

Captives in the GCC and their Rating

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19 January 2021

Questions?

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Along with your question, please leave your **NAME** and **COMPANY NAME**



Agenda

Captive GCC Market Development & Owners' Perspective

Analysing Captives: An Interactive Rating Process

Panel Discussion

Presenters & Panelists



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SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

MARSH CAPTIVE SOLUTIONS

AM Best Captive Webinar

Captive GCC Market Development & Owners' Perspective

January 2021

Ronny Vellekoop
Senior Executive Officer – Marsh Captive Solutions

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Section 1

MARSH CAPTIVE SOLUTIONS

What Services Do We Provide?

Captive Management

Marsh Captive Solutions manages 22.5% of the world's captives, utilizing an in-house designed technology platform that maximizes efficiencies and provides high-quality service to our clients.



Of these captives nearly 50% are treated as “insurance companies” for Federal tax purposes and are therefore able to benefit from certain tax efficiencies, such as the accelerated tax deduction on retained casualty reserves. Typically this deduction can produce economic savings of 3% of the annual expected retained losses, per year.

Captive Advisory

In the past two years, our Captive Advisory team has conducted nearly 90 feasibility studies. We implemented 15 captives in 2018.



Through this work, we were able to demonstrate an economic benefit for a majority of these captives.

When aligned with the Marsh Analytics Practice, clients see an additional 3% to 5% savings when funding retained risk through a captive.

Actuarial

In past year, our Captive Actuarial team has worked on approximately 20 new captive implementations and serviced more than 200 captive clients.

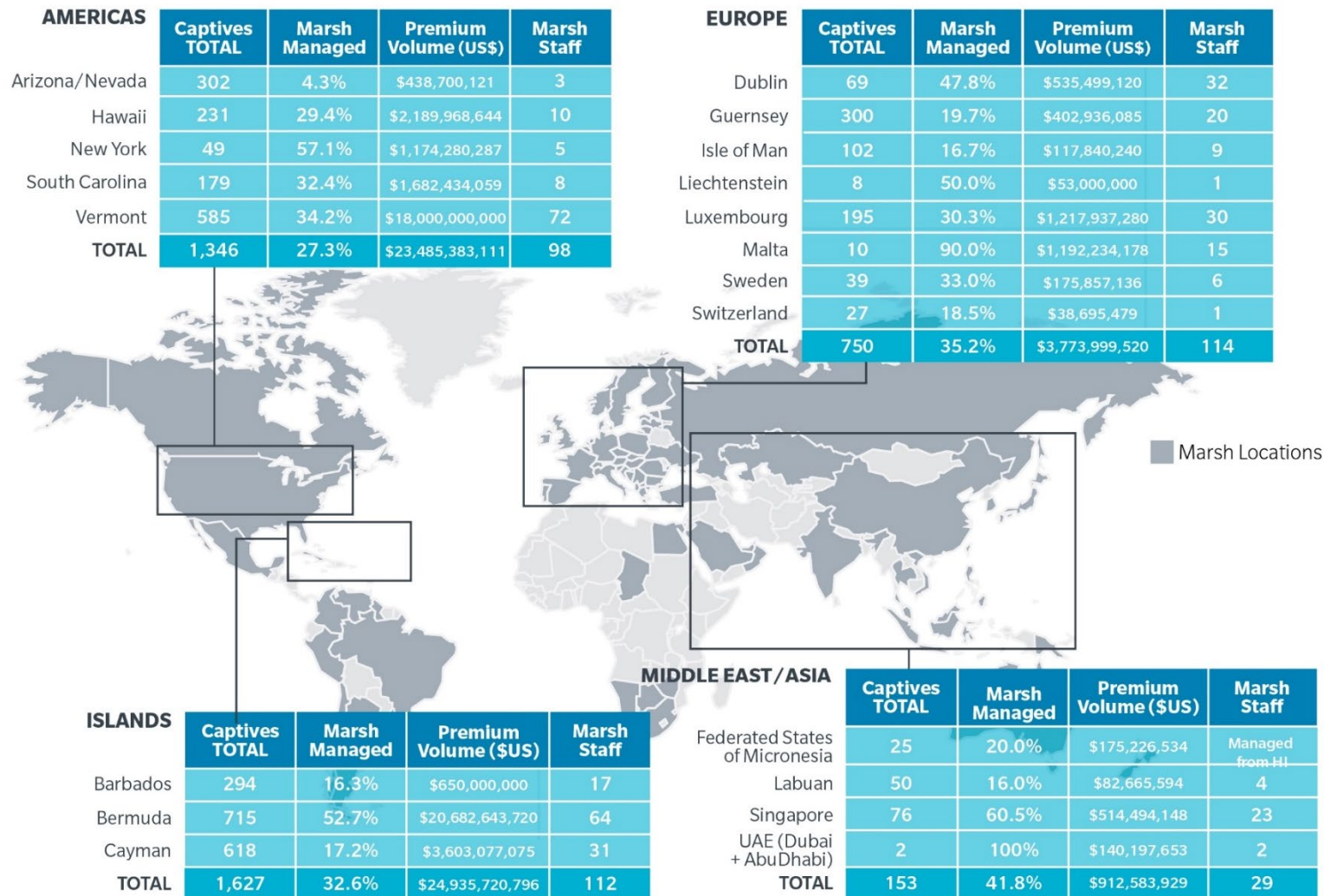


Our actuarial team has assisted the majority of our clients with FASB compliance under ASU 2015-09.

Our actuaries are dedicated to support captives with expertise and familiarity in working with auditors, managers, carriers, brokers, attorneys, third-party administrators, and regulators. Our in-house actuarial services save our clients time, money, and paperwork.

