

Captive 101

2025 Client Symposium



Presenters



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Discussion Points

- Captive Introduction
- Captive Types
- Feasibility & Development
- Daily Operations
- Insurance Investment Solutions



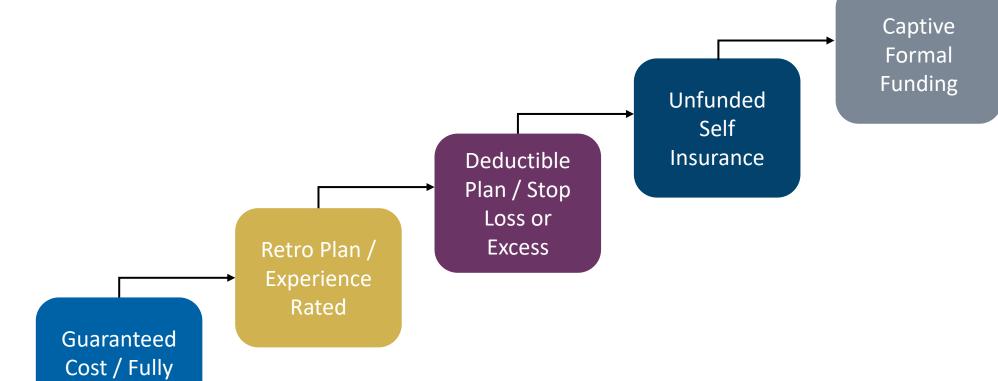
Captive Insurance Definition

- A licensed insurance company owned by one or more non-insurance entities for the primary purpose of providing insurance coverage to the owner or affiliated entities.
 - Separate legal entity
 - Insurance company license
- Regulated under special (less stringent) state (Vermont/Utah) or country (Bermuda/Cayman) legislation regulating captives.
- Can be standalone or within a cell facility, single, or group.



