Marsh

The definitive guide to captive insurance

Marsh Captive Solutions

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About Marsh Captive Solutions

“Captive insurance is a risk-financing mechanism in which a company insures itself against future losses.

What is a captive?

DEFINITION

It seems like everyone is talking about captives these days, regardless of the industry you're in or the size of your organization.

When facing higher premiums, a lack of capacity, increased deductibles, and more stringent terms and conditions, captives offer an opportunity for leaders like yourself to more efficiently manage risk. And, with better risk management comes an array of potential benefits for both your bottom line and employees — including reduced costs, expanded employee benefit offerings, investment strategies, and improved cybersecurity.

Although the advantages are clear, trying to grasp the ins and outs of captives can quickly become overwhelming. So, let's change that.

First, two important definitions:

- **Captive insurer:** A legal entity formed to insure the risks of a corporate parent company, a number of affiliates, or unrelated third parties.
- **Domicile:** The location where the insurer is licensed to do business.
  - The domicile is either onshore, such as the state of Vermont, within the European Union (EU), or offshore, like Bermuda, the Cayman Islands, or Guernsey.

There's a good reason that leaders' interest in captives has been growing in recent years. Increasingly, small-to-medium size firms are able to realize the benefits captives offer, such as the ability to insure their own risk and retain profits.

As the world's largest captive manager (and we're not "tooting our own horn" but here's why it's important), the Marsh team is here to help you understand how a captive could help manage risk on your own terms.

IS A CAPTIVE THE SAME THING AS SELF-INSURANCE?

If the definition of a captive gives you déjà vu, don't worry. Although the concept overlaps a bit with the idea of self-insurance, there are important differences. Self-insurance is a way of retaining all types of risk on your balance sheet.

Captive insurance is a formalized and regulated risk-financing mechanism in which a company insures itself against future losses. However, in a captive insurance arrangement, the insured (the organization covered by insurance) creates a more formal arrangement for protecting against its unique business risks. This means that the potential benefits unique to captives include:

- The ability to build capital and surplus, and to pay insurance claims by paying and setting aside premium payments and underwriting investment to cover losses.
- Better protection against catastrophic losses by formally funding for them now.
- Coverage for unique and emerging risks — such as pandemic and terrorism — that may be unavailable or costly in a traditional insurance arrangement.

Now that you've got the important definitions down, let's explore how your organization can begin to build its own captive.

YOUR OPTIONS WHEN IT COMES TO CAPTIVES

Before you go down the path of creating your own captive, you'll need to know about the four structures available:

Single-parent captive: Created by an organization to insure only its own business and its employees or those of controlled but unaffiliated business, such as a management contract. Single-parent structures account for approximately 85% of all captives.

Cell captives: These programs are sponsored by a third party, usually a captive management company, so that business owners don't have to create their own. This allows an organization to obtain the benefits of a captive insurer without the higher upfront startup costs and slightly higher annual operating costs. Keep in mind cells still need to be capitalized.

If you hear any of the following, just know it's the same thing as a cell captive: cell facilities, protected cell captives (PCC), rent-a-captive, and segregated cell captives.

Cell captives are seeing steady growth because they can be faster, less expensive, and simpler to enter. They provide one or two lines of coverage to those that need to wall off risks in separate cells.

Risk retention group (RRG): In this structure, businesses with similar insurance needs will create and own a liability insurer to pool risk. This is useful for liabilities including automotive risks related to trucking and transportation or medical malpractice. However, it's not applicable for first-party risks, such as property or workers' compensation. It's important to note that RRGs are only available within the US.

Group captives: Ownership of this captive program type is limited to the insureds. The captive exists primarily to provide greater long-term cost stability than the traditional market allows.

Now that you know the options and the important definitions, we'll go over whether a captive makes sense for your organization.

HOW DO I KNOW IF A CAPTIVE IS RIGHT FOR MY ORGANIZATION?

A captive insurance program will likely align with your organization's strategy if it possesses the following traits:

- Exposures to risks that are difficult or expensive to insure, or are entirely uninsurable in the commercial environment.
- A strategic approach to managing risk, exposures, and cost of risk rather than a focus only on purchasing insurance at the lowest price.
- A commitment to improve your risk profile by building and benefiting from long-term relationships with insurance partners.

For owners, captives can also offer improved compliance, better control of premiums, and an enhanced customer experience for third-party unrelated risks, including warranty and independent contractors.

Creating a captive won't be a "set it and forget it" kind of initiative. As time goes on, it will be important to evaluate your strategy and how it has changed since the captive was first introduced. Marsh Captive Solutions will help you answer the following:

- Is the captive aligned with accelerating our corporate objectives?
- How are my peers using their captives for certain risks?
- How can our captive respond to emerging risks?

Applying insights from benchmarking will help to refine your business' long-term risk management strategy and improve your captive program over time.

