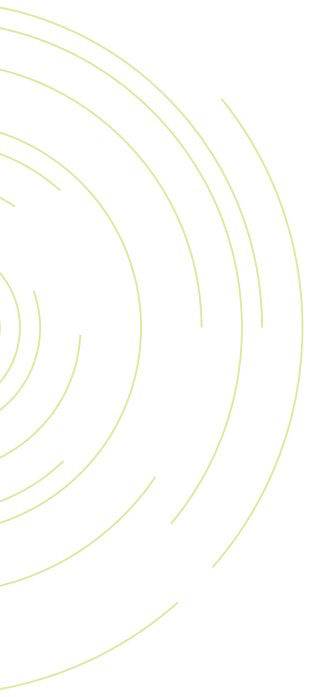
SSA insurance markets facing structural constraints. Across insurance markets in SSA, insurance providers continue to be confronted with challenges that stifle the growth and efficiency of the sector:

- **Highly fragmented insurance markets.** High levels of fragmentation result in many smaller players lacking the necessary capacity in terms of capital and skills to innovate and efficiently offer products that offer both individual consumers and enterprises value. This can hinder the ability of local providers to effectively customise cover for niche corporate risks in the market (Cenfri, 2018a).
- **Informality in the insurance sector.** Many informal players are either unable to break into the formal space or do not see the benefit in doing so, which hinders competition and makes it difficult for regulators to adequately supervise insurance-related activities and achieve real development in insurance markets across SSA.
- **Lack of innovation.** Innovation to better serve retail markets in SSA remains limited, and few insurers have yet been able to tap into alternative distribution channels at scale. Finding alternative distribution partners with the right incentives to develop the necessary distribution channels is often challenging, and this hinders the development of new, innovative insurance solutions.
- **Barriers to establishing offshore financial hub.** There is growing competition among established and newly formed offshore domiciles to attract international corporations and grow the local market. As such, certain offshore jurisdictions in SSA have been unable to achieve the necessary level of market development to disrupt more advanced offshore economies.

Cell captives can help address constraints. Cell captives have emerged as a unique alternative insurance solution with the potential to help address these constraints, in at least four ways:

- As a driver of innovation in retail insurance
- As an enabler of specialised or niche risk cover
- As a tool for insurance market participation
- As a vehicle for promoting the development of offshore financial hubs





Box 1. What is a cell captive?

Globally, cell captive insurance is a relatively new concept that grew out of the captive insurance concept. Captive insurance is a model where a corporate entity self-insures its own assets by setting up its own dedicated insurance licence. Cell captive insurance originated as a means for corporates to do the same but without the need for its own subsidiary licence.

The cell captive concept follows a hub-and-spoke model whereby one central licensed insurer (referred to as the “sponsor” or “promoter”) forms ring-fenced cells issued to other organisations (referred to as the “cell owners”) for the insurance of the cell owner’s own assets or the insurable risks of its client or membership base. Depending on the statutory or contractual conditions in place, the cell owner can draw dividends on the proceeds of the cell, obtain underwriting capacity from the cell captive insurer and benefit from other insurance-related support functions. The cell captive insurer is accountable for all regulatory compliance and holds the insurance licence that covers the business of all the cells.

The cell captive structure thus emerged as a way for a corporate entity to access the benefits of captive insurance without setting up its own captive insurance company. Cell captives have been one of the most important steps in the evolution of the captive insurance space and have become an integral component of the self-insurance market in many of the established captive domiciles. In fact, the growth of such vehicles now outpaces that of traditional captives (Artex, 2019).

Against this backdrop, this study asks two main questions:

- How are cell captive arrangements able to help address key insurance market constraints?
- What is the process by which the cell captive structure can be deployed and regulated to effectively meet local industry requirements in SSA?

Structure. The rest of this paper explains the structure of the cell captive vehicle, explores how cell captives can serve different policy objectives for insurance market development in SSA and outlines a decision framework for regulatory authorities interested in cell captive implementation:

- Section 2 provides an overview of the cell captive structure and landscape: What a cell captive is and how it operates, the different types of cell captives found globally and the landscape of cell captive insurers and cells across international and SSA jurisdictions.
- Section 3 unpacks the use cases for cell captives in the context of key market development policy objectives in SSA.
- Section 4 provides a step-by-step breakdown of considerations faced by decision-makers in determining an appropriate cell captive structure and regulatory framework to meet contextual needs and policy objectives.



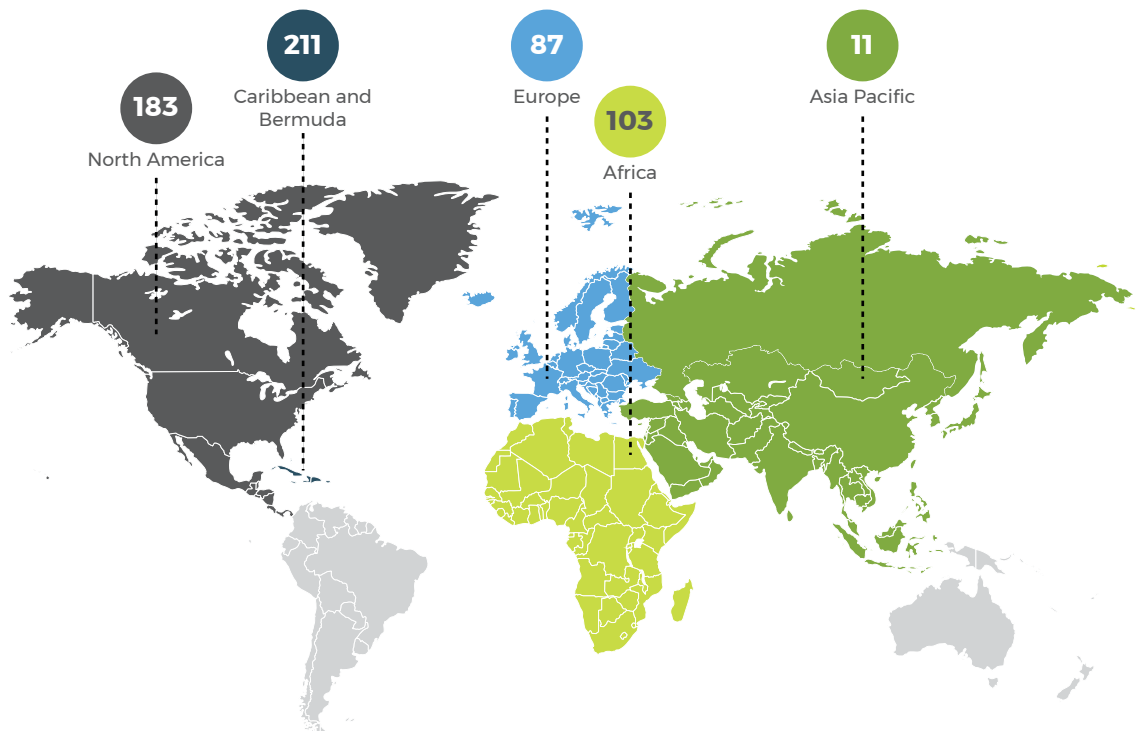
2 The evolution of cell captives

Cell captive structures have manifested in various ways across the domiciles in which they have been adopted. This section provides an overview of the global landscape of cell captives, unpacks the inner workings of the cell captive structure, outlines how cell structures have evolved to cover a range of risks beyond just self-insurance and provides an overview of the different regulatory frameworks for cell captives found globally.

2.1. The global landscape of cell captive insurance

A growing phenomenon. In the last 20 years, the concept and use of cell captives has become increasingly widespread. In 2017, the number of active cell captive companies worldwide stood at 596 spread across 39 active cell captive domiciles (Captive Review, 2017). See a breakdown by region in Figure 1. Together, these structures accounted for gross annual cell premiums of USD3.4 billion (Captive Review, 2017). As the level of sophistication continues to increase, cell captives are likely to become an even more effective and efficient structure for managing risk across a more diverse range of territories and local market contexts.

Figure 1: Number of active cell captive insurance companies by region



Source: Captive Review, 2017



Domicile choice: from tax considerations to regulatory sophistication.

