

AM Best's Overview of the US Captive Industry

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Agenda

- The interactive rating process
- Methodology – determining ratings for captives
- Types of captives rated by AM Best
- US captive performance vs. commercial casualty peers
- Cell captives
- Recent trends and observations

The Interactive Rating Process



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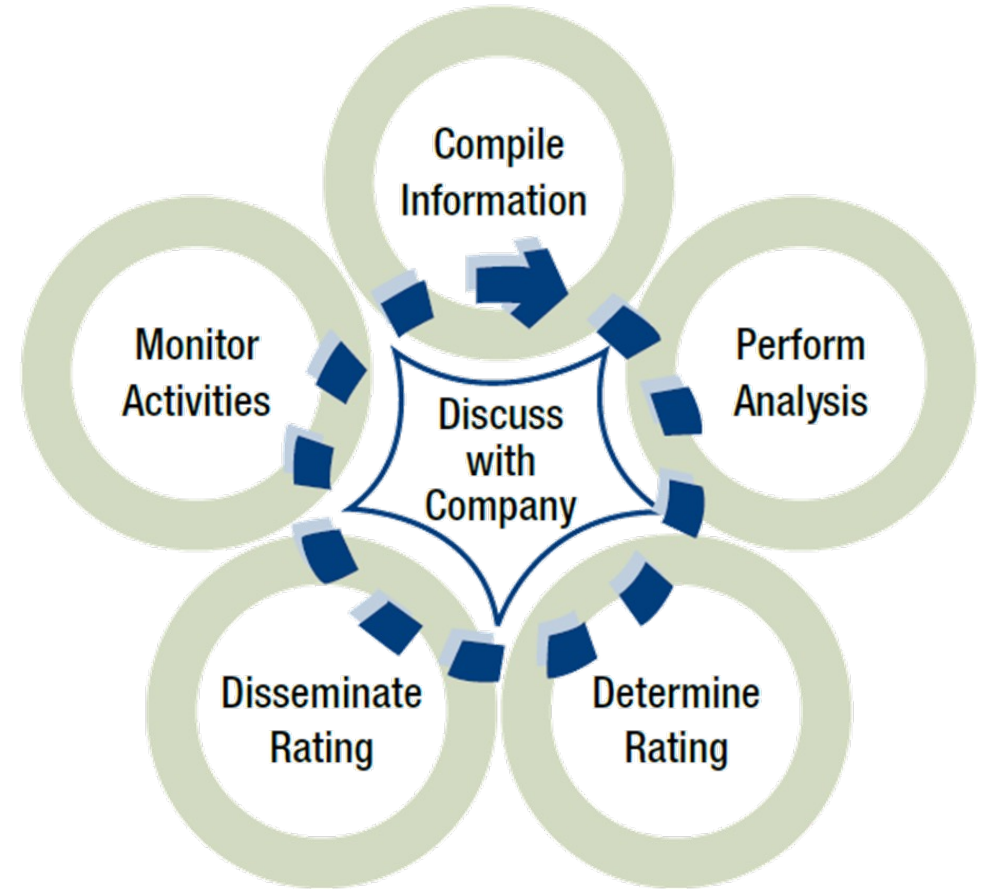


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The Interactive Rating Process

- The rating process starts with an in-depth meeting with captive management and AM Best analytical team
- Primary data sources: Annual/Quarterly Statements, Public Industry Data, Supplemental Proprietary Info
- Ratings are determined by committee process – by a majority vote



AM Best's Ratings

- Financial Strength Rating (FSR)
 - An independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations
- Long-term Issuer Credit Rating (Long-term ICR)
 - An independent opinion of an entity's ability to meet its ongoing senior financial obligations

Issuer Credit Ratings (ICR) and Financial Strength Ratings (FSR)

