

MYTH Busters

Group Captive Edition

by John Sutton & Amy DeJong

Do you catch yourself hesitating before swallowing gum or walking under a ladder? Do you still worry getting years of bad luck after a black cat crosses your path? It's funny how the "old wives' tales" we were told as children linger with us, but old ideas die hard. In similar fashion, many misconceptions exist about group captives. Simply put, group captives are "in-house" alternative insurance structures that are primarily created to cover the assets of a parent company and provide them with more control over their specific insurance needs. However, they are frequently misperceived as self-insurance programs that are designed for large corporations to abuse as shady tax shelters. While most mid-sized companies have heard of group captives, the overabundance of misinformation on the topic has likely prevented many owners from giving them serious consideration.



Let's be honest

The alternative insurance marketplace has been rapidly developing for decades and now accounts for more than 50% of commercial premiums. Group captives are the fastest growing segment, but are oftentimes misunderstood due to perceptions related to single parent captives (used by very large companies). Brokers also have a history of contributing to group captive confusion in their attempts to defend the status quo of traditional insurance programs. In reality, group captives are one of the best ways for mid-sized companies to gain control of their insurance pricing and unlock the value of their risk management investments. It's time to lift the curtain and do a little group captive "myth busting."

Group captives only make sense in a hard market – Myth!

While it is true that some companies have entered group captives after losing coverage in the standard market, this happens to be one of the worst times to enter because they are usually ill-prepared to proactively control their own claims. Captive members enjoy the most success when entering during a soft market because they enter for all the right reasons – not because they are in a scramble after traditional insurance was denied due to high claims activity or because of a hazardous business classification. They should have confidence in their ability to control their risks and there should be a stabilization of market swings.

Implementing group captive insurance during a soft market has a number of advantages worth considering, including:

- Reinsurance within the captive will be competitively priced, leading to lower fixed costs.
- You are not rushed, which leads to better decision-making.
- You have time to bolster your risk management infrastructure prior to entry.
- The best captives will have room for you, which is less likely in a hard market.

Group captives are the same as self-insurance – Myth!

This misperception stems from single-parent captive structures that are, indeed, self-insurance vehicles for large companies. Group captives actually share more similarities to standard guaranteed cost programs than single-parent captives.

Group captives are typically set up with multiple layers of risk-sharing. In the first layer, the owner "self-finances" their own frequency claims. In the second layer, risk is shared among the members of the group for the larger, more severe claims. A third layer of protection exists in outside reinsurance purchased by the group and acts as a stop loss for the captive owners. In addition, standard umbrella or excess insurance is purchased individually by the members, just as it is in standard insurance programs.

It's just a tax dodge – Myth!

"Somewhere, inside, in the dark, the firm is listening" – A memorable quote from the 1993 movie *The Firm*. This iconic film helped create the perception that the Cayman Islands serve as the epicenter for shady business and financial impropriety. A large number of captive

insurance companies are domiciled in the Caribbean Islands; as a result, many assume that one of the primary benefits of group captives is tax avoidance. Foreign domiciled captives that are properly designed for risk transfer have actually been recognized as legitimate insurance structures by the IRS for decades. The primary objective of joining a group captive should not be tax savings, but rather to gain better control of your insurance dollars and to enhance corporate risk management. However, secondary benefits can include broader investment latitude for reserves, a simplified regulatory environment and some tax efficiency.

My company is too small – Myth!

Group captives can benefit companies that are smaller than one might think. The typical premium size for a group captive candidate ranges from \$250,000 to \$3,000,000. However, group captives are available to companies with as little as \$100,000 of combined workers' compensation, general liability and automobile premium.

Not all companies can qualify to join a group captive – Fact!

While this fact may seem discouraging, it also comes with enormous opportunity. The best group captives are akin to an elite club. As a voting member, you only want the best risks in your captive – and you don't hesitate to turn away those who don't qualify. On average, these members/owners have significantly lower claims than their peers who are in the standard insurance market. Furthermore, they get their premium back with interest during years they successfully achieve risk management. This ultimately leads to a significant advantage over competitors because of the lower cost of risk.

Check it out

Properly managed companies can meet the necessary criteria to become a successful group captive member. However, they frequently lack the correct information and/or experience to begin the process. Tax savings should not be your primary objective when considering a group captive. The first step in obtaining group captive insurance is to find a professional who will take a consultative approach when reviewing your program and develop a multi-year service plan for implementation. After debunking the prevailing myths, does a group captive sound right for your company?

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