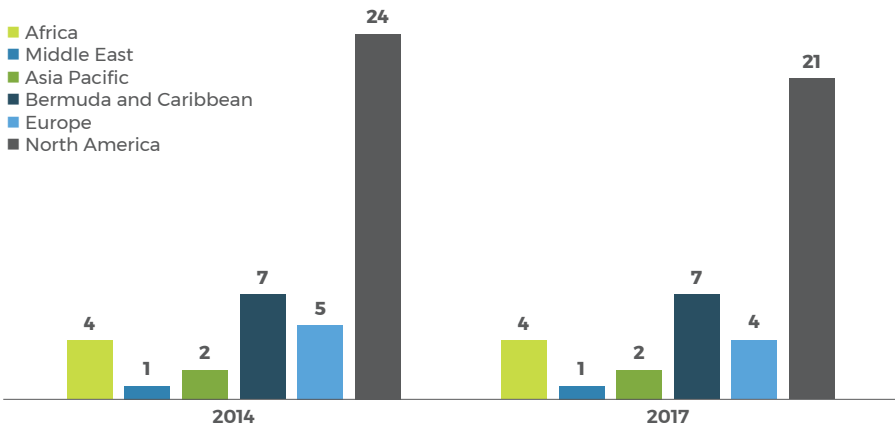
Traditionally, organisations sought to utilise cell captives domiciled in offshore centres for tax purposes, including benefits such as zero taxes on premiums and double tax treaties in certain domiciles (Byrnes, 2011). However, this is no longer a primary consideration, meaning that the structure is spreading beyond the traditional offshore centres. According to stakeholder consultations, the quality and progressiveness of the legislative environment, as well as access to key markets, are more important factors than any significant tax benefits.

US and Caribbean domiciles largest adopters of cell captives.

As Figure 1 and Figure 2, indicates, domiciles in North America¹ and Bermuda and the Caribbean dominate the global cell captive landscape. In fact, domiciles in North America account for 31% of global cell captive companies, and Bermuda and the Caribbean for 35%. North America has the highest number of active cells in operation, at 2,174 compared to the 900 active cells in the Bermuda and Caribbean region (Captive Review, 2017).

Cell captives still nascent in SSA. At present, cell captives, have yet to be extensively explored or implemented across the SSA region. Currently, only South Africa, Mauritius, Namibia² and the Seychelles³ have regulatory frameworks in place to accommodate cell captive structures.

Figure 2: Number of cell captive domiciles per region



Source: Captive Review, 2017

2.2. The cell captive structure

2.2.1. Parties and roles

Cell captive parameters set out in statutory legislation or contractual agreement. A cell structure is created by an agreement between a cell owner and a cell captive insurer. The cell provider and cell owner agree on the parameters of the relationship, ensuring the expectations of both parties are met and regulatory standards adhered to. The nature of the cell parameters is either determined on a contractual basis between the two parties or under regulatory structures entrenched in companies legislation.

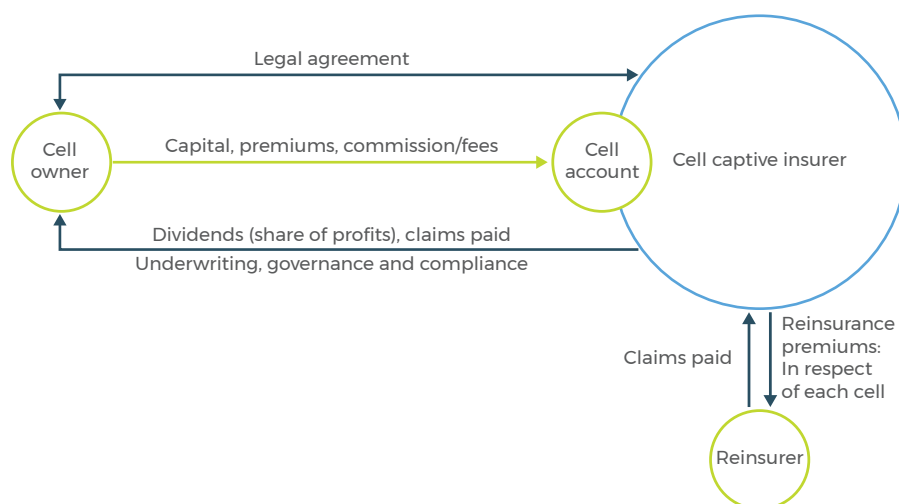
Various parties. A cell captive structure will always have a cell captive insurer and a cell owner. Most cell structures also involve a reinsurer and may involve third-party service providers such as underwriting managers, brokers or administrators. Figure 3, on the next page, outlines the main parties and roles in the cell captive structure.

1 Cell-captive domiciles operate at State level in the USA. As a result, the USA accounts for not one, but several independent cell captive domiciles.

2 Namibian authorities have developed a cell captive standard under the Financial Institutions and Markets Act, 2017.

3 Stakeholder consultations revealed that authorities in the Seychelles are actively exploring the potential of cell captives to spur product innovation in the market and attract improved revenue flows from offshore companies.

Figure 3: Cell captive structure



Source: Cenfri, 2018

Insurer renders services to the cell, assumes compliance accountability; cell owner provides capital and reaps economic benefits. As depicted in Figure 3, the cell captive insurer renders various services to the cell owner, depending on the nature of the relationship between the parties, in return for a fee paid out of the cell account. These services include administration, product design and underwriting, as well as actuarial services (Cenfri, 2018c). Arguably the most important function is that the insurer assumes the accountability for the actions of all the players in the arrangement from a regulatory compliance point of view. Premiums flow from the cell owner to the cell account, and claims are paid back to the cell owner. On the balance sheet side, the cell owner capitalises the cell account and earns dividends on its shares in the cell captive insurance company (Hancock, 2013). Thus, it participates directly in the economic benefits of the insurance conducted under the cell structure.

2.2.2. Risk structures

Self-insurance origins. As discussed, the origins of cell captive insurance lie in first-party risks. A first-party⁴ cell structure is used where a cell owner wishes to insure its own operational risks (FSCA, 2018). In this instance, the cell owner is the policyholder and beneficiary under the insurance policy issued by the cell captive insurer. Claims under the policy are limited to funds available in the cell structure, and the cell owner reaps the benefits via dividends drawn from the cell captive insurer.

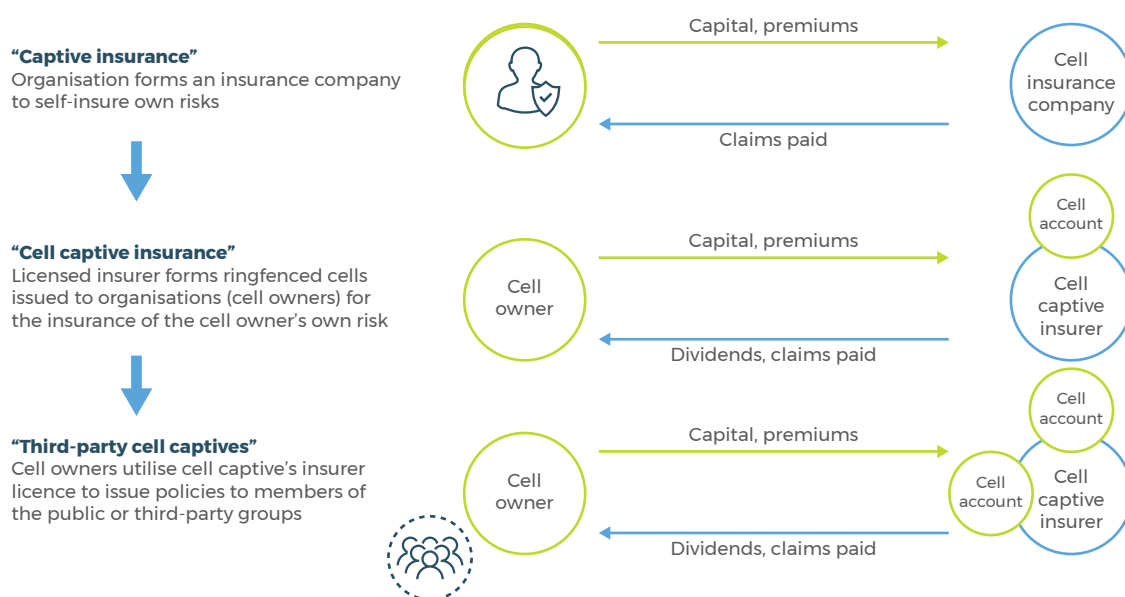
Extension to third-party risks. Over time, the cell captive structure has evolved to enable a cell owner to extend the functions of the cell beyond first-party risks (see Figure 4). Under a third-party cell captive model, a cell owner utilises the cell captive structure to cover the risks of third parties, namely its customers or members. The only difference with the “standard” cell captive structure presented in Figure 3 is that policies are issued via the cell to members of the public. Such policies can be either life or general insurance policies. The third parties covered can be members of an affinity group (such as members of a cooperative or association) or the clientele of the underlying business of the cell owner.

