



IIA'S CAPTIVE SURVEY REVEALS KEY DATA FOR THE INDUSTRY

Earlier this year, IIA conducted a first of its kind survey among its captive insurance members in order to collect key information about the state of the industry. The survey comes after several years of growing advocacy activities by IIA and its Captive Insurance Committee. The goal of the survey is to continue to facilitate coordination among captive professionals with information and data sharing across the industry.

The survey results were formally released in early-July, followed by a webinar to discuss the results in-depth. This initial survey was the first in what IIA hopes will be an annual survey that will be an ongoing information resource for its members.

"The survey results were very informative, specifically in the time of COVID," said Jeff Fitzgerald, vice president of Employee Benefits at Innovative Captive Solutions. "All of us get involved in running our own captives, it's good to have the opportunity to find out what is going on with the rest of the industry, to see where everyone else is."

— Written By Karrie Hyatt

For Jerry Messick, CEO of Elevate Risk Solutions and current chair of SIIA's Captive Insurance Committee, "The results echo how important captives continue to be in protecting the assets of not only larger organizations, but the small to medium sized business market. The survey will hopefully serve as a foundation to build upon in the future as I believe it's critically important to demonstrate the pulse of this growing industry."

RESULTS OF THE SURVEY

The survey focused on three areas: the current state of the captive market, the impact of COVID-19, and the IRS's continued activities surrounding captive insurance companies.

State of the Captive Market

The survey of the captive market found that of the captive managers surveyed, the median number of captives managed is 50, with a range from 18 captives per manager to over 3,000. The top three domestic domiciles utilized by survey participants are Delaware, Tennessee, and North Carolina. In 2020, captive managers saw more captive formations than closures, with an average of 28 new captives formed during the year, and an average of 20.8 captives closed.

"I personally know two companies that closed due to the effects of the pandemic," said Messick, "So that naturally had a dramatic effect. On the other hand, you saw the true benefits of captives that paid millions in claims to their insureds. I would also say that many of these claims would have been denied by the commercial market. The fact that you saw an increase is a testament to progressive companies understanding that well-structured captives provide incredible protection."

New trends identified in the captive insurance space are the hard market's influence on traditional insurance rates which is spurring new captive formations, as well as changes to risks in the in the property and casualty sector, in medical stop-loss, and in self-insurance spaces. IRS activities are still an ongoing concern.

COVID-19 Impacts

COVID-19 is changing the risk landscape for all of these sectors. Responding survey participants said that interest remains high for small businesses to form captives, but those businesses are finding funding unavailable due to capital contraction as a result of the pandemic. Businesses are also more interested in business interruption coverage, pandemic coverage, and risk sharing with fronting carriers post-COVID.

During the pandemic, many businesses being insured by the traditional market were caught off guard by claims denied by their insurers.

According to Messick, "I was astounded at the number of business interruption claims denied by the commercial market. I think that just demonstrates how little most company executives understand about their own policies. While not talked about much, captives are excellent drivers of education in understanding the coverages being purchased. I think you'll see the trend to captive continue because of this and the market conditions."

The pandemic has been a game changer in the insurance marketplace leading to more interest in captives and the more flexible coverage they can provide.

As Fitzgerald said, "Captives are always found where people are frustrated with traditional insurance."



“Captives helped during the pandemic, in many ways, but especially from the supply chain and business interruption coverage perspectives,” said Messick. “While COVID was a major influence on these risks, the repercussions of inflation, reduced manufacturing capabilities, and especially the disruption in the shifting labor market will have profound effects on business. I was on a captive board call recently where the insured said he relied on the captive as a backstop to the more aggressive management decisions they were having to make due to dramatic labor shortages.”

The survey found that the average number of COVID-related claims in 2020 was 75, with one captive manager reporting 300 claims. Going into the pandemic, it was expected that most small business claims would be healthcare related.

However, most claims from captives were related to business interruption. “We just did not see that the economic repercussions of COVID being that the interruption of day-to-day operations would be more expensive than medical claims. The average COVID case was not that expensive, even for those cases that involved a hospital visit, versus the loss of operating revenue,” said Fitzgerald.

At the time of the survey, in the spring of this year, 80.5% of COVID-related claims were paid and approximately six claims on average were still open. The average amount paid on COVID-related claims was \$650,000, with the highest claim being \$2 million.

