

BUSINESS INSURANCE

WORLD

CAPTIVE FORUM

P/C Track: Producer-owned Captives



Jim Swanke
Willis Towers Watson
MODERATOR



Eric Halter
AF Specialty



Steve Love
SolePro



Jeffrey Valentine
SolePro

Session Objectives:

- Demonstrate the use of Producer Owned Captives to facilitate the development of a workers' compensation insurance product that can enhance the revenue opportunities for the Producer's Insured base;
- The role the Producer Owned Captive provides for the alignment of the financial interest of all responsible parties;
- Subsequent enhancement of the product to address additional needs identified within the original targeted industries; and
- Presentation of data demonstrating growth of the program over the seven years of its existence from the perspective of the Captive Owner, the Carrier and the Insured.



#WorldCaptiveForum

BUSINESS INSURANCE
WORLD
CAPTIVE FORUM

Base Understanding of Coverage

- The majority of state employment commissions require the purchase of workers' compensation insurance for those employers with a minimum employee base of three full-time employees. There are a few states with minimums as low as one full-time employee.
- Workers' compensation insurance, benefits are determined by each state, and provides medical care, death, disability, and rehabilitation benefits for workers who are injured, become ill or killed while on the job.
- The insurer agrees to pay all compensable claims related to the insured employer's state's workers' compensation laws without any regard to liability.
- Workers' compensation coverage premiums are based on the employer's payroll and the type of duties its employees perform, payroll class codes.
- Employers pay the premium to the Insurer. The insurer administers/pays the claim.

The Identified Issue

- In-house Underwriters were being bombarded with an unique issue confronted by sole proprietors, multi-member LLCs, partnerships, and one person S-corps. Time frame was the year 2012.
- A sole-proprietor who does not employ workers, when trying to get on various job sites, are being declined prospectively on lucrative projects due to not having workers' compensation coverage even though they fall below the three employee threshold.
- A business normally requires some "proof of insurance" normally provided by a Certificate of Insurance issued by the insurance carrier admitted in the state the work is being performed in. The business requires this to avoid work-related liability from subcontractors or independent contractors impacting their loss ratio.
- The majority of workers' compensation carriers will not insure entities that fall under the state full-time threshold or with minimum premiums.



#WorldCaptiveForum

The Identified Issue – cont.

- Most insurers do not insure sole proprietors, multi-member LLCs, partnerships, or one person S-corps due to two primary reasons:
 - Premium inadequacy for exposure assumed, and
 - Unlimited statutory benefits.
- With majority of the states adopting legislation several years ago providing unlimited statutory benefits under a workers' compensation policy, the potential underwriting exposure is too great for the premiums generated by the payroll of one worker, the proprietor(s).
- An example of this would be a quad claim on a minimum premium policy, receipt of \$1,500 of premium vs. potential of a \$10.0M plus claim cost (age dependent).

The Identified Issue: Target Industries

0042	Landscaping	5478	Floor Covering Installation
0917	Residential Cleaning	5480	Plastering
2585	Carpet Cleaning	5535	Sheet Metal Work, Gutter Installation
3040	Ornamental Ironwork	5537	HVAC
3365	Welding	5539	Metal Building Erection
5020	Acoustic Ceiling Installation	6217	Excavation
5022	Masonry	6400	Fence Installation
5102	Door & Window Installation	7219	Local Trucking
5183	Plumbing	7600	Cable Installation
5221	Concrete Work	8720	Inspection of Insurance Risks
5223	Swimming Pool Installation	8835	Home Health Care
5348	Ceramic Tile	9014	Janitorial Services
5445	Drywall Installation	9082	Restaurant <i>(Plus)</i>
5474	Painting	9102	Lawn Maintenance

#WorldCaptiveForum

The Identified Issue: Alternatives

- For the sole proprietors, multi-member LLCs, partnerships, and one person S-corps there are limited alternatives to main stream insurance carriers for coverage:
 - State Assigned Risk Fund;
 - Very limited carriers with specific, few class codes and applicable states.
- Limit job selection to those not requiring “Proof of Insurance” or certificate of insurance certificates of insurance or having the contract amount reduced as an uninsured sub-contractor.
- Dependent upon the targeted industry, this could severely restrict the ability to generate income contributing to a diminished going-concern position for entities experiencing this issue.

