

A MILLIMAN GLOBAL FIRM



Milliman USA

Consultants and Actuaries

**TRIA - ACCESSING
COVERAGE FOR CAPTIVES**

March 20, 2003

Joel S. Chansky, FCAS, MAAA

Unique Position of Captive: Insured & Insurer

- Get to call all of the shots
- Opportunity for flexibility/optimization
- Single parent captive - complete control
- Groups/RRGs - decisions of members may ultimately impact equity of other members



First Decision: Election to Access Coverage Afforded under TRIA



No Coverage Election

Advantages:

- No pricing work required
- No structural changes required
- Solvency:
Protects captive's surplus (no large deductible or co-pay)

Disadvantages:

- Lose out on possible coverage
- Doesn't protect net worth of parent/owner
- Don't avoid assessments
- May still owe fire following losses



Solvency Example

\$50 million Direct Earned Premium
(DEP)

\$20 million Surplus

\$500 million Loss

Deductible = 7% of DEP = \$3.5 million

Loss Net of Deductible = \$496.5 million

10% Co-payment = \$49.65 million

Loss to Captive = \$3.5 million + \$49.65
million = \$53.15 million



Elect the Coverage

Advantages:

- Access to federal money
- Protects net worth of parent
- Can price at desired level

Disadvantages:

- Solvency issue
- Cash flow/timing of reimbursement
- Management (pricing, claims handling, policy terms/wording)



Conclude: Elect the Coverage

- What do you have to lose?
- May get significant benefits
- Costs can be minimized
- Solvency issues can be addressed
- Overlay on top of existing program



Strategies and Considerations

- Coverages
- Rates
- Solvency
- Assessments
- Sample “Programs”
- Other Issues/Considerations



Coverages

- “Commercial lines of P&C insurance”
- Property
- Workers’ Compensation
- Multi-line
- Some exclusions



Workers' Compensation Issues

- Direct business only covered
- VT: WC not allowed on a direct basis
- Even reimbursement policies considered reinsurance
- Insured/deductible program: Primary company on the hook
- Qualified self-insurance: If excess not statutory limits, could write excess terrorism coverage on direct basis



Rates: Market

NCCI:

- Average 1.5% load (varies by state)
- Low = 0.6% Montana; High = 12.5% DC
- Note: NY not an NCCI state

ISO:

- Property : “Tier 1” - \$30/100k, “Tier 2” - \$18/100k, “Tier 3” - \$1/100k coverage
- Liability: 2-5% base; 10% + high risk



Rates: Captive

Fully Funded

- Estimate maximum probable loss (MPL)
- Fund over “X” years (deductible & co-pay)
- Frictional costs

Zero Fund

- Collect nothing
- Lowers DEP/deductible
- Lowers premium tax, future assessments
- Avoids federal taxes on profits/no CAT reserve issue
- Saves time and effort of pricing



Solvency Issues

- Minimize deductible (low DEP)
- Buy reinsurance on deductible, co-pay
- Limit losses to surplus (parent pays co-pay)



Assessments

- Assessment is 3% of DEP
- DEP in the year after an event (?)
- Possible strategies
 - Self insure that year (vs. captive)
 - Build fund @ 1%/year
- Federal income tax benefit offset by assessment



Sample Program: Property Fully Reinsured

- Obtain market prices with and without terror coverage
- Decline terror coverage (if reinsurance costs less)
- Add terrorism coverage to the captive
- Option 1 - No premium (not recommended, but does minimize deductible, assessment)
- Option 2 - Premium = Cost of reinsurance



Sample Program: Property (continued)

No Premium

DEP = 0

Deductible = 0

Surplus = \$250k +
cost of reinsurance

VT premium tax = 0
(pay min of \$5,000)

Reinsurance Cost=\$1m

DEP = \$1m

Deductible = \$70,000

Surplus = \$250k

VT premium tax = \$4,000
(pay min of \$5,000)



Why Reinsurance May Cost Less

- Primary carrier has high DEP (all insureds)
- Creates high TRIA deductible
- Captive will have low DEP/low deductible
- Reinsurance should be less expensive



Example of Cost of Reinsurance

- Primary Carrier DEP = \$1 billion
- Primary Deductible = \$100 million (2004)
- Max Exposure = \$200 million
- Carrier Exposure = \$110 million (\$100 million deductible + \$10 million co-pay of next \$100 million)
- Parent must pay for \$110 million of cover



Example of Cost of Reinsurance

- Captive DEP = \$1 million
- Captive Deductible = \$100,000 (2004)
- Max Exposure = \$200 million
- Captive Exposure = \$20.09 million
(\$0.1 million deductible + \$19.99 million co-pay of next \$199.9 million)
- Captive must pay for only \$20.09 million of cover - much less than going direct



Other Issues/Considerations

- Groups vs single parent
- Cash flow/timing of reimbursement
- Multiple losses - aggregation issue
- TRIA expires at the end of 2005
- Assessments not restricted to one year
- Loss development may take years (business interruption, long term health issues)



Conclusions

- Captives in unique position
- Elect the coverage
- Minimize frictional costs
- Maximize coverage



A MILLIMAN GLOBAL FIRM



Milliman USA

Consultants and Actuaries