Exploring the Outer Limits of Captives

Tim East, The Walt Disney Company
Tim Padovese, OMIC
Stan McKinley, Wells Fargo & Co.
Anthony Benish, Cook-Illinois
Michael Meehan, Milliman, Inc.

Moderator – Anne Marie Towle, Willis Global Captive Practice

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Agenda

Exploring:

• Goals for Today’s Session
• Disney’s Story
• OMIC’s Story
• Wells Fargo’s Story
• Cook-Illinois’ Story
• Actuarial Insights
• Questions & Answers
Exploring the Outer Limits of Captives

What does this mean to YOU?

Why is it important to YOU?

When does the timing of a captive make sense to YOU?

How do I accomplish what the panelists have?
The Walt Disney Company’s Story

Presented by Tim East
Captive Development at The Walt Disney Company

Buena Vista Insurance Company

Alameda Insurance Company
The Walt Disney Company

Media Networks
2012 Revenue: $19.4B USD

Theme Parks and Resorts
2012 Revenue: $12.9B USD

Consumer Products
2012 Revenue: $3.3B USD

Studio Entertainment
2012 Revenue: $5.8B USD

Interactive Media
2012 Revenue: $845M USD

The Walt Disney Company
2002: The Critical Risk

Disney’s Property Program
2002: The Critical Risk

Disney’s Property Program

New York City

CA Earthquake

FL Wind

Europe

Japan EQ
Buena Vista Insurance Co.

BVIC Formed May 2002

- Supports the global property program
- Earthquake, fire, wind and flood
- Structured for low-frequency/high-severity risk
- Domiciled in the State of Vermont
  - Robust infrastructure
  - Strong regulatory environment
  - Close to other Disney businesses
2003: Emerging Risk Issues

Growth of the Company

- Media networks
- Mix of large and small business units

Motion Picture and Television Production

- Production package program
- Need to fund and promote loss control
Alameda Insurance Company

Formed January 2003

- Casualty insurance for domestic Disney, ABC and other BU’s
  - Workers’ Compensation
  - General Liability
  - Auto Liability
- Motion Picture and Television Production insurance
  - Production Package
  - Media Liability/E&O
  - General and Auto Liability
- Direct: Some special Pollution Liability
Disney Captive Insurance

Results
Buena Vista Insurance Company: 2005

Hurricane Charley over Florida at 7:30 PM EDT.
Buena Vista Insurance Company: 2005
Prior to the Captive

Beginning FY estimates based on previous years claims history only

Final FY cost based on actual claims with significant variation
New “Insured” Program

Beginning FY “premium” based on payroll, size, operations and claims history

Final FY cost remains the same or adjusted within limits based on claims
Captive Performance

Able to handle diverse business units and exposures
Able to Handle Unique Risks

The Ferry Boat Stumpf
Able to Handle Unique Risks

The Former Ferry Boat Stumpf
“In this volatile business of ours, we can ill afford to rest on our laurels, even to pause in retrospect. Times and conditions change so rapidly that we must keep our aim constantly focused on the future.”
OMIC’s Story

How OMIC has become one of the most successful Risk Retention Groups in Vermont and a model for other physician-owned carriers in the United States

*Presented by Tim Padovese*
Historical Perspective

- Medical malpractice crisis during the mid 80’s
- CNA pulls out of the market – hundreds left stranded
- Physicians wanted more control
- Risk Retention Act (RRG) passed in 1986
  - Practice in same professions, or
  - Activities similar or related exposures
- OMIC formed in 1987
- Original insurance program established by the American Academy of Ophthalmology (AAO)
Historical Perspective, cont.

- Initial capital contribution from AAO repaid within 9 months
- New insureds/members paid two times annual premium in the first year only with half paid to equity – surplus notes issued
- Initial challenges – feasibility study, capital, Board, Managing General Agency (MGA), transitioning to stand alone company
Organizational Snapshot

**Ophthalmic Mutual Insurance Company**

- **American Academy of Ophthalmology (AAO) Sponsored**
  - Annual Premium: 2012 - $43M
  - Surplus Growth to $148 M
  - Writes in all 50 states (Eye Banks only in Wisconsin)

**Physician Owners**
- 4470 Policyholders
- 43% Market Share

**Board of Directors**
- 12 Board Members
- 9 Committee Members
- 3 Annual Board Mtgs

**OMIC Staff**
- Underwriting
- Claims
- Risk Management
- Finance
- Sales & Marketing
  - One Location, 43 Employees

- Upgraded to ‘A’ (Excellent) rating by AM Best in 2007
- Continued A Rating by AM Best today
Board of Directors

