Texas Captive Insurance Association

2024 Annual Conference

Texas Captives: Empowering Texas Business

Captive 101 – Everything You Need to Know about Captives

Allan Smith
Client Service Leader
Marsh Captive Solutions

Manuel Guerra
Senior Principal
Oliver Wyman

Captive 101

This session provides a foundational overview of captive insurance, including what captives are, how they operate, and their benefits. It covers the fundamentals of how to evaluate what may be good risks to put into a captive and what to consider when thinking about various coverage lines.

Attendees will gain insights into the regulatory landscape, common structures, and the strategic considerations for choosing a captive as a risk financing tool.

This is intended for newcomers to the captive insurance space, this session sets the stage for deeper exploration of this alternative risk management strategy.

Captive 101 – What is a Captive?

TxCIA
Texas Captive Insurance Association

Captive 101 – Various Captive Types

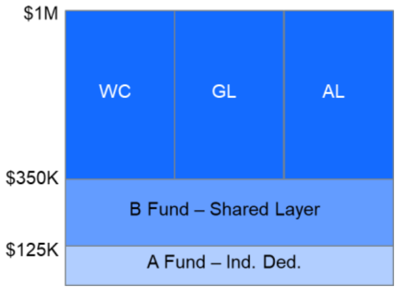
Group / Association Captive

- Columbus
- Fleet Solutions
- Resolute
- RightPath

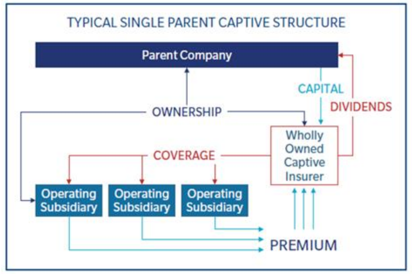
Pure Captive

- Single Parent
- Agency Captive
- Risk Retention Group

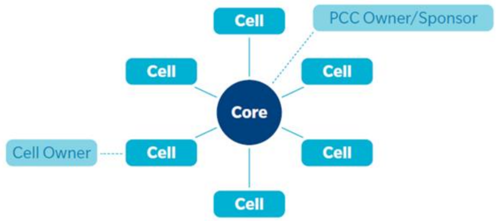
- Traditional Captive
- Branch Captive
- Protected Cell Captive



Typical Group Captive

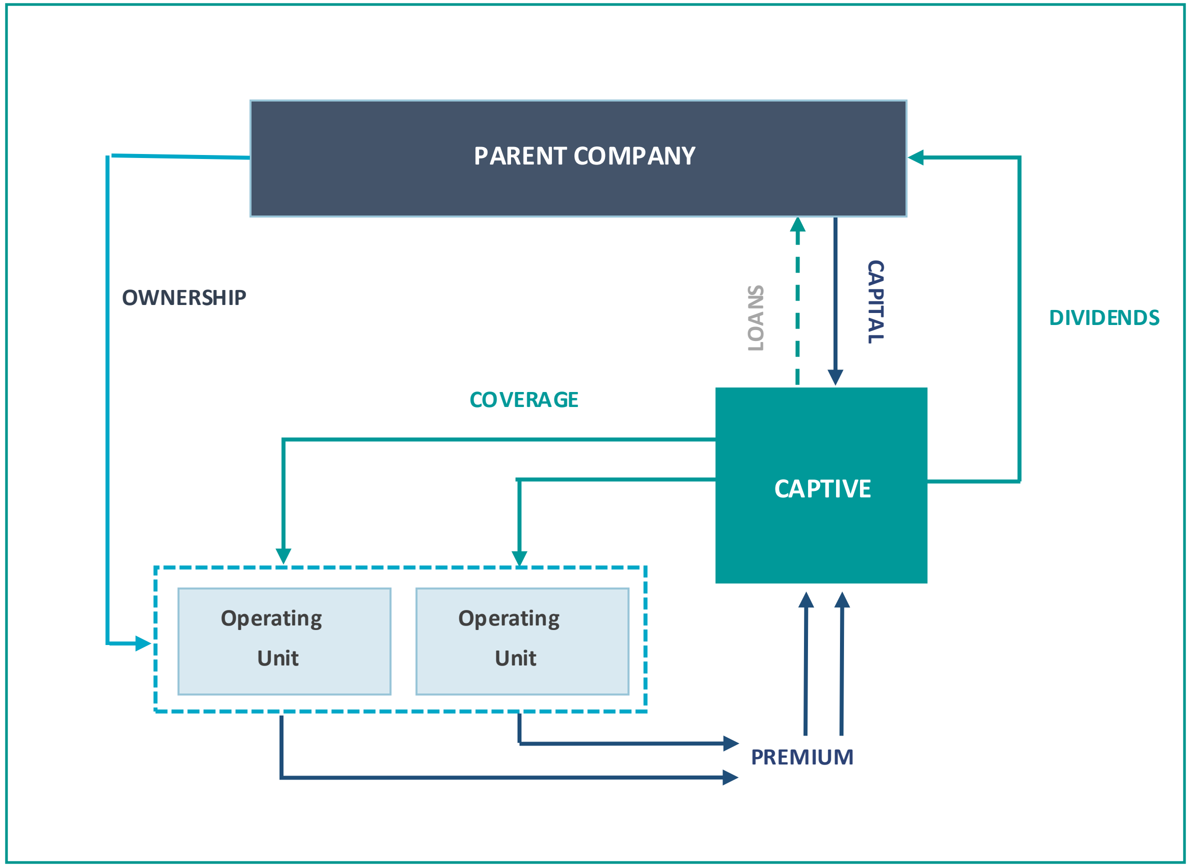


Typical Pure Captive



Texas Captive Insurance Association

Captive 101 – Sample Pure Captive



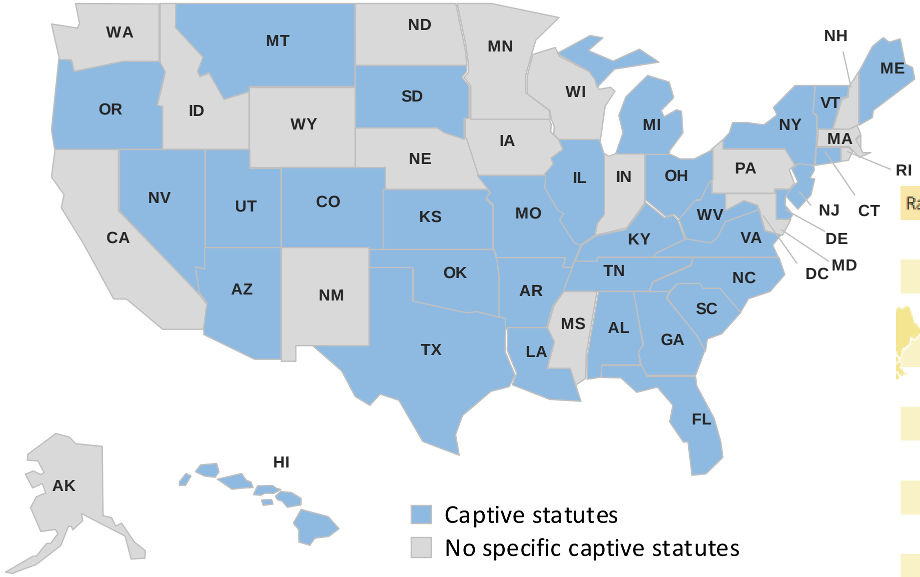
Characteristics of a Captive:

- 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 its state of domicile.
- Regulated under special captive legislation.
- May be located onshore or offshore.
- Can **access reinsurers** on a direct basis to obtain needed insurance capacity.

TxCIA Texas Captive Insurance Association

Captive 101 – Domestic and Global Stats

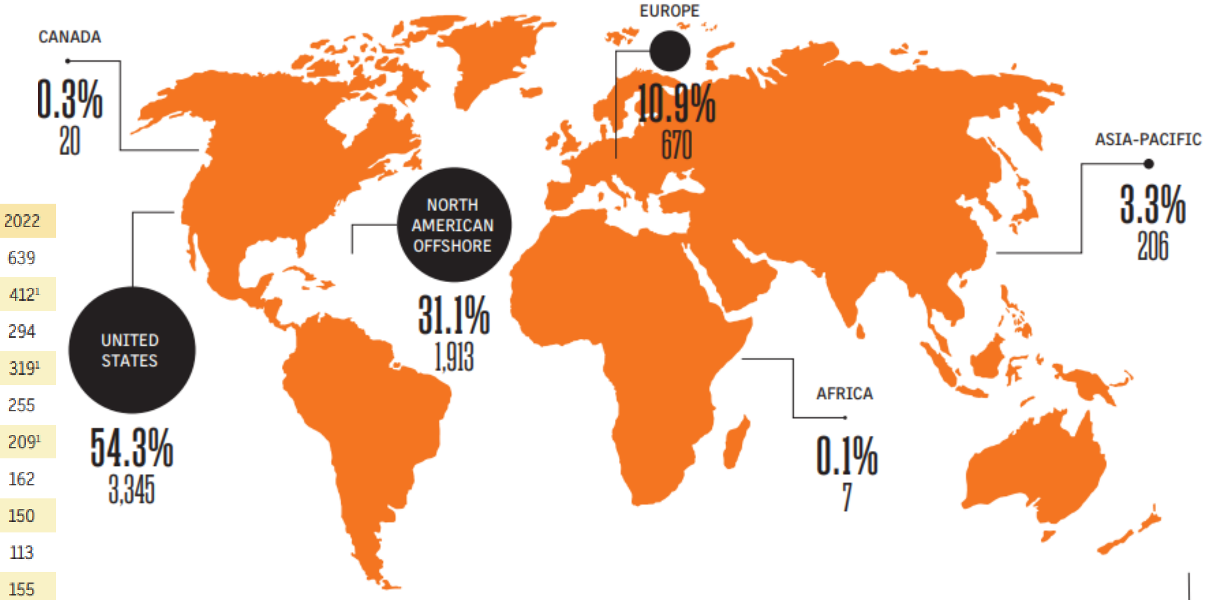
•Source: Business Insurance, 2024 Captive Managers & Domiciles, Rankings + Directory: 6 and governmental websites.



