



2026 Annual Conference

Captives 101

This session provides a foundational overview of captive insurance and the role it can play in alternative risk financing.



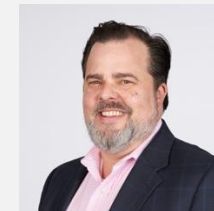
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Captives 101 – foundational overview



This session explains what captives are, how they work, and how they fit into broader risk financing strategies. Captive basics, governance, regulation, actuarial considerations, and strategic use.

1

What captives are

A licensed insurance structure that finances retained risk for the parent company.

2

How they operate

The parent, captive, and service providers work together to manage risk and funding.

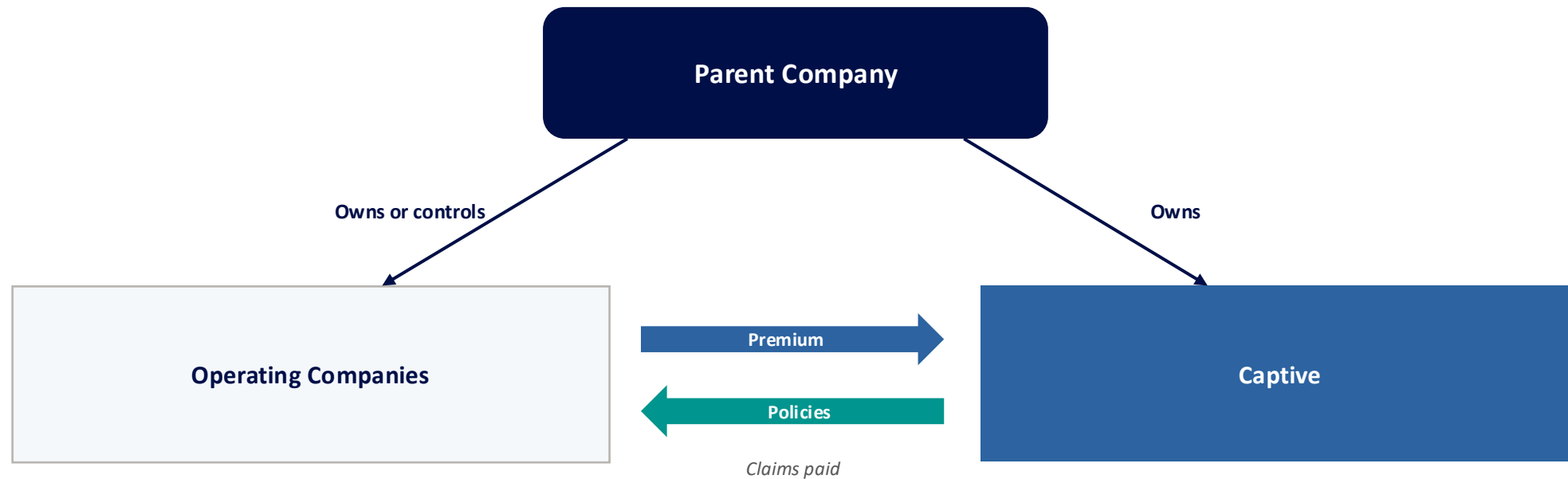
3

Why they matter

Captives help organizations control risk financing, improve flexibility, and capture economics.

Captives 101 – Captive insurance, defined

An insurance company that insures the risks of its affiliated or controlled companies. It issues policies, collects premium, and pays claims.



It issues real policies

Wording, limits, exclusions - documented before the loss

Premium is set at arm's length

By an independent actuary and/or by market rates

It pays claims

Money actually moves when something happens.

Captives 101 – Why have a captive?



FINANCIAL

- Premium efficiency and predictability
- Underwriting profit
- Investment income on reserves
- Cash flow smoothing

CONTROL

- Coverage and terms you design
- Capacity for risks the market prices poorly or will not write at all
- Claims handling & decisions
- Adaptive strategy

STRATEGIES

New Coverage

Finance existing risk more efficiently.

Replace Coverage

Take risk out of the market and into the captive.

Third-party Coverage

Take risk of others into the captive.

CONSIDERATIONS

Capital

\$250K+ of paid-in capital, plus collateral if a fronting carrier is involved.

Time

A board, an actuary, an auditor, statutory filings and a regulatory examination cycle.

Flexibility

Surplus is not freely distributable. Getting money back out takes years and planning.

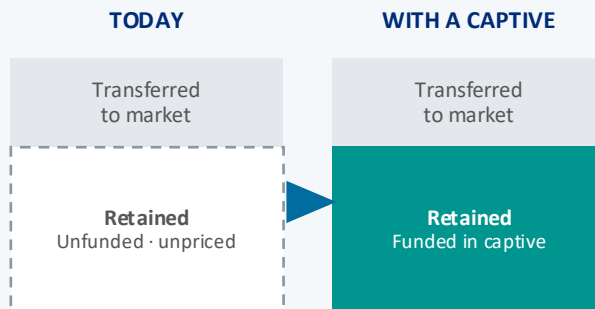
Patience

Most captives take three to five years to prove out.

