The case for insurance innovators to consider the cell captive regulatory model

May 2021

from the British people

Authors

Matthew Dunn
Christine Hougaard
Jeremy Gray

Cenfri

Tel. +27 21 913 9510
Email: info@cenfri.org
The Vineyards Office Estate
Farm 1, Block A
99 Jip de Jager Drive
Bellville, 7530
South Africa

PO Box 5966
Tygervalley, 7535
South Africa

www.cenfri.org

Table of contents

List of tables

List of figures

List of boxes

1. Introduction

The potential for inclusive insurance markets in Africa is significant, but in many African countries this potential is not being reached. High entry barriers for new innovative players and regulation that may not effectively accommodate these insurance models are important contributing factors.

Innovators such as insurtechs operating in these markets are often hamstrung by a finite set of regulatory licence options available to them, usually limited to an agent, broker or full insurance licence (with an increasing number of countries also introducing microinsurance licences). Agent or broker distribution licences usually have lower compliance requirements than insurance licences, but they are also narrow in the activities permitted, meaning that innovators operating under a broker licence may have to comply with regulatory requirements irrelevant to their businesses[1] and may engage in activities not covered under the brokerage licence. On the other hand, start-up innovators may not be able to comply with the requirements, or have the capital, for an insurance licence, even a microinsurance licence. This constrains their role in the insurance value chain – essentially, they are a square peg in a round hole.

To overcome these challenges, one possible option for smaller, innovative insurance players in sub-Saharan Africa (SSA) may be cell captive insurance. Cell captive insurance is a relatively new concept in sub-Saharan Africa (SSA) that could potentially play an important role in the development of insurance markets in the region.

Box 1: What is a cell captive?

A cell captive is an insurance vehicle created by an insurance company (the “cell captive insurer”) whereby its insurance licence is extended for use by another organisation (the “cell owner”) for the insurance of the organisation’s own assets (“first-party cell”) or the assets and/or lives of its customers or members (“third-party cell”).

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.

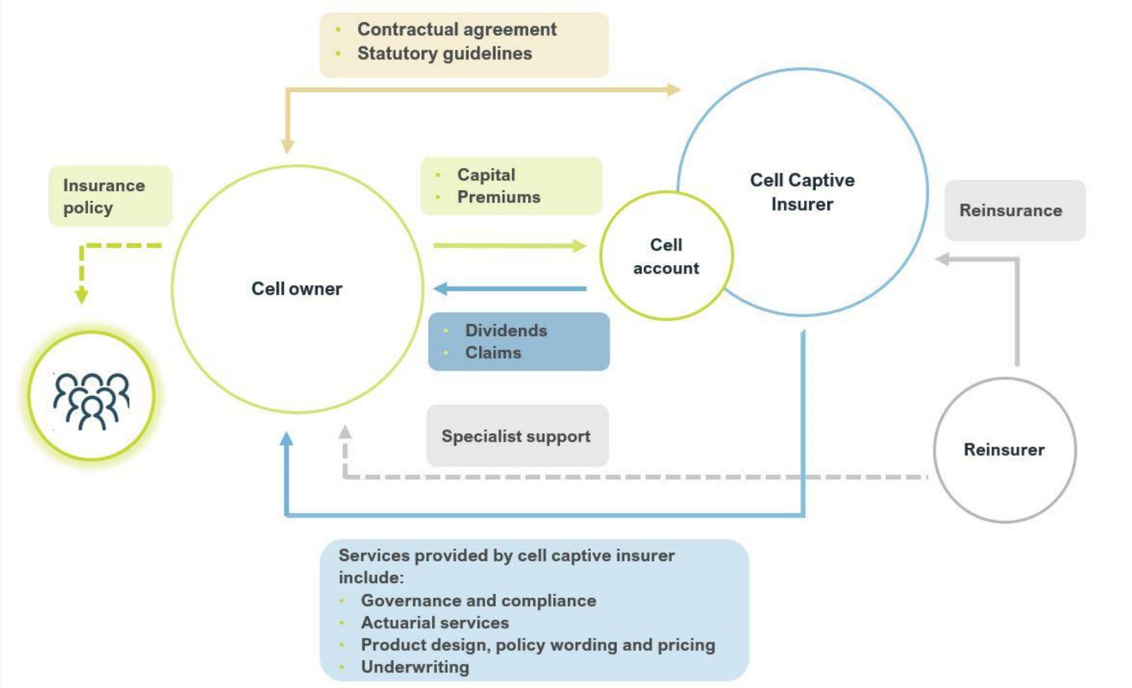
Third-party cell captives offer retail market potential. The original cell captive model covered only first-party risks. In some jurisdictions, the cell captive structure has evolved to also enable a cell owner to cover the risks of third parties, namely its customers or members. The only difference with the “standard” cell captive structure is that policies are issued via the cell to members of the public, rather than carrying the cell owner’s own risk. 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

1 For example, in Nigeria, brokers are required to have a physical presence in multiple geographic regions, and it makes no provision for purely digital distributors.

underlying business of the cell owner. Various applications of this model have evolved, including for white-labelled insurance offerings distributed via auto-dealer chains, cell phone chains or clothing retailers, who are then able to share in the profits of the insurance provided to their customer base without a 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. In SSA, the nature of many insurance markets along with regulatory provisions related to cell captives, to date, would suggest a third-party arrangement is the most likely to be permitted by insurance authorities (Cenfri, 2019).

