The Captive Insurance Company:

BY: JERRY MESSICK
CEO, ELEVATE CAPTIVES

What Is It?

In 1986, Hawaii became one of the first states in America to introduce captive insurance company legislation. Since then, Hawaii has become a leader in regulating captives, with over 230 under license as of December 2018.

In its simplest form, a captive is a closely held insurance company that insures the risks and exposures of its owners or affiliates. There are many different types of captives, such as single-owner (also known as "pure"), group, association and incorporated-cell. The type of structure you choose is typically driven by what you are hoping to accomplish.

Regardless of structure, captives tend to fall into one of two buckets: smaller captives writing less than $2.2 million in premiums and larger captives that write above that amount. In the past, only large companies could afford to own a captive, but now the structure is being used by small- to mid-sized companies too.

Good candidates for establishing a captive insurance company include businesses that:

- want to have better control over their insurance programs, both for property and casualty (P&C) and employee benefit coverages;
- want to provide Enterprise Risk Management (ERM) protection for risk they already have;
- have sufficient business risk to support the premium in the captive;
- have consistent, free cash flow of at least $500,000 per year; and
- are willing to commit to a long-term strategy to control their risk.

While it's important to align the right candidate with the right captive structure, it's equally important to make sure that the captive is created and managed for the right reasons. For example, with a captive insurance company, you no longer need to rely on the whims of the commercial market with its accompanying market swings and potential policy cancellations. Instead, you manage larger retentions backed by your captive, thereby giving you more control over premiums—with possible savings of 20–30 percent or more—along with a potential return on your investment. In a bad year, you can minimize losses with protection through prefunding and reinsurance.

The key to success in the captive market is to only assume reasonable risk with premiums calculated by an independent actuary. You should implement a proper governance structure directed by the captive owner and maintain a conservative and reasonably prudent investment portfolio. Be sure to maintain consistency in your claims guidelines, and don't try to adopt a "we cover everything" approach. Finally, locating your captive in a highly credible captive domicile, like Hawaii, is an excellent idea.

The three primary areas of focus for captives include the following:

- **Deductible Reimbursement and Difference in Conditions (DIC)** – Coverage for exclusions, deductibles, and excess protection. Ability to raise deductibles and retentions to retain greater profit and cut commercial premiums.
- **Risk that is too expensive in the commercial market of uninsured exposure** – Coverage for key employees, health insurance, business litigation or interruption, product recalls, crisis management, employee liability and supply chain risk.
- **Enterprise Risk Management** – Self-governance of loss-control programs and ability to shift financial obligations in certain situations.

Captives—if planned and managed properly—can be extremely effective for managing your organization's risk long-term, providing a multitude of benefits. If a catastrophe hits, your captive will have you ready. And if it doesn't hit? You will have a war chest of savings and sleep a whole lot better at night. +

***Jerry Messick, ACI** has over 35 years of experience in the insurance and alternative risk transfer industry and is a principal and CEO for Elevate Captives. With operations in Arizona, Delaware, Oklahoma, Hawaii New York and Texas, Elevate is a captive consulting and services firm that focuses on multiple industries and trade groups. Prior to becoming CEO of Elevate, Jerry was with a national provider of alternative risk services since 1985, where he held senior management positions with responsibility for loss control, marketing, finance and captive insurance company operations.*