CICA unveils the winner in the Student Essay Contest on Captive Insurance Solutions

The Captive Insurance Companies Association (CICA) announced the winner of its annual Student Essay Contest at the 2024 CICA International Conference. The contest challenges college teams to devise captive insurance strategies for real-world risk management scenarios.

Captive Insurance Times is honoured to be an official media partner with CICA and to have the privilege of showcasing a Q&A with each of the students and publishing each of the finalist essays.

The annual contest invites two-person teams of college students from a variety of disciplines including insurance, risk management, actuarial science, finance and business management.

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Butler University

Bailey Sims

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

The CICA essay contest interested me because I was excited by the opportunity to work through a problem that I could be faced with in my future career. This contest was the perfect opportunity to be able to apply my knowledge of insurance and the captive industry in a practical way. Finally, this contest also challenged me to think critically and collaborate with my partner to develop a creative and unique solution for our chosen organisation.

How was captive insurance helpful for your chosen organisation?

Captive insurance allowed us to address the concerns of our chosen organisation, Vane University. Through the use of a captive structure, we were able to find a solution for Vane University's increasing premiums and unique risks and provide them with adequate coverage for their general liability, vehicle liability, and selling of liability and property insurance. By using the cell captive structure, we were able to address each concern and provide coverage for each risk individually. The cell captive structure allows Vane University to diversify its risks into three separate coverages, as well as provide them with the option of adding more cells for future risks.

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

While doing research for this essay, I learnt a great deal about captive insurance and the captive insurance industry. One of the biggest takeaways I had was how in today's economic climate and hard insurance market, captive insurance is not only a sensible insurance option but also a beneficial one. Captive insurance is flexible and specific to the insured's needs, allowing the insured to receive the necessary coverage they need that they cannot access in the traditional insurance marketplace.

How does your expanded knowledge of captive insurance compare to your understanding before entering the competition?

Through the contest and the research process I have learnt so much more about captive insurance. Prior to the contest, I had limited knowledge of the captive insurance industry. I understood the basics of captive insurance and the more popular captive structures. However, through this contest, I was able to learn about other captive structures and apply my knowledge to problems I may face in a future career.

Would you consider a career in captive insurance? What about captive insurance appeals to you as a career choice?

Before this contest, captive insurance had not piqued my interest. I always saw myself going into traditional commercial insurance on the service side. However, after my participation in this contest I am curious about what a career in captive insurance would look like. The part of captive insurance that I find the most interesting is the fact that the risks you insure are more unique and interesting, allowing you to develop creative coverage solutions for your insureds.

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

Butler University's Risk Management and Insurance programme has introduced me to the numerous opportunities available within the insurance industry, including captive insurance. In fact, Butler University provides a Captive Insurance Operation class that covers many topics relating to captive insurance and other alternative risk financing mechanisms. Butler University also has a student-run captive insurance company that allows students to gain hands-on experience through underwriting and the handling of real risks. Finally, Butler University's Gamma Iota Sigma Chapter hosts many guest speaker events and invites numerous insurance companies, including captive insurance firms, to come and speak to the students. ■

Bailey Sims

Bailey Sims is a senior at Butler University studying finance, risk management and insurance. She is a member of several clubs and organisations including Beta Gamma Sigma, Gamma Iota Sigma, and Butler's environmental club EcoReps. Off-campus she is a competitive Irish dancer, competing in national and international competitions. After graduation, she will work at Shepherd Insurance in Carmel, Indiana as an Associate Commercial Lines Account Manager.

Butler University

Harrison White

Harrison White is a senior studying risk management and insurance at Butler University. He grew up in Cleveland, Ohio. In the past, he interned in an underwriting role at Great American Insurance Group. Currently, he works as an assistant at USG, a wholesale brokerage and MGA, with the hope of becoming a producer. He is the current president of his Gamma Iota Sigma chapter and looks forward to graduation in May.

"I would consider a career in captives. I know it is a growing space and I feel like it is very dynamic. It seems like there is plenty of innovation underway and room for creativity"

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

I was intrigued by the opportunity to explore and write about an unfamiliar area of the insurance world.

How was captive insurance helpful for your chosen organisation?

Captive insurance helped Vane secure coverage in difficult markets with rising premiums.

It enabled them to further isolate and understand their unique and multiple risks through cell-structure organisations.

It also unearthed a potential revenue source for the university, should they ever decide to open up and rent their cells to others.

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

I learnt that captive insurance and its implementation has great flexibility.

A successful captive moulds to fit an insured's individual characteristics and the fluctuations of the broader insurance marketplace.

How does your expanded knowledge of captive insurance compare to your understanding before entering the competition?

I had a very vague idea of what captives were prior to my research and submission. I still feel that way to a certain extent, due to the sheer size of the space.

However, I think my understanding of the multitude of captive structures available has increased.

Would you consider a career in captive insurance? What about captive insurance appeals to you as a career choice?

I would consider a career in captives. I know it is a growing space and I feel like it is very dynamic. It seems like there is plenty of innovation underway and room for creativity.

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

I am taking a captives course this spring. It is one of the unique features of Butler's RMI programme, as the school has an active and growing captive operation. The class is focused on the captive's management and expansion. It is very hands-on and the students are involved in idea generation and decision making. I am very excited to take the class. ■

2023-2024

CICA STUDENT ESSAY CONTEST

Captive Insurance Solutions for Today's Risk Management Challenges

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BUTLER UNIVERSITY

BUTLER UNIVERSITY:

Harrison White & Bailey Sims

VANE UNIVERSITY – CELL CAPTIVE SOLUTION

Introduction

Vane University is a public educational institution constructed via historical land grants. The university and its property spreads over 4 physical campuses. The university is a large institution with an enrollment size of approximately 66,000 students and a staff headcount of around 24,000 members. The institution is also heavily involved in its surrounding communities. The university employs extension agents who provide a multitude of services to inhabitants in around 80 surrounding counties.

The university's operations are unique and varied; consequently, the corresponding risks of those operations share these characteristics. Risks arise from academic, research, and operational activities. Loss exposure is especially high and worrisome in some of Vane's everyday operations, such as student housing and food preparation. Additionally, the school's risks span across multiple, distinct campuses. The university must manage physical risks that rise out of their 4 main campuses, while also keeping a close eye on their off campus programs and investments and the risks borne out of those operations. These programs and the extension agent's employed by the school represent an especially difficult risk to quantify and understand, as they are entirely off site and may be more difficult to hold to existing risk controls and safety measures.

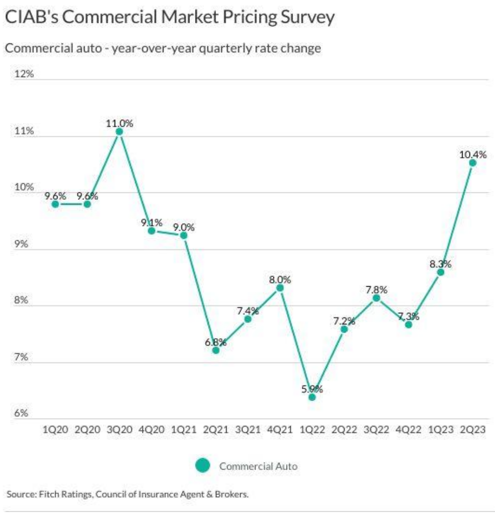
Additionally, the university retains a substantial risk by selling insurance products to third party insureds. The school exposes itself to potential large losses stemming from non-operational activities wherein they may not be able to effectively implement risk controls that standardize and monitor third party insured activities. In the event that a third party insured finds itself underinsured or approaching insolvency, the university's direct assets and personal insurance contracts may be at risk in a claimant lawsuit.

Specifically, the school carries general liability, auto liability, workers' compensation, and property insurance. As touched on earlier, they also sell these products to individual campus departments and third party affiliates. The school struggles with reaching capacity for its general liability and auto liability policies. They also struggle with rising premiums in those vicinities. It's attributable to increased frequency and severity of claims, as well as greater trends within the insurance marketplace. The university currently places all of these policies with a broker, through the traditional, commercial insurance marketplace.

Insurance Marketplace

The insurance market has been faced with a hard market due to the lasting effects of the COVID-19 pandemic including increased interest and inflation rates. These increases have had a large impact on commercial lines, leading to increases in claims costs and renewal premium rates. In fact, during the first half of 2023, an estimated $16,000,000,000 was paid out in additional claims costs. These additional claims costs led to a 14% increase in total claims costs, with a 30% increase in commercial property claims costs, driven by increases in inflation and catastrophic losses (Holzheu & Finucane, 2023). Commercial insurance segments have not only seen an increase in claims costs but have also seen an increase in premium rates and a reduction in coverage options.

Premiums have risen in all lines of commercial insurance, including auto and property. Commercial auto has seen significant increase in premiums due to the post-pandemic economic environment. Within the commercial auto insurance segment, there has been an increase in loss severity due to the higher inflation rates, supply chain and labor shortages, and increasing vehicle costs (Auden et al., 2023). The increase in loss severity has led to stricter underwriting guidelines, which in turn has led to an increase in renewal premiums. According to the Council of Insurance Agents and Brokers, since 2017 increases on renewal premiums average over 8%. In the second quarter of 2023, renewal premiums reached 10.4% (Auden et al., 2023). In the same quarter, commercial property premium rates increased 20%, while the average rate increase for all commercial lines was 8.9% (Holzheu & Finucane, 2023). The increase in claims costs and premium rates has made it more difficult for companies and businesses, including Vane University, to find adequate coverage at affordable rates.



Captive Marketplace

In hard insurance markets, corporations are compelled to think creatively about their insurance structure. They often experience issues with securing adequate capacity. Simultaneously, they face punishment through rate increases and more stringent underwriting. Friendly products are stripped from the market, making way for exclusion-laden, insufficient policies.

Within these environments, organizations are sometimes drawn to alternative forms of risk control. One possibility is for organizations to part with insurance, and retain all of their risk. This is extreme, but there are plenty of options in self-funding. These include arrangements such as risk retention groups, capital market risk transfers, and captive insurance companies.

