And the winners are...

Saint Mary's University seniors Olivia Faulkner and Zane Smith received first-place honours and a US$2,500 prize in the 2022-2023 Captive Insurance Companies Association (CICA) College Student Eessay Contest.

The captive insurance solutions for risk management contest — for college insurance and risk management students — is sponsored by Hylant Global Captive Solutions (Hylant GCS).

In their winning essays, Faulkner and Smith proposed a group captive to help restaurant franchisees manage risks and expenses. Their winning essays can be read exclusively in this issue of Captive Insurance Times.

“Now in its fifth year, our CICA College Student Essay Contest has shown that today’s top risk management students are already 10 years ahead of where my generation was when we graduated. This is the type of talent that we need to help advance the captive industry. At the same time, we recognise these students have limited exposure to the interesting and challenging career opportunities captive insurance offers.

“Today’s businesses are dealing with increased pricing and less capacity in the commercial insurance market, unprecedented supply chain disruptions and increasing liabilities and reputational risks. These timely, real-world issues were all reflected in this year’s case studies. These real-world scenarios and the creative problem-solving required to develop captive solutions are what help students see the opportunities captive insurance careers can offer.

“Part of engaging and retaining talent for the captive industry is helping people network and connect with the broader industry. All of CICA’s programmes: the Essay Contest, NEXTGen, Amplify Women and Mentorship, help participants gain experience and build connections that help them advance their careers. It’s a win for them and for the industry.”

Dan Towle, President, CICA

“We were thrilled to sponsor the CICA College Student Essay Contest. This is such an important initiative for the captive industry and aligns closely with Hylant’s values.

“Engaging these students and other bright young professionals early is very important. Captive insurance is not a big component of today’s college risk management programmes — we heard that from all of the students. That’s why it’s so important for those of us in the captive industry to spend time with them and share our knowledge. It was wonderful to see the students’ willingness to dig in and learn captive insurance. By the time we all got to meet in person at the CICA Conference, it was clear their views of captive insurance had transformed over the course of the competition.

“We have an ideal opportunity right now — we can combine the expertise of experienced professionals who have a deep understanding of captive insurance with the innovative ideas students and young professionals have to offer. They have excellent ideas on ways we can do things in a more efficient manner, especially with the use of technology.”

Anne Marie Towle, CEO, Hylant Global Captive Solutions

Olivia Faulkner

St. Mary's University

What interested you about the CICA Essay Contest Captive Insurance Solutions for Today's Risk Management Challenges?

I saw this opportunity as a way to creatively use my insurance knowledge as well as a tool to expand my understanding about an industry that I did not have much prior exposure to. I enjoyed being able to research and discover new information, think critically and come up with solutions to a unique set of circumstances.

How was captive insurance helpful for your chosen organisation?

Captive insurance was helpful for our chosen organisation, Sammy's Deli, because it has the potential for reduced premiums, specialized and specific coverage options and resulting risk mitigation benefits.

What did you learn about captive insurance while researching and writing your essay?

While doing research for this essay, I discovered how much flexibility a captive can give a company in terms of risk management, freeing up capital and expanding coverage options. The captive insurance industry is truly a place for innovation and creativity within risk management.

Would you consider a career in captive insurance?

Although I already have a job lined up after graduation, I am eager to take my knowledge of the captives industry and apply it to my professional development going forward. There is definitely potential and interest for me to pursue a career in captive insurance in my future. I enjoy the creativity and problem-solving aspects of captive insurance and would love to explore it further.

How does your college coursework align with a career in captive insurance?

St. Mary's Risk Management programme and our Gamma Iota Sigma chapter have given me the opportunity to discuss captive insurance inside and outside of the classroom through guest speakers and attendance at the Texas Captive Insurance Association Annual Conference. Additionally, our Risk Management programme and GIS chapter gives students a strong foundation in risk management principles and requires us to think about emerging trends and potential solutions, within various aspects of risk management.

Olivia Faulkner is a senior majoring in finance and risk management with a minor in business analytics at St. Mary's University. She is currently interning at Marsh. Although originally from St. Louis, Missouri, Olivia has decided to stay in Texas upon graduation where she will be joining Markel as an underwriting trainee in their Dallas/Plano office. Olivia is extremely grateful to be part of the CICA International Conference and looks forward to expanding her insurance knowledge.

Zane Smith

St. Mary's University

What interested you about the CICA Essay Contest Captive Insurance Solutions for Today's Risk Management Challenges?

I am a very competitive person by nature, and I also love to be intellectually challenged.

Considering that, I was very eager to participate in the CICA Essay Contest and take the opportunity to grow my insurance skillset in a fun and competitive format.

How was captive insurance helpful for your chosen organisation?

For our essay, we chose to research and write about Sammy's Deli, a fictional nationwide fast-food franchise.

Captive insurance is a lucrative solution for Sammy's Deli because of its unique risk profile and its dissatisfaction with rising rates. Captive insurance helps Sammy's Deli have more control over the rates they pay and gives them access to more tailor-made coverages.

What did you learn about captive insurance while researching and writing your essay?

Coming into this experience, I had just surface-level exposure to captive insurance. I took this essay as an opportunity to do a deep dive into the subject.

I would say that the biggest thing that I have learned is just how innovative and adaptable captive solutions can be.

Would you consider a career in captive insurance?

I would certainly consider a career in captive insurance.

The insurance and risk management industry is so dynamic and captive insurance is a particularly interesting area within the industry.

How does your college coursework align with a career in captive insurance?

The major that I am enrolled in at St. Mary's University is Finance and Risk Management (FRM). The FRM major is unique in that it combines finance classes and risk management classes into one degree, broadening my skillset.

That coursework aligns perfectly with a career in captive insurance because it has given me an equally strong finance technical skillset in addition to my risk management and insurance technical skillset.

Zane Smith is a senior majoring in finance and risk management at St. Mary's University. He also serves as the student representative on the Gamma Iota Sigma Board of Trustees, an organisation dedicated to sustaining the college talent pipeline for the insurance industry. He has worked in various roles in the industry and after graduation, he will be joining Munich Re's International Graduate Trainee programme in New York as an underwriting trainee.


2022-2023
CICA STUDENT ESSAY CONTEST
Captive Insurance Solutions for Today's Risk Management Challenges
1
ST. MARY'S UNIVERSITY
ST. MARY'S UNIVERSITY:
Olivia Faulkner & Zane Smith
SAMMY'S DELI
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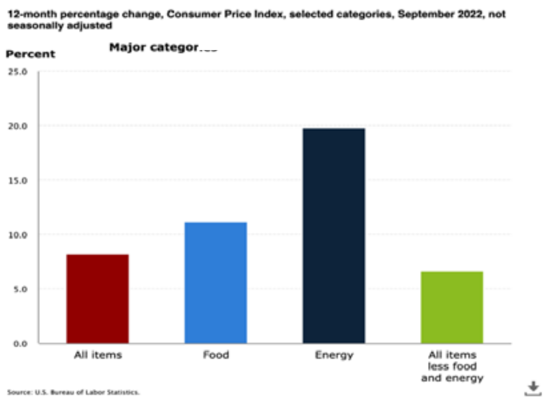
Introduction

Today's economic outlook and insurance environment are characterized by inflation and rising concerns about the economy for businesses of all types. Sammy's Deli, an industry leading fast-food chain with over 200 franchisees operating 1,200 stores across 50 states, is certainly not immune to those impacts. In the 12 months from September 2021 to September 2022, the United States saw an 8.2% increase in the consumer price index (U.S. Bureau of Labor Statistics). Sky-rocketing prices are having a negative impact on consumer spending and are worrying business leaders nationwide. Businesses like Sammy's Deli are faced with increasing general liability insurance premiums driven by social inflation and increased operating costs for insurers.