Risk Financing Options

Insured

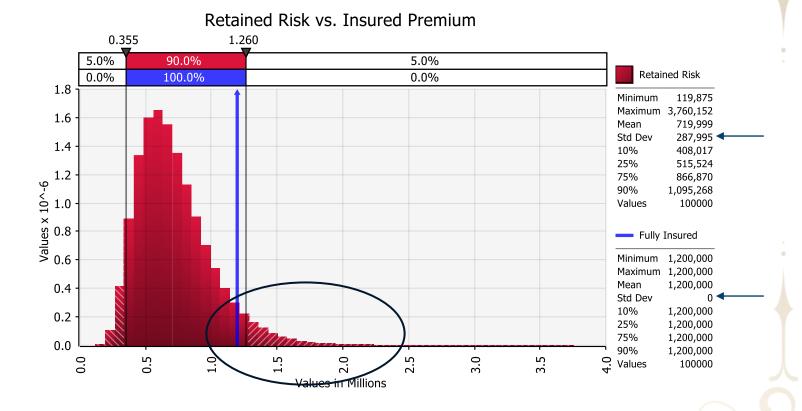


Increased Risk Assumption



Risk Profile Change Case Study

- Changed risk profile
- Need to focus on loss control



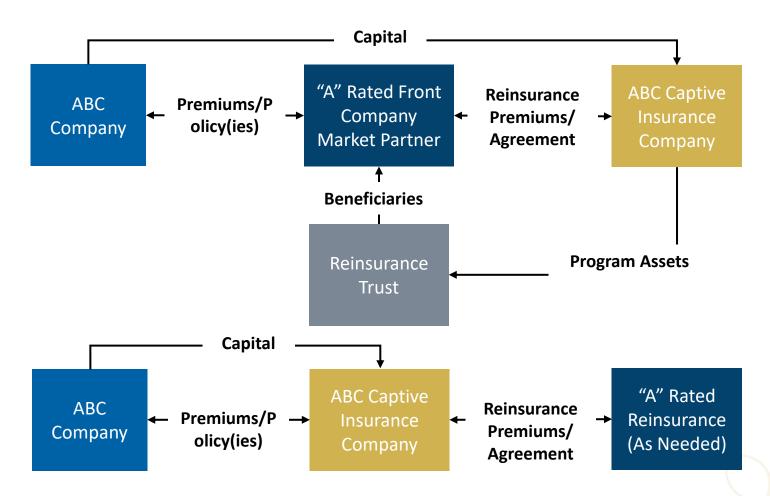


Captive Types



Single Parent Captive

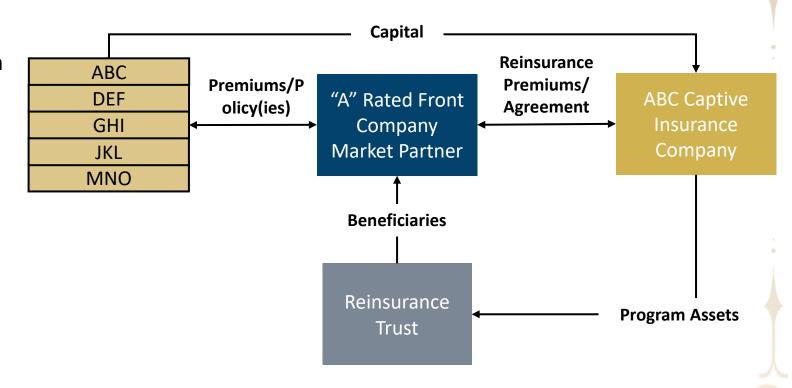
- Wholly owned by one parent company
- Formed primarily to insure or reinsure the risks of the corporate parent or (un)related parties of their choosing





Group Captive

- Owned by two or more companies, often affiliated through a trade association or group of companies in the same industry ("homogenous group captive")
- Formed to insure or reinsure the risks of the group
- Alternative risk-sharing structures known as Risk Retention Groups—a special form of captive limited to underwriting liability risks directly in the US—are also common





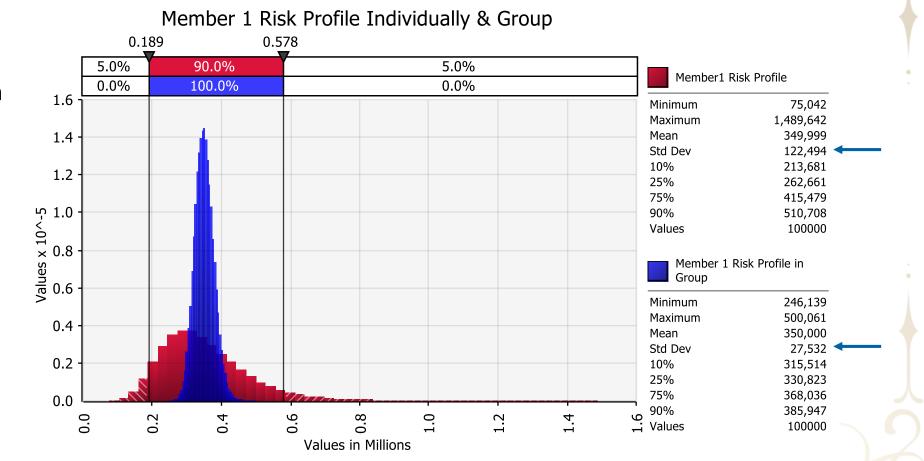
Group Captive/RRG Comparison

Placement	Reinsurance	Direct
Coverage Lines	All lines	Liability only
Admitted Carrier	No – (through front partner)	Yes
Rated Carrier	Yes – through front partner	Not at inception, should be focus
NAIC Filings	No	Yes
Front Fees	Yes	No
Collateral	Yes	No
Catastrophic Coverage	Usually through front partner	Usually through reinsurance
Administrative Expense	Lower	Higher due to increased regulatory requirements
Capital Efficiency	Less efficient due to need for stacking collateral	More efficient due to lack of collateral, can be impacted by domicile, RBC requirements



