

What's Captive Insurance?

A captive insurance company is one which has been set up primarily to insure the risks of its parent company. In other words, it's like having your very own insurance company, so that when you pay the insurance premiums, you're paying yourself rather than somebody else. The obvious benefit of this is that if you don't have any losses then you keep all the premium. Captives then often buy their own wholesale insurance or reinsurance to protect themselves, which is cheaper than you or I would pay.

From this simple explanation it's clear to see that captives work best with companies that have good control over their claims, i.e. those organisations which have good risk management processes in place. The more profitable the captive is the more risk it can retain itself, and so further reduce their insurance costs.

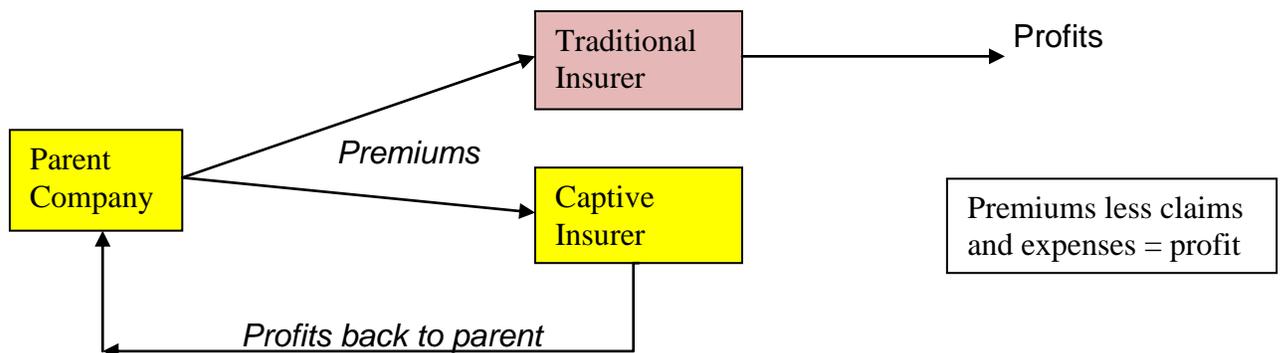
The rate of growth of captive formation is directly related to the underwriting cycle in the insurance market. In other words, when the insurance industry is profitable there is a lot of competition for your business, and insurance rates fall.

However, when insurers suffer a series of large losses such as those resulting from terrorism, hurricanes or from financial collapse they start to lose money and immediately increase insurance premiums. To make matters worse, insurers invest huge amounts of their funds (our premiums) in the stock exchange, and when that falls, so too do the value of the insurance companies.

All in all, insurance companies have been suffering recently, and this will explain why your insurance premiums continue to go up – even if you haven't had any claims.

This uncertain environment has encouraged buyers of insurance to consider alternatives, and captives have proved to be one of the most cost-effective alternative available.

At the end of the day, a captive is really a sophisticated way to reduce the amount of insurance you pay to somebody else, and also a way to build up a fund for a rainy day. Having said that, a proper registered and regulated captive insurance company also offers a number of important tax advantages to which the rest of us are not entitled.



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