



2023 Annual Conference

Texas Captives: Empowering Texas Business

AM Best's Captive Rating Process

Adrienne Stark

Senior Financial Analyst

AM Best

AM Best's Captive Rating Process

Agenda

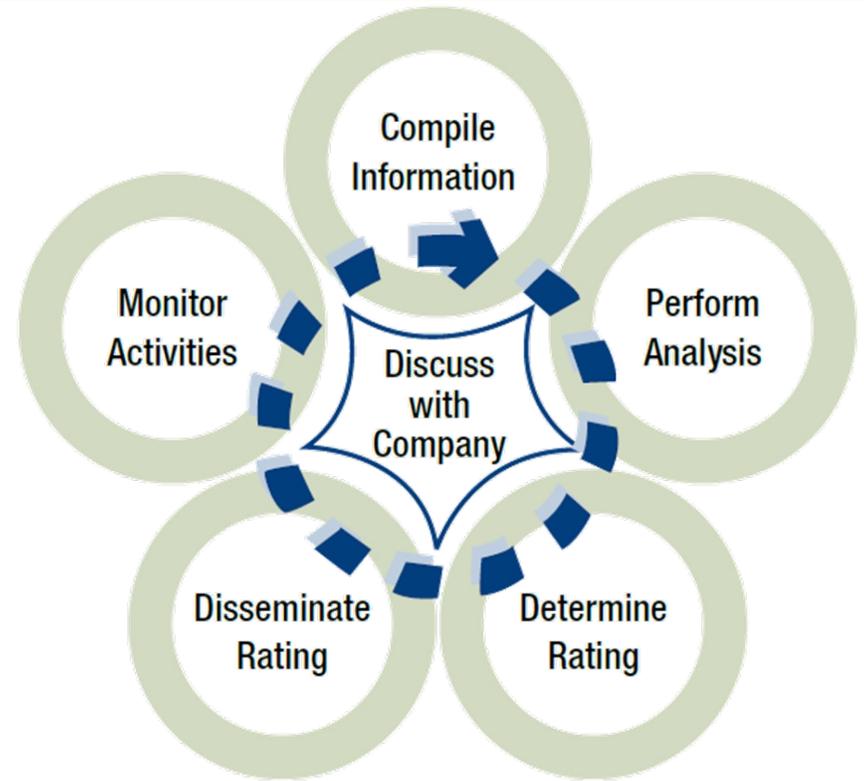
- The Interactive Rating Process
- Methodology – Determining Ratings for Captives
- Types of Captives rated by AM Best
- Rating Benefits for Captives
- US Captive performance vs. Commercial Casualty peers
- Opportunities and Challenges

AM Best's Captive Rating Process

The Interactive Rating Process

The Interactive Rating Process

- The Rating Process starts with an in-depth meeting with captive management and AM Best analytical Team
- Primary data sources: Annual/Quarterly Statements, Public Industry Data, Supplemental Proprietary Info
- Ratings are determined by committee process – by a majority vote



AM Best's Captive Rating Process

AM Best's Ratings

Financial Strength Rating (FSR)

- An independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations

Long-Term Issuer Credit Rating (Long-term ICR)

- An independent opinion of an entity's ability to meet its ongoing senior financial obligations

AM Best's Captive Rating Process

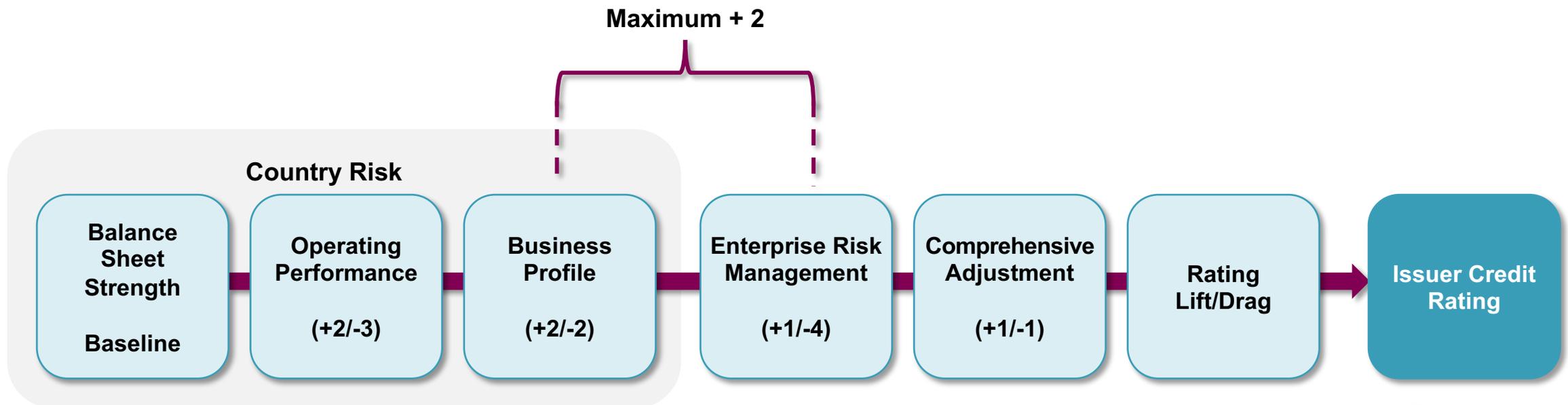
Issuer Credit Ratings (ICR) and Financial Strength Ratings (FSR)

