

BUSINESS INSURANCE®

WORLD

CAPTIVE FORUM

General Track:
Pre-Conference
101 Workshop



Hugh Rosenbaum
Willis Towers
Watson
MODERATOR



Robert Davidson
Davidson Risk
Consulting



Jeff Kenneson
Davies Captive
Management



Daniel Kusaila
Crowe LLP

What is a Captive?

Differentiators (in handout)

To regulators (and the NAIC!) – Cells included?

To the IRS

To the DOL (Benefits)

To managers and service providers

And...their owners! ...or members

Other forms of Captive

Risk Retention Groups

Reciprocals

PORCs and **agency-owned** captives

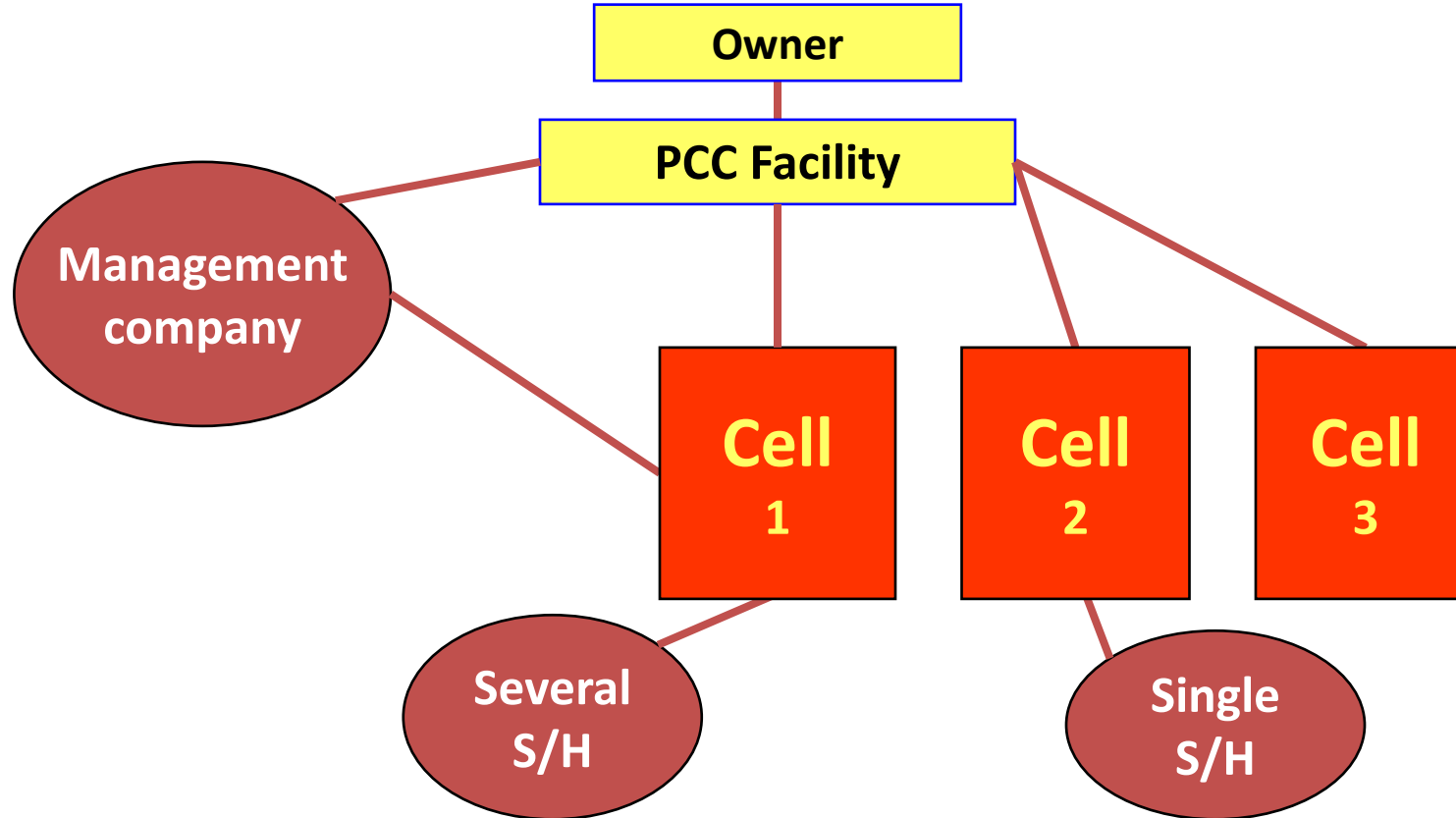
SPVs and XXX entities

Mini or micro (“831-b”) captives

Pools of Captives

Other forms cont'd

Protected Cell Company - Structure



Cell or Captive?

	Captive	Cell
Full control	More	Less
Capital	More	Less
Regulatory fees	More	Less
Management fees	More	Less
Auditor's fees	More	Maybe none
Directors' fees	More	None
Indirect costs	same	same
Liquidator's fees	Higher	lower

More on cells vs stand-alone

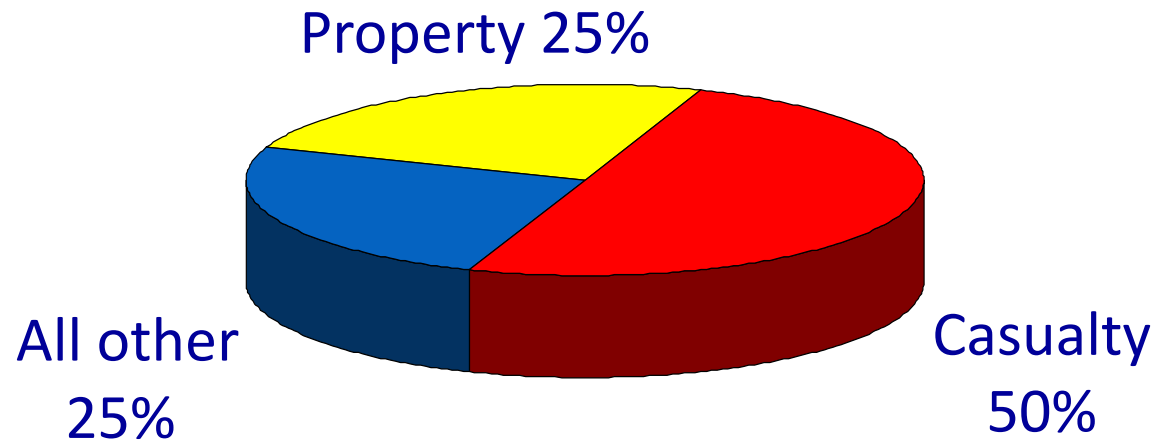


Security risk		Higher	Lower
Regulation of each cell	Onshore	Yes	Yes
	Offshore	Yes but not in Bermuda	Yes
Core capital at risk	Onshore	Yes	Yes
	Offshore	Yes but not in Bermuda	Yes
Inter-cell transactions	Onshore	Yes	Most domiciles
	Offshore	Only some domiciles	Yes

Kinds of cells – comparison

	Protected/Segregated Cell	Incorporated Cell	Series LLC
Governing Law	Insurance	Insurance	Corporate & Insurance
Ownership/Control	Cell ownership, no control	Stock ownership, full control	LLC
Self-Governing?	No	Yes	No
Core - Risk Bearing	Typically no	Typically no	May or may not
Governing Document	Participation Agreement	Participation Agreement/ Incorporation Documents	Participation Agreement/ Series Agreement
Ease of creation	Quick <2 weeks	Longer 4-6 weeks	Moderate 2-3 weeks
Registration	No	Yes	Yes
File income tax return	Yes	Yes	Yes
Capital & Surplus required	If	Yes	Yes

