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18 August 2021 - **Issue 230**


# The Palmetto State

## Experts discuss South Carolina's position as a mature domicile and emerging risks in the pipeline

### Market Update

Industry professionals discuss the current captive insurance market trends

### Emerging Talent

Nick Gurgone
Consulting actuary
Pinnacle Actuarial Resources

captiveinsurancetimes

# Issue 230

www.captiveinsurancetimes.com

Published by

**Black Knight Media Ltd**

16 Bromley Road, New Beckenham
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# In this issue

# VCIA: The captive industry's response to the COVID-19 pandemic

The captive industry has raised a significant amount of capital in terms of start-up companies, existing insurance companies and reinsurance companies, as well as Lloyd's syndicates.

This statement was made at the Vermont Captive Insurance Association (VCIA) 2021 conference in a panel that reviewed the captive industry's response to the COVID-19 pandemic.

Captives are structured to allow companies to set aside reserves to maintain their financial position during volatile market conditions, and are utilised by catastrophe modelling teams to insure against natural disasters.

Even before the disruption of the pandemic, captives were widely used to insure against unforeseen events. During the panel discussion, Hugo Crawley, chairman, TigerRisk Partners (UK), identified that the captive insurance industry saw changes on a macro level arising out of the pandemic, which identified several vulnerabilities.

"In the last 18-24 months there has been a significant amount of capital raised in the industry. I think everyone was anticipating that there would be much greater losses in the market than has actually been the case," said Crawley.

According to Crawley, about $14 billion of new capital has come into the market, which he determined to be significant. He added that as a result of the pandemic, the industry can expect to see a hardening insurance market, and indeed a hardening reinsurance market too.

"It is not that there has been no losses, but it is to correct the balance sheets of the past as well as looking at what the needs are going forward," explains Crawley.

In terms of lessons learned based on the UK experience, Crawley noted that although the market shut down, London "remained open".

Industry participants were still able to trade but they had to adapt to new technology and find new ways to endorse the whole placement and processing of business, panellists agreed. It was also agreed that while new products and innovations were challenging, the pricing environment was more favourable for insurers and there was an increased focus on price adequacy. It was further noted that specialist lines attract more capital and new entrants.

The panel then discussed what the client claim landscape looks like, with Michael O'Malley, managing director, Strategic Risk Solutions Vermont, exploring the impact on business interruption exposure.

O'Malley noted: "We have a quick-service restaurant group captive in 48 US states, in which we studied the COVID-19 related general liability (GL) and workers' compensation claims."

He continued: "There was very minimal shutdown in those locations, so they effectively went from an in-store experience to a pure drive-thru experience. Over that time, we have tracked one workers' compensation claim to GL claims."

"All three were very minor, so I think it just goes to show that businesses in the US, and around the world, did a great job of adjusting to the change in climate and exposure, and this is reflected in claim activity."

Later during the discussion, Gail Newman, vice president, risk management, Bright Horizons, talked about business continuity planning and disaster recovery.

Newman outlined: "Some things that we are doing in order to comfortably approach our captive is strengthening our enterprise risk management approach with more focus on our risk register and how we manage the risk. It is imperative to have risk owners communicating frequently with those owners and assessing the strength of their mitigation plans, as it is a very iterative process now." ■


## Vesttoo raises $6 million in Series A funding

Alternative reinsurance and investment platform Vesttoo has raised $6 million in a Series A funding round led by Hanaco Ventures, a New York and Tel Aviv-based venture capital fund that invests in emerging and late-stage start-ups from the global tech ecosystem.

The round is part of Hanaco's broader investment strategy in Vesttoo, aimed at further developing Vesttoo's insurance-linked programme (ILP) offering.

Vesttoo's ILP offering is a security-based investment portfolio based on non-catastrophe insurance risks, which provides asset managers with the opportunity to earn additional alpha from existing assets without the need to allocate cash.

The ILP structure offers institutional investors risk remote investments in collateralised reinsurance deals, earning BB-grade spread of AA-rated uncorrelated risk in addition to the yield of their existing high-quality assets, with a significant global deal pipeline targeting first closing of $1 billion assets under management within 12 months. Furthermore, Vesttoo's marketplace will allow insurers, reinsurers and pension funds to model, structure, price and place their offering online, while giving institutional investors direct access to the untapped market of alternative reinsurance and exceptional return on risk.

Both the ILP and the marketplace are novel instruments in the insurance space aimed at increasing liquidity and much needed capacity in the reinsurance market, as well as facilitating the alternative reinsurance ecosystem, an integral part of Vesttoo's business strategy to bridge the funding gap in the reinsurance market.

Yaniv Bertele, CEO of Vesttoo, says: "We have a significant global deal pipeline with insurers from the US, UK and mainland Europe, and are looking forward to further scaling Vesttoo's ILP and fully digital marketplace with Hanaco's support."

Pasha Romanovski, co-founding partner of Hanaco Ventures, comments: "Vesttoo is disrupting the reinsurance industry."

"The company is building a digital marketplace and has already proven its ability to sign multi-year contracts with leading US and EU insurance and reinsurance providers."

"Hanaco Ventures chose to invest in Vesttoo because of the unique solution and the company's impressive founding team who will have a big impact in this untapped sector." ■

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## Arbol launches Captive+Parametric solution at VCIA conference

Parametric insurance provider Arbol has launched a solution for climate change risk management, Captive+Parametric.

Announced at the Vermont Captive Insurance Association's (VCIA) annual conference, the solution enables companies to take immediate action in climate change risk management by transferring climate risks into captives through a parametric structure.

