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Captive Insurance in Bermuda

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Introduction

This publication provides an overview of captive insurance and the captive insurance space in Bermuda. In particular, we provide an overview of the incorporation process, an understanding of the benefits and the operation of captives.

Captive Insurance

A captive insurance company is an insurance company whose primary purpose is the financing of the risks of its owners.

The Global Captive Industry

Captives have long been in existence as a means of alleviating the risks faced by organizations. Many risks on a company's balance sheet do not align with its core business pursuits, so companies often transfer these risks to a captive via an insurance contract to better manage the associated volatility.

Captives can be more dynamic than traditional insurance companies and are more capable of serving a wider range of client needs. Captives are used by a wide array of entities including financial institutions, healthcare organizations, manufacturing companies, and insurance groups of all sizes.

In 2020, there were over 7,000 captives in the world and over 1,000 global companies now successfully use captives, with increasing momentum. A common misconception is that captives are only formed by large public companies. However, there is in fact a growing trend for private companies to own captives. Currently 47% of captives are owned by private entities, dispelling the myth that captives are only for large fortune 500 companies.



Benefits of a captive

The benefits of a captive are wide ranging, including:

1. Cost Reduction

- Reduces overall costs of the parent's insurance/risk-management program.
- Any underwriting gains and investment income are retained by the parent.
- Parent benefits from its own loss experience: does not pay a premium based on industry-wide losses or perceptions.
- Since insurance premiums can fluctuate significantly, captives can help normalize any drastic impact on insurance costs year on year.

2. Access to reinsurance

- Established to provide access to the reinsurance market.
- Access to preferential pricing from reinsurance market.
- Potential to earn ceding commission from reinsurers.

3. Investment Income

- Benefit from the lag between paying premiums and payout of losses, earn investment income and possibly reduce or defer tax.

4. Administrative tool

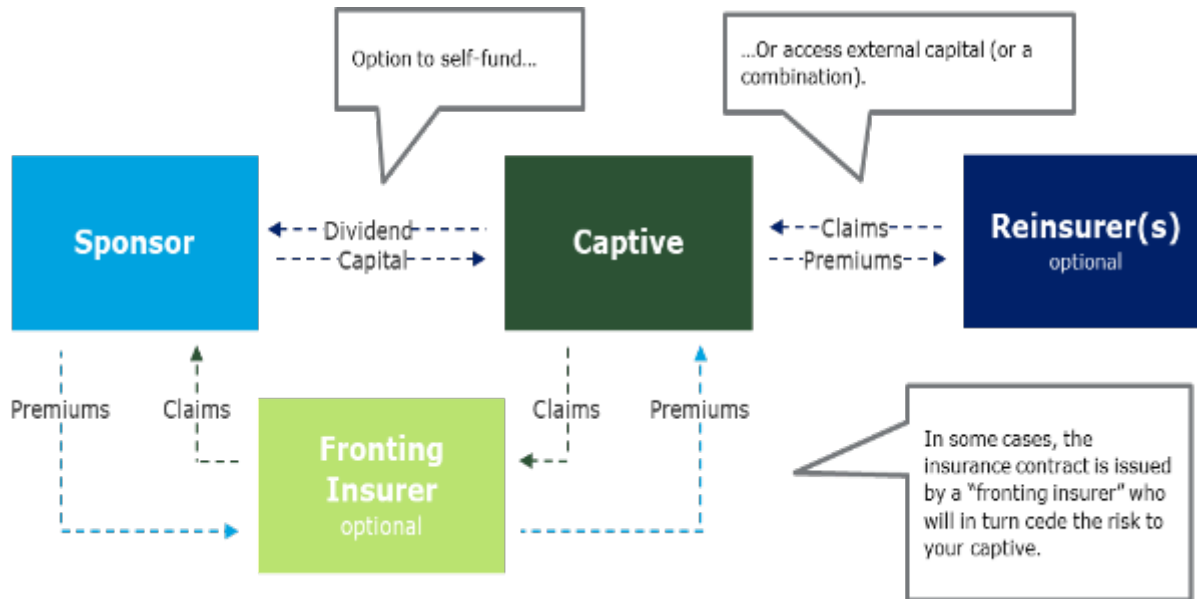
- The parent can tailor insurance policies for its specific needs and risks, providing greater flexibility and control.
- Can help bring a focus to losses and loss prevention within the parent's overall culture.
- Successful captives become an integral part of the Enterprise Risk Management program.
- The parent is usually able to more precisely direct counsel and claims adjusters and influence settlement of claims.



