Captives: Back to Basics

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Agenda

• Brief History of Captives
• Quick Reminder of What They Are
• Two Watershed Events and Insights from the Past
• Growth in Numbers and Domiciles
• Pressures (Opportunities) Currently
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.
Captives

• Definition
  – A subsidiary owned by one or more parent organizations established primarily to insure the exposures of its owner or owners

• In the risk management context, captives combine
  – Risk retention
  – Risk financing
  – “Alternatives” to traditional insurance
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
Total Number of Captives

Hard insurance market

Largest Domiciles
- Bermuda 670
- Cayman Is. 661
- Vermont 620
Watershed Events for Captives

• Liability Insurance Crisis
  – General liability insurance premiums skyrocketed
    • from 1984 to 1987 increased from $6.5bn to $19.5bn (300%)

• Medical Liability Crises
  – Medical malpractice crisis from the 1970s
    • one of the first events that led to insureds seeking relief by forming captives (growth in Cayman Islands)
  – End of soft market in 1984
    • some healthcare providers experienced increased premiums of 50-100% during 1984-1985
Watershed Events for Captives

- **September 11**
  - General market capacity
    - *An insurance broker,* “the events of Sept. 11 have clearly and significantly impacted the insurance marketplace”
    - “I expect with capacity and premium limitations that alternative risk vehicle activity (including captives) will increase significantly”
    - Catastrophic losses in insurance lines that hadn’t seen it before (WC)
  - Terrorism risk
    - For airlines - passenger and third-party war and terrorism risks
    - For other businesses - more control over coverage limitations and the price
Top Domiciles Globally

Number in 2021 (2020)

- Bermuda 670 (680)
- Cayman Islands 661 (652)
- Vermont 620 (589)
- Utah 384 (396)
- Delaware 313 (288)

Since 2010, the number of captives in Bermuda and the Cayman Islands has decreased 15%, and the number in the U.S. has increased 71%
Recent Evolution in U.S. Domiciles

• More favorable regulatory and economic policies in a number of states across the U.S.

• Continued scrutiny of offshore financial arrangements
Growth of Captives in U.S. Domiciles

- Vermont
- Utah
- Delaware
- Hawaii
Pressures (Opportunities) Currently

• Hard insurance market
  – Cat-exposed Property, Excess Liability, and Reinsurance
  – Deductibles, limits and coverage terms
• Growing concern over Cyber risks and D&O
• Interest in cell and group captives by middle-market companies
• IRS scrutiny of 831(b) - microcaptives
• Other emerging risks
  – Pandemic risks
  – ESG strategy