Captives are insurance companies established and owned by a business or group of businesses to manage and underwrite their own risks. They exist for a number of reasons, but mainly to reduce reliance on external commercial insurers. Captives have been in existence for over 100 years, although the actual term was coined in the 1950s (NAIC). They represent a growing marketplace, too. In 1980, there were around 1,000 domiciled captive insurance operations in existence. Recently, that figure was tracked at over 7,000 captives in existence (NAIC). For a period of time, Bermuda was the only eligible place of domicile for these sorts of entities. However, there are now more than 70 jurisdictions with established legal frameworks for captives. The U.S. is at the forefront of this growth, as many states aim to attract new business and resources by establishing captive-friendly legislation.

Within the captive marketplace, there are a number of varied captive structures, each with its own structural and legal requirement differences. Single parent captives are wholly owned by the businesses that they insure. This structure allows the insured to set premium rates with more accuracy, customize insurance solutions through direct access to the reinsurance market, and establish a positive long-term cash flow through personalized risk management and loss control techniques. At the same time, single parent captives possess a higher barrier to entry due to rigid formation requirements and a high initial capitalization requirement.

Group captives are owned and operated by multiple insureds. Competitors within a common industry are one potential realization of this concept. These insureds pool resources together to devise a functional insurance company with all of the benefits present in single parent captives. Like competitors in a common industry, group captives are most effective when their insureds share similar risks or are in similar classes. Unlike single parents, group captives are less expensive to establish and they benefit from the law of large numbers. Apart from these two major types of captives, there are several other structures that fit the captive or near-captive classification. These include association captives, risk retention captives, and rental captives. The cell structure captive, or segregated account company will be explored in detail.

Proposition for a Captive Arrangement

Vane University would be well reasoned to enter the captive space. First, they hold the necessary premium size to make a captive investment attainable. Secondarily, they have experienced difficulties in reaching full capacity for their general liability and auto liability coverages. A captive program would enable them to converse with reinsurers directly, and establish towers with appropriate risk retention and risk ceding. Additionally, the university struggles with rate increases. Establishing a captive program should enable them to stabilize their annual premium rates to a higher degree. They may even garner underwriting profits should they effectively reduce risk and mitigate losses. Furthermore, the university's direct sale of insurance products to individual departments and third party affiliates is troubling, as it stands. It's inefficient and leaves the university potentially liable for claims made against these lower limit policies. This is not to mention that it opens the school up to a whole host of errors and omissions claims possibilities. As discussed later, a cell structured captive would directly remedy these issues.

Cell Captive Arrangement

While single parent captives are the most popular retention structure historically, recent market conditions and consumer demands have given rise to newer, more flexible arrangements (Canadian Underwriter). One notable design is the cell structure captive. It's one of the fastest growing captive arrangements. Marsh notes that the number of new cell captives sold and managed by their organization grew by 49% in 2021, alone.

The cell structure captive is traditionally linked to rental captive companies. It consists of a central core component and any number of separate individual cell components. The core is responsible for cell captive formation, governance, fronting company or captive management relationships, and other administrative functions. Meanwhile, these separate cells serve as distinct insurance captives for individual businesses or assets. They are initially capitalized and hold their surplus reserves at the cell level. Assets and liabilities between cells are segregated from one another via a concept called “ring-fencing” (KPMG). This means that cells are protected from each other. The core is also generally protected from actions of or against individual cells if non-recourse agreements are built into the captive’s structure.

As mentioned earlier, this structure is especially beneficial for smaller businesses looking to rent a captive. Organizations with less than $1 million a year in premium typically do not hold the financial resources requisite to incorporate and sufficiently capitalize their own captive operations. In the rental structure, captive managers, brokers, or others incorporate a cell structure, building out and taking responsibility for the captive’s core components. Once the core is complete, the captive owner may begin incorporating new, individual cell captives and start renting them out to organizations in a ready-made fashion. As a note, there are no hard limits on the number of cells allowed per core structure, and the process of scaling up is straightforward. In these arrangements, core-owning landlords receive steady payments from cell renters with minimal liability exposure of their own. In exchange, cell renters receive a functional captive vehicle that serves as a viable, near-term solution.

While the cell structure most commonly serves groups of smaller, independently owned organizations in cells, it is applicable in other scenarios, as well. For instance, a single large organization could look to implement a cell structured captive to insure its operational risks. In this particular scenario, the cell structured captive may be more appealing than a single parent captive if coverages and liabilities throughout the organization are heterogeneous. It also may be an effective scheme if a parent company holds several subsidiaries. In both instances, the large organization is able to divide dissimilar liabilities and their distinct funding into separate, segregated cells (American Bar Association). At the same time, the organization is able to control and customize the core structure of the overall captive to its liking. This approach successfully classifies and categorizes organizational risks, and effectively ring-fences independent coverages and subsidiary businesses. It also maintains the flexibility of the organization and leaves room for future expansion of captive operations. It even supports the addition of third party tenants into new cells, unearthing a new potential revenue stream for the organization (Captive International).

Proposed Program

Vane University most likely pays for more than $1 million in insurance premiums annually, so much of its framework fits within that of the hypothetical large organization discussed previously. In analyzing its risk exposures, a cell captive structure with 3 segregated cells and a main core best resolves the university's issues while fully employing the unique features of the particular structure.

Like theorized, Vane will first incorporate a core captive that links the branched cells and performs governance duties. Of its three cell captives, one will contain the university's property and worker's compensation coverages, another will involve their general liability and auto liability coverage, while the final will consist of their insurance policies written to external groups and third party affiliates.

The property and worker's compensation coverages will remain separate from the general and auto liability coverages because they should be easier to fund via reinsurance arrangements. At the moment, Vane does not have loss frequency or severity issues with either of the lines. In theory, they could remain exempt from the captive entirely and kept as commercial insurance policies. However, facultative reinsurance could be of use in the captive for the property risk, and especially with respect to the university's historic buildings. In particular, they may have features and nuances associated with reconstruction costs that are better suited for the non-admitted market. Additionally, if current property trends and carrier cutbacks continue, the preemptive placement of property within a captive arrangement could keep the university ahead of the market.

The second cell isolates the university's coverages with high frequency and high severity loss histories. Because they are having trouble securing adequate capacity in the admitted market for general and auto liability, the cell should enter an excess of loss treaty with a reinsurer, for occurence losses over $1 million dollars. Anything beneath this threshold should be retained by the university, as the funds that used to flow out as premiums will now be redirected to fund these lower severity losses. It almost acts as a high deductible policy and if the university is able to effectively lower the frequency of its losses through proper risk controls, the redirected funds will remain as invested assets in the cell, rather than persisting as a premium payment and a cash outflow.

Before advancing to the third cell and its structure, it's important to highlight a few more benefits to the creation of the first two cells and their subsequent segregation by loss experience. First, the separation of problematic coverages from low loss coverages creates more clarity for the organization. When the failures of one cell are directly compared to the successes of another, there should be more of a visceral reaction and desire to implement loss controls internally. The losses cannot be hidden. Continuing, the use of multiple cells allows the organization to manipulate initial capitalization rates and surplus commitments slightly. Because each cell is only responsible for its own assets and liabilities, capital commitments could be theoretically staggered as capacity is scaled up slowly over time. Another benefit of the cell segregation is the potential to offset profits and losses from either account in dividend distribution. Extending further, the presence of two cells allows for creativity in dividend distribution, as different rules may be set for each cell. An additional related benefit is the ability to implement different investment strategies. Not surprisingly, cell captives are not just found in insurance operations, but also have extensive application in a multitude of wealth management and general investment capacities.

The third cell is pivotal and marks the most important segregation of components within the university's captive program. Here, the organization's class of third party policies issued to business partners and outside programs will be deposited. These policies are important to separate because they represent an entirely different risk. It is simply a good protective measure for the university to separate its personal liabilities and retention funds from those of the third party. As discussed earlier, a core value of the captive structure is in its ability to ring-fence one cell and its contents from another. In addition to the exposure reductions, the creation of this third cell allows for separate reinsurance measures. In this cell, the university may even consult its third party insureds as to their preferences for a reinsurance arrangement. As a note, cell captives are gaining popularity in the MGA world, and even have their own term; companion cells (Captive International). This particular university operation definitely shares some characteristics with MGAs.

Beyond base captive structure determination, the decision of whether to directly issue policies or use a fronting insurer is also important and plays a fundamental role in shaping the overall captive arrangement. In this scenario, it is advised that the university implement a fronting insurer arrangement. The fronting insurer should help provide expertise in areas of compliance and allow the captive to use its paper for a small percentage fee.

Domicile

As mentioned earlier, the captive industry is experiencing growth, with many new jurisdictions amending legislation to achieve domicile status. While recent legislative changes offer interesting opportunities for choosing domicile locations, it is advisable for the university to designate operations in a location with a proven history of legal judgments that support captives.

Bermuda is the oldest domicile for captives. It is also one of the largest, with 715 captives recognized in 2019 (KPMG, 2017). Bermuda has a large wealth of captive management and consultant talent, as well. This is important as the university looks to identify a fronting insurer partner to write for its cell structured captive. That relationship is key as fronting partners often advise on policy administration, cash flow management, claims management and an array of general administrative functions.

As specifically applies to cell structured captives, the Bermuda Supreme Court formed a precedent in 2010 by validating the concept of ring-fencing and segregation of assets between cells (Aon). This precedent distinguishes Bermuda from its peers, as not all jurisdictions have as clear of a view established on the matter. As a note, Bermuda references cell structured captives as SACs, or Segregated Account Companies. Terminology varies amongst domiciles.

Initial Capitalization

The cell structured captive has a unique capitalization structure in that each cell must capitalize based on the individual risk that it retains. Initial capitalization ensures that liquidity is maintained during the early stages of captive formation. According to Bermuda insurance licensing law, the university may fall within a class 2 license, as only a small portion of their premium comes from third party risk. Under this license, the university must maintain a minimum capital and surplus equal to or above the amount of premium collected, beyond a $250,000 floor (Bermuda Monetary Authority).

