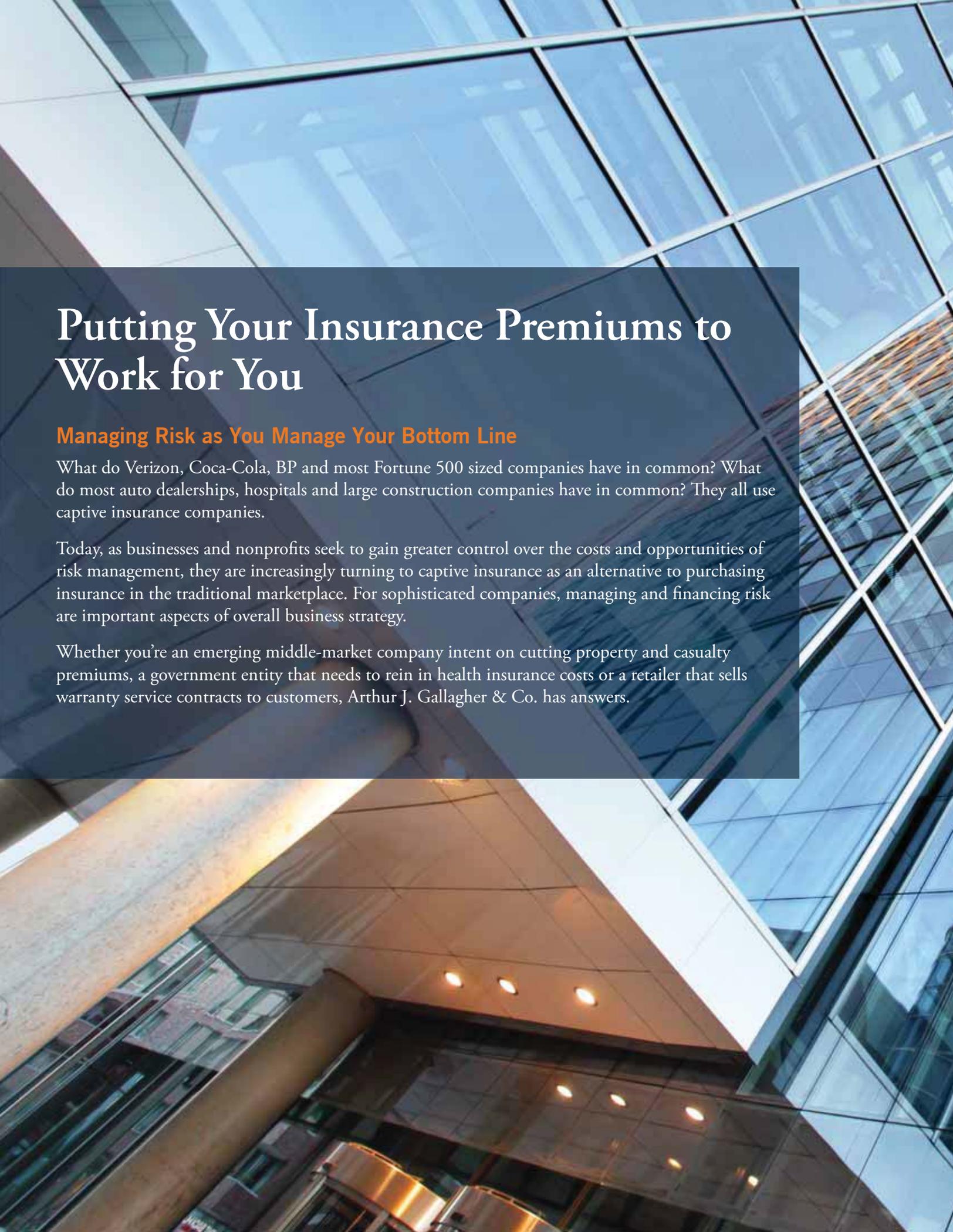




Arthur J. Gallagher & Co.



*Understanding Captives and
Alternative Risk Transfer*



Putting Your Insurance Premiums to Work for You

Managing Risk as You Manage Your Bottom Line

What do Verizon, Coca-Cola, BP and most Fortune 500 sized companies have in common? What do most auto dealerships, hospitals and large construction companies have in common? They all use captive insurance companies.

Today, as businesses and nonprofits seek to gain greater control over the costs and opportunities of risk management, they are increasingly turning to captive insurance as an alternative to purchasing insurance in the traditional marketplace. For sophisticated companies, managing and financing risk are important aspects of overall business strategy.

Whether you're an emerging middle-market company intent on cutting property and casualty premiums, a government entity that needs to rein in health insurance costs or a retailer that sells warranty service contracts to customers, Arthur J. Gallagher & Co. has answers.

