A Guide to Captive Insurance

Artex
THE CAPTIVE MARKET 06
Captive insurance companies are a prominent risk control mechanism in strategic planning of organizations ranging from Fortune 500 companies to medium-sized enterprises, spanning virtually every industry sector and every corner of the globe.

In this section, we explore:
› The current state of the captive industry
› How captives are evolving
› Factors driving captive growth
› The global expansion of captive utilization

WHY FORM A CAPTIVE? 08
Forming or joining an existing captive is a strategic decision. It requires a detailed assessment of your risk exposures, attitude to and appetite for retaining risk, as well as a long-term commitment to optimize the balance between self-insurance and risk transfer to the commercial insurance market.

In this section, we explore:
› The key benefits of a captive:
   • Financial
   • Risk management and claims control
   • Insurance coverage
› Who should consider forming or joining an existing captive
› Why a captive is a long-term strategy

ESTABLISHING A CAPTIVE OR CELL COMPANY 10
From establishing the viability of a captive to the formation and management of the company, we take a detailed look at every stage in the process.

In this section, we explore:
› The range of information and data required
› Stages involved for a feasibility study
› Registration and licensing processes
› The operational administration of the captive
We also provide an overview of the captive formation timeline, from preliminary meetings to post-establishment review, highlighting fees that may be required.

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A captive is a versatile facility that can be used to provide coverage for a broad range of insurance lines. While primarily used for more predictable lines, improved risk management and a growing awareness of captive benefits are expanding the frequency and manner in which captives are used to manage risk.

In this section, we explore:
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› Emerging captive lines
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A range of entity types are available for captive structures, all designed to meet the requirements of a diverse spectrum of clients’ risk management needs.
In this section, we explore:
› Single-parent captives
› Group captives
› Agency/producer owned captives
› Enterprise risk captives
› Employee benefit captives
› Rent-a-captives
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In today’s increasingly competitive captive arena, one of the most important decisions to make when establishing the company is choosing an appropriate domicile.
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› Factors that influence the choice of domicile
› The onshore/offshore decision

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We provide an example of how a captive structure was established to meet the risk requirements of a community hospital, highlighting some of the key decisions that were made during the process.

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We highlight some of the factors which set Artex apart from other insurance managers, including our global reach, extensive experience, flexible approach and independence.
WHAT IS A CAPTIVE?

A captive is a special purpose legal entity which is licensed as an insurer, and is established primarily to insure a proportion of the risks of its sponsor, often a corporate parent, group or association.

It is a risk-bearing vehicle.

It can be either an insurance or a reinsurance entity.

In addition to being used for insuring or reinsuring the risks of its parent and affiliates, a captive can also be used to insure or reinsure the risks of third parties, such as customers, suppliers or subcontractors.
“A well-structured captive can respond quickly and effectively to the changing demands of its parent company or fluctuations in the insurance market.”

**TAKING CONTROL**

In an increasingly dynamic, evolving and volatile global marketplace, the need to establish and maintain control over risk exposures is critical. To do so, successful businesses develop and implement risk management programs that support their strategic objectives, mitigate against new exposures and probe for emerging threats. Through effective levels of control, businesses achieve stability in turbulent markets, grasp opportunities when they arise and grow profitably throughout the market cycle.

**A central role**

A central component of the risk control strategy for a growing number of organizations is the captive insurance company. The primary role of a captive is to insure the parent company, who usually owns or is a sister company to the captive vehicle, for all or a proportion of its insurable risks. In practice, however, a captive creates much greater value.

The captive is an ideal mechanism for:

- Establishing a centralized risk framework
- Creating tailored, comprehensive and responsive coverage
- Improving claims handling and monitoring
- Potentially reducing the overall cost of risk
- Potentially increasing the cash flow of the combined business enterprise

A captive provides more than just a mechanism to control the risks of the parent company. It also offers entrepreneurial opportunities for joint venture partners, associations and insurance agencies. The majority of companies do not have the appetite nor the financial capacity to self-insure all of their risks, and a captive allows the purchaser of insurance to optimize the balance between self-insurance and risk transfer with commercial insurers to suit their risks and resources. The process ultimately provides an excellent management and negotiation tool when trading risk in the market.

**A responsive approach**

One of the main strengths of the captive is its inherent flexibility. A well-structured captive can respond quickly and effectively to the changing demands of its parent company or fluctuations in the insurance market. A captive can adjust retention levels or amend insurance parameters when required, offering a rapid response tool which keeps pace with change.