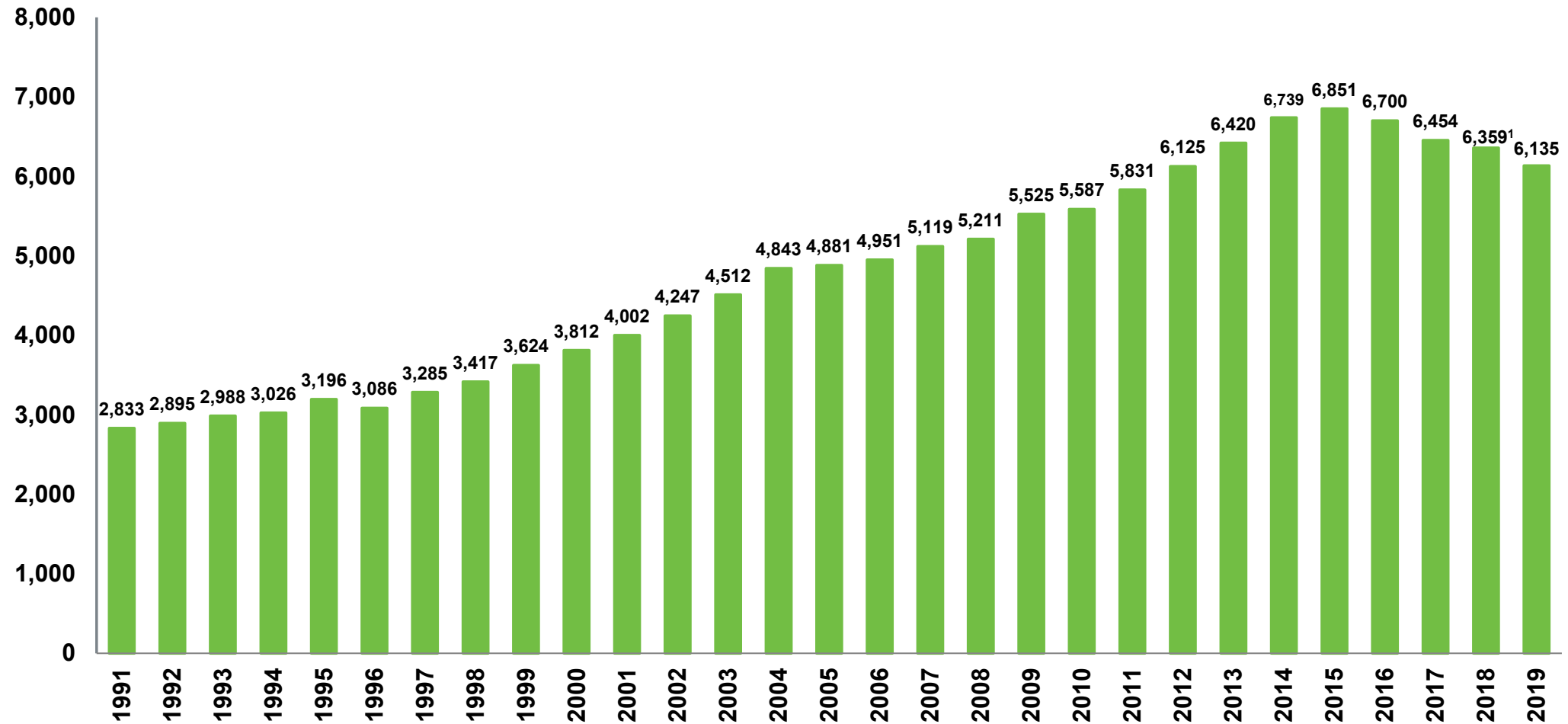
Marsh Presence in the Major Domiciles

Total Global Captive Market: 6,135 (Marsh 22.5% Share)



Marsh Captive Solutions

Number of Captives Worldwide – YE2019



Source: Business Insurance, 2020 Captive Managers & Domiciles, Rankings + Directory: 8

¹2018 is restated. (1994 to present), Source: Insurance Information Institute (1991-1993)

Section 2

MARSH CAPTIVE SOLUTIONS CORPORATE RISK FINANCE

Marsh Captive Solutions

Corporate Risk Finance Philosophy – Risk Transfer vs Risk Retention

Transferring Risk versus Retaining Risk – How to decide?

- Nature of the Risk – Long vs Short Tail Risks; Frequency vs Severity
- Operational requirements
- Capacity for risk retention
- Financial incentives to retain risk
- Market discount for retaining risk (financial rewards for risk retention)

Risk Transfer

versus

Risk Retention



Fixed Cost Insurance Program
(Fully Transferred)

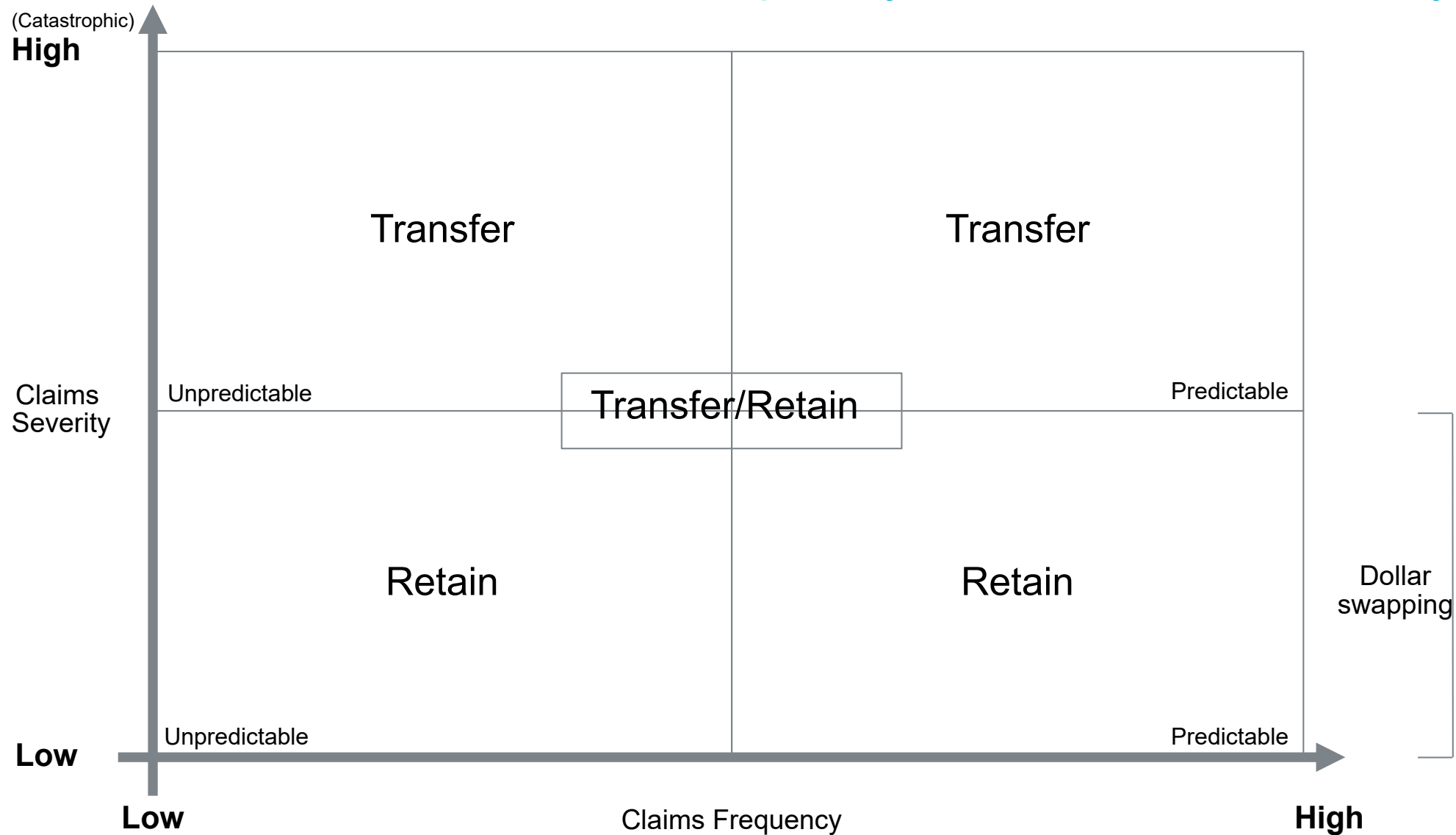
High Deductible/Excess Program
Partly Self-Insured
Balance Sheet Fund / Provision

Captive Insurance
(Partly Self-Insured)