The figure below illustrates the parties that are typically involved in this model. 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. The insurer renders services to the cell and assumes compliance accountability while the cell owner runs the daily operations. The reinsurers play a market-making function in the cell structure and can typically also provide capacity and compliance support to the cell owner.

Third-party cell structure



Source: Cenfri (2018)

A cell structure is created by an agreement between a cell owner and a cell captive insurer. This agreement is commonly referred to as a participation agreement or shareholder's participation agreement (SPA). The SPA will typically cover operational and other governance issues. While the SPA itself does not need to be entrenched in regulation, regulators may seek to develop guidelines that prescribe the conditions for cell captive insurers and owners around what the SPA should, at a minimum, contain. SPAs typically cover matters such as the number of shares issued, share price and the dividend payments and requirements for dividends to be paid, among others.

The cell captive model holds a number of potential benefits for smaller players, including providing an entry route into the insurance market at lower cost and with fewer compliance hurdles than a full insurance licence. This model also provides greater flexibility for innovative players to take on more functions along the insurance value chain and qualify for a share of the profits generated through insurance business. At least for some players, participating in a cell captive can provide a square hole for their square pegs.

However, whilst cell captives may represent a good option for many insurance innovators like insurtechs that want more autonomy and return from their partnerships with insurers, the cell captive model would not be appropriate in all cases, and it is important that prospective cell owners keep in mind a number of key considerations when operating within a cell structure.

This note articulates the case for cell captives for insurance innovators compared to alternative regulatory structures available. The note also takes a sober look at the challenges and considerations of the model.

It is structured as follows:

- ***Section 2*** unpacks the major challenges faced by insurance innovators in Africa, why they occur and what the impact is.
- ***Section 3*** considers the benefits of the cell captive arrangement to address these challenges.
- ***Section 4*** presents the key considerations for prospective cell owners and possible next steps.
- ***Section 5*** concludes.

2. Insurance market challenges

Innovators and smaller organisations who seek to enter and operate in the insurance space face a number of challenges as a result of structural constraints and regulatory hurdles in their markets. Consequently, many are unable to participate fully along the insurance value chain, which hampers innovation and the uptake of insurance. This section outlines the main challenges encountered by insurtechs and start-up innovators in SSA.

2.1.1. High entry bar for insurers

In many countries in SSA, the existing regulatory environment and structural constraints make it difficult for smaller players to become a fully-fledged insurer.

High capital requirements prohibitive. A common barrier faced by new insurance market entrants are the high costs associated with obtaining and maintaining a conventional insurance licence. Smaller companies may find regulation around minimum capital requirements prohibitive, as these standards are often geared towards much larger or established players that have a more comprehensive capital base. Where a microinsurance licence regime exists, these requirements will be lower, but may still be prohibitive for some entrants seeking a proportionate entry or graduation pathway into the insurance market.

Compliance requirements not proportional to risk. Prospective market entrants operating at the lower end of the market may also be challenged by reporting, disclosure and compliance requirements (e.g. regarding internal controls and actuaries) that are originally designed for large insurance companies with complex structures.

2.1.2. Limited alternative options available

Staying informal. As a result of high entry bar and compliance requirements, some players may elect to continue operating informally to avoid having to comply with stringent regulations of an insurance licence. Operating informally, however, apart from creating consumer protection concerns also 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.

Intermediary options. The alternative formal option to obtaining an insurance licence, as introduced in Section 0, would be to register as an intermediary through an agent or broker licence.

Appendix A outlines each alternative option in more detail. These options attract lower compliance requirements, but, as also discussed in Section 1, where these traditional models do not make adequate provision for the type of business they are seeking to conduct, it may lead to innovators complying with irrelevant requirements given their activities or in them engaging in unregulated or unmonitored activities beyond the ambit of the specific licence.

2.1.3. Unproductive partnerships when going the intermediary route

Innovators face challenges in setting up nimble insurer partnerships. Our stakeholder consultations have indicated that current partnership arrangements with traditional insurers are often rigid and inefficient. Incumbent insurance models are largely binary and difficult to build upon, due to legacy constraints in people, process and technology. Innovators and insurtechs looking to participate in the market are often subject to cumbersome onboarding standards and processes that limit their ability to effectively meet the changing needs of the market.