Historically, Sammy's Deli has taken a traditional approach to their insurance strategy by just purchasing standard coverages from the insurance market. Frustrated by increasing premiums, Sammy's Deli is looking into the feasibility of moving its insurance programs into a captive to stabilize rates and provide more control over coverage. Sammy's Deli has also been recently burdened by risks such as supply chain disruption and staffing shortages which they need to find a better way to finance, possibly through a captive.

Pros and Challenges: Group Captive Structure

When structuring a captive, there are many routes that Sammy's Deli could take, including a single cell captive, a segregated cell captive, and a group captive. We have preliminarily identified a group captive as the best solution for Sammy's Deli. A group captive is an insurance company owned by its member companies which it insures. A group captive would enable franchisees to share the financial burden of risks through a unique financing approach.

For Sammy's Deli's purposes, franchisee holding companies, which in turn own individual franchises, will be the owners of the group captive. Franchisees will have the option to be members of the Sammy's Deli group captive. Ideally, top-performing franchisees would join the captive to access better pricing than the market would offer. In order to get approval from current captive members to join, prospective captive members would need to be high performing. This adds additional benefit to the captive in that it will encourage better business practices across the organization.

There are challenges to a group captive structure, including the necessity of a consistent commitment to safety and risk management that must be established across all members of the group captive. For this structure to function properly and cost-effectively, there must be serious investment by each member into risk mitigation and safety. Additionally, even high performing members who have the means to join the captive, might be uncomfortable with the uncertainty of sharing risks with other franchisees, necessitating additional education on why risk sharing can be advantageous.

Initial Capitalization

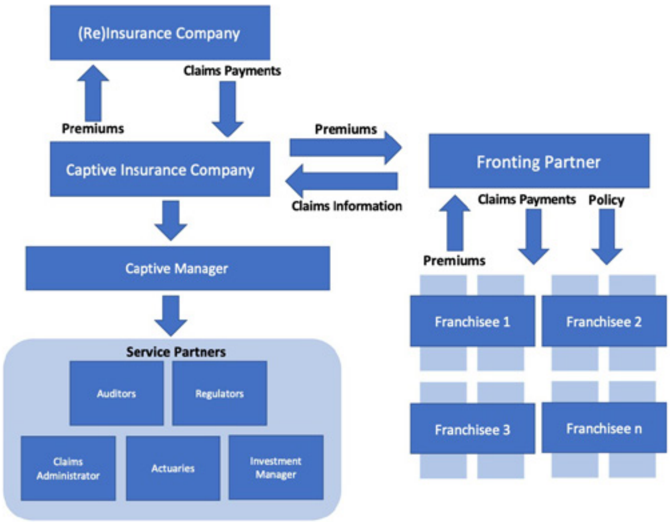
One of the other drawbacks to setting up a captive is the significant capital investment that is needed from Sammy's Deli corporate at the start. Because the captive is a real insurance company, it is subject to capital requirements enforced by a given domicile and must be capitalized to an adequate level before it can begin operating. The captive will be domiciled in Bermuda, which will be evaluated in more depth further in the feasibility study. Bermuda capitalization requirements state that captives with a subject premium in excess of $6 million are only required to maintain a 10:1 premium to surplus ratio. With 1,200 locations that will be insured through the captive, there is an expected annual premium subject base of well over $6 million, likely around $10 million. Despite domicile regulatory requirements, "new captives … usually begin life with a solvency ratio between 3:1 and 5:1" (Riggin 2018). Based on a 4:1 premium to surplus ratio and $10 million of estimated annual premium, Sammy's Deli corporate will capitalize the captive with $2.5 million in initial surplus.

While a large initial capitalization might meet resistance, it is the best possible strategy to ensure the longevity of the captive solution. Strong capitalization also increases the likelihood of the captive becoming a revenue stream for Sammy's Deli. In years that the captive achieves an underwriting profit, underwriting proceeds and investment income can be given back to member companies in the form of dividends. If capital adequacy is low, those underwriting profits and investment income would instead stay in the captive to maintain surplus adequacies. While not directly linked to dividend payout, strong initial capitalization ultimately benefits the financial health of the organization, increasing dividend potential.

Actuarial calculations will play a very important role in initial capitalization, determining premiums, and analyzing ongoing capital adequacy. With 1,200 franchises being insured via the captive, Sammy's Deli will reap the benefits of the law of large numbers and can get an accurate estimate of expected values of losses. A confidence level of 80% will be used to make assessments on capital adequacy. Additionally, in the spirit of the captive being a good financial steward of the capital and premium being paid in by Sammy's Deli franchisees, audit and actuarial partners will work to continuously assess adequacy in line with Actuarial Standard of Practice (ASOP) No. 55 capital adequacy assessment.

Operating Structure

When making the decision to move forward with a captive solution, it is important to have the correct operational structure for Sammy's Deli's group captive. As previously mentioned, The group captive for Sammy's Deli will be domiciled in Bermuda. The captive industry in Bermuda is the most mature captive market worldwide. Domiciling the Sammy's Deli captive in Bermuda will bring many benefits including access to best-in-class captive managers, fronting insurers, and reinsurers. Sourcing top tier captive management partners is essential for Sammy's Deli so that they can manage costs, properly insure their complex risk profile, and allow their captive solution to be globally scalable.



Risk transfer partners

Via the group captive, Sammy's Deli franchisees will have more direct access to the reinsurance market. Rather than retaining all risk via the captive, Sammy's Deli will reap the benefits of risk retention and reinsurance access by entering into an excess of loss reinsurance agreement for each of the coverages that it puts into the captive structure. The specifics of each of those reinsurance agreements will be covered in the 'Coverages' portion of this report.

The captive will partner with a fronting insurer to provide expertise across general liability and business interruption coverages, provide advisory services to ensure compliance, and to write the coverages and issue certificates of insurance on the fronting partner's paper. The captive and the fronting partner will enter into a fronting agreement that cedes the entirety of the risk back to the captive. Despite the fronting partner ceding all the risk back to the captive, we expect the fronting insurer to charge an 8% fee on all gross written premium. Fronting fees typically range "between 6 and 10 percent depending on the scope of services provided" (IRMI 2018). The fronting company charges this fee because in the case that the captive becomes insolvent, the fronting partner could be responsible for outstanding claims payments. We expect the fee charged by our fronting partner to fall at a reasonable 8% because of the various support services the fronting company will provide.

Despite this additional fee, the fronting partnership will still be advantageous for the captive due to the compliance benefits it will have. The ability for the fronting partner to issue certificates of insurance to individual franchise locations on their general liability policies justifies the fee on its own. Efficient access to certificates of insurance is essential for the compliance and operation of fast-food establishments, especially when partnering with vendors.

Captive management

The board of directors for the captive will be a carefully chosen group of stakeholders who will oversee governance and strategic partnership decisions for the organization. The board will consist of six individuals and be chaired by the risk manager of Sammy's Deli. The other five seats will be filled by a franchisee representative, Sammy's Deli's general counsel, the Sammy's Deli CFO, a representative from Sammy's Deli's internal audit team , and a captive manager who is a resident of Bermuda, fulfilling Bermuda's resident director requirement. This cross functional group will ensure diverse representation of thought and interests when making strategic decisions for the captive.

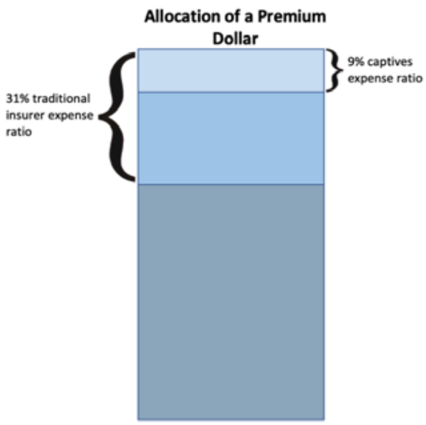
The day-to-day operations of the captive will be managed via a partnership between the Sammy's Deli risk manager and the captive manager chosen by the board of directors. The captive manager will be selected based on demonstrated history of success acting as a liaison with the Bermuda Monetary Authority, expertise in casualty and business interruptions claims handling, and on-island relationships. The captive manager will also be responsible for managing relationships with servicing partners retained by the captive, including auditors, claims administrators, regulators, actuaries, and investment managers. To assist with decision making, the captive will contract services from an actuarial consulting firm specializing in pricing and risk analysis for captives. By using independent actuarial consulting services, the captive will be able to effectively analyze exposure data collected by franchisees and price all the franchises' risks most accurately, drastically reducing the expenses associated with pricing all of the business separately outside of a captive.

