

BUSINESS INSURANCE

Managing Risks in a Captive's Portfolio

2018 World Captive Forum
January 31 - February 2, 2018
Fort Lauderdale, FL

#WorldCaptiveForum

Presenters

Peter Kranz

Managing Director
Beecher Carlson

David Kilborn, CFA

President and Chief Investment Officer
Performa Limited (US), LLC

Courtney Claffin

Executive Director – Captive Programs
University of California, Office of the President

Agenda

Roles & Responsibilities

The Risk of Holding Cash

How to Avoid Portfolio Design Risk

Market Risks and Implementation

Case Study: Fiat Lux

Final Thoughts & Questions

Roles & Responsibilities

Captive Manager Role

- “Quarterback” of the captive program that coordinates needs of the owner and communication with all service providers, including investment managers
- Captive financial controller + regulatory oversight + cash/liquidity tracking
- Direct contact with Captive Board and Officers and Captive Owner
- Positioned to share with client what captive peers are doing
- Regular communications with investment manager

Captive Manager Role

- **Facilitates and coordinates discussion of asset utilization**
- **Works with owner, board and officers to determine high level risk tolerance**
 - Consider need for recapitalization due to unfavorable loss experience and/or unfavorable results
- **Assist in determining key metrics around investable assets**
 - Financial strength of captive
 - Ultimate exposure of programs
 - Cash flow projections
 - Regulatory requirements
- **Facilitate draft of investment policy**

Investment Manager Role

- Discretionary management of investment portfolios & understanding of captives
- Partnership with owners, captive managers & service providers
- Customized solutions tailored to unique needs of each captive
- Input & ongoing review to achieve optimal investment guidelines/IPS
- Comprehensive investment reporting

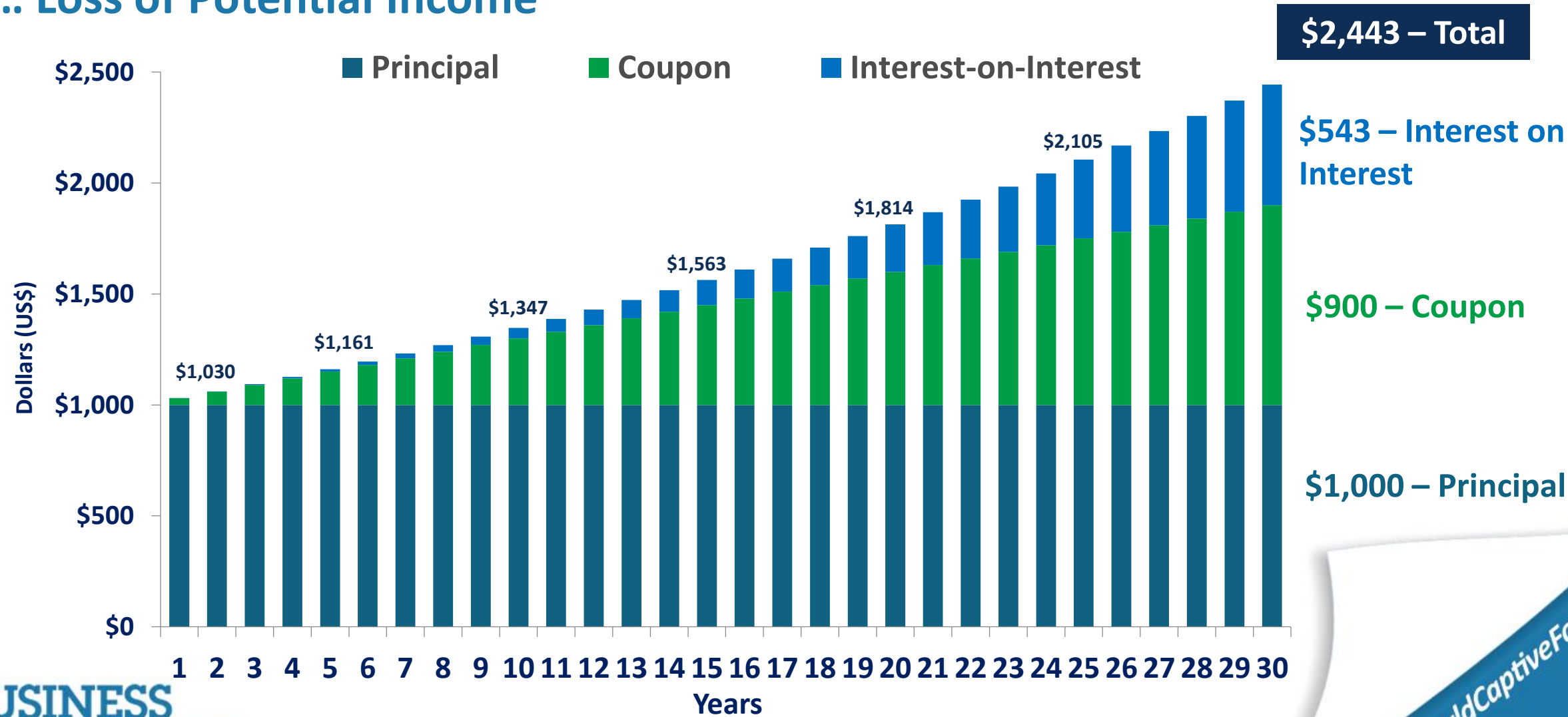
Captive Owner Role

- **Oversight and management of financial and operational aspects of each captive entity in our portfolio**
- **Strategic planning and management of current captive programs, including the formulation and development of new risk financing arrangements utilizing the captive insurance platform**

The Risk of Holding Cash

What Happens When You Don't Have A Plan?

