Captive insurance
Our global insurance services practice

PwC is the world’s largest professional services firm. Our Insurance Industry practice, a part of our broader Financial Services practice, operates across industry sectors, geographies and functional skill areas to bring you the broadest perspectives and responses. Ours is a market-driven, market-specialized, highly credentialed practice that provides independent accounting, business advisory, tax, actuarial, regulatory, and other services to some of the largest, most prestigious institutions in the world.
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One of the primary goals of a captive insurance company is to provide improved risk management for an organization. The following are some of the risk management benefits that can be achieved through the use of a captive insurance company:

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<th>No.</th>
<th>Benefit</th>
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<tbody>
<tr>
<td>1</td>
<td>Increase financial efficiency of one’s risk management program</td>
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<td>2</td>
<td>Mitigate the impact of pricing and capacity volatility in the commercial markets</td>
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<td>Obtain access to reinsurance markets</td>
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<td>Maintain control over claims analysis</td>
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<td>Obtain access to government programs (e.g., terrorism insurance)</td>
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<td>6</td>
<td>Create flexibility in responding to changes in one’s risk retention and risk transfer strategies</td>
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<td>7</td>
<td>Obtain coverage for risks traditionally not readily available or economically feasible in the commercial markets</td>
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<td>8</td>
<td>Create centralized accountability for risk management of diverse operations, business units or insurance programs</td>
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<tr>
<td>9</td>
<td>Reduce insurance administration costs and recapture underwriting profits</td>
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Captive insurance 101 (continued)

**Structure**

A captive insurance company is a separate legal entity, established and licensed as an insurance company in its chosen domicile. As an insurance company, it is subject to regulation. A captive will be subject to the same corporate governance matters as other subsidiaries in the consolidated group, including establishing a sound business plan. A captive may insure brother/sister subsidiaries, the parent entity, or unrelated third parties. The basic captive insurance structure is illustrated below.

The captive insurance company must be capitalized. In order for the captive to have an impact on the corporate group, it requires a material amount of capital and premium funding. As a result, there may be an opportunity cost associated with lower yield captive investments vs. higher parent “hurdle” rate (ROI).

![Captive Insurance Structure Diagram](image)

**Insurable risks**

One of the benefits of a captive insurance company is the ability to tailor the insurance coverage to the needs of the organization. There are a number of types of coverages that are considered “traditional” captive lines of business, as they are common in the industry. However, captive insurance companies can provide more unique and exotic insurance coverages as well, as illustrated in the examples below.

**Traditional coverages**
- General liability
- Worker’s compensation deductible layer
- Auto liability
- Property
- Product liability
- Professional liability

**Other coverages**
- Employee benefits
- Construction exposures (OCIP – Owner Controlled Insurance Programs)
- Trade credit risk
- Cyber risk
- Intellectual property
The tax status of the captive insurance company for U.S. federal income tax purposes is an important consideration. If the captive qualifies as an insurance company for U.S. federal income tax purposes, then premiums paid to the captive are tax deductible by the insured entity, and the captive is afforded special tax treatment under Subchapter L, including generally the ability to defer 80% of the unearned premiums and deduct discounted loss reserves.

Neither the Internal Revenue Code nor the treasury regulations thereunder define the term “insurance” or “insurance contract,” and there are no bright line tests for qualifying as an insurance company for U.S. federal income tax purposes. However, the courts and the IRS have developed a framework for determining whether a contract qualifies as insurance for federal income tax purposes. The courts have explained that in order for an arrangement to constitute insurance, it must meet the judicial standard of insurance as set forth in Helvering v. LeGierse, 312 U.S. 531 (1941), and applied by the courts in subsequent cases. The judicial standard is as follows:

1. Whether the arrangement involves the existence of insurance risk;
2. Whether the arrangement exhibits both risk shifting and risk distribution; and
3. Whether the arrangement is regarded as insurance in its commonly accepted sense.

Captive structures, like most transactions, have federal, state, and international tax considerations and opportunities, which should be carefully analyzed.