A Closer Look at Captives

Taking an Alternative Route to Risk Management

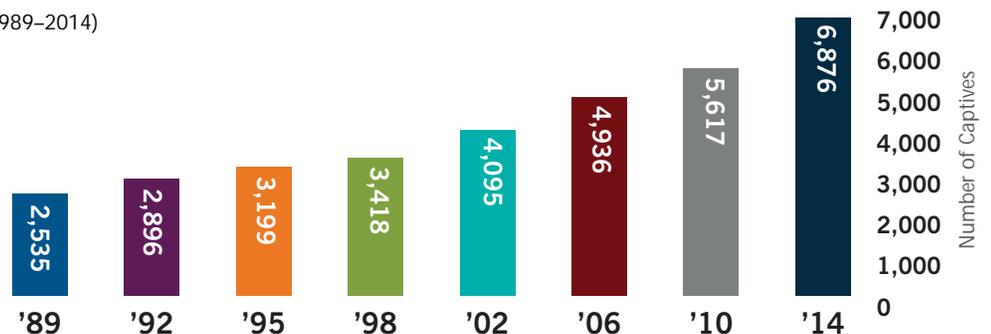
What is a captive?

A captive is an insurance company that insures the risks of its owner, affiliated businesses or a group of companies. It issues policies, collects premiums and pays claims—just like a traditional insurance company. What fundamentally distinguishes a captive and makes it alternative to commercial insurance is the form of ownership and who keeps the insurance company profit. In a traditional commercial insurance arrangement, insurance premiums are paid to an insurance company you do not own, and the profits of that insurance company stay with that third party. In a captive, premiums are paid to a company that you own and the profits can be returned to you. This relationship allows a captive the ability to customize its insurance program to best serve the needs of its owners (you).

As awareness of the benefits of captive insurance grows, the market is soaring. Between 1989 and 2014, the number of captives doubled, and as market forces continue to generate new scenarios for risk exposure—such as cyber security—the potential for captives as an alternative risk management tool continues to expand.

The Rapid Growth of the Captive Industry¹

(1989–2014)



¹ Source: III based on Business Insurance and Conning Research data.

Considerations for Pursuing a Captive Program

For most organizations, the incentive for creating a captive will stem from one of four broad risk management categories:

- Controlling risk
 - » Increase coverage
 - » Increase capacity
 - » Underwriting flexibility
 - » Controlling claims
 - » Incentives for loss control
 - » Access reinsurance market
- Minimizing insurance costs
 - » Reducing premiums
 - » Participating in underwriting profits
 - » Achieving price stability
- Improving financial performance
 - » Retaining premium outlays
 - » Using insurance tax accounting for loss reserves
 - » Increasing investment income
 - » Adding revenue streams
- Protecting the financial statements
 - » Reducing uninsured loss exposures
 - » Protecting assets
 - » Smoothing of loss expenses
 - » Predictability in loss expenses

Captive Insurance Candidates

Four Key Characteristics for You to Weigh

Solutions can be designed for a vast array of customer types—ranging from construction firms and healthcare groups to finance companies and wholesalers. Companies in all industries stand to benefit from captives.

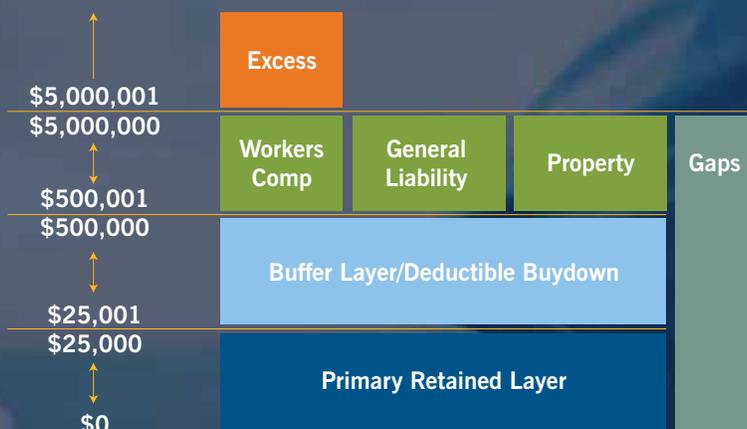
Ideal candidates for captives will possess one or more of these four business characteristics:

- Spend \$200,000 or more annually on property and casualty insurance premiums;
- Cover 75 or more employees on its health insurance policy;
- Gross \$30 million or more in annual revenue; or
- Provide extended warranty service contracts to its customers.

If one or more of these traits applies to your organization, then you would likely gain from an assessment by a captives expert.

A Captive in Practice

No business goes completely captive for its insurance needs. Captives will always be used in conjunction with commercial insurance carriers. Each captive is unique. The decision on whether to use a captive or commercial insurance company for a type of risk, or layer within a type of risk, is unique to each business and is done in consultation with you, your insurance advisor and Artex specialists.