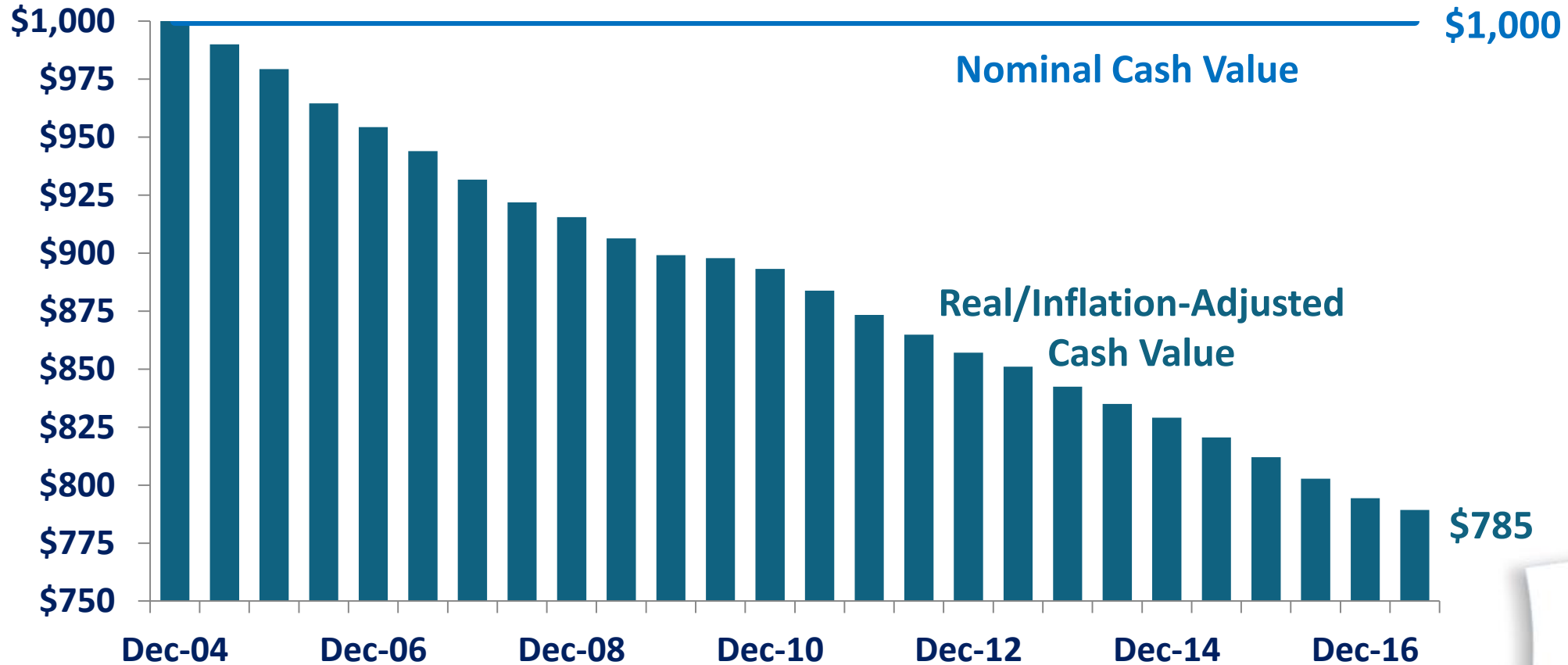
... Loss of Potential Income



Beware of the Inflation Trap...

Value of \$1,000 Investment in Cash

Adjusted for Inflation (using CPI ¹)



Put Your Money To Work!

	A	B	C	D
	BALANCE SHEET ¹	All Cash Portfolio	50% Cash, 50% Bonds Portfolio	100% Bond Portfolio
1	Cash & Cash Equivalents	\$10,000,000	\$5,000,000	\$0
2	Investments	\$0	\$5,000,000	\$10,000,000
3	Total Capital	\$1,000,000	\$1,000,000	\$1,000,000
4	Total Surplus	\$500,000	\$500,000	\$500,000

¹ Figures are provided for general informational purposes only

	INCOME STATEMENT ¹	All Cash Portfolio	50% Cash, 50% Bonds Portfolio	100% Bond Portfolio
5	Underwriting Income	\$1,000,000	\$1,000,000	\$1,000,000
6	Investment Income ²	\$0	\$100,000	\$200,000
7	Operating Expenses ³	(\$75,000)	(\$75,000)	(\$75,000)
8	Net Income Before Taxes	\$925,000	\$1,025,000	\$1,125,000

¹ Figures are provided for general informational purposes only; ² Investment income based on 0% yield for cash and a 2% yield for investment grade bonds; ³ Sample annual captive operating expenses.