Risk Management Techniques

As premium prices continue to increase due to inflation and catastrophic losses, it is important for Vane University to have a risk mitigation plan in place to prevent losses from occurring. In fact, the National Institute of Building Sciences reported that spending $1 on hazard mitigation can lead to saving up to $13 in repair and recovery costs (Bryant et al., 2023). It is important to assess the university's risk exposure in terms of liability and property. As a university, many people visit the campus on a daily basis. Whether it's a student going to class, alumni coming to sporting events, a prospective student on a college visit, or a member of the community walking the campus, it is crucial to understand where and when accidents can occur and have proper signage or items available to notify the individuals of the present risk. It is also important to have the university's property properly valued in the case of a loss to ensure that the university has proper coverage limits in place. In fact, since the increases in inflation and supply chain constraints which have caused property values to rise, many colleges and universities have not updated their property values, leaving them underinsured (Bryant et al., 2023). Since Vane University has many historic buildings, including some on the National Register of Historic Places, it is even more crucial that the university continues to regularly assess its property values as it may impact the replacement and reconstruction costs if a loss were to occur. Implementing a captive insurance operation will not only allow Vane University to have access to the reinsurance market, but it will also increase the university's capacity allowing it to have more coverage for its liability and property (Bryant et al., 2023).

Conclusion

All concluded, establishing a captive insurance arrangement is a worthy pursuit for Vane University. In partnership with reformed loss controls, the cell captive structure will enable the institution to reach full insurance capacity while stabilizing annual premium rates.

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Temple University Team

Gracie Law

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

The CICA essay contest was an excellent opportunity to learn and grow as a young professional.

Risk management is a fascinating industry, so the essay contest was the perfect chance to expand my knowledge of captive insurance programmes.

As a curious student, I do my best to take advantage of every learning opportunity, so this was no different.

How was captive insurance helpful for your chosen organisation?

Our chosen organisation was Vane University, a large fictional institution, so establishing a captive insurance programme tailored for Vane tackles the challenges of securing higher coverage limits and rising premiums.

A single-parent captive is a proactive and strategic risk management tool that provides Vane with increased control, the potential for cost savings, and improved overall risk management capabilities in a dynamic environment.

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

I gained insight into how captive insurance programmes can customise solutions to match an organisation's distinctive risk profile and the potential financial benefits of a successful captive programme.

During the essay's research portion, I enjoyed learning about the regulatory framework that oversees captive insurance.

How does your expanded knowledge of captive insurance compare to your understanding before entering the competition?

Before entering the competition, I was only familiar with the basics of captive insurance. I now have a deeper understanding of the financial considerations, tax implications and effective risk management strategies involved in establishing a captive insurance programme.

Would you consider a career in captive insurance? What about captive insurance appeals to you as a career choice?

After this invaluable experience, I am interested in a career in captive insurance because I enjoyed learning about the regulatory and financial aspects. I am excited to begin my career at Munich Re on the claims track post-graduation, but I plan to continue learning more about captives throughout my career. A career in captives is intriguing because it is a creative and growing tool utilised in the risk management landscape.

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

Temple University's risk management and insurance programme stands out as one of the best in the country, offering a diverse range of risk management courses that provided me with a solid foundation in the fundamentals of the captive insurance industry.

The Gamma Iota Sigma, Sigma Chapter has also provided various opportunities to learn more about captives through presentations from industry professionals and insight into a career in captive insurance. Sandy Bigglestone, the Deputy Commissioner of Captive Insurance from the Vermont Department of Financial Regulation, will be presenting about her experience in the captive industry for our H. Wayne Snider Distinguished Guest Lecturer Series this semester. I am excited to hear about her career and learn from a powerful woman in the captive industry. ■

Gracie Law

Gracie Law is a senior majoring in risk management and legal studies at Temple University. She serves as the vice president of the Risk Management and Insurance Career Development committee for Temple University's Gamma Iota Sigma chapter. After graduating from Temple, she will join Munich Re's International Graduate Trainee programme in Philadelphia as a claims trainee. Outside of her studies, she enjoys working out, cooking and travelling.

Temple University Team

Sofia Davis

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

While entering the world of insurance, I encountered challenges in understanding the complexities of the captive industry. The CICA Essay contest piqued my interest as an opportunity to tackle this difficulty head-on. Participating in this competition would deepen my insights and contribute to my professional growth in navigating risk management challenges within the insurance sector.

How was captive insurance helpful for your chosen organisation?

By implementing a single-parent captive insurance programme, Vane University was able to approach its insurance challenges by designing unique policies to mitigate their specific liability risks. The single-parent captive allows the university to exercise greater control, achieve cost savings over time, and enhance its overall management of handling risks.

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

During my research, I gained a comprehensive understanding of the specific steps involved in conducting a feasibility analysis and how crucial this process is to developing a successful captive insurance programme.

How does your expanded knowledge of captive insurance compare to your understanding before entering the competition?

Considering the initial challenges I faced in navigating the captive industry, my participation in the CICA Essay contest has been instrumental in broadening my knowledge of captive insurance and its intricacies. I now feel confident in my understanding of captive insurance, which I look forward to applying in my career.

Would you consider a career in captive insurance? What about captive insurance appeals to you as a career choice?

I am very satisfied with my full-time position at Conner Strong & Buckelew post-graduation, and I anticipate a long-term commitment to the company.

Given Conner Strong & Buckelew's dedication to providing optimal risk management solutions to clients, it is crucial to have a deep understanding of captive insurance programmes.

That being said, I plan to further my education on captives and collaborate closely with captive insurance experts throughout my career to ensure I provide top-tier service to our clients.

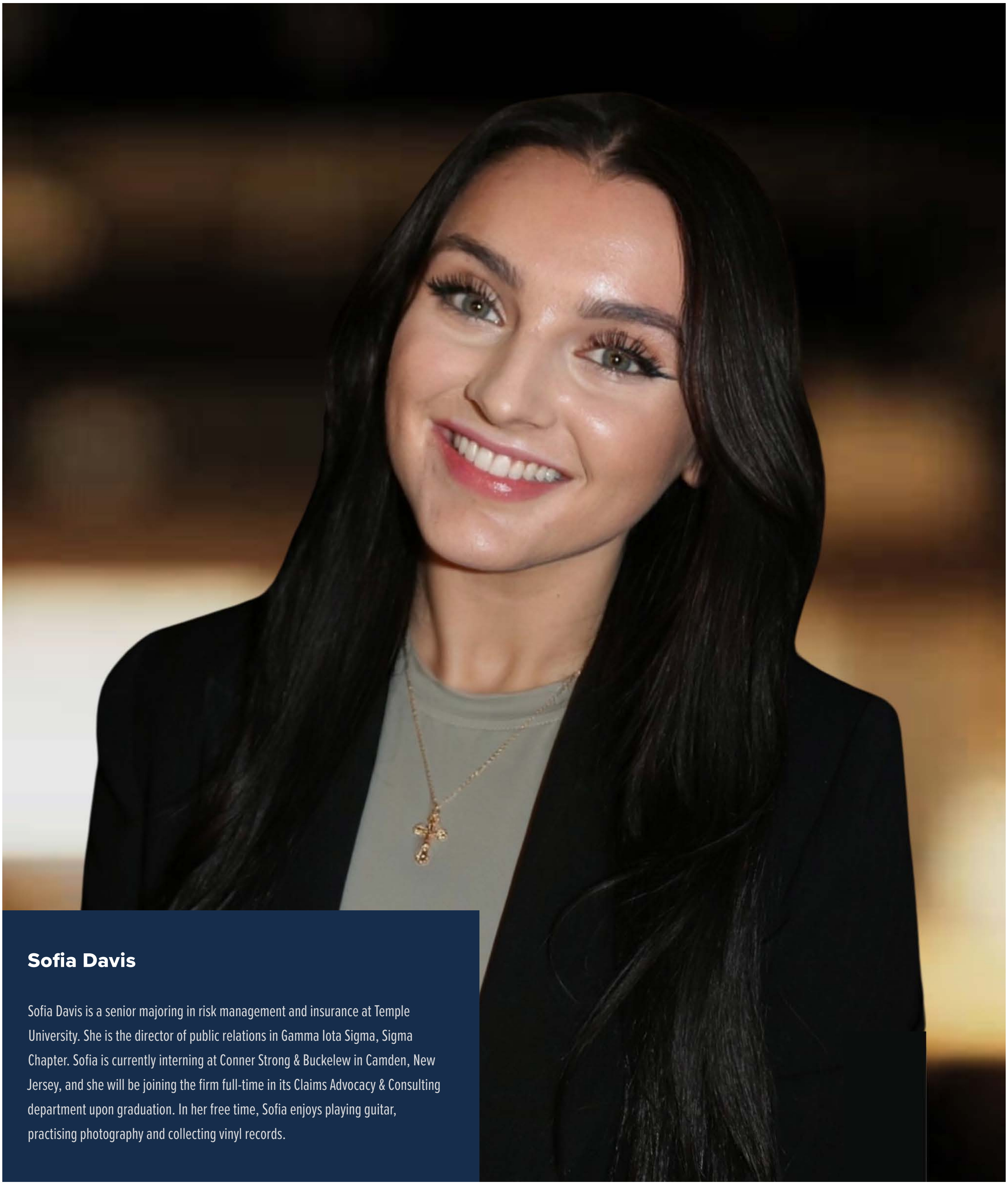
How does your college coursework align with a career in captive insurance?

My college coursework aligns seamlessly with a career in captive insurance.

Being a risk management and insurance major with a concentration in managing corporate risk, my classes are designed to equip students with a thorough comprehension of risk management in complex global organisations.

The curriculum includes specific courses that delve into financing techniques within the property-liability insurance industry and identifying and managing emerging risks.

Temple provides an excellent academic foundation that directly supports the skills and knowledge essential for a successful career in the field of captive insurance. ■



Sofia Davis

Sofia Davis is a senior majoring in risk management and insurance at Temple University. She is the director of public relations in Gamma Iota Sigma, Sigma Chapter. Sofia is currently interning at Conner Strong & Buckelew in Camden, New Jersey, and she will be joining the firm full-time in its Claims Advocacy & Consulting department upon graduation. In her free time, Sofia enjoys playing guitar, practising photography and collecting vinyl records.