Unable to share in profits. Intermediaries are limited in terms of the earnings they are able to generate from insurance business. These earnings are typically in the form of commissions or fees on policies sold. Commissions and fees may be subject to regulatory limits[2]. The intermediary does not have access to profits generated through insurance beyond this, which reduces the incentive to innovate or improve processes to create more value.

2 In Ghana, for example, broker commissions are capped at around 20%.

3. Benefits of cell captive route

The cell captive structure holds a number of benefits from the cell owner's perspective that speak directly to the challenges outlined above. This section explores some of the key benefits that may be realised by cell owners through a cell captive model and presents key examples of insurtech actors that have already adopted this model.

3.1. Lower compliance hurdles enable market entry

Part of the attractiveness of the cell captive vehicle is that it allows a cell owner to be more than just an intermediary, fulfil more functions, but still stop short of having to be an insurer itself, with all the compliance that goes with that.

Lower-bar entry pathway. The cell captive arrangement can provide a way for smaller insurance players and prospective cell owners to operate under proportionate requirements, with the backing and compliance oversight of a licensed insurer. This creates a more cost-effective pathway to market entry for innovators who want to offer inclusive insurance other than through acquiring an insurance licence

Table 1 provides an illustration of the level of compliance and capital required in a cell captive arrangement relative to alternative models in the case of South Africa.

Type of Licence		Type of entity	Types of policies	Prudential and governance compliance by entity	Minimum capital
Insurance licence under Insurance Act 2017		Must be a public company or co-operative	Full range of policies as per the legislation can be underwritten	Strict compliance with prudential and governance requirements for insurers	R15 million
Microinsurance licence under Insurance Act 2017		Profit company, non-profit company or co-operative	Limited types of policies. Limited in value, simple design and subject to prescribed product standards. Both life and non-life available.	Proportionate regulatory framework to facilitate financial inclusion	R4 million
Cell under captive insurer licence	Compliance by cell owner under Insurance Act	Corporate structure of cell owner not prescribed	Full range of policies as applicable to cell captive insurer	Insurer bearing full burden of regulatory compliance. Insurer must oversee cell owner's and other service providers' compliance with governance requirements and all applicable legislation.	R1 million
Microinsurance cell structure under Microinsurance licence		As directly above	Limited range of policies as allowed for microinsurers	Insurer must comply with regulatory requirements for microinsurers and must oversee cell owners' and other services providers' compliance and governance with all applicable legislation.	R250,000
FSP or binder holder-only		Any entity acting as intermediary with underwriting by an insurer	No restrictions, but also limited scope to tailor product offering to own client base	FSP or binder holder compliance only	None

Table 1: Cell ownership compared to other options for participation in the South African insurance market

Source: Cenfri (2018)

Compliance and business support. In a cell captive arrangement, the cell captive insurer is the regulated entity under insurance legislation and takes the compliance responsibility upon itself. This reduces the burden for prospective cell owners of setting up their own licence and having to ensure all necessary compliance and regulatory standards are in place. Depending on the nature of the contractual relationship between the insurer and the cell owner, the cell captive insurer can also provide the cell owner with services including administration, product design and underwriting.

Leverage reputation of cell captive insurer. As a new market entrant, prospective cell owners may not have an established reputation that enables them to successfully compete in an open market. Cell ownership allows organisations to directly leverage the brand equity as well as the strength of the balance sheet of a recognised cell captive insurer in its marketing efforts to provide additional credibility and boost competitiveness.

3.2. Autonomy and control over insurance value chain

Another attraction of the third-party cell captive arrangement from the point of view of the innovator, is that the cell owner is empowered to make its own decisions about how to deliver a product to clients and has the autonomy to tailor products to the needs and realities of its client/membership base.

Control over the value chain. From the perspective of a smaller player or insurtech, a large part of the attractiveness of the cell captive vehicle lies in the ability to design products and to structure and integrate the value chain in a way that meets its business purposes. Entities that have an existing client or membership base often want autonomy in shaping the product offering to fit their clients' or underlying business's specific needs and circumstances (as illustrated by the case of SA Taxi in the box below). If they were to choose the intermediary route, they would not have this autonomy. The cell structure allows the cell owner to structure the product offering and value chain functions to fit its needs, and allows it to do so without being constrained by the legacy IT and other systems and processes typically found in traditional insurance companies. In countries where a microinsurance licence exists and microinsurance is subject to certain prescribed product parameters, participating in a cell structure would also allow the cell owner more freedom in terms of the suite of products that it can provide than the alternative of obtaining a microinsurance licence.

Box 2: SA Taxi

In South Africa, the cell captive vehicle plays an important role alongside traditional insurance models to enable smaller players to participate more meaningfully along the insurance value chain. 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 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.

***Source**: (Cenfri, 2018)*

3.3. Share in economic benefits

An added attraction of the cell captive route is that it allows market entrants to share in the economic gains of insurance.