Captives: What they write



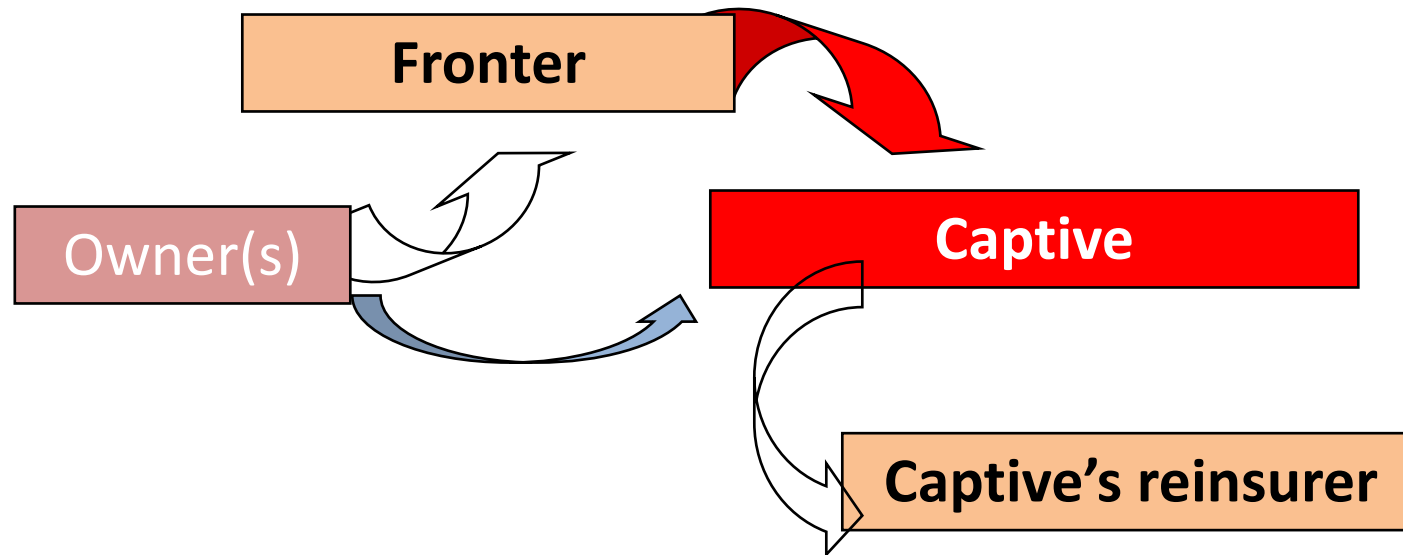
Risk Insured in Captives?

- Property, Business Interruption
- General Liability
- Professional Liability
- Automobile
- Completed Operations Liability

Risk Insured in Captives (cont'd)

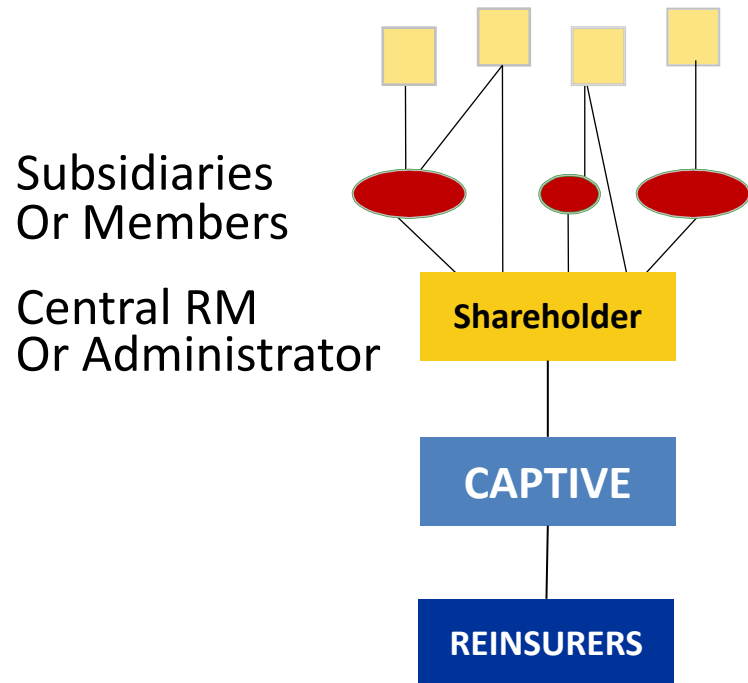
- Marine, transportation
- Terrorism
- Workers Compensation
- Employee Benefits
- Cyber Liability
- Customer, dealer, franchisee ins coverages

Direct or Reinsurance Captives?

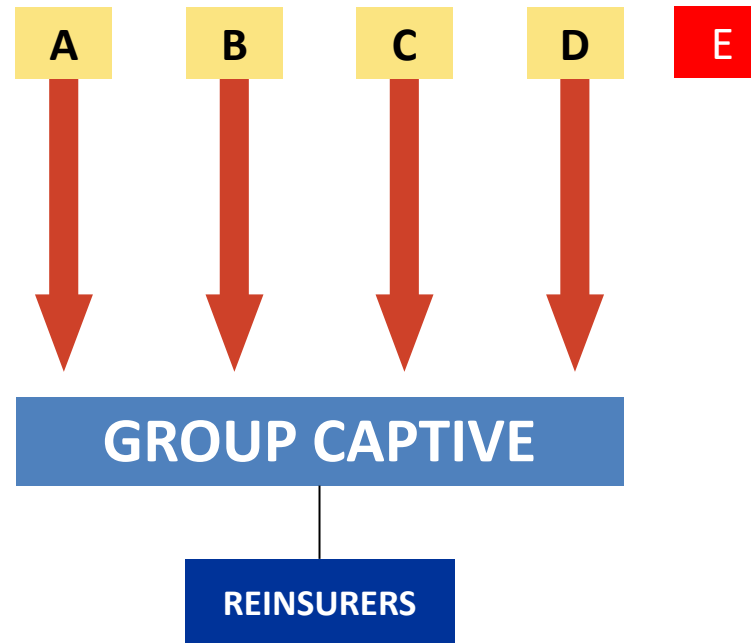


Single Owner / Group Captives

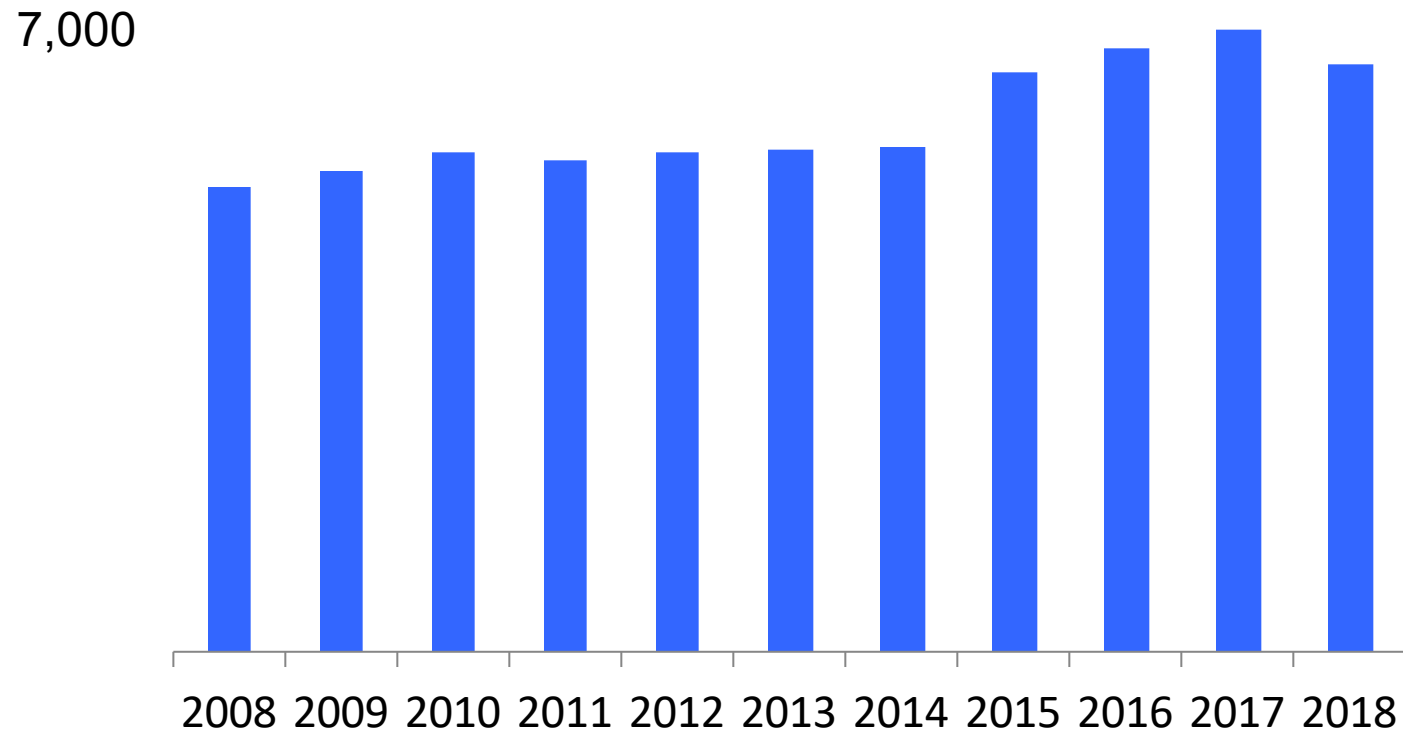
Single Owner – Direct



Group Captive – Direct



Number of Captives: Continual Growth?



