Texas Captive Insurance Association

2023 Annual Conference

Texas Captives: Empowering Texas Business

Captive 101: Everything You Need to Know about Captives!

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Aon

Captive 101: Everything You Need to Know about Captives

Well now, that certainly is a pretty wide-ranging title for a presentation!

No Pressure Eh?

To help me out, let's start the session with a couple of Straw Poll questions!

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Show of Hands – The Old-Fashioned Way!

Who Is New To The Captive Concept?

Who Has A Captive Already?

Who Would Like To Have A Captive Soon?

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Why Is There So Much Interest In Captives Right Now?

2022's Strong Pace of Captive Formations Expected To Continue in 2023

February 01, 2023 | See Related Articles and Videos

December 1, 2022

We are seeing additional consideration given to emerging risks and risks not previously financed through captives.

Article

Historic Captive Growth Continues

9 January 2023 | Analysis

Crawford: captive growth in 2021-22 phenomenal

Benchmarking Report Finds Captive Growth Across Lines, Regions

July 12, 2023 | See Related Articles and Videos

So How Did We Get Here??

US Property-Casualty Underwriting Losses Persisted during First Half

September 22, 2023 | See Related Articles and Videos

Inflation, High CAT Losses to Lead to 2023 Underwriting Loss for P&C Industry, But Recession Likely Avoided This Year, New Triple-I/Milliman Report Shows

FITCH WIRE

US P/C Insurance Underwriting Losses Expand Amid Personal Lines Weakness

Thu 14 Sep, 2023 - 10:56 AM ET

Partnership Aims To Develop Insurance for Climate-Vulnerable Countries

September 26, 2023 | See Related Articles and Videos

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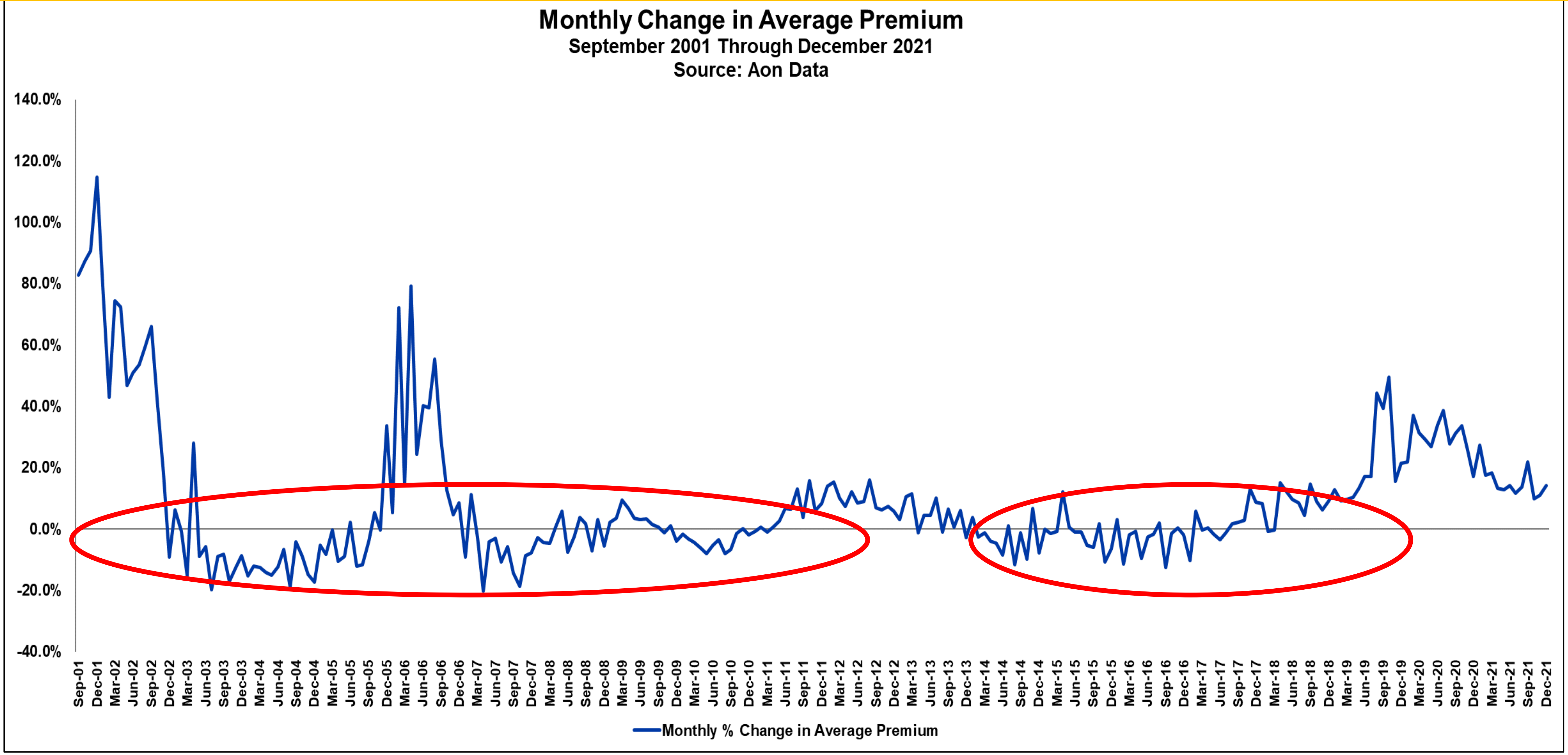
Insurers Can’t Keep Selling a $1 of Claims for 75 Cents of Premium!



The “Hockey Stick” Effect!

When prices go up like a hockey stick – the insurance buyers **feel the pain.**

When at the same time terms and conditions are tightened – the insurance buyers **feel threatened**

When the insurance market retreats from providing cover completely or slashes participation – the insurance buyers **feel abandoned!**

Someone is going to lose some teeth!

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Options for Companies Facing This Hard Market

Status Quo

1. Pay the higher commercial premium
2. Accept more restricted conditions
3. Have no control over your program
4. Be forced to Assume more risk at parent level and self-finance on corporate balance sheet

OR.....

Transfer risk to a captive, build capacity, access reinsurance, and become ***underwriter of choice.***

Captive Options

- Stabilize Pricing
- Reduce Reliance on Commercial Insurance
- Provision of Cover Where Otherwise Unavailable
- Capture Underwriting Profits
- Improved Cash Flow Benefits
- Ability to Customize Insurance Programs
- Greater Control & Leverage
- Flexibility and Nimbleness

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Strategic Thinking About Risk & The Use Of Captives

There is now a recognition that the traditional market cycles leave the insureds vulnerable and without adequate cover whenever insurance markets cycles turn hard.

Insurance buyers are reexamining their existing programs and demanding applying a new way of thinking on how risk is financed in the future.

Captives provide a long-term alternative to traditional insurance with a renewed focus on hard-to-place covers for low frequency but high impact risks for which the traditional market is lagging behind.

This form of critical thinking is an evolving enterprise risk management framework that encourages organizations to leverage their own risk underwriting awareness and capacity to pivot towards becoming the "Underwriter of Choice" in the place of the traditional market and **take on more risk in a controlled manner.**

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The Basics – Captive Definition

A closely held insurance company whose insurance business is primarily supplied and controlled by its owner and affiliates who are its principal beneficiaries”

- **No legal distinction between a captive and an insurance or reinsurance company**
  - ***BUT they are regulated under special legislation in the U.S. or offshore***
- **May insure or reinsure the risks of its owner, affiliated parties or unrelated parties**
- ***The owners of captives choose to put their own capital at risk by working outside of the traditionally regulated commercial insurance marketplace. As a result, there are a few moving parts to the process of forming and using a captive to its best effect.***

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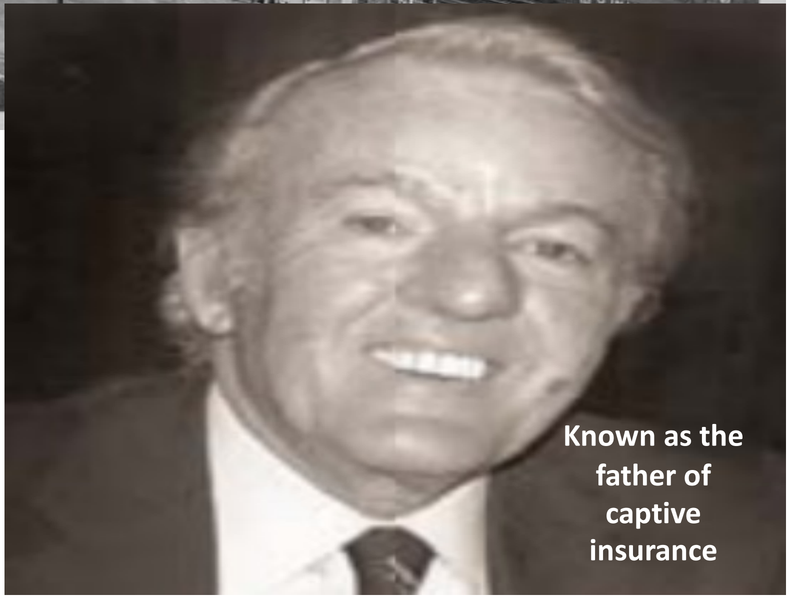
OK…But Why is it Called “Captive” Insurance?

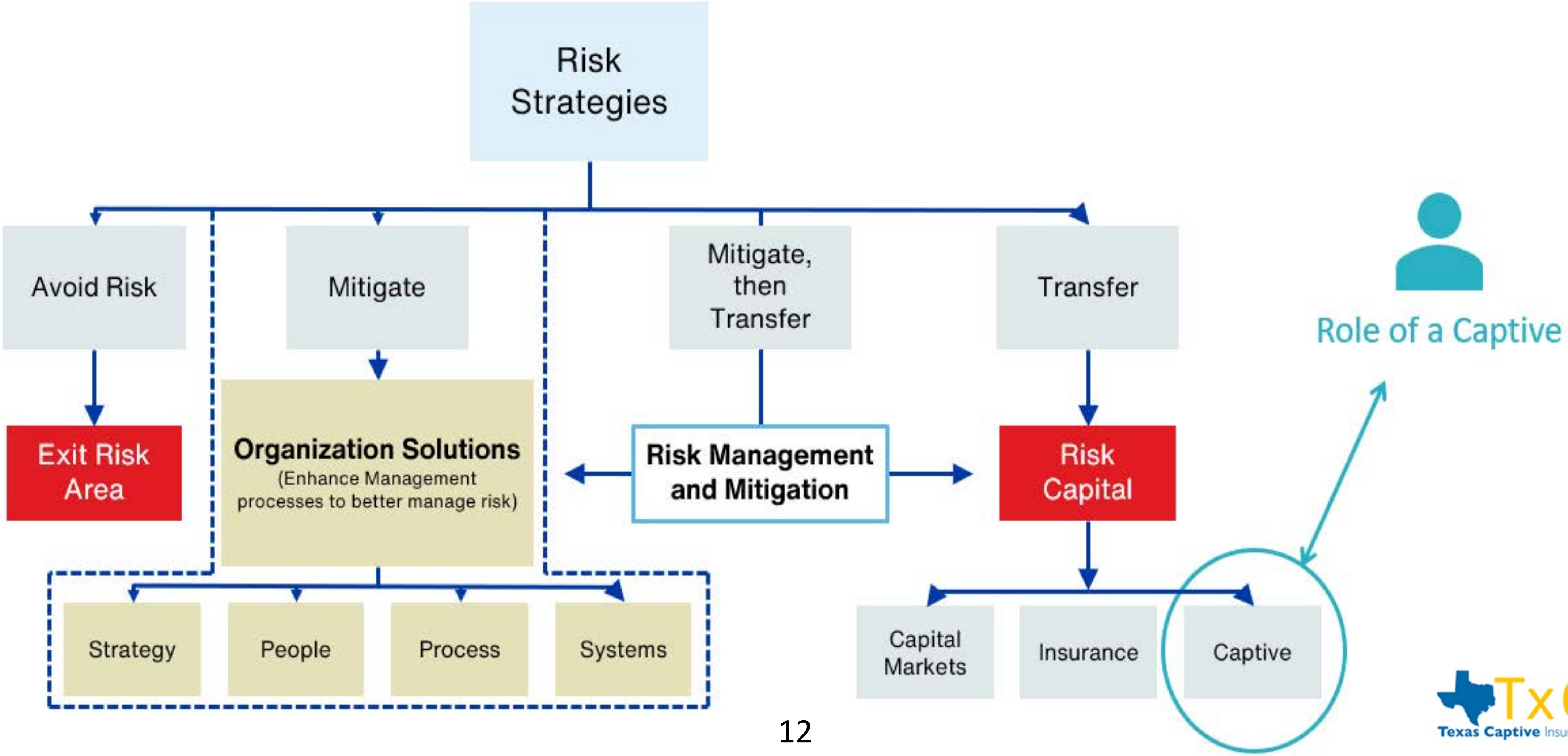
- **Fred Reiss formed the first captive insurance company (in the modern era) for Ohio-based Youngstown Sheet & Tube Company in 1955**
- **Fred was tasked with procuring insurance for the mills and was an engineer by trade.**
- **At the time, most policies were underwritten by only a handful of large insurance companies**
- **Youngstown Steel Company’s financial stability was threatened by rising insurance rates as capacity dried up with only a few insurance carriers willing to underwrite for large factories and mills.**
- **Fred saw the inequity of loss control dollars paid by insureds to benefit the insurers!**
- **Fred came up with the idea of captive insurance…….and formed International Risk Management Group in the late 1950’s – Later sold to Aon in 2000.**



Known as the father of captive insurance

Where Does a Captive Fit Into Risk Management?

One of Many Pieces….