Group Captive Case Study

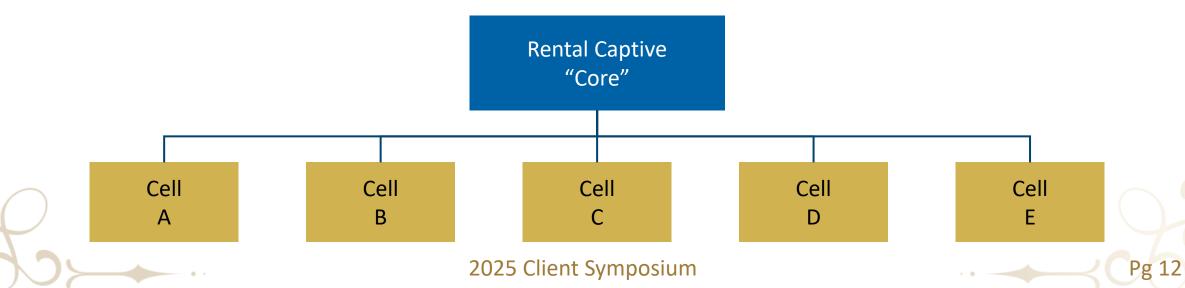
 Risk stability through diversification.





Protected Cell/Rental Captive

- The Core owner takes responsibility for regulatory minimum capital and co-ordinates services to the cells.
- Each cell can be owned by a separate party, with assets and liabilities of each ring fenced from oneanother.
- Individual cells operate under the core's license.





Cell/Rental Captives

Key differences:

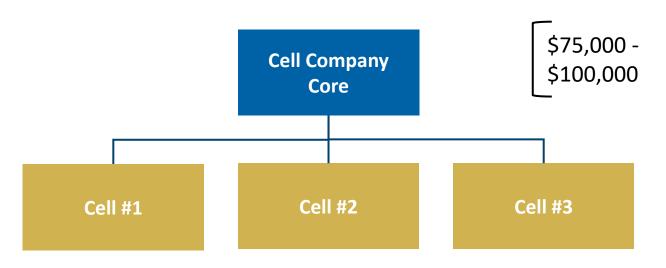
Category	Standalone Captive	Cell Captive	
Cost	Slightly More	Slightly Less	
Capital	Statutory Capital Needed	No Statutory Capital	
Control	Complete Control	Less Control	
Confidentiality	Increased	Less – Due to Core	
Commitment (Time)	Slightly More	Slightly Less	

- Once operational, user experience should be similar.
- Cell rental fee will offset some of the cost difference.



Cell/Rental Captive Case Study

- Cell facilities are increasingly being developed by insureds to own and control the overall facility.
- The core capital was once \$500,000 to \$1,000,000 but has been reduced by domiciles to become more competitive.
- Some examples below:
 - Connecticut \$75,000
 - North Carolina \$100,000
 - Vermont \$100,000