Captives 101 – Captive Strategies

1 New Coverage

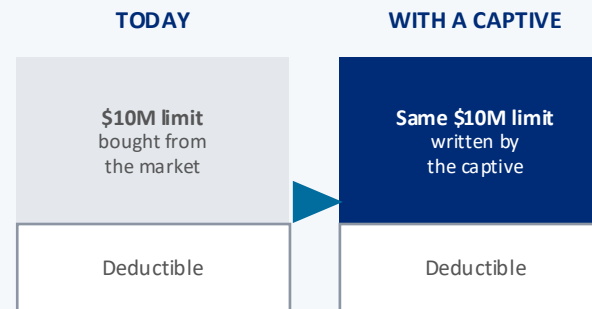
Finance risk you already retain



- Funds deductibles, SIRs and uninsured exposure the balance sheet already absorbs silently.
- Premium becomes deductible and reserves are set before the loss, not after it is paid.
- Net premium spend goes up — you are funding retained risk, not relocating spend.
- Usual first move when loss data is credible but no purchased layer is worth buying back.

2 Replace Coverage

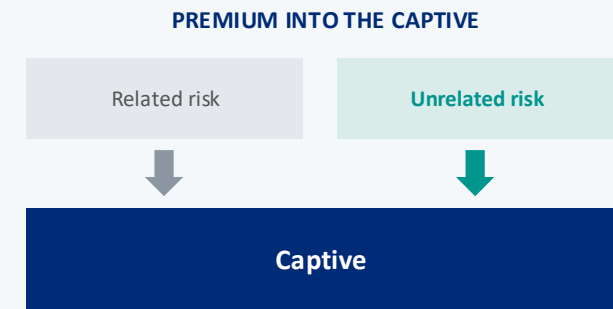
Move a layer out of the market



- Takes a layer the insured already buys and writes it in the captive — same risk, same limit.
- Wants roughly \$500K+ of premium in that line; \$1M–2M if A-rated fronting paper is required.
- Net premium spend is roughly unchanged. What moves is the underwriting margin.
- The good year is kept — and the bad year is funded by the owner, not the carrier.

3 Third-Party Coverage

Write risk that originates elsewhere



- Captive insures parties outside the economic family and earns premium for doing it.
- Common sources: tenants, sub-contractors, franchisee, customer and warranty programs, employee benefits.
- Supports risk distribution.
- A revenue line, but genuine third-party underwriting risk that needs pricing discipline.

Captives 101 – Rate Arbitrage

1

Retail Arbitrage

The spread between retail rates and reinsurance rates

EVERY \$1.00 OF RETAIL PREMIUM

Expected loss & LAE 65¢	Carrier expense 26¢	9¢
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THE SAME RISK CARRIED BY A CAPTIVE

Expected loss & LAE 65¢	10¢	Kept by the owner 25¢
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Narrow bands: carrier underwriting profit (9¢) and the captive's own frictional cost— brokerage, fronting and operating expense (10¢).

- Retail rates carry acquisition cost and carrier overhead — about 26 cents of every premium dollar industry-wide.
- A captive buys the same risk-transfer from the reinsurance market without the same acquisition costs and overhead.

2

Surplus Lines Arbitrage

The spread between surplus lines tax and captive premium tax

TEXAS SURPLUS LINES

Premium tax	4.85%
SLTX stamping fee	0.04%

Total 4.89%

TEXAS CAPTIVE · WRITTEN DIRECT

Premium tax	0.50%
Stamping fee	none

Total 0.50%

4.39% spread on gross premium · **\$219,500** on a \$5M direct placement

- A Texas surplus lines placement carries 4.85% premium tax plus a 0.04% SLTX stamping fee — 4.89% of gross premium, loss or no loss.
- A Texas captive writing the same risk direct pays 0.50%, subject to a \$7,500 minimum and a \$200,000 cap.
- The spread exists only on direct premium. Reinsure a surplus lines front and the 4.89% stays on the front's policy.
- The cap helps at scale: above roughly \$40M of written premium the 0.50% stops accruing, so the effective rate keeps falling.

Captives 101 – What makes it insurance



01 Insurance risk

There must be fortuitous pure risk. Investment risk and ordinary business risk are speculative and deemed “uninsurable” in the traditional sense.

02 Operated as an insurer

Licensed, capitalized, arm's-length pricing by an independent actuary, real policy wordings, claims actually paid, a board that meets. Substance over form, tested on your documents and actions.

03 Risk shifting

The economic loss genuinely moves off the insured and onto the insurer.

04 Risk distribution

Enough independent exposures that the aggregate becomes predictable.

- Unrelated risk
- 12 subsidiaries, each 5-15% of total risk
- Volume of independent exposure units

These requirements apply identically to 831(a) and 831(b) captives. The tax election changes the dollars, not the requirements.

Helvering v. Le Gierse, 312 U.S. 531 (1941); AMERCO v. Comm'r, 96 T.C. 18 (1991); Rev. Rul. 2001-31 (abandoning the economic family theory); Rev. Rul. 2002-89, -90, -91.