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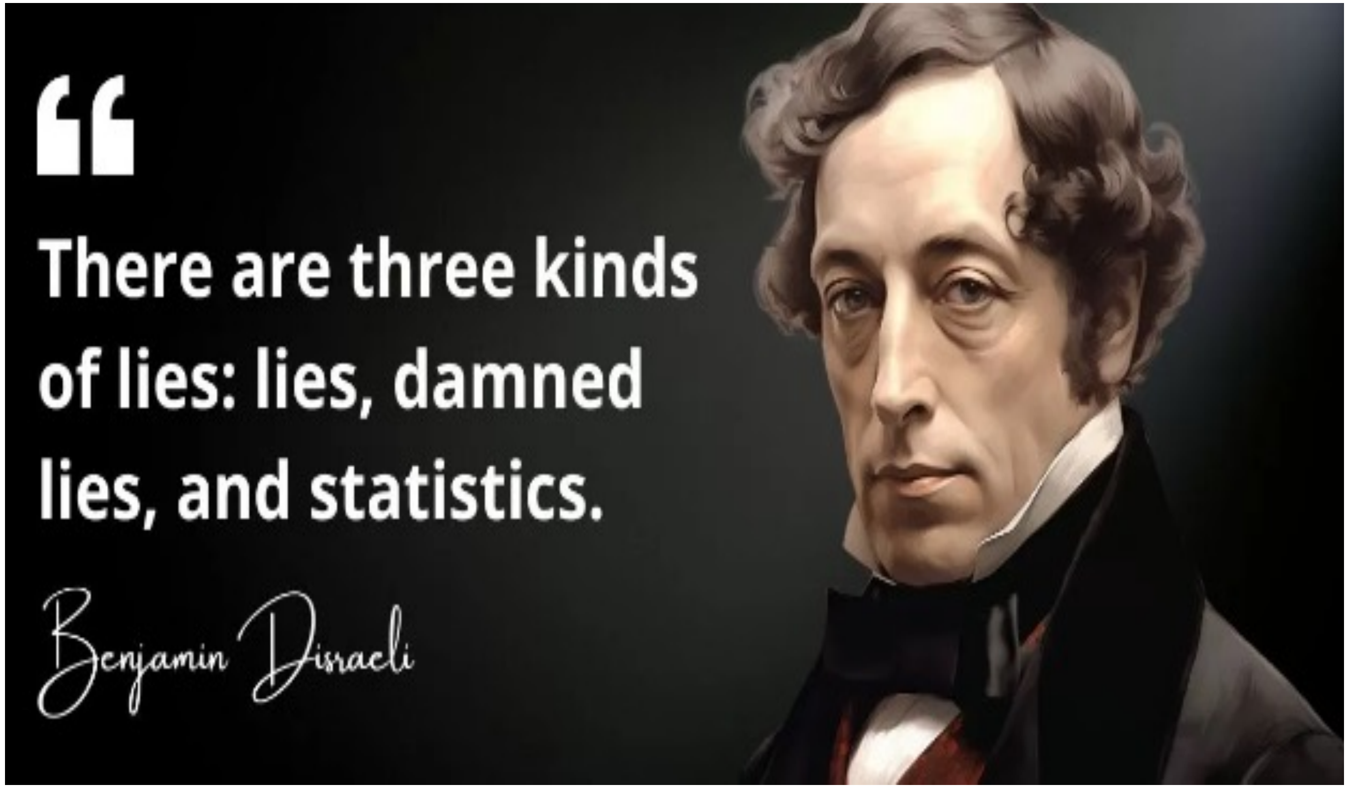
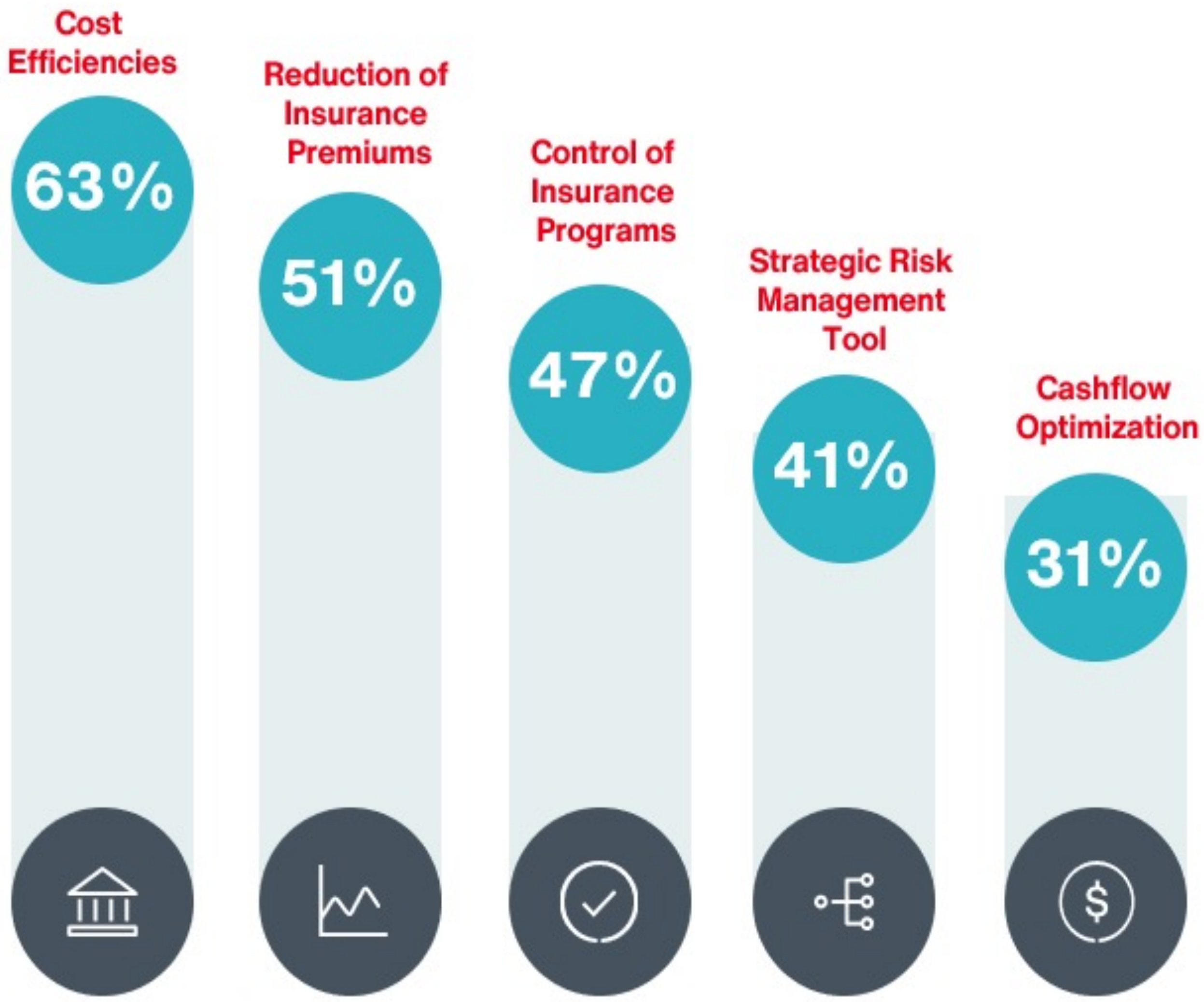
OK Let's Look At Some Numbers

Sorry You Know We Have to Do It!



Why Do Companies Use Captives?



Source: Aon Captive Benchmarking Survey

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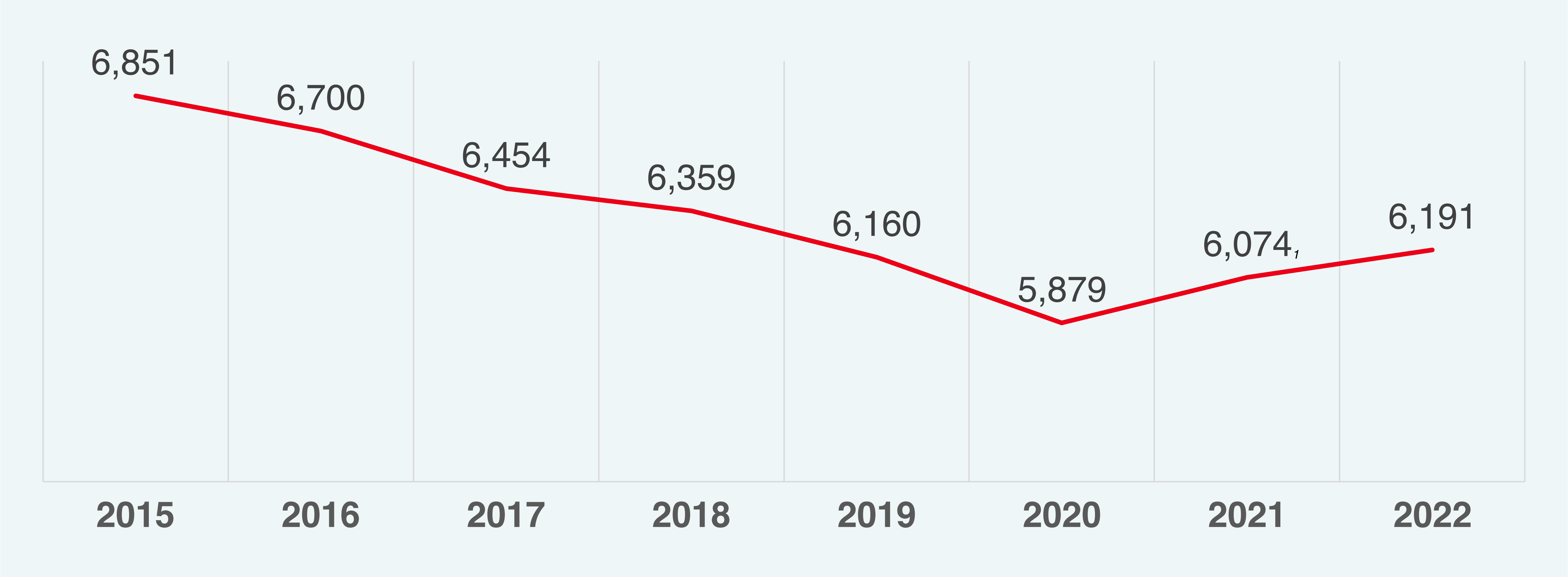
Total Captives Worldwide At 2022 Year-End



Source: Business Insurance, 2023 Captive Managers and Domiciles Rankings + Directory

[1] Restated

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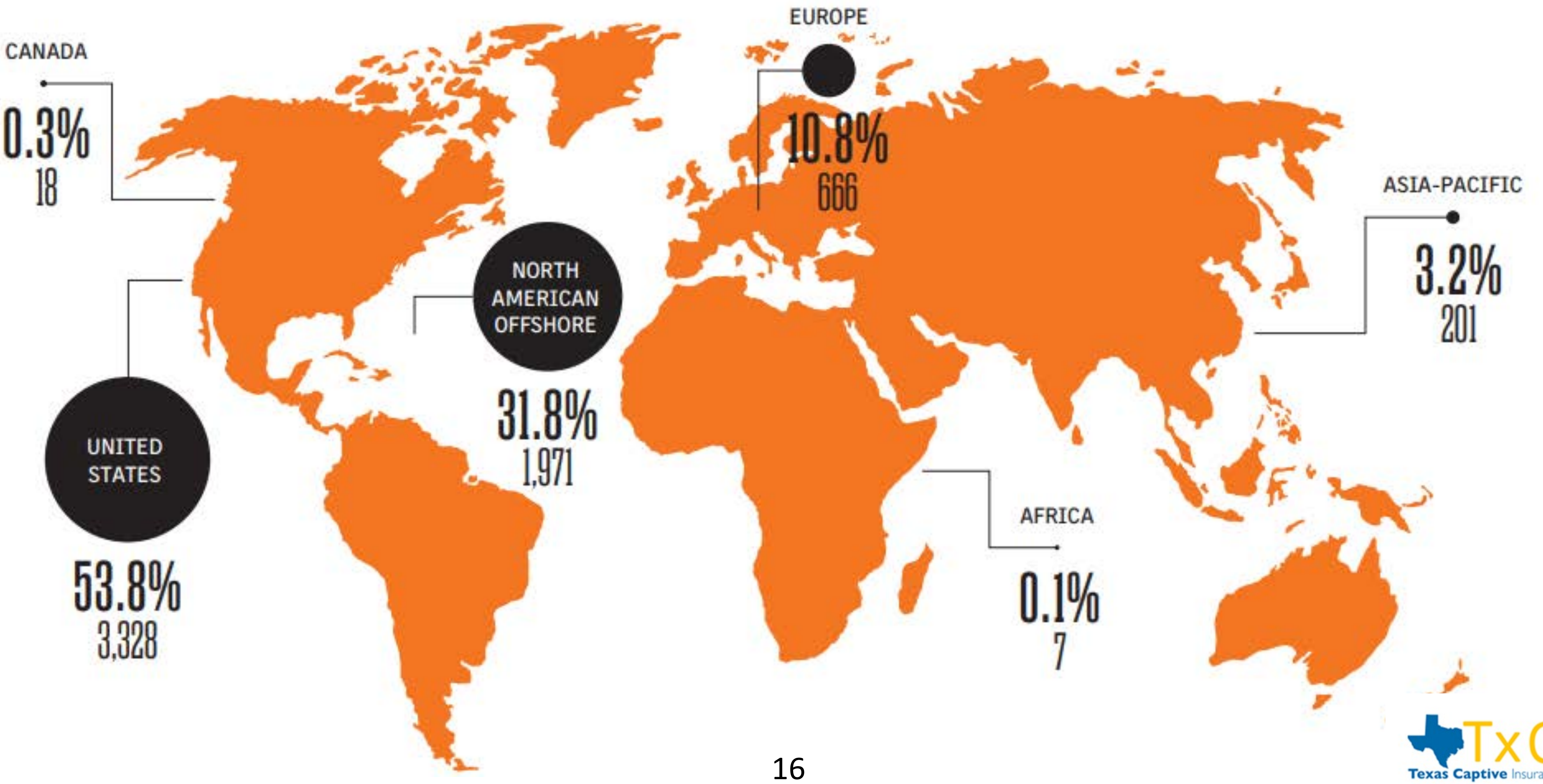
Sources of Captive Insurance Business



