ShareAction»

By email to captiveinsuranceconsultation@hmtreasury.gov.uk

6 February 2025

ShareAction response to HM Treasury's captive insurance consultation

What is ShareAction

ShareAction is a UK registered charity that works to build a financial system that serves our planet and its people. ShareAction works to define the highest standards for responsible investment, mobilising investors to take action to improve labour standards, tackle climate change and the biodiversity crisis, and address global health issues. We have strong relationships with financial regulators, government departments, investors and asset owners. Our remit includes climate change, biodiversity loss, human and labour rights, and public health. We hold meetings with financial institutions from all over the world, and have provided advice to policymakers and regulators in the UK and the EU.

Summary of ShareAction's views on captive insurers

Captives are increasingly and disproportionately used by oil and gas companies. Fossil fuel expansion is both risky to insure and contributes to the climate crisis, costing lives. By making it easier and cheaper for fossil fuel companies to insure themselves, skirting the (limited and imperfect) restrictions that exist in the wider insurance market, regulatory changes like this would unfortunately encourage more fossil fuel extraction.

More broadly, "self-insurance" impacts financial stability since it puts more eggs in the same basket. Without adequate regulation and strong reserves - which the current proposals would water down - there may be extremely negative impacts on the wider economy which the taxpayer would eventually have to pick up. In an era where insurance is increasingly expensive for ordinary people, we consider that is neither fair nor sensible for the government to make it easier for big companies to "insure" themselves, giving license to activities which harm the rest of us and leaving taxpayers to pick up the bill if things go wrong.

Overall, our view is that deregulation of captive insurance is ill-advised. Further analysis is necessary to properly assess the merits of this proposal but also to properly consider the disadvantages and the risks and to conduct a more robust cost-benefit analysis. The consultation does not properly reflect the fact that this proposal could undermine the UK's efforts to combat climate change as well as the broader stability of our financial system.

At the very least, we consider that firms and activities relating to fossil fuels should be excluded from any planned relaxation of the rules.

We thank HM Treasury for its open consultation and for the opportunity to provide feedback on the current proposals. We would be delighted to discuss any of the points raised in this submission.

Our detailed responses to questions 1-17 of the current consultation

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?

Our overarching view is that there is insufficient evidence to suggest that the economic benefits of encouraging the establishment of more captive insurance outweighs the potential costs and risks, and as such, we question the value of pursuing these changes.

The only research cited in the consultation document (page 14, footnotes 5, 6 and 7) has been produced by bodies representing the interests of captive insurers. The London Market Group is the trade body for the specialist commercial (re)insurance industry in London and the research cited in paragraph 3.5 was sponsored by the Vermont Captive Insurance Association. Furthermore the Vermont study is more than five years old and focuses on the industry in a small US state (albeit one with an outsized captives market). These are not conditions that apply to the UK in 2025 for numerous reasons including the nature of the market and macroeconomic factors such as interest rates which have a significant impact on the insurance industry. It is not reasonable to rely solely on evidence produced and sponsored by the insurance sector any more than it would be reasonable to rely on a study on the health impacts of tobacco sponsored by Philip Morris.

We are similarly concerned that recommendations in this proposal lack independence as they follow *"representations from some parts of industry"* (as is stated in paragraph 1.3 of the consultation document) which have a vested economic interest in favourable regulatory changes. We note that the London Market Group states that it has met with the City Minister to discuss captives and that the London Market Group will *"continue its work with the Government and PRA to work towards the introduction of a UK captives regime"* (see page 5 of the London Market Group report referenced in footnote 5 of HM Treasury's consultation document).

Even setting aside such concerns, and even if it could be concluded from a 2019 study in Vermont that each new captive insurer would result in an extra £225,000 per year of benefits to the economy, this seems quite a paltry sum given the downside potential which we can summarise in three points:

i. **Captive insurance concentrates risk.** The risks faced by a company and its captive insurer are axiomatically more correlated than those faced by a company and a non-captive, general insurer. An external shock that hits the company hard is more likely to result in solvency challenges for a captive than independent insurer. This can be addressed somewhat by careful design, but to ensure this takes place, stringent regulation is needed. **Reserves requirements particularly important**: they should be at the level the regulator deems reasonable for general insurers to limit prudential risks, if not higher, but this proposal suggests that they will be lowered. This is deeply concerning.

