

CAPTIVE & INSURANCE BUSINESS TRANSFER
CONFERENCE



OKLAHOMA CITY

Captive 101: Setting up a new captive program – Why & How

Speakers:

- Jerry Messick, CEO, Elevate Risk Solutions
- Heather McClure, Chief Risk Advisor, AON
- Donald Ashwood, Captive Coordinator, OID

Captive 101: Setting up a new captive program – Why & How



Jerry Messick
Elevate Risk Solutions



Heather McClure
AON



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*Oklahoma Insurance
Department*



Setting the Stage: Considering Captive Insurance

- Financial Control
- Engagement in Risk/Safety Mitigation
- Decrease Volatility
- Broadening of coverages – customizable
- Access to reinsurance markets



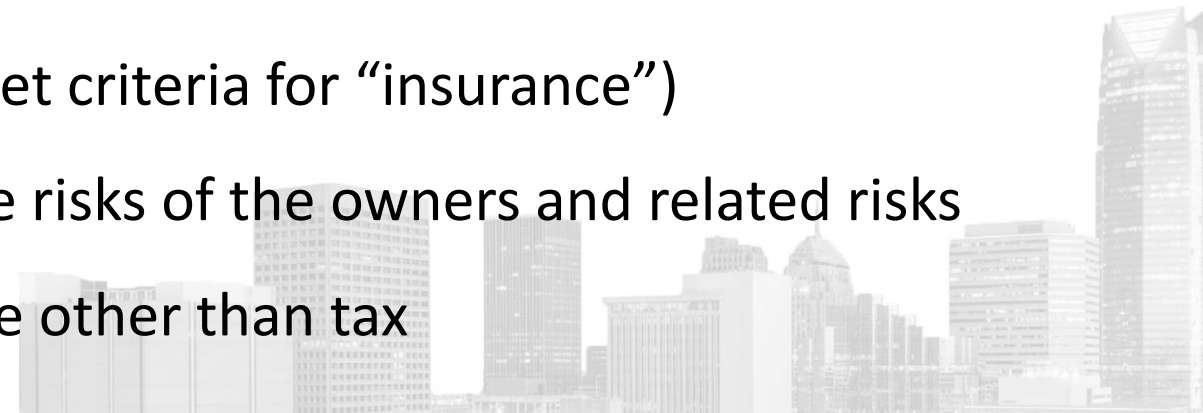
What is a Captive Insurance Company?



“A limited purpose insurance company that exists primarily to underwrite the risk(s) emanating from the owner(s).”

Captives usually have the following characteristics:

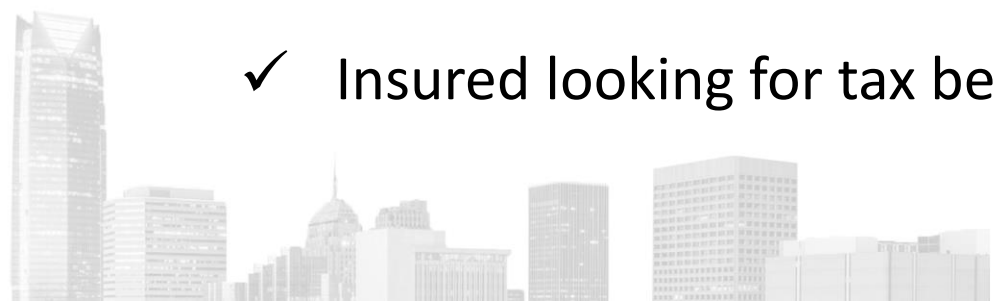
- Privately-owned
- Separate entity (own tax ID)
- Insurance company (must meet criteria for “insurance”)
- Primarily formed to insure the risks of the owners and related risks
- Must fulfill a business purpose other than tax





Examples of indications that forming a captive could be appropriate.