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Total Number Of Captives 2022 By Region

Region	Percentage of total captives per region	Number of captives
United States	**53.8%**	**3,328**
North American Offshore	31.8%	1,971
Europe	10.8%	666
Asia Pacific	3.2%	201
Canada	0.3%	18
Africa	0.1%	7

Total Number of Worldwide Captives 6,191

Source: Business Insurance, 2023 Captive Managers and Domiciles Rankings + Directory

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Top 10 Domiciles at 2022 Year-End

Rank	Domicile	2022	2021
1	Bermuda	660[1]	670[1]
2	Cayman Islands	650[2]	661
3	**Vermont *** **	639	620
4	Utah	419	386[3]
5	Delaware	330	313
6	Barbados	315	308[3]
7	North Carolina	294	257
8	Hawaii	255	250[3]
9	South Carolina	205	183
10	Guernsey	201	192

Source: Business Insurance, 2023 Captive Managers and Domiciles Rankings + Directory

[1] BI estimate [2] From domicile website [3] Restated

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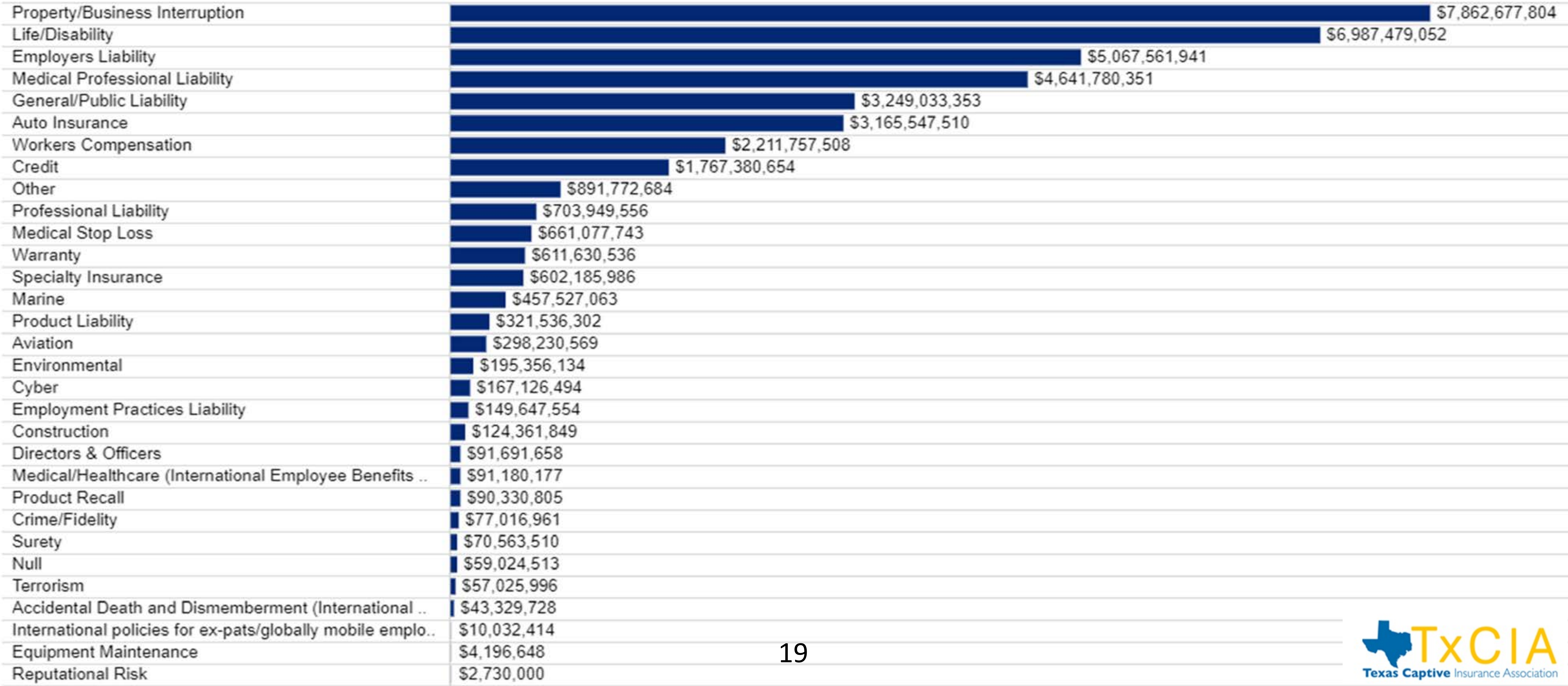
What Lines of Cover Can Be Written By a Captive & *What's Hot?*

Line of Business - All by Gross Written Premium USD



FANTASTIC! – OK SIGN ME UP!!!

Well – Hang On…. Captives are just a form of Self Insurance..

Ask Yourself

<u>Do You Want To Self Insure?</u>

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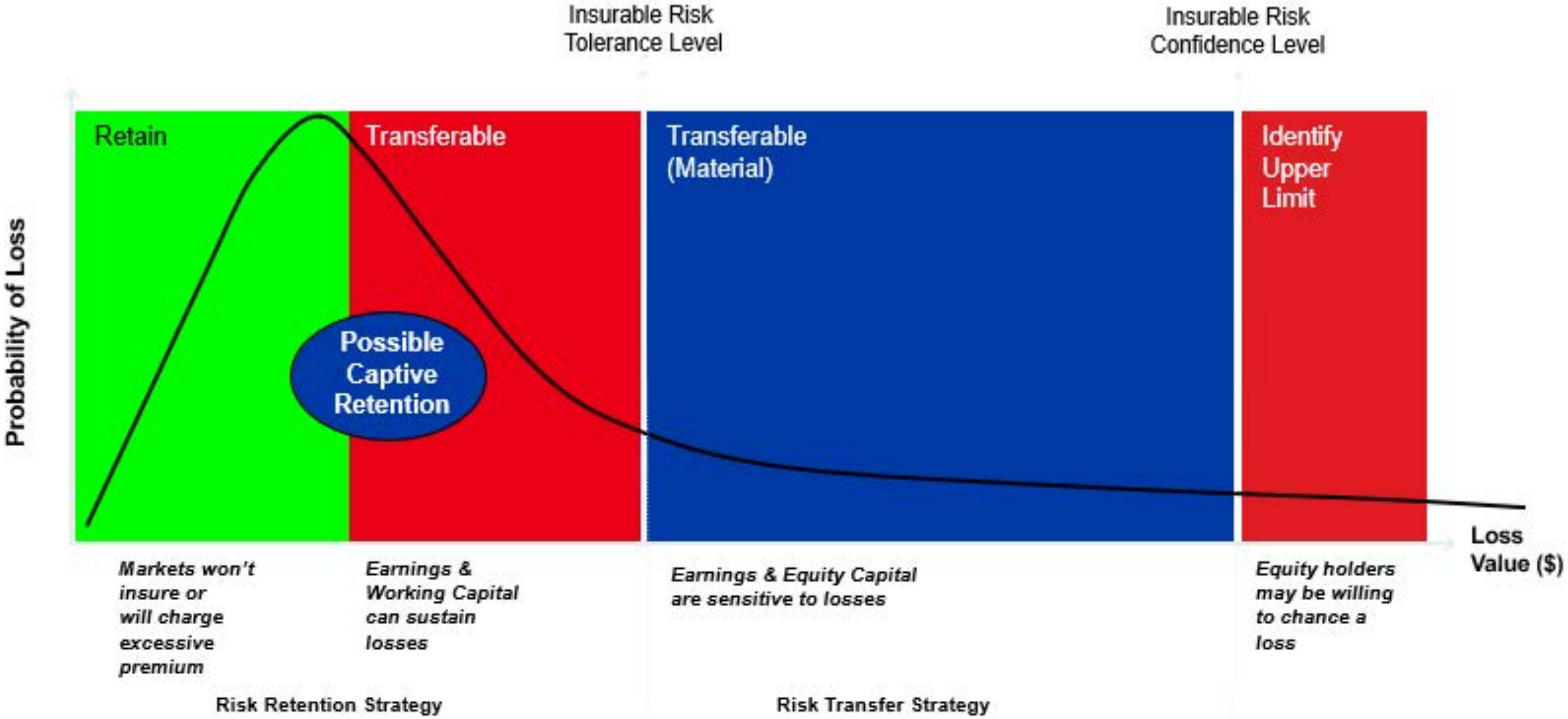
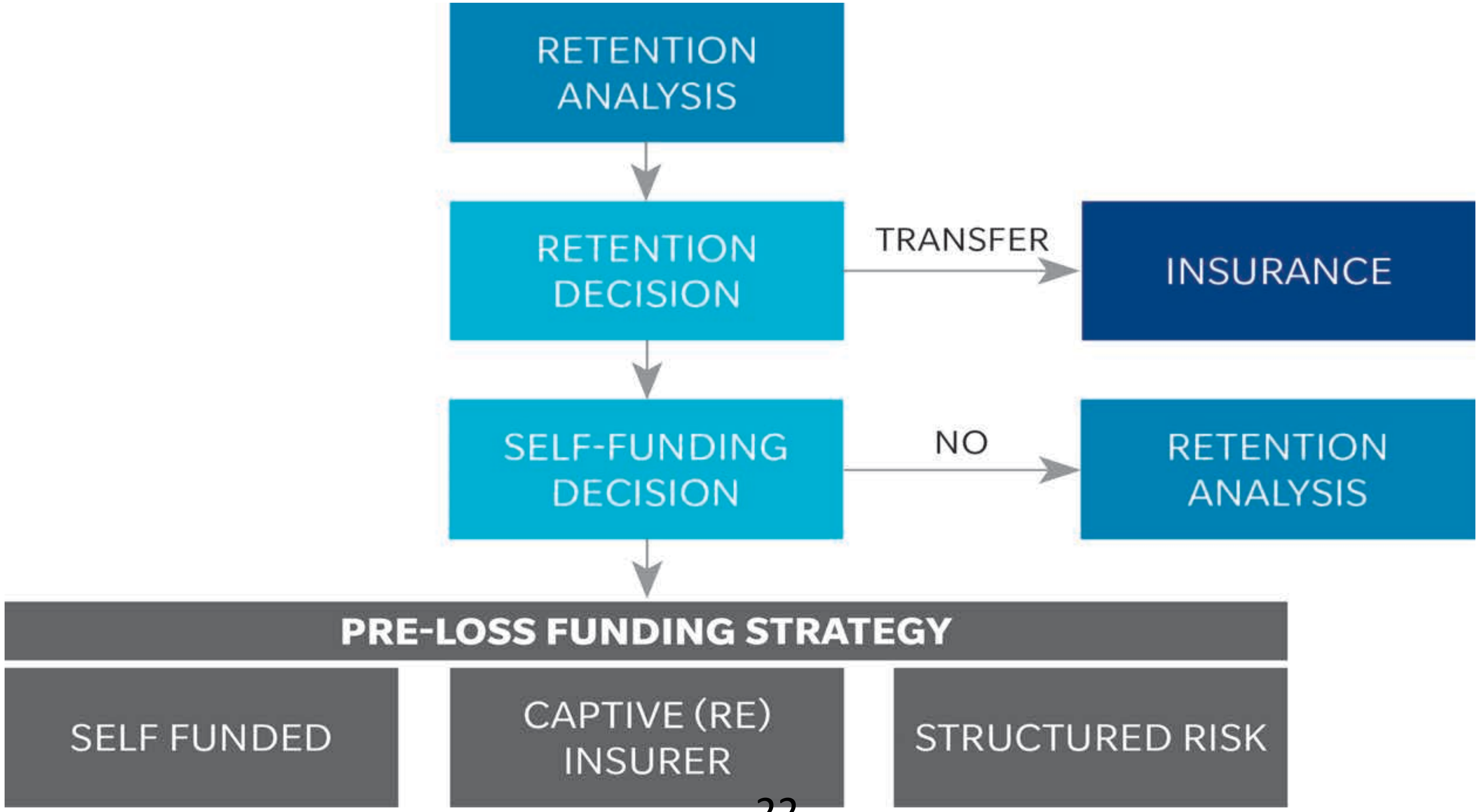
The Retention/ Risk Transfer Decision – What is My Risk Appetite?



A Few Decisions To Make First – How Much Risk To Take?

A corporation's decision on the amount of risk to assume is independent and a priority over determining how to finance the risk, whether on the books of the parent or through a wholly owned captive insurer as illustrated below.



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What Type of Captive Is Best For My Risk???