- Originally established with 17 members – reduced to 11 today
- All except Vermont attorney are ophthalmologist insureds
- Many experienced with leadership from American Academy of Ophthalmology/other associations
- Financial experience - most challenging
- Established term and age limits
Committees

• Board Committees:
  • Executive/Reinsurance/Compensation
  • Finance
  • Audit
  • Underwriting
  • Claims
  • Risk Management/Sales & Marketing

• Decisions ratified by Board
Audit Committee

• Audit Committee established

• Oversee:
  • Financial statements
  • Regulatory audits
  • Legal and regulatory compliance
  • Service provider contracts and performance
  • Conflicts of Interest
Executive Committee

- CEO Compensation/Performance Evaluation

- Board/Committee Structure and Composition, Compensation and Evaluation

- Board/CEO Succession

- Charters, Policies, Guidelines
Board/Committee Training

- Detailed Handbook: role, responsibilities, industry, litigation, logistics
- PIAA Leadership Boot Camp
- Towers Watson Medical Malpractice Program
- Prime Advisors Investment Training
In-House Legal & Management

Oversight of Governance Processes
• Board rotation and membership
• Board/committee meetings

Oversight of Compliance
• Adherence to Articles, Bylaws, laws, NAIC guidelines

Draft charters, policies, guidelines
• Privacy/Security Policy
• Document/Record Retention Policy
• Disaster and Recovery Plan
Challenges

• Getting Board and Management to embrace “imposed” versus organic changes/requirements
• Why do we need an audit committee when the finance committee oversaw audit just fine?
• Why do we need Board to ratify service provider contracts?
• Why would we want to rotate our lead auditor?
• Why do we need a written record retention policy?
• Do we have to be told to be “ethical”?
• Making the tough calls on colleagues
Promoting OMIC Today

- Specific states identified/targeted
  - Direct Mail Campaigns
  - Groups identified
  - Programs through Ophthalmology State Societies
- Social Media used – Facebook, Twitter, LinkedIn
- Website Updated
- Blast email utilized
- Board & Committee Members employed
Lessons Learned

• Educate your Board

• Create culture where governance is seen as top priority and given due consideration, respect and resources

• Financial strength is paramount

• Exceed Surplus requirements

• Make the tough calls- you owe it to all of your policyholders
Wells Fargo & Co.’s Story

Presented by Stan McKinley
“While virtually anything can be insured, many risks can and should be avoided, prevented, controlled, transferred or retained.”

- Risk Identification
- Risk Analysis
- Risk Mitigation
  - Avoidance
  - Loss Prevention
  - Non-Insurance Transfer
  - Risk Financing (retention, self insure, market)
- Evaluation
History

Superior Guaranty Insurance Company
- Formed March 22, 1990 in Vermont
- Insured WC & GL as well as assumed existing losses

Norwest Corporation -1990
- Assets $30.6 Billion
- Net Income $280 Million
- 17,400 Employees
History, cont.

Wachovia Re, Inc.
- Formed July 5, 2005 in South Carolina
- Insured WC, GL, AL and various XS lines
- Moved to Vermont on December 22, 2011

Wachovia Corporation - 2005
- Assets $520.7 Billion
- Net Income $6.6 Billion
- 93,000 Employees
Today

Wells Fargo & Co - 2012

- Assets $1.4 Trillion
- Net Income $18.9 Billion
- 270,000 Employees
- More than 9,000 Locations in 39 States
- Products:
  - Banking
  - Insurance
  - Investments
  - Mortgage
  - Consumer and Commercial Finance
Today, cont.

Captive Programs

• $172 Million Premium / $48 Million Ceded
  • Workers Compensation
  • General Liability
  • Auto Liability
  • Professional Liability
  • Property
  • Mortgage Impairment
  • Employee Benefits
  • Private Mortgage Insurance
  • Credit Risk Insurance
Use of Captive

The captive is used as a Risk Financing Tool to maximize flexibility in developing the right mix of retained risk and what will be insured in the commercial market.

- Operates on a break-even basis
- Virtually all insurable risks are placed into the captive, when allowed
- Use outside actuaries for risks that are difficult to analyze
Captive Oversight

• Dedicated Internal Captive Manager
• Underwriting Committee
• Audit Committee
• Investment Committee
Challenges

• Identifying Risks
• Analyzing New Risks
• Charging the Correct Premiums
• Avoiding Unnecessary Risks
• International Growth
• Increasing Financial Reporting and Disclosure Requirements
• Investment Yields
• Regulatory Environment
Lessons Learned

• Reinsurance is not a sure thing
• If there is a chance of adverse claim development, it will happen
• Develop Strong Internal Relationships
  • Business Units
  • Accounting
  • Taxes
  • HR
Cook-Illinois’ Story

Presented by Anthony Benish
History of Cook-Illinois Corp.