You can benchmark against peers to provide insight into your options within the context of industry, company size, and/or region. This will help to determine whether a captive can help, and can also identify potential opportunities and emerging threats to consider as you go on your captive journey.

> "Applying insights from benchmarking will help to refine your business's long-term risk management strategy and improve your captive program over time.

How a captive makes life easier

RISK MANAGEMENT PAIN POINTS

You know a captive helps with risk management, but the question remains: How does it actually achieve improved risk control?

Captives are created to improve a business' ability to manage the retentions and deductibles associated with traditional risk transfer programs. By forming its own subsidiary insurer to handle some of its risk, a company is freed from the control and restrictions of the commercial insurance market.

This way, a captive can help highlight the impact of effective claims handling, loss control, and engineering programs. And, over the long term, it will help to get everyone on the same page when it comes to your risk management strategy, regardless of the division or subsidiary they work in.

Businesses that create a captive insurance program also have the flexibility to fund traditional coverages — such as general liability, workers' compensation, auto liability, property insurance, and employee benefits — as well as difficult-to-insure exposures, including environmental and cyber risks.

Captives are created to improve a business' ability to manage the retentions and deductibles associated with traditional risk transfer programs.

FINANCIAL FLEXIBILITY

Your organization is probably not retaining as much risk as it could, in theory, since you're carrying the burden of high administrative costs passed on through the commercial market.

By retaining the premium for unexpected losses, a captive can help reduce the overall cost of an insurance program. Translation: You're avoiding those unnecessary premiums feeding into a third-party insurer's overheads and profits.

Captives can also hold and invest premiums for unpaid claims, which are otherwise kept by a commercial insurer. This takes advantage of the time value of money and puts cash back into the organization.

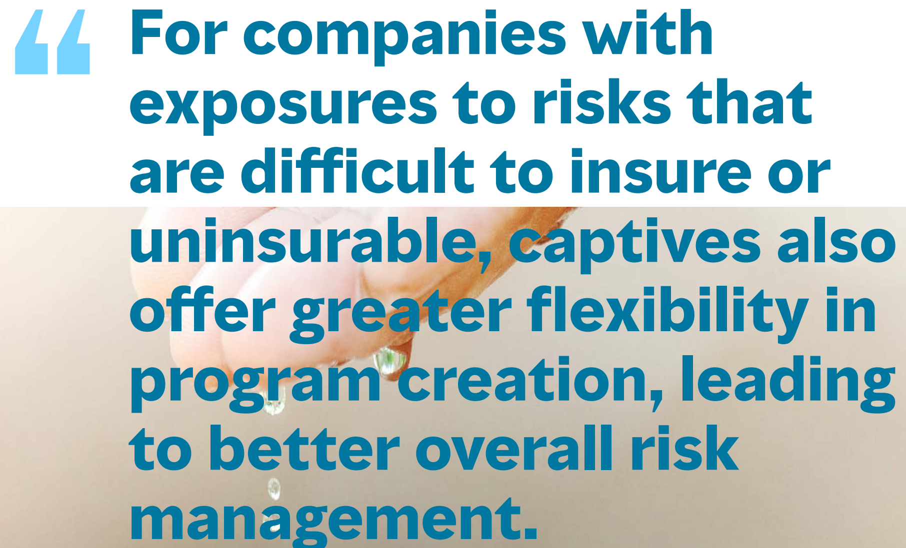
With some types of coverage, such as liabilities to third parties, losses may emerge over a number of years. However, a captive is able to reserve from current funds for future claims payments, matching revenue and expenses attributable to each financial year. Because a captive is a subsidiary of its parent, it will be easier for your team to monitor and evaluate the financial impact the program has on the organization's risk management program through metrics, including your return on investment (ROI) and other financial criteria.

A captive can also expand its book of business by offering insurance to related third parties, such as franchisees, contractors, vendors, or customers, generating an additional revenue stream for its parent. Some captives also write coverage for unrelated third parties through participation in various reinsurance pools or treaties.

From extended warranties to contract vendor liability, captives can insure many different third-party exposures. They can also create a profit center for their parent organizations, diversify the risk in their captives, and improve relationships with end-users. Meanwhile, customers and vendors can gain access to lower-cost coverages and build a better relationship with the captive parent.

By building and maintaining a captive insurance program, your company has the potential to achieve greater overall financial flexibility, allowing you to pursue other valuable initiatives.

> “For companies with exposures to risks that are difficult to insure or uninsurable, captives also offer greater flexibility in program creation, leading to better overall risk management.



STRATEGIC

A captive insurance program offers your organization several strategic benefits, including enhanced group purchasing power and an improved negotiating position.

Employers are increasingly using captives to finance healthcare and employee benefits risks, gaining greater control over costs and access to data. Captives can also be used to access reinsurance capacity for medical stop-loss coverage to reduce the cost of risk.