Coverages

The flexibility of the group captives will provide an avenue for Sammy's Deli franchisees to stabilize rates for their traditional general liability policies as well as an opportunity to provide a risk transfer strategy for traditionally hard to insure risks such as business interruption due to supply chain breakdowns and staffing shortages. Franchisees being covered via the captive can elect to purchase one or both coverages (GL and BI). Rates will be made in partnership with the contracted actuarial consulting firm using experience and exposure data collected from franchise operations and loss runs. Additionally, the fronting partner's actuaries will verify the accuracy of actuarial decisions made by the contracted actuarial consulting firm.

General Liability

General liability coverages in the captive will assist in reducing underwriting-related expenses and stabilize rates for these policies, while maintaining the same level of coverage. From 2016-2020, captives had an average expense ratio of 9% compared to 31% for traditional insurers (McMahon and Provines 2021). The Sammy's Deli captive is expected to have an expense ratio on par with the industry average of 9% for captives. Because of this, the premiums charged to Sammy's Deli franchisees by the captive will be noticeably lower than premiums charged to franchisees by traditional insurers.



Rising general liability rates across the industry also give reason for placement of general liability coverage within the captive. In the first quarter of 2022, the median rate change for general liability policies was 2%, with almost 60% of carriers obtaining these increases (Gallagher Spring/Summer Report 2022). Using the group captive structure, Sammy's Deli can avoid the rate increases and volatility of the market. Placing the general liability coverage needs within Sammy's Deli's captive is also beneficial in stabilizing rates as the proposed captive structure ensures that each member has similar risks with the same risk mitigation standards from an Enterprise Risk Management standpoint. Members of the captives are less exposed to the effects of the underwriting cycle and the larger market resulting from the losses of other businesses. In addition, they have protection from the risk of other franchises because of the approval process that each prospective member must go through to join the captive. Therefore, the loss history that prices are based on becomes more stable as the company can regulate loss control across all franchisees using the captive.

The captive will enter a pro rata reinsurance treaty agreement with its reinsurance partners for its general liability business. The captive will cede 15% of its general liability book to the treaty agreement. As of Q4 2021, average ceding commission for casualty business were hovering in the low 30s (Thaler 2021). The captive will seek to negotiate a 26% ceding commissions considering a captive's uniquely low acquisition costs and the fact that the captive will be a brand-new entity, diluting negotiation power.

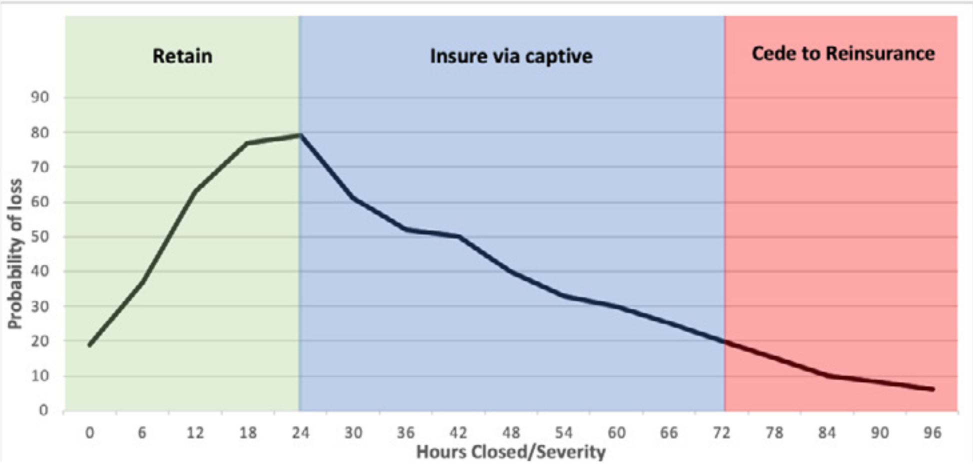
Non-damage Business Interruption

One of the advantages of using a captive is that the captive can write insurance solutions that are not offered on the general insurance market. Captives function as non-admitted insurers, allowing them to exceed the boundaries of product offerings that traditional insurers offer. The general guide is that if the coverage is legal, quantifiable, and is an insurance risk, it can be written as an insurance policy within a captive.

To address Sammy's Deli's concerns about business interruption, the captive will issue non-damage business interruption coverage for operational shutdowns caused by supply chain shortages and staffing shortages. This non-standard business interruption coverage will be rated based on data collected from the Sammy's Deli management information system on staffing shortages and supply chain inconsistencies. Franchisees have the choice between coverage for shutdowns caused by supply chain, staffing shortages, or both. Franchisees will find the availability of coverage for these challenging risks to be very attractive.

The policies will have a 24-hour waiting period functioning as a retention for the franchisees purchasing coverage. Without a waiting period, prices would skyrocket due to the high frequency of small shutdowns. This coverage is meant to be used as a transfer and financing option for longer shutdowns. Premiums collected from non-damage business interruption policies will be used to pay for losses between twenty-four and seventy-two hours of cancelled operations. The captive will cede loss costs for lost operations past 72 hours to an excess of loss reinsurance treaty. Based on historical loss experience for Sammy's Deli, only a small portion of losses exceed 72 hours of lost operations, but those losses are so severe in terms

of economic value lost that reinsurance is necessary to keep the captive solvent without needing to add capital.



While non-damage business interruption coverage is a non-standard coverage offering, Sammy's Deli holds a set of risks that are homogenous and can be priced together, though are geographically diverse enough to avoid most catastrophic claims scenarios. By paying premiums into the captive, franchisees are pooling the costs of the risks. This strategy reduces the financial severity of a shutdown by splitting the expense into a monthly premium. Reducing the financial volatility resulting from staffing and supply chain related risks will increase the resiliency of Sammy's Deli franchisee operations.

Risk Management Benefits

Aside from participation in the group captive being a corporate requirement of Sammy's Deli's franchisees, creation of a captive will result in several other changes to the company's risk management and operations. One of these changes will be increased data insights due to a more centralized risk reporting system. The group captive structure will require standardization in risk reporting and claims management from each franchisee, which will provide the company with more accurate data to help make risk management and operational decisions in the future.

The structure of Sammy's Deli's captive requires each franchisee to meet specific standards of risk management, increasing the group's members' consistency in risk mitigation actions. Specific risk mitigation standards will include centralized safety standards and reporting. A specific example of this would be extra capital freed by reduced premiums could be invested into third-party supply chain risk management solutions and monitoring systems. More freed capital also creates availability for investment in retention and training programs to keep employees engaged, invested, and growing within the company.

Conclusion

Considering market conditions and cost-effectiveness, we believe that a group captive, domiciled in Bermuda, covering franchisees' general liability and non-damage business interruption policies is the best solution for Sammy's Deli's concerns and coverage needs. A group captive in which each franchisee operates as a member decreases costs associated with using a standard carrier and frees capital for more innovation in risk management and operations within the company and provides access to reinsurance opportunities. In summation, reduced premiums, specialized coverages, and risk management benefits of the captive combine to elevate brand value and attract high-quality franchisee candidates, driving global growth for the organization.

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Carter Cappon

Olivet College

What interested you about the CICA Essay Contest Captive Insurance Solutions for Today's Risk Management Challenges?