Why Captives? The Key Reasons



Cost reduction

Access to reinsurance

Investment income

Administrative tool

Audience? which of these?

- Details of all 4 in the appendix

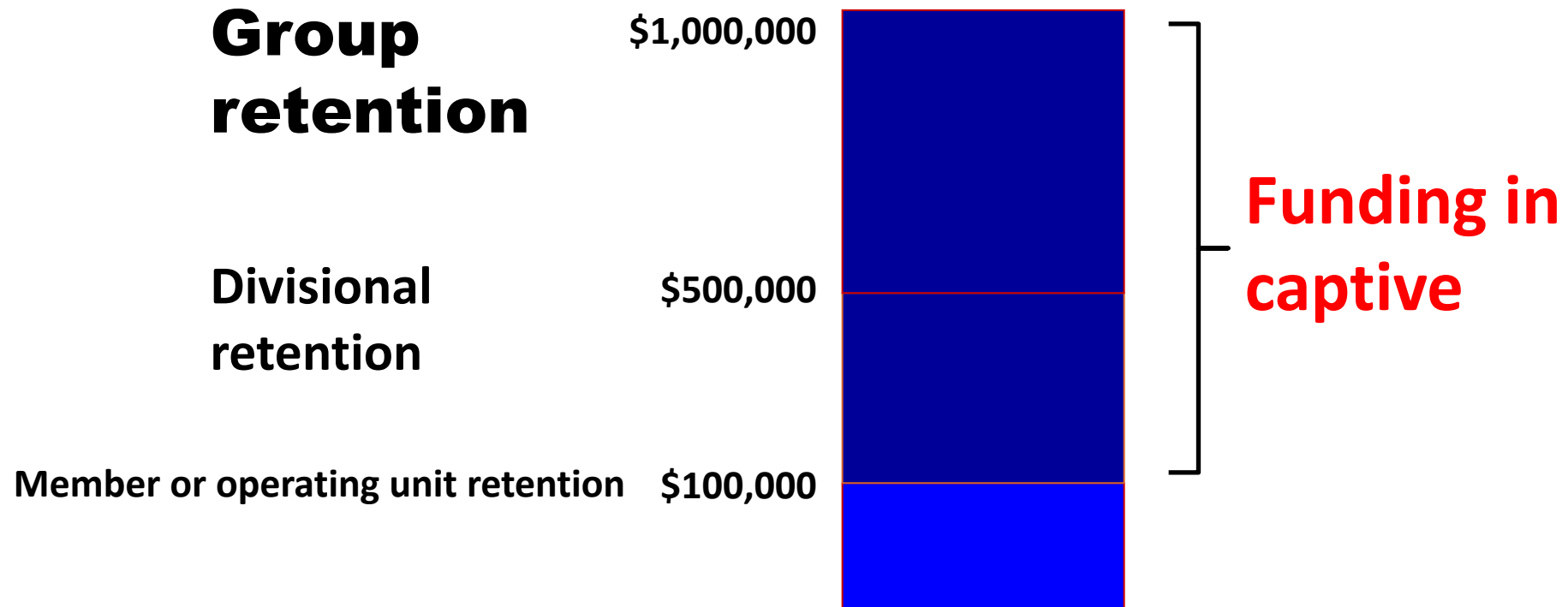
1. Cost Reduction: How?

2. Reinsurance

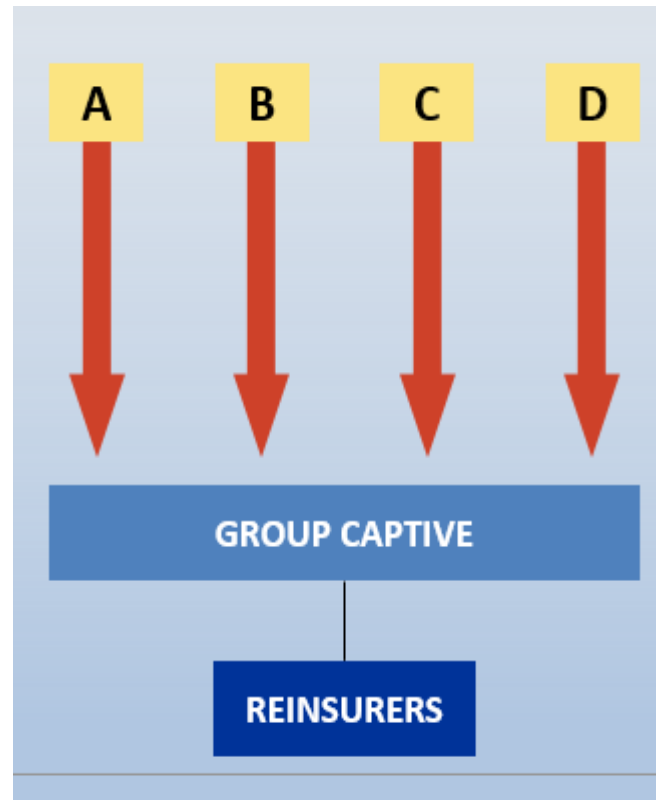
Reinsurance! Where? How much? (Session on Tuesday)

3. Investment Income

4. Administrative Tool

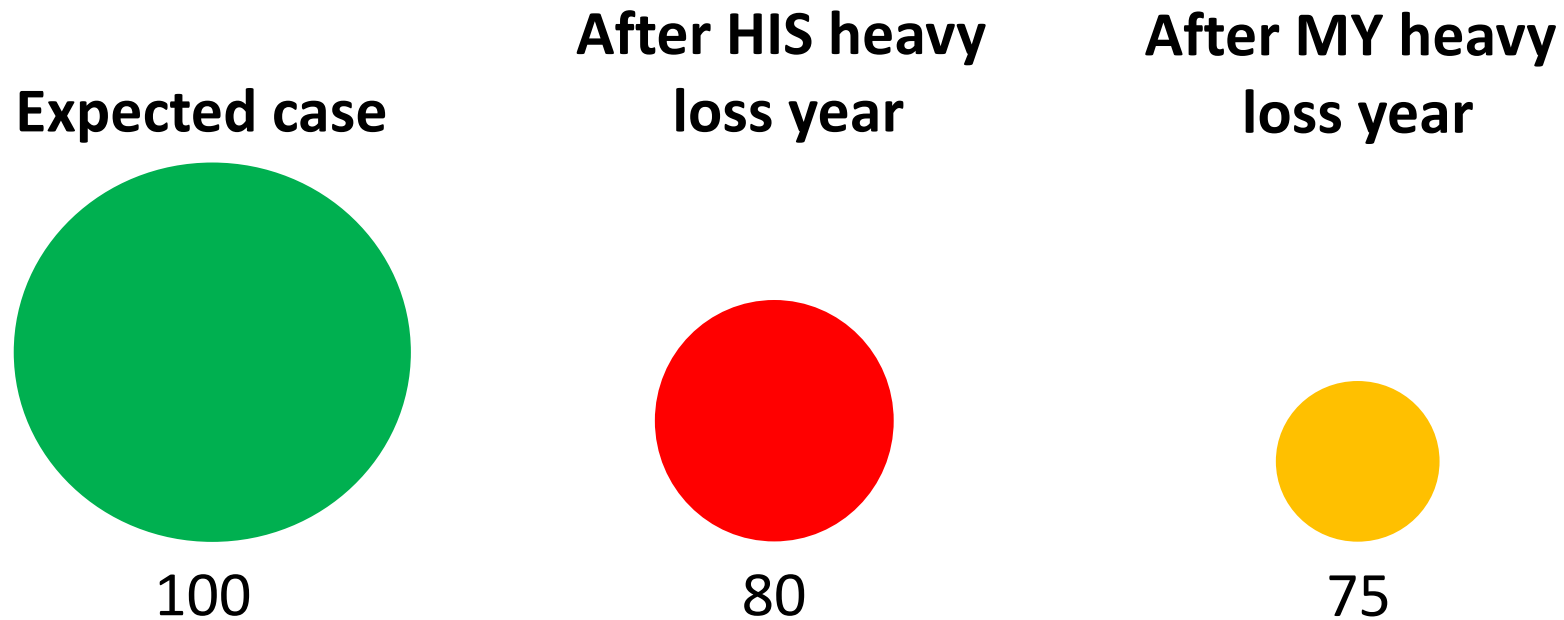


Group Captive – (reminder)



Risk sharing – obstacle or mutuality

Size of my account....