Cell owners 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. The nature of the profit share arrangement is included in the SPA between the insurer and the cell owner. Cell owners can also qualify for a return on the special class of shares acquired in the form of dividends. For new or innovative players, the potential return on investment earned in the form of dividends on the shares in the cell captive insurer is attractive compared to the alternative of being an intermediary or distribution partner, which can only earn commission or fees (Cenfri, 2018).

3.4. Graduation

"Incubation" role into the insurance market for new players. Apart from just offering a relatively "lower-bar" option for insurance market participation than an own insurance licence[3], the cell ownership option can also be part of a graduation path towards a full insurance licence. Cell captives can play the role of incubator by helping newly formed cells to gradually upskill and build up their capital to the point where it is feasible for them to acquire an insurance licence of their own.

Thus, as depicted in Figure 1, there is the opportunity for movement between different levels of participation in the market, with business owners choosing a regulatory form or entity depending on their risk appetite and experience/competency at the time. Not every entrepreneur wants to be the owner of a large insurance company, and other structures that enable participation in the insurance market may better suit their needs. An interesting corollary to this is that in markets where cell captives are an available option, small insurers that consistently struggle to meet the prudential requirements could choose to continue operations through a cell captive structure, thus enabling them to continue serving their customers but reducing onerous compliance requirements. In highly fragmented markets (such as Ghana, Kenya or Nigeria)(Thom etal., 2019), cell captives therefore may offer an important alternative option for smaller insurers (World Bank, 2020).

3 As the insurer carries the prudential and compliance 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.

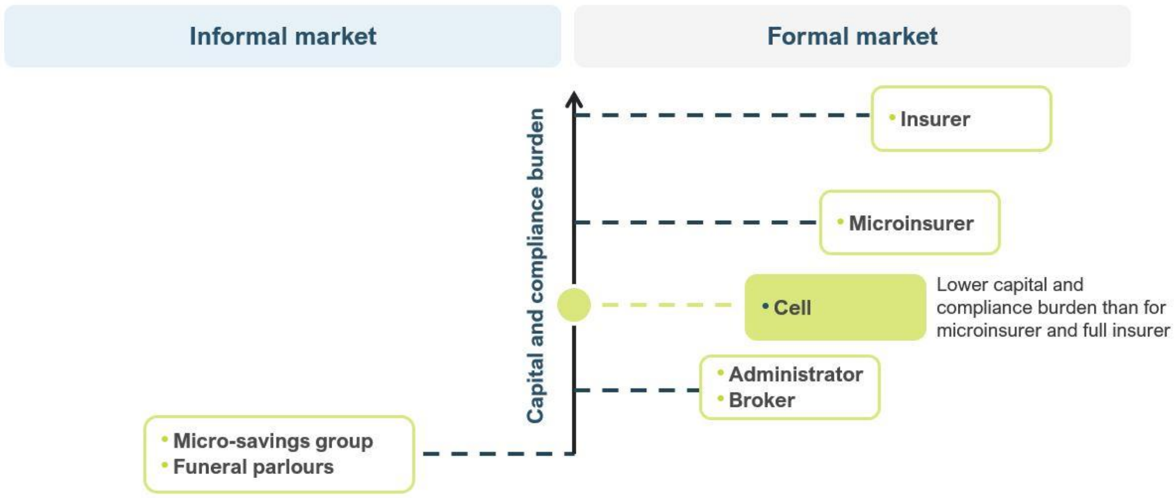


Figure 1: Insurance licence graduation

Source: Authors' own

The Box 3 below illustrates the graduation path followed by an innovative player in the funeral insurance market in South Africa.

Box 3: smartMI graduation

smartMI started their insurance journey as a category IV assistance business financial services provider (FSP) also commonly referred to as an administrator. smartMI spent 20 years distributing and administering Sanlam and Assupol-underwritten group funeral insurance policies through funeral parlours.

By 2016, it was ready to take the next step in their insurance growth journey and become a cell. smartMI's eventual reinsurer, Swiss Re, played a key role in this journey suggesting they consider the cell captive route as well as introducing them to multiple cell captive insurers. One of these providers was Guardrisk who they eventually chose as their cell provider.

This choice was motivated by the support Guardrisk was willing to provide smartMI, including explaining the often very technical requirements associated with being a cell. This was specifically helpful as the step up from administrator to cell captive required quite a big adjustment, with different reporting requirements and terminology applying to cell captives (compared to administrators). The adjustment to new requirements and terminology has been highlighted by smartMI as a specific challenge they experienced in their cell captive journey.

smartMI sells microinsurance products in the form of funeral insurance direct to the public, as well as funeral group schemes. It has grown its own individual insurance book to 50% of its current total membership, therefore now generating 80% of their income from individual business. smartMI has shown 20% year-over-year growth in their individual business the past three years.

