Challenges and Opportunities for Captive Insurance in Mexico

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The use of captive insurance companies in various countries to accommodate risk management strategies is a growing global phenomenon, and Mexico is no exception. Panama, the only country in Latin America with a captive insurance law, demonstrates the importance of devising a regulatory scheme to promote this industry at home, and this may eventually become a trend in Latin America.

Determining whether a captive could be incorporated under existing Mexico Insurance Law (the Law of Insurance and Bonds) is challenging. None has been created under the Mexico Insurance Law, and satisfying the legal and financial requirements to become an insurance company is a complicated process. Further, it is not clear that the National Insurance and Bonding Commission (CNSF) would approve the licence for an applicant seeking to insure only the risks of the applicant company's owners and/or affiliated entities.
Article 74 is the only provision in the Mexico Insurance Law addressing self-insured risks.

Article 74 provides that insurance transactions with related parties (eg, affiliates) cannot be undertaken on more favourable terms and conditions than those offered to the public. In this regard, the Mexico Insurance Law appears designed to regulate the incorporation and supervision of commercial insurance companies offering insurance to the public in Mexican territory.

This provision implies that the Mexico Insurance Law allows a Mexican-licensed insurance company to insure risks of related affiliates, but it appears also to assume that such insurance company is offering insurance products to the public (eg, non-related entities) on the same terms and conditions. Thus, attempting to become a captive under Mexico's current legislative framework has not been attempted by Mexican businesses.

Regulatory challenges and tax implications

Insurance legislation in Latin America is generally complex and restrictive. Historically, these insurance laws have not contemplated the incorporation and licensing of an insurance company to cover only self-insured risks. Thus, companies in Latin America have opted to establish captives in offshore jurisdictions, where favourable laws and lower costs make captive formation attractive.

In the absence of local captives legislation, offshore captives have begun to gain traction in Mexico. They often use fronting arrangements in which a licensed insurer issues the policy directly to the insured and owner or affiliate of the captive and then reinsures a portion or all of the risk to the captive. Mexico might be able to minimise this offshoring if captive insurance legislation were adopted.

Most captives in Latin America are fronted, as regulations in many countries, such as the Mexico Insurance Law, require a locally admitted carrier to issue the policies. The willingness of local authorised carriers to issue such policies and cede the risk to the offshore captive often depends on the carriers' internal policies and the relationship with the prospective insured, as the captive's owner.

Local rules

The offshore captive arrangement used in Mexico typically takes the form of a captive reinsurance entity in an offshore jurisdiction which, under Mexico Insurance Law must be registered in Mexico as an admitted foreign reinsurer. Mexico Insurance Law allows licensed insurance companies to place risks only with local reinsurers or foreign reinsurers that are registered as admitted reinsurers.

In this regard, the foreign captive first registers in Mexico as an admitted reinsurer provided it satisfies certain requirements such as obtaining a minimum international rating established by international rating agencies approved by the Commission.

Under Mexico Insurance Law, if the captive fails to meet the requirements of an admitted foreign reinsurer and is not able to secure such registration, the local insurer has to cede the risk to a fronting foreign admitted reinsurer. The foreign admitted reinsurer would in turn cede the risk to the captive reinsurer.

Captive schemes designed to include the participation of a fronting local carrier and an admitted reinsurer ceding risk to the Mexican owner captive increases the overall cost of insurance, which would include commissions or fees to those participating in the captive arrangement. This has impeded growth of this arrangement in Mexico.

Domiciles

Other countries in Latin American face even greater challenges. In Argentina, for example, local insurance companies can reinsure risks with foreign reinsurers only when there is no local reinsurance capacity, and subject to the approval of the Argentine Insurance Superintendent.

There is an exception if the risk exceeds $50 million, in which case the excess may be reinsured abroad without the Superintendent's prior approval. This would make it almost impossible for a captive to reinsure direct risks located in Argentina and therefore, require the use of a fronting reinsurance company.

Despite these obstacles, knowledge of captives in Latin America has grown due to the efforts of various offshore jurisdictions. Bermuda, the Cayman Islands and Barbados are among the preferred jurisdictions for Latin American-owned companies to establish captives. Bermuda has tax information exchange agreements with Argentina, Colombia and Mexico, which promotes transparency on the captive's arrangements.

As reflected in a Mexican newspaper, El Financiero, Pemex, the Mexican government-owned oil company, created a captive in Zurich, Switzerland to reinsure property and personal risks exclusively for Pemex-related entities.

Local admitted carriers, Banorte Generali and Inbursa, are issuing the insurance policies, retaining a small percentage of the risk and transferring the largest part to Pemex's captive Kot Insurance Company, which is registered as an admitted foreign reinsurer with the CNSF.

Kot Insurance Company obtains reinsurance in the international market. Other public companies such as Femsa, Grupo Modelo, Cemex, Walmart de México and Kaltex have created captives in offshore jurisdictions.

One of the tax implications of using an offshore captive is that article 173 of the Mexico Income Tax Law imposes the obligation to any foreign reinsurer to pay a 2 percent tax on the gross income, without any deductions, received by Mexican persons (including Mexican insurance companies and Mexican insureds) as cross-border premiums. Such tax will be withheld by the Mexican resident and paid to the Mexican tax administrative service (SAT).

The next steps

Interest in captives among Latin America companies continues to grow. However, the absence of captive insurance laws forces businesses to find captives solutions in other jurisdictions.

There are numerous reasons why it makes sense to keep captives business within the country. Insurance regulators in Mexico, Colombia and other countries in Latin America should be thinking about initiatives on captives legislation and regulators should seek recommendations from insurance regulators in countries with well-developed captive insurance industries.

Adopting a captives law in Mexico promoting the creation of local captives and preventing the migration of the captive business offshore would undoubtedly bring economic benefits to the Mexican government. SAT collects 30 percent income tax on the insurance companies' accrued income less authorised deductions; and 16 percent value added tax (VAT) on all insurance services paid by their customers except for certain lines of insurance such as life insurance. The current structure used by Mexican companies with offshore captives, where the fronting local carrier retains only a small percentage of the risk along with the premiums, translates into less income for the authorised local carriers. That means less income tax for SAT.

The private sector should also play a role in encouraging regulators to adopt a captive insurance law and tax incentives for those creating captives. The creation of captives laws could be complemented with amendments to the tax laws, so that the establishment of a captive affords tax benefits to the captive's owners.

This would encourage companies to better manage their risks, achieve insurance cost efficiencies and therefore, keep the captive insurance business in the country.

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