NAIC Classifications

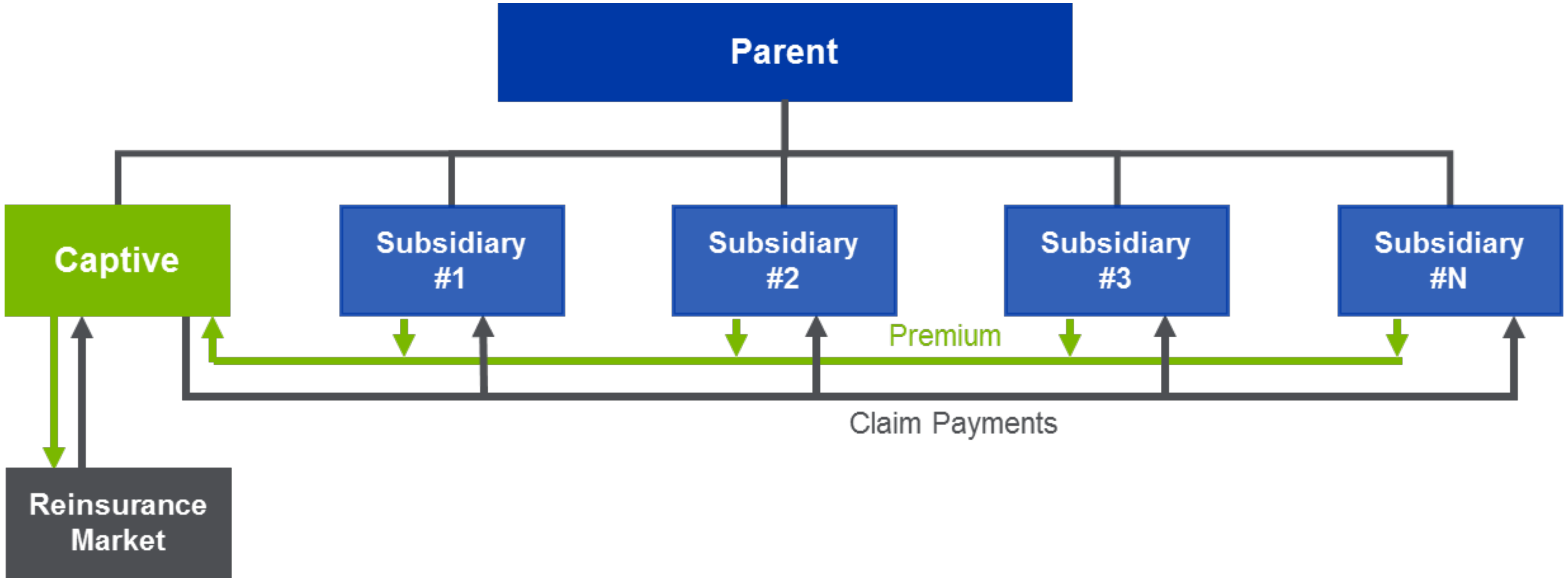
- **Single Parent**
  - **Pure Captive:**
  - **Branch Captives:**
  - **Rental Captives:**
  - **Protected Cell Captives:**
  - **Micro Captives:**

- **Collective Captives**
  - **Group Captive:**
  - **Association Captives:**
  - **Risk Retention Groups:**

An Easier Grouping!

Single Parent Captive	A wholly owned insurance or reinsurance subsidiary that is owned by a single Parent Company to insure the risk of the parent and related companies in the group.
Group / Association Captive	A captive insurance company that insures the risks of a group of unrelated insureds. The risks can be heterogeneous or homogenous, or often organized by members of a common industry or trade association.
Cell Captive "Rent-A-Captive"	A captive structure established by an outside organization whereby an insured can 'rent" the captive facility, which provides many of the benefits of a single-parent captive.

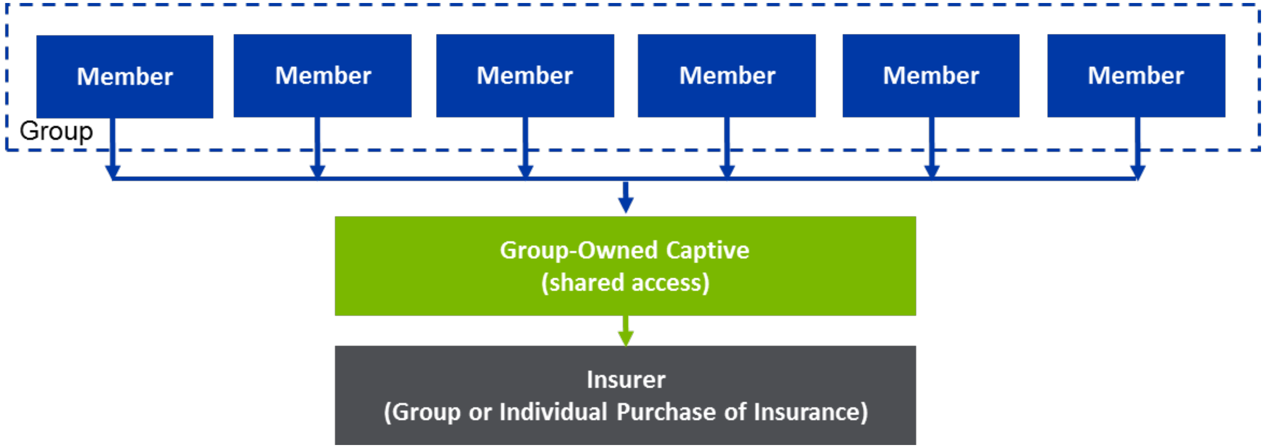
Single Parent Captive



- Wholly owned by one company;
- Jointly owned by interested investors;
- 80% of all captives are formed like this;
- No outside sharing of risk;

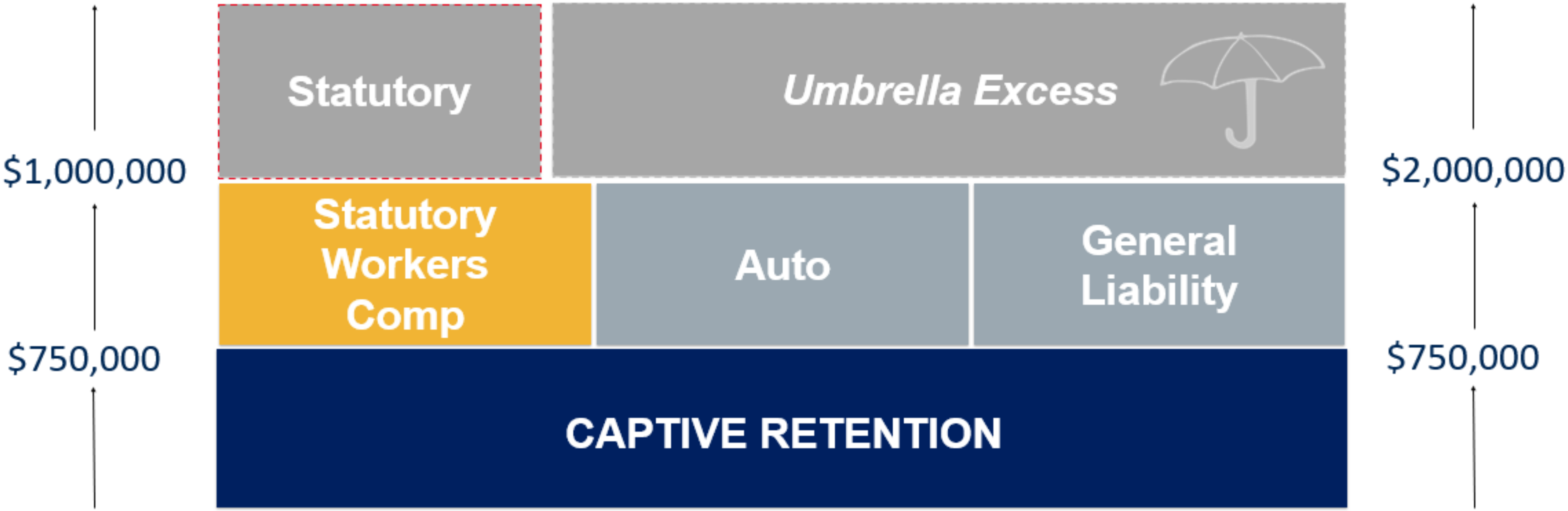
- Designed to cover parent's business;
- Sometimes adapted to make money rather than save money:
  - Self Storage
  - Warranty Business
  - Cell Phone Ins., etc.

Group or Association Captives



- Members form their own insurance company:
- Strict rules in place for underwriting criteria, loss control and member's active participation in the group captive's affairs;
- Usually organized by a sponsor and run by a Captive Manager but at the direction of the member owners
- Profits made by the group are paid back to the members after 3–5 years.
- Losses are shared.

Typical Group Captive Structures By Line (A/B/C Funds)

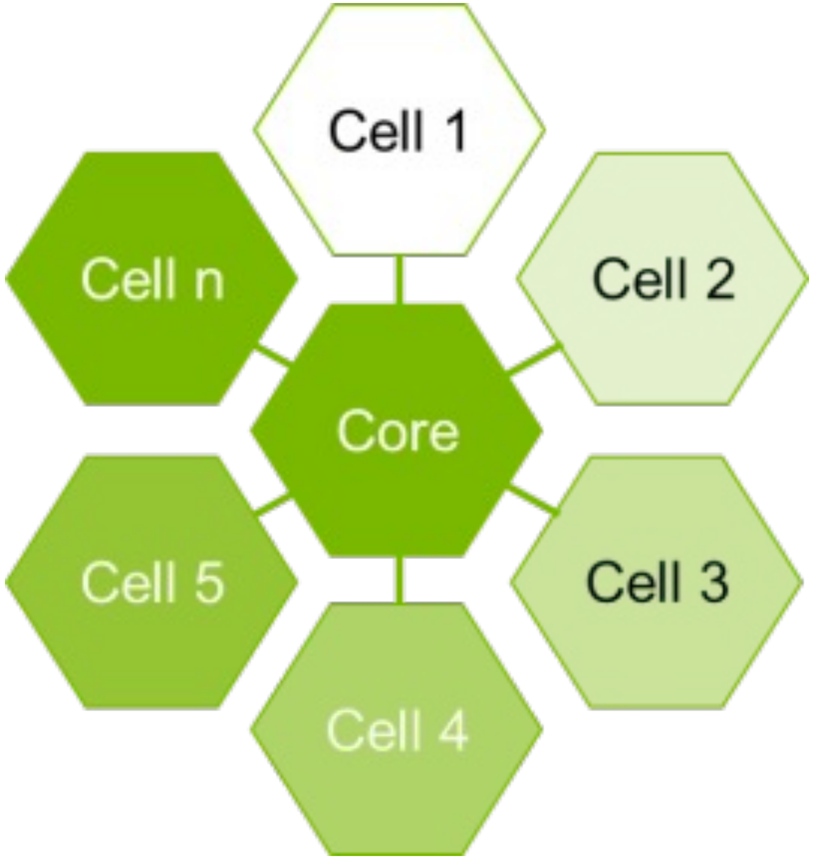


Typical Group Captive Structures By ‘A/B/C Funds’

REINSURANCE	$2,000,000	Third Party Risk Transfer
C FUND	$750,000	Risk Pooling / Pro Rata Risk Sharing
B FUND	$500,000	Severity Fund – Member Funds / Risk Sharing
A FUND	$150,000	Frequency Fund - Member Funds

Rent-A-Captive / Protected Cell Captives

- Uses an existing licensed insurance company to “Rent” space for a dedicated account earmarked for the insured:
- Each cell has legal segregation and protection of assets and liabilities;
- Risk IS NOT SHARED between members in the event that one of the accounts is in deficit;
- Applies to most parental risks but not good for “man in the street” cover;
- Good for solving problems with one or two lines of cover
- Need to look carefully at tax as usually fully funded by LOC;
- Alternative would be to use reinsurance instead of full funding;
- Now the new technology and growing in popularity and has been in place for 25 years.



You Have My Attention!

What Do We Need To Think About Next?

The Mechanics and Processes To Form a Successful Captive

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BUT FIRST
Take a Well Earned 20 Minute Break!

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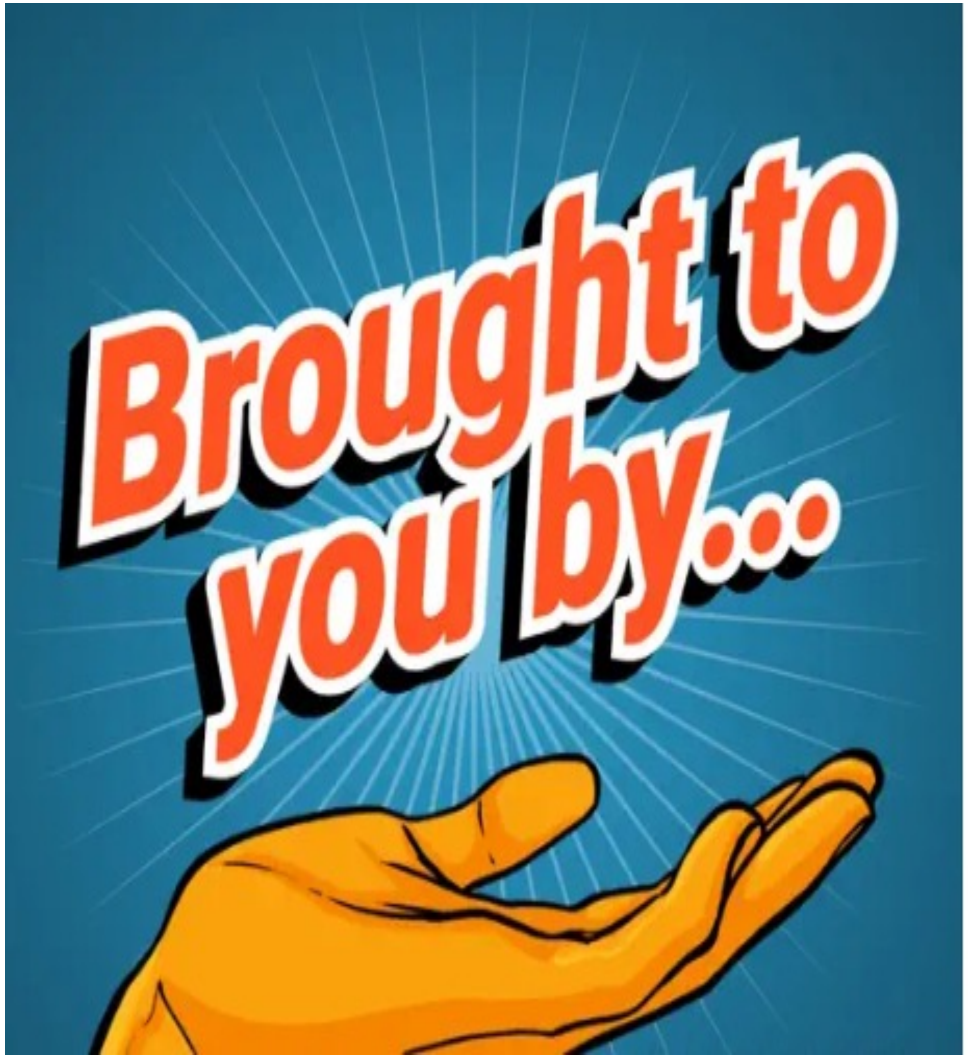
Welcome Back