Boxes represent examples of possible insurance coverage options through a captive program. Numbers used above are for demonstrative purposes. How a captive integrates within your program will be customized to your needs.

Alternative Risk Transfer Solutions

Alternative risk transfer (ART) solutions are alternative methods of financing risk other than buying traditional insurance policies from commercial carriers. While the specific possibilities for captive and alternative risk programs are vast, the Gallagher team provides offerings in six major product categories.

1. **Group captives**

A group captive insures the risks of multiple unrelated companies, each owning a small percentage of the insurance company. We operate multiple member-owned group captives for casualty risks. Group captives typically insure workers compensation risk, general liability and auto liability. The right group captive for your business will require an assessment by a Gallagher professional. At a high level, they are organized into two categories:

- Homogenous group captive: A captive that shares risks within a certain industry or geographic territory.
- Heterogeneous group captive: A captive that shares risk with organizations with similar risk management philosophies, but are not limited by industry or geography.

2. **Single-parent captives**

We can design a captive program that will supplement and improve your traditional insurance program and fill gaps and exclusions in your coverage. From workers compensation risk to cyber liability to farmer's crop loss, we can customize a program to meet your objectives. Gallagher is one of the largest providers of single-parent captives in the world, ranging from captives for large multinational corporations to middle-market companies to nonprofits.

3. **Rent-a-captives**

We can arrange for you to join an established or sponsored captive program. By "renting" a captive, you can earn similar benefits to starting your own captive without having to commit as much capital up front.

4. **Program business**

If you represent a large group of businesses with common interests and collective premium of over \$5,000,000, we can help you achieve savings by pooling coverage across the group into an organized program. Examples of current programs are restaurant franchisees and temporary staffing firms. We also offer guaranteed cost solutions.

5. **Medical stop-loss**

As the costs of healthcare accelerate and regulations mount, self-funding for employee medical benefits becomes increasingly attractive for mid-sized employer groups. We can help you control these costs by creating a captive program for medical stop-loss coverage. We provide protections against lasers and allow mid-size employers to band together to get large employer pricing and risk management services. Plus, the current broker relationship and doctor network stays in place.

6. **Warehouse & logistics solutions**

We can provide several different structures for warehousing and logistics risks: guaranteed cost, small and large deductibles and a group captive. We offer dedicated warehouse expertise to assist brokers and warehouse operators to review operations and determine most appropriate coverage.

We can offer these programs directly through Artex Risk Solutions, a wholly owned subsidiary of Arthur J. Gallagher & Co., which provides a diverse range of captive insurance solutions and alternative risk financing options for clients.

A Closer Look at Captive Uses

Association

An industry, franchise or association with general or specialized risk can form an association captive for underwriting profits, investment income, spreading risk and claims control.

Construction

Captives can cover performance risks, construction defect, mold and other construction-related risks, thereby improving cash flow and profitability of the builder.

Employee Benefits

Captives can insure employee benefits such as medical stop-loss, retiree benefits, group term life and long-term disability, achieving cost reductions to the business and more control.

Enterprise Risk Management

Captives excel at writing specialized coverage, such as nontraditional risks, business interruption, directors and officers, warranties, employment practices, management liability, certain kinds of credit risk, pollution liability and punitive damages liability.

General Liability/Auto Liability

Captives can replace (in whole or part) expensive general liability or auto liability insurance. In other cases, the captive can write the deductible layer of insurance. Captives can cover any type of traditional insurance.

Manufacturing

Captives can insure product recall and business interruption risks for manufacturers.

Medical Malpractice

Hospitals and physician groups can self-insure all or part of medical malpractice risks, obtaining underwriting profit and achieving better loss and claims control.