Conservative investment grade bond portfolio can cover operating expenses!



A Tale Of Two Extremes

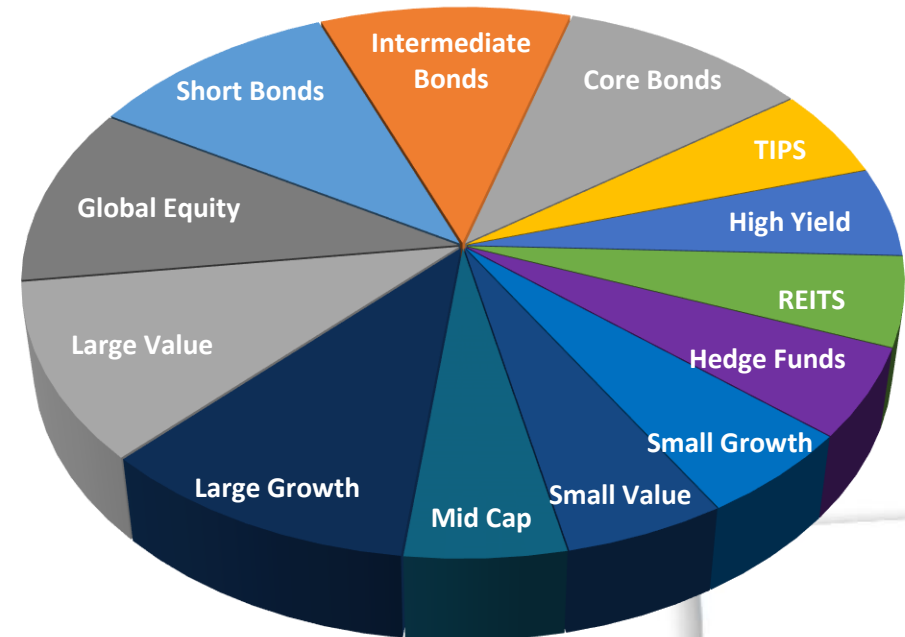
Not Doing Enough

Sitting in Cash leads to lack of income generation and value erosion from inflation



Doing Too Much

Over-diversification can be an administrative challenge, costly and impede growth



How to Avoid Portfolio Design Risk

Develop A Investment Plan!

- **Captive manager or owner initiates discussion regarding asset utilization**
- **Risk tolerance and key metrics determined and assessed**
- **If applicable, move towards process of investing assets**
 - Engage investment manager
 - Develop investment policy
 - Execute on strategy

Planning Ahead

Prepare

- an investment plan at the time of captive approval

Develop

- a strategy tailored to your captive (capital requirements, long tail risks, liquidity, etc)