The
Single Parent Captive Option

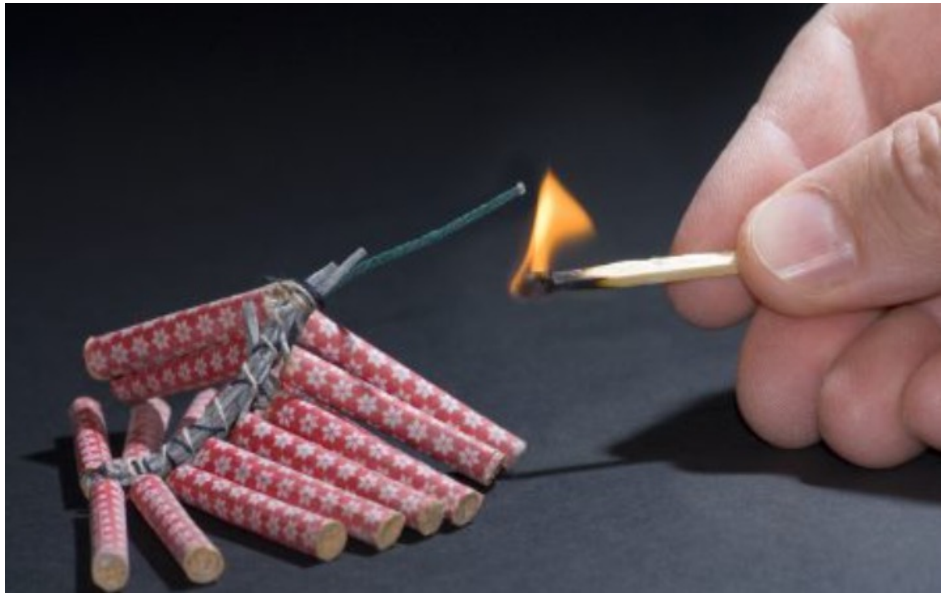
- 100% owned by a Parent Company
- Separate Capital
- Separate Board
- Separate Annual Audit
- Separate Actuarial Review
- Can Write All Lines of Insurance

- As mentioned, – about 80% of all captives are Single Parent Captives



Let’s Recap Where We are.

- We are now motivated to look at a captive option as an alternative to traditional insurance
- We have worked out our “Risk Appetite” for the lines we want to self insure
- We have decided to go the Single Parent Captive route
- The blue touch paper is lit, and we are ready to go!



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Initial Questions To Ask To Help Guide Us

Is you company growing rapidly and needs a flexible risk financing vehicle?

Do your insurance rates seem high vs loss history?

Do you have fairly predictable levels of retained loss costs?

Does your company have the appetite and tolerance to retain more risk?

Do operating units require lower levels of retention than the corporate level?

Are you looking for more efficient ways to finance your retained risk?

Do you have hard to insure or "uninsurable" risk exposures?

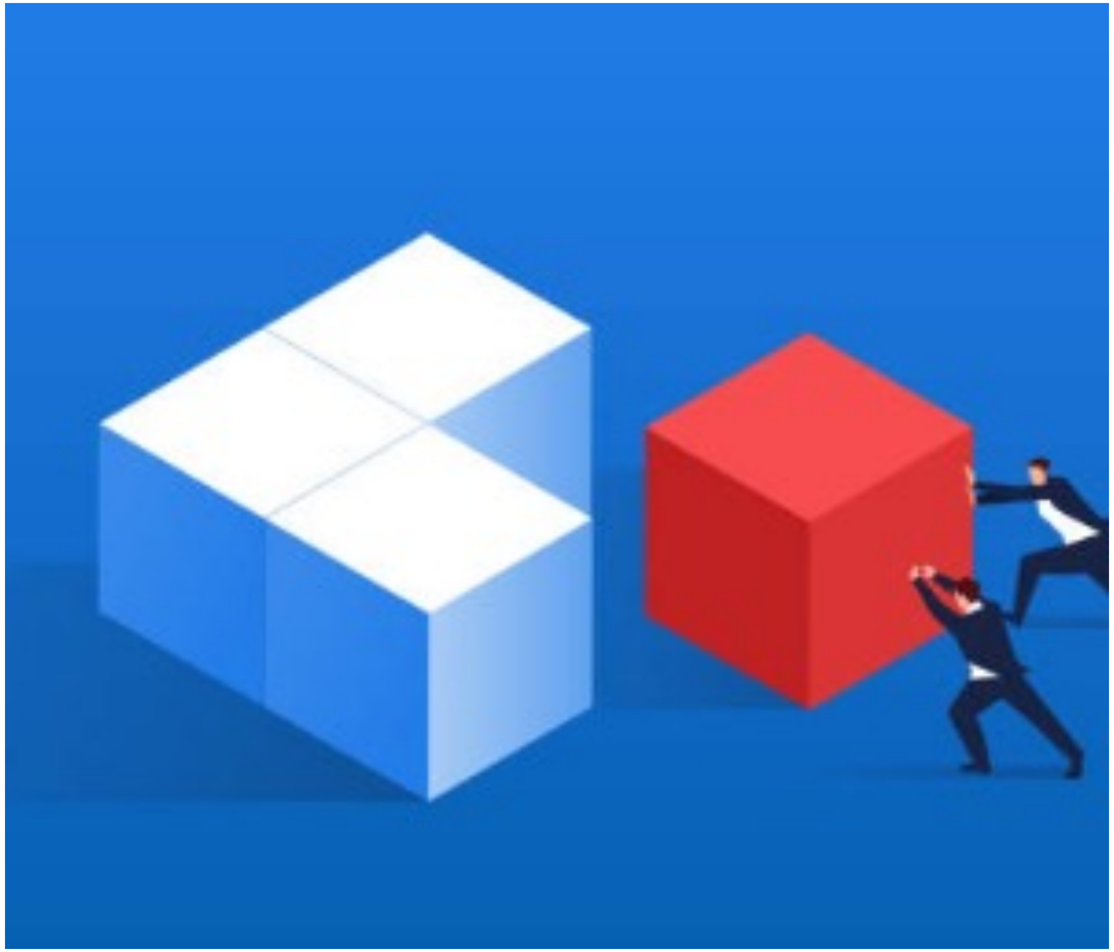
Are you looking for a way to consolidate and/or control insurance purchases across the company?

Have you experienced volatility in coverage in the commercial markets?

Route Map

STEPS	1 Educational Discussion to Identify Captive Opportunities	2 Objectives Defined	3 Feasibility and Modeling	4 Feasibility Report	5 Implementation of Strategic Objectives
KEY ACTIVITIES	• Conduct a basic company diagnostic • Provide a general overview on captives • Identify potential opportunities	• Define captive feasibility study objectives/scope including potential opportunities	• Review potential opportunities and coverages • Analyze operational and financial advantages • Outline captive structures • Review domiciles • Address key cost, tax, and operational considerations • Hold additional discussions with client as needed	• Summarize conclusions of feasibility study and provide recommendations • Outline implementation plan of recommended strategies	• Revise implementation plan • Meet with captive regulators • Draft business plan and pro formas • Prepare and submit regulatory application
DELIVERABLES	• Relevant brochures and educational information	• Engagement letter outlining key objectives	• Data request • Timeline and action plan	• Feasibility report • Implementation plan	• Business plan and pro formas • Regulatory application

Fitting a New Captive Into the Insurance Program



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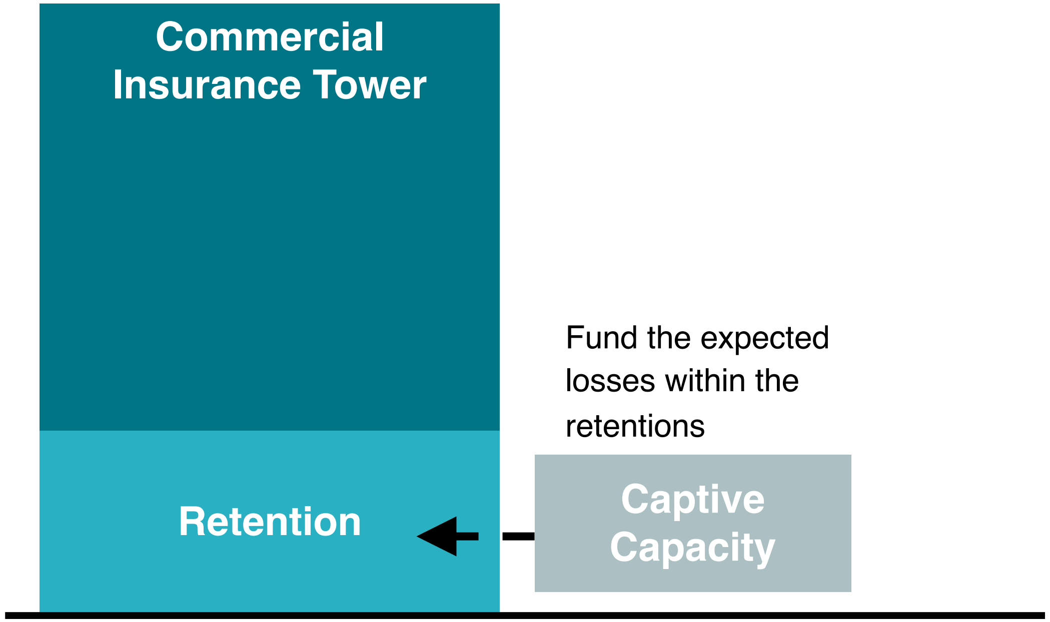
Deductible Reimbursement Policy

- This is an internal transaction that does not involve the external insurance market. A captive is used to finance the retained losses for a proposed property insurance program deductibles /self-insured retentions.

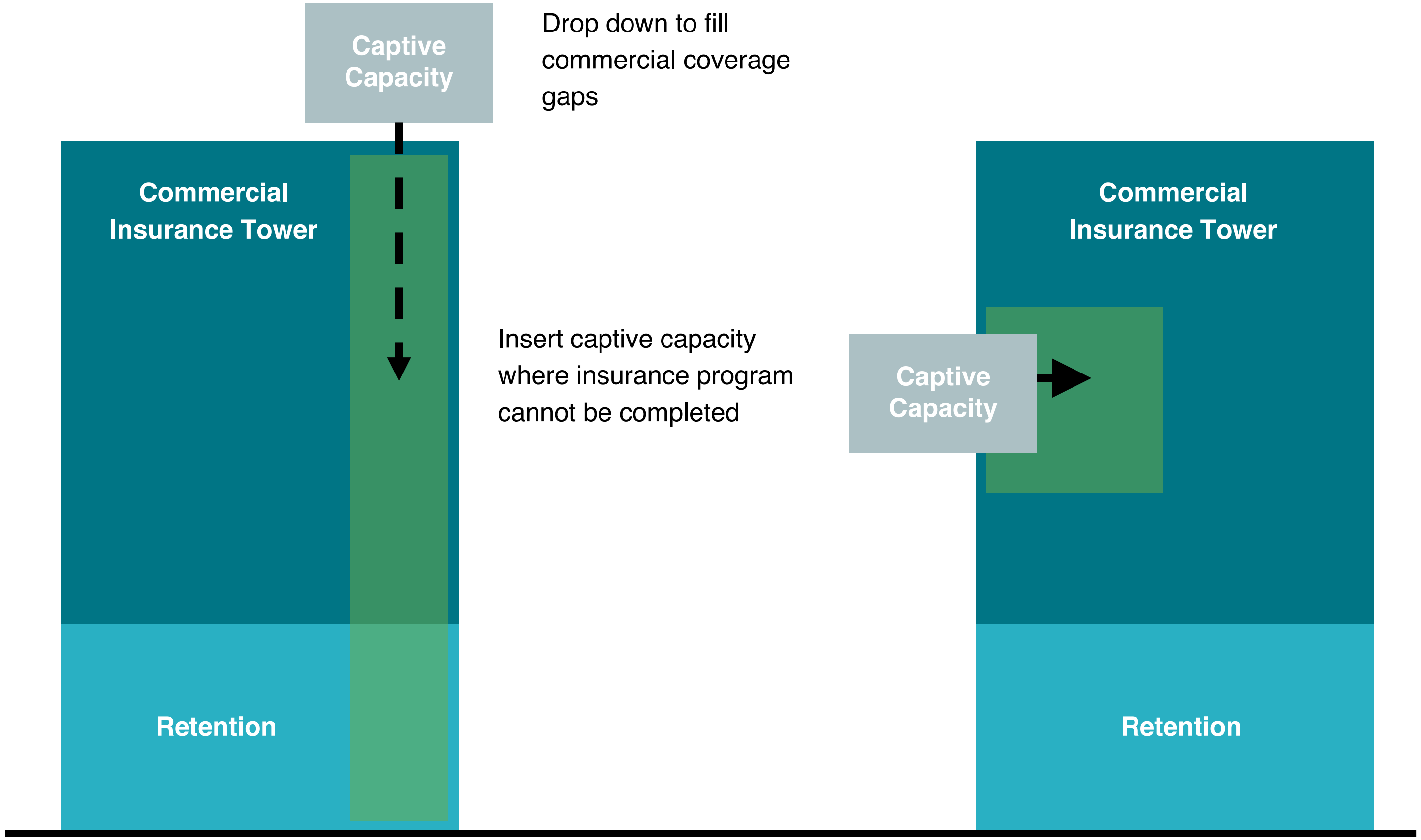
- By using this type of participation, the captive's Parent does not cease buying its current insurance program but rather finances retentions and deductibles through the captive rather than funding them through operating cashflows at a business level.