For companies with exposures to risks that are difficult to insure or uninsurable, captives also offer greater flexibility in program creation, leading to better overall risk management. Through its captive, your company can write policies that cover risks tailored to its exposures in the event of high-severity interruptions.

With a captive, your organization may be able to enjoy a stronger strategic position by having the flexibility to design a comprehensive program that is unique to its risk-related challenges.

OPERATIONAL

By centralizing control and bringing its insurance program in-house, your organization will be able to focus on issues and solutions that are more relevant to specific business operations and stakeholders, resulting in greater alignment in goals between the business and the captive.

As time goes on, the captive will help your business collect and analyze data that will enable more accurate predictions of future claims trends, helping to reduce costs and improve risk management.

Your company will also be able to be more actively involved in claims administration, gaining greater control of claims.

As the primary insurer, a captive insurance vehicle can tailor its policy, manage claims, and obtain subsequent reinsurance so that the organization enjoys the widest possible coverage at a competitive price. When a business establishes a captive, it gains control of premium dollars from the commercial insurance market — and the ability to take on higher retentions.

Although captives are often thought of as a risk management tool, they also can be designed to accelerate the strategic goals of nearly every other stakeholder in your organization.

STAKEHOLDERS

Although captives are often thought of as a risk management tool, they also can be designed to accelerate the strategic and organizational goals of nearly every other stakeholder in your organization, including the following members of your team:

Risk manager: By putting the captive at the core of the organization's risk management program, businesses can achieve a reduced total cost of risk, stabilize risk capacity, and gain access to reinsurance. The captive surplus can also be used to fund incentive programs for increased safety and loss control.

Chief financial officer (CFO): Creating a captive insurance program offers organizations reduced budget variability across business units, greater tax efficiencies, and the ability to form a third-party profit center.

Treasurers: By using a captive to support its overall risk management program, an organization can take advantage of risk retention analytics, access to alternative capital, and intercompany investment strategies.

Human resources (HR): HR executives' principal responsibility has traditionally been to manage employees and employment-related issues. As HR assumes a more strategic role in supporting financial objectives, captives offer several advantages, including:

- Funding employee benefits programs.
- Financing multinational benefits.
- Enhancing employee engagement by offering cost efficient voluntary benefit offerings.

Head of sustainability: Embedding environmental, social, and governance (ESG) in a business is increasingly a source of competitive advantage for companies that do it right. A robust captive program can be used to capture and provide evidence of an organization's integration of sustainability and ESG risks.

Do you need a captive?

CHECKLIST

Assessing whether a captive insurance program makes sense for your business' unique risk vulnerabilities and strategic goals will require a wider conversation across your organization.

The following questions can help support your company's decision-making process and the eventual development of your captive program:

- ☐ Are deductibles and/or rates likely to increase at the next renewal?
- ☐ Are business units unable to absorb increased retention levels?
- ☐ Is capacity and/or coverage becoming limited in the traditional market?
- ☐ Are there any contractual requirements to provide evidence of insurance to facilitate business?
- ☐ Does the organization have uninsured catastrophic type risks?
- ☐ Is the organization incurring sizeable excess and surplus lines taxes in the US that could be mitigated with the use of a captive?
- ☐ Is there frustration with the insurance market?
- ☐ Is there an interest in capturing third-party customer risk?
- ☐ Is there an appetite to get more visibility and control over claims management?

If the answer to all or most of the above questions is "yes," then a captive insurance program may be a viable option for your organization's strategic risk management program.

Although captive insurance programs come with many potential benefits, there are some important considerations that may factor into your decision when it comes to creating one.

TYPICAL STRUCTURES OF A CAPTIVE PROGRAM

For captive insurance programs, there are two distinct programs for you to consider:

Direct writing captive program: With this structure the captive is licensed and issues policies directly to insureds on an admitted basis, or a non-admitted basis where allowed.

An example of a direct writing program is a captive that writes a deductible reimbursement program for property and casualty risks.

Reinsurance: Fronted captive program In this structure, captives use a licensed commercial insurer to issue a policy on the behalf of a self-insured organization or captive insurer without the intention of transferring any risk. In doing so, the risk of loss is retained by the self-insured through an indemnity or reinsurance agreement where the risk is then passed on to the captive.

By using the licensing of the fronting company, the captive insurer doesn't have to maintain licenses in the domicile where business is written.

THINGS TO CONSIDER WHEN FORMING A CAPTIVE

Although captive insurance programs come with many potential benefits, there are some important considerations that may factor into your decision when it comes to creating one, including:

Capital commitments: The parent company must contribute the capital required to support the captive's business plan as determined by the insurance regulator in the selected domicile. Many domiciles allow cash or a letter or credit or a combination of the two. Most domiciles permit the captive to lend assets back to the parent (contingent upon regulatory approval), which helps to mitigate any opportunity cost associated with segregating premium and capital into a wholly owned captive.