Structuring a Captive

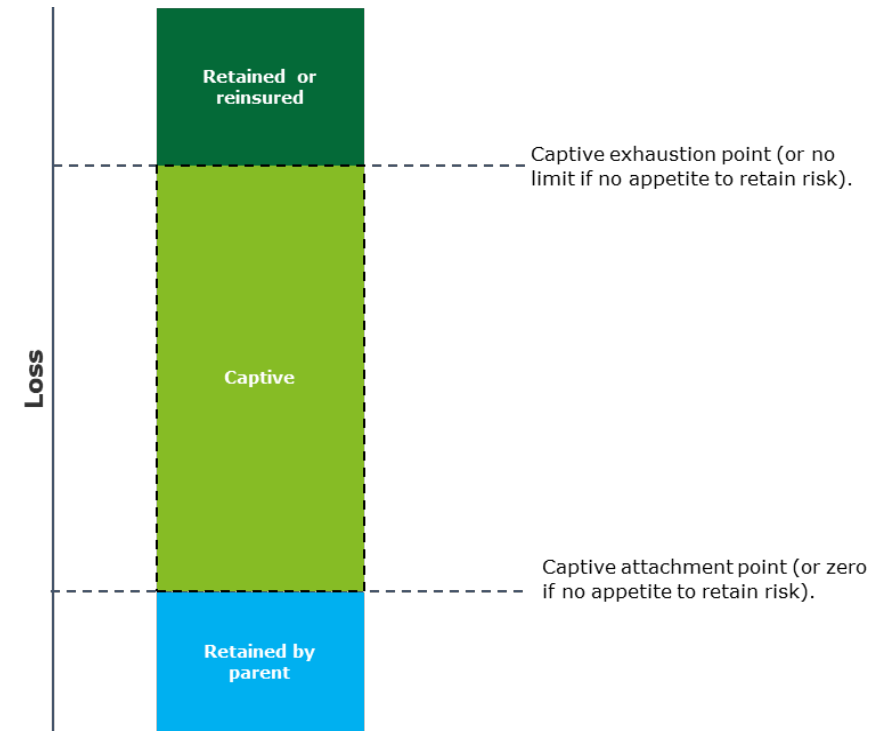
Captives are licensed insurance companies incorporated as a wholly owned subsidiary of the parent company. They are formed to primarily insure or reinsure the risks of its parent and/or affiliates.

Below, we illustrate the potential structure of your captive program.



As shown above, you can either fund the captive yourself or transfer the risk outright to reinsurers/capital markets.

The illustration below shows the risk participation of a captive. The parent retains risks within its risk tolerance and the risks above that threshold are passed to the captive until a pre-determined exhaustion point. Above this exhaustion point, risks can either be ceded to a reinsurer or retained by the parent.



Captive Costs and service providers

Set-up Costs

Cost Item	Service Provider	Low (USD)	High (USD)
Incorporation	Advisor	15,000	20,000
Registration	Regulator	3,000	30,000
Legal	Lawyer	15,000	20,000
FATCA	Tax Advisor	2,000	5,000
Misc.	Misc.	2,000	5,000
	TOTAL	35,000	80,000

Annual Operating Costs

Cost Item	Service Provider	Low (USD)	High (USD)
Management	Insurance Manager	50,000	150,000
Audit	Auditor	15,000	45,000
Business / License	Regulator	3,000	30,000
Actuarial	Actuary	10,000	30,000
Legal	Lawyer	6,000	10,000
Misc.	Misc.	3,000	5,000
	TOTAL	85,000	270,000

Sources: Bermuda Monetary Authority (2020); Bermuda Business Development Agency (2020)

Service Providers

Establishing a Captive requires the involvement of the following service providers.

