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***INFORMATION
ON
BERMUDA CAPTIVES***

1. BACKGROUND

There are now more than 10,000 Captives worldwide and Bermuda is the domicile of choice for the vast majority of them.. The term “captive” refers to companies formed primarily to insure the risks of their parents or affiliates, which was first developed in Bermuda in the early 1960’s and is more popular today than it has ever been.

Bermuda dominates the captive insurance market with some 30% of the world’s captives now on its register representing net annual premiums of US\$ 28 billion and total assets of US\$138 billion. Captive insurance business represents approximately 75% of the Bermuda insurance register.

In soft markets as well as hard, risk managers and others continue to regard captive solutions as highly effective risk management tools.

Item	1998	1999	Growth percent
Net written premiums	\$24.3	\$28.0	15 percent
Capital and surplus	\$54.0	\$70.0	30 percent
Invested assets	\$123.8	\$137.6	11 percent

In 2002, the Registrar of Companies in Bermuda recorded the formation of 94 new insurance companies of which 35 were new Class 1 companies (up more than 52% from

2001). Class 1 insurers are single-parent captives insuring only the risks of its owners or affiliates.

Captives by Domicile in 1999, Western Hemisphere, outside the USA		
Domicile	Official Statistics	Number in Directory
Bermuda	1493	1415
Cayman Islands	499	532
Barbados	215	239
British Virgin Islands	135	137
Bahamas	25	23
Turks and Caicos Islands	95	20
Curacao	15	17
British Columbia, Canada	16	16
Panama	2	2
Total in offshore region	2495	2401

Captive in Bermuda are 62% owned by American interests, 18% by European, 10% by British, 2% by Far Eastern, 2% by Canadian and 6% by other countries.

Captives are considered to represent a significant and permanent alternative to the commercial market.

2. THE CAPTIVE CONCEPT

A captive insurance company is a company generally established in a tax neutral or low tax jurisdiction that offers insurance to its parent or affiliates in return for premiums. It is a closely held insurance company whose business is primarily supplied by and controlled by its owners. Captives are insurers owned by insureds and organized for the main purpose of self-funding the owner's risks. The insured participates in influencing the underwriting, operation, and investment of a captive insurer.

There are primarily two distinct captive structures: single parent or group, the latter typically owned by a number of companies with similar exposures. Some trade associations, for example, operate their own group or association captive insurers.

Captives can be used to provide coverage either directly or as reinsurance of a fronting insurer.

3. TYPES OF CAPTIVES

In Bermuda there are five (5) types of captives, all of which serve a different clientele and purpose. There is also a single general class of companies dealing with captives.

(A) Agency

The Agency Captive was very popular in the insurance days of the mid 1980's. Brokers or intermediaries formed these captives along with their clients. This gives advantages difficult to obtain in the open market. It is a strong marketing tool to reinsurers as it demonstrates that the agent is prepared to join them on the risk. Full disclosure is made to the client if it's placed in an Agency Captive.

(B) Association

Formed by the pre-existing associations (trade or professional associations) to provide insurance coverage for members. Ownership rests with the association or individual members. They too usually have a financial expert at the association level with prime responsibility. However, not all associations have actual insurance specialists on their payroll. When they do not, much more responsibility is given to the Bermuda management company, broker and other consultants. There is usually some form of surplus allocation method agreed upon by members. When captive boards of directors invoke this, it can become the single most time-consuming duty performed by the management company

(C) Industry

Owned by the companies within the same industry, which have come together solely to solve an insurance coverage problem. The stockholders appoint a Board of Directors to whom the Bermuda management company reports. This type of captive usually places a substantial responsibility on the management company, which makes the important decisions. Industry Captives are usually work-intensive due to the need for detailed and regular reporting to stockholders. There is usually some form of surplus allocation method agreed upon by members. When captive boards of directors invoke this, it can be the single most time-consuming duty performed by the management company.

(D) Rent-a-Captive

Certain companies 'rent' their surplus to entities wishing to establish a self-insurance program but not their own captive at the outset. However, a number of 'rent-a-captives' do eventually form their own types of captives, because of their clear advantages. Not all Bermuda management companies have in-house 'rent-a-captives'. These usually require substantial management company time. Contract documentation is usually detailed and voluminous there is substantial work in maintaining individual program funds in segregated accounts.

