

# Captive Insurance

## Terrorism – Tokyo March 20, 1995



# ***Insuring the Uninsurable***

## **What Captive Insurance is and What it Does**

**Presentation for  
Oklahoma Insurance Department  
Insurance Day**

**December 14, 2023**

**Steve Kinion, ACI, APIR  
Director, Captive Insurance  
Oklahoma Insurance Department**



# Outline of Presentation

- **History and Explanation of Captive Insurance**
- **Examples of Captive Insurers**
- **The U.S. and Global View of Captive Insurance**
- **Captive Insurance and Taxes**
- **Oklahoma's Captive Insurance Experience**
- **Closing Credits**
- **Q&A**

# Historical Perspective

- **Late 1950's/1960s – Manufacturing/industrial companies began using captives, mostly to insure property risks**
- **1970s, 1980s, and 1990s – Captives increasingly used for liability insurance**
  - ✓ **Federal Liability Risk Retention Act of 1986**
  - ✓ **Offshore domiciles grow – Bermuda and Cayman Islands**
  - ✓ **Beginning in 1981 Vermont flourishes as only active U.S. domicile**
  - ✓ **Throughout this time, captive formations dominated by large, publicly traded companies**
- **2000's – Increase use of captives by closely held businesses and number of U.S. domiciles increases**
  - ✓ **2005 Oklahoma begins modernizing its captive insurance laws**

# Why Form a Captive?

Time Magazine

March 24, 1986



# Why Form a Captive?

- Multiple reasons such as controlling costs, ensuring the availability of coverage, and tailoring risk control programs.
- Reducing or eliminating transactional costs like state premium taxes, and insurer profit.
- Allow for specific loss control provisions tailored to the captive's insured.
- Management becomes involved in the captive owner's risk management program, because with captives, management reporting is tailored to the needs of the captive owner.
- Access to reinsurance.

# **Various Types of and Uses of Captive Insurance**

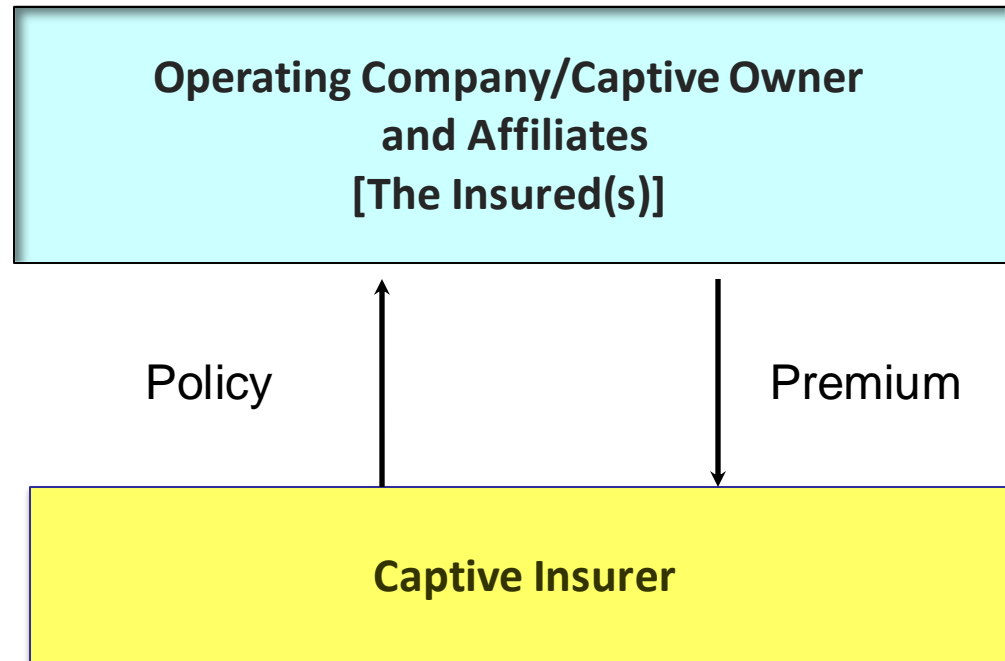
# What Oklahoma Captive Insurers Do Not Insure

- Personal lines
- Personal auto and homeowner insurance
- Directly insurer life insurance
- Oklahoma domiciled captive insurer can directly insure workers' compensation . . . but it's a bad idea!
- Captive insurance is commercial insurance



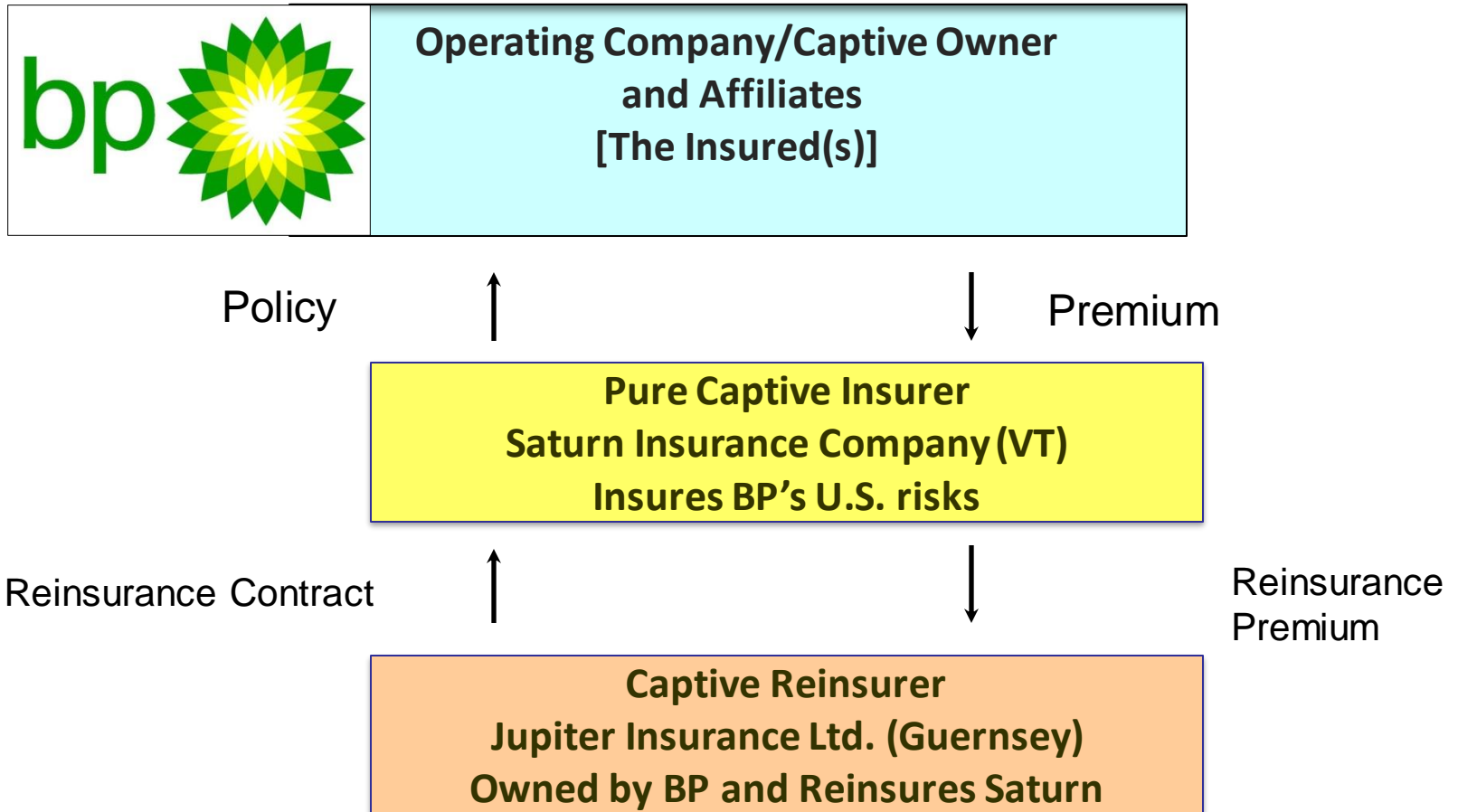
# Captive Insurance is . . . Like Self-Insurance

An insurance company that has as its primary purpose the financing of the risks of its owners and/or affiliates.