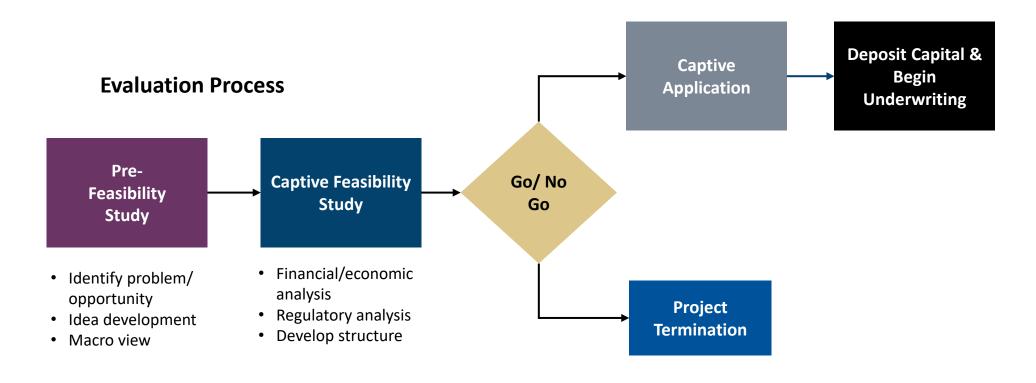






Feasibility & Development

Development





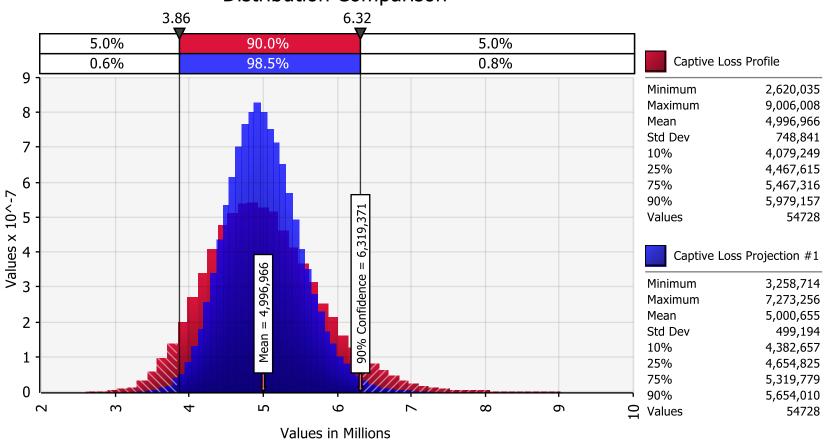
Feasibility Study

i Casibilit	y Study
Business Purpose / Background	 Define captive insurance company objective Confirm coverage lines to be considered Review limits needed Define captive parent(s) risk appetite
Data Collection	 Collection and cleansing of historical loss & exposure data for potential parent(s) Develop a data set for submission to the actuary Actuarial analysis for coverage lines considered Expected & higher confidence level losses Total cost of risk calculation
Captive Structure, Domicile, and Tax	 Compare standalone & rental captive structures Study optimal domicile location Develop captive tax position based on review of parent(s) structure & risk being placed into the captive
Market / Structure Analysis / Economic Analysis	 Confirm captive retention structure Combine actuarial output with insurance market realities in pro-forma financial modeling Review the need for and availability of reinsurance Five-year pro-forma model that considers premium, losses, capital, and operating expenses under various loss and investment scenarios
Report Development	Create formal reporting outlining assumptions, findings, and recommendations on the feasibility of a captive insurance company



Feasibility Study – How Much Capital?







Feasibility Study – How Much Capital?

Risk Profile #1

Mean/Premium Funding	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000
Capital	\$ 825,000	\$ 925,000	\$ 1,025,000	\$ 1,125,000	\$ 1,225,000	\$ 1,325,000	\$ 1,425,000	\$ 1,525,000
Total Funding	\$ 5,825,000	\$ 5,925,000	\$ 6,025,000	\$ 6,125,000	\$ 6,225,000	\$ 6,325,000	\$ 6,425,000	\$ 6,525,000
Premium to Capital	6.061To 1	5.405 To 1	4.878 To 1	4.444 To 1	4.082 To 1	3.774 To 1	3.509 To 1	3.279 To 1
Confidence Level Funding	86.247%	88.574%	90.581%	92.081%	93.580%	95.044%	95.866%	96.688%

Risk Profile #2

Mean/Premium Funding	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000
Capital	\$ 825,000	\$ 925,000	\$ 1,025,000	\$ 1,125,000	\$ 1,225,000	\$ 1,325,000	\$ 1,425,000	\$ 1,525,000
Total Funding	\$ 5,825,000	\$ 5,925,000	\$ 6,025,000	\$ 6,125,000	\$ 6,225,000	\$ 6,325,000	\$ 6,425,000	\$ 6,525,000
Premium to Capital	6.061To 1	5.405 To 1	4.878 To 1	4.444 To 1	4.082 To 1	3.774 To 1	3.509 To 1	3.279 To 1
Confidence Level Funding	80.73%	82.92%	85.09%	86.76%	88.43%	90.06%	91.12%	92.18%



Which Domicile?

There are four principal factors governing choice of domicile:

<u>T</u> ax	Are there tax consequences associated with the domicile selection? Federal as well as state premium tax - fixed fee versus variable premium tax impact and self-procurement.
<u>R</u> egulatory	Does the domicile offer the regulatory flexibility I require to underwrite this risk – personal lines as an example? How much capital will I require? Timing? Accessibility?
<u>I</u> nfrastructure	Does the domicile have the necessary infrastructure to support my captive?
Perception & Logistics	How easy is it to travel to the domicile and are there perception issues with the location?