No Insurance
Fully Self-Insured
Pay-As-You-Go

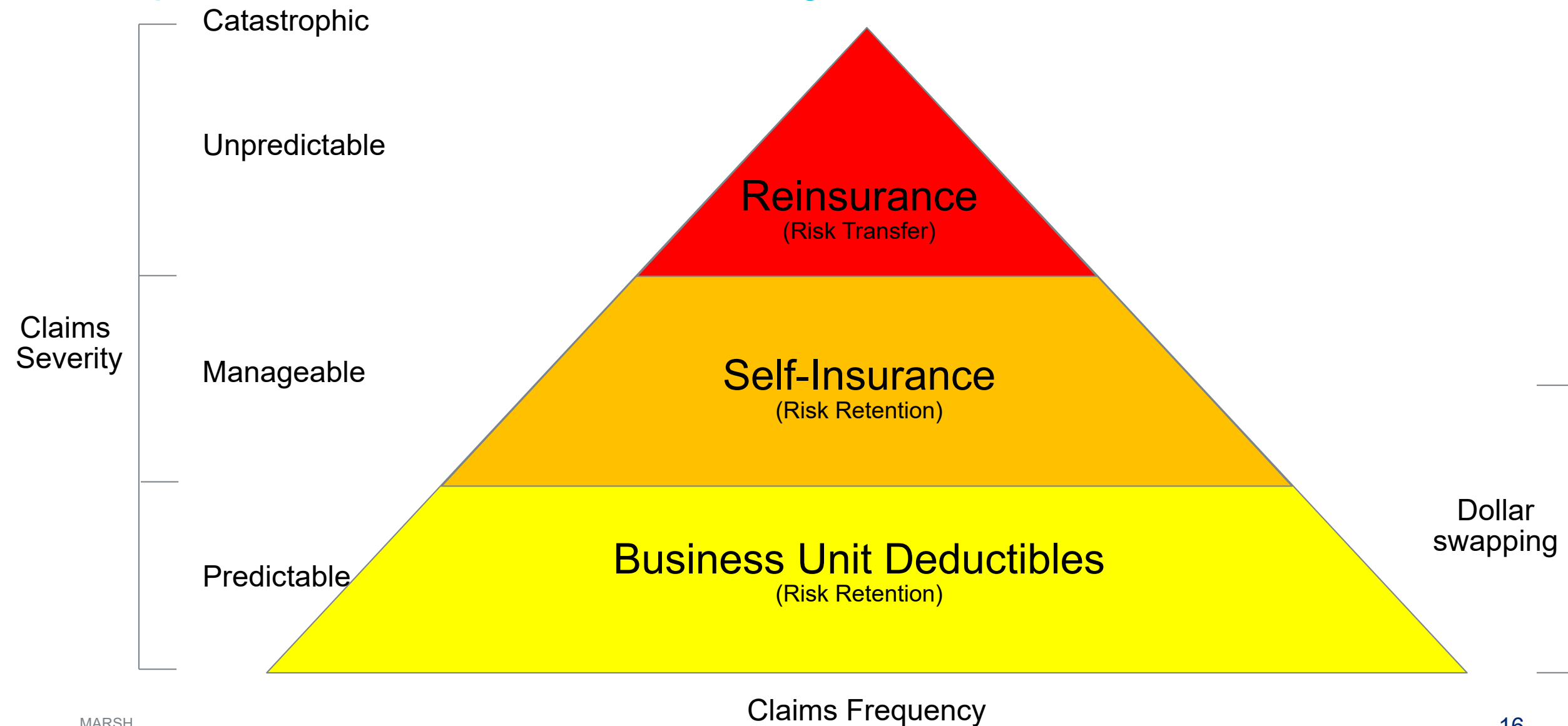
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Corporate Risk Finance – Claims Frequency versus Claims Severity



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Corporate Risk Finance – Risk Triangle



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Corporate Risk Finance – Risk Finance Options

Pay as you go:

- Claims are paid as they arise, out of revenues.

Why use?

- Minimal administration.
- Avoids premium taxes.
- Reduces external insurance costs.

Why avoid?

- Difficult to establish reserves.
- Timing.

Create balance sheet fund:

- Each operating company makes a contribution to a central risk fund.
- Claims are reimbursed from the central fund.

Why use?

- Minimal administration.
- Avoids premium taxes.
- Reduces external insurance costs.
- Improves cash flow.

Why avoid?

- Difficult to establish reserves.
- May breach cross border tax and insurance legislation.

Create captive insurer:

- An insurance vehicle formed by an organisation to participate in its insurance arrangements.

Why use?

- Ring fences funds for specific use.
- Reduces insurance expense.
- Access to reinsurance market.

Why avoid?

- Requires capital commitment.
- Long-term commitment.

Section 3

MARSH CAPTIVE SOLUTIONS

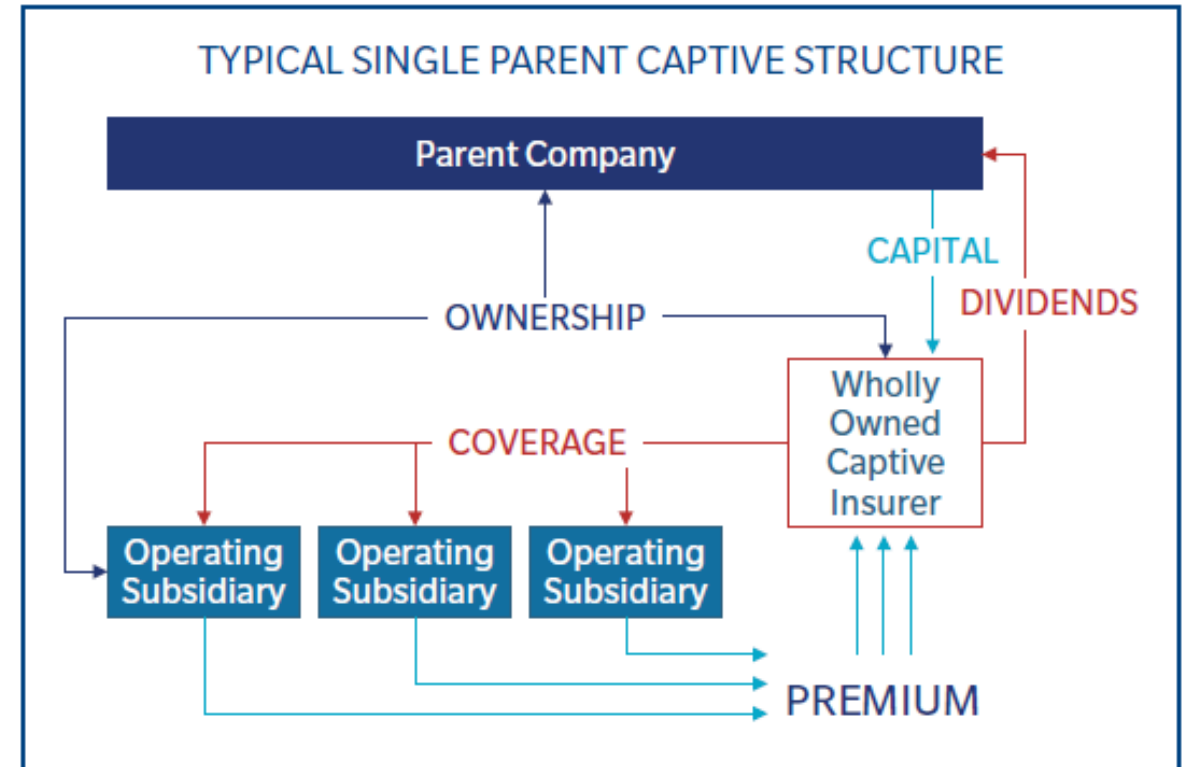
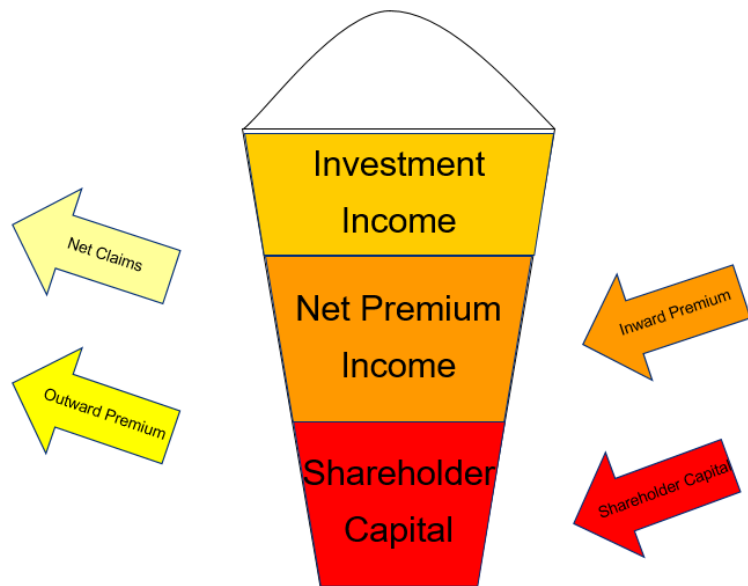
CAPTIVE BASICS

What Is A Captive?

Widely Accepted Definition

A captive insurance company is a bona fide licensed insurance or reinsurance company owned by a non-insurance company and which insures or reinsures the risks of its parent or affiliated companies

Simply put – it is a formalized mechanism to finance self-insured risks.