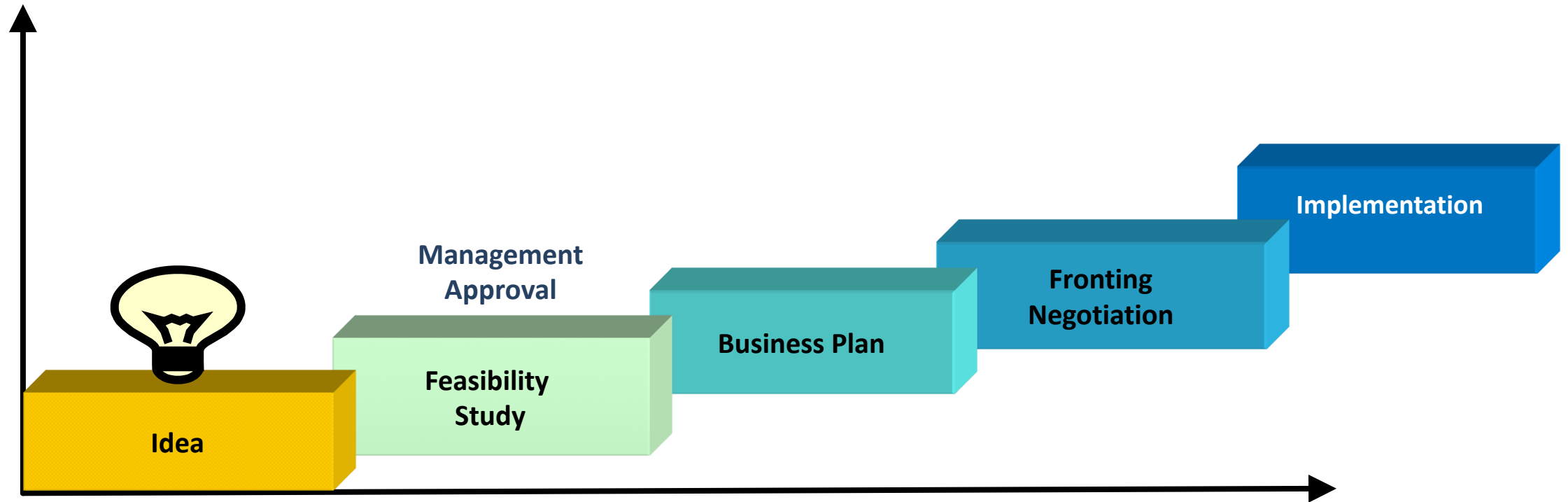
Feasibility of a Captive



Feasibility: The Numbers!

Proforma Projections						
	2020	2021	2022	2023	2024	Total
Underwriting results	1,156,452	1,252,952	1,186,200	1,251,360	1,542,340	6,389,303
Investment Income	<u>94,459</u>	<u>151,402</u>	<u>194,286</u>	<u>238,520</u>	<u>286,213</u>	<u>964,880</u>
Captive net income	1,250,911	1,404,354	1,380,485	1,489,879	1,828,553	
Income tax (if any)						
After-tax income	1,250,911	1,404,354	1,380,485	1,489,879	1,828,553	7,354,183

Start up Captives: The Timeline



Captives: The Big Issues

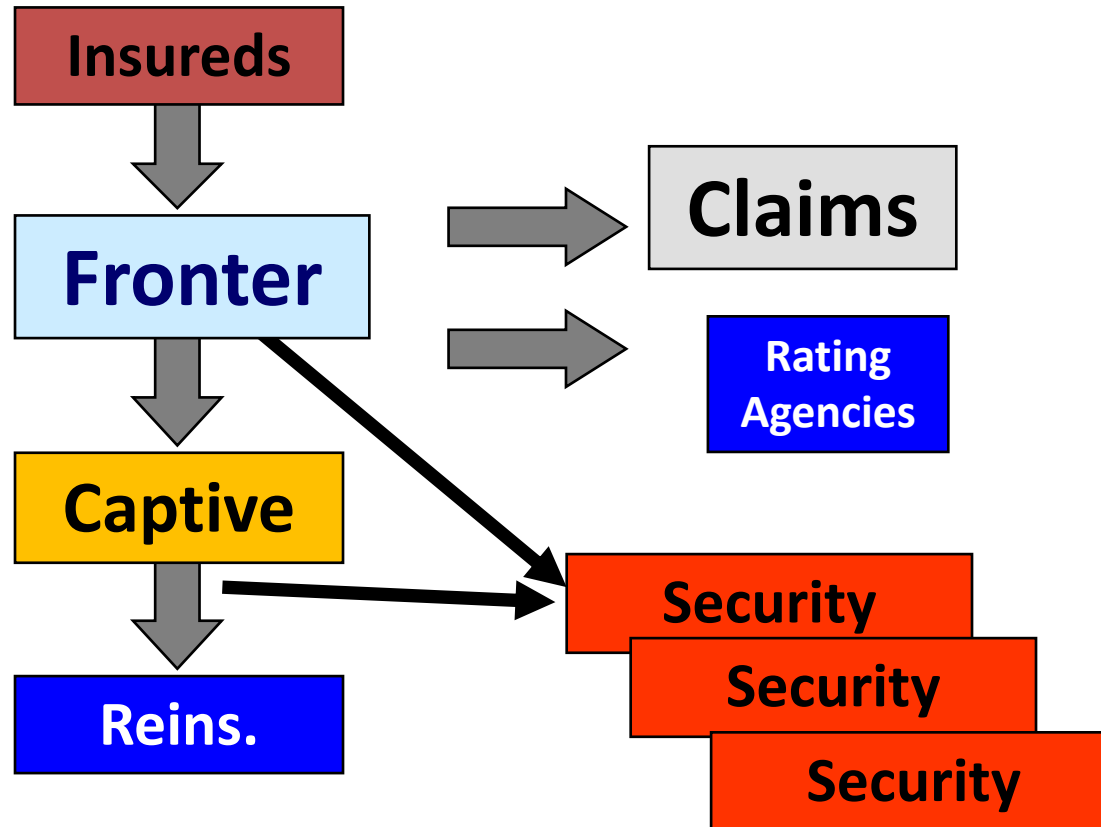
Fronting – what, why, how (in 2020)

