Swiss Re
Corporate Solutions

Virtual Captive

A structured (re)insurance solution to emulate the self-insurance function of a captive.

A Virtual Captive is a structured multiyear agreement with a licensed insurance company.

What is a Virtual Captive?

Our Virtual Captive product is a structured multi-year insurance agreement that emulates the financial mechanics of a traditional captive with a simplified setup, leveraging our strongly rated and broadly licensed insurer balance sheet. Quite simply, you can take advantage of the captive approach for self-insurance but use our balance sheet instead.

How does it work?

A traditional captive's main goal is to help managing a corporate's risk retention by partially or fully self-insuring its parent's risk. The captive thereby collects premiums from the various business units of the organisation to finance losses. The captive's capital serves as the "buffer" in case the sum of the accumulated premiums is not enough. The parent establishes a (re)insurer – injecting the capital and holding the captive against its balance sheet. The financial mechanics of a traditional captive make sense if:

- Your expected loss is lower than what the commercial insurers imply in the market premium
- A hard market demands ever higher premiums and limits coverage capacity
- You are interested in purchasing reinsurance, i.e. interested in accessing the wholesale risk transfer market

However, the cost and the complexity of setting up and running a captive can take a toll on the organisation and its financials. The initial need to inject capital in the captive can also have an impact on the overall financial flexibility.

A **Virtual Captive** can retain the financial mechanics of a traditional captive with one major difference: Swiss Re Corporate Solutions (SRCS) handles the set-up and the administration of the supporting balance sheet, virtually taking it off your balance sheet. A virtual captive makes sense if:

- You want to avoid or defer **the cost behind the set-up**, the need to inject capital and the regulatory complexities
- You want the insurer to bear the cost of running a (re)insurance legal entity and the **related governance**
- The **traditional captive reasons** for self-insurance via an insurance vehicle also apply to you

Within a Virtual Captive agreement, the capital of a captive is replaced by Swiss Re's balance sheet.

How is a Virtual Captive structured?

A Virtual Captive is, effectively, a multi-year insurance agreement between a customer and an insurer. The agreement replaces the legal entity of a traditional captive but retains much of its self-insurance mechanisms.

The multiyear insurance agreement contains some structural elements:

1

Premium calculated based on following variables:

a. Maximum self-insurance appetite of the customer within the defined period
b. The cost of risk for loss scenarios exceeding the variable a.
c. The cost of providing the service and balance sheet

2

It is a multiyear agreement, so the risk is distributed over time and also financed over time ("Mutualisation of underwriting years")

3

Experience Return:

In case loss experience remains below expected scenarios, the customer receives credit for the respective difference, e.g., in the form of a low claims bonus (or other mechanisms, as contractually agreed).

4

Experience surcharge:

If loss experience exceeds pre-agreed scenarios for the defined period, the customer may be obliged to increase the contribution to the structure to the extent of the exceedance. E.g., by way of additional premium, but limited to a maximum as per the self-insurance appetite (1a.)

5

Scenarios exceeding the maximum self-insurance appetite are borne by the providing insurer's balance sheet, much like a stop loss applied to a real captive

Exit of the program is simple, by way of agreement termination and settlement of experience-related elements

Both a captive as well as a Virtual Captive structure require a minimum scale to justify their setup and administration.

If the premium for the program is too low, the expense of running either structure is simply too high.

Virtual Captive: does it work for you?

Clear advantages

- No set-up cost and none of the regulatory and corporate complexities of an insurer legal entity
- No expenses for captive management services, actuarial, audit and other fees
- Speedy implementation; simple, clean exit options; Swiss Re Group financial strength

Things to consider

- Types of risks are limited to those that reflect the insurer's license, capabilities and risk appetite
- Flexibility of the Virtual Captive structure is reduced for the term of the agreement. Once the Virtual Captive insurance agreement is signed, parties are bound for the entire term, and any changes require mutual agreement