- ✓ Insurance program is of a significant premium size (typically at least \$1MM);
- ✓ Good & predictable historical loss experience;
- ✓ Good loss control program in place;
- ✓ Insured's loss expectation is lower than traditional insurance market;
- ✓ Insured's risk is unusual and/or often misunderstood/poorly coded by carriers;
- ✓ Insured is seeking profit center using insurance to generate income stream;
- ✓ Insured looking for tax benefits similar to commercial insurance expenses



What does a Captive insurer look like?

A captive functions similar to a traditional insurance company:

- Issuing policies to the policyholders (i.e. parent, affiliate, etc.);
- Collecting premiums;
- Disbursing claims payments;
- Preparing balance sheets and income statements;
- Comply with regulator requirements of the domicile where licensed.

Used as a risk management component to assist the Parent/Owner with their risk financing needs.

A tool to capture savings and/or generate additional profits to the Parent/Owner of the Captive Insurance company.

Characteristics of the captive insurance industry

- At least **50%** of the world-wide property and casualty (P/C) premiums are paid to a captive insurance company
- **\$55 - \$60 Billion** in annual premiums are paid to captives
- **More than 90%** of the Fortune 500 companies own at least 1 captive
- **Approximately 57%** of the world's captives are owned by U.S. Companies
- **All 30** of the Dow Industrial 30 companies own a captive



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Common Captive Structures

Single-Parent (PURE) Captive

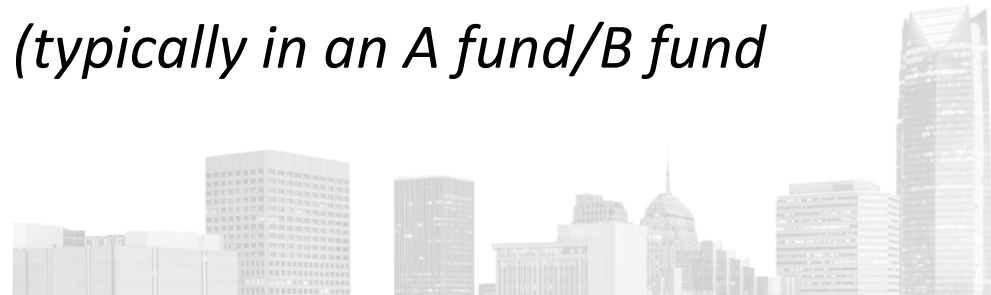
- *Single entity wholly owned*
- *All risk co-mingled within 1 structure*

Sponsored / Protected Cell / Series

- *Can be a self-owned cell company or “rented” cell*
- *Risks are fully segregated between cells*
- *Core is capitalized by owner*
- *Individual cells can be structured as unincorporated or incorporated.*

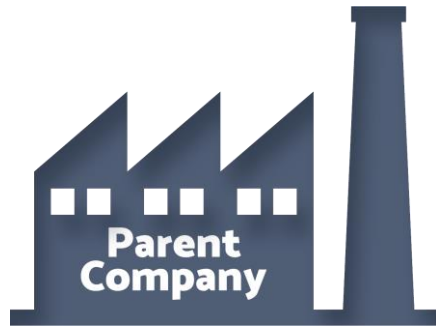
Group / Association Captive

- *Entity owned by its members/insureds*
- *All risks co-mingled within 1 structure (typically in an A fund/B fund format)*



How does a Single Parent/PURE Captive Insurance Company work?

A traditionally larger organization has multiple/complex risks.

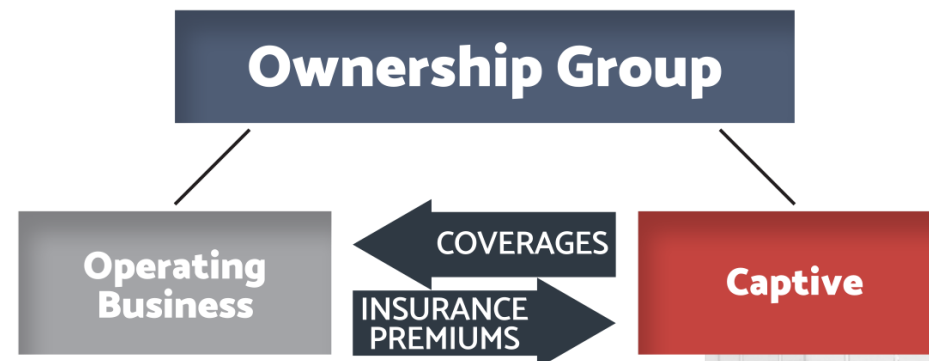


The parent forms a captive insurance company to insure their risks.