Captives were instrumental in helping their owners and parent companies stay solvent during the pandemic. According to Fitzgerald, “For us, with our focus on employee benefits, it was the stability of captives that helped through COVID, as well as having the opportunity to define how coverage could be provided. When everyone was locked down and not going to the doctor, employee benefits captives could recognize those savings and put that money by for later use.”

IRS Activities

The survey’s section on IRS activity focused on four issues: appeals, global settlement, audits, and court cases. In both the appeals and court case section the vast majority of respondents did not have any direct experience—not appealing any IRS decisions nor taking them to court.

In relation to audits, 35% of survey respondents said they have at least one captive currently under audit. With roughly a third of captives under audit, captive managers believed they were not treated consistently under the Taxpayer Bill of Rights.

Respondents reported that the average cost of defending a captive in an audit is \$150,000. The lowest cost reported was \$30,000 and the highest cost estimated

at \$250,000. Captive managers stated that the overall costs of defending their captives during an audit have exceeded \$3 million per manager.

The IRS's global settlement offers have created a lot of tension in the industry, with captives receiving the offers vacillating on whether or not to accept. Respondents to the survey said that, of the captives they manage that received an offer to settle, a majority of their clients chose not to settle. One captive manager reported that 95% of their clients chose not to settle, while several others reported that there was a mixed number of captives that chose to settle—either a 40/60 split or 50/50 split.

Regarding those that accepted the settlement offer, 55% did so even though they believed the merits of their case were inconsistent with the offer. They did so because the cost of litigation outweighed the cost of settlement.

SIIA's Advocacy

The inaugural captive survey is part of SIIA's dynamic captive strategies for the coming months and years. Over the last five years, SIIA's Captive Insurance

Committee has been advancing its charter by taking on policy and regulatory issues, including developing and releasing the Captive Manager Code of Conduct.

The more recently formed Captive Advocacy Team has been instrumental in getting captive owners involved in legislative and regulatory issues. According to Ryan Work, SIIA's vice president of government relations, "This year alone, we have working groups updating the Code and looking at regulatory guidance, conducted the captive survey, in addition to ongoing advocacy on captive policy and regulatory issues."

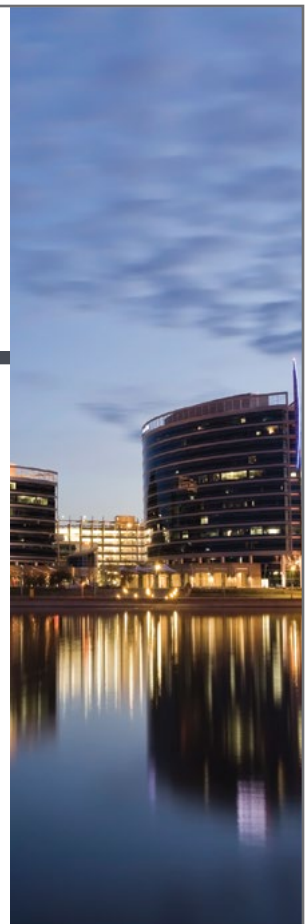


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SIIA's increased focus on captive issues is meaningful in many ways for their captive membership, not least of which is being a vocal supporter of captives. According to Messick, "SIIA's work means responsible captive managers finally have a voice. It means we can try and make our industry stronger as witnessed in the first version of the SIIA Captive Code of Conduct. I've been blessed to be in this business for over 37 years. It's my profession and I'm extremely proud of the work we do. Quite frankly, SIIA's support and involvement means everything to me."

For Fitzgerald, SIIA's engagement with captives and advocacy is key to his involvement with the organization. "I think that it is invaluable. There is more than one captive organization. Most of them are focused on their own jurisdiction. SIIA's mandate is the protection of self-insurance and captives are a great example of self-insurance done well. Being able to look at captives in context with the larger self-funded world is important to understand our place in it. To be a part of that and realize we have the same problems. It's huge to know that, to be a part of it."

SIIA's first annual captive survey will be influential in helping to set the course for its captive engagement in future years. Messick said, "SIIA has once again demonstrated their commitment to the captive management industry by performing a first-of-its-kind survey." ■

Karrie Hyatt is a freelance writer who has been involved in the captive industry for more than ten years. More information about her work can be found at: www.karriehyatt.com.



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