



The Evolution of Captives

Rob Hoyt
Moore Chair and Department Head
University of Georgia

Washington, DC
November 18, 2015

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

Global captive premiums in 2010 were about \$55 billion (50 to 60% from U.S. businesses)

Captives

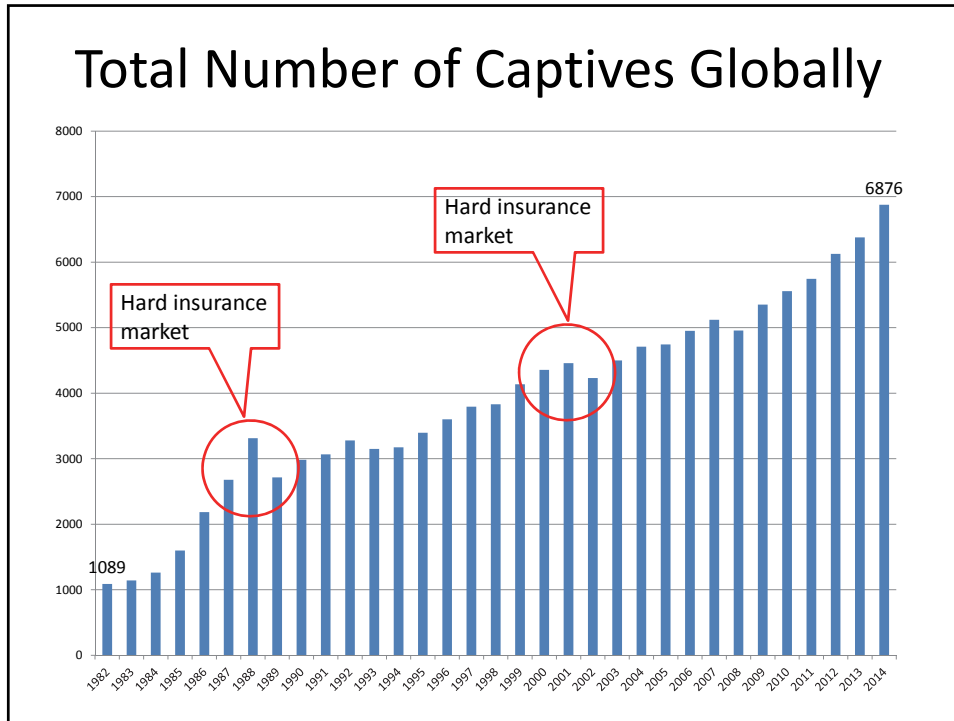
- Definition
 - a subsidiary owned by one or more parent organizations established primarily to insure the exposures of its owner(s)
- In the risk management context, captives combine -
 - Risk retention
 - Risk financing

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



- ### Top Domiciles Globally (Number in 2014)
- Bermuda (800)
 - Cayman Islands (759)
 - Vermont (587)
 - Utah (422)
 - Anguilla (379)
 - Delaware (333)

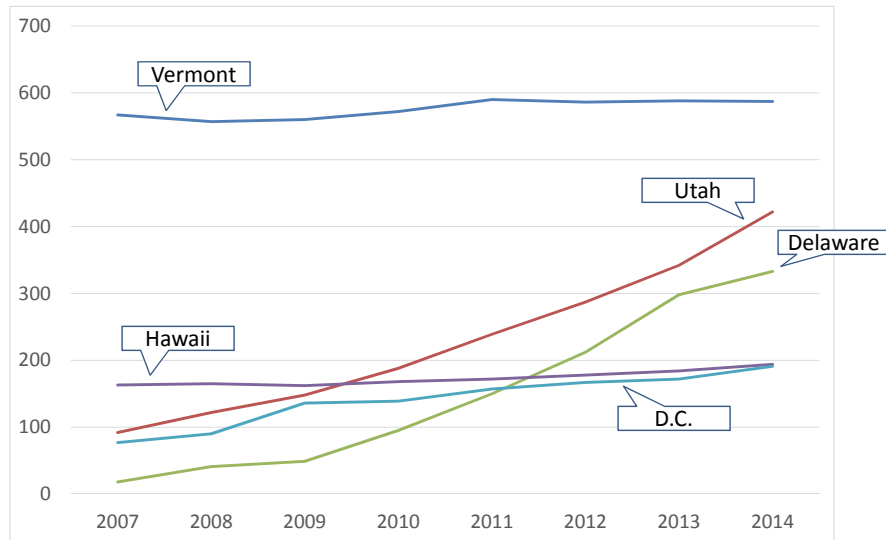
Drivers in the Growth of Offshore Captives

- 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-captives
 - 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

Contact Information for the Risk Management and Insurance Program at the University of Georgia

- Department Head, Rob Hoyt
 - Brooks Hall 206
 - rhoyt@uga.edu
- Our web site
 - www.terry.uga.edu/insurance