Rank	Domicile	2023	2022
1	Vermont	659	639
2	Utah	439	412[1]
3	North Carolina	311	294
4	Delaware	289	319[1]
5	Hawaii	263	255
6	South Carolina	221	209[1]
7	Arizona	176	162
8	Tennessee	162	150
9	District of Columbia	120	113
10	Nevada	100	155

[1]Restated
Source: *BI* survey

There were 6,161 captives in 2023, not including microcaptives, series captives or individual cells of cell members in protected cell companies.



Percentage of total captives per region

Domicile	Captives	Domicile	Captives	Domicile	Captives	Domicile	Captives
Alabama	54	Georgia	57	Nebraska	4	S. Dakota	15
Arizona	176	Hawaii	263	Nevada	100	Tennessee	162
Arkansas	16	Illinois	2	New Jersey	20	Texas	79
Colorado	6	Kansas	1	New York	37	USVI	1
Connecticut	53	Kentucky	32	N. Carolina	311	Utah	439
Delaware	289	Louisiana	0	Oklahoma	56	Vermont	659
Wash., D.C.	120	Maine	3	Ohio	8	Virginia	0
Florida	0	Michigan	26	Oregon	0	W. Virginia	1
		Missouri	54	Rhode Island	0		
		Montana	100	S. Carolina	221		

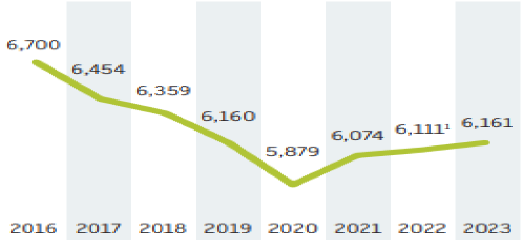
TOP NORTH AMERICAN OFFSHORE CAPTIVE DOMICILES

Ranked by number of captives licensed at year-end 2023

Rank	Domicile	2023	2022
1	Cayman Islands	658[1]	642[1]
2	Bermuda	633[2]	633[1,3]
3	Barbados	267	261[3]
4	Nevis	94	102
5	Turks & Caicos Islands	74	71