In this guide, our goal is to make you aware of what a captive can offer your organization. We will discuss the many benefits of being a captive owner, summarize the processes involved in establishing a captive and provide a brief overview of the different types of captive structures available.

We hope once you have reviewed this guide it will help drive some of the decision making process necessary to determine whether a captive could add value to your organization.
THE CAPTIVE MARKET

Modern captives provide a sophisticated risk transfer mechanism that plays a central role in the medium to long-term strategic planning of organizations ranging from Fortune 500 companies to medium-sized enterprises, and spanning virtually every industry sector.

On the rise
Global captive numbers have risen to beyond 6,900. Increasingly, organizations acknowledge that risk managed through a captive is less costly and more efficient than traditional insurance placement. This is because the captive structure provides a premium rate that reflects the organization’s unique exposures, as opposed to commercial insurance market rates that reflect industry averages and typical exposures.

Spreading the risk
As the captive market has matured the willingness of owners to place a broader array of risks into their captive, and to raise their retention levels, has also increased. The scope of the captive has moved beyond traditional risks such as property, workers compensation and professional liability to encompass risks such as employee benefits, medical stop-loss, supply chain liability, trade credit and employers’ liability, as well as emerging risks such as cyber liability.

TOP 5 EUROPEAN DOMICILES
Number of licensed captives – 31 December 2015
Source - Business Insurance captive survey

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<tr>
<th>Country</th>
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<td>Guernsey</td>
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TOP 9 CAPTIVE DOMICILES
Number of licensed captives – 31 December 2015
Source - Business Insurance captive survey

<table>
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<tr>
<th>Country</th>
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TOP 10 US DOMICILES
Number of licensed captives – 31 December 2015
Source - Business Insurance captive survey

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<td>Tennessee</td>
<td>127</td>
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<tr>
<td>Arizona</td>
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1 According to the Business Insurance captive survey, captive numbers at the end of 2015 had reached 6,939, up from 6,839 at the end of 2014.
Lowering the barriers
Captives have continuously evolved in response to changing market needs. Today, there is a diverse range of captive structures available, including pure captives, group captives, agency captives, captive pools and various cell structures and rent-a-captives. The most recent evolution is enterprise risk captives (also referred to as micro or 831(b) captives), segregated accounts/portfolio companies, protected cell companies and risk retention and purchasing groups. These innovative structures have helped lower the financial and logistical barriers to the captive solution for many organizations, resulting in an expansion of their appeal to a much broader market.

A world of choice
As interest in captives has increased, so too has the number of jurisdictions offering captive legislation and facilities.

While Bermuda, Cayman, Guernsey and Vermont continue to top the captive leader board, playing host to over 40% of captives globally, domiciles such as Delaware, Utah, Anguilla and South Carolina are becoming increasingly popular. Furthermore, in the US, for example, over 35 states currently1 offer captive legislation. Companies can now locate their captive in more geographically desirable locations than was previously possible.

A growth market
The captive market is growing. New formations are on the rise, premium volumes are increasing and overall market appeal is growing. Self-insurance, as part of a risk transfer strategy, is evolving to capture a greater number of risks, industries and territories. As the level of sophistication continues to increase, captives will become an even more effective and efficient structure for managing risk.

1 As of May 1, 2016.
WHY FORM A CAPTIVE?

Making a decision to establish or join an existing captive is strategic. It requires a detailed assessment of your risk exposures, attitude to and appetite for retaining risk, as well as a long-term commitment to optimize the balance between self-insurance and risk transfer to the commercial insurance market.

For most captive owners, the primary reasons for establishing a captive include the ability to:

- Minimize and bring stability to the cost of insurance risk
- Provide customized and responsive insurance coverage
- Embed a proactive risk and claims management framework into the organization
- Access the reinsurance market directly
- Improve enterprise cash flow, cash flow timing and investment returns
- Generate a new revenue stream by covering third-party exposures

Multiple benefits

The range of benefits delivered by a well-structured captive has grown considerably in recent years due to a combination of increased sophistication, changing market dynamics and a more demanding captive client.

The principal advantages of a captive can be divided into three main categories: financial, risk management & claims control, and insurance coverage.