(E) Single Parent

Often described as 'pure captives', these are the companies with a single owner, to whom they provide insurance coverage. A risk manager or financial officer at the parent company level usually monitors them. Some are managed by a Bermuda Insurance Management company, but when monitored by an official at the parent company level, few real decisions are taken by the management company.

(F) Third Party Insurance and Reinsurance

While becoming an increasing part of the 'captive' scene, these companies are **not**, in fact **captives**. A number are formed in 'offshore' insurance domiciles to carry out general insurance and reinsurance business. Bermuda attracts the largest number of players.

3. WHY FORM A CAPTIVE

In almost every case, captives are started because a general dissatisfaction with existing insurance coverage or costs. The advantages are in these areas: Insurance, Commercial, Financial, and Tax.

(A) Insurance

A captive can provide insurance for risks, which may not be normally insurable. For example; there is limited insurance available in the areas of strikes, product recall, patent suits, etc. Loss experience is based on the company's experience rather than being averaged with others that have less stringent controls and more prone to claims. Reduction in insurance costs is available as there is no sales force or overhead to pay for, no claims administration group, etc. Insurance company direct costs run around 2050% compared to 5% for captives. Insurance income is earned on premiums, i.e. ceding commissions from the reinsurance companies inure to the captive rather than an outside insurance company.

(B) Commercial

The prime advantage is the ability to earn interest on capital and reserves, thus turning a cost center into a profit one. The development of insurance to enhance product acceptability is available prenatal planning insurance is a good example of this. The ability to be more flexible in the settlement of claims is possible; i.e. perhaps a company would wish to make a commercial judgment on a claim where an advisor or wholesaler might be held to be more/ or less liable under the ordinary insurance proceedings. The ability to benefit from situations where evidence of insurance is more acceptable than a company guarantee or promise to pay; i.e. sick leave insurance for employees where a union wants a policy of state benefits.

(C) Financial

Captives provide the opportunity of converting specific reserves to insurance costs at the parent level thus converting post tax reserves to the pre tax expenses. Examples reserves against product reliability or subsidiary debt, guarantees, etc. The ability to lower costs derived from the realistic evaluation of exposure vis-a-vis existing premium/risk expenses is available. The ability to convey normally nonconvertible funds for exchange control purposes to a subsidiary as a genuine risk financing measure is generally available. The improvement of cash flow is available using a captive in case of claims, the captive has use of funds until the claim is settled; in the case of reinsurance, premiums are paid quarterly in arrears instead of yearly in advance of normal insurance. Premium expense is generally deductible at the parent level, but income earned on investment at the captive level is not taxable. Special rules apply for U.S. and Canadian companies. The lack of regulation of investments at the captive level means funds could, with prudence, be used to finance the needs of sister companies.

(D) Tax

Premiums paid to a captive are generally deductible at the parent level. U.S. and Canadian companies require special planning, but remember the tax advantages are merely a bonus to the captive idea. Capital reserves and premiums are not taxed in most offshore locations. The success of a captive relies on good management not good luck. Top management must understand the long term commitment to captive insurance. Bad risk assessment or a series of unlucky occurrences can cost a captive dearly in the early years.. Annual premium costs alone are not criteria of risks and low maximum loss potential.

(E) Banking advantages

Captive reserves may be invested in the money markets. Loans may be made to fund capital for the captive. Loans may be made to provide premiums, which must be paid in advance. Loans for claims payments may be made where assets are temporarily not available in the captive or the captive is involved in legal action. New banking relationships are available with the captive. Access to reinsurance companies as possible clients. Added service may be offered to existing clients. Possible foreign exchange dealings are feasible; e.g. premiums, claims, or reinsurance. Security custodianship of investment is available.

(F) General Advantages

Captives can often provide an attractive alternative to purchasing insurance from conventional insurance markets. They can be organized for a number of reasons. Captives are used to meet unique insurance needs. They provide self –funding , and reduce the impact of the insurance industry’s underwriting price cycles. Captives provide opportunities for the organization to improve risk controls by centralizing the risk management function. Captives increase the control over funds flowing through the organization, through possible tax benefits and a reduction in the cost of risk management.

4.1 INSURANCE REGULATION

The insurance legislation is comprised of the Insurance Act 1978 (as amended by the Insurance Amendment Acts, 1981, 1983, 1985, 1995 and 1998) and the regulations promulgated under the Act (the “Regulations”). The Regulations are the Insurance Accounts Regulations 1980 (as amended) and the Insurance Returns and Solvency Regulations 1980 (as amended). References herein to the “Insurance Act” are to the Insurance Act 1978 (as amended) and the Regulations.