Domicile and **regulation**

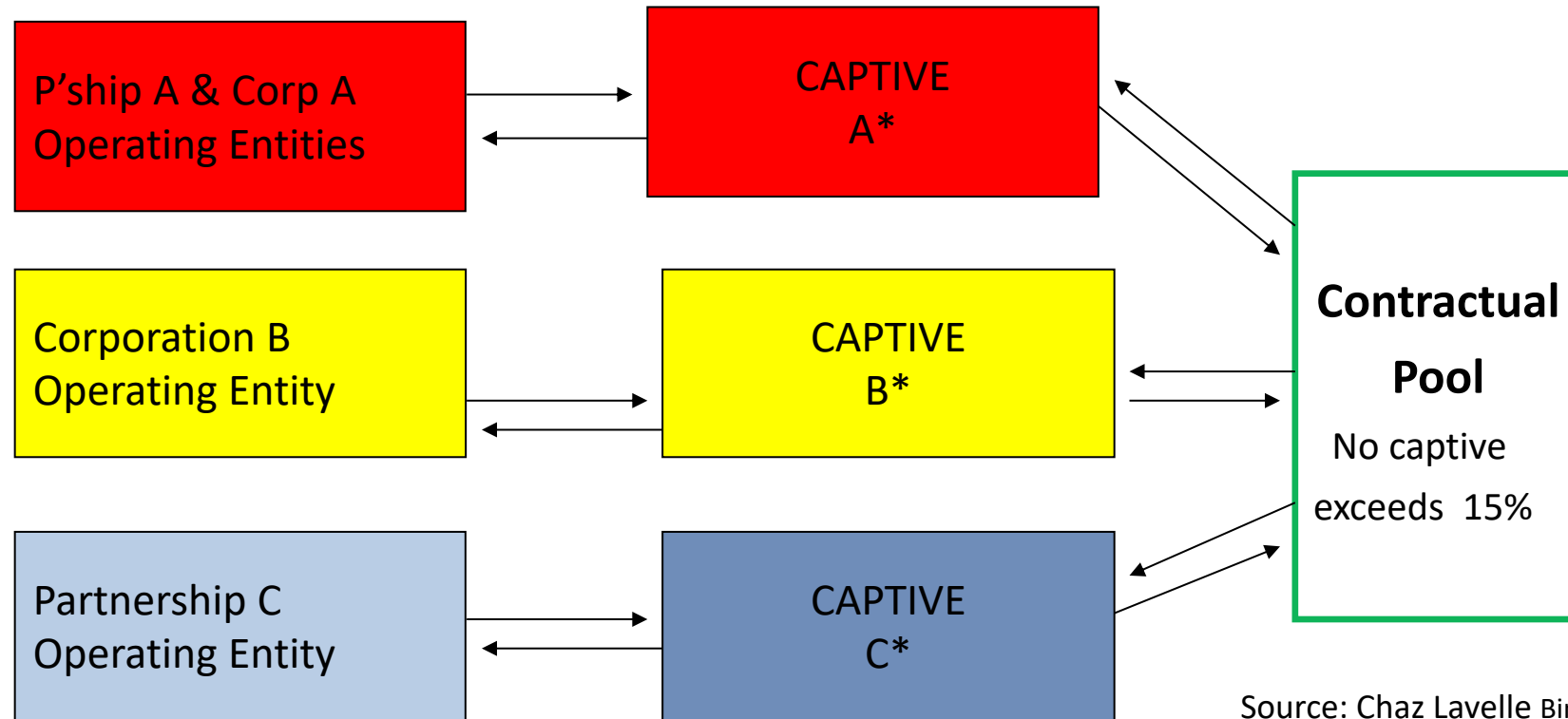
Captive management

....Tax factors

Fronting: 2020 Problem #1



Other issues: Pooling



Source: Chaz Lavelle Bingham Greenebaum Doll

Captive Domiciles

Onshore – offshore: the major factors in 2020

Perception

Regulation (..and FATCA – a non-issue for captives)

Accessibility (....also of the regulator!)

Tax factors (onshore, offshore, self-proc.)

... Costs

Captive by Domicile / Number

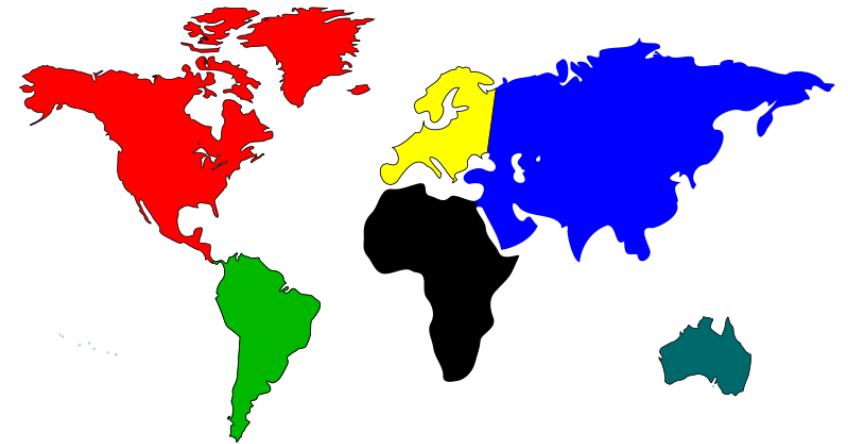
2019 the top nine (out of 70!)		
Bermuda	711	
Cayman	674	
Vermont	580	
Utah	443	
Delaware	421	(1200)
Guernsey	206	(500+)
Barbados	276	
North Carolina	240	
Luxembourg	198	

Top 10 = 2/3 of total. US domiciles = 1/3 of all captives

Domicile Selection

Onshore? Offshore?

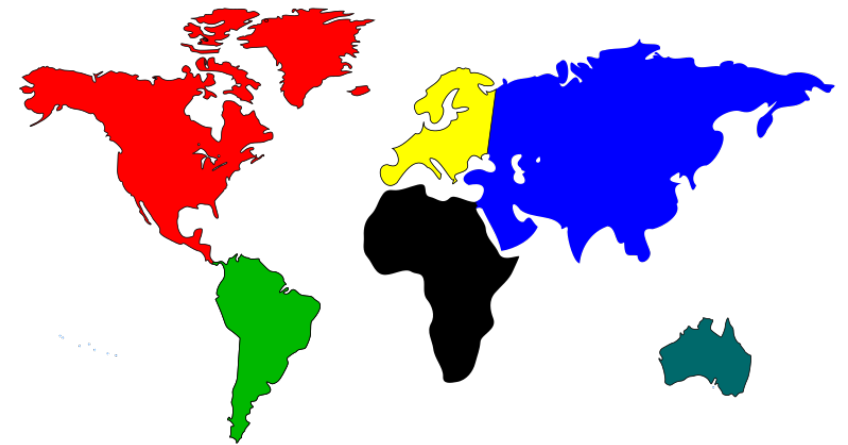
- Capitalization and surplus requirements
- Receptiveness, stability of regulatory environment
- Quality of local infrastructure
- Availability of expertise
- Costs



Domicile Selection (continued)

Onshore? Offshore?

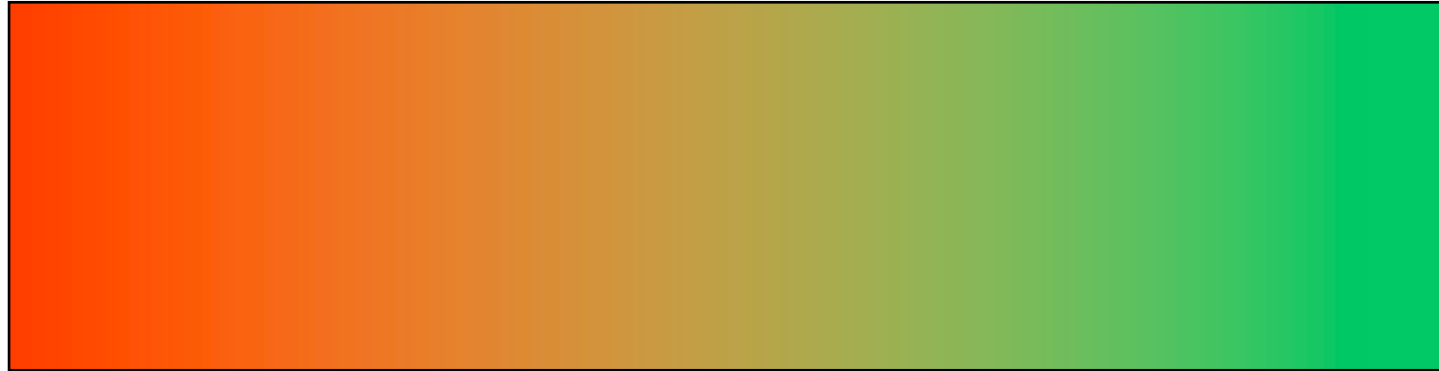
- Investments: flexibility
- Other captives like us domiciled there?
- Experience in our business?
- Tax issues: US Federal, State self-procurement, premium taxes