The captive insurance sector is growing fast but not a lot of young professionals know what captives are or what they do. To be able to fully dissect what a captive does, and how it operates, was a challenge that we wanted to take head-on. When I saw the contest, I saw an opportunity to be a part of the growth of captive insurance.

How was captive insurance helpful for your chosen organisation?

The American College and University Athletic Association (ACUAA) is a non-profit association with more than 850 colleges and universities, with lots of potential risks to be covered it seemed a no-brainer for the ACUAA to fund a group captive. With enough participation, the captive has the opportunity to be funded well enough to cover losses, yet retain profit.

What did you learn about captive insurance while researching and writing your essay?

While researching we had to learn about group captives, how they operate and what it would take to fund the captive. The most challenging part to learn was the AB fund option. We reached out to captive insurance professionals to give us a 101 basics to help us understand how we could make this viable for the ACUAA.

Would you consider a career in captive insurance?

I am studying insurance and risk management at Olivet College and I am currently interning with Hylant on their Global Captive Solutions team under Anne Marie Towle. I have loved learning about captives and being able to intern with such a great team and company, I see myself looking for a career in captive insurance.

How does your college coursework align with a career in captive insurance?

At Olivet College we produce some of the best professionals around the country. However, when it comes to captive insurance, we really do not provide a lot of education about captive insurance specifically. Students are equipped with the main tools and knowledge to understand the industry and find their paths. This essay contest allowed me to dive into the guts of captive insurance and test my knowledge.

Carter Cappon is a junior at Olivet College studying insurance and risk management. He is the the current president of Olivet College's Gamma Iota Sigma Chapter. Insurance has always been a part of his life as he grew up watching his dad succeed in the industry. Carter has enjoyed his internships and is excited to see where his future lies as an insurance professional. He enjoys golfing, snowboarding and various other outdoor activities with family and friends.

Chase Mendham

Olivet College

What interested you about the CICA Essay Contest Captive Insurance Solutions for Today's Risk Management Challenges?

The one thing that drew us to this contest was the ability to challenge ourselves to learn about a growing industry.

I began without knowing much about captives, but with the help of my teammate and lots of research, I started understanding it.

How was captive insurance helpful for your chosen organisation?

With name, image, license deals growing in volume, there is lots of room for potential losses. With the number of participants, no one insurance company would be willing to accept that risk. With a group captive, it gives the ability for the members to feel safe and also the chance to profit.

What did you learn about captive insurance while researching and writing your essay?

When my teammate first asked me to do this essay with him, I knew nothing about captives. It was a huge learning curve, but while researching captives, I started to understand why companies would take this route.

I saw some similarities between traditional insurance and captives regarding paying premiums.

If the captive had a great year and didn't have many losses, they could get that premium back as profit.

Would you consider a career in captive insurance?

I would consider a career in captive insurance. Every day would be different and that is what I am looking for in my career.

How does your college coursework align with a career in captive insurance?

At Olivet College, we have one of the top insurance programme in the country.

We learn all aspects of the insurance industry, but don't dive deep into captives.

Chase Mendham is a senior at Olivet College studying insurance and risk management. He is the chief membership officer for Olivet's Gamma Iota Sigma Chapter. He started his freshmen year knowing little about insurance and is now excited to graduate and pursue a career in the field. Chase competes on Olivet's cross-country and track teams and when he's not running, he enjoys golfing.

2022-2023

CICA STUDENT ESSAY CONTEST

Captive Insurance Solutions for Today's Risk Management Challenges

2

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OLIVET COLLEGE:

Carter Cappon & Chase Mendham

THE AMERICAN COLLEGE AND UNIVERSITY ATHLETIC ASSOCIATION

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The American College and University Athletic Association (ACUAA) – Group Captive Solution

Carter Cappon and Chase Mendham

Introduction

The American College and University Athletic Association (ACUAA) is a phenomenal candidate for establishing a captive insurance company. Being new to the collegiate industry, yet always hovering beneath the surface, the ACUAA is embracing a world of opportunity. As of July 1, 2021, college athletes can now receive profit based off their Name Image and Likeness (NIL). However, with opportunity comes risk. Over the past 7 years the NCAA has paid out over $300 million in lawsuit cases (Sports Illustrated), this is before the era of NIL. As seen in *Figure 1* the top NIL average deal colleges are power 5 schools, to no surprise. These power 5 schools have been running the NCAA in all aspects, it is the responsibility of the ACUAA to make sure they follow code of ethics, recruiting practices, scholarships and more.

Figure 1: Top Performing Colleges NIL Deal Average

The Sherman Antitrust Act of 1890 states that businesses cannot coordinate a monopoly to curve prices as a form of economic power. The ACUAA is a facsimile of the Sherman Antitrust Act, ensuring that colleges and universities cannot band together to inflate prices. It also served as the base for the new legislation stating that collegiate athletes can use their name, image, and likeness to receive profit. The ACUAA is faced with a lot of financial pressure as NIL deals become more desired. The captive insurance company will help reinforce the ACUAA's financial capacity to insure its 450,000 students across 850 programs.

Seeing that the ACUAA is in a position where it can handle a significant amount of loss under a well-funded captive insurance company. The preceding information will discuss and outline the limited insurance coverage needed under a group captive and help resolve risk management needs within the ACUAA organizational structure. Information regarding structure, coverages, domiciliation, and other various knowledge will be provided to better understand the goal of the captive.

Risks Consideration

NIL deals are new and there are still unidentified risks that the captive insurance company must be prepared for. There are also risks that have already been made aware of, one of which has been around for decades: lawsuits. As stated above, $300 million has been paid out in lawsuits over the past 7 years (Sports Illustrated), and now with NIL deals that number is without a doubt going to increase. The NCAA is backed into a corner and the ACUAA is forced to comply with state and federal laws. As large as the ACUAA is, a normal insurance provider would not cover that amount of money arising out of lawsuits, legal liability would be something of keen interest for us to look into. With the correct actuarial analysis, the captive insurance company could fund an appropriate amount to keep the organization profitable.

NIL deals are individualized deals that pay college students money to showcase the sponsor, so the ACUAA needs to pay close attention to discrimination. According to the ON3 NIL top 100 earners, 91of the top 100 are men, only 9 are females. Of those 100 students 62 of them are of color. The ACUAA must continue to monitor these numbers and make sure there are no discrimination cases that may arise. If the program chooses to participate in the group captive, the college/university would pull from the captive funds. The captive insurance company may look into some possible limited coverages. Because the students act as the employees of the ACUAA, employment practices liability insurance would be ideal as it may cover any discrimination cases. Directors and Officers may be ideal as well to cover any decisions that may fall back on the association.

Recruiting for education systems, an abundance of times, falls back on scholarships and any way to reduce the cost for students. Programs and sponsors are using collectives to lure students to attend their programs over others, under the ACUAA this is not allowed and is improperly promising scholarships. This means the student can fall back on promissory estoppel which states, a promise, in writing or not, that affects a decision, the promisee may recover the promised money. If a college or university faces a case with promissory estoppel the program will be held responsible, with the participation of the entity within the group captive, funds would be distributed from the captive insurance company. We are going to recommend Troth Coverage meaning in a case of promissory estoppel, the captive has funding available for the claim.

Pros and Cons to Group Captives

Pros: Group captives are member-owned and operated, this allows members greater control over their premiums, coverages, and arising claims. The group captive also allows the owners to tailor policies to unique exposures. The main purpose of any captive is to allow profits to grow as losses are controlled and gain access to investment income from unused premiums. Instead of paying a fixed premium to an insurer and never seeing that premium money again, in a group captive the more you control your premiums, the more leftover premium and loss funds not paid out in claims will find its way back to the owner's pocket as profit. Group captive members/owners enjoy greater stability as they are not at the mercy of traditional insurance companies, that change policy limits, underwriting guidelines, and expenses at will.