Captives 101 – From question to captive



FEASIBILITY

4-8 weeks

- Risk identification and underwriting review
- Structural analysis and recommendation
- Actuarial analysis of loss data
- Financial analysis and capital recommendation
- Pro forma income, cash flow and balance sheet
- Domicile comparison and recommendation
- A written recommendation - including not to proceed, if applicable

FORMATION

4-12 weeks

- Business plan and regulatory application
- Liaison with the domicile regulator
- Policy wordings and investment policy
- Corporate governance and board appointments
- Capitalization of at least ~\$250K; collateral if fronted

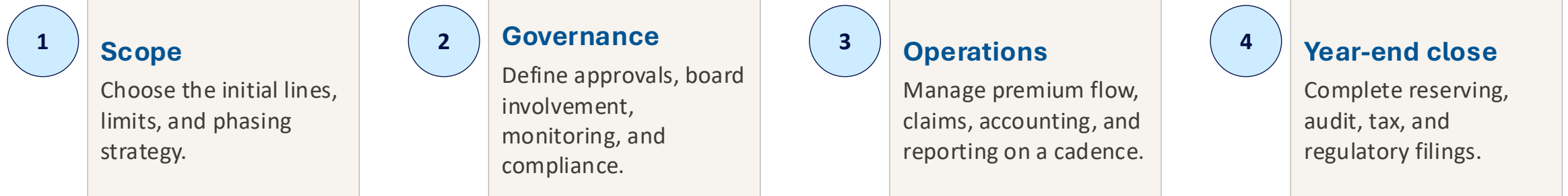
MANAGEMENT

Ongoing

- Policy issuance and claims handling
- Accounting, audit and regulatory compliance
- Financial reporting
- Coordination of actuary, auditor and domicile
- Annual review of coverage, retention and surplus

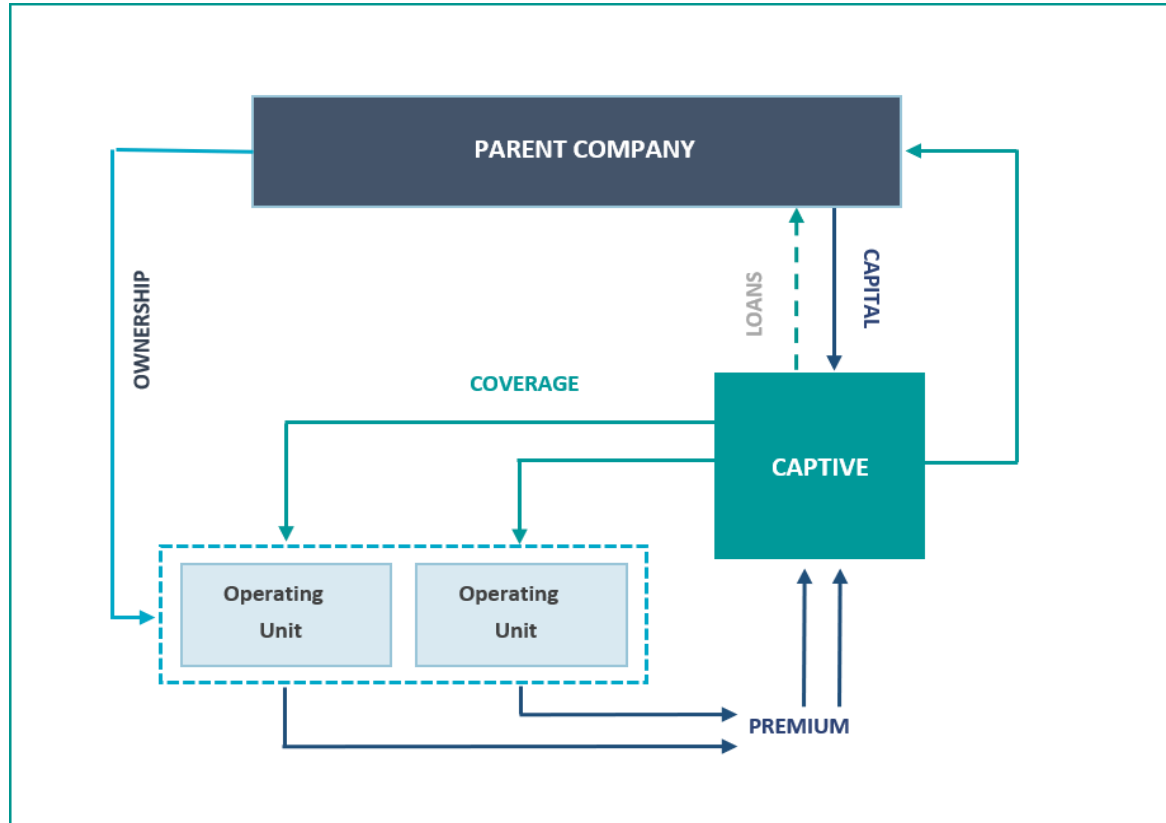
Captives 101 – Year 1

The first year is about governance, reporting, and getting the right team in place.



The first year should be intentional, documented, and measurable.

Captives 101 – Flow of funds



Characteristics of a Captive:

- Captive will be a wholly owned subsidiary.
- Formed primarily to **insure or reinsure the risks of the parent** or unrelated parties affiliated with the parent.
- A **licensed insurance company** in Texas.
- Regulated under special captive legislation. Texas Insurance Code Ch. 964 – Captive Insurance Companies.
- Minimum capital requirements is \$250,000 (or higher as required by Commissioner)
- Business Plan changes need to be approved by TDI.

