



2024 Annual Conference

Texas Captives: Empowering Texas Business

Rating Harmony

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Increasing Utilization Of Captives

Key Factors Driving Growth In Captives



Proven Alternative To The Traditional Market

- Captives are estimated to account for roughly 25%* of all global commercial premiums



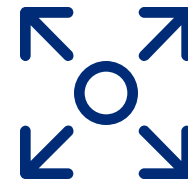
Specialization Advantages vs. Traditional Market

- In-depth knowledge of the parent/group's specific risks allows customized coverage aligned with the group's needs



Enhanced Flexibility For Risk Financing Strategy

- Captives enables better control over risk management strategies and retention/transfer of risk



Expanding Scope and Utility

- Market conditions have driven an uptick in formations, increase in retentions, and expansion into new lines of coverage such as Cyber, Business Interruption and D&O



Loss Control and Risk Management

- Captives contribute to risk management by providing valuable feedback on risk mitigation strategies



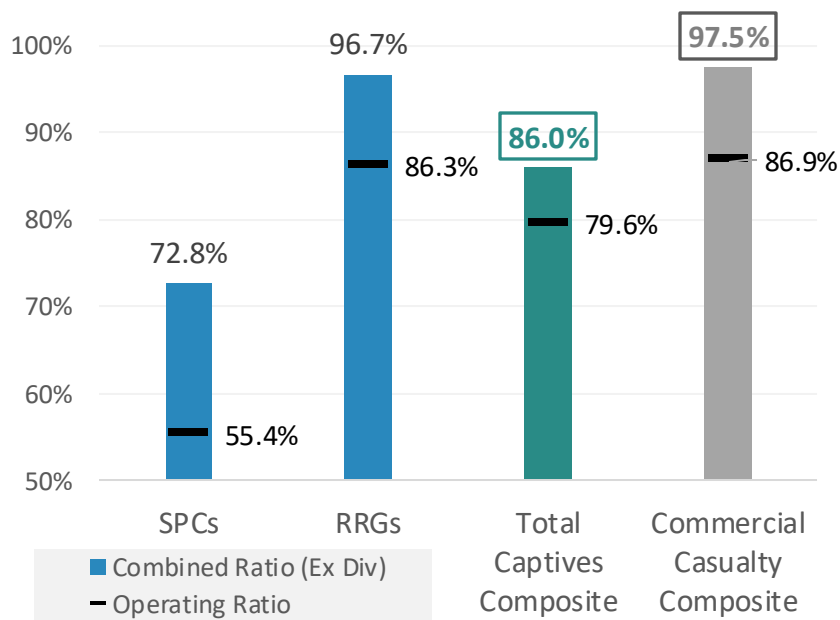
Retained Profitability & Capital Flexibility

- Captive results have outperformed traditional carriers by a significant margin over the last 5 years highlighting appropriate risk pricing and cost efficiency

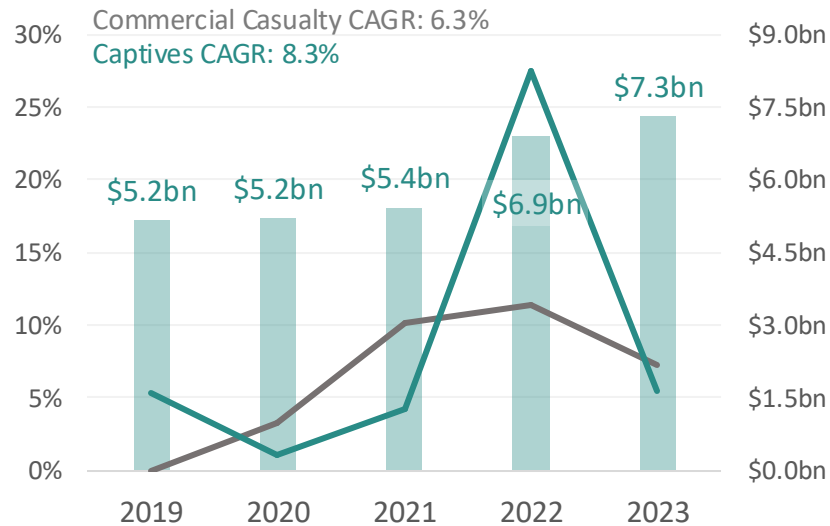
Captives Outperform Commercial Casualty Insurers

