

Captives and Alternative Risk Transfer — overview and summary

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When an industrial group decides how to protect itself against the loss of a factory, a recall of a medicine or a claim from a patient in a clinical trial, it faces a choice that goes back to the beginnings of insurance. It can buy cover from an insurer, which pools the risk with those of many other policyholders, or it can carry the risk itself and set aside funds to pay for losses when they occur. Between these two poles lies a broad field of arrangements in which the group retains part of its risks in a vehicle of its own and transfers the remainder to insurers, reinsurers or investors in the capital markets. The most important of these vehicles is the captive insurance company, an insurer owned by the group whose risks it covers. The fourth chapter of Part D noted that the chemical companies of Basel created such captives early. Part G recalled that Schweizerhalle accelerated their expansion.¹

This chapter examines captives and the wider family of instruments known as alternative risk transfer. It begins with the definition and structure of a captive, its origins in the United States and Bermuda and the domiciles that compete for captive business today, among them Switzerland, Liechtenstein, Luxembourg, Ireland, Malta, Guernsey, Bermuda and Vermont. It then turns to the reasons why the pharmaceutical and chemical groups of Basel use captives, to the tax questions that captives raise under transfer pricing rules, controlled foreign company rules and the global minimum tax, and to the treatment of captives in the revised Insurance Supervision Act. The second half of the chapter describes the transfer of insurance risks to the capital markets through catastrophe bonds and other insurance-linked securities, a field in which Swiss Re and several asset managers in the Zurich region have played a leading role. It closes with three lines of business that earlier chapters promised to treat: catastrophic transport and logistics risks, the insurance of works of art and the insurance of cyber risks.

1 Notes

1. See Part D, chapter IV ("Insuring the chemical industry") and Part G, chapter I ("Liability and insurance after Schweizerhalle") of this book. On the concept of risk retention and risk transfer in corporate risk management, see the standard literature on industrial insurance and risk financing. To be verified. ↩

2 Conclusion of the chapter

Captives and alternative risk transfer show how the instruments of insurance have adapted to the needs of industrial groups and to the limits of traditional capacity. The captive, born in the mining towns of Ohio and raised in Bermuda, has become a standard tool of risk financing for the pharmaceutical and chemical groups of Basel, which use it to retain the lower layers of their property, product liability, clinical trial and environmental risks and to buy reinsurance on better terms. Its regulation has become proportionate, as the revised Swiss supervisory law shows. Its tax advantages have largely disappeared under the OECD transfer pricing guidance, controlled foreign company rules and the global minimum tax, so that its justification now rests on risk management.

Catastrophe bonds, industry loss warranties, sidecars and parametric covers have opened the capital markets to insurance risks, with Swiss Re, PERILS AG and the insurance-linked securities managers of the Zurich region among the main participants and Swiss pension funds among the investors. The same techniques help to cover the accumulation risks of transport and logistics, low water on the Rhine, the works of art that pass through Basel and the cyber risks that commercial insurers are reluctant to carry. As climate change raises the frequency and severity of losses, these instruments will become more important for narrowing the gap between economic and insured losses.

3 Conclusion of Part I

Part I has examined insurance, reinsurance and risk in and around Basel. Chapter I followed Baloise from its foundation after the fire of Glarus to the consolidation of the Swiss insurance industry and to its merger with Helvetia, which created a group with its seat in Basel. It also described the earthquake insurance gap that recurrent political initiatives have failed to close. Chapter II analysed the Insurance Supervision Act and the Swiss Solvency Test, their recognition as equivalent to Solvency II in 2015 and the revision in force since 2024. Chapter III turned to life insurance

wrappers for private clients, which serve as instruments of wealth planning whose cross-border tax treatment determines their value for clients in Germany, France, Italy and other countries.

Chapter IV examined pension funds and investment foundations under the BVG, their investment policy and the decline of full insurance after the life insurers withdrew from it because their long-term guarantees had become too costly at low interest rates. The present chapter has shown how captives and alternative risk transfer allow the Basel groups and the financial markets to retain, finance and transfer risks that traditional insurance carries only in part. Together, these chapters show that insurance in Basel has remained a central part of the financial centre since the nineteenth century, linking the security of households and employees with the risks of industry and the capacity of the global capital markets. Because the insurers, banks and international organisations of Basel have always worked across borders of language and nation, the next Part turns to Language, Border and Identity.

4 In five sentences

1. Baloise grew from the fire of Glarus into one of the leading Swiss insurers and merged with Helvetia into a group based in Basel, while the gap in Swiss earthquake insurance has survived repeated political attempts to close it.

2. The Insurance Supervision Act and the Swiss Solvency Test form a risk-based supervisory regime that the European Union recognised as equivalent to Solvency II in 2015 and that the revision in force since 2024 has made more proportionate.

3. Life insurance wrappers allow private clients to hold investment portfolios within an insurance policy, whose value for wealth planning depends on the cross-border tax treatment of the policy in the country where the client lives.

4. Swiss pension funds and investment foundations invest the retirement savings of employees under the rules of the BVG, while the decline of full insurance shows how costly long-term guarantees became for life insurers at low interest rates.

5. Captives allow the pharmaceutical and chemical groups of Basel to retain and finance their own risks, while catastrophe bonds and other insurance-linked securities transfer catastrophic insurance risks to investors in the capital markets.

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