Paris fantasizes the return of captive insurance companies.

The Ministry of Economy would like large companies choosing to insure themselves - by creating a captive insurance company - to do so in France rather than in Luxembourg.

Background — Near fifty large French companies would like to create their own insurance captive, in other words, to insure themselves via an in-house subsidiary, according to the Association for risks management and company insurances (in French: "*Amrae*").

The pandemic put forward the fact that some large risks were not insurable by the private sector. The government has recently gave up to set up a pandemic insurance plan and is working on a tax exemption for SME's reserves providing self-insurance by setting aside a small amount of money each year. The Ministry of Economy is also in favor of a tax and regulatory framework – to be integrated to the 2022 annual Financial Act – for mid-cap companies (in French: "ETI") and large firms that would create or relocate their captives in France. *L'Opinion* provides an update with Olivier Muraire, CEO of insurance companies, and Jérôme Goy, partner at Enthémis and insurance expert.

What are insurance captives and why are they coming back in the public eye?

Olivier Muraire (O.M.): A captive is a structure belonging to a company that is not an insurer and aiming at participating in its risks' coverage. Created at the end of the 19^{th} Century in the United States, insurance captives are back in the public eye for short-term reasons as the European market has been disrupted for the past two years. While premiums had been falling for more than fifteen years, the interest rates plummeted in August 2018 and the emergence of negative interest rates put pressure on insurers. As a consequence, they realized the cost of risk was key in their economic balance.

Insurance is one of the few economic models where the company is paid before providing the service and knowing the cost price. In the past, insurers collected significant premiums ensuring their cash flow levels and high yields on financial markets. This mechanism allowed them to have a technical risk – strictly related to insurance – balanced while continuing to generate positive results. However, Solvency II – implemented in 2016 – forced them to be cautious of the cost of capital for each risk underwritten. In addition, the interest rates fall creates a jaws effect.

Jérôme Goy (J.G.): By the end of 2018, European insurers begun to stop covering certain types of risks, to lower their capacities and to increase premiums. To insure large risks, large companies often have to find more than one billion euros of insurance capacity and, consequently, call upon insurance "pools". In the United Kingdom, in the beginning of 2019, I saw companies looking to get insured for 500 million pounds as they were offered up to a maximum of 400 million pounds for some insurers had stopped covering this category of risk. The creation of an insurance captive helps to fill a part of this gap.

Is it a common practice in France?

O.M.: 80% of SBF 120 companies have an insurance captive and large-sized companies often have several captives depending on geographical areas. There are 250 insurance captives within French groups but only six are legally based in France and most of them are located in Luxembourg and Ireland even if some of them are also located in Bermuda, Singapore and Malta… Even state-owned companies have created their captives abroad. If few of these companies have created their captives in France, it is arguably for public relations' reasons since there were more considered as a method of tax optimization than as a risk management tool – their real purpose – in the 1980's. One of the main reasons for creating captives abroad is the difficulty of spreading technical reserves over several years.

An insurer must indeed set aside a reserve of money to pay incurred claims it could cover each year but settling claims can last a long period of time due to lawsuits, "*expertises*"… as well as some risks are uncommon events and dictates significant reserves. Spreading reserves over several years has enabled Luxembourg to attract many captives.

Why is the government working on a regulatory and fiscal framework promoting insurance captives?

J.G.: The Ministry of Economy sometimes regards the set-up of reinsurance captives in Paris as a matter of "sovereignty". It is a tremendous activity for a financial hub. Each captive has an average capital of 30 million up to 50 million euros. This industry employs lawyers, auditors… In order to attract investments to a financial hub, there are banks, insurance companies… and reinsurance captives - for instance in Luxembourg alone there are nearly 200 of them.

O.M.: The government was already thinking about it during the 1990's, but it did not take the plunge and gave up the idea of creating similar conditions to those prevailing elsewhere. Apart from Luxembourg, Ireland is another example of a country taxing less companies' profits. Companies often have a direct insurance captive in Ireland to generate profits without excessive taxation and a reinsurance captive in Luxembourg to spread technical reserves over time. The profits of the direct insurance captive are usually recurring since it is well reinsured; it is a two-stage rocket.

Is the French initiative likely to succeed?

O.M.: If this issue is tackled seriously, I must say bravo as it has been neglected for too long. However, when it comes to the impact this initiative would have on the insureds or the French market if it succeeds, expectations should not be too high if there is no way found for bringing back in France already existing captives abroad by major French companies. Yet, it remains very challenging for two reasons. Not only regulatory and fiscal conditions need to be harmonized between countries but also an additional incentive is needed. On the one hand, the European Union is not fond of subsidies in disguise granted by a Member State and on the other hand, it might be difficult for the government to conspicuously set up a mechanism promoting the use of massive equity by wealthy companies. Even if this is good thinking, aren't we coming a day after the fair? Nowadays SPACs are created in Amsterdam and Universal Music Group is listed there. As for the captives, the shot is already fired. Let's act immediately to expand sectors that can grow in France!

J.G. Companies will still have to accept rising premiums and declining insurance capacity for several years. Captives structurally return to becoming an efficient management tool but only when there are old enough – for they have built up reserves – and this does not happen overnight. It would be logical and normal for a French SME to be as easy – if not easier - to set up an insurance captive in Paris as in Luxembourg. Otherwise, it will remain the privilege of large companies. One must not forget captives are a mean to negotiate and create competition with, between and against insurers for non-insurance companies.

Interview by Jade Grandin de l'Eprevier – 5/25/2021.