# Pure Captive Insurer Example

## Captives may also be Reinsurers



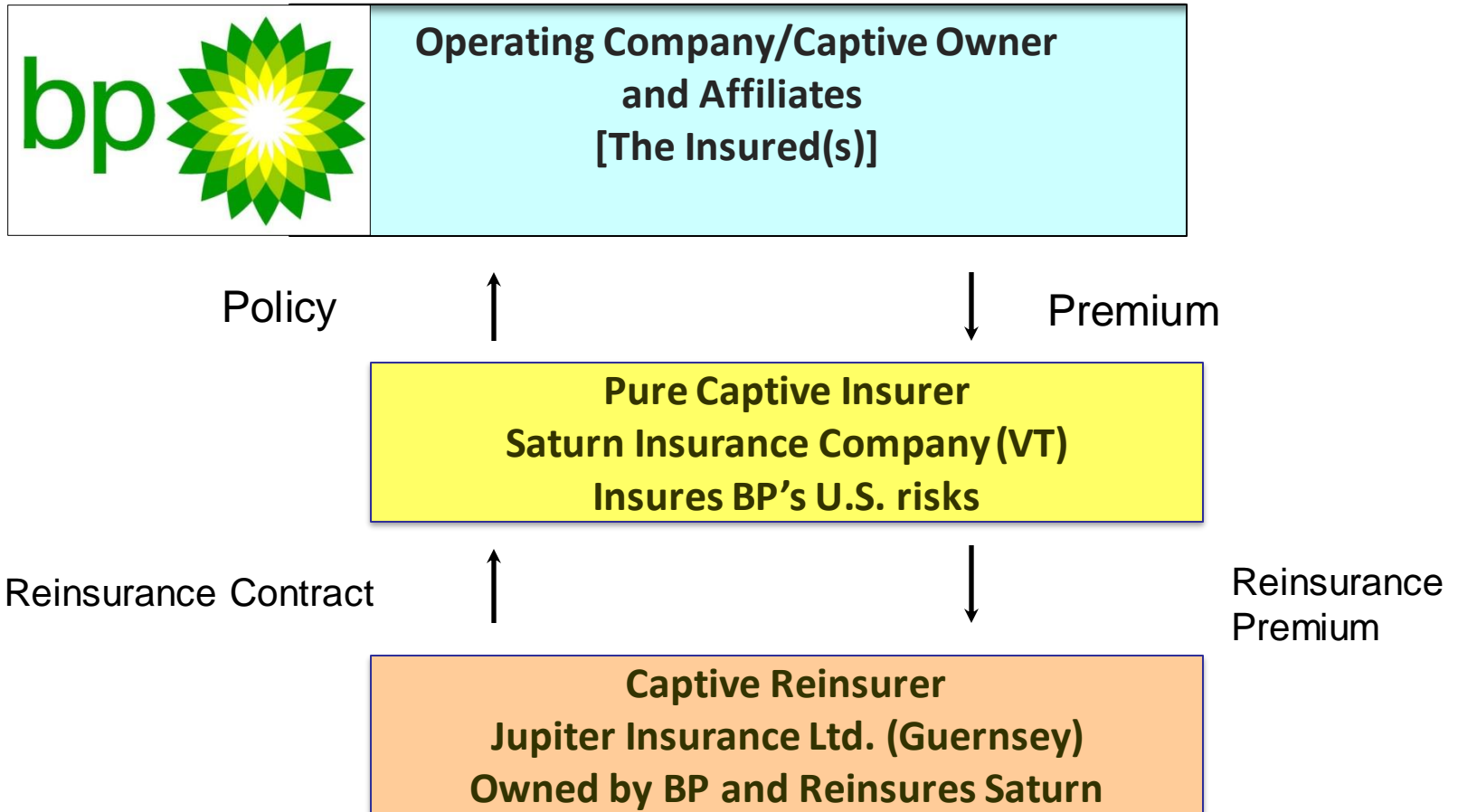
# Pure Captive Insurer Example

## Captives may also be Reinsurers

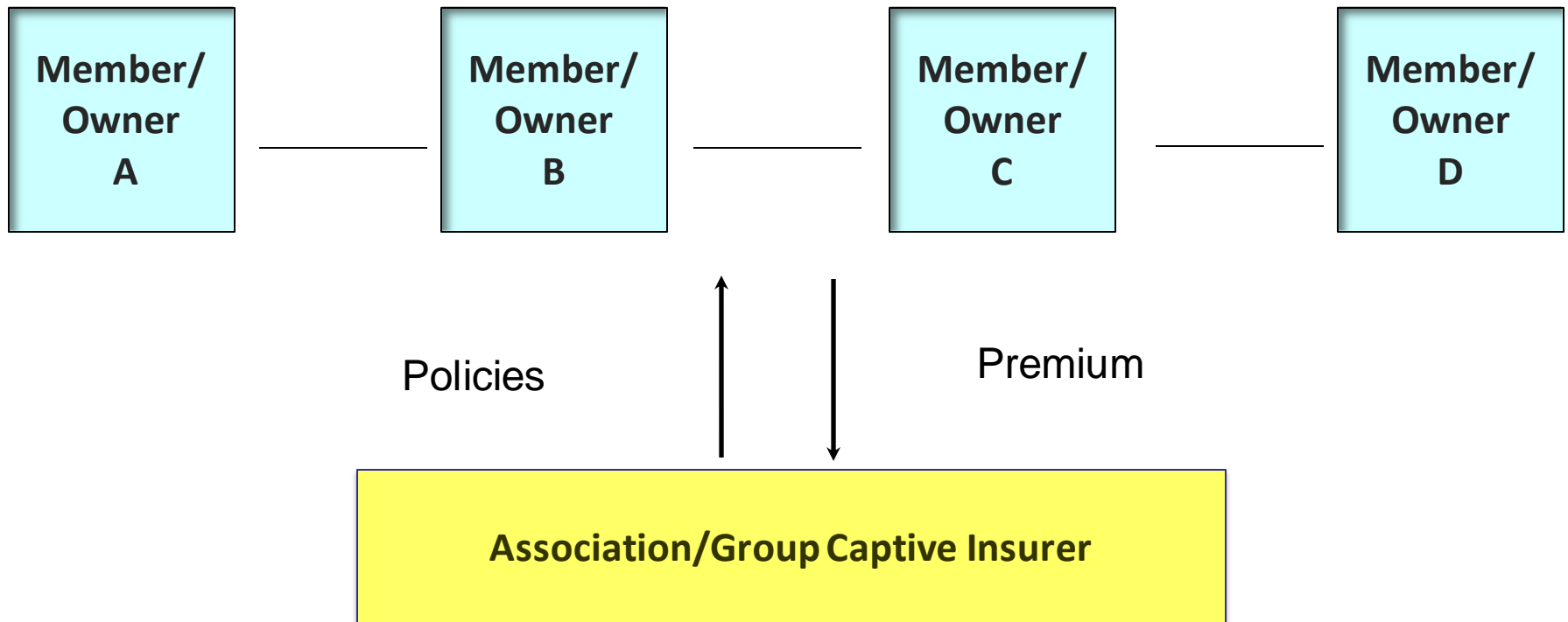


# Pure Captive Insurer Example

## Captives may also be Reinsurers

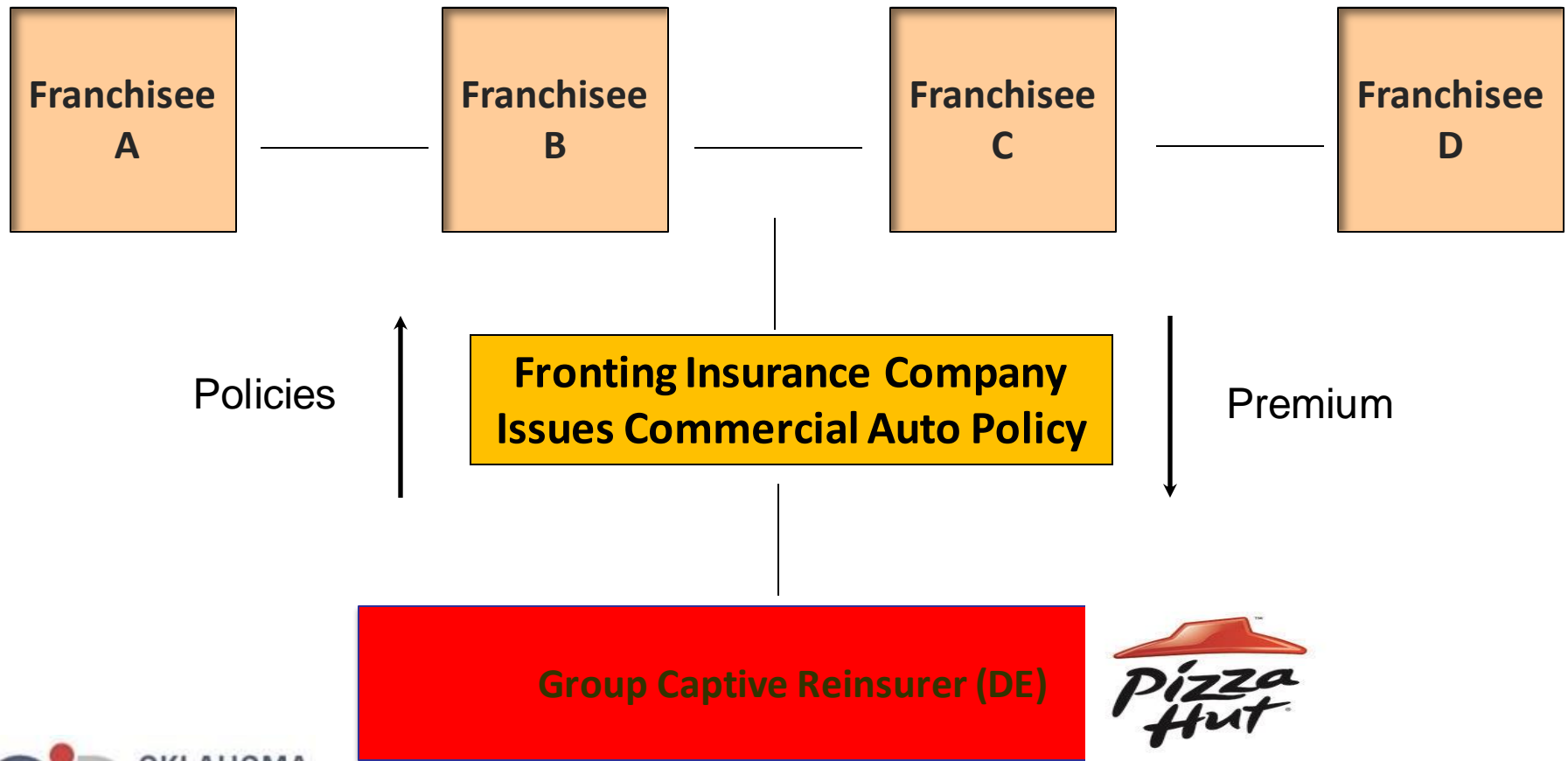


# Captive Insurance is Like Group Self-Insurance



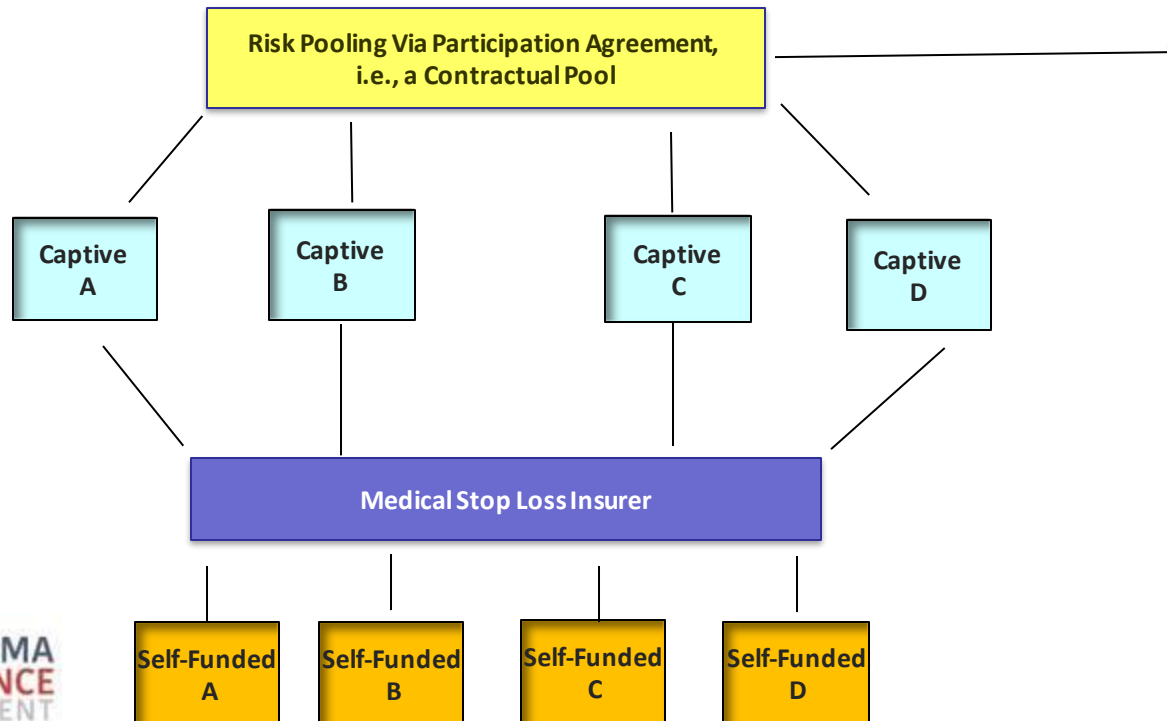
# Group Captive Insurer Example

## Allows all Franchisees to have the Same Insurance for Certain Coverages



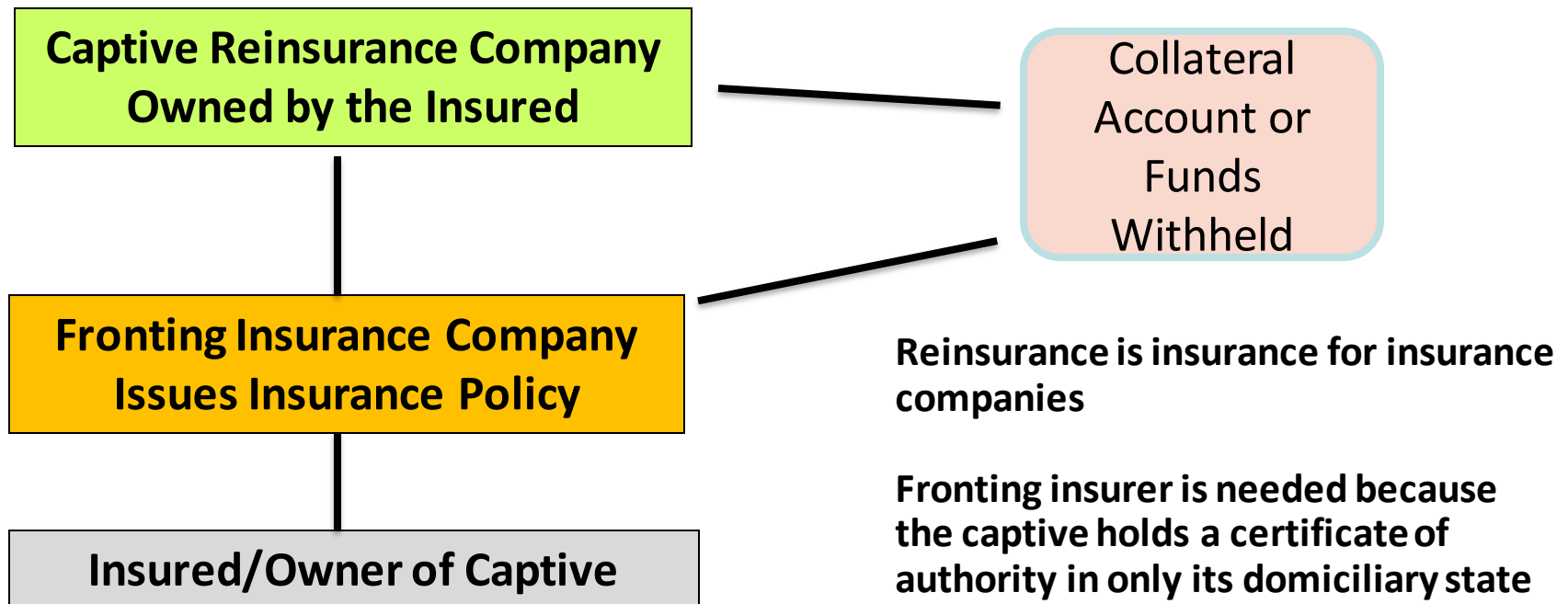
# Captive Insurance: Medical Stop Loss

- Each employer forms their own captive insurer (Captives A-D) and then pools risks via a contractual participation agreement.
- Each captive insurer individually contracts with the medical stop loss insurer which is the same insurer for all captives.
- One advantage is that each employer has control over their captive insurer and typically each captive insurer is responsible for its own assets and liabilities.



In some structures the risk pooling is through a legal entity which is usually another captive insurer solely formed to pool risks

# Captive Reinsurance Fronting Arrangement





# Credit for Reinsurance

- The Credit for Reinsurance Model Act (NAIC MDL-785) codified in Oklahoma as 36 O.S. §§ 5121 to 5124 allows an insurer to take a credit on its accounting balance sheet for the risk transferred to a reinsurer.
- Prescribes the types of reinsurance arrangements that qualify for the recognition of the credit.
- The credit is an asset or a reduction from liability for the reinsurance ceded by an insurer to the reinsurer.