Operating cost: When evaluating the ongoing financial and operational value associated with using a captive insurer, your business should take into account any start-up and annual operating expenses, such as a feasibility study and ongoing captive management, audit, legal, actuarial, and regulatory fees.

Time commitment: The parent company's management team will need to devote time to the captive. Creating a captive is not a short-term initiative used to achieve an immediate goal. It's a long-term commitment to an organizational risk management strategy. It will take time to reduce costs and risk. By allocating the proper time and resources to your captive, your organization will be positioned to gradually achieve better control over claims and loss control efforts as well as lower operating costs compared to commercial insurance programs.

Common captive uses

FINANCING RETAINED RISK

While captives can be created as a means of pursuing your business' unique strategic goals, there are some common applications when it comes to financing retained risk.

Captives may insure any number of risks, from high severity/low frequency ones to risks with predictable, recurring claims, such as workers' compensation. Providing coverage for retained risks enables a captive to tailor terms to the specific risks of the parent organization, and to finance large losses through the accrual of profits during favorable underwriting cycles. Some high severity/low frequency areas of vulnerability include:

- Business interruption.
- Wind, flood, and earthquake.
- Intellectual property.
- Cyber liability.
- Environmental liability.
- Product liability.
- Product recall.
- Terrorism.

Captives are also widely used for high frequency/low severity coverages such as general liability/auto liability deductibles and employee benefits. Taking attritional losses out of the insurance market and self-financing them in a captive can significantly reduce overall program costs.

Captive owners can also access the reinsurance market directly for risks that may be difficult to insure in the commercial market due to a lack of capacity or high rates.

US-domiciled captives are obligated to offer terrorism insurance under the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA). Businesses need to carefully examine their captive structures and TRIPRA's requirements to confirm compliance and to make strategic use of the program when addressing terrorism risks. These provisions only apply to primary insurance; reinsurance transactions are excluded.

Additionally, if the captive performs well, funds from those premiums are kept in the captive, which creates a new profit center for the parent company.

Many non-US captives participate in international terrorism and catastrophe pools, including Pool Re in the UK, GAREAT in France, and Consorcio in Spain.

TRENDING INSURANCE RISKS: WHAT SHOULD I CONSIDER ADDING TO MY CAPTIVE?

Captives can be used as a risk management tool for emerging and historic vulnerabilities, including:

Cyber risks: Captive insurance programs can protect companies from the financial impact of data breaches, including reputational damage, business interruption coverage, and third-party risk for possible damages.

Medical stop-loss: Businesses can reduce and stabilize the cost of providing healthcare on a long-term basis, enhancing the efficiency of employee benefit financing and delivery.

Pandemic: Organizations have the option to design customized coverage that would not be available in the commercial market. Through a captive, a company could write policies, such as business interruption and contingent BI that cover pandemic risks tailored to its unique exposures. For example, event cancellation coverage without pandemic exclusions might be difficult to buy from commercial insurers, but captives are designed to write such a program.

Employee benefits and medical options: A captive can be designed to fund benefits, such as hospital indemnity and safety programs, providing valuable protection for employees and their dependents during health emergencies.

Directors and officers (D&O) liability insurance: D&O aims to protect the personal assets of corporate directors and officers if they're personally sued for actual or alleged wrongful acts while managing a company. This coverage can come in three forms:

- **Side A:** Provides coverage in the form of defense costs and settlements for claims against directors and officers whose costs are not indemnified or advanced by the corporate entity.
- **Side B:** Reimburses the company for the indemnification it provides to directors and officers.
- **Side C:** Insures the company itself for its own liability and, in the context of public companies, is usually limited to securities claims.

Side A coverage won't be suitable for a single parent captive given potential conflicts. While still mostly untested, a cell captive has become a more common solution for companies having difficulties obtaining Side A coverage in the commercial insurance market.

The risks of today's market are increasingly hard to stay in front of, however, a captive can help your organization evolve and adapt as needed to reduce losses and protect your employees.

How to introduce a captive to your executive team

CAPTIVES AT THE CORE OF YOUR RISK MANAGEMENT PROGRAM

Today's business world is marked by rising economic and political uncertainty, disruption from technology innovation, and continued exposure to unfamiliar, sometimes unquantifiable, risks. A captive can help you become more agile in responding to vulnerabilities and protecting your people and assets.

With a captive at the core of its risk management program, your organization can mitigate risks while taking advantage of new opportunities.

Being highly flexible, captives can evolve to help you navigate fluctuating challenges over time, meeting both historical and emerging risks. The ability to design customized insurance coverages, access alternative capital, and generate profits through third-party businesses make captives especially valuable as a risk management tool during market transitions.

COST SAVINGS

As your team navigates a changing market landscape, a captive offers several ways to capture cost savings across your organization. Although there are different methods to achieve cost savings through a captive, we'll focus primarily on the "hard dollar" savings.

