

BUSINESS INSURANCE

2019 WORLD CAPTIVE FORUM

Captive College: Fundamentals and Development Issues

January 30 – February 1, 2019

JW Marriott Turnberry Isle Miami, Florida

#WorldCaptiveForum

Our Panel

Hugh Rosenbaum

Jeff Kenneson

Bob Davidson

Dan Kusaila

Retired principal WTW

President, Quest USA

Captive Consultant

Tax Partner, Crowe Horwarth

Agenda

- Topics
- More
- More

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

Reciprocal

PORCs and **agency-owned** captives

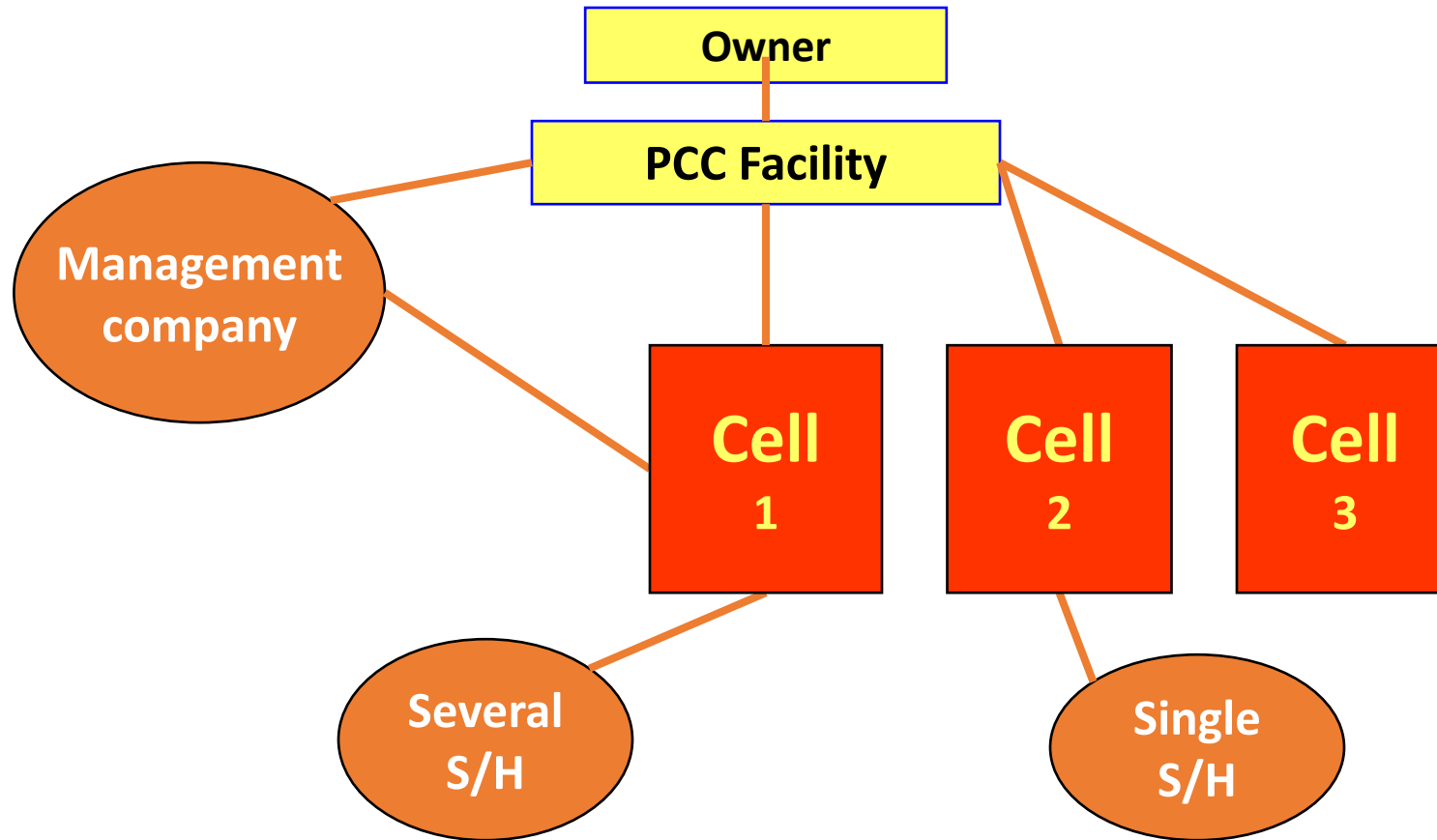
SPVs and XXX entities

Mini or micro (“831-b”) captives

Pools of Captives

Other forms cont'd