2023-2024

CICA STUDENT ESSAY CONTEST

Captive Insurance Solutions for Today's Risk Management Challenges

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Temple University
Fox School of Business

TEMPLE UNIVERSITY:

Gracie Law & Sofia Davis

VANE UNIVERSITY – SINGLE PARENT CAPTIVE SOLUTION

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Introduction

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Vane University offers its students a spacious campus with a rich history, standing tall for over two centuries as a distinguished public institution. The vulnerability of Vane's expansive historical campus has led the university to face recurring challenges similar to those of many other organizations. With the increasing frequency and severity of claims surrounding its general and vehicle liability exposures, affordable and accessible insurance has been challenging to obtain within the standard insurance marketplace. Statistics project that the insurance market will continue to harden in 2024, and the demand for catastrophe reinsurance alone is likely to grow as much as 15% (Deloitte, 2023). With the current and projected state of the market, it would be beneficial for Vane University to implement a captive insurance program.

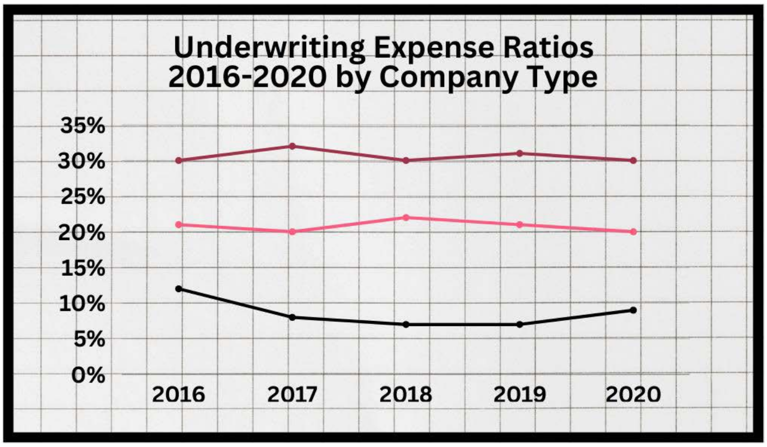
Captive insurance programs offer many benefits to organizations that are less obtainable within the standard insurance market. The interest in using captives is higher than ever, considering its risk funding vehicles have numerous advantages. Captives allow flexibility and control over coverage capacity, operating costs, access to reinsurance, and more. Given Vane's concerns, a single-parent captive program structure will benefit the university, efficiently address the university's increasing frequency and severity claims, and secure higher coverage limits for the university's vast array of liability exposures.

Risk Analysis:

General Liability:

The higher education risk management landscape has grown increasingly intricate due to evolving regulations and legal liabilities. Critical liability risks for universities nationwide are claims stemming from violations of the Americans with Disabilities Act (ADA), sexual abuse and molestation, admission scandals, and Greek life hazing. Universities are highly susceptible to ADA violations, and this exposure stems across various campus operations, such as not providing accommodations for campus facilities, academics, athletics, information technology, dining halls, etc. Another liability exposure for Vane is tort claims because of the university's "obligation to provide a "reasonable duty of care" as "landowners" to those they invite or authorize to use their facilities—like student-athletes" (University Business, 2016).

Vane can secure higher coverage limits through a single-parent captive and combat the increasing liability insurance costs. The average expense ratio for large captives from 2016-2020 was 8% compared to 31% for conventional insurance providers (McMahon & Provines, 2021). The single-parent captive for Vane is likely to maintain an underwriting expense ratio comparable to the industry standard for large captives.



The industry-wide increase in commercial insurance pricing is another reason for utilizing a single-parent captive for its general liability exposure. Commercial insurance prices across the U.S. showed an aggregate increase of just above 6% in the second quarter of 2023 (WTW, 2023). The captive will allow Vane to avoid the increase in pricing and any unforeseeable economic impacts in the future.

Vehicle Liability:

The single-parent captive will also address Vane's concerns regarding market challenges arising from the growing frequency and severity of claims associated with vehicle liability coverage. The commercial auto insurance sector has faced rate increases for the past decade because inflation, supply chain constraints, and greater use of technology have added costs to physical damage losses (Lerner, 2023). The captive program will insulate Vane from market conditions and allow greater control through better managing premium volatility year to year. The university likely has a sizable auto fleet of at least a thousand vehicles, ranging from shuttle buses, maintenance and service vehicles, standard sedans/compact cars, vans, and emergency response vehicles. Vane's auto liability exposures include property damage, bodily injury, and legal liability.

Property damage would cover physical damage to other vehicles and non-university property. Vane can also consider extending property damage coverage to university-owned property losses in the event of an accident. The university's workers' compensation policy would cover bodily injury for Vane's staff; therefore, the captive will provide bodily injury coverage for individuals not employed by Vane. In the event that Vane is found negligent for an accident involving a non-university employee on the job, the insurance company of the non-university employee is likely to seek reimbursement through subrogation for any worker's compensation claims resulting from the accident. In this circumstance, the vehicle liability coverage within the captive can provide coverage to the insurance company seeking compensation.

Property and bodily injury losses can result in legal disputes; therefore, the captive would cover any potential legal issues. Vehicle operation liabilities pose a substantial risk for Vane, but a single-parent captive can precisely tailor coverage to match the university's exposure.

<u>Advantages & Disadvantages of Single-Parent Captive:</u>

Single-parent captives allow a parent company to own, finance, and control its captives for itself and other affiliates. Studies have shown that single-parent captives have continuously outperformed both the commercial insurance market and the overall captive sectors due to their flexibility and control factors (Wright, 2015). Factoring in the diverse risks and loss exposures universities can encounter, the single-parent captive will give Vane complete control during the captive customization process and allow Vane to tailor its coverage to its specific needs. In contrast to group captive structures, using a single-parent captive structure allows for a quicker implementation process. There is no requirement to partner with other companies with similar risk appetites, so there is no discussion of risk transfer levels and profit/loss sharing (Wright, 2015).

Another benefit lies in Vane's ability to generate profits through underwriting and investment income. When the premium exceeds the incurred costs, the captive retains underwriting profits, which can later be transferred as dividends or bolster Vane's financial strength. Vane also has the freedom to decide how to invest its premiums and surplus, and this is critical because these opportunities are not available with coverage through the traditional insurance market.

The downsides to a single-parent captive include the initial capitalization and start-up costs. Starting a single-parent captive structure can be expensive due to the significant initial capital, legal and consulting fees, and regulatory filing fees (West Group, 2023). The high initial costs may be unappealing in the early stages of the captive development process. However, Vane can offset these costs over time through reduced insurance premiums and improved risk management. Another downside is that Vane is taking on the risk of being the sole coverage provider instead of pooling and sharing it with other companies. The university might need to pay more attention to its level of protection, which could lead to insufficient reserves, resulting in inadequate protection. The benefits of a single-parent captive far exceed the drawbacks. With a well-established captive board, the university can anticipate only positive outcomes following the implementation of its captive.

Feasibility Analysis:

The university will perform a feasibility study to determine whether a single-parent captive is the proper risk financing tool to fulfill its objective. It will include a "comprehensive analysis of the captive's legal form, insurance program structure, domicile selection, capitalization, and regulatory and tax issues" (Aon, 2023). To conduct the analysis, the university must gather current and projected exposure values, its five-year loss history by line of business, annual reports or financial statements, copies of current policies, and a premium and claims services payment schedule (IRMI, 2023). The study's results will serve as a baseline for designing and implementing the captive.

Single-Parent Captive Operating Structure:

Captive Management:

Vane University will establish the single-parent captive as a separate legal entity and have full ownership and control of the captive program. The program will have a captive manager who plays a vital role in its development and success. A captive manager brings the following areas of expertise: accounting, actuarial, domiciliary regulatory, investment management, pricing and underwriting, and potentially tax (IRMI, 2019). In conjunction with the captive manager, Vane will strategically integrate a third-party administrator (TPA) into its framework. A TPA will contribute specialized services to the captive, such as claims administration and risk assessment. Vane will also obtain external partners, including a broker, banking/investment manager, legal counsel, tax consultants, an auditor, and an actuary. All of these parties will work closely together to ensure smooth operations and regulatory compliance within the captive.

Domicile:

To determine where to domicile the captive, the captive manager will utilize the feasibility analysis to evaluate each potential state's advantages and disadvantages carefully. Key domicile decision factors include the regulatory environment, such as the solvency requirements, ease of doing business, the flexibility of insurance regulations, and the considerable latitude in the scope of allowable investments. (McArdle, 2023). Financial considerations include capitalization requirements, time and travel costs, taxation policies and incentives offered to captives, and licensing/regulatory fees. Another critical factor is the captive market presence in the domicile and considering the overall reputation and credibility of the jurisdiction. Finally, we want to consider the quality and expertise of local infrastructure and services (WTW, 2023). Considering all these factors, our final choice was utilizing Vermont as our domicile.

