

PUTTING A PROPERTY AND CASUALTY GROUP CAPTIVE TO WORK FOR YOUR BUSINESS



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Many small businesses find that traditional commercial insurance meets their property and casualty needs, but medium and larger-size businesses often spend too much for too little. If Property and Casualty premiums seem high, or coverages are unavailable, a captive may be a better option. A captive can make more customized coverage available, and financially rewards companies for being proactive. Established businesses that have high insurance premiums may likely find this an advantageous alternative to traditional insurance.



WHAT IS A CAPTIVE?

A CAPTIVE is a tool that provides risk financing outside of the traditional insurance marketplace. The business that's being insured creates a subsidiary that provides an alternative way to fund future losses. The insuring subsidiary is a separate business entity that's owned by the insured or a group of insureds. These structures are called "captives" because they are created primarily to insure the risks of the companies and related parties who own them. For all intents and purposes, once established, they look like, operate like, and are regulated like any other insurance company.



WHY DO BUSINESSES USE CAPTIVES?

A captive is sometimes used by businesses with high and/or unique risk profiles. The insurance structure is a solution when coverage is either unavailable or unaffordable through the commercial marketplace of traditional insurance policies. Through a captive, the corporation has the ability to professionally and tax efficiently build up funding within their organization to enable themselves to retain and manage certain risks within their company rather than paying an outside insurance company to do so.

Companies appreciate the control that a captive gives them over their funding. Depending on the specifics of their situation, businesses might use a captive to:

- Secure highly specialized coverages for unique risks not covered in the traditional marketplace such as supply chain interruption, product recall expense, etc.
- Reduce insurance-associated costs by setting aside premiums to cover deductible and retention risks they do incur. (workers compensation, auto liability, general liability, etc)
- The option to retain and shore up profits and equity capital inside the owned captive rather than spending it on an outside insurer.
- Potential tax benefits for retaining risks within the company's captive.
- More professional management of assets.
- Ensuring proper funding for any retained risks or claims.

A CAPTIVE IS A VEHICLE FOR TAKING RISK

It can be formed by a SINGLE COMPANY...



SINGLE PARENT CAPTIVE

... or MULTIPLE COMPANIES.



GROUP CAPTIVE

Another benefit is that, at the end of the year, any remaining premiums that haven't been paid on claims can be retained as profits for the subsidiary. A business could use this profit from unpaid premiums and distribute it back to employees. This incentive can motivate employees

to take precautionary measures throughout the year to avoid risks and prevent claims from happening - leading to a healthier and safer work environment for all.

TYPES OF GROUP CAPTIVES

Group captives are further defined by having multiple businesses own the insuring subsidiary. This structure is distinct from single parent captives and agency captives.

SINGLE PARENT CAPTIVE

A single parent captive is when one business wholly owns the insuring subsidiary. The business that's being insured sets up, owns, and runs the subsidiary, and the subsidiary hence has a single parent company.

Businesses that use single-parent captives tend to be large corporations, often having insurance premiums of \$1 million or more (although sometimes a little less). These corporations could use a captive to insure the entire parent business or part of the parent business's affiliates.

GROUP CAPTIVE

A group captive has multiple businesses that own the insuring subsidiary, so the subsidiary hence has a group of parent businesses. The parent businesses are non-related entities, and they own and control the subsidiary together.

Owning an insuring subsidiary together makes group captives much more feasible at lesser premium sizes than single-parent captives. While businesses with premiums of \$1 million+ often utilize group captives, this solution can be feasible for companies with total premiums as

small as \$125,000 annually.

An insurance professional who specializes in property and casualty captives can help businesses with higher premiums determine whether a group or single parent captive is more suitable for their situation.

Businesses that participate in group captives can use their insuring subsidiary to insure all or part of their parent business.

HOMOGENOUS GROUP CAPTIVE VS. HETEROGENOUS GROUP CAPTIVE

A property and casualty group captive can be further defined by the types of businesses that own the insuring subsidiary.

In a homogenous group captive, the insuring subsidiary is owned by businesses that are in the same industry. A homogenous captive is useful when an industry requires particular and specialized coverage, as the program can be tailored to fit that industry's specific needs.

In a heterogeneous group captive, the insuring subsidiary is owned by businesses that are in different industries. A heterogeneous captive is useful for spreading risk out across various industries and/or managing industry-related insurance cycles.

HOW DOES A GROUP PROPERTY & CASUALTY CAPTIVE WORK?

Businesses that are setting up a single-parent captive must actually form a subsidiary. Businesses that are joining a group captive either set up the subsidiary along with other businesses or take part ownership in an existing group subsidiary.

The specific coverages being provided are created when the subsidiary is set up. Coverages can include any or all of the common protections that would be expected in a traditional commercial policy. Coverages often also include specialized protections, which may be structured as distinct uncommon coverages or as particular terms within more common coverages.

Some highlights of coverages that would be included in a fairly typical group P&C captive are:

GENERAL LIABILITY COVERAGE: Insure against common “slip and fall” accidents, defamation lawsuits, and false advertising claims.