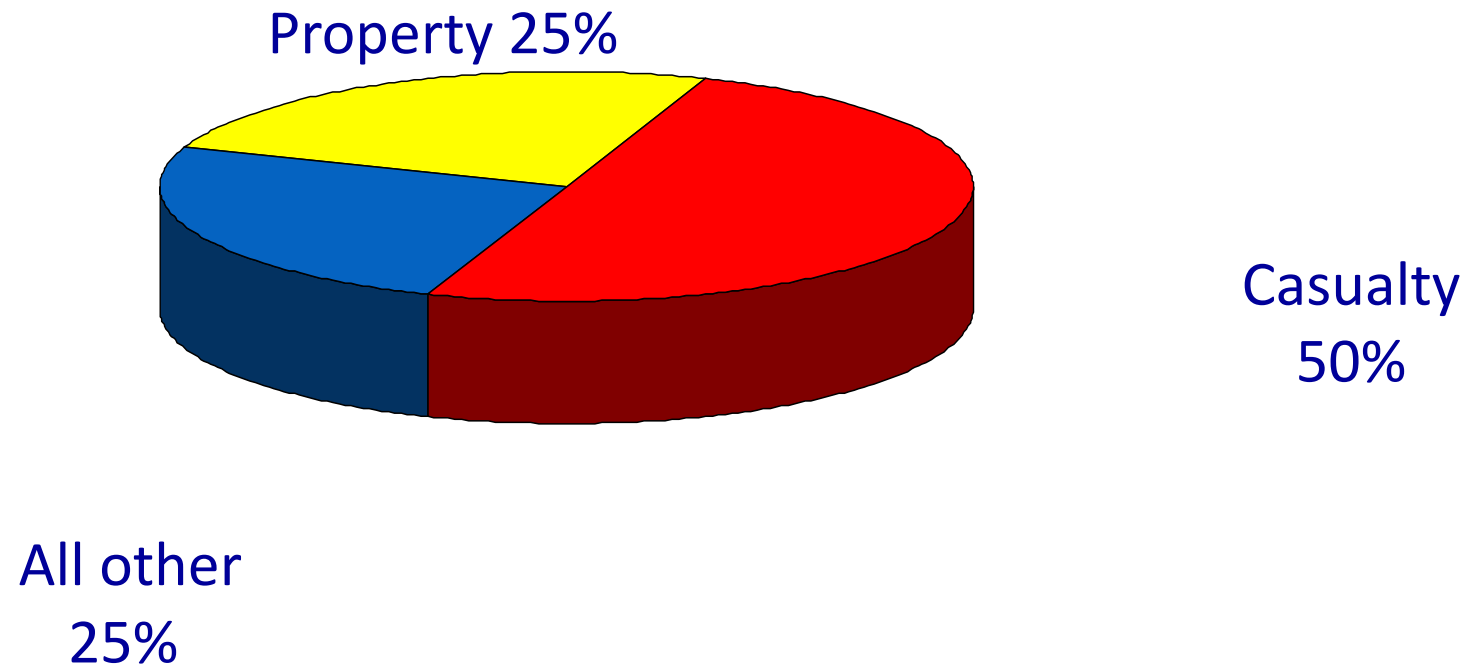
Protected Cell Company - Structure



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

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

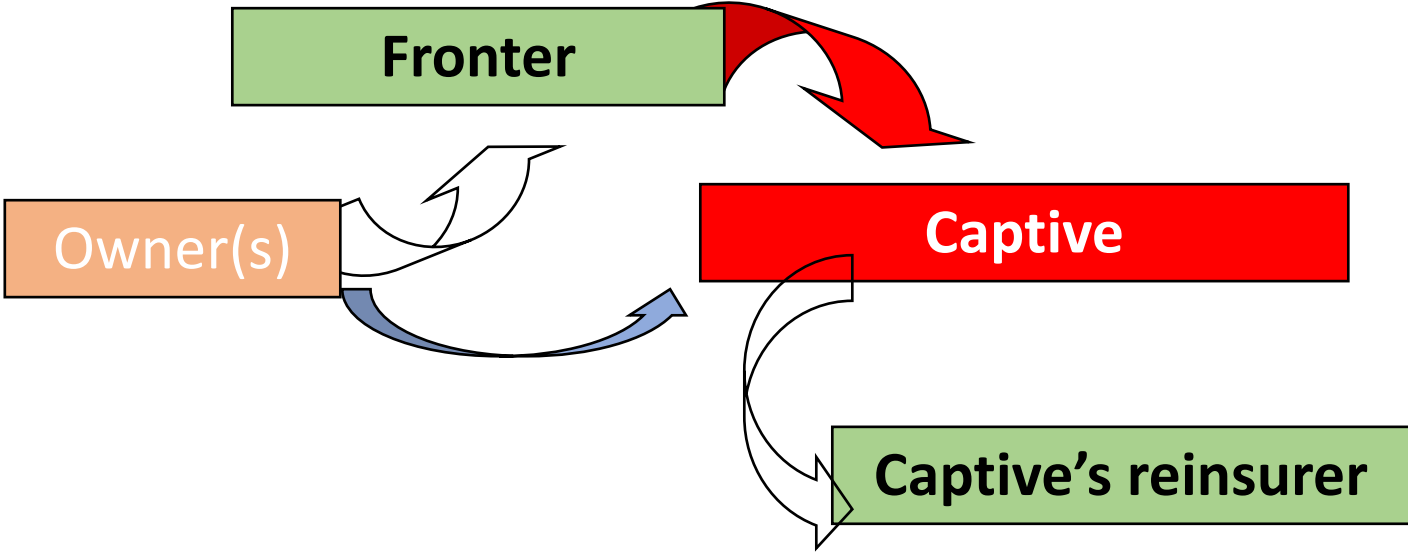
Workers Compensation

Employee Benefits

Cyber Liability

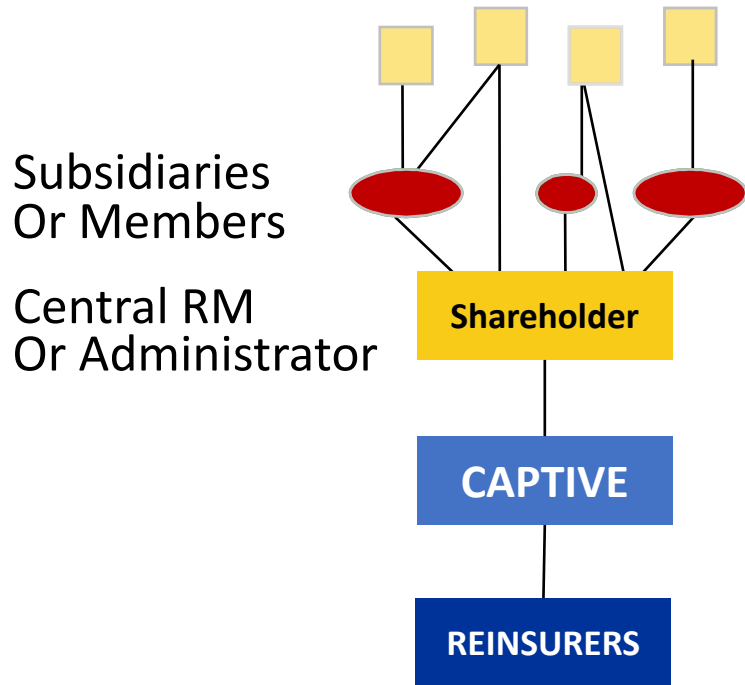
Customer, dealer, franchisee ins coverages

Direct or Reinsurance Captives?

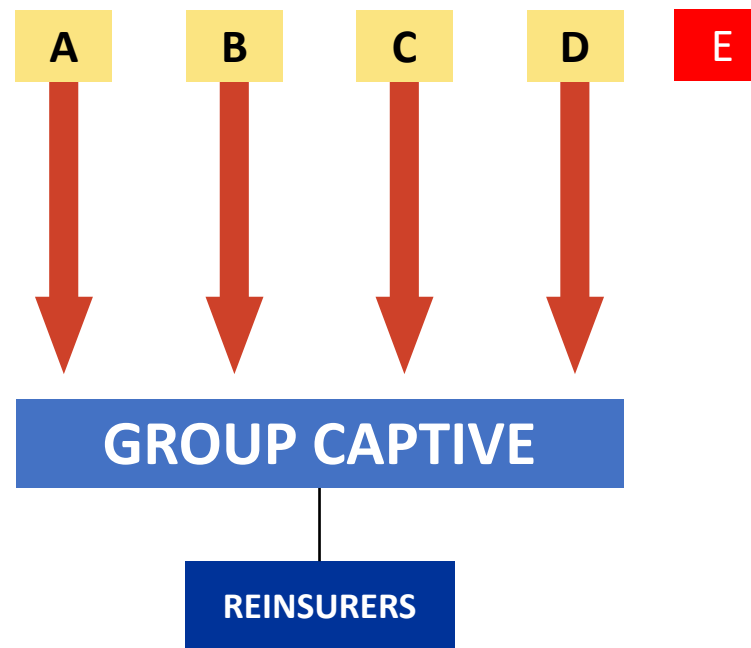


Single Owner / Group Captives

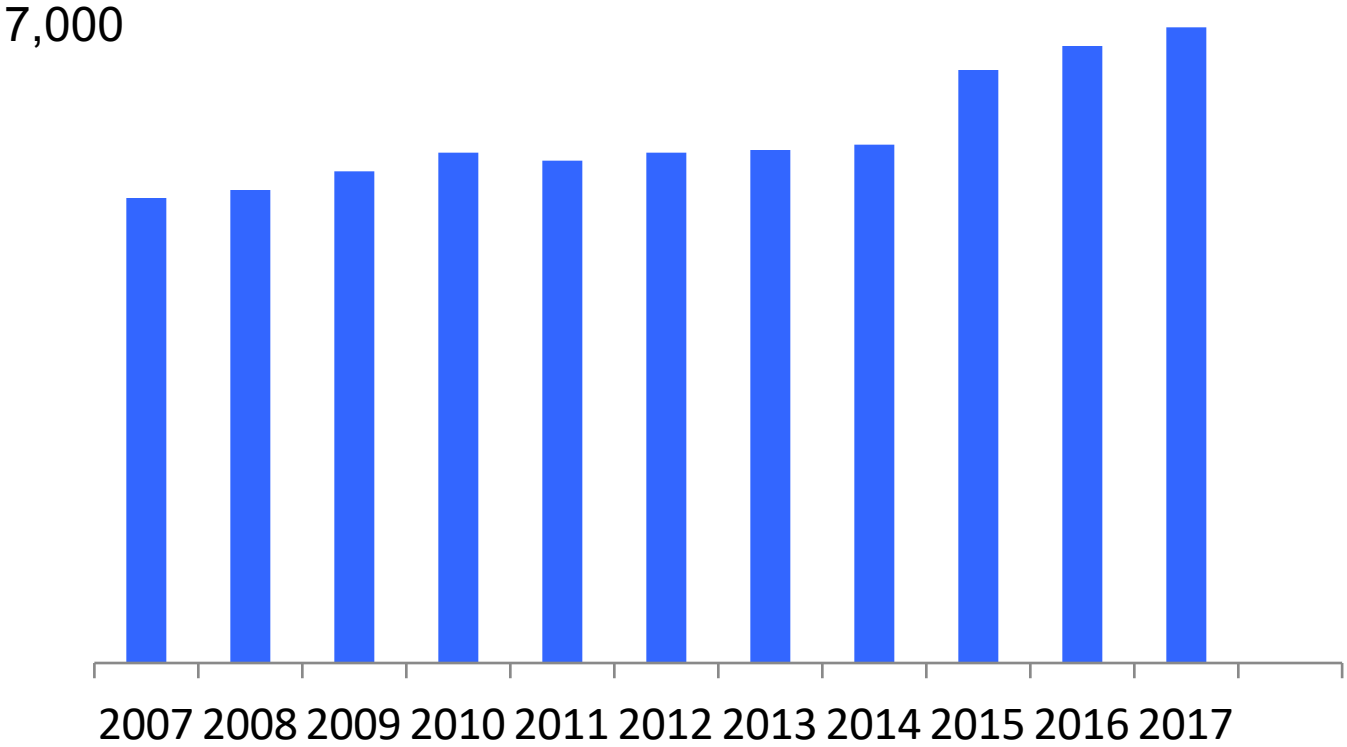
Single Owner – Direct



Group Captive – Direct



Number of Captives: Continual Growth?