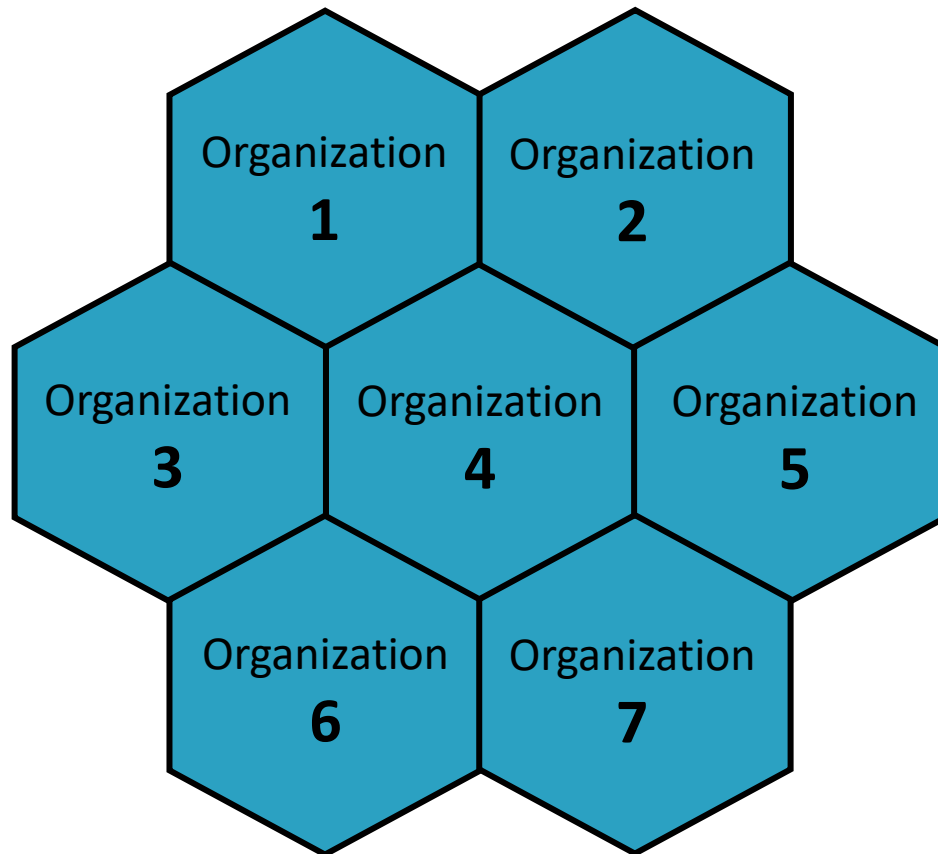
Instead of paying premium to a traditional insurance company, the premium is paid to the captive insurer.