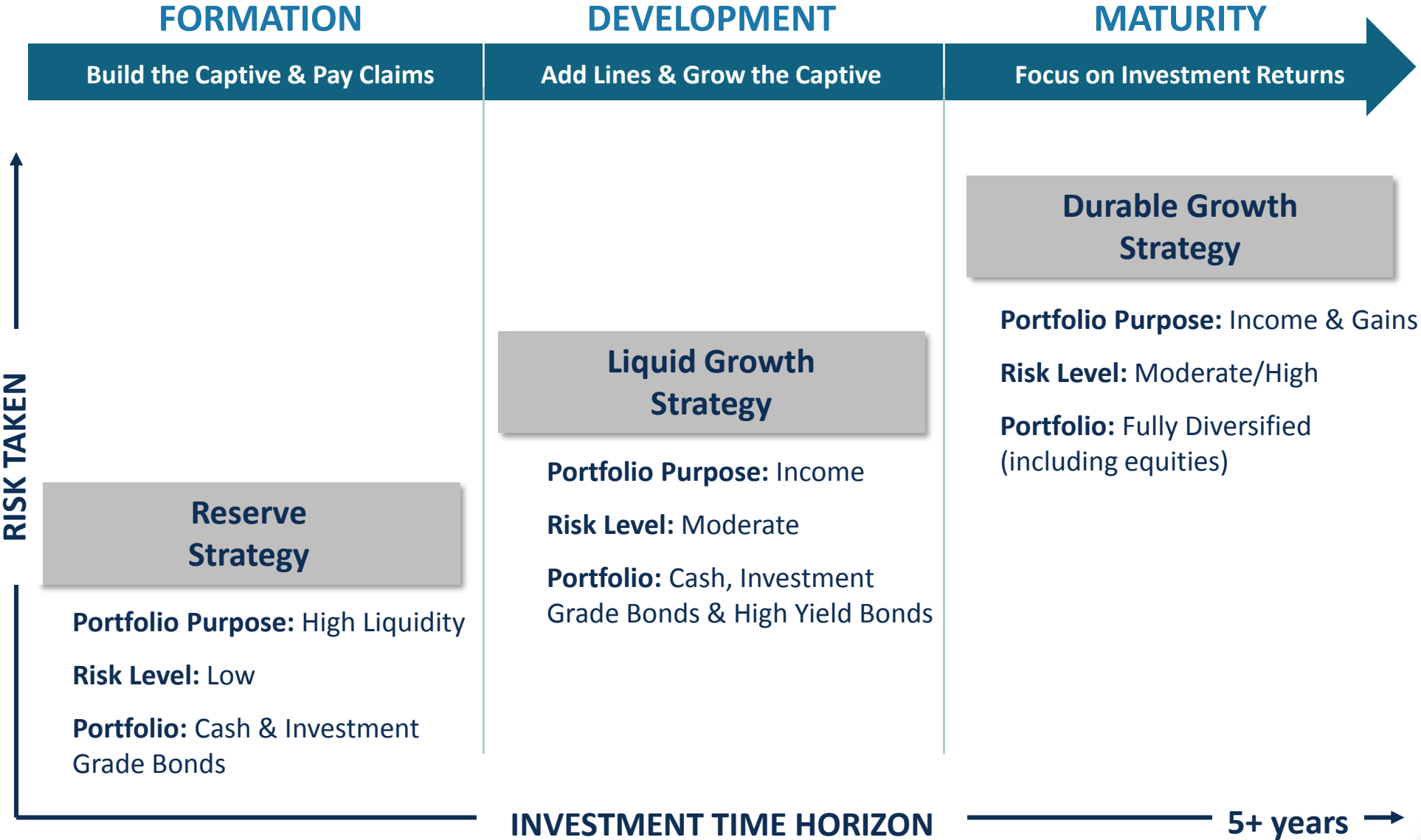
Recognize

- captives are unique and differ from mainline insurers, individuals, parent companies, which have different liability profiles and liquidity needs

Assess

- strength of captive, nature of risks, cash flow projections, domicile, liquidity needs, liability profile, etc

Asset Allocation Through A Captive's Life Cycle



Technical Considerations

- **Diversification**
- **Active Management vs Passive/Buy-and-Hold**
- **Mutual Funds vs Separate Account (of individual holdings)**
- **Investment Manager's Experience & Captive Knowledge**
- **Fees & Transparency**

Market Risks and Implementation

Market Risks

Risks That Should Be Regularly Discussed With Your Investment Manager...

Interest Rates &
Yield Curve

Market/Asset
Class Liquidity

Style
(Growth vs Value)

Issuer/Credit
Limits

Portfolio
Liquidity

Macro Trends &
Global Economy

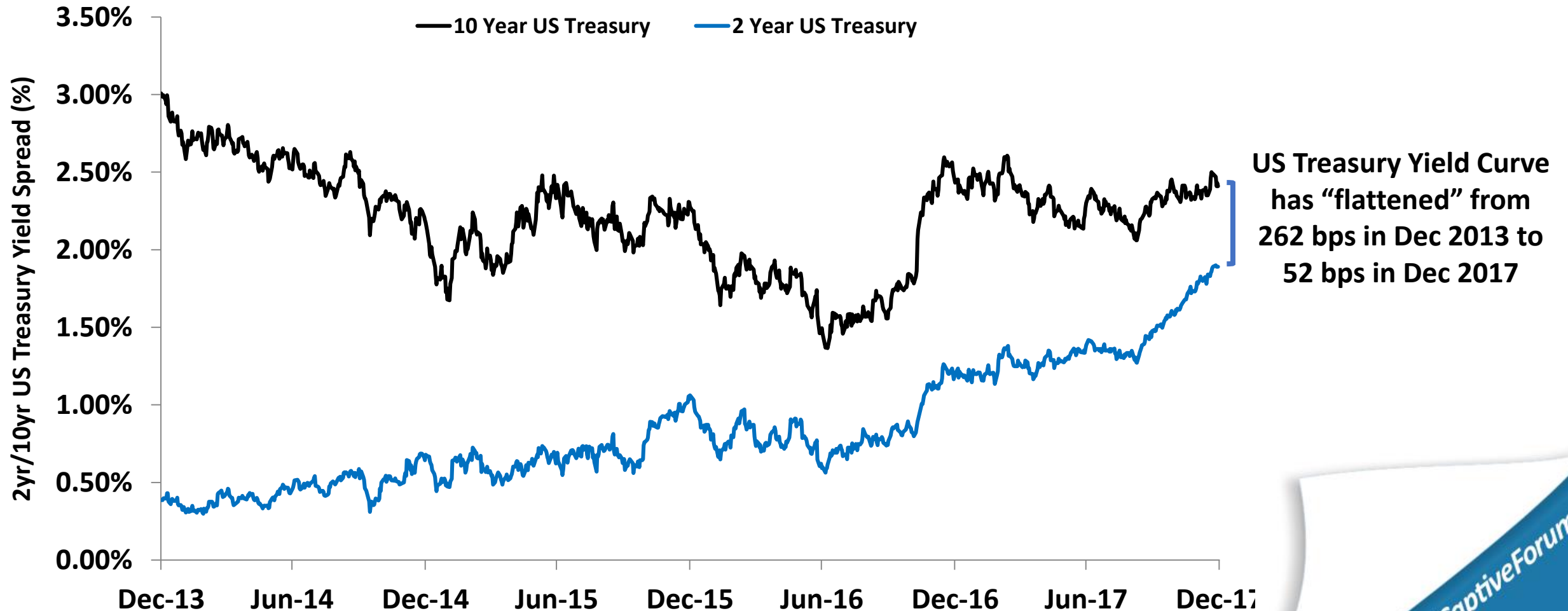
Interest Rates.....