**Key opportunity profile**

**Who should consider a captive insurance company?** The following are characteristics of companies for which a captive insurance company may be beneficial:

1. **Financial stability**
2. **Good risk management practices**
3. **Long-term commitment to the use of a captive insurance company**
4. **Decision to pursue a captive insurance company is driven by an interest in financing assumed risk positions**
Captive insurance 101 (continued)

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<thead>
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<th>Reasonably predictable insurance risk</th>
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<tr>
<td></td>
<td>Sophisticated financial planning</td>
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<tr>
<td></td>
<td>Substantial operations in high tax jurisdictions</td>
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<td></td>
<td>Multiple operating entities with insurable risk spread throughout</td>
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<td></td>
<td>Existing balance sheet reserves for self-insured business risk exposures or large deductibles (i.e., worker’s compensation, general liability, professional liability, etc.)</td>
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Captive lifecycle

- **Establishment**
  - Risk management review
  - Feasibility study/business planning
  - Formation and regulatory consulting
  - Segregated account planning
  - Tax-structuring
    - Optimization
    - Opinions

- **Enhancement**
  - Captive Health Check
  - State tax planning
  - Program expansion (e.g., coverages/retentions)
  - Risk management review
  - Balance sheet monetization

- **Ongoing maintenance**
  - Assurance services
  - Actuarial reserve studies
  - Actuarial reserve certification
  - Tax compliance services
  - IRS audit assistance
  - Transfer pricing support/analysis
  - Experience monitoring/analytics

- **Closure**
  - Assistance with communication strategies
  - Regulatory consulting
  - Liquidation tax planning
  - Run-off strategies consultation
  - Actuarial estimates in run-off
  - Managed wind-up (i.e., solvent schemes, etc.)
Feasibility and structuring services

Making the right choices early

Successful captive operations need to be thoroughly researched and properly planned. Every client has different needs; consequently every captive structure is different. Maximizing the benefits to be gained from your captive means understanding and responding to the various business needs and concerns within your organization. To do this effectively, you need a service provider with a broad range of skills.

PwC has a proven track record of delivering high-quality captive insurance solutions throughout the Captive Lifecycle. What differentiates us is our multi-disciplinary Team Approach. Our clients have access to our team of risk management, actuarial, tax (US federal, state and international), regulatory and accounting professionals.

The result – a menu of captive structuring services ranging from providing turnkey captive solutions to providing specific supplementary expertise to your existing team in support of an ongoing captive initiative, which is perhaps being led internally or by another service provider (e.g., broker or captive consultant).

It’s more than just running some numbers

We offer a broad range of services. Our professionals are ready to assist you with all aspects of the captive establishment process, including:

- Risk management reviews
- Tax structuring and opinions
- Feasibility studies
- Formation assistance
- Regulatory consulting

Our experienced team of captive experts will work with you to complete a comprehensive feasibility analysis which addresses the variety of ways in which the captive will impact your organization, (e.g., Insurance/Risk Management, Tax, Finance, Accounting, Treasury, Legal, and Operations), as well as addressing your questions and discussing opportunities.
Feasibility and structuring services (continued)

The PwC captive insurance team provides full service captive planning, including:

- Helping you identify the right resources in your organization to ensure the feasibility analysis considers all business drivers and requirements
- Assisting in identifying risks and limits that potentially may be insured by the captive
- Evaluating the appropriate arm’s length market premium to be charged by the captive
- Advising on the optimal location of the captive within your organizational structure
- Providing insight into which captive domicile aligns best with your particular goals
- Advising on the considerations in making a domicile selection
- Assisting in evaluating the benefits of onshore vs. offshore domiciling
- Advising on federal income tax implications and structuring the captive and the insurance program to best meet your objectives
- Advising on the potential transactional taxes that may be imposed
- Advising on capital requirements and capitalization options
- Assisting in the identification of alternative investment strategies
- Facilitating the domicile service provider selection process
- Assisting with establishing introductory meetings with domicile regulators to present the plan for the captive
- Advising on tax treatment of the captive as part of the organization's group as well as the tax treatment of premium flow
Captive Health Check

How does your Captive Insurance Company stand up?

While the IRS has accepted the use and role of captive insurance arrangements as an integral part of a comprehensive risk management strategy, they continue to challenge captive insurance arrangements that fail to comply with the principles and guidelines established by the courts in defining “insurance” for U.S. federal income tax purposes. Moreover, the application of Federal excise tax, the Base Erosion and Anti-Abuse Tax (BEAT), as well as the complexities of state income and self-procurement taxes often pose a challenge.