The Companies Amendment Act 2000 (the “Amendment Act”) came into force on 11 August 2000. It amends provisions of the Companies Act 1981 (the “Act”), the legislative foundation of international business in Bermuda.

The Amendment Act is one of a long series of amendments Acts designed to ensure that Bermuda’s principal corporate statute remains at the forefront of current legal thinking, combining flexibility and practicality to meet the challenges of business in the new millennium. It is further evidence of the Bermuda government’s commitment to international business and its passage is welcomed by the industry.

The Insurance Act applies to any person carrying on insurance business in or from within Bermuda including local companies, exempted companies, non-resident insurance undertakings (which sell policies through Bermudian agents on Bermudian lives and property) and overseas companies carrying on non-domestic insurance business from an office in Bermuda under a permit. It should be noted that the act of merely underwriting the risks of, for example, a Bermuda incorporated company may not be within the scope of the Insurance Act where the underwriting is conducted by a non- Bermuda entity and entirely from an office outside Bermuda. Insurance agents, managers, brokers, intermediaries and salesmen not specifically employed by a registered insurance company are required to be registered under the Insurance Act.

The Insurance Act distinguishes between long-term business and general business. Long-term business consists of life, annuity or accident and disability contracts in effect for not less than five years. General business is any insurance business, which is not long term business. General business insurers fall into one of four classes, depending on the nature of the risks underwritten. A further distinction is made between domestic and non-domestic business; non-domestic business being that where the risks underwritten are those, for example, of an exempted company or overseas company registered in Bermuda. Generally, there is no difference in the regulation of insurance and reinsurance business.

4.2 The Regulators

The Supervisory Authority of the insurance industry in Bermuda is the Bermuda Monetary Authority. As required by the Insurance Act, the Minister of Finance (sometimes referred to herein as the “Minister”) has appointed an Insurance Advisory Committee, which the Minister must consult before exercising a number of his or her powers under the Insurance Act.

It is the Government’s policy that, in general, the insurance industry be self-regulating. The Insurance Act is therefore drawn to require certification by the appropriate officers and professionals connected with each company on compliance with the statutory standards applicable to that company.

Sub-committees of the Insurance Advisory Committee have been appointed for the supervision and review of the law and practice of insurance in Bermuda, including reviews of accounting and administrative provisions and procedures. The membership of these sub-committees is basically drawn from the legal and accounting professions and the insurance industry itself. The process of close consultation with the Government on the matters affecting the insurance industry is expected to continue and amendments to the statutes or practice will be made as considered appropriate.

4.3 Bermuda – Tax Neutrality

At the date of this memorandum, there is no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by an exempted insurance company or its shareholders, other than shareholders ordinarily resident in Bermuda.

An exempted insurance company may apply for and is likely to receive from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act, 19966 an undertaking that in the event of there being enacted in Bermuda any legislation imposing tax computed on profits or income, or computed on any assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, such tax shall not until 28 March 2016 be applicable to such company or any of its operations or to the shares, debentures or other obligations of such company except in so far as such tax applies to persons ordinarily resident in Bermuda and holding such shares, debentures or obligations of the company or any land leased or let to the company.

4.4 Avoiding Adverse Tax Consequences in Parent Company's domicile

According to the Federal Taxation of Insurance Companies reference handbook, published by the Research Institute of America, the following steps should help a captive and its parent avoid the adverse tax consequences mentioned in the previous paragraph:

- Establish business objectives and purpose
- Use adequate capitalization
- Get managerial expertise
- Comply with local insurance regulations
- Follow conventional investment strategies
- Use risk-transferring insurance contracts
- Assure sufficient risk distribution
- Transact business at arm's length pricing
- Insure unrelated risk
- Acquire insurance related companies
- Consider multi-ownership

5. GOVERNMENT FEES

Any insurance company which is an exempted company, is required to pay an annual government fee based on assessable capital. For a company with share capital, the assessable capital is the aggregate of its authorized share capital and share premium account. Where the company is a mutual company, the assessable capital is the amount of the company's reserve fund. The government fee is in bold for the following capital.