Cons: The ACUAA has its 850 colleges and universities; participants of the group captive they must be prepared to invest collateral to ensure their dedication to the group. When funding the captive, we need to be aware that having a bad year where loses were greater that the premium the embers must be prepared to pay an additional premium per the group's assessment provision when failure to control frequent smaller claims; penalize for frequency and forgive for severity. An off the radar con is the unequal implementation and start-up costs that are associated at the beginning. The captive insurance industry as a whole is regulated very heavily, each domicile has a list of statutes, guidelines, and regulations that the group captive must abide by. The bright side to that is once accepted and admitted into a domicile, it is typically smooth sailing moving forward. Distributing profits can be quite tricky as well; with leftover loss funds - what is considered investment income and what will be paid out as dividends (typically will be voted by the board of directors).

Group Captive Structure

A group captive is reliant on the number of participants. Because the ACUAA is made up of its 850 colleges, these members are going to make up a homogeneous group captive. Being that the ACUAA is responsible for those schools we will assume there will be 80% participation meaning 680 various colleges and universities under ACUAA. With NIL deals being so new to the collegiate world, there will need to be limits and guidelines for members of the captive to help mitigate some of the risk. We are going to set up the group captive with an A fund B fund approach to try and diversify the funds for better distribution (see *Group Captive Operations* for more detail). Once the data collection period begins, we will be able to dissect the high-risk members and losses to appropriately adjust the funding.

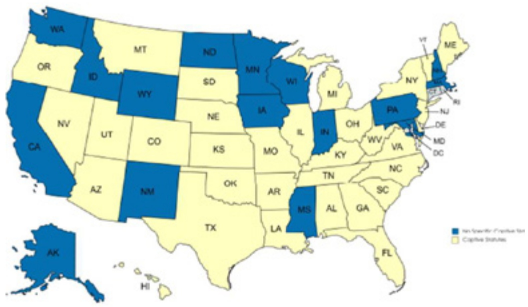

Figure 2: US states with Captive Legislation

When considering where to domicile the captive there are numerus things we want to take into consideration and make known to the ACUAA, before ultimately, they decide where they want to domicile. *Figure 2* shows US states with captive legislation, the yellow shows states with captive legislation and the blue shows states with no captive statutes. From what we know about legislation, taxation, and requirements for the domiciles we have created a domicile comparison. Non-profit organizations have different tax regulations and there are a number of non-profits set up already in these four domiciles, regulators can aid in the implementation process. Our top four are Hawaii, Tennessee, Vermont, and Utah.

First, we will look at Hawaii, Hawaii has 259 active captives currently domiciled. They have fees that will not cause an issue and their minimum capitalization requirements are $250,000, and ACUAA capitalization is well above that minimum threshold. Hawaii has no minimum premium tax and has no premium taxation on assumed reinsurance premium which will benefit the group captive. In ranking of Hawaii's stability, they are quite stable, and they have only been growing in number of captives which means the captive will be in more experienced hands.

Next, we will look at Tennessee, the state currently has 196 active captives domiciled within the state. Like Hawaii, the minimum capitalization is $250,000 which causes no issues for the ACUAA. Initial license fees are a little more expensive than Hawaii, but the numbers are marginally similar. Tennessee does have a minimum premium tax of $5,000 but unlike Hawaii's max of $250,000, Tennessee has a max of only $100,000. State legislation does state that there is a small premium tax on assumed premiums. Overall Tennessee has a very reasonable financial and operational view on group captives.

Next is Utah, one of the more popular and well-known domiciles in the US and outside the US. With 396 current captives domiciled, they have one of the higher numbers in the country. With a minimum capitalization like the rest, $250,000 there is no change there. Where we see some change from the previous 2 domiciles is their initial licensing fees and renewal fees. While the others have around $1,000, Utah has around $6,000 in initial implementation fees. Nevertheless, Utah has no premium tax legislation, making it a top contender for new captives to domicile. With fair operation practices and financial support, Utah remains a top domicile globally.

Lastly, we will look at Vermont, who is arguably the most used and well know domicile within the captive industry. Their regulators work fast and efficient and have been known to work quite nicely. With about 625 active domiciles it has more than double Tennessee and Hawaii and has about 200 more than Utah. It, like the rest, has a minimum capitalization of $250,000, however its initial licensing fees, like Utah, are more than the other two. With premium tax at a minimum of $7,000 and max of $200,000 there is no cause of worry there. Although Vermont may have high fees, you are paying for what you get, their legislation and regulators are quite extraordinary.

While ultimately the choice of domicile comes down to the ACUAA, we would like to make our recommendations based off of our experience. Recommendation 1: Vermont - its experience with non-profit organizations and captives in general, there is no doubt the implementation process and operations will run smoothly. It also is a great choice because of the easy accessibility into and out of the state. One requirement is the ACUAA must meet annually inside of the domicile to review legislation and the performance of the captive. Recommendation 2: Hawaii - This domicile has been enacted for some time and gets global recognition; it has favorable premium tax legislation as well. Hawaii also has an association that is focused on growth and continued improvements of its legislation. Being that the ACUAA will have several members, Hawaii has been known for its flexibility with its distribution of profits. Overall, it comes down to the association's decision, but we believe Vermont would be the most suited for the captive and its needs.

Group Captive Operations

The captive insurance company will utilize a third-party fronting carrier as a form of reinsurance and to comply with the chosen domicile's regulations. Typically, captive insurers are unlicensed insurers, by bringing in a fronting company who is comfortable with the risks and with the association as a whole, they add an extra protection layer to the captive. Fronting carriers will typically "rent" their paper to the captive for regulation compliance, this is so the captive will be written on a licensed company's paper. The fronting company will retain some of the risk working as a reinsurer in excess of the captive as seen in figure 3.

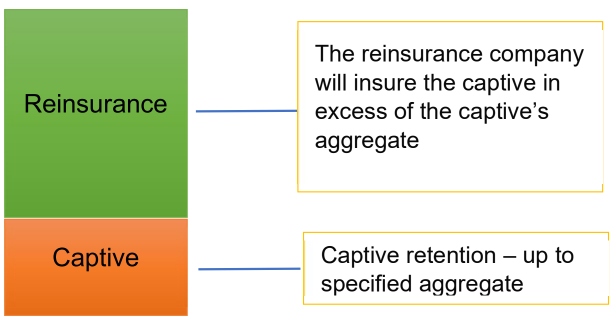

Figure 3: Retention Limits

We believe that an A/B fund would be most appropriate for this specific type of risk. The ACUAA, assuming we will have 80% participation, approximately 680 various programs, with an A/B fund in place we will have the captive retain all claims under a specified amount. A funds are referred to as the captive loss frequency layer; B funds are referred to as the captive shock loss layer and reinsurance is a safety net. For example, if we have member XYZ looking for a captive and we set up an A/B fund this is what it could look like. Assuming prospective member, XYZ, has an expected loss of $320,000, and the Captive fixed expenses are 36%, this means XYZ would have a Captive premium charge of $500,000 ($180,000 in expenses and $320,000 ceded to Loss Fund). The proposed captive retention would be $400,000. Utilizing an A/B structure, the A fund (frequency layer) would be responsible for claims from $0-$100,000, the B fund (severity layer) would be responsible for claims $100,001 to $400,000. Any claims $400,001 to policy limits would be reinsured away utilizing a reinsurance partner. Now, typically, approximately 75% of the loss fund is funded to the A fund bucket and 25% funded to the B fund bucket. This means we would have $240,000 in our A fund and $80,000 in our B fund. Let's say member XYZ has $200,000 of losses in a particular year that are less than $100,000 each. The $200,000 in losses would be paid through the A fund, meaning the member would have surplus (underwriting profit) of $120,000 (A fund surplus of $40,000 + B fund surplus of $80,000).

Now let's say member XYZ has a single loss of $500,000. The captive retains only $400,000 of any one loss, so $100,000 is reinsured away to reinsurance partner leaving us $400,000 to worry about. The first $100,000 will be paid via the A fund leaving us $300,000. The B fund has $80,000 to pay claims over $100,000, so in applying this, it leaves an unpaid balance of $220,000. The remaining $220,000 is then shared among the other members in the captive.