...Have Decreased In Recent Years Due to Federal Reserve Policies...



Yet This Is Reversing As.....

...Fed Policy Started to Change in Late 2015 and into 2016/2017



Source: Barclays Live; Performa Limited (US), LLC

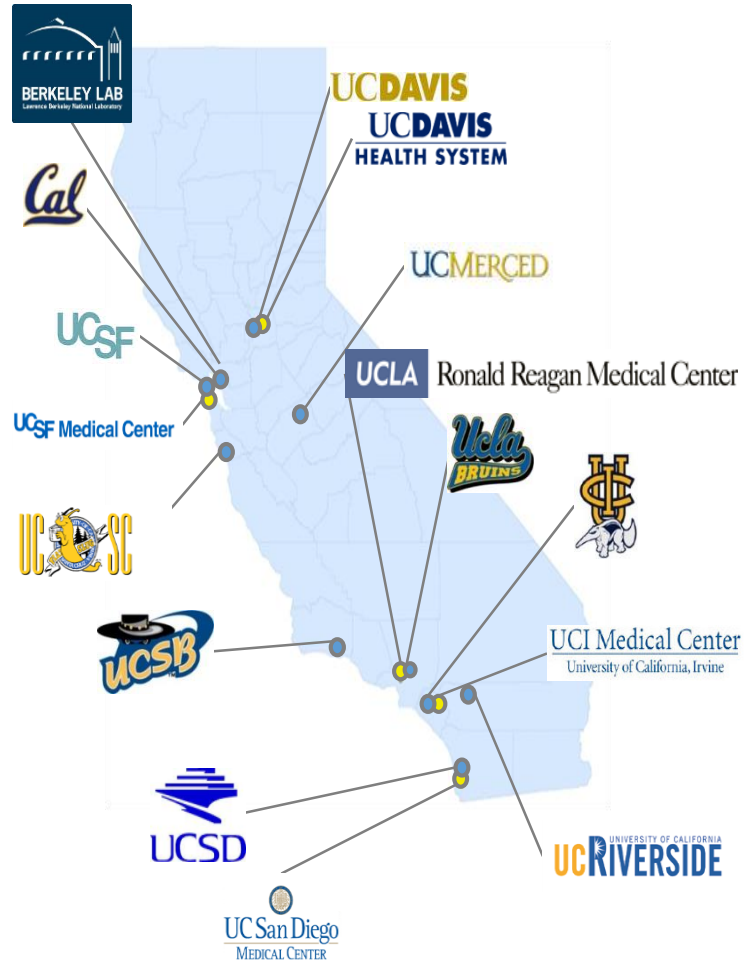
#WorldCaptiveForum

Ways To Offset The Negative Impact Of Rising Rates

- **Reduce interest rate risk via Short Duration**
- **Combined with “Barbell” Yield Curve Strategy**
- **Using Fixed Rate & Floating Rate Bonds**