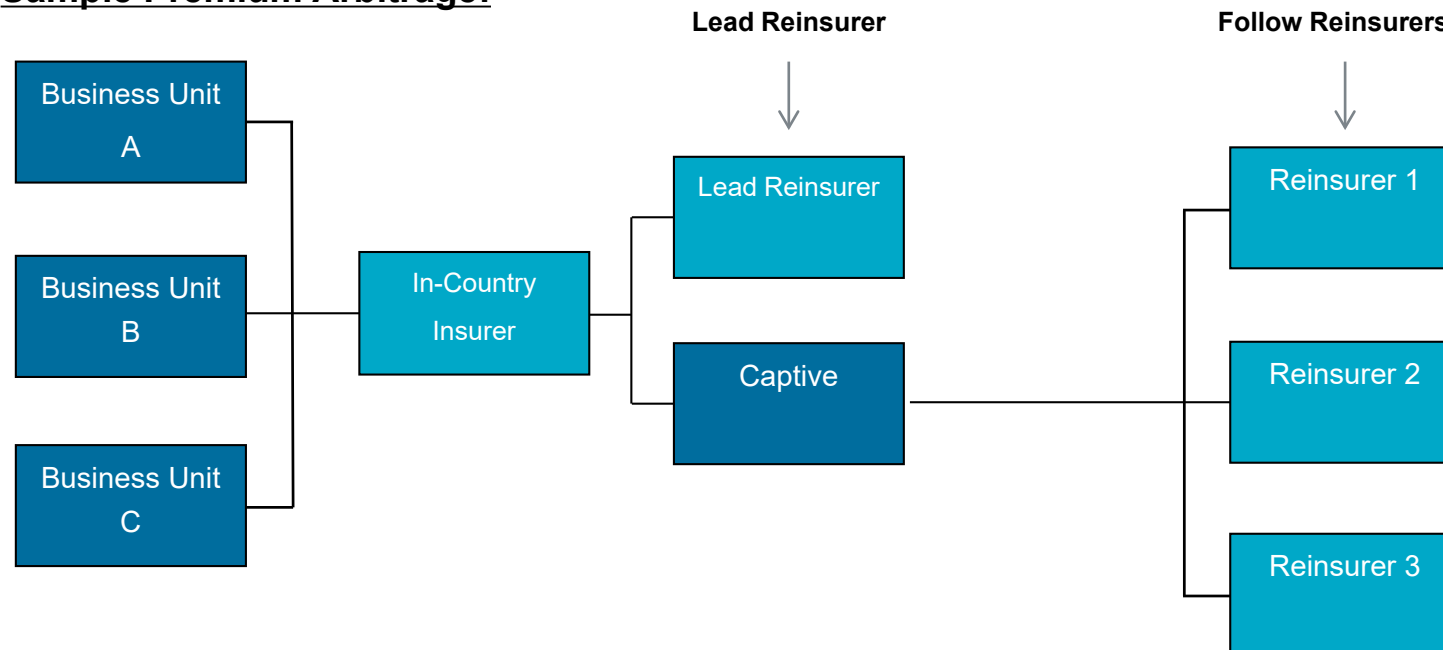


Captive Insurance

How do captives make money?

- **Premium Arbitrage** – difference between the (higher) commercial retail rates and the (lower) international wholesale reinsurance rates.
- **Underwriting Income** – difference between net premiums received and net retained claims paid.
- **Reinsurance Ceding Commissions** – commissions paid by reinsurers to cedants.
- **Investment Income** – investment income from capital, unearned premium reserves and claims reserves.

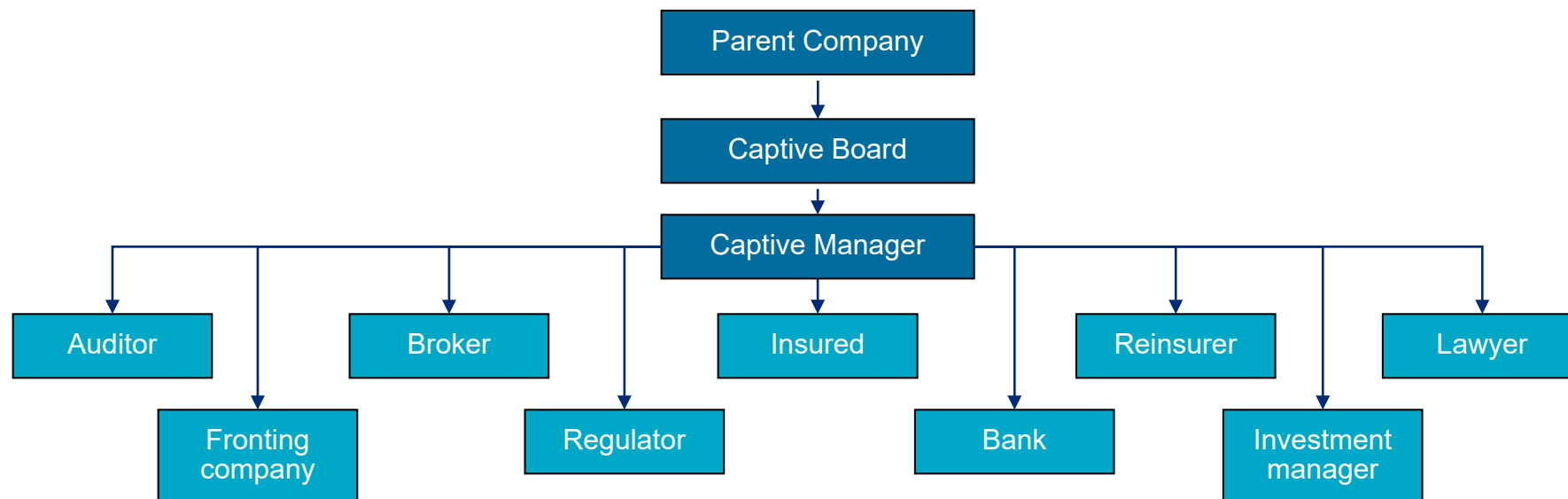
Sample Premium Arbitrage:



Captive Insurance

How is a captive managed

- Control of the captive will be with the board of directors elected by the parent (shareholder), usually a mix of executives from the parent company and local Marsh professionals.
- The board then appoints companies for central services like banking, broking, auditing and actuarial services.
- Licensed captive manager is appointed to carry out all operational functions on behalf of the captive and provides insurance and other expertise that is required by the captive.



Captive Insurance

Potential Benefits of Captive Utilization

Financial benefits

- Can potentially reduce insurance costs by retaining a portion of the premium for expected losses.
- Can improve control and the parent's negotiating position with the commercial insurance and reinsurance markets.
- Direct access to the lower cost international reinsurance market.
- Can generate underwriting profits and investment income otherwise retained by commercial insurers.
- Rewards good enterprise risk management practice.

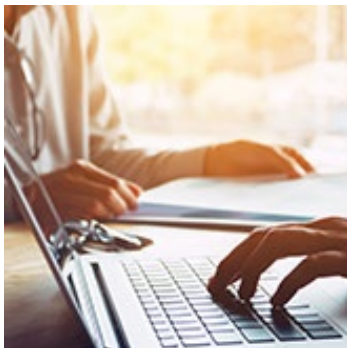
Strategic benefits

- Control and transparency.
- Facilitates a group-wide insurance procurement strategy.
- Can provide coverage for risks not insurable in the commercial market.
- Can reduce the dependence on commercial insurance
- Can improve control, continuity and flexibility in program design and broader, more simpler insurance contracts
- Can play the volatile market cycles.
- Can play focus point in enterprise risk management process.

What Are Other Companies Doing With Their Captives?

Casualty/Liability

- Employers/WC, auto, public/general, and professional liability.
- Products liability, product recall.
- Environmental liability.
- Excess liability/umbrella.
- Banker's blanket bond.
- Credit.
- Medical malpractice.
- Crime.
- Employment practices.
- Cyber risk.



Property

- Terrorism insurance.
- Quota share reinsurance.
- Shipping, cargo, and transit insurance.
- Marine cargo.
- Motor.
- Aviation.
- Residual value.



Third-Party Insurance

- Extended warranty.
- Customer, vendor, and joint-venture business.
- Service contracts.
- Employee benefits.



