

Captives and Self-Insurance

Oval Insurance Broking (Oval) is one of the UK's largest insurance brokers and risk management consultancies. At Oval we believe in delivering the highest possible service standards on a truly personal level.

Insurance vs. Self-Insurance - What's the difference?

All companies and organisations face risks every day. Many of those risks are quantifiable and many companies choose to simply insure themselves against those particular risks causing loss. The most common examples are, of course, the risks of fire or flood affecting your premises, the risk of motor accidents destroying one or more of your vehicles, employees injuring themselves in the course of their duty or a business interruption loss following a fire at a major customer's premises.

Insurance is the process of paying another company (such as an insurance company or Lloyd's syndicate) to accept the risk on your behalf. In traditional insurance contracts, you simply pay a premium and then claim from the insurance company if the insured event occurs.

Self-Insurance is a process of setting aside a fund either within your own business or through a subsidiary or an associated company in order to pay for the costs to the business should a loss occur.



So, what are the Pros and Cons?

Disadvantages:

- One of the big disadvantages of traditional insurance is the fact that there is very little incentive to manage your risks as effectively as possible. Premiums are as much to do with the state of the insurance market and factors entirely beyond your control as they are to do with your own individual company's claims experience. Floods in Wales or Cornwall can have a significant impact on the premium you pay as a business based in Northampton which is not always a fair situation.
- Another significant disadvantage of traditional insurance is that insurance companies, by their very nature, exist to make a profit. Taking a long term view, say over 10 years or more, it is almost inevitable that the sum total of premiums that you pay will be significantly in excess of the sum total of claims that you make. If you suffer a poor run of claims, your premiums will simply rise to reflect the perceived increased risk that insurers cover on your behalf.
- Traditional insurance is useful for events that are considered to be 'one in a million', but could conceivably cost a great deal of money. These can be cheaply insured against because the insurance company work on the basis that they might insure a thousand companies and take a small premium from each, which would be more than sufficient to pay for the one in a thousand companies that actually suffer a loss.

Advantages:

- The advantages of self-insurance are many and varied. Firstly, there is the significant advantage of being in control of your own destiny. If you self-insure, when your claims experience is good, you stand to make all of the gains previously enjoyed by an insurance company. The answer is simple. If you manage your risks to the best of your ability, the chances are that you will enjoy significant savings.
- The second significant advantage is that you effectively remove yourself from the vagaries of the insurance cycle bringing budgeting stability. It is all too common to see premiums increase by 30% one year and reduce by 20% two years later. For small premium risks this may not be too much of an issue, but for our larger clients, it is a constant cause of complaint.

Self-insurance can also be a far more practical and cost effective way of dealing with day-to-day losses which are inevitable in many businesses. Examples might be minor goods-in-transit losses, small motor claims and small employer's liability claims. Most businesses of any size will suffer such losses, no matter how good the management. In such circumstances, if a company's anticipated losses are always going to be at a certain level, why pay an insurance company 20% of those anticipated losses to administer them for you?

There can be significant cash flow advantages to self-insurance. Many losses are 'long tail' in nature and whilst an insurance company might charge you an additional premium as soon as you notify an employer's liability claim for example, it could be many years before they actually make a payment. If the risk is self-insured, you enjoy cash flow advantages in the interim period. For motor risks in particular, these advantages can be significant.

Finally, through self-insurance techniques, it is possible to arrange cover for risks which the insurance market is either unwilling or unable to accept.



I'm interested in the benefits - what techniques are available to me?

A meeting with one of our risk finance experts will quickly establish the level of self-insurance which may be of interest to your company. The techniques available range from simply accepting larger deductibles or excesses, through to more complicated risk sharing agreements with insurers, right up to the pinnacle of self-insurance techniques where we help you to form your own captive insurance company.

Put simply, if you are spending in excess of £100,000 a year on conventional insurances, there is every chance that you could benefit from a degree of self-insurance.

Oval can accurately work out, based on your past exposures and claims experience, the detailed effect of self-insurance on various classes of business. We can tailor-make a self-insured approach to maximise the benefits of self-insurance whilst minimising the risks to your business.

We need not take up too much of your time. It will seem very similar to a conventional insurance review but the results may well be of interest as the following case studies show.



Case Studies

Construction company expanding rapidly through acquisition

A large construction company was growing through the acquisition of various small house builders around the UK. Each new acquisition brought its own legacy of insurance claims and the conventional premium was in excess of £1.5m when Oval became involved. Oval were able to arrange for the formation of a self-insured fund within the parent company which provided access to funds by the various subsidiaries for claims up to a certain pre-capped level. Oval then arranged insurance protection should those pre-set levels be exhausted or should the fund be exhausted over a period.

Alongside this process, Oval undertook risk management surveys at each of the newly acquired companies and formulated new strategies for dealing with liability claims, which were the main cause of the insurance difficulties.

Result

The company in question now pays insurance premiums of just £340,000 per annum and their own self-insured fund has increased in size to currently stand at £1.2m. With a fair wind and good risk management over the next few years, the company is aiming to achieve their first zero-cost insurance year whereby some of the excess funds available in their self-insured fund are used to pay their catastrophe premiums.

Case Studies

A transport company were referred to Oval when their employer's liability claims reached alarming levels

The conventional premium required in the market was in excess of £600,000. Oval were able to set up a 3-year fixed rate self-insured approach whereby the transport company paid a premium to insurers of £150,000 per year, with the transport company accepting the first £500,000 worth of losses that may occur.

Once again this programme was set up in conjunction with liability surveys at all locations that had suffered losses, all employees were provided with expert training on avoiding slips and trips which had been the main cause of the losses.

Result

The company's claims experience has returned to normal levels for the industry. The company is now deciding whether to maintain their self-insured fund at its current level or to return some of the capital to the business to help future growth. This option simply would not have been available had they continued down the conventional insurance route.

If only to demonstrate that self-insurance works at lower levels as well, we can apply similar self-insurance techniques to the most humble of motor fleets.

A cash rich company approached us as they were irritated by the fact that their motor premiums had increased in excess of 15% per annum of the last 4 years peaking at £120,000 premium.

Result

We were able to negotiate a self-insured approach whereby they paid a premium of just £30,000 per annum but in return, they had to accept that they pay the first £130,000 of all losses that would occur during the course of the year. They felt that this was a gamble worth taking, as their previous claims history had never shown a year where they had suffered more than £75,000 worth of claims. Even if they had a similarly bad year, they would be £20,000 better off in pure claims terms, not to mention the savings in insurance premium tax, ease of administration and efficiency.

What next?

For Oval to carry out a proper review of your insurance exposures and to advise you whether self-insurance would be right for your business, we need a slightly longer lead-in time than for conventional insurance renewals.

For most businesses, this means a minimum of 8 weeks before your conventional insurance renewal date. Please therefore contact us as soon as possible to advise when your insurances fall due for renewal and we will agree a timetable for our discussions.



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Registered in England No: 01195184

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Oval Insurance Broking Limited is authorised and regulated by the Financial Services Authority

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