BUSINESS INSURANCE

Time for a Captive Refresh?

2018 World Captive Forum

January 31 – February 2, 2018

Fort Lauderdale, FL

#WorldCaptiveForum

With You Today…

Karin Landry, CEBS, ACI, CLTC

Managing Partner

Spring Consulting Group

Michael Lubben, CPCU, CRM, AIC

Director of Global Risk Management

Henry Crown and Company/CC Industries

Agenda

- Importance of Refeasibility (Why & When)
- Recommended Captive Optimization Process
- How to Get Started
- A Demonstrative Case Study: Adding Value to the Organization

Importance of Refeasibility

- Our Spring Captive Analytical Risk Evaluation ("CARE") Team recommends a captive evaluate its risk appetite and exposure at least every 5 years

Importance of Refeasibility

Questions to be answered in a review:

- Are you still writing the right lines in your captive?
- Are you still in the right domicile?
- Would a different structure be more profitable?
- Would other service providers make a difference?
- Have your claims changed significantly?
- Have regulations changed over the years?

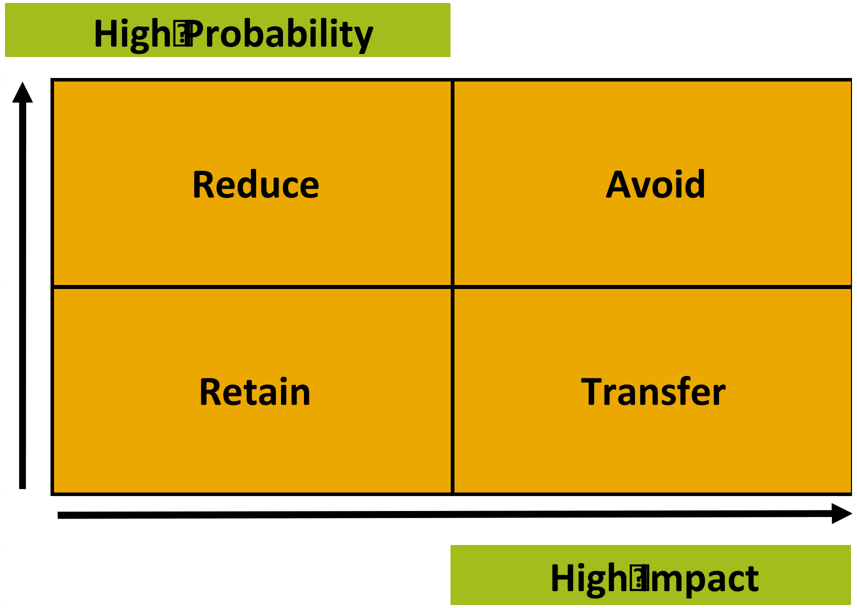
Captive Optimization Process

- Starts with a captive refeasibility study

- Cannot take a “one-size-fits-all” approach, but through our Spring CARE system, we follow/recommend this general evaluation structure

Goals Stage

- Focus on confirming goals & objectives of your captive, both old and new
  - Have original goals been achieved? How have goals changed over the years?
- Collect data
- Identify changes in your risk profile → Matrix to the right shows the 4 classic actions a company can use to handle each risk



De Loach, J. W. (2000). *Enterprise-wide Risk Management: Strategies for linking risk and opportunity*. London: Financial Times/Prentice Hall.

Goals Stage

Emerging risks should be considered in addition to these common captive coverages

Employee Benefits	• AD&D • Life/Loss of Key Employee • Long-Term Disability • Medical Stop-Loss • Voluntary Benefits	• Cyber Liability • Directors & Officers Liability • General Liability • Professional Liability • Property (deductible or excess layer) • Reputation/Brand • Trade Credit • Workers' Compensation (deductible layer)	Property & Casualty
Property & Casualty	• Auto Liability • Business Interruption • Commercial Policy Excluded Risk		

Impact Stage

- How would all the different pieces of the captive puzzle be affected by the changes you're considering?
- A professional captive optimizer would look to accomplish the following in this phase:
    - Conducting an analysis of your risk financing optimization
    - Reviewing your current reinsurance levels and optimizing your use of reinsurance
    - Stress testing of the captive with reasonable adverse case outcomes

Strategies Stage

What methods will you utilize in your captive refresh?

- Any additional lines of coverage that could be insured by your captive?
- Surplus management strategy – considerations include:
  - Average cost of capital
  - Retention levels
  - Reinsurance use
  - Taxes

BUSINESS INSURANCE

#WorldCaptiveForum

Structure Stage

How will it all work together?