Captive premium growth has been robust, and entities are well capitalized

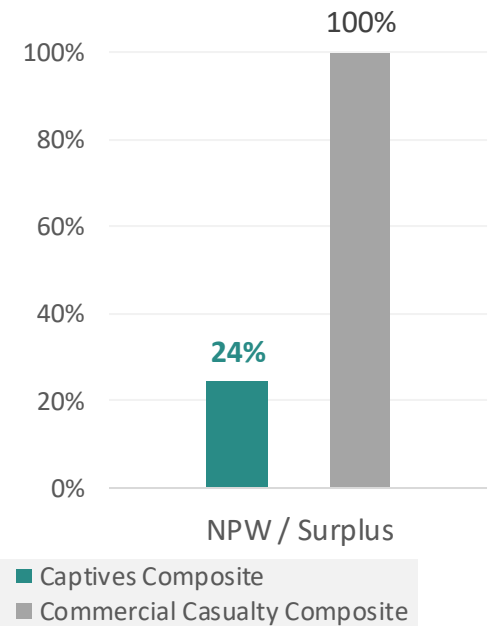
Five Year Average Performance (A.M. Best Rated Captives)



Premium Growth Captives vs. Commercial Composite



Premium Leverage 2023 Composite Avg.



Why Captives Seek Ratings

Ratings provide certain benefits



Reduction In Fronting And Collateral Costs



Credibility With Third Parties & Access To New External Business



Access to Reinsurance Markets



Capital Market Access



Flexibility In Risk Financing



Supports Risk-Based Pricing Discovery



Compliance with Regulatory and Contractual Obligations



Corporate Governance and Oversight

Considerations for Engaging the Rating Agency(ies)



Reason for Seeking Rating

Marketing, Capital, Reinsurance, etc.



Which rating agencies rate start-ups?



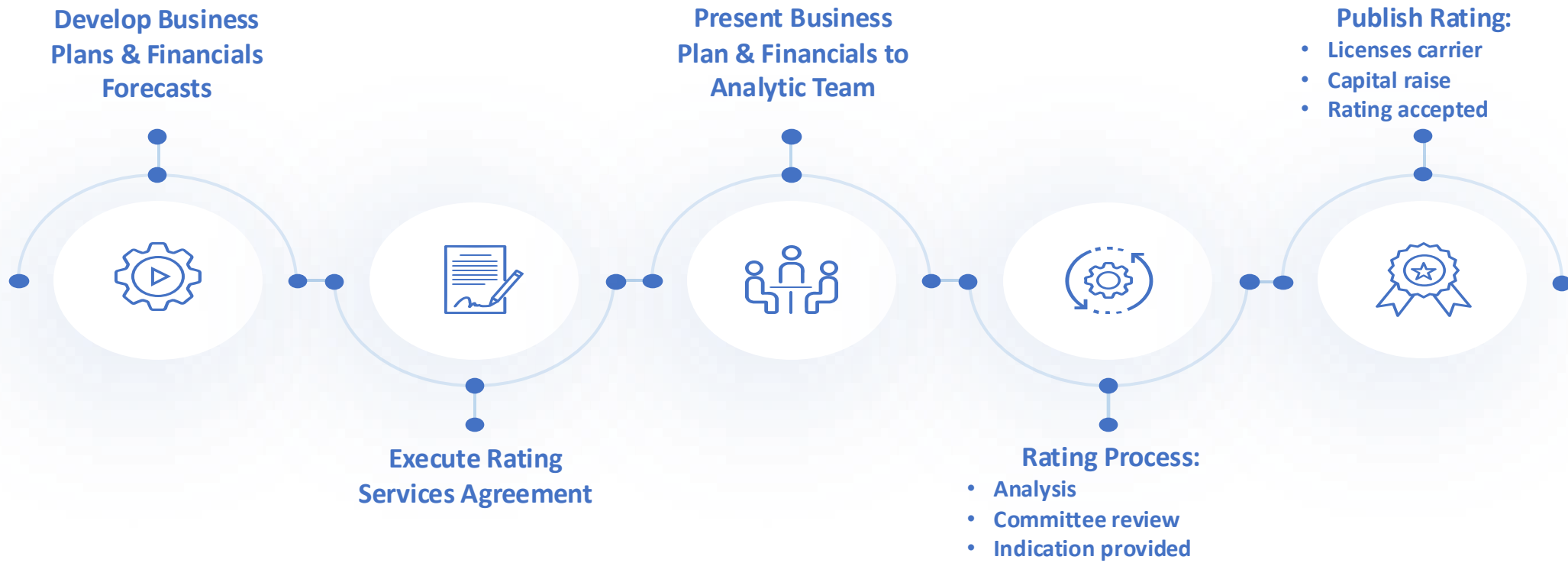
Necessary/Desired Rating

Financial Strength and/or Debt Rating

	Insurance Coverage				
	S&P	Moody's	Fitch	AM Best	KBRA
Coverage	Public Debt/FSR	Public Debt	Public Debt	FSR	Building Coverage
Entity Level	Top Down	Top Down	Top Down	Bottom Up	Bottom Up
Framework	Matrix	Scorecard	Scorecard	Scorecard	Scorecard
Capital Model	Public	Private	Private/Public	Public	NA
Drivers	Diversity & Capital	Diversity & Earnings	Diversity & Capital	Quantitative	Credit Narrative