AUTO LIABILITY COVERAGE: Insures against vehicle accidents in which employee drivers are responsible for causing injuries and/or property damage.

AUTO PHYSICAL DAMAGE COVERAGE: Insures against damage that company-owned vehicles sustain during collisions or non-collision accidents.

WORKERS COMPENSATION COVERAGE: Insures against workplace injuries and illnesses that employees sustain while on the job.

SPECIALIZED COVERAGES: Can insure against a range of particular risks depending on a business’s situation and coverage terms.

WHAT IS A GROUP CAPTIVE?

A GROUP CAPTIVE can be made up of companies in the same industry or different.



SAME INDUSTRY
Closed membership (homogeneous)



DIFFERENT INDUSTRIES, SIZES, OR REGIONS
Open membership (heterogeneous)

Once the subsidiary and insurance are in place, the parent business pays premiums to the subsidiary. The subsidiary processes any claims and maintains cash reserves to pay out valid claims. Remaining premiums that aren't paid on claims can be profits for the subsidiary.

In some cases, the subsidiary may additionally purchase reinsurance just as traditional insurance companies do. Reinsurance is secondary insurance that helps protect against multiple large claims. It's similar to an umbrella policy except for insurance claims.

ADVANTAGES OF A GROUP CAPTIVE

Businesses that are good candidates for a group captive will likely find that it has several advantages compared to traditional insurance. A Group Captive offers:

GREATER CONTROL

Businesses have more control over their insurance coverages because they can better select and set up coverages according to their needs. Even in group captives where multiple businesses negotiate coverage terms, specialized protections are still available (especially through homogenous group captives).

BUSINESS-SPECIFIC PREMIUMS

The premiums assessed for a group captive are based on a business's particular risk profile and claims history. This is distinct from traditional commercial insurance, which is also largely influenced by industry trends. Limiting premium calculations to an individual business's profile and history is fairer, and protects businesses from undue market trends that raise rates.

COST REDUCTION

The business structure of group captives enables businesses to control their total cost of risk and their risk financing. Total cost of risk is decreased when businesses reduce the number of claims, as premiums are heavily based on claims and subsidiaries retain any

profits from unpaid premiums. Risk financing is more manageable because the insurance is so customizable.

HEIGHTENED SAFETY: The financial incentive to reduce rates causes businesses to have a heightened awareness of safety. One survey found that companies with a captive experienced 48% fewer fatalities and 22% fewer worker's compensation claims compared to their traditionally insured counterparts. Employers and employees alike benefit when accident rates are reduced.

TRANSPARENCY

Owning and operating a subsidiary gives businesses comprehensive transparency of how their insurance premiums are being managed. Premiums, overhead, claims payments, and other expenses are all readily available for businesses to review.

INCREASED PROFITS

Businesses can benefit from underwriting profits and investment income that their subsidiary generates. This combined with cost savings may make a captive quite financially beneficial.

GROUP CAPTIVE VS. SELF INSURANCE

A group captive is a form of self-insurance, but it's different from the simple model of saving up for when something happens. The business structure of a group captive may afford tax advantages that aren't available when merely saving.

GROUP CAPTIVE VS. SINGLE PARENT CAPTIVE

Of course, both a group captive and a single parent captive provide the benefits noted above. The advantage of a group captive is that these benefits become available for established small and medium businesses, and aren't limited to only large corporations.



WHEN IS A GROUP CAPTIVE A GOOD FIT?

A group captive should be evaluated on a case-by-case basis, as every business's particular risk profile, premiums and coverage needs should be considered on their own. In general, however, businesses are good candidates for a group captive if the business:

- Pays combined property and casualty insurance premiums of at least \$125,000, which includes general liability, commercial auto, and workers compensation premiums
- Wants to reduce insurance costs and better manage risk financing through an alternative solution
- Prefers insurance premiums to be based on the business's actual losses rather than industry averages (or has losses below the industry average)
- Has a 5-year loss history of incurred claims consistently being below 50% of the premiums paid (across all coverages)
- Commits to taking proactive measures that will improve overall safety and reduce accident rates

In short, businesses that are financially stable and consistently pay high insurance premiums relative to the claims that are paid out by their insurer should consider whether a property and casualty group captive is right for them. This evaluation is somewhat complex, so businesses ought to work closely with a knowledgeable insurance professional who specializes in captives when making this evaluation. Businesses should look at joining a group captive as a long-term decision, as entering and leaving a captive is more complicated than simply changing insurance companies.



EVALUATE A GROUP CAPTIVE FOR YOUR BUSINESS

If your business might be a good fit for a property and casualty group captive, take the online assessment at Winter-Dent. Our assessment will provide an initial evaluation. We can then use this information to help you walk through all of the details that must be taken into account.

When you meet with one of our consultants, we'll take a comprehensive look at your business in order to understand its unique risk profile and insurance needs. Our team has the expertise necessary to help you make an informed decision about how to best insure your business. Of course, we can assist with joining a group captive if you decide to do so.

For more information about property and casualty group captives or to learn how we can assist, contact one of our agents today.



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