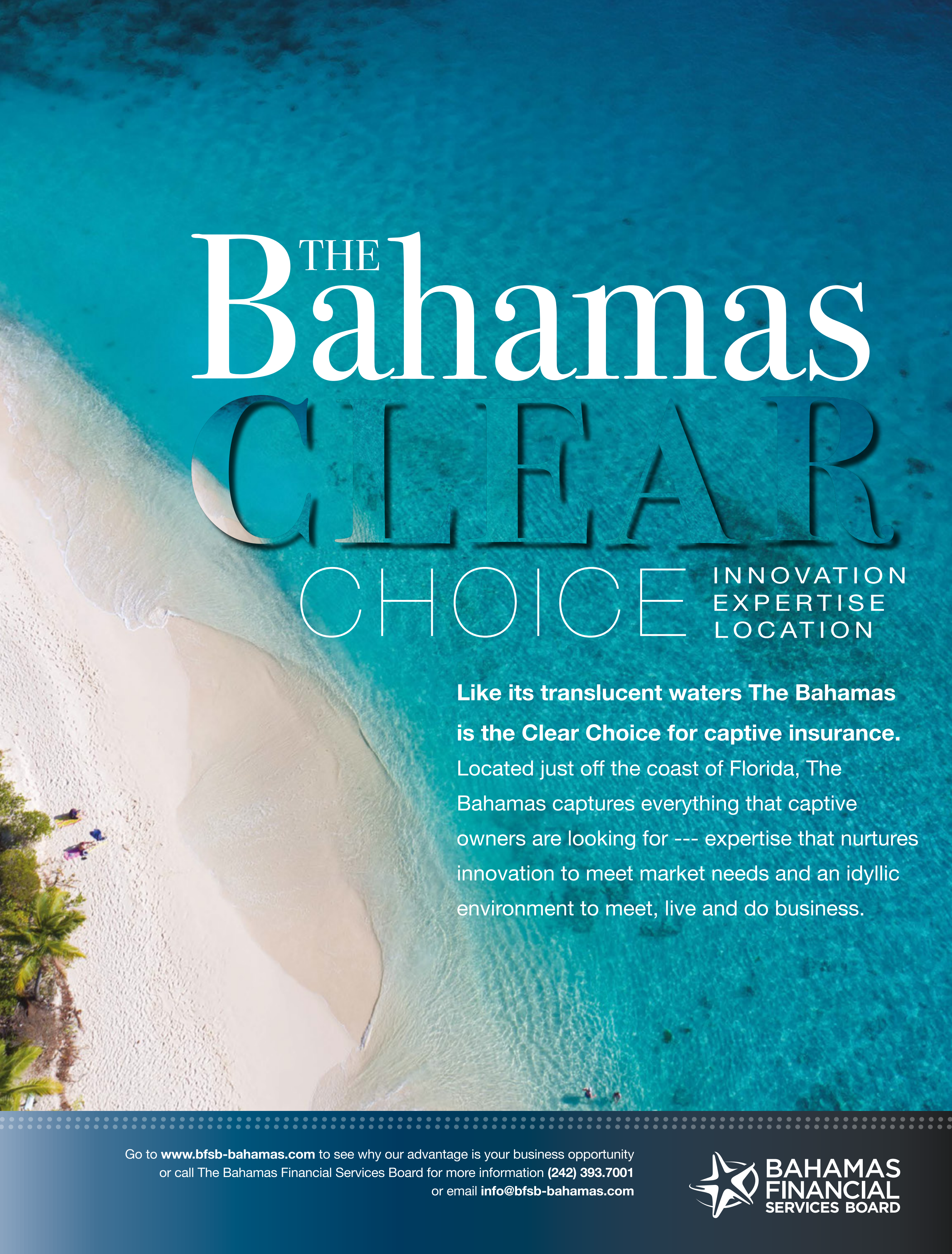
Arbol implements machine learning, artificial intelligence and blockchain technology to provide transparency and efficiency within the weather risk market.

Captive+Parametric will provide participating companies with full access to Arbol's technology and data tools, including data and climate intelligence, online structuring and pricing tools, and automatic settlements.

Hong Guo, executive vice president and chief insurance officer at Arbol, explains the demand for the solution: "90 per cent of Fortune 500 companies have captive insurers for managing traditional and emerging risks. As severe weather events become a greater point of global concern, the traditional risk management framework will need to account for risks related to climate and weather."

"We believe that a captive is the best mechanism and that parametric protection is the ideal product structure for corporations to start actively managing mounting climate risks," Guo adds.

The Captive+Parametric solution follows Arbol's launch of a standalone network and climate intelligence platform, dClimate, earlier this year. ■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## Moody’s acquires risk modelling company RMS

Moody’s is set to acquire Risk Management Solutions (RMS), a leading provider of climate and natural disaster risk modelling and analytics, to advance its global integrated risk assessment strategy.

The acquisition is expected to close in late Q3 2021 and is reported to be around $2 billion, which will increase Moody’s insurance business to almost $500 million in revenue.

RMS primarily serves the global property and casualty insurance, reinsurance and insurance-linked securities industries, and is expected to secure around $320 million in revenue and $55 million in operating income for fiscal year ending 30 September 2021.

The firm’s global risk offering spans natural and man-made catastrophes, cyber risk and pandemics across risk identification, mitigation, underwriting and portfolio management.

Following the acquisition, global integrated risk assessment firm Moody’s will combine its risk and finance solutions for life insurers with RMS’ risk modelling solutions to provide capabilities across climate, cyber, commercial real estate and supply chain risk.

Rob Fauber, president and CEO of Moody’s, comments: “We are excited to add RMS and its team of world-class data scientists, modellers and software engineers to the Moody’s family to help accelerate solutions that enable customers to build resilience and make better decisions.”

Karen White, CEO of RMS, adds: “Moody’s is an exceptional fit for RMS and our customers. We share the vision to bring a global, integrated risk assessment platform to our markets with the goals of deeper, more sophisticated risk insights and greater global resiliency.”

“Within Moody’s, I am confident RMS will be able to accelerate technology and model innovations while combining with Moody’s core data and analytics offerings for powerful, holistic solutions. The team and I are excited to bring new value to customers as we transform how we are able to understand and mitigate the future of risk,” she continues. ■

## Aon: industry collaboration and revenue growth for Q2 2021

Insurance broking in North America has become more innovative and symbiotic, according to Aon's new report, 'Global market insights Q2 2021'.

The report identifies that industry professionals are collaborating more across risk, consulting and reinsurance to support risk assessment and risk financing, as well as exploring alternative capital and captive feasibility evaluation.

Looking at the US in particular, Aon determines that cyber coverage has high underwriting scrutiny with significant rate increases, while casualty and liability has difficult coverage negotiations as underwriters are especially restrictive on wording related to communicable diseases and pandemic exclusions.

Aon's report also notes that in South America, rate increases and policy restrictions are generally less intensive; at the same time, cyber coverage continues to explore alternative risk transfer methods such as captives.

