Captive Insurance
Our Global Financial 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 financial services institutions in the world. Our global team of over 30,000 financial services professionals serves virtually every segment of the financial services industry – Insurance, Banking and Capital Markets, Investment Management and Real Estate.

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Captive Insurance 101

Background

A captive insurance company is a subsidiary established by one or more commonly-owned businesses to insure the risks of the controlling entity and/or its affiliates or its individual owners. A captive insurer is under the purview of the respective insurance regulatory authority and prepares a separate audited financial statement.

There are in excess of 5,000 captives, including group and cell captives, established in various domiciles throughout the world. Businesses have been using captives for decades as a risk management tool. All types of industries may benefit from a captive insurance company.

While there are a number of different forms of captive insurance companies, this document will focus on pure captives, also known as single parent, wholly-owned captive insurance companies.

Risk Management

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:

- Increase financial efficiency of one’s risk management program;
- Create flexibility in responding to changes in one’s risk retention and risk transfer strategies;
- Mitigate the impact of pricing and capacity volatility in the commercial markets;
- Obtain coverage for risks traditionally not readily available or economically feasible in the commercial markets;
- Obtain access to reinsurance markets;
- Maintain control over claims analysis;
- Create centralized accountability for risk management of diverse operations, business units or insurance programs;
- Obtain access to government programs (e.g. terrorism insurance);
- Reduce insurance administration costs and recapture underwriting profits.
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 to the right.

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).

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.

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**Taxation**

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 premium paid to the captive is tax deductible by the insured entity, and the captive is allowed favorable tax treatment under Subchapter L of the Internal Revenue Code.

Neither the Internal Revenue Code nor the treasury regulations thereunder define the terms “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 analyzed.

**Key opportunity profile**

**Who should consider a captive insurance company?** The following are characteristics of companies where a captive insurance company may be beneficial to the organization:

- Financial stability
- Good risk management practices
- Long-term commitment to the use of a captive insurance company
- Decision to pursue a captive insurance company is driven by an interest in financing assumed risk positions
- Reasonably predictable insurance risk
- Sophisticated financial planning
- Substantial operations in high tax jurisdictions
- Multiple global operating entities with insurable risk spread throughout
- Existing balance sheet reserves for self-insured business risk exposures or large deductibles (i.e., worker’s compensation, general liability, professional liability, etc.)
## Captive Lifecycle

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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, Operations), as well as addressing your questions and discussing opportunities.
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 structuring the captive and the insurance program to best meet your federal income tax objectives;
- Advising on the potential transactional taxes which may be imposed;
- Advising on capital requirements and capitalization options;
- Advising on the potential transactional taxes which may be imposed;
- 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;
- Assisting in the identification of alternative investment strategies;
- Providing insight into which captive domicile aligns best with your particular goals;
- Facilitating the domicile service provider selection process; and
- Advising on the considerations in making a domicile selection;
- Assisting in evaluating the benefits of onshore vs. offshore domiciling;
- Assisting our clients with establishing introductory meetings with domicile regulators to present the plan for the captive.
Captive Health Check

How Does Your Captive Insurance Company Stand Up?

While the Internal Revenue Service ("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 which fail to comply with the principles and guidelines established by the courts in defining "insurance" for US federal income tax purposes. 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 and possible enhancements to improve the captive’s financial benefits.

Why a Captive Health Check?

First – most corporations change over a period of 5 or 10 years. They acquire companies, dispose of companies, 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 Service 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 US federal, state, and international tax perspective; and
- Providing the captive owner with recommendations to strengthen the overall tax position of the captive, while at the same time considering 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 upon our experience, including:

- Expand the risk program to include additional alternative risks in the captive;
- Identify potential alternative investment and cash repatriation options;
- Explore alternative methods of funding employee benefits related costs through the captive; and
- Identify 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 the Global leader 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 rationalizing. 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 could otherwise be deployed elsewhere.

