BEST'S REVIEW® ISSUES & ANSWERS:

- # Captive Services & Domiciles
- # Data
- # Reinsurance

Industry experts discuss how captives have shown steady growth as they help fill in gaps in coverage, and how telematics continues to give insurers new layers of useful data in terms of auto pricing. They also address what lessons reinsurers have learned during periods of high inflation.

Interviewed Inside:

Stephen Taylor
Delaware Department of Insurance

Roosevelt Mosley
Pinnacle Actuarial Resources

Chris Donelan
Sompo International

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Delaware Captive Insurance Advantage

- Delaware takes captive insurance company licensing to a new level with its Speed to Market option for captive licenses.
- Delaware's first in the nation Conditional Certificate of Authority provides a license to conduct insurance business effective the same day of submitting the captive license application.
- A Conditional Certificate of Authority removes uncertainty because it provides captive managers and owners date certainty for when the captive can begin writing insurance business.

Stephen Taylor
Director, Bureau of Captive & Financial Insurance Products

Trinidad Navarro
Insurance Commissioner

BUREAU OF CAPTIVE & FINANCIAL INSURANCE PRODUCTS
Delaware Department of Insurance
1007 North Orange Street, Suite 1010
Wilmington, DE 19801
302-577-5280 | captive.delaware.gov
Trinidad Navarro, Insurance Commissioner

First State for Captives

Stephen Taylor, Director of the Bureau of Captive & Financial Insurance Products, Delaware Department of Insurance, said the captive industry there is built on the "Delaware advantage." "The Delaware advantage is the state's gold standard of business formation and corporate law upon which the captive program is built and supported," he said. Following are excerpts from an interview.

Stephen Taylor
Director of the Bureau of Captive & Financial Insurance Products
Delaware Department of Insurance

"For companies considering captive formation, Delaware is business-friendly, politically stable, a great location on the East Coast, easy to get to, and with great corporate and captive laws."

Visit the Issues & Answers section at *bestsreview.ambest.com* to watch an interview with Stephen Taylor.

What is the state of the captive industry, and how is Delaware faring?

The captive industry is doing pretty well. Following the pandemic, the industry had been seeing about a 2% growth worldwide in the number of captive formations. In the commercial sector, you still see some increases in property and cyber covers. That's helped push for increased demand in the use of captives. Captives are also being used more to fill in some gaps in coverage, as well as address some of the issues in the higher layers of coverage. Delaware has also done very well in the last couple of years with a healthy number of formations. There were 70 in 2021, and about 60 in 2022.

What makes Delaware an attractive captive domicile?

Delaware is still doing well because we have a great program. We have an excellent team of very talented, experienced, credentialed people—regulators who know how to regulate captives and understand that captive insurance is a little bit different than traditional insurance, in terms of regulatory requirements. We also have a very collaborative relationship with the industry, specifically the Delaware Captive Insurance Association, where we really work well to promote, support and market the industry in Delaware. We have a fantastic set of laws for captives which are very flexible, where we allow companies to take various forms on how they want to set up. We allow a number of types of captives, and we also allow companies to use other foreign entities as well for captives.

Delaware corporations can now obtain D&O coverage from captive insurance companies. How's the change been received by the industry?

The change has been received very well. We licensed the first captive to use that law, where they were able to purchase from a captive D&O liability for their officers and directors. We have a number of others who have expressed interest in using the new law. And we are working to provide some guidance on the matter.

What is the new direction that you're taking the captive bureau?

One of the big things we're doing right now is we're working with the Delaware Captive Insurance Association to streamline our licensing process, application process. Some of the complaints in the past have been that we're a little slow to respond. We're going to provide some more metrics that help us keep things moving, increase speed to market and be more responsive. Also, we're looking to ease the unnecessary regulatory burdens that we've had, making sure that we're going to regulate appropriately. We're also going to work on improving transparency, and that's going to be codifying some of the public-facing policies and procedures that we have. We intend to adopt innovative ways to make sure our program is a great program. Delaware is the first state, and we want to make sure the Delaware captive program remains a great first choice for captives.

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Pinnacle Scores Again

Roosevelt Mosley, Principal and Consulting Actuary with Pinnacle Actuarial Resources, said that from summary data, the company has the flexibility to add and use different characteristics of the road-level data to develop scores. "After ensuring that we are comfortable with the data elements, we use more complex modeling approaches to ensure that the key interrelationships between the road segment data items are captured," he said. Following are excerpts from an interview.

Roosevelt Mosley
Principal and Consulting Actuary
Pinnacle Actuarial Resources

"So, as we drill down even deeper to geographical location, road-level data and usage data provided by automobile-mapping technology arms insurers with even more accurate and effective data."

Visit the Issues & Answers section at *bestsreview.ambest.com* to watch an interview with Roosevelt Mosley.

How does road-level data improve the accuracy of auto pricing?