Process To Obtain An Initial Rating

The process typically takes about three to four months



Guy Carpenter: A Case Study



Challenge:

Commercial real estate company seeking to expand its captive's role in managing its insurance risk



Guy Carpenter's Approach:

- Recommended that the Company seek two ratings, and advised through the ratings process
- Consulted on strategic capital management, risk adjusted view of capital, and target performance





Outcome

- Dual ratings met the bank lending requirements, allowing the captive to take on the group risk directly, including joint venture partners, thereby reducing fronting costs
- Improved capital efficiency and enhanced pricing visibility due to a clearer understanding of risk-adjusted capital
- Better flexibility to access capital markets and reinsurance capacity

AM Best Ratings Methodology

AM Best Credit Rating Methodology

Rating Scales

	ICR	FSR
 Secure Investment Grade	aaa	A++
	aa+	A+
	aa	A
	aa-	A-
	a+	B++
	a	B+
 Vulnerable Speculative Grade	bbb+	B
	bbb	B-
	bbb-	C++
	bb+	C+
	bb	C
	bb-	C-
	b+	D
	b	E, F
	b-	
	ccc+	
ccc		
ccc-		
cc		
c		
rs		



Issuer Credit Rating (ICR)

- An opinion as to the ability of the issuer's ability to meet its ongoing senior financial obligations
 - Starting point from which the FSR, and Issue Credit Ratings are derived
 - Facilitates comparisons to other rating agency scales



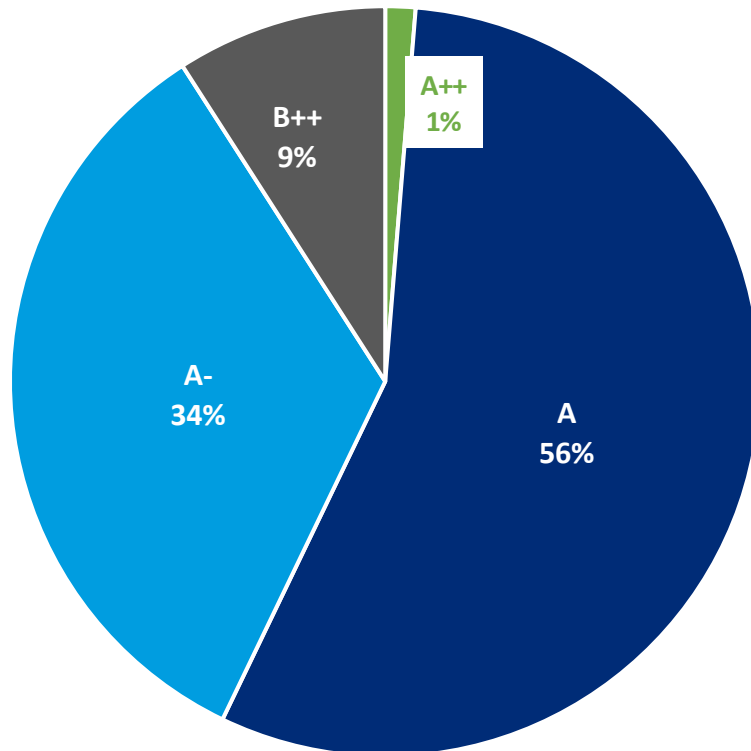
Financial Strength Rating (FSR)

- An opinion as to an insurer's ability to meet its ongoing obligations to policyholders
 - Typically used by agents, policyholders and mortgage companies/banks