BASIC **CAPTIVE** STRUCTURE

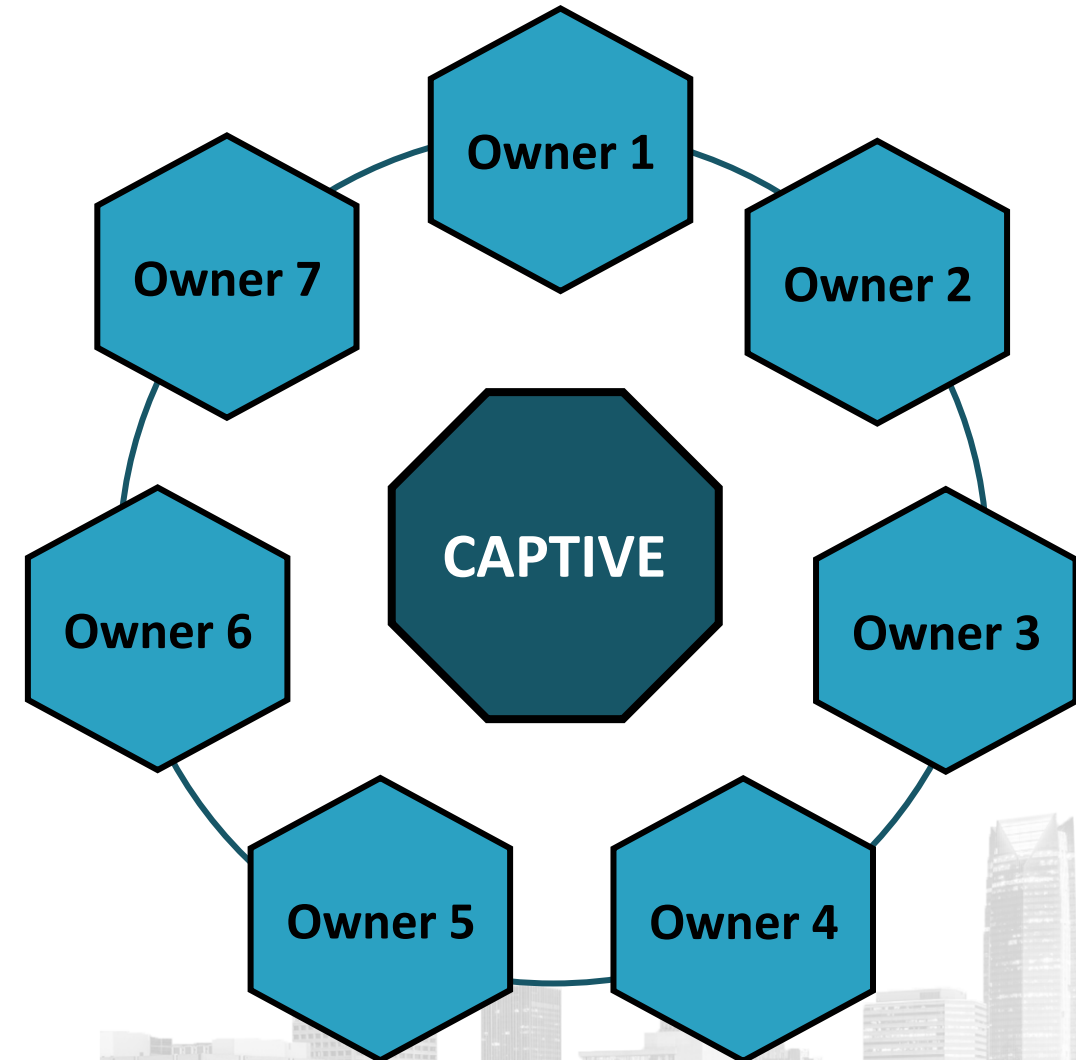


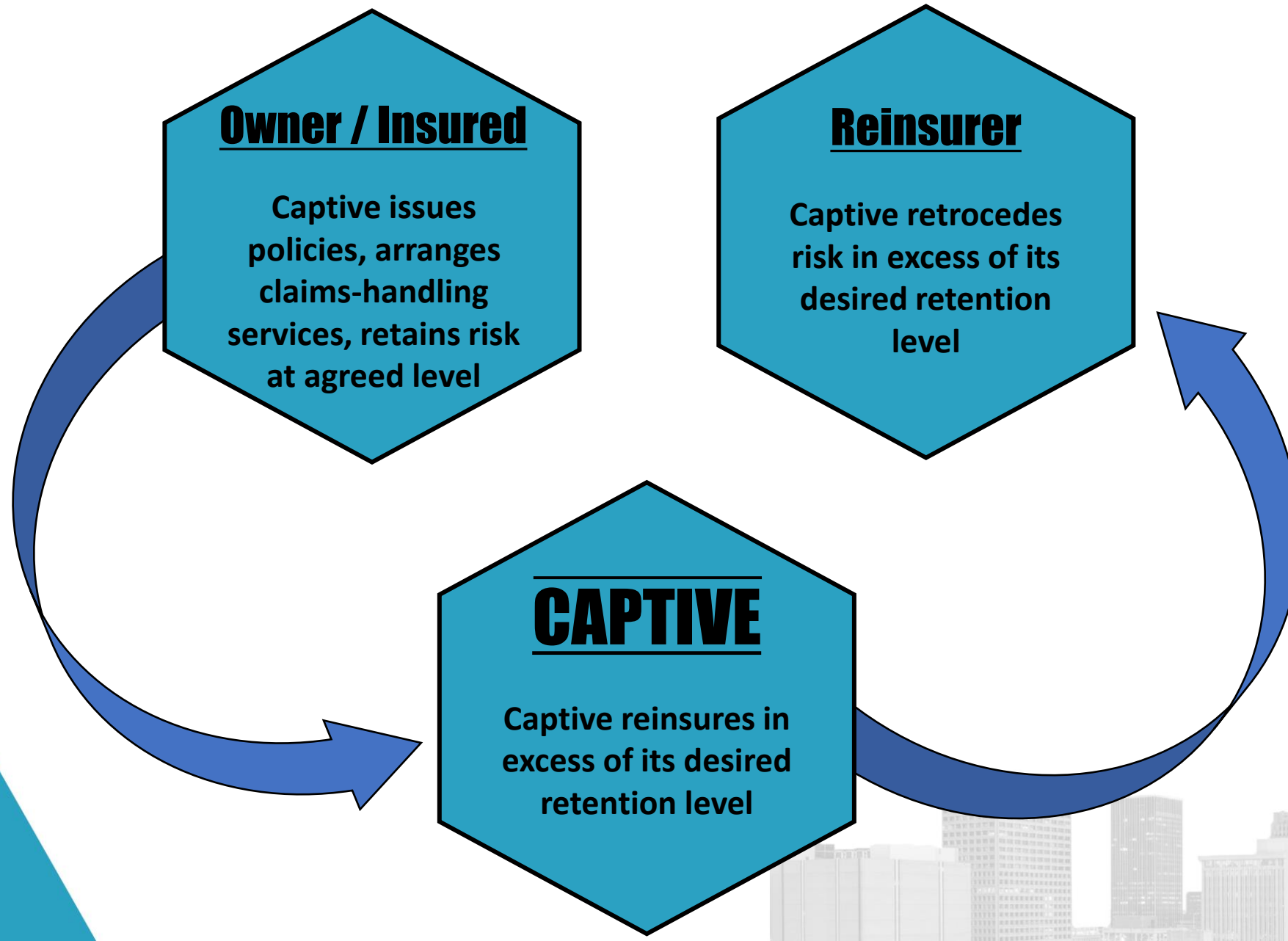
How does a Group Captive work?

Multiple traditionally mid-sized/larger organizations
(WC/GL/Auto commonly sought)