Long-Term ICR	FSR
aaa, aa+	A++
aa, aa-	A+
a+, a	A
a-	A-
bbb+, bbb	B++
bbb-	B+
bb+, bb	B
bb-	B-
b+, b	C++
b-	C+
ccc+, ccc	C
ccc-, cc	C-

AM Best's Captive Rating Process

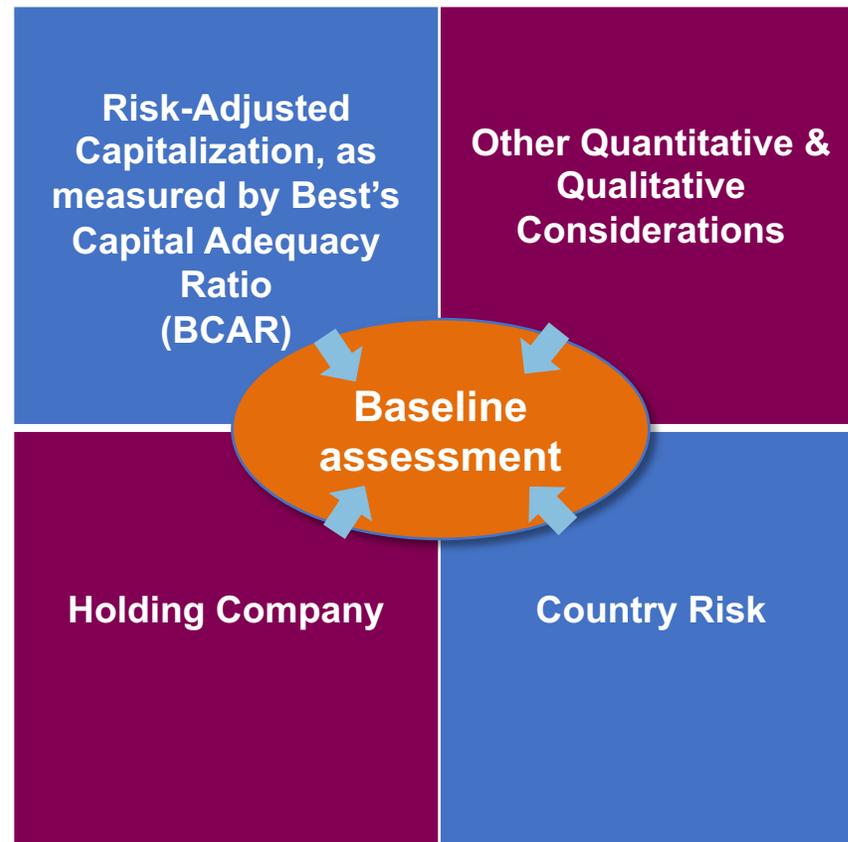
Methodology – Determining Ratings for Captives

