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Captives in the spotlight around the world

The UK and French governments are taking steps to encourage the establishment of captives, while in Germany and the US the captive regulatory environments are becoming more restrictive

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There is increasing demand for captives globally, but the specific regulatory and market conditions in each country create a diverse and dynamic landscape

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There is increasing demand for captives the world over as a result of a multitude of factors ranging from the fallout of the Covid-19 pandemic to increased geopolitical risk and the impacts of climate change.

Jurisdictions are alive to this change, but their appetite for their own captive regime varies. The UK and French governments are taking steps to encourage the establishment of captives, while in Germany and the US the captive regulatory environments are becoming more restrictive.

This article examines the latest regulatory and market developments in a range of key captive jurisdictions.

UK consults on new regime

The UK may be finally opening its doors to captives. In November last year, HM Treasury launched its long-awaited consultation on captive insurance, taking the first step towards implementing a dedicated captive regime in the UK.

The UK has long been a global hub of insurance, but has never created a regulatory framework for captives, which has led to captives only being established overseas in more friendly regimes.

Industry groups have estimated up to 700 captives could be either established in or relocated to the UK, bringing in an additional £153m ($188.7m) to the economy, according to the London Market Group.

The consultation suggests HM Treasury is considering a wide range of regulatory changes to facilitate and speed up the process of establishing a captive. However, HM Treasury is considering limiting what captives can write, by excluding life insurance and compulsory lines. Regulated firms dealing with financial services and pensions (including insurers) may also be excluded from creating their own captives (to avoid regulatory arbitrage).

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A dedicated captive regime could not come soon enough. Against a changing risk landscape, insurers have grown much more selective about their exposure, leading to an increased reliance on captives. Companies that have previously used captives only for more traditional risks (such as property damage and business interruption) are increasingly turning to captives for additional types of cover, like cyber. This creates a gap in the UK domestic market that can be effectively filled by the establishment of an attractive onshore captive regime.

Lloyd’s has recently begun to promote the establishment of captive syndicates. Movement on this front has been slow: 2024 saw the first new captive syndicate. While it is still early days, its progress will be followed with interest and may well open the doors to additional captive syndicates in the coming years.

US captives face continued scrutiny

The captive market in the US continues to grow and evolve as a result of governmental and regulatory pressures, as well as market forces.

The US Internal Revenue Service (IRS) has continued what some have called a “war” against captives, with numerous lawsuits remaining pending following the disallowance of premium deductions taken by numerous companies paying premiums to captives, as well as treating dividends from captives to captive owners as ordinary income, rather than tax-advantaged capital gains.

The antagonism from the IRS toward captives is ongoing; the disadvantageous treatment of many captives and their owners happened under the Obama administration and has continued under both Republican and Democratic presidents since. The recent presidential election gives no reason to expect regulatory changes or policy shifts in this area of the insurance market.

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SOME FEEL THE US INTERNAL REVENUE SERVICE IS WAGING A 'WAR' AGAINST CAPTIVES

Additionally, while there are no formal reports of the outcome of IRS litigation relating to captives, it appears the IRS has prevailed in all or the vast majority of its captive-related litigation. While captives remain legal in the US, they are likely to find themselves under scrutiny for the foreseeable future.

The overall captive market is in good health, however, with new captives continuing to be licensed throughout the US in 2024 and captive directors from various state insurance departments, including Utah and Vermont, indicating a positive outlook for continued growth.

Use of captives is hard to track perfectly for several reasons. New captive licences are not a clear indication because "series" captive use is hard to investigate and quantify because each series is not a separately registered legal entity; repurposed captives may be tantamount to new captives; leased captives exist; and captives that cease to operate may remain registered but dormant. The evidence still suggests, however, US captive usage is likely to continue increasing.

France promotes captive formation

Before 2023 there were very few captives domiciled in France. French companies had typically set up their captives in more favourable jurisdictions in Europe such as Luxembourg or Ireland, as well as in Switzerland, Guernsey and Malta.