FINANCIAL

- Helps reduce total insurance costs over time by aligning premiums with actual loss experience
- Increases stability of premium rates during times of market volatility
- Provides direct access to the reinsurance market
-Eliminates high expense ratios applied by commercial insurers
- Offers enhanced investment and cash flow benefits
- Can create new revenue generating opportunities
- May provide an efficient accounting and tax structure

RISK MANAGEMENT AND CLAIMS CONTROL

- Delivers centralized information and risk control
- Facilitates improved risk capital allocations
- Consolidates and manages global programs
- Provides a vehicle to support enterprise risk management initiatives
- Allows for the ability to create more effective claims handling processes
- Improves claims monitoring capabilities
- Can expose any areas of higher than average loss activity through claims audits

“The captive structure provides a premium rate that reflects the Organization’s unique exposures, rather than the commercial Insurance market rates.”
Who should consider forming a captive?

Any company with some of the following attributes should give serious consideration to making a captive part of their risk strategy:

- $30,000,000 or more in US dollars or equivalent gross revenue
- $200,000 or more in US dollars or equivalent annual P&C insurance spend
- 75 or more employees
- Proactive approach to risk management
- Long-term commitment to risk financing
- Strong financial balance sheet
- Appetite to finance retained risk

Long-term commitment

Establishing a captive, or joining an existing captive program, requires a long-term commitment in order to fully capitalize on the many benefits. Depending on the type of captive structure selected, the capital required can vary from nominal to significant. In terms of risk capital expenditure, we normally recommend that only those companies with an annual insurance spend of over $200,000 in US dollars or equivalent consider a group captive or small captive program. Consideration for a larger pure captive should have an annual insurance spend of over US$1,000,000 or equivalent, and US$500,000 or equivalent if considering a cell-type structure.

Forecasting exposure/premium growth may be an appropriate way for smaller companies to consider a captive.

INSURANCE COVERAGE

- Enables the development of tailored insurance policies
- Increases negotiating power with the commercial market at renewal when purchasing excess insurance
- Provides broader coverage options
- Can be adapted in response to changing market conditions
- Ability to overcome exclusions or other restrictions applied by the commercial market
- Delivers more responsive coverage
- Offers entrepreneurial opportunities for joint venture partners, associations and insurance agencies
- Centralized and improved risk retention strategies
- Stability of cover if commercial insurers withdraw from particular lines
- Can be used to underwrite third-party business
ESTABLISHING A CAPTIVE OR CELL COMPANY

The first stage in the process of establishing a captive is to confirm whether it is both viable and feasible for your organization. There are a number of practical considerations which should be addressed, including:

1. What is the primary motivation for establishing or participating in a captive?
2. What lines of business would be included?
3. Can coverage, premium and loss information be provided for the last 3–5 years?
4. Is there an indication available of renewal terms for the lines of insurance being considered for the captive, and how do they compare?
5. What are the corporate growth projections and how do these impact the risk profile?
6. Consideration of any regulatory requirements in relation to insurance arrangements?
7. Captive ownership structure?
8. Capitalization required to establish the captive?
9. The funding of any security/collateral requirements?

COMPILING INFORMATION

As with any important business decision, having relevant and accurate information is essential. When assessing the suitability of all captives, the following information is required:

- Description of business operations
- Historical loss and exposure data
- Financial information
- Details of the current insurance program, including any retained loss funding
- Details of additional risk capital expenditure
- Marketplace summary
- Business motivation for the establishment of a captive
- Review of any uninsured liabilities
- Details of the planned ownership structure
- Due diligence information on the captive sponsor and related parties
Consult the experts
To ensure that each component of the captive is effectively structured and aligned with risk and business objectives requires the appointment of a team of experts.

A comprehensive captive team can include:
- Insurance/captive manager
- Insurance broker/consultant
- Legal adviser with captive experience
- Tax advisor with captive experience
- Claims administrator
- Actuary
- Auditor
- Bank/Investment advisor
- Regulator

The feasibility study
A feasibility study is a collaborative study of a company’s risk profile that often includes actuarial reports, financial models, a review of the insurance market conditions and an assessment of regulatory, legal and tax issues. This report recommends risk management options, and establishes whether or not a captive is feasible and, if so, how this should be structured. Components of this review often become part of the insurance license application in the captive domicile selected. A feasibility study is generally based on the following framework:

**Introduction and executive summary**
- Terms of reference
- Report objectives

**Organization overview**
- Current insurance program
- Premium expenditure
- Details of any current self-insurance funding and non-conventional risk transfer
- Loss history information
- Actuarial report (if applicable)

**Captive requirements**
- Cost/benefit analysis
- Minimum requirements:
  - Solvency
  - Capitalization
  - Premiums
- Captive entity or structure options:
  - Fronting arrangements (if required)
  - Reinsurance (if required)
  - Retention levels
  - Claims management
- Domicile review
- Regulatory and compliance
- Timelines for establishment and ownership
- Directors

**Financial analysis**
- Stress testing, including loss scenarios and net captive retention
- Premium funding estimates
- Prospective pro forma
- Expected loss calculations
- Comparison of a captive to the existing risk financing program
- Estimate of likely expenses
- Surplus and capital contributions
- Investment strategy
- Tax position

**Other considerations**
- Future development opportunities of the captive
- Tax and accounting
- Ownership structure
- Class of license
- Exit strategy

**Recommendations**
Registration and licensing

It is essential to work with an experienced captive manager when registering and licensing a captive with a regulatory authority. They should be conversant in all regulatory requirements of the chosen captive domicile. It is also advantageous if they have a strong working relationship with the regulator.

The captive manager will work closely with you and the regulatory authority in the chosen domicile to complete all necessary documentation and submit all information required for the license submission. This will include a detailed business plan incorporating the following information:

- Full details of proposed ownership and supporting due diligence
- Description of the insurance program to be underwritten by the captive
- Strategic and underwriting objectives
- Reinsurance, fronting and any security requirements
- 3-5 year financial projections
- Capital adequacy calculations
- Risk management framework
- Compliance and corporate governance procedures
- Appointment of service providers
- Board of directors
- Investment strategy
- Dividend policy

“*It is essential that you work with an experienced captive manager when registering and licensing a captive with a regulatory authority.*”
Ongoing captive management

Once the captive is operational, the captive manager’s role becomes focused on ensuring that the new captive delivers the full extent of the benefits possible and evolves over time to meet the owner’s strategic and risk objectives. These services will include:

- Company and secretarial administration
- Regulatory liaison and compliance
- Corporate governance
- Accounting and financial reporting
- Coordination of any third-party service providers
- Strategic advice on the evolution of the captive

The captive manager’s role is wider than the operational maintenance of the captive. It is critical that the manager also ensures that the captive continuously evolves to meet the parent organization’s needs throughout its lifecycle. This involves working in partnership with senior management so that any changes in the risk profile or requirements of the parent, or variations in the commercial insurance market, are reflected in operation of the captive.

“The manager ensures that the captive continuously evolves to meet the organization’s needs throughout its lifecycle.”

IMPLEMENTATION

Work with client and other professional advisors to implement the agreed strategy
Appoint any required service providers
Negotiate coverage, fronting, reinsurance and security requirements
Submit license application
Execute agreements
Select domicile

CAPTIVE IS OPERATIONAL

Management account preparation
Policy issue and premium collection
Administer loss payments
Investment of assets
Annual audit
Schedule board meetings

FIRST ANNUAL REVIEW

Review captive participation, operations and coverages against ongoing objectives
Continue working with client’s professional advisors to evolve and add new lines of coverage where appropriate
Artex provides a gateway to creative programs, competitive capacity and collaborative expertise. We’re experienced in the full spectrum of risk management alternatives.
Captive fees and costs

The costs associated with administering a captive vary depending on captive type, complexity, domicile and levels of administration required.

Elements that impact these costs are:

- Number and type of insurance policies
- Number and territories included in the captive program
- Service requirements for insurance and claims administration
- Number of currencies, frequency of premium receipts and claims payments
- Any reinsurance-related work
- Liaison with fronting carrier(s)
- Need for administration of security arrangements
- Volume and type of investments
- Expected treasury and investment activity
- Liaison with professional and service providers
- Frequency and format of financial reporting
- Customized reports
- Number of board meetings or other necessary meetings per year
- Volume of certificates of insurance required

KEY CAPTIVE CONSIDERATIONS

When establishing a captive, you will need to consider the following:

- Fronting vs. direct policy issuance
- Reinsurance
- Program administration
- Claims administration
- Actuarial analysis
- Financial reporting
- Choice of domicile to meet requirements
- Captive ownership and type of entity
The typical costs and fees associated with a captive can include the following:

➤ Feasibility study
  • Actuarial fees
  • Legal, tax and accounting advice
  • Completion of report

➤ Captive establishment
  • Capitalization
  • Application fee (an independent application review fee may also apply in some domiciles)
  • Year 1 license fee
  • Incorporation costs
  • Captive manager fee
  • Legal fees

➤ Ongoing costs
  • License renewal fee
  • Other domicile fees
  • Captive management fee
  • Any necessary ongoing legal advice
  • Director’s fees
  • D&O insurance
  • Auditor fees
  • Actuarial fees
  • Sundry expenses, including meeting costs, travel and accommodation
WHAT CAN A CAPTIVE INSURE?

The captive is a versatile instrument which can be used to provide cover across a broad range of insurance lines. It allows the parent to efficiently optimize its mix of risk transfer to the commercial market and self-funding.

Some captives focus on traditional limits while other captives write less predictable lines. The majority of captives tend to underwrite aggregate loss limits to ensure the captive’s long-term viability. Larger risk layers are generally placed into the commercial insurance market, which has greater capital, appetite and capacity for such risks.

The types of insurance coverage which are suitable for a captive, particularly one newly formed, tend to be those that pay a reasonable level of premium and offer the potential for profit supported by historical data, plus projected investment earnings on cash flow. The total premium generated in aggregate across all lines being underwritten by the captive, net of administrative and reinsurance costs, should be sufficient to make establishing and administering the captive worthwhile.

It is important to note that companies that lack sufficient premium volume, resources or appetite for establishing their own captive can still access many of the benefits by participating in a cell-type structure, such as a Protected Cell Company, a Segregated Portfolio Company or by joining an existing group captive program.

Extending its reach

In recent years many captives have expanded their risk appetite to include an increasingly diverse range of insurance coverages. This is mainly due to greater awareness of the parent’s risk profile and better understanding of the costs associated with managing those risks effectively, as well as a greater understanding of the overall benefits offered by a captive.

Given its inherent flexibility, a captive also offers the parent company an efficient means of responding quickly to changing market dynamics, whether attributable to regulatory changes, volatility in the commercial insurance market or emerging risks. Examples have included interest in using captives to provide medical stop-loss cover following the Affordable Care Act in the US, trade credit following the financial crisis and more recently exploring the potential for covering cyber liability.

What risks can be placed into a captive?

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<th>TRADITIONAL CAPTIVE LINES</th>
<th>EXPANDED CAPTIVE LINES</th>
<th>EMERGING CAPTIVE LINES</th>
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<td>General Liability</td>
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<tr>
<td>Product or Service Extended Warranty</td>
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TYPES OF CAPTIVES

Captives come in a variety and ever-evolving range of formats designed to meet the requirements of a diverse spectrum of clients. While the single-parent or pure captive remains the most common, group captives, association captives and agency captives have served to enhance the overall appeal. The phenomenal growth in the formation of segregated/protected or sponsored facilities, cell-type structures and enterprise risk captives has also opened up the benefits to much smaller organizations.

**Single-parent (pure) captive**
- Owned and controlled by one owner
- Formed to insure the risks of the parent only
- Most popular structure
- Certain captives can expand into third-party business

**Risk retention group**
- Every insured must be an owner
- Writes only liability lines of insurance for policyholders engaged in similar business activities
- Authorized by the Federal Risk Retention Act of 1986; only available to customers in the United States

**Group captive**
- Owned by a group of companies
- Can be related (i.e., trade groups) or unrelated (i.e., same size)
- Insures the risks of the group
- Can be subject to joint and several liability

**Agency/producer owned captive**
- Owned by a producing retail or wholesale insurance agency/broker
- Can be homogeneous or heterogeneous books of business
- Assumes underwriting risk on the portfolio as a new revenue stream

**Enterprise risk captive**
- Smaller insurance company filed under tax code IRC Sec 831(b)
- Annual premiums must not exceed US$2.2 million (starting 1/1/17)
- Certain ownership limitations apply
- Can insure a variety of risks such as first-party exposures, deductible reimbursements, policy exclusions, specialized coverage that is unavailable or excessively priced in the conventional market, as well as other risks that are retained by the business

**Employee benefit captive**
- Can insure medical stop-loss, retiree benefits, group term life and long-term disability
- US-based medical stop-loss group captives designed for employers with 50 to 1,000 employees

