20 Captive Myths

By Lauren Ingram captivereview.com/features/20-captive-myths/

There are a number of myths about captive insurance, so we're bringing you the truth about the 20 most common myths in the market.

1. Captives are only formed for tax reasons
One of the most common myths about captives is that they are only formed as tax shelters, to try and hide money from a government's tax collector. However, this could not be further from the truth. A captive is primarily a risk management tool for a company, a way to better manage its risk. While there can be some cost savings when it comes to tax in some domiciles, captives are not formed just for tax reasons.

2. Captives are only formed in hard markets
A long-standing myth is that a captive is a short-term fix to market fluctuations, something that you can set up while the market is hardening and then discard when the market is soft. And while there is more interest in the captive industry during a hard market due to price increases in the traditional insurance market, captives have stayed strong and had many new formations in the past 15 years despite the soft market, proving this is well and truly a myth.

3. Only Fortune 500 companies form captives
While many large companies, including those on the Fortune 500 list, have captive insurance companies, organizations of any size can set up a captive. Many small and medium-sized companies form successful captive insurance companies as a way of managing their risk. Micro captives, group captives and cell captives are also becoming more and more popular options for smaller organizations.

4. Captives don't pay tax
While many captives may wish this were the case, unfortunately it is not so. Captives do pay tax, and both federal and state governments of countries where captives are based are quite resolute in ensuring that the correct taxes are paid, at the correct time. While the captive insurance industry may benefit from some slightly beneficial tax incentives in some domiciles, there is always tax to be paid. You know the saying – you can never cheat death or taxes.

5. Only certain industries use captives
This is a pervasive myth that sometimes stops some organizations from investigating the possibility of a captive, because they believe that captives are limited to certain industries. Healthcare is a popular industry that has used captives in the past and continues to successfully use captives. However, any industry can set up a captive, the only thing stopping a company is their willingness to investigate the possibility and transfer their risk.

6. The most popular domiciles are tax shelters

Many myths about captive insurance companies center around tax, and another one plays on the stereotype that the most popular domiciles are simply tax shelters, a way to move money offshore and avoid tax liabilities. As lovely as it would be, it is not the case. While the largest captive domicile by number of captive licenses is Bermuda, don't head there thinking you'll get to dodge your taxes – the Bermuda Monetary Authority (BMA) is the regulator there and they run a tight ship.

7. Captives must assume all liability

When explaining the concept of a captive insurance company to someone who has never heard of the concept, they often assume that having a captive means an organization is completely self-insuring and taking on all liability for the risk themselves. However, this is of course not the case because of the reinsurance market, which captives have access to.

8. You can only use captive for certain risks

It is a common assumption that captives are only used for certain risks, such as property and casualty, and not for any other type of risk. In reality, property and casualty are a common type of risk seen in captives, the fact is that if anything, captives are very flexible when it comes to the types of risk they can handle, such as cyber risk, for example.

9. Captives are expensive to run

One of the reasons why captives continue to be so appealing to the organizations that have them is that not only do they provide good risk management, but they are also a good financial decision.

10. There are no captives in Asia

While there are less captive insurance companies by number in Asia than in the rest of the world, it is completely incorrect that there are no captives in Asia. In fact, Singapore is a hub for captives, with at least 73 domiciled in the country as of the end of 2018. China and Hong Kong also have captives domiciled in their countries, and in early 2020, Kazakhstan also changed its legislation and had its first captive license issued. The Pan-Asia Risk and Insurance Management Association (PARIMA) supports local captives in Asia and is based in Singapore.

11. There are no captives in the Pacific

Just as it is a myth to think there are no captives in Asia, it is also a myth to believe there are none in the Pacific. Australia, New Zealand, the Cook Islands, Micronesia and Vanuatu are all captive domiciles. Fiji also recently announced that it is considering becoming a captive domicile as part of an overhaul of their insurance legislation, adding a potential for more captives in the Pacific. While the number of captives in the Pacific are small, they do exist.

12. It takes a long time to set up a captive
Different regulators have different processes in setting up a captive, and different timelines for how long this takes. Most regulators want to ensure that captives pick their domicile and make the process as easy as possible for them. However, you still can't set up a captive overnight, so it does take some time to go through the process.

13. Captives are a new concept
Many people believe that captive insurance is a new concept, something that was invented in the past 25 years, which is far from the truth. The term 'captive' came to be in the 1950s, when the modern captive insurance industry began to come together. In the 1980s, the US captive industry started to flourish, with the State of Vermont becoming a domicile, but other domiciles have been in on the game for years before that, including Guernsey and the Caribbean.

14. You need a certain level of risk to justify a captive
There is no one level of risk that determines when a company should have a captive. Any company, with any level of risk, can choose to use a captive. Dependent on the size of its risk, the type of its risk and its industry, a company may choose a different type of captive, but you don't need to be a $1bn company to have a captive.

15. Domiciles are picked for their beaches
Going hand in hand with the myth that the most popular domiciles are tax shelters, is the myth that companies pick offshore domiciles such as Bermuda and the Cayman Islands so they can visit the country and lay on the beach getting some sun. However, 60% of all captives are domiciled in the US, and after Bermuda and the Cayman Islands, some of the domiciles with the highest number of captives are places like Vermont and Delaware – lovely places, but not exactly where you would go for a beach holiday all year round.

16. A captive manager is for life
While many captive owners stay with their captive manager for many years, it is a myth that you are stuck with your captive manager for life. More frequently captive owners are changing their captive managers, or at least calling around and seeing what else is out there.

17. Brokers actively dislike captives
While in the past this myth may have been true, or at least partially true, things have changed. A decade ago, some brokers may have disliked captives, or simply not known about the niche area, but more and more brokers are now more educated about captive insurance. The broking industry has realized that it needs to offer captives as an option to its clients, and so 'brokers hating captives' is certainly a myth.

18. Captives trap a company's money
Captives never trap an organization's money, and people who think that captives 'trap' money have misunderstood how the industry works. While in most cases a company must prove they have certain amounts of capital in order to set up a captive, this will not 'trap' their capital.

19. Captives can't be used for emerging and complex risks
Captive insurance companies can be used for any risk you need them to, not just simple risks. In recent years, captives have been used for some very complex and specific emerging risks that mainstream insurance companies were not able to place. In 2019 some captives were created to place risks for cryptocurrencies, a first in the insurance world.

20. A captive is forever
Another common myth is that once you decide to set up a captive, you are stuck with it forever. But this is not the case at all. There are a number of options if for any reason you decide that a captive isn't the best risk-management tool for your organization anymore. Legacy solutions, closure – all options that mean that the captive can be taken off your hands

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