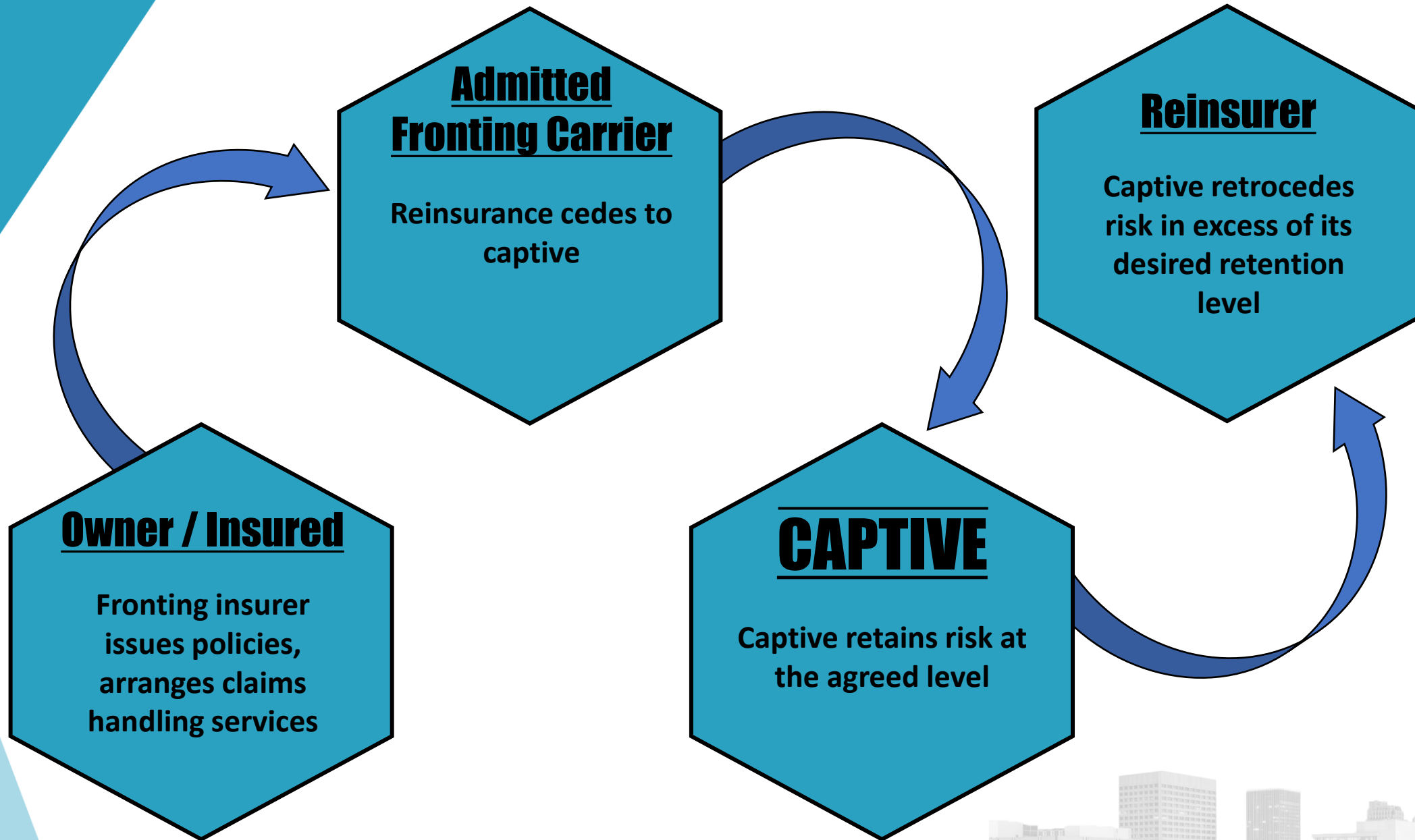


The group of organizations form a captive insurance company to insure their collective risks.





Fronted Reinsurance Program



Type of
Sample
Coverages in
Captive
Programs

“Fat Finger” Insurance
Administrative Actions
Adverse Party Legal Risk
Business Interruption/DIC
Business Litigation DIC
Credit Default
Cyber Liability
Directors & Officers Liability
Employee Dishonesty
Employment Practices/DIC
Environmental Liability/Excess
Errors & Omissions Liability DIC
General Liability DIC
HIPAA/Billing Audit Liability
Contractual Liability
Inland Marine DIC

