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BEPS, benefits and big data:

The mining captive of the future

Introduction – a renewed interest from the mining community?

Captives have historically been quite prevalent in the mining sector. The ability to build cash reserves through risk retention, access greater capacity and exert greater control over insurance programme design has traditionally appealed to the larger mining corporation.

However, like everything, the relationship the mining sector has with captives is subject to change. A slight downturn in captive utilization was experienced during the extended period of macro-economic depression and then uncertainty from 2008 until relatively recently. Despite this, there has been a renewed interest in captive utilization amongst the mining community over the last 24 months or so.

The explanation for this renewed interest can be explained by the desire for the core risk financing benefits that a captive can provide, but also in some new developments in the captive industry.

How are captives being used for mining risks?

Mines introduce a particular set of risks, for which, a captive can be part of a solution. Although the risk profile associated with mine operation (low frequency/high severity liability risks) is not typically viewed as conducive to a captive participation, mines also contain their fair share of higher frequency and lower severity claims that a captive could accommodate.

In addition to this, some observable trends in mining industry captives include, for example, losses associated with process disruption/ key machinery breakdowns. Captives can also provide access to greater capacity for risks associated with pit wall collapse or tailings dam failure.

Parametric insurance is also garnering more interest as familiarity with the concept grows. Water availability based metrics can prove particularly relevant for mining based parametric solutions and help smooth the impact of any costs associated with the unavailability of water.

How are captives adapting to a new environment?

The emerging trends that provide an insight into the evolution that captives are currently experiencing is arguably more interesting and exciting.

In general, the two most notable evolutionary traits that captives have displayed in recent times have been:

- the utilisation of data to optimize risk financing arrangements
- the way in which they mirror the evolving risk profile of mining corporations accommodating a far broader range of risks

Data and captives

Data has become valuable currency in all facets of life in recent years and the capacity of captives to act as a repository for risk management data has grown exponentially as a result.

Through the correct use of their own data, mining corporations now have a wealth of insight to inform what and how they retain risk and this has led to an emergence of captive owners who speak in terms of “optimal retention structures”, “portfolio benefit maximization” and “maximization of return on equity” – a genuine insurance mind set. This has led to the pursuit of more sophisticated structures such as multi-year, multi-line programmes, to refine and optimize how corporates finance their risk and provide additional cash flow benefits – something that most mine operators would welcome.

In a sector with complex and potentially high severity risks, with high degrees of interdependencies between loss events, the ability to firstly model the operations risk profile, and then use these insights to make financially beneficial retention decisions is of paramount importance.

Broader risk profile associated with new ways of working

It is not a coincidence that the major trends and innovations of the captive industry in recent years have been in areas such as human capital benefits, political risk and cyber liability to name but a few – these represent the fastest growing risks of most major corporates.

Captives are rapidly adjusting to the new reality of a more interconnected global economy, where human capital is more than ever seen as the greatest asset a company can have.

The emergence of captives as viable insurers of employee benefit risk is one of the most noteworthy developments in recent years and exemplifies the evolution of captives from vehicles for ‘traditional P&C’ risk to enterprise wide risk solution vehicles. The ability for mining corporations to have more flexibility in employee benefit design and execution could have a profound impact on talent attraction and retention in a period of a well – documented ‘talent war’ within the sector.

This broadening of captive’s risk profiles has also improved the efficiency of captives through increasing diversification benefits but also ensured that they remain relevant to the key risks corporations face today.

Increasing globalization of captives

Another trend which has become more evident in recent years is the increasing global spread of captive hubs or domiciles. Historically, captives congregated in a handful of captive strongholds such as Bermuda, Luxembourg and Guernsey. However, there are now over 60 recognized captive domiciles with insurance legislation specific to captives.

This development underlines the growing demand for captive solutions outside Europe and the US, and is a reflection of the globalization of modern business environments. This is particularly encouraging for the mining community, which is truly globally spread and will likely provide mining corporations in locations such as Australia and South Africa having more genuine choice of where they locate their captive.

Current challenges to the industry – Base Erosion and Profit Shifting ('BEPS')

One of the most significant challenges facing the captive industry is BEPS, which is an Organisation for Economic Co-Operation and Development (OECD) led taxation initiative, expected to become a global taxation standard. This initiative aims to renovate global taxation frameworks and 'close the loop' in tax legislation which allows multinational corporates to artificially shift profit to lower tax jurisdictions and reduce their overall tax bill. Although the measures introduced by BEPS are not specifically aimed at captives, as subsidiaries of large multinational companies they fall within its remit. It is likely that many companies in the mining sector will own captives in locations where the corporate tax rate is lower than that of the headquarter jurisdiction, and if this characteristic applies, so may BEPS.

However, it is important to stress that having a captive in a location where corporate tax rates are lower (relative to the organization average) does not imply wrongdoing, nor should captive owners be unduly concerned.

However, what is important is positive preparation. Although the ultimate guise of BEPS in all jurisdictions is still to emerge, there is enough in the principles covered in the OECD guidance for captive owners to be preparing for. A sensible first step on the preparation project journey, through our proprietary proposition, RADAR, will be to review the captive's position in relation to the principle expectations of the BEPS package. Measuring the captive against key metrics, and documenting where positive compliance can be demonstrated - and where remedial action - is required will allow captive owners to begin thinking about BEPS in specific terms that are actionable. This can lead to a BEPS preparation plan which ultimately puts the captive owner in control of the challenge and removes much of the uncertainty that currently exists for many captive owners.

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Implications for the mining sector

So what conclusions can the mining industry draw from these developments?

Utilization of data to achieve a more analytical approach

A common theme ties the various developments observable in the captive industry of today – captives have continued to keep pace with economic and risk management developments. Big data, cyber risk, changing work places and practices, and challenges related to the governing of an interconnected global economy are all terms that will be encountered when reading any commentary of today's economy. Utilization of data to achieve a more analytical approach, accommodating risks such as employee benefits and cyber, and aligning to regulations designed for interconnected global economies through BEPS suggest that captives have more than kept pace and are displaying the ability to 'future proof' themselves.

Periodic review and realignment of captive deployment

However, none of these benefits will happen automatically. Captive owners who derive the best value, and maintain the greatest relevance from the captive strategy, employ an approach of periodic review and realignment of their captive deployment. The rate of change in the risk profile of mining companies, with changing work practices, regulations and commodity price volatility, together with the numerous external forces impacting a captive approach, results in the "shelf life" of a given captive strategy becoming potentially shorter.

However, this should not be viewed as a negative development as the greatest benefit of a captive is its ability to adapt and transform to meet the demands of the group as and when they change. If reviewed regularly, the enhancements to strategy will take the form of incremental improvements as opposed to any fundamental change in the strategic direction of the captive.

To conclude: a captive remains a flexible and dynamic tool for the management and financing of the traditional risks associated with operating a mine, but significantly it can also prove an effective tool for dealing with emerging risks associated with more sophisticated work practices. The benefits of a captive strategy also now span further than the risks typically under the remit of the risk manager and can be considered on a truly enterprise - wide basis.

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