

MY BENEFIT  
ADVISOR

# Rethinking Risk: Captive Insurance & Cost Control



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## INTRODUCTION

# The Evolution of the Captive Insurance Concept

The phrase *captive insurance* emerged in the 1950s when an insurance broker used the term “captive” to describe an insurance company he helped form to provide coverage exclusively to his client and its “captive” subsidiaries. For decades, it was primarily larger companies that benefited from operating their own captive insurance companies.

In recent years, however, many small and mid-sized employers have discovered that they too can take advantage of captive insurance as an alternative to a traditional fully insured funding model.



There are numerous factors to consider when determining whether forming a captive insurance company is an appropriate alternative to a conventional self-insurance model. However, the analysis is worth the time and effort because captive insurance may be a viable and effective solution for your business. The experts at My Benefit Advisor (MBA) can help you analyze your company’s utilization patterns, financial data, and risk tolerance to determine whether a captive arrangement is feasible and advantageous.

## CHAPTER ONE

# Providing Control & Transparency

Captive insurance generally refers to an insurance company established and wholly owned by a non-insurance organization. It acts as a direct insurer or reinsurer for its parent company and subsidiaries, with the primary goal of reducing the total cost of risk.

At its core, captive insurance is a regulated form of self-insurance created, owned, and controlled by the participating businesses. The owner may be a single company or a pool of employers joining together to reduce medical benefit costs. By self-insuring within a captive, typical insurance company profit margins are essentially eliminated. The primary goal is to insure the risks of its owners and allow participants to benefit from any underwriting profits.



## Types of Captive Structures

### Single-Parent (Pure) Captive Insurance

A single-parent captive, or pure captive, is a licensed reinsurance company formed by a single organization to reinsure its own risk.

### Group Captive Insurance

A group captive is an insurance or reinsurance company owned by multiple participating businesses that pool their risk.

## CHAPTER ONE

# Providing Control & Transparency (cont.)

By incorporating a captive into a health plan strategy, members can invest their assets and benefit as owners of an insurance company. This is one of the key distinctions between a captive and a mutual insurance company. Although policyholders in a mutual company technically own and have influence within the company, they do not put any of their own assets at risk.

For the right business, a captive can be a way to take more control over your health plan, lower long-term costs, and support a healthier workplace.

For many companies, finding group health coverage can be a difficult and complicated process. Traditional insurance often provides very little insight into how premiums are calculated or how claims are handled. A captive program brings everything together — plan design, claims processing, risk protection, and reporting — into one clear system.

## What You See in a Captive

- ✓ Where every dollar goes
- ✓ What claims cost and why
- ✓ How reinsurance protects the group

With a captive, you can see exactly where your dollars are going. You get access to detailed claims information, how much money goes toward retention and risk, and what is paid for reinsurance. Because everyone in the captive can see this information, members often share ideas and best practices to help each other reduce claims and improve results for the whole group.

## CHAPTER TWO

# Achieving Business Objectives Through a Captive Program

For a business owner, the main goal of participating in a group captive insurance program is the long-term reduction and stabilization of health insurance premiums. Most employers with more than 1,000 employees already self-fund their group insurance program. Employers in the middle market, with 20 to 1,000 employees, could benefit from the savings of self-funding but often struggle with the large cost swings that can occur when claims exceed \$100,000.

A group captive helps address this issue by placing members into a program where the premium is based on each member's own claims experience. Instead of being affected by the yearly ups and downs of the insurance market, members are priced based on their actual performance.

## Key Advantages Include

- ▶ Return of underwriting profit
- ▶ Earning investment income
- ▶ An ownership mindset that encourages data-driven decision-making
- ▶ Customizable plan design and fewer ACA-related restrictions
- ▶ Improved long-term premium stability

As owners rather than buyers of insurance, captive members are incentivized to actively manage risk, prevent avoidable claims, and invest in healthier workforce strategies.

## CHAPTER THREE

# Benefits of a Captive Program

## Customization of Insurance

Traditional insurance is designed for the average group and often does not meet the specific needs of a company's employees. Traditional insurance companies also tend to be more cautious and general in how they design plans. Captives allow companies to customize their coverage. Instead of relying on a commercial insurance carrier and the limits that come with a fully insured model, a captive lets a company tailor coverage to fit its specific needs.

## Underwriting Advantages & Cost Transparency

Captives have access to detailed, real-time information, including claims data, medical diagnoses, provider usage, and types of services used. This level of visibility is not usually available with traditional insurance.

