



Captives 101

Presented by:
Andrew Sargeant
President, Captive Operations
USA Risk Group

Presentation Outline

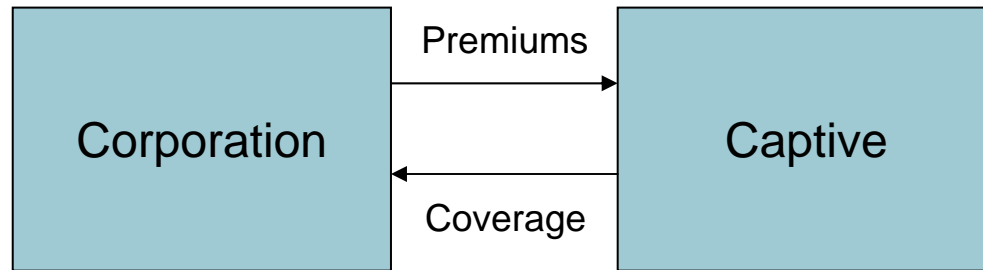
- What is a captive?
- Why have a captive?
- Why not have a captive?
- Types of captives
- Captive structures
- Formation process
- Management of the captive

Captive

- A closely held insurance company controlled by its owners
 - Offers insurance/reinsurance support to its owners as the principal beneficiaries
 - Owners participate in decisions influencing underwriting, operations and investments
 - A long term alternative

Captives are established to either insure or reinsure risk

....direct insurance



...reinsurance



Risks Written by Captives

- Workers compensation, auto and general liability
- Professional Liability/Medical Malpractice
- Products/completed operations, errors & omissions, environmental, pollution
- Property, Business Interruption, Auto Physical Damage
- D&O, Surety, Credit, etc., etc.
- Employee Benefits
- TRIA

Captives: Motivations

Financial and Non-Financial Reasons



- Cash Flow
- Reinsurance
- Insurance Costs
- Allocation
- Investment Income
- Rewards for Good Claims Record
- Stabilization

- Availability
- Broaden Terms
- Tailored
- Uninsured Risks
- DIC
- Co-Insurance Participation

- Increase
- Cover New Risks
- Build Limits
- Access to Reinsurance Markets

- Claims
- Service Providers
- Profit-Center Potential
- Focus Risk Management Efforts
- Enhanced Loss Control & Prevention

Controlling Costs

- All things being equal, captives should produce lower long-term costs
- Primary reasons
 - Lower frictional costs
 - Minimal acquisition cost
 - Reduction in claims cost?

Controlling Coverage

- Problem exists when exact coverage unavailable
- Policies manuscripted
- Exact match of risk to coverage
- Responsible underwriting
- Charge for the risk

Providing Capacity

1. Problem exists when insureds cannot get all limits required.
2. Captive structured to provide desired capacity at necessary levels.
3. Hard market is making this a problem once again.

Accessing Reinsurance

- Access to the reinsurance market is one of the keys to the success of captives.
- Captives can take the predictable losses but are not able to handle shock losses.
- Risk transfer is still required for catastrophes and excess aggregate losses.

Characteristics of Successful Captives

- ***Well identified objective***
- ***Realistic expectations***
- ***Support of senior management***
- ***Long-term commitment***
- ***Prudent funding***
- ***Similar risks***
- ***Reasonable administrative expenses***
- ***Experienced consultants***
- ***Proactive claims administration***
- ***Dedication to loss prevention***
- ***Involved, committed Board***