AM Best's Rating Process – Building Block



AM Best's Captive Rating Process

Balance Sheet Strength Assessment



Specialty Criteria Considerations Alternative Risk Transfer

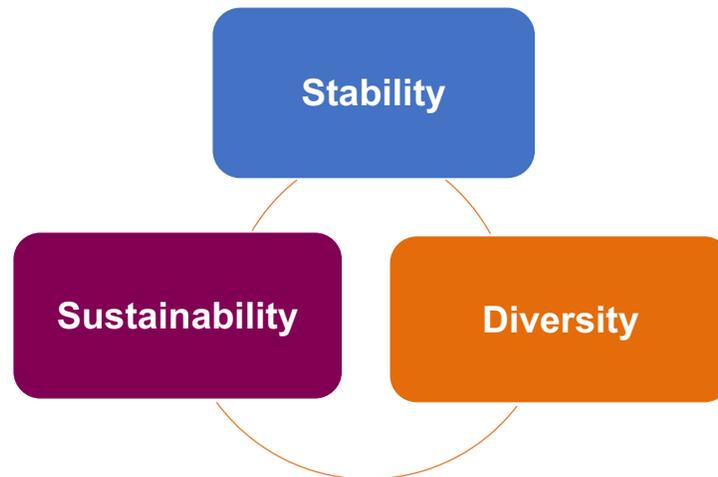
Exposure to large loss events

Loan-backs to parents &
Letters of Credit

Assessment of non-insurance
parent carried out under
lift/drag rather than balance
sheet strength

AM Best's Captive Rating Process

Operating Performance Assessment



Specialty Criteria Considerations Alternative Risk Transfer

Volatility of operating results

Mission to provide consistent tailored coverage at stable pricing

Investment income in light of allocation

- In general, more diversity in earnings streams leads to greater stability in operating performance
- Analysis reflect a variety of quantitative and qualitative measures to evaluate operating performance

AM Best's Captive Rating Process

Business Profile Assessment

Product/Geographic Concentration	Product Risk
Market Position	Degree of Competition
Pricing Sophistication and Data Quality	Management Quality
Regulatory, Event and Market Risks	Distribution Channels
Innovation	

Specialty Criteria Considerations Alternative Risk Transfer

Relationship with parent determines access to business in absence of market profile

Concentration by product/geography

Often high product risk

AM Best's Captive Rating Process

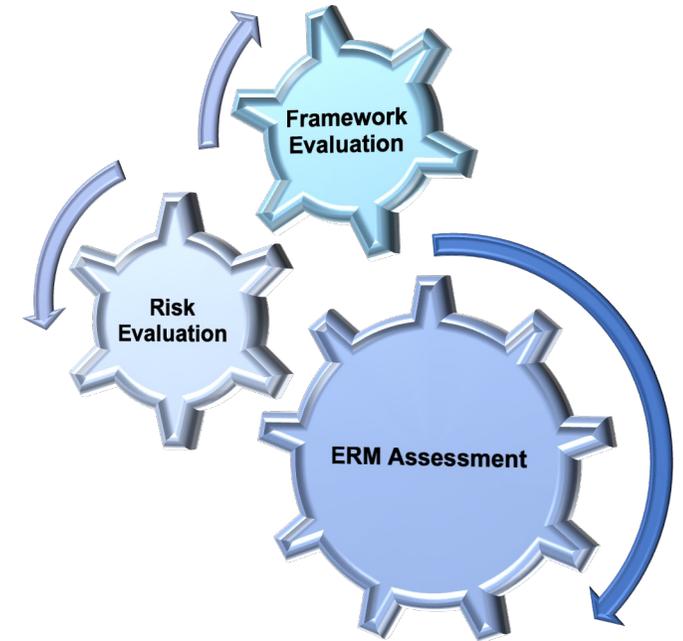
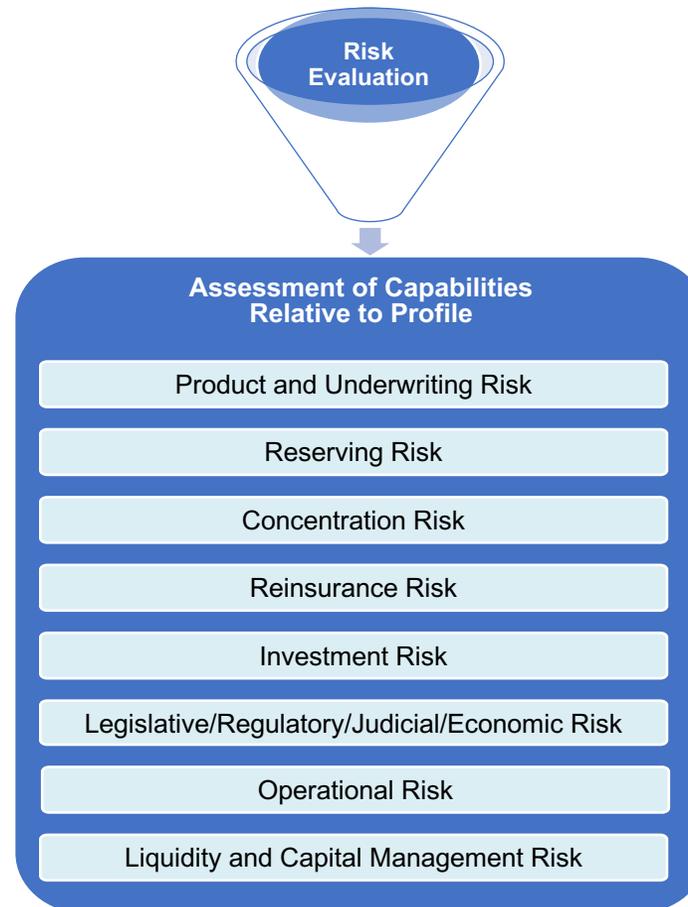
Enterprise Risk Management (ERM) Assessment