More generally, Aon recognises new capacity in the global insurance market, described as "tight but sufficient", as well as more detailed and rigorous underwriting standards as insurer decision-making becomes more centralised and new capital in the market causes reinsurers to continue to evaluate new areas for growth.

The insurance-linked securities (ILS) market in Q2 2021 was described as "record-setting", with robust momentum for both investors and sponsors. For Q3, Aon predicts that additional capital in the ILS market will be reallocated into the cat bond space, owing to the focus of many investors on liquidity and a reduced risk tolerance.

Aon also recently released its revenue statistics for Q2 2021, reporting a 16 per cent year-on-year increase in total revenue to $2.9 billion, including an organic revenue growth increase of 11 per cent. The organic revenue of commercial risk solutions grew by 14 per cent, which Aon attributes to strong new business generation, retention and management of renewal book portfolios. Aon's risk solutions segment encompasses casualty risk management, business continuity risk management, environmental risk services, and captive insurance, management and consulting.

In its Q2 2021 report, Aon notes core property and casualty coverage remained strong across North America, South America, Asia, Europe, Middle East and Africa. In addition, transaction liability, construction and cyber consulting indicated "significant growth", following a negative impact in Q2 2020.

Elsewhere, reinsurance solutions' organic revenue growth increased by 9 per cent, with Aon stating this reflects growth in treaty, supported by net new global business generation and capital markets transactions. Aon's reinsurance segment covers risk transfer, claims advocacy and capital management solutions for speciality practice groups, including environmental, terrorism, cyber, general liability and workers' compensation.

Operating income increased to $672 million, while total operating expenses increased by 16 per cent as a result of transaction costs related to the terminated proposed business combination with Willis Towers Watson, which requires Aon to pay a $1 billion termination fee.

Greg Case, CEO of Aon, comments: "The results demonstrate the incredible resilience of our colleagues and the power of Aon United. We are moving forward at an accelerated pace, with a proven leadership team and an enduring strategy. Our ability to innovate on behalf of clients remains unrivaled and continues to translate into significant progress against key financial metrics and shareholder value creation." ■

## State of Delaware to participate in NAIC climate risk survey

The US state of Delaware will participate in the National Association of Insurance Commissioners' (NAIC) Insurer Climate Risk Disclosure Survey, in an effort to assess how the impacts of climate change could reverberate across the insurance industry.

Some 82 Delaware insurers that reported $100 million or more in 2020 premiums have been asked to respond to questions about their investment and risk management policies.

This includes their processes to identify, assess and reduce climate-related risks as well as actions taken to encourage policyholder mitigation efforts and engage key constituencies in climate-based discussions, and information about a company's existing analysis of risk and its climate-related goals, such as reducing emissions.

The changing environment means that "insurance must be a changing industry", according to the NAIC, with its effects being felt across investment practices, increased claim occurrences which impact companies' financial sturdiness, and the access that consumers have to insurance products .

Insurance departments throughout the US are working to evaluate both risks to the industry and its resiliency in responding to those challenges to ensure continued market stability through several mechanisms, including the NAIC's Climate and Resiliency Task Force and the eight-section survey. In total, over 1,200 insurers are expected to complete the survey, representing more than 70 per cent of the US insurance market.

The California Department of Insurance, who asked the state of Delaware to participate in this year's survey, will compile the data of all participating states and issue a public report.

The closing date for survey submissions is 31 August 2021.

Insurance commissioner Trinidad Navarro says: "In Delaware and across the country, residents are feeling the impacts of climate change, relying on insurers to respond to the heightened risk of damage to our properties, businesses, homes, and lives. As natural disasters occur more frequently and with more intensity, the industry must be prepared to provide rapid response."

He adds: "Through participating in the Climate Risk Disclosure Survey we can better understand how prepared Delaware insurers are for these events and what opportunities we have to protect residents from these effects."

### BMS Re acquires Trean Intermediaries

BMS Re, the independent reinsurance broker, has completed its acquisition of Trean Intermediaries.

Trean Intermediaries specialises in workers' compensation, property and casualty, accident and health, personal auto, public entity, and professional liability lines for insurers and managing general agent clients.

*Read the full article online*

### AXA XL bolsters insurance firm's H1 2021 results

Multinational insurance firm AXA has reported a gross revenue figure of €54 billion for H1 2021, marking a year-on-year increase of 7 per cent.

This increase was also attributed to continued favourable price effects, as well as growth in the insurer's health and life and savings lines.

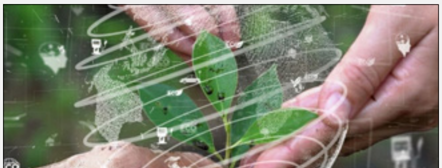
*Read the full article online*


### A.M. Best: US rated captives continue strong performance

The operating performance of rated US captive insurance companies exceeded that of the commercial insurance market in 2020, according to a new A.M. Best report.

The market segment report attributes this performance to COVID-19 market conditions, which fuelled emerging areas of growth.

*Read the full article online*



### Guernsey ESG accreditation scheme brings business

The accreditation scheme for managing environmental, social and governance opportunities, risk and impact in Guernsey has attracted new insurance businesses to the island, according to Guernsey Finance. The scheme was constructed by the Guernsey International Insurance Association with environmental assessment company ESI Monitor.

*Read the full article online*


### Hylant acquires employee benefits agency

Hylant has acquired Cobalt Benefits to expand its employee benefits services offering.