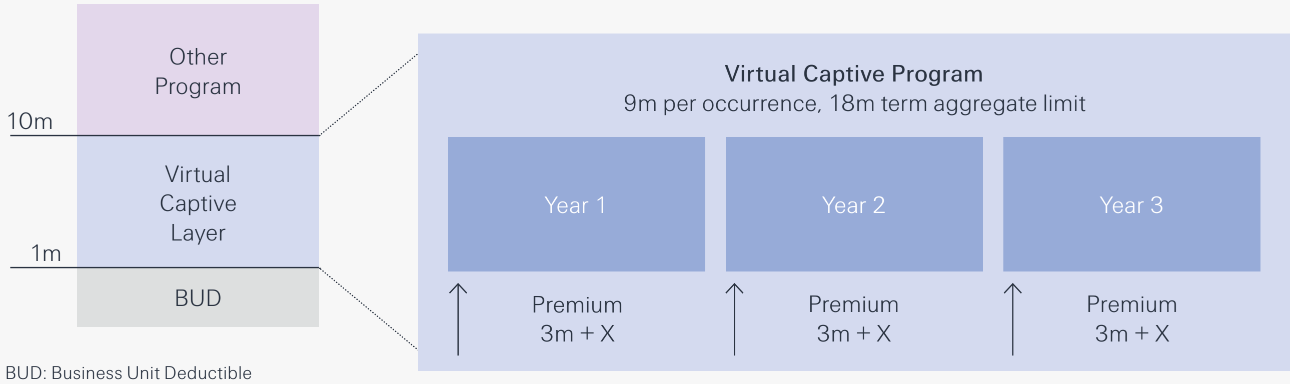
Comparing the Virtual Captive mechanics with the mechanics of a captive

Traditional Captive (subsidiary)	Virtual Captive (contractual relationship)
Set up to exist for many years or indefinitely, finances risks over time ("mutualisation of underwriting years")	Covers a defined multi-year period and **includes exit option** (termination or non-renewal); finances risks over time ("mutualisation of underwriting years")
Is a regulated entity affiliated to the client parent; responsibility for regulatory compliance stays within the client group	Is a contractual agreement with a non-affiliated regulated insurer and insurance regulatory **responsibilities are with that insurer**
Infrastructure to issue licensed policies needs to be established by the captive or bought from a 3rd party insurance company (fronting)	**Infrastructure is provided by the Virtual Captive solution provider.** All necessary insurance licenses and policy issuing capabilities are provided through that infrastructure
The captive's capital (and beyond that, the parent's capital) carries the risk of loss scenarios beyond the expected	Contractually agreed elements (premium, multiple years, surcharges) are financing risk and the **Virtual Captive provider's balance sheet carries loss scenarios beyond that risk financing**
Funds available as a result of lower-than-expected losses (a captive's underwriting profit) are returned to the parent by paying a dividend	Funds available as a result of lower-than-expected losses are returned to the customer by way of **Experience Refund mechanisms** (sometimes referred to as Low Claims Bonus)
Funds to finance loss scenarios exceeding those expected are provided by the parent's capital injection(s)	Funds to finance loss scenarios exceeding those expected are provided by way of **Experience Surcharge features** (sometimes referred to as additional premium)

Virtual Captive Examples

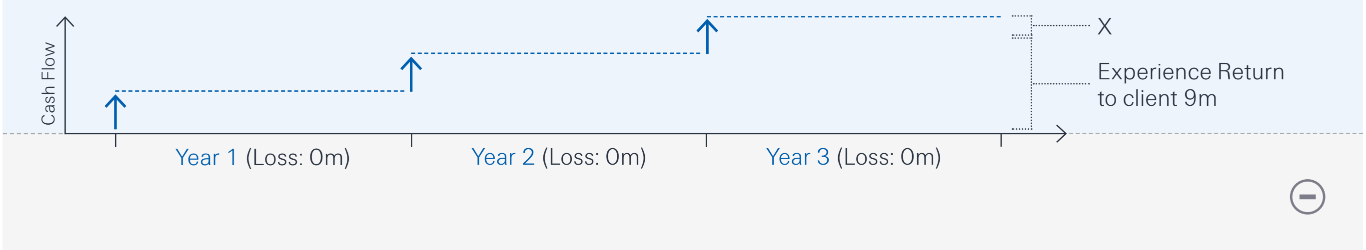
1 Virtual Captive – illustrative example w/o Experience Surcharge

