Managing and Financing Mining Risk
The Captive Insurance Solution

Mining has always rated high on any risk index, and especially so with regards to insurance. Whether underground or surface mining, multiple risks are present, many with the power to cause significant loss of life, equipment (machinery can cost tens of millions of dollars), loss of production and income, as well as serious environmental damage.

Because of the extreme nature of the risks involved, risk management tends to be very developed in the well run and successful mining companies. An integral and essential part of any risk management process is insurance, and this explains why mining company executives and their insurance brokers are generally very familiar with and sensitive to shifts in annual insurance rates. Those mining companies with a good appreciation on their own risk management and insurance programs have probably gone the next stage to retaining more of their own risk instead of 'giving' it away every year to the traditional insurance market. One of the most effective and proven methods of retaining risk is via a captive insurance company. This is essentially your own insurance company which takes a share of your risk, and if you have no claims, you end up keeping all the premium.

For the major mining corporations (just six control approximately 70% of the industry), captive insurance companies are the norm. Mining continues to be a growth sector, with a continuing tendency for assimilation of smaller players and increasing levels of risk retention and self-insurance. Beyond the retentions, limits of up to a billion dollars per loss, placed into international reinsurance markets, are not unusual. Property damage programs are generally all-risk with peril limits, such as for flood, and options to buy additional covers. Depending on the market, treaty or facultative reinsurance is available, facultative being the more usual as each mine presents a highly individual risk.

Warning. Any form of self-retention, and captive insurance in particular, only works if over time your claims are lower than your premiums, and this only tends to happen if there is a top class risk management program in place.

Historically, Barbados has been the domicile of choice for Canadian owned captives and why around 200 Canadian companies are already there. However, due to a tax information exchange agreement (TIEA) recently signed between Canada and Cayman, there is now a lot of interest in establishing new captives in Cayman or moving existing captives from Barbados to Cayman. In fact, Vancouver-based mining company, Teck, was the first Canadian company to redomicile its captive insurer from Barbados last September.

The TIEA has now put Cayman on a level footing with Barbados.

Some of the obvious advantages of captive insurance are:

1. **Reduced Reliance on Commercial Insurance**
   As the captive matures, its surplus grows, giving it greater capacity to retain risk. Increased surplus also creates new opportunities for accessing reinsurers and entering pooling arrangements, which further increase available capacity.

2. **Reduction of the Costs of Risk Management**
   The price of insurance coverage purchased in the conventional market typically reflects a significant markup to pay for the insurer's acquisition costs (including marketing and broker commissions), administration, and overheads as well as profit for the insurer. The fact that premiums are paid in advance represents a lost opportunity to earn investment income.

   Establishment of a captive cannot eliminate these costs, but it can reduce them. The extent of the reductions will depend on the captive's own loss experience, the claims handling costs and the degree to which the captive promotes cost consciousness and efficiency in the parent.

3. **Stabilization of Pricing**
   Where the insured enjoys a stable and reasonable loss experience from year to year, a captive affords the ability to price insurance coverage accordingly. By contrast, the conventional insurance market will often set prices in relation to broad industry classifications, and thereby fail to reflect key differences in loss experience among individual insured parties. The result is price volatility based on general market conditions and the actions of other insured parties. In addition to the stabilization of pricing over time, there are also advantages to be realized in terms of the organization's financial planning and control functions.

4. **Provision of Cover Where Otherwise Unavailable**
   From time to time, the conventional market is unwilling or unable to provide cover for certain risks, especially for liability and casualty loss. The establishment of a captive (or group captive) to write such lines or to provide additional capacity can be an answer to these market problems. Coverage, which has at times been unavailable or difficult to obtain on satisfactory terms, includes product liability, professional liability, and oil pollution, hazardous waste and labor strike insurance. Whenever insurance cover is unavailable or overpriced, the feasibility of a captive is enhanced.

5. **Access to Reinsurance Markets**
   Because reinsurers generally deal with insurance companies, a captive affords direct access to the international reinsurance markets. In bypassing conventional insurers, the insured is spared markup costs. The savings associated with eliminating these costs will frequently outweigh the incorporation and other startup costs of a captive.

6. **Improved Cash Flow Benefits**
   The ability of a captive to generate investment income from unearned premiums received, is often a critical advantage in forming a captive. This is especially so where premiums are paid in advance and losses are paid out over a lengthy period of time (which, in turn, depends on the kinds of risks insured). To the extent that investment income can accumulate in a tax-free domicile, there will be additional funds available to pay losses and a corresponding reduction for further funding of the captive.

7. **Reduction of Government Regulations and Interference**
   In contrast with the rigorous insurance regulation in most industrialized countries, a domicile can provide a less onerous, yet responsible, regulatory framework. This has been described as a system of shared regulation, whereby the regulated cooperate with each other, with a view to achieving the most appropriate level of policyholder protection while at the same time permitting the captive to grow and prosper.

8. **Ability to Customize Insurance Programs**
   A captive has complete freedom to insure any risk it chooses and to customize the terms and conditions of its policies. This can lead to improved loss control efficiency and promote greater awareness of the factors that commonly give rise to losses.

9. **Formalization of the Allocation of Deductibles for Self-Insurance Retention within a Corporation**
   A medical facility may want to allocate costs to locations by loss ratios while a real estate partnership may need to bill each partner for its respective cost (rather than an arbitrary allocation). With a captive, it is easier for the smaller entities to justify these expenses.

10. **Underwriting Advantages Inherent in Captives**
    A key advantage of a captive is its ability to provide management information across a spectrum of disciplines. Among these is an ability to analyze historical claims information. When feasibility studies are undertaken, it is not uncommon to find that pre-captive loss experience is unreliable.

11. **Opportunities for Improved Claims Handling and Control**
    A captive is also free to establish its own claims handling policies and procedures. This has obvious advantages such as the reduction of the time taken to process and pay claims.

12. **Creation of a Profit Center**
    To the extent that a captive might offer insurance coverage to unrelated customers (sometimes in response to tax planning objectives of the captive), it will have diversified into open market operations not unlike conventional insurers. Although there are special risks and capital requirements associated with engaging in such business, doing so will have the potential to generate additional profits.

13. **Tax Advantages**
While professional tax advice should be sought before making the decision to form a captive, there may be certain tax advantages associated with such a decision. These might include the tax-favored accumulation of underwriting and investment income (which may depend on, among other factors, the domicile of the captive, the residence or citizenship of the captive's owners or the source of its income). Another advantage may be the deductibility of premiums paid for by the insured for tax purposes (as premium expense of the insured).

    Also, if a captive qualifies as a true insurance company for tax purposes, then unlike other corporations, it can deduct currently a "reasonable and fair" loss reserve for unpaid actual losses incurred. Finally, state premium taxes otherwise payable in a commercial insurance program may be reduced. Although tax advantages may be of significance in the decision to form a captive, they should never be the prime-motivating factor.

14. **Ability to Direct Investment Options**
Generally when you purchase commercial insurance you do not control the investment of the premiums. However, a captive is able to direct all these investment choices.

Conclusion

If you already have a captive and are considering moving it, or if you are thinking about setting up a captive, speak to your own risk manager and insurance broker at once. They are the experts and will be able to guide you through the change-process. Refer them to Captiva Managers, specialist captive insurance managers based in the Cayman Islands, British Virgin Islands and Anguilla.

Conor Jennings
Captiva Managers
Cjennings@captiva,managers.com