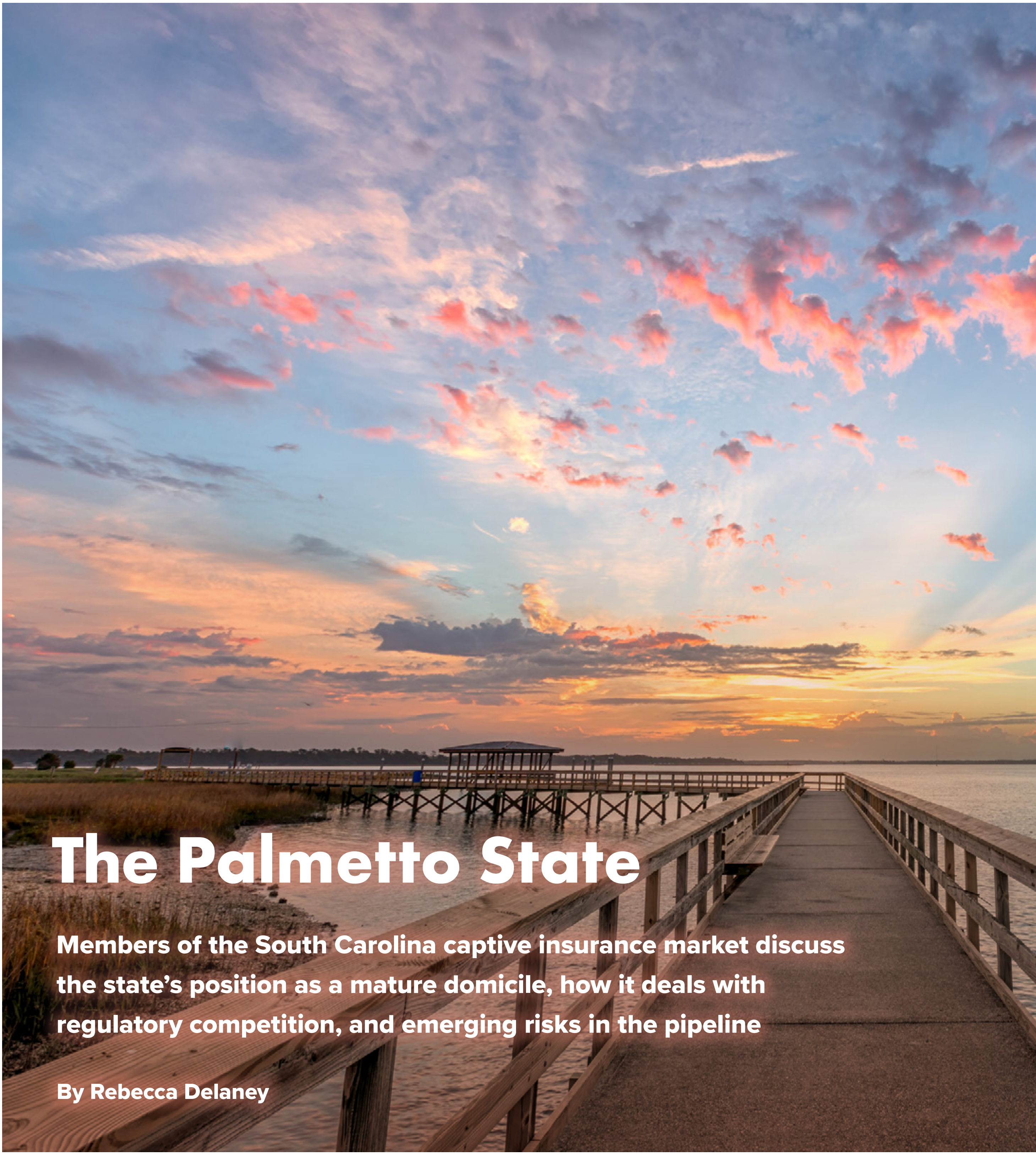
The Indiana-based agency specialises in self-funding and traditional medical, dental, vision, life and disability brokerage services.

*Read the full article online*

### VCIA: Data shows increased success rates of cyber attacks

Data from the National Association of Insurance Commissioners identified that the number of cyber-attacks has not just simply increased throughout the pandemic but the success rate of the attacks has increased too.

*Read the full article online*



# The Palmetto State

**Members of the South Carolina captive insurance market discuss the state's position as a mature domicile, how it deals with regulatory competition, and emerging risks in the pipeline**

**By Rebecca Delaney**



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With world-class golf courses, sprawling beaches, gallons of sweet tea, smokey barbecue and old-fashioned southern hospitality, South Carolina also boasts a reputable captive insurance market among the onshore US captive industry, supported by its established service infrastructure and competitive operating expenses and tax rates.

The captive insurance industry as a whole has benefitted from the overarching context of a hardening insurance market, and South Carolina is no exception. As a captive domicile, the Palmetto State has licensed more than 300 captives since it enacted alternative risk management legislation in 2000.

Another current broad trend is the Internal Revenue Service's (IRS) ongoing litigation with the wider captive insurance industry over micro captives that make the 831(b) election under the US Tax Code. However, South Carolina does not have a particular reputation as a 'tax haven', as regulatory regimes are abided by to ensure the legitimacy of captive structures as risk management and risk financing vehicles in the domicile.

Dan Morris, deputy director of the South Carolina Department of Insurance (SCDOI), comments that the current landscape of the captive industry in South Carolina is optimistic: "There is a lot of interest, energy and growth in our domestic industry so far in 2021."

"This is the 21st year of our programme and we have invested in high-quality staff that has allowed us to maintain a solid reputation in the captive community as a knowledgeable, accessible, innovative and business-friendly domicile that partners with captive managers and companies alike to accomplish the goals they have set."

*"I believe it will be a strong next couple of years for South Carolina and I know the captive community here is more than ready for the growth"*

"In response to the challenging commercial market conditions, new formations are increasing and existing captives continue to seek new and innovative ways to retain more risk and deploy their capital in more meaningful ways," he continues.

Morris notes that the department is currently working on its ninth new license of 2021, equivalent to the total licensing output of 2020. Gary Osborne, vice president of Risk Partners, adds that the state department also has four more applications currently in the active application stage, anticipating "it seems likely that the state could see 20 or more new formations for the first time in several years".

Osborne identifies several of these new licensed structures as risk retention groups (RRGs), specifically for commercial auto liability coverage, attributing this to South Carolina's reputation as a well-regulated domicile for RRGs (as opposed to other states' unwillingness to recognise RRGs as meeting regulatory or financial responsibility requirements) and understanding of the additional obstacles for transportation RRGs, including intra-state filings and federal filings.

This sunny outlook of increased licenses and applications is echoed by Warren Miller, client relationship manager at Performa, who adds: "I am confident there are new South Carolina captives on the way, especially when you consider the hardening market and recent uptick in captive formations across all domiciles in 2020. I believe it will be a strong next couple of years for South Carolina and I know the captive community here is more than ready for the growth."