Growing recognition of third-party structures. While many jurisdictions around the world cater for cell captive insurance in their regulatory frameworks, this appears to be mainly limited to first-party cell captive business, and the accommodation of third-party arrangements is a more recent phenomenon. In the SSA region, South Africa has made regulatory provision for third-party cell captive insurance business alongside first-party

⁴ First-party business is defined under the Insurance Act and means “in respect of a cell captive insurer, the operational risks of the cell owner and the operational risks of (a) the group of companies of which the cell owner is a part, (b) any associate of a company that is part of the group of companies referred to in subparagraph (i); or (c) any joint arrangement that a company that is part of a group of companies referred to in subparagraph (i) participates in”.

business and is a pioneer in the application of the third-party cell captive model globally. Furthermore, Namibia has developed a regulatory standard that supports cell captive insurance business.

Figure 4: Evolution of captive insurance



Source: Authors' own

Various applications in South Africa. The current cell captive landscape in South Africa comprises more than a dozen cell captive insurers that, together, have a cell base of well over 300, of which around 70% are third-party cells (Cenfri, 2018c). Various applications of this model have evolved, including for white-labelled insurance offerings distributed via auto-dealer chains, cellphone chains or clothing retailers, who are then able to share in the profits of the insurance provided to their customer base without the need to acquire their own insurance licence. The structure is also increasingly used by insurtech ventures for the flexibility it provides outside of the legacy systems of insurers and has become a hub for insurance innovation in South Africa⁵.

Broader SSA retail market participation and innovation potential.

Despite the application currently being limited to South Africa, and to a lesser extent Namibia⁶, the business case for third-party cell captives is more broadly applicable throughout SSA. In emerging markets like in SSA, where traditional distribution channels like brokers, agents and bancassurance are usually costly and limited to urban areas, third-party cell arrangements can be an appealing market participation option for organisations/businesses serving previously excluded target markets. Section 3 will return to the question of how third-party cell captives could be applied to some of the common insurance market development problems in SSA.

5 Third-party cell captives as an enabler for transformation in the insurance sector (Cenfri, 2018c)

6 Stakeholder consultations indicate that Mauritius is currently exploring the incorporation of third-party business to its cell captive framework.

7 Also known as a segregated portfolio company, a separate accounts company or a private act company, depending on the domicile.

2.3. Regulatory structures

One of the key regulatory principles that guide cell captives is the separation of assets and liabilities across cells. Three main types of regulatory models have emerged, globally, to ensure such separation: the protected cell company (PCC)⁷ structure (which is the most well known); the incorporated cell company (ICC) structure; and the shareholder participation agreement (SPA) structure.



2.3.1. Protected cell company (PCC)

A PCC structure is established in companies legislation and is used to give effect to cell captive insurance. PCCs were first introduced in Guernsey in 1997 and since then have continued to evolve to become one of the most widely used cell captive structures. The PCC as a legal, corporate entity, enables assets and liabilities to be segregated and protected across cells within the company, also called the “core.” Each cell is legally independent from the other cells and often from the main core itself. Therefore, each protected cell’s finances must be separately accounted for on the books of the core company. With this structure, the assets of one cell cannot be affected by the liabilities of another. It is worth noting that while the PCC (or ICC in the next sub-section) governs the overall company structure, the incumbent insurance regulatory framework will still apply to the provision and distribution of insurance through the structure (Captive Review, 2017).

The preferred cell captive arrangement globally. PCCs account for around 95% of the total cell companies as outlined in Section 2.1. One of the reasons for the popularity of the PCC is that they provide participants with the benefits of a pure captive’s risk management at a potentially lower cost and overhead (Willis, 2008).

In SSA, only Mauritius currently has an operational PCC insurance structure in place, though the underlying companies legislation also exists in the Seychelles.

2.3.2. Incorporated cell company (ICC)

ICCs are a variation of the PCC structure where each individual cell is incorporated and is considered its own separate legal entity. The core company and the incorporated cells must file separate tax returns and each is required to meet the minimum and maximum premium tax limits as legislated by their domicile. The cells segregated by this structure are considered to have “higher and thicker” walls that separate them from one another (Hyatt, 2014). Furthermore, unlike in PCC legislation, individual incorporated cells can transact with one another and exchange assets. ICC legislation also clarifies and facilitates the conversion of cells into fully fledged captives and vice versa and provides participants with greater flexibility in the way they operate their segregated accounts (Willis, 2008).

2.3.3. Shareholder participation agreement (SPA) cell captives

It is possible for cellular structures to exist without dedicated companies legislation to support them. One example of this is the shareholder agreement cell facility, which operates on the same basis as a PCC, but without the statutory protections entrenched in companies legislation. The individual cells are segregated contractually, via the shareholders’ participation agreement entered between the cell captive insurer and each individual cell owner. This structure is found in South Africa and, at the time of writing, was under development in Namibia. In the case of South Africa, apart from the shareholder participation agreements, cell captive arrangements are also subject to specific licence requirements placed on the cell captive insurer, as well as specific prudential and market conduct requirements included in the insurance regulatory framework. The appendix outlines the evolution of cell captive regulation in South Africa⁸.

8 Third-party cell captives as an enabler for transformation in the insurance sector (Cenfri, 2018c)



3 Cell captive use cases for sub-Saharan Africa

While it is not the only solution, the cell captive mechanism can help to address a number of the constraints that insurance market development faces in SSA, as outlined in Section 1 – if implemented alongside other enabling environment and market development initiatives. This section outlines four practical use cases for the cell captive arrangement to contribute to insurance market development policy objectives in SSA:

- Bridging local capacity gaps to cover specialised risk needs
- Facilitating retail innovation by changing incentive structures
- Diversifying insurance market participation without the need for additional insurance licences
- Helping to develop an offshore financial centre to expand the reach of the insurance industry beyond local market demand

3.1. Specialised risk management

As discussed, the original – and globally still most prevalent – use case for cell captive facilities is for corporates that wish to have a direct-writing or reinsurance facility without the need to establish a separate captive insurance company. Organisations that face niche or complex risks that are not effectively met by available insurance policies on the market are prime candidates to establish a cell to tailor insurance covers to their specific risks.

Constraints to specialised corporate cover. In certain markets, insurers are unable to customise cover for niche corporate risks, meaning that specialised corporate risks go uncovered or that large corporate premium volumes flow offshore, largely via the reinsurance market. This is due to capital constraints and, more broadly, a lack of skills and capacity. This lack of skills contributes to difficulties for large corporates to access tailored cover locally – something that is exacerbated where localisation requirements apply that limit to the flow of premiums offshore. Where local capacity is limited but local content requirements apply⁹, this may lead to fronting and/or drawn-out offshoring applications that incur efficiency costs and create gaps in coverage. It may also lead to unsustainable business practices in the local insurance market whereby local insurers or insurance pools take on larger risks than are warranted by their capital base and technical expertise¹⁰.

Cell captives can help to bridge the gap. Cell captives are well suited to bridge the protection gap where local insurance markets cannot meet specialised risk management needs and, in doing so, can help to build local skills. The adoption of a cell captive regime enables corporates to own an insurance cell through which to insure their first-party business. This arrangement enables them to use their own capital to capitalise the cell and, in return, reap the profits from their own insurance business and tailor the insurance cover to their specific needs.¹¹ The cell captive insurer centralises the reinsurance component and provides compliance and other services. Box 2 provides an example of the potential benefits of such an arrangement:

9 A number of governments in SSA have instituted local insurance content requirements requiring explicit approval for offshoring of risks.