How can PwC add value?
Restructuring and rationalization of captive arrangements can mitigate exposures to legacy liabilities, generate cost savings and 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;
- Savings 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 Schemes of Arrangement or Statutory Liquidation;
- Performance and process improvement in operational areas such as claims handling and reinsurance; and
- Actuarial support in valuing and managing complex related or third party exposures.
Our Specialist Resources

Our Captive Practice is geared to 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 make it all work. 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

Anthony J. DiGilio  
Partner  
Tony is the National Practice Leader of PwC’s Captive practice with more than 26 years of experience providing compliance, consulting, and accounting services to the insurance industry while assisting clients with strategies to navigate legislative and regulatory systems.  
anthony.digilio@us.pwc.com  
202.253.9028

Byron Crawford  
Director  
Byron is a CPA with more than 30 years of insurance tax experience. He has been involved in all aspects of insurance taxation, and he serves as the principal Tax Specialist supporting the firm’s audits of captive insurance companies.  
byron.a.crawford@us.pwc.com  
314.206.8131

Mark S. Smith  
Managing Director  
Before joining PwC, Mark served for 5 years with the Treasury Department Office of Tax Policy, and for over 18 years with the IRS, including 9 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.  
mark.s.smith@us.pwc.com  
202.312.7518

Katherine Freed  
Director  
Katie has spent her career providing tax services to the insurance industry with a primary focus on captive insurance. She received her Juris Doctor from the University of Missouri School of Law, with a Taxation Certificate. 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.  
katherine.freed@us.pwc.com  
314.206.8175
**Tax – Bermuda**

**Richard E. Irvine**  
*Partner*  
Rick leads PwC’s Offshore Tax Practice in Bermuda and the Cayman Islands. With over 32 years of experience, Rick is responsible for providing tax consulting and compliance services to offshore financial services companies, including captive insurance, offshore reinsurance, and offshore investment funds.  
[richard.e.irvine@bm.pwc.com](mailto:richard.e.irvine@bm.pwc.com)  
1.441.299.7136

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**Scott Slater**  
*Director*  
Scott provides tax consulting and compliance services to insurance companies, offshore investment funds, and multi-national clients. He assists clients with the structuring of and providing tax consulting and compliance services to captive insurance companies, offshore reinsurance companies, and hedge and private equity investment funds.  
[scott.slater@bm.pwc.com](mailto:scott.slater@bm.pwc.com)  
1.441.299.7178

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**Tax – International Services (ITS)**

**Surjya Mitra**  
*Managing Director*  
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.  
[surjya.mitra@us.pwc.com](mailto:surjya.mitra@us.pwc.com)  
202.414.4382

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**Tax – State and Local Tax (SALT)**

**Michael Palm**  
*Director*  
Michael specializes in state and local taxation matters in the insurance industry. He has over 20 years of tax experience, including Tax Director at the Nationwide Insurance group of companies prior to joining PwC.  
 michael.palm@us.pwc.com  
312.298.2483

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**Advisory – Insurance Risk Management Services**

**John Merrigan**  
*Managing Director*  
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.  
 john.merrigan@us.pwc.com  
646.471.5847

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**Nieves Serrano**  
*Director*  
Nieves has just rejoined the practice after four years working in Europe for a major brokerage firm, in a consulting role, assisting corporations to holistically implement global insurance risk management programs, as well as specializing in the captive consulting arena.  
 nieves.serrano@us.pwc.com  
646.471.1048
Actuarial and Insurance Management Solutions

Christopher Walker
Principal
Chris has more than 25 years of experience as a Casualty Actuary, and he leads the Midwest Property and Casualty Actuarial Consulting practice. His technical capabilities include loss reserve, ratemaking, and regulatory assistance to various insurance carriers and self-insurers.
christopher.walker@us.pwc.com
312.298.3223

Lisa Slotznick
Managing Director
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.slotznick@us.pwc.com
678.419.7126

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 comprises 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 in all levels of both federal and state tax controversy issues concerning their captive insurance companies.