- The retained loss costs associated with these programs can potentially be financed more efficiently through a captive over the current strategy of funding through the cash flows of the business.

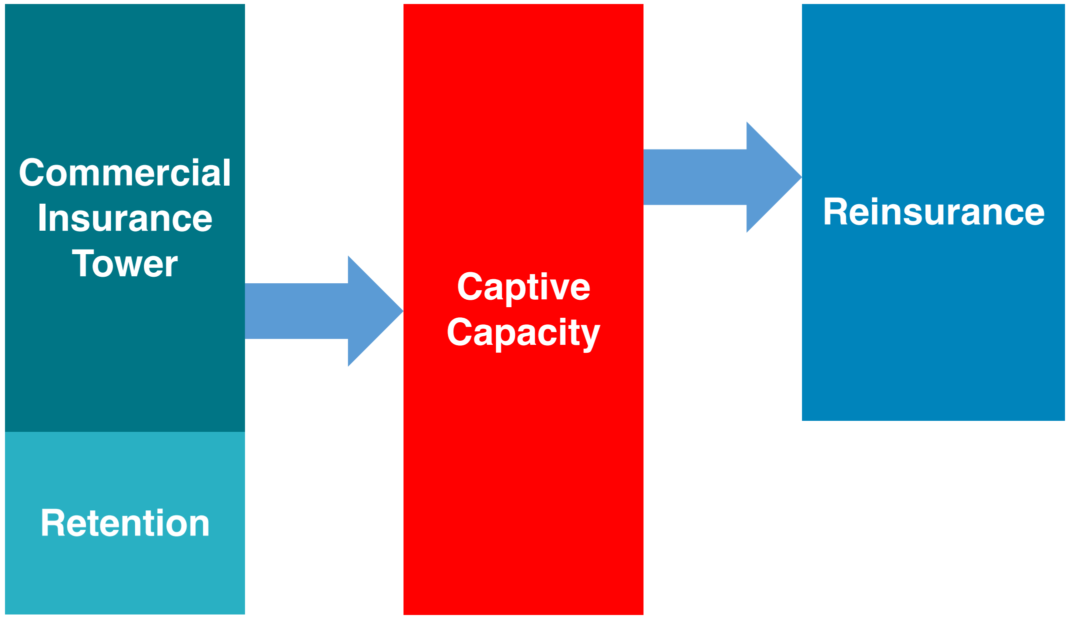
Captive Participation in Tower Gaps or Corridor Deductibles

- The captive could be used to provide necessary capacity, plug gaps in coverage, and/or be used to create leverage in pricing negotiations with incumbent insurance markets.
- The use of this participation by a captive is more common when insurance prices are rising, and available capacity is shrinking.
- The continued hard market is being experienced in 2023 in almost all classes of insurance.



Using a Captive To Access to Reinsurance

- The captive takes all or a portion of the risk and then reinsures to the wholesale reinsurance markets for either better terms or better pricing



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The Push / Pull of Saving Money vs Creating Value

Saving Money On The Premium Spend

- To save money on the insurance spend, look at the level of risk that is within a company's risk tolerance and retain that level of risk.
- If the company's risk tolerance is greater than the current level of retention or deductible, the result will be buying less insurance from the open market and pocketing the difference in premiums paid.
- Simply put - Saving money by not buying insurance.

Creating Value With a Captive

- The use of a captive, however, is a different proposition than simply buying less insurance.
- The captive concept recognizes that increased retentions will lead to increase retained losses.
- Prudence dictates that this risk be offset with both active loss control efforts and putting monies aside to pay for the increased exposure to risk.
- A captive is a better vehicle to do this rather than paying from operating expenses or establishing a "loss fund."
- A captive is an insurance company that can create value for the company over and above simply saving the difference in premium from a higher retention.

Top 10 Ways To Create Value Using a Captive

1

Reduced Reliance on Commercial Insurance

As the captive matures, its surplus grows, giving it greater capacity to retain risk. Increased surplus also creates new opportunities for accessing reinsurers which further increases available capacity;

2

Reduction of the Costs of Risk Management

The price of insurance coverage purchased in the conventional market typically reflects a significant markup to pay for the acquisition costs for commercial insurers including marketing, broker commissions, administration, and overhead as well as profit to the insurer.

3

Stabilization of Pricing

Where the company enjoys a stable and reasonably low loss experience year over year, a captive affords the ability to price insurance coverage based on your own loss history and not that of the portfolio of companies insured by a traditional insurer;

4

Provision of Cover Where Otherwise Unavailable

From time to time, the conventional market is unwilling or unable to provide cover for certain risks. The establishment of a captive to write such "problem" lines or to provide additional capacity can be an answer to these market problems. Whenever insurance cover is unavailable or overpriced, the feasibility of a captive is enhanced;

5

Access to Reinsurance Markets

Because reinsurers generally deal with insurance companies, a captive affords direct access to the reinsurance market. In bypassing conventional insurers, the insured is spared markup costs. The savings associated with eliminating these costs can outweigh the incorporation and other startup costs of a captive.

6

Seeking Improved Cash Flow Benefits

The ability of a captive to generate investment income from unearned premiums received is an advantage in forming a captive. This is especially so where premiums are paid in advance and losses are paid out over a period of time, as with Workers Compensation. General Liability or other long tail lines;

7

Ability to Customize Insurance Programs

A captive has the flexibility to insure any risk it chooses and to customize the terms and conditions of its policies. This leads to improved efficiency and promotes greater internal awareness of the factors that commonly give rise to losses;

8

Opportunities for Improved Claims Handling and Control

A captive is free to establish its own claims handling policies and procedures. This has advantages such as the reduction of the time taken to process and pay claims;

9

Ability to Direct Investment Options

A captive has the ability to direct the investment of its own funds while they are within the captive.

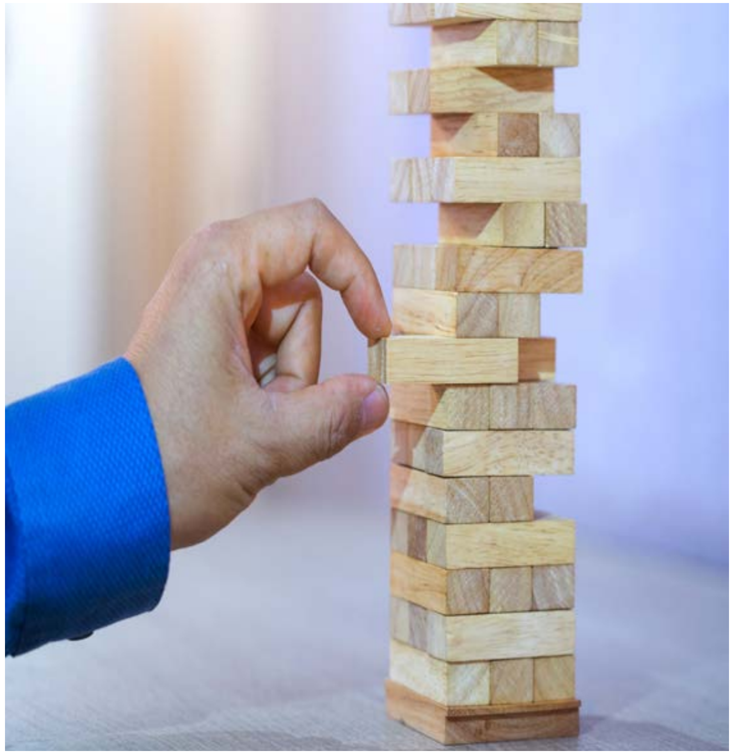
10

Potential Tax Advantages

Where a captive obtains favorable tax treatment, the Parent Company should be allowed to deduct the premiums it pays to its wholly owned captive subsidiary as a normal business expense. At the same time, the captive may be able to place all, or most, of the received premiums into a loss reserve which may defer the timing of the payment of taxes. While this is only a timing difference for federal taxes, it is a permanent savings for state taxes;

But It Is Not All Rainbows & Unicorns – Some Disadvantages

- The risk(s) to be insured may be inappropriate for retention;
- Poor early loss experience may bankrupt a captive
- Potential for inadequate loss reserves;
- The program requires an up-front capital investment;
- Lost opportunity cost of capital;
- Frictional costs;
- Increased regulatory oversight;
- Increased management oversight;
- Increased exposure to volatility;
- Closure strategies can be lengthy and complex.



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Cut To The Chase – How Dow We Save $$ With a Captive?

Premium

- Replace open market layers with a captive to save premium dollars which would otherwise be paid away to the retail market;
- Increase deductibles on the current programs to push markets higher into the program and obtain a premium discount;
- Use the captive to access reinsurance markets for either lower premiums, broader cover or provide capacity;
- Premiums for the captive policies are based on the captive parent's own losses and are *not influenced* by market conditions.

Conditions

- Use the captive to provide coverage for risks which may be excluded by the carrier. This is not a hard dollar item, but the cover provided is the cover required.

Tax

- Some tax savings may be available from the tax deduction acceleration.

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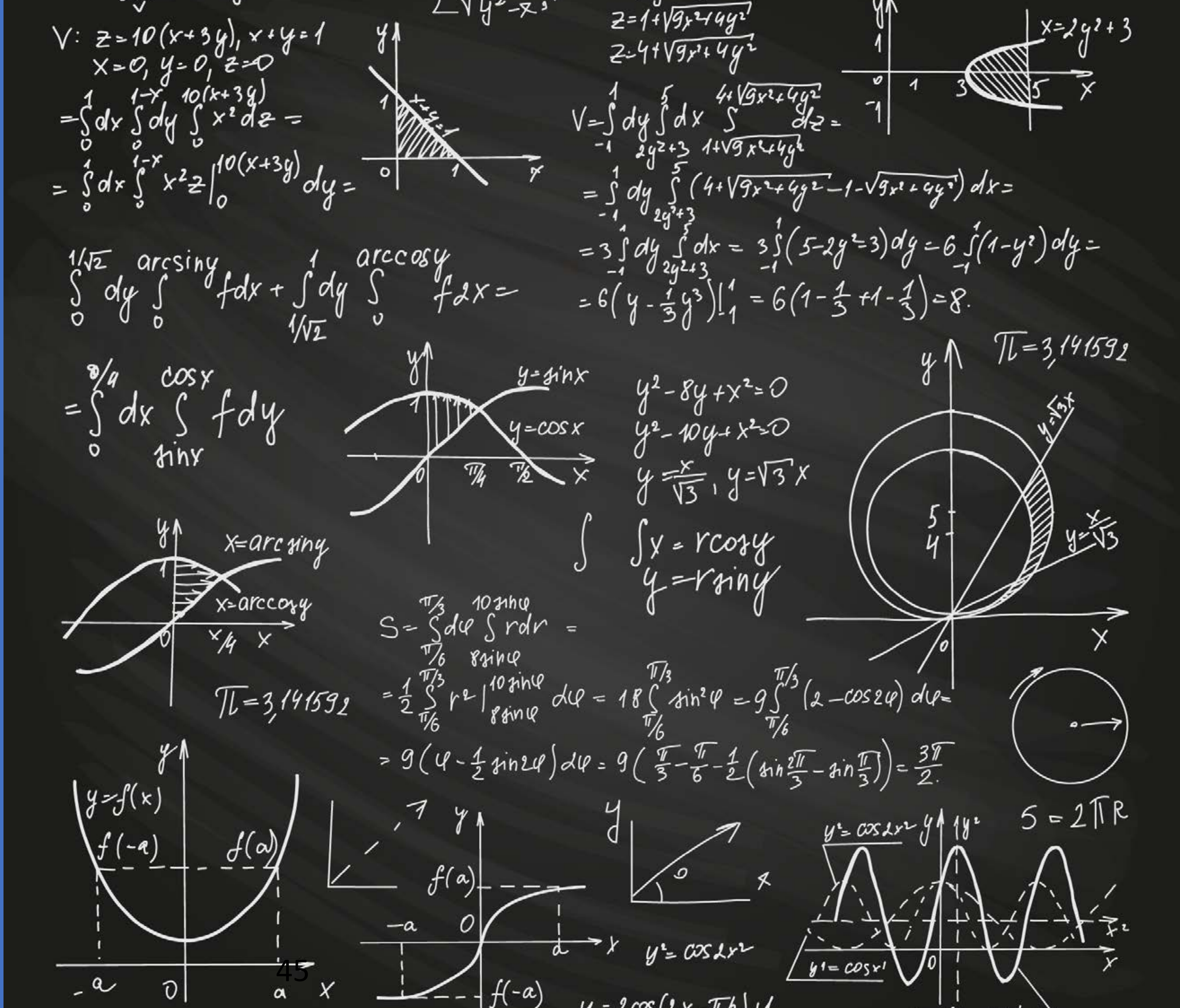
What Is Next?

Doing the Math…..