Miller, who is also a board member of the South Carolina Captive Insurance Association (SCCIA), outlines that the advantages of South Carolina as a domicile are rooted in the priority of quality over quantity, which has helped to form a stable captive industry with a measured approach to growth.

He also notes the high level of expertise among professionals in associated industries in the state: "The regulators are knowledgeable and easy to work with, while the local service provider community provides a host of highly experienced professionals across all disciplines, including captive management, legal, actuarial and investment management."

## The road to regulation

The established infrastructure surrounding the core captive insurance industry is vital to the success and growth of a domicile. South Carolina is considered one of the top five mature domiciles in the Western Hemisphere owing to the passage of its Captive Insurance Law in 2000.

The captive statutes of this legislation clarified, among others, the definitions, capitalisation requirements, licensing, reinsurance, tax payments and certificates of authority for captive insurance companies, RRGs and purchasing groups within the state. The legislation was originally introduced at a time when only 12 states had such captive enabling legislation, of which South Carolina was the only southern state actively engaging in a growth strategy. From this dynamic early approach, South Carolina positioned itself to adeptly promote the statutory advantages of having a captive structure, including: reduction of the total cost of risk through stabilisation and control of insurance costs; strengthened and centralised control over insurance programme structure and participants; less reliance on the commercial insurance market, which is prone to volatility; and tailored coverage for a company's risk profile.

The early promotional efforts of states such as South Carolina helped to establish captives as a legitimate strategic risk management tool for a parent organisation, and to be perceived as a real insurance company subjected to regulatory oversight.

More than 30 states now have captive statutes. Therefore, South Carolina must operate in a competitive environment. The capital and surplus requirements of the captive division of the SCDOI are overall relatively in-line with other onshore domiciles, while the department also offers relatively low application and license fees, and does not charge processing or actuarial fees.

Miller affirms the benefits of the regulatory infrastructure in South Carolina: "I have heard from captive owners time and time again how happy they are to be in South Carolina. The domicile has a dedicated group of regulators that focus exclusively on the captive sector, are business friendly and are always willing to work creatively to find solutions that benefit current and prospective captive sponsors."

Primary considerations for the regulator when reviewing new captive applications include: analysis of an organisation's risk exposures, losses and payouts; projected capital requirements and operating expenses; and the performance of its service providers.

"When you pair the robust regulatory framework with an experienced service provider community and an active association in SCCIA, it makes for a great home for any captive," Miller adds.

Reflecting on the progressive regulatory environment within the state, Morris says: "The statutes are competitive, costs are reasonable, our turnaround time is first-class, and we enjoy great relationships with our service provider community, many of whom are based here in South Carolina."

## Diverse lines

A strength of the captive insurance industry as a whole is that it accommodates diversity; in South Carolina alone, a variety of captive structures offer coverage in healthcare finance, transportation, manufacturing, real estate, workers' compensation, medical malpractice and professional liability.

South Carolina is also noted for its hurricane and adverse weather coverage owing to its geographic location and climate.

Morris explains: "We have seen many companies adjust their property coverage programmes due to wildfires, the Texas deep freeze and other catastrophes, to become more innovative in their approach to solving capacity problems or utilising excess surplus to take layers of coverage that they otherwise would have laid off in years past."

He highlights medical professional liability as another notable specialised sector in South Carolina in terms of stop-loss and employee benefit-related coverage: "A considerable portion of our portfolio writes professional liability for hospitals, physicians and other healthcare providers."

"Even within that specialty, we see a great deal of variety in how the programmes are structured and how they fit within the owners' broader risk management programmes."

The traditional liability market has been understandably affected by the COVID-19 pandemic, with Morris identifying a trend among South Carolina's RRG portfolio towards new formations and changes to existing business plans in this market to take affordability and availability into account.

Osborne adds that, although the hardening market existed before the pandemic, the two factors combined to "[drive] substantial movement into South Carolina in terms of both business and people. This could also have a knock-on benefit to the captive community as more talent and more businesses look to enjoy all that South Carolina has to offer, and hopefully take advantage of the still competitive and strong captive marketplace."

## Moving forward

Looking ahead, the South Carolina captive marketplace will have to position itself to deal with the ever-evolving landscape of emerging risks. The COVID-19 pandemic and subsequent models of remote working made organisations especially vulnerable to cyber risk, while Morris identifies volatility in property as a significant emerging risk.

*"We see a great deal of variety in how the programmes are structured"*

He explains: "The frequency and severity of catastrophic events has been accelerating and captives have been adapting in response. We have had discussions with owners about emerging risks such as supply chain risk, cyber, business interruption, contingent business interruption and pollution."

However, he notes that so far, captives are predominantly filling in the gaps from commercial coverages rather than writing large layers, owing to the nature of the exposures.

In a more short-term view of the future, Morris expresses excitement for SCCIA's upcoming annual conference in September, which will allow industry participants to engage face-to-face rather than remotely following more than a year of remote working.

"Interaction with my fellow South Carolina captive industry colleagues has been mostly limited to virtual calls over the past 18 months due to the pandemic, but as the state reopens, we are starting to meet with clients and partners in-person again," Miller adds. ■

# It’s not market science

## Industry professionals discuss the current captive insurance market trends, causes of the hardening market, and the impact of COVID-19 on interest around alternative risk financing

**By Rebecca Delaney**

Following around 15 years of soft performance in traditional insurance markets, consisting of stable premium pricing, lower underwriting criteria and relatively affordable insurance rates, the last few years have experienced a definitive trend towards a hardening market.

A hard market is characterised by several factors, including higher insurance premiums, reduced capacity, less competition among insurance carriers, more stringent underwriting standards, and general uncertainty and volatility in financial markets.

Pete Kranz, captive practice leader at Beecher Carlson, identifies that in this context of a hard market, there has been a significant pattern of pushback by umbrella and excess insurance markets against captives, noting: “Where it was historically easier to have captives participate in high umbrella and excess layers, including on a quota share basis, we are beginning to see some pushback which definitely gets my attention.”

Looking broadly across the captive insurance industry, Nate Reznicek, head of US distribution at International Re, adds: “Generally speaking, workers’ compensation still remains soft while commercial auto and general liability classes rise. From a trade perspective, it has made hard-to-place trades even more difficult to place, especially heavy transportation, general contractors and general liability for the habitational trade.”