**Rent-a-captive**
- Licensed offshore group insurers owned by an outside organization (broker, reinsurer or insurer)
- Available to unrelated organizations for a “rental” fee
- Designed for parties not wanting their own captive
- Segregation is contractual and not enshrined in legislation

**Segregated/protected/incorporated cell company**
- Owned by a third-party sponsor (often an insurance manager)
- Insures the risks of multiple insureds
- Individual “cells” are beneficially owned by the insureds
- Cells are legally segregated from each other
- Offers the benefits of a captive without the same level of financial commitment and associated costs
- Some domiciles permit the formation of incorporated cells
THE CAPTIVE STRUCTURE

The following diagram provides an outline of the structure of a single-parent captive, indicating the key parties in the structure and showing how capital, services and fees flow.

*The business organization can be the parent or the captive, or a related party (i.e., sister company) to the captive.

**Many captives do not require a fronting insurer.
SELECTING THE RIGHT DOMICILE

One of the most important decisions to make when establishing a captive is choice of domicile. Competition within the captive sector has never been greater, as emerging domiciles compete for market share with the leading domiciles. While competition is healthy, the range and diversity of potential locations for a captive make this challenging for the customer.

Domicile factors

For most organizations geographical proximity and ease of travel has made the decision of where to domicile their captive more straightforward.

However, there are a range of factors which should also be given careful consideration when selecting the most appropriate domicile, including:

- Solvency, capitalization and surplus requirements
- Approach, responsiveness and efficiency of the regulator
- Stability of regulatory and business environment
- Legislation: company and insurance law and the availability of cell legislation
- Maturity and quality of local financial services infrastructure
- Availability of high-quality expertise
- Convenience of travel to and from domicile
- Operational costs
- Taxation and accounting requirements
- Compatibility of language, currency and culture
- Convenience of time zone
- Political stability
- Redomiciliation agreements

If your organization conducts the majority of its business in a territory other than the one in which the business is headquartered, it may be beneficial to establish the captive in a domicile close to that business.
The onshore/offshore decision

A key consideration when choosing the most appropriate domicile for a captive will be whether to locate the entity in an onshore or an offshore jurisdiction. In recent times there has been an increase in organizations establishing their captive onshore in the US and EU.

There are a number of factors which can influence this decision: regulatory developments, tax and accounting considerations, travel cost savings, and also the surge in the availability of new onshore domiciles with captive legislation. However, despite this development, mature offshore domiciles like Bermuda, Cayman and Guernsey continue to dominate the captive marketplace, benefiting from their established and constantly evolving captive legislation, well-reputed and proportional regulatory environments, extensive captive-focused infrastructure and ease of conducting business.

Selecting the right domicile is a process which must be closely aligned to the organization’s objectives for establishing the captive. While it is possible to redomicile the captive, this is generally not straightforward and the goal should always be to select the appropriate domicile at the start.
That pivotal meeting triggered the hospital’s risk manager and CFO to review the hospital’s history of premiums paid, claims reimbursed and exposures growth.

A CAPTIVE CASE STUDY

A community hospital was considering setting up a captive, despite relatively sophisticated risk management procedures and better than average claims experience. The hospital was weighing a significant reduction in its OB/GYN practice given its inability to secure continuous insurance coverage at stable rates. The impact of this on their community would be devastating, as access to local OB/GYN practitioners would be severely restricted. Sense prevailed when a board member called this the tail wagging the dog. “We’re letting insurers dictate our mission. Show me Plan B.”

That pivotal meeting triggered the hospital’s risk manager and CFO to review the hospital’s history of premiums paid, claims reimbursed and exposures growth. They discovered that over the ten years prior, the hospital had paid in premiums five times the amount of claims reimbursed. The excess carrier experienced only one payout of US$250,000 on an OB/GYN case that they insisted be settled out of court, regardless of what the hospital’s risk manager and legal team considered a very defendable claim. The hospital’s loss experience had improved significantly during the ten-year period, despite significant growth in exposures (i.e., occupied beds, outpatient visits, employed practitioners, etc.).

Presented with the facts and the board’s instruction to take control of risk financing, the hospital’s broker agreed to explore the idea of using a captive with the assistance of an independent consultant.