In response, PwC has developed a comprehensive Captive Health Check to assist companies in assessing how their captive insurance arrangements stand up against these principles and guidelines and to serve as a platform for identifying best practices, potential enhancements, and possible exposures.

Why a Captive Health Check?

First – most corporations change over a period of 5 or 10 years. They acquire companies, dispose of companies, and start and end lines of business. Their structures and operations change over time. These changes can provide new opportunities for enhanced risk management and tax benefits.

Second – substantial changes have occurred in the tax landscape dealing with captive insurance companies. The IRS has issued a number of revenue rulings setting out what it believes are the requisite fact patterns for a valid captive insurance arrangement, and more recently the Tax Court has examined captive insurance arrangements and further clarified the requirements for a valid captive insurance arrangement.

The Captive Health Check provides the captive owner with an experienced overview of the structural and functional aspects of their captive insurance company and is designed to provide the captive owner with a range of benefits, including:

• Identifying structural and operational deficiencies and/or opportunities in current captive insurance arrangements from a U.S. federal, state, and international tax perspective
• Providing the captive owner with recommendations to strengthen the overall tax position of the captive, in coordination with the overall risk management and business goals of the company

The Captive Health Check allows us to gain insight into the structure and operations of the captive to inform the captive owner of “best practices” based on our experience, including:

• Expanding the risk program to include additional alternative risks in the captive
• Identifying potential alternative investment and cash repatriation options
• Exploring alternative methods of funding other coverages' related costs through the captive
• Identifying opportunities to reduce the company’s overall tax burden
Captive closure

How do you release your captive’s embedded value?

Many companies seek to rationalize their captive arrangements and release capital or simply seek to exit third-party lines of business to enable their captive insurance affiliates to focus on core group insurances.

PwC is well-versed in assisting owners and shareholders of insurance entities to extract surplus value and bring closure to their discontinued insurance holdings.

Whether you are seeking the controlled, accelerated, wind-down of an entire insurance captive, or you simply wish to exit discreet lines of insurance business in order to reallocate capital, we are able to assist you in achieving your goals.

Why seek finality?

The use of a captive insurer is a well-accepted and useful risk transfer mechanism. In a climate of rising rates and restricted coverage, captives have frequently delivered cost savings and invaluable in-house expertise in risk management and loss prevention.

Extensive consolidation in most industry sectors has often resulted in companies maintaining duplicate captive arrangements that require rationalization. Many captives have also written third party legacy insurance and reinsurance business, not always profitably, that now require servicing, incurring administrative expenses and requiring capital support that otherwise could be deployed elsewhere.

How can PwC add value?

Restructuring and rationalizing captive arrangements can mitigate exposures to legacy liabilities, generate cost savings, and enhance financial value through:

- Prevention of deterioration of reserves on third-party business and release of redundant reserves
- Protection of reinsurance assets through accelerated collection activity
- Reduction in ongoing administration and management costs

PwC can assist clients in reorganizing their captive insurance arrangements in the following ways:

- Accelerated portfolio de-scaling through commutation advice and support
- Whole captive closure through structured exit mechanisms such as statutory liquidation
- Performance and process improvement in operational areas such as claims handling and reinsurance
- Actuarial support in valuing and managing complex related or third-party exposures
Our specialist resources

Our Captive Practice is geared toward meeting the needs of our clients and their stakeholders. Our leading insurance industry expertise and captive specialization allows our professionals to focus on helping you resolve your business issues. Our multi-disciplinary approach to captives means that our team of seasoned tax, actuarial, risk management, accounting and business recovery experts can help you identify, plan and address business issues, opportunities, and challenges in a timely manner, minimizing any last minute surprises and increasing the benefits you derive. We can help you bring it all together. We have excellent working relationships with the major domicile regulators and captive management companies and are accustomed to helping you meet the demands of corporate timetables and objectives.

Contact our national captive insurance team

Tax

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Scott is the National Practice Leader of PwC’s Captive practice, providing compliance, consulting, and accounting services to the insurance industry, while assisting clients with strategies to navigate legislative and regulatory systems.

Katherine Freed
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Katie has spent her career providing tax services to the insurance industry with a primary focus on captive insurance. She has worked as a part of PwC's national captive insurance team for over 15 years. Her areas of expertise include all aspects of captive insurance arrangements, and she serves as a Tax Specialist supporting the firm's audits of captive insurance companies.