The Identified Issue: Alternatives cont.

- The alternatives previously identified are not viable, long-term solutions since:
 - State Assigned Risk Funds are the markets of last resort which is very costly eroding the margins on prospective jobs;
 - State Assigned Risk funds also have additional problematic areas which are mid-term audits and change of primary carrier every two years;
 - Limited carriers with specific, few class codes and applicable states are virtually non-existent and normally have very clunky processes causing potential issues for ease of use thus increasing legal or coverage risks;
 - Limiting job selection limits opportunity thus revenue which dependent upon geographic demand for services may be a death warrant to the entity; and
 - Charges for being an uninsured sub can exceed having own policy.

The Key Elements for Success

- Seeking a solution for the identified targeted insured, SolePro considered the key elements for success would be:
 - Exclusion of the Owner from the coverage of the policy, minimizing underwriting exposure, allowing a minimum premium to be charged;
 - Confirmation of exclusion of the Owner by the Owner in the total underwriting and binding process;
 - Protection of the carrier by transferring the majority of underwriting exposure to an alternative risk bearing entity on a quota share basis sufficiently collateralized to cover anticipated claims.


The Key Elements for Success


- Require the purchase an accident policy providing insurance coverage to the policyholder in the event of an injury. The accident policy should provide 24-hour accident coverage, including Accidental Death & Dismemberment; and
- Strict enforcement of Owner exclusion, Owner indemnification of the Insurer and the existence of the accidental policy is non-negotiable.

Characteristics of a Solution for the Opportunity

- A.M. Best Admitted carrier willing to limit underwriting exposure through an alternative design of risk transfer while providing a viable product subject to State Insurance Department scrutiny;
- Deliverable Certificate of Insurance from an A.M. Best rated insurance carrier licensed in the particular state to allow the Sole Proprietor to accept the job;
- Price solution below state assigned risk plans;
- Provide Owners protection/benefit in the event that they are injured;
- Restrict or transfer the underwriting exposure of the insurance carrier minimizing/eliminating the premium inadequacy; and
- Implement restrictive cancellation underwriting requirements to maintain integrity in the program and managing the overall underwriting risk.

SolePro X: Initially Created 2013





Solo X

- ✓ Owners excluded
- ✓ Accident policy included
- ✓ Online submission process

Our most popular plan offers minimum premium workers' comp with an added accident policy. Solo X excludes owners from coverage, and is designed for sole proprietors and businesses with no employees, subcontractors, or day labor. Should an accident occur, the 24-hour accident policy provides coverage. This program has more benefits, and is less expensive, than the Assigned Risk plan. Better yet, it's all online-- agents can quote, bind, and renew policies with the click of a button.



#WorldCaptiveForum

Partnerships Committed



MGA and Captive Owner



Program/Fronting Partner



Insurance Carrier: Accident Fund Insurance Company of America

#WorldCaptiveForum



Carrier and Fronting Partnership



- Issuing paper for Certificate of Insurance
- A.M. Best “A” Stable
- 50 state footprint
- Workers’ compensation specialist
- \$1.0B of workers’ compensation premium annually



- Facilitator of issuing paper
- Risk partner
- Aggregate Reinsurance Provider
- Multi-line program/fronting facilitator

#WorldCaptiveForum



Captive Requirement

- Insurance carrier requires the captive remains in place and sufficiently capitalized to assume the risk of the program.
- Without the captive in place, the carrier would not act as the issuing carrier for the program.
- The captive is a segregated cell captive domiciled in the Cayman Islands.
- SolePro is the owner of the captive.
- AF Specialty, the program/fronting arm of AF Group, shares a risk position in the program. If the claims breach the aggregate limit, AF Specialty, through other insurance carrier consolidation, provides aggregate cover.
- The insurance carrier is essentially covered 100.0%.