Corporate Risk Management

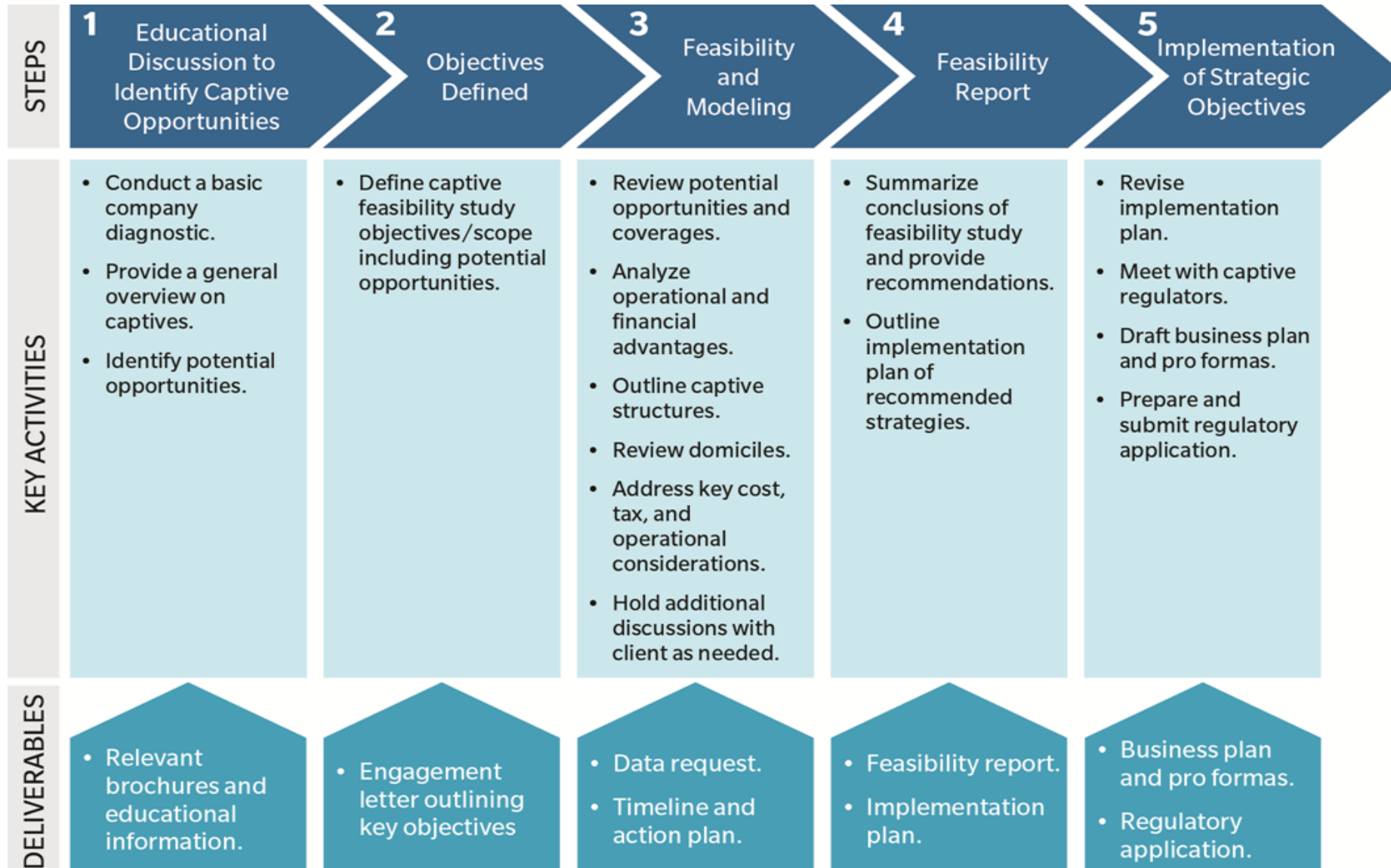
Captives and Risk Managers at the Core



Section 4

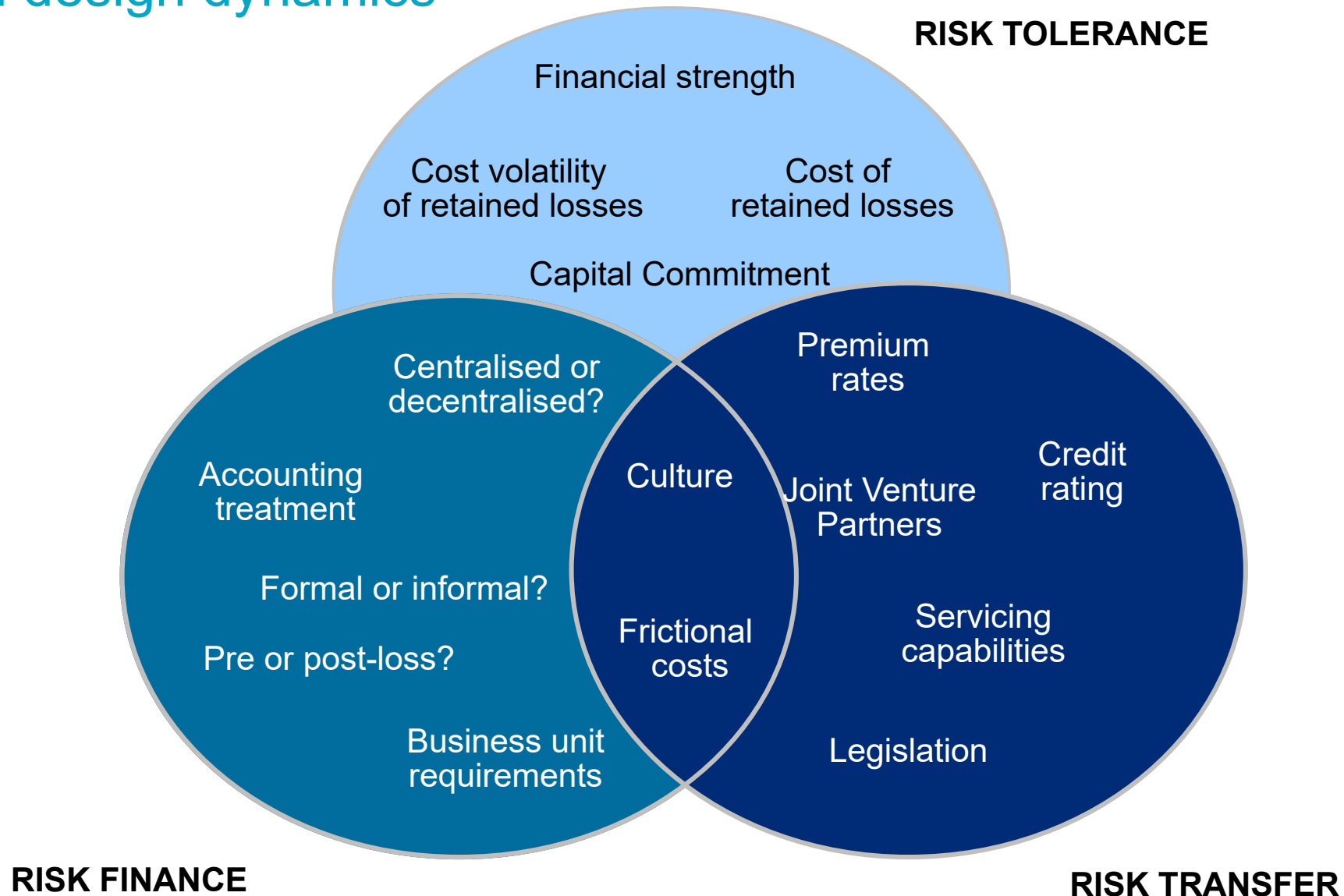
MARSH CAPTIVE SOLUTIONS FEASIBILITY STUDY