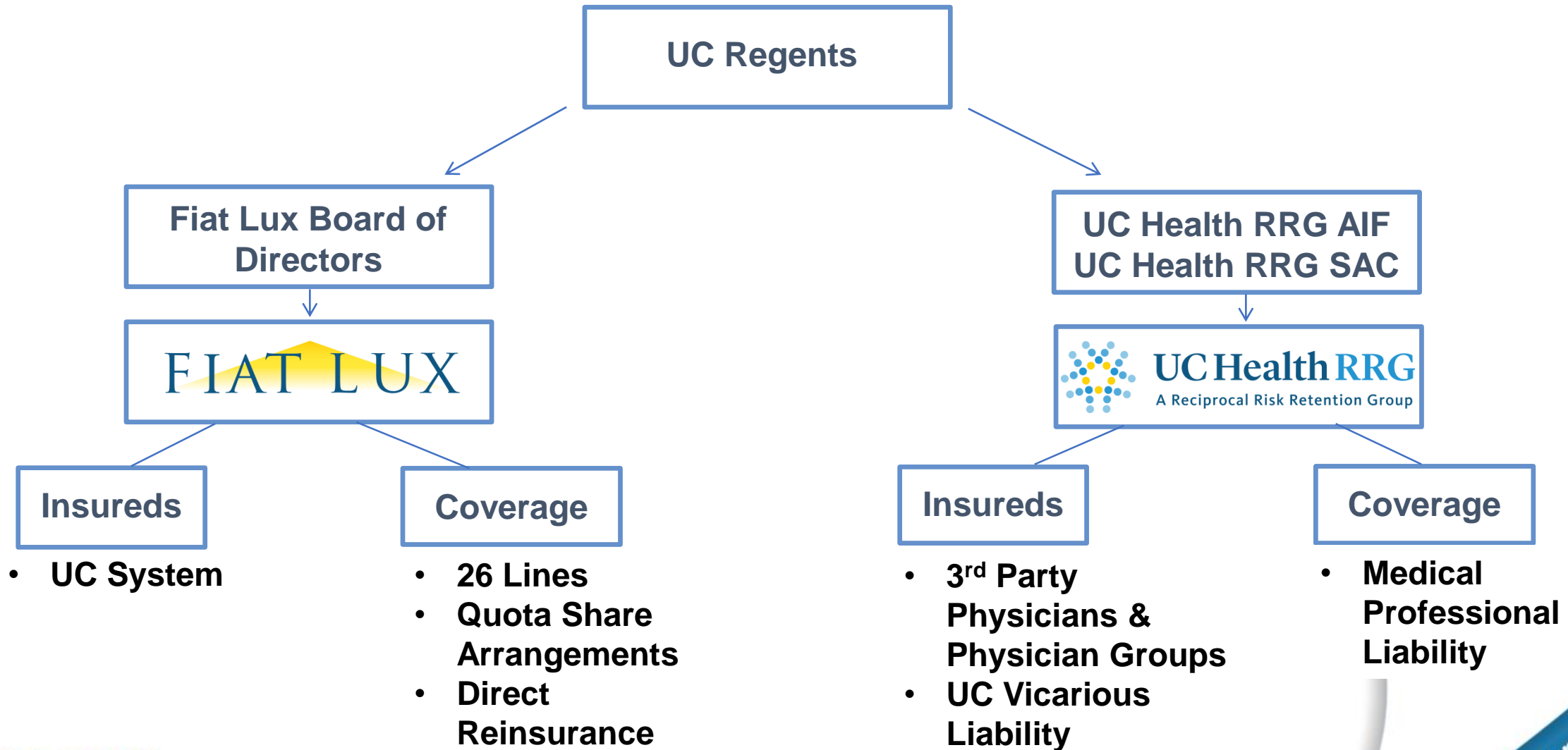
Case Study: Fiat Lux

University of California System

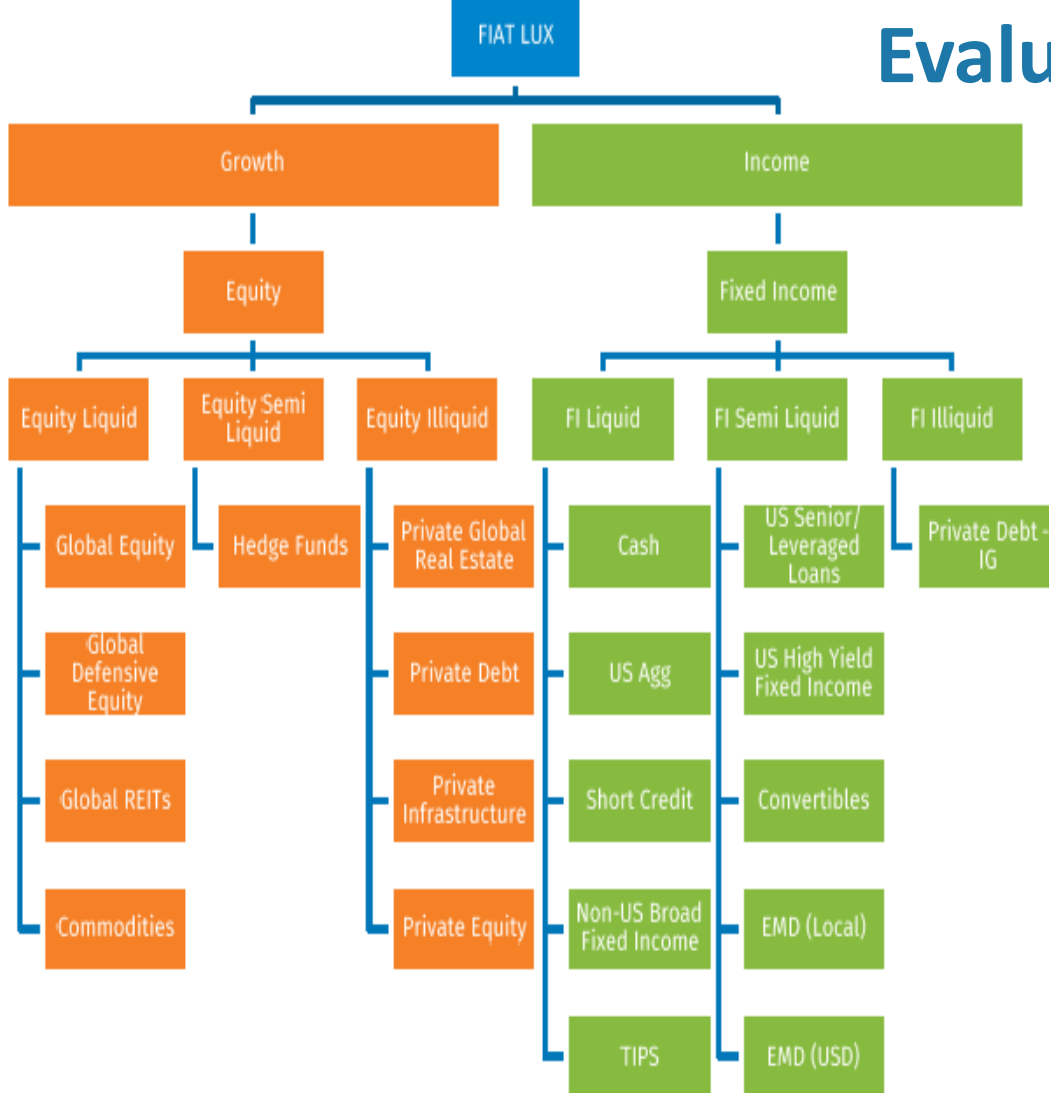


- **10** university campuses
- **\$33** Billion Annual revenues
- **5** academic medical systems
- **3** national laboratories
- **280,000** employees
- **375,000** students
- Sports teams, stadiums, airplanes, airports, foreign ... everything imaginable