Captives 101 – Texas Regulatory calendar



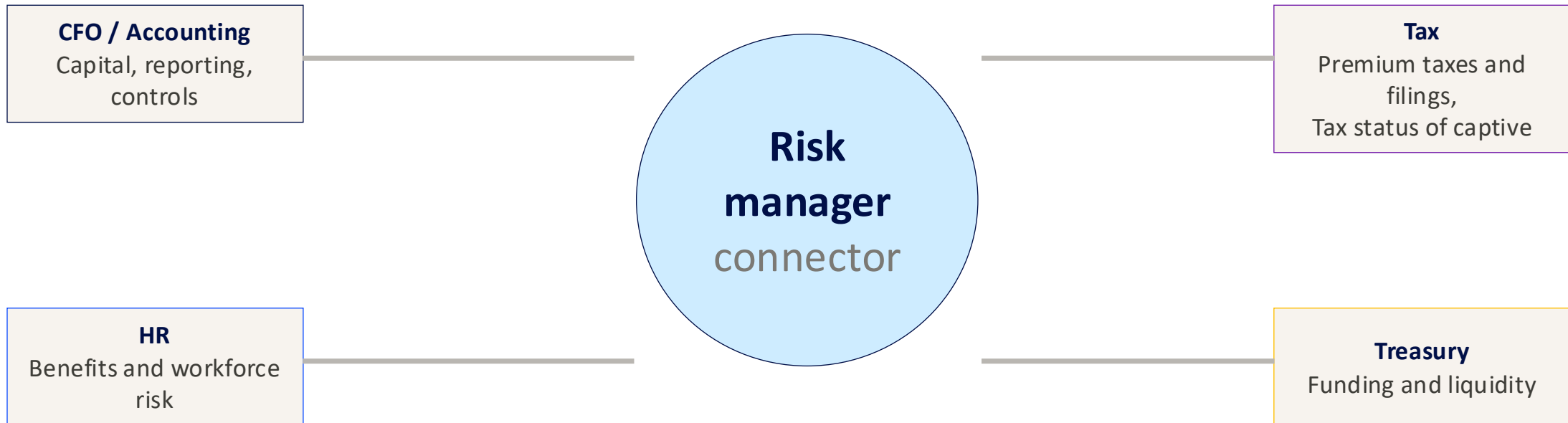
DATE	REQUIREMENT	
MARCH 1	Annual Return — TAC §6.401	Signed annual return filed on portal.
MARCH 1	Actuarial opinion / report — TAC §6.1 unless waived	Coordinate exposure data, reserves, opinion and any waiver request. Filed on portal
MARCH 1	Texas captive premium-tax report/payment	Premium and maintenance tax. Filed on websystem.
JUNE 1	Audited financial-condition report — TAC §6.403	Coordinate CPA, audit deliverables, and board review.
ANNUALLY	Texas board / governing-body meeting	Schedule in Texas; retain minutes and approvals.
AS NEEDED	TDI examination / material changes — TAC §6.304	Keep records ready; route changes through the approval process.

Important: approved non-calendar fiscal years and actuarial waivers change the timing. Confirm the applicable TDI approval and current instructions.

Captives 101 – Risk manager the connector



The risk manager is the connector: matching parent company needs, brings the right people together, and finding new captive opportunities.



1 Parent company needs

The captive plan should fit finance, control, tax, and operating requirements.

2 Team coordination

The risk manager keeps CFO / Accounting, HR, Tax, and Treasury aligned.

3 New opportunities

The risk manager listens for additional exposures the captive can absorb.

Captives 101 – Service providers



Captives 101 – Ongoing requirements



Captives 101 – Actuarial Support

Captive growth has drawn increased scrutiny from regulators and tax authorities. Actuaries provide the analytics that substantiate a captive's actions, so it can keep delivering value to its parent company. Four core studies are part of the standard operation of a captive:



1. Loss Reserving

Are we holding enough for claims already incurred?

- Unpaid loss & LAE, including IBNR
- Projections for the upcoming year
- Statement of Actuarial Opinion



2. Technical Pricing

Is the premium we charge reasonable and defensible?

- Indication with a reasonable range
- Own history plus industry data
- Expected loss, capital & return, expense



3. Risk Transfer

Does the program transfer real insurance risk?

- Is a significant loss reasonably possible?
- 10-10 test and ERD test
- Distribution of PV underwriting losses



4. Risk Distribution

Are risks pooled widely enough to behave like insurance?

- Sufficient number of risks
- Independence of risks
- Law of large numbers
- Is it viewed as insurance?



YOUR TURN · THINK

As we go, ask yourself: which of these four could we document today?