- Market changes should give you some food for thought
  - E.g., pure captives are increasingly changing to sponsored entities
- Identify investment management best practices as well as the optimal collateral structure

Measurement Stage

- Professional consultant will develop implementation plans based on findings and make actionable recommendations for achieving the goals established in phase 1
- At the conclusion of the measurement phase, a report is produced, containing:
    - All of the findings of the refeasibility study, reviews and recommendations

Ongoing Captive Review

- Align with Risk Management and company strategies
  - ERM
  - Acquisition Activity
- Consider BOD and officer engagement/involvement
- Captive usage should change with the business
- Challenges within the company can be solved/mitigated with the captive

A Case Study

Now let’s look at the process in a real-life business situation…

Henry Crown and Company / CC Industries

Wholly owned companies:

Great Dane

Selig liners

Little Lady Foods

PROVISUR TECHNOLOGIES

CROWN COMMUNITY DEVELOPMENT

GILLIG

J.L.CLARK

ASPEN SNOWMASS

TRAIL KING industries

Globalization of insurance programs:
- Tough risks
- Deductible "buy-downs"

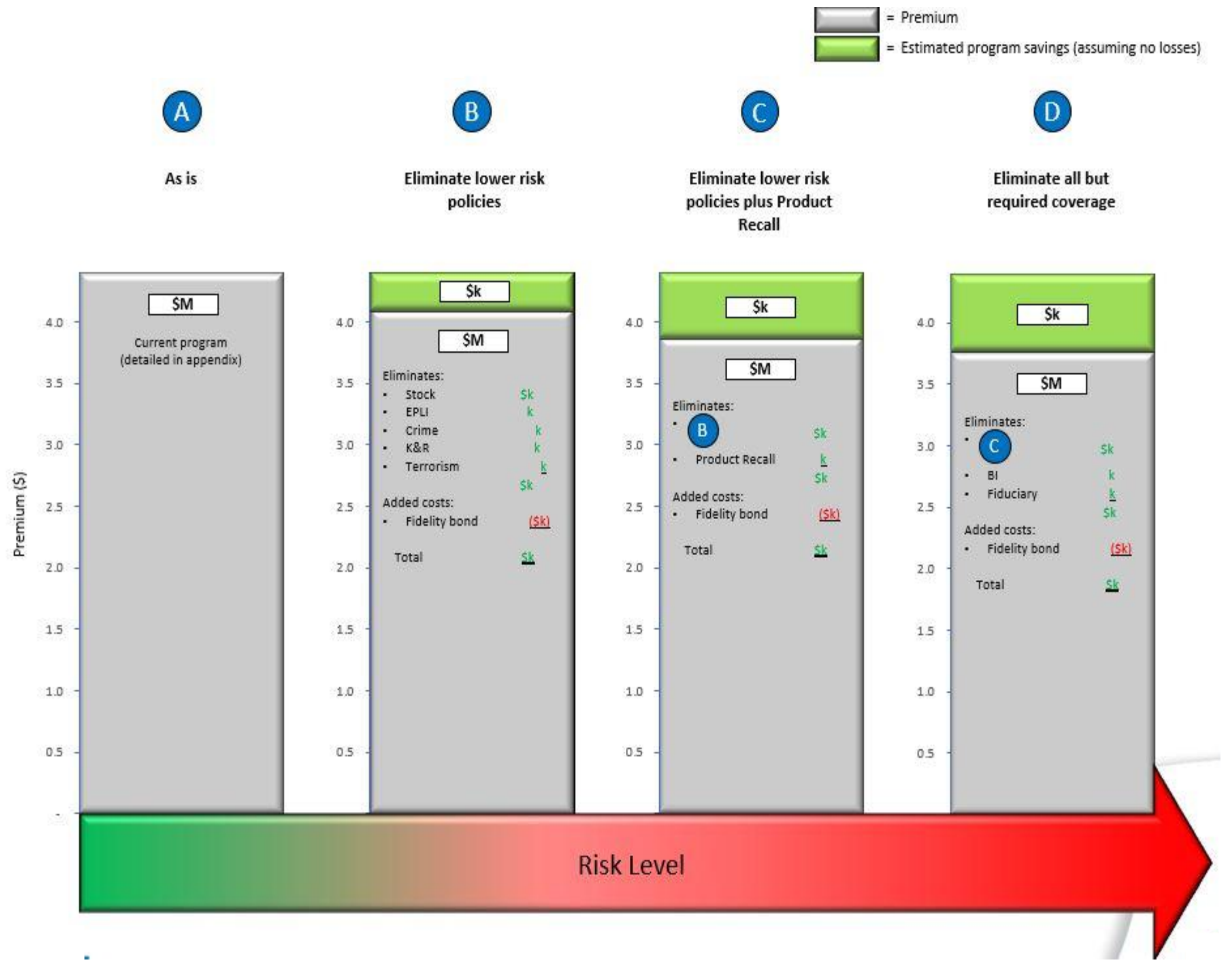
Significant Ownership:

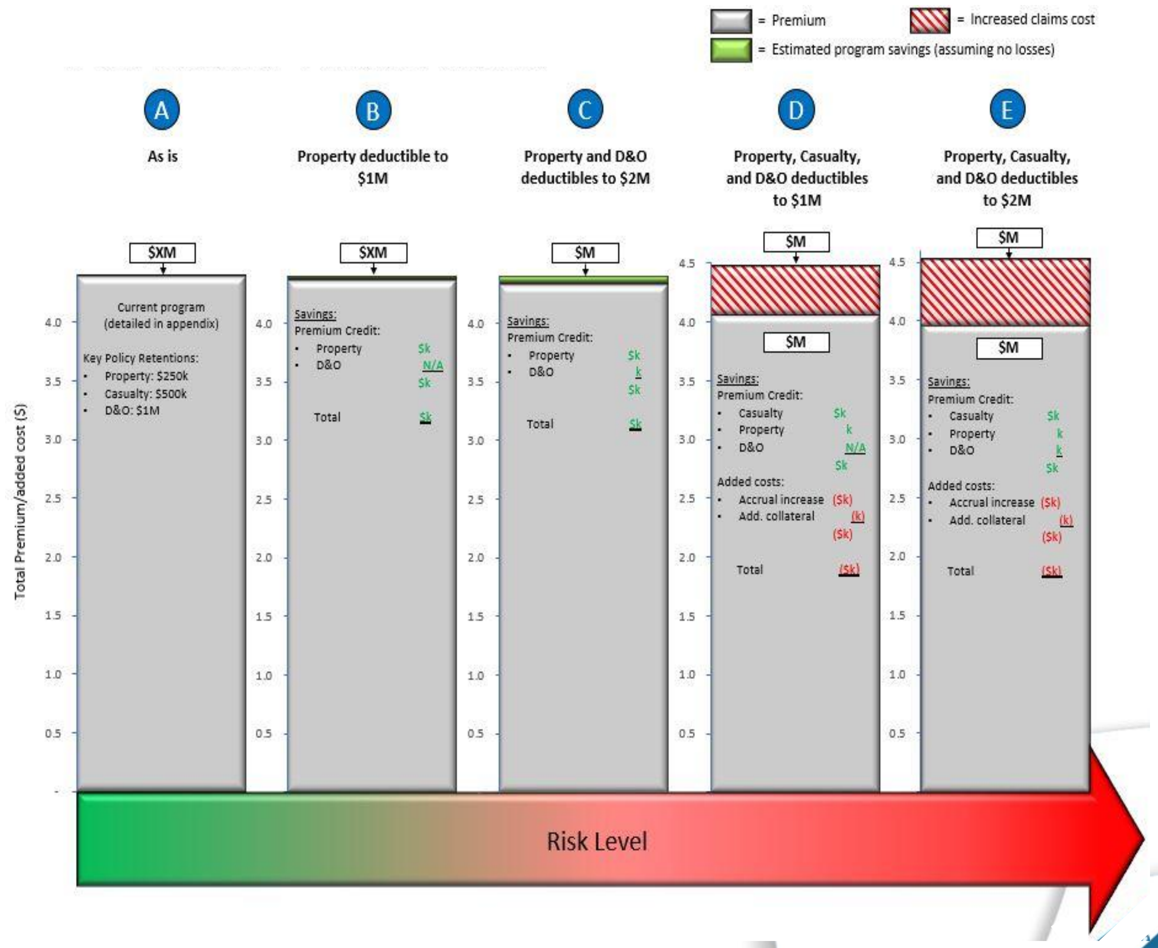
Yankees

Mammoth

CHICAGO BULLS

Select Policy Non-Renewal / Increased Retentions





Change of risk appetite – temper with captive

Workers' Compensation Claims Actuarial Analysis Comparison (1/31/16 vs. 10/31/15) & Retention Loss Portfolio Transfer (LPT) Options