Evaluating a Captive Program



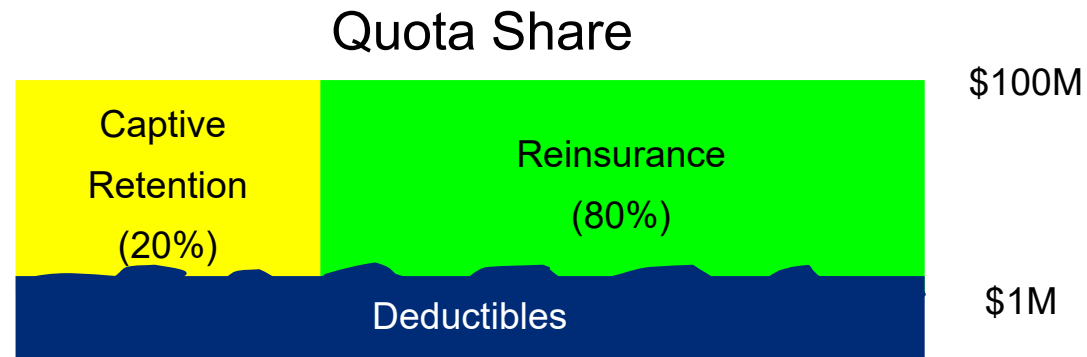
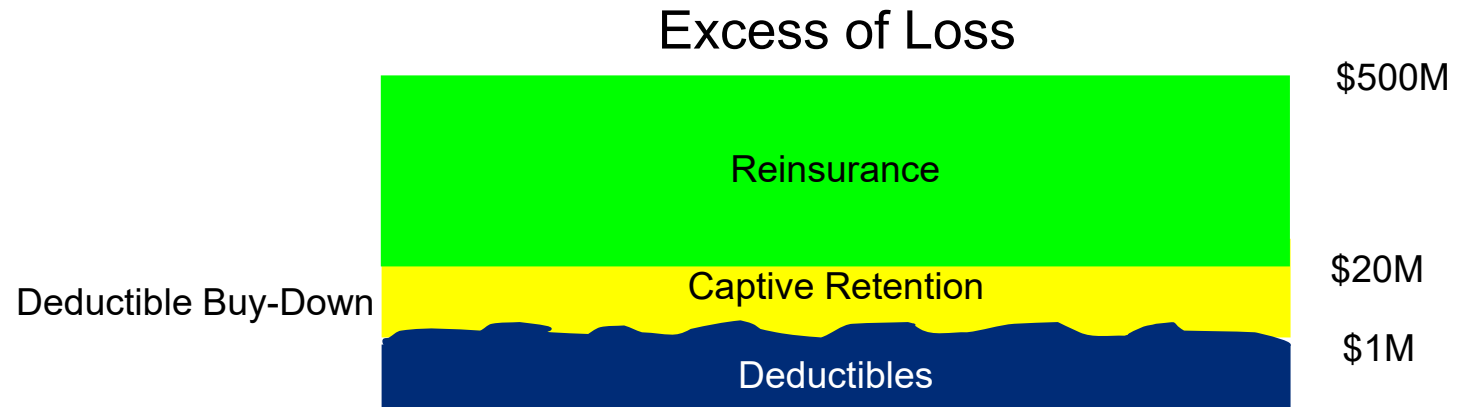
Evaluating a Captive Program