Captives 101 – Warm-Up Poll



SHOW OF HANDS

**Which of these does
your captive already
have in place?**

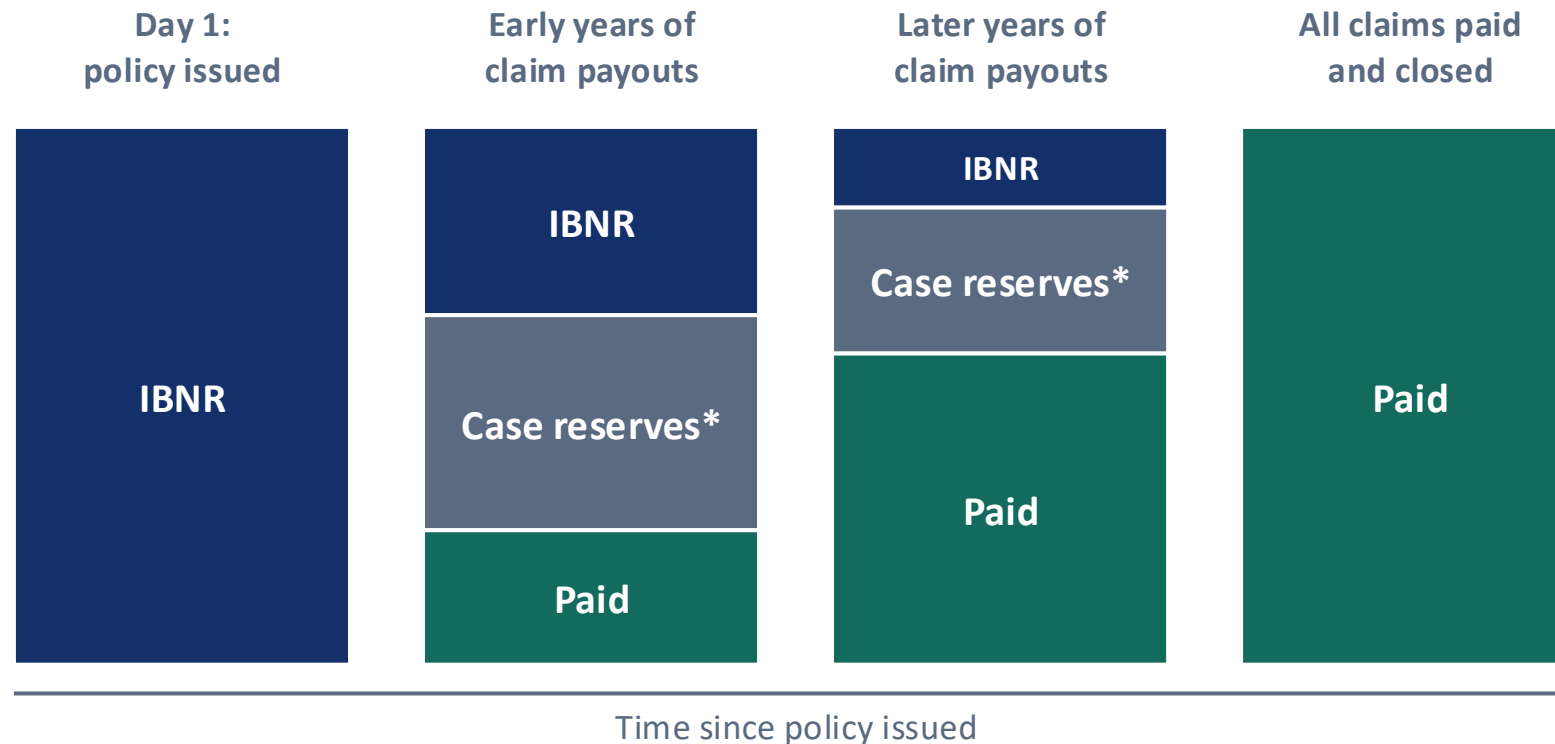
Raise a hand, call out your answer, or
type it in the chat.

- A** Annual loss reserve study Study 1
- B** Statement of Actuarial Opinion Study 1
- C** Technical pricing study Study 2
- D** Risk transfer & distribution analysis Studies 3 & 4
- E** Not sure yet – that's what today is for

We'll come back to your answers at the Captive Health Check.

Captives 101 – Loss Reserving

How ultimate losses break down over time on the books (illustrative)



KEY TERMS

IBNR

Incurred But Not Reported: losses that have occurred but haven't been reported yet

Case reserves*

Adjuster estimates for claims that are reported and still open

LAE

Loss adjustment expense: the cost of investigating and settling claims



YOUR TURN · DISCUSS

Which bucket is hardest to estimate – and why?

Captives 101 – Benefits of a Reserve Study

A reserve study does more than satisfy a filing requirement



Captive feasibility & reporting requirements

Tailored to the client's needs and regulator requirements. Supports pricing, modeling, and allocations to divisions and operating companies.



Forecasting & budgeting

Forecasts for renewal policies help with budgeting. Roll-forwards of reserves set expectations for reserve growth.



Insurance carrier negotiations

Can be shared with carriers to help negotiate collateral and pricing.



Claim metrics & insights

Identifies drivers such as claim frequency, severity, and loss costs. Helps allocate costs internally, which drives accountability and results.