Corporate's risk self-insurance appetite: 1 full loss

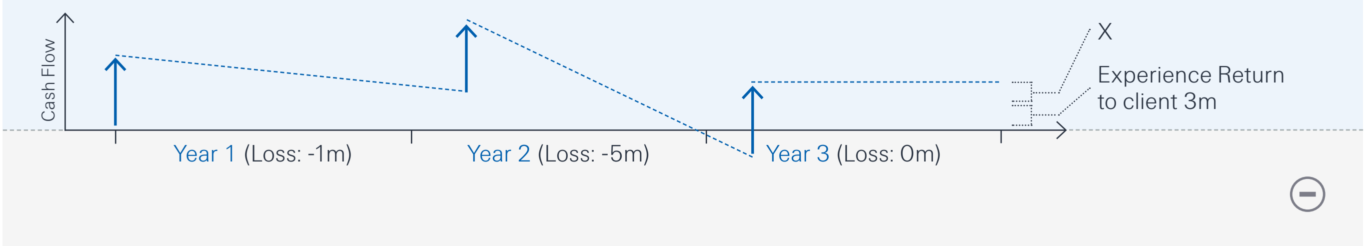


BUD: Business Unit Deductible
X: deductions for risk- & other costs

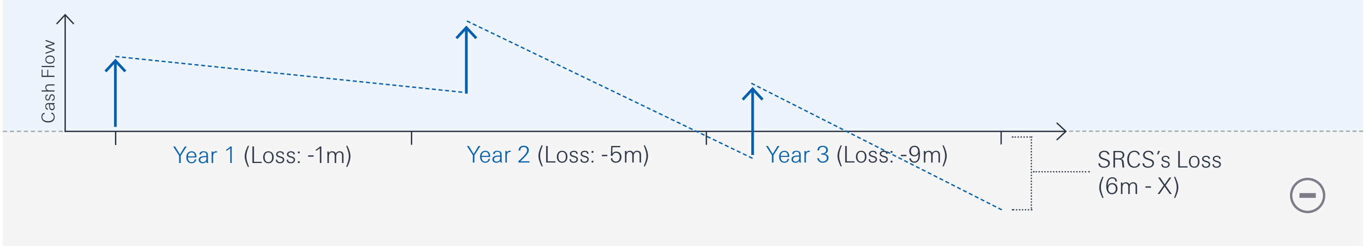
No Loss Scenario



Loss Scenario



Full Loss Scenario

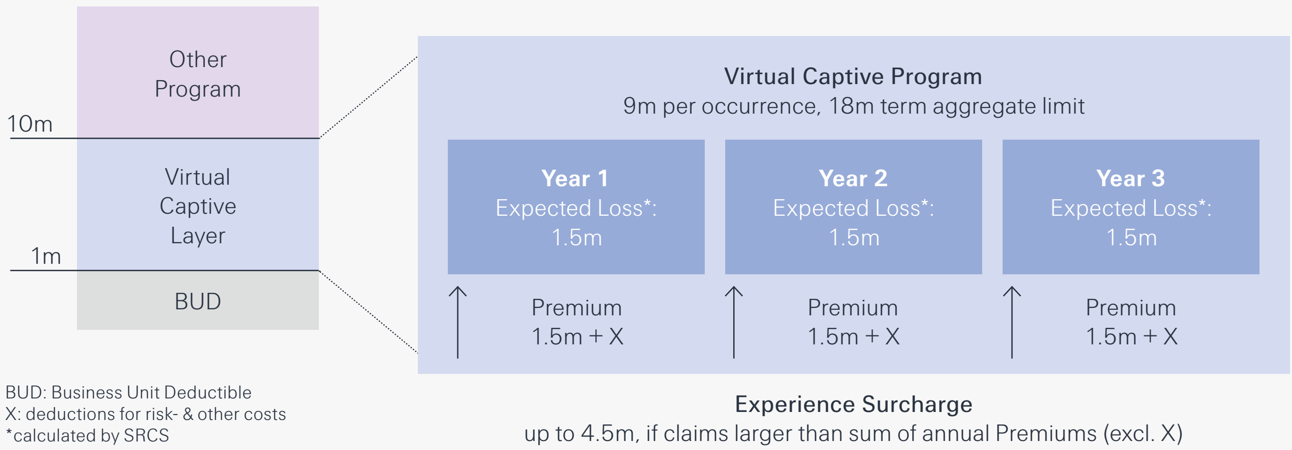


Premium (in) Claims payments (out)