#WorldCaptiveForum

Captive Parameters

Domicile:

Cayman

Number of Participants	1.0
Estimated Premium for Program	\$ 10,000,000
Fronting Carrier Retention	25.0%
Program Quota Share	75.0%
Program Expenses	41.0%
Aggregate of Program	74.0%
Attachment Point	59.0%

Captive Working Funds

Formation Costs	25,000
Annual Management Fees	40,000
Collateral As a % of Gross Premium	15.0%
Collateral As a % of Ceded Premium	20.0%

Investment Detail:

Amount

GAP funding for program	\$ 1,500,000
Captive working funds	-
Formation costs (initial year)	
Annual management fees	\$ 33,000
Government fees	510
Audit fees	15,000
Actuarial fees	4,000
Bank Fees	400
Sundry	50

Total Investment

\$ 1,552,960

#WorldCaptiveForum

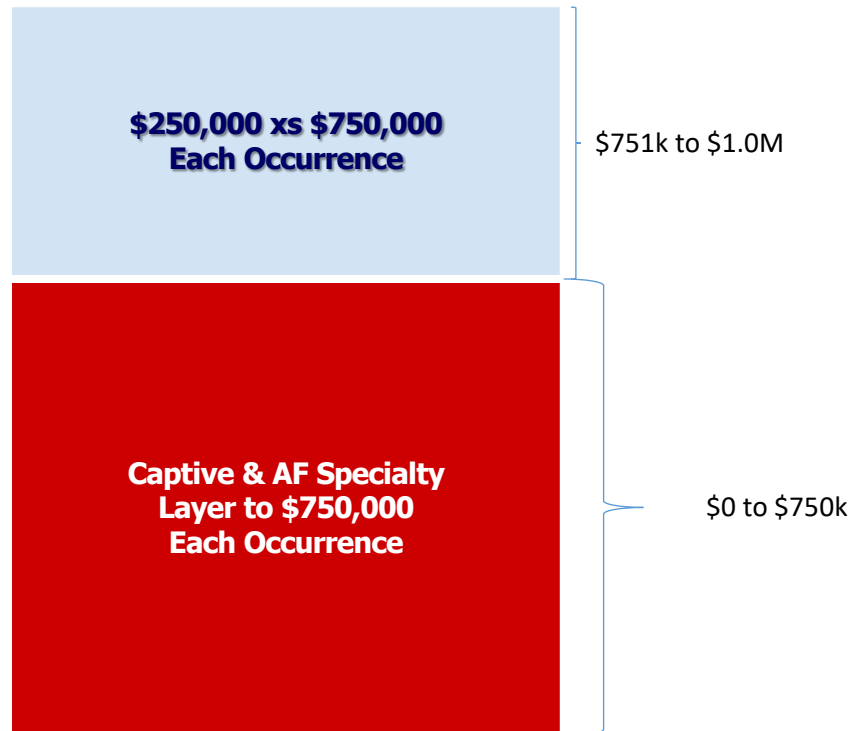
Underwriting Requirements of the Program

- The Insured must be a sole proprietor, multi-member LLCs, partnerships, and one person S-corps.
- Owner(s) must exclude themselves electing not to be covered under the state workers' compensation act(s) applicable to Proprietor and acknowledge that such election was done with full knowledge that workers' compensation insurance will not be available to Proprietor in the event Proprietor suffers bodily injury while performing work whether said injury is self-caused or the result of an unrelated third party.
- Represent and warrant that no day laborers or uninsured subcontractors are used while conducting uninsured entities' business and electronically warrants and covenants that no employees, day laborers or uninsured subcontractors are utilized while conducting Proprietor's business during the period any insurance is issued to Proprietor by the Program. SolePro also should be notified by the Agent or Insured.

Underwriting Requirements of the Program cont.