In June 2023 France's financial regulator, the Autorité de Contrôle Prudentiel et de Résolution, published a comprehensive guide for the regulation of captives. The aim was to set out the main regulatory and prudential principles to be respected to facilitate the processing of captive applications for approval. Since then the French authorities have actively promoted the creation of captives in France.

The Finance Act for fiscal-year 2023 added a new section to the French tax code, which allows captive insurers and reinsurers, subject to a number of conditions, to accumulate tax-free reserves of up to 90% of underwriting profits in the form of a "resilience" provision, similar to the one in effect in Luxembourg.

In November 2023, France's risk management association, Amrae, created a new trade body, the Fédération Française de Captives d'Entreprise (FFCE), to work with companies and authorities to facilitate setting up and managing captives and to raise awareness of the benefits of captives.

In this context, in November 2024 the FFCE hosted its first congress on the captive market. In a vote of confidence for the French captive insurance regime, more than 180 businesses attended the congress.

In conclusion, France remains a very small player in the captive market but its recent regulatory initiatives are clearly having some impact. Since 2023, the number of French captives approved by Amrae has increased from six to 19 and the aim is to have the same quality of service as Ireland and Luxembourg.

It remains to be seen whether the number of captives domiciled in France will continue to increase, but that is the French authorities' goal.

Germany takes strict approach

In view of rising insurance rates, a lack of capacity and stricter insurance conditions, the number of captives in Germany continues to grow, especially for cyber insurance and companies with risks some insurers no longer underwrite, such as coal, oil and gas.

However, Germany is a comparatively unattractive domicile for captives. The German supervisor, BaFin, has a stricter approach for captives to meet Solvency II requirements than other EU member states, so German companies prefer captives in other EU member states or further afield.

Insurance industry associations such as the Gesamtverband der versicherungsnehmenden Wirtschaft are advocating strongly for Germany to follow the example of France and Italy by applying Solvency II rules less strictly. A meeting with the German insurance associations at the end of 2023 generated no noticeable outcome.

Instead, German companies tend to create protected cell companies, as it combines the advantages of a captive with less financial and organisational effort. In this case, the captive cells are provided by a third party (often large insurance brokers) for external companies and they take on the regulatory, actuarial and accounting-related tasks.

In November 2023 PwC Germany and Versicherungsforen Leipzig published a study, Modern risk transfer solutions: Captives in focus. It surveyed 61 risk management experts from industrial companies. Of those surveyed, 32% believe setting up a captive is an option for their company. This study named regulatory requirements and suitable internal and external personnel as major challenges in forming a captive. These companies are therefore heavily reliant on external consultants and brokers.

The German market is awaiting changes from the EU Solvency II reviews. It is hoped captives will fall under the new category of “small and non-complex undertakings” (SNCU) introduced in the Solvency II reviews. Businesses in this category would see administrative simplifications and would not be subject to the (new) obligation to specify climate scenarios and assess their impact on their business.

The revised Solvency II Directive is expected to be published by the end of the year and then has to be transposed into national law.

On the other hand, the Digital Operational Resilience Act (Dora), which comes into force in January 2025, will include captives in its scope. The new rules introduce strict cyber security requirements for Europe’s insurers. Dora includes a proportionality principle to ease compliance for smaller firms, but this may not benefit captives if they were considered part of their larger parent company and their associated cyber risks.

It is a pity the German insurance supervisory authority and the German legislator have not recognised the potential opportunity of implementing a less strict approach for captives as in other EU countries like France and Italy. This is particularly the case as

German companies have an increasing appetite for captives owing to economic conditions and environmental changes and the associated uninsurable risks.

Luxembourg remains beacon of stability

Luxembourg established itself as an early leader on captives, establishing its legal framework in 1984. Since then, it has become the leading jurisdiction in the EU for captives, home to close to 200 so far.

Captives in Luxembourg primarily cater to multinational corporations seeking to self-insure risks traditional insurers might decline to cover.