**Captive Reinsurance Company**

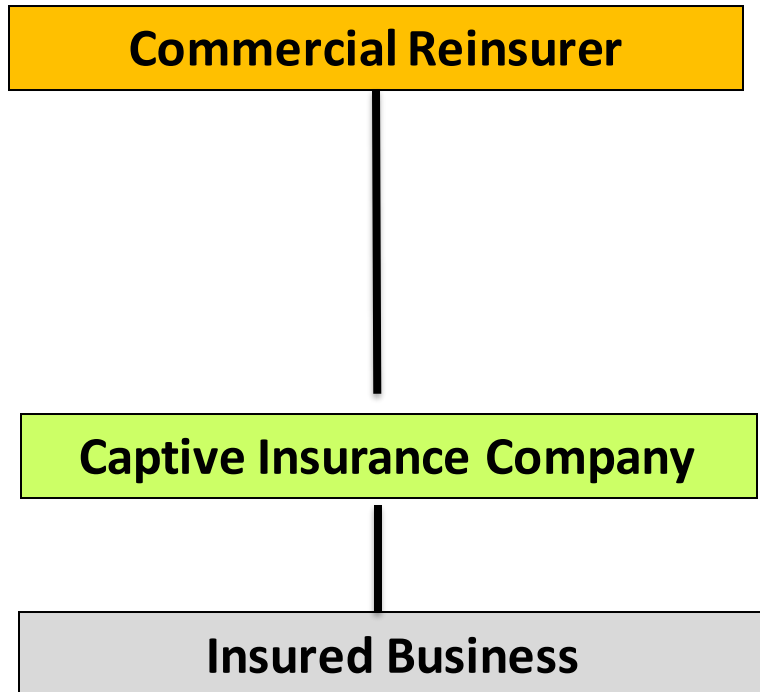


**Ceding Insurance Company**

**Ceding Insurer Takes Credit  
on Balance Sheet for Ceding  
Risk**

**Cedes Risk to  
Reinsurer**

# Using a Captive to Access Reinsurance



- An advantage of captive insurance is it allows access to the reinsurance market

# Life Reinsurance Captives XXX and AXXX

Reinsurance Captive Insurer  
for XXX or AXXX Business  
Within Same Holding Company as  
Life Insurance Company

Life Insurer Takes Credit on  
Balance Sheet for Ceding Risk



Cedes Risk to Captive  
Reinsurer

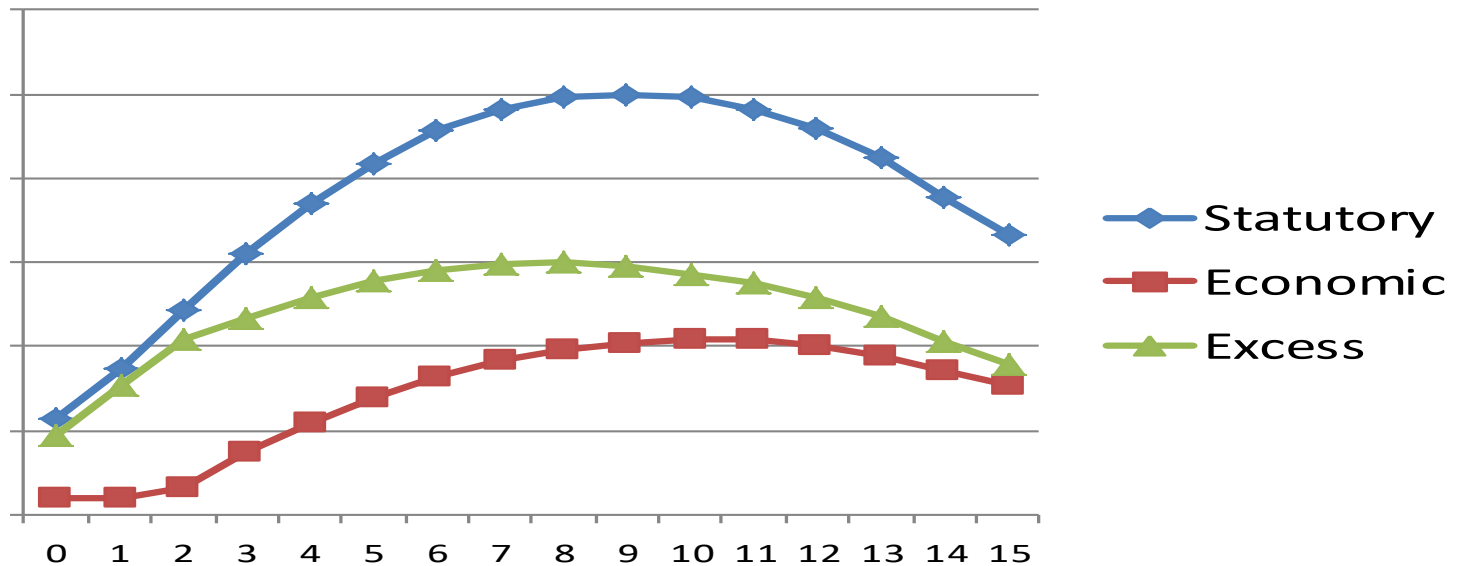


Life Insurance Company

- XXX means term life
- AXXX means universal life with secondary guarantees
- Considered multi-state insurers for accreditation even though captives are only licensed in one state
- Since January 1, 2015 AG 48 applies to non-grandfathered transactions
- Subject to Holding Company laws

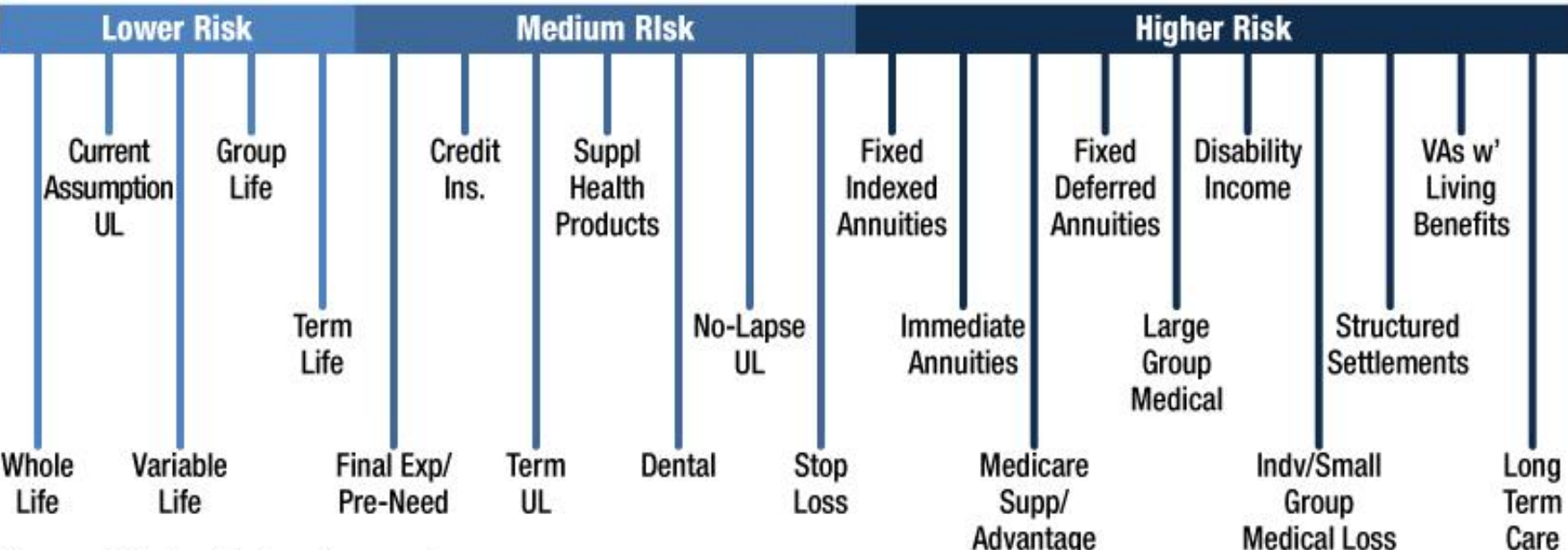
# Pre-AG 48 Financing the Excess of Statutory over Economic Reserves

- The definition of economic reserves has historically been a negotiated term that for XXX/AXXX financing deals has often been determined with best estimate assumptions.
- Economic Reserve + Excess Reserve = Statutory Reserve.



# How Much Risk is There for Life Reinsurance Captives?

Exhibit 1  
Product Risk Scale



Source: A.M. Best data and research

# Health Care Risks

- **Accountable Care Organizations**
- **Capitated payment**
- **Value based health care**
- **Health provider assumes the risk**

# Public Entity Owned Captives

- Tennessee and Utah have formed state owned captive insurers to cover state risk exposures
  - UT earthquake risk
  - TN property and cyber
- Landfill fill district in Pennsylvania and water districts in California
- Property – many public entities own property in a condensed area
- Liability – qualified tort immunity written into the law
- Access to reinsurance

# Life Insurance for Oil Wells

Partnering with the Energy Industry to Systematically and Responsibly  
Manage its Asset Retirement Obligations



OneNexus



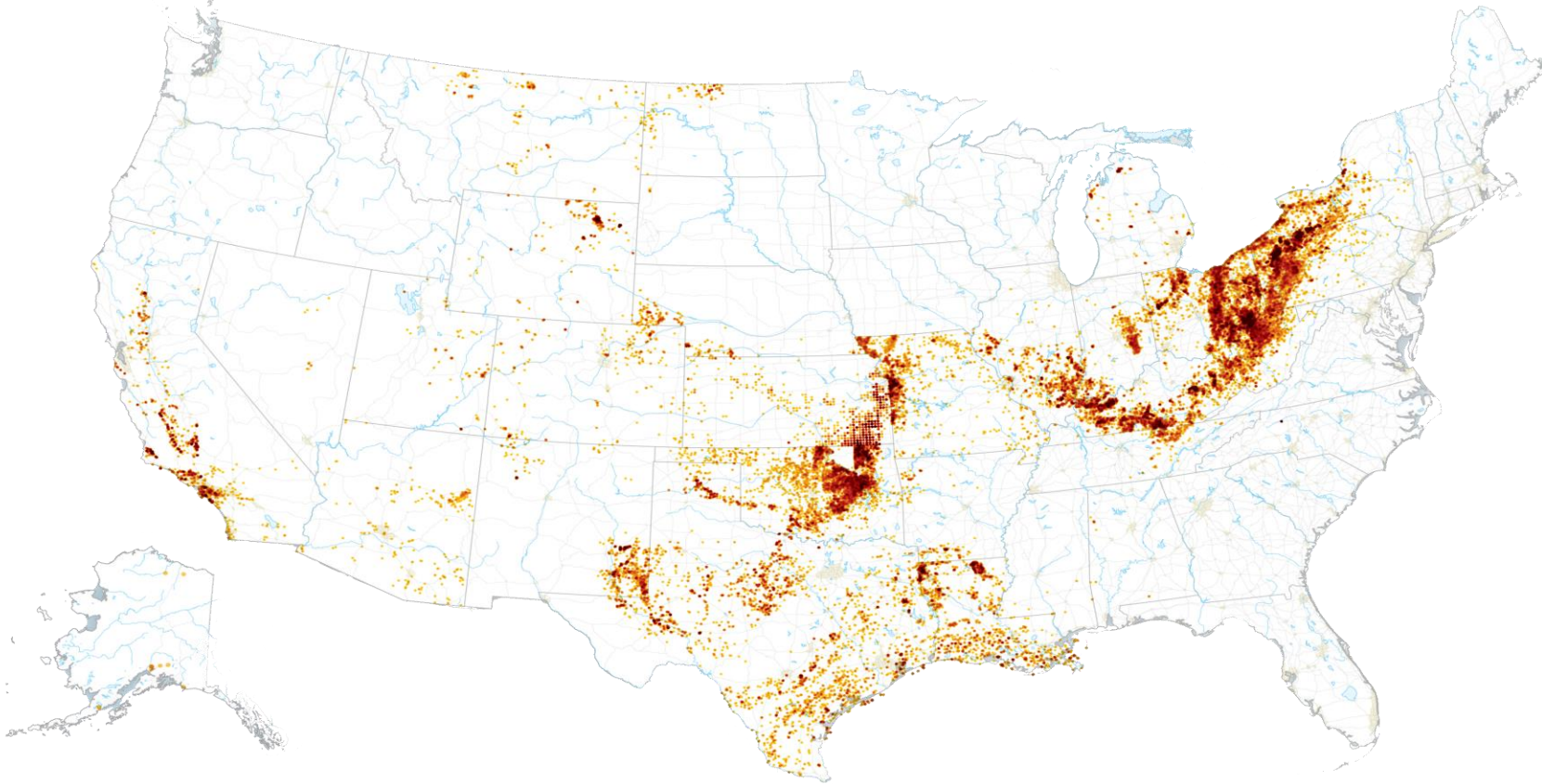
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- Oil well Plug & Abandonment (P&A) Costs
- Abandoned Oil Wells
- Environmental Threat