Why Captives? The Key Reasons

Cost reduction

Access to reinsurance

Investment income

Administrative tool

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.

1. Cost Reduction: How?

Reduce or eliminate commissions

Eliminate insurer profit margins

Control of claims

1. Cost Reduction: How?

Reduce high commercial rates

Eliminate non-essential services

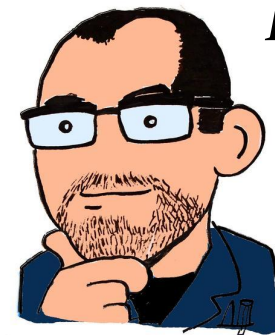
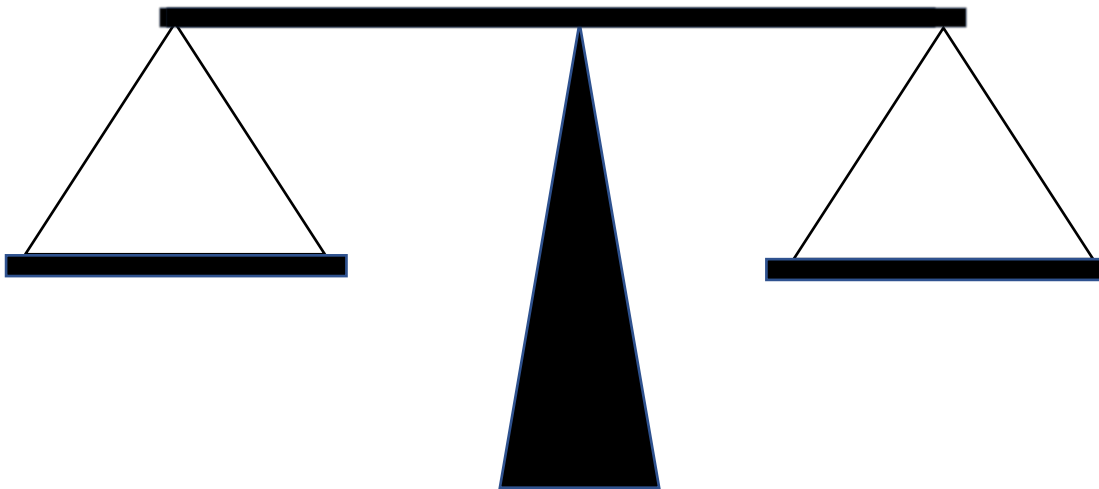
Eliminate pooling charges

Avoid charges for guarantee funds

Cost Savings? Discuss!

Cost Increases

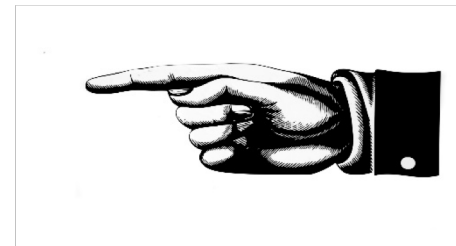
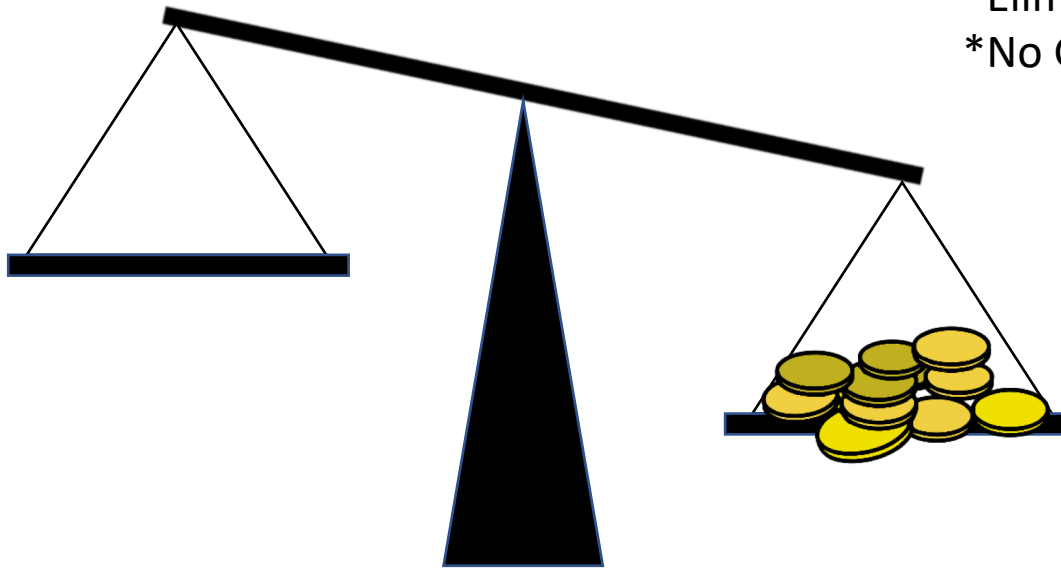
Cost Savings/Reductions



Hmm...

Cost Savings? Discuss!

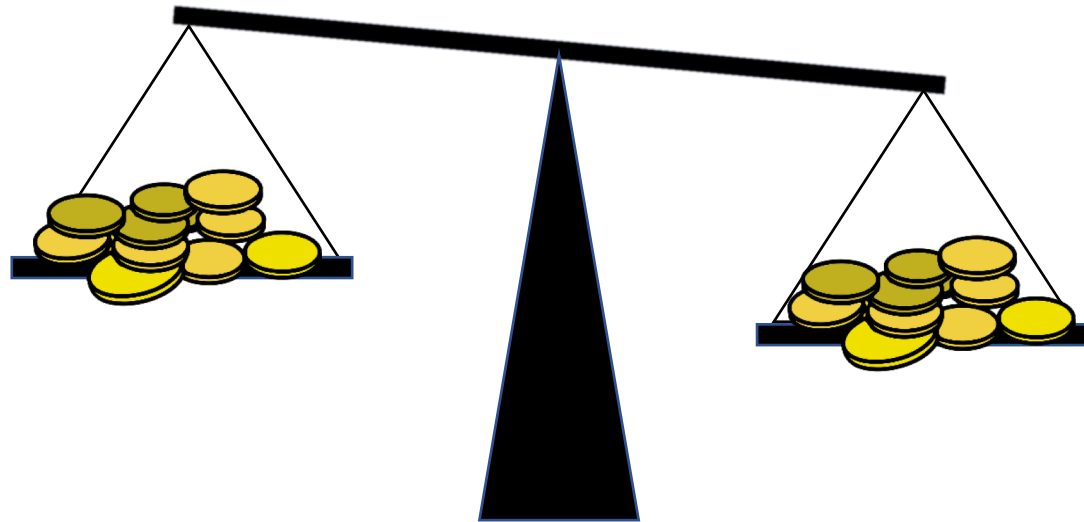
- *Insurer Profit Margin
- *Pricing more consistent with loss experience
- *Control Claims
- *Eliminate Non-Essential Services
- *No Guarantee Fund