10 For example: in Nigeria the size of the oil-and-gas-sector and the risks involved are perceived to present a lucrative market opportunity for insurance companies, where the local content regulations in principle protect insurers from foreign competition. However, in practice, the insurance industry does not have the capacity to cover the full scope of oil-and-gas risks in Nigeria. Interviews with stakeholders suggested that some insurance companies have limited capacity to honour claims and that the sector struggles to address particularly large risk events and claims (Cenfri, 2018b).

11 For large industries, this could also take the form of a mutual cell captive, where the cell captive insurer is owned jointly by the cell owners. For large corporates, an alternative to the cell captive route could technically be to set up an insurance licence (to establish a captive insurer), but that would require meeting the full insurance licensing requirements. This option is unlikely to be viable or desirable for most corporates in SSA.

Box 2. The potential of cell captives to support the coverage of large oil-and-gas risks: the case of Ghana

In Ghana, a recent insurance diagnostic study (Cenfri, 2018a) showed that certain sectors of the economy (such as oil and gas or the energy sector) are unable to fully access appropriate insurance policies from the local insurance industry due to the market's lack of capacity to cover large, specialised risks. This situation is likely to continue with the expected increase in the growth of the Ghanaian oil and gas sector. At the same time, local content requirements imply added costs and procedures for local corporates to access foreign cover. Cell captive arrangements could, in principle, address this constraint by allowing corporates to capitalise a cell account to self-insure their risks via a cell captive arrangement, tailoring the coverage to meet their specific needs. Should this be the case, the cell captive arrangement would be hosted by a local insurer licensed for this purpose, with centralised reinsurance arrangements as appropriate, and would serve to crowd in capital from the large players in the extractive industries for each cell.

3.2. Retail innovation

Across SSA, retail insurance innovations remain limited and few insurers have been able to tap into alternative distribution channels at scale. This means that insurance still plays a limited role in building household resilience on the continent (Thom, et al., 2019). Cell captives, specifically third-party cell structures, can facilitate insurance product and distribution channel innovation by allowing innovators in the insurance value chain to retain control and share in the profits of the insurance products without requiring an insurance licence of their own.

Low product diversification. Insurance product suites remain limited in many SSA countries (Cenfri, 2017). Insurers often find it challenging to design products for the underserved market that are tailored to their context-specific needs. Insurance products created for middle- or higher-income customers are not necessarily relevant for the realities of a low-income customer who faces different circumstances and risks.

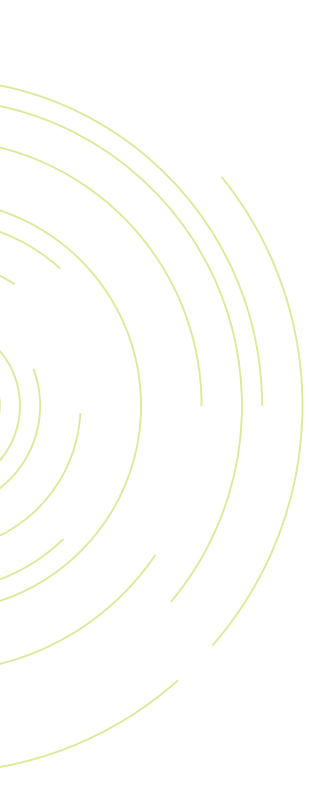
Enhanced innovation incentives. Third-party cell captive structures can be a conduit for innovation in the retail space, in at least two ways:

- **Enabling cell owners to share in economic benefits.** Through the acquisition of a cell account in a cell captive structure, cell owners can share in the underwriting profits generated by the insurance policy, but without having to meet the full capital and operational requirements of setting up an own insurance company. This may attract new types of players with new ideas into the insurance space. This could include MNOs, retailers or other client aggregators, who serve an existing client or membership base and feel entitled to the profits from their underlying client base, yet do not have the appetite or resources to set up an insurance subsidiary. For such entities, the return on investment earned in the form of dividends on the shares in the cell captive provider is attractive compared to the alternative of being a pure intermediary or distribution partner (Cenfri, 2018c).
- **Increased autonomy and control over insurance value chain.** From the cell owner's perspective, a large part of the attractiveness of the cell route lies in the ability to design products and structure and integrate the value chain in a way that meets its business purposes. Entities with an existing client or membership base want autonomy in shaping the

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Insurers often find it challenging to design products for the underserved market that are tailored to their context-specific needs.

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product offering to fit their clients' or underlying business's specific needs and circumstances. The cell structure allows the cell owner to structure the product offering and value chain functions to fit its needs, and to do so without being constrained by the legacy IT and other systems and processes typically found in traditional insurance companies. In the case of South Africa, this has meant that the cell captive vehicle has become a preferred space for retailers' insurance offerings, as well as for insurtech-driven innovators (Cenfri, 2018c).

By allowing the cell owner to share in the economic benefits of the insurance and through the autonomy offered by the structure, the cell captive structure means that players are incentivised to develop innovative, cost-effective products and distribution channels that best meet the needs of local retail markets. Furthermore, the entry of new, innovative actors can prompt existing market players to invest more into their own innovation (Cenfri, 2018c).

Box 3. Third-party cell structures a catalyst for innovation in the retail insurance space

In South Africa, the cell captive vehicle plays an important role alongside traditional insurance models to facilitate retail innovation.

A good example of a third-party cell captive innovation in the South African market is SA Taxi. SA Taxi provides credit to finance the purchase of minibus taxis. Based on the needs of its customer base and the fact that existing insurance offerings were not tailored to its customers' unique needs and realities, it decided to branch out into the provision of insurance cover to its clients. It wanted autonomy in the design of its offering to fit the realities of its particular customer base, but lacked in-house insurance experience and expertise. Thus, SA Taxi opted to acquire a cell with Guardrisk, the largest South African cell captive insurer, rather than set up its own insurance licence. This allowed it to focus on the customer-facing components of the insurance value chain, with Guardrisk fulfilling the other value chain functions, carrying the risk and ensuring compliance. Over time, as they gained experience, SA Taxi was able to take on more value chain functions.

The cell captive arrangement has enabled SA Taxi to fully engage its large client base of just over 31,000 individuals in the taxi industry (SA Taxi, 2019). It incentivised the company to design appropriate products to meet the needs of its customers at an affordable rate, while simultaneously supporting the financial viability of its underlying credit business model. Given SA Taxi's proximity to its clients, it has over time identified further customer needs, such as life insurance cover for the dependants of taxi drivers, and has expanded its product range to also accommodate such needs (Cenfri, 2018c).

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The cell captive structure affects market participation by fulfilling an “incubation” role into the insurance market for new players, either to become cells on a permanent basis, or to eventually become insurance licence holders themselves.

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3.3. Insurance market participation

The cell captive structure affects market participation by fulfilling an “incubation” role into the insurance market for new players, either to become cells on a permanent basis, or to eventually become insurance licence holders themselves. Either of these pathways to market participation can simultaneously serve formalisation objectives:



- **Broader market participation without need for additional licences.** In cases where capacity is constrained or where regulators want to avoid further fragmentation of the local insurance market by issuing additional licences, the cell captive structure can provide an alternative means of market participation to an own insurance licence. The nature of a cell captive arrangement means that several players can utilise a single insurance licence by establishing a cell account within a cell captive insurer.
- **Graduation pathway for potential new licensees.** Cell captive structures can also help new players to enter the insurance market, by gradually upskilling and building up capital to the point where it is feasible for them to acquire an insurance licence of their own. In addition to carrying the prudential risk, the cell captive structure enables the centralisation of compliance and reporting, as well as pricing and other skills, thereby reducing operational cost and risks for potential market entrants. For those cell owners that have the ambition to become an insurer in their own right, but that do not yet have the systems, skills or experience to do so, it thus provides a graduation path to fully-fledged insurer status.
- **A potential formalisation pathway.** In the absence of social protection and commercial insurance coverage, numerous informal insurance schemes have emerged across SSA (Microinsurance Network, 2015). Many informal players are unable or unwilling to break into the formal sector¹². Persistent informality not only hinders competition but makes it difficult for regulators to protect consumers. By providing a lower-bar entry space, as well as a means of reaping economic benefits without the need for an own licence, cell captives can serve the formalisation objective – with cell ownership serving either as a stepping stone towards full insurer status, or as an end-destination in itself (South African National Treasury, 2011).