***Source**: (Cenfri, 2018).*

4. Key considerations for cell ownership

Becoming a cell owner is not an insubstantial process, and setting up a cell still requires considerable technical, administrative and managerial skills. This section sets out considerations for prospective cell owners around the establishment, maintenance and ongoing engagement with other actors in the insurance value chain, plus potential challenges to navigate, based on consultations with current and prospective players in the cell captive market in SSA.

4.1. Navigating the regulatory environment

Understanding the local regulatory environment will be important for prospective cell owners, particularly since the cell captive concept is still at very early stages of development in most markets in SSA.

Cell captives not prohibited under common law framework. Our research[4] has revealed that the third-party cell captive model can operate without dedicated regulation, at least initially, in many markets in SSA. The reason for this is that, given that this is still quite a nascent concept in SSA, few countries currently reference cell captives in their insurance regulatory framework or have developed dedicated cell captive regulation. However, many of these countries do operate under a common law system, under which innovative models such as the cell captive would not be explicitly prohibited – but merely be considered a structure implemented by licensed insurers within the parameters of the existing regulation. A good example of this is the South African case where, prior to 1998, there was effectively no regulatory dispensation for cell captive insurance in South Africa, though there was cell captive market activity from 1993.

This is quite important for players who are considering the cell captive route, as it means that even though the market in which they operate may not yet have adopted cell captive regulation, this should not be taken as a signal that the model would not be permitted. Regulators have, in fact, appeared open to the concept and may consider allowing interested parties to pilot a cell captive structure as a means of establishing the feasibility of the model in the market. Thus, proactive engagement between prospective cell captive insurers, cell owners and regulatory authorities would be an important first step.

4.2. Set-up and maintenance of a cell

4.2.1. Setting up a cell

Developing a clear strategy and value proposition. When considering moving to a cell captive set-up, one of the first steps for prospective cell owners is to ensure a strong business case to convince cell captive insurers of the value in entering into a partnership.

4 The potential of the cell captive structure for sub-Saharan Africa (2019)

Cell captive insurers do not have unlimited capacity and can be cautious about the partners they select to enter into an SPA with. Each insurer will have different requirements and expectations when it comes to choosing a partner. For instance, certain cell captive insurers are happy to manage hundreds of cells, while others prefer to engage with more established or specialised organisations.

Determining the contractual structure. Globally, there are several variations of the cell captive model currently in use, including the protected cell company (PCC), incorporated cell company (ICC) and shareholder's participation agreement (SPA) cell structure (see Appendix B for an overview of each). In SSA, given the current regulation in place (or lack thereof), an SPA arrangement may be particularly suited for third party cell captives. In South Africa, the SPA works through a preference share agreement with insurers, which gives cell owners a right to profits in the cell based on ownership of a special class of shared. This usually takes the form of dividends paid out to the cell owners as surplus built over time, after all costs. Reinsurance of the risk depends on the appetite and capital of the cell. The SPA sets out the parameters of the relationship between the cell owner and cell captive insurer and is likely to include explicit provisions for profit-sharing, technical assistance and dividends.

Considering capacity and levels of expertise needed to operate cell. Before electing to become a cell owner, it is important to consider whether the required capacity and technical expertise are on hand to successfully manage the ongoing operations of a cell. Despite posing a lower bar than a would be the case for a fully-fledged insurer, being part of a cell captive may require a significant level of capacity, skills and capital. Stakeholder consultations reveal that capabilities around the development of efficient systems and products, availability of capital in operating business and the ability to agree terms with the cell captive insurer are important considerations. Moreover, although the cell captive structure does require less capital and leave the accountability for compliance to the cell captive insurer, this does not mean that cell owners have no compliance responsibility. For the cell captive owner to comply with regulatory requirements, it will require the cell owner to comply with certain prudential and reporting requirements. These would ordinarily be established in the SPA but would be subject to change as the cell grows or if regulatory requirements change. Furthermore, it is worth considering how much of the value chain the cell owner wants to feasibly take on. Given that the cell captive partnership arrangement can be structured in different ways, the more responsibility an insurer takes on, the less autonomy and share of profits the cell owner is likely to retain.

Existing customer base an advantage when starting out. As a prospective cell owner, being able to demonstrate an established customer base or affinity places it in a strong position for partnership with a cell captive insurer. An existing customer base can act as a signal of the financial soundness of the prospective cell owner's operations and strengthens the business case of insurance distribution in the eyes of the insurer. In cases where a cell owner is starting from scratch, they would need to present a much more compelling case as to why the insurer should partner with them, such as a strong team, technical expertise or underwriting capacity. For example, where prospective cell owners already have a strong customer base/affinity base, it is more likely that the cell structure will work, as most distribution problems would already have been solved. If, however, newer players struggle for distribution, they may be better placed to start with an alternative insurance model, such as an intermediary, to test and prove that they are able to reach consumers effectively.

4.2.2. Ongoing maintenance of cell business

Upon the successful establishment and capitalisation of the cell, the cell owner's attentions switch to ensuring the ongoing sustainability of the cell and related functions.

