MORETON & COMPANY

Property & Casualty Newsletter

August 2021: Captives

Using A Captive to Navigate Challenging Insurance Market Conditions

Until 2020, most businesses did not consider the risk presented by a global health crisis or whether their insurance coverage provided coverage for business losses caused by a global pandemic. Many businesses were not prepared for the losses related to the COVID-19 pandemic, and their traditional insurance policies did not provide coverage for the types of losses companies experienced due to COVID-19. (The U.S. reported over 200,000 more permanent business closures in 2020 than an average year.) An ongoing “hard” insurance market, where certain lines of coverage are difficult to find and premium costs continue to climb, have compounded this financial stress. In light of the foregoing, many businesses have turned to alternative risk structures such as captive insurance companies to meet their risk transfer needs.

What is a Captive Insurance Company and How Can It Help Your Company Survive These Challenges?

While a captive insurance company is not for everyone, it can offer a good alternative for a business with difficult-to-place risks or when used to reduce the impact of a hard market. A captive insurance company is set up by, and insures the risks of, its owner. Essentially, a business either individually, or together with other companies, forms its own insurance company to cover some or all of its business risks. As with traditional insurance coverage, the captive charges the insured (its owner) an actuarially determined premium together with certain fixed costs. However, unlike a traditional insurance company, if the insured’s losses for the policy year are less than the amount of premium paid, over time the unused funds are returned to the insured/captive owner.

A captive solution can provide coverage for risks that the traditional market is unwilling or unable to accept, such as the risks presented by a COVID-19 pandemic. A captive may allow a company to write policies covering pandemic-related risks tailored to the company’s particular risks. For example, depending on the situation, a captive may be able to provide contingent/event cancellations coverage without a pandemic exclusion. A captive can also allow a business to navigate a hard insurance market, as the cost of coverage through a captive does not follow a hard or soft market. Captive premiums are based solely on the risk profile and loss performance of the owner/insured, and not on general market conditions.

As noted above, a captive is not for everyone. The best candidates are businesses with robust safety and risk management practices and a positive loss profile. In addition, depending on whether a company pursues a single parent vs. a group captive, premium minimums may apply. If your company has a solid safety program and good loss record, now is the time to consider a captive solution that can provide your business protection from vacillating market conditions and unknown risks.