Ratings Distribution

Most AM Best Rated Captives maintain an A- or higher rating

US Captives Rating Distribution*

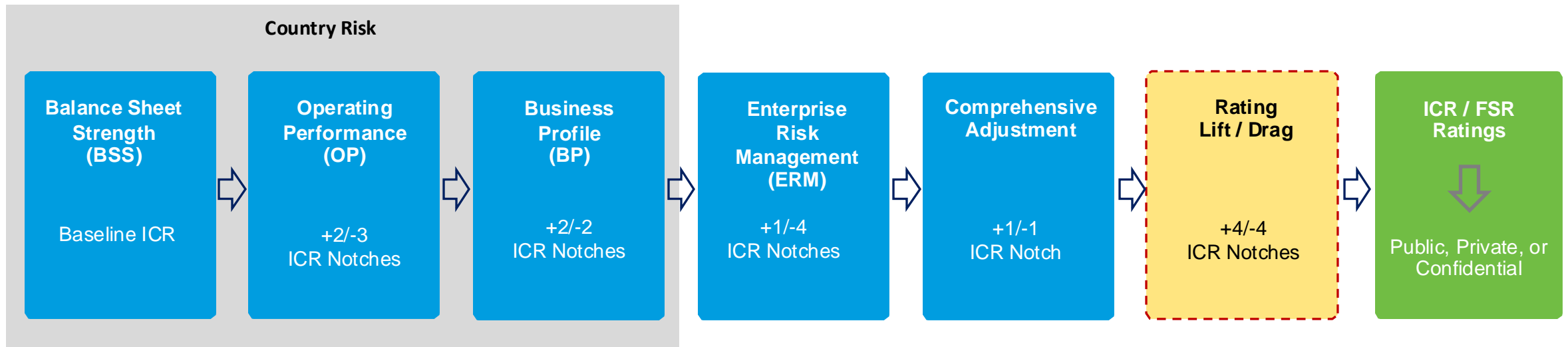


- Approximately 90% of rated captives have A- or higher FSR
 - Self-selection bias present in the sample
- Rated captives make up a small proportion of the captive universe

A.M. Best Credit Rating Methodology: Building Blocks

Rating assessment path

A.M. Best's Rating Assessment Components



BCAR (Best's Capital Adequacy Ratio)

How to Interpret the BCAR Score

BCAR score: Percentage of excess surplus/capital after deducting the amount of capital needs to support the business' operational risk

- **Required Capital** is segmented into eight risk categories
- **Available Capital** is the amount of economic capital available
 - Hard vs. Soft Capital Mix
 - Soft Examples: Surplus Notes, Letters of Credit, Loanback arrangements, and Reinsurance
 - >\$20 mil. of capital to achieve the highest assessment
- **Excess Capital** is the residual surplus/capital after considering required capital



Balance Sheet Strength (BSS) Assessment Scorecard

Assessment is a combination of quantitative and qualitative factors

1

BCAR	Baseline		Stressed	
	Assessment	VaR Level	Tolerance	VaR Level
Strongest	99.6%	>25%	99.6%	>10%
Very Strong	99.6%	>10%	99.5%	>0%
Strong	99.5%	>0%	99.0%	>0%
Adequate	99.0%	>0%	95.0%	>0%
Weak	95.0%	>0%	95.0%	<-15%
Very Weak	95.0%	<0%	95.0%	<-30%