[1]From website [2]*BI* estimate [3]Restated
Source: *BI* survey

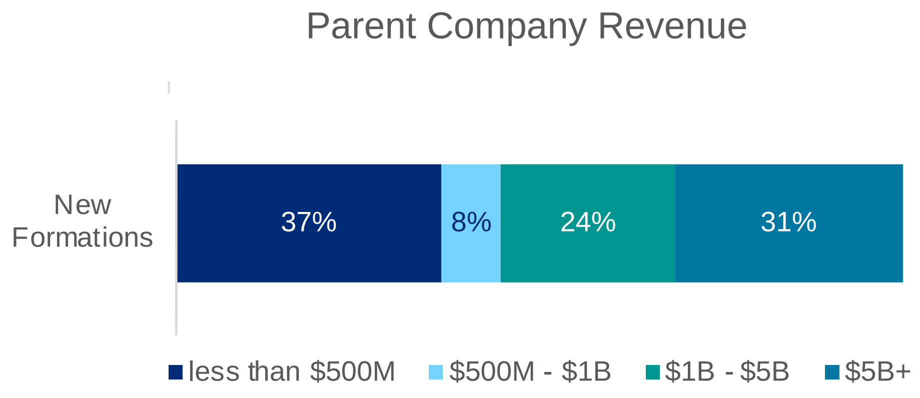
TOTAL CAPTIVES WORLDWIDE

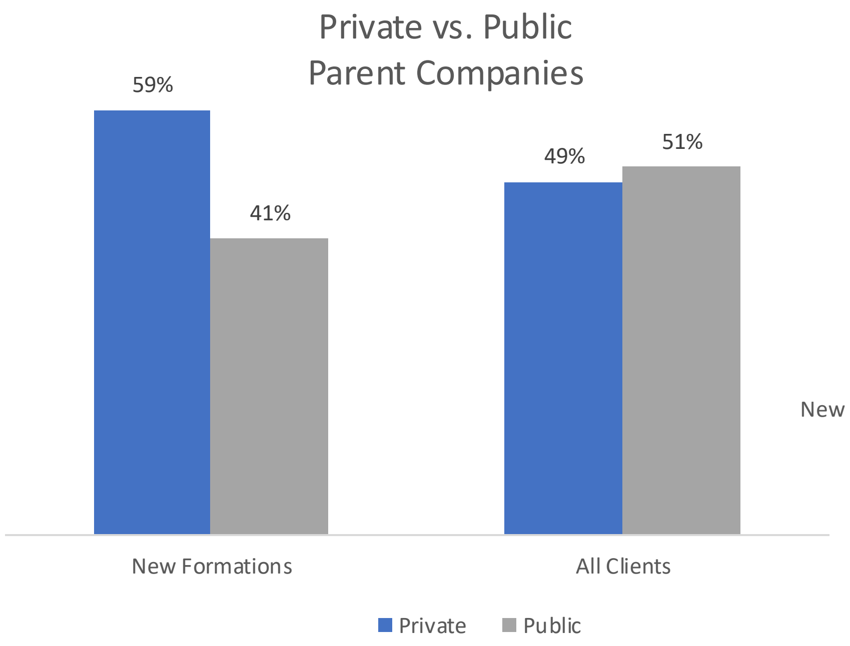


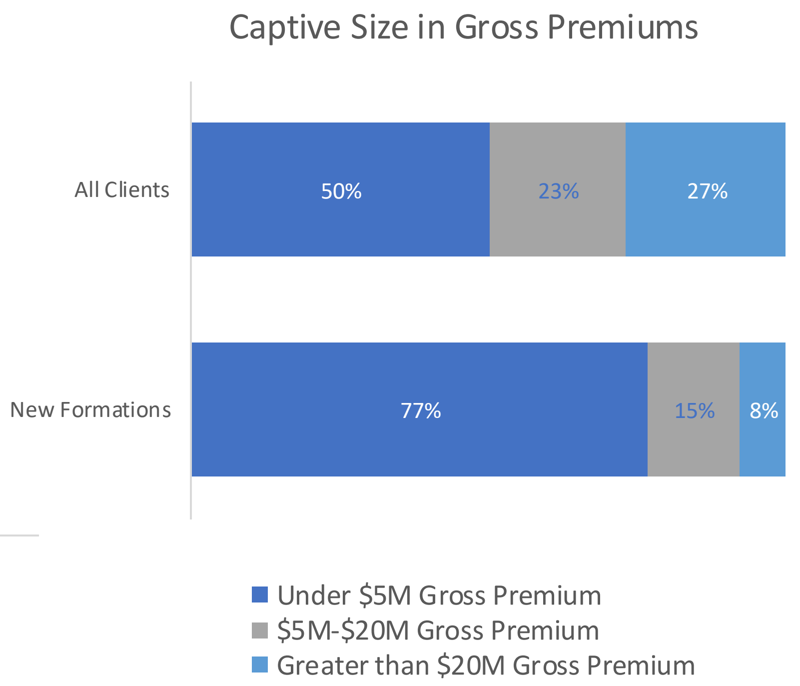
[1]Restated
Source: *BI* survey

TxCIA
Texas Captive Insurance Association

Captive 101 – Who are Forming Captives

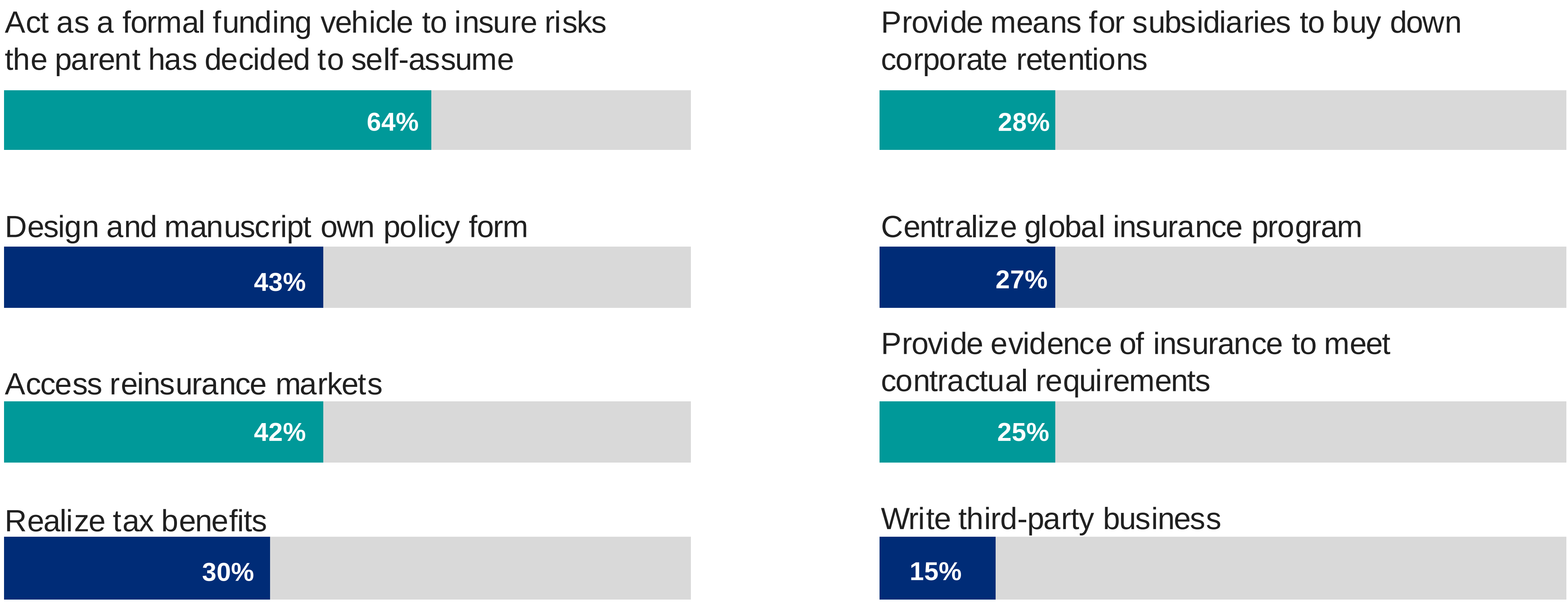






- Percentage is based on Marsh’s clients of newly formed captives ~200

Captive 101 – Value to Captive Owners



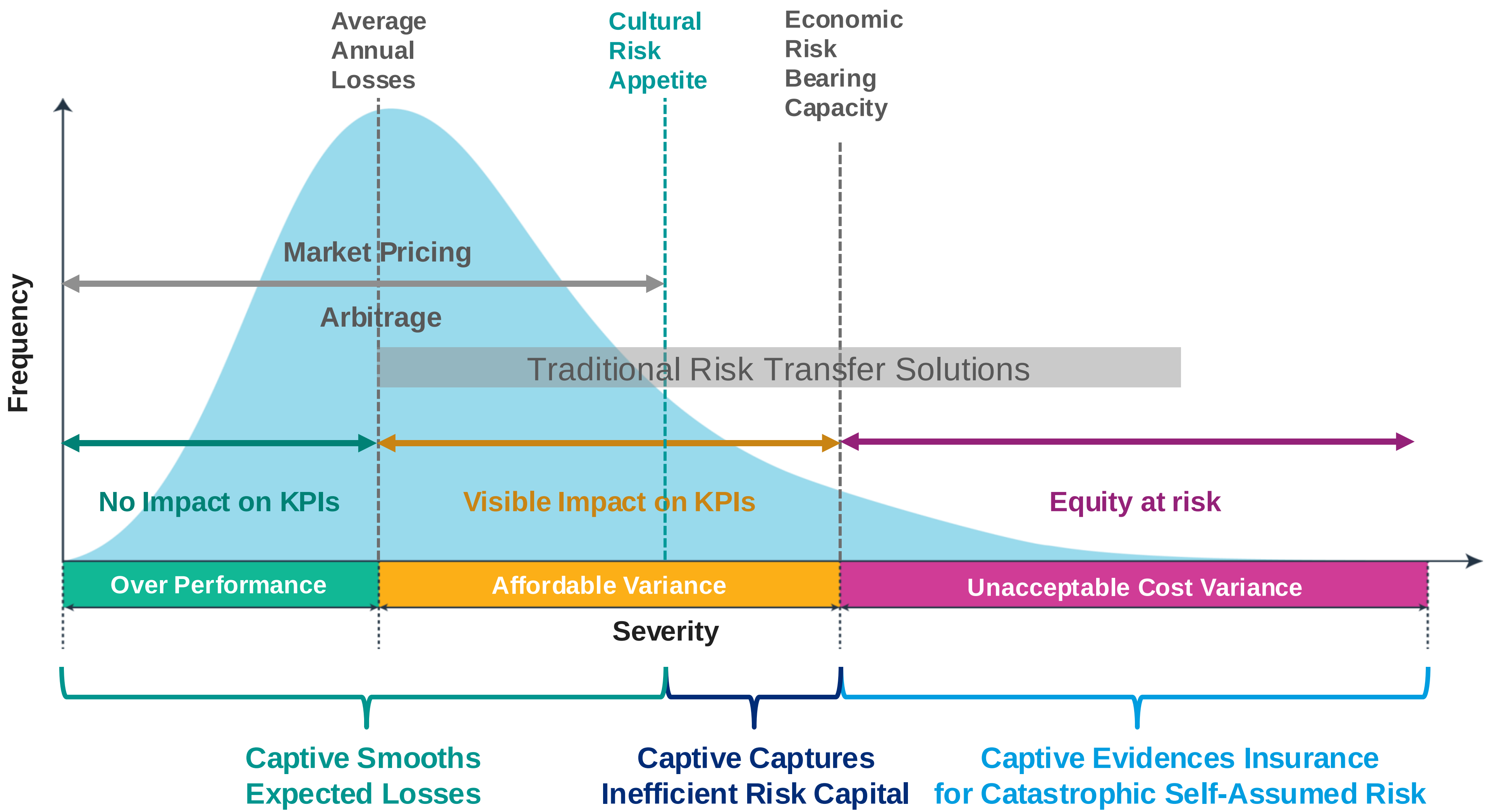
Texas Captive Insurance Association

Captive 101 – Marsh Premium Growth by Industry

	2020 Gross Written Premium in USD	2024 Gross Written Premium in USD	% Change in Premium
Agriculture & Fisheries	0.21 B	0.96 B	357%
Automotive	2.09 B	2.80 B	34%
Aviation, Aerospace & Space	0.41 B	2.20 B	437%
Chemical	0.39 B	0.62 B	59%
Communications, Media & Technology	6.35 B	8.20 B	29%
Construction	0.51 B	0.57 B	12%
Education	0.29 B	0.18 B	-38%
Energy	1.72 B	1.90 B	10%
Financial Institutions	28.12 B	25.20 B	-10%
Food & Beverages	0.08 B	1.20 B	1438%
Health Care	2.61 B	7.40 B	184%
Hospitality & Gaming	0.20 B	0.11 B	-45%
Life Sciences	1.42 B	1.10 B	-23%
Manufacturing	1.93 B	2.10 B	9%
Marine	0.64 B	1.10 B	72%
Mining, Metals & Minerals	0.61 B	0.62 B	2%
Power & Utility	0.91 B	1.20 B	32%
Public Entity & Not For Profit	0.14 B	0.03 B	-79%
Real Estate	0.11 B	0.21 B	91%
Retail/Wholesale	2.88 B	5.00 B	74%
Sports, Entertainment & Events	0.25 B	0.25 B	0%
Transportation	0.19 B	1.00 B	426%

TxCIA
Texas Captive Insurance Association

Captive 101 – Sweet Spot for Economic Savings



TxCIA
Texas Captive Insurance Association

Captive 101 – Typical Captive Coverages

Retained Risks:

- Property Ded. (AOP & DIC)
- Casualty Ded. (GL, AL, WC)
- FinPro Ded. (D&O, EPLI, Cyber)
- Supply Chain Ded.
- Business Interruption W.P.
- Product Recall
- Mfg. Warranties

Policy Exclusions / Sublimits:

- Mold / Asbestos / Lead
- High Hazard Cat (EQ / Flood / Wind)
- Professional Liability

Reinsurance Access:

- Medical Stop Loss
- Property Tower Participation
- Integrated Risk Programs
- Insurance Linked Securities

Uninsured Risks:

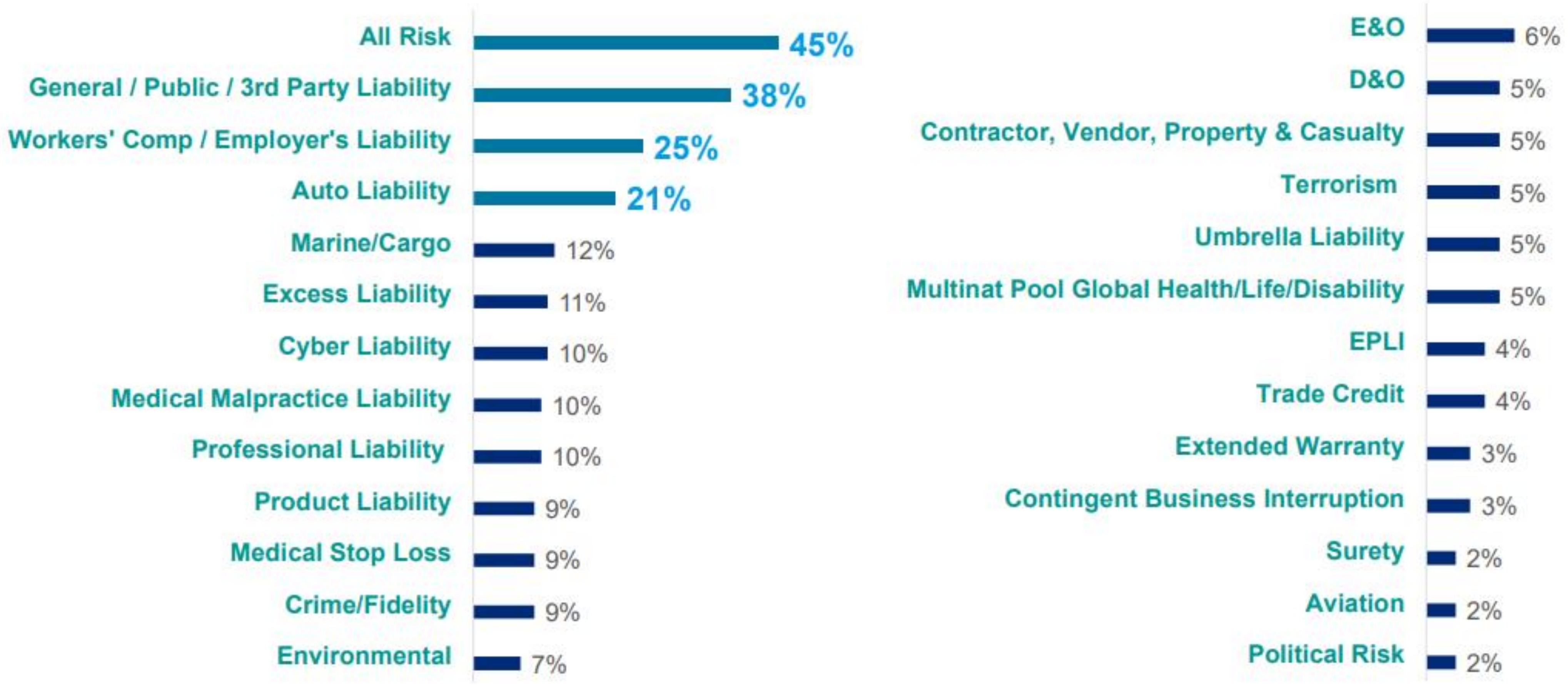
- Wage and Hour Liability
- Trade Credit
- Intellectual Property
- Weather Parametric
- Contractual Liability
- Legal Defense Expenses
- Terrorism / NCBR / Active Shooter
- Auto Physical Damage
- Pandemic / Contagious Disease B.I.

Third Party Risks:

- Cyber Breach Protection
- Customer Auto Liability
- Extended Warranties
- Voluntary Employee Benefits
- Travel Insurance
- Vendor Product Recall Insurance

TxCIA
Texas Captive Insurance Association

Captive 101 – What are Captive Writing?



TxCIA
Texas Captive Insurance Association

Captive 101 – Actuarial Support for Captives

The growth of captives has drawn increased scrutiny from regulators and tax authorities. Actuaries can provide captives with actuarial support and analytics to substantiate the captive's actions, thereby allowing the captive to continue to provide value to the parent company. There are general four key actuarial studies as part of the standard operations of the captive.

1. Loss Reserving

- Analysis of retained unpaid loss and LAE reserves, including IBNR
- Projections for the upcoming year based on historical results and projected exposures
- Statement of Actuarial Opinion

2. Pricing

- Pricing indication including reasonable range based on captive's historical experience supplemented with industry information
- Individual estimates for:
  - ✓ Expected loss
  - ✓ Required capital with return
  - ✓ Expense

3. Risk Transfer

- Review whether insurance program exposes captive to reasonable possibility of significant loss, specifically looking at:
  - ✓ 10-10 Test
  - ✓ ERD Test
  - ✓ Distribution of present value of captive's underwriting losses

4. Risk Distribution

- Analyze and comment on:
  - ✓ Sufficient number of risks
  - ✓ Independence of risks
  - ✓ Applicability of law of large numbers
  - ✓ Is transaction viewed as insurance

TxCIA
Texas Captive Insurance Association

Captive 101 – Actuarial Reserving Approach

01 Review of Data

- Become familiar with the Captive insurance program structure and any changes in operations, claims handling, or loss control activities over time
- Review claims data
- Compile exposure data for each line of business and compare to prior report for consistency
- Compare claims data to prior on individual claim basis for consistency

02 Derive Assumptions

- Loss and claim count development patterns
- Reporting lag pattern
- Long-term average frequency, severity and loss costs and annual trends
- Size of loss distribution, or increased limit factors
- Utilize the Captive's data to greatest extent possible and supplement with industry/other internal or external data if adds value

03 Perform Diagnostic Testing

- Consistency in:
  - Claim settlement patterns
  - Case reserve adequacy levels
  - Claim reporting patterns
- Trends in:
  - Claim cost severity
  - Large claim activity

04 Projection Methods

- Paid and incurred loss development methods
- Case loss development method
- Frequency/Severity method
- Loss cost method
- Bornhuetter-Ferguson methods

05 Test reasonability of results

- Implied ultimate loss costs, claim severity and claim frequency by policy period
- Implied incurred but not reported (IBNR) per pending claim
- Implied unpaid per pending claim
- Implied ratio of IBNR to case reserves

Captive 101 – Reserve Work and Forecasting

Are year over year loss cost trends being driven by frequency, severity, or both?

How are risk management programs impacting frequency and severity?

How are changes in the legal, social, and regulatory environments and delivery of medical care impacting your program costs?

Are losses emerging favorably compared to prior report expectations?

What are the drivers of the change in estimated unpaid losses since the prior report?

Are changes in the loss forecast related to exposure growth, long-term cost trends or changes in loss experience?

How does recent large claim activity compare to historical trends?

Have there been any changes in claim settlement rates or case reserve adequacy?

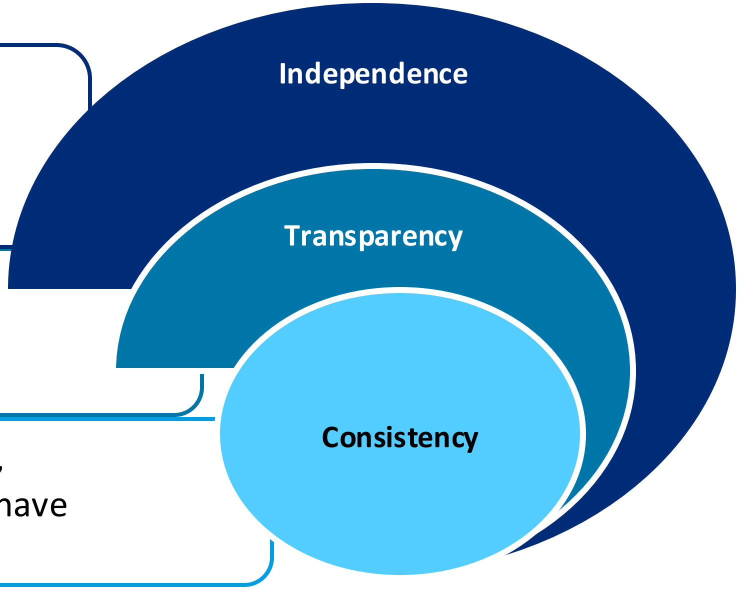
Are there particular facilities or business units that are driving changes in actuarial results?

TxCIA
Texas Captive Insurance Association

Captive 101 – Actuarial Technical Pricing

A rigorous approach that satisfies internal and external stakeholders

- Independent pricing analysis separate from broker and captive providers reflecting risk and capital associated with underwriting the exposures
- Transparent documentation using US actuarial standards of practice, including report and exhibits to be presented internally and externally (e.g. tax authority)
- Approach that is based on long term experience to estimate the true price, unaffected by the insurance market cycle, helping companies ensure they have capacity to responsibly retain the risk and fully understand the cost



Captive 101 – What are Captive Writing?

A rigorous approach that satisfies internal and external stakeholders

EXPECTED LOSS

- Rely upon historical experience
- Leverage industry loss trends as needed
- Consider cost differences such as geography, coverage, asset, etc.