## Improved Cash Flow

Premiums for captives are paid up front, and claims are usually paid out over a longer period of time. This creates opportunities for investment income. In addition, captives can collect and review detailed data that is not normally available in other insurance arrangements. This can help improve plan results.

## Tax Advantages

A properly structured and well-managed captive may provide certain tax efficiencies. These can include tax-favored growth of underwriting and investment income, the ability to deduct premiums, and favorable tax treatment on distributions to owners. The exact benefits depend on where the captive is located and how it is structured.

## Ability to Direct Investment Options

In a captive arrangement, the business has control over how premium dollars are invested. This is different from commercial insurance, where the insurance company makes those decisions.

## Improved Customer Service & Claims Processing

Captive programs can set their own rules for customer service and claims handling. This can lead to faster processing times and better service for employees.

## CHAPTER FOUR

# Potential Downsides of a Captive Program

## Administrative Burden

Unlike a traditional commercial insurance plan, a captive is responsible for its own underwriting, claims administration, loss control, and customer service. This requires additional money, staff, time, management, and expertise to handle these responsibilities. Some of the work can be outsourced to a third-party administrator, but doing so reduces some of the potential savings.

## Capital Commitment

Captives require a significant financial commitment at the start. This includes the cost of setting up the plan, hiring needed personnel, paying legal fees, and meeting the capitalization requirements set by the state or country where the captive is licensed.

## Increased Risk

With a captive, the business owner is putting some of the company's own money at risk. If the company has a year with high claims, the owner's capital could be affected. Participants also need to stay aware of regulatory requirements, including accurate reporting, proper document management, consistent administrative practices, and keeping up with any rule changes.

A captive program may work very well for some companies, but it may not be the right fit for everyone. While there are many potential benefits, there are also responsibilities and risks that must be considered. With a detailed feasibility study and careful planning, the right company can take advantage of the benefits of a captive and reduce many of the possible drawbacks.

## CHAPTER FIVE

# Determining the Feasibility of a Captive Arrangement

Although a captive insurance arrangement has many benefits, it is not the right approach for every organization. A detailed and professional analysis should be completed before any decisions are made. In addition to working with tax, accounting, and legal professionals, business owners can rely on the guidance and support of MBA.

## Key Criteria to Consider

### Claim Utilization History

A loss ratio of less than 50 percent is ideal, along with low claim frequency and a history of few major claims. If claims regularly cost more than the premiums paid by the company, it may be better to have a traditional insurance carrier bear the risk.

### Profitable Business Entity

A captive arrangement requires strong and steady cash flow to handle any fluctuation in claim funding.

### Ability to Post Collateral

Companies participating in a captive must set aside funds to pay potential claims. This collateral is a key requirement of the arrangement.

### Minimum Level of Health Insurance Premiums

While requirements may vary, most captive programs work best when the company pays at least \$100,000 in annual health insurance premiums.

### Sufficient Tolerance for Risk

A captive is a form of self-insurance and involves real financial risk. Companies considering this approach must be comfortable taking on some of that risk.

### Long-Term Strategy

A captive program should be viewed as a long-term commitment. The advantages of a captive cannot be achieved in a short period of time.

### Low-Risk Business Operations

Companies involved in hazardous or high-risk activities are usually not good candidates for a captive program.

## CHAPTER SIX

# The Process of Forming or Joining a Captive Program

For the most part, a captive insurance program works in a similar way to a conventional insurance plan, with a few important differences. Below is a simple overview of the basic steps involved when a company joins a captive program.

## Feasibility

A feasibility study is performed to determine if a captive arrangement is a good and realistic option for the business.

## Coverage Levels

Once feasibility is confirmed, the company selects its desired level of coverage. Both aggregate and specific attachment points are set to protect the company from unexpected or catastrophic losses.

## Pricing

The captive manager's underwriting team reviews the company's data and calculates the pricing needed to fund the program properly and maintain financial stability.

## Funding

Each participating business provides collateral to support the captive's assumed risk beyond the premium that was collected. If actual claim expenses are lower than expected for a given year, the extra funds can be returned to the business.

## CONCLUSION

# The Path Forward with Captive Insurance

A captive program can open the door to better control, more stability, and real savings, but it takes the right partner to know whether it will truly work for your business. Careful planning and expert evaluation are essential in determining whether a captive is the right strategy.

MBA offers the experience, tools, and support needed to complete a proper feasibility review and guide you through every step of the process. Whether you want a full feasibility study or just have questions about how a captive works, MBA can guide you from start to finish.



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