Development Needs

Business Plan

Application

Pro-Forma Financial Statement

Actuarial Study

Legal/Organizational Documents

Biographical Affidavits

Service Provider Engagement Letters







Daily Operations - Management

Regulatory & Compliance
Oversight

insurance laws and regulations

Financial & Accounting Management

Overseeing financial statements, budgeting, and reporting

Risk Management & Underwriting

Advising on risk retention strategies and capital adequacy

Operational & Governance Support

Coordinating board meetings, governance policies, and reporting

Strategic Planning & Optimization

Advising on captive expansion, new coverages, and cost efficiencies





Daily Operations – Management Focus

Key management touchpoints:

Underwriting & Risk
Assessment

Claims Management

Regulatory & Compliance Oversight

Finance & Investment Management

Policy Administration & Customer Service

Reinsurance & Risk Transfer Technology & Data
Analytics

Governance & Strategic Planning



Insurance Investment Solutions

Captive Insurance Investment Process



WHEN:

We manage each portfolio according it its cash flow needs. We also coordinate with your actuaries, domicile, third-party administrator (TPA), and bank partners when needed.

WHY:

Primary objective – meet expected claims & maintain liquidity buffer for unexpected events Secondary objective – grow capital prudently

HOW:

We manage each portfolio according it its cash flow needs. We also coordinate with your actuaries, domicile, third-party administrator (TPA), and bank partners when needed.

WHO:

Investment portfolios are integrated into each insurance program. Each portfolio is customized through coordination with your captive manager (SRS) and the captive's committee(s).

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Insurance Investment Process Steps



We Partner with SRS to Provide: Strategic asset allocation, portfolio management, and reporting aligned with your liquidity needs, forecasted liabilities, and regulatory structure.

Identify

- Liquidity needs
- Claims forecast
- Trust and domicile investment requirements
- Investment policy parameters

Analyze

- Review and analyze claims projections
- Assess trends from historical claims
- Understand risk preferences versus regulations
- Confirm trust limits are aligned

Implement

- Well-defined investment policy statement
- Clear investment strategy and plan outlining liquidity, liability, and risk expectations
- Portfolio benchmarks that effectively gauges performance of the overall approach

Monitor

- Consistent communication with **SRS and Captive Committee** members
- Portfolio positioning given liability and liquidity needs
- Market conditions, risk, and return potential

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Formation

- < 2 years old</p>
- Premium payments are made & company seeks to understand future expected claims
- Development of investment policy

Development

- 2-5 years old
- Established capital base & surplus assets
- Forecasting for future liabilities & cash flow cycle
- Track underwriting history & results vs. forecast

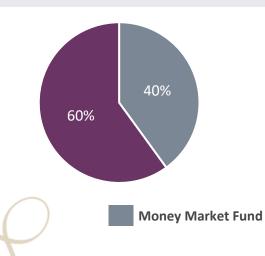
Expansion

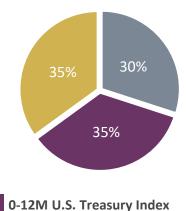
- 5-8 years old
- Surplus assets accumulated
- Detailed understanding of liability stream using actuarial data

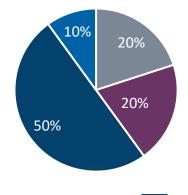
Maturity

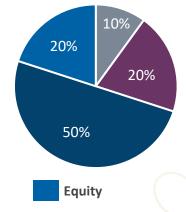
- > 8 years old
- Optimization of capital & dividend program
- Continued diversification of investments to maximize long-term growth
- Claims continue to be paid from assets & growth of investment