SAVINGS

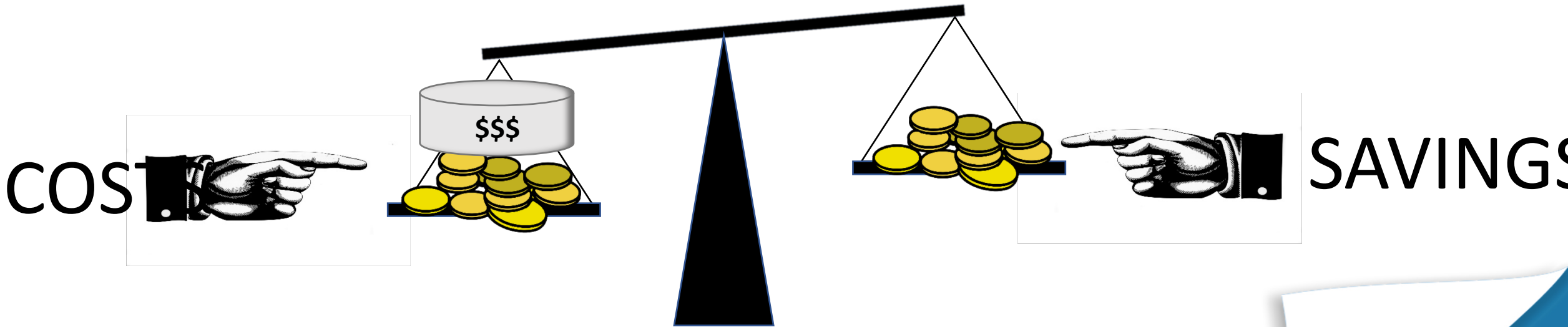
Cost Savings? Discuss!

- *Cost of Capital
- *Operating Expenses
- *Cost of Collateral
- *Reinsurance



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)

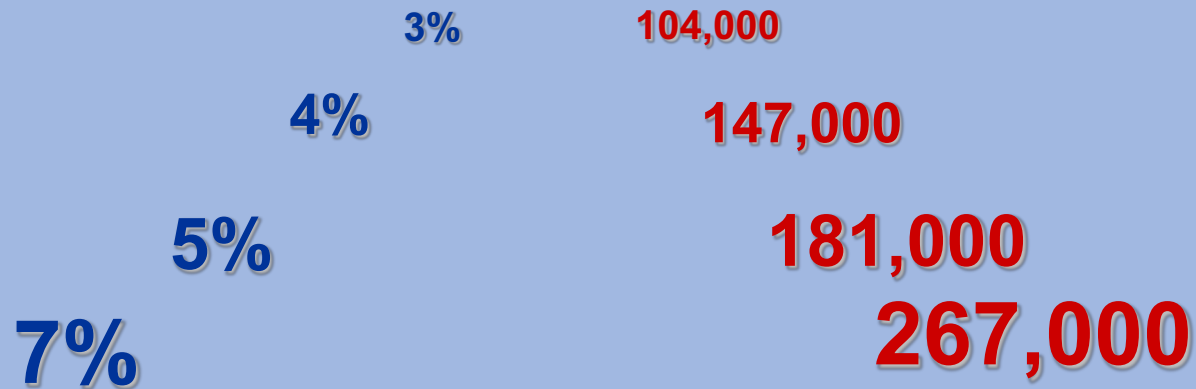
3. Investment Income



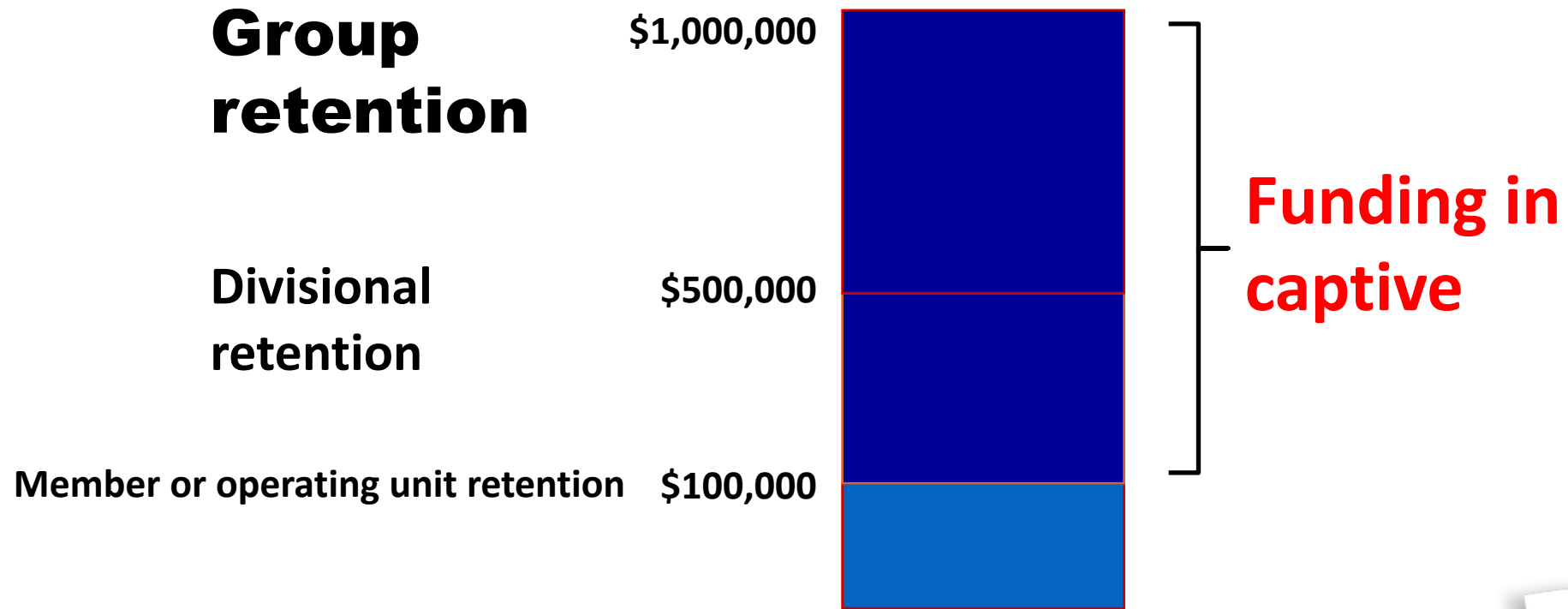
When interest rates are high enough, loss reserves for lines with longer payout patterns generate extra income

3. Investment Income (2)

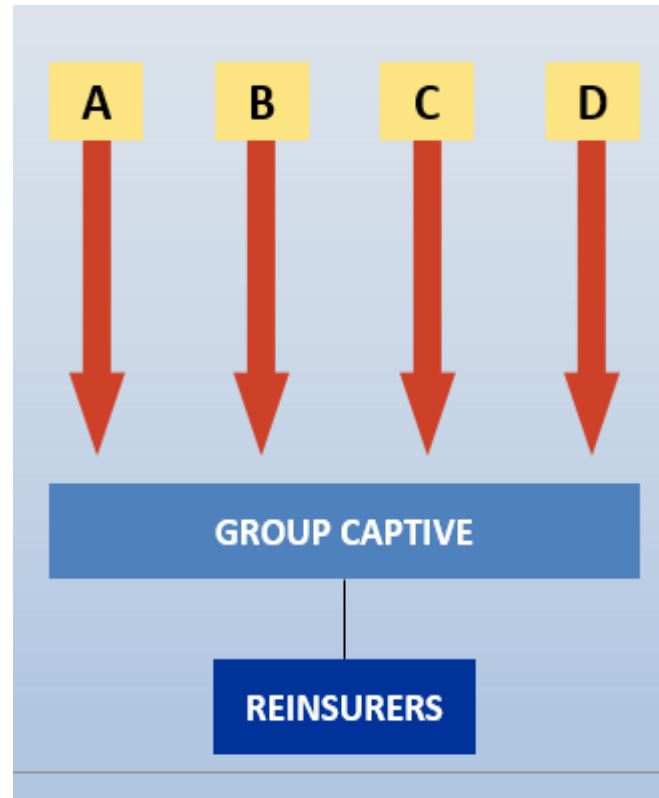
1,000,000 of loss reserves, paid out over seven years produces investment income



4. Administrative Tool



Group Captive – *(reminder)*



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

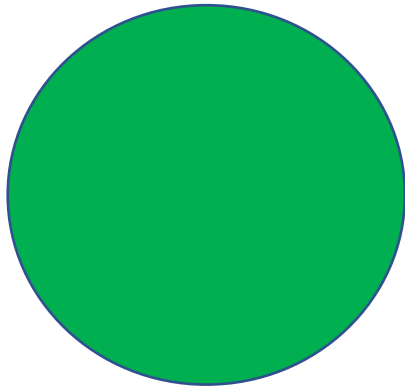
Example: Risk Retention Groups (Session on Friday)

-an “escape from fronting”

Risk sharing – obstacle or mutuality

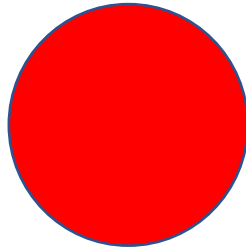
Size of my account....

