Institute and Faculty of Actuaries

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HMT Consultation: Captive Insurance

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 34,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers. Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

Key points

Current regulations allow captive insurers to set up in the UK with a similar treatment to all other insurers. To encourage the establishment of UK captive insurers would likely mean some form of relaxation of requirements specifically for captives in the UK, such as a lower capital requirement for captives, reduced public reporting or reduced private reporting.

Where captive insurers are directly providing the insurance which affects third parties or for compulsory insurance (e.g. Employers Liability and Motor third party Insurance), we do not believe the relaxation of these requirements would be appropriate, given the reliance that individual claimants have on these entities.

Where the insurance only impacts the group of entities of the captive, or the captive is providing reinsurance of a third party-fronting insurer, then this may be reasonable as the Group or the third party fronting insurer would be in a position to make a determination of the security being provided by the captive.

We do not see a compelling reason for preventing regulated firms or pension funds dealing with financial services and pensions from transferring first-party risks to their own captives, in the same way as any other corporate entity.

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HMT Consultation Captive Insurance: IFoA Response

Introduction

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the HMT's Consultation Paper (CP) - Captive Insurance. Members of our General Insurance Standards & Consultations Committee reviewed the PRA's proposals within the CP. Members of the committee work for a range of insurers or insurance consultancy firms.

2. It is important to note that, as for any IFoA response, we have considered HMT's proposals from an independent, public interest perspective.

HMT Consultation Questions

Note that we answer a subset of HMT's consultation questions below, restricting our responses to those questions where we have a specific point to raise, from a public interest perspective.

Question 1: What specific aspects of the existing insurance regulations (both prudential and conduct) do you consider need to change to encourage the establishment of UK captive insurers? Where you suggest changes, how might these impact on a) the level of protection offered to those who benefit from policies written by a captive or b) wider financial stability?

3. Current regulations allow captive insurers to set up in the UK with a similar treatment to all other insurers. To encourage the establishment of UK captive insurers would likely mean some form of relaxation of requirements specifically for captives in the UK. The key changes which may make this more attractive could be around a lower capital requirement for captives, reduced public reporting or reduced private reporting.

4. Where captive insurers are directly providing the insurance which affects third parties or for compulsory insurance (e.g. Employers Liability and Motor third party Insurance), we do not believe the relaxation of these requirements would be appropriate given the reliance that individual claimants have on these entities.

5. However, where the insurance only impacts the group of entities of the captive, or the captive is providing reinsurance of a third party-fronting insurer, then this may be more reasonable as the Group or the third party fronting insurer would be in a position to make a determination of the security being provided by the captive. That said, there may still be significant dangers and systemic risks in relation to that approach with respect to third parties.

Question 2: Do you agree with the approach of differentiating based on different types of captive? If not, are there alternative approaches that should be considered?

6. As we mention in our answer to question 1 above, where captive insurers are directly providing the insurance which affects third parties or for compulsory insurance, we do not believe the relaxation of these requirements would be appropriate, given the reliance that individual claimants have on these entities.

7. Where the insurance only impacts the group of entities of the captive or the captive is providing reinsurance of a third party-fronting insurer, then this may be reasonable, for the reasons given above.

Question 3: How important would it be to ensure that further types of captive could be added in the future?

8. It is important to maintain flexibility and consider - on a continual basis - newly emerging types of entities and risks.

Question 4: Do you agree that regulated firms dealing with financial services and pensions should be excluded from setting up and passing risks to their own captive insurance companies?

9. We do not see a compelling reason for preventing regulated firms or pension funds dealing with financial services and pensions from transferring first-party risks to their own captives, in the same way as any other corporate entity.

Question 6: Do you agree with the proposed limitations on what lines of business UK captives might be able to write?

10. We would agree that, if the regime were to be different for UK captives compared to other insurers, the direct writing of compulsory insurance should be excluded. However, in our view the CP is not clear on the writing of reinsurance of this business, which we believe would be a potentially valid business for a UK captive to write.

Question 7: How should lines of insurance which may benefit third parties (directly or indirectly) be treated, under any new approach to captive insurers?

11. If the UK is to have a differentiated captive insurer insurance regulatory regime, then we would propose only first-party exposures be permitted and assumed reinsurance business of fronting insurers.

Question 9: Should it be possible for businesses to establish a captive cell using the UK's protected cell company framework? What are the advantages, and risks of this approach?

12. We are neutral on this proposal. However, we note that this can reduce cost for entities using captives, which may make them more attractive for a wider range of underlying entities.

Question 10: Would a new approach to captives, along the lines suggested in this consultation, make the UK a more attractive place to base a captive insurer? If not, what specific proposals would make the UK more attractive?

13. A new approach to captive insurers could, in principle, increase the attractiveness of the UK from a captive insurer perspective. In practice however, it is not clear how many entities would then set up captives in the UK, as they may already have captives in other locations which have already established captive markets.

Question 11: Are there further policy issues not covered in this consultation document that would need to be addressed in order to make a new approach to captives successful?

14. In our view the *'Government's view is that tax incentives are not a necessary component of implementing a modern, competitive UK captive insurance approach'* may overlook the point that tax benefits can often accompany other reasons for entities to set up (and locate) their captive. It is also not clear whether the regime would allow UK captives to be branches of other entities (say other captives in other jurisdictions),or would need to be subsidiaries.

Question 12: In your view, would introducing a specific UK captive insurance approach have positive or negative effects on the wider UK insurance market?

15. We think it would be very important to be able to demonstrate that the regime for non-captive insurers were not being diluted as part of the changes. If this were clear, then we would not anticipate a material impact on the wider UK insurance market.

Question 13: Do you agree with the figures set out above on the size of the potential market? Please provide any additional quantitative or qualitative information.

16. Views on the size of the UK captive insurance market appear to vary. We note that different commentators and analysts have provided alternative estimates of the size of the captive market, with some being smaller and some larger than the figures quoted in the CP.

Question 14: What sort of companies might be interested in establishing UK captives? Any further information on the potential pool of interested firms, or their specific needs, would be helpful.

17. UK Groups with UK risks which could be insured by a UK captive could be interested. This could include Groups currently using an offshore captive (where more of the risk could be retained in the UK), or Groups not currently using a captive. Overseas Groups could also be interested in reinsuring risks to a UK captive, given the UK's reputation in the insurance market.

Question 15: The UK already is already a hub of insurance sector expertise and related ancillary services. What new job creation or relocation of existing roles could be expected should a new approach for UK captive insurers be introduced? Please provide any supporting evidence you may have.

18. Although HMT's proposals could potentially lead to some new job creation, we would be surprised if any such impact were significant.

Question 16: If captive insurers set up in the UK, would any additional investment flow into the UK? Please provide any evidence to support your answer.

19. By setting up UK captives, this might encourage more investment in the UK. However, given the likely liabilities being considered, these may be largely matched by investments already in the UK, and so any additional impact could be limited.

Should you want to discuss any of the points raised please contact me, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham
On behalf of Institute and Faculty of Actuaries