Insurers have worked diligently over the years to ensure that data points—such as a driver's or an automobile's age—are efficient, accurate and as predictive of risk as possible. Geographical location, naturally, has long been a key data point used to understand the risk of an auto policy. That makes perfect sense, as driving-associated risk and loss are different in, say, Boise rather than in Boston. So, insurers start with geographical location to understand and price insurance based on relative risk. And while recent innovations such as telematics have given insurers even keener and finer data and added new layers of useful data, geographical location still is key to the process of underwriting risk.

What does road-usage data consist of?

There would be three key dimensions of data. Taken together, they form a very clear picture of road conditions and commensurate risk. One dimension would be traffic density, or the number of vehicles traveling on a particular road segment during any given period. Another is road design and how that may impact speed and variability of risk on a particular road segment during a defined time period. Finally, it is the variable of speed itself, and the ratio of actual speed of vehicles on a road segment to the speed limit and the flow of traffic of that particular road segment. Pinnacle can take that road-level data and, using machine learning modeling techniques, develop a score that is easy to use, understand and communicate to help insurers to better price risk in a certain territory.

Does the modeling process differ from other analytical modeling techniques?

The model doesn't function differently, per se. But like all modeling processes, it is the quality of the data that goes in. One of the axioms in any data analysis is "garbage in, garbage out." The opposite can also be true. The quality of data going into the model can result in quality results. That is what makes road-level data so useful. Once we process this very real-world data and filter it for reasonability, we test it to ensure it provides additional value above and beyond traditional rating characteristics. This involves reviewing one-way summaries of the data. For example, the longer the average travel time of a trip in a ZIP code, the lower the claim frequency.

What are the benefits of scoring?

The scoring system that we've developed is a lot about simplicity and efficiency for writers. Scoring removes a lot of the confusing analytic and modeling terms and processes, distilling data down to something simple, communicable and practical for insurance companies. We call that a precision scoring framework. Another great benefit is that the framework can also be adaptable to the writers' preferred or requested inputs. Scoring, therefore, will not only be more precise, and reflect real-world road conditions, but it can also be customized to what insurers are looking for with respect to the territory conditions that will impact their customers and their risk.

Lessons of Inflation

Chris Donelan, CEO, Global Reinsurance, Sompo International, said the reinsurance industry was not expecting a housing material shortage, rising labor costs, chip shortages, and then unemployment at historical lows with almost 10% inflation all at once. "The lesson we learned is that a lot can happen with inflation, and it's almost a silent heart attack at times if you're not paying attention to it," he said. Following are excerpts from an interview.

Chris Donelan
CEO, Global Reinsurance
Sompo International

"Pricing is relatively tame, and the limits for the most part are staying at their historical lows for the time being."

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Were there lessons for reinsurers regarding periods of high inflation?

As an industry, we've always thought about how we can make sure we stay ahead of inflation as we operate in a pretty competitive environment. When inflation goes up so fast, it's hard for the industry to keep ahead of that. We learned that it can hit you pretty hard and pretty quickly. The rate adequacy and the reserve adequacy is something we've been dealing with in this industry for a pretty long time, so we have a better feel for that. The good news is inflation is projected to be in the low twos relatively soon, which should help us get some rate equilibrium, as higher interest rates can help offset the higher inflation.

What have the long-term implications of inflation been on property insurers?

I'm not sure property insurers are ready for the explosion of property values and its effect on their PMLs and how they can deploy capital. It created a little bit of a capacity constraint. At the same time, we were coming off nearly five years of $100 billion losses into the industry. This made companies think about their willingness to be in the property market or the property cat market. That's a different discussion than inflation, and that was just an add-on. If you think about it, Hurricane Ian was the second-largest, most expensive storm in the history of the United States. It didn't feel that large when it hit, but the numbers get very large very quickly when you throw in inflation on top of that. Every part of the world had higher-than-expected losses on storms.

What are the challenges reinsurers face over the second half of 2023?

Management liability is in a state of lower rates, but coming off three or four years of very good rates, and terms and conditions. That's going to be something that people are going to be concerned about. Catastrophe pricing is better than it was for the last couple of years. Capacity is there at the right price, but if something unexpected occurs, we could have another year like last year. Then in property non-cat we're in the one true hard market to speak of, and I don't see that changing this year. Then, when you get to other lines of business, it's just really going to come down to reinsurers' appetite, and the casualty people are going to start lifting their limits and pricing down.

What is your outlook for Jan. 1 and the year ahead?

January seems so far away, but we've just gotten into cat season. Companies feel pretty confident that they've taken their books into an area where they can sustain losses and still make money for the year. It's going to come down to all events happening between now and the end of the year. If there's not much unexpected loss, then we would probably see a pretty stable renewal at Jan. 1, and we won't be going into Dec. 31 like we did last year. My guess is it's going to be event-driven—and depending how large will affect the year-end trading.

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