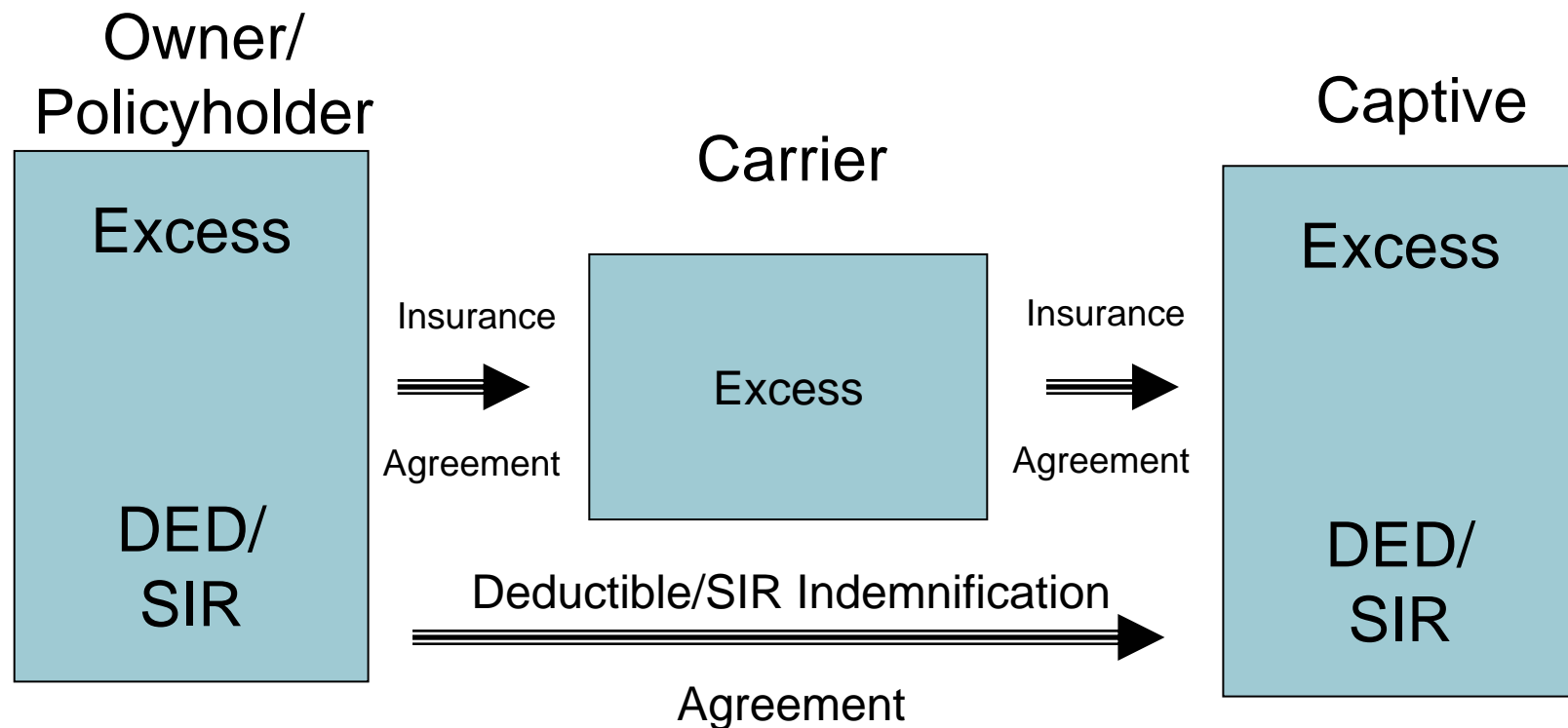
Why Not?

- ◆ Organizational and Ongoing Costs
- ◆ Investment of Capital
- ◆ Long Term Vehicle
- ◆ Management Oversight
- ◆ Unfavorable Loss Experience