The Captive Feasibility Study



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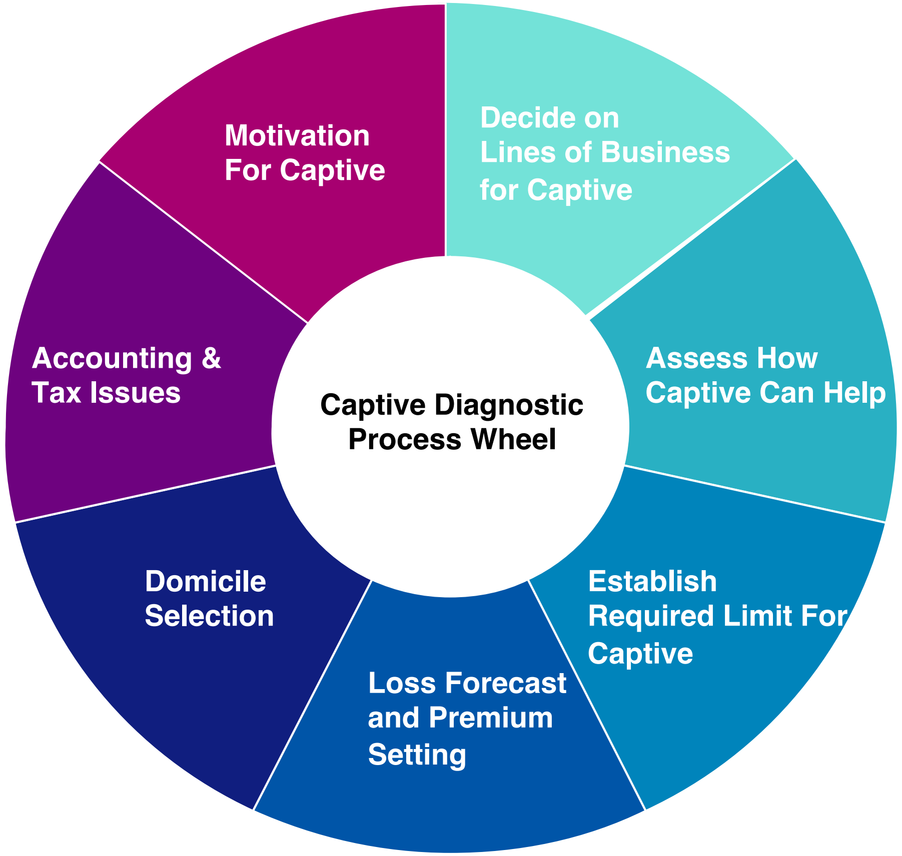
The Captive Feasibility Study

- The study process is designed to formally ask and then formally answer the key questions which need to be identified and documented for both the captive owner and for regulatory purposes.

- The captive feasibility study process will identify the value a captive can deliver to the captive owner as a risk financing mechanism.

- The study will assess and recommend an effective captive program structure and provide reasoned recommendations on domicile, capitalization, expected losses and expected investment returns.

- The study will provide financial pro forma financial statements to be used to assess the viability of the captive over a 5-year period. These are also used to form the basis of the business plan and incorporation documents in the chosen domicile.



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The Captive Feasibility Study Process and Timeline

Step I

Define business objectives and assess initial viability

1. Discuss the fit between business objectives and captives
2. Collect relevant information
3. Review the current profitability of the selected lines of insurance
4. Determine the appropriate lines to consider for the captive

Step II

Analysis of insurance program and identify opportunities

1. Assess the captive's opportunity to participate in the risk management program
2. Forecasting retained loss costs for those lines under consideration

Step III

Creating the feasibility study output

1. Perform a robust cost benefit analysis
2. Review of multiple alternative domiciles
3. Prepare financial statements for regulatory submission
4. Establish capital requirements

Actuarial work needed

2-3 Weeks

4-6 Weeks

7-8 Weeks

Kick off meeting

Report Delivery

Decision to Form

Financial Pro Forma

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Typical Capital Requirements

- **Minimum Capitalization**
  - Each regulator will have its own requirements for determining the adequacy of capital funding in a captive. However, typical capital requirements can be summarized as follows:

	Premium	to	Capital
Short Tail Risk	$2	:	$1
Medium Tail Risk	$3	:	$1
Long Tail Risk	$5	:	$1
Mixed Risk	$4	:	$1

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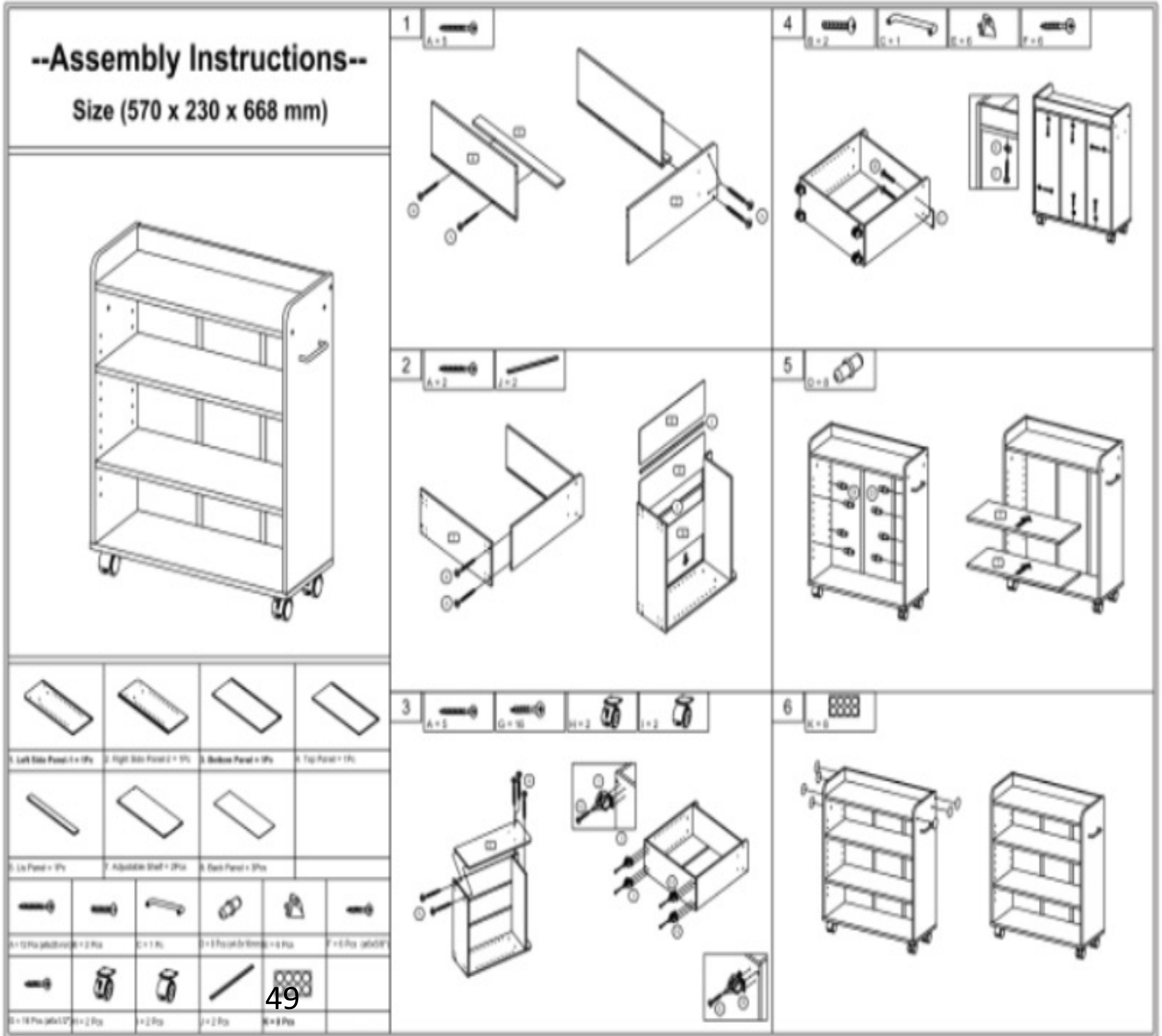
What Is the Process to Form A Captive?



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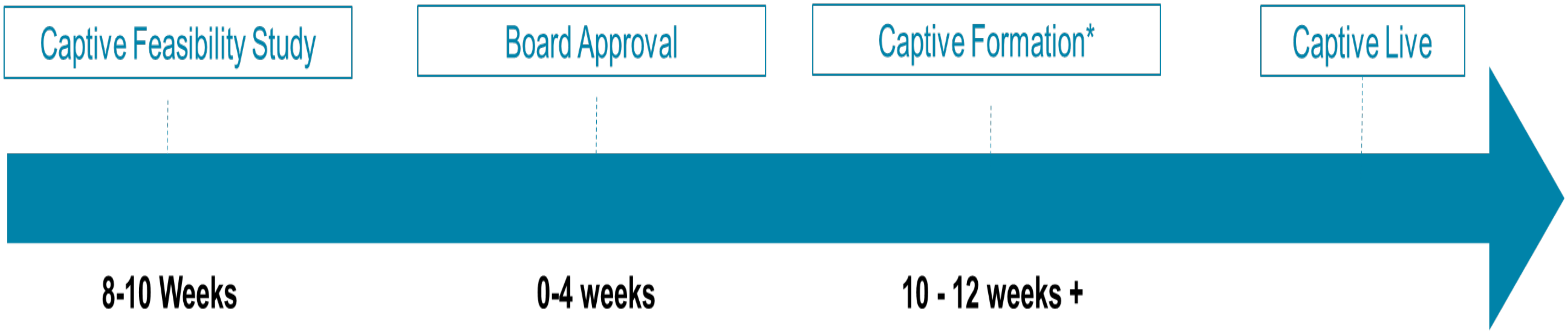
Establishing A Captive – Typical Timeline



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Key Milestones (Get Your Spectacles On!)

- Using the feasibility study as basis for the business plan to be filed with the domicile Regulator
- Decide Name for Captive;
- Nominate Captive's Board of Directors;
- Biographical affidavits / background checks
- Determine form of organization for captive (C- Corp)
- Select service providers
  - Captive Manager
  - Auditor
  - Legal counsel for captive formation
  - Tax
  - Actuary
  - Bank
- Establish were on the Parent's organization chart the new captive should be placed
- Establish tax status for the captive and tax issues such as Self Procurement Tax;
- Establish local Registered Agent
- Meet with Captive Regulator
- Provide summary of loss prevention plans / Risk Mgt plans
- Establish claims handling procedure
- Establish accounting frequency and timelines & fiscal year end for the captive
- Establish investment guidelines for captive
- Create Articles and By-Laws for formation
- Submit full application for review and approval by Regulator
- Obtain FEIN
- Open bank accounts
- Capitalize captive
- Certificate of Authorization issued
- Draft policy language
- Commence captive operations

A Word About Tax

- **To qualify as an insurance company the captive must be a bona fide insurance company with a clear business plan. The IRS does not define insurance, but does look for:**

- **Risk Shifting**
  - **Moving the risk from one balance sheet to another**

- **Risk Distribution**
- **Law of large numbers**
- **Arms Length Transactions**
- **No Parental Guarantees**
- ***The single most difficult obstacle to achieve in captive insurance***

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A Word About Tax

- The IRS Revenue Rulings attempt to create safe harbors that ensure risk shifting and risk distribution.

- There is additional case law that gives further guidance on qualification thresholds for the insurance company tax treatment for captives.

- The IRS will want to ensure that a captive taking a tax position adheres to many qualifications, including:

  - A valid non-tax business purpose;
  - Adequate capitalization;
  - No parental support agreements;
  - Limited loan backs of captive assets to parents or affiliates
  - Formation in well-regulated domiciles; and
  - Operation on an arm’s length basis (similar to commercial insurers).

Risk Distribution – Route One – Third Party Business

Safe Harbor – 50%
Rev. Rulings 2002-89, 92-93
(Employee Benefits = Unrelated Risk)

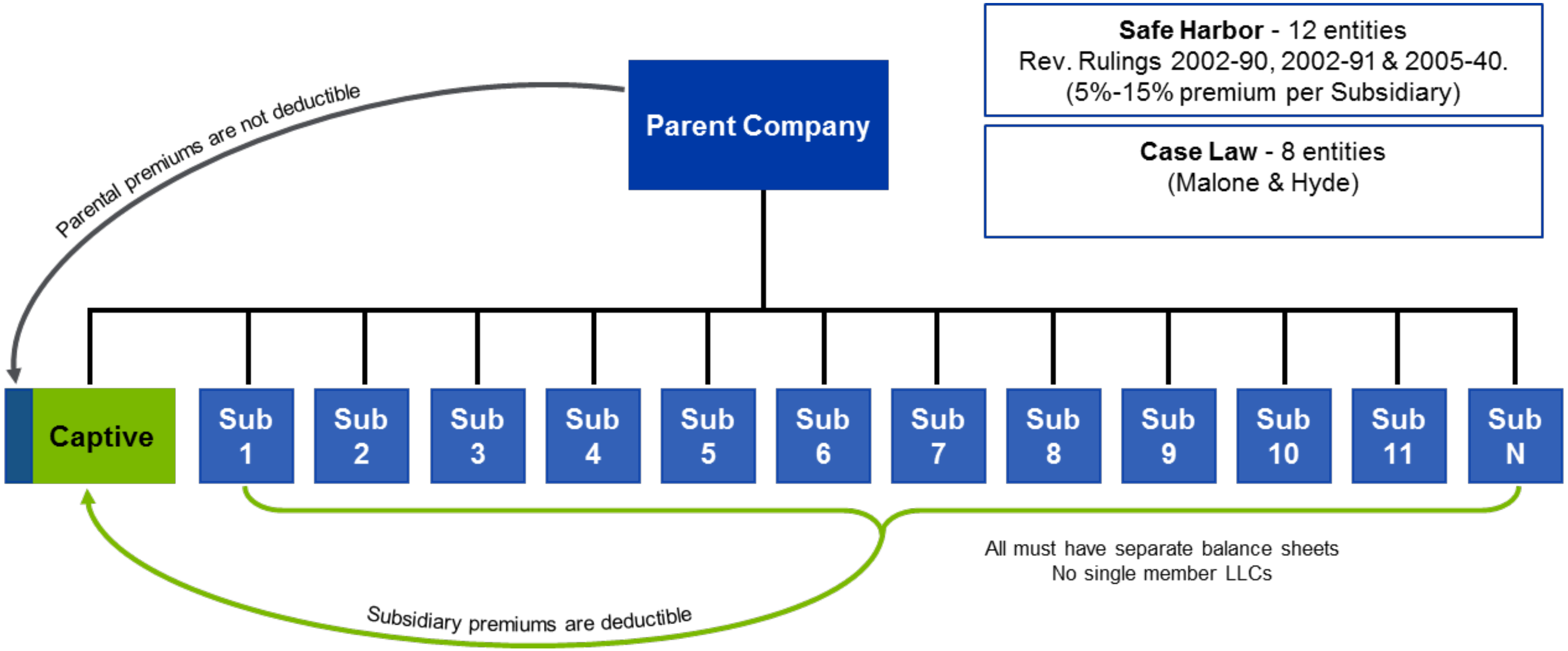
Case Law – 29%
(The Harper Group)

A distinguishing feature of an insurance company is the writing of insurance business that is unrelated to the owners of the captive

Unrelated Risk can be sourced through

- Controlled or affiliated business e.g. employee benefits are considered “unrelated” yet the insured is your employee;
- Third parties either indirectly through “pooling” mechanisms, or directly with individuals;
- Insurance programs sold to third parties (Renters Insurance / Extended Warranty etc.)