VOLATILITY LOAD

- Consider reasonable capital for underwritten risks and reasonable return
  – Reasonable capital consider various tail risk scenarios and regulatory guidance (e.g. Solvency II)

NATURAL CATASTROPHE LOAD

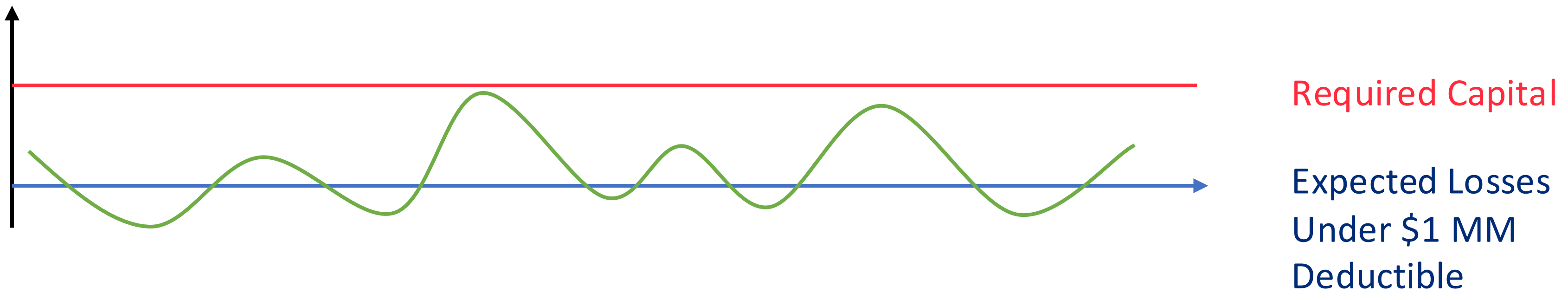
- Based on natural catastrophe modeling
- Analysis performed using models from external vendors (e.g. RMS, AIR, EQECAT)
- Reasonability check from available industry data

EXPENSE LOAD

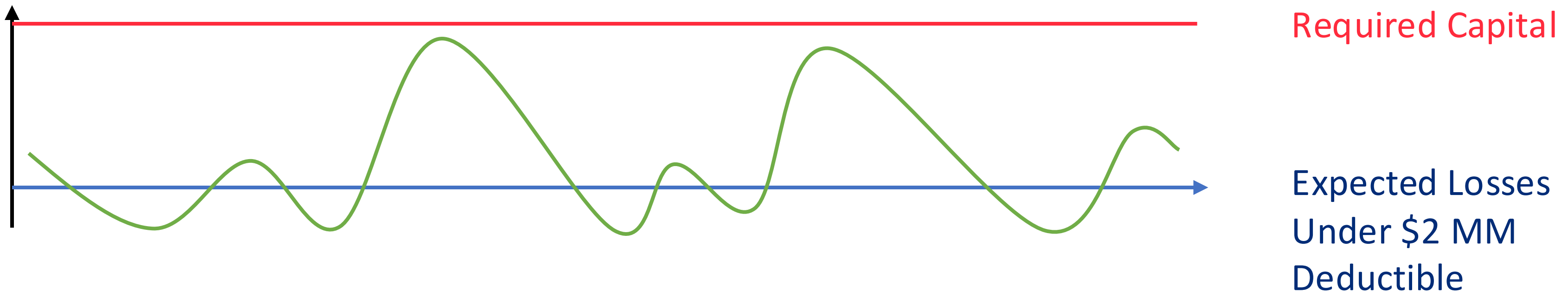
- Load based on actual expenses of captive
- Information provided by captive management
- Reasonability check from annual financial statements

Captive 101 – Why Actuarial Technical Pricing?

- The total cost of risk is the sum of the cost of the retained risk plus the cost of insurance premiums
- Retaining risk requires free capital to pay losses



- Retaining more risk require more free capital to pay losses:



TxCIA Texas Captive Insurance Association

Captive 101 – Risk Transfer

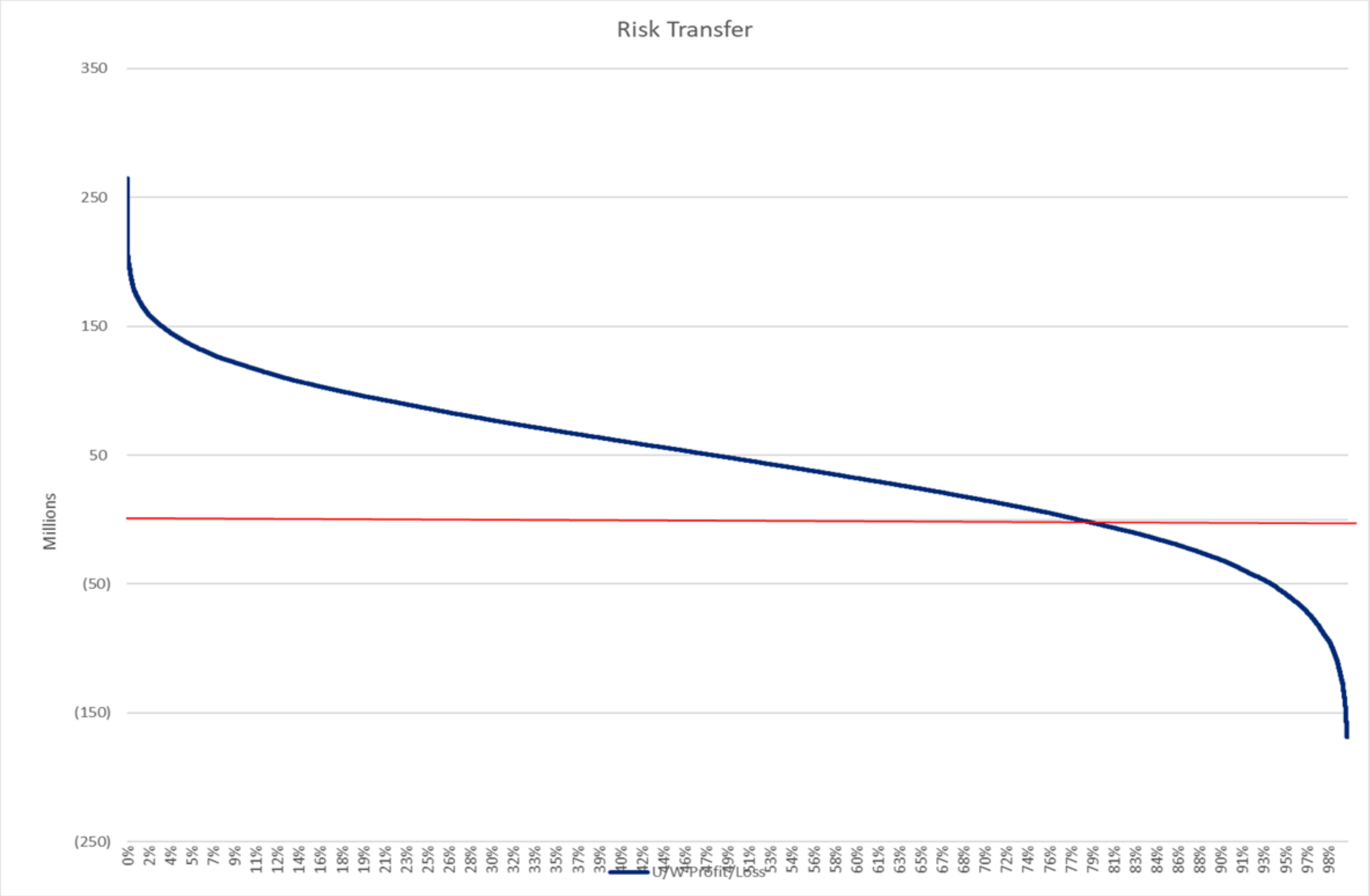
Elements of Risk Transfer:

- Captive assumes significant insurance risk
- Reasonably possible that captive may realize a significant loss

There is no specific rule for risk transfer. However, two common tests for risk transfer are:

- "10/10" rule – 10% chance of at least a 10% loss

- ERD – Expected Reinsurer Deficit – (Probability of present value UW loss) X (present value underwriting loss across all loss scenarios)



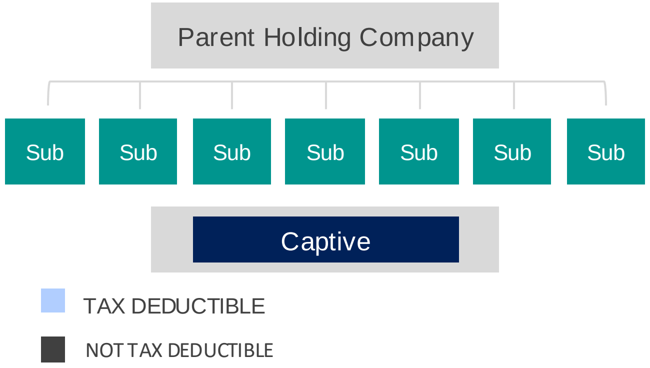
TxCIA
Texas Captive Insurance Association