Captives can provide premium savings on payments normally made to commercial markets. Your organization can pay itself a premium for certain lines of coverage rather than paying another insurer. When losses are favorable and investment income is earned on invested assets, your organization makes out for the better.

In other circumstances, you may want to increase deductibles or retentions on a line of coverage, such as property. Here, a commercial insurer charges less premium, and your company can take that saving and pay itself premium, saving some hard dollars.

Finally, captives can be used for third-party business — that is, the risk of individuals and/or organizations other than the captive parent — including for customers, vendors, or contractors insurance. When the business is profitable, your organization can actually make money on these risks.

RETURN ON INVESTMENT/ SURPLUS BUILDUP

Regulators require captives to maintain a certain amount of surplus based on the industry and complexity of the parent's program. But the excess surplus can be made available for other purposes, including liquidity needs such as:

- **Dividends:** A captive can build its surplus by accumulating profits, which can be returned to its parent through dividends. This is a relatively quick and simple process, but requires calculation and regulatory approval in most jurisdictions.
- **Premium financing via discounts and premium holidays:** With sufficient surplus, a captive can offer its parent a premium discount or holiday for an upcoming renewal for first-party coverage. This can allow a parent company to retain more cash.
- **Risk management expenses:** A captive, rather than the parent organization, can pay for appropriate risk consulting projects, such as property engineering expenses and loss control programs.

Your organization will need to work with its captive manager to make sure it never falls below the regulatory minimum. However, captive surplus above this minimum can sometimes be leveraged to support management and operating expenses.

Captive cost, budget, and timeline considerations

BUDGETING AND COSTS

The first question your team probably has on their mind is exactly how much a captive insurance program will cost to set up. Captives aren't a one-size-fits-all solution, so as you begin to build a program, the following costs will factor into the budget:

Feasibility study: In a feasibility study, the Marsh Captive Advisory team and our Marsh Captive actuaries will analyze your current insurance structure and help evaluate the potential of establishing a captive to optimize total cost of risk. This helps to generate detailed insights into your organization's previous loss history and risk profile — both of which are especially important when it comes to maximizing ROI.

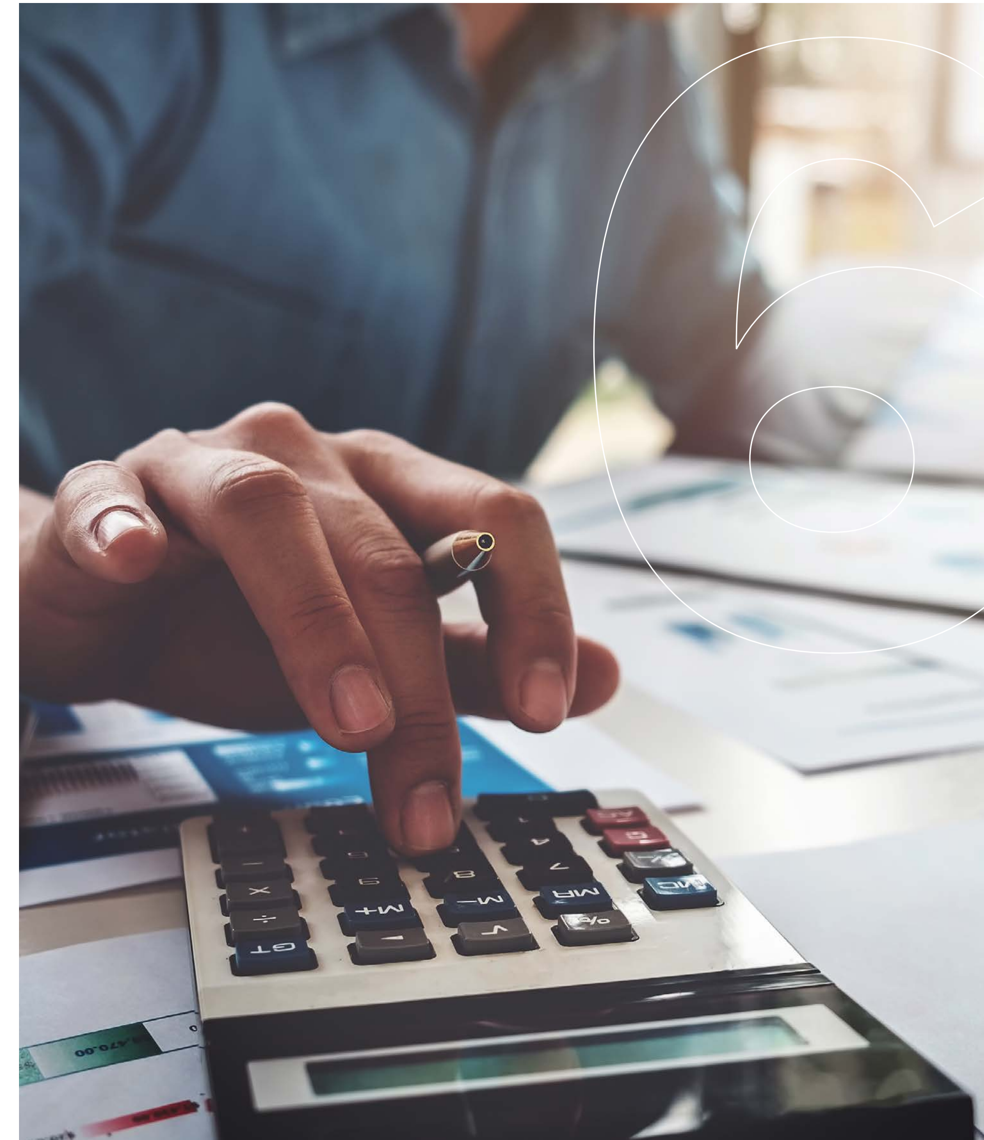
Fees for a project will vary, depending on the following:

- Number of lines of coverage.
- Amount of loss history and volume of data.
- Number and type of captives considered.
- Tax considerations or complications.
- Complexity of required analytics and number of "what if" scenarios.
- Actuarial work requirement.

Startup costs: These expenses represent regulatory, legal, actuarial, and implementation fees in creating a captive program.

Annual operating costs: Once your captive is up and running, there are annual operating expenses to factor into the organization's budget, including regulatory, legal, actuarial, audit, and captive management fees. Typically, a wholly owned captive's costs of setup and operation are not prohibitive and rarely impact the decision to proceed, with cell captives being less expensive to set up and operate.

Marsh Captive Solutions will work with you to explain these costs based on the organization's needs and expectations for the captive's performance.



In addition to standard start-up and operating costs, captive owners will need to budget for the following tax considerations:

Captive domicile premium tax: This tax is only imposed by select onshore captive domiciles within the US. Typically, owners are taxed 0.38% on direct captive placements and 0.225% on reinsurance captive placements.

US self-procurement tax: A US state premium tax is imposed on an insured by its "home state" when procuring insurance directly from a non-admitted insurer such as a captive, which resides outside the insured's home state.

Non-US insurance premium: This tax is imposed by an insurer writing directly into a country where insurance premium tax applies.

The final two cost considerations for captive owners include:

Capitalization: Typically, the premium-to-capital ratio required ranges from 3:1 for more unpredictable or catastrophic perils such as property or liability lines, and to 5:1 for more predictable risks such as casualty. This ratio may be met through cash or a letter of credit depending on the domicile.

Opportunity cost on funding captive premium: This is driven by the ability for a captive to mirror investment returns on cash flow to be used to support premiums versus if the cash had remained with the parent company.

Marsh Captive Solutions and your selected service providers (auditor and lawyer) can help to create a structure and annual budget to support the costs specific to your captive and those related to the parent organization's existing needs.

The first question your team probably has on their mind is exactly how much a captive insurance program will cost to set up.

TIMELINE

Alright, you're ready to commit to the costs associated with starting a captive. So how long before you start seeing returns? Typically, building a single-parent captive program will take approximately two to four months in the US and offshore locations, and four to six months in other jurisdictions, such as the EU.

Creating a captive insurance program begins with preparing a formal application, a process that can take one to three months. Your organization will need to select service providers, including a captive manager, auditor, attorney, bank, actuary, and asset manager. Next, you'll meet with regulators to develop a business plan tailored to the organization's strategic needs and unique risk areas.

Once you submit the application, it typically takes two to four weeks to receive an approval letter and capitalize. The final step will be receiving a certificate of authority for the captive and holding an organizational meeting to confirm the decision. After this process is completed, you can begin underwriting.

Although this process is fairly standardized, the timelines can vary and typically tend to be longer in European captive domiciles. Just remember that a captive isn't a short-term solution or a quick fix; it is a long-term strategy to improve risk management.

Three to four months (Steps 1–4)

One to two months (Steps 5–6)

1 (Step 1)
- Decision to proceed

2 (Step 2)
- Select service providers to work alongside of Marsh

3 (Step 3)
- Meet regulators
- Develop business plan

4 (Step 4)
- Submit application

5 (Step 5)
- Submit final documentation
- Receive approval letter
- Capitalize

6 (Step 6)
- Receive Certificate of Authority
- Hold organizational meeting
- Start underwriting

Steps to creating and owning a captive

EVALUATE AND BUILD A CAPTIVE PROGRAM

You understand the costs and time associated with setting up a captive. Now, there are just five key steps to tackle:

