The Concept

A captive is an insurance company usually formed to insure or reinsure the risks of its parents and affiliates. In some cases, captives are also used to insure risks that are not related to their parent organization.

The main types of captives are single parent, Class 2 captives and group captives. The latter is typically owned by a number of companies with similar exposures. Some trade associations, for example, operate their own group, or association captive insurers, providing coverage to association members.

Captives can be used to provide coverage either directly or as reinsurance of a primary or fronting insurer.

The Financial Benefits

Used as part of an overall risk management approach, captives can help reduce the cost of insurance programs by mitigating or avoiding commercial insurers' administrative overheads and recapturing underwriting profits and investment income that would have otherwise gone to the commercial marketplace. Other potential savings can be made by using a captive to access the reinsurance markets, which operate on a lower cost structure than direct insurers.

Additional financial benefits include:

- A captive allows its parent to earn investment income on unpaid loss reserves.

- A captive owner can benefit from its own individual loss experience rather than pay premiums based on industry-wide losses or perceptions.
- Depending on its location and the domicile of the parent organization, a captive may offer tax planning advantages.

The Insurance Benefits

Captives help to provide a greater degree of flexibility and control over the risk management function by allowing programs to be designed in response to specific coverage, premium and retention requirements. These programs can be designed to offer individual operating units of a company the coverage and deductibles they require while the overall control and design of the insurance program is maintained at the corporate level. Thus captives can help centralize the financial and administrative operation of a corporate insurance program.

In addition to providing unbundled support services, captives have access to reinsurance markets - an avenue that a captive parent may use to obtain

wholesale premium quotes, which primary insurers can not offer.

Captives can be used as vehicles for funding the exposures a company decides to self-insure or for which commercial insurance cover is unavailable or uneconomical. As a captive matures and its surplus increases, it will develop a greater capacity to retain risk. The increased surplus will also create new opportunities for accessing reinsurers and entering pooling arrangements. As a result, the captive owners will be less reliant on the commercial markets.

Captive owners have found that owning a captive insurance company brings much more focus to the derivation and amount of losses being incurred. This leads to a greater emphasis on loss prevention programs and the use of the captive to measure the impact of such programs.

The Legislation

Insurance legislation in Bermuda consists of the Insurance Act 1978 and the Act's various amendments and regulations.

Some of the Act's key requirements for non-life insurers are:

- A company must be registered under the Act before it may carry on business in Bermuda.
- Every insurer must appoint and maintain a Principal Representative in Bermuda. The Principal Representative is a corporation or individual who is resident in Bermuda and who can represent the company.
- Every insurer must appoint an auditor to report on the company's annual financial statements and Statutory Financial Return.
- Companies must meet minimum capital and solvency requirements as
- required under the terms of their licences (see multi-licence system and solvency table).
- Insurers must maintain "relevant" or liquid assets equal to at least 75 percent of their liabilities.
- A Statutory Financial Return must be prepared annually. This return is filed with the Bermuda Monetary Authority (BMA) but is not available for public review (see also Statutory Financial Statements).
- A company whose gross premiums from professional liability insurance constitute more than 30 percent of gross premiums written is required to appoint a Loss Reserve Specialist who must, annually, certify the adequacy of loss reserves.
- Companies which discount their loss reserves must provide details of the methodology and rationale for discounting and an annual actuarial opinion on the discounted reserves if the captive has not met its general business solvency margin on an undiscounted basis.