How do I know if a captive is right for my organisation?

From Aon's experience of helping organisation's create and manage a captive, the common factors seen in the companies looking to establish a captive are both quantitative and qualitative.

Quantitative criteria

Premium Volume

There needs to be a critical mass in annual premiums to justify the considerable frictional costs in forming a captive. While situations and objectives vary, annual gross premiums of at least USD 1 million for any class of risk can be used as a benchmark.

Risk Retention Level

There needs to be sufficient capital should the organisation choose to retain risks substantially higher than its current level. It would be prudent to perform a risk retention analysis to determine the organisation's risk bearing capabilities. Aon undertakes this assessment using the organisation's annual report and other available data.

Positive Loss Ratio

A strong recent loss history speaks well for the organisation's positive risk management results. In addition, loss ratios are a quick test of whether the organisation could have taken advantage of increased self-retention. A loss ratio of 80 percent or lower is normally sufficient to generate a meaningful return in the captive for short-tailed risks, i.e. Property Damage / Business Interruption (PD/BI).

Time Lag between Loss Occurrence and Payment(s)

The time lag between loss occurrence and payment(s) is often significant. Even claims for short-tailed risks like PD/BI can take more than a year to settle. The captive allows the organisation to retain use of its cash while claims adjustments are in progress. For longer-tailed risks, i.e. liability risks, the cash can remain accessible for years.

Qualitative criteria

Premium/Risk Distribution among Countries

A company with only one exposure is not likely to be a captive candidate. However, many Asian companies have diversified by owning insurable assets in different parts of the world. The risk exposure is different across locations and hence a captive is a good way to capitalise on the organisation's lowered volatility in its risk profile.

Commitment of Senior Management

The Chief Financial Officer and Risk Manager should have an initial interest in both quantitative and qualitative advantages of captive formation. It is noteworthy that they are often influenced by others in the same industry. Once the exploratory stage is under way, it is crucial for a captive management provider to walk through the process with management when they have to present the concept to board and committee members.

Loss Control Capability and Attitude Towards Risks

The organisation's risk management should have the desire and capability to keep losses to a minimum. Top management should have the ability to influence the operating business units to make loss control a priority.

Contact:

Aon has a team of experienced captives specialists who are able to assist your organisation. If you would like to find out more or discuss further, please contact Kate Shum.

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