ii. **Climate change is making this problem worse.** The insurance sector depends on taking care of relatively low probability, more or less independent events. The deepening physical impacts of climate change increases the probability of disasters, which are correlated. The result is that our current regulatory regime, indeed our overall approach to insurance, may not be fit to meet the challenges of the coming decades. This is not a good time to be relaxing requirements.

iii. **Incentivising the growth of the captive insurance market could contribute to worsening climate change.** Fossil fuel companies are some of the major users of captive insurance, partly due to their size and complexity, but also because a large number of traditional insurers and reinsurers refuse to take on the risks associated with at least some forms of fossil fuel extraction[1]. Without some sort of exemption to this proposal for these companies (or their core activities), a relaxation in the rules governing captives will effectively make it easier for fossil fuel companies to pursue captive insurance in the UK. Especially if this is done at lower cost than regular insurance, as this proposal incentivises, it will leave more capital for the sorts of polluting activities that contribute to carbon emissions, feeding the physical risks and financial uncertainty which an underregulated captive insurance regime would be ill-equipped to address. In summary, the likely consequence of incentivising the growth of captives creates even more financial instability than one might imagine at the outset, because the industries that will take advantage of this regime are those that themselves contribute most to instability.

On the last point, we would like to highlight that **the European Insurance and Occupational Pensions Authority (EIOPA) recently recommended raising capital requirements for insurance investments in fossil fuels**, following analysis of both historic trends and forward projections[2]. This is based on the volatility of fossil fuel stocks – and the relatively higher risks of participation in the fossil fuel market – which have to be compensated for. By contrast, the suggestion in the current consultation to reduce capital requirements for captives in this proposal has essentially the opposite effect – amplifying the risks of an already risky industry.

We consider it reasonably foreseeable that the current proposals would result in:

(i) Increased financial instability;
(ii) Potential losses to consumers if this affects the provision of goods/services made by a company using captives;
(iii) Potential costs to the taxpayer if bailouts are required.

The consultation document does not include a prudential assessment of the risks which is significant cause for concern.

HM Treasury should stress-test any proposals to expand captive insurers and consider the risks associated with a situation such as the Deepwater Horizon explosion and the resultant oil spill and environmental disaster. This project was underwritten by BP's captive insurer for just a fraction of the cost of cleanup and settlement claims and BP was required to cover the majority of the costs incurred. Another Deepwater Horizon is an extreme but not impossible scenario and it should be noted that far less extreme scenarios could result in a parent company not having sufficient capital and needing emergency funding or government support.

[1] Karaul Z (2024) Captives—Too Late for Fossil Fuels or Too Soon for Green Energy? (An IRMI ERIC Session Recap). In: Spring Consulting Group. https://www.springgroup.com/captives-too-late-for-fossil-fuels-or-too-soon-for-green-energy-an-irmi-eric-session-recap/. Accessed 29 January 2025.

[2] EIOPA (2024) EIOPA recommends a dedicated prudential treatment for insurers' fossil fuel assets to cushion against transition risks - EIOPA. https://www.eiopa.europa.eu/eiopa-recommends-dedicated-prudential-treatment-insurers-fossil-fuel-assets-cushion-against-2024-11-07_en. Accessed 29 January 2025.

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?

One way in which captives can spread risk is by reinsurance, which can be accessed from traditional reinsurers. However, climate change is already bringing a hardening of the reinsurance market[3], which may limit the ability for reinsurance to be accessed in future.

The consultation refers to representations previously received suggesting a differentiation between direct-writing captives and reinsurance captives. We submit that <u>the key factor is what is actually being insured</u>. The risk profile and the potential implications for the UK financial sector would be significantly different for the following illustrative examples:

(i) the development of the Rosebank oil field in the UK; or
(ii) a UK company building an unabated coal power station in another country; or
(iii) a UK professional services firm looking to use a captive for its professional liability; or
(iv) a UK manufacturing firm looking to use a captive for its product liability.

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

Firms and activities relating to fossil fuels should be excluded from any planned relaxation of the rules, now and in the future.

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?

Yes, and fossil fuel companies should also be excluded (see Q6).

5. Do you see any circumstances where it might be beneficial to allow regulated financial firms to set up and pass risk to their own captives? Please explain why this would be the case.

It is possible that there may be benefits in specific cases but it is worth querying who these benefits would pertain to (for example if this were to benefit a UK bank, or to unfairly benefit a global bank at the expense of smaller UK rivals).