<p>Lawyer</p> <p>Prepares registration documents and insurance contracts.</p>	<p>Auditor</p> <p>Provides independent assurance of business records.</p>
<p>Insurance Manager</p> <p>Serves as Principal Representative and manages accounts.</p>	<p>Bank</p> <p>Holds accounts and/or collateral in trust.</p>
<p>Advisor</p> <p>Assists in overall analysis of insurance program.</p>	<p>Approved Actuary</p> <p>Provides Loss Reserve Specialist Opinion or Actuarial Opinion on reserve adequacy.</p>

Uses of Captives

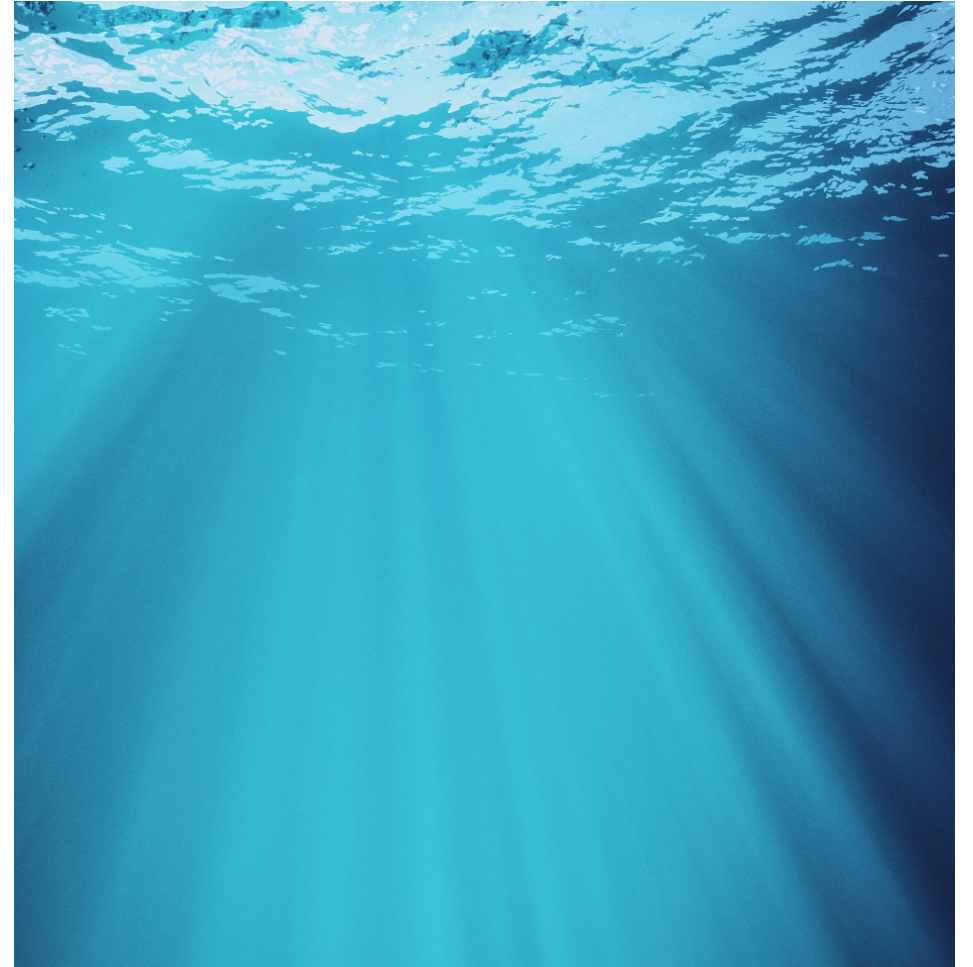
Traditional Uses

Traditionally, captives are used by insurance companies as a front for reinsurance capacity, as a form of direct insurance, for deductible reimbursement, large retentions and when insurance coverage is not available in the commercial market. We have observed diverse uses for traditional captive programs, from employee benefits, professional liability, commercial property, workers' compensation, and more. More recently, we have noticed companies becoming more sophisticated and innovative in the way in which they use captives and the risks they are willing to manage with their captives.

Emerging Trends

Captives are increasingly becoming a key risk management tool as companies identify emerging risks that are underserved or prohibitively expensive in traditional insurance markets. Going forward, we expect captives to help sponsors manage cyber, environmental, longevity, and many other risks. Additionally, with various financial reporting standards trending toward fair value accounting, we anticipate increased interest among financial institutions to use captives as a means of managing fair value volatility. The industry is also looking at how it can embrace technologies such as blockchain and other forms of insurtech.

Recent developments have opened the door for companies looking to self-fund their employee health insurance plans through medical stop loss captives.