“In some cases, rates in the excess market increased so dramatically that purchasing the coverage became non-viable, leaving many insureds potentially under-insured or unable to meet the insurance requirements within their agreements,” Reznicek explains. “Although it has long been a talking point in the industry, for the first time we are consistently seeing captives take a hard look at buffer layers as potential premium savings.”

Richard Smith, president of the Vermont Captive Insurance Association (VCIA), affirms that a hard market is beneficial to captive owners: “There has been continued robust growth not only in Vermont, but throughout the captive insurance industry.”

“Obviously, the continued hard market in the traditional insurance industry has fuelled this growth, but we saw growth trends even before the hardening — there was growing interest by small- to mid-sized companies seeking to get control over their risk.”



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## Creating a hard market

The landscape of a hard market has been galvanised by several significant factors, including heightened frequency and severity of natural catastrophes as a result of climate change, such as hurricanes, flooding and wildfires. According to Kranz, this has caused increased claims activity, diminished capital and scared insurers.

Smith concurs that such catastrophic events have increased rates on property and casualty lines, as well as impacted reinsurance and other alternative capital sources.

He notes that while capacity remains within these marketplaces, losses over the past few years have caused a ‘tightening’ to underwriting and pricing. In addition, investment returns due to low interest rates have prevented insurance companies from meeting their capital costs, therefore causing increased rates.

Kranz identifies a pattern following a year of such activity, whereby insurers release a handful of their redundant reserves — referring to reserves that are reasonably held for adverse years to transfer losses from the income statement to the balance sheet in order to mitigate the impact on capital and surplus — and the investment market’s support through capital injections.

“Two years of adverse losses later, and there has not been time to rebuild reserves, so the carriers do not have as much to release, the capital markets are more cautious, and premiums have increased,” Kranz explains. “In the third year of the hardening market, there are no reserves to release and the capital markets are balking, causing the carriers’ need rate to increase.”

Kranz notes that the current hardening market is interesting because it will not yield when pressed on rate increases by insureds and brokers. Where underwriters traditionally worked to balance rate increases while filling their capacity, the insurance industry is now instructed to only write profitable business.

He comments: “The hardening market is forcing more and more insureds to take on risk through increased retentions, and to really start thinking about how they finance risk.”

However, Reznicek points out that “hard markets are more than just a simple increase of industry pricing to offset losses. The price increase is being driven by significant reductions in the available capacity insurers are willing to deploy, but also by the fact that there are less insurers available due to changes in appetite”.

Another contributing factor to the hardening market is emerging cyber risks, sensationally demonstrated in the ransomware cyberattack on the Colonial Pipeline in May of this year. The current work-from-home model during the COVID-19 pandemic has also raised the vulnerability of many industries to cyber attacks.

## Captives and COVID-19

The pandemic has exacerbated the stagnant economy and magnified operational obstacles and overall market volatility. A hard market will inevitably develop during a period of economic downturn, as insurance companies struggle with capacity, availability and higher retention, coupled with declining insurance capital and competition.

The parallel difficulty and expense of placing insurance in a hard market encourages

*“Hard markets are more than just a simple increase of industry pricing to offset losses”*

companies to adopt a revised alternative risk management strategy by either forming new captives or expanding their existing captive structures.

Therefore, the COVID-19 pandemic has provided new opportunities for insureds wishing to include communicable diseases coverage, including contingent business interruption (BI), in their commercial property policies. Captives in particular provide the ability to add or modify coverages in order to best suit the insureds.

In this environment, the alternative capital market is perceived as beneficial to reinsurers because the cost between alternative and traditional capital has considerably narrowed, allowing reinsurers to utilise this as a negotiating tool when balancing captive insurer capacity and reinsurer capacity.

Smith says: “I believe that the uncertainty we saw regarding the ability of companies with BI policies to collect has made many organisations rethink their risk financing. A pandemic is a difficult type of risk to insure — many say it is uninsurable — however, we have seen organisations with captives use their flexibility

*"We have seen organisations with captives use their flexibility to cover impacts from the pandemic"*

to cover impacts from the pandemic where traditional insurers would not."

"Furthermore, many companies that do not have pandemic coverage are looking to their captive for liquidity that may come in the form of large intercompany investments like loans and receivables, investments and subsidiaries, or projects."

"Covering BI or other lines impacted from a pandemic is challenging, as it will surely need to be adequately capitalised. Longer-term, we will see captives issuing some pandemic coverage or wrap-around to commercial coverage to cover the next COVID-19 type event," Smith adds.

## Federal backstop

As companies look to include pandemic coverage in their offering, those domiciled in the US will be paying attention to the passage of the Pandemic Risk Insurance Act (PRIA).

This bill establishes the Pandemic Risk Reinsurance Programme within the Department of the Treasury, which would allow captives to write pandemic risk with a federal backstop. Under the Act, general compensation will be provided to insurers incurring aggregated industry losses over $250 million as a result of a pandemic or disease outbreak.

Kranz describes PRIA as "a very interesting piece of legislation, particularly with respect to captives. Thinking about captives for non-physical damage BI coverage, one has to ask what the value is. For those chasing tax deductions, such as public accounting and actuarial firms, you cannot build up a reserve over time to 'smooth' the expense".

He explains that building up a cash reserve in a captive depends on an individual organisation's cash position, predicting that in several years' time some captive owners may collect the profit and dividend or loan it back, thereby defeating the original purpose.

Reznicek agrees that the legislation certainly promises to be an interesting solution for pandemic exposures, observing that the federal backstop would be advantageous in providing a needed diversity of exposures over a larger subset of risks, both in terms of numbers and geography. This diversification would be beneficial for insurers, allowing them to confidently extend coverage while investigating opportunities to deploy capital elsewhere.

However, he highlights that the current proposed PRIA framework stipulates insurer participation on a voluntary basis, meaning that the benefit of additional extension of risk could be hindered by low adoption rates. Furthermore, ultimate losses as a result of COVID-19 will not be definitively known for several years.

The extent to which PRIA will benefit captives remains unknown, with Reznicek noting that captive insurers and other self insured structures, such as state workers' compensation pools, require specific approval by the Secretary of the Treasury to be eligible for participation.

