BEST'S REVIEW®

ISSUES & ANSWERS:

CAPTIVES AND DOMICILE SOLUTIONS

Industry experts discuss how to choose a captive manager and the role of actuaries in captive management.

Interviewed Inside:

Daniel Linton
Pinnacle Actuarial Resources

Christopher J. Flatt
AIG Programs & Captive Solutions

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Daniel Linton, Senior Consulting Actuary, Pinnacle Actuarial Resources, said that for a captive insurer, discussions regarding capital deployment strategy is the ideal time for the actuary, the captive manager, and the captive owner to engage in productive dialogue about opportunity—and risk. "The types of risks that keep you up at night," he said.

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Daniel Linton
Senior Consulting Actuary
Pinnacle Actuarial Resources

"When it's time to deploy capital, you want to make sure that you're leaving enough economic capital to support the operations of the captive to manage the risks that are already there."

Visit the Issues & Answers section at *www.bestreview.com* to watch an interview with Daniel Linton.

What is the actuary's role in the formation of a captive?

The actuary serves as a trusted adviser—playing a critical role in the formation phase of a captive. First, the actuary needs to be heavily involved in setting the overall structure of the captive—determining what coverages should be considered, as well as how much risk should be retained (i.e., risk tolerance). Ideally, this advisory relationship should be a dialogue between the actuary, the captive manager, and the captive owner to set a solid foundation for how the captive will operate in the coming years. In addition, the actuary will construct an actuarial analysis that will set rates and estimate the expected losses that will flow through the captive in the captive's first years of operation. Based on sound actuarial understanding of expected losses, the actuary can build a set of pro forma financial statements which will give stakeholders an understanding of the overall feasibility of the proposed structure.

Do reinsurance costs and available capital play into that decision?

Absolutely. It's a balancing act between reinsurance costs and how much capital the captive wants to hold. For example, rather than carry a $500,000 per occurrence limit, a captive owner chooses a $250,000 per occurrence limit. The result would be a lower capital requirement because the captive is taking on less risk. On the other hand, it increases your reinsurance costs because you're buying more reinsurance in the commercial market. It's a sophisticated balance that will vary from captive to captive based on risk tolerance.

What is the actuary's role as the captive grows up?

When the captive grows up, the actuary is going to serve two primary roles. The first is to review incurred claims and present an analysis of estimated outstanding losses (i.e., reserves). That gives captive management an opportunity to understand how actual claim development compares with projections derived from the previous actuarial report. Further these analyses give guidance to management on what they should book as reserves on the balance sheet. What follows is the actuary's review of the booked reserves and the issuance of the statement of actuarial opinion—a document that must be filed with the insurance department, or other regulatory body, where the captive is domiciled. Secondly, the actuary will set the expected losses for the upcoming policy period—similar to the exercise performed during the feasibility phase. During this time, the actuary, the captive owner, and the captive manager can discuss other opportunities available to the captive—whether it be introducing new coverages, expanding limits, etc.

How important is the actuary's relationship with the captive manager?

It's very important. I have found that the better the communication between the captive manager and actuary, the better the captive operates. It opens up the lines of communication, providing a conduit to respond to unexpected events quickly and efficiently. A sound relationship allows all parties, ideally including the actuary, captive manager and captive owner, to have meaningful discussions about the results of the actuarial report. That, in turn, provides all with key insights and hopefully agreement into how much capital is necessary to support the operations of the captive. Capital deployment should be an area of strategic opportunity for the captive and should be evaluated and planned for carefully.

Captive Solutions

Christopher J. Flatt, President, AIG Programs & Captive Solutions, said the company develops innovative, customized captive programs for clients. Following are excerpts from an interview.

Christopher J. Flatt

President & CEO Glatfelter Insurance Group
President, AIG Programs & Captive Solutions

"Captive management is all about service."

What is driving growth in captives?

Whenever clients experience things like increasing premium rates, coverage restrictions, or reduced capacity, they look for alternatives and captives are often the option to which they turn. For example, large companies that already own a captive can expand the use of captives by adding new lines of business or adding increased net retentions or limits to their program. We are also seeing more mid-sized companies looking at whether a captive might be right for them, either through the use of cell captive facilities or joining a group captive program. Certainly more challenging lines (e.g., property, cyber, D&O, professional liability) and industries (transportation, health care, construction/energy) are driving a lot of the growth currently, but the interest is widespread.

What should a captive consider in selecting a captive manager?

Captive Management is all about service, so important considerations for a prospective captive owner include:

- The manager's experience and expertise—review the services they provide, how long have they operated and how many clients they have in their portfolio.
- Industry reputation—ask the domicile regulators, captive law firms, auditors, etc. about what they have experienced with the manager. Getting these third-party views is important to choosing the right captive manager.
- Staffing levels, tenure, and turnover—people provide the service and low turnover typically leads to higher consistency of service.
- Domiciles the manager operates in—it is important to be sure they can operate in the domicile that is right for the client.

What should a captive consider when selecting a domicile?

- Regulatory Environment—domicile should have a clear regulatory framework while providing a degree of flexibility for the regulator to apply to each situation.
- Infrastructure—established domiciles typically have more services available (managers, audit, tax, legal, etc.).
- Taxes—captive owners should review both premium tax and federal tax implications with their professional advisers.
- Cost—some domiciles can be a bit less expensive than others—but typically the costs are similar.

How is AIG Captive Solutions meeting the needs of its captive clients?

AIG Captive Solutions develops innovative, customized captive programs for clients employing AIG's extensive knowledge and collaborating across our underwriting, claims, credit, legal and actuarial teams. AIG has been in the captive business for over 50 years, and knows that captive clients value expertise, creativity and responsiveness to their needs. We deliver these solutions across three businesses:

- Group Captives—provides fronting and excess risk transfer to large member owned captives for primary casualty (i.e., Auto, GL, and WC);
- Fronting provides fronted paper for nearly any line of business, admitted and non-admitted paper, and typically reinsured to single parent captives;
- Captive Management—provides captive feasibility studies, formation services and ongoing domicile management for captives. Also sponsors and manages protected cell captive facilities in Bermuda and Vermont.

To learn more about AIG Captive Solutions, you can visit *https://www.aig.com/business/why-aig/captive-solutions*.