Virtual Captive Examples

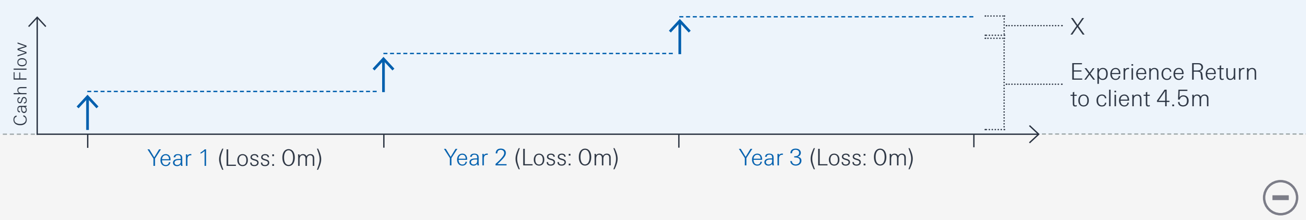
2 Virtual Captive – illustrative example w/ Experience Surcharge

Corporate's risk self-insurance appetite: 1 full loss

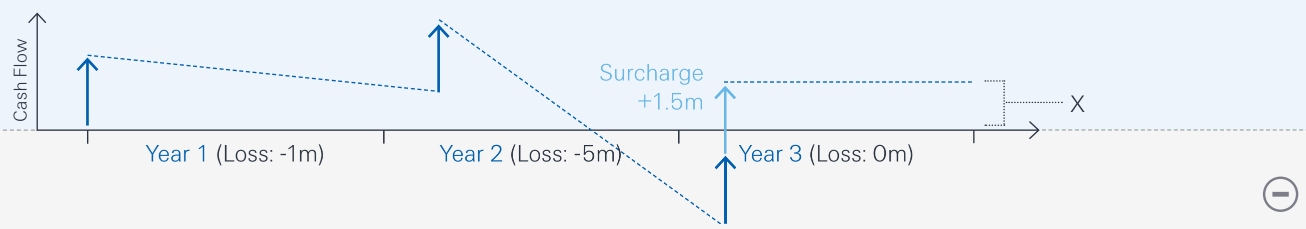


BUD: Business Unit Deductible
X: deductions for risk- & other costs
*calculated by SRCS

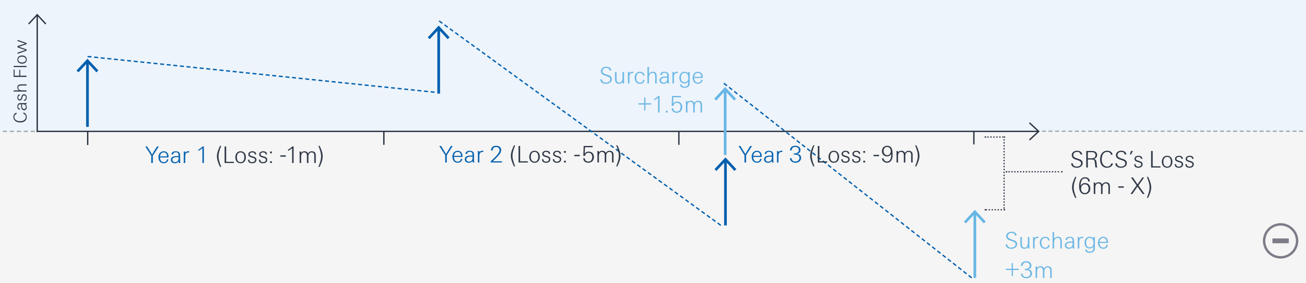
No Loss Scenario



Loss Scenario



Full Loss Scenario



Premium (in) Claims payments (out)

Next steps

In a hardening insurance market, understanding alternative ways of insuring your company can help to create more efficient risk transfer strategies.

1

Confirm the motivation for setting up a Virtual Captive. Are you prepared to retain a larger part of your risk, but through an insurance vehicle? A Virtual Captive, much like a real captive, does not necessarily mean a reduced premium spend on a single year basis. The reduced cost of risk plays over multiple years, essentially by way of higher flexibility for the rest of the risk transfer program and the benefitting from "underwriting profits" in the (Virtual) Captive.

2

Assess self-insurance appetite for a 3, or 5-year period. How much insurable loss is your company prepared to retain and finance?

3

Evaluate the optimal retention on the relevant lines of business from ground up within current insurance market. Where is the optimal attachment point of the regular insurance program?

4

Involve Accounting/Tax to ensure understanding and support.

5

Discuss the appropriate structure with Swiss Re Corporate Solutions, evaluate its value and make a decision to implement.

6

Implement with Swiss Re Corporate Solutions.

Contact

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