A feasibility study was completed to further analyze the loss history, develop actuarial estimates of current claims liabilities and future liabilities, explore regulatory and tax parameters, evaluate ownership structures, compare alternative attachment points for commercial coverage, determine capital and solvency requirements and compare domiciles. The outcome was a recommendation to establish a captive prior to the next insurance renewal date.

The captive’s capital requirement was minimized by adding the following program features:

› Premiums for the limits retained by the captive were actuarially determined using a 75% confidence level
› Premiums were set sufficiently higher than this to cover the captive’s annual operational costs
› The primary insurance policy contained a mechanism for retrospectively adjusting premiums to partially counter any significant under/overfunding of a given policy year
› The excess limits insured by the captive were fully reinsured in the commercial market
As shown in the case study, conservative funding at the 75% confidence level meant that the captive had built up surplus of US$7.4 million after 5 years (US$3.5 million difference between insurance liabilities estimated at the expected and 75% confidence level, and US$3.9 million of funding in excess of liabilities estimated at the 75% confidence level). The retrospective rating plan allowed for some but not all of this surplus to be utilized by setting premiums for the 6th policy year at the actuary’s estimate of expected losses, without adding a margin for the 75% confidence level. Delaying release of all the surplus recognizes the long tail nature of hospital and physician professional liability insurance, and the possibility of still seeing the loss experience for any prior period deteriorate. This long tail also has its benefits, because premiums can be invested in the meantime, with investment returns supplementing any surplus from the insurance transactions.

Fifteen years after the captive’s establishment, it was in a position to negotiate better excess premiums in the market by increasing the excess attachment point and also taking a vertical slice of the excess layer. It also was in a position to release surplus to the hospital to fund ongoing healthcare initiatives, and had sufficient capacity to start considering other lines of coverage in the captive.

The captive afforded the hospital control of its destiny, and its mission was intact.

This case study highlights the importance of certain features in ensuring the success of a captive program:

- Good risk management
- Favorable loss experience
- Accurate exposure data
- Disciplined application of retrospective premium mechanism
- Prudent release of surplus reserves
- Long-term commitment to this strategic initiative on the hospital’s part.
THE ARTEX ADVANTAGE

At Artex, we create a diverse set of alternative risk management solutions created for clients’ individual challenges. Conventional thoughts produce conventional results, and we promise to deliver more than that to our clients.

We believe there are a number of factors that set us apart:

The best of both

As one of the world’s largest insurance managers, we combine our international experience and local market expertise in every captive solution we deliver. Our global reach means we can offer a domicile-neutral approach, which delivers the most appropriate captive location based on your needs. Our independence from any broker means the guidance you receive is always impartial and objective.

Service with experience

Our range of specialist services, delivered by insurance industry experts, spans the full lifecycle of the captive structure and covers all permutations of captive arrangements. We also offer access to the largest independent network of cell companies, as well as a variety of risk pooling services. The hallmarks of our success lie in our attention to detail and personalized approach with every customer we serve to truly understand the DNA of each business. We also believe that by understanding where we are today we can better help our brokers and their clients move ahead with true control over what the future may bring. We view today’s challenges as tomorrow’s opportunities and leverage this mindset to create alternative risk management solutions that change the way clients conduct business and plan for the future.

Risk pooling services

For those single-parent captives looking to participate in a risk pooling facility and meet the underwriting requirements, Artex operates five pools:

› AEX (large deductible workers compensation programs based in the US)
› Vantage (medical stop-loss in the US)
› Copper Mountain enterprise risk pool
› Copper Mountain management liability pool
› Copper Mountain deductible reimbursement pool

Artex also has experience with the accounting and administration services for government pools.

A flexible approach

By expertly combining the benefits of a tailored captive vehicle with insurance and reinsurance products, our risk transfer structures are designed to flex with changing organizational and market dynamics. That way we guarantee a solution that is always fit for purpose. In today’s volatile environment, that makes a compelling option for any insurance buyer.

Only with such depth of experience, breadth of choice and level of expertise can we guarantee each solution we provide is custom-built to support the business objectives.
Artex’s global operations platform means that we are always able to locate your captive in the most appropriate domicile, no matter where in the world that happens to be.
The information contained in this guide provides a general overview of captive insurance companies. The information may vary by domicile. It is not intended to provide legal, accounting or tax advice and should not be relied upon in that regard. You are asked to review all such matters with your qualified advisors.

Please note that some of the terminology used in this guide may vary depending on the particular domicile.

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