Program design dynamics



Captive Insurance

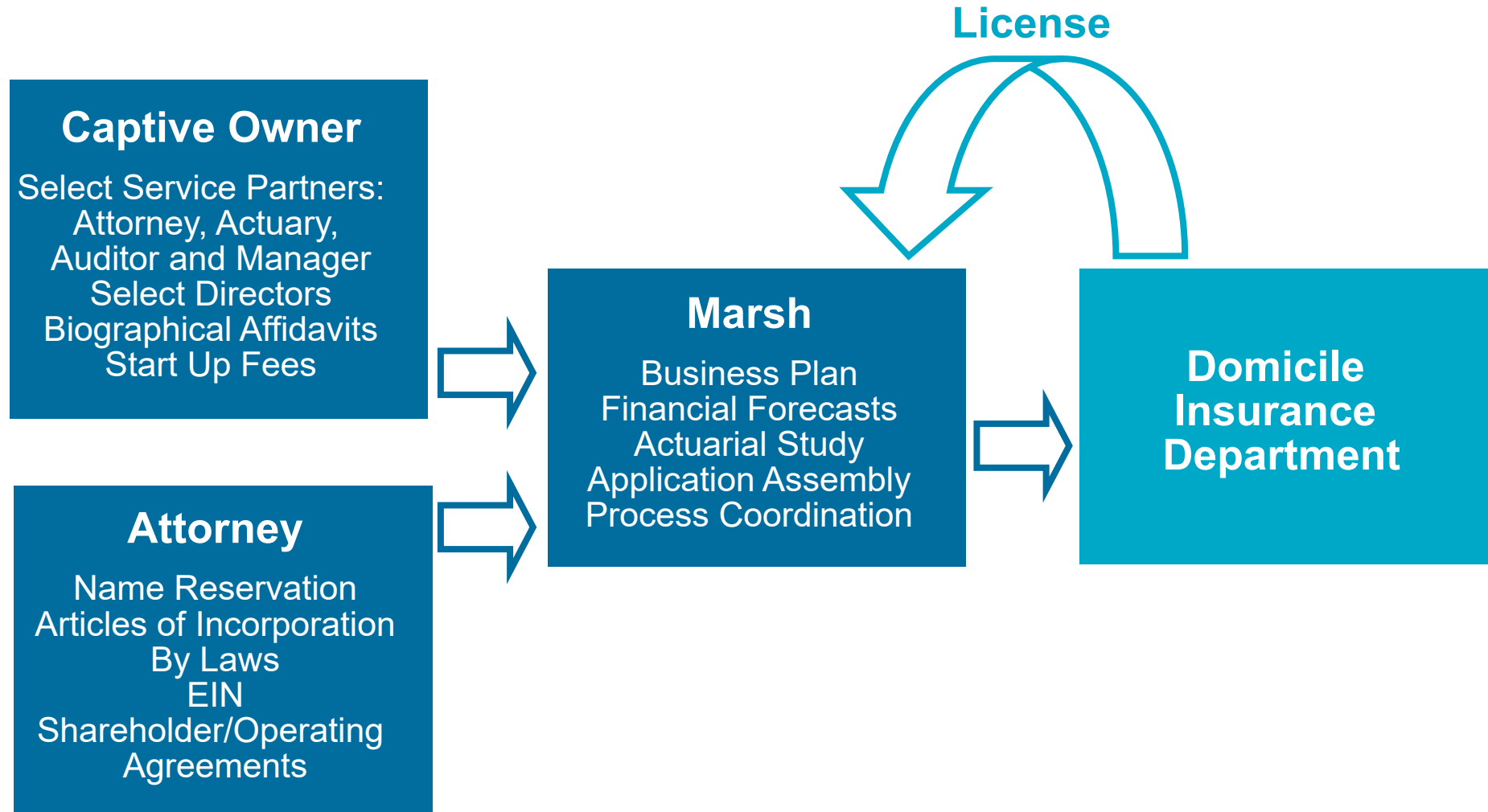
Captive program design



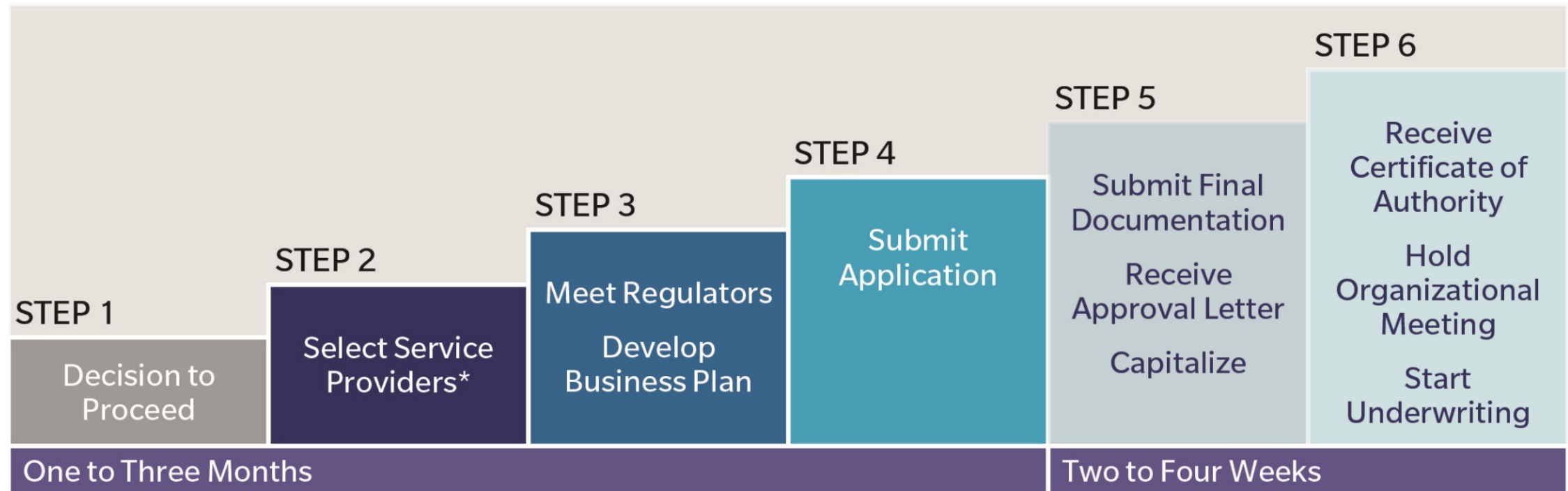
Section 5

MARSH CAPTIVE SOLUTIONS FORMATION PROCESS AND FEES

Application Process



Building a Captive Program



* Including selection of captive manager, auditor, attorney, bank, actuary, and asset manager (optional).

Matters for Consideration

Captive Feasibility Study	Fees on average range from US\$30,000 to US\$65,000.
Start Up Costs	Regulatory, legal, actuarial, and implementation fees (approximately US\$35,000 to US\$45,000 depending on domicile).
Annual Operating Costs	Regulatory, legal, actuarial, audit, and captive management fees (approximately US\$90,000 to \$150,000 per year).
Capitalization	Typical premium to capital ratio required ranges from 3:1 (more severity type risks such as property) to 5:1 (more predictable risks such as casualty) and may be met through cash or a letter of credit depending on domicile.
Opportunity Cost on Funding Captive Premium	Ability for captive to mirror investment returns on cash flow used to support premiums versus if cash had remained with parent company.

Section 6

MARSH CAPTIVE SOLUTIONS CAPTIVE MANAGEMENT

Marsh Captive Solutions

Captive Management

- Our captive management service enables our clients to operate their own insurance company without incurring high staff and infrastructure costs.
- Our professionals work with you every step of the way from the incorporation of your captive through to its active day-to-day management.
- Services we offer cover a wide range of activities including:
 - Insurance administration.
 - Claims management services.
 - Accounting and treasury services.
 - Compliance and statutory reporting.
 - Management information systems.
 - Consulting services.
 - Incorporating new captives.
 - Company secretarial.
 - Corporate governance.



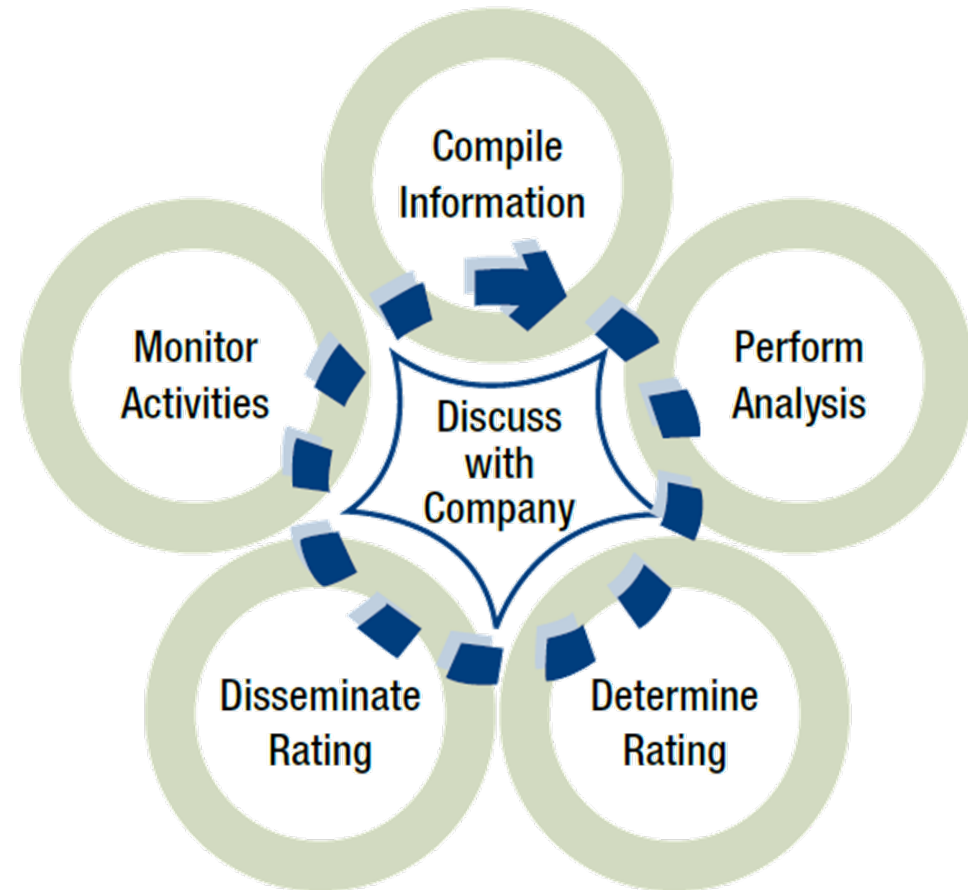


Analysing Captives: An Interactive Rating Process

Ghislain Le Cam, Director, Analytics
AM Best

The Interactive Rating Process

- The rating process starts with an in-depth meeting with senior management
- Ratings are determined by committee – by 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

Rating Translation Table

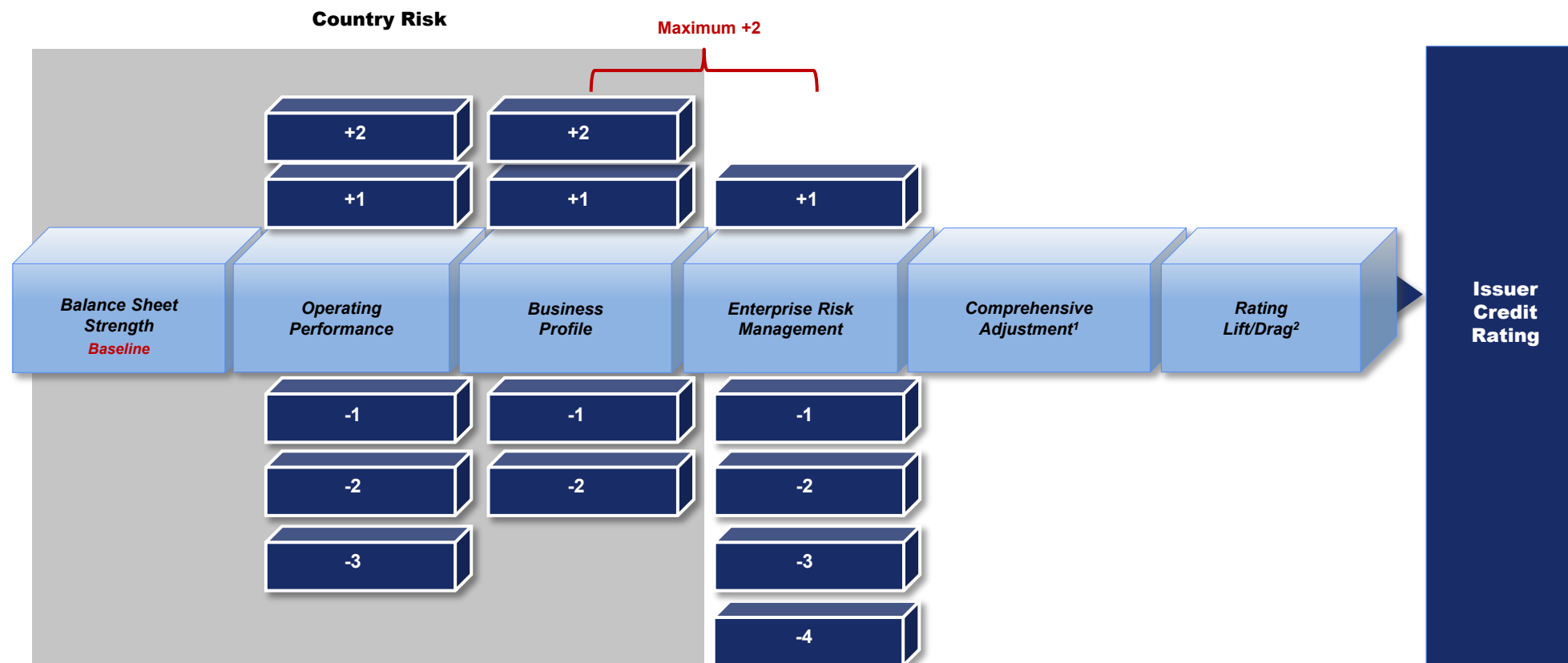
Long-Term ICR	FSR
aaa aa+	A++
aa aa-	A+
a+ a	A
a-	A-
bbb+ bbb	B++
bbb-	B+

