2019 Kentucky Captive Conference

Market & Domicile Update

Captive Insurance Industry at a Glance

- Globally, growth was flat with 5,580 active captives and another 3,223 active cells
  - With cell gains matching pure/group closures one-to-one
- $66.7 billion global premium (down slightly)
- Why?
  - On-going soft commercial market,
  - Uncertain investment environment,
  - Increased global solvency standards and disclosures

US Captive Insurance Industry

- 2017 (US) was a stunning change with 335 captive closures, and another 150+ cell closures

- 2018 (US) ended with 3,123 active captives
  - 203 new formations and 226 closures (net -23)
  - In addition, total 1,865 cells, with 261 formations (up), but also 263 closures (also up) (net -2)

Why was growth flat? Healthcare mergers & consolidation, and efforts by IRS to discourage smaller pure captives engaged in pooling (and more aggressive state premium tax efforts)

RRGs In the News

- Risk Retention Group (RRG) numbers continued to decline
  - 219 RRGs as of year-end 2018

    (down from 228 in 2017, and 237 in 2016---peaked at 261 in 2012)
  - There were 10 new formations and 19 closures in 2018

    (second highest number of closures in 15 yrs)
  - Healthcare and Professional Services reported moderate income increases
  - Mixed losses reported in Construction and Leisure & Hospitality (including voluntary shutdowns of Home Construction (NV) and National Home (Co).
  - Large losses in Transportation ($35.8 million sector losses, surplus down avg. 6%* not including capital contributions and assessments),
    - Transportation RRGs have operated at a loss since 2013, with 2017 being the worst year for losses
    - Wave of transportation RRG insolvencies, including most recent Federal Motor Carriers RRG (Del), Elite Transportation RRG (VT), Allied Premier Ins, RRG (CT), and Spirit Commercial RRG (NV)

Slow Growth, but Premium Up

- Another slow year for captive growth in most domiciles
  - Larger domiciles (+5 to 25 new per domicile)
  - Medium domiciles (-1 to -26 net loss per domicile—Ky, Utah, Nevada, Tennessee, and Montana)
  - Small domiciles (+1 to 10 new per domicile---Georgia, Alabama, Texas)

- Soft-markets and numbers down—but US captive premium growth?
  - Continued growth in group captive and RRG membership (up approx. 10%) and premium (up 15%)
  - Continued growth in alternative coverages & integrated commercial options
  - Continued growth in reinsurance options where insured “has skin in the game”
    - Reinsurance market off-shore and on-shore rapidly changing (increased fronting & partnering)

Top U.S. Domiciles

(by number of actively writing companies)

• Vermont	580
• Delaware	421
• Utah	388 (480?)
• North Carolina	241
• Hawaii	231
• Nevada	184
• Montana	140 (288?)
• South Carolina	144
• Tennessee	133
• Kentucky	64

Kentucky year-end stats

- Kentucky had 7 new formations during 2018.
- We had 8 dissolutions, cessations, re-doms, or mergers
- Net captives currently include 64 licensed and actively writing.
- This includes: 53 pure, 8 group/association, and 3 RRGs.
- Aggregate premium is $108 million (up from $96).
- Total assets under management were up to $138 million.

Hot Topics

- 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 pricing declines for many years
  - Litigation costs and M&A are key contributing factors
  - Privacy, employee data, and internal crime issues expanding claims
  - "Shrinking limits" provisions, that insurer's payment of defense costs (which are often a substantial part of a claim) reduce the policy's limits
  - Exclusions for "cover-ups and destruction of evidence"

- Employee Mental Health Coverage
  - Workers Comp, employee health plans, and short-term disability
  - Uncovered treatment for mental health, trauma, and PTSD
  - Focus on pro-active services and treatment

Cyber Liability Stats

- 2018 picked up where 2017 left off in terms of data breaches.
- Despite slight decrease in number of reported data breaches (1,232, down from 1,597), the number of overall records exposed increased 133%.
  - **Up 263%** -cyber-liability gross written premium (Aon)
  - **$3.86 million** – average cost of a data breach (reported by BI)
  - Average time to identify a breach: **197 days (over six months!!!)**
  - **27%** – Average increase in cost of cyber crime in 2018 (reported FBI/DHS)
  - **$4 billion** – current cost of the Equifax data breach
  - **7 out of 10** organizations say their risk increased significantly in 2018
  - **Newest threat**—IoT networks—specifically CCTV and webcams

- **Three largest data breaches of 2018**:
  > Marriot International – $500M+
  > Exactis – $340M
  > Under Armour – $150M

Expanding Coverages
(not Medical Stop-loss & Cyber)

- Property-Difference in Condition (DIC) and Business Interruption
  - Commercial pricing up 2-5%
  - Highest increases since 2012, against overall downward trend
  - Hurricane, wildfire, flood, tornado, wind/hail and ice
  - Business Interruption-expanding scope
    - Including Blackouts and Utility outages (even pre-emptive outages)
    - Loss of Cloud access (if not addressed by provider Service Level Agreement)
  - Evacuation & Disaster response cost reimbursement
  - Exempted items/replacement cost for depreciated items

    -such as phone equip & switching, IT servers & hardware, and machinery
  - Ordinance Or Law Coverage (increases in demolition & clean-up and rebuilding to Code & site-preparation/move costs)

Expanding Coverages

- Reputational Risk/Damage to Brand
  - -increased availability and more quantifiable
  - More loss data & claims experience and high-profile public occurrences
  - Brand, advertising & sponsorship, and intellectual property growing assets
  - Difficult due to overlap with other coverages AND remediation (ads/social media)
  - Elements include: traditional, product liability, supply chain, employee management, cyber/new technology
  - Integrating with liability for libel, defamation, and advertising violations

- Employee/Contractor Crime & Fidelity (embezzlement/defalcation)
  - Average amount stolen over $350,000 (Hiscox)
  - Only 39% funds recovered thru restitution, settlements, and insurance
  - Other costs: lay-offs, lost customers, and increased spending on security & audit
  - 2/3rds involve more than one person, for over 3 years, and trusted/long-tenure

Increases in Captive Use

- **Increases in third-party risks and strategic use of captives to provide insurance products in direct support of an owner’s business**
  - Contractor insurance programs (not just construction---agricultural and equipment leasing & service)
  - Owner-operator programs (new economy—delivery and property management)
  - Franchisee programs (restaurants--purchasing & advertising groups/coops)
  - Healthcare—captive funding of program & training based risk management
  - Warranty and service contract business (single largest increase in Kentucky captive premium)---Caterpillar case study (HBS, Fortune, Forbes, Bloomberg)

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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