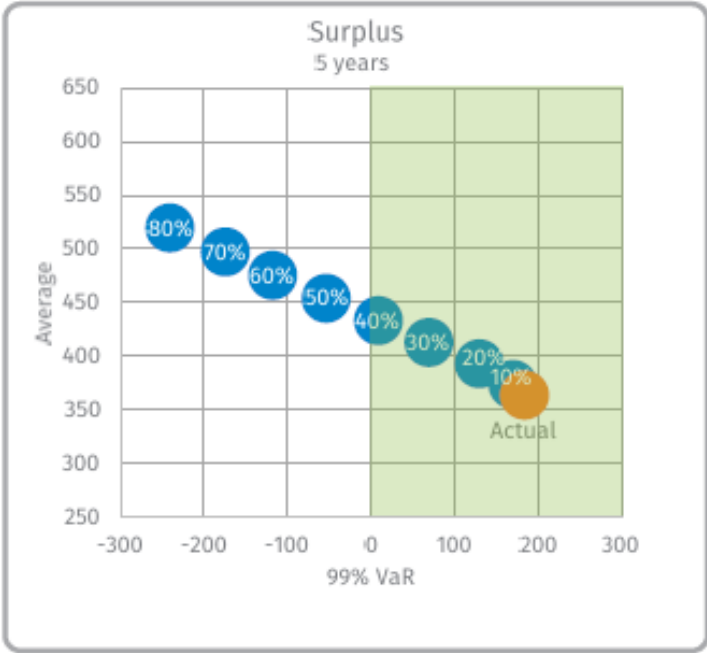
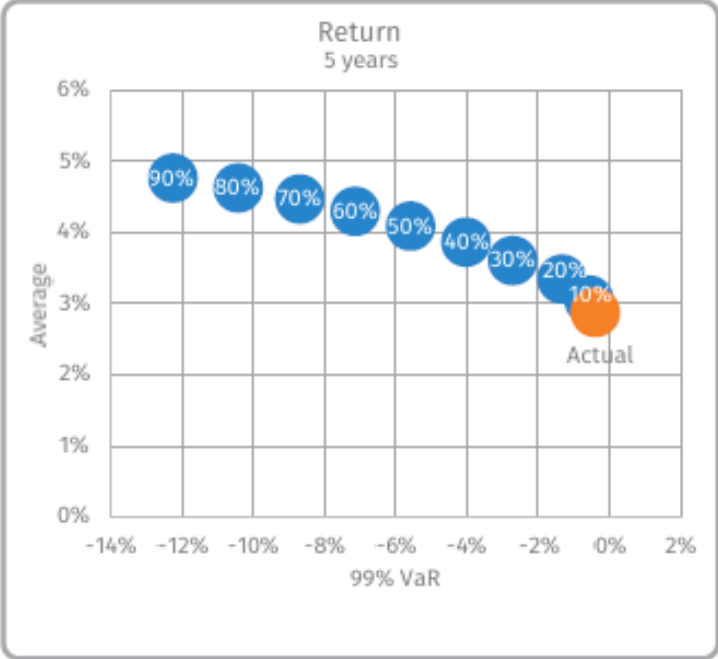
Fiat Lux Structure



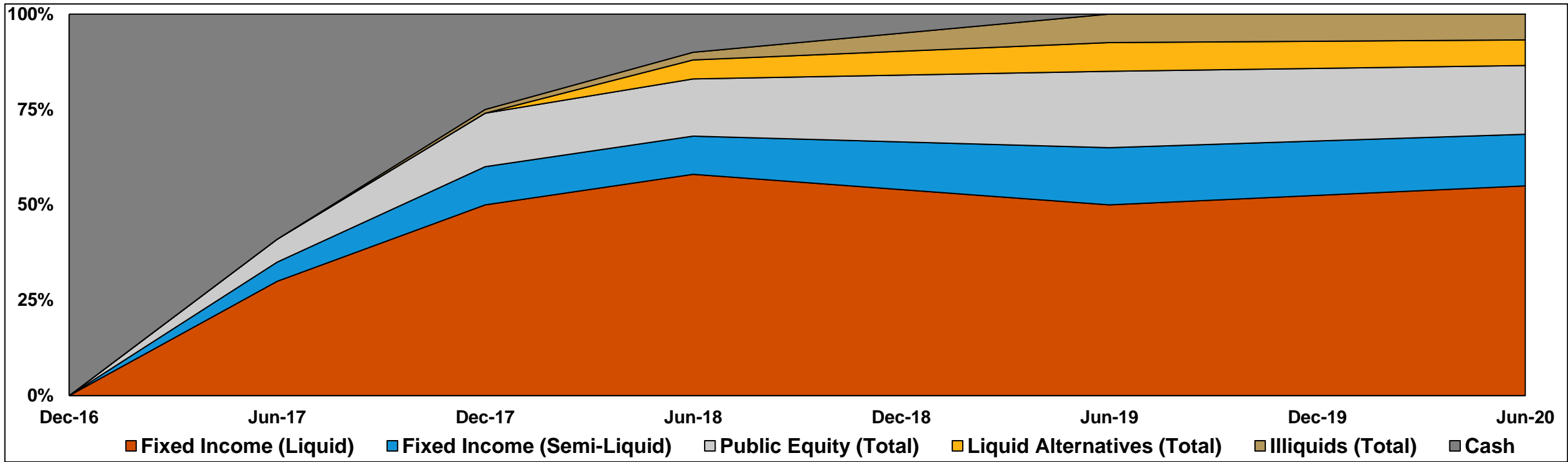
Portfolio Building Blocks: Growth and Income