Labor Strike Reimbursement
Loss of Key Employee
Medical Malpractice/DIC
Medical Stop-loss
Patent Infringement/Intellectual Property
Political Risk
Product Liability/Recall DIC
Professional Liability DIC* Coverage
Professional Misconduct
Property Management Professional
Regulatory Change
Reputational Risk
Subcontractor Performance
Trade Credit
Wage & Hour Liability
Wind Deductibles on Property

*Difference in Conditions



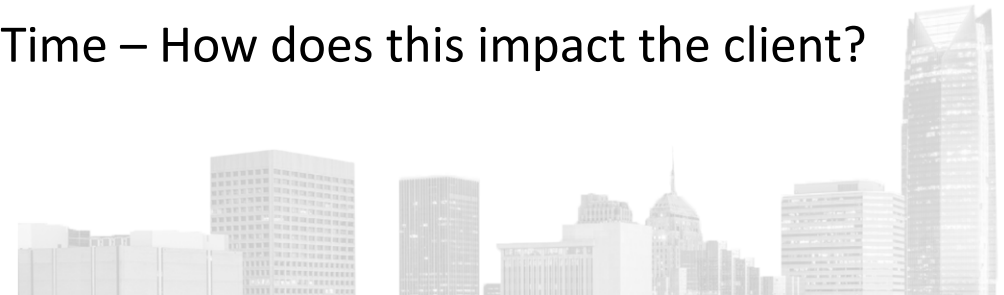
Build a Captive – Step by step example

Agent / Consultant Helps Define

1. The Scenario – what problem is the client trying to solve?
2. The Objective – Business Purpose of Captive... “why does it matter to them?”
3. The Data – What data tells the story?
4. The Analysis – Are they a good candidate? By the numbers; by the attitude
5. The Captive Structure – Best fit: Group -vs- Individual
6. The Risk Assessment – Quantify the problem; Identify coverage
7. Evidencing insurance – Do they need a Front?

Consultant / Professionals Define

8. The Pricing – Draft likely pricing – Reality check
9. Actuarial
10. The Pro Forma
11. Domicile
12. Costs / Expense
13. Governance / Accounting
14. Tax – Are they an insurance company?
15. Exit Strategy
16. Time – How does this impact the client?