Cell operations maintained in line with insurer standards. The level of involvement of the cell owner versus the insurer in the ongoing maintenance of the cell will depend on the terms included in the SPA. Stakeholder consultations with cell owners suggest that there is an underlying expectation that cell business will be managed in compliance with cell and insurer standards, including ongoing financial reporting and the ability to produce accurate data on a monthly basis. Also important is the ongoing tracking of fund performance and ensuring that a sufficient level of cell capital is maintained. In addition to this, it would be important to have established channels to access additional capital if needed, particularly if the cell owner is a start-up and likely to consume capital early on.

Risk management capabilities. Identifying and proactively managing risk is another competence that cell owners must be able to demonstrate. In most cases, a cell captive insurer forms part of a wider group structure. It is therefore important for cell owners to prove that they can effectively manage and mitigate any risks that may result in financial or reputational harm to the insurer and the broader group.

4.2.3. Engaging with the cell captive insurer

Varied cell captive insurer involvement in product approval. The role of cell captive insurers in the design and approval of insurance products can vary depending on the level of technical and industry expertise and capacity that the cell owner already possesses. For example, a cell owner may already be able to assess market needs, develop and price their products and prepare the product for launch independently. They would then send the product to the cell captive insurer to conduct their own review of the product according to pricing and statutory requirements for sign-off. Depending on the assessment of the insurer, they may require the cell owner to make certain changes to the product.

Claims sign-off from insurer. Cell owners will typically work with the cell captive insurer in the claims approval process. In cases where a cell owner declines a claim, this would normally need sign-off from the cell captive insurer due to potential reputational risk. On larger claims, a cell owner may also seek sign-off from the insurer before approving them.

4.2.4. The role of the reinsurer

Reinsurers provide key support function. As a part of a cell captive structure, cell owners may have direct access to reinsurers, who can often play an important capacity-building role related to the cell owner's operations. Although the reinsurance arrangement is a contract between the cell captive insurer and the reinsurer, the reinsurer in many instances also has a direct relationship with the cell owner. Because reinsurance agreements are often long-term agreements, reinsurers are prepared to assist prospective cell owners with their products and pricing before the cell structure is finally established. Consultation with cell owners suggest reinsurance partners can play an important role in terms of providing support around product design, access to expertise and access to players in other markets to learn from. It may therefore be worthwhile for any prospective cell owner to make valuable partnerships with a reliable and established reinsurer.

Reinsurance capital efficiency function. In a cell structure, reinsurance can work to improve capital efficiency within a cell arrangement, with one stakeholder noting that funding support from reinsurer will likely surpass the savings realised from using cell captive rather than a full licence. This is possible due to the reinsurer having access to a global pool of capital making the cost of capital relatively low. Reinsurers are also able to take on most of the risk from an insurance loss perspective and, depending on nature of product, they may be willing to provide upfront finance that enables the cell owner to fund acquisitions to a large extent and to make repayments over time.

4.3. Graduation considerations

As mentioned in Section 3.4, cell captive structures can help new players to gradually upskill and build 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 who have the ambition to become an insurer in their own right but who don't yet have the systems, skills or experience to do so, it thus provides a graduation path to fully fledged insurer status.

When does it make sense to graduate? There are at least three key considerations for a cell owner when deciding whether to transition to a full insurer:

- **Risk appetite:** Firstly owners should consider whether they can be more open to taking risks and how these risks could potentially impact their operations – whether they have or can implement the systems (and capital – see below) to manage the risks.
- **Capital:** The next main consideration is whether the player is able to raise the capital needed for an own insurance licence.
- **Cost:** Graduation to a full licence would signal that operations have reached a significant threshold in terms of size. To replicate the compliance and regulatory support the cell captive insurer provides, the cell owner would need to have large-enough operations to absorb the resultant costs. Some cell owners may wish to internalise functions to save on the management charges paid to cell captive insurers. However, one stakeholder suggested that it may be more prudent to first switch cell insurers and test whether this has the desired results before starting to pursue a full licence.

4.4. Challenges

Our consultations suggest at least four potential challenges for prospective cell owners to navigate when opting to go the cell route:

Limited input from cell captive insurer. The potential to leverage the cell captive insurer's technical expertise and capabilities may be appealing for a prospective cell owner, but this is not always the case, and the extent to which insurers provide this support is largely dependent on the nature of the cell captive relationship. In certain cases, cell captive insurers may offer limited support beyond their brand, compliance and capital efficiencies to fulfil a plug-in compliance/licensing function. It is also worth noting that typically cell captive insurers form part of a bigger group where barriers to entry are important to maintain competitive advantage. In such cases, large cell captive insurers may be hesitant to share strategic insights or allow underwriting autonomy to new cell owners.