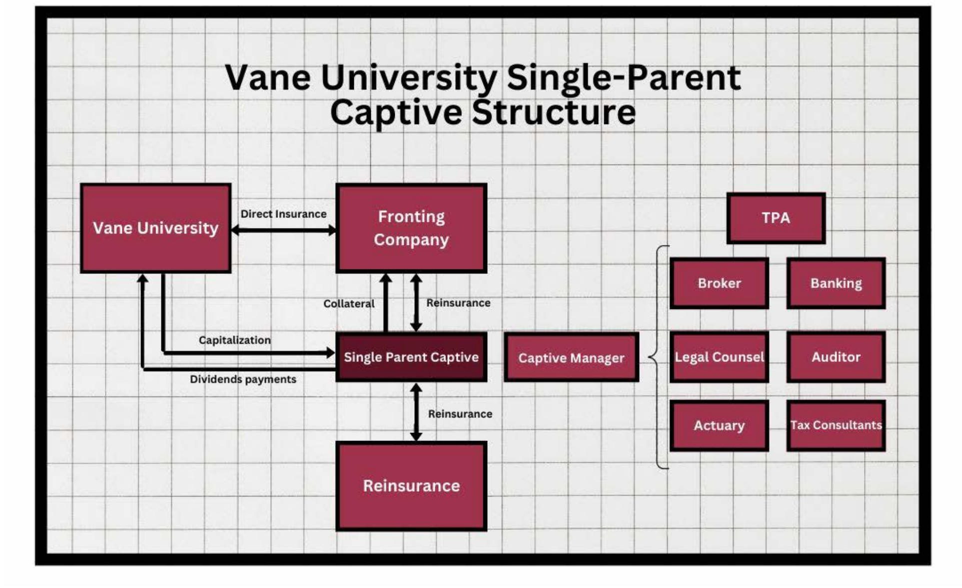
Vermont has been a popular domicile for captives and maintains its status as a reputable domicile acknowledged by captive owners, brokers, regulators, and industry stakeholders. Vermont received multiple awards in 2022 and was named "Domicile of the Year - Highly Commended" (Captive International, 2023). At the end of 2022, Vermont had 639 active captives, and 410 were single-parent captives (Captive International, 2023). It has a history of striving for progress and innovation through unparalleled governmental support. The state's "captive laws are reviewed and revised regularly; a necessity to keep pace with the fast-changing needs of the industry" (Vermont Captive Insurance, 2023). Additionally, Vermont has a unique infrastructure that provides "in-house staffing of examiners and support personnel," and the state's "captive insurance regulators can efficiently process licensing applications, approve business plan changes and answer inquiries in a timely fashion" (Vermont Captive Insurance, 2023). Other reasons we selected Vermont include its competitive costs, gold-standard reputation, an extensive network of experienced captive service providers, and accessibility of service providers and captive regulators.

Risk Transfer Partners:

The university must partner with a fronting company, given that Vane would be considered an unlicensed and unadmitted insurer outside the Vermont domicile. The fronting company that Vane selects must be a licensed insurer that will guarantee compliance with state regulations and financial responsibility laws. The role of a fronting company is to issue Vane an insurance policy, establishing evidence that the coverage offered by the captive is backed by a licensed and admitted insurer. This eliminates the need for the captive to obtain licenses in every state where it operates.

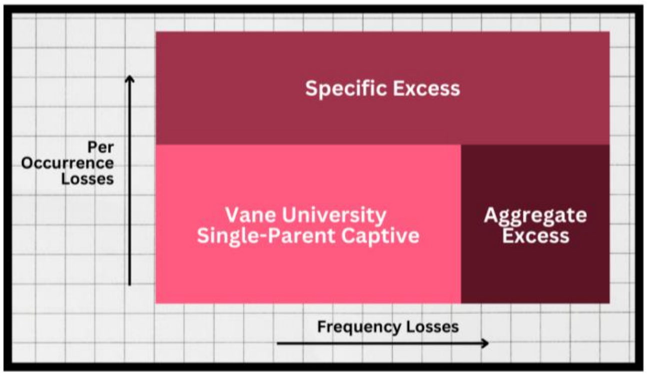
Although the fronting company does not intentionally transfer any risk, they are held responsible for providing financial backing if the captive encounters a significant loss it cannot indemnify. Due to the possibility of risk transfer, the fronting company will require collateral and charge the university a service fee. Collateral is an essential aspect of risk management for both the fronting company and the captive. Collateral requirements are typically outlined in the fronting agreement, and the specific terms will depend on factors such as the captive's financial strength, the nature of the risks being underwritten, and the regulatory environment in the domiciles involved.

Typical service fees can range from 5% to 10% of the premium written by the fronting company (IRMI, 2023). To avoid potential issues, Vane will select a respected fronting company that provides an innovative and highly customized program to conquer and manage complex insurance claims. Therefore, Vane can anticipate the fronting service fee to reach 10%.



Reinsurance:

Due to the possibility of the university incurring losses that exceed the captive's coverage limits, Vane will establish a comprehensive reinsurance program. The reinsurance contract will outline the reinsurer's responsibility for losses beyond a specified threshold and establish the maximum level of risk the reinsurer is willing to undertake on behalf of Vane's captive. Determining the degree of risk transfer is crucial to protect the reinsurance company from assuming unlimited liability. The coverage limits will be defined separately for specific reinsurance and aggregate reinsurance. The specific reinsurance coverage will specify the per-occurrence limits that the reinsurer will indemnify in the case of an individual loss exceeding the captive's retention.



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On the other hand, the aggregate reinsurance coverage will specify the maximum total coverage that the reinsurer will provide within a policy year. This method guarantees transparent handling of significant individual losses and the total losses during the policy duration. To reduce the level of premium charged by the reinsurer, Vane will retain higher limits within its captive coverages, decreasing the probability of reaching the reinsurance attachment point.

Financials:

Initial Capitalization:

Costs to consider include Vermont's required $250,000 minimum capitalization fee, the initial and annual license fee of $500, and the actuarial application review fee of $6,000. Although $250,000 is the minimum amount required to fund a captive, it is recommended to possess capital amounts equivalent to a percentage of Vane's written premium. Estimating the premium amount for the captive involves analyzing extensive information. The appointed actuary will assess the suitable underwriting amount by reviewing Vane's previous loss history and current loss exposures.

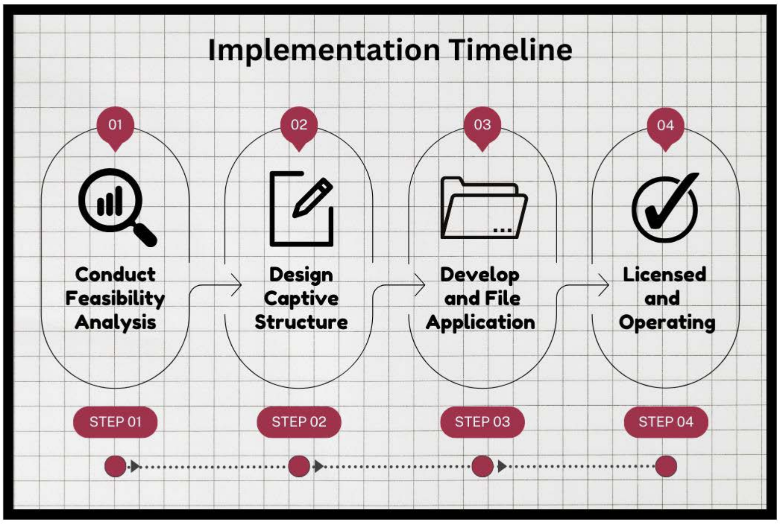
Vane generates money through endowments, gifts, tuition and fees, athletics, and grants; therefore, it has the financial strength to maintain and operate a single-parent captive program. The average revenue from tuition and fees for public universities is $8,720, so Vane's annual revenue would be estimated to be $575 million from tuition and fees (NCES, 2023). Considering the various sources of revenue, Vane is likely to have the financial strength and available capital to utilize a single-parent captive successfully.

Taxes:

The captive insurance premium is being taxed and has different rates depending on the total amount of premiums. For example, "0.38% on the first $20 million; 0.285% on the next $20 million, 0.19% on the next $20 million, 0.072%" (State of Vermont, 2023). Vane will have the opportunity to receive a $5,000 new captive tax credit in the first two years of licensure. The tax rates for a single-parent captive domiciled in Vermont include a minimum of $7,500 and a maximum of $200,000 (Captive International, 2023).

Implementation:

Vane University can begin with the implementation process when the feasibility analysis is complete, and the desired captive structure is selected. The implementation process involves submitting an application and "filing the necessary documents at the domicile of choice with the help of selected members of the management" (Zurich, 2022). Vane can expect this process to take up to 30 days. Once the documentation is submitted and the application is approved, the regulators will issue Vane University a captive license to fund its newly opened bank account and begin operating as a single-parent captive insurance company.



Risk Management Considerations:

Vane should invest in specific risk management tools to leverage the single-parent captive for short and long-term gains. Loss prevention tools for vehicle liability include introducing driver training and safety programs, conducting regular vehicle maintenance checks, utilizing telematics and monitoring systems, and formulating a comprehensive emergency response plan outlining procedures for accidents, breakdowns, and unforeseen occurrences.

For the university's general liability exposures, we recommend that Vane develops and enforces clear policies addressing ADA violations, administration practices, sexual abuse and molestation, and hazing within Greek life. Vane should provide easily accessible channels where students and staff can confidentially report any instances linked to its liability exposures and ensure that all reports receive prompt attention and undergo a thorough investigation. Lastly, we suggest that Vane implement a surveillance plan, including a security team and cameras to monitor and observe the various operations and activities on campus. These risk management recommendations will help minimize Vane's total cost of risk by decreasing the frequency and severity of claims.

Conclusion:

Implementing a single-parent captive insurance program will address the specific insurance challenges faced by Vane University and provide a proactive and strategic approach to risk management. With the single-parent captive, Vane can design unique insurance policies to mitigate the liability risks associated with its large student population and historic campus buildings. Following a successful year of operation, Vane can explore incorporating its workers' compensation and property insurance policies into the captive structure. Despite already securing cost-effective and accessible policies for these coverages, consolidating all loss exposures within its single-parent captive can further reduce premium and administrative costs. In conclusion, Vane University's newly-formed captive positions itself to exercise greater control, achieve cost savings over time, and enhance its overall management of handling risks in the ever-changing world of liability issues.

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Middle Tennessee State Team

Brian Dunn

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

CICA is known for its commitment to accessing and providing opportunities for the upcoming generation.

I value this purpose as a young professional, so I jumped at the opportunity to be a part of this contest. The future is us and we are grateful to be involved in this process.

How was captive insurance helpful for your chosen organisation?

Captive insurance was helpful for our chosen organisation because it allowed them to find solutions to limitations that were faced in the commercial insurance market. In our case, the main struggle was the coastal commercial property market. The implementation of a captive insurance company will help our organisation to better navigate and manage risk.

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

While researching and writing our essay, I learned that there are multiple paths to success through the utilisation of a captive.