Long-Term ICR	FSR
aaa, aa+	A++
aa, aa-	A+
a+, a	A
a-	A-
bbb+, bbb	B++
bbb-	B+
bb+, bb	B
bb-	B-
b+, b	C++
b-	C+
ccc+, ccc	C
ccc-, cc	C-

Methodology – Determining Ratings for Captives



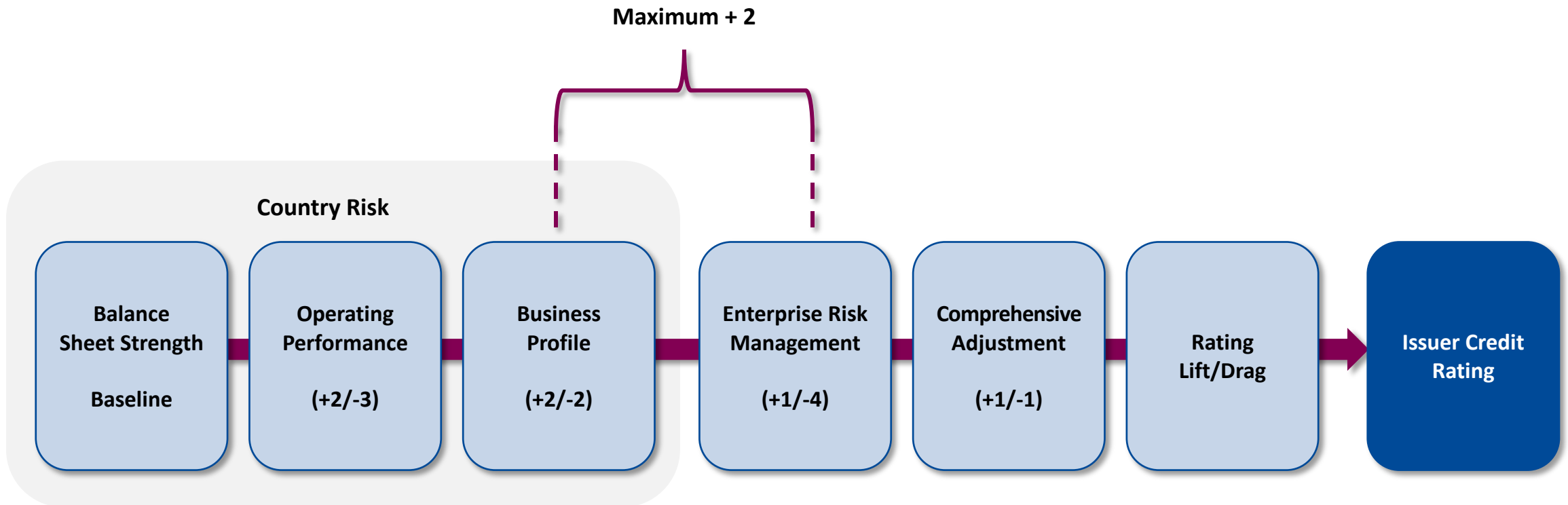
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AM Best's Rating Process – Building Block Approach



Balance Sheet Strength Assessment



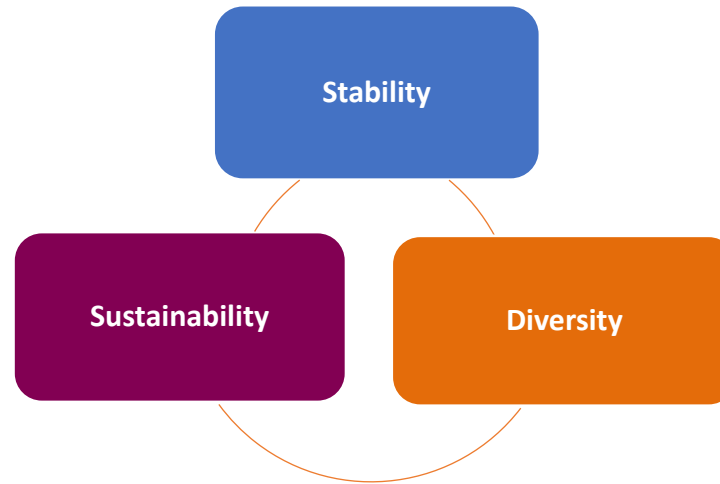
Specialty Criteria Considerations Alternative Risk Transfer