# Abandoned Oil & Gas Wells in the U.S.



**2.3 M**

Abandoned wells – drilled but not plugged

**25 K**

Total U.S. wells plugged annually\*

**\$50 K**

Average cost to plug a well

**\$1.3 B**

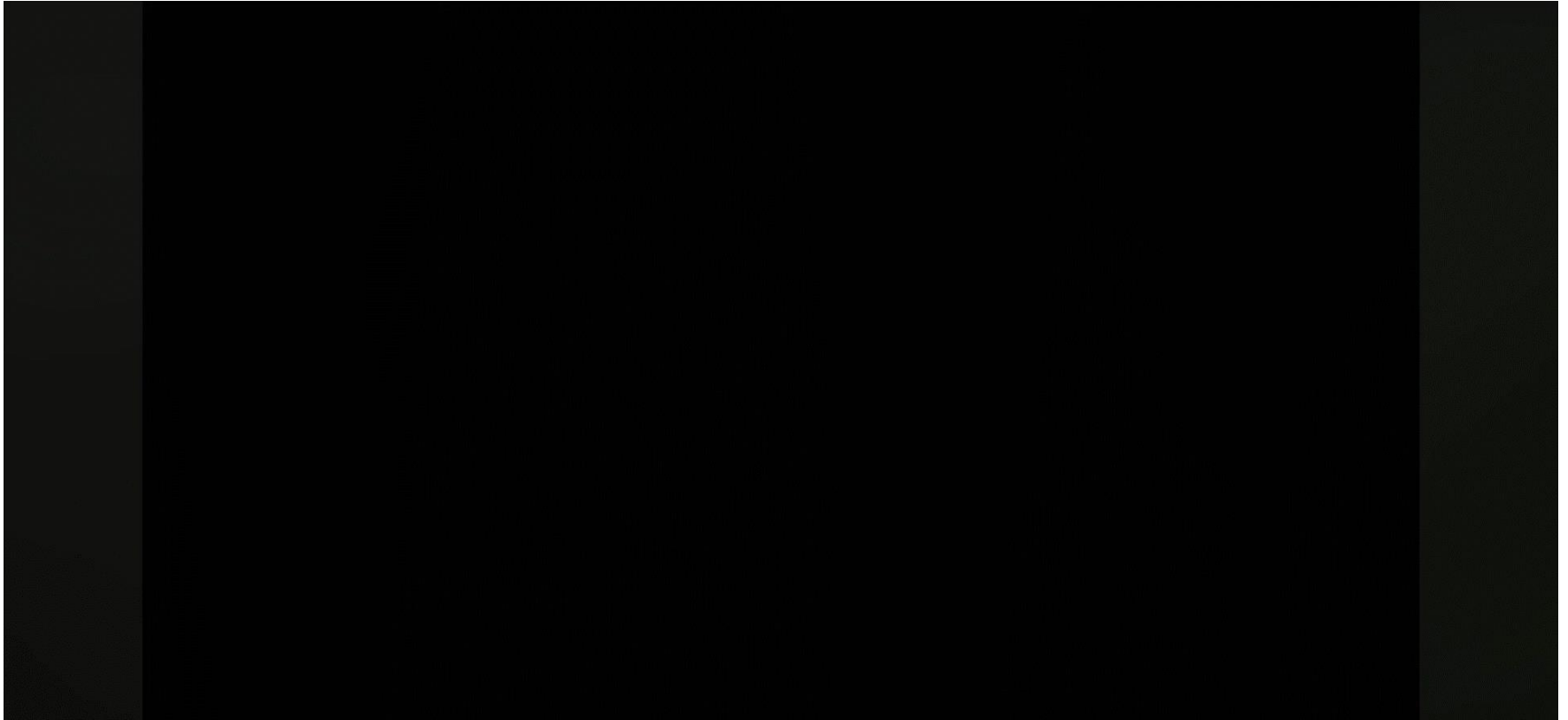
Estimated annual cost to plug eligible U.S. wells

**?**

Number of wells with guaranteed funding

*\*Orphaned well report (2018 - 2020)*

# Abandoned gas and oil wells becoming an environmental threat in the U.S.



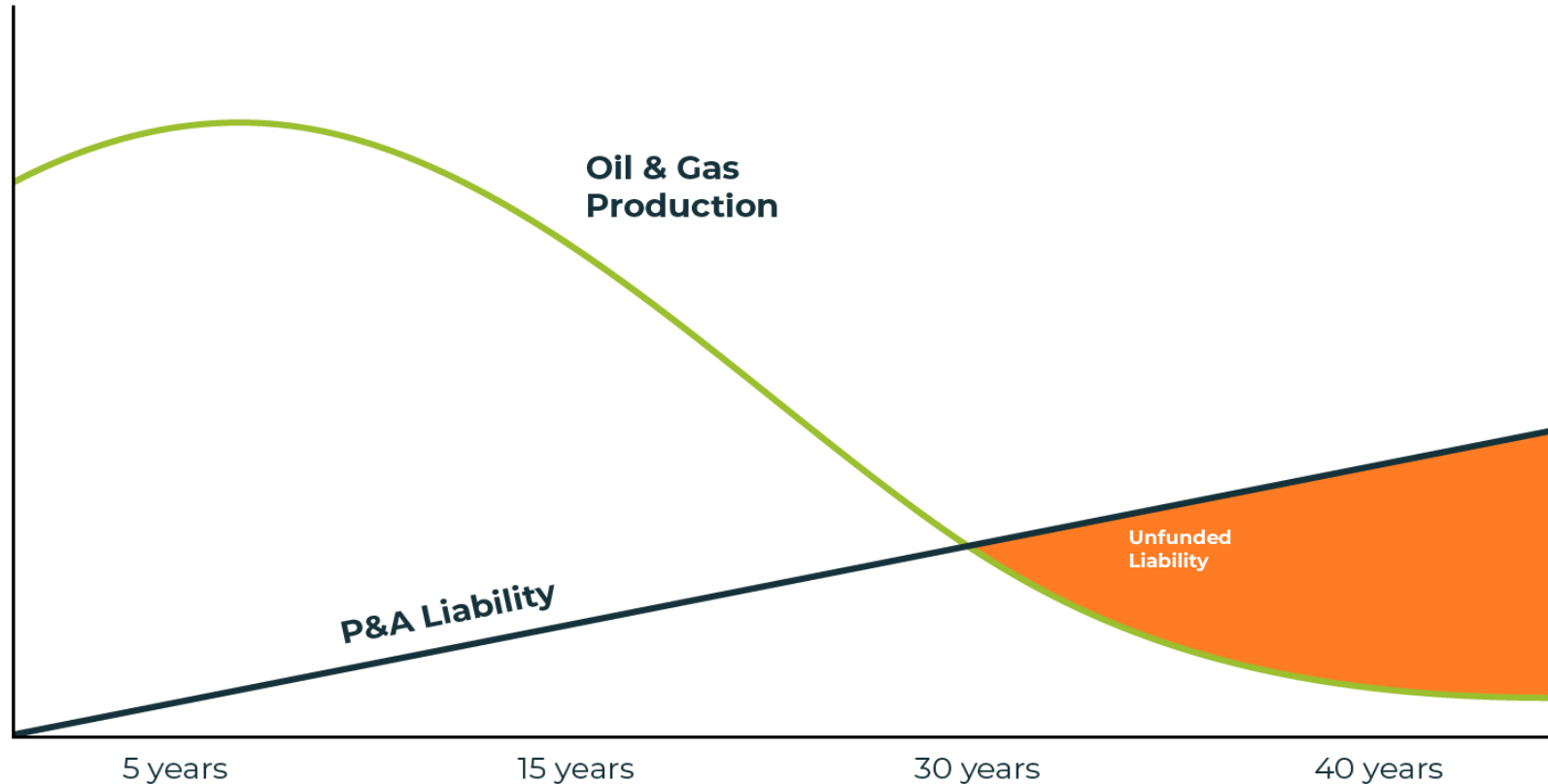


# The Problem: Unfunded Well Decommissioning Liabilities



**When Production Ends, All that Remains is an Unfunded Liability**

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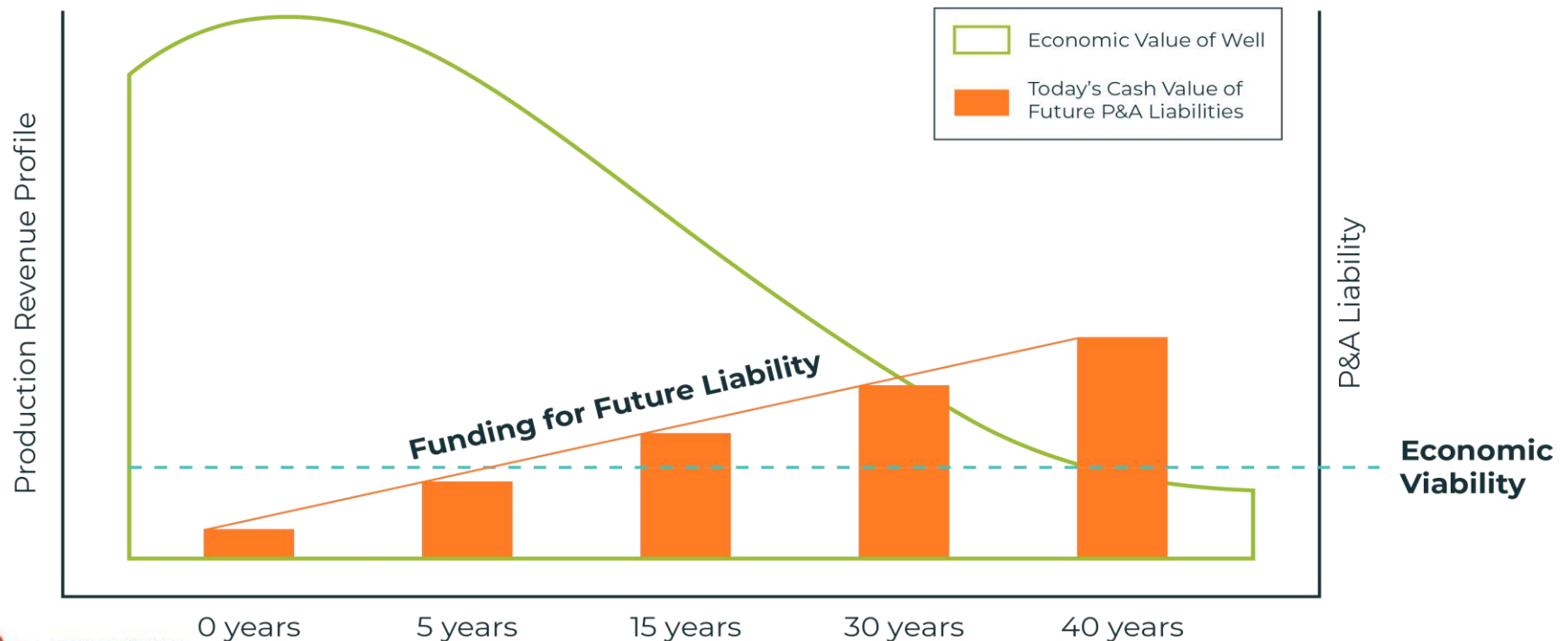


# Solution: Planning for the Future



## Financial Assurance for Oil & Gas Decommissioning Liabilities

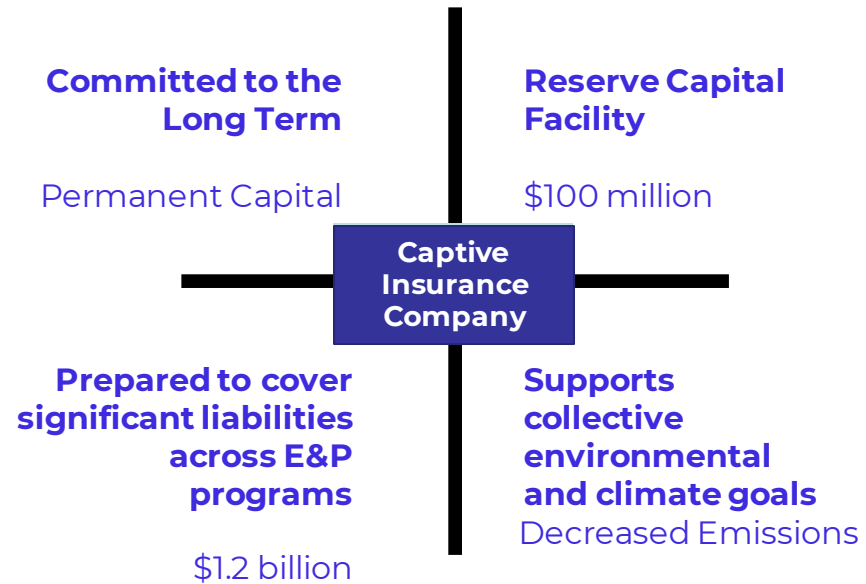
- Capital is available at the time of plugging, assuring that Operators will have funding for future decommissioning expenses.
- Funding is secured in an Oklahoma domiciled captive insurance company with reserve capital provided by Munich Re, an AA-rated global insurance company



# Secured Funding for the Future



OneNexus Oklahoma Captive Corp (OCCC) : Insuring Financial Contracts and Managed by SRS



# Unique Risks



**Cyber security and excess cyber security. Consider the recent “WannaCry” ransomware.**



**Kidnap and ransom for doing business in some parts of the world.**



**Nuclear, biological, and chemical risk which is typically excluded from commercial coverage and TRIA.**

# Terrorism Risks – Chemical/Nerve Agent



**That's not me . . . but I  
looked like this a few times  
in my life**



# Terrorism Risks – Chemical/Nerve Agent



Workers cleaning a subway car

March 20, 1995 five members of the cult Aum Shinrikyo, puncture bags of liquid sarin, a nerve agent, in the Tokyo subway system. The sarin vaporized in the subway cars. The result is 13 deaths and thousands of injuries.