Cell owner does not have carte blanche over product design. Because final sign-off sits with the insurer, there is still a level of dependence on the insurer for products and marketing, which the cell owner should be aware of. This can be a challenge, because as a start-up, time is critical for cash flow and cadence of the cell owner, and the cell captive insurer may not always be in alignment, which can lead to unforeseen bottlenecks in cash flow. It is, therefore, important to ensure that expectations are aligned at the outset.

Misalignment of incentives between cell owner and insurer. Within a cell captive arrangement, the alignment of incentives between the cell owner and the cell captive insurer is important, as it is often the insurer's brand that is exposed, for example to regulatory risk or social backlash. Therefore, a situation should be avoided where the insurer is taking much of the risk but feels that it is not getting benefits[5] in return, as this may lead to a conservative stance.

Regulatory risk. Given that the cell captive model is still evolving in SSA and the regulatory environment is not yet set, the risk arises that structures that are legal today may not be legal tomorrow. This can create uncertainty with regard to future-proofing a business. This is particularly relevant in less developed markets where the concept is still nascent and regulators are still trying to understand the model and develop appropriate legislation that suits the local context. Cell captive participants should be aware of this and take steps to remain flexible and responsive to external market changes, plus, as noted, maintain open and proactive engagement with regulatory authorities.

5 Such as access to a new client pool.

5. Conclusion

This report provides a sober look at the current suite of licensing options that are typically available to prospective insurance market players in SSA markets and articulates the case for insurance innovators to consider cell ownership as part of a cell captive arrangement as a meaningful option for participation in insurance markets in SSA.

From the overview presented above, it is clear that cell captives represent a potentially valuable alternative insurance model for smaller players or insurtechs to consider when compared to traditional licensing options available, on at least four fronts:

- **Lower barriers to entry.** The cell captive arrangement can provide a way for smaller insurance players and prospective cell owners to operate under proportionate requirements, with the backing and compliance oversight of a licensed insurer. In this way it actually lowers the minimum capital requirements and places the regulatory compliance burden on the cell captive insurer.
- **Autonomy in the insurance value chain.** Within a third-party cell captive arrangement, the cell owner can participate more meaningfully along the insurance value chain and is empowered to make its own decisions about how to deliver a product to its clients without having to comply with all regulatory requirements for licensed insurers.
- **Share in the benefits.** Unlike in the case of a pure intermediary model, such as a brokers or agent, cell owners are able to share in the profits of insurance business through a return on investment earned in the form of dividends on the shares in the cell captive insurer. This provides an incentive for the cell owner to continue driving innovation and operational efficiency as it stands to benefit from the strong performance of the insurer.
- **Graduation.** 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. 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.

It will, however, be important to keep in mind that the cell captive is not a panacea. It requires a level of professionalism, systems and skills and that players can proactively navigate partnerships in an often-unchartered regulatory context. Thus, the cell captive route needs to be considered alongside other insurance models to determine the best fit given the market and regulatory context and the specific needs and capabilities of the insurance player.

Appendix A

Alternative models for inclusive insurance

Intermediary

Intermediaries help insurance consumers to identify their specific insurance needs, translate these needs into coverage that corresponds to the profile, and match this with the appropriate insurance products. They provide services to insurance companies and consumers that facilitate the insurance placement process. The types of insurance intermediary in the market varies depending on the jurisdiction, reflecting different activities undertaken by intermediaries, as well as the legal and regulatory frameworks applying to the distribution of insurance products.

Variation in intermediary functions. The classification of intermediaries is generally based on their custom, contractual ties with insurers, and their role towards the insured. There are, however, certain differences in the characteristics of intermediaries that may be worth noting for newer or innovative players who are considering this model.

- **Tied agents:** Tied agents are insurance intermediaries who are under a contractual obligation to conduct insurance distribution business exclusively for one or more insurance undertakings. Tied agents are characterised by the fact that they represent one or more insurers, without having an employment relationship with the insurer. Tied agents can inform and advise customers about available product options of a single insurer (exclusive or captive agents), or of multiple insurers for non-competing insurance lines (multi-tied agents).
- **Brokers:** Brokers act as market-makers, helping insurance consumers select the most appropriate product from a range of competing offers covering any insurer willing to underwrite the specific risk in the market. Such selection is unconstrained, as the broker is not acting in the name or on the account of any insurer and has no commitment to insurers. The growth in digital intermediation has led to the emergence of innovative players such as peer-to-peer (P2P) insurance companies, insurtechs and price aggregators, which often fall under a broker licence (OECD, 2020).

Authorisation of distribution activity and supervision. Entities that wish to pursue insurance intermediation must usually receive permission from the supervisory authority in the vast majority of jurisdictions and for most intermediary types. Such authorisation or licensing is granted provided that the intermediary fulfils certain criteria related to their capacity to mediate insurance. These include professional competencies, association accreditation and financial solvency and liability insurance provisions, among others. There is no specific licence for insurance aggregators or insurtech companies in most countries, and such entities are typically registered under one of the established/traditional insurance intermediary classes.