Exposure to large loss events

Loan-backs to parents & Letters of Credit

Assessment of non-insurance parent carried out under lift/drag rather than balance sheet strength

Operating Performance Assessment



Specialty Criteria Considerations
Alternative Risk Transfer

- Volatility of operating results
- Mission to provide consistent tailored coverage at stable pricing
- Investment income in light of allocation

- In general, more diversity in earnings streams leads to greater stability in operating performance
- Analysis reflect a variety of quantitative and qualitative measures to evaluate operating performance

Business Profile Assessment

Product/Geographic Concentration	Product Risk
Market Position	Degree of Competition
Pricing Sophistication and Data Quality	Management Quality
Regulatory, Event and Market Risks	Distribution Channels
Innovation	

Specialty Criteria Considerations
Alternative Risk Transfer

Relationship with parent determines access to business in absence of market profile

Concentration by product/geography

Often high product risk

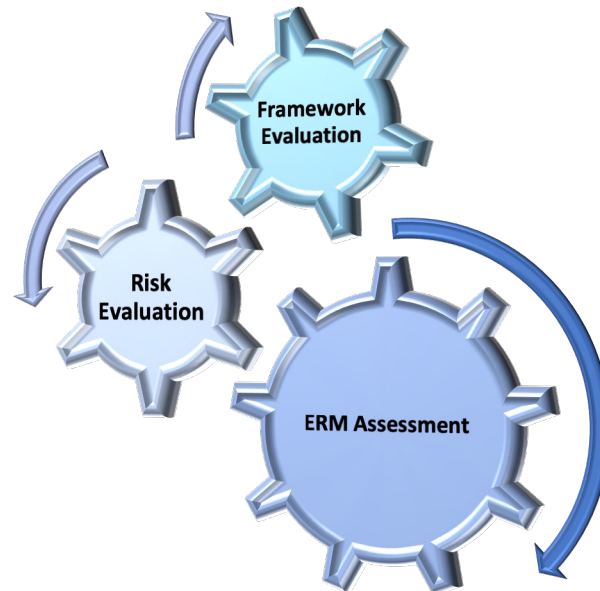
Enterprise Risk Management (ERM) Assessment

Holistic evaluation of ERM

- Assessment of the risk management framework and the insurer's risk management capability relative to its risk profile

Risk Impact Worksheet (RIW)

- Part I: Framework Evaluation
- Part II: Risk Evaluation
- Part III: Overall ERM Assessment