# Terrorism Risks – Chemical/Nerve Agent State Actors



# Terrorism Risks – Chemical/Nerve Agent

## State Actors



February 13, 2017 Kim Jung-Nam, the half brother of North Korean leader Kim Jung Un, is killed in the Kuala Lumpur Airport. A substance containing VX nerve agent is sprayed on his face and then his face is covered with a liquid laced cloth. Decontamination did not occur until almost two weeks later.



# Terrorism Risks – Chemical/Nerve Agent State Actors



A screenshot of a CNN News Stream broadcast. The screen is split into two panels showing news anchors. A red banner at the bottom left reads "DEVELOPING STORY". A white banner across the bottom contains the headline "POLICE SAY KIM JONG NAM KILLED BY VX NERVE AGENT". To the right of the headline, there is a "LIVE" indicator, the CNN logo, and the time "2:01 PM CET". At the bottom right of the screen, the text "NEWS STREAM" and the CNN logo are visible.

# Cannabis Risks in a Captive

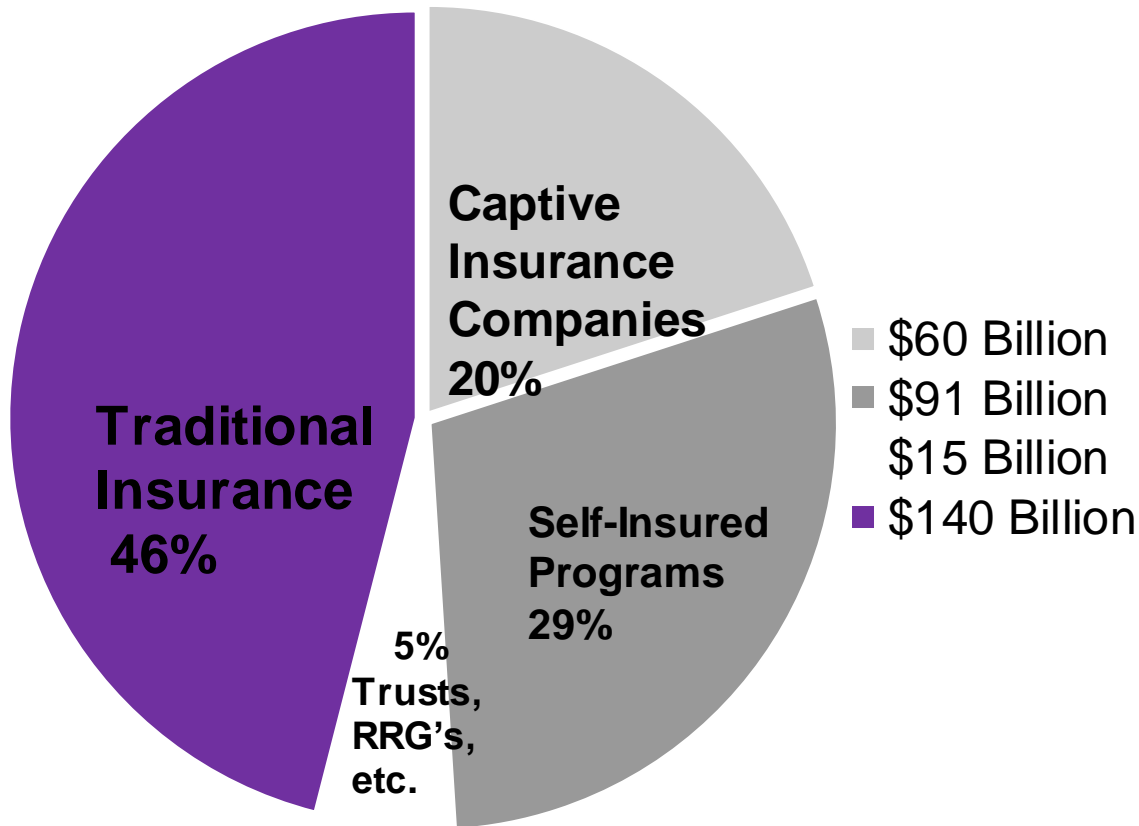
## Medical and Recreational marijuana risks.

- crop insurance
- product liability
- food safety for edible products
- dispensaries are responsible to track and validate medical marijuana cards
- premises liability and theft risk because marijuana is a small portable product and mostly cash basis
- medical conditions are protected health information
- cyber coverage for data breach or theft for mishandling patient information
- environmental damage



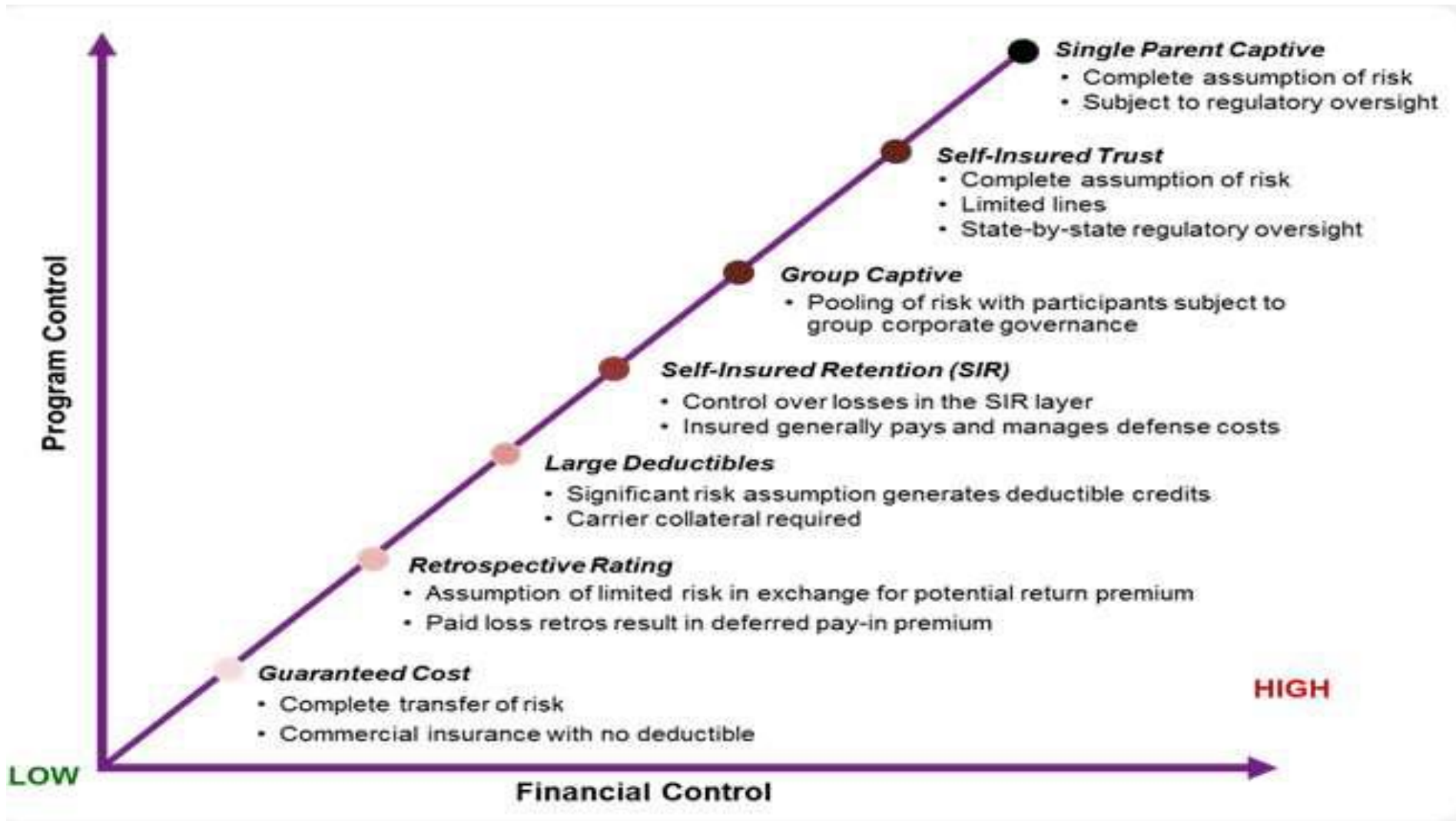
# **Captive Insurance as Alternative Risk Transfer (ART)**

# U.S. Commercial Insurance Market



According to AM Best, 2004 was the hallmark year when alternative premium dollars exceeded 50% of all premium volume in the commercial marketplace.

