Captive Basics and Trends for Casualty Actuaries

Casualty Loss Reserve Seminar
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Captive Basics

- A form of risk sharing between the company and its agents/customers
- Reinsurance contract between fronting company and those looking to share risk
- "Skin" in the game for participants

Types of captives / advantages

- Agency – as a risk sharer, agency tends to be more conservative since they are taking risk
- Single Entity – way for individual entity to insure a significant portion of their own risk

Types of captives / advantages (Cont'd)

- Group
  - Homegeneous
    - Benefit of having similar loss exposures to be controlled; sharing of best practices
    - Peer pressure about taking actions to improve risks in the captive

Types of captives / advantages Group (Cont'd)

- Heterogeneous
  - Could have advantage of risks not being highly correlated
  - Sometimes affinity is locale – reputation in that community
  - How do you ask low hazard members to share risk with high hazard members?

Types of reinsurance

- Quota Share – usually up to a certain retained level
- Excess of Loss

Appeal of Captives

- Attractive because there is alignment of interests between the company and its captive partner
- Exposure and Underwriting issues are of mutual concern
- Interest in improving risk is shared
- Increased level of cooperation on claims

Captives are not always a good fit

- Limited or Inconsistent Risk management practices or company culture
- Data are limited or volatile due to heavy M&A or divestiture activity
- Inability to support collateral needs
- Transaction/Commodity Focus: looking for "the best deal"

Captives are not always a good fit (cont'd)

- Unwillingness to lead and govern an insurance company
- Uninterested in a long term approach – looking for "the best deal"

Process of developing terms and conditions

- Underwriting
  - What are exposures?
  - Evaluate the frequency and severity
  - Does this fit within the risk profile of the captive?
  - Should exposure be taken outside of the captive?
  - Financials – does the entity have the wherewithal to share in the risk?

Process of developing terms and conditions (cont'd)

Pick losses

- Use conventional ways of projecting losses for program
- Develop and Trend losses and exposures
- Develop a loss cost

Process of developing terms and conditions (cont'd)

- Determine the cost of reinsurance
  - Specific
  - Aggregate
  - Use industry data as benchmark
  - Use internal data within company
  - Use data from captive itself

Process of developing terms and conditions (cont'd)

- What are expenses associated with writing the business
  - Bundled or unbundled services
  - Expense items
    - Commissions
    - Front: Underwriting, Policy issuance, Loss Control, Audit
    - Claims
    - Taxes, Assessments, RML
    - Offshore expenses
    - FET

Collateral, Reinsuance Contracts

- Determine collateral needs, surplus to be maintained
- Reinsurance contracts executed

Actuaries and Opportunities with Captives

- Loss Pick - (include quality of data)
- Appropriate Aggregate
- Cost of Specific and Aggregate Reinsurance
- Collateral – how much, when to release
- Developing appropriate expenses for captive