INDUSTRY BULLISH ON FUTURE OF CAPTIVES

Written By Caroline McDonald

The 2023 survey of captive owners and service providers by the Self-Insurance Institute of America, Inc., released in October, found that they were overwhelmingly positive about the direction of the industry. More than 30 individual captive companies, service providers, and owners provided feedback on a number of topics important to captives.

This year's survey was divided into three sections focusing on general industry issues, service providers, and captive owners.

"Overall, the 2023 captive survey underlines what many in our industry see; that the captive market is growing, particularly in the employee benefit and medical stop-loss side," said Ryan Work, Senior Vice President, Government Relations at SIIA.

Most respondents (77%) selected Employee Benefits/Medical Stop Loss as the area in which they have seen the most growth this past year.

In addition, Work said, the emerging trends identified by the survey, "really capture the other hot topics of the day." They include cyber, medical stop loss; and larger healthcare trends, "such as the cost of new cell and gene therapies – some drugs which can cost upwards of $25 million or more."

Because of those trends, he added, "We are seeing increased cost of risk, in addition to much higher costs to obtain coverage in the commercial market, if any coverage exists at all."

Work also concluded that inflation "is a much newer driver this year, that cascades to larger economic issues that may very well be pushing business owners to look at captive coverage for not only benefits, but other risks in the P&C space."

Simon Kilpatrick, President at Advantage Insurance Management (USA) LLC noted, "I wasn't surprised that the industry outlook was very bullish. Responses to other survey questions are that captives are growing. Most managers are forming captives at four times the rate that they were closing captives last year."

He noted, "I expected to see that the industry is growing, because now is the time for the captive market."

Kilpatrick added that there were also a few negative responses regarding the outlook. "I can only assume they have very specific reasons," he said. "They may have a type of captive that is challenged, such as § 841(b) captives." In this case, "The question is what will happen with all these regulations being challenged by the IRS with small captives. I can see that if you are focused on small captives, you might have a less positive outlook than the rest of the industry."

GENERAL INDUSTRY OBSERVATIONS

SIIA stated:

> "The positive data and industry growth trends reported in the survey include increases in staff hiring, captive formations, and total captive premium amounts. This is especially true in the employee benefits and medical stop-loss areas, where 77 percent of respondents reported strong growth in the past year."

Jeff Simpson, Partner at Womble Bond Dickinson (US) LLP, said that the first thing that stuck him about the survey results was that "It's a small sample, but it shows me massive numbers of captives and really large premium amounts." This, he said, suggests that "there is much more uptake of captive insurance than people appreciate."

Simpson observed that trade press counts of captives usually come in at about 6,000 worldwide. "Our survey, however, accounts for 6,000 participating captives." He added that with other statistics, "The number of cells or the number of group captives and participants are not being counted."

What's more, group captive formations, he said, are moving to the forefront. "This year in our practice, we've seen more group captives being formed than any year previously. What I'm seeing reported on the survey is consistent—a lot of group captives are being formed for a lot of reasons," Simpson said.

More traditional groups—"your classic property-casualty and workers' comp general liability being formed," he said. "The conclusion is that we're seeing so much more because more people are learning about it."

Another underlying factor, Simpson said, is inflation, which is pushing more people into captives. "Inflation is everywhere, including insurance premiums, and when premiums go up, people start looking for alternatives," Simpson said.

Kilpatrick said that what was not surprising is stop-loss purposes. "That response was consistent from the service providers and also the captive owners and prospective captive owners," he said.

The reason for these formations, he added, is the increasing costs in the industry, "and captives can be a way to maintain control, but also to find capacity that may not exist in the commercial market. You can use a captive to fill gaps that you can't fill commercially."

SERVICE PROVIDER REPORTS

Service providers, instructed to count individual cell structures for the survey, noted that the total of reported clients currently served is 5,377.

The estimated average premium per captive is $6,734,722 and the highest estimate of average premium per captive is $65 million.