Luxembourg’s insurance regulator, the Commissariat aux Assurances, is well versed in licensing procedures and applies the principle of proportionality to captive insurers. The country’s legal framework offers

flexibility and clarity, allowing captives to structure bespoke solutions tailored to their parent company's needs.

The EU's Solvency II Directive remains a cornerstone of the regulatory landscape for captives in Luxembourg. While the directive has been implemented for years, the proposed Solvency II 2024 review could have an impact on captives. The changes are expected to address proportionality for captives more explicitly, potentially reducing the administrative and capital burden for smaller entities. Additionally, Luxembourg is monitoring developments in environmental, social and governance-related regulation, which could introduce new reporting obligations and risk management considerations for captives. To maintain its position as the number one jurisdiction for reinsurance captives in Europe, Luxembourg must leverage its sophisticated financial ecosystem to offer added value to captive owners.

The availability of cutting-edge financial tools, a highly skilled workforce and access to the EU single market amplify the operational efficiency and scalability of captives. Additionally, Luxembourg's commitment to innovation is evident in its support for digitalisation and insurtech solutions.

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LUXEMBOURG REMAINS THE NUMBER ONE EUROPEAN JURISDICTION FOR CAPTIVES

Luxembourg distinguishes itself through its equalisation reserve system, which enables captives to allocate technical profits on a pre-tax basis to mitigate potential future losses. This unique feature of the Luxembourg regulatory framework enhances the financial robustness of captives – a critical competitive advantage. Moreover, the seamless integration of captives in Luxembourg's wider financial ecosystem creates synergies that are challenging to replicate elsewhere in the EU.

In conclusion, Luxembourg's captive regime remains a beacon of stability and innovation, well positioned to adapt to emerging challenges and opportunities in the global risk landscape.

Ireland faces competition

Ireland's push to put itself "back on the radar" for captives is welcome, but it faces stiff competition to return to its perch as a go-to European captive destination.

Ireland was one of the first jurisdictions in Europe to establish a dedicated captive insurance regulatory regime in the 1980s. This, along with relatively light capital requirements for company formation and financial services-friendly government policies, led to Ireland quickly establishing itself as one of Europe's leading locales for captives.

Following the introduction of Solvency II, however, the market stagnated, despite increased captive activity across Europe over the same period. The blame for this has generally been attributed to the Central Bank of Ireland's (CBI) perceived lack of proportionality and increasingly conservative regulatory approach. As such, companies looking to establish European captives have turned to other more captive-friendly domiciles such as Luxembourg (which opened doors to nine captives in 2022 versus Ireland's one).

In response, the CBI has put additional focus in recent years on promoting captives and easing regulation, with increased industry engagement and recent implementations providing additional clarity to companies looking to set up an Irish captive.

Ireland faces increased competition from the rest of Europe... with countries such as France and Spain (and potentially soon Italy) looking to promote their own regimes, many European-owned captives may look to relocate back to their home markets, leaving Dublin behind

The regulator’s work is expected to continue into 2025 and beyond. However, it faces increased competition from the rest of Europe. In July the European Insurance and Occupational Pensions Authority (Eiopa) released guidelines to standardise supervision across Europe. This, coupled with its recent consultation on a proportionality framework under Solvency II, indicates a greater push for more European domiciles to get involved in the captive market. With countries such as France and Spain (and potentially soon Italy) looking to promote their own regimes, many European-owned captives may look to relocate back to their home markets, leaving Dublin behind.

All is not lost, however. Ireland is still well positioned as, post-Brexit, it remains the only native English-speaking country in the EU – an attractive bonus for US firms, which we expect to make up a larger share of the Irish captive market in coming years.

The CBI is no doubt aware of the competition. We expect it will continue to try to convince European-owned captives currently in Ireland to stay put – or for new incorporations to choose Ireland. Captives are also increasingly being used for insuring more diverse risks, such as cyber and directors’ and officers’ liability, which should see the market continue to increase in 2025 – providing further incentives for the CBI to keep as much captive activity in Ireland as possible.

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