1. **Identifying captive opportunities:** The first step to evaluating a captive program is for us to provide a general overview on captives. The consultant should also identify the potential opportunities in a way that is easy to understand.
2. **Defining objectives:** Your captive manager will help define the objectives of the captive feasibility study and its scope, including risks to consider, potential operational and financial advantages, key costs and tax considerations, program structure, funding requirements, and a domicile review.
3. **Feasibility and modeling:** Your company will be asked to provide information to help determine the optimal path for its captive.
4. **Feasibility report:** After collecting and analyzing all of the information, the captive advisor will provide a feasibility report. This will summarize the conclusions of the feasibility study and offer recommendations, including an outlined implementation plan of the best strategy for your organization.
5. **Implementation:** It's time to kick off your strategic objectives with the formation of your captive! During implementation, your organization can revise the plan provided in the feasibility report and meet with captive regulators to draft a finalized business plan. The last step before the captive is approved is to prepare and submit the regulatory application, which includes the following:
   - Captive application form (varies by domicile).
   - Captive business plan, including risks to insured, ownership, premium, losses, tax treatment, names of service providers, board of directors, investment policy, and loss prevention guidelines.
   - Captive incorporation and governance legal documents.
   - Captive financial pro formas.
   - Parent financial information and organization structure.
   - Actuarial study.
   - Draft policy forms.
   - Biographical affidavits for captive directors and officers.

The exact timeline for these steps and the application approval can vary depending on the captive structure and domicile selected.

EVALUATE AND SELECT SERVICE PROVIDERS

As you evaluate the service providers that will help operate the captive on a day-to-day basis, you'll also need to appoint several key positions, including:

Captive manager: Marsh Captive Solutions, as your manager and actuary, is responsible for the day-to-day administrative activities relating to claims and we will act as a liaison, handling claims assessment and other operational activities.

Auditor: Carries out the statutory audit and prepares an independent audit report for the company.

Insurers: Commercial insurers that may be part of the captive program, either fronting for the captive in locations where the captive does not write direct policies or providing reinsurance to the captive.

Attorney: Provides legal support during captive establishment.

Your company will also need to select a board of directors to oversee the captive. When selecting these individuals, consider the following:

- Their ability to understand and execute their duties as directors.
- Their understanding of the coverages being written and the insured.
- Their general financial and insurance knowledge.

In overseeing the captive's day-to-day operations, the captive manager should prioritize your organizational needs. When looking for the right provider, you'll want to consider the following characteristics:

Independent versus broker-owned: The largest captive managers tend to be owned by insurance brokers, where synergies arise from the alignment of risk management, insurance, and risk financing. This gives access to a full range of services across the risk management spectrum and a 360-degree view of your entire risk program. Independent managers are those that are not owned or aligned with an insurance broker or insurer.

Technological capabilities: Captives process a significant amount of underwriting and financial information that must be synthesized in different formats for various stakeholders, including internal group financial reporting, auditors, and regulators.

It's critical that a captive manager has IT platforms suitable to house data and help better manage your specific captive structure. An effective platform should meet your evolving needs. Some technical capabilities to look for in a captive manager include automation, insurance integration, and benchmarking, along with the flexibility to handle multi-currency transactions and provide extensive reporting in an integrated, accessible cloud-based portal.

The wave of digitization across industries, including insurance, creates opportunities for captives to invest in technology innovations that can reduce administrative expenses. As time goes on, captives may benefit from cloud-based digital platforms that allow you to offer enhanced insurance products and services to customers, contractors, and employees.

As innovations such as blockchain and mobile apps are applied across your organization, they also introduce new risk exposures. In evaluating the right captive manager, you should prioritize their capability to grow alongside any and all of your evolving industry-related challenges.

SELECT A CAPTIVE DOMICILE

There are more than 70 captive domiciles globally — but don’t let that number overwhelm you. They can be grouped into two categories: onshore or offshore.

How do you decide which one is right? Your captive manager has the knowledge and the experience working with regulators and service providers to help identify the optimal locale. And they’ll work with you over time to determine whether the domicile continues to make sense based on the organization’s needs. However, just remember that your captive must be in good standing in its current domicile to begin the process of relocation.

An onshore domicile is located within a major country or region, such as the US or the EU. The key benefit of an onshore domicile is the potential ability to issue direct policies and avoid fronting fees.

An offshore domicile is located outside a major country and refers to domiciles such as Bermuda, the Cayman Islands, Guernsey, and the Isle of Man. Offshore domiciles typically have similar corporate tax rates (none or 0%) and lower operating costs.

Additionally, your organization should consider any potential regulations that may impact day-to-day operations, such as the flexibility and stability of the legal environment in a selected domicile.

If your captive insurance program has significant European exposures, the captive may need to be European-domiciled, which classifies the captive as “admitted” and permits it to write coverage on a direct basis into EU locales.

“There are more than 70 captive domiciles globally — but don’t let that number overwhelm you.