MULTIPLE CAPTIVE FINDINGS

The average reported percentage of customers with multiple captives is 14%

Median reported percentage of customers with multiple captives: 13%

Types of captives formed:

Group captives—43.2 %

Single parent—35.1 %

Cell—18.9 %

Risk retention group—2.7 %

CAPTIVE TRENDS

Most captive owners (43 percent) reported first hearing about captives from working in the insurance industry and 29 % of respondents reported that they heard about captives from their brokers.

"Owners are moving to captives for specific reasons, including the increased costs of risk – from health to P&C, to cover risks when coverage is unavailable in the commercial market, and to take advantage of economies of scale in the self-insured market," Work said. Captive owners, he added, are looking at other risks that they may be able to insure in a captive structure, "whether that is on the medical side, or whether it's an emerging risk like cyber or an economic risk."

As for trends, Kilpatrick said, "Not surprising was that the risk people were considering most was cyber insurance. That's been a trend for years and I believe the reason is that captives are able to adapt very quickly to changes in the outlook."

This is important because cyber risk has changed so rapidly, Kilpatrick observed. "A couple of years ago a cyber claim was related to a data breach and the cost of the claim was the cost of notifying all of your customers that their card number was leaked and putting them on a credit watch for a year."

The reality now, he added, is that "Everyone's credit card information has leaked and is potentially out there."

An onerous risk for businesses now is "being hacked with ransomware and being held hostage," Kilpatrick said. "They have to negotiate a settlement with the ransomer or retool and repurchase equipment and try to rebuild their backup with servers."

Risks have changed, "and coverage of commercial carriers has evolved over time as well," he said. "But the carriers are so large that it takes them a couple of years to get new policy rates and forms approved and to decide at the board level what to do."

Captive managers, on the other hand, "can come in and change a manuscript policy very quickly and get it approved in a matter of days by their regulator. Captives are always able to react to big changes in the industry."

Similarly, another relevant topic is the versatility of captives "and how they can be used in areas in which commercial insurers are exiting markets, as is happening with storm, fire and other property-casualty risks in Florida and California," Work said. "Business owners are acutely aware of both cost and risk, and they see the upside of covering them through captive insurance structures."

SURVEY HIGHLIGHTS

- Survey respondents rated the future of the captive industry as a 9 on a scale of 1-10. This is a nearly identical result from last year, when close to 90% of respondents reported having a bullish outlook on the future of the captive industry.
- Nearly 75% of respondents reported that they have added staff in the past year, with a significant number of these additions being management staff, underwriting, and accounting. This is an increase from last year's survey, where 66.7% of respondents reported staff growth.
- For the third year in a row, captive formations have significantly outpaced closures. Survey respondents reported an average of 4 new captive formations for every 1 captive closure per respondent. That is nearly double last year's reported rate, in which there were an average of 2.5 formations for every 1 closure.
- 43% of respondents reported group captives as the captive structure most formed, with single-parent captives coming in a close second at 35%, compared to last year's survey, in which single parent was the most selected, followed by group captives.
- The average respondent reported 206 captive clients being served by their organization, an increase from last year, which reported an average of 137 clients served. The total number of captive clients served by ALL respondents in this year's survey was 5,377 – nearly double last year's reported total of 2,884.
- The average estimated premium per captive was $6,734,722.
- Employee benefit and medical stop-loss growth – A majority of respondents (77%) reported seeing the most growth in employee benefits and medical stop-loss captives. This was the third year in a row demonstrating this trend.
- Price inflation is up – 34% of respondents listed price inflation as the biggest yearly trend, with staffing shortages coming in second at 19%. They were also listed as the top two trends in last year's survey.
- Captive Domiciling Moving Onshore – Onshore domiciles reported included Vermont and North Carolina, while Bermuda was a top offshore response.
- Captive Owners Setting Up Multiple Captives – Captive owners reported an average of 1.6 captives per business, an increase from last year.
- Captive Owners Benefit from Captives – The majority of captive owners (71.4%) reported that they have not considered closing or leaving their captives. At the same time, 57% of respondents reported that they were able to find similar coverage in the commercial market, an increase from last year's 42%. ■

Caroline McDonald is an award-winning journalist who has reported on a wide variety of insurance topics. Her beat has included in-depth coverage of risk management and captives.