\$3,460 (for capital of \$120,000)

\$5,340 (for Capital from \$120,001 to \$1,200,000)

\$7,120 (for Capital from \$1,200,001 to \$12,000,000)

\$8,900 (for Capital from \$12,000,001 to \$100,000,000)

\$15,900(for Capital from \$100,000,001 to 500,000,000)

\$26,500 (for Capital from \$500,000,001)

NOTE

- (1) The premium share capital for an insurance company starts at \$120,000 (higher if the company carries on long term business or both general and long-term business). For mutual funds, the minimum reserve fund is \$250,000.

- (2) The annual government fee for an insurance holding company is \$1,695 (being the lowest rate for non-insurance companies which companies must have a minimum share capital of \$12,000), regardless of its capital.

An annual declaration is submitted each year at the time of payment of the annual government fee. This declaration states the type of business carried on by the company, the amount of its assessable capital and how the assessable capital has been calculated.

In addition to the annual government fee, an insurance company is required to pay a initial license fee and thereafter an annual insurance registration fee. An application fee of \$121 is payable (except in the case of registration as an insurance salesman where the fee is \$61) on the initial application together with the following initial registration fee:

- (a) An insurer, being:
- i. **\$3,000** A non-resident insurance undertaking under the Non-Resident Insurance Undertakings Act 1967 (fees in subparagraphs (ii) to (x) below do not apply to these undertakings)
 - ii. **\$800** Class 1 insurer carrying on general business
 - iii. **\$800** Class 2 insurer carrying on general business
 - iv. **\$2,500** Class 3 insurer carrying on general business
 - v. **\$15,000** Class 4 insurer carrying on general business
 - vi. **\$2,500** Long-term insurer
 - vii. **\$2,500** Class 1 insurer carrying on both general business and long-term business
 - viii. **\$2,500** Class 2 insurer carrying on both general business and long-term business
 - ix. **\$2,500** Class 3 insurer carrying on both general business and long-term business
 - x. **\$15,000** Class 4 insurer carrying on both general and long-term business

5. OTHER REASONS FOR FORMING A CAPTIVE

Tax deferral is commonly thought to be the primary reason for forming a captive insurance company. In practice, however, this is typically not the case. Captives are formed to provide necessary coverage at acceptable prices and for various good economic reasons, some of which are listed below:

(A) Unavailability of Coverage

The insurance industry is subject to considerable cyclical changes in which excess capacity leads to increased competition, resulting in decreased premium rates and poor underwriting results. This in turn causes a market reaction resulting in dramatic increases in premium rates and restriction on the availability of some types of coverage. In some cases premium rates may be set unrealistically high as the commercial insurance sector attempts to recover some of its losses from the previous cycle of depressed rates. This is particularly the case with liability lines, excess covers and catastrophe risks. Many captives have been formed to provide coverage, which was otherwise not available due to the cyclical process of the market. Many of these have remained in place providing ongoing coverage at more stable premium rates than is available in the market.

(B) Insuring the Uninsurable

Captives can provide coverage in areas such as new or potentially hazardous products, hazardous waste, nuclear risks or environmental pollution. Wherever protection is (i) unavailable in the conventional market, (ii) available only at an unacceptably high price or (iii) available subject to onerous policy conditions or exclusions, there is an opportunity for a captive.

(C) Cost Reductions

One of the most common reasons for establishing a captive is to minimize the costs of risk management by creating a captive profit centre. The price of insurance purchased in the conventional market obviously includes a portion of the insurer's acquisition costs, overheads and profits, and they may be as much as 40% of the premium. Although establishing a captive does not avoid all these costs, it should reduce them, and, if the captive's own loss experience is no worse and claim handling costs are no greater than the average of the conventional insurer's business, there may be substantial underwriting profits available to the captive.

In addition, the offshore captive may substantially reduce, or even avoid, other expenses, such as administration and settlement of claims, loss of control expenses, various state

and federal taxes, brokerage commissions, and other acquisition costs and consulting fees.

The rising premium cost of certain high risk or 'long-tail' insurance (such as product liability or medical malpractice) has been successfully contained by some association or industry captives, which are formed to avoid the volatility of market cycles.

(D) Risk retention, risk management and loss control

When a company has a better loss history than it's industry average, the assumption or retention of its own risk within certain limits is attractive. Yet for many types of risk, self-insurance is not permitted and tax deductibility is not available. An offshore captive reinsurer, however, may enable a company to achieve these objectives, subject to reasonable fronting costs.

In most cases insurance is seen by operating managers as a fixed cost. By replacing insurance at least partially with self-insurance, the concept of variable cost is introduced as the losses are seen to fluctuate and to some extent reflect the quality of management control.