Remuneration structures defined for intermediaries. The most common forms of remuneration that an intermediary can expect are fees charged to the customer, commissions agreed with the insurer and expressed as percentages of the premium paid by the insured, or a combination of these two. Commissions (both premium-based and contingent ones) are in most cases incorporated in the insurance premium in order to compensate the intermediaries for the customer acquisition costs and are not necessarily visible by the insured. As mentioned above, these can vary depending on local insurance regulation but can be as high as 40%. In some cases, these costs are prorated in the premium of all contracts, thus there is no cost advantage or incentive for customers to directly contact the insurer. Intermediaries may also receive non-monetary compensation in the form of benefit linked to the activity of intermediation (IT assistance, training or marketing support) or other soft incentives (e.g. trips).

Licensed insurer (Full or micro-)

Obtaining an insurance licence, be that a full insurance licence or a microinsurance licence, is often considered the final destination for players within the insurance value chain. There are, however, a number of considerations that prospective licence holders should consider before pursuing this model.

Establishing an insurance entity takes time. Establishing an insurance company can be a time-consuming process and requires proposals and a three-year business plan to be submitted to the regulator. The regulator will assess a number of factors and must be satisfied as to the quality of management and the ability of the infrastructure to support an insurance company before it can be approved.

Higher capital reserves are needed. There are several key differences between cell captives and fully licensed insurers, an important one being the capital requirements. The minimum capitalisation requirement (MCR) for an insurance licence (full or micro-) is substantially higher than would be required for cell ownership, although a microinsurance licence represents the lower cost option of the two (see Table 1).

Varied capacity under insurance licences. Insurers are generally restricted only to certain classes of insurance business (and rarely receive a licence to write third-party business). For a full insurer, a range of policies as per the legislation can be underwritten. Under a microinsurance licence, the types of policies are offered are limited in terms of value and design and are subject to prescribed product standards. Both life and non-life policies are available, however. Figure 2 (on the next page) highlights some of the key differences between conventional insurance and microinsurance.

	Conventional insurance	Microinsurance
Delivery channels	Sold by licensed agents or brokers to the wealthy, the middle class or companies that typically understand insurance	Often sold by unlicensed non-traditional agents to low-income persons, preferably in groups, requiring significant product education
Controls	Screening requirements may include a medical examination or other tests	If there are any screening requirements, they are very limited in order to control costs/ Controls are appropriate to the market
Premium collection	Typically regular annual, quarterly or monthly payments	Frequent or irregular premium payments Matches cash flow cycles
Premium calculation	Based on age and other specific risk characteristics	Group pricing with links to other services/ Diverse risk structures
Policies	Complex policy document, many exclusions, usually annual terms	Simple language, few or no exclusions, terms appropriate to market
Claims	Claims process for large sums insured may be quite difficult	Claims process for small sums insured is simple and fast, yet still controls fraud

Figure 2 Selected differences between conventional insurance and microinsurance

Source: IFAD (2012)

Appendix B

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 independent 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, 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).

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).

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 Africa.

6. Bibliography

Captive Review. (2017). Cell & Series Guide 2017.

Cenfri. (2018). Third-party cell captives as an enabler of transformation in the insurance sector. Cape Town: Cenfri. Retrieved from: https://cenfri.org/wp-content/uploads/2018/07/Third-party-cell-captives_Cenfri_Guardrisk_July-2018-1.pdf

Cenfri. (2019). The potential of the cell captive structure for sub-Saharan Africa. Retrieved from: https://cenfri.org/wp-content/uploads/FSDA-and-Cenfri_The-potential-of-the-cell-captives-structure-for-sub-Saharan-Africa.pdf

OECD (2020), Regulatory and Supervisory Framework for Insurance Intermediation. Retrieved from: www.oecd.org/finance/insurance/Regulatory-and-Supervisory-Framework-for-Insurance-Intermediation.pdf

McCord, M. J. (2012). Microinsurance product development for microfinance providers. International Fund for Agricultural Development (IFAD).Retrieved from: https://www.ifad.org/documents/38714170/39144386/Microinsurance+Product+Development+for+Microfinance+Providers.pdf/bf81e93a-971d-41c2-9913-a87212f77dc6

Thom, M. et al. (2019). Insurance for inclusive and sustainable growth: Imperatives for action from a four-country synthesis. Retrieved from: https://www.fsdafrica.org/wp-content/uploads/2019/10/Insurance-for-growth-01.10.19.pdf

World Bank (2020). Does fragmentation and a reliance on compulsion hinder innovation, growth and development?. Retrieved from: http://documents1.worldbank.org/curated/en/810771577710977236/pdf/Developing-Insurance-Markets-Does-Fragmentation-and-a-Reliance-on-Compulsion-Hinder-Innovation-Growth-and-Development.pdf

Willis. (2008). The present and future: Protected cell companies.