¹² The prevalence of informal insurance schemes in SSA suggests that existing laws and regulations are in some ways preventing inclusion into the formal insurance market (African Insurance Organisation, 2017). High capital requirements, for instance, can impede the entry of regulated insurance institutions dedicated to the low-income market. In cases where reporting and disclosure requirements, originally designed for large insurance companies with complex structures, are imposed on smaller market players operating at the lower-income end of the market, costs are likely to become unsustainable. As a result, players may elect to continue operating informally to avoid having to comply with stringent regulations and compliance requirements i.e. comprehensive reporting, internal controls and actuaries. Operating informally, however, does limit access to additional sources of capital or reinsurance, which ultimately inhibits their growth and makes it difficult for them to achieve economies of scale and extend coverage to the unserved markets.

¹³ The Protected Cell Company (PCC) Act 1999 in Mauritius came into force in January 2000 (Ertner, 2017)

Box 4. Cell captives as formalisation pathway: the case of South Africa

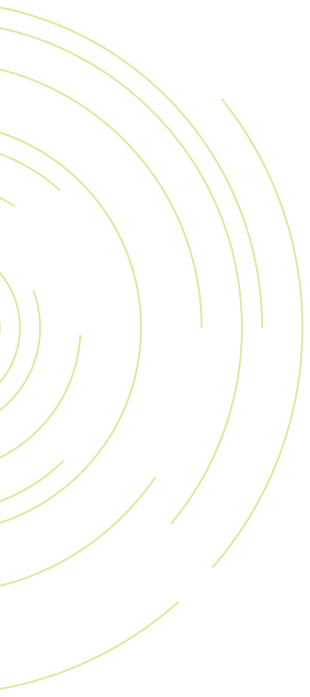
The South African Microinsurance Regulatory Framework (2011) outlines the South African approach to facilitating the formalisation of microinsurance entities that are operating without a licence. To accommodate legitimate new entrants who cannot immediately put up the required minimum capital, the paper noted that it is important from a formalisation-and-enforcement point of view that a graduation path be provided towards full compliance, rather than entities continuing to operate informally. One of the pathways put forward is to enter into a cell captive arrangement that meets the requisite regulatory requirements (South African National Treasury, 2011). Since then, the cell captive structure has been used to incorporate a number of funeral parlour groups and burial societies that previously operated informally into the formal market. In at least one instance, the end-result was graduation to a full insurance licence.

3.4. Helping to develop an offshore financial centre

The use of alternative risk strategies such as cell captives in offshore domiciles has been well documented over the years (Hyatt, 2018).

Growing interest from emerging offshore domiciles in Africa.

For emerging offshore domiciles, the introduction of cell captive arrangements can be a potential driver of local insurance industry



growth. In the African context, two offshore financial markets stand out: Mauritius and Seychelles. Mauritius and Seychelles boast the traditional advantages of offshore financial centres in the Indian Ocean, i.e. no capital gains tax, no withholding tax, no capital duty on issued capital, confidentiality of company information, exchange liberalisation and free repatriation of profits and capital (Mondaq, 2011). Mauritius is already utilising cell captives to extend its position as an offshore hub for African markets to the insurance sector, based on a PCC framework¹³. It adheres to international insurance standards and relies on sophisticated systems for the administration of capital in cells (FSC, 2000). Seychelles has similar aspirations, and regulators are in the process of developing a regulatory framework to support the use of cell captives in the local market. PCC companies legislation has already been introduced, but the regulatory framework remains nascent beyond the definition of PCCs and the approval of licensing (SEYLII, 2003).

Competition from established offshore centres may limit market development impact. Establishing a market as an offshore financial centre relies on the creation of a framework that domiciles insurers in one's market while enabling these insurers to cover risks in other jurisdictions via the provision of cover to multinational corporations (MNCs). This provides a way to grow the local insurance industry beyond the demand from the often-small domestic market. To do so, a country would need to compete with established PCC domiciles in terms of the soundness and sophistication of their insurance regulatory frameworks. Consultations with international cell captive players suggest that this may be challenging for emerging offshore centres in sub-Saharan Africa. Whereas cell captives in jurisdictions such as Guernsey, for example, can cover risks of enterprises in other European jurisdictions, few SSA countries permit cross-border risk coverage. Hence a cell captive licensed in one African market would in most instances not strictly be permitted to cover risks that arise in another SSA country, unless it pertains to companies domiciled in its jurisdiction. This means that, unless an emerging or aspiring offshore centre already has a strong base of MNCs registered locally, together with a sophisticated regulatory framework, this use case is unlikely to deliver the desired level of market development impact.

Box 5. Key considerations for offshore cell captive domiciles

There is growing competition among established and newly formed offshore cell captive domiciles to attract international corporations and grow the local insurance market. There are several key considerations for decision-makers as they shape their regulatory approach (Cutts-Watson, 2015):

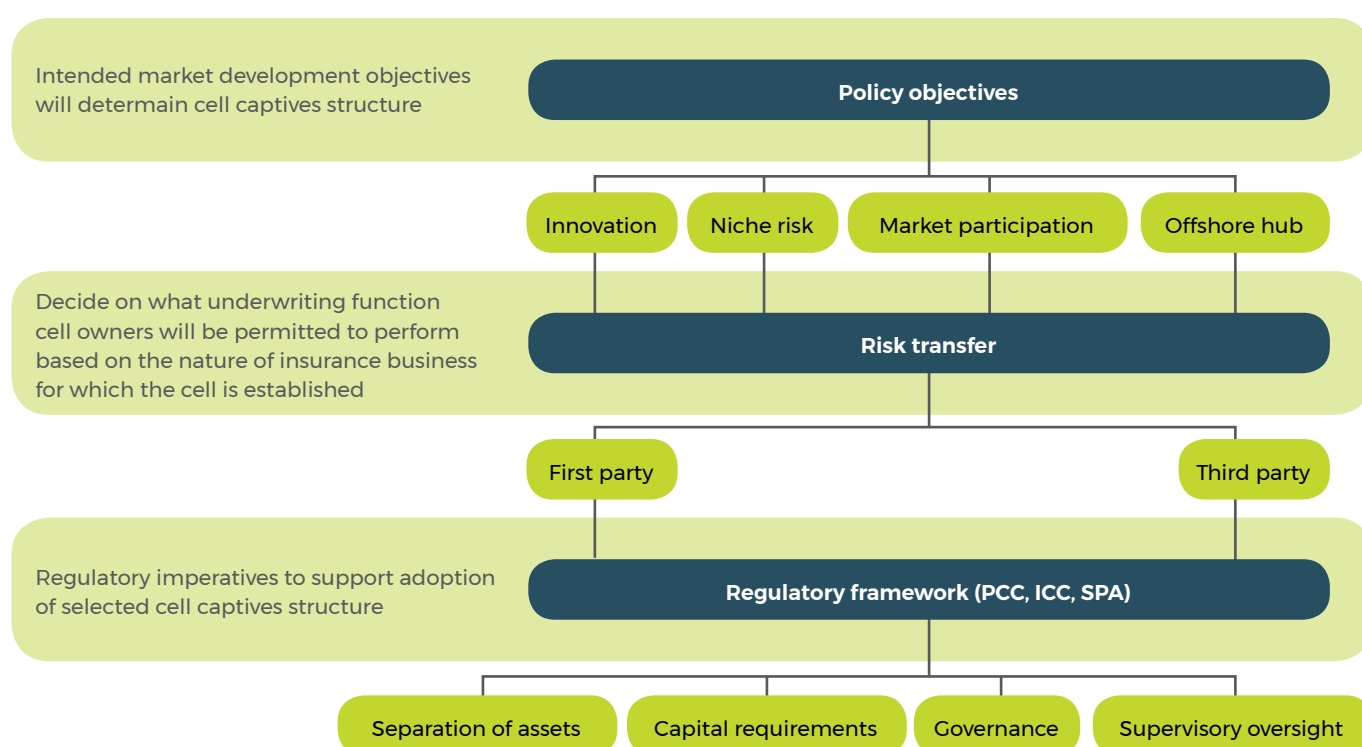
- Successful offshore domiciles benefit from regulators that have significant cell captive expertise, or the capacity to acquire the necessary skills, to achieve competitiveness.
- Innovative, sophisticated regulation supplemented by strong supervisory capacity and ongoing management processes (i.e. a long-term vision and business continuity) are important in convincing international organisations to choose a particular offshore domicile.
- The overarching attitude of regulators (i.e. a pro-business approach) can be crucial in attracting multi-national companies.
- Formulating a well-constructed marketing and promotion plan that underlines the main value proposition and key market differentiators compared to other domiciles.