"There are other factors and potentially unintended consequences of the passage of PRIA in its current form," Reznicek explains. "The bill would likely formalise acknowledgement that what was once considered a business risk for US federal income tax purposes would now officially be an insurance risk, all but eliminating an argument that the Internal Revenue Service has routinely made when challenging the legitimacy of micro captive arrangements for the cover."

Therefore, in order to accurately assess the benefits of PRIA on captive owners, the industry needs to know whether captives will be included as insurers eligible to participate in the programme and what the programme covers, as well as specifics such as the triggers, allocated shares of losses and deductibles.

Kranz affirms: "We need these specifics to see if there is value in writing the coverage in captives in order to access PRIA like is done for the Terrorism Risk Insurance Act (TRIA)."

"Once we see those specifics, we will need to see how the markets respond. I am certainly anxious to see how it plays out!"

## What next?

A continuation of the hard market will bring increased commercial insurance prices, inevitably causing more companies to consider forming captives as an alternative risk financing tool.

Smith remains confident, commenting: "The captive industry always thrives during a hard insurance market, so I see no reason that it will not do the same this time. Captives offer their owners control, clarity, and cost savings even in a soft market — the hard market only amplifies these benefits."

Kranz notes: "The hard market has been pushing insureds to take on more risk, while the increase in risk retention has been pushing down from the large market, the middle market and into the small market."

While previously smaller companies may have been somewhat limited to cell captives — less expensive and less complex to manage, these allowed smaller firms to pool their resources while segregating their assets from the risks of other members in the pool — Kranz says more insureds of all sizes are considering alternative risk financing options. Going forward, a continuation of the hard market will affect the landscape of the captive insurance market as financial professionals listen more closely to risk innovators about alternative structures and persist with their interest in such programmes.

Kranz identifies the current priority is traditional carriers with unused capacity, as well as reinsurers and capital markets, who must now deploy their resources to the multi-line aggregate structures in the alternative risk financing space.

He warns: "If the typical players do not step up quickly, someone else is going to fill the void. We are in an incredibly interesting time seeing truly innovative structures being utilised, and we could see some very different capital and structures developed to sit above and around captives as the risk financing picture gets flipped on its head."

## Looking ahead

Kranz predicts a further 18-24 months of busy activity in the captive insurance market, citing: "In the past few years, the hardening market persisted even with a strong stock market, so I do not see the market or economy dramatically slowing the pricing increases."

If severe and frequent natural catastrophes endure, he believes the hard market will be prolonged even further. In addition, inflation, nuclear verdicts and 'social inflation' (increased insurance losses resulting from new tort and negligence concepts, higher jury awards, higher workers' compensation claims and higher legislated compensation) may make the current conditions the new norm in traditional markets.

Kranz adds: "That said, captives were being formed before this current hardening and will continue after. I think the longer-term implications are that, based on how this market has been playing out, more captives will be utilised. Once you start rolling that ball it is tough to stop it."

This positive outlook is echoed by Reznicek, who predicts that increased rates and lack of markets will continue to drive negotiating power back to the traditional carriers. He notes that this in turn will continue to provide the opportunity and motivation for smart insureds to limit their exposures to the volatility of the guaranteed cost market and enter into alternative risk transfer and captive insurance arrangements.

"I fully expect to see increased interest from existing carriers and the accelerated formation of specialty fronting carriers into the captive market to attempt to fill the need," Reznicek says. "From a captive perspective, I believe

*"We are in an incredibly interesting time seeing truly innovative structures being utilised"*

that there is an increasing trend and desire for fronting carriers to actually take on risk instead of just providing paper. Value-added fronting, which was once arguably just a bit of puffery, could now actually begin to have meaning in the marketplace."

Looking further into long-term consequences, Smith observes that the hard market will inevitably soften at some point — although when this will be is unknown, and he predicts that this will not cause captive owners to abandon their structures and fully return to the traditional market.

He ends on a positive note: "Over the past years there has been little increase in productivity in the traditional insurance market, and providers have been fat and happy for some time. Captives are the scrappy upstarts that have the will and flexibility to meet the needs of their owners in ways the traditional market cannot. What we will likely see is some leveling off on the growth, but once new captive owners see all the benefits of owning a captive they will be hooked!" ■

# Nick Gurgone

## Consulting actuary

## Pinnacle Actuarial Resources

### Personal bio

I grew up in the suburbs of Chicago and moved to Bloomington-Normal, Illinois, to attend college at Illinois State University (ISU). Pinnacle Actuarial Resources is located in Bloomington, so I have stayed in the area to work at Pinnacle.

I am a fellow of the Casualty Actuarial Society (CAS) and a member of the American Academy of Actuaries.

I have a number of interests. In particular, I very much like making music and have been playing guitar since I was 12. My interests also include history, politics and social issues, and I frequently read about these topics. I also have to say I “enjoy” running!

### Professional profile

I am a consulting actuary with Pinnacle, where I started as an actuarial analyst six years ago. A significant portion of my work at Pinnacle has been in the captive space, and I have been involved with a wide variety of captives, from groups offering traditional coverages, to captives offering enterprise risk coverages.

I have performed feasibility and funding analyses, reserve analyses and a variety of other analyses for captives.

I started off at ISU as a maths education major but switched to actuarial science in the middle of my freshman year. I had not heard of actuarial science before I was at ISU. When a professor told me about the career, the combination of maths, business and insurance interested me and I was convinced to change majors.

While in college, I had a summer internship with Mercer working on pensions in their retirement services department in Louisville, Kentucky. I graduated with a bachelor of science degree from ISU and began working at Pinnacle and in the captive industry right away.

I currently volunteer on a few CAS committees, such as the syllabus and examination committee, and stay involved with the important work by CAS through volunteering.

### How did you end up in the captive industry?

While in college, I really did not know much more about captives other than that they existed. I was interested in Pinnacle because of its reputation and for the very interesting variety of work its professionals did, rather than specifically being a leader in the captive industry. As I am now aware, a large part of the variety in what Pinnacle does is due to our track record of work in, and contributions to, the captive industry. It is an exciting and constantly evolving industry to work in.

### What has been your highlight in the captive industry so far?

Professionally, one of my highlights was finishing my actuarial exams. Alongside my excitement about the end of consecutive years of study, receiving my actuarial credentials helped open doors to advancing a career in the industry.