Evaluate tradeoff with Return and Surplus



Portfolio Glide Path



	Dec 2016	Dec 2017	June 2018	June 2019	June 2020
Fixed Income (Total)	0%	50%	58%	50%	50%
Fixed Income (Semi-Liquid)	0%	10%	10%	15%	15%
Public Equity (Total)	0%	14%	15%	20%	20%
Liquid Alternatives (Total)	0%	0%	5%	5%	7.5%
Illiquid (Total)	0%	0%	2%	5%	7.5%
Cash	100%	26%	10%	5%	0%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

Portfolio Performance, Risk and Characteristics

NET RETURNS (%)

As of December 31, 2017

	1-Month	3-Months	FYTD
Fiat Lux	0.4	1.1	2.1
Benchmark	0.4	0.8	1.7
Value Added	0.0	0.3	0.4

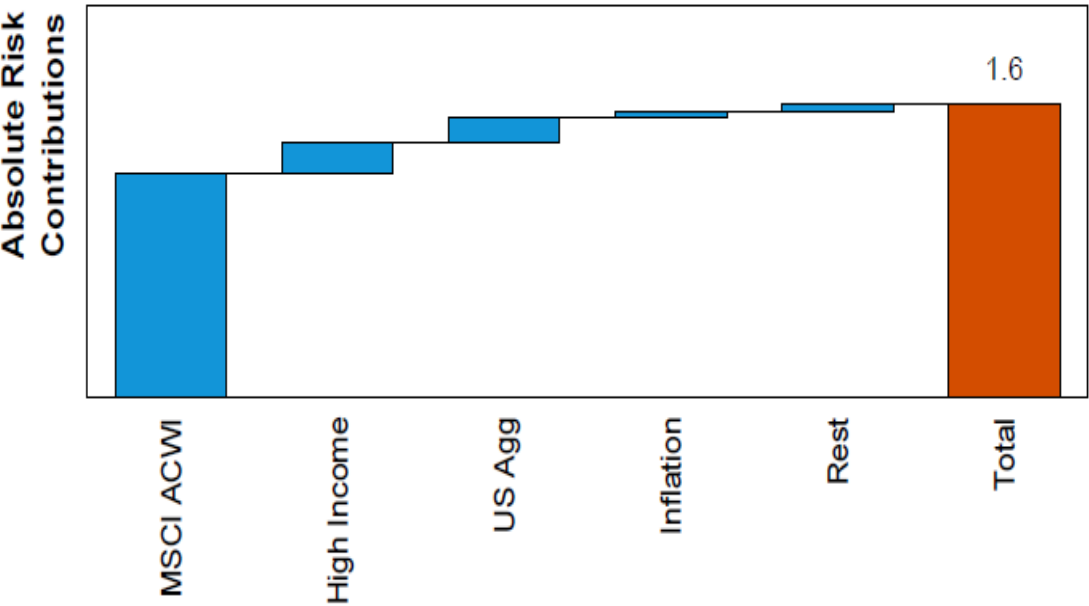
ANNUALIZED RETURNS

	1-Year	3-Years	5-Years	7-Year	ITD
Fiat Lux	3.0	--	--	--	2.4
Benchmark	2.3	--	--	--	1.6
Value Added	0.6	--	--	--	0.8

Macro Risk

Growth (Equity)		
Real Rates		
Commodity		
FX		
Emerging Markets		
Inflation		
Credit		

Absolute Risk



Characteristics

Duration	2.1 Year
Maturity	3.5 Year
Yield	2.5% (12-Month)
Quality	AA

Final Thoughts

A Few Final Thoughts

Portfolio Design

- Put your captive's assets to work
- Plan ahead: it's never too early (or late)!
- Choose an investment manager with captive experience

Markets

- Short term interest rates pose a risk to bond portfolios
- Be wary of too much risk in less liquid sectors

Contact Information

Peter Kranz

Managing Director

Beecher Carlson

802-658-7834

pkranz@beechercarlson.com

David Kilborn, CFA

President and Chief Investment Officer

Performa Limited (US), LLC

843-297-4130

dkilborn@performausa.com

Courtney Claffin

Executive Director – Captive Programs

University of California, Office of the President

510-287-3339

Courtney.claflin@ucop.edu