The Evolution of Captives

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Agenda

• History of Captives
• Alternative Risk Transfer
• Definition
• Benefits
• Legislation, Domiciles, and Numbers
• Types
• Uses and Applications
The Early History of Captives

• Early history
  – Lloyd’s Coffee House (1687)
    • Sharing maritime / ocean marine risk by ship owners
  – New England textile mills in late 1800s
    • Sharing fire risk
  – Episcopal Church in the U.S. in the early 1900s
    • The Church Properties Fire Insurance Corporation

The History of Modern Captives

– Term “captive insurance” coined by Frederic Reiss, a property-protection engineer in Youngstown, OH in 1955

– Youngstown Sheet and Tube (formed its wholly-owned insurer, Steel Insurance Company of America)
  • Availability and cost of traditional insurance
  • Why are they called “captive insurance companies”?

– Reiss established the first captive insurance company in Bermuda in 1962, International Risk Management Ltd.
Alternative Risk Transfer Market

- Key Mechanisms of ART
  - Self insurance (including deductibles and retentions)
  - Captives
  - Risk retention groups
  - Capital market securitizations (CAT bonds, side cars, etc.)

- Estimated that ART is about 30% of the total commercial risk protection market

Captives

- Definition
  - a subsidiary owned by one or more parent organizations established primarily to insure the exposures of its owner(s)

- In the risk management context, captives combine -
  - Risk retention
  - Risk financing

Global captive premiums in 2010 were about $55 billion (50 to 60% from U.S. businesses)
Benefits of Establishing a Captive

– Broader coverage
– Stability in pricing and availability
– Direct access to reinsurance
– Improved cash flow
– Increased control over the program
– Structure and discipline

Some Key Enabling Legislation

• Bermuda (Insurance Act of 1978)
• Vermont (established captive law in 1981)
• Other early states
  – Colorado (1972)
  – Tennessee (1978)
  – Virginia (1980)
• The IRS and tax rulings
Total Number of Captives Globally

Top Domiciles Globally
(Number in 2014)

- Bermuda (800)
- Cayman Islands (759)
- Vermont (587)
- Utah (422)
- Anguilla (379)
- Delaware (333)
Drivers in the Growth of Offshore Captives

- Captive insurers were required to hold the same levels of capital as traditional insurers in many countries (including U.S. and U.K.)
- Tariff arrangements in Europe limited pricing and discounts for self-insured deductibles
- Flexible regulation in offshore domiciles around rates, forms, and investments
- Recent evolution in U.S. domiciles

Competitive Elements Across Domiciles

- Investment flexibility
- Minimum capitalization requirements
- Legislative responsiveness
  - how willing and quickly the legislators of a particular domicile can pass new laws to remain competitive against other domiciles
- Infrastructure support
  - ensuring that the DOI of the domicile can handle the establishment of captives and provide the support they require
Recent Growth of Captives in U.S. Domiciles

Types of Captives

- Single-Parent
  - Pure or profit center
- Group or Association
- Rent-a-captive
- Risk retention group
- Sponsored Captives, Segregated Cells & Protected Cells
  - All forms of rent-a-capitves
  - Terminology is based on domicile
    - Bermuda = segregated cell companies
    - Cayman Islands = segregated portfolio companies
    - South Carolina = protected cell companies
    - Vermont = sponsored captives
- Reciprocal insurer
- Agency
- Branch
Applications of Captives

- General property-casualty coverages
- Directors & officers
- Professional liability and E&O (medical liability)
- Fiduciary, EPL, crime
- Cyber
- Workers’ compensation
- Terrorism

Other Applications

- Third-party business (e.g., warranties, shipping insurance)
- Life captives (owned by life insurers)
  - XXX and AXXX reserves
  - AG-48
  - PBR
- 831B captives (minicaptives)
- Long-term care captives (owned by SNFs)
- Emerging risks
Concluding Comments and Observations

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