Expected case



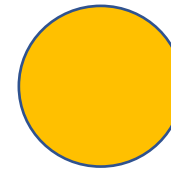
100

**After HIS heavy
loss year**



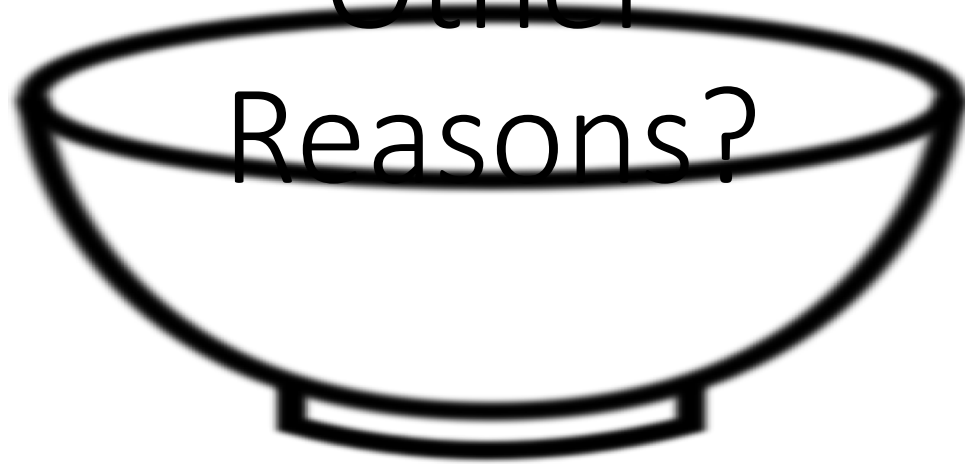
80

**After MY heavy
loss year**



75

Other
Reasons?



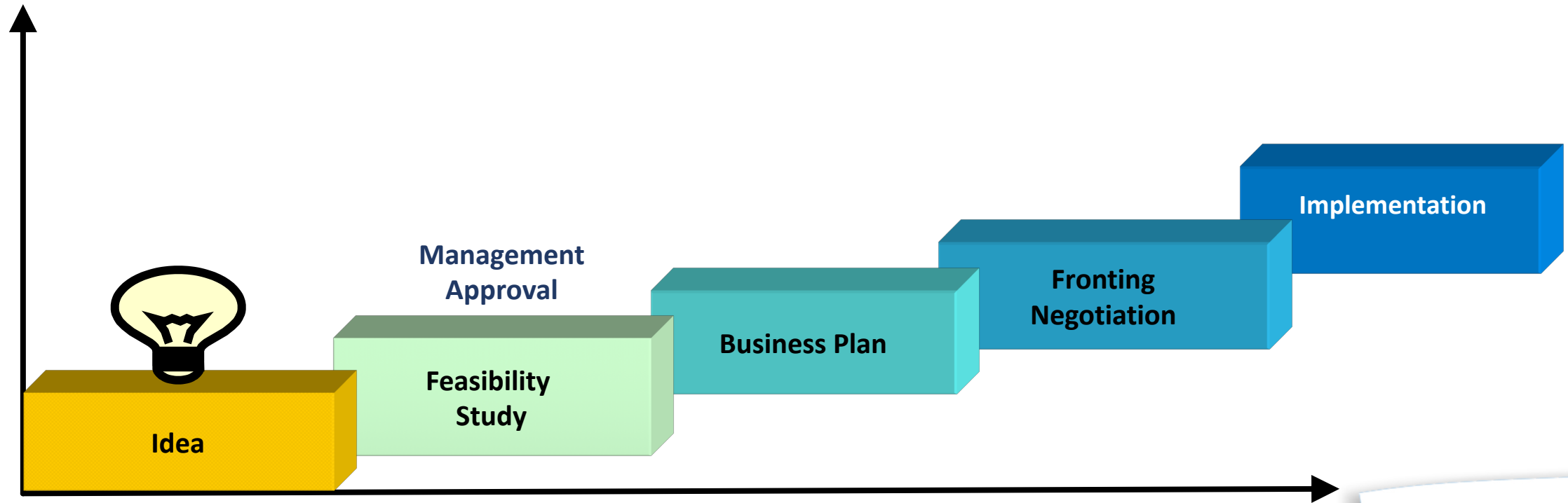
Feasibility of a Captive



Feasibility: The Numbers!

Proforma Projections						
	2016	2017	2018	2019	2020	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

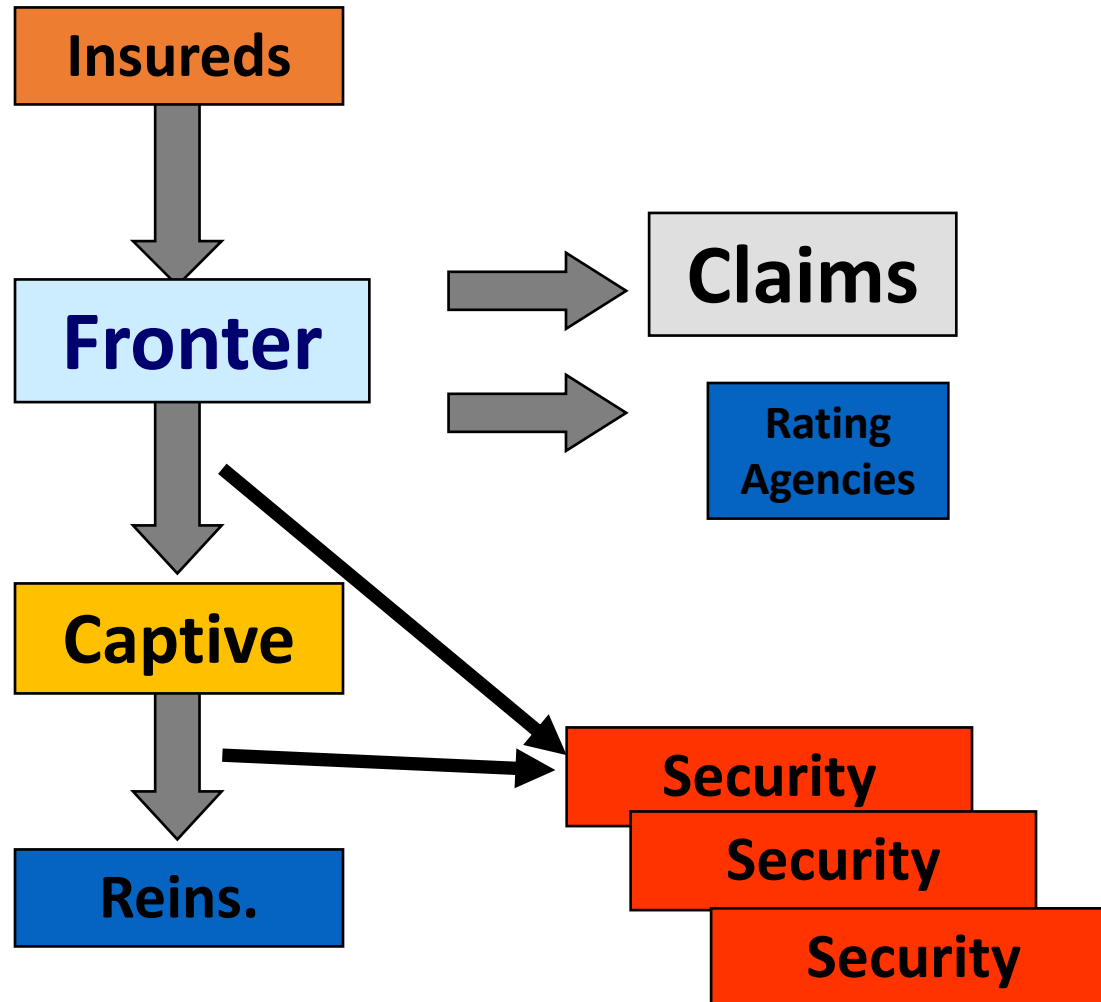
Fronting – what, why, how (in 2018)

