

INSURANCE & REINSURANCE CAPTIVES - A CHECKLIST OF KEY ISSUES

This checklist notes the principal issues to consider in the establishment of a captive insurer. It is provided for reference only and detailed legal, accounting and tax advice should be obtained on a jurisdiction-specific basis in relation to any particular proposal.

1. Nature of captive

Issue	Points to note
Objectives of captive	Identify motivation for the captive route as this will drive strategy – purposes could include: <ul style="list-style-type: none">(i) insurance cover where otherwise uninsurable or premiums prohibitive(ii) retention of profits (technical and investment) within group rather than by third parties(iii) potentially lower premiums due to removal of third party profit requirements(iv) flexibility to retain different levels of risk depending on market appetite (hard or soft market) and(v) improved claims management by removal of third party.
Structure of captive	Distinguish between: <ul style="list-style-type: none">(i) group (or single parent) captive(ii) association captives (e.g. for trade bodies)(iii) agency captive (used by a broker for clients' risks) and(iv) rent-a-captive arrangements (perhaps through a segregated cell company).
Classes of risk	Consider in particular position re compulsory insurances (e.g. employer's liability cover) where direct insurer may need to be admitted in the jurisdiction. Is the captive just to cover risks which group companies cannot otherwise insure?
Short tail or long tail?	Long-tail lines may require the group to continue with the captive longer than advantageous (particularly if there is a change in law, e.g. tax law meaning the original drivers for the captive no longer exist). The desirability of locking capital up long-term will need to be considered.
Location of risks	In the context of global programmes, local law insurance requirements will need to be considered and the captive may need to reinsure a local insurer (fronting).
Retention of risk by insureds	Determine alignment-of-interest issues for members of the group. Aggregate retentions or per loss retentions?
Retention of risk by captive	Consider captive's retention whether as insurer of third party insurer or as insured of third party insurer - in each case whether by deductible, limits, proportion of loss etc.

2. Operational considerations

Issue	Points to note
Capital resources	Decide on capital resources to be made available to captive – issues include internal/external funding and extent to which the wider group will have to issue any guarantees to third party funders. Note regulatory requirements may also be a driver.

Underwriting and claims	<p>Determine the extent to which a broker or other third party service provider is to deal with insured group members, in terms of both underwriting business and claims handling.</p> <p>Determine any delegated authority limits for the above.</p> <p>Consider broker independence issues, e.g. ties to reinsurers or insured group members and how any conflicts can be managed in practice.</p> <p>Remuneration arrangements for any brokers need to be considered carefully so that broker interests are in line with those of the group.</p> <p>Consider rights of captive for audit, review and termination of arrangements.</p>
Investment management	<p>Specialist advisers are likely to be required, particularly in ensuring there are no timing mismatches between investment returns/maturities and claim projections.</p>
Directors and administration	<p>Identify the directors of the captive – from group or third parties? Are corporate directors (i.e. companies) a possibility/appropriate?</p> <p>Determine the extent to which general administration of the captive is to be outsourced. Where third party administrators/directors are appointed, note independence and review/termination requirements.</p> <p>Where administration is provided centrally and a charge is made back to the group, consider the VAT (or similar) implications.</p>
Reporting	<p>Determine the frequency of broker and administrator reporting to captive directors, and the frequency at which the captive must report to the group.</p>

3. Choice of jurisdiction

Issue	Points to note
Tax considerations	<p>Consideration of the tax position of the group as a whole will be essential.</p> <p>Premium deductibility will be a key issue (and extent to which policies must be on arms' length terms in order to obtain deductibility status).</p> <p>Any insurance premium taxes?</p>
Permitted structures	<p>Most captives will be set up using a limited liability company, but in some cases (for example for tax reasons) another form of vehicle may be sought – check the desired structure is available in the jurisdiction.</p>
Directors' duties	<p>The scope of directors' duties in some jurisdictions may be less onerous than, say, the UK or US. Key areas for consideration relate to directors' duties in the event of an insolvency e.g. liability for wrongful trading.</p> <p>Do directors have to be resident?</p>
Ongoing company filing requirements	<p>In particular, are audited accounts required each year?</p>
Regulatory requirements – capital	<p>In addition to any levels of capital required, the manner and frequency of calculation will need to be considered.</p>
Regulatory requirements – staffing	<p>Do individuals need regulatory approval? Any ongoing requirements such as residence?</p>
Regulatory requirements – conduct of business	<p>A check will need to be made in relation to areas such as policy documentation and claims handling requirements.</p>
Regulatory requirements – filing obligations	<p>How often must returns be filed and how onerous will it be to compile them?</p>

Regulatory requirements – consents Are regulatory consents required for changes in the business structure or in the scope of activities? Or does the regulator simply have to be informed? This can be an issue where the group (or at least a member of the group ‘above’ the level of the captive) may be sold.

4. Initial documents

Document

Parties

Constitutional documents of captive such as articles of association, any shareholders’ agreement

Shareholders (i.e. in a group, the relevant parent company or companies)

Corporate filings

Captive and corporate registry

Filings with tax authorities

Captive and tax authority

Documentation evidencing capital resources

Captive and relevant counterparty (e.g. bank for loans, companies for equity investments)

Underwriting agreement for brokers

Captive and broker

Claims handling agreement

Captive and broker

Investment management agreement

Captive and investment manager

Management services agreement

Captive and manager

Directors’ service

Captive and relevant director

Contracts Service agreement with group

Captive and relevant group companies providing services to captive

Policy wordings

Captive and insured/reinsured/reinsurer

Our captives team



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