Risk Distribution – Route Two – Brother Sister Approach



Where a separate tax-paying subsidiary of the parent transfers the risk to a captive that is also a subsidiary then this **does qualify** as risk transfer (because the balance sheet of the captive is not consolidated with the other insured subsidiaries).

Oh Yeah – And Don't Forget Self Procurement Tax!

- **This US tax is imposed on directly procured non-admitted insurance i.e., it is applied where "foreign or alien" insurers are providing insurance to local insureds.**

- **Under the Non-Admitted & Reinsurance Reform Act ("NRRA") – where it applies – this tax is collectable only by the "Home State" of the insured, typically the principal place of business of the insured US organization.**

- **If there is no nexus of exposure in that State, then it would be payable to the State with the largest concentration of exposure.**

- **This tax ultimately drives up the cost of buying insurance and applies to insurance obtained from an out-of-state captive insurer.**

- **This tax varies by state and can range between 0.5% and 6% percent of gross premiums paid.**

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Formation & Management

There Are Lots of Moving Parts!

Who Does What?

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Captive Formation Division of Labor

Captive Owner

- Meet with captive regulators (virtual)
- Select captive name
- Determine legal form of captive (Inc., LLC, etc.)
- Determine Directors & Officers and prepare biographical affidavits
- Appoint Captive Manager
- Appoint registered agent
- Select captive financial year-end
- Select basis of accounting Provide 10k or financial statements
- Provide risk management/safety program information
- Open bank account & fund captive with capital

Captive Manager

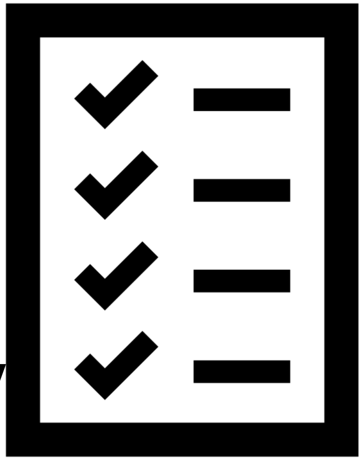
- Arrange and attend meeting with regulators
- Prepare & submit captive application package
- Obtain proposals for other captive services providers (audit, tax, actuarial, legal)
- Assist with preparing investment policy

Legal Counsel

- Reserve captive name with Secretary of State
- Draft organizational documents (Articles of incorporation/bylaws)
- Petition for Certificate of Public Good upon submission of application
- Obtain FEIN
- Prepare organizational consent
- Issue stock certificates

What is in the Application?

- Captive Application form for selected domicile
- Draft Articles of Incorporation and Bylaws
- Captive Business Plan
- Biographical Affidavits for captive Directors & Officers
- Actuarial & Captive Feasibility Study
- Projected 5 Year Financial Statements (prepared in feasibility study)
- Loss Prevention and Safety Program Information
- Statement of Benefit to domicile
- Parent Company Information



What Does The Captive Owner Have To Do?

Captive Directors & Officers

The number of captive Board members is specified in the captive’s bylaws. Standard practice is a minimum of 3 Directors with option of more.

The required Officer positions of a captive is dictated by the domicile captive statutes. Most domiciles require:

- President
- Secretary
- Treasurer

Other Officers can be added at the company's discretion. Other common positions include Vice President(s) and Assistant Secretary.

One Director must be resident in the state of domicile. If none of Captive Owner ’s employees that will serve on the Board are physically located in the domicile, an individual from the Captive Manager or local legal counsel can be appointed to serve as a local Director and/or Officer.

Managing The Service Providers!

Auditor

- Annual audit is required by local regulation
- Current audit services at the parent level may be extended to the captive
- Most large multinational firms have a presence in major captive domiciles

Captive Manager

- Financial Accounting/Management
- Insurance Services
- Compliance Services
- Cash Management
- Board Meeting Services

Actuary

- Engagement of a loss reserve specialist in respect of the captive's loss and loss expense provisions is mandatory in most jurisdictions

Captive

Investment Manager

- Long-term and more aggressive investment strategies should be developed by a professional investment manager
- Management of short-term investments can be provided by the Captive Manager or in-house

Claims Management

- A captive is required to manage claims that occur within its share of retained risk
- Depending on volume & complexity, this is usually outsourced to a TPA

Fronting and Partner Insurer(s)

(if applicable)

- A fronting insurer may be required to issue a local policy where legislation requires it

Legal Counsel

- Incorporation and regulatory support
- Ongoing legal and secretarial support

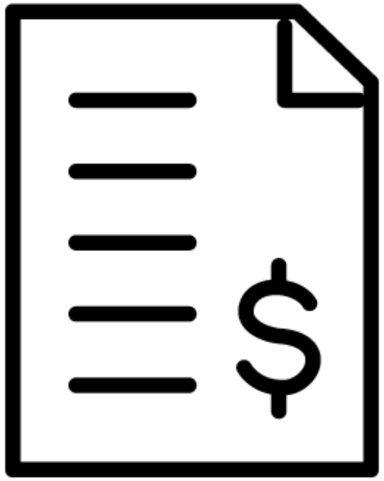
Captive Is Now Operational!

Into the Weeds – Captive Financials What is Provided?

- Provision of management accounts (monthly, quarterly, semi-annual, annual)
- A comparison against budget and other specifically requested schedules such as investment details, and underwriting and claims information
- Management commentary highlighting any significant items in the financial statements, budget variances, statutory compliance issues, etc.
- Oversight and management of a timely and successful annual audit in conjunction with the captive's auditors
- Effective management of operations and assets
- Handling all correspondence in relation to the captive's continuing business

Into the Weeds – Insurance Policy Matters

- Preparation and issuance of policies and endorsements to ensure suitability within the overall risk financing objectives
- Preparation and issuance of certificates of insurance where required by the captive
- Assistance with claims history requests
- Liaison with the captive’s insurance brokers to ensure its efficient use as a core part of the risk management program
- Collaboration with the captive’s brokers to structure and place any required reinsurance program behind the captive
- Coordination with the appointed actuaries for the captive
- Maintenance, reporting and analysis of underwriting and claims statistical records
- Underwriting functions such as captive premium recommendation and allocation



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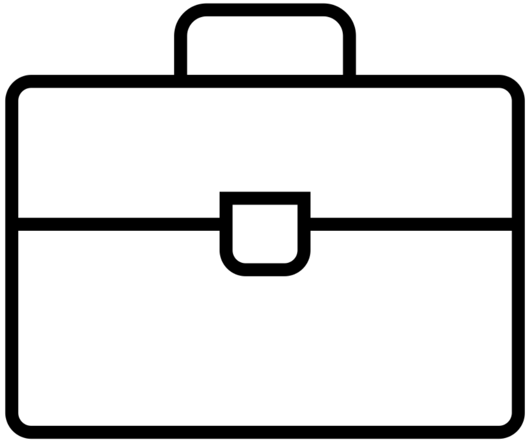
Into the Weeds – Regulatory & Compliance

The Captive Manager is responsible for ensuring regulatory compliance. They will act as the principal representative for the captive as set out under the provisions of the laws of the various domiciles and fulfill the following duties:

- Maintain principal place of business in the domicile, if required;
- Monitor the captive’s compliance with insurance regulations and requirements contain in the applicable laws and, if necessary, make recommendations as to corrective action
- Prepare, coordinate and submit the annual filings as required by laws and regulations
- Arrange for the payment of appropriate local government fees
- Prepare and submit business plan amendments for regulatory approval, including the addition of new covers, changes in limits, rotation of directors, etc.
- Liaise with the captive’s appointed attorneys and auditors



Into the Weeds – The Annual Board Meeting

Services for the annual Board meeting, include:

- Preparation of a comprehensive Board book of agenda items and supporting materials including
  - - Prior minutes for ratification
  - - Interim and audited financial reports for review and acceptance
  - - Underwriting reports
  - - Claims reviews
  - - Actuarial summaries
  - - Investment reports
  - - Management Company Report including:
    - ➢ legislative, accounting and general insurance industry updates and regulatory compliance checklists
  - -Special items for consideration by the Board,
- As necessary, the Captive Manager can act as the captive's Secretary and prepare necessary resolutions and actions of the shareholder and the Board of Directors

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What If You Already Have a Captive

Keeping the Captive Up To Date and Relevant

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The Captive Utilization Review

Captives are complex vehicles designed to help businesses meet their risk financing objectives.

To accomplish this, a captive must respond to emerging and evolving insurance needs and be aligned with the corporate strategic and operational objectives.

A captive utilization review is designed to ensure the captive is being utilized optimally in support of the Parent Company's risk financing goals.

A utilization review is particularly well-suited to captives that have been in existence for several years, particularly where there has been program stability and where service providers have remained static.

In addition, a review should be considered whenever there are material developments to the Parent's business profile (rapid growth, significant acquisitions or divestitures or changes in business direction) or when the insurance market cycle changes.

Key Items To Review To Keep Your Captive On Track

- **Captive strategic rationale** – an examination of strategic approach, to the extent that it has changed over the life of the captive and how compatible it is with the Parent Company's current objectives.
- **Insurance market conditions** – an overview of current market conditions, designed to identify particular issues that are likely to impact the role or performance of the captive, and to consider the extent to which the captive is positioned to respond.
- **(Re)Insurance program review** – a high-level review of the current (re)insurance program, outlining opportunities for alternative classes and structures.
- **Benchmarked financial performance** – a comparison of financial performance of the captive against captive benchmark standards.
- **Domicile consideration** – an assessment as to whether the current domicile remains appropriate.
- **Corporate governance** – a review to ensure the captive has met with domicile rules and regulations and to identify issues that may need to be addressed.
- **Upcoming regulatory issues** – a review to identify, as applicable, impending changes to rules and regulations that will impact the captive, and comment on its readiness for these changes.

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Bonus Section – Current Developments In The Captive Market

New Developments & Opportunities

1.) Property is Number One With a Bullet!

Real Estate Owners / Managers are seeing real opportunities by taking on more risk in captives in light of the continually increasing property market rates.

Private Equity Firms are now starting to put their toes in the water to look at captives as a viable way to finance the risk for their portfolio companies. This has been a very slow burn, and the charge is being led by real estate private equity specialists as well as REITS.

All clients with significant property towers and especially those with Cat exposed risk.

2.) High Level Excess / Umbrella Layers – Overpriced layers which are out of sync with the rest of the tower are being replaced by captives. Similarly, where there is no capacity for the high layer – captives are being used to plug the gaps.

3.) Increased Interest In Getting Captives Rated – This is being driven by the Parent Companies realizing that the captive is the way to go but then they bump up against the need to evidence certificates of insurance on rated paper. – This has resulted in an increase in interest in getting the captive rated to help reduce collateral and generate competitive opportunities.

4.) International Benefits – Being driven by the need to show better ESG credentials. The captive is helping companies level the playing field for all employees to receive the same level of benefits worldwide and deals with the "S" part of ESG – especially in regard to reproductive rights and spousal rights.

New Developments & Opportunities

5.) Cyber – To provide additional cover at the top of the cyber insurance tower or to fill gaps.

6.) Medical Stop Loss – Continues to be a very popular line to include into a captive for those clients with good loss experience.

7.) Third Party Business – Saving money is good – but using the captive to make money is better! – Lines include Extended Warranty / Renters Insurance / Homeowners and even Auto bundles are now being discussed. – But tread carefully and make sure you know your policyholders well!

New Obstacles & Issues

1.) High Prices and Reduced Capacity – This is the theme for every renewal discussion. – If you want to save money – Simple!!! - don't buy insurance. – **BUT** do it in a controlled manner by using a captive to give you discipline.

2.) The General Post Covid Malaise – It seems that post Covid, there is a great sense of malaise worldwide.

- The great resignation
- The sudden realization! (that it was a really bad idea!!)
- Violent crime is up
- Inflation is up
- Interest rates are up
- Real wages are down
- Industrial unrest is on the increase globally

This leads to industrial action and class actions for Wage and Hour which has always been an expensive insurance to buy. Employers are looking to their captives as a way to provide more reasonably priced cover for this risk. It also makes good business sense!

3.) Political Risk – Geopolitical unrest / Domestic political unrest – This is being seen in countries which previously had never demonstrated this level of political violence in post war years.

4.) The ESG " Phony War" – Covid and financial issues allowed companies say that they had too many other existential things to worry about to focus on ESG issues. - Now thing have changed, and this "phony war" is over and a real one is starting as 2023 has already proven itself to be hottest on record and every nation is suffering. – AND they are looking for someone to blame. – Smart companies are looking at their captive as a quick fix to help reestablish their ESG credentials.

What Hard-to-Place Lines Are Being Placed in Captives?

1. Property (Cat Exposed);
2. Excess / Umbrella Casually High Layers;
3. Wildfire (US and International);
4. Employee Benefits (US);
5. D&O is still being discussed even though prices have stabilized;
6. Active Shooter Cover;
7. Reputation Repair (A developing line as ESG comes back to the top of the agenda);
8. Coal / Oil / Gas where the traditional market is retreating and the demand for fossil fuels continues;
9. Renewables (oddly enough) as the renewable energy risks are proving hard to insure!

And That Brings Us Full Circle!
You Made It !

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Questions?

THANK YOU!

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For online courses and webinars in captive insurance, visit the website of the official education program of the captive industry: www.iccie.org

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