The opportunity for a company to centralize and tailor its risk management programs and to improve loss control efficiency is an important, but often overlooked, reason for establishing a captive. This particularly applies to diversified or multinational corporate groups.

(E) Cash Flow Benefits

The insurance industry has traditionally relies upon high investment income to supplement modest or negative underwriting results. Such investment income is generated primarily from funds represented by unearned premiums and unpaid losses, since premiums are usually paid in advance, often annually, while claims tend to be paid out over a much longer period, depending on the type of business insured.

(F) Access to the Reinsurance Market

A fundamental benefit of establishing a captive is the captive's ability to gain direct access to the international insurance market, the wholesale market for insurance. Captives can often obtain reinsurance that is less expensive than conventional direct excess and umbrella coverage.

In addition,, a captive has the opportunity to reduce costs by combining two or more lines of risk, and may also earn ceding and/or profit commissions.

(G) Diversification into a Profit Center

Another reason for establishing a captive is to diversify into open market insurance operations and operate as a separate commercial profit center. Whereas the primary reason for forming a single parent captive is usually to reduce insurance costs, an ancillary benefit may be the generation of profits from third party unrelated business. However, the underwriting of such business could also expose the captive to underwriting losses, and captives should make sure that this business is professionally vetted. Some control by the parent company may be desirable.

(H) “Unbundling” of Services

A company may not be satisfied with the technical services provided by its conventional insurer and may wish to “unbundled” risk control and claim handling services from the actual purchase of insurance cover. This is usually an ancillary reason for forming a captive.

(I) Reduction of government regulations and restrictions

The insurance industry is heavily regulated in all developed economies, with minimum capital and surplus requirements, solvency margins, specific ratios of premiums written to net assets (and requirements), and, in some cases, restrictions on investments. In addition, many multinational corporations experience difficulties in the international transfer of funds through dividend payments because of national exchange restrictions. An offshore location for a captive insurance or reinsurance company can, if properly established within the legal requirements of the domicile, provide a less onerous regulatory environment, widen investment opportunities, and facilitate legitimate international movement of funds, all of which may be of vital importance to the commercial interests of the multinational corporation.

(J) Tax minimization and deferral

As previously indicated, the establishment of a captive insurance company should be determined by its viability as an insurance operation. Tax advantages should be viewed as an incidental, although potentially significant, benefit.

(K) Taxation in U.S.

This discussion of U.S. taxation is not intended to give advice to any person reading this booklet. It is only intended to discuss general tax concepts and principles.

The issue of several recent judicial rulings in favor of the taxpayer establishing captive arrangements, specifically, *Humana Inc. v. Commissioner*, *AMERICO Subsidiaries v.*

Commissioner, *The Harper Group v. Commissioner*, *Sears, Roebuck v. Commissioner*, and *Ocean Drilling and Exploration co. v. United States*, indicate that the opportunities for successful tax strategies for captive arrangements seem to have entered a new era. Tax benefits available to a captive insurance operation may vary depending upon the form, operation and ownership of the company. A number of potential tax advantages are briefly summarized as follows:

- In an offshore captive, depending on the source of the underwriting income and the residence of all or some of the shareholders of the captive, the underwriting and investment income may be accumulated free of income tax.
- The premium paid to the captive may be tax deductible as an expense by the insured.
- Offshore captives may avoid paying U.S. State premium taxes.
- A captive may establish tax-deductible loss reserves.

6. INCORPORATION AND REGISTRATION OF A CAPTIVE

The majority of companies in Bermuda are incorporated by registration under The Companies Act 1981. This is a relatively simple process, commencing with an advertisement in the official government gazette setting out the proposed name of the company, its principal objectives, and the fact that it is to be exempted from Bermudian ownership. Thereafter, application for the incorporation is made to the Minister of Finance.

The application must set out, among other things, the name, address, occupation and nationality of the major shareholder and the nature of the business the company intends to carry on. Bank references on the major shareholder of the proposed company must be submitted with the application, or, if the majority shareholder is a company the latest annual report must be enclosed with the application. This information is treated in the strictest confidence. Emphasis is placed on clean company operations backed by reputable persons, and the bank serves as a means of screening out undesirables.

Insurance companies must also register under The Insurance Act 1978. Again, the process is not complicated and is done in conjunction with local lawyers or insurance management companies. At the time of registration, the company must appoint a resident “principal representative”, a position normally filled by the local insurance management company. The application for registration requires information on intended underwriting, together with projected premium volumes, underwriting results, and capital surplus for the first two years of operation.

