Captive Feasibility Study

The Steps

Setting up a Captive Insurance Company ('Captive') or Protected Cell Company ('PCC') requires a long term commitment and detailed study in order to determine the optimal program structure, ideal domicile, best service providers such as fronting insurers or auditors and a detailed planning of the set-up and licensing of the insurance company.

Because the insured entities, the parent company and the Captive are usually located in different jurisdictions, the analysis requires a deep practical knowledge of the respective legislations, tax and transfer pricing rules, insurance, underwriting and accounting issues. We have identified 5 steps from the first assessment until a Captive is fully operational, which is shown on the right and discussed below in more detail.

Pre-Assessment

A detailed feasibility study requires commitment of your time and exposure to your management. We don't expect you to commit to a detailed study without assurance that the study is likely to reduce costs and create value to your company. Therefore, we are offering a free pre-assessment, in order to determine whether (i) the new structure is likely to reduce cost and (ii) the company's financial strength, premium volume and profitability of the insurance program are sufficient to make the cost savings higher than the frictional costs.

Not only do we assess whether a feasibility study is worth pursuing – if we are of the opinion it is, we also provide you with details and the analysis needed to. This includes detailed scope, cost, time schedule and process of the study, the deliverables of the feasibility report and the steps thereafter.

Engagement

We support your decision making process and help you promoting and explaining the idea. We are also happy to assist in the presentation to and convincing of your senior management. Finally, we set up an engagement contract, where we outline the deliverables and time schedule in detail.

Detailed Feasibility Study

The detailed Feasibility Study includes 4 steps, as indicated overleaf and takes about 6 weeks to complete. It is important to note that some of the choices are interdependent; for instance, the decision on the optimal risk wrapper might be different in a different domicile, which will have different tax, capitalization, investment and cost implications influencing the business plan, cost of capital and investment strategy.
We compare all options providing full business plans for each case. However, we reduce complexity by introducing the parameters step by step and rule out certain combinations based on our longstanding experience.

**Risk Retention and Transfer**

Based on your specific loss and exposure data, indicative insurance quotes and your existing program structure, we determine the optimal program structure and risk retention.

- **Risk Bearing Capacity**: Before identifying the optimal risk retention, we first determine the maximal exposure the group is able absorb without suffering major cash drains, financing or rating issues. Among others, we consider the financial strength, impact on shareholder’s equity, free cash flows, earnings per share, key performance indicators relevant for rating or debt covenants, as well as the risk appetite of senior management and shareholders.

- **Risk Modelling**: Based on your individual loss history, exposure data and/or industry benchmark data, we model the expected losses for different retention options. In addition, we determine losses that are expected to incur once in 10 years and once in 50 years, in order to provide worst case scenarios. Our qualified actuary uses modelling techniques recognised by the profession that provides the best possible accuracy based on the data available.

- **Reinsurance**: Your insurance broker or we approach insurers and/or reinsurers in order to get indicative quotes for different programme structure options. This allows us to combine it with the loss modelling above and the cost of capital to optimize the programme structure.

- **Optimization**: Based on the steps above, we determine the program structure that minimises your Total Cost of Risk within the ability of your organisation to retain risk.
**Structuring**

- **Optimal Domicile:** Globally, there exist over 50 captive domiciles. Based on the location of the insured risks and of the parent company, many jurisdictions can be ruled out, usually leaving around 5 domicile candidates for an in-depth analysis. The choice also depends upon the chosen risk financing vehicle, tax considerations, fronting requirements, cost of operation, capital requirements, flexibility in the underwriting and investments, capitalisation, solvency requirements and infrastructure in the domicile as well as practical considerations such as different time zones.

- **Optimal Vehicle:** Besides the classical wholly owned Captive insurance company, other options include Protected Cell Companies, Rented Captives, pure balance sheet financing and others. The choice of the vehicle is interdependent with the choice of domicile. We are also able to analyse and offer Sharia compliant options.

- **Fronting and Claims Settlement:** Once the technical and financial issues are analysed, practical issues of fronting and claims management will be addressed and solutions presented.

**Business Plan**

The financial analysis is based on detailed business plans comparing all options. In addition, special consideration is given to tax issues, capital requirements of a Captive, investment strategy and operating costs. These issues will be influenced by the program structure, corporate governance, regulatory requirements and constraints in the respective domicile. We outline in detail all costs associated with management, audit and claims management.

**Implementation**

We are particularly strong at implementing the structures we are suggesting. In the feasibility study, we outline the detailed steps, data requirements, time line and cost of implementation. At this stage we might have first discussions on a ‘no-names’ basis with insurers and regulators, in order to confirm assumptions and ensure the business plan is accurate. However, the implementation itself is a separate engagement, as steps and cost differ among Captive domiciles.

**Decision**

We support your decision making and respond to any questions that may arise in the process. The delivery of our report is a first step and we will support you until a decision is reached.

**Set up, Licencing and Renewal**

The set up, licensing and renewal will be subject to separate engagement. However, we will provide full details about the steps and costs as integral part of the feasibility study, so there will be no surprises.
Time Line

Typically, a feasibility study takes about 6 weeks to complete, provided all information is available on time. The time schedule on the right outlines the entire process and is indicative. Time varies depending on complexity of the risks and programs, domiciles (for a Captive set up) and your own internal procedures of decision making.

<table>
<thead>
<tr>
<th>Step</th>
<th>Weeks</th>
<th>Cumulative Weeks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-Assessment</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Engagement</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Detailed Feasibility</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Decision</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td>Set up &amp; Licensing</td>
<td>12</td>
<td>27</td>
</tr>
</tbody>
</table>

Data Requirement

For a first assessment, we require the insurance premium, loss data and program structure of the two largest lines of business for the last 5 years. In addition, we need the annual reports of the group to determine its Risk Bearing Capacity. Where the availability of data is an issue, we might include industry benchmark data into the analysis.

Our Experience

The engagement will be led by Daniel Koepfer. He is one of the most experienced specialists in risk financing structures, including the feasibility and management of Captives in Asia. He has over a decade of experience in this field in Europe and Asia. During that time, he set up and managed structures from medium sized companies with simple structures to multi-Captive structures for global corporates with market capitalisations over USD 100bn.

Daniel is supported by a qualified actuary with over 20 years of experience in pricing and reserving for corporate retention structures as well as insurance companies and an accountant with over 20 years of experience in insurance accounting, tax and corporate governance issues.

Captives

Captive insurance is considered the world’s best practice in risk retention financing. The use of Captive insurance subsidiary is common among large corporations, as 64% of the Fortune Global 500 companies own a Captive.

While there are close to 5,000 Captive insurance companies worldwide, the utilization (or “take up”) rate in Asia is still low, especially for non-Japanese corporations. However, recently numbers are picking up as more emphasis is put on risk management in Asia.

Contact

Please contact us for more details. We are happy to discuss the opportunity in more detail.

NMG Risk Solutions Pte Ltd
Daniel Koepfer, CFA, CII
Partner
Tel.: +65 6325 9872
Email: Daniel.Koepfer@NMG-group.com