Assessment of Capabilities Relative to Profile

Product and Underwriting Risk

Reserving Risk

Concentration Risk

Reinsurance Risk

Investment Risk

Legislative/Regulatory/Judicial/Economic Risk

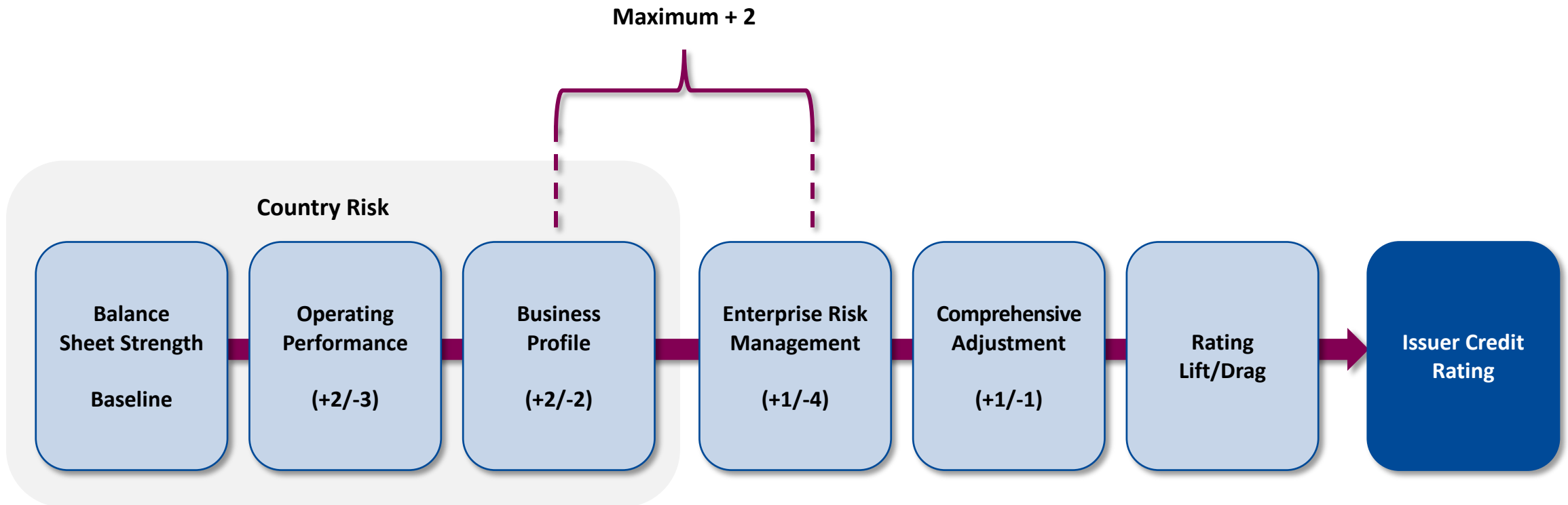
Operational Risk

Liquidity and Capital Management Risk

Indications for Potential Lift/Drag

Focus on captives: Are the resources of the parent available to the captive or could the captive be called upon to service the obligations of the parent?	
Lift	Drag
The credit profile of the parent is stronger than that of the captive	The credit profile of the parent is weaker than that of the captive
The captive is important to the parent	The captive's importance to the parent is limited
History of capital support or explicit support in place	History of punitive capital actions
	Risk of capital extraction by parent - no regulatory restrictions on the flow of capital

AM Best's Rating Process – Building Block Approach



Methodology References and AM Best's Industry Research

For further information, please see Best's Credit Rating Methodology



Key Criteria:

<http://www3.ambest.com/ambv/ratingmethodology>



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Types of Captives AM Best Rates



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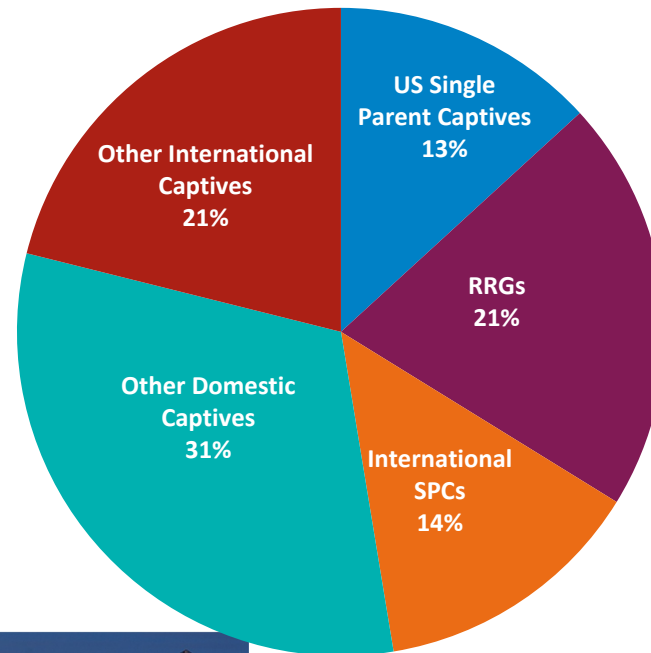