2

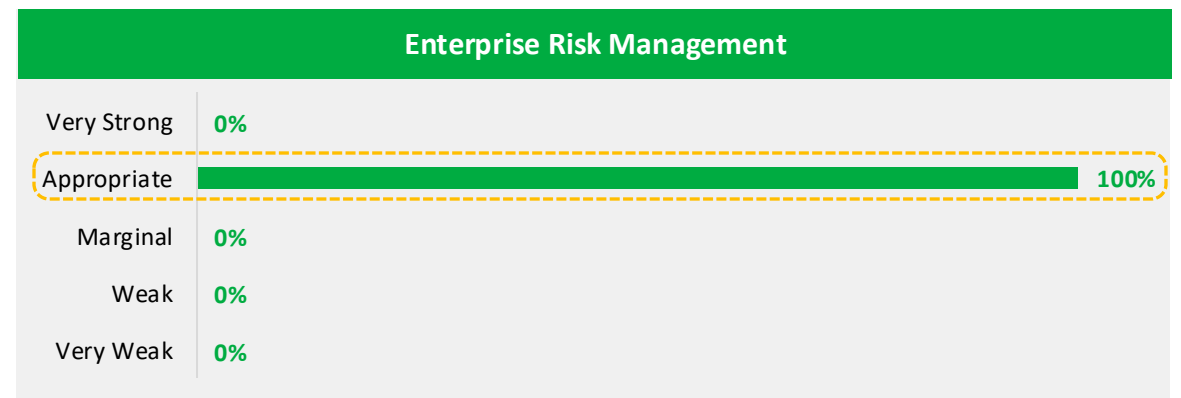
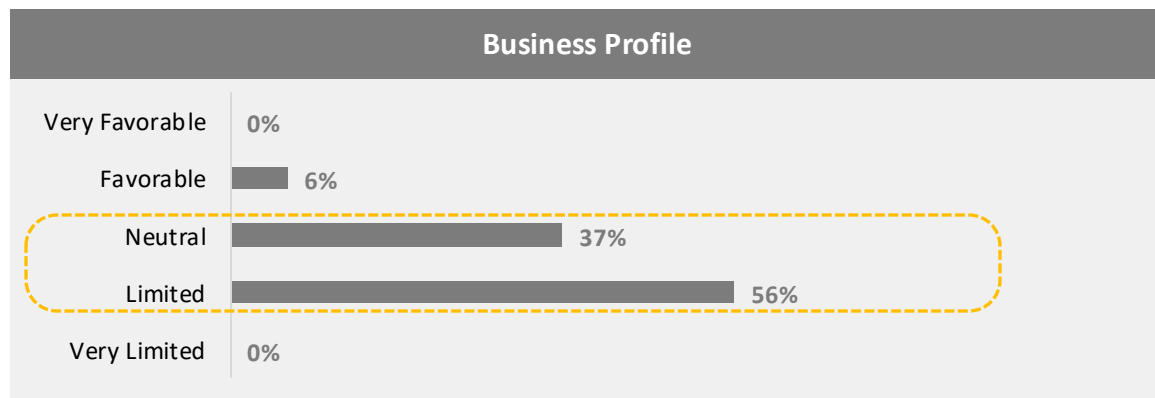
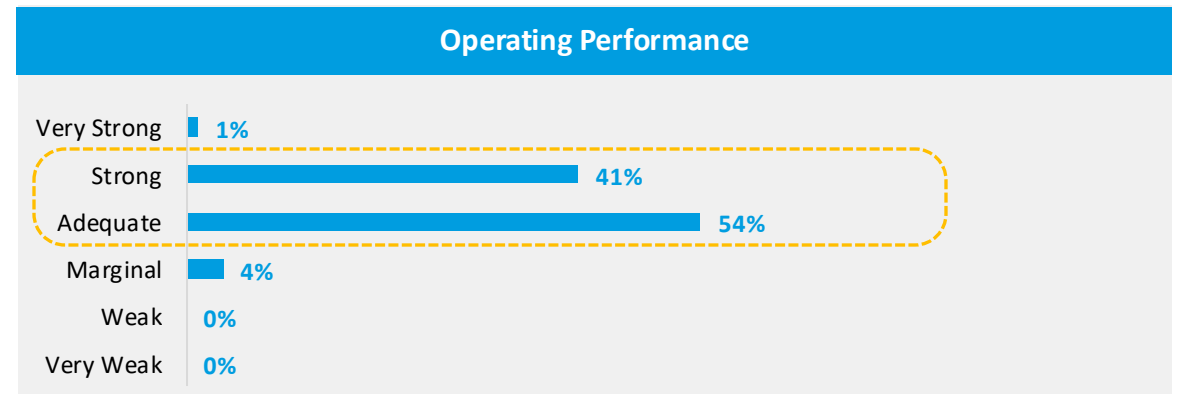
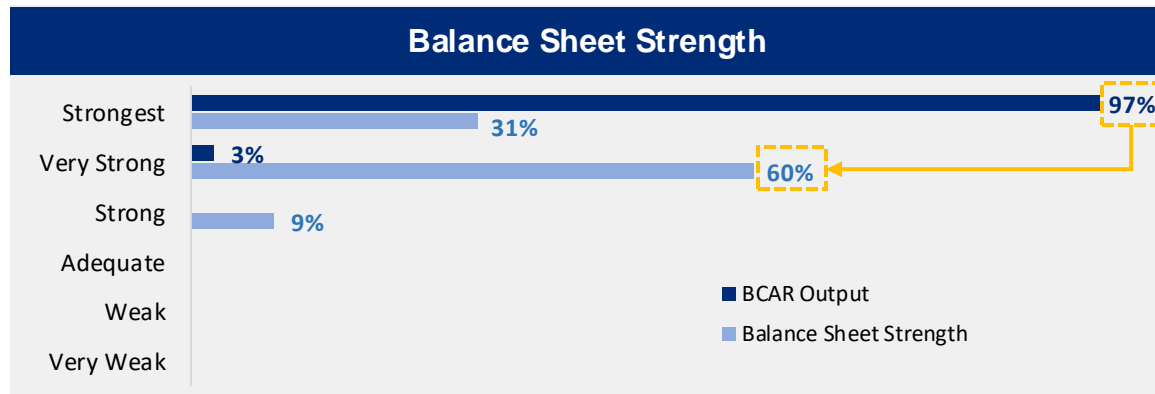
Other Balance Sheet Adjustments
Trend in BCAR
Quality of Capital
Leverage
Reserve Development
Reinsurance Utilization
Liquidity/Cash Flow
Asset Liability Management
Internal Capital Models

3

Rating Unit BSS	
Assessment	ICR
Strongest	a+/a
Very Strong	a/a-
Strong	a-/bbb+
Adequate	bbb+/bbb-
Weak	bb+/bb-
Very Weak	b+ and lower