- Started over 50 years ago as a privately held transportation company
- Primary business is owning and operating school buses for schools districts in the Chicago metropolitan area
- Family owned and operated; one of the largest family owned school bus operations in the U.S.
- Currently operates over 2,200 school buses primarily in the Chicago metropolitan area
Evolution of Five Families

• Five Families Insurance was created to support the large deductible program of the parent corporation, Cook-Illinois Corporation

• Began large deductible program in latter 1980’s in response to rising costs of insurance

• Better performance and cost containment as Parent took over control of its risk program
History of Five Families

• Formed in 2006 and domiciled in Bermuda
• Single parent captive
• Wrote the 14 separate operating subsidiaries of Cook-Illinois Corp.
• Originally wrote only auto and general liability coverage under a deductible buy back program
• Re-domesticated to Vermont in 2010
• Added worker’s compensation coverage in 2011
• Increased deductible on Auto in 2012
Current Utilization

• Continue to write Auto/GL, Worker’s Compensation for not only subsidiaries but also two new joint ventures
• Added a union activity policy to the Captive
• Was able to underwrite the paper for a specialty line of coverage (sexual molestation)
• Expanding ways to use Captive resources to fund loss control measures
  • Safety software including cameras, GPS and real time route information
Benefits of Captive Utilization

- Increased ability to retain more risk within the captive
- Ability to support Letter of Credit requirements
- Reinsurance and stop losses
- Funding of Loss Control measures
- Manuscript & tailor policies to Cook-Illinois’ needs
- Placement of difficult exposures
  - Union activity
  - Sexual molestation
Challenges

Domicile

- Bermuda chosen for off-shore benefits; instead elected IRS Code 953 (d) designation to be taxed as US Company
- Access to re-insurance; never accessed the market, but instead utilized savings in the Captive to increase deductibles
- Off shore management made communications and responsiveness challenging
- Need to issue two separate Letters of Credit as Carrier would not accept LOC from Bermuda bank
- At times became “lost in the crowd” as a small single parent captive
- Foreign based insurance company not in-line with our marketing of being one of the few remaining American owned school bus companies
Challenges

Letters of credit

• Change in carrier requires additional letter of credit; will have outstanding LOC’s with legacy carriers for many years.
Lessons Learned

• You must have in place the systems to adequately monitor all aspects of the Captive
  • Accounting
  • Auditing
  • Financial reporting
  • Overall captive management
  • Underwriting and premium pricing
  • Tax management

• Approach the Captive as you would your losses; the more control and involvement you have the less likely costly mistakes will be made
Actuarial Insights

Presented by Michael Meehan
Actuarial Analysis

- Review historical loss information (company?)
- Consider policy limits and net retentions
- Forecast losses for prospective period
- Pro Forma Financial Statements
- Confidence level analysis
Actuarial Analysis

Necessary Data

- Historical loss data, multiple evaluations
- Corresponding exposures
  - payroll, sales, etc.
- Claim counts
  - open/closed/reported
- Large loss information
- Policy limits / net retention
- Historical premiums (if exposures were insured)
- Other (changes in claims handling, risk management, etc.)
Actuarial Analysis - Challenges

Company Has Limited or No Historical Data

- Look to industry data
  - Publicly available rate filings
  - Annual statement information
  - Other?

Examples:  Auto Liability (by state)
           TRIA
Actuarial Analysis - Challenges

Industry Has Limited or No Historical Data

Need to “create”

• Research exposures
  • Interview experts
• Determine parameters (frequency/severity) of claim distribution

Examples: Employment practices liability
           Underground storage tanks
Actuarial Analysis - Results

- Forecast of expected ultimate loss and allocated loss adjustment expenses
- Confidence level analysis
- Pro Forma Financial Statements
  - Expected and Adverse/Alternative Scenarios
- Capitalization
Management Considerations

- Objectives and risk appetite
- Impact on capitalization
- Cost / Benefit
  - Economic / Non-economic
- Focus on long-term results
Exploring the Outer Limits of Captives – Wrap Up

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When does the timing of a captive make sense to YOU?

How do I accomplish what the panelists have?
Questions & Answers
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