Domicile and **regulation**

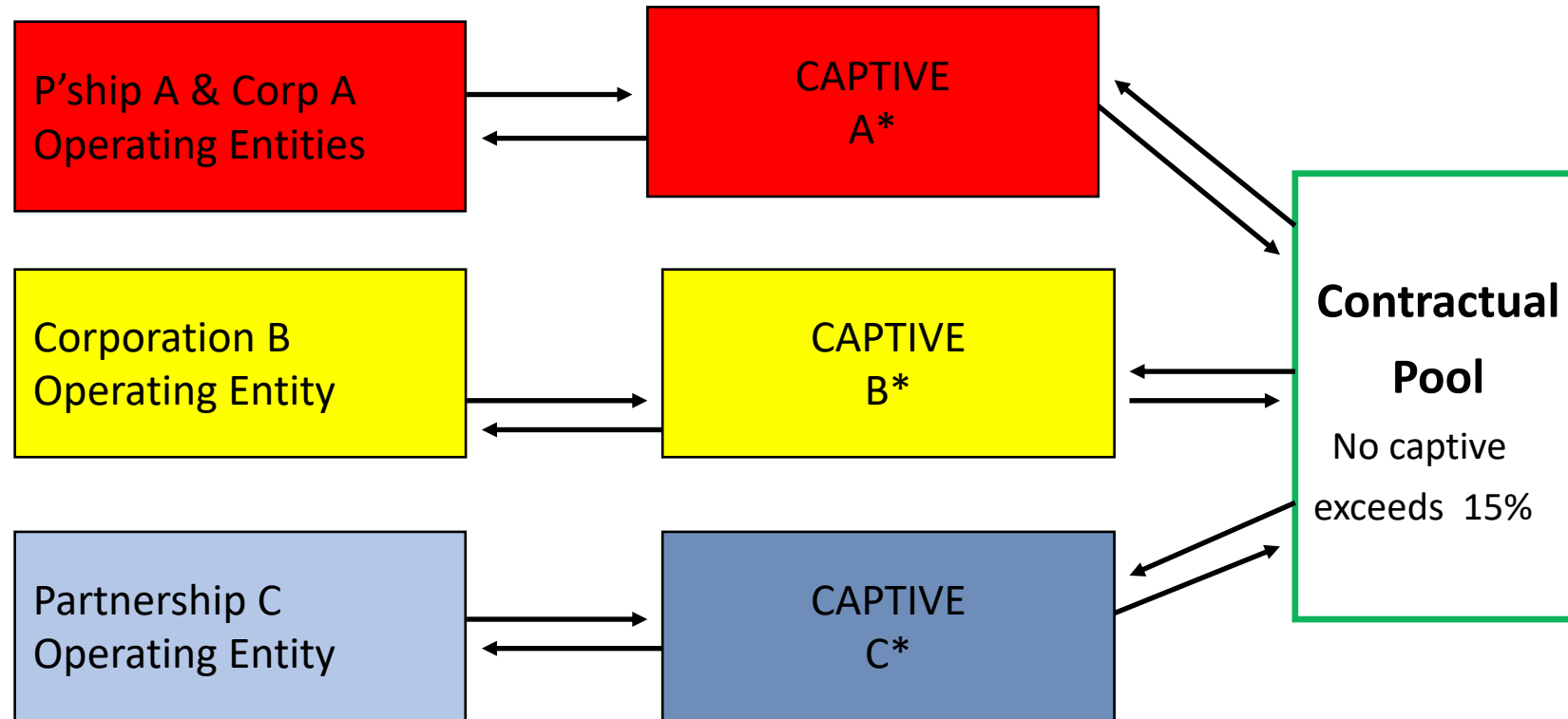
Captive management

....Tax factors

Fronting: 2018 Problem #1



Other issues: Pooling



Source: Chaz Lavelle Bingham Greenebaum Doll

Captive Domiciles

Onshore – offshore: the major factors in 2018

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

2017 the top nine (out of 70!)		
Bermuda	776	
Cayman	711	
Vermont	593	
Utah	462	
Delaware	385	(1108)
Guernsey	321	
Anguilla	287 e	
Barbados	246	
Luxembourg	208	

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

Domicile Selection

Onshore? Offshore?

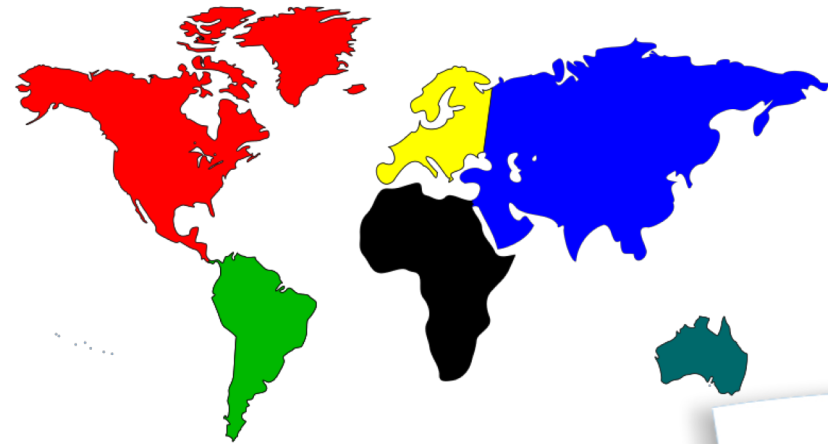
Capitalization and surplus requirements

Receptiveness, stability of regulatory environment

Quality of local infrastructure

Availability of expertise

Costs



Domicile Selection

Onshore? Offshore?

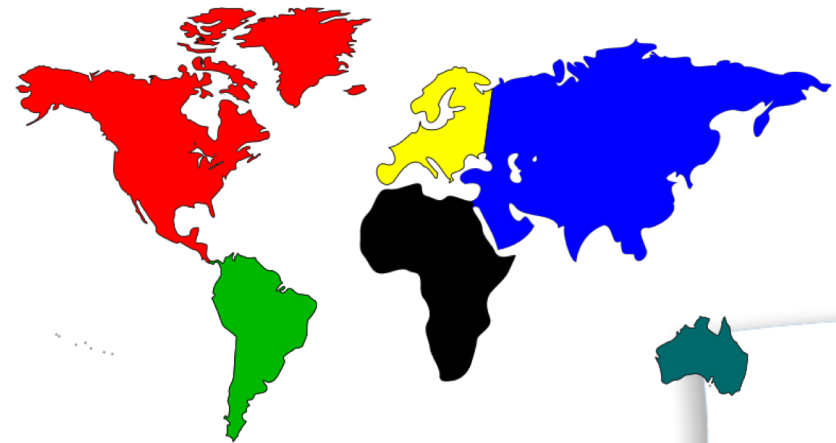
Investments: flexibility

Other captives like us domiciled there?

Experience in our business ?

