



Private Client and Wealth Structuring

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Captive insurance

What is captive insurance?

Captive insurance is basically self-insurance using a company owned directly or indirectly by the insured person. Most captives are formed in jurisdictions that specialise in this type of business, including Guernsey, the Isle of Man and Bermuda.

What are the advantages of captive insurance?

Lower insurance costs

The use of a captive insurance company can result in a potential reduction in insurance costs. The costs of commercial market insurance takes into account the claims, overheads, and profit retained by the insurance company. In the case of a captive, the profit will remain with the business of the owner, in effect allowing the owner to share in the underwriting profit on its own insurance. A captive may also reduce insurance premiums by charging a premium that more accurately reflects the claims history of the parent/owner.

Form of Investment

As with any other kind of investment, profits of the captive's business can be paid out to its owners.

Access to the reinsurance market

Reinsurers are the international wholesalers of the insurance world. The captive's ability to deal directly with reinsurers can produce additional cost savings. The reinsurance market can also have additional capacity and a willingness to insure more difficult risks.

Unavailability of coverage

A captive may be able to provide insurance coverage where none is available in the commercial market, or only at a prohibitive cost.

Control

The use of a captive can increase the control of the business over claims and the insurance process in general.

Taxation

There may be tax advantages. A captive may prove to be a more tax-effective approach than simply self-insuring on a formalised basis. The extent of this advantage will depend partly on the tax residence of both the captive and its owners. Generally speaking, arm's length insurance premiums of captives, as with any other insurance company, are an allowable expense for tax in the country from which they are paid.

Why consider captive insurance?

To plug gaps in your existing insurance cover

Captive insurance is often used to fill gaps where commercial insurance providers will not provide cover, or where the cost is uneconomic: it rarely replaces commercial insurance. Common areas of risk that can be included in a captive are the deductibles and exclusions of the business' commercial insurance cover. Other risks that are often uninsured by commercial policies but could be covered by captive insurance include business interruption, loss of key customers, credit default, extended warranty claims, directors and officers, errors and omissions, litigation defence, construction defects, pollution and natural disasters.

To obtain specialist coverage

A captive may also be worth considering for more specialist coverage that is not necessarily connected to a business, for example, to insure an art collection.

Captive insurance as part of an estate plan

Use of a captive also can provide significant opportunities to retain and transfer family wealth to other members of the business owner's family. Funds that would otherwise would have been paid to a third party to purchase insurance cover are retained within the family, either by the business owner, an associated company, or a trust set up for the benefit of the owner's family. In some cases, it may also be appropriate for the captive to be held through a pension plan.

Conclusion

A captive insurance company can provide some businesses with an effective means of funding self-insured risks, lowering the cost of certain types of insurance, and maintaining greater control of the risk management process. There may also be opportunities for individual business owners to transfer substantial wealth to younger generations or key management personnel in a tax-efficient manner.

Setting up and operating a captive can involve several different areas of law. Our team of specialists can work with you and your other advisers to determine whether captive insurance is appropriate to your circumstances.

Contact

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