Sample Investment Allocations¹









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1-3Y Govt/Credit Index

Intermediate Agg Index



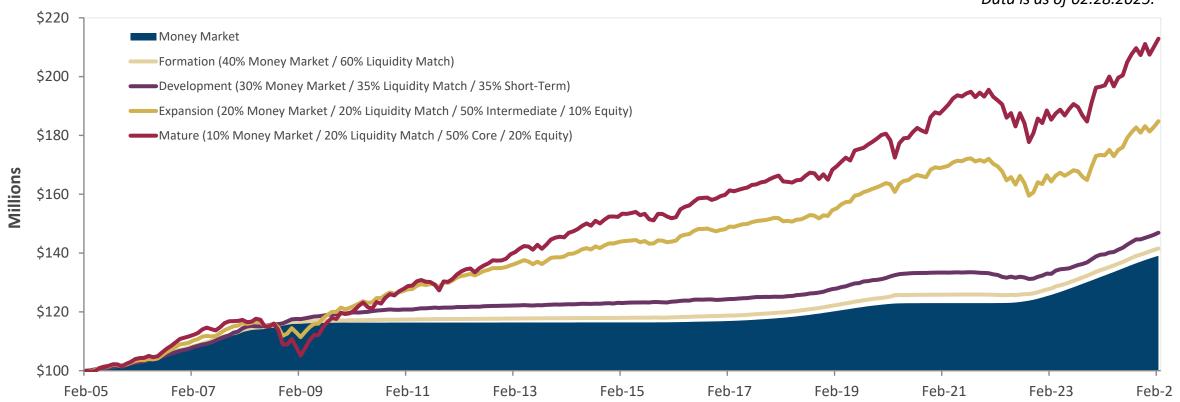


Estimated duration Cash flow dictates yield requirement **Analysis of Liabilities** and return potential Surplus and capital requirements Sector forecast models **Asset Class Return Expectations** Interest rate forecast models Yield curve analytics **Optimization Process** Proprietary risk analytics Liability/liquidity, capital, and Asset Class Risk & regulatory implications of Empirical duration analytics **Correlation Estimates** insurer portfolio Returns based attribution Relative value of available investment universe **Allocations** Determine appropriate **Insurance Investment Portfolio Structure** allocation given constraints and relative valuations





Data is as of 02.28.2025.







Captive Formation Assu	umptions
Initial Capital Funding	\$2,000,000
Net Earned Premium	\$10,000,000
IBNR	\$8,000,000
Initial Invested Assets	\$2,000,000

Lifecycle of Captive	Years 0-2: Formation	Years 3-5: Development	Years 6-8: Expansion	Years 9 & Up: Maturity
Progression of	40% Money Market	30% Money Market	20% Money Market	10% Money Market
Reserve Asset Allocation	60% Liquidity Match	35% Liquidity Match 35% Short-Term	20% Liquidity Match 50% Intermediate 10% Equities	20% Liquidity Match 50% Core 20% Equities
Progression of Surplus Asset Allocation	100% Liquidity Match	30% Liquidity Match 70% Short-Term	20% Liquidity Match 50% Intermediate 30% Equities	10% Liquidity Match 50% Core 30% Equities 10% Alternatives

Liquidity Match = 0-12 Month Bonds; Short-Term = 0-5 Year Bonds; Intermediate = 0-10 Year Bonds; Core = 0-20 Year Bonds.



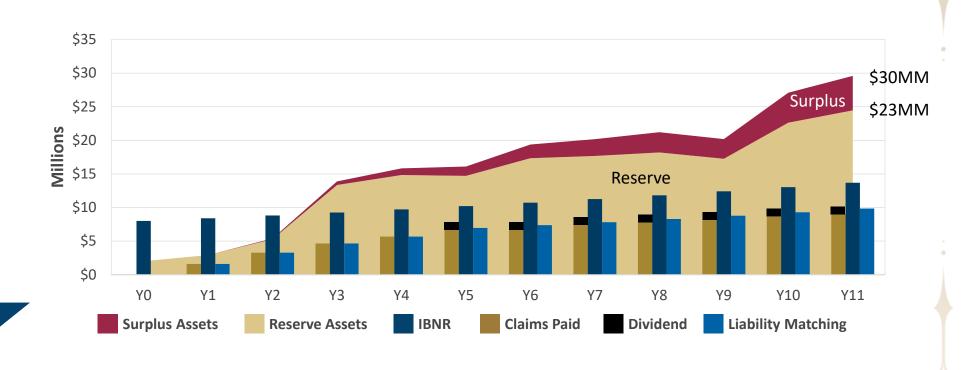
Results of an Integrated Insurance Investment Management Approach



Asset/liability matching analysis

Asset class risk/return modeling

Custom multi-class investment strategy





Thank You!

For questions, please reach out to Mike – Michael.O'Malley@strategirisks.com Laura – Laura.Rodrigo@strategicrisks.com Max - manthony@sterlingcapital.com