Holistic evaluation of ERM

- Assessment of the risk management framework and the insurer's risk management capability relative to its risk profile

Risk Impact Worksheet (RIW)

- Part I: Framework Evaluation
- Part II: Risk Evaluation
- Part III: Overall ERM Assessment



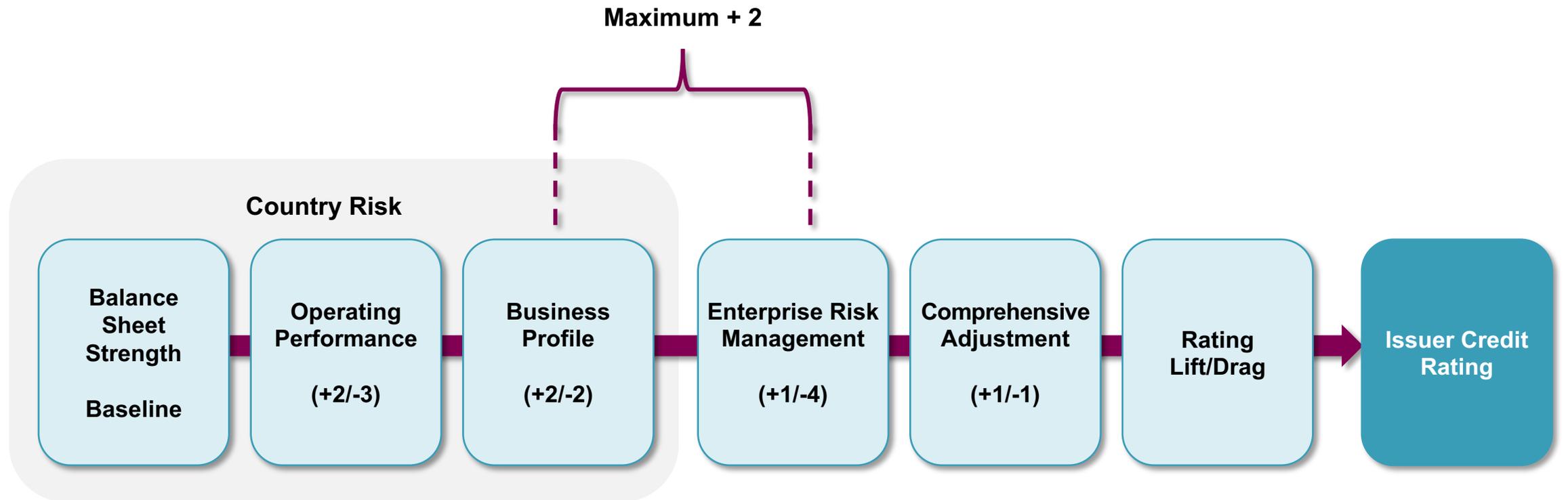
AM Best's Captive Rating Process

Indications for Potential Lift/Drag

Focus on captives: Are the resources of the parent available to the captive or could the captive be called upon to service the obligations of the parent?	
Lift	Drag
The credit profile of the parent is stronger than that of the captive	The credit profile of the parent is weaker than that of the captive
The captive is important to the parent	The captive's importance to the parent is limited
History of capital support or explicit support in place	History of punitive capital actions
	Risk of capital extraction by parent - no regulatory restrictions on the flow of capital

AM Best's Captive Rating Process

Building Block Approach



AM Best's Captive Rating Process

Methodology References and AM Best's Industry Research

For further information, please see
Best's Credit Rating Methodology



Key Criteria:

<http://www3.ambest.com/ambv/ratingmethodology>

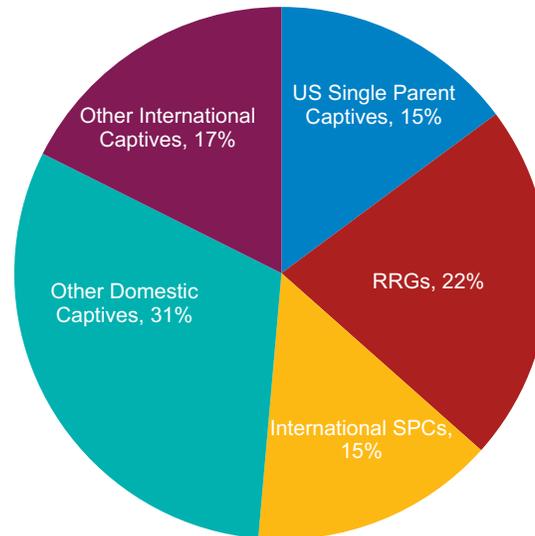
AM Best's Captive Rating Process

Types of Captives AM Best Rates

Rated Captive Types

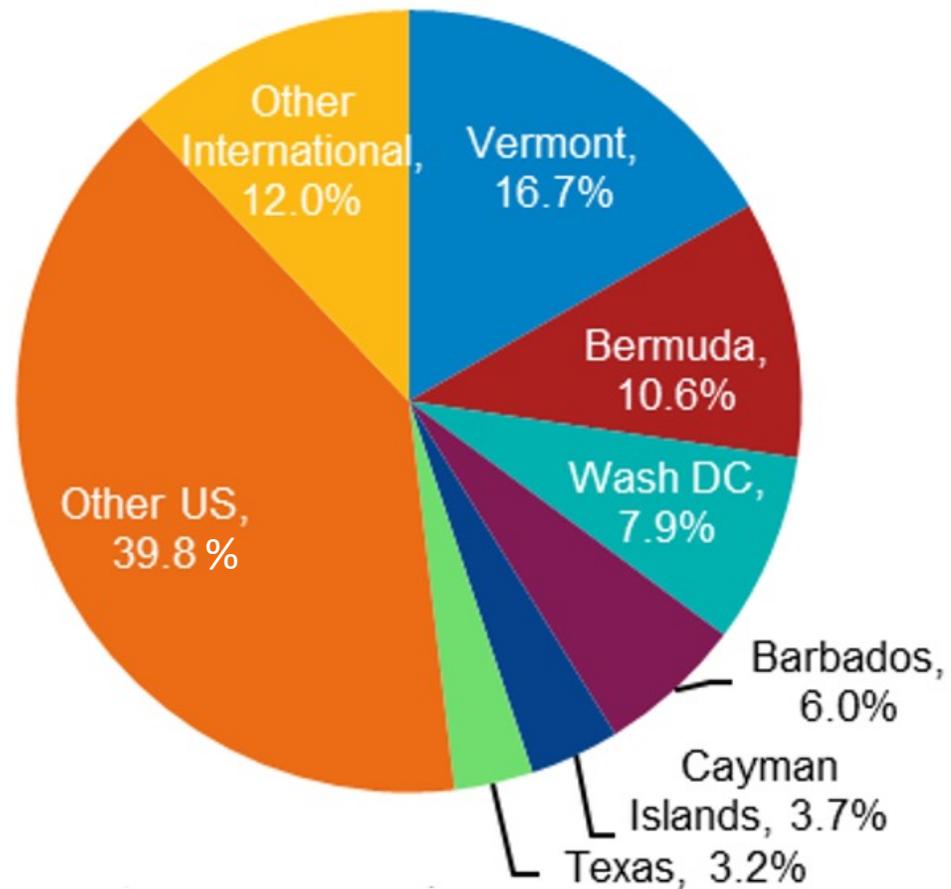
- AM Best currently rates more the 200 captives worldwide

AM Best's Rated Global Captives – by Type



AM Best's Captive Rating Process

AM Best's Rated Global Captives - by Domicile



AM Best's Captive Rating Process

Rating Benefits for Captives – Examples of Benefits of a Captive Rating

Provides greater flexibility regarding fronting arrangements and enhanced access to reinsurance

Offers possible reduction of collateral requirements of lead insurers

Compliments national and international regulatory requirements

Provides support to corporate financial and governance policy by validating strength and credibility of a captive

Increases control and flexibility for risk managers in managing group insurance and reinsurance programs

Enhances quality of risk auditing process

Facilitates coverage for joint-venture risks and issuance of acceptable insurance certificates

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Performance Trends of Rated Captives

Combined and Operating Ratio

- The most recent five-year average Combined and Operating Ratios of the rated US Captive Insurance Composite beat those of its Commercial Casualty peers by significant margins.