Let's now say that member XYZ has $300,000 in losses that are all less than $100,000. Again, our A fund has $240,000 in so subtracting $300,000 leaves us an A fund deficit of $60,000. This becomes the trigger for our A fund assessment. Each member can be assessed one additional A fund (so an additional $240,000). Member XYZ would now receive an assessment for the $60,000 and that would be additional pay in. Typically, assessments in a group captive are accounted for over a 3-year period of time to pay. It's also important to note that, even in this assessment position, the member is still building surplus as they still have the $80,000 sitting in their B fund that was not touched. The beauty of our group captive concept is that we penalize for frequency and forgive for severity, and we believe the examples above show how that works. *Please note that our above examples do not include risk sharing or investment income.

Premium Development and Profit Distributions

Each participating member in the group captive will provide relevant loss runs from the past 5 years. This will be sent and reviewed by a third-party actuarial service provider, for a fee, to provide a rough estimate of premium calculations. The actuarial analysis will not only provide premium calculations but expected losses, percent of losses to be paid by captive and percent of losses to be excess the captive shock loss layer. The actuarial analysis will include a year-to-year prediction of loss funds and expected reserves. During the initial stages of the captive each member will pay a small startup fee that will be used for the A/B funding, these amounts are determined via the actuarial analysis.

Profit distributions are not guaranteed as it is up to the group captive and its members, to mitigate and limit risks and to properly fund the captive. For profits to be paid out, actual losses need to be less than expected losses, and if actual losses are more than expected losses, there is no profit. Decisions for making profit distributions can be tricky both internally and externally, so thresholds are typically a good way to determine the amount at which distributions will be made. By using this threshold, the captive can hold itself to standards, meaning if there is an amount that is under this specific threshold, the profit would be used for investment income. If amounts, however, are above this threshold the amount which is above the specified threshold will be paid out in dividends.

Conclusion

The American College and University Athletic Association has several already identified risks that can be placed within the captive; however, the tricky part will be identifying the newly related risk with NIL deals as they progress and become more and more common. Currently we are looking at legal liability, employee practices liability, directors and officers and an awareness around the thin waters of promissory estoppel. The group captive approach will not only give the association the freedom to make decisions, but it also allows the association to insure its more niche risks that traditional insurance may choose to exclude or charge overpriced premiums to insure. The captive will allow for coverage gaps to be filled, program designing capabilities, easier management of claims, and market leveraging to mitigate the cost of insurance. Also, take into consideration that once the captive matures, more coverages can and may be looked at. Implementing a group captive solution will unquestionably be the most advantageous for the needs of the ACUAA.

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Nachapol Charamornburapong

Temple University

What interested you about the CICA Essay Contest Captive Insurance Solutions for Today's Risk Management Challenges?

Insurance professionals and leaders sometimes mention captives as a tool for risk management. However, not many people understand the potential that captives can offer. When I started learning about captives, it broadened my understanding of risk management. There is more to the discipline than just treating and financing risks.

How was captive insurance helpful for your chosen organisation?

Our captive insurance company supports the American College and University Athletic Association (ACUAA). The organisation wishes to minimise liabilities resulting from actions taken by the entity and/or its member associates.

A well-organised single-parent captive benefits from the economies of scale by reducing costs. Furthermore, the ACUAA can better provide risk control guidance and establish accountability among its members.

What did you learn about captive insurance while researching and writing your essay?

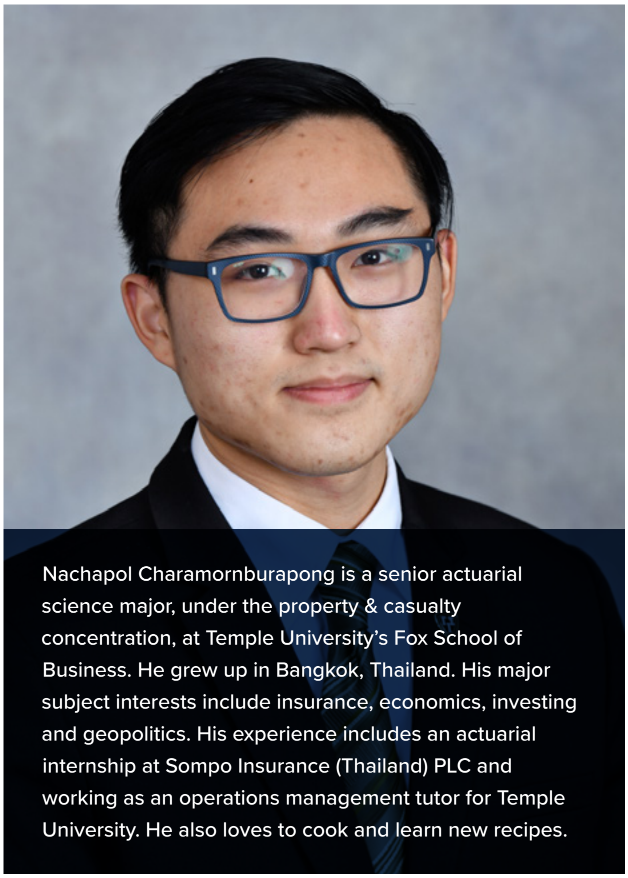
Captive insurance, despite its niche appearance, is relevant to countless organisations. Its compatibility with ERM promotes its adoption in the business world. Captives will continue to grow in the risk management space due to their tremendous potential.

Would you consider a career in captive insurance?

Yes, but after I have more experience in the overall insurance industry. Captive provide careerists with a specialised advantage over the traditional insurance space.

How does your college coursework align with a career in captive insurance?

My studies and career plans are actuarial science focused. Likewise, insurance and risk management go hand in hand with quantifying risks. Actuarial practices are essential for the feasibility study while ensuring the captive structure remains sustainable.



Nachapol Charamornburapong is a senior actuarial science major, under the property & casualty concentration, at Temple University's Fox School of Business. He grew up in Bangkok, Thailand. His major subject interests include insurance, economics, investing and geopolitics. His experience includes an actuarial internship at Sompo Insurance (Thailand) PLC and working as an operations management tutor for Temple University. He also loves to cook and learn new recipes.

Ting-Wei Liu

Temple University

What interested you about the CICA Essay Contest Captive Insurance Solutions for Today's Risk Management Challenges?

Since I have not been exposed to too much information about captive insurance from my college coursework, I was interested in learning about the non-traditional type of insurance.

Additionally, I had some relevant working experiences with student-athletes at Temple University's Resnick Center. The topic interested me when I read Case Study #3, ACUAA.

How was captive insurance helpful for your chosen organisation?

Due to the size of the ACUAA and the unavailability in the current insurance market, forming a captive for the association is the best solution. It allows the association to customise policies based on its members' needs and efficiently reduce its financing costs.

What did you learn about captive insurance while researching and writing your essay?

I learned the advantages of forming a captive, such as providing direct access to the reinsurance markets and controlling the policy design. I also learned that there are several captive structures that a business can utilise, including fronting and non-fronting. Hence, it is critical to understand each structure's pros and cons when an organisation decides what type to form.

Would you consider a career in captive insurance?

I would absolutely consider a career in captive insurance. Working in the captive insurance industry will help my professional development by enhancing my creative problem-solving and analytical skills. Furthermore, because captives could be applied to various industries, I hope to utilise captives as a tool to solve real-world puzzles.

How does your college coursework align with a career in captive insurance?

Although my college coursework included some information regarding captive insurance, the meetings hosted by Temple University's Gamma Iota Sigma Chapter have assisted me in learning the new field. The entire experience of researching and applying these learnings to a case study is beneficial and valuable.