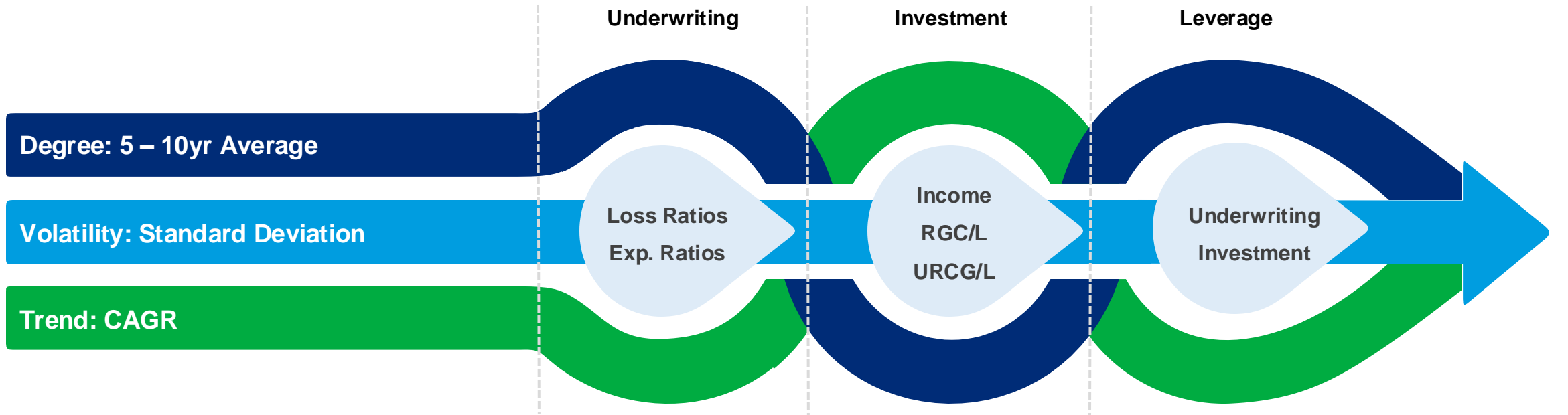
Building Block Assessments Distribution

Captives Composite



Operating Performance Assessment

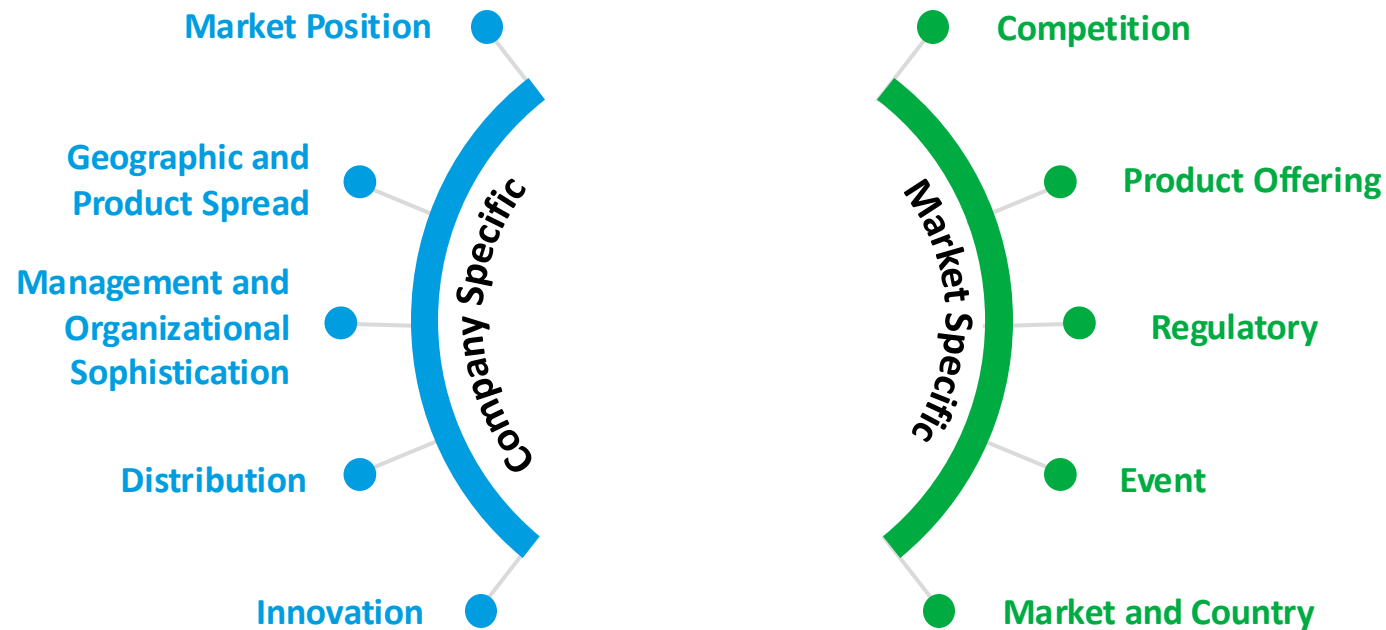
Captives typically assessed Adequate



Assessment Notches	Very Strong	Strong	Adequate	Marginal	Weak	Very Weak
	+2	+1	0	-1	-2	-3