As humans, we want to recognise decisions as correct and incorrect. However, captives offer the flexibility to create a plethora of solutions.

There is a creativity piece when it comes to developing a captive that is like the creation of any new business. It is likely that if we asked a group of 10 captive professionals to individually develop a plan for one captive, that they would provide 10 different answers. Each developed plan has its benefits and opportunity costs.

How does your expanded knowledge of captive insurance compare to your understanding before entering the competition?

Participating in this competition forced me to contemplate the details of a captive insurance company in a comprehensive way. Before this process, I had very minimal exposure to captive insurance except for concepts I studied at MTSU and in courses offered by The National Alliance.

While these experiences offered a solid foundation, I discovered that a captive is composed of many working parts that require diligence to function properly.

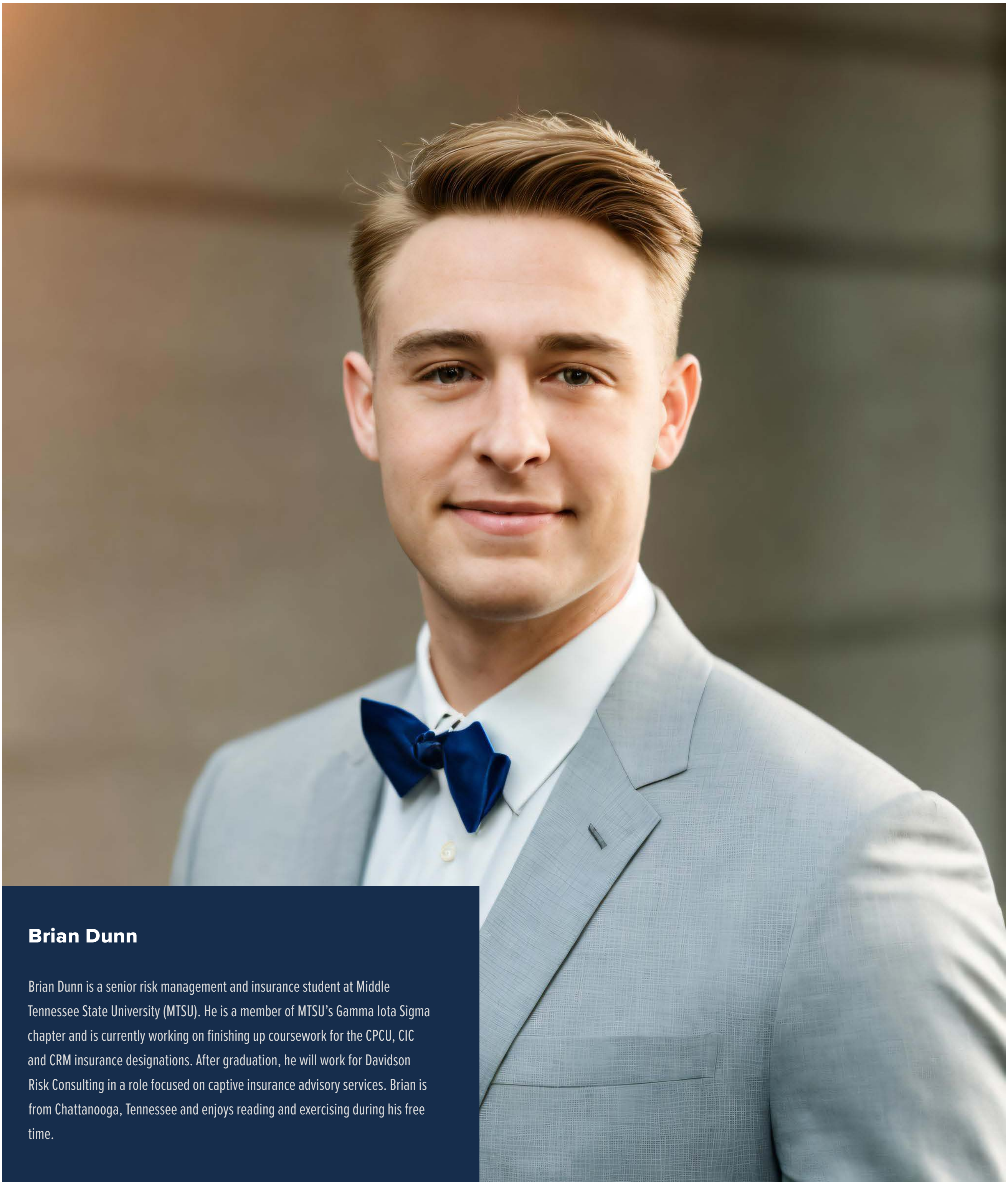
Would you consider a career in captive insurance? What about captive insurance appeals to you as a career choice?

I would consider a career in captive insurance because it offers a role in helping businesses protect their assets and prosper. No two captives are exactly the same, therefore no two days on the job will be exactly the same.

If captive insurance was well filled with information and discovery, it would never run dry. I am looking forward to the breadth of knowledge that I will learn about various industries as I help the businesses within them.

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

Middle Tennessee State University's risk management and insurance programme understands the importance of captive insurance in the commercial space. The professors make sure that students understand the many alternative risk transfer options that can supplement traditional insurance. Students are given the opportunity to attend our state's annual captive insurance conference and to connect with professionals in the industry. ■



Brian Dunn

Brian Dunn is a senior risk management and insurance student at Middle Tennessee State University (MTSU). He is a member of MTSU's Gamma Iota Sigma chapter and is currently working on finishing up coursework for the CPCU, CIC and CRM insurance designations. After graduation, he will work for Davidson Risk Consulting in a role focused on captive insurance advisory services. Brian is from Chattanooga, Tennessee and enjoys reading and exercising during his free time.

Middle Tennessee State Team

Rose Gendy

Rose Gendy is a recent graduate of Middle Tennessee State University (MTSU). She graduated in December 2023 with a risk management and insurance degree. She was involved in MTSU's Gamma Iota Sigma Chapter. She interned with HUB International last summer and is now working full-time there. She is in the process of getting her P&C licence. Rose is from Cairo, Egypt and enjoys cooking and spending time with her family.

"Captive insurance provides alternative plans of action to handle the market pattern of insurance"

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

I heard about this competition last year through social media and that is what got me interested in it.

I thought it would be a cool experience to enter this competition.

How was captive insurance helpful for your chosen organisation?

Captive insurance was helpful because it helped them find solutions that are not available in the current commercial market.

They also have the ability to make risk management decisions that could benefit the operations of their company.

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

I learned that captive insurance can be beneficial as a risk management tool and the process of creating a captive.

How does your expanded knowledge of captive insurance compare to your understanding before entering the competition?

Before entering this competition, I did not know too much about captive insurance, but it sure has surprised me. It is interesting how it creates its own insurance to provide for risks associated with the business needs and operations.

Would you consider a career in captive insurance? What about captive insurance appeals to you as a career choice?

I found captive insurance appealing because of the fact that it has its flexibility. Captive insurance provides alternative plans of action to handle the market pattern of insurance. Of course, like everything else it does come with its advantages and disadvantages, but I would consider a career in it if I had the opportunity.

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

Courses that relate to risk management typically provide us with a solid foundation in understanding risks which is very crucial in that field. It is also crucial in captive insurance. What I have learnt in my college coursework relates to captive insurance with just slight differences. ■

2023-2024

CICA STUDENT ESSAY CONTEST

Captive Insurance Solutions for Today's Risk Management Challenges

3

MIDDLE TENNESSEE STATE UNIVERSITY

MIDDLE TENNESSEE STATE UNIVERSITY:

Brian Dunn & Rose Gendy

LOVEIT! RENTALS – SINGE PARENT CAPTIVE SOLUTION

Introduction

LoveIt! Rentals is a Florida-based company that leases coastal vacationing properties to groups of 10 or more. The company has 100 rental properties along the coasts of Alabama, Georgia, Florida, North Carolina, and South Carolina. Most rental listings feature a private swimming pool. The core of their business plan is to provide affordable, pet-friendly rentals that differentiate through top-notch customer service. This focus is driven by 350 full-time employees who support bookings and rental activities.

LoveIt! Rentals (LoveIt!) has demonstrated interest in exploring the implementation of a captive insurance program to reduce their overall cost of risk and help resolve issues they currently face in the commercial market. LoveIt! has reported a 26% increase in commercial property premiums this year. Carriers are forced to reduce coverage limits and scope provided to limit coastal exposure. Property is not the only coverage line the company is struggling to renew; excess general liability coverage is proving difficult to obtain. Together, these two risks are accounting for higher expenses this year, and LoveIt! may be forced to forego necessary investment activities to afford its insurance premiums.

Analysis of Risks

Commercial Property

Commercial Property experienced a double-digit price increase during the first two quarters of 2023 (WTW). These increases continue the trend of a hardening market and make renewal difficult for insureds like LoveIt!. Significant named storm and flood exposure due to their spread of locations within five minutes of the beach is a risk that insurers are hesitant to write, even while charging a premium rate. The 26% premium increase that LoveIt! faces results from catastrophic losses and the reinsurance response for carriers to protect themselves from insolvency.

High-severity catastrophic losses in areas prone to natural disasters occur more frequently due to climate change. In 2022, Hurricanes Ian and Nicole made landfall in Florida, resulting in separate billion-dollar losses. This year, Hurricane Idalia has been one of the 25 catastrophic events with losses exceeding $1 billion in the United States (NOAA). Catastrophe loss from named windstorm events necessitates higher premiums and more stringent underwriting standards. To mitigate loss, many reinsurers are withdrawing from underwriting property risk, creating a capacity crunch, reducing the limits of liability that the commercial insurer can underwrite, and consequently, higher pricing. The effects of limited coverage and increased reinsurance rates are passed directly to commercial consumers like LoveIt!.

After the catastrophic event, the increased cost of building materials and skilled labor leads to higher replacement cost values and costlier claims. Construction costs increased by 14.1% in 2022 and are expected to increase by 2-4% in the following years (CBRE). Rising commodity costs, increasing demand, supply chain issues, and skilled labor shortages drive these costs. As costs drive insurable values up, insurers must increase premiums to offer a higher level of indemnification.