Mark S. Smith
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Before joining PwC, Mark served for five years with the Treasury Department Office of Tax Policy, and for over 18 years with the IRS, including nine years as the chief of the Insurance Branch in the Office of Chief Counsel. Mark either drafted or reviewed much of the government’s administrative guidance on captive insurance from 2001-2011.
Our specialist resources (continued)

Tax – Caribbean

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After retiring from PwC’s Offshore Tax Practice in Bermuda and the Cayman Islands after 20 years, Rick has been retained as a specialist resource with over 37 years of experience providing tax consulting services to offshore financial services companies, including captive insurance, offshore reinsurance, and offshore investment funds.

Scott Slater
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Scott is the leader of PwC’s Caribbean region international tax services group based in Bermuda and the Cayman Islands. He leads a team of specialists in providing tax consulting and compliance services to insurance, asset management, and multi-national clients. Prior to joining PwC Bermuda in 2005, Scott worked in the PwC Chicago office where he practiced in a variety of tax technical areas. Scott has assisted clients with structuring and compliance regarding U.S. tax requirements of captive insurance companies, international re/insurance companies, and hedge and private equity investment funds and their shareholders/investors.

Tax – International Services (ITS)

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Surjya is a CPA and an attorney, with an LLM in Tax, and a member of PwC’s International Tax Services Practice in the National Tax Office in Washington, D.C. He provides tax advice to a number of inbound and outbound insurance clients and has worked with many domestic and foreign insurance companies, brokers, investment banks, and their clients.

Josie Lowman
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Josie has spent over 25 years specializing in state and local taxation matters in the insurance industry. Josie was formerly Deputy Director, Taxes - Global Tax Reporting and Analysis at a Fortune 50 insurance company, with more than 10 years with the company of which she spent more than eight years as head of global indirect taxes, including state taxes. Prior to that she was with PwC. Josie has a strong background in the state taxation of insurance companies, including captive insurance arrangements.

Tax – State and Local Tax (SALT)
Our specialist resources (continued)

Advisory – Insurance Risk Management

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With over 35 years of risk management and insurance experience, John is the National Practice Leader of PwC’s Insurance Risk Management Solutions practice. He has worked as part of PwC’s national captive insurance team for over 15 years, focusing on the identification of risks suitable for the captive and working with clients on the premium for risk and the associated capital requirements.

Keith Opferkuch
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Keith has over 10 years of insurance risk management in an advisory capacity at PwC and has worked on many captive insurance engagements.

Actuarial Services

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Kris is a Partner in PwC's Actuarial Services practice and has over 20 years of experience working with captive insurance companies and other alternative risk vehicles. Kris began providing actuarial services to captives while working for a captive manager before moving to an actuarial consulting firm and then PwC in January 2019. Kris has worked on various projects for captives including loss reserving, reserve variability, funding projections, risk transfer analyses, simulation modeling, capital adequacy, predictive analytics, and management presentations. Kris is a frequent speaker at captive and other conferences and a publisher on traditional actuarial topics, as well as new emerging areas impacting captives and the insurance market.

Lisa Slotznick
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Lisa has more than 35 years of property and casualty reserving experience, and she leads PwC’s actuarial asbestos and environmental valuation team. She is the primary consultant for worker’s compensation, general liability, and professional liability services for large commercial self-insurers, insurers, and reinsurers. Lisa is also PwC’s lead resource on statements of actuarial opinion and actuarial professional standards.

Lisa advises companies on captive insurance company formation, along with other members of the PwC captive team, with her focus on the actuarially determined premium.
Our specialist resources (continued)

Why is PwC the right choice?

PwC’s extensive experience and in-depth knowledge of the insurance industry has allowed us to maintain the largest presence of the Big Four firms in the global insurance market. In addition, we currently audit more than 40 percent of the Global Top 50 insurance companies and serve more than 4,000 insurance companies and groups around the world. We provide tax, risk management, actuarial and assurance services globally to more than 500 captives from our various offices around the world.

We believe that our multi-disciplined team approach distinguishes PwC in the captive insurance and alternative risk transfer arena. Our Captive Insurance Team is comprised of experienced tax and insurance professionals with expertise in accounting, risk management, actuarial, and US federal and state taxation. We are uniquely qualified to address the issues facing your captive. We regularly assist our clients at all levels of both federal and state tax controversy with issues concerning their captive insurance companies.
Thank you