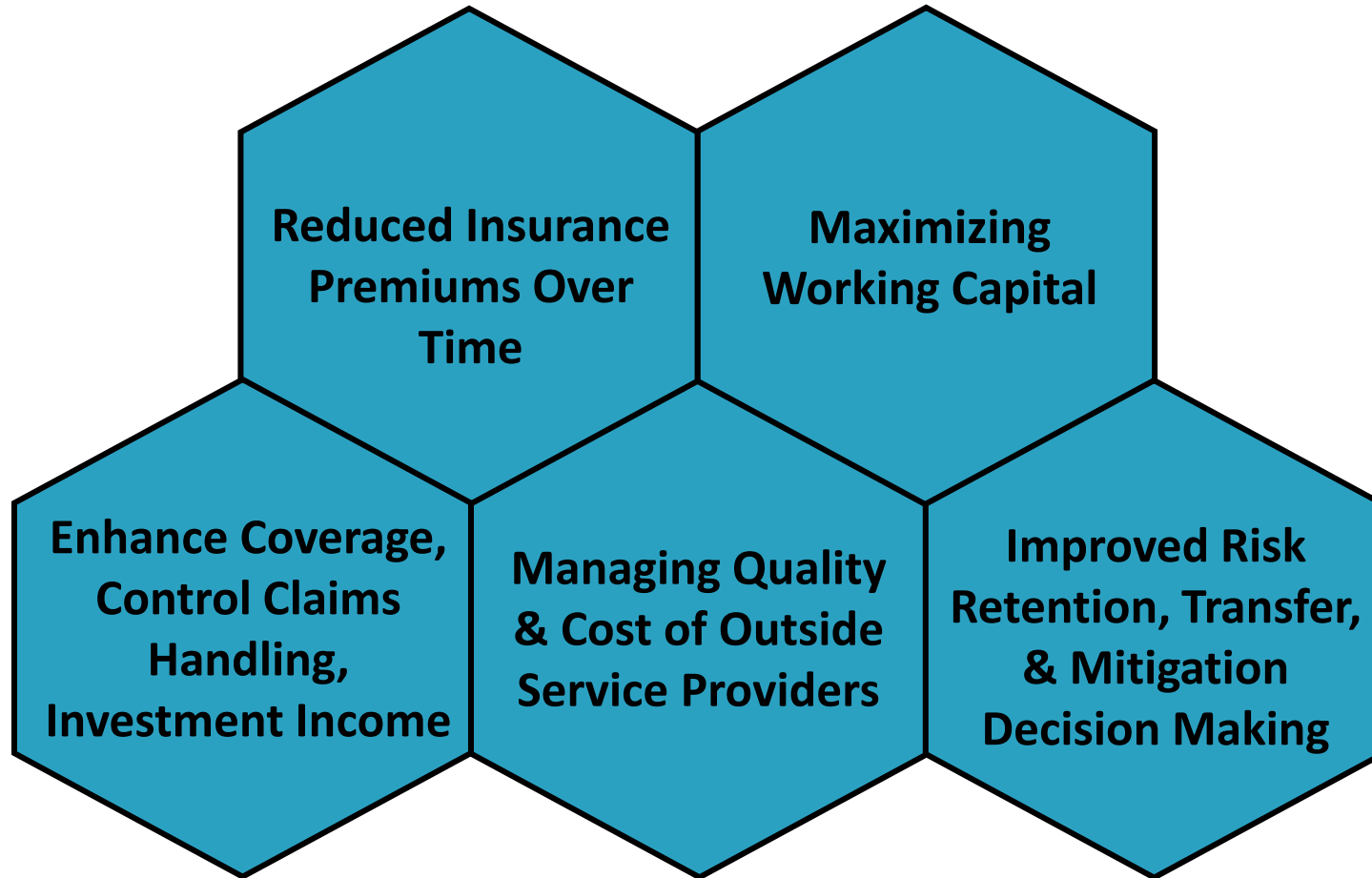


What about the regulatory process for new captive insurance applications?

NOTE: Please include the following information with this application:

1. An explanation of insurance coverage/limits/reinsurance.
2. A certified copy of the captive's charter, certificate of incorporation, articles of association and bylaws, or if being formed as a reciprocal, a certified copy of the Power of Attorney-in-Fact and the subscribers agreement. Certified copies of these documents must be filed before a license will be issued.
3. A non-refundable fee of \$500.00
4. A feasibility study
5. Biographical affidavits for all officers and directors (the biographical questionnaire form can be found on the website)
6. If applicant is an association, please give history, purpose, size, and other details of parent association.
7. A detailed Business Plan with supporting data which may include:
 - a. Risk to be insured, direct, assumed, and ceded by line of business
 - b. Fronting company if operating as a re-insurer
 - c. Expected net annual premium income
 - d. Maximum risk retained (per loss and annual aggregate.)
 - e. Rating program
 - f. Reinsurance program
 - g. Organization and responsibility for loss prevention and safety including the main procedures followed and steps taken to deal with events prior to possible claims
 - h. Loss experience for past three years together with projections for the ensuing three years
 - i. Organizational chart
 - j. Financial projections on an expected and worst case scenario
 - k. Provide copies of all agreements between the captive and its manager, reinsurers and other service providers
8. Additional information to provide if applying as a sponsored captive:
 - a. Materials demonstrating how the applicant will report to the Commissioner on and account for, the loss and expense experience of each protected cell
 - b. A statement acknowledging that all financial records of the sponsored captive, including records pertaining to any protected cells, shall be made available for inspection or examination by the
 - c. All contracts or sample contracts between the sponsored captive insurance company and any participants
 - d. Evidence that expenses shall be allocated to each protected cell in a fair and equitable manner

What value can captives deliver over time?



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*Questions or
Comments?*

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THANK YOU!