Incorporation & licensing process

Captive Formation

The steps required to form a captive include:

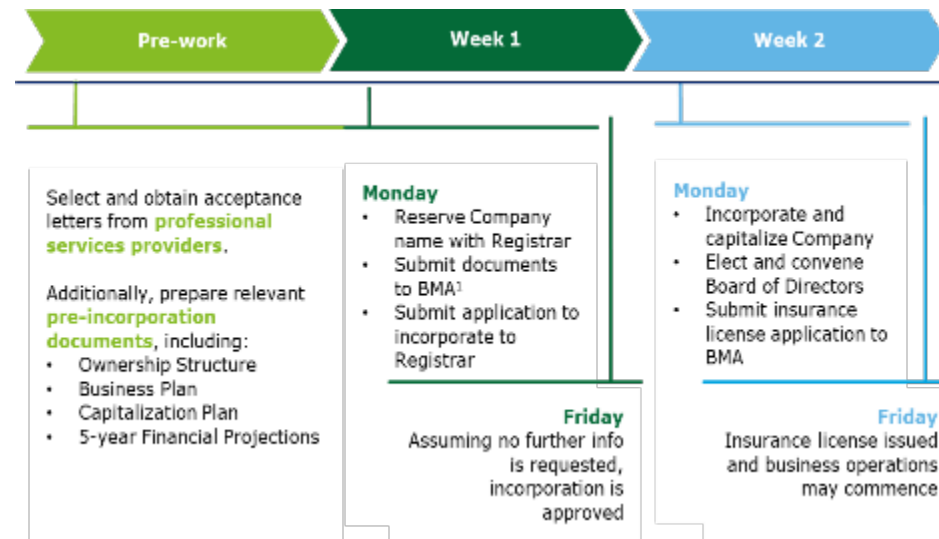
1. Conducting a feasibility study
2. Engaging service providers
3. Business planning & Incorporation

Before a captive can be formed in Bermuda, it has to be incorporated and licensed. Supporting documents generally include the following:

- Business Plan
- 5 year pro-forma financial projections
- Selection and acceptance of service providers: Principal representative (usually a captive management company), audit firm, actuary, corporate secretary and bankers
- Directors/senior officer resumes and personal declarations

Captive Incorporation

Bermuda has a short lead-time to establish a captive. A company can generally be registered in the same week an application is submitted. Following this, the BMA's Insurance Licensing and Authorization Committee (ILAC) will meet weekly to approve license applications.



- Application to incorporate the company – this can have same day response.
- Application for insurance license – this can be done concurrently to incorporation. Completed applications received by 5 p.m. on Monday will be reviewed and responded to on Friday of the same week.
- Final registration and insurance licensing - Upon approval for application, receipt of all registration documentation and confirmation that captive is funded in accordance with its Business Plan, license is issued (within approximately 5 business days).

Captive insurer classes in Bermuda

Captive insurers are classes include 1,2,3 and A and B. This facilitates proportional risk-based regulation and supervision. Classes 1-3 are used to write general (i.e., non-life or P&C) contracts and Classes A-B are used to write long-term (i.e., life-contingent) contracts.

The table below shows the general regulatory requirements associated with each class.

Class of Insurer	Class 1 (100% related business)	Class 2 (less than 20% unrelated business or multi-owned insurer)	Class 3 (20% to 50% unrelated business)	Class A (100% related business)	Class B (less than 20% unrelated business or multi-owned insurer)
Minimum paid up share capital	\$120,000 (General Purpose) \$370,000 (Composite)	120,000 (General Purpose) \$370,000 (Composite)	\$120,000 (General Purpose) \$370,000 (Composite)	\$120,000	\$250,000
Actuarial Opinion	Not required to file Loss Reserve Specialist Opinion (LRSO) unless Company discounts the loss and loss expense provisions and does not meet the solvency requirements on undiscounted basis OR greater than 30% written professional liability, otherwise required to file LRSO annually.	Required to file an LRSO every 3 years unless Company discounts the loss and loss expense provisions and does not meet the solvency requirements on undiscounted basis OR greater than 30% written professional liability, otherwise required to file LRSO annually.	Required to file an LRSO annually.	Required to file an Approved Actuary's Opinion every 3 years.	Required to file an Approved Actuary's Opinion annually.