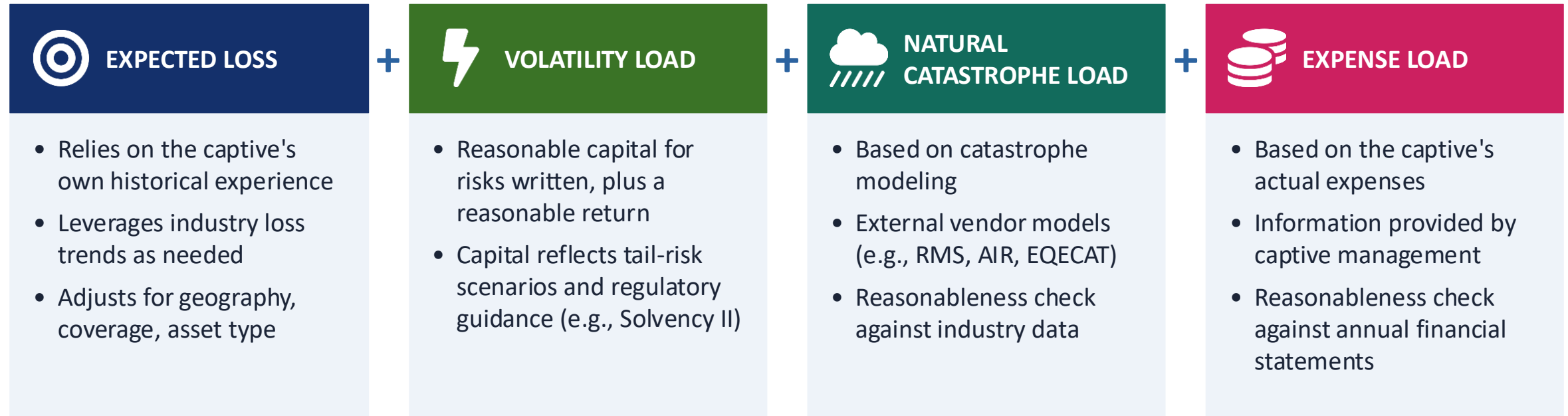


YOUR TURN • DISCUSS

Which benefit would matter most to your board or your parent's CFO?

Captives 101 – Technical Pricing

A rigorous approach that satisfies internal and external stakeholders



= Technical premium indication, presented as a reasonable range



YOUR TURN · DISCUSS

How would you show a regulator that your premium is reasonable?

Captives 101 – Risk Transfer

WHAT IS RISK TRANSFER?

- The captive assumes significant insurance risk
- It is reasonably possible the captive may realize a significant loss

Two common tests, applied to this example:

10 / 10

At least a 10% chance of at least a 10% loss.

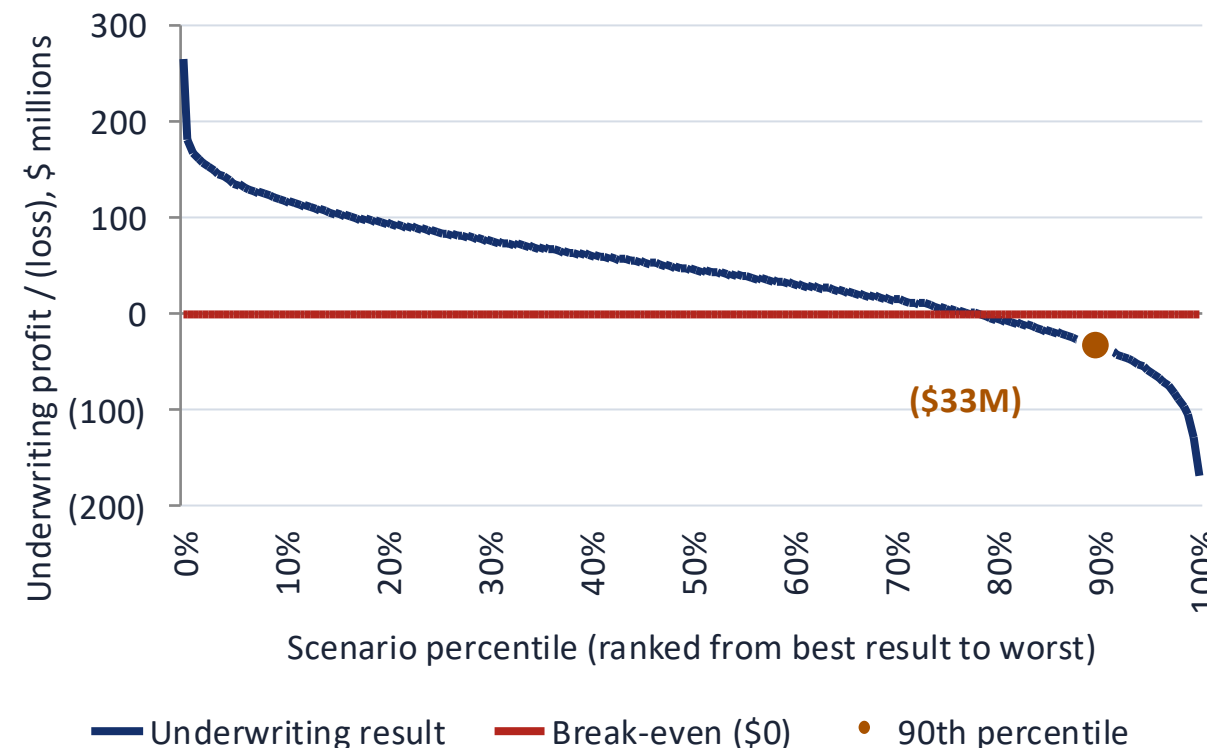
At the 90th percentile the loss is about \$33M, roughly 11% of an illustrative \$300M premium. Test met.