- Proprietor understands if any employees are hired or any day laborers subcontractors are used, Proprietor will immediately notify SolePro, who will cancel and rewrite in another program developed in 2018.
- The state filed minimum premium for the class must be charged in full but not less than \$750.
- The annual premium must be paid at binding.
- The Proprietor must purchase the accidental death and dismemberment policy to participate in the program.

Captive Coverage



- AF Specialty provides cover 100.0% above \$750k per occurrence limit.
- Losses above \$1.0M are covered through other \$9.0M xs \$1.0M excess.
- If loss exceeds \$10.0M, there is a Corporate CAT cover in place.
- Captive Owner and AF Specialty share up to the attachment point on QS basis.
- Captive retains 100.0 % from the attachment point to the aggregate limit.

#WorldCaptiveForum

Illustration of Captive Structure



- Cayman Island SP Cell
- 75 / 25 Quota Share
- 41.0% Ceding Commission



- Minimum premium policy issued
- Owner excludes himself
- Accident Policy Purchased

- Accident Fund requires captive to assume risk
- Quota Share Reinsurance Agreements in place
- Aggregate reinsurance provided by AF Specialty via AFICA

#WorldCaptiveForum

Financial Flow of Captive Funds

	QUOTA SHARE		
Description	Total Program	Program	AF
Estimated Premium	\$ 10,000,000	\$ 7,500,000	\$ 2,500,000
Quota Share	100.0%	75.0%	25.0%
Aggregate	74.0%	74.0%	
Program Expenses	41.0%	41.0%	
Attachment Point	59.0%	59.0%	
Aggregate - \$	\$ 7,400,000	\$ 5,925,000	\$ 1,475,000
Ceded Premiums - \$		\$ 7,500,000	
Program Expense - \$		3,075,000	
Net Ceded Premium - \$		\$ 4,425,000	
Aggregate Liability		\$ 5,925,000	
Net Ceded Premium (Loss Fund)		4,425,000	
Gap to Collateralize		\$ 1,500,000	
Collateral As a % of Gross Premium		15.0%	
Collateral As a % of Ceded Premium		20.0%	

#WorldCaptiveForum

Aggregate Liability of Program

	Total Program	Program	AF
Description			
Estimated Premium	\$ 10,000,000	\$ 7,500,000	\$ 2,500,000
Total Aggregate of Program	\$ 7,400,000		
Calculation:			
<u>Quota Share of Aggregate</u>			
Attachment point	59.0%		
Quota Share	100.0%	75.0%	25.0%
Quota Share Allocation	\$ 5,900,000	\$ 4,425,000	\$ 1,475,000
<u>Attachment Point to Aggregate</u>			
Attachment Point to Aggregate Allocation		\$ 1,500,000	
<u>Summary of Aggregate Allocation</u>			
Quota Share Allocation	\$ 5,900,000	\$ 4,425,000	\$ 1,475,000
Attachment point to Aggregate Limit	1,500,000	1,500,000	-
Total Aggregate	\$ 7,400,000	\$ 5,925,000	\$ 1,475,000



#WorldCaptiveForum

Financial Profitability of Program

	Estimated	Estimated	Estimated	Estimated	Estimated	Estimated
Loss Ratio	20.00%	40.00%	50.00%	59.00%	70.00%	74.00%
Underwriting Income						
Premiums Earned	\$ 7,500,000	\$ 7,500,000	\$ 7,500,000	\$ 7,500,000	\$ 7,500,000	\$ 7,500,000
Underwriting Expenses						
Program expenses	3,075,000	\$ 3,075,000	\$ 3,075,000	\$ 3,075,000	\$ 3,075,000	\$ 3,075,000
Claim incurred	1,500,000	3,000,000	3,750,000	4,425,000	5,250,000	5,925,000
Net Underwriting Income	\$ 2,925,000	\$ 1,425,000	\$ 675,000	\$ -	\$ (825,000)	\$ (1,500,000)
Net Underwriting Margin	39.0%	19.0%	9.0%	0.0%	-11.0%	-20.0%
Administration Expenses						
Captive management fee						
Premium Tax						
Government Fee						
Audit Fee						
Miscellaneous Charges						
Letter of Credit						
Income from Insurance Operations	\$ 2,925,000	\$ 1,425,000	\$ 675,000	\$ -	\$ (825,000)	\$ (1,500,000)
Net Underwriting Margin	39.0%	19.0%	9.0%	0.0%	-11.0%	-20.0%
Collateral Placed for Securitization of GAP	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000
Reduction of Collateral for Loss Activity	-	-	-	-	(825,000)	(1,500,000)
Collateral Remaining	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000	\$ 675,000	\$ -