Business Profile Assessment

Captive risk portfolios are typically concentrated



Enterprise Risk Management Assessment

Captive ERM frameworks are typically rated Appropriate




ERM Framework Evaluation

- **Risk Identification and Reporting**
Internal and External Communication
- **Risk Appetite and Tolerance**
Risk Statements
- **Stress Testing**
- **Risk Management and Controls**
- **Risk Culture and Governance**
Oversight and Accountability




Key Risk Evaluation

- Product and Underwriting Risk
- Reserving Risk
- Concentration (includes Natural and Terrorism Catastrophe Accumulations)
- Reinsurance Credit and Dispute Risk
- Liquidity and Capital Management
- Investment Risk
- Regulatory/Market/Economic Risk
- Operational Risk



How well developed is the ERM framework by category?
(Unrecognized < Nascent < Emerging < Developing < Embedded)



How well do the ERM capabilities support the risk profile by risk category?
(Deficient < Insufficient < Adequate < Excellent)

Assessment Notches	Very Strong	Appropriate	Marginal	Weak	Very Weak
	+1	0	-1	-2	-3/-4

Preparing For Rating Agency Meeting

Preparing For Rating Agency Meeting



Loss Cost Trends

- Detail how you are maintaining rate adequacy (rate in excess of loss costs) in the face of increasing inflation, supply chain issues, heightened weather-related losses, increased reinsurance costs, insurance to-value
- **Outline other underwriting actions that will reduce volatility/improve underwriting performance**



Reinsurance Market Hardening

- Increase in reinsurance costs and tightening terms and conditions impacting BCAR/capital model and earnings volatility as well as impacting ERM assessments
- Rapidly changing risk appetites and shifts to higher reinsurance pricing, higher retentions, and tighter terms and conditions mean quick action is needed to address changes
- Many buyers were forced to make significant changes to protection
- **Address the impact on capital, earnings and volatility, recognizing higher primary rates and investment income**



Investment Income/Liquidity

- Unrealized loss on investments heightens focus on liquidity and cash flows as AM Best seeks to determine the ability to hold bonds to maturity to avoid realizing losses
- Higher interest rates will be a tailwind for insurers, but the transition causes marked-to-market losses
- Investment losses that reduce capital levels until the interest rates peak and portfolios rollover
- **Outline maturity of securities and expectations for unrealized loss position**



Regulatory Challenges

- Rate regulation in some states is slowing action needed to mitigate the rising loss cost trend, pressuring 2023 and 2024 underwriting results
- AM Best evaluates the impact on performance and capital when adequate rates cannot be achieved due to regulatory issues
- **Address how management manages limited, slow, or unresponsive regulatory rate approvals**



Reserve Uncertainty

- Reserve uncertainty for many lines of business has increased because of rapidly changing loss cost trends
- Ultimate loss picks will be further scrutinized to evaluate the potential for adverse development
- **Outline steps taken to address future uncertainty in loss cost trends and the degree to which these trends are factored into the current carried loss position**

GC Provides A Wide Range Of Ratings Advisory Services

Our global team of experts, which includes former ratings analysts, has a deep understanding of various rating agency methodologies.



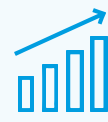
Rating position analysis & communication strategy

- Provide a detailed understanding of the current rating position & develop an ongoing communication strategy for the rating agencies
- **Audit the rating agency capital models** to ensure all necessary analytic adjustments are incorporated
- **Develop benchmarks** for quantitative metrics relative to desired rating
- **Evaluate the qualitative factors** that are impacting the rating
- **Develop communication strategy** for quarterly surveillance & annual discussions



Ratings defense

- Alongside you, we will identify & help remediate the key issues putting the rating at risk. This typically includes:
- In-depth review of the current rating position to **identify key issues**
- Recommend a **strategy to communicate corrective actions** to mitigate/remove the negative rating pressure
- Provide a **detailed review & input into presentation materials** & rating agency capital models
- Management **meeting rehearsals & post meeting debrief**



Capital optimization strategy

- Capital models are a key component of the rating agency's scorecard. We have the expertise necessary to **evaluate the capital model impact** on the following;
- Organic growth plans
- Mergers & acquisitions
- Corporate structure changes
- Reinsurance optimization
- Capital raising activities
- Investment strategy



