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Insurance Strategies

Captives as Part of a Risk Management Plan

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A captive insurance company is an alternative approach to traditional insurance or risk financing. Generally established as a subsidiary of a parent company, or a group of companies that come together to share risk, captives insure the owners' risks and allow them to benefit from underwriting profit.

When used as a part of an organization's overall risk management plan, a captive can help elevate its focus on core risk management principles, which can lead to lower commercial insurance costs and improved claims experience.

How a Captive Is Different from Traditional Insurance

Traditional insurance may be characterized as the transfer of risk through the payment of a premium to a third-party insurer, who in turn promises to administer claims and pay losses under specific circumstances. The insurance company uses the premium to pay claims, regulatory and compliance expenses, underwriting costs and more for all policy holders. If an underwriting profit is achieved, the insurer retains that profit.

A captive is a form of self-insurance whereby a business owner funds its own losses, typically up to a pre-defined level. The company pays the premium into the captive and retains all underwriting profit and investment return.

Because captives are self-funded, there is a risk of loss. They may also carry additional administrative costs, over and above what one would expect from the traditional insurance market. Additionally, there are complex regulatory and compliance issues to consider. However, the financial benefits are very attractive in the right situation.

Why Consider a Captive Arrangement?

When a captive is properly established, the owner's reliance on commercial insurance is reduced and, over time, leads to lower premiums. The premiums paid into the captive are also invested, based on the investment guidelines by the domicile regulators, with the returns offsetting some administrative costs. As premiums are paid and invested, with positive loss experience, the captive company will build equity. Some additional benefits include:

- Reduced reliance on commercial insurance
- Ability to cover for risks traditionally not readily available or economically feasible in the commercial markets
- Opportunity to choose own legal counsel
- Potential financial advantages relating to tax and other long-term planning goals

Organizations Best Suited for a Captive

Although a company may be interested in protecting itself financially while having more control over how it is insured, that doesn't mean the business is automatically a good candidate for a captive. Some specific traits an organization should have to reap the most benefit from a captive include:

- Consistent high-profit performance
- Minimal loss history
- Comprehensive risk management strategies
- Preference to control the claims process

Additional Considerations

Determining if a captive insurance program will meet an organization's risk needs and goals is an important first step. Finding the right advisor to manage your program is imperative. Not only will they implement and manage the program, they will also ensure it is compliant with applicable regulations. It is best to work with someone who is experienced in establishing captive programs and transparent about fees.

Businesses and groups that want to take financial control and manage risks by underwriting their own insurance rather than paying premiums to third-party insurers should explore a captive insurance option.

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