US CIC – Five-Year Combined Ratios (%)		
	5-Year Combined Ratio (Ex Div)	5-Year Operating Ratio
SPCs	69.7	52.6
RRGs	96.9	86.6
All Captives (CIC)	83.9	79.4
5-Year Commercial Casualty Composite (CCC)	98.0	87.3

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Performance Trends – Policyholders' Surplus

US CIC – Policyholders' Surplus \$ millions					
	2018 PHS	2022 PHS	Increase	Stock and Policyholder Dividends	Total Savings
SPCs	10,546	13,440	2,894	1,574	4,468
RRGs	2,464	2,767	303	268	571
All Other Rated Captives	11,517	12,408	891	3,471	4,362
Total Rated Captives	24,527	28,615	4,088	5,314	9,402

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Performance Trends – Net Premium Written

US CIC - Net Premium Written, 2018-2022 (\$ millions)

Net Premium		
Year	Written	% Change
2018	4,935	4.7
2019	5,193	5.2
2020	5,247	1.0
2021	5,474	4.3
2022	6,963	27.2
5 Yr. CAGR		8.1
5 Yr. Chg		47.8

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Performance Trends – Ratio Analysis

US CIC – Ratio Analysis, 2018-2022 (%)						
	Loss & LAE	Underwriting Expense	Combined (Ex Div)	Policyholder Dividends	Investment	Operating
2018	62.5	19.9	82.4	13.3	20.3	75.4
2019	64.9	19.6	84.4	17.7	20.7	81.4
2020	68.3	18.9	87.2	11.8	16.4	82.7
2021	66.1	19.3	85.4	14.8	12.9	87.3
2022	64.4	16.4	80.8	4.9	14.4	71.3
5 Yr. Avg. (CIC)	65.2	18.7	83.9	12.3	16.8	79.4
5 Yr. Avg. (CCC)	69.0	29.0	98.0	0.3	11.0	87.3

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Performance Trends – Underwriting Expenses

US CIC vs. CCC – Underwriting Expense Analysis, 2018-2022 (%)						
Year	Commission Expense Ratio		Other Expense Ratio		Total Underwriting Expense Ratio	
	US CIC	CCC	US CIC	CCC	US CIC	CCC
2018	1.6	12.0	18.3	17.3	19.9	29.3
2019	2.0	12.0	17.6	17.3	19.6	29.3
2020	1.5	11.7	17.4	17.0	18.9	28.7
2021	2.3	11.6	17.0	16.1	19.3	27.7
2022	2.7	11.9	13.7	15.7	16.4	27.6
5 Yr. Avg.	2.1	11.9	16.6	16.6	18.7	28.5

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Opportunities and Challenges

Opportunities – Increased Captive Formations/Expansion for Reasons Including:

- Continuation of hard market conditions
- Capacity constraints in re(insurance) markets
- Offer flexibility and customization
- Provide efficient, creative solutions for specific needs
- Set risk appetites and risk tolerances
- Knowledge of own risk
- Claims management ownership and oversight

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Opportunities and Challenges

Opportunities (continued) – Captives Taking on New Exposure, broadening Coverages, Filling Gaps

- Property (including CAT) – Moving more exposure into the captive
- Cyber Coverage – Captives become more viable and attractive option
- Medical Stop-Loss and Medical Expense Cost Containment in captives
- Directors & Officers – Side A Coverages
- Increased Retention and Deductibles on primary lines of coverage
- Captives participating in the insurance tower
- Increased interest in Parametric Contracts

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Opportunities and Challenges

Challenges

- Rising costs of repairs (vehicle parts, building materials)
- Supply chain shortages driving claim settlement time and cost
- Social Inflation, Litigation and Judicial Environment
 - Captives aren't immune to social inflation, which is driving up claims costs
 - Litigation financing is driving higher verdicts, particularly in healthcare
- IRS's Proposed Captive Regulations
 - Could impose additional administrative, legal and financial burdens on captives

Questions?

THANK YOU!

Adrienne Stark

Am Best

Adrienne.stark@ambest.com

(908) 882-2336



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