In principle, we agree with the government's view as stated in the consultation document that for policy reasons, regulated firms dealing with financial services and pensions should be excluded from establishing (and passing risk to) their own captives.

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

We agree that the government should look to limit captive insurers' ability to write certain lines of insurance business.

As stated above, we strongly recommend that limitations on captive insurance should be extended to include fossil fuel extraction and associated activities. If however these are to be allowed, government and regulators should apply the recent EIOPA recommendations to **<u>increase</u>** capital requirements for fossil fuel assets, recognising that fossil fuel assets hold a significantly larger financial risk, requiring a greater sum of capital requirements to mitigate under transition.

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[3] Kousky C, Treuer G, Mach KJ (2024) Insurance and climate risks: Policy lessons from three bounding scenarios. Proceedings of the National Academy of Sciences 121:e2317875121. https://doi.org/10.1073/pnas.2317875121

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

We would be very cautious about insurance involving third party beneficiaries being incorporated into this approach.

8. How should captive managers be regulated for conduct and competence to ensure the robustness of the approach and encourage the growth of a UK captives market?

Captive fossil fuel insurers should have **higher** capital and reporting requirements and be required to provide data and insurance certificate information on the projects they insure given the huge risks these activities pose to our legally binding emissions goals, our health and the environment, here and in other countries.

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?

We do not have a view about cells specifically, only that the general proliferation of captive insurance could undermine financial stability, particularly if reserves requirements are reduced.

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?

For the reasons outlined at the beginning of our response we do not view this as a worthy goal. We suggest that a laudable alternative would be to lessen the attraction of tax havens.

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?

We suggest that the regulatory approach to insures generally should be updated for new challenges and risks, particularly as a result of climate change and other systemic risks. We note, for example, that the Lloyd's Act has not been updated since 1982.

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

There may be some benefits to the wider market in the short-term as insurers seek business opportunities in captive management.

If the "specific approach" involves adopting recommendations along the lines of those proposed in paragraph 2.13 of the consultation, in the longer run we believe the effects would be negative for the reasons mentioned above, including increased risks, potential financial instability, potential costs to taxpayers and environmental damage.

We also note that these proposals could result in a negative impact on traditional insurers in the UK who would be operating in a (rightly) more stringent regulatory regime. This would be partly addressed by simply having the same requirements (in terms of reserves etc.) for captives as for general insurers, as well as by excluding certain clearly harmful activities (e.g. fossil fuel extraction with huge negative externalities, risks and longer term financial downsides).

We note that it may be possible to address such concerns with rigorous cost-benefit analysis and proper modelling of the prudential impact of encouraging captive insurance.

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.

We challenge these figures for the reasons stated in question 1 above. These figures are not robust and are manifestly insufficient for evidence-based policy-making.

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.

We consider that these proposals would be more likely to create opportunities for the biggest firms who have the resources to benefit from these proposals, whilst smaller firms are less likely to benefit. This could create issues of unfair competition if a regulatory change then creates a regulatory advantage for bigger firms which may not benefit UK firms, UK people and the stability of the UK financial sector. Whilst the consultation document suggests these proposals may attract business to the UK, we are also concerned about the impact on competition **within** the UK.

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.

We do not have any evidence on this point. We are keen to see evidence of the benefits but we also urge a thorough examination of the potential costs and risks, in particular in relation to the expansion of captives for fossil fuel companies.

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.

The captives industry may have argued that this would help the UK bring insurance business back from tax havens. However we note:

i) HM Treasury should ensure that captives operate with tighter (or at least equivalent) regulation.

ii) Many of these tax havens in which captives are currently domiciled are Crown dependencies or British Overseas Territories. The government could therefore put in place appropriate measures there to limit the future attraction of these tax havens.

iii) As noted above, in terms of additional investment flows being assumed we query the figures and note the likely bias in the research from Vermont referenced in question 1.

17. How else might a new approach to captives create costs or benefits in the UK economy? Please provide any specific examples, or quantitative or qualitative data to support this.

We do not have any evidence on this point but as noted we query the figures and note the likely bias in the research from Vermont referenced in question 1. We are keen to see evidence of the benefits but we also urge a thorough examination of the potential costs and risks, in particular in relation to the expansion of captives for fossil fuel companies.

Conclusion

Instead of measures that risk encouraging a race to the bottom with tax havens, we suggest that the government should close loopholes that allow this and prioritise financial stability, revenue raising, and sustainable economic growth.