ERD

Chance of a loss × size of that loss, across all scenarios.

About 22% chance × \$39M average loss ≈ \$8.5M, or ≈2.8% of \$300M premium. Above the 1% benchmark.

Simulated underwriting result by scenario



Each point is one simulated scenario. Dollar values are read from the original chart and are approximate; the \$300M premium is illustrative.

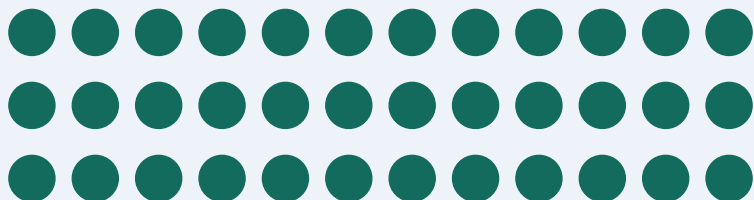
Captives 101 – Risk Distribution

Spreading risk across enough independent exposures that results become more predictable

Few risks: results swing widely



Many independent risks: results converge



Sufficient number of risks

More exposure units (vehicles, employees, locations) make results more predictable



Independence of risks

Losses shouldn't all hinge on the same event or the same insured



Law of large numbers

Does the pool support actual results converging toward expected?



Viewed as insurance?

Would the arrangement be recognized as insurance in the commonly accepted sense?



YOUR TURN · THINK

How many independent exposures sit behind your captive?

Captives 101 – Other Actuarial Services

Statement of Actuarial Opinion

Most jurisdictions require an actuary to sign off on the captive's reserve position.

An independent view on whether the reserves are reasonable, typically tied to the annual reserve study.

Capital Modeling

Ensure you are using your captive as efficiently as possible:

- Are you over- or under-capitalized?
- Is there a diversification benefit from including several lines of business?

Captive Health Check

Is your captive responsive to:

- Volatility
- Difficult market conditions
- Internal pressures

Do your assumed risks meet the definition of risk transfer?

- 10-10 rule: 10% chance of a 10% loss
- ERD of 1% – loosely based on the 10-10 rule



YOUR TURN · DISCUSS

Which of these three gets the least attention in your organization?

Captives 101 – Captive Health Check

Quick self-check: tick each statement you could support with documentation today

☐

We have a current loss reserve analysis, including IBNR

Loss Reserving

☐

A qualified actuary has signed a Statement of Actuarial Opinion

Loss Reserving

☐

Our premiums are supported by a documented pricing study

Technical Pricing

☐

We've tested risk transfer (10-10, ERD) on our current program

Risk Transfer

☐

Our risks are spread across enough independent exposures

Risk Distribution

☐

We know whether we are over- or under-capitalized

Capital Modeling

5–6 ticks

Well supported

3–4 ticks

A few gaps worth closing

0–2 ticks

A good time to start the conversation

Captives 101 – Key Takeaways & Q&A

1

Loss reserving

Know what you owe, and have an actuary stand behind it

2

Technical pricing

Build premium from expected loss plus volatility, catastrophe, and expense loads

3

Risk transfer

Test it with 10-10 and ERD, and document the result

4

Risk distribution

Show enough independent exposures to behave like insurance



Questions?

CONVERSATION STARTERS

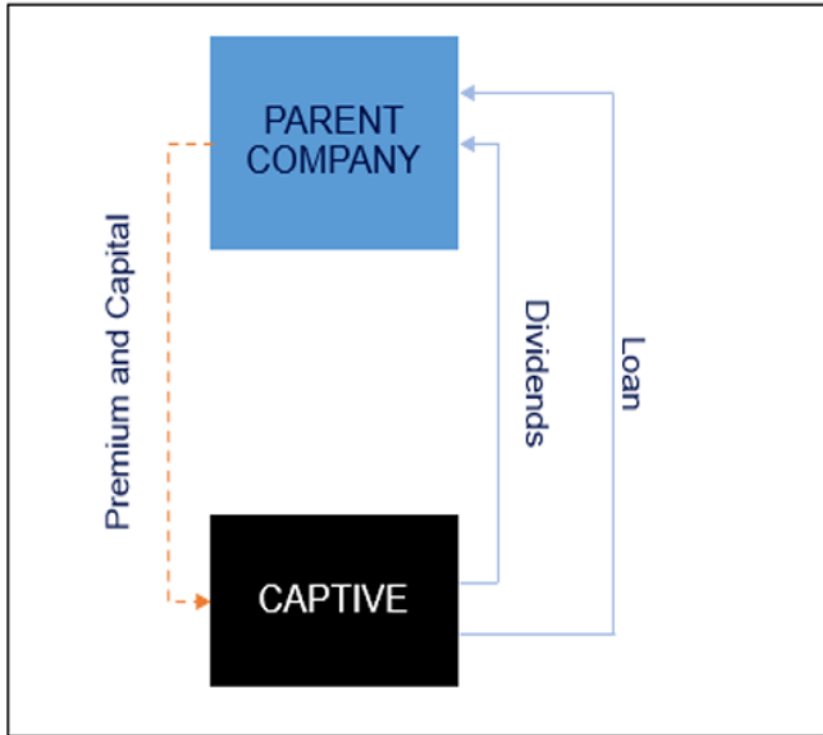
- What would your regulator ask first?
- Which study would you commission next?
- What surprised you today?