Regulation



Regulation Differences



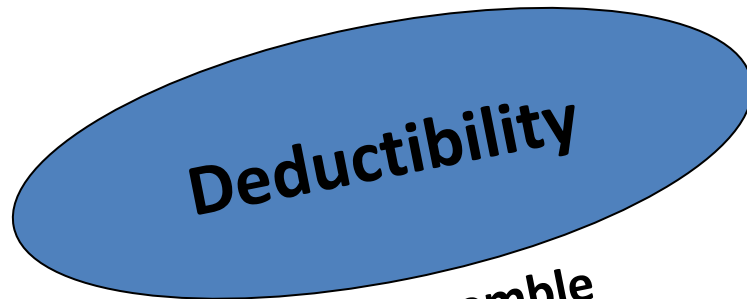
Too much

Just Right

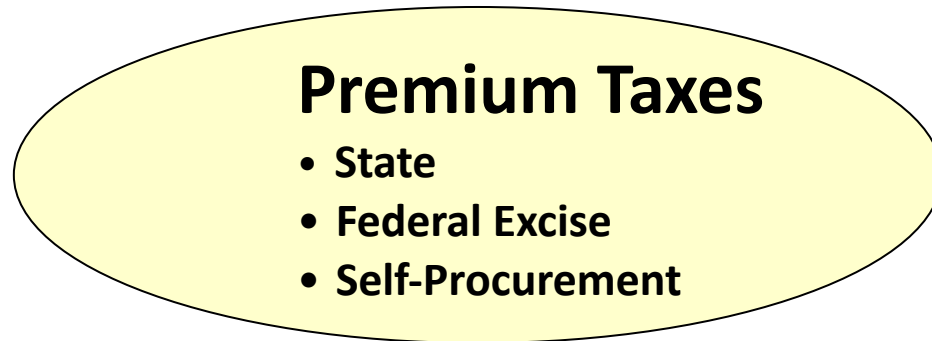
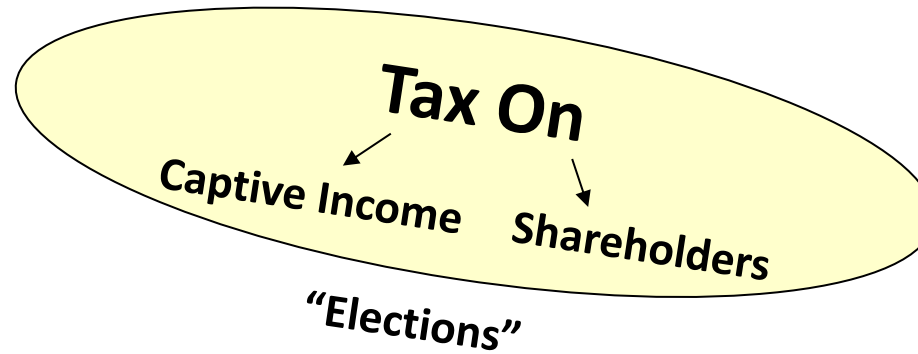
Too little



Tax Factors: The three things



Must resemble
“normal” insurance



And...
Offshore/onshore
“non-profits”
831-b small ones

Tax Factors - Deductibility

Must demonstrate

- Risk shifting
- Risk distribution
- Business purpose
- Attributes similar to the existing marketplace

Taxation – Current Issues

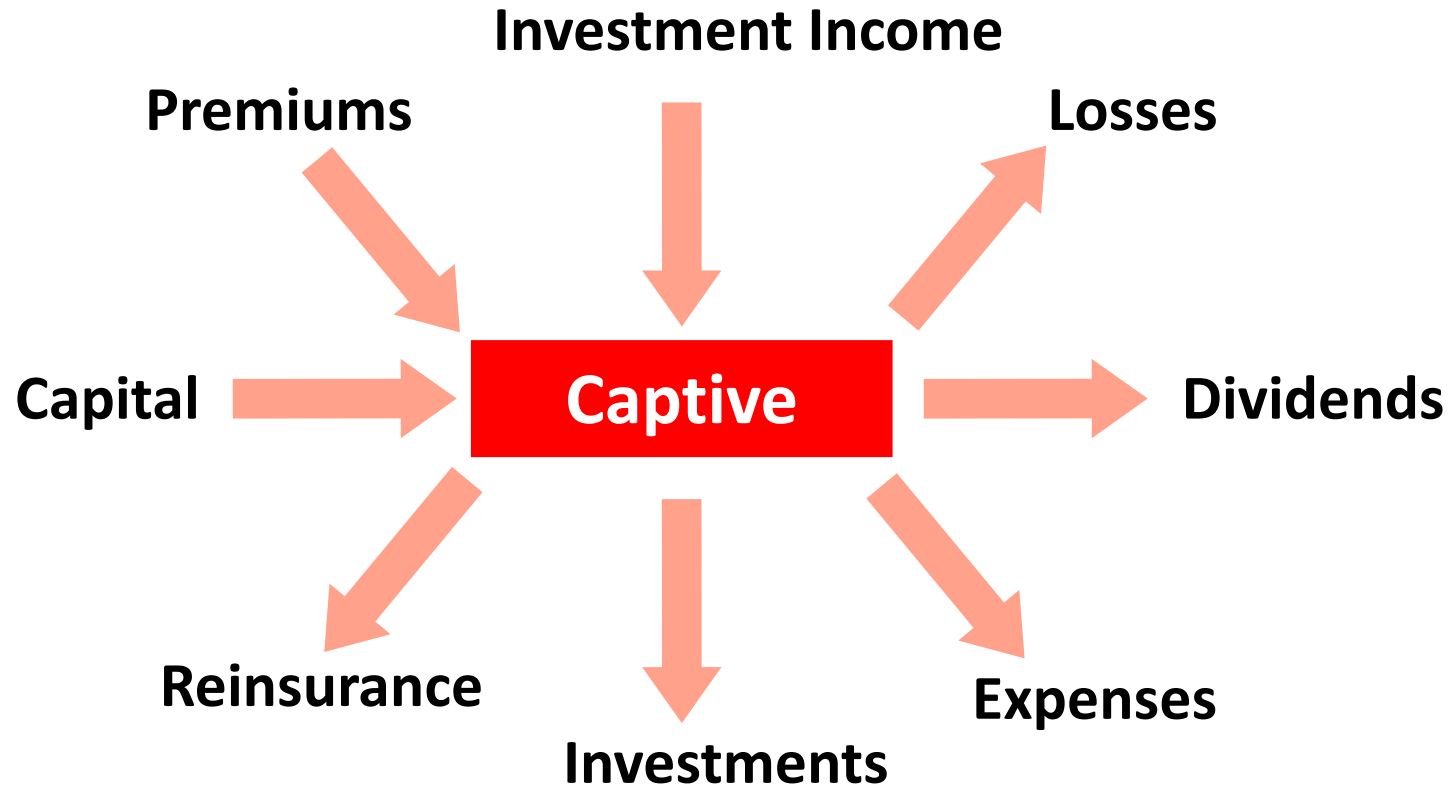
831b structures : use and abuse, IRS “attacking”

More intrusive activity for offshore

Example: FATCA

Other issues (Come to the round table!)

How It Works: Cash flow, management



Unrelated business?

Necessary, profitable, dangerous?



Your own (employee benefits)

