AICC Captive Information

What is a Captive?

Captive insurance organizations include insurance companies that are owned and controlled by their insured. A captive insurance company is described as **single parent captive** if it is owned and controlled by one company and insures that company and/or its subsidiaries.

A **group captive** is an insurance company owned and controlled by two or more non-affiliated organizations the captive insures.

A **group captive** can be either homogeneous and insure similar types of businesses risks or non-homogeneous and insure risks of several types of organizations. In the U.S., **group captives** are licensed by a domiciliary state and use a fronting carrier, or they operate under the Federal Risk Retention Act. The companies may be stock, reciprocal or mutual in organizational form.

What is a Captive Program?

A captive program can be the effective way to manage risk and provide adequate coverage to its parent company or group owners. Sometimes, state laws do not allow captive insurance programs to issue insurance policies. In these instances a captive insurance company uses an admitted insurer to front the insurance program. A fronted program offers four major advantages:

1. Insurance policies are issued by the fronted carrier to meet state filing and financial responsibility requirements.
2. Fronted companies can offer a wide range of services including risk prevention, underwriting, pricing, claims handling, accounting, policy services and reinsurance.
3. A fronting arrangement allows the captive to generate cash/flow and investment income benefits from lines of insurance which cannot be written by the captive because of state insurance regulation.
4. Stable pricing and consistent coverage availability can be achieved from a long term partnership between the captive and fronted company.

Insurance companies benefit from fronting in several ways. Fronting insurance programs generate more business to the insurance companies that would otherwise be written by another insurance entity. A fronting program which is adequately secured with reinsurance and financial guarantees should generate a higher rate of return on equity to the fronted company than the traditional insurance company.

A significant risk for a fronted company is the credit risk of the captive. Credit risk is generated from the captive's inability to meet its financial obligations from the business and financial risk. They include adverse loss experience, catastrophic loss or inadequate spread of risk.

Nine Reasons for Forming a Captive Insurance Company

Q:
What are the reasons for forming a captive insurance company?

A:
There are numerous advantages to forming a captive insurance company.

A partial list includes:

1. the alternative to trading dollars with commercial insurers in the working layers of risk,
2. direct access to the reinsurance markets,
3. coverage tailored to your specific needs,
4. accumulation of investment income to help reduce net loss costs,
5. improved cash flow control,
6. incentive for loss control,
7. greater control over claims,
8. underwriting and retention funding flexibility, and
9. Reduced cost of operation.

CAPTIVE FAQ'S

Should you consider an alternative to your present insurance situation? To help you evaluate this question, here are a few "captive FAQ's" that will give you a brief "primer" on captives.

What are the broad classifications of captives?

Answer:
1. Group or association captives; and
2. Single parent captives

The group or association captive is an insurance company formed to provide insurance to its group or association of owners. The owners consist of companies usually from a related business field.

The second type of captive, a single parent captive, is an insurance company formed to provide insurance coverage's to its single parent owner.

How large does a company have to be in order to form a captive?

Answer:
This depends on the coverage's and limits of insurance to be written through the captive. In general, to form a single parent captive, a company's annual insurance premium should be a minimum of $750,000. However, just about any size company can be part of an association captive.

If my annual insurance premium is greater than $750,000 does that mean I should form a single parent captive and not be part of an association captive?

Answer:
Not necessarily. It depends on your reasons for forming a captive. Deductibility of premium for tax purposes may be better served by an association captive. There are plusses and minuses to both forms. An association captive may involve sharing of some financial information with other companies.

In a single parent captive, you have much more control of its operations than under an association captive where you have to share control with other parties. However, an association captive allows you to spread the risk of losses among a larger group of risks.

Why do companies form captives?

Answer:
The reasons for forming a captive are varied. Some of the common reasons cited include:
a. Greater availability of insurance coverage's at a reasonable cost or any cost
b. Use of a captive may have significant tax advantages
c. Greater control of their insurance needs
d. Better service for their insurance exposure. A captive can tailor its insurance program to meets its own specific situation. This can involve better loss control, better underwriting and more control over the handling and settlement of claims
e. Ability to obtain broader coverage's
f. In general, the ability to have greater stability in the cost of insurance
g. Potential for improved cash flow. The premium collected by the captive earns investment income which accrues for the benefit of the captive owner(s)
h. Direct access to the reinsurance market
i. More immediate reward for controlling the cost of claims

Joining an Association Captive

Should you consider an Association Captive as an alternative to your present insurance situation? This page will help get you started in your evaluation process.

Following is a list of questions to consider before forming or joining an Association Captive:

1. How many other members or companies are interested?
2. What lines of insurance would be written through the captive?
3. How do you and the other members feel about pooling of risks -- that is, sharing the cost of losses with other members, some of whom may be competitors? *(Note: It is sometimes possible for a captive to be formed such that each member is responsible for all or most of its own losses.)*
4. Are you and the other members willing to make a long term commitment, say for at least five years?

5. Are you and the other members willing to make a financial commitment in order to capitalize the captive?
6. Are you and the other members willing to make a commitment to loss control?
7. Will the captive be able to provide you with coverage are that you cannot obtain at a reasonable price in the traditional market?

Forming a Single Parent Captive

Should you consider a Single Parent Captive as an alternative to your present insurance situation? This page will help get you started in your evaluation process.

Following is a list of questions to consider before forming or joining a Single Parent Captive:

1. Is your company willing to make the financial commitment for the formation of a captive?
2. Would the formation of a captive lower your insurance costs through the elimination of unnecessary or redundant services and improved loss experience?
3. Will a captive allow you to obtain insurance for coverage’s that are difficult to obtain at a reasonable price in the traditional market?
4. Does your company need to find insurance for its international exposures?
5. Is your company willing to make a commitment to loss control?