NEXT STEP

Pick one study to revisit for your captive next quarter.

Captives 101 – Intercompany and dividends TxCIA



Intercompany loan

- Arm's length transaction and terms, interest, repayment terms and date
- Intercompany Loan agreement
- Regulatory approval TAC §6.407.
- Board approval

Dividend

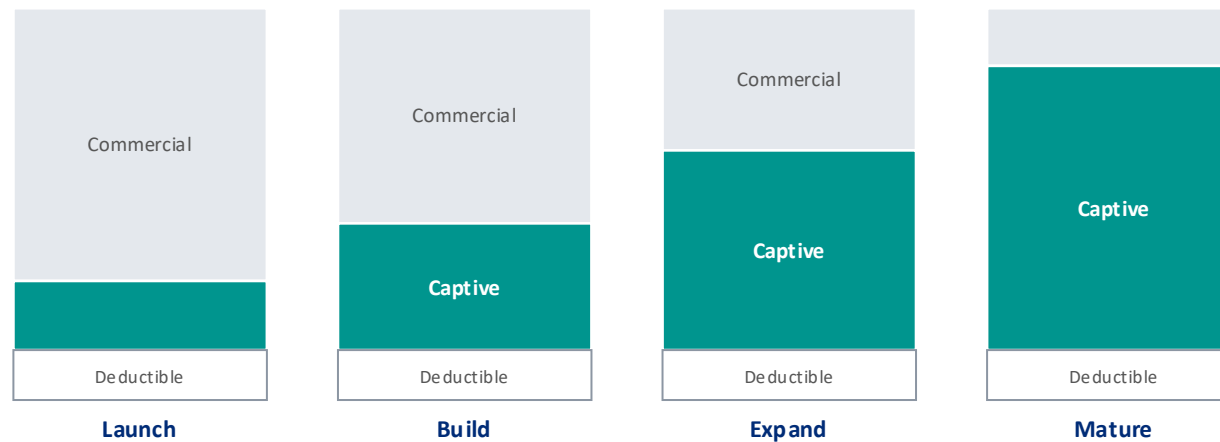
- Excess surplus maintaining capital requirements, reserve and operating needs met
- Regulatory approval TIC §964.063 (b)
- Board approval

Captives 101 – How Captives Evolve

A captive is not a decision made once. It is a platform the parent grows into.



THE CAPTIVE LAYER WIDENS WITH EACH RENEWAL



CAPTIVE EVOLUTION

	AT FORMATION	AT MATURITY
Lines of coverage	1–2	→ 4–6+
Retention	Conservative	→ Optimized
Surplus	Capital at risk	→ Funded cushion
Loss data	The carrier's view	→ Your own history
Role	Risk financing	→ Strategic capital

Total program limit is unchanged. What changes is how much of it the captive carries.

Captives 101 – Exit Strategies

Run-off Mode

- The captive does not write coverage in the future.
- The captive remains licensed and subject to ongoing regulation and audit until all outstanding claims are paid.
- The parent would incur ongoing operational expenses on a reduced basis.

Definitions:

- **Commutation** - Usually refers to the cancellation or dissolution of an insurance or reinsurance contract in which there are profits or losses to be allocated.
- **Novation** - An agreement to replace one party to an insurance policy or reinsurance agreement with another company from inception of the coverage period.
- **Loss Portfolio Transfer** - A financial reinsurance transaction in which loss obligations that are already incurred and will ultimately be paid are ceded to a reinsurer.

Captive Shuts Down Immediately and Liquidates

- Commute all outstanding liabilities back to parent (permitted for only direct placements) or transfers the obligation for the outstanding liabilities to a third-party insurer via Novation or Loss Portfolio Transfer.
- Once all liabilities have been extinguished from the captive, the parent will then need to file a petition to the Department of Insurance (Captive Department) to dissolve the company.
- The parent avoids the ongoing cost to keep the captive operational in future years.
- Should the parent decide to transfer the liabilities to a third-party insurer for a premium, they should weigh the risk margin assessed for loss volatility by the insurer against the savings associated with not incurring ongoing operational cost to keep the captive open.

Captives 101 – Closing

This session provides a foundation for understanding captive insurance. The next step is to explore how captives compare with other alternative risk financing strategies.

1 **Foundations**

You now have the core ideas behind captive insurance.

2 **Decision points**

Next conversations should focus on fit, structure, and governance.

3 **Next exploration**

Use this foundation to compare captives with other risk financing tools.



Questions



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Director, Captive Business Development

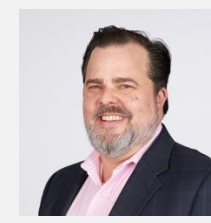
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