Captive 101 – Risk Distribution

Brother-Sister Approach

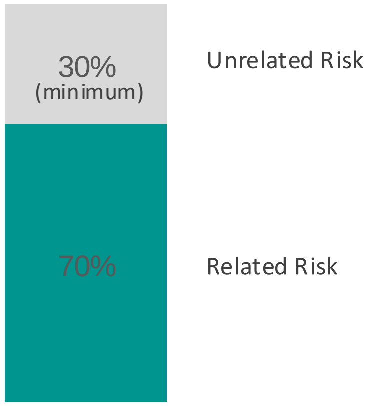
OR

- Captive insures a minimum of seven legal subsidiaries
- All subsidiaries insured by the captive need to be legal C-Corporations (Not divisions or LLC's)
- No one subsidiary should represent greater than 50% of the total risk



Third-Party Writings Approach

A captive insurer needs a minimum of $0.30 of unrelated risk premium for every $1of total premium



Sources of Third-Party Business include:

- ❖ Employee Benefits
- ❖ Contractor Risks
- ❖ Risk Pooling
- ❖ Customer Risks
- ❖ Franchisee Risks

- To recognize the tax benefits available to captives, the captive must qualify as an insurance company for US federal tax purposes and show existence of:
    1. **Legitimate Fortuitous Risks**
    2. **Regulated Environment**
    3. **Risk Shifting / Transfer** and
    4. **Risk Distribution** among a sufficient number of insureds in the captive transaction.
- In determining the presence of risk distribution, the captive must mirror one or both of the fact patterns noted to the left which are the result of precedent setting case law and IRS revenue rulings.
- Other facts that the IRS and the courts have generally looked favorably upon for captive arrangements include:
    - ✓ The captive was set up for clear and valid (non-tax) business reasons
    - ✓ The captive is adequately capitalized
    - ✓ The captive secures its own obligations, including issuing its own letters of credit for example
    - ✓ The identity of the captive as a separate entity should not be eroded by parent guarantees or other similar agreements

We recommend all clients obtain a tax opinion and/or FIN 48 memorandum regarding the federal tax treatment of any proposed US captive.

TxCIA Texas Captive Insurance Association

Captive 101 – Captive Tax Treatment

Insurance Company for US Federal Tax Purposes

- Premium payments are tax deductible by the insured
- Captive recognizes income
- Captive recognizes deduction for loss reserves on discounted basis
- The ability to potentially build up underwriting income in the captive on a tax exempt basis per Section 831(b) of the US Tax Code contingent upon premium not exceeding $2.45 million annually

Captive Tax Treatment

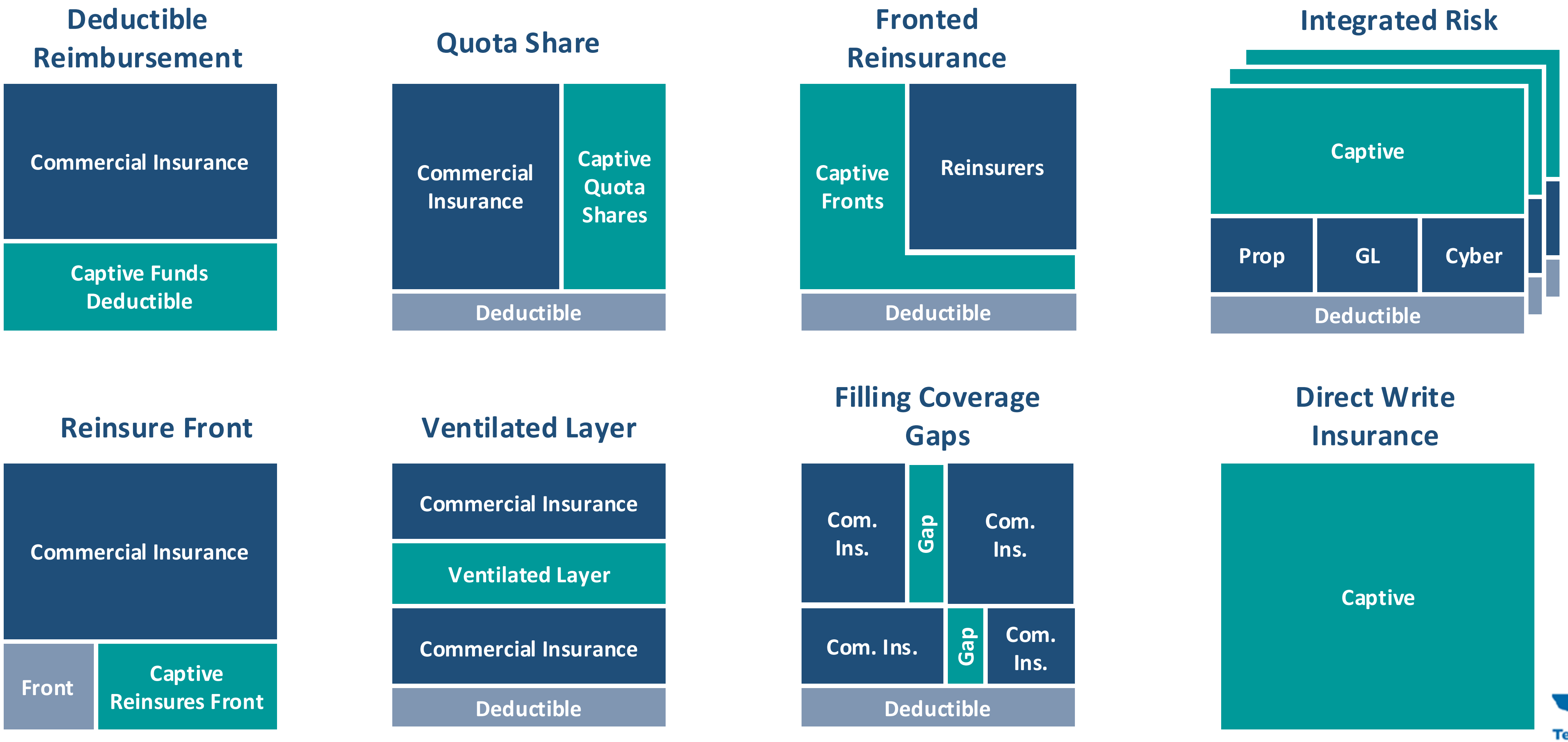
State Taxation of Captives

- Captives are typically exempt from state income tax.
- Instead, a nominal state premium tax is payable depending on the chosen domicile.

Deposit Accounting for US Federal Tax Purposes (Self Insurance)

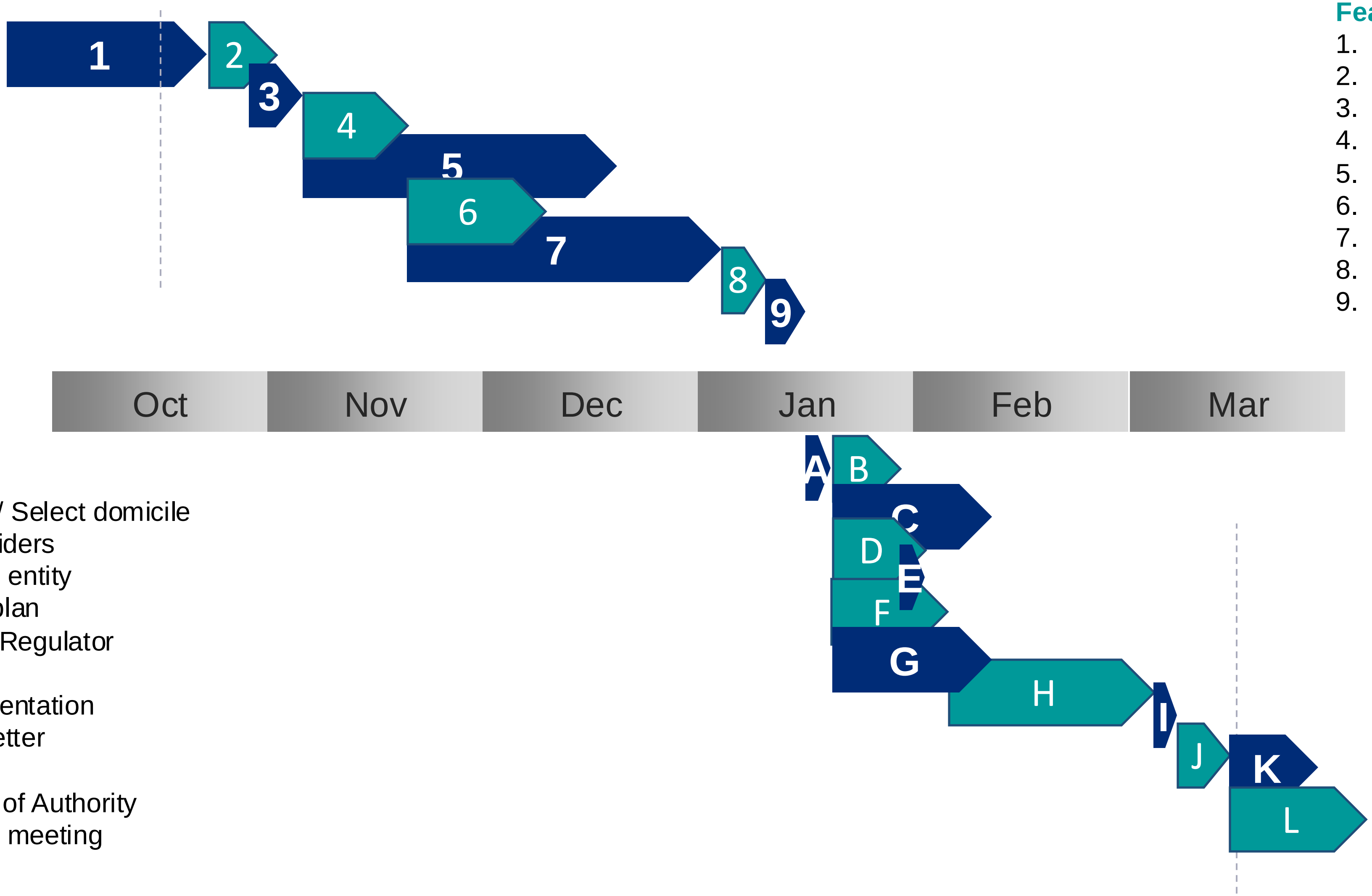
- Payments are non-tax deductible.
- No tax deduction for loss reserves.
- Claims are tax deductible when paid.