Long-Term ICR	FSR
bb+ bb	B
bb-	B-
b+ b	C++
b-	C+
ccc+ ccc	C
ccc- cc	C-

Note: Scales E to NR not shown

The rating symbols A++, A+, A, A-, B++, B+ are registered certification marks of AM Best Rating Services, Inc.

Building Block Approach



Notes:

1: A comprehensive adjustment can be applied of + 1 or - 1 for creditworthiness not captured elsewhere

2: Lift/drag applies to assessment of non-lead rating units in relation to the broader organisation leading to typical lift/drag of +4 to -4

Balance Sheet Strength Assessment



Specialty Criteria Considerations

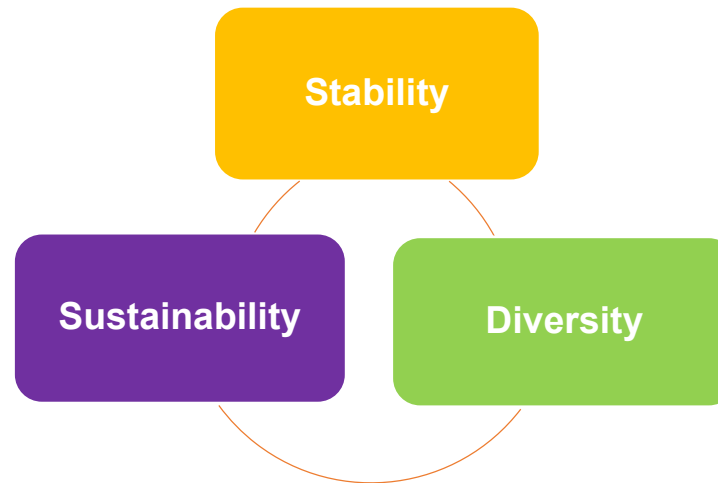
Alternative Risk Transfer

Exposure to large loss events

Loan-backs to parents

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

Operating Performance Assessment



- 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

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

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

No special ERM considerations for captives

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 and the captive's resources are meaningful for the parent
History of capital support or explicit support in place	History of punitive capital actions
	No regulatory restrictions on the flow of capital

Methodology References and AM Best's Industry Research

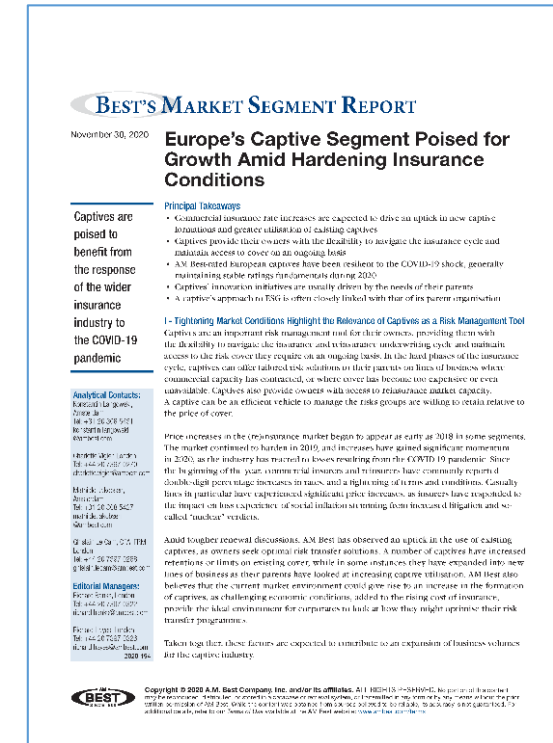
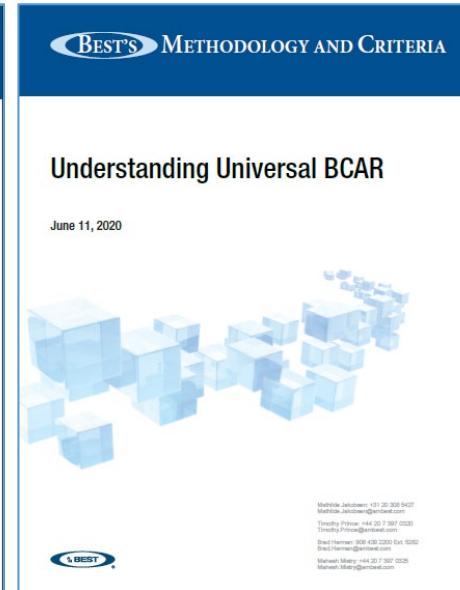
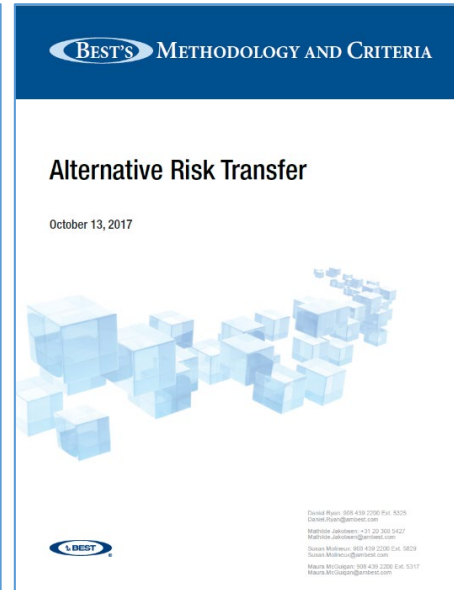
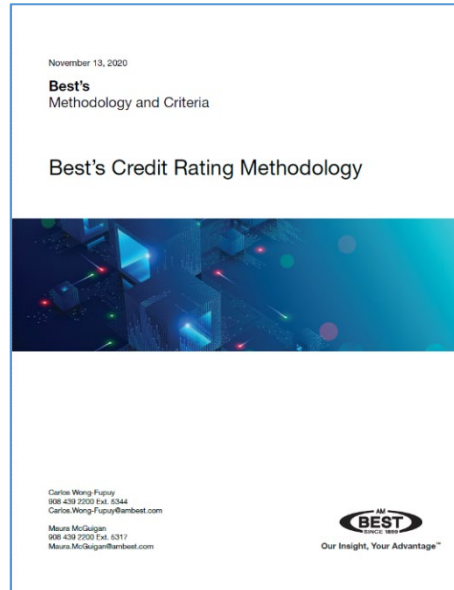
For further information, please see:

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

Key Criteria:

<http://www3.ambest.com/IndustryResearch>

AM Best's Special Reports



Panel Discussion

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