Vantage

Richard Packman, CEO

Captive Insurance for Family Offices and Private Clients

Once the preserve of the corporate world, more HNWI's and family offices are now realising the benefits of forming their own insurance company to insure their assets.

It is well known that the conventional insurance market frequently fails to meet the needs of the buyer, with criticism usually falling into one, or more, of three categories - price, cover, and service. What if you could have more control of these elements? What if you could form your own insurance company for your own purposes? Well, the captive insurance market can enable this.

A number of different reasons exist for the consideration of the formation of a captive insurance company, but for private clients and family offices one main driver is the ability to retain wealth. Insurance premiums paid into a captive are retained and invested within the structure and are thus not "lost" as they are in the traditional insurance market. Captives can provide significant estate planning, wealth transfer and asset protection opportunities.

Captive insurance

People forming their own insurance company to insure the risks of the owners dates back to the dawn of the modern insurance industry. From the 1920s more and more larger corporations established their own insurance companies, but the term "captive" (as we know it today) was first used in the 1950s. A US industrial company in Ohio had a series of mining operations and its management referred to the mines whose output was put solely to the corporation's use as captive mines. When they incorporated their own insurance subsidiaries, they were referred to as captive insurance companies because they wrote insurance exclusively for the captive mines.

Today the captive insurance industry is still growing, with many thousands of captives established in more than 50 jurisdictions around the world. The rate of captives traditionally develops in response to "hard" insurance markets (that is, where premiums increase and cover becomes more difficult to obtain), although they are to be regarded as part of a longer term risk management strategy, and can provide a number of benefits for those that participate.

Why do it?

The conventional insurance market can be a cumbersome and inflexible risk management tool. Creating a captive insurance vehicle provides a bona fide mechanism for self-insurance which can offer a superior alternative to the traditional insurance market for all, or sometimes just part, of an insurance programme.

Advantages fall broadly into the following categories:

- The opportunity to retain underwriting profit - usually "lost" to your insurance company, but paid as dividends to the captive owner.
- Investment income - control over the investment of premiums until they are paid out in losses or in dividends.
- Flexibility as to cover and rating - more cost effective risk transfer where the traditional market may be applying high rates, restricted cover, increased deductibles or where there is limited capacity.
- Control - captives wrest a degree of control away from the commercial insurance markets and allow the policyholder to take an active role in how it pays for the primary-level, reasonably predictable losses.

The object of a captive is to provide a self-insurance programme that will fund predictable losses and both reduce and stabilise the cost of the insurance to the Insured. In addition, in a carefully managed programme, profits will be earned and a return on capital will be achieved.

Captives can offer a degree of insulation from the unpredictable swings of the insurance market cycle, and additional benefits such as direct access to the reinsurance market, positive cash flow, capital leverage, retention of investment income and ability to bespoke cover all contribute to the rationale.

How does it work?

In short, a captive is a specific insurance company established to insure specific risks. In most cases a captive insurer's owner and its customer(s) - the Insured(s) - are one and the same, which results in captives being different from commercial insurance companies.

A captive is a registered and authorised insurance company established to write all or part of the risks of an entity, its affiliates, or for the members of a group.

Traditionally they have been subsidiary companies of their parent (whose risks they underwrite), however, there are now numerous additional uses for such vehicles - including the writing of thirdparty risks. Commonly located in an offshore domicile, the captive will be licensed by the local regulator to operate either as an insurance or reinsurance company.

Invariably the premium paid into the captive will not be sufficient to cover the overall exposure insured within; for example, a £1million premium spend for a portfolio of 50 properties valued at £10m each. The captive will therefore purchase reinsurance protection to cover this additional financial risk. Reinsurance increases the captive's underwriting capacity and enables it to stabilise its underwriting results. Pound for pound, reinsurance is cheaper to buy than primary insurance as it is effectively buying from the wholesale market, and reinsurers do not have the frontline overheads of insurance companies.

Who is it for?

Traditionally captives have been used by corporations for their commercial insurance risks (PLCs, private companies, the public sector, and trade associations) but more recently interest is being received from private clients.

High net worth individuals and family offices with significant premium spend are realising the benefits of a self-insurance arrangement.

They may have substantial property assets, art collections, yachts or even a garage full of classic cars – all of which will require insurance protection. It can also insure their commercial interests.

Estate planning

A captive may also provide some additional estate planning benefits as a HNW individual or privately owned business can structure their captive for it to be owned by a trust. Premiums are paid by the family into the captive and, over time, the profits generated can be paid as dividends to the trust. Captives can therefore legitimately transfer wealth to future generations.

The PCC structure

A Protected Cell Company ("PCC") is an innovative structure that can open up captive insurance opportunities to a wider market. Many entities may wish to manage their risk(s) in a proactive manner but do not have the size of premium spend, nor the capital, to establish the own individual captive insurance company.

Historically corporations have formed what are called "pure" captives, which are stand-alone companies (owned subsidiaries of the parent company). These are generally for larger premium paying entities and although permitting a wider scope of control, they can be expensive in both monetary and management time concerns.

A PCC (as a whole) is one single legal entity, with one board of directors, one memorandum and articles of incorporation and one company registration number. It comprises a core and any number of cells.

The use of a cell within a PCC can provide access to a self-insurance solution for entities for which it was previously uneconomic. Typically this solution may suit small and medium sized enterprises where there are cost efficiencies over a stand-alone captive.

A cell company is a legal entity where each Insured's business, i.e.; the assets and liabilities, are legally segregated from all other cells in the structure. An Insured provides the working capital for its own cell, usually by preference shares, giving policyholders ownership of their cell.

In summary, captives offer a wide range of opportunities for a wide range of clients and their growth will continue as more realise the benefits that they can provide.

Key Contact

Richard Packman
Chief Executive Officer
D: +44 (0)1534 706503
E: richard.packman@vantage.je
View my profile