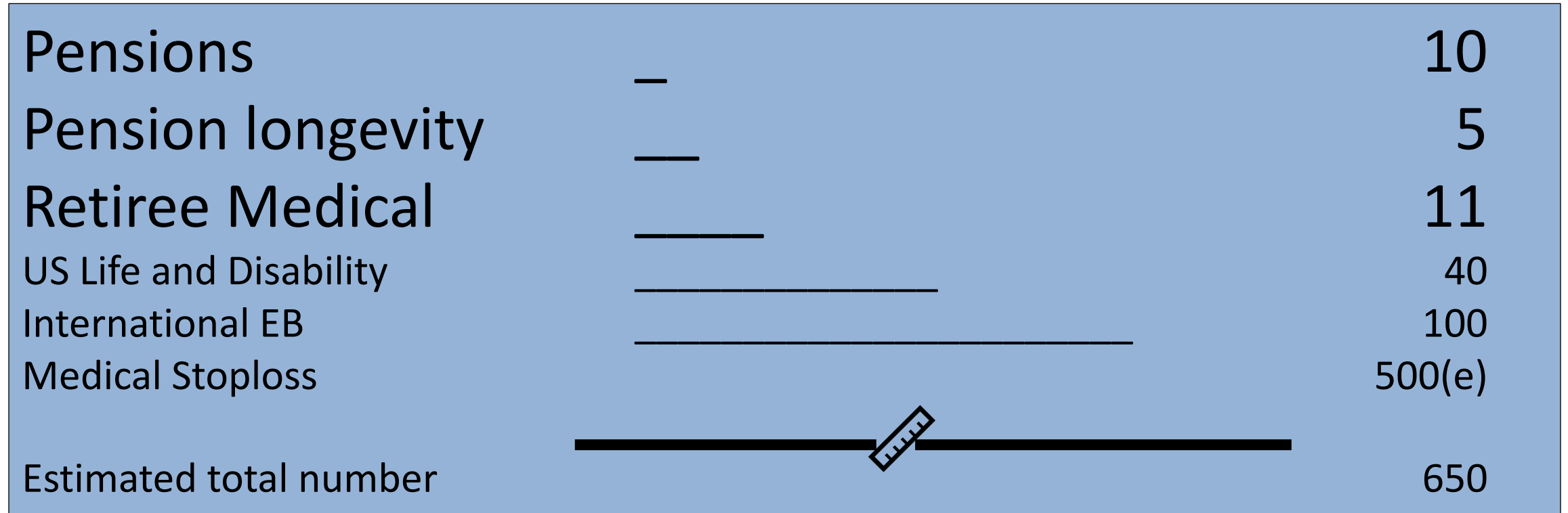
Controlled unaffiliated

EB in captives 2019 per Mark Cook



Employee Benefits in Captives 2019

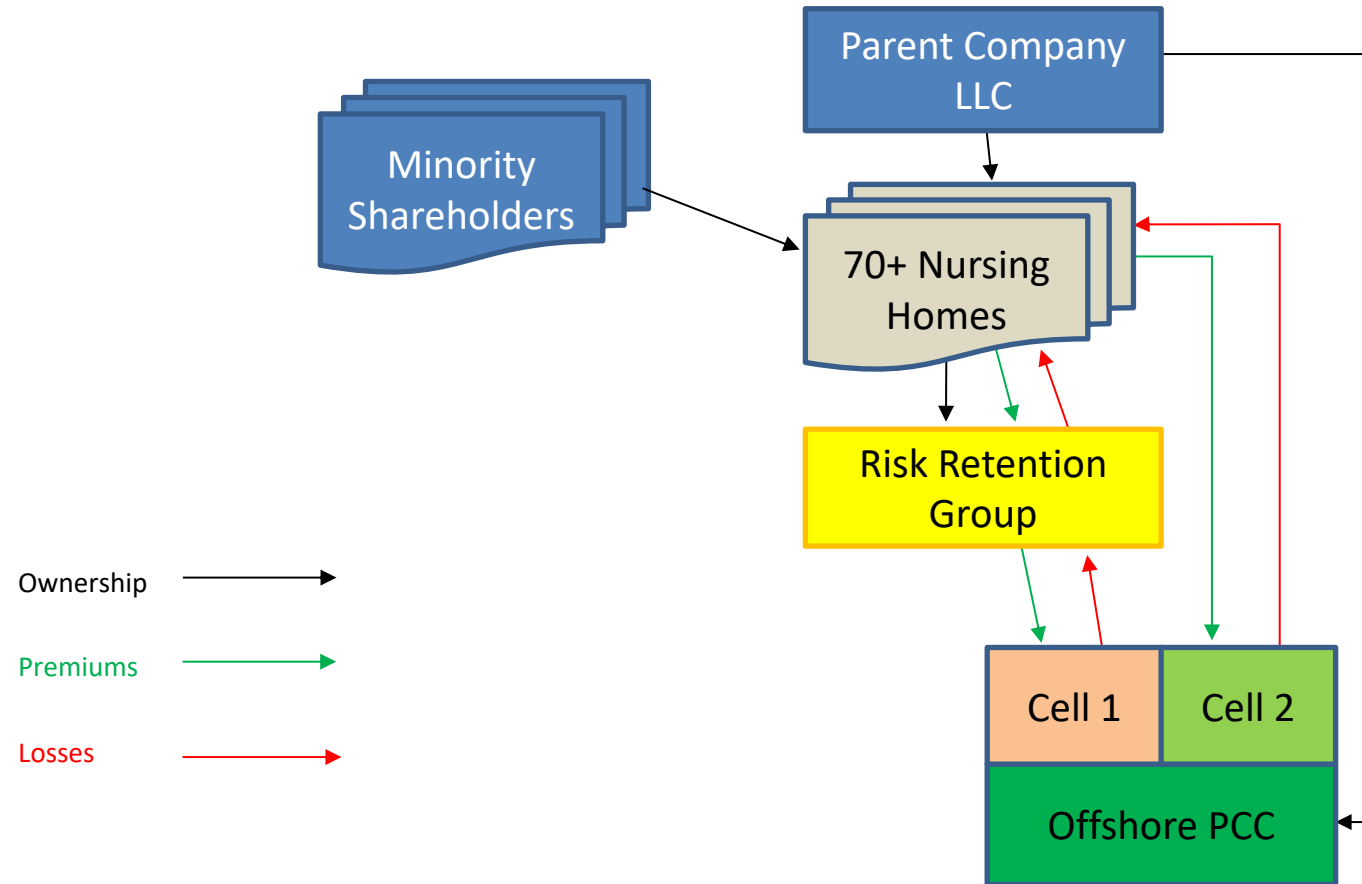
Estimated Number of Programs



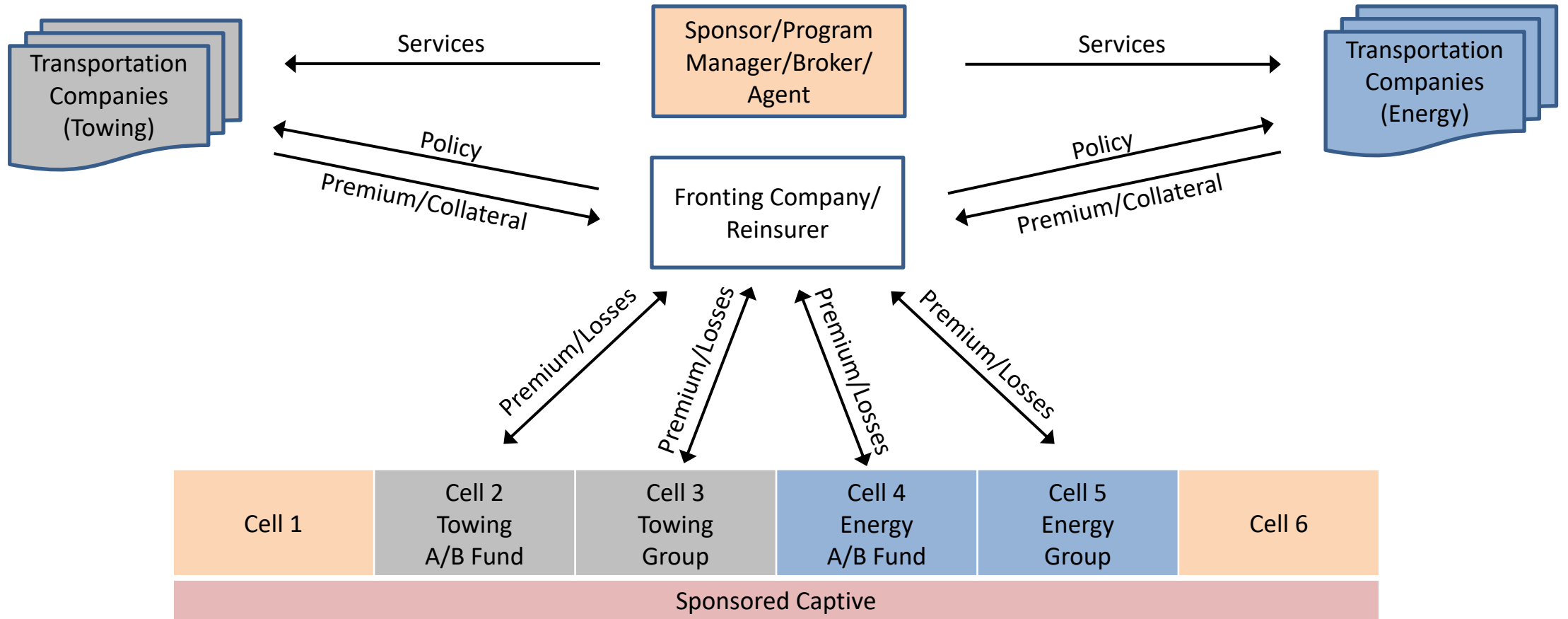
What are the savings?