Excess General Liability

Excess general liability coverage faces similar issues, leading to limited coverage and increased premiums for LoveIt!. Social inflation is when an insurer’s claim costs rise above general economic inflations. This results from unusually high jury awards, long-tailed legal proceedings, and, in some cases, the rollback of State Tort Reform. A contributor to the social inflation issue is the emerging third-party litigation finance (TPLF) industry in the United States. Corporations and other institutional investors provided $17 billion dollars for litigation in 2020 (Holzheu 2021). TPLF funding is enabling a larger number of legal cases that result in exhaustive, expensive settlements. As a result, liability consumers such as LoveIt! Rentals are finding it harder to obtain coverage and are seeing increasing rates from carriers.

LoveIt! faces company-specific exposures, causing it to be classified as a riskier-than-average insured. A fundamental part of LoveIt!'s business model is that they rent to large groups of people, have swimming pools, and allow pets. Such risks have unique profiles that enhance the likelihood of a general liability loss. Having swimming pools on the rental property creates the risk of accidental drowning and increases the probability of slip-and-falls. Insurance companies view pools as an "attractive nuisance," meaning they tend to attract children and create a dangerous situation. The swimming pool risk, added to the fact that ten people can occupy the house, leads to a greater chance of liability accidents. These exposures are dear to the business plan and must be adequately insured, not avoided.

Captive Benefits

There are a multitude of reasons why over 7,000 captives are functioning globally, and 90% of Fortune 500 companies utilize a captive (NAIC). Above all else, a captive is a risk management tool offering greater flexibility to tailor coverages for their insureds. Endless possibilities and combinations of risk transfer exist; making the captive unique, for no two captives are alike. Coverage lines not feasible in the commercial market can be insured through the captive, because it can offer broader terms and conditions. Commercial insurers limit their contractual exposure by utilizing exclusions, sub-limits, and restrictive definitions and conditions in their policy forms. Often the customer doesn't fully grasp these limitations until their claim is denied or pays much less than expected. Captive insurance offers innovative solutions in areas where traditional insurance companies are lacking.

The captive insurance company can utilize intentional management to be more cost-efficient than a commercial carrier. Costs of a commercial carrier include commissions, fees, underwriting expenses, administrative expenses, and taxes. Commercial insurers spend an average of 25% of every premium dollar on operating expenses (KPMG). This statistic results from the failing operational efficiency of commercial insurance companies that multiply with size and scale. Above operating expenses, agent commission costs generally amount to 10-20% of every premium dollar. LoveIt!'s captive can eliminate unnecessary frictional costs by leveraging strong leadership capabilities. Depending on the structure, captive operational cost can be less than 15% of premium.

Any captive's long-term strategy must focus on growing value through stable premiums and practicing risk control. Claims management will transform under captive ownership. The ownership of the captive will soon realize that any claim that is not had or can be successfully mitigated will impact the bottom line. Because of this financial driver, there will be greater emphasis on timely reporting and taking adequate action to prevent or mitigate loss. Loss control should be at the forefront of each manager's mind and is integral to the captive's success. Claims management will be more effective and efficient, for the captive will have greater control over the process.

Risk Transfer

For premiums paid by an insured to be deductible as a business expense, the IRS provided Letter Ruling guidance regarding sufficient risk transfer. Specifically, this means risk shifting (moving risk from one party to another) and risk distribution (spreading the risk among the group). Applicable to LoveIt!'s paradigm, Revenue Ruling 2002-90 provides as guidance a tax scenario based on *Commissioner v. Humana*, whereby a captive insurance company provided insurance to its 12 wholly-owned subsidiaries each operating independently from the parent company and paying premium to the captive insurer. It is important to note, in Revenue Ruling 2002-90, each subsidiary had its own employer identification number and filed its own tax return, allowing it to deduct premium as an ordinary business expense. The court determined that there was risk distribution and risk shifting present.

This case is examined because it embodies the organizational structure envisioned for LoveIt!. Premiums will be allocated to each subsidiary and paid to the captive, who will pool the risk and issue policies to each subsidiary. Details have not yet been disclosed, but it will be assumed that LoveIt! has adequate subsidiaries to warrant sufficient risk transfer. The captive must act strategically, profitably, and serve the insured's risk management and business objectives. The parent should undoubtedly operate at an arm's length from its insureds.

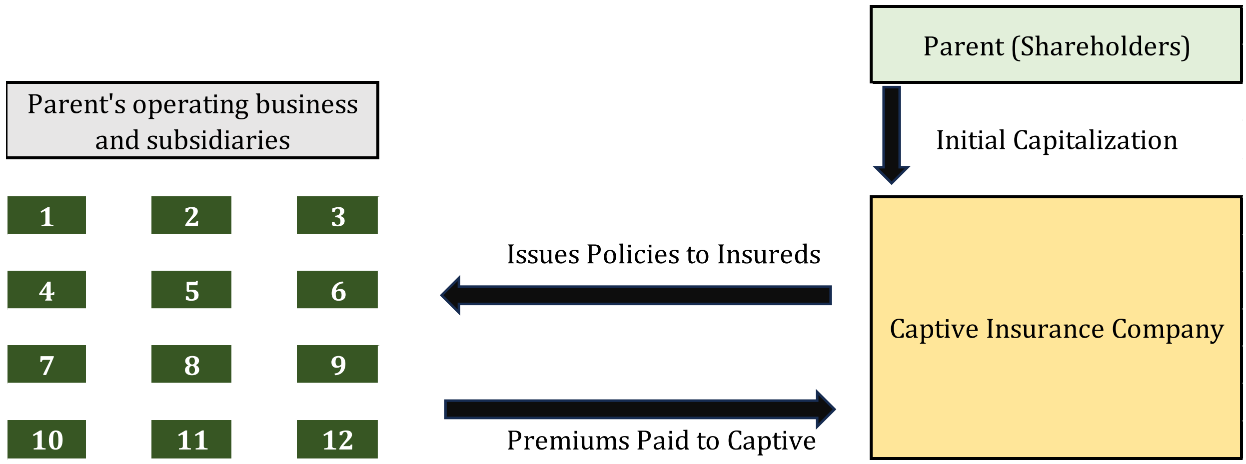
Domicile Selection

Selecting a domicile that will have regulatory oversight of the captive is an integral part of the captive creation process. Regulators play a decisive role in determining the environment in which captives operate. The *Captive Insurance Times Domicile Guidebook* provides a valuable tool to evaluate the details of each domicile.

We believe that Bermuda, one of the largest captive domiciles based on volume, will be a promising home for LoveIt!'s pure captive. Bermuda stands out due to the presence of commercial insurance and reinsurance companies that primarily serve the island nation. It would be difficult to match the open-market underwriting capacity of Bermuda in other domiciles. Another upside to a Bermuda captive is that there is currently no income, corporation, or profit taxes, withholding tax, capital gains tax, or transfer tax payable by exempted companies. Every domicile has formal regulations and requirements to establish and maintain a captive. Bermuda captives are required to have a physical presence in Bermuda. This requirement could be fulfilled by having an individual who conducts business in the domicile as a qualified officer of the captive. The minimum statutory capital requirement for a Class 1(a) Bermuda captive is $120,000, considering that LoveIt!'s captive insures related risks. Also available in Bermuda is a cell structure, whereby the captive could capitalize with less than $50,000. To operate in Bermuda, LoveIt! must submit a formal licensing application to the domicile that will include the captive's business plan, five-year proformas, the pre-incorporation form, resumes of proposed board members, and other supportive information.

Captive Structure

As briefly touched on in a preceding paragraph, LoveIt! Rentals will elect to form a pure captive. A pure captive, also known as a single-parent captive, is the most common form of captive ownership. This type of ownership structure was selected for LoveIt! because of its ability to personalize and focus on the specific risk profile of its insureds. All insureds of the captive are related and owned by the parent, LoveIt! Rentals. While there is more flexibility with the pure structure, the ownership is more expensive. The cell structure is a turn-key structure that includes captive management, audit, actuarial, and administration. Of consideration, as well, is the investment income generated by the captive's premium, reserves and surplus.



As shown above, LoveIt! Rentals, the parent, will have to provide capital to begin the captive. The parent must obtain initial capitalization in the form of a Letter of Credit or cash per statute. The captive insurance company will then issue policies to the insureds in return for premium. The parent can return excess profits to its owners in the form of dividends, but this money might be used more efficiently to fund risk management services that would decrease losses. For example, services that could help prevent storm losses to property, such as trimming trees or repairing roofs. Another important unallocated loss adjustment expense could be the implementation of background screening software that all guests must register through to vacation with LoveIt!. The captive can offer a method of funding for these necessary projects.

Coverages Contemplated

Property DIC

This policy will be written to provide three coverages:

1. Deductible Reimbursement coverage for the current commercial property program. This feature allows LoveIt! to fund the high commercial property deductible that will be taken to get a substantial premium credit.

2. Difference in Conditions coverage in excess of the coverage provided under the commercial property form will be available with a $2,500 deductible. For example, if the Increased Cost of Construction sub-limit on the commercial policy is $100,000, the DIC will increase this to the policy limit. This coverage section will cover specific types of property and causes of loss that are excluded from the commercial property form. For example, a falling tree could damage the designer pavement surrounding the swimming pool. The Property DIC policy could be tailored to cover excluded items, such as pavement, that would be denied by the commercial carrier. There are numerous physical risks that a swimming pool could face, which this policy could be written to handle.
3. Business Income Coverage including Extra Expense will be written into the policy and will not require "physical loss or damage to insured property" to respond to a loss. For example, if one of LoveIt!'s rentals were located in an area that faced heavy storms that damaged the surrounding houses but did not damage any LoveIt! property, the BI & EE form could respond to this loss. Another consideration would be to write pandemic disease or insect infestation as a covered loss under this form. This would allow the company to recuperate the net income and continuing expenses including payroll that were suffered due to these perils.