IMPLEMENT

Operating a captive facility

On to the fun stuff. Once the application is approved, both your parent organization and individual service providers will have a specific role in establishing and maintaining ongoing operations:

Financial reports and exams:

- **Captive annual report:** Your company will need to review this report and provide approval to the captive manager to execute and file on a yearly basis.
- **Captive audited financials:** If required, you may need to travel to the captive domicile to review the final draft and sign a management representation letter.
- **Actuarial certification of loss reserves:** The captive parent will need to provide exposure and loss data to an independent actuary.
- **Periodic examination by regulators:** Typically conducted every three to five years, your board of directors will review the final report during their meeting and alert the captive management of any concerns.

Tax:

- **Captive premium tax submitted:** If required, the board will review the captive premium tax return, which is usually submitted annually to the regulators.
- **Captive income tax return:** The captive tax advisor will assist with the preparation of the return as needed to make sure the captive's taxable income is calculated accurately, taking such things as proper loss reserve discounting into consideration, when applicable.

Underwriting:

- **Insurance program changes:** If there are any desired changes to the existing business plan, the organization will need to notify its captive manager. The captive manager will then determine if regulatory approval is required and submit the required documentation.
- **Policies and reinsurance agreements:** Your parent organization, with potential assistance from its broker, will need to provide details on the required terms and conditions of insurance coverage for new and existing policies. On an annual basis, captive managers will also need copies of overlying coverages related to any deductible reimbursement program.

Investments:

- **Minimum capital:** In the event of a shortfall in the minimum capital required, the parent organization will need to make a capital infusion to achieve regulatory compliance.
- **Intercompany loans:** Your company will need to communicate with the captive manager if there is any desire for an intercompany loan to the parent and the amount of the monthly interest payments.
- **Shareholder/policyholder dividends:** Although contingent on regulatory approval, if there is interest in issuing a dividend, your organization will work with its captive manager to declare it.

Corporate governance:

- **Directors and officers:** If there are any changes of directors and officers, captive managers will need to know.
- **Collect conflict of interest disclosures:** A captive's directors and officers must sign and return conflict of interest disclosures at an annual directors meeting.
- **Board meetings:** Board directors will need to work with the captive manager when scheduling, setting agendas, attending, and participating in regular meetings.

MEASURE ONGOING CAPTIVE PERFORMANCE

A captive isn't a "set it and forget it" kind of initiative. It will require ongoing support and review to make sure you're maximizing its potential benefit.

Experienced captive owners — something you're soon to be — continuously review opportunities to write additional lines of coverage, confirm whether the current domicile continues to be the best choice, uncover new tax considerations that may affect them, and determine optimal program structures.

An ongoing strategic review can also reveal overlooked possibilities for tapping the potential economic benefits available with the use of a captive.

At Marsh Captive Solutions, we use a proprietary captive modeling system so that your captive runs at optimal performance. The model evaluates the after-tax present net value of the new strategy and projects its long-term financials. It also enables Marsh to offer a full-scale captive strategic review that creates a roadmap for your company, helping to optimize the captive's capabilities going forward.

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About Marsh Captive Solutions

Marsh Captive Solutions is focused on planning, implementing, and optimizing captives. We work with both US-based and international companies and perform captive feasibility studies and captive strategic reviews.

At Marsh, we offer the support and technology that can make owning and operating a captive insurer easier, more efficient, and optimally effective for your organization. Our captive management staff prides themselves on their high degree of expertise and a client-focused service strategy, and are ready to help you manage risk on your own terms.

As a client of Marsh Captive Solutions, your company will also have access to Marsh's resources, expertise, and sophisticated captive technology products.

For further information, please contact your local Marsh office or visit our website at: marshcaptivesolutions.com

Marsh Captive Solutions has been ranked #1 on the Business Insurance annual "Top 10 Captive Managers" list for the past 15 years.

Licensed captive manager in **55** domiciles.

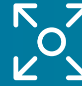
Premium volume of **US$70B** with capital and surplus of more than **US$118** billion.

Annually invests **US$2M+** in our proprietary technology systems, designed in-house by captive professionals.

Manages **25%** of the world's captives.

Industry leader for **50+** years.

Captive Operations Group located in three countries: **Halifax, Canada; Warsaw, Poland; and Mumbai, India.**



1,900 captives and other entities, making us the largest captive manager in the world.

Over **550** colleagues

About this report

Except as indicated, all data in this report is based on approximately 1,300 Marsh-managed captives that agree to share their data on an anonymous and aggregated basis. Clients can opt out of the analysis.

Contributors

Guy Carpenter
Mercer
Marsh's Climate and Sustainability Strategy Team

About Marsh

Marsh is the world's leading insurance broker and risk advisor. With over 45,000 colleagues operating in 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services. Marsh is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. With annual revenue over $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. For more information, visit marshmclennan.com, and follow us on LinkedIn and Twitter.

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