4 Choosing a model to meet policy objectives

Although not yet widespread in SSA, there is clear potential for the cell captive structure to serve several of the use cases in SSA as outlined in this document. As the analysis has also shown, there are various ways in which this structure can be established and regulated. If a jurisdiction in SSA is interested in introducing cell captives to the local market, what is the best regulatory framework in which to do so to fit the local context? And what are the key considerations in reaching this decision?

Decision tree framework. Figure 5 maps the key considerations for a regulator in choosing and designing a context-appropriate cell captive regulatory framework:

Figure 5: Cell captives decision tree



Source: Authors' own

Below, we unpack each consideration:

4.1. The policy objective to be served

The first consideration is what the market development outcomes or policy objectives are that the cell captive vehicle should serve. As outlined in Section 3, we identify four primary policy use cases for cell captives:

- Specialised risk coverage
- Product and distribution innovation
- Insurance market participation
- Developing an offshore financial centre

The use case(s) inform subsequent decisions relating to risk transfer and regulation of the cell captive structure.

4.2. The risk transfer functions to be performed

The second key consideration is the main risk transfer role that the cell captive structure should serve towards the intended use case, namely first party and/or third party. As discussed in Section 2.2, the cell structure can be used to directly cover risks of the cell owner (first-party risks). Alternatively, the cell owner may choose to underwrite the risk of third parties such as affinity groups or members of the public that form its client base. It is important that the regulator specifies upfront which underwriting function(s) apply and who ultimately bears responsibility for the risk being transferred. This depends on the identified use case(s): the specialised risk cover and offshore centre use cases will require only first-party cover, while third-party cover is needed for the retail innovation and market participation or formalisation use cases.

Separation of business to avoid conflicts of interest. Where the decision is to allow both first-party and third-party risk coverage, a further consideration is whether both types of underwriting should be allowed within a single entity. Where single cells are permitted to conduct both first-party and third-party business, operational risk tends to increase. Furthermore, where third-party cell captive insurance business is undertaken in addition to traditional insurance business, there is an inherent risk of conflicts of interest arising¹⁴. A dedicated focus on third-party cell captive insurance business mitigates such operational risk, and for this reason it may be prudent from a regulatory and commercial perspective to require that third-party cell captive business be conducted in a separate legal entity, as is the case in the South African cell captive regulatory framework (FSCA, 2018).

4.3. What regulatory framework would be most appropriate?

The final consideration is what regulatory framework to employ to give effect to the intended purpose and risk transfer structure as determined above. We identify four broad regulatory criteria that form part of an overarching regulatory strategy for cell captives, each of which is discussed below:

- Separation of assets in cell captive structure
- Capital requirements
- Governance
- Supervisory oversight

4.3.1. Separation of assets in cell captive structure

The segregation of the assets and liabilities of each individual cell is core to the cell captive concept. The ability to separate risks by lines of business, geographic region or risk/responsibility centres can be an attractive tool for prospective cell owners (Hyatt, 2014). From a regulatory perspective, creating clear parameters around the legal separation of cellular assets and liabilities and ensuring that adequate recourse mechanisms are in place are key considerations in ensuring sustainable cell captive operations (Murray, 2016). Thus, it is important to assess the legal strength of the “walls” separating assets and liabilities between cells. There are two main ringfencing options: statutory and contractual.

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It is important that the regulator specifies upfront which underwriting function(s) apply and who ultimately bears responsibility for the risk being transferred.

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¹⁴ Refer to FSCA (2018) for further details on why and how such conflicts of interest manifest.

PCC and ICC structures ensure statutory ring-fencing. Protected and incorporated cells are both statutory creations meant to be “holding pots” to cover the risk of their clients (see Section 2.2). Both structures operate similarly in the sense that they will each hold assets to satisfy specifically delineated risks. Unlike in an SPA cell structure, however, the risks of each cell are statutorily ring-fenced or firewalled (Captive Review, 2017). While the PCC and ICC structures appear similar in many ways, there are several key differences, captured in Table 1, which should be considered before introducing one or the other into a market.

According to the expert interviews conducted for this study, the ICC structure is mainly geared to provide cover for infrequent, niche risks, with their higher cost and administrative burden being similar to that of a traditional captive insurer. As a result, as discussed in Section 2.1, PCCs rather than ICCs remain the most prevalent structure globally.

Table 1: Differentiation between ICC and PCC structures

Incorporated cell company (ICC)	Protected cell company (PCC)
The ICC and each cell is a separate legal entity.	The PCC is a single legal entity.
Liability is limited by structure (separate legal personality of cells).	Liability is limited by the ring-fencing principle.
Cells can contract because of separate legal personality. The ICC shall not have the power to contract on behalf of a cell by virtue of it being the ICC.	PCC directors transact on behalf of the cell. Directors are obliged to notify and record when contracting for a cell.
Claims limited to assets of that cell. No recourse from ICC assets is envisaged.	Directors to properly separate cellular assets. Primary recourse is to cellular assets. If cellular assets are exhausted, secondary recourse from non-cellular assets may be available.
Does not enable capital leverage for insurance solvency purposes.	Enables capital leverage for insurance solvency purposes.

Source: PWC, 2011

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According to the expert interviews conducted for this study, the ICC structure is mainly geared to provide cover for infrequent, niche risks, with their higher cost and administrative burden being similar to that of a traditional captive insurer.

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SPA structure relies on contractual ring-fencing. Under the SPA cell captive arrangement, assets and liabilities are contractually ringfenced. This means that all liabilities of the cell captive insurance company can, in principle, be sued for or executed-upon against the company and its assets (Feetham & Jones, 2010). Furthermore, upon insolvency contractual provisions may not necessarily be respected in all cases. This means that there may theoretically be contagion across cells, despite the contractual ring-fencing introduced by the SPA. However, as the South African experience as outlined in Box 6, this is not necessarily the case in practice, and there may also be strong arguments in favour of contractual rather than statutory ring-fencing.

Box 6. South African regulators remain proponents of SPA structure

In South Africa, cell captive structures continue to be shaped by SPA arrangements, despite the reservations around the legal ring-fencing of assets and liabilities between cells as outlined above.

In the view of the South African Prudential Authority (PA), an SPA arrangement enables risk pooling to remain a key feature of insurance business in the country, and the legal ring-fencing of parts of the third-party insurance business within an insurer would run contrary to the very nature of insurance. It is argued that, third-party policyholders contract with the insurer based on, among others, reputation and size. They do not contract with a cell owner. These policyholders are unaware of the potential risks to them associated with limited liability, and disclosure thereof does not appropriately mitigate these risks (FSCA, 2018).

As a result, the PA in 2018 reconfirmed that it would continue to rely on SPA arrangements for the cell captive regulatory framework. It is confident that this approach will allow for the benefits associated with PCC legislation to be achieved while affording adequate protection to policyholders.

Market context shapes the type of ring-fencing needed. The specific market context would inform what the most appropriate ring-fencing framework would be. In Ghana, for instance, explicit standards on the separation of assets and liabilities in cell structures are likely to be needed to convince corporate players of their benefit. Hence, a PCC would be most appropriate to give effect to the specialised risk cover use case. However, introducing a PCC framework may only be feasible in the medium term, as the concept is yet to be accommodated in insurance and companies legislation. In the meantime, an SPA framework that builds in clear ring-fencing may be appropriate to serve immediate retail market development objectives, notably the innovation use case.

