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

Speakers:
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Elevate Risk Solutions

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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
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**

- **Ownership Group**
- **Operating Business**
- **Captive**
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.
Direct-Issue Program

**Owner / Insured**
- Captive issues policies, arranges claims-handling services, retains risk at agreed level

**Reinsurer**
- Captive retrocedes risk in excess of its desired retention level

**CAPTIVE**
- Captive reinsures in excess of its desired retention level
Fronted Reinsurance Program

- **Admitted Fronting Carrier**: Reinsurance cedes to captive
- **Captive**: Captive retains risk at the agreed level
- **Reinsurer**: Captive retrocedes risk in excess of its desired retention level
- **Owner / Insured**: Fronting insurer issues policies, arranges claims handling services
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 Propert
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

<table>
<thead>
<tr>
<th>Agent / Consultant Helps Define</th>
<th>Consultant / Professionals Define</th>
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</thead>
<tbody>
<tr>
<td>2. The Objective – Business Purpose of Captive... “why does it matter to them?”</td>
<td>9. Actuarial</td>
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<tr>
<td>3. The Data – What data tells the story?</td>
<td>10. The Pro Forma</td>
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<td>4. The Analysis – Are they a good candidate? By the numbers; by the attitude</td>
<td>11. Domicile</td>
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<td>6. The Risk Assessment – Quantify the problem; Identify coverage</td>
<td>13. Governance / Accounting</td>
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<td>7. Evidencing insurance – Do they need a Front?</td>
<td>14. Tax – Are they an insurance company?</td>
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<td>15. Exit Strategy</td>
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<td>16. Time – How does this impact the client?</td>
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What about the regulatory process for new captive insurance applications?

<table>
<thead>
<tr>
<th>NOTE: Please include the following information with this application:</th>
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<tbody>
<tr>
<td>1. An explanation of insurance coverage/limits/reinsurance.</td>
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<tr>
<td>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.</td>
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<tr>
<td>3. A non-refundable fee of $500.00</td>
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<td>4. A feasibility study</td>
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<td>5. Biographical affidavits for all officers and directors (the biographical questionnaire form can be found on the website)</td>
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<td>6. If applicant is an association, please give history, purpose, size, and other details of parent association.</td>
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<td>7. A detailed Business Plan with supporting data which may include:</td>
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<tr>
<td>a. Risk to be insured, direct, assumed, and ceded by line of business</td>
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<tr>
<td>b. Fronting company if operating as a re-insurer</td>
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<tr>
<td>c. Expected net annual premium income</td>
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<tr>
<td>d. Maximum risk retained (per loss and annual aggregate.)</td>
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<tr>
<td>e. Rating program</td>
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<tr>
<td>f. Reinsurance program</td>
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<tr>
<td>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</td>
</tr>
<tr>
<td>h. Loss experience for past three years together with projections for the ensuing three years</td>
</tr>
<tr>
<td>i. Organizational chart</td>
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<tr>
<td>j. Financial projections on an expected and worst case scenario</td>
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<tr>
<td>k. Provide copies of all agreements between the captive and its manager, reinsurers and other service providers</td>
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<tr>
<td>8. Additional information to provide if applying as a sponsored captive:</td>
</tr>
<tr>
<td>a. Materials demonstrating how the applicant will report to the Commissioner on and account for, the loss and expense experience of each protected cell</td>
</tr>
<tr>
<td>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</td>
</tr>
<tr>
<td>c. All contracts or sample contracts between the sponsored captive insurance company and any participants</td>
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<tr>
<td>d. Evidence that expenses shall be allocated to each protected cell in a fair and equitable manner</td>
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What value can captives deliver over time?

- Reduced Insurance Premiums Over Time
- Maximizing Working Capital
- Enhance Coverage, Control Claims Handling, Investment Income
- Managing Quality & Cost of Outside Service Providers
- Improved Risk Retention, Transfer, & Mitigation Decision Making
Questions or Comments?