Tax issues: US Federal, State

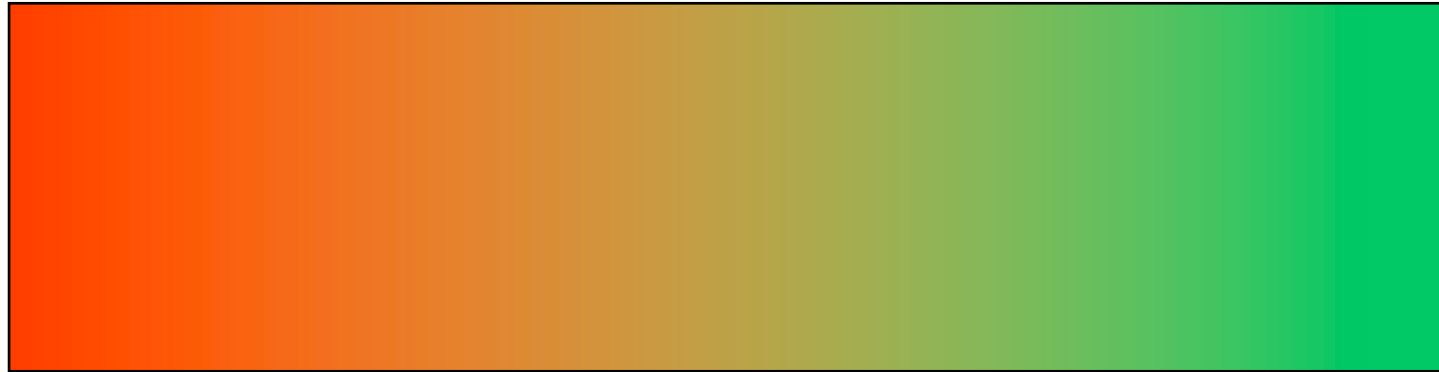
self-procurement, premium taxes



Regulation



Regulation Differences



Too much

Just Right

Too little



Tax Factors: The three things

Deductibility

Must resemble
"normal" insurance

Tax On
Captive Income Shareholders

"Elections"

Premium Taxes

- State
- Federal Excise
- Self-Procurement

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

Tax Factors - Deductibility

Must demonstrate

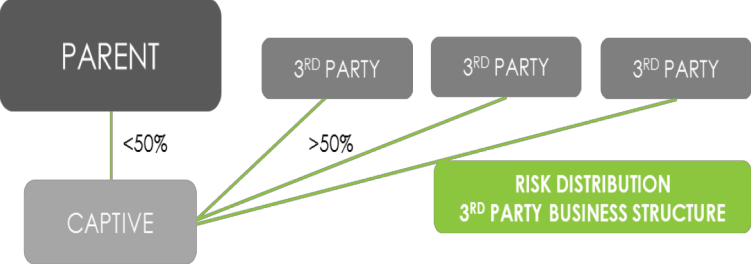
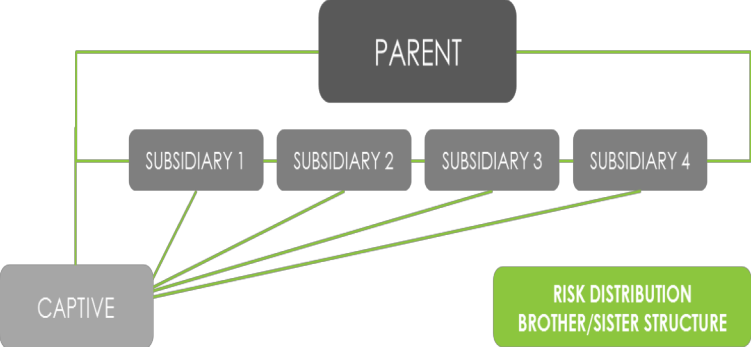
Risk shifting

Risk distribution

Business purpose

Attributes similar to the existing marketplace

Deductibility – Two examples



Taxation – Current Issues

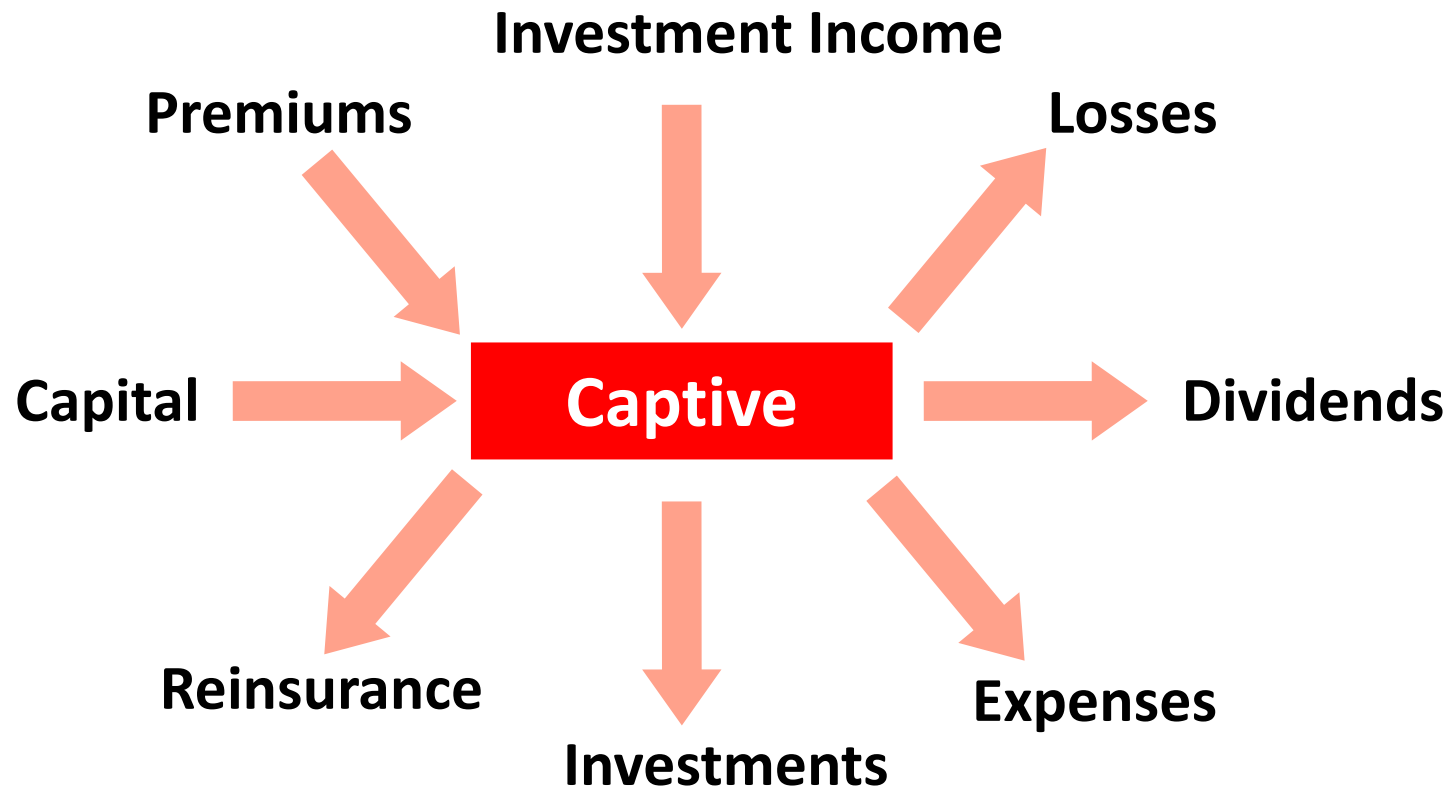
831b structures : use and abuse, IRS “attacking”

More intrusive activity for offshore

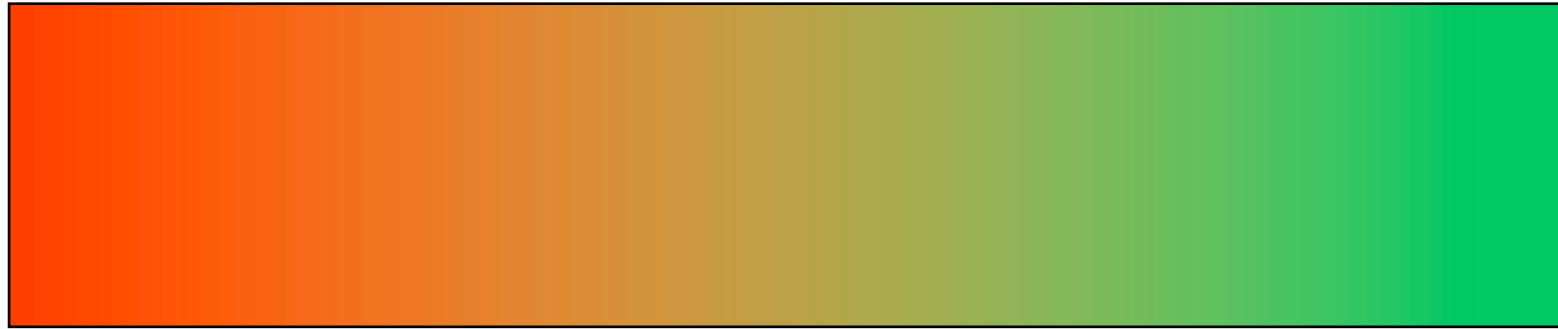
Example: FATCA

Other issues (Come to the round table!)