Initial & new company ratings

- We will be with you every step of the way. This typically includes:
- **Identify & engage the rating agency** that is right for your organization
- **Review business plan** & financial forecasts
- **Calculate the KPI & capital model** results for the forecasted period
- Develop presentation outline & **review presentation materials**
- Management **meeting rehearsals**

GC Provides A Wide Range Of Ratings Advisory Services

Our team of experts is composed of former rating analysts from AM Best, Standard & Poor's and Fitch. Together we have successfully supported dozens of clients across the world in their journeys to obtain credit ratings, improve ratings, strengthen and defend their ratings.



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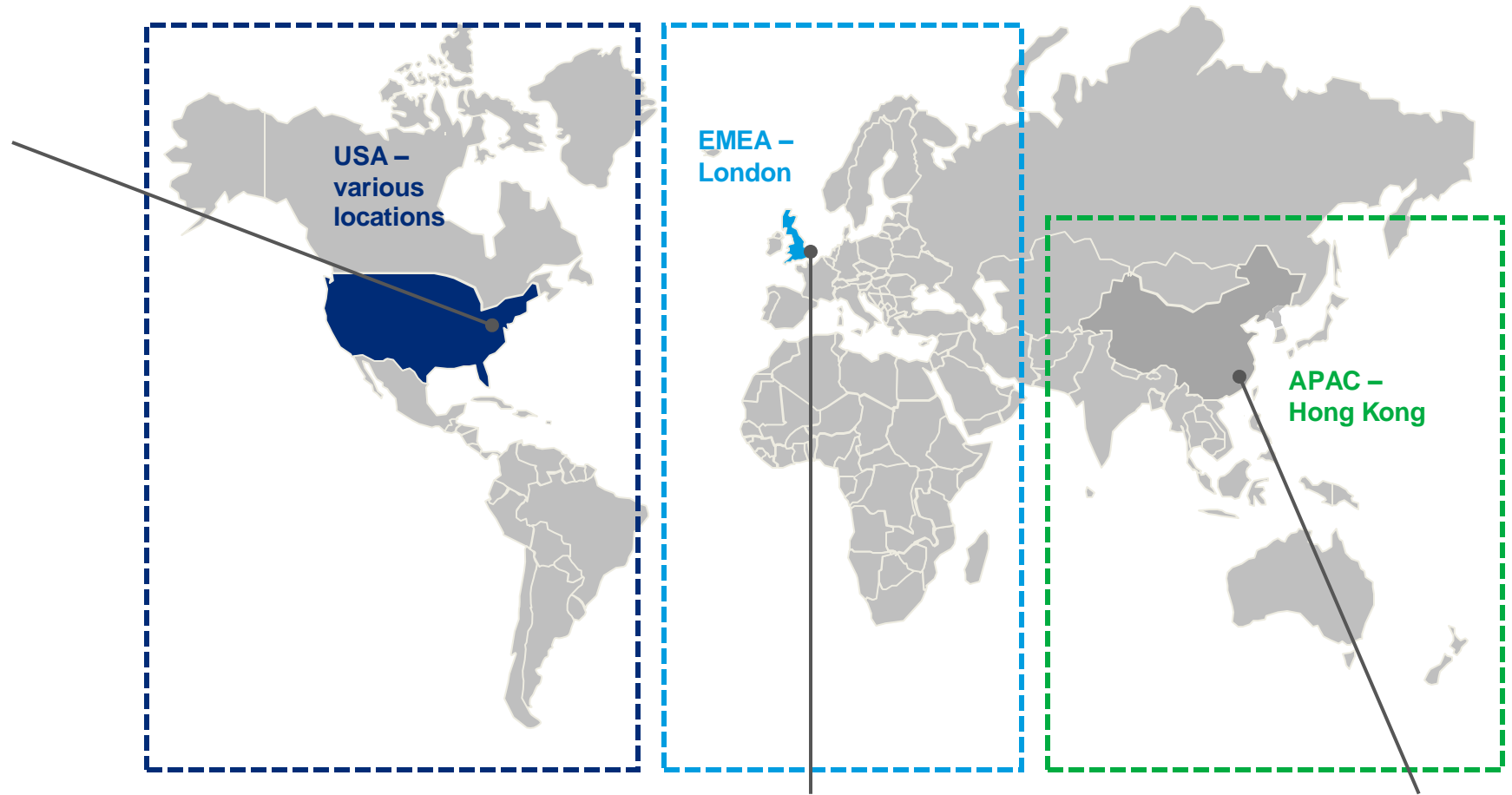
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Questions?

THANK YOU!

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