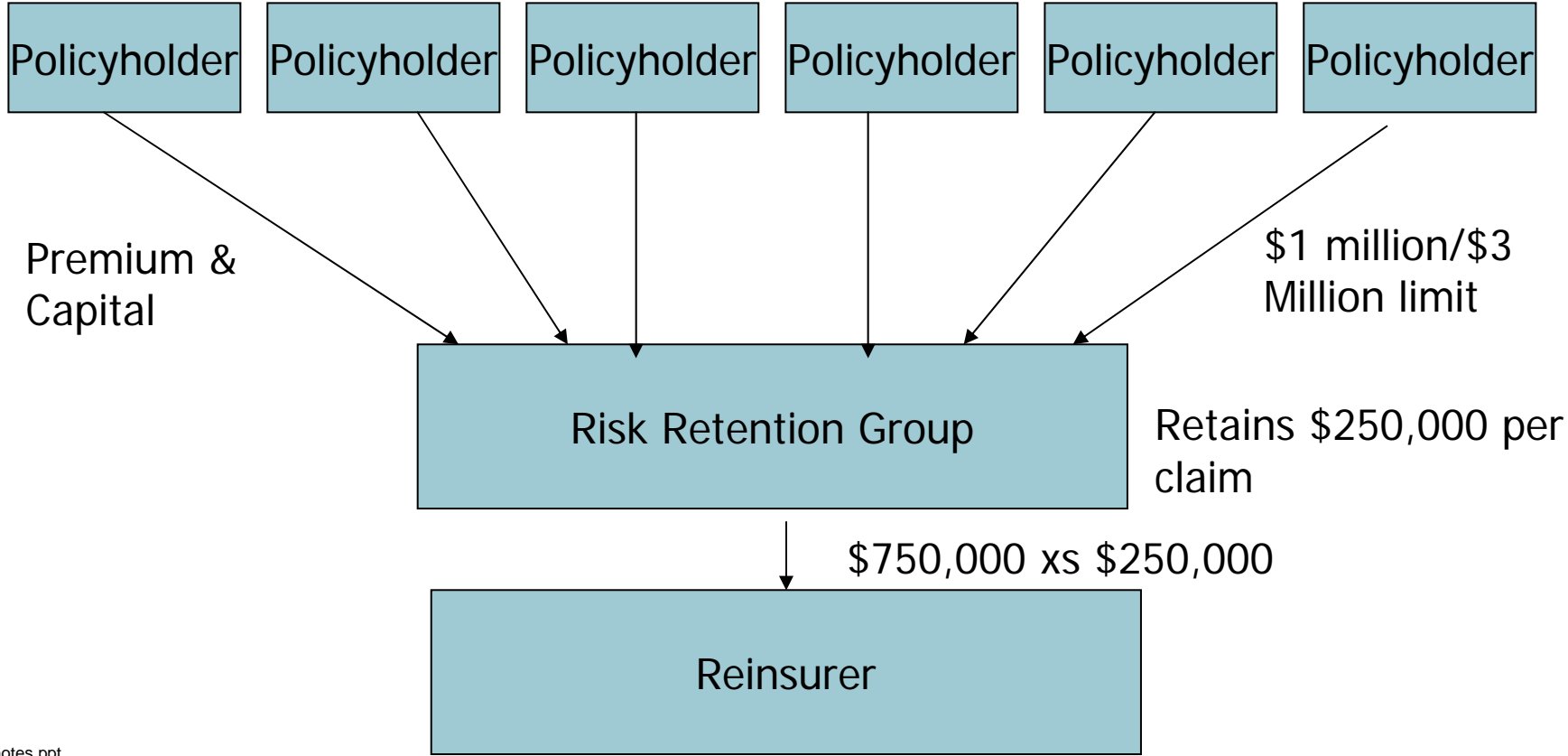
Types of Captives

- **Single Parent** - A wholly owned subsidiary which insures or reinsures all or part of its parent and affiliates.
- **Association or Group Captive** - Jointly owned by a number of companies that are usually affiliated through a trade, industry or service group.
- **RRG - Liability**-only group captive whose members are engaged in similar activities. A subset of group captive.
- **Agency Captive** - Unrelated investors. Promoter driven. Promoter and insureds are unrelated.
- **Rent-A-Captive or Protected Cell Captive** - Owned by investors rather than insureds. Organized to insure or reinsure third-party risks.
- **Branch Captives** – An on shore subsidiary of an off shore captive. Developed for the writing of employee benefits into captives.

