Captive Industry Sees Solid Growth in 2015 and Looks for More in 2016

Numbers released for 2015 captive formations shows that captives are continuing to grow despite a lingering soft market.

Since the beginning of the year, U.S. captive domiciles have been releasing results of captive activity in 2015. These results show that overall captive formation was strong even while pricing results for the property and casualty market were down. Captives are being formed all over the U.S. in both established domiciles and newly legislated domiciles and, according to industry insiders, 2016 is shaping up to be an even better year for the industry.

2015 Numbers

Quite a number of domiciles posted double digit gains in captives last year. Delaware led the way with nearly 200 new captives. At the end of 2015, the domicile's total number of operating captives was 1060. Seventy-four pure captives were licensed, three special purpose captives and 112 series captives for a total of 189 last year. Series captives, as legislated in Delaware, segregate risks into subsidiaries all owned by a parent company. Over the last five years, the domicile has become a specialist in licensing and regulating this type of captive structure. The domicile is looking to continue expanding their captive program in

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2016. Steve Kinion, director of the state's captive program, said, "Our plan is to continue to offer a good captive product with firm and fair regulation. So we plan to have an equal number or more in 2016. Any good captive applicant is welcome in Delaware."

Following Delaware is Utah, which licensed 66 new captives in 2015. The domicile added pure captives, cell captives and association captives to their roster. According to David Snowball, director of captive insurance in the state, "2015 was slower in growth than the prior couple of years which were very high years for growth. It was good to settle in at a more reasonable rate... It allowed us time to implement some efficiency measures such as developing an online annual reporting process as well as an online captive application process and establishing an online secure document upload process that is more efficient approach for providers and the Department."

He also believes that 2016 is shaping up to be another big year for the department,

> *"We expect to have strong growth with at least as many [captives] as in 2015, and probably more. There will be some extra work to accommodate the changes in the IRS 831(b) election rules but that also will increase the number of potential captives that will be able to afford the captive process."*

Tennessee and Nevada licensed 57 and 50 new captives, respectively. Tennessee saw a number of redomiciled captives – seven in total – which is the highest number the state has experienced. In Nevada, the domiciled nearly doubled the number of captives licensed compared to the prior year. Michael Lynch, captive director in Nevada, is pleased with the growth in his department, saying, "With 50 new captives, I feel we did very well."

North Carolina followed closely with 42. One of the newest U.S. domiciles, North Carolina has been climbing the ranks of top captive domiciles. In 2015, the state licensed pure captives, protected cell captives, special purpose captives and risk retention groups. Since it began operation in late 2013 until the end of 2015, the domicile licensed 96 captives and 240 "cell business plans."

Montana, Vermont and South Carolina garnered 38, 33 and 30 captives each respectively. These domiciles licensed pure captives, reinsurance captives, special purpose captives, sponsored captives, incorporated cell captives, association captives and risk retention groups. Eleven of Vermont's new captives were redomiciled captives.

Domiciles that licensed between 10 and 30 captives last year were Texas (11), Hawaii (19), Washington D.C. (21) and Oklahoma (26). The types of captives licensed ran the gamut of captive structures, including cell and pure and also included risk retention groups (RRGs).

"We are pleased with the 21 new companies and also that this represented a mix of RRGs, pures and cell companies," said Sean O'Donnell, director of financial examination for the Risk Finance Bureau at D.C.'s Department of Insurance, Securities and Banking.

He continued, "For 2016, we expect to continue to see growth in the protected cell [captive (PCC)] area. We have already licensed one PCC in 2016 and we have several prospects in the pipeline, both for new PCCs as well as the addition of more cells in existing PCCs. And we expect additional companies in other areas as well. We already licensed a pure captive and in 2016 and we have several prospects in the pipeline, including an RRG and several pures."

How the Soft Market Affects Captive Formations

News of strong growth is good for the industry, especially since the property and casualty insurance market is still sluggish. Captives, like other alternative risk transfer insurance mechanisms, are typically formed as a result to a hardening or hard insurance market – when premiums increase and capacity narrow. Hard markets are hallmarked by less competition and strident underwriting. Higher premiums generally help to expand alternative risk transfer insurance marketplace.

Soft markets involve lower premiums, expanded capacity and stiff competition among traditional insurers. Because of the competition in the traditional insurance marketplace, alternative insurance system structures are not typically sought after as a way of saving money.

However, since 2007, the property and casualty sector has been experiencing a soft market with only occasional upticks. According to a recent report published by Marsh, U.S. Insurance Market Report 2016, rates have been softening since 2014 and look to continue softening throughout

2016. Yet, captive formation, among most U.S. domiciles, has not slowed at all in the last several years. Even with the surge in stateside domiciles, captives are still forming at an unprecedented degree during the continued soft market.

A reason behind this growth is that captives are becoming more well-known and more trusted as alternative insurance providers. Other reasons are: regulation has become more sophisticated; captives have proven to be viable insurance mechanisms; and many more people, both inside and outside the insurance industry, are familiar with their uses. Even as the insurance market remains soft, captives are enjoying the fruits of their established success.

A hallmark of this trend is interest in RRGs. This alternative risk transfer mechanism does not necessarily have to be a captive, but most RRGs are regulated as captives by captive domiciles. RRGs are federally legislated insurance companies that provide insurance to their members. RRGs can operate in any state in which they are registered but can only be regulated by their domicile. More so than any other type of captive, RRGs are a bell weather for soft and hard markets – their numbers increasing during a hard market and falling off during a soft market. Since RRGs are typically owned by individual members (i.e. physicians, truck drivers, or non-profits), their operation is more in tune with the vagaries of premium rates.

Since the soft market beginning in 2007, RRG numbers have been in an overall slow decline. However, interest in RRGs and also in association captives, has been increasing in the last year. Tennessee, Vermont, Washington D.C., North Carolina and Hawaii all saw RRG formations in 2015. Several states have indicated that more RRGs are looking to form in the next year. According to Michael Lynch, captive director in Nevada, "I am seeing more RRG applications that I have in the past couple of years, also segregated cell applications continue to grow." While this doesn't necessarily indicate a hardening market, it does indicate that alternative risk transfer insurance is becoming an option for any type of insurance market. ■

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