RISK FINANCING THROUGH CAPTIVES

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This paper discusses advantages and disadvantages of, and economic and employment impact by, a risk finance scheme through captives.

Captive is a form of risk finance schemes, which is owned by owners of risks and provides coverage for losses arising out of the risks. While typical commercial insurance provides coverage for third parties seeking profit in a form of spreading risks, a captive scheme has risks retained and thus the risks are "not transferred" to outside the group of the company. In a word, captives are "not insurance" per se as insurance typically involves "transfer of risks" from a purchaser of insurance to insurance companies. In Year-2002, there are about 4,500 captives worldwide with US$50 billion in annual premiums, US$230 billion in assets, and US$202 billion in capital and surplus, creating a large market. The market has still been expanding. Why is captive so attractive to corporate risk managers and domiciles? What problems do they have to conquer? We mainly discuss the merits for Japanese corporations.

We also discuss the results of simulations for probable economic and employment impacts to a local economy based on the following assumptions: (1) 80 captive set-ups in Scenario 1, (2) 40 captive set-ups in Scenario 2, and (3) 10 captive set-ups in Scenario 3. As a result of our simulations, captives would have a considerable impact to the local economy as well as the employment directly and indirectly, especially as exemplified in cases of Scenario 1 (80 captives) and Scenario 2 (40 captives). For example, Scenario 1 would contribute annually money of approximately 16.8 billion yen and 1,200 employments to the domicile.

As a case study, a success at Dublin City of Ireland and a failure at Lloyd's of London are compared. Learning from those lessons, we come up a list of suggestions so that a new domicile could reduce the potential problems and take as much advantage of the captive merits as possible.