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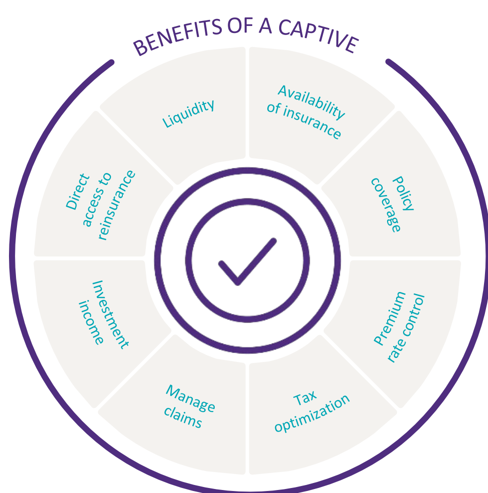
Exploring the opportunities of captive insurance companies

Insurance premiums are skyrocketing. Claims are being denied. Now is the time to rethink a captive strategy.

Organizations with a complex risk profile can yield savings and other benefits by electing to self-insure through a captive. Captive insurance companies are often formed to supplement commercial insurance, allowing the company that forms the captive the ability to decide upon coverage, make claims decisions, retain the money that otherwise would be spent on insurance premiums and benefit from the profits the captive generates.

The impact of COVID-19 on risk management strategies

COVID-19 has raised questions about what actually is covered in various types of insurance policies such as business interruption, workman's comp, trade credit or event cancellation. While many policies specifically exclude claims tied to a pandemic, others are vague, thus lining up potential law suits for denial of coverage. This dynamic, along with rising insurance premiums, is causing many companies paying significant premiums through the traditional commercial insurance channel to consider establishing their own captive company to manage their organization's risk.



Considerations for evaluating a captive

Economic benefits of a captive

Traditional insurance premiums paid through brokers to insurance carriers include rates to cover potential litigation, overhead, and other costs. When an organization runs its own captive, the premiums and claims are managed by the owner, providing opportunities to effectively manage liquidity. The organization benefits by designing insurance coverage that makes sense at prices determined by the captive owner. Organizations considering a captive insurance solution must be willing and able to invest their own resources and choose to participate in the risks and rewards of using their own risk capital rather than paying a traditional insurance company to use their capital. A captive enables self-insured, under-insured, un-insurable or complex risks that struggle to find economical rates in the traditional commercial market to be tailored to the particular needs of the insured, converting them into tax-deductible premiums that are paid to the captive.

Captive structure

Captives typically fall into the following categories:

1. Single parent captive: typically used when an organization has a complex risk management program and pays significant premiums for traditional commercial insurance. These captives only insure the risks of their owners.
2. Group captive: formed when companies, often from a similar industry, agree to establish a captive, to keep separate, pool together or both to share risk across the group. A rent-a-captive is a version of the group captive, where the insured pays an access fee to participate in a captive where others co-exist, but the risk is not pooled amongst members (each company has their own segregated cell).

Considerations for evaluating a captive continued…

Domicile location

A captive must be regulated locally where domiciled (at the state level in the U.S.), and demonstrate risk transfer[1] and risk distribution[2]. In the U.S., states often used for captives are Vermont, Arizona and North Carolina, while internationally Bermuda, Barbados and Cayman Islands are the most common domicile locations.

Ultimately, the jurisdiction chosen to setup a captive largely comes down to specific attributes of the company forming the captive, regulatory benefits, tax optimization considerations and operational ease.

Effort to establish a captive's infrastructure

Creating a captive involves setting up an insurance company as a separate, legal entity and establishing the infrastructure to operate independently. The management of a captive can be handled entirely by the owner, partially or fully outsourced, or individuals can be hired to run portions of, or the entire business. Determining the right mix for the captive's internal and outsourced operating model depends on a variety of variables, such as the owners goal for creating a captive, risk profile, capabilities to manage an insurance company, and appropriate tax analysis.

At the ready to help you

Grant Thornton's team of insurance professionals have worked in the insurance industry themselves, and use that practical know-how to advise clients around accounting, tax and regulatory considerations of risk management decisions.

Captive Phase Zero Assessment

We help organizations quickly evaluate the viability of a captive strategy, and will produce a business plan through the Captive Phase Zero Assessment.

THE ASSESSMENT INCLUDES EXPLORING THE BENEFITS OF A CAPTIVE FOR YOUR ORGANIZATION IN THE FOLLOWING AREAS:

- Domicile assessment and considerations
- Regulatory review and your organization's alignment
- Risk profile analysis (actuarial review)
- Operations / integration plan to build into your organization
- Business plan

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Footnotes:
1. Risk Transfer: requires the contractual shifting of risk from one party to another.
2. Risk Distribution: requires the premiums of the many, pay the losses of the few (actuarially proven and reasonable).

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