There is generally no objection to shareholders' and directors' meetings being held outside Bermuda, provided that copies of the minutes are forwarded to the company secretary in Bermuda for inclusion in the official minute book. However, it is generally accepted that, if captive companies continually hold meeting outside the Island, the company's principal representative and the resident directors reserve the right to attend such meetings wherever they may be held.

7. COST OF INCORPORATING AND OPERATION A BERMUDA CAPTIVE

The following estimates, explained in United States Dollars, are for minimum size captives. Costs obviously increase with size and complexity.

Start-up Costs (including the first year's government fees)

	Range	
	Low	High
Lawyers' fees for incorporation	\$ 4,000	\$ 4,500
Other disbursements	1,500	2,000
Registration fee – Companies Act*	3,360	3,360
Registration fee – Insurance Act	2,205	2,205
	\$ 11,065	\$ 12,065

Annual Operating Costs

	Range	
	Low	High
Lawyers' secretarial and directors' fees	\$ 5,000	\$ 5,000
Manager's fees (basic captive)	20,000	30,000
Registration fee – Companies Act*	3,360	3,360
Registration fee – Insurance Act	1,100	1,100
Audit fee (basic captive)	8,500	13,000
Other (telephone, telex, bank charges, etc.)	750	1,500
	\$ 38,710	\$ 53,960

8. SETTING UP A CAPTIVE

The careful preparation and planning are essential ingredients in the process of creating a successful captive. The first step should be a feasibility study. Such a study usually consists of financial analysis, legal research, actuarial projections, tax projections, domiciling options, comparisons, and an insurance issues analysis.

The next step is a more detailed analysis focusing on the geographical implications of possible domiciles for a future captive. This should include finding answers to the following questions:

- How might political instability affect the captive's ability to function ?
- Would the time spent traveling to and from the location be difficult to manage ?
- Could capable employees or management companies be found at a reasonable cost ?
- How friendly and sophisticated is the regulatory body of the considered domicile.

Once the site of the captive is decided upon, a line of communication should be established with regulators. Regulators should be consulted on the most appropriate captive structure. Detailed regulatory financial requirements should be obtained. If a foreign country is selected, currency deposit requirements should be determined. Any information on the licensing and incorporation process obtained through the internet should be confirmed with the regulators and attorneys. Most licensing applications ask for the following:

- Biographical information;
- Financial information such as capital requirements, letters of credit, and method of funding;
- Names of service providers, such as actuaries, CPAs, management firms, and attorneys;
- A business plan. This would usually include an actuarial report, summary of risks to be insured by the line of business, identities of fronting companies to be used, anticipated annual premiums, maximum retained risk, rating program, and reinsurance program;
- A copy of the proposed charter and byelaws, and
- Financial reports of the parent.

The next step is to submit a complete license application form to the regulators. It is advisable to e-mail completed forms initially, followed by personal delivery or mailing.

Usually, after an initial review of the application, executed copies of the charter and bylaws have to be filed with the regulators. In most domiciles, upon a determination that

the applicant has complied with the domicile law and regulations, a certificate of authority is issued to the captive insurer.

Once the captive is licensed, officers of the captive, or a manager of the captive would market any insurance or reinsurance for the captive. At that point it is essential to verify that the capitalization not only meets legal requirements but also takes into consideration initial and anticipated reserving needs of the captive.

9. SUMMARY

In conclusion, captives are usually formed offshore and as an alternative to the traditional coverage. This alternative allows the owners and its affiliates to insure their own risks. Captives are self-insurers; they exist to cover the parent company's risks.

Captives were first coined in Bermuda in the 1960's. Bermuda is the home to almost one half of existing worldwide captives and the leading choice of new captive formation. Out of all the jurisdictions available to form a captive, Bermuda still remains the most popular.

There are many reasons for setting up a captive. Tax minimization or deferral is the most common reason for setting up a captive. The other two main reasons include unavailability of coverage and insuring the uninsurable. During a "hard" market, premium rates can be set at an unrealistically high rate, and restrictions on the availability of some type of coverages. Setting up a captive can provide coverage for companies with this problem. Captives can also provide coverage for companies introducing a new or potentially hazardous product or waste, nuclear risks or environmental pollution.

Ten Steps in the Formation of a Captive Insurance Company