4.3.2. Capital requirements

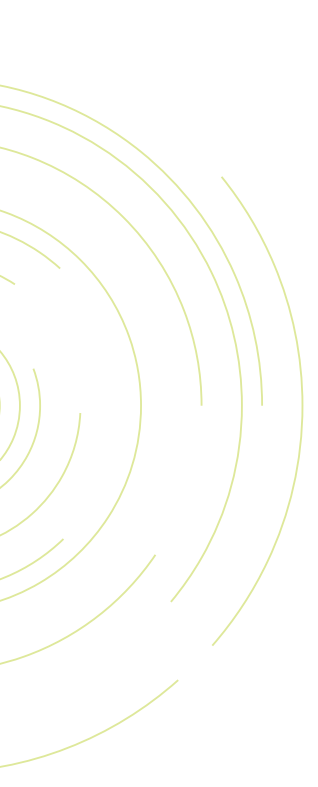
As more corporates and SMEs turn to cell captives as an alternative risk transfer solution, and as third-party cells cover larger customer bases, ensuring that the actors within the arrangement be sufficiently capitalised to support the risk they assume becomes systemically important. Ultimately, capital requirements will be determined by a combination of cell captive funding needs and the domicile's statutory requirements (Mesquite Captive, 2019).

Capital sourcing requirements. A first regulatory consideration is what the permitted source(s) of capital would be. There are two main cell capitalisation arrangements, internationally. The first is where the cell is capitalised by the cell owner, and the second where a cell is capitalised by the cell captive insurer or reinsurer (Cenfri, 2018c). The first serves to crowd in capital from the cell owner. The second applies where the cell owner may be unwilling or unable to tie up the necessary capital in the cell account. If this is the case, and regulation permitting, the cell captive insurer or reinsurer could agree to pre-fund the cell account for a fee, with capital then being built up as cell operations grow. Regulators may want to consider practical cases where each capitalisation arrangement has been implemented. For example, Namibia allows both options, while South Africa prohibits the latter¹⁵.

Minimum capital requirements for financial soundness of individual cells. A second capital-related consideration is the minimum level of capital to be held. Regulators considering the cell captive model must

“Ultimately, capital requirements will be determined by a combination of cell captive funding needs and the domicile's statutory requirements.

¹⁵ In South Africa, cell owners must have a material interest and role to play in the underwriting performance of the business conducted in terms of the cell arrangement. Regulation therefore requires a minimum level of capitalisation on the part of the cell owner (FSCA, 2018).



ensure that the risk pools in the various cells are sufficiently large and diversified enough to reduce underwriting volatility. In the case of third-party cell captive insurers, for instance, the risk to policyholders increases if the cell owner does not have the capital necessary to recapitalise the cell in respect of losses, or is not adequately managing underwriting risks (FSCA, 2018). Introducing an absolute minimum capital requirement (MCR) for prospective cell owners ensures that a cell owner has capital at risk or “skin in the game”. In South Africa, for example, a minimum capital requirement of ZAR 1 million (approximately USD70,000) was instituted for all cells in 2018. According to stakeholder consultations, most cell captive arrangements already adhere to this minimum capital requirement or are in the process of implementing it.

Risk-based capital to tailor requirements to risk profile. A third consideration is aligning capital adequacy and solvency requirements for cell owners to the overall level of risk retained by the cell operations (Captive.com, 2018). Where this method is adopted, supervisors base the capital adequacy requirements on the scale, nature and risk profile of the cell. Where third-party or unrelated party business is written by a cell owner, the risk profile is significantly altered, and this should be reflected in the capital adequacy and solvency requirements. In countries that are transitioning to risk-based capital, such as Ghana, specific consideration will be required on how to accommodate cell captives within the framework, in a way that is appropriate to the local market context and that suits the cell captive structure (Cenfri, 2018a).

4.3.3. Governance

Developing a clear and comprehensive framework for the governance and management of a cell structure is important to ensure that cell captive insurance entities do not represent a systematic financial risk or threaten consumer wellbeing. Typical governance and risk management considerations include:

Clear board responsibility. There can potentially be a large number of cells that are unrelated to the core, a wide geographical spread of cell owners and a diverse range of insurance business written across different cells (IAIS, 2015). The board of a cell captive has overall responsibility for all aspects of its business, including actions taken by the owners and management of cells. Supervisors should be satisfied that the board has the necessary skills and experience and has put appropriate systems and controls in place to allow it to exercise proper control over all aspects of the business.

Governance structures to avoid conflicts of interest. Supervisors should also be satisfied that the board has put suitable corporate governance procedures in place to ensure that potential conflicts of interest that may exist between the owners and management of the cell captive and that of its cells can be identified and managed (Global Credit Rating Co., 2018).

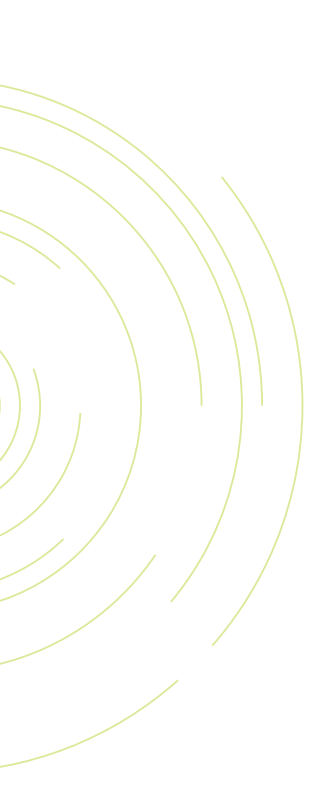
Clarity on risk management and ring-fencing measures. The International Association of Insurance Supervisors cautions that, where PCC legislation does not exist or is materially different across jurisdictions, there may be uncertainty in the treatment of “ring-fenced” assets (IAIS, 2008). Supervisors should be satisfied that the board has adequate measures in place to assess and manage risk and should require that the legal status of the cell captive and cells be clearly explained to any contracting party (Global Credit Rating Co., 2018).

Holding the cell captive insurer accountable. For an SPA arrangement, governance requirements furthermore typically entail requiring cell captive insurers to ensure that the agreement is in precise terms and regulates all aspects of the shareholder and business relationship with the cell owner.

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Developing a clear and comprehensive framework for the governance and management of a cell structure is important to ensure that cell captive insurance entities do not represent a systematic financial risk or threaten consumer wellbeing.

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Further, insurers are required to assess the fitness and propriety of cell owners prior to entering into a cell structure, and regularly thereafter (FSCA, 2018).

4.3.4. Supervisory oversight

A cell captive arrangement is composed of a number of actors that interact across activities in the provision of insurance products and services. In a first-party cell captive arrangement, there are likely to be at least three actors: cell owner, cell captive insurer and a reinsurer. In a third-party cell captive arrangement, this figure is likely to rise, as affiliated customer groups, third-party brokers and underwriting managers or agents may also be included. This raises several oversight considerations for supervisors, for example:

Level of supervision varies depending on cell captive structure.

Supervisors should be aware that the regulatory risk inherent in a cell captive insurer can vary substantially based on the type of cell captive structure in place. Depending on the type of cell captive, the following factors may be considered (IAIS, 2015):

- **Ownership and structure:** Certain structures, such as a PCC, maintain legal separation between assets and liabilities of each policyholder while in an SPA structure these may not be kept legally separate.
- **Business underwritten:** Depending on the class of business underwritten, it is important for supervisors to establish what obligations are held by which parties within the cell captive structure.
- **Policyholders and beneficiaries:** Supervisors should bear in mind that cell captives that underwrite third-party risks on a direct basis may require heightened regulation or supervision.

Authorisation of new cells. Where new cells are added, the IAIS (2008) advises that supervisors should consider whether the addition of new cells should be subject to formal supervisory approval or authorisation.