# Captive Insurance & Control

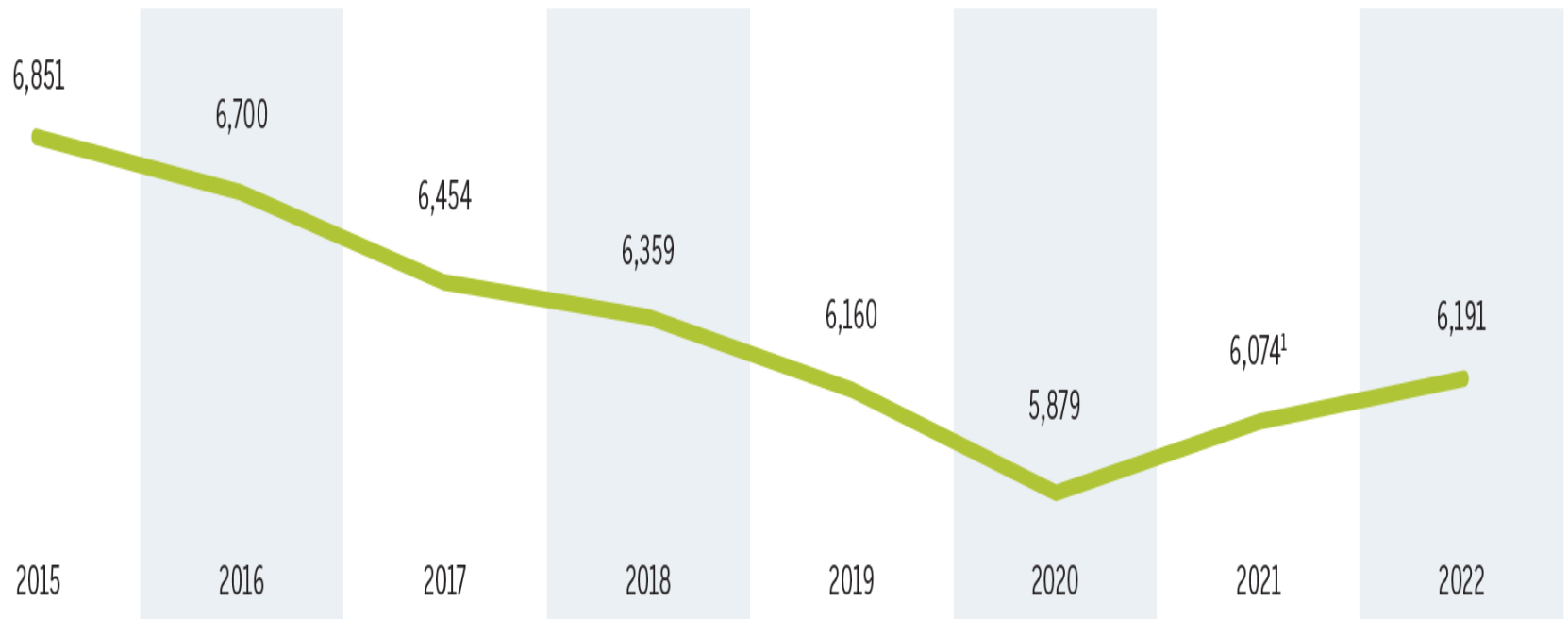




# **The U.S. and Global View of Captive Insurance**

# Global Captive Insurance 2015 to 2022

## TOTAL CAPTIVES WORLDWIDE



<sup>1</sup> Restated

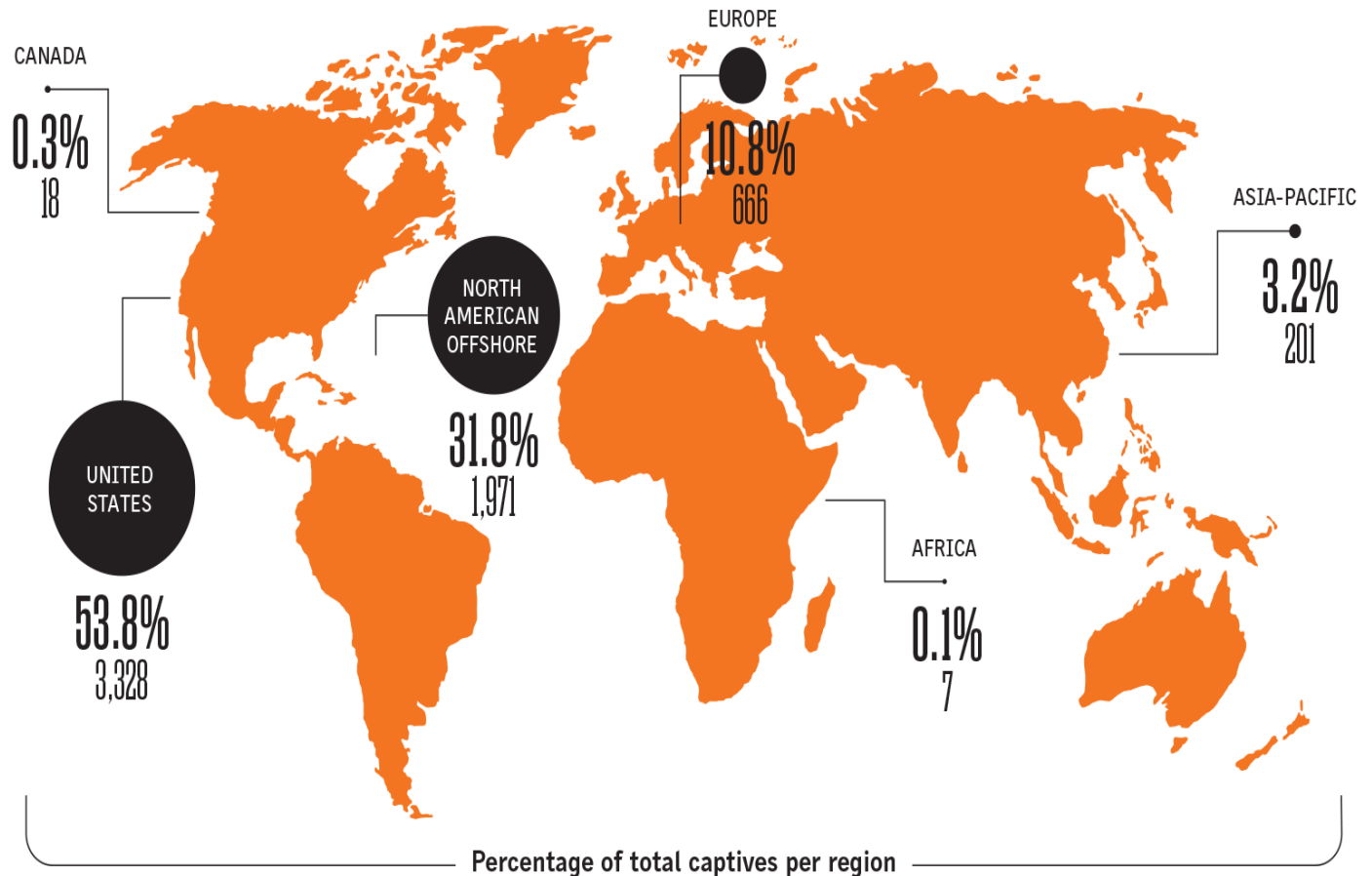
Source: BI survey

# Global Captive Distribution

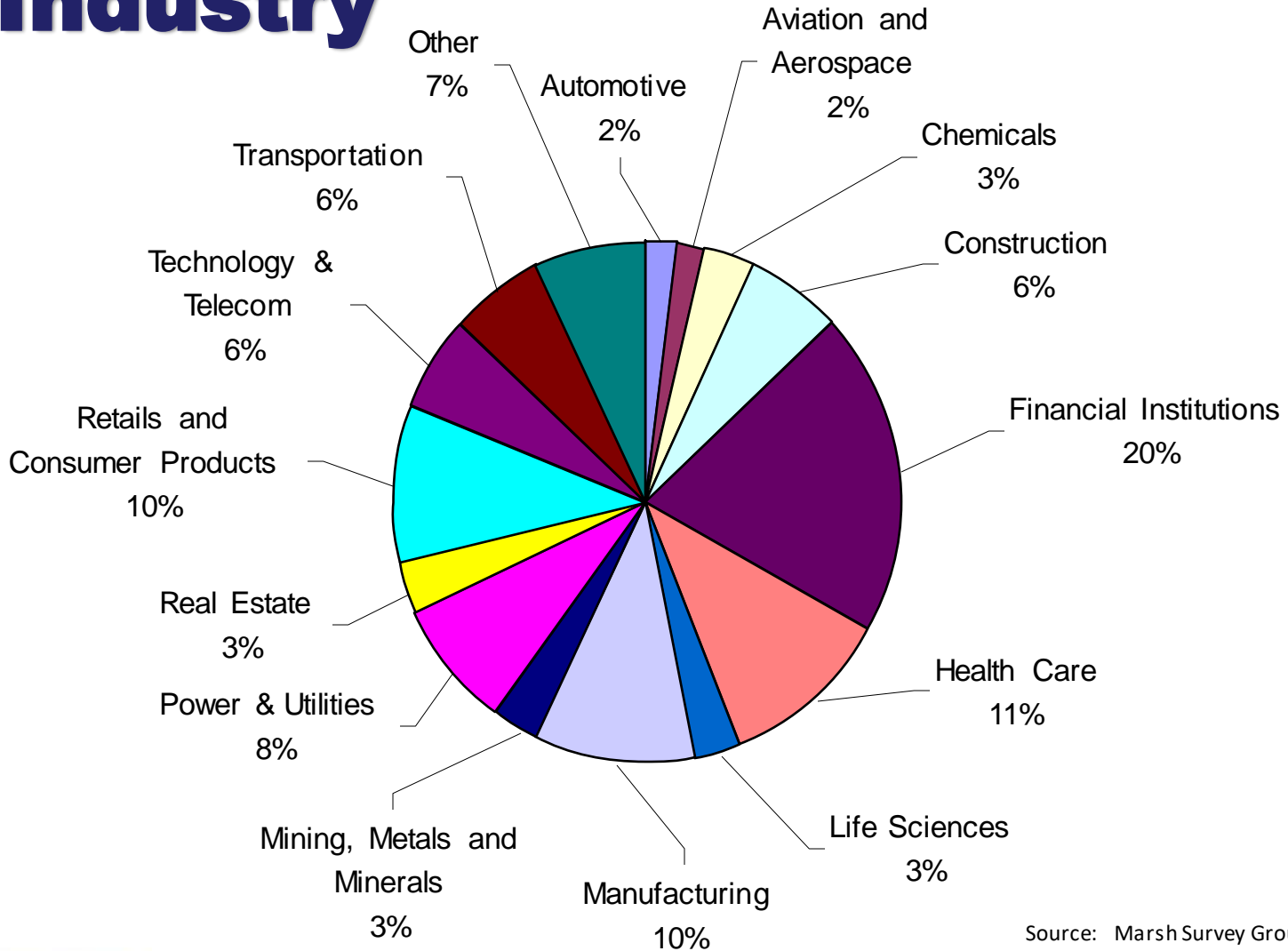
## ONSHORE/ OFFSHORE BY THE NUMBERS

There were 6,191 captives in 2022, not including microcaptives, series captives or individual cells of cell members in protected cell companies.