Since entering the CICA Essay Contest, Ting-Wei Liu has graduated from the actuarial science programme at Temple University. He will be furthering his studies in financial analysis and quantitative risk management at Temple's Fox School of Business. He grew up in Taichung, Taiwan. His work experience includes tutoring student-athletes and he has an upcoming internship with Venerable.

2022-2023

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3

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Table of Contents

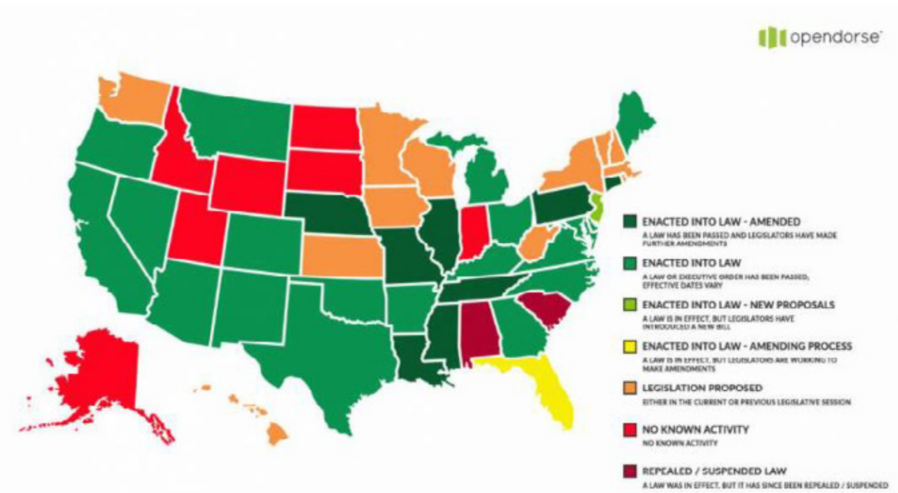
American College and University Athletics Association (ACUAA) – Single Parent Captive Solution

Nachapol Charamornburapong and Ting-Wei Liu

Overview

The American College and University Athletics Association (ACUAA) has great benefit potential through a captive insurance company. Mobility Foresight forecasts that the sports media broadcasting industry will grow from $26.2B in 2021 to $30.8B in 2027 (Mobility Foresights, 2022). In 2021, the National Collegiate Athletic Association published an interim Name, Image, and Likeness (NIL) law which allows registered athletes to earn income via their personal NIL in marketing activities such as advertisement and endorsement. As of November 2022, 29 states have already passed NIL laws in response to this new change, shown in *Exhibit 1* (Saul Ewing LLP, n.d.).

Exhibit 1



StateState NIL Law Status, November 2022 from opendorse by Braly Keller

Since the NCAA's interim NIL policy leaves each state to govern their own NIL statues, it is expected that all states will eventually have their own statute on this topic. These state laws would also apply to student athletes (SA) associated with any non-profit collegiate sport association. The full implication of this new legal environment is uncertain. However, a larger portion of the revenue generated by the industry will now belong to the athletes instead of to the association and its members institutions. Additionally, the recent string of successful litigations by current and former SAs may encourage other SAs affected by the previous NIL rules to sue their sports associations and/or their members.

The hard liability insurance market and the financial scale of the ACUAA suggest that a new captive insurance company could be a highly effective solution for the uncertain future. The NCAA earned around $1.12B in 2019 where over three quarters came from Royalties, Licensing, Advertising, and Media Rights (Gough, 2022). While the ACUAA is substantially smaller than the no.1 association, its 850 schools still present a large market share. A captive could reduce regular and shock loss expenses, and even produce underwriting profits.

Risks for ACUAA and its Members

Although ACUAA and its members may encounter different risks in operation, there are certain risk exposures shared by both parties including pandemic, flood, fire, terrorism, and liability risks. Without applying appropriate risk management and financing strategy, these risks have the potential to interrupt the league's operation and even damage the entire association. It is imperative that the association is proactive about mitigating events that are beyond its control.

Liability Risk

ACUAA and its members are increasingly susceptible to compliance and litigation risks. For instance, the NCAA, a prominent example for many collegiate athletic associations, and its members have long been accused of accepting Name, Image, and Likeness (NIL) proceeds which should have gone directly to the SAs. Even though, the NIL rule change is quite recent, the athletes are suing their intercollegiate sports associations for these actions which were previously allowed. NIL allows SAs to receive payments for the use of their name, appearance, and endorsements for marketing purposes. In *NCAA v. Alston*, the supreme court ruled that the NCAA violated the Sherman Antitrust Act by withholding SAs' NIL proceeds (Frampton & Khosla, 2021). Its aftermath prompts states to amend their NIL laws to attract SAs to their states. As the collegiate sports landscape is shifting, former and existing SAs who felt deprived of their NIL proceeds are emboldened to litigate against their sports association. ACUAA may have to defend against lawsuits regarding events which happened before the passing of the NCAA's interim NIL policy. In addition, state compliance and other SAs' lawsuits would represent most of the future first and third-party liability risks. For instance, Director and Officer (D&O) coverage should be offered by the captive for high-level managers of the ACUAA and the association members.

Event Cancellation Risks

Any cancellation of athletic events incurred by unforeseen perils, namely, pandemics, floods, fires, and terrorism may cause severe financial impacts for ACUAA and its members.

Pandemic Risk

One of the major risks that ACUAA and its participating colleges and universities are facing is a pandemic risk. A large portion of the association's annual revenue is from television and marketing rights for all sports events and ticket sales. The proceeds are used to support its members and SAs across the country. A serious and prevalent outbreak will force the ACUAA and its members into severe financial issues. Since all athletic events may get canceled for an entire season or more, and those cancellations would lead to the association's revenue drop, ACUAA would not have sufficient funds to assist them. Furthermore, due to the lack of estimating techniques in epidemiology, it is hard for both parties to accurately predict how long the epidemic will last, which has a direct relationship with how much loss will be incurred.

Flood, Fire, and Terrorism Risks

If an adverse event involving flood, fire, and terrorism risks occurs at designated venues, it will lead to tournament cancellation and postponement. Both parties will suffer a loss of revenue from broadcasting and marketing rights, and ticket sales, especially during the quarterfinals. While some postponed games would be hosted on different dates and/or locations where the association could generate some revenue, these adjustments could significantly reduce earnings. For example, if a game is put off from its primetime weekend slot onto a regular weekday slot, fewer audiences will be attending. Related sponsorship amounts and concession sales during the game would also decrease. Furthermore, advertisers may not be willing to pay the same price as what was originally agreed since audience turnout would be lower than normal.

Current Commercial Non-Life Insurance Market

Sports associations regularly purchase liability insurance to protect themselves from tort claims made by their institutional members and SAs. The court often rules in favor of the SAs plaintiffs and indirectly drives up the price of liability insurance policies. Monetary and social inflation also plays a key role in driving the hard insurance market. According to Leaders' Choice, the 2021 third quarter rate hikes for general liability, and umbrella and excess liability rose by 6% and 11.7%, respectively (Leaders' Choice Insurance, 2021). It can take only a few years for rates to double as loss frequency and severity grows rapidly. Therefore, the increasing cost of traditional insurance strongly encourages large organizations to manage their own risk via captive insurance.

Traditionally, getting insurance is one way to transfer "act of god" losses to commercial insurers. A common way to transfer this risk is by purchasing venue insurance for each game. This insurance is comparatively easy to access through the insurance market (Smith, 2018). Although, the pandemic policy premiums are becoming pricier as no insurer is willing to cover communicable diseases after experiencing the COVID-19 pandemic (Dodd, 2022). Furthermore, standard commercial insurers do not cover flood, fire, and terrorism. Even federally mandated programs including the National Flood Insurance Program (NFIP) and Terrorism Risk Insurance Act (TRIA) are not primarily meant for event cancellations and lost income. Therefore, the insured would also purchase a difference in conditions (DIC) insurance policy which can cover the peril gaps caused by the mentioned perils. Each peril typically has varying coverage limits.

