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CAPTIVES - IS MY INSURANCE PROGRAM READY?

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As an organization grows, their financial, operational, and strategic risks increase, and risk management and insurance programs similarly become more complex. Overall premiums for purchased coverages often lead to a comprehensive review internally and by a company's risk management team and insurance broker. Companies traditionally begin with guarantee cost insurance programs, meaning the insured pays premiums while the insurance company handles claims, including processing, negotiating, and paying any claims.

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As companies mature and generate more revenue (and thus pay higher premiums), organizations begin reviewing small and large deductibles, risk pools, self-insurance, and captive insurance options to save on their overall premium spend. Captives are typically the most misunderstood of these options, and thus come with many questions when our clients begin down the road of reviewing captives and their feasibility for their organization.

Regardless of your organization's size and industry, exploring a captive can be an eye-opening experience. It will provide you with a deep dive analysis into your own risk management program and potential exposures, gaps, and improvements that might otherwise go left uncovered in your commercial insurance program.

WHAT IS A CAPTIVE?

The definition of a captive is an insurance company that is controlled by its owner and its primary purpose is insuring the risks of its owners and limited other participants. Although alternative markets capture roughly half of the premiums in the US, captives make up 18 percent of that figure. There is a variety of uses for captives, such as estate planning, wealth transfer, off balance sheet transfer of assets, tax deductibility, business continuation, and true self-insurance. The four primary types of captives are:

- **Single Parent Captive** - Captives set up by larger organizations to insure risks of their company.
- **Association or Group Captive** - Set up by associations to insure the risks of the members, typically of similar industry and/or size, and mostly utilized by mid-sized organizations.

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- **Agency Captive** - Formed by insurance agencies to cover risks in business that they produce.
- **Micro Captive (or 831b)** - Insure high severity, low frequency risks with a total premium of not more than $2.2 million.

Of these four types of captives, group captives are the most common and where clients typically are introduced to the captive insurance concept. Let's dive a bit further into the group captives.

GROUP CAPTIVE ADVANTAGES AND POTENTIAL PITFALLS

Group captives provide many advantages over other forms of captives. These benefits include increased control, tax-efficient structure, design that allows for discrimination between "good" and "bad" risks, removal of reliance on the traditional insurance market, multi-state capabilities, and a low barrier to entry. Sharing in the underwriting profits and investment income, along with the financial incentive for your excellent safety and loss performance also make captives an attractive option. Although there are many benefits of considering a group captive, some general guidelines make them not a fit for all companies. Captives require a long-term commitment and focus, can present unknown risks and complexity within the group, and can result in capital requirements to pay losses shared with other members that may not relate to your business.

GROUP CAPTIVE STRUCTURE

Captives have a bit of mystique to them; however, the structures mimic that of a traditional insurance company. Group captives, where a group of companies come together and invest in an insurance company, are no different. The operating company contributes premium and surplus to your insurance company, and the group shares profits and losses determined by the captive's results. There is limited risk sharing with other group members to meet risk sharing and risk distribution requirements, and A-rated insurance companies issue policies to comply with all contractual requirements. Insurance policies typically included in group captives include workers' compensation, general liability, and auto liability (including physical damage).

INTERESTED IN EXPLORING A CAPTIVE?

If you're interested in learning more about whether a captive may be right for your organization, speak with your insurance broker to help conduct an initial due diligence review. A feasibility report is the first step to help you analyze your current structure and insurance program costs, obtain analytics around these premiums and your losses/trends, and provide an initial market presentation for introduction to potential captive managers.