Market conduct measures to ensure fair customer outcomes. For third-party arrangements that serve members of the public, supervisory oversight is also required to ensure that cell captive insurers exercise appropriate control and oversight over the market conduct of cell owners. Relevant market conduct provisions may include requirements on disclosure and restrictions related to “white labelling” of products, where the cell owner is the face of the insurance, to make it clear to the customer who the insurer is that is ultimately liable for the risks being underwritten (FSB, 2014).¹⁶

¹⁶ Further requirements in the South African framework include that the name of the insurer should be prominently disclosed in all marketing material and policy documents. The insurer details must be given for all queries, complaints and other recourse. In the case of third-party affinity schemes, the exact nature of the relationship between the cell owner and the insurer must be disclosed, as well as the remuneration arrangements (including profit share). Disclosure should be such that there is no risk of an illusion of independence of advice being created in the minds of customers.



5 Conclusion

This study explored the potential role of cell captives in SSA and considered how the cell captive insurance vehicle has evolved as an alternative risk transfer solution. We find that cell captives have the potential to address key insurance market challenges in SSA at both the corporate and retail insurance levels, thereby supporting the inclusive development of insurance markets across the region. As discussed in Section 3, there are at least four use cases for which the cell captive structure is geared:

- **Specialised risk management.** Cell captives enable corporates to develop niche insurance offerings without the need to set up a dedicated insurance licence. It facilitates specialised coverage for unusual or hard-to-insure risks in cases where conventional insurance channels are unable to meet specific product requirements or lack the capacity to cover the risk.
- **Retail innovation.** A third-party cell captive structure creates the incentive for cell owners to innovate to meet the needs and realities of their client/membership base. This it does by allowing them to share in the benefits of insurance, exercise autonomy and operate outside of the legacy systems of insurers, without having to become an insurer in their own right.
- **Insurance market participation.** In cases where insurance capacity is constrained or regulators are keen to avoid further fragmenting the local insurance market by issuing additional licences, cell captive structures can provide an alternative operating space, as cell owners, for prospective players. Alternatively, it can provide a pathway into the insurance market for prospective new insurance licensees while they build up capital, skills and experience. In this way, it encourages broad-based market participation and can serve formalisation objectives.
- **Offshore financial centre development.** For emerging offshore domiciles, the introduction of cell captive arrangements can be a potential driver of insurance industry growth beyond the local insurance demand. In this way, offshore domiciles can generate additional revenue streams for the local economy.

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We find that cell captives have the potential to address key insurance market challenges in SSA at both the corporate and retail insurance levels, thereby supporting the inclusive development of insurance markets across the region.

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Realising the true value of the cell captive structure requires a clear regulatory framework to support its adoption and implementation in a way that is appropriate to the specific local context. Regulators that are considering the introduction of cell captives should be guided by the primary policy objective or use case that the cell captive structure will address. This will determine the risk transfer strategy that is most suitable for their market context and the regulatory framework components needed to support local cell captive business.



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Appendix: Evolution of the cell captive regulatory framework in South Africa

Prior to 1998, there was effectively no regulatory dispensation for cell captive insurers in South Africa, though there was cell captive market activity from 1993. It seems to have been first introduced by “normal” insurers conducting special types of business under their standard licence, without any special regulatory dispensation. This changed in 1998 when the previous insurance legislation was enacted (separate acts for long-term and short-term insurance). Figure 6 highlights the development of cell captive regulation in South Africa since this period. Under the 1998 insurance legislation, cell arrangements are regulated through preregistration requirements and conditions of registration and limited reporting requirements imposed under the Long-term Insurance Act No. 52 of 1998 (LTI Act) and Short-term Insurance Act No. 53 of 1998 (STI Act), respectively. In addition, these are indirectly regulated by the provisions of the Companies Act No. 71 of 2008 relating to shareholding. Over time, conditions of registration evolved as new registrations took place and existing registrations were varied.

It is important to note that this was done without any explicit reference to cell captives in the LTI or STI Acts. As cell captives are based on the cell owner buying a class of shares in the cell captive insurer and earning dividends on that, the relevant provisions from the Acts were those relating to dividend payments (that it must not undermine the insurer’s solvency) and the fact that no shares may be issued to independent intermediaries (which implies that cell owners may not be independent intermediaries).

Despite there being no dedicated regulations or references in the Insurance Acts to cell captives, the non-bank regulatory authority, the FSB (Financial Services Board) de facto regulated cell captives via the licence conditions on cell captive insurers. No single set of licence conditions was published, but typical licence conditions emerged.

South Africa also has a separate legislative framework governing intermediation of financial services to consumers, called the Financial Advisory and Intermediary Services Act which came into effect in 2004. It references cell captives, in that it says that cell owners must be registered financial service providers and their sales staff must meet all the necessary fit and proper requirements.

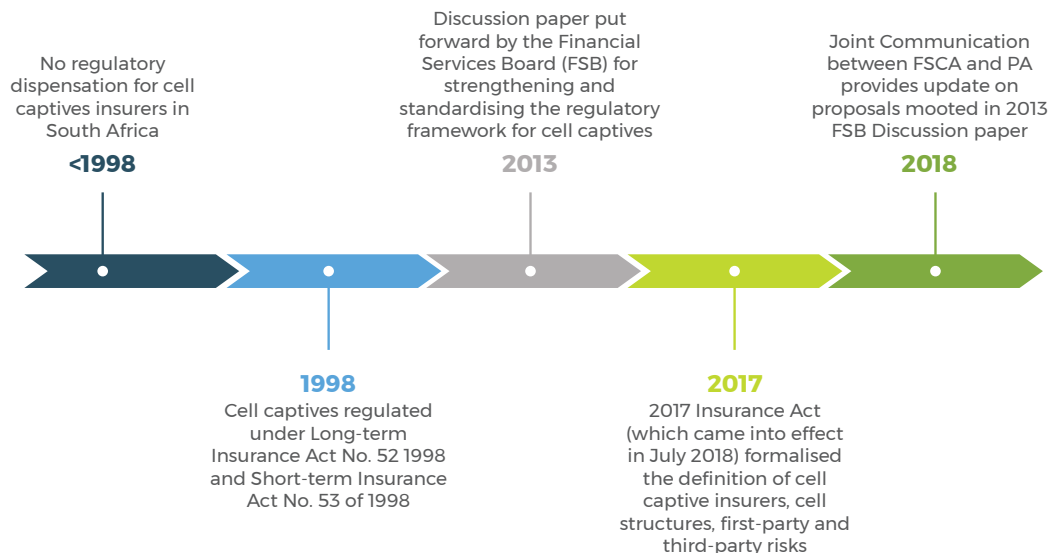
In 2013, the FSB published a discussion paper to put forth proposals for strengthening and standardising the regulatory framework for cell captives, some of which were adopted into subsidiary market conduct instruments issued in the following years.

In 2018, the FSB was replaced by two regulatory bodies as part of a move to a twin peaks financial regulatory structure in South Africa, namely the Financial Services Conduct Authority and the Prudential Authority.

In July 2018, when the new Insurance Act of 2017 came into effect, the FSCA and Prudential Authority issued a Joint Communication to clarify the regulatory position regarding cell captives, provide an update on the status of implementation of the 2013 Discussion Paper proposals and the intended instruments under the new Insurance regulatory framework through which the remaining proposals will be implemented – in original or amended form.

Notably, the 2017 Insurance Act formalised the definition of cell captive insurers, cell structures, first-party and third-party risks. The prudential standards under the Act also specify minimum capital requirements for cells, and the market conduct standards being developed under the Act will further develop the framework to give effect to the proposals as first contained in the discussion paper of 2013.

Figure 6: Timeline of cell captive regulation in South Africa



Source: Author's own



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About Cenfri

Cenfri is a global think tank and non-profit enterprise that bridges the gap between insights and impact in the financial sector. Cenfri's people are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Its core focus is on generating insights that can inform policymakers, market players and donors seeking to unlock development outcomes through inclusive financial services and the financial sector more broadly.

About FSD Africa

FSD Africa is a non-profit company that aims to increase prosperity, create jobs and reduce poverty by bringing about a transformation in financial markets in sub-Saharan Africa (SSA) and in the economies they serve. It provides know-how and capital to champions of change whose ideas, influence and actions will make finance more useful to African businesses and households. It is funded by the UK Aid from the UK Government. FSD Africa also provides technical and operational support to a family of 10 financial market development agencies or "FSDs" across SSA called the FSD Network.