

# **Puerto Rico Insurance Summit**

***“Untapping New Opportunities”***

## ***Captive Insurance***

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**Willis**

# Agenda

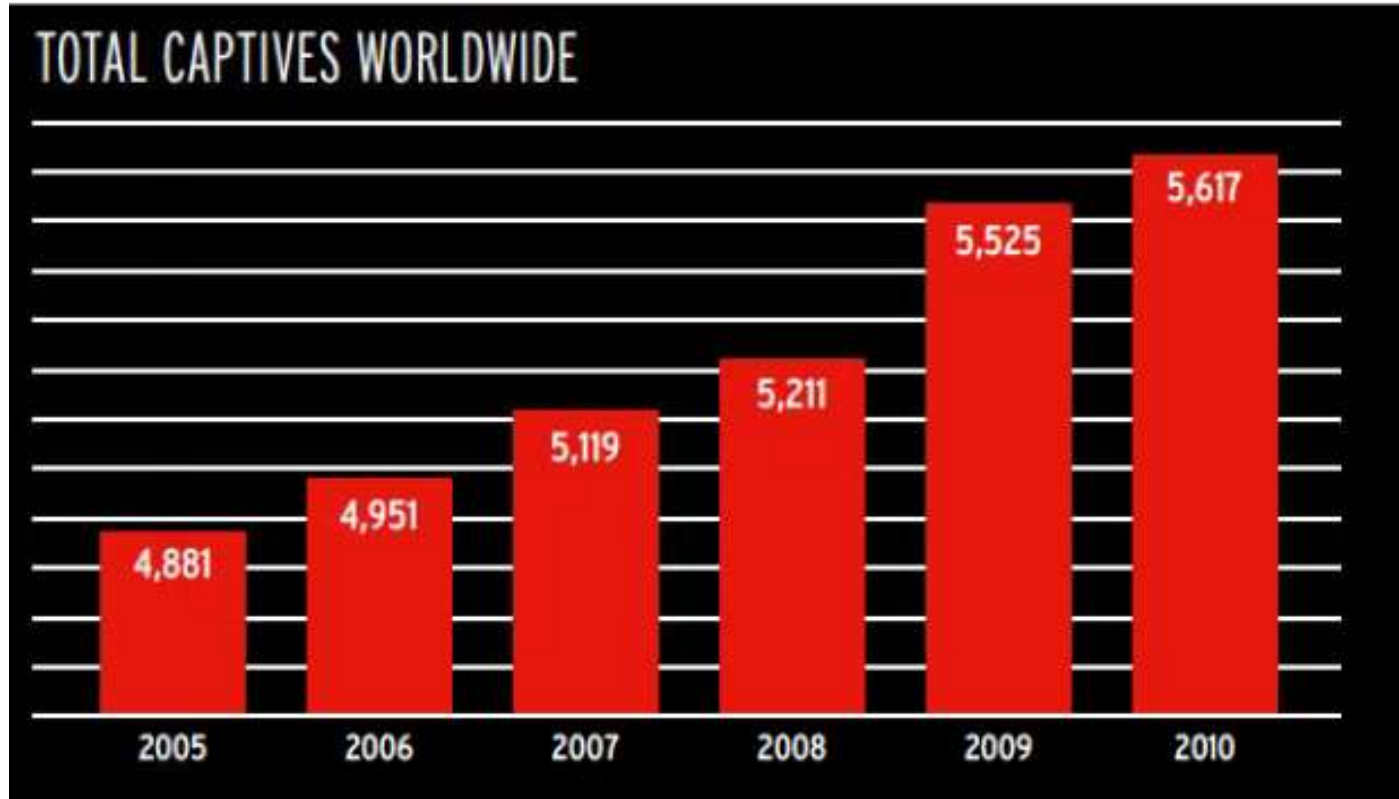
- **What is Captive Insurance?**
- **Why do companies form captives?**
- **How do companies choose their domicile?**
- **Opportunities for Puerto Rico**

# Captive Definition

## What is a captive?

- A limited purpose, licensed insurance company, the main business purpose of which is to insure the risks of the captive's owners
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- A risk assumption vehicle
  - An insurance or reinsurance company
  - Specifically established to insure or reinsure the risks of its parent or associated third parties

# A growth industry



Source: Business Insurance, March 2011

# Counts by domicile

## COUNTING CAPTIVES

*Ranked by number of captives in 2010*

DOMICILE	2010	2009
Bermuda	845	885
Cayman Islands	738	780
Vermont	572	560
Guernsey	341	355
Anguilla	252	209
Luxembourg	244	251
Barbados	242	230
British Virgin Islands	219	285
Turks & Caicos Islands	211 <sup>1</sup>	203 <sup>1</sup>
Utah	188	148
Hawaii	168	162
South Carolina	160	156 <sup>2</sup>
Isle of Man	143	145
District of Columbia	139	124 <sup>2</sup>
Kentucky	127	105
Nevada	124	125 <sup>2</sup>
Nevis	108	63
Arizona	96	99

DOMICILE	2010	2009
Delaware	95	49
Dublin	82	114
Montana	67	47
Singapore	60	63
Sweden	50 <sup>3</sup>	50 <sup>3</sup>
New York	47	47
Switzerland	35	42
Labuan	33 <sup>4</sup>	34
British Columbia	29	18
New Zealand	24	22
Gibraltar	17 <sup>5</sup>	15 <sup>2,5</sup>
Bahamas	16	15 <sup>3</sup>
Georgia	15	15
Netherlands Antilles	13 <sup>3</sup>	14 <sup>3</sup>
Malta	11	9
Missouri	11	6
Norway	11	12
Alabama	10	5