Property Coverage

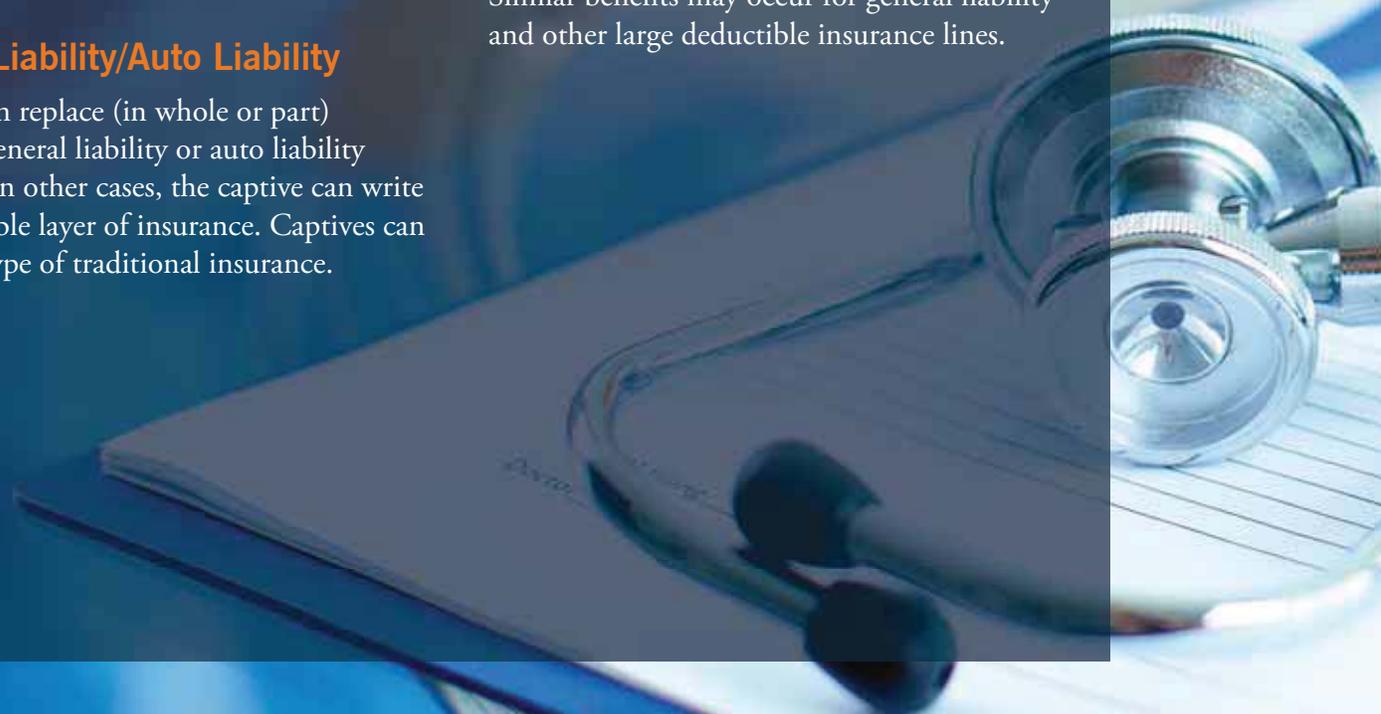
Large property holders can use a captive to write the first layer of property coverage, thereby reducing overall insurance costs.

Warranty

Captives can insure or reinsure the product or service warranty risks of the business or association.

Workers Compensation

A business with large workers compensation deductibles or self-insured retentions (SIRs) may benefit by having the captive set up tax-deductible reserves for losses in future years. Similar benefits may occur for general liability and other large deductible insurance lines.



Choice of Domicile



With the strong growth of the captive market, many domestic and foreign jurisdictions have approved captive insurance legislation. Key domicile considerations are:

1. Capital and surplus requirements
2. Investment limitations
3. Regulatory restrictions
4. Government fees and taxes
5. Infrastructure

Why Arthur J. Gallagher & Co.?

Arthur J. Gallagher & Co. is one of the world's leading insurance brokers and has been designing risk management solutions to meet our clients' unique needs for 90 years. We plan and administer a full array of insurance, risk management, self-insurance, claims management and employee benefit products and services. We pioneered many of the innovations in insurance and risk management used by businesses in all industries today.

Artex Risk Solutions, a wholly owned subsidiary of Arthur J. Gallagher & Co., provides a diverse range of captive insurance solutions and alternative risk financing options for clients around the world. Artex is the industry leader in the development and management of middle-market captive insurance programs. We provide captive services to over 1,000 clients in 22 of the world's most popular domiciles.

Learn how alternative risk transfer solutions from Gallagher—such as captives and guaranteed cost insurance programs—can help you control costs and capture financial benefits for your business.

Reduce your risk. Contact us today.

Gallagher Alternative Risk & Captives Practice

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Arthur J. Gallagher & Co. at a glance

Arthur J. Gallagher & Co. has been designing solutions to meet our clients' unique needs for 90 years. We pioneered many of the innovations in risk management used by businesses in all industries today. We believe that the best environment for learning and growing is one that remembers the past and invents the future.

- Founded in 1927 by Arthur J. Gallagher and still run by the founding family.
- A global corporation with a strong heritage and culture, Gallagher is a company with 24,500+ employees.
- Divisions specializing in retail insurance brokerage operations, benefits and HR consulting, wholesale distribution, and third-party administration and claims processing.
- More than 710 offices in 33 countries and revenues of \$4.2 billion as of 2016.
- Offering client-service capabilities in more than 150 countries around the world through a global network of correspondent brokers and consultants.



Insurance brokerage and services to be provided by Arthur J. Gallagher Risk Management Services, Inc. and/or its affiliate Arthur J. Gallagher & Co. Insurance Brokers of California, Inc.