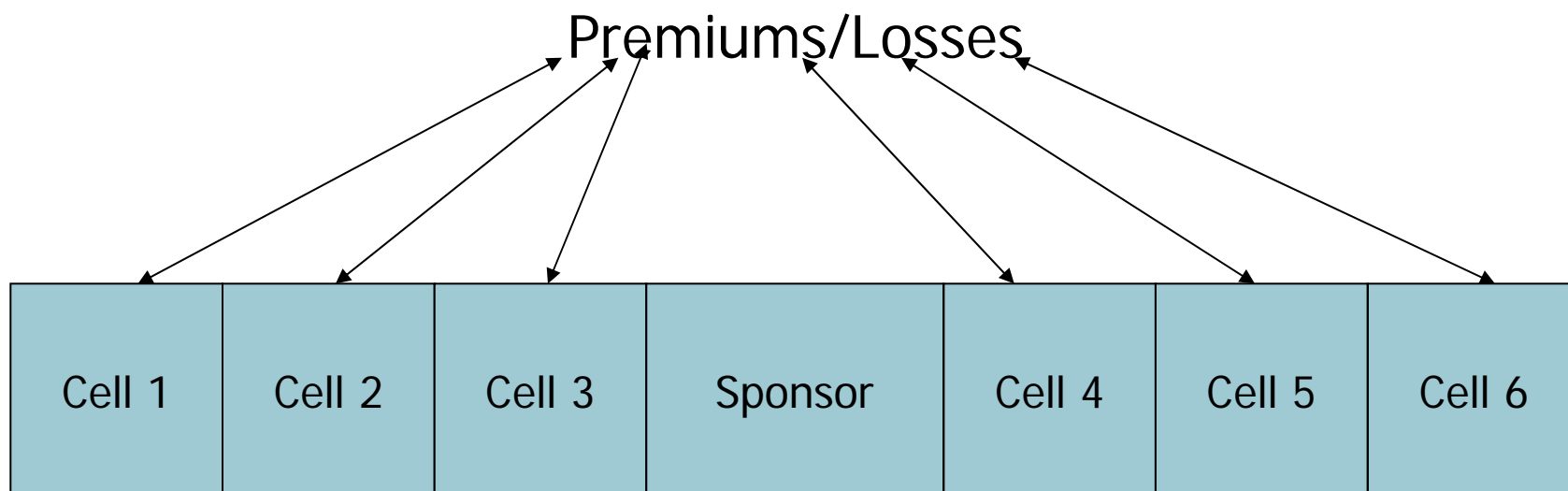
Captives as part of an integrated and complex risk financing program



Risk Retention Group Structure



Cell Captives



1. No pooling of risk
2. Capital from sponsor (some from participants)
3. Sponsor takes no risk. Sponsor controls group.

Captive Formation Process

1. Internal approval for formal feasibility study
2. Engage **actuary** to perform feasibility study
3. Engage **captive manager** to “quarterback” application process
4. Select domicile, hire **domiciliary counsel**
5. Work with **insurance/reinsurance markets** to obtain support
6. Have preliminary meeting with **regulators**
7. File application, which includes:
 1. Application form
 2. Business Plan
 3. Feasibility Study
 4. Parent Company Information
 5. Bylaws & Articles
 6. Underwriting & Safety Procedures
 7. Details of Service Providers – **Manager, Counsel, Actuary, Auditor, Broker/Intermediary**

What's in the feasibility study?

- Loss projections for 5 years based on historical loss data
- Expenses for commissions, reinsurance, fronting fees, loss control, claims administration and general and administrative expenses for the next 5 years.
- 5 years of expected premiums
- 5 year financial proformas with a balance sheet, income statement and cash flow
- Narrative describing assumptions, etc.

Captive Timelines – it varies a lot!

- Start:
 - Internal approval
- Week 0 – 2:
 - Engage actuary
 - Engage captive manager
- Week 2 – 10:
 - Data collection
 - Actuary performs feasibility study
 - Ownership, capitalization and governance
 - Select domicile
 - Hire domiciliary counsel
 - Collect all information for application
 - Contact markets
 - Meet regulators
- Week 10 –14:
 - Internal approval of business plan, feasibility study, capitalization
 - Discussion with markets
- Week 14 – 18:
 - Captive application filed with the state of domicile
 - Finalization of market arrangements
 - License approved

Ongoing Management of the Captive

- Risk Management/Loss Control
- Underwriting
- Claims Handling
- Insurance/Reinsurance Market Support
- Accounting & Administration
- Legal
- Treasury
- Actuarial
- Audit
- Company Meetings - Directors & Committees
- Regulatory

Ongoing Actuarial Requirements

- Year End
 - Actuarial opinion on year end reserves
 - By February 28th for RRG's
 - 6 months after year end for other captives
 - Low, select and high range
 - Management discretion
- Ongoing
 - Setting rates
 - Expected loss ratio

Top 16 Captive Domiciles

1. Bermuda – 987
2. Cayman Islands – 733
3. Vermont – 542
4. British Virgin Islands – 383
5. Guernsey – 382
6. Barbados – 301
7. Luxembourg – 208
8. Dublin – 207
9. Turks & Caicos – 166
10. Isle of Man – 165
11. Hawaii – 158
12. South Carolina – 122
13. Singapore 60
14. District of Columbia – 59
15. Nevada – 58
16. Arizona - 53