#WorldCaptiveForum

Benefits of the Program to the Insured

- Sole proprietor, multi-member LLCs, partnerships, and one person S-corps now have the ability to accept higher paying jobs requiring a Certificate of Insurance enhancing their financial performance allowing growth and employment stability. For the latest concluded policy year, there were 6,242 policies issued.
- Total policy premiums are on average \$2,500 which is substantially less than the primary alternative which is the State Assigned Risk Funds which would be in excess of \$5,000.
- The program is designed to provide the Owner(s) who utilized minimum premium policies more benefits by requiring an accidental policy providing 24 hour accident coverage, including accidental death and dismemberment.

Benefits of the Program to the Insured cont.

- Policy is issued by an A.M. Best A Rated Admitted Carrier with an expertise in workers' compensation (107+ years in existence);
- No mid-term audits, on-line annual audits; and
- Once policy is issued, the policy is renewable with minimum efforts provided the Insured complies with the underwriting requirements of the program, i.e., no employees, subcontractors and excludes themselves.

Growth of Programs




	Policy Year					
	2013	2014	2015	2016	2017	2018
Policy Count	63	835	2,121	2,964	4,290	6,242
Gross Premium	\$ 53,290	\$ 716,784	\$ 1,678,233	\$ 2,152,195	\$ 7,926,435	\$ 8,706,860

#WorldCaptiveForum


The Additional Market Deficiencies Identified - 2017

- Owner(s) desired coverage and optional accident policy.
 - Entity is still restricted to no employees, subs or use of day labor.



Solo I

- ✓ Owners included
- ✓ Optional accident policy
- ✓ Pay plans available



Unlike many carriers, Solo I will provide coverage to business owners with no employees, subcontractors, or day labor. Before, these business owners typically had to rely on the Assigned Risk plan. With us, businesses with no employees can get the coverage they need, and at a very competitive price. Insureds can customize this plan, whether they are looking for increased limits, or are interested in adding an optional accident policy.



#WorldCaptiveForum

BUSINESS INSURANCE
WORLD
CAPTIVE FORUM

The Additional Market Deficiencies Identified - 2017

- Owners(s) growth of business required to have two or more employees (full-time or part-time).
 - Owner can exclude or include themselves and have the option to purchase or decline accident policy.



Plus

- ✓ Owners can include/exclude
- ✓ Optional accident policy
- ✓ Pay plans available



This flexible program allows business owners with one or more (full-time or part-time) employees to get workers' comp at an affordable price. With Plus, insureds can choose to include or exclude themselves from coverage, and can have the peace of mind that their employees will be covered either way. Increased limits are available, as is an optional accident policy. Working with a fresh business? We consider new ventures.

#WorldCaptiveForum

Additional Application of Concept

- AF Specialty has another captive based program that utilizes a segregated cell captive that assumes 90.0% of the underwriting exposure associated with the program. Our carrier brands would be reluctant to write this business on a guaranteed cost basis.
- The Insured enables individuals with long-term care needs or disabilities to easily hire and employ caregivers legally by handling all required employer and employee paperwork, time tracking, payroll, tax filings and insurance concerns as a fiscal intermediary.
- Again, a very successful program that would not have been in existence without the use of a captive to facilitate the risk.



#WorldCaptiveForum



Questions?



#WorldCaptiveForum