Captive insurer classes in Bermuda

The tables below shows how the Minimum Solvency Margins (“MSM”) and liquidity ratio are determined:

Class of Insurer	Class 1	Class 2	Class 3	Class A	Class B
MSM greater of:					
Minimum Statutory Capital & Surplus	\$120,000	\$250,000	\$1,000,000	The greater of \$120,000 or 0.5% of assets	The greater of \$250,000 or 1.0% of assets
Premium Test	20% of first \$6m NPW plus 10% for excess \$6m	20% of first \$6m NPW plus 10% for excess \$6m	20% of first \$6m NPW plus 15% for excess \$6m	n/a	n/a
Loss Reserve Test	10% of Net Loss & Loss Reserves	10% of Net Loss & Loss Reserves	15% of Net Loss & Loss Reserves	n/a	n/a

Class of Insurer	Class 1	Class 2	Class 3	Class A	Class B
Where solvency test is failed	Principal Representative must report to the BMA within 30 days	Principal Representative must report to the BMA within 30 days	Notify the BMA; pay no dividends until position rectified; file revised business plan within 30 days	Principal Representative must report to the BMA within 30 days	Principal Representative must report to the BMA within 30 days
Liquidity ratio	Relevant assets must equal at least 75% of relevant liabilities	Relevant assets must equal at least 75% of relevant liabilities	Relevant assets must equal at least 75% of relevant liabilities	n/a	n/a

Relevant assets refer to certain items contained in the insurer’s statutory balance sheets including cash and cash equivalents, quoted investments, unquoted bonds and debentures, investments in first mortgage loans on real estate, investment income due and accrued, accounts and premiums receivable, reinsurance balances receivable and funds held by ceding reinsurers.

*Relevant liabilities are total insurance reserves and total other liabilities less deferred income taxes, sundry liabilities, and letters of credit, guarantees or other instruments that do not relate to the insurers’ insurance contracts.

Captive insurer classes in Bermuda

The table below shows the restrictions for different classes of captives:

Class of Insurer	Class 1	Class 2	Class 3	Class A	Class B
Reduction of statutory capital	BMA approval prior to any reduction by 15% or more of its total statutory capital as shown in the previous years statutory financial statements	BMA approval prior to any reduction by 15% or more of its total statutory capital as shown in the previous years statutory financial statements	BMA approval prior to any reduction by 15% or more of its total statutory capital as shown in the previous years statutory financial statements	BMA approval prior to any reduction by 15% or more of its total statutory capital as shown in the previous years statutory financial statements	BMA approval prior to any reduction by 15% or more of its total statutory capital as shown in the previous years statutory financial statements
Dividend restriction	Comply with solvency/liquidity requirements at all times	Comply with solvency/liquidity requirements at all times	Comply with solvency/liquidity requirements at all times	Comply with solvency requirements at all times	Comply with solvency requirements at all times

Domicile Selection - Why Bermuda?

Bermuda has a strong reputation as a robust financial center and has been the premier domicile for captive programs since their inception. The incorporation and licensing process is straightforward and streamlined. Importantly, domiciling in Bermuda enables access to a deep pool of reinsurance capital that may be more difficult to access from alternate jurisdictions. Bermuda also has equivalence tax treaties in place with many jurisdictions, allowing you to recognize credit for your captive program.

Bermuda also has the added benefit of being a one-stop shop for the full suite of services required by a captive including skilled professionals, management companies, attorneys, auditors, banking, and investment services.

The Bermuda Monetary Authority, Bermuda's integrated regulator is a world-class regulator with a pragmatic and flexible approach to regulation. This creates the perfect environment with an emphasis on creativity and innovation.

The BMA has a two-tier approach to regulating captives and commercial insurers. This recognizes that captives serve as risk retention tools rather than insurance companies.

Bermuda has ease of access as well as robust laws and regulations pertaining to captive insurers along with a receptive regulator. In addition, there are many specialist service providers on the Island.



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How Deloitte Can Help

Whether your program's objective is to insure employee benefit/pension obligations, property risks, professional liability exposures, or any other risk that doesn't align with your business goals, we have the right expertise in our global network to appropriately evaluate and develop a suitable solution.

Once you are ready to set up your program, you will need to select professional service providers and prepare the relevant documentation. We have experience developing pre-incorporation documents, and great relationships with local service providers, and can help you with your application. From there, it is a streamlined process to receive your insurance license.

If you would like to learn more about the application process, or would like more information on captive use cases we have observed in the market, please do not hesitate to contact us.



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