2018 Kentucky Captive Conference

Market & Domicile Update

Kentucky
UNBRIDLED SPIRIT

Captive Insurance Industry at a Glance

- 441 new captives formed last year (78% in U.S.)
  - Almost 1/3rd less than prior year
- As of year-end 2017, 6,647 (net +29 to -136)
  - Over **400** ceased writing, dissolved, or merged
  - Bermuda down by over 54 companies
  - Caymans down 48
  - Utah down 104
  - Delaware down 47, VT 42 & MT 33+

This doesn't include estimated 3,000+ cells/SBUs

  - Up from approx. 2,000 from 2016

- $67 billion global premium (up significantly)

Top U.S. Domiciles

(by number of actively writing companies)

Vermont	566
Utah	414
Delaware	381
Hawaii	230
North Carolina	220
Nevada	204
Montana	140
South Carolina	172
Tennessee	155
Kentucky	65

Kentucky year-end stats

- Kentucky had 4 new formations during 2017.
- We had 23 dissolutions, cessations, re-doms, or mergers
- Net captives currently include 65 licensed and actively writing.
- This includes: 54 pure, 8 group/association, and 3 RRGs. Kentucky does not currently license cells or series SBUs (by choice).
- Aggregate premium is approximately $90 million (down from $96).
- Total assets under management were up to approx. $138 million.

Slow Growth & Dissolutions

- Slow year for captive growth in most domiciles (2-5 new per domicile).
- PATH Act amendments and increased IRS scrutiny (especially the Notice 2016-66 reporting requirements) had a chilling effect on the licensing of new companies.
- Lost companies for various reasons:
  - 50+% were for specific business reasons (extended soft market pricing leading to return to traditional or group; or, parent/affiliate insureds being acquired or family-held ownership changes/retirements)
  - Significant number of medical practice mergers contributed to loss of numbers
  - 25% were pure captives that redomesticated and went into cells/SBUs in other domiciles (Del, Utah, and offshore)
  - final 25% shut down for other reasons

Expanding Coverages

- Self-insured Medical Stop-Loss (6% increase in 2017)
- Business Interruption/Supply Chain (4% increase in 2017)
- Terrorism/TRIA (multi-peril & domestic) (5% increase in 2017)
  - TRIA expanding to cover elements of cyber-terrorism liability
  - Increasingly covering limited event liability
- Environmental Liability & Clean-up (6% increase in 2017)
  - Partially driven by M&A activity
- Shipping and Inland Marine (3% increase 2017)

Emerging Trends

- Management Liability—(D&O and employment practices liability)
  - Market hardening due to increases in claim frequency and severity
  - This is against the general trend of D&O pricing declines
  - Litigation costs and M&A are key contributing factors
  - Privacy, employee data, and internal crime prevention expanding claims
  - “Shrinking limits" provisions, that insurer payment of defense costs—which are often a substantial part of a claim, reduce the policy's limits

- Healthcare D&O for tax-exempt hospitals–only 5-6 insurers
  - Merger complications, anti-trust liability, tax-exempt status, accountable care
  - Loss of medical data and privacy; “bundled care” liability & stacking

- Reinsurance for Aggregated Risks
  - Options are expanding for larger and more established captives to retrocede a bundle of captive deductible and retentions

Emerging Risks

- Private flood, tornado, wind/hail, wildfire, and “climate change”-
  - Business Interruption
  - Evacuation & Disaster response cost reimbursement
  - Exempted/replacement cost (phone equip & IT hardware, machinery)
- Reputational Risk-increased availability and more quantifiable
  - More loss data & experience and high-profile public occurrences
  - Elements include: traditional, product liability, supply chain, employee management, cyber/new technology, and social media
- Drones/UAV (unmanned aerial vehicles)-subcontractor liability
- Political Risk and Kidnap & Ransom (for international companies)
  - Mexico, Central & South America, South-east Asia (outside Japan, Taiwan, HK)
- Pension & Benefit
  - International employees & legacy benefits

THE Emerging Risk: Cyber Liability

- <u>Cyber Liability</u>
  - Fastest growing non-traditional risk
  - Almost 90% of cyber coverage is non-admitted (surplus lines)
  - Most policies allow/require higher deductibles and retentions
  - Most coordinated with corp IT security and privacy investments
  - Coverage gaps, such as between property coverage and cyber claims
  - Up 210% in captive programs since 2012- per Marsh

Cyber Liability Stats

Of those companies with Cyber Liability Coverage:

-76.2% have a stand-alone cyber policy

-93% purchased through a broker

-2/3rds first purchased coverage in last 5 years

-1/2 all cyber insurers and brokers **did not** offer five years ago

-global premium projected to be $4 billion by 2021—per Aon

-premium growth at a 14.1% compound annual growth rate

-average premium is $188,250 with average limits of $12.7 million

Most common breaches: Phishing, hacking, employee, malware, social

Approximately 40% of breaches result in losses, with multiple occurring

Quantifiable Losses: Cost to remediate (included in 58.3% of claims), Work stoppage (28.3%), Brand and reputation (18.3%), Equipment & Property damage (13.3%), and Litigation (5%)

5 Yr Examination Costs

-The Department streamlined exam procedures in 2010 to be captive specific and risk-focused

-Our examination costs have been in line with the lowest 50% among reporting U.S. domiciles with a typical range of $6,500 to $14,500

-Exam Costs are extremely dependent on <u>good record keeping</u> and <u>quality of audit workpapers</u>

-Other factors: Size & Complexity of captive
Lines of Business (W.C., Med-mal, warranty, & surety)
Reinsurance arrangements (complexity & execution)
Non-brokered investments (real estate, loans, P.E.)
Restructuring, Ownership changes, & Form D compl.

What Kentucky has to Offer

- --<u>Captive Law</u> that is up to date and well crafted
- --<u>Regulator</u> that is firm, but flexible
- --<u>Service Providers</u> who are knowledgeable and experienced
- --<u>Owners</u> who are engaged and satisfied
- --<u>Association</u> that is vocal and active
- --<u>Legislature and Administration</u> that is informed and supportive

Values/Goals Kentucky is promoting:

- --Long-term Stability
- --Reliability
- --Responsiveness
- --Convenience & Value

Questions & Answers

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