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Rated Captive Types

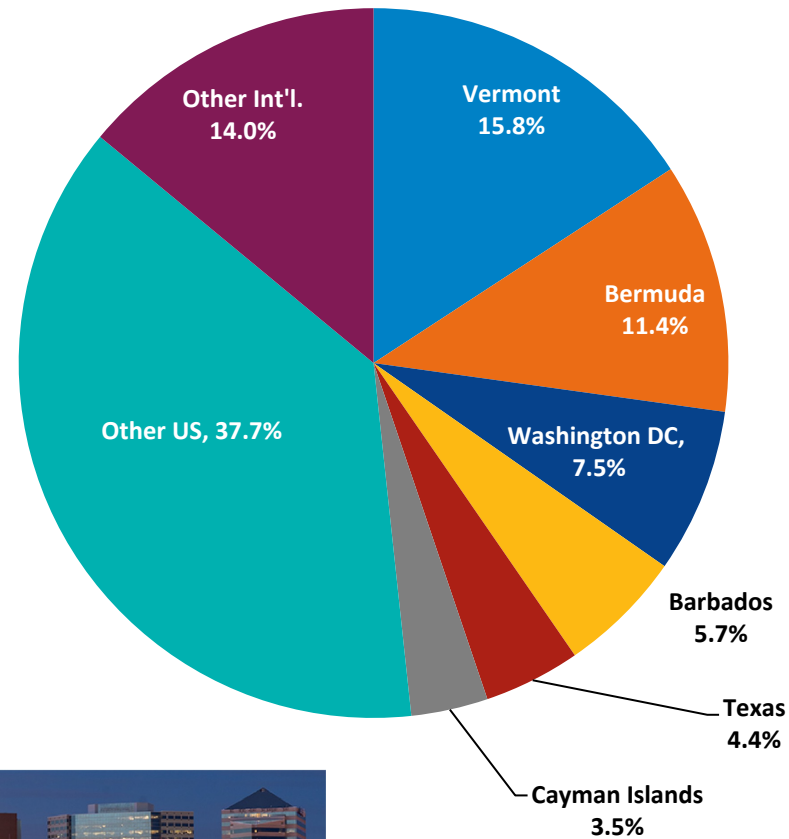
AM Best currently rates more than 200 captives worldwide

AM Best's Rated Global Captives – by Type



Rated by Domicile

AM Best's Rated Global Captives – by Domicile



Performance Trends of Rated Captives



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Performance Trends – Combined and Operating Ratio

US CIC – Five-Year Combined Ratios (%)		
	5-Year Combined Ratio (Ex Div)	5-Year Operating Ratio
SPCs	72.4	53.6
RRGs	95.7	85
All Captives (CIC)	84.5	80.1
5-Year Commercial Casualty Composite (CCC)	99.4	88.0

The most recent five-year average Combined and Operating Ratios of the rated US Captive Insurance Composite beat those of its Commercial Casualty peers by significant margins.

Performance Trends – Policyholders’ Surplus

US CIC – Policyholders' Surplus \$ millions					
	2017 PHS	2021 PHS	Increase	Stock and Policyholder Dividends	Total Savings
SPCs	9,939	12,331	2,392	1,759	4,151
RRGs	2,490	3,090	600	388	988
All Other Rated Captives	11,815	13,139	1,324	3,607	4,931
Total Rated Captives	24,244	28,560	4,316	5,754	10,070

Performance Trends – Ratio Analysis

US CIC – Ratio Analysis, 2017-2021 (%)						
	Loss & LAE	Underwriting Expense	Combined (Ex Div)	Policyholder Dividends	Investment	Operating
2017	62.2	20.5	82.6	9.9	19.4	73.1
2018	62.5	19.9	82.4	13.3	20.3	75.4
2019	64.9	19.6	84.4	17.7	20.7	81.4
2020	68.3	18.9	87.2	11.8	16.4	82.7
2021	66.1	19.3	85.4	14.8	12.9	87.3
5 Yr. Avg. (CIC)	64.8	19.6	84.5	13.6	17.9	80.1
5 Yr. Avg. (CCC)	69.9	29.5	99.4	0.3	11.7	88.0