Advantages and Disadvantages of a Single-parent Captive

Advantages: A single-parent captive offers great flexibility for both its owner and the affiliated insureds. Firstly, a captive controlled solely by its owner can more quickly adapt to specific risk controlling needs. The captive could set up loss control programs with the help of a contract captive administrator who has access to subject matter experts. Secondly, the captive reduces risk financing costs and may even produce underwriting profit during periods with low losses. Traditional insurance carriers charge higher prices because of their underwriting expenses, the desire to make underwriting profit, and the policyholders' sharing of that insurer's risk pool. While forming a single-parent captive requires a considerable up-front investment, the potential to reduce underwriting expenses outweighs the cost in the long term. This is due to increased transparency and customized loss control programs of a captive. The core foundation of a captive is that it has an idiosyncratic risk pool that is unaffected by the losses of other policyholders. Thirdly, apart from insuring the direct owner, a single-parent captive could insure affiliated entities via fronted captive-reinsured insurance. Association-owned risk-retention groups require all members to participate, which is not necessary for a single-parent captive. Certain members already have their own liability insurance and would continue to do so. Prospective captive owners could also recognize the benefit of access to reinsurance markets, which are only available to insurance carriers. A captive can increase its capacity and maintain its solvency via the markets' funding instruments. It is also possible to restructure the captive in the future if it proves to be successful.

Disadvantages: Although a captive company is not under the same level of scrutiny as an admitted insurer, it is more heavily regulated than the average corporation. Firstly, a single-parent captive must have a fronting insurer when insuring affiliated entities in states other than the captive's domicile. Certain captive forms, such as Risk Retention Groups (RRG), do not require a fronting carrier to do business in non-domiciliary states. Secondly, single-parent ownership indicates that the ACUAA will contribute all the required captive capital. Larger captive forms such as association captives receive starting contributions from all members. Additionally, a single-parent captive would miss out on the larger risk pool that is normally available under an association captive structure. Lastly, a captive has great prospects if managed well, but a single-parent captive owner would bear the losses and sunk costs if the captive becomes unsustainable.

Solutions

Feasibility Study

Prior to any decision to invest in a captive, the owner must engage industry experts to conduct a feasibility study. The study considers aspects such as risk exposures, potential coverages and limits, premium estimates, underwriting expenses, potential domiciles and the owner's level of control. It is highly recommended that a third-party captive manager help facilitate the process. Frequently required items from the insured owners are their (1) current and projected exposure values, (2) five years' prior loss history by line of business (LoB), (3) annual financial statements, (4) copies of current policies, and (5) premium and claims services payment schedules. The study would answer questions such as (1) whether the organization could sustain a captive, (2) which coverages should be insured or reinsured by the captive, (3) which domiciles are best suited for the owners' needs, and (4) projected expected losses. There are several parties which participate in the feasibility study. The prospective captive owner's staff, insurance brokers, captive managers, actuaries, and independent risk managers are the usual partakers of this process.

Domicile

Another vital consideration is the captive's domicile. When choosing a domicile, the feasibility study should weigh the pros and cons of each state. Major factors related to domiciles are (1) the regulatory environment; (2) capitalization, taxes, and fees; (3) captive community agglomeration, and (4) onshore/offshore implications (Captive.com, 2020). There are two main locations that we recommend, Vermont and Utah. VT is the largest onshore captive domicile with captive-friendly legislation, the greatest agglomeration of captive professionals, low premium tax rates, and low capital and surplus requirements (Reger, 2017).

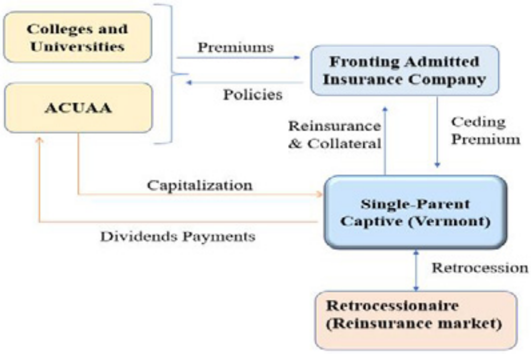
Single-Parent Captive Structure

A single-parent captive is financially jump-started by an individual corporate entity that is also a parent company. Since the parent company provides all the capital, it "wholly owns" the captive insurance company. The captive, under the management of a captive manager, issues coverage nationwide through one or more fronting insurers. Fronters are admitted primary insurers who can operate in permitted states (Insurance Information Institute, 2022). It is recommended that the owner contracts with a fronter who operates across all the states where the owner's affiliates are situated. Otherwise, the captive may require additional fronter to satisfy geographical coverage needs. ACUAA's members are affiliates who are spread across all fifty states. Affiliated institutions that wish to receive coverage by the single-parent captive must pay premiums directly to the fronting insurer who then cedes most of the coverages to the captive. However, there is a possibility that the captive may go under. In this circumstance, the fronter must still indemnify the insured affiliates, as required by law. Therefore, a fronter often asks for fronting collateral to compensate for this risk and also charges a fee to participate in the risk (Autunes, n.d.). Any underwriting profits earned by the single-parent captive can be retained or paid as dividends to the parent company.

Operations and Captive Lines of Business

A captive manager would be monitoring the operations of the ACUAA's single-parent captive. Captive managers look at the captive's underwriting, claims, investments, and operating functions. They report and work with regulators to ensure the captive's compliance status. (Mead, 2010). Managers could be employed by the parent company or contracted via a third-party service company. Management fees can vary depending on the size of the captive and labor costs. It could cost from $10,000 to $100,000 annually. However, a single-parent captive's expenses are generally lower than the high-maintenance captive forms such as a RRG.

Exhibit 2: Single Captive Structure



This captive will cover only pandemic and liability risks based on their cost-reduction potential. Pandemic coverage will indemnify lost profits due to event cancellations and postponements. As mentioned, pandemic perils are generally excluded by traditional insurance due to the high payout and unpredictability. Liability risks to the ACUAA and its members are within the captive's capabilities. Liability coverage for the association would include general liability at ACUAA's venues and third-party liability to its participating members. The captive can combine liability claims data from the parent company, the affiliated members, and the captive third-party administrator (TPA) to forecast losses. However, the captive will only offer college third-party liability for the captive-reinsured affiliates. Since the ACUAA award penalties to member colleges for policy violation, it is a morale hazard for the former to provide the latter with affiliate-to-association liability insurance. This is one of the reasons that we choose single-parent captive over association captive. The ACUAA also has access to capacity from its revenue sources and alternative risk capital market (ARCM). For instance, the captive could enter excess-of-loss reinsurance treaty via other reinsurers and retrocede through the ARCM.

<u>Risk Control</u>

A captive's large capital and access to TPA expertise and support helps create an in-house risk treatment function. Unlike traditional insurers who create incentive for risk control implementation via premium discounts, a captive has direct access to loss data and subject matter experts. The captive's risk treatment program spends capital on safety investments such as programs that regularly educate the association's and insured affiliates' employees about compliance and safe practices including procedural checklists. Other programs may include venue risk controls, namely, routine structural inspections to reduce the frequency and severity of general liability cases.

<u>Considerations</u>

Parent companies may opt for a 2nd captive form different from the first. The decision could be based on the need to provide different lines of coverage for different affiliated entities. In the case of the ACUAA, it could conduct an association-wide survey regarding the members' interest in contributing capital to an association captive. In response to positive feedback, this 2nd captive could be a separate entity or a conversion from the original single-parent captive. It could offer liability coverage to the affiliates but only for public and SAs lawsuits.

Conclusion

ACUAA and its members confront various challenges coming from the size of the association and the unavailability of coverage in the current insurance market. Establishing a single-parent captive is a promising alternative for ACUAA to the commercial insurance market. It could shrink the coverage gap between members and reduce their risk financing costs. More importantly, it could customize policies based on specific risk needs.

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