DOMICILE	2010	2009
Vanuatu	10	10
Denmark	8 <sup>3</sup>	8 <sup>3</sup>
Finland	8 <sup>3</sup>	8 <sup>3</sup>
Panama	7 <sup>3</sup>	5 <sup>3</sup>
Puerto Rico	7	6
U.S. Virgin Islands	7	3
Colorado	5	6
Michigan	4	2
Tennessee	4	4
Jersey	3	3
Micronesia	3	1
Hong Kong	2	2
Arkansas	1	1
Illinois	1	1
Kansas	1	1
Maine	1	0
Oklahoma	1	1
South Dakota	1	1

Source: Business Insurance, March 2011

# Captive Advantages

## Advantages over traditional commercial insurance

- Access to underwriting and investment income
- Component pricing gives ability to control frictional costs
- Enhanced focus on loss prevention and claims handling
- Ability to provide coverage that may be unavailable or over-priced in the market
- Uses rating plans that reflect groups' own good experience rather than insurers' pools
- May be able to access excess protection at lower cost
- Facility for pooling risks of groups of employers

# Captive Challenges

## Challenges of using captives

- Need to dedicate capital for solvency and reinsurance security
- Risk of higher claims than expected
- Risk of higher tax costs than expected
- Complexity
- “Distraction” risk

# Lines of Business

## TRADITIONAL

- Workers' Compensation
- Auto Liability
- General Liability
- Professional and Products Liability
- Director and Officer Liability
- Employment Practices Liability
- Environmental Liability
- Product or Service Extended Warranty
- Property and Business Interruption

## EXPANDED

- Employee Benefits
- Terrorism (TRIA)
- Shipping Coverage
- Title and Private Mortgage Insurance
- Equipment Maintenance
- Construction Exposures
- Trade Credit Risk
- Cyber-Risk
- Managed Care Errors and Omissions

## EMERGING

- Medical Stop-Loss
- Reputation/Brand/Loss of Income Risks
- Intellectual Property (patent, trademark, copyright)
- Product Recall Coverage
- Medicare "Fraud and Abuse" Insurance
- Lease Residual Value Risk
- Punitive Damages Coverage
- International Kidnapping Protection



# Retained Risk Finance

There are generally three models for managing retained risks in captives, each have different motivators, benefits, and challenges

Global Fronting	Deductible Reimb	Cat Excess
<ul style="list-style-type: none"><li>■ Property</li><li>■ Business Interruption</li><li>■ Environmental Liability</li><li>■ General Liability</li><li>■ Auto Liability</li><li>■ Employee Benefits</li><li>■ Product or Service Extended Warranty</li><li>■ Clinical Trials risks</li><li>■ Construction Exposures</li><li>■ Equipment Maintenance</li></ul>	<ul style="list-style-type: none"><li>■ Workers' Compensation</li><li>■ General Liability</li><li>■ Auto Liability</li><li>■ Product or Service Extended Warranty</li><li>■ Construction Exposures</li><li>■ Environmental Liability</li><li>■ Property and Business Interruption</li><li>■ Equipment Maintenance</li><li>■ Employee Benefits</li><li>■ Medical Stop-Loss</li></ul>	<ul style="list-style-type: none"><li>■ Reputation/Brand/Loss of Income Risks</li><li>■ Intellectual Property (Patent, Trademark, Copyright)</li><li>■ Product Recall Coverage</li><li>■ Punitive Damages Coverage</li><li>■ International Kidnapping Protection</li><li>■ Trade Credit Risk</li><li>■ Professional and Products Liability</li><li>■ Cyber-Risk</li></ul>

# Regulatory Compliance

## US Department of Labor

Captive transactions for benefit plans must comply with the Employee Retirement Income Security Act of 1974 (ERISA)

- ERISA prohibits plan sponsors from dealing in benefit plan assets
  - When captives are “parties in interest”
  - When the assets used are “plan assets”
- Individual exemptions are given if certain requirements are met:
  - Transaction is fronted
  - **Captive is licensed in US State or Territory**
  - Value is given to plan participants (“benefit enhancement”)
  - Independent fiduciary certifies that the transaction is compliant with ERISA
- 30 such exemptions have been granted since 2000, mostly for life and disability plans

# Domicile Selection

Decision Criteria	Puerto Rico Score?
<b>Regulatory</b>	
Capitalization and surplus requirements	Average
Stability of regulatory environment	High
Experience in business under consideration	Low?
Flexibility in investment choices	Average
Receptiveness of regulatory environment	High, e.g. Series LLC
Tax costs	?
Qualifies for ERISA benefits (State or Territory)	High
<b>Local services</b>	
Quality of local infrastructure	Average
Service costs	High (low cost)
Availability of expertise	?
Location: Proximity to directors and corporate HQ	High, for Latin America

# Example of Growth



**Utah:** growth from micro-captives (less than \$1.2mm premium) that attract family-owned enterprises; no premium tax

**Kentucky:** redomestications; KY-based captive managers

**DC:** “geography helps”; incorporated cells

**Delaware:** Series LLC legislation; integration of business entity and corporate law with captive insurance

# Opportunities

## Define Profiles of Target Captive Owners, e.g.,

- Non-US multinationals with US benefit plans
  - US state or territory needed
  - Lower operational costs
- Latin American corporations
  - Proximity
  - Language

## Promotional Efforts

- Marketing and Business Development – Role and Function
- Representation at captive events
- News magazines, e.g., Captive Review, Captive Insurance Company Reports