Source: BI survey

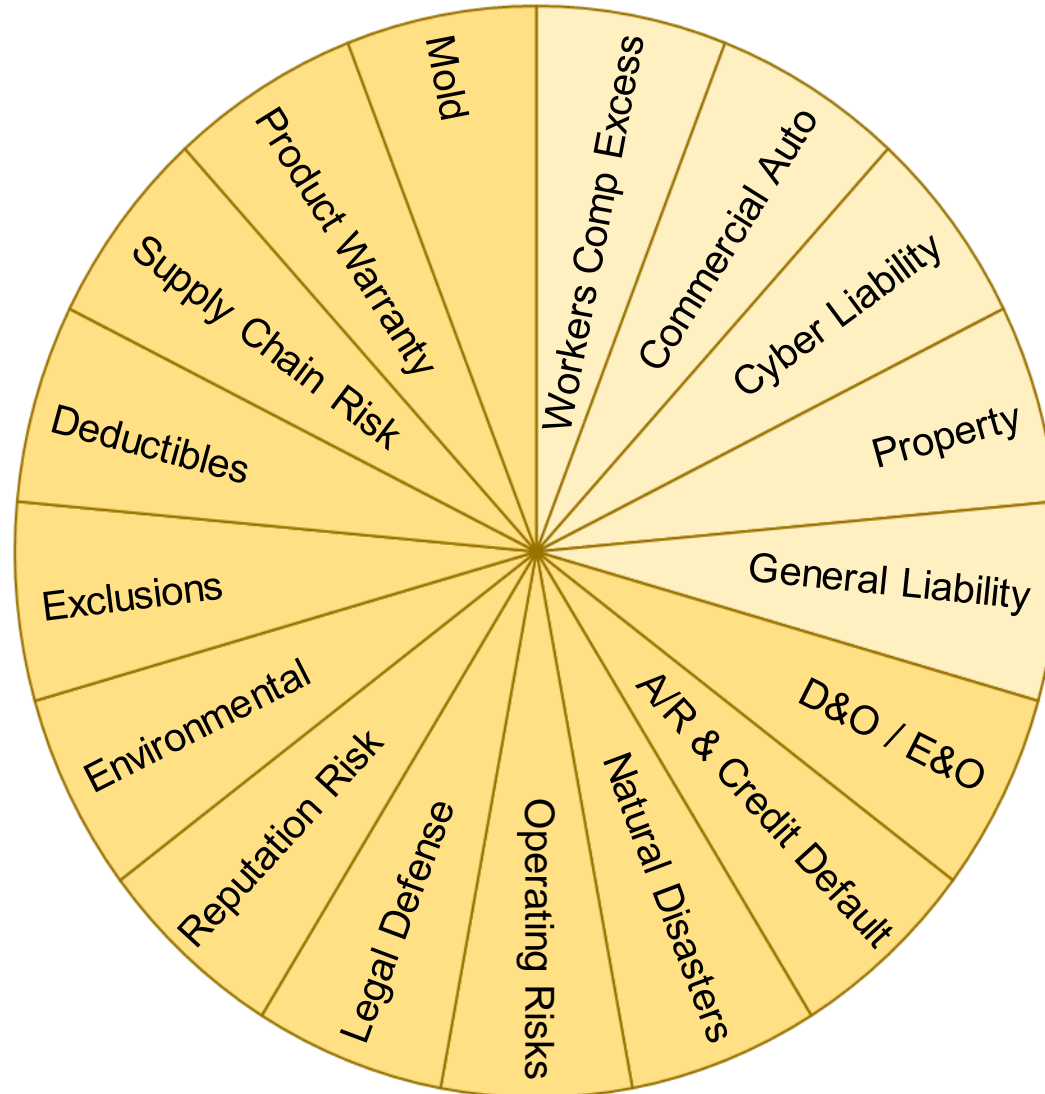


# Captive Utilization By Industry



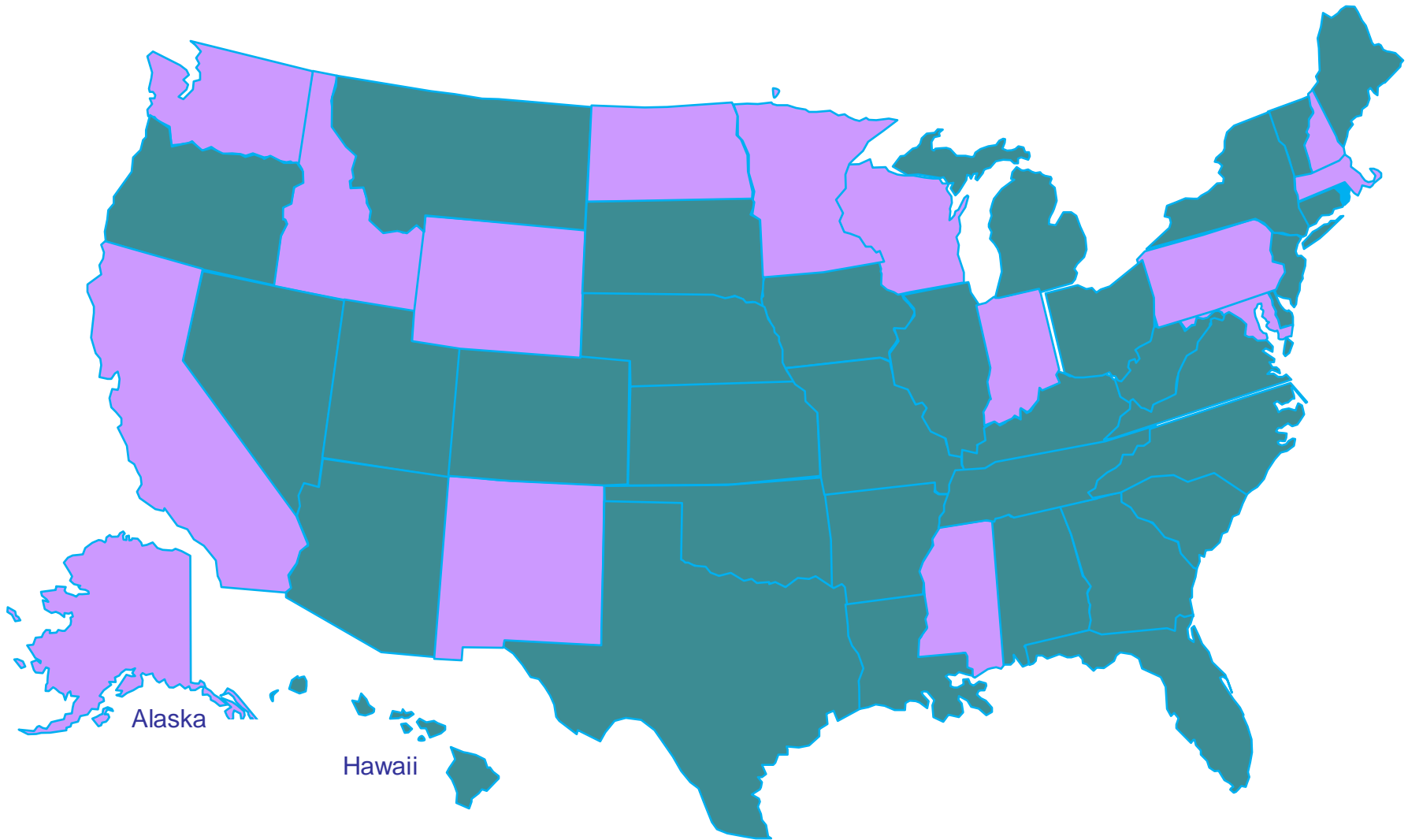
Source: Marsh Survey Group

# Sample Captive Insurance Coverages



# States Without Captive Insurance Laws

Shown in lavender



Alaska

Hawaii

# Top 5 Global Captive Domiciles in 2022



- Bermuda 660 captives



- Cayman 650 captives



- Vermont 639 captives



- Utah 419 Captives



- Delaware 330 captives

Source: Business Insurance, March 2023

# Top 5 U.S. State Captive Domiciles in 2022



- Vermont 639 captives



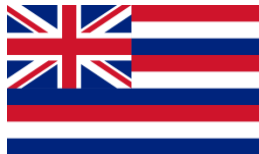
- Utah 419 captives



- Delaware 330 captives



- North Carolina 294 captives



- Hawaii 255 captives

Source: Business Insurance, March 2023



# Top 5 N. American Offshore Captive Domiciles in 2022



- Bermuda 660 captives



- Cayman Islands 650 captives



- Barbados 315 captives



- Nevis 102 captives



- Anguilla 62 captives

Source: Business Insurance, March 2023

# Top 5 European Captive Domiciles in 2022



- Guernsey 201 captives



- Luxembourg 195 captives



- Isle of Man 98 captives



- Ireland 66 captives



- Sweden 29 captives

Source: Business Insurance, March 2023

# Top 5 Asia Pacific Captive Domiciles in 2022



- Singapore 82 captives



- Labuan 67 captives



- Federated States of Micronesia 25 captives



- New Zealand 9 captives



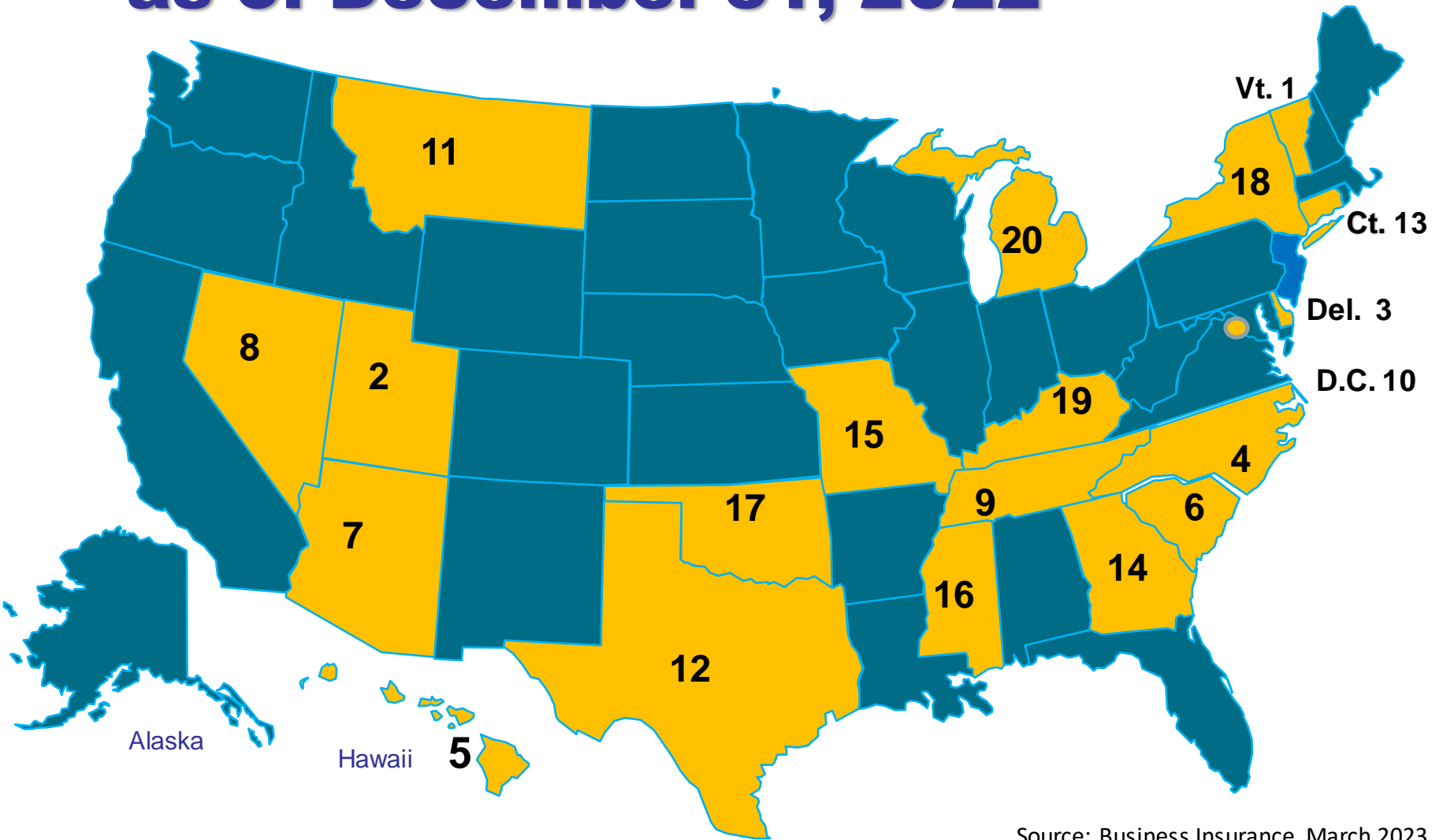
- Vanuatu 5 captives

Source: Business Insurance, March 2023

# Native American Insurance Domiciles

- **Chiricahua Apache Mimbres Band Tribal Nation**
- **Modoc Nation**
  - **21 reinsurance captives**
- **Southern Cherokee**
- **Delaware Tribe of Indians**
  - **1,819 reinsurance captives**
  - **Mostly focused on automobile F&I or finance and insurance market**
  - **Operates out of Caney, Kansas**

# Top 20 U.S. Captive Domiciles as of December 31, 2022



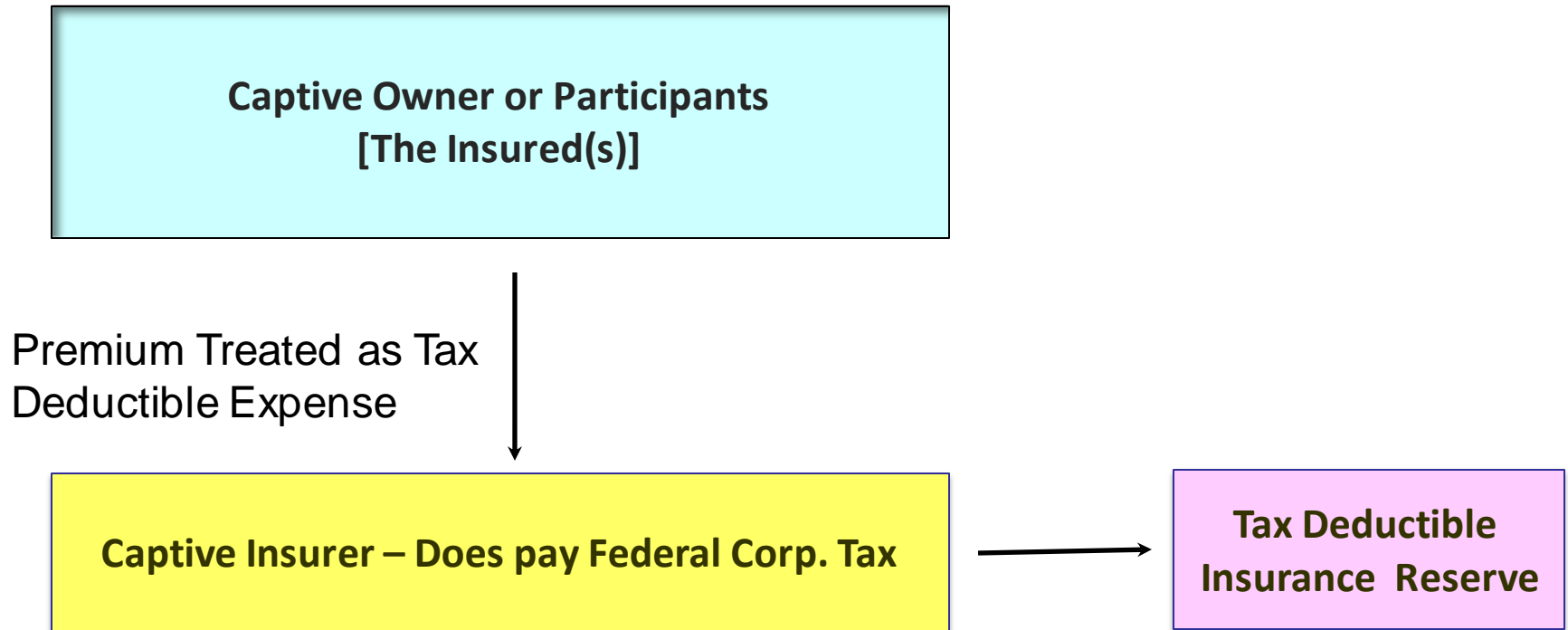
Source: Business Insurance, March 2023

# Captive Insurance and Taxes

# Captives and Taxes

- The tax rates for Oklahoma domiciled captives are-
  - .2% for direct premium but tax liability is capped at \$100,000.
  - .1% for reinsured premium but tax liability is capped at \$100,000.
- Minimum tax is \$3,500 for series captive insurers and \$5,000 for all other captives.
- Except for the franchise tax, captives pay no other state tax.
- If the captive insurer has 25 or more employees in Oklahoma it pays no more than \$50,000 in tax regardless of the amount of premium.
- In contrast, the premium tax for commercial insurers is 2.25%.