Increasing predictability of losses:
- Greater control of reserving practices
- Loss portfolio transfers

Operations Workers' Compensation Actuarial Analysis as of 01/31/16								
	Claim Counts			Paid and Expected to Pay (TPA reserve & recommended IBNR)				
Insurance policy effective date	Total (a)	Closed (b)	Open (a-b)	Total Paid (c)	TPA reserve (left to pay estimate) (d)	Additional reserve (further left to pay) (actuarial IBNR) (e)	Total expected to pay; actual accrual (f)=(d+e)	Accrual $ left to pay per open claim f/(a-b)
Prior to 6/1/02	12,357	12,344	13	$59,872,262	$138,884	0	$138,884	$10,683
6/1/2002	579	577	2	5,858,284	297,289	0	297,289	148,645
6/1/2003	466	462	4	7,513,107	91,704	0	91,704	22,926
6/1/2004	375	373	2	4,726,754	99,008	0	99,008	49,504
6/1/2005	303	301	2	5,220,721	190,135	39,144	229,279	114,640
6/1/2006	299	294	5	6,306,926	547,954	45,120	593,074	118,615
6/1/2007	259	256	4	3,826,498	195,424	28,078	223,502	55,876
6/1/2008	210	204	6	4,524,319	232,049	143,633	375,681	62,614
6/1/2009	193	185	8	3,433,767	505,408	10,825	516,233	64,529
6/1/2010	161	150	11	3,201,071	659,390	139,539	798,929	72,630
6/1/2011	198	182	16	4,146,640	900,889	452,471	1,353,360	84,585
6/1/2012	205	190	15	5,427,750	954,284	1,017,966	1,972,250	131,483
6/1/2013	59	57	2	766,375	371,476	262,149	633,625	316,813
9/1/2013	212	186	26	2,358,805	762,434	2,248,761	3,041,195	116,969
9/1/2014	270	198	72	1,588,120	1,616,985	2,794,895	4,411,880	61,276
9/1/2015	79	34	45	$122,869	$376,969	$1,856,745	$2,233,715	$49,638
TOTAL	16,226	15,993	233	$118,894,268	$7,940,282	$9,039,326	$17,009,608	

Operations WC Actuarial Analysis 01/31/16				
	Actuarial Accuracy			
Insurance policy effective date	Most recent actuarial estimate /accrual at 1/31/16 (g)=(f+c)	Prior actuarial estimate /accrual at 10/31/15 (h)	(B)/W Change (g-h)	Comments
Prior to 6/1/02	$60,011,145	$60,062,845	($51,700)	Adjuster reserve takedowns with no closures
6/1/2002	6,155,573	6,051,584	103,989	$239k reserve increase on previously denied claim
6/1/2003	7,604,811	7,647,300	(42,490)	Adjuster reserve takedowns with no closures
6/1/2004	4,825,762	4,749,021	76,741	Adjuster reserve increase due to ongoing medical
6/1/2005	5,450,000	5,450,000	0	No change
6/1/2006	6,900,000	6,680,000	220,000	Serious injury (loss of eye) couldn't be settled
6/1/2007	4,050,000	4,050,000	0	No change
6/1/2008	4,900,000	4,900,000	0	No change
6/1/2009	3,950,000	4,000,000	(50,000)	Set at adjuster's total incurred; no IBNR
6/1/2010	4,000,000	3,700,000	300,000	Actuarial range: $4M to $5.2M
6/1/2011	5,500,000	5,500,000	0	Actuarial range: $5.5M to $7.8M
6/1/2012	7,400,000	7,200,000	200,000	Actuarial range: $7.4M to $11M
6/1/2013	1,400,000	1,100,000	300,000	Actuarial range: $1.4M to $3M
9/1/2013	5,400,000	5,125,000	275,000	Actuarial range: $5.4M to $6.7M
9/1/2014	6,000,000	5,875,000	125,000	Actuarial range: $6M to $9.1M*
9/1/2015	$5,655,800	$5,655,800	$0	Actuarial range: $5.7M to $12.1M*
TOTAL	$139,203,091	$137,746,550	**$1,456,540**	**Needed adverse accrual adjustment**

All actuarial estimates set at lowest possible level (adjuster total incurred or lowest pick from 8 actuarial methods)

Claim count running higher (79 vs. 75) in 9/1/15 vs. same time prior year; but estimate is less ($5.65M vs. $6.0M); '15 estimate may be low