Captive 101 – Sample Structure Options



Texas Captive Insurance Association

Captive 101 – Timeline to Evaluate and Form a Captive



Feasibility Process

1. Captive Education
2. Determine Scope of Study
3. Execute SOW
4. Complete Data Request
5. Respond to additional questions
6. Actuarial modeling completed
7. Captive modeling completed
8. Draft study submitted
9. Final study presented

Formation Process

A. Decide to proceed / Select domicile
B. Select service providers
C. Establish corporate entity
D. Develop business plan
E. Initial meeting with Regulator
F. Submit Application
G. Submit final documentation
H. Receive approval letter
I. Capitalize captive
J. Receive Certificate of Authority
K. Hold organizational meeting
L. Issue policies

Texas Captive Insurance Association

Captive 101 – Domicile Selection Considerations

- **Statutory Flexibility** – can you write all the coverage lines you want to, can you write 3rd party business
- **Domicile Maturity and Experience** - (i.e. VT is most mature US domicile with 620 captives, HI second oldest with 251 at the end of 2021)
- **Financial Considerations**:
  - Self Procurement Tax (Home State?) – varies by state
  - Premium Taxes – varies by domicile from 0% (AZ, UT, NV) to 0.38% (VT) up to a cap (i.e. $200K)
- **Location and convenience:**
  - Domicile requirements for board meetings
  - Travel time & expense (on-shore vs. off-shore).
- **Industry expertise and density of peers** – e.g. CMT captives in domicile (ex. HI is primary hub for CMT captives)
- **Funding and capital flexibility:**
  - Investment restrictions – *minimal restrictions in most domiciles*
  - Ability of loan and dividends back to parent company
  - Minimum capital required – *most domiciles require minimum of $250,000*
  - Flexibility of capitalization – in addition to Cash/LOC, Surety, accounts receivable, etc.
- **Frequency of regulatory exams** (AZ – no minimum requirement; most other domiciles – at least once every 3 - 5 years)

TxCIA
Texas Captive Insurance Association

Captive 101 – Making Changes to Captive Coverages

Does it add or subtract risk from the captive?

Subtract

- Send notice to the regulator of the change,
- Amend policy accordingly,
- Incorporate difference in annual regulatory filings.

Add

- Assess new risk's loss exposure
- Determine appropriate structure (fronting, TPA, reinsurance, etc.)
- Determine appropriate premiums
- Model impact of addition with proforma statements
- Review current capital for adequacy
- Present Business Plan Amendment (BPA) to the regulator for review and approval
- Amend policy(s) accordingly
- Incorporate differences into annual regulatory filings
- Board of Directors to approve or ratify amendment

Captive 101 – Third Party Risk

EXPOSURES

- CUSTOMERS
- MERCHANTS/ JOINT VENTURES
- EMPLOYEES

RISKS/INSURANCE OFFERINGS

- SERVICE CONTRACTS
- GIG WORKER INSURANCE
- EMPLOYEE BENEFITS
- EXTENDED WARRANTIES
- CUSTOMER PROGRAMS/PERSONAL LINES: HOME/AUTO/UMBRELLA
- VOLUNTARY EMPLOYEE BENEFITS
- LIFE INSURANCE
- CYBER LIABILITY
- PET INSURANCE

Capture underwriting profit and investment income on program cash flow associated with insuring third party risks.

RETAIN RISK

IN CAPTIVE

Third party risks in the captive creates risk distribution which supports tax deductibility of captive premiums.

Captive 101 – Captive 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

- ❖ Commutes 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.

Captive 101 – Captive Expenses

Captive Cost Item	Description
Captive Feasibility Study	Fees start from $XX,000 + Actuarial work, if needed (approx. $X,000 per coverage line)
Start Up Costs	Regulatory, legal, actuarial, and implementation fees (approximately US$XX,000 to US$XX,000 depending on domicile)
Annual Operating Costs	Regulatory, legal, actuarial, audit, and captive management fees (approximately US$XX,000 to $XXX,000 per year).
Captive Domicile Premium Tax	Only imposed by select onshore captive domiciles (ranges from 0% to 0.38%) subject to a maximum.
Regulatory Fees	Annual licensing and exam fees vary by domicile
Self Procurement Tax	US state premium tax imposed on an insured by its "home state" when procuring insurance from an insurer (which may include a captive) not admitted in the insured's home state (tax due by state ranges from 0 to 6% which may be imposed on the total US premium at the "home state" rate)
Capitalization	Typical premium to capital ratio required ranges from 3:1 (more severity type risks such as property) to 5:1 (more predictable risks such as casualty) and may be met through cash or a letter of credit depending on domicile.
Opportunity Cost on Funding Captive Premium	Ability for captive to mirror investment returns on cash flow used to support premiums versus if cash had remained with parent company.

TxCIA
Texas Captive Insurance Association

Captive 101 – Questions for a Captive Manager

- Do they have experience with the type of captive you want to form?
- Do they specialize in any type of captive structure / type?
- What is their depth of bench if there are sickness / turnover?
- What is their industry reputation?
- What is their experience in your selected domicile?
- What is their relationship with other service providers?
- What scope of services do they provide? (actuarial, brokerage, audit, tax, etc.)
- Do they provide consulting work for evaluating your risk needs after implementation?
- What technology do they use for daily activity tracking, financial statements, governance
- Is the manager limited in what type of captive or insurer relationships they can provide access to?
- What is the breadth of geographical footprint of the manager?
- Do they provide services for your peers? Would this be beneficial for best practices?
- Are they an industry thought leader?

TxCIA
Texas Captive Insurance Association

Captive 101 – Role of a Captive Manager

Financial Reports and Exams

Captive Annual Report
Review and approve

Captive Audited Financials
Review and approve

Actuarial Certification of Loss Reserves
Provide data

Five Year Financial Projections
Provide assumptions

Periodic Examination by Regulators (Every Three to Five Years)
Review for any concerns

Interim Financials
Provide claims data

Accounts Payable/Accounts Receivable
Approve transactions

Annual Budget
Review and approve

Tax

Captive Premium Tax Submitted (If Required)
Review

Captive Income Tax Return
Review and approve

Investments

Minimum Capital
Coordinate required capital

Intercompany Loans
Request loan and remit monthly interest payments

Shareholder/Policyholder dividends
Request dividends (contingent upon regulatory approval)

Underwriting

Insurance Program Changes
Communicate desired changes to existing business plan

Insurance Policies and Reinsurance Agreements
Review and approve

Corporate Governance

Directors and Officers
Communicate any changes of directs and officers

Collect Conflict of Interest Disclosures from All Directors and Officers
Sign and return disclosures at the annual directors meeting

Board Meetings
Provide dates of availability, approve agenda, and participate

Captive 101 – Captive Committees

CAPTIVE SUBSIDIARY
CAPTIVE'S BOARD OF DIRECTORS

UNDERWRITING COMMITTEE

- Set policy language.
- Set strategy and timeline for underwriting other exposures.
- Evaluate occurrence and aggregate levels based on market conditions and corporate goals.
- Consider reinsurance needs/application.
- Address domicile regulations.
- Review applications for coverage.

CLAIMS AND RISK MANAGEMENT COMMITTEE

- Establish insurer-driven "best practice" guidelines for coverages underwritten by the captive, including:
  - Loss control.
  - Claims management.
  - Claims litigation and settlement.
- Evaluate quality of RMIS claims detail to assist with pricing support, focusing loss prevents services, etc.
- Consider cost allocation techniques that reward business unit controls.