# P&C Insurance Company Taxation: IRC 831(a)





# P&C Insurance Company Taxation: IRC 831(b)

Captive Owner or Participants  
[The Insured(s)]

Premium  $\leq$  \$2.65  
Million Annually, Treated  
as Tax  
Deductible Expense

Captive Insurer Doesn't Pay Federal Corp. Tax  
On Premium if  $\leq$  \$2.65 Million, but Does Pay  
Federal Corp. Tax on Investment Income

Contractual Pooling  
Arrangement for  
Unrelated Business  
for Risk  
Distribution

No Tax Deductible Insurance Reserve  
nor Net Loss Carryforward

# IRS Proposed Regulation

- Issued in April 2023 and applies to captive insurers making the IRC 831(b) tax election
- Deems these captive insurers as listed transactions and/or transactions of interest if -
  - (1a) It does not engage in transactions with a related party that produces taxable income
  - (1b) A related party owns at least 20% of the voting power, equity, or stock of the captive insurer; or,
  - (2) Has an average loss ratio of less than 65% over the past ten years

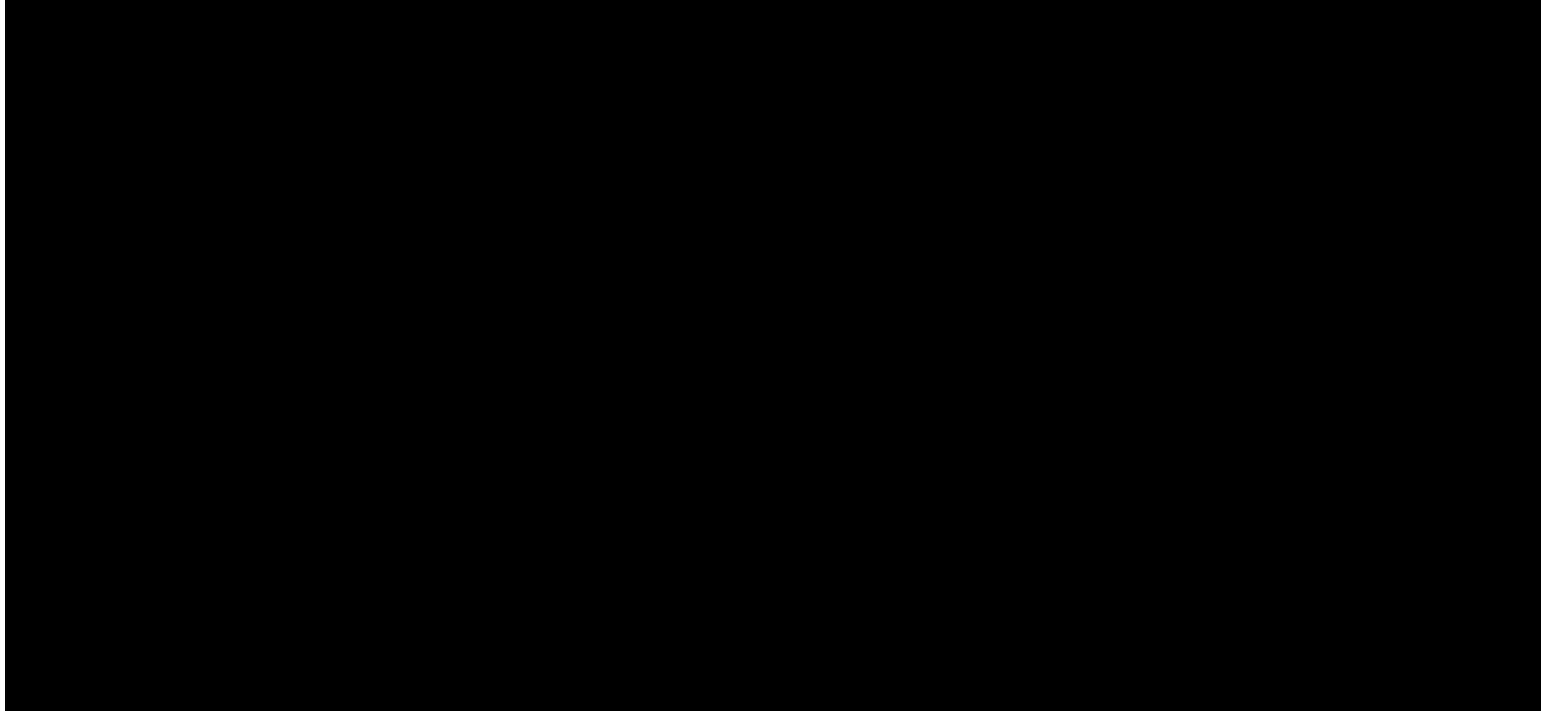
# IRS Proposed Regulation

- **Oklahoma domiciled captive insurer formed in 2013 that insures for terrorism risks**
- **No acts of terrorism means there are no claims and no losses**
- **No acts of terrorism is a societal good and something to celebrate**
- **Yet . . . under the proposed IRS regulation the captive insurer is penalized for failing the 65% loss ratio test and becomes a listed transaction**
- **A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be tax avoidance.**
- **Substantially increases compliance costs and exposure to penalties**

# **FBI Director Christopher Wray**

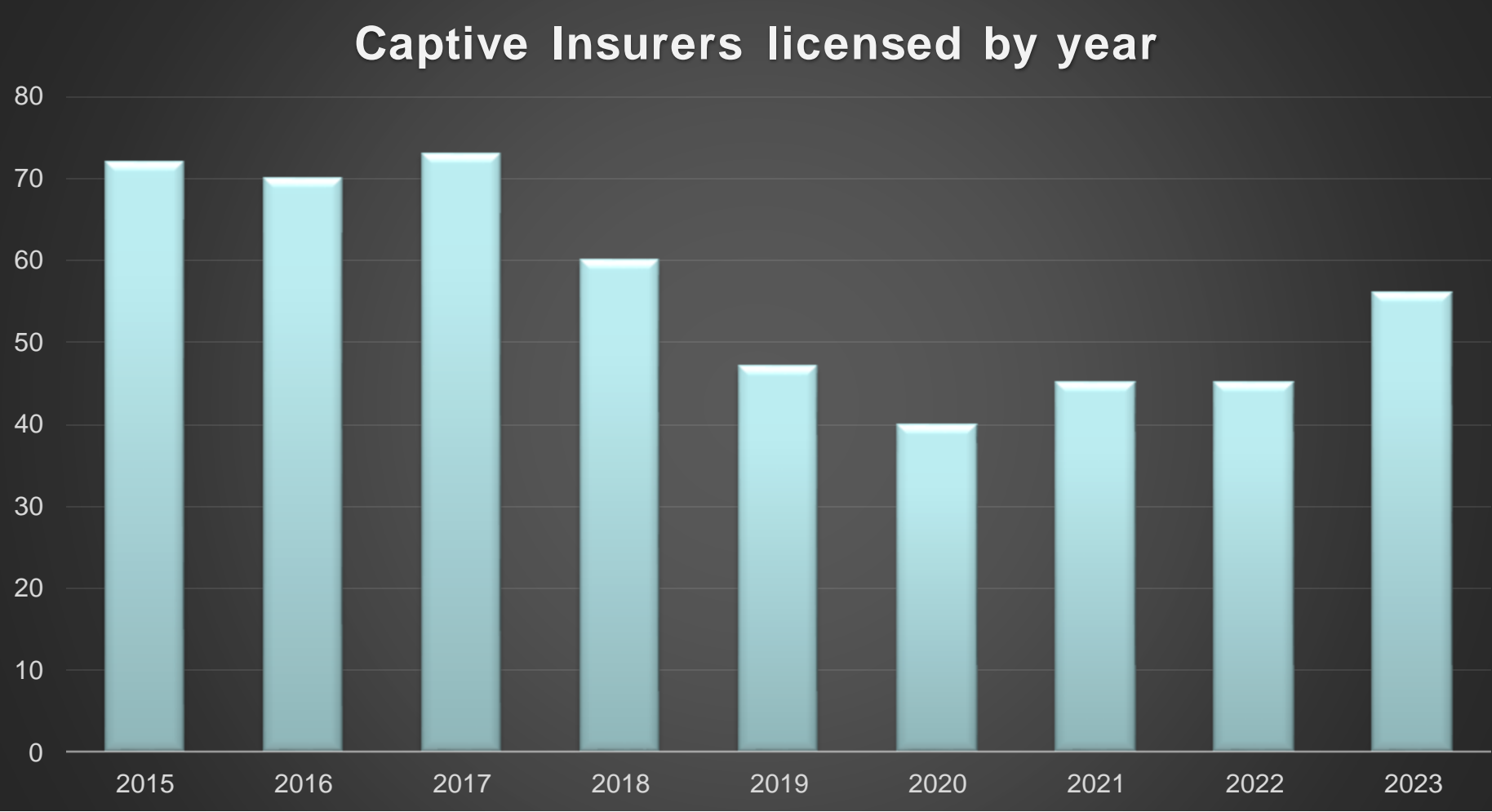
## **U.S. Senate Testimony**

### **December 5, 2023**



# **The Oklahoma Captive Insurance Experience**

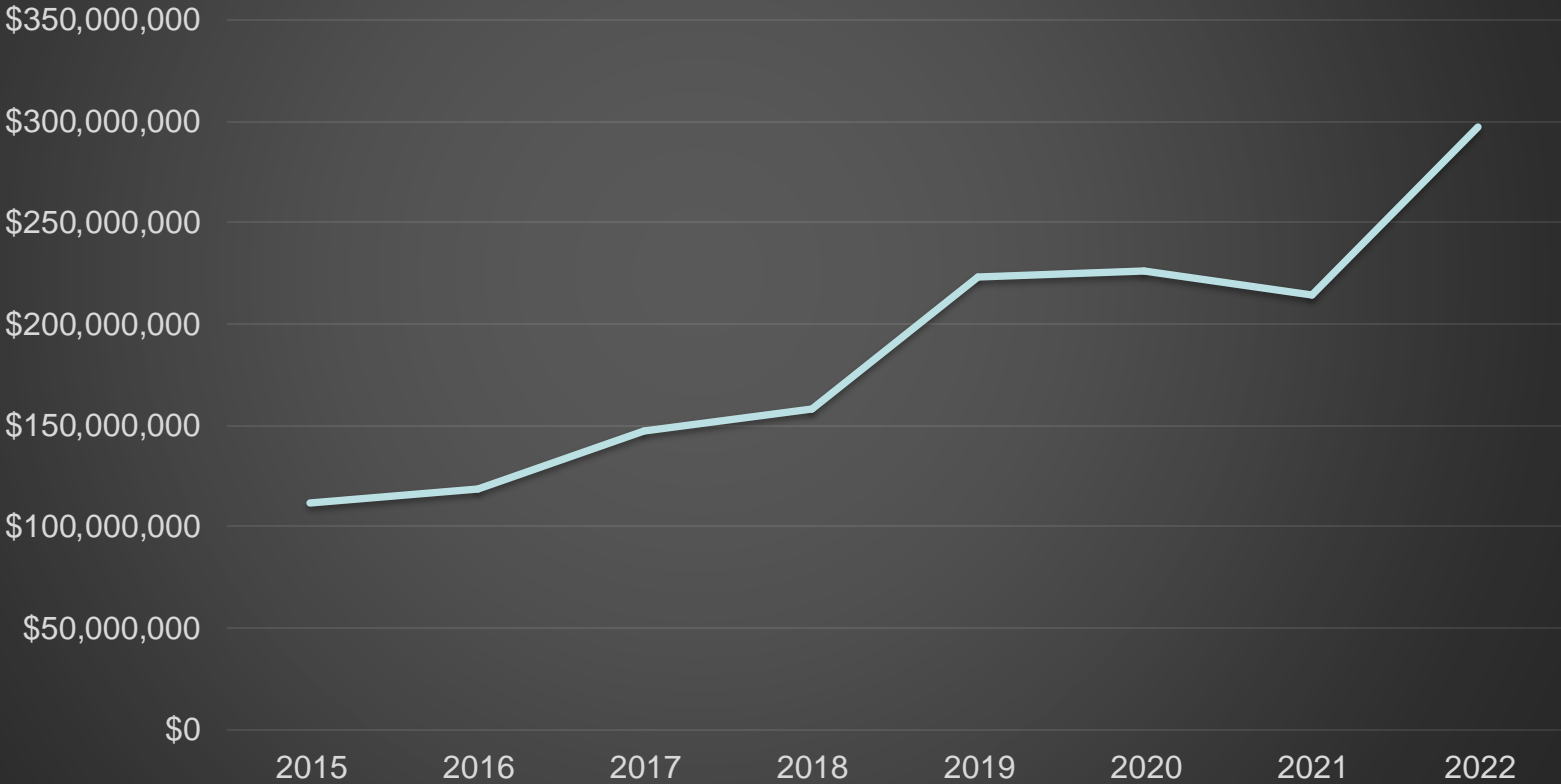
# Oklahoma Captive Insurers



\*2023 is through November 2023 62

# Oklahoma Captive Insurers

## YEAR END CAPTIVE INSURANCE GENERATED PREMIUM





# Allocation of Captive Insurance Revenue

- The first \$500,000 of revenue –
  - 36% to the Oklahoma Firefighters Pension and Retirement Fund
  - 14% to the Oklahoma Police Pension and Retirement System
  - 5% to the Law Enforcement Retirement Fund
  - 45% to the state General Revenue Fund
- The next \$250,000 used by the OID for the captive insurance program
- Of all amounts exceeding \$750,000 –
  - 36% to the Oklahoma Firefighters Pension and Retirement Fund
  - 14% to the Oklahoma Police Pension and Retirement System
  - 5% to the Law Enforcement Retirement Fund
  - 15% to the state General Revenue Fund
  - 30% used by the OID for the captive insurance program

# **Interested in Oklahoma's Captive Insurance Program?**

**Follow the OI&D on LinkedIn**

**Join the Oklahoma Captive Insurance Association**

**[www.okcaptives.org](http://www.okcaptives.org)**

## **Resources**

[Captive Intelligence – High-value news, insight and analysis of the global captive insurance market](#)

**Captive Insurance is a  
Team Effort  
Thank you!**

**Liz Heigle**

**Rachel Phan**

**Wyatt Stanford**

**Victor Gallardo**

# Questions and Answers

## Connect with me on LinkedIn

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