Claim count increased 29% YOY; estimate rose only 11% with no change in severity mix (MO vs. LT); estimate appears low

We should expect continued unbudgeted adverse development if we continue this practice

* Removed extreme projections due to immaturity of data

Legacy practice of choosing lowest ultimate resulted in insufficient accruals; We need to:

1. Shore-up older policy periods through claim reviews
2. Consider moving to mid or lower-mid section of range
3. Recognize increased claim frequency in policy years 9/1/2014 and 2015

Options:	Captive	Insurance	
Premium (one-time)	$21.7M (75% Conf. level)	$17.6M (Indication)	➢ Insurer covers 6/1/96 – 8/31/15; Captive covers all losses ➢ Underwriter will conduct final due diligence to bind
Current year tax benefit	$8M	$5.9M	➢ ($21.7M@37%=$8M)–($21.7@3.125% mfg ded.)=$7.3M ➢ ($17.6M@37%=$6.5M)–($17.6M@3.125% mfg. ded=$5.9M
Loan back to company	$10.8M (1.4% int. rate)	N/A	➢ Captive loan back is intracompany accounting ➢ $300k credit from insurer for not taking loan back
EBIT Impact B/(W)	($5.0M)	($1.1M)	➢ Captive: $21.7M prem. - $16.7M booked = ($5M) ➢ Insurance: $17.2M prem. – $16.1M* booked = ($1.1M)
P&L Impact B/(W)	$3.0M	$5.0M	➢ Captive: EBIT ($5.0M) + tax ben. $8.0M = $3.0M ➢ Ins: EBIT ($1.1M) + tax ben. $6.4M – int. $0.25M = $5.0M
NPV (8 years with 8% IRR) vs. current program	$1.6M	$0.9M	➢ Captive could provide dividends back to the business should losses trend favorably; liabilities stay with company ➢ Insurance completely eliminates risk of adverse development and removes liabilities from company
Retained risk	Aggregate Losses > $21.7M	*Pre-1996 losses ($600k)	➢ Captive provides for approx. $5M in further adverse development over all policy periods ➢ Insurer would not take pre-1996 losses. Very predictable losses lifetime payouts on 80+ year-olds ($600k reserves)

➢ Potential risk transfer of problematic years and minimal EBIT impact

Workers' Compensation (WC) Retention Loss Portfolio Transfer (LPT) Options

Options:	Captive	Insurance	
Premium (one-time)	$21.7M (75% Conf. level)	$17.6M (Indication)	➢ Insurer covers 6/1/96 – 8/31/15; Captive covers all losses ➢ Underwriter will conduct final due diligence to bind
Current year tax benefit	$8M	$5.9M	➢ ($21.7M@37%=$8M)–($21.7@3.125% mfg ded.)=$7.3M ➢ ($17.6M@37%=$6.5M)–($17.6M@3.125% mfg. ded=$5.9M
Loan back to company	$10.8M (1.4% int. rate)	N/A	➢ Captive loan back is intracompany accounting ➢ $300k credit from insurer for not talking loan back
EBIT Impact B/(W)	($5.0M)	($1.1M)	➢ Captive: $21.7M prem. - $16.7M booked = ($5M) ➢ Insurance: $17.2M prem. – $16.1M* booked = ($1.1M)
P&L Impact B/(W)	$3.0M	$5.0M	➢ Captive: EBIT ($5.0M) + tax ben. $8.0M = $3.0M ➢ Ins: EBIT ($1.1M) + tax ben. $6.4M – int. $0.25M = $5.0M
NPV (8 years with 8% IRR) vs. current program	$1.6M	$0.9M	➢ Captive could provide dividends back to the business should losses trend favorably; liabilities stay with company ➢ Insurance completely eliminates risk of adverse development and removes liabilities from company
Retained risk	Aggregate Losses > $21.7M	*Pre-1996 losses ($600k)	➢ Captive provides for approx. $5M in further adverse development over all policy periods ➢ Insurer would not take pre-1996 losses. Very predictable losses lifetime payouts on 80+ year-olds ($600k reserves)

➢ Potential risk transfer of problematic years and minimal EBIT impact

Questions?

Karin Landry, CEBS, ACI, CLTC

Managing Partner

Spring Consulting Group

617-589-0930

Karin.Landry@springgroup.com

Michael Lubben, CPCU, CRM, AIC

Director of Global Risk Management

Henry Crown and Company/CC Industries

312-984-1480

MLubben@crown-chicago.com

BUSINESS INSURANCE

#WorldCaptiveForum