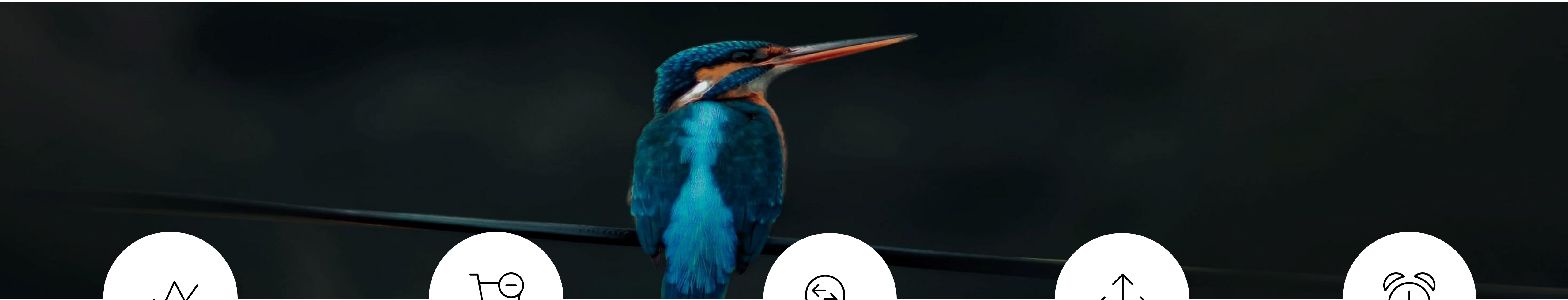
FINANCE AND INVESTMENT COMMITTEE

- Oversee actuarial year-end reports, address impact with other two committees.
- Oversee financial report consolidation processes; address YE audit work.
- Create and adjust investment policies.
- Provide guidance for effective utilization of equity.
- Provide planning and management oversight of captive's relevant tax issues.

TxCIA
Texas Captive Insurance Association

Captive 101 – Captive Health Check

Understanding the overall health of the captive is imperative for all captive owners.
But when is the most appropriate time to perform a Captive Health Check?



Volatility

Adverse loss experience

Changing retentions and limits, and adding new coverages

Commerical premium swings

Difficult Market Conditions

Hard market reducing capacity and unavailability

Premiums not aligned with losses

Pressure from carriers to take on more risk

Internal Pressures

Management seeking best use of capital and demanding return on investment

Opportunities

Desire to take on more or new risks

Achieving optimal capital levels and deployment

Timing

May been in "auto-pilot" resulting in a lack of understanding of the underlying risk

TxCIA
Texas Captive Insurance Association

Captive 101 – Captive Health Check

Reserving

- Analysis of retained unpaid loss and LAE reserves, including IBNR
- Projections for the upcoming year based on historical results and projected exposures
- Statement of Actuarial Opinion

Pricing

- Pricing indication including reasonable range based on captive's historical experience supplemented with industry information
- Individual estimates for Expected loss, Required capital with return, Expense

Risk Transfer

Review whether insurance program exposes captive to reasonable possibility of significant loss, specifically looking at:
(1) 10-10 Test; (2) ERD Test; (3) Distribution of present value of captive's underwriting losses

Risk Distribution

- Analyze and comment on:
- Sufficient number of risks
- Independence of risks
- Applicability of law of large numbers
- Is transaction viewed as insurance

TxCIA
Texas Captive Insurance Association

Captive 101 – Captive Health Check

What does the Health Check entail

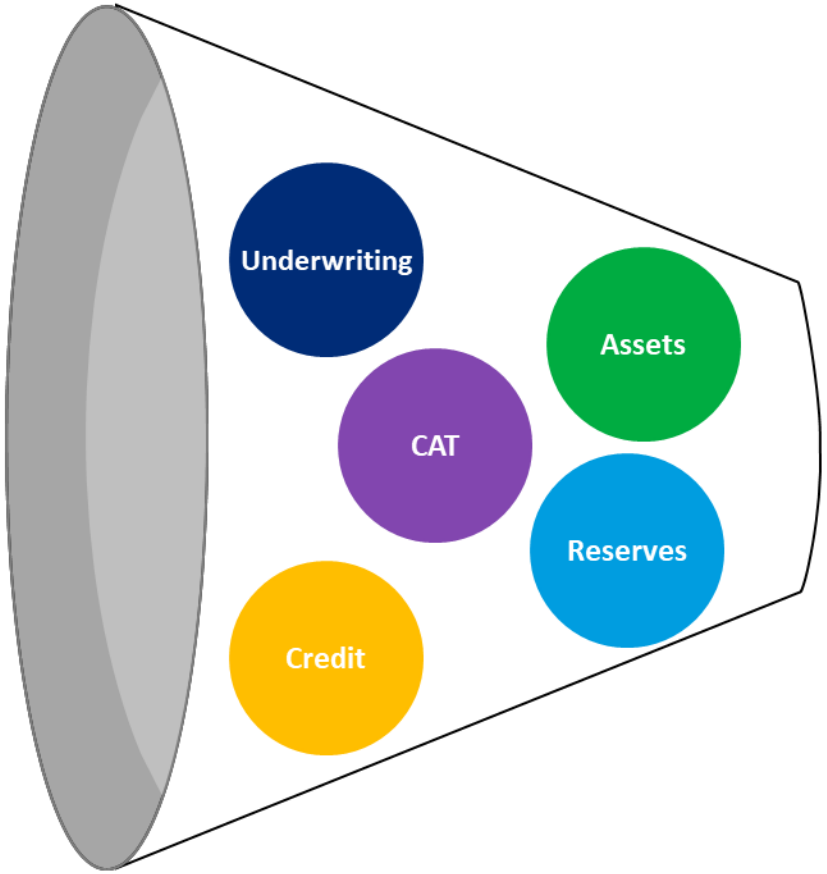
Captive Review

Holistic deep-dive:

- Understanding total risk profile and drivers of risk
- Current capital position and ability to pay claims in the future
- Actuarial review for regulatory and tax purposes: Loss reserving, pricing, risk transfer, risk distribution
- Understanding of loss funding and whether captive is charging the appropriate premium to cover risk
- Assessment of risk concentration whether by geography, correlated risks, or concentration of exposures
- Determine impact of adding or removing coverages, or changing risk profile through program structure changes
- Optimal use of capital based on Company's risk appetite
- Develop investment strategy that is aligned with business objectives

Captive 101 – Capital Modeling

Traditional risks in a capital model can include…



Balance sheet

Income statement

Projected over Multiyear Timeline

Underwriting Risk (UW Risk)

Simulate the ultimate value of claims expected to occur in prospective policy periods

Reserve Risk

Simulate the unpaid liability for claims that have already occurred

Asset Risk

Simulate investment income generated in each prospective year

Catastrophe Risk

Input event set output data from commercial catastrophe software models to incorporate catastrophe risk

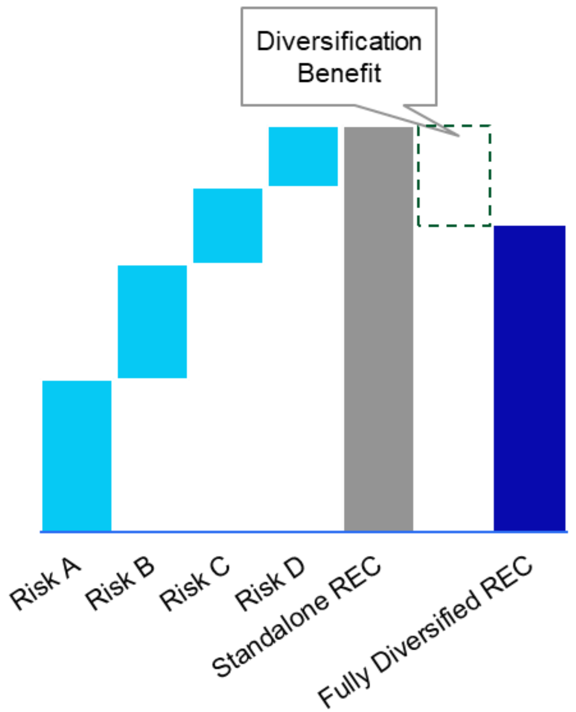
Credit Risk

Simulate reinsurer default scenarios and associated uncollectible amounts

TxCIA
Texas Captive Insurance Association

Captive 101 – Capital Modeling

Required Economic Capital (REC) by Risk



Benefits of Economic Capital Modeling

- Enhance understanding of total risk exposures and interactions
  - Uncorrelated risks make the enterprise exposure smaller than the sum of the parts
- Improve capital efficiency
  - Identifies opportunities to leverage underwriting strategy and reinsurance structure
- Strengthen enterprise risk strategy
  - Portfolio view leads to risk financing decisions consistent with enterprise risk tolerances

Quantification of financial risks provides clarification of key exposures to the organization

TxCIA Texas Captive Insurance Association

Captive 101 – Shameless Plug for ICCIE

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

iccie

International Center for Captive Insurance Education

TxCIA

Texas Captive Insurance Association

Questions?

THANK YOU!

Allan Smith

Client Service Leader

Marsh Captive Solutions

Allan.smith@marsh.com

+1 714 356 6208

Manuel Guerra

Senior Principal

Oliver Wyman

Manuel.guerra@oliverwyman.com

+1 214 908 6386

TxCIA

Texas Captive Insurance Association