

What a captive is

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A captive insurance company is an insurance or reinsurance undertaking that belongs to a group whose principal business lies outside insurance and whose purpose is to insure the risks of that group. The definition in European law is close to this description. Article 13 of the Solvency II Directive defines a captive insurance undertaking as an insurance undertaking owned by a financial undertaking other than an insurer, or by a non-financial undertaking, whose purpose is to provide insurance cover exclusively for the risks of the undertaking or undertakings to which it belongs. A parallel definition applies to captive reinsurance undertakings.¹ Swiss law does not use an identical formula, although the Insurance Supervision Ordinance and the practice of FINMA have long distinguished captives from insurers that offer cover to the public.²

Three elements distinguish a captive from an ordinary insurer. The first is ownership, because the captive belongs to the group whose risks it covers and is not offered to outside shareholders. The second is the limited circle of insured persons, which is confined to the companies of the group and in some cases to closely connected parties such as employees, suppliers or customers. The third is the function of the captive within the risk management of the group. A captive is a tool for financing retained risks, for buying reinsurance on better terms and for collecting the data that allow the group to understand its own losses. Underwriting profit from outside clients is not its purpose, although a well-run captive can be profitable.³

The simplest captive is a direct captive, which issues insurance policies to the companies of the group and pays their claims. A direct captive requires a licence as a primary insurer in each country in which it writes business, or a passport under the law of the European Union. Because many groups operate in dozens of countries with their own licensing rules, most large captives work as reinsurance captives. In such a structure a licensed

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insurer, known as the fronting insurer, issues the local policies to the subsidiaries of the group, collects the premiums and then cedes most of the risk to the captive by way of reinsurance. The fronting insurer keeps a small share of the risk and charges a fee for its services, which include the issue of policies, the handling of claims and compliance with local tax and regulatory requirements.⁴

1 Notes

1. Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Art. 13(2) and (5) (definitions of captive insurance and captive reinsurance undertakings). To be verified. ↩
2. On the treatment of captive insurance and reinsurance companies in Swiss supervisory law, see the Insurance Supervision Act (ISA, SR 961.01) and the Insurance Supervision Ordinance (ISO, SR 961.011) in their revised versions in force since 1 January 2024, together with the publications of FINMA on captives. Status to be verified. ↩
3. On the characteristics and functions of captives, see the standard literature on captive insurance, for example the publications of the European Captive Insurance and Reinsurance Owners' Association (ECIROA) and the Federation of European Risk Management Associations (FERMA), and the textbooks on alternative risk transfer. To be verified. ↩
4. On fronting arrangements and the distinction between direct and reinsurance captives, see the literature on captive insurance and international insurance programmes; on the fronting fee and the credit risk borne by the fronting insurer, see the publications of the major fronting insurers and brokers. To be verified. ↩

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