Captive Cash Flows: How It Works



Management Matters



Too much



Just Right



Too little



Unrelated business?

Necessary, profitable, dangerous?

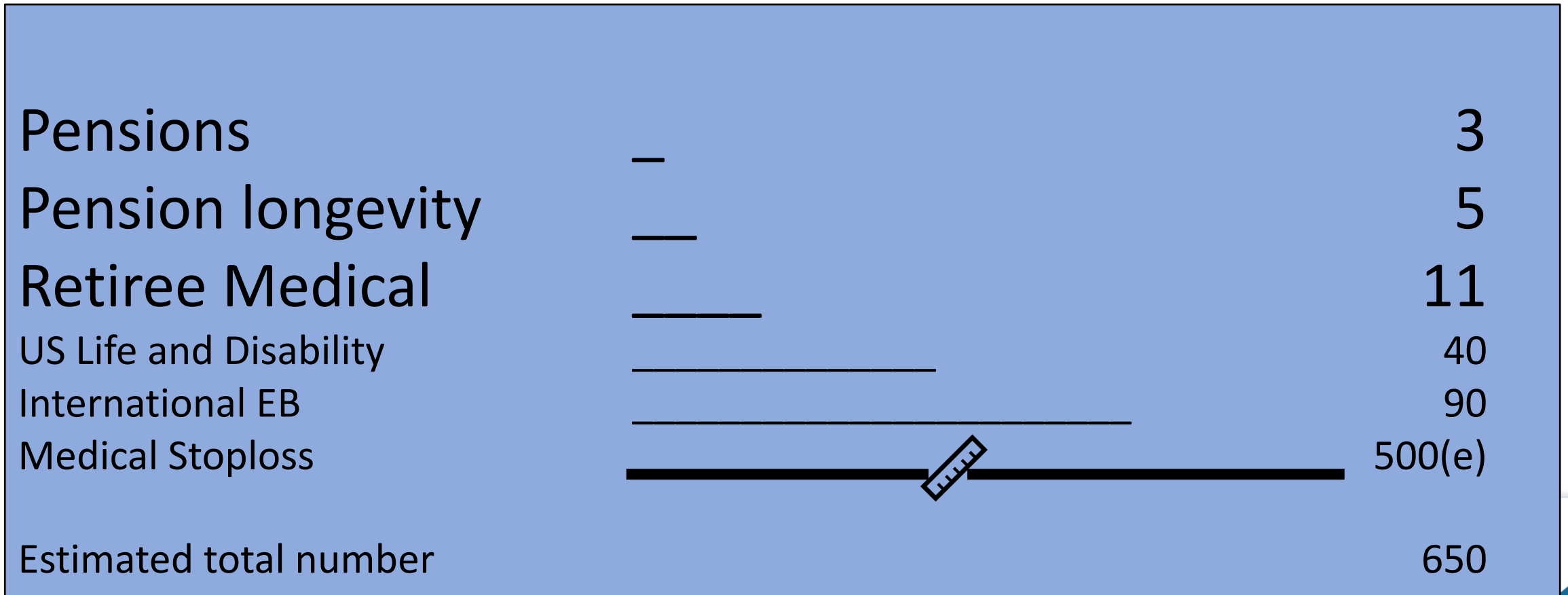


Your own (employee benefits)

Controlled unaffiliated

Employee Benefits in Captives 2017

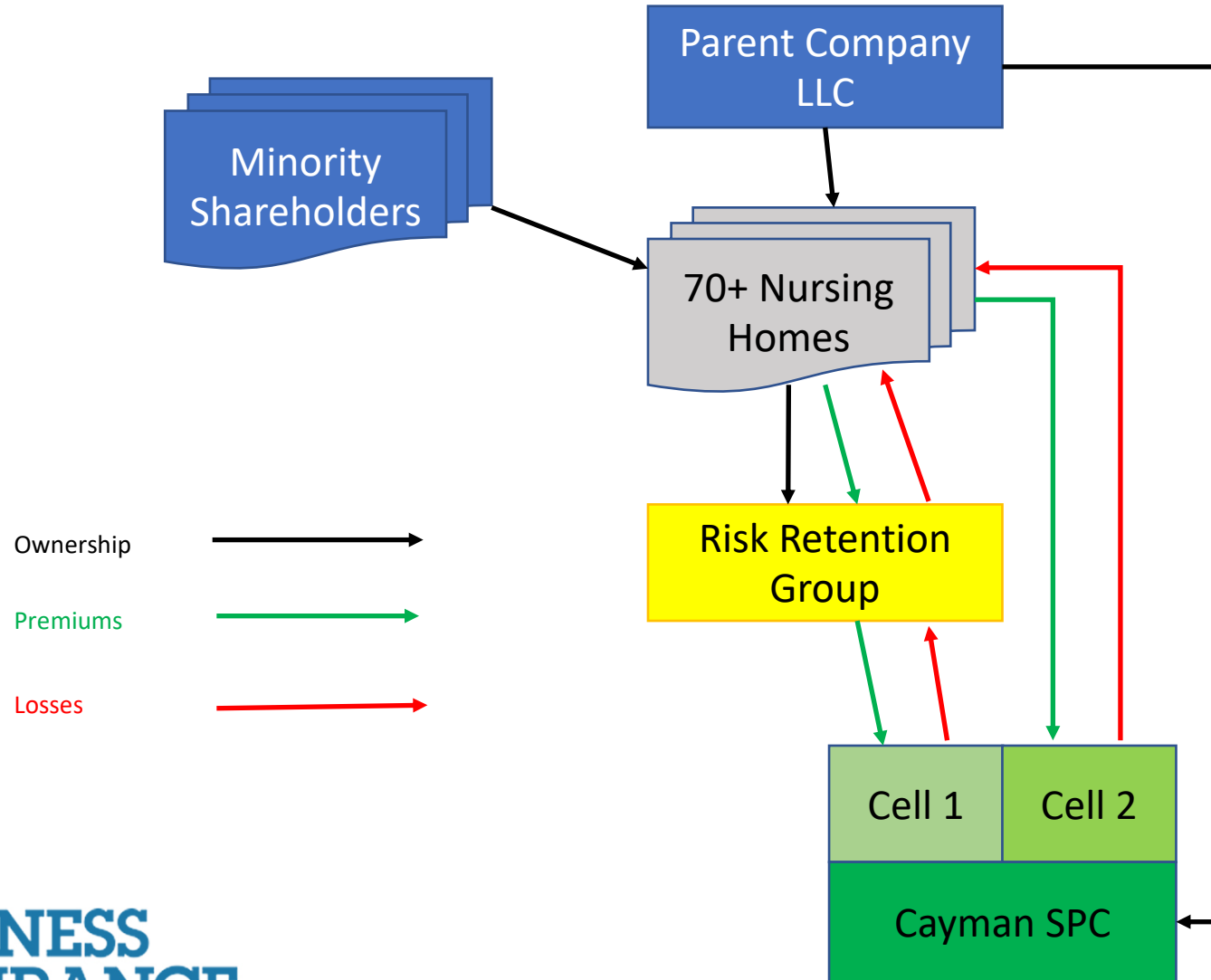
Estimated Number of Programs



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 – Nursing Homes



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”**

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

Dan Kusaila, Tax Partner, Crowe Horwath