Coverage	Savings Range*
Retiree medical	<ul style="list-style-type: none">• 7% – 10%+ of the accumulated postretirement benefit obligation
Long-term disability	<ul style="list-style-type: none">• 15% – 25% of commercial insurance• On self-insurance, accelerated deduction of claims cost and tax-effective investment accumulation on reserves
Term life insurance	<ul style="list-style-type: none">• 10% – 15% of commercial insurance
Multinational pooling	<ul style="list-style-type: none">• 10% – 15% of the pooled premium
Active medical	<ul style="list-style-type: none">• First year only, incurred but not yet paid• After first year, medical trend
Multinational pooling	<ul style="list-style-type: none">• 10% – 15% of the pooled premium
Active medical stop loss	<ul style="list-style-type: none">• 10% – 12% of the cost of stop loss

Case Study#1 – Nursing Homes



Case Study #2 – Transportation Firms



Financial Keys to Captive Financial Success

- The right **initial capital** (how much, what form?)
- **Surplus** accumulation
- The **right investments** (by whom?)
- **Return on capital** (what capital?)

Operational Keys to Captive Financial Success

- ➡ The **right rates** (who sets them?)
- ➡ **Low expenses** (what expenses?)
- ➡ The right **loss estimates** (actuaries!)
- ➡ **Reinsurance** protection that works

Two more keys to Captive Success

 **Long-term dedication**

 **Risk management**
(of the **captive's** risks!)

Our Time-tested slogan



**“Captive business
is
the best business”**

International Center for Captive Insurance Education



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

www.iccie.org

Q & A

Hugh Rosenbaum, Retired Principal, WTW

hughro2@gmail.com

Jeff Kenneson, President, Quest Captive Management LLC

jeff.kenneson@questgroup.bm

Bob Davidson, Captive Consultant

bob@davidsonrisk.com

Dan Kusaila, Tax Partner, Crowe Horwath

Daniel.Kusaila@crowe.com

Appendix

- Reasons for captives - details

1. Cost Reduction: How?

- Reduce high commercial rates
- Eliminate non-essential services
- Eliminate pooling charges
- Avoid charges for guarantee funds

1. Cost Reduction

*“I want to **reduce insurance costs.**”*

Obvious example:

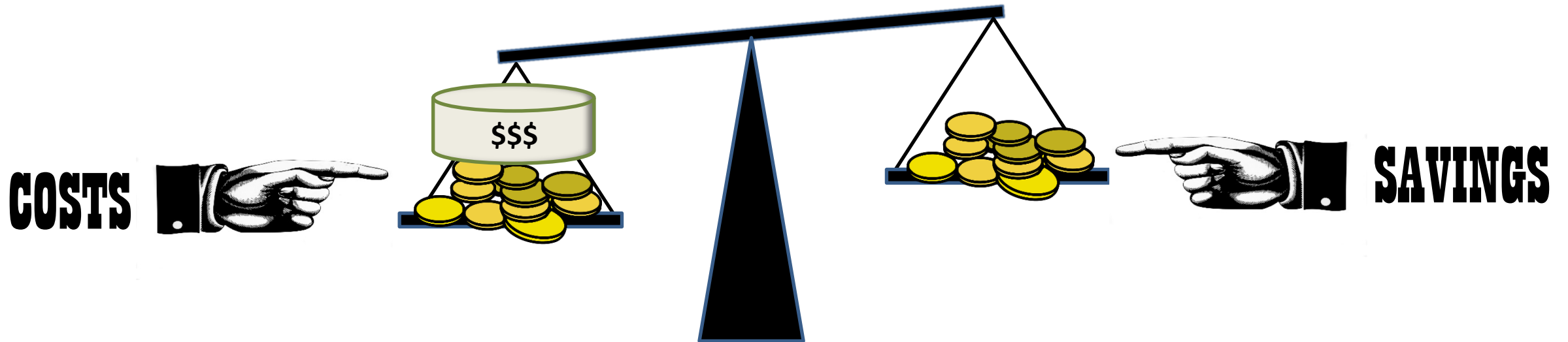
*“**Low loss ratio?**”*
$$\frac{\text{Losses incurred}}{\text{Premiums retained}}$$

Less than 30%

Retentions: The group could take higher retentions, but the individual members or business units can't.

Cost Savings? Discuss!

*Adverse/Catastrophic
Claims Activity



2. Reinsurance

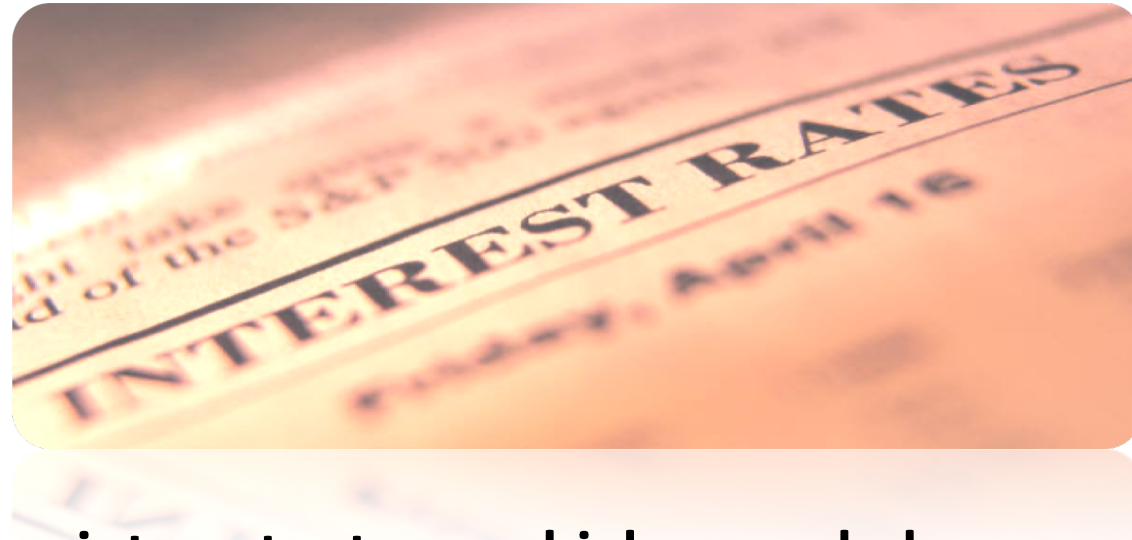
*“I want **access to reinsurance capacity.**”*

Example:

A large healthcare group found reinsurers were
more willing to reinsure a captive
...than excess insurers willing to
insure above a SI trust

Reinsurance! Where? How much? (Session on Thursday)

3. Investment Income



**When interest rates are high enough, loss reserves
for lines with longer payout patterns generate
extra income**

3. Investment Income (2)

1,000,000 of loss reserves, paid out over seven years produces investment income

3%	104,000
4%	147,000
5%	181,000
7%	267,000

4. Administrative Tool (cont.)

*There might be economies of scale in a **group captive***

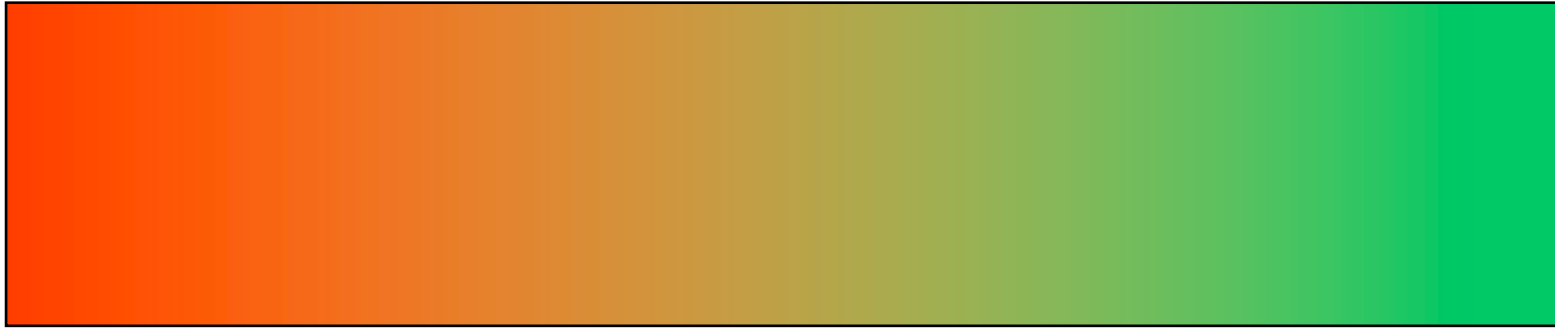
All the previous reasons plus ...

The value of shared retentions, shared
aggregates, shared services

Example: Risk Retention Groups (Session on Friday)

-an “escape from fronting”

Management Matters



Too much



Just Right



Too little