Source: AM Best data and research



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Performance Trends – Underwriting Expense

US CIC vs. CCC – Underwriting Expense Analysis, 2017-2021 (%)							
Year	Commission Expense Ratio		Other Expense Ratio		Total Underwriting Expense Ratio		
	US CIC	CCC	US CIC	CCC	US CIC	CCC	
2017	1.2	11.5	19.2	18.6	20.5	30.1	
2018	1.6	13.0	18.3	16.8	19.9	29.8	
2019	2.0	13.3	17.6	16.9	19.6	30.2	
2020	1.5	12.8	17.4	16.5	18.9	29.3	
2021	2.3	12.6	17.0	15.8	19.3	28.4	
5 Yr. Avg.	1.8	12.7	17.9	16.8	19.6	29.5	

Cell Captives



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Cell Captives – Highlights

- Increased interest in cell structures during hardening market
- By borrowing third-party insurance management and licensing, can address certain risk transfers more quickly
- Smaller amount of capital investment, while gaining professional oversight, enables cells to focus on the business they are insuring
- Easier to close/suspend if desired when market softens or when sponsor closes (or sells)
- Conversely, can be restarted quickly if the market turns or if business need arises
- Protected cells can range from single-cell subsidiary in a corporate structure to “rent-a-captive”
- Variety of names: Segregated Account Company, Segregated Portfolio Company, Protected Cell, Incorporated Cell
- Serve a wide variety of industries with broad coverage offerings
- Risks tend to align between executive management team and the policyholders



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Protected Cell Companies – AM Best Criteria Highlights

- Evaluating a Protected Cell Company (PCC) requires a clear understanding of the characteristics of the business in the PCC, and its structure, domicile and ability to manage the exposures of its sponsor
- If an insured established its own PCC and divides its risk into a number of protected cells within the PCC, it will be treated as a pure captive for rating purposes
- If a PCC is made up of unaffiliated protected cells, each protected cell will be reviewed independently
- AM best considers the PCC to be only as strong as its weakest cell. Hence the onus is on the PCC to ensure that each segregated cell is adequately capitalized.
- Regulatory framework under which the PCC is established is a key component in the business profile evaluation
- Controls and monitoring of a PCC is crucial to ensure expectations for claim response are met
- Considers the contractual relationship among the cells in the program and between them and the PCC itself

Recent Trends



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Challenging Market Conditions

- Increased captive formations
- Captives taking on new exposure, broadening coverages, filling gaps
 - Professional lines – medical malpractice, errors & omissions
 - Directors & officers coverages
 - Cyber coverage – captives become more viable and attractive option
 - Casualty & property (including CAT) – moving more exposure into the captive
 - Increased retention on primary lines of coverage
 - Captives participating in the insurance tower

Friendly Regulatory and Legislative Environments

- Regulators competing for new formations
- Why? Bringing insurance industry participants into the state and keeping them can foster a long-lasting business relationship



- Captives can contribute economically to their domiciles:

Jobs

Premium
Taxes

State
Income Tax

Friendly Regulatory and Legislative Environments

- Observation: More captive friendly state regulators in the last 12-18 months
- Actions & initiatives to attract business:
 - Easing reporting & meeting requirements
 - Modifying capital requirements for cells to permit easier establishment
 - Enabling parametric reinsurance policies
 - Permitting state-domiciled SPCs to issue Side A D&O for state-domiciled corporate parents
 - Short-term tax holidays as incentive to re-domesticate
 - Streamlining licensing and registration process – conditional certificate of authority while application is reviewed

Thank You



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