Learning about how diverse and dynamic the captive industry is has been a highlight as well. I have been increasingly working with captives for sectors such as warranty, and recently presented a Pinnacle APEX webinar on the topic. It goes to show how much uncharted territory there is in the captive space.

### What/who have been your influences in the captive industry?

A number of Pinnacle colleagues and principals of the firm have been great influences and mentors. In particular, I started working regularly with Rob Walling, one of Pinnacle's principals, early on in my career. Rob is well known and respected in the industry and has a large captive practice, which are both long-term goals of mine. Rob has been a great mentor, spending significant time and effort helping me gain experience and grow in my career.

### What is your impression of the industry?

This is an industry where you can see things that are unique within the property and casualty actuarial world. Because of that, it is both interesting and challenging.

I think the captive industry has great capacity to innovate and facilitate innovation. It is ahead of the curve on some major emerging risks and will continue to be in the future.

### What are your aspirations for your career in the captive industry?

I hope to build my own consulting practice at Pinnacle and be a well-rounded actuary that clients can come to without all of the ordinary projects and requests.

I also hope to be a mentor to other actuaries that want to work in the captive industry.

*"It is important to keep pushing yourself to grow, venturing outside of your comfort zone with different types of projects"*

### What advice do you have for someone considering a role in the industry?

It is important to keep pushing yourself to grow, venturing outside of your comfort zone with different types of projects. Equally important is finding a good mentor. Mentors are so helpful because they can keep pushing you to learn and make sure that you are heading down an appropriate and worthwhile path. ■

"Over the past few years, Nick has played a vital role in the success of our captive and alternative risk programmes. In an ever-evolving captive industry, Nick continues to take an innovative approach to finding solutions and communicating these strategies to clients."

"In addition to his knowledge, expertise and professionalism as an actuary, Nick has exhibited the dedication and work ethic that has allowed us to meet client needs during this demanding period in the captive industry. Nick consistently delivers quality work in a timely manner, and we look forward to watching his influence and impact on the captive industry expand."

***John Yaple, director of captive marketing, HUB International***

**BMS Re has appointed Adam Mullan as executive director to launch the firm's operations in Bermuda.**

The global broker, providing specialist insurance, reinsurance and capital markets advisory services, is expanding its offering into Bermuda to consolidate its global footprint.

This follows BMS Re's established presence in the US under president and CEO, Pete Chandler, as well as in Europe and Latin America headed by Hannah Watkins, Andrew Wheeler and Aidan Pope respectively.

BMS Re's presence in Bermuda will be coupled with the group's investment in actuarial and analytics capabilities through BMS Re's Pathlight Analytics platform.

In his new role, Mullan will assume responsibility for driving the expansion of the firm's Bermuda operations.

He most recently served as reinsurance consultant at Attestor Capital, where he was responsible for non-executive consulting assignments for reinsurance acquisitions, business planning and strategy.

Other previous roles include CEO of Alterra Global Reinsurance, where he led the management and operations of Alterra's Lloyd's and global reinsurance business.

Nick Cook, CEO of BMS Group, comments: "BMS Re's launch in Bermuda builds on the already strong presence we have on the island as a specialty broker and our expanding global footprint demonstrates our commitment to the reinsurance broking business."

"We are extremely pleased to have Adam Mullan leading our Bermuda operations. He

**Aon has appointed Tasha Barbour as managing director of the managed care team at Aon's Reinsurance Solutions.**

Based in Kansas City, Missouri, Barbour will be responsible for supporting new business development for managed care organisations, including innovative reinsurance and stop-loss solutions.

In addition, she will support Aon's evolving healthcare market provision, particularly the innovative programmes of the Center for Medicare and Medicaid Services.

Aon Reinsurance Solutions provides risk transfer and capital management solutions to reduce market volatility.

Barbour will report to national managed care reinsurance practice leader, Christina Mendez.

She previously served as chief business development and marketing officer at PartnerRe, as well as holding senior roles at Swiss Re, GE Insurance and KPMG.

Bob Black, executive managing director of Aon Reinsurance Solutions' accident, health and life team, says: "As the dynamic managed care market continues to evolve, Aon has a continued focus on expanding our team and developing our thought leadership to support our clients' risk, capital and growth strategies."

"Tasha Barbour's wealth of experience in the sector and reputation in the market is a perfect fit, and we are very excited to have her on board." ■

has a distinguished career and is aligned with BMS Re's strategy and vision. I look forward to working with him on this exciting new venture."

**Fidelis Insurance has appointed Charles Mathias and Phillip Murfet as group director of underwriting and group chief risk officer, respectively.**

In the newly created role of group director of underwriting, Mathias will be responsible for ensuring a high standard of underwriting data, systems, processes and reporting, as well as supporting the CEOs of insurance and reinsurance.

Having previously served as group portfolio manager and head of catastrophe modelling at the insurance firm, Murfet will assume Mathias' previous role of group chief risk officer.

Fidelis provides speciality insurance and reinsurance solutions to the aviation, marine, energy, terrorism and contigency sectors.

Richard Brindle, chairman and group CEO of Fidelis, comments: "Our underwriting controls, systems and data are at the centre of what we do, not just for our own needs but also for those of our partners and stakeholders."

"We now need to move to the next level of automation and reporting. Charlie Mathias has great experience in these areas and will ensure we remain efficient and focused."

Mathias adds: "Phil Murfet has already shown real understanding and innovation in his roles in portfolio management and modelling. He will be looking for opportunities to enhance our risk management and reporting tools for operational and all other risk sectors." ■

**Belinda Fortman, the director of captive insurance for the Tennessee Department of Commerce & Insurance (TDCI), has left her role.**

A spokesperson for the TDCI tells *Captive Insurance Times*: "We thank Belinda for her service to the department and Tennessee's captive industry."

"Tennessee is a leader in the captive insurance space and we will work quickly to identify and name the next section director for captives."

They add: "We continue to operate efficiently thanks to a talented, professional and responsive captive division team that remains dedicated to our excellent customer service to Tennessee's captive industry."

Tennessee is one of the nation's largest and fastest-growing captive domiciles. At the end of 2020, Tennessee had 146 active captives, up from just 68 in 2014.

Last year, captive premium volume topped $1.6 billion, up from just under $670 million in 2015. ■