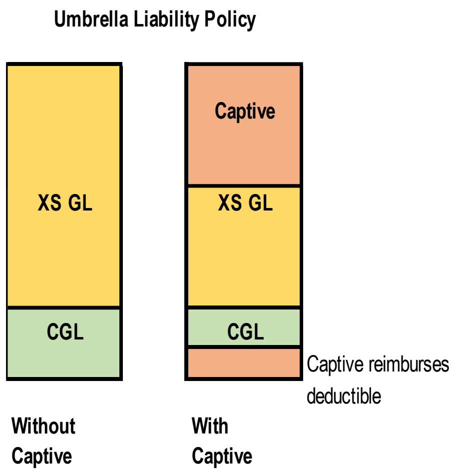
The Property DIC policy is excellent for insureds to establish thorough property and business income exposure coverage.

Named Perils

LoveIt! has strong distribution of risk among five states and over 100 properties, allowing them to address the named windstorm risk through the captive. LoveIt! will write a named perils windstorm policy issued to their insureds and then look to the Bermuda markets for reinsurance.

This named storm policy will cover direct physical loss from any named storm, including the storm surge that results. LoveIt! will look to the NFIP for underlying coverage of $500,000 per building for storm surge, and if NFIP coverage is not available, this policy will be primary. The premium savings comes from LoveIt! having direct access to the Bermuda reinsurance markets, saving them the transaction costs they previously paid for their agents to access the market. This policy will also include business interruption and loss of income resulting from named perils covered under the policy.

Umbrella Liability



The captive will write the last layer of umbrella liability coverage. The excess general liability carrier is mainly concerned about taking on the higher limit of risk. The insured may consider purchasing a Commercial General Liability insurance policy with a large deductible that the captive can insure. The CGL premium savings can be paid as premium to the captive, minimizing the premium paid to the commercial insurer. Ownership may decide to cede some of the umbrella liability policy limits to prevent paying entirely out of pocket for a large claim.

While this paper is written to address LoveIt!'s top two risks through a program offered by a captive insurance company, the captive should not limit its purpose to these two lines of insurance. As a profit center, the captive can utilize fronting facilities and managing general agency (MGA) arrangements to offer profitable lines of insurance to the customer base, including, but not limited to, accident and sickness coverage to vacationers, trip cancellation coverage, and personal liability including damage to owned or rented property.

Ultimately, actuaries will determine the pricing of these coverages, and the captive manager will oversee the operations in conjunction with other service providers.

Conclusion

While it would require an examination of existing commercial policies, loss runs, financials, and other important information to determine whether a captive would be feasible for LoveIt! Rentals, our study has demonstrated how a captive could potentially benefit the company. We analyzed LoveIt's commercial property and general liability risks, and determined that Property DIC, Named Storm, and Umbrella Liability Policies would begin to address their most urgent needs under a single-parent captive domiciled in Bermuda. LoveIt! could then write other ancillary lines of coverage in an effort to provide more funding for the captive. Year after year, by practicing good loss control, the captive will begin to build up its surplus and have more flexible options with coverages. In conclusion, LoveIt! Rentals can use the captive as a risk management tool and profit center to give them a competitive advantage.

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Modoc Nation

Providing a seat at the table for tribal domiciles

Chief Robert Burkybile III, tribal chief of the Modoc Nation in Oklahoma, discusses concerns about misconceptions and prejudices towards tribal domiciles in the micro-captive insurance industry and provides clarity regarding the Modoc Nation's high standards

As the chief of a small, federally recognised Native American tribe involved in the captive insurance industry, I have recognised a trend of misconceptions and prejudices held by several captive professionals regarding our place in the industry.

One difficulty lies in the confusion around what a "federally recognised tribe" is.

As the Bureau of Indian Affairs notes: "A federally recognised tribe is an American Indian or Alaska Native tribal entity that is recognised as having a government-to-government relationship with the United States, with the responsibilities, powers, limitations and obligations attached to that designation, and is eligible for funding and services from the Bureau of Indian Affairs."

In other words, federally recognised tribes have a certain level of sovereignty and the right to self-government that is similar to, but different from, a state government.

For example, tribes and states both have the right to regulate business transactions such as insurance, with tribes possessing the authority to develop regulations separate from the state in which their territory is located.

Many Native American tribes in the United States choose to exercise these rights to act as a captive domicile.

Generally speaking, a captive domicile is a jurisdiction that licences captive insurance companies and has primary regulatory oversight over them.

Tribes choose to become domiciles for the same reasons that more than 25 US states have passed legislation legalising captive insurance. Namely, becoming a captive domicile generates revenue for the tribe or state in the form of captive premium taxes, registration fees and licensing fees.

While I cannot speak for every tribe and how they use these funds, I can speak for the Modoc Nation, as we put the funds generated by the Modoc Domicile to use, doing good for our tribal members. In particular, we help provide child care assistance, higher education scholarships and housing. The revenue has also enabled us to reintroduce a herd of 400 bison into the Modoc range, demonstrating our tribe's commitment to conservation and restoring a part of our heritage.

The Modoc Domicile has taken an innovative and affordable approach to captive regulation. We hold our domicile to the same level of sophistication, competence and knowledge as any state would to properly regulate and oversee captive transactions. The domicile is overseen by our insurance commissioner, Mark Weitz, an expert in the field who has an impressive resume across insurance and law, as well as an entire team dedicated to captives.

The captive industry is progressive and takes diversity and inclusion seriously. Tribal domiciles, such as the one operated by the Modoc Nation, support critical social services for members of the tribe and others across the country. While there is certainly room for improvement, tribes such as ours possess the sovereign right to regulate captive insurance and the know-how to do so properly. All we ask is for a seat at the table, and an opportunity to prove it. ■

Chief Robert Burkybile III

Tribal chief of the Modoc Nation

Robert Burkybile III of Oklahoma was elected chief of the Modoc Nation in 2022. He possesses a strong background in financial services, including seven years as executive director of the Modoc Tribe Financial Services Authority, three years as executive director of the Modoc Housing Authority, and a stint as a board member of the Modoc Gaming Authority.

Moriarty to chair CICA Board

Mary Ellen Moriarty, vice president for property and casualty at Educational and Institutional Insurance Administrators (EIIA) , will chair the board of directors of the Captive Insurance Companies Association (CICA).

Moriarty has been actively engaged in the insurance industry for more than 30 years.

As a CICA member for more than a decade, Moriarty has served on the Amplify Women Committee and board of directors.

Commenting on the role, Moriarty says: "The need for the captive insurance vehicle has never been as important as it is today which will continue the rapid growth for CICA and the captive insurance industry.

"We will continue to raise awareness and advocate for our industry while also being prepared to defend against potential threats."

Banard joins Blackwell Captive Solutions

Taylor Barnard joins Blackwell Captive Solutions as executive assistant. Working remotely, he will support the firm's president, Kari Niblack, as well as the wider Blackwell staff. Barnard joins the insurance firm with a multidisciplinary background. Previously, he spent eight months as a graduate teaching assistant at the University of Kansas.

Earlier in his career, he was a research analyst at the Kansas Department of Health and Environment, between 2018 and 2022.

Commenting on the hire, Blackwell says: "Barnard brings new ideas and promise to the table and fully embodies our company values. He's a go-getter, and we are thrilled to have him onboard!"

Tyler Maconaghy appointed at Hartwell Insurance

Hartwell Insurance has appointed Tyler Maconaghy as vice president.

Maconaghy has more than 10 years of experience in the insurance industry, specialising in primary and excess liability programmes for construction and transportation companies.

Before Hartwell Insurance, Maconaghy was a risk management consultant at Oxford Risk Management Group, which he joined in 2022. Prior to this, he held a three year tenure at Maximum Independent Brokerage, where he was a producer.

Commenting on his move Maconaghy says: "In a market where it is becoming progressively harder to insure property in weather prone states, Hartwell has created an unmatched solution."

NAIC welcomes Anderson as CEO

The National Association of Insurance Commissioners (NAIC) has appointed Gary D. Anderson as CEO.

In his new role, Anderson will be leading the insurance standard-setting organisation governed by the chief insurance regulators from the 50 states, the District of Columbia and five territories in the US.

Prior to his appointment as CEO, Anderson served as a policy adviser and senior counsel in the Massachusetts State Senate President's office, where he was involved in several policy areas, from the state's broad efforts to control health care costs to all matters affecting the financial services sector.

Anderson joined the Massachusetts Division of Insurance as First Deputy Commissioner in February 2014. His responsibilities included strategic planning and policy development for all aspects of the agency.

Andrew Mais, NAIC president and Connecticut insurance commissioner, states via LinkedIn: "Gary's dedication to our state-based system of insurance regulation and his insurance expertise are top notch. We look forward to his leadership as we navigate the complexities of regulating the insurance sector and deliver on our mission to protect consumers."

Commenting on his appointment, Anderson says: "I am excited to embark on the next adventure as CEO of the NAIC, supporting the state-based system of insurance regulation. Thank you to the NAIC Members for the trust and faith you have placed in me." ■

KPMG Bermuda appoints Payne

KPMG in Bermuda welcomes Jay Payne to its leadership team in the role of tax partner.

With more than 30 years of experience in US taxation, Payne has collaborated with clients and colleagues, providing tax consulting and compliance services across various industries.

Previously, Payne worked on the management board at different offices of BDO USA, providing tax consulting and compliance services.

Payne's career began at PwC's Washington National Tax Services consulting practice, where he developed technical skills and a focus on problem-solving. He has since applied his expertise to address tax issues related to business transactions, mergers and acquisitions, joint ventures and growing businesses.

Commenting on his appointment, Payne says: "I am ready to leverage my US tax expertise to drive success for our clients and contribute to our team's growth. Let's make an impact together."

Gatsch takes on role at Hansen Actuarial

Hansen Actuarial has appointed Matthew Gatsch as director and actuary.

Gatsch has been actively engaged in actuarial consulting for more than 26 years, specialising in reserving and funding for insurance companies, captives, self-insured groups and government entities. Prior to the role, Gatschas served as a senior manager for more than two decades at Oliver Wyman, a management consulting company, where he mainly focused on reserving and funding for captives and other property, as well as casualty loss exposures. ■