

CAPTIVE INSURANCE INFORMATION SHEET

WHAT IS CAPTIVE INSURANCE?

- **Definition:** A captive insurance company is a risk retention mechanism that businesses use to manage their risks.
- **Structure:** Owned by a noninsurance company, it primarily underwrites the risks of its parent and affiliated companies.
- **History:** Emerged in the 1960s as an alternative to traditional insurance's challenges in covering unique or high-risk scenarios. Evolved significantly alongside the development of the insurance industry, regulatory frameworks, and advancements in risk management practices.
- **Single parent captive:** Wholly owned by a single parent company to insure its risks.

WHY SELF-INSURE WITH A CAPTIVE?

- **Market conditions:** Shifts from a buyer's market to a seller's market due to high loss levels and evolving risks.
- **Benefits:** Mitigates volatility, stabilizes pricing, and provides coverage where traditional insurance may not. In years when claims are less than premiums, a private insurance company would take the surplus. With a captive, the surplus can be invested to grow and be available for future catastrophic claims, like earthquake damage that could break pipes or impact sewage treatment plants
- **Key considerations:** What risks can the captive insurance cover? How much risk to retain? How much risk to transfer?

OPERATIONAL REQUIREMENTS:

- **Compliance:** Adheres to strict regulatory and financial reporting standards.
- **Management:** Managed by representatives from the parent company and service providers, including auditor, actuary, captive manager, claims management, fronting and partner insurers, investment manager, and legal counsel.

USE OF CAPTIVES:

- **Risk management:** Used for high-frequency, low-severity risks; property damage; business interruption; and optimizing strategic risk.
- **Integration:** Fits within broader risk strategies, balancing risk transfer and retention.

DOMICILE SELECTION:

- **Considerations:** Domicile experience, flexibility and efficiency of regulator, legal and regulatory infrastructure, geographical convenience, capital and solvency requirements, competitive operating costs, attractive tax regime, and parent company presence/substance.
- **Popular domiciles:** Vermont, Bermuda, Cayman Islands, Hawaii, and Arizona.