

Captive Insurers – Part 2

The implementation of the Federal Risk Retention Act encouraged formation of captive insurance companies known as Risk Retention Groups (RRGs). These were formed under the federal law to write liability insurance for members of the group. Captives were usually formed at locations outside of the United States or “off-shore.” Foreign and “off-shore” captives had the advantage of not being subject to the premium taxation and insurance regulations of any state. Bermuda was a major domicile location for offshore captives but other popular locations included the Bahamas, Barbados and the Cayman Islands. These groups contributed to the viability of the alternative risk market because they represented another method of insuring risk beyond the traditional insurance mechanism.

Other Captive Concepts

Pure captive: refers to a captive that is owned by a single, parent company. This form was the initial technique for solving insurance cost and availability problems because of the failure of traditional insurance markets to respond to those needs. Shortly after they came into existence, retention groups developed. The concept continued to mature and spawned more variations. They included:

Rent-a-captives: These are captives formed by insurance agents or brokers. With this concept, interested businesses rent the operating shell of the captive insurer to handle the coverage needs of the business. It allows the business to solve coverage problems and avoid high start-up and operating costs. The disadvantage is that the rented captive controls premiums and investment income but it still fulfills the main purpose of resolving the issues of cost and availability.

Segregated Cell: This is a sophisticated modification of a rent-a-captive. There is a significant difference. In the rent-a-captive approach, all premiums of the participants contribute to the group as a whole and the poor results from one participant affect all the others. In a segregated cell captive, the premiums, losses, reserves and investment income of each participant is separated from those of every other participant.

These modifications and others contributed to the growth of the alternative market. It allowed businesses skilled in handling risk to take advantage of new strategies where insurance is a component of risk management, rather than being the entire strategy.

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